BSCEE

Review

2012

INTRODUCTION

The Group of Banking Supervisors from Central and Eastern Europe (the BSCEE Group) was established in 1991. The Agreement of the BSCEE Group was signed during the Stockholm International Conference of Banking Supervisors (ICBS) in 1996. The BSCEE Group is operating according to its Agreement and Operational Bylaws that determine its organizational structure and the rules governing its operations. As of 2012 it has been signed by twenty three member institutions from twenty two member countries: Albania, Armenia, Austria, Republic of Belarus, Bosnia and Herzegovina (Banking Agency of the Federation of Bosnia and Herzegovina and Banking Agency of Republika Srpska of Bosnia and Herzegovina), Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Moldova, Montenegro, Poland, Romania, Russia, Serbia, Slovakia, Slovenia and Ukraine. In 2012 the National Bank of Georgia has applied for the BSCEE membership and has been accepted to the Group. Georgia will officially join the BSCEE Group as the twenty fourth member in 2013.

The Chairmanship of the BSCEE Group rotates on annual basis. In 2012 Mr. Michael Hysek, Managing Director of the Banking Supervision in the Austrian Financial Market Authority chaired the Group.

In 1996 the Members of the BSCEE Group entered into an agreement setting out a framework for cooperation and coordination in organizing common events. The primary role of the BSCEE Group Secretariat is to provide technical assistance in organizing conferences, leaders' meetings, workshops and training seminars. The Secretariat also facilitates cooperation among the member countries, the Basel Committee on Banking Supervision (BCBS) and other international institutions and organizations in the sphere of banking supervision. The permanent Secretariat of the Group until 2005 was located at the premises of the Hungarian Financial Supervision Authority(HFSA) and as of January 2006 is located in Poland, at the KNF – Polish Financial Supervision Authority (PFSA).

According to the previous years' practice, the Annual Review of the BSCEE Group summarizes the developments of the member countries in 2012. This publication gives an overview of the macroeconomic circumstances in the twenty three member states, and it describes the banking sector as well as the supervisory activities. It was prepared on the basis of the information given by the member countries. The Annual Review also summarizes the main events of the BSCEE Group, including the workshops co-organized by the Financial Stability Institute (FSI) and other regional meetings. The 25th Annual Members' Conference was organized by the Austrian Financial market Authority in Vienna on April 24 – 26, 2012.

This Annual Report intends to provide in-depth information reflecting the mission of the BSCEE Group in a detailed and accurate manner regarding the banking sector of the member countries.

We hope that you will find this publication informative and useful. We are sure that this will help you become acquainted with our supervisory job in the Central and Eastern European region, the cooperation among the supervisory authorities of the member countries and with the Basel Committee.

BSCEE Secretariat

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2012 DEVELOPMENTS IN THE BANKING SYSTEM OF THE MEMBER COUNTRIES

2012 DEVELOPMENTS IN THE ALBANIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The Albanian economy experienced a slowdown of economic growth during the last quarter of 2012 after two consecutive quarters with a higher growth rate, reaching an average annual growth of 1.6%. Industry, agriculture and services provided a positive contribution to economic growth. Meanwhile, transport and construction continued to shrink during the whole period. Indirect indicators show that consumption and private investments remained at low levels during 2012. Lending and fiscal stimulus deceleration affected the weakening of domestic and aggregate demand albeit the improved net exports. External demand remains unstable due to the weak economic performance in partner trading countries. At end-2012, the average wage in economy shrank by 6.5% in real terms. Thus, the pressure of a decline in disposable income was higher. The significant deterioration in consumer's confidence indicators in 2012Q4 reflects this situation. Unemployment rate stood at 13.26% at end-2012, narrowing only by 0.03 percentage point y-o-y. Fiscal indicators display a decrease in total income by 0.03% y-o-y in the end of 2012, while expenditures dropped at a similar level. The budget deficit reached 3.4% of GDP, being financed at 57.8% by internal resources and 42.2% by external resources. At end-2012 the public debt stock reached ALL 828 billion. The domestic debt accounted for about 56.8% of the total debt. The current account deficit was down by 13.8% y-o-y, amounting to EUR 1.02 billion at end-2012. Remittances improved slightly in 2012Q4, recording an annual growth of 1.6%. The trade deficit stood at EUR 1.99 billion at end of this period, dropping by 10.8% from a year earlier. Its decline reflects an annual growth in exports by 8.5% and a decline in imports by 3.4%. For the same period, the financial and capital account amounted to EUR 867.3 billion, down by 11.3% y-o-y. The foreign direct investments remained at almost the same levels to the previous year, amounting EUR 744.9 billion, while portfolio investments and other investments narrowed in this period. The Bank of Albania implemented a notably eased monetary policy during the period under review, aiming at encouraging consumption and investments in Albania. The repo rate was lowered by 25 basis points in January, March and July 2012, reaching a level of 4%. The inflation rate reflected the low inflationary pressures resulting within the aimed band of the Bank of Albania's main objective during 2012. The average inflation rate for 2012 H2 was 2.5%, 0.6 percentage points higher from 2012 H1.

DEVELOPMENT IN THE BANKING SYSTEM (INCLUDING THE ASSETS TOTAL / GDP)

The banking sector remains the main segment of financial intermediation in Albania. As of end-December 2012, the banking sector assets accounted for 87.9% of GDP, or 3.1 percentage points higher than a year earlier. The banking sector is dominated by five banks, which altogether account for 67.8% of the system's loan portfolio and 74.4% of deposits

During 2012, the loan portfolio was increased by a lower rate, compared to recent years. This low growth had its structural impact on the increase of the non-performing loan ratio, while this portfolio itself underwent further growth this year. Banks compensated the modest growth of the loan portfolio, by mainly increasing theirs investments in debt securities. Although the credit risk seems to be elevated, banks show satisfactory level of capitalization that even appears to be higher than in previous year.

Liquidity situation in local currency as well as in foreign currency was stable and satisfactory throughout 2012.

A summary of the main developments in the banking sector observed during 2012 are presented below:

1. Total loan portfolio was increased by only 2%, while during 2011 this portfolio increased by 15.3%.
2. The total assets were increased by 6.1 %.
3. Non-performing loan ratio was increased to 22.5% from 18.8% in 2011.
4. Capital adequacy ratio is above the regulatory minimum of 12%, reaching 16.2% at the end of December 2012, from 15.6% at the end of 2011.
5. The financial performance of the banking system appears satisfactory during 2012. The net income was increased to 3.8 billion All from 0.7 billion ALL at the end of 2011.
6. Customer deposits growth rates slowed to 7.3 percent versus 13.1 percent in 2011.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS.
LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN ALBANIA

In 2012, new regulations and amendments to some other regulations on banking supervision were finalised. They target the alignment with Basel Committee standards, EU directives and best practices in the field of banking supervision and regulation.

The following new regulatory acts and important amendments to effective banking supervision regulations were approved in 2012:

- Regulation 'On creating, licensing and functioning of the bridge bank', which provides the rules on the process of creating, licensing and functioning of a bridge bank. This is a newly-introduced concept in the latest amendments to the banking law;
- The revised Regulation 'On core management principles of banks and branches of foreign banks and criteria on approval of their administrators', which perfects further regulation of the supervisory authority requirements regarding the process of prudential and effective management of banks

and foreign bank branches, mainly about risk management systems and respective structures, remuneration policies, etc.

Some additions and amendments were made to the following regulations:

- On licensing and operation of banks and branches of foreign banks in the Republic of Albania', which aimed at incorporating and further regulating the conduct of insurance, reinsurance and intermediation in insurance and reinsurance", even for banks and/or branches of foreign banks, as a financial activity that requires preliminary approval by the supervisory authorities and is provided under the law on insurance;
- On defining the level of decision-making in the supervision of banking and financial activity', which aimed to fulfil and update the process of decision-making in supervising the banking and financial activity of banks and other institutions licensed and supervised by the Bank of Albania, according to levels/hierarchy defined in the matrix provided under this Regulation.
- On licensing the savings and loan associations and their unions', which aimed that the changes in the Regulation 'On defining the level of decision-making in the supervision of banking and financial activity' comply with the function of facilitating, accelerating and effectiveness in the decision-making process.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2012

Approximation of legislation with EU directives

The harmonization of our regulatory framework with European standards in the field of regulation continued to be the focus of the Department of Supervision in 2012. Thus, during this year was finalized the draft of new capital adequacy regulation, based on Basel framework, which in the following periods shall be consulted with the banking industry. Parallel with the drafting this regulation, a special attention was paid to its reporting framework to Bank of Albania, based in COREP standards, compiled by the European Banking Authority (EBA).

Issues related to managing non-performing loans and finding ways to reduce them

During 2012, supervision department laid emphasis on the improving of the internal policies and on creating of necessary infrastructure by banks to reduce the non-performing loans stock. Recommendations and corrective actions taken by the Supervision Department aimed to bring in place the latest international practices, adapted to Albania's context to ensure effective treatment of the non-performing loans.

Cooperation with foreign banking supervision authority

Albania's banking system is dominated by subsidiaries of foreign banks or group banks. The level of capitalization and that of expertise and technology of banks is highly correlated with the performance of their parent's banks. In these conditions, it is assessed as of great importance the establishing and the expanding of relationships with supervisory authorities of the countries of origin of these banks or group banks.

Methodological development

During 2012, was finished the work already begun for the revision of the examinations manuals by adopting the modern concepts of the supervisory process, based on European standards in this field, especially by improving risk assessment systems and by further structuring the criteria for the exercise of supervisory powers under Pillar II of Basel framework. The testing of these manuals was incorporated as part of bank examinations agenda.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2012

Bank of Albania is the supervisory authority of banks, branches of banks and non-bank financial institutions. It carries out its supervisory role, pursuant to the Law "On banks in the Republic of Albania" aiming to ensure sound banking activities by developing and implementing policies and an appropriate regulatory framework, flexible and in line with the dynamics of development in the country, in order to maintain the health of banks, the stability of the banking system and beyond, preventing crisis in the sector, and the protection of depositors;

The Albanian banking sector underwent significant restructuring during 2012. Amendments to the banking law at end-2011 generated applications from the Branch of Alpha Bank in Albania and the Branch of the National Bank of Greece for their transformation into domestic banks/subsidiaries of foreign banks. Uncertainty about Greece's financial stability exposed both Greek bank branches in Albania to parent-bank risk. In order to address that risk, the Bank of Albania approved the licensing of the Alpha Bank Albania sh.a. and the National Bank of Greece Albania sh.a., to operate as banks in Albania. In this way, the licensed banks became subject to prudential supervision, fulfilling the same regulatory framework as other banks or branches of foreign banks in Albania.

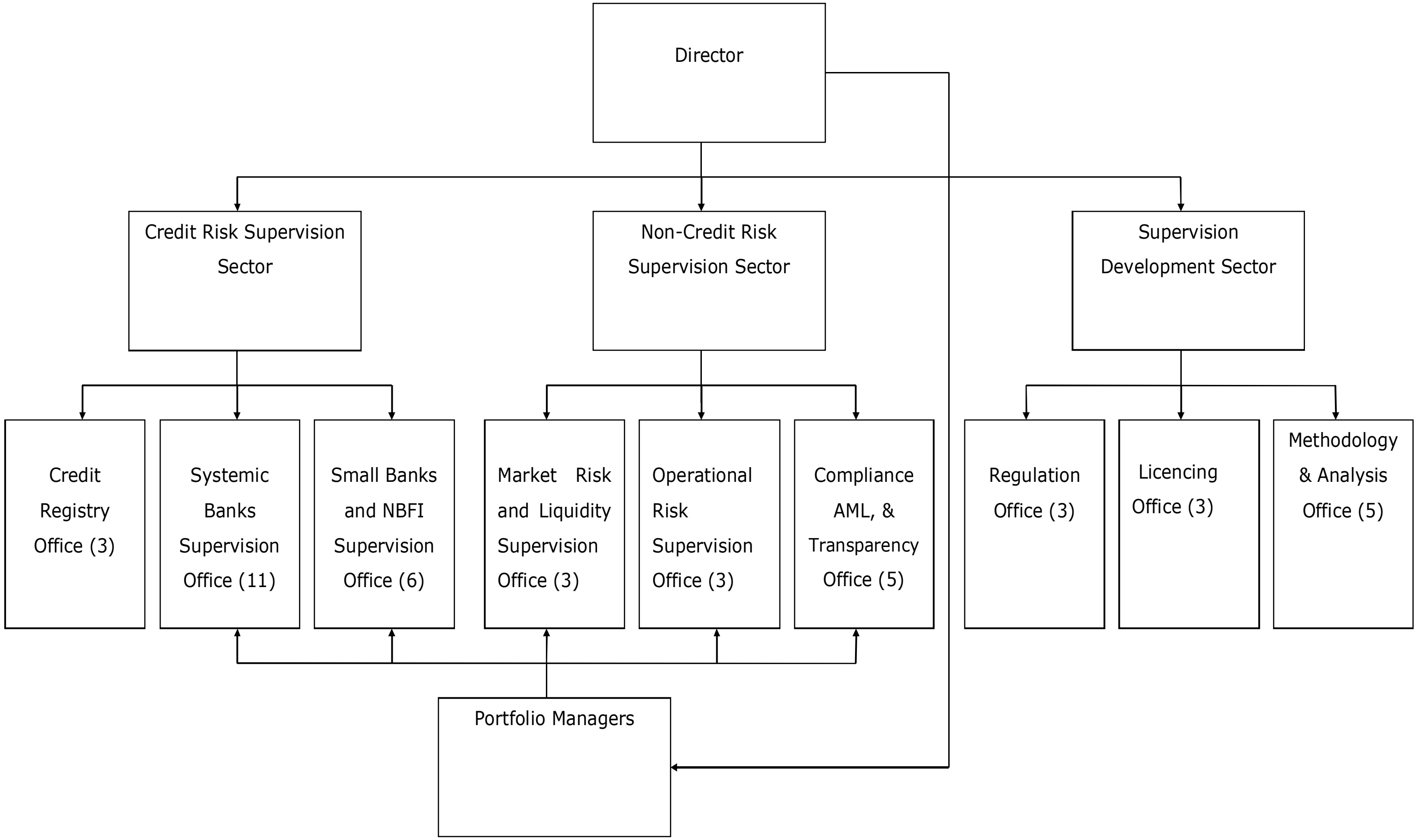
During 2012, banks submitted their applications for expanding their bank branches and agencies in the country, the approval of which led to the opening of 15 new bank branches/agencies, hence indicating similar expansion rates to those of a year earlier. 11 bank branches/agencies closed down in 2012

In non-bank financial market, during 2012, the Bank of Albania licensed two new non-bank financial institutions: one for providing advisory, intermediation and other auxiliary foreign-exchange services and the other for conducting factoring.

Supervisory activity during 2012 was characterized by a rather frequent on site examinations of banks, organized in a way that combined the examination needs based on the supervisory cycle established by the operational supervisory policy and the importance of issues in individual banks. In 2012, full-scope examinations took place in ten banks, three non-bank institutions and one savings and credit union. Besides full-scope examinations, several other examinations addressed specific issues, through the Bank of Albania's cooperation with other authorities.

The combination of results from on-site and off-site analysis have been translated into supervisory actions, and have been used for the assessment of possible changes in regulatory framework as well as for identification of needs for development of internal capacity.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

Cooperation with foreign authorities continued during 2012. This year marked the finalization of the twinning project with the Bank of Italy, under which the Bank of Albania in particular strengthened its supervisory capacity, and further developed risk assessment methodology. In terms of human resources, a series of training conducted by experts missions of Bank of Italy at the Bank of Albania, as well as study visits of Bank of Albania staff, contributed to the further improvement of the knowledge of a substantial part of Supervision Department staff on banking supervision and regulation in accordance with EU standards.

On the basis of cooperation agreements with several foreign supervisory authorities, for certain banks, whose subsidiaries perform banking activity in the Albania, necessary information has been exchanged. Also, following the initiative of the European Central Bank for the functioning of colleges of supervisors of the largest European banking and financial institutions, Bank of Albania representatives has been taken part taking part in panels organized by Bank of Greece.

Finally, the Bank has continued its close cooperation with the International Monetary Fund and World Bank. In this context, information exchange has been continuous in order to better identify the challenges facing by Supervision Department. In response to these challenges, especially focusing on addressing the quality of the loan portfolio of the banking system, it is worth mentioning in particular cooperation with the World Bank to lay the foundation for a term cooperation in order to create the necessary conditions for reducing non-performing loans in the banking business

COOPERATION WITH OTHER SUPERVISORY BODIES IN ALBANIA

During 2012 Bank of Albania has strengthen its cooperation with General Directorate for Prevention of Money Laundering, which is the competent authority for prevention of money laundering and terrorist financing in Albania, mainly in the fight against financial crime in the context of the implementation of the National Strategic Document "For the investigation of financial crime".

This cooperation is not limited to periodic reporting, regarding the implementation of the strategic document for the investigation of financial crime, but also includes joint on- site inspections of banks, joint activities in order to expand the supervisory capacity and exchange different professional experiences, training of other subjects etc.

During 2012, there have been a total of eight joint inspections and three rounds of joint training in Tirana, for exchange offices and non-bank financial entities.

On the other hand, cooperation with various institutions which monitor specific activities of the financial market, such as Financial Supervision Authority[1]

[1] The competent authority for supervision of insurance companies.

has continued to be effective during 2011. The cooperation has been focused in the exchange of information and data and on carrying out joint inspections.

STATISTICAL TABLES

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution	2010	2011	2012
Commercial banks	14	14	14
Branches of foreign credit institutions	2	2	2
Cooperative banks	n.a.	n.a.	n.a.
Banking sector, total:	**16**	**16**	**16**

Ownership structure of the financial institutions on the basis of registered capital (%) (at year-ends)

Type of financial institution	2010	2011	2012
Public sector ownership	0	0	0
Other domestic ownership	7.92	9.7	10.2
Domestic ownership total	7.92	9.7	10.2
Foreign ownership	92.08	90.3	89.8
Banking sector, total	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	57.6	73.2	1.46
Branches of foreign credit institutions	N/A	N/A	N/A
Cooperative banks	N/A	N/A	N/A
Banking sector, total:	**57.6**	**73.2**	**1.46**

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2010	2011	2012
Commercial banks	11.32	6.94	3.78
Cooperative banks	N/A	N/A	N/A
Other	N/A	N/A	N/A
Banking sector, total:	**7.58**	**0.76**	**3.78**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2010	2011	2012
Commercial banks	89.10	90.4	100
Branches of foreign credit institutions	10.90	9.6	N/A
Cooperative banks	N/A	N/A	N/A
Other	N/A	N/A	N/A
Banking sector, total:	**100.0**	**100.0**	**100.0**

The structure of assets and liabilities of the banking system (%) (at year-end)

Assets	2010	2011	2012
Financial sector	10.3	12.52	17
Nonfinancial sector	45.5	45.5	42.37
Government sector	38.8	36.75	35.22
Other	5.4	5.24	5.4
Liabilities	**2010**	**2011**	**2012**
Financial sector	4.8	3.91	3.4
Nonfinancial sector	81.8	82.03	83.0
Government sector	2.03	2.9	2.4
Capital	9.40	8.67	8.57
Other	1.97*	2.49*	2.63*

Capital adequacy ratio of banks

Type of financial institution	2010	2011	2012
Commercial banks	16,2*	15.6 *	16.2*
Cooperative banks	N/A	N/A	N/A
Banking sector, total:	**16,2***	**15.6 ***	**16.2***

(* - for Basel I; ** - for Basel II)

Asset portfolio quality of the banking sector (share of impaired receivables / share of non-performing loans)

Asset classification*	2010	2011	2012
Non financial sector**	13.96	18.77	22.5
- households	11.77	15.84	24.4
- corporate	15.49	20.80	17.2

The structure of deposits and loans of the banking sector in 2012 (%) (at year-end)

	Deposits	Loans
Households	87.62	25.87
Government sector	2.23	4.39
Corporate	10.15	69.73
Other (excluding banks)		
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends)

P&L account	2010	2011	2012
Interest income	69,332.68	73,324.06	76,731.57
Interest expenses	32,350.32	33,689.43	36,960.64
Net interest income	36,982.36	39,634.64	39,770.93
Net fee and commission income	5,353.33	6,110.92	6,294.80
Other (not specified above) operating income (net)	1,857.49	3,830.21	3,616.35
Gross income*	***44,193.17***	***49,575.76***	**49,682.08**
Administration costs	23,491.22	24,490.67	25,930.61
Depreciation	N/A	N/A	N/A
Provisions			
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	***13,078.47***	***22,912.21***	***18,591.47***
Profit (loss) before tax	8,029.12	2,262.07	5,160
Net profit (loss)	6,715.13	706.26	3,768.57

* In million ALL

Total own funds in 2012 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	74,576.64	67,167.42	7,409.22	N/A
Cooperative banks	N/A	N/A	N/A	N/A
Banking sector, total:	74,576.64	67,167.42	7,409.22	N/A

In million ALL

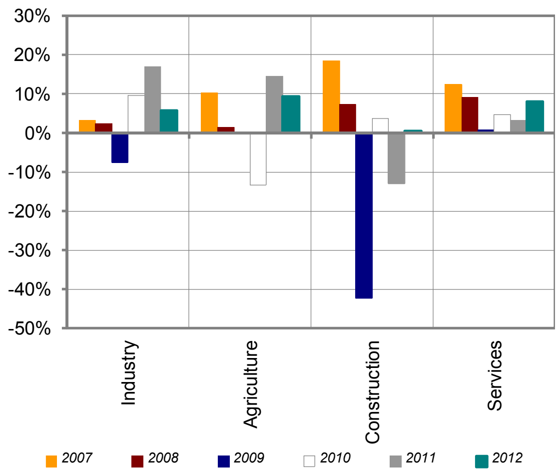
2012 DEVELOPMENTS IN THE ARMENIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Economic growth in Armenia in 2012 was 7.2%. As in the previous year, economic growth reported this year was mainly due to the growth of industry (5.7 percent), agriculture (9.3 percent) and service (8.0 percent) sectors. Recovery of the domestic economy continued on the back of increased inflow of funds and export, household income growth and private demand amidst persisting international prices of oil products and base metals.

By expenditure components of GDP, the highest growth was observed in private consumption, with an annual real growth of 10.0% percent. This has been attributable to some growth in household incomes and revived economic activity as a result of recovering inflows of private transfers, growth in loans, consumer confidence, as well as low prices. Unlike the reported growth in private consumption, public consumption has declined by 5.2 percent, mainly as a consequence of the policy steered to reduce the state budget deficit. Investment environment was not proactive during the year: there were marked reductions in both government investment and private investment.

Chart 1.Economic growth rate, by sector



In 2012, relative to the end of the previous year, the public debt has grown by 4.8 percent and reached USD 3738.3 million. The external debt to GDP ratio was an estimated 37.6 percent, representing a slight increase in relation to the previous year. The other debt sustainability indicators posted increases though Armenia remains a country with a low debt burden.

On the back of developments in global and domestic economies foreign trade also reported positive trend. Annual growth of exports of goods and services in real terms amounted to 7.3 percent, and annual real growth of imports of goods and services has been low, amounting to 2.5 percent.

DEVELOPMENT IN THE BANKING SYSTEM (INCLUDING THE ASSETS TOTAL / GDP)

As of 31 of December, 2012, 21 commercial banks and one development bank (Panarmenian Bank OJSC) operated in Armenia. In 2012 considerable growth of financial intermediation in banking system was observed. In 2012 banking system assets to GDP ratio increased by 8.2 percentage points and totaled 62.2 percent, while banking system loans to GDP ratio increased by 7.0 percentage points and totaled 38.6 percent.

During current year the number of bank branches increased by 32 and at year end was 474. As a result, the number of bank branches per 100 000 adult population increased by 0.2 point and totaled 18.9 percent. Other indicators describing the financial accessibility also increased.

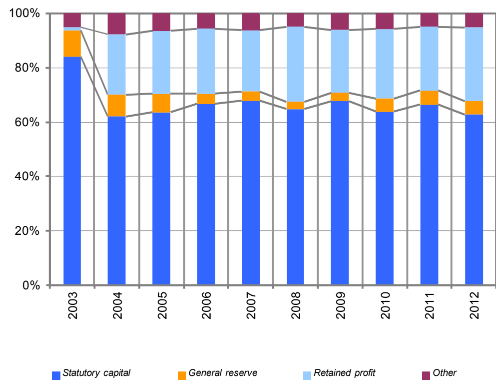
The number of bank employees (including service personnel) increased by 8.7 percent and at year-end reached 10 981. Compared to previous year the share of managerial staff in total number of employees decreased by 0.6 percentage points and at year-end amounted 16.5 percent.

Banking system capital

Over the reporting year, total capital of the banking system grew by 10.3 percent (AMD 37.6 billion), and totaled AMD 400.7 billion. Growth of the total capital was mainly driven by the growth of net profit and statutory capital.

During 2012, 3 banks replenished statutory capital by AMD 10.2 billion, out of which AMD 9.0 billion were foreign funds. As a result, the share of non-residents within the total statutory capital of the banking system increased by 0.8 percentage points and totaled 73.1 percent. The growth of total assets was 9.1 percentage points higher than the growth of total capital due to active lending policy in banks. As a result, total capital to total assets ratio dropped by 1.3 percentage points totaling 16.2 percent at the end of the year.

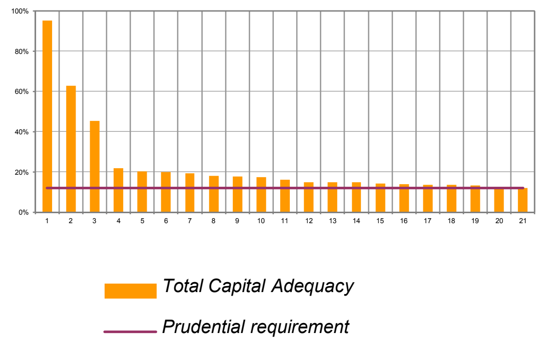
Chart 2. The Structure of the Banking System Total Capital



Banking system capital adequacy

As a result of active lending policy the growth rate of risk weighted assets of commercial banks exceeded growth rate of regulatory capital by 9.9 percentage points, which resulted in 1.5 percentage points lower capital adequacy ratio, which at year end was 16.8 percent (prudential minimum requirement is 12 percent). Capital adequacy ratio was also higher than the prudential requirement for individual banks and none of the banks breached the prudential requirement during the year.

Chart 3. Capital Adequacy of Commercial Banks



During current year commercial banks

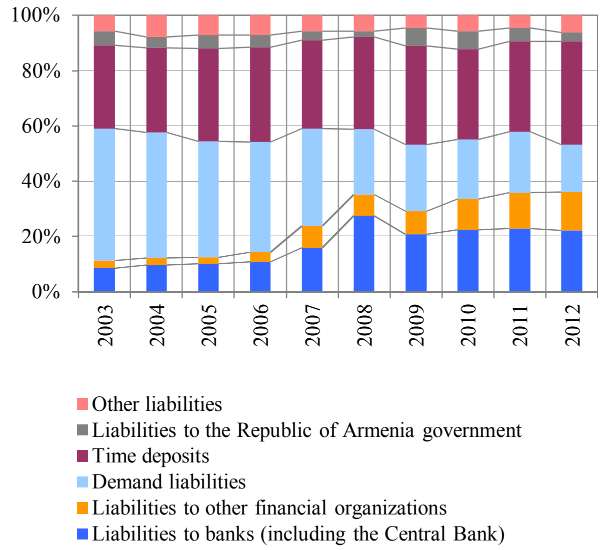
continued to allocate attracted funds to credit investments. Accordingly, the credit risk is considered as major risk factor accounting for 92.3 percent of risk weighted assets (as of 31.12.2011-92 percent).

Banking system liabilities

In 2012, total liabilities of the banking system increased by 21.4 percent (AMD 366.3 billion) and at the end of the year totaled AMD 2 trillion 77.1 billion. Dram liabilities increased by 16.1 percent and foreign exchange liabilities increased by 24.5 percent. As a result, the share of foreign exchange liabilities increased by 1.6 percentage points and at the end of the year totaled 64.9 percent.

The growth of liabilities was mainly driven by the growth of total deposits (AMD 198.2 billion), loro correspondent accounts and other liabilities of the banks (AMD 67.5 billion growth) and liabilities to other non-bank financial organizations (AMD 67.5 billion growth).

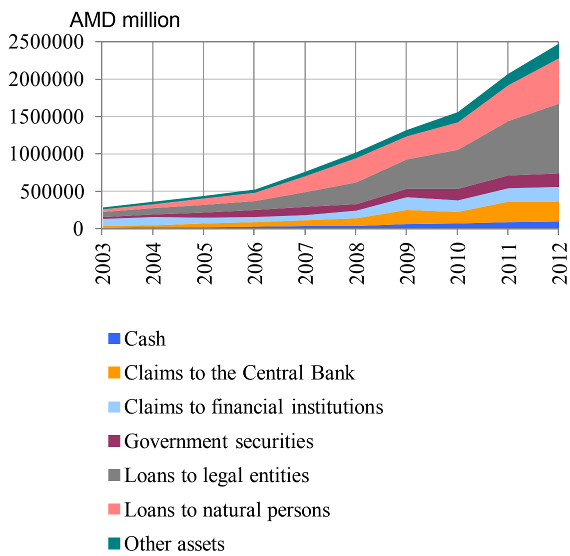
Chart 4. Structure of the Banking System Total Liabilities



Banking system assets

Over 2012, total assets of the banking system increased by 19.5 percent (by AMD 404 billion), and totaled AMD 2 trillion 478 billion at the end of the year. Growth of assets was mainly driven by the growth of loans to the economy. Compared to the previous year, the loans to the economy increased by 26.9 percent and totaled AMD 1 trillion 536 billion.

Chart 5. Structure of the Banking System Assets



Banking system financial performance

In 2012, net profit of the banking sector according to supervisory reports totaled AMD 42.4 billion. During the year, 18 banks operated with profit. Compared to 2011, the return on assets (ROA) and return on equity (ROE) decreased by 0.1 and 1.4 percent respectively totaling 1.9 and 11.2 percent. Over the year, banking system net operational margin stayed unchanged at 3.3 percent level. According to IFRS, net profit was AMD 42.5 billion, ROA was 1.9 percent and ROE 10.8 percent.

LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN THE COUNTRY

In 2006 a single framework for risk-based financial regulation and supervision was introduced in Armenia in compliance with international practice. The Central Bank was given the authority to regulate and supervise activities of all participants of the financial sector. So, the Central Bank took on the function of mega-regulator along with responsibility for maintaining financial stability.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN THE COUNTRY.

The following adjustments in regulatory framework of banking sector were introduced in 2012:

Amendments were made to Internal Controls regulation of banks, according to which a new requirement is imposed on banks to conduct their own stress-tests (quarterly) with regard to credit, market, liquidity, FX and contagion risks.

- In order to ensure that banks maintain sufficient level of liquidity also by foreign currencies, new liquidity prudential standards (4% and 10%) were imposed on banks with regard to Group I and certain Group II currencies.
- New supervisory guidance was issued which empowers the CBA supervisors to require from banks to build loan loss provisions for a portion (group) of assets in certain cases without classifying it. Those cases include:
  - deterioration of macro-economic indicators;
  - misuse of distributed loans by borrowers;
  - issues related to internal controls;
  - over-valuation of pledged assets (intentional or non-intentional), etc.

Maximum amount of provision which may be stipulated by supervisors under this guidance constitutes 25% of bank's loan portfolio. In order to require banks to build adequate provisions, supervisors are required to review statistically significant amount (50% of portfolio amount or sufficient quantity of loans) of loans.

- New licensing regime is designed – simple (for branch managers, internal audit members, member of IU) and complicated (for the remaining)

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2012

Individual departments (mainly Financial Supervision Department, Financial Monitoring Centre, Financial Stability and Development Department) of the Central Bank perform off-site and on-site inspections of the financial institutions aimed at monitoring the risk level of the financial system participants, combating money laundering and terrorism financing, protecting financial system consumer rights, as well as monitoring the compliance of financial system's activities to the regulatory framework.

In 2012, on-site and off-site inspections of the Financial Supervision Department focused on the following areas: risk management system, asset quality, transparency, internal control system, corporate governance, IT, compliance with the requirements relating to security and sustainability of business operations, risk level of reinsurance, compliance of organizations to the changes of regulatory framework, organization and control of Prospectus and/or Trade Prospectus registration procedures, transparency, combating against money laundering and terrorism financing, quality control of rendered services, consumer rights protection, prevention of operations by non-licensed entities.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2012

In 2012, the Financial Supervision Department performed 241 on-site inspections. Compared with previous year, in 2012 the number of infringements of banks dropped in total number of infringements identified during on-site and off-site inspections performed by the Central Bank Financial Supervision Department. Compared to the previous year, the number of penalties also decreased.

Table1. On-Site Inspections and Workload of the Supervisors

	2010	2011	2012
Number of Supervisors in the Financial Supervision Department	83	84	84
Total assets of commercial banks, credit organizations, insurance companies, securities market participants and pawn shops (annual average)	AMD 1.580 trillion	AMD 2.047 trillion	AMD 2.457 trillion
Average work load per supervisor of the Financial Supervision Department	AMD 19.0 billion	AMD 24.4 billion	AMD 25.3 billion
Number of inspections performed during the year, including:	380	235	241
Comprehensive inspections in banks	7	7	5
Targeted inspections in banks	24	13	8
Comprehensive inspections in credit organizations	6	6	5
Targeted inspections in credit organizations	2	1	1
Comprehensive inspections in insurance companies	3	3	3
Targeted inspections in insurance companies	8	-	12
Insurance broker companies	1	-	-
Insurance agents	-	38	-
Investment companies	4	4	2
Other participants of financial market(exchange offices, pawnshops, payments system organizations and other)	325	163	205

	Commercial banks	Credit organizations	Insurance companies	Pawnshops	Payment system Companies*
Area of Violation					
Accounting	23	22	24		
Asset classification norms	2	1	9		
Legislation	313	135	254	235	5
Prudential standards	6	1	26		
Incompliance with instructions			3		
Reporting delays	1		47	3	
Inconsistent data	20	7	181	81	
Total regulatory capital					
Credit register	31	3			

Indicators	Commercial banks	Credit organizations	Insurance companies	Pawnshops	Payment system Companies*
Penalties					
Revocation of License			1	3	
Fines imposed on organization	177	122	282	248	2
Fines imposed on managers			5		
Penalty					
Warning	325	47	256	39	3
Revocation of manager's professional qualification license					
Termination of license				28	
Cessation				3	

ORGANIZATIONAL CHART OF BANKING SUPERVISORY AUTHORITY

Chart 6: Organizational chart of Central Bank of Armenia

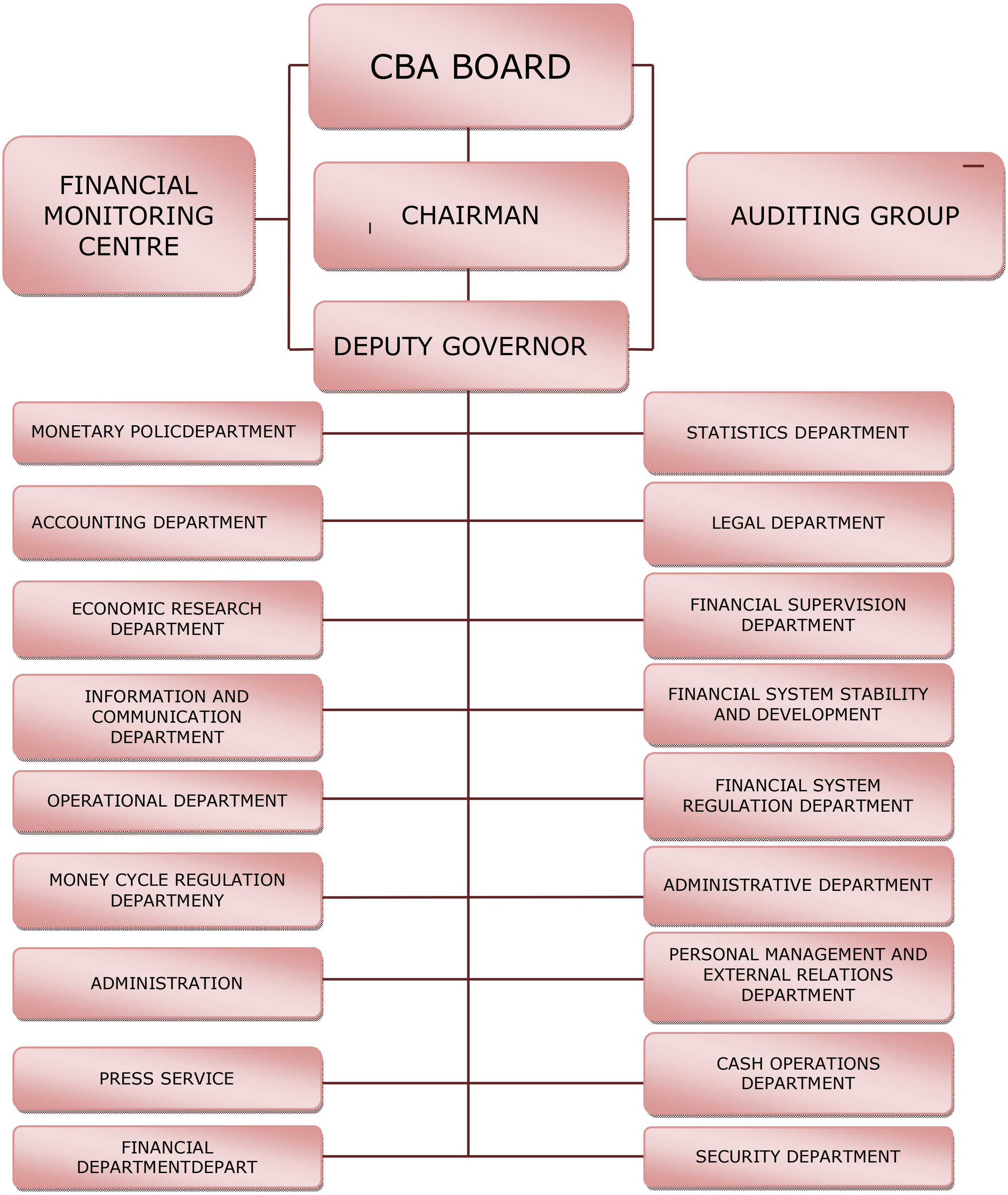


Chart 7: Organizational chart of Financial System Stability and Development Department

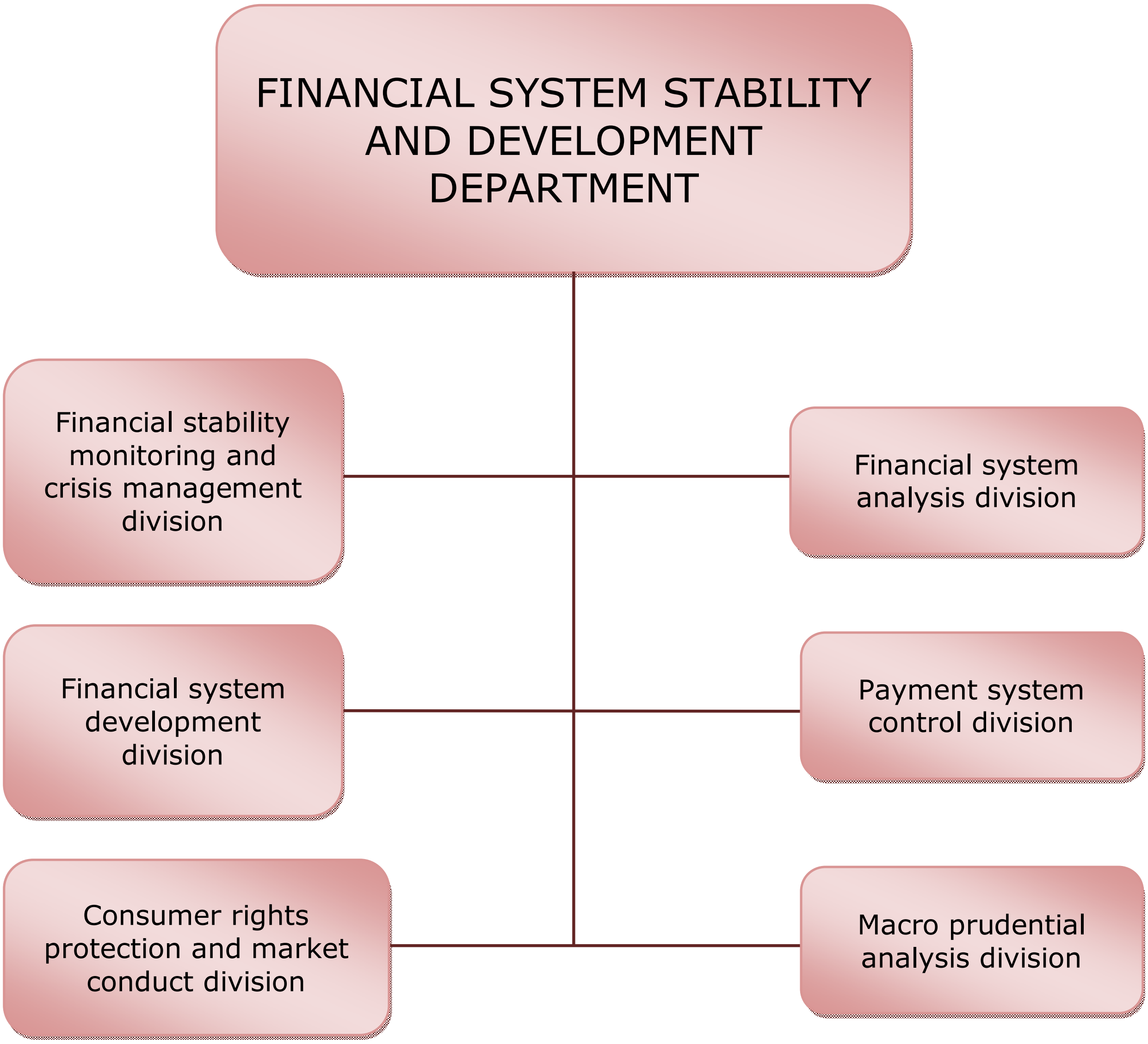


Chart 8: Organizational chart of Financial System Regulation Department

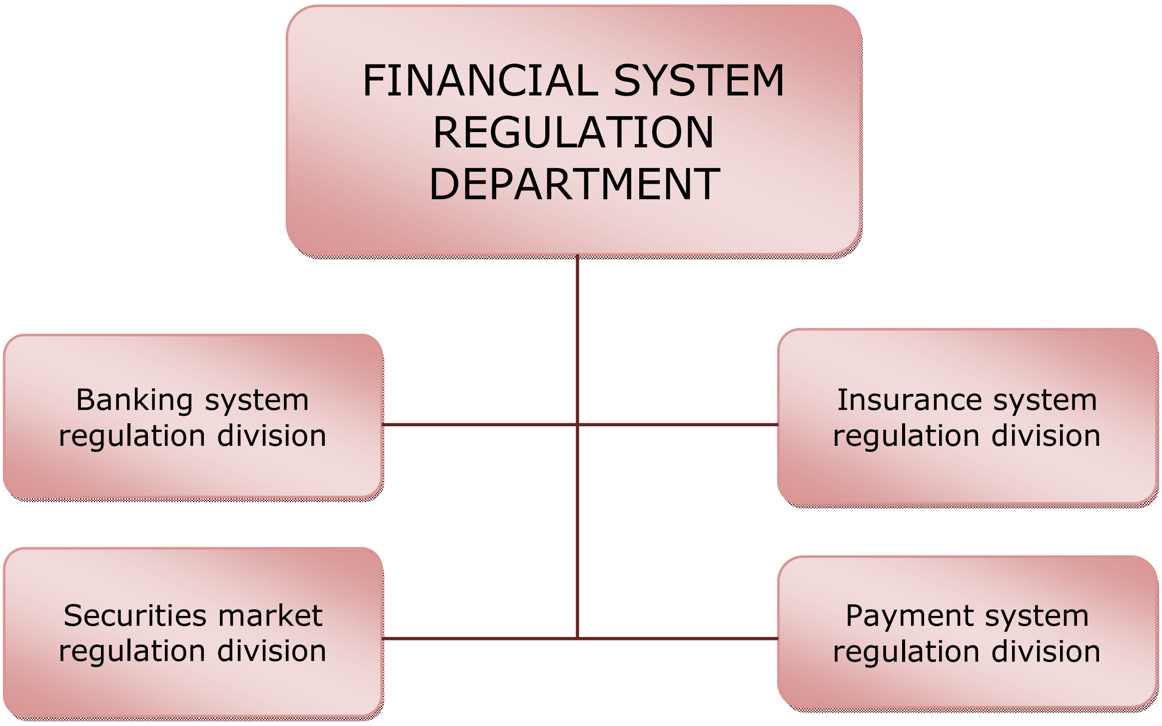
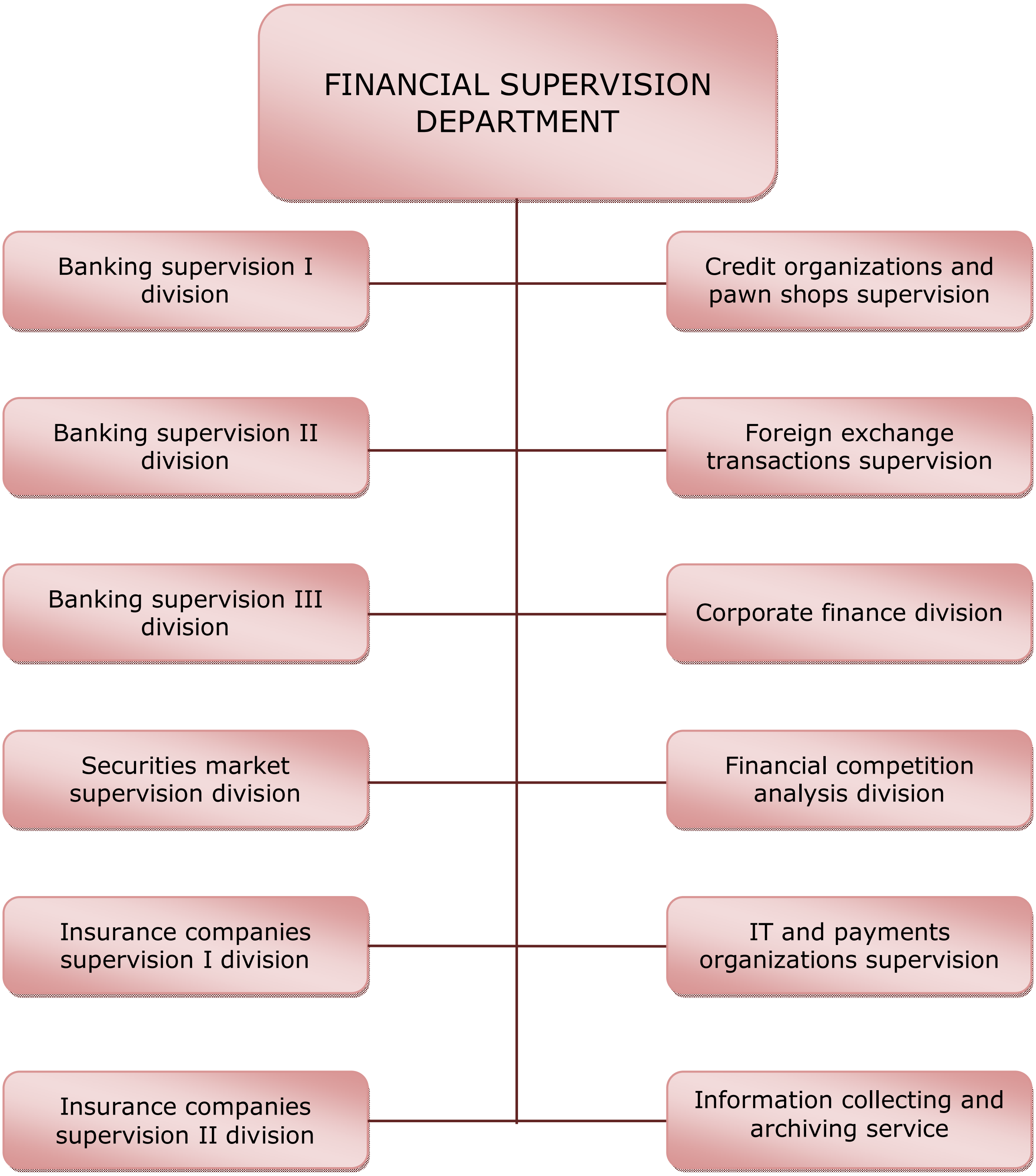


Chart 9: Organizational chart of Financial Supervision Department



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

In 2012, the Central Bank continued cooperation with International Monetary Fund, Bank for International Settlements, Financial Stability Institute, Joint Vienna Institute, central banks of member countries of Eurasian Economic Community, Switzerland, Italy, Lithuania, France, Germany, Netherlands, Poland, Czech Republic, Austria, central bankers training center at Bank of England, International Organization of Securities Commissions and other institutions. Topics covered in training courses, conferences and seminars conducted by the above mentioned institutions, related to financial stability and present issues concerning banking, insurance, securities market participant regulation and supervision.

Several specialists from the Central Bank attended online training courses arranged by the Financial Stability Institute (FSI). Experienced supervision specialists of the Central Bank continued to organize training courses for younger colleagues in order to share their experience and knowledge with them.

In 2012, Central Bank continued multilateral and bilateral cooperation with international and foreign organizations.

During 2012, within the framework of the technical assistance by the International Monetary Fund and World Bank, the Central Bank hosted number of missions on banking supervision and financial operations, monetary policy and statistics. From February 1-14, 2012 the Central Bank hosted a World Bank- IMF mission to undertake an update of the Financial Sector Assessment Program (FSAP) conducted in 2005.The team was headed by Jennifer Eliot and John Pollner.

With the view of expanding business connections, introducing macroeconomic environment of Armenia and conducting negotiations, the Central Bank hosted experts from Japan International Cooperation Agency, business mission from Chinese Sinocop Resources Holdings and China Sports Development headed by deputy-director of Chinese Development State Bank Gao Czyan, delegation from European Reconstruction and Development Bank headed by managing director of Eastern Europe and Caucasus regions Olivier Decamps, delegation from Italian investment company FINEST S.p.A. headed by the president of the company Renato Pujatti, delegation from Polish National Bank headed by the chairman of the bank Marek Belka, delegation from State Commission for Securities and Stock Market of Ukraine headed by the chairman of committee Dmitriy Tevelyev.

During 2012, the Central Bank organized number of business meetings, working sessions, a "round table" and conference. The Central Bank continued the process of signing agreements and memorandums of understanding (MOUs) with other central banks within the framework of the bilateral and intergovernmental committees.

The Central Bank of Armenia signed memorandum of understanding with Financial Supervision Agency of Poland on "Cooperation in the Field of Banking Supervision, as well as State Commission for Securities and Stock Market of Ukraine.

On 24 of April in Vienna, Austria the Central Bank of Armenia was officially admitted into the group of Banking Supervisors from Central and Eastern Europe as its 23rd member.

From 3-4 September, 2012 the former Minister of Labor and Social Security of Chile Jose Piñera visited Yerevan for steering the round table on "Process of Pension Reforms in Armenia" and reading a lecture on pension reforms.

The Central Bank of Armenia and KfW Bank of Federal Republic of Germany signed a credit contract concerning the program for the promotion of renewable energy (Phase III).

STATISTICAL TABLES

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution	2010	2011	2012
Commercial banks	21	22	22
Branches of foreign credit institutions	0	0	0
Cooperative banks	0	0	0
Banking sector, total:	**21**	**22**	**22**

Ownership structure of the financial institutions on the basis of registered capital (%) (at year-ends)

Type of financial institution	2010	2011	2012
Public sector ownership[2]	0,00	0,35	0,29
Other domestic ownership[3]	21,10	24,55	24,01
Domestic ownership total	21,10	24,90	24,30
Foreign ownership[4]	78,90	75,10	75,70
Banking sector, total:	**100,0%**	**100,0%**	**100,0%**

Concentration of asset by the type of financial institutions in 2012 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	31	48	0.0687*
Branches of foreign credit institutions	n/a	n/a	n/a
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	31	48	0,0687

*HHI of assets (min0, max 1)

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2010	2011	2012
Commercial banks	10,7%	9,8%	11,2%
Branches of foreign credit institutions	n/a	n/a	n/a
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	10,7%	9,8%	11,2%

Distribution of market shares in balance sheet total (%)

Type of financial institution	2010	2011	2012
Commercial banks	100	100	100
Branches of foreign credit institutions			
Cooperative banks			
Other[5]			
Banking sector, total:	**100**	**100**	**100**

Capital adequacy ratio of banks

Type of financial institution	2010	2011	2012
Commercial banks**	22.2%**	18.3%**	16.8%**
Cooperative banks	n/a	n/a	n/a
Banking sector, total: **	22.2%**	18.3%**	16.8%**

(* - for Basel I; ** - for Basel II)

Asset portfolio quality of the banking sector*
(share of impaired receivables / share of non-performing loans)

Asset classification	2010	2011	2012
Non financial sector	3,3%	3,8%	3,9%
- households	4,4%	3,5%	3,7%
- corporate	2,8%	3,9%	4,0%

*Nomerator include assets of watch, substandard and doubtful categories
Denominator include whole assets of the given borrowers

Central Bank of Armenia

The structure of deposits and loans of the banking sector in 2012 (%) (at year-end)

	Deposits	Loans
Households	67,21	36,02
Government sector	0	0
Corporate	22,92	59,98
Other (excluding banks)	9,87	4,00
Total	**100,0%**	**100,0%**

*Includes data for residents
Source: Annual Statistical Bulletin of CBA

P&L account of the banking sector (at year-ends)

P&L account	2010	2011	2012
Interest income	282 985	351 868	424 652
Interest expenses	(121 928)	(163 343)	(208 863)
Net interest income	161 056	188 524	215 789
Net fee and commission income	40 062	46 140	47 619
Other (not specified above) operating income (net)	175 013	224 489	303 092
Gross income	498 060	586 097	775 364
Administration costs	(68 529)	(78 695)	(84 499)
Depreciation	(16 938)	(18 789)	(20 568)
Provisions	(151 167)	(173 210)	(281 602)
Net provisions on financial assets (loans, securities, other assets)	(143 286)	(159 002)	(269 433)
Profit (loss) before tax	80 862	85 923	102 376
Net profit (loss)	62 760	66 538	79 709

Total own funds in 2012 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	706 816	645 188	61 628	
Cooperative banks				-
Banking sector, total:	706 816	645 188	61 628	

2012 DEVELOPMENTS IN THE AUSTRIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Subdued economic growth in Austria in the year 2012. The robust recovery of the Austrian economy from the financial and economic crisis ended in mid-2011. From that time the European sovereign debt crisis undermined confidence and, consequently, dampened economic activity. A loss of export momentum, the postponement of capital investment projects as well as consumer restraint resulted in very subdued growth rates for the Austrian economy up to the third quarter of 2012. Yet unlike the euro area, where real GDP growth turned negative already in late 2011, output growth did not start to shrink in Austria until the fourth quarter of 2012. Moreover, the growth setback was less pronounced than in the euro area and Austria's major trading partners. Eventually, the domestic economy grew by 0.8% in 2012.

In 2012, Austria recorded a current account surplus of EUR 5.5 billion (2011: EUR 4.1 billion) as well as a small but unprecedented net positive international investment position of EUR 1.5 billion, thanks to a steady string of current account surpluses since 2002. The reversal of Austria's net financial liabilities also led to lower net interest payments to international creditors. Exports and imports broadly stagnated at the levels of 2011. On the import side, price pressures eased considerably. The weak momentum of exports to other EU countries was compensated for, to some extent, by trade with non-EU countries, above all Switzerland, Russia, the U.S.A. and China.

Annual HICP inflation totaled 2.6% in 2012. HICP inflation first dropped significantly in 2012 but started to rebound around the middle of the year. Starting from a level of 2.9%, HCPI inflation shrank by 1 percentage point until midyear but subsequently regained as much until the end of the year.

Strong rate of employment growth despite weak economic activity. Employment growth observed in the Austrian labor market since its opening to Eastern European EU citizens in May 2011 continued in 2012 with 1.3%, which is less than in 2011 (1.8%), but still a robust growth rate. At the same time, data show a pronounced increase in the number of jobless people and in the number of jobless people undergoing training. This notwithstanding, the Austrian labor market continued to do well in an international comparison.

Government deficit remained stable in 2012, burdened by support measures to banks. Austria reported a general government deficit of 2.5% of GDP, virtually unchanged from 2011. Despite the weakness of the economy, the increase in revenues from taxes and social security contributions was comparatively strong; at the same time the budget was burdened by high capital transfers to banks, totaling some 0.9 % of GDP (compared with 0.2% of GDP in 2011). Other expenditure growth was below the long-term trend but more pronounced than in 2011 on account of higher adjustments for public sector wages and pensions. The debt ratio rose from 72.5 % in 2011 to 73.4 % of GDP in 2012. This increase is attributable above all to euro crisis management measures.

DEVELOPMENT IN THE BANKING SYSTEM (INCLUDING THE ASSETS TOTAL / GDP)

Consolidation trends in the Austrian banking market remained muted in 2012. Nevertheless, unconsolidated total assets of the Austrian banking system decreased by 3.2% in comparison to the previous year to EUR 982 bn, the equivalent of 318% of GDP.

Austrian banks remain committed to the CESEE region. The exposure of domestic banks remained largely flat at around EUR 210 billion as of year-end 2012. The exposure to CESEE is relatively high, but broadly diversified and more than half of it remains located in investment grade countries. Recent developments in different countries are diverging. Exposure reductions in some countries are in essence outweighed by expansions in others. Nevertheless, the market share of Austrian banks in CESEE declined slightly in 2012 to around 11%. The reduction was among others due to a sale of operations in Kazakhstan and Kyrgyzstan.

Austrian banks' profitability rose in 2012 mainly influenced by one-off effects and activities in CESEE. The consolidated profitability of Austrian banks increased in 2012. Net profits after taxes rebounded to EUR 3 billion, which is more than three times higher than in 2011. However, 2012 results should be interpreted with caution, as results were driven by hybrid capital repurchases and similar one-off measures. Operating results were rather weak in 2012 and risk costs remained a burden on net profits.

Asset quality of Austrian banks is still an issue of concern. While credit quality of the domestic market remained fairly benign, deterioration at CESEE subsidiaries continued. On a consolidated basis, net provisioning by Austrian banks increased during 2012 by around EUR 400 million compared to the preceding year. This development was mainly driven by banks that had already experienced problems in the past but to a certain extent also by some of the medium sized Austrian banks. In the domestic market, the LLP ratio increased slightly to 3.3% at end-2012.

The legacy of past exuberances in foreign currency lending will remain a challenge for financial stability in Austria for the coming years. While domestic FC loans have declined rapidly over the past years the legacy of the boom in the last decade will continue to be a challenge. This is most importantly due to the fact that the majority of FC loans are designed as bullet loans with a repayment vehicle which exposes those loans not only to foreign exchange but also to asset price risks.

The tier 1 ratio of the Austrian banking system continued to improve in 2012, partly due to reductions in risk-weighted assets. After its plunge in the second quarter of 2008, the aggregate tier 1 capital ratio (capital adequacy ratio) of all Austrian banks rose steadily and reached 11.0% (14.2%) by year-end 2012. The increase of the aggregate tier 1 capital ratio can be mainly attributed to two effects. First, the volume of eligible tier 1 capital has risen by more than a third since 2008, reflecting capital increases (private placements, capital injections from the parent group, retained earnings and other measures) as well as government measures under the bank stabilization package. Second, in a direct response to the financial crisis, banks were reducing their risk-weighted assets until the fourth quarter of 2009, inter alia by streamlining their balance sheets and cutting off-balance sheet activities.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN AUSTRIA

The FMA is an independent, autonomous and integrated supervisory authority for the Austrian Financial Market, established as an institution under public law. It is responsible for the supervision of credit institutions, payment institutions, insurance undertakings, pension funds, staff provision funds, investment funds, investment service providers, credit rating agencies and stock exchanges, as well as for prospectus supervision. The FMA is also responsible for monitoring trading in listed securities to ensure that it is carried out properly and for monitoring issuers' compliance with information and organization obligations. Further tasks include combating the unauthorized provision of financial services and taking preventive action against money laundering and terrorist financing. The FMA is an integral part of the European System of Financial Supervisors (ESFS) and represents Austria in the relevant European institutions, closely cooperating with the network of supervisors and actively contributing to its work.

In accordance with its statutory mandate, the tasks of the Banking Supervision Department of the FMA include in particular the performance of licensing, authorization and notification procedures, the performance of supervisory procedures, the official supervision of intra-bank models, commissioning the OeNB to carry out on-site inspections, officially monitoring action taken by the credit institution to remedy shortcomings, the interpretation of the law with regard to banking supervision, collecting and analyzing qualitative information, evaluating analysis results with respect to official measures and the involvement in legislation related to banking supervision, sending departmental representatives to international bodies, supervising branches and representative offices of foreign credit institutions as well as cross-border supervision within the scope of the Consolidating Supervision concept.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2012

The banking supervision department of the FMA has set the following objectives for the year 2012:

- The quality and effectiveness of operative banking supervision is further enhanced, especially standard proceedings are conducted in a consistent and swift manner.
- Operative banking supervision is prepared for the new legal requirements (especially CRD IV/CRR).
- Key elements of the smart regulation-concept (CESEE) are integrated in operative banking supervision.
- FMA banking supervision plays an active role in the developments of European regulatory and supervisory initiatives.
- The international cooperation with banking supervision authorities in the context of Consolidating Supervision is further intensified.

- Inter-divisional and joined-up thinking at management and individual staff member's level is strengthened.
- In case of recent market developments that are relevant for the banking sector, necessary steps are promptly taken at micro-level.
- Necessary measures for employee qualification and retention are ensured, maladjustments in the workload are reduced.
- Precautionary actions for crisis management and the necessary implementation steps concerning the proposal for a European directive establishing a framework for the recovery and resolution of credit institutions and investment firms are taken and further developed.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

As banking supervisor, the FMA is responsible for granting, extending or withdrawing licenses. In 2012 the FMA granted two new licenses to credit institutions and one new license to a payment institution. Three licenses were extended,[2] five licenses were declared expired or revoked. One license application had to be refused due to formal deficiencies pursuant to Article 5 para. 1 Federal Banking Act (BWG).

In accordance with its statutory mandate, the FMA is charged with monitoring the credit institutions' compliance with statutory provisions pertaining to banking, with ascertaining facts in cases involving the endangering of creditors' interests and with introducing appropriate remedial measures. On eight occasions during the period under review the FMA ordered credit institutions, under threat of a coercive penalty, to establish compliance with statutory provisions within an appropriate period of time. One license was revoked.

Since the implementation of Basel II, credit institutions and groups of credit institutions with head offices in Austria have been permitted, with the approval of the FMA, to apply internal ratings-based models (IRB) for calculating their regulatory capital requirements in the area of credit risk. Over the course of 2012, nine models relating solely to the Austrian market were approved in total. In the case of a cross-border approval for a model, the FMA in its capacity as home supervisor was able to bring eight cross-border approval processes to a successful conclusion in 2012. All of these cross-border approvals referred to banking groups operating in the CESEE region.

In addition to the reports and notifications received from the credit institutions, the FMA also actively approaches the supervised banks. Pursuant to Article 70 para. 1 no. 1 BWG and Article 63 para. 2 no. 2 Payment Services Act (ZaDiG), the FMA may request information at any time from the supervised credit institutions and payment institutions and inspect their business documents. This enables the authorities to acquire additional information or to check the accuracy of reported data. There were 402 instances of information being obtained or of documentation being inspected in the year under review. This number of cases includes requests for statements concerning the issue of foreign currency loans, which is a special focus of supervisory efforts. Furthermore, the FMA may obtain information not only from the credit institutions themselves but also from bank auditors and auditing associations,

[2] Extending a license means to allow an existing credit institution to conduct additional banking business.

from protection schemes as well as from government commissioners. The FMA issued 29 such requests for information in 2012.

Apart from these formal ad-hoc information requests the FMA based its decisions on various sources such as the credit institution's financial statements, the reports of auditors and state commissioners, as well as on standardized meetings with the management of numerous credit institutions, the so called management talks. Another important source of information are the on-site inspections and analyses conducted by the OeNB. In 2012, the OeNB conducted 47 on-site inspections on behalf of the FMA. The audit plan focused on the topics of counterparty credit risk and liquidity risk.

While previously existing for insurance and securities supervision, the FMA's powers to conduct on-site inspections for combating money laundering and terrorist financing were extended from 29 December 2011 on to include credit institutions as well. Therefore, for the purpose of preventing money laundering and terrorist financing, six on-site inspections of credit institutions were conducted for the first time in this area by the FMA in 2012. Additionally, in relation to preventing money laundering and terrorist financing, the FMA carried out a total of 20 company visits at credit institutions during the year under review.

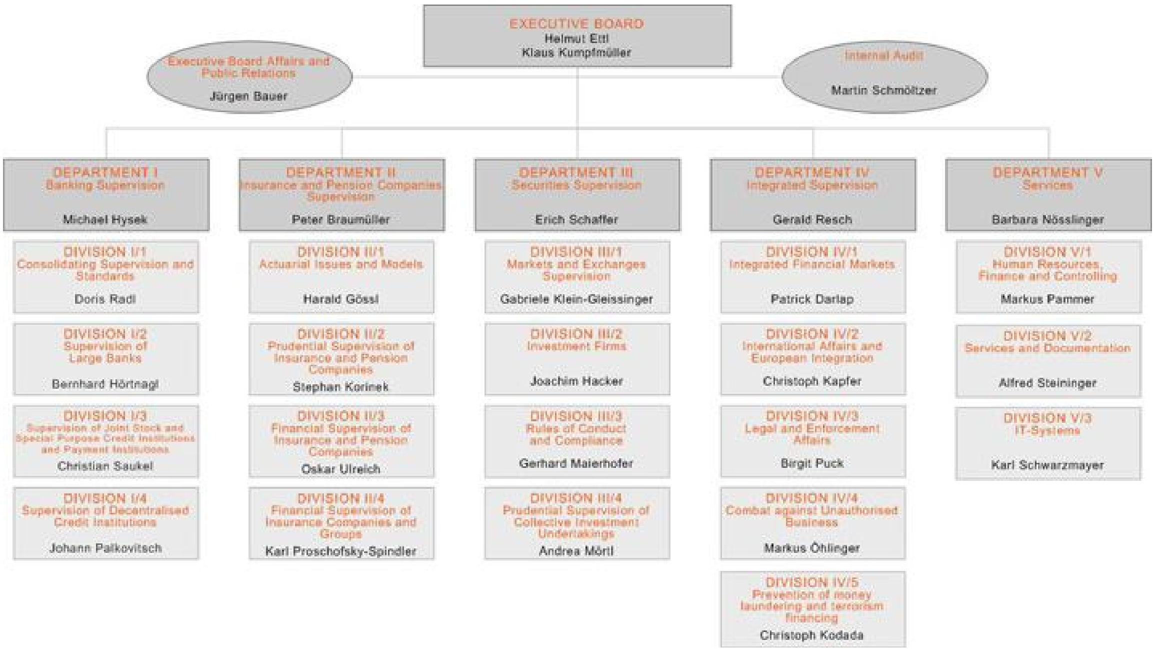
In view of the significance of the CESEE region for Austrian credit institutions, on-site inspections of credit institutions in that region are being conducted with greater frequency within the framework of consolidated supervision. Such inspections are held with the consent of the competent supervisory authority in the particular case (see also subsection "CESEE supervisory colleges and management talks").

- *Supervisory colleges and management talks for banking groups operating on a cross-border basis, especially in CESEE-region:*

Supervisory colleges have gained in significance, not least because of Article 77c Austrian Federal Banking Act, which defines the cross-border decision-making procedure. As of the end of 2012, the FMA has established 14 supervisory colleges as specified in Art 131 CRD (FMA as home supervisor, 5 of them are related to the CESEE region). Four "fully fledged" supervisory colleges for banking groups operating on a cross-border basis, that have at least two significant subsidiary institutions or branch offices in other EEA Member States, were established, as well as another ten "nonfully fledged" supervisory colleges, having a more flexible structure. Within the scope of its coordinating role, the FMA in its capacity of home supervisor held a total of nine college meetings devoted to cross-border groups of credit institutions in 2012. Representatives of the competent EEA and third-country authorities as well as EBA staff members also participated in the college meetings.

Austrian credit institutions are prominent in Central and Eastern Europe, and thus great significance is associated with this region for the business development of Austria's major credit institutions. Correspondingly, priority is given to discussing the risk situation in the context of management talks involving the major banking groups with a strong CESSEE commitment. The purpose of the talks is to develop a clear view of the structure and business activities of CESEE subsidiaries as well as of the risks to which they are exposed. Detailed information is also provided by the banks concerning their strategy for Eastern Europe, the group risk management system and the development of their most significant subsidiaries abroad. For further international activities of the FMA especially in the CESEE region see also answer to Question 7.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY[3]



INTERNATIONAL ACTIVITIES OF THE AUTHORITY AND COOPERATION WITH OTHER SUPERVISORY BODIES

The FMA consistently strives to nurture and further expand the dialogue with other supervisory authorities, particularly those in Central, Eastern and South-Eastern Europe. To this end, bilateral meetings were held in the various areas of supervision and at different levels, including a High Level Meeting with the Central Bank of the Russian Federation in Vienna and visits to the Central Banks of Ukraine and Poland. These meetings focused on such issues as the exchange of information on supervised institutions and groups engaging in cross-border activities.

Also, the FMA is constantly engaged in the ongoing work of the European Banking Authority (EBA) and other EU supervisory structures, alongside the supervisory authorities of the CESEE region's EU Members States.

For the first time since joining the BSCEE in 2008, the FMA had been elected by the member organizations to chair the Group in 2012. The chairmanship, which was one of the FMAs flagship international activities in 2012, was exercised by Michael Hysek, who heads the FMA's Banking Supervision Department. In this capacity, the FMA hosted the XXV BSCEE Annual Conference in Vienna in April 2012.

According to international requirements, Austria has established a regional cross border stability group (AT CBSG) for cross-border active Austrian banking groups in the CESEE region. In 2012, additionally to the at least annually

[3] Please note that the FMA is an integrated supervisory authority, therefore banking supervision is one of five departments in the FMA - see also answer to question 3.

meeting, a Crisis Simulation Exercise was conducted to explore bilateral and multilateral cooperation.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

In handling official activities related to supervision, the FMA must, as far as possible, draw on analysis and inspection results as well as the results of the expert opinions prepared by the OeNB during model approval procedures, in addition to using information from third parties or from the respective bank. This collaborative setup calls for intensive, timely coordination between the two institutions.

This reconciliation process is supported by a database, the joint information system. Various reporting data, relevant information available from the FMA's supervisory activities as well as data and results of OeNB analyses are filed in this database.

Moreover, a Financial Market Committee is established at the Federal Ministry of Finance to foster cooperation and the exchange of views, and to provide advice on financial market and financial stability issues. The committee has one member each from the FMA, the OeNB and the Federal Ministry of Finance and meets at least once every quarter. The committee discusses national legal and overall financial market policy issues, and discusses the Austrian position on drafts of European legislation. Moreover, the Financial Market Committee also coordinates action during financial crises; in this function, it acts as the domestic standing group established in line with the 2008 Memorandum of Understanding.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

As reported in the BSCEE 2011 questionnaire, FMA and OeNB have presented the "sustainability package" in November 2011 to enhance the sustainability of the business models applied by Austrian banking groups operating in CESEE. Its objectives are to be met by means of the following three sets of measures:

<u>Greater Capitalisation</u>

The provisions of Basel III pertaining to Common Equity Tier 1 capital (CET1) will apply without any transitional period, already from 2013 onwards, to the banks falling under the regulations, while an additional CET1 capital buffer of up to three percentage points is planned for 2016 and beyond.

<u>Stable refinancing of subsidiary banks</u>

The local deposit base and local issuing activity, as well as refinancing through supranational institutions are to be bolstered. A more balanced net credit growth rate relative to the stable refinancing forms at the local level are to be achieved. For this purpose, what is referred to as the Loan-to-Local Stable

Funding Ratio (LLFSR) was defined at 110% as an indicator for existing business and net new transactions.

Submission of restructuring and winding down plans

The banking groups were requested to submit restructuring and winding down plans by the end of 2012. Such plans are to blueprint the steps to be taken towards restructuring in the event of adverse market conditions, as well as the steps for winding down the business while causing a minimum amount of financial market instability. The major banks presented to the supervisory authorities the required living wills and resolution schemes at the end of 2012. Among the items identified in

this documentation are the system-relevant functions of the banking groups. The plans will be evaluated by the supervisory authorities and further developed by the institutions in 2013.

According to European legislation, the national provisions relating to remuneration policies entered into force in Austria on 1st January 2011. Alongside ongoing analysis and assessment of the theory behind the remuneration systems in place in credit institutions, the first review of practical implementation was carried out in 2012. The remuneration figures for 26 randomly selected banks/banking groups were investigated. In order to make it easier for the banking industry to apply the remuneration principles coherently and in accordance with the statutory provisions, the FMA revised its Circular on remuneration and republished it in December 2012.

STATISTICAL TABLES

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution	2010	2011	2012
Commercial banks	207	197	192
Branches of foreign credit institutions	30	30	29
Cooperative banks	606	597	584
Banking sector, total:	**855**	**824**	**809**

Source: OeNB, unconsolidated data.

Ownership structure of the financial institutions on the basis of registered capital (%) (at year-ends)

Type of financial institution	2010	2011	2012
Public sector ownership	11.5	10.6	10.1
Other domestic ownership	68.7	68.1	66.8
Domestic ownership total	80.2	78.7	76.9
Foreign ownership	19.2	21.3	23.1
Banking sector, total:	**100.0**	**100.0**	**100.0**

Source: OeNB, unconsolidated data.

Concentration of asset by the type of financial institutions (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	40.2	49.0	737.7
Branches of foreign credit institutions	69.6	77.3	3,447.0
Cooperative banks	38.9	54.0	755.0
Banking sector, total:	**28.8**	**36.2**	**388.0**

Source: OeNB, unconsolidated data.

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2010	2011	2012
Commercial banks	4.8	-0.1	3.4
Branches of foreign credit institutions	6.6	4.3	5.2
Cooperative banks	-	-	-
Banking sector, total:	**5.8**	**1.6**	**4.2**

Source: OeNB, unconsolidated data.

Distribution of market shares in balance sheet total (%)

Type of financial institution	2010	2011	2012
Commercial banks	62.3	61.3	62.6
Branches of foreign credit institutions	1.2	1.2	1.3
Cooperative banks	36.6	37.5	36.1
Other	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

Source: OeNB, unconsolidated data.

Capital adequacy ratio of banks

Type of financial institution	2010	2011	2012
Commercial banks**	13.2	13.4	13.9
Cooperative banks**	13.4	13.7	14.7
Banking sector, total:**	**13.2**	**13.6**	**14.2**

Source: OeNB, unconsolidated data.
(* - for Basel I; ** - for Basel II)

Asset portfolio quality of the banking sector (share of impaired receivables / share of non-performing loans)

Asset classification	2010	2011	2012
Non financial sector	4.7	4.5	4.7
- households	**n.a.**	**n.a.**	**n.a.**
- corporate	**n.a.**	**n.a.**	**n.a.**

Source: OeNB, unconsolidated data; NPL of domestic business.

The structure of deposits and loans of the banking sector in 2012 (%) (at year-end)

	Deposits	Loans
Households	71.3	41.1
Government sector	4.4	8.9
Corporate	17.4	42.7
Other (excluding banks)	6.9	7.3
Total	**100.0**	**100.0**

Source: OeNB, unconsolidated data; only domestic business

P&L account of the banking sector (at year-ends)

P&L account	2010	2011	2012
Interest income	26.6	28.2	25.6
Interest expenses	17.8	18.6	16.8
Net interest income	9.1	9.6	8.8
Net fee and commission income	4.0	3.8	3.8
Other (not specified above) operating income (net)	6.6	5.8	6.5
Gross income	**19.7**	**19.2**	**19.1**
Administration costs	**9.7**	**10.0**	**10.4**
Depreciation	0.6	0.5	0.5
Provisions	3.3	5.7	2.5
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	n.a.	n.a.	n.a.
Profit (loss) before tax	4.8	2.2	4.3
Net profit (loss)	4.2	1.2	3.2

Source: OeNB, unconsolidated data in EUR bn.

Total own funds in 2012 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	52.9	42.5	12.4	0.6
Cooperative banks	35.3	27.3	9.0	0.4
Banking sector, total:	**88.2**	**69.8**	**21.5**	**1.0**

Source: OeNB, consolidated data in EUR bn.
Total own funds before deductions; Tier capital after deductions

2012 DEVELOPMENTS IN THE BANKING SYSTEM OF THE REPUBLIC OF BELARUS

MACROECONOMIC ENVIRONMENT

Economic situation in the Republic of Belarus in 2012 was characterized by strengthened macroeconomic and financial stability, considerably decelerated inflation processes, ensured foreign economic balance, and recovered growth of households' incomes.

The above-mentioned trends were developing on the background of slowing down economic growth and industrial output growth rates, as well as decreasing investment activity.

In 2012, GDP increased in comparable prices by 1.5% on the previous year (in 2011 – by 5.5%). Inflation in the consumer market stood at 21.8%, compared with 108.7% in 2011.

DEVELOPMENT OF THE BANKING SYSTEM (INCLUDING THE ASSETS TOTAL / GDP)

As at January 1, 2013, the banking sector of the Republic of Belarus included 32 operating banks. The number of branches fell in 2012 from 138 to 105 owing to the streamlining by banks of their regional structures. At the same time, the total number of banks' organizational units (branches, banking services centers, settlement and cash centers, and exchange offices) in the territory of the country grew by 3%, amounting as at January 1, 2013 to about 3,700. Foreign banks ran eight representative offices in the territory of the country.

Foreign capital participated in the authorized capital of 27 banks, including eight wholly-foreign owned banks. As at January 1, 2013, the non-residents' share in the aggregate authorized capital of the Belarusian banks stood at 19.6% (in 2012 – 14.5%). The share of the State Committee on Property of the Republic of Belarus exceeded 50% of authorized capital in three banks.

In 2012, the banks' aggregate authorized capital grew by 7.9%, amounting at the year-end to BYR29.8 trillion, or EUR2.6 billion in equivalent.

In the period under review the banking sector's assets increased by 23.8%, amounting to BYR321.2 trillion (EUR28.3 billion in equivalent). The annual average assets/GDP ratio dropped from 61.1% in 2011 to 54.1% in 2012.

In 2012, banks' profits amounted to BYR5.4 trillion, exceeding 1.7 times the 2011 level. Return on the banking sector's assets[4] totaled 1.8% (as at January 1, 2012 – 1.6%); return on the regulatory capital – 12.7% (as at January 1, 2012 – 14.9%).

[4] After tax profit is used in the calculation of this indicator.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS

Current environment of banking activities as well as the changes in the international approaches of the banking supervision, including those caused by the global economic crisis, necessitated the introduction of amendments and modifications to the regulatory legal acts governing banking supervision.

According to the changes of the Banking Code of the Republic of Belarus made in 2012, since 2013 the National Bank of the Republic of Belarus in interaction with the Government of the Republic of Belarus officially carries out the function of monitoring of financial stability.

In 2012, the procedures for state registration and licensing of banks were separated, the requirements applied to banks when issuing licenses were tightened, and the requirements to the banks' major shareholders and beneficiary owners and transparency of the banks' ownership structure were set as part of the measures designed to improve the procedures for state registration and licensing of banks' activities.

With a view to improving the quality of corporate governance, upgrading the system of internal control, and enhancing risk management at banks the following requirements were specified in 2012:

- requirements to the organization of the system of bank corporate governance, including the composition of the board of directors (supervisory board) and its members;
- tasks and functions of the board of directors related to the organization of the corporate governance;
- fields and conditions of occurence of the conflict of interests in the activities of a bank; and
- requirements to the banks' internal control and risks management systems complying with the character of operations performed thereby.

With due regard to the need of improving the quality of strategic planning at banks, the procedures for strategic planning based on the international and national practice of developing business projects (strategic development plans) were set in 2012.

In 2012, the procedures for applying a motivated opinion when taking corresponding supervisory decisions by the Board of the National Bank and the National Bank's authorized persons were set due to the assignment to the National Bank of the right to use a motivated opinion when taking supervisory decisions.

With a view to regulating the procedures of applying supervisory response measures by the National Bank, a more flexible system of supervisory response measures, focused to the extent possible on tackling negative situations and discontinuing negative trends in a concrete bank, was established in 2012.

In 2012, the procedures for passing the assessment of compliance with qualification and business reputation requirements by certain officials of a bank, as well as corresponding requirements applied thereto, including the members of the board (supervisory board), were set for the purpose of improving the quality of bank governance.

LEGAL COMPETENCE OF THE BANKING SUPERVISION AUTHORITY IN THE REPUBLIC OF BELARUS

In the Republic of Belarus the supervisory functions are entrusted to the central bank of the country – the National Bank, which incorporates a special supervisory unit - the Banking Supervision Directorate.

In carrying out banking supervision in the Republic of Belarus the National Bank performs the following functions:

- development of secure functioning requirements and other prudential requirements to the banks to ensure the banking system's stability and soundness;
- state registration of banks and licensing of banks' activities;
- monitoring of financial stability;
- regulation of the foreign capital access to the banking system of the Republic of Belarus;
- analysis of banks' reports;
- on-site inspection of a bank and evaluation of its operational risks;
- detection of violations of banking legislation;
- monitoring of the banking sector's risks;
- setting the rules of publication of the information used to assess the degree of banks' and non-bank financial institutions' reliability; and
- regulation of banks' reorganization and liquidation.

Also, the system for guaranteeing the repayment of funds attracted by banks from natural persons is operated in the Republic of Belarus. The natural persons' deposits guarantee fund is built up at the expense of monthly irrevocable contributions of banks licensed to accept deposits from natural persons that are accumulated by the Agency on the Guaranteed Repayment of the Natural Persons' Deposits.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2012

In 2012, the goals and objectives of the banking supervision were determined by the need to ensure a stable functioning of the banking sector and protect the interests of depositors and other banks' creditors. Their implementation was associated with improvement of prudential requirements and supervisory procedures and an increase in the level of all components of the supervisory process (pre-supervision on the stage of state registration of banks and licensing of banks' activities; current supervision, including off-site and macroprudential supervision and inspections).

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2012

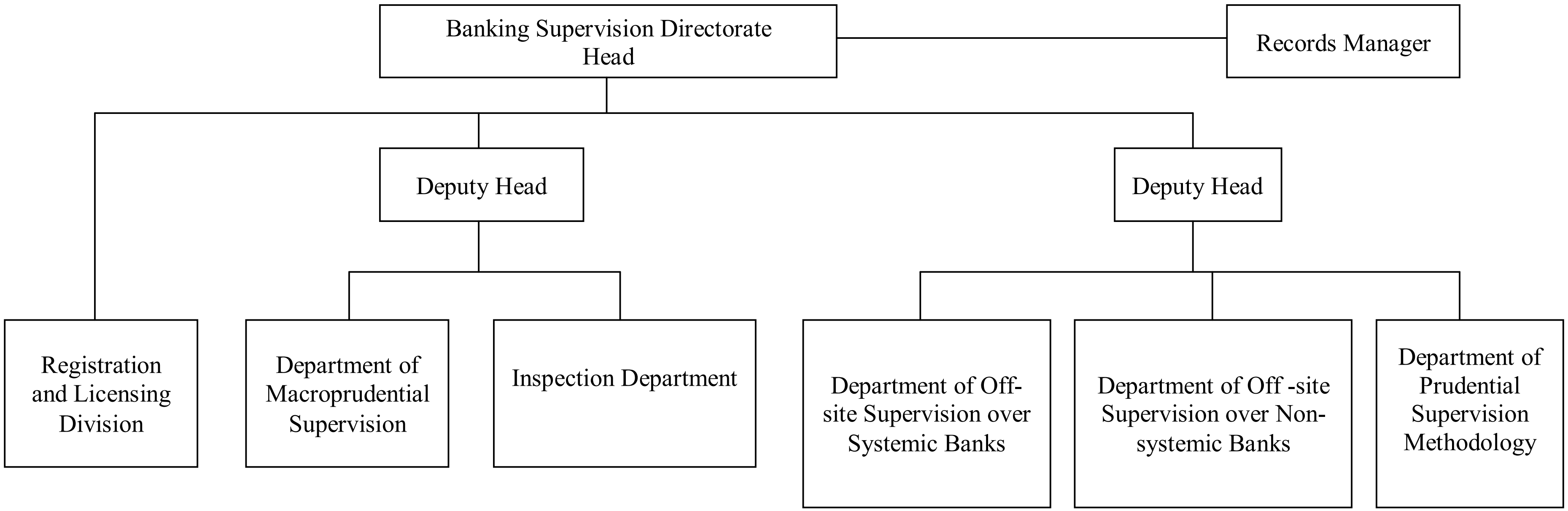
The strengthening of the off-site supervision was aimed at improving the process of analyzing the indicators of banks' activities, meeting the safe functioning requirements thereby, and revealing the adverse trends and crisis developments at early stages. The measures designed to improve the National Bank's information and analytical system were taken for the purpose of automating and, correspondingly, speeding up the process of processing the data of financial and other reports.

With a view to discontinuing the adverse trends and eliminating (preventing) the situations posing a threat to the depositors' and other creditors' interests, the National Bank (based on the analysis of reports and other obtained information) submitted to banks the instructions to eliminate the revealed violations, applied sanctions thereto, and carried out the meetings with executive bodies thereof in the National Bank and in their offices, as well as submitted letters to the banks' management bodies (supervisory boards and executive bodies). The cooperation of the National Bank with audit organizations and the Association of Belarusian banks was intensified.

In 2012, the National Bank's specialists conducted 21 inspections of banks and their structural units on various aspects of banking activities. 17 banks were monitored as to their compliance with legislation on combating money laundering and terrorism finanacing. Based on the results of inspections, the acts reflecting the violation of legislation on banking activities and statements on the level of risks assumed by banks, the adequacy of internal control systems, and the quality of banks management were drawn up. Recommendations to remedy the deficiencies revealed and instructions to eliminate violations were submitted to banks, as well as the measures stipulated by legislation on administrative offenses were applied in appropriate cases. The meetings with the bank's senior managers were carried out following the results of inspections.

In 2012, significant attention was paid to the issues of analyzing and assessing the banking sector's systemically important risks. In particular, the approaches to the assessment of the core banks functioning in the Republic of Belarus were developed based, inter alia, on the international practice.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

The National Bank is endeavoring to establish and develop contacts and exchange of information with foreign banking supervision authorities. Cooperation with those countries in which representative offices of the Belarusian banks are located and the banks of which established subsidiaries and representative offices in the Republic of Belarus is of particular interest.

In 2012, 16 bilateral agreements with foreign banking supervision authorities were in force.

In 2012, the issues of improving efficiency of banking supervision in line with the best international practices, streamlining the banking sector's structure and infrastructure, and carrying out stress testing were considered within the scope of consultations with the representatives of the IMF's technical mission.

COOPERATION WITH THE OTHER SUPERVISORY BODIES IN THE REPUBLIC OF BELARUS

More detailed information on the developments in the banking sector and banking supervision in the Republic of Belarus is available on the official website of the National Bank of the Republic of Belarus (www.nbrb.by/engl/).

STATISTICAL TABLES

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution	2010	2011	2012
Commercial banks	31	31	32
Branches of foreign credit institutions	-	-	
Cooperative banks	-	-	
Banking sector, total	**31**	**31**	**32**

Ownership structure of the financial institutions on the basis of registered capital (%) (at year-ends)

Type of financial institution	2010	2011	2012
Public sector ownership	71,7	64,9	65,3
Other domestic ownership	1,0	1,1	1,0
Domestic ownership total	72,7	66,0	66,3
Foreign ownership	27,3	34,0	33,7
Banking sector, total	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions in 2012 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	69,6	80,5	0,22
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**69,6**	**80,5**	**0,22**

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2010	2011	2012
Commercial banks	11,77	14,87	12,74
Branches of foreign credit institutions	-	-	
Cooperative banks	-	-	
Banking sector, total:	**11,77**	**14,87**	**12,74**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2010	2011	2012
Commercial banks	100.0	100.0	100.0
Branches of foreign credit institutions			
Cooperative banks			
Other			
Banking sector, total:	**100.0**	**100.0**	**100.0**

The structure of assets and liabilities of the banking system (%) (at year-end)

Assets	2010	2011	2012
Claims on general government	4,1	5,5	4,9
Claims on economic entities*	54,9	48,1	55,9
Claims on natural persons	17,9	12,6	12,8
Claims on the National Bank	14,8	22,2	17,6
Claims on banks	2,7	3,0	2,3
Claims on non-residents	3,5	7,3	4,2
Other assets	2,1	1,3	2,4
Liabilities	**2010**	**2011**	**2012**
Central government funds	8,7	4,6	6,1
Local government funds	2,5	2,5	3,3
National Bank funds	21,9	7,3	3,7
Economic entities' funds*	18,1	26,1	26,2
Natural persons' funds	18,0	19,5	25,1
Banks' funds	2,9	3,1	2,4
Funds received from non-residents	13,5	19,3	16,3
Other liabilities	14,5	17,6	16,9

* Economic entities - non-bank financial institutions, commercial and non-profit non-financial enterprises and organizations, individual entrepreneurs.

Capital adequacy ratio of banks

Type of financial institution	2010	2011	2012
Commercial banks	20,5%**	24,7%**	20,8%**
Cooperative banks	-	-	
Banking sector, total:	**20,5%**	**24,7%**	**20,8%**

(* - for Basel I; ** - for Basel II)

Asset portfolio quality of the banking sector (share of impaired receivables / share of non-performing loans)

Asset classification	2010	2011	2012
Non financial sector	3,71%	3,68%	5,82%
- households	4,80%	4,59%	7,16%
- corporate	0,52%	0,47%	0,40%

The structure of deposits and loans of the banking sector in 2012 (%) (at year-end)

	Deposits	Loans
Households	40,1	19,0
Government sector	20,8	0,2
Corporate	35,2	80,4
Other (excluding banks)	3,9	0,4
Total	**100,0**	**100,0**

P&L account of the banking sector (at year-ends)

P&L account	2010	2011	2012
Interest income	2640,3	2126,7	3690,7
Interest expenses	1607,7	1481,5	2666,7
Net interest income	**1032,6**	**645,2**	**1024,0**
Net fee and commission income	**451,4**	**280,5**	**515,9**
Other operating income (net)	**-753,9**	**-415,7**	**-727,1**
Net provision assignments	**364,0**	**364,6**	**409,0**
Net other income	**163,4**	**203,7**	**151,2**
Gross income	4073,6	7517,0	9594,2
Profit (loss) before tax	**529,5**	**349,1**	**555,0**
Income tax	98,4	63,2	79,3
Net profit (loss)	**431,1**	**285,9**	**475,7**
Interest income	2640,3	2126,7	3690,7

Total own funds in 2012 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	3959,9	3077,7	892,3	0,0
Cooperative banks	-	-	-	-
Banking sector, total:	**3959,9**	**3077,7**	**892,3**	**0,0**

2012 DEVELOPMENTS IN THE BANKING SYSTEM OF THE FEDERATION OF BOSNIA AND HERZEGOVINA

MACROECONOMIC ENVIRONMENT

According to the preliminary estimates[5], the nominal value of the GDP for Bosnia and Herzegovina (B&H) in 2012 was 25.900 billion KM, which represents a minimum nominal increase of about 1%, compared to the year 2011. According of estimate by Central Bank of Bosnia and Herzegovina GDP/ per capita in 2012 amounted to 6.745 KM for Bosnia and Herzegovina. The analysis of the industrial production index structure (December 2012 /December 2011) shows that in FBH there was a decline of the production volume in mining by 6.4% and in manufacturing industry by 2.9%, while growth was recorded in supply of electricity, gas and water by 10.1%.

The annual inflation rate in December 2012 in BH was lower than the annual inflation rate in the euro area

by 40 basis points, and compared to EU by 50 basis points. In the countries in the region, the annual inflation rate was higher than in BH. So, the inflation rate in Serbia was higher by 10.4 percentage points, those in Macedonia and Croatia were higher by 4.7 percentage points each, that in Montenegro by 3.3 percentage points and that in Slovenia by 0.9 percentage points. Consumer price index structure shows that the level of prices, observed at the annual level, in December 2012, was caused by the growth of prices of goods and also the growth of prices of services. The prices of goods increased by 2.0 pp, and prices of services by 1.6 pp. The composition of the Consumer Price Index in B&H shows that the average prices in BH in 2012 compared to 2011 were higher by 2.1%. The annual inflation rate in December 2012 was 1.8% which was lower by 50 basis points compared to the annual inflation rate in September. In the fourth quarter of 2012 compared to the previous quarter, there was a growth of average prices by 0.5%.

The number of employees in B&H in December 2012 amounted to 691.896 persons; out of that number 437.331 are employed in the FBiH, 238.178 in RS and 16.387 people in the Brcko District.

The ceiling for insured deposits scheme under the auspices of the Deposit Insurance Agency was 35,000 KM and it applied exclusively to physical persons, with 26 banks participating in the deposit insurance.

At the end of the fourth quarter of 2012, the total deposits were KM 13.32 billion, which was an increase of KM 183.1 million or 1.4% in comparison with the data from the end of the previous quarter. The annual growth rate of the total deposits amounted to 2.6% in December 2012. The share of KM deposits in the total deposits decreased by 0.1 percentage point to 53.6% in December compared to September 2012.

The total deposits of the government sector remained at the same level in the fourth quarter of 2012 and amounted to KM 1.31 billion and their share in

[5] Estimates of Central Bank of Bosnia and Herzegovina which are in use as preliminary data till publishing of BH Agency of statistics official GDP

the total deposits was 9.9%. The increase of the total deposits was mainly related to the increase of deposits of the non-governmental sector in the amount of KM 182.8 million or 1.5% compared to the previous quarter, which in December amounted to KM 12.00 billion. At the annual level, deposits of nongovernment sector increased by 4.4%.

Spread between lending and deposit interest rates of the commercial banks in BH was 6.94 percentage points in December, which is lower by 6 basis points compared to the level from September 2012. Such decrease in spread is caused by decrease of the weighted average of lending interest rates. The spread between lending and deposit interest rates, in which only term and savings deposits are included, was 4.05pp, which is by 10 bp lower compared to September 2012, caused by decrease of the weighted average of lending interest rates, as well as weighted average of deposit interest rates.

DEVELOPMENT IN THE BANKING SYSTEM (INCLUDING THE ASSETS TOTAL / GDP)

The banking sector performance in 2012 is still under the impact of the financial and the economic crises, which spread over the majority of the economy in Europe and which did not only reflect on the banks and financial systems, but also real economy, and overall economic environment of a large number of countries. The recovery of the global economy has again slowed down, and uncertainty in regard to the future development of events is more and more present. The banking sector in F BiH in 2012 is stagnating, the balance sheet has a slight decline, credit activities slowed down, and continued is the increase of the poor quality loans, although with somewhat slower trend in comparison to the previous year. The sources of financing (deposits and loan obligations) also have a declining trend, and especially the foreign sources of financing, which the banks had as a financial support from their groups. In spite all the negative impacts, the banking sector has still remained stable, adequately capitalized, the citizens' savings kept the increasing trend, the liquidity is still satisfactory and the profitability improved.

As of 31.12.2012., there were 18 banks (17 banks with majority private ownership and one bank with majority state ownership) with banking license issued in the Federation of BiH, of which number one bank was under provisional administration. As of 31.12.2012., the number of employees in banks declined by 3,2% in comparison to 31.12.2011.

Aggregate balance sheet of the banking sector, at the end of 2012, amounted to 15 billion KM, which presents a decrease by 1,8% or 272 million KM in comparison to end of 2011. Capital of banks in the Federation of BiH, as of 31.12.2012., amounted to 2,2 billion KM. In 2012, capital increased by 3% or 70 million KM in comparison to 2011, while the changes in core and supplementary capital influenced the changes in the structure of regulatory capital. The core capital increased by 4% or 70 million KM, and participation from 78% to 79%, supplementary capital decreased from 22% to 21%. The core capital growth is a result in most part of the inclusion of the realized profit for 2011. Capital adequacy rate of the banking system, as of 31.12.2012., was 17,4%, which is still much more than the minimum prescribed by the law (12%), representing satisfactory capitalization of the entire system and very strong basis and foundation to preserve its safety and stability.

The impact of the economic crises on the overall economy and industry in BiH is still present, which had a significant impact on the banks' operations that is the segment of lending. Loans as of 31.12.2012 were 10,7 billion KM, with a minimum growth of 2% or 178 million KM in comparison to the end of 2011, while the participation in the assets increased by 2,4 percent points and is 71,1%. The total nonperforming loans are 1,4 billion KM with participation in the total loans of 13,2%.

Deposits, with participation of 73,1%, amounting to 11 billion KM, still represent the most significant source of funding for banks in the FBiH. In the same period the saving deposits, as the most important segment of deposit and financial potential of the banks, maintained the positive trend of growth and at the end of 2012 were 5,76 billion KM, which is by 7,4% or 395 million KM higher than at the end of 2011. The cash funds are 3,96 billion KM or 26,4% of the balance sheet of banks in F BiH and is lower by 9,5% or 415 million KM in comparison to the end of 2011.

According to the data from the financial reports which show the banks' performance success that is from the income statement for 2012, at the level of the banking sector in the Federation of BiH and realized is a positive financial result – profit in the amount of 111,7 million KM.

Liquidity of the banking system in the Federation of BiH is still good, with satisfactory participation of liquid assets in total assets and very good maturity match of the financial assets with the liabilities, with and improving trend in 2011 and 2012. However, since the financial crisis is still present worldwide which has an adverse reflection to the banking systems of certain European countries, which had a negative effect on certain European countries and parent banks in FBiH, it is estimated that liquidity risk still needs to be under enhanced supervision.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN BOSNIA AND HERZEGOVINA

A) LAWS (new developments in 2012)

1. Law on Amendments to the Law on the FBiH Banking Agency (Official Gazette of the Federation of BiH,
   No.:34/12 and 77/12) - in order to promote and protect the rights and interests of consumers.

B) PRUDENTIAL REGULATION ISSUED BY FBA – Federal Banking Agency(new developments in 2012)

1. Decision on changes to the Decision on minimum standards for liquidity risk management in banks (Official Gazette of FBiH, No 110/12);
2. Decision on changes to the Decision on provisional measures to renegotiate the credit terms of natural and legal persons in banks (Official Gazette of FBiH, No 111/12);
3. Decision on minimum standards for activities of the banks on prevention of money laundering and financing of terrorist activities (Official Gazette of FBiH, No 48/12);
4. Decision on amendments to the Decision on determining the tariff of administrative fees for the FBiH Banking Agency (Official Gazette of FBiH, No 48/12);
5. Instruction on amendments to the Instruction on licensing and other approvals issued by the FBiH Banking Agency (Official Gazette of FBiH, No 48/12);
6. Decision on format of banks' reports submitted to the FBiH Banking Agency (Official Gazette of FBiH, No 110/12);
7. Decision on conditions and manner for leasing companies' performance in reference to complaints from the lessee (Official Gazette of FBiH, No 48/12);
8. Decision on the minimum standards of the leasing companies' activities on prevention of money laundering and terrorism financing (Official Gazette of FBiH, No 48/12);
9. Decision on unified manner and method for calculation and reporting of the effective interest rate for financial leasing contracts (Official Gazette of FBiH, No 48/12);
10. Decision on amendments to the Decision on the form and content of the reports which the leasing companies submit to the FBiH Banking Agency and the reporting deadlines (Official Gazette of FBiH, No 48/12);
11. Decision on amendments to the Decision on the form and content of the reports which the leasing companies submit to the FBiH Banking Agency and the reporting deadlines (Official Gazette of FBiH, No 110/12);
12. Decision on the minimum standards of the microcredit organisations'activities on prevention of money laundering and terrorism financing (Official Gazette of FBiH, No 48/12);

13. Decision on the amendments to the Decision on the form and content of the reports which the microcredit organizations submit to the FBiH Banking Agency and the reporting deadlines (Official Gazette of FBiH, No 110/12).

Legal competences of FBA:

1. Issuance of license for establishment and work of banks, micro-credit organizations and leasing companies, issuance of license for changes of organizational system of banks, micro-credit organizations and leasing companies, type of activity and approvals for appointment of their managing staff;
2. Supervision of banks, micro-credit organizations and leasing companies, undertaking of measures in accordance with law;
3. Revoking work license from banks, micro-credit organizations and leasing companies in accordance with law;
4. Administration or supervision of bank rehabilitation and liquidation process and initiation of bank bankruptcy procedure;
5. Adoption of sub-legislation regulating work of banks, micro-credit organizations and leasing companies;
6. Evaluation of conditions and issuance of approval to banks for the next issue of shares;
7. Implementation of actions in the support of anti-terrorist activities related to banks;
8. Taking all such actions as may be appropriate, which may include the blocking of customer accounts in any bank or banks within the jurisdiction of the Federation Banking Agency, in order to prevent the funding of activities which are, or which threaten to be, obstructive of the peace implementation process as pursued under the aegis of the General Framework Agreement for Peace in Bosnia and Herzegovina and requiring the Central Bank of Bosnia and Herzegovina to open a special reserve account; requiring the banks in which accounts are blocked under item, aforesaid and transfer criminal funds to the safe keeping of the Central Bank of Bosnia and Herzegovina, or one of its main units and undertake numerous actions related to above mentioned issues including revocation of banking licenses and other kinds of authorizations;
9. Evaluating and promoting the consumers protections rights and interests, with the aim to facilitate that the disputes and conflicts occurred between the banking system institutions and the users can be rightfully and promptly resolved by the independent parties, with a minimum formality through reconcilement, negotiation or other peaceful manner.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2012

The focus of Federal Banking Agency in 2012 were maintaining its stability as a priority task in the current stress conditions, as well as its progress and development. Also, in 2012. FBA set up the following priorities:

1. Continue implementing activities, from the scope of its authority, to consolidate supervision on state level;
2. Take measures and activities within its powers to overcome and mitigate adverse effects to the banking sector of the FBiH caused by the global financial crisis;
3. Proceed with a continues supervision of banks through on-site and off-site examinations, focusing on targeted examination of dominant risk segments of banking operations, which will make supervision more effective, in regard to:
   - persist on capital strengthening of banks, especially those recording outstanding assets growth,
   - continue permanent monitoring of banks, primarily those with systemic importance to development of credit activities with the highest concentration of savings and other deposits in order to protect depositors,
   - continue a systematic monitoring of banks' activities in prevention of money laundering and terrorism financing and improve cooperation with other supervisory and examination institutions,
   - maintain continuity in payment system examinations,
   - continue working on further development of regulation for the financial sector, which refers to the action, the status and operations of banks, microcredit organizations, leasing companies,
   - continue working on further development of regulation based on the Basle Principles, the Basle Capital Accord, and relevant EU directives, as part of BiH's preparation to join the European Union,
   - establish and expand cooperation with home country supervisors of the investors present in the banking sector of the FBiH, and other countries in order to have more effective supervision,
   - continue improving cooperation with the Banks Association in all banking performance segments organization of counseling and professional assistance in the area of implementation of banking laws and regulations, advancement of cooperation in regard to professional development, proposed changes of all legislative regulations.
   - Continuously improve operational information system that will enable early warning and preventive action to eliminate weaknesses in the banking business,
   - Further strengthening capital and solvency levels in proportional with growth of assets and risk, higher profitability, consistent implementation of adopted policies and procedures to prevent money laundering and financing of terrorism, and the safety and security of the financial sector, in accordance with the law and regulations;
4. Work on continuous education and training of staff.

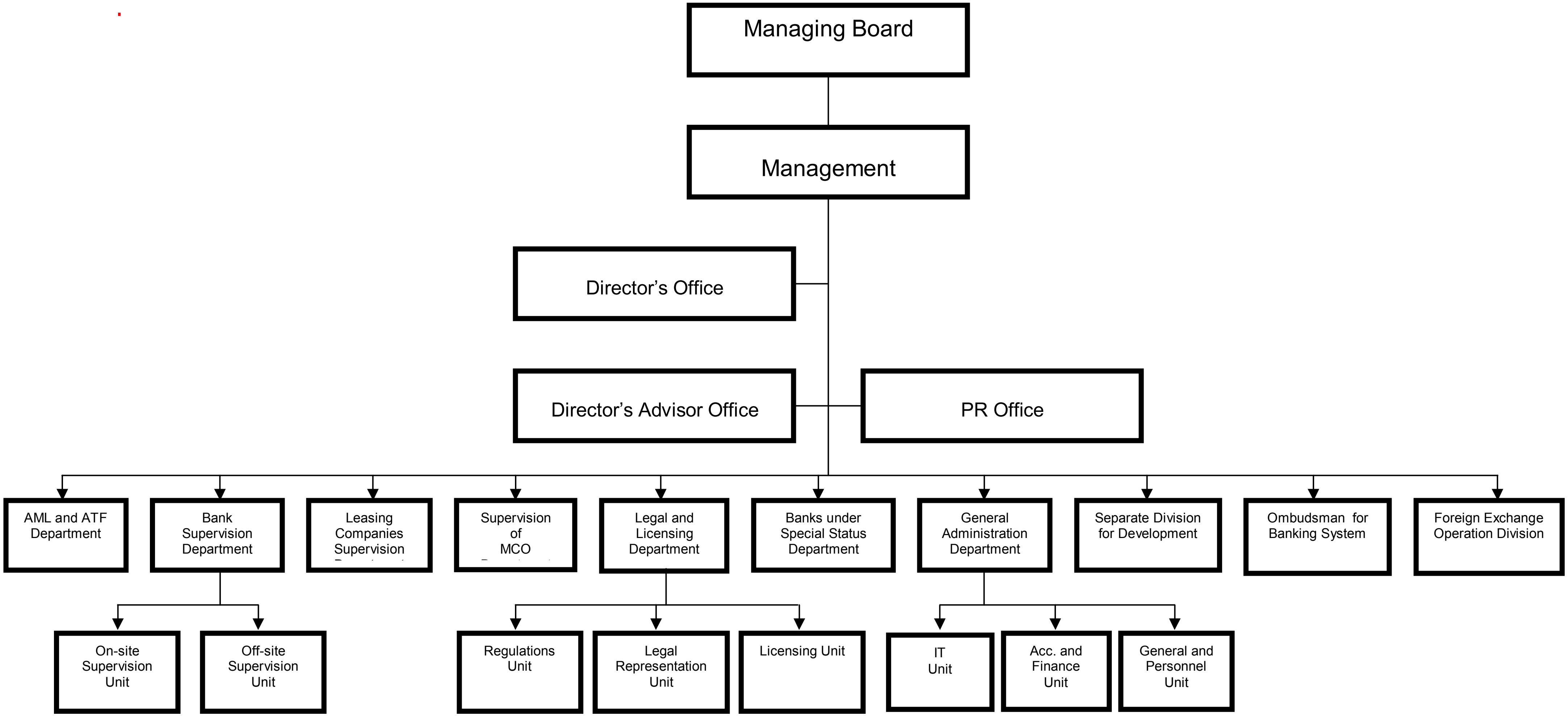
THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2012

The activities of FBA, in 2012, among other things, implemented the following activities:

1. continuous monitoring through a continuous process of on-site and off-site examination, monitoring of financial condition of banks in order to synchronize and coordinate activities to preserve the stability of banking sector;
2. taking measures anticipated by laws and other regulations within the scope of its authority;
3. further implementing of the Strategy to Introduce Basel II - "International Convergence of Capital Measurement and Capital Standards", and adopting revision of the same Strategy, with emphasizing on FBA capacity building and improving business modalities;
4. development and advancement of the regulatory framework in accordance with the law, development trends of generally acceptable international principles and standards, as well as recommendations made by the international bank supervision institutions, amending the law and by laws of FBA, (find in question number 3), relating on the supervision of the banks, microcredit and leasing companies, and examination of prevention of money laundering and terrorism financing;
5. strengthening of banks capital, enhancement of their lending policies and their consistent implementation in practice, raising prudency to the highest possible level;
6. the focus of supervision was on dominant risk segments such as credit risk, process control of the regulatory framework of international accounting standards 39;
7. further cooperation with domestic and foreign global and other institutions, as the International Monetary Fund (IMF),European Central Bank (ECB), the World Bank, Group of Banking Supervisors of Central and Eastern Europe (BSCEE) and others, as well as with supervisory authorities from home countries of parent banks that in the FBiH have their banks-subsidiaries;
8. in cooperation with the IMF and the BiH Central Bank, the Entities' banking agencies continued the project of stress tests implementation in 2012 to assess the level of resilience of the banking sector to stress. In late 2012, the representatives of the BiH Central Bank and the Entities' banking agencies formed a working group to draft a proposal of the Guidelines for Bank Stress Tests based on the recommendation of the IMF technical assistance mission (from May 2012).
9. Recently, in accordance with the IMF guidelines, the International Financial Stability Board and the Bank for International Settlements – BIS, the proposed list of systemically important banks in BiH has been established, subject to consideration by the Coordination of Banking Supervision and the Standing Committee for Financial Stability. The proposal is based on the guidelines and recommendations of international institutions in terms of the criteria used in determining systemically important banks, as well as applicability thereof to the banking system in BiH. The need for development of the list of systemically important banks emerged from

recommendations and conclusions from the IMF technical assistance mission held in May 2012 in Chapter Mid-term preparations for crisis prevention - Strengthening banking supervision.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

In the framework of bilateral cooperation, the Agency has cooperated, through the regular exchange of information and supervision of banks - members of foreign banking groups that have their subsidiaries in both BiH Entities, with the banking regulators of the following countries: Slovenia (participation in the Supervisory Colleges), Turkey (through regular exchange of information with the banking regulator in Turkey), Austria (regular exchange of information on a quarterly basis, information on banking groups and their subsidiaries in the FBiH, as well as the annual reports of the supervisory controls and evaluation process).

In the framework of the activities related to the signing of a Memorandum of Understanding with the Austrian banking regulator – Financial Market Authority (FMA), the FBiH Banking Agency has immediately informed the FMA about the amendments to the Law on the FBiH Banking Agency in terms of exchange of information and confidentiality once they had entered into force. These are being evaluated.

COOPERATION WITH OTHER SUPERVISORY BODIES IN BOSNIA AND HERZEGOVINA

The FBA has established cooperation with many supervisory bodies and other institutions in our country (e.g. Memorandum of Understanding with: Central Bank of Bosnia and Herzegovina, Deposit Insurance Agency of B&H, Insurance Companies Supervision Agency, Intelligence-Security Agency of B&H and other domestic institutions).

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

Bosnia and Herzegovina is the host of the XXVI conference BSCEE groups which will take place in June this year. Activities, by both entities agencies, are focused on the preparation, organization and maintenance of the BSCEE conference. This event is of great importance for the FBA, where they will be present banking supervisors from 24 countries, current issues in the banking systems of member states BSCEE and recent trends in the world.

STATISTICAL TABLES

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution	2010	2011	2012
Commercial banks	19	19	18
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**19**	**19**	**18**

Ownership structure of the financial institutions on the basis of registered capital (%) (at year-ends)

Type of financial institution	2010	2011	2012
Public sector ownership	1,1	1,3	1,4
Other domestic ownership	7,0	7,7	7,6
Domestic ownership total	8,1	9,0	9,0
Foreign ownership	91,9	91,0	91,0
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions in 2012 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI*
Commercial banks	59,3	74,2	1.524
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	59,3	74,2	1.524

*Whole percentages are used.

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2010	2011	2012
Commercial banks	-6,0	4,8	6,2
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	-6,0	4,8	6,2

Distribution of market shares in balance sheet total (%)

Type of financial institution	2010	2011	2012
Commercial banks	100,0	100,0	100,0
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Other	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

Capital adequacy ratio of banks

Type of financial institution	2010	2011	2012
Commercial banks	16,2*	17,0*	17,4*
Cooperative banks	-	-	-
Banking sector, total:	16,2*	17,0*	17,4*

(Please, mark for each item: * - for Basel I; ** - for Basel II)

Asset portfolio quality of the banking sector (share of impaired receivables / share of non-performing loans)

Asset classification	2010**	2011	2012
Non financial sector*	9,3	12,0	13,3
- households	6,1	10,8	10,5
- corporate	12,3	13,2	15,9

*Share of NPL (past due 90 days) to total gross loans. Financial and government sectors not included.
**Fully irrecoverable (risk category E) loans not included in 2010.

The structure of deposits and loans of the banking sector in 2011 (%) (at year-end)

	Deposits	Loans
Households	59,5	47,6
Government sector	6,8	1,2
Corporate	26,0	50,6
Other (excluding banks)	7,7	0,6
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends)

P&L account	2010	2011	2012
Interest income	856.528	866.684	809.424
Interest expenses	325.773	294.557	269.642
Net interest income	530.755	572.127	539.782
Net fee and commission income	n/a	n/a	n/a
Other (not specified above) operating income (net)	n/a	n/a	n/a
Gross income*	859.328	887.169	849.039
Administration costs	242.690	250.783	243.133
Depreciation	n/a	n/a	n/a
Provisions**	386.102	190.499	144.750
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	n/a	n/a	n/a
Profit (loss) before tax	-94.219	96.605	127.601
Net profit (loss)	-102.976	81.242	110.767

*Net interest income and gross operational income.
** In 2010 provisions according to the Decision on Minimum Standards for Credit Risk and Assets Classification Management. In 2011 and 2012 impairment according to IAS39.

Total own funds in 2012 (in EUR)

Type of financial institution	Total own funds (for CAR)	Tier 1	Tier 2	Tier 3
Commercial banks	1.069.768	881.391	238.820	-
Cooperative banks	-	-	-	-
Banking sector, total:	1.069.768	881.391	238.820	-

2012 DEVELOPMENTS IN THE BANKING SYSTEM OF REPUBLIKA SRPSKA OF BOSNIA AND HERZEGOVINA

MACROECONOMIC ENVIRONMENT

After the recovery of certain areas in the world economy from the global economic crisis in 2010, in 2011 year there was a new slowdown in global economic movements, while the negative trends due to new wave of the crisis, re-appear in the 2012. World economic trends had the impact on economic developments in Republika Srpska as well. In first nine months of 2012, the reduced economic activity was recorded in Republika Srpska in comparison with the same period 2011. In 2011, the quarterly GDP growth rates were recorded (1.4%, 1.1%, 0.8% and 0.0%), which indicate the slowdown of GDP growth at the end of year. The negative GDP growth rates were realized in first two quartiles of 2012 (-0.9% and -0.3%).

Lower external demand, on the one hand, and poor conditions for production of electricity energy, on the other hand, led to a slowdown in industrial production in Republika Srpska in first nine months of 2012 (- 4,6% in comparison with the same period 2011).

The decline in export activities was recorded in first nine months of 2012 as well (-4,7%), while on the other side, import activities increased by 2%.

The one of the main challenges of Republika Srpska in high level of unemployment.

DEVELOPMENT IN THE BANKING SYSTEM

Under influence of the economic and financial crisis both development and growth of the banking sector have been slowed down. As a reaction to the crisis banks' managements have applied a more restrictive and prudent lending policy, while a special attention was directed to planning and maintaining liquidity position, as well as to capital strengthening and maintenance of capital ability to absorb increasing risks. Nevertheless, the banking sector has retained confidence of its clients – legal entities, and, above all, citizens.

In 2012, banks undertook considerable activities in implementing provisions of the Law on Banks of Republika Srpska stipulating protection of rights of financial services users.

Basic indicators of the banking sector operation as of 31.12.2012:

- Total balance sheet amount was EUR 3.659 million with growth rate of 8% if compared to 31.12.2011.
- Total gross loans increased by 10%, and loans to citizens by 2% in comparison to the end of 2011.
- Share of NPLs i.e. non-performing loans (loans classified into higher risk categories) in the total loan portfolio increased by 2.66 percentage points in comparison with the year- end 2011. (11.46%, and as of 31.12.2012 it

was 14.12%). The NPLs level calls for an additional attention and prudence.

- Total reserves calculated for coverage of potential credit and other losses under regulatory requirement increased by 30% in comparison with the previous year, while rate of coverage of classified assets by reserves amounted to 10.8% and improved in comparison with the previous year (as of 2011 YE the rate of coverage amounted to 8.8%).
- An average rate of coverage of classified assets by the value corrected under IAS amounted to 7.5% (as of 31.12.2011 it amounted to 6.5%).
- Deposits were a basic source of funding of banks' operation, and their share was 70%. In 2011 a decreasing trend of deposits from previous years was discontinued and as of 31.12.2012 the level of deposits increased by 9% if compared to the end of the previous year.
- Trend of growth in citizens' deposits continued also in 2012 and as of 31.12.2012 increased by 14%. Share of citizens' deposits in total deposits increased from 42% to 44%.
- Banks' total capital increased by 2% if compared to the condition as of 31.12.2011.
- Core capital (increased by 2% in comparison with the previous year and the law defined it as a parameter to measure a maximum exposure of banks to loan and other risks concentrations.
- Average rate of capital adequacy was 16.1%, which was by two percentage points lower than as of the end of the previous year (the minimum stipulated by the law is 12%).
- Banking sector of Republika Srpska was liquid and able to meet all its obligations in due terms, although a smaller bank facing difficulties in maintaining current liquidity position failed to meet average decade limit of cash funds at the CBBH reserve account in one decade, while in other decades it used short-term borrowings from other banks in order to meet the requirement. All other banks met prescribed requirements for liquidity maintenance.
- As of 31.12.2012 net profit at the level of the total banking sector was generated in an amount of EUR 7.9 million.

The Banking Agency of Republika Srpska (hereinafter: the BARS) continued requesting from banks not to allocate profit to dividend payment, but to use it to strengthen their own capital bases.

Banks constantly worked on having their operations comply with requirements stipulated by the Law on Prevention of Money Laundering and Financing Terrorism, thus it can be said that they managed to systemize that segment of operation and improved their cooperation with other regulatory and supervisory authorities.

All banks were in possession of certificates on their membership in the Deposit Insurance Program.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN RS AND BH

In order to improve debt collection practices, the Law on Domestic Payment Operations was amended in 2012 („The Official Gazette of Republika Srpska", no. 52/12).

At the moment, the amendments to following laws are under the Parlamentary procedure:

- the Law on Banking Agency were amended in order to meet EU minimum standards on confidentiality and professional secrecy,
- the Law on Banks were amended in accordance with IMF recommendations on improvement of temporary administration.

The BARS amended following regulations:

- Decision on effective interest rate and Decision on loan prepayment (harmonization with Consumer Credit Directive),
- Decision on Restrictions on dividend and bonuses pay out.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2012

The BARS main strategic objective is to maintain sound and stable banking system of Republika Srpska, as well as to improve its safe, quality and legal operation. In that sense the BARS will continue to:

- enhance supervision of banks' credit risk, primarily in the sense of adequacy of reserves for potential loan loss,
- insist on capital strengthening of banks,
- strengthened (daily) off-site supervision over banks' current liquidity,
- undertake activities directed to further strengthening of transparency of banks operation and maintenance of confidence into banking system,
- play an active role in protecting rights of beneficiaries of financial services,
- continue adequate monitoring of payment transactions and banks' activities in preventing money laundering and terrorism financing, and improve cooperation in that sense with other competent authorities,
- undertake activities and passing measures within the scope of the BARS authority to alleviate negative effects of the global financial and economy crisis on banking system of Republika Srpska,
- further improvement and establish cooperation with bank supervisors, especially from those countries whose banks are shareholders in banks in Republika Srpska,
- take an active part in the work of Committee for Coordination of Financial Sector of Republika Srpska etc.

Also, the BARS is strategically committed to harmonization of the banking regulation with EU provisions (CRD I, II and III packages). In that sense the Banking Agency of Republika Srpska in cooperation with Banking Agency of

Federation of Bosnia and Herzegovina up to this date prepared the following draft regulation (with technical assistance of USAID PARE project):

- final drafts – published at the BARS web site for comments (decisions on Remuneration policy and practice, Assessment of the suitability of members of the management body and Diligence of members of the management body).
- work drafts (decisions on Credit risk under the standardized approach, Credit risk mitigation techniques, External credit risk assessment institutions Operational risk, Market risk and Own funds).

ACTIVITIES OF THE RS BANKING AGENCY IN 2012

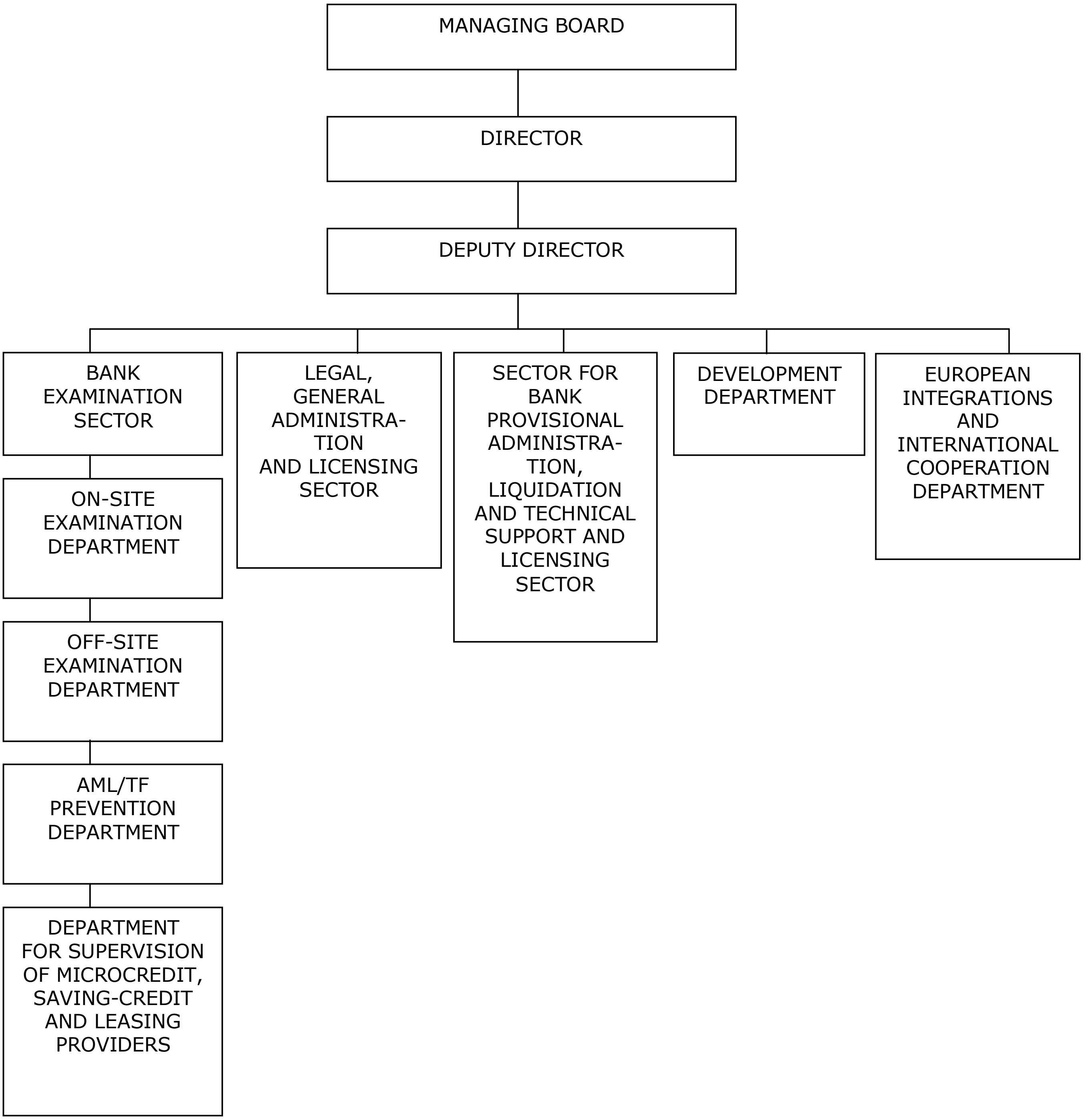
Applying complete legal regulation and regulation prescribed, the BARS through its Off-site Examination Department in continuity supervised and analyzed operation of banks based on daily, decade, monthly and quarterly reports. The Off-site Examination Department was engaged in preparation of data, analyses, information, recommendations, and indication of particular areas of each bank's operation where special supervisory attention should be paid in targeted or overall on-site examinations.

The On-site Examination Department, in accordance with the 2012 Supervisory Plan, performed overall and targeted on-site examinations of banks.

Both On-site and Off-site examination departments was included in post-examination bank supervision process by observing contents of examination reports and corrective measures undertaken, and monitored implementation of corrective orders.

The BARS performed 5 overall examinations, while subject of most targeted on-site examinations was implementation of the consumer protection legislative implemented in December 2011.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE BANKING AGENCY OF REPUBLIKA SRPSKA.

The BARS has established cooperation with bank supervision authorities from countries whose banks have equity share in banks of Republika Srpska and Bosnia and Herzegovina. Up to now the BARS has signed Memoranda on Understanding (MOUs) with bank supervisory authorities of: Macedonia, Romania, Bulgaria, Serbia, Monte Negro, Cyprus, Croatia, Slovenia, Albania, Greece and Turkey. Among other issues, such Memoranda prescribe exchange of information on change of ownership and managing structures, policies and procedures, capital, assets quality, levels of profitability, liquidity and corrective measures.

In 2012, the BARS exchange information through quarterly Supervisory Newsletters with FMA for Hypo Alpe Adria Bank and Banka Slovenija for NLB Bank.

Also, the BARS attended Supervisory Colleges organized by National Bank of Serbia (Komercijalna banka Beograd) and Banka Slovenija (NLB banka Ljubljana).

COOPERATION WITH OTHER SUPERVISORY BODIES IN BOSNIA AND HERZEGOVINA.

In the course of 2012, and within its tasks and in accordance with the Law on Committee for Coordination of Republika Srpska Financial Sector Supervision, the BARS continued its active cooperation with the Agency for Insurance Companies of Republika Srpska and Securities Commission of Republika Srpska.

Also, under the Memorandum of Understanding the Agency participated in work of permanent Financial Stability Committee established by Fiscal Council BiH, CBBH, Banking Agency of Republika Srpska, Banking Agency of Federation BH and Deposit Insurance Agency of Bosnia and Herzegovina. Besides its work in the Committee above, the BARS continued its intensive bilateral cooperation with Central Bank of Bosnia and Herzegovina, Banking Agency of Federation of BiH and Deposit Insurance Agency of Bosnia and Herzegovina.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS IN 2012.

For further information on the BARS supervisory activities and regulations, please visit the BARS website at http://www.abrs.ba/.

STATISTICAL TABLES

Number of financial institutions (at year-ends)

Type of financial institution	2010	2011	2012
Commercial banks	10	10	10
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**10**	**10**	**10**

Ownership structure of the financial institutions on the basis of assets total

Item	2010	2011	2012
Public sector ownership	-	-	-
Other domestic ownership	4.7	5.2	5.7
Domestic ownership total	4.7	5.2	5.7
Foreign ownership	95.3	94.8	94.3
Financial institutions, total	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	60.0	82.6	1 560
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Financial institutions, total	**60.0**	**82.6**	**1 560**

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2010	2011	2012
Commercial banks	- 4.6	8.2	2.0
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Financial institutions, total	**- 4.6**	**8.2**	**2.0**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2010	2011	2012
Commercial banks	100.0	100.0	100.0
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Other*	-	-	-
Financial institutions, total	**100.0**	**100.0**	**100.0**

Capital adequacy ratio of banks

Type of financial institution	2010	2011	2012
Commercial banks	16.7*	18.1*	16.1*
Cooperative banks	-	-	-
Financial institutions, average	**16.7***	**18.1***	**16.1***

(* - for Basel I;   ** - for Basel II)

Asset portfolio quality of the banking system
(share of impaired receivables)

Asset classification	2010	2011	2012
Non financial sector			
- households	53.4%	60.5%	70.5%
- corporate	45.8%	52.3%	51.1%

*Note: NPL coverage ratio

The structure of deposits and loans in 2012 (%) (at year-end)

	Deposits	Loans
Households	53.8	37.0
Government sector	22.1	17.1
Corporate	15.4	44.9
Other (excluding banks)	8.7	1.0
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends) in EUR

P&L account	2010	2011	2012
Interest income	158.711	166.190	177.705
Interest expenses	64.362	62.877	65.028
Net interest income	94.349	103.313	112.677
Net fee and commission income	-	-	-
Other (not specified above) operating income (net)	-	-	-
Gross income	233.905	229.053	241.436
Administration costs	98.721	104.078	108.143
Depreciation	-	-	-
Provisions	-	-	-
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	69.806	20.073	47.243
Profit (loss) before tax	(10.898)	34.131	12.161
Net profit (loss)	(10.898)	29.812	7.993

Total own funds in 2012 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	369.531	309.361	93.723	33.553
Cooperative banks	-	-	-	-
Financial institutions, average	369.531	309.361	93.723	33.553

2012 DEVELOPMENTS IN THE BULGARIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The economic activity in Bulgaria began to weaken under the influence of the unfavourable international situation and the entry of the euro zone into recession. The growth rate of real GDP slowed down from 1.8% in 2011 to 0.8% in 2012. A major contribution to the slower economic growth was the decreased external demand of Bulgarian goods and services by major trade partners from EU. The negative effect on the exports was limited since Bulgarian companies managed to reorganize part of the exports to fast growing countries outside the EU and that mitigated the effect of the recession of the euro area and in real terms the exports decreased only by 0.4% (having grown by 12.3% in 2011). Domestic demand had a major contribution to the growth of real GDP in 2012. The deterioration of the economy during the second half of the year led to a slight decrease of domestic demand during the last quarter of 2012. Imports of goods and services in the country continued to improve due to the increase of domestic demand and increase of inventories but the decrease of exports that contains significant import component contributed to the slowdown of the growth of imports in real terms to 3.7% (8.8% in 2011).

The recovery of household consumption that started in 2011 continued throughout 2012 which contributed by 1.6 percentage points to the growth of real GDP.

Significant contribution by 1.9 percentage points to the growth of GDP during the year had the recovery of the levels of inventories in the economy. Investment into fixed assets (gross fixed capital formation) showed signs of recovery during the year growing by 0.8% after three consecutive years of decrease.

The growth rate of gross value added in real terms slowed down to 0.3% in 2012 (2.1% in 2011). A positive contribution to the growth of gross value added had industry and the sectors trade, transport, hotels and restaurants. Slower economic activity was observed in construction and most sectors of services. A decrease in gross value added was registered in some subsectors that were comparatively less affected by the crisis – information services, financial and insurance activities, professional services and academic research, administrative and ancillary services.

In 2012 the labour market conditions continued to deteriorate. Employment further decreased by 4.3% (3.4% in 2011). A major contribution to the bigger drop in employment in 2012 had the services sector. Unemployment in 2012 slightly increased compared to 2011 reaching an average level for the year of 12.3%, according to NSI data, (11.3% for 2011).

In 2012 inflation remained comparatively low and at the end of the year consumer price index registered a 2.8% yearly growth rate (2% at the end of 2011) and the average annual inflation for 2012 was 2.4% (3.4% in 2011). [6]

In 2012 the total current and capital account balance of the balance of payments was in surplus by EUR 8.6 million (0.0% of GDP) compared to EUR 536

[6] Analysis based on HICP data.

million (1.4% of GDP) surplus in 2011. The contraction of the surplus was as a result of a deficit of the current account in the amount of EUR 528.2 million in 2012 compared to a registered in 2011 surplus of EUR 39.2 million. The current account deficit was as a result of the increase of the trade deficit that was EUR 3622.1 million for 2012, or by EUR 1466 million more compared to the previous year.

In 2012 the nominal growth rate of exports (2.6%) slowed down compared to the previous year (30.2% in 2011). The growth rate of imports (8.9%) outpaced that of exports.

Preliminary balance sheet data show a EUR 1478.3 million positive direct investment inflow into Bulgaria in 2012 (3.7% of GDP) compared to EUR 1314.6 million (3.4% of GDP) in 2011.

The surplus of the balance of payments financial account was EUR 2231.3 million in 2012 compared to a deficit of EUR 968.2 million in 2011. A main contribution to the surplus had the inflow of foreign direct investments and the emission in July of Bulgarian Eurobonds with nominal value of EUR 950 million on the international capital markets. Banks' transactions during the period also contributed to the surplus. In 2012 the banks increased their assets (by EUR 481.8 million, total portfolio and other investments) and also they increased their liabilities (by EUR 832.4 million, total portfolio and other investments) which were mainly due to one-off effect transactions during November. During the same month a significant inflow of resources was registered in other liabilities of banks and at the same time proportionate outflow of resources in portfolio assets – debt instruments. Excluding the value of these transactions in 2012 foreign assets and foreign liabilities of banks decreased. Their gross external debt grew by EUR 806 million during the year mainly as a result of these transactions and the share of banks in the total gross external debt increased from 15.6% in December 2011 to 17.2% in December 2012.

In 2012 gross external debt increased by EUR 1364 million and at the end of December 2012 was EUR 37.6 billion (94.8% of GDP).

As a result of all external current, capital and financial transactions, the BNB international reserves rose by EUR 2161 million for the period of January-December 2012 (valuation adjustments excluded). Given the change in the international foreign reserves on the BNB Issue Department balance sheet, including revaluation adjustments, they rose by EUR 2203.8 million.

DEVELOPMENT IN THE BANKING SYSTEM

In 2012 the development of banking intermediation in the country continued to be influenced by the weak economic and investment activity. The uncertain economic environment had a major impact on the high propensity of households to save and the weak demand of new loans. The sustainable growth of deposits of the population contributed to the improvement of the liquidity ratios of banks and also to the reduction of dependence of the subsidiaries on foreign parent companies. The higher growth rate of attracted funds compared to that of loans was a factor for the maintaining of high liquidity in the banking system. The "ageing" of the loan portfolio during the year was a further challenge for banks. The active management of credit risk contributed to the improved profitability of the banking sector and as a result the achieved profit exceeded that of last year.

Asset quality

The quality of banks' loan portfolio remained influenced by the adverse economic conditions. At the same time, the expansion of the set of instruments for management of credit risk led to a downward trend in the rate of impairment of assets. The annual growth of classified exposures was limited to 5.7% (from 13.7% at the end of 2011). The portion of classified corporate loans increased by 5.3%, and that of household exposures – by 6.6%. A positive development was observed in non-performing loans past due more than 90 days and their annual growth was 14.6% (compared to 30.2% a year earlier). A contribution to that had the actions taken by banks, including the write-off and sale of portfolios and the acquisition of collaterals. At the end of December 2012 the total amount of non-performing loans past due more than 90 days to gross loan portfolio of the banking system (excluding loans to credit institutions) reached 16.6%[7] and their net value – 10.6%[8]. With the growth of impairment costs and specific provisions for credit risk the total amount of provisions of the banking system increased.

Profitability

At December 31, 2012 the banking system reported an audited profit of EUR 268 million which was by EUR 26 million (10.8%) higher than the one registered during the previous year. Due to the higher profit the ROA slightly increased from 0.63% to 0.66% at the end of 2012. The growth of the indicator ROE was more pronounced (from 4.93% to 5.29%). The major factors that had a negative impact on the profit of banks during the period were the decreasing interest income and the growing interest expenses that led to a consecutive contraction of net interest income. An adverse effect on the profitability of the banking system had the reported lower net fee and commission income and the increased administration costs. Whereas the descending growth rate of impairment costs and the higher net income from financial instruments and operating income contributed to the better financial result of the banking system compared to the previous year.

Solvency

Total capital adequacy of the banking system of 16.64% at the end of 2012 (17.55% at the end of 2011) remained among the highest levels for the countries from the EU. The amount of the available capital surplus (the excess of capital over the regulatory minimum) was EUR 1.3 billion at the end of 2012 and that provided an additional resource for the coverage of classified exposures. Also the audited financial result for 2012 is an opportunity for additional capital support. During the year the amount and quality of the capital position of the banking system was influenced by the effect of several factors. Favourable effects on the amount of own funds had the increased issued capital and reserves. At the same time a reduction was achieved by the increased specific

[7] Mechanical comparison should be avoided in international analysis of the ''relative weight of loans past due over 90 days indicator in the banking system gross loan portfolio''. It should be considered in the context of the structure of balance sheets of individual banking systems. For example, there are no sizeable portfolios of instruments for trade which are sensitive to market impairment (including also those triggered by debt crisis) in the structure of the Bulgarian banking system balance sheet. In contrast to some European banking groups and systems banks in Bulgaria did not suffer losses from these portfolios. Concurrently, EU leading banks maintaining a low share of non-performing loans incurred losses from debt securities which then required their recapitalisation.

[8] The amount of net non-performing loans is calculated by subtracting impairment costs from the gross value of loans.

provisions for credit risk and the lower amount of subordinate debt compared to the end of 2011. Tier one ratio decreased from 15.73% at the end of 2011 to 15.13% for end 2012 due to the higher growth rate of capital requirements compared to that of Tier one capital.

Liquidity

The liquidity position of the individual banks during the whole 2012 was at levels that provided adequate coverage of the attracted funds and proper functioning of financial intermediation. The resources of financing remained stable and there was not a change in the tendency the growth of attracted funds to be defined by the maintained propensity of households to save. During 2012 the liquid assets ratio was within the range of 25-26% reaching at the end of the year its highest value for the last five years – 25.96%. The growth rate of liquid assets (by EUR 0.8 billion or 9.4%) was similar to that in 2011 and at the end of December 2012 they reached EUR 9.4 billion.

Market structure

In 2012 the number of credit institutions was 31. During the year, banking system's assets increased by EUR 2.9 billion (7.4%) and the ratio of their total amount to GDP was 106.2%. The assets of the five largest banks comprised 49.5% of the total banking system's balance sheet amount.

Foreign presence

During the year a significant contribution to the assets growth of the banking system had domestic banks which increased their market share to 26.4%. The market position of EU subsidiaries continued to decrease to 65.3% while the share of EU bank branches increased to 6.1%. The market positions of banks and bank branches outside the EU decreased in about a percentage point to 2.2%.

Products and distribution channels

For end 2012 there are 52 points of sale (branches, offices, representative offices and remote workstations), 80 ATMs and 948 POS terminals per 100 000 population.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN BULGARIA

The Bulgarian National Bank (BNB) is the competent authority in charge of banking supervision, and its main objectives are maintaining the stability of the banking system in Bulgaria and protecting the interests of depositors. In 2012, the focus of the supervision policy of BNB was aimed at improving the legal framework in congruence with the regulatory reform in the EU. The new EU architecture of financial oversight, and particularly that for credit institutions and investment companies, is pursuing harmonization of regulation and practices at national level and across member states, based on the direct application of provisions. Simultaneously, efforts were aimed at negotiating at different EU fora national positions on various regulatory topics, and enabling BNB to further conduct efficient and effective supervisory policies and modi to the domestic banking system and financial intermediation. This is most concerned about the capital requirements arising from the development and adoption of the new regulation on prudential requirements for credit institutions and investment firms based on Basel III. Rules on own funds, credit risk adjustments, key risk factors, liquidity ratios and large exposures, reporting, possible impact on banks, etc., were among the issues scrutinised.

In connection with the development and approval by the European Banking Authority (EBA) of common technical standards aimed at the convergence of national practices in the EU, BNB updated particular national requirements.

In order to encourage governing bodies of supervised institutions to enhance management of operational risks stemming from trading operations, specific principles and criteria were introduced, i.e. in the governance mechanisms, internal controls and internal reporting systems.

Subsequently, the BNB extended and improved previously adopted principles and requirements for maintaining sound and effective banking structures, i.e. for establishing appropriate composition of, and granting sufficient powers to management bodies and executive committees for independent risk management and internal control compatible with the market strategy and risk profile of the institution.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2012

During 2012 the main strategic objectives of banking supervision in Bulgaria continued to be further strengthening of the resilience of the banking system towards risks and vulnerabilities stemming from national and international environment. To achieve this purpose BNB continues to use its anti-cyclical policy in respect to sustaining strong solvency and liquidity buffers of the banking system through a set of macro-prudential and micro-prudential measures. Among these measures were:

- Amendment of regulatory framework to achieve harmonization with the EU regulatory reform and also to keep the ability of BNB to decide in order to maintain anti-cyclical policy;
- Maintaining the stability of the banking sector – assessment of risks; stress – tests; strengthening of banking system’s stability towards external risks and the elimination of speculations; supervisory actions to address identified risks;
- Development of effective systems of good corporate management;
- Addressing clients’ needs and concerns by maintaining a customer manual; determining risky bank practices; participation in the creation of a European register of bank products and services.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

The hesitant recovery of financial markets in the EU during 2012, as well as the sluggish economic growth internally and within the EEA, involving difficulties and problems that have piled up with a number of international systemically important institutions, were demanding the BNB to continue its policy towards banks operating on the local market to maintain a high level and quality of capital and liquidity positions. With a view to sustain not only a good solvency of the particular institutions, but also the stability of the banking system and the protection of depositors, beyond the amendments of the regulatory framework, resources of the banking supervision were placed in carrying out intensive on-going monitoring of the activity and financial state of credit institutions.

In pursuance of making clear and reliable supervisory assessments of banks' capital adequacy and corporate governance, during the past year, the focus of the on-site inspections was directed to the management of the running bank risks, i.e. credit, liquidity, operational and market risk and concentration risk, as well as assessment of the ability of institutions to generate profits, and to preserve their stability and integrity during the current time of weak demand and depressive economy. Twenty on-site examinations were carried out. The overall result showed that banks operating in Bulgaria keep up capital adequacy and liquidity above the regulatory minimum and according to risks inherent for the local market.

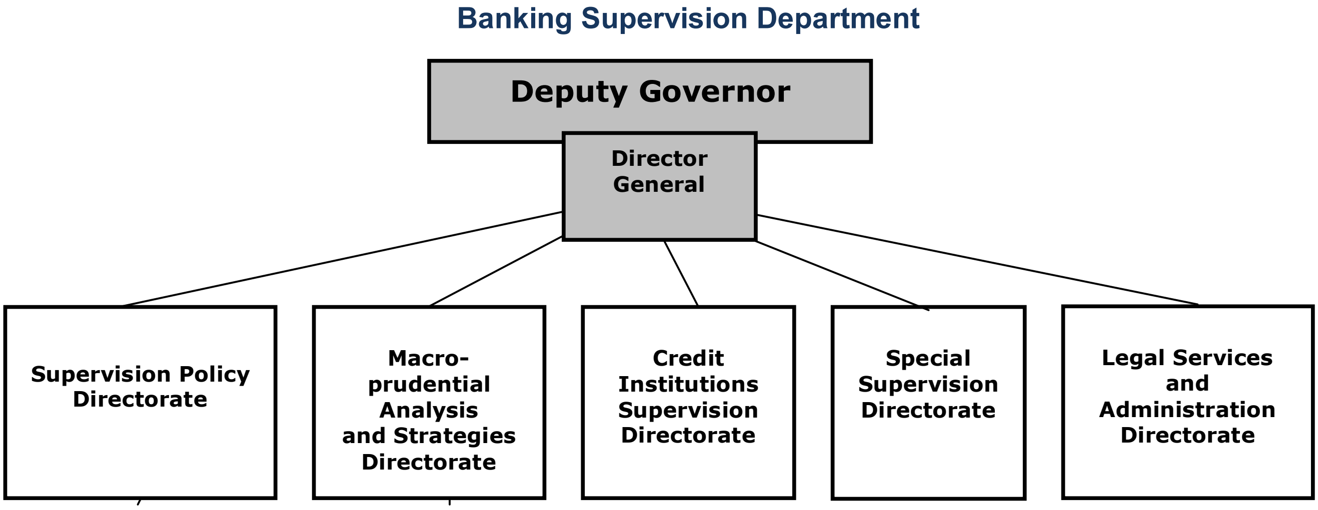
Except for micro-prudential approach, ensuring the stability of the banking system requires also monitoring of the processes at macro level. Continuous monitoring and analysis of the financial parameters of the banking system as a whole, and of individual banks were carried out during the year. Studies were focussed on the expected condition of banks at the end of 2012 and particularly in the management of credit risk. The analysis of the data on certain parameters (e.g. credit activity and funding) and risk sensitive areas (credit quality and capital support) contributed to achieve and keep a detailed view on the results in 2012, the expectations of the bank management, and the actions undertaken with respect to the risks and their effects.

The BNB continued with carrying out stress testing for checking the systemic or individual capacity to withstand possible shocks. The outcomes were used not only for macro-prudential assessment, but also as additional information source for planning the supervisory monitoring of credit institutions in consistence with the dynamics within the banking system, and the need for timely, accurate and objective analysis of the situation and the risk profile of each bank.

Beside the banking sector, BNB was carrying out also monitoring of non-banking financial institutions. In general, lending and financial leasing are most practiced by them. Bearing in mind the overall developments in the banking sector and in order to prevent possible complications, BNB imposed minimal thresholds for own funds for strengthening the financial state of lending firms, and to encourage them to do their business in a more prudent manner.

The BNB continued to play an important role also in enhancing the resilience of banks against recent practices of money laundering and criminal funding. In 2012, supervisors continued implementing the policy of improving control systems and practices for protection of the banking sector from penetration of money of criminal nature, and to ensure consistent application of the principles of good corporate governance in this regard, e.g. for building up sufficient resources, for strengthening prevention capacity, etc.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES

An important side of the activity of the BNB continues to be the participation in various banking supervisory fora within the European Union, as well as the cooperation with competent authorities of other member states.

In 2012, the BNB representatives were taking part in the work streams and meetings of the General Board of the European Systemic Risk Board (ESRB) and its substructures. In addition to the regular exchange of information, for the purposes of identification of systemic risks in the EU financial system, and indication of measures for dealing with them, the BNB attendees were actively participating in discussions, where topics of particular interest were scrutinised, e.g. development of a framework for implementation of macro-prudential policy and tools at EU and national level, the macro-prudential aspects of the proposal for the establishment of a single supervisory mechanism in the Euro zone, etc..

With regard to the new EU capital framework (CRD-IV/CRR) for credit institutions and investment companies, BNB experts were participating in various committees and working groups within the ECOFIN, EBA, etc., where a lot consultations were held. The main focus was placed in preparation of rules, and respectively in the elaboration of common technical standards for banking supervision. Within the EBA standing committees and working groups, experts from BNB were involved also in carrying out a number of queries and impact assessments in various areas, e.g. exchange of information between home and host authorities, notifications under the single passport regime, supervisory inspections, stress testing in banks, joint decisions in supervisory colleges, etc. Work with above structures is deemed very useful and contributory to sharing ideas and experience among supervisors from all member states.

Another very essential part of the international supervisory activity of BNB constitutes the cooperation with the competent authorities from other member states (AT, BE, FR, DE, GR, HU and IT), involved in the SREP of banking groups that have subsidiaries operating in Bulgaria. Representatives from BNB participate in the work of 13 supervisory colleges for cross-border banking groups through regular exchange of supervisory information and assessments on entities of the relevant groups, in accordance with Multilateral MoUs signed for this purpose. Once these information and assessments were discussed and duly reasoned, the respective joint decisions on the capital adequacy on consolidated level have been agreed.

Within the EU supervisory cooperation, BNB continued its participation within the European Council Committees ECOFIN and MONEYVAL in the process of collaboration of common regulatory frameworks and convergence of practices in other areas of supervision, e.g. for protection of the depositors, for recovery and resolution of problem banks, for prevention of money laundering, terrorism and other criminal financing respectively.

COOPERATION WITH OTHER SUPERVISORY BODIES IN BULGARIA

The BNB continued communication and cooperation with other relevant national authorities. It regularly provides the Advisory Council for Financial Stability (ACFS) with information and assessments on the condition of the national financial sector, as well as on topical issues of the current developments and risks in the banking sector of the EU, on the Single Supervisory Mechanism (SSM) that was announced recently, etc. Members of the ACFS are the Minister of Finance, the Governor of BNB and the Chair of the Financial Supervision Commission that meet regularly, and upon the Council's agenda inform one another on issues of mutual concern.

During the year, BNB and the Deposit Insurance Fund in Bulgaria (DIFB) were collaborating in terms of depositors' protection. Interaction between them, as usually was aimed also at regular information exchange on the deposit base, respectively the banks' fees, and other relevant topics.

BNB is also committed and continued cooperation with the relevant authorities in implementing the last national strategy for combating money laundering for the period 2011-2015. Relevant expertise and lessons learnt from the practice were exchanged with the State Agency of National Security and within the Multidisciplinary Task force for Prevention of ML and TF. Joint inspections and, where necessary, actions were taken against firms or persons providing financial transactions without any relevant registration or license, or if another offence of the law has been established.

STATISTICAL TABLES

Number of financial institutions (at year-ends)

Type of financial institution	2010	2011	2012
Commercial banks	24	24	24
Branches of foreign credit institutions	6	7	7
Cooperative banks			
Banking sector, total:	**30**	**31**	**31**

Note: "The Bulgarian banking system does not consist of cooperative banks, therefore we have not provided data for cooperative banks".

Ownership structure of banks on the basis of assets total

Type of financial institution	2010	2011	2012
Public sector ownership	1.86	2.44	2.04
Other domestic ownership	17.41	21.06	24.38
Domestic ownership total	***19.27***	***23.50***	***26.42***
Foreign ownership	80.73	76.50	73.58
Financial institutions, total	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	34.34	49.54	93.23*
Branches of foreign credit institutions	6.21	6.76	6.77*
Cooperative banks			
Banking sector, total:			**100**

*Note: the reported data is market share and not HHI.

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2010	2011	2012
Commercial banks	6.55	4.93	5.29
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**6.55**	**4.93**	**5.29**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2010	2011	2012
Commercial banks	95.17	95.46	93.23
Branches of foreign credit institutions	4.83	4.54	6.77
Cooperative banks			
Other			
Banking sector, total:	**100.0**	**100.0**	**100.0**

The structure of assets and liabilities of the banking system (%) (at year-end)

Assets	2010	2011	2012
Cash in hand, balances with central banks	9.94	9.92	11.47
Loans and advances to credit institutions	10.39	10.83	8.36
Loans and advances to customers	68.84	67.73	64.62
Financial assets at fair value through profit or loss, held-to-maturity investments, available-for sale assets and investments in associates, subsidiaries and joint ventures	8.06	8.60	10.11
Tangible assets and Intangible assets	2.12	2.06	2.37
Residual assets	0.65	0.84	3.07
Total assets	**100.00**	**100.00**	**100.00**
Liabilities	**2010**	**2011**	**2012**
Amounts owed to credit institutions	17.95	12.74	12.86
Amounts owed to customers	63.93	69.31	69.96
Debts evidenced by certificates	0.81	0.67	0.55
Residual liabilities	1.08	1.15	1.30
Provisions	0.10	0.11	0.10
Subordinated liabilities	2.53	2.54	2.12
Equity (including valuation adjustments)	12.77	12.86	12.47
Profit or loss for the financial year	0.81	0.62	0.64
Total liabilities and equity	**100.00**	**100.00**	**100.00**

Note: The common way to present information about the banking sector assets/liabilities is not the aggregated balance sheet. In Bulgaria banks use FinRep reporting framework since the beginning of 2007 and the data presented here are based on annual reports of credit institutions.

Note: The sum total may not add up to 100 per cent owing to rounding.

Capital adequacy ratio of banks

Type of financial institution	2010	2011	2012
Commercial banks	17.39**	17.55**	16.64**
Cooperative banks			
Banking sector, total:	**17.39****	**17.55****	**16.64****

(* - for Basel I; ** - for Basel II)

Asset portfolio quality of the banking sector (share of impaired receivables / share of non-performing loans)

Asset classification	2010	2011	2012
Net Non-performing loans past due over 90 days (excl. those to credit institutions) as a % of net loans (excl. those to credit institutions)	8.02	9.60	10.57

Note: Total loans of banks are Net loans (gross loans minus impairment expenses).

The structure of deposits and loans of the banking sector in 2012 (%) (at year-end)

	Deposits[6]	Loans[7]
Households[1]	49.53	25.72
Government sector[2]	2.82	0.38
Corporate[3]	20.48	48.24
Foreign[4]	19.38	10.64
Other[5]	7.80	15.01
Total	**100.0**	**100.0**

[1] Data refer to ESA'95 sectors S.14 Households and S.15 Non-profit institutions serving households.
[2] Data refer to ESA'95 sector S.13 General government (S.1311 Central government, S.1313 Local government and S.1314 Social security funds).
[3] Data refer to ESA'95 sector S.11 Non-financial corporations.
[4] Data refer to ESA'95 sector S.2 Rest of the world.
[5] Data refer to ESA'95 sector S.12 Financial corporations (monetary financial institutions, other financial intermediaries, financial auxiliaries, insurance corporations and pension funds).
[6] In accordance with the requirements of Regulation ECB/2008/32, in the liability side, instrument *deposits* also includes loans and repurchase agreements.
[7] In accordance with the requirements of Regulation ECB/2008/32, in the asset side, instrument *loans* includes also claims on deposits and repurchase agreements.
Source: Other monetary financial institutions.

Note: The sum total may not add up to 100 per cent owing to rounding.

Note: Due to the revision of data for 2011 we have also included a revised table for 2011 below:

The structure of deposits and loans in 2011 (%) (at year-end) Monetary statistics data

	Deposits[6]	Loans[7]
Households[1]	47.67	27.20
Government sector[2]	2.84	0.86
Corporate[3]	21.11	48.11
Foreign[4]	19.24	10.78
Other[5]	9.14	13.06
Total	**100.0**	**100.0**

[1] Data refer to ESA'95 sectors S.14 Households and S.15 Non-profit institutions serving households.
[2] Data refer to ESA'95 sector S.13 General government (S.1311 Central government, S.1313 Local government and S.1314 Social security funds).
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[7] In accordance with the requirements of Regulation ECB/2008/32, in the asset side, instrument *loans* includes also claims on deposits and repurchase agreements.
Source: Other monetary financial institutions.

Note: The sum total may not add up to 100 per cent owing to rounding.

P&L account of the banking sector (at year-end) (EUR'000)

P&L account	2010	2011	2012
Interest income	2,592,565	2,572,113	2,462,428
Interest expenses	1,101,200	1,104,396	1,120,371
Net interest income	1,491,365	1,467,718	1,342,057
Net fee and commission income	388,186	401,789	399,644
Other (not specified above) operating income (net)	19,768	24,283	38,309
Gross income	2,012,102	2,003,886	1,951,562
Administration costs	865,598	887,673	898,313
Depreciation	116,069	115,921	116,724
Provisions	5,913	10,003	1,696
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans)	680,999	711,964	633,729
Profit (loss) before tax	344,955	279,296	301,651
Net profit (loss)	306,573	242,277	268,496

Total own funds in 2012 (EUR'000)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	4,676,134	4,252,681	423,453	-
Cooperative banks				-
Banking sector, total:	4,676,134	4,252,681	423,453	-

2012 DEVELOPMENTS IN THE CROATIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Gross domestic product of the Republic of Croatia declined 2.0% in real terms in 2012. This was also the fourth successive year that Croatia's economic activity either fell or stagnated, remaining the weakest among those of the Central and Southeast European countries in the period after the beginning of the financial crisis. Croatia's extremely challenging economic recovery from the global crisis is a result of its weak competitiveness in the European and global markets and imbalances persisting from the previous period when growth was based on expansive consumption and investments in non-tradable sectors.

Having dropped in the first quarter of 2012, real activity recovered to some extent in the second and third quarters of the year, boosted to a strong performance by the tourism industry. However, with the deepening recession in the EU, economic activity contracted once again in the fourth quarter. Exports of goods and services were the only demand component to give a positive contribution to growth in 2012. All the other components made negative contributions to growth, with especially strong negative contributions coming from sharp declines in personal consumption and gross fixed capital formation. Gross value added data for 2012 also suggest that a decrease was recorded by almost all of the activities, similar as in the previous year, and that it was especially sharp in industry and construction. Only a few service activities, especially those related to the public sector, recorded an annual increase. Consumer price inflation accelerated in 2012, its average annual rate of change up to 3.4% from 2.3% in 2011.

Adverse labour market developments deteriorated further. The number of employed persons dropped by 1.2% and the number of unemployed persons surged as a result. The average ILO unemployment rate was 15.8% in 2012, an increase from 13.5% in the year before. Labour productivity for the total economy dropped because the GDP decrease was sharper than the decrease in employment. Under such conditions, real wages continued to decline.

The current account deficit had narrowed steadily since the beginning of the crisis, mainly on account of the weakening domestic consumption, and the balance became positive in 2012. Capital inflows, including foreign direct investments, were increasingly low. A temporary uptick in inflation in 2012 resulted from a rise in the basic VAT rate and administrative increase in prices. Regarding positive factors, domestic financial market conditions improved somewhat from 2011 on the back of decreases in European markets' interest rates and in the global risk premium. The risk perception for Croatia also improved under such conditions in line with those for other countries in the region, which enabled smooth government borrowing in the foreign market.

Liquidity in the domestic banking system was exceptionally strong and interbank and T-bill interest rates hit their historical lows. Real sector trends can be reversed only by the implementation of structural reforms aimed at increasing the competitiveness of the domestic economy and foreign direct investments, which are the preconditions for export growth. Monetary policy will support these trends by maintaining the stability and adequate liquidity of the financial system.

DEVELOPMENTS IN THE BANKING SYSTEM

At the end of 2012, there were 36 credit institutions operating in the Republic of Croatia: 30 banks, one savings bank and five housing savings banks. The number of credit institutions fell by one from the end of 2011 due to a merger of a small bank with the parent bank. Bank assets and housing savings bank assets accounted for 98.2% and 1.8% respectively in the total assets of credit institutions. There were 20 credit institutions in the majority ownership of foreign shareholders at the end of 2012, with their assets accounting for 90.1% of the total assets of all credit institutions. Three credit institutions were in majority state ownership and their assets accounted for 4.8% of the total assets of all credit institutions. The remaining 13 credit institutions, their assets totalling 5.1% of the total assets of all credit institutions, were in majority domestic private ownership. Credit institutions employed 22,048 persons at the end of 2012.

The long-standing challenges in the domestic economy and economic environment left a significant mark on banks' business operations and results in 2012. Total assets of banks were HRK 399.9bn (121.1% of GDP at the end of 2012), a decrease of 1.7% from 2011. Credit activity of banks also declined, for the most part due to corporate and household deleveraging, with the significance of less risky investments in the exposure structure increasing, similar as in the previous year. This refers especially to placements to the public sector and incentive-based placements.

Due to risk aversion and weak prospects for a marked economic recovery, banks started to deleverage against their foreign owners, a trend that continued at an increased pace late in the year. As a result of a rise in the domestic sources of financing, especially in the deposits of households and domestic financial institutions, liquidity reserves remained strong, with the result that the deleveraging process did not have a significant impact on credit supply. Portfolio ageing, coupled with increased problems with loan repayment performance, raised the level of partly recoverable and fully irrecoverable loans to 13.9%. The quality of corporate loans deteriorated especially sharply, primarily due to downturns in construction and real estate activities, as in the previous years.

As a result of these developments, bank profit decreased by one fourth and profitability indicators fell to the lowest levels since 1999. The return on average assets (ROAA) decreased to 0.8% and the return on average equity (ROAE) dropped to 4.8% due to a contraction in all margins, and especially in the net interest margin, and an increase in expenses on loss provisions. Pressures on the net interest margin stemmed both from the income and expense side. On the expense side, an increase could be observed in the price of all sectors' sources, with the exception of the household sector. On the income side, changes in the investment structure, persisting since the beginning of the crisis, coupled with an increase in the level of partly recoverable and irrecoverable loans, resulted in a decrease in interest income. Bank profit declined by over one fourth from 2011 and more than one third of all banks operated with losses.

Capital requirements were lower in line with the lower level of assumed risks. An already high capital adequacy ratio increased further to 20.89% as an indication of banks' strong capacity to withstand potential losses.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN CROATIA

The tasks of the central bank, regulated by the Act on the Croatian National Bank, include the issuance and withdrawal of authorisations and approvals for credit institutions and credit unions and the exercise of supervision and oversight over these institutions. The Credit Institutions Act and the Credit Unions Act are the basic acts governing the conditions for the establishment, operation and dissolution of credit institutions and credit unions, as well as the oversight of their operation.

The supervision of credit institutions consists of a series of coordinated activities aimed at verifying whether credit institutions (banks, savings banks and housing savings banks) operate in compliance with the risk management rules, provisions of the Credit Institutions Act and regulations adopted under that act, other relevant laws and regulations governing the carrying out of financial activities, their own rules, and professional standards and rules. In addition to the supervision, the CNB exercises the oversight of the implementation of the Act on the Croatian National Bank, regulations adopted under that act and other laws and regulations for which it is competent.

The CNB exercises the supervision of credit institutions by:

- collecting and analysing prescribed reports and other reports and information;
- an ongoing monitoring of the lawfulness of operation of credit institutions, by carrying out on-site examinations of credit institutions’ operations; and
- imposing supervisory measures in order to take actions at an early stage to improve the safety and stability of credit institutions’ operation and to eliminate any established illegalities.

The CNB exercises the supervision of credit unions in a similar manner.

Other supervisory authorities in the RC that operate in the area of the financial system supervision are the Ministry of Finance and the Croatian Financial Services Supervisory Agency (HANFA). Their competence includes the regulation and supervision of non-banking financial services

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2012

As in the previous years, the main objectives of the supervision exercised by the Croatian National Bank were to maintain confidence in the Croatian banking system and to promote and safeguard its safety and stability. In 2012, in an effort to improve the quality and efficiency of the supervision, the domestic regulatory framework was further harmonised with EU regulations, and other components of the domestic legislation regulating the operation of credit institutions continued to be improved. The supervision focused on governance and controls as well as on compliance with regulations, internal rules and supervisory requirements. Special emphasis was put on credit risk management and adequate value adjustments and provisions for partly recoverable and fully irrecoverable placements. In addition, activities were intensified in the area of consumer protection, in order to provide for an adequate availability and transparency of financial services.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY LAST YEAR

As regards bank regulation, 2012 saw intensive work on the proposal for amendments to the Credit Institutions Act and subordinate legislation, which will complete the transposition of the EU acquis in the area of banking into the legislation of the RC. In view of the incoming amendments to EU regulations, the CNB presented a draft of the new EU legislative package to credit institutions (CRD IV). The CNB also carried out a quantitative impact study on the effects of the implementation of the CRD IV proposal, releasing the results in September 2012.

The CNB in 2012 again conducted a supervisory assessment of credit institutions, which included an evaluation of credit institutions' risk profiles regarding all the risks to which they are or might be exposed in their operation, an adequacy assessment of the processes in place for assessing and maintaining credit institutions' internal capital, an ongoing cooperation based on the dialogue between the supervisor and credit institutions, as well as imposing and monitoring the implementation of the supervisory measures to eliminate illegalities and irregularities in the operation of credit institutions. In 2012 priority was given to on-site examinations of credit institutions, the scope of control mainly covering asset quality, with a special emphasis on credit risk management and adequate value adjustments and provisions for partly recoverable and fully irrecoverable placements. Special emphasis was put on the placement monitoring process, above all to early warning indicators for credit risk and their integration in the placement classification process. The evaluation of credit institutions' risk profiles was based on an internal Methodology for the risk assessment of credit institutions. This evaluation is one of the tools used by the CNB to determine the scope of activities, allocation of resources and the credit institutions the supervision of which is to be a priority in the next period.

Over the past few years, the CNB has been active in the adjustment of the prudential reporting system for the purposes of supervision, including financial reporting of credit institutions (FINREP – Consolidated Financial Reporting Framework) and reporting on the capital adequacy of credit institutions (COREP – Common Reporting Framework). The adjustment of the CNB's system of reporting on the operation of credit institutions with EU directives and guidelines continued, in a smaller scope, in 2012.

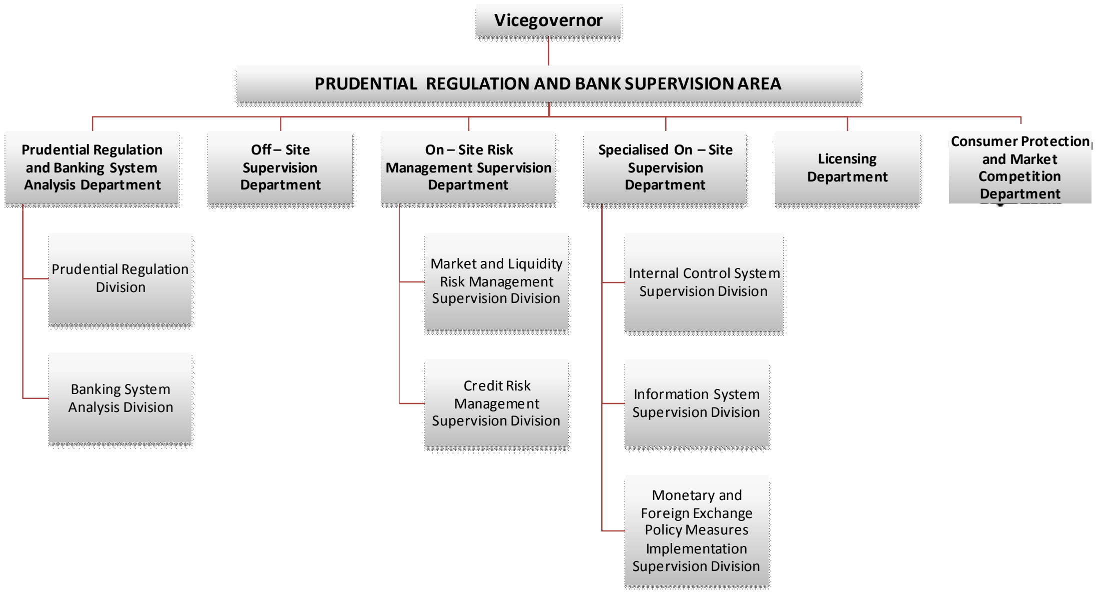
In the past few years the CNB has also significantly improved the legal framework and stepped up its activities aimed at enhancing the quality of protection of consumers – users of banking and financial services. These activities are aimed at maintaining and strengthening the confidence in the financial system. The Consumer Protection and Market Competition Department, established and staffed in 2011 as part of the Supervision Area, provided a further impetus to CNB's activities related to consumer protection policy in 2012. Strong emphasis continued to be placed on addressing complaints by consumers – users of banking and financial services and considerable efforts were put in activities related to regulations, with the aim of improving consumer information, facilitating the comparison of offers and services, increasing transparency and alleviating the position of guarantors. Consumers are additionally warned of specific risks, and safeguards against products/services that proved harmful for consumers have been introduced, which should improve their decision making.

In accordance with the Credit Unions Act, the CNB authorises credit unions and supervises the operation of credit unions by analysing prescribed supervisory and financial reports and by conducting on-site examinations. At the end of 2012, there were 26 credit unions operating in Croatia, and their assets amounted to HRK 602.2m.

ORGANISATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

Supervisory activities are organised within the Prudential Regulation and Bank Supervision Area, which at the end of 2012 employed a staff of 121.

Organisational chart of the Prudential Regulation and Bank Supervision Area



INTERNATIONAL ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

In line with the guidelines and instructions of the European Banking Authority on the strengthening of the role of colleges of supervisors at the European level, the CNB intensively cooperated with foreign supervisors, especially with regard to producing joint assessments of risk in the operation of banking groups and of the adequacy of capital allocation for individual groups' members. In 2012, based on the signed memoranda of understanding and for the purpose of improving the cooperation with foreign supervisors, CNB representatives participated in the colleges of supervisors relating to the supervision of banking groups that include domestic credit institutions as well as in meetings dealing with the issues of the implementation of internal models and joint supervision. The CNB prepared presentations for all the colleges on the risk profiles of credit institutions and on the impact of the financial crisis on their operation, on the measures taken to reduce risk exposure and/or improve risk management, and on certain aspects of future operations, especially with regard to the available capital adequacy. The CNB also participated in the joint supervision of operations with the home supervisor, and CNB employees participated in the colleges of supervisors, mainly addressing the IRB approach and the coordination of activities for the banks planning its application.

In 2012, the CNB delivered to home supervisors the main findings, conclusions and recommendations of on-site examinations of domestic credit institutions that are members of the banking groups. Within the framework of the cooperation with foreign supervisors, the CNB is responsible for the creation of the Supervisory Risk Report, i.e. an annual risk assessment of the domestic credit institution, which serves as an element for making a final Joint Risk Assessment Decision and for adopting a joint decision on the required amount of capital for a banking group.

COOPERATION WITH OTHER SUPERVISORY BODIES IN COUNTRY

In 2012, the CNB continued to cooperate with HANFA by participating in the work of the Joint Working Committee. At Committee meetings, the two institutions exchange information on topical issues in the banking sector and the sector supervised by HANFA, address open issues on the exchange of data and make arrangements for the coordination of supervisory activities. The ongoing cooperation via the Committee, chaired by a CNB representative since its establishment, has been going on for a number of years. The cooperation has been active on amendments to the Cooperation Agreement, due to the changes made to the legal framework governing HANFA's operation.

In addition, the CNB continued to cooperate with other government authorities (the Ministry of Finance, courts, State/County Attorney's offices, etc.).

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

Further information on the CNB's supervisory activities, legislation serving as a basis for the CNB's supervision and relevant regulations can be found on the CNB's website http://www.hnb.hr/.

STATISTICAL TABLES

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution*	2010	2011	2012
Banks	32	31	30
Savings banks	1	1	1
Housing savings banks	5	5	5
Banking sector, total:	**38**	**37**	**36**

*Data refer to credit institutions operating in Republic of Croatia (RoC): banks, savings banks and housing savings banks. There are no branches of foreign credit institutions operating in RoC.

Ownership structure of the financial institutions on the basis of registered capital (%) (at year-ends)

Type of financial institution	2010	2011	2012
Public sector ownership	4,3	4,5	4,8
Other domestic ownership	5,4	4,9	5,1
Domestic ownership total	9,7	9,4	9,9
Foreign ownership	90,3	90,6	90,1
Financial institutions, total	**100,0**	**100,0**	**100,0**

Concentration of asset by the type of financial institutions (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Banks*	58,0	75,6	1 410,4
Housing savings banks	76,0	100,0	2 372,9
Banking sector, total:	**56,9**	**74,2**	**1 376,2**

*From this table onwards, data for savings banks are included in line Banks.

Return on Equity (ROE) by type of financial institutions* (%)

Type of financial institution	2010	2011	2012
Banks	6,5	6,9	4,8
Housing savings banks	3,9	2,2	12,8
Banking sector, total:	**3,9**	**6,8**	**4,9**

*ROAE

Distribution of market shares in balance sheet total (%)

Type of financial institution	2010	2011	2012
Banks	98,3	98,1	98,2
Housing savings banks	1,7	1,9	1,8
Banking sector, total:	**100.0**	**100.0**	**100.0**

The structure of assets and liabilities of the banking system (%) (at year-end)

Assets	2010	2011	2012
Financial sector	15,6	16,8	17,6
Nonfinancial sector	59,9	59,6	56,8
Government sector	16,1	16,1	18,1
Other*	8,3	7,4	7,5
Liabilities	**2010**	**2011**	**2012**
Financial sector	10,4	9,6	10,4
Nonfinancial sector	52,8	52,3	54,6
Government sector	1,9	2,1	2,1
Capital	13,8	13,6	14,2
Other	21,2	22,4	18,6

Capital adequacy ratio of banks

Type of financial institution	2010**	2011**	2012**
Banks	18,8	19,6	20,9
Housing savings banks	20,3	19,9	21,3
Banking sector, total:	18,8	19,6	20,9

** Basel II

Asset portfolio quality of the banking sector (share of impaired receivables / share of non-performing loans)*

Asset classification	2010	2011	2012
Non financial sector	11,5	12,7	14,4
- households	7,8	8,6	9,5
- corporate	18,1	20,1	25,0

*share of partly recoverable (risk category B) and fully irrecoverable (risk category C) loans
Bank loans are classified into risk categories A, B and C pursuant to the Decision on the classification on placements and contingent liabilities of banks (OG 17/2003, 149/2005 and 74/2006) and from March 2010 onwards pursuant to the Decision on the classification on placements and off-balance sheet liabilities of credit institutions (OG 1/2009, 75/2009 and 2/2010).

The structure of deposits and loans of the banking sector in 2012 (%) (at year-end)

	Deposits	Loans
Households	66,0	46,1
Government sector	2,0	13,8
Corporate	16,3	39,4
Other (excluding banks)	15,7	0,8
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-end)*

P&L account	2010	2011	2012
Interest income	21 215	21 779	21 691
Interest expenses	10 251	10 184	11 114
Net interest income	10 964	11 595	10 576
Net fee and commission income	3 209	3 008	2 877
Other (not specified above) operating income (net)	1 479	1 472	1 392
Gross income	15 652	16 075	14 845
Administration costs	6 643	6 810	6 630
Depreciation	940	887	819
Provisions	-75	10	144
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	3 841	3 709	3 862
Profit (loss) before tax	4 303	4 660	3 391
Net profit (loss)	3 451	3 785	2 724

Total own funds in 2012 (in million EUR*)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Banks	7 395,0	6 943,6	451,5	0,0
Housing savings banks	83,7	72,2	11,5	0,0
Banking sector, total:	7 478,7	7 015,8	463,0	0,0

*HRK/EUR 7,54562

2012 DEVELOPMENTS IN THE CZECH BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2012, the Czech economy went through a recession which intensified slightly during the year. Real GDP contraction of 1.2% was recorded for the year as a whole. The unfavourable economic development was chiefly a result of falling domestic demand by households for goods and services and by investors for fixed capital. The decline in domestic demand was due, among other things, to lower household expenditure affected by falling average real wages and rising saving rate. Foreign trade was the only demand component having a positive effect on GDP growth. However, foreign trade was not able to offset the fall in domestic demand despite a rising surplus.

Inflation increased in 2012 compared to the previous year, reaching 3.3% on average. The pick-up in inflation was mainly due to a VAT increase from January 2012, rising administered and food prices and also higher global fuel prices. By contrast, core inflation was still negative, reflecting the anti-inflationary effect of the domestic economy.

The koruna exchange rate depreciated overall against the euro and the dollar in 2012 compared to 2011. The average CZK/EUR exchange rate depreciated from 24.6 in 2011 to 25.1 in 2012. The average CZK/USD rate weakened as well, from 17.7 in 2011 to 19.6 in 2012.

The current account deficit decreased to 2.4% of GDP during 2012, amounting to CZK 94.0 billion in absolute terms. The decline in the current account deficit reflected mainly trade balance developments. As in previous years, the financial account ended in surplus in 2012. The surplus reached CZK 121.8 billion, up by CZK 62.4 billion on a year earlier.

The average registered unemployment rate was broadly unchanged from 2011, reaching 8.6%. Growth in the average nominal wage in the national economy was modest in 2012, at 2.7%. In 2012, the average real wage dropped by 0.6% for the year as a whole amid a higher inflation rate. Aggregate labour productivity also saw a change in trend. It was down by 1.7% year on year in 2012 compared to the previous two years when it was growing.

The measures adopted to decrease the public budget deficit led to a decline in the structural deficit, but the general government deficit under ESA95 increased to CZK 167.9 billion (4.4% of GDP) due to one-off factors. Owing to this – and also to the creation of the debt reserve of 1.8% of GDP – the government debt-to-GDP ratio rose again in 2012, to 45.8% at the year-end.

The Czech National Bank responded to current and forecasted economic developments by lowering its key interest rates three times during 2012. The two-week repo rate fell from 0.75% to 0.05%, the discount rate from 0.25% to 0.05% and the Lombard rate from 1.75% to 0.25%.

DEVELOPMENT IN THE BANKING SYSTEM

The Czech banking sector was sound and well capitalised in 2012 and continued to generate profit. It has sufficient funds and no liquidity problems.

As of 31 December 2012, the Czech banking sector consisted of 43 banks and foreign bank branches. The structure of the banking sector has long been stable.

The shareholder structure of the Czech banking sector is stable. Foreign capital has long dominated banks' capital.

Banks in the Czech Republic perform the important function of banking intermediation. The banking sector continued to grow in 2012. Total assets increased by 3.5% to CZK 4,533.4 billion. `

Traditional banking based on collecting deposits and providing loans prevails in the banking sector. The total receivables of the banking sector grew slightly throughout the year. The sector's receivables make up a large part of its balance-sheet assets. Domestic banks' total loans to clients rose by 2.4% year on year, to more than CZK 2,360 billion at the end of 2012. The rise in lending was chiefly due to loans provided to households (individuals and trades) and non-financial corporations accounting for the largest share. Loans to individuals are the biggest component of client loans. Household debt continues in the Czech Republic, although at a slower rate. As of the end of 2012, bank loans to individuals amounted to more than CZK 1,045 billion. Household debt consists mostly of loans for house purchase, which account for more than 77% of all loans to individuals. Demand for loans for house purchase is concentrated in mortgage loans, which increased by another CZK 41 billion during 2012, to more than CZK 700 billion. Consumer credit, which also contributes to household debt, did not increase it in 2012. Their total value was flat, or fell by less than 1%. As of 31 December 2012, consumer credit provided to households totalled almost CZK 195 billion.

The Czech banking sector as a whole recorded very good financial results in 2012. It generated net profit exceeding CZK 64 billion, which represents an increase of more than 20% compared to the previous year. The main source of net profit was again profit from financial activities (of more than CZK 166 billion), in particular interest profit accounting for almost 65% of profit from financial activities. Profit from fees and commissions accounts for almost 65% of non-interest profit. In 2012, following the criticism pointed at banks, the banking sector's profit from fees and commissions decreased both in absolute terms (by almost CZK 2 billion) and in relative terms (by 4.4%). Total administrative expenses rose by 1% year on year, to more than CZK 66 billion. The banking sector paid aggregate income tax of CZK 12.4 billion, which corresponded to a higher generated profit, and was CZK 2.3 billion higher than in 2011.

Credit risk remains the most serious risk undertaken by the Czech banking sector. The quality of the loan portfolio was stable in 2012. Non-default loans made up a large majority of the investment portfolio (94.8% as in 2011). The total value of default receivables rose by CZK 3.4 billion to CZK 149.0 billion owing to a reduced ability of non-financial corporations and individuals to repay their obligations. The share of default receivables in total investment portfolio receivables is still relatively low, 5.2% at the end of 2012.

Domestic banks are mostly local in nature and their activities are mostly focused on domestic clients. The shares of transactions with non-residents and foreign currency activities are relatively small. The exposure of the banking sector to territorial and foreign exchange risk in 2012 was again assessed as limited. Operations in foreign markets are usually executed by other units from the financial group to which the domestic bank belongs. Transactions with non-residents are significant mainly in the interbank market, particularly as regards derivatives transactions.

The liquidity of the Czech banking sector remains very good, the sector has enough liquid funds as usual. The liquidity sub-indicators were stable during 2012. Quick assets increased by almost 12% year on year to more than CZK 1,346 billion. Sufficient primary funds are available to finance the loans of the banking sector.

The capitalisation of the Czech banking sector is very good. The capital ratio increased and stood at 16.42% at the end of 2012. Regulatory capital rose by 5.7% during the year to more than CZK 321 billion. The value of Tier 1 increased by more than 10% to almost CZK 312 billion, mainly thanks to retained earnings and higher reserve funds. The partial repayment of subordinated debt in several banks led to a decline in supplementary capital (Tier 2). Tier 1 traditionally has a dominant position in the banking sector's capital, accounting for more than 97% of total regulatory capital. The capital requirements of the banking sector started to decrease slightly in line with the evolution of the quality of the loan portfolio. They exceeded CZK 156 billion at the end of 2012, down by 1.6% year on year.

All banks were compliant with the set minimum capital ratio of 8% during 2012.

The depth of banking intermediation as measured by the ratio of total bank assets to GDP has been increasing in the Czech Republic since 2006. It stood at 120.5% at the end of 2012, 3.0 percentage points higher than in the same period of 2011.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN THE CZECH REPUBLIC

In accordance with Act No. 6/1993 Coll., on the Czech National Bank, the Czech National Bank is a supervisory authority of the financial market in the Czech Republic. The CNB therefore supervises the banking sector, the capital market, the insurance industry, pension funds, credit unions, bureaux-de-change and payment system institutions. The CNB lays down rules safeguarding the stability of the banking sector, the capital market, the insurance industry and the pension scheme industry. It systematically regulates, supervises and, where appropriate, issues penalties for non-compliance with these rules.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2012

The key strategic framework for the supervisory work of the Czech National Bank is the Core Principles for Effective Banking Supervision published by the Basel Committee for Banking Supervision in 2012.

The Czech National Bank develops a system of financial market supervision that has clear responsibilities and objectives. In its supervisory activities, it effectively applies its legal powers, all the while pursuing its main objective, namely to safeguard the stability of the financial system of the Czech Republic.

The Czech National Bank applies its legally defined independence in the area of supervision. This independence gives it full discretion to take actions against supervised institutions.

To ensure that supervision is transparent to the public, the Czech National Bank issues reports on supervisory activities and communicates major supervisory actions and selected findings and approaches in a prompt and flexible manner.

The Czech National Bank performs supervision that is based on a forward-looking assessment of the risk profile of supervised institutions, proportionate to their systemic importance. This system identifies material risks relating to their activities and quantifies their impact. It also captures systemic risks regarding the behaviour of financial market participants. The Czech National Banks determines the intensity of its supervision of individual areas of the financial market and specific institutions on the basis of the outputs of this system. When performing supervision, the Czech National Bank assesses compliance with legal requirements in the areas of prudence and professional care. These two areas are supervised in a mutually consistent manner, reflecting the links between them.

The Czech National Bank applies its supervisory powers by means of off-site and on-site supervision.

In its supervisory activities, the Czech National Bank uses a wide information base encompassing both publicly available and confidential information. The information obtained is subject to both regular and extraordinary (thematic) assessments based on analytical tools developed by the Czech National Bank. These tools include regular stress tests of individual banks and insurance companies and a system for monitoring financial market transactions.

The Czech National Bank has a system of regular reporting by supervised institutions and their consolidated groups. The reports defined by the Czech National Bank contain both financial and non-financial data. Supervised institutions are obliged to have internal mechanisms in place to ensure that the reported data are correct. Czech National Bank supervisors verify the reported data and request corrections where shortcomings are identified. The management of the supervised institution is responsible for the correctness of the information reported.

An essential element of supervision is that the Czech National Bank supervises groups of financial institutions on a consolidated basis. The aim of this activity is to identify links between the risks that can arise at group level and the stability of the supervised institution. When performing consolidated supervision, the Czech National Bank requires these risks to be managed effectively.

The Czech National Bank cooperates in the area of supervision with European institutions (the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority) on unifying supervisory procedures and creating conditions for close cooperation between home and host supervisors.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY LAST YEAR

Off-site surveillance performed by the CNB consists in continuously monitoring the activity and financial performance of the individual financial market entities and assessing the evolution of the market as a whole and its key segments. The CNB's supervisory work involves checking compliance with the relevant legal rules and compliance with prudential rules and regularly assessing the financial condition of individual regulated entities and professional care rules.

Banking supervision was performed under the standard regime in 2012. Owing to persisting problems in the global economy, attention was devoted primarily to the quality of credit portfolios, provisioning, sufficiency of capital to cover potential losses, and banks' liquidity and overall performance. The extraordinary reporting duty was extended for selected entities in 2012, the frequency of information about quick assets and intra-group exposures was increased from weekly to daily and the duty to report data on the structure of deposits and other financial liabilities on a weekly basis was newly introduced for these entities. Extraordinary monitoring of the situation of building societies continued owing to changes in the conditions for building savings schemes.

In 2012, **CNB supervision of the credit union sector** focused in particular on assessing the current situation and developments in individual credit unions and on resolving their regulatory problems, mainly with respect to specific risks undertaken by individual entities. Owing to numerous identified shortcomings, supervision focuses mainly on categorisation of the credit portfolio, sufficient provisioning, financing of economically connected groups, compliance with regulatory limits and the origin of capital of credit unions.

The CNB performs supplementary supervision of financial conglomerates under Act No. 377/2005 Coll. and Decree No. 347/2006 Coll. Supplementary supervision of financial conglomerates focuses on capital adequacy, intra-group transactions, risk concentrations, internal control systems and risk management systems. Entities active within financial conglomerates are subject to financial market supervision by various supervisory authorities, so a coordinator is appointed for the purposes of supplementary supervision based on criteria stipulated by law. The coordinator's role consists mainly in coordinating the collection and provision of significant information at financial conglomerate level, monitoring defined indicators and coordinating supervisory authorities' practices in the performance of supplementary supervision. In 2012, the CNB acted as a coordinator in one case. In the other cases, the role of coordinator was entrusted to foreign supervisory authorities, with which the CNB cooperates on an ongoing basis.

The Czech National Bank performs financial market supervision which is based on a forward-looking assessment of the risk profile and proportionate to the systemic importance of supervised institutions. The current situation in the financial sector is also taken into account.

On-site examination work is based on an annually approved plan of activity based primarily on outputs from the internal analytical system for risk assessment of supervised entities, information obtained during off-site surveillance and on-site examinations, and, last but not least, on the requirements of foreign regulators. In addition to examinations, supervisors are also responsible for approving advanced methods for calculating capital requirements. Owing to the links between financial markets, cooperation with foreign regulators is being stepped up systematically.

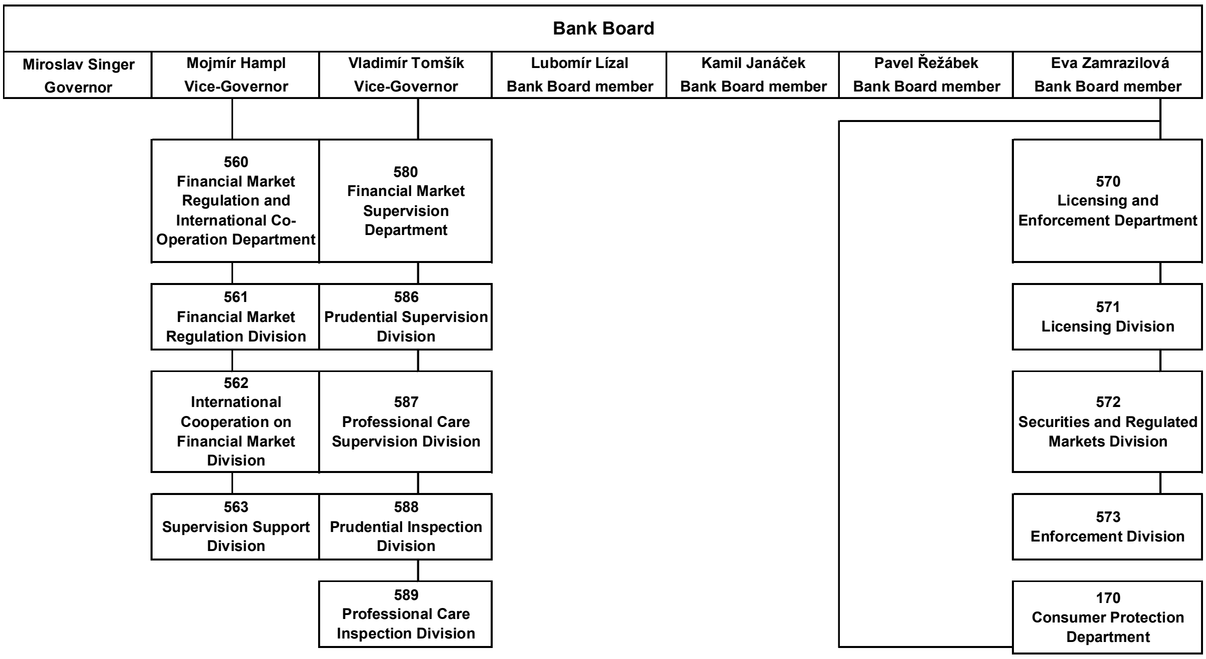
A total of 15 examinations were commenced or conducted **in banks** in 2012. Two of these were comprehensive checks and the remainder were partial examinations.

One comprehensive check and three partial examinations were conducted **in credit unions** in 2012.

ORGANIZATIONAL CHART OF BANKING AUTHORITY

The organisational chart of financial market supervision in the Czech National Bank

as of 31 December 2012



INTERNATIONAL ACTIVITIES OF THE CZECH NATIONAL BANK

The Czech National Bank is very active in the area of international cooperation.

CNB representatives were actively involved in EBA activities in 2012. The CNB was represented and actively involved at the level of the Board of Supervisors, standing committees and working groups. In the first half of 2012, the CNB also had its representative in the EBA's Management Board. A CNB representative acted as Chairman of the Standing Committee on Regulation and Policy.

CNB representatives were involved in ESMA's activities at the level of the Board of Supervisors, standing committees and groups and actively contributed to ESMA's outputs. The CNB participated in preparations of draft implementing measures to the draft MiFID 2/MiFIR, in areas covering, among other things, organisational requirements for trading venues, the pre- and post-trade transparency regime for transactions in investment instruments, disclosure of data.

In 2012, CNB representatives were actively involved in EIOPA's activities, both at the level of the Board of Supervisors and within standing committees and working groups.

The implementation of the Solvency regime remained the key task of the EIOPA in 2012.

The CNB was involved in the activities of working groups of the Joint Committee of the European Supervisory Authorities in 2012. The Committee is a forum for cooperation between the EBA, ESMA and EIOPA.

CNB representatives were actively involved in the activities of the European Systemic Risk Board, both at the level of the General Council and the Advisory Technical Committee (ATC) and its standing substructures – the Analysis Working Group (AWG) and the Instruments Working Group (IWG).

In 2012, the CNB was actively involved in the activities within the structures of the European Central Bank (ECB) in the Financial Stability Committee (FSC) and the Payment and Settlement Systems Committee (PSSC). CNB representatives are actively involved in the activities of the following groups in the FSC. The Crisis Management and Resolution Working Group submitted a case study to the FSC, dealing with adjustments in the financing of consequences of the financial crisis. In 2012, the activities of the Working Group on Credit Registers focused mainly on the launch of data sharing with the Czech Republic and Romania. In 2012, the activities of the PSSC in its extended composition, where the CNB is represented, consisted mainly in discussing SEPA (Single Euro Payment Area), general payment system issues, supervision of payment and settlement systems, and the development of the TARGET system.

The CNB was involved in the preparation for an ECOFIN Council meeting already within the preparations for the meeting of lower working bodies. These were draft changes and amended instructions for meetings of working groups (for indirect taxation, for EU's own resources, FTT) and also for a COREPER II meeting.

As regards cooperation of other international institutions and associations, the CNB participated in the meeting of the Committee on Financial Markets. The CNB was represented at the BCBS in the BCG (Basel Consultative Group), which maintains contacts with BCBS non-member countries. As part of cooperation with the IOPS, the CNB provided statements to draft instructions in the areas of governance of pension scheme supervisory authorities, the use of risk-oriented supervision, supervision of pension intermediaries, supervision of default funds, and contributed to the updating of the study of costs and charges of pension funds. In 2012, the CNB was actively involved in IOSCO's activities regarding the surveys focusing on the mapping of national regulatory and supervisory measures, the use of the IFRS at national level, the use of the Multilateral Memorandum of Understanding (MMoU) in practice, investor education in practice and also e.g. the new organisational structure of the IOSCO entailing a greater involvement of representatives of the emerging markets groups in IOSCO’s regulatory activities.

Within cooperation with partner supervisory authorities, the CNB signed an agreement reached within collages for supervision of bank groups of Raiffeisen Bausparkasse and LBBW in 2012. The CNB also became a signatory of the regional Memorandum of Understanding on Corss-Border Financial Stability covering the groups of Erste Group Bank, Raiffeisen Bank, Őesterreichische Volksbanken and Hypo-Alpe Adria-Bank.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE CZECH REPUBLIC

The CNB’s activities include cooperation with the Czech Ministry of Finance and other state administration bodies. The CNB works in close cooperation with the Czech Ministry of which has primary responsibility for preparing laws in the financial market area. It thus acts in accordance with the agreement on cooperation in the preparation of draft national legislation concerning the financial market and other regulations concluded between the CNB and the Ministry of Finance.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS IN THE COURSE OF LAST YEAR

In 2012, the CNB performed its regular half-yearly stress-testing of banks’ loan portfolios. The stress-testing methodology is being refined on the basis of the experience gained since 2009. Two rounds of stress tests assessed banks’ resilience to adverse economic developments using data as of 31 December 2011 and 30 June 2012. Nine selected banks which have received approval to use the special IRB approach for calculating the capital requirement for credit risk, or which are in the process of IRB pre-validation by the CNB, took part in the testing. The aggregated results of the two rounds of stress tests confirmed the good resilience of domestic banks. In addition to these bottom-up tests, the CNB conducts quarterly stress tests of the banking sector (top-down tests). The results are regularly published on the CNB website.

A Task force pilot project for credit registers took place in 2012, which focused on the assessment of the usability of data from credit registers and recommendations of areas in which harmonisation was necessary. As part of the project, a transmission of anonymised data from individual registers to the ECB was conducted as specified in five-year time series at quarterly or monthly frequency. The project was assessed positively and data from credit registers were assessed as being beneficial and important for users from the financial stability, economic research, monetary policy and statistics units.

In early October 2012, a meeting of a Working Group for Credit Registers (WGCR) at the ECB took place at the CNB, at which, in addition to the basic agenda of the working group, the real involvement of the Czech Republic and Romania in regular data sharing received a positive assessment.

STATISTICAL TABLES

Number of financial institutions (at year-ends)

Type of financial institution	2010	2011	2012
Commercial banks	22	23	23
Branches of foreign credit institutions	19	21	20
Credit unions	14	14	13
Banking sector, total:	**55**	**58**	**56**

Ownership structure of banks on the basis of assets total (%) (at year-ends)

Type of bank	2010	2011	2012
Public sector ownership	2.9	3.0	4.2
Other domestic ownership	0.6	0.9	0.4
Domestic ownership total	3.5	3.9	4.6
Foreign ownership	96.5	96.1	95.4
Banking sector, total*	**100.0**	**100.0**	**100.0**

* The ownership structure of banks, without credit unions.

Concentration of asset by the type of financial institutions (2012 year-end)

Type of financial institution	3 largest (%)	5 largest (%)	HHI*
Commercial banks	55.5	67.9	0.120
Branches of foreign credit institutions	61.5	72.6	0.157
Credit unions	66.9	88.7	0.181
Banking sector, total:	49.8	61.0	0.098

*Data as of the end of 2012.

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2010	2011	2012
Commercial banks	21.8	19.3	21.41
Branches of foreign credit institutions	n.a.	n.a.	n.a.
Credit unions	- 2.27	5.50	n.a. [i)]
Banking sector, total:	21.0	18.8	n.a. [ii)]

[i)] Indicators don't have information content due to the different accounting periods in the credit unions sub-sector.
[ii)] Within the CNB we have only banking sector data due to the different accounting periods in the credit unions sub-sector.

Distribution of market shares in balance sheet total (%)

Type of financial institution	2010	2011	2012
Commercial banks	88.3	88.0	89.8
Branches of foreign credit institutions	11.2	11.4	9.3
Credit unions	0.5	0.6	0.9
Other*			
Banking sector, total:	**100.0**	**100.0**	**100.0**

Note: Banking sector = commercial banks + bank foreign branches + credit unions.
**Not relevant for the Czech Republic.*

The structure of assets and liabilities of the banking system (%) (at year-end)

Assets	2010	2011	2012
Financial sector	11.3	10.4	10.0
Nonfinancial sector	48.9	48.8	48.3
Government sector	1.7	1.7	1.7
Other	38.1	39.1	40.0
Liabilities	**2010**	**2011**	**2012**
Financial sector	10.7	11.2	8.9
Nonfinancial sector	60.3	58.9	60.0
Government sector	7.0	7.0	8.3
Capital	8.2	8.1	9.2
Other	13.8	14.8	13.6

Note: Banking sector = commercial banks + bank foreign branches, excl. credit unions

Capital adequacy ratio of banks

Type of financial institution	2010	2011	2012
Commercial banks**	15.52	15.27	16.42
Credit unions**	12.21	12.07	13.27
Banking sector, total:	n.a.	n.a.	n.a.

(* - for Basel I; ** - for Basel II)
Note: Commercial banks do not include branches of foreign credit institutions.

Asset portfolio quality of the banking sector
(share of impaired receivables / share of non-performing loans)

Asset classification	2010	2011	2012
Non financial sector	7.0	6.6	6.2
- households	5.2	5.0	5.2
- corporate	9.0	8.2	7.4

Note: Banking sector = commercial banks + bank foreign branches; share of receivables in default (substandard, doubtful and loss) by sector.

The structure of deposits and loans of the banking sector in 2012 (%)
(at year-end)

	Deposits	Loans
Households	57.6	50.3
Government sector	12.4	2.9
Corporate	23.7	38.9
Other (excluding banks)	6.3	7.9
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends)
Income statement of the banking sector
Absolute indicators
(data as of the given date; in CZK millions)

P&L account	2010	2011	2012
1. Financial & operating income and expenses	157 376	162 090	166 456
1.1 Interest income	166 962	172 316	170 345
1.2 Interest expenses	61 655	62 391	62 453
1.3 Dividend income	5 859	7 578	6 607
1.4 Fee and commission income	48 369	50 011	49 168
1.5 Fee and commission expenses	9 876	10 950	11 883
1.6 Realised gains (losses) on financial assets and liabilities not measured at FV through profit or loss, net	-1 451	-1 112	-115
1.7 Gains (losses) on financial assets and liabilities held for trading, net	11 016	1 149	7 706
1.8 Gains (losses) on financial assets and liabilities designated at fair value through profit or loss, net	2 398	- 1 868	888
1.9 Gains (losses) from hedge accounting, net	-208	51	-416
1.10 Exchange differences, net	-3 097	8 388	5 125
1.11 Gains (losses) on derecognition of assets other than held for sale, net	18	233	1 433
1.12 Other operating income	3 339	3 044	4 460
1.13 Other operating expenses	4 324	4 359	4 408
2. Administration costs	62 381	66 047	66 575
2.1 Staff expenses	31 603	33 776	34 392
2.2 General and administrative expenses	30 777	32 271	32 184
3. Depreciation	6 926	6 826	6 752
4. Provisions	-258	706	743
5. Impairment	22 535	25 506	15 411
5.1 Impairment on financial assets not measured at fair value through profit or loss	22 317	25 250	13 673
5.2 Impairment on non-financial assets	218	255	1 738
6. Negative goodwill immediately recognised in profit or loss	0	0	0
7. Share of the profit or loss of associates and joint ventures	0	3	-3
8. Profit or loss from noncurrent assets and disposal groups	-157	405	-204
Total profit or loss before tax from continuing operations (1 - 8)	65 636	63 413	76 767
9. Tax expense	9 980	10 092	12 350
10. Profit (loss) after taxation, total	55 656	53 321	64 417
10.1 Profit (loss) from continuing operations after taxation	55 656	53 321	64 417
10.2 Profit (loss) from discontinued operations after taxation	0	0	0

Note: Commercial banks and foreign bank branches.

Total own funds in 2012 (in EUR)

Type of financial institution	Total Regulatory Capital	Tier 1	Tier 2	Tier 3
Commercial banks	12 765 890	12 391 954	654 186	0
Credit unions	172 447	159 285	13 162	0
Banking sector, total:	12 938 337	12 551 239	667 349	0

Note: Banking sector = commercial banks + credit unions.
Note: EUR = 25.14 CZK as at 31 December 2012.

2012 DEVELOPMENTS IN THE ESTONIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2012, economic growth perspectives for the European Union and the euro area deteriorated. Several European countries, including major trading partners of Estonia, lowered their economic growth forecasts at the end of 2012. Weakened economic environment had a negative effect also on the profitability of credit institutions and the quality of loan portfolios; the latter is one of the most important systemic risks for the EU financial stability. According to the data of Statistics Estonia, the GDP of Estonia increased 3.2% in 2012 compared to the previous year (8.3% in 2011). Economic growth in Estonia was primarily supported by domestic demand that increased by 8% in 2012. Positive trends on labour market triggered higher consumption. The growth in exports accelerated to 7% in the last quarter despite the deterioration of external growth perspectives. Imports were supported by increased investment activity and the growth in consumption expenditure, and the overall annual growth in imports exceeded the growth in exports. Growth rates in import and export of goods experienced a significant slowdown in 2012 compared to the previous year: the annual growth in exports was 4% and in imports 8%. Consequently, the foreign trade deficit was the highest of recent years. The deficit of current account balance accounted for 1.2% of GDP (surplus of 2.1% of GDP in 2011). In 2012, the consumer price index increased in comparison with the last year's average by 3.9% (5% in 2011), primarily driven by the increase in prices of electricity and heating. Employment increased and unemployment decreased in 2012, and the growth in average salary continued. The average unemployment rate was the lowest of the last 4 years – 10.2% (12.5% in 2011). In 2012, the average number of active persons was 624,000, i.e. 15,000 (2.5%) more than a year ago. Employment increased the most in transportation and storage, information and communication, education, administration and support activities.

DEVELOPMENT IN THE BANKING SYSTEM (INCLUDING THE ASSETS TOTAL / GDP)

As at 31 December 2012, there were 8 locally authorised credit institutions and 8 branches of foreign credit institutions operating in Estonia. The ratio of banking sector's total assets to GDP was 114%.

Estonian banking market was still very concentrated in 2012. The aggregate market share of 4 major banks – Swedbank AS, AS SEB Pank, Nordea Bank Finland Plc Estonian Branch and Danske Bank A/S Estonian Branch – by loan volumes totalled 90% (92% in 2011). Loan demand that recovered slightly in the second half of 2012 had no major influence on the shares of credit institutions on the lending market. Nordea Bank Finland Plc Estonian Branch and AS DNB Pank continued to increase their market share in loans. This occurred on the account of major credit institutions – Swedbank AS, AS SEB Pank and Danske Bank A/S Estonian Branch. Similarly to previous years, writing off a bulk of problematic loans in 2012 contributed to the decrease in the volume of loan portfolios. AS DNB Pank merged its banking and leasing portfolios after receiving the credit institution license and this action increased also its market share. Some of the smaller credit institutions – BIGBANK AS and AS LHV Pank – also increased their market shares. Loan portfolio of Pohjola Bank plc Estonian Branch was included to the aggregate statistics and this had a certain effect on the market distribution.

Total assets of banks increased by 5% in 2012 and totalled € 19.4 billion as at 31 December 2012. The growth in balance sheet volume was mostly driven by the increase in cash and receivables for the central bank. The combined loan portfolio of credit institutions amounted to € 14.2 billion at the end of 2012, accounting for 73% of total assets (77% in 2011).

The total volume of overdue loans decreased in the end of 2012 both in absolute figures and as a share of the combined loan portfolio. The quality of loan portfolio improved primarily due to the decrease in the volume of long-term loans overdue. This decrease was the most prominent in case of loans overdue for more than 90 days – in total 31%. At the end of 2012, loans overdue for more than 90 days formed 3.1% of the combined loan portfolio (4.6% in 2011). The volume of long-term loans overdue dropped due to write-offs in order to clean up loan portfolios and also due to the selection of better risk classes. Changes in the valuation reserves occurred generally in conformity with changes in quality parameters of loan portfolio. The drop in valuation reserves was also driven by the improved quality of loan portfolios due to better ratings and the value increase in collateral securities. The coverage with valuation reserves was good: 81% of loans overdue for more than 90 days were covered by valuation reserves at the end of 2012.

At the end of 2012, the total volume of resources of credit institutions totalled € 16.6 billion, increasing by 1% in a year. Resources increased mostly due to the growth of client deposit. The volume of client deposits grew by 9% and the share of deposits in total resources of credit institutions increased to 76% (71% in 2011). Due to the drop in the volume of composite loan portfolio and significant increase in the volume of deposits, the ratio of loans to deposits continued to improve in 2012: from 122% at the end of 2011 to 113% at the end of 2012. The volume of loans received from foreign credit institutions decreased as the volume of client deposits increased and loan demand stayed at a relatively moderate level. Consequently, the share of foreign borrowing decreased even further: from 29% in 2011 to 23% at the end of 2012.

2012 was a profitable year for credit institutions. Profits were earned on both solo and consolidated basis; however, on solo basis by 47% and on consolidated basis by 40% less than in the previous year. Credit institutions earned the profit of € 348.5 million on solo basis and € 318.2 million on consolidated basis (€ 656.9 million and € 533.9 million respectively in 2011. The drop occurred primarily due to decrease of extraordinary income.

Capitalisation of the banking sector was excellent on both solo and consolidated basis in 2012. As at 31 December 2012, the composite capital adequacy of credit institutions on solo basis was 19.3% (18.61% in 2011). Consolidated capital adequacy of banking groups was 23.51% at the end of 2012 (19.56% in 2011). It's mostly high-quality capital, capital structure of the banking sector is relatively simple and it was still based primarily on Tier 1 capital. Tier 1 capital remained thus on an adequate level both on solo and consolidated basis throughout the year: Tier 1 capital was on solo basis 18.92%

and on consolidated basis 23.22% at the end of 2012 (17.66% and 18.70% respectively at the end of 2011).

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN ESTONIA

Pursuant to the Financial Supervision Authority Act, one of the tasks of the FSA in developing the regulative environment is to make proposals for the establishment and amendment of Acts and other legislation concerning the financial sector and related supervision, and participate in the drafting of such Acts and legislation. According to the Financial Supervision Authority Act, the FSA must approve draft legislation regulating supervised entities or the activities of the FSA or having otherwise an effect on the achievement of objectives of financial supervision. In 2012, legislation related to the financial sector was developed in line with amendments made in EU law. The FSA contributed to this legislative process within the scope of its powers, depending on the importance of the regulated area and its potential impacts on development and seamless functioning of the financial sector, and presented its opinions and approvals to working groups that developed draft legislative acts or ministries that were responsible for developing draft legislative acts.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2012

The approval of the new strategy for financial supervision (2011-2015) by the Supervisory Board was an important milestone for the FSA. This new strategy outlines three main operational goals for the coming years: to increase the supervisory capacities of the FSA; to foster cooperation partnerships; and to increase the role of the FSA in providing advice and guidance to consumers of financial services.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2012

In 2012, the FSA issued a license of credit institution to AS DNB Liising (AS DNB Pank since 31 August 2012). Bank DNB A/S operated formerly on Estonian banking market as a branch.

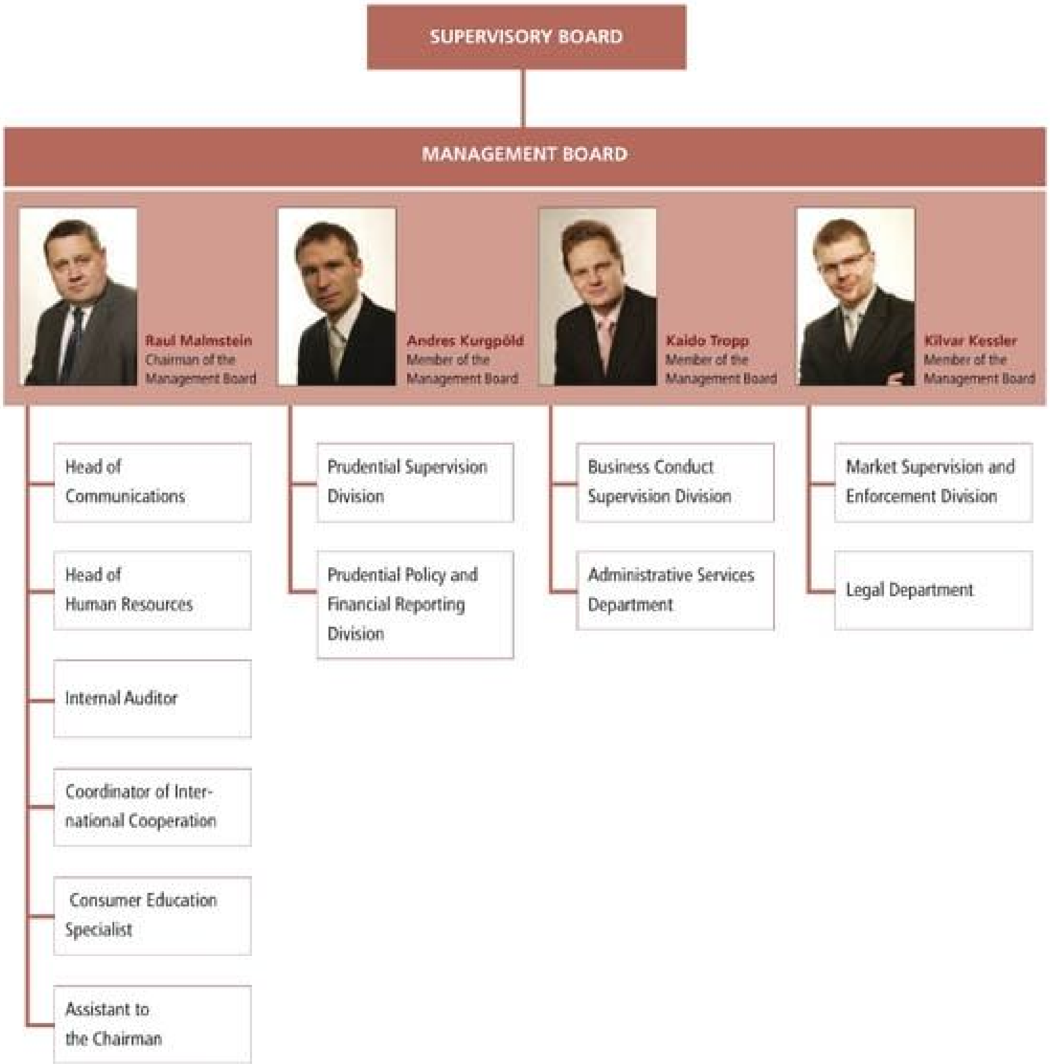
In 2012, the risk analysis of credit institutions performed by the FSA was based on traditional quarterly reports. Besides the analysis of developments in the economic environment and financial market as a whole, also major risk areas of credit institutions – credit risk, operational risk, liquidity risk, market risk, etc. – are evaluated during such an analysis. The analysis is based both on quantitative and qualitative information. Profitability and adherence to standards is also monitored. Results of this analysis provide an important input for planning supervisory activities and are regarded as a primary source of information for performing on-site inspections. Considering current developments in the economic environment, the FSA focused its attention in 2012 primarily on the area of liquidity risk and continued to monitor the quality of loan portfolios of credit institutions.

In order to evaluate the level of preparedness of credit institutions to apply the new capital regulation, the FSA performed an impact analysis of CRD IV/CRR in 2012. It showed that the majority of Estonia's credit institutions are already at present moment capable of meeting both higher capital requirements and these new liquidity and leverage requirements. In October 2012, the FSA initiated a monthly monitoring of requirements that have the biggest effect on Estonian banking sector; the FSA is going to continue with this monitoring until the establishment of compulsory liquidity reports under the European Banking Authority's common regulatory reporting framework (COREP).

Regular risk analyses based on quarterly data of 2012 covered all supervised entities. Also, the FSA analysed the capital adequacy of credit institutions under the SREP process, performed stress testing of credit risk and several targeted risk-based analyses as well as participated in the work of supervisory colleges for cross-border financial groups, including in joint risk evaluation activities.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

The activities of the EFSA are managed and organized by the Management Board, which consists of four members (Mr. Raul Malmstein, Mr. Andres Kurgpõld, Mr. Kaido Tropp and Mr. Kilvar Kessler) and is simultaneously the management body and the administrative body. The Management Board has competence over the organization of all activities of the EFSA and making decisions related to the financial supervision.



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

Estonia as a EU Member State is a part of the common financial services market and its financial stability depends directly on its cooperation with other EU Member States, especially with Nordic countries. The FSA can influence the development of

European supervisory practices and policy primarily through its participation in the work of European financial supervisory authorities.

In 2012, representatives of the FSA were members of 53 different committees or working groups and participated in 99 meetings of these committees or working groups. Participation of officials of the FSA in various working groups is based on the principle of feasibility, i.e. on the extent to which the working group is related to the Estonian market and on the importance of various issues in the context of the European Union.

As far as the work of supervisory colleges is concerned, several multilateral meetings were organised in 2012 between the representatives of Scandinavian and Baltic supervisory authorities. Supervisory colleges of banking groups focused on the adoption of Joint Risk Assessment Decisions (JRAD). Estonia participates in 6 supervisory colleges of banking groups – Citadele, Danske, DNB, Nordea, SEB and Swedbank.

STATISTICAL TABLES

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution	2010	2011	2012
Commercial banks	7	7	8
Branches of foreign credit institutions	11	10	8
Banking sector, total:	**18**	**17**	**16**

Ownership structure of the financial institutions on the basis of registered capital (%) (at year-ends)

Type of financial institution	2010	2011	2012
Public sector ownership	0.0	0.0	0.0
Other domestic ownership	2.0	2.9	4.2
Domestic ownership total	2.0	2.9	4.2
Foreign ownership	98.0	97.1	95.8
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions in 2012 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Banks	76.4	89.2	2,472.7

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2010	2011	2012
Banks	2.1	37.5	9.5

Distribution of market shares in balance sheet total (%)

Type of financial institution	2010	2011	2012
Commercial banks	71.1	69.9	69.6
Branches of foreign credit institutions	28.9	30.1	30.4
Banking sector, total:	**100.0**	**100.0**	**100.0**

Capital adequacy ratio of banks

Type of financial institution	2010	2011	2012
Commercial banks	22.1 **	18.6 **	19.3 **
Cooperative banks			
Banking sector, total:	22.1 **	18.6 **	19.3 **

(* - for Basel I; ** - for Basel II)

Asset portfolio quality of the banking sector (share of impaired receivables / share of non-performing loans)

Asset classification	2010	2011	2012
Non financial sector	6.1	4.6	3.1
- households	**5.0**	**4.3**	**3.2**
- corporate	**8.5**	**5.9**	**3.7**

The structure of deposits and loans of the banking sector in 2012 (%) (at year-end)

	Deposits	Loans
Households	40.5	48.9
Government sector	5.9	3.4
Corporate	47.0	44.4
Other (excluding banks)	6.6	3.3
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends)
mln EUR

P&L account	2010	2011	2012
Interest income	583	627	568
Interest expenses	260	232	175
Net interest income	323	395	393
Net fee and commission income	133	130	134
Other (not specified above) operating income (net)	101	407	81
Gross income	**866**	**1 213**	**831**
Administration costs	249	269	258
Depreciation	11	11	11
Provisions	-8	4	5
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	-223	10	41
Profit (loss) before tax	56	660	363
Net profit (loss)	**56**	**657**	**348**

Total own funds in 2012 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	1 747 895 635	1 713 273 203	34 622 432	0
Cooperative banks				
Banking sector, total:	**1 747 895 635**	**1 713 273 203**	**34 622 432**	**0**

2012 DEVELOPMENTS IN THE HUNGARIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

After a fragile recovery phase in 2010 and H1-2011, Hungarian economy experienced recession in 2012: real GDP fell by 1.7%. Main reasons were poor domestic demand (both consumption and investments), sluggish export activity and low agricultural production. Labour markets suffered from weak prosperity; unemployment stuck close to 11% parallel with moderately rising activity and employment rates, latter due to seasonal public work programs. Economic recovery is expected to start in the second half of 2013, while unemployment is expected to decrease up to economic activity, probably only in 2014.

Government overperformed its ESA-95 fiscal deficit target and reached a public deficit at 1.9% of GDP in 2012. Government debt declined to 79% to GDP in 2012 compared to 81.4% in 2011.

External balances have also continued to improve. Net external financing capacity (current plus capital account) has reached 4.3% of GDP in 2012, due to falling import coupled with stagnating export and to significant EU transfers. In Q1 2013 both the export and the import has started to increase. Gross external debt (excl. intracompany FDI type lending) decreased to 96% in 2012 as a result of massive deleverage.

MNB (central bank of Hungary) prime rate has passed a loosening cycle of 100 bps in the second half of the last year and reached 5.75% in 2012, mainly due to still favourable market environment and easing inflation pressures. Monetary easing has continued since then and the prime rate decreased to 4.50% by the end of May 2013. CPI fell to 5% yoy in December 2012 and further to 1.7% by April 2013.

DEVELOPMENTS IN THE BANKING SYSTEM

The economic crisis that began in 2008 severely impacted the Hungarian money market and the country's banks. Financial sector's participants were still struggling with its effects also in 2012 and the HFSA will be dealing with the negative fall out of the prolonged crisis for years to come.

Lending activity

Hungary's loan-to-GDP ratio decreased since 2008 from 63.9% to 56.18. Shrinking lending activity stemmed from both decreasing loan demand and supply. The final repayment of retail foreign exchange housing loans (mortgages) also drove Hungary's loan-to- GDP ratio downward.

Loan-to-deposit ratio (LDR)

Shrinking lending activities triggered the decrease of this indicator at Hungarian banks in 2012. Further, total loans were also reduced in Hungary by the final repayment of retail foreign exchange mortgages, perceived as an intentional loan reduction effort induced by the government. Final mortgage repayment had a complex impact on the LDR: finally repaid foreign exchange mortgages decreased LDR, while that impact was lessened where final repayment was financed from new loans and also by the utilization of existing deposits. ***LDR ratios in 2012 were the following: 119% in case of banks (144% in 2011), 105% in case of branches (125% in 2011) and 48% in case of credit cooperatives (50% in 2011).***

Non-performing loan (NPL) rate

In recent years, the year-one-year NPL rate consistently increased in Hungary. As the foreign exchange lending was popular for several years in Hungary, depreciation of the local currency as a consequence of the Lehman shock significantly increased foreign exchange loan instalments. Banks in Hungary responded to the new situation after the onset of the crisis by raising loan interest rates (in excess of CDS spread growth). This resulted in higher net interest rates, thus the instalments of Hungarian foreign exchange debtors were not only augmented by the deteriorating forint exchange rate but also by rising loan interest rates. Only the strict regulatory changes in 2010-2011 limited Hungarian banks passing on funding costs to clients. As unemployment increased, the loan portfolio of banks decreased, and - as Swiss franc-based lending was the most significant in the region - the higher Swiss franc exchange rate is clearly reflected in the country's rising NPL rate. The final mortgage repayment also increased the NPL rate, as the loans of clients opting in to the final repayment scheme were no longer in the performing loan portfolio. ***NPL ratios – according to the total loans, classified by contracts and the highest number of days of arrears, officially published at HFSA's website - in 2012 were the following: 13,7% in case of banks (11,3% in 2011), 11,4% in case of branches (5,9% in 2011) and 19,8% in case of credit cooperatives (18,9% in 2011).***

Profitability

The impact of rising NPL rates in Hungary is also reflected in deteriorating profitability indicators. In Hungary, the profitability of banks was further worsened in 2011 by final mortgage repayment, almost a country-specific factor. One of the most important profitability indicator ratios, the ROE fell to near 0% during the year and was -5,7% at the end of 2012.

Capital adequacy

In 2007, Hungary had the lowest capital adequacy ratio in the CEE region, but the indicator improved year by year, and today Hungary has one of the highest capital adequacy ratio (13.5%) of the CEE countries. This was helped by the fact that Hungary's banking sector was profitable until 2010 and that banks increased their ratio of low-risk assets in the period concerned. The losses made on final repayment had a negative impact on the profitability of Hungarian banks and, through that, on their capital adequacy. However, the owners of Hungarian banks typically responded to these losses by a capital increase, thus the capital adequacy of local banks improved.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN HUNGARY

The operation of financial institutions are regulated by different pieces of legislation, the most important one is the Act CXII of 1996 on Credit Institutions and Financial Enterprises. The HFSA is the sole licensing and supervisory authority, regulated by Act CLVIII of 2010 on the Hungarian Financial Supervisory Authority. In 2012 the President of the HFSA issued 29 decrees, 14 recommendations and 8 circular letters.

Main changes in the HFSA Act, expanded decree-issuing rights

From October 2012, three new rights of issuing decrees[9] have been assigned to the President of the HFSA: 1. Definition of detailed rules for reports related to severe IT system problems occurring during data reporting; 2. Creating detailed rules for setting, collecting, managing, recording and refunding the administrative services fee in the case of financial, capital and insurance market organizations, voluntary mutual funds, private pension funds and occupational pension service providers. 3. Setting detailed rules regarding the content, form and submission of licensing and reporting forms and electronic templates.

Liquidity

Recognizing the key importance of liquidity, two new indicators were launched at the HFSA's initiative last year. Effective from January 2012, all credit institutions operating as joint stock companies must calculate these ratios on a daily basis based on their data reported to HFSA and meet one of the two ratios at all times. A third indicator, the FX Funding Adequacy Ratio is aimed at regulating the maturity mismatch of banks' assets and liabilities. The ratio, set at 0.65%, should be met at all times, effective from July 2012.

MAIN STRATEGIC OBJECTIVES OF THE HFSA IN 2012

In 2012 the priorities of the HFSA in the banking sector were:

Supervision of Capital

Due to the lingering negative effects of the crisis, the HFSA has been paying special attention to the capital position of institutions and the quality of capital elements. The purpose of this intensified treatment was to identify risks, to detect unfavourable trends in a timely manner, and to deal with them swiftly

[9] The President of the HFSA shall issue decrees by statutory authorisation, which may not conflict with any Act, government decree, any decree of the Prime Minister, ministerial decree or with any order of the Governor of the National Bank of Hungary. Decree designated deputies of the President of the HFSA may issue decrees on behalf of the President.

and correctly. As a result of the HFSA's approach, the solid capital adequacy of Hungarian institution is considered secure even in international comparison.

Supervision of Liquidity

Checking the compliance with the new indicators was a new task and a priority for 2012.

Supervision of Credit Risk

Credit portfolios deteriorated significantly in recent years, thus the HFSA paid special attention to credit risk trends, focusing on restructured receivables and work-out activities during inspections. The prudential management, in particular the adequate provisioning in the light of deteriorating portfolios, growing non-performing loan ratios and the related capital requirement of credit risk was scrutinized during both comprehensive inspections and annual SREP dialogues. The management of credit risk was also a focus item for consumer protection. In H1 2012, the HFSA scrutinized the compliance of final repayment plans offered by credit institutions for retail foreign exchange-based mortgages. Further, through 2012, the HFSA closely inspected the forced collection and debt management activities of financial enterprises, their compliance with the requirements for transparent pricing and the practices of institutions.

Business strategy

Recent changes in the international, EU and domestic economic environment had a significant impact on Hungarian credit institutions. Owners revised existing medium and long-term business strategies and were compelled to specify the changes to the HFSA. This re-drafting of former business models can be regarded as one of the responses of financial market participants to the crisis. The HFSA must know these responses in detail as they may convey risks, therefore monitored changes to credit institution strategies in 2012, via on-site and off-site supervision.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2012

Prudential supervisory activity

On-site supervision

In 2012 in the money market sector, comprehensive inspections were carried out at five banking groups, including 23 institutions belonging to these groups, at four small and medium banks and 33 credit cooperatives. Follow-up and targeted inspections were held at two banking groups, including nine institutions belonging to these groups, at two small and medium banks and at two credit cooperatives. The scope of these comprehensive inspections included the main activities of the institutions and their key risks. During the inspections, special attention was paid to the compliance of managing non-performing loans, the portfolio of which augmented owing to the crisis, the adequacy of provisioning, restructuring practices, the proper management of liquidity risks, compliance with accounting and data reporting requirements and capital position trends. At credit cooperatives, inspection focus was extended to strengthening the governance and control role of owners; to requiring compliance with membership-related legal provisions consistently; and to internal control systems (risk management, internal audit and compliance activities) and their strengthening in line with HFSA requirements. The LIBOR and EURIBOR investigations directed attention all around the world to the vulnerability of interbank interest rate setting mechanisms. In response, the HFSA launched inspections at 17 BUBOR-subscriber institutions. Regarding BUBOR[10] subscription practices, the purpose of the prudential thematic inspection at banks participating in subscription was to assess internal procedures, the level of their documentation and the established control environment. The HFSA's statistical analysis proved that no wilful diversion [of the interest rate] took place in the past, as BUBOR smoothly followed the central bank interest rate trend. However, the inspection also found that the process was not and is still not sufficiently regulated at banks that shape the BUBOR. Further, the process was not integrated into risk management systems and control was also lacking. The HFSA's thematic inspection was closed at each institution in early 2013, with resolutions not setting out any measures. The HFSA outlined proposals and non-binding requirements in a CEO letter to the management of institutions on how to strengthen the subscription control environment.

Off-site supervision

In addition to monitoring continually the actual capital position of banking groups, the HFSA regularly analysed the changes of banking portfolios and profitability, and elements of strategy change by foreign owners. In 2012, so-called prudential meetings were held with the leaders of large banks on two occasions. Based on those meetings, the HFSA gained a comprehensive picture of the current position, measures and future expectations of banks.

Payments

In February 2012, frequent hacker attacks and frauds, and the bankruptcy of Malév Hungarian airlines called for consumer protection inspections of service provider conduct concerning banking cards. In addition, customer informing prior to payment service contract signing also became an inspection focus. Further, compliance with the new four-hour limit for electronic transfers that entered into effect on 2 July 2012 was also subjected to intensified supervisory scrutiny.

Prevention of money laundering

When verifying compliance with legal provisions on the prevention of money laundering and terrorism financing during inspections, the HFSA identified violations of varying severity at nearly every bank. The most frequent problems in this field emerged in relation to beneficial ownership statements, for which the HFSA imposed fines ranging from HUF 500 000 to 3 000 000 on a total of four credit institutions.

Protection of financial consumers

A significant increase was seen during 2012 in the number of customers struggling with payment difficulties and inquiring about options to restructure their contract with the bank. Some customers turned to the HFSA's customer service with questions and problems about debt management and forced collection. Late in the year a remarkable increase was witnessed in the number

[10] Budapest Interbank Offered Rate

of inquiries about the unilateral interest rate and fee raises of institutions. In the same period many customers inquired at the HFSA about the transaction levy. Priorities of targeted and thematic consumer protection inspections in the money market sector in 2012 were: complaint management practices of institutions, compliance with response deadlines; implementation of final repayment at a fixed exchange rate; unilateral contract modifications that are adverse for consumers; sending out annual notifications and balance statements; information on payment relief options pertaining to certain loans; information on data transfer to the Centralized Credit Information System; Exchange rate and instalment calculation related to lending; compliance with the APR cap; transparent pricing; unfair commercial practices; compliance with the customer informing obligations; whether customers received the repayment instalment table upon request during the contract term or in case of early repayment; practice of delivering cash substitutes and the related PIN codes to customers; online and off-line advertisements of financial organizations. ***The HFSA took 516 consumer protection measures last year.***

The Financial Arbitration Board

The Financial Arbitration Board (FAB) has been operating effectively beside the HFSA for more than one and a half years. The FAB and the HFSA complement each other: proceedings that can be initiated at both forums enable timely remedy to almost the entire spectrum of financial consumer right encroachments. Under the framework of consumer protection proceedings launched at the HFSA’s own initiative, the supervisory authority had to take measures at the FAB’s request on eight occasions in 2012. As a consequence of these exercises, total fines of HUF 6,300,000 were imposed owing to failures of financial organizations to fulfil their cooperation obligations in the course of proceedings brought before the FAB to resolve legal disputes with financial consumers.

Law enforcement

Money market law enforcement

In 2012, the HFSA’s money market law enforcement area passed 83 resolutions after inspections (including 56 comprehensive inspections, 19 targeted inspections and 8 follow-up inspections). With only a few exceptions, the resolutions involved various supervisory measures owing to violations of legal provisions. In particular, these measures obliged institutions to fulfil certain requirements, to comply fully with legal provisions and to submit extraordinary data reports in order to eliminate discrepancies revealed by the inspections. On 26 occasions, the HFSA imposed total fines of HUF 500 000-10 000 000 on institutions involved in violations.

Banks

As part of supervising banks in 2012, measures taken by the HFSA against institutions related to the breaching of legal and internal rules on risk assumption, customer and partner rating, accounting and analytic records, and the management and record keeping of restructured loans. Further violations identified by the HFSA related to the content and method of data reporting, forced sale procedures, and the calculation of solvency capital.

Credit cooperatives

Most frequent violations revealed by comprehensive inspections at cooperative credit institutions related to risk assumption and management, collateral valuation, the management and recording of restructured loans and to accounting and analytic records. Another typical fault was that savings cooperatives failed to comply with legal and internal provisions on customer and contract rating and thus failed to charge sufficient impairment.

Financial enterprises

In 2012, the HFSA closely examined the capital position of financial enterprises. Last year the HFSA revoked the operating licence of six financial enterprises, mostly because of fundamental deficiencies in the material and personal conditions of providing financial services, regular failures to provide data reports to the HFSA, and insolvency. In addition, the lack of membership in the Credit Information System was a key assessment consideration for the HFSA when passing resolutions against these institutions.

Money market licensing

Credit institution licensing

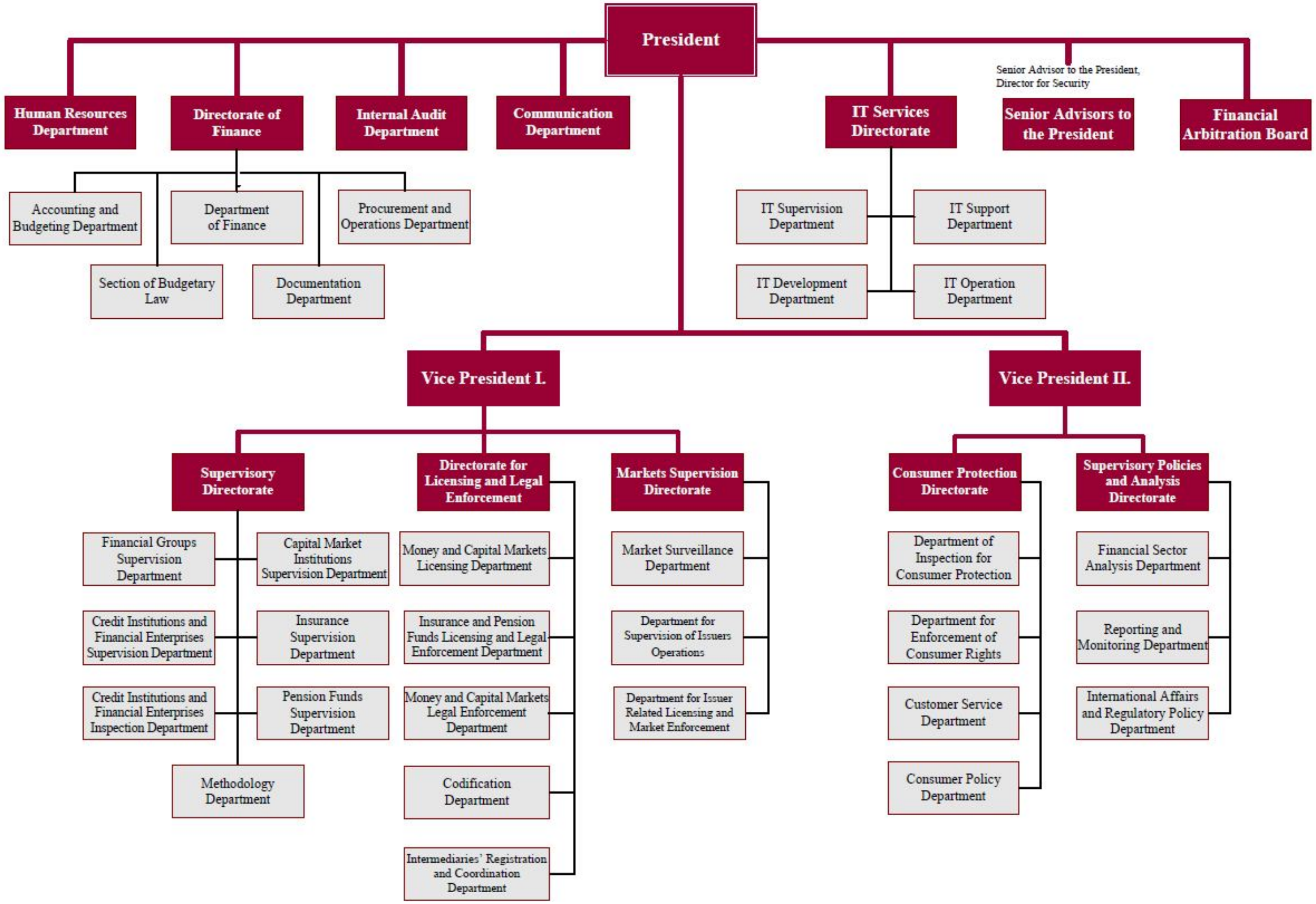
The number of participants in the credit institution sector decreased in 2012: two credit institution branches (HSBC Bank Plc, Budapest Branch and Crédit Agricole Corporate and Investment Bank's Hungarian branch) terminated operations, while no new credit institution was founded and no new player entered the market. Two mergers impacting the composition of banking groups took place in 2012. Three mergers affecting savings cooperatives were licensed last year; the purpose of each merger was to offset losses, improve operating efficiency, cut costs and simplify group governance. The ownership structure of multiple credit institutions underwent changes last year. For savings cooperatives, the use of pawnbrokers as key intermediaries remained an important source of revenue, thus many savings cooperatives resort to this option. The unusually high number of licensing requests received by the HFSA in relation to pawnbroker contracts and contract modifications is a clear sign of this trend. Otherwise, credit institutions mainly use key intermediaries for debt collection. The related licensing applications represented a significant volume in 2012.

Licensing financial enterprises and independent intermediaries

The decreasing trend seen in 2010-2011 regarding financial enterprises seems to have stopped in 2012: the number of foundation and operating license applications reflected slow growth during the year, especially in the last six months. Most companies newly licensed by the HFSA were mainly engaged in debt purchasing. Further companies were licensed to provide loans, cash and financial leasing services without business limitations and to provide loans against pledged property collateral. In 2012, the HFSA revoked the operating licence of three financial enterprises at their request. ***There were 1141 licensing measures taken by the HFSA in 2012.***

ORGANIZATIONAL CHART OF THE HFSA BANKING SUPERVISORY AUTHORITY

The HFSA's organizational structure (as at 31 December 2012)



INTERNATIONAL ACTIVITY OF THE AUTHORITY

Cooperation at EU level

The HFSA made a series of strategic decisions in 2012 in order to use available resources as efficiently as possible in its increasingly concentrated professional relations with the ESFS. In each case, thorough internal assessment precedes the selection of working committees and working groups in which participation offers the most significant results in promoting international efforts on the topic concerned and in respect of the HFSA's own activities. The HFSA undertook an active role in the decision-making bodies, professional committees and working groups of the **EBA**. In 2012, agreements were made on the joint supervisory reporting framework and the EBA's commitment to support consumer protection and supervisory colleges was strengthened further. Fulfilling its obligations, the HFSA's senior management participated in the sessions of the EBA's Board of Supervisors in 2012. ***Actually, the HFSA is represented in 26 different committees, working groups and task forces of the EBA.***

In addition, HFSA takes part actively in the **ESRB**'s work at Presidential, vice Presidential (Advisory Technical Committee) and expert level.

The HFSA contributes also to the activities of the **AMLC**[11] and the **CPMLTF**[12]**.**

International cooperation outside the European Union

Global LEI (Legal Entity Identifier) Process[13]

HFSA takes part as an observer in the Global LEI Program.

OECD (Organisation for Economic Co-operation and Development)

The HFSA was represented in 2012 at senior level at the session of the OECD's Economic and Development Review Committee that inspected Hungary. The HFSA is a member of the OECD National Council and is represented also in the Committee on Financial Markets.

CBSG (Cross-Border Stability Group)[14]

In July 2012 the CBSG hold a Crisis Simulation Exercise in Vienna, where the HFSA was represented at managing director level.

FSB (Financial Stability Board) Regional Consultative Group for Europe.

The HFSA, the Ministry for National Economy and the MNB are all members of the FSB's regional organization. The Hungarian authorities were

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[11] Anti-money Laundering Sub-Committee, a body reporting to the Joint Committee that comprises the leaders of the three European Supervisory Authorities.

[12] A second level committee operated by the European Commission and established by the directive on the prevention of money laundering and terrorist financing.

[13] The Legal Entity Identifier (LEI) program is designed to create and apply a single, universal standard identifier to any organization or firm involved in a financial transaction internationally.

[14] The CBSG is the joint platform of Austria, Bulgaria, the Czech Republic, Hungary, Slovakia and Slovenia and consists of Finance Ministers, Central Banks and Financial Supervisory Authorities, with the objective to enhance preparedness in normal times and facilitate the management and resolution of a cross-border financial crisis.

represented at managerial level at the sessions and the HFSA President attended both meetings of the FSB European Regional Consultative Group in 2012.

V6 Financial Stability Meeting

The Financial Stability Meeting of V6 countries (Austria, Czech Republic, Poland, Hungary, Slovakia and Slovenia) took place in Prague in June. Key topics of the meeting included fiscal consolidation, the restoration of banks, definition and regulation of G-SIBs and D-SIBs, macro-prudential issues and the implementation of ESRB recommendations. The HFSA was represented at Presidential level at the meeting.

Other events of international relevance

HFSA managers and staff members held several consultations and meetings with delegation and leaders of other national supervisory authorities and international organizations also in 2012, and gave presentations at various meetings and conferences at the request of partner supervisory authorities and other organizations. In the capacity of financial expert, an HFSA staff member named on Moneyval’s list of experts took part in the assessment of an EU member state as part of the international assessment team.

At the June 2012 meeting of the European Council, member states negotiated measures aimed to further enhance the Economic and Monetary Union and decided on establishing the banking union, an initiative encompassing multiple elements. In this respect, the European Commission first elaborated the proposal package of the Single Supervisory Mechanism (SSM). The SSM comprises the banking supervisory authorities of all Eurozone countries; Non-Eurozone countries can also participate in the mechanism if they sign a close cooperation agreement with the ECB. The decision on Hungary’s potential accession to the SSM can only be made once the final texts of legislations and other components of the banking union are known, i.e. after the comprehensive weighing of benefits and drawbacks. Currently there is no pressure to make this decision as regulations allow member states outside the Eurozone to decide on accession to the single supervisory mechanism at anytime.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

The HFSA is an integrated regulatory authority responsible for the supervision of banking, insurance, capital market and pension sectors. Therefore there is no other supervisory body in the field of financial supervision at national level to cooperate with.

STATISTICAL TABLES

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution	2010	2011	2012
Commercial banks	35	35	35
Branches of foreign credit institutions	10	10	9
Cooperative banks	138	132	128
Banking sector, total:	**183**	**177**	**173**

Ownership structure of the financial institutions on the basis of registered capital (%) (at year-ends)

Type of financial institution	2010	2011	2012
Public sector ownership	3,94	4,57	5,05
Other domestic ownership	13,24	12,96	12,72
Domestic ownership total	17,18	17,54	17,77
Foreign ownership	82,82	82,46	82,23
Banking sector, total:	**100**	**100**	**100.0**

Concentration of asset by the type of financial institutions (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	44,5	61,5	11,2
Branches of foreign credit institutions	79,0	94,3	24,8
Cooperative banks	11,8	17,2	1,4
Banking sector, total:	**39,1**	**54,0**	**8,7**

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2010	2011	2012
Commercial banks	0,5	-9,5	-6,4
Branches of foreign credit institutions	4,9	4,2	6,6
Cooperative banks	7,2	- 9,6	-4,7
Banking sector, total:	**1,1**	**-8,9**	**-5,7**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2010	2011	2012
Commercial banks	83,5	83,0	83,7
Branches of foreign credit institutions	7,0	7,1	6,1
Cooperative banks	5,1	5,0	5,5
Other	4,4	4,9	4,8
Banking sector, total:	**100.0**	**100.0**	**100.0**

The structure of assets and liabilities of the banking system (%) (at year-end)

Assets	2010	2011	2012
Financial sector	22,2	24,7	26,1
Nonfinancial sector	47,5	44,8	42,7
Government sector	13,8	13,3	15,1
Other	16,6	17,2	16,1
Liabilities	**2010**	**2011**	**2012**
Financial sector	12,9	14,0	14,9
Nonfinancial sector	36,8	38,3	42,0
Government sector	2,0	1,9	2,0
Capital	8,1	7,7	9,0
Other	40,2	38,1	32,1

Capital adequacy ratio of banks

Type of financial institution	2010	2011	2012
Commercial banks	13,0**	13,0**	15,8**
Cooperative banks	15,6**	15,4**	16,9**
Banking sector, total:	**13,1****	**13,1****	**15,9****

(* - for Basel I; ** - for Basel II)

Asset portfolio quality of the banking sector (share of impaired receivables / share of non-performing loans)

Asset classification	2010	2011	2012
Non financial sector	27,3	36,4	36,8
- households	**22,7**	**36,7**	**35,4**
- corporate	**32,7**	**36,0**	**38,2**

The structure of deposits and loans of the banking sector in 2012 (%) (at year-end)

	Deposits	Loans
Households	52,5	40,1
Government sector	3,6	3,6
Corporate	29,9	35,6
Other (excluding banks)	14,0	20,7
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends)

P&L account *(in EUR)*	2010	2011	2012
Interest income	2 319 324	2 307 956	2 380 453
Interest expenses	1 306 105	1 304 316	1 453 828
Net interest income	1 013 219	1 003 640	926 625
Net fee and commission income	296 858	268 646	265 410
Other (not specified above) operating income (net)	-91 979	15 710	-343 674
Gross income	1 218 098	1 287 996	848 361
Administration costs	596 922	572 845	636 357
Depreciation	53 414	52 770	56 382
Provisions	-410 867	-741 839	-177 819
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)			
Profit (loss) before tax	56 993	-206 906	-78 434
Net profit (loss)	18 232	-239 260	-154 654

Total own funds in 2012 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	8 192 561 486	7 084 793 155	1 092 774 064	14 994 268
Cooperative banks	490 062 560	439 876 353	50 186 206	0
Banking sector, total:	**8 682 624 046**	**7 524 669 508**	**1 142 960 270**	**14 994 268**

2012 DEVELOPMENTS IN THE GEORGIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2012 economic growth in Georgia reached 6.1%. Major contributors to the growth in 2012 were manufacturing industry (35%), construction (16%) and trade (19%). Double digit growth rates were recorded in manufacturing industry, communication, financial, construction and hospitality sectors. Output of agriculture has contracted by 3.3%.

Under moderate growth rate of about 5%, private consumption accounted for almost half of nominal growth of GDP in 2012. Other sources of growth, namely, gross capital formation and export of goods and services, have increased by 19% and 14%, respectively. Tourism sector significantly supported the growth of export revenues in 2012. Investments in fixed capital made up 25% of GDP, slightly increased from last year.

Savings rate has increased up to 16.3% of the national income from 13.1% in 2011. Unemployment rate remained high and made up 15%, about the same as in the previous year (15.1%).

Inflation rate had a declining trend in 2012. Since February it became negative and made up -1.4% in December. Major contributors of deflation were food prices that had decreased in 2012, after the sharp rise of food prices in the international market in the first half of 2011. As a response on deflation, NBG has reduced the policy rates from 6.75% to 5.25% by the end of 2012.

Fiscal consolidation continued in 2012, accompanied with rapid economic growth. Consolidated budget deficit has declined to 2.9% of GDP compared with 3.6% in 2011. Tax revenues have increased by 8.7% and budget expenditures by 7.6% in 2012. Tax burden made up 25.5% of GDP, which is 0.3 percentage point higher than in 2011. Public debt to GDP remained on sustainable level and made up 37.9% in 2012, while in 2011 it was 38.6%.

After increasing in the beginning of the year, current account deficit decreased in the second half of 2012. In total, current account deficit reached 11.5% of GDP in 2012, which is 1.3 percentage point lower than in 2011. Although the growth of import by 14.3% and export by 7.6% were lower than in 2011, trade deficit has widened and made up 29% of GDP in 2012, when in 2011 it was 25.5%. Revenues from tourism, as well as transfers and remittances were significant sources of financing of trading good’s deficit. Other sources of financing of current account deficit were FDIs, which made up 866 million USD in 2012. At the same time, portfolio investments increased significantly and made up almost 900 million USD (mainly derived by long term Eurobond placements of one commercial bank and two large state-owned corporations). As the result, total external debt increased by 1.8 billion USD up to the 13.4 billion USD, which is 6 percentage points growth to 84.7% of GDP (mainly consisting of FDI-related debt through intra-company lending and/or long-term borrowing). In the same period, External public debt declined slightly and amounted to 30.6% of GDP. Large portion of the state borrowing consisted of low interest bearing loans from donor organizations.

Lari exchange rate was characterized by stability. Lari appreciated against US dollar insignificantly by almost 1% by the end of 2012 and NBG interventions on FX market were very limited. Due to deflation, Georgian Lari's real effective exchange rate has declined by almost 5% in 2012.

DEVELOPMENTS IN THE BANKING SYSTEM

Banking is the main financial intermediary in Georgian economy. Foreign investments dominate banking sector and accounts for almost 90 percent of total equity. Banking sector was growing in 2012, but at lower rates than in the previous year. This was related to the reduced demand on loans from business sector. Credit portfolio increased by 13% at the end of 2012, compared with 24% in 2011. In total, credit portfolio accounted for 33.4% of GDP, which is 1.6% higher than in 2011. As for the total assets of banking sector, they accounted for 55% of GDP that is almost 3% higher than in 2011.

In 2012, the highest growth rate was recorded in retail lending (17.5% annual growth), followed by SMEs and corporate sectors. Banking sector loan portfolio break-down by products is the following: 41% accounts for corporate sector, 39% - retail sector, and 20% - SMEs.

Throughout the year, loan portfolio quality worsened slightly. According to NBG's more forward-looking methodology and taking into account restructured loans with no evidence of being able to repay them under the new schedule, NPL ratio has increased by 0.7 percentage points and made up 9.3% of total portfolio (mainly caused by a number of idiosyncratic factors). At the same time, NPL ratio calculated with widely accepted methodology - the loans with more than 90 days overdue to total portfolio had improved and made up 3.7% in 2012, compared with 4.5% in 2011.

In 2012, banking sector accumulated liquidity above the prudential minimum. The share of liquid assets to total assets and non-bank deposits made up 23% and 44%, respectively. As a result, banks started lowering interest rates on liability side more aggressively.

Banking system still remained highly dollarized, contributing to currency induced credit risk. In 2012, the dollarization of loans decreased by 1%, down to 67.5%, but dollarization of deposits, on the contrary, increased by 4% and made up 64% for 2012.

To mitigate this risk, NBG employs additional risk weights for foreign currency exposures.

Georgian banking system was well capitalized, mainly driven by aforementioned risk weighting. At the end of 2012, CAR for Tier I capital and regulatory capital were 13.4% and 17%, respectively, which are significantly higher than the required prudential minimum. The same indicators, calculated based on Basel I methodology, were 18.2% and 23%, respectively.

Profitability of banks had decreased in 2012. Financial profit of the system has dropped from 323 million GEL in 2011 to 134 million GEL in 2012. At the end of 2012 RoA made up 1% and Roe made up 5.84%. Low growth rate of credit portfolio, increase in net provisions (326 million GEL by the end 2012 versus 78 million GEL in 2011, including loans which were provisioned and written off) led to lower profitability in banking system. However, the efficiency of banking system continued to improve with the increase of scales of operations. Cost to income ratio declined from 58.6% in 2011 to 56.9% in 2012.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN HUNGARY

The National Bank of Georgia (NBG) is the central bank of the state and an independent public body, which exercises supervision over the activities of financial sector in accordance with Organic Law of Georgia on National Bank of Georgia, Law on activities of the Commercial Banks, Law on Securities Market, Law on Microfinance Institutions, Law on Credit Unions, and other special laws and regulations. Function and powers of NBG includes supervision over activities of financial institutions through their licensing, registration, regulation and examination to ensure stable and effective functioning of the financial system, management of systemic risk, establishment of competitive environment, and reduction of potential risks.

Throughout 2012, basic prudential powers and rights have been augmented by several regulatory amendments, the most significant of which are the following:

According to the supplement to the legislation, NBG can qualify certain credit institutions as “qualified credit institutions” and NBG will have the right to exercise similar regulation and supervision powers over them as over commercial banks. Institutions that are engaged in attracting funds on retail markets can be subject to such qualification. The amendment should ensure that there is no possibility of regulatory arbitrage and that retail depository funds are subject to prudent supervision. This was especially valuable through increasing activities of individual or legal persons who attract funds from physical persons. Although no excessive risks are foreseen currently, due to the small scale of the mentioned practice, NBG aims to alleviate risks on a forward-looking basis for the sake of maintaining prevailing consumer confidence and financial sector stability.

The legislative framework providing for the supervision and regulation of financial institutions, including in terms of AML, has undergone significant structural changes in 2011-2012. NBG decided to strengthen the AML/CFT supervision framework by introducing a systematic AML/CFT off-site monitoring. Furthermore, NBG adopted the AML/CFT Supervision Policy where its off-site monitoring function is founded on a risk-based approach. NBG also decided to strengthen the sanctioning regime on AML/CFT violations by introducing sanctions on failure to maintain proper internal controls and impose pecuniary sanctions on directors and management of financial institutions, in case they fail to ensure the adoption and observance of appropriate internal control mechanisms and rules by relevant financial institutions. In July 2012, Fourth Round “Detailed Assessment Report on Anti-Money Laundering and Combating the Financing of Terrorism” Report prepared by IMF was adopted on the 39th MONEYVAL plenary meeting.

MAIN STRATEGIC OBJECTIVES OF THE HFSA IN 2012

Throughout 2012, the main strategic objective of the banking supervision was further enhancement of risk-based supervisory process and its convergence with accepted international guidelines, including Basel II/III capital and liquidity standards.

In the past years, the National Bank of Georgia has moved to risk based supervision process that was accompanied with significant organizational and functional changes. The main objective, starting from 2012, was to formalize General Risk Assessment System – GRAPE to achieve further efficiency of the process, and to allocate resources based on risk-based priorities, so that the risk of failure are minimized in the sector and supervisory remedial actions are taken at an early stage.

NBG set an objective of converging towards Basel II/III standards in 2012 as well. Apart from the adoption of the standardized formula of the pillar I, NBG aims to promote calculation of internal capital adequacy by banks. Implementation of pillar II and afterwards, pillar III of Basel II/III should promote enhancement of corporate governance practices in banks, better analyses of their own risks by banks, calculation of necessary capital level and more effective dialogue between the supervisor and the bank. NBG also aims at convergence towards liquidity standards of Basel and has been actively implementing the LCR framework.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2012

2012 was an active year for bank supervisors in Georgia both in terms of intensity of supervision and organizational accomplishment of the risk based supervisory process, and international collaboration.

In 2012 there was a great interest from investors to enter Georgian banking sector. NBG approved banking license to the branch of Turkish Is Bank.

In 2012 NBG continued identification and monitoring of key risks in the financial sector through its assessment of bank-specific and sector-wide risks. In parallel with increasing competition on the market, NBG kept a close eye on sustainability of decreasing margins and intensively monitored lending standards so that excessive credit risk-taking to be avoided.

NBG increased collaboration with internal and external audits of commercial banks to further strengthen timely identification of commercial bank risks, and support the exploitation of such collaboration benefits.

Having distributed updated draft regulation on capital adequacy based on Basel II/III, supervisors started to monitor capital adequacy and LCR reports based on Basel II/III. The quantitative impact study showed that local banks' capitalization would remain at comfortable levels based on the new framework and they would not face any major obstacles in convergence phase.

NBG has performed self-assessment against Basel Core Principles for Effective Banking Supervision and elaborated further convergence plans.

In 2012 the National Bank of Georgia started disseminating financial stability indicators based on IMF guidelines.

2012 can also be marked as a significant year in terms of consumer protection enhancement. Commercial banks were trying to eliminate consumer-related problems more actively. Several banks developed special brochures dedicated to consumer protection issues that encompass explanations to the regulations enacted in 2011 by NBG with easily understandable language for the consumers. In cooperation with SBFIC (Savings Banks Foundation for International Cooperation), Mystery Shopper survey was conducted in the period of late 2011 – early 2012 with the support of NBG staff. Findings were further discussed with commercial banks and a plan of taking adequate measures was set. World Savings Day was celebrated by Georgian commercial banks for the first time in 2012 with the support of NBG.

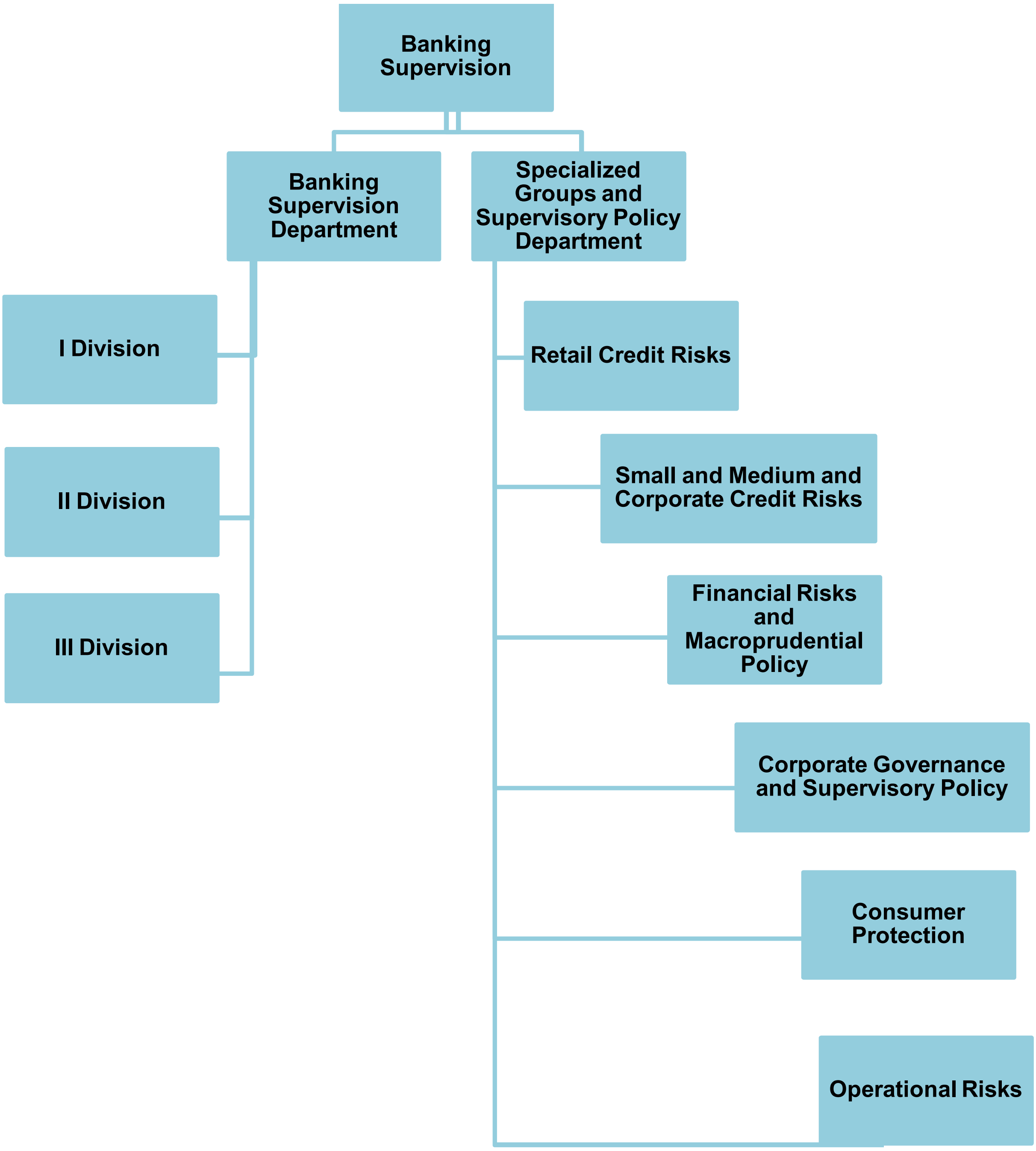
ORGANIZATIONAL CHART OF THE HFSA BANKING SUPERVISORY AUTHORITY

Supervisory functions are performed by two closely related groups, in particular, bank supervisors and specialized groups. Bank supervisors (Banking Supervision Department) are responsible for all risk areas across each bank, while specialist risk teams (Specialized Groups and Supervisory Policy Department) are responsible for the system-wide monitoring and assessment of their particular risks across all banks, which supports macroprudential regulation as well.

Normally, the assessment of each risk (inherent risk and risk mitigants) at every bank will be prepared and/or reviewed by these two departments. The separation of the tasks of reviewing and preparing depends on resource availability and task complication level. This approach contributes to more appropriate and consistent benchmarked assessments, while also meeting the "four eyes" principle. It also ensures that a strong element of peer group review and consistency of treatment across banks is introduced at an early stage in the risk assessment process, in contrast to other systems where the risk assessment process is driven almost entirely by the bank supervisor and any peer group or "panel review" procedures are introduced only towards the end of the process. Both the supervisors and the specialist risk teams undertake a mixture of on-site and off-site work, and risk assessments are based on a combination of on-site and off-site reviews and analysis.

Banking Supervision Department is represented by three divisions. The distribution of supervised banks is based on risk-based principle for the sake of efficient resource allocation. Specialized Groups and Supervisory Policy Department is represented by six divisions that specialize in respective risk areas.

The structure of banking supervisory authority at the end of 2012



INTERNATIONAL ACTIVITY OF THE AUTHORITY

NBG aims to further increase international cooperation for the sake of experience and knowledge–sharing, as well as for the cooperation for supervising internationally active banking institutions.

The National Bank of Georgia aims at active international cooperation. In 2012 NBG became a member country of BSCEE group, which is an outstanding opportunity for efficient dialogue for enhancement and convergence of local supervisory practices.

In 2012 NBG got involved in a supervisory college of international banking group, with BaFin acting as the host supervisor.

Throughout 2012, NBG hosted colleagues from various peer countries to share supervisory knowledge and experience, and to promote enhancement of bilateral relations in banking and financial fields.

The National Bank of Georgia hosted the 2nd Caucasian Expert Panel on Central Banks Statistics. Along with the Georgian experts, the specialists from Lithuania, Armenia, Ukraine and Kazakhstan participated in the panel.

The National Bank of Georgia maintains cooperation regime with international financial institutions and other supervisory agencies world-wide.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

In 2012, The National Bank of Georgia represented the sole supervisory authority.

STATISTICAL TABLES

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution	2010	2011	2012
Commercial banks	17	17	16
Branches of foreign credit institutions	2	2	3
Cooperative banks			
Banking sector, total:	**19**	**19**	**19**

Ownership structure of the financial institutions on the basis of registered capital (%) (at year-ends)

Type of financial institution	2010	2011	2012
Public sector ownership	0	0	0
Other domestic ownership	5.17	3.56	2.74
Domestic ownership total	5.17	3.56	2.74
Foreign ownership	94.83	96.44	97.26
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	69.79	82	0.21783
Branches of foreign credit institutions	100	100	0.35501
Cooperative banks			
Banking sector, total:	**69.79**	**82**	**0.21783**

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2010	2011	2012
Commercial banks	9.6	17.3	5.9
Cooperative banks			
Other			
Banking sector, total:	**9.6**	**17.3**	**5.9**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2010	2011	2012
Commercial banks	99.64	99.68	99.61
Branches of foreign credit institutions	0.36	0.32	0.39
Cooperative banks			
Other			
Banking sector, total:	**100.0**	**100.0**	**100.0**

The structure of assets and liabilities of the banking system (%)
(at year-end)

Assets	2010	2011	2012
Financial sector	18.26	11.72	11.15
Nonfinancial sector	53.31	56.18	56.11
Government sector	12.35	17.20	17.21
Other	16.08	14.90	15.52
Liabilities	**2010**	**2011**	**2012**
Financial sector	24.11	25.76	23.56
Nonfinancial sector	50.41	50.57	52.31
Government sector	5.76	4.01	4.77
Capital	16.92	16.60	16.65
Other	2.80	3.07	2.71

Capital adequacy ratio of banks

Type of financial institution	2010	2011	2012
Commercial banks*	22.20	23.30	23.01
Cooperative banks			
Banking sector, total*:	22.20	23.30	23.01

(* - for Basel I; ** - for Basel II)

Asset portfolio quality of the banking sector
(share of impaired receivables / share of non-performing loans)

Asset classification	2010	2011	2012
Non financial sector	5.61	4.64	3.82
- households	**3.93**	**2.07**	**3.08**
- corporate	**6.50**	**6.26**	**4.31**

The structure of deposits and loans of the banking sector in 2012 (%) (at year-end)

	Deposits	Loans
Households	50.65	42.73
Government sector	1.84	0.76
Corporate	47.51	56.51
Other (excluding banks)	0.00	0.00
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends) (EUR thousands)

P&L account *(in EUR)*	2010	2011	2012
Interest income	469,185	621,274	710,165
Interest expenses	219,759	289,926	345,825
Net interest income	249,426	331,348	364,340
Net fee and commission income	59,845	81,742	83,577
Other (not specified above) operating income (net)	7,119	4,931	12,870
Gross income	316,390	418,021	460,787
Administration costs	141,063	177,367	192,783
Depreciation	31,122	37,476	36,777
Provisions	64,515	36,295	149,399
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)			
Profit (loss) before tax	79,691	166,882	81,829
Net profit (loss)	66,498	149,457	61,503

Total own funds in 2012 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	1,160,883	919,145	407,677	
Cooperative banks				
Banking sector, total:	1,160,883	919,145	407,677	

In thousand EUR

2012 DEVELOPMENTS IN THE LATVIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Latvia has posted the most rapid GDP growth rate in the EU in 2012 (5.6%). Exports, investment and private consumption contributed equally to GDP growth in 2012. The state budget deficit has continued to shrink and the consolidated general government budget posted a small deficit of 1.2% of GDP.

Private consumption picked up 5.4% in 2012. The rise was supported by growing disposable income and improving household confidence. Investment increased by 12.3% during 2012, where productive investment grew most. Investment was mainly financed with corporate own funds, foreign direct investment and EU funds.

Despite unfavorable external environment, Latvian export dynamics was spurred due to regained competitiveness and also the steep rise in investment in the previous year. Real exports of goods and services grew by 7.1% in 2012. Imports of goods and services in 2012 increased only moderately (by 3.1%).

In 2012, current account posted a small deficit 1.7% of GDP. Compared to previous year current account deficit has decreased mainly because of strong growth of goods exports; also trade in services continued to increase. Inflation decreased notably during 2012 due to both global developments and domestic factors. The average annual inflation stood at 2.3%.

As unemployment rate was gradually going down, the labour market situation improved further. In terms of new job creation Latvia ranked in the first position in the EU, and the rising employment was mostly dependent on the private sector. In 2012, unemployment rate fell down by one third (from its high at the beginning of 2010) and was approaching the level recorded prior to the period of rapid growth following accession to the EU.

Productivity gains allowed raising remuneration without a simultaneous increase in production costs: unit labour costs in real terms were almost flat. In 2012, the average monthly wages and salaries increased by 3.7%. Consequently, on-going recovery of the labour market does not create inflation and competitiveness risks to the economy.

DEVELOPMENT IN BANKING SYSTEM

Year 2012 is characterised by a stabilisation of key performance indicators and with a number of positive developments in the banking sector.

Banks dominate the financial sector in Latvia, accounting for about 91.1 % of its total assets. At the end-2012, 29 banks, including 9 branches of EU banks were operating in Latvia. As at end-2012, total banking assets to GDP ratio reached 130.3% (20 230 mln lats (assets)/ 15 520 mln lats (GDP)). 71.2% of the Latvian banks' share capital was owned by foreign investors. All other banks in Latvia are privately owned, except for 2 government-controlled banks.

All banks comply with the regulatory requirements. Still comparatively low lending activity determined the high level of the banking liquid assets and the liquidity ratio[15] retained a high level – 59.7% at end-2012. The bank capitalization level had minor improvement, as a number of banks had made use of the possibility to strengthen capital base and by the end -2012 the capital adequacy ratio[16] was 17.6%, whereas the tier 1 ratio stood at 15.3%.

In 2012, the bank deposit stock amounted to 12.5 bln lats, having increased by 12.7% over the year, where resident deposits increased by 530 mln lats whereas non-resident deposits grew by 876 mln lats.

Lending resumed gradually in line with positive macroeconomic developments. In 2012, banks granted new loans at the total amount of 1.9 bln lats, incl. 1125 mln lats to residents (enterprises – 655 mln lats, financial institutions – 286 mln lats, households – 184 mln lats) and 819 mln lats to non-residents.

The quality of loan portfolio has stabilized. The share of loans with more than 90 days overdue payments in the total loan portfolio continued shrinking and by the end-2012 was 11.1% (13.3% at end-2011[17]). The total share of overdue loans in the banking sector loan portfolio reduced from 20.6%[3] to 17.4% over the year. The balance of loan loss provisions made by the banks at the end-2012 shrank to 937.4 mln lats or 8.0% of total banking loan portfolio (9.8% at end-2011[3]).

With a loan portfolio contraction and increase in deposits in 2012 the necessity for additional financing also reduced and the funding raised by banks from MFI continued declining by 19.1% (980 mln lats), mainly due to contraction in funding volumes from foreign affiliated and associated banks by 830 mln lats.

After the three loss-making years, the year 2012 was the first one where the banking sector made profits amounting to 122.3 million lats (compared to 178.7 mln lats losses in 2011). Banking profitability was positively affected by both the increase in the commission fee income and comparatively high interest rate spread on loans and deposits, as well as stabilization of amount and quality of loan portfolio.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN LATVIA

The Financial and Capital Market Commission (FCMC) is an autonomous public institution and has been performing in this capacity for nearly 12 years as of its establishment on 1 July 2001. It carries out the supervision of Latvian banks, credit unions, insurance companies and insurance brokerage companies, investment management companies, participants of financial instruments market, electronic money institutions, payment services providers as well as private pension funds. The FCMC ensures regulatory framework for and supervision of the Latvian financial and capital market as well protects the

[15] Banks have to maintain liquid assets in amount not less than 30% of current liabilities (i.e. with maturity up to 30 days).
[16] regulatory minimum – 8%
[17] Excluding problem banks.

interests of customers of market participants and promotes soundness, competitiveness and development of the sector in general.

The competence of the FCMC is set forth in the Law on the Financial and Capital Market Commission and the Credit Institution Law. As regards the banking sector, the FCMC has authority to issue regulations and guidelines governing activities of banks, to request and receive information from banks necessary for the execution of its functions; to set forth restrictions on the activities of banks, to examine compliance of the activities with the legislation, and regulations and directives of the FCMC, and to apply sanctions set forth by the regulatory requirement on banks and their officials in case any of regulatory requirements are violated.

MAIN STRATEGIC OBJECTIVES OF FCMC IN 2012

In 2012, the FCMC Board approved amendments to the strategy of the FCMC's activities for 2012–2014 by defining three strategic priorities aimed at a more efficient implementation of the functions of a supervisory authority:

- to streamline the regulatory framework and supervise the performance of the financial and capital market and of market participants including participation in the process of establishing a single EU framework for crisis management and recovery and resolution framework, promoting free and fair competition and diversification of the financial market as well as participation in the introduction of the euro,
- to strengthen supervisory framework and promote soundness, competitiveness and development of the financial market including enhancement of macro supervision, stronger monitoring of the performance of market participants and supervision of the internal control system;
- to improve the level of financial education and awareness as well as to protect interests of investors, depositors and the insured persons.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

Regulatory developments

Amendments to the **Law on the Financial and Capital Market Commission** took effect whereby the FCMC was entrusted with the authority to carry out on-site searching and inspecting upon receipt of permission by a judge and in the presence of the State Police.

In 2012, the FCMC adopted also a number of regulations that were directed towards strengthening internal governance and improving risk management.

The **Regulations for Establishing the Internal Control System** establish more stringent requirements for the level of knowledge, skills and experience needed for the members of supervisory boards and management boards of credit institutions in accordance with the "Principles for enhancing corporate governance" by the Basle Committee on Banking Supervision and "Guidelines on Internal Governance" by the European Banking Authority (EBA).

Amendments to the **Regulations on the Compliance with Restrictions on Exposures** were developed to specify the establishment of internal limits for claims on institutions taking also into account risks that a bank is likely to incur in transactions with other banks. However, amendments to the **Regulations on the Information Disclosure** were prepared to promote the introduction of the best practice for disclosing information on remuneration and ensure disclosing of information in accordance with the guidelines of the EBA.

Supervision

In 2012, the FCMC was expanded to enable a more efficient implementation of the supervisory function – it has been authorised to carry out on-site searching and inspecting upon receipt of permission by a judge and in the presence of the State Police. The FCMC also started applying new and innovative supervisory techniques thereby enhancing the protection of customer interests.

In 2012, the following priorities were determined in banking supervision, namely:

- to assess adequacy of the capital basis of Latvian banks;
- to assess sufficiency and quality of liquidity maintenance and management;
- to assess sufficiency of banks' work with problem loans and recognition of loan impairment losses in their statements;
- to assess the potential impact of banks' activity strategy on the structure and volume of risks.

In performing 35 on-site inspections and analyzing financial statements of banks the FCMC continued monitoring the measures taken by banks for ensuring efficient credit risk management in loan restructuring. Apart from individual bank on-site inspections, also horizontal reviews were carried out to assess the credit restructuring process and market risk management in these banks, as well as enforcement of policies under the FCMC regulations. Internal capital adequacy assessment processes were thoroughly evaluated in the banks to clarify whether minimum capital adequacy requirements were sufficient to cover credit risk, market risks and operational risk inherent in the bank activities and if there were no other material risks arising from the bank activities (for instance, concentration risk, interest rate shift risk in a banking book and other) where capital add-on would be required to cover risks.

The FCMC has entered into the cooperation and information exchange agreements with all foreign supervisory authorities regarding bank group supervision, if subsidiaries of their banks operate in Latvia or Latvian banks have subsidiaries in their countries. The FCMC representatives participated in the colleges of supervisors on a regular basis. The FCMC continued regular supervision of parent bank exposures in Latvia which are registered in the EU Member States to all type of debt instruments and capital, as well as net deposits granted to banks in Latvia.

Consumer education

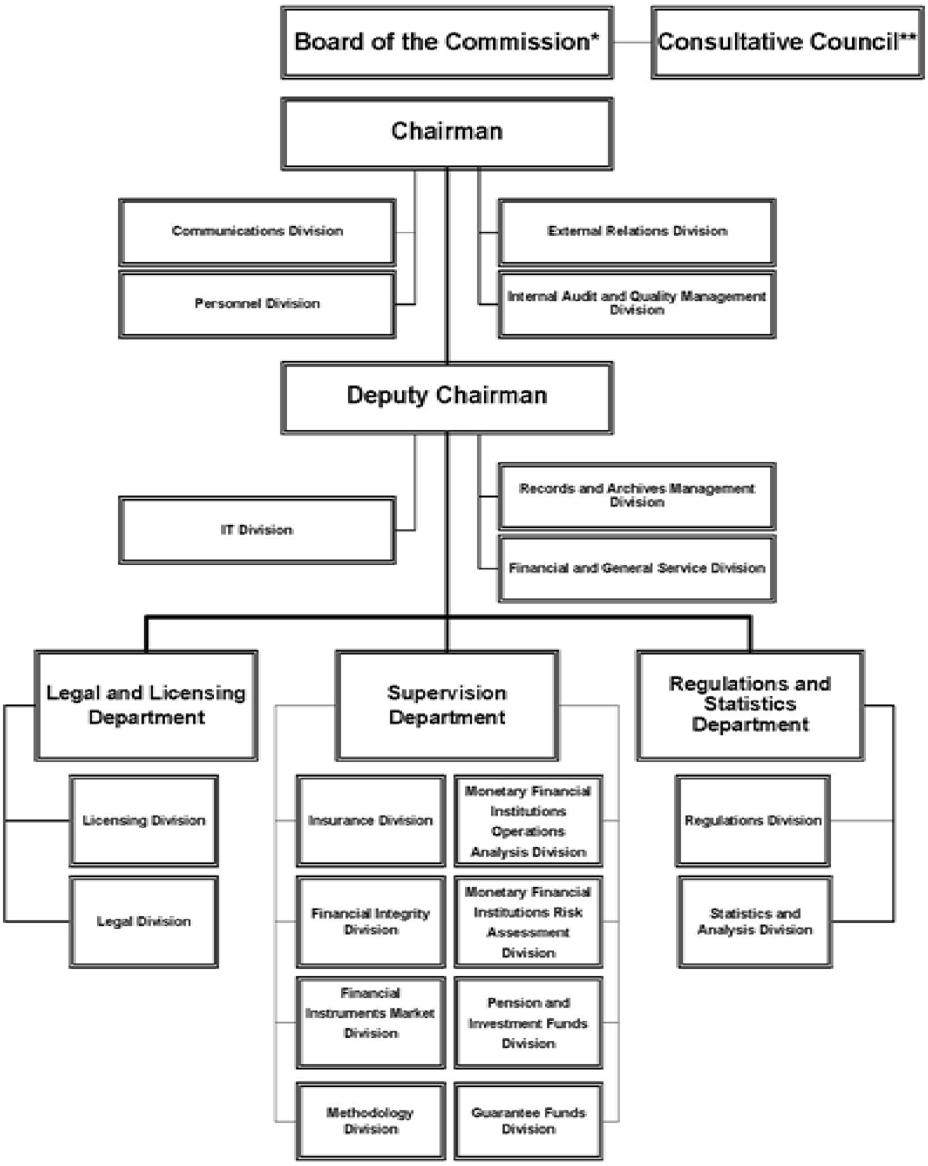
Promoting financial knowledge is one of the FCMC priorities to ensure that people are increasingly aware of the products and services available in the financial sector and the potential risks related thereto. In 2012, the FCMC became the coordinating authority for financial awareness issues between the financial sector institutions and public institutions in continuing education programmes. The FCMC signed a cooperation agreement with the National Centre for Education whereby information will be exchanged to improve the content of education. Work is on-going to improve the FCMC's education site KLIENTU SKOLA (Customer School, available in Latvian at www.klientuskola.lv) that provides objective information about the most frequently used financial services.

Since banks cannot be grouped according to single criteria, we have suggested a solution by establishing an informative tool BANK COMPASS: it provides the key performance indicators of banks on the basis of their publicly available quarterly reports. More detailed information is available on FCMC's website at www.fktk.lv.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

During the reporting year, notable changes took place in the composition of the FCMC Board. On 12 January 2012, new Chairman of the FCMC was appointed (Mr Kristaps Zakulis). At the end of the year, the Saeima of the Republic of Latvia appointed also new Deputy Chairman of the FCMC (Mr Pēters Putniņš) as the term of office of the previous one expired. On 1 March 2012, Director of the Supervision Department (Ms Jeļena Ļebedeva) was appointed as a Member of the Board of the FCMC.

New strategic priorities along with the goal to develop the FCMC and improve efficiency and transparency of its activities triggered organizational changes in the FCMC. At the beginning of 2012, the Communication Division was established. After the suspension of the activities of JSC „Latvijas Krājbanka" and first pay out of the guaranteed compensations from the Deposit Guarantee Fund the Guarantee Fund Division was established and due to the increasing volume of supervisory methodology the Methodology Division was formed. In 2012, also some administrative changes were made, namely, EU and International Affairs Division was renamed to External Relations Division as a result of extension of its functions on cooperation with other local governmental institutions, and Financial Division was merged with General Service Division.



*The Board consists of five Board members: Chairman of the Commission, Deputy Chairman of the Commission and three Board members, who are simultaneously directors of the departments of the Commission.

**The Consultative Council of the Financial and Capital Market is formed on a parity basis from representatives of the Commission and heads of professional organizations of financial and capital market participants.

INTERNATIONAL ACTIVITIES OF THE AUTHORITY

In 2012, negotiations on the legislative proposals concerning CRD IV/CRR, MIFID/MIFIR, MAD/MAR, Omnibus II, bank recovery and resolution mechanism, PRIPs and single banking supervision mechanism were conducted at the level of the Council of the EU. The FCMC's experts were involved in developing the national positions and discussing proposals in the Financial Services Working Group of the Council of the EU.

As a national supervisory authority the FCMC regularly participated in the work of the EBA and the European Systemic Risk Board (ESRB), their committees and working groups and made its contribution to the documents elaborated and negotiated by the EBA and the ESRB.

As regards cooperation with other supervisory authorities the FCMC gave priority to cooperation within the Nordic Baltic region. Exchange of information with the supervisory authorities of banking groups functioning in Latvia was ensured on a regular basis, especially in the framework of the colleges of supervisors. Also, exchange of views took place in the Nordic Baltic Stability Group that was created under the agreement in the area of cross-border financial stability, crisis management and prevention signed by the ministries of finance, central banks and financial supervisory authorities of the region. In 2012, cooperation with supervisory authorities of the Central and Eastern Countries was enhanced in order to negotiate positions regarding EU legislative proposals with the aim to defend interests of host countries' supervisors during the negotiation in EU.

COOPERATION WITH OTHER SUPERVISORY BODIES IN LATVIA

The FCMC is a unified financial sector supervisory authority in the Republic of Latvia.

STATISTICAL TABLES

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution	2010	2011	2012
Commercial banks	21	22	20
Branches of foreign credit institutions	8	8	9
Cooperative banks	0	0	0
Banking sector, total:	**29**	**30**	**29**

Ownership structure of the financial institutions on the basis of registered capital (%) (at year-ends)

Type of financial institution	2010	2011	2012
Public sector ownership	15.5	14.7	9.0
Other domestic ownership	15.5	20.3	27.1
Domestic ownership total	31.0	35.0	36.1
Foreign ownership	69.0	65.0	63.9
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions in 2012 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	49.3	69.2	0.116
Branches of foreign credit institutions	97.1	99.0	0.722
Cooperative banks	-	-	-
Banking sector, total:	**43.2**	**62.8**	**0.100**

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2010	2011	2012
Commercial banks	-20.4	-11.2	5.6
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**-20.4**	**-11.2**	**5.6**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2010	2011	2012
Commercial banks	87.9	87.7	86.6
Branches of foreign credit institutions	12.1	12.3	13.4
Cooperative banks	0	0	0
Other	0	0	0
Banking sector, total:	**100**	**100**	**100**

The structure of assets and liabilities of the banking system (%) (at year-end)

Assets	2010	2011	2012
Financial sector	25.2	25.0	28.7
Nonfinancial sector	64.9	64.6	60.2
Government sector	4.2	3.9	5.3
Other	5.7	6.5	5.8
Liabilities	**2010**	**2011**	**2012**
Financial sector	35.1	27.3	23.7
Nonfinancial sector	42.4	48.1	54.9
Government sector	4.4	2.1	3.6
Capital	7.3	7.5	9.3
Other	10.8	15.1	8.5

Capital adequacy ratio of banks

Type of financial institution	2010**	2011**	2012**
Commercial banks	14.64	17.40	17.61
Cooperative banks	-	-	-
Banking sector, total:	**14.64**	**17.40**	**17.61**

(* - for Basel I; ** - for Basel II)

Asset portfolio quality of the banking sector (share of impaired receivables / share of non-performing loans)

Asset classification	2010	2011	2012
Non financial sector	19.8	18.1	11.6
- households	18.7	19.6	15.1
- corporate	21.0	17.2	9.2

The structure of deposits and loans of the banking sector in 2012 (%) (at year-end)

	Deposits	Loans
Households	30.7	40.2
Government sector	5.9	0.7
Corporate	57.8	54.6
Other (excluding banks)	5.6	4.5
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends)

P&L account	2010	2011	2012
Interest income	973 758	910 850	764 763
Interest expenses	633 532	478 464	317 081
Net interest income	340 226	432 386	447 682
Net fee and commission income	200 263	235 252	269 768
Other (not specified above) operating income (net)	188 507	187 959	215 231
Gross income	728 996	855 598	932 681
Administration costs	472 000	480 851	457 874
Depreciation	52 923	36 442	28 532
Provisions	721 905	542 400	228 197
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	721 905	542 400	228 197
Profit (loss) before tax	-517 832	-204 095	218 078
Net profit (loss)	-513 229	-254 211	174 079

Total own funds in 2012 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	2 723 024	2 357 970	365 054	0
Cooperative banks	0	0	0	0
Banking sector, total:	2 723 024	2 357 970	365 054	0

2012 DEVELOPMENTS IN THE LITHUANIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Lithuania's economic development in 2012 was among the strongest in the European Union. It was mostly stimulated by export that grew because of the capability of Lithuania's enterprises to compete on an international scale and record-high agricultural crops. However, household consumption expenditure growth decelerated and investment decreased. The unwillingness of enterprises to invest was driven most likely by the uncertainty surrounding further economic development of the main trading partners while stronger growth in consumer spending was hampered by a slower increase the disposable income of households. The growing economy improved the situation in the labour market — the average annual rate of unemployment dropped to 13.2 per cent (15.3% in 2011). Unemployment in all age groups of the population was less; however, the rate of unemployment among young people fell significantly.

In 2012 average annual inflation stood at 3.2 per cent — it was lower than in 2011 due to a slower rise of food and fuel prices associated with developments in international commodity markets. Development of global commodity prices was much more favourable to consumers than in 2011: food commodity prices decreased in 2012, the oil prices remained unchanged. Thus, the impact of external factors on inflation in Lithuania weakened, but remained substantially more important than that of domestic factors. In the context of a continuing rather complicated situation in Lithuania's labour market and slow growth of unit labour costs, core inflation related to domestic environment was modest.

DEVELOPMENT OF THE BANKING SYSTEM

In 2012, bank assets contracted slightly, yet the contraction from the previous year was insignificant — just LTL 0.5 billion (0.7%). As of 1 January 2013, banks assets stood at LTL 74.3 billion. The ratio of total assets to GDP comprised 70,71 %.

In 2012 a particularly rapid increase in deposits was observed and the loan portfolio picked up after a few years' pause. Following the contraction during the first quarter, the loan portfolio grew constantly during the remainder of the year. In 2012, the loan portfolio of banks grew by LTL 1.1 billion and amounted to LTL 52.9 billion as of 1 January 2013.

Albeit dominating particularly low interest rates, deposits of the banking sector grew significantly in 2012. Deposits within the banking sector as of 1 January amounted to as much as LTL 43,6 billion. Annual growth rate of deposits was even 9.6 per cent. With low interest rates, depositors look for more profitable saving instruments (e.g., the volume of Government saving notes placed increased); moreover, depositors do not tend to keep funds for a lengthy term, thus the share of demand deposits grew markedly.

In 2012, banks earned LTL 721.7 million profit — down by more than a third (35.6%) from 2011. Last year, the operations of six banks and six foreign bank branches were profitable; those of one bank and two foreign bank branches were loss incurring.

As of 1 January 2013, all banks (except AB Ūkio bankas) complied with all prudential requirements for banking activities. As of 1 January 2013, the bank capital adequacy ratio was 14.4 per cent (minimum requirements is 8%), the liquidity ratio — 40.8 per cent (minimum requirement is 30%).

The Supervision Service of the Bank of Lithuania constantly encourages banks to hold capital buffer in line with their business profile that would be much higher than the minimum required capital level. The issue of capital levels will become still more relevant after entering into effect of amendments to the Capital Requirements Directive, when capital ratios will be tightened. Banks perform on an annual basis the internal capital assessment process to assess all the risks they face and the results of stress testing. During this process, all banks operating in Lithuania self-established the capital adequacy ratios at least 2 percentage points higher than the minimum requirement.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS IN LITHUANIA, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN LITHUANIA

On 2 January 2012, a new structural unit at the Bank of Lithuania — the Supervision Service — started operating. Having merged three institutions that supervised separate financial market segments, the responsibility for the supervision of the whole financial market was shifted to the Bank of Lithuania. The functions performed by the Bank of Lithuania in the area of supervision also expanded, i.e., alongside prudential supervision, the supervision of the provision of financial services started as well. This new infrastructure enabled supervision of all financial market participants according to the same principles, to pursue reliable and effective operation of the financial market, responsible behaviour of market participants and rational decisions made by consumers. This year saw a supervision integration process of three different financial sectors — different supervisory systems were merged into a single, more progressive one, uninterrupted supervisory process was ensured. Introduction of the new supervisory model entailed a change of supervisory principles of the financial market participants — supervision has become more future-oriented, with the main focus on identification of all risks and problems, and decision making at an early stage. Moreover, a more risk-oriented supervisory process, began to be implemented by performing the closest supervision of systemically important and the riskiest financial market participants of individual sectors, thus enabling pursuit of a more reliable and safer financial system. The IMF positively assessed the actions of the Bank of Lithuania in the field of supervision.

MAIN STRATEGIC OBJECTIVES OF THE BANKING SUPERVISORY AUTHORITY IN 2012

The main strategic objective of the newly structured supervisory authority was to implement the most effective supervisory practices and innovative management techniques to become a symbol of trust in society and leading financial market supervisory authority in the Nordic-Baltic region.

Vision

Risk-based supervision: focus on systemically important and risky financial market participants as well as high-risk activities.

Activity focused on the prevention: identify the risks and problems at an early stage and take timely appropriate supervisory actions.

Result orientated initiative and openness: achieve results by taking initiative for open communication, cooperation, consultation with consumers and consulting, market participants and public authorities and other interested parties.

Values-based activity: create a values-based organization culture and an attractive environment to employees, which would motivate them to get involved in activity, take the initiative, learn, improve and stimulate for innovate solutions, promote communication and cooperation.

Philosophy

Responsibility. We work for a person and a society honestly, attentively and in full of sense. We admit our mistakes and strive not to repeat them. We always seek the best results for Lithuania.

Professionalism. We constantly deepen our knowledge, accumulate experience, develop and apply innovations. We are open, proactive and creative. We create public value trying to prevent and resolve problems in advance.

Respect and Cooperation. We like working together, thus we achieve better results. We promote discussions with all our stakeholders. We value different approaches and respect each other.

Goals

Issue licenses only to transparent and financially capable financial market participants operating in a market and ensure that their managers and other responsible bodies are competent and of an impeccable repute.

Regulate activities of financial market participant so that they operate safely and soundly and that the conditions are set for a sustainable development of the financial market.

Supervise financial market participants in such a way that they have adequate capital, sufficient liquidity, are effectively managed and the risks assumed by them are appropriately managed.

THE ACTIVITIES OF BANKING SUPERVISORY AUTHORITY IN 2012

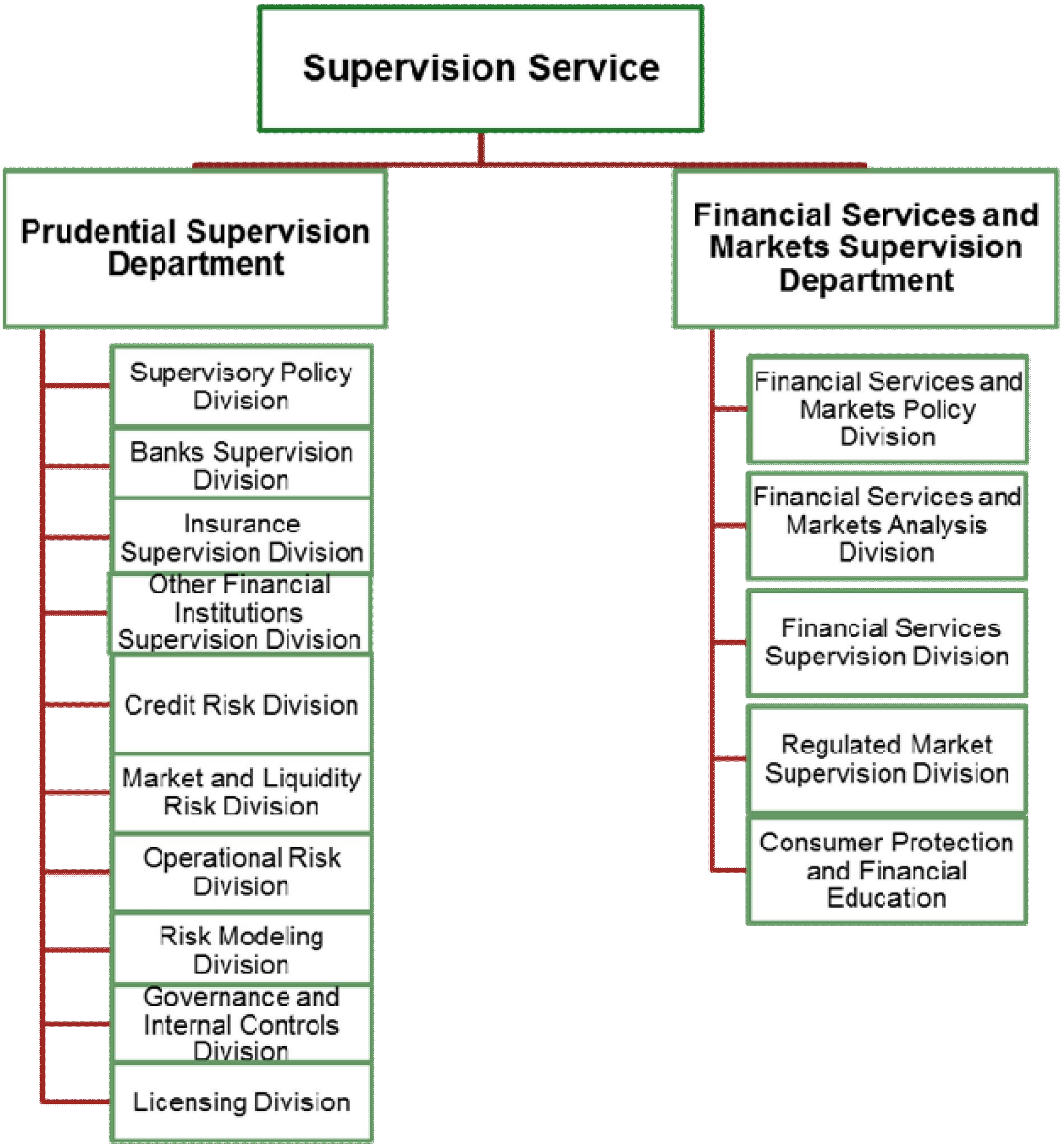
In 2012 the main activities were cantered in three main areas – licensing, regulation and supervision.

In the area of licensing, the work was done integrating licensing systems of different financial sectors into one and developing a modern and unified licensing system; and revising of the procedure of assessing the qualification, experience, and repute of management of the financial market participants and setting higher standards for managers, including the possibility to examine them. High quality new electronic licensing forms (instead of paper ones) were implemented and a functional register of electronic licenses (permissions) was developed.

In the area of regulation the main work was centred in the review process of legal acts leading to harmonization of the prudential supervision requirements to the overall financial sector. In implementing CRD IV/CRR Directive and Regulation of banks and investments firms, supplement legal acts of the BoL in relation to capital adequacy and risk assessment reform the preparatory work was done. In implementing EBA guidelines, a document regulating internal governance of banks has been drafted. Legal act regulating organization of internal controls and risk assessment (management) (requirements for risk strategy, risk control etc.) was redrafted. A transparent consultation process of legal acts with public was established. Supervisory policy exerts were consulting and providing methodological assistance to financial market participants during the process of implementation of the changes of BoL legal acts and EU documents of direct application (regulations and technical standards).

In the area of supervision of banks the main work was concentrated in developing a new supervision model of institutions using the best practice of three former supervisory authorities as well as positive trends of other EU countries. A system, according to which a detail analysis of each bank was carried out quarterly (together with experts of different risk areas, receiving the additional information from banks, with more access rights to registers) was developed. A unified on-site inspection methodology and procedures of market participant, integrate different on-site inspection practices taking into account the transformed supervision model was prepared. The supervision system of market participants according to Pillar II (RAS), SREP and ICAAP were improved. An analysis of remuneration and other compensation mechanism in banks was made. More intensive dialogue with financial sector participants (regular meetings with management boards, managers) was established.

THE ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

The major banks and branches of foreign banks operating in Lithuania's financial sector belong to large financial groups. Therefore, the Bank of Lithuania, in conducting the supervision of banks within these groups, regularly cooperates with the financial sector supervisory authorities of other countries. Particularly intensive cooperation is maintained with representatives of the supervisory authorities of the financial sector of Sweden and the Baltic States.

Lithuanian supervisors also actively cooperate at supervisory colleges. Their activities involve representatives of the financial supervisory authorities of all countries in which a certain banking group is operating. These colleges are highly important in carrying out the function of banks relevant information on the activities and performance of banks and their groups, the economic situation in individual countries is exchanged at these colleges, prospects for the supervision of financial institutions are discussed, a joint supervisory strategy is prepared there. In 2012, representatives of the Bank of Lithuania participated in the activities of banking supervision colleges founded by financial supervisory authorities of Denmark, Latvia, Norway and Sweden.

Risk assessment of supervised units within the group, performed by individual countries continued to be the most important issue at banking supervisory colleges. When carrying out on-site inspections of banks or performing verification of foreign bank branches, the Bank of Lithuania cooperates with financial supervisory authorities of foreign countries.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

Particularly intensive work in 2012 was done in relation to AB Ūkio bankas. During the on-site inspection of AB Ūkio bankas at the end of 2012–beginning of 2013 it was established that the Bank's assets were significantly overestimated, its liabilities exceeded its assets, and the Bank de facto was insolvent. Moreover, independent auditors conducted valuation of the Bank's assets and identified significant mismatches in the real value of the assets. Major problems of AB Ūkio bankas are related with irresponsible actions of its main shareholder, financing of business projects related to him, and not implemented business projects. The Bank of Lithuania had for more than a year already closely controlled transactions concluded by AB Ūkio bankas, applied various restrictions, approved for AB Ūkio bankas a plan according to which it was requested to gradually reduce the exposure to credit risk. All these measures did not lead to desirable results, though; to ensure the Bank's operation, additional capital was necessary, but the Bank's main shareholder did not provide it. Given these circumstances, the Board of the Bank of Lithuania declared a moratorium on the Bank's operations on 12 February 2013, appointed a temporary administrator, and six days later announced the Bank as de jure insolvent and revoked its banking licence. In the findings of the Temporary Administrator submitted to the Board of the Bank of Lithuania it was proposed to separate part of the assets and liabilities of AB Ūkio bankas and to transfer them to some operating bank. The suspension of the operations of AB Ūkio bankas did not have a systemic impact on the banking sector.

Particularly strong focus was given to strengthening of supervision of credit unions — more stringent requirements were set for the top management of credit unions. Persons not complying with these requirements and applicants for such positions were obliged to take a special examination. Aiming at sustainable development of credit unions and proper management of risk assumed by them, new prudential requirements (liquidity, capital adequacy, maximum exposure requirement) have been set. The supervision of systemically the most important (the largest) and the riskiest credit unions was also tightened, the number of inspections has been increased.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS IN THE COURSE OF LAST YEAR

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STATISTICAL TABLES

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution	2010	2011	2012
Commercial banks	9	8	8
Branches of foreign credit institutions	11	12	8
Cooperative banks*	69	75	78
Banking sector, total:	**89**	**95**	**94**

Ownership structure of the financial institutions (at year-ends)

Type of financial institution	2010	2011	2012
Public sector ownership	-	-	-
Other domestic ownership	-	-	-
Domestic ownership total	21.1	12.3	12.7
Foreign ownership	78.9	87.7	87.3
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	85.3	96.3	1596
Branches of foreign credit institutions	98.4	99.0	179
Cooperative banks	27.8	35.7	0
Banking sector, total:	**86.4**	**95.3**	**1775**

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2010	2011	2012
Commercial banks	-4,72	15.23	6.57
Branches of foreign credit institutions	-4.3	-9.3	-30.8
Cooperative banks*	-	-	-
Banking sector, total:	-	-	-

Distribution of market shares in balance sheet total (%)

Type of financial institution	2010	2011	2012
Commercial banks	79.9	78.8	77.5
Branches of foreign credit institutions	18.2	19.1	19.9
Cooperative banks	1.9	2.1	2.6
Other	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

Capital adequacy ratio of banks

Type of financial institution	2010**	2011**	2012**
Commercial banks	15.64	13.92	14.17
Cooperative banks	20.16	19.76	16.53
Banking sector, total:	15.71	14.04	14.23

(* - for Basel I; ** - for Basel II)

Asset portfolio quality of the banking sector (share of impaired receivables / share of non-performing loans)

Asset classification	2010	2011	2012
Non-financial sector	19.50	16.27	13.87
- households	**x**	**x**	**x**
- corporate*	**x**	**x**	**x**

*Information not available for this type of breakdown

The structure of deposits and loans in 2012 (%) (at year-end)

	Deposits	Loans
Households	57.43	41.87
Government sector	7.20	6.20
Corporate	32.89	46.51
Other (excluding banks)	2.48	5.42
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends)

P&L account	2010	2011	2012
Interest income	939.8	593.1	664.4
Interest expenses	593.6	283.0	334.8
Net interest income	346.2	310.1	329.6
Net fee and commission income	195.8	151.0	176.0
Other (not specified above) operating income (net)	-22.3	-	-21.7
Gross income	576.6	470,7	527.3
Administration costs	316.7	252	130.8
Depreciation	26.5	21.4	18.7
Provisions	-18.0	-4.5	2.4
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	209.9	-51.9	-16
Profit (loss) before tax	-92.5	322.2	236.6
Net profit (loss)	-81.1	288.3	209.0

Total own funds in 2012 (in mln EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	1846.8	1739.9	106.9	-
Cooperative banks	52.0	44.3	7.7	-
Banking sector, total:	1898.8	1784.2	114.6	-

2012 DEVELOPMENTS IN THE BANKING SYSTEM OF THE REPUBLIC OF MACEDONIA

MACROECONOMIC ENVIRONMENT

In 2012, the Macedonian economy contracted by 0.3% despite the economic growth of 2.8% last year. The contraction of the Macedonian economy was mainly related to the deterioration of the external economic environment, i.e. the decline of the euro-zone economy and the foreign effective demand of the Macedonian economy. On the production side of the economy, the contraction led to shrinkage of the industrial production that contributed wholly for the annual decline of the domestic GDP. From the demand side, the worsening of the external economic environment resulted in increased uncertainty about the expected income of the households in future that led to decline of the personal consumption that, together with the annual fall in the exports, contributed fully for the shrinkage of the domestic economy.

The average annual inflation in 2012 decelerated to 3.3% from 3.8% in 2011.

In 2012, the external position of the Macedonian economy remained relatively favorable despite the increased risks in the external environment. The current account deficit increased by 0.9 p.p. of GDP on annual basis and it equaled 3.9% of GDP. This increase of the current account deficit was mainly caused by the larger trade deficit that widened additionally by 1.3 p.p. of GDP in 2012. The trade deficit was mainly financed by the net-inflow of private transfers that reached the historical pick of 21.5% of GDP. Net-inflows on the capital and financial account (excluding official reserves), moderated slightly in 2012, but they were still sufficient to finance the capital account deficit. The largest part of the capital and financial account inflows in 2012 came from the trade credits that registered substantial rise in 2012 on annual basis. The net foreign direct investments declined in 2012 on annual basis, due to the deterioration of the external economic environment of the Macedonian economy that increased the risk aversion of foreign investors, as well as the outflow of foreign direct investments on the basis of intercompany loans from the foreign owned companies in Macedonia to their parent companies abroad. The net inflows in the balance of payments contributed for the foreign reserves to reach their historically highest level of Euro 2,193 million or 29.2% of GDP at the end of 2012 that are high enough to cover more than 4 months of imports.

DEVELOPMENT OF THE BANKING SYSTEM (INCLUDING THE ASSETS TOTAL/GDP). STRUCTURE OF THE BANKING SYSTEM

In 2012, due to the unfavorable economic conditions in the country and abroad, total activities of the banking system grew with slower pase than the previous years. Banks' perceptions for the real sector risks, the increase in the credit risk, as well as the conservative policies of part of the parent entities due to the financial deleveraging, impacted the slower increase of banks' lending activity in 2012. The intensified banks' investments in low-risk securities, given reduced placement of assets on foreign bank accounts verify the banks risk awareness. Although these factors can prevent larger credit growth in the following period, the National Bank forecasts, however, continue to indicate possible moderate credit growth in 2013 and 2014. It is expected that under the influence of expectations for more stable environment, the deposit growth, the strengthening of the global economy, as well as the monetary policy changes made during 2012 and early 2013, will ensure larger financial support to the non-financial sector.

As of December 31, 2012, the total assets of the banking system equaled Denar 352,886 million, which meant an annual growth rate of 6.6%, being the lowest in the last ten years. The asset structure underwent certain changes, with a slowdown of the credit growth, increase of the securities investments and decrease of the placements with banks and other financial institutions. Regarding the degree of financial intermediation of the banking system, at the end of 2012 there was an increase of all indicators. The assets-to-GDP ratio equaled 76.3%, which is an increase of 4.6 percentage points relative to 2011. The gross credits and the deposits reached 46.7%, i.e. 53% of the gross domestic product, respectively (growth of 2.9 percentage points, i.e. 2.3 percentage points, respectively, compared to 2011).

The increase of the credit risk and the deteriorated risk perceptions of the banks contributed to an annual credit growth rate of 6.8%.

The annual growth rate of the deposits in 2012, as the main drvier of the assets movements, equals 4.8%. The long term household deposits are the main generator of the banks' deposit base. The enterprise deposits registered a decrease. The denarization, due to the strengthened preferences to save in domestic currency, which began at the end of 2011, endured in 2012, and continued in 2013.

The growth rate of the nonperforming loans decelerated in 2012 (12.9%, compared to the growth rate in 2011, which equaled 16.2%). At the end of 2012, the NPL ratio equaled 10.5% (0.6 percentage points higher compared to 2011). The increase in the nonperforming loans almost fully arises from the corporate sector. The level of the nonperforming loans is monitored carefully, and for the time being, it is not the reason for serious concern, having in mind its full coverage with the accrued impairment.

The liquidity of the banking sector is stable and high. The stable liquidity is due to the constant rise of the liquid assets, which surged by Denar 10,702 million, i.e. 10.7% in 2012. The liquid assets remain to comprise one third of the total assets of the banking sector, covering 53% of the total household deposits.

Parallel to the stable liquidity, the high solvency is the second pillar of the banking system stability and its resilience to schoks. As of December 31,2012, the capital adequacy ratio equaled 17.1% being twice higher than the regulatory minimum of 8%. The profitability of the banking system improved, due to the increase of the income arising from the main banking activity, i.e. the net interest income. The ROA and ROE increased substantially, and on December 12,2012 they equaled 0.4% and 3.8%, respectively. Operational efficiency of the banks improved.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN MACEDONIA

The National Bank of the Republic of Macedonia (NBRM) is Banking Supervisory Authority responsible for licensing and supervision of banks and savings houses in the Republic of Macedonia. Within the National Bank of the Republic of Macedonia, the Supervision, Banking Regulations and Financial Stability Division (Three Departments: Off-site Supervision and Licensing, On-site Supervision and Financial Stability and Banking Regulations) performs the supervisory function.

These competences of the NBRM are regulated with the Law on the National Bank of the Republic of Macedonia and the Banking Law. The Banking Law and the relevant by-laws follow the provisions of the Capital Requirements Directive, as well as the principles and standards developed by the Basel Committee on Banking Supervision and the European Banking Authority.

In order to achieve further enhancement of the banking regulatory framework, in 2012 the following acts were prepared and adopted:

- A new Decision on the methodology for determining capital adequacy, which determines capital requirements for banks for credit, operational and market risks in line with the standardized approaches under Basel II;
- Amendments to the Decision on accounting and regulatory treatment of foreclosed assets, which required banks to provision the assets foreclosed until the adoption of the amendments in the amount of at least 20% p.a of the value of that asset[18];
- Amendments to the Decision on risk management, which prescribes in more details the requirements regarding the ICAAP of banks, its main elements, manner of reporting to NBRM, etc;
- Ammendments to the Decision on the manner of conducting supervision and inspection, which regulated the procedure of reporting to audit company when the examination report contains findings concerning the operations of the audit company. Additionally, the amendments enable for more detailed regulation of procedure for supervising the opreation of persons connected with the bank, other entities in the banking group and ancillary service undertakings.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2012

Maintaining of the stability of the banking system as a basic prerequisite for financial stability and sustainable economic growth is the main strategic objective of the National Bank as the Macedonian banking supervisory body. This objective is achieved by:

[18] At the beginning of 2013, NBRM has issued a new Decision on accounting and regulatory treatment of foreclosed assets, which prescribes in more details the treatment of these assets, from the time of their foreclosure until their sale by the bank.

1. Further improvement of the supervision of banks and savings through strengthening of the capacity for risk-based supervision, including corporate governance of banks, as well as strengthening the capacity for supervisory assessment of the banks' ICAAPs.
2. Enhancement of financial stability tools by further improvement of the methodology for determining systemically important banks, comprehensive analysis of the real estate market, organizing survey for households, performing regular stress-test analyzes, including macro-stress analysis and further capacity building for application of econometric techniques in order to create a model for screening of important positions of banks' balance sheets.
3. Continuous improvement of banking regulations by completing the implementation of Basel II (advanced approaches) and preparatory work for implementation of Basel III.
4. Harmonization of banking supervision and regulatory framework with the new Basel Principles for Effective Banking Supervision (issued in September 2012).
5. Maintaining stability of the financial system by expanding the cooperation with other supervisory authorities, the Deposit Insurance Fund and the Ministry of Finance.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2012

In 2012, the planned activities for revision of the risk-based supervision methodology were completed. Procedures for assessment of credit risk, currency risk, liquidity risk, interest rate risk, money laundering risk, operational risk and risk of inadequacy of information systems were revised.

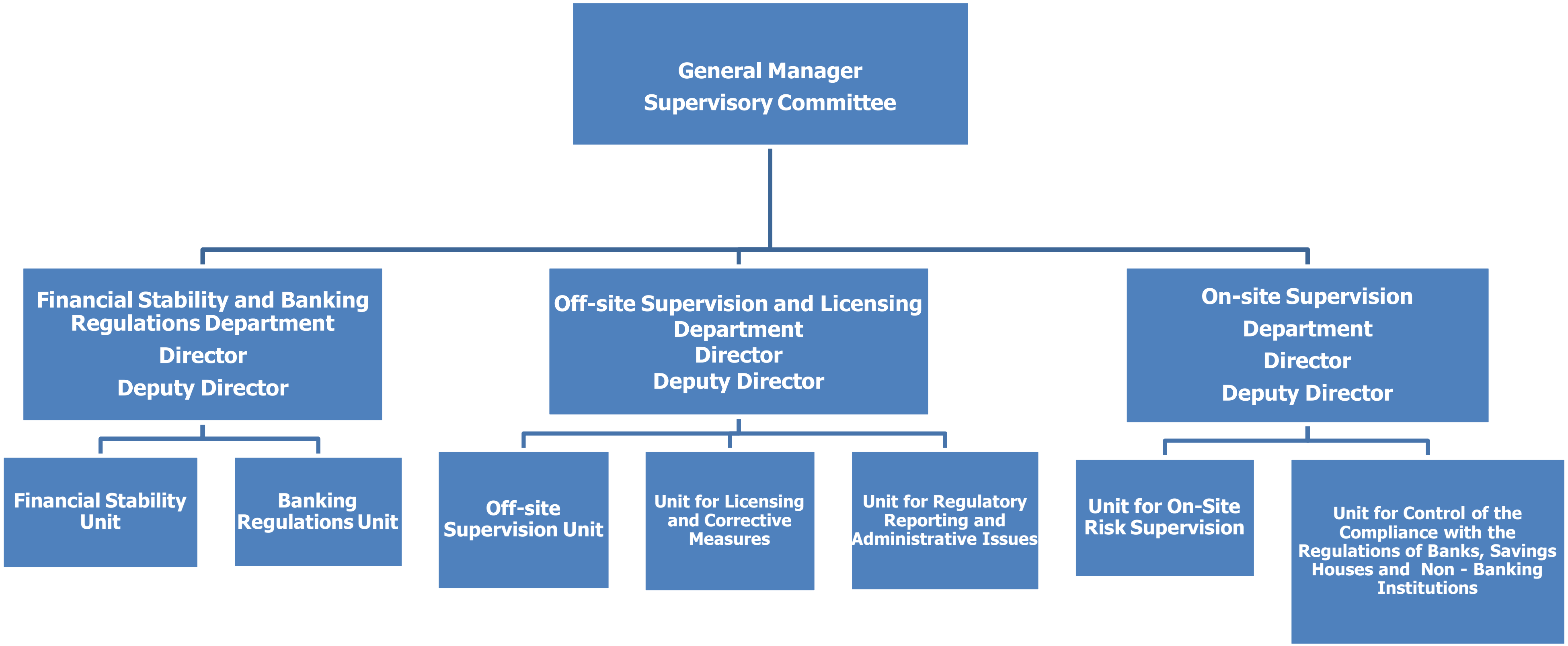
During 2012, NBRM performed 18 targeted on-site examinations, of which 17 examinations of banks and one of a saving house. Examinations were focused on credit risk, liquidity risk, earnings performance, determining the status of corrective measures, operational risk, IT risk and the ICAAP methodology. In addition to the regular controls, three extraordinary on-site examinations were conducted in this period.

The off-site supervisory function of the NBRM is carried out through 3 cornerstone activities: licensing (issuing licenses and approvals to banks and savings houses), regular off-site supervision of the operations of the banks and the savings houses and undertaking corrective actions. Within this framework, during 2012 the National Bank has performed the following activities:

- 10 different types of licenses and approvals were issued, among which the main were related to issuing: approvals for appointment of members of the Boards of Directors and members of the Supervisory Boards, amending and/or supplementing the Statute of the banks and approvals for shareholders with qualified holdings in the banks. In 2012 one license for acquisition of one bank by another was issued. Also, a prior consent for termination of the operation of one savings house was issued, i.e. its founding license was revoked and it was determined that the conditions for conducting liquidation procedure were fulfilled.

- Regular off-site analysis of the operations and the risk profiles of banks.
- Within its legal authorization, and in order to maintain the stability and the safety of certain banking institutions and the whole banking system, the NBRM undertook corrective actions towards banks and saving houses where irregularities, noncompliance and illegitimacies in their operation were found. The aim of the bulk of the undertaken measures was the improvement of certain elements of the risk management systems of banks.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

The cooperation with foriegn supervisory bodies continued in 2012 under the signed MoUs. Among other activities, within this cooperation, NBRM supervisory staff attendend several supervisory colleges (in two countries).

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

The collaboration of the domestic supervisory authorities in 2012 was further enhanced. Macedonian financial supervisors started with a new practice of organizing quarterly meetings, during which the main trends, regulatory changes and risks for the financial system are discussed.

In addition, in 2012 the Committee for Financial Stability became operational. Its establishment and operation is defined with the Memorandum of Understanding signed between the NBRM and Ministry of finance for maintenance, while its main task is to monitor and guard the financial stability. Members of the Committee are the Minister of Finance and the Governor of the NBRM and other relevant representatives from the two institutions.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

As of the end of 2012 the National bank of the Republic of Macedonia has issued draft version of the Methodology for identifying systemically important banks and additional loss absorbency requirements based on selected indicators according to their potential impact on the stability of the Macedonian financial system and the real economy. The process of identification and ranging of the banks according to their systemically importance takes into account a number of quantitative indicators classified in four categories: size, interconnectedness, substitutability and complexity and also an additional qualitative category (the role of the Deposit Insurance Fund and reputational effects, that might influence on the extension of the list of indentified systemically important banks). For each identified systemically important bank additional loss absorbency requirement is defined, according to the level of systemic importance to which it fits in.

In the second half of 2012, initial steps were made towards constructing a banking stability indicator as an attempt to assess the risks to financial stability by focusing on a set of key financial soundness indicators of the banks for the period from December 31, 2005 to December 31, 2012, on a quarterly basis. Indicators that are included in the index are selected on the basis of their relevance to the stability of the banking system, given its nature and size (capital adequacy; credit, liquidity and currency risk and profitability).

In 2012, as part of the technical assistance from the World Bank, NBRM launched a project on Contingency Planning (CP). The aim of the project is to assist the NBRM in developing a CP to ensure a prompt and effective response to financial distress and potential systemic crisis, including guidance on assessing the solvency of a bank or banks in a short period of time to support lender of last resort functions. The main goal of the proposed crisis contingency plan is to prevent or reduce the impact of a crisis by taking action to: 1/ Better understand the risks and inter-connections of the financial system; 2/ Use supervision to strengthen the resilience of banks; 3/Put in place: legislation, policies, organization, arrangements and tools for crisis management; 4/ Have a strategy to manage a crisis using carefully selected scenarios; and 5/ Have resources available: financial and human to develop and execute the plan.

STATISTICAL TABLES

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution	2010	2011	2012
Commercial banks	18	17	16
Branches of foreign credit institutions	0	0	0
Cooperative banks	0	0	0
Banking sector, total:	**18**	**17**	**16**

Ownership structure of the financial institutions on the basis of registered capital (%) (at year-ends)

Type of financial institution	2010	2011	2012
Public sector ownership	2,3%	3,1%	3,5%
Other domestic ownership	4,8%	4,5%	4,4%
Domestic ownership total	7,1%	7,6%	7,9%
Foreign ownership	92,9%	92,4%	92,1%
Banking sector, total:	**100.0%**	**100.0%**	**100.0%**

Concentration of asset by the type of financial institutions in 2012 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	61,7%	74,5%	1 456
Branches of foreign credit institutions	0	0	0
Cooperative banks	0	0	0
Banking sector, total:	**61,7%**	**74,5%**	**1 456**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2010	2011	2012
Commercial banks	100,0%	100,0%	100,0%
Branches of foreign credit institutions	0,0%	0,0%	0,0%
Cooperative banks	0,0%	0,0%	0,0%
Other	0,0%	0,0%	0,0%
Banking sector, total:	**100,0%**	**100,0%**	**100,0%**

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2010	2011	2012
Commercial banks	7,3%	3,4%	3,8%
Branches of foreign credit institutions	/	/	/
Cooperative banks	/	/	/
Banking sector, total:	7,3%	3,4%	3,8%

P&L account of the banking sector (at year-end)

in million of Denars*

Type of financial institution	2010	2011	2012
Interest income	19 535	19 522	20 104
Interest expenses	-9 138	-9 120	-8 734
Net interest income	10 397	10 401	11 370
Net fee and commission income	3 383	3 482	3 790
Other (not specified above) operating income (net)	1 586	2 356	2 497
Gross income	15 366	16 240	17 656
Administration costs**	-8 926	-9 318	-9 556
Depreciation	-1 150	-1 145	-1 084
Provisions***	-93	-676	-972
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)****	-2 856	-3 883	-4 540
Profit (loss) before tax	2 340	1 218	1 504
Net profit (loss)	2 307	1 183	1 461

* 1 EUR = 61,6625 MKD, as of 31.12.2012
** Administration costs include all operating expenses.
*** Provision items include: impairment losses of non-financial assets, provisions for off-balance sheet items and other provisions.
**** Presented on net basis.

The structure of assets and liabilities of the banking system (%)
(at year-end)

Assets	2010	2011	2012
Cash and balance with NBRM	11,4	11,5	11,7
Nbrm bills	8,5	9,7	7,4
Debt securities	6,1	5,0	8,5
Placements to other banks	13,3	13,1	12,2
Placements to clients	55,1	54,7	54,1
Accrued interest and other assets	2,6	3,1	3,0
Securities investments	0,3	0,3	0,4
Fixed assets	2,7	2,5	2,8
Non allocated reserves for potential losses	0,0	0,0	0,0
TOTAL ASSETS	**100,0**	**100,0**	**100,0**
Liabilities	**2010 (%)**	**2011 (%)**	**2012 (%)**
Deposits of financial institutions	0,1	4,2	4,9
Sight deposits of nonfinancial entities	24,2	23,0	22,3
Short-term deposits up to one year of nonfinancial entities	34,9	35,3	32,7
Short-term borrowings up to one year	1,2	1,1	0,9
Long-term deposits over one year of nonfinancial entities	2,6	2,2	2,1
Long-term borrowings over one year	10,8	12,4	14,5
Provisions for off-balance sheet liabilities and other provisions	9,5	10,5	11,1
Equity and reserves	0,2	0,2	0,3
Other liabilities	10,6	11,0	11,2
TOTAL LIABILITIES	**94,1**	**100,0**	**100,0**

The structure of deposits and loans of the banking sector in 2012 (%) (at year-end)

	Deposits	Loans
Households	67,6	36,4
Public sector	0,4	0,8
Corporate	22,4	56,9
Domestic Banks	0,3	4,8
Foreign	4,7	0,8
Other	4,6	0,3
Total	**100.0**	**100.0**

Capital adequacy ratio of banks

Type of financial institution	2010	2011	2012
Commercial banks*	16,10%	16,80%	17,10%
Cooperative banks			
Banking sector, total:	16,10%	16,80%	17,10%

(* - for Basel I; ** - for Basel II)

Asset portfolio quality of the banking sector

Asset classification	2010	2011	2012
Non financial sector	9,30%	9,90%	10,50%
- households	**8,10%**	**7,50%**	**7,10%**
- corporate	**10,00%**	**11,40%**	**12,90%**

Total own funds in 2012 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	723,617,936	615,074,598	108,543,338	/
Cooperative banks	/	/	/	/
Banking sector, total:	723,617,936	615,074,598	108,543,338	/

2012 DEVELOPMENTS IN THE BANKING SYSTEM OF THE REPUBLIC OF MOLDOVA

MACROECONOMIC ENVIRONMENT

According to the National Bureau of Statistics data, in 2012 the GDP recorded a contraction of 0.8 percent in real terms compared to 2011, primarily due to the negative development of the agricultural sector, attributable to a pronounced drought, and due to a poor domestic demand.

At the same time, the external environment was less favorable, with the contracting European economy, which resulted in a moderate external demand, the exports increasing only by 2.3 percent. Household consumption increased by 1.0 percent in 2012, the increment being much lower than in 2010 and 2011, due to a slower growth in the population's disposable income and a reduced consumption of goods and services in kind. General government final consumption recorded an increase of 0.5 percent. By categories of resources, the GDP contraction was caused by the negative contribution from agriculture, which has dropped by 23.3 percent compared to 2011. Manufacturing and the extractive industry showed insignificant increases (1.0 and 2.0 percent, respectively), while the energy industry contracted by 2.6 percent compared to 2011. As a result, the industry's contribution to the GDP growth was negligible. A positive contribution was generated by the increase in gross value added of services (financial activities, health and social services, trade, real estate transactions, transport and communication). The modest growth rate in domestic consumption and the investment contraction led to a lower growth rate of imports of goods and services - 2.5 percent.

In 2012, the unemployment rate was of 5.6 percent, decreasing by 1.1 percentage points compared to 2011. However, the reduction in the number of unemployed people has not been accompanied by a positive trend in employment. It rather decreased by 2.3 percent, resulting in a lowering of the employment rate to the level of 38.4 percent (versus 39.4 percent in 2011). As a result, there was a 3.4 percent decrease in the economically active population.

The National Bank of Moldova has created the appropriate conditions to keep the inflation rate within the range of 5.0 percent ± 1.5 percentage points, a goal set for 2012 according to National Bank's monetary policy strategy for 2010-2012. Thus, in December 2012 the annual inflation rate was of 4.1 percent, by 3.7 percentage points lower than the 7.8 percent recorded in December 2011. The dry weather in the region, which caused increases in food prices, was the main factor that has exerted inflationary pressures during 2012. At the same time, price increases in the CPI were favored by side effects caused by rises in tariffs in the fall of 2011 and electricity tariff increments in May 2012. The main factor that weakened the price increase during 2012 was a lower aggregate demand than in the previous years due to the slowdown in the growth of household disposable income. The nominal exchange rate of the national currency against the currencies of major trading partners exercised, overall, disinflationary pressures in the reporting period.

In 2012, the Moldovan economy continued to be strongly influenced by the external economic environment (the euro area sovereign debt crisis and fiscal problems of the U.S., which led to an increased volatility of major currencies and a reduction in international trade), through the capital and trade channels.

During 2012 the nominal official exchange rate of the national currency against the U.S. dollar has weakened by 3.0 percent and against the EUR – by 6.1 percent as compared to the end of 2011.

At the same time, the real effective exchange rate of the national currency (calculated as compared to December 2000) depreciated by 3.8 percent as compared to December 2011. The respective change was due to a more favorable dynamics of domestic consumer prices compared to those of the largest trading partners and the nominal appreciation against the US dollar of some currencies (such as Polish zloty – by 8.0 percent, Hungarian forint – by 5.6 percent, Turkish lira – by 4.2 percent and Russian ruble – by 2.3 percent). All of the main trading partners, except Ukraine, have contributed to the depreciation of the Moldovan Leu in real effective terms.

During 2012 the exchange rate dynamics of the Moldovan Leu against the US dollar has been influenced by a series of factors, such as: an excessive amount of liquidity induced by a high FX supply from individuals and a weaker demand of FX from legal entities, a massive inflow of external credits, the evolution of foreign currencies on international markets and the NBM's interventions.

DEVELOPMENT IN THE BANKING SYSTEM

On December 31, 2012, there were 14 banks licensed by the National Bank of Moldova (NBM). Note that, from January 1, 2012 they moved to International Financial Reporting Standards (IFRS).

At the end of 2012, Tier I capital amounted to 432.05 million EUR. It decreased during 2012 by 35.79 million EUR (7.6 percent). As of 31.12.2012 all banks met the NBM requirements for Tier I capital (minimum required capital - 12.5 million EUR), with the exception of two banks. Tier I capital decrease was due to the increase in the calculated but unformed yet amount of allowances for impairment losses on asset and conditional commitments with 61.09 million EUR or 61.1 percent, which are excluded from the calculation of Tier I capital. Losses on assets and conditional commitments increased as a result of worsening loan portfolio quality at some banks.

System average risk-weighted capital adequacy still remains at a high level of 24.4 percent, well above the 16% prudential level.

Assets under IFRS amounted to 3636.28 million EUR, increasing by 657.44 million EUR (22.1 percent), compared to the previous year. The asset growth was determined by the increase in liabilities with 532.89 million EUR (21.5 percent) and the capital increase of 124.96 million EUR (24.9 percent). The assets of banking sector constituted 66.22% from GDP.

Gross loan portfolio increased during 2012 by 323.12 million EUR (17.3 percent) and constituted 2186.84 million EUR at 31.12.2012. The largest share of the total loan portfolio was held by loans to trade - 36.7 percent, followed by loans to agriculture and food industry - 16.8 percent and loans to productive industry - 8.3 percent. The share of non-performing loans (substandard, doubtful, losses) in the total amount of loans increased by 1.6 percent from the beginning of the year, and constituted 14.5 percent.

The net profit for the banking sector amounted to 35.79 million EUR. Compared with 2011, the profit has decreased by 14.57 million EUR (28.9 percent). This situation was determined by higher interest expense and non-interest expenses, as well as a decrease in non-interest income. Net interest margin was 5.1 percent, decreasing by 1.3 percent from the end of 2011. Return on assets and return on equity of licensed banks have equaled 1.1 percent and 5.6 percent respectively, decreasing by 0.7 percentage points and 5.0 percentage points respectively, compared to previous year.

Long-term liquidity in the banking sector amounted to 0.7 (maximum is 1.0) by December 31, 2012. Current liquidity in the banking sector was 32.9 percent (minimum requirement is 20.0 percent) at the end of 2012. Both indicators are met by all banks.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN MOLDOVA

The two-level banking system of the Republic of Moldova consists of the National Bank of Moldova and 14 commercial banks, of which 4 subsidiaries of the foreign banks and financial groups (Joint Stock Commercial Bank "EXIMBANK - Gruppo Veneto Banca", Banca Comerciala Romana Chisinau S.A., Commercial Bank "MOBIASBANCA - Groupe Societe Generale" S.A. and Commercial Bank ProCredit Bank S.A.).

According to the Law on National Bank of Moldova, the NBM is the institution that licenses, supervises and regulates the activity of financial institutions[19], including banks[20]. For this purpose, the NBM is empowered to issue the necessary normative acts and to undertake the proper measures in order to exercise its powers and duties under the legislation.

The current legal framework for banking in the Republic of Moldova is ensured by the Law on financial institutions, enacted in 1995. The respective Law determines requirements regarding the process of licensing banks, transparency of ownership, their organization and administration, operations, reporting and inspection, applying of remedial measures, sanctions and interventions as well as banks liquidation.

Simultaneously, in their activity, banks are guided by the provision of the normative acts issued by the National Bank of Moldova based on the Law on Financial Institutions through which are established requirements for licensing process, holding substantial shares in banks capital, requirements for capital,

[19] *financial institution* - a legal person engaged in the business of accepting deposits or their equivalents, that are not transferable by different payment instruments and that uses such funds in whole or in part to grant credits or to make investments on its own account and risk. (Art.2 of the Law on National Bank of Moldova and Art.3 of the Law on Financial Institutions).

[20] *bank* – a financial institution engaged in the business of accepting from natural or legal persons deposits or their equivalents, that are transferable by way of different payment instruments, and that uses such funds in whole or in part to grant credits or to make investments on its own account and risk (Art.2 of the Law on National Bank of Moldova and Art.3 of the Law on Financial Institutions).

liquidity, bank exposures, foreign currency position, assets and contingent commitments evaluation, banks investment in the capital of legal entities, reports to the National Bank of Moldova, banks' disclosures, internal control systems, etc.

During 2012 in order to align the provision of the legislation in force related to the professional/banking secret and the provisions of the EU were performed amendments in the Law on the National Bank of Moldova (art.36). Thus, the positions of keeping the professional/banking secret were strengthened and specific situations when the information and data, which were obtained in the license process and bank's supervision may be disclosed, were established.

MAIN STRATEGIC OBJECTIVES OF THE BANKING AUTHORITY IN 2012

During 2012, to access private financing investment through reforms for stimulating the banking sector, the National Bank of Moldova had as major aim to create an adequate legal framework on bank shareholders in order to ensure a high level of banks owners' transparency, as well as not to allow a proper influence on the banks activity. The objective is focused on forming a shareholding which will provide assurance on sound and prudent management in each bank, on examination the situation and adopted position by the shareholders during the existence of a bank, measures circumscription that can be applied by the supervision authority, as result of the performed analyze to ensure the compliance of the legal provisions.

ACTIVITY OF THE BANKING SUPERVISORY AUTHORITY IN 2012

During 2012, the legal framework of the banking sector was improved in the field of banking supervision.

As result, for further consolidation of the banking reporting process and in order to achieve a higher level of harmonization and convergence in the reporting requirements, the **Instruction on FINREP financial situations at individual level, applicable to banks** was modified and completed with additional reports**.** Thus, the banks shall submit new reports related to: loans and receivables classification by type of products (FIN 6.A); loans and receivables classification of collateral and guarantees (FIN 6.B); movements in allowances for impairment and impairment of equity instruments (FIN 9 B); guarantees held which can be sold or repledged (FIN 9 C); assets obtained during the period by taking possession of real guarantees (FIN 9 D); tangible and intangible assets: assets subject to operational leasing (FIN 13B); the geographical structure of the assets (FIN 15.A); the geographical structure of the liabilities (FIN 15.B); the statement of the comprehensive income (FIN 21).

Also, certain changes in the mentioned Instruction were performed in order to specify some aspects regarding the information reflection by the banks in the FINREP report, as well as control relation between reports positions have been established and specifically within the vertical and horizontal positions.

In order to promote a relaxed macroeconomic policy by the National Bank of Moldova, in the **Regulation on risk-weighted capital adequacy** were performed modification regarding the exclusion of the expected requirements to increase the risk weighted capital adequacy ratio at the rate of 18% - starting from June 30, 2013 and 20% - starting from June 30, 2014. As result, one of the solutions will be increase of access to banking credits for legal entities through mitigation prudential requirements related to risk weighted capital adequacy

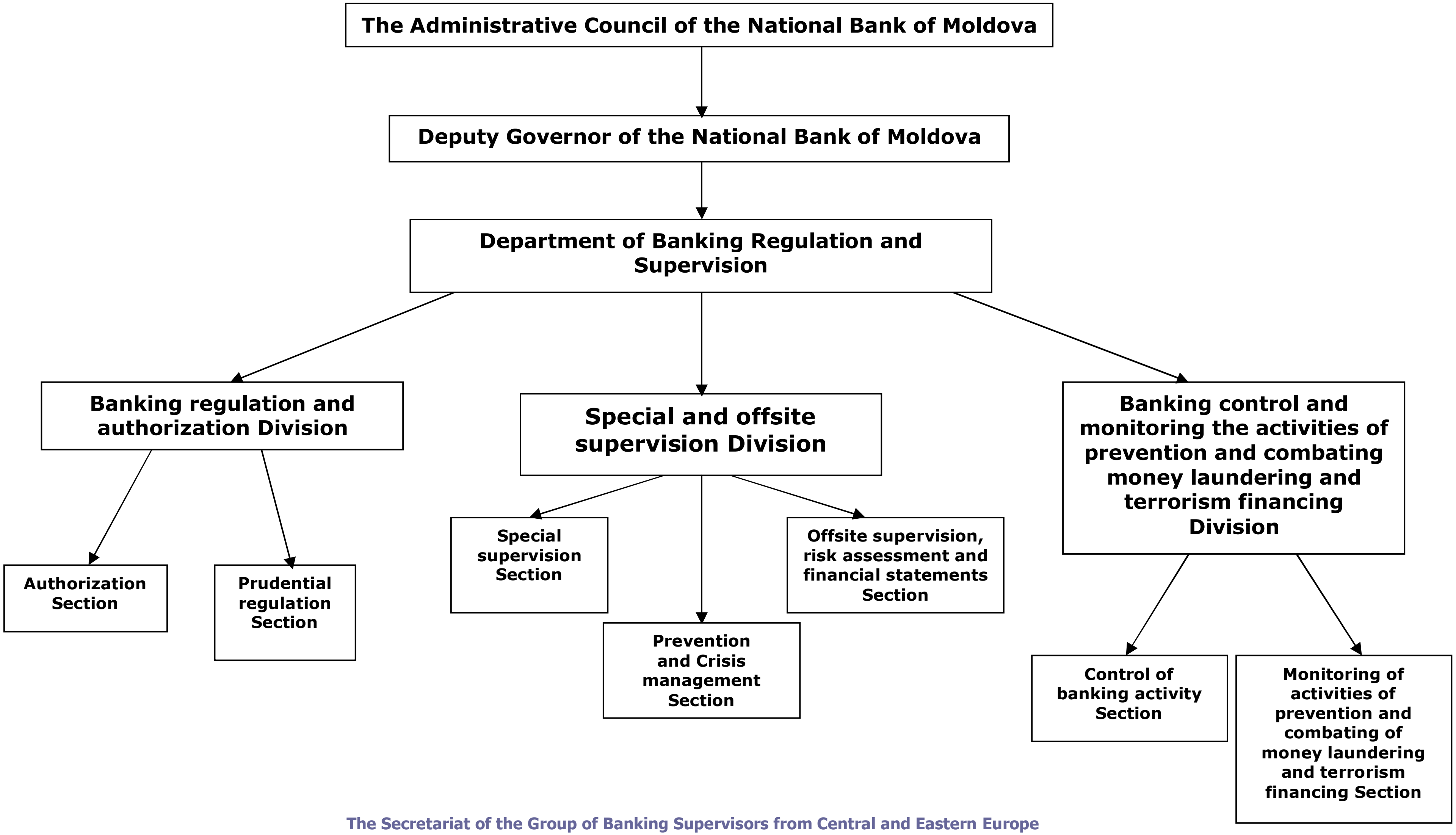
Regulation on assets and conditional commitments classification was modified in order to stimulate bank's lending activity through less restrictive classification of credits secured with financial guarantees granted within specialized projects by the international financial organizations and legal entities whose main activity is to guarantee credits and whose heritage, mainly, is constituted of banks or state's participation. Also, in the respective Regulation, were included modifications regarding: the possibility of reviewing the interest rate on renegotiated credits, classification of extended credits in more favorable categories, taking into account the ability of implementing the commitments made by the debtor; details related to assets classification transmitted into bank's possession for credits repayment and related to the forming term of the general reserves for banking risk.

In the **Regulation on bank transaction with its affiliated persons** were included provisions regarding the necessity of review and approve by the Board of Directors of the transaction after the affiliate relation's appearance, as well as review of the transaction with affiliated persons at least once per year.

In order to protect the individuals and legal entities interests, which receive banking services, were performed modifications related to extending the possibility for using of the cost simulator by all persons (both individual and legal) to determine the total cost of credit, as well as for total payment deposit, requirements on credit cards information disclosure by the banks, conditions for deposit acceptance, which will include the deposit amount, acceptance term, interest rate (variable / fixed), its calculating method, necessary documents for opening the deposit account etc. in the **Regulation on publishing information on financial activity by licensed banks of the Republic of Moldova.** Also, the requirements on financial positions that need to be disclosed by the banks under the new reporting requirements were improved.

Regulation no.23/09-01 on licensing of banks was completed with provisions regarding obtaining from the National Bank of Moldova the information of the banks shareholders general meeting. Thus, the banks submit the information about the agenda of the general meeting, date, time and place of the meeting, its form, as well as publication copy where was placed the notice of shareholders general meeting (except cases when shareholders representing the entire capital social decide unanimously to hold the meeting).

ORGANIZATIONAL STRUCTURE OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL COOPERATION OF THE BANKING SUPERVISORY AUTHORITY

During 2012, in order to further develop the local banking system, performing prudential regulation and banking supervision mechanism, the National Bank of Moldova collaborated with a number of international organizations such as: International Monetary Fund, World Bank, European Bank for Reconstruction and Development, U.S. Department of the Treasury and Group of Banking Supervisors from Central and Eastern Europe.

Also, in order to achieve adequate information exchange regarding banks authorization, the National Bank of Moldova collaborated with National Bank of Romania, The Central Bank of the Russian Federation, the Central Bank of Bosnia and Herzegovina, the Nederlandsche Bank, the National Bank of Georgia and the National Bank of Serbia.

On international level, the National Bank of Moldova has concluded agreeement with banking supervision bodies from other countries as Romania, Russia, Kazakhstan, Belarus. Currently, we negotiate the conclusion of new agreements with supervision authorities from Germany, Italy, France and Austria.

COOPERATION WITH OTHER SUPERVISORY AUTHORITIES OF MOLDOVA

On national level, the National Bank of Moldova has worked with various supervision bodies of the countries for monitoring and supervision the banking activity.

Thus, in order to achieve the adequate function of bank’s licensing and supervision and the information exchange between supervision authorities, the National Bank of Moldova has worked based on the concluded agreement with the National Anticorruption Center, National Commission of Financial Market, the State Chamber of Registration, the State Enterprise „Cadastru”, and Office of the General Prosecutor.

Currently, the National Bank of Moldova negotiates the conclusion of the new agreement with the Main State Tax Inspectorate.

OTHER INFORMATION AND RELEVANT TRENDS IN 2012

In order to enhance contribution efforts of the National Bank of Moldova to the economic development of the Republic of Moldova, the National Bank of Moldova elaborated the Strategic plan of the National Bank of Moldova for 2013-2017, which is available on the official website of the National Bank of Moldova (http://www.bnm.md/en/nbm_organization). The mentioned Strategic Plan determines the strategic objectives derived from the mission’s statements and different vision and are aligned with the basic activities of the National Bank of Moldova namely strengthening the inflation control mechanism, promoting cashless payments, to align prudential supervision requirements of the banking sector to the international standards and norms, to modernize the information systems in accordance with the best practices in information technology field, to increase the effectiveness of operational activities, and other activities designed to increase public confidence in the National Bank of Moldova.

STATISTICAL TABLES

Number of financial institutions
(at year-ends)

Type of financial institution	2010	2011	2012
Commercial banks	12	12	10
Branches of foreign credit institutions	3*	3*	4
Cooperative banks	-	-	-
Banking sector, total:	**15**	**15**	**14**

* Only branches of foreign banks.

Ownership structure of banks on the basis of assets total
(at year-ends)

Type of financial institution	2010	2011	2012
Public sector ownership	7.2	7.1	6.52
Other domestic ownership	50.3	42.7	43.42
Domestic ownership total	57.5	49.8	49.94
Foreign ownership	42.5	50.2	50.06
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions
(at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	51.73	68.65	0.110
Branches of foreign credit institutions	17.87	19.78	0.011
Cooperative banks	-	-	
Banking sector, total:	**100.0**	**100.0**	**100.0**

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2010	2011	2012
Commercial banks	2.61	10.55	5.60
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**2.61**	**10.55**	**5.60**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2010	2011	2012
Commercial banks	82.19	83.65	80.22
Branches of foreign credit institutions	17.81*	16.35*	19.78
Cooperative banks	-	-	-
Other	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

* Only branches of foreign banks.

The structure of assets and liabilities of the banking system (%) (at year-end)

Assets	2010	2011	2012
Cash	4.72	4.18	4.20
Due from banks and NBM, net	15.47	16.47	16.03
Net loans and financial leasing	55.17	58.21	56.93*
Total securities, net	15.74	13.47	7.27**
Other, net	8.90	7.67	15.57
Total assets	100	100	100
Liabilities	**2010**	**2011**	**2012**
Deposits by natural persons	43.00	43.39	43.81
Deposits by legal persons	23.07	22.06	17.99
Others	16.76	17.72	20.99
Shareholder capital	17.17	16.83	17.21
Total liabilities and shareholder capital	**100**	**100**	**100**

* Calculated according to IFRS.
** Includes only government securities. Data for total securities is no longer available.

Capital adequacy ratio of banks

Type of financial institution	2010	2011	2012
Commercial banks	30.00*	30.11*	24.38*
Cooperative banks	-	-	-
Banking sector, total:**	30.00*	30.11*	24.38*

(* - for Basel I; ** - for Basel II)

Asset portfolio quality of the banking system (%)

Loan classification	2010	2011	2012
Standard	44.21	49.78	48.32
Supervised	42.47	39.49	37.18
Substandard	8.89	7.97	4.97
Doubtful	3.56	2.29	6.36
Bad	0.87	0.46	3.17
Classified total	**100**	**100**	**100**
Specific Reserves/Total Loans	**8.55**	**6.96**	**10.65**

The structure of deposits and loans in 2012 (%)
(at year-end)

	Deposits	Loans
Households	64.07	13.64
Government sector	2.97	0.16
Corporate*	30.36	78.24
Other (excluding banks)	2.60	7.96
Total	**100.00**	**100.0**

* Including bank deposits and loans

P&L account of the banking sector (at year-ends)

P&L account	2010	2011	2012
Interest income	-	-	276.16
Interest expenses	-	-	138.56
Net interest income	-	-	137.60
Net fee and commission income	-	-	50.51
Other (not specified above) operating income (net)	-	-	-110.43
Gross income	-	-	381.25
Administration costs	-	-	93.49
Depreciation	-	-	14.19
Provisions	-	-	128.67
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets, (%)	-	-	35.81
Profit (loss) before tax	-	-	37.89
Net profit (loss)	-	-	27.17

As at December 31, 2011, 1 EUR=15.9967 lei.
* As of Januay 1, 2012, the banks moved to International Financial Reporting Standards (IFRS).

Total own funds in 2012 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	438.06	432.05	6.03	-
Cooperative banks	-	-	-	-
Banking sector, total:	438.06	432.05	6.03	-

As at December 31, 2011, 1 EUR=15.9967 lei.

2012 DEVELOPMENTS IN THE MONTENEGRIN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The slowdown in economic activity and negative forecasts in the EU Member States affected the conditions of Montenegrin economy. As a result of negative tendencies, the Ministry of Finance revised the real GDP growth rate in the basic scenario for 2012 from 2% to 0.5%.

Montenegrin economy is still very vulnerable, particularly due to slow GDP recovery and real sector's illiquidity. Moreover, there is a growing trend in already high level of non-performing loans. Growing credit risk and non-servicing of liabilities to banks draw a conclusion that the recorded volume of lending activity was lower than real demand. Still, we have to note the significant level of new loans in 2012 which, according to the Credit Registry data, amounted to EUR 702.6 million. Such level of new lending may be assessed adequate, disregarding already present risks in the banking sector.

The annual **CPI inflation** amounted to 5.1% in December 2012, while the average annual rate amounted to 4.1%. Inflation was significantly higher than the inflation in the Euro area (2.2%) and the inflation in EU (2.3%).

Total **revenues of the Budget** and State Funds, as per preliminary data of the Ministry of Finance, amounted to EUR 1,447.4 million in 2012 or 43.5% of GDP, of which source revenues amounted to EUR 1,118.8 million. The budget revenues recorded decline in relation to plan and in relation to 2011 by 2.7% and 0.9%, respectively. Total **budget expenditures** amounted to EUR 1,451.3 million or 43.7% of the estimated GDP. Relative to 2011, budget expenditures were 2.7% lower, yet 1.8% higher than planned. The Budget of Montenegro recorded a EUR 163.8 million **deficit, or 4.9% of GDP** in 2012.

At end-2012, the **public debt** of Montenegro, as per the Ministry of Finance data, amounted to EUR 1,699.5 million or 51.1% of the estimated GDP for 2012. In relation to end-2011, the public debt increased by 14.6%. This brings us to the conclusion that that the share of public debt in GDP was lower than in many EU Member States. Still, the major concern is rapid growth in share of public debt in the GDP, and the risk of activating some guarantees.

The number of **employed** persons in 2012 amounted to 166,531, thus being 2.1% higher than the average number of employees in the previous year. As per the Employment Agency of Montenegro's records, the number of registered **unemployed** persons averaged at 30,182 in 2012, which is 2.2% less than in the same period last year. The **unemployment rate** announced by the Employment Agency of Montenegro in December 2012 amounted to 13.43%, which is 1.86 percentage points higher than in December 2011.

Monstat data show that an **average salary** in Montenegro in 2012 amounted to EUR 727, being 0.7% higher than in the previous year. An average salary without taxes and contributions totalled EUR 487, also showing the year-on-year increase of 0.6%.

Current account deficit increased in 2012. The current account deficit amounted to EUR 587.2 million or 2.4% more than in 2011, while the share of deficit in GDP remained the same as in 2011 (17.7%). Growing current account deficit resulted from higher external trade balance, and/or significant decline in export of goods (17.8%), while export of goods remained at the year 2011 level. Current account deficit was mostly financed with the net FDI inflow (77.3%).

Foreign direct investments trended up in 2012. Preliminary data show that net FDI inflow in 2012 amounted to EUR 453.6 million or 13.6% of GDP, which is 16.6% more than in 2011. Of total FDI inflow, the share of equity investments was 69.3%, while the share of debt investments amounted to 30.7%.

DEVELOPMENT IN THE BANKING SYSTEM (INCLUDING THE ASSETS TOTAL / GDP)

As well as in 2011, the banking system was relatively stable in 2012. Banking operations were characterised by a restrictive lending policy, as well as the sale or relocation of a part of loan portfolios to factoring companies or parent banks. There were evident changes in some banks' market share structure. As at 2012 year-end, aggregate capital adequacy ratio amounted to 14.71%, and it declined by 1.8 percentage points relative to the 2011 year-end, when it amounted to 16.51%. As at 2012 year-end, total own funds of banks amounted to EUR 290.2 million and total risk-weighted assets amounted to EUR 1,972.7 million.

Banks' total capital amounted to EUR 288.7 million as at 2012 year-end, and it declined by EUR 16.5 million or 5.42% as compared to the previous year. Despite the fact that eight banks reported profit, high levels of loss in three banks led to the reported end-year loss of EUR 56.5 million at the entire banking system level.

Liquidity of the banking sector was satisfactory in the reporting year. Due to a growth in liquid assets of banks, the key liquidity indicators recorded significant annual growth. Daily and ten-day liquidity indicators were above the prescribed minimum.

Banks' total loans amounted to EUR 1,862.5 million as at 2012 year-end and they showed the year-on-year decrease of 4.76%. Observed by banks, five banks reported a decline, while six banks reported growth in lending activity in the reporting year. The main reasons for the decline in lending activity were: the sale of parts of loan portfolios of some systemic banks, defaults in repayment of previously granted loans, high dispersion of liquidity shortfalls in the real sector, inadequate maturity match of sources and placement of funds, high interest rates and still present high operating risk.

As for the maturity structure of total loans, long-term loans accounted for 79.02% and short-term loans made up the remaining 20.98%, thus stopping the uptrend in long-term loans' share in total loans which decreased by 0.68 percentage points relative to 2011. The most important loan beneficiaries were private companies and natural persons (holding credit cards) with the share of 90.8% in total loans granted until 2012 year-end. As at 2012 year-end, loans granted to private companies amounted to EUR 882 million (47.37% of total loans), and loans granted to natural persons amounted to EUR 809 million (43.45% of total loans).

Banks' total deposits amounted to EUR 1,981 million at 2012 year-end and they showed the year-on-year increase of 9%. Household deposits increased by 10.97%, indicating that the crisis of confidence is generally over. The most important depositors were natural persons and private companies, accounting for

57.90% and 24.26% of total deposits, respectively. The maturity structure of deposits remained at the 2011 year-end level. Demand deposits accounted and time deposits accounted for 38.35% and 61.65% of total deposits, respectively. Deposits in euros prevailed in the currency structure, while deposits in other currencies made up 4% of total deposits.

Loan to deposit ratio was positive at the system level, amounting to EUR 118.2 million, being more favourable relative to 2011, when the difference was negative (EUR -138.7 million). The most obvious negative loan to deposit ratio was in trade, construction and service sectors. Beside households, the most important net lenders at the aggregate level were the finance, energy and transport industries.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN MONTENEGRO

In 2012, regulatory activities referring to the banking sector were mainly focused on further harmonization of secondary legislation with relevant EU directives as well as promotion of the existing regulatory framework, especially in the part of determining and expressing banks’ financial condition.

In March 2012, the CBCG adopted Decision on Bank Exposure Calculation in order to harmonize calculation and treatment of banks' large exposures with the Directives 2006/48 EC and 2009/111/EC.

The most important change in the regulatory framework was implementation of IAS. Work on the implementation of the IAS has started in Q1 2012 with adoption of Decision on Minimum Standards for Credit Risk Management in banks which entered into force on 01 January 2013.

Adoption of a new Decision on Minimum Standard for Credit Risk Management affected substantial changes in the existing regulations. They are as follows:

1) Decision on the Chart of Accounts regulates bookkeeping records on corrections of values and provisions according to IAS. At the same time, the base for improved reporting to the CBCG for statistical, analytical and supervisory needs was created by increasing the number of more adequately structured accounts;
2) Decision amending the Decision on Minimum Standards for Credit Risk Management in Banks which regulates treatment of provisions and correction of values when calculating banks’ regulatory capital;
3) Decision amending the Decision on Capital Adequacy of Banks aligns the way of calculating banks' own assets with new solutions contained in the Decision on Minimum Standards for Credit Risk Management in banks;
4) Decision amending the Decision on Minimum Standards for Risks Management in Micro-Credit Financial Institutions binds MFIs to evaluate balance and off-balance sheet items by IAS/ISFR;
5) Decision amending the Decision on Minimum Standards for Bank Investment in Immovable Property and Fixed Assets harmonizes the

manner of recording the acquired immovable properties and other assets with new solutions contained in the Decision on Chart of Account for Banks;

6) Instructions on the manner of recording the loan loss provisions, correction of values and written-off balance sheet asset items regulates in more details the manner of recording loan loss provisions and values' corrections of assets;
7) Decision on Reports to be Submitted to the Central Bank of Montenegro harmonizes reporting forms submitted to the CBCG with the Decision on Minimum Standards for Risks Management in Banks, new Decision on Chart of Accounts of Banks and Decision amending the Decision on Minimum Standards for Risks Management in Micro-Credit Financial Institutions;
8) Decision amending the Decision on Credit Registry adjusts reporting for the Credit Registry to the new solutions from the Decision on Minimum Standards for Credit Risk Management in Banks.

Adoption of a secondary legislation created assumptions that banks and MFIs shall evaluate and disclose their financial assets according to IAS/ISFR as of 01 January 2013.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2012

In 2012, the CBCG continued the improvement of the regulatory framework in order to conduct harmonization with relevant EU directives and Basel II international standards. New Decision on Minimum Standards for Credit Risk Management, adopted in Q1 2012, which entered into force as at 1 January 2013, creates legal base for evaluation of the financial assets by implementing IAS. The same Decision implied adoption of a set of new decisions and amendments that complement existing regulations within specified area. It is expected that these changes will result in more precise and comprehensive reporting to the CBCG, which implies implementation of IAS.

Aimed at maintaining financial stability, the CBCG conducted regular stress tests of banks in 2012. In accordance with stress testing results, two banks were recapitalized in amount of EUR 46.5 million. Recapitalization of banks has been conducted through increase of equity capital in amount of EUR 26.5 million and transforming subordinated debt to equity capital in amount of EUR 20 million. In December 2012, one bank additionally increased equity capital (EUR 10.5 million), and EUR 4 million based on the contract on hybrid loan. However, these changes in capital shall be recorded in the balance sheets of banks in Q1 2013.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2012

In 2012, the CBCG rejected issuance of work permit to the credit union which was in accordance with prudential supervision policy regarding entry of new financial entities to the market and protection of interests of bank's depositors and creditors.

In the course of 2012, following acts have been adopted as well:

- Twenty-six decisions were made for granting approvals for the election of members of the board of directors in banks.
- Fourteen decisions were made for granting approvals for the election of CEO in banks.
- Eight approvals were granted for the election of an audit firm in banks.
- Three approvals were granted for performing internal audit in banks.

According to the Inspection plan, there were 13 targeted and regular on-site inspections in 10 banks within the system and 13 extraordinary and targeted on-site inspections in 7 banks. In 2012, there were no full scope inspections according to the risk based supervision. The focus was placed on supervision of credit risk, operational risk, liquidity risk and capital adequacy. The CBCG disclosed irregularities in seven banks. Hence, CBCG imposed measures against these banks in the form of two written warnings and two decisions defining measures against these banks. In addition, misdemeanour proceedings were initiated against three banks due to violation of regulations related to money laundering.

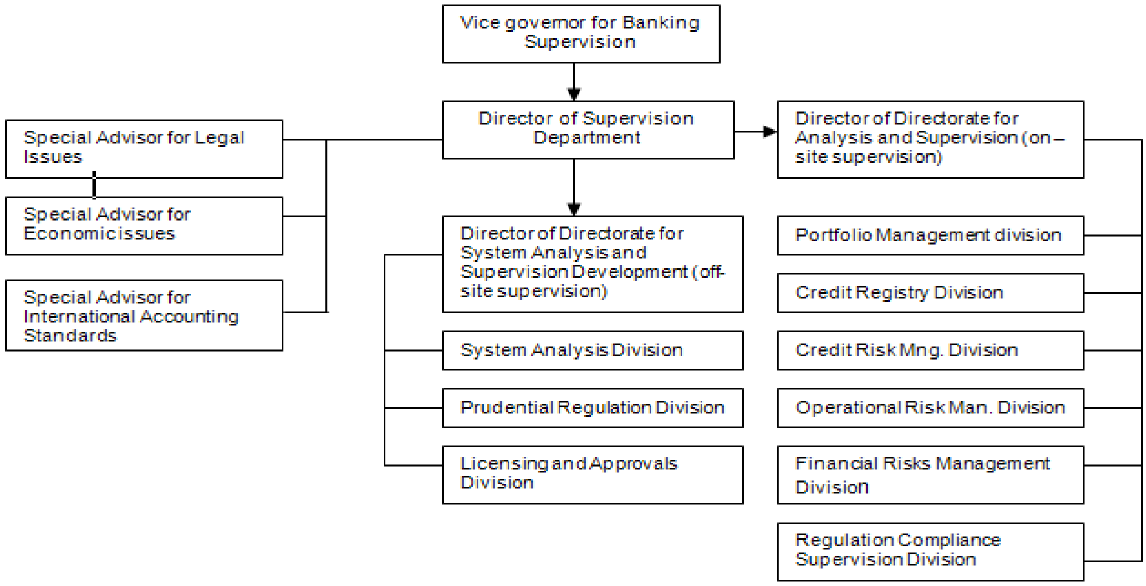
According to two CBCG decisions, one bank was obliged to increase the level of own assets up to the legally prescribed minimum and conduct additional activities aimed at increasing own assets. Pursuant to the Decision as of 09 March 2012, the CBCG ordered one bank to provide minimum 12% Solvency ratio and maintain it on that level up to 31 December 2012. The bank acted according to prescribed measure and reached 12% Solvency ratio as at 31 March 2012.

Substantial activities regarding prevention of money laundering and terrorist financing are related to the preparation of answers for the Second and Third Progress Report, as well as the presentation of these reports before the MONEYVAL experts.

In 2012, pursuant to the Decision on Capital Adequacy of Banks, for the first time banks submitted the report on Capital Adequacy Assessment Process (ICAAP). Based on examination and assessment of the ICAAP report, and according to SREP methodology, CBCG determines whether arrangements, strategies, processes and mechanisms which banks are implementing provide safe management and risk coverage in its business operations.

Introduction of the IAS 39 standards was successfully implemented. It included preparation of the new Decision on Minimum Standards for Credit Risk Management and change of the Chart of Accounts. These changes implied change of reporting tables and adoption of a new Decision on Reports submitted by banks to the CBCG.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

On 26 June 2012, the Council of Ministers of the European Union rendered a decision on the opening of EU accession negotiations for Montenegro, which were officially launched by holding a bilateral inter-governmental conference in Brussels. In 2012, CBCG invested intense efforts into the preparation of materials and documents submitted to the European Commission during the screening process.

In 2012, CBCG intensified the cooperation with the representatives of the EU institutions, strengthening in particular the cooperation with the European Central Bank. The ECB invited the CBCG to give its contribution in the drafting of biennial report on Financial Stability Challenges in EU Candidate Countries for the first time.

In 2012, CBCG hosted the IMF representatives as a part of the regular consultations in line with Article IV of the IMF Articles of Agreement. CBCG representatives also attended the IMF and WB spring meetings in Washington, as well as the regular annual meeting of the Dutch Constituency in the IMF and the World Bank. IMF experts' assistance was provided during the drafting of the Contingency Plan and the practical guidelines for the efficient intervention and problem solving in troubled banks and the technical assistance provided in the field of the balance of payment statistics.

The CBCG organized a series of visits of World Bank high officials and representatives, most of them on the Fiscal Sustainability Development Policy Loan, drafting of the Economic Memorandum for Montenegro and Financial Sector Policy Based Guarantee (PBG) aimed at helping the economic reform programme in Montenegro as well as financial planning and banking system supervision. Within the preparations of PBG for Montenegro, CBCG made an official request for WB's assistance in the implementation of international accounting standards, as well as for the technical assistance in drafting and implementation of the specific strategy for the reduction of the NPL levels in the financial sector of Montenegro.

COOPERATION WITH OTHER SUPERVISORY BODIES IN MONTENEGRO

The key challenge for the CBCG during the next year will be decreasing the level of non-performing loans. In that context, the CBCG cooperates with the World Bank and the Ministry of Finance in activities on restructuring non-performing loans. This project is focused on comprehensive diagnostics followed by the implementation of corrective measures in the aim of creating real and sustainable reinforcement of the Montenegrin NPL workout framework.

Central Bank and Ministry of Finance and all financial system supervisors participated in the adoption of the National Contingency Plan aimed at maintaining financial stability. The plan will enable monitoring, identification and possible prevention and/or mitigation of potential systemic risks in the financial system in an efficient, effective, consistent and comprehensive manner. This will help Montenegro to be better prepared for some possible future crisis.

STATISTICAL TABLES

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution	2010	2011	2012
Commercial banks	11	11	11
Branches of foreign credit institutions			
Cooperative banks			
Financial institutions, total	**11**	**11**	**11**

Ownership structure of the financial institutions on the basis of registered capital (%) (at year-ends)

Type of financial institution	2010	2011	2012
Public sector ownership	-	-	-
Other domestic ownership	12	10	10
Domestic ownership total	12	10	10
Foreign ownership	88	90	90
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions in 2012 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	52.4	72.3	1,351
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total	52.4	72.3	1,351

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2010	2011	2012
Commercial banks	-27.27	-1.08	-18.32
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	-27.27	-1.08	-18.32

Distribution of market shares in balance sheet total (%)

Type of financial institution	2010	2011	2012
Commercial banks	98.04	98.45	98.71
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Other*	1.96	1.55	1.29
Banking sector, total	**100.0**	**100.0**	**100.0**

Capital adequacy ratio of banks

Type of financial institution	2010	2011	2012
Banks	15.85	16.51	14.71
Cooperative banks	-	-	-
Banking sector, total	**15.85**	**16.51**	**14.71**

(Please, mark for each item: * - for Basel I; ** - for Basel II)

Asset portfolio quality of the banking sector (share of impaired receivables / share of non-performing loans)

Asset classification	2010	2011	2012
Non financial sector			97.32
- households			19.40
- corporate			73.78

The structure of deposits and loans of the banking sector in 2012 (%) (at year-end)

	Deposits	Loans
Households	57.9	43.4
Government sector	9.6	8.0
Corporate	24.9	47.6
Other (excluding banks)	7.6	1.0
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends)

P&L account	2010	2011	2012
Interest income	213892	195960	189451
Interest expenses	-100191	-89797	-83472
Net interest income	113701	106169	105979
Net fee and commission income	34431	30384	25660
Other (not specified above) operating income (net)	8972	84402	46026
Gross income			
Administration costs	-101675	-106447	-112756
Depreciation			
Provisions	-136280	-116300	-120510
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)			
Profit (loss) before tax	-80850	-1792	-55599
Net profit (loss)	**-81677**	**-3219**	**-56527**

Total own funds in 2012 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	290.2	254.6	46.6	0
Cooperative banks	-	-	-	-
Banking sector, total:	290.2	254.6	46.6	**0**

2012 DEVELOPMENTS IN THE POLISH BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2012 the Polish economy grew by 1.9%, which was less than in 2011, i.e. 4.5% (GUS data). However, Poland performed quite well compared to other European countries as the economy avoided recession and output growth was resilient. The development was stimulated by net exports, where contribution to the economic growth amounted to 2.1 pp., as well as individual consumption (0.5 pp.). In 2012 gross capital formation had a negative contribution of -0.2 pp. Nevertheless, despite output growth, trends in the labour market even worsened. Unemployment rate totalled 10.4% at the end of 2012 (according to the Eurostat data), compared to 9.6% as for the end of 2011. In 2012 wages grew at a modest rate of 3.5% yoy in nominal terms, which gives a decrease of 0.2% yoy in real terms. Inflation (CPI) was equal to 3.7% yoy (inflation target is 2.5% with possible deviation of +/-1%) compared to 4.3% yoy in 2011.

In 2012 the Monetary Policy Council (RPP) raised its main refinancing rate to 4.75% (in May) and then cut the rates twice, each time by 25 bps (in November and December). As a result, at the end of 2012 the main refinancing rate was at 4.25%.

What still poses non-negligible problems to the Polish economy is the performance of the public finance. On the one hand, the government deficit as a percentage of the GDP in 2012 dropped to 3.9% vs. 5.1% the year before. But on the other hand, the government debt in 2012 totalled 55.6% of the GDP, compared to 56.3% in 2011. Although certain steps have already been taken by the government in those areas, improvement of the condition of the domestic public finance will be one of the main challenges for the Polish economy in coming years.

DEVELOPMENT IN THE BANKING SYSTEM (INCLUDING THE ASSETS TOTAL / GDP)

In 2012 the situation of the banking sector remained stable.

The situation with respect to the capital base had been strengthened substantially and at the end of 2012 was considered as a strong one. Banks are expected to maintain their capital base, only some of them still have to improve it.

The situation as regards the liquidity was stable. Only 6 small banks (out of 643) did not fulfill one or more liquidity measures.

The level of non-performing loans increased slightly and still poses risks to the banking sector.

The slowdown in the Polish economy observed in the second half of year 2012 and high volatility in the financial markets represent major risk to the Polish banking sector. It is necessary that banks keep on monitoring potential threats and strengthen their liquidity position and maintain their capital buffers.

The importance of banking sector in Polish economy remains at the same level and in 2011 relation of its banking sector assets to GDP amounted to 84.8% compared with 84.7% in 2011 and 81.8% in 2010.

It is well-founded to expect long-term stability of the Polish banking sector.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN POLAND

The Polish Financial Supervision Authority (the KNF) acts pursuant to the Act on Financial Market Supervision of 21 July 2006. The KNF supervises the banking sector, the capital market, the insurance industry, credit unions and pension funds. The KNF lays down rules safeguarding the stability of the entire financial sector. It systematically regulates, supervises and, where appropriate, issues penalties for non-compliance with these rules.

Credit unions (SKOKs)

Since 27th October 2012 the credit unions (SKOKs) have been supervised by the KNF. From the legal point of view credit unions are co-operatives that solely operate in favour of their members. SKOKs are allowed to collect deposits and issue loans, as well as to carry out financials settlements and act as intermediaries in insurance agreements. All SKOKs are united in the National Association of Credit Unions (NASCU). In comparison to the co-operative banks' assets, the overall credit unions' assets are five times lower. In the end of 2012 there were 55 credit unions in Poland that altogether had 2.57 million members.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2012

In 2012, the Polish Financial Supervision Authority adopted the Recommendation J concerning the principles of gathering and processing real estate data by banks. Recommendation J provides the guidelines for creating and using external (interbank) real estate market databases by banks, which would contribute to improved risk management market standards for mortgaged-backed credit exposures.

In 2012, the KNF Office presented for consultation the drafts of Recommendations: M concerning operational risk management at banks, D concerning management of IT areas and IT environment safety at banks, T concerning best practices related to managing risk under retail loan exposures and S concerning best practices in managing mortgage-backed credit exposures; detailed data about abovementioned amendments (as well as other KNF activities) are contained in the Report on Activities of the Polish Financial Supervision Authority in 2012, available at KNF website:

http://www.knf.gov.pl/en/About_us/KNF_OFFICE/reports_on_actives/index.html

In 2012, works were commenced on the new version of the "BION Methodology" ("BION" stands for "Supervisory Review And Assessment"). BION process rules were reviewed. The aim of the review was to develop draft with amendments allowing to more completely consider banks' risk profile, integrate arrangements arising from analysis and inspection procedures with the use of the proportionality rule to the extent greater than to date. As a result of performed works, the BION Methodology was amended through elimination or adjustment of certain criteria, grade scale modification as well as change to the rules on weight determination for individual risk types.

In 2012, in total 684 BION analyses were carried out, including 682 in co-operative banks (438 as part of the BION process for 2011 and 244 for 2012) and 2 in associating banks. As a result of the analytical works, 10 supervisory warnings were issued as part of analytical activities taken in co-operative banks.

In 2012 the KNF carried out 20 complex inspections and 63 targeted inspections both in commercial and cooperative banks. Targeted inspections were focused on the areas of bank's activity considered to generate the highest risk.

One of the important activities of the KNF in 2012 was banking sector stress testing, based on bottom-up approach. The KNF Office performed stress tests of the banking sector aimed at determining the potential impact of the volatile macroeconomic environment on the financial standing and capital position of the Polish banking sector institutions as well as resilience of the Polish banking sector to potential adverse macroeconomic scenarios. As in previous years, the KNF also took part in EBA stress-test exercise.

INTERNATIONAL ACTIVITIES OF THE AUTHORITY.

International activity of the KNF is driven by the characteristics of the Polish financial sector - domination of entities belonging to international groups – and by the dynamics of global and EU regulatory processes.

Co-operation with financial supervision bodies from other countries – both bilateral and through sitting on supervisory colleges – directly contributes to execution of our supervisory goals. In 2012, the KNF participated in supervisory colleges for 16 cross border banking groups and 20 insurance groups. Bilateral relationships cover sharing supervisory information as well as opinions and experience and are fostered both on the working and executive levels. In autumn 2012, the Chairman of the KNF, accompanied by other top officials, held a series of meetings with heads of financial supervision authorities in the home states of most significance for Poland: Italy, the Netherlands, Sweden and Germany. Bilateral co-operation is facilitated by agreements on co-operation and information exchange, which the KNF already concluded with the regulators from 26 jurisdictions (besides the multilateral memoranda under IOSCO and IAIS).

By dint of active participation in the work of the European Supervisory Authorities, the KNF can exert influence on regulatory and supervisory processes initiated in the EU. The authority wants to be represented in all the major work streams of EBA, EIOPA and ESMA, as well as ESRB. A representative of the KNF continued his work as a member of the Management Board of the EIOPA.

In 2012 the most important legislative processes in the EU were related to the CRD IV package, the banking union, the bank recovery and resolution directive, the Solvency II and Omnibus II directives and EMIR and MIFID II regulations. The KNF strove to influence the international negotiations, so that the interests of Poland (looser rules for smaller entities, room for national discretion, host-country-friendly rules of international cooperation) are properly accounted for.

The KNF assigns great value to close cooperation with supervisory authorities form other Central and Eastern European members of the European Union. The CEE Forum - an informal forum of regulators from ten countries established in 2010 upon the initiative of the KNF Office - is the most important ground for co-operation. Its primary objective is to bring closer the positions of members towards proposals of the EU regulations so as to secure as far as possible the interest of host states. In 2012, the CEE Forum held three meetings. Among the primary results of the cooperation was a joint address of six Forum members to the Dutch Presidency of the EU Council with a proposal of detailed amendments to the CRD IV package, as well as alignment of opinions on the BRR directive and on banking union.

Looking beyond the European level, the KNF is a member of international organisations grouping supervisors responsible for particular sectors of the financial market. These are, primarily, IOSCO (the KNF participated in 9 committees and working groups), IAIS (2 committees and working groups) and IOPS. The KNF is not a part of the Basel Committee, so we try to take part in important work it does by means of participating in three working groups of the Committee, the BSCEE and the FSB Regional Consultative Group for Europe, as well as responding to the Committee's public consultations.

As in previous years, in 2012 the KNF assisted other countries with less established supervisory frameworks. This activity included a twinning project for the State Committee for Securities of the Republic of Azerbaijan, participation in technical assistance for Moldavia, Ukraine and the Turkish Republic of Northern Cyprus under TAIEX and maintaining TIFS, a training centre for European supervisors.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY.

The KNF is the only authority in Poland responsible for supervising the financial sectors. Besides credit institutions (commercial banks, cooperative banks, credit and savings unions), we supervise insurance and reinsurance undertakings, publicly-mandated pension funds, the Warsaw Stock Exchange, the clearing house, investment firms, investment funds, payment institutions and some other types of entities. Division of tasks within the KNF is mostly sector-wise, with common support functions.

The KNF maintains close relations with other institutions responsible for financial stability, that it the Ministry of Finance (regulations), National Bank of Poland (macroeconomic analyses) and the Bank Guarantee Fund (fortunately, not activated for many years). To deal with emergency situations, Financial Stability Committee has been created - it encompasses the KNF, the MoF, the NBP and the BGF and meets at least twice a year.

ORGANIZATIONAL CHART OF THE SUPERVISORY AUTHORITY

Organisational chart of the Polish FSA

STATISTICAL TABLES

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution	2010	2011	2012
Commercial banks	49	47	45
Branches of foreign credit institutions	21	21	25
Cooperative banks	576	574	572
Banking sector, total:	**646**	**642**	**642**

Ownership structure of the financial institutions on the basis of registered capital (%) (at year-ends)

Type of financial institution	2010	2011	2012
Public sector ownership	21.5	22.2	22.9
Other domestic ownership	12.3	12.8	13.5
Domestic ownership total	33.8	35.0	36.4
Foreign ownership	66.2	65.0	63.6
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	32.42	44.92	690
Branches of foreign credit institutions	1.42	1.70	1940
Cooperative banks	0.45	0.66	51
Banking sector, total:	**32.42**	**44.92**	**580**

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2010	2011	2012
Commercial banks	10.19	12.71	11.19
Cooperative banks	10.46	11.59	11.20
Other	-	-	-
Banking sector, total:	**10.21**	**12.64**	**11.19**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2010	2011	2012
Commercial banks	89.2	91.7	91.6
Branches of foreign credit institutions	4.7	2.2	2.1
Cooperative banks	6.1	6.1	6.3
Other	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

The structure of assets and liabilities of the banking system (%) (at year-end)

Assets	2010	2011	2012
Financial sector	8.1	7.5	8.1
Nonfinancial sector	60.3	61.9	59.9
Government sector	5.5	6.6	6.8
Other	26.2	24.1	25.2
Liabilities	**2010**	**2011**	**2012**
Financial sector	25.4	26.3	25.2
Nonfinancial sector	53.5	54	53.5
Government sector	4.6	3.8	4.4
Capital	10.0	10.0	10.8
Other	6.5	6.0	6.0

Capital adequacy ratio of banks

Type of financial institution	2010	2011	2012
Commercial banks	13.9	13.1	14.8
Cooperative banks	13.2	13.4	13.8
Banking sector, total:	13.8	13.1	14.7

(* - for Basel I; ** - for Basel II)

Asset portfolio quality of the banking sector (share of impaired receivables / share of non-performing loans)

Asset classification	2010	2011	2012
Non financial sector	8.8	8.2	8.9
- households	**7.2**	**7.2**	**7.4**
- corporate	**12.4**	**10.4**	**11.8**

The structure of deposits and loans of the banking sector in 2012 (%) (at year-end)

	Deposits	Loans
Households	62.0	57.0
Government sector	7.2	9.8
Corporate	23.0	29.1
Other (excluding banks)	7.8	4.0
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends)

P&L account	2010	2011	2012
Interest income	57 268	64 773	71 321
Interest expenses	26 368	29 793	35 812
Net interest income	30 899	34 966	35 509
Net fee and commission income	13 754	14 295	14 342
Other (not specified above) operating income (net)	7 425	6 984	8 013
Gross income	53 083	57 305	58 761
Administration costs	25 477	26 684	27 781
Depreciation	2 534	2 576	2 580
Provisions	769	670	1 126
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	10 545	7 609	8 204
Profit (loss) before tax	14 206	19 594	19 259
Net profit (loss)	11 420	15 539	15 518

Total own funds in 2012 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	29 433	26 101	3 273	58
Cooperative banks	2 119	1 996	123	0
Banking sector, total:	**31 552**	**28 097**	**3 396**	**58**

2012 DEVELOPMENTS IN THE ROMANIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The year 2012 saw a significant slowdown in real GDP growth (to 0.7 percent from 2.2 percent in 2011), as a result of the pronounced dependence of internal growth on the development in the agricultural production. Apart from the influence of agriculture sector (GVA contraction of -21.6 percent), the Romanian economy would have increased the pace of growth in 2012 (from 1.5 to 2.2 percent). Downward trajectory, but with slopes more attenuated compared to agriculture, were registered by other two sectors: industry, whose gross value added fell by 1 percent and constructions, with a fall of 0.3 percent due to the restrain of the activity on the residential segment. Domestic demand in 2012 was the main growth factor, with gross fixed capital formation increasing by 4.9%, while the final consumption increased by 1.2%. Private consumption expenditures went up by 1.1% and the government consumption expenditures by 1.7%. After two years of important increase, exports of goods and services declined by 3.0%, while imports of goods and services declined by 0.9% in real terms. As a consequence, net export registered a negative contribution to GDP's real growth of 0.8%.

During 2012, the annual inflation rate has evolved unevenly, continuing an upward trend after reaching a new historic low in April and May (1.8%) and subsequently exceeding the upper limit of the target range (3% ± 1 percentage point). Level of 4.95% recorded in December 2012 (compared to 3.14% a year earlier) was the result of transitory supply-side shocks.

DEVELOPMENT IN THE BANKING SYSTEM

During 2012 there have been some changes in the Romanian banking system structure. Thus, the number of credit institutions decreased from 41 to 40 entities against December-end 2011, following the merger by acquisition between two banks with Italian capital. A number of other changes occurred in the banking sector in Greece had further impact on the banks having shareholders originated in that country. Consequently, at the end of 2012, the Romanian banking system comprises 32 banks, Romanian legal entities (including one credit cooperative organization) and 8 branches of foreign banks.

Credit institutions reported a sufficiently high capital adequacy ratio in order to cover credit risk as a result of the NBR exercising tighter oversight of developments in this area and banks' efforts to raise additional capital, as required by the central bank. In order to increase banks' resilience to global financial crisis, the NBR established a 10% prudential threshold for the solvency ratio (against the minimum regulated level of 8%). In addition, with a view to ensuring effective supervision, the central bank required solvency reports to be submitted on a monthly basis (rather than quarterly, as stipulated under the legal framework in force) by banks with negative financial results, a large volume of non performing loans or below-average solvency ratios. The solvency ratio stood at a comfortable level 14.9% both in December 2012 and December 2011. Tier 1 capital ratio (Tier 1 capital per total capital requirements) posted an increase to 13.8% as at 31 December 2012. The capital base of Romanian banks proved its resilience; as Tier1 capital accounts for 80% of total own funds until December 2011 and 92% as at the end of 2012.

Overall, 2012 was a difficult year for banks operating in Romania. Credit risk has remained the major vulnerability of the banking sector. Loan portfolio quality worsened further, albeit at a slower pace. The NPL ratio (compiled as loans and interest overdue for more than 90 days and/or for which legal proceedings were initiated) reached 18.2% in December 2012 (against 14.3% as at 31 December 2011). However, total prudential provisioning per non-performing loans stood at 102.1% in December 2012 (97.8% in December 2011). The implementation of International Financial Reporting Standards (IFRS) of January 2012 resulted in a positive difference between the previous total prudential provisions and those determined according to IFRS. In order to avoid a distortion of the prudential indicators – due solely to changes of the reporting standards – and an artificial improvement in financial indicators, prudential filters were introduced at the same time when the IFRS became the new accounting standards, ensuring the consistency of prudential indicators with their values under the previous accounting regime.

The continued need to adequately provision for NPLs and the slowdown in the growth rate of credit to the private sector have kept profitability in negative territory (at the end of December 2012, ROA stood at -0.6 % and ROE at -5.9%).

The contagion risk from the European banking sector is important, but manageable. However, the specific challenges faced by parent banks in their home country call for more effort in assessing risks. The NBR closely monitors domestic and international developments, while also adequately managing and maintaining system-wide liquidity and pursuing comfortable levels of provisioning and solvency ratios. To date, the Romanian Government has not used public funds to support the stability of the financial system. The recapitalisation of the banking sector was entirely supported by bank shareholders.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE ROMANIAN BANKING SUPERVISORY AUTHORITY

Credit institutions are currently principally regulated by Government Emergency Ordinance No. 99/2006 on credit institutions and capital adequacy (the Banking Law). Notable recent amendments to the main legal framework include:

- amendments to the Banking Law and to the Deposit Guarantee Fund (DGF) brought by Government Ordinance No. 1/2012 aimed at providing the legal framework for a set of stabilisation measures, including bridge-bank powers, as tools at the NBR's disposal for dealing with credit institutions in distress, when they pose a threat to financial stability;

- amendments to the Banking Law were introduced by Government Emergency Ordinance No. 43/2012, in the context of regulating adequate procedures in case of prudential vulnerability of credit institutions, allowing, as a stabilisation measure, the involvement of the DGF as a shareholder in such credit institutions.

  As a result of the implementation of a variety of regulations and amendments to their provisions, the current prudential regulatory framework ensures:
- harmonisation with Basel II framework (Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions and Directive 2006/49/EC on the capital adequacy of investment firms and credit institutions, as amended by, among others, Directive 2009/111/EC, Directive 2009/83/EC and Directive 2009/27/EC). The prudential regulatory framework was also amended in order to transpose Directive 2010/76/EU amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies (CRD III); and
- harmonisation with guidelines issued by the CEBS, including in the field of prudential reporting system harmonised with COREP and FINREP requirements. As of 1 January 2011, CEBS' responsibilities have been taken over by the EBA, established by Regulation (EC) No. 1093/2010). Other areas in which the CEBS guidelines/Basel Committee documents were transposed into Romanian regulations refer to governance arrangements, remuneration policies, internal capital adequacy assessment process and management of significant risks, liquidity cost benefit allocation, conditions for outsourcing of activities, assessment and validation of using advanced approaches for calculating capital requirements for credit and operational risks, retention requirements in securitisation transactions, clarifications regarding the revised large exposures regime and clarifications regarding the exemption of some short-term exposures from the application of the large exposures regime.

One of the key objectives of the regulation activity in NBR is to continue the harmonization process of national regulations with the guidelines and standards issued by CEBS/EBA.

In 2012, the NBR issued Regulation No. 10/2012 amending NBR Regulation No. 18/2012 on governance arrangements of credit institutions, internal capital adequacy assessment process and the conditions for outsourcing their activities, as further amended and supplemented was issued in order to bring the provisions of Regulation No. 18/2009 in line with those of ESRB Recommendation of 22 December 2011 on U.S. dollar denominated funding of credit institutions (ESRB/2011/2). To this end, the NBR regulated credit institutions' obligation to establish formal contingency funding plans determining strategies for solving liquidity deficits in crisis situations, whether such crises are at the level of the relevant credit institutions or at the global market level, for currencies in which credit institutions are active. Such contingency funding plans should consider at least the contingency funding sources available in the event of a reduction in supply from different counterparty classes and should be integrated with the continuous liquidity risk assessments and with the results of scenarios and assumptions used in crisis simulations. Credit institutions should consider the feasibility of measures included in their contingency funding plans if more than one credit institution tries to undertake them at the same time.

At the beginning of 2012, the Romanian banking system implemented IFRS as its accounting basis and for the drawing up of individual financial statements. In the context of IFRS implementation as an accounting basis at individual level, the prudential regulatory framework establishing the treatment of prudential filters that would preserve prudent bank solvency, provisions and reserves was finalised.

As regards the implementation of Basel III and CRD IV Directive (Capital Requirements Directive IV), Romania will follow the implementation timetable to be adopted after the negotiation of the CRD IV Directive and implementing regulation proposals at EU level including taking into consideration the developments related to the EU Banking Union.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2012

The difficult external environment poses a challenge to financial stability in Romania. Thus, the main objective of NBR was linked with the main goal which is to assure the stability of the Romanian banking system, attributable to its capacity to act as a monetary and supervisory authority. NBR acted to limit the impact of the international crisis on the local banking market. At that time the most likely way to affect domestic credit institutions condition appeared to be the liquidity channel. As a result, NBR has taken a number of important measures to manage developments in this field. Also, measures to strengthen banks capital positions and to maintain access to external finance have had a high priority.

Important measures have been taken in 2012 to facilitate rapid action in the area of bank resolution and to strengthen the options for bank restructuring and to strengthen the special administrator’s ability to deal with banks in weak financial positions. Among the tools at the NBR's disposal for dealing with credit institutions in distress are also the bridge–bank powers. The harmonization process of national regulations with the guidelines and standards issued by CEBS/EBA was also one of the main directions of activity.

The main challenges lying ahead are: (i) managing the risk that could occur in the event of adverse developments in international markets (ii) improving bank asset quality; (iii) achieving a more balanced currency breakdown of flows of new loans; and (iv) enhancing the early intervention tools and stabilisation measures for distressed credit institutions. These challenges call for further efforts to maintain adequate solvency, provisions and liquidity, as well as for additional prudential measures.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2012

As a banking supervisory authority, NBR paid a lot of attention to enhance credit institutions' capacity to withstand economic shocks. Respective to the NBR actions, liquidity on the interbank market was monitored on a daily basis so as to identify or prevent any deterioration. In prudential terms, credit institutions were required to have alternative financing plans, to provide regular analyses of liquidity under extreme market conditions, to maintain a certain level of reserves in the form of highly liquid assets or to diversify the resources attracted and to weekly report the volume and structure of external financing sources, especially those from the parent group. Furthermore, in order to prevent the worsening of capital adequacy ratio, as a result of larger losses due to non-performing loans, the supervisory authority stepped in to preserve a comfortable solvency level, by requesting that the structure and the level of capital are adequate to the risk profile specific to each credit institution, as well as to the context of the crisis. In this regard, a number of credit institutions supplemented own funds by raising share capital in cash, retaining the prior year's profit or by resorting to subordinate loans. After the recently introduced bank resolution measures, several commercial banks participated in a successful simulation exercise of the NBR on the establishment of a bridge bank.

In the off-site monitoring process, during 2012 were carried out 51 actions to 22 banks and 2 branches of foreign banks, among them 6 having full objectives and other 45 with specific topic. Additionally, there were carried out 26 joint actions (on-site and off-site) within the annual evaluation program approved by the NBR board. On-site supervision consisted in the performance of 39 inspection actions on 28 banks and 5 foreign bank branches, of which 33 were performed as overall assessment and other 6 were held on specific topic. Also, two targeted actions were carried out at co-operative organisation network.

The objectives referred mainly to minimum capital requirements, risk management, lending activity, loans classification, as well as determining and using prudential adjustments, large exposures, exposures to related persons, liquidity risk and liquidity indicator, operational risk, changes in the situation of credit institutions, prudential reporting, trend of prudential indicators, complaints and petitions, the performance of the measures set by the NBR. Further to the inspections, sanctions have been applied in cases of 12 credit institutions, consisting in fines and / or written warning.

ORGANISATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

ORGANISATION CHART OF THE NATIONAL BANK OF ROMANIA
as of 1 April 2013

BOARD OF DIRECTORS

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    - Liquidity Management Division
  - **MACROECONOMIC MODELLING AND FORECASTING DEPARTMENT**
    - Macroeconomic Forecasting Models Division
    - Macroeconomic Assessment Models Division
  - **FINANCIAL STABILITY DEPARTMENT**
    - Financial Institutions Division
    - Financial Markets and Infrastructure Division
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    - Inspection Division II
    - Inspection Division III
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    - Cash Management Division
    - Central Vault Division
    - Cash Processing Coordination Division
  - **PAYMENTS DEPARTMENT**
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    - Financial Instruments Depository and Settlement Division
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    - Balance of Payments Division
    - Direct Statistical Reporting Division
    - Statistical Data Processing Division
    - SIRBNR Data Management
  - **IT DEPARTMENT**
    - IT Systems Division
    - Network Administration Division
    - IT Support Division
    - Multimedia Support Division
  - **LEGAL DEPARTMENT**
    - Legal Documentation and Advisory Opinion Division
    - Contract Assistance and Disputed Claims Division
    - European and International Law Division
  - **TECHNICAL AND MAINTENANCE DEPARTMENT**
    - Construction Maintenance Division
    - Equipment and Installations Maintenance Division
    - Administration Division
    - Negru-Vodă Building Administration Division
    - Dr. Staicovici Building Administration Division
  - **PROCUREMENT DEPARTMENT**
    - General Procurement Procedures Division
    - Methodology and Contracting Division
    - Planning and Monitoring Division
    - Direct Procurement Division
    - Banking Procurement Procedures Division
- **Chancellery**
  - The Executives' Offices
  - Chief Economist and Advisers' Group
  - Governor's Control Office
  - Board Secretariat Division
  - Information Management and Protection Division
  - Protocol Division
  - Document Management Division
- **MARKET OPERATIONS DEPARTMENT**
  - Monetary Policy Operations Division
  - State Treasury Operations Division
  - Foreign Reserve Management Division
  - Back Office Division
- **COMMUNICATION DEPARTMENT**
  - Website and Electronic Publications Division
  - Media Relations Division
  - Institutional Image Analysis and Public Relations Projects Development Div.
  - Financial Education Division
- **SECRETARIAT**
  - Documents Registration Division
  - Archives Division
  - Library Division
  - Public Information Division
  - Events Organisation Division
  - Transport Division
  - Cafeteria Division
- **HUMAN RESOURCES DEPARTMENT**
  - Organising and Planning Division
  - Human Resources Management Div.
  - Training and Career Development Division
- **INTERNAL AUDIT DEPARTMENT**
  - General Audit Division
  - Analysis and Synthesis Division
  - IT Audit Division
- **BUDGET AND FINANCIAL ANALYSIS DEPARTMENT**
  - Budget and Financial Analysis Div.
  - Preventive Financial Control Division
- **SECURITY DEPARTMENT**
  - Crisis Management & Business Continuity Division
  - Internal Protection Division
  - Special Transport Division
  - Security Systems Division
  - Emergencies Medical Services Div.
- **TRAINING AND SOCIAL EVENTS FACILITY DEPARTMENT**
  - Training Support Division
  - Social Events Division
  - Auxiliary Activities Division
  - Training and Social Events Units
- **BRANCHES**

Note: Colour patterns show the departments' co-ordination

INTERNATIONAL ACTIVITIES OF NBR

After Romania accession and central bank integration into the European System of Central Banks, NBR joined to the European Central Bank and the other central banks efforts, in the framework of technical cooperation programs, with a view to assist the partner institutions from the candidate states to comply with the acquis communautaire requirements.

During 2012, the National Bank of Romania has been involved in the following projects of technical assistance:

- Technical assistance program for the National Bank of Serbia (NBS), entitled Technical Assistance Programme for the National Bank of Serbia - Strengthening the Institutional Capacities of the National Bank of Serbia. It aims to support NBS efforts to align its operational and regulatory framework to the ESCB standards. NBR participated in this program in 2012 by providing technical expertise for component "Support for EU membership." In the second stage of the program, the NBR will participate under the “Financial Stability” component.

- Technical assistance program for Central Bank of Egypt, which ended in 2012, the two levels which was structured as: (i) implementation of Basel II (involving NBR experts and Bank of France) that targeted institutional capacity development of the staff involved in on-site monitoring of the credit institutions and (ii) the management of international relations in the context of Basel II (additionally involving Bank of Greece experts).

In July 2012, the Latvia assessment mission was completed in terms of prevention and combating of money laundering and terrorist financing. The evaluation was conducted by a panel of experts, including members of the Council of Europe's MONEYVAL Committee, of which a representative of NBR took part.

COOPERATION WITH OTHER SUPERVISORY BODIES IN ROMANIA

Starting with 2007, Ministry of Public Finance, National Securities Commission, National Bank of Romania, Insurance Supervisory Commission, and Private Pension Supervision Commission agreed to co-operate in view to exchange and disseminate the information among them on financial stability and financial crisis management. According to the provisions of their multilateral agreement, a major role plays the National Committee for Financial Stability (NCFS). The key responsibilities of the NCFS are to promote a steady and efficient information exchange between the sectorial financial supervisors and the Ministry of Public Finance, and to appraise, prevent and, where appropriate, manage financial crises at individual financial institutions level, financial groups level or financial market as a whole.

During their meetings in 2012, the members of the NCFS have examined the Recommendation of the European Systemic Risk Board (ESRB) on the macro-prudential mandate of national authorities, and the institutional arrangements for the implementation of macro-prudential policies in selected EU member states. In this context, the NCFS members established the steps for the preparation of an interim report on macro-prudential mandate in Romania, as a first stage for the transposition into the national legislation of ESRB Recommendation.

During the discussions, the most recent measures for enhancing the financial stability in line with the provisions of the external financing agreements with the European Commission, the International Monetary Fund and the World Bank were presented. It was emphasized that the Romanian financial sector remained stable, well-capitalized, in spite of a persistent difficult economic and financial environment in Europe and worldwide.

STATISTICAL TABLES

Number of financial institutions (at year-ends)

Type of financial institution	2010	2011	2012
Commercial banks	32	32	31
Branches of foreign credit institutions	9	8	8
Cooperative banks	1	1	1
Banking sector, total:	**42**	**41**	**40**

Ownership structure of banks on the basis of assets total (%) (at year-ends)

Type of financial institution	2010	2011	2012
Public sector ownership	7.4	8.2	8.4
Other domestic ownership	7.5	8.8	1.8
Domestic ownership total	14.9	17.0	10.2
Foreign ownership	85.1	83.0	89.8
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	44.4	60.0	996
Branches of foreign credit institutions	86.9	96.8	3410
Cooperative banks	-	-	-
Banking sector, total:	**40.5**	**54.7**	**852**

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2010	2011	2012
Commercial banks	-2.44	-3.79	-6.85
Branches of foreign credit institutions	15.02	24.84	16.99
Cooperative banks	2.19	3.33	1.97
Banking sector, total:	**-1.73**	**-2.56**	**-5.92**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2010	2011	2012
Commercial banks	92.8	91.8	91.1
Branches of foreign credit institutions	7.0	8.0	8.7
Cooperative banks	0.2	0.2	0.2
Other	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

The structure of assets and liabilities of the banking system (%) (at year-end)

Assets	2010	2011	2012
Financial sector	22.5	20.6	18.1
Nonfinancial sector	55.8	56.7	58.8
Government sector	18.1	19.0	-
Other	3.6	3.7	23.1
Liabilities	**2010**	**2011**	**2012**
Financial sector	29.1	29.0	29.0
Nonfinancial sector	56.5	56.8	57.3
Government sector	-	-	-
Capital	5.5	5.5	10.4
Other	8.9	8.7	3.3

Capital adequacy ratio of banks

Type of financial institution	2010**	2011**	2012**
Commercial banks	15.0	14.8	14.9
Cooperative banks	32.4	32.8	32.4
Banking sector, total:	**15.0**	**14.9**	**14.9**

(* - for Basel I; ** - for Basel II)

Asset portfolio quality of the banking sector (share of impaired receivables / share of non-performing loans)

Asset classification	2010	2011	2012
Non financial sector	11.9	14.3	18.2
- households	**10.0**	**11.3**	**12.3**
- corporate	**13.6**	**16.9**	**23.6**

*Non-performing loans ratio is calculated based on banks prudential reports regarding loans classification, as a share of loans having debt service over 90 days and/or legal proceedings initiated in the total classified loans portfolio

The structure of deposits and loans of the banking sector in 2012 (%) (at year-end)

	Deposits	Loans
Households	53.7	33.2
Government sector	13.3	25.1
Corporate	26.9	37.7
Other (excluding banks)	6.1	4.0
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends)

P&L account in million LEI	2010	2011	2012
Interest income	26,723.7	26,142.1	23,389.0
Interest expenses	12,154.7	11,869.8	11,467.0
Net interest income	14,569.0	14,272.3	11,922.0
Net fee and commission income	3,965.3	4,117.3	3,833.5
Other (not specified above) operating income (net)	5,504.5	4,634.2	3,373.8
Gross income	**24,038.8**	**23,023.8**	**19,129.3**
Administration costs	14,535.0	14,491.7	10,227.1
Depreciation	1,054.5	1,114.2	1,005.1
Provisions	8,616.1	7,827.5	780.4
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	na	na	9,866.6
Profit (loss) before tax	**-166.8**	**-409.6**	**-2,749.9**
Net profit (loss)	**-516.4**	**-777.3**	**-2,341.9**

Total own funds in 2012 (in million EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	6,558.1	6,055.9	502.2	-
Cooperative banks	52.7	43.5	9.2	-
Banking sector, total:	**6,610.8**	**6,099.4**	**511.4**	-

Rate of exchange: 4.4287 RON/EUR

2012 DEVELOPMENTS IN THE RUSSIAN BANKING SYSTEM

MACROECONOMIC SITUATION IN RUSSIA

In 2012 the situation in the Russian economy remained stable enough, growth of industrial production has proceeded, the rate of unemployment decreased. A major factor of economic growth still was high domestic demand. However, the unstable situation with regard to the economy of countries that are Russia's trade partners, a low external demand for the Russian exporters' production influenced the economic activity. Inflation rate (6.6%) exceeded the 2011 figures (6.1%). The essential private sector's net capital outflow from Russia ($54.1 billion) reflected investors' tendency to minimize their risks.

Russia's international reserves grew by $39.0 billion to $537.6 billion as of January 1, 2013.

Russia's foreign debt rose by 17.2% in 2012 and totalled $631.8 billion in early 2013. The debt burden on the country's economy was not critical according to internationally recognised criteria: foreign debt amounted to 31.4% of GDP in 2012 (28.4% of GDP in 2011).

In 2012 Russia's GDP increased by 3.4% (as against 4.3% in 2011).

In 2012 employment rose (in comparison with 2011). Unemployment amounted to 5.5% of the economically active population in comparison with 6.5% in 2011.

Gross fixed capital formed in 2012 was up by 6.6%.

The real wage growth and the consumer lending increasing stimulated enlarging real consumer spending. In 2012, household final consumption rose by 6.8%.

DEVELOPMENT IN THE BANKING SECTOR (INCLUDING THE ASSETS TOTAL / GDP)

In 2012, most of the key indicators that reflected the banking sector's role in the economy exhibited positive dynamics. The ratio of banking sector assets to GDP increased from 74.6 to 79.1% during the year. The ratio of banking sector capital to GDP grew by 0.4 percentage points to 9.8%.

In 2012, as in the previous years, household deposits were the principal source of funds for credit institutions: their share of GDP got higher by 1.5 percentage points to 22.8%. The ratio of corporate entities' deposits to GDP rose by 0.4 percentage points to 15.4%.

In 2012, as before, loans prevailed in the structure of banking sector assets. The total loans to GDP ratio increased by 2.8 percentage points – to 54.3%. The ratio of loans to non-financial organisations and households to GDP grew by 2.6 percentage points to 44.3%.

LEGISLATIVE AND INSTITUTIONAL FRAMEWORKS FOR THE ACTIVITY OF CREDIT INSTITUTIONS AND BANKING SUPERVISION, MAIN CHANGES. SUPERVISORY AUTHORITY'S LEGAL COMPETENCE

In compliance with Federal Law No. 86-FZ, dated July 10, 2002, "On the Central Bank of the Russian Federation (Bank of Russia)" (hereinafter referred to as the Bank of Russia Law), the Bank of Russia is a body of banking regulation and supervision. Its main goals are to maintain stability of the Russian banking system and protect the interests of creditors and depositors. For these purposes, the Bank of Russia constantly supervises compliance by credit institutions and banking groups with banking legislation, laws on counteraction of money laundering and terrorist financing, Bank of Russia regulations and required ratios.

Pursuant to the Bank of Russia Law, to ensure the soundness of credit institutions, the Bank of Russia may establish the following prudential standards (also for the banking groups):

- maximum amount of property (non-monetary) contributions to a credit institution's charter capital, as well as the list of types of property in non-monetary form that may be contributed in payment of charter capital;
- maximum risk per borrower or group of connected borrowers;
- maximum amount of major credit risks;
- a credit institution's liquidity standards;
- equity (capital) adequacy standards;
- amounts of currency, interest-rate and other financial risks;
- minimum amount of provisions for risks;
- standards for a credit institution's use of its equity (capital) for acquiring shares (interest) in other legal entities;
- the maximum amount of loans, bank guarantees and sureties granted by a credit institution (banking group) to its participants (shareholders).

The Bank of Russia establishes the methodology for determining a credit institution's equity (capital), assets, liabilities and amount of risk on assets for each standard, taking into account international standards and consultations with credit institutions and banking associations and alliances. The Bank of Russia is empowered to establish differentiated standards and methods for calculating them according to types of credit institutions.

In order to exercise its banking regulatory and banking supervisory functions, the Bank of Russia conducts examinations of credit institutions (their branches), sends them binding orders for the elimination of violations that have been discovered in their operations, and applies the sanctions specified in the Bank of Russia Law with respect to violators.

In cases of a credit institution's violation of federal laws or the Bank of Russia's supporting regulations and orders, failure to provide information, or provision of incomplete or inaccurate information, the Bank of Russia has the power to demand that the credit institution eliminate the identified violations, impose a fine of up to 0.1 percent of minimum charter capital, or restrict the credit institution from engaging in certain operations for a period of up to six months.

The Bank of Russia has the power to revoke a credit institution's banking license on grounds stipulated in the Federal Law on Banks and Banking Activities. The procedures for revoking a banking license are established in Bank of Russia regulations.

At the same time, the Bank of Russia analyzes the performance of credit institutions (banking groups) in order to identify situations threatening the legitimate interests of their depositors and creditors and the stability of the Russian Federation's banking system.

Russian Federation banking legislation (including the Bank of Russia's regulations) in the area of banking supervision is being changed in order to maintain it's effectiveness in light of the development of the national banking system and regulatory practices, which take international banking supervision experience into account. Pursuant to Article 77 of the Bank of Russia Law, Bank of Russia cooperates with credit institutions and their associations and alliances, and holds consultations with them before adopting the most important regulatory decisions. To ensure the orderly development of the legislative base, the Russian Federation Government and Russian Federation Central Bank approved the Strategy for development of the Russian Federation Banking Sector in the Period up to 2015, which provides for improving banking regulation and supervision and enhancing protection of the interests and strengthening the confidence of depositors and other bank creditors.

The Bank of Russia is taking consistent steps to implement Basel II[21] in the Russian banking sector as the internationally recognised standard for capital adequacy assessment, including adjustments made for the development of internal risk management systems, supervisory process arrangements and information disclosures by banks. This work is phased to ensure the consistent introduction of various options available for the regulatory assessment of capital adequacy, ranging from simple (based on regulatory assessments) to more complex (based on internal bank risk assessments).

In 2012, the Bank of Russia amended the procedure for calculating banks' required ratios aimed at the most complete realization of Pillar I «Minimum Capital Requirements», Basel II, and issued methodical recommendations on implementing the internal ratings-based approach to the evaluation of the borrowers' credit risks (the IRB-approach).

Within the framework of implementing Basel 2.5[22] the Bank of Russia issued the document on application of higher requirements regarding capital coverage of market risk.

As new international requirements concerning the quality and adequacy of capital and liquidity become part of the Russian bank regulation practices in keeping with Basel III[23], in 2012 the Bank of Russia issued new Regulation on the methodology of defining credit institutions' capital and estimating capital adequacy.

In addition, other amendments were made to the regulatory framework of credit institutions to develop risk-based supervision, improve corporate governance, assess credit institutions' operations and apply measures of supervisory response and regulate other issues.

[21] "International Convergence of Capital Measurement and Capital Standards. A Revised Framework. Comprehensive Version", Basel Committee on Banking Supervision, Basel, June 2006.

[22] The BCBS document "Revisions to the Basel II market risk framework (updated as of 31 December 2010)" clarifies the approaches of the BCBS document "International Convergence of Capital Measurement and Capital Standards. A Revised Framework. Comprehensive Version (June 2006)"

[23] Basel III: An International Framework for Liquidity Risk Measurement, Standards and Monitoring, and Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems, issued by the Basel Committee on Banking Supervision.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2012

In 2012, principal efforts of banking supervision continued to focus on developing risk-based approaches under assessing the soundness of credit institutions and supervisory arrangements for protecting the interests of depositors and creditors and maintaining the stability of the banking sector. The key task of supervision was early identification of negative trends in bank operations. Special attention was paid to increasing transparency of credit institutions' activity, the adequate recording of risk exposure in financial statements.

The Bank of Russia paid close attention to the largest banks of federal and regional importance entering in the so-called «second line» of supervision.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2012

In 2012, the Bank of Russia adopted regulatory acts to improve banking regulation and supervision, including the state registration of credit institutions, licensing of banking activities, off-site supervision, on-site inspections, the financial rehabilitation and liquidation of credit institutions, anti-money laundering and counter-terrorist financing.

The area of special concern was evaluation of the quality of bank assets, essentially credit portfolios. Close attention was paid to monitoring real concentrations of bank owners' business risks.

In 2012, in view of retaining trend to accumulate risks in the sphere of consumer lending, especially unsecured consumer lending, the Bank of Russia examined adequacy of credit institution's internal procedures for defining solvency and estimating consumer lending risks as well as it assessed models of consumer loans portfolios management and formation of provisions in banks.

The Bank of Russia also evaluated market risk, including the reality of the securities issuers' business activities, as well as recording the value of securities in credit institution's balance sheets or adequate provisioning.

In 2012 efforts were made to reveal fiducial transactions between banks, aimed at hiding the non-compliance with prudential regulations. In this connection the economic nature of operations performed by banks, the quality of corporate management and internal controls were studied.

As a result of revealing the facts of inaccurate reporting the value of cash by individual credit institutions, in 2012, the Bank of Russia concentrated their attention on analysis of cash transactions performed by banks.

In 2012 the Bank of Russia continued to estimate capital quality when credit institutions' stock (shares) had been purchased by persons whose business scale and (or) character were non-transparent.

The supervisor paid additional attention to banks pursuing aggressive policies in various segments of the banking services market, including taking household deposits and retail lending. The Bank of Russia monitored regularly (every ten days) the interest rates level on household deposits based on market average interest rates on rouble-denominated deposits. A credit institution setting its interest rates above those of the market would be given recommendations and proposals and, where necessary, restrictions and (or) bans on certain banking transactions would be imposed.

ORGANIZATIONAL STRUCTURE OF BANKING REGULATION AND SUPERVISION IN RUSSIA

The Supervisory Authority of the Bank of Russia head office includes the Banking Supervision Department, Banking Regulation Department, the Credit Institution Licensing and Financial Rehabilitation Department, the Financial Monitoring and Foreign Exchange Control Department and the Main Inspectorate of Credit Institutions. The major tasks of these divisions are to provide methodological and organisational support to the Bank of Russia statutory functions of banking supervision within the framework of the entire supervisory cycle: from the licensing of credit institutions, establishment of regulatory requirements, the exercise of on-going supervision of their activities and the conduct of on-site inspections to financial rehabilitation of credit institutions and implementation of measures, if necessary, to liquidate financially unviable credit institutions.

The supervisory divisions are managed by the Bank of Russia Banking Supervision Committee, which is headed by the Bank of Russia First Deputy Chairman in charge of this area. The Committee is responsible for making decisions on banking supervision policies.

The Bank of Russia carries out its banking supervision policies through its regional offices in the constituent entities of the Russian Federation (national banks or regional branches). As of January 1, 2013, there were 20 national banks and 59 regional branches operating in the Bank of Russia system.

INTERNATIONAL ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

In 2012, the Bank of Russia continued to take part in the activities of the Basel Committee on Banking Supervision (BCBS) and its working groups and sub-groups on macroprudential supervision and supervisory colleges.

In 2012, it also worked to prepare information and other material at the request of the Secretariat of the BCBS Group of Bank Supervisors from Central and Eastern Europe.

The Bank of Russia also took part in the mutual assessment of BCBS documents' implementation[24] by countries participating in BCBS.

Within the framework of its cooperation with the G20 and the Financial Stability Board (FSB), the Bank of Russia participated in the assessment of the Russian banks' implementation of the FSB Principles and Standards for Sound Compensation Practices at financial institutions (Peer Review 2012), as well as it contributed to quarterly reports on the implementation of Russia's commitments under the Framework for Strong, Sustainable and Balanced Growth and the Seoul Plan of Action, including information on building additional capacity and

[24] Principles for Sound Stress Testing practices and Supervision (May 2009) and Good Practice Principles on Supervisory Colleges (October 2010).

enhancing transparency of the financial market; improving legal regulation of the financial market; the creation of an international financial centre in Russia.

In the framework of its cooperation with the International Monetary Fund (IMF), the Bank of Russia met with IMF experts for Article IV consultations (May 2012).

Efforts were continued to update information on banking laws and regulations for the IMF electronic database on a regular basis, which is published quarterly on the Bank of Russia website.

There was a meeting at the Bank of Russia with World Bank representatives for assessing the effects of the World Bank Programs realized in Russia. (June 2012).

As it cooperated with the Organization for Economic Cooperation and Development (OECD), the Bank of Russia made efforts and held consultations with the OECD Investment Committee concerning Russia's commitments to join the OECD. This work included comments on a survey of investments and the Russian Federation's financial system (OECD Financial Market Committee Survey), as well as proposals for a draft legislative plan to bring Russian legislation in line with its future obligations in the OECD.

In preparing for the presentation of the Russian Federation's progress report on preventing the legalization (laundering) of criminally obtained incomes, an information sheet was made up on implementing the 23rd FATF Recommendation (criminals shall not be allowed to hold a controlling interest or management function in a financial institution).

The Bank of Russia attaches great importance to cooperating and exchanging information with the banking supervisory authorities of foreign countries. It has signed 37 cooperation agreements (memorandums of understanding) with foreign bank supervisors. In 2012, Memorandums of Understanding were signed with the Financial Inspectorate of Sweden (February 2012) and the Reserve Bank of India (August 2012). Cooperation agreements (memorandums of understanding) were drafted with the banking supervisory authorities of several foreign countries.

In 2012, the Bank of Russia met to review key topics related to banking supervision and regulation with the supervisory authorities of Austria, Belarus, Hungary, Germany, India, Kazakhstan, Latvia, as well as it consulted with the Bank of Korea.

To coordinate the activities of authorities supervising banking groups' cross-border establishments, the Bank of Russia has been cooperating with foreign supervisors in multilateral colleges.

COOPERATION WITH OTHER SUPERVISORY BODIES

The Bank of Russia developed cooperation with agencies, regulators and supervisors of financial markets within the framework of inter-agency agreements and arrangements that were reached with the Ministry of Finance, the Federal Financial Market Service, the Federal Anti-Monopoly Service, the Federal Tax Service, the Federal Customs Service, Federal Treasury, Pension Fund of Russia and other federal agencies.

STATISTICAL TABLES

Number of financial institutions (at year-ends)

Type of financial institution	2010	2011	2012
Banks	955	922	897
Non-bank credit institutions	57	56	59
Banking sector total	**1012**	**978**	**956**

Ownership structure of banks on the basis of assets total (%) (at year-ends)

Type of financial institution	2010	2011	2012
State-controlled banks	46,0	50,4	50,6
Other banks controlled by residents	35,9	32,6	31,5
Banks controlled by residents, total	81,9	83,0	82,1
Foreign-controlled banks (banks with non-resident interest in excess of 50%)	18,1	17,0	17,9
Banking sector (excluding non-bank credit institutions), total	**100,0**	**100,0**	**100,0**

Concentration of asset by the type of financial institutions in 2012 (at year-end)

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Banks	43,9	50,5	0,102
Non-bank credit institutions	83,9	89,6	0,461
Banking sector, total	43,7	50,3	0,101

Return on Equity (ROE) by type of financial institutions*

Type of financial institution	2010	2011	2012
Banks	12,5	17,6	18,1
Non-bank credit institutions	31,2	48,7	58,2
Banking sector total	**12,5**	**17,6**	**18,2**

* Calculated as the ratio of the current years balance sheet profit to the average chronological value of capital over the accounting period

Distribution of market shares in balance sheet total* (at year-ends, %)

Type of financial institution	2010	2011	2012
Banks	99,6	99,6	99,7
Non-bank credit institutions	0,4	0,4	0,3
Banking sector total	**100,0**	**100,0**	**100,0**

* Share in aggregate banking sector assets

Structure of Credit Institutions' Assets (at year-ends, %)

Assets	2010	2011	2012
Financial sector	15,9	16,1	16,5
Nonfinancial sector	53,7	42,6	40,3
Government sector (including the Bank of Russia)	12,2	9,2	7,5
Other	18,2	32,1	35,6
Liabilities	**2010**	**2011**	**2012**
Financial sector (including credit institutions)	14,3	14,5	13,5
Nonfinancial sector	51,8	51,4	49,2
Government sector (including the Bank of Russia)	2,5	5,2	7,1
Capital (profits, funds)	12,8	11,9	11,9
Other	18,5	17,0	18,3

Capital adequacy ratio of banks

Type of financial institution	2010	2011	2012
Banks	18,8	14,6	13,7
Non-bank credit institutions	85,4	38,2	36,9
Banking sector, total	**18,8**	**14,7**	**13,7**

Asset portfolio quality of the banking sector (share of non-performing loans, %)

Asset classification	2010	2011	2012
Non financial sector	9,7	7,7	6,9
households	10,3	7,9	6,5
corporate (including individual entrepreneurs)	9,5	7,6	7,0

The structure of deposits and loans of the banking sector in 2012 (at year-end, %)

	Deposits and other funds raised by credit institutions	Loans, deposits and other funds provided by credit institutions
Households	59,7	26,0
Government financial authorities and off-budget funds *	3,2	1,8
Non financial and financial institutions *	37,1	70,4
Other *	0,02	1,8
Banking sector, total *	100,0	100,0

* Excluding credit institutions and the Bank of Russia

P&L account of the banking sector in EUR (at year-ends)

P&L account	2010	2011	2012
Interest income	63 813 556	66 767 871	89 018 905
Interest expenses	31 758 166	30 555 209	43 512 634
Net interest income	32 055 390	36 212 662	45 506 272
Net commission income	11 206 719	11 963 258	14 052 923
Other (not specified above) income (net)	3 509 886	4 577 883	7 537 236
Gross income	46 771 995	52 753 803	67 096 431
Administration costs	26 572 942	29 752 830	36 814 528
Depreciation	n/a	n/a	n/a
Loan loss provisions	5 791 991	2 645 635	5 102 870
Impairement on financial assets not measured at fair value through profit and loss| Provisions on financial assets (loans, …)	n/a	n/a	n/a
Profit (loss) before tax	14 407 062	20 355 338	25 179 033
Profit (loss) after tax	11 359 824	16 625 730	20 101 727

Total Own Funds in 2012 (in EUR)

Type of financial institution	Total own funds (capital)	Core capital	Additional capital
Banks	151 586 314	94 567 083	57 669 599
Non-bank credit institutions	368 694	227 708	141 024
Banking sector, total	**151 955 008**	**94 794 792**	**57 810 623**

2012 DEVELOPMENTS IN THE SERBIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Large part of 2012 was recessionary and turbulent, although some positive signs towards economic recovery and macroeconomic stabilization were observed in late 2012.

GDP contracted by 1.7% in 2012, primarily as a consequence of the poor agriculture harvest and the eurozone recession. Some promising signs in terms of the economic outlook, that were observed during the last months of 2012, reflected the beginning of the expansion in the automobile industry and the recovery in the production of petroleum products (after the overhaul of the oil refinery in Pančevo). From the demand side, the main contributors to GDP fall in 2012 were personal consumption and investment, while small positive contribution came from government spending and net export.

Last year was also marked by high inflation pressures, resulting in 12.2% CPI inflation in December 2012 – above NBS target of 4±1,5%. Inflation pressures were primarily caused by rising cost-push pressures on food prices (because of severe and long-lasting draught), depreciation of the dinar in H1 2012 and VAT and excise tax hike in October.

Exchange rate movements were very turbulent in 2012. Dinar weakend significantly in H1 2012 (approx. 15%) due to fiscal expansion during that period, which in combination with political uncertainty and financial stress in the eurozone caused rise in country risk premium. The trend reversed since September 2012 following formation of the new government, reduced financal stress in the eurozone and restrictive monetary policy measures.

In mid-2012 NBS began tightening cycle of the monetary policy, by raising its key policy rate (from 9.5% to 11.25% by the year-end), changing currency composition of reserve requrements and changing direction of repo transactions. These measures contributed to fall in inflation pressures that was already observed in the last couple of months of 2012.

In 2012, consolidated budget deficit amounted to 6.4% of GDP, up by 1.4 pp from 2011. Real growth in budget expenditure was considerably higher than that of revenues. Though VAT rate was increased by 2% in October, real VAT receipts stagnated at the annual level. Growth in consolidated expenditure oscillated throughout the year. In real terms, total expenditure in H1 rose by 9.0% y-o-y, while in H2 it declined by 1.2% y-o-y. In October 2012, the Government started implementing fiscal consolidation measures that should help reduce the share of the public debt in GDP in the medium-term. However, as it is already certain that the planned budget deficit will be exceeded in 2013, new fiscal consolidation measures are required to ensure long-term sustainability of public finances.

The current account deficit widened to 10.5% GDP in 2012. The deficit increased on the back of rising trade and income deficits, including weaker current transfers compared to 2011. The deficit was especially wide in H1 2012 due to rise in imports caused by fiscal expansion. However, it narrowed significantly in late 2012 due to expansion of exports of cars and petrol as new production facilities in these industries began mass production.

The financial account saw a reversal of the FDIs trend in early 2012. The government repurchased the remaining 20% of shares of "Telekom Srbija" from Greek "OTE", and capital of the mobile operator "Telenor" was partially withdrawn. As a result, net FDIs amounted to only EUR 231.9 mln. The net portfolio investment was EUR 1.7 bln, up by 2.9% on 2011. On account of financial loans, banks repaid EUR 400.9 mln net over the whole 2012. In respect of the IMF loan, the NBS repaid EUR 212.1 mln. By contrast, enterprises and the government net borrowed EUR 104.9 mln and EUR 261.0 mln respectively.

The year-end saw NBS FX reserves at EUR 10.9 bln (, down by nominal EUR 1.1 bln). Reserves covered money supply M1 by 402.1% and 7.6 months of imports of goods and services.

Appendix

Key macroeconomic indicators

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Q1 2013
Real GDP growth (in %)[1]	4.3	2.5	9.3	5.4	3.6	5.4	3.8	-3.5	1.0	1.6	-1.7	1.9
Consumer prices (in %, relative to the same month a year earlier)[2]	14.8	7.8	13.7	17.7	6.6	11.0	8.6	6.6	10.3	7.0	12.2	11.2
NBS foreign exchange reserves (in EUR million)	2,186	2,836	3,104	4,921	9,020	9,634	8,162	10,602	10,002	12,058	10,914	11,844
Exports (in EUR million)[3][8]	3,125	3,847	4,475	5,330	6,949	8,686	10,157	8,478	10,070	11,472	11,913	2,968
- growth rate in % compared to a year earlier	16.0	23.1	16.3	19.1	30.4	25.0	16.9	-16.5	18.8	13.9	3.8	17.8
Imports (in EUR million)[3][8]	-6,387	-7,206	-9,543	-9,613	-11,971	-16,016	-18,843	-13,404	-14,643	-16,627	-17,211	-4,074
- growth rate in % compared to a year earlier	27.2	12.8	32.4	0.7	24.5	33.8	17.7	-28.9	9.2	13.6	3.5	0.8
Current account balance[4][8]												
(in EUR million)	-671	-1,347	-2,620	-1,778	-2,356	-5,053	-7,054	-1,910	-1,887	-2,870	-3,155	-615.2
as % of GDP	-4.2	-7.8	-13.8	-8.8	-10.1	-17.7	-21.6	-6.6	-6.7	-9.1	-10.5	-8.1
Unemployment according to the Survey (in %)[5]	13.3	14.6	18.5	20.8	20.9	18.1	13.6	16.1	19.2	23.0	23.9	
Wages (average for the period, in EUR)	152.1	176.9	194.6	210.4	259.5	347.6	402.42	337.9	330.1	372.5	364.5	370.8
RS budget deficit/surplus (in % of GDP)[6]	-4.3	-2.6	-0.3	0.3	-1.9	-1.7	-1.7	-3.4	-3.7	-4.2	-5.7	-5.9
Consolidated fiscal result (in % of GDP)	-1.8	-2.4	0.8	0.9	-1.9	-2.0	-2.6	-4.5	-4.7	-4.9	-6.4	-4.5
RS public debt, (external + internal, in % of GDP)[6][7]	72.9	66.9	55.3	52.2	37.7	31.5	29.2	34.7	44.5	48.2	59.3	62.2
RSD/USD exchange rate (average, in the period)	64.29	57.56	58.45	66.87	67.03	58.39	55.76	67.47	77.91	73.34	88.12	84.61
RSD/USD exchange rate (end of period)	58.98	54.64	57.94	72.22	59.98	53.73	62.90	66.73	79.28	80.87	86.18	87.43
RSD/EUR exchange rate (average, in the period)	60.69	65.12	72.69	82.99	84.11	79.96	81.44	93.95	103.04	101.95	113.13	111.70
RSD/EUR exchange rate (end of period)	61.52	68.31	78.89	85.50	79.00	79.24	88.60	95.89	105.50	104.64	113.72	111.96
Memorandum												
GDP (in EUR million)	16,028	17,306	19,026	20,306	23,305	28,468	32,668	28,954	28,006	31,472	29,932	7,592 [1]

[1] At constant prices of previous year.

[2] Retail prices until 2006.

[3] Trade with Montenegro is registered within relevant transactions as of 2003.

[4] In accordance with BPM 5, a portion of estimated remittances was transferred from the financial account to the current account.

[5] Source: Labour Force Survey, Statistical Office.

[6] Source: MoF for public debt and NBS for estimated GDP.

[7] Gouverment securities at nominal value.

[8] As of 1 January 2010, the Statistical Office, according to UN recommendations, applies the general trade system which is a broader concept and includes all goods entering/exiting the country's economic territory, apart from goods in transit. The Statistical Office published comparable data for 2007, 2008 and 2009. Previous years are disseminated under a special trade system.

[9] NBS estimate.

Notes:

1. Data are subject to corrections in line with the official data sources.

DEVELOPMENT IN THE BANKING SYSTEM (INCLUDING THE ASSETS TOTAL / GDP)

Throughout the period of crises, the banking sector of Serbia was well protected and not dramatically affected by the negative effects of the crises. Banking sector is adequately capitalized and liquid, as measured by international standards and local regulation, and reliant predominantly on domestic sources of funding (primarily foreign currency savings of citizens).

At the end of 2012, there are **32 banks** operating in Serbia. All banks in Serbia are operating as independent legal entities, no branching is allowed. 21 banks are in majority foreign ownership, 3 banks are in majority ownership of domestic natural persons and legal entities, while 8 banks are in majority ownership of the Republic of Serbia. Foreign-owned banks are members of banking groups from 11 countries and the most significant foreign banks are from Italy and Austria (23% and 16%, respectively), followed by banks from Greece (15%), France (10%) and other countries (11% share in total).

Total balance sheet assets of the banking sector in Serbia reached 25.3 bln EUR with growth rate of 8.7% in 2012.

With a large number of banks holding small shares in total assets, lending, deposits and income, the Serbian **banking sector is fragmented**. The market share of the top five banks in Serbia is 48% for assets, 51% for lending and 48% for deposits.

The nominal growth of banks' total net **loans** was 4.8%, and it was reduced comparing to the growth in the year 2011 (8.9% nominal growth), mainly because of revocation of licence of one bank and significant write-off of another. To great extent, the growth of lending activity is a result of the growth of loans to corporates (12.7%) and households (6.6% nominal growth), while repo transactions with NBS decreased (to 1/3 of repo transactions at the end of 2011, or by 0.8 bln EUR).

At the end of 2012, the share of **NPL**'s in total loans granted was 18.63% gross (10,38% net), while in absolute terms, their level reached 3.2 bln EUR gross. Despite the relative size of the non-performing share of lending portfolios in Serbia's banking sector, significant provisioning has been established both by means of International Financial Reporting Standards ("IFRS") rules (54.9% of NPL's was provisioned) and local asset classification rules (120.7%). At the end of 2012 the National Bank of Serbia adopted measures (primarily related to the conditions under which the banks may assign receivables), which should significantly contribute to resolution of accumulated non-performing loans and produce favorable effects on banks' credit portfolio quality and credit growth.

Deposits recorded growth of 11.3% in 2012, mostly because of a growth in households' deposits (15.8%) with share in the total bank funding sources of 57.1%. At the end of 2012 total FX household saving reached 8.3 bln EUR (0.7 bill EUR more than in 2011).

Also, banks recorded growth in **own funding** sources (8.3% in 2012) which resulted in equity of 5.2 bln EUR and still high proportion of own fund to total liabilities side of balance sheet (20.5%). The **capital adequacy ratio** is 19.9%, significantly above the regulatory minimum of 12%.

The average regulatory **liquidity ratio** for the Serbian banking sector as at 31 December 2012 was 2.1, indicating that liquid assets (core and receivables maturing in the next 30 days) are twice as large as liabilities without maturity and liability maturity within 30 days. Liquid assets comprised 34.5% of total assets and amounted to 57.5% of total short-term liabilities.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN SERBIA

The broader regulatory framework in the field of banking supervision consists of two laws of systemic importance: The Law on the National Bank of Serbia, and the Law on Banks.

Within one of its main objectives - contribution to the safeguarding and strengthening of the stability of the financial system, the National Bank of Serbia is responsible for issuing and revoking operating licenses for banks, as well as carrying out prudential supervision of safety, soundness and legality of bank's operations, and perform other activities in accordance with the Law on Banks.

Activities of National Bank of Serbia are aimed at achieving and maintaining stability of banking sector and whole financial system on one hand, and amending and supplementing existing regulatory framework according to macroeconomic developments and international standards of supervision on the other hand.

During 2012, amendments to the Law on the National Bank of Serbia were adopted with the aim of increasing the quality of supervision of the Serbian financial system. In accordance with these amendments, which came into force in August and November 2012, The Administration for Supervision of Financial Institutions (hereinafter: the Supervision Administration) was formed. The Supervision Administration is an organizational unit within the National Bank of Serbia and does not have a legal personality.

The Supervision Administration was set up to perform activities related to the supervision of banks, insurance companies, financial leasing companies and voluntary pension fund management companies. Supervision Administration can propose to the Executive Board by-laws and issuance of licenses to financial institutions, and must deliver a report to the Council of the Governor each quarter. The Director of the Supervision Administration is appointed by the National Assembly on proposal of the Assembly committee in charge of finance for a six-year renewable term of office, and the Director is a member of the Executive Board of the NBS. Supervision Administration and its mandate are in more detail regulated by the NBS by-law.

The Law on Banks, which was adopted in 2005, has been amended and supplemented in 2010 to widen the set of central bank's instruments for dealing with crisis situations, and to create additional legal grounds for enacting secondary legislation harmonized with Basel II standards.

Implementation of Basel II standards was a strategically important activity for Bank Supervision Department and the whole NBS in 2010 and 2011. This process was successfully completed – regulation in accordance to Basel II standards was published and is effective from 31st December 2011.

In addition to Basel II standards the set of regulations implementing these standards introduced some elements of Basel III such as: (i) exclusion of Tier 3 capital from the total regulatory capital; and (ii) introduction of a capital conservation buffer which effectively disallows banks with a capital adequacy ratio of below 14.5 per cent. (or banks that would fall below a capital adequacy ratio of 14.5 per cent. if dividends were to be paid) to pay out dividends.

During 2012, the National Bank of Serbia continued to improve its regulatory framework in line with international standards of supervision, while taking into account macroeconomic developments and characteristics of the local banking sector. This also included the adoption of certain countercyclical measures aimed at achieving and maintaining the stability of banking sector and whole financial system.

In June and July 2012, amendments and supplements to the Decision on the Classification of Bank Balance Sheet Assets and Off-balance Sheet Items and the Decision on External Bank Audit were adopted to further improve the regulatory framework, and in September 2012, amendments to the Decision on Bank Reporting Requirements were adopted with the aim of improving data quality and quantity.

On 27 October 2012, the Law on the Assumption of Assets and Liabilities of Certain Banks for the purpose of Maintaining the Stability of the Financial System of the Republic of Serbia entered into force and will remain in effect until 31 December 2014. The purpose of this law is to allow for the timely transfer of assets and liabilities of banks (including bridge banks and banks under administration proceedings) owned wholly or partially by Serbia or the autonomous province of Vojvodina, before the revocation of that bank's license and the initiation of the bankruptcy proceedings, thus ensuring the protection of bank's depositors, avoidance of costs for the taxpayers, and maintenance of the stability of the financial system. The transfer, which is subject to a positive opinion of the National Bank, is conducted on the basis of a contract between the bank whose assets and liabilities are being transferred and the transferee bank.

In December 2012, the National Bank of Serbia adopted the amendments and supplements to the Decision on Risk Management by Banks, in which the contents and format of the ICAAP Report were prescribed, allowing banks to submit their first ICAAP Reports as of 31 December 2012. Also, this Decision introduces a narrower liquidity ratio in addition to the ratio currently in force, in order to preserve current levels of liquidity and improve management of liquidity risk in the banking sector. Futher amendments to this Decision were made later in December 2012 in line with the concept of countercyclical regulatory measures. These amendments primarily relate to the conditions under which banks may assign receivables, and should significantly contribute to resolution of accumulated non-performing loans and produce favorable effects on banks' credit portfolio quality and credit growth.

Amendments to the Decision on the Classification of Bank Balance Sheet Assets and Off-balance Sheet Items from December 2012 introduced changes to the regulatory framework relating to: (i) adequate collateral - period of recognition for property mortgage as adequate collateral was extended to 720 days when the debtor is past-due, (ii) receivable restructuring - second restructuring is also recognized for the purposes of calculating days past due under certain conditions, and (iii) credit indebtedness of natural persons – rather than setting a uniform debt-to-income ratio, banks are allowed to regulate through their internal acts the assessment of creditworthiness of natural persons and the assignment of maximum debt-to-income ratios to individual clients.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2012

As 2011, the year 2012 was also the year of Basel II implementation in Serbia. Since the Pillar 1 and Pillar 3 entered into force at the end of 2011, implementation focus in 2012 was mainly related to Pillar 2. As of 31st December 2012 banks were obliged to submit to the NBS the first ICAAP report. On the other hand, during 2012 as preparation for the SREP processes, the NBS developed the new Methodology for assessment of risk profile of the banks. Therefore, in the following period the NBS will devote a lot of its effort in organizing and conducting supervisory dialog with banks, based on principle of proportionality.

In addition, during 2012 the National Bank of Serbia closely monitored the developments regarding the implementation of Basel III standards both EU and worldwide, in the course of preparation for formalizing the Strategy for the implementation of Basel III in Serbia.

Last but not the least, the NBS has envisaged to strengthen its supervisory function. In order to implement SREP successfully, intensify on-site examinations, and prepare for Basel III implementation, the process of recruitment of additional 20 employees in BSD begun in the late 2012. This process was successfully completed at the beginning of 2013.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2012

Measures Against Banks

During 2012, National Bank of Serbia – Banking Supervision Department issued following measures against banks: 14 letters of warning and two ordering letters, five resolutions with orders for banks to undertake certain measures, one resolution on temporary measures and two resolutions on revoking banks' operating licenses, six resolutions on imposing fines to banks and/or a member (members) of the banks' managing and/or executive board; the NBS – BSD also approved three action plans – two for eliminating irregularities in accordance with ordering letters and 1 action plan proposed by shareholders of a bank under a receivership, terminated 18 procedures of examination of particular banks and submitted 12 reports against banks and responsible persons for commercial offences and 16 requests for initiation of the proceedings for commercial misdemeanors against banks and responsible persons.

Licensing and Approvals Regarding Banks

In 2012, NBS - BSD issued one operating license and it was for a bridge bank; approved 42 requests for amendments of banks' founding acts and their articles of association (one procedure was terminated because the request was withdrawn) and 61 requests regarding appointment of managing and executive board members (one request was denied and three procedures were terminated because requests were withdrawn); approved three times acquisiton of an ownership in banks in Serbia, three times denied such approval and one procedure was terminated because request was withdrawn; approved to one bank to acquire its own shares; one bank was permitted to acquire a subsidiary; granted its consent to three banks not to include a subsidiary in consolidated financial statements; approved two times that a bank exclude a claim secured by an adequate guarantee from the calculation of total exposure to single person or a group of related persons; granted to one rating agency *(Moody's Investory Service LTD London)* eligibility of its credit ratings; granted to one external auditor company to be on the List of authorized auditors that can audit financial statements of a bank; approved three requests for including a profit of the current year in the core capital of a bank and denied one; granted consent to one bank for distribution of profit; processed 30 notifications from banks regarding externalization of bank business activities and processes; processed notifications from three banks about their intent to include its subordinated obligations into the supplementary capital (two of which were positively resolved, and one not).

On-site banking supervision

33 on-site supervisions were conducted in 2012. (3 supervisions of safety and soundness and legality of bank's operations from the aspect of risk management- one is still in progress and 10 follow-up on-site supervisions of bank's operations, 9 related to AML/CTF issues and supervision of payment transactions, 8 follow up on-site supervisions of implementation of measures imposed to banks in relation to AML/CTF supervision and supervision of payment transactions, 2 related to supervision provisions of Financial Services Consumer Protection Law and 1 on request of Special Prosecutor's Office.

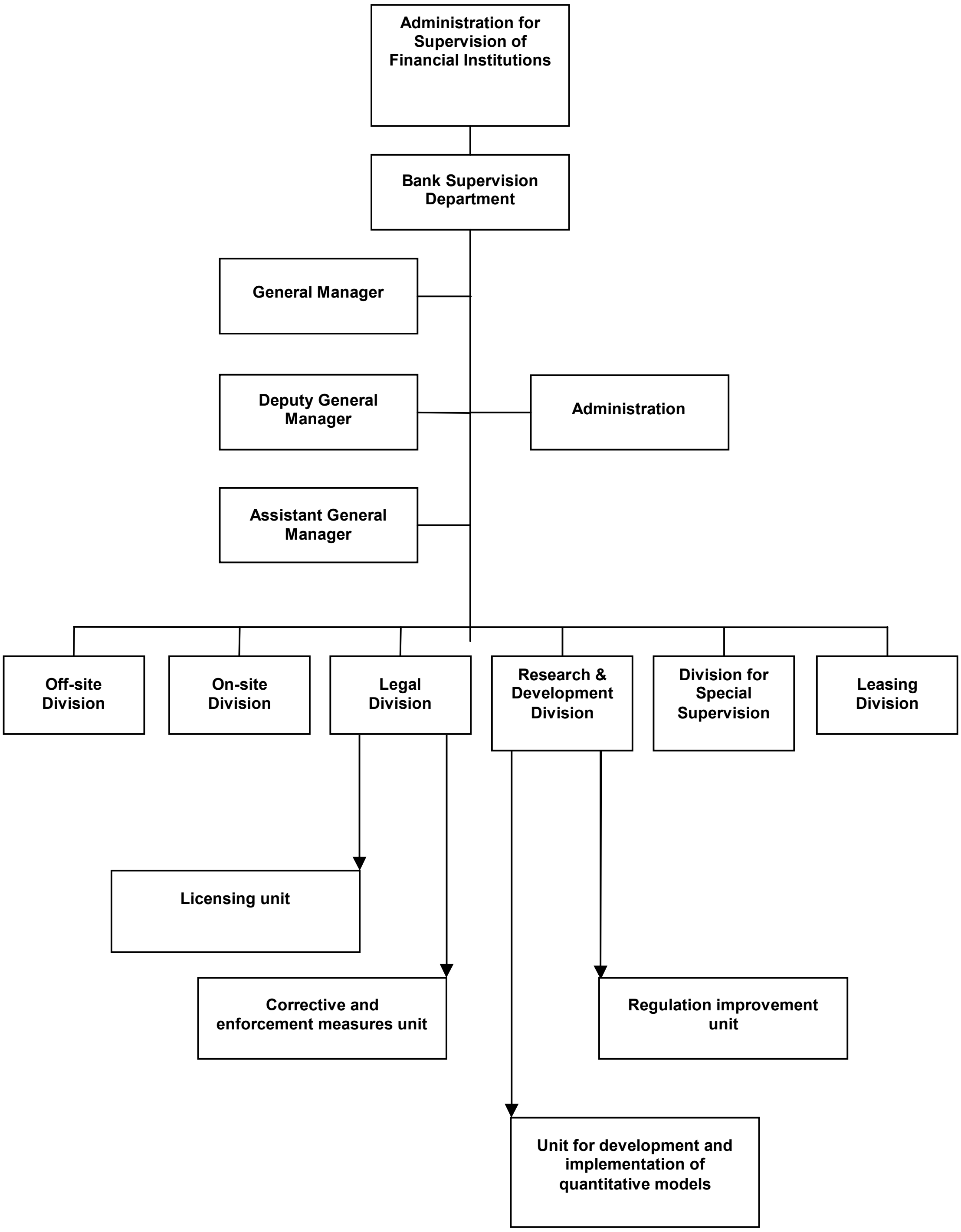
AML

National bank of Serbia, as supervisory body in the field of Prevention of Money Laundering and Financing of Terrorism continued participation in Project against Money Laundering and Terrorist Financing in Serbia (MOLI-Serbia), the most important and the most valuable project to date in Serbia intended against money laundering and terrorist financing. This project is worth 2,365,000 Euros and is mostly funded by the EU through its IPA funds (EUR 2 million), with the Council of Europe participation (EUR 200.000) and a contribution from Serbian Budget. The aim of the project is to improve Serbia's AML/CFT capacities in terms of legislative provisions, professional training and supervisory and operative capacities.

As a part of Project MOLI – Serbia, Republic of Serbia completed Comprehensive National risk assessment of Money Laundering (NRA), based on the World Bank methodology. National bank of Serbia, Banking Supervision Department was the coordinator in conducting Assessment of vulnerability of the banking sector.

Banking supervision staff also participated in the preliminary NRA using IMF methodology, through filling-in of a series of questionnaires related to supervisory and other relevant AML/CFT issues.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

In the field of banking supervision, the National Bank of Serbia, signed Memorandums of Understanding with foreign supervisory authorities from 12 countries and one Multilateral Agreement on Cooperation and Coordination regarding the consolidated supervision of a specific banking group (establishing College of supervisors for that banking group) in previous period. It is important to mention that the National bank of Serbia has already established very successful practical cooperation with all supervisory authorities which supervise parent banks that have their subsidiaries in Serbia.

Beyond signing Memorandums of Understandings, cooperation is extended through active participation at Supervisory Colleges organized by competent authorities in Italy, Austria, Slovenia, Hungary, Greece, Belgium and Cyprus. Although more often as host supervisor, the National bank of Serbia was active as home supervisor, as well: relevant supervisory college was organized in Belgrade.

COOPERATION WITH OTHER SUPERVISORY BODIES IN SERBIA

Cooperation with other supervisory bodies in the country was already established. The NBS has signed Memorandums of Understanding with following domestic bodies and institutions:

- Association of Serbian Banks
- Deposit Insurance Agency
- Tax Administration of the Republic of Serbia
- Securities Commission
- Belgrade Stock Exchange
- Commission for Protection of Competition
- Administration for the Prevention of Money Laundering

The NBS successfully cooperates with all before mentioned supervisory authorities whenever there is a need for sharing information in accordance with MoUs signed.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

In Serbia, as well as in other countries in the CEE region, there is relatively high level of non-performing loans. In addition to introducing regulatory measures aimed at resolving the problem of high NPLs in Serbia, the National bank of Serbia analyzed various topics related to the monitoring of NPLs and loan loss provisioning.

In March 2012, the National Bank of Serbia prepared The Questionnaire on Loan Loss Provisions and Non-performing Loans in order to analyze different regulations and practices in the field of loan loss provisioning and NPLs across jurisdictions of BSCEE member countries. The findings of this comparative analysis, which were shared with BSCEE members, highlighted the existence of cross-country comparability issues regarding definition of NPLs and structure of NPL ratios, as well as variations in loan classification practices across jurisdictions which may have implications for the comparability of banks' financial condition and, ultimately, financial stability.

As a result of these conclusions, in March 2013, the NBS came forward with a proposal to all BSCEE member countries to prepare a joint initiative towards the Basel Committee for Banking Supervision (BCBS) regarding the need for developing a unique methodology for calculating NPL ratio which would be universally accepted by BSCEE members strictly for reporting purposes and would make possible the creation of a framework for common and comparable reporting in the issues of NPLs.

The above mentioned initiative coincided with the publication of the Consultation Paper on definitions and associated reporting templates on forbearance and non-performing exposures by the European Banking Authority (EBA). Having in mind the need for harmonization in the EU regarding this matter, possible further proposals by the NBS to BSCEE members will be made taking into account this document, upon its final publication.

STATISTICAL TABLES

Number of financial institutions (head offices/branches)
(at year-ends)

Type of financial institution	2010	2011	2012
Commercial banks	33	33	32
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**33**	**33**	**32**

Ownership structure of the financial institutions
on the basis of registered capital (%)
(at year-ends)

Type of financial institution	2010	2011	2012
Public sector ownership	17.9	17.9	18.1
Other domestic ownership	8.6	8.0	6.8
Domestic ownership total	26.5	25.9	24.9
Foreign ownership	73.5	74.1	75.1
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions
(at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	34.1	48.1	678
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**34.1**	**48.1**	**678**

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2010	2011	2012
Commercial banks	5.4	6.0*	4.7**
Cooperative banks			
Other			
Banking sector, total:	5.4	6.0*	4.7**

* Data without Agrobanka (licence revoked in May 2011)
** Data without Razvojna banka Vojvodine (licence revoked in April 2013)

Distribution of market shares in balance sheet total (%)

Type of financial institution	2010	2011	2012
Commercial banks	100.0	100.0	100.0
Branches of foreign credit institutions			
Cooperative banks			
Other			
Banking sector, total:	**100.0**	**100.0**	**100.0**

The structure of assets and liabilities of the banking system (%) (at year-end)

Assets	2010	2011	2012
Financial sector	10.8	9.6	7.1
Nonfinancial sector	54.1	52.5	53.0
Government sector	11.0	12.1	14.8
Other	24.1	25.8	25.1
Liabilities	**2010**	**2011**	**2012**
Financial sector	17.9	13.6	12.3
Nonfinancial sector	44.0	47.1	48.5
Government sector	3.1	3.3	3.5
Capital	19.7	20.6	20.5
Other	15.3	15.5	15.2

Capital adequacy ratio of banks

Type of financial institution	2010	2011	2012
Commercial banks	19.9	19.1	19.9
Cooperative banks			
Banking sector, total:	**19.9**	**19.1**	**19.9**

(* - for Basel I; ** - for Basel II)

Asset portfolio quality of the banking sector (share of impaired receivables / share of non-performing loans)

Type of financial institution	2010	2011	2012
Non financial sector			
- households	7.85	7.93	8.49
- corporate	21.85	24.62	21.19

The structure of deposits and loans of the banking sector in 2012 (%) (at year-end)

	Deposits	Loans
Households	59.9	34.3
Government sector	4.2	9.1
Corporate	22.7	49.6
Other (excluding banks)	13.1	7.0
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends)

P&L account	2010	2011	2012
Interest income	179,702	201,234	200,683
Interest expenses	71,315	82,558	83,611
Net interest income	108,387	118,676	117,072
Net fee and commission income	32,985	35,335	35,543
Other (not specified above) operating income (net)	17,439	10,818	16,528
Gross income	158,811	164,829	169,143
Administration costs	92,229	93,535	100,375
Depreciation	8,588	8,353	8,462
Provisions	0	0	0
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	32,596	61,689	45,652
Profit (loss) before tax	25,398	1,252	11,654
Net profit (loss)	22,622	-1,877	8,446

Total own funds in 2012 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	3,078,407	2,940,591	137,816	
Cooperative banks				
Banking sector, total:	**3,078,407**	**2,940,591**	**137,816**	

2012 DEVELOPMENTS IN THE SLOVAKIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Growth of real GDP slowed down to 2.0 % in 2012, from 3.2 % in 2011. This deceleration was mainly the consequence of recession and ongoing debt crisis in eurozone. Nevertheless, growth rate of Slovak economy was one of the fastest within Europe in 2012.

However the progress of Slovak economy was not robust enough. Then only driver of growth was export of goods and services. This was to a large extent connected to the increase of industrial production in Slovakia (of which automotive industry is the most important part), which is predominantly earmarked for foreign markets.

All components of domestic demand acted as a drag on Slovakia's economic growth. Consumption of households and investments of non-financial enterprises were negatively affected by poor confidence due to uncertainty about future macroeconomic developments (domestic as well as in whole Europe). Households suffered another year of shrinking real incomes, what weighted on their consumption too. Public sector consumption also decreased somewhat as a part of government's consolidation effort.

From second half of the year 2012 on worsening macroeconomic conditions resulted in the increase of unemployment rate which approached the level of 15 %, one of the highest in eurozone.

According to economic forecasts of NBS Slovak economy is expected to decelerate still further in 2013 as domestic demand will remain sluggish and export performance will slow down.

DEVELOPMENT IN THE BANKING SECTOR

Development in the Slovak banking sector in 2012 can be assessed as modestly positive. Gross assets of sector grew by 3.4 % y-o-y. Since nominal GDP of Slovakia increased by the same rate in 2012, Total assets-to-GDP ratio remained unchanged at the level 85 %.

Growth of balance sheet total was driven by loans to households whose volume increased by 9 %. Dynamics of housing loans in Slovakia, which represent the major part of loans to households, was even the highest among all EU counties. Both, demand and supply factors, contributed to this growth. Development of loans to enterprises was more in line with trends observed in the rest of Europe. Annual growth rate of these loans turned negative during the course of 2012 and stood at -3.5 % as at December 2012.

Deposits from customers, which represent stable form of financing, continued growing during 2012. Positive consequence of this is that Loans-to-Deposits ratio in Slovakia (82 % as at 31.12.2012) remained one of the lowest in EU.

In 2012 profitability of the Slovak banking sector decreased by one third in comparison to 2011. Two main factors behind deterioration of profitability were imposition of bank levy by government and increase of credit risk's costs. Narrowing of interest margins also contributed to lower profitability.

Capital adequacy ratio of Slovak banking sector increased significantly to historically high level of 15.99 %. Banks, at the sectoral level, strengthened their own funds via issuance of new capital and retained earnings of the year 2011.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN SLOVAKIA

The National Bank of Slovakia performs supervision of the financial market.

As part of its supervision of the financial market, the National Bank of Slovakia shall perform supervision of banks, branch offices of foreign banks, securities dealers, branch offices of foreign securities dealers, stock exchanges, central depositories, asset management companies, branch offices of foreign asset management companies, mutual funds, foreign collective investment undertakings, insurance companies, reinsurance companies, branch offices of foreign insurance companies, branch offices of foreign reinsurance companies, branch offices of insurance companies from another state, branch offices of reinsurance companies from another state, pension asset management companies, pension funds, supplementary pension insurance companies, supplementary pension companies, supplementary pension funds, payment institutions, branch offices of foreign payment institutions, rating agencies, electronic money institutions, branch offices of foreign electronic money institutions, independent financial agents, financial advisers, the Deposit Protection Fund, the Investment Guarantee Fund, the Slovak Bureau of Insurers, consolidated groups, subconsolidated groups, financial holding institutions, mixed financial holding companies, financial conglomerates, also over other persons, other property associations with a designated purpose and over groups of persons and property associations with a designated purpose.

No major changes in the area of legal competence of the National Bank of Slovakia were applied during the year 2012.

MAIN STRATEGIC OBJECTIVES IN 2012

The main strategic objectives of the banking supervision could be summarized in the following points:

- Capital Adequacy Assessment (RAS-ICAAP-SREP)
- Credit risk, including IRB model validations
- Anti-Many Laundering

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2012

on-site

15 on-site examinations started in 2010 (14 in banks and 1 in branch of foreign bank). Ten examinations were formally completed in 2011, while other was formally completed in the first quarter of the year 2013.

The main topics of on-site supervision of banks were checking the quality of the risk management system, particularly credit risk, liquidity risk, market and operational risks and the related issues of capital requirements reporting for individual risks.

In addition the provisioning, credit receivables, investment services and the prevention of money laundering were examined.

off-site

Off-site supervision of banks and branches of foreign banks includes regular analyzing of reports, monitoring of prudential indicators, analytical work, and communication with the supervised entities and with HOME supervisory authorities.

In the 2012 Department of the banking supervision and payment services prepared monthly assessment of banks and branches of foreign banks, semi-annual analysis of individual banks and annual reports of each bank containing a detailed assessment of each bank, including an assessment of capital adequacy under Pillar II. Detailed reports were provided for HOME supervisors for the Join Risk Assessment purposes.

ORGANISATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

- Executive Director of the Financial Market Supervision Unit
  - BANKING AND PAYMENT SERVICES SUPERVISION DEPARTMENT
    - First Instance Proceedings Section
    - Section for Supervision of Banks with Advanced Risk Management Approach
    - Section for Supervision of Banks with Standardized Risk Management Approach
    - Supervision of Payment Services and Foreign Exchange Supervision Section
  - SECURITIES MARKET, INSURANCE AND PENSION SAVINGS SUPERVISION DEPARTMENT
    - First Instance Proceedings Section
    - Securities Market and Pension Savings Supervision Section
    - Insurance Supervision Section
    - Financial Mediation and Financial Advisory Supervision Section
  - REGULATION DEPARTMENT
    - Banking and Payment Services Regulation Section
    - Securities Market and Pension Savings Regulation Section
    - Insurance Regulation Section
    - Financial Models and Information Support Section
  - MACROPRUDENTIAL POLICY DEPARTMENT
  - Financial Clients Protection Section

INTERNATIONAL ACTIVITIES

The representatives of the Department are members of the EBA Board of Supervisors. Several employees have been nominated as members of all working groups across the four Standing Committees.

An essential part of the banking supervision constitutes the cooperation with supervisory bodies which supervise parent institutions of subsidiaries based in Slovakia. This cooperation is realized mainly through the colleges of supervisors for the respective banking group.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

The Banking and Payment Services Supervision Department communicates with all relevant sector associations, especially within the processes of preparation of regulation, recommendations and guidelines. There is a close cooperation among the NBS, the Ministry of Interior and the Police Headquarters. In 2012 the cooperation between the NBS and Financial Police has been strengthened (AML, terrorism financing).

STATISTICAL TABLES

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution	2010	2011	2012
Commercial banks	15	14	14
Branches of foreign credit institutions	14	17	14
Cooperative banks	0	0	0
Banking sector, total:	**29**	**31**	**28**

Ownership structure of banks on the basis of assets total (%)

Type of financial institution	2010	2011	2012
Public sector ownership	0.9	0.9	0.8
Other domestic ownership	0.3	0.3	0.4
Domestic ownership total	1.2	1.2	1.2
Foreign ownership	98.8	98.8	98.8
Financial Institutions, total	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	59.1	76.8	1429
Branches of foreign credit institutions	59.1	80.3	1526
Cooperative banks	-	-	-
Banking sector, total:	**54.5**	**70.7**	**1221**

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2010	2011	2012
Commercial banks	12.28	14.19	9.09
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**12.28**	**14.19**	**9.09**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2010	2011	2012
Commercial banks	93.1	92.8	92.1
Branches of foreign credit institutions	6.9	7.2	7.9
Cooperative banks	-	-	-
Other	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

The structure of assets and liabilities of the banking system (%) (at year-end)

Assets	2010	2011	2012
Financial sector	12.7	10.1	11.0
Nonfinancial sector	56.7	60.2	60.0
Government sector	24.8	23.3	22.8
Other	5.8	6.4	6.1
Liabilities	**2010**	**2011**	**2012**
Financial sector	13.9	13.0	12.1
Nonfinancial sector	61.6	62.5	63.5
Government sector	3.3	1.5	1.5
Capital	12.4	13.6	14.2
Other	8.9	9.3	8.7

Capital adequacy ratio of banks (%)

Type of financial institution	2010	2011	2012
Commercial banks	12.68**	13.41**	15.99**
Cooperative banks	-	-	-
Banking sector, total:	**12.68****	**13.41****	**15.99****

(* - for Basel I; ** - for Basel II)

Asset portfolio quality of the banking sector (share of impaired receivables / share of non-performing loans) (%)

Asset Classification	2010	2011	2012
Non financial sector	6.07	5.75	5.36
- households	**5.12**	**4.85**	**4.33**
- corporate	**8.2**	**7.97**	**7.63**

The structure of deposits and loans in 2012 (%) (at year-end)

	Deposits	Loans
Household	62.2	50.1
Government sector	2.1	2.7
Corporate	34.9	46.6
Other (excluding banks)	0.7	0.6
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends)

P&L account	2010	2011	2012
Interest income	2 264 837	2 522 076	2 483 203
Interest expenses	575 829	714 796	722 346
Net interest income	1 689 008	1 807 280	1 760 857
Net fee and commission income	419 562	444 026	429 087
Other (not specified above) operating income (net)	-63 416	33 564	-282 112
Gross income	2 065 011	2 302 153	1 942 863
Administration costs	957 595	990 124	1 011 199
Depreciation	150 976	133 577	143 966
Provisions	290 172	336 358	167 172
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	1 671 684	1 987 592	1 528 511
Profit (loss) before tax	646 411	824 811	585 495
Net profit (loss)	503 650	674 245	485 782

Total own funds in 2012 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	4 963 820 460	4 649 358 260	314 462 200	0
Cooperative banks	-	-	-	-
Banking sector, total:	**4 963 820 460**	**4 649 358 260**	**314 462 200**	**0**

2012 DEVELOPMENTS IN THE SLOVENIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

According to figures adjusted for the season and the number of working days, Slovenian GDP was down 2.2% in 2012. The fall was 1.7 percentage points higher than the euro area average. Total domestic consumption was down by nearly 6% in Slovenia and by 3.7 percentage points less in the euro area. A more significant drop in GDP in 2012 was prevented by the high contribution of net exports, which was primarily the result of a sharp decrease in imports.

The crisis spread to all categories of economic activities in 2012. All categories of service activities in the private sector, where total value-added was down nearly 2%, were hit harder than in 2011 due to increasingly weak domestic consumption. The contraction in construction activity accelerated due to the continued sharp decline in investment in the aforementioned sector.

The deteriorating economic situation accelerated the decline in employment. The workforce in employment was down 3% in year-on-year terms at the end of 2012, bringing employment close to the level recorded in 2005.

By the end of 2012, the number of registered unemployed rose to nearly 120,000, bringing the unemployment rate to 13%, the highest since May 1999. The surveyed unemployment rate was also high at the end of the year, at 9.6%, but was still considerably below the euro area average.

As measured by the harmonised index of consumer prices, average inflation in Slovenia was up 0.7 percentage points in 2012 relative to 2011 to stand at 2.8%. Average annual inflation in Slovenia was somewhat above the euro area average of 2.5%.

A high current account surplus was achieved in 2012. The surplus amounted to EUR 818 million or 2.3% of GDP, largely due to the rapid narrowing of the merchandise trade deficit. The decline in domestic consumption picked up pace in the second quarter. This, together with declining growth in foreign demand and exports, accelerated the drop in imports.

Net external debt rose by EUR 954 million in 2012 to stand at EUR 14.3 billion at the end of the year. The increase in net external debt was the result of an increase in the gross external debt and a decline in gross external claims. The main contributions to the increase in net external debt came from the government sector and the Bank of Slovenia, in the combined amount of more than EUR 3.2 billion. The government issued USD 2.25 billion of government bonds last year, thereby increasing the government sector’s net external debt by almost EUR 1.5 billion.

According to ESA 95 methodology, the general government deficit narrowed by 2.7 GDP percentage points in 2012 to 3.7% of GDP. General government revenues were down 0.4% in the context of the adverse economic conditions. General government expenditure was down in 2012 for the first time since the crisis period started, by 5.7%. Government expenditure on investment was down for the fourth consecutive year. The largest year-on-year decline was recorded by capital transfers, which were particularly high in 2011 due to transactions of a one-off nature (three major transactions of a one-off nature amounted to 1.1% of GDP), while only the recapitalisation of NLB d.d. in the amount of 0.2% of GDP was disclosed in 2012. Although the general government deficit narrowed significantly in 2012, it was 0.2 GDP percentage points higher than expected in the April 2012 update to the Stability Programme. According to the European Commission's estimates from February 2013, the structural deficit amounted to 3.1% of GDP, down 1.4 GDP percentage points on the previous year.

At the end of 2012, the general government debt stood at EUR 19,189 million or 54.1% of GDP. Borrowing was mostly undertaken in October via the issue of ten-year bonds on the US market in the amount of USD 2.25 billion, and via the issue of treasury bills and the raising of long-term loans. Slovenian government guarantees were down by nearly EUR 0.5 billion in 2012, to stand at EUR 6.5 billion or 18.3% of GDP at the end of the year.

The spreads on Slovenian long-term government bonds over the benchmark German bonds fell until the middle of March and gradually increased after March. In the middle of the summer, the spreads reached their peak of around 600 basis points and the required yield was close to 7.4%. Ratings agencies downgraded Slovenia twice during the year, during the first two months of the year and in August. The spreads on Slovenian long-term government bonds gradually fell from the middle of August on. From October on, when a Slovenian long-term bond was issued on the US market, the spreads reached a relatively stable level of close to 400 basis points, while required yields fluctuated at around 5.5%.

In December 2012 the National Assembly unanimously passed pension reform, which took effect on 1 January 2013. The implementation of structural reforms and the continuation of fiscal consolidation remain a priority for Slovenia in the future, in terms of requirements to further reduce the general government deficit, and in terms of accessibility to and the prices of financing on foreign markets and achieving long-term sustainable public finances.

DEVELOPMENTS IN THE BANKING SYSTEM

At the end of 2012 the Slovenian banking system comprised 17 banks (including seven subsidiary banks), three branches of foreign banks and three savings banks. The number of banks was down by two. One smaller bank under majority domestic ownership merged with another bank, while one bank under majority foreign ownership ceased to operate in Slovenia. The banks accounted for 98.8% of the total assets of the Slovenian banking system. In terms of ownership structure, the banking system comprises ten banks under majority domestic ownership and seven banks under majority foreign ownership. The proportion of the banks' equity held by non-residents increased by 3 percentage points in 2012 to 41%.

The banking system's total assets amounted to EUR 46.1 billion at the end of 2012, having declined by EUR 3.1 billion or 6.3% during the year. Deposits by non-banking sectors, as the most important source of funding, were down by EUR 724 million last year, compared to an increase of EUR 703 million in 2011. Despite recapitalisations at seven banks in the total amount of EUR 576 million, the banking system's equity was down by EUR 212 million in 2012 due to losses generated during the year.

Among investments, which were down by EUR 3.3 billion relative to 2011, the banks primarily reduced loans to non-banking sectors. Loans to households were down for the first time last year owing to a decline in consumer loans. The downturn in economic activity resulted in lower corporate and household demand for loans. At the same time, limited access to funding on the international financial markets forced banks to reduce their lending. The need to rationalise the use of their capital also forced the banks to restructure investments, as their capital adequacy is lower on average than the capital adequacy of EU banks.

Refinancing risk remains high for Slovenian banks. The intense restructuring of the banks' funding continued in 2012. Banks reduced their dependence on wholesale funding due to the uncertain situation on the international financial markets. The banks compensated for the loss of international sources of funding primarily by borrowing via the Eurosystem's 3-year LTROs. The proportion of total funding accounted for by LTROs was thus up by 5.1 percentage points to stand at 8.7% or EUR 4 billion at the end of 2012. At 51.7% of the banks' total liabilities, deposits by non-banking sectors still represent the banks' most important source of funding. The stock of deposits by non-banking sectors was down 2.9% in year-on-year terms in 2012.

Slovenian banks were exposed to significant income risk again in 2012. Growth in net interest income was down in 2012 due to a more significant decline in interest income relative to interest expenses. The banking system's net interest income was thus down 12.9% last year. Higher net non-interest income, which was mostly of a one-off nature, had a positive impact on the operating results of the entire system. The banking system recorded a loss after taxation of EUR 754 million.

Credit risk continued to rise in 2012, but at a slower pace than in 2011. The further deterioration in the credit portfolio was evidenced by an increase in the proportion of non-performing claims, as measured by claims more than 90 days in arrears, by 3.2 percentage points to 14.4% of classified claims.

Liquidity risk, as measured by the first-bucket liquidity ratio, was moderate and lower relative to 2011. The restructuring of funding and the increase in the banks' net borrowing from the Eurosystem resulted in a decrease in the proportion accounted for by the pool of eligible collateral for Eurosystem transactions. However, that proportion remains at a satisfactory level for the banking system overall.

At 11.9% at the end of December 2012, capital adequacy on an unconsolidated basis was up 0.3 percentage points on the end of 2011. The Tier 1 capital ratio was up by 0.6 percentage points to stand at 10.2%. Nevertheless, the values of the two ratios on a consolidated basis are below the euro area average, which increases the lack of confidence of foreign investors.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN SLOVENIA

The financial market comprises three sectors and is supervised by three autonomous independent supervisory authorities:

- the banking sector (principally represented by banks and branches of foreign banks) supervision is under competence of the Bank of Slovenia,
- the capital market is supervised by the Securities Market Agency and
- the insurance sector with pension savings is supervised by the Insurance Supervision Agency.

According to the Bank of Slovenia Act the central bank carries out supervision of credit institutions in order to maintain the stability and security of their operations and for the creation of confidence in the banking system, particularly among savers and depositors. In accordance with the statutory mandate the tasks of the Banking Supervision Department of the Bank of Slovenia include in particular the performance of licensing, authorisation and notification procedures for the work of these institutions, giving consent for members of boards of management to hold their offices in banks, and other authorisations and consents prescribed by The Banking Act, the performance of on site inspection in banks, collecting and analysing quantitative and qualitative information from supervised entities and other sources, cooperate with other supervisors in the country and outside, participate actively at international supervisory forums, working groups and colleges.

Regulations developments, by months:

- In March:
  Regulation on the calculation of capital requirements for credit risk under the standardised approach, Regulation on the calculation of capital requirements for credit risk under the internal ratings-based approach, Mortgage Bond and Municipal Bond Act (ZHKO-1), Regulation on the books of account and annual reports of banks and savings banks, Guidelines for compiling the statement of financial position, income statement and statement of comprehensive income, and calculating the performance indicators of banks and savings banks, Regulation on the reporting of individual facts and circumstances of banks and savings banks
- In April:
  Regulation on the minimum requirements for ensuring an adequate liquidity position at banks and savings banks, Regulation on the assessment of credit risk losses of banks and savings banks, Regulation amending the regulation on the deposit guarantees system
- In May:
  Regulation on the reporting of Member State bank branches
- In September:
  Regulation on the reporting of individual facts and circumstances of banks and savings banks.

- In October:
  Regulation on the deposit guarantee system, Guidelines for compiling the statement of financial position, the income statement and the statement of comprehensive income, and for calculating performance indicators of banks and savings banks
- In December:
  Banking Act, Regulation on the calculation of the own funds of banks and savings banks, Regulation on the calculation of capital requirements for credit risk under the standardised approach for banks and savings banks, Regulation on credit protection

For detailed information on specific amendments see Annual Report 2012 published on http://www.bsi.si/.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2012

The main strategic orientation of banking supervision, coming out of The Bank of Slovenia's strategic plan for the period 2009 – 2012 is to design and introduce conditions for a stable and efficient banking system and for the security of deposits at banks and savings banks.

In the frame of this strategic objective and considering the current situation of the macroeconomic environment the main focus of banking supervision in 2012 were:

- evaluation of increasing credit risk in banks as a consequence of economic and financial crisis,
- carefully monitoring of overall liquidity in the banking system as well as the position of individual banks,
- emphasizing the attention to the capital position of banks and required increase of Tier I capital with the goal to increase robustness of banks,
- adoption of the national legislation according to the latest changes of EU legislation,
- further intensifying of cross-boarder cooperation with foreign supervisory authorities at IRB and AMA approval processes and supervisory colleges.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

LICENSING

The Bank of Slovenia issued a total of 21 authorisations in 2012, and suspended the authorisation procedure for five applications. Most authorisations (twelve) issued in 2012 were to hold office as a member of a bank's management board, three were to provide ancillary financial services, two were to merge one bank with another bank, and one was to acquire a qualifying holding in a bank. One authorization was issued to issue municipal bonds, while two related authorisations were issued to provide cover pool trustee transactions. The Bank of Slovenia revoked two authorisations to acquire a qualifying holding in a bank in 2012, because the holders no longer satisfied the conditions defined by regulations that owners of a significant holding should permanently satisfy.

EXAMINATIONS OF BANKS AND SAVINGS BANKS

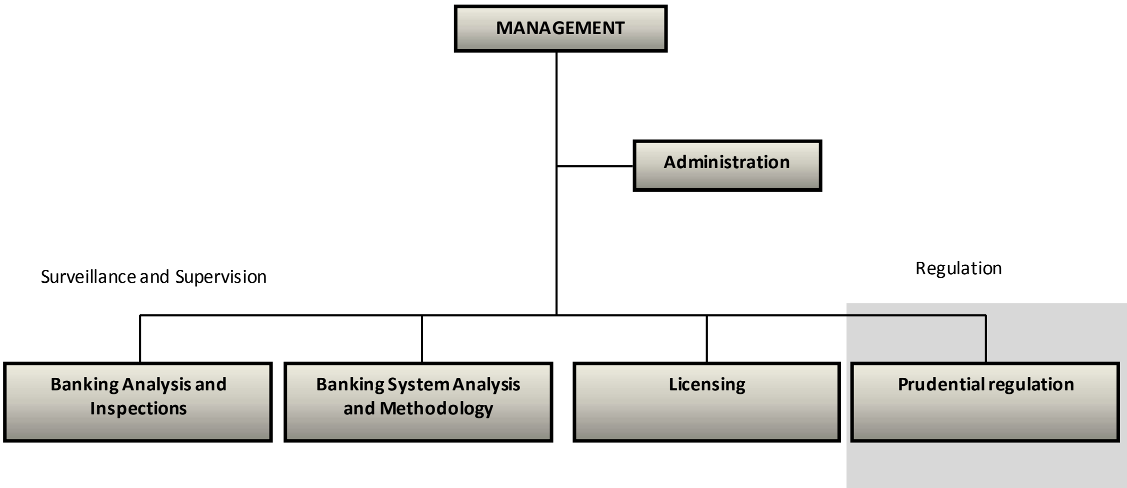
Given the situation in the banking system, the priorities of banking supervision in 2012 were the monitoring of increasing credit risk and the deteriorating liquidity at the banks, and achieving the required level of capital. In procedures initiated in 2012 and procedures initiated prior to that, the Banking Supervision Department carried out:

- 13 prudential examinations which covered specific risk areas (e.g. credit, liquidity, market, operational, interest rate, capital and liquidity risks) and the control environment, and checks on compliance with legislation,
- 30 follow-up examinations to review the implementation of measures,
- 26 thematic examinations,
- two examinations in cooperation with other domestic supervisors (ISA and SMA), and
- two examinations of other non-banking entities due to suspicion of the performance of banking activity.

Based on the findings of examinations and reviews at banks and savings banks, the Bank of Slovenia may issue recommendations, admonishments or orders, or another measure in accordance with the Banking Act. There were 18 orders to eliminate violations issued in 2012, along with 56 admonishments and 64 additional reporting requirements and recommendations to improve operations, and conditions for the granting of authorisations. The majority of measures were issued in the area of credit risk. More attention in banking supervision was also given to the governance and management of banks in 2012, as the crisis causes inappropriate decisions and misconduct of banks, and thus requires truly experienced and professional personnel on the management boards and supervisory boards of banks. The Bank of Slovenia imposed measures on seven banks in 2012 relating to conduct and the fulfilment of the conditions to serve as a member of the management board or supervisory board of banks:

- demands for the dismissal of eight supervisory board members who did not possess the required expertise and necessary experience for the supervision of banks;
- admonishments of four management board members for inappropriate conduct in connection with the management of banks, and
- two decisions to dismiss two management board members for repeated violations.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISION DEPARTMENT



TIES OF THE AUTHORITY

Supervision is also carried out by participating in supervisory colleges and in other forms of bilateral cooperation between supervisors (e.g. final meetings following examinations, cooperation in the implementation of the measures for banking groups or individual banks from a group for which supervisors are jointly responsible, etc.). Bank of Slovenia supervisors participated in 15 procedures with other supervisors in 2012, as follows:

- eight supervisory colleges of internationally active banking groups, whose subsidiary banks operate in Slovenia;
- two supervisory colleges for Slovenian banks with bank subsidiaries in other countries, where the Bank of Slovenia, as the home supervisor of the group in question, acted as the organiser of the colleges; and
- five other bilateral supervisory procedures.

COOPERATION WITH OTHER DOMESTIC SUPERVISORY AUTHORITIES

The Bank of Slovenia cooperates with other competent authorities in Slovenia when irregularities that surpass the competences of banking supervision are identified. In 2012 the Bank of Slovenia filed charges in three cases with the National Bureau of Investigation and charges in one case with the Ljubljana Police Department due to suspicion of criminal acts. At the invitation or request of other authorities, the Bank of Slovenia cooperated with the State Prosecutor General in two matters, the National Bureau of Investigation in seven matters, and in two matters with the Maribor Police Department and the Office for the Prevention of Money Laundering, and in one matter with the Commission for the Prevention of Corruption, by providing data and information relating to banking supervision.

STATISTICAL TABLES

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution	2010	2011	2012
Commercial banks[1]	22	22	20
Branches of foreign credit institutions	3	3	3
Cooperative banks	0	0	0
Banking sector, total	**25**	**25**	**23**

[1] including 3 savings banks

Ownership structure of the financial institutions on the basis of registered capital (%) (at year-ends)

Type of financial institution	2010	2011	2012
Public sector ownership	21,7	24,2	22,9
Other domestic ownership	40,1	37,7	38,3
Domestic ownership total	61,8	61,9	61,2
Foreign ownership	38,2	38,1	38,8
Banking sector, total	**100,0**	**100,0**	**100,0**

Concentration of asset by the type of financial institutions in 2012 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	43,9%	58,1%	0,0814
Branches of foreign credit institutions	100,0%	/	0,7245
Cooperative banks	/	/	/
Banking sector, total	**43,2%**	**57,1%**	**0,1042**

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2010	2011	2012
Commercial banks	-2,4	-12,7	-19,2
Branches of foreign credit institutions	/	/	/
Cooperative banks	/	/	/
Banking sector, total	**-2,3**	**-12,5**	**-19,0**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2010	2011	2012
Commercial banks	99,0	98,7	98,3
Branches of foreign credit institutions	1,0	1,3	1,7
Cooperative banks	/	/	/
Banking sector, total	/	/	/

The structure of assets and liabilities of the banking system (%) (at year-end)

Assets	2010	2011	2012
Financial sector[1]	14,4	13,8	12,8
Nonfinancial sector[2]	66,1	64,8	63,3
Government sector[3]	11,2	12,8	14,8
Other	8,4	8,6	9,1
Liabilities	**2010**	**2011**	**2012**
Financial sector[1]	29,8	26,2	23,2
Nonfinancial sector[2]	41,0	42,9	45,2
Government sector	6,0	7,0	6,6
Capital	8,2	8,0	8,1
Other[4]	15,0	15,8	17,0

[1] banking sector
[2] non-banking sector
[3] included government debt securities
[4] included funding from ECB

Capital adequacy ratio of banks

Type of financial institution	2010	2011	2012
Commercial banks**	11,3	11,6	11,9
Cooperative banks	/	/	/
Banking sector, total**	**11,3**	**11,6**	**11,9**

(* - for Basel I; ** - for Basel II)

Asset portfolio quality of the banking sector[1] (share of impaired receivables / share of non-preforming loans[1])

Type of financial institution	2010	2011	2012
Non financial sector	7,2	11,1	14,4
- households[2]	4,0	4,5	4,9
- corporate	12,3	18,5	24,0

[1] Table includes only share of non-performing loans. Non-performing loans include all classified claims (financial assets at amortized cost and some risky-bearing off-balance sheet items) more than 90 days in arrears.

[2] Just citizens without small entrepreneurs

The structure of deposits and loans of the banking sector in 2012 (%) (at year-end)

	Deposits	Loans
Households	62,16	28,57
Government sector	12,67	5,66
Corporate	15,57	53,10
Other (excluding banks)	9,60	12,67
Total	**100,0**	**100,0**

P&L account of the banking sector (at year-ends)

P&L account	2010	2011	2012
Interest income	2.075.028	2.207.430	1.944.092
Interest expenses	1.027.718	1.189.886	1.057.784
Net interest income	1.047.310	1.017.540	886.310
Net fee and commission income	349.798	346.460	339.436
Other (not specified above) operating income (net)	93.933	82.842	302.558
Gross income	1.491.041	1.446.842	1.565.693
Administration costs	691.422	687.096	658.268
Depreciation	87.248	89.502	84.411
Provisions	20.047	62.227	-30.100
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	791.231	1.144.536	1.629.502
Profit (loss) before tax	-98.907	-536.521	-776.375
Net profit (loss)	-96.289	-441.998	-754.031

Total own funds in 2012 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	4.196.409.314	3.603.875.704	592.533.611	/
Cooperative banks	/	/	/	/
Banking sector, total	**4.196.409.314**	**3.603.875.704**	**592.533.611**	**/**

* There is no Tier 3 capital applied in our banking system.

2012 DEVELOPMENTS IN THE UKRAINIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

External economic conditions in 2012 were unfavourable for Ukraine. Demand for, and the prices of, traditional Ukrainian exports fell amid the prevailing recession trend in the world economy. This had an impact on Ukraine's economic development indicators.

Real GDP grew by 0.2% in 2012, compared to 5.2% in 2011. Nominal GDP was UAH 1,408.9 billion, an increase of 8.6% from the previous year. Industrial output declined by 1.8% in 2012, while real disposable household income rose by 9.7% (in 2011: by 6.1%).

Headline inflation stood at 99.8% compared to 104.6% in 2011. The industrial producer price index was 100.3%.

Core inflation was 0.8% in 2012 compared to 6.9% in 2011.

Foreign direct investment increased by 14.5%, to USD 8.3 billion (the real economy received 94% of the investment).

DEVELOPMENT IN THE BANKING SYSTEM

As of January 1, 2013, 176 banks (public joint-stock companies) had an NBU banking license.[25]

The number of banks with foreign capital remained unchanged in Ukraine, at 53, of which 22 banks were banks with 100% foreign capital.

The share of foreign capital in the registered authorized capital of Ukrainian banks decreased from 42% to 39.5%.

Foreign capital in Ukraine is represented by 26 countries. The following countries have the largest presence in Ukraine: Cyprus (with 29%), the Russian Federation (23%), Austria (13%) and Sweden (8%).

By the end of 2012, positive trends had consolidated in Ukraine's banking system:

- Total assets grew by 5% in 2012, to UAH 1,268 billion (EUR 120 billion);
- Corporate lending increased by about 5%, to UAH 609 billion (EUR 58 billion);
- Banks' liabilities grew by 7%, to UAH 958 billion (EUR 91 billion);
- Household deposits rose by 19%, to UAH 364 billion (EUR 35 billion);
- Corporate deposits increased by almost 9%, to UAH 203 billion (EUR 19 billion);
- Banks' regulatory capital increased by 0.3%, to UAH 179 billion (EUR 17 billion);
- Banks earned a profit of UAH 5 billion (EUR 0.5 billion).

[25] Of which one bank was licensed to operate as a remedial bank.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN UKRAINE

The main laws that regulate banking in Ukraine are as follows:

- On Banks and Banking;
- On the National Bank of Ukraine;
- On Households Deposit Guarantee System;
- On Financial Services and State Regulation of Financial Markets;
- On Joint Stock Companies;
- On Prevention and Counteraction of Legalization (Laundering) of the Proceeds from Crime or Terrorism Financing.

Pursuant to the Laws *On the National Bank of Ukraine and On Banks and Banking*, banking regulation and supervision in Ukraine are conducted by the National Bank of Ukraine.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2012

The National Bank of Ukraine took steps to further stabilize Ukraine's banking system, promote lending to the real economy, enhance the loan portfolio quality, reduce the share of negatively classified loans, improve the legal basis, and ensure appropriate banking supervision.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2012

The National Bank of Ukraine continued to work to improve banking regulation and supervision laws, in order to safeguard the banking system's stability and to strengthen public confidence.

The National Bank of Ukraine contributed to the development and adoption of the new version of the ***Law of Ukraine on Households Deposit Guarantee System*** by the Ukrainian Parliament. The law fundamentally alters the role and powers of the Deposit Guarantee Fund by giving it a range of functions and tools for resolution of insolvent banks.

Pursuant to the Household Deposit Guarantee System Law, the National Bank of Ukraine adopted a new version of the ***Regulation regarding the use of enforcement measures for breaches of banking laws***, and amended several other regulations, in connection with the transfer of functions to resolve and liquidate insolvent banks to the Deposit Guarantee Fund.

With a view to implement the adopted in 2011 legal provisions on consolidated supervision the National Bank of Ukraine has approved:

- ***Regulation on the procedure for banking groups identification and recognition***, which sets forth a procedure for:
  - banking groups identification;

- – banking groups recognition;
- – appointing the responsible person of a banking group;
- – approval of the responsible person by the National Bank of Ukraine;
- – ceasing of banking groups recognition, etc.

- ***Regulation on the procedure for banking groups regulation***, which sets forth a procedure for:
  - – calculation of the consolidated regulatory capital of a banking group, subgroups of a banking group;
  - – banking group capital adequacy requirements;
  - – calculation of the prudential ratios;
  - – consolidated statements compilation and submission by a banking group and its subgroups.

The National Bank of Ukraine has also approved a new ***Regulation on the procedure of establishment and use of provisions of Ukrainian banks against possible losses on asset operations*** which has implemented new methodological approaches to the assessment of credit risks and calculation of provisions on asset operations, which are based on the International Financial Reporting Standards and take into account the recommendations of the Basel Committee on Banking Supervision.

The document provides for:

- application of unified approaches to assessment of all asset transactions of a bank, in particular: loans, funds placed with other banks, accounts receivable, securities and other financial commitments;
- performing an integral assets assessment, both the principal amount and income accrued;
- defining asset impairment (calculation of provisions) based on the current value of expected future cash flows;
- substantial increase of impact of debt servicing on asset classification;
- determination of financial assets quality category by taking into account changes in terms of initial agreements, including debt restructuring;
- financial standing assessment of debtors-legal entities, particularly through a mathematical model that is based on the financial reporting of such debtors and takes into account types of their economic activity.

ORGANIZATIONAL STRUCTURE OF THE BANKING SUPERVISORY AUTHORITY

In 2011, the following structural subdivisions within the National Bank of Ukraine were responsible for banking supervision:

- General Department of Banking Supervision;
- Department for Legal and Methodological Support of Banking Regulation and Supervision;
- Department for Registration, Licensing and Reorganization of Banks;
- Financial Monitoring Department.

General management of the afore-mentioned subdivisions was effected by the NBU Deputy Governor in charge of banking supervision.

INTERNATIONAL ACTIVITIES OF THE BANKING SUPERVISION SERVICE

During 2012, the National Bank of Ukraine continued to work on establishing and strengthening of cooperation with foreign supervisory authorities in the area of banking supervision.

In May 2012, the National Bank of Ukraine signed the Bilateral Memorandum of Understanding on cooperation in the area of banking supervision with the Bank of Greece.

Overall, the National Bank of Ukraine had entered into bilateral Memoranda of Understanding on cooperation with supervisory authorities of 14 countries, namely: Greece, Cyprus, Latvia, Kyrgyz Republic, Republic of Armenia, Lithuania, People's Republic of China, Poland, Republic of Belarus, Russian Federation, Luxemburg, Hungary, Turkey and Sweden.

The National Bank of Ukraine has also signed two Multilateral agreements on cooperation and coordination of supervision of OTP Group and Cyprus Popular Bank Group. The National Bank of Ukraine experts took part in supervisory college meetings concerning these banking groups.

COOPERATION WITH OTHER SUPERVISORY AUTHORITIES

As a banking supervisor, the National Bank of Ukraine has been coordinating its activities and communication with other domestic supervisory authorities, in particular: the National Commission for Regulation of Financial Services Markets and the National Commission for Securities and Stock Market, with whom the National Bank of Ukraine has signed the respective agreements on cooperation and exchange of information.

STATISTICAL TABLES

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution	2010	2011	2012
Commercial banks	176	176	176
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**176**	**176**	**176**

Ownership structure of the financial institutions on the basis of registered capital (%) (at year-ends)

Type of financial institution	2010	2011	2012
Public sector ownership	14.0	14.1	15,4
Other domestic ownership	39.0	47.9	46,1
Domestic ownership total	53.0	62.0	61,5
Foreign ownership	47.0	38.0	38,5
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	30.7	38.6	0.0471
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	27.9	36.6	0.0426

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2010	2011	2012
Commercial banks	-10.19	-5.27	3.03
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	-10.19	-5.27	3.03

Distribution of market shares in balance sheet total (%)

Type of financial institution	2010	2011	2012
Commercial banks	100.0	100.0	100.0
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Other	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

Capital adequacy ratio of banks

Type of financial institution	2010	2011	2012
Commercial banks	20.83*	18.90*	18.06*
Cooperative banks	-	-	-
Banking sector, total:	20.83*	18.90*	18.06*

(* - for Basel I; ** - for Basel II)

Asset portfolio quality of the banking sector
(share of impaired receivables / share of non-performing loans)

Asset classification	2010	2011	2012
Non financial sector	14.6	13.8	16,5*
- households	**4.3**	**4.3**	**6,2**
- corporate	**10.3**	**9.5**	**10,3**

(*Classification of loans is carried out according to a new methodology which provides for an integral assessment of an asset (i.e. including accrued income))

The structure of deposits and loans of the banking sector in 2012 (%)
(at year-end)

	Deposits	Loans
Households	63.1	25.1
Government sector	0.8	1.1
Corporate	31.1	71.8
Other (excluding banks)	5.0	2.0
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends)
(in EUR million)

P&L account	2010	2011	2012
Interest income	10,719	11,007	11,156
Interest expenses	5,808	5,778	6,451
Net interest income	4,911	5,229	4,705
Net fee and commission income	6,104	1,496	1,710
Other (not specified above) operating income (net)	-0,432	-984	-700
Gross income	12,943	13,865	14,229
Administration costs	2,748	3,333	3,524
Depreciation	0,302	343	366
Provisions	4,367	3,545	2,215
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	-	-	-
Profit (loss) before tax	-1,244	-631	499
Net profit (loss)	-1,232	-749	463

Total own funds in 2012 (in EUR)

Type of financial institution	Total own funds (for CAR)	Tier 1	Tier 2	Tier 3
Commercial banks	18,06[26]	12,94	4,43	-
Cooperative banks	-	-	-	-
Banking sector, total:	18,06	12,94	4,43	-

[26] After supervisory deductions

MAIN GROUP EVENTS OF THE YEAR 2012

25th Annual BSCEE Members' Conference
Vienna, Austria, April 24 – 26, 2012

The Chairmanship of the BSCEE Group in 2012 was held by the Austrian Financial Market Authority and Mr. Michael Hysek, Managing Director of the Banking Supervision, was entrusted the position of the Chairman. Therefore, the 25th Annual BSCEE Members' Conference was hosted by the Austrian FMA on April 24 - 26, 2012 in Vienna.

The Conference covered a range of regulatory issues and the two conference days were dedicated to the themes of *The cross border cooperation- theory versus practice* and *Basel III ante portas.* The specific topics that were discussed during the Conference included:

- The concept of consolidated supervision
- Cross border cooperation- how does it work in practice
- Home-host supervision – mutual expectations and possible ways forward
- Basel III – the road ahead
- Main challenges for supervisors implementing and supervising the new Basel III framework
- Possible implications of Basel III on the CESEE region

The Banking Agency of the Federation of Bosnia and Herzegovina and the Banking Agency of Republika Srpska of Bosnia and Herzegovina volunteered to hold the 2013 BSCEE Chairmanship as well as host the 26th Annual Conference and the Member countries accepted this candidature by acclamation.

FSI – BSCEE Regional Seminar
Tallinn, Estonia, May 22 – 24, 2012

The Estonian Financial Supervision Authority in cooperation with the Financial Stability Institute and the BSCEE Secretariat organized a regional seminar for BSCEE member countries on *Basel III and Supervision of Systemically Important Banks.* The seminar provided a forum for supervisors to hear from experts on the latest regulatory reforms and to share experiences and discuss challenges relating to implementation of Basel III and regulation and supervision of systemically important banks. The programme for the seminar covered the topics of:

- Basel III Framework
- SIBs: Assessment Methodology and Additional Loss Absorbency Requirement
- Intensity and Effectiveness of Supervision of SIBs
- Micro and Macroprudential Supervision
- Country Perspectives on Regulation and Supervision of Global-SIBs and Domestic-SIBs
- Case Study on SIBs: Identification and Additional Capital Requirements

BSCEE High-Level Meeting in Warsaw, Poland, May 24 – 25, 2012

The Second High-Level Meeting on *Strengthening Financial Sector Supervision and Current Regulatory Priorities* was jointly organized by the Basel Committee on Banking Supervision (BCBS), the Financial Stability Institute (FSI) and the Group of Banking Supervisors from Central and Eastern Europe (BSCEE), and was hosted by the Polish Financial Supervision Authority.

The specific topics that were discussed during the meeting included:

- Challenges for regulation and supervision in a low interest environment
- Do the new capital and liquidity regimes go far enough?
- Stress testing in the United States and Europe
- Updating the revised Core Principles – an investment in more stability
- Why living wills and good resolution plans matter with Systemically Important Financial Institutions (SIFIs)
- How Basel III and other regulatory reforms will impact banks' business models
- Cross-Border Issues: everyone for himself?
- How to blend more effective supervision with macro issues?

XVII ICBS, Istanbul, September 11 – 14, 2012
BSCEE Regional Meeting, September 12, 2012

The XVII International Conference of Banking Supervisors was jointly hosted by the Central Bank of the Republic of Turkey and the Turkish Banking Regulation and Supervision Agency and coorganized by the Basel Committee on Banking Supervision. The Conference focused on the key challenges that lie ahead in adapting banking supervision and regulation to the changing realities of the market. It has also examined and debated recent policy responses to strengthen the safety and soundness of banks and the stability of the banking system in all jurisdictions.

During the event, on September 12, the BSCEE Regional Meeting took place and focused on two main topics of the Conference: *Towards a more resilient banking sector* and *A stable financial environment for sustained economic growth.*

BSCEE CONTACT LIST

Supervisory Authorities of the Member Countries	Address	Web-site address
Bank of Albania	*Sheshi Skënderbej No. 1* *Tirana, Albania*	www.bankofalbania.org
Central Bank of Armenia	*6, Vazgen Sargsyan str.* *PO Box 0010, Yerevan* *Republic of Armenia*	*www.cba.am*
Austrian Financial Market Authority	*Otto-Wagner-Platz 5* *1090 Wien* *Austria*	www.fma.gv.at
National Bank of the Republic of Belarus	*Nezavisimosty Ave. 20* *Minsk 220008* *Republic of Belarus*	www.nbrb.by
Banking Agency of Federation of Bosnia and Herzegovina	*Kosevo 3, Sarajevo 4000* *Bosnia and Herzegovina*	www.fba.ba
Banking Agency of Republika Srpska, Bosnia and Herzegovina	*Vase Pelagića 11 A* *78000 Banja Luka* *Republika Srpska*	www.abrs.ba
Bulgarian National Bank	*1 Knyaz Alexander I Square* *Sofia 1000, Bulgaria*	www.bnbank.org
Croatian National Bank	*TRG Hrvatskih velikana 3* *Zagreb 10002, Croatia*	www.hnb.hr
Czech National Bank	*Prague 1,Na Prikope 28* *115 03 Czech Republic*	www.cnb.cz
Estonian Financial Supervision Authority	*Sakala 4* *Tallinn 15030, Estonia*	www.fi.ee
National Bank of Georgia	*2 Sanapiro Street* *0114 Tbilisi, Georgia*	www.nbg.gov.ge
Hungarian Financial Supervisory Authority	*Krisztina krt. 39* *1013 Budapest, Hungary*	www.pszaf.hu
Financial and Capital Market Commission	*Kungu iela 1* *Riga, LV-1050, Latvia*	www.fktk.lv
Bank of Lithuania	*Zirmunu St 151* *Vilnius, LT-09128 Lithuania*	www.lbank.lt

National Bank of Macedonia	*Kuzman Josifovski Pitu Blvd 1 Skopje, 1000 Macedonia*	www.nbrm.mk
National Bank of Moldova	*1 Grigore Vieru Ave. Chisinau, MD-2005 Moldova*	www.bnm.org
Central Bank of Montenegro	*Bulevar Svetog Petra Cetinjskog 7 Podgorica, Montenegro*	www.cb-cg.org
Polish Financial Supervision Authority	*Plac Powstańców Warszawy 1 00-950 Warsaw, Poland*	www.knf.gov.pl
National Bank of Romania	*25, Lipscani str. Bucharest 1, Romania*	www.bnro.ro
Central Bank of the Russian Federation (Bank of Russia)	*12 Neglinnaya str. 103016 Moscow, Russia*	www.cbr.ru
National Bank of Serbia	*Kralja Petra 12 11000 Belgrade, Serbia*	www.nbs.rs
National Bank of Slovakia	*Imricha Karvasa 1 813 25 Bratislava, Slovakia*	www.nbs.sk
Bank of Slovenia	*Slovenska 35 1505 Ljubljana , Slovenia*	www.bsi.si
National Bank of Ukraine	*Institutska str. 9. 01601 Kiev, Ukraine*	www.bank.gov.ua
BSCEE Secretariat	*Plac Powstańców Warszawy 1 00-950 Warsaw, Poland*	www.bscee.org