BSCEE Review

2020

Albania

Armenia

Austria

Belarus

Bosnia and Herzegovina

Bulgaria

Croatia

Czech Republic

Estonia

Georgia

Hungary

Kazakhstan

Latvia

Lithuania

North Macedonia

Moldova

Montenegro

Poland

Romania

Russia

Serbia

Slovakia

Slovenia

Turkey

Ukraine

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 operates according to its Agreement and the Operational bylaws that determine its organizational structure and the rules governing its operations. As of today, the Agreement is signed by twenty six member institutions from twenty five member countries: Albania, Armenia, Austria, Republic of Belarus, Bosnia and Herzegovina (Federation of Bosnia and Herzegovina, Republika Srpska), Bulgaria, Croatia, Czech Republic, Estonia, Georgia, Hungary, Kazakhstan, Latvia, Lithuania, North Macedonia, Moldova, Montenegro, Poland, Romania, Russia, Serbia, Slovakia, Slovenia, Turkey and the Ukraine.

In 2020, the outbreak of COVID-19 pandemic had a negative impact on the global financial sector and it presented a significant, unexpected challenge for regulators and supervisors, including the BSCEE members. This Review provides for an overview of selected measures initiated by members, which in 2020 were at the heart of the activities initiated to maintain the financial stability. According to the previous years' practice, the Annual Review summarizes the developments of the member countries in 2020 – a time of great uncertainty - including the macroeconomic situation in the twenty five member states, and it describes the banking sector as well as the supervisory activities undertaken by each BSCEE member. The Review was developed on the basis of the information provided by the member countries.

The Chairmanship of the BSCEE Group rotates, as a rule, on an annual basis. In 2020 Mr Mukhtar Bubeyev, Chief Executive Officer, Astana Financial Services Authority (AFSA) chaired the Group. Given the COVID-19 pandemic, the BSCEE 2020 Annual Conference has been cancelled and the BSCEE Members decided to extend the AFSA's chairmanship in the BSCEE also for 2021. The Secretariat of the Group since January 2006 has been located in Poland, with the Polish Financial Supervision Authority (PFSA). In 2020 the PFSA's mandate to host the BSCEE Secretariat has been extended for the term 2021-2025.

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

BSCEE Secretariat

Contents

Macroeconomic environment

The Albanian economy has initiated its rebound from the depth of the adverse shock induced by the Covid-19 pandemic. The annual GDP growth rate increased to 5.5% in 2021Q1, following a contraction of 4% in 2020. Private consumption, private investments and exports contracted sharply in 2020, with the fiscal stimulus containing somewhat the economic fallout. GPD outcomes for both years have been better than expected reflecting the flexibility of the Albanian economy, the resilience of the financial sector, and adequate policy support.

The recovery has thus far resulted broad-based across most sectors of the economy and its demand components. Household consumption, investments and exports of goods have all embarked on gradual but a stable recovery paths, whereas exports of services are still subject to international travel restrictions. Public sector investment linked to the reconstruction process has continue to provide an additional push to the economy. The latest information – survey, trade and fiscal data – corroborate our expectation for a faster growth for the remaining of 2021. The latest data for the labour market in 2021:Q2 show an unemployment rate of 11.6%, which is lower than the peak reach in the heat of the crises. However, it still remain above the pre-pandemic level of 11.2%. The underlying wage pressures remain subdued.

Inflation has been volatile during 2020 and 2021, mainly due to pandemic related supply disruption. The volatility in consumer prices for this period has primarily embodied fluctuations in unprocessed food prices and in international oil prices. On the other hand, measures of underlying price pressures have remained stable, with core inflation hovering around 1.4% this year. Inflation has been increasing recently due to food and oil prices, which in turn have reflected the increase in the commodity prices in the international market.

The expansionary macroeconomic policies undertaken by the Albanian authorities in 2020 have proved instrumental in containing the economic fallout for the pandemic and keeping the financial market quiet. The Bank of Albania strengthened the monetary stimulus by lowering the policy rate to 0.5% and by increasing liquidity injections in the market, instructed banks to offer liquidity relief to viable businesses facing temporary difficulties and facilitated the possibility of targeted credit restructuring for said businesses. Fiscal policy turned expansionary through direct financial support schemes and sovereign guarantee schemes.

The measures taken by the Bank of Albania have helped to alleviate debt-servicing costs for businesses and households and to preserve monetary and financial stability as a precondition for the recovery. The financial markets are calm, stable interest rates have prevailed and the declining market premia trends have continued. Bank lending has been strong, supported by favourable financing conditions and a conducive policy environment. Businesses credit and lek credit has been at the forefront of this expansion. The Albanian banking sector remained solid, solvent and liquid. NPLs have remained on their secular downward trend owing to a large extent to the crisis mitigation measures undertaken in 2020.

The economic activity is expected to accelerate this year and remain on a stable growth path thereafter. We project most aggregate demand components to experience a rebound in 2021 and to continue to grow thereafter. The recovery is expected to benefit from an accommodative policy-mix, a recovery in our main trading partner's economies and, increasing domestic demand, as uncertainties dissipate.

Inflation is projected to gradually increase towards the target of 3% by next year. As economic activity continues to improve, economic slack is expected to be absorbed. We expect domestic inflationary pressure to gather pace helping to bring inflation to target by 2022.

Development in the banking system (including the assets total / GDP)

As at end of 2020, the banking system remains consolidated to 12 banks, 4 of which with Albanian capital and 8 with foreign capital. Of the latter, 6 originate from European Union countries. In terms of total assets, year 2020 recorded an increase in the share of banks with Albanian capital, by around 1.32 percentage points, and a decrease in the share of banks with European capital, by 0.6 percentage points. The growth in the share of banks with Albanian capital was noticed in the credit portfolio, with 1.48 percentage points, as well as in deposits, whose share grew by 0.80 pp. In December 2020, these banks accounted for 30.58 % of total assets in the banking system and 35.42% of total assets in credit portfolio.

During 2020, banking system assets grew by around ALL 106.42 billion or 7.22%, compared to the ALL 22.1 billion or 1.52% growth of a year earlier. The loan portfolio grew by ALL 33.08 billion or 5.77%, during this year.

The share of the banking system in the economy, measured by the ratio of total assets to the Gross Domestic Product (GDP), remains high. This ratio increased by 10.43 percentage points this year, standing at 98.35%. Meanwhile, the loan to Gross Domestic Product ratio also increased at 37,9% due to the decrease of GDP against the increase in the loan portfolio. Total credit grew by ALL 33.16 billion, or about 5.76% during 2020.

The most important indicator of supervision, the capital adequacy ratio (CAR), at the end of 2020, stood at 18.32%9. Compared to the same period in the previous year, this ratio shows a fall of 0.34 percentage point.

The non-performing loans ratio (NPLR) dropped by 0.26 percentage point, in annual terms, to 8.11% at the end of 2020.Thenon-performing loans reached ALL 49.4 billion as at end of 2020. Meanwhile, the loan portfolio increased by ALL 13.74 billion, or 2.39% during the year.

Profitability indicators – Return on Average Assets (RoAA) and Return on Average Equity (RoAE) – decreased compared to 2019. At the end of 2020, RoAA stood at 1.10% and RoAE at 10.65%, from 1.39% and 13.45%, respectively at the end of 2019.

The following are banking system highlights for 2020:

1. Net outstanding non-performing loans to total credit portfolio stood at 2.8%, down by 0.57 percentage point compared with December 2019;
2. Non-performing loans ratio dropped by 0.26 percentage point, in annual terms, to 8.11% at the end of 2020;
3. Provisioning of NPLs was 65.2%, from 59.4% a year earlier;
4. Liquidity indicators continuously appear significantly above the regulatory requirement set out in the Bank of Albania's regulatory acts. In December 2020, the ratio of liquid assets to short-term liabilities in the banking system was 47.4%10, down by 2 percentage points from the previous year.
5. Liquidity coverage ratio stood at 449% against the regulatory limit of 100%. This ratio started to be reported in March 2020;
6. In December 2020, the total value of deposits in the system amounted to ALL 1.286 billion, recording 7.8% annual growth from the previous year. The share of the domestic currency in total deposits slightly decreased to 49.5%, from 48.51% in December 2019;
7. At the end of 2020, the capital adequacy ratio – the main supervision indicator – was reported at 18.32%. This ratio decreased by 0.34 percentage point, compared to the same period of the previous year;
8. The banking system's profit was positive in 2020, at around ALL 16.88 billion, or ALL 3.02 billion lower than in 2019.

The legal and institutional framework of the operation and supervision of financial institutions, new developments. Legal competence of the Banking Supervisory authority in Albania

The drafting of new bylaws and the review of the regulatory framework in force aims at supplementing and improving it, in order to carry out more effective supervision, in compliance with legal requirements on banks and other financial entities being licensed and supervised by the Bank of Albania, through the approximation with the EU regulatory acts and Basel Committee documents.

Following are listed the new regulatory acts approved and reviewed over 2020.

I. In the framework of approximating the legal supervisory requirements of the Bank of Albania with Basel III requirements and European regulations[1], the following were approved:

- Amendments to the Regulation "On capital adequacy ratio", (adopted with Decision No. 7, dated 5.2.2020 of the Supervisory Council of the Bank of Albania).
- Amendments to the following regulations, with Decision No. 53 and No. 54, respectively, dated 2.9.2020 of the Supervisory Council of Albania:
  - Regulation "On the risk management from large exposures of banks''
  - Regulation "On consolidated supervision
- The new Regulation "On the financial leverage ratio of banks" (adopted with the Decision No. 63, dated 4.11.2020 of the Supervisory Council of the Bank of Albania).
- The new Regulation "On the net stable funding ratio of banks" (adopted with Decision No. 70, dated 2.12.2020 of the Supervisory Council of the Bank of Albania).

II. Pursuant to the Law "On the recovery and resolution of banks", as part of the early intervention framework, the following were approved:

- Regulation "On determining the conditions for granting the prior approval to the intra-banking group financial support agreement" (adopted with the Decision No. 6, dated 5.2.2020, of the Supervisory Council of the Bank of Albania).
- The new Regulation "On triggers for use of early intervention measures and on the conditions and manner of carrying out the temporary management" (adopted with Decision No. 61, dated 4.11.2020, of the Supervisory Council of the Bank of Albania)
- The new Regulation "On the establishment, licensing, supervision, functioning, and termination of the operation of the bridge bank" (adopted with the Decision No. 62, dated 4.11.2020, of the Supervisory Council of the Bank of Albania).
- Amendments to the following regulations, adopted by the circulatory Decisions No. 22 and 23, dated 1.4.2020, respectively, of the Supervisory Council of the Bank of Albania:
  - Regulation "On capital adequacy ratio":
  - Regulation "On risk management from large exposures of banks".
- Amendments to the following Regulations, adopted by the circulatory Decisions No. 33 and 34, dated 28.5.2020, respectively, of the Supervisory Council of the Bank of Albania:
  - Regulation "On credit risk management from banks and branches of foreign banks";
  - Regulation "On out-of-court treatment of distressed borrowers by banks".

III. In the framework of the measures taken due to the COVID-19 situation, the following were approved:

- Amendments to the following regulations, by the circulatory decisions No.13, 14 and 15, dated 12.3.2020, respectively, of the Supervisory Council of the Bank of Albania:
  - Regulation "On credit risk management from banks and branches of foreign banks";
  - Regulation "On risk management in the activity of non-bank financial institutions";
  - Regulation "On risk management in the activity of savings and loan associations and their Unions".
- Amendments to the following regulations, adopted by the circulatory Decisions No. 22 and 23, dated 1.4.2020, respectively, of the Supervisory Council of the Bank of Albania:
  - Regulation "On capital adequacy ratio":
  - Regulation "On risk management from large exposures of banks".
- Two Decisions "On the Suspension of the Profit Distribution from Banks" adopted by circulatory Decision no. 24, dated 8.4.2020, and Decision No. 40, dated 1.7.2020, respectively.
- Amendments to the following Regulations, adopted by the circulatory Decisions No. 33 and 34, dated 28.5.2020, respectively, of the Supervisory Council of the Bank of Albania:
  - Regulation "On credit risk management from banks and branches of foreign banks";
  - Regulation "On out-of-court treatment of distressed borrowers by banks".

III. In the framework of reviewing and improving the regulatory requirements, to adopt to the current market developments, the following were approved:

- Amendments to the Regulation "On risk management in the activity of savings and loan associations and their Unions" (adopted with Circulatory Decision No. 20, dated 26.3.2020, of the Supervisory Council of the Bank of Albania)
- Amendments to the Regulation "On the reports at the Bank of Albania accordingly to the Unified Reporting System" (adopted with Decision No. 71, dated 2.12.2020, of the Supervisory Council of the Bank of Albania)
- Regulation "On the functioning of Credit Registry at the Bank of Albania, and the conditions and procedures on the information, use and revision of data being administered in this Registry" (adopted with Decision No. 72, dated 2.12.2020 of the Supervisory Council of the Bank of Albania)

Main strategic objectives of the Supervisory Authority in 2021

Banking supervision will continue to focus on providing a sound financial system, which guarantees public confidence, ensures stability and contributes to a stable economic growth. The development of the regulatory framework will continue to be oriented towards alignment with the Basel III standards and the European Union legislation. The effects of the Covid-19 pandemic on credit, liquidity, information technology and systems security risks, as well as the planning of capital needs of financial entities will also be monitored and assessed. Banks will be oriented towards a risk-based approach, to address and mitigate, in a timely manner, the increased risks and weaknesses identified as a result of the pandemic.

The activities of the Banking Supervisory Authority

Covid-19 Pandemic

Similarly to all the other aspects of the economy, the financial activity in 2020 was conducted under the strong impact of the pandemic effects. Financial institutions readopted their activity to new market developments. The Bank of Albania undertook significant regulatory changes to alleviate the possible effects to financial institutions, in order to create facilities to borrowers for the repayment of loans:

- In March 2020, the moratorium on credit instalments was undertaken through regulatory changes, which eased the mandatory classification and provisioning of loans until May 2020;
- In May, the deadline of the moratorium was extended until August 2020 and re-determining an easier framework on the classification and provisioning of restructured loans, until December 2020.

Pursuant to these regulatory amendments, the Bank of Albania conducted communication in written form with banks in order to determine certain prudential measures to be taken into consideration for managing the created situation, possible risks and conveying the right message to the market. Thus, banks were required to create adequate structures, give complete instructions regarding them, document the entire process, assess and select the appropriate borrowers, channel the restructuring in compliance with the legal framework and reduce internal expenditures.

To protect the financial situation of banks against threats and uncertainties brought about by the situation, the following initiatives were undertaken:

- In April, the Supervisory Council of the Bank of Albania decided the suspension of dividend distribution by banks of the allocated profit from the previous periods, and the profit to be realised in 2020;
- In January 2021, the Supervisory Council decided to suspend the distribution of profit dividend by banks of 2020 and 2021.

Cooperation with the European central banks to enhance the supervision capacities

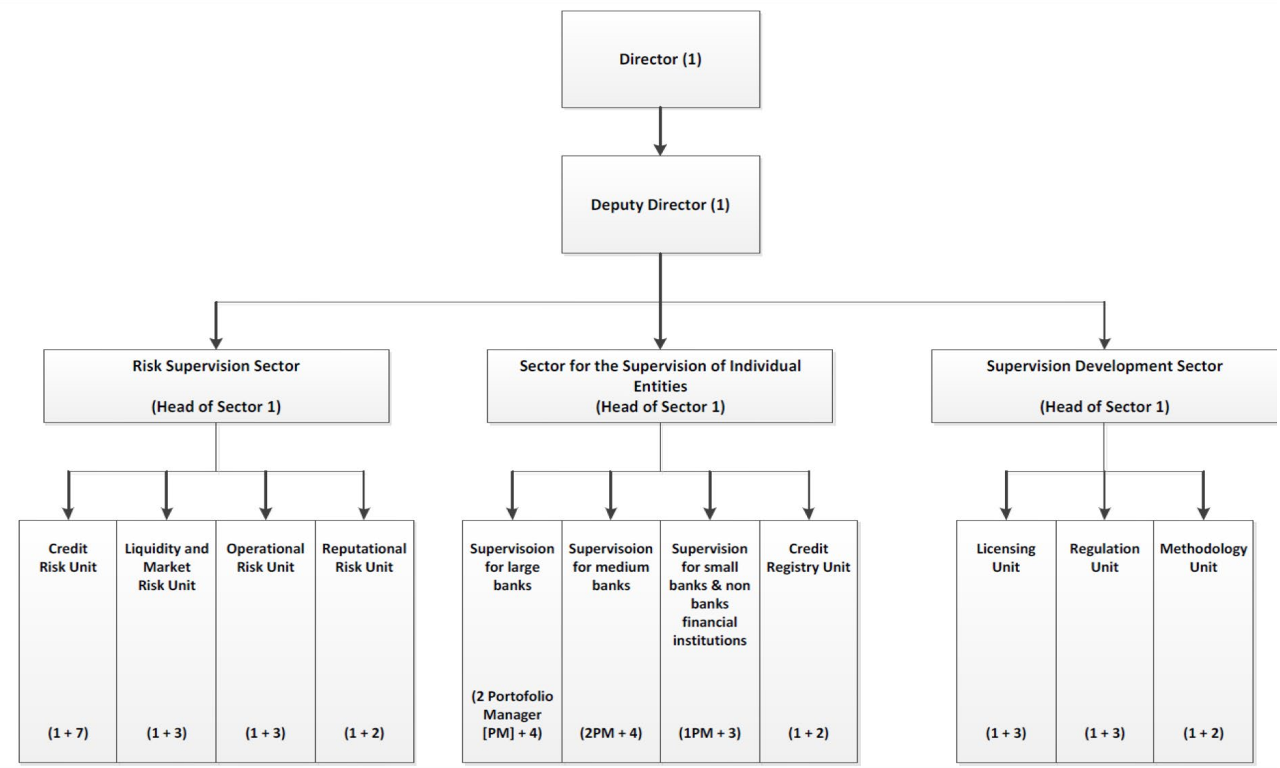
During 2020, a large share of the work was dedicated to the development and finalisation of the twinning project with the Bank of Italy and the Bank of Germany, which started in November 2019. The project's aim was to approximate the regulatory and methodological supervisory framework with the European Union regulations, which would enhance the capacities in supervising the licensed entities.

In this regard, several changes were initiated consisting of:

- reviewing the Regulation "On capital adequacy" on credit risk, market risk, operational risk and securitisation. The amendments consisted in the revision of the calculation method of capital requirements for exposures related to these risks;
- reviewing the Guideline "On the internal capital adequacy assessment process" (ICAAP);
- drafting the new Regulation in compliance with the Directive on Payment Accounts;
- training on the actual control method of the implementation of ICAAP Guideline, as well as on the improvement of the Supervision Review and Evaluation Process(SREP);
- establishing an internal methodology for assessing the borrowing capacity of enterprises related to the implementation of the international accounting standard IFRS 9.

Organizational chart of the Banking Supervisory Authority

The organizational structure of the Supervision Department hasn't had any changes during 2020. The last structural change was in 2016.



Questionnaire tables for the 2020 review

Number of financial institutions (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	14	12	12
Branches of foreign credit institutions	0	0	0
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	**14**	**12**	**12**

Total assets of banking sector (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	11,772.21*	12,117.52*	12,784.69*
Branches of foreign credit institutions	n/a	n/a	n/a
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	**11,772.21***	**12,117.52***	**12,784.69***
y/y change (in %)	**8.29%**	**2.93%**	**7.22%**

*The values are in millions Euro

Ownership structure of banks on the basis of assets total

Item	2018	2019	2020
Public sector ownership	0	0	0
Domestic ownership total	16.55%	22.84%	30.58%
Foreign ownership	83.45%	77.16%	69.43%
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	57.16*	75.21%	0.15
Branches of foreign credit institutions	n/a	n/a	n/a
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	**100.0**	**100.0**	**100.0**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2018	2019	2020
Commercial banks	12.96%	13.45%	10.65%
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	12.96%	13.45%	10.65%

Distribution of market shares in balance sheet total (%)

Type of financial institution	2018	2019	2020
Commercial banks	100	100	100
Branches of foreign credit institutions	n/a	n/a	n/a
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2018	2019	2020
Receivables			
Financial sector	17.92	17.98	13.86
Nonfinancial sector	36.78	36.92	36.29
Government sector	41.23	41.30	45.96
Other assets	4.06	3.80	3.89
Liabilites			
Financial sector	2.88	3.60	3.33
Nonfinancial sector	80.28	79.90	80.28
Government sector	3.81	3.26	3.2
Other liabilities	2.88	2.21	2.8
Capital	**10.17**	**10.45**	**10.39**

Capital adequacy ratio of banks

Type of financial institution	2018**	2019**	2020**
Commercial banks	18.24%	18.28%	18.28%
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	**18.24%**	**18.28%**	**18.28%**

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

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

Asset classification	2018	2019	2020
Non-financial sector, including	11.08	8.37	8.11
- households	6.44	5.19	5.52
- corporate	14.25	10.73	9.85

The structure of deposits and loans of the banking sector in 2020 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:		
Households	82.49	32.77
Corporate	14.96	63.97
Government sector	2.55	3.26
Financial sector (excluding banks)	n/a	n/a
Total	**100.0**	**100.0**

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

P&L account	2018	2019	2020
Interest income	421.97	404.86	414.80
Interest expenses	69.25	67.00	61.63
Net interest income	352.72	277.45	285.51
Net fee and commission income	75.57	84.94	88.39
Other (not specified above) operating income (net)	138.04	178.56	151.06
Gross income	382.64	421.03	391.57
Administration costs	223.84	242.47	240.51
Depreciation	n/a	n/a	n/a
Provisions	50.76	1.76	49.99
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	170.70	182.38	159.10
Net profit (loss)	149.01	157.93	136.42

*The values are in million Euro

Total own funds in 2020

Type of financial institution	Total own funds **	Core Tier 1**	Tier 1**	Tier 2**	Tier 3**
Commercial banks	865.83	1,159.44	1,159.44	73.79	n/a
Cooperative banks	n/a	n/a	n/a	n/a	n/a
Banking sector, total:	865.83	1,159.44	1,159.44	73.79	n/a

The values are in millions Euro

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

Macroeconomic environment in the country

In 2020, Republic of Armenia economy suffered from the effects of two successive shocks, the pandemic and the martial law. Restrictions to prevent the spread of the coronavirus, martial law at the end of the year and the high level of uncertainty that followed, resulted in an economic downturn. The 7.4% economic decline was mostly the result of a decline in value added of services and construction. Given the systemic nature of the pandemic, it has a differentiated unequal impact on different sectors of the economy. The negative impact of the pandemic and anti-pandemic measures has been greater and more direct in a number of areas related to the organization of accommodation and catering, as well as the organization of recreation and services. At the same time, as a result of the reduction of income and demand in the economy, construction, wholesale and retail trade, as well as processing industry, have strongly suffered. The negative developments recorded during the year had the weakest impact on agriculture, health and mining industry.

Amid the declining external demand and drop of prices for raw materials, a decrease in the volume of exports of goods and services was observed, which, to some extent, moderated in the second half of the year. Annual real exports fell by 3.9%. The decline in consumption and investment demand let to a stronger decline of imports compare to exports (around 17.7%).

Because of the economic downturn and migration restrictions in the partner countries, net remittances to Armenia dropped by 12.3% y/y. As a result of these developments, the current account deficit has narrowed compared to the previous year, amounting to 3.1% of GDP.

Development in the banking sector (including assets total / GDP)

As of 31 December 2020, 17 commercial banks operated in Armenia. The banking sector remains the largest participant of the financial system and accounts for 84.5% of the system’s assets. In 2020, the assets of the banking system increased by 14.8%, total capital, by 6.6%, and liabilities, by 16.2%.

Loans to the economy increased by 14.5%, which mostly maintained the growth rate of the previous year. The increase was due to the growth of lending to legal entities by 17.0% and household lending by 11.6% (mainly due to mortgage loans). The indicators of the banking system assets to GDP and credits to GDP increased respectively by 19.3 and 11.1 percentage points, reaching 108.2% and 63.2%, respectively.

In comparison with the previous year, the share of non-performing loans, and receivables increased by 0.8 percentage points to 6.6% of total loans and receivables at the end of 2020.

The banking system remains profitable, capitalized, and liquid. Credit, liquidity, and market risks are manageable. The capital adequacy and liquidity ratios that describe the banking system stability continued running above the established thresholds. Specifically, the total capital adequacy ratio amounted to 16.9% (minimum threshold: 12.0%). The banking system liquidity persisted at the level almost twice as high as minimum thresholds, pointing to the sufficient liquidity in the banking system. As of the end of 2020, commercial banks’ total and current liquidity ratios were 25.6% and 108.8% (minimum thresholds: 15.0% and 60.0%), respectively.

Profitability of the banking sector decreased in 2020. The return on assets and return on equity ratios amounted to 1.3% and 8.9%, respectively (1.5% and 10.2% in 2019).

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

One of the main objectives of the Central Bank of Armenia is to ensure stability and normal activity of the financial system of the Republic of Armenia, including ensuring of necessary conditions for stability, liquidity, solvency and normal activities of the banking system of the Republic of Armenia.

According to the Law on the Central Bank of Armenia, in performing the underlying objectives stipulated in the Law, the Central Bank shall:

- license banks, as well as other entities, in case if envisaged by law, and regulate and supervise activities thereof,
- provide loans to the banks as a last-resort-lender,
- collect, coordinate and analyze information concerning legalization of criminal proceeds and financing of terrorism, exchange and deliver such information to intra-governmental competent authorities and international organizations, and competent authorities of other countries, if stipulated by international agreements of Armenia.

In implementation of its tasks, the Central Bank of Armenia shall be independent from the state authorities.

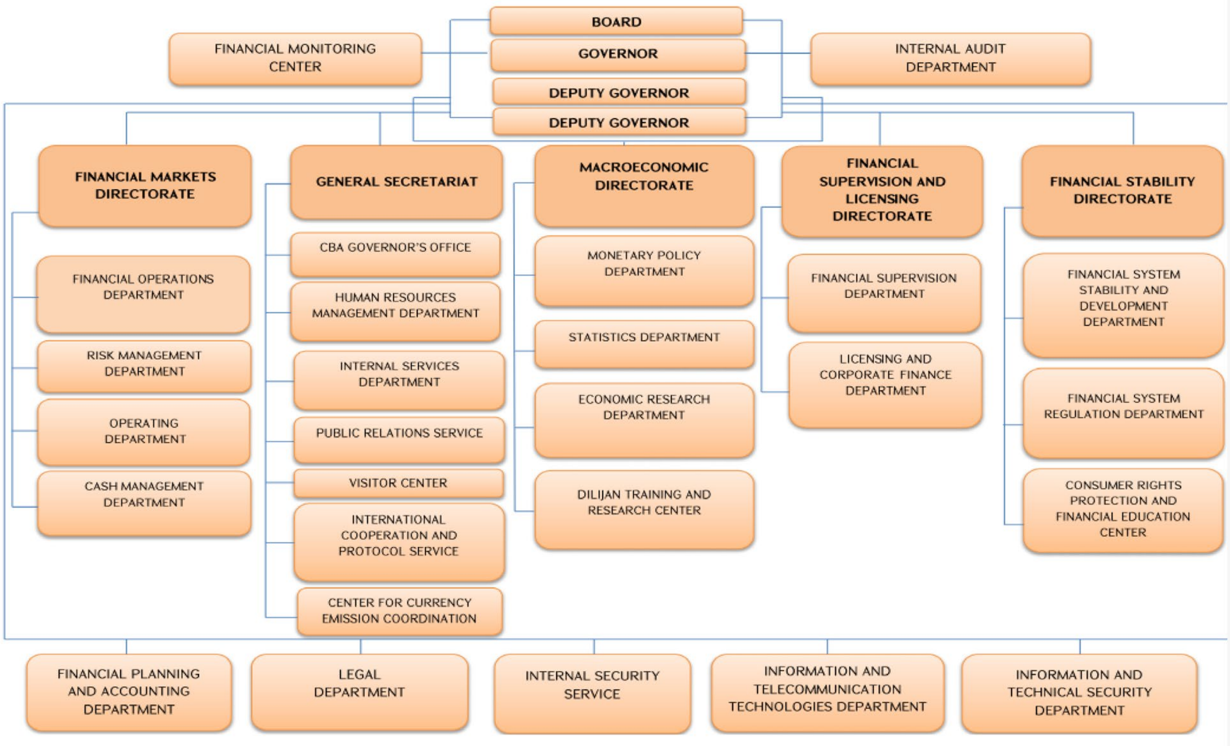
A number of legislative changes have been introduced in the field of financial system regulation both on the initiative and in close cooperation with the Central Bank. In particular, in order to strengthen trust in the banking system, to maintain and increase the deposits, an amendment was made to the Law of the Republic of Armenia "On Guaranteeing Compensation of Individuals' Bank Deposits". Guaranteed deposit limits have been increased to AMD 16 million instead of AMD 10 million for dram deposits and AMD 7 million drams instead of AMD 5 million for foreign exchange deposits.

In the context of developing policy of "non-cash" economy, in 2020 the Central Bank continued to discuss with public stakeholders the legislative package aimed at promoting non-cash operations. The adoption of the legislative package will increase citizens' access to noncash payment services and allow convenient payments at points of sale. Moreover, the adoption of the RA Law on Non-Cash Transactions will increase the efficiency of measures aimed at curbing moonlighting, and will expand financial intermediation.

To mitigate the negative impacts of uncertainty on the economic activity and its perspective conditioned by the spread of the pandemic the CBA Board has decided to decrease the Tier 1 capital adequacy ratio from 10% to 9%. Aiming to ensure the availability of HQL in FX assets in banks equivalent to the funds attracted in FX, as well as to increase the efficiency of liquidity management by banks the CBA makes a gradual transition to mandatory FX reserves for attracted funds in FX. As another step in the implementation of this policy, the CBA made a decision according to which the 10% out of 18% reserve requirement for funds attracted in FX should be implemented in AMD and 8% out of 18% should be implemented in FX. Under the same policy and aiming to increase the liquidity risk management in banks the CBA Board adopted LCR and NSFR prudential ratios which will come into force from January 1, 2021. LCR prudential ratio aims to ensure short-term liquidity of the bank in high-stress situations (30 days); on the other hand, the NSFR ratio aims to stimulate banks to finance their long-term transaction from more stable sources.

To implement macroprudential policy tools, e.g. LTV and DSTI, in 2020 the CBA started collecting and processing relevant information from financial institutions.

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Banking Supervisory Authority in 2020

Financial Supervision Department (FSD) is the main unit within the CBA in charge for supervision of all types of financial institutions in the Republic of Armenia. FSD accomplishes its tasks in close cooperation with the Financial Monitoring Centre (AML/CTF monitoring unit) and Financial Stability Department.

In 2020 FSD's main objective was to maintain healthy and sound financial sector during the COVID 19 pandemic and military escalation. FSD performed its activities taking into account following main objectives:

- Close monitoring of asset quality (in light of increasing NPLs)
- Strengthening operational resilience in financial institutions (BCM)
- Increasing crisis preparedness (bank recovery and resolution frameworks)
- Enhancing supervisory capacities and tools
    - RBS methodology, including control guidelines
    - ICAAP accountability and evaluation process
    - Micro Prudential Stress Testing Process
- Business Model Assessment and proper changes in the regulation framework to promote sound and progressive business models

The activities of the Banking Supervisory Authority in 2020

In 2020 the Central Bank continued performing its supervisory functions to maintain the stability of the financial system, while making sure an effective AML/CTF framework is in place and interests of consumers in the financial market are duly protected. The Central Bank continually monitors the activities of financial institutions, identifies and assesses risks and evaluates the compliance of their activities with the legal framework.

In 2020, focus area for Central Bank was to overcome the challenges of COVID-19 pandemic and military escalation: increase of uncertainty and credit risk, liquidity pressures, operational challenges to work remotely. In this regard, FSD was receiving daily reports from banks and working closely with FIs on these issues to timely implement counter-cyclical measures and to ensure the continuity of financial intermediation. CBA authorized moratorium for credit payments in the beginning of the pandemic and gradual increase in loan provisioning after the initial stabilization.

Business continuity management team was created in Central Bank with agenda to identify the risks and weaknesses financial system faced during the pandemic.

CBA is working on fine-tuning the RBS methodology, including enhanced requirements for recovery plans, business plans and a framework for resolution.

During the year, FSD accomplished targeted on-site inspections in 5 banks mainly focused on internal governance, investment activities, consumer protection structures and processes. Besides, FSD carried out on- site inspections in 1 insurance company and 36 other financial market participants. FSD had to amend supervisory procedures, by expanding off-site tools (enhanced reporting requirements, frequent meetings with the management of the FIs, targeted risk analysis and reports) to partially replace on-site procedures in light of recent COVID-19 restrictions.

International activities of the authority

The Central Bank of Armenia sustained its multilateral and bilateral cooperation with international financial institutions during the year. However, due to the pandemic and globally imposed travel restrictions the number of visits of partners and delegations decreased.

Since 2020, the Central Bank has been officially a full member of the international platform Network for Greening Financial System (NGFS). NGFS is composed of central banks or financial regulators and supervisors from around 89 countries, and its goal is to strengthen global capacity for implementation of the Paris Agreement, and to this end, to encourage and assist financial system participants in attracting risk management and green financing, implementing environmentally friendly investments and sustainable development. To this end, NGFS is committed to supporting the implementation of international best practices and standards for green financing in member countries and beyond, as well as to conduct analytical work in this area.

At the request of the Central Bank, the World Bank provided technical assistance on supervisory organization and crisis preparedness. The technical assistance was provided through the Vienna-based Financial Sector Advisory Center (FinSAC) in the last quarter of 2020.

In 2020, the Dilijan Training and Research Center (DLC) continued to work in the areas of research, international cooperation and social responsibility to achieve its goals, but due to COVID-19, it was not possible to carry out the work in full and some of it was done online. DLC has organized a distance learning internship for 11 research fellows from Harvard, Notre Dame, Chicago and Tufts universities.

In November, the Central Bank in cooperation with the Toronto Center organized an international practical online course on "Reinsurance for Supervisors of Insurance Companies". The main purpose of providing hands-on training was to promote the financial stability and overall accessibility of financial regulators and regulators in emerging markets and low-income countries.

Cooperation with other supervisory bodies in the country

Central Bank is the sole supervisory body of the financial system of Armenia.

Questionnaire tables for the 2020 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	17	17	17
Branches of foreign credit institutions	0	0	0
Cooperative banks	0	0	0
Banking sector, total:	**17**	**17**	**17**

Total assets of banking sector (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	9,006,500	10,848,309	10,438,046
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	9,006,500	10,848,309	10,438,046
y/y change (in %)	19.71%	20.4%	-3.8%

Ownership structure of banks on the basis of assets total

Item	2018	2019	2020
Public sector ownership	2.22	2.22	2.20
Domestic ownership total	34.91	37.13	37.45
Foreign ownership	62.87	60.65	60.35
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2020

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	44.13%	57.38%	915.86
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**44.13%**	**57.38%**	**915.86**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2018	2019	2020
Commercial banks	7.61%	10.24%	8.93%
Cooperative banks	-	-	-
Banking sector, total:	**7.61%**	**10.24%**	**8.93%**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2018	2019	2020
Commercial banks	100	100	100
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2018	2019	2020
Receivables	**100.0**	**100.0**	**100.0**
Financial sector	26.62	26.63	23.62
Nonfinancial sector	59.50	58.21	58.14
Government sector	10.65	10.30	12.59
Other assets	5.04	4.86	5.66
Liabilites	**86.07**	**85.87**	**86.88**
Financial sector	12.21	21.50	27.21
Nonfinancial sector	41.60	59.96	54.90
Government sector	0.67	0.67	0.52
Other liabilities	31.59	3.74	4.25
Capital	**14.74**	**14.14**	**13.13**

Capital adequacy ratio of banks

Type of financial institution	2018	2019	2020
Commercial banks	17.66%	17.58%	16.93%
Cooperative banks	-	-	-
Banking sector, total:	**17.66%**	**17.58%**	**16.93%**

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

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

Asset classification	2018	2019	2020
Non-financial sector, including	4.89%	5.76%	6.55%
- households	5.83%	6.03%	9.84%
- corporate	4.46%	5.61%	4.85%

The structure of deposits and loans of the banking sector in 2020 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	75.47	78.45
Households	44.48	35.51
Corporate	30.99	42.94
Government sector	0.78	16.89
Financial sector (excluding banks)	23.75	4.66
Total	**100.0**	**100.0**

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

P&L account	2018	2019	2020
Interest income	634,726.08	734,741.94	709,691.48
Interest expenses	363,816.47	416,141.02	389,311.85
Net interest income	270,909.61	318,599.92	320,379.63
Net fee and commission income	93,237.81	123,006.52	99,667.09
Other (not specified above) operating income (net)	-20,703	8,984.82	36,990.58
Gross income	1,160,938.53	1,322,466.03	1,248,448.26
Administration costs	121,480.80	144,243.09	120,930.11
Depreciation	22,523.94	27,920.58	32,297.38
Provisions			
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	99,985.47	128,689.73	181,826.94
Profit (loss) before tax	99,454.13	149,737.87	122,004.66
Net profit (loss)	69,275.23	115,797.55	97,797.92

Total own funds in 2020 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	1,357,838	1,143,275	1,168,101	189,736	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**1,357,838**	**1,143,275**	**1,168,101**	**189,736**	**-**

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

Macroeconomic environment in the country

The coronavirus pandemic seriously impacted economic developments in 2020. After contracting sharply during the first lockdown in spring, the Austrian economy recovered over the summer months. The GDP losses during the second and third lockdowns in fall and winter 2020 were not as pronounced as those incurred during the first lockdown. Overall, Austrian GDP declined by 6.6% in real terms in 2020.

The number of insolvencies dropped by 40% compared to the previous year. However, this reduction did not reflect economic developments but was solely attributable to the large-scale government aid and protection measures. On the one hand, the impact of the economic slump on companies was cushioned by a series of liquidity-supporting measures. On the other hand, companies benefited from deferrals of taxes and social security contributions. In addition, the obligation to file for bankruptcy due to overindebtedness was temporarily suspended. Other policy measures, such as loan guarantees and moratoria, which temporarily shielded firms from the economic effects of the pandemic, also contributed to this decline.

Despite the lockdown and the slump in economic activity, Austria has managed to avoid more severe consequences for its labor market thanks to the use of short-term work schemes, which, in Austria, are a well-established policy tool. According to Eurostat, unemployment rose by 0.8 percentage points to 5.3% in Austria, well below the 7.9% in the euro area.

In 2020, HICP inflation in Austria was 1.4% and thus only slightly below the level of 2019. The inflation differential vis-à-vis the euro area rose from 0.3 percentage points in 2019 to 1.1 percentage points. This is attributable, on the one hand, to specifically Austrian special effects (e.g. comparatively higher price increases in the catering and hotel industry due to forward projections) and, on the other hand, to special effects in the euro area (e.g. VAT reduction in Germany).

After posting considerable budget surpluses in 2018 and 2019, Austria recorded a massive deterioration in the budget balance in 2020 (-8.9% of GDP).

Development in the banking sector (including assets total / GDP)

Austrian banks' total assets increased despite the pandemic. The consolidated balance sheet of the Austrian banking sector increased by 10% to more than EUR 1.1 trillion in 2020 (303% of GDP). Most notably, the cash reserve on the asset side doubled and central bank liabilities increased even more strongly. However, Austrian banks also pressed ahead with transformation processes: the number of banks continued to go down, with the number of domestic branches declining at an even faster pace.

In 2020, the Austrian banking sector's consolidated operating income as well as operating costs were flat year on year, contributing to stable operating profits. Risk provisioning, however, soared and absorbed nearly half of banks' operating profit. This led to a significant fall in the consolidated profit, which totaled just EUR 3.7 billion in 2020 (–45% year on year).

Austrian banks recorded a significant increase in corporate loan demand – in particular for bridging loans and refinancing – due to the economic impact of the COVID-19 pandemic. At the same time, lending to households was quite stable during 2020 because of ongoing mortgage lending supported by low interest rates and increased demand for home ownership.

The pandemic-related support measures (including loan moratoria) adopted in Austria were instrumental in preventing major loan defaults in 2020, which is why the nonperforming loans (NPL) ratio remained at a low 2.0% on a consolidated basis.

As of end-2020, Austrian banks reported a consolidated common equity tier 1 (CET1) ratio of 16.1% (50 basis points higher than at the end of 2019). Compared with levels before the global financial crisis that started in 2008, the Austrian banking sector has more than doubled its capital ratio, in line with tighter prudential requirements.

Supervisory measures adopted by the OeNB and the FMA early on have contributed to the fact that foreign currency loans extended in Austria declined significantly over the past decade and do not pose a systemic risk. In 2020, the volume of outstanding foreign currency loans to domestic households fell by 13.5% (exchange rate adjusted) to EUR 11.6 billion. This corresponds to a foreign currency loan share of 6.6%.

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 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 supervising credit institutions together with the European Central Bank – ECB), payment institutions, deposit guarantee schemes, insurance undertakings, pension companies, corporate provision funds, investment funds, licensed 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 this is carried out properly and for monitoring issuers' compliance with information and organization obligations. Further tasks include combating the unauthorised provision of financial services and taking preventive action against money laundering and terrorist financing. Thus, in its capacity as a cross-sectoral integrated supervisory body, the FMA is responsible for addressing the challenges created by a high degree of interweaving within the Austrian financial market due to ownership structures, sales cooperation agreements and financial transactions. The legal framework in terms of banking supervision still comprises the Austrian Banking Act (Bankwesengesetz – BWG) as well as the Bank Recovery and Resolution Act (Bundesgesetz über die Sanierung und Abwicklung von Banken – BaSAG), transposing the European Bank Recovery and Resolution Directive (BRRD) the Deposit Guarantee Schemes and Investor Compensation Act (Einlagensicherungs- und Anlegerentschädigungsgesetz – ESAEG – revised in 2019).

With effect from 1. January 2015, the FMA also holds the function of the National Resolution Authority (NRA) for banks and forms part of the Single Resolution Mechanism (SRM). The main responsibilities of the NRA are resolution planning, the analysis and elimination of obstacles to resolution, and the conducting of resolution procedures in cases of credit institutions that have failed or are likely to fail. As the NRA for Austria, the FMA is an integral part of the SRM.

Lastly, the FMA is the National Designated Authority (NDA) for all macro-prudential tasks and responsibilities.

With the Single Supervisory Mechanism (SSM) in place, banks in the participating Member States are now supervised by means of a decentralized system involving close cooperation between the ECB and the National Supervisory Authorities (NCAs). The FMA is the NCA in Austria. The SSM was launched on 4. November 2014 and as of 31.12.2020 eight Austrian banking groups in total have been classified as "significant institutions" (SIs), encompassing 75 individual credit institutions that thus fall under the direct supervision of the ECB. SI supervision takes place in so-called Joint Supervisory Teams (JSTs), consisting of the relevant NCAs and chaired by the ECB. The remaining credit institutions based in Austria, classed as "less significant institutions" (LSIs) as well as those national credit institutions that are not part of the SSM (non-CRR CI) continue to be supervised directly by the FMA. This means that the FMA remains directly responsible for currently 441 Austrian credit institutions as of 31.12.2020. Regarding LSI, the ECB only carries out indirect supervision. When supervising LSIs, the FMA bases its supervisory approach on the harmonised rules developed by the EBA as well as guidance provided by the ECB to ensure consistent SI and LSI supervision. In case of common procedures (granting and withdrawal of authorisations, qualifying holdings procedures), the decision-making competence for both SIs and LSIs lies exclusively with the ECB. However, the FMA is the entry point for notifications and prepares draft decisions for the ECB.

Organizational chart of the Banking Supervisory Authority

Please see *https://www.fma.gv.at/en/organisation/*

Main strategic objectives of the Banking Supervisory Authority in 2020

Please see *https://www.fma.gv.at/en/publications/facts-and-figures-trends-and-strategies/*

The FMA is committed to the principle of transparency, engaging in open dialogue with the market and the supervised companies. It shares the main findings of its annual analysis, provides information on the main risks it has identified on the financial markets for the coming years, and gives updates on its medium-term supervisory strategy based on this analysis. Every year the FMA also publishes in detail its priorities for supervision and inspections in the coming year. These are explained in its "**Facts and Figures, Trends and Strategies**" publication and on the FMA website.

The aim is to alert the supervised entities to the risks applicable to their area of business and to give them an opportunity to prepare in a targeted way for the risk-based priorities set for the coming year. This raises awareness of risk and creates transparency around the challenges that the supervisory authority has identified and wishes to focus on. In this way, the supervised entities are also given a clear indication of which areas they should be particularly focusing on. The state of the economy as a whole highlights the challenging nature of the current situation as the FMA looks to next year. While the economic upturn of recent years boosted profitability and capitalisation in the financial sector, a loss of momentum has again increased the pressure on traditional players on Austria's financial market. Moreover, this pressure is only growing, as more and more new players and digital business models force their way on to the market. As far as the FMA is concerned, this means it must, firstly, continue with the work it has started and further improve companies' resilience and corporate governance. And secondly, it must place an additional focus on new players, new business models and their impact on the financial market of old.

As far as operational supervision is concerned, and based on its medium-term risk 18 analysis and supervision strategy (2020-2024), the **FMA is therefore setting the following priorities for its inspection and supervision work in 2020**:

1. Expanding collective consumer protection,
2. Strengthening the governance of supervised companies,
3. Embracing the opportunities of digitalisation while addressing the risks,
4. Making financial service providers more resilient,
5. Providing a regulatory and supervisory context for new business models,
6. Securing the clean status of Austria's financial centre.

These main priorities in operational supervision activities will also be supplemented during the coming year with a diverse range of activities to expand and develop the regulatory framework and with numerous supervisory policy initiatives.

The activities of the Banking Supervisory Authority in 2020

Please see
https://www.fma.gv.at/en/publications/fma-annual-report/
https://www.fma.gv.at/en/publications/facts-and-figures-trends-and-strategies/

The **priorities for the FMA's operational supervision activities** (please see as well answer to question 5) were **complemented by a diverse range of activities to expand and develop the regulatory framework and by numerous supervisory policy initiatives**. As part of its advisory and marketrelated support of a number of regulatory projects, the FMA focused in the reporting year 2020 on, for example:

- Shaping the sustainable finance rules.
- Developing Basel 3.5 from the perspective of the Austrian financial market.
- Preparing the FMA for the changes to the three European Supervisory Authorities (ESAs), namely the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA). The FMA has a seat and a vote at each of these European institutions and contributes actively to their work in the interests of Austria as a financial centre. The ESA Review, which has analysed and evaluated the efficiency and effectiveness of these institutions on the basis of their practical work in their early years, provides a good starting point in this regard.
- Strengthening international cooperation across all areas of supervision, particularly in terms of the working relationship with partner authorities in Central, Eastern and SouthEastern European (CESEE) countries.

International activities of the authority

The Austrian FMA is part of the European cooperation within the European System of Financial Supervision (ESFS) and contributes actively to the activities of the European Supervisory Authorities (EBA, ESMA, EIOPA) as well as the ESRB. Furthermore, the FMA is National Competent Authority within the Single Supervisory Mechanism (SSM) and National Resolution Authority within the Single Resolution Mechanism (SRM).

On an international level, the FMA is an active member of the IAIS, IOPS and IOSCO and attends the Integrated Financial Supervisors Conference (IFSC) on a regular basis as well as meetings of the Basel Consultative Group (BCG), a subgroup of the BCBS.

In addition to active cooperation with international organisations, the fostering of bilateral relations with other supervisory authorities is of particular importance. Bilateral cooperation is facilitated by memoranda of understanding on cooperation and exchange of information, which the FMA has already signed with supervisory authorities from 45 jurisdictions. Furthermore, the FMA has signed multilateral memoranda of understanding under ESMA, IOSCO, IAIS and the ECB.

Cooperation with other supervisory bodies in the country

In handling official activities related to supervision, the FMA must, as far as possible, draw on analyses and inspection results as well as the results of the expert opinions prepared by the Oesterreichische Nationalbank (OeNB) during model approval procedures, in addition to using information from third parties or from the respective bank. The 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. This close cooperation continues within the framework of the SSM and the SRM. In line with the macro-prudential measures set out in the CRD IV the Financial Market Stability Board (Finanzmarktstabilitätsgremium) was established. Its main tasks are to promote financial market stability, reduce the systemic threat and lower the systemic and procyclical risks. It consists of representatives of the Federal Ministry of Finance, the FMA, the OeNB as well as the Fiscal Council. In accordance with the European Systemic Risk Board (ESRB) warnings and recommendations, the Financial Market Stability Board is mandated to act on a possible threatening of the Austrian financial stability amongst others with warnings and recommendations.

Other relevant information and developments in 2020

Please see *https://www.fma.gv.at/en/publications/fma-annual-report/*

The Covid 19 pandemic and its subsequent massive and dramatic economic impact forced the FMA to rethink its supervision and inspection priorities from early 2020 onwards. Its focus shifted to mitigating the pandemic’s economic consequences and limiting the economic risks for the Austrian financial market, without, of course, losing sight of its mediumterm supervisory objectives and current supervision priorities.

Coronavirus began spreading rapidly around the globe in early 2020. In just a few weeks it developed into a pandemic, with devastating consequences. Tackling this global health crisis required deep political incursions into social and economic life. The impact on the real economy has been huge. Many businesses, indeed entire industries, were forced to close for months, unemployment soared, sales markets collapsed, supply chains were destroyed and economic output nosedived. There were times when the financial markets, and the stock markets in particular, went a little crazy. Faced with this emergency, national governments and the European Union launched aid and support programmes on an unprecedented scale, the European Central

Bank and national central banks flooded the markets with cheap money to keep them afloat, and regulators and supervisors in the European Economic Area came together with a commitment to support politicians, central banks and financial service providers to the best of their ability. With the first lockdown in Austria in March 2020, the FMA also immediately put together a comprehensive package of measures: to prevent any contagion to the financial market of the crisis affecting the real economy, and to adequately support the measures taken by politicians, central banks and financial service providers. To this end, it started with its three most important functions: its role as supervisor, its role as regulator and its role as an information hub for the Austrian financial market. The Authority pursued a crystalclear strategy: allowing as much flexibility as possible from a regulatory point of view. At the same time, however, it cannot accept any compromises in the identification of risks, even in times of crisis. Risks must always be properly monitored and managed.

Questionnaire tables for the 2020 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	160	162	156
Branches of foreign credit institutions	25	22	24
Cooperative banks	412	389	363
Banking sector, total:	**597**	**573**	**543**

Source: OeNB, unconsolidated data

Total assets of banking sector (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	524.4	536.4	592.1
Branches of foreign credit institutions	22.8	23.0	24.5
Cooperative banks	307.2	325.6	357.3
Banking sector, total:	854.6	885.0	973.8
y/y change (in %)	**+4.8%**	**+3.6%**	**+10.0%**

Source: OeNB, unconsolidated data in EUR bn

Ownership structure of banks on the basis of assets total

Item	2018	2019	2020
Public sector ownership	4.8	4.7	4.6
Domestic ownership total	75.6	81.1	81.1
Foreign ownership	24.4	18.9	18.9
Banking sector, total:	**100.0**	**100.0**	**100.0**

Source: OeNB, unconsolidated data.

Concentration of asset by the type of financial institutions, 2020

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	40.1	51.4	735
Branches of foreign credit institutions	54.8	71.1	1,474
Cooperative banks	41.6	50.3	760
Banking sector, total:	**27.8**	**36.8**	**375**

Source: OeNB, unconsolidated data.

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2018	2019	2020
Commercial banks	7.2	6.9	3.3
Cooperative banks	9.0	5.8	3.6
Banking sector, total:	**8.4**	**6.4**	**3.4**

Source: OeNB, unconsolidated data

Distribution of market shares in balance sheet total (%)

Type of financial institution	2018	2019	2020
Commercial banks	61.4	60.6	60.8
Branches of foreign credit institutions	2.7	2.6	2.5
Cooperative banks	35.9	36.8	36.7
Banking sector, total:	**100.0**	**100.0**	**100.0**

Source: OeNB, unconsolidated data.

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

	2018	2019	2020
Receivables	**n.a.***	**n.a.***	**n.a.***
Financial sector	n.a.*	n.a.*	n.a.*
Nonfinancial sector	n.a.*	n.a.*	n.a.*
Government sector	n.a.*	n.a.*	n.a.*
Other assets	n.a.*	n.a.*	n.a.*
Liabilites	**n.a.***	**n.a.***	**n.a.***
Financial sector	n.a.*	n.a.*	n.a.*
Nonfinancial sector	n.a.*	n.a.*	n.a.*
Government sector	n.a.*	n.a.*	n.a.*
Other liabilities	n.a.*	n.a.*	n.a.*
Capital	**n.a.***	**n.a.***	**n.a.***

** a breakdown of the whole balance sheet into these categories is not possible because this structure is only given for loans and deposits.*

Capital adequacy ratio of banks

Type of financial institution	2018	2019	2020
Commercial banks	18.7***	19.0***	20.2***
Cooperative banks	18.4***	18.3***	18.8***
Banking sector, total:	**18.6*** **	**18.7*** **	**19.5*** **

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

Source: OeNB, consolidated data.

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

Asset classification	2018	2019	2020
Non-financial sector, including			
- households	3.5	3.0	2.8
- corporate	3.7	3.1	3.1

Source: OeNB, consolidated data.

The structure of deposits and loans of the banking sector in 2020 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:		
Households	68.6	44.5
Corporate	20.3	44.4
Government sector	5.6	6.7
Financial sector (excluding banks)	5.5	3.6
Total	**100.0**	**100.0**

Source: OeNB, unconsolidated data; only domestic

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

P&L account	2018	2019	2020
Interest income	15.1	15.1	13.4
Interest expenses	6.5	6.5	4.8
Net interest income	8.6	8.6	8.6
Net fee and commission income	4.6	4.6	4.7
Other (not specified above) operating income (net)	6.9	6.5	6.0
Gross income	19.4	19.7	19.3
Administration costs	11.2	11.6	10.8
Depreciation	0.9	1.0	1.0
Provisions	0.3	0.2	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	6.6	5.7	3.4
Net profit (loss)	5.7	4.8	2.7

Source: OeNB, unconsolidated data in EUR bn.

Total own funds in 2020 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	53.1***	42.7***	46.1***	7.0***	n.a.
Cooperative banks	41.2***	34.8***	36.8***	4.3***	n.a.
Banking sector, total:	94.3***	77.5***	82.9***	11.3***	n.a.

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

Source: OeNB, consolidated data in EUR bn.

Macroeconomic conditions

In 2020, the Belarusian economy faced a number of unanticipated challenges. External and domestic factors made an impact on the financial sector of the Republic of Belarus. On the background of pandemic COVID-19, a sharp decrease in the global oil prices was observed over 2020. Downfall of the global economy, including the countries – main trade partners of the Republic of Belarus, was accompanied by the closure of external markets and shrinkage of demand for key export positions. As a consequence, economic activity declined, while inflation, on the contrary, accelerated.

In these terms, the National Bank in cooperation with the Government of the Republic of Belarus managed to maintain financial stability in 2020 and avoid considerable acceleration of inflationary processes, as well as provide required resources support to the economy.

Development of the banking sector (including assets/GDP)

In the year under review, the banking sector's income had the following structure: interest income – 55.2%, commission income – 21.4%, other banking income – 20.6%, other operational income – 2.7%, and receipts under written-off debts – 0.1%.

As at January 1, 2021, the banking activities in the Republic of Belarus were carried out by 24 banks and three non-bank financial institutions. Three banks underwent liquidation. The total number of banks' and non-bank financial institutions' organizational units (branches, banking services centers, settlement and cash centers, and exchange offices) in the country dropped over 2020 by 5.1%, amounting as at January 1, 2021 to 3,098.

As at January 1, 2021, there were five representative offices of foreign[1] banks in the Republic of Belarus.

Foreign capital participated in the authorized capital of 19 banks. At 15 banks the share of foreign investors in the authorized capital exceeded 50% (of which four banks were wholly-foreign owned).

As at the beginning of the year under review, the share of foreign investments in the total volume of the registered authorized funds of the Belarusian banks amounted to 20%. As at January 1, 2021, the share of state-owned banks amounted to 76.9% of the aggregate authorized fund of the banking sector.

As at January 1, 2021, the aggregate registered authorized fund of the banks totaled BYN5.8 billion, having increased by 4.7% over 2020.

In 2020, the banking sector maintained sustainability.

As at January 1, 2021, the volume of the regulatory capital of the banks amounted to BYN12.2 billion, having increased by 9.6% over 2020.

As at January 1, 2021, the assets of the acting banks totaled BYN90.6 billion, with an increase over January-December 2020 by 15.6%.

The volume of the gross domestic product in 2020 in the current prices amounted to BYN147 billion. In comparable prices the volume of GDP went down by 0.9% versus 2019 (in 2019, increased by 1.4%).

[1] For the purposes of this report:
- state-owned banks are banks in which the state owns more than 50% of shares (equity interest) in the authorized capital;
- foreign banks are banks in which the share of foreign investors in the authorized capital exceeds 50%; and
- private banks are banks other than foreign and state-owned banks.

As at January 1, 2021, the ratio of the assets (liabilities) to GDP to 61.6% (as at January 1, 2020 – 58.1%). The regulatory capital/GDP ratio was 8.3%.

In 2020, the operating banks' aggregate profit* totaled BYN1 billion, a 13.5% decline compared with 2019, or BYN0.2 billion lower than 2019 profit. A decrease in the profit obtained by banks led to reduction in the indicators of efficiency of their activities. Thus, the return on assets in annual terms went down from 1.5% to 1.1%, the return on regulatory capital in annual terms – from 11% to 8.9%.

The legal and institutional framework of the operation and supervision of financial institutions, new developments

In 2020, the work on streamlining regulatory legal framework governing banking supervision and bringing it into line with international standards having regard to the experience of practical application continued.

With the purpose of increasing the financial sustainability of banks and expanding their capacity to continue provision of financial support to the real sector of the economy under conditions of an increased influence of negative factors, in the course of 2020, the National Bank was taking measures providing for temporary adjustment of the requirements to the secure functioning ratios (in particular, minimum amount of regulatory capital, its adequacy, the net stable funding ratio, liquidity coverage ratio, and concentration of risk per debtor); temporary change in certain requirements to the classification of assets exposed to credit risk; usage of the minimal amount of the regulatory capital; and submission of recommendations to banks that determine priority areas of profit distribution and cases of non-payment of dividends, the procedures for updating and approving the plans of financing in crisis situations and contingency action plans.

The approaches to assessing the transparency of the ownership structure of a bank and a non-bank financial institution were updated with account of the existing practice and practical aspects of issuing a special permit (license) to carry out banking activities when making a decision to change a license, that is not related to modification of the list of banking operations specified therein, have been updated.

In order to improve the internal control systems at banks, JSC "Development Bank of the Republic of Belarus", non-bank financial institutions, banking groups and bank holding companies, additional requirements were established to the policy of informing about the facts of violations or illegal actions related to the activities of the head of the bank, senior managers and founders (participants, property owners) of organizations that are incorporated in a bank holding.

In the reporting year, within the framework of improvement of the AML/CFT system, the work on the incorporation of the FATF* international standards into the legislation of the Republic of Belarus continued.

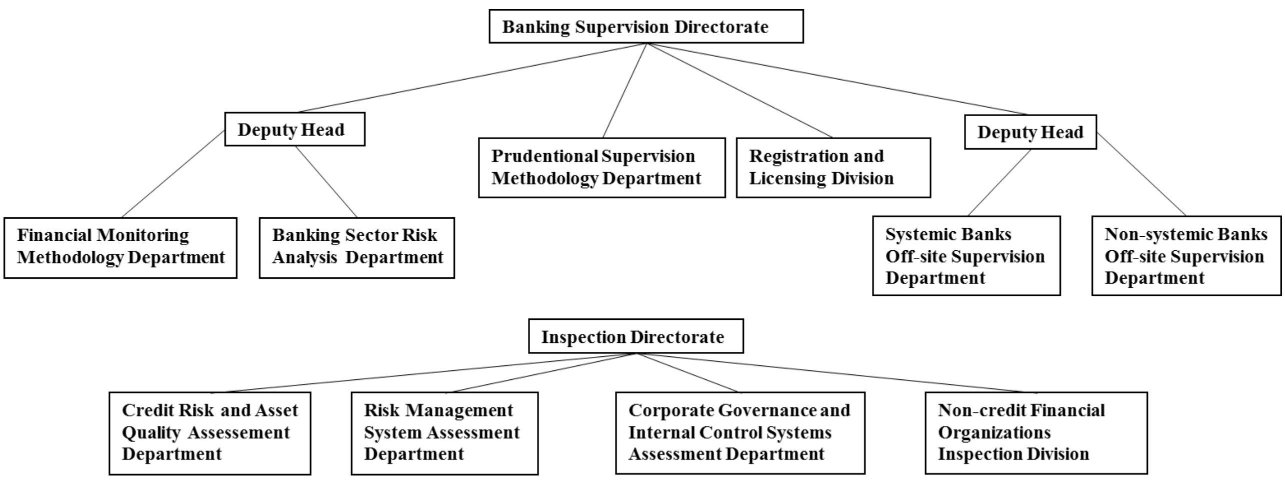
Legal competence of the Banking Supervisory Authority

The National Bank is the banking supervision authority.

In the Republic of Belarus, there is a system of banking supervision, which generally meets the world standards. It includes:

- registration and licensing of banks and non-bank financial institutions;
- off-site supervision of banks and the JSC "Development Bank of the Republic of Belarus" (Development Bank) on the basis of reporting, on-site supervision in the form of inspections;
- application of appropriate supervisory response measures to banks and the Development Bank in case of violation of banking legislation thereby and deterioration of their financial condition;
- reorganization and liquidation of banks and non-bank financial institutions;
- systemic analysis of the banking sector's risks;
- regulation and control in the sphere of preventing the legalization of proceeds from crime, financing terrorist activities and financing the proliferation of weapons of mass destruction, and exercise of foreign exchange control.

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Supervisory Authority in 2020

In 2020, the activities of the National Bank were aimed at achieving the main targets and carrying out functions of a central bank assigned to it according to the legislation.

The main tasks of the National Bank within the framework of conducting off-site supervision of banks (banking holdings), non-bank financial institutions and the Development Bank were aimed at ensuring their sustainable and secure functioning, protecting the interests of depositors and other creditors, including by taking timely supervisory response measures, minimizing risks accepted by banks and increasing the efficiency of their activities, as well as preventing the bankruptcy of the banking sector's participants.

The activities of the Banking Supervisory Authority in 2020

In 2020, a general supervisory assessment of the activities of separate banks (taking into account the nature, scale and complexity of their activities) over 2019 was carried out, which included a comprehensive assessment of the strategy and performance of these banks, the organization of corporate governance, risk management and internal control, capital adequacy and liquidity to ensure their safe and stable operation. Based on the results of the assessment, appropriate recommendations were submitted to the banks.

Besides, in order to reveal the problems in banks' activities at an early stage of their occurrence, within the year under review, the early warning indicators, banks' performance efficiency indicators, levels of risks assumed by banks, as well as their compliance with the secure functioning and other prudential requirements, were monitored on a permanent basis, including with account of use by banks of countercyclical and stabilization measures on regulation of banking activities, which were adopted by the National Bank in 2020.

The early and (or) supervisory response measures, particularly those aimed at increasing banks' capitalization, ensuring profitable work and liquid functioning, improving corporate governance, internal control in the area of AML/CFT and excluding participation in non-core activities, were taken with respect to banks when violations and drawbacks in the banks' activities were revealed. Subsequently, the assessment of the fulfillment of the mentioned measures was conducted, and additional supervisory actions were taken if necessary.

Strategic plans of banks' development were considered with the purpose of assessing their ability to ensure financial reliability and sustainability in the long-term perspective within implementation of the presented strategic plans and under the influence of the current foreign economic situation. Also, the issuance of licenses for banks' participation in the authorized capital of other legal entities was considered taking into account the effectiveness and expediency of such investments.

International cooperation

According to recommendations of the Basel Committee on Banking Supervision (BCBS), the National Bank continued work on concluding bilateral agreements with foreign banking supervisory authorities. These agreements provide for the exchange of information in the sphere of creating and licensing of cross-border institutions, supervision over these institutions, conduct of inspections, taking decisions on issuing licenses for purchasing shares of a credit institution, and ensure effective operation of supervision bodies and stable functioning of the banking systems. As of January 1, 2021, 17 bilateral agreements in the sphere of cross-border banking supervision were in force.

Cooperation with other supervisory bodies

In carrying out banking supervision functions, the National Bank of the Republic of Belarus cooperates on a regular basis with the Ministry of Finance of the Republic of Belarus, Ministry of Internal Affairs of the Republic of Belarus, General Prosecutor's Office of the Republic of Belarus, State Control Committee of the Republic of Belarus, State Customs Committee of the Republic of Belarus, financial intelligence units, and tax authorities.

Other information

More detailed information about the development of 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 (http://www.nbrb.by/engl/).

Questionnaire tables for the 2020 review

Number of financial institutions (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	24	24	24
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**24**	**24**	**24**

Total assets of banking sector (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	100.0	100.0	100.0
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**
y/y change (in %)	**10.5**	**6.3**	**15.6**

Ownership structure of banks on the basis of assets total (%)

Item	2018	2019	2020
Public sector ownership	64.9	63.0	64.6
Domestic ownership total	67.8	66.3	68.0
Foreign ownership	32.2	33.7	32.0
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2020

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	63.5	74.8	0.2
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**0.2**

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

Type of financial institution	2018	2019	2020
Commercial banks	10.72	10.92	8.86
Cooperative banks	-	-	-
Banking sector, total:	**10.72**	**10.92**	**8.86**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2018	2019	2020
Commercial banks	100.0	100.0	100.0
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2018	2019	2020
Receivables	**100.0**	**100.0**	**100.0**
Financial sector	1.9	1.4	1.5
Nonfinancial sector	67.2	70.0	74.0
Government sector	21.9	21.7	18.6
Other assets	9.0	6.9	6.0
Liabilites	**100.0**	**100.0**	**100.0**
Financial sector	2.0	1.4	1.8
Nonfinancial sector	54.4	56.9	50.8
Government sector	8.9	7.8	11.0
Other liabilities	34.7	34.0	36.4
Capital	**14.4**	**14.8**	**14.1**

Capital adequacy ratio of banks (%)

Type of financial institution	2018	2019	2020
Commercial banks	17.7***	17.8***	17.2***
Cooperative banks	-	-	-
Banking sector, total:	**17.7*** **	**17.8*** **	**17.2*** **

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

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

Asset classification	2018[2]	2019	2020
Non-financial sector, including	5.01%	4.63%	4.83%
- households	0.09%	0.12%	0.18%
- corporate	4.92%	4.51%	4.65%

[2] Since April 1, 2018, the classification of assets exposed to the credit risk has been implemented according to the six groups of risk. Also the concept "non-performing assets" was introduced. The non-performing assets of the acting banks are equal to the assets classified under V and VI risk groups, as well as the restructured indebtedness classified as IV-VI risk groups.

The structure of deposits and loans of the banking sector in 2020 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	84.9%	58.3%
Households	56.8%	26.6%
Corporate	28.1%	31.7%
Government sector	10.7%	37.1%
Financial sector (excluding banks)	4.4%	4.6%
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-end, in million EUR)

P&L account	2018	2019	2020
Interest income	1928.6	2166.8	1725.0
Interest expenses	761,6	957.6	808.5
Net interest income	1167.0	1209.2	916.5
Net fee and commission income	452.9	545.8	429.6
Other (not specified above) operating income (net)			
Gross income	6740.9	7126.4	6483.5
Administration costs			
Depreciation			
Provisions	383.9	358.4	424.5
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)			
Profit (loss) before tax	536.1	587.6	390.2
Net profit (loss)	443.0	499.6	321.0

Total own funds in 2020 (in million EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	3861.5***	3118.9***	3119.8***	741.6***	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**3861.5*** **	**3118.9*** **	**3119.8*** **	**741.6*** **	**-**

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

Macroeconomic environment in the country

According to information from the Agency for Statistics of BiH[1], the nominal gross domestic product (GDP) in BiH in 2020 was BAM 34.2 billion, down by 3% compared to 2019. Observed by business activities, the most significant nominal growth of gross value added was seen with the construction industry, forestry and fishery. The nominal decrease of gross value added was seen with accommodation, transport, warehousing, entertainment, recreation and retail and wholesale sectors. The real GDP decrease rate in 2020 stood at 3.2% and GDP per capita at BAM 9,853/USD 5,038[2], down by 2.5% compared to 2019. In 2020, an average trend of the production price index in BIH posted a rise of the total index by 3.3%[3] compared to the base average. An average annual deflation in BIH in 2020 was 1.1% (compared to 2019).[4]

Although impacted by negative economic consequences caused by the COVID-19 disease, the BiH banking system remained stable, liquid, well-capitalised and profitable in 2020. The balance sheet total of the BiH banking sector as at YE2020 was BAM 32.9 billion, up by 1.2% against the same period of the year before. Despite evident effect of the pandemic on business activities of banks, at an annual level, loans amounted to BAM 20.7 billion and have risen by 0.3%, while deposits amounted to BAM 26.2 billion and have climbed by 1.4% against the end of 2019. The own funds ratio of the banking sector in BiH in 2020 increased from 18% to 19.2% and is much above the statutory minimum. The net profit figure of the BiH banking sector in 2020 equaled BAM 227.1 million, thus being much lower than the one posted in the same period of the previous year. The loan portfolio structure saw no major changes and noted effects resulted from implementation of new regulations and temporary measures adopted for purpose of mitigating negative economic consequences caused by the pandemic. In late 2020, return on average assets (ROAA) stood at 0.8% and return on average equity (ROAE) at 6%.[5]

Development in the banking sector (including the assets total / GDP)

As of 31.12.2020, there were 15 commercial banks operating in the FBIH with 531 organizational parts and a total of 6,522 employees. Despite the impact of the negative economic effects of the pandemic, positive trend in the FBIH banking sector have continued, reflecting in growth of assets, loans and deposits. The share of NPLs, as a key indicator of loan quality, still displays a downward trend. What has also continued is the increase of total deposits and savings representing the most significant and the biggest segment of the deposit and financial potential of banks. As of 31.12.2020, banks in the FBIH have generated positive financial result. The FBIH banking sector is stable, adequately capitalised, liquid and profitable.

Total net assets of the FBIH banking sector amounted to BAM 24.4 billion, up by BAM 0.2 billion or 0.8% vs. YE2019. The share of total assets of the FBIH banking sector vs. the GDB in FBIH[6] was 1.1.

Total capital as of 31.12.2020 equaled BAM 3.1 billion (shareholder capital amounting to BAM 1.3 billion), thus going down by 2.1% vs. 2019. Regulatory capital was BAM 2.7 billion and increased by KM 8.5 million, or 0.3% compared to the end of 2019. The own funds rate of the FBIH banking sector as of 31.12.2020 was 19.1%, which is by 1.2 percentage points higher than as at YE2019, i.e. by 7.1 percentage points above the

1 Agency for Statistics of BiH, news release related to the gross domestic product in BiH for 2020 – initial results, July 2021
2 Agency for Statistics of BiH, news release related to the gross domestic product in BiH for 2020 – initial results, July 2021
3 Agency for Statistics of BiH, price index of industrial production in BiH in 2020, tematic bulletin 12
4 Agency for Statistics of BiH, price index of industrial production in BiH in 2020, tematic bulletin 09
5 Central Bank of BiH, statistical web portal, financial stability indicators for the banking sector and information on the banking sector proviced by the entity-level banking agencies
6 FBiH Statistics Bureau, Press release regarding the annual gross domestivc product for the Federation of BiH, 2020 – initial results, July 2021

legal minimum of 12%. At the FBIH banking sector level, other capital rates (common equity Tier 1 rate and common equity rate, i.e. CET1 and T1) also exceeded the prescribed minimum. The financial leverage rate (the ratio of common equity and total bank exposure) at the FBIH banking sector level as of 31.12.2020 was 10.1%, which is by 0,4 percentage points lower than at YE2019 (prescribed minimum being 6%).

Loans, holding a share of 62.5% in total assets, posted a rise against the end of 2019 of BAM 33.9 million or 0.2%, thus arriving to the figure of BAM 15.3 billion as of 31.12.2020. Corporate loans went up by 152.6 million or 2.0%, reaching BAM 8 billion of 31.12.2020 and holding 52.3% share in total loans. Over the same period, household loans achieved a decrease by BAM 118.7 million or 1.6%, thus holding a share in total loans of 47.7%. Their amount as of 31.12.2020 was BAM 7.3 billion. The share of NPLs dropped from 8.2% to 6.4% as a result of the collection activities and performed write offs. The share of corporate NPLs in total corporate loans was 6.8%, while the share of household NPLs in total household loans was 6.0%.

Cash funds amounted to BAM 7.4 billion and represented 30.4% of total assets, thus being by BAM 227 million or 3.0% lower than at the end of 2019.

The FBIH banking sector's deposits reached a value of BAM 19.7 billion, thus going up by BAM 246.6 million or 1.3% and represented 80.6% of total liabilities. Savings deposits, as the most significant and the biggest segment of the deposit and financial potential of banks, increased by BAM 341.9 million or 3.6% to BAM 9.9 billion.

As of 31.12.2020 (based on final unaudited reporting data), the FBIH banking sector posted a positive financial result – profit of BAM 174.3 million, which is by BAM 99.6 million or 36.4% lower than in the same period in 2019.

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

A) Prudent Regulatory Framework issued by the FBA (changes in 2020):

In the process of the FBA regulatory activities related to preparation of regulations, the following decisions were adopted in 2020:

- FBA Decisions, Instructions and Guidelines related to the operations and supervision of the banks, micro credit organisation and leasing companies :
  - Decision on Amendments to the Decision on Reports Banks Deliver to the Banking Agency of the Federation of Bosnia and Herzegovina;[7]
  - Decision on Amendments to the Decision on Internal Capital Adequacy Assessment Process and Internal Liquidity Adequacy Assessment Process in Banks[8] and changes to the existing reporting guidelines;
  - Decision on Amendments to the Decision on Capital Calculation in Banks, Decision on Amendments to the Decision on Credit Risk Management and Determination of Expected Credit Losses, Decision on Amendments to the Decision on Foreign Exchange Risk Management in Banks with accompanying instructions, Decision on Amendments to the Decision on Liquidity Risk Management in Banks, Decision on Amendments to the Decision on Minimum Standards for Documenting Financing under

[7] FBiH Official Gazette No. 18/20
[8] FBiH Official Gazette No. 30/20

Leasing Agreements and Assessment of Credit Standing, Decision on Correction of the Decision on Amending the Decision on Supervision of Leasing Companies;[9]

- Decision on Interest Rate Risk Management in the Banking Book[10] and accompanying instructions;
- Decision on Amendments to the Decision on Minimum Standards for Documenting Lending Activities in Micro Credit Organisations and Assessment of Credit Standing;[11]
- Decision on Amendments to the Decision on Capital Calculation in Banks[12], as well as changes to the existing instructions for regulatory reporting;
- Decision on Reports Banks Delivery to the Banking Agency of the Federation of Bosnia and Herzegovina according to the standardised regulatory reporting framework (COREP), Decision on Reports for supervisory and statistical purposes, Decision on Amendments to the Decision on Purchase and Sale of Bank Investments, Decision on Amendments to the Decision on the Fee Tariff for Micro Credit Organisations;[13]
- Instructions for Preparation of Recovery Plans of Banks and Banking Groups in 2020;
- Instructions for Assessment of Market Value of Collateral;
- Reporting Instructions for Micro Credit Organisations;

• FBA Decision related to bank resolution:

  - Decision on Conditions and Methods of Supervision and Ordering Measures for purpose of Performance of Competencies within the Bank Resolution Area;[14]

• FBA temporary Decisions and Instructions related COVID -19:

  - Decision on Temporary Measures for Reporting by Banks to the Banking Agency of the Federation of Bosnia and Herzegovina, Decision on Temporary Measures for Reporting by Micro Credit Organisations to the Banking Agency of the Federation of Bosnia and Herzegovina, Decision on Temporary Measures for Reporting by Leasing Companies to the Banking Agency of the Federation of Bosnia and Herzegovina, Decision on Temporary Measures of Banks to Mitigate Negative Economic Consequences Caused by COVID-19 Disease, Decision on Temporary Measures of Leasing Companies and Micro Credit Organisations to Mitigate Negative Economic Consequences Caused by COVID-19 Disease, Decision on Temporary Measures for Reporting by Factoring Companies and Banks Dealing with Factoring Business to the Banking Agency of the Federation of Bosnia and Herzegovina;[15]
  - Decision on Temporary Measures for Reporting by Banks to the Banking Agency of the Federation of Bosnia and Herzegovina, Decision on Temporary Measures for Reporting by Micro Credit Organisations to the Banking Agency of the Federation of Bosnia and Herzegovina, Decision on Temporary Measures for Reporting by Leasing Companies to the Banking Agency of the Federation of Bosnia and Herzegovina, Decision on Temporary Measures for Reporting by Factoring Companies and Banks Dealing with Factoring Business to the Banking Agency of the Federation of Bosnia and Herzegovina, Decision on Form and Deadlines for Reporting by Banks on Effects of Performance of Special Measures to Mitigate Consequences Caused by COVID-19 Disease, Decision on Form and Deadlines for Reporting by Leasing Companies and Micro Credit Organisations on Effects of Performance of Special Measures to Mitigate Consequences Caused by COVID-19 Disease;[16]
  - Decision on Amendments to the Decision on Temporary Measures for Banks to Mitigate Negative Economic Consequences Caused by COVID-19 Disease, Decision on Amendments to the Decision on

[9] FBiH Official Gazette No. 37/20
[10] FBiH Official Gazette No. 41/20
[11] FBiH Official Gazette No. 54/20
[12] FBiH Official Gazette No. 81/20
[13] FBiH Official Gazette No. 86/20
[14] FBiH Official Gazette No. 54/20
[15] FBiH Official Gazette No. 22/20
[16] FBiH Official Gazette No. 25/20

Temporary Measures for Leasing Companies and Micro Credit Organisations to Mitigate Negative Economic Consequences Caused by COVID-19 Disease;[17]

- Decision on Temporary Measures of Banks to Mitigate Negative Consequences Caused by COVID-19 Disease, Decision on Temporary Measures of Micro Credit Organisations and Leasing Companies to Mitigate Negative Consequences Caused by COVID-19 Disease;[18]
- Decision Rendering Ineffective the Decision on Forms and Deadlines for Reporting by Banks on Effects of Performance of Special Measures to Mitigate Consequences Caused by COVID-19 Disease, Decision Rendering Ineffective the Decision on Forms and Deadlines for Reporting by Leasing Companies and Micro Credit Organisations on Effects of Performance of Special Measures to Mitigate Consequences Caused by COVID-19 Disease;[19]
- Instructions for Completing the Reports on Special Measures approved in line with relevant decisions on temporary measures by banks, leasing companies and micro credit organisations to ensure recovery from negative consequences caused by COVID-19 disease.

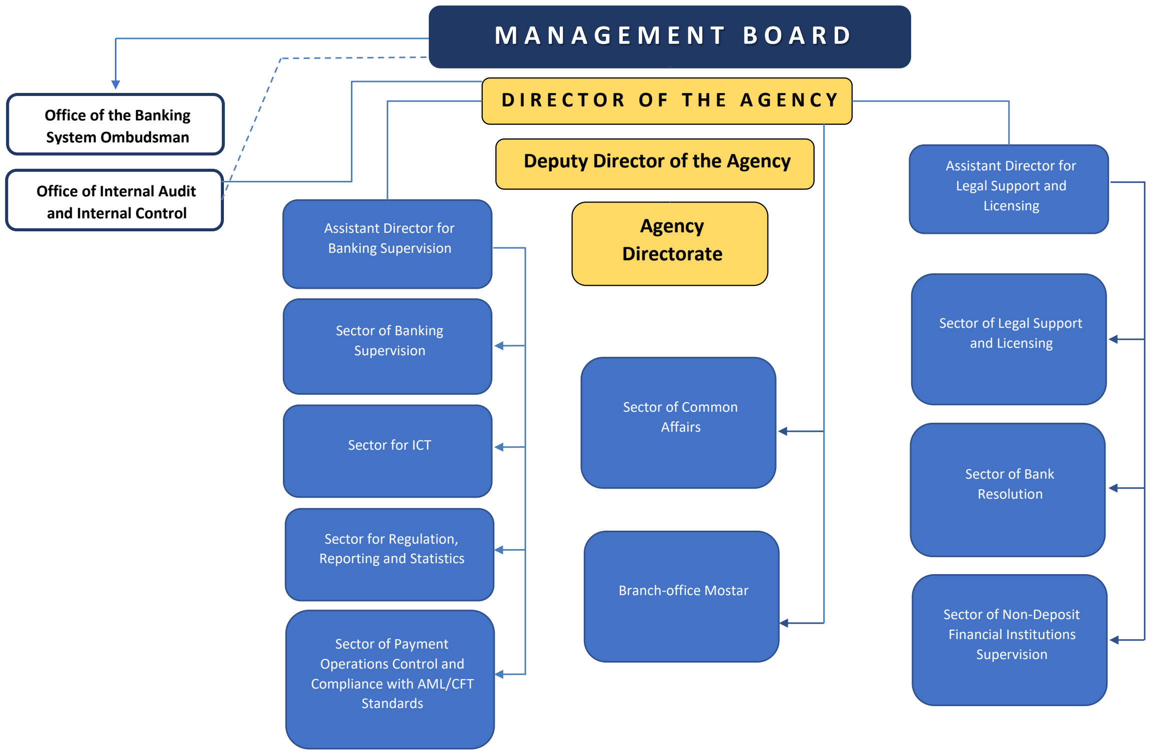
B) Legal competences of the FBA:

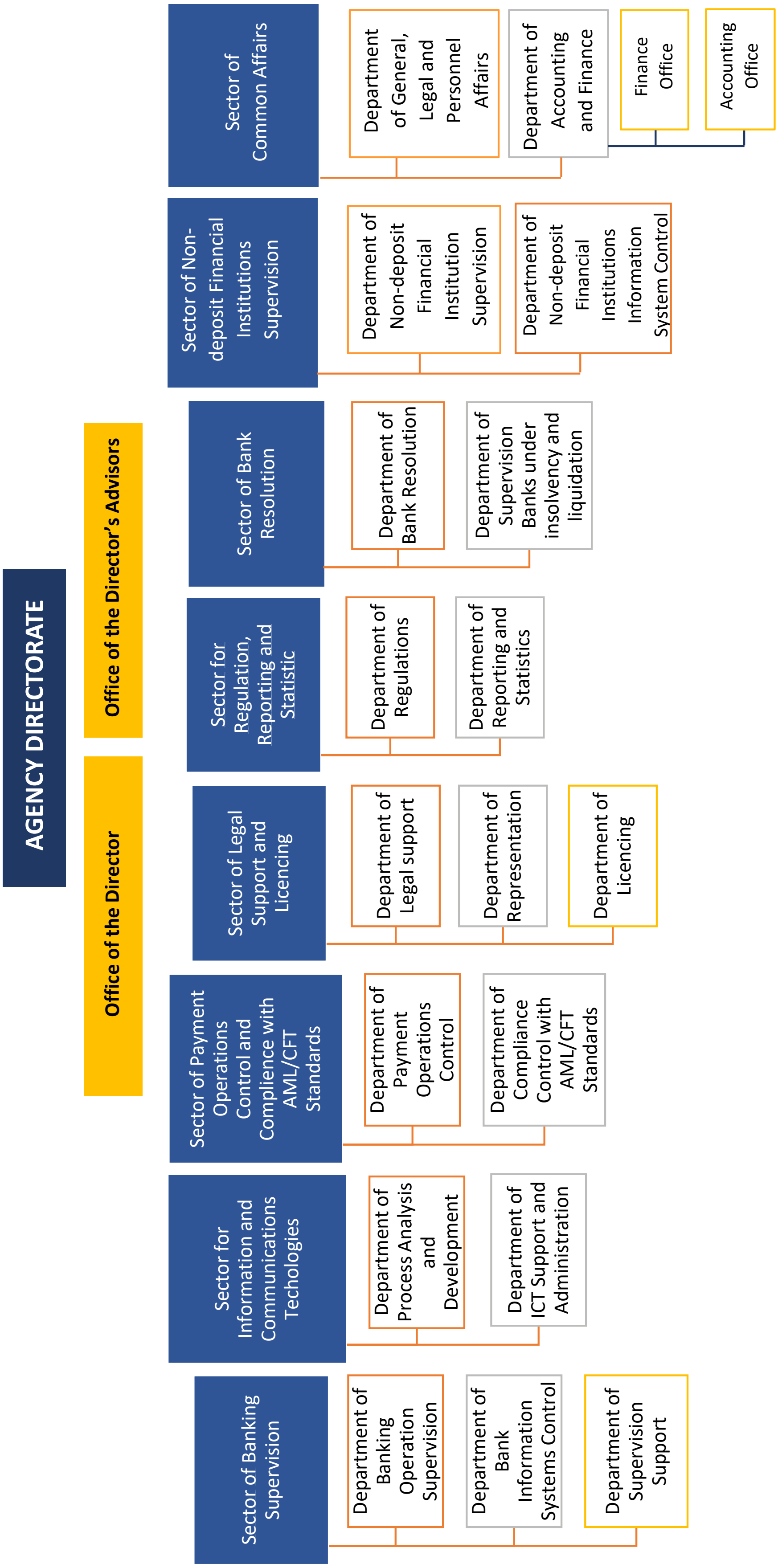
Pursuant to the Law on the Banking Agency of the Federation of BiH, the competences of the FBA are the following:

- identifying and performing activities and measures to maintain and strengthen the banking system stability,
- establishing, enforcing and supervising prudential rules regulating the operations of the banking system entities (banks, banking groups, development banks, microcredit organisations, leasing companies, factoring companies, exchange offices and other financial organisations which operates under FBA supervision according to the law),
- issuing and revoking licenses and other relevant acts to the banking system entities when authorized to do so by special regulations,
- supervising operations of the banking system entities when authorized to do so by special regulations,
- supervising operations of the development bank, ordering supervision measures and other competences under regulation governing operations of the development bank and this Law,
- ordering supervision measures and other competences when authorized to do so by special regulations,
- adopting acts regulating operations of the FBA,
- adopting acts regulating operations of the banking system entities,
- adopting acts, supervising and undertaking the necessary measures related to anti-money laundering and terrorist financing that apply to the banking system entities in cooperation with the competent authorities and institutions in the field of anti-money laundering and terrorist financing under regulations governing anti-money laundering and terrorist financing,
- adopting acts and performing activities to protect the rights and interests of users of financial services in the banking system, performing supervision of implementation of regulations from this field and undertaking other activities and relevant measures within the scope of its authorities,
- Adopting and updating the resolution plan, establishing eligibility for initiation of bank resolution proceedings, conducting resolution proceedings, deciding on tools and measures to undertake in resolution and performing other activities relating to resolution under the law regulating banks.

[17] FBiH Official Gazette No. 37/20
[18] FBiH Official Gazette No. 60/20
[19] FBiH Official Gazette No. 70/20

Organizational chart of the Banking Supervisory Authority




AGENCY DIRECTORATE
Office of the Director
Office of the Director's Advisors
Sector of Banking Supervision
Department of Banking Operation Supervision
Department of Bank Information Systems Control
Department of Supervision Support
Sector for Information and Communications Techologies
Department of Process Analysis and Development
Department of ICT Support and Administration
Sector of Payment Operations Control and Complience with AML/CFT Standards
Department of Payment Operations Control
Department of Compliance Control with AML/CFT Standards
Sector of Legal Support and Licencing
Department of Legal support
Department of Representation
Department of Licencing
Sector for Regulation, Reporting and Statistic
Department of Regulations
Department of Reporting and Statistics
Sector of Bank Resolution
Department of Bank Resolution
Department of Supervision Banks under insolvency and liquidation
Sector of Non-deposit Financial Institutions Supervision
Department of Non-deposit Financial Institution Supervision
Department of Non-deposit Financial Institutions Information System Control
Sector of Common Affairs
Department of General, Legal and Personnel Affairs
Department of Accounting and Finance
Finance Office
Accounting Office

Main strategic objectives of the Banking Supervisory Authority in 2020

The main strategic objectives of the FBA were focused on preserving the stability of the banking system entities and their further enhancement and development through:

- continuation of activities on creation of the regulatory framework in line with the EU's regulatory framework, as a step of the BiH preparations on the accession path to the European Union;
- control of the dominant operational risks segments, control over the banks of systemically importance for development of credit activities, control of the applicable practices in the banks in the segment of protection of users of financial services and guarantors, etc.;
- continuation of activities with the objective to implement recommendations of the FSAP mission related to improvement of the banking sector supervision, projects related to strengthening banking supervision within the technical assistance provided by the international financial institutions;
- strengthening bank capital;
- monitoring the application of IAS/IFRS with the objective to adequately valuate financial assets and expected credit loss provisioning in order to maintain an adequate capitalization of banks in the FBiH;
- systemic monitoring of bank's activities on application of AML/CFT standards and enhancing cooperation with other competent institutions in this segment;
- building, expanding and improvement of the cooperation with the competent supervisory authorities for supervision of banking groups from the EU whose members having seat in the FBiH, as well from others countries, for the purpose of more efficient supervision and improvement of supervisory practices, cooperation and exchange of information with the ECB and the EBA in terms of the supervision and banking regulations, and international financial institutions;
- improving cooperation by signing new memorandums on cooperation with relevant institutions in BiH included into the institutional supervisory framework, crisis management and systemic risk, as well as protection of users of financial services.

The activities of the Banking Supervisory Authority in 2020

FBA operations in 2020 were marked by further strengthening of institutional capacities related to demanding processes of regulatory and supervisory reforms, as well as activities regarding enactment of measures for negative consequences caused by the pandemic. In the pandemic situation, FBA acted proactively and enacted series of measures and decisions, whereas in the situation of extended crisis, it has continuously acted to avoid further negative consequences and ensure recovery of the economy, as well as to preserve stability of the banking system. FBA has issued adequate and sound measures to mitigate negative economic consequences of the pandemic to the banking system, economy and general population. In addition to the set of regulations on temporary measures related to the pandemic, FBA provided full support to banks and non-deposit financial organisations in implementation of these regulations. It continued with intensive communication with international partners and institutions for purpose of ensuring the best possible approach to the crisis.

Key activities related to supervision of banks' operations in 2020 were aimed at the following:

- Monitoring implementation of FBA's temporary measures aimed at mitigating negative economic consequences caused by the pandemic, as well as monitoring key ratios related to banks' operations under extraordinary circumstances;
- Introducing a new supervisory approach resting on the SREP methodology and performing first SREP processes in banks;
- Evaluation of ICAAP and ILAAP reports delivered by all commercial banks – as a part of SREP;
- Adequacy assessment of recovery plans delivered by banks, whereas a new round of recovery plans assessment has started in late 2020;
- Performance of scheduled examinations of bank operations and examinations of management of IT risks and outsourcing in banks;
- Improving cooperation with supervisory authorities of parent banks and other priority supervisory activities;
- Continuing with the project of establishing supervisory stress testing in banks, subject to technical assistance by USAID FINRA and revising the methodological framework for performance of such testing.
- As a part of its bank resolution competencies, FBA's activities in 2020 were aimed towards the following:
- Updating and adopting resolution plans for banks in the FBiH;
- Calculating MREL and determining key functions in banks;
- Developing and adopting regulations related to supervision authorisations and rules, as well as types of measures performed and regulations implemented regarding bank resolutions.

International activities of the authority

Also in 2020, FBA continued with activities to strengthen and improve cooperation with local and international financial institutions and regional and other organisations, as well as to strengthen bilateral and multilateral cooperation with bank regulators from the country, the region and beyond, all subject to existing and new agreements on cooperation and information exchange.

In March 2020, it signed a MoU with the Central Bank of Russia, while in September 2020 the MoU was signed with HNB. The said MoU with HNB is in fact an update of the previous MoU signed in 2003 in order to reflect new circumstances of HNB operations within the banking union. Subject to a MoU signed with ECB, FBA exchanges information and participates in bank supervisory colleges and regular annual meetings with ECB, as well as meetings with EBA. The cooperation with ECB is very important in the context of improving stability and efficiency of BSE supervision, as well as in the context of bringing banking regulations in alignment with EU regulations.

FBA exchanges information and participates in supervisory colleges for banks whose banking groups are seated in Slovenia and Austria. Improving cooperation with supervisory authorities of these parent banking groups in the domain of information exchange, joint assessment of risk profile of particular group or individual bank, evaluation of recovery plans, joint actions, interaction with banking groups and improving readiness to respond to crisis situations will all be in the focus of its supervisory activities in the forthcoming period as well. Other important activities taken by the FBA referred to taking part in missions/visits by international financial organisations (International Monetary Fund, World Bank, etc.) in terms of providing information and trend analysis related to the FBiH banking system and bank supervision strengthening.

Cooperation with other supervisory bodies in the country

Cooperation with the competent institutions in BiH has continued. Cooperation with the CBBH is carried out in the domain of top-down test tests conducted by the Financial Stability Department. FBA participates in this process by providing data for conducting top-down stress tests, participating in the analysis of projections related to credit growth, and providing comments on testing methodology, while the results of top down stress tests are used in supervisory assessments. In addition to the above, FBA submit to the CBBH the data necessary for the calculation of financial stability indicators (FSI) at the level of BiH, and regularly exchange other relevant data and information with the CBBH (reports and information related to regulatory framework effects, network analysis of systemic risk spillovers, etc).

Cooperation has continued with the BARS and DIA (Deposit Insurance Agency) in the form of regular exchange of information and joint actions, and also with the BARS in the part of creation new regulations, which includes cooperation with the entity's ministries of finance. In 2020, a cooperation continued with the BA BiH (Banks Association of Bosnia and Herzegovina) both in terms of implementation of the existing regulatory framework and proposals for revision, and in the process of adoption a new regulatory framework for bank operations and supervision.

Other relevant information and developments in 2020

The FBA continues to actively participate in a different project to enhance the capacities for the effective supervision and resolution of banks, of which key ones are the USAID FINRA Project, Programme for strengthening the central banks capacities in the Western Balkans and World Bank Project - Strengthening the Banking Sector.

In December 2019, the Banking Agency of the Federation of BiH, in cooperation with the team of the World Bank - FINsac, completed all activities envisaged by the project of introducing SREP and adopted the Methodology for Supervisory Review and Assessment of Banks - SREP Methodology. The full application of the SREP Methodology is from 01.01.2020. years. From a perspective of the FBA, this means introduction of a single supervisory procedures and practices, which are accepted and applied in the EU Member States. The project of Strengthening the Banking Sector continues in 2020 with planned trainings of all banking supervisors in this segment, development of internal tools to support SREP and full application of SREP Methodology in the supervision of all commercial banks operating in FBiH.

Within the USAID FINRA project, the FBA continued to carry out activities to further strengthen the capacity for effective banking supervision and bank restructuring. In this regard, FBA continued with implementation of the regulatory framework for NSFR, corporate governance, FINREP, as well as updating the methodology for supervisory stress testing, etc. Technical assistance was provided to entity banking agencies in the segment of review and evaluation of ILAAP reports. In the segment of bank restructuring, activities are focused on further capacity building in terms of defining key functions, adopting MREL approach, defining indicative MREL, as well as updating restructuring plans and the possibility of using the bank's special purpose instrument and asset separation instrument.

In 2020, FBA continued to actively participate in the Programme for strengthening the central banks capacities in the Western Balkans began with the aim of integration into the European System of Central Banks. Considering the situation caused by the pandemic, the dynamics of all initiated activities within the Programme is adjusted to the situation. In this regard, activities on further implementation of Programme began more actively in 2021.

Questionnaire tables for the 2020 BSCEE Review

Number of financial institutions
(at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	15	15	15
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**15**	**15**	**15**

Total assets of banking sector (in 000 KM)
(at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	22.094.135	24.217.016	24.396.438
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**22.094.135**	**24.217.016**	**24.396.438**
y/y change (in %)	**2018/2017 Index 109 (+9%)**	**2019/2018 Index 110 (+10%)**	**2020/2019 Index 101 (+1%)**

Ownership structure of banks on the basis of assets total

Item	2018	2019	2020
Public sector ownership	3,5	3,3	3,6
Domestic ownership total	6,3	6,3	6,7
Foreign ownership	90,2	90,4	89,7
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2020

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	54,8	68,1	1.341
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**54,8**	**68,1**	**1.341**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2018	2019	2020
Commercial banks	8,8	8,8	5,8
Cooperative banks	-	-	-
Banking sector, total:	**8,8**	**8,8**	**5,8**

**Return on average equity (ROAE)*

Distribution of market shares in balance sheet total (%)

Type of financial institution	2018	2019	2020
Commercial banks	100,0	100,0	100,0
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2018	2019	2020
Receivables	**n/a**	**n/a**	**n/a**
Financial sector	n/a	n/a	n/a
Nonfinancial sector	n/a	n/a	n/a
Government sector	n/a	n/a	n/a
Other assets	n/a	n/a	n/a
Liabilites	**n/a**	**n/a**	**n/a**
Financial sector	n/a	n/a	n/a
Nonfinancial sector	n/a	n/a	n/a
Government sector	n/a	n/a	n/a
Other liabilities	n/a	n/a	n/a
Capital	**n/a**	**n/a**	**n/a**

**Breakdown of the total balance sheet not applicable. Loans and deposits structure is given in a table below.*

Capital adequacy ratio of banks

Type of financial institution	2018	2019	2020
Commercial banks	17,5***	17,9***	19,1***
Cooperative banks	-	-	-
Banking sector, total:	17,5***	17,9***	19,1***

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

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

Asset classification	2018	2019	2020
Non-financial sector, including	9,2	8,3	6,8
- households	6,8	6,5	6,0
- corporate	11,5	10,2	7,7

**Share of NPLs to total gross loans. Financial sector is not included.*

The structure of deposits and loans of the banking sector in 2020 (%)
(at year-end)

	Deposits	Loans
Non-financial sector, including:	83,9	98,0
Households	53,6	50,3
Corporate	30,3	47,7
Government sector	11,7	1,4
Financial sector (excluding banks)	4,4	0,6
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-end) (in 000 KM)

P&L account	2018	2019	2020
Interest income	741.366	733.732	698.808
Interest expenses	130.053	130.668	130.227
Net interest income	611.313	603.064	568.581
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	1.051.108	1.070.879	1.035.059
Administration costs	256.407	260.389	257.639
Depreciation	n/a	n/a	n/a
Provisions	108.662	77.315	182.004
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	289.768	318.814	187.250
Net profit (loss)	256.236	273.889	174.265

Total own funds in 2020 (in 000 EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	1.379.752***	1.319.904***	1.319.904***	59.848***	
Cooperative banks	-	-	-	-	-
Banking sector, total:					

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

Macroeconomic environment in the country

As a result of the negative impact of the crisis caused by the COVID – 19 pandemic, the economic growth of Republika Srpska in 2020 slowed down compared to the previous year and amounted to -2.5%. Although the initial estimate of GDP in 2020 was more pessimistic (-6.8%), the mild recovery was recorded in second half of 2020 and the GDP was 2.5% lower compared to previous year.

The increased engagement of Republika Srpska institutions in the fight against the spread of the pandemic and preserving the stability of the health system (increased health expenditures in order to strengthen the capacity and resources of the health sector) and economic stability (assistance through the IDB and Republika Srpska Guarantee Fund) is evident, and additional economic measures to reduce the negative effects of the epidemic are planned, so that an increase in government spending in GDP can be expected, which will partially offset the decline in private consumption.

In 2020, the average net salary in the RS amounted to EUR 488,8 and it has increased by 5,5% compared to 2019. An inter-annual inflation rate of -1,9% was registered in the period from January to December 2020.

Development in the banking sector (including assets total / GDP)

The banking sector of RS at the end of 2020 consisted of eight banks, out of which five banks were with majority foreign private ownership, while three banks were in majority private domestic ownership.

Taking into account the banking sector results generated in 2020, it can be stated that, despite the increased risks stemming from the COVID-19 viral disease, the banking sector of RS is stable, adequately capitalized, with liquidity on satisfactory level and able to meet all its obligations in due terms. The profitability decreased compared to the previous year, primarily due to increase of impairment costs.

Basic indicators of the banking sector operations as of 31/12/2020:

- total gross balance sheet amounted to EUR 4,5 billion and it is at the approximately same level as compared to the previous year,
- cash funds (EUR 1 billion) accounted to 22% out of total balance sheet assets with an increase rate of 2% when compared to the previous year,
- total gross loans (EUR 2.8 billion) increased by 1% compared to the previous year,
- share of non-performing loans in the total loan portfolio decreased by 1.7 p.p. compared to the previous year (from 6,9% to 5,2%),
- the coverage rate of total non-performing loans with value adjustments amounted to 81% and recorded an increase of 3 p.p. compared to the previous year,
- deposits (EUR 3,3 billion), as a basic source of funding bank operations, had a share of 77% out of total bank liabilities and increased by 2% when compared to the previous year,
- trend of growth in retail deposits continued also in 2020 and they increased by 4% compared to the previous year,
- regulatory capital of the banking sector of RS as of 31/12/2020 amounts to EUR 521 million which is an increase of 4% compared to the previous year,
- the regulatory capital ratio of the banking sector of RS as of 31/12/2020 is 19,3% and is higher by 7,3% p.p. compared to the stipulated minimum regulatory capital ratio of 12%,
- The leverage ratio at the level of the banking sector of the RS is 10,4% and it is 4.4 pp. higher than the minimum stipulated ratio (6%),

- at the level of total banking sector as of 31/12/2020, a net positive financial result was reported in the amount of EUR 27 million which is a decrease of 45% when compared to the previous year.

As of 31/12/2020, total assets / GDP amounted to 79,9%.

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

Prudential regulation governing the operations of banks issued by the BARS in 2020:

- Decision on amendments to the Decision on minimum standards for FX risk management in banks,
- Decision on liquidity risk management,
- Decision on amendments to the Decision on banks' business operations with persons in a special relation with a bank,
- Decision on amending the Decision on calculation of capital in banks,
- Decision on outsourcing management,
- Decision on internal capital adequacy assessment process,
- Instruction for collateral value assessment,
- Instructions for reporting on the liquidity coverage ratio,
- Instruction for application of particular provisions of the Decision on calculation of capital in banks,
- Decision on banks' temporary measures to mitigate the negative economic consequences caused by the COVID-19 viral disease,
- Decision on temporary measures in terms of delivering reports to the Banking Agency of Republika Srpska,
- Decision on temporary method of reporting to the Banking Agency of Republika Srpska,
- Decision on the amendments to the Decision on banks' temporary measures to mitigate negative economic consequences caused by the COVID-19 viral disease,
- Instruction on reporting on the application of special measures in accordance with the Decision on banks' temporary measures to mitigate the negative economic consequences caused by COVID-19,
- Instruction for drafting bank and banking group recovery plans in 2020,

Instruction for the treatment of loans included in the guarantee program of economic support for mitigation of the consequences of the COVID-19 pandemic.

Prudential regulation issued by the BARS in the field of bank resolution in 2020:

- Instructions for determination of the minimum capital requirement and eligible liabilities of the bank.

Prudential regulation governing the operations of microcredt orgaizations (MCO) issued by the BARS in 2020:

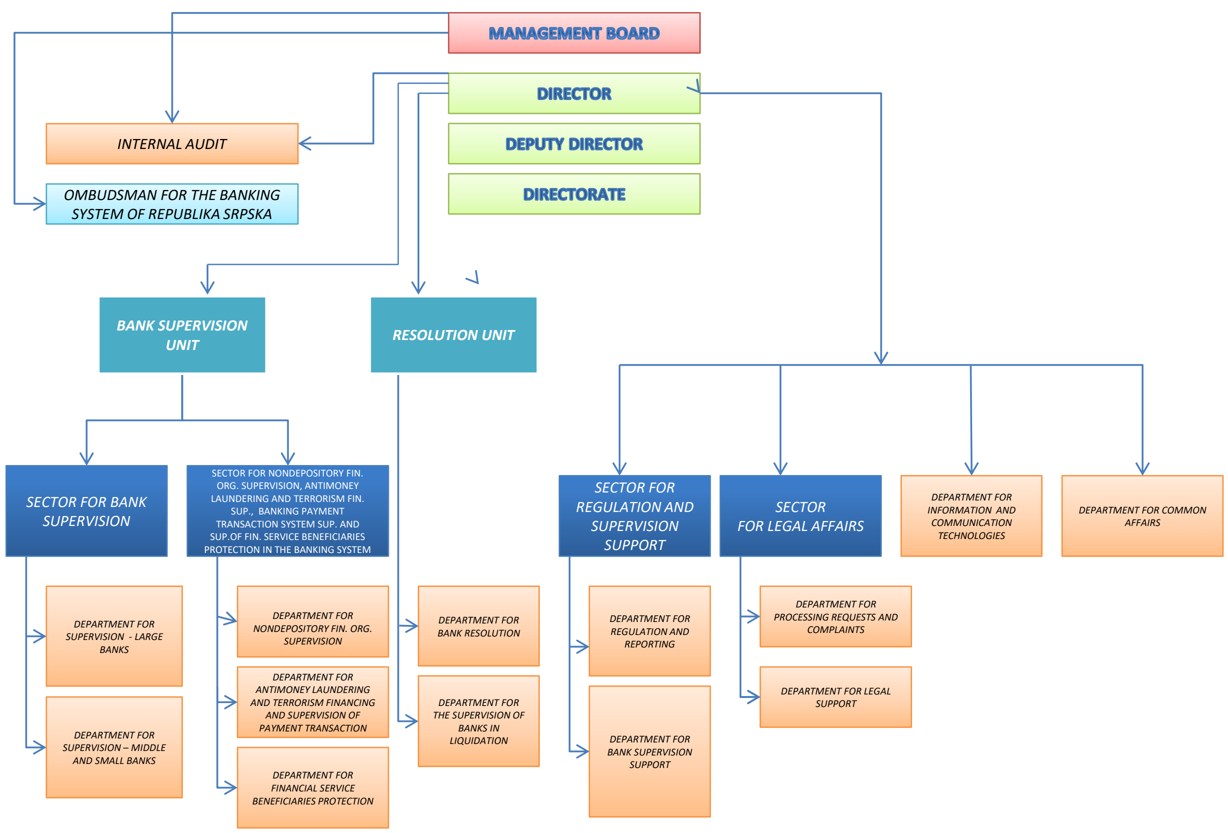
- Decision on temporary measures of microcredit organizations to mitigate negative economic consequences caused by the COVID-19 viral disease,
- Decision on the amendments to the Decision on temporary measures of microcredit organizations to mitigate negative economic consequences caused by the COVID-19 viral disease,
- Instruction on reporting on the implementation of special MCOs' measures.

The BARS has a mandate to regulate and supervise banks, microcredit organizations, leasing companies and saving-credit organizations. Namely, the BARS competencies are as follows:

- identification and implementation of activities and measures to safeguard and strengthen the banking system stability, in accordance with the law,
- adoption of regulations governing the operations of banks, microcredit organizations, saving-credit organizations, leasing providers and other financial organizations of the banking system,
- issuance and revocation of bank licenses and other corresponding by-laws in accordance with its competencies, indirect and direct supervision of bank operations, imposing and ordering measures of supervision and other competencies in accordance with the law governing banks,
- issuance and revocation of microcredit organization licenses and other corresponding by-laws in accordance with its competencies, indirect and direct supervision of microcredit organization operations, imposing and ordering measures of supervision and other competencies in accordance with the law governing microcredit organizations,
- issuance and revocation of saving-credit organization licenses and other corresponding by-laws in accordance with its competencies, indirect and direct supervision of saving-credit organization operations, imposing and ordering measures of supervision and other competencies in accordance with the law governing saving-credit organizations,
- issuance and revocation of leasing provider licenses and other corresponding by-laws in accordance with its competencies, indirect and direct supervision of leasing provider operations, imposing and ordering measures of supervision and other competencies in accordance with the law governing leasing providers,
- issuance and revocation of licenses for other financial organizations of the banking system and other corresponding by-laws when it is authorized for the above mentioned by this law or separate laws, indirect and direct supervision of operations of other financial organizations of the banking system, imposing and ordering measures of supervision and other competencies in accordance with this law and separate laws,
- adoption of corresponding legislation, supervision and undertaking of necessary measures regarding the anti-money laundering and financing of terrorist activities related to banks, microcredit organizations, saving-credit organizations, leasing providers and other financial organizations of the banking system, in cooperation with competent authorities and institutions in the area of anti-money laundering and financing of terrorist activities, and in accordance with regulations governing the anti-money laundering and financing of terrorist activities,
- supervision and undertaking of necessary measures in accordance with regulations governing the introduction and implementation of specific interim measures to efficiently enforce international restrictive measures,

- adoption of by-laws and performing tasks from the area of protection of rights and interests of financial service beneficiaries in the banking system, supervision of implementation of regulations from this area and undertaking of other activities and appropriate measures within its competencies,
- determining the fulfillment of requirements for initiation of bank resolution procedure, conducting the resolution procedure, deciding on instruments and measures to be undertaken in resolution procedure and performing other tasks related to resolution, in accordance with the law governing banks,
- issuance and revocation of consents and approvals for establishing representative offices, supervision of representative office operations, imposing and ordering measures of supervision and other competencies in accordance with the law governing banks,
- imposition of fines and issuance of misdemeanor warrant and
- other competencies in accordance with this law and other laws.

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Banking Supervisory Authority in 2020

Due to the emergence of COVID-19 viral disease, the main strategic objective of the BARS in 2020 was to implement necessary measures to mitigate the negative economic consequences caused by the COVID-19 viral disease pandemic in order to preserve and strengthen the stability of the banking system of Republika Srpska. Other objectives of the BARS in 2020 were:

- continuous supervision of banks and other financial institutions through off- and on-site inspections,
- insistence on capital strengthening and deferral of the dividend payouts,
- enhanced supervision of credit risk, primarily in terms of adequacy of loan loss provisioning and the adequacy of credit risk management,
- enhanced monitoring of the loan portfolio covered by temporary measures in accordance with the Decision on banks' temporary measures to mitigate negative economic consequences caused by the COVID-19 viral disease,
- enhanced monitoring of the banks' liquidity on a daily basis,
- further development and improvement of supervisory practices (implementation of the SREP methodology, ICAAP and ILAAP assessment methodology, Recovery plans assessment methodology, supervisory stress testing, etc.),
- monitoring of international and EU banking and accounting standards and further development and improvement of the regulatory framework,
- professional training of staff and strengthening capacity for efficient supervision of banks, and further continuous development of information system,
- active role in supervision and protection of financial services consumers' rights,
- continuation of adequate monitoring of payment transactions and activities regarding the anti-money laundering and financing of terrorism, and in this regard improving cooperation with other relevant institutions,
- continuation of improvement and establishment of cooperation with banking supervisors, particularly from countries whose banks have shares in banks in Republika Srpska,
- continuation and improvement of cooperation with external auditors,
- actively participating in the work of the Committee for Coordination of the financial sector of Republika Srpska,
- continuation and improvement of cooperation with the Banks Association, the Association of microcredit organizations in BiH and the Association of Leasing.

The activities of the Banking Supervisory Authority in 2020

In 2020 the BARS activities were aimed at maintaining the stability and improvement of the quality and legality of the RS banking system operations, on the basis of continuous supervision of banks, microcredit organizations and leasing companies.

In addition, the BARS continued to control the operations of financial organizations through the off-site and on-site supervision, primarily by means of monitoring the solvency, liquidity, capitalization and profitability of all individual financial organizations, as well as the system as a whole. The BARS orders were primarily aimed at the strengthening of capital, improving of loan policies and consistent application of the same, improving the management of credit and liquidity risk. In addition, a special attention was also dedicated to the control segments which were related to the assessment of harmonization of banks, microcredit organizations and leasing companies with the standards for the anti-money laundering and terrorism financing, as well as ensuring and improving the protection of rights and interests of the banking service consumers.

A significant part of the BARS activities was related to the development of a temporary regulatory framework, which was adopted in response to the crisis caused by the pandemic of the viral disease COVID-19. The pandemic of the viral disease COVID-19 has led to various challenges in the functioning and maintenance of key functions of banks. By adopting a temporary regulatory framework, and in response to the crisis caused by the pandemic of the viral disease COVID-19, the Agency defined a clear, flexible and realistic framework for the operations of banks and MCOs. The adopted interim acts enabled banks and MCOs to adjust when adopting temporary measures for all clients that are directly or indirectly affected by the negative consequences of the pandemic.

Despite all the challenges posed by the COVID-19 pandemic, we managed to execute a transition from the CAMELs bank rating system to the bank rating according to the SREP methodology and the first assessment of banks in accordance with the new methodology was performed for all banks of the Republika Srpska banking sector.

In the reporting period, other activities of the BARS could be summarized as:

- BARS continued with the activities on strengthening and improving the cooperation with international and domestic institutions, regional and other organizations,
- BARS continued to perform the activities aimed at the strengthening of institutional capacities of the BARS and gradual transition to the new regulatory framework (harmonization with the provisions of the EU directives and Basel principles), as well as further development and improvement of the existing secondary regulatory framework.
- Ombudsman for the banking system of RS, who acts within the BARS, continued to perform the function of protection of rights of financial service consumers.

International activities of the authority

During 2020, the BARS continued with the activities on strengthening and improving the cooperation with international financial institutions, regional and other organizations, as well as bilateral cooperation with regulators from other countries. Apart from attending the meetings, the BARS responded, on a regular basis, to the inquiries, requests for data collection and questionnaires of international institutions and organizations (European Central Bank, European Banking Authority, International Monetary Fund, World Bank, EBRD, BSCEE, etc.).

The BARS submitted reports on progress regarding the implementation of legislation in the banking sector, which the European Commission uses for the needs of regular meetings of sub-committees between Bosnia and Herzegovina and the European Union.

The BARS continued to cooperate with home supervisory authorities through regular contacts and exchange of relevant information, sending SREP analysis and the participation of representatives of the BARS at the supervisory colleges organized by home supervisors.

Additionally, in 2020 the BARS signed memorandums of understanding with the Central bank of Russian Federation and the National bank of Croatia, with aim to establish more efficient cooperation and a mechanism for the exchange of information between the signatory institutions.

Cooperation with other supervisory bodies in the country

In 2020, the BARS continued to actively cooperate with the Insurance Agency of RS and Securities Commission of RS in accordance with the Law on Committee for Coordination of RS Financial Sector Supervision.

Furthermore, under the signed Memorandum of understanding, intensive cooperation with the Central bank of Bosnia and Herzegovina, Banking Agency of the Federation of Bosnia and Herzegovina and the Deposit Insurance Agency of Bosnia and Herzegovina was continued in 2020.

Other relevant information and developments in 2020

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

Questionnaire tables for the 2020 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	8	8	8
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**8**	**8**	**8**

Total assets of banking sector (at year-end) (in 000 EUR)

Type of financial institution	2018	2019	2020
Commercial banks	4,207,661	4,470,804	4,544,976
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**4,207,661**	**4,470,804**	**4,544,976**
y/y change (in %)	**+10.0%**	**+6.9%**	**+1.7%**

Ownership structure of banks on the basis of assets total

Item	2018	2019	2020
Public sector ownership	0	0	0
Domestic ownership total	30.5	34.8	36.1
Foreign ownership	69.5	65.2	63.9
Banking sector, total:	**100,0**	**100,0**	**100,0**

Concentration of asset by the type of financial institutions, 2020

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	65.2	86.0	1,753
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**65.2**	**86.0**	**1,753**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2018	2019	2020
Commercial banks	7.8	9.7	5.1
Cooperative banks	-	-	-
Banking sector, total:	**7.8**	**9.7**	**5.1**

**Return on average equity (ROAE)*

Distribution of market shares in balance sheet total (%)

Type of financial institution	2018	2019	2020
Commercial banks	100.0	100.0	100.0
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**100.0**	**100.0**	**100.0**

Capital adequacy ratio of banks

Type of financial institution	2018	2019	2020
Commercial banks***	17.7	18.3	19.3
Cooperative banks	-	-	-
Banking sector, total:	**17.7**	**18.3**	**19.3**

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

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

Asset classification*	2018	2019	2020
Non-financial sector, including	9.5	6.9	5.2
- retail	7.4	7.6	5.5
- corporate	11.4	7.2	5.1

**Share of NPLs to total gross loans.*

The structure of deposits and loans of the banking sector in 2020 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	85.3	86.5
Retail	62.7	46.8
Corporate	22.6	39.7
Government sector	10.1	12.5
Financial sector (excluding banks)	4.6	1.0
Total	**100.0**	**100.0**

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

P&L account	2018	2019	2020
Interest income	154,011	150,945	150,696
Interest expenses	34,032	31,946	30,057
Net interest income	119,979	118,999	120,638
Net fee and commission income	-	-	-
Other (not specified above) operating income (net)	-	-	-
Gross income	197,819	204,933	204,936
Administration costs	114,607	114,940	122,600
Depreciation	-	-	-
Provisions	-	-	-
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	20,485	16,582	35,227
Profit (loss) before tax	43,055	54,884	29,071
Net profit (loss)	37,943	43,397	26,999

Total own funds in 2020 (in 000 EUR)

Type of financial institution	Total own funds***	Core Tier 1***	Tier 1***	Tier 2***	Tier 3***
Commercial banks	520,604	468,817	471,885	48,720	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**520,604**	**468,817**	**471,885**	**48,720**	**-**

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

Macroeconomic environment in the country

The 2020 spread of the COVID-19 pandemic and the introduction of anti-pandemic measures on a global scale had a significant negative effect on economic activity in Bulgaria, both in terms of lower foreign demand, and restrictions in the activity of firms in certain sectors. Stricter measures aimed at limiting the spread of the coronavirus were present at the end of the first quarter and in the second quarter, followed by a partial loosening of the anti-pandemic measures, and then tighter measures again in the end of the year. As a result, 2020 real GDP decreased by 4.2% on an annual basis.

Limiting factors in the contraction of economic activity were the adopted counter-cyclical fiscal policy, which included higher net transfers to economic agents, employment protection programs, and higher government consumption and investment. The procedure for deferral and settlement of liabilities payable to banks and their subsidiaries[1], approved by the Bulgarian National Bank (BNB), had an important role in mitigating the worsened liquidity of firms and households.

The main negative contributor to the decrease in real GDP in 2020 was net exports, the yearly contraction of which was higher compared to the decrease in imports. Bulgaria is a net exporter of services in the tourism and transport sectors, which were some of the most affected sectors by the pandemic. At the same time, the decrease in imports was partially offset by the growth in total consumption.

While the growth of private consumption was weak (0.2%), the government consumption grew by 7.5% (5.5% in 2019), driven by compensation and healthcare expenditures, the latter being a result of the anti-pandemic measures adopted by the government.

Total gross value added for the economy decreased in real terms by 4.3% in 2020 (3.0% growth in 2019), with a contraction in economic activity in every sector, with the biggest reduction in the services sector, especially in retail, transport, accommodation and food service activities, which were all directly affected by the anti-pandemic measures. The reduction in total value added in the industry sector was due to the decrease in exports, as well as weaker domestic consumption.

Weaker economic activity in 2020 reversed the favourable developments in the labour market present over the past several years. Employment decreased by 2.3% compared to 2019, predominantly in the services sector, with the socio-economic measures adopted by the government helping to cushion negative effects in employment. Nevertheless, a decrease in labour productivity due to weaker economic activity, combined with relative wage growth, contributed to an increase in the real unit labour cost growth in the economy.

Because of the effects of COVID-19 on the economy, as well as the anti-pandemic measures, HICP annual inflation was 0.0% at end-2020 (3.1% at end-2019). All components of the consumer price index registered a reduction in price or a decrease in price growth.

As of December 2020, the gross external debt increased by EUR 1646.4 million compared to the end of 2019, amounting to EUR 36.8 billion (60.7% of GDP). This increase was mainly on account of the *general governments* sector, a result of the issuance of Eurobonds by the government. The external debt of the banking sector and *other sectors* decreased.

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[1] On 9 April 2020, the Bulgarian National Bank approved the proposal submitted by the Association of Banks in Bulgaria (ABB) of a „Procedure for Deferral and Settlement of Liabilities Payable to Banks and their Subsidiaries – Financial Institutions in relation to the state of emergency enforced by the National Assembly on 13 March 2020". After its approval, the document constitutes a private moratorium within the meaning of the Guidelines of the European Banking Authority on legislative and non-legislative moratoria on loan repayments applied in response of the COVID-19 crisis (EBA/GL/2020/02).

Development in the banking sector (including assets total / GDP)[2]

in 2020, the banking sector's activity was realised amid a sharp reduction in economic activity. In general, banks in Bulgaria met this economic shock in good condition, with a solid capital and liquidity position, which allowed for uninterrupted and reliable financial intermediation by banks. The stability and flexibility of the banking system amid highly unfavourable macroeconomic developments is the result of a policy over the past several years aimed at building up buffers in the system, as well as the measures implemented by the BNB on 12 March 2020 to further enhance banks' equity and liquidity. The measures include the capitalisation of the profit of credit institutions and the introduction of individual and aggregate limits on foreign exposures with the aim of minimising credit risk, as well as the cancellation of the planned increase of the level of the countercyclical capital buffer. Taking into consideration the worsened financial position of some firms and households due to COVID-19, banks raised their credit risk assessment and tightened their credit criteria, while increasing impairment costs. These additional costs, in addition to reduced revenue from banks' main operational activities due to a prolonged period of low interest rates, and the worsened economic environment, had an unfavourable effect on the return on assets in the banking system.

In 2020 the total assets of the banking system increased by 8.5% (BGN 9.7 billion) to BGN 124.0 billion. The amount of loans and advances was lower than in 2019 and their share in the total assets decreased to 58.9% (65.7% in 2019). The share of „cash, cash balances at central banks and other demand deposits" – the most liquid item in the balance sheet – increased to 21.9% (15.9% in 2019), while debt securities increased by 23.3% (BGN 3.3 billion) and their share was 14.2%.

The ratio of the banking system's total assets to GDP was 104.6% as of end-2020.

Loans and Deposits

In 2020 the gross loan portfolio[3] increased by BGN 3.2 billion (4.8%), amounting to BGN 69.5 billion. Loans to households increased by BGN 1.7 billion (7.0%), while those to non-financial corporations increased by BGN 1.5 billion (4.0%), with their share in the loan portfolio decreasing to 54.7% (55.2% in 2019). Loans to other financial corporations increased by BGN 85 million (1.9%), while those to the general governments sector decreased by BGN 36 million (3.8%).

In 2020 gross loans and advances denominated in BGN increased to 60.3% of the total amount (59.4% in 2019), while claims in EUR and claims in other currencies were 36.6% and 3.1%, respectively (35.4% and 5.2%, respectively, at end-2019).

In 2020, the deposits in the banking system increased by BGN 8.5 billion (8.8%), totalling BGN 105.7 billion at the end of the year. Household deposits had the biggest contribution and they grew by BGN 5.0 billion, amounting to 59.2% of total deposits. Deposits from non-financial corporations increased by BGN 3.6 billion (12.6%). Deposits from the general governments sector grew by BGN 369 million (13.8%), while deposits from credit institutions and from other financial corporations decreased by BGN 296 million (5.5%) and BGN 122 million (3.6%), respectively.

Market structure

At the end of 2020, there were 24 credit institutions and foreign branches, of which one was a state-owned bank. The process of consolidation in the banking sector continued during the year. The acquisition of Société Générale Expressbank by DSK Bank was complete in the end of April 2020. As a result of the ongoing

[2] Based on supervisory statements on an individual basis as of end-December 2020 submitted by 22 February 2021 and as of end-December 2019 revised by 8 March 2021.

[3] The scope of the loan portfolio comprises the sectors *non-financial corporations, households, other financial corporations and general governments*. Gross loans and advances and deposits are reported in Macroprudential Reporting Form 1 (MPF1).

consolidation in the banking sector, the share of the assets of the five largest banks increased to 66.6% at the end of 2020 (62.2% at the end of 2019). The market share distribution by bank groups did not change significantly – the market share of credit institutions with predominantly Bulgarian equity increased slightly to 22.4%, while the share of EU subsidiaries and branches decreased just about to 74.5%. The share of non-EU banks and branches was 3.1%.

The share of the assets of banks classified as significant, which are under the direct supervision by the ECB as of 1 October 2020, was 65.7% of the total in the banking system, while the share of less significant credit institutions was 31.1% of total assets.

Asset quality

The gross amount of all non-performing exposures[4] was BGN 5.72 billion (BGN 6.1 billion in 2019) and their share decreased to 4.8% of all exposures (5.6% at the end of 2019).

The share of non-performing loans decreased in all sectors, a result of *the procedure for deferral and settlement of liabilities*, as well as the sale or write-off of non-performing loans by banks. As of the end of December 2020, under the aforementioned procedure 89 478 applications for a total gross amount of BGN 8074 million were approved.

Calculated based on the revised reporting standards[5] (narrower scope methodology), implemented as of end-June 2020, the share of gross non-performing loans and advances in the banking system was 7.5% (7.8% as of end-2019 based on the same reporting standards). Based on the wider scope methodology for reporting gross loans and advances, the share of gross non-performing loans and advances was 5.7% at the end of 2020 (6.5% at the end of 2019).

The net amount of non-performing loans and advances[6], representing the potential credit risk in bank balances, decreased by 2.9% to BGN 3.1 billion on an annual basis and remained fully covered by the capital surplus above the minimum regulatory requirement of 8%. Based on the wider reporting scope for loans and advances, the share of net non-performing loans and advances decreased from 3.5% in 2019 to 3.1% at the end of 2020. Calculated based on the narrower reporting scope in effect since end-June 2020, the share of net non-performing loans in the total loans and advances was 4.2% at the end of 2020.

The assets in the balance sheet other than loans retained a high level of liquidity. Securities portfolios increased, mainly due to banks' acquisitions of debt instruments of the *general governments* sector, and amounted to BGN 17.6 billion at the end of 2020.

Profitability

The profit of the banking system at the end of 2020 amounted to BGN 815 million, less than the profit recorded in 2019 (BGN 1.7 billion). The main factors behind this development were the decrease in income across all main income categories, as well as the higher impairments costs. As a result, and in combination with the increase in total assets and total balance sheet equity compared to 2019, the ratios ROA and ROE decreased to 0.66% and 5.31%, respectively (from 1.45% and 11.50% respectively, in 2019).

[4] Non-performing exposures are defined according to the broadest definition in the EBA methodology, which includes gross loans and advances as well as debt securities, other than held for trading.

[5] Regulation (EU) No 2020/429 amending Implementing Regulation (EU) No 680/2014 on supervisory reporting introduced changes in the scope of the reported gross loans and advances, wherein the item "cash balances at central banks and other demand deposits" is no longer reported in the gross loans and advances, but is reported separately since end-June 2020.

[6] The net amount of non-performing loans and advances is calculated according to EBA methodology and their gross amount is reduced with the accumulated impairment inherent to them. When calculating the share of net non-performing loans and advances their net value is used and also the net value of the total loans and advances.

Net operating income for 2020 decreased by BGN 84 million (2.0%) due to the lower net interest income, net income from fees and commissions, and net income from financial instruments. The cost to income ratio, calculated as a ratio of administrative expenses and depreciation costs to total net operating income, was 54.3% in 2020 (45.6% in 2019) and its level was influenced by the methodological changes in reporting framework FINREP 2.9 applicable from 1 June 2020[7].

Impairment costs for 2020 amounted to BGN 0.9 billion (BGN 0.5 billion in 2019), while the ratio of impairment costs to net operating income rose to 21.1% (11.1% at end-2019).

Solvency

The reported capital ratios in the banking system at the end of 2020 remained significantly above the regulatory minimum. All credit institutions observed the capital buffer requirements (2.5% capital conservation buffer, 3% systemic risk buffer, 0.5% countercyclical capital buffer, and O-SII buffer rates for other systemically important institutions[8]).

At the end of the year, the own funds in the banking system rose by BGN 1.3 billion (9.7%) compared to end-2019, amounting to BGN 14.7 billion. Both Tier 1 capital and Common Equity Tier 1 capital increased to BGN 14.3 billion and BGN 14.0 billion, respectively.

The total risk exposures amount in the banking system decreased by BGN 1.1 billion (1.7%) to BGN 64.5 billion, partially as a consequence of some regulatory easing taken during the year in response to the Covid-19 pandemic. For example, under Regulation (EU) 2020/873 adopted at the end of June 2020, preferential risk weights apply to banks' exposures to central governments and central banks denominated in the currency of another Member State. This contributed to a decrease in risk exposures and an improvement in the capital position of the banking system during the year. As of 31 December 2020 the ratios of CET 1 capital, Tier 1 capital and total capital adequacy were 22.69%, 22.10% and 22.74%, respectively (19.25%, 19.71% and 20.37%, respectively, as of end-2019). At the end of 2020, the amount of capital above the minimum requirement of 8% amounted to BGN 9.5 billion, BGN 1.4 billion higher than in end-2019.

The indicator of indebtedness – the leverage ratio (using a fully phased-in definition of Tier 1 capital) – increased slightly to 10.74% at the end of 2020 (compared to 10.64% at the end of 2019).

Liquidity

The liquidity position of the banking system remained stable in 2020, and all credit institutions exceeded the minimal regulatory requirement for liquidity coverage of 100%. The liquidity coverage ratio (LCR) of the banking system increased to 279.0%, compared to 269.9% at the end of 2019.

The liquidity buffer, the numerator of the liquidity coverage ratio, grew by 17.1% and amounted to BGN 36.2 billion. As a result of the measures implemented by the BNB on 12 March 2020, aiming to reduce credit risk from foreign exposures in banks' balance sheets, withdrawable central bank reserves increased by BGN 8.0 billion (67.0%) and they held a 55.4% share in the liquidity buffer at the end of 2020 (38.9% at the end of 2019).

Net liquidity outflows, the denominator of the liquidity coverage ratio, increased by BGN 1.5 billion (13.3%) to BGN 13.0 billion.

The loan-to-deposit ratio (LTD[9]) for the banking system decreased to 69.0% in 2020 from 72.2% at end-2019, due to lower credit growth (4.8%) relative to the growth in deposits (9.6%).

7 Since 1 June 2020 methodological changes have taken place in reporting framework FINREP 2.9 and in the Statement of profit or loss. The data for end-2019 are calculated according to the methodology applicable as of end-2019.

8 More information on the effective capital buffer rates is available on the BNB website: Bulgarian National Bank (bnb.bg).

9 Source: Macroprudential Reporting Form 1 (MPF1). The ratio is calculated excluding central banks and credit institutions from the numerator and denominator.

Products and distribution channels

At the end of 2020 there were 51 points of sale (branches, offices, representative offices and remote workstations), 78 ATMs and 1489 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

In general, the activity of banking supervision in Bulgaria is based on the European regulatory framework for credit institutions (CRD/CRR, BRRD, AMLD, etc.), including the EC delegated acts in relevant areas, the EBA guidelines and the ESRB recommendations. Depending on the needs in practice, as well as the changes made at EU level, individual policies and measures within the national framework are subject to amendments.

On this basis, novelties and amendments to the legal and regulatory framework were applied also in 2020. Following the dynamics of the lockdown imposed against the spread of the Covid-19 pandemic and the measures taken by the EBA, the BNB implemented a series of regulatory amendments. The most important of them are outlined below.

- On April 3, 2020, the BNB Governing Council decided to apply the EBA Guidelines on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis (EBA/GL/2020/02). These guidelines introduce temporary relief in the form of an exemption from the obligation to reclassify exposures as restructured or defaulted in the presence of a moratorium on bank loan repayments, subject to strictly defined conditions.

- On 9 July 2020, the BNB Governing Council adopted the EBA Guidelines on reporting and disclosure of exposures subject to measures applied in response to the COVID-19 crisis (EBA/GL/2020/07). With these Guidelines, the EBA introduces a single coordinated approach to gather additional information in order to monitor the implementation of the above-mentioned EBA Guidelines on legislative and non-legislative moratoria.

Regulatory changes, aimed at mitigating the effects of the crisis were implemented in June 2020[10], which reduced the risk weights of certain exposures to central governments and central banks.

Other EBA Guidelines adopted by the BNB for mitigating the negative effects of the pandemic on the activities of credit institutions were:

- EBA/GL/2020/11 on supervisory reporting and disclosure requirements in compliance with the CRR ‘quick fix’ in response to the COVID-19 pandemic, as well as

- EBA/GL/2020/12 amending Guidelines EBA/GL/2018/01 on uniform disclosures under Article 473a of Regulation (EU) No 575/2013 on the transitional period for mitigating the impact of the introduction of IFRS 9 on own funds.

In 2020, the BNB prepared instructions and reporting forms for credit institutions licensed to operate in the Republic of Bulgaria, as well as branches of foreign credit institutions in terms of the macro-prudential

[10] Regulation (EU) No 2020/873 (CRR – Capital Requirements Regulation –”quick fix”) of 24 June 2020 amending Regulation (EU) No 575/2013 and Regulation (EU) No 2019/876 provides for the application of preferential risk weights to bank exposures to central governments and central banks when denominated in the currency of another EU Member State.

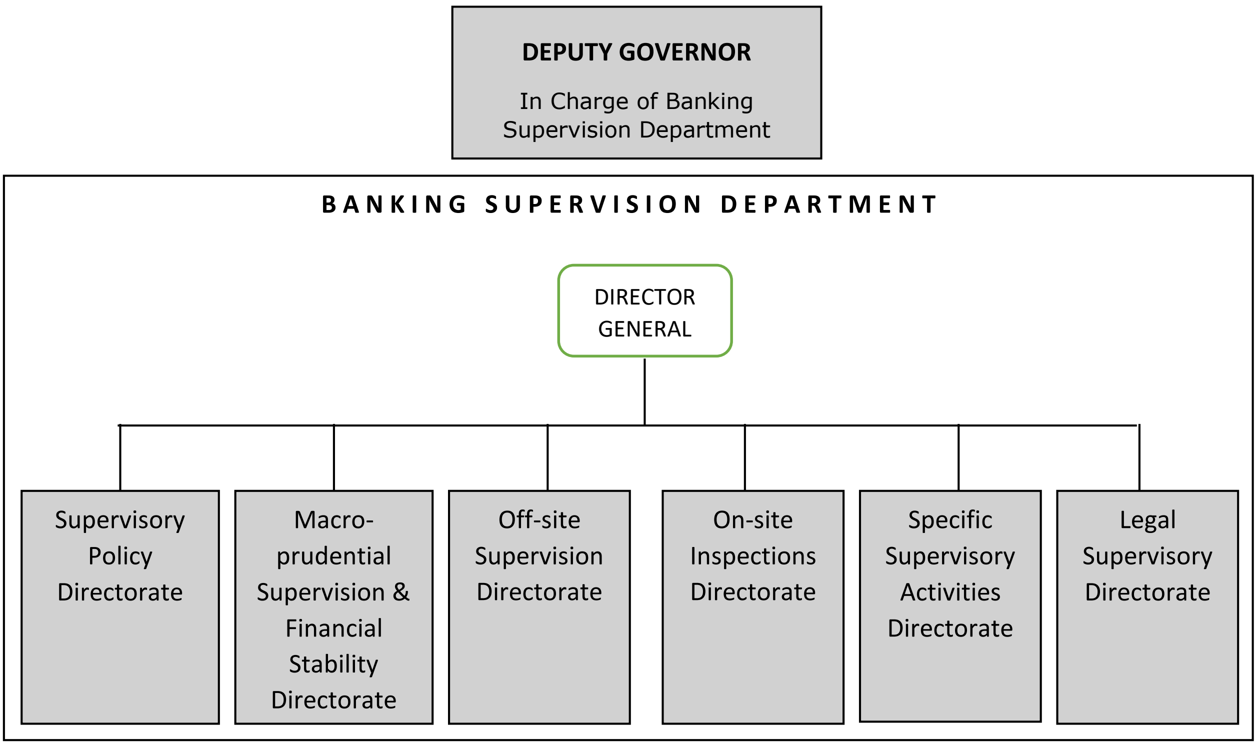
measures taken during the year and the non-legislative moratorium on loan repayments.

At the end of 2020, the BNB joined also the European recommendation to limit the distribution of dividends by credit institutions and to limit the repurchase of shares, as the recommendations of the ECB and the ESRB, and the EBA statement were extended until September 2021.

Similarly, the existing database of supervisory data in the Banking Supervision Department of the BNB was updated because of changes in the European regulatory framework, including a change in the business-reporting card. One of the main priorities related to supervisory reporting was to ensure the quality of the data in the supervisory reports following the introduction of EBA reporting related to COVID-19, as well as versions 2.9 and 2.10 of the reporting framework.

In addition to imperative regulatory measures in response to the effects of Covid-19, in 2020 the BNB developed and adopted Ordinance No 40 on determining the amount of fees for covering administrative costs of the Bulgarian National Bank, arising from supervisory and resolution functions (in force since 1 January 2021). It elaborates on the procedure and methods for determining the amount of fees, and the implementation covers all credit institutions operating in Bulgaria.

Organisational chart of the Banking Supervisory Authority



Main strategic objectives of the Supervisory Authority in 2020

in 2020, the BNB was controlling the activities of credit institutions in accordance with two different, albeit similar, supervisory frameworks, i.e. the domestic and, after the accession to SSM, this of the ECB.

By joining the SSM, the main objectives of the BNB are bound by ensuring safe and sustainable development of the Bulgarian banking system, which is closely connected with the European one, to strengthen financial integration and the implementation of consistent supervision. In the framework of close cooperation, the BNB shall exercise banking supervision in cooperation with ECB by pursuing a common approach to ongoing supervision, taking coordinated supervisory actions and corrective measures, and ensuring compatible application of provisions and supervisory policies.

Since Bulgaria is not a member state of the Eurozone and the decisions of the ECB have no legal force in Bulgaria, the BNB issues individual administrative acts in respect of significant institutions at the request of the ECB.

The activities of the Banking Supervisory Authority in 2020

In the time of anti-pandemic restrictive measures, given the imposed lockdowns and changed working conditions in offices and for teamwork, all the staffing had to move over to working from home and in rotation from the supervisory offices.

In 2020, the off-site supervisory activity under the supervisory review and evaluation process was focused on the ongoing monitoring of the risk profile of credit institutions. After 1 October 2020, the SREP activity is covering mainly the less significant institutions (LSIs) that remain under the direct supervision of the BNB. On quarterly basis continued monitoring on key risk indicators for identifying the level and trends in risks assumed by banks and their impact on the overall financial condition of credit institutions. In terms of the moratorium on bank loans repayment, checks and analyses were carried out on the monthly reports of the institutions. Furthermore, the annual review and evaluation of banks' documents was conducted on the Internal Capital Adequacy Assessment Process (ICAAP) and the Internal Liquidity Adequacy Assessment Process (ILAAP) as of 31 December 2019, as well as on their implementation by the boards for capital planning, liquidity management and budgeting. Respectively, institutions' funding plans for a three-year period (2020-2022) were reviewed.

In 2020, supervisory inspections were conducted actually off-site, from home and from supervisory offices in staff rotation, which led to some delays for on-site missions initiated in 2019. Overall, this did not affect the objectives and scope of the controls, since there was some rearrangement in the on-site supervisory activities in relation to the pandemic developments. Partially relevant also to the implementation of bank loans moratorium, they were focused on reviewing and assessing the level and management of credit risk, verifying the quality of risk reporting for supervisory purposes. The supervisory inspections casted necessary attention and laid efforts on reviewing and assessing the bank ICAAPs on how the risks are treated, in terms of their dynamics and forecast over time, as well as the ILAAPs, esp. for intra-group placements. Quality of information used for setting up or updates to recovery plans also was assessed under the on-site reviews.

As it regards the internal framework for on-site activity, the calculation methodology in terms of key risk indicators (KRIs) was updated.

The BNB's macro-prudential supervisory activities in 2020 played an important role in mitigating the negative effects of the pandemic on banks' liquidity and capital position. Their transition through the crisis without severe consequences is due both to the consistent BNB policy of accumulation and conservation of buffers in the banking system, pursued over the years, and to the measures taken in March 2020 to preserve the resilience and flexibility of the sector in a deteriorating macroeconomic environment.

The macro-prudential activity continued to be carried out both, based on a regular analysis of the risk profile of the banking system, including asset quality, profitability, capital adequacy and liquidity, and on assessment of the cyclical and structural dimensions of systemic risk, which serve to outline the use of available macro-prudential tools. The measures taken in March 2020 aimed together at i) maintaining the capital buffers built and providing loss absorbency capacity in the event of expected deterioration of loan portfolios, ii) limiting credit risk and concentrations risk in banks' balance sheets, iii) maintaining capital above the minimum regulatory requirements and a high liquidity, enabling banks to maintain their lending activity.

Within the annual review for identification of "Other Significant Institutions" (O-SIs), eight banks with a total market share of over 80% of the assets of the banking system were ascertained. In compliance with the EBA methodology thereon, buffer levels between 0.5% and 1% were assigned. With regard to the countercyclical capital buffer, the decision from March to maintain the level of 0.5% was confirmed also in the next quarters of 2020.

The BNB continued to perform its supervisory mandate of controlling banks' adherence (significant and less significant) to the requirements of the Law on the Measures against Money Laundering and the Law on the Measures against Financing of Terrorism after its accession to the SSM and the establishment of close cooperation with the ECB.

As usual, the main priority in the "specific supervisory activity" falls to periodical checking of internal rules, and prevention of money laundering and terrorist financing. The focus in this area is placed on the continuous and consistent application of the requirements for thorough customer verification ("know your customer"), as well as to basic and further training of the staff, and enhancing administrative capacity in the business departments of the credit institutions and of credit intermediaries.

In 2020, supervisory inspections, e.g. in the prevention of money laundering and terrorist financing, on mortgage lending for consumers, etc. were conducted entirely off-site, under the exceptional circumstances of Covid-19.

International activities of the authority

After joining the SSM, a change in some of the activities, responsibilities and tasks of the BNB as a competent supervisory authority over the activities of credit institutions in Bulgaria occurred following Decision (EU) 2020/1015 of 24 June 2020 of the ECB, which established close cooperation between the BNB and the ECB starting on 1 October 2020. As a result, the BNB joined the Single Supervisory Mechanism (SSM) and acquired the status similar as of a competent authority from a participating Member State within the meaning of Art. 2, item 1 of Regulation (EU) No 1024/2013.

In this context, a series of meetings were held with ECB representatives to discuss issues of close cooperation. Experience was exchanged on the structure, organisation, processes, regulatory frameworks and supervisory policies of the BNB and the ECB. As supervisory reporting and data quality checks are essential for the smooth conduct of the supervisory process, they have also been the subject of attention. Data and assessments on the risk profile, capital and liquidity position, corporate governance, business model of banks in Bulgaria were provided.

With regard to the regulatory framework, Standing Committees and Working Groups at the EC and EBA were continuing their work, despite the anti-pandemic restrictions. Meetings were conducted mainly in the form of video conferences through the Internet. Representatives of the BNB participated in the discussions and elaboration of common policies and standards for supervision, as well as in the multilateral exchange, in joint assessments, peer reviews on the level of convergence in national practices of implementation of the EU prudential requirements and framework.

In the context of the crisis, the work of the European Systemic Risk Board (ESRB) over the past year was particularly important. The BNB representatives were regularly taking part in its advisory and working structures at the respective levels. The topics of highest priority for preserving financial stability, which were subject of discussions, can be summarised, as follows: i) the guarantee schemes and other fiscal measures for crisis support and their effect on the financial system; ii) the liquidity of financial markets and the consequences for AMCs and insurers; iii) pro-cyclical downgrades of securities' ratings and their effects on the markets and financial companies; iv) limiting dividends distribution and buyback of shares and other payments; and v) liquidity risks arising out of extra collateralisation requirements by creditors.

Over the past year, BNB experts, together with colleagues from other national central banks (from the ESCB) and the ECB, took part in the program of technical cooperation with the central banks and supervisory authorities of the Western Balkans - candidates and potential candidates for EU membership. The programme is funded by the EU and administered by the Deutsche Bundesbank. In the first half of 2020, BNB experts participated as lecturers in financial stability training for the beneficiary institutions. Consultations and work within the bilaterally agreed programme between the BNB and the Central Bank of the Republic of Kosovo continued as well. Activities under the programme are aimed at preventing money laundering and terrorist financing. Again, because of the Covid-19 circumstances working sessions were carried out in the form of video conferences via Internet.

Cooperation with other supervisory bodies in Bulgaria

In accordance with their powers for the performance of dedicated verifications in the prevention of money laundering and financing terrorism, experts of the BNB conducted joint examinations with representatives of the Financial Intelligence Directorate of the State Agency of National Security (DANS).

In connection with the bank deposit guarantee, the BNB keeps up a cooperation with the Bank Deposit Insurance Fund. Reports of credit institutions in respect of deposits protected by law are subject of regular checks.

The BNB keeps a cooperation also with the Commission of Consumer Protection in cases of complaints and alerts received from consumers of banking and financial services. Supervisory experts prepare opinions and replies to the complainants and the Commission, which has a mandate for providing protection in case of infringed consumer rights and interests.

Other relevant information and developments in 2020

From 1 October 2020, the ECB is responsible for the direct supervision of eligible significant institutions (SIs). Five leading credit institutions were identified as such: UniCredit Bulbank AD, DSK Bank AD, United Bulgarian Bank AD, Eurobank AD and Raiffeisenbank (Bulgaria) AD. In parallel, the ECB is also responsible for monitoring institutions identified as less significant (LSIs) and the general procedures for all credit institutions.

Direct supervision of credit institutions identified as less significant continues to be carried out by the BNB, but in harmonisation of the supervisory process with that of the ECB.

Questionnaire tables for the 2020 review

Number of financial institutions (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	20	19	18
Branches of foreign credit institutions	5	5	6
Banking sector, total:	**25**	**24**	**24**

Total assets of banking sector (at year-end) (EUR'000)

Type of financial institution	2018	2019	2020
Commercial banks	52 400 040	56 601 160	61 373 696
Branches of foreign credit institutions	1 569 873	1 845 379	2 027 581
Banking sector, total:	**53 969 913**	**58 446 538**	**63 401 277**
y/y change (in %)	**8.0%**	**8.3%**	**8.5%**

Ownership structure of banks on the basis of assets total (%)

Item	2018	2019	2020
Public sector ownership	2.9	2.8	3.2
Domestic ownership total	22.0	21.8	22.4
Foreign ownership	78.0	78.2	77.6
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset based on market share in terms of total assets

Type of financial institution	The first three largest (%)	The first five largest (%)
Banking sector, total:	48.2%	66.6%

Return on Equity (ROE) (%)

	2018	2019	2020
Banking sector, total:	**11.97**	**11.50**	**5.31**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2018	2019	2020
Commercial banks	97.1	96.8	96.8
Branches of foreign credit institutions	2.9	3.2	3.2
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

Assets	2020
Cash, cash balances at central banks and other demand deposits	21.9
Financial assets held for trading	0.4
Non-trading financial assets mandatorily at fair value through profit or loss	0.6
Financial assets designated at fair value through profit or loss	0.1
Financial assets at fair value through other comprehensive income	9.0
Financial assets at amortised cost	63.7
Derivatives – Hedge accounting	0.0
Fair value changes of the hedged items in portfolio hedge of interest rate risk	0.0
Investments in subsidiaries, joint ventures and associates	0.6
Tangible assets	2.0
Intangible assets	0.3
Tax assets	0.0
Other assets	1.3
Non-current assets and disposal groups classified as held for sale	0.1
TOTAL ASSETS	**100.0**
Liabilities	**2020**
Financial liabilities held for trading	0.2
Financial liabilities designated at fair value through profit or loss	0.0
Financial liabilities measured at amortised cost	86.4
Derivatives – Hedge accounting	0.1
Fair value changes of the hedged items in portfolio hedge of interest rate risk	0.0
Provisions	0.3
Tax liabilities	0.0
Share capital repayable on demand	0.0
Other liabilities	0.6
Liabilities included in disposal groups classified as held for sale	0.0
TOTAL EQUITY	**12.4**
TOTAL EQUITY AND TOTAL LIABILITIES	**100.0**

Capital adequacy ratio of banks ***

	2018	2019	2020
Banking sector, total:	20.38	20.37	22.74

*** - *for Basel III*

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

Asset classification (narrow scope)[11]	2020
Gross non-performing loans and advances to total gross loans and advances (%)	7.5
Net non-performing loans and advances to total net loans and advances (%)	4.2
Asset classification (broad scope)[12]	2020
Gross non-performing loans and advances to total gross loans and advances (%)	5.7
Net non-performing loans and advances to total net loans and advances (%)	3.1

The structure of deposits and loans and advances of the banking sector in 2020 (%) (at year-end)[13]

	2019		2020	
	Deposits	Loans and advances	Deposits	Loans and advances
Central banks	0.0	14.3	0.0	0.0
General governments	2.7	1.0	2.9	1.2
Credit institutions	5.5	15.6	4.8	9.4
Other financial corporations	3.5	4.9	3.1	6.1
Non-financial corporations	29.0	38.7	30.0	49.6
Households	59.3	25.6	59.2	33.8
Total	**100.0**	**100.0**	**100.0**	**100.0**

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

P&L account	2018	2019	2020
Interest income	1,553,737	1,548,946	1,534,946
Interest expenses	152,005	153,406	180,788
Net interest income	1,401,733	1,395,539	1,354,158
Net fee and commission income	545,247	565,554	531,087
Other (not specified above) operating income (net)	209,207	207,045	240,185
Total operating income, net	2,156,187	2,168,139	2,125,430
Administrative expenses	878,061	852,276	854,530
Depreciation	89,634	137,216	145,472
Provisions or (-) reversal of provisions	11,542	36,124	57,003
Impairment or (-) reversal of impairment on financial assets not measured at fair value through profit or loss	244,096	241,029	447,939
Profit or (-) loss before tax from continuing operations	923,216	928,257	460,872
Profit or (-) loss for the year	850,962	844,925	416,938

[11] The AQT 3.2.1.2 indicator introduced by the European Banking Authority (EBA) to measure the share of gross non-performing loans and advances is based on a narrower definition of loans and advances, according to which cash balances and other demand deposits are excluded. The narrow scope of loans and advances covers the credit portfolio and claims on credit institutions other than demand deposits.

[12] The AQT 3.2 indicator used by the EBA is based on a broad definition encompassing all counterparties, including cash balances at central banks and other demand deposits.

[13] Source: Macroprudential Reporting Form 1 (MPF1). Pursuant to the new reporting framework FINREP 2.9 introduced on 1 June 2020 with Regulation (EU) 2020/429 the items "cash balances at central banks" and "other demand deposits" are no longer included in the loans and advances.

Total own funds in 2020 (in EUR'000) ***

	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Banking sector, total:	**7,504,246**	**7,158,676**	**7,292,750**	**211,496**	**-**

**** - for Basel III*

Macroeconomic developments under Covid-19 pandemic

The COVID-19 pandemic caused a global crisis in all segments of society and irreversibly marked 2020. Although this crisis had no origin in the economy, no segment of the economy remained unscathed – from oil prices and inflation to personal consumption, supply chains, output and employment. The key consequence of the pandemic is certainly the sudden halt in economic and social activities, accompanied by turbulence in international financial markets. The HNB responded promptly to the disruptions in the financial system caused by the pandemic. In doing so, it adapted regular measures to the new circumstances and applied them to an unprecedented extent. It also introduced new measures in order to preserve exchange rate stability and favourable financing conditions for citizens, enterprises and the government. Although each regulator acted independently within its own competence, the HNB, the Government of the Republic of Croatia and HANFA continuously harmonised their activities and acted in cooperation with European regulators, the European Central Bank, the European Banking Authority and the European Systemic Risk Board.

During 2020, HNB pursued an extremely expansionary monetary policy, which allowed financing conditions in the country to remain favourable despite the outbreak of the crisis, with high liquidity surpluses and interest rates that generally continued to decline, while maintaining a stable kuna/euro exchange rate. In accordance with monetary policy measures aimed at stabilising the exchange rate, within seven days of the declaration of the global pandemic of COVID-19, the HNB's supervision adjusted the regulatory framework on 19 March 2020 for the period up to 31 March 2021, thus providing an important contribution to alleviating the social and economic consequences of the pandemic and creating business certainty for credit institutions in times of extreme uncertainty. Among other things, the approval of moratoriums for debtors with good rating and the restructuring of existing and approving of new loans without regulatory costs were facilitated, with the aim of stopping forced collection by allowing dormancy or restructuring past due obligations, and in order to alleviate the effects of the pandemic on citizens and enterprises.

Since Croatia has been recognised as a country heavily oriented towards tourism, it is noteworthy that the decline in tourist activity was somewhat smaller than in most Mediterranean countries. This was due to the improvement of the epidemiological situation during the summer months and the predominant use of road transport as a means of arrival in Croatia. The financing costs of domestic sectors remained relatively favourable. However, they were accompanied by a tightening in lending conditions, especially in the corporate sector. Favourable conditions were also maintained for government financing on the foreign market. Consumer lending declined amid uncertainty due to the pandemic-induced crisis, while the growth in housing loans continued to accelerate as a result of subsidy programmes.

Real gross domestic product decreased by 8% in 2020, reflecting the shock of aggregate supply and demand due to the pandemic. Average annual consumer price inflation slowed down, mainly due to falling energy prices and lower prices of petroleum products. The current and capital account surplus on Croatia's balance of payments decreased as a result of declining tourism revenues, while negative trends were mitigated by a reduction in the foreign trade deficit, enhanced utilisation of EU funds and lower profits of foreign-owned banks and enterprises. The HNB reacted strongly to the unfavourable trends caused by the pandemic with monetary policy measures, and the Government of the Republic of Croatia with fiscal policy measures. The contraction in economic activity and measures to alleviate the negative effects of the pandemic on employees have contributed to the deterioration of the general government budget balance in 2020. Declining budget revenues and rising costs associated with the pandemic have significantly worsened fiscal indicators. General government deficit reached 7.4% of GDP, while the public debt to GDP ratio rose to 88.7% at the end of 2020.

Towards Euro and Banking Union

On 10 July 2020, the Croatian kuna was included in the Exchange Rate Mechanism (ERM II). The currency must participate in the Exchange Rate Mechanism for at least two years, observing the central rate of HRK 7.53450 for 1 euro with a standard fluctuation band of 15 percent. Upon joining ERM II, Croatia committed to implementing additional reform measures and further implementation of sound economic policy, and adopted the National Euro Changeover Plan, which elaborates a number of practical activities that need to be implemented to ensure successful transition to the new currency.

By establishing close cooperation with the European Central Bank and joining the Single Resolution Mechanism in October 2020, the Republic of Croatia became a full member of the banking union, thus fulfilling one of the most important and complex conditions in the procedure of adopting the euro as the national currency. During 2020, the existing national laws were amended in order to harmonise them with European regulations so as to enable the operation of the European Central Bank and the Single Resolution Board in the Republic of Croatia after the establishment of close cooperation. It was crucial to amend the Act on the Croatian National Bank, the Credit Institutions Act and the Act on the Resolution of Credit Institutions and Investment Firms, as well as to harmonise a number of by-laws with these amendments.

Establishing close cooperation in chronological order:

1

27 May 2019
The Republic of Croatia submits a request to the ECB for the establishment of close cooperation in the performance of supervision

2

Sept. 2019
Commencement of a comprehensive assessment of five Croatian banks

3

5 June 2020
The ECB publishes the results of the comprehensive assessment of five Croatian banks

4

10 July 2020
The Governing Council of the ECB adopted a decision on the establishment of close cooperation with the HNB

5

15 July 2020
The HNB sends a notification letter to the ECB on the appointment of the vicegovernor in charge of supervision a member of the ECB Supervisory Board

6

11 Sept. 2020
Announcement of the assessment of the significance of eight Croatian banks and the intention to start direct supervision

7

1 Oct. 2020
The beginning of close cooperation and direct supervision of significant Croatian institutions by the ECB

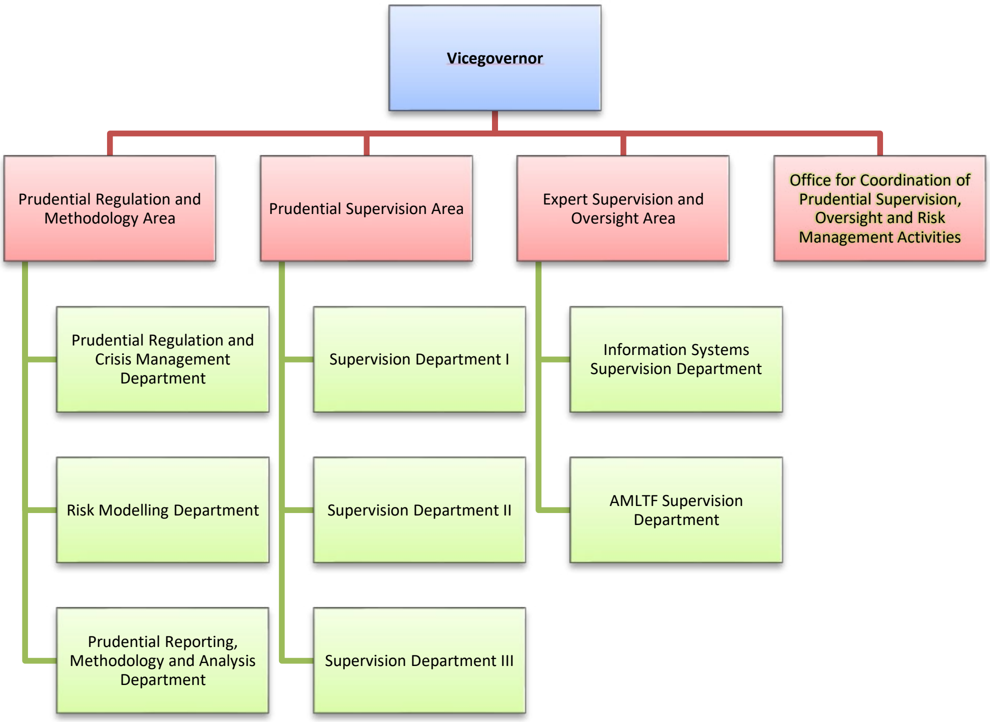
Banking supervision activities in 2020

Prompt adjustment of supervision and the regulatory framework to the circumstances of the COVID-19 pandemic marked the year 2020. Due to persistent supervisory insistence on high levels of capital adequacy, the banking system was ready for the pandemic, and the sensitivity test confirmed that credit institutions were able to withstand the materialisation of consequent credit risk. By coordinating and acting in solidarity, moratoriums and refinancing have been approved without creating a legal obligation for credit institutions, and according to the needs of their clients. Every crisis is an opportunity for change, and both clients and credit institutions have successfully adapted to the inevitable digitalisation, which has not only accelerated the technological adjustment of the work of credit institutions, but also increased operational risk.

Despite the challenging conditions of the COVID-19 pandemic, the HNB's supervisors successfully completed the process of establishing close cooperation with the ECB. Close cooperation began on 1 October 2020, after an 18-month review of Croatian banks and Croatian supervisors and adjustment of the framework of operations. In June 2020, euro area supervisors evaluated the asset quality of five banks and the HNB's supervisory capacity as adequate, as well as the adjustment to the regulatory framework for supervision (the necessary reorganisation of supervision was carried out in 2019).

After the reorganisation, the new organisational structure of the supervision function has been harmonised with the organisational structure of the SSM and consists of four organisational units.

Organisational chart of the Banking Supervisory Authority:



Three departments were established within the Prudential Regulation and Methodology Area. The Prudential regulation and Crisis Management Department adjusted three acts related to the entry into ERM II in 2020, and HNB supervisors worked vigorously to improve the regulatory framework of credit institutions in the part related to the calculation of capital requirements and harmonisation with European supervisory standards. The focus of the work of experts from the Risk Modelling Department was on the credit risks caused by the COVID-19 pandemic. On a monthly basis from April 2020, data on loans to clients whose business operations were affected by the pandemic were collected, and expert support was provided in the preparation of the Covid score. The Prudential Reporting, Methodology and Analysis Department made several significant reporting and methodological adjustments to the supervision support process in 2020. In terms of reporting, the application development has been completed, which enables the HNB to meet its obligations to the ECB. Based on supervisory reports, supervisors continuously assessed and analysed all risks to which the banking system in the Republic of Croatia is exposed, as well as the risk at the level of the euro area and the EU.

The Prudential Supervision Area consists of prudential supervisory teams. In the course of supervision, supervisory teams evaluate risks arising from the credit institution's operations and verify the lawfulness of a credit institution's operations. Should they identify weaknesses or deficiencies in credit institutions' operations, and illegalities related thereto, the supervisors propose to the Governor that measures should be imposed to eliminate the unlawfulness and irregularities established. Almost all credit institutions were covered by at least one of the six standard supervisory activities in 2020.

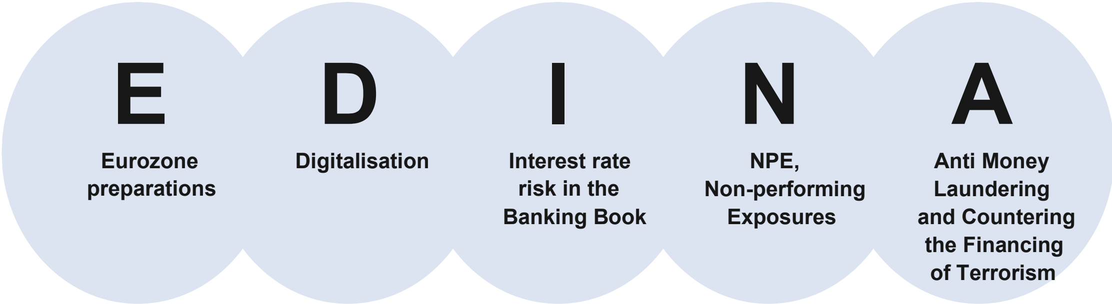
Pursuant to the new organisational structure of the supervision function, Specialist supervision is divided into Specialist ICT risk supervision and Specialist supervision of anti-money laundering and terrorist financing. Due to the consequences of the COVID-19 pandemic and the earthquakes, banks had to hastily adjust their information systems in 2020 to ensure continuous and reliable customer service. Major adjustments included supporting teleworking for most employees and significantly increasing users' reliance on direct channels. In accordance with the supervisory priorities, the supervision of AMLTF that is based on risk assessment and continuous raising of awareness of AMLTF risks was one of the strategic objectives of supervision in 2020, especially due to the new regulatory framework and preparations of credit institutions for joining the euro area. Through the supervision, the HNB verifies the efficiency and legality of their systems as well as measures put in place to manage that risk.

The Office for Coordination of Prudential Supervision, Oversight and Risk Management Activities, which was established in 2019 as the central contact centre for supervision within and outside the HNB, enabled appropriate coordination of daily cross-sectoral activities between supervision and horizontal functional units in 2020, in line with the challenges posed by the establishment of a mechanism for close cooperation with the ECB within the Single Supervisory Mechanism. The Office coordinated communication with the ECB's project teams in charge of establishing close cooperation, preparing meetings and information exchange and played a key role in coordinating the ECB's comprehensive assessment. Upon the establishment of close cooperation, the Office took over the tasks of the secretariat for the Supervisory Board within the Single Supervisory Mechanism and the application of special instructions of the ECB with the decision-making bodies of the HNB. This process was supposed to be created for the first time in cooperation with colleagues from the ECB, given that the decision-making process in close cooperation is more complex than in the standard procedure of SSM members.

The process for monitoring written procedures of the ECB and exchanging information within the HNB was established, materials for meetings of the ECB's Supervisory Board and numerous ECB's instructions were applied. Representatives of the HNB supported the decision-making of the Board of Supervisors at the EBA during 2020 by analysing written procedures and coordinating the preparation of materials for meetings of the Board. In addition to the above, the Office has prepared for adoption two agreements on supervisory cooperation with supervisors from the United Kingdom and the Federation of Bosnia and Herzegovina, and has regularly updated the single passport register, which contains data on EU institutions that directly provide services in Croatia.

The timely adjustment of supervision marked 2020. Despite the WFH situation and the effects of the earthquake on their workplaces, supervisors successfully completed the process of establishing close cooperation with the ECB and have been part of the joint supervisory teams of banking groups operating in the Republic of Croatia since 1 October.

Credit institutions ended 2020 with extremely liquid balance sheets and moderate lending activity. In 2020, the profit of credit institutions was halved due to the increase in provisions for expected loan losses. At the end of 2021, the final credit risk materialisation resulting from globally deteriorating macroeconomic business conditions is expected, which is monitored using the Covid score. Until then, credit institutions are not allowed to distribute profits and variable remuneration payments by a macroprudential measure that will be reviewed by 30 September 2021. Therefore, supervisory priorities in 2021 remain the same, their mission being to preserve the safety and stability of operations with an aim of maintaining confidence in the banking system.



Cooperation with other supervisory authorities in the country was active throughout 2020. In addition to the HNB, as the supervisory authority competent for the supervision of credit institutions, the Croatian Financial Services Supervisory Agency (HANFA) is the supervisory authority competent for the supervision of financial markets, financial services and legal and natural persons providing these services, as well as for the supervision of business operations of stock exchanges and regulated public markets, investment firms and securities issuers, brokers and investment advisors, insurance companies and legal persons carrying out leasing and factoring operations, unless they are provided by banks as part of their registered activities. The cooperation and interaction between the HNB and HANFA is carried out via the committee for the cooperation between the two institutions, which, at its regular meeting discusses key information on supervisory and oversight activities. In addition, a mechanism for continued exchange of information relevant for the supervision of the financial system of the Republic of Croatia as a whole has been established.

Questionnaire tables for the 2020 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	25	23	23
Branches of foreign credit institutions	1	1	1
Cooperative banks			
Banking sector, total:	**26**	**24**	**24**

Total assets of banking sector (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	55.829,7	57.919,9	61.360,3
Branches of foreign credit institutions	351,1	370,9	391,6
Cooperative banks			
Banking sector, total:	56.180,8	58.290,8	61.752,0
y/y change (in %)	**5,2**	**3,8**	**5,9**

Ownership structure of banks on the basis of assets total

Item	2018	2019	2020
Public sector ownership	6,2	6,0	5,9
Domestic ownership total	9,8	9,5	9,3
Foreign ownership	90,2	90,5	90,7
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2020

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	63,5	81,3	1.621,0
Branches of foreign credit institutions	100,0	100,0	10.000,0
Cooperative banks			
Banking sector, total:	**63,1**	**80,8**	**1.600,9**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2018	2019	2020
Commercial banks	8,4	9,8	4,4
Cooperative banks			
Banking sector, total:	**8,4**	**9,8**	**4,4**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2018	2019	2020
Commercial banks	99,4	99,4	99,4
Branches of foreign credit institutions	0,6	0,6	0,6
Cooperative banks			
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2018	2019	2020
Receivables			
Financial sector	28,4	27,1	29,0
Nonfinancial sector	47,2	47,6	45,7
Government sector	21,9	22,8	23,0
Other assets	2,4	2,5	2,3
Liabilites			
Financial sector	11,2	9,6	10,5
Nonfinancial sector	68,2	68,7	69,4
Government sector	6,1	6,9	5,8
Other liabilities	0,7	0,9	0,8
Capital	**13,9**	**13,9**	**13,4**

Capital adequacy ratio of banks

Type of financial institution	2018	2019	2020
Commercial banks	23,1	24,8	25,6
Cooperative banks			
Banking sector, total:	**23,1**	**24,8**	**25,6**

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

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

Asset classification	2018	2019	2020
Non-financial sector, including	10,3	7,4	7,6
- households	6,8	5,8	7,1
- corporate	20,4	13,6	12,5

The structure of deposits and loans of the banking sector in 2020 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	90,8	79,7
Households	66,5	49,5
Corporate	24,3	30,2
Government sector	4,5	19,0
Financial sector (excluding banks)	4,7	1,3
Total	**100.0**	**100.0**

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

P&L account	2018	2019	2020
Interest income	1.607,0	1.641,1	1.499,9
Interest expenses	258,1	206,8	163,8
Net interest income	1.348,8	1.434,3	1.336,0
Net fee and commission income	444,2	484,5	428,3
Other (not specified above) operating income (net)	198,4	268,7	185,8
Gross income	1.991,4	2.187,5	1.950,1
Administration costs	863,0	878,7	937,7
Depreciation	90,6	135,6	134,1
Provisions	55,0	174,5	85,6
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	222,4	103,9	355,9
Profit (loss) before tax	760,4	894,7	436,8
Net profit (loss)	663,6	779,5	357,3

Total own funds in 2020 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	8.238	8.015	8.054	184	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**8.238**	**8.015**	**8.054**	**184**	**-**

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

Macroeconomic environment in the country

In 2020, the Czech Republic recorded the deepest decline in economic performance in its history (since 1993) when real GDP decreased by 5.8% year on year. Economic activity fluctuated from quarter to quarter, corresponding, to a considerable extent, with lockdown measures and the variable risk appetite of economic agents during the year. The table below shows quarterly real GDP growth.

Real GDP growth rate in the Czech economy (seasonally adjusted)

	Q1	Q2	Q3	Q4	Year 2020
Compared to the previous quarter (%)	-3.4	-8.9	+6.8	+0.7	-5.8
Compared to the corresponding quarter of 2019 (%)	-1.5	-10.9	-5.4	-5.3	

Source: Czech Statistical Office (CZSO)

All expenditure GDP components, excluding government expenditure, contributed to the year on year decline in real GDP. The decline was driven by a large decrease in household consumption (-7.4%), corporate investment (-7.2%) and net exports (-8.2%), while government expenditure went up by 3.4%.

The level of inflation was slightly above the upper boundary of the tolerance band around the CNB's 2% target for most of 2020. The average year on year inflation rate measured by CPI amounted to 3.2% (+0.4 pp year on year).

In February 2020, the CNB raised the 2W repo rate by 0.25 pp to 2.25% in response to inflationary pressures. As a reaction to the pandemic situation, the CNB subsequently cut this rate to 1.75% followed by another decrease to 1.0% (both in March) and finally to 0.25 % in May. It remained at this level for the rest of the year.

The Czech koruna depreciated slightly in 2020 against safe haven currencies, e.g. against the euro (3.0%), the US dollar (1.1%) and the Japanese yen (3.2%). In contrast, the Czech koruna appreciated against the Russian rouble (9.0%), the Hungarian forint (4.6%) and the Polish zloty (0.6%). The average nominal exchange rate of the Czech koruna to the euro stood at CZK 26.4/EUR in 2020, while the exchange rate of the Czech koruna to the US dollar reached CZK 23.2/USD on average.

The employment rate decreased by 0.9 pp compared to the previous year, while the general unemployment rate rose by 0.6 pp to 2.6%. The moderate increase in the unemployment rate was a result of the impacts of the pandemic, mitigated partly by government supportive measures. In 2020, growth in the average nominal wage was 4.4% y o y (1.2% in real terms).

Development in the banking sector (including assets total / GDP)

At the end of 2020, the Czech banking sector comprised 24 domestic banks (including five building societies), eight credit unions and 24 branches of foreign banks. The group of the four largest domestic banks held 60.3% of the banking sector's total assets.

The total assets of the Czech banking sector increased year on year by 5.6% to CZK 7,977.8 billion as of the end of 2020. The relative size of the domestic banking sector, expressed as the ratio of total bank assets to GDP, went up in 2020. The ratio stood at 140.1% at the end of 2020, i.e. 9.6 pp higher than in the previous year.

The quality of the loan portfolio deteriorated slightly in 2020 when the NPL ratio for client loans stood at 2.7%, i.e. 0.4 pp higher than in 2019, mostly due to the higher level of corporate NPLs.

The domestic banking sector has long enjoyed favourable liquidity characteristics in the context of a constant excess of client deposits over client loans.

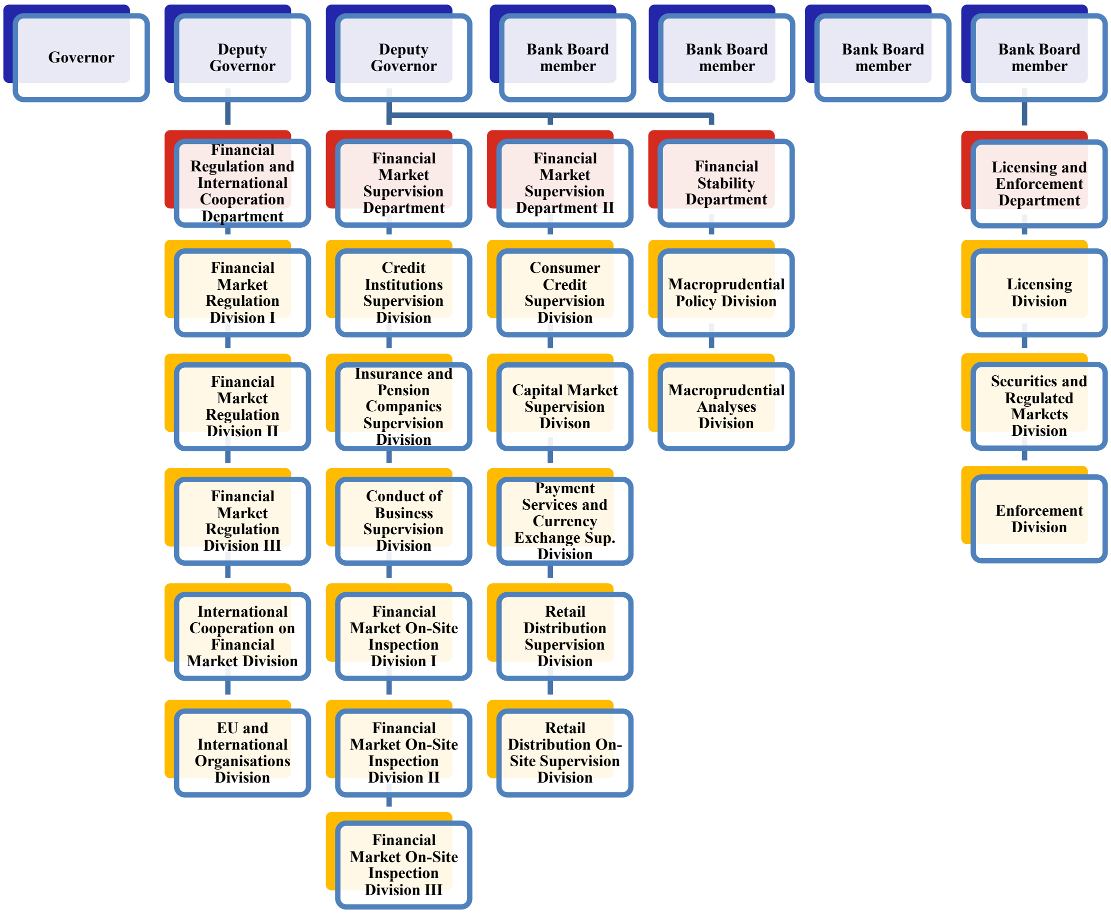
Banking entities generated a total net profit of CZK 47.5 billion in 2020, down almost 50% year on year. Despite a significant year on year decline (12.9%), net interest income remained the main component of the profit, amounting to CZK 126.9 billion. Return on equity, as expressed by the ratio of total net profit to Tier 1 capital, declined by 9.5 pp year on year to 7.7%.

The capitalization of the Czech banking sector remained satisfactory in 2020. Tier 1 capital, the main component of capital in the banking sector, rose by 16% in 2020. The total capital ratio of banks operating in the Czech Republic was 24.3%, which corresponds to a year on year increase of 3 pp. Domestic banks were comfortably compliant with the capital requirements as defined by CRD IV/CRR throughout 2020.

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

In accordance with Act No. 6/1993 Coll., on the Czech National Bank, the CNB is the supervisor of the financial market in the Czech Republic. It supervises the banking sector, the capital market, the insurance industry, pension funds, credit unions, bureaux-de-change, payment system institutions, non-bank consumer credit providers and other institutions operating on the Czech financial market. 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.

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Banking Supervisory Authority in 2020

As defined by Act No. 6/1993 Coll., on the Czech National Bank, the CNB's general objective in the area of supervision is to ensure financial stability and the safe and sound operation of the financial system in the Czech Republic. This objective defines the CNB's area of competence as regards supervision of compliance with prudential rules and supervision of compliance with the rules of business conduct.

The CNB endeavours to supervise the banking market and its institutions in accordance with international standards. The key strategic framework for the supervisory work of the CNB is the Core Principles for Effective Banking Supervision published by the Basel Committee for Banking Supervision. The long-term strategic objectives of financial (including banking) market supervision are described in the Long-term Supervisory Strategy which is published on its website.

In 2020, the COVID-19 pandemic considerably affected financial market conditions and this was significantly reflected in the CNB's supervisory priorities for the year. Due to the effects of the pandemic and in line with the strategic supervisory objectives of the CNB, the CNB's core supervisory activities in 2020 were focused on assessing the financial situation, checking compliance with prudential requirements, monitoring other relevant quantitative and qualitative information about the credit institutions, especially in the area of asset quality, and monitoring business continuity in changed market conditions. The supervisory activities of the CNB were concentrated on the quality of banks' credit portfolios (both on a solo and consolidated basis), their overall performance and a sufficient level of capitalisation and liquidity. The CNB's off-site surveillance of credit institutions was combined with on-site examinations.

The activities of the Banking Supervisory Authority in 2020.

The CNB´s core activities in the area of the banking supervision in 2020 were as follows:

- evaluating the ability of credit institutions to cope with the effects of the coronavirus pandemic crisis especially in the area of capital adequacy, risk management, loan portfolio quality, provisioning and business continuity management, including the application of legislative moratoria on loan repayments and its adequate reflection in financial statements;
- intensifying communication with supervised entities which included communication regarding the CNB's expectations in relation to dividend and remuneration policies or an adequate approach to provisioning in light of COVID-19;
- focusing on information security in digital channels used by credit institutions highlighted by more people working remotely due to anti-pandemic measures, as well as resilience to cyber risks in the banking sector (e.g. protection against advanced cyber threats and cyber resilience tests);
- assessing the effectiveness of measures in the area of AML/CFT and identifying the associated risks, constructing risk profiles for each credit institution based on a special procedure for the Supervisory Review and Evaluation Process (SREP);
- supervising the provision of information to clients, communication with clients, procedures for concluding and terminating contractual relationships with clients, processes for requesting information from clients and last but not least, proactively detecting unfair business practices of credit institutions;
- supervising the implementation of strong customer authentication and securing communication for internet card transactions;
- conducting stress tests on the domestic banking sector which were focused on assessing the sector's resilience to potential adverse developments.

In 2020, the "pragmatic approach" to the review and evaluation process was applied in line with the relevant EBA guidelines, which focused mainly on the ability of supervisory authorities to cope with the challenges of the crisis associated with the effects of the coronavirus pandemic. In this context, the CNB adjusted its supervisory practices and introduced a number of additional monitoring tools enabling detailed monitoring of the development of individual credit institutions in all the key areas of their activities.

International activities of the authority

The Czech National Bank actively cooperates with foreign supervisors to ensure effective supervision within its area of competence as well as to coordinate supervisory response to crisis situations. Where the CNB is the home supervisor, it manages the work of the college taking into account the risk profile and systemic importance of the supervised group and of the individual institutions that make up the group. Where the CNB is the host supervisor, it coordinates and plans its activities in cooperation with the home supervisor.

At international level, the CNB focuses on integration and cooperation within European structures. In 2020, the CNB cooperated with the European Banking Authority (EBA), the European Systemic Risk Board (ESRB) and the European Central Bank (ECB). The CNB also closely followed the discussions in the EU Council and its structures. Last but not least, the CNB is actively involved in the work of Basel Committee on Banking Supervision (BCBS).

Cooperation with other supervisory bodies in the country

The CNB is an integrated supervisory authority which oversees the subjects on the Czech financial market however the CNB works in close cooperation with the Czech Ministry of Finance, which has primary responsibility for preparing laws in the financial market area. The basis for such cooperation is laid down in the Agreement on cooperation on the preparation of draft national legislation concerning the financial market in the Czech Republic. Under the Agreement, the CNB and the Czech Ministry of Finance cooperate in the preparation of laws, statements of intent for laws and implementing legislation regarding: (i) the foreign exchange system and regulation of electronic money issuance; (ii) payments and accounting in the financial market; (iii) banking, AML, the capital market, consumer protection in the financial market, insurance and pension schemes.

Other relevant information and developments in 2020

In 2020, the CNB had to react to a change in market conditions due to the coronavirus pandemic.The CNB was involved intensively in the preparation of Act No. 177/2020 Coll., on the loan moratorium associated with pandemic, which was adopted in April 2020. The moratorium was binding for all bank and non-bank lenders, and it allowed borrowers to postpone instalments of both consumer credit and corporate loans agreed and drawn before 26 March 2020. The loan moratorium could be applied until 31 October 2020.

In the context of the prediction of an economic slowdown in 2020, the CNB raised – as a precautionary measure – the frequency of monetary policy operations to supply liquidity to banks. Banks (and also insurance and pension companies) were advised in March to postpone dividend payments and to avoid any actions which might threaten their capital resilience. Furthermore, the CNB sent a communication to banks (and external auditors) in March and October, in which it placed increased emphasis on ensuring an adequate response by credit institutions to the effects of the crisis when classifying receivables and calculating provisions and reserves. To ease the administrative burden during the pandemic, the deadlines were extended for the submission and publication of certain mandatory reports by institutions and issuers of listed securities. The CNB also warned of the risks of money-laundering and terrorism financing practices, as the pandemic fostered new types of illegal activities and also made it more difficult to identify them.

The CNB was also involved in the preparation of Act No. 49/2020 which amended the Act on Banks and other acts relating to the banking identity project (Bank ID). This should enable bank clients to use electronic services provided by public and private sector on the basis of reliable verification of client identity through Bank ID. In 2020, the CNB set a minimum requirement for own funds and eligible liabilities (MREL) for banks for the first time.

Questionnaire tables for the 2020 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	23	24	24
Branches of foreign credit institutions	27	25	24
Cooperative banks	10	9	8
Banking sector, total:	**60**	**58**	**56**

Total assets of banking sector (in billions CZK, at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	6,596.1	6,874.0	7,259.4
Branches of foreign credit institutions	683.1	673.2	708.5
Cooperative banks	20.2	10.2	10.0
Banking sector, total:	**7,299.4**	**7,557.4**	**7,977.9**
y/y change (in %)	**3.9**	**3.5**	**5.6**

Ownership structure of banks on the basis of assets total

Item	2018	2019	2020
Public sector ownership	1.1	0.9	0.9
Domestic ownership total	7.0	7.7	7.2
Foreign ownership	91.9	91.4	91.9
Banking sector, total:	**100.0**	**100.0**	**100.0**

Note: Banking sector=commercial banks + bank foreign branches

Concentration of asset by the type of financial institutions, 2020

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	57.3	71.9	1,298.8
Branches of foreign credit institutions	52.0	71.1	1,245.1
Cooperative banks	85.8	97.7	2,615.4
Banking sector, total:	**52.1**	**65.4**	**1,085.2**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2018	2019	2020
Commercial banks	16.6	17.3	7.7
Cooperative banks	-1.0	-2.1	-6.5
Banking sector, total:	**16.5**	**17.2**	**7.7**

Note: RoE is calculated as a ratio of (sub)sector's net profit to annual average of (sub)sector's Tier 1 capital.

Distribution of market shares in balance sheet total (%)

Type of financial institution	2018	2019	2020
Commercial banks	90.4	91.0	91.0
Branches of foreign credit institutions	9.4	8.9	8.9
Cooperative banks	0.2	0.1	0.1
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2018	2019	2020
Receivables			
Financial sector	7.0	6.7	6.7
Nonfinancial sector	41.7	42.0	41.1
Government sector	0.8	0.8	0.9
Other assets	50.5	50.5	51.3
Liabilites			
Financial sector	20.0	18.2	12.3
Nonfinancial sector	53.9	54.7	58.4
Government sector	4.0	4.2	4.0
Other liabilities	14.2	14.7	16.9
Capital	**7.9**	**8.2**	**8.4**

Note: Banking sector=commercial banks + bank foreign branches.

Capital adequacy ratio of banks***

Type of financial institution	2018	2019	2020
Commercial banks	19.6	21.3	24.3
Cooperative banks	21.1	29.2	26.7
Banking sector, total:	**n.a.**	**n.a.**	**n.a.**

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

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

Asset classification	2018	2019	2020
Non-financial sector, including	2.7	2.3	2.7
- households	2.1	1.7	1.8
- corporate	3.6	3.2	4.2

Note: Banking sector=commercial banks + bank foreign branches; share of non-performing loans by sector.

The structure of deposits and loans of the banking sector in 2020 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	87.6	88.5
Households	61.9	52.3
Corporate	25.6	36.2
Government sector	6.0	2.0
Financial sector (excluding banks)	6.4	9.6
Total	**100.0**	**100.0**

Note: Banking sector=commercial banks + bank foreign branches.

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

P&L account	2018	2019	2020
Interest income	179,170,6	225,926.6	186,104.6
Interest expenses	49,416.8	80,179.0	59,229.9
Net interest income	129,753.8	145,747.6	126,874.7
Net fee and commission income	33,646.4	33,050.7	30,947.4
Other (not specified above) operating income (net)	2,935.7	2,681.4	2,736.4
Gross income	254,167.7	295,572.5	253,989.1
Administration costs	76,744.6	77,717.4	73,305.7
Depreciation	8,133.3	12,366.5	12,909.0
Provisions	2,045.9	-707.0	2,528.4
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	5,679.4	3,818.4	29,020.5
Profit (loss) before tax	98,032.1	109,210.4	57,433.4
Net profit (loss)	81,439.8	91,105.3	47,470.4

Note: Banking sector=commercial banks + bank foreign branches.

Total own funds in 2020 (in EUR) ***

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	24,027.4	22,395.8	23,306.8	720.6	n.a.
Cooperative banks	62.6	59.7	59.7	3.0	n.a.
Banking sector, total:	**24,090.0**	**22,455.5**	**23,366.5**	**723.6**	**n.a.**

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

Note: EUR= 26.25 CZK as at 31 December 2020.

Macroeconomic environment in the country

Considering COVID-19 crisis, the restrictions imposed in response to the virus and relatively pessimistic forecasts made in the first half of the year, the economic reality in Estonia turned out to be better than afraid in 2020. The gross domestic product (GDP) of Estonia fell 2,9% y/y in 2020, reaching to 27 billion euros at current prices, according to Statistics Estonia. Comparing the result with EU average, we can look at seasonally and working day adjusted GDP, which fell 2,6% in Estonia and 6,2% in EU.

The main contributors to the decline were manufacturing, trade and accommodation and food services sectors. Household consumption fell by 2.5% in 2020 due to goods and services related to travelling, commuting and leisure activities outside of the home. There was an increase in expenditure related to the stay-at-home lifestyle and health. Healthcare was also the main driver of the 3.6% increase in government expenditure in 2020. While foreign trade also suffered in 2020, it showed signs of recovery in the second half of the year.

The pattern of the sharp decline in first half of the year and recovery in second half of the year was also reflected in unemployment rates. While at the end of the March the unemployment rate in Estonia was 5,0%, then three months later the comparable figure jumped to 7,1%, falling to 6.8% by the end of 2020.

Driven by the vaccinating against the COVID-19 virus and easing the restrictions to the economic activity, Estonian central bank forecasts Estonian economy to grow by 5,3-8,2% this year (2021) and 3,8%-4,9% next year (2022). Forecasted GDP increase in 2021 is expected to lay mainly on private consumption as restricted consuming possibilities increased households' savings and money taken out form the second pillar pension fund both will boost the domestic consumption.

Development in the banking sector (including assets total / GDP)

At the end of the year there were 14 banks operating in Estonia, of which 5 were branches of foreign banks. This is one less than a year earlier as the Estonian branch of Svenska Handelsbanken AB ceased its activities. The assets of the banking sector stood at 44.7 billion euros at the end of 2020, which was a fifth more than a year earlier, and the loan balance increased by 2.3% over the year to 28.3 billion euros.

Contrary to what was feared about the impact of the Covid-19 virus, overdue loans and bad or non-performing loans held relatively stable as a share of the whole loan portfolio throughout last year. At the time the coronavirus crisis started on 25 March, 3.4% of the loan portfolio in the Estonian banking system was overdue by at least one day, and 1.9% was non-performing loans. These figures were even lower at the end of the year and there was no particular evidence of the crisis impacting the profit or profitability of the sector. The return on equity (ROE) of the Estonian banking sector was 8.8% in 2020, which was even better than a year earlier and substantially more than the average in the European Union. The caution that the banks showed about lending proved temporary, and remained mostly in the second quarter. This meant that the stock of loans of the Estonian banking sector continued to grow in 2020 as it had in previous years. At the same time, the banks reacted to the crisis by increasing their liquidity, as this had proved very important during the previous economic crisis.

It can be argued that the impact of the Covid-19 pandemic on the Estonian banking sector was quite small, as the impact was evident but the situation was kept under control by various measures. The share of the loan stock of the banking sector with payment holidays grew relatively rapidly to 11% by the end of the second quarter, to some extent replacing overdue and non-performing loans, but it shrank back also rapidly as economic activity recovered from the third quarter, and only 2.5% of the loan stock in the sector had payment holidays at the end of 2020. The situation improved faster than expected during the summer and applications for payment holidays faded away.

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.

Finantsinspektsioon is an independent financial supervision and resolution authority. Finantsinspektsioon acts on behalf of the Estonian state and works to ensure that the regulated financial market is stable and transparent.

In financial supervision and in resolving financial crises, Finantsinspektsioon works for the benefit of the public interest. Its work is funded not from the state budget but by the supervision and procedural fees that are paid by the market participants that Finantsinspektsioon supervises

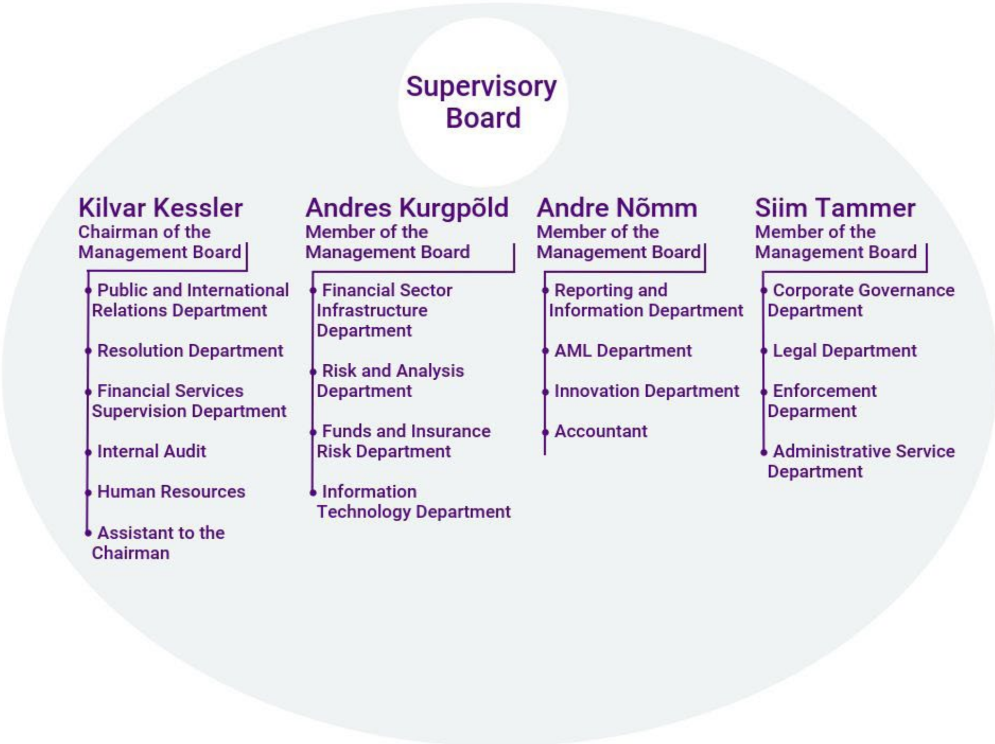
The work of financial supervision focuses on keeping the financial sector stable, trustworthy, transparent and efficient. Finantsinspektsioon reduces the systemic risks in the financial sector and contributes within the limits of its responsibility to preventing criminal activity. Finantsinspektsioon supports the stability of the Estonian monetary system through its supervisory work. Finantsinspektsioon also prioritises the sustainability of the critical functions of the banks during crises and sufficient protection for the funds of depositors, investors and other clients.

Finantsinspektsioon carries out state supervision over licensed banks, insurance companies, insurance intermediaries, investment firms, fund managers, investment and pension funds, payment institutions, e-money institutions, creditors and credit intermediaries, and the securities market.

Finantsinspektsioon is part of the European Single Supervisory Mechanism (SSM), which has carried out capital supervision for the most important banks and banking groups in Europe since November 2014. Finantsinspektsioon is also part of the European Single Resolution Mechanism (SRM) and the Single Resolution Board (SRB).

The activities of Finantsinspektsioon are planned and controlled by the Supervisory Board. Its work is managed by a four-member management board, which takes decisions by majority vote.

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Banking Supervisory Authority in 2020

Finantsinspektsioon´s strategy for 2019-2021 emphasises the important values of the financial market, which are stability, reliability and openness to innovation. The main strategic goals are that: Estonia has an effective safety net for the financial market to prevent and resolve financial crises; participants in the market have large enough financial buffers to hedge their risks; market participants have internal control systems that suit their business models, especially in relation to combating money laundering; market participants have transparent and effective funded pension products; Finantsinspektsioon has an effective but responsible enforcement policy; market participants have modern information technology infrastructure; Finantsinspektsioon recommends or makes changes to outdated rules or updates them.

The activities of the Banking Supervisory Authority in 2020

Evidently the coronavirus was the main actor on the negative side in the financial markets in 2020. The initial scenarios for the devastating impact the virus would have in the financial sector were not realised, but Covid-19 still posed two main types of risk for the financial supervisor. The first risk was one that could materialise quickly and was the operational risk that illness could leave financial intermediaries unable to provide services, worsening the stagnation in the economy and in the worst case causing public panic. The Estonian financial sector managed this operational risk very well during the crisis. Their starting position for doing this was good, as financial supervision has over the years consistently required the large market participants to have recovery plans and to test them, and has monitored those plans. The Covid-19 pandemic turned those exercises into a reality.

The second serious risk was credit risk. Negative developments mean that people and businesses are no longer able to meet their loan obligations and so credit losses occur, which in the worst case could leave banks insolvent and depositors losing more funds than the Guarantee Fund could cover. The biggest capital buffers of the banks in Estonia are made up of accumulated profit. This meant it was reasonable to freeze the existing profit buffers immediately to preserve the capacity of the banks to bear credit losses. Finantsinspektsioon also started a discussion about this with colleagues in Frankfurt and Stockholm, as that is where the authorities that supervise the largest banks in Estonia are based. The outcome was an agreement that was later reached throughout the whole European Union that banks would not pay out profits from the start of the pandemic in 2020.

Finantsinspektsioon also worked on compliance with obligations to allow borrowers who were facing difficulties to postpone their repayments temporarily, while at the same time offering some relief to the banks to encourage them to allow these postponements. The majority of financial supervisors in the European Union had similar thoughts and plans, and so a single framework for payment moratoriums was introduced. On this basis the banks in Estonia agreed on a payment moratorium in spring 2020, following the single conditions set by the financial supervisor.

The main challenges for Finantsinspektsioon in 2021 will come from the coronavirus crisis, the reform of the mandatory pension system, and the opinions of foreign assessors on the anti-money laundering capacity of Estonia. In addition, we are working towards our strategic priorities of helping the state to establish a framework for administrative sanctions and the institution of a financial ombudsman, mapping regulatory barriers to innovation in the financial sector, and moving towards a more generalised supervisory model based on IT solutions.

International activities of the authority

Finantsinspektsioon contributes to designing the financial supervisory policy of the European Union through the European supervisory authorities. There are three European supervisory authorities, which are the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), and the European Securities Market Authority (ESMA). The European Systemic Risk Board (ESRB) is also part of the European system of financial supervisors, and handles macro supervision.

As Estonia is also a member of the euro area, the everyday work of Finantsinspektsioon is affected by the single supervisory mechanism (SSM). This is a banking supervision system for the euro area that takes in the European Central Bank and the supervisory authorities of the euro area countries. The European Central Bank conducts direct supervision through the SSM over important credit institutions in the euro area. The banks in Estonia that met the criteria for direct supervision in 2020 were AS SEB Pank, Swedbank AS and Luminor Bank AS.

Finantsinspektsioon is also responsible for crisis resolution, and works in the Single Resolution Board (SRB), which is the central resolution authority in the euro area for some credit institutions.

Finantsinspektsioon participates in supervisory colleges for banking and insurance and in resolution colleges to make supervision over individual banks and insurers and over resolution of them as efficient as possible, and to make cooperation between the institutions responsible in different countries as effective as possible.

Finantsinspektsioon is also a member of the International Association of Insurance Supervisors (IAIS), the Group of Banking Supervisors from Central and Eastern Europe (BSCEE), and the International Organization of Securities Commissions (IOSCO). It also promotes cooperation between Nordic and Baltic countries in the Nordic-Baltic Macroprudential Forum (NBMF) and the Nordic-Baltic Stability Group (NBSG).

At the end of 2020, Finantsinspektsioon started a monthly meeting and discussion with the leaders of the financial supervisors from the other Baltic states on current topics in the Baltic financial markets to help create a joint viewpoint on European Union legislation.

Other relevant information and developments in 2020

Finantsinspektsioon carried through important structural changes in the organisation in 2020. The structural changes were needed because there have been substantial changes in recent years to the structure of the Estonian financial market and the dynamics of risk in it, and also to the content, complexity and amount of the legislation of it.

Finantsinspektsioon joined the crisis resolution function of Finantsinspektsioon with the Guarantee Fund. Finantsinspektsioon signed an agreement with the Guarantee Fund at the end of 2019 under which Finantsinspektsioon started in 2020 to provide services to the Guarantee Fund that will help the fund achieve its goals better.

Finantsinspektsioon took the initiative in 2020 to establish its own out-of-court resolution body, or financial ombudsman, to handle disputes about financial services. This gives consumers faster resolutions to arguments than court proceedings do.

To help improve the financial literacy of the Estonian public, Finantsinspektsioon set up the consumer website minuraha.ee 10 years ago. The texts on the consumer website were updated substantially in 2020 together with partners at the Ministry of Finance, Eesti Pank and the Estonian Banking Association. Finantsinspektsioon started to produce podcasts in 2020 for consumers who know more about the financial world and are more interested in it, and the blog on the Finantsinspektsioon website was revived.

Questionnaire tables for the 2020 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	8	9	9
Branches of foreign credit institutions	8	6	5
Cooperative banks	0	0	0
Banking sector, total:	**16**	**15**	**14**

Total assets of banking sector (mln EUR, at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	23 925	36 294	43 664
Branches of foreign credit institutions	2 194	1 066	1 010
Banking sector, total:	**26 119**	**37 360**	**44 675**
y/y change (in %)	**3.3**	**43***	**20%**

**fast growth is mainly a result of Luminor's structural change in 2019*

Ownership structure of banks on the basis of assets total

Item	2018	2019	2020
Public sector ownership*	0	0	0
Domestic ownership total	7.9	8.5	9.4
Foreign ownership	92	91.5	90.6
Banking sector, total:	**100.0**	**100.0**	**100.0**

**Assuming public sector ownership is meant to be also domestic*

Concentration of asset by the type of financial institutions, 2020

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	82	94	2522
Branches of foreign credit institutions	2.2	2.3	3
Banking sector, total:	**82**	**94**	**2525**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2018	2019	2020
Commercial banks	11.1%	7.7%	8.8%
Banking sector, total:	**11.1%**	**7.7%**	**8.8%**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2018	2019	2020
Commercial banks	92	97	98
Branches of foreign credit institutions	8.4	2.9	2.3
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2018	2019	2020
Receivables			
Financial sector	31	32	39
Nonfinancial sector	63	66	59
Government sector	2.2	1.6	1.9
Other assets	3.5	0.0	0.0
Liabilites			
Financial sector	25	16	17
Nonfinancial sector	70	75	72
Government sector	4.7	8.7	11
Other liabilities	0.3	0.0	0.0
Capital	**15**	**14**	**12**

Capital adequacy ratio of banks

Type of financial institution	2018	2019	2020
Commercial banks***	30.1	26.3	27.9
Banking sector*, total:**	**30.1**	**26.3**	**27.9**

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

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

Asset classification	2018	2019	2020
Non-financial sector, including	1.8%	2.2%	1.8%
- households	1.4%	1.8%	1.7%
- corporate	2.3%	2.9%	2.1%

The structure of deposits and loans of the banking sector in 2020 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	79.6	85.4
Households	43.4	50.7
Corporate	36.3	34.7
Government sector	12.6	2.7
Financial sector (excluding banks)	7.8	11.9
Total	**100.0**	**100.0**

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

P&L account (mln EUR)	2018	2019	2020
Interest income	551	814	839
Interest expenses	72	140	127
Net interest income	479	674	712
Net fee and commission income	150	206	197
Other (not specified above) operating income (net)	169	195	292
Gross income	967	1 329	1 447
Administration costs	332	533	542
Depreciation	13	38	41
Provisions			
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	-8	61	124
Profit (loss) before tax	459	440	463
Net profit (loss)	370	370	418

Total own funds in 2020 (in mln EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks***	4 912	4 768	4 806	106	
Banking sector, total*:**	**4 912**	**4 768**	**4 806**	**106**	

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

Macroeconomic environment in the country

In 2020, the outbreak of the COVID-19 pandemic affected economies around the world more than any other standard driver of business cycles. Georgia has not been an exception - the real economy declined by 6.2% in 2020. Given a high vulnerability of the Georgian economy to external shocks, severe disruptions in foreign inflows generated by tourism and merchandise trade significantly contributed to the economic downturn. In terms of sectoral contributions, the sharp decline in tourism had a particularly negative effect on restaurants, hotels, and transport. The restaurants and hotel services went down by 37.9% YoY and its contribution amounted to -1.7 pp of total growth. Transport and storage declined by 22.3%, contributing -1.3 pp. Notably, domestic travel has increased, but this does little to help developing countries like Georgia, which are crucially dependent on international travel.

Against such a backdrop, the National Bank of Georgia (NBG) implemented several temporary and standard policy measures to support the economy. At the onset of the pandemic, the NBG eased its policy rate from 9 to 8 percent and kept it unchanged till the end of the year. Despite downward pressures on prices from the collapsed aggregate demand, average inflation remained above the 3% target and amounted to 5.2% in 2020. The seeds of the inflation came from the significant leap in unit labor costs driven by pandemic-related constraints and nominal effective depreciation of lari. The depreciation, in turn, followed a widening in current account deficit and hikes in sovereign risk premia, which resulted in higher import prices as well as higher balance sheet costs for companies with foreign currency liabilities. The latter typically exerts a significant pressure on consumer prices due to high dollarization of the Georgian economy.

In the wake of strict restrictions to contain the spread of the virus, the government of Georgia implemented numerous stimulus measures, resulting in expanded budget deficit. In particular, the budget deficit reached 9.3% of GDP while external government debt to GDP increased by 15.5 pp YoY and amounted to 47.5%. On a side note, the tax burden made up around 22.2% of GDP, lower by 1 pp YoY.

Under such a big shock, the unemployment rate increased by 0.9 pp YoY and equaled 18.5% in 2020.

The current account deficit in the balance of payments widened by 7 pp YoY and stood at 12.5% of GDP in 2020. The increase of the deficit was mainly driven by the decline in the tourism revenue by 83.4% YoY. This was partially offset by an improvement in the trade balance of goods by 15.7% YoY – largely driven by a weak growth in imports - and a solid increase in net remittances by 27.5% YoY. Besides, in tandem with the widened CA deficit, FDI inflows contracted significantly, in particular, by 52.9% YoY, and the gross national savings rate lowered by 5.5 pp YoY to total 14.3% of GDP in 2020.

Developments in the banking system (including the assets total/GDP)

Banking is the main financial intermediary in Georgian economy. Foreign investments dominate banking sector and account for more than 85% of total equity. Banking sector assets grew by 20% in 2020. Credit portfolio increased also by 20% YoY at the end of 2020, less than in 2019. In total, credit portfolio accounted for 77% of GDP, which is 12 percentage points higher than in 2019. As for the total assets of banking sector, they accounted for 115% of GDP that is 19 percentage points higher than in 2019.

In 2020, the highest growth rate was recorded in SME (23% annually), followed by corporate and retail sectors. Banking sector loan portfolio break-down by products is the following: 35% accounts for corporate sector, 39% - retail sector, and 26% - SMEs.

Throughout the year, due to the Covid-19, loan portfolio quality has slightly deteriorated. According to the 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 increased by 4 percentage points and made up 8.4% of total portfolio. At the same time, NPL ratio calculated with widely accepted methodology - loans with more than 90 days overdue to total portfolio - increased to 2.3% in 2020, 0.4 percentage points higher than in 2019.

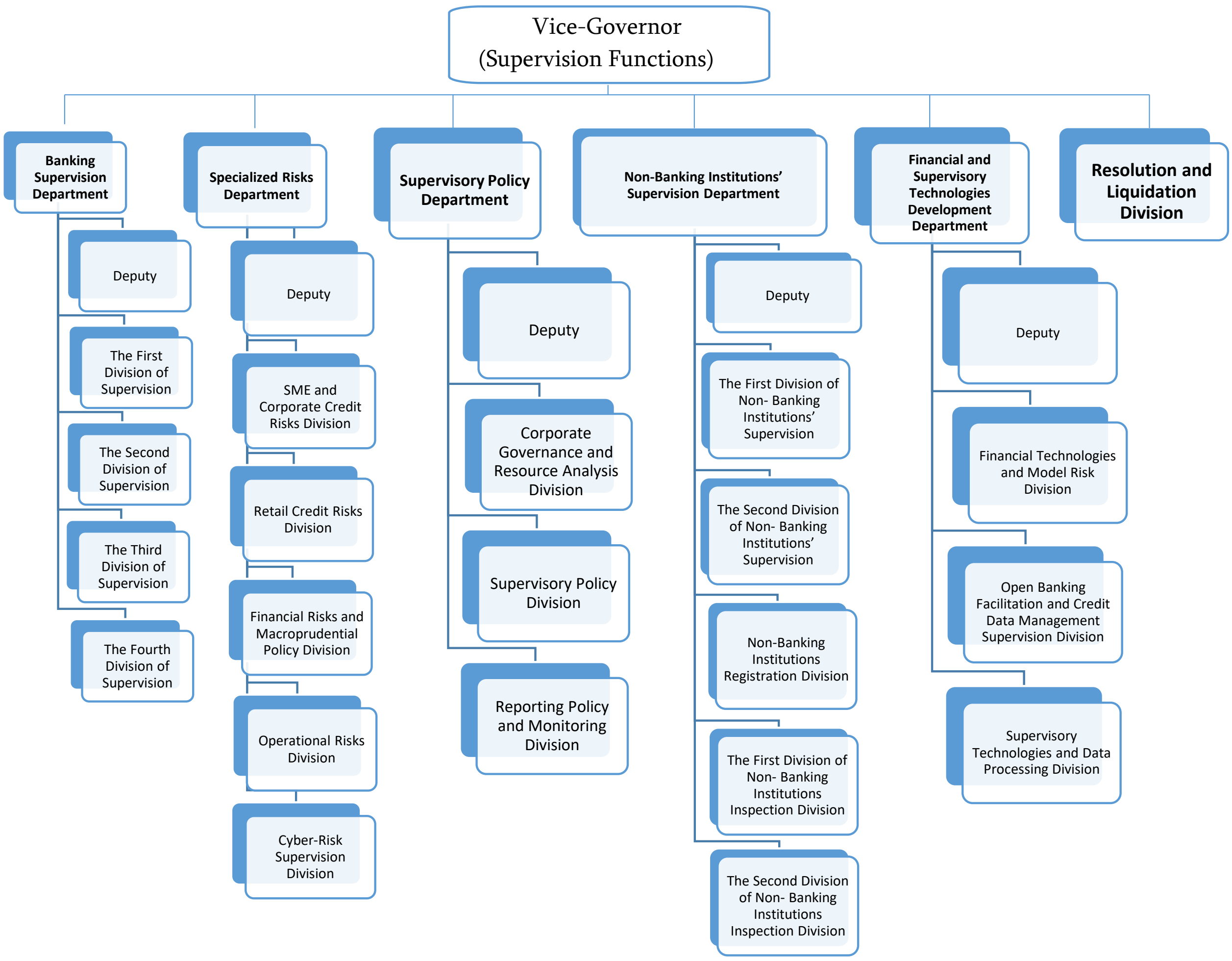
Due to the Covid-19 pandemic related credit losses, profitability of banks decreased in 2020. Net income of the system decreased from 953 million GEL in 2019 to 99 million GEL in 2020. At the end of 2020, RoA made up 0.2% and RoE made up 1.8%. Compared to 2019, cost to income ratio remained the same at 48.3% in 2020.

In 2020, banking sector maintained strong liquidity buffer above the prudential minimum. The share of liquid assets to total assets and non-bank deposits made up 21% and 35%, respectively.

Georgian banking system is adequately capitalized. At the end of 2020, core Tier 1, Tier 1 capital and regulatory capital ratios calculated based on Basel III framework were 11%, 12.8% and 17.6%, respectively (minimum requirements are 6.1%, 7.6% and 9.6%).

Banking system remained highly dollarized, contributing to currency induced credit risk. By the end of 2020, the dollarization of loans stands at 55%, and while dollarization of deposits decreased, making 62%. To mitigate this risk, NBG applies additional risk weights for foreign currency exposures and higher reserve requirement for foreign currency deposits, as well as tighter Payment-to-Income and Loan-to-Value limits for foreign currency retail credit.

Organizational chart of the Banking Supervisory Authority



The activities of the Banking Supervisory Authority in 2020

2020 has been a challenging year due to COVID-19 pandemic. Despite, NBG continued efforts to improve the supervisory framework and harmonize domestic rules with international best practices.

In 2020, NBG continued working on legal acts to fully enact the Commercial Banks Recovery and Resolution Framework approved following the legislative amendments of late 2019. The first part of the regulations was approved before July 1, 2020, and the second - before January 1, 2021. As a result, the National Bank of Georgia has a full-fledged framework for the recovery and resolution of commercial banks from January 1, 2021.

The Framework was developed based on modern international best practices and authorize the NBG to exercise early intervention measures when a commercial bank is faced with financial difficulties or to apply resolution tools.

Considering globally emerging trends, the NBG started working on analyzing and developing the competition policy and relevant competition standards applicable for the financial sector in late 2020. Hence, the NBG has set up an internal working group staffed with relevant representatives from all related NBG departments to develop competition-related policies and facilitate their enforcement in practice, as well as to share concerns and problems raised in practice and come up with the ways to solve them. The NBG continues to work on applicable competition-related legal acts with technical assistance of the World Bank (WB).

Draft regulation on Fit and Proper Criteria for shareholders was developed and relevant amendments were planned regarding the fit and proper criteria for administrators, licensing requirements and standards in 2020. However, the NBG announced a temporary moratorium on the development and imposition of new supervisory requirements in response to the challenges of the COVID-19 pandemic, which also affected these regulations and thus postponed their approval until 2021.

In 2020, the NBG published the supervisory strategy document for 2020-2022.[1] This includes the NBG's vision, objectives, supervisory principles and values, strategic supervisory priorities and plan for reforms and amendments with relevant timelines. The aim of the strategy is to provide the financial sector, investors, international financial institutions, rating agencies, the public and other stakeholders with access to information on the NBG's supervision priorities, plans and future activities.

Furthermore, a draft amendment to the Corporate Governance Code of Commercial Banks was prepared in 2020 and submitted to the representatives of the banking sector for consultation, to ensure the improvement of corporate governance standards at commercial banks and to harmonize them with the international best practices. It is already enacted in February 2021.

It is worth noting, that the NBG continues to implement the measures listed in the Sustainable Funding Guide. In particular, the Corporate Governance Code of Commercial Banks integrated environmental, social and governance (ESG) issues. In addition, the NBG, in cooperation with the OECD, developed the principles of disclosure and reporting of ESG issues and the applicable template. Another step towards developing a sustainable financing framework was joining the Network of Central Banks and Supervisors in February 2020 for the Network for Greening the Financial System (NGFS). The NBG is pursuing the Action Plan given in the Sustainable Financing Guide and is working with the IFC to develop a sustainable funding taxonomy.

The NBG continues to work on the consolidated supervision framework. Amendments made to the Organic Law on the National Bank of Georgia at the end of 2017, the National Bank of Georgia was empowered with a mandate to execute supervision of banking groups (the so-called consolidated supervision).

1 For further details, visit https://www.nbg.gov.ge/index.php?m=756

In 2020, the NBG worked on the calibration of the net stress test buffer. In addition, the NBG formalized the stress-testing framework in cooperation with commercial banks during the same period.

Considerable effort was devoted to transitioning the financial statements of the banking sector to International Financial Reporting Standards (IFRS) during 2020. However, due to the complexity of the project, commercial banks will need some time to adapt to the updated requirements. Accordingly, commencement of reporting according to the IFRS standards will be voluntary for commercial banks from 2021, while from 2022 it will become mandatory.

In support of this project, the NBG decided to implement an international standard for data exchange (the Extensible Business Reporting Language (XBRL)) to improve the data quality and started receiving financial statements in the first phase based on the XBRL standard accepted in the European Union (FINREP).

The NBG made a significant change in the Regulation on "Statutory Audit of Consolidated Financial Statements of Commercial Banks and the disclosure of Information in the Notes to the Financial Statements", in order to facilitate the independent conduct of the audit process of commercial banks.

The Regulation on the Management of Interest Rate Risk for the Banking Book (IRRBB) came into force in 2020. The purpose of the regulation is to identify, assess, and manage interest rate arising on banking book, and by imposing relevant requirements, to promote the stability and sound functioning of commercial banks and the financial sector.

The NBG started working with commercial banks to manage business continuity from the beginning of 2020, as the spread of the new coronavirus contoured possible impact on the financial sector. The NBG instructed commercial banks to upgrade and expand their business continuity plans according to the virus spread scenario. In parallel, the NBG developed recommendations and guidelines for operational risks related to pandemics for commercial banks.

Recommendations to harmonize with the EU legislation were developed, as part of the project "Strengthening the Capacities of the National Bank of Georgia in banking and payment services" in cooperation with the Polish Financial Supervision Authority (UKNF). These recommendations aim to improve the requirements for information disclosure under Pillar 3. Significant changes are planned in this area in 2021.

Due to increase in cyber risks, the NBG, together with commercial banks, has been working on the introduction of appropriate security measures and control mechanisms in banks, raising awareness of employees, security of internal corporate network, personal computers and other areas to deter cyber-attacks on remote banking.

In late 2020, the NBG transformed the remote assessment of the operational and cyber risk management framework of commercial banks.

The following actions were taken by the NBG in response to the COVID-19 pandemic:

- As a post-COVID-19 pandemic shock action, the imposition of a grace period on loans was encouraged and the provisioning policy was temporarily altered;
- Moratorium on new supervisory reforms and sanctions;
- The increase in scheduled Tier1 capital requirements in March 2020 for loan portfolio concentration risk and net GRAPE buffer were temporarily deferred;
- The conservation buffer (2.5 per cent risk-weighted assets) and part of the Pillar 2 buffer (2/3 of the unhedged credit risk buffer, 1.6 per cent risk-weighted assets) were cancelled;
- On-site inspections of supervised entities were suspended; lending procedures were simplified: temporarily, it was no longer required to perform an on-site evaluation of the real estate; requirement related to updating the financial statements was eased;

- The enactment of the Regulation on Concentration of Risk Exposures and Major Risks scheduled for June 2020 was deferred for one year;
- Restrictions were imposed on payments of dividends, repurchases of shares, investments and other forms of capital reduction.

International activities of the authority

Over the year 2020, the NBG has participated in various international events, from which part of them were held online.

The Global Finance, the renowned international publication, nominated the Governor of the NBG, for the third time in a row, among the best governors of central banks in 2020.

Earlier this year, Governor of the NBG, participated in an event organized by the International Monetary Fund in Rabat, Morocco: Promoting Better Economic Governance and Eradicating Corruption in the Middle East, North Africa and Central Asia. In his speech, he spoke in detail about the reforms of the NBG, crucial for long-term sustainability.

The NBG professionals participated in various high-level meetings throughout the year, which, due to the global circumstances, were held online. Governor Gvenetadze took part in a discussion organized by the International Monetary Fund, dedicated to monetary and financial policy, as a response to the pandemic in emerging markets and developing economies. The participants of the events discussed examples from various countries.

Governor of the NBG was invited to be the keynote speaker at the World Bank's Reserve Advisory and Management Partnership (RAMP) - "Global Response to COVID-19: Open Talk on Challenges and Goals". Koba Gvenetadze spoke in detail about how the COVID-19 pandemic affected the process of managing the reserves of the NBG, how the process is performed remotely and how it may help to create a model in the future.

Governor of NBG was the keynote speaker at the webinar of the Astana International Finance Center and the Bretton Woods Committee. He spoke about the impact of COVID-19 on the financial sector and the role of central banks.

Representatives from Financial and Supervisory Technologies Development Department of NBG participated in discussion organized by the Global Financial Innovation Network, dedicated to share knowledge on COVID-19 related solutions within the RegTech/SupTech ecosystem.

Cooperation with other supervisory bodies in the country

Importantly, 2020 saw intensified cooperation with various domestic public institutions, including the Competition Agency, and the Communications Commission. The NBG is cooperating on a number of supervisory areas with the latter, in efforts to upgrade its supervisory framework.

Following the global trend, banking groups in Georgia have been vigorously developing e-commerce platforms and subsequent ecosystems. To manage ecosystem risks, the NBG shared with systemically important commercial banks the basic principles of ecosystem operation, including platform openness, accessibility and arms-length operation, possession of adequate resources by the ecosystem to avoid the use of the bank's resources and avoid conflicts of interest in decision-making processes. The NBG cooperates with the Competition Agency on issues related to the functioning of ecosystems. It is also planned to upgrade the regulatory framework for ecosystems as needed.

Considerable effort was devoted to transitioning the financial statements of the banking sector to International Financial Reporting Standards (IFRS) during 2020. Working groups were set up with participants from the NBG, the banking sector and the banking association of Georgia. Supported by the World Bank, the project involves local and international experts with diverse experience, who consult with the project working groups and discuss with them the best practices implemented by the advanced countries.

As part of the obligations stipulated by the EU-Georgia Association Agreement, the NBG, in cooperation with the State Insurance Supervision Service, continues to work on elaboration and implementation of a supplementary supervision framework for financial conglomerates, with a focus on approximating the legislation to the agreed acts and international legal instruments within a specific timeframe. This supervisory framework implies supplementary prudential supervision with respect to capital adequacy, risk concentration, intra-group transactions, internal control mechanisms and risk management processes for entities within financial conglomerates.

Other relevant information and developments in 2020

In late 2020, the NBG actively worked on preparatory arrangements for the Financial Sector Assessment Program (FSAP) implemented by the Joint Mission of the International Monetary Fund and the World Bank, that included the completion of questionnaires and self-assessment for all the areas to be addressed by the mission. The FSAP mission, which is planned for 2021, will assess the stability and soundness of the financial sector, the NBG reforms, and growth and development prospects.

Also during 2020, the NBG actively worked on the factors to encourage the emergence of sound entities in the market. There are notable reforms in this regard:

- **The enactment of the Regulation on Regulatory Laboratory in May 2020,** which enables the financial sector representatives regulated by the NBG to test innovative services and products in a supervised environment in a real time. The Regulation aims to facilitate testing and rapid development of innovative financial services and products developed in the context of rapidly evolving financial technologies, the timely detection of potential systemic risks, compliance with the supervisory requirements of the NBG, while identifying the need for possible changes in the regulatory requirements.
- **Publication of digital bank licensing principles by the NBG in July 2020.**[2] By the developing the digital banking model, the NBG aims to promote the development of innovative business models and the diversity of financial products, the entry of new technology players and enhancing of competition in the financial sector. The principles define what kind of business model is perceived by the NBG as a digital bank and what additional requirements and incentive conditions will be assessed in the licensing process.

[2] For further details, visit https://www.nbg.gov.ge/index.php?m=340&newsid=4000

Questionnaire tables for the 2020 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	15	15	15
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**15**	**15**	**15**

Total assets of banking sector (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	39,682,984,387	47,183,026,804	56,870,926,138
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**39,682,984,387**	**47,183,026,804**	
y/y change (in %)	**14.71%**	**18.89%**	**20.53%**

Ownership structure of banks on the basis of assets total

Item	2018	2019	2020
Public sector ownership			
Domestic ownership total	13%	12%	12%
Foreign ownership	87%	88%	88%
Banking sector, total:	**100%**	**100%**	**100%**

Concentration of asset by the type of financial institutions, 2020

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	79.01%	85.94%	28.08%
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**79.01%**	**85.94%**	**28.08%**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2018	2019	2020
Commercial banks	19.38%	17.75%	1.82%
Cooperative banks			
Banking sector, total:	**19.38%**	**17.75%**	**1.82%**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2018	2019	2020
Commercial banks	99.71%	100%	100%
Branches of foreign credit institutions	0.29%	0%	0%
Cooperative banks			
Banking sector, total:	**100**	**100**	**100**

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

	2018	2019	2020
Receivables	**100.00%**	**100.00%**	**100.00%**
Financial sector	1.08%	1.37%	0.93%
Nonfinancial sector	62.34%	62.44%	62.55%
Government sector	3.63%	3.91%	3.75%
Other assets	32.96%	32.27%	32.77%
Liabilites	**87.07%**	**87.82%**	**89.72%**
Financial sector	2.20%	2.10%	1.44%
Nonfinancial sector	56.02%	53.93%	9.07%
Government sector	1.96%	1.65%	1.37%
Other liabilities	26.90%	30.15%	77.83%
Capital	**12.93%**	**12.18%**	**10.28%**

Capital adequacy ratio of banks

Type of financial institution	2018	2019	2020
Commercial banks	18.39%	19.41%	17.59%
Cooperative banks			
Banking sector, total:	**18.39%**	**19.41%**	**17.59%**

Note: All above information are according to Basel III

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

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

Asset classification	2018	2019	2020
Non-financial sector, including	2.71%	1.96%	2.31%
- households	1.92%	1.41%	1.58%
- corporate	3.34%	2.32%	2.78%

The structure of deposits and loans of the banking sector in 2020 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	95.80%	98.28%
Households	53.31%	37.91%
Corporate	42.50%	60.37%
Government sector	4.20%	0.38%
Financial sector (excluding banks)	0.00%	1.34%
Total	**100.00%**	**100.00%**

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

P&L account	2018	2019	2020
Interest income	3,375,387,165	3,663,335,867	4,037,403,688
Interest expenses	1,468,274,598	1,732,915,557	2,188,353,998
Net interest income	1,907,112,566	1,930,420,310	1,849,049,690
Net fee and commission income	429,385,296	421,851,708	368,240,090
Other (not specified above) operating income (net)	387,766,389	455,331,337	506,567,508
Gross income	4,192,538,850	4,540,518,913	4,912,211,286
Administration costs	671,956,367	730,245,358	692,117,351
Depreciation	126,364,198	189,325,528	218,419,501
Provisions	396,448,870	385,261,724	1,329,203,782
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	396,448,870	385,261,724	1,329,203,782
Profit (loss) before tax	1,106,409,941	1,067,114,438	78,814,348
Net profit (loss)	914,718,058	953,294,854	99,261,850

Total own funds in 2020 (in EUR)

TYPE OF FINANCIAL INSTITUTION	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
COMMERCIAL BANKS	2,453,339,188	1,615,000,616	1,844,055,199	609,283,988	
COOPERATIVE BANKS					
BANKING SECTOR, TOTAL:					

Note: All above information are according to Basel III

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

Macroeconomic environment in the country

Hungarian GDP decreased by 5.0 percent, and inflation was 3.3 percent in 2020. The budget deficit rose to 8.1 percent, while current account deficit was 0.1 percent of GDP.

Hungarian economic growth was mainly affected by coronavirus pandemic in 2020. From the expenditure side, contribution of household consumption, investments and net exports was negative, while changes in inventories mitigated the decline. Hungary's economic performance in 2020 was favorable in a European comparison. Positive developments in lending, wages and consumption were the main supporters of the economy.

Household consumption expenditures only declined to a medium degree in a European comparison. The relatively favorable performance of consumption was attributable to the fact that the labor market adjustment was smaller compared to the 2009 global economic crisis, with contributions from the sustained functioning of loan markets as well as the loan repayment moratorium.

Gross fixed capital formation fell in 2020. Both the private and government sectors contributed to the decline. The lower level of corporate profits and the uncertain global economic environment resulted in a significant decline in corporate investments. Similar to the private sector, government investments declined due to pandemic. The cautious attitude that has appeared among households and the temporary worsening in the income position resulted in more subdued investment activity.

Inflation was around the Central Bank of Hungary's ("MNB") target in 2020, as consumer prices increased by 3.3 percent on average. Inflation developments during the year were strongly influenced by changes in commodity prices as well as the pandemic, which caused substantial volatility. In contrast to the usual pattern, more robust price dynamics were observed in the summer months, which was probably attributable to repricing arising from the sudden shift in supply and demand conditions related to restarting the economy. Disinflationary effects strengthened from September. Consistent with this, the final period of the year was characterized by more muted price dynamics.

The Hungarian labor market proved to be resistant to the pandemic. Rapid adjustment was seen in the first wave of the pandemic, during which the number of part-time employees, unemployed and inactive grew almost immediately. The first wave of the pandemic was followed by quick adjustment in terms of both headcount and working hours, strongly supported by the fact that – with the lifting of the restrictions – those in inactive status were able to return to the labor market. Further waves of the pandemic and lockdowns affected fewer sectors, thus triggering a lower degree of adjustment in the labor market. On the whole, compared to the previous crisis, the labor market departed from full employment to a lesser degree. In 2020, the number of people in private sector employment declined by 0.5 percent. The unemployment rate rose to 4.1 percent in 2020.

Hungary's current account balance was −0.1 percent in 2020, while net lending of the economy was around 1.9 percent of GDP. The increase in the trade balance – seen for the first time since 2016 – was supported by accelerating exports in the second half of the year as well as lower import demand attributable to decreasing domestic absorption and an improvement in the terms of trade.

Development in the banking sector (including assets total / GDP)

Despite the adverse economic effects of the COVID-19 pandemic, the Hungarian banking sector's shock-absorbing capacity has remained strong. In 2020, growing lending and the MNB's liquidity support measures helped keep the banking system's balance sheet total on a growth path. Reflecting strong credit growth, the additional impact of the general moratorium on loan repayments and shrinking GDP, the total assets-to-GDP ratio (excluding state-owned specialized banks) increased by 10 percentage points to 96 percent at the end of 2020 relative to the end of 2019. However, the liquidity support measures and the decline in GDP should be considered temporary factors.

The stock of household loans expanded by 14 percent year on year as a result of disbursements and repayments. Following a temporary decline in Q2 due to developments related to COVID-19 (isolation measures on the demand side, tightening of credit conditions on the supply side), the volume of new loans grew strongly during the rest of the year. Although the volume of new contracts in 2020 fell short of the figure for 2019 by 4 percent, still heavily influenced by the massive drop in personal loans, the volume of new housing loan contracts was higher than a year earlier. Subsidized loans related to family protection and home creation programs continue to support retail lending, with subsidized schemes [House Purchase Subsidy scheme for families ("HPS"), rural HPS and prenatal baby support] accounting for over a third of the issued volume. The volume of prenatal baby support loans was over HUF 1,000 billion at the end of 2020, accounting for 13 percent of household credit.

To reduce the adverse effects of COVID-19 and adjust to the changed funding needs of SMEs, the MNB launched a new phase of the Funding for Growth Scheme called "FGS Go!" in April 2020, which offered a wide range of options for utilization. The annual growth rate of corporate credit amounted to 9 percent at the end of 2020. The loan repayment moratorium used by companies, the FGS Go! and the loan and guarantee schemes run by various government institutions all helped maintain credit expansion. 31 percent of the loan contracts concluded in 2020 within the FGS and herewith amounting to HUF 1,605 billion were new investment loans or leases, 55 percent were working capital loans and 14 percent were transactions related to the refinancing of earlier investment loans. More than a quarter of the volume of loans financed microenterprises, and a third were disbursed to small enterprises.

Following the trend of recent years, credit institutions' non-performing loan portfolio continued to decrease in 2020. The adverse effects of COVID-19 on the ability to repay loans have been mitigated by the moratorium on loan repayments, but credit institutions have already started to recognize impairments in preparation for a potential rise in default rates after the termination of the moratorium. The non-performing household loan portfolio dropped to HUF 250 billion by the end of 2020, with nearly 60 percent comprising loans more than 90 days past due. During the year, the share of non-performing household loans dropped by 1.1 percentage points to 3 percent, mainly owing to credit institutions' portfolio cleaning activities, but the dynamic expansion of lending also contributed to the decline in the ratio. Following an annual increase of HUF 6 billion, the volume of non-performing corporate loans amounted to HUF 327 billion in December 2020, resulting in an NPL ratio of 3.5 percent calculated in accordance with the broader NPL definition. For total outstanding loans, this ratio amounted to 3.2 percent, in contrast to 4 percent recorded at the end of 2019.

Based on individual (unconsolidated) reporting data, profit after tax of the credit institution sector amounted to HUF 207 billion in 2020, down by HUF 294 billion from the previous year. Twelve month rolling return on equity (ROE) fell by 7.2 percentage points to 4.4 percent and return on assets (ROA) by 77 basis points to 43 basis points. This decline is basically attributable to the sector's risk costs rising to HUF 271 billion (0.57% compared to total assets), mostly linked to large banks. However, for most credit institutions, this already includes the expected increase in the riskiness of outstanding loans, although further increase in risk costs of the sector is foreseen for the quarters ahead. On the revenue side, although nominal net interest income was up year on year, net interest margin edged down slightly reflecting narrowing margins. The banking system's consolidated capital adequacy ratio rose to 18.3 percent by the end of December 2020, and the same figure was 19.3 percent when calculating with total profits for 2020.

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

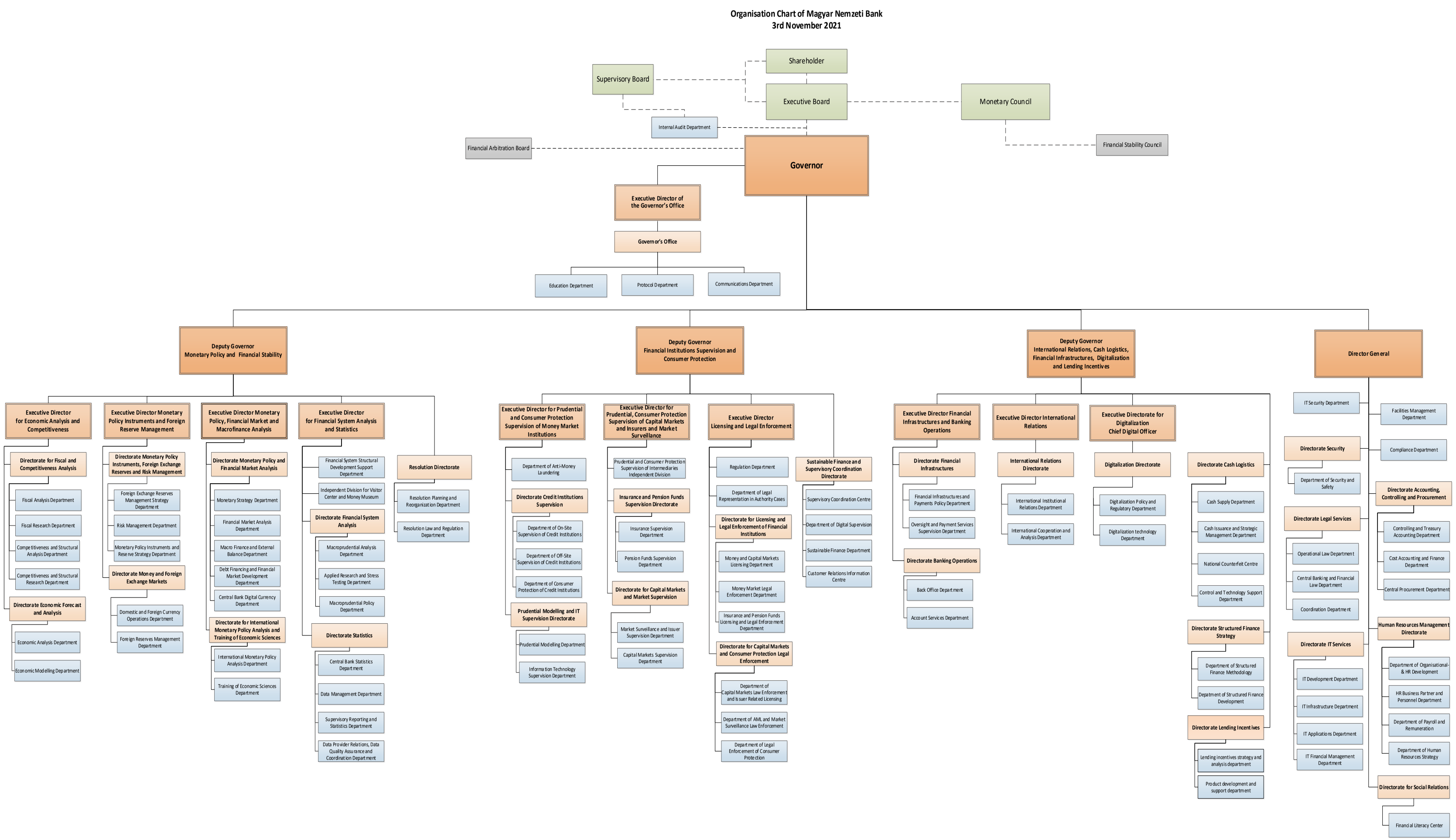
The MNB performs its supervisory and consumer protection tasks according to the Act CXXXIX of 2013 on the Magyar Nemzeti Bank.

In order to give information and guidance for the supervised institutions in connection with the supervisory interpretation of the sector-specific legislation and the expectations of MNB, the MNB issues binding MNB decrees and non-binding recommendations, documents with information purposes and CEO letters.

Regarding the legislative developments in 2020, the Act CX of 2020 on amending the laws affecting certain elements of the financial intermediation system for the purpose of legal harmonization should be mentioned. The main purpose of this Act was the implementation of EU legislation, of which the following can be highlighted:

- CRDV [Directive (EU) 2019/878 of the European Parliament and of the Council amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures],
- modified BRRD [Directive (EU) 2019/879 of the European Parliament and of the Council amending Directive 2014/59/EU as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms and Directive 98/26/EC]
- CRR2 [Regulation (EU) 2019/876 of the European Parliament and of the Council amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012];
- SFDR [Regulation (EU) 2019/2088 of the European Parliament and of the Council on sustainability-related disclosures in the financial services sector];
- IFD [Directive (EU) 2019/2034 of the European Parliament and of the Council on the prudential supervision of investment firms and amending Directives 2002/87/EC, 2009/65/EC, 2011/61/EU, 2013/36/EU, 2014/59/EU and 2014/65/EU];
- AMLD [Directive (EU) 2019/2177 of the European Parliament and of the Council amending Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), Directive 2014/65/EU on markets in financial instruments and Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money-laundering or terrorist financing].

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Supervisory Authority in 2020

The MNB's supervisory strategy for the period covering 2020–2025 was approved by the Financial Stability Board in December 2019. The strategy determines the mission of the MNB, according to which it aims at maintaining and even strengthening the stability of the financial system and at deepening the participants' confidence both in the system as a whole and individually in each other. The vision of the MNB has also been updated, and the long-term objective is to have a developing, competitive and sound financial sector, supported, shaped and efficiently overseen by the MNB. To achieve this, it is necessary to support and deepen the stability of the financial system, with special focus on consumer protection, digitalization and sustainability. The management of the MNB defined confidence and stability as priority values for the supervisory area for the aforementioned period.

Healthy competition for customers could be strengthened by expanding the range of certified consumer-friendly products under the new strategy. Consumers should be able to compare products of the same type, with the development of the MNB's consumer-friendly comparison sites and consistent supervisory expectations for market calculators. Furthermore, as part of strengthening its consumer protection activities, the MNB pays special attention to cross-border financial activities.

Financial institutions need to incorporate environmental sustainability considerations into their corporate governance and risk management systems. The MNB establishes a cooperation network with the involvement of market participants, governmental, civil, interest representation and university organizations in order to develop green financial and capital market services and promote sustainable investments.

Supervisory and regulatory systems must also be prepared for the digital future, as more and more information technology systems supporting the business process come to the attention of consumers and the MNB. Thus, the basic goal is to modernize the regulatory environment related to IT technologies, and to develop supervisory methodologies and new IT supervision methods.

The strategy contains clearly set objectives for the forthcoming years regarding the supervised markets. Moreover, the MNB has internal, organizational goals as well that it endeavors to achieve with the assistance of the instruments at its disposal. Every supervised sector and supervisory area has its own tasks to be fulfilled in order to be able to achieve the long-term objectives.

The activities of the Banking Supervisory Authority in 2020

In 2020 the directorate of MNB responsible for credit institutions supervision concluded overall 37 comprehensive, targeted, thematic, follow-up and 12 other type of inspections. As a result of the completed inspections 544.3 million HUF prudential fine was imposed on credit institutions, emphasizing that the MNB is taking a stand firmly against infringements and the institutions that had failed to comply with the former resolutions.

In the period under consideration, internal capital adequacy assessment process ("ICAAP") reviews were only carried out at banks' request[1]. As a result, the MNB had to reduce the number of complex ICAAP reviews in 2020: instead of the originally planned 16 inspections, only 8 were launched, and a total of nine ICAAP reviews were closed out of those started in 2019-2020. In the case of the institutions where no ICAAP review was performed in 2020, the MNB conducted continuous off-site supervision to monitor the risks.

[1] With the exception of the simplified ICAAP review based on banks' self-assessment.

In 2020, internal liquidity adequacy assessment procedures (ILAAP) were launched at 16 credit institutions, with 8 of these procedures closed by the end of the year. During the annual planning of inspections, institutions can be classified into three risk categories based on their riskiness and impact rating, complete with an appropriate review type (simplified, focused, comprehensive). To reduce the burden caused by the pandemic, the comprehensive category was modified to focused in several cases, and therefore the MNB audited the institutions via off-site inspections. In the inspections, only minor shortcomings were identified, which were pointed out to the institutions by the MNB during its continuous off-site supervision. Additional liquidity requirements were only set in the case of a concentration of depositors, and no further requirements in excess of this were laid down during the ILAAP reviews.

As included in the 575/2013/EU regulation, special care is required when an institution has an exposure to its own parent institution or to another subsidiary of its own parent institution, and such exposures shall be managed in a fully autonomous manner, without taking into account other considerations. In order to comply with the above principles, MNB's earlier published recommendation on the credit risk management was amended by adding a new point, which sets out MNB's expectations regarding the management, registration and control of exposures and internal loans outstanding towards enterprises under the influence of the owners of credit institutions. The recommendation is being revised in 2021.

The MNB also defined recommendations regarding the application of the default definition as included in Article 178 of the 575/2013/EU regulation and the EBA's related guidelines (EBA/GL/2016/07) and prepared a questionnaire for institutions to control their regulatory conformity.

During the pandemic in 2020, the MNB closely monitored the institutions in relation to their compliance with the legal provisions ordering and stating the detailed rules of payment moratorium and examined the related information given by financial institutions to consumers.

The MNB renewed its consumer protection recommendation that contains new expectations on the cooperation between financial institutions and heirs of clients, on electronic communication and contracting, and in connection with cross-border service provision.

During the comprehensive inspections there were multiple findings regarding the work of the supervisory board, the internal control and in general with the average quality of the control points implemented in the different processes. Regarding the credit risk the MNB has found that in multiple cases the credit risk processes were not supported properly with efficient controls, there were problems with the evaluation of collaterals, with client and transaction rating procedures and with the IFRS9 provision calculation models and methods.

The MNB also applied short-term procedures for credit institutions, in which the MNB made conclusions concerning data reporting and PTI limits.

Besides the IFRS/IFRS9 implementation remaining a key priority, the most important focus topics for 2020 regarding to the credit institutions' supervision were the adequacy of the collateral assessment processes; the compliance with the macroprudential requirements; the sector level NPL reduction; the adequacy of the lending processes and the risk monitoring of the project finance; the operational and independency issues of the internal governance; the IT strategy and Fintech preparedness; the AML and CFT issues.

During the reporting period the MNB actively participated in the risk assessment of the international banking groups as home and as host authority. In course of the college activity, under the joint decision the MNB urged requirements for the institutions, active in Hungary that ensure the risk-awareness and effective functioning of these banks from a micro-prudential aspect. As result of the intensive cooperation the recovery plans have been adopted, which ensure that an institution hit by crisis to be capable of operating and restoring the course of business without any state aid.

Table 1: Number of closed inspections, reviews and validations in money market

Type of institution	Type of inspection	Number
Credit institution (and Bank branch)	Comprehensive audit	11
	Targeted audit	11
	Thematic audit	2
	Follow-up audit	2
	ICAAP	9
	Validation	9
	ILAAP	8
	Supervisory inspection	12
Financial enterprise	Targeted audit	6
Payment service provider	Comprehensive audit	2
	Targeted audit	2

Due to the COVID-19 pandemic lockdown measures introduced from March 2020, the annual investigation plan had to be significantly rewritten and the commencement of several planned inspections had to be postponed. As a result, significant number of investigation launches culminated in the second half of the year, therefore the conclusion of these investigations took place dominantly in 2021. In addition to rewriting the annual investigation plan, during the lockdown the MNB focused on other supervisory tools in prudential supervision.

Due to the pandemic, on-site inspections were mostly conducted by remote access provided by electronic means, during supervisory activities more emphasis was given to the tools of off-site supervision, and data collection and processing via extraordinary data requests and questionnaires. The on-line communication to banks grew in importance: the MNB issued 6 circulars in 2020 to give guidance to the sector for the extraordinary environment in fields strict portfolio monitoring, to set out expectations for financial institutions regarding own resources required for retail mortgages and in regard to the Loan Register (KHR) data providing of the overdue loans before the moratorium. The MNB furthermore issued an executive circular on using macroeconomic information and the factors indicating a significant increase in credit risk under the IFRS 9 standard, and in line with the EU-wide approach the MNB has introduced restrictions on dividend payments and remuneration.

With publishing several press briefings and 4 professional articles, the supervisory territory of the MNB contributed to the efficient and proper information flow between consumers and financial institutions in connection with the payment moratorium introduced by the Government of Hungary in March, 2020.

International activities of the authority

ESRB

The MNB actively participates in the workstream of the ESRB both at managerial and expert levels through several working groups and expert groups. The leaders of national supervisory authorities and central banks meet four times per year in General Board ("GB") sessions, while members of the Advisory Technical Committee meet with the same frequency preceding the GB meetings. Regular discussion topics at these sessions include risks and vulnerabilities, the capital and liquidity position of banks, the ratio of non-performing and restructured loans, the banking sector stress tests, the cross-border effects of macro-prudential policy, macro-prudential instruments for insurance, countercyclical capital buffers, shadow banking and other key issues related to financial stability. In 2020 the ESRB General Board virtual meetings focused primarily on the consequences of the coronavirus pandemic for the EU's economy and the financial system.

FSB Regional Consultative Group for Europe

The MNB and the Ministry of Finance both are members of the FSB's regional substructure. The MNB was represented at managerial level at the virtual meetings of the FSB European Regional Consultative Group in May and in November 2020. Participants exchanged views on the challenges in addressing the evolving financial stability issues as a result of the COVID-19 pandemic, including the resilience of the banking sector in continuing to finance the real economy.

EBA

The experts of MNB actively participated in the professional work of the EBA, mainly in the framework of EBA's various working groups. There is a constant effective communication between the MNB and the EBA, as well as the Hungarian BoS Member is a substitute member of the EBA Mediation and Breach of Union Law (BUL) Panels.

Memorandum of Understanding

On 22 June 2020 the Magyar Nemzeti Bank and the Banca Națională a Moldovei signed a Memorandum of Understanding (MoU) which serves as a basis for co-operation between the two Authorities.

On 27 November 2020 the Magyar Nemzeti Bank signed the amendment of the 'MMoU (Multilateral Memorandum of Understanding) on consultation, cooperation and exchange of information between each of the EEA competent authorities and the UK Financial Conduct Authority'.

On 9 December 2020 the Magyar Nemzeti Bank and the Monetary Authority of Singapore (MAS) signed a Co-operation Agreement to strengthen cooperation in FinTech innovation between Singapore and Hungary.

Supervisory colleges

The supervisory colleges of financial groups operating in multiple countries are forums of supervisory cooperation. Under the framework of cooperation in supervisory colleges, regular and significant exchange of information takes place among national supervisory authorities.

Since European Central Bank ("ECB") is the consolidating (home) supervisor in case of parent institution of the financial group in SSM-countries, colleges are organized and led by the joint supervisory team (JST) representing ECB and national supervisory authority supervising the parent institution (former home supervisor). College members (home and host supervisors) regularly exchange information on the group concerned, assess risks of the group, parent company and subsidiaries, evaluate the appropriateness of the group's and subsidiaries' recovery plan and may request each other to carry out supervisory procedures. The framework of this cooperation is stated in Written Coordination and Cooperation Arrangements. As a result of colleges' work college members made joint decision on capital and liquidity adequacy and group recovery plan assessment. In total, the MNB participates in 9 banking colleges as host supervisor authority.

As home supervisor, MNB leads the banking supervisory college of OTP Group. In 2020, due to the exceptional circumstances caused by the pandemic, one online college meeting was organized via Webex and a regular monthly Covid report was implemented where supervisors share information about their country's pandemic measures, the status of the supervised OTP entity and their supervisory work. The college work resulted among others in the joint decision on capital and liquidity adequacy and on group recovery plan assessment. The WCCA of the supervisory college was updated during 2020, and new members (ECB as supervisor of OTP's Bulgarian subsidiary, DSK and Bank of Slovenia as supervisor of the Slovenian subsidiary, SKB) and observers (Bank of Moldova as supervisor of Mobiasbanca being active in the Republic of Moldova) also signed the updated WCCA.

Cooperation with other supervisory bodies in the country

The MNB performs supervisory and consumer protection tasks as well. The MNB monitors and supervises the activities of financial and capital market institutions, funds, insurance companies and institutions of the financial infrastructure as well, furthermore, it carries out investor protection tasks and it operates the Financial Arbitration Board[2] and the Financial Consumer Protection Center.[3]

The MNB and the Ministry of Finance ("Ministry") are the most important Hungarian organizations responsible for the establishment and maintenance of financial stability hence the MNB cooperates closely with the Ministry, first and foremost, in the area of legislation.

Furthermore, the MNB collaborates with other competent Hungarian authorities as well, such as the Ministry for Innovation and Technology in charge of General Consumer Protection Activities.

Other relevant information and developments in 2020

Supervisory measures to mitigate the impact of COVID-19:

The **MNB took several measures to support corporations, households and the banking system** in a difficult situation or potentially facing difficulties due to the coronavirus epidemic. The measures – which were **published through several executive circulars (CEO letters), press releases and Q&As** – reduced the administrative burden on banks and have allowed for the flexible application of macro- and micro-prudential rules. These measures helped to address expected temporary difficulties and maintain the lending capacity of the banking system.

Based on the above, the **MNB issued executive circulars (CEO letters)** as follows:

- In line with the ECB approach, the MNB **recommended credit institutions not to pay dividends or not to make any irrevocable commitment to pay dividends after the 2019 and 2020 financial year, or from previous years' profits, until 30 September 2021.** Furthermore, the central bank suggested that **credit institutions should refrain from share buybacks aimed at shareholders' remuneration** (share buybacks for management remuneration purposes are allowed). The banks should also consider more conservative variable remuneration pay-outs (e.g. higher ratio to be deferred, for a longer period).
- **The MNB maintained its previous decision to temporarily release the O-SII buffers from 1 July 2020**, institutions will be required to rebuild the buffers gradually in three years starting in 2022. MNB also declared in this circular that **it won't impose sanctions until 31 December 2021 if credit institutions breach their P2G requirement.** Furthermore, **the non-fulfilment of capital conservation buffer (CCB) will be temporarily tolerated** by the central bank, but banks should rebuild at least 50% of this buffer until 30 June 2022 and 100% until 1 January 2023. Moreover, meeting the level of MREL requirement postponed by 6 months (first binding interim MREL target date: 1 January 2022).
- Banks have to closely monitor their loan portfolio due to the limited visibility of NPL changes under the moratorium.

[2] a professionally independent alternative forum for resolving disputes

[3] it supplies consumers with comprehensive and easy to understand information about the products and processes in the financial sector and handles consumer claims

- **Regarding IFRS9 related measures the MNB requires banks**
  - **to have minimum impairment level** (shall not result in a lower average impairment coverage rate than that of the end of 2019),
  - **to use overlay approach** (recommended to perform expert adjustment to the models and to apply and recognise the related portfolio-level management correction),
  - **how to use definition of default** (exposures under the moratorium should not be treated automatically as default, the assessment of "unlikely to pay" condition is necessary) and **definition of forborne** (exposures under the moratorium for more than 9 months shall be treated as forborne, exception if the institution is able to prove that the obligor has no financial difficulties).

Questionnaire tables for the 2020 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	35	30	29
Branches of foreign credit institutions	9	8	8
Cooperative banks	13	0	0
Banking sector, total:	57	38	37

Total assets of banking sector (at year-end in HUF million)

Type of financial institution	2018	2019	2020
Commercial banks	32 041 608	37 066 732	45 619 416
Branches of foreign credit institutions	3 731 478	3 462 173*	3 863 518
Cooperative banks	1 278 624	-	-
Banking sector, total:	**37 051 710**	**40 528 905***	**49 482 934**
y/y change (in %)	**8.6%**	**9.4%**	**22.1%**

** Data correction due to the availability of audited data*

Ownership structure of banks on the basis of assets total*

Item	2018	2019	2020
Public sector ownership	3.3%	3.7%	4.4%
Domestic ownership total	19.6%	18.0%	21.9%
Foreign ownership	80.4%	82.0%	78.1%
Banking sector, total:	**100.0%**	**100.0%**	**100.0%**

** Ownership structure based on the ultimate majority owners*

Concentration of asset by the type of financial institutions, 2020

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	43.1%	58.0%	0.105
Branches of foreign credit institutions	75.7%	93.4%	0.295
Cooperative banks	-	-	-
Banking sector, total:	**39.7%**	**53.5%**	**0.091**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2018	2019	2020
Commercial banks	13.7%	12.6%	5.1%
Cooperative banks	-1.4%	-	-
Banking sector, total:	**13.4%**	**12.6%**	**5.1%**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2018	2019	2020
Commercial banks	86.5%	91.5%	92.2%
Branches of foreign credit institutions	10.1%	8.5%	7.8%
Cooperative banks	3.4%	-	-
Banking sector, total:	**100.0%**	**100.0%**	**100.0%**

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

	2018	2019	2020
Receivables			
Financial sector	32.2%	33.0%	35.2%
Nonfinancial sector	41.5%	42.5%	39.6%
Government sector	23.5%	21.5%	22.7%
Other assets	2.8%	3.0%	2.5%
Liabilites			
Financial sector	29.1%	29.3%	30.6%
Nonfinancial sector	51.9%	51.2%	51.6%
Government sector	3.1%	3.3%	3.5%
Other liabilities	5.2%	5.5%	5.3%
Capital	**10.7%**	**10.7%**	**9.0%**

*Capital adequacy ratio of banks****

Type of financial institution	2018	2019	2020
Commercial banks	21.3%	22.1%	22.3%
Cooperative banks	13.9%	-	-
Banking sector, total:	**21.1%**	**22.1%**	**22.3%**

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

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

Asset classification	2018	2019	2020
Non-financial sector, including*	5.5%	3.7%	2.9%
- households	7.2%	4.2%	3.1%
- corporate	4.1%	3.2%	2.8%

** Domestic loans*

The structure of deposits and loans of the banking sector in 2020 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	84.0%	87.8%
Households	40.3%	42.4%
Corporate	43.7%	45.4%
Government sector	5.8%	5.7%
Financial sector (excluding banks)	10.2%	6.5%
Total	**100.0%**	**100.0%**

P&L account of the banking sector (at year-end, in HUF million)

P&L account	2018	2019	2020
Interest income	1 120 679	1 143 603*	1 233 035
Interest expenses	353 798	404 608	384 417
Net interest income	766 881	738 995*	848 618
Net fee and commission income	541 973	569 276	600 711
Other (not specified above) operating income (net)	231 240	296 444*	216 296
Gross income	1 540 093	1 604 715*	1 665 625
Administration costs	947 534	939 833*	1 039 545
Depreciation	69 672	95 237	120 418
Provisions	43 905	-27 370*	-250 370
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	0	0	0
Profit (loss) before tax	566 792	542 275*	255 292
Net profit (loss)	519 928	499 098*	222 544

** Data correction due to the availability of audited data*

Total own funds in 2020 (in EUR)***

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	12 924 438 396	11 167 937 309	11 418 161 887	1 506 276 509	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**12 924 438 396**	**11 167 937 309**	**11 418 161 887**	**1 506 276 509**	**-**

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

Macroeconomic environment in the country

N/A

Development in the banking sector (including assets total / GDP)

In 2020 the banking sector consisted of 6 banks, including 3 branches, 2 Representative offices and 1 start-up. By 2020 the total amount of assets constituted to 398,567 thousand of USD. More data on the banking sector is displayed in the questionnaire tables below.

As of the end of 2020, the AIFC financial services framework included:

- 27 types of regulated activities:
- 8 types of market activities;
- 5 types of ancillary services.

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

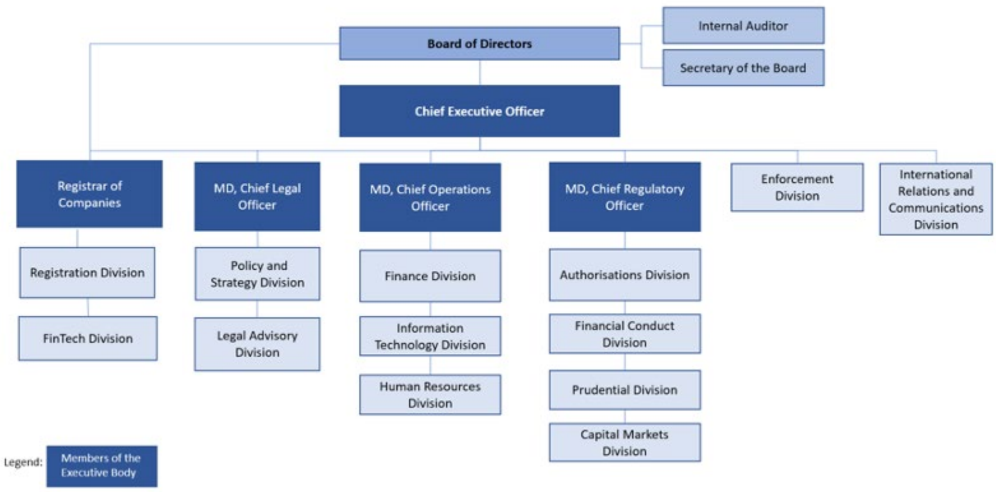
Following legal acts provide basis for the AFSA to regulate and supervise banking activities in the territory of the AIFC:

1. Constitutional Statute of the Republic of Kazakhstan "On the Astana International Financial Centre" (7 December 2015), provides the legal basis for the establishment of the AIFC;
2. AIFC Financial Services Framework Regulations (20 December 2017), enacted by the Governor in exercise of the powers conferred on the AIFC Bodies, including the Governor by the Constitutional Statute, and specifically by Article 4(3) of the Constitutional Statute;
3. AIFC General Rules (17 October 2017), complement the regulatory framework established by the Financial Services Framework Regulations;
4. AIFC Conduct of Business Rules (1 January 2018), ensures that financial services firms operating in the AIFC meet the standards of conduct with regard to the treatment of their clients and other market participants;
5. AIFC Banking Business Prudential Rules (30 July 2018), establish the prudential framework for Authorised Firms carrying out Banking Business;
6. AIFC Islamic Banking Business Prudential Rules (1 January 2018), establish the prudential framework for Authorised Firms carrying out Islamic Banking Business;
7. AIFC Banking Prudential Guideline (28 January 2019), supplement the AIFC Banking Business Rules in establishing the regulatory framework for Authorised Firms carrying out Banking Business.

In 2020, AFSA continued improving the existing regulatory framework, further tailoring the legal and regulatory environment towards providing a conducive and safe environment for financial services and professional service providers.

Enhancing the AIFC Banking Business / Islamic Banking Business Frameworks. With the objective of addressing the enhancement of prudential regulations for Islamic banks to increase the equivalency with those of conventional banks and ensure compliance with global standards (Islamic Financial Services Board (IFSB), Basel) and best international practice, AFSA amended the banking and Islamic banking framework. This included (1) the introduction of quantitative requirements for liquidity risk management, (2) enhancement of group risk management and consolidated supervision rules, (3) implementation of a Leverage Ratio, (4) implementation of Supervisory Review and Evaluation Process (SREP), and (5) Internal Capital Adequacy Assessment Process (ICAAP) and introduction of disclosure requirements. In addition, a number of changes were made to enhance the rules from both legal and Shariah terminology perspectives.

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Banking Supervisory Authority in 2020

AFSA Strategy 2019-2020 has been prepared in 2018 within the context of Kazakhstan's 100 Concrete Steps to Implement Five Institutional Reforms and is consistent with the "Strategy for the Development of the Astana International Financial Centre". The strategic goals were set in the following areas:

Regulation: the AFSA continues to develop and strengthen its legal and regulatory framework that complies with international best practices.

Prudential supervision: the AFSA establishes a risk-based supervision framework and a continual supervision cycle to monitor financial activities by AIFC Participants thereby fostering and maintaining confidence in the AIFC's financial system and regulatory regime.

Business conduct: the AFSA strives to protect customers from activities not permitted in the AIFC and from financial products that are high risk, through the strict enforcement of rules, and will resolve disputes between customers and AIFC Participants in a fair and timely manner.

National and international cooperation: the AFSA creates awareness and build strategic partnerships and memberships with local, regional and international stakeholders such as standard setting bodies, other international financial regulators, ministries and state agencies in Kazakhstan.

The activities of the Banking Supervisory Authority in 2020

The activities of AFSA in 2020 were guided by the overarching goals of its midterm strategy for 2019-2020.

1) AFSA developed and adopted the following Rules and Regulatory materials:
    - Guidance on Providing Consultancy Services
    - Notice on the Provision of Ancillary Services and Financial Services within the Same Legal Entity
    - Joint Order of the AIFC on financial services provided by participants of the AIFC, the income from which is exempt from payment of corporate income tax and value-added tax
    - AIFC Framework on harmonisation of titles used for the cryptocurrencies regulated in the AIFC and national legislation of Kazakhstan
    - Class Modifications and Waivers for Reduction of prudential requirements for Authorised Firms in the AIFC
2) AFSA enhanced the following legislative frameworks:
    - AIFC Waivers and Modifications Framework
    - AIFC Banking Business Prudential Rules
    - AIFC Islamic Banking Business Rules
    - AIFC Representative Offices Framework
3) Commitment to International Standards and International Cooperation:
    - AFSA became a signatory to IOSCO's Enhanced Multilateral Memorandum of Understanding concerning cross-border enforcement cooperation and IAIS Multilateral Memorandum of Understanding
4) Combating money laundering:
    - Completed the second off-site thematic review of AML policies
    - Developed AML/CTF supervisory framework
5) Supervision of firms:
    - supervised 17 prudentially regulated firms (including 4 banks)
6) Promotion of FinTech and Innovations in the AIFC and beyond:
    - Received and processed 63 applications and accepted 12 firms to the FinTech Lab
    - By the end of 2020, there were 34 firms in total accepted to the FinTech Lab from 12 jurisdictions offering 7 different types of innovative financial services in the areas of money services/banking, digital assets, investment business, Islamic finance, crowdfunding and factoring.

International activities of the authority

In 2020, AFSA's main priority was accession to multilateral regulatory co-operation agreements due to the following reasons: first, it demonstrates adherence to global standards; second, it increases AFSA's global regulatory co-operation coverage; third, it ensures confidence in the AIFC's financial system and regulatory regime.

Multilateral relations of AFSA have continued focusing on establishing and developing cooperation with global standard setting organizations:

- September 2020 – AFSA has become a signatory to the IAIS Multilateral Memorandum of Understanding (IAIS MMoU).
- November 2020 - AFSA has become a signatory of IOSCO Enhanced Multilateral Memorandum of Understanding concerning cross-border enforcement cooperation (IOSCO EMMoU).

The AFSA signed Bilateral Memorandum of Understanding and Agreements on banking supervision with the following peer regulators:

- Central Bank of UAE
- Cyprus Securities and Exchange Commission (General MoU)
- Cyprus Securities and Exchange Commission (AIFMD MoU)
- Agency on regulation and development of financial markets of Kazakhstan and the National Bank of Kazakhstan
- Bulgarian Financial Services Commission
- Financial Services Authority of Indonesia (OJK)

AFSA is a member of working groups and committees of global standard setting activities of international organisations and contributes to international activities and surveys of standard setting bodies throughout 2020.

Cooperation with other supervisory bodies in the country

AFSA has worked closely with the Kazakhstani authorities, the National Bank of the Republic of Kazakhstan (NBK) and the Agency for Regulation and Development of the Financial Markets of the Republic of Kazakhstan (ARDFM), to develop an appropriate supervisory co-operation framework. The three regulatory authorities formalised cooperation in a tripartite agreement aimed at strengthening co-operation on supervision of financial markets, maintenance of financial stability, and the protection of financial services consumers. The agreement provides a comprehensive framework for co-operation and exchange of information in areas such as authorisation, ongoing supervision, insolvency procedures, financial recovery, anti-money laundering, unfair practices in the financial market, and violations of the laws.

Questionnaire tables for the 2020 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks			1
Branches of foreign credit institutions		2	3
Cooperative banks			
Banking sector, total:		**2**	**4**

Total assets of banking sector (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks			10,1 million USD
Branches of foreign credit institutions		212,5 million USD	388,5 million USD
Cooperative banks			
Banking sector, total:		**212,5 million USD**	**398,6 million USD**
y/y change (in %)		**-**	**86,6%**

Ownership structure of banks on the basis of assets total

Item	2018	2019	2020
Public sector ownership			
Domestic ownership total			2,5%
Foreign ownership		100	97,5%
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2020

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	2,5%	2,5%	
Branches of foreign credit institutions	97,5%	97,5%	
Cooperative banks			
Banking sector, total:	**2,5%**	**2,5%**	

Distribution of market shares in balance sheet total (%)

Type of financial institution	2018	2019	2020
Commercial banks			2,5%
Branches of foreign credit institutions		100%	97,5%
Cooperative banks			
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2018	2019	2020
Receivables			
Financial sector			45%
Nonfinancial sector		100%	43%
Government sector			10%
Other assets			2%
Liabilites			
Financial sector		100%	38%
Nonfinancial sector			39%
Government sector			
Other liabilities			21%
Capital			**3%**

The structure of deposits and loans of the banking sector in 2020 (%)
(at year-end)

	Deposits	Loans
Non-financial sector, including:		
Households		
Corporate		100%
Government sector		
Financial sector (excluding banks)	100%	
Total	**100.0**	**100.0**

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

P&L account	2018	2019	2020
Interest income		304 000 USD	12 653 th USD
Interest expenses		181 000 USD	9 900 th USD
Net interest income		123 000 USD	2 753 th USD
Net fee and commission income		-106 000 USD	24 th USD
Other (not specified above) operating income (net)		0 USD	16 th USD
Gross income		15 000 USD	2 793 th USD
Administration costs		928 000 USD	4 620 th USD
Depreciation		67 000 USD	434 th USD
Provisions		527 000 USD	166 th USD
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)		527 000 USD	166 th USD
Profit (loss) before tax		-1 506 000 USD	-2 427 th USD
Net profit (loss)		-1 506 000 USD	-2 427 th USD

Macroeconomic environment in the country

In 2020, the Covid-19 pandemic affected the global economy: introduction of different infection containment measures as well as precautionary considerations caused significant supply and demand shocks. Latvia's GDP growth contracted by 3.6%, mainly as the result of a decrease in domestic demand. Due to various restrictions and a high uncertainty the private consumption in Latvia plunged by 9.9%.

During the decelerated economic activity and shrinking business incomes, employment was maintained by government support measures, for instance furlough benefits and wage subsidies, holding down the unemployment rate to 8.1%. Employment mostly decreased among the low-skilled workers and in sectors with below the national average salary, thus the average wage continued to grow at annual rate of 6.2%. A decline in economic activity was also reflected in consumer prices, shifting the annual consumer price inflation to only 0.1%, with the biggest drop in prices being related to energy products and accommodation.

The global epidemiological challenges also resulted in a lower global demand and therefore decline in Latvia's exports. Most notably the imposed restrictions resulted in a steep decline in exports of services, while the exports of goods remained resilient. Also, a drop of domestic demand affected imports which decreased stronger than exports, resulting in a current account surplus of 3.0% of GDP.

EU fiscal rules were relaxed during the Covid-19 pandemic which allowed Latvian government to be more flexible and increase the fiscal deficit in addressing the consequences of this crisis. To reduce the fallout, a financial support from Latvian government was provided to businesses and households, increasing the fiscal deficit to 4.5% of GDP. Moreover, in the absence of any major macroeconomic imbalances as opposed to the situation of the global financial crisis in 2009, the government support was available to mitigate the impact of covid-19. The support to various business sectors was introduced by expanding the government debt to 12.7 bil. EUR (43.5% of GDP) at the end of 2020.

Development in the banking sector (including assets total / GDP)

In the first quarter of the year, the winding-up process of several credit institutions in Latvia was completed. Implementing groups' strategic decisions on the termination of businesses in Latvia, in the first quarter of the year the activities of branches of "Danske Bank" and "Svenska Handelsbanken AB" groups were suspended in Latvia. On 18 February 2020, the European Central Bank (ECB) decided to withdraw authorisation of "AS PNB Banka", which had actually been suspended since 15 August 2019, when the ECB, as the direct supervisor of "AS PNB Banka", declared "AS PNB Banka" as failing or likely to fail, and the European Single Resolution Board decided not to take resolution actions.

The total assets of Latvian banking sector increased significantly, growing by EUR 1.9 billion or 8.4% during the year, and excluding the impact of the termination of credit institutions – by 10.9%, reaching EUR billion 24.3 EUR or 75% of GDP at the end of 2020. Relatively rapid increase in the amount of assets in the reporting year was driven by two factors – the participation of a number of credit institutions in the auctions of the European Central Bank's targeted longer-term refinancing operations (TLTRO III) with a total of almost EUR 1.2 billion and a rapid increase in deposits of domestic non-financial corporations and households.

The amount of deposits held by non-bank customers in the banking sector as a whole increased significantly during the year (by EUR 1.3 billion or 7.6%). Domestic deposits increased considerably, i.e., by EUR 1.4 billion or 10.1% (including non-financial corporations by EUR 827 million or 17.4%, households – by EUR 966 million or 12.8%). At the same time, deposits of foreign customers continued to fall (by 2.1% or EUR 73 million). The geographical structure of deposits continued to change in favour of domestic deposits, reaching a share of 81.7%, while the share of non-EEA customer deposits in total deposits continued to shrink (from 6.7% to 5.7%).

Liquidity indicators continued to improve during the reporting year. The average EU harmonised liquidity coverage ratio (LCR) increased in the reporting quarter, reaching 371%, which was 56 percentage points higher than at the end of the previous year. For individual banks, the ratio ranged from 137% to 590%, well above the minimum requirement of 100%. The improvement in the liquidity situation of the banking sector was mainly driven by the rapid increase in deposits, with banks substantially increasing their balances in the central bank.

The total amount of loans granted to non-bank customers in Latvia's banking sector diminished by 3.9% during the year, including 3.0% for domestic customers. The overall decrease in the amount of loans to non-bank customers was largely due to structural changes in the Latvian banking sector: the withdrawal of authorisation of one credit institution and termination of the activities of two branches of foreign banks.

Excluding the effects of the above-mentioned structural changes, the size of the non-bank customer loan portfolio decreased by 1.0% in the reporting year, mainly due to a reduction in the domestic loans (by 1.1%). Loans of domestic non-financial corporations declined (by 2.0%), while the domestic households' loans increased slightly (by 0.8%). In 2020, the loans of foreign customers continued to decrease, including loans to non-EU customers declined by 12% overall. At the same time, loans to EU customers even slightly climbed (3.9%).

The quality of loans to non-bank customers continued to improve, with the share of non-performing loans (NPL) shrinking to 4.7% at the end of 2020. In 2020, there were changes in the structure of the NPL, particularly in the last quarter of the year when individual banks made write-offs of long-outstanding and irrecoverable loans. The proportion of loans past due more than 90 days decreased in the NPL structure, reaching 2.3% at the end of 2020 (compared to 3.2% at the end of the previous year). In general, these processes had a positive impact on the quality of loan portfolio, and in the last quarter of the year the share of NPL decreased significantly in both domestic non-financial corporations and foreign loans, reaching 4.2% and 12.8% at the end of 2020, respectively. The quality of domestic households' loans also continued to show a sustainable positive trend throughout the year, with the share of NPL falling to 3.1% at the end of 2020, due to an improvement in the quality of the housing loan portfolio of 3.0%, while consumer loans showed a slight deterioration of 2.4%.

In the banking sector as a whole, the share of provisions to NPL shrank to 27.8% at the end of 2020, including a steeper reduction in the last quarter of the year (from 30.2% to 27.8%), when several credit institutions realised write-offs of long-outstanding and irrecoverable loans. The coverage of such loans with provisions has traditionally been significantly higher, so their write-off reduced the average ratio of provisions of the sector to the NPL ratio.

Total profit of banking sector in 2020, was 36% lower than in the corresponding period of the previous year less, reaching a total of EUR 154 million. The fall in profits was driven by both higher expenditures for provisions (EUR 21 million or 46%) and lower operating income (EUR 57 million or -7.4%). Operating income was significantly affected by a substantial decrease in profit from financial instruments and exchange rate fluctuations (-47%). Net interest and commissions income decreased by -1.7 % and -5.3%, respectively. Though with the decreasing rate of decline in operating income, the ratio of cost to income (CIR) in 2020 decreased from 61.6% to 67.8%. A more rapid deterioration in the CIR rate was hampered by a reduction in administrative costs of credit institutions of EUR 13.4 million or 3.1%. Accordingly, the rate of return on capital (ROE) decreased to 5.4%, thus significantly lagging behind the 2019 figure (9.5%) and showing that overall the impact of the COVID-19 pandemic on banks' profitability had been significant. Four credit institutions closed the year with losses and their ROE ranged from -47.4% to -3.7%.

Banks' capital ratios improved significantly in 2020, providing sufficient capital buffers to cover potential losses during the economic downturn. In line with the ECB and the Financial and Capital Market Commission (FCMC) call to refrain from paying dividends with a view to continue lending, as well as ensuring the absorption of potential losses in the future, a number of banks decided on the inclusion of retained earnings of previous years in capital, significantly improving the overall capital ratios of the banking sector. Thus in 2020, CET1 ratio of the banking sector improved from 22.1% to 24.6%, while the total capital ratio from 23.4% to 25.7%.

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

Financial and Capital Market Commission (FCMC) has been operating as an autonomous public institution since 1 July 2001, regulating and monitoring Latvian financial and capital market, ensuring protection of the interests of customers, and promoting the stability, competitiveness and development of the whole sector. The scope of the FCMC competence is set forth in the Law on the Financial and Capital Market Commission and other relevant sectoral laws[1]. The activities of the FCMC are managed by its Board – the Chairperson and two Board members[2].

In 2019, changes in the financial sector supervision framework in Latvia were initiated. In the first step the supervision framework mostly in the field of anti-money laundering and prevention of counter-terrorism and proliferation financing (AML/CTPF) supervision was strengthened by adopting several amendments to the national legislation as well as providing gradual changes in the existing governace model of the FCMC.

Further changes foresees integration of the FCMC into the Bank of Latvia. 2020 marked the path to this integration, and at the end of the year work on the law on merging the Bank of Latvia and the FCMC began (it is expected that the law will be adopted by the end 2021). The joint body is scheduled to become operational in 2023.

As regards the supervision of 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 impose restrictions on the activities of banks, to examine compliance of the activities with the legislation and the FCMC regulations, and to apply sanctions set forth by the regulatory requirement on banks and their officials in case of any violations of regulatory requirements.

Since introduction of the Single Supervisory Mechanism (SSM) in November 2014, the FCMC has been sharing banking supervision powers with the ECB. Three banks in Latvia are classified as significant credit institutions and thus subject to the ECB direct supervision, while other banks operating in Latvia are subject to direct FCMC and indirect SSM supervision. However, monitoring of AML/CTPF still remain within the FCMC competence.

Resolution and Protection Schemes Department of the FCMC operates in a capacity of a national resolution authority and forms a part of the Single Resolution Mechanism (SRM), its activities and functions are separated from the supervision functions. In addition, the Department is also responsible for administering the Latvian Deposit Guarantee Fund, the Fund for the Protection of the Insured and the Investor Protection Scheme.

The FCMC is also a designated authority for implementation of macro-prudential instruments according to the EU legislation.

[1] E.g., Credit Institution Law, Insurance and Reinsurance Law, Law on the Financial Instruments Market, Private Pension Fund Law etc.

[2] The Chairperson, upon the proposal of the Cabinet of Ministers, and the Board members, upon the proposal of the Chairperson, are approved in the office by the Saeima (national Parliament).

Legislative developments in 2020

In 2020, the FCMC continued to improve the legal framework governing the activities of the participants of the financial and capital market. The changes within the framework of regulatory requirements were mainly based on the legal acts issued by the EU institutions in order to ensure a harmonised framework in the EU single financial market.

In May 2019, in updated EU "Banking Package" was published, which includes amendments to the Capital Requirements Directive and the Capital Requirements Regulation, as well as the Bank Recovery and Resolution Directive. In order to ensure the implementation of the EU requirements, the FCMC developed amendments to Credit Institution Law, Financial Instruments Market Law and Law on the Recovery and Resolution of Credit Institutions and Investment Firms. Certain requirements of the directive will be implemented in the FCMC regulations and other regulatory enactments.

In relation to the spread of Covid-19, the FCMC, like other European supervision authorities, in a letter to banks supported the flexible application of existing regulations encouraging banks to apply sustainable and socially responsible solutions to customers, who lost income due to economic constraints and failed to make loan payments on time. In accordance with the guidelines developed by the European Banking Authority (EBA), the Finance Latvia Association established moratoriums for individuals and legal entities.

At the beginning of the Covid-19 pandemic, the FCMC also called on the institutions under its direct supervision to refrain from dividend payments and share repurchases aimed at rewarding shareholders, as well as to apply prudent and sustainable variable remuneration policy and practice. Currently, the recommendations are valid until 30 September 2021.

In the field of AML/CTPF, the FCMC, in cooperation with the financial sector, developed recommendations that serve as a practical guide for financial institutions in conducting customer research and improving internal control systems. The aim of the recommendations is a common understanding by banks, financial institutions and supervisors of the application of legislation in relation to the prevention of financial crime, as well as the introduction of a risk-based approach.

Organizational chart of the Banking Supervisory Authority

During 2020, the organisational structure of the FCMC – first time since its establishment in 2001 – was significantly changed. With the decision of the Saeima (in 2019), the FCMC governance model was changed reducing the number of members of the FCMC Board from five to three, and the new FCMC Board started its work on 30 March 2020.

The new Board took a decision for organisational restructuring of the FCMC with an aim to promote the efficiency of the FCMC's work, changing the existing decision-making process and the focus from hierarchy and strict control to the person, trust and personal responsibility, as well as reviewing and optimising processes and functions, and saving the costs. The new FCMC structure came into force in November 2020.

Main strategic objectives of the Banking Supervisory Authority in 2020

In 2019, the FCMC Board approved Operational Strategy for 2019 – 2023, setting five priority areas, which were in the FCMC focus also during 2020:

- to ensure consistent and professional supervision of the financial sector by developing an appropriate and proportionate regulatory environment of the financial sector, promoting a high level of compliance of the financial sector, and mitigating the risks, inter alia, in the AML/CTPF field, as well as by raising effectiveness of the financial sector supervisory and control measures and facilitating deeper integration in the SSM;
- to continue developing as a professional and responsible organisation with effective corporate management and processes by improving corporate culture and developing professional knowledge and skills of the staff, as well as the IT used on an everyday basis, in light of the development trends thereof and the needs of the users;
- to actively involve in the dialogue with the representatives of the financial sector, implement clear and understandable strategic communication with the public, and to continue enhancing financial literacy of the population;
- to facilitate a business environment favourable for innovative and reliable financial services and to proactively follow up the development of financial innovations, to actively be involved in the dialogue with the participants of the financial sector regarding risks caused by innovations, and to ensure the timely response and adaptation of the supervisory approach;
- to continue stronger integration in the Single Resolution Mechanism and the Single Deposit Insurance Mechanism, to improve the effectiveness of the crisis management mechanism of Latvian financial sector, and to ensure the resolution solution corresponding to the public interest.

The activities of the Banking Supervisory Authority in 2020

During the spread of Covid-19, the FCMC successfully adapted the processes to work remotely, ensuring that all monitoring activities were performed as planned. FCMC continued to work on strengthening the framework for the supervision of credit institutions, ensuring a comprehensive supervisory process, as well as promoting the operation and development of a stable and crisis-resistant sector of credit institutions.

Based on the assessment of the risks inherent to the operation of credit institutions and trends in the financial system, as well as taking into account the priorities set by the ECB and the EBA, in the beginning of 2020, the FCMC identified the following credit institution supervision priorities:

- Monitoring the implementation of strategy and business model change and valuation of profitability with a focus on balancing sustainability and profitability;
- Strengthening compliance and risk management functions with a focus on the effective operation of the bank's internal control system and reputation risks;
- Credit risk and capital adequacy with an emphasis on problematic loans and bank measures to reduce them.

Prudential supervision

Covid-19 pandemic and related restrictions did not have a significant impact on the Latvian financial sector, as Latvian banks were well prepared for the Covid-19 crisis with sufficient capital reserves. FCMC has ensured an individual and flexible approach to the supervision of financial and capital market participants in order to facilitate the ability of banks to continue to play their role in financing the real economy and to minimise the negative effects of the consequences of Covid-19.

During the reporting year, the FCMC carried out six on-site inspections in banks, paying particular attention to the lending process, including work with problematic assets and industries affected by Covid-19, as well as risk management functions – management of credit risk, strategy, and business risk. The deficiencies and irregularities identified during inspections were discussed with the bank management and action plans were coordinated to implement the necessary improvements. Follow-up monitoring was carried out within the scope of off-site supervision by controlling the course of implementation of the action plan in the field of the prevention of deficiencies.

AML/CTPF supervision

In the field of AML/CTPF supervision, the decision of the Financial Action Task Force (FATF) not to include Latvia on the so-called "grey list" was the most important event in 2020, as well as the follow-up report of the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (Moneyval), which welcomes the improvement of Latvian legislation and compliance with the requirements of international law (40 FATF recommendations), thus confirming the effectiveness and irreversibility of reforms carried out by Latvia in the field of AML/CTPF.

In 2020, the FCMC paid special attention to strengthening the risk-based approach, both in applying the requirements of regulatory enactments to financial institutions and in planning and performing supervisory activities by the FCMC as the supervisory authority. The dialogue between the FCMC and market participants was significantly strengthened, both by organising training seminars and discussions, and by providing explanations and developing a manual for the application of AML/CTPF requirements in cooperation with the Finance Latvia Association.

During the reporting year, the FCMC conducted 13 inspections in banks in the field of AML/CTPF and concluded that, in general, banks have taken significant measures to improve their internal control systems. In previous years, most of the inspections ended with the initiation of administrative cases and the imposition of fines, while in 2020 the FCMC only had to decide on the initiation of administrative proceedings or the application of sanctions in certain cases. FCMC imposed a fine of 1.7 million euros on 3 banks for violations in the field of AML/CTPF, as well as determined legal obligations aimed at eliminating the identified deficiencies and improving the internal control systems.

International activities of the authority

Year 2020, also in the field of international cooperation was a year under the influence of Covid-19. International co-operation became highly digital, with no possibilities for expansion of direct contact networking, which had previously been an integral part of international co-operation.

As in previous years, at the international scale, the activities of the FCMC focused on the cooperation and exchange of information with supervisory and resolution authorities of other countries and participation in the SSM and SRM as well as cooperation with the European authorities – ECB, European Supervisory Authorities (EBA, ESMA, EIOPA), and Single Resolution Board. FCMC continued to maintain close contacts with national supervisory and resolution authorities from other countries. An essential part of the banking supervision constitutes the cooperation with home supervisor authorities, also participating in the work of the supervisory and resolution colleges for cross-border banking groups.

During the reporting year, the FCMC continued its co-operation, exchange of information and representation of Latvia's interests in the Nordic-Baltic cooperation forums, the European Forum of Deposit Insurers, Moneyval, BSCEE and the International Organization of Securities Commissions (IOSCO).

The FCMC also provided support to ministries and other state institutions, contributing to the representation of Latvia's interests and the preparation of opinions on issues relevant to the financial market in the work of the EU Council working parties, European Commission's Expert Groups and the Organisation for Economic Co-operation and Development (OECD), as well as preparing information for various EU, OECD, International Monetary Fund (IMF) reports and reviews on Latvia.

Cooperation with other supervisory bodies in the country

The FCMC is a unified financial sector supervisory authority in the Republic of Latvia. Nevertheless, the FCMC works in a close cooperation with different national public authorities and institutions, i.e. the Bank of Latvia (macroeconomic, macro-prudential and financial stability issues), the Ministry of Finance (preparation of national legislation and collaboration in development of financial policy issues), the Financial Intelligence Unit (FIU) of Latvia (AML/CTPF issues), Ministry of Justice, Consumer Rights Protection Centre and other government bodies.

The FCMC cooperates and consults also with all the relevant sector associations, especially within the processes of preparation of regulation, recommendations and guidelines.

Other relevant information and developments in 2020

More detailed information about the developments in the banking sector and banking supervision in Latvia is available on the FCMC website: https://www.fktk.lv/.

Questionnaire tables for the 2020 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	15	14	13
Branches of foreign credit institutions	5	5	3
Cooperative banks	0	0	0
Banking sector, total:	**20**	**19**	**16**

Total assets of banking sector (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	21 651 497	17 652 267	20 270 764
Branches of foreign credit institutions	917 441	4 853 172	4 024 983
Cooperative banks	0	0	0
Banking sector, total:	**22 568 937**	**22 505 439**	**24 295 747**
y/y change (in %)	**-20.7**	**-0.3**	**8.0**

Ownership structure of banks on the basis of assets total

Item	2018	2019	2020
Public sector ownership	0	0	0
Domestic ownership total	8.2	14.7	13.4
Foreign ownership	91.8	85.3	86.6
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2020

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	81.4	92.2	0.246
Branches of foreign credit institutions	100.0	100.0	0.009
Cooperative banks	-	-	-
Banking sector, total:	**67.9**	**88.5**	**0.192**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2018	2019	2020
Commercial banks	9.7	3.1	5.3
Cooperative banks	-	-	-
Banking sector, total:	**9.7**	**3.1**	**5.3**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2018	2019	2020
Commercial banks	96.1	78.6	83.4
Branches of foreign credit institutions	3.9	21.4	16.6
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2018	2019	2020
Receivables			
Financial sector	30.0	31.9	38.5
Nonfinancial sector	59.9	58.7	56.0
Government sector	5.7	6.0	9.6
Other assets	4.4	3.4	3.4
Liabilites			
Financial sector	13.3	9.5	11.7
Nonfinancial sector	67.9	69.7	71.0
Government sector	4.0	4.0	1.8
Other liabilities	2.1	7.5	5.5
Capital	**12.7**	**9.4**	**10.0**

Capital adequacy ratio of banks

Type of financial institution	2018***	2019***	2020***
Commercial banks	22.31	21.04	26.8
Cooperative banks	-	-	-
Banking sector, total:	**22.31**	**21.04**	**26.8**

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

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

Asset classification	2018	2019	2020
Non-financial sector, including	7.4	7.1	4.9
- households	5.2	4.9	3.7
- corporate	9.1	8.9	5.9

The structure of deposits and loans of the banking sector in 2020 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	91.7	94.9
Households	55.7	43.6
Corporate	36.0	51.3
Government sector	2.3	1.3
Financial sector (excluding banks)	6.0	3.8
Total	**100.0**	**100.0**

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

P&L account	2018	2019	2020
Interest income	554 305	543 609	505 744
Interest expenses	102 532	103 716	81 062
Net interest income	451 773	439 893	424 683
Net fee and commission income	282 142	228 787	207 897
Other (not specified above) operating income (net)	99 266	117 618	48 052
Gross income	833 181	786 298	680 631
Administration costs	464 712	471 833	423 421
Depreciation	34 621	38 472	34 410
Impairment and Provisions	41 973	185 154	67 932
Profit (loss) before tax	291 874	90 839	154 869
Net profit (loss)	283 983	83 935	150 375

Total own funds in 2020 (in EUR)***

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	2 315 443	2 219 056	2 219 456	95 987	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	2 315 443	2 219 056	2 219 456	95 987	-

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

Macroeconomic environment in the country

Lithuania's GDP shrank by 0.8% on a year-on-year basis, which was one of the best indicators in the EU. Deeper economic downturn was contained by general government support schemes intended to stimulate economic recovery, a relatively small first wave of the COVID-19 pandemic, successful performance of the country's exporters and small dependence of the economy on the most restricted and affected activities, such as accommodation and catering, arts, entertainment and recreation.

The operating surplus and mixed income showed a rather modest decline in the period under review, whereas household disposable income followed an upward path, which was mainly due to the economic recovery and stimulus measures taken by the general government.

Robust corporate performance was well underpinned by successful expansion in foreign markets, optimised stock of inventories and cuts in investment. In 2020, Lithuanian exporters managed to grow their export market shares in key export partners twice as fast as was observed in 2009-2019. This was mainly due to Lithuania's specialisation in the production of goods and the provision of services that were less affected by the COVID-19 pandemic or even saw their demand increase during the pandemic period. A significant part of goods and services sold came from existing inventories, which led to an improvement in corporate performance in the short term. A similar effect on corporate performance was produced by lower investment, which, as estimated by the Bank of Lithuania, had decreased for the first time over the last decade.

Even though household disposable income increased at quite a rapid pace, consumption was subdued. The Bank of Lithuania estimates showed that real disposable household income continued to increase at a rapid pace in 2020, whereas consumption shrank by 1.5%. These trends were driven by both lower household propensity to consume due to higher precautionary saving, as well as the constraints on the supply of certain goods and services.

Development in the banking sector (including assets total / GDP)

In 2020, Lithuania's banking sector remained stable despite the worldwide outbreak of the coronavirus pandemic and the ensuing lockdown restrictions. Over the year, banks managed to ensure business continuity and provision of critical services to the country's economy without greater complications. In addition, banks reached an agreement (moratorium) relevant to bank clients, thereby making a commitment to allow all eligible debtors to apply for the deferral of their loan payments without changing the terms and interest rates established in their contract. As a result of this and other state aid measures for business, the deterioration of the quality of bank loans was relatively small. In the period under review, a record surge in deposits with banks was observed, while credit levels rose only in the portfolio of housing loans. Due to the pandemic and respective containment measures, in 2020, compared to 2019, bank profits sank by approximately 20%: bank's income plummeted, while expenditure increased as a result of the poorer quality of loans. All banks complied with the established minimum capital adequacy and liquidity coverage requirements over the period under review.

As of 1 January 2021, 11 banks held a banking or a specialised bank licence in Lithuania, while 6 banks operated as foreign bank branches.

In 2020, a specialised bank licence was issued to 1 bank and at the beginning of 2021, one more specialised bank licence was issued, which was already the seventh specialised bank licence issued in Lithuania.

In 2020, 2 foreign bank branches terminated their activities.

Despite the rise in the number of market participants in the recent three years, the banking sector remains concentrated: although the new market participants are growing, for now they are still unable to create stronger competition for market old-timers. The 2 largest banks hold 64.2% of the market. Foreign bank branches account for 25.9% of the market.

The previous year was exceptional for the dynamics of bank assets and liabilities: deposits grew significantly, whereas banks directed these new funds to accounts with the Bank of Lithuania or credit institutions instead of lending.

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 main legislative amendments made in 2020 were related to the protection of borrowers facing financial difficulties. The Seimas of the Republic of Lithuania adopted the amendments to the Republic of Lithuania Law on Consumer Credit and the Republic of Lithuania Law on Real Estate Related Credit (LRERC). The Law on Consumer Credit provides for a possibility of postponement of credit payments (excluding interest) for up to 3 months by applying to the credit provider, if the consumer credit borrower faces financial difficulties in complying with the creditworthiness assessment and responsible lending requirements established by legal acts. The consumer's right to the postponement of payments may be realised in the event of the death of a spouse, termination of marriage or loss of earning capacity, as well as in the event of job loss by consumer credit borrower or their spouse or the loss of no less than one third of their income. LRERC amendments also provide for the possibility of postponement of credit payments (excluding interest), if the borrower or their spouse loses no less than one third of income. The right to postponement of payments in other cases (death of a spouse, termination of marriage or loss of earning capacity as well as job loss by consumer or their spouse) has been already envisaged in the previous version of this law.

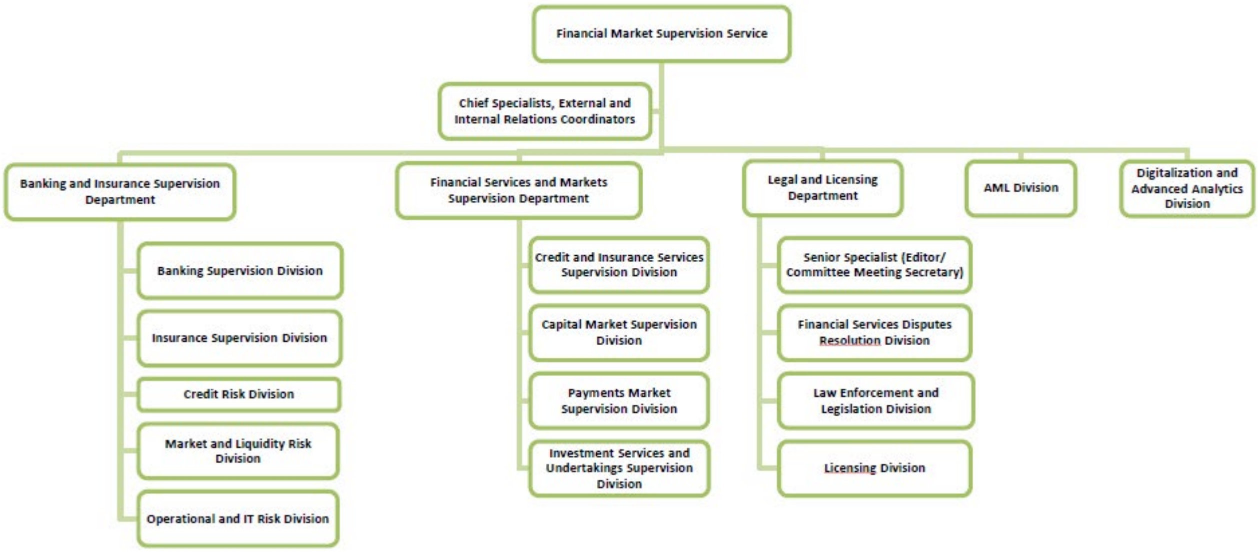
The Board of the Bank of Lithuania adopted the Regulations of the Procedure for the Transfer of the Rights and Obligations of Credit Providers According to Effective Credit Agreements. They are targeted at consumer credit providers, real estate related credit providers and peer-to-peer lending platform operators that grant credits in accordance with the Republic of Lithuania Law on Consumer Credit and the LRERC, when they themselves make a decision to transfer their rights and obligations according to effective consumer credit and real estate related credit agreements to a new creditor as well as when such credit providers are removed from the Public List of Credit Providers under the decision of the Bank of Lithuania.

The Consumer Credit Provision Guidelines adopted by the Bank of Lithuania were updated in a new wording. This update was made to take into consideration the amendments to the Law on Consumer Credit, practices of Lithuanian and international courts and issues raised by the financial market participants.

In order to ensure that money laundering and terrorist financing (MLTF) risk management measures applied by banks and credit unions are not only proportionate to risks, but also comply with the right and/or obligation of electronic money institutions and payment institutions to have bank accounts and use them, which is envisaged by legal acts, on 25 May 2020, the Financial Market Supervision Service of the Bank of Lithuania published its position on the right of electronic money institutions and payment institutions to use bank accounts opened with credit institutions.

In 2020, banks and other payment service providers were presented with the draft Guidelines for the Provision of Payment Services. After considering the proposals and notes received, these guidelines were adopted on 15 February 2021. The Guidelines provide explanations, best practice examples and other recommendations regarding the practical implementation of the conditions for the provision of payment services envisaged by the Republic of Lithuania Law on Payments, communication with payment service users as well as recommendations on other relevant issues related to the provision and use of such services.

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Banking Supervisory Authority in 2020

The Bank of Lithuania in its 2017-2020 strategic plan dedicated the following strategic objective and tasks for the financial market supervision authority:

- Develop an innovative, attractive and competitive regulatory and supervisory environment for the financial sector:
  - Improve regulatory and supervisory environment, remove barriers to entry and barriers to operate;
  - Develop strong and trust-based relationships with supervised financial market participants.
- Lithuania – a financial technology centre in the Nordic-Baltic region:
  - Concentrate on research and application of innovations in the financial sector at the Bank of Lithuania;
  - Implement sandbox regime in Lithuania.
- Increase the level of maturity of business processes.
- Improve cyber security of financial market participants.

The activities of the Banking Supervisory Authority in 2020

The Bank of Lithuania publishes on an annual basis the schedule and scope of its routine inspections, visits, and investigations to be carried out in areas with most potential risk, thus allowing financial market participants to make necessary preparations.

The Bank of Lithuania annually announces the intended legislative changes so that market participants could prepare for public consultations in advance. The legislative changes planned in 2020 aimed at increasing the resilience and stability of the financial system, concurrently establishing proportionate requirements with respect to the complexity of financial participants' activities and risk profile, without affecting market growth and innovation development.

For the purposes of fostering an open and attractive space for financial activities, the Bank of Lithuania holds annual meetings with the supervised financial market participants to discuss annual results and present plans for the next year, including intended regulatory changes. In cooperation with associations of financial market participants, the Bank of Lithuania had inquired about the need for such consultations, and the most relevant topics still included money laundering risk management, compliance with the legislative requirements for banks, insurance and payment companies, as well as issues related to the requirements applicable to electronic money and payment institutions. In light of the information received, in 2020, the Bank of Lithuania started regular anti-money laundering (AML) meetings for compliance specialists to discuss new developments in legislation, the national risk evaluation, and market analyses for individual sectors. Given the rapid expansion of the sector of electronic money and payment institutions the Bank of Lithuania organised a cycle of four events to overview relevant trends in the sector so as to ensure that new market entrants are well informed about the requirements applicable to their activities and expectations of the supervisory authority. The Bank of Lithuania also shared advice on proper preparation for operation upon obtaining a license, presented the principal supervisory requirements applicable to electronic money and payment institutions, as well as regulatory changes with regard to the delegation of operational functions to third parties.

Particular attention was devoted to AML measures.

The Bank of Lithuania cooperates with the private sector by using their proposed innovative data processing solutions that help to strengthen supervisory actions, enhance the quality of the supervisory data obtained from market participants, and identify areas exposed to highest risk more rapidly. In 2020, the Bank of Lithuania implemented the money laundering and terrorist financing risk evaluation model and will improve it further in 2021. In view of the risks arising in the financial sector, the Bank of Lithuania exchanged data on the number of non-resident accounts in the country with other state authorities and foreign Supervisory authorities (in particular the Baltic and Scandinavian supervisory authorities) as well as the State Tax Inspectorate. It also cooperated with the Financial Crime Investigation Service to plan and align supervisory actions as well as exchange supervisory information, and with the Gaming Control Authority to identify risks pertaining to the sector of game providers.

Seeking to bolster cooperation between the public and private sectors, the Bank of Lithuania contributed to the establishment of the Centre of Excellence in Anti-Money Laundering. In the fourth quarter of 2020, Lithuania's government gave the green light to the establishment of the Centre of Excellence in Anti-Money Laundering, which will bring together the efforts of the public and private sectors in the fight against money laundering and terrorist financing, thus strengthening the overall prevention system.

International activities of the authority

On 1 October 2020, a consortium of Lithuanian and Polish national central banks launched the implementation of the EU Twinning project "Strengthening the institutional and regulatory capacity of the National Bank of Ukraine to implement the EU–Ukraine Association Agreement". The project aims to support the central bank of Ukraine in the performance of certain banking supervision functions, develop payment systems, and strengthen strategic planning and cooperation with international institutions.

Launched in 2019, the EU-funded "Programme for Strengthening the Central Bank Capacities in the Western Balkans with a view to the integration to the European System of Central Banks" continued into the year 2020. The Bank of Lithuania participates in the project jointly with other EU national central banks.

On 1 October 2020, the Bank of Lithuania, together with ACAMS Baltics Chapter, Fintech Hub LT, and the Association of Lithuanian Banks, organised a virtual international conference "Anti-Money Laundering and Counter Terrorist Financing: from Challenges to Possibilities". Supervisors, financial intelligence units as well as representatives of various financial market associations talked about the AML/CTF measures they have been taking, the challenges they are facing and the future possibilities to strengthen the AML/CTF system. Smart regulation solutions were also presented during the conference as they would allow the transition to real-time monitoring for supervision purposes and would help to save resources for both market participants and supervisory authorities.

Other relevant information and developments in 2020

The Lithuanian financial market has recently undergone significant changes: rapid technological progress prompts increasingly more financial services to move to the digital environment, thus inciting respective changes in consumer expectations and habits. The Bank of Lithuania, together with other institutions, has been actively promoting pro-competitive financial innovations, as a result of which a number of new market participants entered the country's financial market. As a general rule, they operate exclusively in cyberspace not only in Lithuania, but across the entire EU. This alters the profile of financial market risks. Cybersecurity and money laundering risks have acquired greater significance, making it necessary to adapt and change certain supervisory priorities. Both the market and the supervisory authority will see greater need for digitalisation in the future, therefore, in response to new challenges, more consideration should be given to advanced analysis and supervision methods.

With a view to making Lithuania the fintech hub in the Nordic-Baltic region, the Bank of Lithuania created a fintech conducive environment that attracts new market players and encourages product development in the country. The Bank of Lithuania launched a one-stop shop, allowing foreign citizens to submit documents necessary for obtaining authorisation in English, published a Licensing Guide in both Lithuanian and English, provided practical advice on how to prepare for authorisation, and prepared a "roadmap" presenting the key stages of the licensing process. The Bank of Lithuania's website has a section dubbed the Newcomer Programme, which presents key information for new market entrants in a concise and clear manner.

The Bank of Lithuania was acknowledged as the most progressive supervisory authority in the country after the study carried out by the Ministry of the Economy and Innovation in 2020. The study assessed the progress of 47 business supervisors according to 9 criteria and the Bank of Lithuania took a lead between institution whose main activity is business supervision, showed a Business Supervision Scoreboard.

Questionnaire tables for the 2020 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	6	10	11
Branches of foreign credit institutions	7	8	6
Cooperative banks	67	65	62
Banking sector, total:	**80**	**83**	**78**

Total assets of banking sector, in mEUR (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	27 034,9	21 978,2	27 968,3
Branches of foreign credit institutions	1 585,3	8 707,4	9 777,0
Cooperative banks	741,1	791,3	964,9
Banking sector, total:	**29 361,4**	**31 477**	**38 710,3**
y/y change (in %)	**4,8**	**7,2**	**23,0**

Ownership structure of banks on the basis of assets total

Item	2018	2019	2020
Public sector ownership	-	-	-
Domestic ownership total	11,7	10,0	9,8
Foreign ownership	88,3	90,0	90,2
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2020

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	97,4	99,1	3966,3
Branches of foreign credit institutions	93,7	98,5	6674,0
Cooperative banks	16	24,8	283,7
Banking sector, total:	**83,1**	**92,5**	**2496,7**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2018	2019	2020
Commercial banks	12,8	10,8	10,5
Cooperative banks	4,99	6,27	8,91
Banking sector, total:	**-**	**-**	**-**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2018	2019	2020
Commercial banks	92,1	69,8	72,3
Branches of foreign credit institutions	5,4	27,7	25,3
Cooperative banks	2,5	2,5	2,5
Banking sector, total:	**100.0**	**100.0**	**100.0**

Capital adequacy ratio of banks

Type of financial institution	2018	2019	2020
Commercial banks	18,58***	19,49***	23,98***
Cooperative banks	13,97**	14,5**	16,43**
Banking sector, total:	**18,46**	**19,45**	**23,73**

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

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

Asset classification	2018	2019	2020
Non-financial sector, including	2,37	1,63	1,27
- households	3,03	2,14	1,86
- corporate	4,33	3,11	3,75

The structure of deposits and loans of the banking sector in 2020 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	86,2	95,6
Households	56,4	55,7
Corporate	29,8	39,9
Government sector	11,4	1,8
Financial sector (excluding banks)	2,5	2,7
Total	**100.0**	**100.0**

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

P&L account	2018	2019	2020
Interest income	505,9	558,8	579,7
Interest expenses	66,2	80,2	82,1
Net interest income	439,7	478,6	301,5
Net fee and commission income	218,1	232,2	72,7
Other (not specified above) operating income (net)	64,5	74,8	90,1
Gross income	730,6	796,3	825,5
Administration costs	313,3	348,5	366,8
Depreciation	19,5	30,5	37,1
Provisions	-0,3	-4,2	2,5
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	5,2	21,9	54,6
Profit (loss) before tax	385,0	386,7	272,7
Net profit (loss)	334,5	324,7	272,7

Total own funds in 2020 (in mEUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks***	2233,1	-	2200,2	33,0	-
Cooperative banks**	72,7	-	61,5	11,2	-
Banking sector, total:	**2305,8**	**-**	**2261,7**	**44,2**	**-**

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

Macroeconomic environment in the country

Economic activity

In 2020, GDP contracted by 7.0%, largely in the context of internal restrictions related to COVID-19, the regional economic climate affected by the pandemic, but also adverse conditions for the agricultural sector. In structure, this dynamic was mainly determined by the negative impact of domestic consumption and exports. In this sense, the consumption of households was 7.0% lower than in the previous year, mainly due to the moderation of disposable income of the population, but also, to some extent, the uncertainty associated with the COVID-19 pandemic, which would have caused some expenses to be postponed. Exports, in the conditions of a modest external demand, of some restrictions related to COVID-19 in the region, but also of a smaller harvest, outlined a negative dynamics, registering a decrease of 15.5% compared to 2019. A negative impact, but of a smaller magnitude on the economic activity was generated by the investment dynamics, fact that can be associated with the restrictions and uncertainty related to the pandemic, but also to the contracting of incomes. Final consumption of the administration in the reporting year recorded a minor decrease compared to the previous year. The reduction in domestic demand led to a negative dynamics of imports, which were 8.9% lower than in the same period of the previous year, which, however, mitigated the negative impact generated by the subcomponents mentioned above. Within the sectors of the national economy, the most pronounced negative impact was exerted by the dynamics of the agricultural sector. This, in the context of unfavorable agro-meteorological conditions for some agricultural crops at the end of 2019 and during 2020, registered a decrease of 26.4% compared to the previous year. At the same time, a significant negative contribution was determined by the decrease of 9.6% of the gross value added in "Trade, transport and storage", sectors severely affected by the restrictions related to COVID-19. Negative developments were also recorded in the industry, in the real estate transactions and in the communications sectors. At the same time, a positive dynamic in 2020 was attested in the financial and construction sectors.

Inflation

In 2020, the average annual rate of CPI inflation was 3.8%, 1.0 percentage points lower than in 2019. During 2020, the annual rate of inflation recorded a sharp downward trajectory, decreasing from 7.5% in December 2019 to 0.4% in December 2020. The downward trajectory of the annual inflation rate was supported, according to estimates, by an aggregate disinflationary demand determined mainly by the impact of local restrictions and regional measures imposed by the authorities on economic activities to stop the spread of COVID-19. At the same time, the downward trend in the annual inflation rate has been driven by declining prices for energy resources internationally and regionally, similarly in the context of the global pandemic impact, which has led to lower fuel prices in the domestic market, but also preconditions for the downward adjustment of tariffs for services included in regulated prices in the second half of 2020. At the same time, the impact of the above-mentioned factors has been partially mitigated by the tariff increase for intercity transport from early 2020 and adverse weather conditions that led to a modest harvest for certain crops and inflationary pressures on food prices in the summer months. Subsequently, towards the end of 2020, the atypical warm weather which delayed and reduced the intensity of the positive seasonal effect characteristic of that period, as well as the decrease in import prices led to a decrease in the contribution of food prices to the dynamics of the annual CPI rate.

In 2020, the domestic FX market was strongly affected at the onset of the COVID-19 pandemic. In the first half of the year, especially in March-April, disruptions caused to economic activity, international trade and financial flows triggered depreciation pressures on the exchange rate and accordingly, central bank FX interventions to prevent excessive fluctuations. In the second half of the year, the exchange rate followed an appreciation pattern with the gradual lifting of restrictions, resumption of economic activity and relative recovery of remittances, which is an important inflow for the Moldovan economy. Under these circumstances, in 2020, the Moldovan Leu has strengthened, on average, by 1.5% against the USD and by 4.8%, in real terms, against main trading partners' currencies, while it has slightly depreciated against the EUR, by 0.4%.

The international reserves, already at robust levels according to commonly known reserve adequacy metrics, have increased by around 24%, up to USD 3.8 billion.

External sector

According to preliminary data, in 2020, the **current account** balance of the Republic of Moldova recorded a deficit of US$ 795,73 million, 28,9% lower as against 2019. The CAB to GDP ratio was -6,7% (-9,3% in 2019). This dynamic was driven by the considerable decrease in the foreign trade in goods deficit, substantial increase in secondary income surplus, and by the slight increase in services surplus, while the primary income balance deteriorated.

The trade deficit in goods and services totalled US$ 2 687,44 million, decreasing by 9,2% as compared to 2019. The exports of goods and services amounted to US$ 3 239,21 million, decreasing by 11,5%. This decrease was conditioned by the significant reduction in physical volumes of exported goods, while their prices increased. The imports of goods and services amounted to US$ 5 926,65 million, 10,5% lower as against 2019. The decrease in imports was driven by the reduction in households' final consumption, as a result of lower income of some categories of households caused by layoffs, the reduction in working hours, and technical unemployment, as well as of savings fuelled both by precaution and by the limitation of consumption opportunities in the pandemic situation. Both physical volumes of imported goods and their prices decreased in 2020.

The primary income surplus decreased by 23,9% in 2020 as against 2019 and amounted to US$ 472,74 million. This dynamics was driven by a considerable decrease in primary income inflows (-16,3%). Thus, the compensation of resident employees by nonresident employers went down by 14,6%. At the same time, primary income outflows also decreased (-4,5% compared to 2019), especially reinvested earnings by non-resident direct investors (-40,7%).

The secondary income surplus increased by 16,2%, up to US$ 1 418,97 million compared to 2019. Personal transfers from abroad received by Moldovan residents increased by 11,3%. The total amount of technical assistance, humanitarian aid and grants received by all sectors within international cooperation decreased by 10,0%.

Personal remittances (the sum of net compensation of employees, of personal transfers and of capital transfers between households) received by Moldovan residents in 2020 were estimated at US$ 1 810,42 million (-0,4% as against 2019), which represents 15,2% as a ratio to GDP (the same as in 2019).

The **capital account** recorded a negative balance amounting to US$ 61,10 million, up by 22,5% as compared to 2019. This balance stemmed from capital outflows recorded by the private sector (US$ 72,57 million), while the inflows of external assistance received by the general government for the financing of investment projects totalled US$ 11,50 million.

The **financial account** recorded a net capital inflow of US$ 942,62 million, resulting from the net increase in residents' liabilities to nonresidents by US$ 714,95 million in actual transactions, along with the net decrease in residents' foreign financial assets by US$ 227,67 million.

Liabilities grew, in particular, as a result of net drawings of US$ 505,30 million on external loans. In 2020, the general government made drawings on new loans amounting to US$ 551,59 million from the following creditors: IMF – US$ 246,70 million, EIB – US$ 89,91 million, the European Commission – US$ 82,22 million, IDA – US$ 57,42 million, EBRD – US$ 47,37 million, CEB – US$ 14,80 million, IFAD – US$ 6,78 million, IBRD – US$ 6,37 million. The repayments made by the general government in the same year amounted to US$ 139,24 million. The NBM received US$ 8,03 million from the IMF and repaid US$ 53,20 million on previously contracted loans. Commercial banks made net repayments on external loans amounting to US$ 0,12 million, and other sectors – net drawings amounting to US$ 138,24 million.

The net liabilities in the form of trade credits and advances from nonresident trading partners also increased by US$ 149,10 million.

Liabilities in the form of direct investment increased by US$ 62,45 million during 2020. This dynamics was driven by the net increase in equity belonging to nonresidents by US$ 61,89 million as a result of actual transactions, as well as by the reinvestment of earnings amounting to US$ 30,25 million. At the same time, affiliated enterprises made net repayments amounting to US$ 29,69 million on loans previously received from foreign direct investors. The stock of liabilities in the form of direct investment recorded a slight growth (+2,5%) and totalled US$ 4 851,39 million as of the end of 2020.

The net decrease in external financial assets was driven by the net reduction in currency and deposits assets by US$ 864,90 million (of which the assets of commercial banks decreased by US$ 59,12 million and the assets of other sectors – by US$ 805,78 million).

Nonresident trading partners made net repayments amounting to US$ 34,30 million on trade credits and advances previously received from residents, contributing in this way to the decrease in total financial assets. Residents' foreign assets in the form of direct investment also decreased by US$ 3,93 million.

At the same time, the NBM's official reserve assets increased by US$ 637,41 million, as well as residents' net assets in the form of loans extended to nonresidents - by US$ 36,60 million.

The gross external debt of the Republic of Moldova grew by 12,7% and amounted to US$ 8 357,73 million as of 12/31/2020, which is 70,1% as a ratio to GDP.

Development in the banking sector (including assets total / GDP)

The share of banking sector assets in GDP increased during 2020 by 7.2 pp, reaching the level of 50.3 percent as of December 2020. The upward dynamics is due to both the sharp growth rate of banking assets by 14.4% as well as GDP reduction. The assets of large banks accounted for just over ¾ of total banking assets registered at the end of 2020.

Total own funds amounted to 13,626.0 million lei and during the year 2020 it recorded an increase of 19.9 % (2,257.9 million lei). The increase in own funds was mainly due to the reflection by banks of the eligible profit. The total own funds ratio in the banking sector according to the data presented by the licensed banks recorded the value of 27.3 %, decreasing by 2.5 pp. compared to the end of the previous year.

Assets amounted to 103,773.6 million lei, increasing compared to the end of the previous year by 13,095.4 million lei (14.4%).

At 31.12.2020, the gross loan portfolio constituted 44.0% of the total assets or 45,643.2 million lei, increasing by 13.0% (5,267.7 million lei) during 2020. During 2020, the share of non-performing loans in total credits decreased by 1.1 pp. compared to the end of the previous year, constituting 7.4 percent as of 31.12.2020. In the context of risk distribution, the largest share in the total loan portfolio was held by loans granted to commerce - 23.5% or 10,745.0 million lei, followed by the share of loans granted for purchase/construction of real estate – 17.3% (7,880.4 million lei) and consumer loans - 16.4% (7,480.2 million lei).

As of December 31, 2020, the profit for the year amounted to 1,501.2 mln. lei. Compared to the same period of the previous year, profit decreased by 33.6 percent (758.7 million lei), largely due to the increase in impairment or resumption of impairment losses on financial assets that are not measured at fair value through profit or loss by 872.0 million lei (241.6%), simultaneously with the reduction of interest income by 140.4 million lei

(3.1%). Return on assets and return on capital at 31.12.2020 constituted 1.5 (2.5) percent and 8.9 (14.6) percent respectively, decreasing compared to the end of the previous year by 1.0 pp and 5.7 pp respectively.

Banks maintained liquidity ratios at a high level. Thus, the value of the long-term liquidity indicator (principle I of liquidity) constituted 0.7, being at the same level as the end of the previous year. Current liquidity by sector (principle II of liquidity) constituted 50.6%, being at the same level as the end of the previous year. Liquidity coverage ratio (LCR) was 318.4 % (minimum requirement in 2020 was 70%).

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 banking system in the Republic of Moldova consists of two levels: the National Bank of Moldova and 11 licensed banks. The National Bank of Moldova regulates and supervises the banks in accordance with the Law on the National Bank of Moldova and the Law on banking activity, which provide the competence, main objective, basic attributions of the National Bank, its relationship with banks and other Competent Authorities, in the process of performing the supervisory function.

According to the Law on the National Bank of Moldova, the National Bank is exclusively responsible for the licensing, supervision and regulation of the banks and foreign banks' branches' activity. To that end, the National Bank is empowered:

a) to issue the necessary regulations and to take the proper actions in order to perform its powers and duties under the mentioned law and Law no.202/2017 on banking activity, by way of licensing banks and elaborating supervision standards and establishing the way of implementing the regulations and measures mentioned above;
b) to perform, through its staff or other qualified professionals involved for this purpose, inspections over all banks, and to examine theirs books, documents and accounts, conditions in which the business is carried out and the compliance with the legislation;
c) to require any employee of the bank to provide the National Bank with the information necessary for the purpose of supervision and regulation of the banks' activity;
d) to prescribe to any bank, to its shareholders, to the members of the bank's management body, to the persons holding key positions within the bank, supervisory measures or to apply the sanctions and sanctioning measures foreseen in the Law no.202/2017 on banking activity, if they have violated the provisions of the mentioned law, of the normative acts or other acts issued for its application;
e) to act as a resolution authority for the banks in accordance with the Law no.232/2016 on banks' recovery and resolution.

Therefore, in order to implement the provision of the Law no.202/2017 on banking activity, in the context of transposing the requirements of the Basel III capital agreement, during the 2020 year has been approved a number of normative acts applied to banks:

Regulation on the requirements for publication of information by banks (in force since September 24, 2020) - sets requirements relating to the minimum information which needs to be published, the periodicity, the form and method of publication. The Regulation requires banks to make public information relating, at least, to the banking activity management framework, own funds and capital requirements, liquidity, risk exposures, capital buffers, internal policies, including the remuneration policy.

Regulation on Liquidity Coverage Requirements for Banks (in force since October 01, 2020) - defines the liquidity coverage indicator (calculated as the ratio between the bank's liquidity reserve to its net liquidity outflows during a 30-day crisis period expressed as a percentage), provides requirements for the composition of banks' liquidity reserves, the methodology for calculating liquidity outflows and inflows, the value of the liquidity coverage indicator (at least 100%), the gradual implementation of the indicator from 60% (starting October 1, 2020) to 100% (starting January 1, 2023).

In order to calculate banks' credit risk and own funds requirements, has been amended the Regulation on the treatment of banks' credit risk using standardised approach (in force since May 29, 2020). The amendments clarified the provisions on the treatment of credit risk related to public sector entities from the Republic of Moldova.

Regulation on the treatment of counterparty credit risk for banks (in force since January 01, 2021) - contributes to maintain an adequate level of own funds in relation to the level of counterparty credit risk assumed by banks in the case of derivatives and long-term settlement transactions.

Regulation on Credit Valuation Adjustment risk (in force since January 01, 2021) - provides new capital requirements that aim to absorb losses arising from the risk of credit valuation adjustment and lays down rules on the calculation of own funds requirements for the CVA risk for all OTC derivatives.

Regulation on banks' supervision on a consolidated basis (in force since January 01, 2021) - establishes the regulatory framework for banks' supervision on a consolidated basis, by providing the cases when to applying or derogate from the prudential requirements, consolidation methods, basis of consolidation, including situations where certain entities in the group will not be included, the power of the National Bank to express its opinion on the prudential consolidation method and provides requirements for intra-group transactions with mixed-activity holding companies.

Regulation on outsourcing the bank's activities and operations (new version, in force since April 20, 2020) - contributes to a better management of outsourcing and associated risks by establishing rigorous requirements for supplier's assessment. The regulation provides requirements on chain outsourcing and related to external audit to outsourced activities of material importance.

Regulation on Leverage for Banks (in force since 30.03.2021) - aims to limit bank indebtedness, strengthen risk-based capital requirements, compare the level of indebtedness between banks in a simple and consistent manner. In accordance with the regulation, banks shall report to the NBM the information related to the leverage indicator, and the NBM based on the observation and analysis of the reported data shall determine the minimum level of this indicator. A 3-year leverage indicator observation period is expected (from March 30, 2021 to December 31, 2023).

Amendments to the Instruction on COREP reports submitted by banks for supervisory purposes – related to the reporting on liquidity coverage requirement, counterparty's credit risk, credit valuation adjustment risk and information on the leverage indicator.

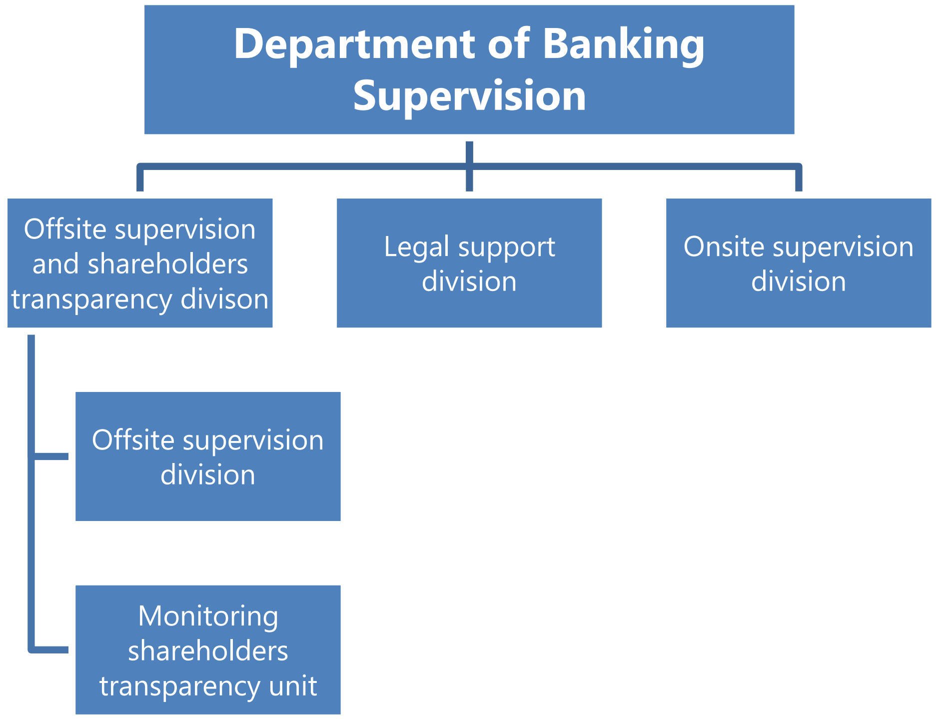
The National Bank of Moldova continues to draft and revise, as appropriate, the normative acts in order to implement the Law no.202/2017 on banking activity.

For the purpose of implementing the provisions of the Law on supplementary supervision of banks, insurers/reinsurers and investment firms in a financial conglomerate no. 250/2017, has been approved the Regulation on regulatory technical standards on supplementary supervision of financial conglomerates (in force since April 13, 2020) which provides technical principles and calculation methods for determining own funds and capital adequacy supplementary requirement for financial conglomerates, as well as provisions relating to the materiality of intra-group transactions and risk concentration.

Alignment of Republic of Moldova's banking legislation with international standards by improving quantitative and qualitative mechanisms for managing banks will help to promote a safe and stable banking sector, to increase the transparency, confidence, attractiveness of the domestic banking sector for potential investors, depositors and customers, to develop new financial products and services.

Thus, through a number of requirements provided through the normative acts, the National Bank of Moldova maintains the mechanism of supervision and regulation of banks' activity in the Republic of Moldova, based on international accepted principles.

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Banking Supervisory Authority in 2020

The development of banking supervision function remains an objective of strategic importance to the National Bank of Moldova. In order to strengthen the capacity in banking regulation and supervision field, the National Bank of Moldova undertakes a number of activities directed towards achieving the implementation of the requirements of Basel III. The National Bank of Moldova continues the drafting process of the normative acts in order to implement the provisions of the new Law on banking activity, in the context of harmonization of the national banking legislation with the international standards.

For the year 2020, according to the set priorities the main areas of focus in the banking supervision process were:

- Internal governance, risk management, internal capital adequacy assessment process (ICAAP)
- Combating money laundering and terrorist financing
- Credit risk
- Operational risk
- Recovery plans
- Risk associated with information and communication technologies (ICT)
- Risks associated with the use of payment systems

The activities of the Banking Supervisory Authority in 2020

During the 2020 year, a number of actions have been taken to maintain banking system stability and to ensure its further development. To this end, the National Bank of Moldova approved a number of normative acts, by transposing the provisions of the Directive 2013/36/EU and Regulation 575/2013, which implement the provisions of the international regulation framework Basel III.

At the same time, in order to overcome the difficult period in the context of the negative economic consequences generated by Covid-19, have been approved Decisions of the Executive Board of the National Bank of Moldova no.69 of March 17, 2020 "on certain measures concerning the classification of loans to individuals" (that includes individuals carrying out entrepreneurial activities) and no.81 of March 27, 2020 "on certain measures concerning the classification by banks of loans granted to legal persons".

The mentioned Decisions allowed banks to manage flexibly the payment obligations of individuals, including individuals carrying out entrepreneurial activities and legal entities, which, are in difficulty to pay their loans under the conditions of state of emergency generated by Covid-19.

International activities of the authority

In order to strengthen the regulatory and supervisory framework of the Moldovan financial and banking system, the National Bank of Moldova (NBM) cooperates with international organizations, foreign central banks and other development partners.

In 2020, the cooperation between the Republic of Moldova and the International Monetary Fund (IMF) has mainly developed in the context of the implementation of the reform program supported financially by the IMF through the Extended Fund Facility (EFF) and Extended Credit Facility (ECF), which was completed in March 2020, as well as during the discussions regarding the negotiations of a new financial assistance program for the next period.

An IMF team visited Chișinău from January 22 to February 5 to conduct the 2020 consultation based on Article IV of the IMF's Articles of Agreement and the sixth and final review of the implementation of the IMF supported reform program. Thus, the IMF officials noted essential progresses in reforming the banking sector and the significant achievements on strengthening the NBM's governance and responsibility, as well as strengthening the NBM operational framework for providing emergency liquidity assistance as a lender of last resort.

Considering negative economic effects generated by restrictive measures imposed by authorities during the pandemic, NBM along with the Government of the Republic of Moldova actively participated in the discussion with the IMF representatives to obtain emergency financial assistance for improving the economic impact and for covering the urgent needs related to balance of payments and state budget. As a result, Moldova obtained access to IMF finance through Rapid Credit Facility (RCF) and Rapid Financing Instrument (RFI).

In the context of implementing the common objectives of the Association Agreement between the Republic of Moldova and the European Union (EU), NBM continued strengthening the cooperation between the central banks from EU responsible for the supervision of EU credit institutions with subsidiaries in the Republic of Moldova. Thus, in 2020, the NBM has concluded two memorandums of understanding in the field of banking supervision: one with the central bank of Hungary (Magyar Nemzeti Bank), into force since 22 June 2020 and another - with the European Central Bank, into force since 22 September 2020. It should be mentioned that in 2020 the NBM, along with several other European central banks, became a signatory of the Agreement on cooperation and coordination within the college of supervisors of the banking group OTP. In the same year, 2020, NBM continued the negotiations with the National Bank of Romania for concluding a new cooperation agreement. Also, NBM initiated a dialogue with the Banking Regulation and Supervision Agency of the Republic of Turkey for the conclusion of a memorandum of understanding.

At the same time, the NBM took part in the negotiations of a new draft memorandum of understanding between the Republic of Moldova and the EU regarding the macro-financial assistance for the Republic of Moldova.

In 2020, the NBM has also maintained the dialogue with the World Bank, by providing all the necessary information for a fair and objective assessment of the situation of domestic financial system, in order to support decision-taking related to further financing in various priority areas for the Republic of Moldova.

The NBM has collaborated with the representatives of the European Bank for Reconstruction and Development's (EBRD) by ensuring a regular dialogue regarding the macroeconomic situation and the evolution of the banking system. At the same time, NBM is constantly cooperating with the EBRD to increase and enhance the resilience of the domestic banking sector, in the context of implementation the EBRD Moldova Country Strategy for the period 2017-2022.

During 2020, the NBM continued to cooperate with the European Automated Clearing House Association (EACHA) by exchanging information and experience regarding the activity of clearing houses. Furthermore, the NBM continued to participate in activities carried out by the International Operational Risk Working Group (IORWG), providing responses to the requests and studies undertaken by the IORWG. Likewise, the cooperation with the Center of Excellence in Finance (CEF) was continued, by participating in the activities organized by CEF, including online training courses. At the same time, the NBM continued to cooperate with the members of BSCEE through exchanges of information and experience in the field of banking supervision and regulation.

In 2020, NBM received technical assistance from the external development partners in order to strengthen its institutional competences for various areas specific to central banks.

In this regard, but also to achieve its medium-term strategic objectives, in 2020, the NBM continued to benefit from the assistance of the IMF.

The European Union remains one of the main development partners for the NBM. In 2020, the NBM continued to receive the assistance of the High-Level Adviser for the Financial sector, in the context of the EU High Level Adviser's Mission for the Republic of Moldova for the period 2019 – 2021, which provided policy advice to the NBM in the field of banking supervision and the implementation of risk-based supervision, effective communication, as well as in order to facilitate the cooperation of the NBM with various national and international authorities. Furthermore, from 1 October 2019 to 26 April 2020, the NBM was assisted by an EU medium-term expert for banking supervision, delegated by the National Bank of Romania, in order to provide support for the transposition of international standards and best practices in banking supervision, including for the development of supervisors' capacities required for preparing reports following the supervisory review and evaluation process (SREP). Likewise, thanks to the support provided by the EU through the Twinning instrument, the NBM received assistance within the project "Enhancing the system of prevention and combating money laundering and terrorism financing in the Republic of Moldova".

Also, the representatives of the Financial Sector Advisory Center (FinSAC) of the World Bank continued to support the NBM in the field of banking recovery, resolution and supervision.

During 2020, the NBM continued to intensify bilateral technical cooperation with central banks (of Belgium, Federal Republic of Germany, Republic of Turkey, Luxembourg and Ukraine), in order to benefit from good practices in the areas of competence and to provide support to institutions with similar attributions in other states.

In order to carry out the banking authorization function in accordance with the Law no.202/2017 on banking activity and normative acts of the National Bank in force in 2020, the NBM has provided the exchange of information with the following supervisory authorities:

Capital Markets Board of Turkey, Polish Financial Supervision Authority, Financial Supervision Commission of Bulgaria, Bank of Poland, Magyar Nemzeti Bank, Financial Conduct Authority, Austrian Financial Market Authority, Ministry of Finance of the Republic of Macedonia, Federal Financial Supervisory Authority Frankfurt am Main, the Central Bank of the Russian Federation, the National Bank of Ukraine, Bulgarian National Bank, Bank of Slovenia, Bank of Albania, Central Bank of the Republic of Azerbaijan National Bank of Slovakia, Austrian Financial Market Authority, Central Bank of Armenia, National Bank of Serbia, European Central Bank.

Cooperation with other supervisory bodies in the country

According to the legal framework in force and bilateral agreements, the National Bank of Moldova cooperates with other supervisory authorities from the Republic of Moldova. Thus, during 2020, in order to efficiently perform its functions, the National Bank of Moldova collaborated with the National Commission of the Financial Market of the Republic of Moldova.

In addition, for the purposes of banking authorization, the National Bank of Moldova cooperates with other competent authorities, such as Office for Prevention and Combating of Money Laundering, National Anticorruption Center, Security and Intelligence Service, Office the Prosecutor General of the Republic of Moldova, and other.

Other relevant information and developments in 2020

In addition to the minimum own funds requirement, banks are obliged to maintain additional capital buffers. For the end of 2020, capital conservation buffer rate equaled 2,5%, countercyclical capital buffer rate for Republic of Moldova was established at 0% and systemic risk buffer rate for all banks was set at the level of 1% (depending on banks' shareholders structure systemic risk buffer rate of 3% applies for several banks). At the same time, buffer for other systemically important institutions (O-SIIs) was established for 4 largest banks (ranging from 0,5% to 1,5%). During 2020, the NBM Executive Committee approved the results of the supervision and evaluation process of banks' activity for 2018 and their subsequent evolution (for 10 licensed banks), imposing specific capital requirements on each bank depending on the individual risk profile, which were respected by banks.

Questionnaire tables for the 2020 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	6	6	6
Branches of foreign credit institutions	5	5	5
Cooperative banks	-	-	-
Banking sector, total:	**11**	**11**	**11**

Total assets of banking sector (at year-end, mil. MDL)

Type of financial institution	2018	2019	2020
Commercial banks	48,459.0	53,009.6	61,533.7
Branches of foreign credit institutions	34,756.0	37,668.6	42,239.9
Cooperative banks	-	-	-
Banking sector, total:	**83,215.0**	**90,678.2**	**103,773.6**
y/y change (in %)	**4.7%**	**9.0%**	**14.4%**

Ownership structure of banks on the basis of assets total

Item	2018	2019	2020
Public sector ownership	0.0	0.0	0.0
Domestic ownership total	46.99	31.95	32.08
Foreign ownership	53.01	68.05	67.92
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2020

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	53.39	57.94	0.130
Branches of foreign credit institutions	33.40	40.70	0.046
Cooperative banks	-	-	-
Banking sector, total:	**86.8**	**98.65**	**0.176**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2018	2019	2020
Commercial banks	10.3	14.6	8.74
Cooperative banks	-	-	-
Banking sector, total:	**10.3**	**14.6**	**8.74**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2018	2019	2020
Commercial banks	58.23	58.46	59.30
Branches of foreign credit institutions	41.77	41.54	40.70
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2018	2019	2020
Assets			
Receivables	6.04	5.79	5.79
Financial sector	33.14	31.78	28.98
Nonfinancial sector	41.34	45.18	43.27
Government sector	7.90	7.06	11.57
Other assets	11.38	10.19	10.39
Liabilities			
Financial sector	4.58	4.33	4.30
Nonfinancial sector	74.83	74.18	74.99
Government sector	0.10	0.10	0.40
Other liabilities	3.39	3.31	3.08
Capital	17.10	18.08	17.23

Capital adequacy ratio of banks

Type of financial institution	2018	2019	2020
[1]Commercial banks	26.0***	24.8***	27.3***
Cooperative banks	-	-	
Banking sector, total:	**26.0*** **	**24.8*** **	**27.3*** **

[1]The information is presented for the banking sector (11 banks)

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

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

Asset classification	2018	2019	2020
Non-financial sector, including	12.54	8.49	7.38
- households	11.37	7.22	5.57
- corporate	1.17	1.27	1.82

The structure of deposits and loans of the banking sector in 2020 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	97.72	96.25
Households	63.75	35.78
Corporate	33.97	60.46
Government sector	0.52	0.99
Financial sector (excluding banks)	1.57	2.76
Total	**100.0**	**100.0**

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

P&L account	2018	2019	2020
Interest income	220.46	234.06	206.74
Interest expenses	74.62	72.40	62.26
Net interest income	145.85	161.66	144.48
Net fee and commission income	54.39	59.58	56.26
Other (not specified above) operating income (net)	-17.09	15.25	-17.17
Gross income	354.87	387.44	369.32
Administration costs	108.44	117.45	112.82
Depreciation	14.19	22.36	21.50
Provisions	143.09	105.91	115.60
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	6.08%	17.7%	20.9%
Profit (loss) before tax	84.32	131.38	78.43
Net profit (loss)	74.36	117.33	71.06

Total own funds in 2020 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	644,97***	-	638,41***	6,56***	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**644,97*** **	**-**	**638,41*** **	**6,56*** **	**-**

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

As of December 31.12.2020, 1 EUR=21.1266 MDL.

Macroeconomic environment

During 2020, economic trends both in Montenegro and globally, were significantly determined by the outbreak of the COVID-19 pandemic, which had a strong impact on decline of relevant economic indicators. According to quarterly Monstat estimates, after significant growths in the previous three years, a negative real GDP growth rate of -15.2% was recorded in 2020. A gradual recovery of the economy is expected in 2021. International institutions` forecasts for Montenegro`s GDP growth in 2020 are positive, ranging from 5% to 9%. The Central Bank forecasts are also within this range.

According to Monstat data, consumer prices recorded negative annual rates as of April in all months except September (when it equalled 0.1%). In December, the annual CPI inflation was -0.9% and the HICP inflation was -1.3%, while the average annual growth rate was -0.3%.

Montenegro's budget deficit is estimated at 425.3 million euros or 10.1% of GDP, being higher by 282 million euros than the cash deficit, and 280.8 million euros than the adjusted deficit from 2019. In 2020, according to preliminary data of the Ministry of Finance, public spending recorded a deficit of 463.7 million euros or 11.1% of GDP and it was 391.5 million euros higher in relation to the 2019 deficit.

At end-2020, the net public debt of Montenegro as per the Ministry of Finance data, amounted to 3.54 billion euros or 84,3% of estimated GDP for 2020. Compared to the end-2019, net public debt recorded an increase of 10.8%. The high level of public debt, which in previous years was mostly contributed by Eurobond issues and the withdrawal of funds from the Chinese Exim Bank to finance the construction of the priority section of the highway, may continue to grow, especially if the negative effects of the pandemic on the state budget continue. The latest issue of Eurobonds in the amount of 750 million euros in Q4 2020, the negative effects of the pandemic on the state budget, as well as the expected decline in gross domestic product in 2020, conditioned the gross public debt to reach 105.1% of estimated GDP at end-2020.

According to Monstat data, the average number of employed persons amounted to 176,693 in 2020, thus being 13.2% lower than the average number of employees in the previous year. As per the Employment Agency's records, the number of registered unemployed persons averaged at 41,612 in 2020, which was 13.4% more than in the same period last year. The unemployment rate published by Employment Agency of Montenegro amounted to 20.48% in December 2020, recording a year-on-year increase of 4.27 percentage points. The Labour Force Survey, published by Monstat on quarterly basis, shows that the the unemployment rate of 16.3% was recorded in Q1, while the unemployment rate amounted to 15.2% and 19% in Q2 and Q3, respectively.

Monstat data showed that an average gross earnings in Montenegro was 783 euros in 2020 and it increased by 1.3% in relation to the average earnings in 2019. An average earnings without taxes and contributions amounted to 524 euros, showing the year-on-year increase of 1.7%.

In 2020, current account deficit recorded an increase. Preliminary data indicate that the current account deficit amounted to 1.1 billion euros or 26% of GDP, which is a significant increase in relation to 15% of GDP in 2019. The increase in the deficit predominantly came as a result of a decline in the surplus on the services account, caused by the decline in revenues from travel and tourism services.

In 2020, net foreign direct investments in the financial account amounted to 467.5 million euros, recording the year-on-year increase of 53.2%, and accounting for 11.2% of GDP. These trends came as a result of a smaller outflow, with a simultaneous increase in inflow arising from intercompany debt when compared to 2019.

Banking system

At the end of 2020, there were 12 banks operating in Montenegro, after the merger of CKB and Podgorička banka in December 2020. The banking system in Montenegro, despite the decline in economic activity due to the outbreak of the pandemic, has maintained stability, high liquidity and good capitalization.

In order to preserve the stability of the financial system and the security of deposits, the Central Bank has adopted several packages of measures since the beginning of the pandemic, providing a relatively strong defence mechanism against potential negative shocks.

In the one-year comparative period, loans grew, while other key balance sheet items declined. Total loans (gross loans and receivables from banks and customers) increased by 3.18%, however, total bank assets decreased by 0.38%, total bank deposits (with funds on escrow accounts) decreased by 2.96% and total capital by 1.43%.

The financial result at the aggregate level was positive and in 2020 the banks made a profit in the total amount of 22.3 million euros, which is a decrease of 56% compared to the previous year. At the end of 2020, eleven banks in the system operated with a profit, while one bank recorded a negative financial result.

The total capital of banks amounted to 589.5 million euros at the end of 2020 and compared to the previous year it decreased by 8.6 million euros or 1.43%. The capital adequacy ratio at the aggregate level was 18.52%, while at the end of the previous year it was 17.73%, which is significantly above the statutory minimum of 10%.

Total loans (gross loans and receivables from banks and clients) amounted to 3,159.2 million euros and increased compared to the previous year by 97.4 million euros or 3.18%.

Total deposits (with funds on escrow accounts) in banks amounted to 3,372.9 million euros at the end of 2020 and decreased by 2.96% compared to the previous year. Deposits of natural persons decreased by 1.35%, while deposits of legal persons decreased by 4.64%.

The main parameters of asset quality in the one-year comparative period recorded a negative trend. At the end of December 2020, the share of non-performing loans in total loans was 5.47%, while in the same period last year, their share was 4.72%. This is an expected reduction given the current pandemic. Past due loans over 30 and 90 days also recorded an increase in the observed one-year period.

Change in regulatory framework

In July 2020, the IPA 2014 funded Twinning Project "Support to Regulation Financial Services" was successfully completed. The project was implemented in cooperation with a consortium consisting of the Deutsche Bundesbank, Croatian National Bank, De Nederlandsche Bank, Federal Financial Supervisory Authority and HANFA. The project addressed all financial sector supervisors in Montenegro, and its main goal was to provide more stable, sustainable and efficient financial services, in line with best practices of the EU, with a view to supporting private sector development and strengthening the competitiveness of the economy. During the 27 months of the project, regulations were developed in line with the acquis communautaire, which focused on the implementation of modern prudential supervisory standards in the area of banking, as one of Montenegro's obligations in the process of accession to the European Union (in addition to this, regulation in the area of insurance and capital markets was developed).

Aimed at fulfilling these obligations, related to the negotiation chapter 9 - Financial services, the Central Bank is obliged to harmonize the legislation governing banking operations with Directive 2013/36/EU, that is to create a legal basis for the adoption of a set of enabling regulation with a view to implementing Regulation 575/2013 on prudential requirements for credit institutions and investment firms.

During this project, which started in April 2018 for the area of supervision, a total of 15 missions were held in cooperation with experts from the Croatian National Bank (of which 11 during 2020). Three of those missions were held with experts from the Deutsche Bundesbank (one of which in 2020), with two study visits to the Deutsche Bundesbank (one of which in 2020). In addition, with a view to successfully implementing the project, there was intensive communication with experts engaged in this project via email and video calls, especially after the outbreak of the COVID-19 pandemic. Cooperation on this project was organised so that the Central Bank used the expertise of the Croatian National Bank in the preparation of draft documents for clarifications, assessments and suggestions for their improvement and harmonisation with relevant EU regulations.

During 2019, the first versions of the draft Decision on Capital Adequacy, the Decision on Large Exposures and the Decision on the Manner of Calculating Liquidity Indicators were completed, followed by the preparation of the Quantitative Impact Study on the application of solutions envisaged in these drafts. As part of these activities, templates and instructions for filling in the data necessary to quantify the effects of the new provisions prescribed in the drafts of these three decisions were prepared, as well as examples for their better understanding. Also, questionnaires that make qualitative part of the study were prepared.

In the first part of 2020, the data obtained from banks on these templates were analysed and report on the effects of the new regulations on the banking system was prepared, while in the second part of 2020 the analysis of the impact study was repeated using updated data of banks aimed at reviewing specific provisions of the regulations on the operations of banks.

Successful implementation of this project led to the preparation of 25 regulations harmonised with Regulation 575/2013 and accompanying technical standards integral to this Regulation, as well as guidelines issued by the European Banking Authority, EBA. The adoption and implementation of the new legislation will lead to full harmonisation with regulation currently in force in the European Union.

Following the analysis of effects of implementation of the Decision on macro prudential measures relating to retail banking loans, which was adopted in 2019, amendments were adopted in October 2020. The amendments introduced the loan insurance policy as an additional collateral to secure the loan in addition to the collateral recognised by the prevailing decision from 2019, provided that the insurance policy is issued by insurance companies having their head offices in Montenegro, while the CBCG will assess the acceptability of individual insurance policies from the aspect of coverage of risks the banks are exposed.

At end-July, the Central Bank decided to support the postponement of the application of the Law on Credit Institutions and the Law on Resolution of Credit Institutions (which were supposed to be in force as of 1 January 2021). This was done with respect to the numerous aggravating circumstances for banks' operations, at the initiative of the Association of Montenegrin Banks, aimed at relieving banks' capacities and enabling their full commitment to the implementation of priority tasks, that is measures to mitigate the negative effects of the pandemic and the implementation of AQR activities. As at 20 January 2021, the Parliament adopted the Law Amending the Law on Credit Institutions and the Law Amending the Law on Resolution of Credit Institutions, which entered into force on 26 January 2021.

Main strategic objectives of the Supervisory Authority in 2020

Activities of the Central Bank during 2020 were primarily focused on mitigating the adverse effects of the COVID-19 pandemic on the financial system. CBCG adopted measures that had a strong impact on reducing uncertainty and increasing the liquidity of the economy and households. Measures included, amongst others, ban on the payment of dividends to shareholders (except for payments in the form of bank shares), moratorium on loan repayment of the loan beneficiaries from the sectors most affected by the COVID19, right to a moratorium on loan repayment for a period of six months to natural persons, etc.

With an aim to further strengthen the confidence in the banking system, the Central Bank started implementation of the asset quality review process (AQR), as the most effective prudential instrument for assessing the quality of banks' assets. The main objective of the AQR is to ensure an external, independent assessment of the quality of the banking system assets.

Activities of the Banking Supervisory Authority last year

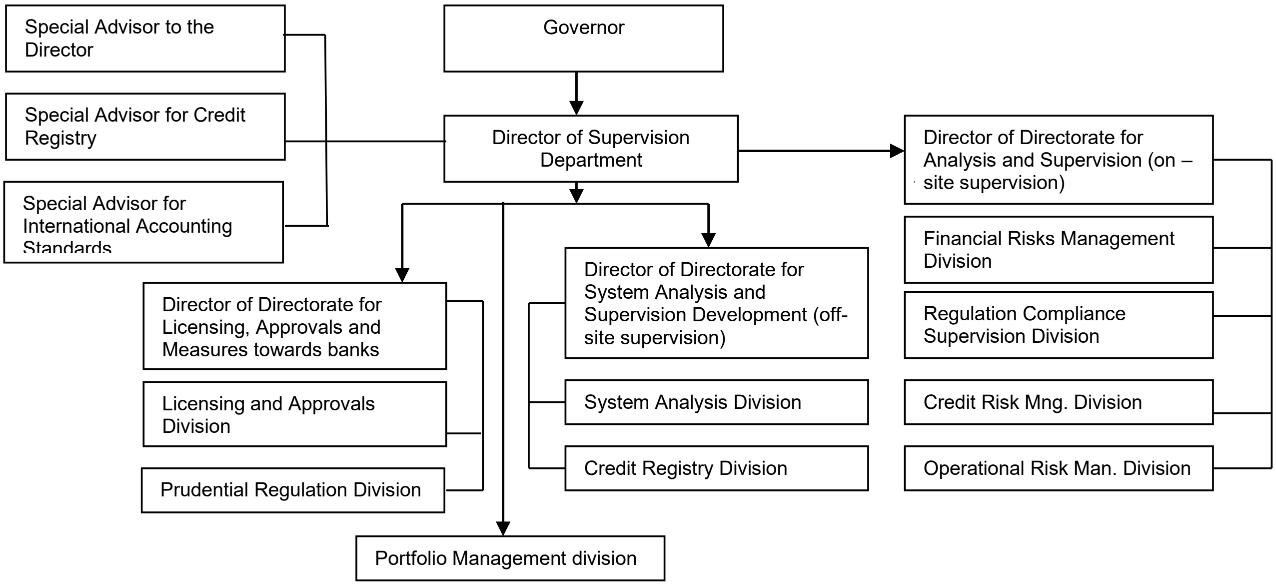
In 2020, the CBCG continuously worked on the identification of potential risks, acted preventively with regard to recognised vulnerabilities, and directed actions at maintaining stability of the banking sector. Within its supervisory activities, due to identified irregularities in the operations, the Central Bank imposed relevant measures against three banks, whereby misdemeanour proceedings were initiated against four banks and responsible persons in them.

The Central Bank continued to align its regulatory framework with the EU acquis and international financial services standards, and the Asset Quality Review (AQR) process was also prepared and initiated.

In addition to the above, five sets of measures have been prepared to mitigate or reduce the negative effects of the COVID-19 pandemic on the financial system, and the effects of these measures have been continuously monitored.

The process of merger of the Crnogorska Komercijalna Banka AD Podgorica Member of the OTP Group and Podgorička Banka was finalised successfully under the Central Bank's monitoring.

Organizational chart of the Banking Supervisory Authority



International activities of the authority

In 2020, the Central Bank continued its active participation in the process of Montenegro's accession to the European Union. As members of the working groups for negotiations for the chapters chaired by the CBCG (4 - Free movement of capital, 9 - Financial services and 17 - Economic and Monetary Union) and in which it has a significant role (18 - Statistics and 32 - Financial Control), the CBCG representatives participated actively in the work and the preparation of documents and materials important to successfully continue the EU membership negotiations process.

In drafting the Economic Reform Programme 2021-2023, as the most important strategic document in the economic dialogue with the European Commission and EU Member States, the CBCG participated in preparing the segment concerning the medium-term macroeconomic framework and defining measures for implementing the recommendations of the May 2020 Ministerial Dialogue concerning the financial sector.

The CBCG representatives participated in the meetings of the bodies established to monitor the implementation of contractual obligations under the SAA. Thereby, during 2020, the CBCG experts prepared materials for the meetings of the Sub-committee for Internal Market and Competition, the Sub-committee for Economic and Financial Issues and Statistics, and the Stabilisation and Association Board, which were held in virtual format due to the pandemic.

Moreover, the CBCG representatives continued to participate in the work of the Economic and Financial Dialogue concerning the preparation of Joint Conclusions from the Economic and Financial Dialogue between the EU and the Western Balkans and Turkey held in May 2019.

In 2020, through regular visits and continuous communication, the CBCG continued intensive cooperation with institutions and bodies of the European Union and the central banks of EU Member states. Concerning this, the ECB and the EC representatives visited the CBCG. Also, senior management of the Central Bank continued the High Level Dialogue with the ECB conducted annually with central banks of the EU candidate countries that started the negotiation process. Due to pandemic-caused circumstances, the High Level Dialogue meeting was done in virtual format.

Due to the pandemic, the CBCG has been in very frequent communication with the IMF Mission to Montenegro since March 2020. During this period, the IMF received data and information on the economy's current state and measures taken by the CBCG and state authorities of Montenegro to prevent or limit the infection spread and the pandemic's adverse consequences on the economy and the financial sector.

High CBCG officials participated in the Spring Meeting and the Annual Meetings of the IMF and the World Bank, held in the virtual format in 2020. During the meetings, they discussed most current issues related to preserving human health in a pandemic, the state and prospects of the economy and the financial system, and ways to overcome the current crisis.

The CBCG's cooperation with the World Bank group in 2020 was marked by many activities of the CBCG in meeting the conditions for approving the second policy-based guarantee in the area of fiscal and financial resilience (PBG2).

Due to the pandemic-caused circumstances, bilateral technical cooperation with other partner central banks took place at a reduced intensity compared to previous years and in a virtual format. During 2020, two already mentioned technical support programmes were implemented with the Bundesbank and the Croatian National Bank.

Cooperation with other supervisory authorities in the country

In 2020, the Central Bank continued successful cooperation with other regulators in the country, which is based on the regular exchange of information in accordance with the objectives defined in the concluded bilateral agreements and MoUs, and which largely relate to the exchange of information regarding the acquisition of qualified participation with financial market participants and AML/TF information.

Questionnaire tables for the 2020 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	15	13	12
Branches of foreign credit institutions	0	0	0
Cooperative banks	0	0	0
Banking sector, total:	**15**	**13**	**12**

Total assets of banking sector (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	4406813	4603931	4586507
Branches of foreign credit institutions	-	-	
Cooperative banks	-	-	
Banking sector, total:	**4406813**	**4603931**	**4586507**
y/y change (in %)	**5.37**	**6.61**	**-0.38**

Ownership structure of banks on the basis of assets total

Item	2018	2019	2020
Public sector ownership	-	-	-
Domestic ownership total	20.43	19.73	19.67
Foreign ownership	79.57	80.27	80.33
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2020

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	54.20	73.65	1,460
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**54.20**	**73.65**	**1,460**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2018	2019	2020
Commercial banks	4.87	8.66	4.10
Cooperative banks	-	-	-
Banking sector, total:	**4.87**	**8.66**	**4.10**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2018	2019	2020
Commercial banks	100	100	100
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2018	2019	2020
Receivables			
Financial sector			
Nonfinancial sector			
Government sector			
Other assets			
Liabilites			
Financial sector			
Nonfinancial sector			
Government sector			
Other liabilities			
Capital			

**CBCG database does not provide data in accordance with required format*

Capital adequacy ratio of banks

Type of financial institution	2018**	2019**	2020**
Commercial banks	15.63	17.73	18.52
Cooperative banks	-	-	-
Banking sector, total:	**15.63**	**17.73**	**18.52**

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

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

Asset classification	2018	2019	2020
Non-financial sector, including*	98.4	99.8	99.9
- households	35.7	37.7	33.45
- corporate**	59.2	62.0	66.31

**excluding government sector and financial institutions; share of total NPL*

***state companies, private companies and entrepreneurs; share of total NPL*

The structure of deposits and loans of the banking sector in 2020 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	91.61	82.69
Households	51.24	44.53
Corporate	38.51	37.80
Government sector	6.67	9.51
Financial sector (excluding banks)	1.72 (0.39)	7.80 (0.52)
Total	**100.0**	**100.0**

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

P&L account	2018	2019	2020
Interest income	168297	173390	152807
Interest expenses	29216	22247	21192
Net interest income	139081	151140	131618
Net fee and commission income	40197	35339	24310
Other (not specified above) operating income (net)	19854	18509	13971
Gross income	276337	278286	230874
Administration costs	116201	121785	95778
Depreciation	10199	10700	14983
Provisions	16561	10582	29551
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)			
Profit (loss) before tax	31238	53574	24551
Net profit (loss)	27270	48652	22335

Total own funds in 2020 (in EUR)

Type of financial institution	Total own funds **	Core Tier 1	Tier 1**	Tier 2**	Tier 3
Commercial banks	488818	-	460038	29890	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**488818**	**-**	**460038**	**29890**	**-**

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

Macroeconomic environment in the country

During 2020, in line with the global developments, the Covid-19 pandemic and the subsequent restrictive measures had a strong impact on the domestic economy. Economic activity dropped by 4.5%, amid a decline in both domestic and export demand. The decline in economic activity was deepest in the second quarter, amid the introduced measures for public health protection and deteriorating external environment, which adversely affected almost all economic activities. The service sector, construction and industry were particularly affected, as activities that are mostly exposed to the measures of social distancing and the temporary disruption in global supply chains. In the second half of the year, the decline in the gross domestic product slowed down significantly, supported by more favorable movements in export and personal demand and maintained continuity of higher public consumption in order to protect public health and support the economy. With the onset of the pandemic, policymakers reacted promptly with measures to support the economy. The policy reaction contributed to mitigating the adverse effects on the economy and indirectly on the financial sector and thus preserving financial stability. The latest projections of the National Bank from the April 2021 cycle point to expected recovery of the economic activity in 2021 (with growth of 3.9%), which will continue in the medium term with a growth rate of 3.9% in 2022 and 4% in 2023. However, uncertainty and risk remain high, mainly related to the duration of the pandemic and its impact on the economic recovery.

The labor market was only moderately impacted by the pandemic supported by the measures that were taken to counter the crisis. The adverse effects were mainly concentrated in the second quarter of 2020 which corresponds with the acute phase of dealing with the pandemic, when the most severe restrictions were imposed to prevent the spread of the infection. The unemployment rate stood at 16.4% at the end of 2020 as compared to 17.3% in 2019.

During 2020, the inflation rate remained at low level of 1.2% on average (0.8% in 2019). The rise in the general price level in 2020 was mainly driven by the higher food prices and to a lesser extent by core inflation. Import prices have exerted downward pressures on domestic inflation in 2020, amid the sharp drop in oil prices. According to the April projections of the National Bank, in 2021 the inflation rate is expected to accelerate moderately to 2.2%, as a temporary effect of the higher world food and oil prices. This would be followed by stabilization with an expected inflation rate of about 2% for the period 2022-2023.

The fiscal response to the crisis widened the budget deficit and increased the level of public debt. The health spending and measures aimed at supporting the economy have increased the budget expenditures, which in conditions of reduced revenue collection due to the decline in economic activity, but also tax relief under anti-crisis measures, widened the budget deficit to 8.1% of GDP (2.0% of GDP in 2019). Public debt rose to 60.2% of GDP at the end of 2020, largely driven by the increased external borrowing, while domestic debt increased as well.

The external position of the economy was stable during the year and enabled further growth of foreign reserves. The current account deficit on the balance of payments has moderately widened and in 2020 amounted to 3.5% of GDP. In conditions of lower trade deficit, the widening of the current deficit is mainly due to the reduced net inflows from private transfers, as one of the channels of transmission of the crisis. The financing of the current transactions in 2020 was largely enabled through the external borrowing of the state, and additional inflows were realized through the borrowing of the private sector, foreign direct investments, as well as trade credits. Gross external debt increased, but remains sustainable at 80% of GDP which is the only indicator that ranks the country as moderately indebted, while all the other indicators point to a low level of external debt.

The appropriate level of foreign reserves provided support for exchange rate stability, enabling the National Bank to respond by easing monetary policy. During the year, the National Bank reduced the key policy rate on three occasions to its historical low of 1.5% and reduced the offered amount of CB bills, thus releasing liquidity in the banking sector. Additionally, regulatory flexibility was provided in the area of credit risk management, which enabled temporary deferral of credit payments and thus easing the debt burden of households and the corporate sector. Support to the companies in the activities that are most affected by the pandemic was also provided through non-standard measures that were taken in the reserve requirement area. The measures of the National Bank contributed to the maintenance of favorable financial conditions, thus mitigating the impact of the pandemic and supported the credit cycle as an important factor in supporting economic activity.

Development in the banking sector (including assets total / GDP)

In 2020, despite the prolonged duration and uncertainty about the intensity of the coronavirus pandemic, the banking system maintained its stability. So far, the banking system has managed to withstand the negative effects of the health crisis, but challenges remain. The resilience of the banking sector to shocks is confirmed by the conducted stress tests, which show a good capacity to absorb credit losses, even in extreme and unlikely shocks of more pronounced materialization of credit risk.

In conditions of unpredictable environment, the banking system managed to maintain the credit cycle, which was financed by the solid deposit growth. At the end of 2020, the credit growth slowed down compared to last year, but it is still solid (4.1% on 31.12.2020, compared to 6.1% on 31.12.2019). The growth of lending activity in 2020 largely resulted from loans granted to households, but, although lower, the contribution of corporate loans is also positive. According to the currency structure, the annual growth of total loans is largely due to the growth of domestic currency loans.

Deposits continued to record solid growth in 2020, but slower (from 9.2% on 31.12.2019, to 6.2% on 31.12.2020). The deposits of corporates and households have almost equal contribution to the increase of the total deposits. According to the currency and maturity structure, the increase in total deposits on a larger scale stems from the growth of demand deposits in domestic currency, but the contribution of deposits in foreign currency is also significant. The overall growth of the deposits in 2020 confirms the public confidence in the banking system, that was supported by the economic measures of the Government to deal with the crisis of Covid-19, which include liquidity support to companies and households, in order to maintain enterprise liquidity and support households' purchasing power.

In 2020, the role of the banking system as a financial intermediary increased (as of December 31, 2020, the shares of total assets of the banking system, loans and deposits in GDP[1] increased compared to the level achieved in the same period of 2019, and reached 88.2%, 53.2% and 64.9%, respectively).

In 2020, the indicators for the materialization of the credit risk of the banks improved. Non-performing loans of banks decreased by 26.5%, which reduced their share in total loans to a historic low of 3.4% (from 4.8% at the end of 2019). Analyzed by individual sectors, the share of corporate non-performing loans in total corporate loans was reduced to 5.2%, while the share of households' non-performing loans in total household loans decreased to 1.6%. The reduction of non-performing loans continues to be influenced by the regulatory measure for mandatory write-off of fully provisioned non-performing loans[2]. However, the dynamics of non-performing loans are also influenced by the regulatory measures from March 2020, which provided conditions for banks to approve a temporary moratorium on customers' loan repayments. Banks used this opportunity twice (in April-May for a large number of customers, and again in September 2020 only for those categories of customers who are most affected by the crisis). These measures helped the banks to

1 Source: State Statistical Office. The GDP for 2020 is estimated.

2 From July 2019, the National Bank introduced an obligation for mandatory write-off of non-performing exposures that are fully provisioned for more than one year. Until July 2019 (from 1.1.2016 to 30.6.2019), this period was two years.

facilitate credit risk management in the period when it was expected that the effects of the pandemic would be more pronounced, i.e. provided greater flexibility and incentives for banks to lend. Given the temporary nature of these measures, as well as the uncertainty about the duration of the consequences of the pandemic, in the coming period can be expected higher materialization of credit risk and increase in non-performing loans (mainly after Q1 2021 and until the end of 2021)[3]. As a result, it is expected from the banks to continue to plan carefully their capital needs and to give priority to the preservation and further strengthening of their capital positions. Hence, the National Bank in February 2021, adopted Decision on temporary restriction of the distribution and payment of dividends to the shareholders of banks and savings houses, which was the case in several countries in the region and the EU. This Decision was temporary with validity until the end of 2021, and the National Bank, no later than September 30, 2021 was supposed to reevaluate the circumstances that actually led to the adoption of this Decision. In August 2021, the National Bank Council decided to repeal the Decision, based on assessments of reduced risks and adequate resilience of the banking system.

High and stable liquidity and solvency of banks are the two main pillars of the stability of the banking system. Their volume and quality were maintained during 2020 and contributed for banks to deal with the consequences of the Covid-19 pandemic. The banking system traditionally maintains a high volume of liquid assets, which provide for their high resistance to shocks and capacity for further credit support of the real sector. At the end of 2020, the liquidity indicators are solid and are within their usual satisfactory levels (the share of liquid assets in total assets, household deposits and short-term liabilities is 32.5%, 64.4 % and 53.8%, respectively). The Loan to deposit ratio is below 100% (it equals to 82.0%) and indicates acceptable level of liquidity risk and room for increased lending activity of banks, supported by domestic sources of funding. Compared to previous year, the capitalization of the banking system, measured through the capital adequacy ratio, has improved (16.7% on 31.12.2020, 16.3% on 31.12.2019). Own funds have high quality structure, with the CET1 ratio of 15.2%. Over 90% of the own funds belong to CET1 capital, while the share of "excess (free)" capital is 9.1%. However, 43% of the own funds of the banking system belong to the capital requirements determined in accordance with the supervisory assessment (pillar 2) and the capital buffers, which, in turn, are especially important in times of crisis episodes, when can be used to cope with challenges. In January 2021, a new regulation on liquidity risk management came into force, introducing the Liquidity Coverage Ratio.

Profitability of the banking system is solid. The profit of the banking system for 2020 is by 8.5% higher compared to the previous year. The indicators through which the profitability and efficiency of the banking sector are monitored are solid. As of the end-2020 ROAA is 1.3%, ROAE equals to 11.2% and Cost to income is 48.5%. In conditions of prolonged health crisis and negative effects from the crisis, the banking system increased the impairment on loans for the overall portfolio. Net interest income remains the main component of banks' total income (with a share of two thirds), which in 2020 remained at almost the same level as in 2019. Expected increase in non-performing loans and subsequent increase in impairment costs after the end of the approved moratorium, may affect the financial result of the banking system.

[3] For most of the households' loans, the approved grace period (moratorium) ends by the end of March 2021, while for legal entities by the end of September 2020.

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 National Bank of the Republic of North Macedonia is the Banking Supervisory Authority responsible for licensing and supervision of banks and savings houses in the Republic of North Macedonia. The Supervision Sector, through its two departments, Off-site Supervision and Licensing Department and On-site Supervision Department, performs the supervisory function. The Financial Stability, Banking Regulations and Bank Resolution Department is responsible for analysis of the financial system and the financial stability in the country and for development of the relevant banking regulation in line with international standards and best practices. The resolution function is also resonsibility of this Depertment, which will be fully put into operation upon the adoption of the relevant regulation.

These competences of the National Bank are regulated with the Law on the National Bank of the Republic of North Macedonia and the Banking Law.

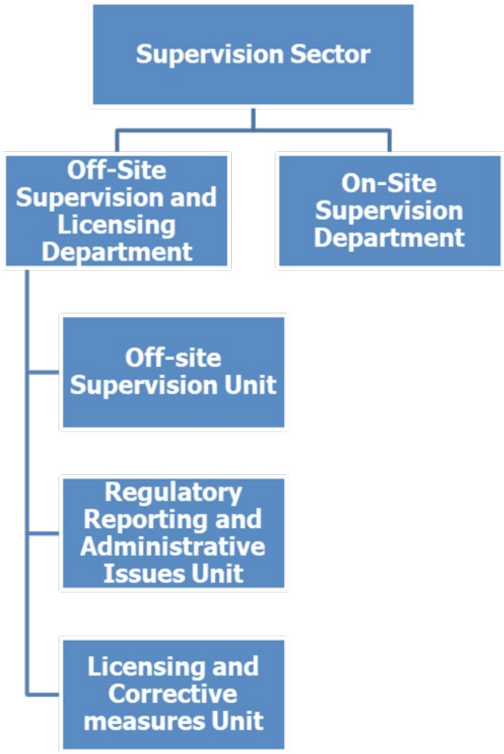
The most significant activities of the National Bank in 2020 in the field of banking regulation can be divided into two groups: (1) further harmonization with the relevant EU legislation and (2) regulatory changes to adequately address adverse effects of the Covid-19 pandemic on the domestic banking system and on the domestic private sector.

Within the first group of activities, during 2020 the National Bank has enacted the following acts:

- New regulation for liquidity risk management, which, inter alia, enabled introduction of the Liquidity Coverage Ratio, as a short-term liquidity standard that banks will have to follow and comply with, starting from January 1, 2021. The drafting of the new regulation followed the requirements of the European Capital Requirements Regulation (Regulation (EU) No 575/2013), including amendments to this Regulation from May 2019, as well as the relevant acts of the European Commission. In addition to this novelty, the new regulation enables further improvement of the manner of liquidity risk management, primarily in the field of liquidity risk monitoring by monitoring the liquidity coverage ratio on aggregate level and by each significant currency, establishing and maintaining an appropriate maturity structure, monitoring of sources of funds and their concentration, monitoring of available unencumbered assets and determination, monitoring and maintenance of internal liquidity ratios;
- New regulation on the manner of determining related persons and the exposure limits which enables more appropriate implementation of the relevant provisions of EU Regulation 575/2013 (CRR), including the latest amendments to this regulation from May 2019 on setting and monitoring the exposure limits. The guidelines of the Basel Committee and the European Banking Authority for determining large exposures and identifying related persons were also taken into account during the drafting of this new regulation. Due to the importance of the introduced novelties and the need for appropriate adjustments of banks' systems for adequate implementation of the new requirements, this regulation also came into force on January 1, 2021;
- Amendments to risk management regulation to comply with new liquidity risk management requirements. Starting from January 1, 2021, within internal liquidity adequacy assessmen process (ILAAP), the banks will be required to adequately monitor the liquidity coverage ratio and to use all other liquidity monitoring tools, defined in the new liquidity risk management regulation.

For the purpose of adequate response to challenges caused by the global pandemic, the National Bank introduced several regulatory changes, the most significant of which relates to the regulation on credit risk management. Following the example of the activities undertaken in the EU, the regulatory changes from March 2020 enabled the changes in the contractual terms of the exposures approved by the banks not to be treated as foreborne exposures. This option was allowed on a temporary basis, i.e. until the end of September 2020, with the focus on good banks' clients with performing status, which avoids excessive accumulation of risks in the balance sheets of the domestic banks. Banks were allowed, in mutual agreement with the borrowers, to offer more favorable contractual terms of the existing loans, including the possibility of granting a grace period (moratorium). The modified contractual terms did not trigger a foreborne treatment of those exposures, given the fact that they are response to systemic risk caused by the COVID-19 and were aimed at a broad set of customers and products offered by the banks. However, banks were still required to carry out adequate analysis of the quality of the credit exposure and of the customer, especially for customers - non-financial entities.

Organizational chart of the Banking Supervisory Authority



The organizational structure of the supervisory function within the National Bank remains unchanged. As explained previously, the supervisory function is performed by a separate organizational part (Supervision Sector) consisted of two departments: Off-site Supervision and Licensing Department and On-site Supervision Department. This Sector is headed by a General Manager, appointed by the governor of the National Bank.

The organizational structure of the National Bank provides for a division of the activities of the Supervision Sector and the Financial Stability, Banking Regulations and Resolution Department (FSBRRD), especially in terms of performing the supervisory and resolution functions. The FSBRRD is directly subordinated to the Governor and is responsible for development of the secondary banking regulations (by-laws) and for the monitoring of the financial stability in the country and proposing adequate macro-prudential measures, if needed. This Department will also be responsible for bank resolution after the completion of the preparatory activities for introduction and implementation of the relevant law and by-laws.

The cooperation between the Supervision Sector and FSBRRD is channeled through a separate Committee for supervision, financial stability and resolution. The Committee serves as a platform for exchanging relevant information and data between this organizational units and it is an integral part of the whole decision-making process within the National Bank.

Main strategic objectives of the Banking Supervisory Authority in 2020

As over the previous year, the main objectives of the supervision were to maintain stable and reliable banking system as the main prerequisite for financial stability and sustainable economic growth of the country. In 2020, the supervision of banks was focused on regular assessment of the risk profile ,the required level of capital of individual banks and timely taking of appropriate supervisory action. Credit risk, continues to be in the focus of supervisory activities, this year, specifically in the so called „Covid portfolio" or the portfolio impacted by the Covid-19 crisiss and the part of the portfolio that was granted moratorium. Also, corporate governance and operational risk, and within its framework, especially the risk arising from the information system security and the risk of money laundering and financing of terrorism, were primarily subject of assessment this year.

In addition, the National Bank continued to strengthen the existing supervisory capacity and continued its activities to follow and harmonize the regulatory framework with the international standards and the European legislation in the field of banking operation.

The activities of the Banking Supervisory Authority in 2020

Activities of the Off-Site Supervision Department

The activities of the Off-site Supervision and Licensing Department continued on regular basis. It means, that it determines the overall risk profile of the bank, which includes an assessment of: the business model, the corporate governance, the liquidity position and the risks to the bank's capital position. Also, it has continued with its activities for determining banks' minimum capital requirement (Pillar 2) which is communicated with the banks at least once a year.

In 2020, all banks submitted their ILAAP reports to the National bank for the first time. The Department was involved in their initial assessment, as well as in building internal methodology for their assessment, which will enable consistent supervisory assessment of the banks' practices. The activity was the part of the EU Twinning Project for strengthening the institutional capacity of the National Bank in the process of its accession to the ESCB.

The Department was engaged in the assessment of the recovery plans submitted by all systemically important banks. As in previous years, the National bank gave the banks recommendations for further enhancements of their recovery plans.

The process of further development of the internal methodology for the assessment of the banks' business models and strategies continued. As an outcome, development of a so-called "BMA tool" for assessment of viability of bank's existing business model and sustainability of bank strategy over a forward - looking period was finalized.

Within its legal authorization, the off-site supervisory function of the National bank was involved in issuing licenses and approvals to banks and savings houses and undertaking corrective measures. During 2020, The Governor of the National bank has issued 87 licenses which were related to: approvals for appointment of members of Supervisory Board and Management Board of banks, amending and/or supplementing the

Statutes of banks, approvals for commencement of new financial activities by banks, approvals for acquiring ownership in banks and change the address of the bank. In order to maintain the stability and safety of the banking institutions and banking system, the National bank undertook corrective measures towards banks and saving houses where illegitimacies, irregularities and non-compliance with Law on Banks and by-laws were determined during on-site inspections.

Activities of the On-Site Supervision Department

Having in mind the Covid-19 outbreak in 2020, the regular supervisory activities were performed online. 9 controls on banks and 2 controls on fast-money service providers took place in 2020. Focal points of the banks' on-site examinations were assessing of the credit risk, ML/TF risk, IT risk, corporate governance, operational risk and banks' responsiveness to measures from previous examinations in the areas of credit risk, ML/TF risk and operational risk.

Focal points of the credit risk assessment were banks' risk strategy and risk appetite, credit exposure (classification and impairment), monitoring and management with non-performing loans, as well as the previouselly pointed "Covid portfolio".

AML/CFT controls were focused on customer due diligence (especially the process of monitoring of business relationship and transactions), quality of STRs and feedback from the FIU, process of determining of inherent and residual risk etc.

IT risk controls consisted of Corporate management – IT, information security (including IT operations), development, maintenance and acquisition, audit – IT and alternative channels.

Operational risks controls consisted of assessment of adequacy of risk strategy and risk appetite, risk identification, source of operational risk and its measurement, analysis of the harmful events basis, internal audit, outsourcing etc.

Supervisory activities in the area of corporate governance consisted of following the banks' responsiveness of the previous measures regarding the activities of the management and supervisory bodies, rewarding process, risks, compliance and internal audit.

Focal points of the fast-money transfer services were international transactions with focus on proper use of documents, spreadsheets and payment limits prescribed by the National bank and ML/TF risk (same focal points as banks).

Also, during 2020 on-site risk assessment methodologies were improved through adjustment of the separate risks' internal procedures with the ECB standards, as well as relevant amendments of laws and by-laws. For instance, a new methodology for ICT Risk Assessment under the Supervisory Review and Evaluation process (SREP) was adopted. The new AML/CFT methodology introduced new elements regarding inherent and residual risk, as well as monitoring of restrictive measures towards banks' clients.

In 2020, the National Bank took part in the preparation of the National strategy of money laundering and terrorist financing prevention. In terms of the supervisory function, the National Bank improved the risk assessment methodologies, especially the process of supervisory assessment of ML/TF and IT risk.

Besides previous activities, National bank organized on-line workshops for employees from fast-money transfer services and exchange offices where most important AML/CFT issues from the regulatory and supervisory point of view were discussed.

International activities of the authority

Even in the unusual circumstances existent dring 2020, the National Bank continued with the capacity building and acquiring appropriate knowledge on the best standards and practices, but also for enhancing its supervisory practices and capacity through participation in trainings organized by other central banks or relevant international organizations. Particular importance in this area was the twinning program with the European Union which ended at the beginning of 2021, and that, inter alia, was aimed at further harmonization of the banking regulation with the relevant European legislation and strengthening of the established supervisory practices, with special highlight on the activities related to the establishment of Liquidity Coverage Ratio, resolution of non-performing loans and enhancement of its practices for licensing. The National Bank is also part of the regional program of the European Union for strengthening the capacities of the central banks from the Western Balkans in order to integrate them in the European system of central banks. Within this program, several trainings in the field of supervision, financial stability and bank resolution have already been organized. Finally, the technical assistance received from the World Bank Sector Advisory Center (FinSAC), based in Vienna should also be highlighted. The cooperation with this Center is of particular importance for the preparation of the Law on Bank Resolution, as well as in relation to the development of an internal model of the National Bank for credit risk assessment of individual banks' clients.

Within the cooperation based on bilateral and multilateral Memorandums of Understandings and Written Coordination and Cooperation Agreement, the National Bank's supervisory staff attended supervisory college for Slovenian subsidiary. In early 2020, the Written Agreement for the Greek banking group was terminated, based on the ECB's notice that after the sale of a significant subsidiary, there were no longer significant subsidiaries in the group. However, in the sense of good cooperation, in December 2020, a meeting between National Bank and JST/ECB was held, at which both institutions exchanged information regarding SREP results for the supervised parent bank and its subsidiary.

National bank employees took part at the Moneyval (Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism) plenary meetings in 2020 where latest information of the 5th round of evaluation were discussed.

Cooperation with other supervisory bodies in the country

Despite the prolonged duration of the coronavirus pandemic which lasted throughout the 2020 and beyond, the cooperation with other supervisory bodies continued without delay of the planned activities. The process of updating of some of the Memorandums of understanding signed between the NBRNM and the other domestic financial regulators that began in late 2019, continued throughout 2020. These activities resulted in a newly signed Memorandum of understanding with the Security and Exchange Commission (June 2021), and entering into the final stage of signing new memorandums with the Agency for supervision of Insurance and with the Agency for Supervision of Fully Funded Pension Insurance.

Following the general post-crisis trends and in line with the recommendations of the 2018 FSAP mission, important steps were taken in 2020, to further strengthen financial stability framework in the country. By signing a Memorandum of Understanding in the first quarter of 2020, Financial Stability Committee (FSC) was reconstituted to serve as principal domestic coordination body for macro prudential policy and crisis management. FCS now comprises of all the regulatory and supervisory authorities in the country (National Bank of the Republic of North Macedonia, Ministry of Finance, Agency for Insurance Supervision, Securities and Exchange Commission and Agency for Supervision of Fully Funded Pension Insurance) and Deposit Insurance Fund providing a platform for joint risks assessment and policy coordination among different authorities. In support to the FSC, two sub-committees are operationalized – Sub-Committee for monitoring systemic risk and recommendation of macro prudential measures and Sub-Committee for preparing financial crises management, both working under the guidelines of FSC. The Governor of the National Bank chairs the Committee meetings and is the national coordinator. The Committee meets regularly twice a year, and if necessary more often, while sub-committees meet at least on a quaterly basis. During 2020, a new Law on Financial Stability was drafted which will strengthen the legal ground for adequate operation of this Committee with clear macroprudential powers and tools of the financial regulators. In parallel, amendments to central bank's law have been drafted to provide the National Bank a clearer mandate for macro prudential policy. Macro prudential policy strategy has been drafted, but not adopted yet, describing how financial stability and macro prudential policy functions are going to be organized in the country including the risk identification process, instrument selection and calibration, implementation and communication and evaluation of the impact of the instruments. National Bank will continue to build capacity for risk assessments and analysis and improve its macroprudential framework in order to identify and address systemic risks on a timely and effective basis and sustain financial stability in the country.

In 2020, National bank submitted two semi-annual reports to the Financial Intelligence Office with information concerning examinations performed and findings. Also, National bank sent separate information to the Financial Intelligence Office concerning supervisory controls on separate banks.

Questionnaire tables for the 2020 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	15	15	14
Branches of foreign credit institutions	0	0	0
Cooperative banks	0	0	0
Banking sector, total:	**15**	**15**	**14**

Total assets of banking sector (in millions of Macedonian Denar) (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	503,469	549,969	585,501
Branches of foreign credit institutions	0	0	0
Cooperative banks	0	0	0
Banking sector, total:	**503,469**	**549,969**	**585,501**
y/y change (in %)	**9.0%**	**9.2%**	**6.5%**

** 1 EUR = 61.6940 MKD, as of 31.12.2020*

Ownership structure of banks on the basis of assets total

Item	2018	2019	2020
Public sector ownership	2.0%	1.9%	2.0%
Other domestic ownership	26.4%	26.3%	26.1%
Domestic ownership total	28.4%	28.2%	28.1%
Foreign ownership	71.6%	71.8%	71.9%
Banking sector, total:	**100.0%**	**100.0%**	**100.0%**

Concentration of asset by the type of financial institutions

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	57.3%	76.5%	1,394
Branches of foreign credit institutions	/	/	/
Cooperative banks	/	/	/
Banking sector, total:	**57.3%**	**76.5%**	**1,394**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2018	2019	2020
Commercial banks	16.0%	11.7%	11.3%
Cooperative banks	/	/	/
Banking sector, total:	**16.0%**	**11.7%**	**11.3%**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2018	2019	2020
Commercial banks	100.0%	100.0%	100.0%
Branches of foreign credit institutions	/	/	/
Cooperative banks	/	/	/
Banking sector, total:	**100.0%**	**100.0%**	**100.0%**

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

Assets	2018	2019	2020
Cash, balances and deposits with central bank (National Bank)	14.2%	17.1%	16.7%
Placements in securities	12.2%	12.7%	14.1%
- issued by domestic government sector	7.0%	7.7%	12.0%
- issued by central bank (National Bank)	5.0%	4.5%	1.7%
- other (including non residents)	0.3%	0.5%	0.4%
Loans, deposits and accounts with financial institutions (excluding central bank, including non residents)	10.1%	7.7%	7.3%
Loans with non-financial sector (including non residents)	59.6%	58.5%	57.5%
- loans with domestic government sector	0.4%	0.3%	0.3%
Other assets	3.9%	3.9%	4.5%
Total	**100.0%**	**100.0%**	**100.0%**
Liabilities	**2018**	**2019**	**2020**
Deposits of financial institutions (including non residents)	5.5%	5.5%	5.3%
Deposits of non financial sector (including non residents)	73.8%	73.7%	73.6%
- deposits of domestic government sector	0.2%	0.2%	0.2%
Borrowings, issued securities and liabilities on the basis of subordinated and hybrid instruments (including non residents)	6.6%	6.7%	6.8%
- domestic financial sector	5.5%	1.8%	1.9%
- domestic government sector	0.1%	0.1%	0.0%
- other	4.5%	4.8%	4.9%
Other liabilities	3.4%	1.7%	1.4%
Equity and reserves (including loss in current year)	10.8%	11.0%	11.6%
Profit after tax in current year	1.7%	1.4%	1.2%
Total liabilities	**100.0%**	**100.0%**	**100.0%**

Capital adequacy ratio of banks

Type of financial institution	2018***	2019***	2020***
Commercial banks	16.5%	16.3%	16.7%
Cooperative banks	/	/	/
Banking sector, total:	**16.5%**	**16.3%**	**16.7%**

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

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

Asset classification	2018	2019	2020
Non-financial sector, including	5.2%	4.8%	3.4%
- households	2.3%	2.0%	1.6%
- corporate	8.0%	7.6%	5.2%

The structure of deposits and loans of the banking sector in 2020 (%)
(at year-end)

	Deposits	Loans
Non-financial sector, including:	93.8%	99.8%
Households	62.9%	51.2%
Corporate	27.7%	47.6%
Government sector	0.3%	0.6%
Financial sector (excluding banks)	6.2%	0.2%
Total	**100.0%**	**100.0%**

P&L account of the banking sector, in millions of Macedonian Denar (at year-end)

P&L account	2018	2019	2020
Interest income	19,605	19,247	18,525
Interest expenses	-4,225	-4,232	-3,451
Net interest income	15,380	15,015	15,074
Net fee and commission income	4,639	5,075	4,844
Other (not specified above) operating income (net)	4,217	3,004	3,951
Gross income	24,236	23,093	23,869
Administration costs**	-10,029	-10,427	-10,374
Depreciation	-1,078	-1,050	-1,084
Provisions***	-717	392	-57
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)****	-3,071	-4,496	-4,429
Profit (loss) before tax	9,341	7,514	7,925
Net profit (loss)	8,353	6,685	7,252

** 1 EUR = 61.6940 MKD, as of 31.12.2020*

*** Administration costs include all operating expenses, except for depreciation.*

**** Provision items include: impairment losses of non-financial assets, provisions for off-balance sheet items and other provisions.*

***** Presented on net basis.*

Total own funds in 2020 (in EUR)

Type of financial institution	Total own funds***	Core Tier 1***	Tier 1***	Tier 2***	Tier 3
Commercial banks	1,144,369,287	1,040,929,461	1,045,815,852	98,553,435	/
Cooperative banks	/	/	/	/	/
Banking sector, total:	1,144,369,287	1,040,929,461	1,045,815,852	98,553,435	/

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

Macroeconomic environment in the country

As in the case of other economies in the region, the COVID-19 pandemic had a significant negative impact on the macroeconomic situation in Poland in 2020. Poland's GDP in fixed prices decreased by 2.8% in 2020 (compared to an increase of 4.5% in 2019 and 5.4% in 2018). It was a first economic recession in Poland after many years of intensive growth. However, taking into account the level of GDP decrease in 2020, Poland was one of the European countries which were least affected by the COVID-19 crisis. Detailed data of GDP structure show that the main factor contributing to the GDP decrease in 2020 was decreased domestic demand (including household consumption).

The pandemic adversely affected other macroeconomic indicators. The average annual inflation measured by consumer price index (CPI) in 2020 was 3.4% compared to 2.3% in 2019. The economic shock caused by the COVID-19 pandemic is comparable to the greatest crises faced by the global economy in the last century. The recession amplified some tendencies which were present on the market earlier, mainly contributing to further interest rate cuts and flattening the yield curve. In the face of the pandemic, the Monetary Policy Council decided to lower interest rates three times in March (from 1.5% to 1.0%), April (from 1.0% to 0.5%) and May 2020 (from 0.5% to 0.1%). Altogether, the reference rate was decreased by a total of 140 basis points and as of 29 May 2020 was set at a record low of 0.1%.

The cumulative balance of the current account from the previous twelve months amounted to PLN 81.4 billion in December 2020 (compared with PLN 11.2 billion in December 2019). Differences compared to the previous year were noticed mostly in the area of commodity trade, whose balance was higher by PLN 47.2 billion than in the same period of the previous year.

On the domestic labour market, in December 2020, the officially recorded unemployment rate was 6.2% (as compared to 5.2% at the end of 2019). It means halting the positive trend in the area of unemployment rate decline, which started in 2013.

2020 saw the weakening of the Polish zloty against the euro and the Swiss franc. At the end of the year, the average PLN/EUR exchange rate was 4.61 compared to 4.30 at the beginning of the year, and the average PLN/CHF exchange rate was 4.26 (compared to 3.90). On the other hand, the Polish zloty strengthened against the US dollar (USD). At the end of 2020, the average PLN/USD exchange rate was 3.76 compared to 3.90 at the beginning of 2020. At the end of 2020, the interest rate on 10-year Treasury bonds amounted to 1.25% and was much lower than the year before (2.06%).

Development in the banking sector (including assets total / GDP)

At end of 2020, the KNF Board supervised 30 commercial banks (including 1 state bank and 2 affiliating banks), 2 institutional protection systems, 530 cooperative banks, and 37 branches of credit institutions. In 2020, the KNF Board approved the merger processes for four cooperative banks.

The total balance sheet of the Polish banking sector at the end of December 2020 amounted to PLN 2 355.6 billion (an increase of 17.8% as compared with the end of December 2019). Domestic commercial banks (with foreign branches) account for 89.6% of the sector's assets, branches of credit institutions for 3.3%, and cooperative banks for 7.1%.

In the structure of assets, 57.3% (PLN 1 350.4 billion) were loans and other receivables, 20.7% (PLN 487.9 billion) were available-for-sale financial assets, 1.5% (PLN 35.4 billion) were held-for-trading financial assets, and 4.8% (PLN 112.7 billion) were cash, cash at central banks and other demand deposits. As for liabilities, deposits accounted for 72.1% of total liabilities (PLN 1 697.9 billion), and equity for 9.7% (PLN 227.6 billion). In

2020, gross receivables from the non-financial sector increased by 0.8%, reaching PLN 1 157.5 billion at the end of December.

An important component of the banking sector's assets are housing loans, including loans denominated in or indexed to Swiss franc (CHF). In 2020, for another year, there was a clear decrease in the volume of loans in CHF; their sum decreased from CHF 25.0 billion at the end of December 2019 to CHF 22.7 billion at the end of December 2020, i.e. a decrease of 9.1% over the year and 34.9% over five years (from CHF 34.9 billion at the end of December 2015). At the same time, the quality of housing loans, including those denominated in CHF, remains good - in 2020 it was at a level similar to the previous year. The share of non-performing loans in the portfolio of housing loans is the lowest of all loan portfolios.

In 2020, the net financial result of the banking sector amounted to PLN 7.6 billion and was lower by 45.3% as compared to 2019. In 2020, 16 commercial banks and 8 branches of credit institutions paid a total of PLN 4.5 billion on account of the banking tax. It is PLN 0.44 billion (+108%) more than in 2019. The net interest income amounted to PLN 47.0 billion (-4.3% YoY), of which the interest income amounted to PLN 56.6 billion (-14.3% YoY), and interest expenses to PLN 9.6 billion (-43.4%). The commission income was PLN 14.9 billion (+11.1% YoY). Banks' operating expenses were 0.4% lower than in the previous year and amounted to PLN 34.7 billion, and impairment write-downs of financial assets increased by 34.1% YoY to PLN 11.8 billion.

The Polish banking sector assets in relation to the Polish GDP was at level close to 100%. Whereas the domestic financial system's assets to GDP ratio at the end of 2020 was 137%.

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 Polish Financial Supervision Authority (Polish: 'Urząd Komisji Nadzoru Finansowego', hereinafter: 'PFSA') and the KNF Board (Polish: 'Komisja Nadzoru Finansowego') operate under the Act of 21 July 2006 on financial market supervision[1], hereinafter: 'Act on financial market supervision'. The PFSA has the status of a state legal person, the bodies of which are the KNF Board and the Chair of the Board. The Chair of the Board manages the activities of the KNF Board and the PFSA and represents them externally.

The KNF Board is competent for supervision of the financial market, which under the legal framework as at 31 December 2020 included:

- banking supervision,
- pension supervision,
- insurance supervision,
- capital market supervision,
- supervision of payment institutions, payment services offices, electronic money institutions, branches of foreign electronic money institutions,
- supervision of credit rating agencies,
- supplementary supervision of credit unions, insurance undertakings, reinsurance undertakings and investment firms included in a financial conglomerate,
- supervision over credit unions and the National Association of Credit Unions,

[1] On 5 February 2020, the consolidated text of the Act was announced (Journal of Laws 2020, item 180), in 2020 amendments were announced in the Journal of Laws items 284, 568 and 695. On 20 November 2020, the consolidated text of the Act was announced (Journal of Laws 2020, item 2059).

- supervision of mortgage credit intermediaries and their agents,
- supervision as provided for in Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014 and supervision as provided for in Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012.

The purpose of supervision of the financial market is to ensure its proper functioning, stability, security and transparency, confidence in the financial market, and to ensure that the interests of market participants are protected. That purpose is also achieved through reliable information concerning the functioning of the market, through the pursuit of objectives stated, in particular, in the Banking Law of 29 August 1997, the Act of 22 May 2003 on insurance and pension supervision, the Act of 15 April 2005 on supplementary supervision of credit institutions, insurance undertakings, reinsurance undertakings and investment firms being part of a financial conglomerate, the Act of 29 July 2005 on capital market supervision, the Act of 5 November 2009 on credit unions and the Act of 19 August 2011 on payment services.

The PFSA's statutory task is to provide assistance to the KNF Board and the Chair of the KNF Board. The activities of the PFSA as a state legal person are supervised by the President of the Council of Ministers. The PFSA is managed by the Chair of the KNF Board assisted by Deputy Chairs of the KNF Board, Director General, Managing Directors who direct their respective divisions, and Directors of organisational units.

Main strategic objectives of the Supervisory Authority in 2020

In 2020 the activities of the KNF Board (and subsequently - the PFSA) focused primarily on the objectives set out by the Act on financial market supervision i.e.: ensuring the proper functioning of the financial market, its stability, security and transparency, confidence in the financial market, and ensuring that the interests of market participants are protected. However, the impact of COVID-19 pandemic on the financial market was a key issue around which the supervisor's activities (based on strategic objectives) were focused.

The activities of the Banking Supervisory Authority in 2020

At the very start of the epidemic, the PFSA took firm actions to support the functioning of the supervised sectors: banking, capital and insurance sectors. The PFSA developed and published the Supervisory Stimulus Package for Security and Development (Polish: 'Pakiet Impulsów Nadzorczych', hereinafter: 'PIN'). PIN was aimed at ensuring the necessary balance between the relevant stability indicators of the Polish financial system on the one hand, and supporting business activities (particularly maintaining credit availability for businesses) on the other.

PIN comprised a package of measures to boost the resilience of the Polish banking sector and its capacity for financing the economy. With respect to bank financing of corporate customers in the face of the COVID-19 pandemic – it was aimed at enabling banks to maintain or change the terms of bank financing (e.g. to extend repayment deadlines or to increase amounts) of corporate customers. To that end, the PFSA in agreement with the banking industry, presented its position on the interpretation and application of Article 70(2) of the (Polish) Banking Law. With respect to bank financing of micro-, small- and medium-sized enterprises - banks were offered an approach which, on the one hand, paved the way for secure bank financing of the SMEs that despite their good business activity history have not been assigned a positive credit score, and, on the other hand, ensured proper allocation of risks and distribution of economic incentives between the funding banks and such SMEs and their owners.

The supervisory activities in the banking sector in 2020 covered the full supervisory process, including the licensing process, the off-site supervision and the inspection activities carried out on-site. The COVID-19 crisis caused significant organisational challenges related to the performance, on a big scale, of inspection activities at banking sector entities, which resulted from a high number of simultaneous inspection activities as well as the broad scope of inspection. The measures undertaken, related to developing new organisational solutions, ensured an efficient and effective course of inspection activities at the entities under inspection. The adopted solutions made it possible to carry out inspection activities in a secure and effective manner, making maximum use of remote work.

Supervisory activities carried out with respect to banking sector included i.a.:

(1) examining the impact of the pandemic on the banks' credit portfolio
Due to the development of the COVID-19 pandemic in 2020, the PFSA constantly monitored the impact of the COVID-19 crisis on particular banks. Regular review covered assistance funds used by the banks in response to the COVID-19 crisis, including the banks' use of legislative and non-legislative moratoria, adopting other restructuring measures and taking advantage of public guarantee programmes. These activities were aimed at a timely identification of situations which are a potential threat to the security of particular banking sector entities and the stability of the sector as a whole, and at enabling preventive measures.

(2) assessment of the rre(fx) portfolios
In 2020, due to a significant increase in the number of disputes related to the portfolio of foreign currency mortgage loans for households, the impact of the growing legal risk on the situation of particular banks was constantly monitored. The PFSA also regularly assessed the legal risk resulting from the portfolio of mortgage-secured CHF- and EUR-denominated loans for households. These activities were aimed at a timely identification of situations which are a potential threat to the security of particular banking sector entities and the stability of the sector as a whole, and at enabling preventive measures.

(3) stress testing
As in previous years, in 2020 the PFSA carried out stress tests in the commercial banks sector, which make it possible to assess the banks' resilience to macroeconomic shocks. Banks provided the estimate assessments of their capital position on the basis of the National Bank of Poland's macroeconomic scenarios, using the reporting template drawn up by the PFSA. The PFSA verified the received results for their internal coherence and the reality of the financial projections. It paid special attention to credit risk projections, the quality of the asset portfolio, and covering non-performing exposures by write-downs. It assessed the level of provisions for the risk of mortgage-secured foreign currency loans. It also adjusted the estimates related to, among others, asset profitability, commissions and funding costs.

The PFSA participated in the work of the Financial Market Development Council's Special Task Force for analysing legal solutions related to financial instruments which could be classified as Additional Tier 1 capital (AT1). As a result of the works of that Task Force, draft Act amending the Act on bonds and certain other laws (UC 32) was prepared that at the turn of 2020/2021 was still subject to interministerial consultations, in which the PFSA participated. The draft introduces instruments which banks and brokerage houses will be able to classify as Additional Tier 1 capital and as RT1 own funds of insurance and reinsurance undertakings.

The PFSA also worked on the project of reform of the mortgage bank model. The need to start this work resulted from the need to implement the Covered Bond Directive (CBD) and from regulatory changes proposed by the banking sector in relation to reducing the operating costs of mortgage banks, which are supposed to lead to increasing the volume of the issue of mortgage bonds.

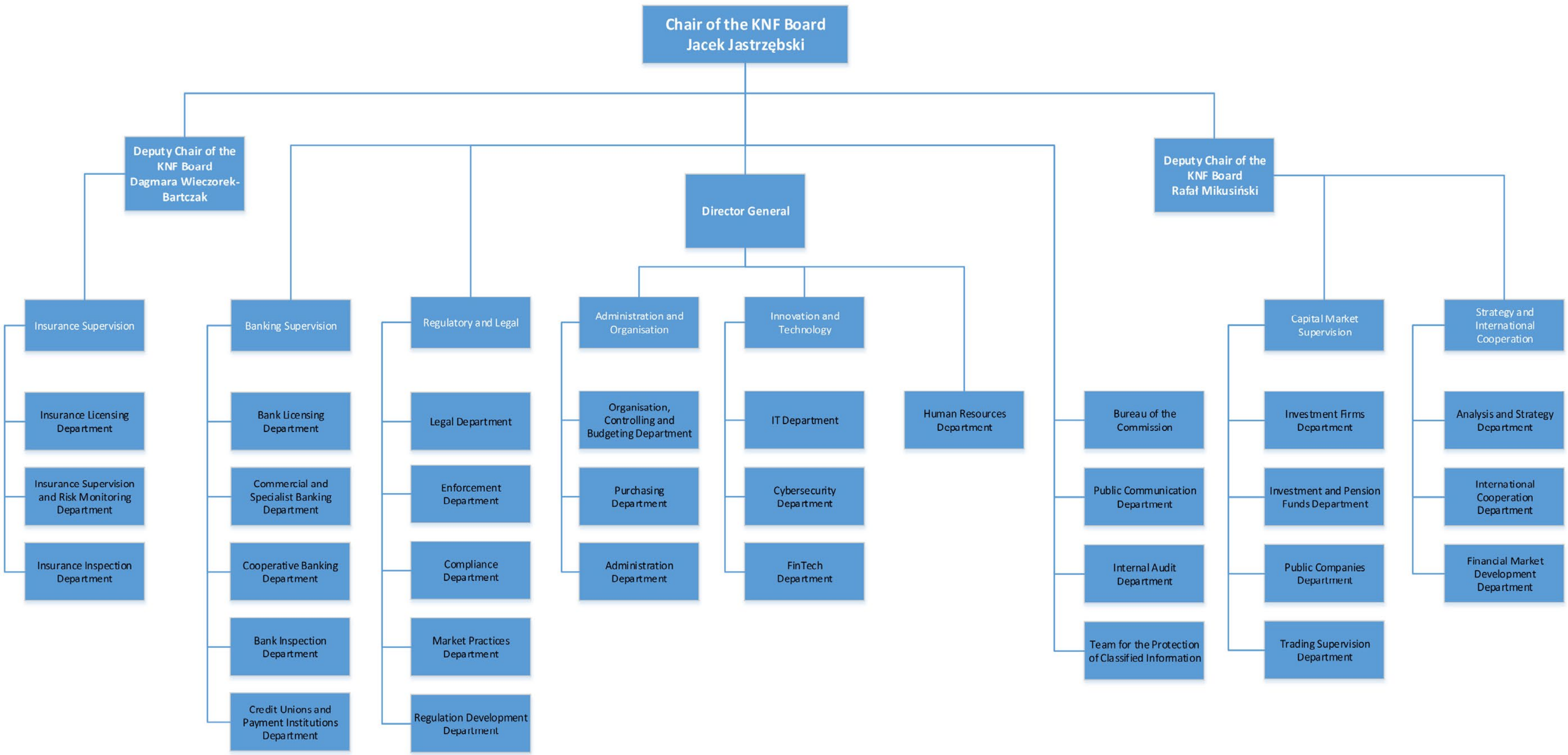
Under the project, the PFSA prepared a detailed analysis of:

- legal changes proposed by mortgage banks;
- possibility of introducing the proposed changes to the Act of 29 August 1997 on mortgage bonds and mortgage banks and the Act of 29 August 1997 – the Banking Law.

The main focus was placed on matters related to differences between the regulations on mortgage bonds in Poland as compared to other European markets. As a result of the work, the PFSA proposed significant changes to the Act on mortgage bonds and mortgage banks in the context of outsourcing in the banking sector as part of capital groups, and other measures facilitating the operations of mortgage banks.

Organizational chart of the Banking Supervisory Authorit

the Polish Financial Supervision Authority



International activities of the authority

Involvement of the PFSA in international fora was an essential element in the process of building a stable regulatory environment for financial market participants in Poland. The international cooperation has become particularly important in view of the challenges posed by the COVID-19 pandemic. The Cooperation with financial supervisory authorities from other countries in bilateral and multilateral forms, including colleges of supervisors, by exchanging information and experiences, served the implementation of the PFSA's supervisory objectives.

The European System of Financial Supervision (ESFS) remained particularly important field of international activities – as the key laws setting the framework for the functioning of financial institutions are adopted at the EU fora. Throughout 2020, the cooperation of European institutions within the European System of Financial Supervision involved actions related with the need to introduce solutions aimed at minimising the negative consequences of the COVID-19 pandemic.

In 2020 the day-to day involvement of the PFSA employees in the activities of the European Banking Authority (EBA) remained crucial from the banking supervision perspective.

During the COVID-19 crisis, the PFSA actively cooperated with the EBA in preparing positions/guidelines in support of banks' operating activities and focusing supervisory processes on the assessment of key risks in the sector, including risks caused by the pandemic, for example in preparing guidelines on legislative and non-legislative moratoria on loan repayments. Actions were also taken to ensure the convergence of supervisory practices with respect to the 2020 supervisory review and evaluation process at the EU level. The new arrangements were reflected in the PFSA's initiative in the form of the Supervisory Stimulus Package (PIN) and allowed for effective bank supervision during the crisis. To help achieve that goal, positions were prepared on the postponement of reporting deadlines, as well as draft regulatory technical standards on disclosures under the Capital Requirements Regulation (CRR).

Employees of the PFSA were also actively engaged in the updating of the methodology for the EU-wide stress tests. The main emphasis in that work was to consider the impact of the COVID-19 pandemic (and related remedial measures) on the situations of banks in the stress test exercise.

The PFSA's international activities also took the form of deepening cooperation within Central and Eastern Europe and with non-euro area countries whose supervisors, due to the characteristics of those markets or convergent interests, quite often present similar positions.

The PFSA cooperated on an ongoing basis with central authorities (Ministry of Finance, Ministry of Foreign Affairs, Ministry of Development) and European financial supervisory authorities in the context of international events which may affect the stability of the Polish financial market.

Cooperation with other supervisory bodies in the country

In 2020 the KNF Board took part in the works of the Financial Stability Committee (KSF) – a body comprising: (i) The KNF Board, (ii) the National Bank of Poland, (iii) the Ministry of Finance and (iv) the Bank Guarantee Fund. The KSF is responsible for both: (1) macroprudential supervision and (operating under the chairmanship of the President of the NBP), and (2) crisis management in the financial system (operating under the chairmanship of the Minister of Finance).

As in the previous years, the KNF Board continued its cooperation – in the area of prevention of money laundering and terrorist financing - with the General Inspector of Financial Information (GIFI). The cooperation covered in particular the following areas:

- preparation, as appropriate, of the list of information on technical compliance of the Polish AML/CFT system with the recommendations of the Financial Action Task Force (FATF) and demonstration of the effectiveness of the system in connection with the planned evaluation of the Polish AML/CFT system as part of the 5th round of evaluation of Poland run by the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL) at the Council of Europe;
- participation in the work on the implementation of the Fifth AML Directive;
- participation in activities aimed at preparing an update of the national risk assessment of money laundering and terrorist financing, including providing a substantive contribution to the GIFI;
- active participation in the Financial Security Committee attached to the GIFI;
- notification of transactions the circumstances of which indicate that the transaction is related to money laundering or terrorist financing;
- reporting irregularities identified at obliged institutions in the course of ongoing analysis;
- exchange of information on the plans and results of inspections at obliged institutions;
- participation in working meetings, training sessions and workshops.

The statutory tasks of the KNF Board included also participation in the process of drafting laws regulating supervision over the financial market, which was particularly important in the COVID-19 pandemic, given the necessity to provide swift regulatory responses to emerging challenges.

Other relevant information and developments in 2020

In 2020 the KNF Board revised the list of O-SIIs (Other Systemically Important Institutions) and the buffer rates imposed on identified O-SIIs. Following the review, the KNF Board confirmed the identification of ten banks as O-SIIs. On that basis, the KNF Board also decided to set appropriate buffer rates, ranging from 0.1% to 1.0%. The list of the identified entities is subject to annual review (under the Act of 5 August 2015 on macroprudential supervision) and, if necessary, the buffer rates are adjusted accordingly.

Questionnaire tables for the 2020 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	32	30	30
Branches of foreign credit institutions	31	32	36
Cooperative banks	549	538	530
Banking sector. total:	**612**	**600**	**596**

Total assets of banking sector (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	1 689 645 807 178	1 780 157 094 516	2 106 035 795 905
Branches of foreign credit institutions	65 844 638 264	69 290 186 151	76 847 609 684
Cooperative banks	138 252 091 690	150 684 769 806	167 174 803 181
Banking sector. total:	**1 893 742 537 132**	**2 000 132 050 473**	**2 350 058 208 770**
y/y change (in %)	**6.58%**	**5.62%**	**17.50%**

Ownership structure of banks on the basis of assets total

Item	2018	2019	2020
Public sector ownership	39.37%	39.87%	44.11%
Domestic ownership total	52.90%	53.57%	56.32%
Foreign ownership	47.10%	46.43%	43.68%
Banking sector. total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2020

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	42.61%	60.86%	950.8
Branches of foreign credit institutions	37.13%	51.81%	809.4
Cooperative banks	1.74%	2.75%	38.9
Banking sector. total:	**38.19%**	**54.54%**	**764.6**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2018	2019	2020
Commercial banks	6.61%	6.87%	-0.32%
Cooperative banks	5.26%	4.69%	3.61%
Banking sector. total:	**6.53%**	**6.73%**	**-0.08%**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2018	2019	2020
Commercial banks	89.22%	89.00%	89.62%
Branches of foreign credit institutions	3.48%	3.46%	3.27%
Cooperative banks	7.30%	7.53%	7.11%
Banking sector. total:	**100.0**	**100.0**	**100.0**

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

	2018	2019	2020
Receivables	**100%**	**100%**	**100%**
Financial sector	9.16%	9.23%	9.31%
Nonfinancial sector	58.27%	57.42%	49.00%
Government sector	8.44%	9.33%	10.44%
Other assets	24.13%	24.02%	31.24%
Liabilites	**89.23%**	**89.53%**	**90.65%**
Financial sector	19.21%	17.54%	19.53%
Nonfinancial sector	61.33%	63.65%	61.21%
Government sector	4.41%	4.26%	5.12%
Other liabilities	4.28%	4.09%	4.80%
Capital	**10.77%**	**10.47%**	**9.35%**

Capital adequacy ratio of banks***

Type of financial institution	2018	2019	2020
Commercial banks	19.14%	19.18%	20.78%
Cooperative banks	17.62%	17.71%	18.94%
Banking sector. total:	**19.05%**	**19.09%**	**20.67%**

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

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

Asset classification	2018	2019	2020
Non-financial sector. including	6.85%	6.68%	7.00%
- households	5.88%	5.68%	6.01%
- corporate	8.73%	8.65%	9.12%

The structure of deposits and loans of the banking sector in 2020 (%) (at year-end)

	Deposits	Loans
Non-financial sector. including:	88.93%	82.36%
Households	63.04%	54.85%
Corporate	24.05%	26.94%
Government sector	7.44%	17.55%
Financial sector (excluding banks)	3.64%	0.09%
Total	**100.0**	**100.0**

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

P&L account	2018	2019	2020
Interest income	60 469 041 317	66 022 972 895	56 700 317 658
Interest expenses	15 648 748 941	16 907 276 786	9 568 304 089
Net interest income	44 820 292 376	49 115 696 109	47 132 013 569
Net fee and commission income	12 306 064 352	13 363 364 420	14 849 764 166
Other (not specified above) operating income (net)	7 438 715 211	8 147 983 136	-32 198 215
Gross income	64 565 071 939	70 627 043 665	61 949 579 520
Administration costs	33 460 788 440	34 818 276 985	34 702 153 976
Depreciation	2 905 062 296	4 429 096 652	4 588 421 895
Provisions	628 854 192	2 405 534 620	5 495 061 648
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans. ...)	9 430 478 468	9 566 108 776	13 347 319 790
Profit (loss) before tax	18 222 628 307	19 324 005 973	3 756 761 667
Net profit (loss)	13 046 230 072	13 806 199 663	-324 719 017

Total own funds in 2020 (in EUR)***

Type of financial institution	Total own funds	Core Tier 1****	Tier 1	Tier 2	Tier 3
Commercial banks	47 232 215 638	42 011 770 163	42 011 770 163	5 220 445 476	
Cooperative banks	2 829 511 365	2 734 659 690	2 734 659 690	94 851 675	
Banking sector. total:	**50 061 727 003**	**44 746 429 852**	**44 746 429 852**	**5 315 297 151**	

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

***** here: Common Equity Tier 1*

Macroeconomic environment in the country

The shock wave generated by the measures adopted worldwide with a view to flattening the epidemic curve of SARS-CoV-2 reached a peak, in Romania in 2020 Q2, the economic activity contracting by 10 percent in annual terms. Nonetheless, the subsequent rebound exceeded expectations, so that in 2020 as a whole, real GDP fell by merely 3.9 percent, a result that placed the Romanian economy among the countries that outperformed the EU-27 average (-6.1 percent).

Household consumption dropped by 5 percent, the restrictions on people's mobility and social interaction leading to divergent paths of demand across different groups of goods and services. Unlike consumption, fixed capital investment was affected only to a small extent by the pandemic-induced demand shock, its total volume posting positive dynamics also in Q2 (the increase in 2020 as a whole stood at 6.8 percent).

The annual CPI inflation rate returned into the variation band of the flat target in February 2020, ending the year in its lower half, at 2.1 percent, compared to 4 percent at end-2019. The shock wave generated worldwide by the outbreak of the COVID-19 pandemic and the subsequent containment measures adopted by the authorities reflected also in consumer price inflation.

Starting in April, producer prices for consumer goods discontinued their strong upward path, their annual rate of increase gradually declining to 2.9 percent in December (compared to an average of around 6 percent in 2020 Q1). This trend reflected the evolution in the food industry and was almost entirely due to some base effects associated with the meat industry.

At end-2020, Romania's international reserves amounted to EUR 42,517 million. The gold reserve remained unchanged at approximately 104 tonnes. In terms of value, Romania's gold reserves went up EUR 614 million from end-2019 (to EUR 5,138 million), as a result of the rise in the gold price on international markets

Development in the banking sector (including assets total / GDP)

During 2020, the total number of credit institutions operating in Romania remained unchanged the decrease determined by the merger between two banks being offset by the opening of a new branch. Thus, the Romanian banking system comprised 26 banks, Romanian legal entities and 8 branches of foreign banks at the end of 2020.

The aggregated banking system assets amounted to lei 560.0 billion at December 2020, up by 13.1% against the previous year level, and held a share of 53.1 % in GDP.

The banking system was in good condition in 2021 and recorded positive developments of prudential indicators, their levels being deemed adequate in terms of regulatory requirements. Solvency indicators show a higher capitalization than that recorded at end-2019. Across the banking system, total capital ratio increased, from 22.0 percent in December 2019 to 25.1 percent at end-2020. The breakdown shows that Tier 1 capital and Common Equity Tier 1 capital further hold the prevailing share in total own funds, accounting for approximately 92 percent. It is also worth mentioning the measures established since the very beginning of the pandemic regarding the non-distribution of dividends by credit institutions from the 2019 profit, the non-performance of buy-back operations of their own shares and the postponement for a longer period of variable remuneration.

Liquidity of the banking sector, determined according to the liquidity coverage ratio (LCR), further stood above the double of regulatory requirement at aggregate level, i.e. 265.9 percent at 31 December 2020 versus the minimum requirement of 100 percent, pointing to a sizeable stock of high-quality liquid assets in a 30-day stress scenario. At end-2020, all credit institutions posted values above 100 percent for the LCR at the aggregate level, as well as by each significant currency, i.e. leu, euro and US dollar. Funds raised from the local market remain the main financing source of the Romanian banking sector, by means of strengthening household deposits. Specifically, deposits taken from non-bank clients expanded by 14.4 percent compared to end-2019.

The NPL ratio decreased by 0.3 percentage points against December 2019, coming in at 3.8 percent at 31 December 2020 and maintaining the downward trend due to the mix of implemented policies (mainly the public/private moratoria and the state guarantees granted). Moreover, NPL coverage by provisions (coverage ratio) for the banking sector, calculated based on the EBA definition, remained adequate and continued to improve throughout 2020, the average standing at 63.3 percent, a 2.6 percentage point rise compared to end-2019 (60.7 percent). At the same time, the indicator is in the least risky category according to EBA and in a favorable position compared to the European average (44.9 percent in December 2020).

Banking sector profitability remained in positive territory throughout 2020 as well, amid the further high operating profit, the financial result being however weaker than that in the year before due to the rise in net expected credit losses. Return on assets (ROA) reached 1.0 percent at end-2020, slightly down by 0.3 percentage points versus 2019, given the decline in net profit (by 20.7 percent) and the rise in average total assets (by 11.4 percent). Return on equity (ROE) came in at 8.7 percent at end-2020, down 3.5 percentage points from end-2019. In terms of determinants, the lower ROE was ascribable, on the one hand, to the smaller net profit, and on the other hand, to the rise in average total equity (+11.6 percent).

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 National Bank of Romania is the competent authority for the regulation, licensing, prudential supervision and resolution of credit institutions, and shall monitor the activities of credit institutions, as well as, where it is the authority responsible for supervision on a consolidated basis, the activities of financial holding companies and mixed financial holding companies, for the provisions applicable to them, so as to assess compliance with the prudential requirements of the Banking Law, of Regulation (EU) no.575/2013 and of the applicable regulations. The NBR Regulation No. 5/2013 on prudential requirements for credit institutions, as amended and supplemented, ensures the transposition of the provisions of Directive 2013/36/EU and specifies the manner in which the national options included in the CRD IV package have been exercised. Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms ("BRRD") was transposed into Romanian legislation by Law No. 312/2015, which establishes the domestic grounds for the recovery and resolution of credit institutions. Moreover, beginning with the CRD IV/CRR and BRRD implementation, credit institutions are required to observe the EC's implementing regulations laying down technical standards, directly applicable in all Member States, including also those related to the reporting field.

Related to NBR Regulation No. 5/2013 on prudential requirements for credit institutions, in 2020 was issued the NBR Regulation No. 11/2020, amending and supplementing Regulation no. 5/2013, in the fields related to the credit institutions' business management framework, assessment of the suitability of members of the management body and key function holders, the internal capital adequacy assessment process (ICAAP), the internal liquidity adequacy assessment process (ILAAP), significant risk management, stress tests.

Starting in March 2020, as a result of the specific health context created by the outbreak of the COVID-19 pandemic, in order to support certain categories of borrowers who were faced with the contraction in income or a severe liquidity shortage, which led to loan repayment difficulties for both individuals and legal entities, the Government issued GEO No. 29/2020, GEO No. 37/2020 and the Norms for implementing GEO No. 37/2020, and GEO No. 42/2020 for ensuring social protection and the continuation of economic activity.

A new regulation, NBR Regulation No. 12/2020, was issued related to the authorization and changes in the situation of credit institutions, merger/division and authorization of the bridge bank. The regulation was drafted taking into account the drafts of regulatory and implementing technical standards on information requirements in the authorization of credit institution, adopted at the level of the European Banking Authority, which have been under review by the European Commission since July 2017.

Concerning the security, oversight and innovation in the field of payments, the National Bank of Romania continued to regulate payments with a view to ensuring their safety and efficiency. Thus, the NBR issued Regulation No. 2/2020 on the security measures concerning operational and security risks and the reporting requirements for payment services.

In the field of accounting regulation, in 2020, the NBR adopted new following regulations: NBR Order 2/2020 approving the Methodological norms on preparing the annual accounting reports designed to meet the information requirements of the Ministry of Public Finance, NBR Order No. 3/2020 to implement NCMO Recommendation no. R/2/2020 amending the strategy regarding the implementation of the International Financial Reporting Standards by non-bank financial institutions as a basis of accounting and for preparing individual financial statements, NBR Order No. 8/2020 to update the FINREP reporting framework at solo level and the regular reporting framework applicable to branches in Romania of credit institutions having their head offices in other EU Member States, NBR Order No. 4/2020 to implement in the context of the COVID-19 pandemic crisis the measures related to easing the requirements for the reporting frequency and/or to derogation from the reporting deadlines or requirements for reports included in the national regulations issued by the and and NBR Regulation No. 7/2020 related to the exchange rate regime.

Organizational chart of the Banking Supervisory Authority

Organisation Chart of the National Bank of Romania

BOARD OF DIRECTORS

The Audit Committee

Governor **Mugur Isărescu**

- The Monetary Policy Committee
- The Supervisory Committee
- The Foreign Reserve Management Committee

First Deputy Governor **Florin Georgescu**

FINANCIAL STABILITY DEPARTMENT
- Macroprudential Policies Division
- Systemic Risk Monitoring Division
- Quantitative Assessment Division

REGULATION AND LICENSING DEPARTMENT
- Financial Activities and Non-bank Financial Institutions Regulation Division
- Foreign Exchange and Accounting Regulation Division
- Licensing Division
- Prudential Banking Regulation Division 1
- Prudential Banking Regulation Division 2

SUPERVISION DEPARTMENT
- Inspection Division
- Bank Supervision Division 1
- Bank Supervision Division 2
- Assessment and Supervisory Policy Division
- Non-bank Financial Institutions and Payment Institutions Supervision Division
- Prevention of Money Laundering and Terrorist Financing & Intl. Sanctions Enforcement Supervision Division.
- Legal Advice on Supervisory Acts and Petitions Office

ISSUE, TREASURY AND CASH MANAGEMENT DEPARTMENT
- Issue Division
- Cash Management Division
- Central Vault Division
- Cash Processing Coordination Division

ACCOUNTING DEPARTMENT
- Operational Accounting and Internal Accounting Rules Division
- Internal Administration Accounting-Financial Issues Division
- Internal Administration Accounting-Fixed Assets Division

ESTATE MANAGEMENT AND INVESTMENT DEPARTMENT
- Investment Division
- Movable Assets Division
- Immovable Assets and Management Division

Deputy Governor **Eugen Nicolăescu**

STATISTICS DEPARTMENT
- Monetary and Financial Statistics Division
- Balance of Payments Division
- Direct Statistical Reporting Division
- Statistical Data Processing Division
- SIRBNR Data Management Division
- Credit Risk Statistics Division

BANK RESOLUTION DEPARTMENT
- Resolution Strategies and Policies Coordination Division
- Resolution Decisions Preparation and Implementation Division
- Monitoring of the Implementation of Measures for Resolvability Enhancement Division
- Resolution Planning and Decisions Implementation Division

IT DEPARTMENT
- IT Systems Division
- Network Administration Division
- IT Support Division
- IT&C Security Division

PROCUREMENT DEPARTMENT
- Standardisation, Planning and Monitoring Division
- Procurement Contracts Award Division
  - > EPCO Related Procurements Office
- Purchase Order Division
- Methodology and Contracting Division

FINANCIAL EDUCATION AND MUSEUM DEPARTMENT
- Museum
- Financial Education Division

PAYMENT AND SETTLEMENT SYSTEMS REGULATION AND OVERSIGHT UNIT
- Financial Market Infrastructures Oversight Division
- Payments and Payment Instruments Oversight Division

Deputy Governor **Leonardo Badea**

MACROECONOMIC MODELLING AND FORECASTING DEPARTMENT
- Macroeconomic Forecasting Models Division
- Macroeconomic Assessment Models Division

PAYMENTS DEPARTMENT
- ReGIS Division
- Financial Instruments Depository and Settlement Division
- Financial Messages Processing Division
- TARGET2 Division
- Business Continuity Division

INTERNATIONAL RELATIONS DEPARTMENT
- European Banking System Division
- International Financial System Division
- International Financial Conditions Analysis Division

SECRETARIAT
- Documents Registration, Dispatching and Check-in Desk Division
- Archives, Library and Publications Dissemination Division
- Events Organisation and Protocol Division

TECHNICAL AND MAINTENANCE DEPARTMENT
- Buildings Maintenance Division
- Equipment and Installations Maintenance Division
- Administrative Maintenance and Utilities Division

LEGAL DEPARTMENT
- Banking and Financial Law Division
  - > Prudential Legislation and Corporate Law Office
- Banking and Financial Law & International Legal Cooperation Division
  - > Prudential Legislation & Banking and Financial Activities Office
- Litigation and Legal Assistance Division
  - > Legal Advice and Assistance Office

TRAINING AND SOCIAL EVENTS FACILITY DEPARTMENT
- Training Support Division
- Social Events Division
- Auxiliary Activities Division
- Cafeteria Division
- Training and Social Events Units

COMPLIANCE DIVISION

REGIONAL BRANCHES AND AGENCIES

Governor

INTERNAL AUDIT DEPARTMENT*
- General Audit Division 1
- General Audit Division 2

CHANCELLERY
- The Euro Office
- Financial Economy - Real Economy Office
- Role, Developments and Prospects of Central Banks Office
- Cryptocurrency and Digital Currency Office
- Sustainability and Green Economy Office
- The Executives' Offices and Document Management
- Governor's Control Office
- Board Secretariat Division
- Information Management and Protection Division
- Administration of Special Computer Systems and Personal Data Protection Division

MONETARY POLICY DEPARTMENT
- Monetary Policy Analysis and Strategy Division
- Liquidity Management Division

MARKET OPERATIONS DEPARTMENT
- Monetary Policy Operations Division
- State Treasury Operations Division
- Foreign Reserves Management Division
- Back Office Division
- Foreign Reserves Risk Management Division

ECONOMICS DEPARTMENT
- Economic Analysis and Short-Term Forecasting Division
- Publications Division
- Translation and Editing Division

COMMUNICATION AND PUBLIC RELATIONS DEPARTMENT
- Media Relations Division
- Intranet and Internal Communication Division
- Online Communication Division
- Multimedia Support Division
- Public Relations and Documentation Division

HUMAN RESOURCES DEPARTMENT
- Organisation and Planning Division
  - > Payroll Office
- Human Resources Management Division
- Training and Career Development Division

BUDGET AND FINANCIAL ANALYSIS DEPARTMENT
- Budget and Financial Analysis Division
- Preventive Financial Control Division
- Consumption Standards and Norms Division
- Risk Monitoring Division

SECURITY DEPARTMENT
- Crisis Management & Business Continuity Division
- Internal Protection Division
- Special Transport Division
- Security Systems Division
  - > Emergency Intervention Office
- Transport and Maintenance Division
- Territorial Network Coordination Division

Note:
Colour patterns show the departments' coordination.
*The Internal Audit Department reports functionally to the Audit Committee and administratively to the Governor of the National Bank of Romania.

Main strategic objectives of the Banking Supervisory Authority in 2020

As the supervisory competent authority, the main objective of the National Bank of Romania is to carry out the prudential supervision of credit institutions, Romanian legal entities, and of their branches established in other Member States or in third countries, with a view to assure compliance with the requirements of the law and regulations applicable both on an individual basis and on a consolidated or sub-consolidated basis, as appropriate, in order to prevent and contain banking risks.

In 2020, the flexibility provided by the regulatory framework and the measures adopted by the supervisory authority in order to ensure an adequate level of own funds allowed for a sound management of risks.

Also, the National Bank of Romania has taken the necessary measures to ensure the proper management of non-performing and forborne exposures. Credit institutions have been recommended to take the necessary measures to ensure that impairment adjustments are made at an appropriate level to cover expected losses and, where necessary, to develop a strategy to reduce NPL ratio and ensure the efficient management of the non-performing exposures stock.

Recording positive performances, fulfilling prudential requirements and preserving the adequate levels of indicators contributed to the proper functioning of the banking system in the current period, marked by the fallout from the COVID-19 pandemic.

The activities of the Banking Supervisory Authority in 2020

During 2020, 30 supervisory actions were conducted, of which 25 at credit institutions, Romanian legal entities, 3 at the branches in Romania of credit institutions having their head offices in other Member States and 2 at two credit cooperatives in the CREDITCOOP network. Following the outbreak of the COVID-19 pandemic in March 2020, the supervisory actions that were scheduled at the head offices of banks (on-site inspections) were replaced by remote supervisory actions.

The priorities and specific risks assessed during the supervisory actions conducted under the annual inspection programme were established based on the risk profile of each credit institution as shown in the latest assessment.The thematic objectives focused on the viability and sustainability of the business model, internal governance and institution-wide controls, the assessment of risks to capital and capital adequacy, the assessment of risks to liquidity and liquidity adequacy, as well as on verifying the implementation of the measures imposed by the NBR and of the action plan prepared by the credit institution.

Following the SREP assessment conducted in 2020, the assigned scores were as follows: 19 percent of the 26 credit institutions were assigned an overall score of 2, 69 percent an overall score of 3, 12 percent an overall score of 4, and none received an overall score of 5. In addition, the average and median of total SREP capital requirements (TSCR) across the banking system were of 11.3 percent and 11.7 percent, respectively.

In 2020, the Supervisory Committee, a standing decision-making body composed of 10 members and chaired by the NBR Governor, passed decisions in 24 meetings, while nine other meetings were held January through May 2021, the analysed materials relating primarily to: (i) the notification of the intention to acquire a qualifying holding in the share capital of a credit institution and/or to increase such participations; (ii) applications submitted by credit institutions, Romanian legal entities, pursuant to prudential regulations, for approval of changes in their standing as concerns the Board members and/or executives, expansion of their scope of business, the financial auditor, operations on preferential terms set forth in the employee benefits and incentive packages, exemption from the obligation to exchange guarantees for intercompany

OTC derivative contracts, exemption from the assignment of risk weights to subsidiaries, mergers, etc.;(iii) proposals to erase some non-bank financial institutions and, implicitly, to impose a ban on lending; (iv) draft regulatory acts to be issued by the central bank or other authorities concerning the activity of credit institutions, of payment institutions, of electronic money institutions and of non-bank financial institutions, as well as in the fields of the exchange rate regime, of anti-money laundering and countering the financing of terrorism and of deposit guarantee schemes; (v) the implementation of EBA Guidelines in the national legal framework and/or in supervisory practices, from the perspective of the central bank's powers; (vi) legislative proposals for transposing EU regulations in the field of credit institutions; (vii) proposals for positions, to the national authorities, in the other areas of competence of the central bank; (viii) measures regarding financial reporting requirements in the context of the COVID-19 crisis; (ix) the monitoring of developments in terms of financial stability, identifying systemically-important credit institutions, monitoring and assessing systemic risks, specific analyses such as monitoring the lending terms and conditions, the systemic risks survey, the periodical stress tests of the banking sector's solvency and liquidity, analyses regarding the recalibration of macroprudential instruments - capital buffers, the systemic risks outlook, the measures implemented by the NBR in the context of the COVID-19 pandemic; (x) analyses on the activity of the Central Credit Register and of the Payment Incidents Register; (xi) other matters in connection to the banking system functioning, to payment institutions and to electronic money institutions.

International activities of the authority

As regards the responsibilities of the National Bank of Romania concerning the alignment to the European regulatory and supervisory framework, the NBR have been pursued the harmonization efforts with regard to the supervision of credit institutions through the participation of Romania in a number of working groups set up at the EBA level. At the same time, the oversight activity continued through JSTs (Joint Supervisory Teams). In the supervision of cross-border banking groups, the NBR has maintained its cooperation with the other supervisory authorities through the Supervisory Colleges, structures that ensure both optimal dissemination of information and joint decisions on capital adequacy and liquidity or recovery plans of supervised credit institutions.

Regarding the structures and substructures of the EBA, the NBR, as the regulatory and supervisory authority of the banking sector in Romania, is a member of the European Banking Authority, an independent authority of the EU that aims to ensure an efficient and consistent level of regulation and prudential supervision throughout the EU banking sector. In this capacity, the NBR participates in the decision-making process of the authority, as well as in the working parties constituted at its level.

We also mention that, due to the pandemic caused by the SARS-CoV-2 virus in Europe, starting with March 2020, the meetings of different working structures and substructures were held using facilities of remote communication, throughout 2020 and in the first part of 2021.

Cooperation with other supervisory bodies in the country

The cooperation and coordination in the field of macroprudential oversight of the national financial system is ensured by the National Committee for Macroprudential Oversight (NCMO). This committee was established by virtue of Law No. 12/2017 on the macroprudential oversight of the national financial system, as an inter-institutional cooperation structure without legal personality.

The NCMO's mission is to ensure coordination in the field of macroprudential oversight of the national financial system by setting the macroprudential policy and the appropriate instruments for its implementation.

Four meetings were held in 2020 by written procedure between representatives of the National Bank of Romania (NBR), the Financial Supervisory Authority (FSA) and the Government within NCMO. Thus, in 2020, the NCMO recommended the NBR, in its capacity as competent authority, to take among others the following actions in relation to credit institutions/non-bank financial institutions:

- to maintain the countercyclical buffer (CCyB) rate at 0 (zero) percent and to monitor developments in the economy and lending at aggregate and sectoral levels, with a focus on the impact of COVID-19 epidemic on household and corporate financing by credit institutions.
  The decision to keep the CCyB rate at zero percent was in line with the fiscal, monetary and micro- and macroprudential supervisory measures taken at national and European level to maintain a sound capital and liquidity base for the banking sector with a view to supporting the real economy;
- to amend, in compliance with the applicable legal provisions, the regulatory framework necessary for the full implementation of IFRS by non-bank financial institutions (NBFIs) entered in the General Register, as a basis of accounting and for preparing individual financial statements, so the plan to implement IFRS by NBFIs was extended by one year;
- to request financial institutions under their supervisory to refrain, at least until 1 January 2021, from undertaking any of the following actions: (i) make a dividend distribution or give an irrevocable commitment to make a dividend distribution; (ii) buy-back ordinary shares, (iii) create an obligation to pay variable remuneration to a member of a category of staff whose professional activities have a material impact on the financial institution's risk profile, which has the effect of reducing the quantity or quality of own funds at the consolidated and/or individual level;
- to impose, starting 1 January 2021, a capital buffer for other systemically important institutions (O-SII buffer), on an individual or consolidated basis, as applicable, calculated based on the total risk exposure amount for all the credit institutions identified as having a systemic nature based on the data reported as at 31 December 2019.

Questionnaire tables for the 2020 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	26	26	26
Branches of foreign credit institutions	7	7	7
Cooperative banks	1	1	1
Banking sector, total:	**34**	**34**	**34**

Total assets of banking sector (mill.RON) (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	398,622.3	433,282.3	488,054,5
Branches of foreign credit institutions	51,232.2	60,457.8	70,389.8
Cooperative banks	1,315.2	1,474.1	1,589.9
Banking sector, total:	**451,169.7**	**495,214.2**	**560,034.2**
y/y change (in %)	**+5.5%**	**+9.8%**	**+13.1%**

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

Item	2018	2019	2020
Public sector ownership	8.1	8.2	10.6
Domestic ownership total	25.0	26.3	29.5
Foreign ownership	75.0	73.7	70.5
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2020

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	50.1	69.9	1187
Branches of foreign credit institutions	94.8	98.5	6040
Cooperative banks	-	-	-
Banking sector, total:	**43.7**	**62.4**	**997**

Return on Equity (ROE) by type of financial institutions(%) (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	13.87	11.13	8.30
Cooperative banks	1.28	1.41	2.09
Banking sector, total:	**14.59**	**12.21**	**8.68**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2018	2019	2020
Commercial banks	88.3	87.5	87.1
Branches of foreign credit institutions	11.4	12.2	12.6
Cooperative banks	0.3	0.3	0.3
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2018	2019	2020
Receivables	**100.0**	**100.0**	**100.0**
Financial sector	19.6	19.9	22.5
Nonfinancial sector	55.0	53.9	49.9
Government sector	-	-	-
Other assets	25.4	26.2	27.6
Liabilites	**89.2**	**88.9**	**89.1**
Financial sector	7.8	6.0	5.1
Nonfinancial sector	78.1	78.9	79.8
Government sector	-	-	-
Other liabilities	3.3	4.0	4.2
Capital	**10.8**	**11.1**	**10.9**

Capital adequacy ratio of banks (%)
(at year-end)

Type of financial institution	2018***	2019***	2020***
Commercial banks	20.7	22.0	25.1
Cooperative banks	30.1	28.4	28.9
Banking sector, total:	**20.7**	**22.0**	**25.1**

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

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

Asset classification	2018	2019	2020
Non-financial sector, including	6.6	5.4	5.3
- households	4.8	4.0	4.1
- corporate	8.6	7.1	6.6

The structure of deposits and loans of the banking sector in 2020 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	84.4	62.3
Households	53.6	34.1
Corporate	30.8	28.2
Government sector	12.1	33.2
Financial sector (excluding banks)	3.5	4.5
Total	**100.0**	**100.0**

P&L account of the banking sector (mill.RON at year-end)

P&L account	2018	2019	2020
Interest income	16,767.7	18,831.7	19,179.9
Interest expenses	2,943.3	3,581.8	3,755.3
Net interest income	13,824.4	15,249.9	15,424.6
Net fee and commission income	4,134.2	4,152.7	3,841.6
Other (not specified above) operating income (net)	3,172.1	3,561.1	3,676.1
Gross income	21,130.7	22,963.7	22,942.3
Administration costs	10,323.2	10,758.1	10,552.1
Depreciation	912.1	1,716.2	1,800.0
Provisions	468.8	1,613.8	518.0
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	1,030.6	1,164.9	3,835.3
Profit (loss) before tax	8,463.9	7,817.2	6,103.6
Net profit (loss)	6,827.5	6,334.3	5,024.8

Total own funds in 2020 (in mill.EUR)

Type of financial institution	Total own funds***	Core Tier 1***	Tier 1***	Tier 2***	Tier 3***
Commercial banks	11,943.2	10,975.6	11,024.6	918.6	-
Cooperative banks	69.5	68.7	68.7	0.8	-
Banking sector, total:	**12,012.7**	**11,044.3**	**11,093.3**	**919.4**	**-**

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

Macroeconomic environment in the country

In 2020, the Russia's economy was under pressure due to the COVID-19 pandemic. The introduction of anti-pandemic restrictions on an unprecedented scale led to a contraction in economic activity, income and demand. Fast and coordinated actions of the Bank of Russia and the Government made it possible to mitigate the negative consequences of the crises. GDP decreased by 3.0% after 2% growth in 2019. However, this is less than expected at the start of the pandemic and than its decline in many other emerging market economies.

Amid declining in economic activity, real disposable household income decreased and consumer activity fell significantly, average unemployment rate grew to 5.8% from 4.6% in 2019.

In order to create conditions for the restoration of economic growth and stabilization of annual inflation near 4%, the Bank of Russia switched to a soft monetary policy. In 2020, the key rate was reduced by a total of 200 basis points – to a historical minimum of 4.25% per annum. In 2H2020, the gradual lifting of restrictions was accompanied by a recovery in demand and accelerated price growth under the influence of short-term pro-inflationary factors. Inflationary expectations accelerated, and annual inflation increased to 4.9% from 3.0% in 2019. In these conditions, the Bank of Russia didn't change the key rate level, maintaining the monetary policy stimulating nature.

Development in the banking sector (including assets total / GDP)

In 2020, assets of the Russian banking sector grew by 12.5% (exchange rate adjusted); the assets to GDP ratio increased to 97.4% from 80.7%.

Corporate loans grew by 9.9% driven by an increased credit demand from companies due to a severe drop of their revenues in the 2Q2020. Starting from the second half of 2020 corporate lending growth has moderated due to the recovery of economy and cancellation of severe anti-pandemic restrictions.

In 2020, retail loans grew by 13.5%. The growth of retail loans has been accelerating starting from the mid-2020 both in mortgage and unsecured loans segments. Still mortgage lending was the main driver – it increased by over 20% in 2020 supported by declining interest rates (down to 7.4% in Dec2020 from 9.1% in Dec2019), partially due to government support programs (about 30% of mortgage loans were granted under these programs). The growth of unsecured lending was rather muted until August 2020. In 4Q2020, its growth has returned to pre-crisis levels.

Despite challenging economic conditions, loan deterioration has been only moderate in 2020. The share of non-performing loans (NPLs) in the corporate book decreased from 11.0% to 9.9%. In the segment of unsecured consumer loans, NPLs increased moderately to 8.8% from 7.5%. NPL level of mortgage loans was only about 1%. Loan quality was to a significant extent supported by active restructurings. Since mid-March 2020, Russian banks have restructured about 12% of total loan portfolio by end-2020.

Funding was stable throughout 2020, although its structure shifted somewhat towards corporate segment. In 2020, household accounts (excluding individual escrow accounts) increased moderately, by 4.2% (10% in 2019), due to higher demand on cash during the COVID-19 restrictions and on alternative investments amid low interest rates. The banking sector funding was supported by corporate accounts (growth by 15.9%) and escrow accounts (growth from USD1.9bn to USD15.9bn) as a result of development of the housing construction project finance amid low base[1].

[1] Starting from mid-2019 constructing residential property can be sold only by placing cash on escrow accounts

The situation with liquidity in the banking sector remained stable. The volume of rouble liquid assets covered a third of the total rouble clients' funds. Additionally, banks could also attract about USD65bn from the Bank of Russia by pledging some of their non-marketable assets (loans that meet the requirements of the Bank of Russia).

In 2020, despite COVID-19 banks earned RUB1.6 trln (USD22bn). ROE stood at 16% as of 1 January 2021 (19.5% at the beginning of 2020). Capital adequacy ratios reached 12.5% for N1.0, 8.7% - N1.1 (common equity Tier I), 9.7% - N1.2 (Tier I) in 2020.

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

Article 75 of the Constitution of the Russian Federation establishes the special legal status of the Central Bank of the Russian Federation (Bank of Russia). The status, goals, functions and powers of the Bank of Russia are defined by Federal Law No. 86-FZ, dated 10 July 2002, 'On the Central Bank of the Russian Federation (Bank of Russia)' and by other federal laws. The banking regulation and banking supervision aimed at identifying risks at the earliest stages to ensure stability of the banking sector and protect creditors' and depositors' interests.

In 2020, the main challenge for the Bank of Russia was overcoming the consequences of the pandemic. The Bank of Russia has taken a wide range of measures to alleviate the financial impact of the Covid-19 on the banking system, to maintain its capability to provide resources to the economy and to protect households and firms affected by the pandemic.

The Bank of Russia has introduced the temporary forbearance allowing not to increase loan loss provisions for borrowers affected by the pandemic. Certain risk weights / macroprudential add-ons for the credit risk calculation were also reduced. The recommendation to banks to postpone dividend payments is in effect. Systemically important credit organisations subject to the liquidity coverage ratio (LCR) requirements were allowed to use the high quality liquid assets to meet their liquidity needs if necessary. Several measures aimed at supporting the credit supply were undertaken by the Government and the Bank of Russia, including guarantees for lending to small and medium entities, subsidised interest rates for mortgage lending and lending to strategic companies.

Organizational chart of the Banking Supervisory Authority

Structural units of the Bank of Russia head office involved in banking regulation and banking supervision include Banking Regulation Department, Banking Supervision Support Department, Systematically Important Banks Supervision Department, Service for Ongoing Banking Supervision, Financial Market Infrastructure Department, Risk Analysis Service, Bank of Russia Chief Inspection, Financial Resolution Department, Department for Market Access and Activity Termination of Financial Institutions and Financial Monitoring and Foreign Exchange Control Department.

The major tasks of these divisions are to provide methodological and organizational 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 coordinated by the Bank of Russia Banking Supervision Committee. The Committee is responsible for decision-making on banking supervision policies.

Main strategic objectives of the Supervisory Authority in 2020

The main priorities for banking regulation and banking supervision are the stable functioning of the banking sector, stability and reliability of its institutions. The systemic risks' identification system is based on a constant analysis of the banking activities and accepted risks, taking into account external factors.

In 2020, the supervision was carried out in proportion to the specifics of credit organisations' activities in accordance with the type of licence, taking into account:

in relation to banks with universal licence – increased regulatory requirements in terms of risk management systems, capital and internal control;

in relation to banks with basic licence – their compliance with regulatory restrictions in terms of operations[2] due to limited capital and less competitiveness of the banks with basic licence;

in relation of non-bank credit institutions (NCIs) – risks in payment systems, since the NCIs' business models are often based on money transfers (including e-money transfers).

The activities of the banking Supervisory Authority in 2020

As of the year-end of 2020, as a part of consolidated supervision 26 financial groups were supervised by the Bank of Russia. As a result of the group supervision the key risks of the financial groups were identified, information on group companies is consolidated and updated in the electronic dossier.

In 2020, the Bank of Russia introduced temporary measures to reduce the supervisory burden on credit institutions. In the acute phase of the crisis, on-site inspections were suspended, the number of regular requests for information was reduced as much as possible, and the period for providing responses was significantly increased. The deadlines for drawing up and submitting regular prudential reports to the Bank of Russia were also extended.

The advisory supervision was further developed to prevent negative trends in the activities of credit institutions. Much attention was paid to the adaptation of banks to the impact of the pandemic on their activities. At the same time, in 2020 the Bank of Russia conducted a supervisory stress testing of largest banks (with a total share in the sector's assets of more than 80%). Its results indicated a high resistance of the Russian banking sector to stress.

Other relevant information and developments

More detailed information about the development of the banking sector and banking supervision in the Russian Federation is available on the official website of the Bank of Russia (http://www.cbr.ru/eng).

[2] These banks have a more limited range of operations compared to other banks.

Questionnaire tables for the 2020 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2018	2019	2020
Banks	440	402	366
Non-bank credit institutions	44	40	40
Banking sector, total	**484**	**442**	**406**

Total assets* of banking sector (at year-end, trln rub)

Type of financial institution	2018	2019	2020
Banks	82,1	84,6	98,5
Non-bank credit institutions**	4,1	4,2	5,4
Banking sector, total	**86,2**	**88,8**	**103,8**
y/y change (in %, nominal)	**10,6**	**3,0**	**16,9**

** Bank assets decreased by the amount of provisions for possible losses*

*** Non-bank credit institutions include the Non-bank Credit Institution - Central Counterparty National Clearing Centre (Joint-stock Company) (NCI NCC (JSC)), which is the central counterparty (CC).The share of NCI NCC (JSC) in the Russian banking sector assets was 4,5% in 2018, 4,4% in 2019 and 4,7% in 2020.*

Ownership structure of banks on the basis of assets total, %

Item	2018	2019	2020
Public sector ownership	69,8	71,2	72,5
Domestic ownership total (public + residents)	87,4	87,5	87,7
Foreign ownership	12,6	12,5	12,3
Banking sector (excluding non-bank credit institutions), total	**100,0**	**100,0**	**100,0**

Concentration of asset by the type of financial institutions in 2020 (at year-end)

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Banks	57,6	66,0	0,153
Non-bank credit institutions	98,3	99,0	0,823
Banking sector, total	**54,6**	**63,6**	**0,140**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2018	2019	2020
Banks	13,4	19,4	17,4
Non-bank credit institutions	42,6	53,7	43,0
Banking sector, total	**13,8**	**19,7**	**17,6**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2018	2019	2020
Banks	95,2	95,3	94,8
Non-bank credit institutions	4,8	4,7	5,2
Banking sector, total	**100,0**	**100,0**	**100,0**

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

Assets	2018	2019	2020
Financial sector (including credit institutions)	19,7	19,0	19,5
Nonfiancial sector (including households)	56,0	57,9	55,7
Government sector (including the Bank of Russia)	11,9	10,6	10,6
Other assets	12,5	12,6	14,3
Liabilities	**2018**	**2019**	**2020**
Financial sector (including credit institutions)	15,0	13,6	13,2
Nonfiancial sector (including households)	63,9	63,5	62,6
Government sector (including the Bank of Russia)	7,0	6,9	7,3
Capital (profit, funds...)*	10,4	10,8	10,3
Other liabilities	**3,7**	**5,2**	**6,6**

** Balance sheet capital excluded income tax*

Capital adequacy ratio* of banks (N1), %

Type of financial institution	2018	2019	2020
Banks	12,0	12,2	12,4
Non-bank credit institutions	34,3	40,5	36,3
Banking sector, total	**12,1**	**12,2**	**12,5**

** Capital adequacy ratio takes into account the data of "bad" bank, which lowers the banking sector indicator*

Asset portfolio quality of the banking sector (share of non-performing loans*), %

Asset classification	2018	2019	2020
Non-financial sector, including:	10,8	9,6	9,0
- households	7,6	6,6	7,4
- corporate (including individual entrepreneurs)	12,2	11,0	9,9

** Share of problem and loss loans (quality categories IV and V, respectively)*

The structure of deposits and loans of the banking sector in 2020 (at year-end, %)

	Deposits	Loans
Non-financial sector, including:	89,3	88,1
- households*	46,7	30,5
- corporate	42,6	57,6
Government sector**	5,5	1,2
Financial sector**	5,3	10,7
Total	**100,0**	**100,0**

* *Including escrow accounts*

** *Excluding transactions with credit institutions and the Bank of Russia*

P&L account of the banking sector* (at year-end, thous. EUR)

	2018	2019	2020
1. Interest income	77 762 608	97 028 619	70 827 252
2. Interest expences	37 622 390	48 941 647	30 977 950
3. Net interest income (1-2)	40 140 217	48 086 973	39 849 302
4. Net fee and comission income	13 096 853	16 919 487	14 167 784
5. Other (not specified above) operating income (net)	8 104 645	8 763 466	11 506 015
6. Gross income (3+4+5)	61 341 715	73 769 926	65 523 101
7. Administration costs	24 864 547	31 375 728	25 059 397
8. Depreciation**	1 463 871	1 922 522	2 619 206
9. Provisions	20 536 161	12 613 056	19 409 639
10. Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial asets (loans,...)	n/a	n/a	n/a
11. Profit (loss) before tax	16 924 490	29 388 736	21 763 765
12. Net profit (loss)	12 558 299	24 748 604	17 733 572

* *Data with adjusted aggregation*

** *Depreciation for fixed assets and intangible assets*

Total own funds* in 2020 (thous. EUR)

Type of financial institution	Total capital	Tier I capital	Tier 2 capital
Banks	124 491 462	97 057 209	27 434 253
Non-bank credit institutions	1 366 953	985 993	380 960
Banking sector, total	**125 858 415**	**98 043 202**	**27 815 213**

* *Total own funds include the data of TRUST Bank (PJSC), which underestimates the banking sector indicator*

Macroeconomic environment in the country

GDP in 2020, recorded a real decline of 1.0%, which is better result than initially expected, and one of the smallest declines of economic activity in Europe. Covid-19 and the global recession had a weaker impact on Serbia than on other European countries, due to good economic fundamentals before the crisis (macroeconomic, financial and fiscal stability, strong growth, enough fiscal space), as well as favourable economic structure. On top of that, timely reaction of the NBS and the Government in the adoption of comprehensive and large packages of monetary and fiscal measures, of which the first was worth about EUR 5 billion (about 11% of GDP), and the second worth about EUR 700 million (about 1.5% of GDP) slowed the decline in GDP, which would have been much more pronounced if there had been no measures.

On the production side, the decline in GDP was determined by the decline in the service sector of 1.6% (contribution -0.8 pp), and the decline in construction of 5.1% (-0.3 pp). On the other hand, favourable trends came from agriculture, with growth of 4.2% (+0.3 pp). When it comes to the industry, it has recovered faster than expected since May and recorded even a slight growth of 0.3% (+0.1 pp) at the annual level. On the expenditure side, GDP structure was determined by a temporary decline in domestic demand (personal consumption and fixed investments), while on the other side, stocks had a high positive contribution, due to the growth of stocks of agricultural and industrial products (+1.5 pp). In addition, net exports had a negative contribution (-1.0 pp) due to a slowdown in external demand, as well as higher imports of medical equipment and materials, medicines and other pharmaceutical products during the pandemic, but lower than expected due to exports resilience. The decline in fixed investments has been minimal and amounted only -2.8% (-0.6 pp), thanks to high capital investments and relatively normal implementation of construction projects during Q4 2020.

When it comes to external sector, in 2020 CAD amounted to EUR 1.9 bn (4.2% of GDP), while imports of goods and services decreased (-5.7% y/y) more than exports (-4.6% y/y).

From a macroeconomic perspective, the reduction of CAD is a consequence of the fall in domestic demand, i.e. private consumption and investment which reflected on lower imports. In addition, the decline in imports was also influenced by the fall in world oil prices. Within the structure of the balance of payments, the deficit of goods and the deficit of primary income decreased, the surplus of services increased slightly, while the surplus of secondary income decreased primarily due to lower remittances inflow. In the same period, full coverage (152.4%) of CAD with net FDI was achieved, as net FDI inflow stood at 2.9 billion EUR.

Despite major challenges coming from the pandemic and the global uncertainty, inflation remained stable throughout 2020. Inflation dynamics have mainly been determined by movements in unprocessed food prices (especially vegetables and fruits) and oil derivatives – in both directions. At the end of 2020 y/y inflation stood at 1.3%. Average y/y inflation in 2020 stood at 1.6%. At the same time, inflation did not exceed the level of 2% in any month, nor was it negative in any month, which happened in many countries.

When it comes to fiscal movements, general government budget posted a deficit of 8.1% of GDP in 2020, which is by around 0.9% of GDP better result than projected after the breakout of the pandemic. Such high deficit is entirely a consequence of the crisis caused by the COVID 19 pandemic, necessary health expenditures and high expenditures to support the economic activity. At the same time, share of general government public debt in GDP remained below the Maastricht criteria and stood at 58,2% at the end of 2020.

Development in the banking sector (including assets total / GDP)

Despite the COVID-19 pandemic, Serbian banking sector (which makes over 90% of its total financial sector) remained adequately capitalized and highly liquid throughout 2020. The National Bank of Serbia preserved financial stability while non-performing loans were further reduced, which kept the banking sector attractive for reputable investors. The banking sector profitability was also satisfactory in 2020, pre-tax profit being EUR 391.9 million, with ROA of 1.06% and ROE of 6.48%.

At the end of 2020, 26 banks were operating in Serbia, 3 of which were majorly owned by the Republic of Serbia with a share of 7.1% in banking sector's total assets, 3 banks were majorly owned by private shareholders with a share of 6.9% and 20 banks were majorly owned by foreign shareholders with a share of 86%. Since branching is not allowed in Serbia, all banks operate as independent legal entities. Banks that are majorly foreign-owned are parts of banking groups from 13 countries. Italian major shareholders were dominant with 26.2% share in total banking sector assets, followed by Austrian (14.4%), Hungarian (13.4%) and Slovenian (11.7%) shareholders. All other foreign shareholders account for 20.3% of total banking sector assets. Banking sector assets to GDP ratio was over 84% at the end of 2020.

Total net balance sheet assets of the banking sector in Serbia reached EUR 39.1 billion at the end of 2020 which is an increase of 12.7% compared to the end of 2019.

The level of competition in Serbian banking sector is at a satisfying level. Top five banks have a market share of 52.5% of assets, 51.0% of lending and 53.1% of deposits. HHIs of assets, lending and deposits are below 1,000.

Total loans[1] amounted to EUR 22.84 billion, which is a growth of 9.8% compared to 2019. Loans to corporates[2] made 50.6% of total loans and amounted EUR 11.56 billion, while households[3] loans made 45.9% and amounted EUR 10.48 billion. Liquidity/current assets financing loans and investment loans had almost equal share in total corporate loans in 2020, while cash and housing loans dominate households lending.

As a result of numerous supervisory and regulatory measures adopted by the NBS with the of reducing NPL in banks' portfolios (especially The Strategy for NPL resolution adopted in August 2015 and The Decision on Accounting Write-off of Balance Sheet Assets in 2017), the gross NPL ratio has been steadily declining since 2015 to reach one of its lowest levels of 3.71% at the end of 2020. Since the adoption of the Strategy for NPL Resolution, the gross NPL ratio was reduced by 18.54 p.p.

The largest portion of NPLs (54.3%) comes from corporate sector (EUR 472.6 million at the end of 2020). The NPL ratio for corporates was reduced from 4.37% in 2019 to 4.03% in 2020. Households NPLs make 44.1% of total NPLs (EUR 384.1 million at the end of 2020). The households NPL ratio decreased from 3.94% in 2019 to 3.61% in 2020. The coverage of NPLs by total loan provisions is increasing and amounted 93.44% at the end of 2020.

At the end of 2020, total deposits[4] were at the level of EUR 27,24 billion, which is an increase by 16.8% compared to the end of 2019. Household deposits made 54.6% of total deposits and amounted EUR 14.9 billion while corporate deposits made 36.0% of total deposits and amounted EUR 9.8 billion.

1 Central bank, domestic and foreign banks are excluded.

2 Public enterprises, private companies, legal persons, and institutions in the areas of education and health protection not financed from the budget, public enterprises in bankruptcy and private companies in bankruptcy.

3 Households, entrepreneurs, entrepreneurs in bankruptcy, private households with employed persons, registered agricultural producers.

4 Central bank, domestic and foreign banks are excluded.

Regulations harmonized with "Basel 3" and EU capital and liquidity rules that the NBS had adopted in 2017 have provided an incentive for banks to build significant capital buffers and liquidity reserves, making them capable to cope successfully with the risks that may arise in the system and maintain banking sector stability in case of disturbances. The capital adequacy ratio at the banking sector level was 22.42% at the end of 2020, which is significantly above the regulatory minimum of 8%. In addition to the high capital adequacy ratio, Serbian banking sector is characterized by favorable capital structure, bearing in mind that Tier 1 capital makes more than 96% of total regulatory capital. The high solvency of the banking sector is also indicated by the (Basel III) leverage ratio, which amounted 12.40% at the end of 2020. The proportion of balance sheet capital to total assets stood at 15.58% at the end of 2020.

The average regulatory liquidity ratio for the Serbian banking sector in December 2020 was 2.22, indicating that liquid assets (core liquid assets and receivables maturing within the next 30 days) were more than twice as large as liabilities without maturity and liability maturing within 30 days. Liquid assets comprised 37.19% of total assets and 50.71% of total short-term liabilities at the end of 2020. The funding of the banks' lending activity is adequate, having in mind that gross loans to nonfinancial sector are fully covered with nonfinancial sector's deposits (loan to deposit ratio was 85.70% at the end of 2020). Liquidity coverage ratio of 211.79% also confirmed high liquidity of Serbian banking sector.

In the aim of taking proactive action regarding unsecured retail lending under unjustified long tenors, The Decision on Managing Concentration Risk Arising from Bank Exposure to Specific Products was adopted by the NBS at the end of December 2019. Through this Decision, a new indicator - Concentration Risk Indicator was introduced. The numerator of this indicator comprises the existing portfolio of cash, consumer, and other loans (that are not mortgage loans nor overdrafts) with contractual maturity above eight years. The denominator is the sum of regulatory capital (minus regulatory adjustment, current and previous years losses and unrealized losses) and dinar liabilities whose remaining maturity is more than 5 years. This indicator represents additional regulatory and supervisory instrument bearing in mind that it defines the "cap" of the bank's exposure to certain unsecured long-term retail loans. The effects of measures taken by the NBS are already visible through continuous reduction of Concentration Risk Indicator (13.16% in December 2020, by 2.51 p.p. less than in December 2019).

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

In the observed period, exercising its regulatory competences in the area of bank supervision the NBS issued the following regulation:

At the session held on January 9, 2020, the Executive Board of the National Bank of Serbia adopted the Decision Amending the **Decision on Detailed Terms and Manner of Performing Bank Supervision and Special Bank Audit.**

On March 2020, the Executive Board of the National Bank of Serbia adopted:

- **Decision Amending the Decision on Reporting Requirements for Banks**
- **Decision Amending the Decision Reporting on Capital Adequacy of Banks.**

The reason for the adoption of these regulations is the adjustment of the reporting system to the regulations adopted in December 2019 in order to encourage the practice of lending in dinars. At the same session of the Executive Board of the National Bank of Serbia, **the Decision Amending the Decision on Risk Management by Banks** was adopted, in order to improve the practice of banks in introducing new products and outsourcing activities to a third party.

Bearing in mind the need to preserve the achieved level and further strengthen the stability of the financial system in conditions of potential risks caused by the emergency health situation in the country, the NBS at an extraordinary session of the Executive Board held on March 17th adopted **the Decision on Temporary Measures for Preserving Financial System Stability and the Decision on Temporary Measures for Lessors Aimed at Preserving Financial System Stability** prescribing a suspension of debt payments (moratorium) of debtors to banks and financial lessors that cannot be shorter than 90 days.

In respect that the emergency health situation continued, on July 27th, at an extraordinary session of the Executive Board, the NBS adopted **the Decision on Temporary Measures for Banks for the Purpose of Mitigating the Consequences of COVID-19 Pandemic in Order to Preserve Financial System Stability**, and **the Decision on Temporary Measures for Financial Lessors for the Purpose of Mitigating the Consequences of COVID-19 Pandemic in Order to Preserve Financial System Stability**, prescribing an additional suspension of debt payments of debtors to banks and financial lessors (additional moratorium) that matured in the period from August 1st, 2020 until September 30th, 2020, as well as suspension of debt payments that matured in July this year, and the debtor has not settled them.

Having in mind the fact that the negative development of the epidemiological situation caused by the COVID-19 pandemic continued in the 2020, NBS several times has postponed the application of measures that discourage the approval of new, non-purpose and non-investment, foreign currency indexed loans and loans in foreign currency to companies, entrepreneurs and farmers, adopted in December 2019, in the part of those measures relating to capital by amending the Decision on Capital Adequacy of Banks[5]

According to the last Decision Amending the Decision on Capital Adequacy of Banks, due to the postponement of application for twelve months, for the calculation of the deductible from Common Equity Tier 1 are relevant newly approved FX-indexed and FX loans from July 1, 2022. Consequently, the deductible shall apply if the bank's exposures under FX-indexed dinar loans and FX loans extended as of 1 July 2022 to debtors from the non-financial and non-government sector exceed:

1) 71% of the amount of the bank's exposure under dinar loans (including FX-indexed loans) and FX loans, extended to those debtors as of 1 July 2022 – in the period from 1 July 2022 to 30 June 2023;
2) 64% of the amount of the bank's exposure under dinar loans (including FX-indexed loans) and FX loans, extended to those debtors as of 1 July 2022 – in the period from 1 July 2023 to 30 June 2024;
3) 57% of the amount of the bank's exposure under dinar loans (including FX-indexed loans) and FX loans, extended to those debtors as of 1 July 2022 – in the period from 1 July 2024 to 30 June 2025;
4) 50% of the amount of the bank's exposure under dinar loans (including FX-indexed loans) and FX loans, extended to those debtors as of 1 July 2022 – in the period from 1 July 2025.

On December 2020, the Executive Board of the National Bank of Serbia adopted the Guidelines Amending **the Guidelines for the Identification of Default**, postponing the application of the Guidelines for the Identification of Default, in such a manner that instead of January 1, 2021, it shall apply as of 1 January 2022 (except the provisions of item 10 of the Instruction which refers to the manner of determining the materially significant amount, already applied as of 1 January 2019). By this decision, banks were given an additional period of time to adjust to new rules in the context of determining status of default.

5 The application of measures had been postponed by adopting the decisions on May 2020 and on November 2020, while the last postponement of the application of measures were on 10 June 2021 by adopting the following regulation: Decision Amending the Decision on Capital Adequacy of Banks and Decision on deadlines for compliance of banks' internal acts on risk management and for reporting by banks and Decision Amending the Decision on Reporting Requirements for Banks.

On June 2020, the NBS adopted **Decision Amending the Decision on Measures for Safeguarding and Strengthening Stability of the Financial System**, creating regulatory assumptions for the allocation of lower downpayment for first home buyers. Namely, in accordance with new rules, banks may approve a mortgage loan to a natural person provided that the amount of the loan does not exceed 90% of the value of the property mortgaged – for the first home buyers (exception from the general limit of 80%).

As a carefully weighed response of the NBS to a possible deterioration in the financial position of citizens who took out consumer loans (including consumer loans intended for the purchase of motor vehicles), cash or other loans (except housing loans and current account overdrafts) before the extraordinary circumstances brought on by the COVID-19 pandemic, the new regulations were adopted in July 2020:

- **Decision Amending the Decision on Capital Adequacy of Banks and**
- **Decision Amending and Supplementing the Decision on Managing Concentration Risk Arising from Bank Exposure to Specific Products.**

The adopted decisions should facilitate loan repayment conditions to citizens facing or likely to face income or job losses, but also to citizens who are not experiencing financial difficulties but want to settle their outstanding liabilities over a longer period of time than initially envisaged. These regulations give additional scope to banks to offer adequate facilities on loan repayment during this and the next year to the borrowers who took out the above loans before the onset of the current extraordinary circumstances, without jeopardizing their performance indicators. More specifically, as of the effectiveness of the above regulations banks will be encouraged to offer to borrowers refinancing or change of the maturity date of the last instalment of consumer, cash and other loans (except housing loans and current account overdrafts) approved by 18 March 2020 for additional two years relative to the current repayment regime (implying the repayment term of up to 7 years in the course of 2020, up to 6 years in the course of 2021, and up to 8 years for consumer loans approved for the purchase of motor vehicles irrespective of the year). These facilities can be offered to borrowers even in case where their debt-to-income ratios would exceed 60% after the refinancing or change of the maturity date of the last instalment under the conditions envisaged by the new regulations.

On August 2020 the NBS Executive Board adopted **the Decision on Temporary Measures for Banks to Facilitate Access to Financing for Natural Person**. Three sets of temporary measures were adopted in order to provide the natural persons with easier access to housing loans, and thus support the economy (easier access to housing loans in the earlier phase of construction, the possibility of extending the repayment period of housing loans to a maximum of five years and temporary relaxation of credit procedures for natural persons to loans up to 90,000 dinars). Banks will be able to apply the adopted set of measures until end-2021.

Having in mind the complexity of the pandemic's fallout on households and businesses, On December 14th 2020, NBS adopted new measures by **the Decision on Temporary Measures for Banks to Enable Adequate Credit Risk Management amid COVID-19 Pandemic** and **the Decision on Temporary Measures for Financial Lessors to Enable Adequate Credit Risk Management amid COVID-19 Pandemic** prescribing the measures and activities to be applied by banks and lessors in order to ensure adequate credit risk management, which implies timely identification of debtors faced with potential difficulties and taking of appropriate steps. Debt repayment facilities are provided for natural persons, farmers, entrepreneurs and companies. Debt repayment facilities are provided for the settlement of liabilities on the basis of loans, credit cards and current account overdraft, provided that the debtor was orderly in settling liabilities to the bank in the relevant period before the pandemic (as at 29 February 2020 and in the 12-month period before that date, a borrower did not default on its liabilities to such bank and neither of the claims on such borrower in respect of the loans and other loan products - credit cards and current account overdrafts was classified as a non-performing loan in such bank).

The facilities that the bank was obliged to provide to the borrower who meets the above-mentioned condition of prior orderliness in settling its liabilities and the prescribed conditions due to pandemic are a six-month grace period during which a bank shall not collect its claims in respect of principal. The agreed interest calculated for the duration of the grace period is collected either during such period or after its expiry, depending on the facility model chosen by the borrower. Based on the application of the facilities, the new agreed repayment period shall be extended in such manner that the amount of the annuity (monthly liabilities of the borrower) after the expiry of the grace period and until the end of the new loan repayment period is not higher than that amount in the period before the facility was applied.

The National Bank of Serbia estimated that the need for facilities especially have borrowers who, as at the date of entry into force of this decision (15 December 2020) and/or as at 28 February 2021, are more than 30 days past due in a materially significant amount on any obligation to the bank arising from products to which this decision applies, unemployed persons, debtors whose average net monthly income in the last three months is below the average wage in the Republic of Serbia, as well as debtors with average net monthly income in the last three months up to 120,000 dinars, with the net monthly income lower by 10% or more related to the income before March 15, 2020 and whose degree of credit indebtedness, ie the coverage of monthly income with credit and other obligations is above 40% of that income.

For borrower who is a farmers, entrepreneurs or a company, it is estimated that the facilities should be offered especially to borrowers who, as at the date of entry into force of this decision (15 December 2020) and/or as at 28 February 2021, are more than 30 days past due in a materially significant amount on any obligation to the bank arising from products to which this decision applies, debtors who recorded a decline in operating income, and/or turnover by at least 15% in 2020 relative to the same period of 2019 or a borrower's operations were suspended for at least 30 successive days due to the COVID-19 pandemic.

Contractual interest is calculated during the grace period, but it is up to the debtor to decide, in the request, whether it will pay interest during the grace period or after its expiry.

A request for facilities might be filed with banks until 30 April 2021 and the bank's deadline for deciding upon request is within 30 days of receiving the request.

AML

On February 13, 2020, the Government of the Republic of Serbia adopted the new National Strategy for the Fight against Money Laundering and the Financing of Terrorism for the period 2020 - 2024, and the Action Plan for the implementation of this Strategy (2020-2022). Its overall objective is to protect the economy and financial system of the Republic of Serbia from the threat caused by money laundering and terrorism financing and proliferation of weapons of mass destruction. The Strategy is implemented through measures and activities contained in the Action Plan.

In order to comply with the 5th EU Directive and FATF Recommendation 15, in December 2020, Republic of Serbia adopted the Law on Amendments to the Law on Prevention of Money Laundering and the Financing of Terrorism („Official Gazette of the Republic of Serbia", No. 153/2020) and the Law on Digital Assets („Official Gazette of the Republic of Serbia", No. 153/2020), both updating legal framework concerning the virtual (digital) assets (virtual currencies and digital tokens).

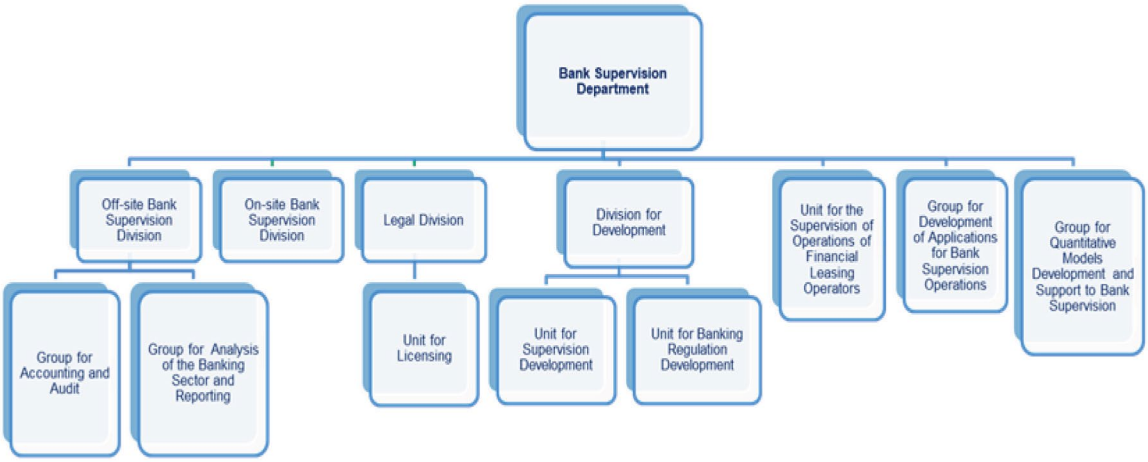
The Law on Amendments to the Law on Prevention of Money Laundering and the Financing of Terrorism was adopted with the aim of harmonizing the AML/CFT Law with the law governing digital assets, which comprehensively regulates the issuance and trading of digital assets, services that can be provided in relation to those assets and supervision over virtual assets service providers. It's provided full harmonization with international standards in this area defined by the FATF recommendations (Recommendation No. 15) which require licensing or registration of persons providing services related to virtual assets, as well as supervision over them.

The authorities competent for licensing digital assets service providers (VASPs) and for supervision of issuing digital assets and providing services related to digital assets are the NBS (in respect to virtual currencies) and Securities Commission (in respect to digital tokens). The same division of competences has been made in AML/CFT Law so the NBS continues to supervise implementation of that Law by virtual currencies service providers, taking into account that from April, 1st, 2018, the NBS has assumed responsibility for supervision of implementation of AML/CFT Law by providers of services related to the virtual currencies (Law on Prevention of Money Laundering and the Financing of Terrorism – „Official Gazette of the Republic of Serbia", No. 113/2017), including the supervision over custody wallet services providers related to virtual currencies (Law on Amendments to the Law on Prevention of Money Laundering and the Financing of Terrorism – „Official Gazette of the Republic of Serbia", No. 91/2019), in accordance with 5th EU Directive. On the other side, within the scope of responsibility of the Securities Commission is supervision over the implementation of that Law by virtual assets service providers, which services are not related to virtual currencies (e.g. investment tokens).

The NBS has adopted the Decision on Amendments to the Decision on Guidelines for the Application of the Provisions of the Law on the Prevention of Money Laundering and Terrorism Financing for Obligors Supervised by the National Bank of Serbia („Official Gazette of the Republic of Serbia", No. 137/2020) in November 2020. Reasons for these amendments were harmonisation with the Law on Amendments of the Law on Prevention of Money Laundering and the Financing of Terrorism which had entered into force on January 1, 2020, and which stipulate custody wallet services providers as obligors supervised by NBS, in order to clarify the e-money issuer obligations when dealing with distribution of e-money over third party not being obliged entities, as well as to improve the provisions concerning obligations of obliged entities to monitor transaction (real-time and ex-post) and to check adequacy and reliability of the established system of monitoring. In addition, amendments to these guidelines closely regulate the use of Central Records of Beneficial Owners by obligors supervised by the NBS while preforming customer due diligence, provide further improvement of the legal framework for the prevention of money laundering and terrorism financing according to the best international practices and standards, and provide clarifications concerning the interpretation of certain provisions.

In accordance with the obligation arising from the AML/CFT Law, during 2020 the NBS established a mechanism to encourage persons to inform the NBS about violations of the AML/CFT Law by obliged entities within its competence. On its website NBS published information of the established mechanism, whose application provides maximum confidentiality of data, protection of integrity and personal data of persons who submit information about violations of the AML/CFT Law by obliged entities to the NBS. The establishment of this mechanism helps to preserve the integrity of the financial system and prevent the abuse of financial institutions within the competence of the NBS for the purpose of ML/TF.

Organizational chart of the Banking Supervisory Authority



The Bank Supervision Department consists of seven lower-level organizational units: Off-site supervision division (with two lower-level organizational units: Unit for banking sector analyses and supervisory reporting and Unit for accounting and auditing), On-site supervision division, Legal division (with lower-level organizational unit: Unit for licensing), Division for development (with two lower-level organizational units: Unit for supervision development and Unit for banking regulation development), Unit for the supervision of operations of financial leasing operators, Group for development of quantitative models and support to bank supervision and Group for development of applications for bank supervision operations.

Main strategic objectives of the Banking Supervisory Authority in 2020

It should be noted that legislative activities in previous period were mostly in the light of situation caused by Covid19 pandemic. Namely since the occurrence of the emergency health situation caused by the Covid 19 pandemic, the National Bank of Serbia has carried out numerous and comprehensive activities, preserving the stability of the financial system, providing debt repayment facilities to the debtors and creating conditions in order to facilitate access to financing for clients. This is best evidenced of the readiness and ability of the banking sector to respond to all challenges in the current unprecedented extraordinary health circumstances in recent history.

AML

Main strategic objectives of the supervisory authority in RS in the field of prevention of ML/FT were to maintain the quality of the control function in the conditions of the Coronavirus, implementing National Strategy for the Fight against Money Laundering and the Financing of Terrorism for the period 2020 – 2024 (hereinafter: National AML/CFT Strategy) through measures and activities contained in the Action Plan for the implementation of this Strategy (2020-2022) (hereinafter: Action Plan),and further improvement of the legal framework to align with the 6th EU Directive and with updated the FATF recommendations in a manner which ensures the strengthening of the AML/CFT system in RS, and to ensure implementation of that improved legal framework by conducting supervisions activities.

The activities of the Banking Supervisory Authority in 2020

Measures Against Banks

During 2020, in the process of banks supervision, the National Bank of Serbia has taken following measures against banks: 11 letters of warning, 4 decisions on orders and measures and 3 fines imposed toward 3 banks. Also, the National Bank of Serbia dismissed 11 control procedures.

Licensing and Approvals regarding Banks

In the procedures for applications for operating licence, various consents and approvals, the National Bank of Serbia in 2020 issued:

- 2 decisions on giving prior consent for acquisition of ownership in banks;
- 21 decisions on giving prior consents for amendments of banks' founding acts and their articles of association (one request was rejected);
- 83 decisions on giving prior consent for appointment of managing and executive board members;
- 4 decisions on giving prior approval for distributing bank's profit through payment of dividends to its shareholders;- 2 decisions on giving prior consent for inclusion interim profit in common equity tier 1 capital;
- 5 decisions on giving prior consent for inclusion in the calculation of the common equity tier 1 - of the capital elements referred to in item 7, paragraph 1, provision under 1) of the Decision on Capital Adequacy of Banks, by increasing the basic share capital;
- 1 decision on giving prior consent for reducing the value of the elements of the Tier 1 capital and 1 decision on the termination of proceeding for giving prior consent for reducing the value of the elements of the Tier 1 capital;
- 2 decisions on giving consent to bank/ultimate parent company not to include a subordinated company/ subordinated companies (entities in the financial sector) in Annual audit of financial statements of banking group for 2019;
- 3 decisions on giving consent to bank/parent company not to include a subordinated company in consolidation of financial statement of their banking group as of december 31, 2019;
- 266 notifications from banks regarding outsourcing of their business activities were processed and
- 1 notification of consent to the bank not to include the exposure to a member of the group in the calculation of the limit of large exposures to related parties.

On-site inspections

Regarding activities of prudential on-site supervision of bank operations in 2020, 20 on-site inspections were conducted with different types of risks within their scope: 7 targeted inspections and 13 follow-up inspections related to corrective measures that have been undertaken.

AML

Performing its control function in the conditions of the Coronavirus was a special challenge for the employees of the NBS who are engaged in supervisory activities of financial institutions under the jurisdiction of the NBS. In the area of AML/CFT in banks, in 2020 the NBS conducted regular off-site supervisions activities by analyzing bank's responses to submitted questionnaires on their operations in the area of ML/CFT risk management, monitoring of compliance submitted internal acts with AML/CFT regulations, monitoring of internal controls finding etc. Also, in 2020, NBS's, performed targeted AML/CFT on-site controls in 6 banks, and two AML/CFT off-site controle in one bank, and in case of iregularety imposed corrective measures and fines.

In order to strengthen administrative capacity the NBS organised internal trainings for its employees in AML/CFT area. In the same period, the NBS representatives participate in online trainings organised by the FATF, the Central Bank of France, the Administration For the Prevention of Money Laundering, etc.

International activities of the authority

The NBS cooperates with foreign regulatory authorities, for the purposes of cooperation and exchange of data (information) with a view to exercising and promoting its supervisory function.

In that respect in 2020, the NBS continued to implement the Memorandums of Understanding (hereinafter: the MoUs) signed with foreign regulatory authorities in the field of banking and insurance supervision.

The NBS has very successful cooperation with all of the home supervisors of the banks whose subsidiaries are conducting its business in Serbia, through the Supervisory colleges, conference calls, joint on-site review etc.

Regarding the competencies of the NBS, which is the central bank in the Republic of Serbia, and the supervisory authority of the largest part of the financial system in RS, its general empowerment for the cooperation with foreign central banks and regulatory authorities is defined by the Law on NBS and sectoral laws (such as the Law on Banks).

Despite the possibility of exchanging information without concluded MOUs, the NBS has numerous bilateral and multilateral agreements with supervisory authorities from foreign countries.

The NBS most frequently exchanges information with its counterparts about the main findings on performed controls, as well as the information needed in the licensing process.

AML

The Delegation of the RS (consisting of representatives from the Administration for the Prevention of Money Laundering, the NBS and the Ministry of Internal Affairs) participated in the 60th Plenary meeting of the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and Financing of Terrorism of the Council of Europe (Moneyval).

Cooperation with other supervisory bodies in the country

The NBS successfully cooperates with all supervisory authorities in the country whenever there is a need for sharing information in accordance with signed MoUs.

Regarding its supervisory task, National bank of Serbia has signed MoUs with following domestic bodies and authorities: Deposit Insurance Agency, Securities Commission, Administration for the Prevention of Money Laundering, Tax Administration of the Republic of Serbia, Commission for Protection of Competition, Association of Serbian Banks and the Belgrade Stock Exchange.

The NBS successfully cooperates with all before mentioned domestic supervisory authorities whenever there is a need for sharing information in accordance with provisions of MoUs signed.

AML

During 2020, the NBS continued with successful cooperation with other supervisory bodies in the RS, by participating in the work of the established Coordination body for prevention of ML/FT. Also, the NBS successfully cooperates with other supervisory bodies in the RS by participating in the drafting of regulations, in exchanging of information regarding identified irregularities in the control process in accordance with the

AML/CFT Law, also the NBS informs other supervisory authorities about irregularities in their competence and conduct other activities.

Other relevant information and developments in 2020

The National Bank of Serbia is committed to continuous improvement of regulation in the field of banking, and continues to enhance the regulatory framework for banks. The amendments of prudential legislation for credit institution at the European Union level are being intensively analyzed. The National Bank of Serbia has successfully faced the challenges so far and continues to keep a close eye on the situation in the financial sector, as well as the situation on the entire domestic and international market, and undertake all necessary activities within its competences in the interest of citizens and economy.

Questionnaire tables for the 2020 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	27	26	26
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**27**	**26**	**26**

Total assets of banking sector (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	31,931,225	34,731,173	39,132,130
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**31,931,225**	**34,731,173**	**39,132,130**
y/y change (in %)	**12.27**	**8.77**	**12.67**

Ownership structure of banks on the basis of assets total

Item	2018	2019	2020
Public sector ownership	17.5	16.8	7.1
Domestic ownership total	24.6	24.3	14.0
Foreign ownership	75.4	75.7	86.0
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2020

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	36.1	52.5	786
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**36.1**	**52.5**	**786**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2018	2019	2020
Commercial banks	11.3	9.8	6.5
Cooperative banks			
Banking sector, total:	**11.3**	**9.8**	**6.5**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2018	2019	2020
Commercial banks	100.00	100.0	100.0
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2018	2019	2020
Receivables			
Financial sector	14.7	13.1	14.4
Nonfinancial sector	57.2	58.2	57.4
Government sector	17.8	17.4	17.0
Other assets	10.3	11.3	11.2
Liabilites			
Financial sector	10.7	9.9	8.7
Nonfinancial sector	68.4	68.9	71.9
Government sector	2.0	2.7	2.5
Other liabilities	1.0	1.2	1.3
Capital	**17.9**	**17.3**	**15.6**

Capital adequacy ratio of banks

Type of financial institution	2018	2019	2020
Commercial banks	22.3	23.4	22.4
Cooperative banks			
Banking sector, total:	**22.3**	**23.4**	**22.4**

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

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

Asset classification	2018	2019	2020
Non-financial sector, including			
- households	4.44	3.94	3.61
- corporate	7.15	4.37	4.03

The structure of deposits and loans of the banking sector in 2020 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	94.65	97.65
Households	54.62	45.88
Corporate	35.97	50.60
Government sector	2.52	1.62
Financial sector (excluding banks)	2.83	0.73
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-end), in EUR thousand

P&L account	2018	2019	2020
Interest income	1,254,773	1,293,036	1,279,362
Interest expenses	180,610	197,855	178,702
Net interest income	1,074,162	1,095,181	1,100,660
Net fee and commission income	341,594	357,878	345,342
Other (not specified above) operating income (net)	149,058	95,905	170,478
Gross income	1,564,815	1,548,964	1,616,480
Administration costs	887,859	909,026	918,507
Depreciation	59,963	104,448	114,949
Provisions			
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	76,836	60,011	224,902
Other income	100,451	100,097	33,805
Profit (loss) before tax	640,608	575,576	391,928
Net profit (loss)	595,839	543,545	357,480

Total own funds in 2020 (in EUR thousand)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	5,314,609	5,102,638	5,116,020	198,589	N/A
Cooperative banks					
Banking sector, total:	**5,314,609**	**5,102,638**	**5,116,020**	**198,589**	**N/A**

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

Macroeconomic environment in the country

The corona crisis hit Slovak economy in first quarter 2020. After onset of a pandemic, Slovak government was forced to introduce containment measures that in combination with marked weakening of foreign demand resulting from containment measures in other countries led to the recession of Slovak economy. Slovak GDP declined by -4.75 % in 2020 with the sharpest decline during the second quarter 2020. The corporate sector experienced a severe drop in sales especially in the service sector, in particular the hospitality, recreation and transport industries. Negative economic situation has subsequently mirrored in unfavorable development of the labor market when the unemployment rate increased by more than 2.5 p.p. to 7.58 % at the end of 2020. The average wage recorded historic year on year decline in second quarter 2020 when it decreased by -1.2%. The situation started to improve during the summer months in line with release of containment measures. The recovery was driven by rising exports, with the automotive industry in particular experiencing a relatively stable period of production. The favorable trend in the second half of the year was cooled by the onset of pandemic's second wave at the end of 2020, however the second wave has not so detrimental impact on the economy as was the case during the first wave.

Development in the banking sector (including assets total / GDP)

The corona crisis has not affected banking sector to a significant extent. The banking sector assets recorded a growth by 8.1 % in 2020, the highest rise during the last decade, rising to €95 billion. Beyond this marked increase was situation on credit market since loans compose 70% of the assets of Slovak banking sector. Despite the economic decline, the amount of outstanding loans increased by 5%. However, in contrast to asset increase, the profitability of banking sector slumped significantly when ROE recorded decrease by 2.8 p.p. to 5.9% in 2020. Drop in profitability was induced by increased provisioning due to uncertainty after onset of coronacrisis and to certain extent also by the bank levy that Slovak banks were obliged to pay within the first half of 2020. Good news was that the banking remained resilient even during the crisis times. The banking sector's aggregate total capital ratio increased from 18.2% at the end of 2019 to 19.7% a year later. The main factor behind this increase was decision of banks to retain 2019 profits in banks. However increasing pressure on Slovak banks' business model due to compressed interest margins in Zero Lower Bound environment remain still a challenge for Slovak banks.

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 National Bank of Slovakia (NBS) was established as the independent central bank of Slovakia on 1 January 1993, under Act no. 566/1992 Coll. On Národná banka Slovenska.

In 2020 NBS carried on with the Eurosystem membership, which includes the European Central Bank (ECB) and the national central banks (NCBs) of those countries that have adopted the euro. NBS had joined the Eurosystem on 1 January 2009, the date on which Slovakia adopted the euro. The NBS Governor continued to be a member of the ECB's Governing Council, the Eurosystem's highest decision-making body. Thus NBS, together with other NCBs and ECB, contributed to achieving the common goals of the Eurosystem. NBS participated in activities of the Eurosystem and the ESCB through its involvement in the Eurosystem and ESCB committees.

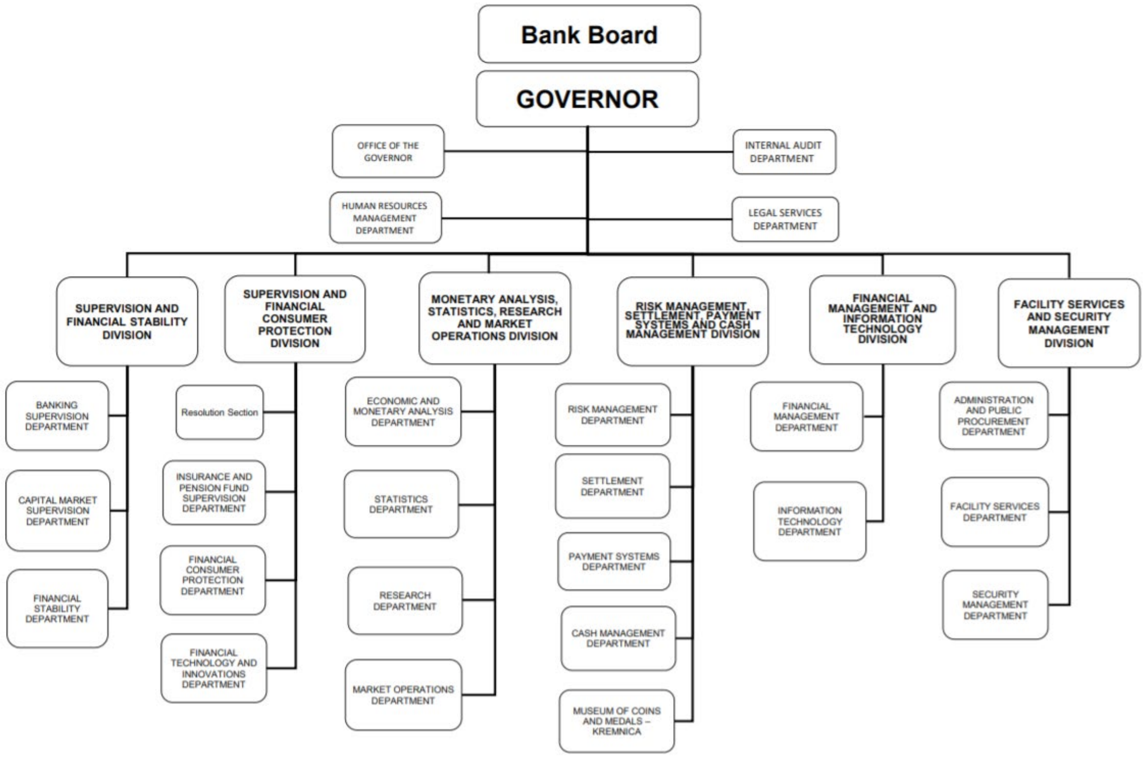
As the national supervisory authority in Slovakia, NBS has been part of the EU's Single Supervisory Mechanism (SSM) – a mechanism for exercising supervision over credit institutions in participating EU Member States – since the SSM came into operation on 4 November 2014.

The NBS participated in specific supervisory tasks of the ECB through the direct involvement of staff members of the NBS Financial Market Supervision Unit in Joint Supervisory Teams and through cooperation in the drafting of ECB decisions. As regards the supervision of significant banks, NBS exercised supervision over the banks' activities on a daily basis and continuously monitored quantitative data and oversaw risk management processes.

Slovakia's Resolution Council was established in January 2015 as part of the EU's Single Resolution Mechanism – the second of the Banking Union's three pillars – with NBS assigned the role of providing expertise to the Council and organising its functioning.

Since 1 January 2015 NBS has been the financial consumer protection authority in Slovakia. As such, the central bank supervises the protection of financial consumers' and other clients' rights in order to support the secure and sound functioning of the financial market.

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Banking Supervisory Authority in 2020

The COVID-19 pandemic has brought about the need for an operational change in banking supervision. Priorities as such have not been changed, but supervisory activities have focused mainly on assessing them in the context of a pandemic.

The priorities of the Single Supervisory Mechanism for 2020 were:

1. Recovery of bank balance sheets

- reducing the level of non-profit assets
- changes in internal models for risk assessment
- asset valuation

2. Strengthening the resilience of banks

- evaluation of credit standards and credit quality
- assessment of capital and liquidity management
- assessing the sustainability of business models
- information and cyber risk assessment
- evaluation of stress testing
- evaluation of internal management and organization of banks

3. Other priorities

- especially Brexit

The activities of the Banking Supervisory Authority in 2020

The year 2020 can be called a pandemic in terms of supervisory performance. The corona crisis also affected all sectors of the financial market in Slovakia. However, from the very beginning of the crisis, the NBS's supervision approached its resolution very actively, in an effort to keep the Slovak financial sector healthy and stable.

In the banking sector, supervision focused in particular on sufficient capital to ensure resilience to potential losses. Sufficient capital is also important for the continuation of lending. The ECB and the NBS applied capital and liquidity concessions to banks operating in the Slovak Republic, enabling banks to meet the capital requirement from Pillar 2 with instruments other than Tier 1 equity (CET1). The countercyclical capital buffer level has been reduced several times to the current level of 1%. These steps created a sufficient amount of free capital that banks could use for lending. Recommendations were issued by the NBS, as well as by the ECB and the ESRB, for banks to maintain a sufficient amount and quality of capital during the pandemic and to limit the payment of dividends to shareholders. The NBS also co-operated in the issuance of the "Lex Corona Act", which created a legislative framework for deferring the repayment of bank borrowers. This step significantly reduced the risk of loan losses. The deferral mechanism was intensively used by bank clients, especially at the beginning of the crisis, in April and May 2020.

The COVID-19 pandemic has brought about the need for an operational change in banking supervision. On-site supervision was ensured by the use of means of remote communication. A team has been set up to monitor the impact of the pandemic in banks. The internal management and organization of the banks during the pandemic were independently monitored. Credit risk (including deferral of payments and use of state guarantee schemes), liquidity risk, which were of great importance especially in the beginning of the pandemic, as well as the technical readiness of banks to switch to work from home via remote approaches were assessed. Banking supervision has adopted a pragmatic approach to implementing the annual SREP assessment. Detailed monitoring of banks during the pandemic, as well as the annual assessment confirmed the stability of Slovak banks.

International activities of the authority

At the international level, NBS focused on integration and cooperation within European structures. Increasing international cooperation in financial markets requires the respective supervisory authorities to work more closely together. Thus, through the European System of Financial Supervision (ESFS), the activities of NBS as supervisor of the domestic financial market were closely coordinated with those of other supervisory authorities in the EU.

The single supervisory regime works on basis of continual cooperation between the ECB and the national supervisory authorities. NBS participated especially in supervisory tasks of the ECB through its involvement of NBS staff in Joint Supervisory Teams and in the drafting of ECB decisions during 2020.

For supervision at the level of the European financial system, NBS continued in co-operation with the European Systemic Risk Board (ESRB), the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA).

NBS's ongoing cooperation with the EBA focused, in 2020, on the drafting of implementing technical standards (ITSs), regulatory technical standards (RTSs) **and guidelines** required under the EU's Capital Requirements Regulation and Directive (CRR/CRD IV) and related legal acts. NBS cooperated with the EBA at all levels of competence, from working groups to the highest approval bodies.

Cooperation with other supervisory bodies in the country

In 2020, the dominant cooperation was with the Ministry of Finance regarding work related to the transposition of the CRD V Directive and the transposition of the CBD. As has been the case for many years, the Ministry of Finance is responsible for drafting government bills in the area of financial services. Thus, it also applies in these two cases of directives that the Ministry of Finance has invited the National Bank to cooperate in the preparation of texts of draft laws with regard to supervisory experience in the supervision of banks. In the first half of 2020, cooperation was more or less completed with regard to the amendment of the Banking Act and related laws regarding the transposition of CRD V, and in the autumn of 2020 the draft law was approved and issued. In the second half of the year, preparatory negotiations began with the Ministry regarding the transposition of the CBD, as it was already in the stage before its publication in the Official Journal of the EU. Transposition work in this direction affected several laws, but even in this case the law on banks was andis the main factor.

The second important area of cooperation was the working coordination with the Ministry of the Interior, specifically with the financial intelligence unit, regarding the ongoing fulfillment of tasks from the AML Action Plan adopted after the previous evaluation of the Slovak Republic by the Moneyval Committee in 2019; many of these tasks relate to the National Risk Assessment program.

Other relevant information and developments in 2020

Despite the pandemic, the NBS worked intensively to support innovation and fintech. The range of tools to support innovative entrepreneurship has expanded. Thanks to the Innovation Hub, which has been operating for the second year in a row, the discussion on innovations within the NBS has intensified and deepened. The NBS Bank Board has decided to support the creation of a sandbox. The cryptoactive market has also been mapped, with up to 70% of respondents emerging in the last three years. Work also continued to improve supervisory information systems.

Two main tasks related to a comprehensive assessment of the risks of money laundering and terrorist financing were also carried out. In the area of banking, the capital market and insurance, the NBS also actively participated in the preparation of individual steps related to Brexit.

The year 2020 also brought a significant organizational change in both departments of financial market supervision, which resulted from the need of modernising the supervision. Extensive changes to existing and the setting up of several new internal processes and procedures have been launched. At the same time, this change logically linked and interconnected the area of regulation and supervision. The approach resulted from the real experience and needs of the NBS as a supervisory authority. The NBS has taken a more ambitious approach to the issue of fintech by creating a department that covers this issue.

Questionnaire tables for the 2020 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	12	12	12
Branches of foreign credit institutions	15	15	15
Cooperative banks	0	0	0
Banking sector, total:	**27**	**27**	**27**

Total assets of banking sector (in EUR thousands) (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	69 544 067	73 968 089	79 617 275
Branches of foreign credit institutions	10 463 396	10 697 315	12 018 938
Cooperative banks	-	-	-
Banking sector, total:	**80 007 463**	**84 665 404**	**91 636 213**
y/y change (in %)	**5.5%**	**5.8%**	**8.2%**

Ownership structure of banks on the basis of assets total

Item	2018	2019	2020
Public sector ownership	0,79	0,66	0,60
Domestic ownership total	0,36	0,32	0,23
Foreign ownership	98,85	99,02	99,17
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2020

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	69.0%	86.5%	1830
Branches of foreign credit institutions	71.5%	87.3%	2818
Cooperative banks	-	-	-
Banking sector, total:	**59.9%**	**76.8%**	**1430**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2018	2019	2020
Commercial banks	9.17%	8.73%	5.94%
Cooperative banks	-	-	-
Banking sector, total:	**9.17%**	**8.73%**	**5.94%**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2018	2019	2020
Commercial banks	86.9%	87.4%	86.9%
Branches of foreign credit institutions	13.1%	12.6%	13.1%
Cooperative banks	-	-	-
Banking sector, total:	100.0	100.0	100.0

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

	2018	2019	2020
Receivables	**100,0%**	**100,0%**	**100,0%**
Financial sector	12,7%	11,4%	13,8%
Nonfinancial sector	74,0%	74,1%	72,1%
Government sector	12,0%	12,1%	12,0%
Other assets	1,4%	2,5%	2,2%
Liabilites	**91,9%**	**92,0%**	**92,0%**
Financial sector	17,9%	17,3%	16,8%
Nonfinancial sector	67,4%	67,9%	68,3%
Government sector	3,4%	2,5%	2,5%
Other liabilities	3,1%	4,3%	4,4%
Capital	**8,1%**	**8,0%**	**8,0%**

Capital adequacy ratio of banks

Type of financial institution	2018	2019	2020
Commercial banks	18.43	18.21	19,67
Cooperative banks	-	-	-
Banking sector, total:	**18.43**	**18.21**	**19,67**

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

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

Asset classification	2018	2019	2020
Non-financial sector, including	3.12	2.91	2,57
- households	2.94	2.85	2,43
- corporate	3.88	3.46	3,32

The structure of deposits and loans of the banking sector in 2020 (%)
(at year-end)

	Deposits	Loans
Non-financial sector, including:	92.7%	91.82%
Households	68.63%	62.54%
Corporate	24.10%	29.29%
Government sector	3.58%	1.43%
Financial sector (excluding banks)	3.69%	1.94%
Total	**100.0**	**100.0**

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

P&L account	2018	2019	2020
Interest income	2 044 610	1 986 132	1 871 379
Interest expenses	272 350	264 094	216 578
Net interest income	1 772 260	1 722 038	1 654 801
Net fee and commission income	602 913	621 842	622 313
Other (not specified above) operating income (net)	-180 645	-192 614	-189 565
Gross income	2 278 433	2 231 211	2 234 502
Administration costs	1 169 485	1 151 047	1 116 811
Depreciation	120 714	165 520	162 123
Provisions	158 584	135 361	348 051
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)			
Profit (loss) before tax	824 471	804 393	602 172
Net profit (loss)	639 969	636 027	469 916

Total own funds in 2020 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	7 303 331 084 ***	6 323 790 176 ***	6 723 790 176 ***	579 540 908 ***	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**7 303 331 084 *****	**6 323 790 176 *****	**6 723 790 176 *****	**579 540 908 *****	**-**

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

Macroeconomic environment in Slovenia

The epidemic and containment measures also hit the Slovenian economy hard last year, although the crisis was slightly less severe than expected and slightly smaller than the euro area average. GDP declined by 5.5%, driven largely by a decline in final household consumption. Households strongly increased their saving, as a result of increased caution and an inability to spend, but their purchasing power remained stable amid the extensive support measures. The shock to investment was smaller than forecast last year: firms in most sectors adapted quickly to doing business in the more challenging circumstances, and their financial position remained stable on aggregate thanks to subsidies. Foreign demand also began to recover in the second half of the year. Exports of merchandise and most services thereby began to rise, and net trade actually made a positive contribution to last year's change in GDP. This is also the case of government consumption, which is the expected response from fiscal policy in an economic crisis. The nature of the containment measures meant that large differences arose between sectors: for example, turnover in accommodation and food service activities fell by more than 40%, while turnover in online and mail-order retail was up more than a half.

Developments in the banking sector

The number of credit institutions in Slovenia has fallen in recent years. It fell to 16 last year, down one following the merger of two banks. At the end of 2020 there were 11 banks, three savings banks and two branches of foreign banks operating in Slovenia. The banks dominate the banking system with a market share of 90.8%, while the savings banks held a share of just over 5% and the branches of foreign banks a share of just over 4%. There was no significant change in the shares compared with previous years. The trend of decline in the number of banking institutions is nevertheless continuing, as a result of the consolidation process. The merger of second and third largest bank in Slovenia went through on 1 September 2020.

The banking system's balance sheet total increased by 8.3% in 2020 to EUR 44.7 billion. On the funding side, the largest factor in the increase was deposits by the non-banking sector, i.e. household deposits and corporate deposits, most of which are sight deposits. On the investment side, the slowdown in growth in loans led to an increase of EUR 3 billion in the most-liquid forms of asset, i.e. claims against the central bank. Having declined in the years before the crisis triggered by the epidemic, the ratio of the banking system's balance sheet total to GDP ended last year at 96.4%, up 11.2 percentage points amid the decline in nominal GDP.

Year-on-year growth in loans to the non-banking sector slowed sharply last year, to end the year at just 0.2%. The sharp slowdown was mainly attributable to the economic struggles driven by the containment measures. Year-on-year growth in household loans slowed sharply, but remained in positive territory in December at 0.1%. The largest decline in year-on-year growth was recorded by consumer loans. Slower growth was evident even after the introduction of binding macroprudential restrictions on household lending in November 2019, and rates slowed further after the outbreak of the pandemic. The stock of consumer loans has been contracting since May of last year, the year-on-year contraction reaching 7.8% by the end of the year. Growth in consumer loans also slowed in other euro area countries during the pandemic, and hit negative territory in most of them before the end of the year. By contrast year-on-year growth in housing loans remained relatively stable, despite the adverse economic situation: it was down less than 1 percentage point on the previous year on average, and ended the year at 4.1%.

There was also a sharp slowdown in growth in corporate loans in 2020: year-on-year growth came to an end in June, and has been in negative territory since August. The rate stood at -1.4% in December. Firms came into the adverse economic situation in good financial shape, and adapted their operations to maintain liquidity while deferring planned investments. Similarly to 2019, last year saw notable growth in loans to non-residents, the rate reaching 27.7% by December. These loans account for just 3.0 % of the balance sheet total.

Behind us lie several years of successful reduction of non-performing exposures (NPEs) in the banking system, but the Covid-19 epidemic brought this to an end in late 2020.

The key factor in limiting the rise in NPEs was the loan moratorium measure in connection with the Covid-19 epidemic, which eased the difficulties facing households and firms in repaying bank loans. More flexible regulatory treatment of legislative moratoria was also allowed under certain conditions. There was no need to automatically reclassify exposures of this type as forborne (performing or non-performing) exposures when the moratorium was approved. By the end of 2020 the banks had received almost 27,000 applications for moratorium from borrowers, the majority of which have already been approved, covering loans in the amount of almost EUR 2.5 billion. By far the largest number of applications were received during the first officially declared epidemic last spring (in April and May), while the second epidemic declaration (mainly November) brought another bout of applications.

The loan moratorium measure is temporary, which means that NPEs could gradually increase in the banking system after the loan moratoria expire. The longer the Covid-19 epidemic lasts, the more chance that loan liabilities covered by moratoria will be classed as NPEs, i.e. as liabilities that will not be repaid in part or in full. At firms in the sectors hit hardest by the containment measures, i.e. accommodation and food service activities, and arts, entertainment and recreation, the moratoria on liabilities to banks (and liquidity loans to a lesser extent) account for more than 60% of the total exposure to firms in these sectors.

The majority of the banks saw an improvement in capital adequacy in 2020, although there are considerable differences in the size of the capital surplus at individual banks. The banks are in a better capital position than when they went into the last financial crisis, which will have a significant impact on their ability to cover the losses driven by the economic shock of the Covid-19 epidemic. The banking system's total capital ratio fell to 18.3% on a consolidated basis at the end of 2020, while the common equity Tier 1 capital ratio declined to 16.7%. The changes in the capital ratios at system level reflect declines at just a few banks, while the majority of banks saw an improvement in their capital ratios. The banks primarily increased their regulatory capital via retained earnings from the previous financial year and other reserves, as they applied the Banka Slovenije macroprudential measure restricting profit distributions; some also increased capital by issuing subordinated debt securities included in Tier 2 capital. Risk-weighted assets mainly declined at the banks that reduced their lending to non-financial corporations and households after the declaration of the Covid-19 epidemic.

The legal and institutional framework of the operation and supervision of financial institutions, new developments. Legal competence of Banka Slovenije

The Single Supervisory Mechanism (SSM) is one of the three pillars of the EU banking union, created in response to the financial crisis with the aim of restoring and maintaining confidence in the European banking system. The banking union complements the economic and monetary union (EMU) and the single market by coordinating the responsibility for bank supervision, resolution and funding at the EU level, and ensuring a level playing field for banks across the euro area. Alongside the SSM, which has been in operation since 4 November 2014, the other two pillars of the banking union consists of the Single Resolution Mechanism (SRM), which has been in operation since 1 January 2015, and the European Deposit Insurance Scheme (EDIS), which is still being established.

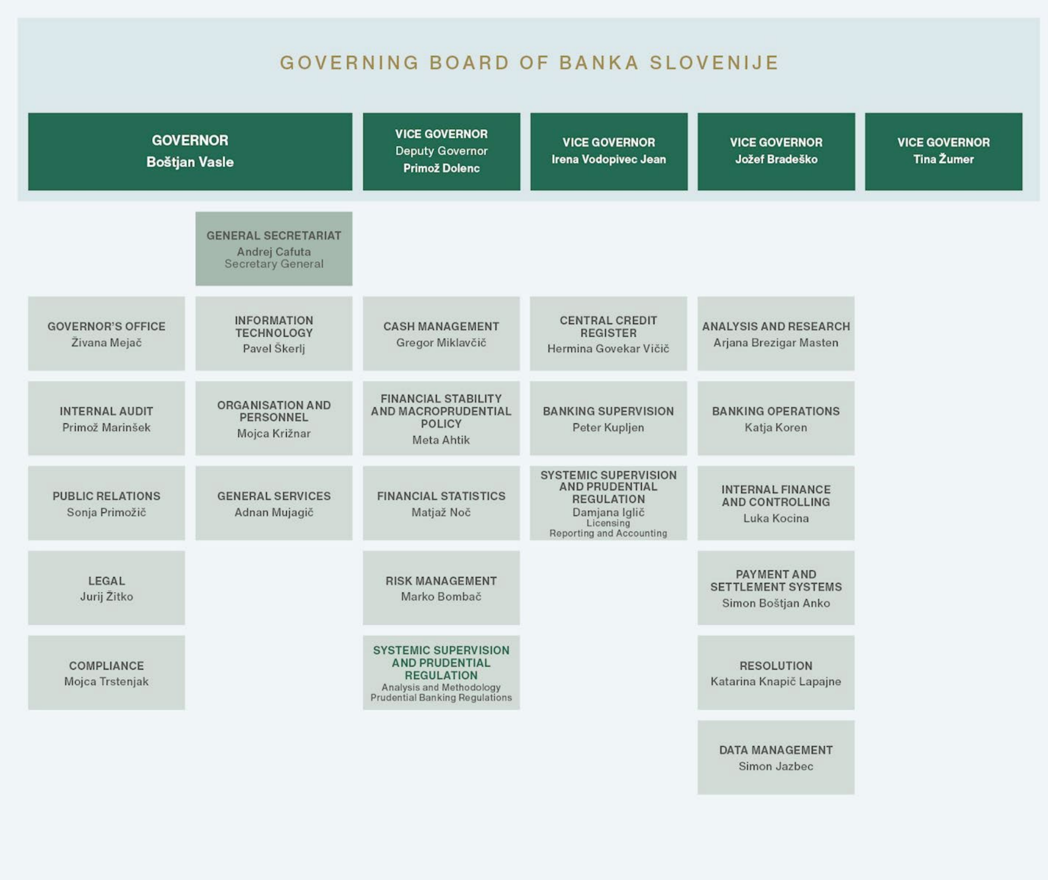
The establishment of the SSM saw supervision of significant institutions (SIs) in the EU transferred to the ECB in 2014, although this supervision is conducted in operational terms via joint supervisory teams (JSTs). The JST for each bank consists of a coordinator from the ECB, and members from the national supervisory authority and the ECB. The national supervisory authorities (the Bank of Slovenia in Slovenia's case) participate in all the supervisory activities, while the supervisory decisions with regard to these banks are made by the ECB.

The supervision of banks and savings banks that do not meet the criteria for being classed as significant institutions, i.e. less significant institutions (LSIs), is conducted by national supervisors, i.e. the Bank of Slovenia in Slovenia's case, in accordance with the rules and methodology of the ECB and the SSM. National supervisors regularly submit supervisory data for less significant institutions to the ECB, and inform it of the material findings of their supervision. The national supervisory authorities may consult the ECB on the imposition of measures, but the final decision is their responsibility, other than in exceptional cases. The new arrangements allow the ECB to directly take over the supervision of less significant institutions at the proposal of the national supervisor, at its own initiative in the event of the potential occurrence of a systemic crisis, or if the national supervisor is failing to conduct adequate supervision.

According to the Bank of Slovenia Act (ZBan-2) 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 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.

The Bank of Slovenia also participates in the activities of the EBA within the scope of its competences. With the aim of putting in place consistent, effective and efficient supervisory practices and ensuring the harmonised application of European legislation in all EU Member States, the EBA issues guidelines and recommendations addressed to competent supervisory authorities and banks. It is the duty of supervisory authorities and banks to endeavour to uphold these guidelines and recommendations to the greatest possible extent. The guidelines and recommendations relate to the areas of banking supervision, bank recovery and early intervention, AML/CFT, payment services and systems, consumer protection and financial innovations. Pursuant to the ZBan-2 the Bank of Slovenia also decides on the application of individual guidelines or recommendations issued by other European supervisory authorities (ESMA, EIOPA) in the form of regulations on the application of guidelines or recommendations.

Organizational chart of Banka Slovenije



Main strategic objectives of Banka Slovenije in 2020

We set the following supervisory priorities in 2020, which also formed the starting point for the supervision of Slovenia's banks:

1. the ongoing clean-up of bank balance sheets, including monitoring of:
    - non-performing assets;
    - IRB approaches;
    - risks inherent in the trading and valuation of assets;
2. the strengthening of future resilience and the assessment of:
    - loan approval criteria and exposure quality metrics;
    - capital and liquidity management, and improvements to the ICAAP and ILAAP at banks and their inclusion in the SREP;
    - business model viability;
    - IT and cyber risk;
    - internal governance with an emphasis on the actions of management bodies;
    - stress tests;
3. other priorities: preparations for Brexit.

In light of the outbreak of the epidemic, the priority tasks in the supervision of significant banks and less significant banks alike were adjusted, and were refocused on monitoring and assessing the banks' ability to deal with the consequences of the epidemic. The stress tests were postponed until 2021. In light of the above, we took a pragmatic approach to carrying out our annual SREP activities, in line with EBA guidelines. The process focused on the banks' ability to manage the challenges and risks to capital and liquidity inherent in the current crisis. We took the decision not to make any changes in general to quantitative capital requirements, unless the change was justified by exceptional circumstances affecting the bank in question. The qualitative recommendations issued to banks focused on internal governance (in particular internal control functions and data quality issues) and credit risk (mainly in connection with classification of loans and creation of impairments).

The activities of Banka Slovenije in 2020

We responded to the outbreak of the Covid-19 epidemic with a broad palette of proposals in the area of credit risk. The purpose of supervisory initiatives and communiques is to ensure that banks have effective credit risk management practices, and sufficient operational capacity to ensure that credit risk is adequately assessed and classified on their balance sheets. Promptly identifying increased credit risk helps to mitigate the cliff effect that might arise when loan moratoria expire. Throughout the year we monitored the implementation of supervisory expectations with regard to credit risk.

We conducted a thematic review in the area of IFRS 9. The objective of the review was to establish the adequacy of the identification of a significant increase in credit risk and the inclusion of forward-looking information in the calculation of expected credit losses. The review was conducted at three significant banks and one less significant bank. Deficiencies were identified in both areas, and measures were imposed on the banks that were subject to the review. In addition, we issued guidance to banks and savings banks in connection with improving the application of IFRS 9 to the calculation of expected credit losses.

A prudential inspection in the area of operational risk was conducted at one of the significant banks, with supervisors from another country participating as members of the inspection team.

Prudential inspections at banks were curtailed by the Covid-19 epidemic, and were conducted entirely off-site.

In accordance with Article 84 of the Banking Act, at the end of 2019 the banks again submitted updated recovery plans, which we reviewed and assessed in accordance with Article 197 of the Banking Act.

As part of our prudential supervision we also granted several different authorisations in connection with the inclusion of capital instruments in regulatory capital, the inclusion of negative goodwill under common equity, the acquisition of a qualifying holding, a bank merger, the use of IRB models and the application of the transitional provisions of IFRS 9.

In 2020 we conducted six on-site supervisory inspections at less significant banks in the areas of credit risk, operational risk, interest rate risk and liquidity risk. We also conducted follow-up inspections of the implementation of measures as part of our ongoing supervision.

There are two branches of foreign banks and banking groups of Member States operating in Slovenia (one from Austria and one from France). Supervision of their operations was conducted via regular reports, requests for additional clarification, and the monitoring of their liquidity positions.

International activities of Banka Slovenije

European Union;

Last year the Economic and Financial Committee (EFC) discussed economic and financial developments, the response to the crisis, issues relating to the banking union and capital markets union, non-performing loans and the international role of the euro.

International Monetary Fund;

Slovenia is a member of the IMF, and the Governor of Banka Slovenije is a member of the IMF Board of Governors. Slovenia's quota at the IMF stood at SDR 586.5 million at the end of 2020, or 0.12% of the total IMF quota. A Banka Slovenije delegation participated in the annual and spring meetings of the IMF and the World Bank in 2020, which were held virtually. The main topics of the meetings were current developments in the global economy and on international financial markets, the outlook and the potential policy responses in light of the epidemic, and measures to alleviate its impact on the global economy. Within the framework of Banka Slovenije's participation in the IMF's financial arrangements, a bilateral loan agreement between Banka Slovenije and the IMF was entered into in 2020, and is in force until the end of 2023, with the option of a one-year extension subject to our approval.

Bank for International Settlements;

The Governor of Banka Slovenije attends meetings of central bank governors of members of the Bank for International Settlements (BIS), which are held every two months. The meetings discuss developments in the global economy and on the financial markets. The governors' meetings are also an opportunity to exchange views on various central banking issues, and in 2020 the focus was on policies for the use of personal data in finance, online risk in finance, and the use of big data.

Organisation for Economic Co-operation and Development;

Banka Slovenije representatives attended sessions of certain committees and working groups of the Organisation for Economic Co-operation and Development (OECD). They participated in virtual meetings of the Committee on Financial Markets, the Working Group on International Investment Statistics, the Working Party on Financial Statistics, and the Working Party on International Trade in Goods and Services, and provided information for the Working Party on SMEs and Entrepreneurship.

Technical assistance

In recent years Banka Slovenije has received European Commission technical assistance under the aegis of the programme to support structural reforms in EU Member States. Work to assist the creation of an effective data management system thus continued in 2020. Banka Slovenije staff take part in programmes of technical assistance to other central banks and supervisory institutions. In 2020 they provided assistance to the central bank of Serbia in the area of accounting, and to the central bank of North Macedonia in the area of compliance with European ethical standards and principles.

Cooperation with other supervisory bodies in Slovenia

Financial Stability Board:

Slovenia's Financial Stability Board (FSB) again discussed systemic risks in 2020, and was briefed on supervisors' macroprudential measures and actions taken to meet the ESRB's recommendations. A recommendation on the restriction of profit distributions by financial corporations (OFS/2020/1) was issued with the aim of ensuring that the financial system retains the highest level of capital to withstand potential losses, and to further ensure the stable supply of financial services to households and businesses. Other subjects discussed in connection with Banka Slovenije's work included the establishment of simplified obligations for recovery plans under the ZBan-2, adjustments to the macroprudential restrictions on household lending, and AML/CFT activities in 2019 and 2020. An FSB climate risk taskforce was also established.

Committee for Cooperation between Supervisory Authorities:

Banka Slovenije representatives took part in meetings of the Committee for Cooperation between Supervisory Authorities (Banka Slovenije, Ministry of Finance, Securities Market Agency, Insurance Supervision Agency) in 2020. The meetings discussed the following:

- legislative innovations in the financial realm;
- the financial sector's response to the spread of Covid-19 and the measures put in place by supervisory authorities to alleviate the impact of the epidemic;
- joint inspections and major individual inspections by supervisory authorities at supervised entities;
- major decisions and discussions by the EBA's Board of Supervisors, the SSM, the ESMA and the EIOPA; and
- other subjects of relevance to supervisory authorities.

National Payments Council

As part of its mission, the National Payments Council (NPC) was briefed in 2020 on the European Commission's new strategy for retail payments and on the Eurosystem's activities in connection with the potential issuance of a digital euro. The issue of the grey economy was also debated in two meetings. In the context of links between the grey economy and various means of payment, and on the basis of examples of best practice in the fight against the grey economy abroad, the NPC is planning to put forward concrete proposals to the competent institutions.

Questionnaire tables for the 2020 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	15	15	14
Branches of foreign credit institutions	2	2	2
Cooperative banks	0	0	0
Banking sector, total:	**17**	**17**	**16**

Total assets of banking sector (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	37.286.775	39.593.306	42.817.107
Branches of foreign credit institutions	1.490.186	1.619.485	1.833.974
Cooperative banks	0	0	0
Banking sector, total:	**38.776.961**	**41.212.791**	**44.651.081**
y/y change (in %)	**2,2**	**6,3**	**8,3**

Ownership structure of banks on the basis of assets total

Item	2018	2019	2020
Public sector ownership	25,2	21,9	17,4
Domestic ownership total	35,1	29,9	22,6
Foreign ownership	64,9	70,1	77,4
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2020

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	55,7%	69,8%	0,1194
Branches of foreign credit institutions	/	/	0,7675
Cooperative banks	/	/	/
Banking sector, total:	53,4%	66,9%	0,1327

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2018	2019	2020
Commercial banks	10,3%	10,9%	10,4%
Cooperative banks	/	/	/
Banking sector, total:	**10,3%**	**10,9%**	**10,4%**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2018	2019	2020
Commercial banks	96,2%	96,1%	95,9%
Branches of foreign credit institutions	3,8%	3,9%	4,1%
Cooperative banks	/	/	/
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2018	2019	2020
Receivables			
Financial sector	12,6	12,1	12,0
Nonfinancial sector	52,9	53,1	49,3
Government sector	20,7	19,1	17,3
Other assets	13,8	15,7	21,4
Liabilites			
Financial sector	8,2	6,8	5,3
Nonfinancial sector	72,1	72,9	74,7
Government sector	2,7	2,5	2,1
Other liabilities	4,9	5,7	7,1
Capital	**12,2**	**12,0**	**10,8**

Capital adequacy ratio of banks*

Type of financial institution	2018	2019	2020
Commercial banks	17,9	18,5	18,3
Cooperative banks	/	/	/
Banking sector, total:	**17,9**	**18,5**	**18,3**

**Table includes Total Capital Ratio on Consolidated basis.*

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

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

Asset classification	2018	2019	2020
Non-financial sector, including	3,9	2,2	1,9
- households	2,5	2,1	2,1
- corporate	9,3	4,7	4,1

**Table includes share of Non-Performing Exposures (NPE).*

The structure of deposits and loans of the banking sector in 2020 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	93,8	88,2
Households	65,4	45,5
Corporate	28,4	42,8
Government sector	2,8	6,6
Financial sector (excluding banks)	3,4	5,1
Total	**100.0**	**100.0**

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

P&L account	2018	2019	2020
Interest income	775.339	789.969	753.991
Interest expenses	103.618	107.256	114.873
Net interest income	671.719	682.708	639.117
Net fee and commission income	315.405	333.821	329.682
Other (not specified above) operating income (net)	166.392	239.574	392.924
Gross income	1.153.292	1.256.077	1.360.072
Administration costs	614.411	639.681	615.152
Depreciation	55.067	69.618	71.953
Provisions	4.707	-4.282	13.778
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	-57.730	-55.522	147.984
Profit (loss) before tax	530.865	592.509	472.033
Net profit (loss)	495.198	530.501	450.343

Total own funds in 2020 (in EUR)*

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	5.366.990	4.889.464	4.904.078	462.913	/
Cooperative banks	/	/	/	/	/
Banking sector, total:	**5.366.990**	**4.889.464**	**4.904.078**	**462.913**	**/**

**Table includes data on Consolidated basis.*

Macroeconomic environment in the country

Turkey is the 19th-largest economy in the world with a GDP around USD 720 billion[1] as of 2020. From 2000 to 2020, GDP per capita in Turkey more than doubled from USD 4,200 to USD 8.636. The growth pace of Turkish economy has been noteworthy in the recent past despite adverse shocks. This performance has been driven by a dynamic, well-diversified economy and policy stimulus.

2020 became a year of weak global demand due mainly to the pandemic driven high uncertainties and unfavourable developments in economies. Turkey has decoupled positively from other countries as Turkish economy grew by 1.8 percent in an extremely tough environment of 2020.

After contracting significantly in the second quarter of 2020, Turkish economy made a strong rebound in the second half of the year with the contribution of the measures taken to minimize the effects of the pandemic, normalization starting with June and rebound in export markets. Economic activity has recovered rapidly mainly on back of strong domestic demand.

Although there were losses in employment due to the pandemic, a significant part of the losses was regained in a short time thanks to the supports provided for working and social life since the beginning of the pandemic. Employment increased by about 1.5 million people between May and November 2020, after a decline of 2.4 million between January and April.

After the initial pandemic shock, exports of goods started to recover quickly and even increased by 3.8 percent y-o-y, in June-December 2020 period with the normalization process both in our country and world economies. However, as a result of strong gold imports and sharp decline in travel revenues, current account deficit to GDP ratio was realized as 5.1 percent in 2020.

However, the measures taken to reduce the effects of the pandemic have also led an accumulation of risks in macroeconomic balances. Consumer inflation was 14.6 percent at the end of 2020 due to supply chain issues, exchange rate pass-through, food prices and deterioration in pricing behaviour.

In 2020, we were able to use our fiscal space, in order to minimize pandemic related effects. As a result, central government budget deficit to GDP ratio increased to 3.4 percent in 2020 from 2.9 percent in 2019. However, the deterioration in the budget balance is quite moderate compared to many developed and developing countries.

Development in the banking sector (including assets total / GDP)

The Turkish financial system is dominated by the banking sector, which represents about 90[2] percent of total financial sector assets. As of December 2020, there were 54 banks operating in the Turkish Banking Sector (TBS) of which 34 were deposit banks (86.4% market share in terms of asset size), 6 were participation banks (7.2% market share) and 14 were development and investment banks. All banks are under the supervision of the Banking Regulation and Supervision Agency (BRSA). TBS operates with 11.188 branches and 203.223 employees as of 2020. Asset size of the sector grew by 36% in year 2020 and reached nearly TL 6.1 trillion. As of year-end 2020, the total assets to GDP ratio for the TBS is at 121%.

After the slowdown in economic growth and the emergence of financial market volatilities, the macro-financial outlook in Turkey was improving since the second half of 2019. The economic rebalancing was remarkable and the economic recovery was gaining momentum before COVID-19 outbreak. In 2020, the global COVID-19

1 The World Bank data
2 BRSA 2020 Annual Report

pandemic has caused significant market disruptions mainly due to pandemic-driven volatilities in global financial markets and the deterioration in expectations. As a result, to minimize the impact of the pandemic, like many authorities all over the world, Turkish authorities have launched fiscal and monetary packages. In this context, the BRSA took a series of new measures to support the banking sector and accordingly the economy. The aim was to keep the credit channel operational to minimize malign impact of the pandemic on both companies and households in need of working capital and liquidity, respectively, while supporting financial stability. Thanks to credit incentives in the form of asset ratio (AR) implementation[3], increase in the Credit Guaranty Fund (CGF) limits and low cost lending campaigns, loan growth (particularly led by state banks) accelerated significantly. The total FX adjusted annual loan growth rose from 10% in March to 27.5% in mid of August 2020. In the 3rd quarter of 2020 economic recovery was more evident. Then, CBRT started to tighten monetary stance gradually in that quarter, along with simplified monetary policy framework. As a result lending momentum has lost steam starting from September 2020, and the FX adjusted annual loan growth was realized at 25% as of end of year 2020.

The volume of loans reached to TL 3.6 trillion which constitutes 58.6% of total assets as of December 2020. The increase in total loans has stemmed from both the TL denominated commercial loans and consumer loans. As of December 2020, the retail segment posted a growth rate of 41.6% and the commercial segment displayed a growth rate of 19.9%, annually.

The NPL ratio of the sector which was at the level of 3.9% in the 2018 year end, had increased to 5.4% in the December, 2019, with the inclusion of asset quality review (AQR) results conducted by BRSA staff in 2018. In terms of asset quality, relatively low level of new NPL inflow compared to previous year because of the measures supporting restructuring, changes in overdue criteria and loan deferrals, the significant increase in the loan volume and TL depreciation against major currencies helped decline in the NPL ratio from 5.4% in 2019 to 4.1% in 2020. Moreover, the improvements in the cash flow of the companies and the debt payment capacity of the households have supported the NPL collection.

Securities are the second biggest item of Turkish banks' balance sheet following loan portfolio. Total share of securities in total assets is 16.7% and the amount of securities is nearly TL 1 trillion as of 2020 year-end.

For Turkish banks, the main funding source is deposits (56.6% of total liabilities). Total deposits reached to TL 3.5 trillion, and FX deposit constitutes 55.3% of total deposits as of December 2020. Funds from abroad were around USD 89.9 billion and constitutes 10.9% of total liabilities, including repos, deposit, loans and syndication and securitization loans. External borrowing trends of TBS are closely monitored by the BRSA. Even in the most difficult times, Turkish banks have generally maintained a rollover ratio exceeding 80% in syndications. The sector's rollover ratio of the syndications was above 90% as of December 2020. Moreover, bond issuances with a share of 3.7% in total liabilities reached to TL 224 billion.

Although the pandemic caused short-term fluctuations in banks' profits, as of December 2020, the net profit of the TBS increased by 19.1% (TL 9.3 billion) annually and realized at TL 58.4 billion. Banking sector preserved its high profitability, which helped to build enough capital buffers. The capital structure of the banking sector remains strong. As of December 2020, the capital adequacy ratio (CAR) was 18.7% and higher than 12% target ratio. Moreover, Common Equity Tier1 ratio was 14.5%, and highly above the regulatory thresholds.

[3] AR target was revoked as of December 2020

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

In Turkey, Banking Regulation and Supervision Agency (BRSA) with the authority given by the Banking Law No. 5411 (The Banking Law) regulates and supervises banks (commercial-deposit banks, investment and development banks and participation banks and the branches in Turkey of such institutions established abroad), financial holding companies, financial leasing companies, factoring companies, consumer financing companies, asset management companies and savings finance companies. Moreover, BRSA authorizes independent audit, rating, valuation and outsourcing firms that give service to supervised institutions.

Within the scope of the Law on Bank Cards and Credit Cards, the institutions willing to establish card systems, issue bank cards and credit cards, exchange information on card holders, and engage in clearing and settlement activities are also regulated by BRSA. In addition, BRSA is empowered to authorize and terminate the activities, temporarily or permanently, of institutions that performs the independent audit, valuation, rating and outsourcing activities for banks.

BRSA is a public legal entity with administrative and financial autonomy. The independence of the BRSA gives autonomy in three main areas:

i) autonomy in regulation and supervision,
ii) autonomy in Agency administration,
iii) autonomy in using financial resources.

With the enactment of the Banking Law, regulatory and supervisory framework of the banking system has been reshaped in a more systematic way in the light of international best practices. Furthermore, The Banking Law is codexed in accordance with the "Core Principles for Effective Banking Supervision" document published by the Basel Committee on Banking Supervision (BCBS). The Banking Law in force gives the BRSA all the powers to regulate, enforce and ensure the implementation of the establishment, activities, management and organizational structure, merger, disintegration, change of shares and liquidation of banks and monitor and supervise enforcement. BRSA uses its powers through regulatory transactions and specific decisions taken by its Board. Banking Regulation and Supervision Board is authorized to revoke the operating permissions of failing banks or to transfer the shareholder rights except dividends and the management and supervision of the banks to the Savings Deposit Insurance Fund (SDIF), for the purposes of transferring, selling or merging them partially or fully. The banks whose operating permissions have been revoked are liquidated as subject to the provisions of the Banking Law by SDIF.

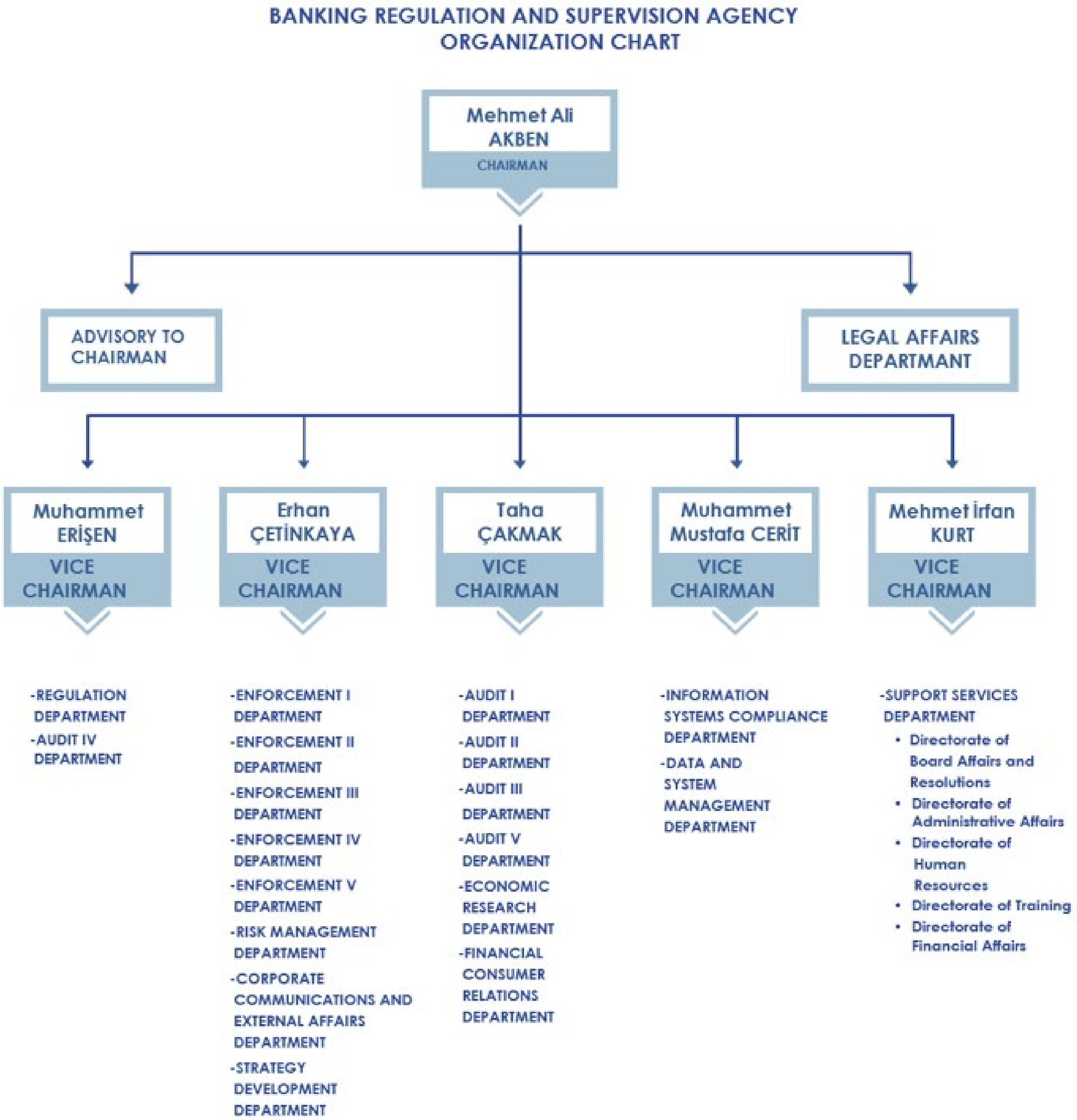
As a member of the BCBS and the Financial Stability Board (FSB), Turkey is closely monitoring developments in the international standards set out by these organizations. Since January 2014, Basel III standards have been implemented in Turkey, and as a result of the Regulatory Consistency Assessment Program (RCAP), which was previously held by the BCBS, Turkey's banking regulatory and supervisory framework is recognized as fully in line with international standards. Furthermore, as a part of aligning the bank resolution framework in Turkey more closely with the FSB standards, the Banking Law was amended as of February 20th, 2020 to introduce Recovery Plans to be prepared by the banks, which requires systematically important banks in Turkey to prepare recovery plans and submit them to the BRSA.

The supervisory approach of the BRSA is a dynamic risk-focused one that aims to ensure efficiency, continue adequacy of supervision and efficient allocation of supervisory resources. The approach proposes to shape supervision form, scope, time, content and intensity based on the risk profile and adequacy of internal controls and risk management systems of each institution.

The BRSA's methodology for ongoing supervision of banks, established in the Supervisory Manual on Banking Supervision Process is organized in supervisory cycles

Supervision and risk management departments are responsible for on-site examinations. That includes regular annual on-site supervision, which includes risk assessment, credit model evaluation, IFRS 9 expected credit loss model evaluations, Pillar 1 credit risk calculations, supervisory risk rating, targeted inspections, complementary and compliance inspections.

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Banking Supervisory Authority in 2020

Bank and non-bank financial institutions under the regulation and supervision of the BRSA constitute 86.5% of total assets of the financial sector in Turkey.

BRSA's main strategic objective is to ensure market efficiency, with aiming full functioning credit system, protecting depositor's rights and improving financial markets.

Major strategic objectives of BRSA can be summarized as;

- Diminishing the effects of Covid-19 Pandemic on economy and financial sector
- Increasing the solvency of companies,
- Enhancing continuity plans of banks,
- Encouraging banks to keep their credit channels open,
- Improvement of prudent approach based effective management of risks,
- Improving the capacity to analyze systemic fragilities,
- Strengthening corporate structures of factoring companies and investment banks,
- Developing the participation banking and interest-free finance,
- Supporting the ecosystem needed for development of green finance and increase of our country's share in the international green finance,
- Supporting the development of sustainable finance framework

The activities of the Banking Supervisory Authority in 2020

During 2020, BRSA has taken a series of actions and measures to alleviate economic and financial effects of pandemic in cooperation with all stakeholders of economy management.

All the measures taken can be classified as macro prudential measures, which aims at smoothening fluctuations in the market; ensuring stability, enhancing effectiveness of credit channel, improving liquidity and capital adequacy, strengthening foreign exchange position and financial tightening. Some of the regulations and enforcement measures taken listed below;

- The minimum amount of credit card payment was determined as 20 % of the total debt and banks have been enabled to postpone their customers' card debts until 31.12.2020
- Banks were instructed to take the necessary measures against the increased information security risks because of the increasing use of electronic distribution channels in banking services and remote working methods.
- In order to smooth excessive fluctuations in financial markets flexibility has been provided to banks in meeting the maximum rate of interest rate risk standard ratio.
- Flexibility was given to banks on legislative requirements of periodic valuation of financial collaterals.
- Loan to Value ratio of the housing loans increased to 90% from 80%
- In order to ensure that the asset structures of banks are compatible with the pandemic conditions, Active Ratio regulation was introduced. Implementation period of the Asset Ratio regulation unwound by 31.12.2020.
- The 90-day past due criteria for classifying credits to NPL portfolio has been extended to 180 days and 30-day past due criteria for classifying credits in stage 2 has been extended to 90 days. However banks are expected to use their own IFRS 9 ECL methods regarding forborne loans.

- Banks have been encouraged to ease their lending policies, especially for firms in temporary payment difficulties due to the COVID 19 pandemic. Besides, during the process the financial soundness of the banks was maintained.
- Banks, factoring, leasing and consumer finance companies have been provided with the opportunity to postpone principal and interest payments of consumer and vehicle loans by 31.12.2020, upon request of customers.
- In credit risk calculation, risk weight for the FX receivables of banks from the central government of Turkey has been decided to be 0%.
- Ensuring flexibility to banks for calculation in equity, capital adequacy and foreign exchange net general position and in liquidity liabilities,
- Reviewing bank's business continuity plans,
- Providing extension provided in periods of classification of loans,
- Disregarding the deferment to be made in loan repayments for consumer loans in calculation of maturity limitations set forth in laws, encouragement of banks to keep their credit channels open, and initiation of weekly calculation of Asset Ratio in order to encourage and monitor use of resources for financing of real economy.
- In order to provide flexibility in meeting minimum requirements of liquidity ratios, banks have been exempted from certain regulatory provisions and some reporting obligations until 31.12.2020
- In order to minimize the adverse effects of financial market fluctuations stemming from the COVID-19 pandemic on banks' capital adequacy and foreign currency net general position, flexibility has been provided to banks in the calculation procedures of these ratios until 31.12.2020. The forbearance has been extended until 30.06.2021.

In 2020, BRSA continued its regulation and supervision activities with prudent approach based on effective management of risks as well. Within this framework, the "Law Amending Banking Law and Some Other Laws" no. 7222 prepared mainly in the year 2019 was promulgated on 25.02.2020 with immediate effect.

The Law ensures harmonization with recent changes in the related international standards and principles, and brings new clauses for further development of participation, development and investment banking and further strengthening of corporate structures of factoring companies, and allows imposition of ban on access against unauthorized banking activities, and increases amounts of administrative fines for the sake of increase of deterrence, and requires banks with systemic importance to prepare and submit to BRSA per se their own plans containing their measures to be taken against probable negative developments in the sector.

The Amendment further expands the definition of risk group deemed significant in monitoring of credit risks of banks by groups, and relieves doubts that may be faced in practice in processing and transfer of data classified as client secrets, and prohibits transfer of client secrets to any persons or entities at home or abroad without a prior request or instruction of clients even if their explicit consent has already been taken.

Another important legal amendment was put into force by "Law Amending Some Laws and Decree Laws" no. 7247 promulgated on 26.6.2020. This Law allows execution of contracts on distance basis by using remote communication means or by methods permitting verification of client identity via information or electronic communication devices, as designated by the Board, whether distanced or not.

In 2020, some changes were made also in the fields of responsibility of our Agency. The authorityo regulate and supervise payment service providers, payment institutions and electronic money institutions, held by our Agency since 2013, was transferred to the Central Bank of the Republic of Turkey as of the start of 2020. The aim of this transfer was to ensure that, in consideration of the advancements in IT and communication technologies and the newly launched products and practices in the field of payments, the regulation and control mechanism managed at the helm of two separate authorities till then is taken under management of a single authority for the sake of higher efficiency in line with global practices.

Our Agency has introduced another new service to financial consumers as a part of e-Government gateway. With the "Querying of Banks Holding Deposit/Participation Fund Accounts" service started in March 2020, applicants can safely inquire information regarding deposit and participation fund accounts as of that time in reliance upon data collected from banks..

This system aims to transfer public services into electronic media from a citizen-oriented point of view, and increase transparency in the relations between financial institutions and financial consumers, and protect the rights of financial consumers more effectively. In addition to making a major contribution to development of finance industry, the developments in IT technologies also pave the way for certain risks. This in turn requires frequent review and update of the cyber and physical security controls used on the technological infrastructure and various service channels currently used by the banking industry, identified as one of critical infrastructure industries. To this end, in the light of experiences gained from supervisory activities, and as a result of assessing the international good practices, as well as the demands, suggestions and complaints received from other institutions, banks and bank clients, in March 2020, the "Regulation on Information Systems and Electronic Banking Services of Banks" was enacted. Also, banks are permitted to enter into distance contracts with their clients by using various different information technologies by the "Regulation on Remote Identification Methods to be Used by Banks and on Execution of Contracts via Electronic Media" greatly prepared in 2020 and published on 01.04.2021 with effect from the beginning of May 2021.

Another agenda topic will be to ensure the adaptation of saving finance companies, under our Agency's power of regulation and supervision, to the new legal framework and infrastructure built by the "Law Amending Law on Financial Leasing, Factoring and Financing Companies and Some Other Laws" no. 7292 promulgated on 07.03.2021.

The saving finance model based on collection of savings for a certain period of time according to interest-free financing for acquisition of houses, offices or vehicles, and provision of finances to clients, and management of savings collected as above, provided that certain pre-determined conditions are satisfied under a contract, meets a significant need and demand of particularly fixed-income and low-income financial consumers. Saving finance activities, which have considerably increased and turned into a commonly used financing method in the recent years in particular have started to be regulated with the aim of making sure that such activities are performed more safely and effectively.

In 2021, parallel to the trends in the world, the initiatives focused on sustainable finance are also expected to gain momentum. BRSA is going to closely monitor various international principles and standards to rapidly develop capacity in sustainable finance field in the coming period.

On the other hand, the development of sustainable finance has also become an important agenda topic in national level as well. As a matter of fact, within the frame of Economic Reforms Action Plans published on 12.03.2021, such actions as strengthening the ecosystem needed for development of green finance and increase of our country's share in the international green finance have been identified and formulated. BRSA will also actively participate in the aforesaid action process and give contribution to national and international initiatives aimed at development of sustainable finance.

International activities of the authority

i. Close Cooperation with Foreign Supervisory Authorities

In order to improve the effectiveness of the consolidated supervision, the BRSA collaborates with foreign supervisory authorities. Accordingly, the BRSA signs Memorandum of Understanding (MoU) with foreign counterparts pursuant to Article 98 of the Banking Law Nr. 5411.

As of the end of 2020, total number of MoUs signed with foreign counterparts of the BRSA has reached to 40 from 36 countries. (Detailed information for the MoUs is provided in the table below). The draft MoUs with the supervisory authorities of Belarus and Sudan are at its final stage while the process for signing an MoU with supervisory authorities of Austria and Moldova was initiated in 2020.

Table: MoUs that have been signed with foreign supervisory authorities

Country	Institution	Date
North Cyprus	Central Bank of North Cyprus	17.09.2001
Albania	Central Bank of Albania	19.10.2001
Romania	Central Bank of Romania	19.02.2002
Bahrain	Bahrain Monetary Authority	30.07.2002
Indonesia	Central Bank of Indonesia	11.12.2002
Kazakhstan	Central Bank of Kazakhstan Astana FSA	22.05.2003 12.02.2019
Pakistan	National Bank of Pakistan	20.01.2004
Malta	Financial Service Auth. of Malta	10.12.2004
Greece	Central Bank of Greece	28.01.2005
Kyrgyzstan	Central Bank of Kyrgyzstan	17.05.2005
Azerbaijan	National Bank of Azerbaijan FMSA	14.06.2005 28.12.2018
Bulgaria	National Bank of Bulgaria	13.09.2005
China	China Banking Regulatory Com.	11.07.2006
Georgia	Central Bank of Georgia	02.11.2007
Kosovo	Kosovo Central Banking Auth.	12.05.2008
Luxembourg	Com. De Surveillance du Sec. Fi	13.03.2009
Lebanon	Banking Contr. Com.of Lebanon	10.06.2009
Bosnia-Herz.	Banking Agency of Bosnia-Herz.	12.06.2009
Ukraine	Central Bank of Ukraine	19.02.2010
Macedonia	Central Bank of Macedonia	30.08.2010
Russia	Central Bank of Russia	30.09.2010
Syria	Central Bank of Syria	21.12.2010
Qatar	Qatar Financial Cent Reg. Auth.	25.07.2011
Germany	Federal Financial Superv. Auth.	05.08.2011
Croatia	Croatian National Bank	29.08.2011
Jordan	Central Bank of Jordan	06.09.2011
Belgium	National Bank of Belgium	18.11.2011
S. Korea	Fin. Supervisory Service	25.11.2011
Iraq	Central Bank of Iraq	20.12.2011
Spain	Central Bank of Spain	17.12.2013
Holland	Central Bank of Holland	24.01.2014
Serbia	Central Bank of Serbia	09.06.2015
United Arab E.	Dubai Fin. Services Authority UAE Central Ban Abu Dabi Fin. Ser.Super.Auth	23.08.2007 17.02.2009 17.06.2016
India	India Central Bank	23.11.2016
UK	UK Central Bank	22.05.2017

ii. Close cooperation with European Union

As a candidate member country, Turkey has been showing an extensive effort to align national legislation with EU acquis and to improve the administrative capacity for an effective implementation of new regulations.

The BRSA continued working to complete its commitments under the "ability to assume the obligations of membership" in 2020 and made amendments in banking regulations accordingly.

The Agency attended to the meetings set by the TR Directorate for EU Affairs, to discuss the EU Programmes that is open to the participation of Turkey.

iii. Strong links with multinational institutions

The BRSA is a member of Basel Committee on Banking Supervision (BCBS), Islamic Financial Services Board (IFSB), Supervision and Reconciliation Committee (SRC), which is the standing committee of Financial Stability Board (FSB) and the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI).

The BRSA has strong ties with multinational institutions such as International Monetary Fund (IMF), World Bank (WB), Organization for Economic Cooperation and Development (OECD), World Trade Organization (WTO), Black Sea Economic Cooperation Organization (BSEC). The BRSA continued to attend the meetings set by these institutions and contributed to the reports issued by them in 2020.

iv. Relations with other international and foreign institutions

The BRSA holds explanatory meetings with various foreign institutions such as supervisory colleges, credit rating agencies, foreign banks that have exposures to Turkish markets, foreign investors and country analysts. The Agency continued to meet with these stakeholders in 2020 as well.

Cooperation with other supervisory bodies in the country

Based on the Article 98 of Banking Law, the BRSA exchanged views and shared information with the Presidency Strategy and Budget Office, Ministry of Treasury and Finance, the CMB (Capital Markets Board), the SDIF (Savings Deposit Insurance Fund), the FCIB (Financial Crimes Investigation Board) and the CBRT (Central Bank of the Republic of Turkey) in order to ensure coordination and cooperation in executing monetary, credit and banking policies. Additionally, with other public institutions such as the Ministry of Foreign Affairs and the Ministry of Commerce, the BRSA exchanged views on the issues related to the banking sector.

Financial Sector Commission (FSC): The FSC has been established as per the Article 99 of the Banking Law to ensure reliability and stability in the financial markets through information exchange and cooperation and collaboration between institutions, to propose shared policies and to provide opinions on the future of the finance industry.

The FSC consists of representatives from the Ministry of Treasury and Finance, Revenue Agency, Presidency Strategy and Budget Office, the CBRT, the CMB , the SDIF, Competition Board, Borsa Istanbul and the BRSA. The Commission convenes once in every six months and present to the Presidency the conclusions reached at the meetings.

Accordingly, the Commission convened two times in 2020 - in May and in November, and the conclusions of the meetings were presented to the Presidency.

Coordination Committee: The Coordination Committee has been established per the Article 100 of the Banking Law and consists of BRSA's Chairman and Vice Chairmen and, also SDIF's Chairman and Vice Chairmen.

The Committee is in charge of ensuring that maximum cooperation is established between the BRSA and the SDIF.

Consequently, The Committee convened on a quarterly basis in 2020 and discussed the outlook of the banking sector, measures to be taken in accordance with the supervisory findings of the credit institutions, calculation of risk-based insurance premiums and the situations which require SDIF procedures to be applied.

Financial Stability and Development Committee (FIKKO) consists of the chairmen of the CBRT, the BRSA, the CMB, the SDIF, Borsa Istanbul and the Banks Association (TBB) and chaired by Treasury and Finance Minister. FIKKO is in charge of sustainable development and financial stability.

The Committee was established with the aim of managing systemic risks, ensuring harmonization in financial regulations and practices, and increasing coordination with the real sector in order to ensure that the financial system supports economic growth in a healthy way and maintaining confidence in the markets. The working mechanism of the Committee is being regulated and carried out by the Ministry of Treasury and Finance.

Questionnaire tables for the 2020 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks[4] (including branches of foreign credit institutions)	39	40	40
Branches of foreign credit institutions	5	5	5
Cooperative banks	0	0	0
Banking sector, total:	**52**	**53**	**54**

Total assets of banking sector (billion TL, at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	3610,2	4188,5	5718,6
Branches of foreign credit institutions	14,6	16,4	22,7
Cooperative banks	-	-	-
Banking sector, total:	**3867,4**	**4490,8**	**6106,4**
y/y change (in %)	**18,71**	**16,12**	**35,98**

Ownership structure of banks on the basis of assets total

Item	2018	2019	2020
Public sector ownership	38.61	41.02	45.29
Domestic ownership total[5]	72.56	73.53	74.95
Foreign ownership	27.44	26.47	25.05
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2020

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	38.04	55.88	808.89
Branches of foreign credit institutions	0.36	0.37	0.11
Cooperative banks	-	-	-
Banking sector, total:	**38.04**	**55.88**	**822.05**

[4] There are no cooperative banks in Turkey. Commercial banks are defined as deposit taking institutions, therefore investment & development banks are excluded. We have, as of year-end 2020, 14 investment & development banks. Also there are 6 participation banks and 2 SDIF operated banks.

[5] Public and private

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2018	2019	2020
Commercial banks	14.95	11.16	11.15
Cooperative banks	-	-	-
Banking sector, total:	**14.83**	**11.48**	**11.36**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2018	2019	2020
Commercial banks[6]	93.3	93.3	93.6
Branches of foreign credit institutions	0.4	0.4	0.4
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2018	2019	2020
Receivables			
Financial sector[7]	5.6%	5.4%	6.1%
Nonfinancial sector	66.2%	65%	61.4%
Government sector[8]	21.8%	23.2%	26.4%
Other assets	6.4%	6.4%	6.1%
Liabilities			
Financial sector[9]	20.9%	16.3%	18.6%
Nonfinancial sector	60.6%	64.2%	62.6%
Government sector	5.0%	4.1%	4.3%
Other liabilities	2.6%	4.4%	4.7%
Capital	**10.9%**	**11.0%**	**9.8%**

Capital adequacy ratio of banks

Type of financial institution	2018	2019	2020
Commercial banks***	16.9	18.0	18.3
Cooperative banks	-	-	-
Banking sector, total:	**17.3**	**18.4**	**18.7**

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

6 Remaining shares belong to investment &development banks.
7 Consists of receivables from banks and money markets, reverse repo.
8 Consists of required reserves in CB,receivables from CB, government securities and credit loans..
9 Consists of debts to banks, debt to money markets and banks deposits.

Asset portfolio quality of the banking sector[10] (share of impaired receivables / share of non-performing loans)

Asset classification	2018	2019	2020
Non-financial sector, including			
- households	3.4	3.3	2.0
- corporate[11]	4.0	6.0	4.7

The structure of deposits and loans of the banking sector in 2020 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:		
Households	60.4%	24.6%
Corporate	36.0%	72.3%
Government sector	3.7%	1.8%
Financial sector (excluding banks)	NA	1.3%
Total	**100.0**	**100.0**

P&L account of the banking sector (billion TL, at year-end)

P&L account	2018	2019	2020
Interest income	368.4	420.5	423.5
Interest expenses	222.3	258.2	208.7
Net interest income	146.2	162.4	214.8
Net fee and commission income	37.0	49.2	45.0
Other (not specified above) operating income (net)	-19.5	-24.5	-28.8
Gross income	446.0	526.9	507.3
Administration costs	27.9	34.1	39.3
Depreciation	3.6	6.8	7.6
Provisions	21.0	21.2	52.7
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	8.9	7.0	17.2
Profit (loss) before tax	66.4	60.6	75.9
Net profit (loss)	54.1	49.0	58.5

Total own funds in 2020 (billion EUR)

Type of financial institution	Total own funds***	Core Tier 1***	Tier 1***	Tier 2***	Tier 3
Commercial banks	77,6	59,4	53,6	13,1	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**84,4**	**65,1**	**70,6**	**13,8**	**-**

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

10 NPL Ratio

11 Including SME Loans

Macroeconomic environment in the country

In 2020, Ukraine's real GDP shrank by 4%, which was much less than expected at the start of the coronavirus crisis and on par with the regional peers. The main factor behind the decrease in real GDP was the quarantine, both in Ukraine and in the world, imposed in response to the spread of COVID-19. Deep declines were reported for sectors where activities were restricted (mainly service sectors, including tourism, entertainment, trade, and transport). Weaker foreign and domestic demand also contributed to a decrease in GDP, particularly in Q2 2020. In addition, agricultural production decreased in 2020 as major crops were hit by unfavourable weather conditions. The situation in the labour market deteriorated with a sharp decrease in employment. However, social programs introduced by the government supported household income.

After quarantine restrictions were eased, Ukraine's economy started to recover rapidly in H2 2020. The recovery was mainly driven by the growth in consumption. Increasing wages and higher social spending from the state budget bolstered strong consumer demand. Unemployment also started to subside.

Headline consumer inflation remained subdued and was below its target range of 5% ± 1 pp for most of 2020 due to low global energy prices and weaker demand for nonstaple goods and services. However, consumer price growth in December 2020 accelerated to 5% yoy, the midpoint of the target range, driven by faster-than-expected recovery of the global economy and domestic consumer demand. Underlying inflation pressures also heightened, as evidenced by the acceleration of core inflation (to 4.5% yoy by year-end 2020) and worsened inflation expectations.

In 2020, Ukraine's current account surplus hit one of its highest levels on record (USD 5.2 billion or 3.4% of GDP). The surplus resulted from a significant drop in imports of goods and services and lower primary income payments, while exports of goods and remittances showed resilience to the crisis.

The financial account recorded USD 3.2 billion in capital outflows, which were generated by the private sector. Banking assets increased by USD 0.9 billion, mainly due to FX receipts from the government as it made repayments on FX domestic government debt securities. Real sector capital flows were influenced by the effects of the global lockdown: the amount of FX cash outside the banks increased (to USD 4.7 billion) as informal trade shrank and international travel stalled, while poorer financial performance of businesses resulted in negative reinvested earnings and, consequently, FDI outflows (USD 0.1 billion). Nevertheless, the public sector recorded capital inflows (USD 0.9 billion). Official financing and funds attracted from private creditors exceeded the outflows related to external debt repayments.

The current account surplus exceeded the financial account outflows. Coupled with the IMF financing, this allowed for raising international reserves to an 8-year high of USD 29.1 billion. This level was equivalent to 92% of the required minimum according to the IMF's reserves adequacy metrics.

Developments in the banking sector (including assets total/GDP)

The banking sector has successfully come through the coronavirus crisis and performed its functions properly, supporting the economy. That was facilitated by the regulator's earlier efforts to clean up and improve the resilience of the banking system, as well as timely emergency measures taken by the banks and the NBU.

In response to the COVID-19 shock, the NBU deployed the following range of tools to support lending, provide banks with flexibility in their liquidity management, ease regulatory pressure, and calm financial markets. Those measures included:

- long-term financing for banks for a term of one to five years at an interest rate that equals the key policy rate
- interest rate swaps, which enable banks to manage their interest rate risk
- zero reserve requirements for hryvnia deposits and a change in the method for determining bank liabilities subject to reserve requirements
- suspending the requirement that banks create capital buffers
- postponing the submission and publication of banks' financial statements
- suspending all on-site inspections and stress tests of banks
- FX interventions to sell foreign currency in the interbank FX market
- additional supply of foreign currency cash to the banks in order to eliminate the difficulties that the banks were facing due to disruptions in air travel.

In 2020 the banks remained liquid and did not suffer deposit outflows, except for a brief period in spring 2020, at the beginning of the coronavirus crisis. Decreased loan rates and state support programs for businesses boosted lending, especially hryvnia lending, after it slowed somewhat at the start of the year. The dollarization of bank balance sheets declined.

As of the end of the year, 73 banks were solvent and operational. Two banks were declared insolvent after they failed to meet capital requirements. Although the share of state-owned banks in the sector's net assets shrank throughout the year and the share of private banks grew, state-owned banks still accounted for more than half of the sector's assets. At the end of the year, the 20 largest banks held more than 90% of the sector's assets.

Assets

An increase in holdings of government securities made the largest contribution to the growth in banks' net assets. The growth in domestic government debt securities accounted for two-thirds of the nominal growth in net assets for the full year, and for almost 80% in Q4. The government incurred large budget expenditures during the last days of December, which increased banks' liquidity and holdings of NBU certificates of deposit.

Net hryvnia corporate loans grew markedly in Q3–Q4 after falling in H1 due to the crisis. The fastest growth occurred in private and foreign-owned banks. The volumes of net FX loans decreased in annual and quarterly terms.

Growth in the net hryvnia retail loan portfolio slowed abruptly in 2020 due to the quarantine restrictions imposed in H1. Lending for housing purchases picked up markedly in H2, outpacing consumer lending. Monthly average volumes of new loans more than doubled compared to both H1 2020 and the whole of 2019.

In 2020 banks actively wrote off non-performing loans (NPLs), with state-owned banks making the largest write-offs in Q4. As a result, the system's total NPL ratio declined to 41.0% at year-end 2020, down from 48.4% at the end of 2019.

Funding

This year the banks' liabilities increased because of customer deposits and the NBU's liquidity assistance. Refinancing loans tripled in volume in Q4, with their share in liabilities growing by 2.5 pp. At the same time, corporate and retail deposits remained the main funding source for banks, accounting for 84.6% of liabilities.

Hryvnia deposits grew rapidly in 2020. Deposit outflows at the start of the coronavirus crisis lasted for less than two weeks. However, in the conditions of pandemic-induced uncertainty, the growth was driven by demand deposits: their volumes increased by 49% yoy. PrivatBank and private banks reported the largest growth in deposits. As a result, in terms of maturity composition, demand deposits accounted for 55.2% of hryvnia deposits at the end of the year. Although FX retail deposits, which were much cheaper, grew in Q4, they remained almost unchanged at the end of the year.

Hryvnia corporate deposits surged by 34.5% yoy. The highest growth in hryvnia corporate deposits was seen in private banks and PrivatBank. On the other hand, FX deposits in the U.S. dollar equivalent increased by only 2.2% over the year, and declined in Q4. The level of dollarization of customer deposits decreased to 38.0%.

Interest Rates

The NBU cut its key policy rate four times in H1 2020, by a total of 7.5 pp, to an all-time low of 6% per annum. Rates on both retail deposits and hryvnia corporate loans declined by more than 6 pp throughout the year and entered the single-digit range.

The cost of deposits remained almost unchanged in Q4. The spread between interest rates on 3-month and 12-month retail deposits remained less than 1 pp. At the same time, rates on corporate loans continued to decline moderately, which narrowed the spread.

Financial Performance and Capital

In 2020, the banking sector posted profits of UAH 39.7 billion, down almost one-third from 2019. PrivatBank accounted for more than half of the total profit generated by profitable banks. As with 2019, eight financial institutions were loss-making.

Cumulatively, the sector (excluding PrivatBank) took losses in Q4, primarily due to heavy provisioning by several banks. Compared to the previous quarter, the banks' operating income decreased (mainly driven by the negative effect from a revaluation of domestic government debt securities) and operating expenses rose. Operating income and operating profit increased in 2020, although the year-end Cost-to-Income ratio (CIR) increased moderately to 53.6% (up from 50.8% in 2019). As a result, operational efficiency slightly deteriorated.

The annual growth rates of net interest income and fee and commission income were at four-year lows. At the same time, interest income and fee and commission income started to recover from the shock experienced at the start of the pandemic, which affected performance in Q2. Despite the weekend quarantine, fee and commission income grew by 20% yoy in Q4, in part due to growth in the internet trading segment.

Provisions the sector made in 2020 were three times the level of the previous year. PrivatBank's provisions against legal risk accounted for a quarter of the provisions made in the sector. At the same time, loan loss provisioning increased by 91% yoy.

Legal and institutional framework of the operation and supervision of financial institutions: new developments. Legal competence of the Banking Supervisory Authority in the country

Banking in Ukraine is regulated by the following laws: the Constitution of Ukraine, the Civil Code of Ukraine, the Economic Code of Ukraine, Laws of Ukraine "On the National Bank of Ukraine", "On Banks and Banking", "On Households Deposit Guarantee System", "On Financial Services and State Regulation of Financial Markets", "On Joint Stock Companies", "On Preventing and Counteracting to Legalization (Laundering) of the Proceeds of Crime, Terrorist Financing, and Financing Proliferation of Weapons of Mass Destruction"[1], "On Consumer Lending", "On Payment Systems and Money Transfers in Ukraine", "On Simplifying Bank Reorganization and Capitalization Procedures".

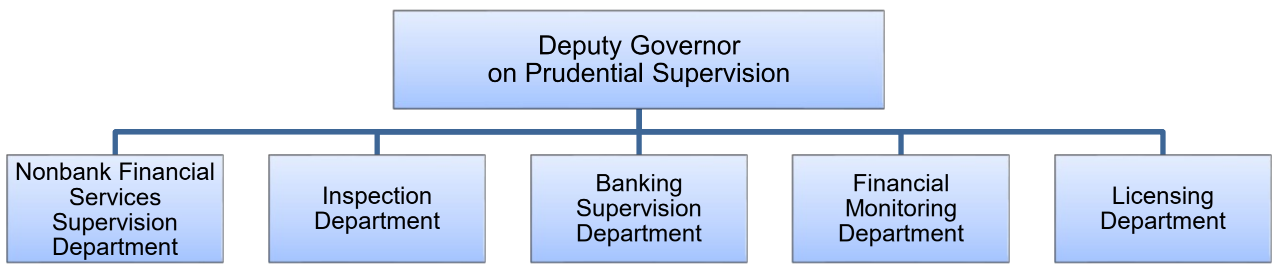
In 2020, the Verkhovna Rada of Ukraine passed the following laws:

1) The Law of Ukraine No. 361-IX On the Prevention and Counteraction to Legalizing (Laundering) the Proceeds from Crime, Terrorism Financing, and Financing the Proliferation of Weapons of Mass Destruction, which took effect on 28 April 2020
2) Law of Ukraine No. 590-IX On Amendments to Certain Laws and Regulations of Ukraine Concerning the Improvement of Banking Regulation Framework, which improves the regulation of banks, in particular by providing the NBU with the necessary instruments of influence in this area.

In addition, the Law of Ukraine No. 79-IX On Amendments to Certain Laws of Ukraine On the Consolidation of Functions of the State Regulation of the Financial Services Markets took effect on 1 July 2020. In accordance with this Law, the NBU became the regulator of most of the nonbank financial sector, and (in addition to the regulation of banks) the central bank's regulation and supervision mandate was expanded to include insurers and insurance intermediaries, leasing companies and legal entity lessors, factoring companies, credit unions, credit bureaus, pawnshops, others financial institutions (specializing in currency exchange, money transfers, lending, guarantees, etc.).

Organizational chart of the Banking Supervisory Authority

Prudential Supervision Block of the National Bank of Ukraine:



Full organizational chart can be found on:
https://bank.gov.ua/en/about/structure#orgchart

[1] new version adopted on 6 December 2019, registered as No. 361–IX

Main strategic objectives of the Banking Supervisory Authority in 2020

The NBU in 2020 continued to pursue its Strategic Goals until 2020, which were approved in 2018. The NBU also developed the 2020 Action Plan, through which it pursued the following strategic goals: (1) ensuring low and stable inflation, (2) maintaining a stable, transparent, and efficient banking system, (3) resuming lending, (4) introducing the effective regulation of the financial sector, (5) continuing the currency liberalization, (6) developing and promoting financial inclusion and (7) continuing to evolve as a modern, open, and efficient central bank.

Activities of the Banking Supervisory Authority in 2020

During 2020, the NBU implemented a risk-based approach to banking supervision by following the guidelines of the European Banking Authority on common procedures and methodologies for the Supervisory Review and Evaluation Process (SREP) and recommendations of the Basel Committee on Banking Supervision, while taking the proportionality approach to supervision.

Given the restrictions related to the spread of COVID-19, which triggered a global crisis, the NBU and regulators in other countries in 2020 directed their efforts to support the banking system and minimize the adverse effects of the anti-COVID-19 measures on the financial and banking systems, and approved some temporary rules for the application of certain regulations in banking regulation and supervision (also known as emergency measures). These measures eased the regulatory burden on banks and supported the sectors and borrowers hit hardest by the tight quarantine restrictions.

The implementation of off-site banking supervision on an individual and consolidated basis took into account the emergency measures introduced in 2020.

In line with its mandate to supervise banks, the NBU in 2020 ensured:
- the assessment of 72 banks under the SREP methodology, the results of which informed the banking supervision strategy for 2021
- the conduct of ongoing monitoring of banks' financial standing and bank groups' performance
- the identification of banks' related parties, control over banks' transactions with their related parties, and analysis of the terms of banks' transactions with their customers to detect collaboration that is not market-driven
- the assessment of the resilience of banks, which was carried out in one stage (without stress testing) as the authorities imposed quarantine restrictions in Ukraine, and the conduct of an asset quality review (AQR) of all banks in Ukraine as part of the resilience assessment
- quality control of audit services.

In addition, based on EU legislation, the recommendations of the Basel Committee on Banking Supervision, and the documents of the European Banking Authority and the European Central Bank, the NBU:
- introduced a new NSFR prudential standard that will encourage banks to secure more stable and long-term sources of funding and help reduce one of the systemic risks to financial stability associated with short-term bank funding
- improved its approaches to credit risk assessment, including the requirements for group risk assessment, and introduced approaches to risk assessment for specialized types of lending
- streamlined the requirements for setting up risk management systems in Ukrainian banks and banking groups
- introduced requirements for regulations and reports on the remuneration of members of banks' supervisory boards and boards of directors.

International activities of the authority

In 2020 the NBU continued to develop its relations with its foreign partners and international organizations.

In June the NBU started new 18-month Stand-By Arrangement (SBA) with the International Monetary Fund that includes measures aimed at further strengthening the Ukrainian banking sector and further developing the financial markets. Under the program the NBU has been strongly committed to continue prudent monetary and exchange rate policies, to anchor inflation expectations and build stronger reserve buffers.

The NBU was very active in technical cooperation with IFIs, central banks and financial sector regulators from other countries. There was an increase in technical assistance received and provided by the NBU during 2020. The key TA partners of the NBU were the EU, IMF, WB, USAID, IFC and the EBRD, the Deutsche Bundesbank, the National Bank of Moldova, the Central Bank of the Republic of Azerbaijan, the Bank of Lithuania to exchange experience and practices on corporate governance, risks management, onsite/off site supervision, own capital and leverage, remote identification, regulation of financial groups etc.

In addition, the NBU has been involved in implementing the EU-Ukraine Association Agreement, focusing on the harmonization of national laws with EU acquis in the areas of banking regulation and supervision, AML/CFT, liberalisation of capital movements, insurance and the operation of payment systems.

On 1 October 2020, the NBU launched the Twinning project "Strengthening the NBU's Institutional and Regulatory Capacity to Implement the EU-Ukraine Association Agreement" with Central Banks of Poland and Lithuania. The aim of the Twinning project is to support the NBU in developing approaches to banking supervision in the framework of the SREP, implementing an instant payment system, and strengthening strategic planning and cooperation with international institutions.

Cooperation with other supervisory bodies in the country

In January 2020, the NBU, the National Securities and Stock Market Commission, the National Commission for Regulation of Financial Services Markets, the Deposit Guarantee Fund, and the Ministry of Finance of Ukraine signed and started implementing the Strategy of Ukrainian Financial Sector Development until 2025.

The NBU continued to cooperate with financial regulators of Ukraine under the Financial Stability Council.

Other relevant information and developments

For further information on the NBU's supervisory activities and regulations, please visit the NBU's website at www.bank.gov.ua

Questionnaire tables for the 2020 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	77	75	73
Branches of foreign credit institutions	-	-	
Cooperative banks	-	-	
Banking sector, total:	**77**	**75**	**73**

Total assets of banking sector (at year-end)

Type of financial institution	2018	2019	2020
Commercial banks	1 910 614	1 981 594	2 205 915
Branches of foreign credit institutions	-	-	
Cooperative banks	-	-	
Banking sector, total:	**1 910 614**	**1 981 594**	**2 205 915**
y/y change (in %)	**3.8**	**3.7**	**11.3**

Ownership structure of banks on the basis of assets total

Item	2018	2019	2020
Public sector ownership	59.71	60.39	55.88
Domestic ownership total	28.47	27.19	28.88
Foreign ownership	11.82	12.42	15.24
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2020

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	48.99	61.01	0.100
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**48.99**	**61.01**	**0.100**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2018	2019	2020
Commercial banks	14.67	33.45	19.22
Cooperative banks	-	-	-
Banking sector, total:	**14.67**	**33.45**	**19.22**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2018	2019	2020
Commercial banks	100.0	100.0	100.0
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2018	2019	2020
Receivables	**100**	**100**	**100**
Financial sector	14.42	21.42	19.08
Nonfinancial sector	45.39	38.35	32.99
Government sector	21.91	19.31	28.18
Other assets	18.28	20.92	19.75
Liabilites	**100**	**100**	**100**
Financial sector	34.70	28.99	24.88
Nonfinancial sector	18.24	22.43	25.05
Government sector	1.37	1.28	0.94
Other liabilities	36.36	35.71	38.35
Capital	**9.33**	**11.59**	**10.78**

Capital adequacy ratio of banks

Type of financial institution	2018	2019	2020
Commercial banks	17.69**	19.66**	21.98**
Cooperative banks	-	-	-
Banking sector, total:	**17.69****	**19.66****	**21.98****

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

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

Asset classification	2018	2019	2020
Non-financial sector, including	27.9	37.9	37.7
- households	4.1	9.8	8.8
- corporate	23.8	28.1	28.9

The structure of deposits and loans of the banking sector in 2020 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	95.9	98.2
Households	55.1	21.8
Corporate	40.8	76.4
Government sector	1.3	1.2
Financial sector (excluding banks)	2.8	0.6
Total	**100.0**	**100.0**

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

P&L account	2018	2019	2020
Interest income	140 803	152 954	147 743
Interest expenses	67 760	74 062	62 895
Net interest income	73 043	78 892	84 848
Net fee and commission income	37 809	43 961	46 508
Other (not specified above) operating income (net)	8 589	8 147	6 813
Gross income	204 554	243 102	250 171
Administration costs	53 670	62 936	69 437
Depreciation	5 417	6 149	7 553
Provisions	23 758	10 714	31 037
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	-	-	-
Profit (loss) before tax	51 153	73 838	3 811
Net profit (loss)	22 339	58 356	39 727

Total own funds in 2020 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	5 242	-	3 737	1 518	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**5 242**	**-**	**3 737**	**1 518**	**-**

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