BSCEE Review 2022

Albania

Armenia

Austria

Belarus

Bosnia and Herzegovina

Bulgaria

Croatia

Czech Republic

Estonia

Georgia

Hungary

Kazakhstan

Latvia

Lithuania

North Macedonia

Moldova

Montenegro

Poland

Romania

Serbia

Slovakia

Slovenia

Turkey

Ukraine

Introduction

We are pleased to present you with the next edition of the BSCEE Group's annual report. 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. At the time of publishing the report, the BSCEE Group comprised twenty five Member Institutions from twenty four 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, Serbia, Slovakia, Slovenia, Turkey and the Ukraine.

The Chairmanship of the BSCEE Group rotates on an annual basis. In 2022 Mr Papuna Lezhava, Vice Governor of the National Bank of Georgia chaired the Group. The Secretariat of the Group was located in Poland, with the Polish Financial Supervision Authority (UKNF). The 2022 BSCEE Members' Conference was held in a hybrid format in December, with delegates taking part in-person in Tbilisi and the participants joining the discussions virtually.

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 Institutions. We hope that you will find this publication informative and useful. We are certain that this will help you become acquainted with the supervisory an regulatory activities of the Group's members in the Central and Eastern European region.

BSCEE Secretariat

* the information contained in the Report was provided solely by the Member Institutions of the BSCEE Group and is presented in that form therein.

Contents

Macroeconomic environment

The Albanian economy has outperformed expectations in 2022. Despite headwinds from rising inflation, global slowdown and tighter domestic and external financing conditions, GDP growth was strong in 2022, at 4.8%. Growth was driven largely by household consumption, private investment and tourism. The latter has followed an increasing trend – with the exception of the pandemic year – which has accelerated considerably in the last two years, notwithstanding a jump in outbound tourism. Despite the economic slowdown in 2023:Q1 – with GDP growth standing at 2.7% – the available data for the following quarters suggest the continuation of these trends, with the numbers of visitors and sentiment of households and businesses reaching historical highs, and employment growing strongly and unemployment rate hovering at historical lows.

The labour market remains tight amidst labour shortages and low unemployment. The unemployment rate stood at 10.8% in 2022 and 10.6% in 2023:Q2, while employment growth was slightly above 4% in the respective periods. In response to the tight labour market and high inflation, wages growth has picked up, with wages in the private sector increasing by 12.2% in 2022 and the first half of 2023. Surveys point to continued demand for labour while businesses continue to face labour shortages.

Inflation is gradually coming down towards the Bank of Albania's target of 3%. After years of very low inflation – 1.8% on average over 2017-2021 – inflation peaked at 8.3% in October 2022 and started to decline thereafter. The surge of inflation was initially propelled by rising commodity prices and supply-chain bottlenecks – following the pandemic and Russia's war of aggression in Ukraine – which later passed through to domestic prices in an environment of strong domestic demand, tightening of labor market, and increasing inflation expectations. Retreating commodity prices and monetary policy tightening is contributing to the decline in inflation rates. The latest figure of August 2023 puts the headline inflation rate at 4.0%.

Since March 2022, the Bank of Albania has increased the policy rate to bring inflation to target. The policy rate was increased cumulatively by 250 basis point, to reaching 3% actually. The rate hikes are being transmitted to financing conditions and credit growth, while the exchange rate of the lek against the euro has continued to appreciate. This trend is driven mainly by the secular improvement of external sector of the economy, with the current account deficit shrinking to 5.9% of GDP in 2022 and 3.2% in the first half of 2023. Buoyant tourism and increasing remittances have been the main driver of this improvement. The current account deficit continues to be financed mostly through FDIs, which averaged around 6.6% of GDP in 2022 and 5.6% in 2023:H1. International reserves have remained broadly stable and at optimal levels. The appreciating trend of the Albanian lek has helped reduce foreign inflationary pressures.

The macroeconomic policy mix has been conducive to stabilizing the economy towards its equilibrium and to steering inflation to target. The monetary policy tightening has proved instrumental in curtailing deviation of inflation expectations from target, reducing uncertainties and putting headline inflation rates in a firm downward trajectory. The restrictive fiscal stance has not induced inflationary pressures while giving the central bank space to fight high inflation rates. Parallelly, carefully designed and implemented micro and macro-prudential policies have strengthened the soundness of the banking system. The banking system remains well capitalized, liquid and profitable. Credit quality remains good, with nonperforming loans to total loans (NPL) ratio standing at 5.3% in August 2023, compared to 5% in the end of 2022. Despite the low level of nonperforming loans ratio, the pressures for the potential transformation of interest rate risk to credit risk have increased. The BoA is taking active steps to ensure continued banking sector soundness through enhanced monitoring of credit risk, more intensive communication with banks, vigilant on-site and of-site supervision as well as continued alignment of banking regulatory framework with the EU standards.

In our baseline scenario, the Bank of Albania expects economic growth to continue in the coming years supported by the solid balance sheet of the private sector, a strong labour market and an overall conducive financing environment. Growth is expected to slowdown in near term on the back of tighter financing condition, and a soft EU growth. On the medium term, growth is expected to return to its historical growth rates. **Inflation is expected to continue to decline gradually in the next quarters and return to the target by the mid-2024**. This trajectory factors in a continuous decline of inflation in our trading partners and a more sustainable balance of demand and supply in the economy as the monetary policy tightening continues to feed through the economy.

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

As at the end of 2022, the structure of the banking and financial system in Albania consisted of 11 banks, 38 non-bank financial institutions (NBFIs), 583 foreign exchange bureaus, 16 Savings and Loan Associations (SLAs) and 1 Union of SLAs.

During 2022, banking system assets grew by around EUR 911 million or 5.87%, compared to the EUR 1,685 million or 12.21% growth a year earlier. The loan portfolio grew by EUR 385 million, or 6.55% during this year.

The banking system's share in the economy, measured by the ratio of total assets to the Gross Domestic Product (GDP), continues to remain at high levels, though this indicators decreased by 7.58 percentage points in 2022, standing at 87.95%. Meanwhile, the loan to Gross Domestic Product ratio fell due to the higher growth of GDP against the increase in the loan portfolio.

The most important indicator of supervision, the capital adequacy ratio (CAR), at the end of 2022, stood at 18.13%. This ratio shows a fall of 0.4 percentage point, compared with the same period in the previous year.

As at end of 2022, the non-performing loans ratio (NPLR) dropped by 0.69 percentage points, in annual terms, to 5%. At the end of 2022, the non- performing loans reached at EUR 312.68 million

Profitability indicators, Return on Average Assets (RoAA) and Return on Average Equity (RoAE), respectively, decreased compared with 2021. As at end-2022, RoAA stood at 1.2% while RoAE stood at 12.3%, from 1.3% and 12.6%, respectively at the end of 2021.

The banking system's share in the economy, measured by the ratio of total assets to the Gross Domestic Product (GDP), continues to remain at high levels, though this indicators decreased by 7.58 percentage points in 2022, standing at 87.95%. Meanwhile, the loan to Gross Domestic Product ratio fell due to the higher growth of GDP against the increase in the loan portfolio.

The following are banking system highlights for 2022

1. The non-performing loans ratio (NPLR) dropped by 0.69 percentage point in annual terms, to 4.99 % at the end of 2022.
2. Net outstanding non-performing loans to total credit portfolio stood at 1.84%, down by 0.03 percentage point compared with December 2021.
3. Provisioning of NPLs was 64.36%, from 68.36% a year earlier.
4. Liquidity indicators continuously appear significantly above the regulatory requirement laid down in the Bank of Albania's regulatory acts. In December 2022, liquid assets ratio to short-term liabilities in the banking system was 41.08%, down by 4.3 percentage points from the previous year.
5. Liquidity coverage ratio stood at 300% form the regulatory limit of 100%.

6. In December 2022, total value of deposits in the system amounted EUR 13,289 million, recording 5.9% annual growth compared to the previous year. The share of the domestic currency in total deposits increased to 46.1%, from 41.1% in December 2021.
7. As at the end of 2022, the Capital Adequacy Ratio (CAR) - the main supervision indicator was reported at 18.13%, slightly down by 0.4 percentage point, compared with the same period in the previous year.
8. The banking system's profit was positive in 2022, amounting around EUR 189.77 million or EUR 4.37 million higher than in 2021.

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

Throughout 2022, the Bank of Albania has continued the drafting of new bylaws and the reviewing of the regulatory framework in force, through the approximation with the EU directives, or in compliance with legal requirements, with a view to accomplish a more effective supervision on banks and other financial entities, being licensed and supervised by the Bank of Albania. Through the approval of several bylaws provided for in the National European Integration Plan 2022- 2024, the Bank of Albania has fulfilled the relevant commitments in view of the continuous alignment of the regulatory framework with the EU acquis.

In 2022, a special attention was paid as well on drafting the new regulatory framework, pursuant to Law 55/2020 "On payment services", to complete this framework with new requirements in accordance with the EU regulations and the guidelines of the European Banking Authority (EBA), compiled for the implementation of the Payment Services Directive (PSD2). Also, the regulatory framework - which lays down the supervisory requirements for the exercise of a safe and stable activity for electronic money institutions- was drafted through the further alignment of the requirements for these institutions with the EU E-Money Directive.

In the framework of fulfilling the National Retail Payments Strategy (2018- 2023), also during 2022, the work continued for the transposition of the Payment Account Directive 2014/92/EU (PAD) and the regulations of the European Commission 2018/32 /EU, 2018/33/EU and 2018/34/EU in the legal and regulatory framework of the Bank of Albania. This commitment aims to both bolstering transparency and competition in the market, as well as promoting financial inclusion of the Albanian citizens. The transposition of several chapters of this Directive was finalized with the approval at the end of 2022 of the regulation "On the comparability of fees related to payment accounts and payment account switching service". Meanwhile, the work continued on the consultation with the stakeholders of the draft-law

"On the payment accounts with basic features". Through this draft-law, it has become possible to transpose several chapters of the Directive, related to the requirements for the payment account with basic features. This draft-law is foreseen to be submitted for approval within 2023. The new legal and sub-legal acts, as well as the amendments to the regulatory framework in force, have been consulted with banks or other entities, licensed and supervised by the Bank of Albania, which have contributed through their comments and suggestions.

The new regulatory acts approved, as well as those revised during 2022, are listed in details below.

I. Sub-legal acts drafted for the implementation of the Law 55/2020 "On Payment services":

- Approval of the Regulation "On the public registry of payment services providers" (approved by Decision No. 7, dated 2.2.2022 of the Supervisory Council of the Bank of Albania).
- Approval of the guideline "On the criteria on how to stipulate the minimum monetary amount of the professional indemnity insurance or other comparable guarantees" (approved by Decision No. 1, dated2.3.2022 of the Supervisory Council of the Bank of Albania).
- Approval of the Regulation "On strong customer authentication and common and secure open standards of communication" (approved by Decision No. 29, dated 1.6.2022 of the Supervisory Council of the Bank of Albania).

II. In the framework of further approximation with the requirements laid down in Directive 2009/110/EC (the revised Payment Services Directive PSD2), and pursuant to the requirements set out in the Law 55/2020 "On payment services":

- Approval of the new Regulation "On the pursuit of the activity and supervision of electronic money institutions" (approved by the Decision No. 57, dated 21.12.2022 of the Supervisory Council of the Bank of Albania).
- Approval of amendments to the Regulation "On risk management in the activity of non-bank financial institutions", (approved by Decision No. 58, dated 21.12.2022 of the Supervisory Council of the Bank of Albania).

III. In the framework of reviewing the regulatory framework, for the implementation of Basel III requirements and alignment with the EU acquis, the following developments have taken place

- Amendments to the Regulation "On core management principles of banks and branches of foreign banks and the criteria for the approval of their administrators" and the new guideline "On the Internal and effective management of banks"1 (approved by Decision No. 21, dated 6.4.2022 of the Supervisory Council of the Bank of Albania).
- Amendments to the Regulation "On capital adequacy ratio", and to the Regulation "On regulatory capital of bank" (adopted with Decision No. 44 and 45, dated 2.11.2022 to the Supervisory Council of the Bank of Albania).

IV. In relation to the transposition of Payment account Directive 2014/92/ EU (PAD) and the regulation issued for its implementation (Regulations 2018/32, 2018/33 and 2018/34 of the EU):

- Approval of the Regulation "On the comparability of fees related to payment accounts and to the service of payment account switching" (Approved by Decision No. 59, dated 21.12.2022 of the Supervisory Council of the Bank of Albania).

V. Other developments

- Approval of the Decision "On suspending the dividend distribution by banks" (approved by Decision No. 6, dated 2.2.2022 of the Supervisory Council of the Bank of Albania).
- Approval of amendments to the Regulation "On licensing and activity of non-bank financial institutions", (approved by Decision No. 51, dated 7.12.2022 of the Supervisory Council of the Bank of Albania).
- Approval of amendments to the Regulation "On licensing and activity of savings and loan associations (and their Unions" (adopted with Decision No. 52, dated 7.12.2022 of the Supervisory Council of the Bank of Albania).

Main strategic objectives of the Supervisory Authority in 2023

Based on the main macro and micro risks arising from the national and international economic environments and the challenges over one year, the Supervision Department has set these main objectives for 2023:

- Monitoring of financial health of licensed institutions with focus on credit risk due to rising interest rates and inflation spikes;
- Monitoring of cyber risk which are associated with digitalisation especially in relation to events occurred in 2022;
- Meeting the FATF recommendations on AML and FT prevention with the purpose to improve the current position of the country;
- Improving the legislative framework with the purpose of further harmonizing it with the EU framework in the EU accession process;

The activities of the Banking Supervisory Authority

Structural Developments

Inflationary pressures, due to international developments dictated the performance of banking activity over 2022. The increase in key interest rates from central authorities, as a response to upsurge in prices, drove to rising interest rates on both banking and financial products. Credit portfolio of banks, despite the elevated price of loans, continued to grow over the course of previous year by 6.55%. In addition to the growth of this portfolio, its quality has been improving, mainly on the back of the reduced volume of non-performing loans by 5.8%.

The further consolidation of the banking activity where one of the banks in the domestic market, OTP bank, purchased the shares of Alpha Bank in Albania, is one of the most important developments in 2022. This process was concluded with the complete absorption of Alpha Bank's activity. Thus, since December 2022, the Albanian banking system consists of 11 banks.

Meanwhile, other changes were also carried out in the share structures, where the Eurosig Company took possession of the controlling package of shares of the United Bank of Albania. This development led the share of banks with Albanian capital reaches at 33.8% of the total assets of the banking system. Banks with Albanian capital have registered a stable growth over the last 3 years, further boosting the banking intermediation process through lending to the domestic economy.

Rising interest rates

International financial developments, under the impact of the war in Ukraine, affected in an unfavorable manner the banking activity. Inflationary pressures triggered rising interest rates. This increase was more concentrated in the second half of year. These developments resulted in increased credit costs, and consequently may trigger difficulties in repaying loans with variable interest rates. To this end, the Bank of Albania started an open discussion with banks on this potential risk, by requiring them to conduct detailed analyses on the potential effects that may implicate their financial position through stress test exercises under various assumed scenarios.

Meanwhile, this situation, in a theoretical view, is expected to drive up non- performing loans, as materialized in the analyses submitted by banks themselves. Results about the non-performing loans ratio, as at to the end of 2022, show this risk still remains non-materialized. Nevertheless, the risk on the increase in interest rates remains present in view of developments during 2023. Being aware of this risk, the Bank of Albania remains attentive to these developments with an active approach to prevent possible adverse developments through undertaking the adequate measures

Assessment of the Equivalence of the Regulatory Supervisory Framework

An independent evaluation of the current regulatory framework of supervision was conducted with the technical assistance of the European Bank for Reconstruction and Development (EBRD) and PriceWaterhouseCooper (PwC), through the adoption of a comprehensive approach. At the beginning of 2022, a revaluation of equivalence level was carried out, pursuant to the new methodology as published by the EBA at the beginning of 2022. This analysis concluded that the procedural and regulatory framework, as well as the supervisory practices, are at a high degree of equivalence and approximation with the applicable standards of the EU countries. This approximation is assessed particularly high in relation to capital requirements, applicable mitigation techniques, large exposures, liquidity, financial leverage, macroprudential supervision, professional secrecy, and international cooperation.

At the mid of 2022, the Bank of Albania submitted the official application to the European Banking Authority to include Albania in their schedule for starting the assessment process of equivalence based on the updated methodology by the EBA for this purpose.

Contribution in the Accession Negotiation Process to the EU

The Supervision Department has provided its contribution related to Chapters 3, 4, 9, 17, 20 and 28 in the Inter-institutional Work Groups throughout 2022. An important contribution is provided through the participation in the explanatory screening sessions for these chapters taking place in Brussels in the last quarter of year, and for the preparation of presentations in these bilateral screenings which were organized at the beginning of 2023 in Brussels. In these sessions, the Bank of Albania will present its achievements towards the approximation of the legal and regulatory framework with the European Union Acquis, as well as the plans for further approximation up to the Albania's membership in the EU.

Compilation of the Regulatory Framework on Payment Services

In 2022, the Bank of Albania has continued working on completing the regulatory framework in accordance with the requirements set forth in the Law "On payment services". This completion is achieved through the approval of other crucial sub-legal acts on the regulation of the activity, supervision and risk management across entities on which the law applies. These by-laws are drafted pursuant to the EU directives and the guidelines issued by the European Banking Authority (EBA). In addition, special attention was paid on drafting the new regulation on the risk management and supervision of electronic money institutions, in view of further approximation with the relevant EU Directive 2009/110/EC.

In 2022, work has continued for the transposition of Directive 2014/92/ EU (PAD) into the legal and regulatory framework of the Bank of Albania. The transposition of this directive aims at enhancing transparency and competitiveness in the market, as well as bolstering financial inclusion of the Albanian citizens.

Green Finance

The Bank of Albania has extended its willingness to join the Government's initiative in implementing the international undertaken measures regarding the orientation of the economy towards the green one. The supervision commitment in this regard has consisted in including the climate risk issue into the supervision process of the licensed institutions. The drafted strategy on climate change risk contains also a supervisory action-plan for the period 2023-2025 in the framework of harmonization with the relevant international processes. These steps were determined in collaboration with the FinSAC project of the World Bank, by delineating in the relevant draft the tasks to all departments prior to submitting it for approval to the Supervisory Council.

Preparation of the Guideline on Financial Reporting

In the framework of the project of implementing international accounting standards, for most of the year, work has been done for the preparation of the relevant guide on data reporting, according to the required form. In addition to this guide, the reporting tables that will compose the reporting system after the entry into force of the guide have been prepared. Under the same project, the bridge tables, which facilitate the conversion process of reporting, from the existing Unified Reporting System (SRU) to the new form, according to IFRSs have been drafted. These tables, which refer to the core financial statements: assets and liabilities, income and expenditure statements and off-balance sheet items, were compiled with the assistance of the FinSAC project of the World Bank and the participation of some banks in Albania.

Cyber Risk

In 2022, an intense wave of cyber-attacks bumped critical sectors in the Republic of Albania - including the banking system. Some of these attacks have been partially successful. Cyber-attacks have been and remain present against the banking sector, which has gradually increased vigilance regarding the protective and preventive systems, as well as the investigative ones. In this context, several isolated incidents were evidenced in the sector of non-bank financial institutions, and as in one of the banks, in 2022. The latest incident put in difficulty the business continuity of the bank. However, these issues were quickly recovered, while services turned back to normal.

Under these circumstances, almost throughout 2022, but especially in the last period of the year, banks aimed at strengthening cooperation with third parties to support security and information systems, with each other and with the National Authority for Electronic Certification and Cyber Security (NAECCS), by maximizing synergies through sharing information on increased cyber security controls, indicators of compromise, etc. In terms of cyber security, the situation in the banking system has continued to remain under control and with no materialized incidents.

Meanwhile, the Bank of Albania has been attentive to this situation by intensifying communication with the banking industry and the presence in Albania, where the need for enhanced attention to security measures is emphasized, especially in third-party access to the bank's systems, as well as reporting in the most real time of the occurred incidents in order to coordinate the addressing measures.

Implementation of recommendations of evaluation report by money Val committee and Erg/Fatf action-Plan

In the framework of implementing the recommendations from the Committee of Experts of CoE on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL), the BoA was committed in the implementation of the national plan of measures, with a view to improving the regulatory framework and strengthening the effectiveness of the supervisory process, with the purpose of addressing the main problems evidenced in this report.

In this framework, a considerable number of on-site examinations have been carried out related to anti-money laundering, particularly focusing on terrorism financing issues and for the implementation of the international sanctions, especially on non-bank financial institutions (NBFIs) and foreign exchange bureaus (FEBs), as vulnerable entities.

Related to the identified violations, in addition to the recommendations for specific entities, also supervisory measures, such as "warnings" and "fines" are implemented. A total of 82 examinations were carried out in 2022, in the field of preventing money laundering and terrorism financing, which comprised 5 banks, 5 non-bank financial institutions, 2 SLAs and 70 FEBs (of which 28 FEBs underwent the process of implementing recommendations as a result of deficiencies observed in previous examinations). Four of these examinations were carried out in collaboration with the General Directorate for the Prevention of Money Laundering (GDPML).

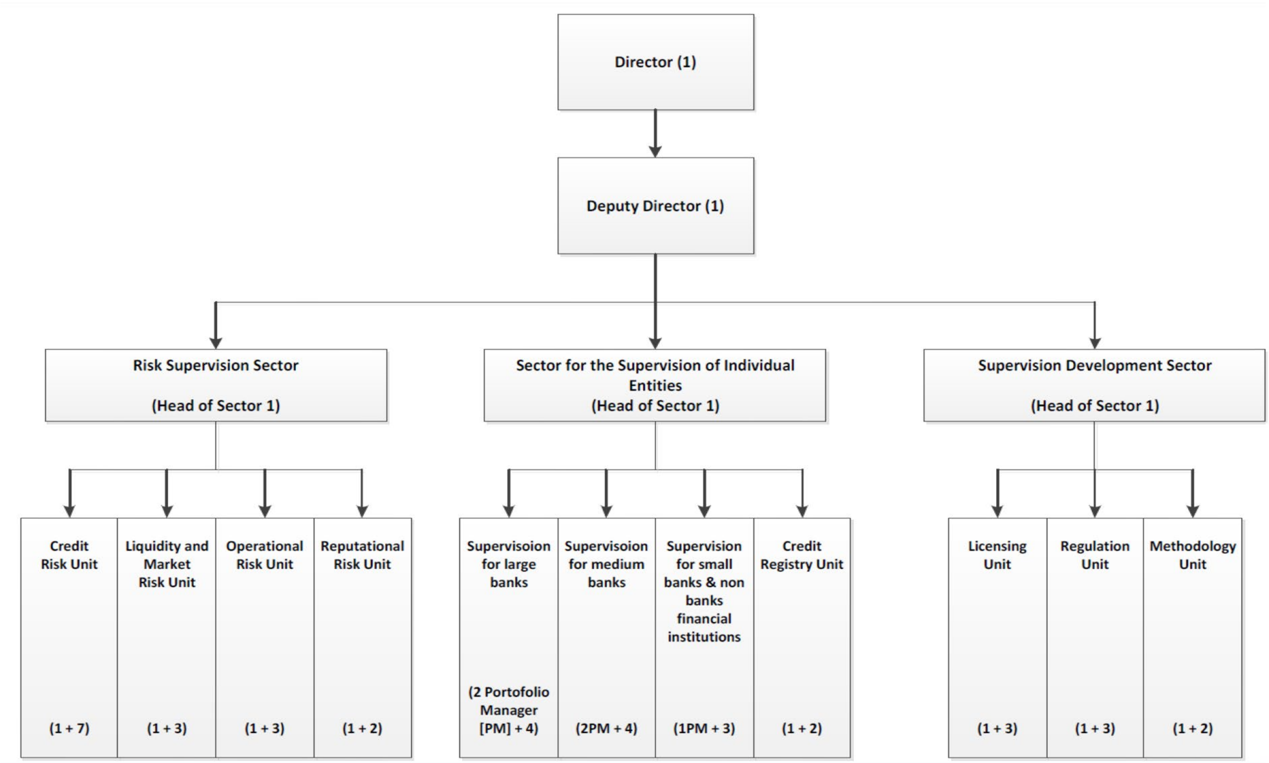
Adjusting Interest rates on consumer loans

In 2021, the Bank of Albania undertook a regulatory amendment whose subject matter are the interest rates on consumer loans. Through this amendment it was defined the way to set forth a maximum limit on effective interest rates (Maximum EIR) that lending entities apply on consumer credit products, for the purposes of regulating their costs. To determine this limit, the reports submitted by the entities for the existing products are considered and the 6-month average of the applied rates is calculated. Then, a limit of no higher than 33% of the calculated average is set.

During 2022, two publications of the maximum EIR for consumer loans were carried out. The impact of this limiting rate has been considerable, driving to a drop in effective interest rates by almost three times in the segment of very small loans, thus contributing to the normalization of the mark.

Organizational chart of the Banking Supervisory Authority

The organizational structure of the Supervision Department hasn't had any changes during 2022. The last structural change was in 2016.



Questionnaire tables for the 2021 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	12	12	11
Branches of foreign credit institutions	0	0	0
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	**12**	**12**	**11**

Total assets of banking sector (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	13,838.91*	15,523.86*	16,434.4*
Branches of foreign credit institutions	n/a	n/a	n/a
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	**13,838.91***	**15,523.86***	**16,434.4***
y/y change (in %)	**7.22%**	**12.21%**	**5.87%**

*The values are in million Euro converted to the exchange rate of December 2022

Ownership structure of banks on the basis of assets total

Item	2020	2021	2022
Public sector ownership	0	0	0
Domestic ownership total	30.58%	31.91%	33.8
Foreign ownership	69.43%	68.11%	66.2%
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2022

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	57.45	77.33	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	2020	2021	2022
Commercial banks	10.41%	12.63%	11.8%
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	**10.41%**	**12.63%**	**11.8%**

** Changes from previous publication comes from the reporting of revised data after auditing results*

Distribution of market shares in balance sheet total (%)

Type of financial institution	2020	2021	2022
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)

	2020	2021	2022
Receivables			
Financial sector	13.86	17.57	13.67
Nonfinancial sector	36.29	36.34	36.18
Government sector	45.96	44.26	48.66
Other assets	3.89	1.83	1.49
Liabilites			
Financial sector	3.33	3.11	3.23
Nonfinancial sector	80.28	79.42	78.66
Government sector	3.2	3.74	4.08
Other liabilities	2.8	3.8	2.76
Capital	**10.39**	**9.91**	**11.24**

Capital adequacy ratio of banks

Type of financial institution	2020	2021	2022
Commercial banks	18.70%	18.00%	18.13%
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	**18.70%**	**18.00%**	**18.13%**

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

Asset classification	2020	2021	2022
Non-financial sector, including	8.11	5.65	5.0
- households	5.52	4.45	3.79
- corporate	9.85	6.63	5.97

The structure of deposits and loans of the banking sector in 2022 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:		
Households	79.49	34.97
Corporate	17.32	61.50
Government sector	3.19	3.53
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	2020	2021	2022
Interest income	449.41	475.17	589.49
Interest expenses	66.77	65.80	76.82
Net interest income	382.37	409.37	512.67
Net fee and commission income	75.29	93.44	102.15
Other (not specified above) operating income (net)	18.36	12.31	19.10
Gross income	418.79	487.46	508.05
Administration costs	260.52	281.82	296.33
Depreciation	n/a	n/a	n/a
Provisions	64.12	8.03	35.81
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	166.97	217.02	220.18
Net profit (loss)	144.42	185.4	189.77

** The values are in million Euro converted to the exchange rate of December 2022*

Total own funds in 2022 (in EUR)

Type of financial institution	Total own funds **	Core Tier 1**	Tier 1**	Tier 2**	Tier 3**
Commercial banks	1,613.18	1,412.62	1,412.62	104.16	n/a
Cooperative banks	n/a	n/a	n/a	n/a	n/a
Banking sector, total:	**1,613.18**	**1,412.62**	**1,412.62**	**104.16**	**n/a**

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

Macroeconomic environment in the country

During 2022, the macroeconomic environment of Armenia was mainly characterized by positive development trends. The high level of economic activity was sustained through external demand, which was boosted by a rise in international visitors, financial resources, workforce, and exports. Armenia's economy experienced a growth of 12.6% in 2022, primarily driven by the service sector, which was largely attributed to the strong external demand. This economic growth indicator was observed in the context of growing uncertainties during the year due to many external factors, in particular, the sharp weakening of economic growth in partner countries due to the escalation of the Russia-Ukraine conflict and disruptions in commercial transactions, business relationships, and supply contracts between Armenia and the Russian Federation against the backdrop of the devaluation of the ruble. These events had a negative impact on the Armenian economy in the short term, which manifested in some weakening of economic activity. At the same time, several external factors had a positive impact on economic growth, in particular, the increase in aggregate demand due to the large-scale inflow of international visitors to Armenia (from the Russian Federation, Belarus, and Ukraine).

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

In 2022, the Central Bank of Armenia issued a banking license to a previously credit organization. As a result, by December 31, 2022, there were 18 commercial banks operating in Armenia, representing an increase of one.

Although the banking system retained its position as the largest participant in the Armenian financial system, its assets/GDP and loans/GDP indicators decreased by 2.8 and 7.1 percentage points, respectively, totaling 98.7% and 45.9%. However, the deposits/GDP ratio increased by 3.0 percentage points, reaching 54.8%.

The year 2022 was favorable with regard to the increase in profitability that was at a low level for a long time. As a result, on one hand, the business prospective of financial intermediation in Armenia has become more substantive, and on the other hand, banks have a good opportunity to undertake the implementation of long-term development and investment projects to further increase efficiency. According to the reports submitted to the Central Bank, in 2022, return on assets (RoA) and return on equity (RoE) tripled compared with the previous year and reached 3.2% and 21.7%, respectively. The increase in profitability is mainly due to the multifold increase in the volume of payment-and-settlement and foreign currency transactions as a result of the large inflow of new customers.

The banking system also remained highly capitalized. In particular, in December 2022, the total capital adequacy was 20.3%, higher by 3.1 percentage points compared with December of the previous year. The growth of capital, the decreases in the dram equivalent of risk-weighted assets (loans) as a result of the appreciation of the Armenian dram, as well as the reduction in the share of foreign currency loans, had a positive impact on the change in capital adequacy.

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) Changes in the regulatory framework

In 2022, the Central Bank initiated a number of changes to the financial system regulation framework:

- Calculation of the Capital Adequacy Ratio has been revised to align it with international best standards. These changes include aligning the capital structure with the Basel Framework (CET1, Tier 1, Tier 2) and reducing the Total CAR to 11%. Additionally, the Central Bank has expanded its acceptance of credit ratings beyond the traditional Big Three agencies (S&P Global, Moody's, and Fitch). These changes will come into effect starting in June 2023.
- In December 2022, the CBA adopted a package of sub-legal acts amending the existing regulations for banks and other financial institutions regarding qualification requirements for their managers. Previously, managers were required to take qualification examinations at the CBA and obtain a certificate. Starting in April 2023, these requirements will be abolished, and FIs will be able to determine the qualifications their managers should have. It is expected that, when doing so, FIs will consider their business models, organizational structures, and complexity. However, the Central Bank will still conduct fitness and probity assessments for FI managers.
- During the year, the Central Bank also revised the calculation of the foreign currency disposition standard to align the foreign exchange risk management approaches by banks with the changes made within international standards. Among other changes, the rules for the inclusion of derivatives in the calculation of the standard have been revised, which is expected to contribute to an increase in derivatives transactions in the Republic of Armenia.
- To ensure a higher degree of independence of financial institutions, as defined by auditing organizations, amendments have been made to the relevant normative legal act establishing requirements making it possible to prevent an institution from consistently undergoing financial audits by a single auditing company. Also, the qualification requirements of the auditor in charge and the audit team have been tightened up to ensure a better-quality audit. As a result, a more impartial and high-quality audit is expected, contributing to increasing consumer and investor confidence in financial institutions.
- The Central Bank also approved the legal framework regulating crowdfunding services, which will enable entrepreneurs, especially start-ups and SME companies, to attract up to 2.5 billion AMD in annual financing from investors through the sale of securities in a simplified manner, without extensive transparency requirements. This will moreover create new investment opportunities (online, 24/7, fast, small investments, etc.) for investors.

The Central Bank also continued working in the following areas to further enhance the regulatory framework of the financial system:

- Throughout the year, extensive work has been carried out in drafting the law on bank resolution. During this process, the CBA paid great attention to the best international practices.
- Additionally, a key focus for the CBA has been to cultivate a resilient financial system and integrate optimal risk management practices into the Armenian banking sector. To achieve this goal, the CBA continued its work on the introduction of Basel Pillar 2 requirements.

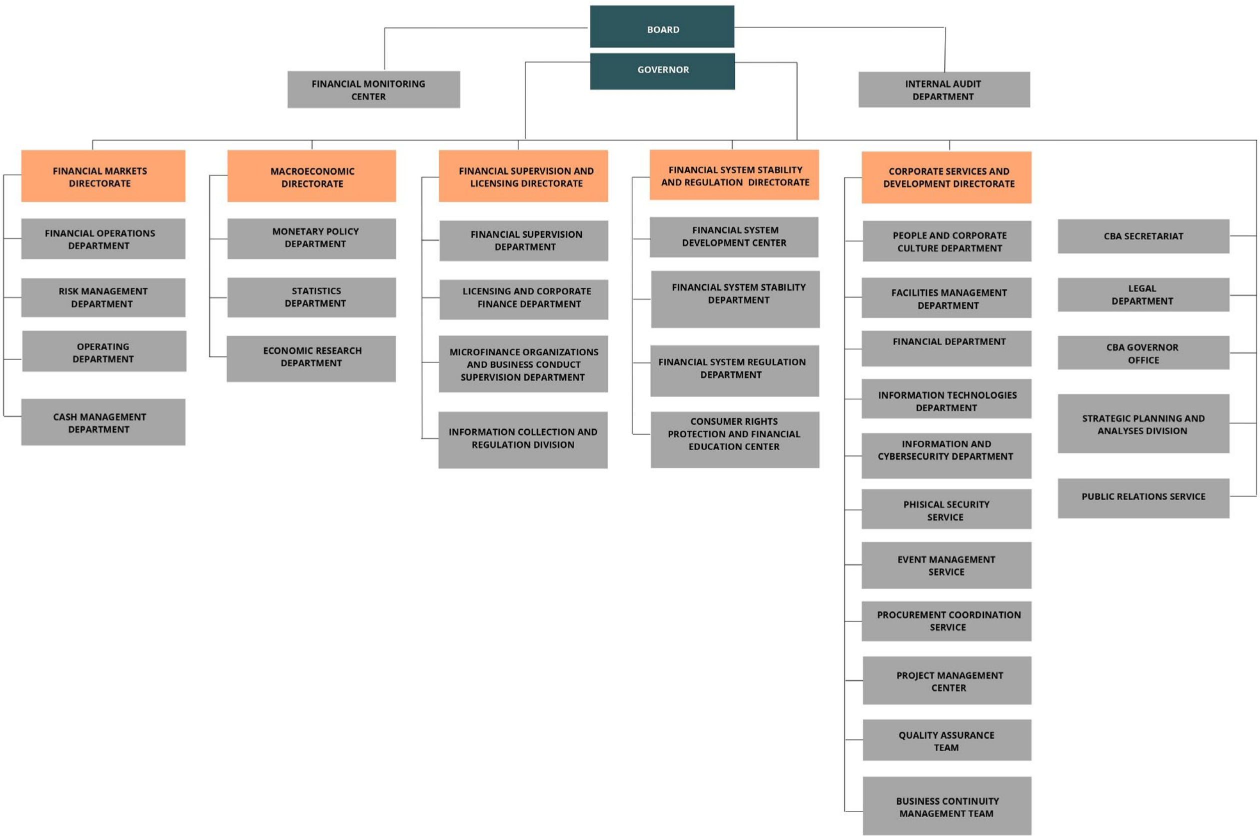
b) Legal competences of the CBA

One of the main objectives of the CBA is to ensure stability 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 CBA 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 shall be independent from the state authorities.

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Banking Supervisory Authority in 2022

The CBA's main strategic objective in supervision area is to ensure the stability and sustainable development of banking system by making sure that significant risks are duly managed and consequences of any significant issues or crises are minimized. To achieve this goal, the Central Bank carries out forward-looking and proactive risk-based supervision, which is concentrated on building resilience for financial institutions and protecting consumer rights. Global developments, diverse challenges, significant growth in the volume of the financial system, as well as new developments and risks arising in financial markets require significant changes in supervisory approaches and capabilities. That involves the parallel and consistent formation of relevant capacities in the Central Bank and financial institutions and ensuring a new quality of communication between them, application of new supervisory approaches in terms of consumer protection and improving the culture of communication with them. In accordance with these goals and changes, a number of supervision-related projects were consistently continued or initiated in 2022 and were mainly aimed at the development and operational implementation of risk-based supervision tools.

The activities of the Banking Supervisory Authority in 2022

In 2022, supervisory activity primarily focused on revamping supervisory tools and methodology. In this regard, the Supervisory Review and Evaluation Process (SREP) is in the process of implementation, and some banks were evaluated accordingly.

To enhance the crisis preparedness of financial institutions and assess their internal capabilities, recovery plans for all banks were assessed, and the results were communicated to the banks.

Micro-prudential supervisory stress tests (MSST) were conducted jointly with some banks to assess the impact of micro-financial developments on individual bank solvency. The stress-testing methodology has been revised based on the MSST results and feedback received from the banks.

2022 was difficult in terms of geopolitics and the resulting challenges facing the financial system. Taking into account the significant increase in transactions performed by non-resident clients in banks, in 2022, inspections and thematic reviews were carried out in banks and other financial institutions in order to assess and mitigate AML/TF risks.

In order to ensure free and fair competition in the financial system, measures have been taken to both identify and eliminate competitive offenses and to prevent anti-competitive behaviors. Thus, demonstrations of anti-competitive behavior were identified in the foreign exchange market and disciplinary measures were imposed.

International activities of the authority

Throughout the year, the Central Bank maintained and strengthened its extensive network of partnerships and collaborations with international institutions. It actively engaged in various regional and global initiatives, spanning across diverse domains, which encompassed:

- **Research capacities:** The Central Bank hosted professionals from a number of world renewed universities and research centers, who provided professional advice and/or conducted research jointly with other professionals engaged in economic research. In 2022, the Central Bank's Dilijan Training and Research Center hosted representatives of leading global organizations (Accenture, UBS, Visa) as part of a high-level international conference on "Finance and Money in the New Macroeconomic and Technological Environment."

- **Consumer protection:** The CBA sustained its membership and effective collaborations with the Alliance for Financial Inclusion (AFI), the Organization for Economic Co-operation and Development (OECD), and the Eurasian Economic Union. The jointly developed and published documents and guidelines also present the policy and measures of the Central Bank aimed at protecting consumer rights.

- **Education and development:** The CBA also maintained its partnerships with other central banks and foreign organizations, including the International Monetary Fund, the Bank for International Settlements, the Financial Stability Institute and others. 188 courses were organized, 132 of which were remote and 54 on-site, and in which 344 employees participated. The courses included special, tailor-made seminars designed to address issues of interest and aimed at exchange of experience that were organized in the scope of technical assistance by the Bank of Italy, the Bank of Israel, De Nederlandsche Bank, and the National Bank of Belgium.

The CBA also continued close cooperation with the World Bank, the Financial Sector Advisory Center in Vienna (FinSac), which provided crucial technical assistance for key projects and initiatives.

Cooperation with other supervisory bodies in the country

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

Other relevant information and developments in 2022

In 2022, the National Assembly of the Republic of Armenia adopted the Law on Cashless Transactions. In this context, the Central Bank has emphasized the importance of enhancing the convenience of cashless payments for both citizens and businesses that accept such transactions, while also ensuring the expansion of the cashless payment infrastructure. Notably, significant progress has been made in increasing the number of physical POS terminals at sales and service points. This increase in the number of POS terminals reflects a growing willingness among business entities to accept non-cash payments.

Questionnaire tables for the 2022 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	17	17	18
Branches of foreign credit institutions	0	0	0
Cooperative banks	0	0	0
Banking sector, total:	**17**	**17**	**18**

Total assets of banking sector (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	10,438,046	13,058,211	19,973,676
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**10,438,046**	**13,058,211**	**19,973,676**
y/y change (in %)	**-3.8%**	**25.1%**	**52.9%**[1]

Ownership structure of banks on the basis of assets total

Item	2020	2021	2022
Public sector ownership	2.20	2.02	7.69
Domestic ownership total	37.45	39.16	29.08
Foreign ownership	60.35	58.82	63.23
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2022

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	43.3%	57.6%	938.5
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**43.3%**	**57.6%**	**938.5**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2020	2021	2022
Commercial banks	8.93%	7.07%	21.65%
Cooperative banks	-	-	-
Banking sector, total:	**8.93%**	**7.07%**	**21.65%**

[1] *y/y change in local currency 18.4%*

Distribution of market shares in balance sheet total (%)

Type of financial institution	2020	2021	2022
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)

	2020	2021	2022
Receivables	100	100	100
Financial sector	23.62	24.89	29.23
Nonfinancial sector	58.14	52.75	46.30
Government sector	12.59	16.16	19.58
Other assets	5.65	6.20	4.89
Liabilites	86.88	87.04	85.14
Financial sector	27.21	26.42	20.64
Nonfinancial sector	54.9	56.24	59.50
Government sector	0.52	0.32	0.17
Other liabilities	4.25	4.06	4.83
Capital	**13.12**	**12.96**	**14.86**

Capital adequacy ratio of banks

Type of financial institution	2020	2021	2022
Commercial banks	16.93%	17.20%	20.3%
Cooperative banks	-	-	
Banking sector, total:	**16.93%**	**17.20%**	**20.3%**

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

Asset classification	2020	2021	2022
Non-financial sector, including	6.55%	3.52%	4.45%
- households	9.84%	5.12%	3.89%
- corporate	5.63%	3.87%	3.96%

The structure of deposits and loans of the banking sector in 2022 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	45.62%	40.26%
Households	27.72%	21.84%
Corporate	17.90%	18.42%
Government sector	0.14%	16.94%
Financial sector (excluding banks)	8.62%	2.54%
Total	**100.0**	**100.0**

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

P&L account	2020	2021	2022
Interest income	709,691.48	903,206.94	1,349,655
Interest expenses	389,311.85	516,977.16	740,162
Net interest income	320,379.63	386,229.78	609,493
Net fee and commission income	118,529.63	(57,037.13)	449,704.34
Other (not specified above) operating income (net)			
Gross income	1,248,448.26	1,691,432.93	2,485,987
Administration costs	120,930.11	154,543.90	307,069
Depreciation	32,297.38	43,826.83	63,668
Provisions			
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	181,826.94	187,703.57	335,234
Profit (loss) before tax	122,004.66	141,489.08	723,964
Net profit (loss)	97,797.92	115,796.53	569,648

Total own funds in 2022 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	2,906,207	2,669,697	2,713,546	192,661	-
Cooperative banks					-
Banking sector, total:	**2,906,207**	**2,669,697**	**2,713,546**	**192,661**	**-**

Macroeconomic environment in the country

In 2022 economic activity in Austria grew by 5 % and surpassed its pre-pandemic level (2019). The economic development was shaped by strong growth due to pandemic-related catch-up effects in the first half of the year and deteriorating growth due to the consequences of the Russian war against Ukraine in the second half of the year. The war in Ukraine accelerated inflation triggering a substantial loss in purchasing power.

The Austrian labor market remains robust despite the predicted slowdown in activity and the high inflation environment. The Austrian unemployment rate reached its pre-pandemic levels in 2022. The shortage of skilled workers that has persisted for quite some time, broadened in terms of occupations, sectors and skill levels. Recording an average inflation rate of 2.1 % since the introduction of the euro in 1999, Austria has been among the countries that have successfully maintained price stability in line with the Eurosystem's definition. However, as a result of the COVID-19 pandemic, supply chain disruptions and in reaction to the war in Ukraine, energy prices have risen significantly causing the highest HICP inflation rates since the introduction of the euro. According to the flash estimate of Statistics Austria, HICP inflation was at 9.2 % in March 2023, well above historical averages but also above the euro area average.

The Austrian real estate market has been buoyant since the mid-2000s. However, waning affordability and rising funding costs herald a trend reversal. Austrian housing prices declined in the fourth quarter of 2022 for the first time in years. According to the results of the OeNB fundamentals indicator for residential property prices, real estate price growth in Austria is still above of what can be explained by economic fundamentals. However, increasing inflation and the recent decline in prices reduced the gap somewhat.

Austria's foreign trade in goods is well diversified both by region and product type. In 2022, more than half of Austria's foreign trade involved other euro area countries and was therefore not exposed to any direct exchange rate risks. After Germany, which still accounted for an export share of 30 %, CESEE is Austria's second most important export market. In 2022 the worsening deficit in the goods balance due to the increased energy prices was outweighed by a higher services balance surplus. Austria recorded a current account surplus of EUR 3 billion or 0.7 % of GDP in 2022, but the surplus is below the 2008-2020 average of 2.1 %. Following the strong macroeconomic environment and inflation-driven revenue growth in 2022, the budget balance further improved to –3.2 % of GDP (after –5.8 % of GDP in 2021).

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

The Austrian banking sector is in a position to face the challenging environment, due to banks' as well as macro- and microprudential measures to increase resilience. Positively, the Austrian banking system is ranked among the highest rated systems globally as confirmed by S&P Global Ratings' Banking Industry Country Risk Assessment. In 2022, the Austrian banking sector's operating profit increased by more than 40% year on year. Consequently, profits rose by two thirds and reached EUR 10.2 billion, a new historic high. While 2022 profits were boosted by one-off effects and results in Russia, there are however caveats to their sustainability as the Austrian banking sector's profitability faces continuing adversities with the Russian invasion of Ukraine, inflation developments and structural efficiency challenges. The consolidated NPL-ratio of Austrian banks remained at a historic low of 1.7% as of end-2022.

The business of Austrian banks' subsidiaries in CESEE accounted for total assets of EUR 279 billion and a net profit (after tax) of EUR 5.2 billion while credit risk costs doubled in 2022, however starting from a low level. The region thus remains a very important market for the Austrian banking system, with CESEE EU countries accounting for about 80% of total assets. In a year-on-year comparison, Austrian banks' subsidiaries' net result in CESEE increased by 74%, and reached a new record level.

The Austrian banking sector has more than doubled its capitalization compared with levels recorded before the global financial crisis in 2008/09 and thus increased its resilience. As of December 2022, the CET1-ratio of Austrian banks stood at 16.3%. In light of the current uncertainties, the careful handling of profit distributions is still warranted. Total assets climbed to 1,200 bn EUR, this corresponds to 268% of the Austrian GDP.

The demand for home ownership and corporate liquidity drove bank lending in Austria in 2022 and early 2023. Loan growth, however, has been decelerating also due to rising interest rates. In order to reduce systemic risks from residential real estate and also protect borrowers from taking on excessive household debt, the Austrian Financial Market Authority (FMA) issued a regulation for sustainable lending standards for residential real estate financing, becoming effective as of August 1, 2022. It includes upper limits for loan-to-value ratios, debt service-to-income ratios and loan maturities – subject to exemptions that would give credit institutions adequate operational flexibility. An amendment has become effective as of April 2023 and allows for an even greater flexibility as already provided for by the initial regulation. Commercial real estate lending attracts increasing attention as property valuations are challenged by increasing interest rates. Lenders are therefore called upon to ensure appropriate valuations and provide for adequate risk provisioning.

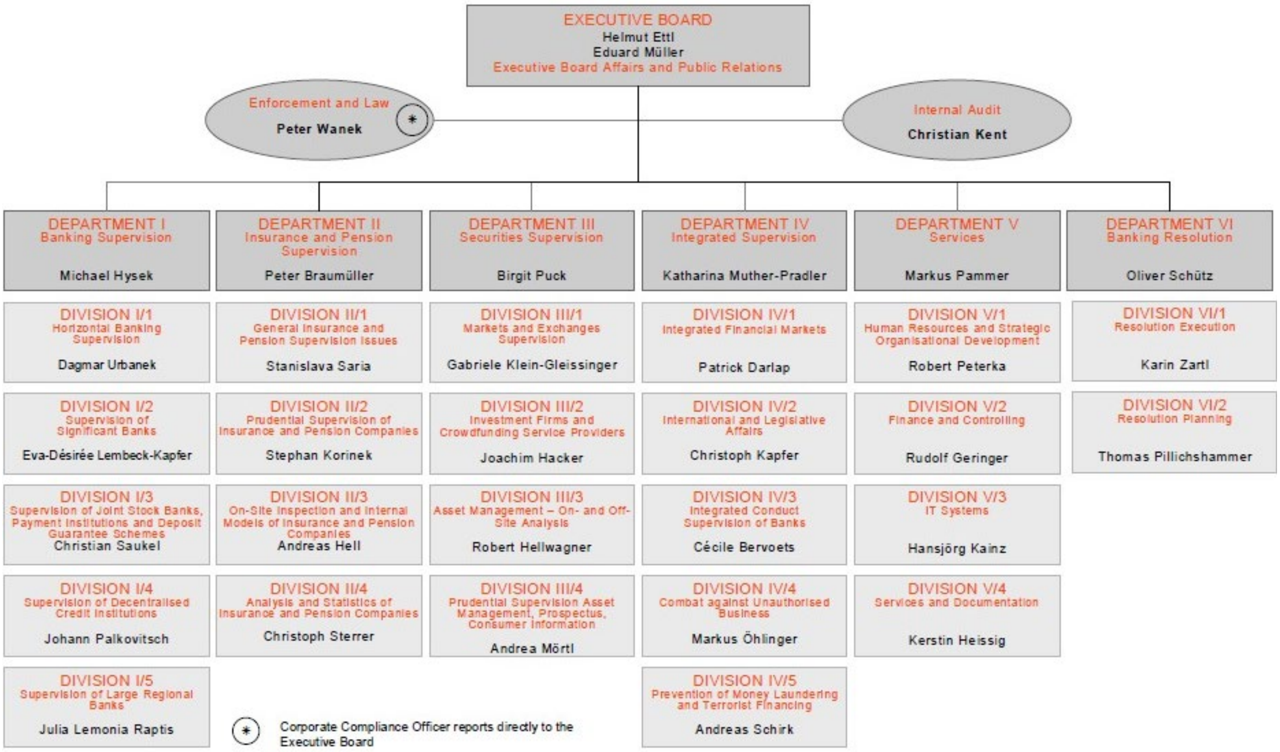
After completing its evaluation of the macroprudential capital buffers, the Austrian Financial Market Stability Board (FMSB) concluded that structural systemic risks still persist and adjusted its recommendations in September 2022: The systemic risk buffer, SyRB, and the other systemically important institution, O-SII-buffer should be increased by 50bp (phase-in by 25bp) at maximum for 12 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 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 formonitoring 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 31.12.2022 seven Austrian banking groups in total have been classified as "significant institutions" (SIs), encompassing 72 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 401 Austrian credit institutions as of 31.12.2022. 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



The FMA is divided into six departments:

1. Banking Supervision
2. Insurance and Pension Company Supervision
3. Securities Supervision
4. Integrated Supervision
5. Services
6. Bank Resolution

The two staff divisions "Enforcement and Law" and "Internal Audit" report directly to the Executive Board.

Main strategic objectives of the Banking Supervisory Authority in 2022

Please see the "Facts and Figures, Trends and Strategies" publication
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.

Please see the FMA´s priorities for supervision and inspections in 2022 in the FMA´s 2022 annual report https://www.fma.gv.at/en/publications/fma-annual-report/

Based on the risk analysis for 2022-2026, and its medium-term supervisory strategy as adapted in line with its analysis, the FMA set the following priorities in 2022 for supervision and inspections in 2022:

- **RESILIENCE AND STABILITY:** Strengthen the resilience of supervised financial service providers and preserve the stability of the Austrian financial market as a whole. DIGITALISATION: Exploit the opportunities of digitalisation while also consistently addressing the associated risks.
- **NEW BUSINESS MODELS:** Provide regulatory and supervisory support for innovative business models as early as possible in order to promote the innovative strength of the Austrian financial market, to ensure fair competitive conditions and to guarantee appropriate consumer protection.
- **COLLECTIVE CONSUMER PROTECTION:** Strengthen consumer protection through information and financial literacy.
- **SUSTAINABILITY:** Create transparency on sustainability risks and integrate them into the risk management and governance of supervised companies.
- **A CLEAN FINANCIAL CENTRE:** Preserve the clean financial centre as an essential asset of any business location.

In setting these supervisory and inspection priorities for 2022, the FMA has addressed current developments and trends that harbour particular risk potential for supervised companies or markets. The aim is not simply to contain risks, but also to tap into opportunities and potential. At the same time, the FMA wants to draw the attention of the supervised entities to risk areas in their area of activity while also giving them the opportunity to prepare in a targeted way for the risk-oriented priorities for supervision in 2022. 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 focusing on.

The activities of the Banking Supervisory Authority in 2022

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/
- and answers to question 5 (in this questionnaire)

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 2022

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

- pages 10 and 11: "2022 at a glance"; with "The FMA in 2022"
- page 17: "FIT FOR FUTURE" – The change project equipping the FMA or the future": The central aim of the "FMA 2025" strategy is to create an environment and culture within the organisation that will enable us to actively shape the future of the financial market – with all of its current and future challenges. The FMA strategy is designed to enable us to respond quickly to the changing environment by taking into account both current and future-oriented priorities.
- page 83 "Innovation at the FMA"

Please also refer to information provided above in chapter "Main strategic objectives of the Banking Supervisory Authority in 2022".

Questionnaire tables for the 2022 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	156	151	149
Branches of foreign credit institutions	24	22	20
Cooperative banks	363	347	324
Banking sector, total:	**543**	**520**	**493**

Source: OeNB, unconsolidated data

Total assets of banking sector (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	592.1	624.3	605.0
Branches of foreign credit institutions	24.5	15.4	13.0
Cooperative banks	357.3	385.7	396.4
Banking sector, total:	**973.8**	**1,024.4**	**1,014.4**
y/y change (in %)	**+10.0%**	**+5.2%**	**-1.0%**

Source: OeNB, unconsolidated data in EUR bn

Ownership structure of banks on the basis of assets total

Item	2020	2021	2022
Public sector ownership	4.6	4.5	2.3
Domestic ownership total	81.1	82.7	86.8
Foreign ownership	18.9	17.3	13.2
Banking sector, total:	**100.0**	**100.0**	**100.0**

Source: OeNB, unconsolidated data.

Concentration of asset by the type of financial institutions, 2022

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	42.6	54.6	785
Branches of foreign credit institutions	50.7	65.5	1,219
Cooperative banks	42.7	50.7	804
Banking sector, total:	**28.9**	**39.1**	**402**

Source: OeNB, unconsolidated data.

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2020	2021	2022
Commercial banks	3.3	9.5	6.9
Cooperative banks	3.6	6.7	1.1
Banking sector, total:	**3.4**	**8.7**	**6.5**

Source: OeNB, unconsolidated data.

Distribution of market shares in balance sheet total (%)

Type of financial institution	2020	2021	2022
Commercial banks	60.8	59.0	59.6
Branches of foreign credit institutions	2.5	1.5	1.3
Cooperative banks	36.7	39.5	39.1
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)

	2020	2021	2022
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	2020	2021	2022
Commercial banks	20.2***	19.9***	19.4***
Cooperative banks	18.8***	17.9***	19.0%***
Banking sector, total:	**19.5*** **	**19.3*** **	**19.2*** **

*(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	2020	2021	2022
Non-financial sector, including			
- households	2.8	2.4	2.1
- corporate	3.1	2.8	2.6

Source: OeNB, consolidated data.

The structure of deposits and loans of the banking sector in 2022 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:		
Households	68.5	44.4
Corporate	20.0	47.0
Government sector	5.7	5.6
Financial sector (excluding banks)	5.8	3.0
Total	**100.0**	**100.0**

Source: OeNB, unconsolidated data; only domestic

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

P&L account	2020	2021	2022
Interest income	13.4	13.0	19.0
Interest expenses	4.8	4.0	8.3
Net interest income	8.6	9.0	10.6
Net fee and commission income	4.7	5.3	4.9
Other (not specified above) operating income (net)	6.0	6.9	8.2
Gross income	19.3	21.2	23.7
Administration costs	10.8	11.0	10.5
Depreciation	1.0	1.2	1.2
Provisions	2.5	-0.4	3.6
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	3.4	7.5	6.4
Net profit (loss)	2.7	6.5	5.1

Source: OeNB, unconsolidated data in EUR bn.

Total own funds in 2022 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	56.0***	46.2***	49.6***	6.3***	n.a.
Cooperative banks	47.2***	41.2***	43.1***	4.1***	n.a.
Banking sector, total:	**103.2*****	**87.3*****	**92.8*****	**10.4*****	**n.a.**

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

Source: OeNB, consolidated data in EUR bn.

Macroeconomic environment in the country

The trends in the development of the global economy formed before 2022, which were accompanied by disruptions in the supply chains due to the pandemic and a heightened external pro-inflationary background, made a considerable impact on the economic processes in the Republic of Belarus. Acceleration of the inflationary processes in the world forced the leading economic centers to reject the extra-soft monetary policy and begin its gradual toughening.

In 2022, The National Bank ensured the continuous functioning of all payment systems, including retail ones. Particular attention was paid to the uninterrupted provision of payment services that are critical for the payment system, preventing the escalation of certain types of payment risks into a systemic payment risk and ensuring payment services that are convenient and simple for citizens and economic entities.

The work continued to improve the regulation of financial transactions, formation of legal conditions for the development of new financial institutions and instruments. The issues of ensuring the completeness of disclosure of information and transparency of the financial service terms, improving their quality, as well as enhancing the system for protecting the rights of financial services consumers were considered on a priority basis.

Development of the banking sector (including assets/GDP)

As at January 1, 2023, the banking sector of the Republic of Belarus included 21 operating banks.

As at January 1, 2023, the operating banks' assets totaled BYN104.9 billion, an increase by 6.6 percent over 2022. The share of assets in foreign exchange went down since the beginning of the year from 51 percent as at January 1, 2022 to 47.3 percent as at January 1, 2023. The ratio of the banking sector's assets to the GDP stood at 54.8 percent as at January 1, 2023.

As at January 1, 2023, the banks' aggregate registered authorized capital amounted to BYN9.1 billion, having increased over 2022 by 38.0 percent.

In 2022, the banking sector maintained sustainability and improved efficiency compared with 2021. As at January 1, 2023, banks' regulatory capital totaled BYN17.5 billion, having raised over 2022 by 25.7 percent. The main source of the regulatory capital growth in the banking sector was an increase in the registered authorized capital and in the funds established at the expense of banks' profit. The regulatory capital/GDP ratio was 9.1 percent.

In 2022, the operating banks' aggregate profit totaled BYN2.1 billion, a 57.6 percent increase compared with 2021 (BYN1.3 billion). Following the growth of profit obtained by banks, their efficiency indicators improved. Thus, on an annual basis, return on assets went up from 1.4 percent to 2 percent, return on regulatory capital – from 10 percent to 13.2 percent.

Banks met the National Bank's requirements for the regulatory capital adequacy, including with account of the values of the conservation buffer. The regulatory capital adequacy ratio totaled 21 percent as at January 1, 2023, with the prescribed minimum requirement for an individual bank being 10 percent (with account of the conservation buffer – 12.5 percent).

Banks met the secure functioning requirements with regard to liquidity. The Liquidity Coverage Ratio (LCR) for the whole of operating banks totaled 180.6 percent as at January 1, 2023, with the prescribed requirement being no less than 100 percent. The Net Stable Funding Ratio (NSFR) for the whole of operating banks totaled 137.6 percent as at January 1, 2023, with the prescribed requirement being no less than 100 percent.

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

In 2022, 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.

In the year under review, in the context of improvement of supervisory requirements and supervisory procedures, the National Bank streamlined approaches to calculation of the values of operational, market and credit risks with a view to determining adequacy of the regulatory capital of banks, JSC "Development Bank of the Republic of Belarus" and non-bank financial institutions (hereinafter, for the purposes of this section – the "banks"), as well as approaches to the calculation of liquidity and other indicators, characterizing the fulfillment of the secure functioning requirements.

As additional secure functioning requirements, the ratios of the open balance sheet and the open off-balance sheet position were established, with the simultaneous cancellation of the ratio of the net open position on forward transactions, as well as the ratio of the total amount of raised obligees' funds was introduced.

As part of the convergence of approaches to the operational risk calculation with the international Basel III standard methodology, on December 1, 2023, the basic indicative approach to calculating the value of operational risk was canceled and the updated standardized approach was introduced as the only one acceptable for use, which is based on the identification of the business indicator and the multiplier of losses from operational incidents.

As part of the improvement of organization of the corporate management system and formation of the efficient system of remuneration and compensation at banks, the National Bank set additional requirements related to the conduct, at least once a quarter, by the Remuneration Committee, in the event of its absence – by the Supervisory Committee (Council of Directors), of the analysis of the remuneration and compensation system as to its compliance with the scale and effectiveness of the bank's activities and its risk profile.

In the year under review, within the framework of improvement of the system preventing money laundering, terrorism financing and financing proliferation of weapons of mass destruction (hereinafter – the "AML/CFT"), the work on the incorporation of the FATF international standards into the legislation of the Republic of Belarus continued with a view to improving the efficiency of the internal control systems at banks, non-bank financial institutions, JSC "Development Bank of the Republic of Belarus", and non-credit financial institutions. The obligation to implement the AML/CFT measures was prescribed for new financial market participants – providers of payment services.

In order to improve the efficiency of the internal control system in the field of AML/CFT, recommendations on identifying illegal activities of individuals with virtual assets were developed and submitted to banks. Based on the results of participation in the International Compliance Council and systematization of the practice of identifying beneficiary owners of clients of financial institutions in the complex (multi-level) corporate structures, the recommendations on the revealing of data on beneficiary owners of clients were prepared and communicated to the entities being under control of the National Bank.

Within the framework of further implementation of a risk-based approach to exercising control over the activities of non-credit financial institutions in the AML/TF sphere, a risk matrix based on indicators developed on the basis of reports submitted to the National Bank and used to improve the efficiency of planning selective audits was introduced.

In the year under review, the National Bank, in the course of plenary events of the Eurasian Group on Combating Money Laundering and Financing of Terrorism (EAG), took part in the defense of the following reports:

- on the regional risk assessment in the field of AML/CFT, the summary of which was communicated to the entities being subordinated to the National Bank in order to update the internal assessment of the risks of money laundering and terrorism financing thereby; and

- on the progress of the Republic of Belarus in implementing into the national legislation of the EAG experts' recommendations made on the basis of the results of the international mutual assessment carried out in 2019.

An active participation was taken in the EAG international researches with regards to the organization of risk-based supervision of non-credit financial institutions and the activities of financial pyramids. Based on the results, relevant reports on legislative approaches implemented in the Republic of Belarus were prepared and submitted.

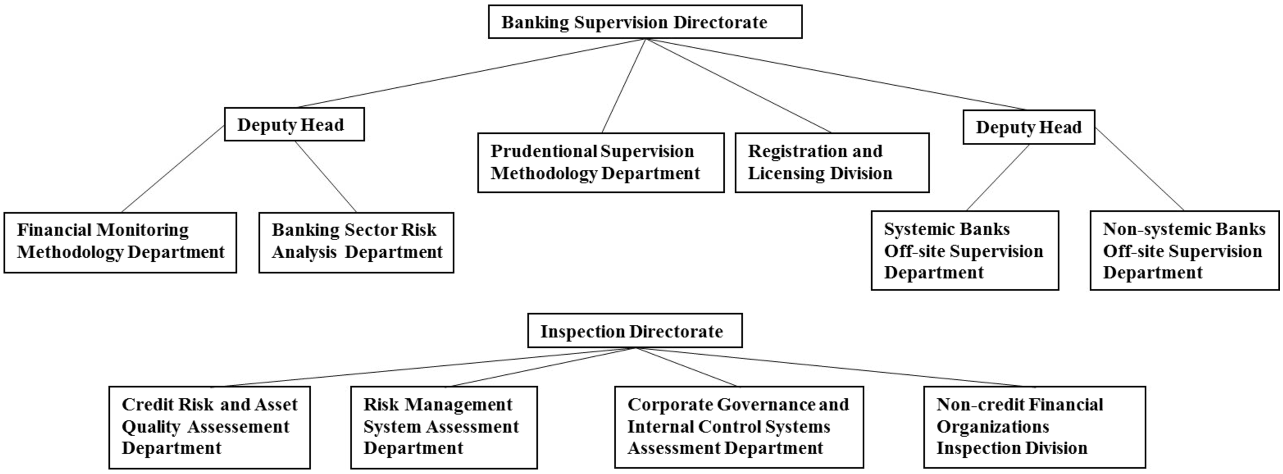
Legal competence of the banking supervisory authority in the country

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, JSC "Development Bank of the Republic of Belarus" and non-bank financial institutions on the basis of reporting and on-site supervision in the form of inspections;
- application of appropriate supervisory response measures to banks, JSC "Development Bank of the Republic of Belarus" and non-bank financial institutions in case of violation of banking legislation thereby or deterioration of their financial condition;
- reorganization and liquidation of banks and non-bank financial institutions;
- systemic analysis of the banking sector's risks; and
- regulation and control in the field of AML/CFT.

Organizational chart of the banking supervisory authority



Main strategic objectives of the supervisory authority in 2022

In 2022, the National Bank's activities were aimed at establishing conditions required for stable growth in well-being and improving the quality of the population's life. With a view to attaining the key target of the state policy of the Republic of Belarus, the National Bank within its competence took measures designed to ensure macroeconomic stability and promote investment activities in the country, establish transparent and comfortable business environment as a basis for enhancing the capacities in increasing the income of Belarusian citizens, as well as to improve social standards and the level of protection of the population in the financial sphere.

Within the framework of the off-site supervision of banks (bank holding companies), non-bank financial institutions and JSC "Development Bank of the Republic of Belarus", the National Bank's activities were aimed at ensuring their stable and secure functioning, protecting the interests of depositors and other creditors, including by means of reducing (limiting) risks accepted by banks.

The activities of the banking supervisory authorities in 2022

In order to reveal the problems in banks' activities at an early stage of their occurrence, the quantitative and qualitative 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, including with account of use by banks of countercyclical measures adopted by the National Bank with a view to providing banks with the opportunity to maintain financial support for the real sector of the economy, were monitored in 2022 on a permanent basis.

A general supervisory assessment of the activities of a number of banks (taking into account the nature, scale and complexity of their activities) over 2021 was carried out, which included a comprehensive assessment of their strategic development, performance efficiency, corporate governance systems, risk management and internal control systems, capital adequacy and liquidity to ensure their safe and stable operation. Based on the results of the assessment, the letters indicating the main deficiencies revealed were submitted to the banks to take remedial actions.

In order to avoid the development of negative trends, resolve or prevent the situations threatening the interests of creditors and other depositors from happening, the early and/or supervisory response measures were taken with respect to banks when violations and drawbacks in the banks' activities were revealed, including those aimed at ensuring their profitable work and stable functioning, improving the systems of corporate governance and risk management, inclusive of the outsourcing and internal control risks, including in the area of AML/CFT, as well as excluding participation of banks in non-core activities. Special attention was paid to the issues of corporate governance in terms of organizing the effective system of remuneration and compensation, as well as the implementation by banks of plans of work with unused real estate.

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. The issuance of licenses for participation of banks in the authorized capital of other legal entities, including banks, was considered with account of the assessment of effectiveness and expediency of such investments.

In 2022, at the suggestion of the National Bank, the systemically important banks carried out the audit of ensuring the integrity, confidentiality, availability and safety of personal data, as well as the information constituting bank secrets of customers, in order to assess their information security. The results of analysis of the reports submitted by banks will be used by the National Bank in assessing the level of operational risk accepted by banks.

International activities

The National Bank carries out work to establish and develop contacts and information exchange with banking supervisory authorities of foreign countries. Of particular interest is cooperation with those countries in which representative offices of Belarusian banks are opened, and with countries, the banks of which have created subsidiaries and representative offices in Belarus.

Currently, 16 bilateral agreements in the field of cross-border banking supervision are concluded by the National Bank. These agreements are focused on the information exchange in the sphere of establishing and licensing the activities of cross-border institutions, supervising their current activities, conducting inspections, making decisions on issuing the permissions to acquire shares in a credit institution in order to effectively perform their functions by banking supervisory authorities and ensure the stable functioning of banking systems.

Also, since 1996, the National Bank has been a member of the Group of Banking Supervisors from Central and Eastern European Countries (BSCEE), which includes banking supervisory authorities of 24 countries.

Cooperation with other supervisory bodies

In carrying out banking supervision functions, the National Bank 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.

Questionnaire tables for the 2022 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	24	23	21
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**24**	**23**	**21**

Total assets of banking sector (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	100.0	100	100
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**
y/y change (in %)	**15.6**	**8.6**	**6.6**

Ownership structure of banks on the basis of assets total

Item	2020	2021	2022
Public sector ownership	64.6	66.5	66.1
Domestic ownership total	68.0	68.2	67.7
Foreign ownership	32.0	31.8	32.3
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2022

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	67.4	76.9	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	2020	2021	2022
Commercial banks	8.86	9.97	13.20
Cooperative banks	-	-	
Banking sector, total:	**8.86**	**9.97**	**13.20**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2020	2021	2022
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)

	2020	2021	2022
Receivables	100.0	100.0	100.0
Financial sector	1.5	2.0	2.2
Nonfinancial sector	74.0	70.0	67.2
Government sector	18.6	20.1	19.4
Other assets	6.0	7.9	11.2
Liabilites	100.0	100.0	100.0
Financial sector	1.8	2.6	2.3
Nonfinancial sector	50.8	51.9	53.4
Government sector	11.0	11.6	9.7
Other liabilities	36.4	33.8	34.6
Capital	**14.1**	**14.7**	**17.9**

Capital adequacy ratio of banks

Type of financial institution	2020	2021	2022
Commercial banks	17.2	17.9	21.0
Cooperative banks	-	-	-
Banking sector, total:	**17.2**	**17.9**	**21.0**

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

Asset classification	2020	2021	2022
Non-financial sector, including	4.83%	5.30%	4.91%
- households	0.18%	0.13%	0.14%
- corporate	4.65%	5.17%	4.67%

The structure of deposits and loans of the banking sector in 2022 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	79.7	61.9
Households	45.0	27.3
Corporate	34.7	34.6
Government sector	14.2	34.3
Financial sector (excluding banks)	6.1	3.8
Total	**100.0**	**100.0**

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

P&L account	2020	2021	2022
Interest income	1725.0	2170.4	2 939.6
Interest expenses	808.5	1132.8	1 605.6
Net interest income	916.5	1037.6	1 334.0
Net fee and commission income	429.6	552.7	579.5
Other (not specified above) operating income (net)			
Gross income	6483.5	7332.1	11 780.1
Administration costs			
Depreciation			
Provisions	424.5	303.7	602.1
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)			
Profit (loss) before tax	390.2	565.6	900.0
Net profit (loss)	321.0	461.7	719.4

Total own funds in 2022 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	6 004.9	5012.0	5013.1	991.9	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**6 004.9**	**5012.0**	**5013.1**	**991.9**	**-**

Macroeconomic environment in the country

According to the information of the BiH Agency for Statistics[1], the nominal gross domestic product (GDP) in BiH in 2022 had a nominal value of BAM 45.5 billion. The nominal increase of GDP in relation to 2021 was 16.2% while real increase was 4.1%. GDP deflator for 2022 was 11.6%. Regarding the activities the significant nominal increase of the gross value added was recorded in: accommodation and food service activities; administrative and support service activities; arts, entertainment and recreation. GDP per capita amounted 13,263 BAM/6,781 EUR or 7,130 USD[2].

Average trend of the production price index in BiH in 2022 went up by a total of 30.7%[3] compared to the base average. The average annual inflation in BiH in 2022 vs. 2021 stood at 14%.[4]

The banking system in BiH is liquid, well capitalized and profitable. The balance sheet total of the BiH banking sector has been posting a continuous increase over the course of 2022, thus reaching a value of BAM 36.9 billion at the end of 2022. This represents an increase of 4.2% compared to the same period the year before. In 2022, there was an increase of assets, cash, loans, deposits and capital - all compared to the same period of the previous year. The share of non-performing loans (as a key indicator of loan quality) in total loans was reduced. Total loans in 2022 stood at BAM 22.3 billion and this total loan growth of the BiH banking system of 3.3% vs. the year before was mostly affected by the increase of loans approved to the households segment. Total deposits of the BiH banking system in 2022 amounted to BAM 30.0 billion, whereas the biggest contribution to the total deposit increase of 4.7% vs. the previous year came from non-financial private companies deposits. The BiH banking system, whose operations fall under the competency of the two state entity level banking agencies, posted a net profit of BAM 500.7 million. In late 2022, return on average assets (ROAA) equaled 1.6% and return on average equity (ROAE) at 12.0%.[5]

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

As of 31.12.2022, there were 13 commercial banks operating in the FBIH with 509 organizational parts and a total of 6,410 employees. Compared to the end of the previous year, there was an increase in net assets, cash, loan portfolio, investments in securities, placements to other banks, deposits and total capital. The share of non-performing loans in total loans, as a key indicator of asset quality, recorded a decrease compared to the end of the previous year, with an increase in the rate of coverage of non-performing loans by value adjustments to cover for expected credit losses. As of 31.12.2022, 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 27.2 billion, up by BAM 1.3 billion or 5.1% vs. YE2021. The share of total assets of the FBiH banking sector vs. the GDP in FBIH[6] was 92.7%.

Total capital as of 31.12.2022 equaled BAM 3.2 billion (shareholder capital amounting to BAM 1.6 billion), thus going up by 4.2% vs. 2021. Regulatory capital was BAM 2.9 billion and increased by BAM 73.7 million, or 2.6% compared to the end of 2021. The own funds rate of the FBiH banking sector as of 31.12.2022 was

1 BIH Agency for Statistics, Press release regarding gross domestic product in BIH – initial results, July 2023
2 BIH Agency for Statistics, Press release regarding gross domestic product in BIH – initial results, July 2023
3 BIH Agency for Statistics, industrial production price index in BIH in 2022, Thematic bulletin No. 12
4 BIH Agency for Statistics, consumer price index in BIH in 2022, Thematic bulletin No. 09
5 Central Bank of BIH, statistical web portal, Financial soundness indicators of the banking sector and Basic information on the banking sector
6 FBIH Statistics Bureau, Press release regarding the annual gross domestic product for the Federation of BIH, 2022 - initial results, July 2023

19.4%, which is by 0.3 percentage points lower than as at YE2021, i.e. by 7.4 percentage points above the 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 31.12.2022 was 9.8%, which is lower by 0.3 percentage points compared to the end of 2021 (prescribed minimum being 6%).

Loans, holding a share of 60.7% in total assets, posted a rise against the end of 2021 of BAM 622.2 million or 3.9%, thus arriving to the figure of BAM 16.5 billion as of 31.12.2022. Corporate loans went up by 213.1 million or 2.6%, reaching BAM 8.5 billion of 31.12.2022 and holding 51.4% share in total loans. Over the same period, household loans achieved an increase by BAM 409.0 million or 5.4%, thus holding a share in total loans of 48.6%. Their amount as of 31.12.2022 was BAM 8.0 billion. NPLs amounted BAM 798.9 million, thus constituting 4.8% of the total loan portfolio, down by 1.6 percentage points vs. YE2021. The share of corporate NPLs in total corporate loans was 5.0%, while the share of household NPLs in total household loans was 4.6%.

Cash funds amounted to BAM 8.2 billion and represented 30.3% of total assets, up by BAM 251.4 million or 3.1% vs. YE2021.

The FBiH banking sector's deposits reached a value of BAM 25.4 billion, thus going up by BAM 1.3 billion or 5.9% and represented 82.5% of total liabilities. Savings deposits, as the most significant and the biggest segment of the deposit and financial potential of banks, decreased by BAM 136.5 million or 1.3% to BAM 10.3 billion.

As of 31.12.2022 (based on final unaudited reporting data), the FBiH banking sector posted a positive financial result - profit of BAM 361.4 million, which is higher by BAM 67.8 million or 23.1% than in the same period in 2021.

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 2022):

In the process of the FBA regulatory activities related to preparation of regulations, the following decisions were adopted in 2022:

- **FBA Decisions and Instructions related to the operations and supervision of the banks, micro credit organisation and leasing companies:**
  - Decision on Amendments to the Decision on Recovery Plans of Bank and Banking Group[7],
  - Decision on the Amendments to the Decision on Requirements for Consolidated Banking Group[8],
  - Decision on Amendments to the Decision on Reports Banks Deliver to the Banking Agency of the Federation of Bosnia and Herzegovina according to Standardised Regulatory Reporting Framework (COREP)[9],
  - Decision on Amendments to the Decision on Reports Banks Deliver to the Banking Agency of the Federation of Bosnia and Herzegovina for Supervisory and Statistical Purposes[10],

[7] FBiH Official Gazette Nos. 81/17, 48/21 and 26/22
[8] FBiH Official Gazette Nos. 81/17 and 43/22
[9] FBiH Official Gazette Nos. 86/20, 61/21 and 103/22
[10] FBiH Official Gazette Nos. 86/20, 43/22 and 103/22

- Decision on Outsourcing Management in Bank[11],
- Decision on Temporary Measures to Mitigate the Risk of an Interest Rate Increase[12],
- Decision on Amendments to the Decision on External Audit and Contents of a Bank Audit[13],
- Instructions for Classification and Valuation of Financial Assets,
- Instructions for Appraisal of Market Value of Collateral,
- Instructions for Reporting on Information System Management,
- Instructions for Completing the Report on the Volume of Currency Exchange Deals and Domestic and International Payments,
- Instructions for Completing Supervisory and Statistical Reports for Banks,
- Instructions for Reporting on Implementation of the Decision on Temporary Measures to Mitigate the Risk of an Interest Rate Increase.

• **FBA Decision related to bank resolution:**

- Methodology of the Banking Agency of the Federation of Bosnia and Herzegovina for Determination of the Minimum Requirement for Own Funds and Eligible Liabilities in Bank[14],
- Guidelines for the Resolution Planning - expectations from banks[15].

B) Legal competences of the FBA:

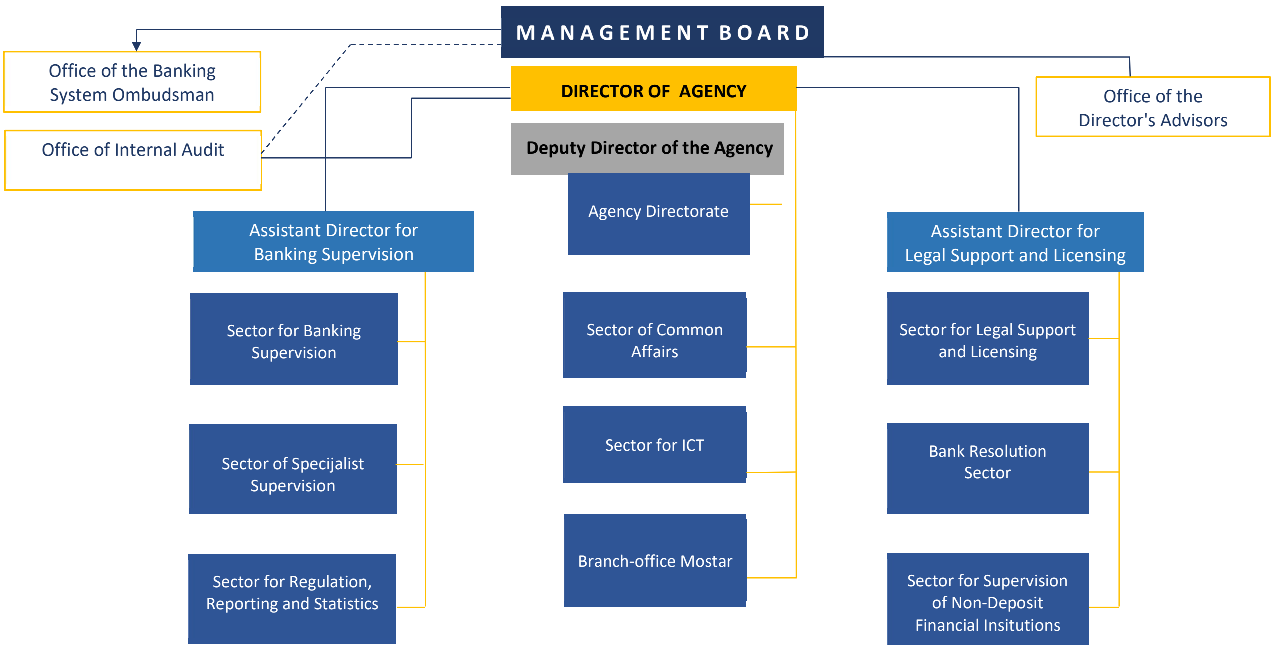
Pursuant to the Law on the Banking Agency of the Federation of BiH, the competences of the FBA are the following:

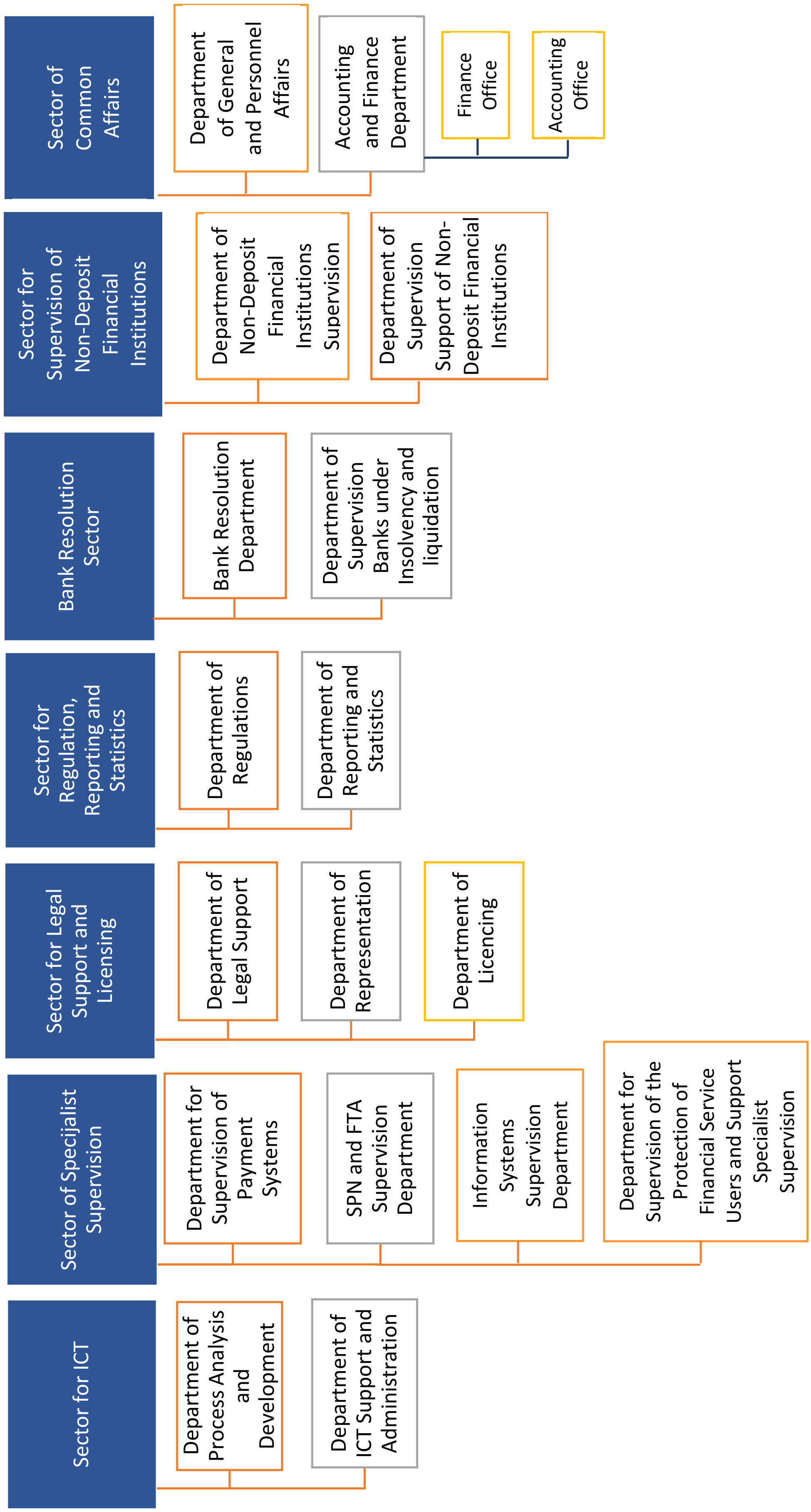
• identifying and performing activities and measures to maintain and strengthen the banking system stability,
• establishing, enforcing and supervising prudential rules regulating the operations of the banking system entities (banks, banking groups, development banks, microcredit organisations, leasing 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,

11 FBiH Official Gazette No. 75/22
12 FBiH Official Gazette No. 79/22
13 FBiH Official Gazette Nos. 81/17 and 26/22
14 FBiH Official Gazette No. 26/22
15 FBiH Official Gazette No. 75/22

- 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.

Organizational chart of the Banking Supervisory Authority





Sector of Common Affairs
Department of General and Personnel Affairs
Accounting and Finance Department
Finance Office
Accounting Office
Sector for Supervision of Non-Deposit Financial Institutions
Department of Non-Deposit Financial Institutions Supervision
Department of Supervision Support of Non-Deposit Financial Institutions
Bank Resolution Sector
Bank Resolution Department
Department of Supervision Banks under Insolvency and liquidation
Sector for Regulation, Reporting and Statistics
Department of Regulations
Department of Reporting and Statistics
Sector for Legal Support and Licensing
Department of Legal Support
Department of Representation
Department of Licencing
Sector of Specijalist Supervision
Department for Supervision of Payment Systems
SPN and FTA Supervision Department
Information Systems Supervision Department
Department for Supervision of the Protection of Financial Service Users and Support Specialist Supervision
Sector for ICT
Department of Process Analysis and Development
Department of ICT Support and Administration

Main strategic objectives of the Banking Supervisory Authority in 2022

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:

- monitoring the risk profile and capital position of all banks, to include also fulfillment of capital requirements as a result of the SREP process;
- monitoring the interest rate increase and its impact on the banking sector and taking measures to mitigate the effects and monitoring implementation by banks of the Decision on Temporary Measures to Mitigate the Risk of Interest Rate Increase (through onsite and off-site examinations);
- continuation of activities on further alignment of the regulatory framework with the EU's regulatory framework, as a step of the BiH preparations on the accession path to the EU;
- examining dominant risk segments of operations, examining banks holding systemic relevance over development of lending activities and sustainability of long-term funding sources of banks with concentrations of large savings and other deposits, as well as examining banks' actions in the segment of protection of financial service users and guarantors, etc.;
- strengthening bank capital;
- control of implementation of the Decision on Credit Risk Management and Determination of Expected Credit Losses, including also an analysis of internal models for credit risk parameters assessment;
- monitoring implementation of strategies related to handling non-performing exposures and annual business plans of banks having NPL share in total loans above 5%
- systemic monitoring of bank's activities on application of AML/CFT standards and enhancing cooperation with other competent institutions in this segment;
- continued cooperation with competent supervisory authorities for the supervision of banking groups from the EU and third countries whose members are seated in the FBIH, with a view to supervising more efficiently and improving supervisory practices and cooperating and sharing information with the ECB and EBA on the issues of supervision and banking regulations, as well as with the international financial institutions. FBA continued improving cooperation by signing new cooperation agreements with relevant institutions in B&H, which are included in the institutional framework for the performance of supervision, crisis and systemic risk management, financial users' protection.

The activities of the Banking Supervisory Authority in 2022

FBA's activities in 2022 focused on the following:

- mitigation of risks related to the consequences of the Russian-Ukrainian crisis, which resulted in the announcement of sanctions, relating to capital and banks associated with the Russian Federation. FBA undertook key activities within its authorities, which resulted in the adoption of adequate supervisory measures, the appointment of an external administrator, and the initiation of resolution proceedings over Sberbank BH d.d. Sarajevo, which was successfully completed, thus ensuring the continuity of key functions, avoiding adverse effects on financial stability and the financial system, and ensuring the protection of depositors, funds and assets of its customers,
- mitigating the risks arising from the growth of reference interest rates in the EU, but also the risks that may arise from the general growth of interest rates on the BiH market. FBA has adopted temporary measures to mitigate the risk of rising interest rates, with the aim of timely management of credit risk, the allocation of additional reserves for expected credit losses and mitigating the consequences of a potentially significant increase in debt repayments, i.e. protecting users of financial services,

- continuation of activities to maintain an appropriate level of equivalence with the EU regulatory framework. This entailed the development of Strategic priorities for maintaining the equivalence of banking regulations with the EU regulatory framework for the period 2022-2026 with the aim of maintaining the status of a "third country",
- revising the reporting regulations, regulations from the segment of external audit and audit content in the bank, as well as regulations related to bank and banking group recovery plans, as well as ICAAP and ILAAP in banks,
- development of the document - Strategic priorities in the management and supervision of climate-related and environmental risks in the banking sector for the period 2023-2025, and preparatory activities on the development of a regulation that will define the rules for managing climate-related and environmental risks,
- supervisory action in accordance with the standardised SREP methodology,
- preparation for the second cycle of supervisory stress testing of banks' solvency,
- strengthening the internal governance system in the bank.

International activities of the authority

FBA continued its activities to strengthen and improve cooperation with 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.

FBA exchanges information and participates in supervisory colleges for banks whose banking groups are seated in Slovenia, Austria, and Germany. Improving cooperation with supervisory authorities (ECB, FMA, Bank of Slovenia, BaFin and Croatia National Bank) 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. In 2022 FBA and the Single Resolution Board (SRB) signed Cooperation Agreement on the exchange of information and cooperation in connection with the Resolution planning and the implementation of such planning with respect to Entities with cross-border operations.

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. FBA submit to the CBBH the data necessary for the calculation of top-down 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). Also, cooperation with the CBBH is continued in the segment of supervisory stress testing (conducted by the Agency).

Cooperation has continued with the BARS and DIA (Deposit Insurance Agency) in the form of regular exchange of information and joint actions, and with the BARS in the part of creation new regulations, which includes cooperation with the entity's ministries of finance. FBA continued the exchange information and the presentation of key SREP findings and assessments for banking groups that have banking subsidiaries in the territory of both entities, with the aim of effective coordination, cooperation, and joint action with the BARS. In the part of drafting the new regulation and further harmonization with the EU regulatory and supervisory framework, the entity's banking agencies have a joint and coordinated action in terms of the formation of joint working groups. The new Memorandum of Understanding and Cooperation between the entity banking agencies and DIA was signed in January 2023. In 2022, 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 2022

FBA, together with the BARS continued cooperation with the World Bank FinSAC in a segment of climate and environmental risks, further harmonization with CRR2/CRD IV and preparation of instructions for the development of strategies and operational plans for dealing with non-performing exposures as well as education for supervisors. USAID FINRA project ended in September 2022.

The FBA continued its active participation in the Program for Strengthening the Capacity of Central Banks in the Western Balkans with a view to the integration to the European System of Central Banks, Phase II (ESCB project), along with an aim to improve the alignment of national regulatory frameworks with the European and international standards. In September 2022, Deutsche Bundesbank, together with the 19 national central banks of the European System of Central Banks (ESCB) and the European Central Bank (ECB), relaunched an EU-funded program in favor of the following beneficiary institutions: the Bank of Albania, the Central Bank of Bosnia and Herzegovina, the Banking Agency of the Federation of Bosnia and Herzegovina, the Banking Agency of the Republic of Srpska, the Central Bank of the Republic of Kosovo, the Central Bank of Montenegro, the National Bank of the Republic of North Macedonia and the National Bank of Serbia. Until 2025, the Bundesbank, together with partner central banks and with input from the ECB, will organize an intensive regional training program on key issues related to central banks and bank supervision. A special focus of the training will be on the areas of combating money laundering, banking supervision, financial stability, protection of users of financial services and financial inclusion, bank restructuring, communications, financial markets, information technologies, monetary policy research, payment systems, statistics, EU integration, politics management, accounting and internal audit. In addition, three policy workshops will be held for decision makers on payment systems, cash handling and governance. Furthermore, apart from regional trainings, the program will support the implementation of specific bilateral measures.

Questionnaire tables for the 2022 BSCEE Review

Number of financial institutions
(at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	15	14	13
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**15**	**14**	**13**

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

Type of financial institution	2020	2021	2022
Commercial banks	24.396.438	25.890.829	27.199.283
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**24.396.438**	**25.890.829**	**27.199.283**
y/y change (in %)	**2020/2019 Index 101 (+1%)**	**2021/2020 Index 106 (+6%)**	**2022/2021 Index 105 (+5%)**

Ownership structure of banks on the basis of assets total

Item	2020	2021	2022
Public sector ownership	3,6	4,1	3,9
Domestic ownership total	6,7	6,8	13,3
Foreign ownership	89,7	89,1	82,8
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2022

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	53,1	70,3	1.315
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**53,1**	**70,3**	**1.315**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2020	2021	2022
Commercial banks	5,8	9,3	12,0
Cooperative banks	-	-	-
Banking sector, total:	**5,8**	**9,3**	**12,0**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2020	2021	2022
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)

	2020	2021	2022
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**

Capital adequacy ratio of banks

Type of financial institution	2020	2021	2022
Commercial banks	19,1***	19,7***	19,4***
Cooperative banks	-	-	-
Banking sector, total:	**19,1*** **	**19,7*** **	**19,4*** **

*(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	2020	2021	2022
Non-financial sector, including	6,8	6,9	5,1
- households	6,0	5,8	4,6
- corporate	7,7	8,1	5,6

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

The structure of deposits and loans of the banking sector in 2022 (%) (at year-end)

	Deposits	Loans	
Non-financial sector, including:	81,6	98,0	
Households	48,6	50,6	
Corporate	33,0	47,4	
Government sector	14,6	1,5	
Financial sector (excluding banks)	3,8	0,5	
Total	**100.0**	**100.0**	

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

P&L account	2020	2021	2022
Interest income	698.808	688.459	673.528
Interest expenses	130.227	120.198	92.886
Net interest income	568.581	568.261	580.642
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	1.035.059	1.098.649	1.190.021
Administration costs	257.639	259.673	262.807
Depreciation	n/a	n/a	n/a
Provisions	182.004	75.703	79.112
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	187.250	327.077	395.807
Net profit (loss)	174.265	293.560	361.381

Total own funds in 2022 (in 000 EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	1.496.327,9***	1.422.750,4***	1.422.750,4***	73.577,5***	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**1.496.327,9*** **	**1.422.750,4*** **	**1.422.750,4*** **	**73.577,5*** **	**-**

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

Macroeconomic environment in the country

The business operations of the Republika Srpska banking sector during 2022 were marked by events on the geopolitical scene, especially in the first half of the year (conflict in Ukraine), which consequently had a negative impact on Russian-owned banks. Economic risks have risen sharply in many countries, as well as inflation, fueled by a combination of rising energy, food, and consumer goods prices.

Global financial conditions are somewhat softened by market expectations, despite huge economic uncertainty, and the continued tightening of monetary policy in the fight against inflation, which is still at a high level.

GDP of Republika Srpska in 2022 was 7,4 billion EUR which is a significant 15,6% higher than in previous year. The overall index of consumer prices in Republika Srpska, in 2022 compared to the previous year, is higher by 13,6%. The average net salary paid-out in 2022 was 584,9 EUR and has increased by 13,9 % compared to the previous year.

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

The banking sector of Republika Srpska in 2022 had a total gross financial asset in the amount of 5,1 billion EUR which is higher by 1,8% compared to the previous year. Total deposits also recorded growth of 1,3% compared to 2021. The profitability of the RS banking sector during 2022 was growing by 20% compared to the previous year. ROA and ROE maintained values above those generated in the previous year. Analyzing the operations of the RS banking sector, it is evident that after the period marked by the pandemic and geopolitical events, in the second half of 2022 there was a recovery in credit growth.

Banks in the Republika Srpska are traditional commercial banks, as in most countries in the region, they have traditional and conservative business policies and are subject to strict regulatory criteria. The responsible behavior of banks in accordance with the measures adopted by the Agency in earlier period, related to mitigating the consequences of Covid-19 and consequences caused by conflict in Ukraine and global financial conditions, resulted in preserving the liquidity and stability of the banking sector. Indicators of capital adequacy and liquidity of the banking sector are favorable, above prescribed regulatory minimum, and indicate high resistance of the banking sector to external shocks.

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 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.

Prudential regulation governing the operations of banks issued by the Banking Agency of Republika Srpska (BARS) in 2022:

- Decision on amendments to the decision on calculating capital in banks,
- Decision on amendments to the decision on liquidity risk management,
- Decision on amendments to the decision on recovery plans of a bank and a banking group,
- Decision on amendments to the decision on conditions and procedure for issuing licenses, approvals and consents to banks operating in Republika Srpska,
- Decision on supplement of the decision on internal liquidity coverage adequacy assessment process in a bank,

- Decision on repealing the decision on temporary measures in terms of delivering reports to the Banking Agency of Republika Srpska,
- Decision on repealing the decision on temporary measures of banks to mitigate negative economic consequences caused by the "COVID-19" viral disease,
- Decision on amendments to the decision on outsourcing management,
- Decision on amendments to the decision on management system in a bank,
- Decision on amendments to the decision on the form and content of reports banks deliver to the Banking Agency of Republika Srpska,
- Decision on content, deadlines and method of delivering data on interbanking charges,
- Decision on determining the list of most representative services regarding payment account,
- Decision on determining the content of informative overview of services and charges regarding payment account,
- Decision on determining the form and content of report on service charges regarding payment account,
- Decision on temporary measures to mitigate the risk of interest rate increases.

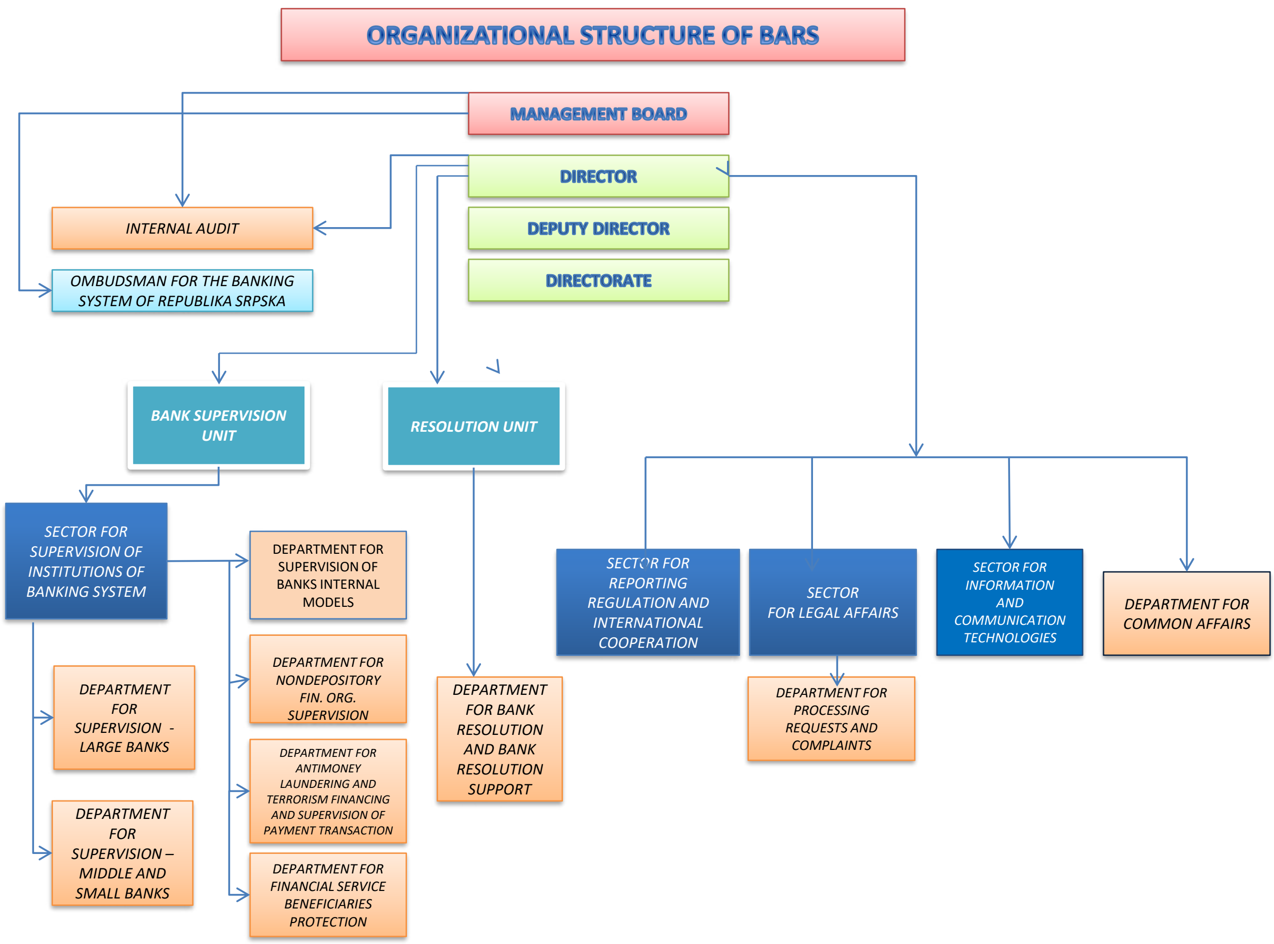
Prudential regulation issued by the BARS in the **field of bank resolution** in 2022:

- Decision on amendments to the decision on manner of conducting inspection and imposing measures for the purpose of performing tasks and objectives from the competences of bank resolution.

Prudential regulation governing the operations of microcredit organizations (MCO) issued by the BARS in 2022:

- Decision on amendments to the decision on requirements and procedure for the issuance of operating license to microcredit organizations, organizational units of microcredit organizations from the federation of BiH, District Brcko, and foreign microcredit organizations in Republika Srpska,
- Decision on conditions and procedure of issuance of consents for founding acts of microcredit organizations,
- Decision on amendments to the decision on a uniform method of calculating and disclosing the effective interest rate on microloans.

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Banking Supervisory Authority in 2022

Main objectives of the BARS in 2022 were:

- preserving the liquidity and further promoting and ensuring financial stability,
- effective supervision,
- digitalization of finance,
- supporting the banking sector in the process of including risks related to climate change in internal risk management systems,
- implementation and further development of a regulatory framework that is aligned with EU directives and Basel standards,
- active role in supervision and protection of financial services consumers' rights,
- further cooperation between competent banking supervision authorities, and domestic and international institutions.

The activities of the Banking Supervisory Authority in 2022

In 2022 the BARS activities were aimed at maintaining the stability and improvement of the quality and legality of the RS banking system operations, based on continuous supervision of banks, microcredit organizations and leasing companies.

As a reaction to the economic challenges, one of the most important activities of the Agency in 2022 is related to the successful restructuring of "Sberbank". The Agency undertook key activities within its competences that are regulated by legal acts, i.e., initiated restructuring procedure of "Sberbank", which managed to preserve the stability of the financial system, as well as protection of clients' and depositors' funds. Today, the bank is successfully operating under the name "Atos Bank". The entire process conducted by the Agency in the case in question is completely identical to the process conducted in neighboring countries that faced the same problem.

In order to mitigate the risks resulting from the general increase in interest rates on the market, in 2022 the Agency adopted a **Decision on temporary measures to mitigate the risk of interest rate increases.** Primary objectives of the decision in question are mitigation of the active interest rates growth, protection of users of banking services who would pay borrowed funds at increased interest rates, and the stability of the banking sector in terms of the impact of the decision on the adequate coverage of loans with reserves for the potentially increased risk of the inability to service the debt.

In addition, a special attention was also dedicated to further development of regulatory and reporting framework in line with EU directives and Basel standards, with special emphasis on alignment with the capital requirements directive - (CRD 5) and the capital requirements regulation (CRR 2). BARS adopted the document **Strategy of priority activities for maintaining equivalence of banking regulations with EU regulations for the period 2022-2026**. The Strategy contains a plan of future amendments to regulations necessary to maintain the status of equivalence of banking regulations with the EU regulatory framework.

Agency adopted the document **Strategic Framework for the Management and Supervision of ESG Risks in the Banking Sector for the period 2023-2025** which will be the basis of future activities in this segment. Strategic framework contained in this document reflects an effort to initiate the necessary activities to determine future regulatory and supervisory requirements for the assessment, management, and control of climate risks to which banks are exposed or may be exposed.

During 2023, the minimum requirement for capital and eligible liabilities (MREL) will be established and become binding for all banks, thereby further promoting, and ensuring financial stability.

The BARS continued to supervise 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 financial organizations under its authority. The BARS activities were primarily aimed towards strengthening the capital base and improving the management of credit and liquidity risk.

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 2022, the BARS continued with its 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.

The Agency continues to be part of the European Commission project **Strengthening the capacities of the central banks and banking agencies of the Western Balkans with the aim of integration into the European system of central banks**, which aims to strengthen monetary and financial stability in the Western Balkans region and improve the alignment of national regulatory frameworks with European and international standards.

During 2022 the **technical assistance from World Bank** (Vienna Financial Sector Advisory Centre (FinSAC) Technical Assistance Mission) took place, ensuring further development of the BARS capacities in the segment of management of ESG risks and NPL management.

In 2022, activities were also initiated to provide **technical assistance to the Agency by the Deutsche Bundesbank**. As part of this bilateral cooperation, significant benefits are expected in the form of the transfer of experience of Deutsche Bundesbank experts, primarily in the areas of off-site supervision.

In addition to the above, the Agency continued cooperation within the framework of the Vienna initiative, which provides support to regulators from the region with the aim of improving cooperation with regulators from the EU, and in 2022, the focus was on environmental risk management.

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 subcommittees between Bosnia and Herzegovina and the European Union.

Cooperation with other supervisory bodies in the country

The BARS continued to cooperate with other BiH supervisory authorities, primarily Banking Agency of the Federation of Bosnia and Herzegovina through regular contacts and exchange of relevant information, participation of representatives of the BARS at the supervisory colleges, etc.

In 2022 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.

Other relevant information and developments in 2022

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

Questionnaire tables for the 2022 BSCEE Review

All finacial figures are in '000 EUR, unless stated otherwise.

Number of financial institutions
(at year-end)

Type of financial institution	2020	2021	2022
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)

Type of financial institution	2020	2021	2022
Commercial banks	4,544,976	5,057,852	5,148,725
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**4,544,976**	**5,057,852**	**5,148,725**
y/y change (in %)	**2020/2019 Index 102(+2%)**	**2021/2020 Index 111(+11%)**	**2022/2021 Index 102(+2%)**

Ownership structure of banks on the basis of assets total

Item	2020	2021	2022
Public sector ownership	0	0	0
Domestic ownership total	36,1	37,0	50,0
Foreign ownership	63,9	63,0	50,0
Banking sector, total:	**100,0**	**100,0**	**100,0**

Concentration of asset by the type of financial institutions, 2022

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	63,8	84,4	1,762
Branches of foreign credit institutions	-	-	
Cooperative banks	-	-	
Banking sector, total:	**63,8**	**84,4**	**1,762**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2020	2021	2022
Commercial banks	5,1	10,4	11,9
Cooperative banks	-	-	-
Banking sector, total:	**5,1**	**10,4**	**11,9**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2020	2021	2022
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)

	2020	2021	2022
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, Loans and deposits structure is given in a table below*

Capital adequacy ratio of banks

Type of financial institution	2020	2021	2022
Commercial banks	19,3	19,2	20,2
Cooperative banks	-	-	-
Banking sector, total:	**19,3**	**19,2**	**20,2**

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

Asset classification	2020	2021	2022
Non-financial sector, including	5,2	4,0	3,7
- households	5,1	3,9	3,4
- corporate	5,5	4,0	4,0

The structure of deposits and loans of the banking sector in 2022 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	82,3	89,5
Households	55,5	50,5
Corporate	26,8	39,0
Government sector	13,5	9,5
Financial sector (excluding banks)	4,2	1,0
Total	**100,0**	**100,0**

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

P&L account	2020	2021	2022
Interest income	150,696	157,569	168,499
Interest expenses	30,057	29,624	25,734
Net interest income	120,638	127,945	142,765
Net fee and commission income	-	-	-
Other (not specified above) operating income (net)	-	-	-
Gross income	204,936	225,083	255,048
Administration costs	122,600	125,634	127,538
Depreciation	-	-	-
Provisions	-	-	-
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	35,227	12,785	22,916
Profit (loss) before tax	29,071	63,738	78,177
Net profit (loss)	26,999	59,030	71,220

Total own funds in 2022 (in 000 EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	556,247	529.735	532,799	23,448	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**556,247**	**529.735**	**532,799**	**23,448**	**-**

Macroeconomic environment in the country

Bulgaria's real GDP growth was 3.4% in 2022, with private consumption making the largest positive contribution, supported by higher wage growth than inflation, strongly negative real interest rates on loans and deposits, and increased net fiscal transfers to households. The reported economic growth had a favourable impact on the labour market, as the number of persons employed and the economic activity rate increased, while the unemployment rate declined. Wage growth tended to accelerate significantly in 2022, driven by stronger labour demand amid rising labour shortages and elevated inflation expectations. In nominal terms, compensation per employee for the total economy rose by 18.4% in 2022, and in real terms by 4.6%.

Annual inflation in Bulgaria, measured by the HICP, accelerated to 14.3% in December 2022 (from 6.6% in December 2021). The most significant upward pressure on consumer prices came from price rises in major energy sources and agricultural products in international markets. Main factors related to the internal macroeconomic environment that contributed to the high inflation throughout 2022 included strong growth in unit labour costs and higher household consumption.

In the context of retained robust inflows of attracted funds, high liquidity and bank competition, the transmission of ECB monetary policy changes to the deposit and lending rates in Bulgaria was very limited. Annual credit growth remained high in 2022. Loans to non-financial corporations followed an accelerated upward trend in the first eight months of the year, driven by the strong demand for financial resources for working capital and accumulation of inventories due to the significant increase in raw material prices, supply chain bottlenecks and the heightened uncertainty in the economic environment. The reported decline in inventories in the economy after the high levels reached in the first half of 2022 contributed to some decline in corporate credit growth, its rate reaching 10.4% in December (4.6% in December 2021). Higher wage growth relative to inflation and strong negative real interest rates supported demand for consumer and housing loans. Growth in housing loans (by 17.8% as of December 2022 compared with 16.5% at the end of 2021) reflected also households' maintained preferences for real estate purchases as an alternative form of saving or investment. In December 2022, consumer loans increased by 12.4% year on year (12.2% at the end of 2021).

Development in the banking sector (including assets total / GDP)[1]

In 2022 Bulgaria's banking sector operated in a context of accelerated inflation and heightened uncertainty in the economic environment caused by the war in Ukraine. Against the backdrop of strongly negative real interest rates, a significant volume of attracted funds and high liquidity in the banking system, annual growth of loans and total assets in the banking sector accelerated in 2022, while non-performing loans and advances in bank balance sheets declined. Total amount of risk exposures increased, whereas banking sector's capital ratios remained significantly above the minimum regulatory requirements and capital buffer requirements. Banking liquidity position remained stable and deposits continued growing at high rates. Over the period under review, the volume of non-performing loans and advances and their share in total loans and advances continued to decrease, reflecting non-performing loan sales and write-offs and growing credit portfolio. Following the increase in banking sector activity and the change in the global interest rate cycle, banking system net operating income and profit rose compared to 2021. Banks' return on assets and return on equity indicators improved compared to 2021 to 1.34% and 12.01% respectively (against 0.99% and 8.11% as of 31 December 2021).

[1] Based on supervisory statements on an individual basis as of end-December 2021 submitted by 17 February 2022 and as of end-December 2020 revised by 24 February 2022.

In 2022 the consolidation process in the Bulgarian banking sector continued. At its meeting of 29 June 2022, the BNB Governing Council granted a preliminary approval for the direct acquisition by KBC Bank NV, Belgium of the shares in the capital of Raiffeisenbank (Bulgaria) EAD[2].

In 2022 the total assets of the banking system were BGN 155.4 billion (or 94.0% of GDP[3]), they increased by 14.8% (BGN 20.1 billion) – higher than the growth reported for 2021 (9.3%, BGN 11.5 billion). Loans and advances increased by 17.8% (BGN 14.0 billion) and their share in the total assets reached 59.6% (58.1% in 2021). The share of „cash, cash balances at central banks and other demand deposits" was 20.9%, while debt securities held a 15.2% share in the balance sheet (21.0% and 16.3%, respectively, at the end of 2021).

The amount of debt securities in the balance sheet of the banking system reached BGN 23.6 billion at the end of 2022, owing to the increase of sovereign debt instruments by BGN 1.5 billion (7.8%).

Loans and Deposits

At the end of 2022, the share of banks' loan portfolio[4] in total banking system assets was 53.2 percent. Based on data from supervisory reports in 2022 the gross loan portfolio increased by BGN 10.3 billion (13.5%), amounting to BGN 86.1 billion. Gross loans to non-financial corporations grew by BGN 4.7 billion (11.6%) ad their share in the loan portfolio was 52.2%. Loans to households rose by BGN 4.5 billion (15.2%), while their share was 39.4%.

In the currency structure of gross loans and advances in 2022 those denominated in BGN were 63.2% of the total, while claims in EUR and in other currencies were 33.3% and 3.5%, respectively.

The deposits in the banking system increased by BGN 18.7 billion (16.2%), totalling BGN 134.1 billion at the end of 2022. Deposits of non-financial corporations grew by BGN 8.8 billion (25.8%) and amounted to 32.2% of the total. Deposits of households rose by BGN 6.2 billion (9.1%), while their share was 55.4%.

Market structure

At the end of 2022, there were a total of 25 credit institutions and foreign branches, of which one was a state-owned bank. Five banks[5] were classified as significant institutions (SIs), under the direct supervision of the ECB, with a 67.0% share of the total assets in the local banking system. The remaining thirteen credit institutions were classified as less significant (LSIs), with a 29.6% share in the total assets, while the share of foreign bank branches was 3.4%. Less significant institutions and branches of foreign banks stay under the supervision of the BNB.

Asset quality

During 2022, gross non-performing loans and advances in the banking system decreased by BGN 441 million (9.0%) to BGN 4.4 billion at the end of the year. The gross loans and advances in the banking system amounted to BGN 96.1 billion by end-2022 and the share of non-performing loans[6] decreased to 4.6% (5.9% a year

[2] On 14.07.2022, a change has been registered in the Commercial Register of Registry Agency concerning the ownership of Raiffeisenbank (Bulgaria) EAD, by which the new sole owner of the equity of the bank becomes KBC Bank NV, Belgium. Effective from this date, the name of Raiffeisenbank (Bulgaria) EAD has been changed to KBC Bank Bulgaria EAD.

[3] Based on NSI data on GDP for 2022 at current prices.

[4] Loan portfolio includes the sectors of non-financial corporations, households, other financial corporations and the general government.

[5] As part of the close cooperation process between the BNB and the ECB pursuant to Decision (EU) 2020/1015 of the ECB of 24 June 2020 on 11 September 2020 the ECB announced the list of banks in Bulgaria which are subject to direct supervision by the ECB as from 1 October 2020. These credit institutions are UniCredit Bulbank, DSK Bank, United Bulgarian Bank, Eurobank and Raiffeisenbank, determined on the basis of two criteria: the three most significant banks in Bulgaria and banks which are part of significant groups.

[6] Calculated on the basis of narrow scope of total loans and advances (excl. cash balance at central banks and other demand deposits). Total loans and advances including cash balances at central banks and other demand deposits reached BGN 125.3 billion by end-2022, and the share of non-performing loans under this broader scope stood at 3.5% by end-2022 (against 4.5% at end-December 2021).

earlier). The decrease in the share of non-performing loans and advances was driven by sales and write-offs of non-performing loans coupled with gross credit portfolio growth.

Gross non-performing loans and advances *impairment coverage ratio* rose on an annual basis to 49.2% by end-2022 (from 47.9% at the end of 2021).

The net NPL ratio[7] was 2.4% at the end of 2022[8] (3.2% for end-2021).

Profitability

Banking system profit was BGN 2.1 billion by end-2022, marking an increase of BGN 733 million or 54.6% from 2021. Net interest income growth contributed most to the rise in banks' profits for 2022. Net fee and commission income and other net income was also higher on an annual basis. Lower impairment charges compared to those for 2021 coupled with reversals of provisions contributed positively to sector's profit. At the same time, banking sector operating costs grew throughout the year. As a result of increased annual profit, the return on assets (ROA) improved by end-2022 to 1.34% (0.99% a year earlier) and return on equity (ROE) to 12.01% (8.11% by 31 December 2021).

Impairment costs for 2022 amounted to BGN 584 million, 20.3% (BGN 149 million) less than the ones accrued for 2021, while the ratio of impairment costs to total net operating income decreased to 11.0% (16.2% at end-2021). The *cost to income ratio*[9] of the banking system improved to 46.3% (from 48.9% in 2021).

Solvency

The capital position of the banking system remained stable in 2022 and the reported capital ratios were significantly above the minimum regulatory requirements and applicable capital buffers. Regulatory *own funds* in the banking system increased by 1.1% (BGN 177 million) and amounted to BGN 15.6 billion at the end of 2022. Tier 1 capital and Common Equity Tier 1 (CET1) capital increased, respectively by BGN 277 million (1.8%) to BGN 15.3 billion and by BGN 163 million (1.1%) to BGN 14.9 billion.

The total risk exposures amount rose by 9.6% to BGN 74.6 billion, due to the growth of risk weighted exposures for credit risk.

At the end of 2022 the ratios of *CET1 capital, Tier 1 capital* and *total capital adequacy* were 19.98%, 20.48% and 20.88% (21.66%, 22.04% and 22.62%, respectively, at end-2021). All credit institutions met the capital requirements and the buffer requirements[10]. The amount of capital in the banking system exceeding the Pillar 1, Pillar 2, and the combined buffer requirement[11] amounted to BGN 2.9 billion. The net value of non-performing loans and advances (BGN 2.3 billion at the end of 2022), which is the potential residual credit risk in bank balance sheets, remained entirely covered by the excess of capital above capital requirements and applicable capital buffers.

The *leverage ratio* of the banking system[12] was 9.41% at the end of 2022 (10.48% at end-2021). Over the year all credit institutions in Bulgaria reported a leverage ratio exceeding the minimum requirement of 3.0%.

7 Net NPL ratio uses net NPLs (gross NPLs minus impairments on NPLs) and net total loans and advances (gross loans and advances minus total accumulated impairments)

8 Calculated on the basis of narrow scope (excl. cash balance at central banks and other demand deposits). On the basis of the broader scope net NPL ratio was 1.9% for end-2022 (2.4% for end-2021).

9 The cost-to-income ratio is the sum of administrative costs, depreciation costs and (as from June 2020) resolution fund and deposit guarantee scheme costs to net operating income.

10 More information on the effective capital buffer rates is available on the BNB website.

11 A 'combined buffer requirement' is a concept referred to in Article 2, paragraph 3 of the BNB Ordinance No 8 of 27 April 2021 on Banks' Capital Buffers.

12 Calculated using a fully phased in definition of Tier 1 capital. The regulatory requirement for the leverage ratio was introduced on 28 June 2021 in compliance with Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019, amending Regulation (EU) No 575/2013. The rate of 3% is defined in compliance with the value in the Basel III regulatory

Liquidity

The liquidity position of the banking system remained stable in 2022, with all credit institutions exceeding the minimum regulatory requirement for liquidity coverage of 100%. The *liquidity coverage ratio (LCR)* of the banking system was 235.0% (274.0% in end-2021). The *liquidity buffer* (the liquidity coverage ratio numerator) grew by 11.0% (BGN 4.6 billion) and reached BGN 46.0 billion. Net liquidity outflows (the liquidity coverage ratio denominator) increased by 29.4% (BGN 4.4 billion) to BGN 19.6 billion.

At the end of 2022, *the net stable funding ratio (NSFR[13])* of the banking system was 162.4%, all credit institutions in Bulgaria met the minimum requirement of 100%.

The *loan-to-deposit ratio (LTD)*[14] for the banking system decreased to 68.2% as of end- 2022 (69.3% at end-2021). The credit portfolio grew by 13.5%, while deposits (excluding those from credit institutions) grew by 15.4%.

Products and distribution channels

At the end of 2022 there were 70 points of sale (branches, offices, representative offices and remote workstations), 77 ATMs and 1924 POS terminals per 100 000 population.

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

The BNB powers for banking supervision are regulated in the Law on the Bulgarian National Bank (LBNB), the statutory law, and the Law on Credit Institutions (LCI). The Banking Supervision Department of the BNB is, according to Art. 19, para. 1 of LBNB, one of the three basic departments of the BNB and is directly headed by a Deputy Governor designated by the National Assembly. Art. 20, para. 3 of LBNB explicitly empowers the Deputy Governor heading the Banking Supervision Department to exercise supervision over the banking system in the context of close cooperation under Article 7 of Regulation (EU) No 1024/2013.

The close cooperation regime between the BNB and the ECB has modified the supervision of the Bulgarian banking sector by establishing direct supervision by the ECB on the significant supervised entities with the cooperation of the BNB.

The Bulgarian banking system is subject to the international regulatory framework for banks - Basel III introduced in Bulgaria by the EU Capital Requirements Regulation and Directive, and the national legislation and BNB ordinances in the field. The legal framework provides for the powers for the supervisor to set and enforce prudential standards for banks by adopting respective ordinances.

During the reporting period, with the adoption of the Law on Covered Bonds (LCB), the requirements of Directive (EU) 2019/2162 of the European Parliament and of the Council of 27 November 2019 on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU (the Directive) were introduced. In June 2022, the Governing Council of the BNB adopted Ordinance No.

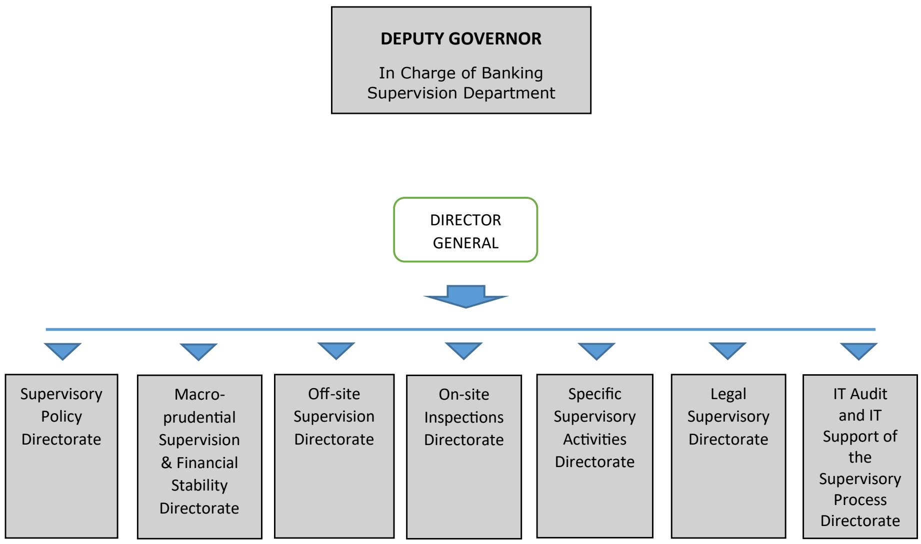
framework.

13 The regulatory requirement for the NSFR was introduced on 28 June 2021 in compliance with Regulation (EU) 2019/876 of the European Parliament and of the Council, amending Regulation (EU) No 575/2013.

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

42 on the Terms and Procedure for Issuance of Covered Bonds, effective from 8 July 2022. With its adoption, the work on creating a comprehensive legal framework for the issuance of covered bonds by banks in the country in accordance with the Directive was completed. The ordinance defines the required parameters for calculation of the amount of covered bond liabilities and of cover assets; periodic stress tests of the cover assets; the documents required for selection of a cover pool monitor and insurance of the cover pool monitor.

Organisational chart of the Banking Supervisory Authority



Main strategic objectives of the supervisory authority in 2022

- Addressing risks stemming from climate change and environmental degradation. Supervised institutions should incorporate climate-related and environmental risks into their strategies, governance and risk management frameworks, in order to mitigate and disclose such risks and comply with the corresponding regulatory requirements.
- Focus on IT outsourcing risks by supervised banks in conjunction with their increasing reliance on third-party IT providers (including cloud service providers).

The activities of the Banking Supervisory Authority in 2022

In 2022, the Banking Supervision Department, in cooperation with the ECB, carried out an assessment in the area of operational risk and made an analysis of inherent risks at the level of competent supervisory authorities. The study referred to official authorisations issued by the relevant competent authorities, as well as specific mechanisms for the institutional management of operational risk by these authorities.

During the year, the main ongoing supervisory activity, as usual, was related to SREP analyses and evaluations. The 2020 cycle was completed and the next one was held accordingly for 2021, in line with the SSM LSI SREP Methodology, version 2022. Supervisors reviewed also banks' ICAAP and ILAAP reports with reference date 31st December 2021, along with their funding plans for the 2022 – 2024 period. Updated recovery plans of the LSIs were reviewed as well to assess their credibility, and the implementation of supervisory recommendations.

Furthermore, banks' NPL targets were analysed and assessed in relation with their strategies and business plans. In view of the aggravation of the geopolitical processes, the consequences of the war in Ukraine, a review and assessment of the exposure of local banks' assets and liabilities to Russia, Ukraine and Belarus was carried out.

In 2022, the work within JSTs under the regime of close cooperation with the ECB continued. The respective joint decisions on capital and liquidity, also the recovery plans of the respective European banking groups, to which five significant Bulgarian subsidiaries are part, were negotiated and adopted.

In 2021, on-site inspections continued to focus on assessing specific risk areas related to the activities of inspected banks. Thematic checks on credit risk management in LSIs subject to direct supervision by the BNB were completed. As regards ICT risks, banks under review had to provide replies to a standardised questionnaire on measures planned and implemented by them to enhance digitalisation in various areas, aimed at reducing risks, expanding customer base, updating product portfolios by using digital channels, and enhancing security in customer service.

Under the regime of close cooperation with the ECB, a supervisory review of one SI was carried out. The scope of the inspection was in line with the plan set by the SSM for the 2022-2024 period. The internal model team conducted an inspection mandated by the ECB concerning the assessment of a submitted application for material changes in the internal model used by a SI.

In pursuit of its main goal of keeping banking sector stability and weakening risks associated with COVID-19 pandemic, the BNB Governing Council decided in February 2022 to suspend the macroprudential measures imposed in March 2020 and confirmed in January 2021, related to the restriction on banks' profit distribution for 2019 and 2020 and the imposed limits on banks' foreign exposures. In line with the BNB Governing Council resolutions taken in 2021 and disclosed 12 months before their entry into force, the countercyclical capital buffer rate was increased from 0.5 to 1.0% as of 1 October 2022, and to 1.5% as of 1 January 2023. Given the persistently high credit growth rates and the heightened uncertainty in the economic environment, the BNB Governing Council decided on 29 September 2022 to raise the countercyclical capital buffer rate to 2.0%, effective from 1 October 2023.

In cooperation with the ECB, the BNB monitors compliance with the requirements of the Law on Measures against Money Laundering (LMML) and the Law on Measures against Financing of Terrorism (LMFT) of all banks (SIs and LSIs) while applying risk-based approach. The priority for risk-based supervision is to examine the policies and procedures implemented in banks to prevent money laundering and terrorist financing. In 2022, thematic inspections were focused on the main risks identified in the National Risk Assessment and in connection with the exchange of information with other competent authorities.

The control over financial institutions registered under Article 3a of the Law on Credit Institutions (LCI) and Ordinance No 26 of the BNB on Financial Institutions was carried out through regular reviews of the data and information concerning changed circumstances of registration. Inspections were carried out on alerts from customers or enquiries from other state authorities and institutions, or on violations of regulatory requirements admitted by the respective financial institution under Article 3a of the LCI.

During the year, the BNB IT audit and IT risk supervision activities in the LSIs were related to the extension of supervisory IT inspection scope, participating in a pilot project to collect information on their outsourced activities as part of the assessment of banks' readiness to implement Regulation (EU) 2022/2554 (Digital Operational Resilience Act - DORA).

In 2022, one IT on-site inspection and horizontal supervisory review were performed at all supervised institutions on "The outsourcing of activities focusing on the management of IT outsourced activities", with an overall assessment for each bank's performance in the management of outsourced activities and analysis of areas for improvement and concentration risk.

International activities of the authority

In the context of the established close cooperation with the ECB, persons with management functions and experts from the BNB are involved at different levels and formats in the relevant ECB governance and working structures, e.g. in the Supervisory Board, in joint supervisory teams, supervisory colleges, etc., in the discussion and decision-making process in the field of banking supervision.

At EU level, the BNB representatives in Standing Committees and Working Groups at the EC and EBA continued their participation in meetings and TelCos. The topics discussed were related to elaboration of common policies and standards for supervision, cooperation and coordination in joint assessments and decisions within supervisory colleges, in peer reviews on the level of convergence between national practices of implementation of the EU prudential requirements and framework.

The BNB continued to participate in cooperation between member states' NCAs in the field of combating money laundering and terrorist financing, and on other topics of common interest. The most important of them concern the policies and actions of banking groups to improve the efficiency of systems for risk monitoring and minimisation, the protection of consumer rights, and the financial innovations.

In 2022, BNB experts participated in the OECD Global Forum visit, together with representatives of the National Revenue Agency and Counter-Terrorism Committee Executive Directorate (CTED) at the UN visit. BNB experts were also part of the initiative for launching a follow-up programme to further support central banks and banking supervisory authorities from the Western Balkan – from candidate countries and potential candidates for EU membership.

Cooperation with other supervisory bodies in Bulgaria

In accordance with their competences defined by the Law on Measures against Money Laundering (LMML) and the Instruction for Conducting Joint Inspections, BNB experts and representatives of the Financial Intelligence Directorate of the State Agency for National Security (FID-SANS) conducted in 2022 joint inspections. Both institutions have also developed joint guidelines for commercial banks regarding preparation of own AML/CFT risk assessment. Furthermore, BNB experts have participated in an interagency working group regarding the preparation of the second national AML/CFT risk assessment and two sectorial risk assessments which were finalised later in 2023.

The BNB together with the Commission for Consumer Protection (Commission) are the competent authorities under the Act on Credits for Immovable Properties of consumers (transposing the Mortgage Credit Directive). Based on this Law the BNB cooperates and performs supervisory activities with the Commission.

In relation to the Law on Bank Deposit Guarantee, the BNB cooperates with the Bulgarian Deposit Insurance Fund (BDIF). One of the main functions of the BDIF is to monitor and analyse the reports provided by the credit institutions regarding the deposit base. Upon request of BDIF, the BNB conducts targeted inspections of banks for compliance with the requirements of the Law on Bank Deposit Guarantee under the Deposit Guarantee Schemes Directive.

Questionnaire tables for the 2022 review[15]

Number of financial institutions (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	18	18	18
Branches of foreign credit institutions	6	7	7
Banking sector, total:	**24**	**25**	**25**

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

Type of financial institution	2020	2021	2022
Commercial banks	61 303 530	67 119 135	76 739 140
Branches of foreign credit institutions	2 027 581	2 079 413	2 718 147
Banking sector, total:	**63 331 111**	**69 198 548**	**79 457 287**
y/y change (in %)	**8.4%**	**9.3%**	**14.8%**

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

Item	2020	2021	2022
Public sector ownership	3.1	2.5	2.0
Domestically controlled total[16]	28.7	28.0	27.1
Foreign controlled total 2	71.3	72.0	72.9
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:	**48.5%**	**67.2%**

Return on Equity (ROE) (%)

	2020	2021	2022
Banking sector, total:	**4.57**	**8.11**	**12.01**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2020	2021	2022
Commercial banks	96.8	97.0	96.6
Branches of foreign credit institutions	3.2	3.0	3.4
Banking sector, total:	**100.0**	**100.0**	**100.0**

[15] Data for 2021 is revised.

[16] Based on the reporting methodology for the purposes of ECB Consolidated Banking Data.

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

Assets	2022
Cash, cash balances at central banks and other demand deposits	20.9
Financial assets held for trading	0.3
Non-trading financial assets mandatorily at fair value through profit or loss	0.3
Financial assets designated at fair value through profit or loss	0.0
Financial assets at fair value through other comprehensive income	5.2
Financial assets at amortised cost	69.6
Derivatives – Hedge accounting	0.1
Fair value changes of the hedged items in portfolio hedge of interest rate risk	0.0
Investments in subsidiaries, joint ventures and associates	0.4
Tangible assets	1.9
Intangible assets	0.3
Tax assets	0.0
Other assets	0.9
Non-current assets and disposal groups classified as held for sale	0.1
TOTAL ASSETS	**100.0**
Liabilities	**2022**
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	87.7
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	0.1
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	**11.1**
TOTAL EQUITY AND TOTAL LIABILITIES	**100.0**

Capital adequacy ratio of banks ***

	2020	2021	2022
Banking sector, total:	**22.66**	**22.62**	**20.88**

**** - for Basel III*

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

Asset classification (narrow scope)[17]	2022
Gross non-performing loans and advances to total gross loans and advances (%)	4.6
Net non-performing loans and advances to total net loans and advances (%)	2.4
Asset classification (broad scope)[18]	2022
Gross non-performing loans and advances to total gross loans and advances (%)	3.5
Net non-performing loans and advances to total net loans and advances (%)	1.9

The structure of deposits and loans and advances of the banking sector (%)
(at year-end)[19]

	2021		2022	
	Deposits	Loans and advances	Deposits	Loans and advances
Central banks	0.0	0.0	0.0	0.0
General governments	2.6	1.2	3.0	1.0
Credit institutions	5.3	7.9	5.9	10.5
Other financial corporations	3.3	6.3	3.5	6.6
Non-financial corporations	29.8	48.9	32.2	46.7
Households	59.0	35.8	55.4	35.3
Total	**100.0**	**100.0**	**100.0**	**100.0**

17 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.

18 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.

19 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.

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

P&L account	2020	2021	2022
Interest income	1,535,142	1,557,260	1,856,934
Interest expenses	180,888	145,914	206,993
Net interest income	1,354,253	1,411,346	1,649,940
Net fee and commission income	531,182	636,151	730,964
Other (not specified above) operating income (net)	241,336	269,861	322,711
Total operating income, net	2,126,771	2,317,358	2,703,615
Administrative expenses	855,632	913,874	1,008,607
Depreciation	145,473	139,805	143,581
Provisions or (-) reversal of provisions	63,181	31,532	-7,799
Impairment or (-) reversal of impairment on financial assets not measured at fair value through profit or loss	503,032	374,456	298,448
Profit or (-) loss before tax from continuing operations	397,489	771,699	1,161,809
Profit or (-) loss for the year	354,144	686,254	1,060,811

Total own funds in 2022 (in EUR'000) ***

	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Banking sector, total:	**7,967,359**	**7,624,829**	**7,817,517**	**149,842**	

**** - for Basel III*

Macroeconomic environment in the country

After the strong recovery in 2021, the level of economic activity surpassing the pre-pandemic level, the economy continued its relatively strong growth in 2022, despite strong inflationary pressures and the deterioration of trade conditions related to the significant rise in energy prices. Croatia's real gross domestic product increased by 6.3% on an annual level, with an increase in all foreign and domestic demand components. Consumer price inflation accelerated considerably in 2022, partly resulting from the spillover of the high prices of raw materials and other input costs in the world market to domestic prices. In addition, profit margins increased and inflationary pressures also came from the domestic labour market, resulting from strong tourism-related demand. The surge in energy prices also contributed to a deeper foreign trade deficit, which resulted in a noticeable fall in the current and capital account surplus.

In 2022, the character of the CNB's monetary policy was predominantly marked by the preparations for the introduction of the euro, which to a large extent offset the pressures of external shocks on the domestic financial market. The adjustment of the monetary policy instruments resulted in a record-high liquidity level in the banking system, which mitigated the transfer of tighter financing conditions spurred by the ECB's monetary policy normalisation. Irrespective of the gradual rise in interest rates on loans and stricter standards, bank lending activity was exceptionally strong in 2022, so that the growth in loans also accelerated significantly on an annual level. The strong real growth and the increase in the price level had a favourable impact on budget revenues, enabling the general government to run a surplus, with a considerable reduction in the public debt-to-GDP ratio.

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

At the end of 2022, there were 21 credit institutions operating in the Republic of Croatia: 20 banks and one housing savings bank, two housing savings banks merging with their parent banks in the course of the year. In addition, there was one branch of an EU credit institution operating in the country, of BKS Bank AG, Main Branch Croatia, while over 200 institutions from the EU and the European Economic Area had notified the CNB of the intention to directly provide mutually recognised services in the territory of the Republic of Croatia. The merger of housing savings banks and the change in the ownership structure of Nova hrvatska banka d.d. slightly changed the features of the ownership structure of the banking system. The number of credit institutions in the majority ownership of foreign shareholders fell from 14 to 11, thus also reducing the share of their assets in the total banking system assets. However, their share remained dominant, accounting for 88.8% of the total banking system assets. The years-long moderate decline in the number of employees continued, and at the end of the year 2022 the credit institutions system had 18,363 employees.

The assets of credit institutions rose to a record high of HRK 572.2bn in 2022. The key source of their growth was the increase in deposits in the current accounts of households, increased by deposits of surplus funds in the run-up to the introduction of the euro, and deposits of non-financial corporations also increased. Assets mostly increased in the form of highly liquid cash instruments, in particular by the end of the year as a result of the larger inflow of deposits and the end of the adjustments of monetary measures to the monetary policy instruments in the euro area. The strengthening of cash balances in total assets of credit institutions pushed up the value of the liquidity coverage ratio (LCR) to a record high of 242.4%, a level that was almost two and a half times higher than the prescribed minimum of 100%. The long-term liquidity and the requirements for stable sources of financing in the environment of rising assets were to a large extent ensured by the above-mentioned increase in deposits of households and non-financial corporations, which contributed to a growth in the value of net stable funding ratio (NSFR) to as much as 179.0%.

Cash balances also had a favourable effect on improved quality of total assets and contributed to the high total capital ratio of all credit institutions of 24.6%. Although the total capital ratio decreased under the impact of unrealised losses based on bonds carried at fair value, it is still among the highest of all EU member states. All credit institutions reported a total capital ratio above the prescribed minimum of 8% and eight of them, which accounted for two thirds of the total system assets, boasted a total capital ratio of above 20%.

Credit activity in 2022 resulted in a 5.5% increase in loans. The increase in loans was mostly directed at non-financial corporations, in particular at the financing of corporations in the activities of energy supply, trade and real estate operations. Housing loans to households continued to increase, further supported by the participation of credit institutions in the government programme for subsidising these loans, and a moderate growth in general-purpose cash loans also continued.

The quality of credit institutions' assets measured by the non-performing loans ratio (NPL), continued to improve, although this ratio, after declining to 3.0%, continues to be less favourable than the EU average (1.8%). Non-performing loans continued to decline in all more important activities of the non-financial corporations sector, which resulted in a decrease in the NPL share in total loans to non-financial corporations, to 6.4%. The share of NPLs in total loans to households fell to 5.0%, with the size of this share being primarily influenced by difficulties in the collection of general-purpose cash loans.

The positive development in the non-performing share of the credit portfolio is contrasted with the situation in the performing share of the credit portfolio that is not yet in default. The level of credit risk in this share of the portfolio is still higher than before the period of the COVID-19 pandemic and has yet to show signs of declining.

Credit institutions' operations in 2022 generated HRK 5.3bn in profit, 4.9% down from the profit generated in 2021. Profitability indicators decreased as well – ROA totalled 1.0% and ROE 8.2%. The decrease in the profit was mostly the consequence of the higher general operating expenses, largely associated with the costs related to the introduction of the new currency. As a result, the cost efficiency of the banking system was reduced moderately because credit institutions used a larger share of the net income to meet these costs. Net operating income increased, driven by the increase in net interest income following a long period of decline and due to the continued growth in net income from fees and commissions.

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 Credit Institutions Act (hereinafter: the Act) was amended in late 2022. The amendments mostly arose due to the introduction of the euro as the official currency in the Republic of Croatia and the consequent harmonisation with the provisions of the Act on the Introduction of the Euro.

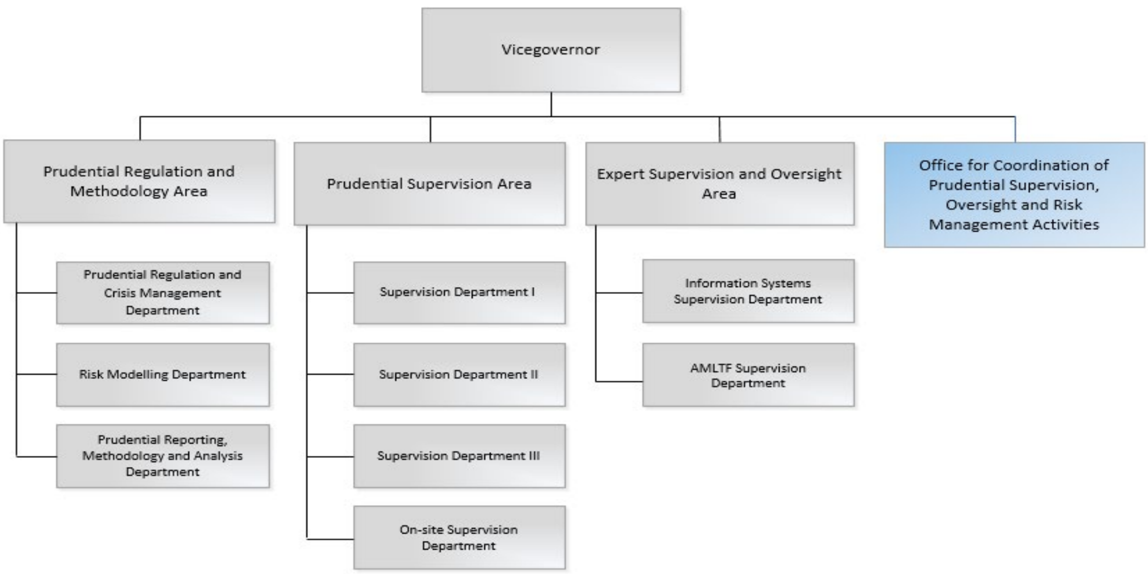
A significant number of subordinate regulations in the field of prudential regulation have also been amended due to the amendments to the Credit Institutions Act. Thirteen subordinate regulations were amended for the purpose of harmonisation with the Act on the Introduction of the Euro. In addition to changes in monetary amounts and the currency, additional adjustments to related acts, guidelines and the relevant prudential regulations were made in certain decisions. In the area of prudential regulation, four subordinate regulations were amended. The subject amendments were not related to harmonisation with the Act on the Introduction of the Euro and the currency changeover:

- The Decision on recovery plans of credit institutions was amended due to the application of the Guidelines on recovery plan indicators of the European Banking Authority (EBA).
- The Decision on employee remuneration was amended due to the harmonisation of the provisions on employee retention bonuses, severance pay and monitoring of the gender-based wage gap with regard to the provisions of the EU directive
- The Decision on governance arrangements was amended due to the transposition of some of the provisions of the Guidelines of the European Banking Authority regarding internal governance.
- The Decision on the assessment of the suitability of the chairperson of the management board, members of the management board, members of the supervisory board and key function holders in a credit institution is amended due to the transposition of some of the provisions of the Guidelines of the European Banking Authority on the assessment of the suitability of the management authority and key function holders.

In addition, in 2022 a subordinate regulation was drafted to clarify the method of exercising oversight of credit unions, as well the preparation and delivery of minutes concerning the oversight of credit unions (Decision on the procedure and the manner of exercising oversight of credit unions and on preparing and delivering reports on examination findings).

Organizational chart of the Banking Supervisory Authority

The organisational chart of Banking Supervision function within the CNB has been changed compared to previous year because of the addition of the On-site Supervision Department. Except for that, it still consists of three main business areas and one office: Prudential Regulation and Methodology Area, Prudential Supervision Area, Expert Supervision and Oversight Area and Office for Coordination of Prudential Supervision, Oversight and Risk Management Activities.



Main strategic objectives of the Banking Supervisory Authority in 2022

The past year was marked to a large extent by macroeconomic and geopolitical developments, which also affected prudential supervision activities that were carried out with the aim of ensuring the safety and stability of the banking system. Prudential supervision activities in 2022 were mainly aligned with the supervisory priorities of the Single Supervisory Mechanism, and were additionally directed at analyses and enhanced monitoring of credit institutions' business areas that were assessed as more risky in terms of the impact of the Russian aggression against Ukraine, changes in interest rates and price growth.

The quality of the credit portfolio and credit risk management were continuously monitored in the context of possible post-pandemic effects, as well as of the impact of the war in Ukraine. In particular, the exposure of credit institutions to vulnerable sectors was monitored in the light of macroeconomic developments in 2022.

The activities of the Banking Supervisory Authority in 2022

The aforementioned challenging environment necessitated an even more intensive engagement in the work of the ECB's joint supervisory teams for significant credit institutions3, as well as cooperation with the ECB's teams for monitoring the implementation of supervision for less significant credit institutions. In addition, the activity of prudential teams was also aimed at monitoring the forecast of the impact of the introduction of the euro on the business plans of credit institutions. On the basis of regular monitoring of key business indicators, additional thematic analyses and the assessment of the adequacy of the risk management system, the level and structure of the capital and liquidity of credit institutions, 98 supervisory measures and recommendations for credit institutions were taken in 2022 with the aim of eliminating identified deficiencies and, in some cases, illegalities in business operations. All credit institutions were covered by at least one of the six standard supervisory activities in 2022.

The most resource-intensive and time-consuming activity related to the regular annual supervisory assessment, which resulted in the official imposition of capital requirements that credit institutions will be obliged to maintain in 2023. In 2022, prudential supervision covered 19 credit institutions through the SREP process, and for some of them qualitative recommendations were issued for improving the risk management process, primarily in the area of credit risk, the structure of management bodies and interest rate risk on the banking book. With a view to still possible vulnerabilities regarding the earnings and capital for credit institutions, prudential supervision continued to pay special attention to monitoring the capitalisation of the Croatian banking system and ensuring its adequacy.

Cooperation with other supervisory bodies in the country

Cooperation with other supervisory authorities in the country remained active throughout 2022.

Other relevant information and developments in 2022

All of the conditions for adoption of the euro have been met in 2022, and operational preparations in the financial and non-financial sectors for the changeover to the new official currency have been successfully completed. The successful completion of the procedure for adopting the euro in the shortest possible time is a significant achievement, especially when it is taken into account that in the key stages of the process Croatia was affected by several strong shocks – the pandemic crisis, devastating earthquakes and global inflation.

Questionnaire tables for the 2022 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	23	23	21
Branches of foreign credit institutions	1	1	1
Cooperative banks	-	-	-
Banking sector, total:	**24**	**24**	**22**

Total assets of banking sector (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	61.379,9	66.473,1	75.933,9
Branches of foreign credit institutions	391,8	437,7	386,5
Cooperative banks	-	-	-
Banking sector, total:	**61.771,6**	**66.910,8**	**76.320,4**
y/y change (in %)	**7,3**	**8,3**	**14,1**

Ownership structure of banks on the basis of assets total

Item	2020	2021	2022
Public sector ownership	5,9	5,9	8,0
Domestic ownership total	9,3	9,4	11,2
Foreign ownership	90,7	90,6	88,8
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2022

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	65,1	83,5	1.670,8
Branches of foreign credit institutions	100,0	100,0	10.000,0
Cooperative banks	-	-	-
Banking sector, total:	**64,8**	**83,1**	**1.654,2**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2020	2021	2022
Commercial banks	4,4	8,8	8,2
Cooperative banks	-	-	-
Banking sector, total:	**4,4**	**8,8**	**8,2**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2020	2021	2022
Commercial banks	99,4	99,3	99,5
Branches of foreign credit institutions	0,6	0,7	0,5
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2020	2021	2022
Receivables			
Financial sector	29,0	32,1	35,0
Nonfinancial sector	45,7	43,8	43,0
Government sector	23,0	22,0	20,0
Other assets	2,3	2,1	2,0
Liabilites			
Financial sector	10,5	9,1	10,1
Nonfinancial sector	69,4	71,4	71,8
Government sector	5,8	5,4	6,0
Other liabilities	0,8	0,9	1,0
Capital	**13,4**	**13,1**	**11,1**

Capital adequacy ratio of banks

Type of financial institution	2020	2021	2022
Commercial banks	25,6	25,9	24,8
Cooperative banks	-	-	-
Banking sector, total:	**25,6**	**25,9**	**24,8**

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

Asset classification	2020	2021	2022
Non-financial sector, including	9,2	7,8	5,6
- households	7,1	6,6	5,0
- corporate	12,5	9,9	6,4

The structure of deposits and loans of the banking sector in 2022 (%) (at year-end)

	Deposits	Loans	
Non-financial sector, including:	88,1	80,0	
Households	62,6	47,2	
Corporate	25,5	32,8	
Government sector	7,1	16,5	
Financial sector (excluding banks)	4,8	3,5	
Total	**100.0**	**100.0**	

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

P&L account	2020	2021	2022
Interest income	1.500,3	1.424,5	1.487,2
Interest expenses	163,9	135,6	149,8
Net interest income	1.336,4	1.288,9	1.337,4
Net fee and commission income	428,4	478,9	543,9
Other (not specified above) operating income (net)	185,9	338,6	334,1
Gross income	1.951,5	2.106,5	2.207,6
Administration costs	938,0	899,1	1.016,2
Depreciation	134,2	133,1	135,5
Provisions	85,6	137,7	203,2
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	356,0	61,2	-17,1
Profit (loss) before tax	436,9	888,0	876,5
Net profit (loss)	357,4	736,7	704,6

Total own funds in 2022 (in mil. EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	8.240,4	7.964,2	8.043,4	197,0	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**8.240,4**	**7.964,2**	**8.043,4**	**197,0**	**-**

Macroeconomic environment in the country

In 2022, the uncertainties regarding energy supply and prices, coupled with surging inflation and rising interest rates, were the main factors of deceleration of economic growth in the Czech economy. Real GDP increased by 2.4% (-0.9 pp y-o-y) in 2022, while growth was driven primarily by capital expenditure (+ 6.2%). Conversely, domestic consumption experienced a slight decline (-0.4%). Net exports stagnated in the same period, as exports and imports of goods and services both increased by 5.7%

The average inflation rate measured by CPI amounted to 15.1% in 2022 as the consumer price index gradually increased throughout the year. The main contributors were housing and energy, food and non-alcoholic beverages, and transportation, which are also the most significant components of the consumer basket.

In response to inflationary pressures, the CNB raised its two-week repo rate from 3.75% to 7.00% in four steps in the first half of 2022. The CNB's official interest rates thus reached a 20-year high. As a result of rate hikes, the costs of financing have increased, followed by growth in term deposits.

The koruna appreciated against euro (4.2%), with an average exchange rate of CZK 24.2/EUR. The koruna also strengthened against the pound sterling, with an average exchange rate of CZK 28.8/GBP. On the other hand, the koruna depreciated slightly against the US dollar, the Swiss franc and the Chinese renminbi.

The general unemployment rate fell in 2022, down by 0.5 pp to 2.3% (1.8% among men, 2.5% among women), and has thus recovered to its pre-pandemic levels. The average gross monthly nominal wage increased by 6.5% in annual terms. However, it decreased in real terms by 7.5%, due to the significant rise in consumer prices.

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

At the end of 2022, the Czech banking sector comprised 21 domestic banks (including five building societies), 23 branches of foreign banks and six credit unions. The four largest domestic banks together held 58.7% of the banking sector's total assets.

At the end of 2022, the Czech banking sector reported total assets of CZK 8,915.1 billion, which represented a y-o-y increase of 4.5%. The ratio of total assets of the banking sector to GDP stood at 131.2% at the end of 2022.

The quality of the loan portfolio improved in 2022 when the NPL ratio for client loans stood at 2.0%, i.e. 0.4 pp lower than in 2021, mostly due to the decline in the volume of non-performing loans.

In terms of liquidity, the domestic banking sector enjoys long-term favourable characteristics in the context of a permanent surplus of client deposits over client loans (143.2%).

Banking entities generated a total net profit of CZK 102.2 billion in 2022, which represents y-o-y growth of 45.3%. This increase was mainly due to growth in net interest income. Return on equity, as expressed by the ratio of total net profit to Tier 1 capital, rose by 5.3 pp to 16.0%.

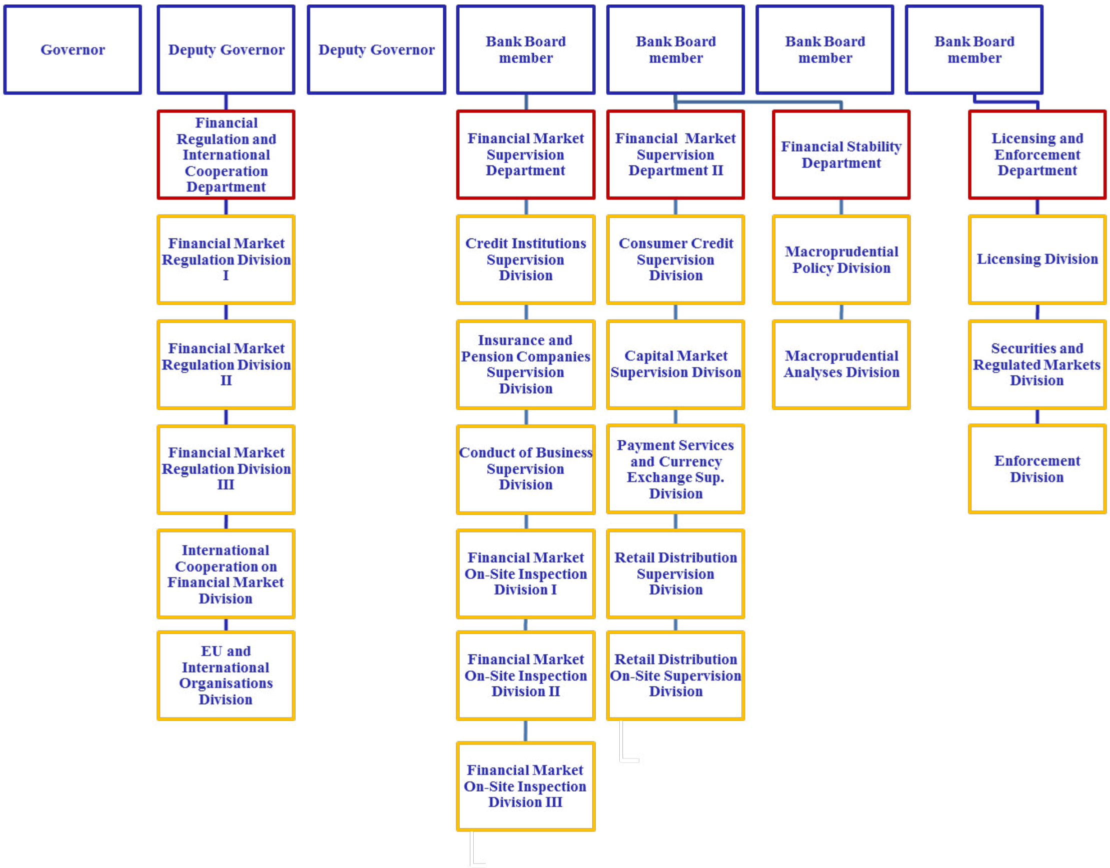
The capitalisation of the Czech banking sector remained satisfactory in 2022. Tier 1 capital, the main component of capital in the banking sector, rose by 1.9% in 2022. The total capital ratio of banks operating in the Czech Republic was 22.3%, i.e. 1.2 pp less than in 2021. Domestic banks were comfortably compliant with the capital requirements as defined by CRD IV/CRR throughout 2022.

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.

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 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.

Organizational chart of the Banking Supervisory Authority

Chart 1: Simplified chart of CNB supervisory organisation as of 31st December 2022



Main strategic objectives of the Banking Supervisory Authority in 2022

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 in the area of financial (including banking) market supervision are described in the Long-term supervisory strategy, which is published on the CNB's website.

Against the background of the increase in interest rates and bank credit clients' costs in 2022, the CNB focused on the adequacy of interest rate risk and credit risk management. The CNB also examined whether credit institutions were able to adequately manage risks related to growth in foreign currency loans driven by the interest rate differential between the koruna and the euro

In carrying out off-site and on-site supervision, the CNB aimed at monitoring the quality of credit portfolios, maintaining sufficient capital and provisions to cover potential losses. Furthermore, the CNB conducted supervision of ICT risks in light of the increasing number of cyberattacks, the management of AML risks, and the requirements of international sanctions measures.

In the area of conduct of business and consumer protection, the CNB comprehensively examined credit institutions' compliance with information duties to clients (including those relating to sustainable financing), compliance with duties linked to maintaining payment accounts, product management and risk management in relevant areas, including the related internal procedures of individual institutions.

The activities of the Banking Supervisory Authority in 2022

The CNB's core activities in the area of banking supervision in 2022 were as follows:

- Revoking the licence of Sberbank CZ, a.s., which experienced an unprecedented liquidity outflow on the 25th of February 2022. To this end, the CNB evaluated whether alternative measures were available at the time of failure that could have averted the bank's failure within a reasonable period.
- Further addressing the liquidity risks stemming from increased cash withdrawals after Russia's invasion of Ukraine, monitoring the liquidity of credit institutions, and engaging in ongoing discussions with each institution regarding the progression of their respective situations.
- Assessing interest rate risk in a high interest rate environment, ICT and AML risk management within the Supervisory Review and Evaluation Process (SREP).
- Examining a comprehensive review on the practices of banks in providing foreign currency loans and identifying potential imprudent procedures. The CNB addressed credit institutions and the Czech Banking Association in a letter, outlining its expectations regarding compliance with prudential rules, professional care, and proper disclosure of related risks to clients.
- Examining the cyber resilience of payment systems, including card payments and new electronic financial services related to digital transformation. Furthermore, the CNB assessed the feasibility of contingency plans and the level of outsourcing management in IT services.
- Focusing on the procedures in the area of AML/CFT, namely in the context of implementing European sanctions against Russia and Belarus. Furthermore, the CNB assessed for the first time the results of the verification of selected credit institutions' AML/CFT procedures by an external auditor.
- Developing data analysis tools, which should lead to a more accurate assessment of fraud detection, money-laundering practices, and market abuse.
- Conducting supervision of professional care and consumer protection, focusing on fulfilling information obligations towards clients, fulfilling obligations related to the management of payment accounts, product management, and risk management in relevant areas, including the establishment of corresponding procedures within internal regulations.

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 a supervisory response to crises. 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 the European structures. In 2022, the CNB cooperated with the European Banking Authority (EBA), the European Systemic Risk Board (ESRB) and the European Central Bank (ECB). Cooperation with the EBA focused on further enhancing the convergence of supervisory procedures of national EU supervisory authorities. The CNB also closely followed the discussions in the EU Council and its structures. In the context of the Czech Republic's presidency of the EU Council, the CNB organised an off-site meeting of the EBA Supervisory Board in Prague in July 2022. Finally yet importantly, the CNB is also actively involved in the work of the Basel Committee on Banking Supervision (BCBS).

Cooperation with other supervisory bodies in the country

The CNB is an integrated supervisory authority, which oversees the entities on the Czech financial market. The CNB works in close cooperation with the Czech Ministry of Finance, which has primary responsibility for preparing laws in the financial market area. On the basis for such cooperation, laid down in the Agreement on cooperation in the preparation of draft national legislation concerning the financial market in the Czech Republic, the CNB and the Czech Ministry of Finance cooperate in the preparation of laws, statements of intent for laws and implementing legislation. In particular, the cooperation includes the following areas (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 2022

In 2022, the Ministry of Finance, in cooperation with the Czech National Bank (CNB), initiated work on the preparation of a law aimed at transposing Directive (EU) 2021/2167 on credit servicers and credit purchasers (NPL Directive) into the Czech legal framework. The Directive establishes a harmonised framework for the activities of credit purchasers and credit servicers in relation to loans provided by credit institutions that are not repaid properly. Furthermore, in response to the amendment of the Act on the CNB, the CNB issued a decree in 2022 that sets out the method and rules for calculating loan indicators (LTV, DTI, DSTI) for residential property-secured consumer loans.

Questionnaire tables for the 2022 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	24	23	21
Branches of foreign credit institutions	24	22	23
Cooperative banks	8	7	6
Banking sector, total:	**56**	**52**	**50**

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

Type of financial institution	2020	2021	2022
Commercial banks	7,259.4	7,850.7	8,159.8
Branches of foreign credit institutions	708.5	672.0	745.8
Cooperative banks	10.0	9.1	9.4
Banking sector, total:	**7,977.8**	**8,531.8**	**8,915.1**
y/y change (in %)	**5.3**	**6.9**	**4.5**

Ownership structure of banks on the basis of assets total

Item	2020	2021	2022
Public sector ownership	0.9	0.8	0.7
Domestic ownership total	7.2	14.5	16.3
Foreign ownership	91.9	84.7	83.0
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, 2022

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	54.8	71.5	1237.6
Branches of foreign credit institutions	48.0	67.6	1229.4
Cooperative banks	86.1	99.6	2607.1
Banking sector, total:	**50.2**	**65.4**	**1049.2**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2020	2021	2022
Commercial banks	7.7	10.8	16.1
Cooperative banks	-6.5	2.5	5.4
Banking sector, total:	**7.6**	**10.8**	**16.0**

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	2020	2021	2022
Commercial banks	91.0	92.0	91.5
Branches of foreign credit institutions	8.9	7.9	8.4
Cooperative banks	0.1	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)

	2020	2021	2022
Receivables			
Financial sector	6.7	6.2	7.0
Nonfinancial sector	41.1	41.3	41.3
Government sector	0.9	0.9	0.9
Other assets	51.3	51.6	50.8
Liabilites			
Financial sector	12.3	11.8	13.4
Nonfinancial sector	58.4	58.3	57.9
Government sector	4.0	4.0	4.6
Other liabilities	16.9	17.7	16.1
Capital	**8.4**	**8.2**	**7.9**

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

Capital adequacy ratio of banks

Type of financial institution	2020	2021	2022
Commercial banks	24.3	23.5	22.3
Cooperative banks	26.7	24.4	24.5
Banking sector, total:	**n.a.**	**n.a.**	**n.a.**

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

Asset classification	2020	2021	2022
Non-financial sector, including	2.7	2.4	2.0
- households	1.8	1.5	1.2
- corporate	4.2	3.8	3.4

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 2022 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	85.5	87.4
Households	60.5	53.2
Corporate	25.0	34.2
Government sector	6.9	1.9
Financial sector (excluding banks)	7.6	10.7
Total	**100.0**	**100.0**

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

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

P&L account	2020	2021	2022
Interest income	186,104.6	184,672.4	430,955.9
Interest expenses	59,229.9	55,808,8	259,087.9
Net interest income	126,874.7	128,863.5	171,868.0
Net fee and commission income	30,947.4	34,910.9	38,102.9
Other (not specified above) operating income (net)	2,736.4	3,825.1	4,541.2
Gross income	248,880.3	249,918.9	502,907.6
Administration costs	73,305.7	75,524.8	79,157.4
Depreciation	12,909.0	13,501.4	14,056.3
Provisions	2,528.4	568.4	4,233.9
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	29,020.5	3919.8	9,894.0
Profit (loss) before tax	57,433.4	85.526.0	121,820.5
Net profit (loss)	47,470.4	70,348.9	102,232.5

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

Total own funds in 2022 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	26,408.9	24,535.9	25,518.9	890.0	n.a.
Cooperative banks	70.3	68.2	68.2	2.1	n.a.
Banking sector, total:	**26,479.2**	**24,604.1**	**25,587.1**	**892.1**	**n.a.**

Note: EUR= 24.12 CZK as at 31 December 2022.

Macroeconomic environment in the country

Estonian economy recovered fast from COVID-19 crisis, gross domestic product (GDP) increased 8.3% in 2021. However, 2022 turned out more challenging as war in Ukraine and other developments had strong impact to our economy. Estonian households and companies had to cope with rapidly rising energy and other costs, which lead to decline in purchasing power and competitiveness. As a result Estonian economy fell 1,3% y/y in 2022. Consumer prices rose by 19% in 2022, while the peak was reached in August with the rate of inflation of 25%. Biggest impact on the consumer price index came from housing-related price increases, which accounted for two fifths of the total rise. Electricity that reached homes was 94%, gas 124%, solid fuels 74% and heat energy 49% more expensive than the average in previous year. Very high rate of inflation pushed real wages down by 9% in 2022, even though the average monthly gross wages and salaries in Estonia increased relatively fast. A downturn in the economy generally causes unemployment to rise and growth in wages to slow, but the labour market has been resilient this time as unemployment has been stable around 5-6%, while wage growth runs near 10%. The greatest difficulties in the labour market are faced by manufacturing and construction, where employment has fallen, while the number employed in the public sector and in private sector services has risen. Eesti Pank sees that economic activity is picking up in 2023. Private consumption has been modest in the first half of the 2023, as it has fallen from the unsustainably high level last year that resulted from the use of pandemic and pension savings. Growth in consumption is expected to pick up in future as purchasing power improves. The capacity for growth in the economy should be supported by the revitalisation of demand in the main export markets, and weaker cost pressures on export prices than before as the energy crisis fades. The position of the Estonian economy is forecasted to improve over the 2023 after declining for five quarters, and so the total volume of the economy is expected to be 1% smaller over the year as a whole.

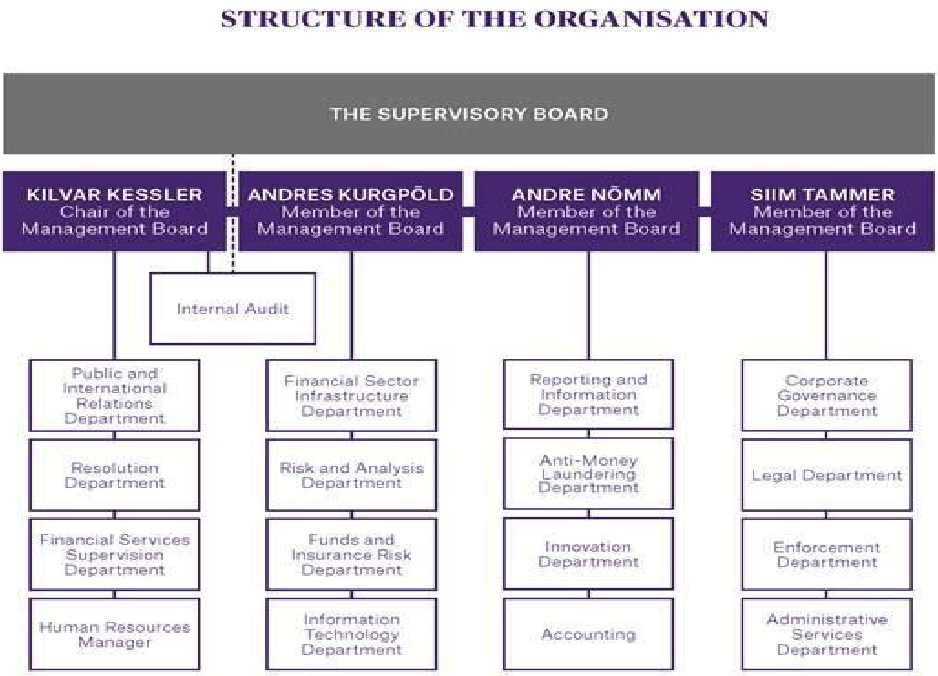
Development in the banking sector (including assets total / GDP)

Despite of economic challenges and even decreasing GDP, Estonian banking sector had another strong year in 2022. At the end of the 2022 there were 14 banks operating in Estonia, of which five were branches of foreign banks. This is one less than a year earlier as the Estonian branch of Nordiska Financial Partner Norway AS stopped its activities. In addition, at the beginning of 2023 Estonian branch of PayEx Sverige AB also ceased its operations in Estonia. Despite of economic challenges, relatively strong performance of Estonian banking sector continued in 2022, meaning healthy loan growth, improved credit quality, high profitability and strong capitalization. The assets of the banking sector stood at 49 billion euros at the end of 2022, which is 1.5% more than a year earlier and 135% of GDP. The loan stock increased by 12% over the year to 35 billion euros. At the end of the year, 1.9% of the loan portfolio in the Estonian banking system was overdue by at least one day and 0.3% at least 90 days. The share of non-performing loans (NPL) declined in 2022 from 1.1% at the end of 2021 to 0.8%. Rising interest rates has helped to increase the net interest margin and together with improved credit quality, banking sector's profitability improved further in 2022. The return on equity (ROE) of the Estonian banking sector reached to 11.1% in 2022, compared to 9.6% in 2021 and 8.8% in 2020. As the majority of the loans in Estonian banking sector are based on 6M Euribor, the positive effect of rising interest rates on the profitability have been even bigger in 2023. Banks' liquidity position remained healthy in 2022 with LCR ratio at 144% and almost 25% of total assets being liquid at the end of the year. Relatively fast growth of loans and risky assets added some pressure to the capitalization as capital ratios turned somewhat lower (sector's CET1 reached to 21% at the end of 2022). However, the capitalization of Estonian banking sector remained as one of the strongest in European Union also in 2022.

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 a financial supervision and crisis resolution authority with autonomous responsibilities, independent in its decision-making and budget being funded by the market participants under its remit. Financial supervision is conducted in order to enhance the stability, reliability, transparency and efficiency of the financial sector, to reduce systemic risks and to promote prevention of the abuse of the financial sector for criminal purposes, with a view to protecting the interests of clients and investors by safeguarding their financial resources, and thereby supporting the stability of the Estonian monetary system. The objective of the financial crisis resolution is to avoid adverse effects on financial stability arising from the insolvency of credit institutions, investment firms and central counterparties, to protect public funds and the assets of depositors, investors and other clients, and to ensure the continuity of the critical functions of credit institutions investment firms and central counterparties. The work of Finantsinspektsioon is planned and monitored by the supervisory board of Finantsinspektsioon, which has six members and is chaired by the Minister of Finance of the Republic of Estonia. The work is managed by a four-member management board, which is a collective management group that takes decisions by majority vote.

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Banking Supervisory Authority in 2022

The Finantsinspektsioon strategy for 2022-2025 focuses on digital skills, environmental sustainability, maintaining financial stability, and protecting the interests of clients and investors. The Finantsinspektsioon strategy also encourages technological innovation to help the market function more efficiently. The full text of the strategy is found on the Finantsinspektsioon website.

The activities of the Banking Supervisory Authority in 2022

The Management Board held 57 meetings in 2022 at which 201 management decisions and 214 administrative rulings were made, of which 13 were written precepts. The Management Board issued nine authorisations and withdrew eight. Finantsinspektsioon assessed in 2022 whether a total of 390 people were fit and proper to operate in the financial sector or to own a qualifying holding in companies in the sector. Finantsinspektsioon carried out on-site inspections at four banks operating in Estonia in 2022 that aimed to identify how effective the risk areas and functions of the banks were, and at two credit institutions providing depository services for pension fund managers. Finantsinspektsioon ran 25 remote inspections of financial services during the year. These checked the existence of internal rules for providing financial services, the services provided, information held on clients including client complaints submitted to market participants, and other similar issues. Finantsinspektsioon prioritised remote inspections in addressing money laundering and terrorist financing prevention and financial sanctions in 2022 at credit and payment institutions, small-scale alternative fund managers. Finantsinspektsioon completed its on-site inspections that assessed the organisational solutions of banks and investment firms for applying financial sanctions. Finantsinspektsioon carried out risk stress tests for all the banks operating with an authorisation in Estonia to assess the sufficiency of their capital if they were faced with negative economic developments.

International activities of the authority

Finantsinspektsioon contributes to designing the financial supervisory policy of the European Union through three European supervisory authorities. These are the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), and the European Securities and Markets Authority (ESMA). The European Systemic Risk Board (ESRB) is also part of the European system of financial supervisors and handles macro supervision, and Finantsinspektsioon works there also. As Estonia is a member of the euro area, the everyday work of Finantsinspektsioon is affected by the single supervisory mechanism (SSM). The banks under direct supervision of SSM in 2022 were AS SEB Pank, Swedbank AS and Luminor Bank AS. Finantsinspektsioon is also involved in crisis resolution works in the Single Resolution Board (SRB), which is the central resolution authority in the euro area. Finantsinspektsioon participates in supervisory colleges for capital supervision, anti-money laundering, and resolution to make supervision over cross-border financial intermediaries 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), and the International Organization of Securities Commissions (IOSCO). It promotes cooperation between Nordic and Baltic countries in the Nordic-Baltic Macroprudential Forum (NBMF) and the Nordic-Baltic Stability Group (NBSG).

Cooperation with other supervisory bodies in the country

The Finantsinspektsioon actively cooperates with the Ministry of Finance and Eesti Pank in maintaining financial stability and supporting market development, based on the joint action agreements concluded and the established cooperation network. In case needed and justified Finantsinspektsioon exchange information with the police and the prosecutor's office. The Finantsinspektsioon and the Guarantee Fund made a cooperation agreement in the beginning of 2020, which allows the Guarantee Fund to use the infrastructure and expertise of the Financial Supervision Authority to achieve these goals and increase its capacity. Finantsinspektsioon and Information System Authority are cooperating in the field of applying Digital Operational Resilience Act (DORA) in Estonia, and also create mutual awareness in the situation of cyberspace concerning cyber threats and attacks. Finantsinspektsioon cooperates with consumer Protection and Technical Regulatory Authority in the field of consumer protection. Finantsinspektsioon cooperation with the Financial Intelligence Unit includes supervision of supervised entities money laundering and terrorist financing risks. Finantsinspektsioon also cooperate with the Tallinn Stock Exchange to supervise the following good corporate governance practices.

Other relevant information and developments in 2022

Finantsinspektsioon celebrated its 20th anniversary in 2022 being independent supervision Authority. The Finantsinspektsioon Innovation Hub completed its first full year of operation in June 2022, during which it handled 207 queries and contacts. Since 2021 the law has required Finantsinspektsioon to assess the capacity of the subjects of financial supervision to apply international financial sanctions in cooperation with the Financial Intelligence Unit.

Questionnaire tables for the 2022 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	9	9	9
Branches of foreign credit institutions	5	6	4
Cooperative banks	-	-	-
Banking sector, total:	**14**	**15**	**13**

Total assets of banking sector (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	43 664	46 843	47412
Branches of foreign credit institutions	1010	1035	1204
Cooperative banks	-	-	-
Banking sector, total:	**44 675**	**47 879**	**48 616**
y/y change (in %)	**20**	**7**	**2**

Ownership structure of banks on the basis of assets total

Item	2020	2021	2022
Public sector ownership	-	-	-
Domestic ownership total	9.4	8.6	10
Foreign ownership	90.6	91.4	90
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2022

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	78	94	2316
Branches of foreign credit institutions	99	100	5455
Cooperative banks	-	-	-
Banking sector, total:	**76**	**92**	**2206**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2020	2021	2022
Commercial banks	8.8%	9.6%	12.2%
Cooperative banks	-	-	-
Banking sector, total:	**8.8%**	**9.6%**	**12.2%**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2020	2021	2022
Commercial banks	98	98	98
Branches of foreign credit institutions	2.3	2.2	2
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2020	2021	2022
Receivables			
Financial sector	39	38	34
Nonfinancial sector	59	60	64
Government sector	1.9	1.9	1.9
Other assets	0.1	0.1	0.1
Liabilities			
Financial sector	17	19	13
Nonfinancial sector	72	75	79
Government sector	11	6.0	8
Other liabilities	0.0	0.0	0.0
Capital	**12**	**11**	**10**

Capital adequacy ratio of banks

Type of financial institution	2020	2021	2022
Commercial banks	27.9	24.4	21.09
Cooperative banks	-	-	-
Banking sector, total:	**27.9**	**24.4**	**21.09**

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

Asset classification	2020	2021	2022
Non-financial sector, including	1.8%	1.2%	0.8%
- households	1.7%	1.0%	0.7%
- corporate	2.1%	1.5%	1.3%

The structure of deposits and loans of the banking sector in 2022 (%)(at year-end)

	Deposits	Loans
Non-financial sector, including:	83.5	82.6
Households	47.1	48.1
Corporate	36.4	34.5
Government sector	8.5	2.6
Financial sector (excluding banks)	8.0	14.8
Total	**100.0**	**100.0**

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

P&L account	2020	2021	2022
Interest income	839	887	1100
Interest expenses	127	125	143
Net interest income	712	762	967
Net fee and commission income	197	232	236
Other (not specified above) operating income (net)	292	206	207
Gross income	1454	1456	1631
Administration costs	542	574	610
Depreciation	41	43	43
Provisions			10
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	124	32	58
Profit (loss) before tax	463	525	662
Net profit (loss)	418	466	583

Total own funds in 2022 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	4771	4544	4621	151	
Cooperative banks	-	-	-	-	-
Banking sector, total:	**4771**	**4544**	**4621**	**151**	

Macroeconomic environment in the country

In 2022, the gross domestic product (GDP) of Georgia increased by 10.1% compared to the previous year. The high growth of the economy was largely caused by the sharp rise in income from abroad. By early 2022, pandemic-related restrictions had almost completely lifted, bringing increased inflows of international visitors/tourists. This was followed by the war started by Russia in Ukraine that brought a large number of migrants into the country, leading to a sharp increase in income from travelers and remittances. Taken as a whole, revenues from international travel almost tripled during 2022 (increasing by 182.5%) compared to the previous year, and remittances from abroad increased by 86.1%. The high growth of monetary income from abroad was especially reflected in the service sector, where the participation of immigrants is relatively high. Services accounted for 6.7 percentage points (pp) of the observed economic growth. Most of that came from transport, information and communication, and accommodation and food service activities, including restaurants and hotels.

In 2022, the current account deficit of the balance of payments amounted to only 4.1% of GDP, a historic low for Georgia. Trade in goods is the most deficient component of the current account. The volume of the goods trade deficit increased by 35% in 2022 compared to the previous year and amounted to 20.9% of GDP. The trade deficit was widened by the high growth of imports. Imports of goods increased by 35.8% in 2022 against the background of strong economic activity. This upsurge was also expedited by higher prices on imported goods as expressed in US dollars. Exports of goods rose by 36.0% annually during 2022. Although the increase in exports of goods slowed down slightly in the first quarter of the year, due to Russia-Ukraine war, exports of goods to other countries continued to grow. Exports to EU countries grew at a high annual rate, while those to Russia rose slightly – mostly due to lower sales of ferroalloys. Exports picked up later in the year, both in the region and in other countries, which was due to a faster-than-expected economic recoveries in most countries. Finally, total exports of goods and services were up by 38.2%, considerably outweighing the 14.4% increase in imports of goods and services. Ultimately, net exports contributed 7.9 pp to the growth of the economy. Investments increased real GDP by an additional 4.4 pp over the same period. The contribution of consumption to GDP growth amounted to a negative 2.2 pp in 2022.

Inflation in 2022 posed a challenge to both developing and developed countries. Expensive energy resources and commodity prices caused inflation to sharply increase globally, reaching historic highs in some countries. The global upward price trend was soon transferred to the Georgian market, causing a price hike on widely consumed products such as fuel and food (including bread and oil). The depreciation of the the Georgian Lari (GEL) in the early stages of the war also added to the rise of inflationary expectations and the increase in prices. As a result, the expected pre-war trend of reduced inflation slowed down, and inflation would ultimately significantly exceed the target rate during the year. Nevertheless, inflation did show a downward trend during the year, and the annual inflation level decreased to 9.8% in December. From the second half of the year, a trend of stabilized commodity prices and reduced transportation costs was evident on the world market. Meanwhile, imported inflation was moderated by the appreciated exchange rate as a result of strong foreign demand and an improved current account balance. The downward inflation trend was facilitated by tightened monetary policy of the National Bank of Georgia (hereinafter - NBG), fiscal consolidation and additional macroprudential instruments.

In the face of high inflation, monetary policy was tightened during the year, as the NBG remained focused on bringing down inflation. The NBG also launched additional macroprudential mechanisms to reduce inflation, which slowed down the growth rate of total lending and helped the trend of reducing inflation through this channel.

The fiscal deficit narrowed to 3.1% of GDP in 2022, supported by strong fiscal revenues and the unwinding of COVID-19-related measures. Public debt stock continued to fall in 2022 to 41.3% of GDP, largely benefiting from the contained fiscal deficit and the appreciation of the GEL.

The unemployment rate declined to 17.3% from 20.6% in 2021, while monthly nominal wages increased. The latter averaged 1590 GEL in 2022, reflecting a 17.4% growth over the year.

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

Banking is the main financial intermediary in Georgian economy. Foreign investments dominate banking sector and account for 87.4% of total equity. Banking sector assets (net of provisions) grew by 16% in 2022 (25% excluding exchange rate effect). Gross Credit portfolio (including interbank loans) increased by 13% YoY at the end of 2022 (excluding the exchange rate effect). In total, credit portfolio accounted for 63% of GDP, which is 9 percentage points less than in 2021. As for the total assets of banking sector, they accounted for 98% of GDP that is 3 percentage points less than in 2021.

In 2022 the highest growth rate was recorded in SME (17% annually, excluding exchange rate effect), followed by retail and corporate segments. Banking sector loan portfolio break-down by segments is the following: 32% accounts for corporate segment, 40% for Retail segment and 28% for SME segment.

The quality of loan portfolio improved in 2022: the share of non-performing loans to total portfolio decreased from 5.2% to 4.1% and the share of overdue portfolio decreased from 4% to 3.8% (Excluding exchange rate effect). This was affected by both the reduction of non-performing loans and new disbursements. The total portfolio reserve was within 4%.

In 2022, return on assets and equity amounted to 3.2% and 24.7% respectively, which was below the previous year's figures of 3.6% and 30.7% respectively. Unlike in previous years, the impact of one-off factors caused by the COVID-19 pandemic on profitability was eliminated. Compared to 2021, the cost-to-income ratio decreased from 41.4% to 39.9%. The cost-to-assets ratio increased marginally to 2.9%.

The volume of liquid assets grew in 2022. As a result, liquid assets account for 23% of total assets, enough to cover up to 37% of non-bank deposits.

By the end of 2022, the Georgian banking system continued to maintain an adequate level of capital under the Basel III capital adequacy framework and in consideration of supervisory measures related to COVID-19 pandemic. As of 31 December 2022, the Tier 1 capital ratio was 17.06% and the total regulatory capital ratio was 20.25%, which was 3.88 pp and 3.47 pp higher than the respective capital adequacy requirements.

Dollarization remains a major challenge for financial sector. By the end of 2022, the dollarization of loans decreased to 44.7%, and the dollarization of deposits decreased to 56.2%. Accordingly, the NBG prioritizes increasing larization (de-dollarization) and aims to maintain incentive reforms.

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 NBG is an independent public entity and is authorized to supervise and regulate the financial services sector in Georgia (except insurance, since 2013), including commercial banks, micro-banks, banking groups, non-bank financial institutions - securities market, credit unions, microfinance organizations, money remittance units, currency exchange bureaus and qualified credit institutions. NBG is the sole authority, which is responsible for the supervision of banking institutions, commercial banks (including digital banks) and micro-banks.

Organic Law "on the National Bank of Georgia" (hereinafter – Organic Law) explicitly defines NBG's functions, tasks, responsibilities and objectives. Laws and regulations are publicly available on the website of NBG.

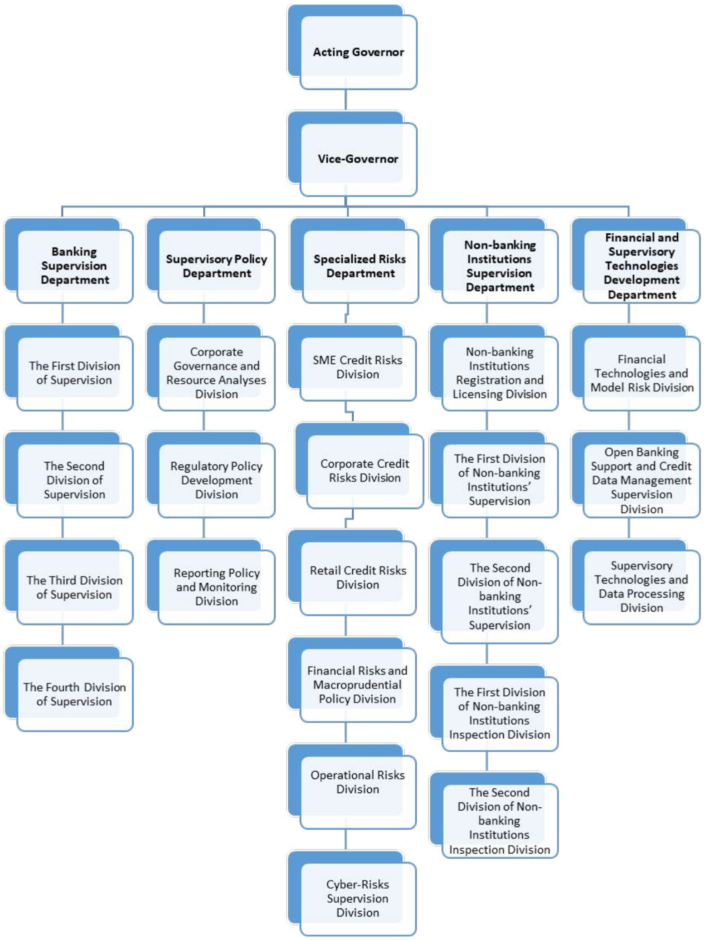
The major legislation that applies to commercial banking sector encompasses the Organic Law, Law of Georgia "on the Activities of Commercial Banks" and by-laws issued in form of decrees of the Governor of the NBG.

The primary legislative package of the regulatory framework for the new supervisory entity – micro-banks was developed in 2022. According to the amendment to the organic law, Micro-bank was also added to the list of entities supervised by the National Bank. The draft law of Georgia "On the Activities of Micro-banks" and related legal acts were approved by the Parliament. The legislative package creates a medium-sized, stable business model and a new highly reputable financial institution in the financial sector, missioned to promote lending to entrepreneurs and agriculture, to increase competition and to reduce interest margins on credit products. The NBG is actively working on remaining required by-laws.

In addition, NBG is publishing an annual supervisory strategy document underlying medium term strategic priorities (more precisely explained below).

Throughout 2022, the NBG continued to work intensively to improve the supervisory framework, bringing it closer to advanced international practice and enhancing a number of supervisory areas. More precisely, information on new developments will be provided below, among the activities of the Banking Supervisory Authority in 2022.

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Banking Supervisory Authority in 2022

Starting from 2020, NBG develops and publishes a three-year Supervisory Strategy document. The document entails the vision, values goals, supervisory principles, strategic priorities and upcoming reforms, and offers a timeline for their implementation. The purpose of the document is to provide information to investors, international financial institutions, rating companies, the public and other stakeholders regarding the supervisory priorities, plans and upcoming arrangements of the NBG. The first supervisory strategy document included the strategic priorities for 2020-2022 and the activities with relevant action plan for their implementation.

The NBG makes sure the supervisory strategy document is updated on an annual basis and is published in the first half of the year. Following includes amendment of the relevant action plan and provision of report on implementation of the action plan.

Similar to 2020 and 2021, the NBG published the annual review of supervisory strategy. Supervisory priorities defined by the NBG's 2020-2022 strategy remained unchanged in 2022 while the information on the already completed activities was updated. Namely, the NBG carried out its activities taking into account the following supervisory priorities:

- **Strengthening the corporate culture that encourages leadership and initiatives**
- **Strengthening the cooperation with the stakeholders**
- **Facilitation of stable functioning of the financial sector**
- **Approximation to international**
- **Development of the ecosystems for sustainable financial technologies**

Summary report on implementation of 2020-2022 supervisory priorities is available in the 2023-2025 supervisory strategy document, accessible through the web-page of the NBG.

In addition, throughout 2022, the NBG conducted work on the Supervisory Strategy for 2023- 2025 with greater involvement of private and civil sectors, including receiving opinions and recommendations of stakeholders through a published questionnaire.

The activities of the Banking Supervisory Authority in 2022

Throughout 2022, the NBG continued to work intensively to improve the supervisory framework, bringing it closer to advanced international practice and enhancing a number of supervisory areas. Among latest regulatory and supervisory developments, following ones are especially noteworthy:

- The draft law of Georgia "On the Activities of Micro-banks" and related legal acts were developed by NBG and approved by the Parliament. The legislative package creates a medium-sized, stable business model and a new highly reputable financial institution in the financial sector, missioned to promote lending to entrepreneurs and agriculture, to increase competition and to reduce interest margins on credit products.
- 2022 amendments in the Law of Georgia "On the Activities of Commercial Banks" set improved requirements for the licensing of commercial banks, and the suitability criteria of administrators and shareholders, substantially aligning them with the Directive on the Activities and Prudential Regulation of Credit Institutions operating in the European Union (CRD). These changes were important both for the fulfillment of the obligation stipulated by the Georgia-EU Association Agreement and for joining the Single Euro Payment Area (SEPA).
- Following the FSAP recommendation and the commitment assumed under the Letter of Intent signed in 2022 by the International Monetary Fund, the Government of Georgia and the National Bank of Georgia, the NBG approved the Guideline on the definition of certain grounds for application of supervisory measures, early intervention measure and revocation of a banking license of a commercial bank. The Guideline explains some of the grounds for the use of supervisory measures, the use of early intervention measures and the revocation of the banking license and also defines the related procedural matters.
- The NBG developed new transparency requirements for financial institutions: financial institutions, when offering financial products in combination, must provide customers with complete information about both the combined offer and the selling price of individual financial products. The requirement is about transparency of the prices on combined financial products, helping consumers make the most informed decisions and encouraging market competition.
- Transition of commercial banks' supervisory reports to International Financial Reporting Standards (IFRS) under the 2020-2022 supervisory strategy was one of the most important priorities in harmonizing with international standards. The Regulation on Idintifying Risk Categories of Financial Instruments and Expected Credit Losses was approved and changes were made to the relevant decrees. Transitioned to

the IFRS, commercial banks must comply with supervisor's regulations with numbers and methodology based on IFRS.

- When transitioning to IFRS, other things being equal, a neutral approach to the cost of regulatory capital should be maintained. The principle was introduced so that the change in accounting standards would not cause additional capital cost for the banking sector. At the same time, banks' capital positions should not deteriorate. A neutral approach to the cost of capital implies reducing the buffer on total regulatory capital in the banking system at the expense of increasing the capital surpluses on CET1 and Tier 1 capital. For this purpose, a credit risk adjustment (CRA) buffer was introduced and a procedure for its calculation was included in the Regulation on Determining Capital Buffers for Commercial Banks under Pillar 2. The credit risk adjustment buffer serves to reduce the credit risk caused by insufficient expected credit loss set up for assets and to determine an adequate capital buffer.

- In 2022, the Financial Stability Committee (FSC) of the NBG, upon recommendation of the Basel Committee, decided to update the framework for setting the countercyclical buffer. Before this update, standard countercyclical buffer base rate was equal to zero and it should take a positive value in case of excess lending. As for the neutral positive countercyclical buffer, base rate will also be positive under normal conditions. Under the new framework, total countercyclical buffer demand consists of the sum of neutral and cyclical demand. On its part, neutral demand has a positive value even in normal conditions, that is, even when the post-crisis economy is completely recovered, lending activity is not excessive, the quality of banking system assets is improved, profitability is stable, and the current trends of the economy are positive.

- The NBG developed an internal procedure for the General Risk Assessment Program (GRAPE), which defines in detail the course of the process, the deadlines and structural units involved, and the decision-making processes. In accordance with risk-based supervision and principles-based regulation, the General Program for Risk Assessment (GRAPE) guide was updated to align with the best international practices, and incorporate the recommendations of the FSAP assessment, hence making the risk assessment processes more efficient and transparent.

- The Corporate Governance Code of Commercial Banks was amended on August 24, 2022 to improve gender diversity in the Supervisory Boards and Directorates of Commercial Banks, which increased the demand of gender diversity. No later than June 1, 2023, banks' Supervisory Boards should have at least 33 percent share of the opposite sex, and at least 40 percent no later than June 1, 2025.

- The NBG worked on updating the Conflict of Interest Regulation: the draft of important changes were developed. Related party transactions and compliance with the requirements of the regulation are part of the corporate governance and group structure risk assessment of commercial banks.

- First digital bank was licensed.

A number developments in direction of operational and cyber risks, ESG and Sustainable financing, as well as resolution have been initiated or implemented. Many draft changes and supervision regulations were published on the website of the National Bank of Georgia to hold public consultations during 2022, giving general public the opportunity to share comments and recommendations. The NBG will continue to publish draft legal acts in the future. This process will be further improved along with upgrading the website, and will be in line with the best international practices in this regard.

Other supervisory and regulatory developments are provided in the Annual report of the NBG for the year 2022.

International activities of the authority

Year 2022 was quite successful and active for NBG on international level. Besides the participation in a number of international events and conferences, NBG has gained international recognition in various directions.

Global Finance, the world's leading financial publication, named Governor of the National Bank of Georgia, among world's best central bankers in 2022 for the fifth time in a row.

In 2022, the National Bank of Georgia chaired the Group of Banking Supervisors from Central and Eastern Europe (BSCEE). In this capacity, the National Bank of Georgia hosted the 34th Annual Conference of the BSCEE Group. The conference held in Tbilisi was dedicated to several important topics: the Basel Committee's work program and strategic priorities, the impact of the Russia-Ukraine war on the performance of central banks and the banking sector, and cyber risk management.

The NBG was represented at international conferences and forums, where the NBG Governor and other management representatives shared the successful experience of the National Bank of Georgia with international colleagues. The first meeting of the Euromoney Central and Eastern European leaders' community was held as a video conference and brought together the lead bankers of Central and Eastern Europe. The discussion was about defining the mandate of central banks and monitoring systemic risks.

The Governor and Vice Governor of the National Bank of Georgia took part in the annual meetings of the International Monetary Fund and the World Bank. In the panel discussion Development of Opportunities, the NBG Governor focused in his speech on the NBG actions on how the financial sector of Georgia was able to successfully pass through a rather severe phase of the shock caused by the pandemic, and on how the adequate policy of the NBG helped the country face the potential threats arising from the situation in the region.

The NBG participated in a conference held by the Central Bank of Belgium for the leaders of the central banks of the IMF Netherlands, Belgium and Luxembourg Constituency. Governor of the NBG was invited as the speaker of the first session regarding COVID-19 Pandemic and Recent Geopolitical Challenges: Macroeconomic Implications and Prospects.

An international conference on Central Bank Digital Currency (CBDC) and Decentralized Finance (DeFi) was held at the discretion of the National Bank of Georgia and the USAID Economic Security Program, and with the involvement of the World Bank. The two-day meeting focused on the public-private dialogue on central bank digital currency and decentralized finance. Governor of the National Bank of Georgia recapped the NBG actions to develop the digital GEL at the CBDC & DeFi conference.

Monetary policy challenges, post-pandemic reality and the economic consequences of Russia's full-scale war in Ukraine were discussed at a conference of central banks held within the framework of the Three Seas Initiative.

In 2022, cooperation with international media was strengthened and expanded. Central Banking, a reputable international publication, often featured news about the NBG projects and actions.

Annual report of the NBG for the year 2022 provides more detailed information on international activities of the NBG.

Cooperation with other supervisory bodies in the country

In 2022, the yearly meeting of the Interagency Financial Stability Committee was held. The committee was chaired by the Minister of Finance and the leaders of the NBG, the Deposit Insurance Agency and the State Insurance Supervision Service participated. The discussion at the session concerned the key elements and aspects of the resolution framework, the interaction of the National Bank of Georgia with the banking sector and the need to envigorate cooperation between agencies.

The National Bank of Georgia started working on the implementation of the framework for the recovery and resolution of commercial banks in 2021. As the work continued during 2022, the NBG closely cooperated with the International Monetary Fund and the World Bank. As part of the IMF technical assistance mission, presentations were made on all major issues of resolution and recovery, and practical recommendations were developed for the staff of the structural units of the NBG concerned, the Deposit Insurance Agency and the Ministry of Finance. The World Bank team, as part of the mission, conducted a simulation of the resolution, with the participation of the NBG, the Deposit Insurance Agency and the Ministry of Finance. The simulation tested preparedness for the financial crisis and gave practical recommendations. The second part of the simulation is planned for 2023, to test the implementation of the resolution.

The draft of the Law of Georgia on owning Dematerialized Securities, composed by the National Bank of Georgia, in cooperation with the Ministry of Economy and Sustainable Development of Georgia, and the amendments resulting from it are still being reviewed in the Parliament of Georgia. The package of legislative changes was initiated in 2021.The draft law describes relations linked with ownership and circulation of dematerialized securities. This type of securities exists only as an entry in the securities account. They appeared as a result of the development of modern technologies, thanks to which it is no longer necessary to own securities in material form or to register them. Accordingly, it is necessary for the legislation to propose their orderly regulation and, first of all, to clearly establish the issues of ownership rights, its confirmation and transfer.

The first international conference on competition and consumer rights was held in Georgia, and the NBG was one of the organizers, among the five regulatory agencies. The conference discussed competition law, consumer rights protection mechanisms and work accomplished by regulatory agencies. Representatives of the diplomatic corps and delegations of 20 countries took part in the two-day international conference.

Other relevant information and developments in 2022

The NBG has adopted an open regulatory policy-driven approach to address the specifics of the financial market of the country. This approach involves creating a fintech infrastructure, removing barriers for fintech companies, and implementing appropriate supervisory policies.

The NBG considers itself as a technological infrastructure provider for the market and has implemented a supervisory sandbox to allow new entrants to test innovative products and services in a supervisor-controlled environment.

In recent years, the NBG has successfully implemented various fintech infrastructure projects such as Open Banking, Credit Information Bureau “Platform”, Digital Bank framework, and electronic KYC.

Work was underway during the year to expand Open Banking services and create prospects for fintech companies to engage in Open Banking. Open Banking involves immediate exchange of information between different financial institutions using electronic technologies, based on the client’s desire and consent. In 2022, the services of exchanging information on standard products and exchanging account information for legal entities were added to the available services of Open Banking. Also, such services as: transfer initiation service for individuals and legal entities and remote identification service using Open Banking were introduced. The Parliament of Georgia approved the relevant legislative changes and from November 2022, non-banking institutions will have the opportunity to join the Open Banking project. In 2023, NBG intends to expand its Open Banking framework through the incorporation of value-added use cases.

As a next step, to create a more favorable environment for the fintech sector in Georgia, the NBG offers market participants a new type of license, "Platform", from November 2022. This license allows Fintech companies, after registration at the NBG, to receive data from the credit information bureaus, process this data, add additional information, including data from Open Banking and build income assessment, PD or other models.

Since launching of Digital Bank license in 2021, several applicants submitted their innovative business models and one of them already received a digital bank license. Presently, NBG is assessing the business models and related documents of other candidates and striving to establish an effective process with interested parties.

More detailed information on discussed and beyond mentioned topics can be found in the annual report of the NBG for the year 2022.

Questionnaire tables for the 2022 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	15	14	15
Branches of foreign credit institutions	0	0	0
Cooperative banks			
Banking sector, total:	**15**	**14**	**15**

Total assets of banking sector (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	56,870,926,138	60,568,300,187	70,351,948,552
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**56,870,926,138**	**60,568,300,187**	**70,351,948,552**
y/y change (in %)	**20.53%**	**6.50%**	**16.15%**

Ownership structure of banks on the basis of assets total

Item	2020	2021	2022
Public sector ownership			
Domestic ownership total	12%	13%	12%
Foreign ownership	88%	87%	88%
Banking sector, total:	**100**	**100**	**100**

Concentration of asset by the type of financial institutions, 2022

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	82.07%	89.60%	30.33%
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**82.07%**	**89.60%**	**30.33%**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2020	2021	2022
Commercial banks	1.82%	30.38%	24.57%
Cooperative banks			
Banking sector, total:	**1.82%**	**30.38%**	**24.57%**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2020	2021	2022
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)

	2020	2021	2022
Claims from	100.00%	100.00%	100.00%
Financial sector	0.93%	0.89%	0.77%
Nonfinancial sector	62.55%	66.45%	59.38%
Government sector	3.75%	3.82%	4.06%
Other assets	32.77%	28.85%	35.80%
Claims due to	89.72%	87.24%	86.85%
Financial sector	1.44%	1.34%	1.16%
Nonfinancial sector	9.07%	7.44%	6.27%
Government sector	1.37%	2.78%	2.53%
Other liabilities	77.83%	75.67%	76.90%
Capital	**10.28%**	**12.76%**	**13.15%**

Capital adequacy ratio of banks

Type of financial institution	2020	2021	2022
Commercial banks	17.59%	19.56%	20.25%
Cooperative banks			
Banking sector, total:	**17.59%**	**19.56%**	**20.25%**

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

Asset classification	2020	2021	2022
Non-financial sector, including	2.31%	1.90%	1.70%
- households	1.58%	1.40%	1.36%
- corporate	2.78%	2.23%	1.94%

The structure of deposits and loans of the banking sector in 2022 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	95.98%	98.47%
Households	54.01%	38.39%
Corporate	41.97%	60.08%
Government sector	4.02%	0.31%
Financial sector (excluding banks)	0.00%	1.22%
Total	**100**	**100**

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

P&L account	2020	2021	2022
Interest income	4,037,403,688	4,819,259,900	5,744,739,777
Interest expenses	2,188,353,998	2,333,418,242	2,776,630,293
Net interest income	1,849,049,690	2,485,841,658	2,968,109,484
Net fee and commission income	368,240,090	517,440,238	621,725,238
Other (not specified above) operating income (net)	506,567,508	677,644,777	1,168,214,066
Gross income	4,912,211,286	6,014,344,914	7,534,679,081
Administration costs	692,117,351	798,417,530	967,194,230
Depreciation	218,419,501	227,082,638	252,641,264
Provisions	1,329,203,782	(179,929,352)	326,659,787
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	1,329,203,782	(179,929,352)	326,659,787
Profit (loss) before tax	78,814,348	2,336,786,113	2,532,700,683
Net profit (loss)	99,261,850	2,082,014,688	2,086,502,661

Total own funds in 2022 (in EUR)
Basel III

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	3,939,674,197	2,935,085,115	3,318,974,979	620,699,219	
Cooperative banks					
Banking sector, total:					

Macroeconomic environment in the country

Gross domestic product grew by 4.6 percent last year, but growth dynamics slowed down to 0.4 percent in Q4 2022 in year-on-year terms. In EU comparison, Hungary's economic performance was in the first third of the ranking last year.

Rise in households' disposable income was supported by historically high employment, favourable income developments (rising wages) and targeted government measures (Personal income tax reimbursement, under 25 years old persons PIT exemption, six-month armed forces benefit, gradual reintroduction of the 13th-month pension, pension premium) mostly in the first half of 2022. In parallel with these, household consumption expenditures increased by 6.5 percent year-on-year in 2022. On the other hand, rising inflation resulted in the slowdown and fall in the purchasing power of wages from the second quarter of 2022.

Gross fixed capital formation rose by 1.2 percent in 2022 in year-on-year terms. The investment rate remained high at 28.5 percent. According to our estimate, both the private and corporate sector contributed to the growth of investments. The corporate loan portfolio increased significantly during the year 2022 supported by subsidized loan and guarantee programs, the banks' ample lending capacity and individual large deals. Household investment increased as a result of favourable income developments in the first half of the year and the Government's home creation programs, while public investment – due to moderate progress of the developments implemented by the government sector – decreased on an annual basis.

The annual average inflation was 14.5 percent in 2022. CPI was significantly affected by the rise in global commodity, food, and energy prices. Energy prices started to increase from mid-2021, but the Russia-Ukraine conflict, started in February 2022, also contributed to the further rise in energy prices. Price shocks gradually passed through to consumer prices resulting in a level of inflation not seen for the last 40 years. According to our estimates, the rise in inflation was at first supported by global factors, then in the second half of 2022 domestic factors increased in importance. The increase in gross operating surplus was the highest in OECD countries, which also contributed to the rise in inflation.

The Hungarian labour market proved to be resilient during the pandemic, and the Russia-Ukraine conflict had smaller effect on the labour market than expected. Employment level continued to be historically high, while the number of vacancies had also increased. In 2022, the number of people in private sector employment rose by 2.1 percent. The unemployment rate was 3.6 percent. Corporate labour demand was growing both in manufacturing and the service sector, the number of vacancies exceeded the pre-pandemic level in the service sector in 2022, while it remained slightly below the pre-pandemic level in the manufacturing sector. Due to the historically tight labour market, wage dynamics have been high, with average wages rising by 15.7 percent in the private sector in 2022.

The budget deficit amounted to 6.2 percent and the current account deficit rose to 8.1 percent of GDP in 2022, while the net borrowing of the economy also rose. The continued decline throughout last year in the trade balance was mostly related to terms-of-trade, so the surge in energy prices.

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

Following record-high lending in early 2022, household lending has started to moderate amid increasing inflationary and rising interest rate environment coupled with uncertain economic outlook. Corporate lending, however, continued to grow, driven by the interest rate subsidized Széchenyi Card Programme for SMEs, and by higher financing need of companies in the energy sector. However, the latter effect should be considered as a temporary factor. Reflecting the diverging trends in corporate and household lending and growing GDP, the ratio of total assets-to-GDP (excluding state-owned specialised banks) declined by 3 percentage points to 100 percent in 2022.

Household loans from credit institutions grew by 6.3 percent in nominal terms year-on-year, as a result of disbursements and repayments. The volume of new loans reached a new peak in the second quarter, mainly due to the new contracts signed under the FGS Green Home Programme (GHP) and loan demand brought forward because of expected interest rate increases. As the programme phased out and lending rates climbed, new lending gradually moderated in the second half of the year, with new contract volume in 2022 10 percent lower than in 2021. The annual volume of new housing loans in 2022 amounted to HUF 1,182 billion, 9 percent less than a year earlier, and the slowdown was clearly reflected in the volume of new loans in December, which decreased by 61 percent compared to a year earlier. Subsidised loans related to the family protection and home creation programmes (family home creation allowance "CSOK", rural CSOK and prenatal baby support) accounted for 38 percent of the volume disbursed in 2022.

The annual growth rate of corporate loans reached 13.8 percent at the end of 2022, while the growth rate of the SME segment was 12.7 percent. In real terms, this means a contraction in total credit and SME credit. Government loan and guarantee programmes and increased financing needs of firms in the energy sector have contributed significantly to sustaining nominal stock growth. Demand in the corporate credit market remained relatively strong despite the climbing interest rate environment: in the second half of 2022, credit institutions signed more than HUF 1,930 billion of new, non-overdraft type loan contracts, representing a 5 percent year-on-year increase. At the same time, there was a shift in the structure of demand towards short-term loans and FX loans.

The volume of non-performing loans in the banking system rose from historic lows in the months following lifting of the general moratorium (2021 October), both in the corporate and the household segments. The stock of loans over 90 days past due increased by HUF 75 billion for corporates and by HUF 28 billion for households in 2022. The stock of loans with less than 90 days past due but classified as non-performing by banks decreased by HUF 39 billion in the corporate sector, while it increased by HUF 13 billion in the household segment. Loans over 90 days past due accounted for nearly one-third of all non-performing loans in both segments. The volume of NPLs stood at HUF 465 billion and HUF 432 billion, respectively, at the end of 2022. As a result of expansion of lending and banks' portfolio cleaning, the share of non-performing loans in the credit institution sector was 3.9 percent in the corporate segment, and 4.4 percent in the household segment at the end of 2022.

Based on stand-alone (unconsolidated) reporting data, the credit institutions sector's profit after tax in 2022 totalled HUF 488 billion, HUF 21 billion (4 percent) lower than in the previous year. The decline in profits was mainly due to the recognition of provisions for loan losses and extra profit (windfall) tax, as well as the impact of the interest rate cap measures, the adverse impact of these measures on profits was partly offset by the high net interest income. With a modest decline in nominal profits, the sector's return on equity (RoE) declined from 10 percent at end-2021 to 9 percent and return on assets (RoA) fell from 0.9 to 0.7 percent.

After three quarters of decline, the consolidated capital adequacy ratio of the banking system rose slightly by 13 basis points to 18.2 percent by the end of 2022. The improvement in capital adequacy is mainly attributable to the decline in risk-weighted assets held by foreign subsidiaries, expressed in HUF. After a 158 basis points decrease in 2022, the CET1 ratio stood at 16.1 percent at the end of December.

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

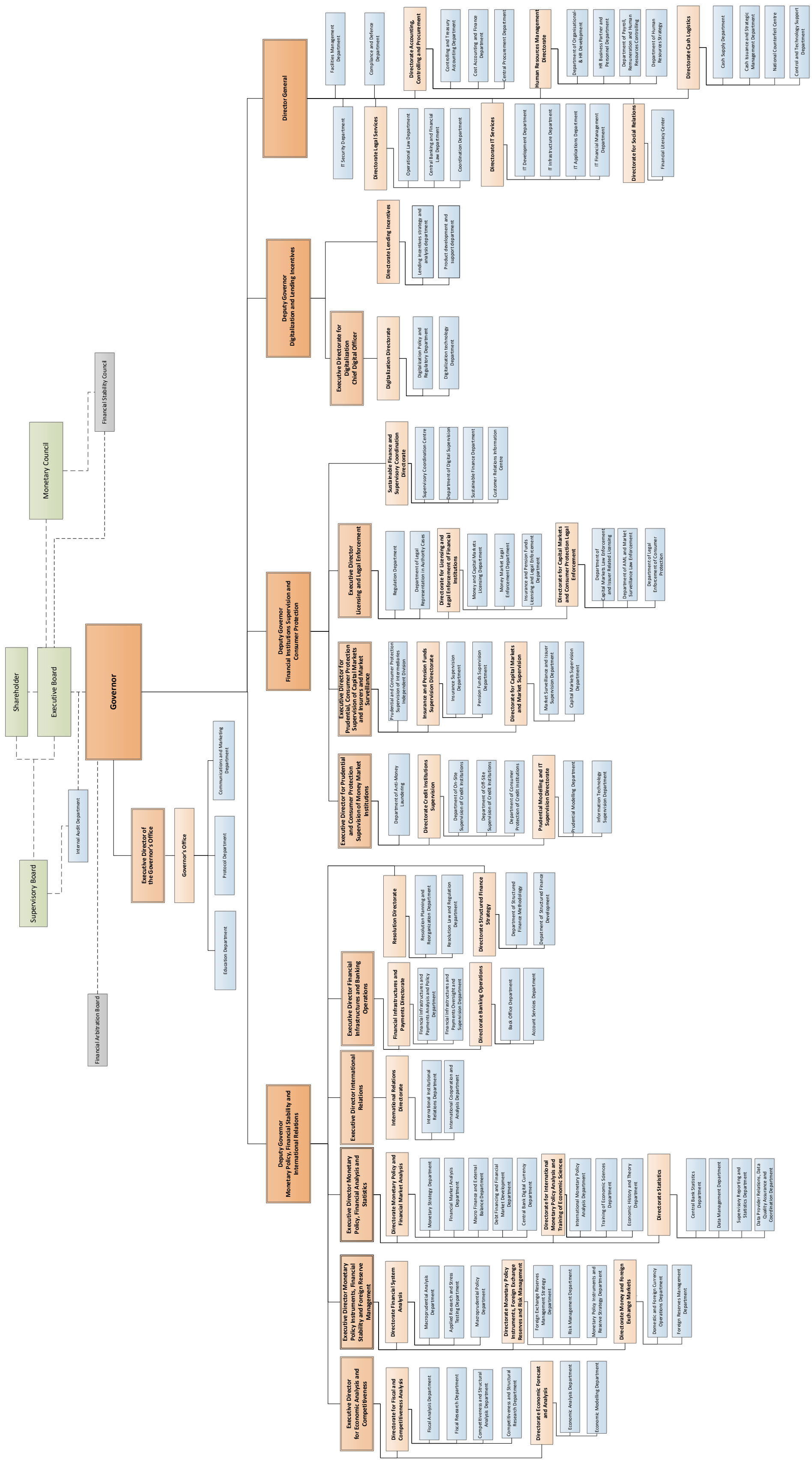
The supervisory and consumer protection tasks of the Magyar Nemzeti Bank (the Central Bank of Hungary, "MNB") are performed according to the Act CXXXIX of 2013 on the Magyar Nemzeti Bank.

The MNB issues binding MNB decrees and non-binding recommendations, documents with information purposes and CEO letters (the latter also called "Executive Circulars") – in order to give information and guidance for the supervised institutions in connection with the detailed rules and supervisory interpretation of the sector-specific legislation and the expectations of MNB.

Regarding the legislative developments in 2022, the Act LVIII of 2021 on amending the laws affecting certain elements of the financial intermediation system for the purpose of legal harmonization should be mentioned. This Act became applicable gradually in 2022, and as regards of banking regulations, the main purpose was the implementation of EU legislation and making further clarifications thereto, of which the following can be highlighted:

- Covered Bonds Directive [Directive (EU) 2019/2162 of the European Parliament and of the Council on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU];
- Crowdfunding Regulation [Regulation (EU) 2020/1503 of the European Parliament and of the Council on European crowdfunding service providers for business, amending Regulation (EU) 2017/1129 and Directive (EU) 2019/1937];
- PEPP Regulation [Regulation (EU) 2019/1238 of the European Parliament and of the Council on a pan-European Personal Pension Product (PEPP)];
- 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].
- In 2022, the MNB reviewed and updated many of its recommendations. The most important topics were the followings:
- assessment of the suitability of members of the management body and key function holders;
- remuneration policy of credit institutions;
- principles of consumer protection regarding non-performing clients;
- application of rules of disclosures;
- Business Reorganisation Plans;
- climate change-related and environmental risks, and the application of sustainability aspects in the activities of credit institutions;
- measurement, management and control of credit risk;
- internal governance function in credit institutions;
- management of risks related to real estates.

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the supervisory authority in 2022

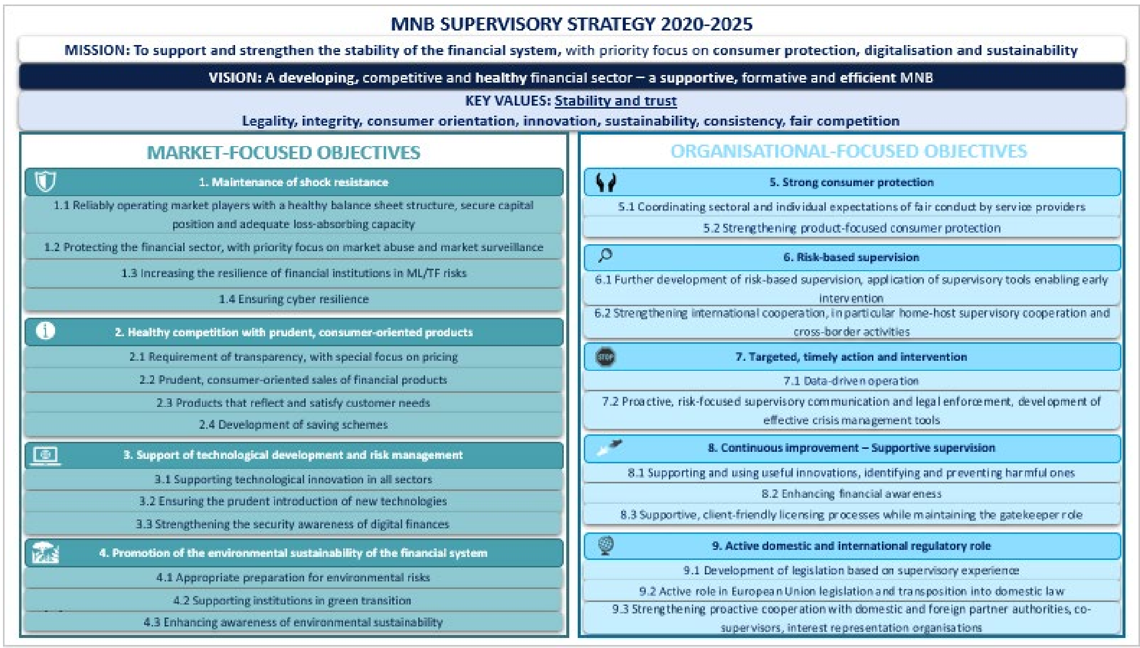
In October 2019 the main priorities and objectives of supervision for the 2020-2025 cycle were set. In developing the new supervisory strategy ("Stability and Trust 2.0"), the MNB relied on the previous strategy in addition to market, social and regulatory changes, the strategic objectives set out in the MNB's Statutes as well as the MNB's Competitiveness Program, thus ensuring a continuous transition and the progression of supervisory objectives.

Following the adoption and start of implementation of the Stability and Trust 2.0, the COVID-19 pandemic triggered swift and decisive action by the MNB to a previously unforeseen extent. The MNB, acting in its supervisory capacity, has taken a number of measures to mitigate the negative economic impact of the coronavirus pandemic and to protect the resilience of institutions to shocks. These crisis management supervisory measures have contributed greatly to maintaining financial stability and successfully relaunching the economy.

At the beginning of 2022, the economic recovery following the coronavirus pandemic and the related supervisory tasks were still dominant, but since the end of February, the Russia–Ukraine conflict has fundamentally changed the previously projected development path of the sectors and institutions supervised. Previously assumed market trends and risks have been significantly altered in a global inflationary environment driven by soaring global commodity and energy prices as well as food prices.

All these significant economic and social changes, not seen since 2008-2009, together with the regulatory changes since autumn 2019 and the MNB's new sustainability mandate, have justified a mid-term review of the Stability and Trust 2.0, and the need to review and adapt supervisory priorities and objectives to current and newly anticipated market risks.

The vision, mission and the values represented and conveyed by the MNB remain unchanged, the descriptions set out in 2019 are still considered valid and are the basis for the revised overall Supervisory Strategy Framework 2022-2025 ("Stability and Trust 2.1"). The revised supervisory strategic framework is also aligned with the MNB's Sustainable Balance and Catching-Up Programme announced in May 2022, and takes into account the proposals and specific tasks set out in the programme for the supervision of the financial intermediary system.



The activities of the Banking Supervisory Authority in 2022

The MNB's supervisory activity related to the financial market sector is based on inspections (on-site supervision) and continuous assessment of the data and information provided by the supervised institutions (off-site supervision). In course of off-site supervision, the risk assessment is mainly based on the continuous analysis of statistical data and the review of the documents provided by the various internal committees of the institutions. Communication and meetings with the management and various experts of the supervised institutions are also contributing to the final supervisory assessments.

In 2022, in the frame of off-site supervision the MNB conducted 104 prudential meetings with senior managements of the supervised institutions and participated in 146 board and other working group meetings. Regular (quarterly) risk assessments based on qualitative and quantitative information are summarized in viability assessments during the annual supervisory cycle, which provides feedback for the senior management of supervised institutions within the framework of SREP CEO meetings.

In 2022 within the framework of the supervision of credit institutions, financial enterprises, payment institutions and money market intermediaries, the MNB concluded 20 targeted, thematic, follow-up and 29 comprehensive and internal capital adequacy assessment process ("ICAAP") / business model analysis ("BMA") inspections. Moreover, supervisors conducted simplified ICAAP review exercises at small institutions that pose a lower level of systemic risk.

As a result of the completed inspections 427.1 million HUF prudential fine was imposed on all players of financial market, emphasizing that the MNB is taking a stand firmly against infringements and the institutions that had failed to comply with the former resolutions.

In 2022 the MNB concluded 26 internal liquidity adequacy assessment process ("ILAAP"). 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). 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 in terms of LCR were only set in the case of a concentration of depositors. Following the foreclosure of Sberbank, and uncertainties of

Raiffeisen the MNB limited the unsecured intra-group lending and launched a specific inspection on this topic. The MNB also issued a CEO letter related to implementation of Covered Bond Directive.

With respect to the appropriateness of impairment, the MNB has been closely monitoring the ECL provisioning levels and practices of supervised credit institutions since early 2021. The guidelines and requirements related to the classification of exposures falling under the moratorium on payments and minimum loan loss provisioning were presented by the central bank in an executive circular, and it has been continuously monitoring the latter.

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, procedures related to Central Credit Information System ("KHR") and with the IFRS9 provision calculation models and methods.

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.

Onn-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.

In 2022 the MNB issued its consumer protection related Recommendation[1] to financial institutions on the treatment of retail credit- and leasing contracts in arrears. It concerns the process financial institutions are recommended to follow while contacting with and providing information to consumers in the course of defaults on payments, in order to avoid the termination of credit agreements.

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. In 2022 the ESRB General Board virtual meetings focused primarily on the risks and vulnerabilities in the financial system, in the EU commercial real estate and in the non-bank financial intermediation (NBFI), digitalization (crypto-assets, Decentralized Finance) and cyber resilience from a macroprudential perspective, and climate risk monitoring, as well as public policy priorities to address them.

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

[1] MNB Recommendation 5/2022. (IV.22.) on consumer protection principles for financial institutions in the management of retail credit, loans and financial leasing contracts in respect of late payments

in May and in November 2022. Participants exchanged views on the global and regional vulnerabilities, the regulatory and supervisory issues related to crypto assets, the climate-related financial risks and the liquidity mismatch in open-ended funds (OEFs).

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 member of the Common Pool of Panellists of the EBA Mediation and Breach of Union Law (BUL) Panels.

Memorandum of Understanding

On 7 July 2022, the MNB and the Bank of Albania signed a Memorandum of Understanding concerning supervision field, to establish an arrangement for the sharing of supervisory information and the enhancing of cooperation in the area of banking supervision.

On 18 July 2022, the MNB and the Bank of Mongolia signed a Memorandum of Understanding concerning information sharing, promoting the development of channels of communication.

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 groups 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 ("WCCA"). 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 8 banking colleges as host supervisor authority.

As home supervisor, the MNB leads the banking supervisory college of OTP Group. In 2022 two personal college meetings were held in Budapest in line with the regular college schedule. The college collaboration resulted among others in the joint decision on the assessment of capital and liquidity adequacy and on the group recovery plan assessment.

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, pension funds, intermediaries 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 Centre[3].

[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

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 2022

Sberbank

In its announcement of 1 March 2022, the Single Resolution Board, the European Union's resolution authority, prohibited the continued operation of the Austrian Sberbank Europe AG, the parent company of the Sberbank Magyarország Zrt. While maintaining the bank's operation in the short term, the MNB made considerable efforts to safeguard the interests of customers and all stakeholders and to find a long-term solution, namely the sale of the Hungarian Sberbank subsidiary, which, however, failed. The MNB withdrew the operating licence of Sberbank Magyarország Zrt., ordered its dissolution and designated the Financial Stability and Liquidator Non-profit Limited Liability Company (PSFN) as the liquidator of the company. Until 5 April 2022, the National Deposit Insurance Fund (NDIF) offered the depositors of the former Sberbank Magyarország Zrt. the option to avail themselves of HUF 141.6 billion, with payment at the Hungarian Post Office, in certain branches of Takarékbank or through a transfer to a bank account provided by the depositors. Following the payment of the insured deposits, unsecured deposits have also been fully refunded. The MNB incorporated the lessons and experiences from crisis management into its practices, making proposals for enhancing the resolution framework in Hungary and the EU.

Supervisory measures to mitigate liquidity risks:

The MNB perceived the elevation of liquidity risks. The events at the **SVB, and Credit Suisse** showed that deposits are less stable than it appears in LCR. Country specific factors – like the **strict monetary policy, the uncertainties in the real economy and the competition for deposits** – also contributed to the risks. The MNB expects banks to address risk properly by managing risks, like building liquidity buffers, stress testing and recovery plans.

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

- Credit institutions with LCR below 140% are subject to more rigorous questions about their liquidity risk management framework.
- Additional liquidity requirements are based on depositors exceeding share of 1% instead of 2.5%

Questionnaire tables for the 2022 BSCEE Review[4]

Number of financial institutions (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	29	29	26
Branches of foreign credit institutions	8	8	9
Cooperative banks	0	0	0
Banking sector, total:	**37**	**37**	**35**

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

Type of financial institution	2020	2021	2022
Commercial banks	45 619 416	53 050 390	60 899 792
Branches of foreign credit institutions	3 863 626	4 142 589	5 633 658
Cooperative banks	-	-	-
Banking sector, total:	**49 483 042**	**57 192 979**	**66 533 450**
y/y change (in %)	**22.1%**	**15.6%**	**16.3%**

Ownership structure of banks on the basis of assets total*

Item	2020	2021	2022
Public sector ownership	4.4%	0.0%	0.0%
Domestic ownership total	49.8%	51.0%	53.0%
Foreign ownership	50.2%	49.0%	47.0%
Banking sector, total:	**100.0%**	**100.0%**	**100.0%**

** Banks controlled by strategic foreign owners are considered in foreign ownership.*

Concentration of asset by the type of financial institutions, 2022

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	48.7%	65.5%	0.126
Branches of foreign credit institutions	77.1%	93.3%	0.259
Cooperative banks	-	-	-
Banking sector, total:	**44.6%**	**59.9%**	**0.107**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2020	2021	2022
Commercial banks	5.1%	10.2%	9.1%
Cooperative banks	-	-	-
Banking sector, total:	**5.1%**	**10.2%**	**9.1%**

4 Without 3 Special Financial Institutions (MFB, EXIM, KELER)
Based on individual data

Distribution of market shares in balance sheet total (%)

Type of financial institution	2020	2021	2022
Commercial banks	92.2%	92.8%	91.5%
Branches of foreign credit institutions	7.8%	7.2%	8.5%
Cooperative banks	-	-	-
Banking sector, total:	**100.0%**	**100.0%**	**100.0%**

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

	2020	2021	2022
Receivables			
Financial sector	35.2%	40.4%	42.8%
Nonfinancial sector	39.6%	38.6%	36.8%
Government sector	22.7%	19.3%	19.5%
Other assets	2.5%	1.7%	0.9%
Liabilities			
Financial sector	30.6%	31.9%	37.7%
Nonfinancial sector	51.6%	52.2%	46.4%
Government sector	3.5%	3.7%	3.7%
Other liabilities	5.3%	3.8%	4.4%
Capital	9.0%	8.4%	7.8%

Capital adequacy ratio of banks

Type of financial institution	2020	2021	2022
Commercial banks	22.3%	21.4%	20.3%
Cooperative banks	-	-	-
Banking sector, total:	**22.3%**	**21.4%**	**20.3%**

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

Asset classification	2020	2021	2022
Non-financial sector, including*	2.9%	3.7%	3.7%
- households	3.1%	4.2%	4.4%
- corporate	2.8%	3.2%	3.1%

** Domestic loans*

The structure of deposits and loans of the banking sector in 2022 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	81.1%	87.3%
Households	35.9%	40.9%
Corporate	45.2%	46.4%
Government sector	6.3%	6.3%
Financial sector (excluding banks)	12.6%	6.4%
Total	**100.0**	**100.0**

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

P&L account	2020	2021	2022
Interest income	1 233 058	1 531 177*	4 236 925
Interest expenses	384 422	505 060	2 592 398
Net interest income	848 636	1 026 117*	1 644 527
Net fee and commission income	600 373	671 347	774 774
Other (not specified above) operating income (net)	215 417	291 166*	155 241
Gross income	1 664 426	1 988 630*	2 574 543
Administration costs	1 038 863	1 147 168*	1 538 519
Depreciation	120 418	132 149	138 841
Provisions	-249 948	-144 408	-373 118
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	255 198	564 904	524 065
Net profit (loss)	222 591	501 002	467 563

** Data correction due to data modification of institutions*

Total own funds in 2022 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	13 268 395 599	11 428 344 161	11 656 907 559	1 611 488 040	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**13 268 395 599**	**11 428 344 161**	**11 656 907 559**	**1 611 488 040**	**-**

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

By the end of 2022 the banking sector in the AIFC consisted of 13 banks, comprised of 4 banks, 3 branches of banks, 4 credit providers and 2 money service providers. By 2022 the total amount of assets constituted to 774 mln of USD. More detailed data on the banking sector is displayed in the questionnaire tables below.

As of the end of 2022, the AIFC financial services framework included:

- 29 types of regulated activities:
- 6 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

2022 marked introduction of a number of important changes in banking regulatory framework of AIFC as follows:

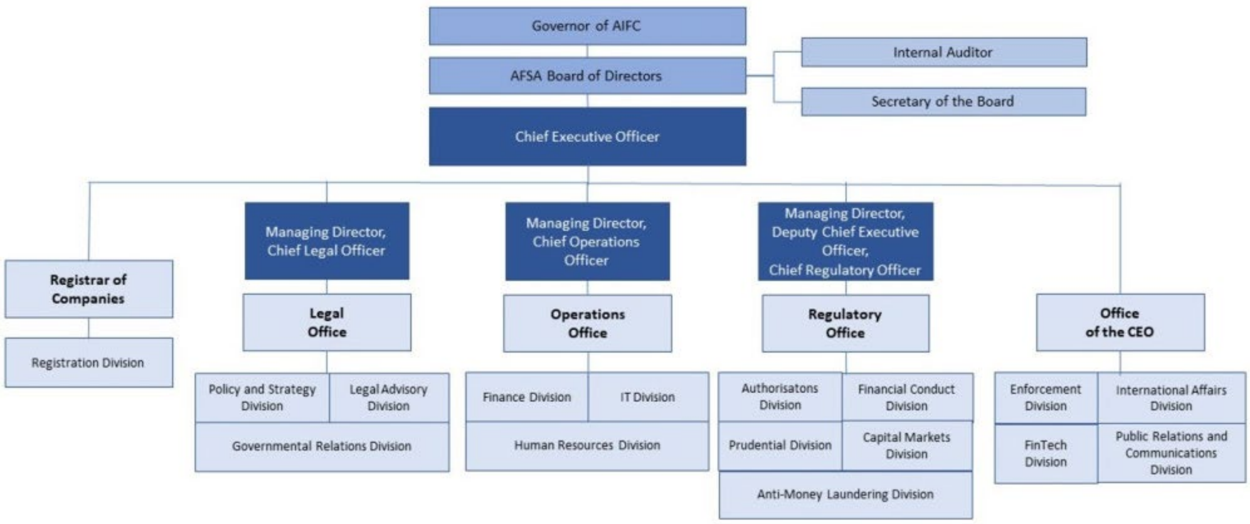
1) Currency Regulation and Information Exchange Rules in AIFC.

AFSA and the National Bank of the Republic of Kazakhstan (NBK) continued negotiations on access of AIFC Participants to the national payment infrastructure. For instance, access to correspondent bank accounts in Kazakhstani second-tier banks (STB RK) was streamlined for AIFC Participants, including banks.

2) Enhancing of the AIFC Banking Business Framework and Adoption of the Captive Finance Regime.

As a result of the enhancement of the AIFC Banking Business Prudential Rules (BBR) undertaken in 2021, provision of credit from own funds was no longer considered as a basis for disapplication of the BBR. Providing credit within the same group was also no longer considered a Regulated Activity. Consequently, the entire BBR was applied to credit providers in the same way it is applied to Banks. In 2022, the analysis of best practice jurisdictions was continued to identify whether credit providers should be given any exemptions or differing prudential requirements. The amendments were enacted in December 2022, they include several exemptions for credit providers and the introduction of the commercial captive finance regime, thereby aligning the treatment of credit providers in the AIFC to international standards.

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Banking Supervisory Authority in 2022

AFSA pursued its activities in 2021 guided by the AIFC Development Strategy 2021 – 2025, adopted by the AIFC Management Council on 2 July 2020. Specifically, AFSA focused on implementing the AIFC's objectives, as envisaged in the Constitutional Statute and contributing to the relevant reforms necessary for the proper functioning of the financial sector. AFSA made contributions to the implementation of the AIFC strategy by pursuing several priorities, including:

(i) More granular and tailored approach towards the activities that grow in the Centre (asset management, commodities, digital assets);
(ii) International assessments (FATF, FSAP);
(iii) Capacity building of supervisors (supervision and reporting under the Currency regulation framework);
(iv) Cooperation with regional and national regulators;
(v) Consistently building internal capacity (digitalisation, introduction of supervision fees).

AFSA also made contributions to the newly adopted "Concept of the Development of Financial Sector until 2030" to engage in implemenatoin of following initiatives:

(i) Expanding the list of financial services provided by AIFC Participants to residents of Kazakhstan and further access to the national infrastructure of financial regulators;
(ii) Implementation of measures to increase the participation of foreign banks in financing the economy;
(iii) Proposing additional measures for the development of Islamic banking.

The activities of the Banking Supervisory Authority in 2022

The activities of AFSA in 2022 focused on following workstreams: (1) development and enhancement of legal framework with a view of further improvements of banking regulation; (2) further alignment with international standards and furthering international recognition of AIFC; (3) combating money-laundering; (4) supervision; (5) development of digital assets regime.

1) AFSA developed and adopted the following Rules and regulatory materials relating or impacting banking sector:

   - AIFC Commodity Exchange Framework

2) AFSA enhanced the following legislative frameworks:

   - AIFC Anti-Money Laundering, Counter-Terrorist Financing and Sanctions Rules
   - AIFC Currency Regulation Framework
   - AIFC Recognition Framework for Recognised Non-AIFC Members
   - AIFC Banking Business Framework and Adoption of the Captive Finance Regime
   - AIFC Asset Management Framework

3) Commitment to International Standards and International Cooperation:

   - **Mutual assessment against the Financial Action Task Force (FATF) standards:** As part of the mutual assessment of Kazakhstan and the AIFC against FATF standards on 14 September 2022 the assessment team of the Eurasian Group on Combating Money Laundering and Financing of Terrorism (EAG) made an onsite visit to AIFC. EAG assessors held interviews with AFSA and AIFC obliged entities to assess the AIFC's compliance with international anti-money laundering (AML) and counter financing of terrorism (CFT) standards. During the meeting, AFSA responded to more than 50 questions from EAG assessors. Tentative outcomes of the assessment indicate the AIFC's high level of technical compliance with international AML/CFT standards.
   - **Recognition of the AIFC tax regime as non-harmful:** Throughout 2022 AFSA continued working with the OECD and the Ministry of Finance of Kazakhstan to introduce substantial presence requirements for AIFC Participants aimed at preventing harmful tax practices in the jurisdiction of the AIFC. This joint co-operation led to the OECD's Forum on Harmful Tax Practices adopting the decision to recognise the AIFC tax regime as non-harmful in July 2022. Practical implication of this development will prevent tax evasion and abuse of harmful tax practices by AIFC participants.
   - **Obtaining ISDA Recognition of the AIFC Netting Regime for international promotion:** To promote the uptake of the netting regime by financial institutions and facilitate a natural progression of the AIFC derivatives sector, AFSA has been working on obtaining ISDA recognition for the AIFC's existing netting regime. As a result, on 28 July 2022, ISDA published an Informal Country Update to all its global members provided by the ISDA Panel law firm (Dentons Kazakhstan) on the enforceability of close-out netting under the Acting Law of the AIFC. The publication of the update marks a significant milestone in AFSA's work with ISDA and marks the completion of the first step towards the full recognition of the AIFC as a 'netting-friendly jurisdiction'.
   - **Assessment against International Organization of Securities Commissions (IOSCO) Principles 1-5:** By the end of 2022 the IOSCO Standards Implementation Review Group (ISIM) completed its assessment of AFSA's compliance with IOSCO Principles 1-5, which cover the responsibilities and powers of the regulator. The report confirms the high-level implementation of IOSCO standards in the AIFC jurisdiction and highlights several best practices applied in the AIFC. The implementation of these five Principles is critical as they establish the desirable attributes of a regulator.

4) Combating money laundering including following activities:

- 57 AML Thematic reviews were conducted including 14 Fintech firms, 40 NPIOs and 3 Foundations.
- 2 on-site inspections were conducted including 1 banking firm and 1 investment firm.
- 19 poilcies and rules of the AIFC were reviewed.
- 40 enhanced due diligence

5) Supervision of firms, including banks entailed following actions:

- 7 warning letters due to breaches of prudential requirements, lack of systems and controls and late submission of prudential returns;
- 2 no-action letters due to breaches of Minimum Capital Requirements and Liquid Assets Requirements;
- 8 written directives due to breaches of prudential requirements and non-compliance with Approved and Designated Individuals requirements;
- 11 late reporting fines due to late or inaccurate reporting.

6) Promotion of FinTech and Innovations in the AIFC and beyond:

- Received a total of 91 pre-applications, of which 30 received eligibility confirmation.

The total number of full applications received during this period was 24, and only 5 of those obtained FinTech Lab licenses. 2022 heralded the first time when a FinTech Lab participant graduated from the regulatory sandbox and received a full license, while 8 licenses were withdrawn. As a result, by the end of 2022, the total number of licensed companies in the Fintech Lab was 18.

International activities of the authority

Throughout 2022, AFSA engaged in international co-operation efforts that led to the favourable positioning of AIFC's jurisdiction, and positioning of AFSA, as a reputable, reliable, and trusted financial services regulator under multilateral and bilateral co-operation mechanisms. AFSA's international relations were pragmatic and outcome-oriented, resulting in the following initiatives: (1) hosting a Regional Round Table of Central Banks Governors, including from Kazakhstan, Azerbaijan, Armenia, Georgia, Kyrgyzstan and Mongolia, in June 2022; (2) organizing the Regulatory Landscape forum in the framework of the Astana Finance Days in June 2022; (3) hosting a High-Level meeting on Regulatory Co-operation in Central Asia in November 2022; (4) organizing 5th World Investor Week in October 2022.

AFSA continued strengthening bilateral relations with peer regulators from Europe and Asia to enhance its ability to exchange information with regulators on supervisory issues. In 2022, AFSA entered into Memoranda of Understanding with the Agency of Securities Market Development and Specialised Registrar of the Ministry of Finance of the Republic of Tajikistan bringing the total number of agreements and memoranda concluded by AFSA to 44.

As part of supervisory co-operation AFSA continued engaging with peer regulators across the world with a view to sharing experience (Bulgaria, DFSA-UAE, Indonesia, Georgia, Hungary, Kyrgyz Republic, Luxembourg, Mongolia, Tajikistan, Turkiye, Turkmenistan, Uzbekistan, QFCRA - Qatar).

AFSA actively contributed to the activities of global standard-setting organisations. The main avenues for AFSA's involvement were (1) through its membership of 15 committees and working groups of international organisations; (2) its contribution to research and survey initiatives globally; and (3) attendance at international forums discussing and expanding the global regulatory agenda.

Cooperation with other supervisory bodies in the country

The adoption of the "AIFC Rules on Currency Regulation and Provision of Information on Currency Transactions in the AIFC" in 2021 was a positive first step in cross-juridictional demarcation between AFSA, NBK and ARDFM. Throughout 2022 AFSA further actively engaged in providing contributions to working groups established peer regulators in Kazakhstan and to mutual implementation arrangements, as well as further proposed development of the above currency rules.

For the purposes of currency regulation, AFSA started collecting currency transactions reports from AIFC Participants and contributed to maintenance of financial stability by making the reports avaialble to the NBK. The total number of reports submitted to AFSA within the AIFC Rules on Currency Regulation reached 636 by the end of 2022. Over the reporting period, the list of respondents included 60 entities, covering 41 AIFC Participants and 19 commercial banks of Kazakhstan that are subject to reporting on currency transactions carried out on behalf of AIFC Participants.

One of the breakthrough achievements of the year was the launch of a pilot project on the interaction of AIFC-registered crypto exchanges and Kazakhstan's second-tier banks. The FinTech Lab developed the rules for the pilot, one of the main aims of which is to demonstrate whether amendments need to be made to national legislation and to the acts of the AIFC to allow general public to use cryptoexchanges on a wider scale. The project is a joint product of the working group consisting of AFSA, the Ministry of Digital Development and Aerospace Industry, NBK, Financial Intelligence Unit and ARDFM.

Questionnaire tables for the 2022 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	1	3	4
Branches of foreign credit institutions	3	3	3
Cooperative banks			
Banking sector, total:	**4**	**6**	**7**

Total assets of banking sector (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	10,1	106,3	66,7
Branches of foreign credit institutions	388,5	907,6	659,9
Cooperative banks			
Banking sector, total:	**398,6**	**1010,9**	**726,6**
y/y change (in %)			

Ownership structure of banks on the basis of assets total

Item	2020	2021	2022
Public sector ownership			
Domestic ownership total	2,5%	3,4%	8%
Foreign ownership	97,5%	96,6%	92%
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2022

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	9,2%	9,2%	
Branches of foreign credit institutions	90,8%	90,8%	
Cooperative banks			
Banking sector, total:	**100%**	**100%**	

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2020	2021	2022
Commercial banks	0	-0,01%	-0,04
Cooperative banks	0		
Banking sector, total:	**0**	**-0,01%**	**-0,04**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2020	2021	2022
Commercial banks	2,5%	3,4%	9,2%
Branches of foreign credit institutions	97,5%	96,6%	90,8%
Cooperative banks			
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2020	2021	2022
Receivables			
Financial sector	45%	23%	32%
Nonfinancial sector	43%	60%	18%
Government sector	10%	17%	50%
Other assets	2%	>1%	>1%
Liabilites			
Financial sector	38%	73%	82%
Nonfinancial sector	39%	11%	6%
Government sector			
Other liabilities	21%	16%	2%
Capital	**3%**	**2%**	**10%**

Capital adequacy ratio of banks

Type of financial institution	2020	2021	2022
Commercial banks		75%	48%
Cooperative banks			
Banking sector, total:		**75%**	**48%**

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

Asset classification	2020	2021	2022
Non-financial sector, including	0/0	0/0	0/0
- households	0/0	0/0	0/0
- corporate	0/0	0/0	0/0

The structure of deposits and loans of the banking sector in 2022 (%) (at year-end)

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

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

P&L account	2020	2021	2022
Interest income	12 653	18 623	24 655
Interest expenses	9 900	13 247	18 097
Net interest income	2 753	5 376	6 558
Net fee and commission income	24	-369	1 198
Other (not specified above) operating income (net)	16	-207	-468
Gross income	2 793	4 800	7 288
Administration costs	4 620	5 563	5 345
Depreciation	434	434	422
Provisions	166	1 145	2 980
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	166	1 145	697
Profit (loss) before tax	-2 427	-2 341	-1 037
Net profit (loss)	-2427	-2 341	-1 037

Total own funds in 2022 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	21 043	20 183	20 183	20 183	
Cooperative banks					
Banking sector, total:	**21 043**	**20 183**	**20 183**	**20 183**	

Macroeconomic environment in the country

In 2022, the economic growth (real GDP increased by 2.8%) was adversely affected by decline in the economic sentiment and a broad-based and sharp rise in costs caused by Russia's invasion of Ukraine. At the same time, lifting of the restrictions related to the Covid-19 pandemic facilitated growth in private consumption. Although the purchasing power of the population decreased amid high inflation, the government support to overcome the impact of the energy price rise and the savings made during the pandemic supported the consumption.

GDP growth was facilitated also by export development in 2022. Although the major contribution to the increase in the value of exports and imports was provided by the rise in prices, the real volume also grew. Export competitiveness remained favorable as indicated by the increase in Latvia's export market shares globally. These developments widened current account deficit to 4.7% of GDP. The elevated uncertainty, high construction costs and rising interest rates dampened investment activity.

In 2022, the high inflation was mainly caused by the supply side, i.e., it was driven by higher commodity prices. With high global energy and food prices, inflation (HCPI) in Latvia has been 17.2%. In response to the soaring inflation in the euro area, the European Central Bank (ECB) began tightening its previously particularly accommodative monetary policy.

With unemployment decreasing further, Latvia's labor market remained tight. The unemployment rate stood at 6.9% in 2022 on average. A low unemployment rate continued to exert pressure on wages. However, the pace of wage growth remained moderate – 7.5%, and concerns about formation of a wage-inflation spiral are limited by a decentralised wage setting system.

Although the government support to shield households and companies from the energy price crisis added to budgetary expenditure, the government deficit (4.4% of GDP) was lower than a year before as support was less extensive than for severe Covid crisis as well as inflation led to higher tax revenues. Despite an additional borrowing in the external markets, Latvia's government debt level was not excessive and decreased in terms to GDP as well (to 40.8% of GDP in 2022).

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

Less significant banking segment has been on a path of consolidation. In 2022, two banks after merger or acquisition left the market and at the end of the year the provision of financial services of „Baltic International Bank SE" was suspended. Therefore, at the end of 2022, nine banks (8 active), four branches of the European Union (EU) banks and one financial holding company were operating in Latvia.

In 2022, banking sector assets grew by 2.4 billion euros or 9.6% mainly determined by the increase in customer deposits (by 1.7 billion euros or 8.4%). Regarding composition of assets noticeable increase of claims to credit institutions by 2.3 billion euros reducing cash and claims to the central bank by 965 million euros was determined by the decision of one bank to transfer funds previously kept at the central bank to parent bank.

Though the banking sector average liquidity coverage ratio, in 2022, decreased determined by the increase in claims to credit institutions, reducing the balances at the central bank, it remained at a high level of 221.8% or more than twice the minimum requirement.

Loan portfolio grew by 6.9% or 1.0 billion euros. Although growth was predominantly driven by the growth of the domestic portfolio by 6.9% or 847.6 million also loans to foreign customers grew by 6.8% or 161.2 million euros, which were fully driven by the increase in loans granted to customers of other Baltic countries (+261.0 million euros or 16.1%), while loans to customers outside the EU continued to decrease (- 97.1 million euros or 25.2%).

Despite the increase in macroeconomic risks, the quality of loans continued to improve. The share of non-performing loans (NPLs) in the non-bank loan portfolio decreased to 2.7% at the end of 2022. During the year, the quality of loans improved in both domestic and foreign loan portfolios, with the share of NPLs decreasing to 1.7% and 8.0%, respectively.

NPL coverage ratio improved to 27.3% determined by both – decline in the volume of NPLs and growth of loan portfolio. If the value of the collateral and financial guarantees is considered the amount of NPL was almost fully covered (94.3%).

Rising interest rates facilitated the improvement of banking sector profitability. In 2022, the banking sector operated with a profit of 324 million euros. Excluding the impact of structural changes, the profit of active banks, in 2022, reached 352 million. euro, i.e., by 17.7% more than the previous year, which was mainly driven by the increase in net interest income of 99 million euro or 21.5%. Accordingly, profitability indicators of active banks also improved, in 2022 – cost-to-income ratio from 61.3% to 53.7%, return on capital – from 10.3% to 11.3%.

Although capitalization of the banking sector slightly decreased driven by the increase in risk-weighted assets by 1.1 billion euros or 11.8% due to growth of loans and changes in structure of assets, banks are well capitalized and shock absorption capacity is high. At the end of 2022, banking sector CET1 ratio was 22.0%, total capital ratio – 23.0%.

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

For the last 21 year (from 1 July 2001 until 31 December 2022) Financial and Capital Market Commission (hereinafter – the FCMC) has been operating as independent, autonomous, and integrated financial sector supervisory and resolution authority, 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 financial sector. FCMC has been performing also as the National Designated Authority for all macroprudential tasks and responsibilities. According to competences and powers set by the national legislative framework – *Law on the Financial and Capital Market Commission* and relevant sectoral laws[1], FCMC has been powered to issue regulations and guidelines, impose restrictions on the activities of market participants, examine compliance with the legislation and apply sanctions.

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

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

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/CTF issues still remains within the FCMC competence.

Resolution and Protection Schemes Department of the FCMC has been operating in the capacity of a national resolution authority forming part of the Single Resolution Mechanism (SRM). Its activities and functions have been separated from the supervision functions. In addition, the Department has also been responsible for administering the Latvian Deposit Guarantee Fund, the Fund for the Protection of the Insured and the Investor Protection Scheme.

Subject to the decision of the national Parliament (*Saeima*) regarding incorporation of the FCMC into the structure of the national central bank and the new *Law on Latvijas Banka*[2] adopted in September 2021, on 1 January 2023, Latvijas Banka overtook all the functions and liabilities of the FCMC, and further on is responsible for the supervision and promotion of development of the financial and capital market as well as the functions of the resolution authority. It should be noted that due to the integration neither the powers, nor the functions of the national competent authority are changed.

Developments in legislative framework for banking sector

In 2022, the FCMC continued to improve the legal framework governing the activities of the participants of the financial and capital market, by implementing the requirements of the EU directives and guidelines issued by the EU institutions, ensuring the application of a directly applicable EU legal framework, as well as by improving the macroprudential legal framework and applying instruments set therein.

During the reporting year, FCMC continued to actively follow the changes in the first level EU legal acts, contributing to the EU Council's work on the review of the Capital Requirements Directive[3] (CRD) and Regulation[4] (CRR) which aims to complete the introduction of the international supervision standards Basel III.

As to the developments in national regulatory framework for banking sector, in 2022, the FCMC Board adopted changes in the FCMC regulations supplementing and improving requirements for providing information to be included in the bank recovery plans with the aim to promoting a timely identification of crisis situations and carrying out efficient recovery measures. Amendments were made to ensure compliance with the European Banking Authority's (EBA) Guidelines on recovery plan indicators.

Addtionaly, two decisions of the FCMC Board were adopted: (1) on equating the risk of Latvia's local governments to the country risk of Latvia in accordance with the CRR requirements[5], and (2) to keep the elevated risk degree determined according to the CRR requirements at 100% for exposures secured with a commercial real estate mortgage registered in Latvia[6].

2 https://likumi.lv/ta/id/326575-latvijas-bankas-likums
3 https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02013L0036-20220101
4 https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02013R0575-20230628
5 Accordingly, henceforth, when calculating the risk-weighted exposure amounts for credit risk, exposures to the local governments of Latvian State cities and municipalities can be equated to exposures to the Latvian government. It will allow the banks to apply a lower risk degree to such exposures, thus reducing the credit risk own funds requirement, and they will also be able to optimise the credit risk management of these transactions by managing them as exposures to the central government in the future.
6 The Decision was adopted taking into account the existing uncertainty, the negative projections on the future economic development as well as the incentive to act prudently, which follows from the warning published by the Europeans Systemic Risk Board on 22 September 2022, regarding vulnerabilities in the EU financial system, also emphasizing a need to prepare for a potential realization of tail-risk scenarios, thus preserving or even strengthening the existing resilience of the financial sector,

Organizational chart of the Banking Supervisory Authority

Last fundamental changes to the FCMC organizational structure were introduced at the end of 2020, no changes were made during 2021. According to the FCMC integration plan, from 1 January 2022, the function of financial literacy was transferred to Latvijas Banka, thus in 2022 the FCMC Communication and Financial Literacy Division was reorganised into the Communication Division. There have been no other changes in the organizational structure of the FCMC in 2022.

Main strategic objectives of the Banking Supervisory Authority in 2022

The following five priority areas set in the FCMC Operational Strategy for 2019 – 2023 served as main FCMC strategic objectives also during 2022:

- to ensure consistent and professional supervision of the financial sector;
- to continue developing as a professional, accountable and responsible organisation with effective corporate governance and procedures;

including by using an adequate macroprudential capital buffer.

- to actively involve in regular and coordinated dialogue with the financial sector, develop strategic communication with the public;
- to facilitate a business environment favourable to innovative and secure financial services;
- to ensure effective mechanism for financial sector crisis management and resolution.

Considering the strategy and priorities of the FCMC, the FCMC Board set the following banking sector supervisory priorities for 2022:

Asset quality and adequacy of provisions	• Covid-19 pandemic • Concentrations, especially in the real estate sector • NPL development • Credit underwriting standards
Strategy, business model and profitability	• Viability and profitability of credit institutions • Transformation of business models • Quality of credit institution strategies
Internal governance	• Sustainability risks • Work quality of the Board, including committees of the Board
Information and communication technologies and security risk	• Information and communication technologies risk management • Cybersecurity • Management of outsourcing providers
ML/FTP risk	• Management of ML/FTP risk • Compliance of the risk assessment performed by credit institutions with the objective

The activities of the Banking Supervisory Authority in 2022

Prudential supervision

In 2022, the 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. Individual market participants supervisory programmes, as well as the horizontal activity plan were developed to ensure an action that is consistent with the FCMC's supervisory priorities, at the same time implementing a risk-based approach. Much emphasis was put on the enforcement and application of the principle of proportionality and improvement of its use in supervisory processes.

The war in Ukraine made supervisors to review the planned activities and supervisory agenda for 2022. Although the FCMC's supervisory priorities were not changed due to the war, the geopolitical situation and its impact were integrated into the key lines of supervisory priorities and in certain supervisory activities. The supervisory measures plan developed according to the selected supervisory priorities in the prudential field included a range of on-site and off-site activities at the level of both individual credit institutions and the sector at large.

In 2022, the credit institution sector experienced consolidation due to merger or reorganisation of credit institutions, leading to cessation of operation of certain credit institutions. During 2022, FCMC decisions was adopted to allow two banks to carry out reorganisation by re-registering them as commercial companies whose activities are not related to the activities of a credit institution. Meanwhile, one branch of credit institutions of the EU Member State announced its final decision not to launch business in Latvia.

To ensure stability of Latvia's financial sector and protect the interests of the credit institution's customers, the FCMC Board, at its extraordinary meeting of 12 December 2022, decided to suspend the provision of financial services by one of the banks in Latvia. The FCMC recognised the bank as failing or likely to fail[7] and decided not to take resolution action, i.e., to implement no measures to stabilise the credit institution.

AML/CTF supervision

In 2022, the FCMC continued strengthening ML/TF risk management, setting the building of quality and efficiency of supervision and strengthening the dialogue with market participants as key priorities.

2022 was a year of a large amount of EU sanctions in the area of AML/CFTP imposed on Russia and Belarus. These sanctions were imposed on an unprecedented scale and rapidly, hand in hand with the dynamic escalation of the situation in Ukraine. They had a significant impact in Latvia, taking into account that our country borders Russia and Belarus, and historically Latvia has had relatively close economic ties with these countries. At the same time, the significant work completed over the last years in Latvia's financial sector by reducing the risk exposure of non-resident customers should be emphasized. The effect of sanctions on the financial sector is therefore much smaller.

In 2022, the FCMC performed 13 inspections in the field of AML/CFTP (four full on-site inspections and nine off-site target inspections) in credit institutions. Out of all inspections performed, six off-site target inspections were carried out focusing on the field of international sanctions. As a result of the full on-site inspections, the FCMC asked the credit institutions to draft the plans for eliminating the shortcomings established during the inspections and supervised the implementation thereof.

International activities of the authority

Activities in 2022, in international cooperation were largely affected by Russia's war in Ukraine, creating new challenges, including reorganising international cooperation framework, as well as reviewing current international relationship models and cooperation principles at the global scale.

As in previous years, FCMC international activities focused on the cooperation and exchange of information with supervisory and resolution authorities of other (mainly EU) 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. An essential part of the banking supervision constitutes the cooperation with home supervisor authorities, also participating in the work of the supervisory and resolution

[7] The FCMC has based its decision to recognise the bank as failing or likely to fail on the grounds that the credit institution was not able to ensure the implementation of a viable business strategy over a sustained period, the strategy did not conform to the credit institution's capacity and was not feasible therefore the credit institution continuously failed to provide a profitable business model. The credit institution also had serious internal governance deficiencies, including the area of AML/CFTP.

colleges for cross-border banking groups.

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, IOSCO and IAIS. 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 OECD, as well as preparing information for various EU, OECD, IMF reports and reviews on Latvia.

Cooperation with other supervisory bodies in the country

Although the FCMC has been operating as an integrated financial sector supervisor, nevertheless, it has close cooperation with different national public authorities and institutions, i.e., Latvijas Banka (macroeconomic, macro-prudential and financial stability issues), 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.

In 2022, FCMC cooperation with Latvijas Banka was even closer due to the integration processes, to ensure smooth merger of the two institutions and for Latvijas Banka to be able to fully overtake and ensure functions of the FCMC as of 1 January 2023. As the core functions of Latvijas Banka are considerably expanding along with the integration of the FCMC, in 2022, special attention was paid to defining the new strategy and values of the merged institution, planning the governance framework, creating the processes necessary for the performance of the new core functions of Latvijas Banka and developing the regulatory framework, as well as integrating employees. All employees of the FCMC ensuring its core functions were transferred in the employment of Latvijas Banka as of 2023.

Other relevant information and developments in 2022

More detailed information about the developments in the banking sector and banking supervision in Latvia is available on Latvijas Banka website: https://www.bank.lv/.

Questionnaire tables for the 2022 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	13	12	10
Branches of foreign credit institutions	3	4	4
Cooperative banks	0	0	0
Banking sector, total:	**16**	**16**	**14**

Total assets of banking sector (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	20 270 666	20 836 356	22 759 164
Branches of foreign credit institutions	4 024 983	4 466 727	4 945 633
Cooperative banks	0	0	0
Banking sector, total:	**24 295 650**	**25 303 084**	**27 704 797**
y/y change (in %)	**8.3**	**4.1**	**9.5**

Ownership structure of banks on the basis of assets total

Item	2020	2021	2022
Public sector ownership	0	0	0
Domestic ownership total	13.4	44.0	43.2
Foreign ownership	86.6	56.0	56.8
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2022

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	84.9	94.0	0.258
Branches of foreign credit institutions	98.3	100.0	0.642
Cooperative banks	-	-	-
Banking sector, total:	**69.7**	**77.2**	**0.195**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2020	2021	2022
Commercial banks	5.3	10.0	10.0
Cooperative banks	-	-	-
Banking sector, total:	**5.3**	**10.0**	**10.0**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2020	2021	2022
Commercial banks	83.4	82.3	82.1
Branches of foreign credit institutions	16.6	17.7	17.9
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2020	2021	2022
Receivables			
Financial sector	36.3	32.2	34.4
Nonfinancial sector	52.0	55.3	53.3
Government sector	4.4	9.7	9.3
Other assets	7.3	2.8	3.0
Liabilities			
Financial sector	11.8	8.2	8.9
Nonfinancial sector	71.0	73.2	71.3
Government sector	1.8	1.3	3.2
Other liabilities	5.4	7.0	6.8
Capital	**10.0**	**10.3**	**9.8**

Capital adequacy ratio of banks

Type of financial institution	2020	2021	2022
Commercial banks	26.85	25.34	22.98
Cooperative banks	-	-	-
Banking sector, total:	**26.85**	**25.34**	**22.98**

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

Asset classification	2020	2021	2022
Non-financial sector, including	4.9	3.8	2.8
- households	3.7	2.3	1.6
- corporate	5.9	5.0	3.9

The structure of deposits and loans of the banking sector in 2022 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	90.5	93.3
Households	54.1	43.1
Corporate	36.4	50.2
Government sector	4.1	2.0
Financial sector (excluding banks)	5.5	4.7
Total	**100.0**	**100.0**

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

P&L account	2020	2021	2022
Interest income	505 744	529 984	616 252
Interest expenses	81 062	63 818	54 389
Net interest income	424 683	466 166	561 863
Net fee and commission income	207 897	234 899	228 999
Other (not specified above) operating income (net)	48 052	75 960	57 193
Gross income	680 632	777 025	848 056
Administration costs	423 441	437 130	426 814
Depreciation	34 410	38 919	33 097
Impairment and Provisions	67 932	6 427	60 072
Profit (loss) before tax	154 849	294 548	328 075
Net profit (loss)	150 355	285 374	321 718

Total own funds in 2022 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	2 310 920	2 207 276	2 210 376	100 544	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**2 310 920**	**2 207 276**	**2 210 376**	**100 544**	**-**

Macroeconomic environment in the country

Having survived energy and commodity price shocks, the Lithuanian economy remained on a growth path in 2022: GDP was 1.9% higher last year than in the previous year. Extremely expensive commodities, especially energy, have led, through production and supply chains, to particularly sharp and strong rises in prices and a reduction in the purchasing power of households. Annual inflation developments in Lithuania in 2022 can be divided into two parts: a consistent increase up to peak inflation in September (22.5%), and a consistent decline in the following months. Rising energy prices were the main contributor to the increase in annual inflation, while the moderation of energy price growth was the main contributor to the decline in annual inflation towards the end of the year. Taking into account the average annual inflation of 18.9%, household consumption was relatively strong, with household consumption expenditure 0.5% higher than a year ago. This resilience was underpinned by the labour market situation, which was favourable for employees. Wages and salaries continued to rise rapidly due to staff shortages – in the period under review, the latter indicator was around 13.4% higher than a year ago.

As part of the Eurosystem, together with the ECB and other euro area central banks, we took significant monetary policy decisions in 2022 and early 2023 with the aim of returning inflation back to 2% over the medium term. Such decisions accelerated the normalisation of monetary policy, ending the era of negative interest rates and then gradually tightening monetary policy. As of March 2023, the key ECB interest rate has been raised six times, to 3.0%. In addition, in July 2022, the Governing Council of the ECB suspended net asset purchases under the asset purchase programme, and, as of March 2023, began to reduce the size of the accumulated portfolio. Such decisions and monetary policy instruments mean a tightening of financing conditions for Lithuania and the euro area economy as a whole, but this will help to bring inflation back on track over the medium term.

Development in the banking sector

At the end of 2022, the Bank of Lithuania supervised 824 financial market participants. In 2022, 67 new financial market participants entered the financial sector. Of these participants, 16 licences (authorisations) were issued to banks, EMIs and PIs, financial brokerage firms and management companies, and 51 companies (crowdfunding platform operators, P2P lending platform operators, intermediaries of EMIs and PIs, consumer credit providers, etc.) were included in the public lists.

The liquidity situation of banks remained very good, and their liquidity buffers were more than sufficient; therefore, banks were safe against the backdrop of the recent global financial turmoil. All banks were in compliance with the capital adequacy requirements set for them, and banks' capital adequacy levels remained high.

Amid weaker growth and rising inflation, the banking sector recorded exceptionally high profitability ratios as the ECB passed the decision to raise interest rates. The banking sector's audited profit was €467,8 million, or 42,7% higher than in 2021. The banking sector's profitability was mainly driven by rapid growth in net interest income, with a particularly strong increase in the final quarter of 2022.

The banking sector remains concentrated, but new market participants are consistently increasing existing assets. As a result of the reorganisation of the group's companies in Lithuania, the market share of Revolut Bank UAB increased significantly in the second quarter of 2022, making the bank the third largest participant in the market in terms of assets. The volume of the bank's assets and liabilities (especially non-resident deposits in the EU countries) has a material impact on the performance indicators of Lithuania's banking sector.

The challenges that arose in 2022 did not suspend lending activity: the loan portfolio increased considerably. Weakening economic activity and rising interest rates have so far not had a major downward impact on the quality of the banking sector's loan portfolio. Deposits also continued to grow at a similar pace as in 2021.

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

Upon a decision of the Board of the Bank of Lithuania, the Financial Market Supervision Committee was established to deal with the financial market supervision matters entrusted by the Board.

The Financial Market Supervision Committee is a collegial body of the Bank of Lithuania established by the Board of the Bank of Lithuania, which, on behalf of the Bank of Lithuania, decides on the issues of financial market supervision assigned by the Board of the Bank of Lithuania, and carries out the other functions set out in the Financial Markets Supervision Committee Regulation. The Committee consists of 3 members: the Director of the Banking and Insurance Supervision Department, the Director of the Financial Services and Markets Supervision Department and the Director of the Legal and Licensing Department. The members and alternate members of the Committee shall be appointed and dismissed by the Board of the Bank of Lithuania. The Board of the Bank of Lithuania appoints the Chairperson and the Deputy Chairperson of the Committee from among the Committee members. The Chairperson and Deputy Chairperson of the Committee are appointed for one year and shall be rotated each year based on proposals submitted by the member of the Board of the Bank of Lithuania responsible for supervision.

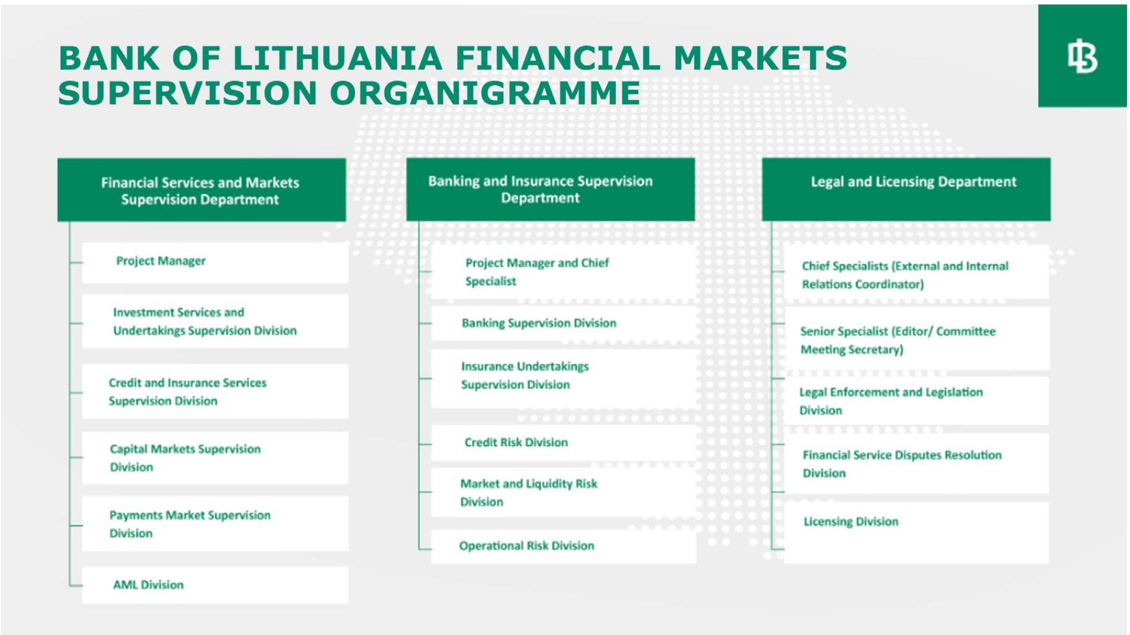
Meetings of the Committee are held on the initiative of the Chairperson of the Committee, but generally, the Committee meets weekly on a set time.

The meeting agenda signed by the Chairperson of the Committee, together with the material on the items proposed for discussion at the meeting, are submitted by the Secretary of the meeting to the members of the Committee, the alternate members of the Committee and the Member of the Board of the Bank of Lithuania responsible for supervision at least 2 working days before the date of the meeting. The Committee solves issues related to imposing measures and instructions to market participants, issuing licences and authorisations, issuing recommendations, also discusses and resolves issues of coordination and cooperation between departments.

However, the Board of the Bank of Lithuania, among its other functions, takes responsibility on the following supervision related matters:

- develops financial market supervision policy;
- if the Bank of Lithuania detects any operational shortcomings of the supervised financial market participants or non-compliance with legal acts, applies enforcement measures, gives instructions, imposes obligations and prohibitions, as well as applies other mandatory measures;
- when necessary, takes decisions on the resolution of financial sector entities, appeals to court regarding the initiation of bankruptcy proceedings against financial market participants under supervision;
- issues licences and other types of authorisation for operating in the financial market, suspends or revokes them when necessary.

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Banking Supervisory Authority in 2022

Banking Supervision Authority is an integral part of the Bank of Lithunia and takes steps in implementing the Bank of Lithuania strategic directions - Value, Sustainability and Progress.

Strategic direction 1. Value

- The Bank of Lithuania increased access to financial services for the population.
- The development of the financial market and the maturity of its participants were improved.
- The Bank of Lithuania promoted financial and economic literacy across society.

Strategic direction 2. Sustainability

- A particular focus is on climate change risks.
- Aiming at reducing the CO_2 footprint.

Strategic direction 3. Progress

- Algorithmic trading for smart investment management.
- Effective data management is a priority.
- Implementation of the Data Management Maturity Programme (DAMAMA).

The activities of the Banking Supervisory Authority in 2022

The Bank of Lithuania provides advice to financial market participants on matters of supervisory competence, consults and discusses issues relevant to the financial sector with financial market participants. The Bank of Lithuania holds annual meetings with supervised financial market participants. The aim of these meetings is to contribute to the prevention of breaches and to boost confidence in the functioning of financial market supervision units as well as to develop a consistent long-term relationship with key stakeholder groups in the financial market. The results of the previous year and supervisory plans for the new (current) year are presented and future changes to the regulatory environment are discussed during these meetings. Periodic meetings are organised with compliance experts of financial market participants to discuss problems faced by financial market participants, expectations of financial market supervisors and other relevant topics.

Financial market participants are informed in advance of planned on-site inspections and assessment visits as well as planned changes to the financial market regulatory environment.

Every year, in line with the expressed needs of financial market participants, annual consultation events are organised on topics relevant to financial market participants. In 2022, 14 events on different topics were organised for different financial market participants. On average, 108 attendees participated in each event.

In response to increased cyber risk, the Bank of Lithuania initiated a discussion on increased information sharing on cyber threats. In cooperation with the National Cyber Security Centre, banks will test dedicated state-of-the-art technical and organisational tools. The Bank of Lithuania also assessed how credit institutions, insurance companies, selected financial brokerage firms and EMIs manage ICT and security risks and provided recommendations for strengthening the management of these risks.

To increase the maturity of financial market participants in the area of AML/CTF and to identify, appropriately manage and respond more quickly to ML/TF risks in the financial sector, the Bank of Lithuania has been carrying out AML/CTF supervision activities, i.e. conducting inspections of financial market participants, training and educating them, cooperating and exchanging information at the national and international levels, developing guidelines and interpretations, as well as focusing on fraud prevention.

The Financial Market Supervision Committee of the Bank of Lithuania has approved the financial sector maturity scoreboard for 2022–2025. Its aim is to set maturity assessment criteria and estimation targets for the main supervised financial sectors for the 2023–2025 period to be used to assess the maturity of the financial sectors in 2022 and to monitor the progress of maturity until 2025. The results of this scoreboard are already being used in the supervisory action planning process. Having identified the financial sectors with low maturity, supervisory measures to promote the maturity of the relevant financial sector have been determined.

International activities of the authority

The consortium of the national central banks of Lithuania, Romania and the Netherlands continued to successfully implement the EU Twinning project launched in 2021 “Strengthening supervision, corporate governance and risk management in the financial sector” in Moldova. The project aims to support the National Bank of Moldova in strengthening its capacity in macroprudential oversight, the supervision of the insurance sector, non-bank credit institutions, payments and financial market infrastructure.

On 21 September 2022, together with 19 ESCB national central banks and the ECB, the Bank of Lithuania launched an 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. Phase II”. It is intended to strengthen the institutional capacity of central banks and banking supervisory agencies in six Western Balkan countries, in particular by improving their analytical and policy tools and by transposing best international and European standards into national practices.

The consortium of the national central banks of Lithuania and Poland continued to implement the EU Twinning project "Strengthening the institutional and regulatory capacity of the National Bank of Ukraine to implement the EU-Ukraine Association Agreement". This project aims to support the capacities of the National Bank of Ukraine in the following key areas: banking supervision, payment system development, strategic planning, and cooperation with international institutions. The project was suspended following the outbreak of russia's war in Ukraine on 24 February 2022, but upon the assessment of the National Bank of Ukraine's abilities to continue the project, as well as an assessment of changed needs, it was relaunched and supplemented with a new area – SEPA – on 1 July 2022.

Cooperation with other supervisory bodies in the country

The Bank of Lithuania is a single supervisor of financial market participants and is in close cooperation with numeros institutions of the country. With a number of institutions cooperatation agreements are signed, e.g. Prosecutor General's Office of the Republic of Lithuania; Department of State Security of the Republic of Lithuania; Deposit and Investment Insurance Fund; Financial Crimes Investigation Service under the Ministry of the Interior of the Republic of Lithuania.

The Centre of Excellence in Anti-Money Laundering was established together with the Ministry of Finance, the Bank of Lithuania and eight commercial banks. The Center of Excellence in Anti-Money Laundering is the first public-private sector partnership in Europe, operating as a separate institution. By pooling the experience, knowledge, and competencies of law enforcement, supervisory, and other public authorities and private sector representatives, the Center aims to create a safer financial system in Lithuania.

Other relevant information and developments in 2022

The Bank of Lithuania supervised the implementation of international sanctions in the financial sector. Due to russia's war in Ukraine, which began in 2022, and both tightened and new sanctions and restrictive measures against russia and Belarus and/or related entities due to actions undermining the territorial integrity, sovereignty and independence of Ukraine, the Bank of Lithuania, within its competence, has been actively working to ensure that financial market participants duly comply with the international sanctions and restrictive measures imposed. As part of its supervision based on risk assessment, the Bank of Lithuania published an analysis of the implementation of international sanctions in financial institutions. Therein, the Bank of Lithuania provides key insights into the measures taken by financial market participants in implementing international sanctions and restrictive measures.

Questionnaire tables for the 2022 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	11	12	13
Branches of foreign credit institutions	6	6	6
Cooperative banks	62	62	61
Banking sector, total:	**79**	**80**	**80**

Total assets of banking sector (at year-end) mEUR

Type of financial institution	2020	2021	2022
Commercial banks	27 968,3	33 567,9	45 391,9
Branches of foreign credit institutions	9 777,0	9 264,8	10 218,9
Cooperative banks	964,9	1 119,7	1 270,4
Banking sector, total:	**38 710,3**	**43 952,4**	**55612, 0**
y/y change (in %)	**23,0**	**13,5**	**26,5**

Ownership structure of banks on the basis of assets total

Item	2020	2021	2022
Public sector ownership	-	-	-
Domestic ownership total	9,8	10,5	10,7
Foreign ownership	90,2	89,5	89,3
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2022

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	88,0	98,1	2868,0
Branches of foreign credit institutions	93,1	99,2	5522,0
Cooperative banks	16,1	25,0	295,6
Banking sector, total:	**71,9**	**81,6**	**2099,6**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2020	2021	2022
Commercial banks	10,5	10,1	14,2
Cooperative banks	8,91	10,64	9,32
Banking sector, total:	**-**	**-**	**-**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2020	2021	2022
Commercial banks	72,3	76,4	18,0
Branches of foreign credit institutions	25,3	21,1	79,7
Cooperative banks	2,5	2,5	2,3
Banking sector, total:	**100.0**	**100.0**	**100.0**

Capital adequacy ratio of banks

Type of financial institution	2020	2021	2022
Commercial banks	23,98***	23,51***	19,05***
Cooperative banks	16,43**	17,65**	18,66**
Banking sector, total:	**23,73**	**23,32**	**19,04**

*(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	2020	2021	2022
Non-financial sector, including	1,27	0,65	0,49
- households	1,86	1,01	0,82
- corporate	3,75	1,85	1,54

The structure of deposits and loans of the banking sector in 2022 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	87,6	94,3
Households	60,6	52,8
Corporate	27,0	41,5
Government sector	9,3	1,3
Financial sector (excluding banks)	3,1	4,4
Total	**100.0**	**100.0**

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

P&L account	2020	2021	2022
Interest income	579,7	586,6	865,7
Interest expenses	82,1	96,7	97,8
Net interest income	301,5	489,8	768,0
Net fee and commission income	72,7	254,2	609,0
Other (not specified above) operating income (net)	90,1	312,0	111,3
Gross income	825,5	1048,1	1488,3
Administration costs	366,8	607,9	738,1
Depreciation	37,1	39,3	35,5
Provisions	2,5	0,2	7,9
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	54,6	-5,2	71,6
Profit (loss) before tax	272,7	387,3	606,2
Net profit (loss)	272,7	318,8	484,9

Total own funds in 2022 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	2784,8		2753,2	31,6	
Cooperative banks	114,6		93,7	21,2	
Banking sector, total:	**2899,4**		**2846,9**	**52,8**	

Macroeconomic environment in the country

Economic activity

In 2022, economic activity in the Republic of Moldova has seen a sharp decline after the positive dynamics of 2021. As a result, GDP decreased by 5.0[1] percent compared to the level in 2021. Among the factors that led to a slowdown in economic activity during 2022 are the decline in the real incomes of the population in the context of accelerating inflation, rising interest rates that slowed lending, increased uncertainty in the region as a result of the escalation of the armed conflict in Ukraine, the real appreciation of the national currency against the currencies of major trading partners and, as a result, a decline in the competitiveness of domestic products. At the same time, in the second part of the year the contraction in GDP was also driven by a lower performance of the agricultural sector as a result of the dry conditions in the summer of 2022. In terms of uses, household consumption decreased by 6.3 percent compared to 2021. On the other hand, general government final consumption increased by 3.2 percent. Gross fixed capital formation decreased by 6.8 percent compared to 2021. Exports, in real terms, increased by 26.7 percent. A pronounced negative impact on GDP dynamics in 2022 was caused by a 15.9 percent increase in imports. Within the sectors of the national economy, the agricultural[2] sector contracted by 21.2 percent. At the same time, a significant negative impact was caused by the decrease in added value in the industry. The construction sector continued the decline seen in 2021, contracting by 7.6 percent compared to the previous year, and added value in the real estate transactions sector contracted by 11.9 percent. A downward trend was also recorded in transportation. Net taxes on products generated a significant negative contribution to GDP dynamics. However, the above-mentioned negative contributions were partly mitigated by developments in financial and insurance activities, information and communication, accommodation and food service activities, and trade.

Inflation

In 2022, the average annual CPI rate was 28.7 percent, 23.6 percentage points higher than in 2021. During 2022, the annual inflation rate continued the pronounced upward trajectory of the previous year until October 2022. Thus, it increased from 13.9 percent in December 2021 to 34.6 percent in October 2022. Subsequently, in the last two months of the year, it showed a downward trend, reaching 30.2 percent in December 2022.

The acceleration of prices in the first ten months of the year was supported by the increase in international and regional prices for food and energy resources, which led to higher prices on the domestic market, as well as the adjustment of several tariffs in regulated prices. At the same time, the adjustment of tariffs, the increase in fuel prices and the upward trend in wages supported the increase in costs for economic agents which was gradually reflected in prices. The impact of the above factors was significantly amplified in the first half of 2022 by the escalation of the situation in Ukraine which generated additional pressures on food, fuel and some core inflation subcomponents. Additional pressures on domestic food prices in the second part of 2022 were caused by the hydrological drought of the previous summer. At the same time, for some CPI subcomponents, additional inflationary pressures were driven by the dynamics of the MDL/USD exchange rate in the first part of 2022. According to the estimates, the demand-side pressures observed during 2021 lost their intensity in the first part of 2022 and subsequently eased the inflationary pressures generated by the above-mentioned factors. Towards the end of 2022, the moderation in the annual CPI rate was supported by the effect of a high base period at the end of 2021, subdued demand from the population in the context of falling disposable income of the population in real terms, and compensation to the population for energy resources in the cold period of the year.

[1] Semi-definitive data

[2] Agriculture, forestry, and fishing

At the beginning of 2022, the local currency market faced major imbalances due to the energy crisis and Russia's war against Ukraine. The combination of these exogenous shocks resulted in high demand for FX currency from both individuals and businesses.

The NBM managed to limit the impact of the crises and maintain confidence in the national currency by promptly utilizing foreign exchange reserves, with net sales of USD 412 million during the first half of 2022, and by steering its monetary policy instruments. In these circumstances, the MDL depreciated, in nominal terms, by 7.8% against the USD in the first six months of 2022.

The local FX market recovered, and the exchange rate stabilized in the second half of the year. Monetary policy tightening and support from external development partners both played key roles in the buildup of FX reserves, enhancing the capacity of the Moldovan economy to withstand shocks.

The international reserves, already at robust levels according to commonly known reserve adequacy metrics, have increased by 14.7%, up to USD 4.5 billion by the end of 2022.

External sector

According to the preliminary data, in 2022, the **current account** balance (CAB) of the Republic of Moldova recorded a deficit of US$ 2,275.2 million, 33.9% higher as against 2021. The CAB to GDP ratio was -15.7% (-12.4% in 2021). This dynamic was driven by the increase in foreign trade in goods deficit and the decrease in primary income surplus. The balance of services surplus increased substantially, but not enough to fully cover the increase in trade in goods deficit and decrease in primary and secondary income surpluses.

The *trade deficit in goods and services* totalled US$ 4,079.6 million, increasing by 9.7% as compared to 2021. The exports of goods and services amounted to US$ 5,976.7 million, increasing by 42.4%. This evolution was determined by the increase in both physical volumes and prices of exported goods. The imports of goods and services amounted to US$ 10,056.3 million, increasing by 27.1%. The increase in imports was determined by the increase in public administration final consumption, while households final consumption decreased because of the substantial increase in consumer price index and the reduction in real income.

The *primary income* surplus decreased by 75.4% in 2022, as against 2021 and amounted to US$ 65.5 million. This dynamic was driven by the increase in outflows (+29.4%), while primary income inflows decreased (-1.3%). Thus, direct investment income outflows increased by 39.3%, while the compensation of resident employees by non-resident employers went down by 6.1%.

The *secondary income* surplus amounted to US$ 1,738.9 million and decreased by 0.8% compared to 2021. Personal transfers from abroad received by Moldovan residents reduced by 2.3% and totalled US$ 1,203.3 million. The total amount of technical assistance, humanitarian aid and grants received by all sectors within international cooperation increased by 61.0% in 2022 and amounted to US$ 563.3 million.

Personal remittances (the sum of net compensation of employees, of personal transfers and of capital transfers between households) received by Moldovan residents in 2022 decreased by 3.6% as compared to 2021 and totalled US$ 1,985.8 million, which represents 13.7% as a ratio to GDP.

The **capital account** recorded for the first time in five years a positive balance amounting to US$ 20.2 million, as compared to the deficit of 51.0 US$ million, recorded in 2021. This balance stemmed from capital inflows of external assistance received by the general government for the financing of investment projects totalled US$ 40.6 million, while inflows recorded by the private sector totalled US$ 72.1 million.

The **financial account** recorded a net capital inflow of US$ 2,357.2 million, resulting from the net increase in residents' liabilities to non-residents, by US$ 1,683.4 million, along with the net decrease in residents' foreign financial assets, by US$ 673.8 million.

Liabilities grew, mainly due to increase, by US$ 780.4 million, in external loans. In 2022, the general government made drawings on new loans amounted to US$ 799.3 million from the following creditors: EBRD – US$ 243.8 million, IMF – US$ 170.7 million, IDA – US$ 141.8 million, French Development Agency – US$ 79.2 million, EIB – US$ 55.4 million, IBRD – US$ 41.2 million, European Commission – US$ 35.9 million, the Government of Poland – US$ 20.0 million and other creditors – US$ 11.3 million. The repayments made by the general government amounted to US$ 115.8 million. Commercial banks made net drawings on external loans amounted to US$ 115.4 million, and other sectors – US$ 5,6 million. The NBM repaid US$ 24.2 million on previously contracted loans.

Liabilities in the form of direct investment increased by US$ 592.0 million during 2022. This dynamic was driven by the reinvestment of earnings amounted to US$ 468.3 million, by the net increase in equity by US$ 102.6 million, as well as net drawings of US$ 21.1 million on loans.

The net decrease in external financial assets was driven by the net reduction in currency and deposits by US$ 1,384.6 million (of which assets of other sectors decreased by US$ 958.9 million, while the assets of commercial banks decreased by US$ 425,7 million). Non-resident trading partners made net repayments amounting to US$ 24.2 million on trade credits and advances previously received from residents.

At the same time, the NBM's official reserve assets increased by US$ 637.3 million. Residents' foreign assets in direct investment increased by US$ 55.4 million and in the form of loans – by US$ 40.4 million.

The gross external debt of the Republic of Moldova grew by 8.0% and amounted to US$ 9.457.8 million as of 31.12.2022, accounting to 65.6% as a ratio to GDP.

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

The share of banking sector assets in GDP decreased during 2022 by 1,0 p.p., reaching the level of 47.9 % as of December 2022. The negative growth was caused by an increase of 10,9% in banking sector assets, against a 13,3% increase in GDP. The assets of systemic important (institutions) banks accounted for just over 80,5% of total banking assets.

Total own funds amounted to 18 357,4 million lei, increasing during 2022 by 20,9% (3 178,7 million lei). The increase in own funds was mainly determined by the reflection of banks of the eligible profits after annual general meetings of the shareholders and after obtaining the NBM's permission regarding the inclusion of the profits in the own funds. At the same time, the positive difference between allowances for losses on assets and conditional commitments (prudential reductions) and allowances for impairment losses on assets and provisions (IFRS reductions) decreased by 760,9 million lei, other reserves with 465,1 million lei (prudential difference and IFRS recorded at the end of the year). Also, subordinated debts increased by 174,8 million lei and capital instruments eligible as Common Equity Tier 1 capital (share capital) following the transaction of redemption of treasury shares of a bank amounting to 168,2 million lei and other intangible assets with 57,3 million lei.

The total ratio of own funds in the banking sector according to the data presented by banks was 29,1%, increasing by 3,2% compared to the end of the previous year.

Assets amounted to 131 368,2 million lei, increasing compared to the end of the previous year by 12 866,3 million lei (10,9%).

On 31.12.2022, the gross loan portfolio constituted 46,9% of total assets or 61 627,2 million lei, up by 9,3% (5 268,0 million lei) compared to the end of the previous year. During 2022, the share of non-performing loans (substandard, doubtful, and compromised) in total loans increased by 0,3 p.p., constituting 6,4% as of 31.12.2022. In the context of risk distribution, the largest share of the total loan portfolio was held by credits granted to trading – 22,5% or 13 880,3 million. lei, followed by the share of loans granted for the purchase/ building real estate - 19,9% (12 293,2 million lei) and consumer loans - 16,2% (10 009,5 million lei).

On 31.12.2022, the level of net profit was 3 664,3 million lei. Compared to the end of the previous year, profit increased by 60,2% (1 377,5 million lei), largely due to the increase in interest income by 4 527,1 million lei (88,6%), mainly from lending activity, income from exchange rate differences by 548,2 million lei (46,8%), income from fees and commissions by 480,4 million lei (19,1%). At the same time, non-interest expenses increased by 2,906.0 million lei (53,3%) and interest expenses - by 1 285,4 million lei (103.3%).

Return on assets and return on capital at 31.12.2022 constituted 2,9 % and 17,0 %, increasing compared to the end of the previous year by 0,9 p.p. and 4,8 p.p. respectively.

Banks maintained high liquidity ratios, respecting all prudential limits related to liquidity indicators.

Thus, the value of the long-term liquidity indicator (principle I of liquidity) was 0,67 (the admissible limit for each bank ≤ 1), decreasing insignificantly by 0.1 p.p. compared to the end of the previous year.

Principle III of liquidity, which represents the ratio between the actual adjusted liquidity and the required liquidity on each maturity band (limit ≥ 1), is also respected by all banks, varying from 1,58 per maturity band up to one month inclusive, up to 182,33 on the maturity band between one month and 3 months inclusive.

The liquidity coverage ratio (LCR) was 238.5% (limit ≥ 80 %- from 1 January 2022 to 1 January 2023), decreasing compared to 31.12.2021 by 119.8 p.p. The liquidity reserve on 31.12.2022 amounted to 25,823.3 million lei, increasing by 4,103.1 million lei (18.9%) compared to 31.12.2021. At the same time, net liquidity outflows during the analyzed period increased by 4,764.3 million lei (78,6%), constituting 10 826,5 million lei.

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 their 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 2022 year has been amended a number of normative acts applied to banks.

The amendments to the *Regulation on Own Funds of Banks and Capital Requirements* provide that to the own funds' calculation, on a consolidated basis, should be included Common Equity Tier 1 instruments that relates to a subsidiary held by persons other than entities included in the consolidation (minority interests) and Additional Tier 1 and Tier 2 instruments issued by the bank' subsidiaries. Also the amendments completed the own funds requirements for credit adjustment risk and counterparty credit risk. At the same time, there has been made amendments concerning prior approval granted by National Bank for the profit distributions to shareholders. The amendments provide the right of National Bank to issue the respective approval for a smaller amount comparing to the amount required by the bank, if it is considered that the distribution of profit to shareholders and/or the payment of interest to holders of additional Tier 1 own funds instruments, in the amount for which the bank has requested prior approval, may lead to non-compliance with the requirements related to own funds or other prudential indicators or to jeopardizing the stability of the bank.

The *Regulation on Large Exposures* has been completed with peculiarities related to the calculation of exposure value, related to the treatment of counterparty credit risk for banks. At the same time, there have been established reporting requirements on a consolidated basis, related to the information on the ten largest exposures to banks and the ten largest exposures to financial sector entities other than banks.

The list of external credit assessment institutions and the list of third countries which apply supervisory and regulatory arrangements at least equivalent to those applied in the EU have been updated by amending the *Regulation on the treatment of banks' credit risk using standardized approach.*

The *Instruction on COREP reports* has been supplemented with provisions on the terms and method of reporting information related to own funds and large exposures on a consolidated basis, considering the changes included in the regulations mentioned above. The initial deadline for consolidated reporting for the fiscal year ending December 31, 2021, was set for June 30, 2022. Subsequent reporting will be done annually, no later than May 31 of the year following the reporting period.

At the same time, it has been provided the bank's obligation to comply with the requirements for banks' own funds, the treatment of credit, operational and market risk not only on an individual basis, but also on a consolidated one.

The and the *Regulation on Requirements Regarding the Members of the Governing Body of the Bank, the Financial Holding Company or Mixed Holding, the Heads of a Branch of a Bank from Another State, the Persons*

Holding Key Positions and the Liquidator of the Bank in Liquidation Process has been amended in order to increase the transparency in the assessment process carried out by the National Bank of persons appointed to certain management and key positions. Thus, through these amendments, it has been established the obligation of the National Bank to conduct an interview with those persons.

Several amendments have been made to the *Regulations on the Banking Activity Management Framework*. Some of the amendments relate to the management of the associated risk of an excessive leverage effect, which is an integral part of the management framework of banks' activities. Also, through other amendments there have been established requirements related to the bank's recovery plan, especially regarding to the content of this plan. So, the main items of the recovery plan should include: summary of key elements, information on governance, strategic analysis, a communication and disclosure plan, an analysis of preparatory measures, a description of recovery indicators, information on the scenarios used. Also, the amendments provide the obligation of banks to notify the National Bank when breaching the indicator's threshold and respectively, the recovery actions applied by the management body.

At the same time, there has been included provisions on issues that should be analyzed within the assessment process of independent thinking of the candidates, namely behavioral skills as well as conflicts of interest among members of the governing body and members of the board of the bank, which would impede the person's ability to perform their duties independently and objectively. In this regard, it was established that the bank is obliged to inform the National Bank, no later than 5 working days, of any information and any identified conflict of interest of which the bank has become aware that may affect the suitability of the members of the governing body or that may have an impact on the independent thinking of a member of the governing body, including the mitigating measures taken.

At the same time, to avoid excessive risk-taking in lending, the requirements for banks' credit risk management policies have been adjusted. In order to avoid a cash flow mismatch in view of the establishment of repayment schedules with repayments only at maturity, it has been laid down requirements on how banks should establish those schedules.

The list of indicators related to the bank's economic and financial situation, namely the indicators related to the bank's liquidity, of the *Regulation on Requirements for the Publication of Information by Banks*, has been updated. Also, the requirements concerning publication of information on the leverage ratio calculated in accordance with *Regulation on Leverage for Banks* has been extended.

The *Regulation on Audit of Financial Statements and Audit for other Purposes of Banks* has been amended in the light of the amendments to the Law on Joint-Stock Companies. In this context, the provisions related to the limitation of audit companies that conduct the audit of the bank's annual financial statements to conclude other contracts with the bank, namely regarding the audit for other purposes, have been excluded.

The *Regulation on Banks' Transactions with Their Related Parties* has been amended in order to revise certain provisions to eliminate deficiencies in the application and interpretation of the provisions of the Regulation in the context of banks' relations with their customers - affiliated persons. Thus, the list of transactions with affiliated persons has been revised and completed in order to exclude those transactions that would not be considered transactions with affiliated persons. At the same time, it has been added the requirement on cumulation of the transaction value of the bank's related party (forming the exposure) with the value of transactions of related customers, with the purpose of determining the threshold in the transaction approval process. Also, the provisions on exemptions from prior approval of transactions with related parties by the bank's management bodies have been supplemented.

Also, in order to ensure maximum objectivity of the assessment of the damage caused to the bank's shareholders by the illegal administrative act of the National Bank and / or the share prices, there have been established criteria applicable to the audit company in order to qualify it as an internationally renowned company.

The *Regulation on Investments in Real Estate of Banks* has been approved in a new version, which aims to implement the provisions of Law on Activity of Banks and align terminology with the Basel III framework and International Financial Reporting Standards.

The Regulation on Qualifying Holdings of Banks has been approved in a new version, which contains provisions on qualifying holdings of banks in the capital of enterprises, including accepted limits for these holdings, and specifies a list of enterprises in the capital of which the bank may have qualifying holdings, including exercising control over the enterprise, and the procedure for obtaining prior approval issued by the NBM for qualifying holdings.

As of 1st of July 2022, the *Regulation on responsible lending to consumers by banks* entered into force, which aims to promote responsible lending practices of banks, market discipline and transparency to reduce systemic risk, prevent excessive credit growth and over-indebtedness of debtors. The Regulation sets the limit at 80% for *loan to value ratio (LTV)* applied to loans for real estate investments, as well as the limit for *debt-service-to-income (DSTI)* at 40% for household loans; with certain exceptions for the limits following the Regulation. To establish single rules for market participants engaged in lending, the National Commission for Financial Markets has concurrently approved a similar act for the non-bank lending market - *the Regulation on responsible lending requirements for non-bank lending organizations.*

The National Bank of Moldova continues to draft and revise, as appropriate, the secondary legislation in order to implement the Law no. 202/2017 on banking activity.

Alignment of the 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.

Anti-money laundering and counter terrorist financing (AML/CFT) supervision

The National Bank of Moldova as a supervisory authority is involved in the process of control over compliance with anti-money laundering and counter terrorist financing normative acts by banks, foreign exchange units and nonbank payment service providers. In this context, in 2022, NBM approved normative acts and guidelines; licensed the supervised entities and authorized its management members; performed off and on site controls; identified and assessed the ML/FT risks in the supervised sectors and applied risk based supervision; applied fit and proper requirements for supervised entities shareholders and management members; applied sanctions to supervised entities for noncompliance with AML/CFT requirements; cooperated with other stakeholders in the supervisory process, etc.

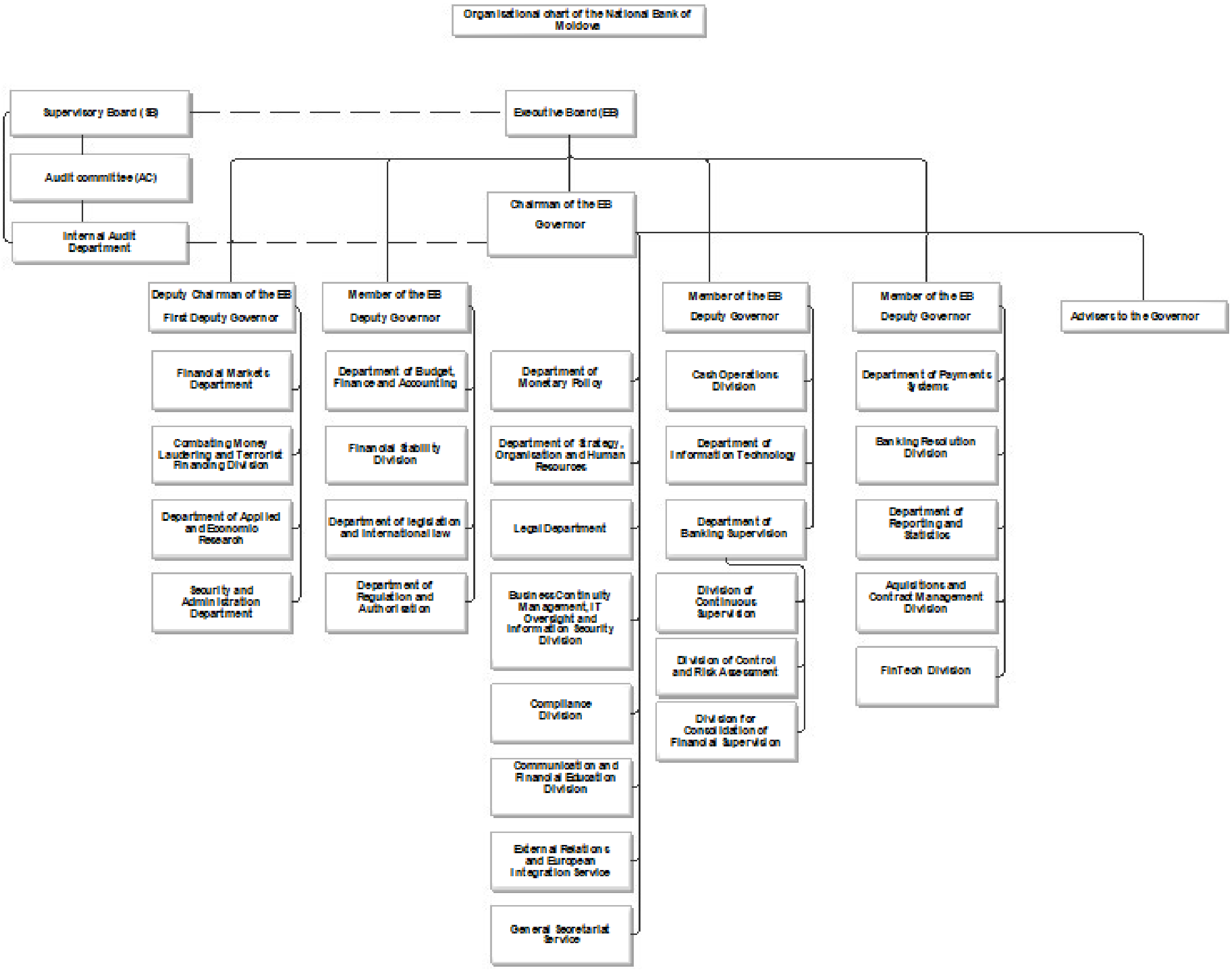
NBM continued to perform regular offsite analysis and onsite inspections to the supervised reporting entities and informs the Office for Prevention and Combat of Money Laundering (Moldovan FIU) if any suspicious of money laundering or terrorism financing are found during the inspections. Thus, during the controls, the NBM highlighted various violations related to the field of money laundering and terrorist financing and non-compliance with the requirements of the normative acts regarding money laundering and terrorist financing by the reporting entities.

Thus, the NBM carried out 25 offsite thematic controls at licensed banks, including one complex control; 33 onsite inspections at currency exchange units, 1 offsite inspection at payment service providers and electronic money issuers and providers of postal services in the field of preventing and combating money laundering and terrorist financing.

As a result of the controls carried out at licensed banks and non-bank PSPs was applied the following sanctions: in the form of a fine for a one bank and in the form of a fine and the prescription for two non-bank entities.

For the violations found at foreign exchange units, was applied sanctions in the form of prescriptions at eight foreign exchange units.

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Banking Supervisory Authority in 2022

The negative effects of the COVID-19 pandemic triggered in early 2020 are felt in most spheres of the economy. Despite the fact that some indicators of the banking sector recorded positive dynamics during 2021, the risk of adverse effects remains.

In these circumstances, the National Bank of Moldova for ensuring the stability of the banking sector defined supervisory priorities based on an assessment of the main risks and vulnerabilities, following the analysis of banks' activity and the evolution of the pandemic, but also taking into account the need to ensure that the banking sector has a rigorous management framework to meet the challenges to which it is permanently exposed.

Thus, throughout 2022, banking supervision established the following priority areas:

I. Credit risk;
II. Internal governance, risk management and internal risk capital adequacy assessment process (ICAAP);
III. Internal liquidity adequacy assessment process (ILAAP);
IV. Risk associated with information and communication technologies (ICT);
V. Anti-money laundering and terrorist financing;
VI. Risks associated with the use of payment systems.

The activities of the Banking Supervisory Authority in2022

Supervisory activity of the NBM

In order to protect depositors' interests, as well as to ensure the stability and viability of the banking system, the National Bank of Moldova shall carry out prudential supervision of banks in the Republic of Moldova, following compliance with legal requirements for preventing and limiting risks specific to banking activity.

The multiple shocks to which the Republic of Moldova was exposed during 2022 led to an increase in uncertainties regarding the evolution of the economy, as well as amplified the risks in the banking system.

Effective management of the immediate effects of the war in Ukraine and those caused by inflation and the COVID-19 pandemic was one of the main concerns of the National Bank during 2022. Thus, despite the negative external factors, the indicators of the banking sector fell within the regulated limits, thus reflecting the resilience of the sector as a result of the reforms of recent years.

In 2022, the NBM continued to supervise banks based on the SREP supervisory review and evaluation process. Thus, the results of the Supervisory Review and Evaluation Process (SREP) imposing specific capital requirements for each bank depending on the individual risk profile were approved by the Executive Board of the NBM.

Off-site checks

The National Bank shall carry out off-site supervision based on the annual prudential supervision program. For 2022, the SEP included various ongoing actions (monitoring key indicators, analysis of financial reports submitted by banks, external audit reports, monitoring of remedial plans following on-site inspections), as well as actions to prepare the SREP report (business model assessment, governance and internal control analysis, capital and liquidity risk assessment, analysis of ICAAP reports, etc.).

The National Bank will continue to act in accordance with the legislation in force and with the best international practices, applying all instruments assigned by law and statute, in order to increase the level of transparency of the ownership structure and ensure a prudent and sound management of licensed banks.

On-site checks

During 2022, 4 thematic inspections were carried out at licensed banks, of which 3 were planned and one unannounced control.

Also, during 2022, the Decisions of the Executive Board of the NBM related to the thematic inspections on the activity of 6 licensed banks were approved.

As a result, the following were applied:

- warnings to 3 banks, to 8 members of the Bank's Board, to 3 members of the bank's Executive Body, and to a Head of Internal Audit Section;
- fines 2 banks, 1 supervisory board member, 4 executive management members and 3 heads of internal control functions.

In general, breaches and deficiencies identified during thematic inspections relate to the bank's business management framework, including internal governance issues, including delegating tasks of a member of the executive body to another person, ensuring independence, and organizing the work of internal control functions, including insufficient and late reaction by internal control functions to some risk events, ensuring the internal control mechanism in the field of the bank's shareholders, some deficiencies in credit risk assessment, violation of minimum requirements for banks' Information and Communication Systems, including on ICT risk management, access control, vulnerability, and incident management, ensuring business continuity, and non-compliance with the measures provided for in the previous control.

The NBM continues the analysis of the reports sent by the external audit companies appointed to carry out AML/FT compliance assessments to the banks. At the same time, the NBM requires the banks to develop an adequate mitigation plan following the external audit reports and to report on the actions taken.

In order to improve NBM's capacity to analyze and monitor commercial banks' activity in AML/CFT field and shareholder transparency, the NBM on the 1st of April 2021 started the implementation of an IT solution. During 2022, the specification was developed, related deliverables were sent, it was tested on some technical tasks. At the end of 2022, was carried out trainings on some segments of the solution. At the moment, the IT solution is at the testing stage and the transition to production.

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 cooperates with international organizations, foreign central banks and other development partners.

In May 2022, following a mission of the **International Monetary Fund**'s **(IMF)** experts carried out between 4-11 April 2022, the IMF Executive Board concluded the ad-hoc review of the 40-month program signed with the Republic of Moldova, under the Extended Credit Facility (ECF) and Extended Fund Facility Arrangements (EFF). Following the request of the Moldovan authorities to increase financing to respond to the impact of the war in Ukraine and the energy crisis, the Executive Board approved an augmentation of this program. Also, the IMF officials appreciated the implementation by the authorities of the Republic of Moldova of the IMF supported program, by fulfilling the structural performance criteria for budgetary-fiscal governance, financial sector supervision and strengthening anti-corruption legislation.

In the context of implementing the common objectives of the Association Agreement between the Republic of Moldova and the **European Union (EU)**, on 4 March 2022, the Republic of Moldova presented its application for membership of the EU. The Council of the European Union invited the Commission to submit its Opinion on the application. Consequently, Republic of Moldova received, from the European Commission, the questionnaires on 11 April 2022 (on the political and economic criteria) and on 19 April (on the EU acquis chapters) and provided its replies on 22 April and on 12 May, respectively.

On 23 of June 2022, the European Council agreed to grant candidate status to the Republic of Moldova. This decision was based on the Commission's Opinion issued as a follow-up to an assessment considering the three sets of criteria to join the EU: political criteria, economic criteria and the ability of the country to assume the obligations of EU membership (EU *acquis*). The European Commission concluded that the country has a solid foundation in place to reach the stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities; macroeconomic policies have been reasonably sound and progress has been made in strengthening the financial sector and business environment, the country has established a solid basis to further alignment with the EU *acquis.* The National Bank of Moldova, as the central bank of the state, participated actively in the process of internal legislative, institutional and functional changes aiming at the achievement of the economic accession criteria to the European Union.

Among the progress listed by the Commission were also mentioned: the banking sector seems well capitalized, with all banks meeting the capital adequacy ratio, and a substantial fall in the share of non-performing loans in recent years. Thanks to successful banking sector reforms, access to finance, in particular for small and medium sized enterprises (SMEs), has improved.

It is worth noting that in 2022, National Bank of Moldova continued the strengthening of cooperation relations with the EU central banks that are responsible for the supervision of credit institutions in the EU and their branches in the Republic of Moldova.

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. Also, the NBM presented its position in relation to the project of the new Country Partnership Framework for Moldova for 2023-2027, by providing the information regarding economic development, statistical data of key macroeconomic indicators, as well as regarding the actions undertaken by the NBM to improve the banking sector supervision.

The NBM is constantly cooperating with the **European Bank for Reconstruction and Development** (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. At the same time, the National Bank of Moldova, continued its collaboration with EBRD in the context of development of the EBRD Moldova Country Strategy for the period 2023-2028.

During 2022, 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), Ljubljana, Slovenia, 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 the **Group of Banking Supervisors from Central and Eastern Europe** (BSCEE) through exchanges of information and experience in the field of banking supervision and regulation.

In 2022, 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 2022, 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 2022, in the context of granting the Republic of Moldova the status of a candidate country to become a member of the EU, the NBM continued with the capacity building and acquiring appropriate knowledge on the best standards and practices in its aspirations to fulfill the assumed commitments on the European course, but also ensuring a high level of stability of the financed sector to the benefit of the citizens.

Of particular importance in this area was the Twinning project with the European Union *„Strengthening supervision, corporate governance and risk management in the financial sector"* which was launched in October 2021, and that, inter alia, was aimed at further harmonization of the banking regulation with the relevant European legislation, building capacity for risk assessments and analysis and improvement of the macroprudential framework in order to identify and address systemic risks on a timely and effective basis, and supervision of the non-banking sector. In addition to that, during the year, the NBM continued with its efforts aimed at the evaluation of the current regulatory framework according to the requirements of the SEPA and preparation of the application file for the accession to European Economic Area.

As of December 2022, the NBM concluded its technical assistance project "EU High Level Adviser's Mission for the Republic of Moldova", within which the NBM continued to receive the assistance of the EU High-Level Adviser for the Financial sector.

In 2022 the NBM continued the negotiations with the **Financial Supervision Commission of Bulgaria** for concluding a memorandum of understanding. The purpose of the memorandum is to develop cooperation between the two central banks in the field of banking supervision and to ensure an efficient exchange of information in the fields that fall within the areas of competence of the NBM and the Commission.

During 2022, the NBM continued to intensify bilateral technical cooperation with central banks (of Romania, Republic of Lithuania, Federative Republic of Brazil, Federal Republic of Germany), in order to benefit from good practices in the areas of competence and to provide support to institutions with similar attributions in other states. Also, in 2022 the NBM provided technical assistance to the Central Banks of Ukraine and Uzbekistan to share the NBM's experience in implementing the IT licensing, authorization, and notification system.

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 2022, the NBM has provided the exchange of information with the following supervisory authorities: Czech National Bank, Banque de France, National Bank of Georgia, Central bank of the Federal Republic of Germany, Bank of Italy, Narodowy Bank Polski, National Bank of Romania, National Bank of Ukraine, Central bank of the Netherlands, Magyar Nemzeti Bank, Polish Financial Supervision Authority.

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 2022, 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, Anti-Corruption Prosecutor's Office, and other.

Other relevant information and developments in 2022

In addition to the minimum own fund's requirement, banks are obliged to maintain additional capital buffers. At the end of 2022, capital conservation buffer rate equaled 2,5%, countercyclical capital buffer rate for Republic of Moldova was established at 0%. At the same time, the buffer rate for other systemically important institutions (O-SIIs) was established for 4 (four) largest banks (ranging from 0,5% to 1,5%). The systemic risk buffer rate for all banks was set at the level of 1% (depending on banks' shareholders structure, an additional 2 p.p. to the systemic risk buffer rate of 1% has been applied for several banks until 31st of December 2022). Moreover, as a prompt response to the negative macroeconomic trends and outlook, taking into account the vulnerabilities of individual debtors and the high- income sensitivity of this category of borrowers to high energy costs, the expected level of inflation and rising credit servicing costs, in May 2022, it was decided to increase by 2 p.p. the systemic risk buffer for banks' credit exposures to resident individuals, excluding individuals engaged in entrepreneurial activity. This rate was calculated and maintained by all banks, in addition to the 1.0 percent rate of total exposure applied to all banks and the 2 p.p. increase in the rate applied to some banks.

Resolution financing arrangements

In 2020, the bank resolution fund became functional. It was established to cover the needs related to the effective application of resolution tools in accordance with the provisions of the Law No 232/2016 on Banks Recovery and Resolution.

The bank resolution fund is financed by:

- annual contributions from banks, in order to reach the target level established by the law;
- extraordinary contributions from banks, in case the annual contributions are insufficient in the opinion of the resolution authority;
- loans and other forms of support.

The resources of the bank resolution fund are managed by the Bank Deposit Guarantee Fund, which, as the manager of the bank resolution fund, has the obligation to invest the available financial resources of the fund in low-risk assets. The use of the resources of the bank resolution fund shall be decided by the NBM, as the resolution authority, for the purposes described in Law No 232/2016. The calculation and payments of contributions by banks shall be performed according to the Regulation on the method of calculation and payment of contributions to the bank resolution fund, approved on April 30, 2020.

According to the law, the financial resources of the bank resolution fund are forecast to reach 3% of the amount of guaranteed deposits of all licensed banks on the territory of the Republic of Moldova until the end of 2024. This amount was approximately MDL 507.8 million at the time of calculating the last annual contributions, for 2023. As of December 31, 2022, the banks have fully paid the annual contributions calculated by the NBM for 2020, 2021 and 2022. As a result, at the end of 2022, the resources of the resolution fund constituted MDL 350.8 million.

Furthermore, the National Bank has notified the licensed banks regarding the amounts, tranches, deadlines, and forms of payment of contributions to the bank resolution fund, which are to be paid by the end of 2023. The amount of annual contributions to be paid during 2023 by all banks is MDL 117.8 million.

The establishment of the resolution fund contributes to the strengthening of the banking sector and its credibility, supporting the depositors' interests.

Questionnaire tables for the 2022 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2020	2021	2022
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, million MDL)

Type of financial institution	2020	2021	2022
Commercial banks	61,533.7	72,444.8	80,476.1
Branches of foreign credit institutions	42,239.9	46,057.1	50,892.2
Cooperative banks	-	-	-
Banking sector, total:	**103,773.6**	**118,501.9**	**131,368.2**
y/y change (in %)	**14.4%**	**14.2%**	**10.9%**

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

Item	2020	2021	2022
Public sector ownership	0.0	0.0	0.0
Domestic ownership total	32.08	33.1	31.63
Foreign ownership	67.92	66.9	68.37
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2022

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	56.22	60.03	1 483.1
Branches of foreign credit institutions	32.77	38.74	435.4
Cooperative banks	-	-	-
Banking sector, total:	**88.99**	**98.77**	**1 918.5**

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

Type of financial institution	2020	2021	2022
Commercial banks	8.74	12.25	17.04
Cooperative banks	-	-	-
Banking sector, total:	**8.74**	**12.25**	**17.04**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2020	2021	2022
Commercial banks	59.30	61.13	61.26
Branches of foreign credit institutions	40.70	38.87	38.74
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2020	2021	2022
Receivables	5.79	4.92	4.99
Financial sector	28.98	29.03	30.30
Nonfinancial sector	43.27	46.10	44.69
Government sector	11.57	13.04	10.79
Other assets	10.39	6.91	9.23
Liabilites			
Financial sector	1.70	1.69	2.20
Nonfinancial sector	74.51	73.86	69.42
Government sector	0.59	0.53	0.80
Other liabilities	5.97	7.54	9.83
Capital	**17.23**	**16.38**	**17.75**

Capital adequacy ratio of banks (%)

Type of financial institution	2020	2021	2022
Commercial banks	27.3	25.9	29.1
Cooperative banks	-	-	-
Banking sector, total:	**27.3**	**25.9**	**29.1**

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

Asset classification	2020	2021	2022
Non-financial sector, including	7.38	6.14	6.44
- households	5.10	4.21	4.61
- corporate	8.70	7.46	7.55

The structure of deposits and loans of the banking sector in 2022 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	99.2	94.84
Households	62.65	36.19
Corporate	34.70	58.65
Government sector	0.53	1.16
Financial sector (excluding banks)	2.12	4.01
Total	**100.0**	**100.0**

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

P&L account	2020	2021	2022
Interest income	206.74	254.16	472.74
Interest expenses	62.26	61.90	124.12
Net interest income	144.48	192.24	348.62
Net fee and commission income	56.26	71.59	72.48
Other (not specified above) operating income (net)	-9.35	-16.91	-21.31
Gross income	369.32	447.03	714.01
Administration costs	112.82	140.89	167.76
Depreciation on financial assets and non financial assets	33.24	4.39	67.78
Provisions	5.58	10.77	17.38
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	18.53%	4.85%	35.39%
Profit (loss) before tax	78.43	129.48	205.34
Net profit (loss)	71.06	113.81	179.81

Total own funds in 2022 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	900.79		871.69	29.10	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**900.79**		**871.69**	**29.10**	**-**

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

As of December 31.12.2022, 1EUR=20,3792

MACROECONOMIC ENVIRONMENT IN THE COUNTRY

In 2022, the Montenegrin economy, despite geopolitical tensions and movements in the global food and energy markets, achieved growth higher than the forecasts given by numerous international institutions with the emergence of the crisis due to the situation in Ukraine. According to preliminary MONSTAT data, based on quarterly estimates, there was a real GDP growth of 6.1%[1].

In 2022, Montenegro recorded the highest inflation since its independence in 2006. In April 2022, a double-digit annual growth rate of consumer prices was recorded, having an upward trend until December 2022, when it recorded a slight decline and amounted to 17.2% (at the same time, annual inflation measured by the harmonized index of consumer prices was 15.7 %).

The budget deficit [2] of Montenegro was estimated at 260.22 million euros or 4.49% of GDP. At end-2022, the net public debt[3] of Montenegro, as per the Ministry of Finance preliminary data, amounted to 3.99 billion euros or 68.84% of estimated GDP for 2022. Compared to the end of the previous year, net public debt increased by 7.91%.

The number of employed persons in 2022, according to MONSTAT data, amounted to 223,744 on average, thus being 18.41% higher than the average number of employees in the previous year.

The Labour Force Survey, published by Monstat on a quarterly basis, shows that the unemployment rate recorded in Q1 stood at 16.78%, while the unemployment rate amounted to 14.58% in Q2, also it amounted to 13.04% and 14.44% in the third and fourth quarter, respectively.

According to MONSTAT data, the average gross salary in Montenegro in 2022 was 883 euros, while the average salary without taxes and contributions was 712 euros, and compared to the previous year, these increased by 11.35% or 33.83%, respectively.

During this year, according to preliminary data, current account deficit amounted to 765.92 million euros or 13.21% of GDP, which is an increase in relation to the previous year when the deficit amounted to 9.20% of GDP.

In 2022, in the financial account, net foreign direct investments amounted to 782.64 million euros, recording the year-on-year increase of 34.56%, and accounting for 13.50% of GDP.

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

At end-2022, there were 11 banks that operated in Montenegro.

All key balance sheet positions recorded growth y-o-y. Total loans (gross loans and receivables from banks and clients) increased by 8.92%, bank's total assets increased by 20.19%, total deposits of banks (with funds on *escrow* accounts) increased by 24.35%, while total capital increased by 11.54%.

1 Preliminary data based on quarterly estimates of GDP. The final data will be published in September 2023.

2 The budget deficit is defined as the difference between source revenues and consolidated expenditures. The data on the deficit for 2022 refers to the cash deficit (not including net liabilities), while the corrected deficit will be published when the Law on budget execution for 2022 is adopted.

3 The public debt of Montenegro (gross) includes government debt, the debt of local self-governments and the debt of companies owned by local self-governments. Net public debt represents the gross public debt less the deposits of the Ministry of Finance.

At end-December 2022, the share of non-performing loans in total loans amounted to 5.71%, which is 0.46 percentage points lower compared to its level in the corresponding period of the previous year (6.17%). Over 30 days past due loans recorded a decrease in the observed one-year period by 12.13%, while loans over 90 days past due loans recorded an increase by 13.87%.

Financial result on the aggregate level was positive, and the banks recorded profit in the total amount of 83.3 million euros in 2022. At end-2022, all banks in the system operated with a profit.

Banks' total capital in Montenegro amounted to 675.5 million euros at end-2022, recording the year-on-year increase of 69.9 million euros or 11.54%. The capital adequacy ratio at the aggregate level was 19.32% at end-2022, while in the corresponding period of the previous year it was 18.50%

Total loans (gross loans and receivables from banks and clients) amounted to 3,660.1 million euros and show growth of 299.8 million euros or 8.92% in relation to the previous year.

Total deposits of banks at end-2022 (with funds on *escrow* accounts) amounted to 5,224.3 million euros or 24.35% more in relation to the previous year.

The **total assets to GDP ratio** at the end of 2022 was 108.15.

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

During 2022, the Central Bank implemented a number of important activities in the area of improving the regulatory framework arising from its functions.

Also, the application of the Law on Credit Institutions and the Law on Resolution of Credit Institutions, as well as all enabling regulations adopted on the basis of these laws, began from 1 January 2022.

During 2022, the Central Bank prepared 9 enabling regulations by-laws, which brought further harmonisation with the EU standards, as well as with the regulations of the regulatory framework of Montenegro.

The aforementioned regulations, inter alia, harmonise the provisions on the content, deadlines and the method of preparing and submitting financial statements of banks with the provisions of the Law on Accounting. The criteria for determining the key functions and core business lines of the credit institution were further harmonised with the EU standards, as well as the provisions on the recovery plans of credit institutions. In addition to the aforementioned adjustments, as part of the regulatory activities, there were amendments to the enabling regulations, which postponed the application of the provisions related to the entry of the debtor into the status of default, aimed at enabling the successful alignment of credit institutions with the requirements of the new regulatory framework. Also, with a view to further limiting the risk for the placement of cash non-earmarked loans, there were changes to the previously established macro-prudential measures relating to loans granted by credit institutions to natural persons, with their application being extended by one year.

Finally, as part of the activities of the Work Group for negotiation chapter 9 - Financial services, the Central Bank, in cooperation with the Ministry of Finance, the Insurance Supervision Agency and the Capital Market Authority, worked on the preparation of a draft law that will regulate the area of additional supervision of financial conglomerates, the adoption of which will ensure full alignment with Directive 2002/87/EC on supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate.

Main strategic objectives of the Supervisory Authority in 2022

The effects of the interim measures aimed at mitigating the adverse effects of the COVID 19 pandemic adopted by the Central Bank in the previous period have been continuously monitored over the year.

The reform of the regulatory framework, with a view to its further harmonising with the EU acquis and implementing the contemporary prudential supervisory standards, was continued as one of Montenegro's obligations in the EU accession process.

The activities of the banking Supervisory Authority in 2022

In 2022, the Central Bank performed continuous off-site monitoring of credit institutions, and conducted planned targeted on-site examinations of credit institutions.

Since the COVID 19 pandemic outbreak, the Central Bank has been receiving information on the amount of funds in foreign banks, and on early cancellations of deposit agreements on a daily basis, while it has been monitoring the trends of credit institutions' external assets on a weekly basis. In addition, since the outbreak of the war in Ukraine, the Central Bank has been receiving information on the amount non-residents' deposits, with a particular focus on deposits from the Russian Federation. On a monthly level, the Central Bank has been monitoring the effects of interim measures through collecting, from the credit institutions, the data on restructured loans and securities portfolios to which the decision on interim measures applies.

The set of measures adopted in 2022, defined the measure aimed at facilitating the calculation of capital requirements of credit institutions, i.e. the possibility for credit institutions to, until 31 December 2022, exclude 70% of accumulated unrealised losses, incurred after the adopted Decision enters into force, when valuing available-for-sale debt instruments determined in accordance with IFRS 9, which are included in the other comprehensive income. This interim measure applies only to debt financial instruments issued by central governments and regional and local self-government units. In addition, in June 2022, the Central Bank adjusted these measures with a view to further mitigating the adverse effects of the situation in Ukraine on the prices of government bonds held by the Montenegrin credit institutions in their portfolios, i.e. the adverse effect on the amount of own funds of credit institutions.

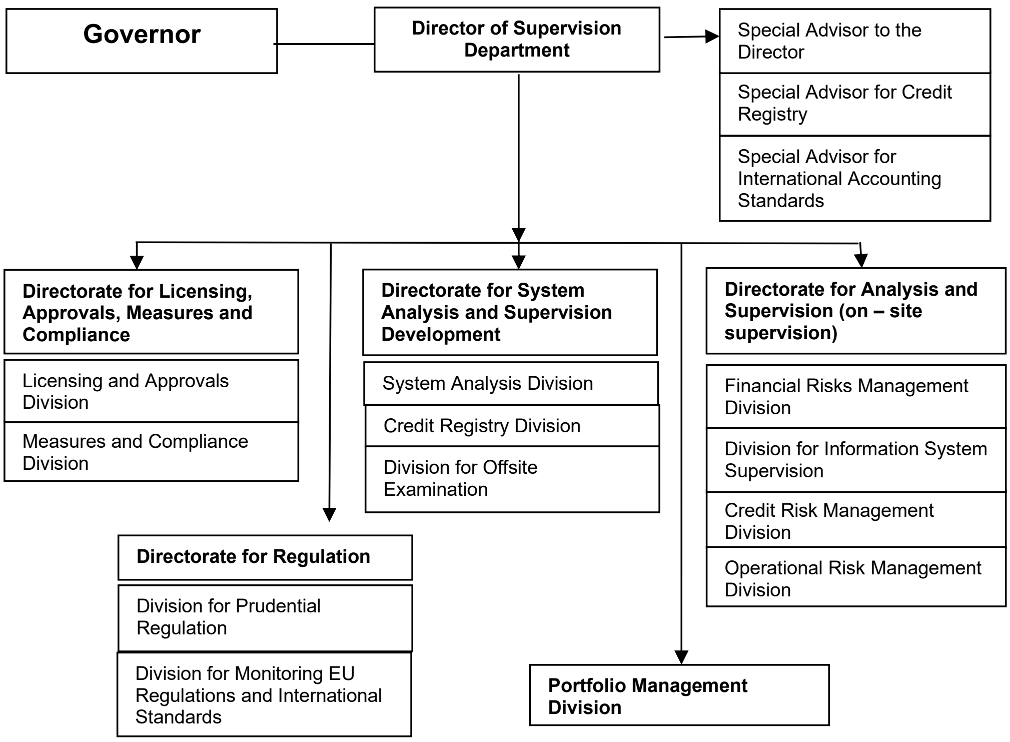
In 2022, eight targeted on-site examinations of credit institutions were planned and conducted. The scope of these examinations included mainly: the assessment of capital adequacy, credit risk, liquidity risk, operational risk, the assessment of earnings, and the assessment of the information system adequacy. Furthermore, in some credit institutions the scope also included the assessment of the adequacy of the established loan granting process, the assessment of the accuracy of the established base of collaterals, the assessment of the internal controls and internal audit functioning, and compliance with measures. Two thematic on-site examinations of all credit institutions were also performed, specifically, the examination of the business model change – reclassification of securities, and the examination of credit institutions' compliance with the decision on interim measures that was in effect when the general moratorium was approved.

Targeted on-site examination of one credit institution commenced in December 2022, and continued into the next year.

In 2022, as a part of the supervision process, the Central Bank maintained communication with all credit institutions. Such communication resulted in issuing two preventive warnings against all credit institutions, aimed at ensuring that the operations of credit institutions are in accordance with regulations.

In addition, due to identified irregularities in operation, the Central Bank issued measures for the removal of irregularities in operation, in the form of a written warning against four credit institutions, and in the form of an administrative decision on imposing measures on two credit institutions. Moreover, in accordance with Article 373 of the Law on Credit Institutions, the Central Bank initiated eight misdemeanour procedures against five credit institutions and responsible persons in those credit institutions.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



International activities of the authority

in 2022, cooperation with supervisory authorities of parent credit institutions continued. The Magyar Nemzeti Bank held two supervisory meetings, one via video conference, while one was organised in Budapest. Supervisory meetings with authorities for the NLB Group (European Central Bank and Bank of Slovenia), and for Addiko Banka (Austrian Financial Market Authority) were held via video conferences. The Central Bank and the Austrian Financial Market Authority agreed on pursuing a more intensive cooperation and more frequent exchange of information in the future.

Communication with the authorities from Central and Eastern Europe was realised through the BSCEE Secretariat (*Banking Supervisors from Central and Eastern Europe*), by exchanging information and replaying to questionnaires of some members with a view to better understanding the best supervisory practices. The meeting held in Tbilisi, Georgia signified the continuation of the practice of holding annual meetings, which was interrupted due to COVID 19 pandemic.

The Centre of Excellence in Finance (CEF) in Ljubljana organised (via video conference) a meeting with banking regulators and supervisors (BRS) from the countries of Southeast Europe with the aim of exchanging knowledge and strengthening capacities. A task force was established for the purpose of exchanging information and considering key challenges for the banking regulators and supervisors.

Cooperation with other supervisory authorities in the country

In 2022, 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 2021 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	12	11	11
Branches of foreign credit institutions	0	0	0
Cooperative banks	0	0	0
Banking sector, total:	**12**	**11**	**11**

Total assets of banking sector (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	4586507	5328574	6407083
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**4586507**	**5328574**	**6407083**
y/y change (in %)	**-0.38**	**16.18**	**20.24**

Ownership structure of banks on the basis of assets total

Item	2020	2021	2022
Public sector ownership	-	-	-
Domestic ownership total	19.67	20.04	18.00
Foreign ownership	80.33	79.96	82.00
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2022

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	52.05	71.95	1,307
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**52.05**	**71.95**	**1,307**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2020	2021	2022
Commercial banks	4.10	4.61	14.44
Cooperative banks	-	-	-
Banking sector, total:	**4.10**	**4.61**	**14.44**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2020	2021	2022
Commercial banks	100	100	100
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	2020	2021	2022
Commercial banks	18.52	18.54	19.32
Cooperative banks	-	-	-
Banking sector, total:	**18.52**	**18.54**	**19.32**

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

Asset classification	2020	2021	2022
Non-financial sector, including*	99.9	99.8	99.98
- households	33.45	30.83	32.49
- corporate**	66.31	68.97	67.29

**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 2022 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	92.9	82.3
Households	45.2	43.3
Corporate	46.3	39
Government sector	5.9	7.0
Financial sector (excluding banks)	1.2 (0.8)	10.7 (0.3)
Total	**100.0**	**100.0**

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

P&L account	2020	2021	2022
Interest income	152807	170322	191512
Interest expenses	21192	22376	20885
Net interest income	131618	147945	170626
Net fee and commission income	24310	37872	52342
Other (not specified above) operating income (net)	14057	22004	16831
Gross income	230874	281181	351965
Administration costs	95778	103428	114970
Depreciation	14983	15647	17451
Provisions	29551	31288	27873
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)			
Profit (loss) before tax	24551	41280	99604
Net profit (loss)	22335	36233	85705

Total own funds in 2022 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	557434	-	531729	25706	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**557434**	**-**	**531729**	**25706**	**-**

Macroeconomic environment in the country

In 2022, the macroeconomic environment was largely influenced by the adverse effects of the war in Ukraine that altered the global trade patterns and produced price shocks on the global energy and food markets. Global developments spilled over into the Macedonian economy through higher inflation and pressures on the balance of payments mainly through the trade channel, while gross foreign reserves remained at adequate level. In order to stabilize inflation, the National Bank of the Republic of North Macedonia reacted by raising the policy rate in several occasions throughout the year.

The growth of the Macedonian economy, which was still not fully recovered from the COVID-19 recession, in 2022 slowed down and amounted to 2.1% as a result of the increased vulnerabilities and uncertainties in the global economy. High investments were the main growth driver, having been more pronounced in the first half of the year mostly due to the increased inventories. Personal consumption also had a positive contribution, but its growth was weaker amid a real decrease of wages and more sluggish growth of consumption loans. On the other hand, net exports had a widened negative contribution because of the more pronounced import growth.

In 2022, inflation rate averaged 14.2% after a prolonged period of low and stable prices. Headline inflation was mainly driven by the global price shocks that spilled –over to the domestic economy through rapidly increasing import prices of food and energy. Core inflation grew by 7.1%.

The National Bank of the Republic of North Macedonia by the end of 2021, started to gradually normalize monetary policy, in order to maintain the medium term price stability. Over the course of 2022, the policy rate was increased in several occasions from 1.25%, in December 2021, to 4.75%, in December 2022. In addition, changes in the reserve requirements instrument were implemented aimed at reducing euroization, but also encouraging lending projects for renewable energy sources. In order to further strengthen the resilience of the banking system and support financial stability, macroprudential measures were introduced through the countercyclical capital buffer and borrower-based measures.

The labour market was also adversely affected by the developments in the external environment, which led to less favourable movements both on the demand and supply sides. Unemployment rate declined to the historically low level of 14.4%, but it was accompanied by a decline of the number of employed persons, which mostly occurred in the agricultural and to a lesser extent in the service sector. Wages grew in nominal terms (by 11.0% and 11.1%, net and gross wages, respectively) amid the increase of the minimum wage as well as the rise in part of the salaries in the public sector. Sectors in which the wages increased the most are accommodation (18.4%), arts, entertainment and recreation (16.4%), manufacturing (14.6%) and trade (14.2%). Given the higher inflation, the real net and gross wages decreased by 2.7% and 2.6%, respectively.

The budget deficit continued to further narrow down and amounted to 4.5% of GDP compared to that of 5.4% in the previous year. Given the challenging environment, Government implemented different sets of measures to support companies and households in mitigating the effect of the energy and price shocks. As a result, budget expenditures increased, most notably the current expenditures but also the capital expenditures. Growth in expenditures was accompanied by a significant increase of budget revenues, largely a result of the increased revenues from taxes and contributions. External government borrowing remained the primary source of financing the budget deficit in 2022. Government debt nominally grew at a lower rate compared to the nominal GDP growth contributing to decrease of central government's debt as a share to GDP to 51.0% (52.0% in 2021). Public debt declined to 59.7% of GDP (61.0% in 2022), with a reduction of both the external (from 39.9% to 39.2% of GDP) and the domestic public debt (from 21.1% to 20.5% of GDP).

At the end of 2022, gross external debt amounted to 80.7% of GDP and recorded a marginal decrease (by 0.1 percentage point). The public sector's debt declined, mostly due to the falling debt of the central government as well as the debt of public enterprises. On the other hand, the private debt increased, mostly as a result of the higher intercompany debt and to a lesser extent the rising debt of companies due to the rising trade loans as well as the increasing debt of the private banks due to the rising short-term liabilities on currency and deposits.

The current account deficit in 2022 expanded to 6.0% of GDP (3.1% of GDP in 2021), which was largely driven by the significantly widened trade deficit as a result of the increased value of imports due to the rising import prices of primary products. Pressures in the trade balance were to some extent mitigated by favorable developments in the other components of the current account, including improved surplus in the services balance and continued growth in private transfers. Foreign direct investment were 5.9% of GDP, which is a marked increase compared to the previous year (by 1.9 percentage point). The stock of foreign exchange reserves increased and is maintained at an adequate level to support the strategy of fixed exchange rate of the Denar against the Euro.

The war in Ukraine caused a strong non-economic shock to the global economy that was still recovering from the COVID-19 pandemic. Geopolitical factors continue to pose challenges for the macroeconomic prospects of the economies going ahead. Downward risks stem from potential adverse effects from a new escalation of the war and an ensuing surge of energy prices, extended tightening of financial conditions on the global markets, fragmentation of the global economy, as well as a slower growth of the Chinese economy.

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

The banking sector retained the leading role in the Macedonian financial sector, with banks' assets accounting for 79% of the total financial sector's assets in 2022. The number of banks operating in the country stayed the same as the previous year and equaled 13. The system noticed a decrease in market concentration, with the top three banks holding 56.5% of total banking sector assets, while there was an increase in market concentration for the top five banks which account for 81,5%.

In 2022, the banking system assets to GDP ratio was reduced by nearly three percentage points relative to the previous year and amounted to 86.1%. The share of total credit to the non-financial sector to GDP stagnated at 53.2% in 2022, while share of total deposits decreased to 62.1%. Financial intermediation indicators saw a decrease in 2022, primarily due to higher nominal GDP this year. The rate of non-performing loans decreased to the historically lowest level of 2,9% in part due to mandatory net write-offs, primarily for loans of non-financial companies. Non-performing loans are in large portion covered by impairment (69.4%), which is around three percentage points increase compared to 2021.

The solvency of the banking system improved. As of 31.12.2022, the capital adequacy ratio reached the highest level in the last decade at 17.7%. The growth of own funds was primarily a result of the reinvested earnings, the issue of new capital instruments, which contributed the most to the increase in the capital adequacy ratio. Over 90% of the own funds account for the Common Equity Tier I capital, which represents the highest-quality segment of the banks' regulatory capital. The excess own funds that are "free" above the minimum supervisory and regulatory level and the capital buffers account for around 20% of the banking system's own funds, which are particularly significant in conditions of crisis episodes to deal with challenges of different natures and intensity. In addition, the 2022 stress testing of the banking system using simulated shocks with extremely conservative assumptions shows increased resilience compared to the previous year.

In 2022, the banking system made a profit from operations that compared to the previous year is higher by 5.7%. The most significant contribution to the profit growth came from net-interest income, which was higher for 12.7% compared to previous year. In addition, a modest contribution was made by the net income from fees and commissions (which increased by 11.5%). On the other side, negative contribution to the profit growth in 2022 had the lower collection of previously written-off receivables as well as the expenses growing trend. Slow pace profit growth made reflection in the profitability indicators. ROAA stayed the same as the previous year at 1.5%, while ROAE slightly decreased to 12.2%.

On the funding side, deposits' annual growth reduced the pace compared to 2021. Households, traditionally the most significant depositor in the Macedonian banking system, increased their funds deposited in banks by 6.3% (compared to 6.9% in 2021). On the other hand, the deposits of non-financial companies increased by 3.8% (11.8% in 2021).

On the banking system's assets side, loans recorded accelerated growth (10.1%), whose annual rate exceeded that achieved in 2021. Enterprises attributed to almost 60% of the annual credit growth while households held more modest share. Nearly two-thirds of the annual growth of total loans to non-financial entities resulted from foreign currency loans, mostly consequential to the stronger growth of foreign currency loans of enterprises, in conditions of increased liquidity needs amid higher prices of energy and imported goods in general.

In 2022 the liquidity indicators of the Macedonian banking system remained stable and on a satisfactory level. Liquid assets accounted for 30% of the banks' total assets, while the coverage of short-term liabilities and deposits from households with liquid assets is 47.7% and 61.1%, respectively. The liquidity coverage ratio of the banking system is 273.8%, 2.7 times over the regulatory minimum (100%) and confirms the satisfactory level of liquidity available to the Macedonian banking system. Furthermore, the regular simulations of individual and combined liquidity shocks confirm the sufficient volume of liquid assets of domestic banks and their adequate liquidity management that allows for sufficient resilience to hypothetical extreme liquidity outflows.

The environment in which the banking system operates is still uncertain, under impact of global factors, followed by still high, though declining inflation and tightening of financial conditions. Near the end of the first quarter of 2023, temporary turbulences were also observed in the financial markets, driven by developments in the US and Swiss banking systems. The Macedonian banking system was not affected by these developments, due to traditional business model, the low exposure and liabilities to abroad and the general absence of greater integration in global financial flows. However, risks mainly related to the external environment, still exist and may impact the environment in which the domestic banking system operates and subsequently its activities and risk profile going forward. The uncertain environment, together with the gradual tightening of financial conditions imposes the need for further careful monitoring of the credit risk and managing capital positions in line with the overall risk profile as well as the market and macroeconomic conditions.

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 three departments, Off-site Supervision and Licensing Department, On-site Supervision Department and Information Systems Supervision Office performs the supervisory function.

The Financial Stability and Macroprudential policy Department is responsible for analysis of the financial system and the financial stability in the country and for development of adequate macroprudential policy. The Banking Regulations and Bank Resolution Department is responsible for development of relevant banking regulation in line with international standards and best practices, as well as for performing the resolution function 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, the Banking Law and the Law on Financial Stability, which was enacted in August 2022.

The following activities were undertaken in 2022 for further strengthening and improvement of the domestic regulations:

a. The National bank continued its activities for development and adoption of adequate bank resolution legislation, in accordance with the the European Directive 2014/59 (BRRD). The Draft Law on Bank Resolution has been submitted to the Ministry of Finance and should be subject to public discussion. During 2022 the Banking Regulations and Bank Resolution Department undertook certain preparatoy activities for perfoming the new function, such as development of the neccessarry by-laws and continuos capacity building.

b. Drafting of the new Banking Law, for the purposes of better alignement with the draft Law on Bank Resolution, as well as for further harmonization with the EU Directive 2013/36/EU (CRD) and Regulation (EU) No.575/2013 (CRR), including the proposed amendments to this framework from October 2021. In addition, for the purpose of harmonization with the Law on Payment Services and Payment Systems, amendments to the Banking Law have been prepared, primarily in the area of financial activities of banks and in the provisions regulating the operation of savings houses.

c. Drafting of a new regulation on the methodology for determining capital adequacy taking into account the requirements of EU Regulation 575/2013, including the amendments to this regulation from 2019 and the proposed amendments from 2022. Having in mind the complexity of the new regulation, it's drafting and adoption is envisaged as a medium-term project.

d. Adoption of a new Decision on publication of data and information by banks (in Febrary 2023). Significant changes were made to widen the scope of data and information that banks will be obliged to publish on a regular basis. This regulation will enable further harmonization with the relevant requirements of the EU Regulation 575/2013.The drafting of the Manual on implementation of this Decision with standardised reporting forms that will be used by banks while public disclosing the required data is currently underway.

e. Adoption of a new Decision on the methodology for credit risk management (in Febrary 2023) that enables impementation of the EU definition of non-performing exposures, as well as enhancing the requirements for management of non-performing and forborne credit exposures. One of the novelties introduced with this new regulation is the requirement for the banks to prescribe the manner of including the impact of climate-related risks in their internal acts for credit risk management. The adoption of the Manual for the implementation of this new Decision is in the final stage.

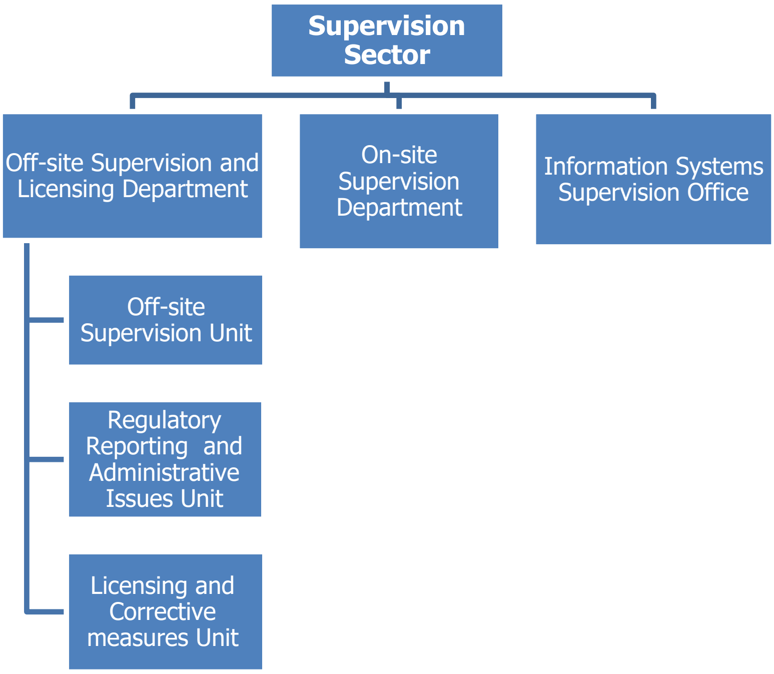
f. In April 2023, macroprudential measures were taken introducing limits for DSTI[1] (55% for new loans in denars and 50% for new loans in foreign currency, including indexed loans) and LTV (85% for mortgage loans used by individuals). With these macroprudential measures, the application of which began on July 1, 2023, the accumulation of systemic risks in the household segment and the real estate market is prevented.

[1] DSTI as a ratio between loan repayment obligations and the income of individuals on a monthly basis.

g. In mid-2022, the countercyclical capital buffer of 0.5% was introduced, applicable from August 2023. Consequently, this rate was increased twice, in December 2022 and in June 2023 by 0.25 pp each to the level of 1% (with delayed application of 12 months).

Organizational chart of the Banking Supervisory Authority

The supervisory function is performed by a separate organizational part (Supervision Sector). In 2022, the organizational structure of this Sector has remained unchanged, consisting of three organisational units: Off-site Supervision and Licensing Department, On-site Supervision Department and Information Systems Supervision Office.



There is a close cooperation among the Supervision Sector, Financial Stability and Macroprudential Policy Department and Banking Regulation and Resolution Department. It is channeled through the Committee for supervision, financial stability, banking regulation and resolution. The Committee is a platform for exchanging relevant information and data among these organizational units and it is an integral part of the complete decision-making process within the National Bank.

Main strategic objectives of the Banking Supervisory Authority in 2022

As over the previous year, the main objectives of the supervision were to contribute to the maintenance of stable and reliable banking system as the main prerequisite for financial stability and sustainable economic growth of the country. In 2022, 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, especially having in mind the macroeconomic developments. Also, corporate governance, liquidity risk, operational risk, and within its framework, especially the risk arising from the information system 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.

The activities of the Banking Supervisory Authority in 2022

Activities of the Off-Site Supervision Department

The Department of Off-site Supervision and Licensing continued with regular activities which were directed to update the overall banks' risk profiles through an assessment of: the business model, the corporate governance, the liquidity position and the risks to the bank's capital position. The Department closely monitored the energy crises developments and increasing inflationary environment and conducted simulations on the banks' financial positions, with the purpose to assess their impact on banks'financial results, capital positions and overall risk profiles. The annual SREP assessments were communicated within the supervisory dialog of the Pillar 2 capital requirements. In 2022, the internal guidance for assessment of the recovery plans was finalised and approved within the Supervision Sector. The Department continued with the regular assessment of the recovery plans for systemically important banks and gave the banks recommendations for their further improvement.

Within its legal authorization, the off-site supervisory function of the National bank was involved in issuing licenses and approvals and undertaking corrective measures toward Banks and Savings houses. During 2022, The Governor of the National bank issued 51 approvals, which were related to: the appointment of members of the Supervisory Board and Management Board of Banks, the amending and/or supplementing of the Statutes of Banks, the commencement of new financial activities by Banks, and change of the headquarters of a Bank. In order to maintain the stability and safety of the banking institutions and banking system, the National bank undertook 12 corrective measures towards banks and saving houses where illegitimacies, irregularities, and non-compliance with the Law on Banks and By-laws were determined during on-site inspections and off-site supervision.

The On-site Supervision Department holds the responsibility of conducting examinations at various financial institutions, including banks, savings houses, exchange offices, and fast money transfer service providers. These examinations can be either comprehensive, covering the entire operations of a bank (full-scope onsite examination), or targeted, focusing on specific areas of a bank's operations.

To ensure effective supervision, the On-site Supervision Department follows risk-based supervision manuals and internal guidelines for conducting examinations of controlled entities.

In 2022, the On-site supervision Department conducted a total of 12 on-site inspections as part of its supervisory duties. Out of these inspections, nine were focused on assessing risks in banks, while the remaining three targeted fast money service providers. Moreover, the department performed 213 inspections at exchange offices.

The On-site supervision Department's activities were carried out in accordance with the annual inspection plan. The inspections conducted on banks encompassed a comprehensive assessment, covering various critical areas such as credit risk, liquidity risk, AML risk, corporate governance, interest rate risk, and operational risk. Additionally, the department diligently followed up on the implementation of previously issued recommendations for the National Bank and monitored the progress of corrective actions taken in response to those recommendations.

Main focus for the credit risk assessment was given on the organizational framework, policies and procedures, credit risk profile and strategies, credit risk management, credit quality review by selection of the sample of exposures and adequacy of the internal audit. Additionally, attention was given on the adequacy of the process for classification and provisioning, credit risk limits, monitoring of the credit portfolio and management of the NPL / forborne credit exposures and stress-testing.

Liquidity risk was focused on the assessment of the organizational framework, policies and procedures, risk profile and risk strategy, operational liquidity management, internal liquidity risk indicators, effectiveness of the process for measurement and monitoring of liquidity and contingency planning, stress testing and proper reporting and disclosure requirements. Inspections included assessment of the inherent liquidity risk based on the internal on-site methodology.

AML/CFT examinations were focused on the bank's risk assessment based on the customers, countries or geographic areas, products, services, transactions or delivery channels, customer due diligence and record keeping (identification and verification of the customer's identity including beneficial owner, purpose and intended nature of the business relationship and source of funds), quality of STRs and feedback from the FIU, AML/CFT roles and responsibilities, internal audit of AML/CFT function. Special focus was given on the measures applied by the banks for enhanced due diligence for customers that are identified as politically exposed persons, correspondent banking, clients from high risk countries, non-profit organizations, complex and unusual transactions and clients that established relationship without physical presence. On-site inspections also covered assessment of the software tools used for AML including identification of the suspicious transactions and unusual behavior of the clients (unusual transactions or complex transactions or transactions executed on an unusual manner.

The Information Systems Supervision Office holds the responsibility of conducting IT risk management examinations at various financial institutions. These examinations can be either comprehensive, covering the entire operations of a financial institutions (full-scope onsite examination), or targeted, focusing on specific areas of a IT's operations.

To ensure effective supervision, the Information Systems Supervision Office follows risk-based supervision manuals and internal guidelines for conducting examinations of controlled entities.

In 2022, the Information Systems Supervision Office conducted a total of 3 on-site inspections as part of its supervisory duties. The Information Systems Supervision Office 's activities were carried out in accordance with the annual inspection plan. The inspections conducted on banks encompassed a comprehensive assessment, covering various critical areas such as IT Governance and Strategy, Information security, ICT operations management, ICT project and change management, Business continuity management, Internal and External Audit, etc. Main focus for the assessment was given on the information security especially at rapidly increasing cyber risks. Additionally, the Office diligently followed up on the implementation of previously issued recommendations for the National Bank and monitored the progress of corrective actions taken in response to those recommendations. In 2022, the Information Systems Supervision Office also conducted annual SREP assessments of the IT risk to the bank's capital position.

In accordance with the Law on Payment Services and Payment Systems (compliant with Directive (EU) 2015/2366 (PSD2) of the European Parliament) adopted in 2022, the Sector was actively involved in the development of new by-laws. Also, the National Bank continued to strengthen the institutional capacity for implementation of the new regulation for licensing and supervision of payment institutions.

International activities of the authority

In 2022 the EU started the opening phase of the Accession negotiations with North Macedonia, following the Decision by the EU Council on 25 March 2020 to open accession negotiations with the Republic of North Macedonia (endorsed by the members of the European Council on 26 March 2020) and the approval of the Negotiating Framework by the Council on 18 July 2022.

The first Intergovernmental Conference on the Accession of North Macedonia (and Albania) was held in July 2022 which officially started the screening process. The EU started organizing explanatory meetings with the aim of preparing the institutions of North Macedonia for the negotiation process.

The National Bank is actively involved in the activities of the working groups in the preparation of the negotiation positions for the country's accession to the European Union. In this context, representatives of the NBRNM participated in the explanatory meetings for the Chapter 4 – Free movement of capital and payments as well as Chapter 9 – Financial services. At the end of 2022 and in 2023, bilateral screening meetings were organized, for the purpose of presenting the relevant domestic legal framework and its alignment with the EU Acquis.

In 2022 the Department for Off-site supervision continued the cooperation with the supervisory authorities of the two international banking groups operating locally. In late 2022, the off-site supervision staff attended supervisory college for Slovenian subsidiary and AML/CFT for the Greek banking group. Additionally, the Off-site supervision Department held bilateral meeting with the ECB/JST team for a Greek banking group, at which both teams exchanged information regarding SREP results for the supervised banks.

Supervisors were actively involved during commenced 5th round of FATF mutual evaluation on the AML/CFT by Moneval Committee of experts. The on-site visit by the experts was between 21 September until 6 October 2022. The final report of the mutual evaluation was adopted at the 65th Moneyval's Plenary meeting held in May 2023.

Cooperation with other supervisory bodies in the country

The National bank has continued the bilateral cooperation with other supervisory authorities in the country, mainly in the field of data and information exchange for the purposes of supervision and licensing. The cooperation is realized through signed memorandums with other supervisory authorities (Financial Intelligence office, Security and exchange commission, The Agency for Supervision of Fully Funded Pension Insurance, The Insurance Supervision Agency, State Foreign Exchange Inspectorate).

Questionnaire tables for the 2022 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	14	13	13
Branches of foreign credit institutions	0	0	0
Cooperative banks	0	0	0
Banking sector, total:	**14**	**13**	**13**

Total assets of banking sector (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	585,501	638,666	684,255
Branches of foreign credit institutions	0	0	0
Cooperative banks	0	0	0
Banking sector, total:	**585,501**	**638,666**	**684,255**
y/y change (in %)	**6.5%**	**9.1%**	**7.1%**

Ownership structure of banks on the basis of assets total

Item	2020	2021	2022
Public sector ownership	2.0%	2.3%	2.4%
Domestic ownership total	28.1%	28.9%	27.4%
Foreign ownership	71.9%	71.1%	72.6%
Banking sector, total:	**100.0%**	**100.0%**	**100.0%**

Concentration of asset by the type of financial institutions, 2022

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	56.5%	81.5%	1,461
Branches of foreign credit institutions	/	/	/
Cooperative banks	/	/	/
Banking sector, total:	**56.5%**	**81.5%**	**1,461**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2020	2021	2022
Commercial banks	11,3%	12,9%	12,2%
Cooperative banks	/	/	/

Distribution of market shares in balance sheet total (%)

Type of financial institution	2020	2021	2022
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)

Assets	2020	2021	2022
Cash, balances and deposits with central bank (National Bank)	16.7%	16.4%	16.6%
Placements in securities	14.1%	13.9%	12.5%
- issued by domestic government sector	12.0%	11.8%	10.4%
- issued by central bank (National Bank)	1.7%	1.6%	1.4%
- other (including non residents)	0.4%	0.6%	0.7%
Loans, deposits and accounts with financial institutions (excluding central bank, including non residents)	7.3%	8.1%	7.7%
Loans with non-financial sector (including non residents)	57.5%	57.5%	59.1%
- loans with domestic government sector	0.3%	0.3%	0.7%
Other assets	4.5%	4.2%	4.1%
Total	**100.0%**	**100.0%**	**100.0%**
Liabilities	**2020**	**2021**	**2022**
Deposits of financial institutions (including non residents)	5.3%	4.8%	6.0%
Deposits of non financial sector (including non residents)	73.6%	73.4%	72.2%
- 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)	6.8%	7.2%	6.7%
- domestic financial sector	1.9%	2.0%	2.3%
- domestic government sector	0.0%	0.01%	0.01%
- other	4.9%	5.1%	4.4%
Other liabilities	1.4%	1.6%	1.3%
Equity and reserves (including loss in current year)	11.6%	11.6%	12.3%
Profit after tax in current year	1.2%	1.4%	1.4%
Total liabilities	**100.0%**	**100.0%**	**100.0%**

Capital adequacy ratio of banks

Type of financial institution	2020	2021	2022
Commercial banks	16,7%	17,3%	17,7%
Cooperative banks	/	/	/
Banking sector, total:	**16,7%**	**17,3%**	**17,7%**

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

Asset classification	2020	2021	2022
Non-financial sector, including	3.4%	3.2%	2.9%
- households	1.6%	2.0%	1.9%
- corporate	5.2%	4.5%	3.9%

The structure of deposits and loans of the banking sector in 2022 (%) (at year-end)

	Deposits	Loans	
Non-financial sector, including:	92.9%	99.8%	
Households	61.8%	49.9%	
Corporate	27.8%	48.5%	
Government sector	0.3%	1.1%	
Financial sector (excluding banks)	7.1%	0.2%	
Total	**100.0%**	**100.0%**	

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

P&L account	2020	2021	2022
Interest income	18,525	18,726	20,660
Interest expenses	-3,451	-3,067	-3,004
Net interest income	15,074	15,660	17,656
Net fee and commission income	4,844	5,594	6,235
Other (not specified above) operating income (net)	3,951	5,000	4,147
Gross income	23,869	26,253	28,039
Administration costs*	-10,374	-14,580	-16,310
Depreciation	-1,084	-1,185	-1,293
Provisions**	-57	148	229
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)***	-4,429	-3,853	-4,286
Profit (loss) before tax	7,925	10,035	10,499
Net profit (loss)	7,252	9,150	9,675

** 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 2022 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	1,414,494,405	1,315,367,402	1,322,756,724	91,737,682	/
Cooperative banks	/	/	/	/	/
Banking sector, total:	**1,414,494,405**	**1,315,367,402**	**1,322,756,724**	**91,737,682**	**/**

1 EUR = 61.4932 MKD, as of 31.12.2022

Macroeconomic environment in the country

In 2022, the economic situation in Poland, including the financial market, was affected by the war in Ukraine. The main factors that had an impact on the Polish economy were: high inflation, interest rate hikes and rising energy prices, mainly due to rising energy commodity prices on global markets. Geopolitical risk related to escalating hostilities was also of great importance. Such risk increased uncertainty in the market and, in addition to rising financing costs, was an important factor limiting the level of investment.

The average annual inflation in 2022 stood at 14.4% compared to 5.1% in 2021. The rise in prices was partly due to external factors: rising energy prices on global markets, unbuilt supply chains and prolonged restrictions in China related to the 'zero COVID' policy, limiting production there. The internal factors of higher inflation included: expansionary fiscal policies, including COVID-19 assistance programmes and expansionary monetary policy. In the face of inflationary pressures in 2022, the Monetary Policy Council continued the cycle of interest rate hikes initiated in the second half of 2021. As a result, the reference rate increased from 1.75 % (as of 1 January 2022) to 6.75 % at the end of 2022.

2022 saw the weakening of the Polish zloty against the euro, the U.S. dollar, and the Swiss franc. At year-end, the average exchange rate of the Polish zloty against the U.S. dollar was 4.40 compared to 4.06 at the beginning of the year. The 2022 weakening against the euro was relatively less pronounced: from 4.60 to 4.67 at year-end. The exchange rate of the Polish zloty against the Swiss franc fell from 4.45 to 4.76. At the end of 2022, the interest rate on 10-year Treasury bonds amounted to 6.88% and was higher by nearly 300 bp than at the end of 2021 (3.71%).

According to Statistics Poland (Polish: Główny Urząd Statystyczny) in Poland the gross domestic product (GDP) in 2022 increased by 5.3% in comparison to 2021.

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

At the end of 2022, the KNF Board *(Polish*: Komisja Nadzoru Finansowego) supervised 29 commercial banks (including two affiliating banks), 1 state bank, 2 institutional protection schemes, 496 cooperative banks, and 34 branches of credit institutions and foreign banks. In 2022, the KNF Board approved the merger processes for 10 cooperative banks.

The balance sheet total of the banking sector at the end of December 2022 was PLN 2 732.9 billion and was 6.2% higher than in 2021. In terms of balance sheet total, commercial banks and foreign branches account for 90.2% of the banking sector, their balance sheet total at the end of 2022 was PLN 2 466.1 billion, while the balance sheet total of cooperative banks was PLN 186.3 billion. The balance sheet total of branches of credit institutions amounted to PLN 80.5 billion. The net financial profit of the banking sector in the period concerned was PLN 12.1 billion (in 2021, the banking sector reported a profit of PLN 6.0 billion). In 2022, higher net results were reported by both commercial and cooperative banks. The main reason for the improved result was significantly higher interest income, which increased by PLN 68.3 billion. This was due to the tightening of monetary policy from the end of 2021 and became apparent in 2022. Other factors had a less significant impact on the results.

At the end of 2022, the Polish banking sector's assets ratio in relation to the Polish GDP was at the level of 88.5% (it stood at 97.1% at the end of 2021). Whereas the domestic financial system's assets to GDP ratio at the end of 2022 was 117% (decline from 133% at the end of 2021 due to faster growth in GDP than in financial sector assets).

In 2022, the legal risk of the foreign-currency mortgage loan portfolio (residential real estate FX loans for households) remained the main risk to the stability of the banking sector. Following a significant increase in the number of disputes and value of claim as well as, in consequence, the evolving trend in the court rulings, banks clearly increased the value of their provisions for legal risk. All banks that hold RRE (FX) portfolios offer the possibility of concluding a settlement agreement. Banks offer settlements before the Arbitration Court or settlements on the terms defined by the banks. The results of the monthly monitoring of the RRE (FX) portfolio, including the credit facilities subject to court proceedings and the settlement agreements concluded by banks, were regularly presented at the meetings of the KNF Board and the Financial Stability Committee. The results of the analyses were taken into account in the methodology on the additional capital requirement to cover the risk associated with foreign-currency loans and in the consultation work on the amendments to the Regulation on risk weights for foreign-currency housing loans.

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, UKNF) and the KNF Board operate pursuant to the Act on financial market supervision. The UKNF has the status of a state legal person, the bodies of which are the KNF Board and the Chair of the KNF Board. The Chair of the KNF Board manages the activities of the KNF Board and the UKNF and represents them externally.

The KNF Board is competent for supervision of the financial market, which under the legal framework as at 31 December 2022 included:

- banking supervision,
- pension supervision,
- insurance supervision,
- capital market supervision,
- supervision of payment institutions, small payment institutions, account information service providers, 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 of credit unions and the National Association of Credit Unions,
- 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 2018 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 ,
- supervision as provided for in Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services;

- supervision as provided for in Regulation (EU) 2020/1503 of the European Parliament and of the Council of 7 October 2020 on European crowdfunding service providers for business, and amending Regulation (EU) 2017/1129 and Directive (EU) 2019/1937.

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 to be achieved through reliable information concerning the functioning of the market, through the pursuit of objectives stated in, in particular, the Banking Law, the Act on insurance and pension supervision, the Act on supplementary supervision, the Act on capital market supervision, the Act on credit unions, and the Act on payment services.

Main strategic objectives of the supervisory authority in 2022

In 2022 the activities of the KNF Board (and subsequently – the UKNF) 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.

I was not an easy task, given the impact the Russia's invasion of Ukraine in February 2022 had on Polish economy and the significant increase in uncertainty on all global markets. Just when the world started to return to its previous rhythm after the COVID-19 pandemic, Russia's invasion of Ukraine turned out to be the biggest armed conflict in Europe after many years of peace, occurring in immediate proximity to Poland. The new serious crisis hindered the much expected return to normality. From one day to another, Poland became a front country, through which millions of people were fleeing the war-torn Ukraine. We became a new home for many of them. That involved another demanding test of the Polish financial market. Banks, insurance institutions and electronic payment systems in Poland saw an unprecedented inflow of new customers and users. From the perspective of the supervisory authority, the financial market quickly adapted to the new situation. More than two million citizens of Ukraine were provided access to necessary financial services, including banking, payment and insurance services.

The Polish financial market has done well in the stress test of operational capacity. After adapting to the requirements in the area of customer service and digitisation of the functioning of the financial market in Poland after the COVID-19 pandemic, the security systems introduced by financial institutions were tested during a hybrid war and enhanced cyberattacks. Institutions in Poland proved resilient, despite many attempts to break the security.

In 2022, the supervisor's attention continued to be focused on the loans denominated in or indexed to a currency other than the Polish currency. Some banks provided clients with the option to enter into a financial agreement on the terms offered by the UKNF or by those banks (in 2020 the UKNF proposed a formula for an alternative dispute resolution according to which an existing loan is settled as if it were originally contracted and repaid in PLN). In 2022, the Mediation Centre of the Arbitration Court initiated 18 511 proceedings regarding agreements for a loan denominated in or indexed to a currency other than the Polish currency, that made up more than 95% of all pending mediation proceedings. In that same year, 22 239 mediation proceedings regarding such loans were concluded, of which 14 980 proceedings were concluded through settlement. Importantly, the alternative dispute resolution meets the expectations of many borrowers, allowing them to avoid lengthy and costly court trial.

The UKNF Strategy for 2021—2025 has been further implemented over the 2022. The UKNF Strategy has been designed as a set of objectives in three directions: more effective and more efficient use of data, information and knowledge, more proactive supervision, and better organisation management and in 2022 the UKNF's employees contributed, directly or indirectly, to the implementation and achievement of the UKNF Strategy objectives, either by performing analyses, providing data or by conducting reviews or taking part in meetings with supervised and non-supervised entities.

The activities of the Banking Supervisory Authority in 2022

2022 brought new challenges for global and domestic financial markets and for the UKNF, the Russian invasion of Ukraine being the major one. Russia's aggression caused a reaction of the European Union, United Nations and other international organisations. The sanctions and actions agreed on at the international level – mostly regarding financial market and related organisations – were one of the topics raised as part of cooperation between the UKNF and the Polish Ministry of Foreign Affairs and foreign international partners, and required ongoing monitoring of the dynamic legal environment in the EU and in other relevant markets (e.g. the United States or the United Kingdom).

Following the outbreak of the war in Ukraine, many actions were taken to ensure uninterrupted functioning of financial markets and to support the KNF-supervised entities:

- coordinated exchange of information and cooperation between financial market entities with regard to the demand for and supply of cash,
- arrangements on the method of information exchange and cooperation with market entities with regard to business continuity and physical security.

The KNF Board adopted a resolution on the circumstances which are relevant for the assessment of warranty in matters regarding financial market in connection with the aggression of the Russian Federation against Ukraine, indicating that any relationship of a licensed entity, its significant shareholders and managers with the Russian Federation or the Republic of Belarus would be treated by the KNF Board as a fact raising material doubt as to whether the operations of the licensed entity would be carried out properly: in a lawful, fair, transparent, prudent and stable manner.

Russia's invasion of Ukraine has caused a significant increase in uncertainty in global markets. It led to the depreciation of our region's currencies, an increase in government bond yields and constituted an additional inflationary impulse, including through higher prices of energy and agricultural raw materials. The supervisory authority responded proactively by launching many initiatives to ensure the stability of the financial sector, including:

- additional monitoring of liquidity at supervised entities,
- accounts for refugees from Ukraine – a recommendation on how to open bank accounts for the refugees, and the monitoring of the market in terms of the number of accounts and the amount of funds stored therein,
- analyses of the exposure of supervised entities to countries associated with the invasion (Russia, Belarus) and to Ukraine and energy-intensive industries (estimating potential losses under various adverse scenarios),

The supervisory activities undertaken by the UKNF in 2022 consisted of ongoing monitoring and quarterly analysis of the economic and financial standing of banks. Particular emphasis is placed on the banks' maintenance and accumulation of good-quality equity and sufficiently high capital in relation to the banks' exposure to risk. The capital surplus above the minimum supervisory requirements ensures a safety buffer for a bank in case of adverse external events which might arise, for example, in connection with a crisis in real terms or turbulence in international financial markets, also allowing for further growth.

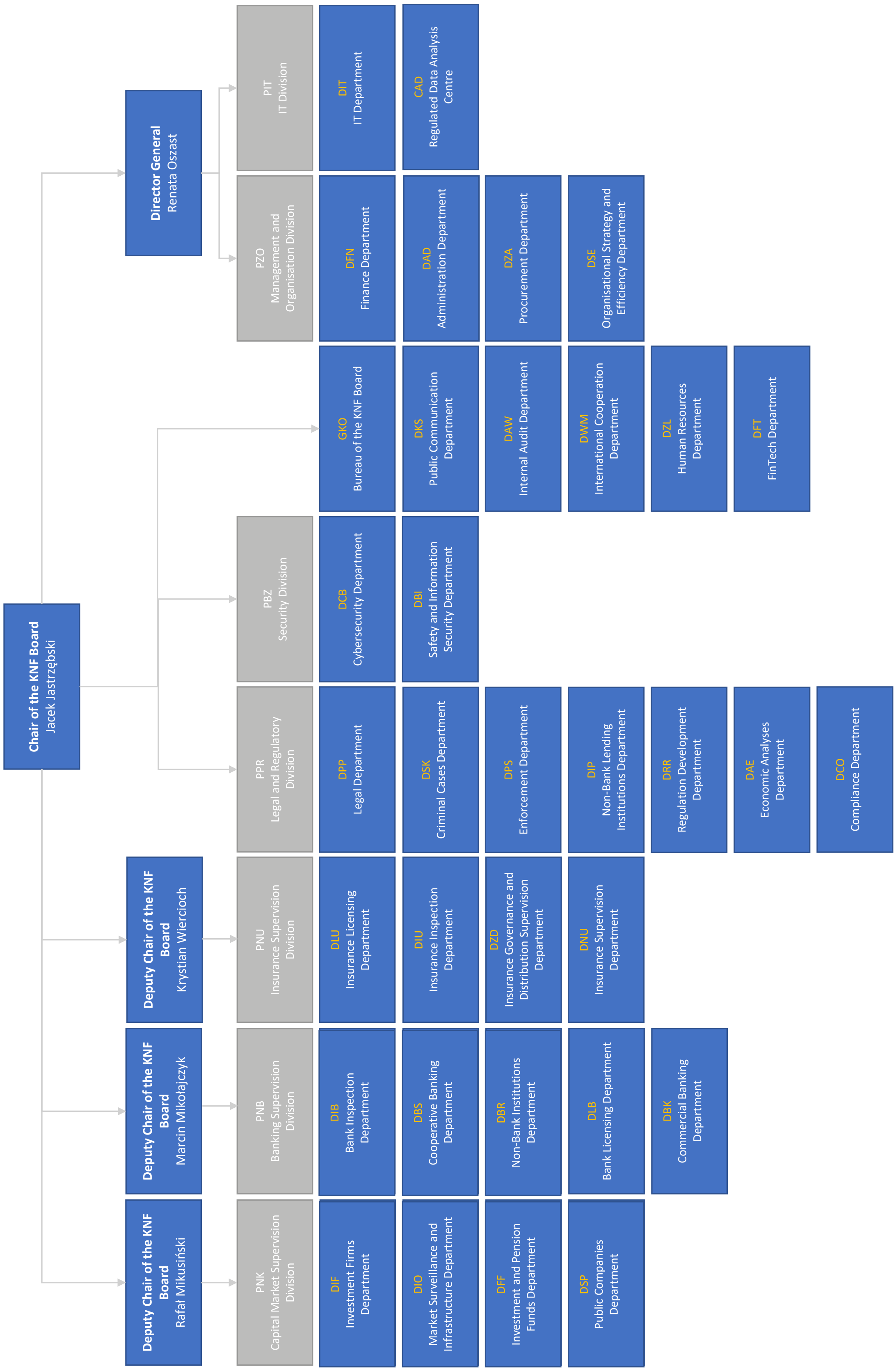
In 2022 the UKNF carried out a stress-testing exercise of banks using the bottom-up approach, based on internal reporting sheets. The main purpose of the exercise was to estimate the banks' possibility of functioning in the case of stressed macro-economic conditions. The stress test results generally showed high resilience to potential shocks and in most cases confirmed that commercial banks were well capitalised. The results are used in the dividend policy to set the amount of the P2G add-on and in the ongoing prudential supervision, including SREP. The UKNF also conducted the fourth edition of liquidity stress tests of commercial banks. The aim of the exercise was to analyse the sensitivity of banks' short- and medium-term liquidity position, verify the liquidity buffers held by banks, as well as estimate possible shortages of liquid assets under stress conditions to comply with the regulatory LCR requirement and survival period. The results were used in the SREP as part of the analysis of banks' liquidity adequacy.

Following the entry into force of the Act on crowdfunding for business ventures and assistance to borrowers, under which a borrower has the right to suspension of the payment of instalments of a mortgage loan granted in the Polish currency, the UKNF started monitoring the scale of borrowers using credit repayment holidays and the amount of the related costs borne by lenders.

At the end of 2022, the number of housing loans in PLN for which the bank granted credit repayment holiday was 1.05 million. The loans covered by repayment holidays accounted for 53.6% of the total number and 67.8% of the total value of all housing loans in PLN. The total cost of repayment holidays included in the banks' financial result and/or capitals at the end of 2022 amounted to PLN 13.41 billion.

The year 2022 saw the continuation of the project of alternative resolution of disputes connected with contracts for a loan denominated in or indexed to a currency other than the Polish currency through settlements concluded before the Arbitration Court attached to the KNF Board. Such settlements are made based on the concept of converting loans denominated in or indexed to a currency other than PLN into PLN loans. The disputes related to contracts for loans denominated in or indexed to a currency other than PLN made up the vast majority of mediation proceedings conducted in 2022. In 2022, 18 511 proceedings related to that type of disputes were initiated in the Mediation Centre of the Arbitration Court, accounting for over 95% of all mediation proceedings.

Organizational chart of the Banking Supervisory Authority



International activities of the authority

In 2022 involvement of the UKNF 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, both in the form of bilateral and multilateral cooperation, including through supervisory colleges, represents an important factor supporting the achievement of the supervisory objectives of the KNF Board. A particularly important area of the UKNF's international cooperation with respect to banking-related issues is the European System of Financial Supervision (ESFS). This is due to the fact that the key legal acts (e.g. CRD and CRR) setting the framework for the functioning of financial institutions are adopted at the EU level. In 2022 the day-to day involvement of the UKNF employees in the activities of the European Banking Authority (EBA) remained crucial from the banking supervision perspective.

Representatives of the UKNF management presented issues relevant to the Polish banking sector at highest-level international fora. Stability of the Polish banking sector in the context of loans denominated in or indexed to the Swiss franc was the main theme of talks, held in Paris, of the Chair of the KNF Board, Jacek Jastrzębski with the Chairperson of the European Banking Authority (EBA), José Manuel Campa, and, in Frankfurt am Main, with Andrea Enria, Chair of the Supervisory Board of the European Central Bank (ECB).

As in previous years, in 2022 the UKNF representatives participated in meetings of supervisory colleges organised by the European Central Bank (consolidating supervisor) for international banking groups whose subsidiaries are present in the Polish market. The colleges are to coordinate supervisory activities with regard to banking groups, i.a. with respect to SREP assessment, recovery and resolution planning.

In 2022 the UKNF continued developing bilateral relations with banking supervisors, which covered the exchange of supervisory information, opinions and experiences, and occurred primarily at the working level. Bilateral cooperation were facilitated by the memoranda of cooperation and exchange of information signed by the KNF Board with other supervisors.

Cooperation with other supervisory bodies in the country

In 2022 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 (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).

The Financial Stability Committee assessed that (i) the legal risk related to foreign-currency housing loans and (ii) the geopolitical risk resulting from the Russian Federation's military action against Ukraine remained the most important sources of threats to the stability of the financial system identified by the Committee in 2022. The Committee assessed, however, that the banking sector remains highly resilient, even in this unfavourable external situation.

As in the previous years, the KNF Board continued its permanent bilateral cooperation also with:

- the National Bank of Poland (NBP) - permanent bilateral cooperation for the exchange of information necessary for the central bank and the financial market supervisor to perform their statutory tasks. The terms of cooperation are laid down in bilateral agreements on cooperation and exchange of information between the KNF Board and the National Bank of Poland (NBP).
- the Bank Guarantee Fund (BFG) reg. information on the scores assigned to banks under the Supervisory Review and Evaluation Process and quarterly assessments of the level of risk existing in banks' operations,

as well as information on the economic and financial standing of banks, including their liquidity and capital position;

- the General Inspector of Financial Information (GIFI): under the AML Act the KNF Board acts as a body cooperating with the GIFI which, as part of its supervisory powers, carries out inspection and analytical activities in the area of prevention of money laundering and terrorist financing at obliged institutions under the KNF supervision,

Other relevant information and developments in 2022

In 2022 the KNF Board revised the list of O-SIIs (Other Systemically Important Institutions) and the buffer rates imposed on the identified O-SIIs. Following the review, the KNF Board confirmed the identification of ten credit institutions as O-SIIs. This process is carried out in accordance with the EBA/GL/2014/102 guidelines and it is based on: the size of the entities, their importance to the economy of the Republic of Poland and the European Union, the importance of cross-border activities and their interconnectedness with the financial system.

On that basis, the KNF Board also decided to set appropriate buffer rates, ranging from 0.25% to 2.0%. 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 2022 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	30	30	30
Branches of foreign credit institutions	36	37	34
Cooperative banks	530	511	496
Banking sector, total:	**596**	**578**	**560**

Total assets of banking sector (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	2 106 035 795 905.0	2 307 868 040 415.7	2 466 159 559 777.0
Branches of foreign credit institutions	76 840 713 347.0	79 627 940 324.5	80 584 811 502.5
Cooperative banks	167 171 678 219.0	184 974 084 211.6	186 315 636 205.7
Banking sector, total:	**2 350 048 187 471.0**	**2 572 470 064 951.7**	**2 733 060 007 485.2**
y/y change (in %)	**17.49%**	**9.46%**	**6.24%**

Ownership structure of banks on the basis of assets total

Item	2020	2021	2022
Public sector ownership	44.95%	46.94%	47.82%
Domestic ownership total	12.22%	11.09%	8.29%
Foreign ownership	42.83%	41.97%	43.89%
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2022

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	44.74%	63.89%	1 023.4
Branches of foreign credit institutions	34.57%	49.61%	732.8
Cooperative banks	4.80%	6.83%	38.8
Banking sector, total:	**40.63%**	**58.02%**	**844.5**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2020	2021	2022
Commercial banks	-0.32%	3.01%	5.60%
Cooperative banks	3.61%	5.21%	20.80%
Banking sector, total:	**-0.08%**	**3.14%**	**6.78%**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2020	2021	2022
Commercial banks	89.62%	89.71%	90.23%
Branches of foreign credit institutions	3.27%	3.10%	2.95%
Cooperative banks	7.11%	7.19%	6.82%
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2020	2021	2022
Receivables	100.00%	100.00%	100.00%
Financial sector	9.31%	10.69%	13.58%
Nonfinancial sector	49.00%	46.95%	43.66%
Government sector	7.94%	10.43%	10.43%
Other assets	33.75%	31.92%	32.33%
Liabilites	90.65%	92.25%	92.59%
Financial sector	21.54%	20.76%	20.34%
Nonfinancial sector	67.36%	65.29%	65.24%
Government sector	5.64%	7.56%	7.35%
Other liabilities	5.46%	6.39%	7.08%
Capital	**9.35%**	**7.75%**	**7.41%**

Capital adequacy ratio of banks

Type of financial institution	2020	2021	2022
Commercial banks	20.78%	19.43%	20.21%
Cooperative banks	18.93%	18.53%	19.13%
Banking sector, total:	**20.67%**	**19.38%**	**20.14%**

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

Asset classification	2020	2021	2022
Non-financial sector, including	6.69%	5.77%	5.51%
- households	6.01%	5.06%	5.03%
- corporate	9.03%	7.34%	6.44%

The structure of deposits and loans of the banking sector in 2022 (%) (at year-end)

	Deposits	Loans	
Non-financial sector, including:	86.85%	92.04%	
Households	68.54%	63.28%	
Corporate	29.29%	35.98%	
Government sector	9.79%	7.89%	
Financial sector (excluding banks)	3.36%	0.07%	
Total	**100.0**	**100.0**	

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

P&L account	2020	2021	2022
Interest income	56 700 767 953.0	51 093 277 635.1	119 396 017 420.8
Interest expenses	9 561 881 458.0	4 485 736 653.9	43 325 923 102.6
Net interest income	47 138 886 495.0	46 607 540 981.3	76 070 094 318.2
Net fee and commission income	14 849 790 555.0	17 158 786 522.1	18 462 745 342.7
Other (not specified above) operating income (net)	-24 508 162.0	3 609 177 906.0	-1 427 014 549.9
Gross income	61 964 168 888.0	67 375 505 409.3	93 105 825 111.1
Administration costs	34 706 629 780.0	35 459 089 164.3	45 267 695 078.5
Depreciation	4 593 023 921.0	4 637 773 681.0	4 560 983 837.3
Provisions	5 495 912 408.0	8 317 369 962.0	7 850 751 784.3
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	13 348 231 900.0	7 149 115 475.5	9 278 017 917.9
Profit (loss) before tax	3 760 510 335.0	12 112 362 843.4	19 213 562 702.4
Net profit (loss)	-322 044 496.0	5 977 402 810.2	10 824 163 279.2

Total own funds in 2022 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	45 137 548 319.15	40 746 229 452.23	40 746 229 452.23	4 391 318 866.93	
Cooperative banks	2 938 276 773.28	2 861 125 889.25	2 861 125 889.25	77 150 884.24	
Banking sector, total:	**48 075 825 092.43**	**43 607 355 341.48**	**43 607 355 341.48**	**4 468 469 751.17**	

Macroeconomic environment in the country

During 2022 Romania's economy showed a high degree of resilience, posting robust growth (4.7 percent), yet the twin deficits remained high. The inflationary cycle peaked in November 2022, with the pace of consumer price increases following a downward course subsequently.

The GDP growth was supported mainly by household consumption, up 5.3 percent, even amid the unfavorable environment stemming from the fast-paced price hikes (driven by the upsurge in energy and agri-food commodity prices), tighter financing conditions and the elevated uncertainty associated with the warfare in Ukraine.

Investment also significantly supported economic growth, primarily via construction works, especially non-residential buildings and civil engineering works. The growth rate of gross fixed capital formation accelerated (up to 8 percent) amid the swifter pace of EU funds absorption, fostered by both the approaching end of the payment period for the multilateral financial framework 2014-2020 and the larger amount of funds provided under the NRRP and the new financial framework (2021-2027).

The annual inflation rate stood at 16.37 percent at end-2022 (against 8.19 percent in December 2021), fueled by multiple supply-side shocks – associated with the impact of the war in Ukraine on commodity prices and with a poor agricultural year –, while the pass-through of these pressures into consumer prices was favored by the excess aggregate demand.

The challenging macroeconomic environment of 2022 determined consecutive and carefully dosed responses from monetary policy instruments, in order to anchor inflation expectations over the medium term and prevent the start of a self-sustained rise in the overall level of consumer prices, possibly via a wage-price spiral.

Romania's international reserves strengthened in 2022. They amounted to EUR 52.3 billion at end-2022, up by EUR 6.5 billion over end-2021, largely as a result of the increase in foreign exchange reserves to EUR 46.6 billion. The gold stock comprised 103.6 tonnes, out of which 61.2 tonnes stored with the Bank of England. At the same time, the adequacy of international reserves improved as well, thus enhancing the capacity of the Romanian economy to withstand potential adverse shocks on financial markets and to contain the government's and local companies' financing costs.

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

The prudential and financial position of the Romanian banking sector remained adequate despite the geopolitical tensions in the region and the implications of the energy crisis.

The aggregated balance sheet assets amounted to lei 701.0 billion at December 2022, up by 9.6 percent against the previous year level, and held a share of 49.7 percent in GDP.

The number of credit institutions operating in Romania decreased during 2022, from 34 to 32 credit institutions, as a result of two mergers through absorption. In structure, there are 24 banks Romanian legal entities and 8 branches of foreign banks. The changes in the shareholding structure of credit institutions is also reflected in their market share in terms of assets, which adjusted accordingly. The share of credit institutions with majority state capital in the aggregate capital of the banking sector widened from 11.4 percent at 31 December 2021 to 12.1 percent at 31 December 2022, and the share owned by credit institutions with majority domestic private capital decreased from 20.4 percent at 31 December 2021 to 19.8 percent at 31 December 2022.

The prudential indicators experienced favorable developments at the end of 2022. The total capital ratio reached 23.4 percent, the liquidity coverage ratio (LCR) rose at 209.2 percent and the net stable funding indicator (NSFR) came in at 177.0 percent.

Asset quality continued to improve throughout 2022, following the downward trend in the NPL ratio (2.7 percent at December 2022, compared to 3.4 percent in 2021) while maintaining a high degree of NPL coverage by provisions around 65 percent.

The key profitability indicators performed favourably, the return on assets (ROA) and the return on equity (ROE) adding 0.1 and 3.1 percentage points to 1.5 percent and 16.4 percent, respectively.

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

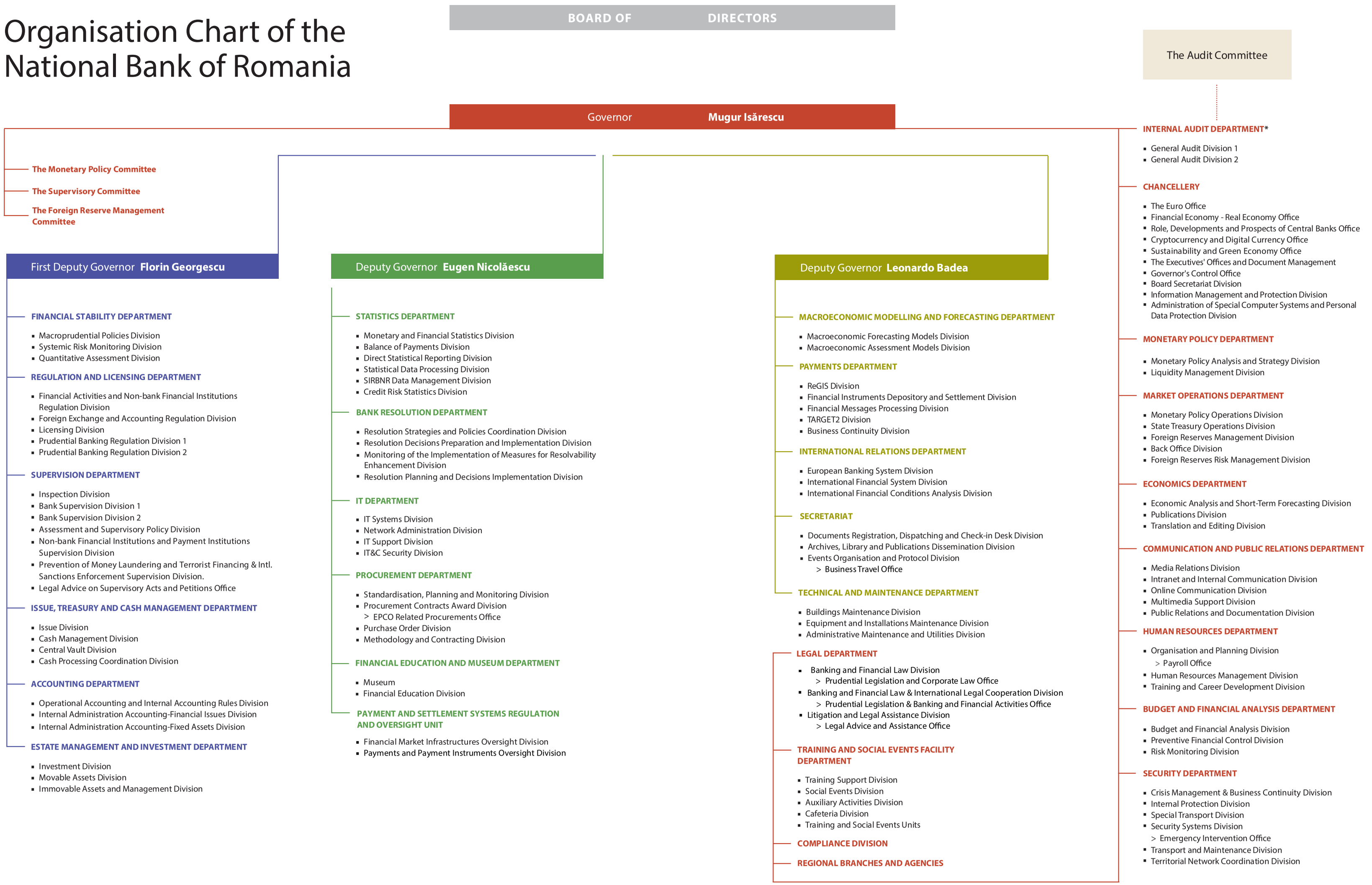
Starting with the CRD IV/CRR and BRRD implementation, credit institutions are required to observe the EC's implementing regulations laying down technical standards, directly applicable in all Member States, including also those related to the reporting field.

In 2022, two laws which ensure the transposition and implementation of European legislative acts and which also apply to credit institutions, were adopted:

- in the area of the prudential supervision of investment firms - Law no.236/2022 transposed the Directive (EU) 2019/2034, which was addressed to investment firms and made changes regarding credit institutions, such as the definition of a credit institution, in the sense that this notion means either a credit institution carrying out banking activities or a large investment firm converted in a credit institution.
- in the area of crowdfunding services - Law no. 244/2022 established measures to implement Regulation (EU) 2020/1503 of the European Parliament and of the Council of 7 October 2020 on European crowdfunding service providers for business, and amending Regulation (EU) 2017/1129 and Directive (EU) 2019/1937 (Crowdfunding Regulation), and regulated the situations in which credit institutions as well as other categories of entities from the financial sector within the competence of the NBR (payment institutions, providers specialised in information services regarding accounts of legal entities and institutions issuing electronic money, non-banking financial institutions) intend to provide crowdfunding services.

In 2022, following the process started by the Ministry of Finance for the establishment of a national development bank, were adopted the Law no. 207/2022 for the regulation of some measures regarding the general framework applicable to the establishment and operation of development banks in Romania with subsequent amendments and supplements, including those provided by Government Ordinance no. 17/2023. Law no. 207/2022 establishes a special prudential regime applicable to development banks, under the conditions in which they will be set up as credit institutions, but exempted from the application of the CRD/CRR framework, without the need of the NBR authorisation, so as to ensure the adapting of the legislation in the banking field to the specifics of the development banks' activity, as well as the legal basis for the elaboration by the NBR of the prudential regulatory framework in the application of the law.

Organizational chart of the Banking Supervisory Authority



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 2022

Starting 2021, the NBR aims to correlate the national supervisory objectives with the strategic supervisory priorities established at the level of the European Union. These priorities are added to those established according to the specificities of the national banking system, its vulnerabilities and the main risks it may face. In this context, the NBR reflected in its activity program for the year 2022 the two strategic priorities discussed and agreed at the EU level, priorities consisting in the sustainability of the business model and the adequate governance of credit institutions.

The activities of the Banking Supervisory Authority in 2022

During 2022, supervisory actions were carried out under the annual inspection programme at 22 credit institutions, Romanian legal entities, and one branch of a foreign bank.

In addition to the scheduled inspections, 6 thematic inspections were also conducted at credit institutions, with specific supervisory objectives. 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 2022, the assigned scores were as follows: 29 percent of the 24 credit institutions were assigned an overall score of 2, 54 percent an overall score of 3, 17 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 12.2 percent and 12.1 percent, respectively.

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

During 2022, the working groups resumed to take place with physical presence, amid the decrease in the number of illnesses and the lifting of travel restrictions imposed to prevent the spread of the SARS-CoV-2 virus, but most of them were also carried out through remote means of communication.

Cooperation with other supervisory bodies in the country

The cooperation and coordination between local supervisory bodies is mainly ensured by the National Committee for Macroprudential Oversight (NCMO), 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. Four meetings were held in 2022 by written procedure between representatives of the National Bank of Romania (NBR), the Financial Supervisory Authority (FSA) and the Government within NCMO. Thus, in 2022, the NCMO recommended the NBR, in its capacity as competent authority, to take among others the following actions in relation to credit institutions:

- to keep in place the measure of setting the countercyclical buffer rate at 0.5 percent, as of 17 October 2022, and to further monitor developments in the economy and lending amid a global environment marked by uncertainty, whereas lending has been confirmed on an accelerating trend and there are ongoing tensions surrounding macroeconomic equilibria;
- to raise the countercyclical buffer rate by 0.5 percentage points as of 23 October 2023. Consequently, the applicable rate for this macroprudential buffer shall be 1 percent in October 2023. The liquidity and profitability indicators of the banking sector in Romania, which stand significantly above the EU average, allow for the consolidation of macroprudential policy without negatively affecting loan supply to eligible borrowers.

Questionnaire tables for the 2022 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	25	25	23
Branches of foreign credit institutions	8	8	8
Cooperative banks	1	1	1
Banking sector, total:	**34**	**34**	**32**

Total assets of banking sector (mill.RON) (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	488,054.5	560,303.9	613,713.3
Branches of foreign credit institutions	70,389.8	77,751.5	85,698.3
Cooperative banks	1,589.9	1,699.1	1,597.2
Banking sector, total:	**560,034.2**	**639,754.5**	**701,008.8**
y/y change (in %)	**+13.1%**	**+14.2%**	**+9.6%**

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

Item	2020	2021	2022
Public sector ownership	10.6	11.4	12.1
Domestic ownership total	29.5	31.8	31.9
Foreign ownership	70.5	68.2	68.1
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2022

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	49.4	69.6	1217
Branches of foreign credit institutions	94.4	98.6	5724
Cooperative banks	-	-	-
Banking sector, total:	**43.3**	**61.1**	**1018**

Return on Equity (ROE) by type of financial institutions (%) (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	8.30	12.35	15.22
Cooperative banks	2.09	1.61	1.31
Banking sector, total:	**8.68**	**13.28**	**16.40**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2020	2021	2022
Commercial banks	87.1	87.5	87.6
Branches of foreign credit institutions	12.6	12.2	12.2
Cooperative banks	0.3	0.3	0.2
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2020	2021	2022
Receivables	100.0	100.0	100.0
Financial sector	22.5	22.0	22.1
Nonfinancial sector	49.9	50.3	52.0
Government sector	-	-	-
Other assets	27.6	27.7	25.9
Liabilites	89.1	90.3	91.3
Financial sector	5.1	6.2	5.3
Nonfinancial sector	79.8	79.1	79.9
Government sector	-	-	-
Other liabilities	4.2	5.0	6.1
Capital	**10.9**	**9.7**	**8.7**

Capital adequacy ratio of banks (%)
(at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	25.1	23.3	23.4
Cooperative banks	28.9	28.0	28.9
Banking sector, total:	**25.1**	**23.3**	**23.4**

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

Asset classification	2020	2021	2022
Non-financial sector, including	5.3	4.7	3.8
- households	4.1	3.8	3.5
- corporate	6.6	5.6	4.0

The structure of deposits and loans of the banking sector in 2022 (%)
(at year-end)

	Deposits	Loans
Non-financial sector, including:	83.8	61.1
Households	51.8	30.1
Corporate	32.0	31.0
Government sector	12.2	30.8
Financial sector (excluding banks)	4.0	8.1
Total	**100.0**	**100.0**

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

P&L account	2020	2021	2022
Interest income	19,179.9	19,178.8	29,151.3
Interest expenses	3,755.3	3,215.6	9,134.5
Net interest income	15,424.6	15,963.2	20,016.8
Net fee and commission income	3,841.6	4,579.6	5,234.8
Other (not specified above) operating income (net)	3,676.1	3,691.6	3,099.5
Gross income	22,942.3	24,234.4	28,351.1
Administration costs	10,552.1	11,251.8	12,883.9
Depreciation	1,800.0	1,814.2	1,890.6
Provisions	518.0	-6.8	-627.2
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	3,835.3	1,322.8	2,081.2
Profit (loss) before tax	6,103.6	9,830.9	11,885.9
Net profit (loss)	5,024.8	8,167.5	10,071.5

Total own funds in 2022 (in mill. EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	12,756.2	10,879.4	11,152.5	1,603.7	-
Cooperative banks	69.6	69.6	69.6	0.0	-
Banking sector, total:	**12,825.8**	**10,949.0**	**11,222.1**	**1,603.7**	**-**

Macroeconomic environment in the country

After the COVID years of 2020 and 2021, 2022 was the year most affected by the Russian-Ukrainian conflict, followed by the energy crisis. Despite the multidimensional crisis that spanned the 3 years, Serbia has managed to preserve the stability of its economy as evidenced by cumulative real GDP growth in the period 2020-2022 of around 9%. Real GDP growth in 2022 amounted to 2.3%, despite the already mentioned international circumstances, coupled with the poor domestic agricultural season.

The growth in 2022 was driven by the growth of domestic demand and above all growth of personal consumption, and, to a lesser extent, by the growth of private investments, while the negative contribution came from net exports as well as the decrease in government capital expenditures. On the production side, growth was driven by growth in industrial production, service sectors and net taxes, while a decline was recorded in construction and agriculture, due to the drought that mostly affected the autumn crops.

Developments in the real sector was the result, among other things, of the continuous improvement of the situation on the labor market. The total number of formally employed persons in 2022 achieved year-on-year growth by about 36 thousand persons (1.6%), and wage growth in the private sector has continued during 2022. Preservation and continuation of wage growth, as well as the increase of the minimum wage in 2022 additionally contributed to the recovery of domestic demand and the improvement of the living standard of the population.

When it comes to external developments in 2022, the current account deficit amounted to EUR 4.1 billion, or 6.9% of GDP. Categories which contributed to the worsening of the CAD by EUR 1.9 bn compared to the 2021, was the trade of goods (EUR 3.3 mn), and the primary income account (EUR 0.9 bn), mostly due to higher dividends payments. On the other hand, the secondary income account and services account, recorded a surplus increase (EUR 1.5 bn and EUR 0.9 bn). About half of total CAD value realized in first four months of the year, due to high energy import prices.

Energy imports in 2022 increased by 3.9 bn euros, of which oil and derivatives imports increased by EUR 1.3 bn, natural gas increased EUR 1.2 bn, and electricity imports increased by EUR 1.1 bn. The price effect accounted for about 84% of the increase in imports of oil, derivatives, and natural gas, while the remaining 16% was due to the increase in the volume of imported energy. Higher coal imports by EUR 300 mn, together with more favourable meteorological conditions contributed to the recovery of electricity production, which resulted in a positive net export of electricity in Q4 2022.

When it comes to the trade of goods, exports recorded an increase of 28.1% in 2022, while goods imports grew at a faster rate of 34.2%. There was a decline in the export of agricultural products because of the drought and consequently less production, while the export of electricity increased, as well as mining and manufacturing industry, which contributed most to the growth of total exports. When it comes to goods imports, the contribution to the growth came from all categories and was driven by the growth of imports of intermediate products (about 60%), with energy being one of its biggest parts. The recovery in imports of equipment and consumer goods indicates a continued recovery of investment and personal consumption. Higher services exports (over EUR 11 bn) partly compensated the negative impact of the goods deficit. The largest contribution to the stronger growth of service exports (by 42.0%) was given by tourism services and ICT services, and when it comes to the growth of service imports (by 36.9%) - tourism and transport services.

The gross inflow of FDI in 2022 amounted to a record EUR 4.4 bn (net inflow of EUR 4.3 bn), while the net outflow of portfolio investments amounted to about EUR 12 million.

Average inflation in 2022 was 11.9%, which is above the target corridor (3% +/- 1.5%), and in December overall inflation stood at 15.1% y-o-y. The increase in inflation during 2022 was driven by the global energy crisis, lingering consequences of the pandemic, and the drought that hit our region, all of which are drivers not affected by monetary policy. At the same time, average core inflation in 2022 was lower and averaged 7.1% and in December was 10.1% y-o-y.

When it comes to the fiscal sector, in 2022 a fiscal deficit was recorded in the amount of RSD 221.2 billion (3.1% of GDP), which continued the trend of reducing the fiscal deficit both in absolute terms and in terms of participation in GDP. In addition, the realized deficit is significantly lower than planned (3.8% of GDP). In 2022, the share of public debt in GDP was reduced to 55.1%, despite the impact of the international energy crisis on the growth of budget expenditures and energy procurement.

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

The Serbian banking sector (which comprises more than 90% of its total financial sector) remained adequately capitalized and highly liquid throughout 2022. The National Bank of Serbia was successful in maintaining financial stability, and NPL ratio was reduced to its historical minimum. The banking sector profitability was also satisfactory in 2022, pre-tax profit being EUR 849.1 million, with ROA of 1.90% and ROE of 13.84%.

At the end of 2022, 21 banks were operating in Serbia, two of which were majorly owned by the Republic of Serbia with a share of 7.8% in banking sector's total assets, two banks were majorly owned by private shareholders with a share of 8.6% and 17 banks were majorly owned by foreign shareholders with a share of 83.6%. Since branching is not allowed in Serbia, all banks operate as independent legal entities. Banks whose major shareholders are from Italy were dominant with 25.8% share in total banking sector assets, followed by banks of Austrian (19.3%), Hungarian (13.6%) and Slovenian (10.1%) major shareholders. All other foreign shareholders account for 14.8% of total banking sector assets. Banking sector assets to GDP ratio was 84.4% at the end of 2022.

Total net balance sheet assets of the banking sector in Serbia reached EUR 46.5 billion at the end of 2022 which is an increase of 8.3% compared to the end of 2021.

The level of competition in Serbian banking sector is at a satisfying level. Top five banks have a market share of 59.3% of net assets, 61.3% of total gross loans and 59.8% of deposits. Banking sector HHIs in terms of assets (936), loans (1004) and deposits (950) indicate low market concentration.

Total gross loans amounted to EUR 27.21 billion, which is a growth of 7.9% compared to 2021. Loans to corporates made 50.1% of total loans and amounted EUR 13.63 billion, while loans to households made 45.4% and amounted EUR 12.35 billion. Liquidity and current assets financing loans and investment loans are the main drivers of corporate lending, while household lending is dominated by cash and housing loans.

As a result of numerous supervisory and regulatory measures adopted by the NBS with the aim 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 adopted in 2017), the gross NPL ratio has been steadily declining since 2015 to reach its historical minimum of 3.01% at the end of 2022. Since the adoption of The Strategy, the gross NPL ratio was reduced by 19.24 p.p.

The corporate sector refers to 40.9% of total NPLs (EUR 346.6 million at the end of 2022). The NPL ratio for corporates was reduced from 3.35% in 2021 to 2.48% in 2022. Households NPLs make 57.5% of total NPLs (EUR 487.8 million at the end of 2022). The households NPL ratio was reduced from 4.09% in 2021 to 3.91% in 2022. The coverage of NPLs by total loan provisions amounted 102.48% at the end of 2022.

At the end of 2022, total deposits were at the level of EUR 33.47 billion, which is an increase by 8.3% compared to the end of 2021. Household deposits made 52.1% of total deposits and amounted EUR 17.44 billion while corporate deposits made 37.3% of total deposits and amounted EUR 12.47 billion.

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 20.15% at the end of 2022, 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 93% of total regulatory capital. The high solvency of the banking sector is also indicated by the (Basel III) leverage ratio, which amounted 10.28% at the end of 2022. The proportion of balance sheet capital to total assets stood at 13.20% at the end of 2022.

The average regulatory liquidity ratio for the Serbian banking sector in December 2022 was 2.19, 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 39.63% of total assets and 51.45% of total short-term liabilities at the end of 2022. 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 82.81% at the end of 2022). Liquidity coverage ratio of 177.50% also confirmed high liquidity of Serbian banking sector.

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

In the observed period, exercising its regulatory competences in bank supervision, the NBS adopted the following regulation:

The “Decision on the Temporary Measure Regarding the Calculation of Bank Capital” was adopted in June 2022 with the aim to mitigate the negative effects of changes in the prices of securities on banks’ capital, caused by current circumstances in the global financial market. The temporary measure relates to debt securities issued by the Republic of Serbia, an autonomous province, or a local government unit of the Republic of Serbia, and which are measured at fair value through other comprehensive income in accordance with IFRS 9. The decision enables banks to exclude 70 per cent. of net unrealized losses and gains resulting from the change in value of such debt instruments from the calculation of the banks’ CETI capital. The decision can be applied until December 31, 2023, since the application of the temporary measure was extended in November 2022, by the Decision Amending and Supplementing the Decision on Temporary Measures Regarding the Calculation of Bank Capital.

Since the most banks operating in the Republic of Serbia significantly increased the price of their payment services, especially services based on payment accounts, the “Decision Supplementing the Decision on Risk Management by Banks” was adoptted in August 2022, with the aim to avoid potential legal risks, protect the citizens’ standard and preserve the stability of the financial system. The decision stipulates, among other things, the bank’s duty to regulate the process of adoption, i.e. changes to its own acts regulating the fees it charges for the provision of payment services (tariffs), with appropriate internal acts. This decision acts as an additional control mechanism so that the banks are transparent while increasing their fees for the provision of payment services or introducing new fees. This regulation ensures that the National Bank is informed of planned changes to the banks' tariff list, which makes it possible to identify in a timely manner whether the banks' behavior is appropriate and undertake appropriate actions.

In line with its well-established practice of responding preventatively in a timely manner to all potential challenges within the international and domestic environment, including the economic situation of agricultural producers, the National Bank adopted the "Decision on Temporary Measures for Banks Aimed at Adequate Management of Credit Risk in Agricultural Loans Portfolio in Conditions of Aggravated Agricultural Production" in October 2022. These regulations enable the rescheduling of existing liabilities of bank borrowers from the agriculture sector. The debtors could opt to postpone the settlement of their liabilities for principal from minimum six to 12 months, depending on their preferred grace period within the rescheduling. During the grace period, these debtors pay the agreed interest.

Given the intention to support the debtors most severely affected by the current aggravated conditions of agricultural production, the debtors entitled to this rescheduling are those who as of 31 May 2022 were not in arrears for longer than 90 days under any obligation to a bank to which the rescheduling applies, were not in a default status in respect of the bank, and whose receivables are not considered to be a non-performing loan and/or a non-performing receivable within the meaning of the National Bank's regulations. A debtor could submit a rescheduling application to a bank, no later than 30 April 2023.

Furthermore, in January 2023, the "Decision Amending the Decision on Temporary Measures for Banks Aimed at Adequate Management of Credit Risk in Agricultural Loans Portfolio in Conditions of Aggravated Agricultural Production" was adopted with the aim to extend the possibility of rescheduling under the same conditions to the new category of borrowers - persons engaged in the purchase and cold storage of fruit, in line with regulations. A debtor could also submit a rescheduling application to a bank, no later than 30 April 2023.

In conditions of the necessary monetary policy tightening, the NBS showed determination to support, within its statutory remit, households in the current situation and, at the same time, maintain banking sector stability, so in December 2022 the following Decisions were adopted.

The "Decision Amending the Decision on Capital Adequacy of Banks" enables banks to restructure their receivables from financially distressed natural persons in respect of consumer, cash or similar loans by extending the maturity of these loans by three years relative to the current regulatory arrangement, without any impact on their capital whatsoever. This means that banks are free to extend the repayment term for these types of loans to borrowers having troubles in settling their liabilities, so that the repayment term for cash and consumer loans is shorter than nine years, and for consumer loans for the purchase of motor vehicles shorter than eleven years. Within these repayment periods, borrowers will be entitled to repayment facilities, regardless of the degree of their debt-to-income ratio at the time of restructuring.

The "Decision Amending the Decision on Temporary Measures for Banks to Facilitate Access to Financing for Natural Persons" extends the application of the measure alleviating the conditions of housing loan repayment. The adoption of the decision extends for additional 12 months the effect of temporary measures prescribed by the Decision on Temporary Measures for Banks to Facilitate Access to Financing for Natural Persons („Official Gazette of RS", No. 108/2020).This means that throughout the whole year banks can offer facilities in the form of extension of the repayment period for housing loans by maximum five years, without any impact on the regulatory treatment of those receivables. In addition to the above, the Decision continues to support natural persons' facilitated access to financing in 2023 as well.

The „Decision Amending the Decision on Capital Adequacy of Banks" was adopted in June 2023. Namely, during three-year period, due to various negative factors of the international environment, the NBS was postponing the application of measures adopted in December 2019[1], that discourage the approval of new, non-purpose and non-investment, foreign currency indexed loans and foreign currency loans to debtors from the non-financial and non-government sector.

The National Bank has assessed that the conditions have been created to start implementing regulations whose purpose is to increase the share of loans in the domestic currency, in a modality that ensures that banks approve new loans taking into account the prescribed limits, but with additional time to adapt their operations to these expectations, in the current market circumstances.

This decision envisaged the inclusion in the reporting and calculation of all newly approved - non-purpose and non-investment loans to business entities, entrepreneurs, and farmers from July 1, 2023, with the simultaneous postponement of the obligation to reduce the capital based on exceeding the limit of 71 % of the maximum share of foreign currency indexed and foreign currency loans in total loans until December 31, 2024. After this date, the same percentages of the participation of foreign currency-indexed and foreign currency loans in total loans are applied, which are the basis for the application of capital deductions and their gradual phase-down, whereby these percentages are now calibrated to the new calendar year (71% in the period from January 1 to December 31, 2025; 64% in the period from January 1 to December 31, 2026; 57% in the period from January 1 to December 31, 2027; 50% from January 1 2028).

In this way, banks are provided with an additional period during which they will be able to approve new foreign exchange-indexed loans and loans in foreign currency to the economy without immediate effects on capital (from July 1, 2023 to December 31, 2024), with the fact that during this additional period, take into account the currency structure of this part of the portfolio, because all loans approved by banks from July 1, 2023 will be included in the scope of loans relevant for the calculation of the new deductible item from capital (which will be calculated for the first time with the balance on March 31, 2025).

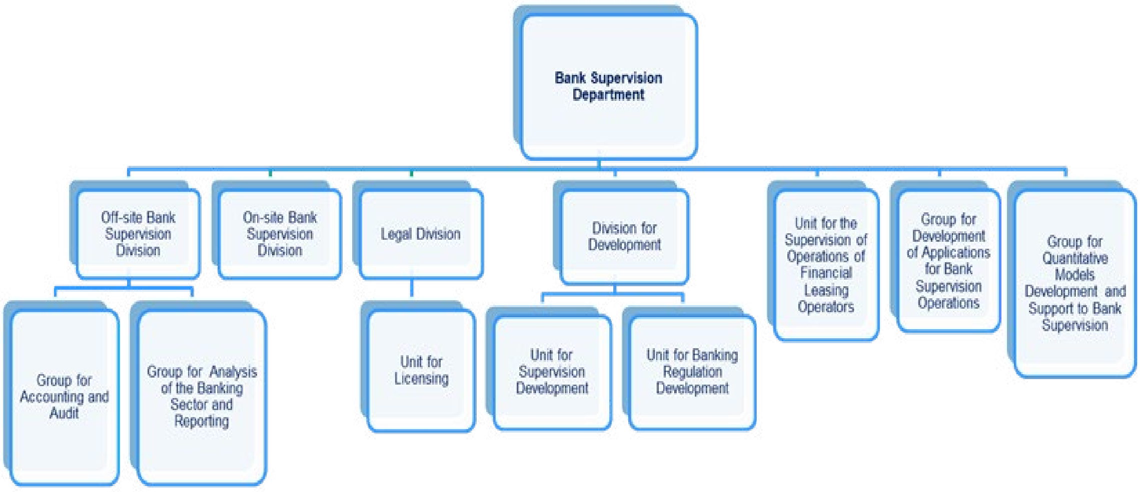
AML

Bearing in mind that the legal framework that regulates the prevention of money laundering and combating against financing of terrorism (AML/CFT) in the Republic of Serbia is aligned with the requirements of the Fifth Directive (EU) 2018/843 (hereinafter: the Fifth Directive) and the recommendations of the relevant international body (FATF), during 2022. there were no new changes in the AML/CFT regulation.

In order to take into account the findings of the national risk assessments that were carried out in 2021 (the National Money Laundering Risk Assessment, the National Terrorism Financing Risk Assessment, the Money Laundering and Terrorism Financing Risk Assessment in the Digital Assets Sector and the Risk Assessment of the Financing of Proliferation of Weapons of Mass Destruction; hereinafter: National Risk Assessment) on 17 March 2022, Serbian Government adopted updated 2022-2024 Action Plan for the implementation of National Strategy for the Fight against Money Laundering and the Financing of Terrorism for the period 2020 – 2024 (hereinafter: AML/CFT Action Plan).

[1] In December 2019 NBS adopted Decision Amending the Decision on Capital Adequacy of Banks, establishing new rules for banks with intention of changing the currency structure of lending towards a larger share of dinar loans in total loans approved in the Republic of Serbia and creating an environment conducive to more favourable dinar financing.
The application of these measures was postponed in May 2020, November 2020, June 2021 and June 2022.

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 2022

The regulatory and supervisory activities of the NBS in 2022 were primarily aimed at the further facilitating the position of citizens and at preserving and strengthening the stability of the financial system.

AML

Main strategic objectives of the supervisory authority in Republic of Serbia in the field of prevention of ML/FT was to ensure, through the further development of supervisory activities and skills, the prevention of abuse of the banking sector for the purpose of money laundering and terrorism financing as well as preserving the financial system.

The activities of the Banking Supervisory Authority in 2022

The global challenges in previous years are still present, but the timely creation of a regulatory and supervisory framework for banks, in accordance with the best international standards and practices enabled the focus of regulatory activities to be on supporting citizens and the economy, and despite numerous challenges and risks, the stability of the banking sector was preserved and additionally strengthened, created regulatory prerequisites for the approval of numerous reliefs in the repayment of loans to entrepreneurs and citizens who are most affected by the crisis, and facilitating access to bank financing.

Measures Against Banks

During 2022, in the process of banks supervision, the National Bank of Serbia has taken following measures against banks: 1 temporary measure, 9 letters of warning, and 5 fines imposed toward 3 banks and 2 to management bodies. 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 2022 issued:

- 3 decisions on giving prior consent for acquisition of ownership in banks;
- 18 decisions on giving prior consents for amendments of banks' founding acts and their articles of association (one request was dissmised);
- 58 decisions on giving prior consent for appointment of managing and executive board members;
- 2 decisions on giving prior approval for distributing bank's profit through payment of dividends to its shareholders;
- 4 decisions on giving prior consent for inclusion interim profit in common equity tier 1 capital;
- 1 decision on giving prior consent for inclusion profit of previous year in common equity tier 1 capital;
- 1 decision on giving prior consent for acquisition of own shares;
- 2 decisions on giving consent for merger by acquisition;
- 2 decisions on giving prior consent for inclusion subordinate obligation in additional capital;
- 3 decisions on giving prior consent to reduce the subordinated obligations from additional capital;
- 1 decision on giving prior consent that a risk weight of 0% shall apply to exposures to the counterparty (two conclusions on termination);
- 1 decision on revocation of the consent for the establishment of representative office of a foreign bank in the Republic of Serbia;
- 2 decisions on giving consent to bank/ultimate parent company not to include a subordinated companies (entities in the financial sector) in annual audit of financial statements of banking group for 2022;
- 3 decisions on giving consent to bank/parent company not to include a subordinated company in consolidation of financial statement of their banking group for 2022;
- 213 notifications from banks regarding outsourcing of their business activities were processed and were processed 33 notifications on the assignment of claims;
- 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

During 2022, in the process of banks supervision, the National Bank of Serbia has taken 16 on-site inspections.

AML

In the area of AML/CFT supervision activities in banks, in 2022 the NBS conducted regular off-site supervisions activities by analyzing bank's responses to submitted questionnaires on their operations in the area of ML/FT risk management, monitoring of compliance submitted internal acts with AML/CFT regulations, monitoring of internal controls finding etc. Also, in 2022, NBS's, performed targeted AML/CFT on-site controls in 5 banks, 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/ physically present trainings organised by the FATF, Council of Europe, OEBS, Deutsche Bundesbank, Deutsche Gesellschaft für Internationale

Zusammenarbeit (GIZ) GmbH, Egmont Group, Global Financial Integrity (GFI), the Administration For the Prevention of Money Laundering, Ministry of European Integration, Association of Serbian Banks 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 2021, 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 representative of the NBS, as a part of the delegation of the Republic of Serbia (composed of representatives of the Administration for Prevention of Money Laundering, NBS and the Ministry of Internal Affairs) participated in the 63th and 64h 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).

Also, the representative of the NBS followed the FATF session, which was held in hybrid form in October 2022.

During 2022, NBS participated in AML Supervisory colleges.

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 2022 the NBS actively participated in the work of the Coordination Body for the Prevention of Money

Laundering and Terrorist Financing (hereinafter: AML/CFT Coordination Body) and of the National Coordinating Body for the Fight against the Proliferation of Weapons of Mass Destruction (hereinafter: WMD Coordination Body), which were set up by the Government of the Republic of Serbia to improve coordination and efficiency of cooperation of all actors in the AML/CFT system and in prevention of the proliferation of weapons of mass destruction in the Republic of Serbia.

For the purpose of coordinated and comprehensive implementation of the activities from the AML/CFT Action Plan, the AML/CFT Coordinating Body set up expert teams whose members are representatives of the relevant competent institutions in Republic of Serbia. During 2022. the employees of the NBS have participated in the work of expert teams whose task is to implement the activities from the Action Plan related to the analysis of the legal framework that regulates the physically transfer means of payment, the assessment of the quality of the risk analysis developed by obligars, doing of a special AML/CFT risk assessment in the real estate sector, drafting of an operational manual for the analysis of the efficiency and effectiveness of the AML/CFT system, for the drafting of recommendations for reporting suspicious activities and for the drafting of an analysis of threats related to the operations of electronic money institutions from third countries.

Other relevant information and developments in 2022

Thanks to the continuous activities that NBS have been carrying out for years, and the awareness of the importance of the areas that we are authorized to supervise, we were adequately prepared for dealing with new risks, including health risks, as well as the risks arising from geopolitical developments.

AML

In 2022. the NBS have continued with all its supervisory activities in performing of-site and on-site controls, as well as further strengthening of its capacities through adequate external and internal trainings, especially concerning the emerging AML/CFT trends and risks.

Questionnaire tables for the 2022 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	26	23	21
Branches of foreign credit institutions	0	0	0
Cooperative banks	0	0	0
Banking sector, total:	**26**	**23**	**21**

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

Type of financial institution	2020	2021	2022
Commercial banks	39,132,130	42,931,356	46,499,625
Branches of foreign credit institutions	0	0	0
Cooperative banks	0	0	0
Banking sector, total:	**39,132,130**	**42,931,356**	**46,499,625**
y/y change (in %)	**12.67**	**9.71**	**8.31**

Ownership structure of banks on the basis of assets total

Item	2020	2021	2022
Public sector ownership	7.1	7.3	7.8
Domestic ownership total	14.0	13.0	16.4
Foreign ownership	86.0	87.0	83.6
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2022

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	39.4	59.3	936
Branches of foreign credit institutions	0	0	0
Cooperative banks	0	0	0
Banking sector, total:	**39.4**	**59.3**	**936**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2020	2021	2022
Commercial banks	6.5	7.5	13.8
Cooperative banks	0	0	0
Banking sector, total:	**6.5**	**7.5**	**13.8**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2020	2021	2022
Commercial banks	100.0	100.0	100.0
Branches of foreign credit institutions	0	0	0
Cooperative banks	0	0	0
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2020	2021	2022
Receivables			
Financial sector	14.4	14.7	18.3
Nonfinancial sector	57.4	58.1	57.2
Government sector	17.0	16.2	13.9
Other assets	11.2	11.0	10.6
Liabilites			
Financial sector	8.7	7.9	9.1
Nonfinancial sector	71.9	74.3	74.1
Government sector	2.5	2.4	2.3
Other liabilities	1.3	1.2	1.4
Capital	**15.6**	**14.3**	**13.2**

Capital adequacy ratio of banks

Type of financial institution	2020	2021	2022
Commercial banks	22.4	20.8	20.2
Cooperative banks	0	0	0
Banking sector, total:	**22.4**	**20.8**	**20.2**

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

Asset classification	2020	2021	2022
Non-financial sector, including			
- households	3.61	4.09	3.91
- corporate	4.03	3.35	2.48

The structure of deposits and loans of the banking sector in 2022 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	95.0	96.6
Households	52.1	45.4
Corporate	37.3	50.1
Government sector	2.2	2.3
Financial sector (excluding banks)	2.9	1.1
Total	**100.0**	**100.0**

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

P&L account	2020	2021	2022
Interest income	1,279,362	1,265,118	1,550,458
Interest expenses	178,702	166,925	272,787
Net interest income	1,100,660	1,098,193	1,277,671
Net fee and commission income	345,342	474,050	593,201
Other (not specified above) operating income (net)	170,478	62,656	45,982
Gross income	1,616,480	1,634,899	1,916,854
Administration costs	918,507	998,805	1,020,716
Depreciation	114,949	112,989	124,387
Provisions			
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	224,902	96,173	194,493
Other income	33,805	31,189	271,884
Profit (loss) before tax	391,928	458,121	849,142
Net profit (loss)	357,480	419,661	748,075

Total own funds in 2022 (in EUR thousand)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	5,460,382	5,081,169	5,094,581	365,801	N.A.
Cooperative banks	0	0	0	0	0
Banking sector, total:	**5,460,382**	**5,081,169**	**5,094,581**	**365,801**	**N.A.**

Macroeconomic environment in the country

Promising rebound from coronacrisis was in 2022 mitigated by the war in Ukraine and the consequent surge in energy prices and increase of the inflation. These factors weighted down economic growth of Slovak economy that decelerated significantly to 1.7%, which accounted for only one third of the previous year dynamics. Economic growth in 2022 was driven by the private consumption. After initially drawing on savings built up during the pandemic, households have seen their saving ratio drop to a historically low level. Net exports started to gradually recover from initial problems related to post-pandemic supply change disruptions. Despite the economic slowdown, labor market remained stable through the course of the year, with the unemployment rate reaching just below 6% at the end of 2022. Prices started to soar, with the annual HICP inflation reaching 15% dynamics at the end of 2022. The main drivers of the inflation were higher energy and food prices, but core inflation also gradually gained its momentum. The perspective of further development is relatively blur. Slovak economy will probably avoid economic recession; however, price growth will remain strong also in 2023.

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

Despite moderation in economic growth, the banking sector recorded one of its best years from the profitability perspective. Credit growth recorded double digit dynamics culminating during the summer months 2022 and thereafter gradually started to slow down. Rising interest rates, persistently increasing living costs and a climate of mounting uncertainty have reduced borrowing appetite of households and firms. Moderation in loan provision was recorded both, in credit to households, as well as in credit provided to corporates. Though the annual credit dynamics remained double digit at the end of 2022, reaching 10.5%, this was the base effect of last spring's surge in lending, while the monthly production decelerated significantly. After period of suppressed interest margins, they increased in 2022, in line with gradual increase of the interest rates. Total banking assets to GDP ratio has declined by 2.3pp to 105.6% of GDP at the end of 2022. Net profit after taxation of Slovak banking sector has increased by 12% up to 829 mil. €, but in ROE terms remains still close to the edge of the 1st quartile of the euro area banks. From the capital perspective, the capital level of Slovak banking sector remains sufficient and above the pre-pandemic level, with the CAR ratio at 19.6% at the end of 2022. The NPL ratios remained lowered.

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

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 2022 NBS carried on with the Eurosystem membership which includes the European Central Bank (ECB) and national central banks (NCBs) of those countries that have adopted the euro. NBS joined the Eurosystem upon entering the euro area on 1 January 2009. 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 the 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.

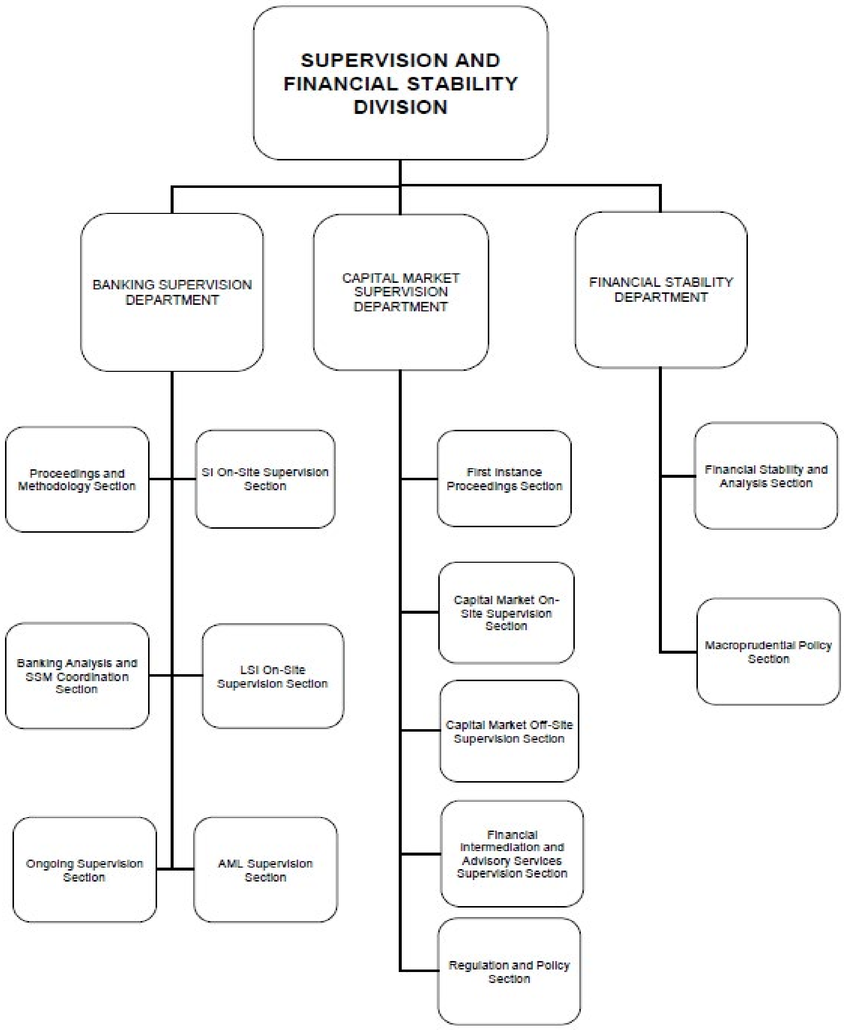
As the national supervisory authority in Slovakia, NBS has been part of the EU's Single Supervisory Mechanism (SSM) – a mechanism for exercising supervision over credit institutions in participating EU Member States – since the SSM came into operation on 4 November 2014.

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 organizing 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 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 2022

The priorities of banking supervision of the NBS are consistent with the priorities of the Single Supervisory Mechanism (SSM) of the ECB. When setting the priorities for the year 2022, it was based, as in previous years, on the assessment of key risks and weak points that the supervised institutions face in the current economic, regulatory, and supervisory environment.

The three priorities of banking supervision (defined by the ECB) have been introduced for the 2022-2024 period as all equally important. They aim to ensure that banks:

(1) emerge from the pandemic healthy,

(2) seize this opportunity to address structural weaknesses via effective digitalization strategies and enhanced governance, and

(3) tackle emerging risks, such as ICT and climate-related risks.

Key areas of focus included the resilience of banks to immediate macroeconomic and geopolitical shocks, addressing digitalization challenges, strengthening internal governance, and intensifying efforts to address climate change.

The activities of the Banking Supervisory Authority in 2022

After the period of the COVID-19 pandemic, the war on Ukraine brought new challenges together with inflation, and rising interest rates. Energy crisis brought the need for close monitoring of the corporate sector. Banks' proactive approach to clients helped to stabilize the financial situation of energy-intensive enterprises. The NBS has therefore focused on detailed analysis of the possible effects of these factors on financial stability.

The NBS continued to actively implement macroprudential policy and accepted several measures that complemented each other. Part of them was adjustment of the capital cushions, as well as new rules for granting loans households.

In accordance with the current trend, shorter on-site thematic supervisions were carried out in 2022, covering several banks, possibly the entire banking sector, while the evaluated areas came out from the risk map.

The assessment of banks focused mainly on the ability of banks to adapt their financial and capital plans to unexpected external changes - especially after the outbreak of war on Ukraine and its impact. In addition to the assessments of standard risks, banking supervision also focused on assessing the state of banks' information systems, cyber risks and banks' preparedness to manage climate and environmental risks.

Despite the challenges and difficulties posed by 2022, the capital situation of banks remained stable. A proactive approach of banking supervision and responsible approach of banks during 2022 has succeeded in strengthening the capital resources of banks by almost € 450 million during 2022, thus maintaining capital adequacy of banks at a stable level of 19.5%.

The NBS guided the supervised entities in connection with the war conflict in Ukraine. The aim was to provide recommendations for determining the optimal balance between AML legislative obligations and ensuring access to essential financial products and services for citizens of Ukraine and other countries fled their country and found temporary refuge in Slovakia.

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 involvement of NBS staff in Joint Supervisory Teams and in the drafting of ECB decisions during 2022.

As a part of the European system of financial supervision, 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 2022, 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) 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

As the result of joint effort of the Ministry of Finance of the Slovak Republic, the NBS and the Slovak Banking Association, it has been adopted regulation governing the opening of accounts for refugees from Ukraine as the part of the Act on certain additional measures in connection with the situation in Ukraine (Lex Ukraine).

The NBS further cooperated with the Ministry of Interior of the Slovak Republic and the Ministry of Finance of the Slovak Republic in 2022 on the transposition of the requirement from Directive (EU) 2019/1153 and Directive (EU) 2018/843 to establish a centralized automated mechanism that will enable authorized public authorities, timely identification of owners and managers of bank accounts or payment accounts, including safe deposit boxes. As a result, it has been created the central register of accounts as a long-term, complex and systemic solution, operated by the Ministry of Finance of the Slovak Republic, while the NBS supervises the fulfillment of the obligations of financial institutions when providing data to the central register of accounts.

Other relevant information and developments in 2022

The NBS is actively increasing the innovation potential of the Slovak financial market. For this purpose, two main instruments to support innovation are used – innovative hub and regulatory sandbox. During 2022, crypto-asset-related initiatives dominated the innovation hub. It was the first year of operation of the regulatory sandbox that dealt with a case related to the digitization of the application process for a mortgage.

The NBS also in 2022 continued to actively pursue macroprudential policy. It adopted a number of complementary measures. These included the adjustment of capital buffers as well as new rules on granting the loans to households.

Questionnaire tables for the 2022 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	12	11	11
Branches of foreign credit institutions	15	15	14
Cooperative banks	0	0	0
Banking sector, total:	**27**	**26**	**25**

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

Type of financial institution	2020	2021	2022
Commercial banks	79 617 275	91 400 102	97 185 443
Branches of foreign credit institutions	12 018 938	13 408 401	15 185 483
Cooperative banks	-	-	-
Banking sector, total:	**91 636 213**	**104 808 503**	**112 370 926**
y/y change (in %)	**8.2%**	**14.4%**	**7.2%**

Ownership structure of banks on the basis of assets total

Item	2020	2021	2022
Public sector ownership	0,60	0,50	0,49
Domestic ownership total	0,23	0,18	0,14
Foreign ownership	99,17	99,32	99,37
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2022

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	69.8	90.2	1901
Branches of foreign credit institutions	71.3	84.6	2689
Cooperative banks	-	-	-
Banking sector, total:	**60.4**	**79.1**	**1471**

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

Type of financial institution	2020	2021	2022
Commercial banks	5.94	9.03	9.52
Cooperative banks	-	-	-
Banking sector, total:	**5.94**	**9.03**	**9.52**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2020	2021	2022
Commercial banks	86.9	87.2	86.5
Branches of foreign credit institutions	13.1	12.8	13.5
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2020	2021	2022
Receivables	100.0	100.0	100.0
Financial sector	13.2	19.3	16.9
Nonfinancial sector	69.8	65.4	68.1
Government sector	12.0	11.4	11.3
Other assets	5.0	3.9	3.7
Liabilites	87.9	88.9	89.3
Financial sector	9.9	16.3	16.1
Nonfinancial sector	65.9	60.5	58.3
Government sector	2.4	2.6	3.0
Other liabilities	9.6	9.6	11.8
Capital	**12.1**	**11.1**	**10.7**

Capital adequacy ratio of banks (%)

Type of financial institution	2020	2021	2022
Commercial banks	19.67	19.81	19.61
Cooperative banks	-	-	-
Banking sector, total:	**19.67**	**19.81**	**19.61**

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

Asset classification	2020	2021	2022
Non-financial sector, including	2.57	2.17	1.95
- households	2.43	2.02	1.78
- corporate	3.32	2.95	2.59

The structure of deposits and loans of the banking sector in 2022 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	89.5	96.8
Households	60.9	63.1
Corporate	28.6	33.7
Government sector	4.5	2.0
Financial sector (excluding banks)	6.0	1.2
Total	**100.0**	**100.0**

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

P&L account	2020	2021	2022
Interest income	1 871 379	1 835 867	2 084 771
Interest expenses	216 578	218 290	338 815
Net interest income	1 654 801	1 617 577	1 745 956
Net fee and commission income	622 313	658 438	747 422
Other (not specified above) operating income (net)	-189 565	-73 110	-108 999
Gross income	2 234 502	2 380 994	2 605 298
Administration costs	1 116 811	1 127 773	1 193 260
Depreciation	162 123	167 750	173 941
Provisions	348 051	125 014	186 004
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	312 697*	113 116*	175 769*
Profit (loss) before tax	602 172	930 408	1 047 355
Net profit (loss)	469 916	738 157	828 745

*Note: * Data for Commercial banks only, according to FinRep Profit and Loss Account, for years 2020-2022.*

Total own funds in 2022 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	8 057 687 652	6 926 125 499	7 406 125 499	651 562 153	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**8 057 687 652**	**6 926 125 499**	**7 406 125 499**	**651 562 153**	**-**

Macroeconomic environment in Slovenia

Slovenia's real GDP growth in 2022 stood at 2.5% with a rather robust domestic demand. Final household consumption increased by 3.3%, supported by buoyant labour market conditions and government measures designed to offset rising energy price costs. Additionally, robust government investments played a pivotal role in boosting economic activity, while government consumption experienced a slightly negative growth. In the private sector, residential investments demonstrated strong growth, while investments in machinery and equipment experienced a more subdued pace. Concerning international trade, the growth in merchandise exports decelerated significantly, yet overall exports registered a 7.2% increase in real terms, driven by strong foreign demand for services, notably in the tourism sector. Nevertheless, the solid domestic demand alongside the export growth contributed to a substantial 9.0% growth in real imports, resulting in a negative net trade contribution to GDP growth. The prevailing uncertainty in the international environment prompted accumulation of inventories, which accounted for 1.0p.p of last year's GDP growth.

Developments in the banking sector

The banking system's balance sheet total[1] increased by 4.9% in 2022 to end the year at EUR 50.6 billion. Last year's increase of EUR 2.3 billion in the balance sheet total was driven on the liability side primarily by deposits, which increased by EUR 2.6 billion, and to a lesser extent by securities and liabilities to banks, while liabilities to the ECB recorded the largest decline. Banks directed the majority of their funding into an increase of EUR 2.5 billion in loans to the non-banking sector. The ratio of the banking system's balance sheet total to GDP declined further to 86.5% last year, amid an increase in nominal GDP and slower growth in the balance sheet total.

Year-on-year growth in loans to the non-banking sector rose sharply in 2022, and significantly outpaced the euro area average. After reaching its highest figure for several years in September (13.0%), it slowed over the remainder of the year reaching 10.0% in December (euro area 4.8%). Year-on-year growth in housing loans, which even during the pandemic did not slow significantly from previous years, increased sharply in 2021, and this trend of increase continued in 2022. By the midpoint of the year it had reached 11.9%, the highest rate in more than a decade. After that it had slowed to 9.9% by December, amid rising interest rates and high prices on the real estate market. The year-on-year contraction in consumer loans slowed during 2022, and the stock moved into growth in November for the first time since April 2020, although it remained weak until the end of the year. The rate stood at 0.9% in December. The strengthening consumer lending was attributable to the recovery in private consumption, which had been curtailed by the pandemic and the containment measures, but the effect of the high base from the period of above-average growth before the introduction of the macroprudential restrictions on consumer lending also waned. Lending to non-financial corporations also significantly increased in 2022. The year-on-year rate of growth hit 18.4% in August, its highest figure in more than a decade, before slowing to 12.8% in December. In terms of the size of the firms obtaining financing at banks, the growth was broadly based, but large enterprises recorded particularly strong growth. It was also broadly based across sectors, with firms in the sectors of manufacturing, wholesale and retail trade, and electricity, gas, steam and air conditioning supply acting as the main drivers.

Indicators of the asset quality remained favourable in 2022, despite an increase in credit risk. The NPE ratio fluctuated between 1.1% and 1.2% during the year, its lowest level since measurement of this indicator

[1] The number of credit institutions operating in Slovenia remained unchanged at 16 last year. At the end of 2022 there were 11 banks, three savings banks and two branches of foreign banks operating in Slovenia. The number of banks has declined in recent years, and the trend of decline in the number of banking institutions is expected to continue this year: the bank acquired by the largest banking group in March of last year is expected to be merged.

began in 2016. NPE ratios in the Slovenian banking system declined in all portfolio segments other than non-residents with direct exposure to customers from Russia, Ukraine and Belarus, and in accommodation and food service activities, where the deterioration in the portfolio that began during the pandemic continued. These two portfolios account for only a small share of the banking system's total exposure. The other asset quality indicator, the breakdown according to credit risk stages, also improved in 2022. The share of exposures with increased credit risk (Stage 2 under the IFRS) declined over the majority of the year, before increasing slightly again over the final two months. It nevertheless ended the year down in year-on-year terms in all main customer segments. The share of Stage 2 exposures in the total portfolio stood at 5.1% at the end of 2022, down 0.7 percentage points on a year earlier.

Banks' pre-tax profit slightly decreased in 2022 (3.9% year on year) to EUR 543 million, with an ROE of 10.8%. ROE in the Slovenian banking system thus remained comparable to previous years. The main driver of higher profit last year was an increase in net interest income. While net interest was still declining in year-on-year terms in the previous year, the rate of growth turned positive in the early part of the year and gradually increased, primarily on account of increased lending. The gradual rise in interest rates was also an increasing factor, particularly from the summer onward. Last year banks brought an end to the net release of impairments and provisions that had been seen in the previous year and in several recent years. The net creation of impairments and provisions was nevertheless very small, and accounted for just 1% of the disposal of gross income.

The banking system's capital position remained solid, but there are still considerable variations from bank to bank in terms of resilience to systemic risks. The banking system's total capital ratio on a consolidated basis increased by 0.2 percentage points over 2022 to end the year at 18.5%, while the common equity Tier 1 capital ratio declined by 1 percentage point to 15.9%. The main factor reducing regulatory capital during the year was the negative effects of securities revaluations, while retained earnings and the issuance of capital instruments acted to increase regulatory capital, the former remaining a major factor in the maintenance of stable capital adequacy. Despite the increase in the total capital ratio at system level, it actually declined at the majority of banks.

The legal and institutional framework of the operation and supervision of financial institutions, new developments. Legal competence of Banka Slovenije

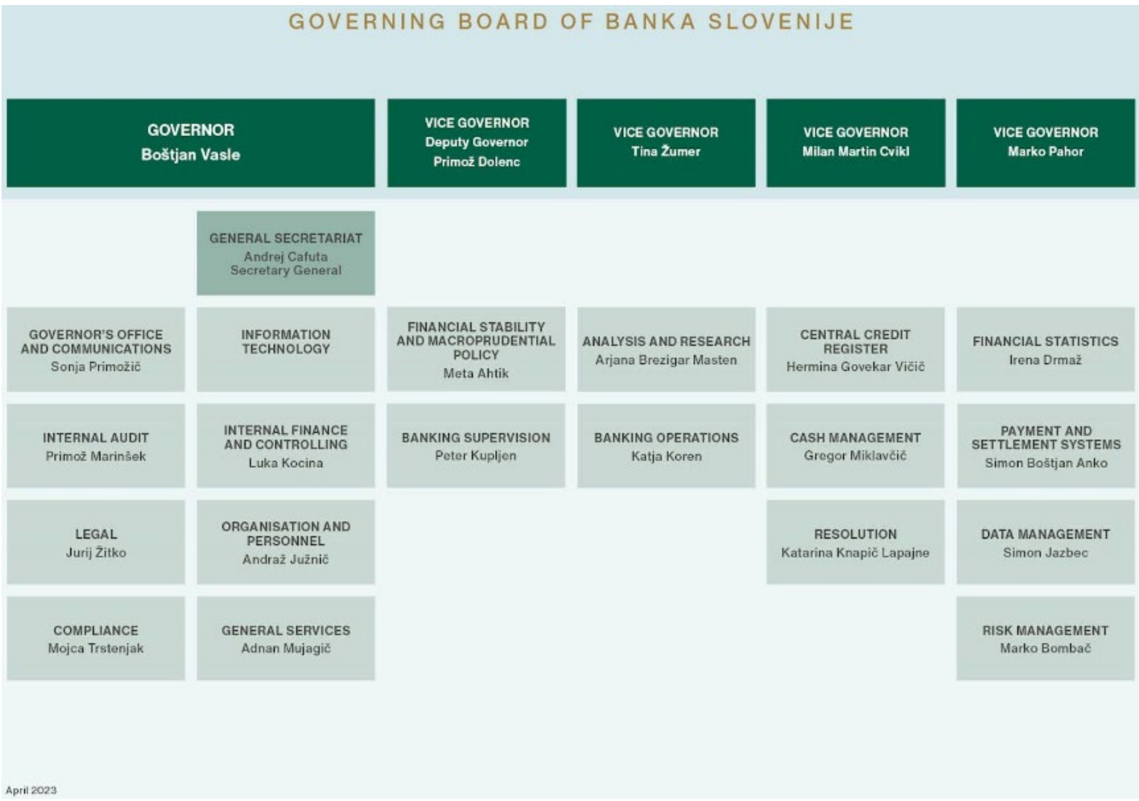
Banka Slovenije is a member of the Single Supervisory Mechanism (SSM), one of the three pillars of the EU banking union, which complements the economic and monetary union (EMU) and the single market by coordinating the responsibility for bank supervision, resolution and funding at the EU level, ensuring a level playing field for banks across the euro area. Alongside the SSM, which has been in operation since November 2014, the other two pillars consist of the Single Resolution Mechanism (SRM) since 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 (Banka Slovenije 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, in accordance with national and EU legislation, having regard for the rules and methodology of the ECB and SSM. National supervisors regularly submit supervisory data for LSIs to the ECB, and inform it of the material findings of their supervision. The arrangements allow the ECB to directly take over the supervision of LSIs 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 Banka Slovenije Act (ZBan-3) the central bank carries out supervision of credit institutions in order to maintain the stability and security of their operations, and to maintain confidence in the banking system among depositors. In accordance with the statutory mandate of the Banking Supervision of Banka Slovenije tasks include the performance of licensing (i.e. authorisation and notification procedures for the work of the institutions, giving consent for members of management boards, and other authorisations and consents prescribed by ZBan-3), the performance of on-site inspections in credit institutions, collecting and analysing quantitative and qualitative information from supervised entities and other sources, cooperation with other supervisors in the country and outside, active participation at international supervisory forums, working groups and colleges.

Banka Slovenije also participates in the activities of the European Banking Authority (EBA), an independent EU authority, whose purpose is ensuring effective and consistent prudential regulation and supervision in the European banking sector by putting in place a single European banking rulebook.

Organizational chart of Banka Slovenije



Main strategic objectives of Banka Slovenije in 2022

We set the following supervisory priorities in 2022, which also formed the starting point for the supervision of Slovenian banks:

i) credit risk management:

- monitoring of covid-vulnerable sectors;
- adequacy of credit risk management (early warning of deterioration in asset quality, adequate creation of impairments);
- management of exposure with high leverage;

ii) management of information and communication technology:

- management of cyber risks and outsourcing;
- digitalization strategy;

iii) strengthened internal governance:

- monitoring of actions of management bodies;

iv) identification and management of climate risks and environmental risks.

The SREP was conducted in its customary and full scope in 2022. The results of the SREP are broadly unchanged, and comparable to previous years. Although there was a post-pandemic recovery, we remained vigilant with regard to exogenous shocks resulting from the long-lasting effects of the pandemic and the war in Ukraine. The majority of the quantitative measures imposed within the framework of the SREP addressed deficiencies in the management of credit risk and operational risk, in internal governance, and in capital management. Measures to address climate and environmental risks were also imposed for the first time. For the first time the latter were also the subject of stress tests, which were conducted within the framework of the SREP.

The activities of Banka Slovenije in 2022

Following the sudden change in the geopolitical environment caused by the war in Ukraine and later the energy crisis, many supervisory activities in 2022 focused on assessing the vulnerability and resilience of the banks. In these circumstances, it is key for the banks to promptly identify vulnerable sectors and debtors, to understand how rising energy prices affect them, to monitor debtors and to reclassify them promptly and appropriately if there are negative developments. The models that banks use to estimate credit losses are not working optimally in uncertain conditions and changing macroeconomic environment (e.g. high inflation), and are therefore in need of adjustment. The supervisory expectations in this regard were communicated to the banks within the framework of the ECB and Banka Slovenije.

In 2022, one thematic review and two in-depth inspections were conducted in the area of credit risk. The thematic review was conducted in the residential real estate segment at one of the significant banks. The focus was on assessing any risks inherent in existing exposure, and deficiencies in risk management for new operations. The review was completed in 2023, and the findings will be incorporated in SREP 2023. In-depth inspections were conducted in two significant banks; one was related to the use of the unlikeliness to pay assessment in the definition of borrower default, and the other was related to the assessment of the adequacy of impairments created in Stage 3 under IFRS 9.

We performed a targeted analysis of the effectiveness and diversity of the management body at one of the significant banks. Findings will be incorporated in SREP 2023.

As the supervisory priorities include addressing the challenges posed to banks by digital transformation, the focus in banking supervision was on assessing the banks' ability to develop and implement digital strategies suitable for strengthening the long-term viability of their business models, and prudently managing the associated risks. Banks were invited to complete a survey on the digital transformation and the use of fintech. The aim was also to improve the supervisory understanding of the development of the market, and to keep pace with fast evolving technological environment.

In the area of climate-related and environmental risks, we conducted several supervisory activities to assess the banks' capacity to manage these risks and to speed up the alignment of banking practices with supervisory expectations. We conducted a thematic review within the framework of the ECB in three significant banks. The thematic review assessed the soundness and comprehensiveness of the banks' key policies and procedures, and their ability to effectively oversee climate and environmental risk strategies and risk profiles. Overall progress was identified in the evolution of practices relative to the supervisory assessment from 2021, but the banks will have to further invest more efforts to align themselves with supervisory expectations. The banks have put in place a framework for addressing climate risks and environmental risks, but the approaches used still lack methodological integrity, the use of detailed information, and active portfolio and risk profile management. Letters with recommendations and deadlines for rectifying the deficiencies were issued to banks.

We assessed readiness of less significant banks to identify and manage climate-related and environmental risks based on their own self-assessment. The supervisory assessment revealed that even though less significant banks acknowledge these risks, their practices still show much room for improvement. Supervisory letters with guidance for further improvements were send to the banks.

Further, we assessed the adequacy of climate-related disclosures in significant banks. The assessment showed that banks have begun to disclose more relevant information, but their disclosures do not yet comply with supervisory expectations. Banks received follow-up letters with recommendations in early 2023.

Three planned inspections were conducted at significant banks and seven planned prudential inspections at less significant banks. At significant banks, two inspections were conducted in the area of credit risk and one in the area of internal governance. At less significant banks, four inspections were conducted in the area of credit risk, two in the area of interest rate and liquidity risk and one in the area of operational risk. In addition, a thematic review of cyber risk was conducted, and has involved four less significant banks.

As part of our prudential supervision we also granted several different authorisations in connection with the exemption from large exposure requirements, the inclusion of interim profit and negative goodwill in common equity, the inclusion of capital instruments in the calculation of Tier 2 capital and additional Tier 1 capital, the acquisition of a qualifying holding, exemption from the approval of qualifying holding, the use of material changes to an IRB model for credit risk, and expansion of the use of a PD model.

Supervision of the operations of the two branches of foreign banks and banking groups from other Member States (one from Austria and one from France) was conducted via regular reports, requests for additional clarification, and the monitoring of the liquidity positions.

International activities of Banka Slovenije in 2022

In the area of microprudential supervision and the setting of policies/rules for credit institutions, Banka Slovenije actively works within the framework of the Single Supervisory Mechanism (SSM) and the European Banking Authority (EBA), in the area of macroprudential supervision, Banka Slovenije works within the institutional framework of the European Central Bank (ECB) and the European Systemic Risk Board (ESRB), and in the area of bank resolution, Banka Slovenije works within the framework of the Single Resolution Mechanism (SRM).

Governor or Vice Governors are members of the most senior decision-making bodies of the SSM, EBA, ESRB and SRB, while experts of Banking Supervision Department, Financial Stability and Macroprudential Policy Department, and Resolution Department participate at the SSM networks, EBA standing committees and SSM, EBA, ESRB and SRB committees and working groups.

In addition to on-site inspections conducted by the local supervisors in Slovenia, Banka Slovenije received SSM support in two missions for significant institutions in 2022 - for credit risk and governance. Credit risk mission was supported by two supervisors from the National Bank of Croatia and one member of SSM JST team. Governance mission in another significant institution was supported by two experts from an external firm.

Banka Slovenije supervisors were also involved in three on-site inspections of significant institutions outside Slovenia within the framework of JSTs (inside the SSM). One inspection was conducted in the Netherlands in the area of credit risk, one in Greece in the area of liquidity risk, and one in France in the area of operational risk.

Banka Slovenije signed Memorandum of Understanding with 5 supervisory authorities some years ago concerning supervision of the largest bank in Slovenia. As in the previous years, Banka Slovenije organised supervisory college for this bank as home supervisor. In addition, Banka Slovenije participated in five supervisory colleges as host supervisor. Furthermore, Banka Slovenije participated in seven supervisory colleges in the area of AML/CFT.

Banka Slovenije provided also technical assistance to the Central Bank of Montenegro in 2022 in the areas of banking supervision, planning of supervisory activity, the SREP, and the credit register.

Cooperation with other supervisory bodies in Slovenia

Slovenia's Financial Stability Committee (FSC) formulates macro-prudential policy in conjunction with Banka Slovenije, the Securities Market Agency, the Insurance Supervision Agency and the Ministry of Finance. As in the previous years, FSC discussed systemic risks, and was briefed on supervisors' macroprudential measures and actions taken to meet the ESRB recommendations. The ESRB issued a new recommendation in 2022 on the pan-European systemic framework for coordinating cyber incidents. In addition, it also regularly followed-up on the implementation of recommendations issued previously. Other subjects related to Banka Slovenije's work that were discussed by the FSC included its opinion of the introduction of a sectoral systemic risk buffer, the upgrade and changes to the existing macroprudential restrictions on household lending, and the letter to the Slovenian government on long-term risks to financial stability inherent in the current arrangements for the pension system in Slovenia. As part of the FSC working group for fintech and cybersecurity, Banka Slovenije continued addressing the trends in the area of algorithmic stablecoins, the impact of quantum computing on financial services, and European legislative proposals and other initiatives related to financial technologies. Banka Slovenije paid particular attention to the development of the regulatory framework for cryptoassets and, in the light of current geostrategic developments, to the issue of cybersecurity. Banka Slovenije discussed issues related to the provision of critical infrastructure and cybersecurity at the level of the wider financial system, and briefed the members of the working group on the activities of the ESRB's cybersecurity working group and on the inter-supervisor project on systemic cyber risk. In 2022 as part of the FSC working group for climate risk Banka Slovenije assessed the transition risks and physical risks in the banking system and at insurance companies, and monitored the evolution of regulations in the area of sustainable financing. Given the interdisciplinary nature of the issue, institutional cooperation was strengthened in 2022 in the area of environmental data relating to physical risks.

The committee for cooperation between supervisory authorities - Banka Slovenije, the Securities Market Agency and the insurance Supervision Agency, which was chaired by Banka Slovenije in 2022, discussed the following during the year:

- legislative changes for the financial sector;
- joint on-site inspections and major individual on-site inspections at supervised entities by Banka Slovenije, the Securities Market Agency and the Insurance Supervision Agency;
- the major decisions and discussions from meetings of the European Banking Authority's Board of Supervisors and the European Central Bank's Supervisory Board, the European Securities and Markets Authority's Board of Supervisors and the European Insurance and Occupational Pensions Authority's Board of Supervisors;
- the risks in the financial sector arising from the war in Ukraine; and
- other issues of relevance to supervisory authorities, the financial sector and users of financial services (e.g. risks related to inflation, exercise of insured parties' rights under supplementary pension insurance).

Questionnaire tables for the 2022 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	14	14	14
Branches of foreign credit institutions	2	2	2
Cooperative banks	0	0	0
Banking sector, total:	**16**	**16**	**16**

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

Type of financial institution	2020	2021	2022
Commercial banks	42.817.107	46.471.250	48.988.493
Branches of foreign credit institutions	1.833.974	1.780.304	1.586.535
Cooperative banks	0	0	0
Banking sector, total:	**44.651.081**	**48.251.554**	**50.575.028**
y/y change (in %)	**8,3**	**8,1**	**4,8**

Ownership structure of banks on the basis of assets total

Item	2020	2021	2022
Public sector ownership	12,7	12,9	12,8
Domestic ownership total	21,0	21,8	24,4
Foreign ownership	79,0	78,2	75,6
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2022

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	58,7%	73,1%	0,1551
Branches of foreign credit institutions	/	/	0,7568
Cooperative banks	/	/	/
Banking sector, total:	**56,9%**	**70,8%**	**0,1463**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2020	2021	2022
Commercial banks	9,6%	11,3%	10,8%
Cooperative banks	/	/	/
Banking sector, total:	**9,6%**	**11,3%**	**10,8%**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2020	2021	2022
Commercial banks	95,9%	96,3%	96,9%
Branches of foreign credit institutions	4,1%	3,7%	3,1%
Cooperative banks	/	/	/
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2020	2021	2022
Receivables			
Financial sector	12,0	11,4	9,4
Nonfinancial sector	49,3	48,9	51,8
Government sector	17,3	14,2	14,3
Other assets	21,4	25,5	24,5
Liabilites			
Financial sector	5,3	3,6	4,0
Nonfinancial sector	74,7	75,0	76,8
Government sector	2,1	2,1	1,9
Other liabilities	7,1	8,9	7,2
Capital	**10,8**	**10,5**	**10,2**

Capital adequacy ratio of banks

Type of financial institution	2020	2021	2022
Commercial banks	18,3	18,4	18,5
Cooperative banks	/	/	/
Banking sector, total:	**18,3**	**18,4**	**18,5**

*(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	2020	2021	2022
Non-financial sector, including	1,9	1,2	1,1
- households	2,1	2,1	1,7
- corporate	4,1	2,2	1,8

The structure of deposits and loans of the banking sector in 2022 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	93,9	89,2
Households	64,9	44,1
Corporate	29,1	45,1
Government sector	2,4	4,8
Financial sector (excluding banks)	3,7	6,0
Total	**100.0**	**100.0**

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

P&L account	2020	2021	2022
Interest income	753.991	737.182	884.339
Interest expenses	114.873	112.034	136.524
Net interest income	639.117	625.150	747.813
Net fee and commission income	329.682	377.286	398.085
Other (not specified above) operating income (net)	392.924	205.210	169.281
Gross income	1.360.072	1.205.628	1.315.136
Administration costs	646.494	654.430	694.561
Depreciation	71.953	62.657	63.001
Provisions	13.778	-12.740	9.334
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	155.811	-60.922	4.807
Profit (loss) before tax	472.033	562.198	543.439
Net profit (loss)	450.343	525.296	501.716

Total own funds in 2022 (in thsd EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	6.026.701	5.170.314	5.257.795	768.906	/
Cooperative banks	/	/	/	/	/
Banking sector, total:	**6.026.701**	**5.170.314**	**5.257.795**	**768.906**	**/**

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

Macroeconomic environment in the country

The global economic activity weakened due to geopolitical risks, high energy prices, inflation developments, rising concerns over a recession in advanced economies, and the uncertainty regarding global demand and supply chains driven by the rising pandemic cases in China in 2022 overall. In addition to pandemic measures and the contraction of economic activity in China for the first time after the pandemic, energy and food prices that increased due to the Russia-Ukraine conflict and the subsequent economic and financial sanctions imposed on Russia caused the slowdown in global growth to become more pronounced. Global inflation, which was driven up by pent-up demand after the pandemic and disruptions in the supply chain, continued to rise in 2022 due to uncertainties regarding energy and food security as well as the ongoing high course of commodity prices. Vulnerabilities for global financial stability increased in that period. Geopolitical risks in particular, reduced risk appetite, supply-demand imbalances, high commodity prices, inflationary pressures and monetary tightening steps in advanced economies to address these pressures, and widespread expectations of a recession played a significant role in the global financial system and the economic outlook.

In these globally volatile times, Turkish economy grew by 3.3% y/y in 4Q22 above market expectation consensus (2.9%), leading to an overall GDP growth of 5.5% in 2022. Domestic demand especially private consumption was the pioneer on the expenditures side, whereas broad-based services sector was the main contributor on the production side. On the expenditures side, private consumption (16.1% y/y) and government consumption (9.0% y/y) maintained their solid pace in 4Q22 but this time investment also recovered by 2.6% y/y after declining by 0.8% in 3Q22.

When the overall 2022 is considered, domestic demand supported growth with 5pp contribution on the back of accelerating private consumption (12.1pp) while investment remained limited (0.7pp). On the external demand, net exports showed a weaker contribution to annual growth with 0.6pp due to both slow-down in exports (9.1% y/y in 2022 vs. 24.9% y/y in 2021) and acceleration in imports (7.9% y/y in 2022 vs. 2.4% y/y in 2021). All in all, the economy grew above potential in 2022 thanks to pro-growth policies on loose monetary policy and expansionary fiscal measures despite the downward pressures from the tighter external financial conditions and the war in Ukraine. Despite the strong outlook for services revenues, the current account deficit widened due to high energy and gold imports accompanied by a limited deceleration in exports, while the current account balance excluding energy and gold remained on a positive trajectory. The robust course of economic activity in this period was mirrored positively in the labor market and budget indicators. While consumer inflation was driven by price hikes in core goods and services, it lost momentum in the second half of 2022.

Corporate sector indebtedness, which declined on a global scale with the rebound in economic activity following the termination of pandemic restrictions, displays a similar trend in Türkiye and remains at a moderate level compared to peer countries. Financial assets of the corporate sector grew steadily compared to its financial liabilities, while the financial leverage ratio of the corporate sector hovered close to the lowest level recorded over the last 10 years. The positive outlook for the exchange rate risk indicators of the corporate sector is maintained. On the back of macroprudential regulations, the share of loans received by manufacturing sector firms with higher export and investment ratios is increasing. The uptrend in the corporate sector' financial assets continues to increase mainly due to TL deposits. In the period of increasing global economic risks, the banking sector has been one of the most important stabilizing dynamics of the Turkish economy. The Turkish banking sector continues to play a critical role in the effective functioning of the credit market and in meeting the financing needs of the real sector.

The strong course of economic activity had positive repercussions on the labor market, and tax revenues maintained the upward trend. With the robust outlook in the labor market and the increase in tax revenues, budget discipline has been maintained. The recent rise in inflation is attributed to supply-side factors and demand developments. Also, rise in inflation has been driven by the lagged and indirect effects of the increase in energy costs, price formations detached from economic fundamentals, and strong negative supply shocks arising from hikes in global energy, food and agricultural commodity prices. Türkiye's household indebtedness (financial debt/GDP) continued to decrease, and it is significantly below the averages of advanced and emerging economies.

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

The Turkish financial system is dominated by the banking sector, which represents about 86.6[1] percent of total financial sector assets. As of the end of 2022, 57 banks were operating in Turkey, including 16 investment and development banks, 6 participation (Islamic) banks, and 32 commercial deposit banks, of which 3 were state banks, 8 were private banks, 21 were foreign banks and 3 were Saving Deposit Insurance Fund (SDIF) banks. The asset share of local private banks and foreign banks stood at 29.6% and 24.9%, respectively, as of 2022 year-end, decreased from 30.7% and 25.9% YoY, respectively. During that period, the asset share of state banks increased from 43.4% to 45.5% in 2022. As of year-end 2022, the total assets to GDP ratio for the Turkish Banking Sector (TBS) is at 95.6%.

In March 2021, CBRT increased the policy rate from 17% to 19%. Starting from September meeting, The Monetary Policy Committee (MPC) gradually reduced the rate from 19% to 18% in September, 16% in October, 15% in November and 14% in the last MPC meeting of the year. The rate remained stable at 14% from the beginning of 2022 until August. Then CBRT continued to reduce the rate gradually from %14 to %8.5.

All temporary measures taken during pandemic were revoked as of December, 2021 except foreign exchange rate fixation in the calculation of risk weighting assets (CAR fixation measure) due to the special conditions of the Turkish economy and financial system. However, BRSA has constantly reviewed the exchange rates used in CAR calculation, in order not to cause any dramatic decline in CAR when lifting these measures. In this context, in January 2023, the exchange rate used in CAR calculation was updated so as to banks can use the fixed 2022 year end exchange rates instead of using fixed 2021 year end exchange rate. In June 2022, the BRSA decided to tighten consumer loans by limiting maturities to 12 months for loans amount above 100.000 Turkish Lira.

In June 2022, in order to decrease residential morgages, BRSA has differentiated and tightened loan-to-value ratios depending on energy performance, value and type of the residential houses whether it is new or second hand. (In Februbary 2023, LTV ratios has been updated with higher ratios and values of houses reflecting price increases)

The macroprodential policy set was strengthened to ensure that commercial loans feed into the economic activity in line with intended purposes. Following the macroprudential regulations introduced in May 2022 and thereafter, the credit composition evolved in the targeted direction and the acceleration in total growth rates slowed in the third quarter of 2022. However, the loan growth rate reached to 41.2% (FX adjusted) annually as of December 2022 mainly because of the retail loans. Following the BRSA's decision to reduce the general maturity limit for general purpose loans above 100.000 TL from 24 months to 12 months, the 13 week general purpose loan growth rates declined significantly. However, the brisk course in the annual growth of personal credit card balances continued thanks to inflation-driven increased consumption demand and upward revisions in limits.

The volume of loans reached to USD 7.6 trillion which constitutes 52.8% of banking sector's total assets as of December 2022. In terms of amount, the increase in total loans has stemmed from the TRY denominated commercial loans, SME loans and retail loans. As of December 2022, the retail segment posted a growth rate

[1] BRSA 2022 Annual Report

* Please return by September 9th, 2022

of 55.8% and the corporate segment displayed a growth rate of 48.9%, annually. However, FX-denominated loans declined by 14.8%.

The non-performing loan (NPL) ratio of the sector which was at the level of 3.2% in the 2021 year end, decreased to 2.1% as of December 2022. In 2022, the moderate course in NPL inflows, TRY loan growth and remarkable collection performance of banking sector led to the decrease in the NPL ratio. Besides, banks allocate provisions prudently for all loan stages. The provisioning rate for stage 2 category loans and non-performing loans, realized at 24.8% and 86.7%, respectively, implied 193 bps and 100 bps rise in provisioning rate in annual terms as of December 2022. Therefore, the sector has sufficient buffers against unexpected credit risks.

The capital structure of the banking sector has remained strong. As of December 2022, the capital adequacy ratio (CAR) is 19.5% and 750 bps higher than 12% target ratio. Moreover, Common Equity Tier 1 ratio is 15.5%, and well above applicable regulatory thresholds. In addition, forbearance measures regarding the calculation of the CAR and capital injection to state banks have positively affected the CAR. Even without forbearance effects (1.8 points), the sector had an adequate CAR of 17.6% as of December 2022.

The resilience of the banking sector against liquidity shocks continues. The current liquidity coverage ratios (LCR) of the sector calculated for total and FX are far above the regulatory limits. Furthermore, a high rollover ratio of external borrowing has been maintained at the current stage. The banks have sufficient liquidity buffers against any liquidity needs. As of December 2022, the FX LCR of the sector was 387.6% while the total LCR level was 180.3%. Besides, the high quality liquid assets to total assets in total was over 20% as of December 2022.

The main funding source is deposits (61.8% of total liabilities) which reached to 8.9 trillion TL. As of December 2021, FX deposit constituted 64.5% of total deposits. After the announcement that the exchange-protected deposit system would be put into use, it was observed that the aforementioned rate dropped to around 46.1% with the appreciation of the TL and the conversion from FX deposits to TL deposits as of December 2022. The share of FX protected deposits reached to 15.1% as of the same period. Funds from abroad were around USD 99.5 billion and constitutes 9.9% of total liabilities, including repos, deposit, loans and syndication and securitization loans. External borrowing trends 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 average rollover ratio of the syndications is still above 90% as of December 2022. However, there has been a slowdown in rollovers of syndications mainly because of the increasing cost of foreign borrowing and declining demand for FX loans.

As of December 2022, the net profit of the TBS increased by 366.3% annually. Banking sector preserved its high profitability, which helped to build sufficient capital buffers. As of December 2022, NIM was 6.5%, ROA was 3.7% and ROE was 49.9% for the banking sector. The net interest margin, increasing thanks to supportive monetary policy, is the main driver behind the increase in Return on Assets (ROA).

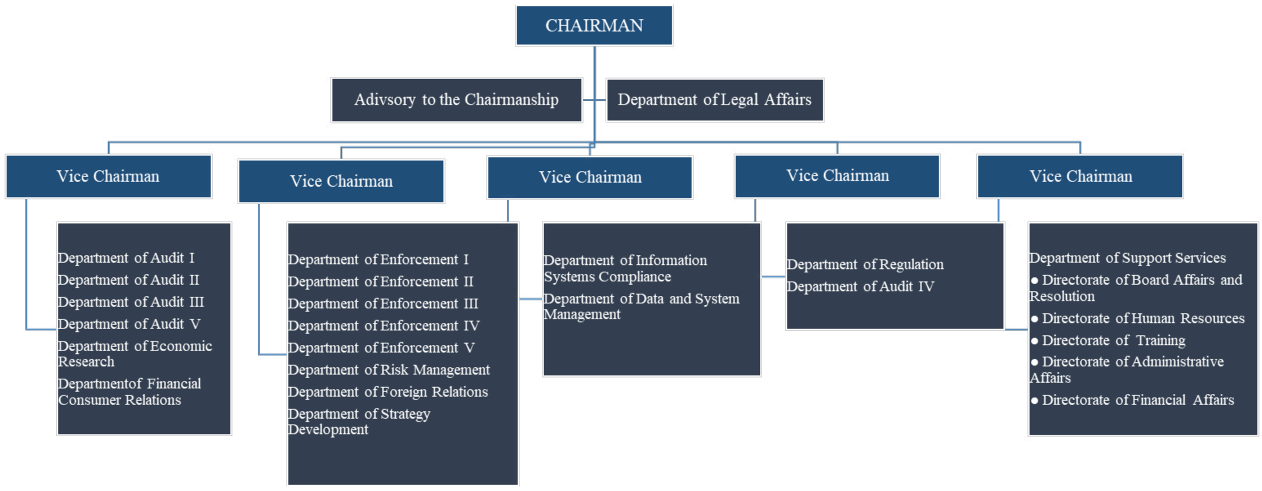
The legal and institutional framework of the operation and supervision of financial institutions, new developments. Legal competence of the Banking Supervisory Authority in the country

The Banking Regulation and Supervision Agency (BRSA) with the authority given by the Banking Law No. 5411 (The Banking Law) regulates and supervises banks (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, financing companies, asset management companies and savings financing companies. Moreover, the BRSA authorizes independent audit, rating and valuation companies that give service to banks or financial holding companies.

Within the scope of the Law on Bank Cards and Credit Cards, organizations and entities, which establish a card system, issue cards and enter into merchant agreements, as well as merchants and cardholders are also regulated by BRSA. Acting as the responsible institution in the field of regulation and supervision of a significant portion of the financial sector the BRSA plays an important role in the Turkish economy in terms of ensuring financial stability, developing the industry, strengthening the framework for practices and regulations, protection of the rights and interests of depositors, and developing an effective financial system and a strong banking industry by increasing the corporate capacity.

Within the framework of the duties and responsibilities assigned by the Banking Law No. 5411, the BRSA continued its regulation, supervision and enforcement activities in 2022 with a prudential perspective based on the effective management of risks. On-site audit process carried out by the BRSA is established so as to provide a risk-oriented, dynamic, efficient and forward looking audit approach by taking into account the international best practices including the Core Principles for Effective Banking Supervision of the Basel Committee. The BRSA's supervisory guidelines were updated by taking into account the principles and rules published by international regulatory bodies and the recommendations in the Financial Sector Assessment Program (FSAP) report for 2022 prepared by the International Monetary Fund (IMF) and the World Bank. In this context, a new risk-focused supervisory methodology called "IDES Rating System" was developed by taking into account the European Banking Authority's (EBA) "Guidelines on Common Procedures and Methodologies on the Examination and Evaluation Process (IDES) and Stress Testing".

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Banking Supervisory Authority in 2022

The 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:

- 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

Other objects of the BRSA in 2022 are summarized below:

- As stated in the Medium Term Program (2022-2024) supervisory technologies among the policy measures expected to be implemented under the heading of "Financial Stability" and aims to implement new supervisory practices and methodologies based on supervisory technologies.
- In parallel with the digital transformation in the world and in our country, establishing the legislative infrastructure for digital (branch-free) banking and service model banking, encouraging financial

innovation, increasing financial inclusion and facilitating access to banking services are emerging as priority targets.

- The BRSA aims to ensure the harmonization of banks' corporate governance with international standards and to make banks' internal capital adequacy assessment processes more effective. Also, The BRSA aims to make the internal capital adequacy assessment processes of banks more effective and to increase compliance with international best practices in this field.
- The BRSA aims to enable banks to interpret the regulations more accurately to improve sectoral practices and to reveal how the asset quality of the banking sector is managed from a holistic perspective.
- The BRSA supports and aims to accelerate the scientific studies that will contribute to the development of the Turkish financial sector.
- Defining its sustainable finance vision as "a banking sector that effectively manages the environmental and social risks and opportunities it faces, especially climate change, and provides the financing needed for the transition to a low-carbon economy, under appropriate conditions", the Green Deal Action Plan includes 3 main strategic objectives: (1) effectively managing and monitoring climate-related risks, (2) improving the financing needed for the transition to a sustainable economy, and (3) improving cooperation between interested parties.

The activities of the Banking Supervisory Authority in 2022

The BRSA took many important structural steps for the healthy functioning of the banking sector and the credit market in parallel with the developments in national and international markets in 2022.

On-site auditing process carried out by the BRSA is established so as to provide a risk-based, dynamic, efficient and forward looking supervision approach by taking into account the international best practices including the Core Principles for Effective Bank Supervision of Basel Banking Committee. The BRSA's supervisory guidelines were updated by taking into account the principles and rules published by international regulatory bodies and the recommendations in the Financial Sector Assessment Program (FSAP) report for 2022 prepared by the International Monetary Fund (IMF) and the World Bank. In this context, a new risk-focused supervisory methodology called "IDES Rating System" was developed by taking into account the European Banking Authority's (EBA) "Guidelines on Common Procedures and Methodologies on the Examination and Evaluation Process (IDES) and Stress Testing". Furthermore, a "Data Analytics Group" was established within the BRSA in order to use audit technologies and data analytics more intensively in the audit processes and outputs of the BRSA. In addition to these, "Guideline on Consideration of the Risks of Prevention of Laundering Proceeds of Crime, Financing of Terrorism and Proliferation of Weapons of Mass Destruction in on-site audits carried out by BRSA" was prepared in order to assess the level of compliance with the legislation on prevention of laundering proceeds of crime, financing of terrorism and financing of proliferation of weapons of mass destruction.

The information systems audit of the institutions that fall under the authority of the BRSA is carried out by the personnel of the BRSA and independent audit firms. Within the framework of the Information Systems Audit Guide prepared by the BRSA's personnel for information systems audit activities, operating permits of 1 bank, 2 electronic money organization, 4 financing companies and 1 asset management company and 3 banks and special comprehensive audits were conducted for 3 banks.

Article 93, paragraph four of the Banking Law No. 5411, stipulates that the BRSA will use its authorities granted as per this law and other applicable legislation in line with the regulating procedures and special decisions and the BRSA is authorized to enact regulations and communiqués regarding the enforcement of this law. In line with the regulating function, efforts were made to amend the banking legislation to ensure compliance with EU and international banking rules and implementations including regulations about net stable funding ratio, large exposures, Basel III finalizing post-crisis reforms, climate related financial risks. In 2022, 4 Laws were amended, 2 new regulations and 1 communiqué were put into effect, 12 regulations and 4 communiqués were amended and 14 Board Decisions were taken. Immediately after the earthquake disaster centered in Kahramanmaraş, the BRSA rapidly implemented measures for the affected citizens and firms in order to alleviate the economic effects of the earthquake. In this context, the necessary regulations and instructions were immediately put into practice in order to change the maturities of vehicle and consumer loans and to provide grace periods, to provide flexibility in credit card limits and payments, to extend the valuation and reporting periods, to facilitate telephone banking services and to ensure the continuity of banking services.

Off-site supervision activities include monitoring banks and financial indicators and risks of banking industry, compliance with the relevant regulations, primarily the legal limits and analyzing them within the frame of macroeconomic developments and policies. In 2022, a total of 1.230 bank reports, including 32 bank oversight report, 599 legal limits reports and 599 monthly ratio reports were prepared as part of bank off-site supervision activities.

As part of establishment, operation and authorization procedures, the BRSA reviews, evaluates and concludes the applications filed by banks and non-bank financial institutions covered by the mandate of the BRSA, as well as independent audit, valuation and rating institutions on matters subject to permit pursuant to Banking Law and the applicable legislation. In 2022, 2 investment banks, 1 (digital) deposit bank, 3 (digital) participation banks, 3 financing companies, 2 asset management companies were granted establishment permits; 2 investment banks, 4 financing companies, 2 asset management companies, and 6 savings finance companies whose adaptation request was deemed appropriate were granted operating permits. In addition, 7 valuation institutions were authorized to perform valuations for banks, and 1 payment and electronic money institution was authorized to operate as an institution making agreements with member merchants.

The Financial Consumer Relations Department conducted works also in 2022 for the purpose of protecting the rights and raising awareness of financial consumers, who are considered as an important part of preserving financial stability and the complaint and application follow-up process was executed meticulously. Also, an audit methodology called Retail Banking Analysis and Rating Model (BAM) has been developed within the BRSA, and on-site audit activities were carried out in 5 banks in 2022 using the methodology in question.

The BRSA has made significant structural changes in digital financial services and digital banking activities. The "Regulation on the Operating Principles of Digital Banks and Service Model Banking", which was prepared to provide a legal infrastructure for digital banking activities in Turkey, entered into force in early 2022. The Regulation regulates the operating principles of branchless banks that provide services only through digital channels and the conditions for the provision of banking services as a service model to financial technology companies and other enterprises. As a matter of fact, 1 digital deposit bank and 3 digital participation banks were granted establishment permits in 2022, and two of the participation banks granted establishment permits were also granted operating permits in 2023.

2022 was a year in which the issue of sustainable finance came to the forefront for BRSA due to the first implementation period of the "Sustainable Banking Strategic Plan (2022-2025)", the inclusion of climate-related financial risks and green finance in the scope of FSAP-Turkey studies, and the intense agenda caused by the 27th United Nations Conference of the Parties. Within the scope of the "Sustainable Banking Strategic Plan (2022-2025)", two pilot studies were conducted in the first half of 2022 on transition risks and physical risks in order to effectively analyze and manage climate-related risks, which is one of the main strategic objectives of the Plan. A "Sustainable Banking" page was created on the BRSA's website in 2022 in order to share the methods, findings and results of these studies as well as other studies carried out by the BRSA in the field of sustainable banking in recent years with national and international stakeholders and the public in a more effective and comprehensive manner and to increase transparency. Again, in accordance with the "Sustainable Banking Strategic Plan (2022-2025)", "Sustainable Banking Working Group" and "Green Asset

Ratio Sub-Working Group" were established at the beginning of 2022 in cooperation with our BRSA and BAT. The working group has prepared a draft methodology to be used as a basis for the calculation of the ratio of green assets to total assets in banks' balance sheets and to be used as an interim taxonomy until the national taxonomy enters into force.

International activities of the authority

In order to improve the effectiveness of the consolidated supervision, the BRSA collaborates with foreign supervisory authorities. As stipulated in Article 98 of the Banking Law, the BRSA cooperates and exchanges information with these institutions for the harmonization of policies and regulations within the framework of bilateral memorandum of understanding. As of the end of 2022, a memorandum of understanding was signed with 40 authorities from 36 countries. In 2022, within the framework of these memorandums of understanding, information requests from foreign supervisory authorities were responded by coordinating with the relevant units of the BRSA.

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 FSAP studies, which are carried out every five years by the IMF and the World Bank due to Turkey's G20 membership and which were initiated for the fourth time in 2021, were completed in 2022.Within the framework of the Bilateral Technical Cooperation Agreement signed between the BRSA and the World Bank in 2013, our relations with the World Bank continue in a positive way. In this regard, contributions were made to the departments that fall under the BRSA's scope of duty in the meetings and joint works carried out under the coordination of the Ministry of Treasury and Finance. Within the framework of studies carried out within the OECD, the BRSA participated in the meetings in which it has an interest and the opinion on the issues of the reports prepared by the OECD within the scope of the BRSA's areas of responsibility was presented.

In order to contribute to the Progress Report prepared by the EU Commission, the BRSA contributed to the studies carried out by the said institution regarding the developments in the chapters within the scope of the BRSA's field and banking sector related issues. The BRSA contributed to the works of the Board as a full member of the IFSB and participated in the meetings. 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).

Cooperation with other supervisory bodies in the country

Based on the Article 98 of Banking Law, the BRSA has exchanged views and shared information with the Presidency Strategy and Budget Office, Ministry of Treasury and Finance, the SDIF (Savings Deposit Insurance Fund) and the CBRT (Central Bank of the Republic of Turkey) in order to ensure coordination and cooperation in executing monetary, credit and banking policies.

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.

Financial Stability Committee (FSC) consists of the Deputy Minister of Treasury and Finance, chairmen of the CBRT, the BRSA, the Capital Market Board, the SDIF, Insurance and Private Pension Regulation and Supervision Agency, Presidency of Strategy and Budget and chaired by Treasury and Finance Minister. The content of the FSC was revised in May 2021. 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 2022 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution[2]	2020	2021	2022
Commercial banks	40	40	41
Branches of foreign credit institutions	5	5	5
Cooperative banks	0	0	0
Banking sector, total:	**54**	**55**	**57**

Total assets of banking sector (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	5.718,6	8.600,1	13.528,3
Branches of foreign credit institutions	22,7	38,0	35,9
Cooperative banks	-	-	-
Banking sector, total:	**6.106,4**	**9.215,5**	**14.347,4**
y/y change (in %)	**36**	**50,9**	**55,7**

Ownership structure of banks on the basis of assets total

Item	2020	2021	2022
Public sector ownership	45,30	43,42	45,55
Domestic ownership total	74,95	74,14	75,10
Foreign ownership	25,05	25,86	24,90
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2022

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	37,76	55,57	823,65
Branches of foreign credit institutions	0,2	0,3	0,05
Cooperative banks	-	-	-
Banking sector, total:	**37,76**	**55,57**	**831,45**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2020	2021	2022
Commercial banks	11,14	15,18	51,23
Cooperative banks	-	-	-
Banking sector, total:	**11,36**	**15,48**	**49,69**

2 There are no cooperative banks in Turkey. Commercial banks are defined as deposit taking institutions, therefore investment & development banks are excluded from Commercial Banks. We have, as of year-end 2022, 16 investment & development banks. Branches of foreign credit institutions are also included in commercial banks.

Distribution of market shares in balance sheet total (%)

Type of financial institution	2020	2021	2022
Commercial banks	93,6	93,3	91,6
Branches of foreign credit institutions	0,4	0,4	0,3
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2020	2021	2022
Receivables			
Financial sector	3,45	5,16	3,89
Nonfinancial sector	68,39	66,75	66,89
Government sector	21,66	22,56	22,51
Other assets	6,50	5,53	6,71
Liabilites			
Financial sector	13,4	13,8	12,7
Nonfinancial sector	63,2	63,8	67,7
Government sector	7,9	9,4	6,8
Other liabilities	5,7	5,2	3,0
Capital	**9,8**	**7,7**	**9,8**

Capital adequacy ratio of banks

Type of financial institution	2020	2021	2022
Commercial banks	18,3	18,1	19,3
Cooperative banks	-	-	-
Banking sector, total:	**18,7**	**18,4**	**19,5**

Asset portfolio quality of the banking sector[3] (share of impaired receivables / share of non-performing loans)

Asset classification	2020	2021	2022
Non-financial sector, including			
- households	2,0	2,4	1,9
- corporate[4]	4,7	3,4	2,2

3 NPL Ratio
4 Including SME

The structure of deposits and loans of the banking sector in 2022 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:		
Households	56,5	20,3
Corporate	38,9	78,3
Government sector	4,6	1,4
Financial sector (excluding banks)	-	-
Total	**100.0**	**100.0**

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

P&L account	2020	2021	2022
Interest income	423,5	641,5	1.403,2
Interest expenses	208,7	376,0	638,9
Net interest income	214,8	265,5	764,3
Net fee and commission income	40,3	70,0	144,5
Other (not specified above) operating income (net)	-24,5	-6,3	86,1
Gross income	526,0	801,5	1.714,9
Administration costs	40,3	48,2	88,9
Depreciation	7,6	8,7	12,0
Provisions	52,7	70,4	135,6
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	17,2	29,9	91,2
Profit (loss) before tax	75,9	118,5	574,1
Net profit (loss)	58,5	93,0	433,5

Total own funds in 2022[5] (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	81,7	64,7	70,0	11,6	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**87,3**	**69,5**	**75,3**	**12,0**	

[5] Billion Euros

Macroeconomic environment in the country.

In 2022, the economy of Ukraine was hit hard by the full-scale war unleashed by the russian federation. Real GDP fell by 29.1% in 2022. The consequences of war: the occupation of certain territories, the destruction of infrastructure and production facilities, the breakdown of logistics chains, the reduction of investments and weak consumer demand, including due to active migration, as well as significantly lower harvest than a year ago, were the main reasons for the deepest recession in the history of the country. At the end of the year, a series of large-scale russian attacks on the energy infrastructure led to a significant shortage of electricity and had an additional negative impact on economic activity.

However, businesses and the population relatively quickly adapted to the challenges of wartime. After the shock of the first months of the war, Ukraine's economy gradually started to recover with the adjustment of logistics, the relocation of enterprises, the expansion of online services, and the reorientation of a number of activities to military needs. The liberation of some of the occupied territories and the return of a part of forced migrants to their places of permanent residence, and the opening of the "grain corridor" also supported the revival of economic activity. A significant portion of businesses has also adapted to electricity deficit by purchasing emergency power supply equipment.

The labor market also experienced a deep recession: the demand and supply of labor force decreased. The closure of enterprises and the reduction in economic activity made the unemployment level surge and pushed the households' labor income to decline, which was only partially compensated by payments to the military and social assistance. During the year, the labor market conditions were significantly affected by the large number of internally displaced people and migrants to other countries.

Consumer prices in Ukraine were under strong upward pressure throughout 2022. Headline consumer inflation accelerated from the start of the full-scale war (to 26.6% yoy in December 2022). This was primarily driven by the effects of russian aggression, such as the destruction of enterprises and infrastructure and disruption of production and supply chains, which resulted in a sharp rise in business costs and a decline in supply. Moreover, business costs grew on the back of russia's energy terror. Pressure from global inflation was also strong. However, inflation remained under control in Ukraine. Both headline inflation and inflation expectations had stabilized by the end of the year. These were driven by the fixing of the hryvnia exchange rate, the strengthening of the exchange rate on the cash market, utility tariffs remaining unchanged, monetary financing of the budget decreasing, and monetary policy tightening. The de-occupation of territories, an increase in supply of food products, and weak consumer demand helped contain inflation pressures as well.

In 2022, the current account recorded a surplus of USD 7.9 billion (4.9% of GDP), while in 2021 there was a deficit (USD 3.9 billion or 1.9% of GDP). The surplus was mainly achieved thank to substantial official financing in the form of grants, a ban on dividend payments, and lower reinvested income. In addition, remittances remained resilient to the crisis, declining by only 10.8% to USD 12.5 billion. This was attributed to the integration of forced migrants into the labor markets of the host countries. However, imports of travel services surged due to large expenses of Ukrainian migrants abroad. Coupled with the subdued services exports, this resulted in a non-typical trade in services deficit, reaching USD 11 billion (compared to a surplus of USD 4 bn in 2021). The merchandise trade deficit also widened significantly (to USD 14.7 billion from USD 6.6 billion in 2021). The decline in exports of goods was substantial (by 35.2%) due to the blockade of seaports, the destruction of production facilities, transport, and energy infrastructure. Meanwhile, merchandise imports experienced a more moderate decline (by 20.4%) given its lower reliance on maritime transport, a recovery in domestic demand, and higher energy prices.

In 2022, an outflow of USD 10.9 billion was registered under the financial account. russia's full-scale invasion resulted in accelerated capital outflows from the private sector (USD 24.1 billion). This was mostly driven by the surge in assets under the trade credits, which reflected complicated logistics, as well as a growing amount of FX cash outside banks. However, the disbursement of USD 15.7 billion in loans (excluding IMF) from international partners helped partially compensate for these FX outflows and generated USD 13.2 billion in net inflows to the public sector.

Unprecedented international financial support in 2022 also stood behind the international reserves resilience in the face of challenges related to the full-scale war. The reserves declined moderately by only USD 2.4 billion over 2022 to USD 28.5 billion – the level sufficient to cover 3.8 months of future imports.

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

During 2022, four small banks left the market. Two of them, which had russian state capital, were removed from the market in February 2022 following russia’s full-scale invasion. At the end of 2022, 67 solvent banks were operating on the market. The share of state-owned banks increased by 3.9% pp in annual terms, bringing their portion of the sector’s net assets to 50.6%. The sector’s concentration increased.

Assets
In 2022, the net assets of solvent banks grew by 16.5% over the year, to UAH 2.354 trillion (45.3% of GDP). The banks continued to provide new loans even in wartime, but such lending has faced difficult conditions. Demand for corporate and retail loans weakened considerably. Therefore, for 2022, the solvent banks’ net hryvnia loans to businesses increased only by 0.4% yoy, while their net FX corporate loans fell by 23.9% yoy in dollar terms. The corporate loan portfolio rose primarily at state-owned banks, mostly through lending to agricultural businesses and predominantly under state support programs.

The volume of the net hryvnia retail loan portfolio fell by 32.7% yoy, primarily in foreign and private banks. That trend persisted since the start of the full-scale war: weak new lending was not offsetting the repayment and write-offs of old loans.

The trend towards a fall in the NPL ratio that began in 2018 was interrupted by russia’s full-scale invasion of Ukraine. Overall, the share of NPLs has grown by 8.1 pp, to 38.1% since the start of the year. The indicator has deteriorated by over 11 pp since the start of russia’s full-scale invasion of Ukraine. The NPL ratio for retail loans increased the most in annual terms, by 13.6 pp.

Funding
Client deposits continue to be the major source of funding for banks. At the end of the year, their share increased to 87.9%.

Hryvnia retail deposits grew by 31.2% yoy. Thanks to salary projects and the concentration of social security payments, two major state-owned banks, Oschadbank and PrivatBank were in the lead in terms of this trend. Most of the new deposit inflows remain in current accounts. Meanwhile, the increase in deposit rates accelerated the growth in hryvnia term deposits at the end of the year. FX retail deposits declined by 4.6% over the year.

After the shock of the early weeks of the aggression, the growth in corporate deposits recovered rather quickly. Despite occasional outflows, hryvnia deposits grew by 11.9% over 2022.

Interest Rates
In June of 2022, the NBU hiked the key policy rate to 25% per annum in response to accelerating inflation, and kept it at this level until the end of the year. Competing for client deposits, the banks raised interest rates on both retail and corporate deposits from the beginning of summer, and also worked on extending their

maturity at the end of the year. On average, interest rates on 12-month retail deposits rose to 12.7% per annum in December 2022, up from 9.2% per annum in December 2021.

In view of loan repayment holidays introduced after onset of russia's full-scale invasion of Ukraine, the interest rate on retail loans dropped almost by 10 pp. In H2, however, it stood at about 30% per annum – the market level observed before the start of full-scale war. The weighted average interest rate on hryvnia corporate loans were rising to cover the growing credit risk as well as driven by policy rate hikes. Thus, it increased over the year to 20% per annum in December 2022 – up from 10.4% in December 2021.

Financial Results and Capital

Despite significant provisions and the loss recorded in H1 (for the first time in five years), the sector made a profit of UAH 24.7 billion in 2022 (a third of that in 2021). Twenty one institutions, including two state-owned banks, ended the year with losses. Their combined loss totaled UAH 20.8 billion.

Most banks maintained high operational efficiency. The sector retained operational profitability even in H1. Net interest income grew in 2022. Growth picked up in H2, reaching 28.9% yoy by the end of the year.

The banks increased their interest income from corporate lending, as well as from investments in securities, including into high-yield NBU certificates of deposit, while income from retail lending was in decline. The increase in funding costs was moderate thanks to the substantial supply of liquidity. So the net interest margin increased.

The banks' fee and commission income fell sharply in the first few months of full-scale war. Later, the security situation improved and transaction volumes started to rise, the banks' fee and commission income recovered. Over the year, fee and commission income declined by 13.5% yoy. The cost-to-income ratio (CIR) in 2022 declined to 41.3%, down from 49.8% in 2021. Overall, 61 banks finished the year with positive operating profitability. For the whole year, the banks put away UAH 118.8 billion in provisions, the bulk of them after the onset of the full-scale war.

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

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 Legalization (Laundering) of the Proceeds of Crime, Terrorist Financing, and Financing Proliferation of Weapons of Mass Destruction , On Consumer Lending, and On Simplifying Bank Reorganization and Capitalization Procedures.*

Following russia's full-scale invasion of Ukraine, Presidential Decree No. 64/2022, dated 24 February 2022 *On Declaring Martial Law* established the legal regime of martial law in Ukraine. Subsequently, parliament adopted a number of new laws and amended existing ones.

Among others, the Ukrainian parliament adopted Law of Ukraine No. 2120-IX *On Amendments to the Tax Code of Ukraine and Other Laws of Ukraine Regarding Legal Provisions in Effect under Martial Law*. This law:

1) amended the Law of Ukraine *On the National Bank of Ukraine*, which

- suspended, for the duration of martial law, the ban on purchasing securities from issuers, thus allowing the NBU to purchase, on the primary market, securities issued by Ukraine's Cabinet of Ministers, in order to provide additional financing to the state budget
- gave the NBU Board the power to take decisions to establish, during martial law or during a special period, a special regime of banking regulation and supervision, as well as state regulation and supervision over nonbank financial services markets, including taking corrective action against (imposing sanctions on) banks, nonbank financial institutions, and other entities that are regulated and supervised by the NBU, and to establish, during martial law or during a special period, a special regime for regulating the money market and conducting currency regulation and supervision;

2) suspended certain provisions of the Law of Ukraine On Banks and Banking where they:

- prohibit banks from issuing unsecured loans, establish the criteria for meeting required ratios, and require the NBU to declare a bank a problem or insolvent one (under certain conditions)
- set up a specific procedure for conducting financial monitoring (identifying the sources of funds) when a private individual deposits funds into their account.

The Ukrainian parliament also adopted the following important laws, which were drawn up with support from the NBU:

- Law of Ukraine No. 2463-IX *On Amendments to Certain Laws of Ukraine Regarding the Specifics of the Financial Sector's Operation Due to the Introduction of Martial Law in Ukraine*, which among other things, empowered the NBU to maintain, during a special period, state agencies' accounts intended for meeting the needs of the state in repelling the armed aggression against Ukraine, ending the armed conflict, and eliminating its consequences, as well as for handling charitable donations and humanitarian aid

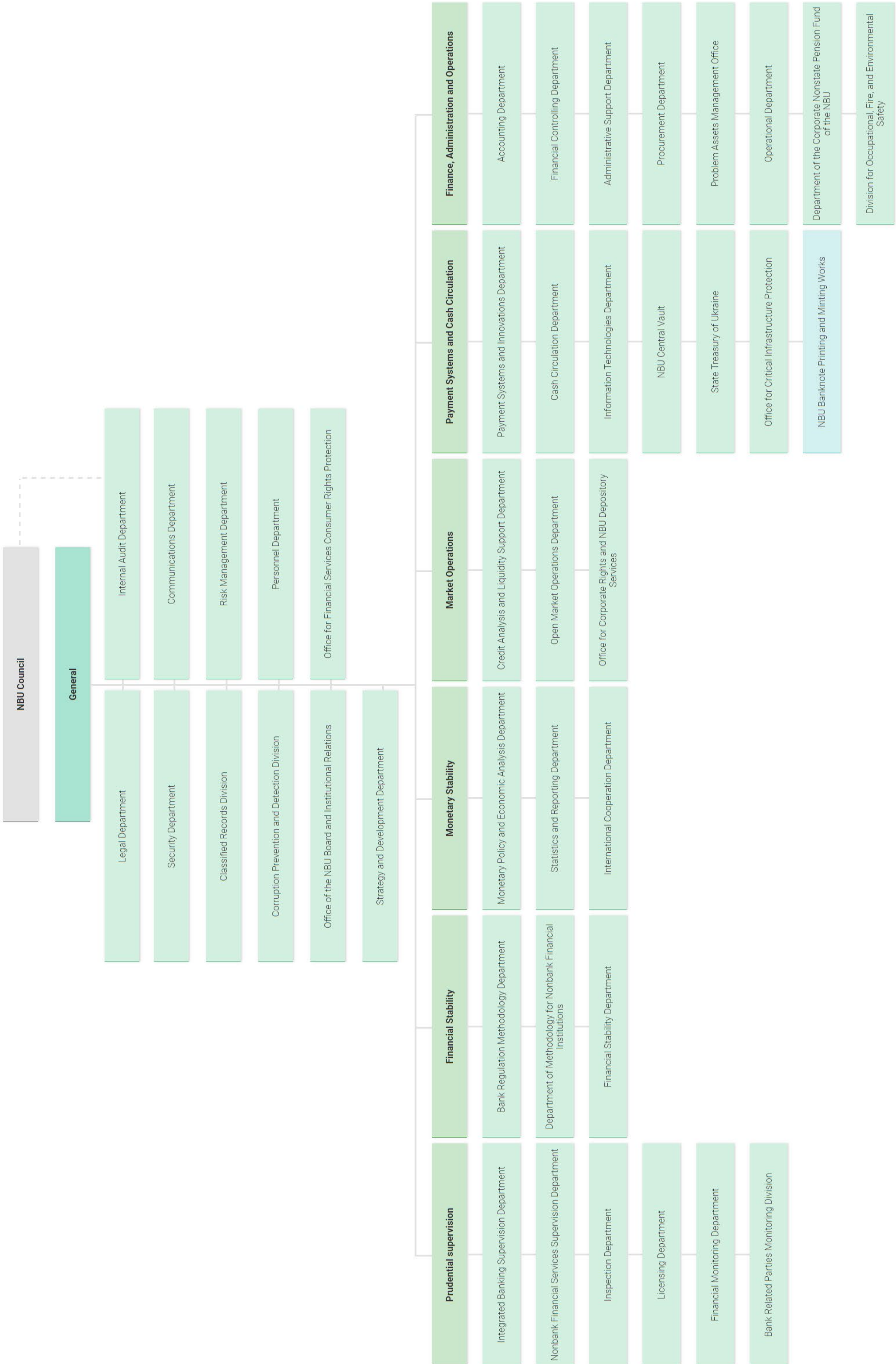
- Law of Ukraine No. 2643-IX *On Amendments to the Tax Code of Ukraine and Other Laws of Ukraine with Regard to the Specifics of Resolving Systemically Important Banks Under Martial Law*, which, for the duration of martial law in Ukraine, introduces an optimized procedure for resolving systemically important banks if these banks lose their liquidity

- Law of Ukraine No. 2075-IX dated 17 February 2022 *On Cloud Services*, in accordance to which Article 7 of the Law of Ukraine *On the National Bank of Ukraine* was supplemented with a provision with regard to the NBU's function of determining the procedure for applying cloud computing technology and providing cloud services by banks, by other entities that operate on the financial services markets and are subject to state regulation and supervision by the NBU, as well as by payment system operators and/or payment system participants and by payment service providers

- Law of Ukraine No. 2180-IX *On Amendments to Certain Laws of Ukraine On Ensuring the Stability of the Households Deposit Guarantee System*, which addresses the issue of restructuring the debt obligations of the Deposit Guarantee Fund and increases the state-guaranteed amount of deposits to UAH 600,000

- Law of Ukraine No. 2801-IX *On Amendments to Certain Laws of Ukraine Regarding the Entry into Agreements between Ukraine and the European Union on the Mutual Recognition of Qualified Electronic Trust Services and the Implementation of European Union Legislation in the Area of Electronic Identification*, which aims to bring national laws closer into line with European requirements for electronic identification and electronic trust services, as well as to improve state regulation of electronic trust services.

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Banking Supervisory Authority in 2022

In 2022, the NBU continued to implement the goals that are envisaged in the NBU's Strategy Until 2025 (the strategy) and aimed to ensure the sustainable development of the central bank and Ukraine's financial ecosystem.

At the same time, due to the declaration of martial law in Ukraine in February 2022 and the materialization of a number of risks, both for the financial sector and the regulator, the NBU reorganized its priority tasks within the framework of its existing strategic goals, with a view to meeting wartime needs.

What is more, in 2022, the NBU launched a complete overhaul of the strategy in order to factor in the risks that the banking system is facing under martial law and will face in the post-war period.

The activities of the Banking Supervisory Authority in 2022

Taking into account the realities of wartime, the NBU in 2022 amended its approaches to discharging its priority functions and applied a wide range of measures to support the banking sector.

More specifically, in 2022, the NBU performed banking supervision using the risk-based approach, in line with the Guidelines of the European Banking Authority on common procedures and methodologies for the Supervisory Review and Evaluation Process (SREP), and the recommendations of the Basel Committee on Banking Supervision, while also taking into account the specifics of regulating banks' activities under martial law.

In 2022, the NBU performed the following activities as part of its banking supervision mandate:

1) conducted SREP assessments for 67 banks, which determined its further strategy for banking supervision in 2023

   In view of the challenges Ukraine's financial sector was facing under martial law, in order to conduct a 2022 assessment the NBU Board took a decision that established the specifics of carrying out SREP assessments in 2022–2023. This decision was based on the key recommendations of the European Banking Authority document related to supervisory assessments during the pandemic, and, among other things, defines the most pressing bank risks and vulnerabilities that require increased attention

2) monitored the banks' current financial health and the performance indicators of banking groups on the basis of offsite supervision findings

3) conducted quality control checks over audit services related to the annual audit of banks' financial statements and consolidated financial statements by audit firms, considering the fact that at the legislative level the submission of audit reports had been postponed due to the imposition of martial law in Ukraine

4) supervised the banks' related party transactions and analyzed the terms and conditions of bank transactions, with a view to identifying those terms and conditions that are not market-driven.

In performing prudential regulation, in 2022, the NBU prioritized the measures that minimized the adverse impact of russia's invasion of Ukraine and safeguarded the stability of Ukraine's banking system.

To that end, the NBU Board set up temporary special rules governing the application of certain NBU's regulations by banks and banking groups while martial law is in effect.

At the same time, in order to prevent an increase in risks to the banking system's functioning under martial law, the NBU Board imposed certain prohibitions/restrictions/requirements with regard to the banks' operations. Among others, the NBU Board:

- banned related party transactions related to entering into new lending agreements and agreements on the provision of financial obligations
- imposed restrictions on those banks against which no corrective action has been taken for failing to meet required ratios because of the war. More specifically, the Board restricted the replacement of collateral for asset exposures if this replacement increased credit risk; repurchases and/or early repayments of the banks' own debt securities; repurchases of the banks' own-issued shares; payments of bonuses, financial incentives and other financial benefits to a bank's management and other high-ranking officials in the bank; purchases of nongovernment securities in one's own name; increases of capital investment in the fixed assets and intangible assets that are not used for conducting banking transactions; and the signing of borrowing agreements that envisage the advance payment of interest.
- required the banks to ensure the business continuity of Ukraine's banking system and households' access to banking services.

Taking into account amendments to Ukrainian laws and in order to help secure continued loan support for the Ukrainian economy, the NBU Board expanded the list of collateral that is used to measure credit risk, and provided more room for banks to apply simplified servicing-based approaches to measuring credit risk.

In the earliest days of the russian invasion, the NBU deployed a wide range of measures to support banks and borrowers as well as stabilize the financial sector. Among the most important were as follows:

- restricting cross-border capital movement and fixing the exchange rate.
- providing access to one-year unsecured refinancing. As liquidity risks eased, the conditions for taking out refinancing loans were clarified, and the instrument ultimately ceased to be used due to lack of demand.
- exempting banks from corrective actions for violating prudential standards, open currency position limits, and deadlines for the filing of statistical reports – if this was a result of the russian aggression.
- forbidding the banks to distribute capital, including through dividend payments
- cancelling 2022 stress-testing and postponing the imposition of a number of new regulatory requirements, including suspending the plans to activate capital buffers, increase risk weights for FX domestic government debt securities and the NSFR requirement to 100% as previously scheduled (the latter was reimposed in April 2023); temporarily easing the requirements for managing impaired assets; suspending the requirements for regular updates of recovery plans and the revaluation and verification of collateral.
- simplifying a number of operational requirements, including temporarily easing of reporting requirements.

International activities of the authority

In 2022 the central bank's international activities were focused on measures that helped:

- initiate the provision of assistance by Ukraine's international partners in the wake of russia's full-scale invasion of Ukraine
- isolate russia in order to narrow its opportunities to finance the criminal war against Ukraine
- Ukraine obtain the status of candidate for EU membership
- develop Ukraine's financial sector and strengthen the NBU's institutional capacity as a regulator.

Despite the war, the NBU continued to actively work together with international financial organizations, such as the IMF, World Bank Group organizations, the EBRD, and the EIB. The result of this cooperation was the rapid launch by these organizations of projects and programs to support the Ukrainian economy, Ukraine's financial sector, state budget and population.

The program of cooperation with the IMF remained the NBU's priority in 2022. Because of the russian invasion, Ukraine asked the IMF to terminate the current Stand-By Arrangement and allocate USD 1.4 billion in emergency financial aid to Ukraine under the Rapid Financing Instrument. The IMF Executive Board made a decision to that effect on 9 March 2022.

The NBU implemented a range of measures to increase russia's isolation and block its operations on the international arena. The NBU successfully communicated the need to suspend or terminate russia's membership of those organizations of which the central bank itself is also a member. The NBU also sent requests in that regard to other leading international financial organizations, and received assurances of support for Ukraine and condemnations of russian aggression.

The NBU was also engaged in activities within the IBRD project "Supplemental Loan For Second Economic Recovery Development Policy Loan – SL ER DPL (FREE Ukraine)" with the aim of providing assistance to the Government of Ukraine in covering an unforeseen financial deficit associated with the increase in geopolitical tension, escalation at the borders with Ukraine and limited access to international capital markets.

In 2022 the NBU continued to fulfill its obligations on the EU-Ukraine Association Agreement implementation, focusing on the harmonization of national laws with EU acquis in the areas of banking regulation and supervision, AML/CFT, insurance and the operation of payment systems.

The year 2022 became the year marked by a breakthrough on Ukraine's path towards EU accession and by the country's reaffirmed vision of its future as an integral part of the EU. According to a number of reforms and measures towards EU, including implemented by the NBU, Ukraine received the EU candidate-member status in 2022.

Ukraine's acquisition of EU candidacy status intensified cooperation with European Central Bank, European Commission, central banks of EU members and successfully established cooperation with the European Banking Authority and the European Insurance and Occupational Pensions Authority.

Despite the military aggression from russia the NBU remained active in technical cooperation with IFIs, central banks and financial sector regulators from other countries.

Fruitful activities were continued by the NBU within the Twinning project "Strengthening the NBU's Institutional and Regulatory Capacity to Implement the EU-Ukraine Association Agreement" with the Central Banks of Poland and Lithuania.

One measure taken in response to the russian invasion of Ukraine was to search for a mechanism to support Ukrainian citizens who were suddenly forced to seek temporary refuge abroad. To enable them to exchange their hryvnia cash for other currency so that they could meet urgent needs, the NBU concluded hryvnia exchange agreements with the central banks of Poland, Germany, Belgium, the Netherlands, Italy, Latvia, Malta, Lithuania, Sweden, and Switzerland. The agreements allowed these displaced Ukrainians to exchange hryvnias at the NBU's fixed exchange rate, within the limits set by these agreements. Several months into the invasion, the financial market stabilized, and the parties agreed to roll back the exchange transactions under the agreements by the end of 2022.

Cooperation with other supervisory bodies in the country

As a banking supervisor, the NBU cooperated with the Deposit Guarantee Fund and the Audit Chamber of Ukraine, as well as with the other financial regulators under the Financial Stability Council.

Other relevant information and developments in 2022

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 2022 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	73	71	67
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**73**	**71**	**67**

Total assets of banking sector (at year-end)

Type of financial institution	2020	2021	2022
Commercial banks	2 205 915	2 358 324	2 716 794
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**2 205 915**	**2 358 324**	**2 716 794**
y/y change (in %)	**11.3**	**6.9**	**15.2**

Ownership structure of banks on the basis of assets total

Item	2020	2021	2022
Public sector ownership	55.88	49.75	52.95
Domestic ownership total	28.88	29.63	27.82
Foreign ownership	15.24	20.62	19.23
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2022

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	47.56	59.84	0.102
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**47.56**	**59.84**	**0.102**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2020	2021	2022
Commercial banks	19.96	35.14	11.02
Cooperative banks	-	-	-
Banking sector, total:	**19.22**	**35.09**	**11.02**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2020	2021	2022
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)

	2019	2020	2021
Receivables	100	100	100
Financial sector	21.42	19.08	20.59
Nonfinancial sector	38.35	32.99	31.88
Government sector	19.31	28.18	27.27
Other assets	20.92	19.75	20.26
Liabilites	100	100	100
Financial sector	28.99	24.88	21.76
Nonfinancial sector	22.43	25.05	26.97
Government sector	1.28	0.94	0.86
Other liabilities	35.71	38.35	38.46
Capital	**11.59**	**10.78**	**11.95**

Capital adequacy ratio of banks

Type of financial institution	2020	2021	2022
Commercial banks	21.98	18.01	19.68
Cooperative banks	-	-	-
Banking sector, total:	**21.98**	**18.01**	**19.68**

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

Asset classification	2020	2021	2022
Non-financial sector, including	37.7	29.0	31.7
- households	8.8	7.8	7.7
- corporate	28.9	21.2	24.0

The structure of deposits and loans of the banking sector in 2021 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	95.9	96.5
Households	53.8	24.4
Corporate	42.1	72.1
Government sector	1.0	2.6
Financial sector (excluding banks)	3.1	0.9
Total	**100.0**	**100.0**

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

P&L account	2020	2021	2022
Interest income	147 743	168 746	217 053
Interest expenses	62 895	51 097	65 358
Net interest income	84 848	117 648	151 695
Net fee and commission income	46 508	57 977	50 173
Other (not specified above) operating income (net)	6 813	7 488	8 126
Gross income	250 171	273 863	357 549
Administration costs	69 437	78 293	82 434
Depreciation	7 553	8 477	8 152
Provisions	31 037	3 448	121 204
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	-	-	-
Profit (loss) before tax	43 537	83 740	29 277
Net profit (loss)	39 727	77 376	21 921

Total own funds in 2022 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	5 419	-	3 614	1 815	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**5 419**	**-**	**3 614**	**1 815**	**-**