BOSNIA AND HERZEGOVINA
FEDERATION OF BOSNIA AND HERZEGOVINA
BANKING AGENCY OF THE FEDERATION OF BOSNIA AND HERZEGOVINA

I N F O R M A T I O N

ON THE BANKING SYSTEM
OF THE FEDERATION OF BOSNIA AND HERZEGOVINA
30. 09. 2014

Sarajevo, November 2014

The Banking Agency of the Federation of B&H, as a regulatory institution conducting banking supervision, has prepared the Information on the Banking System of the Federation of B&H (as of 30.09.2014) based on financial statements and other information and data provided by banks. This also encompasses results and information obtained during on-site examinations in banks and off-site financial analyses in the Agency.

I INTRODUCTION

For quite some time, the operations of the banking sector in the Federation of B&H and B&H have been characterised by the effects of the economic and financial crisis, which also impacts most business segments of banks. The main characteristics of business operations in the first three quarters of 2014 were: the slight growth and total development of the banking sector, the continuous decrease in foreign sources of funding in the form of credit lines, credit activities recorded a slight increase, and there is still a negative trend in the loan portfolio quality, which caused the key asset quality indicators to deteriorate as a result of past due receivables and non-performing loans. On the other hand, an increase in the deposit base was recorded, primarily in terms of savings, and the liquidity, profitability and capitalisation of the banking sector can be assessed as satisfactory, and it can thus be concluded that the banking sector continues to be stable and safe.

As of 30.09.2014, there were 17 licensed banks in the Federation of B&H, and the headcount in banks of the Federation of B&H stood at 7 006, down by 0.6% or 45 employees compared to the end of 2013.

The balance sheet total of the banking sector as of the first three quarters of 2014 amounted to KM 15.9 billion, and is up by 3% or KM 433 million compared to the end of 2013. Even though the balance sheet total was down in the first quarter of 2014 compared to the end of 2013, in the second and third quarter, it was up by 4.2% or KM 642 million compared to the end of the first quarter of 2014.

Asset structure underwent minor changes related to two key assets items: decrease in loan shares from 70.3% to 70.0% and in cash funds from 28.6% to 28.1%.

As of 30.09.2014, cash funds increased slightly by 1% or KM 40 million and amounted to KM 4.5 billion. The recorded increase in cash funds is primarily the result of the increase in deposits.

Loans recorded an increase of 2.4% or KM 260 million and amounted to KM 11.1 billion as of the end of the third quarter of 2014. Total non-performing loans amounted to KM 1.75 billion as of 30.09.2014, up by 10.3% or KM 164 million compared to the end of 2013. The share of non-performing loans in total loans rose from 14.6%, to which it amounted at the end of 2013, to 15.8% as of 30.09.2014. Out of total corporate loans, 21.2% refer to non-performing loans, while their share in retail loans is 9.9%.

In the banks' liabilities structure, deposits in the amount of KM 11.9 billion and with a share of 75% are still a dominant source of funding for banks in the Federation of B&H. as of 30.09.2014, total deposits were up by 3% or KM 351 million compared to the end of 2013. Savings deposits (being the key segment of the deposit and financial potential of banks) were up by 5% or KM 306 million in the same period and amounted to KM 6.5 billion as of 30.09.2014.

Loan commitments in the amount of KM 981 million were down by 5.6% or KM 58 million in the first three quarters of 2014 and their share in the liabilities structure was down from 6.7%, to which it amounted at the end of 2013, to 6.2% as of 30.09.2014. Over the past five years, due to the impact of the financial and economic crisis, banks incurred a much lower level of foreign debt, while the payment of receivables due decreased these sources by more than 55% or KM 1.2 billion (at the end of 2008, they amounted to KM 2.18 billion). Sources of funding of banks in the Federation of B&H (loans taken, deposits and subordinated debt) were reduced by 66% or KM 2.3 billion by their own goups (parent banks and other group members) in the same period. Evidently, the financial support of parent banking groups was significantly reduced, so that credit growth in the Federation of B&H will probably be based on the growth of local sources of funding in the coming period.

In the first three quarters of 2014, total capital was up by 5% or KM 122 million, largely prompted by current profit, but also as a result of the increase in share capital on the basis of recapitalisation. As of 30.09.2014, it amounted to KM 2.43 billion.

As of 30.09.2014, regulatory capital amounted to KM 2.3 billion and is slightly down compared to the end of 2013.

One of the key indicators of the banks' capital strength and adequacy is the capital adequacy ratio. At the banking sector level, this ratio amounted to 17.2% as of 30.09.2014, which is lower by 0.8 percentage points compared to the end of 2013. However, this is still significantly above the legal minimum (12%) and represents a satisfactory capitalisation rate of the overall system.

As of 30.09.2014, a positive financial result in the amount of KM 124 million was recorded at the level of the banking system in the Federation of B&H. A positive financial result in the amount of KM 153.4 million was recorded by 15 banks, while two banks recorded a loss in the amount of KM 29.4 million.

II BUSINESS PERFORMANCE OF BANKS IN THE FEDERATION OF B&H

1. BANKING SECTOR STRUCTURE

1.1. Status, Number and Network of Branches

As of 30.09.2014, there were 17 banks with a banking licence in the Federation of B&H. The number of banks is the same as on 31.12.2013. A special law from 01.07.2008 regulates the establishment and operations of the Development Bank of the FB&H Sarajevo, a legal successor of the Investment Bank of the FB&H dd Sarajevo.

In the first nine months of 2014, there was no major expansion of the banks' network of organisational units, chiefly attributable to the financial crisis and the reduced volume of the bans' business activities.

Banks have reorganised their networks of organisational units by changing the organisational form, membership or address of their organisational parts. This also entailed mergers and closings of some organisational parts, all for the purpose of business rationalisation and operating costs reduction. There was a total of 48 such changes among banks in the Federation of B&H (41 changes on the territory of the Federation of B&H, six changes on the territory of Republika Srpska and one in Brčko District): 11 new organisational units were established, 18 were closed and 19 underwent changes.

Subsequent to such changes, banks in the Federation of B&H had a total of 571 organisational units as of 30.09.2014, down by 1.6% compared to 31.12.2013.

There were five banks from Republika Srpska with 33 organisational units in the Federation of B&H, which is an increase of 22.2% compared to 31.12.2013 (27).

As of 30.09.2014, seven banks from the Federation of B&H had 48 organisational units in Republika Srpska, and nine banks had 12 organisational units in Brčko District.

As of 30.09.2014, all banks had licences to effect interbank transactions within the domestic payment system, and 16 banks had secured deposits.

1.2. Ownership Structure

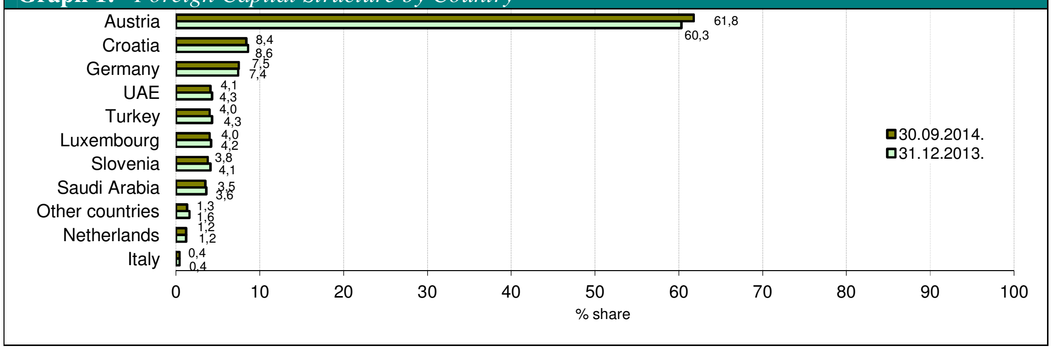
The ownership structure of banks[1] as of 30.09.2014, assessed on the basis of available information and reviews conducted in the banks themselves, is as follows:

- In private or mostly private ownership 16 banks (94.1%)
- In state or mostly state ownership[2] 1 bank (5.9%)

Out of the 16 banks in mostly private ownership, six banks are in majority ownership of local legal entities and natural persons (residents), while 10 banks are in majority foreign ownership.

If observed solely from the perspective of foreign capital, using the criterion of the shareholders' home country, the conditions as of 30.09.2014 changed only slightly compared to those as of 31.12.2013: the largest share of foreign capital in the amount of 61.8% refers to shareholders from Austria, followed by shareholders from Croatia with 8.4% and Germany with 7.5%. Other countries hold individual shares below 5%.

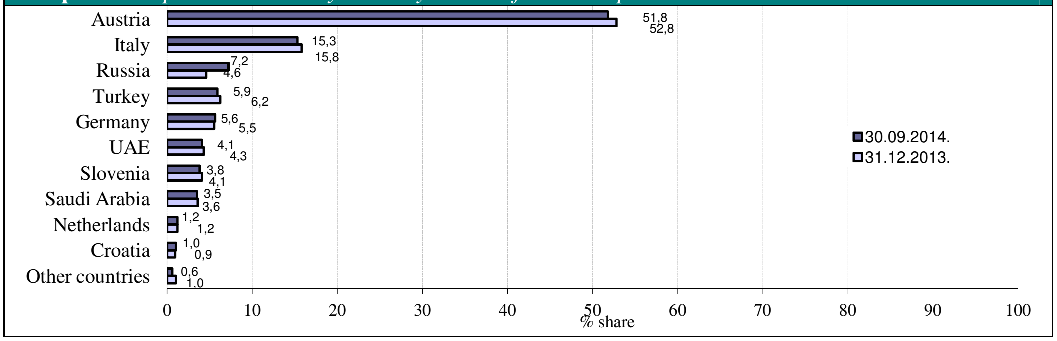
Graph 1: *Foreign Capital Structure by Country*



However, if taking into account capital relations, the structure of foreign capital can also be observed using the criterion of the home country of the parent bank or parent group having majority ownership (direct or indirect via group members) of banks in the Federation of B&H. According to this criterion, the conditions also changed only slightly compared to the end of 2013: the share of banking groups and banks from Austria amounts to 51.8%, followed by Italian banks with a share of 15.3%, while Russia's share[3] in one bank in the Federation of B&H, following recapitalisation in the second quarter, increased from 4.6% to 7.2%, which is the most significant change in the reporting period. Other countries held individual shares below 6%.

[1] The criterion for this particular bank classification is ownership of share capital in banks.
[2] State ownership refers to domestic state capital of B&H.
[3] In 2012, the Russian bank Sberbank purchased Volksbank International from Austria, which also owned Volksbank BH d.d. Sarajevo.

Graph 2: *Capital Structure by Country – Seat of the Group* [4]



The ownership structure may also be observed from the aspect of financial ratios, i.e. according to the total capital value.[5]

-in KM 000-

Table 1: *Ownership Structure by Total Capital*

BANKS	31.12.2012		31.12.2013		30.09.2014		INDEX	
1	2		3		4		5 (3/2)	6 (4/3)
State-owned banks	51 114	2%	51 618	2%	51 711	2%	101	100
Private banks	2 166 261	98%	2 256 327	98%	2 378 406	98%	105	105
TOTAL	2 217 375	100%	2 307 945	100%	2 430 117	100%	105	105

In the first nine months of 2014, total capital was up by 5% or KM 122 million, largely based on current profit and recapitalisation in the amount of KM 41 million in three banks.

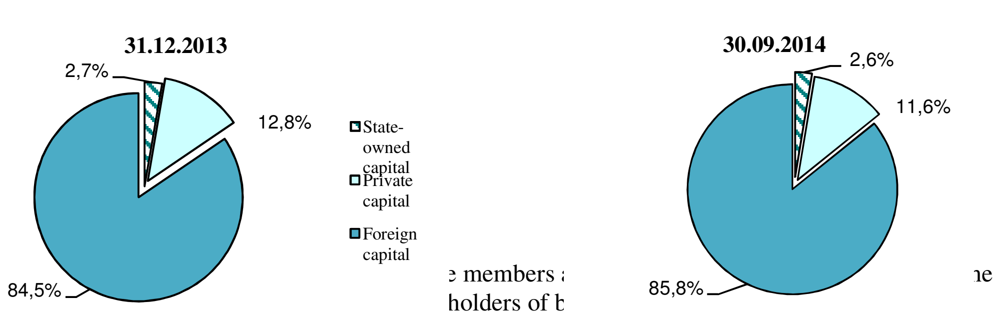
If observed from the perspective of the share of state-owned, private and foreign capital in the banks' share capital, it results in a more detailed picture of the capital ownership structure of banks in the Federation of B&H.

- in KM 000-

Table 2: *Ownership Structure by Share of State-owned, Private and Foreign Capital*

SHARE CAPITAL	31.12.2012		31.12.2013		30.09.2014		INDEX	
	Amount	Share %	Amount	Share %	Amount	Share %	4/2	6/4
1	2	3	4	5	6	7	8	9
State-owned capital	33 096	2.8	32 364	2.7	32 364	2.6	98	100
Private capital (residents)	164 603	13.7	153 549	12.8	142 188	11.6	93	93
Foreign capital (non-residents)	1 003 907	83.5	1 017 822	84.5	1 054 740	85.8	101	104
TOTAL	1 201 606	100.0	1 203 735	100.0	1 229 292	100.0	100	102

Graph 3: *Ownership Structure (by Share Capital)*



[5] According to the balance sheet prepared on the basis of the FBA model: starting from 31.12.2011, loan loss provisions formed from profit were also included in total capital (in addition to share capital, issue premiums, retained profit and reserves and other capital (the financial resut of the current period)).

In the first nine months of 2014, the share capital of banks in the Federation of B&H was up by KM 25.6 million or 2.1% compared to 31.12.2013. The share capital rose by KM 4.9 million in one bank after the Agency withdrew its order for the exclusion of the aforementioned amount from capital as well as following recapitalisation in the amount of KM 42.4 million in four banks (KM 41 million from external sources and KM 1.4 million by technical emission – from reserves), and was reduced by KM 21.7 million following the reduction of the nominal value of a share in one bank in order to cover losses.

The analysis of the ownership structure of banks from the aspect of the share capital shows changes and trends in the banking system of the Federation of B&H, namely changes in the ownership structure, in a more detailed manner.

The share of state-owned capital in total share capital amounts to 2.6% as of 30.09.2014 and is lower by 0.1 percentage point compared to 31.12.2013.

The share of private capital (of residents) in total share capital amounts to 11.6% and is down by 1.2 percentage points compared to 31.12.2013, according to relative indicators. According to absolute indicators, the share is down by KM 11.4 million net due to the revocation of the Agency's order for the exclusion of the amount of KM 4.9 million from one bank's capital, recapitalisation in the amount of KM 3 million in two banks, the reduction by KM 20.2 million following the reduction of the nominal value of a share in one bank in order to cover losses as well as due to the increase in the share of residents after trade in the amount of KM 1 million net.

The share of private capital (of non-residents) in total share capital increased by 1.3 percentage points (from 84.5% to 85.8%), according to relative indicators. According to absolute indicators, the share is up by KM 39.1 million due to recapitalisation, and down by KM 1 million net due to the change and reduction of the share of non-residents after trade.

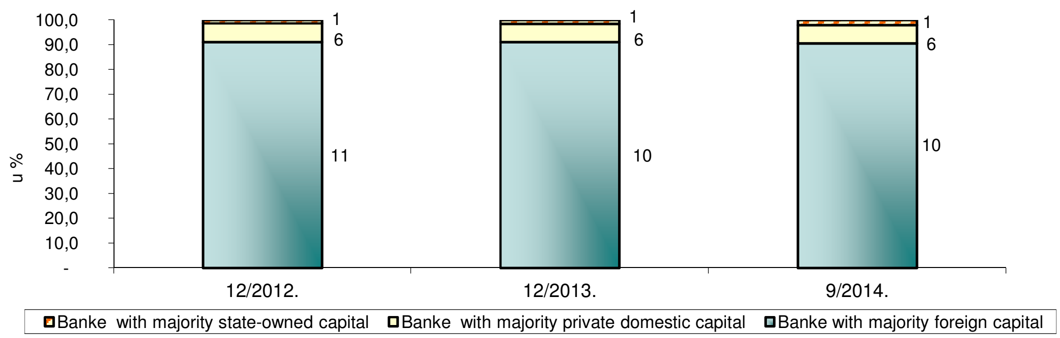
The market share of banks in majority foreign ownership as of 30.09.2014 stood at a high 90.5%, as was the case at the end of 2013, while banks with majority domestic private capital had a 7.4% share and banks with majority state-owned capital a 2.1% share.

- in % -

Table 3: *Market Shares of Banks by Ownership Type (Majority Capital)*

BANKS	31.12.2012			31.12.2013			30.09.2014		
	No. of banks	Share in total capital	Share in total assets	No. of banks	Share in total capital	Share in total assets	No. of banks	Share in total capital	Share in total assets
1	2	3	4	5	6	7	8	9	10
Banks with majority state-owned capital	1	2.3	1.4	1	2.2	1.6	1	2.1	2.1
Banks with majority private domestic capital	6	10.5	7.6	6	9.2	7.4	6	8.0	7.4
Banks with majority foreign capital	11	87.2	91.0	10	88.6	91.0	10	90.0	90.5
TOTAL	18	100.0	100.0	17	100.0	100.0	17	100.0	100.0

Graph 4: *Market Shares by Ownership Type*



1.3. Human Resources

As of 30.09.2014, banks in the Federation of B&H had a headcount of 7 006 employees, 3% of which were employed in banks with majority state-owned capital and 97% of which were employed in private banks.

Table 4: *Employees in Banks of the Federation of B&H*

B A N K S	HEADCOUNT						INDEX	
	31.12.2012		31.12.2013		30.09.2014		3/2	4/3
1	2		3		4		5	6
State-owned banks	183	3%	200	3%	200	3%	109	100
Private banks	6 947	97%	6 851	97%	6 806	97%	99	99
TOTAL	7 130	100%	7 051	100%	7 006	100%	99	99
Number of banks	18		17		17		94	100

Table 5: *Qualification Structure of Employees*

QUALIFICATION LEVEL	HEADCOUNT						INDEX	
	31.12.2012		31.12.2013		30.09.2014		4/2	6/4
1	2	3	4	5	6	7	8	9
University degree	3 479	48.8%	3 673	52.1%	3 757	53.6%	106	102
Two-year post-secondary school qualification	667	9.3%	601	8.5%	602	8.6%	90	100
Secondary school qualification	2 949	41.4%	2 750	39.0%	2 619	37.4%	93	95
Other	35	0.5%	27	0.4%	28	0.4%	77	104
TOTAL	7 130	100.0%	7 051	100.0%	7 006	100.0%	99	99

In the first nine months of 2014, the banks' headcount decreased slightly (by 45 employees or 0.6%). The trend of an improved qualification structure by means of a larger share of employees with university degrees was continued in 2014 as well, as a result of this category's growth by 2% or 84 employees, on the one hand, and as a result of a reduction in the number of employees with secondary school qualifications by 5% or 131 employees, on the other hand.

One of the indicators affecting the performance assessment of individual banks and the banking system as a whole is staff efficiency, expressed a ratio of assets over the number of employees, i.e. assets per employee. A higher ratio is an indicator of better efficiency of both the bank's and the entire system's operations.

Table 6: *Assets per Employee*

BANKS	31.12.2012.			31.12.2013.			30.09.2014.		
	Head-count	Assets (000 KM)	Assets per employee	Head-count	Assets (000 KM)	Assets per employee	Head-count	Assets (000 KM)	Assets per employee

State-owned	183	209 971	1 147	200	241 605	1 208	200	336 748	1 684
Private	6 947	14 780 795	2 128	6.851	15 204 945	2 220	6 806	15 542 783	2 284
TOTAL	7 130	14 990 766	2 102	7.051	15 446 550	2 191	7 006	15 879 531	2 267

At the end of the reporting period, there were KM 2.3 million of assets per employee at the banking system level (end of 2013: KM 2.2 million).

Table 7: *Assets per Employee – by Group*

Assets (000 KM)	31.12.2012	31.12.2013	30.09.2014
	Number of banks	Number of banks	Number of banks
Up to 1 000	3	1	0
1 000 to 2 000	10	8	10
2.000 to 3 000	4	7	5
Over 3 000	1	1	2
TOTAL	18	17	17

Analytical indicators for individual banks range from KM 1 million to KM 4.5 million of assets per employee. There are four banks in which this ratio is better than the one at the banking sector level, while this ratio exceeds the amount of KM 2.4 million in the three largest banks in the system.

2. FINANCIAL PERFORMANCE INDICATORS OF BANKS

Off-site bank controls are performed by means of reports defined by the Agency and reports of other institutions, thus making up a database resting on three sources of information:

1) Balance sheet information for all banks submitted on a monthly basis, together with additional annexes on a quarterly basis. This information contains details of cash funds, loans, deposits and off-balance sheet items, as well as basic statistical data,
2) Information on the solvency of banks, information on capital and capital adequacy, asset classification, concentrations of certain risk types, liquidity position, FX risk exposure, interest rates on loans and deposits, all based on reports prescribed by the Agency,
3) Information on business results of banks (income statement according to the FBA model) and statements of cash flows, all submitted to the FBA on a quarterly basis.

In addition to these standardised reports, the reporting database also consists of information obtained on the basis of additional reporting requests by the Agency in the interest of ensuring quality monitoring and analysis of banks' operations, followed by reports on audits of financial statements of banks prepared by external audit firms, as well as any other information of relevance for the performance assessment of individual banks and the banking system as a whole.

In accordance with the provisions of the Law on Opening Balance Sheet of Banks, banks with majority state-owned capital are required to report to the Agency on the basis of the “full” balance sheet divided into: liabilities, neutral items and assets. In order to obtain more realistic indicators of the operations banks in the Federation of B&H, further analysis of the banking system will be based on indicators from the assets side of the balance sheet of banks with majority state-owned capital.[6]

2.1. Balance Sheet

The balance sheet total of the banking sector at the end of the third quarter of 2014 amounted to KM 15.9 billion, up by 2.8% or KM 433 million compared to the end of 2013. While negative trends were

[6] State-owned banks post the „full balance sheet“, meaning liabilities and neutral items, which the state will take over once the privatisation process gets finalised. As of 30.09.2014, these items amounted to KM 665 million in the case of one state-owned bank.

recorded in the first half of the current year (cash funds dropped by 5.5%, assets by 0.2%, deposits by 1% and loan commitments by 4.3%), the increase in deposits by 4% in the third quarter has reflected positively on the aforementioned segments, i.e. halted a further drop, which resulted in a slight increase on a nine-month basis (with the exception of loan commitments). Changes in the balance sheet total, as well as in key balance sheet categories (loans, deposits, loan commitments, capital, and consequently cash funds), are minor, so that it can be concluded that the situation has been stagnant for an extensive period of time due to the effects of the financial and economic crisis. Key performance indicators of the banking system have generally, with minor oscillations, maintained almost the same level as in the past two years.

- KM 000 -

Table 8: *Balance Sheet*

DESCRIPTION	31.12.2012		31.12.2013		30.09.2014		INDEX	
	AMOUNT	Share %	AMOUNT	Share %	AMOUNT	Share %		
1	2	3	4	5	6	7	8 (4/2)	9 (6/4)
ASSETS:								
Cash funds	3 962 581	26.4	4 417 898	28.6	4 457 490	28.1	111	101
Securities[7]	548 467	3.7	562 513	3.6	728 978	4.6	103	130
Facilities to other banks	78 522	0.5	51 960	0.3	67 806	0.4	66	130
Loans	10 666 124	71.1	10 852 400	70.3	11 112 004	70.0	102	102
Value adjustment	1 007 459	6.7	1 165 928	7.5	1 220 201	7.7	116	105
Net loans (loans minus value adjust.)	9 658 665	64.4	9 686 472	62.8	9 891 803	62.3	100	102
Business premises and other fixed assets	521 493	3.5	512 985	3.3	522 029	3.3	98	102
Other assets	221 038	1.5	214 722	1.4	211 425	1.3	97	98
TOTAL ASSETS	**14 990 766**	**100.0**	**15 446 550**	**100.0**	**15 879 531**	**100.0**	**103**	**103**
LIABILITIES :								
LIABILITIES								
Deposits	10 961 001	73.1	11 523 849	74.6	11 875 307	74.8	105	103
Borrowings from other banks	2 000	0.0	0	0.0	0	0.0	n/a	0
Loan commitments	1 141 561	7.6	1 039 381	6.7	981 279	6.2	91	94
Other liabilities	668 829	4.5	575 375	3.7	592 828	3.7	86	103
CAPITAL								
Capital	2 217 375	14.8	2 307 945	15.0	2 430 117	15.3	104	105
TOTAL LIABILITIES (LIABILITIES AND CAPITAL)	**14 990 766**	**100.0**	**15 446 550**	**100.0**	**15 879 531**	**100.0**	**103**	**103**

- KM 000 -

Table 9: *Banks' Assets by Ownership Structure*

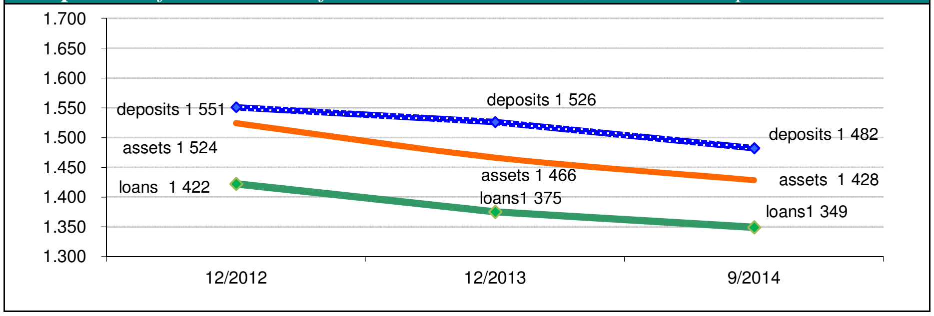
BANKS	31.12.2012			31.12.2013			30.09.2014			INDEX	
	No. of banks	Assets (000 KM)		No. of banks	Assets (000 KM)		No. of banks	Assets (000 KM)			
1	2	3		4	5		6	7		8 (5/3)	9(7/5)
State-owned	1	209 971	1%	1	241 605	2%	1	336 748	2%	115	139
Private	17	14 780 795	99%	17	15 204 945	98%	16	15 542 783	98%	103	102
TOTAL	18	14 990 766	100%	18	15 446 550	100%	17	15 879 531	100%	103	103

In most banks (12), assets are up compared to the end of 2013, while other banks saw a decrease in assets. Three small and two larger banks recorded a somewhat bigger increase in assets (39.4%, 15.0%, 13.9%, 11.9% and 10.5%), while a significant drop (14.5%) was recorded by one large bank.

The concentration indicator used for three key segments of banking operations (assets, loans and deposits) is the Herfindahl index.[8]

[7] Trading securities, securities available for sale and held to maturity securities.

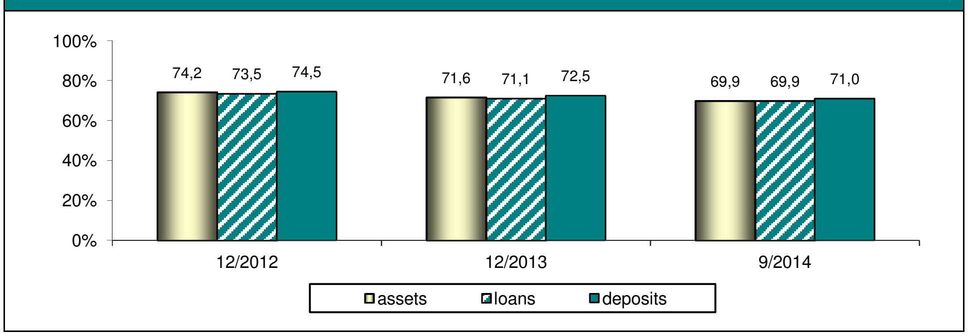
Graph 5: *Herfindahl Indeks of Concentrations in Assets, Loans and Deposits*



In the first three quarters of 2014, the Herfindahl index of concentrations in all three relevant categories (assets, loans and deposits) decreased, by 38 units for assets, by 26 units for loans and by 44 units for deposits, so that it amounted to 1 428 units for assets, 1 349 units for loans, and 1 482 units for deposits as of 30.09.2014, which is indicative of a moderate concentration.[9]

The second concentration indicator for the banking system is the ratio of market concentrations, i.e. the concentration rate[10] (hereinafter: the CR) showing the total share of the largest institutions in the system in selected relevant categories: assets, loans and deposits. Like Herfindahl's index of concentrations, the CR5 also changed only slightly and amounted to 69.9% for market share and loans and 71.0% for deposits. Over the past two years, the value of the CR5 went down slightly across all three categories, but the domination of the five largest banks in the system, which hold approximately 70% of the market, loans and deposits, is still evident.

Graph 6: *Concentration Rates for the 5 Largest Banks – CR5: Assets, Loans and Deposits*



The banking sector can also be analysed from the aspect of several groups formed according to asset size.[11] Changes in share percentage compared to the end of 2013 are minor, which is the result of slight changes in the assets of most banks.

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[8] This index is also called Hirschmann-Herfindahl index or HHI and is calculated according to this formula:

$$HI = \sum_{j=1}^{n} (S)_j^2 ,$$

It represents a sum of squares of percentage shares of specific elements (e.g. assets, deposits, loans) of all market participants in the system. It should be noted that this index does not grow linearly and that the value of e.g. 3 000 does not mean that the concentration in the system is 30%. Hypotethically, if there were just one bank in the entire system, the HHI would be 10 000 at most.

[9] If the value of the HHI is below 1 000, this shows no presence of the concentration on the market, while an index value between 1 000 and 1 800 shows moderate concentration, and a HHI value above 1 800 shows high concentration on the market.

[10] The concentration ratio (CR) rests on the number of institutions included in the calculation.

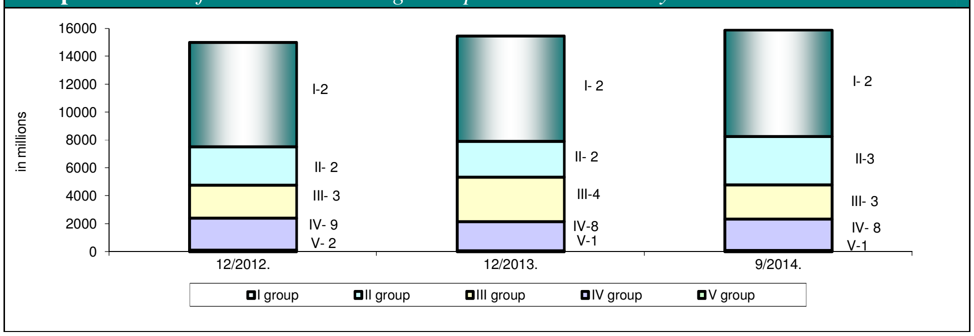
[11] Banks are divided into 5 groups depending on asset size.

The banking system is still dominated by the five largest banks with a share of 69.9%, of which the I group (the two largest banks in the system with assets in the amount of over KM 3 billion) has a share of 48.0% and the II group (three banks with assets in the amount ranging from KM 1 billion to KM 2 billion) has a share of 21.9%, up by 5.4 percentage points following its increase from two to three banks. The share of the III group (three banks with assets ranging from KM 500 million to KM 1 billion) is down by 5.3 percentage points, i.e. to 15.4%, due to one bank moving to the II group, while the share of the IV and largest group (eight banks with assets ranging from KM 100 million to KM 500 million) is 14.2% (+0.7 percentage points). One bank in the V and last group (with assets below KM 100 million) has a share of a negligible 0.5%.
The table below provides an overview of the amounts and shares of individual groups of banks in total assets by period (in KM million).

Table 10: *Share of Individual Banking Groups in Total Assets by Period*

ASSETS	31.12.2012			31.12.2013			30.09.2014		
	Amount	Share %	No. of banks	Amount	Share %	No. of banks	Amount	Share %	No. of banks
I- Over 2 000	7 476	49.8	2	7 546	48.8	2	7 626	48.0	2
II- 1000 to 2000	2 741	18.3	2	2 555	16.5	2	3 471	21.9	3
III- 500 to 1000	2 379	15.9	3	3 195	20.7	4	2 452	15.4	3
IV- 100 to 500	2 280	15.2	9	2 078	13.5	8	2 253	14.2	8
V- Below 100	115	0.8	2	73	0.5	1	78	0.5	1
TOTAL	14 991	100.0	18	15 447	100.0	17	15 880	100.0	17

Graph 7: *Share of Individual Banking Groups in Total Assets by Period*



The balance sheet total decrease of 2.8% or KM 433 million, i.e. to the level of KM 159 billion at the end of the reporting period is mostly a result of the increase in deposits by 3% or KM 351 million, i.e. an increase to the level of KM 11.9 billion, coupled with a drop in loan commitments of 5.6% or KM 58 million. Total capital also rose by 5.3% or KM 122 million, originating mostly from profit of the current period and from recapitalisation in three banks. At the end of the third quarter of 2014, total capital amounted to KM 2.4 billion.

After the drop of 5.5% in the first half of 2014, cash funds saw an increase of 6.8% in the third quarter of 2014, which cumulatively resulted in a slight growth rate of 0.9% or KM 40 million in nine months and as of 30.09.2014 amounted to KM 4.5 billion. The slight increase is due to the aforementioned increase in deposits, coupled with the increase of the securities portfolio and modest credit growth.

The slight credit growth from the first half of 2014 (2% or KM 238 million) stagnated in the third quarter (0.2% or KM 22 million), which cumulatively resulted in a growth rate of 2.4% or KM 260 million in the nine months of 2014, although it should be noted that the credit growth rate amounted to 1.7% in the past two years. At the end of the third quarter of 2014, loans amounted to KM 11.1

billion KM.

Investments in securities recorded an increase of 30.0% or KM 166 million (in 2013, their growth was 2.6% or KM 14 million) and amounted to KM 729 million as of 30.09.2014, thus having a share in assets of a mere 4.6%.

The portfolio of securities available for sale (a small part thereof refers to the trading portfolio), up by 37.8% or KM 144 million, amounted to KM 526 million, and the securities held to maturity increased by 12%, from KM 181 million to KM 203 million. Both portfolios include securities issued by the Government of the Federation of B&H[12] in the total amount of KM 357 million, as well as securities issued by the Government of Republika Srpska in the amount of KM 59 million. Also, the trading portfolio includes shares issued by local companies totaling KM 3 million. The remaining portion of the securities portfolio amounts to app. KM 310 million and refers mostly to bonds of EU countries.

In 2014, the Government of the Federation of B&H issued eleven tranches of treasury bills in the total nominal amount of KM 220 million: one of the nominal value of KM 20 million in February 2014 (maturing in May 2014), two tranches in March 2014 in the amount of KM 20 million each (maturing in June 2014), two tranches in April in the amount of KM 15 million each (maturing in October 2014), one tranche in May in the amount of KM 20 million (maturing in November 2014), one tranche in June in the amount of KM 20 million (maturing in June 2015), one tranche in July in the amount of KM 30 million (maturing in October 2014), one tranche in August 2014 in the amount of KM 20 million (maturing in February 2015), and two tranches in September 2014 in the amount of KM 20 million each (maturing in June 2015). As of 30.09.2014, treasury bills amount to KM 160 million, i.e. their book value is KM 159.3 million, which is the result of a significant increase of 128% or KM 89.6 million in the third quarter of 2014.

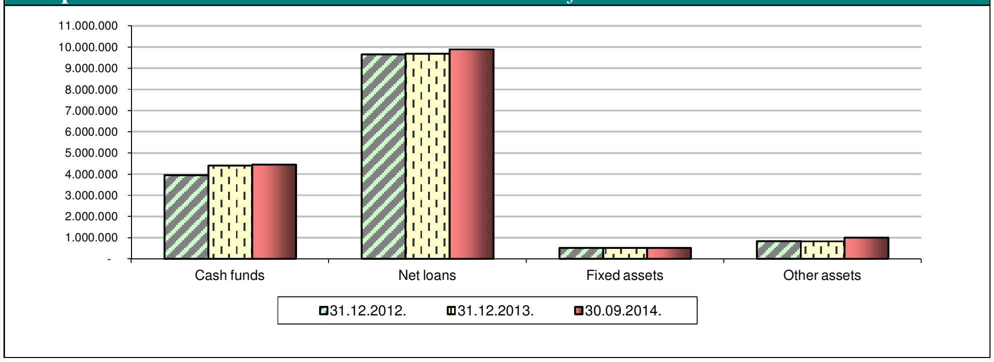
Also, the securities portfolios of banks also include bonds issued by the Government of the Federation of B&H (issued in 2012: the first issue in May 2012 in the amount of KM 80 million, maturing within 3 years, the second one in June and August in the total amount of KM 30 million, maturing within 5 years, the third issue in September in the amount of KM 20 million, maturing within 2 years, the fourth issue in December 2013 in the amount of KM 40 million, maturing within 3 years – with the total value of bonds purchased by banks being KM 17.5 million, and the fifth issue in September 2014 in the amount of KM 50 million, maturing in September 2017) of total nominal value of KM 168 million, i.e. their book value is KM 168.5 million, which is the result of a significant increase of 20% or KM 28.1 million in the third quarter of 2014. It should be noted that the issue of bonds issued on 25.09.2012 in the amount of KM 20 million matured in September 2014. The majority of the treasury bills and bonds with a book value of KM 276 million was classified in the portfolio of securities available for sale, while the rest in the amount of KM 52 million is classified in the portfolio of securities held to maturity.

When analysing the overall securities portfolio (KM 729 million) from the aspect of exposure by country, the largest share is that of B&H (57.4%) (46.4% at the end of 2013), followed by Romania (12.0%), Austria (10.9%), Belgium (6.3%), etc.

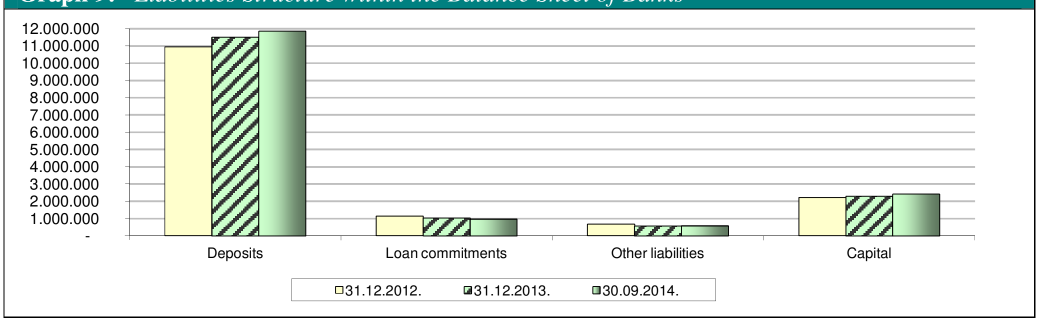
The graphs below show the structure of the key items of the banks' balance sheet.

[12] All types of securities issued by the Government of the Federation of B&H.

Graph 8: *Assets Structure within the Balance Sheet of Banks*



Graph 9: *Liabilities Structure within the Balance Sheet of Banks*



Within the liabilities structure of the banks' balances sheets, deposits still represent a dominant source of funding for banks in the Federation of B&H (with an amount of KM 11.9 billion and a 74.8% share). Following a further slight decrease of 5.6%, the share of loan commitments in the amount of KM 981 million decreased from 6.7% to 6.2%, while the share of capital, which amounted to KM 2.4 billion as of 30.09.2014, increased from 15.0% to 15.3%.

The structure of assets, as well as the structure of sources of funding, saw minor changes related to two key assets items: decrease in the loan share from 70.3% to 70.0% and in cash funds from 28.6% to 28.1%.

- in KM 000 -

Table 11: *Cash Funds of Banks*

CASH FUNDS	31.12.2012		31.12.2013		30.09.2014		INDEX	
	Amount	Share %	Amount	Share %	Amount	Share %	4/2	6/4
1	2	3	4	5	6	7	8	9
Cash	411 726	10.4	431 592	9.8	425 988	9.6	105	99
RR at the CB B&H	2 130 626	53.8	2 622 277	59.4	2 887 332	64.8	123	110
Accounts at deposit institutions in B&H	1 930	0.0	25 181	0.5	10 653	0.2	1305	42
Accounts at deposit institutions abroad	1 417 857	35.8	1 338 347	30.3	1 133 301	25.4	94	85
Cash in the process of collection	442	0.0	501	0.0	216	0.0	113	43
TOTAL	3 962 581	100.0	4 417 898	100.0	4 457 490	100.0	111	101

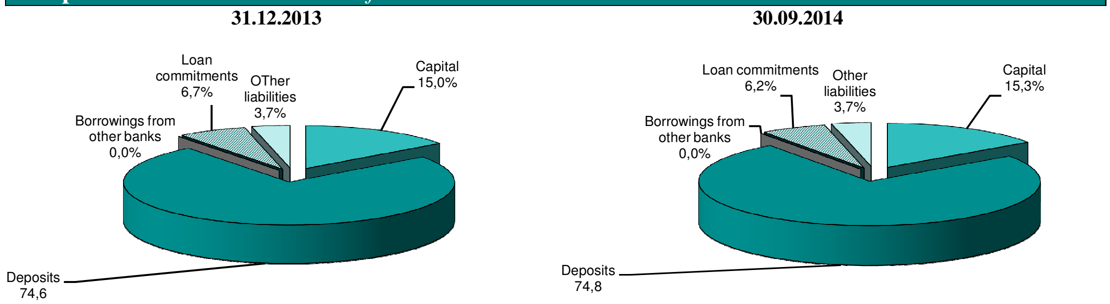
The banks' cash funds in the CBBH reserves account were up by 10% or KM 265 million in the reporting period and amounted to KM 2.9 billion or 64.8% of total cash funds as of 30.09.2014 (59.4% at the end of 2013). The banks' funds in accounts of deposit institutions abroad recorded a significant decrease of 15% or KM 205 million and amounted to KM 1.1 billion or 25.4% of total cash funds (30.3% at the end of 2013). Following their decrease of 1% or KM 6 million, banks held cash funds in the amount of KM 426 million, which represents 9.6% of total cash funds, in vaults and treasuries as of 30.09.2014.

These trends prompted a change in the currency structure of cash funds: in the reporting period, the share of local currency increased from 66.4% to 72.1%, while cash in foreign currency decreased by the same percentage.

2. 1. 1. Liabilities

The total liabilities structure (liabilities and capital) within the banks' balance sheet as of 30.09.2014 is provided in the graph below:

Graph 10: *Liabilities Structure of Banks*



During the reporting period, the share of deposits (74.8%), as the most significant source of funding of banks, was up by 0.2 percentage points, while the trend of the decrease in the share of loan commitments, the second largest source of funding, continued in 2014 as well by 0.5 percentage points (6.2%).
The increase in the share of deposits is the result of their increase by 3% or KM 351 million in the reporting period. As of 30.09.2014, they amounted to KM 11.9 billion and are still the largest source of funding for banks in the Federation of B&H. It should be noted that, in 2014, B&H received the VI tranche of funds in the amount of KM 61.7 million in January based on the stand-by arrangement with the IMF, and the VII and VIII tranche in the amount of KM 215.9 million in July (B&H received app. KM 163 million in 2013 and KM 153 million in 2012).

The second-largest source of funding are loans in the amount of KM 981 million, which banks received mostly by borrowing from foreign financial institutions. In the past five years, due to the effect of the financial and economic crisis, banks incurred significantly fewer loans abroad and, coupled with the payment of matured liabilities, reduced these sources of financing by over 50% (at the end of 2008, deposits amounted to KM 2.18 billion). In 2012, the decrease amounted to 13.5% or KM 178 million, in 2013, these sources dropped by 9% or KM 102 million, while in the first three quarters of 2014, they dropped by 5.6% or KM 58 million. If subordinated loans in the amount of KM 160 million, which the banks withdrew in the interest of strengthening the capital base and improving capital adequacy, were added to loan commitments, total loan funds would hold a share of 7.2% in total sources of funding.

As of 30.09.2014, banks held the largest amount of liabilities towards the following creditors (6 out of a total of 30 creditors), accounting for 78% of total loan commitments: European Investment Bank (EIB), TC ZIRAAT BANKASI A.S. (Turkey), UniCredit Bank Austria AG, European Fund for Southeast Europe (EFSE), the World Bank and EBRD.

As of 30.09.2014, capital amounted to KM 2.4 billion, up by 5.3% or KM 122 million compared to the end of 2013. This primarily relates to the financial result (profit) recorded in the first three quarters of 2014 as well as the recapitalisation in three banks (KM 41 million).

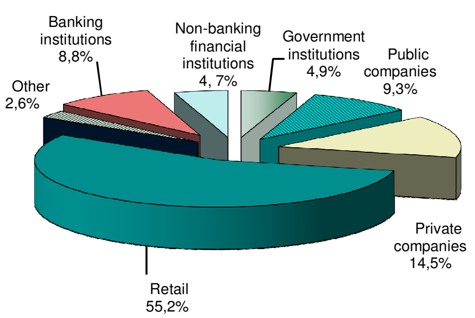
According to the information submitted by banks, out of the total deposit amount at the end of the reporting period, only 5.7% relates to deposits collected in organisational units of banks from the Federation of B&H, which are doing business in Republika Srpska and Brčko District

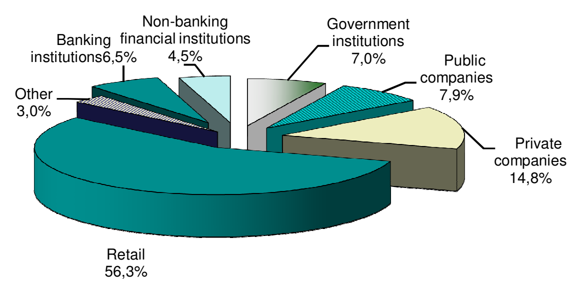
- in KM 000 -

Table 12: *Deposit Structure by Sector*[13]

SECTORS	31.12.2012.		31.12.2013.		30.09.2014.		INDEX	
	Amount	Share %	Amount	Share %	Amount	Share %	4/2	6/4
1	2	3	4	5	6	7	8	9
Government institutions	682 313	6.2	565 533	4.9	834 440	7.0	83	148
Public companies	1 090 870	10.0	1 076 527	9.3	941 445	7.9	99	87
Private companies and enterprises	1 501 232	13.7	1 668 034	14.5	1 760 169	14.8	111	106
Banking institutions	981 562	9.0	1 012 274	8.8	768 446	6.5	103	76
Non-banking financial institutions	493 689	4.5	535 915	4.7	533 179	4.5	109	99
Retail	5 933 071	54.1	6 366 218	55.2	6 682 648	56.3	107	105
Other	278 264	2.5	299 348	2.6	354 980	3.0	108	119
TOTAL	10 961 001	100.0	11 523 849	100.0	11 875 307	100.0	105	103

Graph 11: *Deposit Structure by Sector*





In the reporting period of 2014, minor changes occurred in the deposit structure by sector and they are mostly the result of an increase in deposits of government institutions, private companies, as well as the increase in retail deposits, and a decrease in the deposits of banking institutions and public companies.

Retail deposits displayed continuous growth over the past few years and they rose by 5% or KM 316 million in the first three quarters of 2014, while their share in total deposits rose from 55.2% to 56.3%, so that retail deposits are still the largest source of funding for banks with KM 6.7 billion. Analytical data indicates that the share of this sector's deposits is the largest in 15 out of 17 and it ranges from 35% to 85%.

The second largest source of funding (based on amount and share) are deposits of private companies. After their increase of 11% or KM 167 million in 2013, they rose by 6% or KM 92 million in the first half of 2014, while their share increased to 14.8% (+0.3 percentage points) and they amounted to KM 1.8 billion.

[13] Information from the auxiliary BS-D form, which banks submit on a quarterly basis in addition to the balance sheet (as based on the FBA model).

Deposits of public companies recorded a decrease of 13% or KM 135 million and amounted to KM 941 million as of 30.09.2014, while their share dropped from 9.3% to 7.9%.

From the end of 2007 until the third quarter of 2011, deposits of banking institutions were the second-largest source in the deposit potential of banks. The growth trend was maintained by mid-2009, when they reached their peak of KM 2.3 billion and a share of 21.4% of total deposits. After that, due to the effects of the crisis, the reduced volume of lending and high liquidity, parent groups withdrew their deposits, thus resulting in the reduced share. From the end of 2009 to 30.09.2014, deposits of this sector dropped by app. 60% or KM 1.4 billion. Negative trends in previous years (related to these funds at sector level) are mostly a result of debt reduction, i.e. the repayment of funds to groups that own the banks in the Federation of B&H.

In the first three quarters of 2014, deposits of banking institutions fell by a high 24% or KM 244 million, thus amounting to KM 768 million as of 30.09.2014. This resulted in their share in total deposits dropping from 8.8% to 6.5%. These funds are lower than loan commitments by KM 213 million, which are the second-largest source of funding in banks from the Federation of B&H, just after deposits. Based on the aforementioned information, it can be concluded that the foreign debt level of banks from the Federation of B&H is much lower, especially in terms of deposit funds of parent groups. It should be noted that app. KM 193 million or 27% of term deposits of the group mature by the end of 2014. Considering that the same reduction trend is present with respect to loan commitments, banks are once again facing the problem of maintaining their maturity adjustment, with this being caused by the unfavourable maturity of local deposit funds, due to which they are forced to obtain quality sources of funding in the period to come in order to uphold the trend of increase in approved loans.

It is worth noting that 93% or KM 711 million of deposits of banking institutions relate to deposits of banks from the group (mostly shareholders). Financial support by parent groups is present with respect to nine banks in the Federation of B&H, wherein such financing is still concentrated in five large banks (94%). In this way, banks in majority foreign ownership had financial support and secured inflows of new funds by their foreign groups in previous periods. If these funds are coupled with loan commitments and subordinated debt, the financial support of banks from the group is higher (with respect to 11 banks) and amounts to KM 1.09 billion as of 30.09.2014 (or 6.9% of total liabilities of the banking sector, which is lower compared to the end of 2013 (KM 1.3 billion or 8.6% of liabilities). In total deposits, the funds of banking groups hold a share of 6.0% (8.0% at the end of 2013), while loan commitments to the group account for 24.2% of total loan obligations (this share is down by 1.9%). Compared to the end of 2013, these funds dropped by 18.3% or KM 245 million, largely based on regular maturities (deposits fell by 23% or KM 212 million, loan commitments by 12.4% or KM 34 million, while subordinated loans rose by 1% or KM 1 million).

Considering that lending activities of banks got significantly reduced due to the economic crisis, thus resulting in high liquidity and a good capitalisation rate of most of foreign-owned banks in the Federation of B&H, the trend of the past couple of years is still present when it comes to reduced exposures to the group. This primarily relates to the segment of both deposit sources and loan sources, largely on the basis of regular repayments of matured liabilities. For reasons of unfavourable occurrences in the economies of the home countries of the owners of banks from the Federation of B&H, the problems these countries are facing and consequently, the problems of their financial systems and banking groups, as well as measures taken in Austria to strengthen and ensure the sustainability of the business models of large internationally active Austrian banks and thereby preserve the country's credit rating[14], the financial support of parent banking groups got significantly reduced, so that credit growth in the Federation of B&H will have to rely more on local sources of funding in the period to come. It is especially important to underline that deposit funds that certain banks received from their parent groups over the past two years are mostly of short-term maturity (from one month to one year) and serve the purpose of maintaining maturity adjustment within the prescribed limits, and therefore do not constitute a quality source of long-term funding.

In times of crisis and difficulties in terms of accessing the money market and new funds, the increase of liquidity risk as a result of the impaired collection rate of loans and growth of uncollectable receivables, unsatisfactory maturity structure of local deposit sources and expected further reduction of foreign sources of funding, the problem of the unfavourable maturity structure of sources of funding (primarily deposits) and their growth will be the focus of most of banks in the period to come.

After a longer period of decrease, deposits of government institutions recorded a significant increase of 48% or KM 269 million, which is primarily the result of approved and withdrawn funds on the basis of the stand-by arrangement with the IMF and they amounted to KM 834 million or 7% of total deposits as of 30.09.2014.

Deposits of other sectors saw slight changes in terms of both amount and share.

The currency structure of deposits as of 30.09.2014 has slightly changed: deposits in foreign currency (with a dominant share of EUR currency) in the amount of KM 5.9 billion decreased their share from 51.9% to 49.6% and deposits in local currency amounted to KM 6 billion and hold a share of 50.4%.

At the end of the third quarter of 2014, the structure of deposits by domicile status of depositors changed slightly: resident funds amounted to KM 10.8 billion and had a share of 91% (+2.3%) while non-resident deposits amounted to KM 1.1 billion and represented 9% of total deposits. Resident deposits rose by 5.7% or KM 583 million, while non-resident deposits fell by 17.8% or KM 232 million. Over the past four years, non-resident deposits continuously decreased as a result of the withdrawal, i.e. return of deposits to the parent bank or member of the banking group to which non-resident funds mostly refer. Non-resident deposits had the largest share of 22.1% and nominal amount of KM 2.31 billion at the end of 2008.

In 2014, savings deposits, as the most significant segment of the deposit and financial potential of banks, recorded an increase of 5.0% or KM 306 million and amounted to KM 6.5 billion as of 30.09.2014.

Table 13: *New Retail Savings by Period*

BANKS	AMOUNT (in KM 000)			INDEX	
	31.12.2012	31.12.2013	30.09.2014	3/2	4/3
1	2	3	4	5	6
State-owned	58 050	65 179	70 243	112	108
Private	5 698 300	6 135 693	6 436 803	108	105
TOTAL	5 756 350	6 200 872	6 507 046	108	105

[14] In essence, these measures mean that the lending activity of subsidiaries of Austrian banks in the Central, Eastern and Southeastern Europe (CESEE) is conditioned by stronger and sustainable funding from local sources.

Graph 12: *New Retail Savings by Period*

The two largest banks hold 57% of savings, while nine banks hold individual shares of less than 2%, which amounts to 10.9% of total savings at system level.

Out of the total amount of savings, 39% refers to saving deposits in local currency and 61% to savings deposits in foreign currency.

Table 14: *Maturity Structure of Retail Savings Deposits by Period*

BANKS	AMOUNT (in KM 000)						INDEX	
	31.12.2012		31.12.2013		30.09.2014		3/2	4/3
1	2		3		4		5	6
Short-term savings deposits	2 656 934	46.2%	2 911 827	47.0%	3 012 455	46.3%	110	103
Long-term savings deposit	3 099 416	53.8%	3 289 063	53.0%	3 494 591	53.7%	106	106
TOTAL	5 756 350	100.0 %	6 200 890	100.0%	6 507 046	100.0%	108	105

Compared to the end of 2013, the maturity structure of savings deposits changed slightly through an increase in short-term deposits by 3% or KM 101 million, while long-term deposits rose by 6% or KM 206 million, thus resulting in a slightly higher share of long-term deposits from 53.0% to 53.7%.

Long-standing continuous growth and positive trends in the savings segment of banks in the Federation of B&H are the result of, on the one hand, better safety and stability of the overall banking system (as chiefly attributable to the functional, effective and efficient banking supervision implemented by the Agency) and, on the other hand, the existence of the deposit insurance system, the primary objective of which is increased stability of the banking, i.e. financial sector and the protection of savers. In order to preserve and strengthen the trust of citizens in the safety and stability of the banking system in B&H, the deposit insurance level rose to KM 20 000 in 2008. After that, an initiative was started to increase the insured deposit level. Accordingly, on 01.04.2010, this level rose to KM 35 000. According to the latest decision by the Management Board of the Deposit Insurance Agency of B&H from December 2013, the insured deposit limit increased from the present KM 35 000 to KM 50 000, effective as of 01.01.2014. All these actions are aimed towards limiting the effect of the global economic crisis on the banking and the overall economic system in the Federation of B&H and B&H.

As of 30.09.2014, there was a total of 16 banks from the Federation of B&H included in the deposit insurance program (i.e. holding licences issued by the Deposit Insurance Agency of B&H). There is one bank that is not eligible for this program because it does not meet the criteria defined by the Deposit Insurance Agency of B&H (due to existing composite rating).

2.1.2. Capital – Strength and Adequacy

The capital[15] of banks in the Federation of B&H as of 30.09.2014 amounted to KM 2.3 billion.

It should be noted that the FBA, in order to comply with international standards of regulatory capital, adopted a new Decision on Minimum Standards for Bank Capital Management and Capital Hedge (hereinafter: the Decision), which constitutes an innovated concept of capital, in which the previously prescribed and applied minimum standards in capital management are supplemented by additional measures for strengthening and preserving capital. New and amended provisions have influenced the form and content of regulatory reports in the segment of capital, with them having to be applied as of 30.09.2014.

-in KM 000-

Table 15: *Regulatory Capital*

DESCRIPTION	31.12.2012		31.12.2013		30.09.2014		INDEX	
1	2		3		4		5 (3/2)	6 (4/3)
1.a.**Core capital before reduction**	1 913 841		2 155 188		2 085 248		113	97
1.1. Share capital – common and permanent non-cumulative shares	1 198 516		1 200 644		1 226 201		100	102
1.2. Issue premiums	136 485		136 485		136 485		100	100
1.3.Reserves and retained profit	578 840		818 059		722 562		141	88
1.b.Deductible items	191 304		294 629		198 707		154	67
1.1. Uncovered losses from previous years	120 740		112 610		122 705		93	109
1.2. Current year loss	17 818		140 445		29 423		788	21
1.3. Treasury shares	156		156		81		100	52
1.4.. Intangible assets	52 590		41 418		41 040		79	99
1.5. Deferred tax assets	N/a		N/a		4 698		N/a	N/a
1.6. Negative revalorised reserves	N/a		N/a		760		N/a	N/a
1. Core capital (1a-1b)	**1 722 537**	**79%**	**1 860 559**	**80%**	**1 886 541**	**82%**	108	101
2. Supplementary capital	**467 100**	**21%**	**457 047**	**20%**	**411 880**	**18%**	98	90
2.1. Share capital – permanent preferred cumulative shares	3 090		3 091		3 091		100	100
2.2. General loan loss reserves	211 433		215 083		224 407		102	104
2.3. Positive revalorised reserves	N/a		N/a		24 311		N/a	N/a
2.4. Amount of audited profit	67 243		71 984		N/a		107	N/a
2.5. Subordinated debt	120 264		165 473		158 655		138	96
2.5. Hybrid items and other instruments	65 070		1 416		1 416		2	100
3. Capital (1 + 2)	**2 189 637**	**100%**	**2 317 606**	**100%**	**2 298 421**	**100%**	106	99
4. Deductible items from capital	**98 848**		**159 710**		**197 923**		162	124
4.1. Bank's shares in capital of other legal entities above 5% of core capital	3 043		2 844		3 052		93	107
4.2. Loan loss reserves shortfall at regulatory request	95 720		156 866		192 450		164	123
4.3. Other deductible items	85		0		2 421		N/a	N/a
5. Net capital (3- 4)	**2 090 789**		**2 157 896**		**2 100 498**		103	97

In the first three quarters of 2014, capital[16] decreased by 1% or KM 19 million, and the changes in core and supplementary capital affected the changes in the structure of the regulatory capital. Core capital increased by 1% or KM 26 million, while supplementary capital dropped by 10% or KM 45 million. The change in structure was also influenced by the application of the provisions of the new Decision.

The core capital increase is mostly based on the inclusion (the transfer of one part of profit from supplementary to core capital) of profit earned in 2013. After the implementation of the legal procedure of adopting decisions by the banks' assemblies, the recorded profit in the amount of KM 138 million was distributed as follows: 99% or KM 136 million KM into core capital (retained profit and reserves), two banks distributed a part of the profit in the amount of 1.2 million to partly cover

[15] Regulatorni kapital definiran čl. 7, 8. i 9. Odluke o minimalnim standardima za upravljanje kapitalom banaka i kapitalnoj zaštiti („Službene novine Federacije BiH", broj 46/14). Regulatory capital is defined in Articles 7, 8 and 9 of the Decision on Minimum Standards for Capital Management in Banks and Capital Hedge („Official Gazette of the Federation of B&H", No. 46/14).

[16] Source of information: quarterly Report on Capital Condition in Banks (Form 1-Table A).

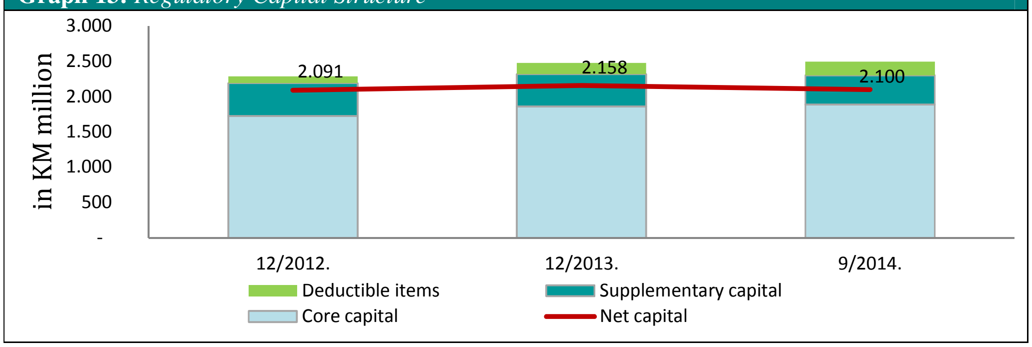
previous losses, while two banks made the decision to pay dividends (a total of KM 44 million). The increase in core capital was also influenced by the recapitalisation of three banks.
Deductible items (which decrease core capital) decreased by KM 96 million, primarily as a result of the decrease on the basis of partial coverage of uncovered losses in four banks in the amount of KM 130 million (KM 107 million of which apply to one bank) and the increase on the basis of the current loss of KM 29 million.

Supplementary capital dropped by 10% or KM 45 million, and was mostly affected by the aforementioned transfer of audited profit to the core capital and the decrease in subordinated debt by KM 6.8 million. The increase in supplementary capital was influenced by the inclusion of a new item of supplementary capital: positive revalorised reserves in the amount of KM 24.3 million and the increase in general loan loss reserves by KM 9 million.

According to regulatory changes in late 2011, deductible items from capital include a new accounting item: the shortfall of loan loss reserves upon regulator's request (i.e. a difference between required regulatory loan loss reserves according to balance sheet and off-balance sheet items[17] and loan loss reserves formed from profit). As of 30.09.14, this item amounted to KM 192 million, up by 23% or KM 36 million compared to the end of 2013 (this item was up by 64% or KM 61 million in 2013).

The graph below shows the regulatory capital structure.

Graph 13: *Regulatory Capital Structure*



As a result of the aforementioned changes, especially due to the negative effect of the increase of the shortfall of loan loss reserves (23% or KM 36 million), net capital fell by 3% or KM 57 million and amounted to KM 2.1 billion as of 30.09.2014.

Capital adequacy of individual banks, i.e. the overall system, depends, on the one hand, from the net capital level, and, on the other hand, on total risk weights (risk-weighted assets and weighted operational risk).

The table below provides a structure of the net exposure of banks by credit risk weight, i.e. conversion ratio for off-balance sheet items.

-in KM 000-

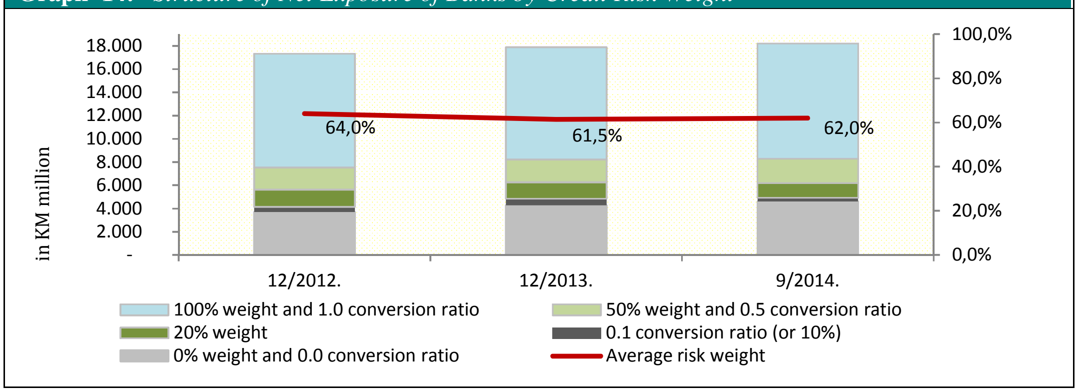
Table 16: *Structure of Net Exposure of Banks by Credit Risk Weight*

DESCRIPTION	31.12.2012	31.12.2013	30.09.2014	INDEX	
1	2	3	4	5 (3/2)	6 (4/3)
TOTAL EXPOSURE (1+2):	**17 310 579**	**17 893 904**	**18 194 737**	103	102

[17] Banks declare required regulatory reserves when the value adjustment (according to IAS) is below calculated regulatory reserves, as determined at the level of the individual debtor. This methodology is in application since 30.06.2012.

1 Balance sheet assets	14 568 957	14 969 445	15 369 995	103	103
2. Off-balance sheet items	2 741 622	2 924 459	2 824 742	107	97
DISTRIBUTION BY RISK WEIGHT AND CONVERSION RATIO					
0% weight	3 647 306	4 198 260	4 568 804	115	109
20% weight	1 460 689	1 424 069	1 258 915	97	88
50% weight	53 155	33 110	33 580	62	101
100% weight	9 407 807	9 314 006	9 508 696	99	102
0.0 conversion ratio	51 131	86 947	46 128	170	53
0.1 conversion ratio	449 627	550 966	305 694	123	55
0.5 conversion ratio	1 867 703	1 916 076	2 080 477	103	109
1.0 conversion ratio	373 161	370 470	392 443	99	106
RISK-WEIGHTED ASSETS AND LOAN EQUIVALENTS	**11 078 498**	**10 998 977**	**11 240 523**	**99**	**102**
Average risk weight	**64.0%**	**61.5%**	**62.0%**	**96**	**101**

Graph 14: *Structure of Net Exposure of Banks by Credit Risk Weight*



In the reporting period of 2014, total net exposure of banks (before being weighted) is up by 2% or KM 301 million. This was influenced by the increase in balance sheet items (mostly as a net effect of the increase in items weighted with 05 and 100% and the decrease in items weighted with 20%), while off-balance-sheet items dropped (the decrease in items weighted with a 0.1 conversion ratio was bigger than the increase in items weighted with a 0.5 conversion ratio). As a result of the aforementioned, the average risk weight rose from 61.5% to 62%.

The same direction was seen with respect to the weighted operational risk (WOR), which also rose slightly and amounts to KM 982 million. All of this resulted in a slight increase in total risk weights (2%).

As of 30.09.2014, the share of risk-weighted assets exposed to credit risk amounted to 92% and to operational risk 8%.

The banks' capitalisation rate, expressed as a ratio between capital and assets, amounted to 13.4% as of 30.09.2014, which is down by 0.5 percentage points compared to the end of 2013.

One of the key indicators of capital strength and adequacy[18] of banks is the capital adequacy ratio, which constitutes a ratio between net capital and risk-weighted assets. At the banking sector level, this ratio stood at 17.2% as of 30.09.2014, down by 0.8% compared to the end of 2013.

[18] The legally defined minimum capital adequacy rate is 12%.

Also, the indicator of capital strength and quality is the ratio of the core capital (Tier I) and total risk assets, which amounted to 15.4% at the level of the banking sector as of 30.09.2014. An important provision of the new Decision is the obligation of banks to intend part of the core capital above 6% of total risk assets to cover the risks related to preventive protection from potential losses in times of crisis or stressful situations through a protective layer for preserving the capital that has been prescribed in the amount of 2.5% of the amount of total risk assets under this Decision. Two other protective layers were introduced – a countercyclical protective layer and a protective layer for systemic risk, which the FBA would determine by a special resolution, if necessary.

The Bank is also, according to the new Decision on capital, obligated to establish and maintain the financial leverage ratio as an additional security and a simple capital hedge, at least in the amount of 6%, starting as of 31.12.2015, with the obligation of quarterly reporting as of 30.09.2014. The financial leverage ratio at the level of the banking sector amounted to 10.3% as of 30.09.2014.

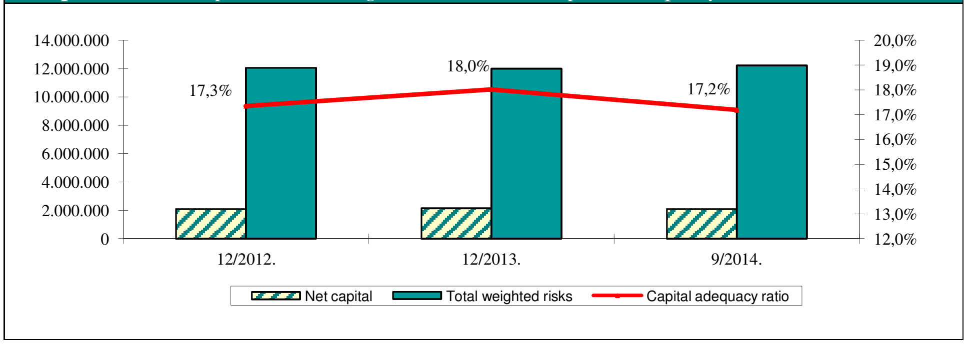
Although operations of the banking sector have been strongly affected by the economic crisis for the past few years, the capital adequacy of the banking sector has been continuously maintained at the level above 16% and above 17% in the past three years. The reason for this is, on the one hand, the credit growth stagnation and decrease of overall weighted risks, and, on the other hand , the fact that banks have retained the largest share of profit from previous years within their capital and several banks have improved their capitalisation rate by means of additional capital injections. However, problems related to the increase in non-performing loans and items not covered by loan loss reserves (net non-performing assets) may significantly impact and cause weakening of the capital base in several banks in the period to come. This is conditioned by continued negative trends regarding asset quality and the worsening of and increase in non-collectable loans. This is illustrated by the following information: at the end of 2008, net non-performing assets amounted to KM 197 million and its ratio (vs. core capital) was 13.2%. At the end of the third quarter of 2014, net non-performing assets reached an amount of KM 518 million and the ratio was 27.5%. Also, according to existing regulations, banks do not calculate the capital requirement for market risks, due to which the capital adequacy rate is higher.

- KM 000 -

Table 17: *Net Capital, Total Weighted Risks and Capital Adequacy Rate*

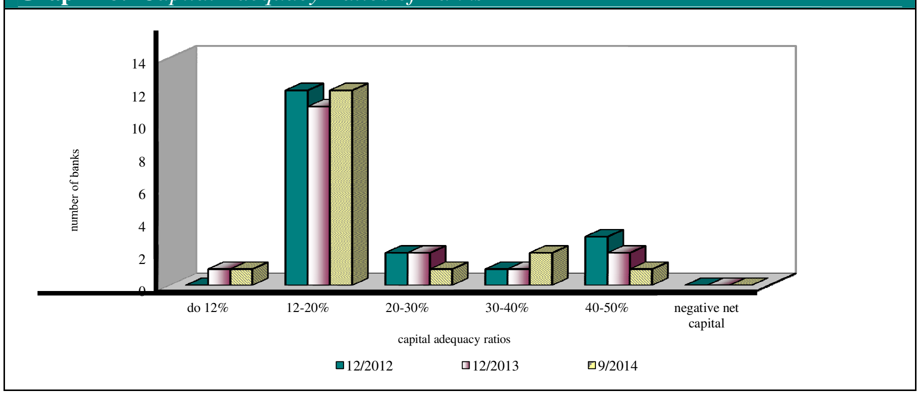
DESCRIPTION	31.12.2012	31.12.2013	30.09.2014	INDEX	
1	2	3	4	5(3/2)	6(4/3)
1. NET CAPITAL	2 090 789	2 157 896	2 100 498	103	97
2. RISK-WEIGHTED ASSETS AND LOAN EQUIVALENTS	11 078 498	10 998 977	11 240 523	99	102
3. WOR (WEIGHTED OPERATIONAL RISK)	974 201	981 318	982 250	101	100
4. TOTAL WEIGHTED RISKS (2+3)	12 052 699	11 980 295	12 222 773	99	102
5. NET CAPITAL RATE (CAPITAL ADEQUACY) (1/ 4)	17.3%	18.0%	17.2%	104	96

Graph 15: *Net Capital, Risk-Weighted Assets and Capital Adequacy Rate*



The capital adequacy rate of the banking system as of 30.09.2014 was 17.2%, which is still quite above the legal minimum (12%) and represents a satisfactory capitalisation rate of the overall system considering the existing level of risk exposure and it represents a strong basis and foundation for the preservation of its safety and stability.

Graph 16: *Capital Adequacy Ratios of Banks*



Out of a total of 17 banks in the Federation of B&H as of 30.09.2014, 16 banks had capital adequacy ratios that were above the legal minimum of 12%, while one bank had a ratio that was below the legal minimum. According to analytical data, 14 banks had a capital adequacy ratio below the one at the end of 2013 (ranging from 0.1 to 6.9 percentage points), while three banks had improved this ratio compared to the end of 2013.

Below is an overview of capital adequacy ratios of banks compared to the legal minimum of 12%:

- 1 bank had a ratio below 12% (7,8%),
- 5 banks had a ratio between 12.3% and 14.9%,
- 7 banks had a ratio between 16.3% and 19.5%,
- 1 bank had a ratio of 20,1%,
- 3 banks had a ratio between 35.8% and 43.1%.

By supervising the operations and financial condition of banks in the Federation of B&H in accordance with its legal competences and for the purpose of improving the safety of both individual banks and the banking system as a whole, the Agency instructed banks to take appropriate measures to strengthen their capital base and ensure capital adequacy in terms of the level and profile of the existing and potential exposure to all risks inherent to banking operations.

As has been the case before, the priority task of most of banks in the system is to further strengthen the capital base, wherein the focus is placed on large banks in the system, especially due to changes in the business and operating environment of the Federation of B&H, actions caused by and negative effects of the global financial and economic crisis on our country, the banking sector and the overall economy in B&H, which was further exacerbated by the effects of the massive damages caused by the floods in the spring and summer of 2014 to both businesses and certain sectors as well as to the population in those areas. Also, the focus is on banks with adverse trends regarding asset quality, which negatively reflects on the capital and represents a realistic possibility for additional weakening of the capital base. Under conditions of economic crisis and credit risk growth caused by the downfall of the loan portfolio quality (due to an increase in uncollectable receivables), this requirement has a high priority and the capital segment is therefore under a continuous reinforced supervision in order to prevent the impairment of the banks' stability and the erosion of the capital base to a level that might jeopardise not only the banks' operations, but also impact the stability of the entire banking system.

2.1.3. Assets and Asset Quality

The Decision on Minimum Standards for Credit Risk Management and Asset Classification in Banks defines criteria for the assessment of banks' exposure to credit risk by means of asset quality assessment and assessment of adequacy of reserves for loan losses and other losses as per risk level of loans and balance sheet and off-balance sheet assets items.

With the Law on Accounting and Audit in the Federation of Bosnia and Herzegovina entering into force on 31.12.2011, banks are required to prepare and present financial statements in accordance with the International Accounting Standards (IAS) and the International Financial Reporting Standards (IFRS), with recognition and measurement of financial assets and liabilities being subject to the IAS 39 – Financial instruments, recognition and measurement and the IAS 37 – Provisioning, contingent liabilities and contingent assets. Therefore, during the assessment of banks' exposure to credit risk, banks are required to continue calculating loan loss reserves in accordance with the criteria from the Decision on Minimum Standards for Credit Risk Management and Asset Classification in Banks, thereby considering already formed value adjustments of balance sheet assets and loss provisions for off-balance sheet items recorded in the banks' books, as well as loan loss reserves formed from profit (found on capital accounts).

-in KM 000-

Table 18: *Assets (BS and off-BS), Loan Loss Reserves according to the Regulatory Body and Value Adjustments according to IAS*

DESCRIPTION	31.12.2012	31.12.2013	30.09.2014	INDEX	
1	2	3	4	5(3/2	6(4/3)
1. Risk-bearing assets [19]	13 286 676	13 517 944	14 082 460	102	104
2. Calculated regulatory reserves for loan losses	1 370 669	1 504 174	1 638 063	110	109
3. Value adjustment and reserves for off-balance sheet items	1 092 535	1 255 162	1 315 513	115	105
4. Required regulatory reserved formed from profit for assessed losses	411 077	411 515	481 402	100	117
5. Formed regulatory reserves from profit for assessed losses	315 734	315 734	315 734	100	100
6. Shortfall of regulatory reserves formed from profit for assessed losses	111 565	156 866	192 449	141	123
7. Non-risk-bearing items	5 579 911	6 145 092	5 977 740	110	97
8. TOTAL ASSETS (1+7)	18 866 587	19 663 036	20 060 200	104	102

Total assets with off-balance sheet items (assets)[20] of banks in the Federation of B&H amounted to KM 20.1 billion as of 30.09.2014 and are up by 2% or KM 397 million compared to the end of 2013. Risk-bearing assets amount to KM 14.1 billion and are up by 4% or KM 565 million.

[19] Does not include amount of facilities and contingent liabilities of KM 204 million that is secured with a cash deposit.

Non-risk bearing items amount to KM 6 billion or 30% of total assets with off-balance sheet items, thus being down by 3% or KM 167 million compared to the end of 2013.

Total calculated loan loss reserves based on regulatory requirements amount to KM 1.6 billion and formed value adjustments for balance sheet assets and provisions for losses under off-balance sheet items amount to KM 1.3 billion. Required regulatory reserves[21] amount to KM 481 million and are up by 17% or KM 70 million. Formed regulatory reserves from profit amount to KM 316 million and are at the same level as a result of changes in regulations, i.e. the shortfall of loan loss reservess being recorded at the end of the business year (starting from 31.12.2012) is not covered by profit, but still represents a deductible item from the capital and affects the calculation of the capital adequacy ratio. The shortfall of regulatory reserves[22] as of 30.09.2014 amounts to KM 192 million, with a growth rate of 23% or KM 36 million compared to the end of 2013, which is the result of the continuous deterioration of the loan portfolio quality.

Table 19: *Total Assets, Gross Balance Sheet Assets, Risk-Bearing and Non-Risk-Bearing Assets Items*

DESCRIPTION	31.12.2012		31.12.2013		30.09.2014		INDEX	
	Amount	Struct. %	Amount	Struct.%	Amount	Struct.%		
1.	2	3	4	5	6	7	8 (4/2)	9 (6/4)
Loans	9 347 370	85.2	9 396 444	84.3	9 550 379[23]	82.7	101	102
Interest	86 650	0.8	81 456	0.7	81 216	0.7	94	100
Past due receivables	1 049 891	9.5	1 144 042	10.3	1 307 557	11.3	109	114
Receivables based on paid guarantees	24 360	0.2	31 783	0.3	31 781	0.3	130	100
Other facilities	172 479	1.6	201 786	1.8	234 100	2.0	117	116
Other assets	292 440	2.7	294 623	2.6	339 151	3.0	101	115
1. RISK-BEARING BALANCE SHEET ASSETS	10 973 190	100.0	11 150 134	100,0	11 544 184	100.0	102	103
2. NON-RISK-BEARING BALANCE SHEET ASSETS	5 084 000		5 523 506		5 621 719		109	102
3. GROSS BALANCE SHEET ASSETS (1+2)	16 057 190		16 673 640		17 165 903		104	103
4. RISK-BEARING OFF-BS ITEMS	2 313 486		2 367 810		2 538 276		102	107
5. NON-RISK-BEARING OFF-BS ITEMS	495 911		621 586		356 021		125	57
6. TOTAL OFF-BS ITEMS (4+5)	2 809 397		2 989 396		2 894 297		106	97
7. RISK-BEARING ASSETS WITH OFF-BS ITEMS (1+4)	13 286 676		13 517 944		14 082 460		102	104
8. NON-RISK-BEARING ITEMS (2+5)	5 579 911		6 145 092		5 977 740		110	97
9. ASSETS WITH OFF-BS ITEMS (3+6)	18 866 587		19 663 036		20 060 200		104	102

Gross balance sheet assets[24] amount to KM 17.2 billion and are up by 3% or KM 492 million compared to the end of 2013, while risk-bearing balance sheet assets amount to KM 11.5 billion or 67% of gross balance sheet assets (thus being up by 3% or KM 394 million compared to the end of 2013). Non-risk bearing balance sheet assets amount to KM 5.6 billion and are up by 2% or KM 98 million. Off-balance sheet risk-bearing items amount to KM 2.5 billion and are up by 7% or KM 170 million, while non-risk bearing items amount to KM 356 million and are significantly down by 43% or KM 266 million compared to the end of 2013.

[20] Assets, as defined in Article 2 of the Decision on Minimum Standards for Credit Risk Management and Asset Classification in Banks („Official Gazette of the Federation of B&H", No. 85/11 – consolidated text and 33/12 – correction, 15/13).

[21] Required regulatory reserves represent a positive difference between calculated loan loss reserves and value adjustments (calculated loan loss reserves are higher than value adjustments).

[22] Shortfall of regulatory reserves represents a positive difference between required and formed loan loss reserves.

[23] This does not include the loan amount of KM 155 million covered by a cash deposit (included in non-risk bearing assets of the balance sheet).

[24] Data source: Report on classification of balance sheet assets and off-balance sheet items of banks.

The effects of the economic crisis on the overall economy and industry in B&H are still pronounced, which is reflected in the key business segment of banks – the lending segment. In the nine months of 2014, banks recorded a moderate loan increase of 2% or KM 260 million, with the annual growth rates amounting to 1.7% in the past two years. As of 30.09.2014, loans amounted to KM 11.1 billion, with a share of 70% (-0.3 percentage points).

However, based on analytical data, it can be concluded that this credit growth was largely generated by an increase of past due, uncollected receivables (default receivables). In the first nine months of 2014, the growth rate was a high 14% or KM 159 million (in 2013, the growth rate amounted to 11% or KM 110 million, i.e. past due, uncollected receivables amounted to KM 1.1 billion) and amounted to KM 1.3 billion as of 30.09.2014. This results in the real credit growth in nine months of 2014 amounting to 1% (app. 0.7% in 2013).

In the first nine months of 2014, a total of KM 5.4 billion of new loans was approved, up by 11% or KM 535 million compared to the same period of the previous year. Out of the total loans approved, 67% relate to the corporate segment and 28.7% to the retail segment (as of 31.12.2013: 67% corporate segment, 28% retail segment). The maturity structure of newly approved loans: 47% long-term loans, 53% short-term loans (as of 31.12.2013: 44% long-term loans and 56% short-term loans.

The three largest banks in the Federation of B&H have an aggregate amount of approved loans of KM 6.1 billion, thus holding a share of 55% in total loans at the banking system level.

The table below provides an overview of the trend and change in shares of individual sectors regarding total loan structure.

-in KM 000-

Table 20: *Loan Structure by Sector*

SECTORS	31.12.2012		31.12.2013		30.09.2014		INDEX	
	Amount	Share %	Amount	Share %	Amount	Share %		
1	2	3	4	5	6	7	8(4/2)	9(6/4)
Government institutions	132 525	1.2	142 010	1.3	191 778	1.7	107	135
Public companies	251 233	2.4	259 769	2.4	258 772	2.3	103	100
Private companies and enterprises	5 141 359	48.2	5 202 269	47.9	5 216 749	46.9	101	100
Banking institutions	11 177	0.1	6 671	0.1	9 238	0.1	60	138
Non-banking financial institutions	41 661	0.4	37 791	0. 3	29 426	0.3	91	78
Retail	5 076 679	47.6	5 194 971	47.9	5 397 225	48.6	102	104
Other	11 490	0.1	8 919	0.1	8 816	0.1	78	99
TOTAL	10 666 124	100.0	10 852 400	100.0	11 112 004	100.0	102	102

In the reporting period of 2014, loan structure by industry sector changed slightly compared to the end of 2013, mostly as a result of the increase in retail loans and loans placed to government institutions. Retail loans amount to KM 5.4 billion and are up by 4% or KM 202 million (at the end of 2013: KM 5.2 billion). Loans to private companies amount to KM 5.2 billion and are at the same level compared to the end of 2013. Retail loans recorded an increase in their share from 47.9% to 48.6%, while the share of private company loans dropped from 47.9% to 46.9%.

According to information submitted by the banks (as of 30.09.2014) regarding the retail loan structure by purpose, consumer loans[25] hold a share of 76%, followed by housing loans with 21%, while the remaining 3% refer to loans to small crafts, small businesses and agriculture (at the end of 2013: 75% consumer loans, 22% housing loans, and 3% small crafts, small businesses and agriculture).

[25] Including cards business.

The three largest banks in the system have approved 62% of retail loans and 47% of private company loans (31.12.2013: 63% retail, 48% private companies).

The currency structure of loans: the largest share of 65% or KM 7.2 billion refers to currency clause loans (EUR: KM 7 billion or 97%, CHF: KM 225 million or 3%), followed by local currency loans with a share of 34% or KM 3.8 billion, while the smallest share of just 1% or KM 85 million refers to foreign currency loans (almost the entire amount thereof refers to EUR: KM 76 million or 89%). The total amount of loans with a currency clause in CHF of KM 225 million amounts to 2% of the total loan portfolio and refers almost entirely to one bank in the banking system.

Since loans are the highest risk category of banks' assets, their quality represents one of key factors determining the stability and success of the banks' operations. Asset quality assessment is in fact an evaluation of credit risk exposure of the banks' loans, i.e. the identification of potential loan losses.

The table below provides an overview of the quality of assets and off-balance sheet risk-bearing items, general credit risk and potential loan losses by classification category.

Table 21: *Asset Classification, General Credit Risk (GCR) and Potential Loan Losses (PLL)*

Classification category	31.12.2012			31.12.2013			30.09.2014			INDEX	
	Classified assets	Share %	GCR PLL	Classified assets	Share %	GCR PLL	Classified assets	Share %	GCR PLL		
1	2	3	4	5	6	7	8	9	10	11(5/2)	12(8/5)
A	10 571 555	79.6	211 433	10 754 079	79.6	215 083	11 220 257	79.7	224 407	102	104
B	1 227 301	9.3	108 313	1 094 361	8.1	93 547	1 017 179	7.2	87 152	89	93
C	334 226	2.5	87 874	356 646	2.6	90 541	420 738	3.0	107 052	107	118
D	443 500	3.3	252 970	502 803	3.7	295 224	490 132	3.5	285 866	113	97
E	710 094	5.3	710 079	810 055	6.0	809 779	934 154	6.6	933 586	114	115
Risk-bearing assets (A-E)	13 286 676	100.0	1 370 669	13 517 944	100.0	1 504 174	14 082 460	100.0	1 638 063	102	104
Classified (B-E)	2 715 121	20.4	1 159 236	2 763 865	20.4	1 289 091	2 862 203	20.3	1 413 656	102	104
Non-performing (C-E)	1 487 820	11.2	1 050 923	1 669 504	12.4	1 195 544	1 845 024	13.1	1 326 504	112	110
Non-risk-bearing assets [26]	5 579 911			6 145 092			5 977 740			110	97
TOTAL (risk-bearing and non-risk-bearing)	18 866 587			19 663 036			20 060 200			104	102

The first indicator and a warning sign of potential problems with loan repayment is the growth of past due receivables and their share in total loans. In the first nine months of 2014, past due receivables had a relatively high increase of 14% or KM 163 million (in 2013: 9% or KM 102 million) and their share rose by 1.2 percentage points, i.e. to 12%.

When analysing the quality of risk-bearing assets through trends and changes of key indicators, it can be concluded that key indicators of asset quality have deteriorated in the first three quarters of 2014 compared to the end of 2013. In some banks, these indicators showed slight oscillations (upgrade or downgrade), i.e. there were nine banks with ratios of the share of classified assets and seven banks with the share of non-performing assets (compared to risk-bearing assets) below the level of the banking sector.

[26] In accordance with Article 2, Paragraph 2 of the Decision on Minimum Standards for Credit Risk Management and Asset Classification in Banks, assets items that are not classified and items for which no general loan loss reserves of 2% are being calculated (as per Article 22, Paragraph 8 of the same Decision).

As of 30.09.2014, classified assets amounted to KM 2.9 billion and non-performing assets to KM 1.8 billion.

The growth rate of classified assets (B-E) (4% or KM 98 million) is twice as large as in 2013, which confirms the observation that the trend of deteriorating asset quality, primarily loan quality, is still present. Within classified assets, non-performing assets (C-E) went up by 10% or KM 175 million (i.e. in 2013, it went up by 12% or KM 182 million), most of which relates to three banks in the system. The continuous increase in non-performing assets is due to the reclassification of items from categories A and B into categories of non-performing assets. Category B is down by 7% or KM 77 million (in 2013: down by 11% or KM 133 million), mostly due to the aforementioned classification into lower categories.

The ratio expressed through the share of classified assets in risk-bearing assets is 20.3%, which is a decrease of 0.1% compared to the end of 2013.

The most significant indicator of asset quality is the ratio between non-performing assets and risk-bearing assets, which rose by 0.7 percentage points compared to the end of the previous year and now amounts to 13.1% (in 2013 this ratio rose by 1.2 percentage points) as a result of the increase in non-performing assets (by 10% or KM 175 million). However, this should be taken with a grain of salt due to the share of category B being 7.2% (end of 2013: 8.1%) and due to the suspicion that a part of the loans classified in this category are of poor quality and need to be classified as non-performing assets.

Sector-level data analysis is based on loan quality indicators for two key sectors: corporate and retail. The two aforementioned indicators for these sectors show major deviation and point to a higher exposure to credit risk and consequently to potential loan losses regarding the corporate segment.

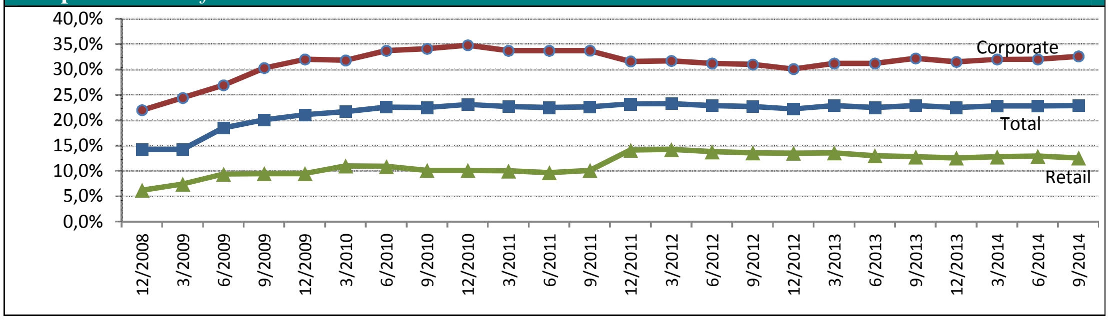
Table 22: *Classification of Corporate and Retail Loans*

Classification category	31.12.2013						30.09.2014						INDEX
	Retail	Share %	Corporate	Share %	TOTAL Amount	TOTAL Share	Retail	Share %	Corpo-rate	Share %	TOTAL Amount	TOTAL Share	
1	2	3	4	5	6 (2+4)	7	8	9	10	11	12 (8+10)	13	14(12/6)
A	4 538 704	87.4	3 874 012	68.5	8 412 716	77.5	4 715 481	87.4	3 854 266	67.4	8 569 747	77.1	102
B	135 873	2.6	717 004	12.7	852 877	7.9	144 968	2.7	646 392	11.3	791 360	7.1	93
C	70 012	1.3	272 940	4.8	342 952	3.2	70 530	1.3	334 408	5.9	404 938	3.6	118
D	128 351	2.5	361 163	6.4	489 514	4.5	81 948	1.5	394 240	6.9	476 188	4.3	97
E	322 031	6.2	432 310	7.6	754 341	6.9	384 296	7.1	485 475	8.5	869 771	7.8	115
TOTAL	5 194 971	100.0	5 657 429	100.0	10 852 400	100.00	5 397 223	100.0	5 714 781	100.0	11 112 004	100.00	102
Class. loans B-E	656 267	12.6	1 783 417	31.5	2 439 684	22.5	681 742	12.6	1 860 515	32.6	2 542 257	22.9	104
Non-perf. loans C-E	520 394	10.0	1 066 413	18.8	1 586 807	14.6	536 774	9.9	1 214 123	21.2	1 750 897	15.8	110
		47.9		52.1		100.0		48.6		51.4		100.0	
Individual sector's share in classified loans, non-performing loans and category B:													
Categories B-E		26.9		73.1		100.0		26.8		73.2		100.0	
Non-performing C-E		32.8		67.2		100.0		30.7		69.3		100.0	
Category B		15.9		84.1		100.0		18.3		81.7		100.0	

As has already been emphasized, the trend of deteriorating loan quality indicators continued in 2014. When observed by sector, it is evident that the negative trends are more apparent in the corporate loan portfolio, as expected.

At the level of the total portfolio, as of 30.09.2014, the share of non-performing loans, following an increase of 1.2 percentage points, amounted to 15.8% (in 2013, the share went up by 1.4 percentage points) as a result of the increase in total non-performing loans by 10% or KM 164 million, with corporate loans increasing by 14% or KM 148 million, and retail loans by 3% or KM 16 million (in 2013, total non-performing loans rose by 13% or KM 180 million, with corporate loans being up by 22.3% or KM 194 million, and retail loans being down by 2.7% or KM 14 million). The share of classified loans increased to 22.9%, i.e. by 0.4 percentage points.

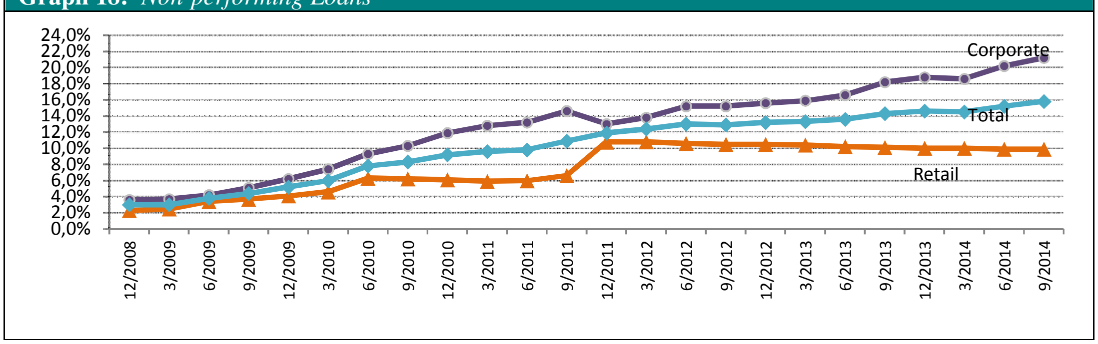
Graph 17: *Classified Loans*



Out of the total approved corporate loans in the amount of KM 5.7 billion as of 30.09.2014, there was an alarmingly high 32.6% or KM 1.9 billion of loans classified within categories B to E, which is an increase of 1.1 percentage points compared to the end of 2013 (in 2013, this share went up by 1.4 percentage points). This indicator is much better for the retail segment. Out of the total approved retail loans in the amount of KM 5.4 billion, there were 12.6% or KM 682 million of loans classified in the aforementioned categories, as was the case at the end of 2013, which is also high.

These trends are the result of the condition in the real sector and the effects of the economic crisis on the overall economy in B&H, due to which the corporate loan portfolio has a significantly lower quality than loans of the retail segment.

Graph 18: *Non-performing Loans*



The most significant indicator of the loan portfolio quality is the share of non-performing loans. Out of total non-performing loans, corporate loans hold a share of 69% and retail loans a share of 31% (at the end of 2013: 67% corporate loans, 33% retail loans). In the first three quarters of 2014, the share of non-performing loans in the corporate segment increased as a result of the aforementioned increase of 14%, while retail non-performing loans remained approximately the same. Out of total approved corporate loans, non-performing loans hold a share of 21.2% or KM 1.2 billion, which is up by 2.4% compared to the end of 2013 (in 2013, this share rose by 3.2 percentage points). This increase rate in the retail segment amounts to KM 537 million, with almost the same share of 9.9% as at the end of 2013 (in 2013, the share dropped by 0.5%).

A more detailed and comprehensive analysis is based on information on loan concentration by industry sector for the corporate segment (by sector) and for the retail segment (by purpose).

Table 23: *Concentration of Loans by Industry Sector*										
	31.12.2013				30.09.2014				INDEX	
	Total loans		Non-performing loans		Total loans		Non-performing loans			
	Amount	Share %	Amount	Share %	Amount	Share %	Amount	Share %		
1	2	3	4	5 (4/2)	6	7	8	9 (8/6)	10 (6/2)	11(8/4)
1. Corporate loans for:										
Agriculture (AGR)	112 695	1.0	30 608	27.2	123 146	1.1	28 517	23.2	109	93
Production (IND)	1 547 431	14.3	333 666	21.6	1 568 790	14.1	414 325	26.4	101	124
Construction (CON)	394 706	3.6	121 971	30.9	395 901	3.6	124 452	31.4	100	102
Trade (TRD)	2 298 260	21.2	392 161	17.1	2 292 895	20.6	444 466	19.4	100	113
Catering (HTR)	162 102	1.5	29 970	18.5	159 681	1.4	28 912	18.1	99	96
Other[27]	1 142 235	10.5	158 037	13.8	1 174 368	10.6	173 451	14.8	103	110
TOTAL 1.	5 657 429	52.1	1 066 413	18.8	5 714 781	51.4	1 214 123	21.2	101	114
2. Retail loans for:										
General consumption	3 906 142	36.0	310 450	7.9	4 148 184	37.3	319 658	7.7	106	103
Housing	1 148 230	10.6	170 282	14.8	1 112 320	10.0	177 695	16.0	97	104
Business activities (small	140 599	1.3	39 662	28.2	136 719	1.2	39 421	28.8	97	99
TOTAL 2.	5 194 971	47.9	520 394	10.0	5 397 223	48.6	536 774	9.9	104	103
TOTAL (1. +2.)	**10 852 400**	**100.0**	**1 586 807**	**14.6**	**11 112 004**	**100.0**	**1 750 897**	**15.8**	**102**	**110**

The largest share in total corporate loans refers to the trade sector (20.6%) and the production sector (14%), while the retail segment is dominated by general consumption loans (37.3%) and housing loans (10%) (at the end of 2013: trade 21.2%, production 14.3%, general consumption 36% and housing loans 10.6%).

For an extensive period of time, the negative and strong effect of the economic crisis is especially pronounced in several key sectors, which is evident from the indicator of the share of non-performing loans. The highest share of non-performing loans in the amount of 31.4% is held by the construction sector, which is up by 0.5 percentage points (in 2013, it rose by 5 percentage points), while its share in total loans stands at a mere 3.6%. In the first nine months of 2014, this sector recorded a slight increase in non-performing loans of 2% or KM 2.5 million. Also, the agricultural sector, despite the lowest share of 1.1%, has a high share of non-performing loans in the amount of 23.2% (12/13: 27.2%), with there being a drop of 7% in non-performing loans in the first nine months of 2014.

However, the focus is on the two sectors with the highest share in total loans – the trade sector (20.6%) and the production sector (14.1%). In the first nine months of 2014, there was a relatively significant increase in non-performing loans in both sectors: by 24% or KM 81 million in the production sector, with the share increasing from 21.6% to 26.4% (in 2013, the increase amounted to a high 37% or KM 90 million, and the share amounted to 21.6%, up by 5.7 percentage points); in the trade sector, non-performing loans recorded an increase in the amount of 13% or KM 52 million, while the share amounted to 19.4%, up by 2.3 percentage point (in 2013, a high increase of 27% or KM 82 million was recorded and the share rose from 13.3% to 17.1%).

The retail sector displays no major changes, its indicators are approximately the same as at the end of the previous year. The lowest indicator of the non-performing loans share in the amount of 28.8% (at the end of 2013: 28.2%) refers to loans to small business owners whose share in total loans is a low 1.2%. A relatively high share of non-performing loans in the amount of 16% refers to housing loans

[27] This includes the following sectors: traffic, warehouse and communications (TRC); financial mediation (FIN); real estate, renting and business services (RER); public administration and defence, mandatory social insurance (GOV) and other.

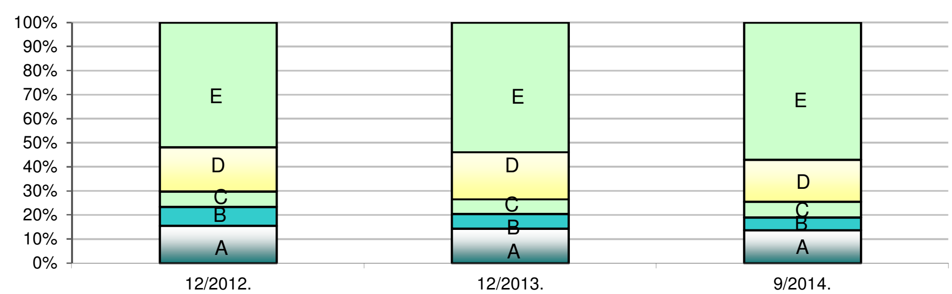
(at the end of 2013: 14.8%), while consumer loans (with the highest share of 37.3% in total loans) hold a lower share of 7.7% (at the end of 2013: 7.9%).

The general credit risk level and estimated potential loan losses by classification category, as determined in accordance with the criteria and methodology defined by the decisions of the Agency, along with their trend and structure at the banking sector level, is provided in the table and graph below.

Table 24: *Structure and Trend of General Credit Risk and Potential Loan Losses*

Classification category	AMOUNT (in KM 000) AND STRUCTURE (in %)						INDEX	
	31.12.2012		31.12.2013		30.09.2014			
1	2	3	4	5	6	7	8 (4/2)	9 (6/4)
A	211 433	15.4	215 083	14.3	224 407	13.7	102	104
B	108 313	7.9	93 547	6.2	87 152	5.3	86	93
C	87 874	6.4	90 541	6.0	107 052	6.5	103	118
D	252 970	18.5	295 224	19.6	285 866	17.5	117	97
E	710 079	51.8	809 779	53.9	933 586	57.0	114	115
TOTAL	1 370 669	100.0	1 504 174	100.0	1 638 063	100.0	110	109

Graph 19: *Structure and Trend of General Credit Risk and Potential Loan Losses*



Based on an analysis of the calculated loan loss reserves (in aggregate terms and by classification category) compared to the end of 2013, the reserves for general credit risk (category A) and potential loan losses went up by 9% or KM 134 million and stand at KM 1.6 billion. The reserves for general credit risk are up by 4% or KM 9 million and amount to KM 224 million, while the reserves for potential loan losses went up by 10% or KM 125 million. By category of classification, there were trends in both directions: the reserves for category B are down by 7% or KM 6.4 million and amount to KM 87 million. Due to the increase in non-performing assets by 10% or KM 175 million, the reserves for non-performing assets are up by 4% or KM 53 million, i.e. amount to KM 1.3 billion. The largest nominal growth of 15% or KM 124 million refers to reserves for category E, while reserves for category C are up by 18% or KM 16 million, while the reserves for category D are down by 3% or KM 9 million. This trend of loan loss reserves points to a constant deterioration of the loan portfolio, which is the result of further effects of the economic crisis on the real sector.

One of the key indicators of asset quality is the ratio between potential loan losses (PLL) and risk-bearing assets with off-balance sheet items. This ratio amounts to 10% and is higher by 0.5% compared to the end of 2013.

As of 30.09.2014, banks had an average calculated reserves in the amount of 8.6% for category B, 25.4% for category C, 58.3% for category D and 100%for category E (at the end of 2013: 8.5% for B, 25.4% for C, 58.7% for D and 100% for E).[28]

In accordance with the IAS/IFRS, banks are required to book assets depreciation through expenses by forming value adjustments for balance sheet items and provisions for risk-bearing off-balance sheet items (previously called costs of loan loss reserves).

An overview of total assets items (balance sheet and off-balance sheet) and default items, as well as relevant value adjustments and provisions (defined in accordance with the banks' internal methodologies, the minimum contents of which are regulated by decisions of the Agency) is provided in the table below.

Table 25: *Assessment and Valuation of Risk-bearing Items According to IAS 39 and IAS 37*

Description	AMOUNT (in KM 000) AND SHARE (in %)				INDEX
	31.12.2013		30.09.2014		
	Amount	Share	Amount	Share	
1	2	3	4	5	6 (4/2)
1. RISK-BEARING ASSETS (a+b)	**13 517 944**	**100.0%**	**14 082 460**	**100,0%**	104
a) Default items	**1 886 251**	14.0%	**1 980 179**	14.1%	105
a.1. BS-items in default	1 863 530		1 962 301		105
a.2. off-BS items in default	22 721		17 878		79
b) Performing assets	**11 631 693**	86.0%	**12 102 281**	85.9%	104
1.1 TOTAL VALUE ADJUSTMENTS FOR RISK-BEARING ASSETS (a+b)	**1 255 162 100.0%**	**100.0%**	**1 315 513**	**100.0%**	105
a) Value adjustments for default	**1 110 375**	88.5%	**1 167 677**	88.8%	105
a.1. Value adjustments for BS items in default	1 105 059		1 162 397		105
a.2. Reserves for off-BS items in default	5 316		5 280		99
b) Value adjustments for performing assets (IBNR[29])	144 787	11.5%	147 836	11.2%	102
2. TOTAL LOANS (a+b)	**10 852 400**	**100.0%**	**11 112 004**	**100.0%**	102
a) Defaulted loans (non-performing loans)	1 799 777	16.6%	1 898 821	17.1%	106
b) Performing loans	9 052 623	83.4%	9 213 183	82.9%	102
2.1. VALUE ADJUSTMENT FOR LOANS (a+b)	**1 165 928**	**100.0%**	**1 220 201**	**100.0%**	105
a) Value adjustments for defaulted loans	1 052 412	90.3%	1 107 964	90.8%	105
b) Value adjustments for performing loans (IBNR loans)	113 516	9.7%	112 237	9.2%	99
Coverage rate of default items	**58.9%**		**59.0%**		
Coverage rate of performing assets	**1.2%**		**1.2%**		
Coverage rate of risk-bearing assets with total value adjustments	**9.3%**		**9.3%**		

In the first nine months of 2014, default loans rose by 6% or KM 99 million (in 2013: up by 9% or KM 155 million). For comparison's sake, non-performing loans rose by 10% or KM 164 million compared to the end of 2013. The share of default loans in total loans increased by 0.5 percentage points and amounts to 17.1% and the share of non-performing loans amounts to 15.8%. The share of all default items in total risk-bearing assets is 14.1%, which is the same as at the end of 2013.

The coverage rate of default items with value adjustments is approximately at the same level and amounts to 59%, while the coverage rate of non-performing assets with loan loss reserves is slightly up and amounts to 71.9% (12/13: 71.6%). The coverage rate of performing assets remains the same and amounts to 1.2%, along with the coverage rate of risk-bearing assets with total value adjustments (9.3%). The coverage ratio of risk-bearing assets with total calculated regulatory reserves for loan

[28] According to the Decision on Minimum Standards for Credit Risk Management and Asset Classification in Banks, banks are required to calculate loan loss reserves by classification category bearing the following percentages: A-2%, B 5-15%, C 16-40%, D 41-60% and E 100%.
[29] IBNR (identified but not reported) – latent losses.

losses (reserves for general credit risk and special reserves for loan losses) improved slightly and amounts to 11.6% (12/13: 11.1%).

On the basis of the aforementioned, it can be concluded that the economic crisis and conditions in the real sector still negatively affect the banks' loan portfolio, past due receivables of debtors, primarily legal entities, which results in the increase in non-performing loans. However, it should be noted that the negative effects the natural disasters from May 2014 had on natural persons and legal entities on territories affected by the flood in B&H, i.e. the effect of the banks' debtors' meeting loan commitments, will impact the business performance indicators of a number of banks in the following period as well, primarily through the increase in default loans and the financial result.

In order to mitigate the negative effects of the natural disaster, on 30.06.2014, the Agency adopted the Decision on Provisional Measures for Treatment of Loan Commitments of Bank Clients Affected by Natural Disasters.[30]

Acting in accordance with the aforementioned Decision, in the third quarter of 2014 and out of a total number of 237 received requests for moratoriums on loan commitments, banks in the Federation of B&H approved 129 requests in the total amount of KM 16.6 million or 54% of the total number of submitted requests for moratoriums. Out of the total amount of moratoriums on loan commitments, KM 13.6 million refer to legal entities and KM 3 million to natural persons.

Also, in accordance with the aforementioned Decision, in the third quarter of 2014 and out of a total number of 247 submitted requests for restructurings of loan commitments, banks in the Federation of B&H approved 132 requests in the total amount of KM 32 million or 53% of the total number of submitted requests for restructurings of loan commitments. Out of the total amount of restructured loan commitments, KM 31 million refer to legal entities and KM 1 million to natural persons.

As of 30.09.2014, loans approved in accordance with the aforementioned Decision have a very low share in relation to total loans: moratorium 0.15% and restructuring 0.28%.

The upward trend of uncollectable receivables, i.e. customer defaults in the payment of past due loan commitments, has caused the activation of the guarantor's obligation in a certain number of defaulted loans (with this form of security). As of 31.12.2009, the Agency has prescribed a report on the repayment of loans by guarantors in order to collect, monitor and analyse information on loans being repaid by guarantors. According to the reports filed by banks in the Federation of B&H as of 30.09.2014, there was a total of 1 116 758 loan accounts, 1 637 of which were being repaid by guarantors (1 922 guranators). The share of loans and number of loan accounts being repaid guarantors in relation to information for the overall system is lowe and amounts to a mere 0.38% and 0.15%.

For the purpose of mitigating the adverse effects of the global financial and economic crisis and considering the preservation of the banking sector's stability, in late 2009, the Agency adopted the Decision on Temporary Measures for Rescheduling of Loan Commitments of Natural Perons and Legal Entities.[31]

The primary objective of these temporary measures is to encourage banks to "boost" lending activities and restructure existing receivables without having to increase prices on loans and raise costs for existing debtors in order to help both natural persons and legal entities to overcome the situation they found themselves in due to the economic crisis (lower payment capacity of natural persons due to the loss of a job, late salaries, salary reductions, etc. and, with respect to legal entities – higher illiquidity, major reduction of business volume, very difficult condition in the real sector in general, etc.).

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[30] "Official Gazette of the Federation of B&H", No. 55/14.
[31] "Official Gazette of the Federation of B&H", No. 2/10, 1/12, 111/12 and 1/14.

Acting in accordance with the said Decision, in the first three quarters of 2014, banks in the Federation of B&H have received a total of 344 requests for loan rescheduling and approved 321 requests in the total amount of KM 55 million or 93%, which higher by 12% compared to the same period in 2013. Out of the total amount of approved rescheduled liabilities, KM 54 million refer to legal entities and KM 1 million to natural persons.

The net effect of loan loss reserves based on performed restructurings is an increase of KM 449 thousand. It is worth noting that there were also contrary trends in sense that there were both increases and decreases in loan loss reserves on this basis, which finally resulted in the aforementioned net effect.

According to the aforementioned Decision of the Agency, rescheduled loans represented only 0.5% of total loans as of 30.09.2014 (i.e. corporate rescheduled loans represented 0.9% of total corporate loans and retail rescheduled loans represented 0.02% of total retail loans).

Based on this information, it can be concluded that the result of restructured loans is relatively modest considering both their number and amount, when compared to the total loan portfolio and sector-level portfolio (for legal entities and natural persons).

Although the results and effects of the Decision's implementation are not significant, the adoption of such a regulation was particularly important, i.e. such temporary measures were truly necessary in the conditions of the financial and economic crisis and their effects on the real sector in the Federation of B&H and had positive effects on debtors (both corporate and retail) by facilitating debt servicing in accordance with their payment capacities. Therefore, the validity prolongation of the Decision to 2014 was justified, especially due to the fact that the effects of the crisis are still evident.

An analysis of asset quality, i.e. the quality of the loan portfolio of individual banks, as well as on-site controls in the banks themselves, indicate that credit risk is the dominant risk in most banks and the fact that some banks have inadequate practices for managing, i.e. assessing, measuring, monitoring and controlling credit risk and for classifying assets is worrisome, which our on-site examinations determined on the basis of major amounts related to the shortfall of loan loss reserves (which were later on adequately formed as per the Agency's orders). Also, the analysis of asset quality in banks grouped according to ownership structure revealed that ratios of banks in majority ownership of residents (6 "local" private banks) were worse than those of banks in majority foreign ownership (10 banks).
After the significant increase in non-performing loans in "local" banks by 45% in 2013, the first three quarters of 2014 saw an increase of 6%, but there is a relatively high increase of 11% in banks that are in majority foreign ownership (the increase in non-performing loans in 2013 was 9%). The share of non-performing loans in banks that are in majority foreign ownership amounts to 14.7%, while it amounts to 29.7% in "local banks". This is the result of inadequate and weak systems for credit risk management, especially in relation to the key stage – loan approval. Major weaknesses and inefficient practices were also identified in the preventive actions stage, i.e. in the early recognition of problems in loan settlement (servicing), as well as when handling non-performing assets in the interest of reducing such assets through collection or sound restructuring.

Banks, in which the Agency identified (through bank examinations) low asset quality and poor practices of credit risk management and/or which displayed adverse trends, i.e. decrease in asset quality, were ordered to apply corrective actions in the sense of drafting an operational program for the management of non-performing assets, which had to contain an action plan for the improvement of existing practices of credit risk management, i.e. asset quality management, for the reduction of existing concentrations and for solving the problem of non-performing assets and preventing their further impairment. Compliance with the Agency's orders is being continuously monitored through an intensified post-control process based on reports and other documentation submitted by banks, as well as through targeted on-site controls. The supervision of this segment of operations has been intensified due to evident negative trends significantly affecting and causing the deterioration of the banks' profitability and the weakening of the capital base of certain banks, due to which banks need to take timely actions to obtain capital from external sources.

Transactions with Related Entities

In their business operations, banks are exposed to different risks, with the risk of transactions with their related entities being especially significant.

In accordance with the Basel Committee standards, the Agency has established prudential principles and requirements for bank transactions with related entities, as regulated by the Decision on Minimum Standards for Banks' Operations with Related Entities, which defines the conditions and manner of the banks' business operations with related parties. Based on this Decision and the Law on Banks, a bank's Supervisory Board (acting on the Director's proposal) is required to adopt special bank policies for operations with related entities and to monitor their implementation.

The Agency's Decision also prescribes a special set of reports on transactions with one part of related entities, encompassing loans and contingent and assumed off-balance sheet liabilities (guarantees, letters of credit, assumed loan commitments) as the most frequent and most risky form of transactions between banks and their related entities.

The regulated set of reports includes information on loans approved to the following types of related entities:

- bank shareholders with over 5% of voting rights,
- members of the bank's Supervisory Board and Management Board, and
- subsidiaries and other companies related to the bank.

- KM 000 -

Table 26: *Transactions with Related Entities*

Description	LOANS APPROVED [32]			INDEX	
	31.12.2012	31.12.2013	30.09.2014	3/2	4/3
1	2	3	4	5	6
To shareholders with over 5% voting rights, subsidiaries and other related entities	156 861	123 889	170 357	79	137
To members of the Supervisory Board and Audit Board	617	570	444	92	78
To the Management of the bank	2 574	2 507	2 063	97	82
TOTAL	160 052	126 966	172 864	79	136
Contingent and assumed off-balance sheet liabilities	21 800	16 046	18 131	74	113

During the reporting period, loan exposures to related entities increased by 36% and contingent liabilities by 13% due to increased exposure related to three banks. Based on the presented information, it can be concluded that the volume of loans and guarantees with related entities is still low, as is the level of risk. The Agency pays special attention (during its on-site controls) to the banks' operations with related entities, especially in terms of assessing their system of identification and monitoring of risk exposure in transactions with related entities. The Agency's examiners give on-site orders for eliminating identified omissions within certain time frames and also initiate violation proceedings, the integral part being monitoring and overseeing the compliance with the issued orders in the post-control procedure. This has reflected positively on this segment of their

[32] In addition to loans, this includes other receivables, deposits and facilities to shareholders (financial institutions) with over 5% of voting rights.

operations since banks have significantly improved the quality of their risk management in this segment.

2.2. Profitability

According to information from the income statement, a positive financial result – profit in the amount of KM 124 million was recorded at the level of the banking system in the Federation of B&H in the first nine months of 2014. This is an increase of 35% or KM 23 million compared to the same period of the previous year. One large bank recorded a significantly smaller loss (by approximately KM 30 million) and this in particular had a positive effect on the financial result at system level, along with higher profit in banks that operated positively in the same period of the previous year (effect KM 15 million) and recorded profit in the case of two banks that operated at a loss last year (effect KM 12 million). On the other hand, a negative effect of KM 11 million is primarily the result of a bigger loss recorded by one bank as well as lower profit recorded by a few banks.

The key effect on improved profitability of most banks is primarily the result of the application of the new methodological approach (implementation of IAS 37/39 starting from 31.12.2011), which led to smaller value adjustment costs.

A better financial result compared to the same period of the previous year is primarily the result of the further reduction of non-interest bearing expenses, especially operating ones, but also of value adjustment costs. On the other hand, the increase in total profit is supported by the increase in operating income and net interest income (greater decrease in interest expenses compared to interest income resulted in a positive effect, i.e. an increase in net interest income).

A positive financial result in the amount of KM 153 million was recorded by 15 banks and it is up by 9% or KM 12 million compared to the same period of the previous year. At the same time, an operating loss in the amount of KM 29 million was recorded by two banks.

Detailed information is provided in the table below.

- KM 000 -

Table 27: *Recorded Financial Result: Profit/Loss*

Description	30.09.2012		30.09.2013		30.09.2014	
	Amount	Number of banks	Amount	Number of banks	Amount	Number of banks
1	2	3	4	5	6	7
Loss	-6 298	3	-49 171	3	-29 423	2
Profit	117 054	15	140 853	14	153 395	15
Total	**110 756**	**18**	**91 682**	**17**	**123 972**	**17**

As in other segments, this segment also shows some concentrations: out of the total profit (KM 153 million), 73% or KM 113 million refers to the two largest banks in the system with an assets share of 48% in the banking sector, while 83% or KM 24 million of the total loss of KM 29 million refer to one small bank. Analytical data indicates that a total of 10 banks has a better financial result (by KM 57 million), while 7 banks have a poorer financial result (by KM 25 million).

Based on analytical data as well as indicators for the assessment of profitability quality (i.e. the level of the recorded financial result – profit/loss and ratios used in evaluating profitability, productivity and efficiency of operations, as well as other parameters related to business result assessment), it is evident that the overall profitability of the system has improved slighty compared to the previous year, especially in relation to large banks that recorded greater profit compared to the same period of the previous year. This is primarily a result of the implementation of a new methodological approach. However, a profitability assessment that is based solely on the recorded financial result would not be an adequate assessment since other important factors that affect sustainability and quality of earnings, i.e. profit, should also be taken into account. In that sense, it is of outmost importance to emphasise credit risk and negative trends in asset quality over the past five years, which is evident from the increase in non-performing and uncollectable loans and which does not correlate with the reduction of value adjustment costs (following the implementation of IAS 39 and 37), this being the most important factor affecting the improvement of the financial result in most banks over the past three years. This leads to the conclusion, as well as suspicion, that value adjustments are underestimated and not at an adequate level in some banks.

At system level, total income amounted to KM 648 million, up by 2% or KM 10 million compared to the same period of the previous year. Total non-interest bearing expenses amount to KM 524 million, with a growth rate of 4% or KM 23 million compared to the same period of the previous year. This has negatively affected the total finacial result of the banking sector.

Despite the increase in average interest-bearing loans in most of banks by 2.9%, a decrease in the average interest rate on loans (as a result of a slight decrease in active loan interest rates and the increase in non-performing loans) led to the further reduction of interest-bearing income. Although some banks recorded higher interest income compared to the same period of the the previous year (as a result of intensified lending activities), a much lower interest income of one large bank has caused the reduction at system level. Interest income amounted to KM 578 million, down by 1% or KM 6 million compared to the same period of the previous year, with the share in the structure of total income being down from 91.5% to 89.2%. The largest share refers to loan interest income, which also recorded the biggest nominal drop of KM 7 million or 1%, with the share in total income being down from 82.5% to 80.2%.

Compared to the same period of the previous year, positive trends were recorded with respect to interest expenses as their rate of decrease was higher (-5%) than the rate of decrease of interest income (-1%). Nominal interest expenses decreased by KM 10 million, and interest income by KM 6 million. Interest expenses amount to KM 171 million, and their share in the total income structure decreased from 28.2% to 26.3%. Average interest-bearing deposits increased by 3% and interest expenses related to deposit accounts amount to KM 146 million and are the biggest item, in both relative and nominal terms, in total interest expenses. This item went down by 6% or KM 9 million, as a result of the deposit base structure (higher share of deposits with lower interest rate), which resulted in a decrease in average interest rates on deposits from 1.71% to 1.57% vs. the comparable period. Interest expenses on loans and other borrowings amount to KM 15 million and are down by 11% compared to the same period of the previous year, with their share going from 2.6% to 2.3%.

As a result of the larger decrease in both interest expenses (-5%) and interest income (-1%), net interest income rose by 1% or KM 4 million and amounts to KM 407 million, but with its share in the total income structure being down from 63.3% to 62.9%.

Operating income amounts to KM 241 million and is up by 3% or KM 6 million compared to the same period of the previous year, and their share in total income structure remained at almost the same level of 37%. Within operating income, the largest share refers to service fees, with an increase of 6% or KM 8 million.

Total non-interest bearing expenses amount to KM 524 million and are down by 4% or KM 23 million compared to the same period of the previous year and their share in the total income structure decreased from 85.6% to 80.9%, which is mainly the result of reduced value adjustment costs by 5% or KM 18 million. Operating expenses amount to KM 360 million and have a share of 56% in total income. The costs of salaries and contributions, as the largest item in operating expenses, remained almost the same (KM 184 million or 28.5% of total income), while fixed assets expenses amount to KM 108 million (their share in total income thus dropping from 18% to 16.7%), following a decrease of 5% or KM 6 million. Other operating expenses with a relatively low share in total income of approximately 10% saw the largest drop of 16% or KM 13 million, which was the key factor in the improvement of the financial result compared to the same period of the previous year. After the crisis emerged, banks took numerous measures to rationalise costs of operations, primarily to reduce operating expenses, which has partly mitigated adverse effects of the interest income decrease caused by the lower volume of lending activities and decrease in loan portfolio quality.

The trend and structure of total income and total expenses is provided in the tables and graphs below.

- in KM 000 -

Table 28: *Total Income Structure*

Total income structure	30.09.2012		30.09.2013		30.09.2014		INDEX	
	Amount	%	Amount	%	Amount	%		
1	2	3	4	5	6	7	8 (4/2)	9 (6/4)
I Interest income and similar income								
Interest-bearing deposit accounts at deposit institution	3 356	0.4	1 664	0.2	3 069	0.4	50	184
Loans and leasing facilities	546 598	65.6	526 568	64.3	519 657	63.5	96	99
Other interest income	55 066	6.6	55 580	6.8	55 066	6.7	101	99
TOTAL	605 017	72.6	583 812	71.3	577 792	70.6	96	99
II Operating income								
Service fees	160 138	19.2	167 613	20.5	176 261	21.6	105	105
Income from FX deals	34 784	4.2	32 568	4.0	33 836	4.1	94	104
Other operating income	33 445	4.0	34 392	4.2	30 465	3.7	103	89
TOTAL	228 367	27.4	234 573	28.7	240 562	29.4	103	103
TOTAL INCOME (I + II)	833 384	100.0	818 385	100.0	818 354	100.0	98	100

Graph 20: *Total Income Structure*

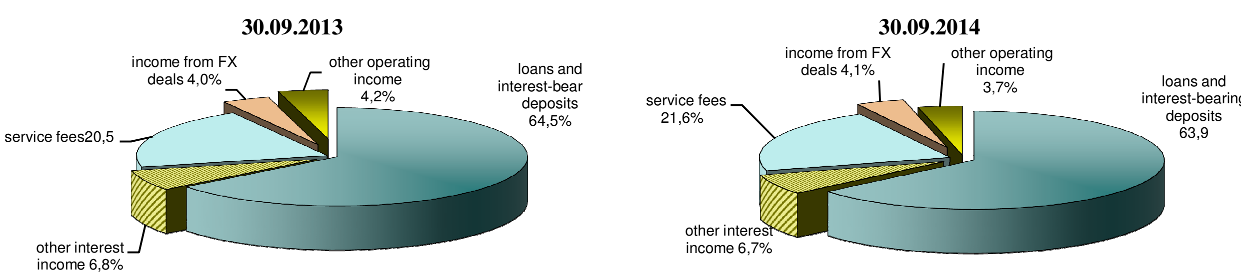
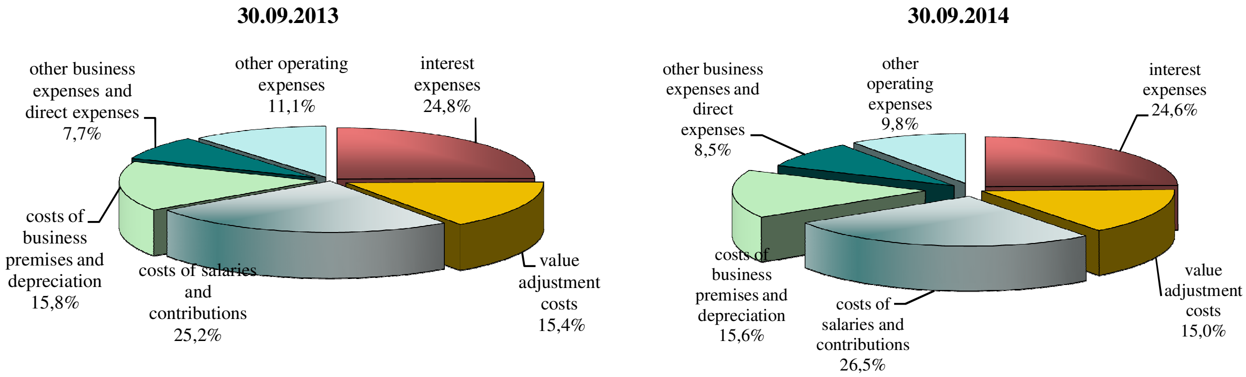


Table 29: *Total Expenses Structure*

Total expenses structure	30.09.2012		30.09.2013		30.09.2014		INDEX	
	Amount	%	Amount	%	Amount	%		
1	2	3	4	5	6	7	8 (4/2)/	9 (6/4)
I Interest expenses and similar expenses								
Deposits	163 678	22.7	154 611	21.3	145 632	21.0	94	94
Liabilities based on loans and other borrowings	29 050	4.0	16 477	2.3	14 694	2.1	57	89
Other interest expenses	11 224	1.6	9 067	1.2	10 177	1.5	81	112
TOTAL	203 952	28.3	180 155	24.8	170 503	24.6	88	95
II Total non-interest-bearing expenses								
Costs of value adjustment of risk-bearing assets and provisions for contingent liabilities and other value adjustments	93 718	13.0	111 933	15.4	104 641	15.0	119	93
Costs of salaries and contributions	184 611	25.5	183 273	25.2	184 319	26.5	99	101
Costs of business premises and depreciation	118 620	16.4	114 689	15.8	108 389	15.6	97	94
Other business expenses and direct expenses	55 089	7.6	56 053	7.7	58 772	8.5	102	105
Other operating expenses	66 603	9.2	80 564	11.1	67 758	9.8	121	84
TOTAL	518 641	71.7	546 512	75.2	523 879	75.4	05	96
TOTAL EXPENSES (I + II)	722 593	100.0	726 667	100.0	694 382	100.0	101	96

Graph 21: *Total Expenses Structure*



The table below provides an overview of key ratios for the assessment of profitability, productivity and efficiency of banks.

- in %-

Table 30: *Profitability, Productivity and Efficiency Ratios by Period*

RATIOS	30.09.2012	30.09.2013	30.09.2014
Profit from average assets	0.7	0.6	0.8
Profit from average total capital	5.1	4.1	5.2
Profit from average share capital	9.4	7.8	10.2
Net interest income/average assets	2.7	2.7	2.6
Operating income/average assets	1.5	1.6	1.6
Total income/average assets	4.2	4.3	4.2
Business expenses and direct expenses[33]/average assets	1.0	1.1	1.1
Operating expenses/average assets	2.5	2.5	2.3
Total non-interest-bearing expenses/average assets	3.5	3.7	3.4

An analysis of key ratios for the profitability quality assessment has shown that, due to the larger amount of recorded profit compared to the same period of the previous year, the ROAA (return on average assets) increased from 0.6% to 0.8%, while the ROAE (return on average equity) increased from 7.8% to 10.2%.

The banks' productivity indicator, measured as a ratio between total income and average assets (4.2%), is slightly lower (by 0.1 percentage point). Other ratios showed slight changes: the business expenses and direct expenses ratio/average assets remained at the same level vs. the comparable period, and the operating expenses/average assets ratio improved from 2.5% to 2.3% as a result of lower operating expenses, along with a simultaneous increase in average assets.

In negative conditions of the banks' operations and prompted by effects of the economic and financial crisis on the banking sector of the Federation of B&H, the profitability of banks will continue to be mostly affected by and will depend on two key factors: a) the further trend of assets quality, i.e. the level of loan losses and credit risk, and b) the efficiency of management and control over operating income and operating expenses. On the other hand, the evident slowdown and downward trend of economic activities caused lower demand for loans and a more restrictive approach on the supply side (banks). This will directly affect the profitability of the entire banking sector in the period to come. Also, the banks' profit, i.e. their financial result, will be largely affected by the price and interest rate risk in terms of both sources of funding and an interest margin sufficient enough to cover all non-interest bearing expenses and thus eventually ensure satisfactory profit related to capital invested by bank owners. Therefore, a key factor for the efficiency and profitability of every bank is the quality of

[33] Expenses also include value adjustment costs.

management and business policies, as well as the quality and efficiency of risk management systems, since this directly affects its performances.

2.3. Weighted Nominal and Effective Interest Rates

In the interest of greater transparency and easier comparability of banks' loan approval terms and deposit taking terms, as well as in the interest of customer protection by means of introducing transparent disclosure of loan approval costs, i.e. deposit income, all in accordance with international standards, criteria and practices in other countries, on 01.07.2007, the Agency prescribed a uniform manner of calculating and disclosing the effective interest rate[34] for all banks seated in the Federation of B&H as well as their organisational units operating on the territory of the Federation of B&H. the effective interest rate represents an actual relative loan price, i.e. income earned on a deposit, expressed as an annual percentage.

The effective interest rate is a decursive interest rate calculated on an annual level by applying complex interest calculation in such a manner that discounted cash receipts are brought to an equivalent level with discounted cash expenditures related to the approved loans, i.e. related to the received deposits.

Banks are required to report to the Agency on a monthly basis regarding weighted nominal and effective interest rates on loans and deposits approved/received in the reporting month in question, all in accordance with regulated methodology.[35]

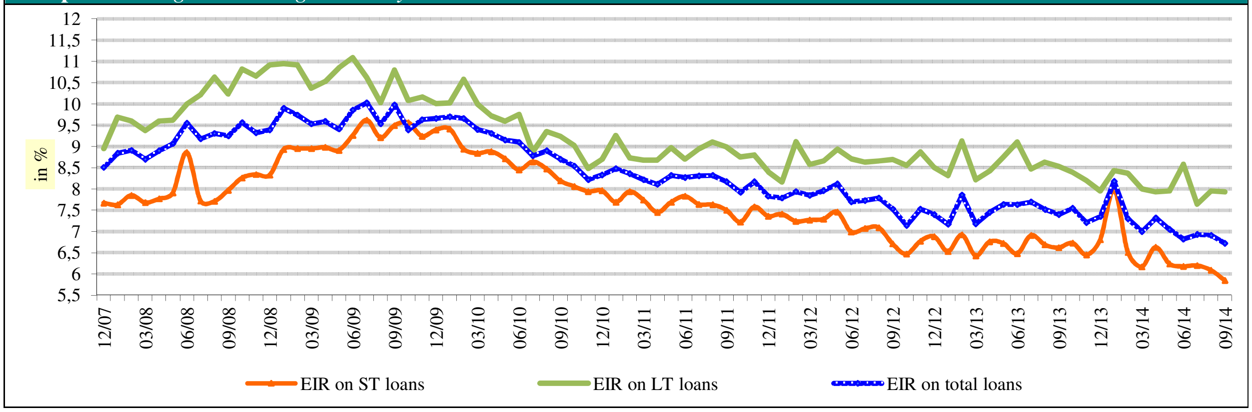
The table below shows an overview of weighted nominal and effective interest rates (hereinafter: NIR and EIR) on loans at the banking sector level and for two key customer segments (corporate and retail) for December 2012, June, September and December 2013, and June and September 2014.

Table 31 : *Weighted Average NIR and EIR on Loans*

DESCRIPTION	12/2012		06/2013		09/2013		12/2013		06/2014		09/2014	
	NIR	EIR	NIR	EIR	NIR	EIR	NIR	EIR	NIR	EIR	NIR	EIR
1	2	3	4	5	6	7	8	9	10	11	12	13
1. Weighted IR on short-term loans	6.39	6.88	6.04	6.48	6.15	6.62	6.18	6.81	5.70	6.24	5.45	5.85
1.1. Corporate	6.39	6.86	6.09	6.47	6.15	6.55	6.21	6.79	5.64	6.13	5.40	5.73
1.2. Retail	8.46	10.89	7.92	10.91	8.29	11.82	6.42	8.51	8.32	11.72	8.21	11.93
2. Weighted IR on long-term loans	7.66	8.50	8.07	9.10	7.72	8.53	7.31	7.95	6.81	7.44	7.16	7.93
2.1. Corporate	6.73	7.22	6.94	7.40	6.71	7.21	6.83	7.17	6.03	6.30	6.27	6.69
2.2. Retail	8.48	9.59	8.52	9.79	8.34	9.35	7.93	8.95	7.54	8.47	7.82	8.84
3. Total weighted IR on loans	6.80	7.40	6.93	7.63	6.79	7.40	6.72	7.35	6.24	6.82	6.17	6.72
3.1. Corporate	6.45	6.93	6.26	6.66	6.27	6.70	6.41	6.92	5.76	6.18	5.61	5.96
3.2. Retail	8.47	9.69	8.49	9.83	8.34	9.47	7.84	8.92	7.56	8.58	7.84	8.97

[34] Decision on Uniform Method of Calculation and Disclosure of Effective Interest Rate on Loans and Deposits („Official Gazette of the Federation of B&H", No. 27/07).
[35] Instructions for Implementation of the Decision on Uniform Method of Calculation and Disclosure of Effective Interest Rate on Loans and Deposits and Instructions for Calculation of Weighted Nominal and Effective Interest Rate.

Graph 22: *Weighted Average Monthly EIR on Loans*



When analysing interest rate trends, it is important to monitor trends of the weighted EIR, with the difference between this interest rate and the NIR representing a fee and commission paid to the bank for an approved loan (and this is factored in the loan price calculation). This is why the EIR represents the actual price of a loan.

The weighted EIR on loans amounts to 6.72% and, compared to the level from December 2013, saw a decrease of 0.63 percentage points, while simultaneously being the lowest recorded rate in the period of the first nine months of 2014. In the reporting period, the weighted EIR had a slight downward trend, with a signifcant oscillation recorded in January 2014, when the EIR amounted to 8.18%, which is also the highest level in the first three quarters of 2014.

Weighted interest rates on short-term loans in the first nine months of 2014 saw higher oscillations (within the range of 2.13 percentage points) compared to those on long-term loans (ranging within 0.99 percentage points).

In September 2014, the weighted EIR on short-term loans amounted to 5.85%, down by 0.96 percentage points compared to December 2013. The weighted EIR on long-term loans amounted to 7.93% in September 2014, slightly down by 0.02 percentage points compared to December 2013.

Interest rates on loans approved to two key customer segments: corporate and retail[36], saw different trends in the reporting period in 2014. The weighted EIR on corporate loans (which is still lower than the EIR on retail loans) saw, with minor oscillations, a slight drop from from 6.92% in December 2013 to 5.96% in September 2014. This downward trend of weighted EIRs on corporate loans was also seen with respect to short-term loans (from 6.79% to 5.73%) and long-term loans (from 7.17% to 6.69%).

In the first nine months of 2014, the EIR on retail loans recorded larger oscillations and amounted to 8.97% in September 2014, which is at a similar level compared to December 2013 (8.92%). It should be noted that the lowest level of 8.56% was recorded in May, and the highest (9.03%) in February. The EIR on long term-loans of this segment dropped slightly compared to December 2013 (from 8.95% to 8.84%). The EIR on short-term loans amounted to 11.93% in September 2014, up by 3.42 percentage points compared to December 2013, when more favourable interest rates were offered.

Compared to December 2013, the most significant decrease of the EIR was recorded in September 2014 with respect to long-term retail loans – small businesses (from 13.77% to 8.17%), while the

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[36] According to the methodology of sector classification, small business owners are included in the retail sector.

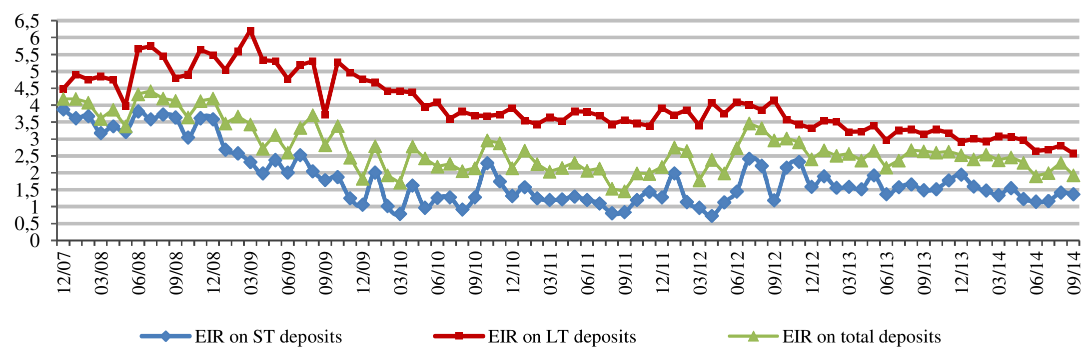
most significant increase was seen in relation to short-term retail loans – general consumption (from 8.16% to 11.94%).

Weighted NIRs and EIRs on term deposits (calculated on the basis of monthly reports) at the banking sector level are provided in the following table.

Table 32 : *Weighted Average NIR and EIR on Deposits*

DESCRIPTION	12/2012		06/2013		09/2013		12/2013		06/2014		09/2014	
	NIR	EIR	NIR	EIR	NIR	EIR	NIR	EIR	NIR	EIR	NIR	EIR
1	2	3	4	5	6	7	8	9	10	11	12	13
1. Weighted IR on short-term deposits	1.59	1.59	1.35	1.37	1.48	1.49	1.94	1.95	1.13	1.15	1.35	1.37
1.1. up to three months	1.28	1.28	1.01	1.01	1.29	1.29	1.92	1.92	0.94	0.95	1.15	1.17
1.2. up to one year	2.53	2.55	1.80	1.86	1.58	1.61	1.99	2.01	1.59	1.62	1.71	1.74
2. Weighted IR on long-term deposits	3.30	3.32	2.95	2.97	3.11	3.14	2.89	2.92	2.62	2.65	2.56	2.57
2.1. up to three years	3.17	3.19	2.64	2.66	2.87	2.90	2.58	2.61	2.55	2.58	2.36	2.37
2.2. more than three years	4.42	4.46	4.32	4.33	4.33	4.35	4.24	4.28	2.83	2.84	3.36	3.37
3. Total weighted IR on deposits	2.39	2.40	2.14	2.16	2.61	2.64	2.50	2.53	1.88	1.90	1.91	1.93

Graph 23: *Weighted Average Monthly EIR on Deposits*



As opposed to loans, the actual price of which is affected by costs related to approval and servicing of loans (on the condition that such costs are known at the time of approval), deposits show almost no difference between the nominal and effective interest rate.

Compared to December 2013, the weighted EIR on total term deposits in September 2014 is down by 0.60 percentage points (from 2.53% to 1.93%).

The weighted EIR on short-term deposits has decreased. In September 2014, it amounted to 1.37%, down by 0.58 percentage points compared to December 2013.

The weighted EIR on long-term deposits also saw a decrease in the reporting period of 2014 and amounts to 2.57%, down by 0.35 percentage points compared to December 2013 (12/2013: 2.92%).

In the period from the second half of 2012 to the second quarter of 2014, new corporate deposits decreased, especially those of short-term nature. This has resulted in a significant increase in short-term interest rates of the corporate segment and eventually to average interest rates of the corporate segment being higher than average interest rates of the retail segment in the reporting period. In the third quarter 2014, weighted EIRs of the corporate segment had a downward trend and amounted to 2.02% as of September 2014, which is down by 0.98 percentage points compared to December 2013, when they amounted to 3% and is lower than the average interest rates of the retail segment (09/2014: 2.24%).

EIRs of the corporate segment in relation to short-term deposits recorded a slight increase (as of 12/2013: from 1.41% to 1.58%), while the aforementioned is lower by 0.45 percentage points with respect to long-term deposits (as of 12/2013: from 3.35% to 2.90%).

The weighted EIR on retail deposits amounts to 2.24%, down compared to December 2013 (2.65%), with a recorded drop of the EIR on long-term deposits (from 3.03% to 2.51%) and short-term deposits (from 1.64% to 1.46%). Both rates saw slight oscillations in the first three quarters of 2014.

Weighted interest rates on loans related to transaction account overdraft facilities and call deposits, as calculated on the basis of monthly reports, are provided in the table below.

Table 33 : *Weighted Average NIR and EIR on Overdraft Facilities and Call Deposits*

DESCRIPTION	12/2012		09/2013		12/2013		06/2014		09/2014	
	NIR	EIR	NIR	EIR	NIR	EIR	NIR	EIR	NIR	EIR
1	2	3	4	5	6	7	8	9	10	11
1. Weighted IR on overdraft facilities	8.43	8.57	8.30	8.47	8.25	8.42	8.14	8.31	8.16	8.33
2. Weighted IR on call deposits	0.19	0.19	0.15	0.15	0.15	0.15	0.13	0.13	0.13	0.13

As a rule, the EIR on these assets and liabilities items is equal to the nominal interest rate. The weighted EIR on total overdraft facilities for the banking sector in September 2014 amounted to 8.33% (down by 0.09 percentage points compared to December 2013) and to 0.13% on call deposits (slightly lower compared to December 2013).

2.4. Liquidity

Along with credit risk management, liquidity risk management is one of the most important and most complex segments of banking operations. Liquidity maintenance within the market economy is a permanent liability of the bank and the basic premise for its sustainability on the financial market, along with being a key precondition to establishing and preserving trust in the banking system of any country as well as in the banking system's stability and safety.

Until the onset of the global financial and economic crisis, in normal operating conditions of banks and a stable environment, the liquidity risk was of secondary importance to banks, i.e. credit risk was the focal point and established management systems, i.e. systems for identification, measurement and control of this risk were under continuous supervision for the purpose of being improved and upgraded.

When financial markets got disrupted due to the effect of the global crisis, liquidity risk suddenly gained importance and managing this risk became a key factor for smooth operations, the timely handling of liabilities due and the preservation of the long-term position of the bank in terms of its solvency and capital base. In addition, it is worth noting that the interdependence of all risks the bank is or may be exposed to in its operations has also come to light with the onset of the crisis.

In the last quarter of 2008, after the global crisis and its negative effect spread to the financial and economic system of B&H, the liquidity risk of banks in the Federation of B&H increased. Although one part of savings deposits got withdrawn and the trust in banks impaired, it was found that the liquidity of the banking system was never at stake since banks in the Federation of B&H (due to regulatory requirements and defined limits based on a conservative approach) had significant liquid assets and a good liquidity position.

In 2009, negative trends from the last quarter of 2008 were halted and basic liquidity indicators improved (mostly thanks to reduced lending activity). 2010 saw a slight deterioration of these indicators, continuing in 2011, but in lesser intensity. A somewhat greater deterioration of these indicators was again seen in the first quarter of 2012 as a result of reduced cash funds related to a slight increase in lending activities and investments in securities, reduced deposits, payment of loan commitments due as well as the increase in outstanding receivables. This was a trend that, with minor oscillations, continued until the end of 2012. The first half of 2013 was characterised by the continued mild worsening of these indicators, caused by the outflow of deposits, payment of loan commitments due and the continued growth of past due outstanding receivables, while the second half of 2013 saw a slight improvement of the indicators, caused by an increase in deposits and cash funds, which continued in 2014 as well and the indicators remained at approximately the same level as of 30.09.2014.

The banks' efforts to achieve better profitability through better allocation of financial assets, changes in the structure of deposit sources, as well as the long-present trend of reducing loan commitments and liabilities under subordinated debt, influenced by the mortgage crisis and recession in the Eurozone, have all led to a faster decrease in liquid assets compared to the reduction of short-term financial liabilities, a decrease in the share of liquid assets in total assets and the deterioration of the ratio of loans to deposits, loans taken and subordinated debt.

However, despite the evident negative trends, the liquidity of the banking system in the Federation of B&H is still seen as sound, having satisfactory share of liquid assets in total assets, as well as a very good maturity adjustment of financial assets and liabilities, with a trend of moderate improvement since the end of 2010. Still, due to the still present effect and impact of the global financial crisis as well as mortgage crisis in the Eurozone (that has adversely affected the banking systems of certain European countries and parent banks of FB&H banks), it was found that the liquidity risk should still be kept under close supervision. Also, it should be kept in mind that the effect of the crisis on the real sector is still present, with its negative consequences reflected in the overall industrial and economic environment in which banks in B&H operate, thus resulting in defaults in terms of the settlement of loan obligations and increases in uncollectable receivables, i.e. reductions of inflows of liquid funds to banks and the conversion of credit risk into liquidity risk. In that sense, one of key influences on the liquidity position of banks in the period to come will be their capacity to adequately manage their assets, which encompasses obtaining assets with good performances and the quality of which ensures that bank loans (and interest) are repaid in accordance with maturity dates.

The Decision on Minimum Standards for Liquidity Risk Management defines minimum standards that a bank is required to ensure and maintain in the liquidity risk management process, i.e. minimum standards for the development and implementation of the liquidity policy that ensures the bank's capacity to meet its obligations on the maturity date fully and without a delay.

This regulation represents a framework for liquidity risk management and encompasses qualitative and quantitative provisions and requirements for banks. It also defines limits that banks are to meet in relation to the average 10-day minimum and daily minimum of cash funds compared to short-term sources of funds, as well as minimum limits of the maturity adjustment of instruments of financial assets and financial liabilities (up to 180 days).

In the structure of the sources of funding of FB&H banks as of 30.09.2014, the largest share of 74.8% still refers to deposits, followed by loans taken (including subordinated debts[37]) with a share of 7.2%. Loans taken have longer maturities and represent a quality source for the approval of long-term loans, while also improving the maturity adjustment of assets and liabilities items, although a downward trend of the aforementioned has been evident for an extensive period of time.

[37] Subordinated debts: loans taken and permanent items.

On the other hand, the maturity structure of deposits is much more unfavourable.[38] After a longer period of improvement (the period before the crisis), it worsened slightly in 2010 and this trend (with minor oscillations) continued in 2011 and the first quarter of 2012, after which it stopped and the structure modestly improved in late 2012, which continued in 2013 and 2014 as well.

- in KM 000 -

Table 34: *Maturity Structure of Deposits by Contractual Maturity*

DEPOSITS	31.12.2012		31.12.2013		30.09.2014		INDEX	
	Amount	Share %	Amount	Share %	Amount	Share %		
1	2	3	4	5	6	7	8(4/2)	9(6/4)
Savings and call deposits	4 805 480	43.8	5 233 356	45.4	5 705 264	48.1	109	109
Up to 3 months	267 199	2.5	365 229	3.2	218 142	1.8	137	60
Up to 1 year	709 620	6.5	668 142	5.8	630 786	5.3	94	94
1. Total short-term deposits	5 782 299	52.8	6 266 727	54.4	6 554 192	55.2	108	105
Up to 3 years	3 576 903	32.6	3 541 354	30.7	3 357 807	28.3	99	95
More than 3 years	1 601 799	14.6	1 715 768	14.9	1 963 308	16.5	107	114
2. Total long-term deposits	5 178 702	47.2	5 257 122	45.6	5 321 115	44.8	102	101
TOTAL (1 + 2)	10 961 001	100.0	11 523 849	100.0	11 875 307	100.0	105	103

Compared to 31.12.2013, total deposits increased by 3% or KM 351 million, largely as a result of an increase in retail deposits by 5% or KM 316 million, deposits of government institutions by 48% or KM 269 million, deposits of private companies by 6% or KM 92 million and deposits of non-profit organisations by 20% or KM 53 million, and, on the other hand, a decrease in deposits of banking institutions by 24% or KM 244 million and deposits of public companies by 13% or KM 135 million. The maturity structure of deposits with contractual maturity is relatively good, with short-term deposits holding a share of 55.2% and long-term deposits a share of 44.8%, which is somewhat better compared to 31.12.2013.

Changes in maturity structure stem from an increase in short-term deposits by 5% or KM 287 million, largely related to an increase in short-term deposits of government institutions by KM 250 million, KM 214 million of which refer to call deposits, followed by short-term deposits of private companies by KM 121 million, retail deposits by KM 111 million and non-profit organisations by KM 38 million, while a drop was recorded with respect to banking institutions (by KM 186 million), public companies (by KM 25 million) and non-banking financial institutions (by KM 23 million). Long-term deposits rose slightly by 1% or KM 64 million, as a result the increase in deposits with a term over three years by 14% (mostly retail deposits), while deposits up to three years recorded a 5% decrease (mostly deposits of public companies and banking institutions). It should be noted that long-term deposits are still dominated by two segments: retail, with the share increasing from 63.6% to 66.7%, and banking institutions, with the share decreasing slightly from 12.3% to 11.1%, although deposits of public companies are also a significant long-term source, with a decrease from 9.2% to 7.0%. In deposits with a term from one to three years, the largest share of 72.5% is held by retail deposits (slightly down by 3.9 percentage points). Deposits over three years mostly consist of retail deposits (56.8%, up down by 1 percentage point) and deposits of banking institutions with a share of 23.8% (having a trend of stagnation after a long trend of reduction) (at the end of 2013: 25.6%, at the end of 2012: 33.0%; at the end of 2011: 46.9%, at the end of 2010: 60.9%).
Although the maturity structure of deposits with contractual maturity is relatively good, residual maturity of deposits is of greater relevance for the liquidity risk analysis since it includes deposit balances from the reporting period to the due date (as presented in the table below).

[38] As per remaining maturity.

- in KM 000 -

Table 35: *Maturity Structure of Deposits by Remaining Maturity*

DEPOSITS	31.12.2012		31.12.2013		30.09.2014		INDEX	
	Amount	Share %	Amount	Share %	Amount	Share %		
1	2	3	4	5	6	7	8(4/2)	9(6/4)
Savings and call deposits (up to 7 days)	4 941 325	45.1	5 343 263	46.4	5 776 584	48.7	108	108
7- 90 days	908 834	8.3	920 951	7.9	691 915	5.8	101	75
91 days to one year	2 278 639	20.8	2 126 249	18.5	2 105 287	17.7	93	99
1. Total short-term deposits	8 128 798	74.2	8 390 463	72.8	8 573 786	72.2	103	102
Up to 5 years	2 609 727	23.8	3 002 846	26.1	3 146 637	26.5	115	105
More than 5 years	222 476	2.0	130 540	1.1	154 884	1.3	59	119
2. Total long-term deposits	2 832 203	25.8	3 133 386	27.2	3 301 521	27.8	111	105
TOTAL (1 + 2)	10 961 001	100.0	11 523 849	100.0	11 875 307	100.0	105	102

Based on the data above, it can be concluded that the maturity structure of deposits by remaining maturity is much worse due to a high share of short-term deposits in the amount of 72.2%. However, there is a trend of moderate improvement compared to the end of 2013. Short-term deposits increased by 2% or KM 183 million, with its share decreasing by 0.6 percentage points, while long-term deposits increased by 5% or KM 168 million and their share went up from 27.2% to 27.8%. Looking at the structure of long-term deposits, it is evidently dominated by deposits with remaining maturity of up to 5 years (95.3% of long-term deposits and 26.5% of total deposits), while the negative trend constitutes a major reduction of deposits with remaining maturity of over 5 years (when observing the period of the past two years). This is despite a moderate increase of 19% or KM 24 million in the first three quarters of 2014. When comparing information on deposit maturities by contractual and residual maturity, it can be concluded that out of the KM 5.3 billion of total long-term contracted deposits, there were approximately KM 2.0 billion, i.e. 38%, of long-term contracted deposits with the remaining maturity of one year as of 30.09.2014.

The existing maturity structure of deposits (being the largest source of funding of banks in the Federation of B&H) has become an increasingly limiting factor of credit growth in relation to most banks since they incline more towards approving long-term loans. Therefore, banks are faced with the problem of finding ways to obtain quality sources of funding in terms of maturity, especially due to the considerably reduced inflow of financial assets (borrowings) from abroad, i.e. both from parent groups and financial institutions-creditors, while local sources of funding are mostly short-term. In June 2014, the FBA amended the existing regulations on liquidity.[39] Having previously met the prescribed requirements and obtained the approval of the FBA, banks have the opportunity to use a certain amount (i.e. a corrective amount) of retail call deposits for loans with longer maturities. As of 30.09.2014, no bank used a corrective amount (two banks submitted requests to the FBA and the aforementioned are being processed), and in the following period, it is expected that some banks apply for the use of corrective amounts. The objective of the regulation amendment is primarily aimed at stimulating credit growth, mostly real sector sector lending, and the effects are expected in the following period.

However, supervisory concern is also present due to to the fact that banks, due to the lack of quality long term-sources of funding and for the purpose of ensuring compliance with legally defined limits related to maturity adjustment, resort to approving revolving short-term loans, i.e. settling existing ones with new short-term facilities, which basically means long-term lending from short-term sources of funding. In such a way, the real loan maturity and its adjustment with sources of funding is being

[39] Decision on Amending the Decision on Minimum Standards for Liquidity Risk Management in Banks („Official Gazette of the Federation of B&H“, No. 46/14)

kept hidden. This may become a serious problem in the period to come as well as a potential threat to the bank's liquidity position.

For the purpose of planning the required level of liquid assets, banks need to account for both their sources of funding and the structure of an adequate liquidity potential, which is also tied to plans for their credit policy. Loan maturity, i.e. the maturity of the loan portfolio, is, in fact, determined by the maturity of sources of funding. Since maturity transformation of funds in banks is inherently related to the functional characteristics of banking operations, banks are required to continuously control and maintain maturity mismatches between sources of funding and loans approved in accordance with the regulated minimum limits.

-in KM 000 -

Table 36: *Maturity Structure of Loans*

LOANS	31.12.2012		31.12.2013		30.09.2014		INDEX	
	Amount	Share %	Amount	Share %	Amount	Share %		
1	2	3	4	5	6	7	8(4/2)	9(6/4)
Past due receivables and paid off-balance liabilities	1 074 251	10.1	1 175 825	10.8	1 339 337	12.1	109	114
Short-term loans	2 472 571	23.2	2 360 832	21.8	2 279 685	20.5	95	97
Long-term loans	7 119 302	66.7	7 315 743	67.4	7 492 982	67.4	103	102
TOTAL LOANS	10 666 124	100.0	10 852 400	100.0	11 112 004	100.0	102	102

In the first three quarters of 2014, long-term loans increased by 2% or KM 177 million, short-term loans recorded a drop in the amount of 3% or KM 81 million, while past due receivables significantly increased by 14% or KM 164 million, which is yet another indicator of the deterioration of the collection rate of loans due and difficulties that debtors have in servicing liabilities towards banks in the light of the economic crisis. In the structure of past due receivables, 68% refers to private companies, 30% to the retail sector and 2% to other sectors.

An analysis of maturities of two key sectors shows that 84.7% of retail loans are long-term loans, while 48.5% of total approved loans refers to private companies.

In the structure of assets, loans, as the key category, still hold the largest share of 70%, down by 0.3% compared to the end of 2013. Loans themselves recorded a slight increase of 2.4%. Cash funds increased by 1% or KM 40 million and their share decreased from 28.6% to 28.1% compared to the end of 2013.

An overview of the main liquidity ratios is provided in the table below. Banks have transitioned to new regulations as of 31.12.2011, which led to a major increase in total loans, thus causing a deterioration of the ratios: loans/deposits and loans taken (if observed across periods). In 2012, liquidity ratios further deteriorated, as prompted by a reduction of cash funds through increased lending activities and the settlement of loan commitments due, while the ratio of short-term financial liabilities/total financial liabilities improved slightly due to the better maturity structure of sources of funding. The increase in deposits and cash funds in 2013 led to a modest improvement of the ratios compared to 31.12.2012. As of 30.09.2014, the ratios were at approximately the same level as at the end of 2013.

- in % -

Table 37: *Liquidity Ratios*

Ratios	31.12.2012	31.12.2013	30.09.2014
1	2	3	4
Liquid assets[40]/total assets	26.8	28.9	28.4

[40] In narrow terms, liquid assets are: cash and deposits and other financial assets with remaining maturity of less than 3 months (excluding interbank deposits).

Liquid assets/short-term financial liabilities	46.2	50.6	49.7
Short-term financial liabilities/total financial liabilities	68.9	67.9	68.1
Loans/deposits and loans taken[41]	88.1	86.4	86.4
Loans/deposits, loans taken and subordinated debt[42]	86.8	85.3	85.4

After deteriorating in 2012, the ratio of loans/deposits and loans taken improved in 2013 (from 88.1% to 86.4%), and as of 30.09.2014, it was maintained at the same level of 31.12.2013. The ratio was above 85% (critical level) with respect to 8 banks. On the one hand, this was the result of their liabilities structure (relatively significant share of capital) and, on the other hand, a result of the high share of loans in assets. During its on-site controls, the Agency paid special attention to banks with identified weaknesses in this business segment and instructed them to take actions and measures to improve the liquidity level and practices of sources of funding management in order to ensure a satisfactory liquidity position.

In 2014, banks have duly fulfilled the requirement of maintaining the defined level of the required reserve at the Central Bank of B&H. The required reserve, being the key instrument of the monetary policy in B&H in relation to the Currency Board and the financially undeveloped market, is the only instrument of the monetary policy that ensures monetary control in sense of the prevention of rapid growth of loans and reduced multiplication, as well as increased liquidity in banks in conditions of crisis and a higher outflow rate of funds from banks (as compared to the situation in B&H as of 01.10.2008). On the other hand, the implementation of foreign currency risk regulations and the maintenance of currency adjustment to the defined limits has also significantly impacted the amount banks hold in their reserve accounts at the Central Bank of B&H (in local currency), thus ensuring a high liquidity of banks, individually and at the banking sector level.

All banks continuously meet and significantly exceed the defined minimum of the 10-day average of 10% (20% until 10.06.2014) in relation to short-term sources of funding and the daily minimum of 5% (10% until 10.06.2014) in relation to the same basis, as illustrated in the table below.

- in KM 000 -

Table 38: *Liquidity Position – 10-Day Average and Daily Minimum*

	31.12.2012	31.12.2013	30.09.2014	INDEX	
	Amount	Amount	Amount		
1	2	3	4	5(3/2)	6(4/3)
1. Average daily balance of cash	3 408 958	3 722 887	4 223 458	109	113
2. Lowest total daily cash balance	3 149 188	3 423 657	4 000 384	109	117
3. Short-term sources of funding (calculation basis)	5 631 431	5 887 967	6 404 036	105	109
4. Amount of liabilities[43] :					
4.1. 10-day average 20% of the amount under item 3	1 126 286	1 177 593	640 404	105	54
4.2. daily minimum 10% of the amount under item 3	563 143	588 798	320 202	105	54
5. Performance of liabilities: 10-day average[44]					
Surplus = no.1 – item no. 4.1.	2 282 672	2 545 294	3 583 054	112	141
6. Performance of liabilities: daily minimum					
Surplus = no.2 – item no. 4.2.	2 586 045	2 834 859	3 680 182	110	130

[41] Empirical standards are: below 70% - very sound, 71%-75% - satisfactory, 76%-80% - marginally satisfactory, 81%-85% - insufficient, over 85% - critical.

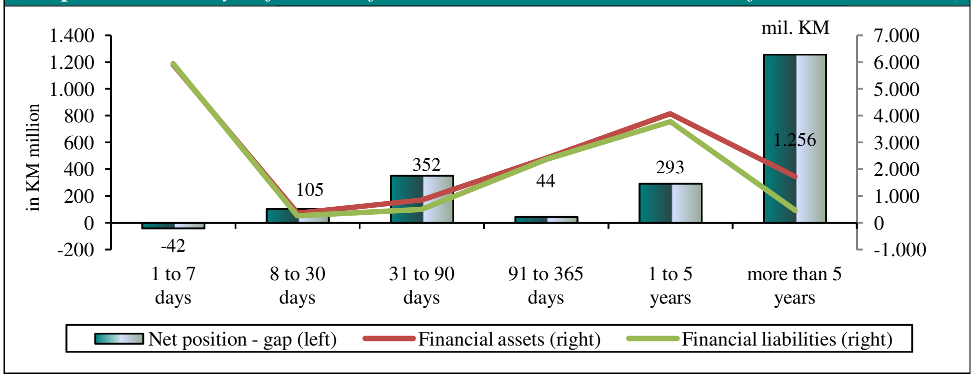
[42] The previous ratio was expanded and sources now include subordinated debts, thus being a more realistic indicator.

[43] According to Article 1 of the Decision on Amending the Decision on Minimum Standards for Liquidity Risk Management in Banks, ("Official Gazette of the Federation of B&H", No. 46/14), the percentage of maintaining the 10-day average liquidity minimum and the daily average cash funds minimum was reduced from 20% to 10% and from 10% to 5%, respectively.

[44] Promjene u indexima na pozicijama 4.1., 4.2., 5. i 6. su rezultat izmjene navedene u prethodnoj napomeni.

When observing the maturity adjustment of remaining maturities of total financial assets[45] and liabilities, it can be concluded that the adjustment rate is good, although somewhat lower compared to 31.12.2012.

Graph 24: *Maturity Adjustment of Financial Assets and Liabilities as of 30.09.2014*



As of 30.09.2014, short-term financial assets of banks were higher than short-term financial liabilities by KM 460 million. Compared to the end of 2013, when the positive gap amounted to KM 522 million, this represents a decrease of KM 62 million or 11.8%, while the coverage ratio of 105.1% is still at a satisfactory level.

Short-term financial assets are up by 2.1% and short-term financial liabilities by 2.9%. In the structure of short-term financial assets, the largest increase of 37.8% or KM 144 million was recorded with respect to trading assets, followed by cash funds (up by 0.9% or KM 40 million). A decrease was recorded in securities held until maturity (down by 11.3% or KM 9 million) and other financial assets (down by 4.9% or KM 7 million). Financial assets with remaining maturity of over one year rose by 4.1% or KM 227 million, mostly as a result of the increase in loans by 3.6% or KM 193 million)

As for liabilities with maturity of up to one year, which have increased by 2.6% or KM 254 million, the largest increase refers to the increase in deposits (by 2.2% or KM 183 million), other financial liabilities up (by 22.8% or KM 40 million), loan commitments (by 9.2% or KM 20 million) and subordinated debt (up by 42.9% or KM 11 million). Liabilities with maturity of over one year increased by 1.8% or KM 74 million, which is mostly the result of an increase in deposits by 5.4% or KM 168 million and a decrease in loan commitments by 9.4% or KM 78 million and liabilities under subordinated debt by 12.7% or KM 18 million.

In addition to the said prescribed minimum standard, a very important aspect of the monitoring and analysis of the liquidity position is the maturity adjustment of remaining maturities of financial assets and liabilities items in accordance with the time scale created to capture a time horizon of 180 days in line with the prescribed minimum limits.[46]

[45] Financial assets are posted on a net basis (after deductions for value adjustments).
[46] The Decision on Minimum Standards for Liquidity Risk Management in Banks defines the following percentages for the maturity adjustment of financial assets and liabilities: min. 85% of sources of funding with maturity of up to 30 days must be used for facilites with maturity of up to 30 days, min. 80% of sources of funding with maturity of up to 90 days must be used for facilities with maturity of up to 90 days, and min. 75% of sources of funding with maturity of up to 180 days must be used for facilities with maturity of up to 180 days.

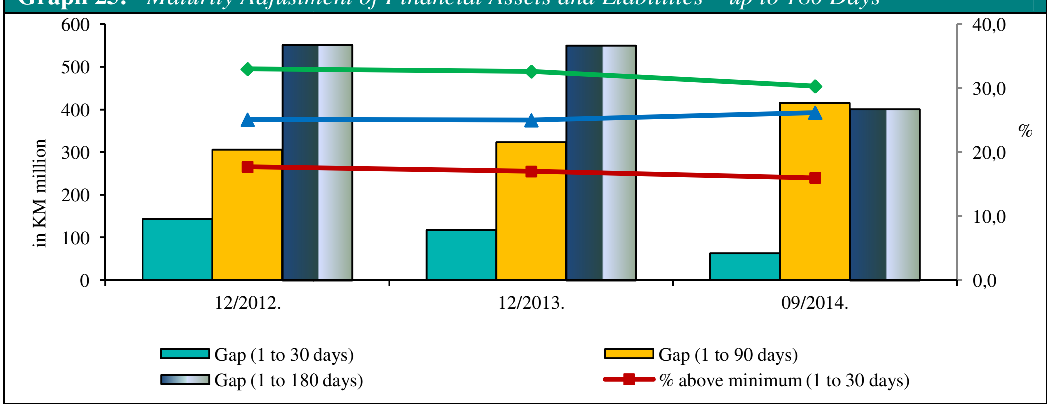
- in KM 000 -

Table 39: *Maturity Adjustment of Financial Assets and Liabilities – up to 180 Days*

Description	31.12.2012 Amount	31.12.2013 Amount	30.09.2014 Amount	INDEX	
1	2	3	4	5 (3/2)	6(4/3)
I. 1- 30 days					
1. Financial assets	5 490 582	5 924 526	6 258 902	108	106
2. Financial liabilities	5 346 703	5 806 822	6 195 927	109	107
3. Difference (+ or -) = 1-2	143 879	117 704	62 975	82	54
Calculation of prescrib. requirement in %					
a) Actual %= no.1/no.2	102.7%	102.0%	101.0%		
b) Prescribed minimum %	85.0%	85.0%	85.0%		
Plus (+) or minus (-) = a - b	17.7%	17.0%	16.0%		
II. 1-90 days					
1. Financial assets	6 355 017	6 809 340	7 113 174	107	104
2. Financial liabilities	6 048 777	6 485 914	6 697 749	107	103
3. Difference (+ or -) = 1-2	306 240	323 426	415 425	106	128
Calculation of prescrib. requirement in %					
a) Actual %= no.1/no.2	105.1%	105.0%	106.2%		
b) Prescribed minimum %	80.0%	80.0%	80.0%		
Plus (+) or minus (-) = a - b	25.1%	25.0%	26.2%		
III. 1-180 days					
1. Financial assets	7 454 731	7 812 974	8 009 014	105	103
2. Financial liabilities	6 903 027	7 263 293	7 608 350	105	105
3. Difference (+ or -) = 1-2	551 704	549 681	400 664	100	73
Calculation of prescrib. requirement in %					
a) Actual %= no.1/no.2	108.0%	107.6%	105.3%		
b) Prescribed minimum %	75.0%	75.0%	75.0%		
Plus (+) or minus (-) = a - b	33.0%	32.6%	30.3%		

Based on the information presented, it is found that, as of 30.09.2014, banks have adhered to prescribed limits and achieved a better maturity adjustment of financial assets and liabilities in relation to the prescribed limits.

Graph 25: *Maturity Adjustment of Financial Assets and Liabilities – up to 180 Days*



Over the past two years, there is an evident trend of improvement in terms of maturity adjustment. As of 31.12.2012, financial assets surpassed financial liabilities accross all three periods of time, along with a somewhat greater improvement of liquidity positions in the period of up to 90 and up to 180 days. The positive gap in the period of up to 30 days was slightly lower compared to 31.12.2011. Maturity adjustment percentages were above the prescribed minimum by 17.7% in the first period, 25.1% in the second period and 33.0% in the third period.

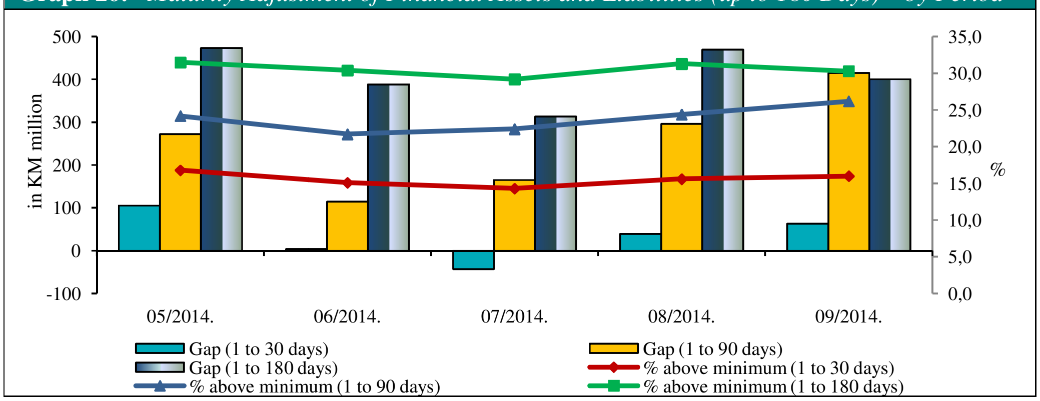
As of 31.12.2013, the maturity adjustment percentage for all three periods of time is somewhat lower compared to the end of 2012, but it is still well above the prescribed minimum (by 17.0% in the first period, 25.0% in the second period and 32.6% in the third period).

As of 30.09.014, the recorded maturity adjustment percentages were somewhat lower in the first and third period compared to the end of 2013 due to the reduced gap on the basis of the greater increase in financial liabilities compared to financial assets, largely on the basis of the increase in deposits, while the increase in financial assets was recorded primarily on the basis of the increase in trading assets. In the second period (1 to 90 days), a larger maturity adjustment percentage was recorded as a result of the increase in the gap on the basis of the greater increase in financial assets, mostly trading assets and the loan portfolio.

The recorded maturity adjustment percentages, although somewhat lower in the first and third period, were still well above the prescribed minimum (by 16.0% in the first period, 26.2% in the second period and 30.3% in the third period).

The chart below shows the trend of the maturity adjustment of financial assets and liabilities in the period from May to September 2013 (by period of time and maturity adjustment percentages in relation to the legally defined minimum standards).

Graph 26: *Maturity Adjustment of Financial Assets and Liabilities (up to 180 Days) – by Period*



Based on all presented ratios, the liquidity of the banking system in the Federation of B&H is still deemed satisfactory. However, we should underline that banks should pay even more attention to liquidity risk management in the period to come by means of establishing and implementing liquidity policies that would ensure the settlement of all liabilities due in a timely manner and based on continuous planning of future liquidity needs while factoring in changes in operating, economic, regulatory and other conditions of the banks' business environment since this business segment and the exposure level to liquidity risk correlate with credit risk, and also considering the effects of the financial crisis on B&H and the banking sector of the Federation of B&H (primarily in the sense of increased pressure on the banks' liquidity). On the one hand, this rests on the poor maturity structure of deposits, the repayment of loan commitments due and a much smaller amount of borrowings from financial institutions (which, over the past few years, were the best source of funding for banks from a maturity perspective) and, on the other hand, of the poor inflow of liquid funds due to a decreased collection rate of loans.

Through its off-site and on-site controls of banks, the Agency will continue to monitor and oversee the manner in which banks manage this risk and whether they act in accordance with adopted policies and programmes.

2.5. FX Risk – Foreign Currency Adjustment of Balance Sheet and Off-Balance Sheet Assets and Liabilities

Banks' operations are exposed to major risks originating from possible losses related to balance sheet and off-balance sheet items, as incurred due to market price changes. One of these risks is the foreign currency risk arising as a result of changes in exchange rates and/or unadjusted levels of assets, liabilities and off-balance sheet items denominated in the same currency – individual FX position or all currencies of the bank's operations together – total FX position of the bank.

In order to ensure the implementation and realisation of prudent principles related to FX activities of banks and to reduce FX risk effects on their profitability, liquidity and capital, the Agency has adopted the Decision on Minimum Standards for Foreign Exchange Risk Management in Banks[47], which regulates minimum standards for adopting and implementing the programmes, policies and procedures for FX risk assumption, monitoring, control and management, as well as limits for the open individual and total FX position (long or short) calculated in relation to the core capital of the bank.[48]

In order for the Agency to monitor the banks' compliance with the regulated limits and their exposure level to FX risk, banks are required to report daily to the Agency. Based on the review, monitoring and analysis of the submitted reports, it can be concluded that banks adhere to regulated limits and conduct their FX activities within such limits.

Since the Central Bank of B&H functions as a currency board pegged to the EUR, banks are not exposed to FX risk in their daily operations with the EUR as the key currency.

As of 30.09.2014, the currency structure of banks' assets included 10.8% or KM 1.7 billion of foreign currency items (at the end of 2013, these items amounted 12.6% or KM 1.9 billion). On the other hand, the currency structure of liabilities is quite different since the share of foreign currency liabilities is much higher and equals 44.6% or KM 7.1 billion (at the end of 2013, this share was 46.7% or KM 7.2 billion).

The table below provides the structure and trend of financial assets and liabilities and FX positions for the EUR as the key currency and for the total position.

-in KM million-

Table 40: *FC Adjustment of Financial Assets and Liabilities (EUR and Aggregate)* [49]

Description	31.12.2013				30.09.2014				INDEX	
	EURO		TOTAL		EURO		TOTAL		EURO	TOTAL
	Amount	Share %	Amount	Share %	Amount	Share %	Amount	Share %	6/2	8/4
1	2	3	4	5	6	7	8	9	10	11
I. Financial assets										
1. Cash	996	13.0	1 516	18.0	755	10.2	1 254	15.4	76	83
2. Loans	40	0.5	44	0.5	36	0.5	39	0.5	90	89
3.Loans with a currency clause	6 285	82.2	6 465	76.9	6 257	84.7	6 420	79.0	100	99
4. Other	332	4.3	386	4.6	336	4.6	418	5.1	101	108
Total (1+2+3+4)	7 653	100.0	8 411	100.0	7 384	100.0	8 131	100.0	96	97
II. Financial liabilities										
1. Deposits	5 345	72.6	5 990	74.7	5 233	72.6	5 898	74.7	98	98

[47] "Official Gazette of the Federation of B&H", No. 48/12 – consolidated text.
[48] Article 7 of the Decision on Minimum Standards for Foreign Exchange Risk Management in Banks defines the following limits: for the individual FX position – up to 30% of the core capital for EUR, up to 20% for other currencies and up to 30% for the total bank position.
[49] Source: Form 5 – FX position.

2. Loans taken	986	13.4	994	12.4	911	12.7	916	11.6	92	92
3. Deposits and loans with a currency clause	798	10.9	798	9.9	816	11.3	816	10.4	102	102
4. Other	226	3.1	237	3.0	246	3.4	262	3.3	109	111
Total (1+2+3+4)	7 355	100.0	8 019	100.0	7 206	100.0	7 892	100.0	98	98
III. Off-balance sheet										
1. Assets	80		80		47		47			
2. Liabilities	255		359		55		113			
IV. Position										
Long (amount)	122		113		171		173			
%	6.6%		6.1%		9.1%		9.1%			
Short										
%										
Allowed	30%		30%		30%		30%			
Lower than the allowed level	23.4%		23.9% 23.9%		20.9%		20.9%			

In terms of the structure of foreign currencies, the dominant share among financial assets[50] is held by the EUR with 65.5%, which is somewhat lower compared to 31.12.2013 (70.3%) due to the lower nominal amount (from KM 1.36 billion to KM 1.13 billion). The share of the EUR in liabilities is 90.3%, which is somewhat lower compared to the end of 2013, coupled with a decrease of the nominal amount by KM 167 million.

However, FX risk exposure calculation also includes the amount of indexed assets items (loans) and liabilities items[51], which is quite significant on the assets side (79.0% or KM 6.4 billion) and, in nominal terms, remained almost the same as on 31.12.2013 (76.9% or KM 6.5 billion). Other FX items on the assets side hold a share of 21.0% or KM 1.7 billion and have the following structure: items in EUR 13.9% or KM 1.1 billion and other currencies 7.2% or KM 0.6 billion (at the end of 2013, other items in EUR held a share of 16.3% or KM 1.4 billion). Out of total net loans (KM 9.9 billion), app. 64.9% have a currency clause (mostly pegged to the EUR – 97.5%).

As for the sources of funding, financial liabilities determine the structure of financial assets items for every currency. The largest share in FX liabilities (KM 7.8 billion) is 81.0% or KM 6.4 billion and refers to items in EUR (deposits mostly), while the share and amount of indexed liabilities is minimal and amounts to 10.3% or KM 0.8 billion (at the end of 2013, the share of liabilities in EUR was 81.8% or KM 6.5 billion, while the share of indexed liabilities was 9.9% or KM 0.8 billion).

When observing banks and the banking sector level of the Federation of B&H, it can be concluded that FX risk exposure of banks and the banking system in the reporting period of 2014 was within the defined limits. As of 30.09.2014, the long FX position was recorded with 14 banks and the short position with 3 banks. At system level, there is a long FX position of 9.1% of the total core capital of banks, which is 20.9% below the allowed limit. The individual FX position for the EUR, like the total position, was 9.1%, which is 20.9% below the allowed limit, with financial assets items being larger than financial liabilities (net long position).

[50] Source: Form 5 – FX position: one part of financial assets (foreign currencies denominated in KM). According to the calculation methodology, financial assets were posted in accordance with the net principle until 31.12.2011 (i.e. after deductions for loan loss reserves), after which the new methodology entailed the depreciation of fixed assets according to IAS, i.e. after deductions for value adjustments and reserves for contingent liabilities

[51] In order to protect against foreign exchange rate changes, banks arrange certain assets items (loans) and liabilities items with a currency clause (regulations allow only for a two-way currency clause).

Although the currency board protects banks from FX risk exposure related to the EUR, they are required to adhere to regulated limits for all currencies, as well as for the total FX position, and to conduct daily risk management activities in accordance with the adopted programmes, policies, procedures and plans.

III CONCLUSIONS AND RECOMMENDATIONS

During the reform period, the banking sector of the Federation of B&H achieved an enviable level of its development and it represents the most developed and the strongest part of the financial and the overall economic system in the Federation B&H. Future activities should be aimed towards the preservation of its stability, with this being a priority in present stressful conditions, and towards the banking system's future progress and development. These onjectives are conditioned by a continuous and committed involvement of all elements of the system, the legislative and executive authorities, thus forming grounds for a more favourable economic environment for banks and the real sector of the economy, as well as for the general population.

In order to further strengthen resilience of banks in the Federation of B&H in the face of a potentially more severe crisis situation, in early 2013, the Agency adopted the Decision on Temporary Measures for Dividends and Discretionary Bonus Disbursement and Repurchase of Own Shares by Banks. This meant that the disbursement of dividends is tied to the existence of a capital buffer in the amount of 2.5% compared to the prescribed minimum capital adequacy rate and core capital rate of banks compared to risk-bearing assets. In May 2014, with the adoption of the new Decision on Minimum Standards for Capital Management in Banks and Capital Hedge, this interim Decision was superseded, and the requirements of the interim Decision were included in the new Decision. As part of the activities regarding the implementation of the Strategy, i.e. Revised Strategy for introducing the International Convergence of Capital Measurement and Capital Standards (Basel II), the Agency has coordinated the matter with the Republika Srpska Banking Agency and USAID (the latter providing technical assistance) to prepare the following draft papers: the Decision on the Remuneration Policy and Practice for Bank Employees, the Decision on Suitability Assessment of Bank's Bodies and the Decision on Diligent Behavior of Members of Bank’s Bodies. The aforementioned decisions were adopted in August 2013 („Official Gazette of the Federation of B&H“, No. 60/13).

In the period to come, the Banking Agency of the Federation of B&H will:

- take measures and actions within its competences to overcome and mitigate the effects of the global financial crisis on the banking sector in the Federation of B&H;
- continue with activities within its competences to consolidate the supervision function at state level;
- maintain continuous supervision of banks through on-site and off-site controls, placing an emphasis on dominant risk segments of banking operations and aiming to improve efficiency by means of:
  - further insistence on capital strengthening in banks, especially in those banks with an above average increase in assets and reduction of the capital adequacy ratio,
  - continued banking supervision that is of system relevance for the development of lending activities where large savings and other deposits are concentrated (all for the purpose of protecting depositors),
  - continued system-based monitoring of banks' activities to prevent money laundering and the financing of terrorism and the improvement of the cooperation with other supervisory and regulatory institutions,
  - working on upgrades to legal regulations as based on the Basel Principles, Basel Capital Accord and European Banking Directives, as has been the case so far, all as part of the

preparations for B&H joining the European Union,
- changing capital regulations for the purpose of ensuring the qualitative and structural strengthening of capital and harmonisation with the capital requirements of Basel II/III and EU directives,
- preparing and adopting a contingency plan (as a part of the crisis preparation process),
- developing and implementing the Early Warning System tool (EWS) for the purpose of an early identification of financial and operational inefficiencies and/or adverse trends in the banks' operations,
- establishing and expanding cooperation with supervisory authorities in home countries of investors in the banking sector of the Federation of B&H, as well as in other countries – all for the purpose of ensuring more efficient bank supervision,
- improving cooperation with the B&H Banks' Association across all segments of the banking business, organising consultations and providing professional assistance in the implementation of banking laws and regulations, improving cooperation in the sense of professional training, proposing amendments to all laws or regulations that have become a limiting factor to the banks' development, introducing new products, collection of receivables and ensuring full involvement in the development and functioning of a unified registry of non-performing clients – legal entities and natural persons (ensuring daily updates of information).

- continue with efforts to improve the information system that would enable early warning and preventive actions with respect to the elimination of weaknesses in the banks' operations;
- continue with the on-going training and professional education of the staff;
- accelerate actions regarding the finalisation of the liquidation processes, as per Management Board conclusions.

Further strong engagement of other institutions and bodies of Bosnia and Herzegovina and the Federation of Bosnia and Herzegovina is also necessary with regards to the following:

- the implementation of the Programme of measures to mitigate the results of the global economic crisis and improve the business environment (as accepted by the Economic-Social Council of the Federation of B&H in December 2008 and in accordance with the relevant document of the Government of the Federation of B&H;
- the implementation of conclusions reached by the Parliament of the Federation of B&H regarding the establishment of state-level bank supervision;
- creating and upgrading regulations pertaining to the financial sector, which refer to the actions, status and operations of banks, microcredit organisations, leasing companies, insurance companies, etc.;
- the accelerated implementation of economic reforms in the real sector of the economy in order to ensure faster alignment with the level achieved in the monetary and banking sector;
- the preparation and adoption of the new Law on Banks/Law on Credit Institutions;
- the preparation and adoption of the Law on Asset Management Companies;
- preparations for drafting legal regulations of relevance for the banking sector and financial system based on the Basel Principles, Basel Capital Accord and European Banking Directives;
- the establishment of special commercial departments within courts;
- the establishment of more efficient enforcement proceedings;
- the adoption of regulations on the protection of users of financial services and the full liability of debtors;
- the creation and adoption of measures for resolving or mitigating the problem of over-indebted persons;
- the adoption of laws or improvement of existing legal regulations defining the segment of security

and protection of money in the bank and in transit, etc.

As key segments of the banking system, banks should concentrate their efforts on the following activities:

- full commitment to quality and prudent operations and to combating the crisis effects presently posing the biggest threat to banks, the real sector of the economy and the general population;
- active participation in the implementation of measures for resolving the problem of individuals' over-indebtedness and the financial consolidation of companies;
- the preparation of and updates to their contingency plans;
- further capital strengthening and ensuring a solvency level proportional to an increase in assets and risk, greater profitability, more consistent implementation of adopted policies and procedures to prevent money laundering and the financing of terrorism, the security and protection of money in the bank and in transit, all in accordance with laws and by-laws;
- strengthening of the internal control system and the internal audit function as segments that are fully independent in the performance of their duties and roles;
- regular, timely and accurate submission of information to the Central Loans Registry and the Uniform Central Registry of Accounts at the Central Bank of B&H.

No.: U.O.-64-2/14
Sarajevo, 04.12.2014

A N N E X E S

ANNEX 1

Banks in the Federation of Bosnia and Herzegovina - 30.09.2014

No.	BANK	Adsress		Telephone	Direcor
1	BOR BANKA dd - SARAJEVO	Sarajevo	Obala Kulina bana 18	033/278-520, fax:278-550	HAMID PRŠEŠ
2	BOSNA BANK INTERNATIONAL dd - SARAJEVO	Sarajevo	Trg djece Sarajeva bb	033/275-100, fax:203-122	AMER BUKVIĆ
3	HYPO ALPE-ADRIA-BANK dd - MOSTAR	Mostar	Kneza Branimira 2b	070/340-341, fax:036/444-235	DRAGAN KOVAČEVIĆ
4	INTESA SANPAOLO BANKA D.D. BOSNA I HERCEGOVINA	Sarajevo	Obala Kulina bana 9a.	033/497-555, fax:497-589	ALMIR KRKALIĆ
5	INVESTICIONO-KOMERCIJALNA BANKA dd - ZENICA	Zenica	Trg B&H 1	032/448-400, fax:448-501	SUVAD IBRANOVIĆ
6	KOMERCIJALNO-INVESTICIONA BANKA DD V.KLADUŠA	V.Kladuša	Ibrahima Mržljaka 3	037/771-253, fax:772-416	HASAN PORČIĆ
7	MOJA BANKA dd - SARAJEVO	Sarajevo	Trg međunarodnog prijateljstva br. 25.	033/586-870, fax:586-880	MIRZA HUREM
8	NLB BANKA dd - TUZLA	Tuzla	Maršala Tita 34	035/259-259, fax:250-596	Interim director - IZTOK GORNIK
9	PRIVREDNA BANKA SARAJEVO dd - SARAJEVO	Sarajevo	Alipašina 6	033/277-700, fax:664-175	ADNAN BOGUNIĆ
10	PROCREDIT BANK dd - SARAJEVO	Sarajevo	Franca Lehara bb	033/250-950, fax:250-971	EDIN HRNJICA
11	RAIFFEISEN BANK dd BiH - SARAJEVO	Sarajevo	Zmaja od Bosne bb.	033/755-010, fax: 213-851	KARLHEINZ DOBNIGG
12	RAZVOJNA BANKA FEDERACIJE BIH	Sarajevo	Igmanska 1	033/724-930, fax: 668-952	BORISLAV TRLIN
13	SBERBANK BH dd - SARAJEVO	Sarajevo	Fra Anđela Zvizdovića 1	033/295-601, fax:263-832	EDIN KARABEG
14	SPARKASSE BANK dd BOSNA I HERCEGOVINA- SARAJEVO	Sarajevo	Zmaja od Bosne br. 7.	033/280-300, fax:280-230	SANEL KUSTURICA
15	UNICREDIT BANK dd - MOSTAR	Mostar	Kardinala Stepinca bb	036/312-112, fax:312-121	IVAN VLAHO
16	UNION BANKA dd - SARAJEVO	Sarajevo	Dubrovačka 6	033/561-000, fax: 201-567	SENAD REDŽIĆ
17	VAKUFSKA BANKA dd - SARAJEVO	Sarajevo	M. Tita 13.	033/280-100, fax: 663-399	Interim director - MIRZET RIBIĆ
18	ZIRAATBANK BH dd - SARAJEVO	Sarajevo	Dženetića Čikma br. 2.	033/252-230, fax: 252-245	ALI RIZA AKBAŞ

ANNEX 2

THE BALANCE SHEET OF BANKS IN THE FEDERATION OF B&H ACCORDING TO THE OUTLINE OF THE FBA
ACTIVE SUB-BALANCE

in KM 000

No.	DESCRIPTION	31.12.2012	31.12.2013	30.09.2014
	ASSETS			
1.	Cash and deposit accounts with deposit-taking institutions	3 962 581	4 417 898	4 457 490
1a	Cash and non-interest bearing deposit accounts	625 188	627 016	547 051
1b	Interest-bearing deposit accounts	3 337 393	3 790 882	3 910 439
2.	Trading securities	375 032	381 909	526 117
3.	Loans to other banks	78 522	51 960	67 806
4.	Loans, receivables based on leasing facilities and past due receivables	10 666 124	10 852 400	11 112 004
4a	Loans	9 591 819	9 676 527	9 772 624
4b	Receivables based on leasing facilities	54	48	43
4c	Past due receivables based on loans and leasing facilities	1 074 251	1 175 825	1 339 337
5.	Held to maturity securities	173 435	180 604	202 861
6.	Business premises and other fixed assets	491 370	476 199	481 190
7.	Other real estate	30 123	36 786	40 839
8.	Investments in unconsolidated related companies	24 756	23 762	24 108
9.	Other assets	255 247	252 122	253 488
10.	LESS: value adjustment	1 066 424	1 227 090	1 286 372
10a	Value adjustments for Item 4. of the Assets	1 007 459	1 165 928	1 220 201
10b	Value adjustments for Assets items, except for the Item 4	58 965	61 162	66 171
11.	**TOTAL ASSETS**	**14 990 766**	**15 446 550**	**15 879 531**
	LIABILITIES			
12.	Deposits	10 961 001	11 523 849	11 875 307
12a	Interest-bearing deposits	9 281 938	9 363 284	9 557 651
12b	Non-interest bearing deposits	1 679 063	2 160 565	2 317 656
13.	Borrowings – liabilities due	1 752	1 577	1 699
13a	Past due liabilities			
13b	Past due – invoked off-balance sheet liabilities	1 752	1 577	1 699
14.	Borrowings from other banks	2 000		
15.	Liabilities to the Government			
16.	Loan commitments and other borrowings	1 141 561	1 039 381	981 279
16a	With remaining maturity of up to one year	244 160	212 485	232 138
16b	With remaining maturity of more than one year	897 401	826 896	749 141
17.	Subordinated debt and subordinated bonds	186 675	166 889	160 071
18.	Other liabilities	480 402	406 909	431 058
19.	**TOTAL LIABILITIES**	**12 773 391**	**13 138 605**	**13 449 414**
	EQUITY			
20.	Permanent preferred shares	26 059	11 959	11 959
21.	Common shares	1 175 547	1 196 633	1 217 333
22.	Issue premiums	136 485	136 485	136 485
22a	Over permanent preferred shares	8 420	8 420	88
22b	Over common shares	128 065	128 065	136 397
23.	Indistributed profit and capital reserves	453 269	649 879	624 634
24.	Foreign exchange rate differences			
25.	Other capital	110 281	-2 745	123 972
26.	Loan loss provisions formed from profit	315 734	315 734	315 734
27.	**TOTAL EQUITY (20. to 25.)**	**2 217 375**	**2 307 945**	**2 430 117**
28.	**TOTAL LIABILITIES AND EQUITY (19 +26)**	**14 990 766**	**15 446 550**	**15 879 531**
	PASSIVE AND NEUTRAL SUB-BALANCE	**661 321**	**638 913**	**664 995**

	UKUPNA BILANSNA SUMA BANAKA	15 652 087	16 087 617	16 544 526

ANNEX 3

OVERVIEW OF ASSETS, LOANS, DEPOSITS AND FINANCIAL RESULTS OF BANKS IN THE FEDERATION OF B&H as of 30.09.2014

in KM 000

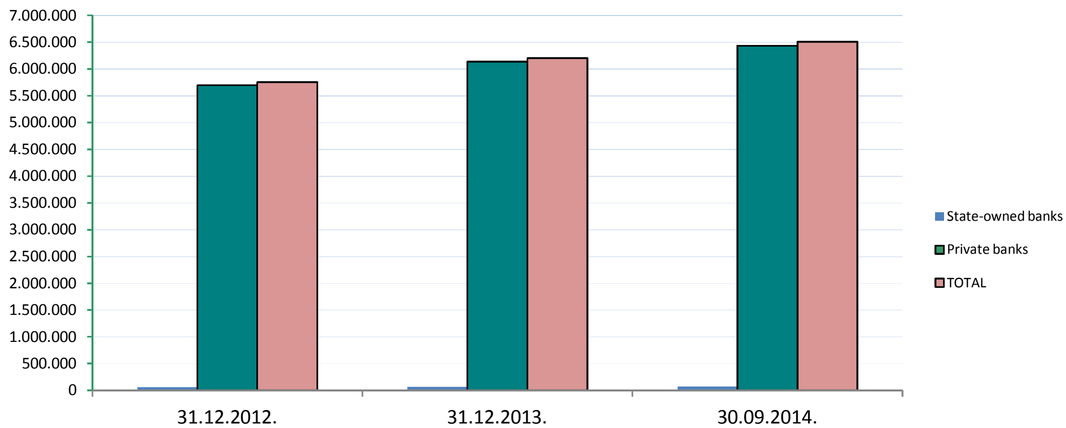
No.	BANK	Assets		Loans		Deposits		Finan-cial result
		Amount	%	Amount	%	Amount	%	Amount
1	BOR Banka d.d. Sarajevo	271 964	1.71%	194 897	1.75%	158 278	1.33%	483
2	Bosna Bank International d.d. Sarajevo	562 112	3.54%	384 874	3.46%	356 837	3.00%	1 944
3	Hypo Alpe Adria Bank d.d. Mostar	1 044 798	6.58%	760 063	6.84%	686 007	5.78%	-5 128
4	Intesa Sanpaolo banka d.d. Sarajevo	1 418 211	8.93%	1 142 236	10.28%	962 090	8.10%	16 780
5	Investiciono Komercijalna banka d.d. Zenica	198 665	1.25%	108 076	0.97%	141 975	1.20%	1 410
6	Komercijalno Investiciona banka d.d. Velika Kladuša	77 837	0.49%	38 976	0.35%	50 904	0.43%	1 111
7	Moja banka d.d.Sarajevo	191 969	1.21%	137 416	1.24%	161 672	1.36%	36
8	NLB banka d.d. Tuzla	923 763	5.82%	642 692	5.78%	762 034	6.42%	3 828
9	Privredna Banka d.d Sarajevo	162 453	1.02%	106 524	0.96%	130 662	1.10%	48
10	ProCredit Bank d.d. Sarajevo	369 513	2.33%	315 618	2.84%	249 104	2.10%	2
11	Raiffeisen Bank dd Bosna i Hercegovina	3 731 420	23.50%	2 334 029	21.00%	2 919 685	24.59%	60 596
12	Sberbank BH d.d. Sarajevo	965 877	6.08%	805 723	7.25%	721 404	6.07%	2 344
13	Sparkasse Bank d.d. Sarajevo	1 008 376	6.35%	823 415	7.41%	845 173	7.12%	9 107
14	Union banka d.d. Sarajevo	336 748	2.12%	119 102	1.07%	275 967	2.32%	92
15	UniCredit bank d.d. Mostar	3 894 310	24.52%	2 661 294	23.95%	2 944 533	24.80%	52 133
16	Vakufska banka d.d. Sarajevo	268 867	1.69%	192 264	1.73%	236 080	1.99%	-24 295
17	Ziraatbank BH d.d. Sarajevo	452 648	2.85%	344 805	3.10%	272 902	2.30%	3 481
	TOTAL	15 879 531	100%	11 112 004	100%	11 875 307	100%	123 972

ANNEX 4

NEW RETAIL SAVINGS IN BANKS IN THE FEDERATION OF B&H

in KM 000

	31.12.2012	31.12.2013	30.09.2014
State-owned banks	58 050	65 179	70 243
Private banks	5 698 300	6 135 711	6 436 803
TOTAL	**5 756 350**	**6 200 890**	**6 507 046**



ANNEX 5

CLASSIFICATION OF BALANCE SHEET ASSETS AND OFF-BALANCE SHEET RISK-BEARING ITEMS
as of 30.09.2014
- CLASSIFICATION OF BALANCE SHEET ASSETS ITEMS -

in KM 000

No.	BALANCE SHEET ASSETS ITEMS	CLASSIFICATION					TOTAL
		A	B	C	D	E	
1.	Short-term loans	2 030 716	209 107	34 405	3 253	2 204	2 279 685
2.	Long-term loans	6 426 701	550 691	267 543	135 784	44 702	7 425 421
3.	Other facilities	228 242	2 208	286	1 239	2 125	234 100
4.	Accrued interest and fees	37 044	5 197	2 754	6 848	29 373	81 216
5.	Past due receivables	44 739	31 537	102 990	336 651	791 640	1 307 557
6.	Receivables based on paid guarantees	30	25		500	31 226	31 781
7.	Other balance sheet assets being classified	297 181	4 264	2 841	3 486	31 379	339 151
8.	**TOTAL BALANCE SHEET ASSETS BEING CLASSIFIED (sum of items 1 through 7 – calculation basis for regulatory loan loss provisions)**	**9 064 653**	**803 029**	**410 819**	**487 761**	**932 649**	**11 698 911**
9.	**CALCULATED REGULATORY RESERVES FOR LOAN LOSSES BASED ON BS ASSETS**	**178 199**	**73 291**	**104 173**	**284 567**	**932 079**	**1 572 309**
10.	**VALUE ADJUSTMENT FOR BS ASSETS**	**118 843**	**64 331**	**126 207**	**227 597**	**749 393**	**1 286 371**
11.	**REQUIRED REGULATORY RESERVES FORMED AGAINST PROFIT FOR PURPOSE OF ASSESSED LOSSES BASED ON BS ASSETS**	**100 585**	**42 053**	**23 534**	**89 900**	**183 513**	**439 585**
12.	**FORMEED REGULATORY RESERVES FORMED AGAINST PROFIT RELATED TO ASSESSED LOSSES BASED ON BS ASSETS**	**76 894**	**26 653**	**25 .615**	**78 705**	**71 122**	**278 989**
13.	**SHORTFALL OF REGULATORY RESERVE FORMED AGAINST PROFIT RELATED TO ASSESSED LOSSES BASED ON BS ASSETS**						**184 576**
14.	**BALANCE SHEET ASSETS NOT BEING CLASSIFIED (gross book value)**						**5 466 992**
15.	**TOTAL BALANCE SHEET ASSETS (gross book value)**						**17 165 903**

OVERVIEW OF BALANCE SHEET ASSETS NOT BEING CLASSIFIED AND FACILITIES SECURED WITH A CASH DEPOSIT

14.a	Cash in cash desk and vault and cash funds at the account with the Central Bank of B&H, gold and other precious metals	3 313 849
14.b	Demand deposits and term deposits up to one month located on accounts of banks with defined investment rating	1 020 203
14.c	Tangible and intangible assets	499 754
14.d	Financial and tangible assets acquired in the process of collection of receivables (within one year upon such acquisition)	9 374
14.e	Own (treasury) shares	92
14.f	Receivables based on overpaid taxes	16 445
14.g	Trading securities	121 948
14.h	Receivables from the B&H Government, FB&H Government and RS Government, securities issued by the B&H Government, FB&H Government and RS Government and receivables secured with unconditional guarantees payable upon the first call	485 327
	TOTAL Item 14	**5 466 992**
8a.	Facilities secured with a cash deposit	154 727

ANNEX 5A

CLASSIFICATION OF BALANCE SHEET ASSETS AND OFF-BALANCE SHEET RISK-BEARING ITEMS as of 30.09.2014

- CLASSIFICATION OF OFF-BALANCE SHEET ITEMS -

in KM 000

No.	OFF-BALANCE SHEET ITEMS	CLASSIFICATION					TOTAL
		A	B	C	D	E	
1.	Payment guarantees	369 351	42 879	3 176	0	1	415 407
2.	Performance guarantees	477 025	99 535	5 556	1 992	262	584 370
3.	Uncovered letters of credit	53 973	1 453	108			55 534
4.	Irrevocably approved, but undrawn loans	1 448 433	69 996	1 079	379	1 123	1 521 010
5.	Other contingent liabilities of the bank	10 961	287	0	0	119	11 367
6.	**TOTAL OFF-BALANCE SHEDET ITEMS BEING CLASSIFIED (sum of items 1 through 5 – calculation basis for regulatory loan loss provisions)**	**2 359 743**	**214 150**	**9 919**	**2 371**	**1 505**	**2 587 688**
7.	**CALCULATED REGULATORY RESERVES FOR LOAN LOSSES RELATED TO OFF-BALANCE SHEET ITEMS**	**46 208**	**13 861**	**2 879**	**1 299**	**1 507**	**65 754**
8.	**LOSS RESERVES FOR OFF-BALANCE SHEET ITEMS**	**22.499**	**2 700**	**2 385**	**456**	**1 102**	**29 142**
9.	**REQUIRED REGULATORY RESERVES FORMED AGAINST PROFIT RELATED TO ASSESSED LOSSED BASED ON OFF.BAL.SHEET ITEMS**	**27 558**	**11 818**	**982**	**943**	**516**	**41 817**
10.	**FORMED REGULATORY RESERVES FORMED AGAINST PROFIT RELATED TO ASSESSED LOSSED BASED ON OFF-BALANCE SHEET ITEMS**	**23 412**	**10 665**	**936**	**1 345**	**387**	**36 745**
11.	**SHORTFALL OF REGULATORY RESERVES FORMED AGAINST PROFIT RELATED TO ASSESSED LOSSED BASED ON OFF.BAL.SHEET ITEMS**	**4 146**	**1 153**	**46**	**-402**	**129**	**5 072**
12.	**OFF-BALANCE SHEET ITEMS NOT BEING CLASSIFIED**						**306 609**
13.	**TOTAL OFF-BALANCE SHEET ITEMS**						**2 894 297**
6a.	**Contingent liabilities secured with a cash deposit**						49 412
6b.	**Approved undisbursed loans with a clause on unconditional cancellation**						212 958

ANNEX 6

INCOME STATEMENT OF BANKS IN THE FB&H ACCORDING TO THE FBA MODEL

in KM 000

No.		DESCRIPTION	31.03.2012	31.03.2013	30.09.2014
1.		**INTEREST INCOME AND EXPENSES**			
	a)	Interest income and similar income			
	1)	Interest-bearing deposit accounts with deposit-taking institutions	2 789	1 026	3 069
	2)	Loans to other banks	2 601	944	1 705
	3)	Loans and leasing facilities	366 570	351 026	519 657
	4)	Held to maturity securities	2 923	3 796	5 352
	5)	Equity securities	165	184	651
	6)	Receivables based on paid off-balance sheet liabilities	0	0	6
	7)	Other interest income and similar income	31 030	32 301	47 352
	8)	**TOTAL INTEREST INCOME AND SIMILAR INCOME**	**406 078**	**389 277**	**577 792**
	b)	Interest expenses and similar expenses			
	1)	Deposits	108 378	104 333	145 632
	2)	Borrowings from other banks	14	112	0
	3)	Borrowings taken – liabilities due	0	0	0
	4)	Liabilities based on loans and other borrowings	20 470	11 607	14 694
	5)	Subordinated debt and subordinated bonds	5 824	4 494	8 512
	6)	Other interest and similar expenses	1 920	1 438	1 665
	7)	**TOTAL INTEREST EXPENSES AND SIMILAR EXPENSES**	**136 606**	**121 984**	**170 503**
	c)	**NET INTEREST AND SIMILAR INCOME**	**269 472**	**267 293**	**407 289**
2.		**OPERATING INCOME**			
	a)	FX income	21 294	19 106	33 836
	b)	Loan fees	3 161	3 195	4 939
	c)	Fees based on off-balance sheet items	12 281	12 102	18 672
	d)	Service fees	88 730	92 436	152 650
	e)	Trading income	324	2 499	178
	f)	Other operating income	23 418	23 501	30 287
	g)	**TOTAL OPERATING INCOME a) to f)**	**149 208**	**152 839**	**240 562**
3.		**NON-INTEREST BEARING EXPENSES**			
	a)	Business and direct expenses			
	1)	Costs of value adjustments, risk-bearing assets, provisions for contingent liabilities and other value adjustments	64 070	54 397	104 641
	2)	Other business and direct expenses	35 403	35 501	58 772
	3)	**TOTAL BUSINESS AND DIRECT EXPENSES 1) + 2)**	**99 473**	**89 898**	**163 413**
	b)	Operating expenses			
	1)	Costs of salaries and contributions	124 146	121 419	184 319
	2)	Costs of business premises, other fixed assets and utilities	79 630	76 433	108 389
	3)	Other operating expenses	44 175	46 276	67 758
	4)	**TOTAL OPERATING EXPENSES 1) to 3)**	**247 951**	**244 128**	**360 466**
	c)	**TOTAL NON-INTEREST BEARING EXPENSES**	**347 424**	**334 026**	**523 879**
4.		**PROFIT BEFORE TAXES**	**77 000**	**91 919**	**153 395**
5.		**LOSS**	**5 744**	**5 813**	**29 423**
6.		**TAXES**	**1 012**	**3 531**	**0**
7.		**PROFIT BASED ON INCREASE OF DEFERRED TAX FUNDS AD REDUCTION OF DEFERRED TAX LIABILITIES**	**0**	**116**	**0**
8.		**LOSS BASED ON REDUCTION OF DEFERRED TAX FUNDS AND INCREASE OF DEFERRED TAX LIABILITIES**	**0**	**0**	**0**
9.		**NET PROFIT 4. - 6.**	**75 988**	**88 504**	**153 395**
10.		**NET LOSS 4. - 6.**	**5 744**	**5 813**	**29 423**
11.		**FINANCIAL RESULT 9.-10.**	**70 244**	**82 673**	**123 972**

ANNEX 7

REPORT ON CAPITAL CONDITION AND ADEQUACY OF BANKS IN THE FB&H
ASSETS SIDE OF THE BALANCE SHEET

in KM 000

No.	DESCRIPTION	31.12.12	31.12.13	30.09.14
1	BANK'S CORE CAPITAL			
1.a.	Share capital, reserves and profit			
1.1.	Share capital – common and permanent preferred non-cumulative shares – cash payments	1 185 966	1 188 094	1 213 651
1.2.	Share capital – common and permanent preferred non-cumulative shares – investments in kind and in rights	12 550	12 550	12 550
1.3.	Amount of issue premiums earned upon payment of shares	136 485	136 485	136 485
1.4.	General mandatory reserves (reserves mandated by the law)	101 836	206 809	115 212
1.5. [52]	Other reserves from profit after tax based on the decision of the assembly Bank			344 143
1.6. [52]	Retained, undistributed profit from previous years and current year's profit			12 550
1.5. [53]	Other reserves not related to the assets quality evaluation	309 179	362 349	
1.6. [53]	Retained – undistributed profit from previous years	167 825	248 901	
1.a.	**TOTAL (1.1 to 1.6)**	**1 913 841**	**2 155 188**	**2 085 248**
1.b.	Deductible items from 1.a.			
1.7.	Uncovered losses transferred from previous years	120 740	112 610	122 705
1.8.	Current year's loss	17 818	140 445	29 423
1.9.	Book value of own (treasury) shares of the bank	156	156	81
1.10[54]	Intangible assets in accordance with the applicable accounting framework	52 590	41 418	41 040
1.11.[52]	Amount of deferred tax assets			4 698
1.12.[52]	Amount of negative revalorised reserves based on the effect of the change in the fair value of assets			760
1.b.	TOTAL (1.7. to 1.10)	191 304	294 629	198 707
1.	**AMOUNT OF CORE CAPITAL: (1.a. - 1.b.)**	**1 722 537**	**1 860 559**	**1 886 541**
2	SUPPLEMENTARY CAPITAL OF THE BANK			
2.1.	Share capital – common and permanent preferred cumulative shares – cash payments	3 090	3 091	3 091
2.2.	Share capital – common and preferred cumulative shares – investments in kind and in rights			
2.3.	General loan loss provisions for the category A – performing assets	211 433	215 083	224 407
2.4. [52]	Amount of positive revalorised reserves based on the effect of the change in the fair value of assets			24 311
2.4. [53]	Current year profit – audited and confirmed by an external audit	67 243	71 984	
2.5.	Profit amount for which the FBA issues an order restricting its disbursement	0	0	0
2.6. [54]	Amount of subordinated debt	120 264	165 473	158 655
2.7. [54]	Amount of hybrid convertible items – capital instruments	0	0	0
2.8. [54]	Amount of other capital instruments	65 070	1 416	1 416
2.	**AMOUNT OF SUPPLEMENTARY CAPITAL: (2.1 to 2.8)**	**467 100**	**457 047**	**411 880**
3	DEDUCTIBLE ITEMS FROM THE BANK'S CAPITAL			
3.1.	Portion of invested share capital that, according to the FBA, represents a received, but over-appraised value	0	0	0
3.2.	Capital contributions of other legal entities exceeding 5% of the bank's core capital	3 043	2 844	3 052
3.3.	Receivables from shareholders with significant voting rights – approved by the bank contrary to Law provisions, FBA regulations and the bank's work policy	85	0	2 421
3.4.	LCRE towards shareholders with significant voting rights in the bank (no FBA approval required)	0	0	0
3.5.	LLP shortfall as per regulatory requirement	95 720	156 866	192 450
3.	**AMOUNT OF DEDUCTIBLE ITEMS FROM THE BANK'S CAPITAL: (3.1 to 3.5)**	**98 848**	**159 710**	197 923
A.	**NET CAPITAL OF THE BANK (1.+2.-3.)**	**2 090 789**	**2 157 896**	**2 100 498**
B. [54]	**RISK OF BALANCE AND OFF-BALANCE ASSETS**	**11 078 498**	**10 998 977**	**11 240 523**
C.	**WEIGHTED OPERATIONAL RISK**	**974 201**	**981 318**	**982 250**
D.	**WEIGHTED MARKET RISK**	0	0	**0**
E. [54]	**TOTAL ASSETS RISK B+C+D**	**12 052 699**	**11 980 295**	**12 222 773**
F.	**NET CAPITAL RATE (A/E) (% 1 dec.)**	**17.30%**	**18.00%**	**17.20%**

52 The item description is valid from 30.09.2014.

53 The item description is valid from 30.09.2014.

54 The item descriptions are valid from 30.09.2014., the old descriptions being as follows:

1.10. Intangible assets: patents, licences, concessions, investments in: market research, trade name, trademark and goodwill, etc..

2. 6. Amount of subordinated debts representing max. 50% of the core capital

2. 7. Hybrid convertible items max. 50% of the core capital

2. 8. Permanent, non-refundable items

B. RISK-WEIGHTED ASSETS AND LOAN EQUIVALENTS; E. TOTAL WEIGHTED RISKS (B+C+D)

ANNEX 8

DATA ON EMPLOYEES IN BANKS IN THE FEDERATION OF B&H

No.	BANK	31.12.2012	31.12.2013	30.09.2014
1	BOR Banka d.d. Sarajevo	62	64	60
2	Bosna Bank International d.d. Sarajevo	247	279	303
3	Hypo Alpe Adria Bank d.d. Mostar	579	517	531
4	Intesa Sanpaolo banka d.d. Sarajevo	537	528	516
5	Investiciono Komercijalna banka d.d. Zenica	166	164	159
6	Komercijalno Investiciona banka d.d. Velika Kladuša	71	71	73
7	Moja banka d.d.Sarajevo	151	156	140
8	NLB banka d.d. Tuzla	456	442	443
9	Poštanska banka d.d. Sarajevo	85		
10	Privredna Banka d.d Sarajevo	179	177	162
11	ProCredit Bank d.d. Sarajevo	344	333	305
12	Raiffeisen Bank dd Bosna i Hercegovina	1 552	1 531	1 501
13	Sberbank BH d.d. Sarajevo	360	411	439
14	Sparkasse Bank d.d. Sarajevo	452	462	468
15	Union banka d.d. Sarajevo	183	200	200
16	UniCredit bank d.d. Mostar	1 305	1 262	1 237
17	Vakufska banka d.d. Sarajevo	230	225	225
18	Ziraatbank BH d.d. Sarajevo	171	229	244
	TOTAL	**7 130**	**7 051**	**7 006**