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 AS OF 30. 06. 2010.

Sarajevo, August 2010.

Information on banking system of the Federation of BiH (as of June 30th, 2010) is prepared by the Banking Agency of the Federation of BiH, as a regulatory authority conducting supervision of banks, based on reports of banks, and other information and data submitted by banks. Findings and data from on-site examinations and analysis performed at the Agency (off-site financial analysis) have also been included.

I INTRODUCTION

Adverse effects of global economic and financial crisis have been more visible in the performance of banks as a result of the transfer and expansion of the crises from the real sector to the banking sector. Negative effects are mostly reflected on the banks' key activity, which are the lending segment and the loan portfolio quality.

The banking system, which had successfully overcome the first impacts of the financial crisis that occurred in the last quarter of 2008 with major withdrawal of cash funds from banks, presently is facing completely different problems and challenges, on one hand how to place the surplus of cash funds through new loans in a profitable manner, and on the other hand how to stop the adverse trends within the asset quality and loan portfolio and the deterioration of the banks' profitability.

As of 31.06.2010., there were 20 banks with banking license issued in the Federation of BiH, of which two banks were under provisional administration (UNA bank d.d. Bihać and Hercegovačka bank d.d. Mostar). Number of organizational units of banks from the Federation of BiH, in the first half of 2010 compared to the end of 2009, decreased by 0,5%, amounting to 632 organizational units. In the first half of 2010, the trend of decrease of the number of employees in banks continued, so as of 30.06.2010, the number of employees in banks was 7.554, which are 102 employees less or 1% compared to the end of 2009.

The aggregate balance sheet of the banking sector, as of 31.06.2010., amounted to 15,1 billion KM, representing a decrease by 1% or 122 million KM compared to 31.12.2009. Although in the first quarter of 2010 there was a minor increase in relation to the end of 2009, of 176 million KM or 1%, in the second quarter there was a downfall of the aggregate balance sheet for 298 million KM or 2% in relation to 31.03.2010. As a result, as of 30.06.2010, the aggregate balance sheet was lower than the end of the previous year. The decrease of the aggregate balance sheet is a result of the payment of the past due liabilities and decrease of capital due to the generated losses in the first half of 2010.

In terms of concentration in the banking system, there have been no significant changes, so the five largest banks in terms of market share (loans, deposits and capital) still hold approximately 80% of the market.

In the first half of 2010, a decrease was recorded of cash funds for 8% or 392 million KM in relation to the end of 2009, and they are 4,4 billion KM as of 30. 06. 2010. The reason for the decrease of the cash funds is mainly due to the repayment of loan obligations that the banks have abroad, mostly towards the „parent" banks. Although there was reported a decrease of cash funds, the banks still have a significant surplus and it participates in the banking system assets with 29%.

Capital of banks in the FBiH, amounted to 1,97 billion KM, as of 30.06.2010, and net capital 1,95 billion KM and both recorded a decline in the first half of the year by 5 % or 95 million KM in relation to the end of 2009. The main reasons for decrease of capital and net capital were current loss in performance and the decrease of the subordinated debt, while simultaneously there was no increase of capital on the basis of inflow of new fresh capital – additional capitalization. The global financial crisis effects are visible in the capital segment as well, through decrease of net capital due to down flow of the profitability (in other words the growth of expenses) and increase of risk assets, resulting with the decrease of capital adequacy ratio by one per cent in comparison to the end of 2009, which amounts to 15,1% as of 30.06.2010. Although the capital adequacy ratio is still significantly higher than the legal minimum, of concern is the trend of its decline (31.12.2008 – 16,4%, 31.12.2009 -16,1% and 30.06.2010. – 15,1%), therefore the Agency has lately devoted special attention and has taken additional measures with an aim to preserve the capital base and security and stability of the banks.

Credit placements, as of 30.06.2010, amounted to 9,8 billion KM, recording a slight increase of 48 million KM or 0,5% in comparison to the end of previous year. Taken the changes recorded in 2009 and the first quarter of 2010, when downturn rates of credit placements were recorded, this is the first quarter in which an increase of loan placements is recorded presenting the first sign of revival of the banks' loan activities. However, under the economic crisis impact, there is still presence of decreasing trend of asset quality and its deterioration that is reflected through the increase of past due claims (growth of 37% in comparison to the end of 2009), classified assets (growth of 8%), nonperforming assets (high increase of 53%) and deterioration of other asset quality indicators. It has to be noted that the largest impact on the significant deterioration of the indicators of asset quality of the total banking system of FBiH had one large bank, which asset quality indicators and loan portfolio are much worse than the average in the banking system in FBiH.

In the bank's sources of financing in the Federation of BiH as of 30.06.2010 the largest participation of 74,6% is still represented by the deposits that are 11,3 billion KM and they increased in comparison to the end of 2009 by 2% or 223 million KM. The second largest source with participation of 9,7% are loan funds that the banks received mostly through borrowings from foreign financial institutions, and if the subordinated loans are added to the loan liabilities, the total loan funds in the sources have a participation of 10,9%. The banks' liabilities decreasing trend continued in the first half of the year due to the payment of past due liabilities, and there were not been any new borrowings from abroad, so the loan liabilities decreased by 17% or 302 million KM in relation to the end of 2009.

Positive changes in the segment of savings deposits as the most significant segment of deposit and financial potential of banks continued through the first half of 2010 when those items recorded growth of 7,6% or 330 million KM in relation to the end of 2009. As of 30.06.2010 the savings reached an amount of 4,69 billion KM that is the highest amount up to date.

At the banking system level in the F BiH, in the first half of 2010, negative financial result – loss was reported in the amount of 68 million KM. Positive financial result was generated by 13 banks, while 7 banks reported loss in their performance for the first quarter of the current year. The significant increase of expenses for provisioning for loan losses, which was the result of the significant downfall in the quality of loans, had the largest impact on the deterioration of the profitability. In the first half of the year the negative results in the banking system performance were significantly impacted by the reported losses of one bank which has an important participation in the banking sector of FBiH. Without the losses reported by that bank, the banking system of FBiH would, in the first half of the year, report a positive financial result.

And finally, we could conclude that the downfall of the lending (present during 2009 and the first quarter of 2010) was stopped in the first half of 2010 the banking system has been faced with new challenges, however there are still no significant revivals of the business activities that would generate new credit growth. Banks still face the problem of how and to whom to lend the surplus of cash funds, they are not starting new borrowings, and the existing sources of funding from abroad (mostly from parent banks) they still have to repay. The decrease of the sources of funding from abroad is not compensated by adequate growth of good quality domestic sources of funding, and that caused the downfall of the aggregate balance sheet of the banking sector. The trend of deterioration of asset quality continued and that as a consequence had increase of expenses for provisioning and the deterioration of the profitability of the banking system of FBiH. The total capitalization of the banking system is satisfactory, however noted is the downfall of the capital adequacy ratio.

II BUSINESS PERFORMANCE OF BANKS IN THE FEDERATION OF BIH

1. STRUCTURE OF THE BANKING SECTOR

1.1. Status, number and business network

As of 31.06.2010., there were 20 banks with the banking license issued in the Federation of BiH. Number of banks remained the same as of 31.12.2009. There is a special law regulating establishment and work of the Development Bank of the Federation of BiH, Sarajevo which is a legal successor of the Investment Bank of the Federation of BiH d.d., Sarajevo, as of 01.07.2008.

As of 31.06.2010., there were two banks under provisional administration (UNA bank d.d. Bihać and Hercegovačka bank d.d. Mostar).

In 2010, the banks continued expanding the network of their organizational units, but at a significantly lower level. At the same time, some banks had to close their organizational units, that is, they reorganized and merged their organizational units for purpose of cost cutting. Consequently, as of 31.06.2010., the banks from the Federation of BiH had a total of 632 organizational units. This represents a downfall of 0,5% when compared to 31.12.2009., as of which date the banks had 635 organizational units.

As of 31.06.2010., seven banks from the Federation of BiH had 56 organizational units in the Republic Srpska and nine banks had 14 organizational units in District Brcko. Five banks from the Republic Srpska had 13 organizational units in the Federation of BiH.

As of 31.06.2010., all the banks had the license for inter-bank transactions in the internal payment system and 15 banks were under the deposit insurance program.

1.2. Ownership structure

As of 31.06.2010., ownership structure in banks[1] based on the available information and on-site visits to banks[2] is the following:

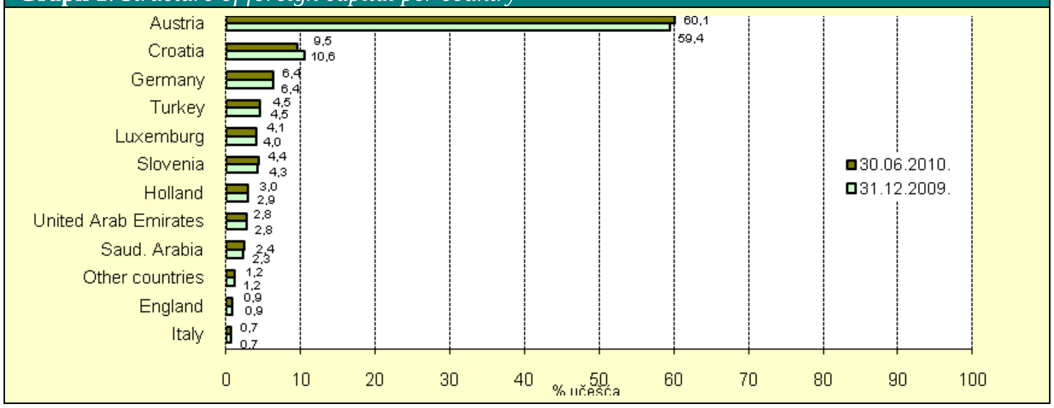
- Private and majority private ownership 18 banks (90%)
- State and majority state ownership[3] 2 banks (10%)

[1] A bank classification criterion is ownership over banks' share capital.
[2] The ownership structure of banks in the FBiH as of 30.06.2010., resulted from received documentation and registrations at authorized courts changes in capital and shareholders structure.
[3] State ownership refers to domestic state capital of BiH.

Six banks, of 18 banks with majority private ownership, are majority owned by domestic legal entities and individuals (residents), while 12 banks have majority foreign ownership.

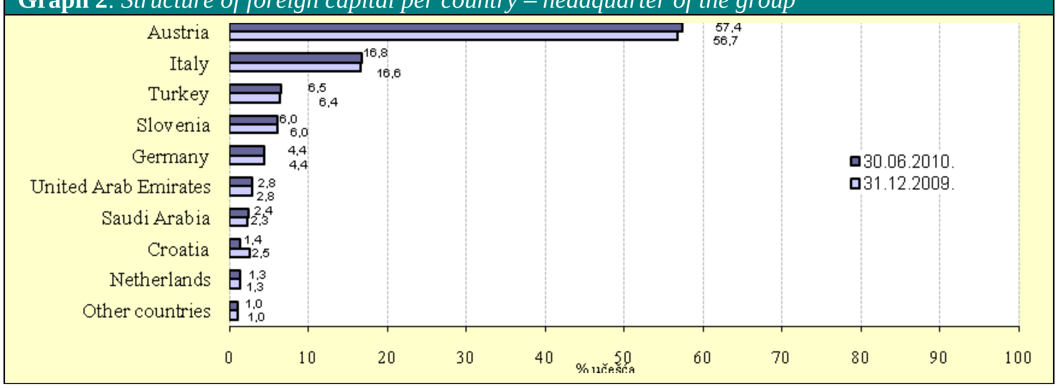
If only foreign capital is analyzed, according to the criteria of the shareholders' home country, as of 31.06.2010., the balance is almost the same as of the end of 2009: shareholders from Austria owned 60,1% of foreign capital; the shareholders from Croatia owned 9,5% of foreign capital; and other countries participated less than 7%.

Graph 1: *Structure of foreign capital per country*



However, if capital correlations are taken into account, the structure of foreign capital could be viewed according to the criteria of the parent-bank or the group's headquarter that has majority ownership (directly or indirectly over the group members) of the bank in the Federation of BiH. According to these criteria, situation as of 31.06.2010. has slightly changed in comparison to the end of 2009: banking groups and banks from Austria with participation of 57,4%, followed by the Italian banks with participation of 16,8%, while other countries had individual participation of below 6,5%.

Graph 2: *Structure of foreign capital per country – headquarter of the group* [4]



The ownership structure could be viewed from the aspect of financial indicators, which is based on the value of total capital [5].

[4] Apart from the country of the headquarter of the parent-group whose members are the banks from the F BiH, the countries of all other foreign shareholders of the banks from the F BiH are also included.
[5] Information from balance sheet – FBA schedule: shareholder's capital, premium issue, undistributed profit and reserves, and other capital (financial results of current period).

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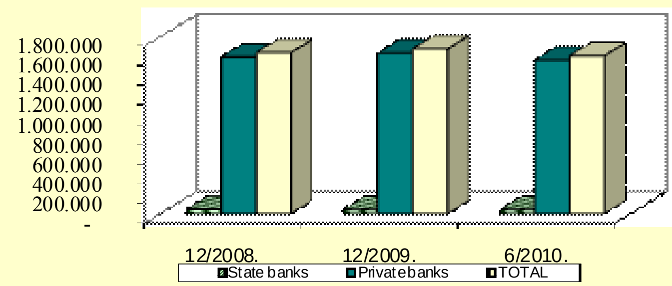
-in 000 KM-

Table 1: *Ownership structure by total capital*

BANKS	31.12.2008.		31.12.2009.		30.06.2010.		INDEKS 3/2	INDEKS 4/3
1	2		3		4		5	6
State banks	42.593	3%	41.736	2%	41.847	3%	98	100
Private banks	1.594.261	97%	1.635.962	98%	1.564.964	97%	103	96
TOTAL	1.636.854	100%	1.677.698	100%	1.606.811	100%	102	96

3: *Preview of ownership structure (total capital)*



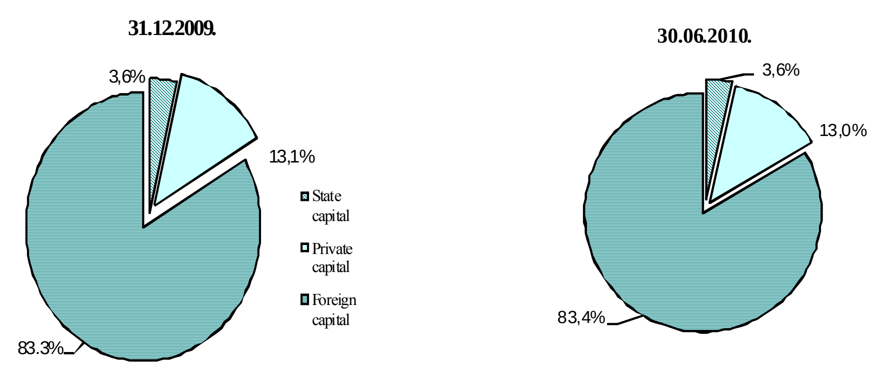
Analysis of participation by state, private and foreign capital in the share capital of banks shows more precise picture of the capital ownership structure in banks of the Federation of BiH.

- in 000 KM-

Table 2: *Ownership structure by participation of state private and foreign capital*

SHARE CAPITAL	31.12.2008. Amount	31.12.2008. Participation %	31.12.2009. Amount	31.12.2009. Participation %	30.06.2010. Amount	30.06.2010. Participation %	RATIO 5/3	RATIO 7/5
1	2	3	4	5	6	7	8	9
State capital	46.100	4,1	41.860	3,6	41.860	3,6	91	100
Private capital (residents)	142.469	12,8	153.365	13,1	149.747	13,0	108	98
Foreign capital (nonresident)	929.447	83,1	975.943	83,3	964.424	83,4	105	99
TOTAL	1.118.016	100,0	1.171.168	100,0	1.156.031	100,0	105	99

Graph 4: *Ownership structure (share capital)*



The share capital of banks in the Federation of, in the first half of 2010, decreased for 15,1 million KM or 1,3%. Structure of share capital insignificantly changed: private capital (residents) decreased by 3,6 million KM, while private capital (nonresidents) increased by 11,5 million KM.

Analysis of the banks' ownership structure shows in the most explicit way, from the aspect of share capital, the changes and trends in the banking system of the FBiH, and especially the changes of the ownership structure.

Participation of the state capital in total share capital, as of 31.06.2010., was 3,6%, which is the same as of 31.12.2009.

Participation of private capital (residents) in total share capital of 13,0% is representing a 0,1 per cent decrease in comparison to 31.12.2009. Nominal decrease of 3,6 million KM was mostly due to the covering the losses from previous years at one bank.

Participation of foreign capital (nonresidents) in total share capital has increased by 0,1 per cent in comparison to 31.12.2009. There was a decrease of 11,5 million KM in the absolute amount, for the same reason as in the private capital residents.

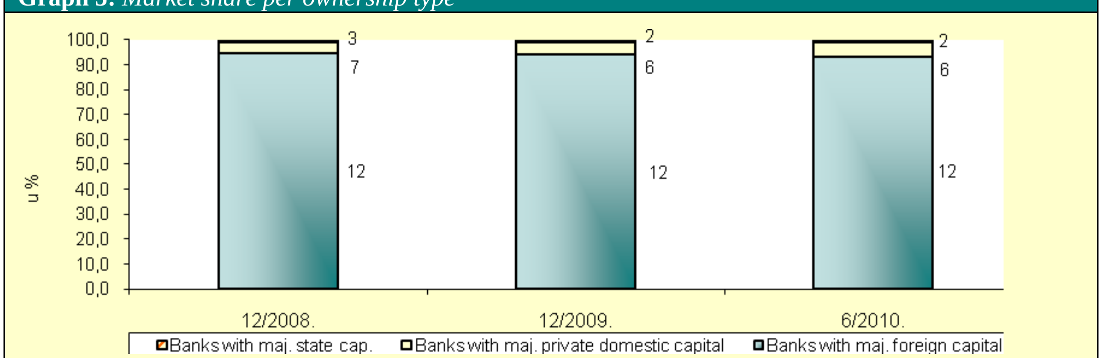
As of 31.03.2010., the market share of banks with majority foreign ownership was a high 93,2%, of banks with majority domestic private capital was 5,6%, and the share of banks with majority state capital was 1,2%.

- in %-

Table 3: *Market share of banks per ownership type (majority owned capital)*

BANKS	31.12.2008.			31.12.2009.			30.06.2010.		
	No. of banks	**Partic. in total capital**	**Partic. in total assets**	**No. of banks**	**Partic. in total capital**	**Partic. in total assets**	**No. of banks**	**Partic. in total capital**	**Partic. In total assets**
1	2	3	4	5	6	7	8	9	10
Banks with majority state capital	2	2,6	1,3	2	2,5	1,1	2	2,6	1,2
Banks with majority private domestic capital	6	10,5	4,4	6	10,7	5,0	6	11,3	5,6
Banks with majority foreign capital	12	86,9	94,3	12	86,8	93,9	12	86,1	93,2
TOTAL	20	100,0	100,0	20	100,0	100,0	20	100,0	100,0

Graph 5: *Market share per ownership type*



1.3. Employees

As of 31.06.2010., there were a total of 7.554 employees in the banks of the Federation of BiH, of that number 3% is in the banks with a majority state capital and 97% in private banks.

Table 4: *Bank employees in the FBiH*

BANKS	NUMBER OF EMPLOYEES						RATIO	
	31.12.2008.		31.12.2009.		30.06.2010.		3:2	4:3
1	2		3		4		5	6
State banks	234	3%	231	3%	230	3%	99	100
Private banks	7.763	97%	7.425	97%	7.324	97%	96	99
TOTAL	7.997	100%	7.656	100%	7.554	100%	96	99
Number of banks	20		20		20		100	100

Decreasing trend in number of employees from the past year has continued through the first half of 2010, which is one of adverse effects of the economic crisis to the banking sector in the F BiH. Number of employees decreased by 102 or 1%, primarily referring to one bank with decrease of 83 or 12%.

Table 5: *Qualification structure of employees*

EDUCATION	NUMBER OF EMPLOYEES						RATIO	
	31.12.2008.		31.12.2009.		30.06.2010.		4:2	6:4
1	2	3	4	5	6	7	8	9
University qualifications	3.007	37,6%	3.104	40,5%	3.181	42,1%	103	102
Two-year post secondary school qualifications	861	10,8%	774	10,1%	743	9,8%	90	96
Secondary school qualifications	4.054	50,7%	3.719	48,6%	3.574	47,3%	92	96
Other	75	0,9%	59	0,8%	56	0,8%	79	95
TOTAL	7.997	100,0%	7.656	100,0%	7.554	100,0%	96	99

The employees' qualification structure has been recording a slight trend of improvement over longer period of time through an increase of participation of the employees with university qualifications, and negative trend of decrease of employees in the prior period, primarily with secondary school qualifications, that has a positive effect to the qualification structure.

One of the indicators influencing an evaluation of performance of a respective bank, and the banking system, is effectiveness of employees and it is shown as a ratio of the assets and the number of employees, that is, the amount of assets per an employee. The higher ratio, the better the performance effectiveness of both the bank and the entire system.

Table 6: *Assets per an employee*

BANKS	31.12.2008.			31.12.2009.			30.06.2010.		
	No. of empl.	Assets (000 KM)	Assets per empl.	No. of empl.	Assets (000 KM)	Assets per empl.	No. of empl.	Assets (000 KM)	Assets per empl.
State	234	187.157	800	231	161.619	700	230	184.707	803
Private	7.763	14.882.747	1.917	7.425	15.074.741	2.030	7.324	14.930.006	2.039
TOTAL	7.997	15.069.904	1.884	7.656	15.236.360	1.990	7.554	15.114.713	2.001

At the end of the first half of 2010, there was a two million KM assets per an employee on the level of the banking system. This indicator is significantly better with the private bank sector, as expected taken the stagnation or the decreased volume of activities of state banks and their consequent excessive number of employees.

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Table 7: *Assets per an employee by groups*

Assets (000 KM)	31.12.2008. Number of banks	31.12.2009. Number of banks	30.06.2010. Number of banks
Up to 500	2	1	1
500 do 1.000	9	8	8
1.000 do 2.000	3	5	5
2.000 do 3.000	5	5	5
Over 3.000	1	1	1
TOTAL	20	20	20

Analytical indicators of respective banks range from 251 thousand KM to 3,6 million KM of assets per an employee. Six banks have a better indicator than the one for the whole banking sector, and three banks in the system have one that exceeds 2,4 million KM.

Finally, we can say that the banks have made a significant progress in improving the quality and conditions in which they offer their services to clients, legal entities and individuals, as well as the conditions under which they offer services and finance clients.

2. FINANCIAL INDICATORS OF BANKS' PERFORMANCE

Examination of banks based on reports is performed through using the reports prescribed by the FBA and the reports of other institutions creating a database constructed of three sources of information:

1. Information on balance sheet for all banks submitted monthly, including quarterly attachments, containing more detailed information on funds, loans, deposits and off-balance sheet items, and some general statistic information,
2. Information on bank solvency, data on capital and capital adequacy, asset classification, concentrations of certain types of risks, liquidity position, foreign exchange exposure, loan and deposit interest rates based on the reports prescribed by the FBA,
3. Information on performance results of banks (income statement – FBA format) and cash flow reports submitted to the FBA quarterly.

Aside from the mentioned standardized reports, the database includes the information obtained from additional reporting requirements prescribed by the FBA in order to have the best conditions for monitoring and analysis of banks' performance in the Federation of BiH. The database also includes audit reports of financial statements of banks prepared by independent auditor, as well as all other information relevant to the assessment of performances of individual banks and the entire banking system.

In accordance with the provisions of Law on Opening Balance Sheet of Banks, banks with majority state owned capital have to report to the FBA "full" balance sheet divided into: passive, neutral and active sub-balance sheet. In order to obtain realistic indicators of banks' performance in the Federation of BiH, all further analysis of the banking system will be based on the indicators from the active sub-balance sheet of banks with majority state owned capital[6].

[6] Some state banks in their "full balance sheet" report passive and neutral items, which will be taken over by the state upon finalization of the privatization process. As of 30.06.2010., these items amounted to KM 682 million.

2.1. Balance sheet

Aggregate balance sheet of the banking sector, as of 31.06.2010., amounted to 15,1 billion KM that is by 1% or 122 million KM higher than at the end of 2009. After a slight increase in the first quarter of 1 % or 176 million KM, mostly through the inflow of funds received from the IMF Stand-by arrangement (second and third tranche in the amount of 180,4 million KM), there was a decrease in the second quarter of 2% or 298 million KM, which in the first half of 2010 resulted with a decrease of 1% or 122 million KM. Taken the crisis impact and condition of the real sector, as well as situation and state in the economy and financial sector of the owners' home countries of the banks in the FBiH, such movements and trends in the banking sector have been expected.

Table 8: Balance sheet

DESCRIPTION	AMOUNT (in 000 KM)							
	31.12.2008.		31.12.2009.		30.06.2010.		INDEX	
	AMOUNT	Partic. %	AMOUNT	Partic. %	AMOUNT	Partic. %	3/2	4/3
1	2		3		4		5	6
ASSETS:								
Cash funds	4.207.559	27,9	4.782.301	31,4	4.389.869	29,0	114	92
Securities[7]	18.814	0,1	119.157	0,8	391.184	2,6	633	328
Placements to other banks	90.415	0,6	111.019	0,7	267.111	1,8	123	241
Loans	10.434.377	69,2	9.796.800	64,3	9.844.469	65,1	94	100
Loan loss provisions (LLP)	381.215	2,5	458.803	3,0	557.541	3,7	120	122
Loans – net value (loans minus LLP)	10.053.162	66,7	9.337.997	61,3	9.286.928	61,4	93	99
Business premises and other fixed assets	467.507	3,1	528.910	3,5	550.630	3,6	112	104
Other assets	232.447	1,6	356.976	2,3	228.991	1,6	154	64
TOTAL ASSETS	**15.069.904**	**100,00**	**15.236.360**	**100,00**	**15.114.713**	**100,00**	**101**	**99**
LIABILITIES:								
LIABILITIES								
Deposits	10.461.850	69,4	11.045.868	72,5	11.269.092	74,6	106	102
Borrowings from other banks	3.089	0,0	3.089	0,0	3.089	0,0	100	100
Loan Commitments	2.176.594	14,4	1.771.978	11,6	1.469.496	9,7	81	83
Other liabilities	791.517	5,3	737.727	4,9	766.225	5,1	93	104
CAPITAL								
Capital	1.636.854	10,9	1.677.698	11,0	1.606.811	10,6	102	96
TOTAL LIABILITIES (LIABILITIES AND CAPITAL)	**15.069.904**	**100,0**	**15.236.360**	**100,00**	**15.114.713**	**100,00**	**101**	**99**

Table 9: *Assets of banks based on the ownership structure*

BANKS	31.12.2008.			31.12.2009.			30.06.2010.			INDEKS	
	No. banks	Assets (000 KM)		No. banks	Assets (000 KM)		No. banks	Assets (000 KM)		5/3	7/5
1	2	3		4	5		6	7		8	9
State	2	187.157	1%	2	161.619	1%	2	184.707	1%	86	114
Private	18	14.882.747	99%	18	15.074.741	99%	18	14.930.006	99%	101	99
TOTAL	20	15.069.904	100%	20	15.236.360	100%	20	15.114.713	100%	101	99

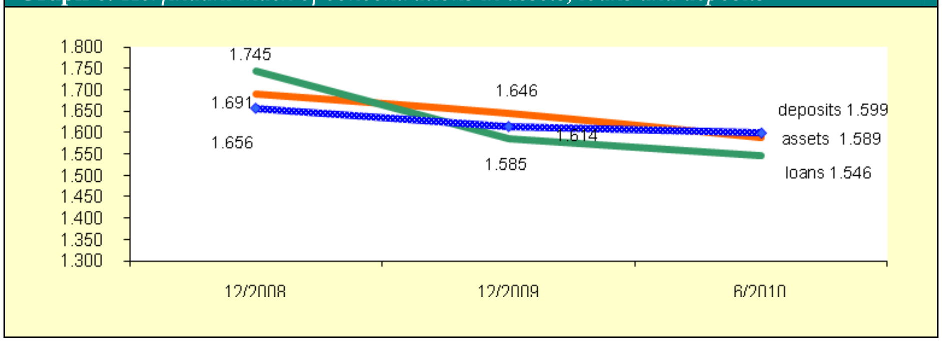
The assets of majority of banks (12) were higher than at the end of 2009, ranging from 1% to 21%. The remaining eight banks recorded the aggregate balance sheet decline from 1% to 12%.

[7] Trading securities and securities held to maturity.

Three largest banks in the system recorded minimum assets changes, two banks recorded decline of 5,3%, and the third bank recorded a minimum growth of 1,2%.

Indicator of concentrations in the three most significant segments of banking performance, in assets, loans and deposits is the value of the Herfffindahl index[8].

Graph 6: *Herfindahl index of concentrations in assets, loans and deposits*



In the first half of 2010, the Herfindahl index in all three relevant categories (loans, deposits and assets) recorded a slight decline in comparison to the end of 2009: by 57 units in assets, 39 in loans and 15 in deposits. Their value, as of 31.06.2010., was 1.599 for deposits, 1.589 for assets and 1.546 units for loans, indicating a moderate concentration[9].

Another indicator of concentration in the banking system is the ratio of market concentration, that is the concentration rate[10] (hereinafter: CR), which indicates the total market participation of the largest institutions in the system per relevant chosen categories: assets, loans and deposits. The CR5 for market participation, loans and deposits of the five largest banks in the system, at the end of the first half of 2010, was 77,0%, 77,9% and 77,5% respectively which is a slight change in comparison to the end of 2009. The situation has almost not changed over the past several years, and dominant is the position of five largest banks in the system that 'hold' approximately 80% of the market, loans and deposits.

[8] It is also called the Hirschmann-Herfindahl index or HHI as calculated in the formula $HI = \sum_{j=1}^{n} (S)_j^2$, representing the sum of square of percentage shares of concrete values (e.g. assets, deposits, loans,…) of all market participants in the system. We should mention that the index is not linearly increasing, and the value of e.g. 3000 does not mean the concentration in the system is 30%. Hypothetically, if there is only one bank in the system, the HHI would be maximum at 10000.
[9] If the HHI value is below 1000, the opinion is that there is no concentration in the market; for the index value between 1000 and 1800 units, concentration in the market is moderate; and if the HHI value exceeds 1800, it indicates high concentration.
[10] Engl.: concentration ratio (CR), assigned to the number of institutions inlcuded in the calculation.

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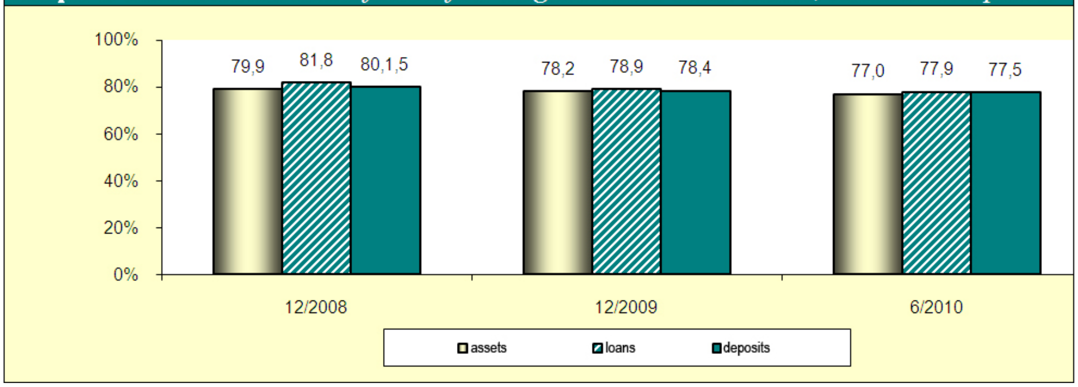
Graph 7: *Concentration rates for the five largest banks-CR5: assets, loans and deposits*



The banking sector could be analyzed from the aspect of several groups established according to the asset size[11]. The minor changes in relation to the end of 2009 refer to the participation of certain groups which is a result of changes of assets with several banks.

The participation of three largest banks (Group I) decreased from 65,1% to 63,6%, while the participation of one bank (II group) of 7,6% remained the same as at the end of 2009. Three banks in Group III (assets between 500 million KM and one billion KM) increased their participation from 15,1% to 15,9%. The largest group IV consisting of nine banks, with assets between 100 and 500 million KM, also increased its participation to 11,5% (by 0,7 per cent), and the last Group V (four banks) still has the same lowest participation of 1,4%.

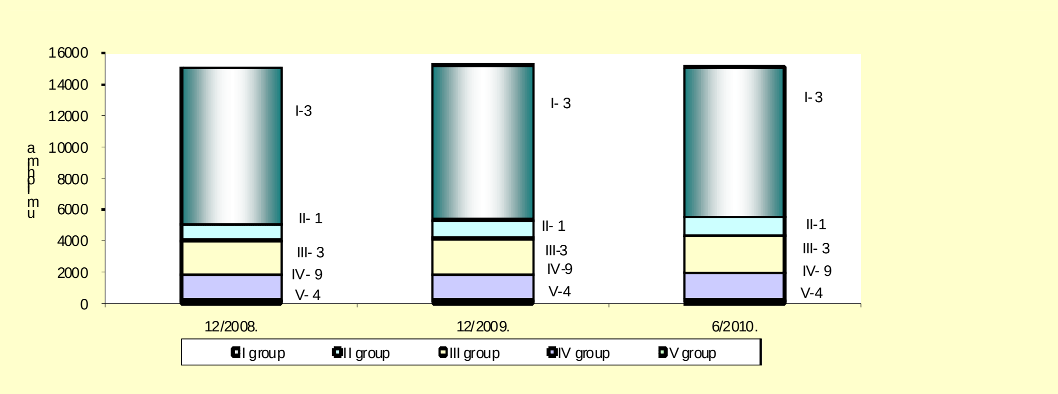
The following table presents a preview of amounts and participations of individual groups of banks in total assets by periods (amounts presented in KM millions).

Table 10: *Participation of individual groups of banks in total assets through periods*

ASSETS	31.12.2008.			31.12.2009.			30.06.2010.		
	Amount	Partic. %	No. of banks	Amount	Partic. %	No. of banks	Amou nt	Partic. %	No. of banks
I- Over 2.000	10.036	66,6	3	9.912	65,1	3	9.612	63,6	3
II- 1000 do 2000	1.017	6,7	1	1.165	7,6	1	1.148	7,6	1
III- 500 do 1000	2.180	14,5	3	2.293	15,1	3	2.403	15,9	3
IV- 100 do 500	1.627	10,8	9	1.648	10,8	9	1.740	11,5	9
V- Below 100	210	1,4	4	218	1,4	4	212	1,4	4
TOTAL	15.070	100,0	20	15.236	100,0	20	15.115	100,0	20

[11] Banks are divided into five groups depending on the assets size.

Graph 8: *Participation of individual groups of banks in total assets by periods*



The slight decrease of the aggregate balance sheet in 2010 of 1% or 122 million KM is a result of the collection of the liabilities from loans, that decreased by 17% or 303 million KM (they were 1,5 billion KM as of 30.06.2010.), as well as the total capital by 71 million KM due to the realized loss in the first half of 2010. At the same time, the growth of deposits of 2% or 223 million KM alleviated the decline of the aggregate balance sheet, and as of 30.06.2010 the deposits were 11,3 billion KM. However, it has to be emphasized that this growth is primarily the result of the funds received through the second and third tranche from the IMF of 180 million KM in the first quarter of 2010.

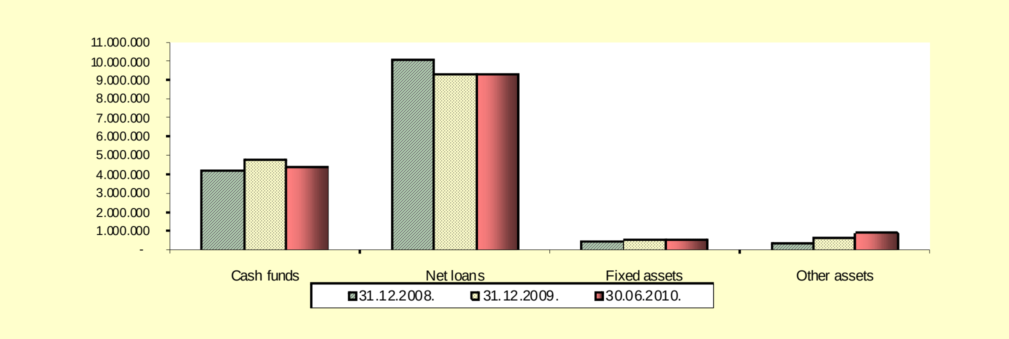
In the assets, cash funds (4,4 billion KM) are by 8% or 392 million in comparison to the end of 2009 mostly due to collection of matured loans liabilities. Also, banks increased the time deposits on the accounts in the foreign banks by 156 million KM, and placed around 76 million KM in securities (mostly EU countries treasury bonds). Significant funds were placed in the IV quarter of 2009 with the same purpose, purchase of securities (around 200 million KM[12]). Due to too high liquidity and minimal return on funds over the obliged reserves on the reserve account in Central Bank of BiH, the banks, mostly the large ones, through placements in the securities and time deposits in foreign banks, are trying to realize higher income and by doing that mitigate the decline of the interest income due to decrease in loan placement.

In the second quarter of 2010, the loans increased by 1% or 76 million KM (in the first half of 2010 the total loan growth was 0,5% or 48 million KM) for the first time after five consecutive quarterly rates of decline of loans (all quarters in 2009 and the first in 2010), which was primarily the consequence and the result of restrictive lending policies of banks and decreased level of lending activities of banks in the conditions of economic crises and recession. Such movements can be considered as a positive sign since they indicate that the banks' activities had, after several months of decrease, intensified which resulted in a slight loan growth. At the end of the first half of 2010 loans were 9,8 billion KM.

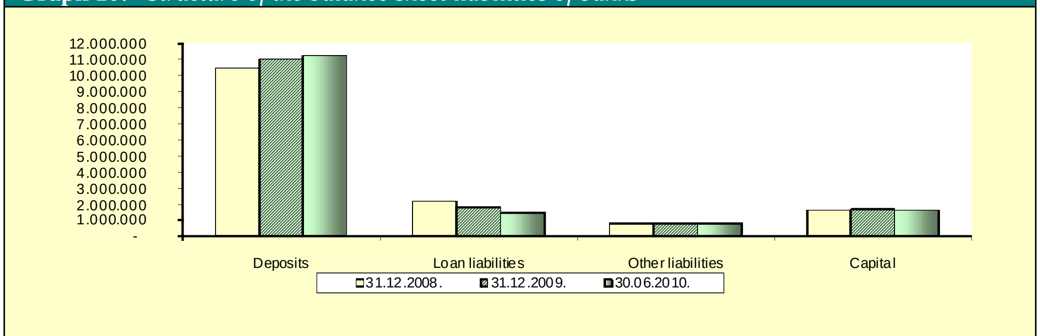
The following table and graph present the structure of the most significant balance sheet positions of banks.

[12] In the II quarter of 2010. these funds were repositioned from other assets to the position 2- Trading securities.

Graph 9: *Structure of the balance sheet assets of bank*



Graph 10: *Structure of the balance sheet liabilities of banks*



In the structure of banks' balance sheet liabilities, deposits in the amount of 11,3 billion KM and participation of 74,6% is still the dominant source of financing for banks in the Federation of BiH. Participation of credit liabilities has decreased from 11,6% to 9,7%, and participation of capital decreased from 11,0% to 10,6%.

The structure of assets, as well as the structure of sources, had relatively significant changes related to two key assets items: decreased participation of loans from 64,3% to 65,1% and of cash funds from 31,4% to 29,0%.

- in 000 KM-

Table 11: *Cash funds of bank*

CASH FUNDS	31.12.2008.		31.12.2009.		30.06.2010.		RATIO	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	4/2	6/4
1	2	3	4	5	6	7	8	9
Cash	344.618	8,2	355.419	7,4	361.796	8,2	103	102
Reserve accounts with CBBiH	2.228.687	53,0	2.455.505	51,4	2.285.946	52,1	110	93
Accounts with deposit institutions in BiH	12.341	0,3	441	0,0	4.107	0,1	4	931
Accounts with deposit institutions abroad	1.621.449	38,5	1.970.473	41,2	1.737.494	39,6	122	88
Cash funds in collection process	464	0,0	463	0,0	526	0,0	100	114
TOTAL	4.207.559	100,0	4.782.301	100,0	4.389.869	100,0	114	92

Cash funds of the banks on the reserve accounts of CBBiH, over the observing period of 2010, decreased by 7% or 170 million KM, amounting to 2,29 billion KM or 52,1% of total cash funds as of 30.06.2010., representing the participation increase of 0,7% in relation to the end of 2009.

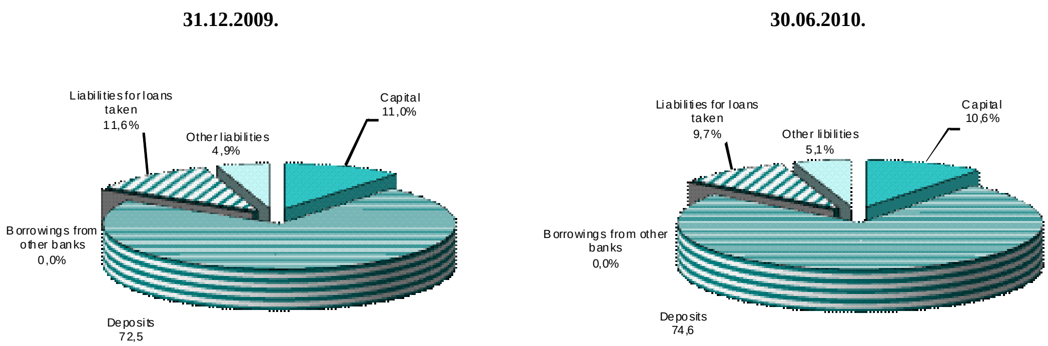
Banks' funds on the accounts with the depository institutions abroad have also decreased by 12% or 223 million KM, amounting to 1,74 billion KM or 39,6% of total cash funds as of the first half of 2010 (41,2% at the end of 2009). The banks have decreased their cash on hand and in vaults by 2% or 6 million KM. At the end of the observing period, those funds amounted to 362 million KM, representing 8,2% of total cash funds (7,4% at the end of 2009).

The participation of domestic currency in the currency structure of cash funds, over the observing period, has increased from 55,8% to 57,6%, while the participation of funds in foreign currency has decreased by the same amount of change.

2. 1. 1. Liabilities

Structure of liabilities (liabilities and capital) in the balance sheet of banks, as of 30.06.2010. is presented in the following graphs:

Graph 11: *Liabilities structure of banks*



Trends in changes of participation of the two most significant funding sources of banks (deposits and credit liabilities) continued developing through the first half of 2010, that is, deposit growth was primarily based on the funds from the arrangement with the IMF, participation of deposits increased from 72,5% to 74,6%, while decrease of credit liabilities due to payment of past due liabilities resulted by downfall in participation from 11,6% to 9,7%.

Deposits participating with 74,6% or 11,3 billion KM still represent the most significant funding source of banks in the Federation of BiH. In comparison to the end of 2009, these items increased by 2% or 223 million KM. Second source, per its size are credit funds obtained by banks primarily through indebtedness with foreign financial institutions. During 2009 the banks had significantly lower debt abroad, and the payment of due liabilities had as a net effect the decrease of loan liabilities from 19% to 405 million KM. In the first half of 2010, the same trend continued, the credit funds decreased by 17% or 302 million KM. If subordinate debts of 175 million KM, which were withdrawn by banks to strengthen capital base and capital adequacy, are added to the credit liabilities then the participation of total credit funds in the sources would be 10,9% (12,8% at the end of 2009).

Capital, at the end of first quarter of 2010, amounted to 1,61 billion KM, and it was decreased by 71 million KM as result of loss reported in the performance for this period.

As of 31.06.2010., the highest bank commitments were towards the following creditors (eight of total 47), representing 72% of total credit commitments: Central Eastern European Finance Agency (CEEFA), European Investment Bank (EIB), EBRD, European fund for Southeast

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Europe (EFSE), Council of Europe Development Bank, Steirmarkische Sparkasse, Raiffeisen Zentralbank Osterreich A.G. (RZB) and ComercBank AG Frankfurt.

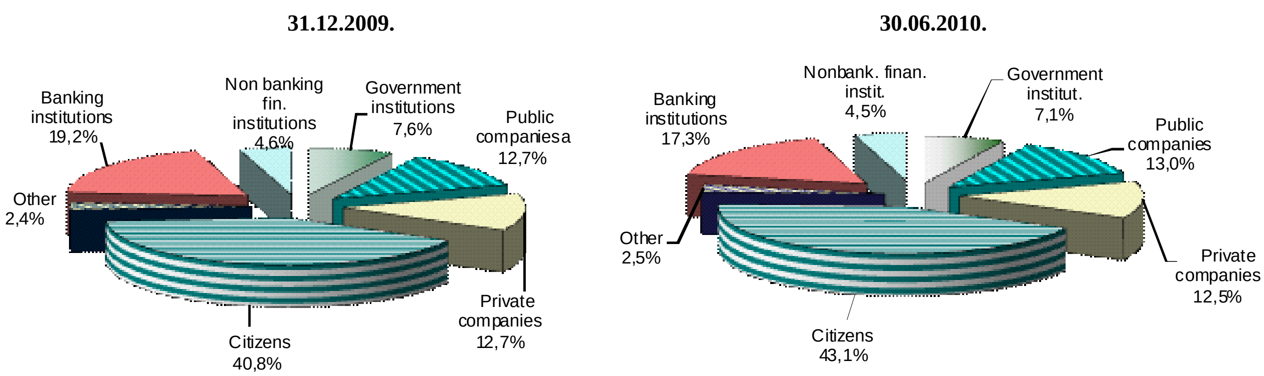
According to the data submitted by banks, out of total deposits as of 31.06.2010., only 6,1% was deposits collected by organizational units of banks from the Federation of BiH operating in Republic Srpska and Brcko District.

- in 000 KM-

Table 12: *Deposit structure by sectors*[13]

SECTORS	31.12.2008.		31.12.2009.		30.06.2010.		INDEX	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	4/2	6/4
1	2	3	4	5	6	7	8	9
Governmental institutions	701.520	6,7	839.926	7,6	797.040	7,1	120	95
Public enterprises	1.245.793	11,9	1.400.839	12,7	1.465.618	13,0	112	105
Private enterprises and assoc.	1.490.139	14,2	1.403.465	12,7	1.415.361	12,5	94	101
Non-profit. organizations	2.172.860	20,8	2.120.143	19,2	1.946.520	17,3	98	92
Banking institutions	403.295	3,9	509.769	4,6	513.086	4,5	126	101
Citizens	4.181.882	40,0	4.506.881	40,8	4.854.168	43,1	108	108
Other	266.361	2,5	264.845	2,4	277.299	2,5	99	105
TOTAL	10.461.850	100,0	11.045.868	100,0	11.269.092	100,0	106	102

Graph 12 : *Deposit structure by sectors*



Under the crises conditions, the high liquidity and decreased loan activity, the banks tend to restructure the funding sources and in such manner decrease the expenses. Apart from the significant decrease of loan liabilities, a change occurred in the sector structure of the deposits, the banking institution deposits decreased (mainly deposits from the parent bank or other members of the group) and in the banks in the Federation of BiH they were substituted by deposits to citizens.

The positive movements in the segment of citizen deposit continued through the first quarter of 2010 with growth of 8% or 347 million KM, amounting to 4,85 billion KM and participation of 43,1% in total deposits, still represents the largest funding source of banks in the Federation of BiH.

Banking institutions deposits are second largest sector source of funds in the banks' deposits potential. At the end of the reported period, after the decline of 8% or 174 million KM in the first

[13] Information from the attached form BS-D, each quarter submitted by banks with bbalance sheet - FBA format.

six months of 2010, they were 1,95 billion KM representing 17,3% of total deposits. As of 30.06.2010. the deposits of the banking institutions are by 477 million KM higher than the loan liabilities, which are, after the deposits, the second most significant source of funding for bank in the FBiH.

It should be emphasized that 96% or 1,87 billion KM of banking institutions' deposits refers to deposits of banks-members of groups (primarily shareholders). Financial support of the groups (banking and nonbanking financial institutions) through deposits in the amount of 1,91 billion KM is present in nine banks in the Federation of BiH, with a concentration on four large banks (87%), with one bank representing 46% of total deposits received from the group. In this manner, the domestic banks-members of the groups receive financial support and have secured inflow of new funding sources by the group whose members they are, which is especially important in times of crisis and more difficult access to money market and new funds, as well as the increase of liquidity risk as result of deterioration in collection of loans and increase of nonperforming claims. If credit liabilities and subordinate debts (loans and deposits in supplementary capital) are added to these funds, the financial support the banks receive from their groups becomes higher (in ten banks), amounting to 2,61 billion KM or 17,3% of total liabilities of the banking sector as of 31.06.2010. In comparison to the end of 2009, these funds were reduced by 432 million KM or 14,2%.

Under the support of IMF and other financial institutions, the FBA has been involved in activities related to signing of the Memorandum of Understanding with parent-banks from the European Union countries whose daughter-banks operate in the territory of BiH, the so called "Vienna Initiative".

Deposits of other sectors had minor changes: growth of the public enterprises' deposits of 5% or 65 million KM and private enterprises of 1% or 12 million KM. The public enterprises' deposits, as of 31.06.210., amounted to 1,47 billion KM, representing 13% of total deposits (by 0,3 per cent higher than at the end of 2009), while deposits of private enterprises amounted to 1,42 billion KM with participation of 12,5%, in decline by 0,2% when compared to the end of 2009.

Deposits of government institutions were lower (by 5% or 43 million KM), amounting to 797 million KM as of 30.06.2010 with participation of 7,1% that were lower by 0,5 per cent in comparison to the end of 2009.

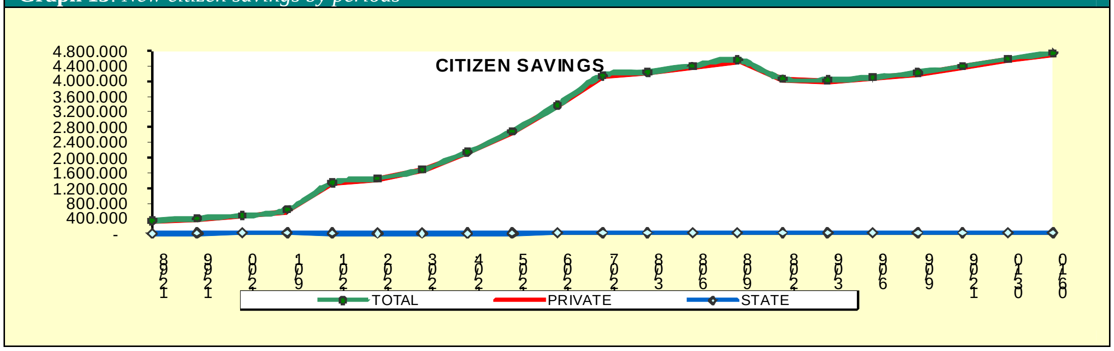
Currency structure of deposits, as of 31.06.2010., was the following: deposits in foreign currencies (with the dominant participation of EURO) in the amount of 6,8 billion KM participated with 60,0% (59,6% at the end of 2009) and deposits in domestic currency in the amount of 4,5 billion KM participated with 40,0% (40,4% at the end of 2009).

Saving deposits, as the most significant segment of deposits and financial potential of banks, following many years of a stable and continuous growth, with the first signs of the economic and financial crisis in the fourth quarter of 2008, decreased by 11% or 494 million KM. The most critical withdrawal was recorded in October. After this period, the condition stabilized, shaken confidence in banks retrieved, resulting by majority of deposits being placed back on bank accounts in 2009.

Positive trends continued in 2010. As of 31.06.2010., savings reached the amount of 4,69 billion KM , which is the highest amount until now, and by 162 million KM higher than the level of savings as of 30.09.2008. that right before the crisis was the highest amount until that time. In the first half of 2010, the savings increased by 7,6% or 330 million KM. Those changes were primarily the result of the crisis and decreased spending, difficult situation in the economy in general and citizens' fear due to uncertainty whether the situation will get better or whether positive development or changes to the best will evolve

Table 13: *New citizen savings by periods*					
BANKS	**AMOUNT (in 000 KM)**			**RATIO**	
	31.12.2008.	**31.12.2009.**	**30.06.2010.**	**3/2**	**4/3**
1	2	3	4	5	6
State	32.481	35.275	41.184	109	108
Private	4.003.184	4.325.926	4.649.821	108	117
TOTAL	4.035.665	4.361.201	4.691.005	108	108

Graph 13: *New citizen savings by periods*



The largest three banks hold 72,4% of savings, while participation of 11 banks has an individual participation of less than 1%, representing only 6,1% of total savings in the system.

Savings deposits in local currency represent 29% and in foreign currency 71% of total savings amount.

Table 14: *Maturity structure citizen saving deposits by periods*								
BANKS	**AMOUNT (in 000 KM)**						**RATIO**	
	31.12.2008.		**31.12.2009.**		**30.06.2010.**		**3/2**	**4/3**
1	2		3		4		5	6
Short term saving deposits	2.119.669	52,5%	2.054.196	47,1%	2.171.143	46,3%	97	106
Long term saving deposits	1.915.996	47,5%	2.307.005	52,9%	2.519.862	53,7%	120	109
TOTAL	4.035.665	100,0 %	4.361.201	100,0 %	4.691.005	100,0 %	108	108

Maturity structure of savings has maintained the trend of positive changes from the past period by further increase of the long term savings participation, as result of higher increase of long term savings (by 9% or 213 million KM) than short term (by 6% or 117 million KM), so as of 31.06.2010. the per cent of their participation was 53,7% and 46,3% respectively.

Long term continuous growth and positive trends in the savings segment of banks in the F BiH result, on the one hand, from strengthening of safety and stability of the overall banking system, giving the key importance to the existence of functional, effective and efficient banking supervision conducted by the FBA, and, on the other hand, deposit insurance system with the main purpose to increase stability of the banking, that is, financial sector and protection of depositors. In December 2008, with purpose to preserve citizens' trust in safety and stability of the banking system in BiH, the amount of insured deposit increased to KM 20.000. Subsequently, initiated was the increase of insured deposit, so as of 01.04.2010 it was increased to 35.000, and all the taken actions are directed to mitigating the impact of the global economic crises on the banking system and the economic system as a whole in FBiH and BiH.

As of 30.06.2010 there are 15 banks in total from the Federation of BiH that were accepted to the deposit insurance program (they hold the Deposit Insurance Agency of BiH license), and according to the submitted data, there is total 97,1% of total deposits and 98,6% of total savings deposited in these banks.

Upon the change of the Law on the deposit insurance in the banks in BiH[14] and elimination of the ownership criteria (participation of private and state capital), in the first quarter of 2010, one state owned bank was accepted to the insurance program. Remaining five banks cannot apply to be admitted since they do not qualify to the criteria prescribed by the Deposit Insurance Agency: three banks due to the existing composite rating and two banks (one private and one state) are under provisional administration. At the same time, there is an initiative made to raise the insured deposit to 50.000 KM, and all the activities undertaken have been directed to reduce an impact of the global economic crisis on the banking and the entire economic system of the FBiH and BiH.

2.1.2. Capital – strength and adequacy

Capital[15] of banks in the Federation of BiH, as of 31.06.2010., amounted to 1,97 billion KM.

-in 000 KM-

Table 15: *Regulatory capital*

DESCRIPTION		31.12.2008.		31.12.2009.		30.06.2010.		RATIO 3/2	RATIO 4/3
1		2		3		4		5	6
STATE BANKS									
1.	Core capital before reduction	44.852		44.906		45.421		100	101
2.	Offsetting items	2.752		3.796		4.074		138	107
a)	Core capital (1-2)	42.100	97%	41.110	97%	41.347	97%	98	101
b)	Supplementary capital	1.335	3%	1.294	3%	1.397	3%	97	108
c)	**Capital (a + b)**	43.435	100%	42.404	100%	42.744	100%	98	101
PRIVATE BANKS									
1.	Core capital before reduction	1.610.692		1.708.796		1.717.901		106	101
2.	Offsetting items	170.042		195.208		242.469		115	124
a)	Core capital (1-2)	1.440.650	72%	1.513.588	75%	1.475.432	77%	105	97
b)	Supplementary capital	574.370	28%	506.458	25%	449.513	23%	88	89
c)	**Capital (a + b)**	2.015.020	100%	2.020.046	100%	1.924.945	100%	100	95
Total									
1.	Core capital before reduction	1.655.544		1.753.702		1.763.322		106	101
2.	Offsetting items	172.794		199.004		246.543		115	124
a)	Core capital (1-2)	1.482.750	72%	1.554.698	75%	1.516.779	77%	105	98
b)	Supplementary capital	575.705	28%	507.752	25%	450.910	23%	88	89
c)	**Capital (a + b)**	2.058.455	100%	2.062.450	100%	1.967.689	100%	100	95

In the first half of 2010, capital[16] was decreased by 5% or 95 million KM in comparison to 2009, while the changes in core and supplementary capital reflected to changes in the structure of regulatory capital. The core capital increased by 2% or 38 million KM, and supplementary capital decreased by 11% or 57 million KM.

[14] „Official Gazette of BiH“ No.75/09.

[15] Regulatory capital as defined by Article 8 and 9 of Decision on Minimum Standards for Capital Management in Banks (Official Gazette of the Federation of BiH, 3/03, 18/03, 53/06, 55/07, 81/07, 6/08).

[15] Data source is the quarterly Report on Capital Positions of Banks (Form 1-Schedule A) regulated by the Decision on Minimum Standards for Managing Capital in Banks.

The core capital decline is a result of increase of offsetting items (that reduce the core capital) by 47,5 million KM, mostly based on the increase of the current loss (90 million KM), with a simultaneous decrease based on partial covering of uncovered losses in the amount of 39,5 million KM. Also, the shareholders capital of one bank decreased by 14,6 million KM due to covering of losses from previous years.

At the same time the negative effect of the current debt was somewhat amortized through inclusion of profit generated in 2009. After implementation of the legal procedure of making and adopting decisions on allocation of the revised profit by the banks assemblies, the profit generated in 2009 (seven banks generated loss in the amount of 53 million KM) in the amount of 54 million KM (13 banks) was 99% allocated in core capital (to reserves and retained profit – the undistributed profit 94% and covering losses 4,8%).

In the first half of 2010, there was no capital increase based on inflow of new, green capital – additional capitalization.

Supplementary capital decreased by 56,8 million KM, with major changes in the structure: the 2009 profit of 49 million KM moved to the core capital, subordinate debts decreased by 11,9 million KM, while items of general loan loss provisions increased by 4,2 million KM. Capital calculations during the year have not included current non audited profit that also resulted by decrease of supplementary capital.

The mentioned changes influenced the structure of the regulatory capital, so participation of core capital has increased from 75% to 77%, while the supplementary capital has decreased from 25% to 23%.

Net capital, as well as regulatory capital decreased by 5% or 95 million KM, amounting to 1,95 billion KM as of 31.06.2010. The largest influence of the decrease of capital was realized at one bank (that reported a loss of 78,7 million KM). During the development of this report, additional capital was added to that bank in the amount of 50 million KM, which partly neutralized the adverse impact on capital.

The banks capital level rate is expressed as a ratio of capital and assets and as of 30. 06. 2010 it was 12,5%, by 0,6 per cent less than at the end of 2009.

One of the most significant indicators of capital strength and adequacy[17] of banks is capital adequacy ratio calculated as a ratio of net capital and risk weighted assets. As of 31.06.2010., this ratio at the banking system level was 15,1% which is lower by one per cent than at the end of 2009. The reason was the increase of total risk weighted risk by 2% or 251 million KM. Although the risk of risk-weighted assets and credit equivalents increased by 189 million KM (from 11,79 billion KM to 11,98 billion KM) primarily due to the increase of investments of banks to securities (mostly bonds). On the other hand, risk-weighted operating risk (POR) increased by 62 million KM (amounting to 945 million KM), resulting by the mentioned increase of total risk-weighted risks. At the end of the first half of 2010, structural participation of risk-weighted assets exposed to credit risk was 93%, and to operating risk 7%.

In process of conducting supervision of operations and financial positions of banks in the FBiH, as regulated by the Law, the FBA issues orders to banks to undertake actions for strengthening of capital base and provision of adequate capital in order to improve safety of both banks

[17] The Law prescribes minimum capital adequacy rate of 12%.

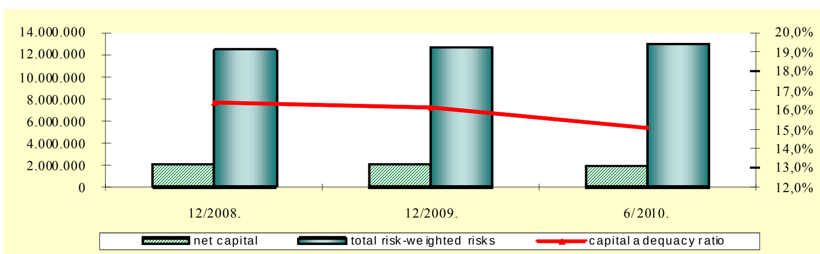
individually and the entire banking system, according to the level and profile of existing and potential exposure to all risks relevant to the banking operations. Under the conditions of economic crisis and the increase of the loan risk caused by the decline of the credit portfolio quality, this request has a priority and that is why the segment of capital is under a continuous enhanced supervision. One of the measures is also a requirement imposed on banks not to distribute the 2009 profit they generated to pay out dividends, but to rather strengthen their capital base, which was accepted by the banks (only one bank upon the Agency's approval paid out dividends to close past due claims of majority owner of the bank).

- 000 KM-

Table 16: *Net capital, risk-weighted assets and capital adequacy rate*

DESCRIPTION	31.12.2008.	31.12.2009.	30.06.2010.	RATIO	
				3/2	4/3
1	2	3	4	5	6
1. NET CAPITAL	2.038.997	2.046.414	1.951.653	100	95
2. RISK WEIGHTED ASSETS AND CREDIT EQUIVALENTS	12.301.441	11.790.234	11.979.260	96	102
3. POR (RISK WEIGHTED OPERATING RISK)	130.975	882.928	944.970	674	107
4. TOTAL RISK WEIGHTED RISKS (2+3)	12.432.416	12.673.162	12.924.230	102	102
5. NET CAPITAL RATE (CAPITAL ADEQUACY) (1/ 4)	16,4%	16,1%	15,1%	98	94

Graph 14: *Net capital, risk-weighted assets and capital adequacy rate*



The global financial crisis effects are also evident in the segment of capital, that is, in the capital adequacy rate, mostly due to the profitability decline in almost all banks in the system (profit decline, that is, loss increase), so the net capital decreased by 5% or 95 million KM (amounting to 1,95 billion KM), as well as the increase of risk assets by 2% or 251 million KM (amounting to 12,9 billion KM). Capital adequacy rate of the banking system, as of 31.06.2009., was 15,1%, which is still much more than the minimum prescribed by the law (12%), representing satisfactory capitalization of the entire system and very strong basis and foundation to preserve its safety and stability. Capital base and/or by law regulated minimal standard of capital adequacy had been jeopardized in several banks, however, in compliance with the Agency's request they provided additional capital, and that process will be completed in the coming period.

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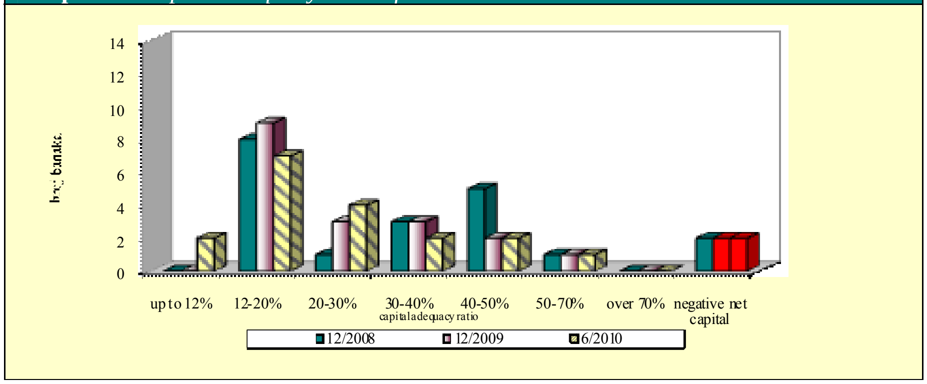
Graph 15: *Capital adequacy rates of banks*



Of total 20 banks in the FBiH, as of 31.06.2010., capital adequacy rate of 18 banks was higher than minimum prescribed by the law of 12%, while four banks recorded capital adequacy rate below 12% (two of them under provisional administration had, negative adequacy rate). According to analytical data at the end of the first half of 2010, 14 banks recorded the capital adequacy rate lower than prior year (of which number two banks do not meet the proscribed minimum of 12%, one bank is not in compliance with the regulations related to net capital that should be below 15 million KM, with a note that the first two banks are in process of solving this problem through providing additional capital), four banks recorded better rate, while two banks under provisional administration recorded negative rate.

Preview of capital adequacy rates of 16 banks in comparison to the minimum prescribed by the law of 12% is the following:

- Seven banks had the rate between 13,6% and 17,8%, and the two largest banks from 14% to 14,6%,
- Eight banks had the rate between 21% and 50%,
- One bank had the rate between 51% and 70%.

Further strengthening of capital base will be priority task in majority of banks as it has been the case so far, especially in the largest banks of the system, which is necessary to strengthen stability and safety of both banks and the entire banking system, especially due to changes in business and operating environment under which banks in the Federation operate, because of the global financial crisis expansion to the area of our country and adverse effects this crisis may have on the banking sector and the entire economy of BiH. Following bank expansion and performing regular supervision of this segment, when acting towards banks, depending on the evaluation of their capital adequacy and risk profile, the FBA takes different corrective and supervisory measures, such as: adoption of strategy to maintain certain level of capital and plan which will provide for quantity and quality (structure) of that capital in accordance with the nature and complexity of bank's present and future business activities and the undertaken and potential risk, then intensified supervision and monitoring of bank, request to supply additional capital in order to strengthen capital base, and elimination of excessive credit risk concentrations and related limitation and decrease of credit risk exposure related to certain types of concentrations, monitoring of implementation and realization of adopted capital plans, especially for additional capital supplied from external resources, supervision of compliance and implementation of the ordered measures, etc.

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2.1.3. Assets and asset quality

Decision on Minimum Standards for Loan Risk Management and Assets Classification of Banks determines the criteria for evaluation of bank's exposure to loan risk based on evaluation of their assets quality and adequacy of reserves for loan and other losses according to the risk of placements and balance sheet and off-balance sheet items.

Total assets with off-balance sheet items (assets)[18] of banks in the FBiH as of 31.06.2010., amounted to 18 billion KM, representing an increase of 44 million KM in comparison to the end of 2009. Gross assets[19] in the amount of 15,7 billion KM are lower by 18 million KM.

Off-balance sheet risk items amounted to 2,3 billion KM and are lower by 3% or 63 million KM.

- in 000 KM-

Table 17: *Assets off-balance sheet items and potential loan losses*

DESCRIPTION	AMOUNT (in 000 KM)						RATIO	
	31.12.2008.	Struct. %	31.12.2009.	Struct. %	30.06.2010.	Struct. %	4:2	6:4
1.	2	3	4	5	6	7	8	9
Loans	10.200.134	66,0	9.442.600	60,1	9.359.170	59,6	93	99
Interests	59.564	0,4	61.797	0,4	57.514	0,4	104	93
Past due claims	231.890	1,5	352.580	2,2	482.545	3,1	152	137
Claims for paid guarantees	2.353	0,0	1.620	0,0	2.754	0,0	69	170
Other placements	39.393	0,2	276.693	1,8	421.763	2,7	702	152
Other assets	4.937.976	31,9	5.581.877	35,5	5.374.985	34,2	113	96
TOTAL ASSETS	15.471.310	100,0	15.717.167	100,0	15.698.731	100,0	102	100
OFF-BALANCE SHEET	2.582.093		2.271.512		2.334.053		88	103
ASSETS WITH OFF-BALANCE SHEET	18.053.403		17.988.679		18.032.784		100	100
RISK ASSETS WITH OFF-BALANCE SHEET	13.304.610		12.583.315		12.984.691		95	103
General loan risk and Potential loan losses	461.839		534.721		640.041		116	120
General and Special loan loss reserves already established	461.687		534.749		639.933		116	120

Non-risk items amount to five billion KM or 28% of total assets with off-balance sheet, and they are by 7% less than as of the end of 2009. On the other hand, risk assets with off-balance sheet items amount to 13 billion KM, and they increased by 3% or 401 million KM .

The impact and negative consequences of the global financial and economic crisis in BiH are increasingly more apparent in banks' operations, as result of the transfer of crisis from real to the banking sector, with the largest impact on banks' key operation and that is the segment of lending and asset quality. Following significant downfall of credit placements of 6% or 638 million KM in 2009, in the first half of 2010, there was a minor growth of 48 million KM that could be assessed positive, since banks have increased their volume of new placements based on which the negative trend from prior years came to an end. As of 31.06.2010., loans amounted to 9,8 billion KM with participation in the assets of 65,1%, which is lower by 0,8 per cent than at the end of 2009. However, due to deepening of the crisis and deterioration of the entire economic condition in BiH, it is expected in the forthcoming periods to see stagnation or minor growth of credit portfolio and indication of that is the level of the newly approved loans. Indeed,

[18] Assets defined by Article 2 of Decision on Minimum Standards for Loan Risk Management and Assets Classification of Banks („Official Gazzette of FBiH“, number 3/03, 54/04, 68/05).
[19] Data source: Report on classification of balance sheet assets and off-balance sheet items of banks.

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in the first six months of 2010 there were only 12% more loans placed in relation to the same period of 2009, and 33% less than the same period of 2008.

The most significant limiting factor to the credit growth is adverse impact of the crisis to the entire economy in BiH and deterioration of condition in the real sector, then decreased citizen's spending, as well as more restrictive and prudent lending policies of banks. It is certain that in the forthcoming period there will be further deterioration in quality of the credit portfolio, increase of bad placements and consequently credit losses, which will have an adverse reflection to the financial result of banks.

The FBA has been involved in the activities aimed at signing of the Memorandum of Understanding with parent-banks from the European Union countries whose daughter-banks operate in the territory of BiH, so called „Vienna Initiative“, which will secure additional financial funds for lending to the real sector, since any deterioration of the economy could adversely reflect to the rating of daughter-banks, and consequently weaken the rating of parent banks.

Three largest banks in the FBiH with credit amount of 6,2 billion KM have participation of 63,4% in total loans at the system level.

In the aspect of sectors to which banks originate their loans, changes over the first half of 2010 could be assessed positive due to increase of placements to private companies along with simultaneous decrease of placements to citizens. However, in comparison to the end of 2009, loans originated to private companies increased by 1% or 58 million KM, amounting to 4,75 billion KM or 48,3% of total loans (47,9% at the end of 2009). Loans originated to citizens are 4,77 billion KM, representing participation of 48,4% (48,6% at the end of 2009). The data submitted by banks, as of 31.06.2010., in the aspect of loan structure originated to citizens (based on the purpose), do not record any change over longer period of time, that is, the highest participation of approx. 72% have loans originated to finance consumer goods[20], 25% have housing loans, and remaining 3% have loans for SMEs and agriculture.

Three largest banks in the system financed 66,3% of total loans originated to citizens, and to private companies 61% of total loans to all sectors (at the end of 2009 to citizens 66,4%, private companies 63,1%).

Trend and changes in participation of individual sectors in the overall structure of loans are presented in the following table:

- in 000 KM-

Table 18: *Structure of loans per sectors*

SECTORS	31.12.2008.		31.12.2009.		30.06.2010.		RATIO	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	4/2	6/4
1	2	3	4	5	6	7	8	9
Government institutions	76.964	0,7	74.609	0,8	84.676	0,9	97	113
Public enterprises	175.424	1,7	184.005	1,9	169.284	1,7	105	92
Private enterprises and assoc.	4.881.526	46,8	4.696.276	47,9	4.754.391	48,3	96	101
Banking institutions	5.805	0,1	6.755	0,1	5.580	0,1	116	83
Non-banking financial instit.	105.352	1,0	51.255	0,5	42.762	0,4	49	83
Citizens	5.146.963	49,3	4.765.656	48,6	4.766.926	48,4	93	100
Other	42.343	0,4	18.244	0,2	20.850	0,2	43	114
TOTAL	10.434.377	100,0	9.796.800	100,0	9.844.469	100,0	94	100

[20] Short- term operation included.

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Currency structure of loans has also been unchanged for longer period: loans financed with currency clause had the highest participation of 75% or 7,2 billion KM, loans in domestic currency of 26% or 2,5 billion KM, while loans in foreign currency had the lowest participation of only 1% or 125 million KM.

Since placements, that is, loans represent the most risky portion of banks' assets; their quality represents one of the most significant elements of stability and successful performance. Evaluation of assets quality is actually evaluation of exposure to loan risk of banks' placements, that is, identification of potential loan losses that are recognized as loan loss provisioning.

Quality of assets and off-balance sheet risk items, general loan risk, potential loan losses by classification categories[21] and off-balance sheet items are presented in the following table:

Table 19: *Asset classification, general loan risk (GLR),potential loan losses (PLL) and off-balance sheet items (charged off assets and suspended interest)*

Classification category	AMOUNT (in 000 KM) and PARTICIPATION (in%)									RATIO	
	31.12.2008.			31.12.2009.			30.06.2010.				
	Assets classif.	Partic. %	GLR PLL	Assets classif.	Partic. %	GLR PLL	Assets classif.	Partic. %	GLR PLL	5/2	8/5
1	2	3	4	5	6	7	8	9	10	11	12
A	11.534.783	86,7	230.749	10.260.601	81,5	205.228	10.478.675	80,7	209.582	89	102
B	1.446.503	10,9	103.385	1.804.767	14,4	136.973	1.723.775	13,3	137.604	125	96
C	165.309	1,2	40.558	307.892	2,5	72.970	436.089	3,4	104.432	186	142
D	154.168	1,2	83.300	206.201	1,6	115.703	342.289	2,6	184.569	134	166
E	3.847	0,0	3.847	3.854	0,0	3.847	3.863	0,0	3.854	100	100
Risk assets (A-E)	13.304.610	100,0	461.839	12.583.315	100,0	534.721	12.984.691	100,0	640.041	95	103
Nonrisk assets[22]	4.748.793			5.405.364			5.048.093			114	93
TOTAL	18.053.403			17.988.679			18.032.784			100	100
OFFBALANCE SHEET ITEMS											
Charged off assets	429.419	89,0		505.635	89,7		558.340	89,4		118	110
Susp. interest	54.479	11,0		57.959	10,3		66.023	10,6		114	114
TOTAL	483.898	100,0		563.594	100,0		624.363	100,0		117	111

Risk assets with off-balance sheet items (A-E) amounted to 13 billion KM, and, as of 31.06.2010., these items increased by 3% or 401 million KM. Non-risk items amounted to 5 billion KM, and decreased by 7% or 357 million KM in relation to the end of 2009.

If an analysis of the risk assets quality is performed, it could be concluded, over the observing period, there was a continued downfall of asset quality and its deterioration as an impact of the economic crisis and the increase of non-payable claims, that is, delinquency of customers to pay past due loan liabilities. However, it must be noted that the largest impact on the significant deterioration of the indicators of the total system had one large bank, which in 2009 started and in 2010 intensified the "clean-up" of the loan portfolio, which resulted with significantly worse indicators of the asset quality of this bank and the whole banking system. The participation of the loan portfolio of that bank as of 30. 06. 2010 was 17,5%, the participation of its classified and nonperforming assets was 32% and 53%, and the increase of the poor loans (nonperforming)

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[21] As regulated in the Article 22 of the Decision on Minimum Standards for Managing Credit Risk and Assets Classification in Banks, banks have to allocate and maintain reserves for general and special loan losses in percentages according to classification categories: A 2%, B 5% to 15%, C 16% to 40%, D 41% to 60% and E 100%.

[22] Assets items that are not, according to Article 22, Paragraph 7 of Decision on Minimum Standards for Bank Credit Risk and Assets Classification Management, subject to accrual of general loan loss provisions of 2%.

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mostly refers to that bank. The other banks had mild oscillations (improvement or deterioration), actually only three banks have asset quality indicators that are worse than the banking system.

Classified assets (B – E), in the observed period recorded growth of 8% or 183 million KM, the category B was decreased by 4% or 81 million KM, and nonperforming assets (C-E) increased by a high 51% or 264 million KM. In the same period performed was the write off of the assets and interest (transferred to off balance sheet) in the amount of 96 million KM. The noted indicators are of concern and that is underlined by the fact that in 2009 the total increase of the classified assets was 31% or 553 million, from which the B category was increased by 25% or 358 million KM, nonperforming by 60% or 195 million KM, the written off assets and interest were 157 million KM. of 16% or 84 million KM, while, during the same period, the assets write off (write off to the off-balance sheet) was in the amount of 35 million KM. In 2010 due to poor collection and increase of due days of the past due receivables, the banks had to perform a reclassification and a significant amount of loans were moved from B category to nonperforming category resulting in the increase of the loan loss provisioning expenses.

The classified assets as of 30.06.2010 were 2,5 billion KM, and nonperforming 782 million KM (31.12.2009: 2,3 billion KM and 518 million KM).

As result of the mentioned, the indicators of asset quality expressed as ratio, that is, participation of individual categories in risky assets have deteriorated in comparison to the end of 2009. This is raising a concern, especially since more adverse effects are expected to happen over the upcoming quarters. The classified assets to risky assets ratio has deteriorated by 0,8 per cent due to the increase of classified assets (8%) over the risky assets (3%) in comparison to the end of 2009, which is currently representing 19,3%.

If an analysis is performed of only the ratio and trend of nonperforming assets and risk assets, as of 30.06.2010., this ratio was 6,0%, which is still relatively low ratio, and, if compared to the end of 2009, it is higher by 1,9 per cent. However, if we take into account that participation of category B in the risk assets is 13,3% and the increasing doubt that portion of placements reported under this category deteriorated in quality and should be categorized as nonperforming assets, in other words that some banks still practice not to timely establish adequate loan loss provisioning (as confirmed through on-site examinations, resulting by insufficient loan loss reserves), it could be concluded that the assets quality still has a decreasing trend. That is why it is of key importance that banks more realistically evaluate quality of their placements and establish adequate loan loss reserves, especially due to the fact that under an impact of the crisis delinquency concerning payment of past due claims increase, provisioning increases, and the earnings of banks decrease.

The analysis of data by sectors is based on the indicators of the quality of loans granted to the two most significant sectors: legal entities and citizens. The two mentioned indicators for these sectors are significantly different and indicate higher loan risk exposure, and also the exposure to potential loan losses with the loans originated to legal entities.

Table 20: *Classification of loans originated to citizens and legal entities*

Classification category	AMOUNT (in 000 KM) and PARTICIPATION (in%)												RATIO
	31.12.2009.						30.06.2010.						
	Citizens	Partic. %	Legal entities	Partic. %	TOTAL Amount	TOTAL Partic.	Citizens	Partic. %	Legal entities	Partic. %	TOTAL Amount	TOTAL Partic.	12/6
1	2	3	4	5	6 (2+4)	7	8	9	10	11	12 (8+10)	13	14
A	4.311.231	90,46	3.421.255	68,00	7.732.486	78,93	4.248.542	89,13	3.367.235	66,32	7.615.777	77,36	98
B	260.509	5,47	1.298.642	25,81	1.559.151	15,91	217.884	4,57	1.238.622	24,39	1.456.506	14,80	93
C	108.969	2,29	193.570	3,85	302.539	3,09	183.465	3,85	247.738	4,88	431.203	4,38	142
D	84.947	1,78	117.677	2,34	202.624	2,07	117.029	2,45	223.949	4,41	340.978	3,46	168
E	0	0,00	0	0,00	0	0,00	5	0,00	0	0,00	5	0,00	100
TOTAL	4.765.656	100,0	5.031.144	100,0	9.796.800	100,00	4.766.925	100,0	5.077.544	100,0	9.844.469	100,00	100
Classi.loans B-E	454.425	9,53	1.609.889	32,00	2.064.314	21,07	518.383	10,87	1.710.309	33,68	2.228.692	22,64	108
NPL C-E	193.916	4,07	311.247	6,19	505.163	5,16	300.499	6,30	471.687	9,29	772.186	7,84	153
		48,64		51,36		100,00		48,42		51,58		100,00	
Participation by sectors in classified loans, nonperforming loans and category B:													
Classification B-E		22,02		77,98		100,00		23,26		76,74		100,00	
NPL C-E		38,39		61,61		100,00		38,91		61,09		100,00	
Category B		16,71		83,29		100,00		14,96		85,04		100,00	

As of 31.03.2010., of total loans originated to legal entities in the amount of 5,08 billion KM, 1,7 billion KM or 33,68% was classified in categories B to E (1,6 billion KM or 32% at the end of 2009), while of total loans originated to citizens in the amount of 4,8 billion KM, classification categories B to E represent 518 million KM or 10,87% (454 million KM or 9,53% at the end of 2009).

Of loans financed to legal entities, 472 million KM were classified as nonperforming loans or 9,29% of total loans originated to this sector (as of 31.12.2009., these items amounted to 311 million KM or 6,19%). Nonperforming loans, in the sector of citizens, amounted to 300 million KM or 6,30% of total loans originated to this sector (as of 31.12.2009., these items amounted to 194 million KM or 4,07%), as result of the increase of the nonperforming loans of 53% over the observing period.

The observed indicators of the quality of loans originated to legal entities and citizens, as well as already stated indicators of the quality of total risky assets, show a decreasing trend in the first quarter of 2010, which is primarily a result of growth in poor quality loans of 53% or 267 million KM (in the sector of citizens 55% or 106 million KM and legal entities 52% or 161 million KM), resulting by the increase of participation of the poor quality loans from 5,16% to 7,84% (in the sector of citizens from 4,07% to 6,30% and the sector of legal entities from 6,19% to 9,29%), as well as other indicators for those two sectors and the entire loan portfolio have deteriorated.

For more realistic assessment, it should take into account the amount of loans that banks, during the observing period, charged off to the off-balance sheet, as presented in the following table.

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-000 KM-

Table 21: *Off-balance sheet records: charged off assets and suspended interest*

DESCRIPTION	CITIZENS		LEGAL ENTITIES		TOTAL	
	Charged off assets	Suspended interest	Charged off assets	Charged off assets	Suspende d interest	Charged off assets
1	2	3	4	5	6	7
Opening balance as of 31.12.2009.	146.613	12.559	359.019	45.398	505.632	57.957
Changes in 2010:						
- new charge offs (current year)	38.248	5.058	42.524	10.807	80.772	15.865
- payments made in the current year	9.252	2.935	9.863	1.946	19.115	4.881
- *permanent charge off*	295	165	8.657	2.755	8.952	2.920
Balance as of 31.06.2010.	175.314	14.517	383.026	51.506	558.340	66.023

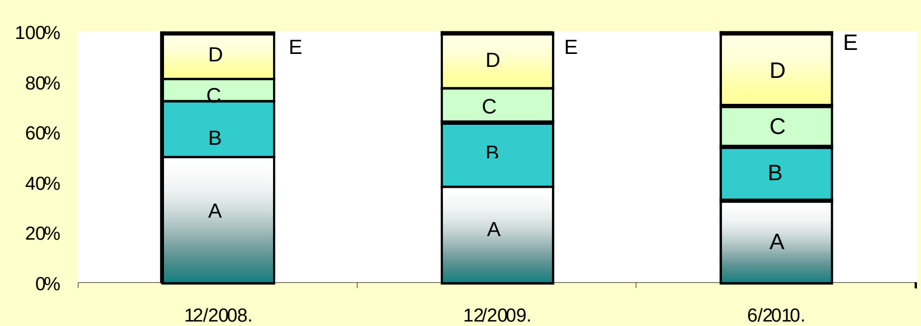
Balance of the charged off assets, as of 31.06.2010. (530 million KM) and the suspended interest (66 million KM) generated the increase of 10%, that is, 14% in comparison to 2009.

Level of general loan risk and estimated potential loan losses in the classification categories, as determined in accordance with the criteria and methodology prescribed by the FBA's decisions, their trend and structure at the level of the banking sector are presented in the following tables and graphs.

Table 22 : *Structure and trend of general loan risk and potential loan losses*

Classification category	AMOUNT (in 000 KM) and STRUCTURE (in%)						RATIO	
	31.12.2008.		31.12.2009.		30.06.2010.		4/2	6/4
1	2	3	4	5	6	7	8	9
A	230.749	50,0	205.228	38,4	209.582	32,8	89	102
B	103.385	22,4	136.973	25,6	137.604	21,5	132	100
C	40.558	8,8	72.970	13,7	104.432	16,3	180	143
D	83.300	18,0	115.703	21,6	184.569	28,8	139	159
E	3.847	0,8	3.847	0,7	3.854	0,6	100	100
TOTAL	461.839	100	534.721	100	640.041	100	116	120

Graph 16: *Structure and trend of general loan risk and potential loan losses*



As reported, banks have established loan loss provisions in accordance with the regulations and level of the estimated credit risk.

Based on an analysis of the established provisions, in total amount and by classification categories, if compared to the end of 2009, general loan risk (for category A) and potential loan loss provisions have increased by 20% or 105 million KM, amounting to 640 million KM (increased just in the second quarter of 2010 by 80 million KM). One of the most important indicators of asset quality, the ration of the potential loan losses and risk asset to off balance sheet, increased from 2,8% to 3,3%. As of 31.06.2010., banks in average allocated reserves for category B 7,9%, for category C 23,9%, category D 53,9% and E 100% (at the end of 2009: B 7,6%, C 23,7%, D 56,1% and E 100%).

The asset quality analysis, that is, the loan portfolio analysis of individual banks, as well as on-site examinations at banks, indicate loan risk as still dominant risk with majority of banks, raising a concern that some banks still have inadequate management practices, that is, evaluation, measuring, monitoring, and control of loan risk and assets classification, which was determined in on-site examinations through significant amount of insufficient loan loss reserves that banks have established based on the orders issued by the FBA. However, this is not adding to an essential resolution of the problem.

The FBA has ordered corrective measures to those banks whose assets quality was rated poor by the examination in sense of preparation of the operating program that has to contain action plan aimed to improve existing practices for loan risk management, that is, assets quality management, decrease of existing concentrations and resolution of the nonperforming assets issue, and prevention of their further deterioration. Implementation of the FBA's orders is continuously monitored through an intensified follow-up procedure based on reports and other documentation submitted by banks, as well as their verification in targeted on-site examinations. Supervision of this segment has been intensified due to obvious adverse trends, which has a significant impact through deterioration of banks' profitability and declining of their capital base, which is a reason for banks to timely take actions to raise capital from external sources.

Transactions with related entities

While operating, banks are exposed to different types of risks, of which the most significant is the risk of transactions with related entities of banks.

In accordance with the Basle Standards, the FBA has established certain prudential principles and requirements related to transactions with related entities of banks, as regulated in Decision on Minimum Standards for Bank's Operations with Related Entities, prescribing requirements and method of operations with related entities. The Decision and Law on Banks regulate the duty of Supervisory Board of a bank, which has to adopt, upon the proposal of the General Manager, special policies regulating operations with related entities and to monitor their implementation.

The FBA Decisions prescribe a special set of reports, including transactions with one segment of related entities, such as loans, and potential and undertaken off-balance sheet liabilities (guarantees, letters of credit, undertaken loan commitments), as the most frequent and the most riskiest form of transactions between a bank and related entities. The set of prescribed reports include data on loans originated to the following categories of related entities:

- Bank's shareholders over 5% of voting rights,
- Supervisory Board members and bank management and
- Subsidiaries and other enterprises related to a bank.

-000 KM-

Table 23: *Transactions with related entities*

Description	ORIGINATED LOANS[23]			RATIO	
	31.12.2008.	31.12.2009.	30.06.2010.	3/2	4/3
1	2	3	4	5	6
Shareholders over 5% of voting rights, subsidiaries and other related enterprises	26.823	29.191	83.347	109	285
Supervisory Board and Audit Board members	304	470	425	155	90
Bank Management	2.315	2.193	2.020	95	92
TOTAL	29.442	31.854	85.792	108	269
Potential and undertaken off-balance sheet liabilities	10.304	5.137	2.930	50	57

In the observed period, credit exposures to persons related to banks increased by 169% (the increase mainly relates to one large bank in the system), while potential liabilities decreased by 43%. Based on the presented data, we could conclude that it is a question of a small amount of loans-guarantees operations with related entities, and the level of risk is low. The FBA pays special attention (in on-site examinations) to banks' operations with related entities, especially in assessing identification system and monitoring of risk exposure to related entities operations. The FBA on-site examiners issue orders for elimination of determined weaknesses within certain deadlines and initiate violation procedures. Part of these activities is also to monitor and supervise implementation of the issued orders in the follow up procedure. This has had a positive influence on this segment of operations, since the risk management quality in this segment has improved.

2.2. Profitability

According to the income statement data, banks in the Federation of BiH, in the first quarter of 2010, realized negative financial result – loss in the amount of 67,7 million KM, while in the same period in 2009, there was profit generated at the banking system level in the amount of 13,9 million KM. Main reason to realizing this negative financial result is primarily the impact of high loss with one bank, which is by 11 million KM higher than the loss on the level of the system. Simultaneously, there was an increase of the losses with banks that operated with negative results, as well as decreased profit with those banks that in previous periods operated with positive result. Major influence to deterioration of profitability of almost all banks had increase of loan loss provisions, as result of considerable decline in quality of loan repayments, that is, increased loan delinquency, as well as downfall in interest income and similar income with majority of banks.

Positive financial result of 22,3 million KM was generated by 13 banks, which is less by 37% or 13,2 million KM than in the same period in 2009. At the same time seven banks reported loss of 90 million KM, this is higher by four times or 68,4 million KM in comparison to the same period in 2009.

High oscillations in the reported financial result at the sector level, if compared to the periods over the past three years, were mainly under influence of the events in stock exchanges related to price changes in securities trading, such as high income in 2007, that is, high expenses in 2008, while in 2009, their influence was at minimum, almost insignificant.

[23] Apart from loans, it includes other claims, deposited funds and the placements to shareholders (financial institutions) exceeding 5% of voting rights.

Detailed data is shown in the following table:

- in 000 KM-

Table 24: *Financial result reported: profit/loss*

Date/Description	At the system level		State banks		Private banks	
	Amount	Number of banks	Amount		Amount	Number of banks
30.06.2008.						
Loss	-24.324	6	-3	1	-24.321	5
Profit	53.279	15	2.219	2	51.060	13
Total	28.955	21	2.216	3	26.739	18
30.06.2009.						
Loss	-21.598	7	-756	1	-20.842	6
Profit	35.584	13	401	1	35.183	12
Total	13.986	20	-355	2	14.341	18
30.06.2010.						
Loss	-90.052	7	-276	1	-89.776	6
Profit	22.336	13	390	1	21.946	12
Total	-67.716	20	114	2	-67.830	18

Similar to other segments, this segment has also encountered concentrations: of total profit generated (22,3 million KM), 80,7% or 18 million was generated by three largest banks in the system with participation in the banking system assets of 35,6%. In the total loss of 90 million KM, 78,7 million KM or 87,4% refers to only one large bank which is in the foreign ownership, with asset participation of 14,1% on the third place in the system (in the first half of the previous year the loss of that bank amounted to 8,7 million KM). Analytical data for the first half of 2010 indicate that a total of ten banks reported significantly deteriorated financial result (for 91,0 KM), and ten banks have slightly better results (the effect is only 9,3 million KM).

The financial result of state owned banks does not have any significant influence to the overall profitability of the banking sector.

Based on the analytical data and the indicators of the quality evaluation of the profitability (the amount of the generated financial result – profit/loss and ratios used for evaluation of profitability productivity and efficiency of operation as well as other parameters related to evaluation of operation) it can be concluded that profitability had declined under the impact of the economic crises from the beginning of 2009, and the overall profitability of the system drastically deteriorated in 2010. Indeed, after 2001 (when loss was reported on the system level of 33 million), initiated was the trend of successful performance that was stopped due to expansion of global and financial crisis, so in 2010 loss was being reported on the banking system level again, as result of the fact that generally in the system, and especially in large banks that generate profitability, interest and net interest income decreased and loan loss provisions recorded high increase, as a consequence of deterioration of loan quality in all banks .

At the system level, total income was realized in the amount of 403,6 million KM with increasing rate of 1% or 2,5 million KM in comparison to the comparative period of prior year. Total noninterest bearing expenses were 471,3 million KM, and growth rate was 22% or 85,7 million KM, which had negative reflection to the overall financial result of the sector.

Stagnation and the subsequent downfall of lending activities in 2009 and the first half of 2010 had negative reflection to the level of interest income. Indeed, total interest income amounts to 426,4 million KM and it decreased by 9% or 43,4 million KM in comparison to the same period last year, and their participation in total income decreased from 117,1% to 105,6%. In the

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structure of interest income, highest participation was realized by interest income on loans that amount to 389,4 million KM or 96,5% of total income, and they decreased by 10% or 41,5 million KM. Significant downfall of 55% or 8,8 million KM was recorded by income on interest-bearing accounts with depository institutions, and their participation decreased from 3,9% to 1,8%. Opposite trend and changes were recorded in securities held to maturity that amount to 1,7 million KM and that in comparison to the same period last year increased by more than 4 times or 1,3 million KM, which under the circumstances of decline in lending activities is result of placing surplus of liquid assets to the securities in order to realize better return on the invested assets as well as the effect to profitability.

On the other hand, positive changes were recorded in interest expenses. In comparison to the decreasing rate of interest income (19%), interest expenses with decreasing rate of 9% recorded faster decline, but in absolute amount it is slightly lower (38,6 million KM). Interest expenses amount to169,9 million KM, and their participation in the structure of total income decreased from 51,9% to 42,1%. In the structure of interest expenses, we should point out a significant downfall of 48% or 19,9 million KM of interest expenses on loans taken and other borrowings, with decreased participation from 10,4% to 5,4% as result of decrease in long term credit indebtedness of banks, primarily with foreign financial institutions ("parent" banks or related banks from the group and in the financial markets with other creditors) of around 20% due to regular payments, and less significantly due to premature payments that the banks practice in order to decrease the expenses due to high liquidity. Interest expenses on deposits with downfall of 10% or 14,8 million KM amount to 140,2 million KM with decreased participation in total income from 38,6% to 34,7% as a result of decreased interest rates on short term and long term deposits for legal entities and citizens.

Net interest income in the amount of 256,5 million KM decreased by 2% or 4,8 million KM in comparison to the same period last year, with decreased participation in total income from 65,2% to 63,5%.

Operating income amounts to147,1 million KM, and, if compared to the prior year, it records an increase of 5% or 7,3 million KM, and the increase in structure of total income from 34,8% to 36,5%.

Total noninterest expenses amount to 471,3 million KM and in comparison to the same period last year they increased by 22% or 85,7 million KM, primarily based on the increase of loan loss provisions, and their participation in the structure of total income increased from 96,1% to 116,8%.

Within the noninterest expenses, both nominally and relatively significant increase of 87% or 90 million KM was recorded by loan loss provisions of 193,1 million KM, and their participation in the structure of total income increased from 25,7% to 47,8%. Opposite trend and changes were recorded by salary and contribution expenses with decreasing rate of 3%, amounting to 122,5 million KM (average number of employees for the first half of 2010 decreased by 4,5% in comparison to the first half of 2009) and fixed assets expenses with decreasing rate of 2% amounting to 75,2 million KM.

Trend and structure of total income and expenses is presented in the following tables and graphs:

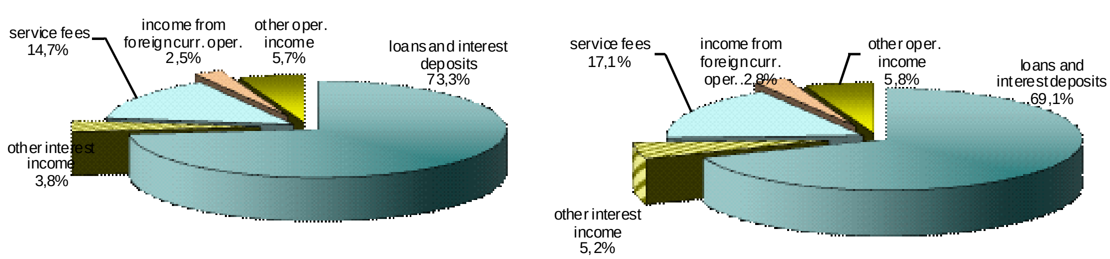
- in 000 KM-

Table 25: *Structure of total income*

Structure of total income	30.06.2008.		30.06.2009.		30.06.2010.		RATIO	
	Amount	%	%	%	Amount	%	4/2	6/4
1	2	3	4	5	6	7	8	9
I Interest income and similar income								
Interest bearing deposit accounts with depository institutions	44.935	7,6	15.979	2,6	7.195	1,2	36	45
Loans and leasing	377.643	63,5	430.843	70,7	389.360	67,9	114	90
Other interest income	24.406	4,1	22.991	3,8	29.813	5,2	94	130
TOTAL	446.984	75,2	469.813	77,1	426.368	74,3	105	91
II Operating income								
Service fees	88.325	14,9	90.002	14,7	98.001	17,1	102	109
Foreign exchange income	15.371	2,6	14.948	2,5	15.999	2,8	97	107
Other operating income	43.489	7,3	34.794	5,7	33.097	5,8	80	95
TOTAL	147.185	24,8	139.744	22,9	147.097	25,7	95	105
TOTAL INCOME (I + II)	594.169	100,0	609.557	100,0	573.465	100,0	103	94

Graph 17: *Structure of total income*

30.06.2009. **30.06.2010.**

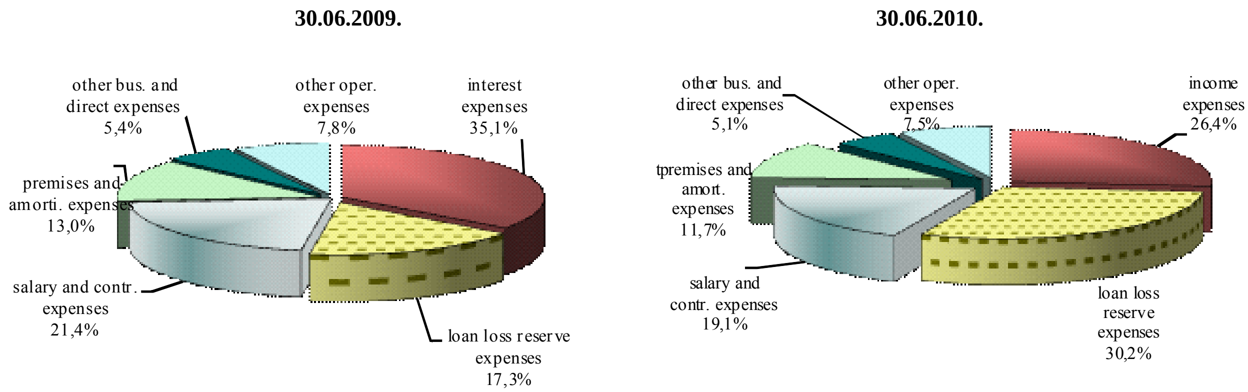


- in 000 KM-

Table 26: *Structure of total expenses*

Structure of total expenses	30.06.2008.		30.06.2009.		30.06.2010.		RATIO	
	Amount	%	Amount	%	Amount	%	4/2	6/4
1	2	3	4	5	6	7	8	9
I Interest expenses and similar expenses								
Deposits	134.545	24,0	155.019	26,1	140.230	21,9	115	90
Liabilities for borrowings	52.099	9,3	41.825	7,0	21.931	3,5	80	52
Other interest expenses	10.657	1,9	11.644	2,0	7.708	12,0	109	66
TOTAL	197.301	35,2	208.488	35,1	169.869	26,4	106	81
II Total non-interest bearing expenses								
General loan risk and potential loan losses Provisioning	84.775	15,1	103.146	17,3	193.149	30,2	122	187
Salary expenses	115.610	20,6	126.943	21,4	122.521	19,1	110	97
Business premises and depreciation expenses	67.602	12,0	76.865	13,0	75.196	11,7	114	98
Other business and direct expenses	26.318	4,7	32.304	5,4	32.142	5,1	123	99
Other operating expenses	69.669	12,4	46.342	7,8	48.265	7,5	67	104
TOTAL	363.974	64,8	385.600	64,9	471.273	73,5	106	122
TOTAL EXPENSES (I + II)	561.275	100,0	594.088	100,0	641.142	100,0	106	108

Graph 18: *Structure of total expenses*



The following tables give the most significant ratios for evaluation of profitability, productivity and efficiency of banks:

- in %-

Table 27: *Ratios of profitability, productivity and effectiveness by periods*

RATIOS	30.06.2008.	30.06.2009.	30.06.2010.
Return on Average Assets	0,21	0,09	-0,44
Return on Average Total Capital	1,93	0,85	-4,10
Return on Average Equity	2,79	1,24	-5,81
Net Interest Income/Average Assets	1,79	1,74	1,68
Fee Income/Average Assets	1,05	0,93	0,96
Total Income/Average Assets	2,84	2,67	2,64
Operating and Direct Expanses[24]/Average Assets	0,79	0,90	1,47
Operating Expenses/Average Assets	1,81	1,66	1,61
Total Non-interest Expanses/Average Assets	2,60	2,56	3,08

-in %-

Table 28: *Ratios of profitability, productivity and effectiveness as of 31.06. 2010.*

RATIOS	30.06. 2010.		
	STATE BANKS	PRIVATE BANKS	AVERAGE IN THE FBiH
Return on Average Assets	0,06	-0,45	-0,44
Return on Average Total Capital	0,27	-4,21	-4,10
Return on Average Equity	0,33	-5,99	-5,81
Net Interest Income/Average Assets	0,94	1,69	1,68
Fee Income/Average Assets	2,90	0,94	0,96
Total Income/Average Assets	3,84	2,62	2,64
Operating and Direct Expanses/Average Assets	0,65	1,48	1,47
Operating Expenses/Average Assets	3,12	1,59	1,61
Total Non-interest Expanses/Average Assets	3,78	3,07	3,08

24 Expenses include provisions for potential loan losses.

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Reported loss at the banking system level for the first half of 2010 resulted by negative key profitability indicators: ROAA (Return on Average Assets) and ROAE (Return on Average Equity). However, productivity of banks, measured as ratio of total income and average assets (2,64%) was slightly lower than the same level as the same period last year (2,67%) due to faster growth of the average total assets than the total income, or the minimum growth of the total income in the compared period for the past three years. It should be emphasized a high increase of business and direct expenses per average assets (from 0,90% to 1,47%), which is related to the increase of loan loss provisions. Banks tried to amortize downfall of income and increase of the mentioned expenses by decreasing operating expenses, so this ratio has decreased from 1,664% to 1,61%.

All key financial indicators of profitability analyzed based on the ownership criteria in banks indicate that private banks operate more cost-effectively, productively and efficiently, which gives them competitive advantage if compared to state banks, emphasizing the need to finish privatization process in remaining state banks.

Under a more deteriorated performance conditions of banks, and due to adverse effects of the economic and financial crisis to the banking sector in the FBiH, profitability of banks, in the forthcoming period, will mostly depend on deterioration of asset quality, that is, continued increase of loan losses and loan risk, and will depend on effective management and operating income and expenses control. Banks will have to increase the level of lending activities, not only to ensure increase of interest income, but to utilize their social core function of the collected financial assets allocation to the economic flows and the economy in compliance with the standards of prudent performance and sound practices of risk management, primarily of credit risk.

In addition, profit of banks, that is, financial result will mostly depend on price and interest rate risk, both in the sources and price changes in funding sources of banks, and possibility to realize interest rate margin sufficient to cover all non-interest bearing expenses, and, eventually, to provide for satisfactory profit on the invested capital for bank owners. That is why the key factor is effectiveness and profitability of each bank's management quality and its business policy since this is the most direct way to affect its performance.

2.3. Risk-weighted nominal and effective interest rates

In order to increase transparency, and to make easy a comparability of conditions of banks in process of originating loans and accepting deposits and protection of customers through a transparent disclosure of loan expenses versus deposit income, and, in accordance with the international standards, criteria and practices in other countries, the FBA, as of 01.07.2007., prescribed unified method of computation and disclosure of effective interest rate[25]for all banks that have their seat in the Federation of BiH, and their organizational units, regardless of the territory in which they operate, including organizational units of the banks operating in the Federation of BiH. Effective interest rate represents a real relative price of a loan, that is, an income generated from a deposit, expressed as per cent at the annual level.

Effective interest rate is a discursive interest rate computed at the annual level. It applies a compound interest rate in a way to equal discounted cash inflows with discounted cash outflows for the originated loans, that is, accepted deposits.

[25] Decision on unified method of computation and disclosure of effective interest rates on loans and deposits ("Official Gazette of the FBiH", number 27/07).

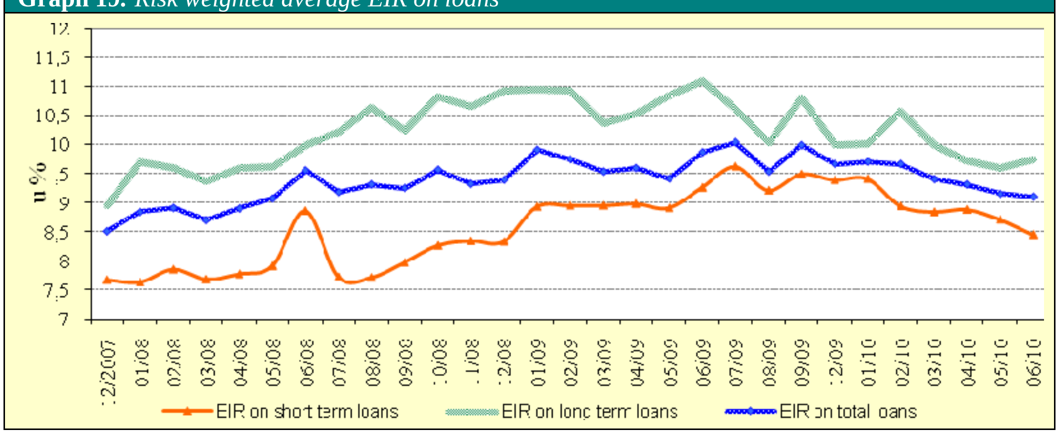
Banks are obliged to monthly report to the FBA of risk-weighted nominal and effective interest rates on loans and deposits originated or accepted within the reporting month, in accordance with the methodology prescribed[26].

The following table presents risk-weighted nominal and effective interest rates (hereinafter: NIR and EIR) for loans on the banking system level for the two most important sectors (economy and citizens) for December of 2008, March, June and December of 2009, and March and June of 2010:

Table 29: *Risk-weighted average NIR and EIR on loans*

DESCRIPTION	31.12.2008.		31.03.2009.		30.6.2009.		31.12.2009.		31.03.2010.		30.06.2010.	
	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. Risk-weighted interest rates for short-term loans	7,82	8,33	8,37	8,95	8,41	9,26	8,55	9,39	8,28	8,84	7,90	8,45
1.1. Economy	7,74	8,19	8,31	8,80	8,40	9,10	8,51	9,27	8,22	8,63	7,86	8,34
1.2. Citizens	10,25	13,04	9,43	12,28	10,03	13,94	9,51	12,9	9,29	12,28	8,97	12,28
2. Risk-weighted interest rates for long-term loans	9,95	10,92	9,37	10,37	9,92	11,09	9,16	10,00	9,02	9,99	8,89	9,75
2.1. Economy	8,33	8,92	8,02	8,96	8,70	9,62	8,46	9,15	8,28	9,04	8,40	8,90
2.2. Citizens	11,16	12,54	11,03	12,10	10,82	12,20	10,21	11,32	9,65	10,80	9,35	10,56
3. Total risk-weighted interest rates for loans	8,69	9,39	8,78	9,53	8,91	9,86	8,82	9,66	8,64	9,40	8,40	9,10
3.1. Economy	7,88	8,37	8,23	8,85	8,45	9,19	8,50	9,23	8,24	8,76	8,04	8,53
3.2. Citizens	11,09	12,58	10,88	12,12	10,75	12,34	10,17	11,42	9,63	10,89	9,34	10,64

Graph 19: *Risk weighted average EIR on loans*



When analyzing the trend of interest rates, it is relevant to monitor risk-weighted EIR, while a difference in the risk-weighted NIR is exclusively the result of fees and provisions paid to banks for originated loans, which is included in the computation of the loan price. That is the reason why the EIR represents a real loan price.

[26] Guidelines for implementation of Decision on unified method of computation and disclosure of effective interest rates on loans and deposits and Guidelines for computation of risk-weigthed nominal and effective interest rate.

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The risk-weighted EIR for loans, for the first half of 2010, had slight decreasing trend. In comparison to the level of 9,66% in December 2009, following minor increase of 0,04 per cent in January 2010, in records a continuous decrease and in June of 2010 are 9,1%.

The risk-weighted EIR for short-term loans, in June 2010, was 8,45%, which was lower by 0,94 per cent in comparison to December 2009.

The risk-weighted EIR for long-term loans, in June 2010, was 9,75%, which was lower by 0,26 per cent in comparison to December 2009.

Interest rates for loans originated in the two most significant sectors: economy and citizens[27], over the observing period of 2010, had the decreasing trend. However, the risk weighted EIR for loans originated in the economy, although still much lower than the EIR for loans to citizens, decreased from 9,23% in December 2009 to the level of 8,53% in June 2010. As for long term loans, downfall was 0,25 per cent (from 9,15% to 8,90%), while EIR for short-term loans recorded higher downfall of 0,93 per cent (from 9,27% to 8,34%).

Overall EIR on loans financed to citizens for the first two months of 2010 had increasing trend both on short term and long term loans, within 0,26 per cent, that was followed by a gradual decrease, and in April of 2010 recorded was the lowest rate of 10,03% in the first half of 2010. EIR for loans to the same sector in June 2010 was 10,64%, which was lower by 0,78 per cent than in December 2009.

EIR for long term loans to the same sector, from the 2009 December level of 11,32%, it was decreased to 10,56% in June 2010. EIR for short term loans in June 2010 was 12,28%, which was lower by 0,63 per cent than in December 2009.

Risk-weighted NIR and EIR for term deposits, computed based on monthly statements, for the banking sector are presented in the following table:

Table 30: *Risk-weighted average NIR and EIR on deposits*

DESCRIPTION	31.12.2007.		30.06.2008.		31.12.2008.		30.06.2009.		31.12.2009.		30.06.2010.	
	NIR	EIR	NIR	EIR	NIR	NIR	EIR	NIR	EIR	NIR	NIR	EIR
1	2	3	4	5	6	7	8	9	10	11	12	13
1. Risk-weighted interest rates on short term deposits	3,87	3,88	3,82	3,82	3,59	3,59	1,99	2,01	1,06	1,06	1,26	1,26
1.1. up to 3 months	3,85	3,85	3,94	3,94	3,48	3,49	1,74	1,74	0,72	0,72	0,39	0,39
1.2. up to 1 year	3,92	3,92	3,6	3,6	4,13	4,14	3,8	3,95	2,90	2,91	3,25	3,26
2. Risk-weighted interest rates on long term deposits	4,48	4,48	5,67	5,67	5,48	5,49	4,72	4,78	4,75	4,77	4,08	4,09
2.1. up to 3 years	4,65	4,66	5,49	5,49	5,41	5,42	4,58	4,66	4,72	4,74	3,86	3,87
2.2. over 3 years	4,32	4,33	6,46	6,47	6,34	6,33	6,14	6,11	5,12	5,13	5,45	5,47
3. Total risk-weighted interest rates on deposits	4,18	4,19	4,33	4,33	4,2	4,2	2,57	2,6	1,82	1,83	2,19	2,19

Graph 20: *Risk-weighted average EIR on deposits*

27 Based on the methodology of classification in sectors: entrepreneurs are included in the sector of citizens.

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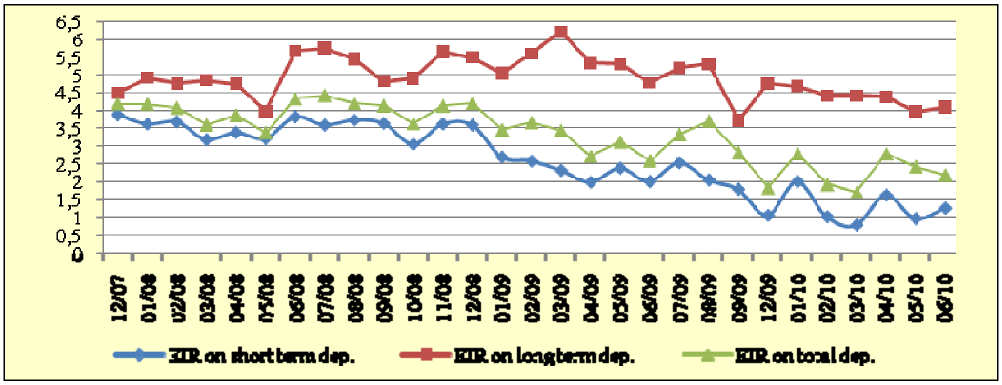

As opposed to loans, where the real price is influenced by the expenses associated with loan origination and servicing (under condition they are known at the time of origination), deposits do not show almost any difference between nominal and effective interest rates.

If compared to December 2009, risk-weighted EIR for total term deposits, in June 2010, increased by 0,36 per cent (from 1,83% to 2,19%). Risk-weighted EIR on short term deposits shows fluctuations within 1,22 per cent, with the highest in January 2010 when it was 2,01 per cent (2009: 1,06%), the lowest in March 0,79%, and in June 2010 it was 1,26% (2009: 1,06). Risk-weighted EIR on long term deposits recorded a downfall of 0,68 per cent in comparison to December 2009, and it was 4,09% in June 2010.

Risk-weighted EIR on long term deposits with term up to three years decreased in comparison to the level from December by 0,87 per cent, and it was 3,87% in June. Opposite direction that is the growth of 0,34 per cent was recorded in EIR on deposits with term over three years, and it was 5,47% in June.

As for interest rates on short term deposits, after the decrease of 0,33 per cent in relation to the level in December, the EIR on deposits with term up to three months was 0,39% in June. On deposits with term up to one year the EIR in June was 3,26%, which is by 0,35 per cent higher in relation to December of 2009.

Banks, in June 2010, paid to the economy much lower EIR on term deposits (1,51%) than to citizens (3,52%), which is directly correlated with the structure of term deposits. However, the economy deposits are usually short term up to three months (smaller portion to one year), and such deposits bare much lower interest rate. On the other hand, in the structure of deposits with term over one year (majority of deposits have term up to three years), dominant are citizens deposits. EIR on term deposits of the economy and citizens, in June 2010, decreased in comparison to December 2009, when they were 3,75, while on the economy deposits they are higher in relation to the December of 2009 (1,1%)

Risk-weighted interest rates for loans referring to the contracted overdraft and demand deposits, computed based on monthly statements, are presented in the following table:

Table 31: *Risk-weighted average NIR and EIR on loans-overdrafts and demand deposits*

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DESCRIPTION	31.12.2007.		30.06.2008.		31.12.2008.		30.06.2009.		31.12.2009.		30.06.2010.	
	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. Risk-weighted interest rates for loans-overdrafts	8,89	9,01	8,59	8,58	8,62	8,81	8,56	9,00	8,96	8,96	8,83	8,84
2. Risk-weighted interest rates for demand deposits	0,37	0,37	0,41	0,41	0,40	0,40	0,40	0,40	0,41	0,41	0,23	0,23

The EIR for the above items of assets and liabilities, in general, should be equal to the nominal interest rate. The risk-weighted EIR for total loans in overdrafts for the banking sector, in June 2010, was 8,84% (an increase of 0,12 per cent in comparison to December 2009), and 0,23% for demand deposits, which was lower by 0,18 per cent in comparison to December 2009.

2.4. Liquidity

Liquidity risk management, along with credit risk, is one of the most compound and most important segments of banking operations. Maintaining liquidity in market economy is a permanent task of a bank and main precondition for its sustainability in financial market. This is also one of the key preconditions for establishment and maintenance of the confidence in the banking system of any country, as well as its stability and safety.

Under normal circumstances of banks' performance and stable environment, until the global financial and economic crisis occurred, liquidity risk has had a secondary significance, that is, credit risk was first priority and management systems established, that is, identification, measurement, and control of such risks were under continuous supervision with purpose of its enhancement and improvement. It should be emphasized, however, that during the course of its performance, a correlation of all risks that any bank is or may be exposed to is very high.

Along with turbulences in the financial market due to the global crisis, liquidity risk has rapidly increased and the risk management has become a key factor for normal operating of a bank, as well as timely meeting of past due liabilities and maintenance of a long term position of a bank in regard of its solvency and capital base.

In the last quarter of 2008 the liquidity risk increased after the expansion of the global crises and its adverse impact on the financial and economic system in BiH. Although a part of the savings was withdrawn and the trust in banks was impaired, it was evaluated that the banking system liquidity was not in danger in any given moment, since the banks in FBiH, due to regulatory requirements and proscribed limits, based on a conservative approach, had significant liquid funds and a good liquidity position.

In 2009 the adverse movements from the last quarter of 2008 were stopped, and general liquidity indicators were improved thanks to primarily decreased lending activity, with a tendency of slight deterioration in the first half of 2010 due to decrease of cash funds from investment in securities and payment of loan liabilities. The statement remains that liquidity of the banking system in the Federation of BiH is still good, with satisfactory participation of liquid assets in total assets and coverage of short term liabilities by liquid assets. However, since the financial crisis is still present worldwide which has an adverse reflection to the banking systems of certain European countries, and since majority of banks in FBiH are owned by the European banking groups that provide financial support to our banks through deposit and credit funding, it is estimated that liquidity risk still needs to be under enhanced supervision.

In addition, we should have in mind the fact that impact of the crisis is higher in the real sector, adverse consequences are being reflected to the entire economy environment under which banks operate in BiH, causing delinquency of debtors and increase of nonperforming claims, which is causing decrease in inflow of liquid assets of banks.

Decision on Minimum Standards for Liquidity Risk Management prescribes minimum standards a bank has to establish and maintain in the process of managing this risk, that is, minimum standards to create and implement liquidity policy, which assures bank's ability to fully and immediately perform its liabilities as they become due.

The mentioned regulation represents a framework for liquidity risk management and qualitative and quantitative provisions and requirements towards banks. It prescribes limits banks have to meet in regard to average ten-day minimum and daily minimum of cash assets in relation to short-term sources, as well as minimum limit of maturity adjustment of the instruments of financial assets and liabilities up to 180 days.

Liquidity risk is closely correlated with other risks and often has an adverse effect on banks' success and profitability.

In the structure of financing sources of banks in the Federation of BiH, as of 31.06.2010., deposits still have the highest participation of 74,6%, followed by loans taken (including the subordinated debt[28]) with participation of 11,3% with longer maturity, representing quality source for long term placements, and have made a significant contribution to maturity match between assets and liabilities.

On the other hand, majority structure of deposits is considerably unfavorable, although it has been some time of an improving trend, with small oscillations in the first half of 2010.

- in 000 KM-

Table 32: *Maturity structure of deposits*

DEPOSITS	31.12.2008.		31.12.2009.		30.06.2010.		INDEX	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	4/2	6/4
1	2	3	4	5	6	7	8	9
Savings and demand deposits	4.186.773	40,0	4.490.845	40,7	4.814.070	42,7	107	107
Up to 3 months	460.100	4,4	322.763	2,9	221.337	2,0	70	69
Up to 1 year	979.516	9,4	833.089	7,5	1.054.667	9,3	85	127
1. Total short term	5.626.389	53,8	5.646.697	51,1	6.090.074	54,0	100	108
Up to 3 years	3.018.766	28,9	3.292.619	29,8	3.096.905	27,5	109	94
Over 3 years	1.816.695	17,4	2.106.552	19,1	2.082.113	18,5	116	99
2. Total long term	4.835.461	46,2	5.399.171	48,9	5.179.018	46,0	112	96
TOTAL (1 + 2)	10.461.850	100,0	11.045.868	100,0	11.269.092	100,0	106	102

Analysis of maturity structure of deposits in two main groups, if compared to 2009, shows an increase in participation of short term deposits by 2,9 per cent, and by the same percentage a decrease of long term deposits, so their participation, as of 31.06.2010., was 54% and 46% respectively.

Total short term deposits, in comparison to 2009, increased by 8% or 443 million KM, while long term deposits declined by 4% or 220 million KM.

[28] Subordinated debt – loans taken and permanent liabilities.

The increase of short term deposits was realized from increased demand deposits of 7% or 323 million KM, while deposits up to three months were decreased by 31% or 101 million KM, along with decrease in participation from 2,9% to 2%, and deposits up to one year increased by 27% or 222 million KM, which is why their participation in total deposits increased from 7,5% to 9,4%. Demand deposits still have the highest participation of 42,7% in total deposits, while deposits up to three months have the lowest participation of 2%. In total demand deposits, the highest participation is still recorded by citizen deposits (37,5%), which, in comparison to 2009, have increased by 11,5% or 186 million KM.

Total long term deposits in 2010 had declined by 4% or 220 million KM. It should be emphasized that of long term deposits, two sectors show dominant participation: citizens of 47,9% and banking institutions of 30,5%. Citizen deposits in term deposits up to three years show the highest participation of 64,2% (58,2% at the end of 2009), while banking institutions' deposits over three years show the highest participation of 67,9% (72% at the end of 2009).

In the function of planning for the necessary level of liquid resources, banks have to plan for sources and structure of adequate liquidity potential, along with planning of credit policy. Maturity of placements, that is, credit portfolio is determined by maturity of sources. Since maturity transformation of assets in banks is inherently connected to the functional characteristics of banking performance, banks continuously control and maintain maturity imbalance between sources and placements within prescribed minimum limits.

-in 000 KM-

Table 33: *Maturity structure of loans*

LOANS	31.12.2008.		31.12.2009.		30.06.2010.		RATIO	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	4/2	6/4
1	2	3	4	5	6	7	8	9
Past due claims and paid off-balance sheet liabilities	234.178	2,2	354.200	3,6	485.299	4,9	151	137
Short term loans	2.337.251	22,4	2.159.008	22,0	2.137.290	21,7	92	99
Long term loans	7.862.948	75,4	7.283.592	74,4	7.221.880	73,4	93	99
TOTAL LOANS	10.434.377	100,0	9.796.800	100,0	9.844.469	100,0	94	100

Over the observing period of 2010, long term loans decreased by 1% or 62 million KM (since loans originated to citizens have the highest participation in the structure of long term loans, it should be pointed out that only a decrease in this segment represents 53 million KM), short term loans also recorded a decrease of 1% or 22 million KM, while past due claims increased by 37% or 131 million KM (private companies represent 99 million KM, citizens represent 29 million KM). In the structure of past due claims, 73% are private companies, 22% are citizens, and 5% are other sectors.

Sector analysis by maturity, in two most significant sectors, indicates that loans to citizens represent 89% of long term loans, and loans to private companies, of total originated loans, represent 58% of long term loans.

In the assets structure, as the most significant category, loans still have the highest participation of 65,1%, which has decreased by 0,9 per cent in comparison to the end of 2009 due to a slight decline of loans of 0,5% or 48 million KM and increase of assets of 122 million KM or 0,8%. Cash funds decreased by 8 or 392 million KM and their participation, in comparison to 31.12.2009., decreased from 31,4% to 29%.

In 2010, banks were regularly meeting a commitment to maintain required reserves with the Central Bank of BiH. The required reserve rate, as of 11.10.2008., decreased to 14% with purpose to enable additional liquidity for banks. In addition, with the same purpose, the CBBiH's decision has been to change basis of the required reserve's computation, so the funds borrowed from nonresidents, based on the contracts signed after 01.11.2008., would not be subject to the basis for computation. As of 01.01.2009., a differentiated required reserve rate has been introduced with regard to the maturity of sources (10% for long term and 14% for short term) and as of 01.05.2009., the rate for long term deposits and borrowings decreased to 7%. Required reserve, as significant instrument of monetary policy in BiH, under the Currency Board and financially underdeveloped market, represents the only instrument of monetary policy used to realize monetary control, in sense of stopping fast credit growth from the past years, and decrease multiplications, as well as an increase of banks' liquidity under an impact of the crisis and intensified outflow of funds from banks that in BiH was experienced after 01.10.2008. On the other hand, implementation of regulation on foreign exchange risk and maintenance of currency adjustment within prescribed limits, also significantly influence the amount of funds banks maintain on the reserve account with the Central Bank in domestic currency, which provides for high liquidity of individual banks and the banking sector.

In liquidity analysis, we use several ratios, and preview of the most significant ones is presented in the following table:

- in %

Table 34: *Liquidity ratios*

Ratios	31.12.2008.	31.12.2009.	30.06.2010.
1	2	3	4
Liquid assets[29] / Total assets	28,3	31,9	30,4
Liquid assets / Short term financial liabilities	51,2	54,2	50,5
Short term financial liabilities / Total financial liabilities	62,9	66,9	68,2
Loans / Deposits and Borrowings[30]	82,6	76,4	77,3
Loans / Deposits, borrowings and subordinate debts[31]	80,9	75,0	75,9

All banks continuously meet, considerably above the prescribed minimum, their obligation of a ten-day average of 20% on a comparable basis with the short term funding sources, and daily minimum of 10%, on the same basis, as presented in the following schedule.

[29] Liquidity assets in the narrow sense: cash and deposits and other financial assets with maturity below three months, except inter-banking deposits.
[30] Empiric standards: below 70%-very solid, 71%-75%-satisfactory, 76%-80%-marginal to satisfactory, 81%-85%-insufficient, over 85%-critical.
[31] Prior ratio has been modified. Subordinated debts are included in the sources, which gives more realistic indicator.

- in 000 KM-

Table 35: *Liquidity position – ten-day average and daily minimum*

Description	31.12.2008. Amount	31.12.2009. Amount	30.06.2010. Amount	RATIO 3/2	RATIO 4/3
1	2	3	4	5	6
1. Average daily balance of cash assets	3.687.406	3.789.107	3.702.302	103	98
2. Minimum total daily balance of cash assets	3.310.173	3.341.965	3.423.217	101	102
3. Short term sources (accrual basis)	5.821.848	5.431.143	6.053.202	93	111
4.Liabilities:					
4.1. ten-day average 20% of Item 3	1.164.370	1.086.229	1.210.640	93	111
4.2. daily minimum 10% of Item 3	582.185	543.114	605.320	93	111
5.Meeting requirement :ten-day average					
Surplus = Item 1 – Item 4.1.	2.523.036	2.702.878	2.491.662	107	92
6. Meeting requirement :daily minimum					
Surplus = Item.2 – Item 4.2.	2.727.988	2.798.851	2.817.897	103	101

Apart from the mentioned prescribed minimum standards, monitoring of remaining maturity of financial assets and liabilities, according to the time scale, is of crucial significance for the liquidity position analysis. The time scale is from the aspect of prescribed minimum limits created based on time horizon up to 180 days.[32]

- in 000 KM -

Table 36: *Maturity match between financial assets and liabilities up to 180 days*

Description	31.12.2008. Amount	31.12.2009. Amount	30.06.2010. Amount	RATIO 3/2	RATIO 4/3
1	2	3	4	5	6
I. 1- 30 days					
1. Financial assets	5.126.920	5.719.878	5.677.555	112	99
2. Financial liabilities	4.763.530	5.070.291	5.552.690	106	110
3. Difference (+ or -) = 1-2	363.390	649.587	124.865	179	19
Accrual of requirement in %					
a) Performed %= Item 1 / Item 2	107,6%	112,8%	102,2%		
b) Required minimum %	85,0 %	85,0 %	85,0%		
Surplus (+) or shortage (-) = a – b	22,6 %	27,8 %	17,2%		
II. 1-90 days					
1. Financial assets	5.892.107	6.479.395	6.447.627	110	100
2. Financial liabilities	5.441.072	5.745.023	6.171.698	106	107
3. Difference (+ or -) = 1-2	451.035	734.372	275.929	163	38
Accrual of requirement in %					
a) Performed %= Item 1 / Item.2	108,3%	112,8 %	104,5%		
b) Required minimum %	80,0%	80,0%	80,0%		
Surplus (+) or shortage (-) = a – b	28,3%	32,8%	24,5%		
III. 1-180 days					
1. Financial assets	6.999.103	7.469.752	7.457.622	107	100
2. Financial liabilities	6.477.230	6.956.965	7.165.256	107	103
3. Difference (+ or -) = 1-2	521.873	512.787	292.366	99	57
Accrual of requirement in %					
a) Performed %= Item 1 / Item.2	108,1 %	107,4%	104,1%		
b) Required minimum %	75,0 %	75,0 %	75,0%		
Surplus (+) or shortage (-) = a – b	33,1%	32,4%	29,1%		

[32] Decision on Changes and Amendments to Decision on Minimum Standards for Liquidity Risk Management in Banks (Official Gazette of the FBiH, number 88/07) dated of 01.01.2008. sets new percentages for maturity matching between financial assets and liabilities: minimum 85% of funding sources (used to be 100%) with maturity up to 30 days must be engaged in placements with maturity up to 30 days; minimum 80% of funding sources (used to be 100%) with maturity up to 90 days in placements with maturity up to 90 days and minimum 75% of funding sources (used to be 95%) with maturity up to 180 days in placements with maturity up to 180 days.

Based on the presented data, we may conclude that banks, as of 31.06.2010., were able to meet the required limits, and have managed to realize better maturity match between financial assets and financial liabilities in relation to the limits prescribed.

Based on all of the above presented indicators, it may be concluded that the negative movements from the last quarter of 2008 were stopped, and the trend of improvement from 2009 continued through the first half of 2010, so the liquidity of the banking system of the Federation of BiH is still assessed as satisfactory. Since this segment of performance and level of liquidity risk exposure correlates to credit risk, having in mind the effects of global financial crisis expansion in BiH and an impact to the banking sector of the FBiH (primarily through a stronger pressure on banks' liquidity), on one side, due to slower inflow of deposits, and, on the other side, poor inflow of liquid assets due to downfall in collection of loans, it should be emphasized that, in the forthcoming period, banks will have to pay more attention to the liquidity risk management by establishing and implementing liquidity policies, which will make sure that all matured liabilities of banks are timely realized, based on continuous planning of future liquidity needs, and taking into account changes in operating, economic, regulatory and other segments of business environment of banks.

The FBA will, both through reports and on-site examinations of banks, monitor how banks manage this risk, and whether they act in accordance with the adopted policies and programs.

2.5. Foreign exchange risk – foreign currency matching between assets and liabilities from balance sheet and off-balance sheet items

In their operations, banks are exposed to significant risks coming from potential losses in balance sheet and off-balance sheet items created as a result of price changes in the market. One of those risks is foreign exchange risk (FX) created as a result of changes of exchange rates and/or the imbalance in assets, liabilities and off-balance sheet items of the same currency – individual foreign currency position or all currencies together used by a bank in its operations – overall foreign currency position of a bank.

In order to enable application and implementation of prudential principles in foreign exchange activities of banks and to decrease influence of foreign exchange risk to their profitability, liquidity and capital, the FBA has issued Decision on Minimum Standards for Foreign Exchange Risk Management in Banks[33] that regulates minimum standards for adoption and implementation of programs, policies and procedures for undertaking, monitoring, control and management of foreign exchange risk, and restrictions prescribed for opened individual and overall foreign exchange position (long or short), calculated in relation to the amount of bank's core capital.[34]

The banks are obliged to report on daily basis to FBA so that FBA can monitor the banks compliance with the prescribed limits and the exposure to the foreign currency risk. Based on examination, monitoring and analysis of submitted reports on foreign currency position of banks, we can conclude that banks meet prescribe limits and perform their FX activities within these limits.

[33] "Official Gazette of F BiH", Number. 3/03, 31/03, 64/03, 54/04.

[34] Article 8 of Decision on Minimum Standards for Capital Management of Banks determines limits for individual foreign currency position in EUR up to 30% of core capital, for other currencies up to 20% and foreign currency of a bank up to 30%.

Since the Central Bank functions as the Currency Board and EUR is an anchor currency of the Currency Board, in practice banks are not exposed to foreign exchange risk in case of the most significant currency EUR.

According to the balance as of 31.06.2010., currency structure of banks' assets on the level of banking system recorded participation of items in foreign currencies of 17,4% or 2,6 billion KM (17,1% or 2,6 billion KM at the end of 2009). On the other hand, currency structure of liabilities is essentially different, since participation of liabilities in foreign currency is significantly higher of 56,5% or 8,5 billion KM (56,7% or 8,6 billion KM at the end of 2009).

The following table presents structure and trend of financial assets and liabilities and foreign currency position for EUR as the most significant currency[35] and total.

-in million KM-

Table 37: *Foreign currency adjustment of financial assets and liabilities (EUR and total)*

Description	31.12.2009.				30.06.2010.				RATIO	
	EURO		TOTAL		EURO		TOTAL		EURO	TOTAL
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	6/2	8/4
1	2	3	4	5	6	7	8	9	10	11
I. Financial assets										
1. Cash assets	1.697	19,4	2.150	22,2	1.439	16,8	1.895	19,8	85	88
2. Loans	90	1,0	124	1,3	81	0,9	116	1,2	90	94
3.Loans with currency clause	6.713	76,6	7.095	73,1	6.542	76,5	6.922	72,4	97	98
4. Other	269	3,0	336	3,4	494	5,8	625	6,6	184	186
Total (1+2+3+4)	8.769	100,0	9.705	100,0	8.556	100,0	9.558	100,0	98	98
II. Financial liabilities										
1. Deposits	5.704	68,9	6.585	71,5	5.823	71,7	6.764	74,2	102	103
2. Borrowings	1.689	20,4	1.727	18,7	1.387	17,1	1.425	15,6	82	83
3.Deposits and loans with currency clause	577	6,9	577	6,3	579	7,1	579	6,4	100	100
4.Other	313	3,8	322	3,5	335	4,1	346	3,8	107	107
Total (1+2+3+4)	8.283	100,0	9.211	100,0	8.124	100,0	9.114	100,0	98	99
III. Off-balance sheet										
1.Assets	50		57		59		59			
2.Liabilities	500		505		422		424			
IV.Position										
Long (amount)	36		46		69		80			
%	2,3%		3,0%		4,3%		4,9%			
Short										
%										
Limit	30%		30%		30%		30%			
Below limit	27,7%		27,0%		25,7%		25,1%			

If we analyze the structure of foreign currencies in the financial assets[36] we see a dominant participation of EUR of 76,4, which decreased somewhat in comparison to the participation as of

[35] Source: Form 5-Foreign currency position.

[36] Source: Form 5-Foreign currency position: portion of financial assets (in foreign currencies denominated in KM). According to the methodology, financial assets are expressed based on net principle (reduced by loan loss reserves).

[37] In order to protect from changes of the exchange rate banks contract certain items of assets (loans) and liabilities with currency clause (regulation allow only two-way currency clause).

Information on the Banking System of the Federation of BiH

31.12.2009. (78,8%) with slight decline in nominal amount from 2,1 billion KM to 2 billion KM. Participation of EUR in the liabilities has slightly decreased from 89,3% to 88,4%, with decline in nominal amount from 7,7 billion KM to 7,5 billion KM.

However, calculation of the FX risk exposure also includes the amount of indexed items of assets (loans) and liabilities[37], which are especially significant in the assets (72,4% or 7,0 billion KM) this is slightly lower in relation to 31.12.2009. (73,1% or 7,1 billion KM). Other foreign currency assets items represent 27,6% or 2,6 billion KM, of which EUR items make 21,1% or 2 billion KM, and other currencies 6,5% or 0,6 billion KM (at the end of 2009, loans contracted with currency clause amounted to KM 7,1 billion with participation of 73,1%, and other items in EUR of 21,2% or 2,1 billion KM). Of total net loans (9,3 billion KM), 74,5% were contracted with currency clause, primarily tied to EUR (94,5%).

On the other hand, the structure of financial liabilities stipulates and determines the structure of financial assets, for each currency individually. In foreign currency liabilities (9,1 billion KM) items in EUR (primarily deposits) had the highest participation of 82,8% or 7,5 billion KM, while participation and amount of indexed liabilities was at minimum, amounting to 6,4% or 0,6 billion KM (at the end of 2009, participation of liabilities in EUR was 83,7% or 7,7 billion KM, while indexed liabilities were 6,3% or 0,6 billion KM).

Observed by banks and overall on the level of the banking system of the FBiH, we can conclude that foreign exchange risk exposure of banks and the system, through the first half of 2010, ranged within the prescribed limits.

As of 31.06.2010., there were 12 banks with long foreign currency position, and eight banks with short position. At the system level, long foreign currency position represented 4,9% of banks' core capital, which is lower by 25,1% than the limit. Individual foreign currency position for EURO was 4,3%, with financial assets items being higher than financial liabilities (long position), representing a decline of 25,7% than the limit.

Although in the environment of the Currency Board banks are not exposed to foreign exchange risk in the most significant currency EUR, they are still required to operate within prescribed limits for individual currencies and for total foreign currency position and to daily manage this risk in accordance with adopted programs, policies, procedures and plans.

III CONCLUSION AND RECOMMENDATIONS

After consolidation, development and stabilization of the banking sector of the Federation of BiH during the period of implementation of the reform has reached an enviable level, the upcoming activities should be aimed at preserving its stability as priority task in the current stressful conditions, and its further progress and development. These goals require continuous and vigilant engagement of all parts of the system, legislative and executive authorities, which is a prerequisite to create the most favorable economic environment that would be stimulating to both banks and consequently to the real sector of the economy and citizens.

In the upcoming period, the Banking Agency of the Federation of BiH shall:

- Take measures and activities within its powers to overcome and mitigate adverse effects to the banking sector of the FBiH caused by the global financial crisis,

- Continue implementing activities, from the scope of its authority, to consolidate supervision on state level,
- Proceed with a continues supervision of banks through on-site and off-site examinations, focusing on targeted examination of dominant risk segments of banking operations, which will make supervision more effective, in regard to:
  - Persist on capital strengthening of banks, especially those recording outstanding assets growth,
  - Continue permanent monitoring of banks, primarily those with systemic importance to development of credit activities with the highest concentration of savings and other deposits in order to protect depositors,
  - Continue a systematic monitoring of banks' activities in prevention of money laundering and terrorism financing and improve cooperation with other supervisory and examination institutions,
  - Maintain continuity in payment system examinations,
  - Continue working on further development of regulation based on the Basle Principles, the Basle Capital Accord, and the European Banking Directives, as part of BiH's preparation to join the European Union,
  - Establish and expand cooperation with home country supervisors of the investors present in the banking sector of the FBiH, and other countries in order to have more effective supervision,
  - Improve cooperation with the Banks Association in all banking performance segments, organization of counseling and professional assistance in the area of implementation of banking laws and regulations, advancement of cooperation in regard to professional development, proposed changes of all legislative regulations that have become a limiting factor to banks' development, introduction of new products, collection of claims and fully involve in building up and functioning of the unified registry of irregular debtors – legal entities and citizens.
- Continuous operational development of the IT system for early warning and prevention in elimination of weaknesses in banks;
- Work on continuous education and training of staff;
- Make effort to accelerate finalization of the remaining provisional administrations and liquidations based on the conclusion made by the Management Board;
- Particularly, accelerate resolution of unsettled issues with the Government of BiH in relation to the Provisional Administration of Hercegovačka Bank d.d. Mostar related to the Dretelj terminals.

In addition, it is necessary to have stronger involvement of other authorized institutions and bodies of Bosnia and Herzegovina and the Federation of BiH in order to:

- Realize Program of measures to mitigate effects of the global economic crisis and improve the business environment, as accepted by the Economic Social Council in the territory of the FBiH in December 2008, pursuant to the document issued by the FBiH Government;
- Realize the conclusion made by the Federation of BiH Parliament to establish banking supervision on state level;
- Form an opinion about status of banks owned by the Federation of BiH;
- Create and further develop the financial sector regulation related to the activity, status and performance of micro-credit organizations, leasing companies, insurance companies;
- Accelerate implementation of economic reform in the real sector in order to reach the level of the monetary and banking sector;

- Prepare for creation of legislative regulation for the banking sector and financial system based on the Basle Principles, the Basle Capital Accord, and the European Banking Directives,
- Establish specialized court departments for economy,
- Establish more efficient process for realization of pledges,
- Adopt law on protection of creditors and full responsibility of debtors,
- Adopt law or improve existing legislation regulating the area of safety and protection of money in banks and in transportation.

Banks, as the most important part of the system, have to concentrate their actions to:
- Full dedication to good quality and prudent performance, and actions to cope with the crisis impact that presently represents the greatest danger for banks and the real sector of the economy and citizens;
- Further capital strengthening and level of solvency proportional to the growth of assets and risk, higher profitability, more consistent implementation of adopted policies and procedures in the area of prevention of money laundering and terrorism financing, and safety and protection of money in banks and in transportation, in accordance with laws and regulations;
- Strengthen internal control systems and internal audit functions as fully independent in performing their duties and roles;
- Regular, updated and accurate submission of data to the Central Loan Registry and Unified Central Account Registry with the Central Bank of BiH.

Number: U.O.-23-2/10
Sarajevo, 07.09.2010.

ATTACHMENTS

ATTACHMENT 1

Banks in the Federation of Bosnia and Herzegovina - 30.06.2010.

Ord. No.	BANK	Address		Telephone	Director
1	BOSNA BANK INTERNATIONAL dd - SARAJEVO	Sarajevo	Trg djece Sarajeva bb	033/275-100, fax:203-122	AMER BUKVIĆ
2	BOR BANKA dd - SARAJEVO	Sarajevo	Obala Kulina bana 18	033/663-500, fax:278-550	HAMID PRŠEŠ
3	FIMA BANKA dd - SARAJEVO	Sarajevo	Kolodvorska no. 5	033/720-070, fax:720-100	EDIN MUFTIĆ
4	HERCEGOVAČKA BANKA dd - MOSTAR	Mostar	Nadbiskupa Čule bb	036/332-901, fax:332-903	Prov. Administrator - Nikola Fabijanić - 16.04.2007.
5	HYPO ALPE-ADRIA-BANK dd - MOSTAR	Mostar	Kneza Branimira 2b	036/444-444, fax:444-235	MICHAEL VOGT
6	INVESTICIONO-KOMERCIJALNA BANKA dd - ZENICA	Zenica	Trg B&H 1	032/448-400, fax:448-501	SUVAD IBRANOVIĆ
7	INTESA SANPAOLO BANKA D.D. BOSNA I HERCEGOVINA	Sarajevo	Obala Kulina bana 9a	033/497-555, fax:497-589	ALMIR KRKALIĆ
8	KOMERCIJALNO-INVESTICIONA BANKA DD V.KLADUŠA	V.Kladuša	Ibrahima Mržljaka 3	037/771-253, fax:772-416	HASAN PORČIĆ
9	NLB TUZLANSKA BANKA dd - TUZLA	Tuzla	Maršala Tita 34	035/259-259, fax:250-596	ALMIR ŠAHINPAŠIĆ
10	POŠTANSKA BANKA BiH dd - SARAJEVO	Sarajevo	Put života 2	033/564-000, fax: 564-050	ADNAN ZUKIĆ
11	PRIVREDNA BANKA SARAJEVO dd - SARAJEVO	Sarajevo	Alipašina 6	033/277-700, fax:664-175	AZRA ČOLIĆ
12	PROCREDIT BANK dd - SARAJEVO	Sarajevo	Emerika Bluma 8	033/250-950, fax:250-971	FRIEDER WOEHRMANN
13	RAIFFEISEN BANK dd BiH - SARAJEVO	Sarajevo	Zmaja od Bosne bb	033/755-010, fax: 213-851	MICHAEL MÜLLER
14	RAZVOJNA BANKA FEDERACIJE BIH	Sarajevo	Igmanska 1	033/277-900, fax: 668-952	RAMIZ DŽAFEROVIĆ
15	SPARKASSE BANK dd - SARAJEVO	Sarajevo	Zmaja od Bosne br. 2	033/280-300, fax:280-230	SANEL KUSTURICA
16	TURKISH ZIRAAT BANK BOSNIA dd - SARAJEVO	Sarajevo	Dženetića Čikma br. 2	033/252-230, fax: 252-245	KENAN BOZKURT
17	UNA BANKA dd - BIHAĆ	Bihać	Bosanska 25	037/222-400, fax: 222-331	Prov.Administrator - Stjepan Blagović - 01.05.2005.
18	UNICREDIT BANK dd - MOSTAR	Mostar	Kardinala Stepinca bb	036/312-112, fax:312-121	BERISLAV KUTLE
19	UNION BANKA dd - SARAJEVO	Sarajevo	Dubrovačka 6	033/561-000, fax: 201-567	ESAD BEKTEŠEVIĆ

20	VAKUFSKA BANKA dd - SARAJEVO	Sarajevo	M. Tita 13	033/280-100, fax: 663-399	AMIR RIZVANOVIĆ
21	VOLKSBANK BH dd - SARAJEVO	Sarajevo	Fra Anđela Zvizdovića 1	033/295-601, fax:295-603	REINHOLD KOLLAND

ATTACHMENT 2

BALANCE SHEET OF BANKS IN THE FBiH - FBA SCHEDULE
ACTIVE SUB-BALANCE SHEET

in 000 KM

Ord. No.	DESCRIPTION	31.12.2008.	31.12.2009.	30.06.2010.
	ASSETS			
1.	Cash funds and deposit accounts at depository institutions	4.207.559	4.782.297	4.389.869
1a	Cash and non-interest deposit accounts	417.601	496.720	468.308
1b	Interest deposit accounts	3.789.958	4.285.577	3.921.561
2.	Trading securities	10.923	12.815	252.525
3.	Placements in other banks	90.415	111.019	267.111
4.	Loans, receivables in leasing and past due receivables	10.434.377	9.797.817	9.844.469
4a	Loans	10.199.978	9.442.689	9.359.029
4b	Receivables on leasing	221	145	141
4c	Past due receivables - loans and leasing	234.178	354.983	485.299
5.	Securities held until maturity	7.630	106.411	138.659
6.	Premises and other fixed assets	440.887	498.959	522.506
7.	Other real estate	24.144	26.260	28.124
8.	Investments in non-consolidated related enterprises	40.732	42.716	44.471
9.	Other assets	206.338	336.955	210.997
10.	MINUS: Reserves for potential losses	400.120	477.611	584.018
10a	Reserves on item 4 in Assets	381.215	455.666	557.541
10b	Reserves on Assets except item 4	18.905	21.945	26.477
11.	**TOTAL ASSETS**	**15.062.885**	**15.237.638**	**15.114.713**
	LIABILITIES			
12.	Deposits	10.461.850	11.045.869	11.269.092
12a	Interest deposits	9.586.215	10.180.008	10.298.113
12b	Non-interest deposits	875.635	865.861	970.979
13.	Loans - past due	3.025	2.744	2.956
13a	Balance of payable loans, unpaid	0	0	0
13b	Unpaid - called for payment off-balance sheet items	3.025	2.744	2.956
14.	Loans from other banks	3.089	3.089	3.089
15.	Payables to Government	0	0	0
16.	Payables on loans and other borrowings	2.176.594	1.771.978	1.469.496
16a	payable within one year	793.837	678.607	457.206
16b	payable longer than one year	1.382.757	1.093.371	1.012.290
17.	Subordinated debts and subordinated bonds	267.737	250.483	240.138
18.	Other liabilities	520.612	486.122	523.131
19.	**TOTAL LIABILITIES**	**13.432.907**	**13.560.285**	**13.507.902**
	CAPITAL			
20.	Permanent priority shares	26.136	25.028	25.028
21.	Common shares	1.091.879	1.145.627	1.131.003
22.	Shares issued	152.892	143.725	136.485
22a	Permanent priority shares	8.420	8.420	8.420
22b	Common shares	144.472	135.305	128.065
23.	Undistributed income and capital reserves	307.464	354.621	380.722
24.	Currency rate difference			0
25.	Other capital	51.607	8.352	-66.427

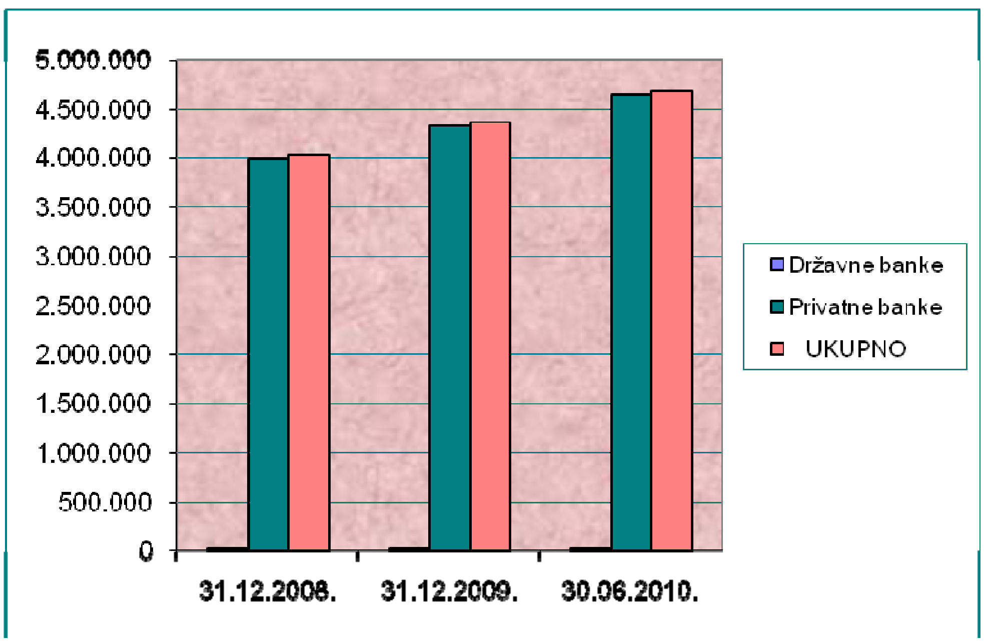
26.	TOTAL CAPITAL (20. TO 25.)	1.629.978	1.677.353	1.606.811
27.	TOTAL LIABILITIES AND CAPITAL (19+26)	**15.062.885**	**15.237.638**	**15.114.713**
	PASSIVE AND NEUTRAL SUBBALANCE	**626.468**	**622.094**	**682.180**
	TOTAL BALANCE SHEET IN BANKS	**15.689.353**	**15.859.732**	**15.796.893**

ATTACHMENT 3

NEW CITIZEN SAVINGS BY PERIODS

in 000 KM

	31.12.2008.	31.12.2009.	30.06.2010.
State banks	32.481	35.275	41.184
Private banks	4.003.184	4.325.928	4.649.821
TOTAL	**4.035.665**	**4.361.203**	**4.691.005**



ATTACHMENT 4

CLASSIFICATION OF ASSETS AND OFF-BALANCE SHEET RISK ITEMS
As of 30.06.2010.

- ACTIVE BALANCE SHEET -

in 000 KM

Ord. No.	BALANCE SHEET ASSETS AND OFF-BALANCE SHEET ITEMS	CLASSIFICATION					TOTAL
		A	B	C	D	E	
1.	Short-term loans	1.718.277	395.526	18.009	5.478	-	**2.137.290**
2.	Long-term loans	5.802.353	966.405	334.016	119.106	-	**7.221.880**
3.	Other placements	420.934	692	90	47	-	**421.763**
4.	Interest accrued	39.185	18.329	-	-	-	**57.514**
5.	Past due receivables	93.726	94.553	77.868	216.393	5	**482.545**
6.	Receivables on guarantees paid	1.420	23	1.311	-	-	**2.754**
7.	Other assets	5.342.511	26.258	1.940	429	3.847	**5.374.985**
8.	**TOTAL ACTIVE BALANCE SHEET**	**13.418.406**	**1.501.786**	**433.234**	**341.453**	**3.852**	**15.698.731**
9.	a) Guarantees payable	313.126	56.857	1.066	339	-	**371.388**
	b) Performing guarantees	453.513	89.873	382	75	-	**543.843**
10.	Unsecured LoC	42.087	22.666	100	-	-	**64.853**
11.	Irrevocable loans	1.284.331	52.493	1.307	422	11	**1.338.564**
12.	Other potential liabilities	15.305	100	-	-	-	**15.405**
13.	TOTAL OFF-BALANCE SHEET	**2.108.362**	**221.989**	**2.855**	**836**	**11**	**2.334.053**
14.	TOTAL BALANCE AND OFF-BALANCE SHEET (8+13)	**15.526.768**	**1.723.775**	**436.089**	**342.289**	**3.863**	**18.032.784**
15.	General credit risk and potential loan losses (#14 x % of loss)	209.582	137.604	104.432	184.569	3.854	**640.041**
16.	Allocated general reserves (A) and special reserves (B, C, D, E)	209.474	137.604	104.432	184.569	3.854	**639.933**
17.	**MORE (LESS) of the allocated reserves (#16 - 15) +or -**	**-108**	**-**	**-**	**-**	**-**	**-108**

ATTACHMENT 5

INCOME STATEMENT

in 000 KM

ELEMENTS	PERFORMED **31.12. 2008.**		PERFORMED **31.12.2009.**		RATIO 4 : 2
	Amount	Partic.in total income	Amount	Partic. in total income	
INCOME					
Interest income	469.813	117%	426.368	106%	91
Interest expenses	208.488	52%	169.869	42%	81
Net interest income	261.325	65%	256.499	64%	98
Fee income and other operating income	139.744	35%	147.097	36%	105
TOTAL INCOME	401.069	100%	403.596	100%	101
EXPENSES					
Reserves for potential losses	103.146	26%	193.149	48%	187
Salaries and contribution expenses	126.943	32%	122.521	30%	97
Fixed assets and overhead expenses	76.865	19%	75.196	19%	98
Other expenses	78.646	20%	80.407	20%	102
TOTAL EXPENSES (without interests)	385.600	96%	471.273	117%	122
NET INCOME BEFORE TAX	15.469	4%	-67.677	117%	-438
Income Tax	1.483	0%	-39	117%	-3
NET INCOME	13.986	4%	-67.716	117%	-484

ATTACHMENT 6

COMPARATIVE SCHEDULE OF CAPITAL BALANCE AND ADEQUACY
ACTIVE SUB-BALANCE SHEET

in 000 KM

Ord. No.	DESCRIPTION	31.12.2008.	31.12.2009.	30.06.2010.
1	**BANK'S CORE CAPITAL**			
1.a.	Share capital, reserves and income			
1.1.	Share capital - common and perm. priority non-cumulat. shares - cash payments	1.102.636	1.155.790	1.140.652
1.2.	Share capital - comm. and perm. prior. non-cumul. shares-invested posses. And rights	12.550	12.550	12.550
1.3.	Issued shares income at share payments	152.892	143.725	136.485
1.4.	General regulatory reserves (reserves as regulated by the Law)	84.319	78.317	77.230
1.5.	Other reserves not related to assets quality assessment	168.927	201.758	231.227
1.6.	Retained - undistributed income from previous years	134.220	161.562	165.178
1.a.	**TOTAL (from 1.1. to 1.6.)**	**1.655.544**	**1.753.702**	**1.763.322**
1.b.	Offsetting items from 1.a.			
1.7.	Uncovered losses transferred from previous years	73.464	82.324	95.746
1.8.	Losses from current year	38.938	52.966	90.052
1.9.	Book value of treasury shares owned by the bank	81	595	81
1.10.	Amount of intangible assets	60.311	63.119	60.664
1.b.	**TOTAL (from 1.7.to 1.10.)**	172.794	199.004	246.543
1.	**AMOUNT OF CORE CAPITAL: (1.a.-1.b.)**	**1.482.750**	**1.554.698**	**1.516.779**
2	**BANK'S SUPPLEMENTARY CAPITAL**			
2.1.	Share capital - common and perm. priority non-cumulat. shares - cash payments	2.829	2.829	2.829
2.2.	Share capital - comm. and perm. prior. non-cumul. shares-invested posses. And rights	0	0	0
2.3.	General reserves for losses on loans from class. A - performing assets	230.596	205.254	209.474
2.4.	Accrued income for current year audited and confirmed by external auditor	74.543	49.186	0
2.5.	Income under FBA's temporary restriction on distribution	0	0	0
2.6.	Subordinated debts, the most 50% of core capital	211.360	184.093	172.217
2.7.	Hybrid convertible items - the most 50% of core capital	0	0	0
2.8.	Items-permanent liabilities without repayment duty	56.377	66.390	66.390
2.	**AMOUNT OF SUPPLEMENTARY CAPITAL: (from 2.1. to 2.8.)**	**575.705**	**507.752**	**450.910**
3	**OFFSETTING ITEMS FROM BANK'S CAPITAL**			
3.1.	Part of invested share capital that according to FBA's assessment represents accepted and overestimated value	0	0	0
3.2.	Investments in capital of other legal entities exceeding 5% of bank's core capital	16.036	16.036	16.036
3.3.	Receivables from shareholders for significant voting shares - approved aside from regulations	0	0	0
3.4.	VIKR to shareholders with significant voting shares in the bank without FBA's permission	3.422	0	0
3.	**AMOUNT OF OFFSETTING ITEMS FROM BANK'S CAPITAL (3.1. to 3.4.)**	**19.458**	**16.036**	**16.036**
A.	**AMOUNT OF BANK'S NET CAPITAL (1.+2.-3.)**	**2.038.997**	**2.046.414**	**1.951.653**
B.	**RISK FROM RISK-WEIGHTED ASSETS AND CREDIT EQUIVALENTS**	**12.301.441**	**11.790.234**	**11.979.260**
C.	**POR (RISK-WEIGHTED OPERATING RISK)**	**130.975**	**882.928**	**944.970**
D.	**PTR (RISK-WEIGHTED MARKET RISK)**	**0**	0	0
E.	**TOTAL RISK-WEIGHTED RISKS B+C+D**	**12.432.416**	**12.673.162**	**12.924.230**

F.	NET CAPITAL RATE (CAPITAL ADEQUACY) (A.:B.) X 100	16,4%	16,1%	15,1%

ATTACHMENT 7

NUMBER OF EMPLOYEES BY BANKS

Ord. No.	BANK	31.12.2008.	31.12.2009.	30.06.2010.
1	BOR BANKA dd SARAJEVO	45	51	56
2	BOSNA BANK INTERNATIONAL dd Sarajevo	171	185	194
3	FIMA BANKA dd SARAJEVO	149	133	133
4	HERCEGOVACKA BANKA dd MOSTAR	87	77	76
5	HYPO ALPE ADRIA BANK dd MOSTAR	626	600	586
6	INTESA SANPAOLO BANKA dd BiH	501	514	513
7	INVESTICIONO KOMERCIJALNA BANKA dd ZENICA	179	174	181
8	KOMERCIJALNO INVESTICIONA BANKA dd VELIKA KLADUŠA	67	68	68
9	NLB TUZLANSKA BANKA dd TUZLA	507	473	479
10	POŠTANSKA BANKA dd SARAJEVO	119	111	104
11	PRIVREDNA BANKA dd SARAJEVO	175	195	203
12	PROCREDIT BANK dd SARAJEVO	888	662	579
13	RAIFFEISEN BANK BH dd SARAJEVO	1.745	1.669	1.653
14	SPARKASSE BANK dd SARAJEVO	379	426	425
15	TURKISH ZIRAAT BANK dd SARAJEVO	149	152	152
16	UNA BANKA dd BIHAĆ	59	56	55
17	UNI CREDIT BANKA BH dd MOSTAR	1.418	1.389	1.376
18	UNION BANKA dd SARAJEVO	175	175	175
19	VAKUFSKA BANKA dd SARAJEVO	204	212	217
20	VOLKSBANK BH dd SARAJEVO	354	334	329
	TOTAL	**7.997**	**7.656**	**7.554**