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

INFORMATION

ON THE BANKING SYSTEM IN
THE FEDERATION OF BOSNIA AND HERZEGOVINA
As of 03/31/02

Sarajevo, May 2002

Banking Agency of the Federation of BiH, as regulatory institution performing supervision of banks, has developed this Information on the Banking System of the Federation of BiH as of March 31st 2002 based on the reports of banks, and other reports and information submitted by banks. The information also includes findings and information attained during on-site examinations and analysis performed in the Agency (off-site control).

I.	INTRODUCTION	3
II.	BUSINESS PERFORMANCE OF BANKS IN THE FEDERATION BiH	4
	1. STRUCTURE OF BANKING SECTOR	**4**
	1.1. Licensing	**4**
	1.2. Ownership Structure	
	1.3. **Staff**	**6**
	2. INDICATORS OF FINANCIAL PERFORMANCE	8
	2.1. Balance sheet	**8**
	2.1.1. Liabilities (liabilities and capital)	11
	2.1.2. Assets and asset quality	14
	2.1.3. Capital - strength and adequacy	18
	2.2. Profitability	**20**
III.	CONCLUSION	21
ATTACHMENTS		

I. INTRODUCTION

Banking sector in the Federation of Bosnia and Herzegovina has achieved positive results in the first quarter of 2002. Indicators of operating and financial results showed that banking system is stabilized, that is, a growing trend for the whole system continues. It is possible that growth ratios in 2002 will not be as significant as during the previous year, but we should have in mind that those indicators were calculated against a base which increased exceptionally in the last year. Therefore, in order to have a complete and realistic picture it is necessary to overview absolute and relative indicators of growth.

According to balance sheets submitted by banks, at the end of March 2002 assets in banking system of the Federation of BiH were KM 3.9 billion, which is an increase of 115 million or 3 percent in comparison to the end of last year. Comparison of results at the end of first quarter in 2001 and 2002 showed that assets increased by almost KM 1.3 billion or 49 percent.

In banks individually, participation of 11 largest banks in total assets amounted KM 3.1 billion or 80 percent.

In the assets structure, cash funds decreased by KM 113 million or 6 percent and at the same time, loan placements were increased by 233 million or 14 percent. Therefore, growth of loans approved to citizens continued. In the first quarter, placements to citizens increased by KM 104 million or 17 percent in comparison to the end of last year.

The structure of liabilities in banks is identical in comparison to end of last year. The major part of liabilities (77.4%) relates to deposits which increased by 109 million or 3 percent during the first three months of this year. Also, growth of long-term deposits continued. At the end of March, long-term deposits represented 16.8 percent on the total deposits, which is 2.1 percent more then in comparison to the end of last year.

Following extreme growth during the last year, citizens savings increased by approximately 1 percent or KM 12 million in the first three months of this year. The amount of savings in banks totals KM 1,326,000,000.00 KM now.

Total capital in banks increased by 5 percent or KM 29.7 million. Capitalization rate in banks amounts 16.5 percent and this is improvement in comparison to the end of last year when it was 15 percent.

Capital adequacy ratio continuously decreased in last three years, as well as during the first quarter of this year. For the whole banking sector, capital adequacy ratio was 21.6 percent which is less by 2 percent in comparison to the end of 2001. It is obvious that growth of risk assets is faster than growth of capital, that is, strengthening of core capital in banks remains one of the main duties for the future period.

Positive financial results at the end of quarter was reported by 24 banks and it amounted to KM 17.7 million. The loss of 1.7 million was recorded in eight banks.

II. BUSINESS PERFORMANCE OF BANKS IN THE FEDERATION BiH

33 banks from the Federation of BIH had received banking licenses, issued by the FBA, as of 03/31/02 in the Federation of BiH. All banks have been performing banking operations and were required to report to the FBA. FBA reviews reports (off-site control) and performs on-site examinations in accordance with its authorities regulated by the law.

1. STRUCTURE OF BANKING SECTOR

1.1. Licenses for inception and operations of banks, consents and approvals

In the first quarter of 2002, FBA did not revoke any banking licenses, and did not receive any applications for issuance of banking licenses. FBA worked on the status changes in Depozitna Bank d.d. Sarajevo due to a merger with Vakufska Bank dd Sarajevo, and Šeh in Bank from Zenica to ABS dd Sarajevo.

Provisional Administration existed in five banks as of 03/31/02:

- Gospodarska Bank dd Mostar
- Mostarska Gospodarska Bank dd Mostar
- Hercegovacka Bank dd Mostar
- UNA Bank dd Bihac and
- Šeh in Bank dd Zenica.

Aside from Hercegovacka Bank dd Mostar, where the High Representative to BiH imposed the provisional administration, other banks were put under provisional administration because they did not comply with legally prescribed conditions for banking operations.

In the first quarter of 2002, banks mainly complied with the laws and regulations passed by the FBA regulating approvals, consents and licenses for status or statutory changes, appointment of general manager, setting up new business units, investing in other legal entities, issuance and purchase of shares, internal payment operations.

31 banks in the Federation of BiH received the license for internal banking operations as of 03/31/02, among those, two banks had approvals for intra-bank transactions and 29 had approvals for inter-bank transactions. In comparison to 12/03/01, there is one more bank that received a license for inter-bank transactions - Bosnia Bank International d.d. Sarajevo. Applications for license for internal banking operations are still accepted by the FBA.

1.2. Ownership Structure

As of 03/31/02, ownership structure in banks[1] was evaluated upon available information received from banks and examinations performed in banks and it is as follows:

- Private and majority privately owned 27 banks (82%)
- State and majority state owned 6 banks (18%)

A special problem in defining the ownership structure of banks for the previous period is related to changes of ownership structure in banks (in favor of private ownership) and to determining status of the existing ownership structure, especially in "old state/social banks".

Based on the documentation received and interventions performed earlier and/or in the mean time, and based on the registrations at authorized courts related to changes of capital and shareholders in banks, it is possible

[1] Classification of banks by type of ownership relates to ownership over equity capital in banks.

to determine the global ownership structure within the presentation of capital in banks in the Federation of BiH as of 03/31/02.

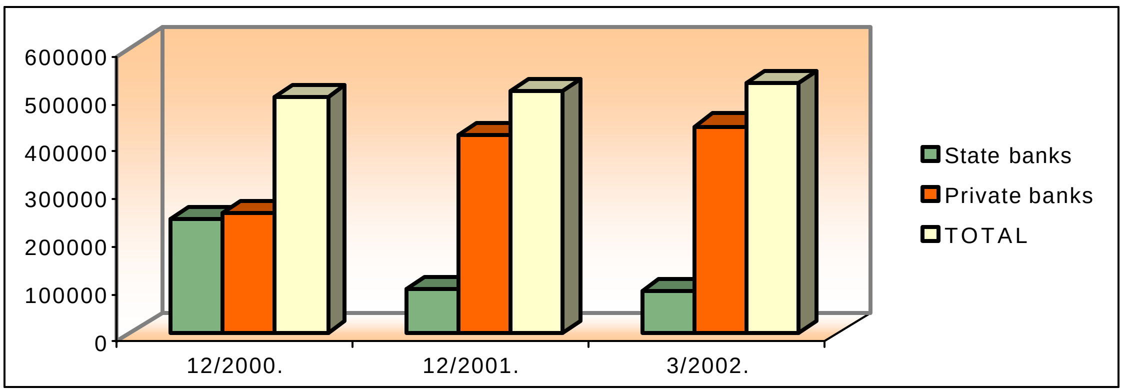
Ownership structure can be observed from the aspect of financial indicators, that is by the value of total capital[2].

Schedule 1: *Ownership Structure to Total Capital*

-In mill. KM-

BANKS	12/31/00		12/31/01		03/31/02		INDEX	
							3/2	4/3
1	2		3		4		5	6
State banks	240.139	48%	91.905	18%	89.658	17%	38	97
Private banks	255.135	52%	418.708	82%	435.817	83%	164	104
TOTAL	495.275	100%	510.613	100%	525.475	100%	103	103

Graph 1: *Schedule of Ownership Structure (total capital)*



More detailed picture on capital ownership[3] in banks in the Federation of BiH can be viewed by analysis of participation of state, private and foreign capital in equity capital in banks.

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

-In 000 KM-

SHARE CAPITAL	12/31/00		12/31/01		03/31/02		RATIO	
	Amount	Participation %	Amount	Participation %	Amount	Participation %	5/3	7/5
1	3	4	5	6	7	8	9	10
State capital	220.847	42,9	66.742	14,5	65.862	14,1	30	99
Private capital (residents)	159.325	30,9	103.117	22,4	102.580	22,0	7265	99
Foreign capital (non-residents)	135.201	26,2	289.947	63,1	298.681	63,9	215	103
TOTAL	515.373	100,0	459.806	100,0	467.123	100,0	89	102

[2] Information from the Balance sheet - FBA schedule.
[3] Ownership structure - equity capital (excluding capital related to housing fund) as reported by banks.

Graph 2: *Ownership Struct ure (equity capital)*

Analysis of ownership structure in banks from the aspect of equity capital shows the most significant changes and trends in the banking system in the Federation of BiH. This is visible form two segments: privatization of existing state capital in mainly privately owned banks and further inflow of foreign capital (mainly foreign banks).

Participation of state capital in total equity capital in banks as of 03/31/02 decreased by 0.3% in comparison to 12/31/00. This resulted from increase of (absolute amount and in percentage) of foreign capital, and from capital decrease in Una Bank dd Bihac by the Decision of the Provisional Administrator. In the structure of equity capital as of 03/31/02, participation of remaining state owned capital in privately owned banks was only 2% or KM 6.6 million.

The most significant changes in the ownership structure in the first quarter of 2002 were related to participation of private (domestic) and foreign capital.

In comparison to 12/31/01, participation of privately owned capital (residents) in total capital for the entire banking sector decreased from 22.4% to 22.0%, while at the same time, participation of foreign capital increased from 63.1% to 63.9%. These changes relate mainly to privately owned banks, and results can be seen in two areas: foreign capital came into the system through purchase of shares (trading with shares) from previous owners (residents – legal entities and individuals), and due to additional capitalization of one bank in foreign ownership.

Progress made in reform and stabilization of banking system resulted in large inflow of foreign capital, mainly foreign banks. It is possible that positive trend of increase of participation of foreign capital in FBIH banks will continue in the future as well.

1.3. Staff

As of 03/31/02 in banks in the Federation BiH, there was a total of 4,765 employees. Out of total number, 12% worked in banks with majority state capital and 88% in privately owned banks.

Schedule 3: *Staff in banks in the F BiH*

BANKS	NUMBER OF EMPLOYEES			RATIO	
	1231/00	12/31/01	03/31/02	3:2	4:3
1	2	3	4	5	6
State banks	1.253	554	553	44	100
Private banks	3.036	4.056	4.212	134	103
TOTAL	4.289	4.610	4.765	107	103
Number of banks	37	32	32		

In comparison to 12/31/01, number of employees increased by 3% or 155 persons in privately owned banks.

Schedule 4: *Qualification structure of bank employees*

EDUCATION	NUMBER OF EMPLOYEES			RATIO	
	12/31/00	12/31/01	03/31/02	3:2	4:3
1	2	3	4	5	6
University degree	1.334	1.434	1.504	107	104
Post-Secondary education	405	467	476	115	101
High school degree	2.331	2.483	2.542	107	102
Other	219	226	243	103	107
TOTAL	4.289	4.610	4.765	107	103

One of the indicators of the success in the banking sector and any bank individually, is ratio between assets and number of staff, that is, assets against an employee. The larger ratio, the better position of banks' operations and the system in whole.

Schedule 5: *Assets/employees*

BANKS	12/31/00			12/31/01			03/31/02		
	Number of staff	Assets (000 KM)	Assets/employee	Number of staff	Assets (000 KM)	Assets/employee	Number of staff	Assets (000 KM)	Assets/employee
State	1.253	772.559	616	554	379.195	684	553	359.612	650
Private	3.036	1.766.760	582	4.056	3.394.959	837	4.212	3.529.377	838
TOTAL	4.289	2.539.319	592	4.610	3.774.154	819	4.765	3.888.989	816

At the end of the first quarter of 2002, for each employee there was KM 816,000 of assets at the level of the entire banking system, which is almost the same as at the end of 2001. The ratio in state banks was lower in comparison to ratio for privately owned banks, or banking system as a whole.

Individual analytical indicators for individual banks were between KM 83,000 up to KM 2,052,000 of assets per an employee. In ten banks, ratio of assets per an employee was less then KM 350,000 which implies that they have excessive number of staff in comparison to assets. That results in larger operating costs and has a negative impact to profitability in those banks. On the other hand, in eight banks assets per employee ratio amounted over 1 million KM, and in one bank alone, this ratio was over 2 million KM.

2. FINANCIAL INDICATORS OF BANKING OPERATIONS

Examination of banks through analysis of banks' reports is executed by review of reports regulated by the FBA and reports of other institutions. Those reports consist of a database covering three groups of information:

1. Information on balance sheet set for all banks (according to IMF and FBA schedules) submitted monthly, including quarterly attachments to balance sheet according to the FBA schedule, which contains more detailed information on cash funds, loans, deposits and off balance sheet items.
2. Information on solvency in banks, information on capital and capital adequacy, assets classification, risk concentration, liquidity, exposure to foreign currency risk, based on the reports regulated by the FBA (quarterly); and
3. Information on results of banks' operations (income statement according to the FBA schedule) and reports on cash flows, submitted to the FBA on quarterly basis.

Aside from above listed standardized reports, data base includes information gathered from additional reporting requirements of the FBA towards banks in order to accomplish the best quality in monitoring and analyzing banks' operations in the Federation of BiH. Also, database includes reports on audit prepared by independent auditors, and all other information relevant for evaluating business performance of every bank individually and of the banking system as a whole.

As it is regulated by the Law on Opening Balance Sheet of Banks, banks with predominantly state capital have to report to the FBA based on a "complete" balance sheet which would be sectioned by: passive, neutral and active sub-balance sheets. In order to have realistic indicators of operations of banks in the Federation of BiH, all further analysis of banking system will be based on information from active sub-balance for banks with predominantly state capital[4].

2.1. Balance sheet

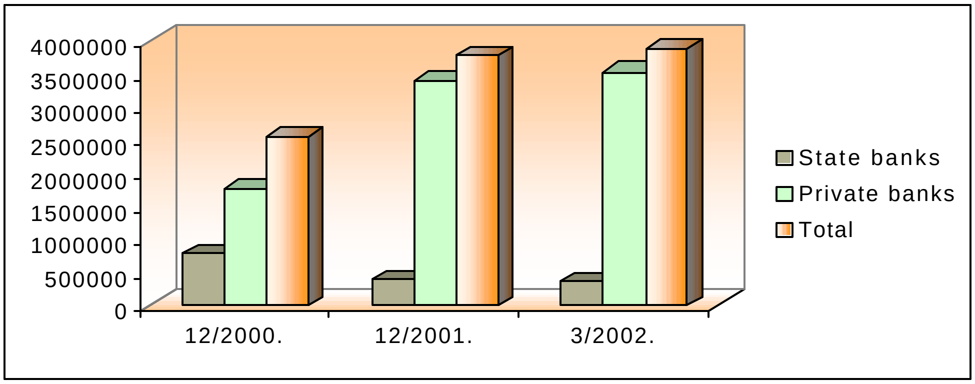
Based on the balance sheet total submitted by banks as of 03/31/02, total balance sheet for the Federation of BiH was KM 3.9 billion, which is more by 3% or KM 15 million in comparison to 12/31/01.

Schedule 6: *Balance Sheet*

DESCRIPTION	AMOUNT (in 000 KM)			RATIO	
	12/31/00	12/31/01	03/31/02	3/2	4/3
1	2	3	4	5	6
ASSETS:					
Cash funds	1.025.813	1.783.234	1.670.221	174	94
Securities	3.912	47.192	47.164	1.206	100
Placements in other banks	20.311	25.355	6.367	125	25
Loans – net	1.142.651	1.575.318	1.798.459	138	114
Premises and other fixed assets	283.436	273.980	272.726	97	100
Other assets	63.195	69.075	94.052	109	136
TOTAL ASSETS	**2.539.318**	**3.774.154**	**3.888.989**	**149**	**103**
LIABILITIES:					
OBLIGATIONS					
Deposits	1.763.000	2.900.614	3.009.818	165	104
Loans from other banks	6.761	5.550	3.050	82	55
Loan obligations	188.448	253.044	252.847	134	100
Other liabilities	85.835	104.333	97.799	122	94
CAPITAL					
Capital	495.275	510.613	525.475	103	103
TOTAL LIABILITIES (OBLIGATIONS AND CAPITAL)	**2.539.318**	**3.774.154**	**3.888.989**	**149**	**103**

[4] Some state owned banks reported passive and neutral items in their "complete" balance sheets. This will be taken over by the state upon the finalization of privatization process.

Graph 3: *Assets in banks according to ownership structure:*



Mentioned growth is related only to privately owned banks where assets increased by 4% or 134 million of KM, while state banks (as a sector) had less assets by 5% or KM 20 million.

Trend of increase of the balance sheet total at the level of the entire banking system continued in the first quarter as well. However, based on the analysis of information for individual banks, it is possible to conclude that assets in majority of banks (20 banks) decreased in comparison to previous year - 2001 (from 1 to 6 percent), while four banks had growth ratio of over 10%.

If we analyze banking system from the aspect of assets size and particular groups within this system, it is possible to conclude that largest banks (with assets over 300 million KM) still have a trend of increase. On the other hand, assets in 21 banks from the group of smallest banks (assets under KM 100 million) decreased during the first three months of 2002, in absolute amount and in relative amount, through participation in the total assets of the entire banking system.

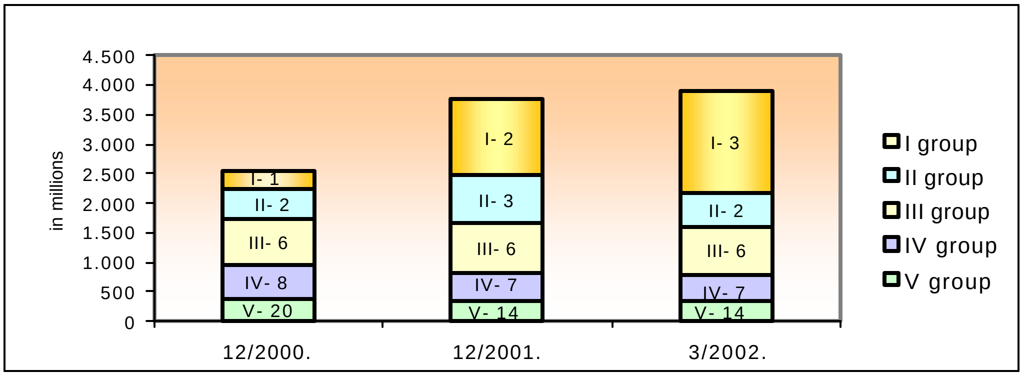
Following schedule presents amount and participation of particular group of banks[5] in the total assets though time periods (amounts are in millions of KM):

Schedule 7: *Participation of particular groups of banks in total assets by time periods*

AMOUNT OF ASSETS	12/31/00 Amount	12/31/00 Particip. %	12/31/00 Number of banks	12/31/01 Amount	12/31/01 Particip. %	12/31/01 Number of banks	03/31/02 Amount	03/31/02 Particip. %	03/31/02 Number of banks
Over 300	309	12,2	1	1.315	34,9	2	1.730	44,5	3
200 to 300	484	19,1	2	778	20,6	3	556	14,3	2
100 to 200	788	31,0	6	854	22,6	6	819	21,1	6
50 to 100	576	22,7	8	461	12,2	7	448	11,5	7
Less then 50	382	15,0	20	366	9,7	14	336	8,6	14
TOTAL	2.539	100,0	37	3.774	100,0	32	3.889	100,0	32

[5] Banks are divided in five groups, by size of assets.

Graph 4: *Participation of particular groups of banks in total assets by time periods*



Participation of 11 largest banks in total assets as of 03/31/02 was 80% or KM 3,105,000,000. At the same time, the groups of banks with largest number of units (assets under KM 50 million) participates with only 9%.

The growth of balance sheet total mainly resulted from growth of deposit base (by 4% or KM 109 million) and capital (by 3% or KM 15 million).

On the other hand, in assets of banks, cash funds decreased by 6% or KM 113 million since during the first quarter of 2002, banks have continued to make new loan placements, so gross loans increased by 14% or KM 233 million.

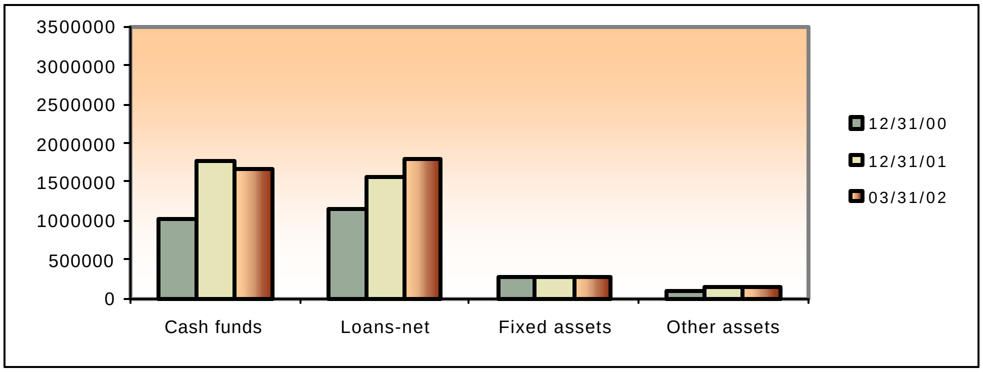
Following schedule and graphs display comparable schedule of the most significant balance sheet items in assets and liabilities side of the active balance sheet:

Schedule 8: *Balance sheet structure*

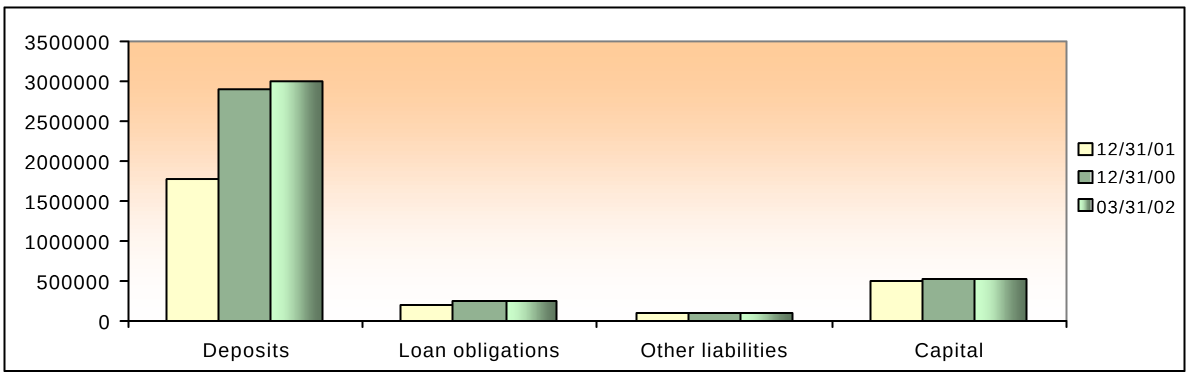
- In % -

DESCRIPTION	PARTICIPATION		
	12/31/00	**12/31/01**	**03/31/02**
ASSETS:			
Cash funds	40,4	47,3	42,9
Securities	0,2	1,3	1,2
Placements in other banks	0,8	0,7	0,2
Loans - net	45,0	41,7	46,2
Premises and other fixed assets	11,2	7,2	7,0
Other assets	2,4	1,8	2,5
TOTAL ASSETS	100,0	100,0	100,0
LIABILITIES:			
OBLIGATIONS			
Deposits	69,4	76,8	77,4
Loans from other banks	0,3	0,2	0,1
Loan obligations	7,4	6,7	6,5
Other liabilities	3,4	2,8	2,5
CAPITAL			
Capital	19,5	13,5	13,5
TOTAL LIABILITIES (OBLIGATIONS AND CAPITAL)	100,0	100,0	100,0

Graph 5: *Assets Structure in Balance Sheets of Banks*



Graph 6: *Liabilities Structure in Balance Sheets of Banks*



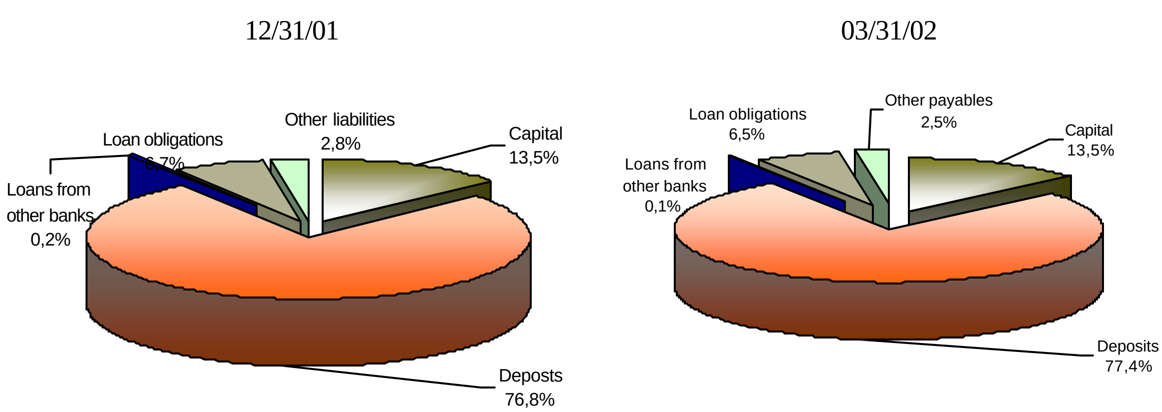
The assets structure in banks did not change significantly in comparison to 12/31/01 on the liability side, while on assets side participation of cash funds decreased by 4%, and participation of net loans increased by the same percentage.

As of 03/31/02, banks in the Federation of BiH had 67% or KM 1.1 billion of total cash funds deposited at accounts in depositary institutions abroad, at the reserve account at Central Bank of BiH there was 20% or KM 335 million, and 13% or KM 214 million was in vaults of banks.

2.1.1. Liabilities (Obligations and Capital)

Structure of obligations and capital in balance sheet of banks as of 03/31/02 can be viewed from the following graph:

Graph 7: *Structure of liabilities in banks:*



In comparison to 12/31/01, liabilities' structure was not significantly changed, therefore, major participation of 77.4% is still with deposits.

In 2002, deposits increased by 3% or KM 109 million. The mentioned growth of deposits relates only to privately owned banks, while in state banks deposits decreased by 8% or KM 19 million.

In private banks participation of deposits in liabilities was 79% and in state 64%.

The indicators of deposit size in banks individually, shows trend of concentration of deposits in five banks which, at the same time, have the largest of 66% of total deposits or KM 1,994,000,000 was deposited in those five banks. Also, deposits' concentration shows that 81% of total deposits is placed in nine banks.

Although maturity structure of deposits is not satisfactory since 59% of deposits are demand deposits, that is, participation of short-term deposits in total deposits is 83%, there was some improving trend during first three months of 2002 as it is possible to see in the following schedule.

Schedule 9: *Maturity structure of deposits*

In 000 KM

DEPOSITS	12/31/01		03/31/02	
	Amount	Participation %	Amount	Participation %
Savings and demand deposits	1.779.672	61,4	1.774.024	58,9
Up to 3 months	413.465	14,2	368.494	12,2
Up to 1 year	280.244	9,7	362.680	12,1
1. Total short-term	2.473.381	85,3	2.505.198	83,2
Up to 3 years	242.924	8,4	266.964	8,9
Over 3 years	184.309	6,3	237.656	7,9
2. Total long-term	427.233	14,7	504.620	16,8
TOTAL (1 + 2)	2.900.614	100,0	3.009.818	100,0

Maturity structure of deposits, as major source for placements, is very significant for banks from liquidity aspect, and especially due to the fact that loans to citizens in the largest banks increased, and it was mainly long-term loans. Therefore, banks have to give special attention to liquidity risk by developing strategy for scope and structure of placements which could at any time provide the bank to meet its past-due obligations and to remain liquid. Each disruption of maturity structure represents danger for future liquidity, and finally, it can endanger financial position of the bank and question its further operations.

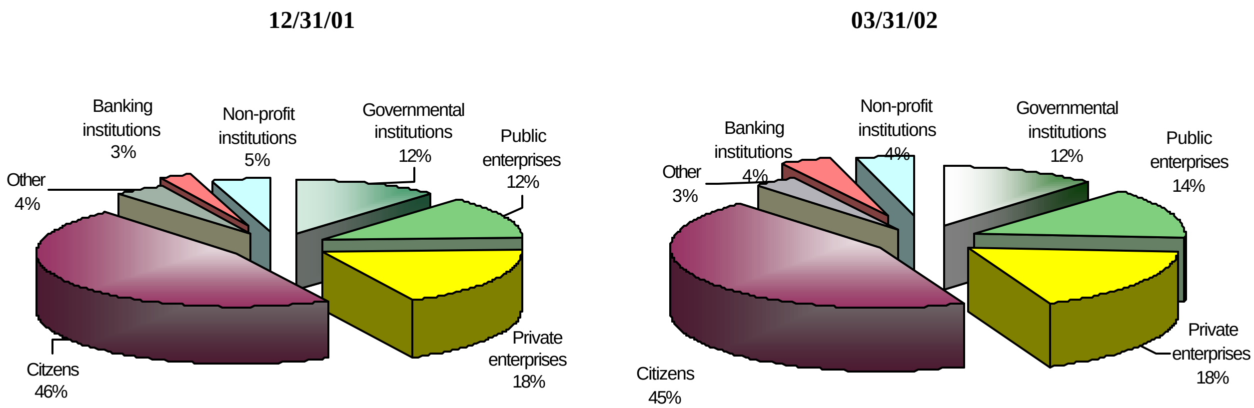
Schedule 10: *Structure of deposits by industry areas*[6]

- u 000 KM -

DEPOSITORS	12/31/01		03/31/02	
	Amount	Participation %	Amount	Participation %
Governmental institutions	339.364	11,7	356.574	11,9
Public enterprises	359.390	12,4	414.398	13,8
Private enterprises and assoc.	536.324	18,5	535.645	17,8
Non-profit. Organizations	132.453	4,6	133.725	4,4
Banking institutions	77.272	2,7	114.355	3,8
Citizens	1.334.337	46,0	1.351.323	44,9
Other	121.474	4,1	103.798	2,4
TOTAL	2.900.614	100,0	3.009.818	100,0

[6] Information from attached form BS-D submitted by banks each quarter with Balance sheet - FBA format.

Graph 8: *Structure of deposits by industry areas*



Structure of deposits by industry areas remained almost unchanged in comparison to end of 2001.

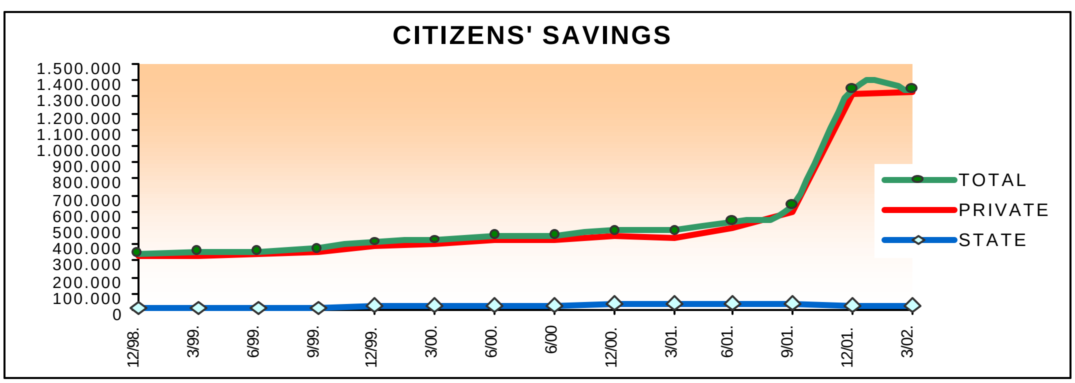
After enormous growth of savings deposits of citizens at the end of 2001 savings did not decrease, during the first quarter of 2002 as we had expected, savings did not decrease, that is, savings increased by 1% or approximately KM 12 million for the whole banking system.

As in other segments, it is necessary to stress that there is large concentration of savings in few banks, since 56% of total savings are placed in three largest banks in the Federation of BiH, that is, 85% of savings in 8 private banks.

Schedule 11: *New citizens' savings by periods*

BANKS	AMOUNT IN (IN 000 KM)			RATIO	
	12/31/00	12/31/01	03/31/02	3/2	4/3
1	2	3	4	5	6
State	34.841	28.787	24.204	83	84
Private	427.166	1.285.803	1.302.531	301	101
TOTAL	462.007	1.314.590	1.326.735	285	101

Graph 9: *New citizens' savings by periods*



2.1.2. Assets and Asset Quality

The Decision on Minimum Standards for Managing Credit Risk and Assets Classification in Banks (the Decision), including amendments and changes of the Decision regulate criteria for assessment of risk in banks' operations by evaluation of their assets' quality and adequacy of their reserves for loan and other losses based on risk in placements and balance and off-balance sheet risk item.

Total assets[7] in the balance sheets of banks in the Federation of BiH as of 03/321/02 was KM 4,086,000,000, which represents an increase of 3% or KM 134 million in comparison to end of 2001, while off-balance sheet risk items were KM 564 million and they increased by 14% or KM 69 million.

Total assets, including off-balance sheet items (assets)[8], were 4.6 billion of KM and they increased by 5% in comparison to year 2001.

Schedule 12: *Assets, off balance sheet items and potential loan losses in active balance sheet*

DESCRIPTION	AMOUNT (in 000 KM)						RATIO	
	12/31/00	Structure %	12/31/01	Structure %	03/31/02	Structure %	4:2	6:4
1.	2.	3.	4.	5.	6	7	8	9
Loans	1.128.493	41,4	1.526.936	38,6	1.713.208	41,9	135	112
Interest	17.644	0,6	18.279	0,5	23.206	0,6	104	127
Past due receivables	168.567	6,2	192.029	4,9	237.794	5,8	114	124
Receivables on paid guarantees	10.913	0,4	8.274	0,2	9.449	0,2	76	114
Other placements	29.151	1,1	28.183	0,7	27.334	0,7	97	97
Other assets	1.372.554	50,3	2.178.298	55,1	2.074.535	50,8	159	95
TOTAL ASSETS	2.727.322	100,0	3.951.999	100,0	4.085.586	100,0	145	103
OFF BALANCE SHEET	435.095		495.029		563.897		106	114
BALANCE AND OFF BALANCE SHEET	3.162.417		4.447.028		4.649.483		141	105
General credit risk and potential loan losses	212.669		201.414		219.784		95	109
Allocated general and special reserves for loan losses	201.198		197.651		216.664		98	110

The most significant change in assets occurred in the first quarter of 2002 was significant growth of loan placements[9], which increased by 14% or KM 233 million. At the same time, cash funds decreased by 6% or KM 113 million. What this represents for banks is increase in credit risk exposure, but we should emphasize that trend of increase in placements to citizens still continues (in this period they increased by 17% or KM 104 million). This is very good if we look from the aspect of risk since practice proved that this part of the credit portfolio bears the least risk in banks.

In the assets structure, major participation of 50.8% is still with "other assets" (cash funds, fixed assets and other items which are relatively insignificant in size), although they decreased by 4.3% or KM 104 million in comparison to the end of 2001. This resulted from above mentioned changes.

This trend, that is, increase of loans to citizens, resulted in changed structure of loans by industry areas in comparison to the end of 2001.

Schedule 13: *Structure of loans by industry areas*

[7] Assets before provisioning for loan losses (gross assets) - information from the Report on classification of balance sheet and off-balance sheet assets.

[8] Assets, as defined in the Article 2 of the Decision on Minimum Standards for Managing Credit Risk and Assets Classification in Banks

[9] Loans with past due receivables, receivables on guarantees paid and other placements.

INDUSTRY AREAS	12/31/00		12/31/01		03/31/02		RATIO	
	Amount	Partici - pation %	Amount	Partici - pation %	Amount	Partici - pation %	4/2	6/4
1	2	3	4	5	6	7	8	9
Governmental institutions	20.428	1,5	26.033	1,5	35.194	1,8	127	135
Public enterprises	285.448	21,8	248.502	14,4	252.253	12,9	87	102
Private enterprises and assoc.	568.773	43,5	770.680	44,6	885.686	45,2	135	115
Non-profit. Organizations	4.995	0,4	6.370	0,4	4.098	0,2	128	64
Banking institutions	62.592	4,8	42.480	2,5	41.431	2,1	68	98
Citizens	362.370	27,7	624.365	36,2	732.265	37,3	172	117
Other	3.652	0,3	8.422	0,4	9.503	0,5	230	113
TOTAL	1.308.258	100,0	1.726.852	100,0	1.960.430	100,0	132	114

Regarding maturity adjustments, we should emphasize that growth of long-term loans still continues (61.4% out of total loans) and especially loans approved to citizens (as of 03/31/02, 88% of those loans were long-term), while 48% of total loans approved to private enterprises were long-term.

If we analyze banks individually, it is possible to see that certain banks did not adjust maturity of financial assets and liabilities, since long-term loans were financed from short-term sources of funds. This could represent serious threat for future liquidity in banks.

Since placements, that is, loans represent part of assets with highest risk in banks, the quality of loans indicates one of the most significant constituents for stability and success of banking operations. Therefore, the rating of assets quality is rating of loan placements in banks, that is, identification of potential loan losses and allocation of reserves for loan losses.

Classification of balance sheet and off-balance sheet assets and potential loan losses as of 03/31/02 is presented in following schedule:

Schedule 14: *Classification of Assets and Off-Balance Sheet Risk Items in Active Balance Sheet*

-000 KM -

RECEIVABLES	CLASSIFICATION					
	A	B	C	D	E	TOTAL
Placements[10]	1.406.417	328.782	105.923	141.554	5.109	1.987.785
Interest	14.904	4.391	1.331	2.639	1	23.266
Total Placements	1.421.321	333.173	107.254	144.193	5.110	2.011.051
Other Assets	2.069.036	322	974	4.203	0	2.074.535
TOTAL ASSETS	3.490.357	333.495	108.228	148.396	5.110	4.085.586
OFF-BALANCE SHEET RISK ITEMS	497.523	54.476	5.101	5.091	1.706	563.897
BAL. SHEET AND OFF-BAL. SHEET RISK ITEMS	3.987.880	387.971	113.329	153.487	6.816	4.649.483
General credit risk and potential loan losses	63.192	33.069	31.326	85.381	6.816	219.784
Allocated general and special reserves for loan losses	64.069	33.056	31.473	86.341	1.727	216.664
Structure of allocated reserves by classification category	29,6	15,2	14,5	39,9	0,8	100,0

[10] Placements include: loans, past due receivables, receivables on guarantees payable and other placements

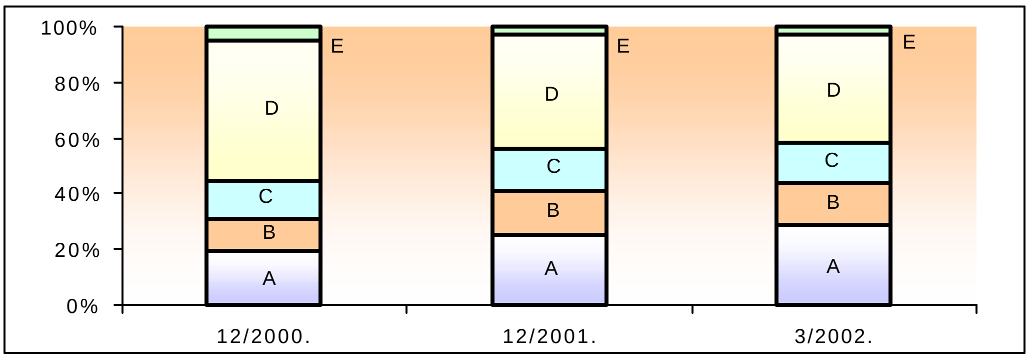
Participation of poor assets (C, D and E) of 5.8% in total assets remained almost unchanged in comparison to the end of 2001 (6.0%).

Level of estimated losses by classification categories, determined upon criteria and methodology regulated by the FBA's decisions, their trends and structure for the whole banking sector are presented in the following schedule and graph:

Schedule 15: *Structure of Potential Loan Losses*

Classification	AMOUNT (in 000 KM) and STRUCTURE (in %)						RATIO	
	12/31/00		12/31/01		03/31/02		4/2	6/4
1	2	3	4	5	6	7	8	9
A	41.521	19,5	51.519	25,6	63.192	28,8	124	123
B	24.357	11,5	31.759	15,8	33.069	15,1	130	104
C	29.822	14,0	29.050	14,4	31.326	14,2	97	108
D	105.597	49,7	83.305	41,4	85.381	38,8	79	102
E	11.372	5,3	5.781	2,8	6.816	3,1	51	118
TOTAL	212.669	100,0	201.414	100,0	219.784	100,0	95	109

Graph 10: *Structure of Potential Loan Losses in Banks*



General credit risk and potential loan losses in banks were KM 220 million as of 03/31/02 (4.7% of total assets including off-balance sheet), which represents an increase of 9% in comparison to end of 2001. The largest increase of 23% is related to general credit risk, that is, classification category "A", which resulted from increase in risk assets in banks.

Although, participation of dassification category "D" has a decreasing trend, it is still too high and it amounts to 38.8% for the whole banking sector and it is an indicator of poor quality of total credit portfolio, and it has negative effect on profitability and capital in banks.

Transactions with Related Entities

In their operations, banks are exposed to different risks, among which the most significant one is risk related to transactions with entities related to the bank.

In accordance with Basle Principles, FBA has issued the Decision on Minimum Standards for Bank Operations With Related Entities[11] by which it has established prudential principles and requirements related to transactions with entities related to the bank, as well conditions and methods of banks' operations with related entities. Based on this Decision and the Law on Banks, and upon the proposal of the general manager, managing board of the bank is required to adopt special policies regulating operations with related entities and to monitor application of those policies.

[11] Article 46, item 2 of the Law on Banks defines term "entities related to the bank".

Majority of banks have adopted special policies and procedures for transactions with related entities, but very often they are not applied entirely. Therefore, transactions with related entities represents the most often source of problems such as inadequate reserves for potential losses and inadequate net capital, even impaired liquidity in banks.

FBA decisions regulate special set of reports that include transactions with one part of related entities, that is loans and potential and accepted off-balance sheet liabilities (guarantees, letters of credit, assumed loan obligations) since they represent the most often and the riskiest type of transactions between banks and their related entities. Set of reports includes information on loans approved to following categories of related entities:

- shareholders with over 5% of voting rights,
- members of the managing board and senior management in the bank, and
- subsidiaries and other enterprises significantly related to the bank on the basis of capital.

However, information reported by banks to the FBA should be taken with certain reservations, since the actual state of mentioned transactions is possible to determine only through verification of reports, on-site examinations, etc. Also, experience proved so far that in majority of banks this segment of operations bears the largest risk, which resulted in high loan losses, that is high provisions for loan losses. This is mainly due to credit transactions with shareholders and their related entities (enterprises owned by them or with capital interests).

Schedule 16: *Transactions with Related Entities*

-000 KM-

Description	APPROVED LOANS		
	12/31/00	12/31/01	03/31/02
Shareholders with over 5% of voting rights, Subsidiaries and other significantly related enterprises	70.677	46.071	52.743
Members of the managing board	1.164	48	86
Managerial staff and employees of the bank	4.537	3.580	3.469
TOTAL	76.378	49.699	56.298
Contingent and Assumed Off-Balance Sheet Liabilities	21.243	4.906	7.384

The Agency pays special attention (during on-site examinations) to banks' operations with related entities. FBA examiners give on-site orders for elimination of oversights identified, give dead lines for and start legal procedures. Part of those activities are monitoring and supervision of execution of ordered corrective actions.

2.1.3. Capital - Strength and Adequacy

Total capital[12] in banks in the Federation of BiH was KM 673,906,000 as of 03/31/02.

Schedule 17: *Regulatory capital in banks*

-In 000 KM-

DESCRIPTION	12/31/00		12/31/01		03/31/02		RATIO	
							3/2	4/3
1	2		3		4		5	6
STATE BANKS								
a) Core Capital	238.314	95%	84.829	93%	84.508	93%	36	100
b) Additional Capital	12.613	5%	6.312	7%	6.080	7%	50	96
c) Total capital (a + b)	250.927	100%	91.141	100%	90.588	100%	36	99
PRIVATE BANKS								
a) Core Capital	310.597	85%	475.845	86%	499.067	86%	153	105
b) Additional Capital	54.669	15%	77.268	14%	84.251	14%	141	109
c) Total capital (a + b)	365.266	100%	553.113	100%	583.318	100%	151	105
Total								
a) Core Capital	548.911	89%	560.674	87%	583.575	87%	102	104
b) Additional Capital	67.282	11%	83.580	13%	90.331	13%	124	108
c) Total capital (a + b)	616.193	100%	644.254	100%	673.906	100%	105	105

Information given in schedule[13] above shows an increase in total capital during the first quarter of 2002 of KM 29.7 million or 5% in comparison to 12/31/01. The core capital increased by KM 23 million, and additional capital by KM 6.7 million.

The most significant changes in core capital resulted from additional capitalization in one bank (KM 8.4 million) and allocation of income to core capital (KM 19 million of undistributed income) based on year-end reports of banks for 2001. At the same time, capital reserves decreased in one bank by KM 5 million due to revaluation of fixed assets to true value.

In comparison to 12/31/01, changes in additional capital resulted from increased general reserves of 2% related to good assets by KM 12 million and relatively (proportionally) decreased income by KM 5 million.

Aside from above mentioned changes in the first quarter of 2002, the structure of regulatory capital did not change due to increase of core and additional capital by approximately same rate. Also, there were no significant changes in the structure of core capital.

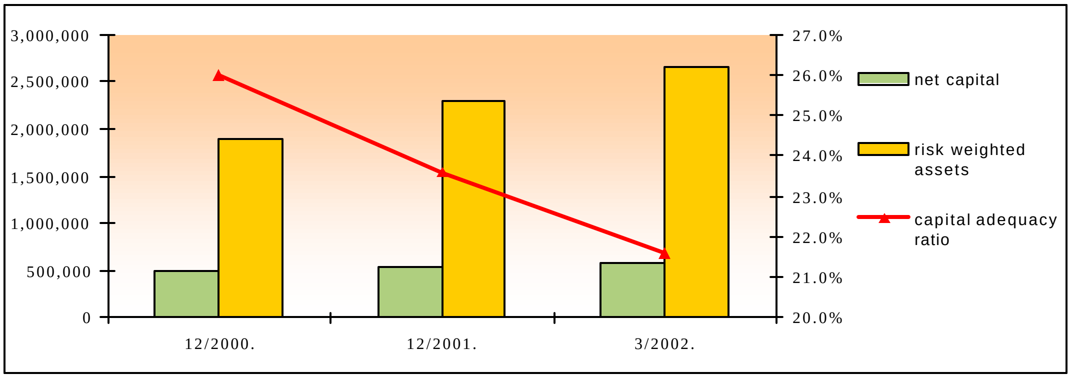
Capital to assets ratio, that is, capitalization rate as of 03/31/02 amounts to 16.5% and is slightly better than in relation to year end 2001, when it amounted to 15.5%.

Net capital amounts to 571 million KM (with private banks it is 495 million KM and with state banks it is 76 million KM) and it increased for 5% or 29 million KM in comparison to the end of 2001. This is the result of increase of total capital.

Capital adequacy ratio, calculated as net capital to risk weighted assets ratio and related to the entire banking sector, was 21.6%, which is less by 2.0% than as of 12/31/01. In period of three past years, this ratio continuously decreased although capital grows and that implies that risk weighted assets grow faster than capital in banks in the Federation of BiH.

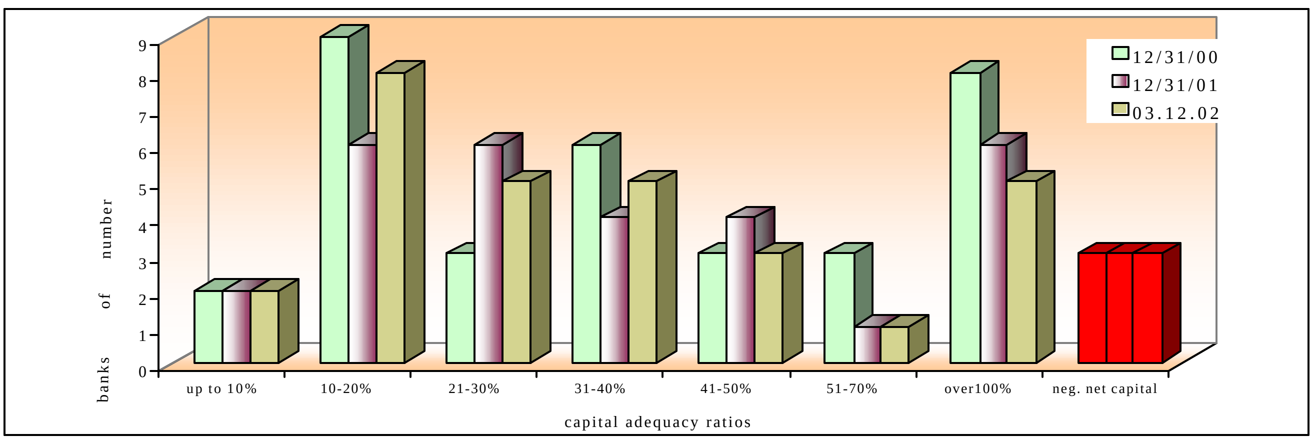
[12] Regulatory capital as defined by Article 8 and 9 in the Decision on Minimum Standards for Managing Capital
[13] Information is from quarterly Report on Capital Positions in Banks (Form 1-Schdule A) regulated by the Decision on Minimum Standards for Managing Capital in Banks.

Graph 11: *Net capital, Risk Weighted Assets and Capital Adequacy Ratio*



Out of total of 32 banks in F BiH, as of 03/31/02, 27 banks (84%) had capital adequacy ratio larger than 10% (some even over 100%), two banks had capital adequacy ratio under regulatory minimum (minimum of 10%) and three banks (two under provisional administration) had negative net capital and capital adequacy ratio.

Graph 12: *Capital adequacy ratio in banks*



We should emphasize that capital adequacy ratio is significantly higher with small banks, mainly due to the fact that small banks did not fully develop their operations, primarily lending activities (there is status quo or poor growth of balance sheet, where the major participation in assets structure is with cash funds) and that resulted in reduced risk in assets of those banks.

Although majority of banks adjusted to regulations related to capital in previous period, the fact is that banking system still consists of too many small banks and that large number of banks are still undercapitalized. By the end of 2002, all banks will have to meet new regulatory requirements related to minimum shareholders' capital paid in cash (KM 15 million). Due to this, smaller banks will have to undertake merger/acquisition processes in the near future. This will result in strengthening and creating larger banks in the banking system of the Federation of BiH. Strengthening of capital base will be necessary in banks which had or have large growth of assets also, and that would provide stability and safety for the bank and for the whole banking system.

2.2. Profitability

As reported in income statements for first quarter of 2002, banks in the Federation of BiH accomplished positive financial results of KM 16,040,000. This is a higher indicator than in comparison to the same accomplished in the first quarter of 2001, when banks had earned only KM 775,000.

Positive financial results of KM 17,753,000 was reported by 24 banks, while 8 banks earned loss of 1,713,000 KM. More detailed information is presented in the following schedule:

Schedule 18: *Realized income/loss*

- 000 KM-

Date/Description	Whole system		Private banks		State banks	
	Amount	Number of banks	Amount	Number of banks	Amount	Number of banks
03/31/01						
Loss	-8.619	14	-8.541	12	-78	2
Income	9.494	22	5.445	14	4.049	8
Total	775	36	-3.096	26	3.969	10
03/31/02						
Loss	-1.713	8	-1.277	6	-436	2
Income	17.753	24	16.396	20	1.357	4
Total	16.040	32	15.119	26	921	6

As in the other operational segments, this one includes certain concentrations: few banks had good profitability, then, larger number of banks had unsatisfactory profitability (observed from aspect of: financial results - they had poor income, and ratios used to rate profitability, productivity and efficiency of banks operations), while groups of 3-4 banks had been earning losses for longer period of time. Out of total income, 73% was realized by four private banks.

In the structure of total income, net interest margin was 39% (in the same period in 2001, it was 44%), and operating income (income from banking fees and other income including collection of previously written off risk placements) participates with 61% (in the same period last year it was 56%).

Total expenses of banks in this period participated with 84% in total income (in the same period in 2000 - 99%). In the structure of total expenses, the major expenses, with 51%, were operating costs (salaries and benefits were 25%), other operating expenses - 12%, costs of business premises, other fixed assets and overhead expenses participated with 14%, while res erves for general loan loss and potential loan losses were 27%.

Following schedules display the most significant ratios necessary to estimate profitability, productivity and efficiency in banks:

Schedule 19: *Profitability, Productivity and Efficiency Ratios by Periods*

-In % -

RATIOS	12/31/01	03/31/02[14]
Return on Assets	-0,56	1,28
Return on Total Capital	-5,14	11,84
Return on Equity	-9,67	13,76
Net Interest Income/Total Assets	3,05	3,28
Fee Income/Total Assets	4,47	5,12
Total Income/Total Assets	7,52	9,76
Operating and Direct Expenses [15]/Total Assets	3,71	2,84
Operating Expense/Total Assets	4,29	4,24
Total Non-interest Expense/Total Assets	8,00	8,44

Schedule 20: *Profitability, Productivity and Efficiency Ratios As Of 03/31/02*

-In % -

RATIOS	03/31/02		
	STATE BANKS	PRIVATE BANKS	AVERAGE IN F BiH
Return on Assets	0,28	1,64	1,28
Return on Total Capital	3,44	13,88	11,84
Return on Equity	5,96	14,92	13,76
Net Interest Income/Total Assets	1,12	4,00	3,28
Fee Income/Total Assets	1,64	6,32	5,12
Total Income/Total Assets	2,96	12,08	9,76
Operating and Direct Expenses/Total Assets	0,84	3,56	2,84
Operating Expense/Total Assets	1,64	5,12	4,24
Total Non-interest Expense/Total Assets	2,64	10,44	8,44

Although majority of banks do not have satisfactory profitability, it is possible to conclude that positive trend continues for this segment of operations, which is the result of the banking system reform and implementation of different actions in past three years. Elimination from the banking system of those banks which did not comply with the law (mainly minimum capital standards) and which, at the same time, operated with losses. This was accomplished through mergers and liquidation procedures, and more efficient operations of banks which remained in the system resulted in better financial results in private and state banks in comparison to previous period.

III. CONCLUSION

Changes and trend in the banking sector of the Federation of BiH were positive and that resulted in their gradual stabilization. There is a need for continuation of such activities performed by all participants of the banking system reform and implementation of actions that would lead this process to the end in the shortest possible time.

Involvement of authorized institutions and entities in the Federation of BiH will affect further positive changes, such as:

- finalization of privatization process in state banks within expected dead lines;
- establishing environment for more successful transformation in material sector, followed by changes in monetary and banking system;
- further strengthening of supervision in banks;
- transferring assets from succession to development, through commercial banks;

[14] Ratios were calculated annually.
[15] Expense includes reserves for potential credit losses.

- accelerating legal procedures, passing judgments and their implementation;
- establishing more efficient procedures for collection of collateral;
- adopting law on protection of creditors and increasing responsibilities of bank debtors;
- setting up regulations which would specify duties of all institutions in the system in the fight against money laundering;
- further improvement of legal and institutional framework for banking system reform, with respect to Basle Principles etc.

The duties of the Banking Agency of the Federation of BiH in future period are:

- continued supervision of banks in order to protect depositors efficiently and eliminate weaknesses in banks;
- cooperation with other institutions, activities for prevention of money laundering, within authorizations of the Agency regulated by the Law;
- finalize provisional and liquidation administrations;
- special supervision of banks with large savings (citizens deposits) and banks with growth above average;
- special supervision of operations with related entities;
- control of application of new operating standards for banks, as regulated by the law and other regulations;
- further development of regulations under authority of the Agency, related to Basle Principles;
- participation in preparations of new laws;
- further education and training of Agency staff;
- establishment of cooperation with supervisory institutions in countries whose natives are investors in our country etc.

And, as the most important part of the system, banks have to take responsibility to:

- further strengthen capital in correlation with growth of assets;
- continue expansion and development of internal payment system, including establishment of unified registry of accounts;
- improve quality of assets;
- strengthen internal control systems and establish internal audits;
- adopt and implement new principles for operations, policies and procedures in accordance with competitive market conditions;
- further develop policies and procedures in order to decrease transactions with related entities;
- development of credit/debit card operations and electronic banking;
- implement more severe and consistent criteria and their implementation in matter of competency and expertise of managerial staff in banks;
- improvement of staff and training in order to establish better relations with customers, especially small and middle sized enterprises, hence, this includes new services, common all over the world, that is, banks should develop financial management operations;
- finalize activities related to association of banks and banking institute;
- take part in global fight against terrorism;
- develop and implement regulations for prevention of money laundering activities as it is regulated by the law etc.