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

INFORMATION
ON BANKING SYSTEM IN
THE FEDERATION OF BOSNIA AND HERZEGOVINA
As of 09/30/04

Sarajevo, November 2004

Banking Agency of the Federation of BiH, as regulatory institution performing supervision of banks, has completed information on the banking system in the Federation of BiH (as of September 30th 2004) 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 examination).

CONTENTS

I INTRODUCTION

Banking sector in the Federation of BiH has maintained stable and moderate trends of growth in third quarter of 2004. At the end of September total balance sheets amounted to KM 7.1 billion which is higher by KM 1.35 billion or 23% in comparison to the previous year. Following financial data illustrates that: the assets increased by 29% (KM 2.66 billion) and loans by 23% (total KM 3.96 billion). At the same time, deposits reached the total of KM 5.22 billion (growth of 22%), liabilities based on loans amounted to KM 790 million (growth of 34%), while capital was increased by 19% in comparison to the end of last year and it amounted to KM 847 million.

Positive financial results of KM 46.5 million was reported in 18 banks, while eight had a loss of KM 14.5 million. Actually, the income in the whole system was close to last year result in the same period, while absolute losses were lower by approximately 30% (last year 21 and this year it was 14.5 million).

Total income and expenses structure was changed. Interest income was 64.3% (last year 59.4%) of total income. Interest expenses out of total expenses were 21.7% (last year 17.8).

Profitability, productivity and efficiency ratios were close to average figures in comparison to two previous years. If we calculate it annually, income to average assets was 0.68% in the reporting period, income to average capital was 5.35%, and income to average share capital was 6.36%.

Concentrating into fewer large banks is in the closing phase. It is noted in reallocation of market participation and growth of banks. Four largest banks hold 66.1% of total assets in the system, and they have 77.7% of total savings. There are four banks in the system with assets over KM 500 million, one with assets of KM 304 million, and group of ten banks reported assets between 100 and 300 million (average assets in those banks were 163 million). At last, the largest peer group was with banks which had not reached to total assets of 100 million and 11 banks from the group owned only 6.7% of assets in the whole system. Among those banks were four banks under provisional administration (Gospodarska Bank, Una, Postanska Bank and Ljubljanska Bank).

Although in the liability structure deposits were predominant, participation of this category was reduced to 73.4% (last year it was 74.4%). Participation of capital is declining as well - from 12.4% last year to 11.9% at the end of September. Comparatively, liabilities on borrowings increased by KM 200 million or 34% and participation of this category increased by 0.9%. Analysis displayed that banks received 45% of these assets from their owners abroad, and remaining amount were funds from borrowings in international financial market or credit lines at foreign or domestic institutions. This improved maturity structure of sources.

Capital ratio in banks remained still the weakest point in the system. The growth of capital did not match assets growth, which resulted in a decrease of capital ratio from 14% at the end of last year to 12.9% at the end of September. That reduced the average capital ratio from 19.5% to 18.2% and even the largest banks have only 0.5% to 1.5% higher capital adequacy ratio than regulated minimum of 12%.

II OPERATIONAL PERFORMANCE OF BANKS IN F BiH

1. STRUCTURE OF BANKING SECTOR

1.1. Status, Number and Operational Network

As of 09/30/04, there were 26 banks[1] with banking licenses in the Federation of BiH. Number of banks decreased in comparison to the 12/31/03 by one bank, which was merged to another bank.

Provisional administrator was instituted in five banks as of 09/30/04 (Gospodarska Bank dd Mostar, Hercegovacka Bank dd Mostar, Ljubljanska Bank dd Sarajevo, Postanska Bank BiH dd Sarajevo and UNA Bank dd Bihac).

In first nine months of 2004, banks tried to further expand network of their organizational parts. Banks in the Federation of BiH have founded 37 new organizational parts, out of which seven in RS. In comparison to 12/31/03, when banks constituted of 394 organizational parts, it represents growth of 9.4%.

As of 09/30/04, ten banks from the Federation of BiH had 23 organizational part in Republic of Srpska and 10 in Brcko District. In comparison to the 12/31/03, when banks from the Federation of BiH had 25 organizational parts in Republic of Srpska and Brcko District, the growth was by 32% as of 09/30/04. At the same time, number of organizational parts of banks from Republic of Srpska in the Federation of BiH increased from eight to nine, that is, as of 09/30/04, three banks from Republic of Srpska had nine organizational parts in the Federation of BiH.

As of 09/30/04, 25 banks had license for interbank transactions in internal payment system, out of that number, 24 banks executed operations of internal payment system. There were 17 banks in the deposit insurance scheme.

1.2. Ownership structure

As of 09/30/04, ownership structure in banks[2] was evaluated upon available information and insight in banks[3] and it was as follows:

- Private and predominately privately owned 19 banks (73%)
- State and predominately owned by state 7 banks (27%).

Ownership structure can be observed from aspect of financial indicators, which is by the value of total capital[4].

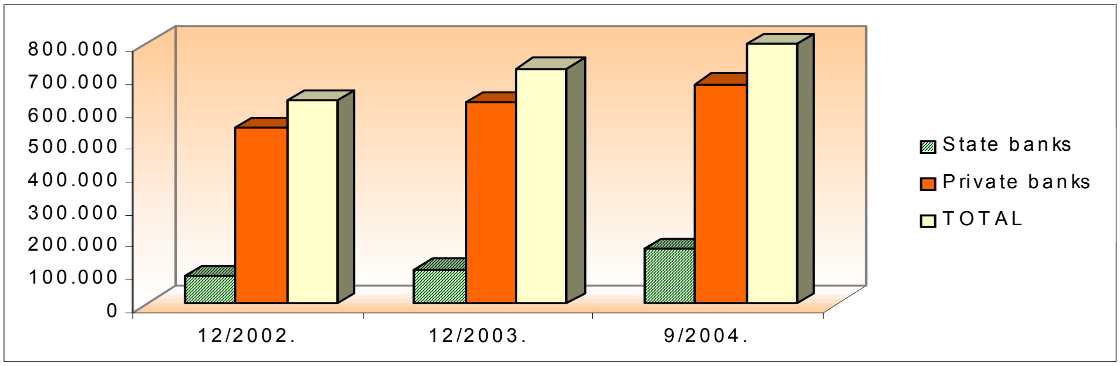
[1] First time after institution of provisional administration in Hercegovačka Bank d.d. Mostar, financial indicators include data for this bank as of 09/30/04.
[2] Classification of banks by ownership type refers to shareholders capital in banks.
[3] General overview of ownership structure of banks in the F BiH as of 09/30/04 resulted from received reports, and registration at authorized courts (changes in capital and shareholders structure).
[4] Information from balance sheet - FBA schedule: share capital, share issues, undistributed income and reserves and other capital (financial result from current period).

Schedule 1: *Ownership Structure by Total Capital*

-In 000 KM-

BANKS	12/31/02		12/31/03[5]		09/30/04		RATIO	
							3/2	4/3
1	2		3		4		5	6
State banks	85,491	14%	106,105	15%	169,849	20%	124	160
Private banks	540,305	86%	607,430	85%	677,374	80%	112	112
TOTAL	625,796	100%	713,535	100%	847,223	100%	114	119

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



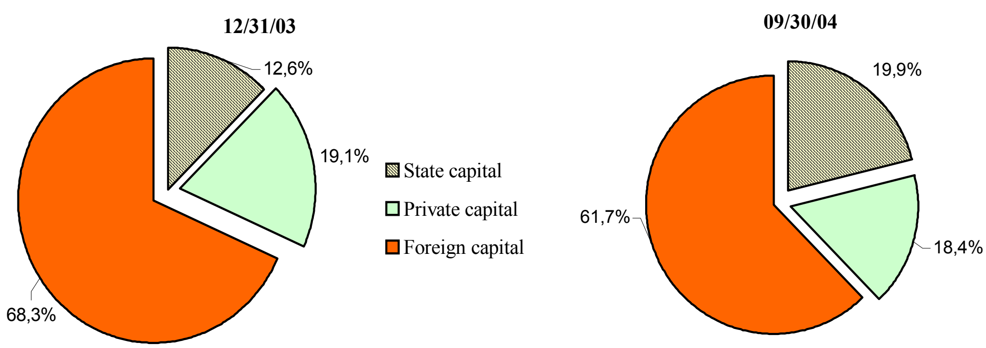
More detailed picture on ownership structure of banks in the Federation of BiH can be viewed by analysis of participation of state, private and foreign capital in share capital in banks.

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

-In 000 KM-

SHARE CAPITAL	12/31/02		12/31/03		09/30/04		RATIO	
	Amount	Participation %	Amount	Participation %	Amount	Participation %	5/3	7/5
1	3	4	5	6	7	8	9	10
State capital	69,249	12.8	75,636	12.6	148,124	19.9	109	196
Private capital (residents)	110,605	20.5	115,411	19.2	137,489	18.4	104	119
Foreign capital (non-residents)	360,758	66.7	408,882	68.2	460,167	61.7	113	113
TOTAL	540,612	100.0	599,929	100.0	745,780	100.0	111	124

Graph 2: *Ownership Structure (share capital)*



[5] All data in the Information reflecting positions as of 12/31/03 were taken from audited financial reports of banks (audit performed by external auditor).

Analysis of ownership structure in banks - shareholders capital - shows the best changes and trends occurred in the banking system in the Federation of BiH, it is visible in ownership structure changes by growth of state capital.

Participation of state capital in total share capital in banks as of 09/30/04 was 19.9% or higher by 7.3% in comparison to 12/31/03. Participation of remaining, state owned capital, in privately owned banks was under 1% or KM 1.2 million.

Major changes in the ownership structure in first three quarters of 2004 were related to participation of state capital, since the Government of F BiH increased its capital in Investicijska Bank F BiH.

In comparison to 12/31/03, participation of privately owned capital (residents) in total capital for whole banking sector was decreased from 19.2% to 18.4%, and participation of foreign capital decreased from 68.3% to 61,7% as well.

1.3. Staff

There were total 5,684 employees as of 09/30/04 in banks in the Federation BiH. Out of total number, 10% worked in banks with predominantly state capital and 90% in privately owned banks.

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

BANKS	NUMBER OF EMPLOYEES						RATIO	
	12/31/02		12/31/03		09/30/04		3:2	4:3
1	2		3		4		5	6
State banks	558	11%	549	10%	542	10%	98	99
Private banks	4,543	89%	4,845	90%	5,142	90%	107	106
TOTAL	5,101	100%	5,394	100%	5,684	100%	106	105
Number of banks	28		26		26			

In the first nine months of 2004, number of employees increased by 5% or 290 persons and the growth relates only to privately owned banks.

Schedule 4: *Educational structure of staff*

EDUCATION	NUMBER OF EMPLOYEES			RATIO	
	12/31/02	12/31/03	09/30/04	3:2	4:3
1	2	3	4	5	6
University education – degree	1,683	1,847	1,997	110	108
University education	533	546	592	102	108
High school	2,665	2,825	2,978	106	105
Other	220	176	117	80	66
TOTAL	5,101	5,394	5,684	106	105

In comparison to the end of 2003, the structure of employees changed in terms of educational structure. Therefore, participation of employees with university degree increased (by 0.9%) and college education (0.3%), while participation of employees from education category "other" (primary school and similar education) decreased by 1.2%. Major participation of 52% was still with category of employees with high school education.

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 higher ratio, the better position of banks' operations and the system in whole.

Schedule 5: *Assets/employees*

BANKS	12/31/02			12/31/03			09/30/04		
	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	558	345,299	619	549	369,974	674	542	388,735	717
Private	4,543	4,242,567	934	4,845	5,402,076	1,115	5,142	6,733,406	1,309
TOTAL	5,101	4,587,866	899	5,394	5,772,050	1,070	5,684	7,122,141	1,253

At the end of third quarter of 2004, for each employee there was approximately KM 1.25 million of assets for whole banking system. The ratio was much better in privately owned banks, which is to be expected since operations in state owned banks were stagnating or decreased size of operations.

Individual analytical indicators for banks were between KM 133 thousand up to KM 2,5 thousand of assets per an employee. With 11 banks, this ratio was better than the ratio for whole banking sector. Other banks had much worse indicators, because nine banks had assets per an employee under KM 500 thousand, which implies that they have excessive number of staff in comparison to assets. That results in larger operational costs and has negative impact to profitability in those banks.

2. FINANCIAL INDICATORS OF BANKING OPERATIONS

Examination of banks through analysis of banks' reports is performed by review of reports regulated by the Agency and reports for other institutions. Those reports represent database of three groups of information:

1. Information on Balance sheet set for all banks submitted monthly, including quarterly attachments to balance sheet containing more detailed information on money assets, loans, deposits and off balance sheet items, and basic statistical information,
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 operational results in banks (income statement - FBA format) and reports on cash flows, submitted to FBA quarterly.

Aside from the above listed standardized reports, database includes information from additional reports requested by the Agency from banks in order to have the best conditions for monitoring banks' operations in the Federation of BiH. Also, database includes reports on audit prepared by independent auditor, and all other information relevant for rating of operational results for each bank individually and banking system in whole.

As it is regulated by the Law on Opening Balance in Banks, banks with predominantly state capital have to report to the Agency "complete" balance sheet which would be sectioned by: passive, neutral and active sub-balance sheet. In order to have realistic indicators of banks' operational results in

Federation of BiH, all further analysis of banking system will be based on information from active sub-balance sheet for banks with predominantly state capital[6].

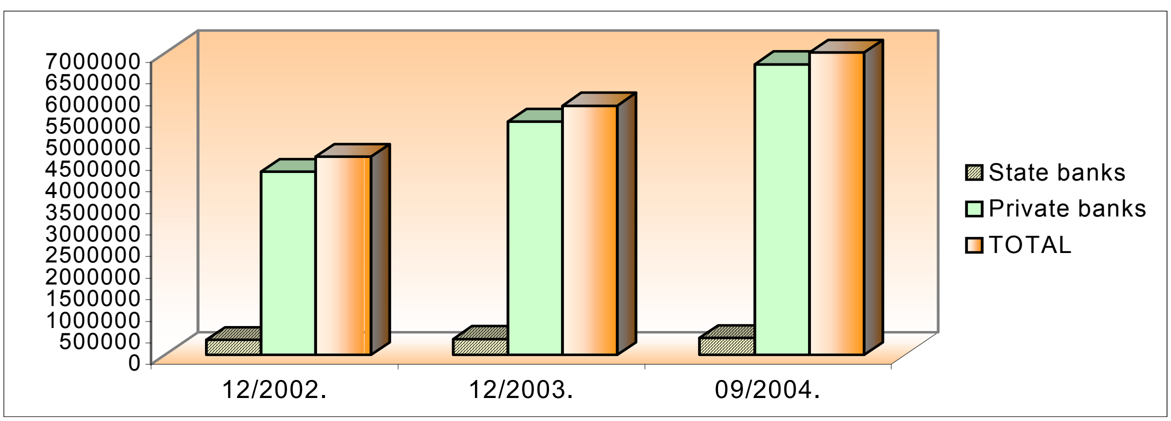
2.1. Balance sheet

Based on the balance sheets submitted by banks as of 09/30/04, total balance sheet in banks in the Federation of BiH was KM 7.1 billion, which is more by 23% or KM 1.35 billion in comparison to 12/31/03. In the same period last year, the growth ratio was 17%, while in 2003 assets increased by 26%. The ratios displayed that banking sector has stable and moderate growth trend.

Schedule 6: *Balance Sheet*

DESCRIPTION	AMOUNT (in 000 KM)			RATIO	
	12/31/02	12/31/03	09/30/04	3/2	4/3
1	2	3	4	5	6
ASSETS:					
Money assets	1,595,154	2,059,285	2,662,208	129	129
Securities	73,150	25,017	18,074	34	72
Placements in other banks	19,952	36,369	34,904	182	96
Loans - net	2,504,415	3,238,270	3,968,365	129	123
Premises and other fixed assets	295,578	304,680	321,632	103	106
Other assets	99,617	108,429	116,918	109	108
TOTAL ASSETS	**4,587,866**	**5,772,050**	**7,122,141**	**126**	**123**
LIABILITIES:					
PAYABLES					
Deposits	3,524,555	4,292,709	5,225,172	122	122
Loans from other banks	3,352	3,779	3,770	113	100
Payables loans	313,009	589,012	790,998	188	134
Other liabilities	121,154	173,015	254,978	143	147
CAPITAL					
Capital	625,796	713,535	847,223	114	119
TOTAL LIABILITIES	**4,587,866**	**5,772,050**	**7,122,141**	**126**	**123**

Graph 3: *Assets in Banks by Ownership Structure:*



[6] Some state owned banks reported passive and neutral items in their "full" balance sheet, which will be taken over by the state upon the finalization of privatization process.

The above-presented growth relates only to privately owned banks, while assets in state banks increased slightly by 5% or KM 19 million in comparison to the end of 2003.

Analysis of individual analytical data in banks displayed that majority of banks recorded growth of assets, and 17 banks had growth over 10%, and seven banks achieved growth over 20%. In six banks, which reported decreased assets, four were state banks, and only one bank recorded significant declination ratio (54%) due to merging of the bank as regulated by the Resolution of the Government of the F BiH and separation balance sheet. We should emphasizes that total growth of balance sheet of 68% or KM 922 million was with five largest banks in the system.

If we analyze banking system from the aspect of assets size and particular groups within this frame, it is possible to make conclusion that changes resulted from assets growth in banks and merging in third quarter of 2004. This reflected the largest banks in the system (banks with assets between KM 300 and 500 million and assets over KM 500 million, groups I and II). On the other hand, 11 banks had assets under KM 100 million and their number and absolute assets still had decreasing trend.

In the first quarter of 2004, the growth of large banks continued, and that resulted in transfer of two banks from group II to group I and increased number of banks with assets of over KM 500 million. At the same time, number of those banks was decreased by one bank due to status changes - merging of two banks. The participation of four largest banks in whole banking sector assets was 66.1% or KM 4.7 billion as of 09/30/04, that is, five largest banks participated with 70.4% or KM 5.1 billion and that is indicator of large concentration. One bank switched from group III to group II, and two banks increased their assets and switched from group IV to group III. Remaining eleven banks (assets under KM 100 million) participated in the assets of the whole banking sector with 6.7%.

The process of strengthening assets concentration in few banks in the system will continue in future due to integration of Central Profit Bank d.d. Sarajevo and HVB Bank BH d.d. Sarajevo.

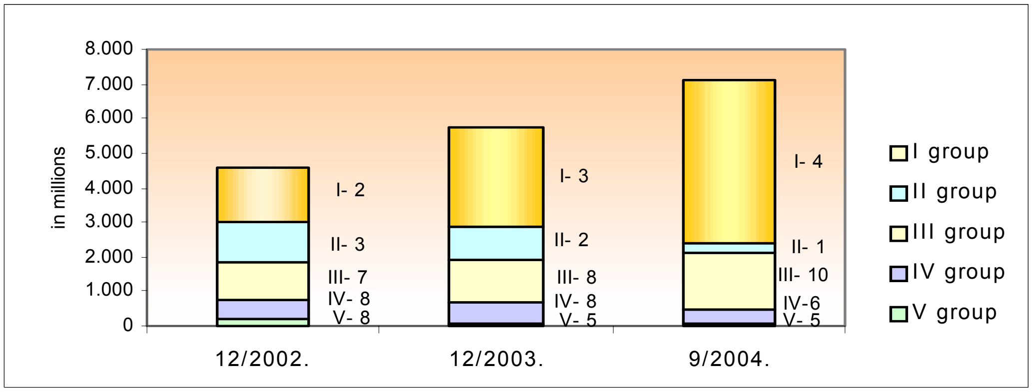
Following schedule presents amount and participation of particular group of banks[7] in time line (amounts are in million of KM):

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

AMOUNT OF ASSETS	12/31/02			12/31/03			09/30/04		
	Amount	Particip. %	Number of banks	Amount	Particip. %	Number of banks	Amount	Particip. %	Number of banks
I- Over 500	1,606	35.0	2	2,882	49.9	3	4,707	66.1%	4
II- 300 to 500	1,163	25.3	3	945	16.4	2	304	4.3%	1
III- 100 to 300	1,072	23.4	7	1,293	22.4	8	1,632	22.9%	10
IV- 50 to 100	543	11.8	8	554	9.6	8	395	5.5%	6
V- Less then 50	204	4.5	8	98	1.7	5	84	1.2%	5
TOTAL	4,588	100.0	28	5,772	100.0	26	7,122	100.0	26

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

Graph 4: *Participation of particular groups of banks in total assets in timeline*



The growth of balance sheet mainly resulted from growth of deposits (by 22% or KM 934 million), borrowings (by 34% or KM 202 million) and capital (by 19% or KM 134 million due to growth of capital in one state bank by KM 73 million, current income and additional capital from external source of funding in five banks totaling KM 44 million).

Assets in banks achieved major growth ratio with money assets category (29% or KM 603 million) and loans[8] (22% or KM 760 million).

Following schedule and graphs display comparable schedule of essential balance sheet items in assets and liabilities in active balance sheet:

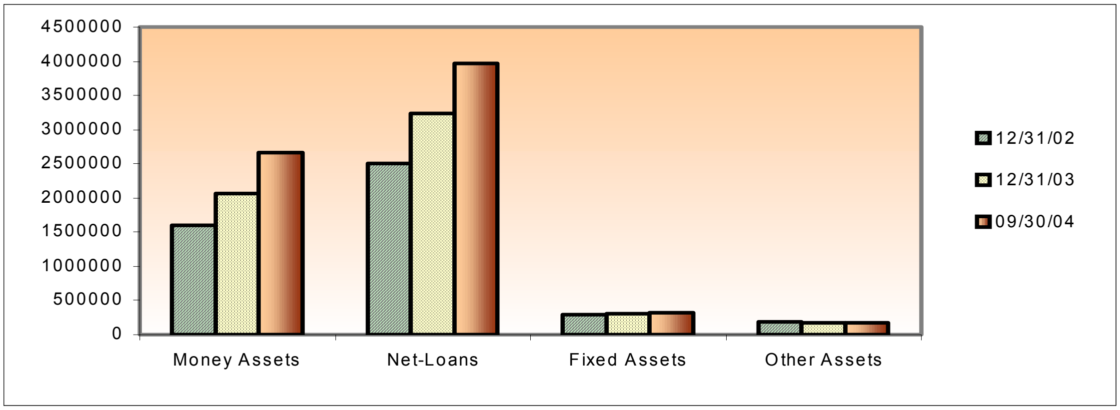
Schedule 8: *Balance sheet structure*

- In % -

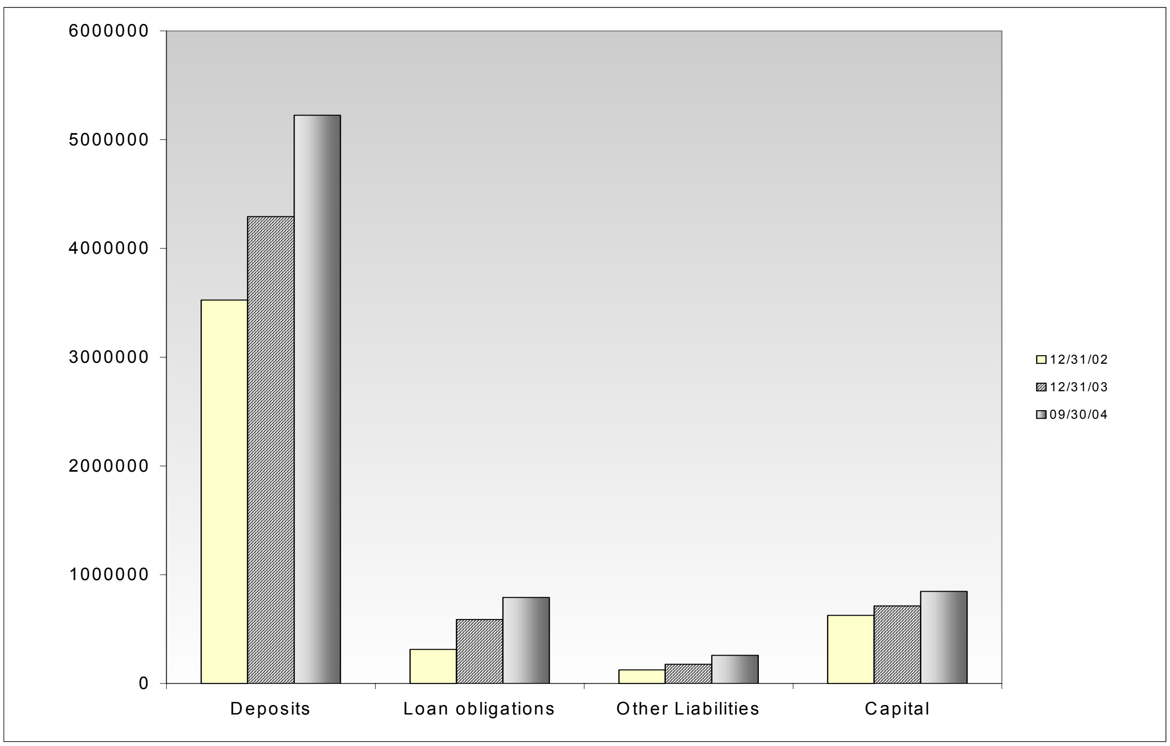
DESCRIPTION	PARTICIPATION		
	12/31/02	**12/31/03**	**09/30/04**
ASSETS:			
Money assets	34.8	35.7	37.4
Securities	1.6	0.4	0.3
Placements in other banks	0.4	0.6	0.5
Loans – net	54.6	56.1	55.7
Premises and other fixed assets	6.4	5.3	4.5
Other assets	2.2	1.9	1.6
TOTAL ASSETS	100.0	100.0	100.0
LIABILITIES:			
PAYABLES			
Deposits	76.8	74.4	73.4
Loans from other banks	0.1	0.1	0.1
Borrowings	6.8	10.2	11.1
Other liabilities	2.6	2.9	3.5
CAPITAL			
Capital	13.6	12.4	11.9
TOTAL LIABILITIES (PAYABLES AND CAPITAL)	100.0	100.0	100.0

[8] **Gross loans (information from balance sheet).**

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



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



Liabilities' structure in banks changed and deposits participation decreased by 1% and capital by 0.5%, and participation of liabilities based on borrowings increased by 0.9%. Deposits still had predominant participation of 73.4%.

Assets structure changed since money assets participation increased by 1.7%, while participation of loans decreased by 0.4%.

At the end of third quarter of 2004, banks in the Federation of BiH had deposits at depository institutions abroad of KM 1.2 billion (mainly in EUR) or 45.8% of total money assets. That is lower by 9.7% in comparison to the end of 2003. That resulted from increased participation of money assets at accounts at Central Bank of BiH (from 34.9% to 43.8%) and those assets were KM 1,165,000.00 as of 09/30/04. In comparison to the end of 2003, this represents an increase of 62% of

KM 446 million. Remaining 8.7% or KM 230 million of money assets banks held at its vaults and tellers.

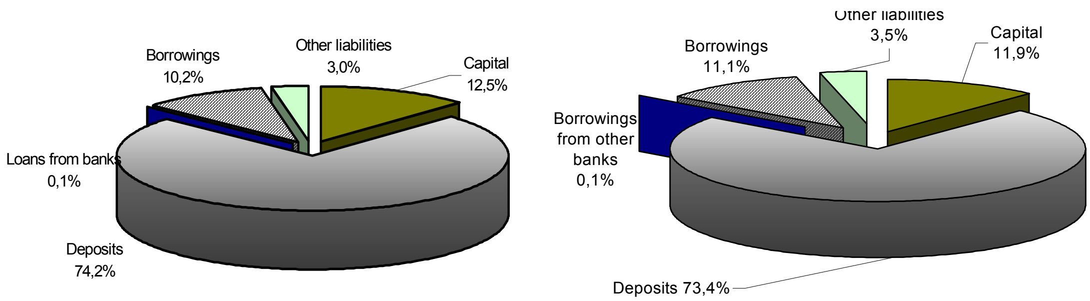
This resulted in continuing changes in the currency structure of money assets, that is, participation of foreign currency was reduced from 61% to 50%, and domestic currency participation increased from 39% to 50%. These changes predominately resulted from changed regulations on regulatory reserves for banks deposited at Central Bank of BiH, and regulations on adjustment of foreign currency balances in banks with limits set up by FBA.

2.1.1. Liabilities

As of 09/30/04, liabilities' structure (liabilities and capital) in balance sheets of banks can be seen from the following graph:

Graph 7: *Structure of liabilities in banks:*

12/31/03 09/30/03



Liabilities' structure was not significantly changed in comparison to the end of 2003. Deposit potential, as a primary source of funding, still has major participation of 73.4% and participation of capital decreased by 0.5%. Liabilities for borrowings increased by 0.9%.

In 2004 banks continued borrowing abroad, but still significantly less in comparison to last year. In this way, banks substantially improved maturity structure of sources of funds and provided long-term funds for financing its clients. Analytical data by banks displayed that approx. 45% of those funds were borrowed from their owners (banks shareholders), and remaining assets were provided by borrowing funds from international financial markets by using credit lines approved by international and domestic financial institutions: Reiffeisen Zentralbank Osterreich A.G. (RZB), European Bank for Reconstruction and Development (EBRD) and Kreditanstalt fur Wiederaufbau (KfW).

In this reporting period, deposits increased by 22% or KM 932 million, while in the same period last year they were increased by 15% or KM 513 million. This increase was recorded only in privately owned banks (rate of increase of 25% or KM 1,001,000.00), while in state banks deposits were reduced by 32% or KM 68 million.

Participation of deposits in liabilities in privately owned banks was 75% and in state banks 38%.

Based on information reported by banks, out of total deposits only 5% were deposits accepted in Federal banks' organizational parts operating in Republic Srpska and Brcko District.

Improving trend of maturity structure of deposits continued in 2004. Increase related to long-term deposits was significantly larger (31%) in comparison to short-term deposits (18%). This resulted in changed maturity structure, that is, participation of long-term deposits increased from 30.9% to 33.1%. This is a very important indicator of positive changes in the banking sector.

Schedule 9: *Maturity structure of deposits*

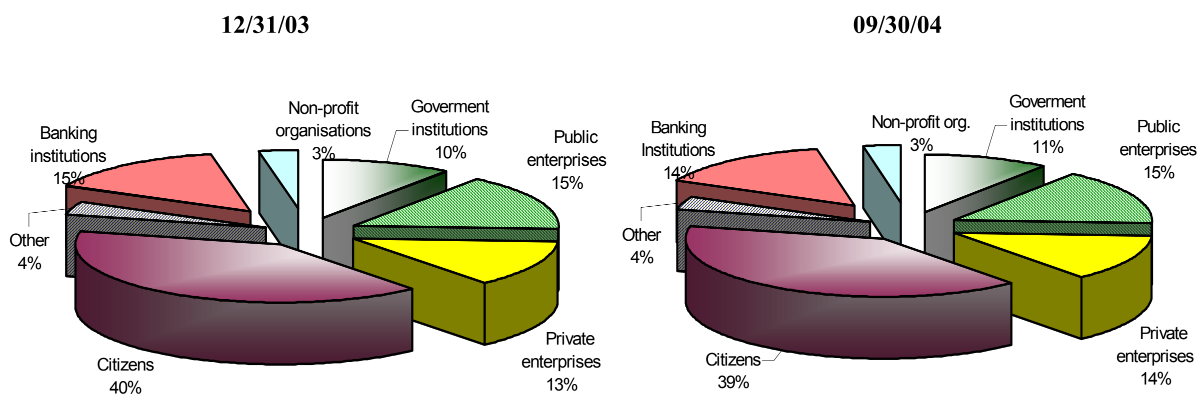
DEPOSITS	12/31/02		12/31/03		09/30/04		RATIO	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	4/2	6/4
1	2	3	4	5	6	7	8	9
Savings and demand deposits	2,012,241	57.1	2,215,925	51.6	2,742,798	52.5	110	124
Up to 3 months	317,862	9.0	303,203	7.1	280,944	5.4	95	93
Up to 1 year	349,586	9.9	447,952	10.4	470,877	9.0	128	105
1. Total short-term	2,679,689	76.0	2,967,080	69.1	3,494,619	66.9	110	118
Up to 3 years	416,718	11.8	715,648	16.7	1,133,216	21.7	172	158
Over 3 years	428,148	12.2	609,981	14.2	597,337	11.4	143	98
2. Total long-term	844,866	24.0	1,325,629	30.9	1,730,553	33.1	157	131
TOTAL (1 + 2)	3,524,555	100.0	4,292,709	100.0	5,225,172	100.0	122	122

Schedule 10: *Structure of deposits by industry areas*[9]

In 000 KM

DEPOSITS BY	12/31/02		12/31/03		09/30/04		RATIO	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	4/2	6/4
1	2	3	4	5	6	7	8	9
Governmental institutions	440,778	12.5	498,132	11.6	571,487	10.9	113	115
Public enterprises	388,271	11.0	567,677	13.2	765,128	14.6	146	135
Private enterprises and assoc.	658,076	18.7	607,046	14.1	756,721	14.5	92	125
Non-profit. Organizations	135,849	3.9	147,606	3.5	164,741	3.2	109	112
Banking institutions	296,215	8.4	557,166	13.0	727,987	13.9	188	131
Citizens	1,480,946	42.0	1,737,238	40.5	2,035,350	39.0	117	117
Other	124,420	3.5	177,844	4.1	203,758	3.5	143	114
TOTAL	3,524,555	100.0	4,292,709	100.0	5,225,172	100.0	122	122

Graph 8: *Structure of deposits by industry areas*



If we make analysis by industry areas in this reporting period, it is possible to conclude that major increase was with deposits of public enterprises (35% or KM 197 million) and banking institutions (31% or KM 171 million), while citizens' deposits increased by 17% or KM 298 million and deposits of privately owned enterprises by 25% or KM 150 million.

[9] **Information from attached form BS-D submitted by banks each quarter with balance sheet - FBA format.**

In this reporting period, there were slight changes, that is, increase of deposits of public enterprises by 1.4%, banking institutions by 0.9% and private enterprises by 0.4%, while participation of decrease of government institutions decreased by 0.7%. Although participation of citizens' deposits decreased, this sector is still predominant with 39% out of total deposits..

Out of total deposits, 44% or KM 2,287,000.00 were in domestic currency and 56% or KM 2,938,000.00 were in foreign currencies. In comparison to the end of 2003, relatively, participation of domestic currency increased by one percent.

Savings still have a growing trend and in this reporting period they increased by 20% or KM 334 million, while in the same period last year increase for this category was 9.1% or KM 131 million. Only one bank had slight decrease of savings, and all other banks reported increase. In seven banks increase rate of savings was between 10% and 20%, while in 11 banks savings increased by over 20%. 78% or KM 262 million of savings was with five largest banks in the system.

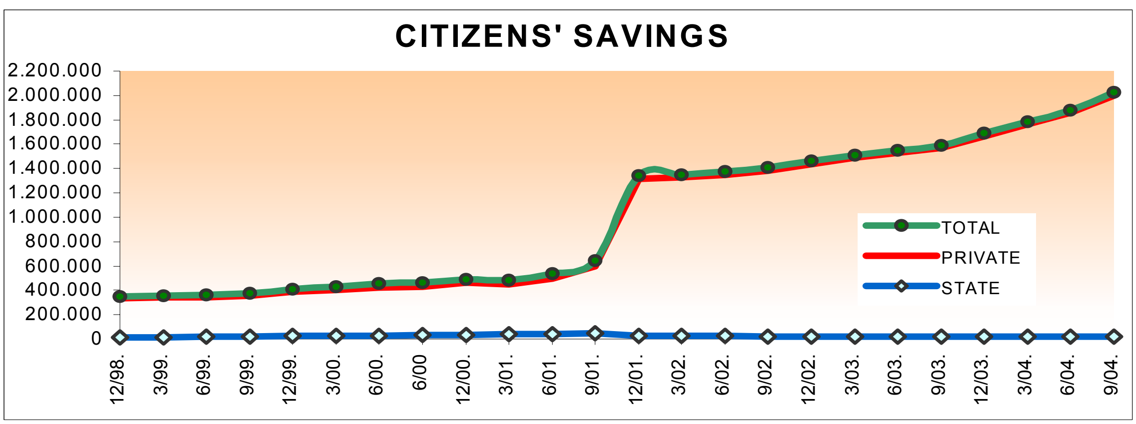
If we observe this in relation to industry areas, almost all savings were in private banks, that is, only 1.1% of total savings was with five state banks.

Schedule 11: *New citizens' savings by time periods*

-000 KM-

BANKS	AMOUNT IN (IN 000 KM)			RATIO	
	12/31/02	12/31/03	09/30/04	3/2	4/3
1	2	3	4	5	6
State	22,072	20,758	22,198	94	107
Private	1,414,814	1,645,991	1,978,721	116	120
TOTAL	1,436,888	1,666,749	2,000,919	116	120

Graph 9: *New citizens' savings by time periods*



As in other segments, we should emphasize concentration of savings with few banks, since 71.3% of total savings was with three largest banks, and, 93.9% of total savings is deposited with ten private banks.

Out of total savings balance, 28% were savings in domestic currency and 72% were in foreign currency.

Schedule 12: *Maturity structure of citizens' savings by time periods*

BANKS	AMOUNT IN (IN 000 KM)						RATIO	
	12/31/02		12/31/03		09/30/04		3/2	4/3
1	2		3		4		5	6
Short-term savings	1,139,707	79.3%	1,228,261	73.7%	1,313,099	65.6%	108	107
Long-term savings	297,181	20.7%	438,489	26.3%	687,820	34.4%	147	157
TOTAL	1,436,888	100.0%	1,666,749	100.0%	2,000,919	100.0%	116	120

Maturity structure of savings, as well as total deposits, recorded a positive trend, mainly due to stable improvement of banking sector and regained trust in banks, which resulted in rapid increase of long-term deposits. Especially important is stability of that increase and larger increase rate of long-term savings. That is a good indicator for positive future trends.

Aside from activities implemented by FBA, increase of savings in banks in FBiH resulted from the deposit insurance system, which was implemented in January 2001 immediately after the inception of the Deposit Insurance Agency of BiH. The Law on Deposit Insurance in Banks in BiH was passed in August 2002 and shortly after that the Deposit Insurance Agency BiH was founded. 16 banks from the Federation of BiH became part of the deposit insurance program and received certificate on insurance of deposits. Analytical information shows an increase of deposits in those banks. Participation of deposits in those banks out of total deposits was 93%, and same ratio for savings was 97%. The admission of banks in the system of deposit insurance for the Federation of BiH is almost finished since, including a fact that remaining nine state owned banks can not apply to become a member because they failed to fulfill criteria (related to ownership structure) regulated by the Deposit Insurance Agency. The safety of deposits is guaranty and incentive for further increase of savings, not only in those banks but also in all other banks.

2.1.2. Capital -Strength and Adequacy

Total capital[10] in banks in the Federation of BiH was KM 953 million as of 09/30/04.

Schedule 13: *Regulatory capital*

-In 000 KM-

DESCRIPTION	12/31/02		12/31/03		09/30/04		RATIO	
							3/2	4/3
1	2		3		4		5	6
STATE BANKS								
1. Core Capital before Reduction			122,937		182,711			
2. Off-setting Items			17,687		18,085			
a) Core Capital (1-2)	101,783	96%	105,250	97%	164,626	98%	103	156
b) Additional Capital	3,879	4%	3,061	3%	2,995	2%	79	98
c) Total capital (a + b)	105,662	100%	108,311	100%	167,621	100%	103	155
PRIVATE BANKS								
1. Core Capital before Reduction			584,221		692,809			
2. Off-setting Items			34,311		85,479			
a) Core Capital	536,203	85%	549,910	75%	607,330	77%	103	110
b) Additional Capital	95,910	15%	183,681	25%	177,551	23%	192	97
c) Total capital (a + b)	632,113	100%	733,591	100%	784,881	100%	116	107
Total								
1. Core Capital before Reduction			707,158		875,520			
2. Off-setting Items			51,998		103,564			
a) Core Capital	637,986	86%	655,160	78%	771,956	81%	103	118
b) Additional Capital	99,789	14%	186,742	22%	180,546	19%	187	97
c) Total capital (a + b)	737,775	100%	841,902	100%	952,502	100%	114	113

[10] Regulatory capital as defined by Article 8 and 9 in the Decision on Minimum Standards for Managing Banks' Capital

New capital accrual method was set up as of 12/31/03[11] and by that regulation, core and net capital were reported on more realistic basis. That is very important for estimation of banks' exposure to risks, especially in relation to concentrations of credit risks.

In the first nine months of 2004, total capital[12] increased by KM 110.6 million or 13% in comparison to year 2003. This resulted from the increase of core capital by KM 117 million and decrease of additional capital by KM 6 million.

The increase of core capital resulted from increased shareholders' capital by KM 146 million (out of which KM 44 million relates to cash payments for additional capital) and reserves by KM 1.8 million.

Off-set items (which influenced the decrease of core capital) increased by KM 51.6 million in this reporting period, mainly due to current loss of KM 14.5 million, intangible assets of KM 16.7 and unsecured loss from previous years of KM 21.7 million[13].

Significant changes occurred in additional capital (increase of general reserves for loan losses of KM 16 million, including income in one bank approved by external audit of KM 12 million, and increase of subordinated debts of KM 21 million, also, decrease of subordinated debts by redistribution of income in 2003 to core capital of KM 45 million and permanent liabilities of KM 10 million) resulted in decreasing of additional capital by total KM 6 million.

Above-mentioned changes influenced the structure of regulatory capital, that is, core capital participation increased from 78% (in 2003) to 81%.

Above-mentioned changes had positive effect to net capital that increased by 11.5% or KM 97 million in 2004. Therefore, as of 09/30/04, total net capital was KM 938 million (KM 770 million in private banks and KM 168 million in state owned banks).

Capital to assets ratio, that is capitalization ratio in banks as of 09/30/04, was 12.9%, which is lower by 1.1% in comparison to the end of 2003, and it means that increase of capital is not matching the increase of assets.

Capital adequacy ratio calculated as net capital against risk weighted assets was 18.2% at the level of the entire banking sector, which is lower by 1.3% in comparison to the end of 2003. Decreased capital adequacy ratio resulted from above mentioned reasons, although two large banks provided additional capital of KM 37 million. Also, significant decrease of capital adequacy ratio was mitigated by including additional KM 21 million of subordinated debt.

Lower ratio at the level of the entire banking system resulted also from continuing decrease of capital adequacy ratio in private banks. It was 15.8% as of 09/30/04, which is lower by 2.4% in comparison to the end of 2003.

In performing supervision of operations and financial positions of banks in the FBiH as regulated by the Law, FBA gave orders to banks to undertake actions for strengthening of capital base and provision of adequate capital in order to strengthen safety in banks individually and in the banking system in whole.

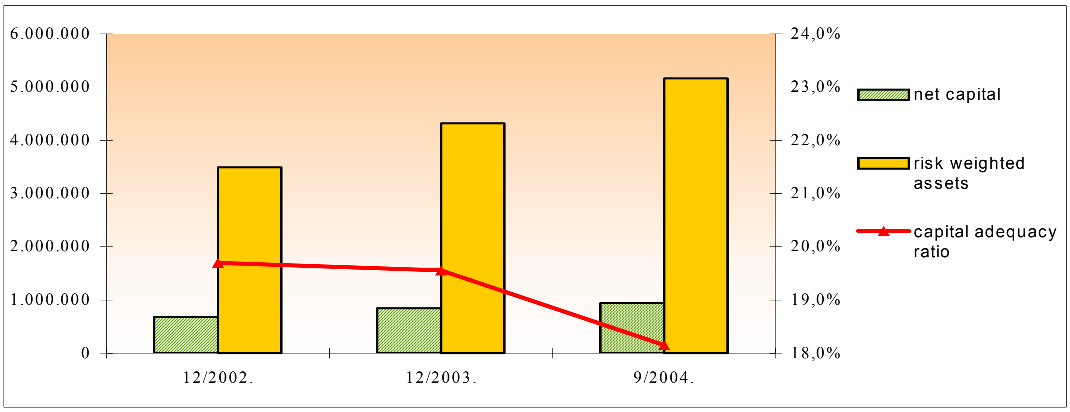
---

[11] The Decision on Changes and Additions to the Decision on Minimum Standards for Managing Capital in Banks ("Official Gazette F BiH", no. 18/03).
[12] Information are from quarterly Report on Capital Positions in Banks (Form 1-Schedule A) regulated by the decision on Minimum Standards for Managing Capital in Banks.
[13] Unsecured losses have changed completely due to inclusion of Hercegovacka Bank by KM 23.8 million and covering loss from reserves with KM 2.1 million.

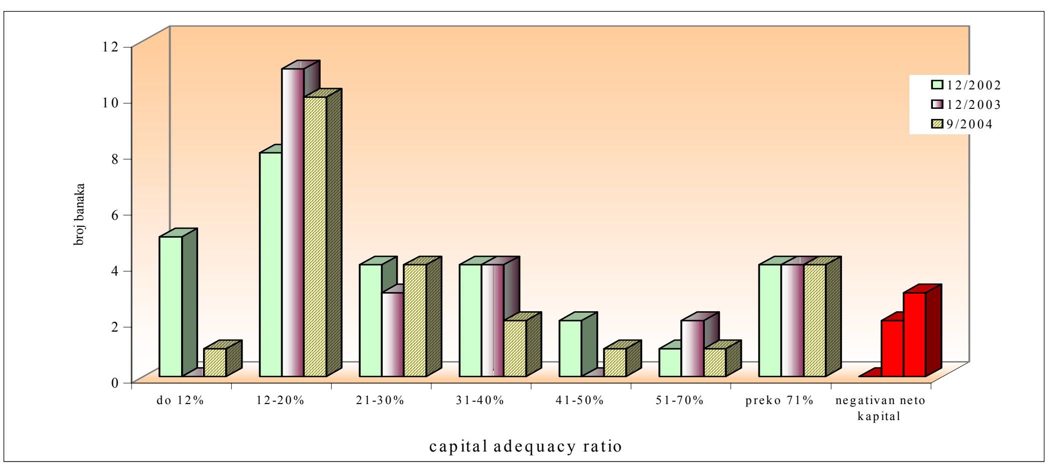
Schedule 14: *Net capital, Risk Weighted Assets and Capital Adequacy Ratio*

DESCRIPTION	12/31/02	12/31/03	09/30/04	RATIO	
				3/2	4/3
1	2	3	4	5	6
NET CAPITAL	687,576	840,605	937,531	122	112
RISK WEIGHTED ASSETS AND CREDIT EQUIVALENTS	3,489,810	4,306,774	5,164,039	123	120
CAPITAL ADEQUAQY RATIO	19.7%	19.5%	18.2%	99	93

Graph 10: *Net capital, Risk Weighted Assets and Capital Adequacy Ratio*



Graph 11: *Capital adequacy ratio in banks*



Out of total 26 banks in F BiH, as of 09/30/04, 22 banks had capital adequacy ratio larger than 12% - regulatory minimum (five banks over 50%), in one bank it was under regulatory minimum, and three banks (under provisional administration) had negative capital adequacy ratio.

In second group (ratio between 12% and 20%) there were 10 banks, while four had ratio between 21% and 30%. But, four out of five largest banks by size of assets (which participate with 60% in total assets of the banking sector) had capital adequacy ratio slightly over the regulatory minimum (between 12.6% and 13.5%). Among them, two banks had lower ratios in comparison to the end of 2003.

Any further increase of risk assets has to be followed by adequate increase of capital, and in that sense banks are required to adopt programs for managing capital and to monitor implementation of the program in order to maintain size and quality of capital at least within regulatory minimums.

Further strengthening of capital base will be priority task in majority of banks, especially after implementation of new capital recording format. This is especially important for the largest banks in the system. FBA will pass appropriate decisions necessary to strengthen capital base in banks and that will guaranty their stability and safety.

2.1.3. Assets and Asset Quality

The Decision on Minimum Standards for Managing Credit Risk and Assets Classification in Banks (the Decision) regulates criteria for assessment of banks' risk exposure by means of evaluating their assets' quality and adequacy of their reserves for loan and other losses by placements and balance sheet and off-balance sheet risk items.

Gross assets[14] in the balance sheet in banks in the Federation of BiH as of 09/30/04 was KM 7.4 billion, which is higher by 23% or KM 1,387,000.00 in comparison to end of 2003. Off-balance sheet risk items were KM 1,006,000.00 and they increased by 34% or KM 256 million.

Total assets, including off-balance sheet items (assets)[15], were 8.4 billion KM and they increased by 24% in comparison to year-end 2003.

Schedule 15: *Assets, off balance sheet items and potential loan losses*

In 000 KM

DESCRIPTION	AMOUNT (in 000 KM)						RATIO	
	12/31/02	Structure %	12/31/03	Structure %	09/30/04	Structure %	4:2	6:4
1.	2.	3.	4.	5.	6	7	8	9
Loans	2,527,745	52.7	3,272,569	54.5	3,960,846	53.7	129	121
Interest	25,897	0.5	26,395	0.4	30,751	0.4	102	117
Past due receivables	156,351	3.3	171,821	2.9	243,289	3.3	110	142
Receivables on paid guarantees	7,486	0.1	5,353	0.1	5,395	0.1	72	101
Other placements	68,945	1.4	50,906	0.9	47,506	0.6	76	93
Other assets	2,006,672	42.0	2,468,073	41.2	3,094,501	41.9	123	125
TOTAL ASSETS	4,793,096	100.0	5,995,117	100.0	7,382,288	100.0	125	123
OFF BALANCE SHEET	693,300		749,382		1,005,755		108	134
BALANCE AND OFF BALANCE SHEET	5,486,396		6,744,499		8,388,143		123	124
General credit risk and potential loan losses	228,522		247,369		284,276		108	115
Allocated general and special reserves for loan losses	224,641		247,411		287,143		110	116

[14] Information from the report on Assets Classification in balance and off-balance sheet.
[15] Assets, as defined in the Article 2 of the decision on Minimum Standards for Managing Credit Risk and Assets Classification in banks

Out of total assets (with Off-balance sheet items), non-risk assets participate with KM 2.9 billion or 35%. This resulted from large increase of money assets KM 603 million or 29% more in comparison to the end of 2003.

The increase of money assets (mainly derived from increase of deposits which increased by KM 932 million or 29%) resulted in changes of risk assets structure. Participation of money assets in total assets increased from 35.6% to 37.4% with insignificant decrease of credit placements from 59.9% to 59.1%, although credit placements were larger by KM 760 million or 22% in comparison to the end of 2003.

Analysis of assets structure changes in banks displayed that seven banks (small and middle-sized banks) recorded decrease of credit placements, five banks had increase of loans over 30%, while in another banks increase ratio was between 5.4% and 28.7%. Total increase of credit placements in three largest banks in the system in the F BiH was KM 377 million or 50% of total increase.

Analysis of credit portfolios structure by industry areas resulted in a conclusion that placements increased in three categories (loans approved to citizens increased by 22% or KM 376 million, to private enterprises by 25% or KM 353 million, to government institutions by 28% or KM 7 million). At the same time, loans approved to public enterprises decreased and loans approved to banking institutions remained unchanged in comparison to the end of 2003.

Changes occurred in participation of industry areas in total structure of loans, so loans approved to citizens increased by 0.2% (from 48.6% to 48.8%) and private enterprises by 0.8% (from 41.7% to 42.5%). Participation of loans approved to public enterprises decreased by 1.2% (from 6.3% to 5.1%), banking institutions by 0.2%, government institutions by 0.1%, and other by 0.3%, while non-profit institutions participation remained unchanged in comparison to the end of 2003.

Changed structure of industry areas' participation in total structure of loans is presented in following schedule:

Schedule 16: *Structure of loans by industry areas*

-in 000 KM-

SECTORS	12/31/02		12/31/03		09/30/04		RATIO	
	Amount	Participation %	Amount	Participatio n %	Amount	Participation %	4/2	6/4
1	2	3	4	5	6	7	8	9
Government institutions	30,194	1.1	24,526	0.7	31,451	0.8	81	128
Public enterprises	247,603	9.2	217,587	6.3	212,884	5.1	88	98
Private enterprises and assoc.	1,078,795	40.1	1,439,009	41.7	1,792,031	42.5	133	125
Non-profit. Organizations	2,834	0.1	3,015	0.1	4,289	0.1	106	142
Banking institutions	46,439	1.7	33,281	1.0	34,097	0.8	72	102
Citizens	1,262,146	46.9	1,676,325	48.6	2,052,182	48.8	133	122
Other	23,571	0.9	55,999	1.6	82,596	1.9	238	148
TOTAL	2,691,582	100.0	3,449,742	100.0	4,209,530	100.0	128	122

Regarding maturity structure, we should emphasize that short-term loans maintained positive increase rate that increased by 16% in this reporting period. But, long-term loans had increase rate of 23% that resulted in increase of their participation in total loans (from 72.4% to 72.7%). Analysis by industry areas displayed that 91% of loans approved to citizens and 56% to private enterprises are long-term.

Schedule 17: *Maturity Structure of Loans*

-In 000 KM-

LOANS	12/31/02		12/31/03		09/30/04		RATIO	
	Amount	Participation %	Amount	Participation %	Amount	Participation %	4/2	6/4
1	2	3	4	5	6	7	8	9
Past due Receivables	163,837	6.1	177,174	5.1	248,684	5.9	109	140
Short-term Loans	620,572	23.0	776,014	22.5	902,106	21.4	125	116
Long-term Loans	1,907,173	70.9	2,496,554	72.4	3,058,740	72.7	131	123
TOTAL LOANS	2,691,582	100.0	3,449,742	100.0	4,209,530	100.0	128	122

Above reported changes had a positive effect to a decrease of maturity mismatch of financial assets and liabilities, that is, in relation to maturity profiles of particular items of assets and liabilities. This mainly resulted from activities and actions implemented by banks, upon FBA's request, in second half of 2003 and first quarter of 2004. Anyhow, some banks still have maturity mismatch of remaining past due financial assets and liabilities. The FBA have issued an order with time lines for correction of found irregularities.

Since placements - loans are the part of assets with highest risk, the quality of loans represents one of the most significant factors of stability and success of operations. Quality rating of assets is actually estimation of credit risk in banks, that is, identification of potential loan losses that are offset from reserves for loan losses.

Quality of assets and Off-balance Sheet risk-bearing items, general credit risk, potential loan losses by classification categories[16] and off-balance sheet items are given in the following schedule:

Schedule 18: *Classification of Assets, General Credit Risk (GCR) and Potential Loan Losses (PLL)*

Classification category	AMOUNT (in 000 KM) AND PARTICIPATION (in %)									RATIO	
	12/31/02			12/31/03			09/30/04				
	Assets classif.	Particip. %	GCR PLL	Assets classif.	Particip. %	GCR PLL	Assets classif.	Particip. %	GCR PLL	5/2	8/5
1	2	3	4	5	6	7	8	9	10	11	12
A	4,713,349	85.9	60,161	5,881,803	87.2	70,974	7,299,315	87.1	87,631	125	124
B	482,988	8.8	42,037	563,498	8.4	46,657	747,300	8.9	56,432	117	133
C	148,267	2.7	40,676	152,581	2.3	44,593	185,734	2.2	51,858	103	122
D	134,419	2.5	78,275	139,311	2.0	77,839	154,485	1.8	87,146	104	111
E	7,373	0.1	7,373	7,306	0.1	7,306	1,209	0.0	1,209	99	17
TOTAL	5,486,396	100.0	228,522	6,744,499	100.0	247,369	8,388,043	100.0	284,276	123	124
OFF-BALANCE SHEET RECORD											
E	298,356	75.1		341,166	79.8		347,449	83.4		114	102
Susp. interest	99,063	24.9		86,205	20.2		69,074	16.6		87	80
TOTAL	397,419	100.0		427,371	100.0		416,523	100.0		108	97

If we analyze assets quality with off-balance sheet items included, it is possible to notice that there was an increase of participation of classified assets (B to E) by 0.1% in total assets although it increased by KM 226 million or 26%. The major increase of KM 184 million or 33% was with assets classified as B (mainly loan placements). Poor assets in the Balance Sheet increased by 14% or KM 42 million. In the same period last year permanent write-offs were KM 14.9 million, and permanent write-offs of suspended interest was KM 6.5 million. At the same time, banks collected earlier

[16] As it is 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 of loans: A 2%, B 5% to 15%, C 16% to 40%, D 41% to 60% and E 100%.

written off of total KM 16.9 million, and collected suspended interest was KM 5 million in this time period.

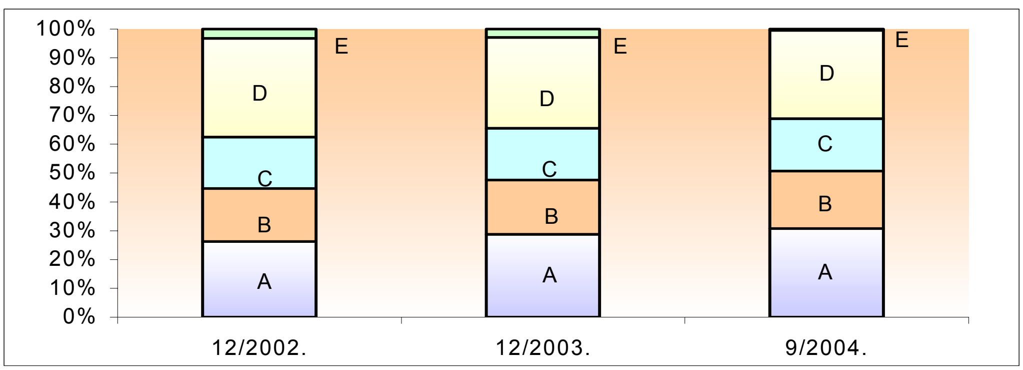
At the end of third quarter of 2004, written-off assets were KM 347 million and this category increased by 2% or KM 7.3 million in comparison to the end of 2003. Total suspended interest was KM 69 million, and that represents an increase of 20% or KM 17 million in comparison to the end of 2003.

Level of general credit risk and estimated loss by classification categories, as 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 19: *Structure and Trend of General Credit Risk and Potential Loan Losses*

Classification	AMOUNT (in 000 KM) and STRUCTURE (in %)						RATIO	
	12/31/02		12/31/03		09/30/04		4/2	6/4
1	2	3	4	5	6	7	8	9
A	60,161	26.3	70,974	28.7	87,631	30.8	118	123
B	42,037	18.4	46,657	18.9	56,432	19.9	111	121
C	40,676	17.8	44,593	18.0	51,858	18.2	110	116
D	78,275	34.3	77,839	31.5	87,146	30.7	97	112
E	7,373	3.2	7,306	2.9	1,209	0.4	84	17
TOTAL	228,522	100.0	247,369	100.0	284,276	100.0	107	115

Graph 12: *Structure and Trend of General Credit Risk and Potential Loan Losses*



Based on reports received from banks, the banks have allocated reserves for loan losses as regulated by the regulations and estimated credit risk.

In comparison to the end of 2003, analysis of the reserves allocated, in general and by classification category, displayed that reserves for general credit risk and potential loan losses increased by 16% and were KM 287 million or 3.4% of total assets, including off-balance sheet. In 2004, banks allocated average reserves for category B of 7.6%, for C 27.9%, for D 58.3% and E 100%. This can be considered as satisfactory.

Assets quality analysis, that is, analysis of loan portfolios in banks individually, as well as on site examinations in banks showed that key risk in banks is still credit risk, therefore problem loans approved to legal entities (enterprises).

The FBA initiated corrective actions in banks with problem assets so they had to prepare programs for improvement of existing practices for managing credit risk, that is, assets quality. Also, they have to decrease existing concentrations, resolve poor assets and prevent any further deterioration of assets. FBA continuously monitors implementation of those actions through reports submitted by banks, as well as during on site examinations in banks.

Transactions with Related Entities

While operating, banks are exposed to different risks, among the most dangerous operations are transactions with related entities.

The Agency has set up, in accordance with Basle Principles, prudential principles and requirements regulating operations with related entities of banks[17]. That is also regulated by the Decision on Minimum Standards for Bank Operations with Related Entities that regulated in detail modes and conditions for operations with related entities. The Decision and the Law regulate the duty of the Managing Board of the Bank, which has to adopt, upon the proposal of the Director, special policies regulating operations with related entities and to monitor application of those policies.

The decision of FBA regulates a special set of reports showing transactions with one part of related entities, including loans and potential and accepted off-balance liabilities (guarantees, letters of credit, accepted loan obligations) since those represent the most often and the riskiest type of transactions between banks and their related entities. The set of reports includes information on loans approved to the following categories of related entities:

- shareholders with more than 5% of voting shares,
- members of the Managing Board and senior management in the bank; and
- subsidiaries and other enterprises significantly related to the bank.

Schedule 20: *Transactions with Related Entities*

-000 KM-

Description	APPROVED LOANS			RATIO	
	12/31/02	12/31/03	09/30/04	3/2	4/3
1	2	3	4	5	6
Shareholders with over than 5% of voting shares, Subsidiaries and other significant related enterprises	59,241	37,050	36,914	63	100
Members of the Managing Board	315	388	146	123	38
Managerial Staff and employees of the bank	2,699[18]	1,670	2,168	62	130
TOTAL	62,255	39,108	39,228	63	100
POTENTIAL AND ACCEPTED OFF-BALANCE SHEET LIABILITIES	6,684	8,689	2,647	130	30

The Agency pays special attention (during on-site examinations) on banking operations with related entities. FBA examiners give on-site orders for elimination of discovered exceptions, give deadlines for and start legal procedures. Part of those activities is monitoring and supervision of execution of ordered corrective actions.

[17] Article 39, item 2 of the Changes and Additions to the Law on Banks defines term “entities related to the bank”. Now it excludes staff of the bank.
[18] Without loans originated to the employees in accordance with the Changes to the Law on Banks.

2.2. Profitability

As reported in Balance Sheets for first three quarters of 2004, banks in the Federation of BiH earned positive financial result - income of KM 32 million which is lower by 1% in comparison to the same period of 2003 when income earned was KM 32.2 million.

Positive financial result was reported by 18 banks with a total of KM 46.5 million (in 2003, 17 banks earned income of KM 53.3 million), while 8 banks reported operating loss (two state and six privately owned) of KM 14.5 million (in 2003 9 banks earned operating loss of total KM 21.2 million).

More detailed information is presented in the following schedule:

Schedule 21: *Income/loss Earned*

- 000 KM-

Date/Description	Whole system		Private banks		State banks	
	Amount	Number of banks	Amount	Number of banks	Amount	Number of banks
09/30/03						
Loss	-21,172	9	-19,864	6	-1,308	3
Income	53,332	17	50,584	13	2,748	4
Total	32,160	26	30,720	19	1,440	7
09/30/04						
Loss	-14,543	8	-14,016	6	-527	2
Income	46,492	18	41,764	13	4,728	5
Total	31,949	26	27,748	19	4,201	7

As in other segments, this one is characterized by concentrations: out of total income (KM 46.5 million) 63.9% or KM 29.7 million was with three largest banks, while 70.9% or KM 10.3 million of total loss (KM 14.5 million) was in three private banks.

In the structure of total income, net interest income has a growing trend and it participates with 55% in total income (in the same period in 2003 it was 51%), and participation of operating income decreased to 45% (in the same period in 2003 it was 49%).

But, net interest income that increased by 12% in comparison to same period last year, including interest income increase of 18%, did not follow the increase of credit placements (increased by 19.5%) and increase of interest bearing assets (average increase of 27.9%). The major reasons for that are a decrease of interest rates and interest margin, high participation of long-term loans in the structure of loan portfolio, but also, increase of poor (non interest bearing) assets (9%) and write-offs with significant amount of suspended interest in observed period (7.3 million) and permanent write-offs of interest as regulated by authorized entity (KM 6.5 million).

On the other hand, banks recorded significant increase of interest expense than revenue with constant increase of their participation in total interest bearing income from 27.5% to 32.5%. This resulted from significant increase of interest expenses for borrowings and loans (93%) and deposits (27%), due to faster increase of funds for placements (loans and borrowings increased by 85% and deposits by 29%).

Operating income decreased by 5% in comparison to the same period last year due to decreased fees for loans, other operating income (including collected write-offs from earlier periods) and income from foreign currency operations.

Total non-interest expenses increased by 4% in comparison to the same period last year, and participation of 90% remained unchanged. Salaries, contributions and taxes, as well as premises expense and fixed assets increased in total by 11%, while reserves for loan losses decreased by 11%. Decreased loan losses reserves imply that it might be underestimated in some banks and that actual financial results were not reported properly. This will be priority in planning future on-site examinations.

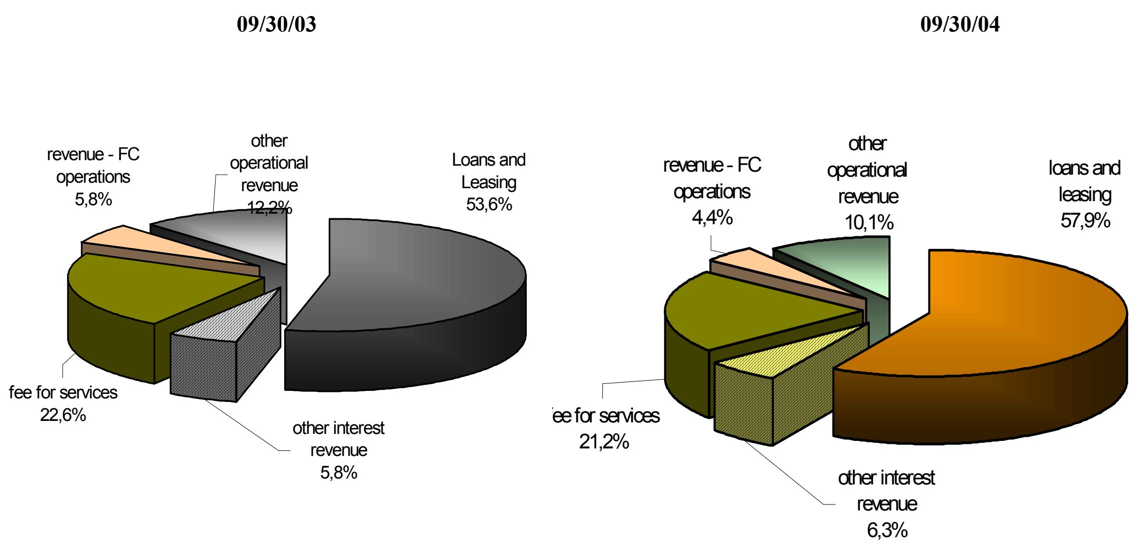
Following schedules display the trend and structure of total income and expense:

Schedule 22: *Structure of total income*

-in 000 KM-

Structure of total income	12/31/02		12/31/03		09/30/04		INDEX	
	Amount	%	Amount	%	Amount	%	4/2	5/6
1	2	3	4	5	6	7	8	9
I Interest income and similar types of income								
Interest bearing deposit accounts with depository institutions	24,675	6.7	18,891	4.6	19,964	4.5	77	106
Loans and lease financing	162,083	44.0	218,029	53.6	255,926	57.9	135	117
Other interest income and all other similar income	4,546	1.2	4,540	1.2	8,304	1.9	100	183
TOTAL	191,304	51.9	241,460	59.4	284,194	64.3	126	118
II Operating income								
Service Fees	88,360	24.0	91,621	22.6	93,449	21.2	104	102
Foreign Exchange Income	33,416	9.1	23,709	5.8	19,349	4.4	71	82
Other Operating income	55,480	15.0	49,799	12.2	44,741	10.1	90	90
TOTAL	177,256	48.1	165,129	40.6	157,539	35.7	93	95
TOTAL INCOME (I+II)	368,560	100.0	406,589	100.0	441,733	100.0	110	109

Graph 13: *Structure of total income*



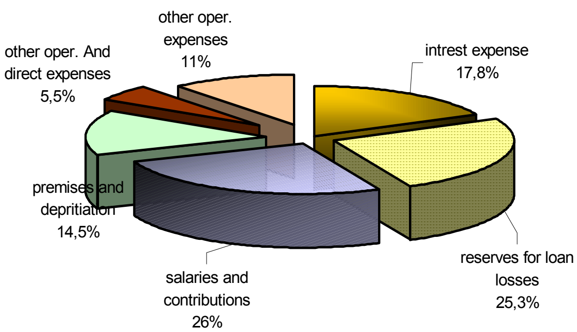
Schedule 23: *Structure of total expenses*

- in 000 KM-

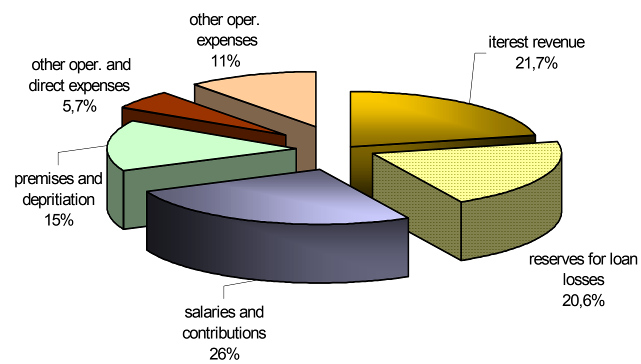
	Structure of total expenses	12/31/02		12/31/03		09/30/04		RATIO	
		Amount	%	Amount	%	Amount	%	4/2	5/6
	1	2	3	4	5	6	7	8	9
I	**Interest expenses and other similar expenses**								
	Deposits	43,221	12.4	56,232	15.0	71,505	17.4	130	127
	Obligations based on loans and other borrowings	10,075	2.9	7,874	2.1	15,197	3.7	78	193
	Other interest expenses	1,937	0.5	2,695	0.7	2,380	0.6	139	88
	TOTAL	55,233	15.8	66,801	17.8	89,082	21.7	121	133
II	**II Total non-interest bearing expenses**								
	Costs of reserves for general credit risk & potential loan and other losses	105,247	30.1	94,678	25.3	83,926	20.6	90	89
	Costs of salaries and benefits	85,475	24.4	97,184	26.0	106,560	26.0	114	110
	Costs of business premises and depreciation	46,252	13.2	54,296	14.5	61,590	15.0	117	113
	Other operating and direct expenses	20,222	5.8	20,399	5.5	23,424	5.7	101	115
	Other operating expenses	37,647	10.7	41,071	11.0	45,202	11.0	109	110
	TOTAL	294,843	84.2	307,628	82.2	320,702	78.3	104	104
	TOTAL EXPENSES (I + II)	350,076	100.0	374,429	100.0	409,784	100.0	107	109

Graph 14: *Structure of total expenses*

30.09.2003.



30.09.2004.



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

Schedule 24: *Profitability, Productivity and Efficiency Ratios by Periods*

-In % -

RATIOS	12/31/02	12/31/03	09/30/04[19]
Return on Assets	0.36	1.09	0.68
Return on Total Capital	2.57	8.33	5.35
Return on Equity Capital	3.00	10.08	6.36
Net Interest Income/Total Assets	4.66	4.60	4.16
Fee Income/Total Assets	5.77	4.42	3.36
Total Income/Total Assets	10.43	9.02	7.53
Operating and Direct Expenses[20]/Total Assets	3.85	2.73	2.29
Operating Expense/Total Assets	6.16	5.16	4.55
Total Non-interest Expense/Total Assets	10.00	7.83	6.84

[19] Ratios were calculated annually.
[20] Expense includes reserves for potential credit losses.

Schedule 25: *Profitability, Productivity and Efficiency Ratios As Of 09/30/04*

-In % -

RATIOS	09/30/04[21]		
	STATE BANKS	PRIVATE BANKS	AVERAGE IN F BiH
Return on Assets	1.52	0.63	0.68
Return on Total Capital	3.04	6.05	5.35
Return on Share Capital	3.85	7.05	6.36
Net Interest Income/Total Assets	3.45	4.21	4.16
Fee Income/Total Assets	7.24	3.12	3.36
Total Income/Total Assets	10.68	7.33	7.53
Operational and Direct Expenses/Total Assets	3.87	2.19	2.29
Operational Expense/Total Assets	5.30	4.51	4.55
Total Non-interest Expense/Total Assets	9.17	6.70	6.84

Achieved financial results at the level of entire banking sector, in the first three quarters of 2003, is one of the indicators of continuing positive trend in the banking system, although two most significant indicators of profitability ROAA and ROAE were slightly worse than last year due to significantly faster increase of average assets and total capital than income earned. At the same time, profitability as expenses against average assets displayed improving trend due to mentioned changes.

Profitability in banks in future period will mainly depend on assets quality, that is, credit risk exposure and efficiency of operating expenses management. Above stated leads to a conclusion that key factor for efficiency and profitability in each bank is management quality and business policy they apply since that has the most direct influence to operating results.

Also, new market conditions will force banks to adopt new concepts of operating policies adjusted to competitive banking striving for maximum profit, providing stability and adequate management and control of all operating risks in the bank, and above all, credit risk. But, taking place in international financial business and market will expose banks to larger market risks: interest rate risk, foreign currency risk and price risk. Earning larger profit from retained income as internal source of funding in banks would provide stronger capital and increase base for further development and growth.

III. CONCLUSION

Consolidation and stabilization of banking sector in the Federation of BiH have reached their final stage and up coming activities should provide further progress and development of the system. This includes continuous engagement of all parts of the system, regulatory and administrative authorities, in order to provide the most favorable environment in economy which would be stimulating to banks and vice versa to economy.

In order to achieve above-mentioned goals, further involvement of authorized institutions and entities in Bosnia and Herzegovina and the Federation of BiH will be necessary in order to:

- accelerating reconstruction process in other sectors in order to achieve level attained by monetary and banking system;
- finalization of privatization process in state banks, that is, resolving their status;
- improvement of environment for bank operations in Bosnia and Herzegovina as a whole;
- accelerating implementation of special court departments for commercial issues;
- implementation of more efficient procedures for collection of collateral;
- passing the Law on Protection of Investors and implementing greater and more defined responsibilities of debtors;

[21] Ratios were calculated annually.

- passing laws for protection of guarantors and putting more responsibility to debtors;
- further improvement of legal framework for banking system and sector of finance, starting from Basle Principles and European banking directives;
- finalization of activities on establishing a banking agency on the state level, "under umbrella" of the Central Bank of BiH; etc.

The Banking Agency of the Federation of BiH in future will:
- continuous supervision of banks, on-site and of-site, and implement preventive measures in order to eliminate causes of potential problems;
- accelerate finalization of provisional and liquidation administrations in banks;
- insist on strengthening of capital in banks, especially those banks which have recorded growth above average;
- in order to protect depositors, implement special supervision in banks with large savings and other types of deposits;
- further development of regulations under authority of the Agency starting from Basle Principles and incorporating European Directives, as part of preparation process for becoming part of European Union;
- work on continuous education and training of Agency staff;
- maintain continuity of control of payment system;
- continue effective monitoring of banks activities on prevention of money laundering and financing of terrorism and improve cooperation with other supervisory institutions;
- work on improving the new information system in order to provide for better quality of the early warning system and preventive actions related to elimination of weaknesses in banks' operations;
- take active part in preparations for establishment of banking agency at the state level, "under umbrella" of the CB BiH.

And, as the most important part of the system, banks have to concentrate their actions to:
- further strengthen capital in correlation with growth of assets;
- improve quality of assets;
- adopt and implement new principles for operations, policies and procedures adjusted to competitive market conditions;
- strengthen internal control systems and establish internal audits, and provide for their independence;
- accelerate the development of credit/debit card operations and electronic banking;
- development of procedures for control and improvement of IT;
- training and staff improvement;
- maintaining prevention of money laundering and terrorism financing activities by implementing adopted policies and procedures;
- improvement of work of Banks' Association; etc.