



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

I N F O R M A T I O N
ON BANKING SYSTEM
OF THE FEDERATION OF BOSNIA AND HERZEGOVINA
AS OF SEPTEMBER 30, 2007

Sarajevo, November 2007

Banking Agency of the Federation of BiH, as a regulatory authority conducting supervision of banks, prepared the Information on banking system of the Federation of BiH (as of September 30, 2007) based on reports of banks, and other information and data submitted by banks. Findings and data from on-site examinations and analysis performed at the Agency (off-site financial analysis) have also been included.

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I. INTRODUCTION

The banking system of the Federation of BiH has maintained positive trends over the last nine months of 2007 in all performance segments as in the past period, which will further increase stabilization and strengthening of the entire system. Significant changes in the ownership structure have occurred in this period. There are three state owned banks (five state owned banks at the end of 2006), seven banks with majority domestic capital (three more than at the end of 2006), and 12 banks with majority foreign capital (14 in 2006). If compared to the end of 2006, participation of private capital (residents) in total share capital of the banking sector has increased from 9,3% to 12,7%, that is, by KM 43 million, while participation of foreign capital is still high of 73,9%. Approval to go into a status change of integration of LT Gospodarska bank d.d. Sarajevo to UPI bank d.d. Sarajevo was issued on 31.07.2007., and as of 01.08.2007. there were 22 banks operating in the Federation of BiH.

Provisional administration in two banks was terminated this year (in the Investment Bank of the Federation of BiH and Poštanska Bank BiH d.d. Sarajevo). Banks have continued expanding the network of their organizational units, so now banks from the FBiH have total of 544 organizational units across BiH.

Total aggregate balance sheet of banks in the Federation of BiH, as of 30.09.2007., amounted to KM 13,6 billion, which is higher by 18% or KM 2,1 billion than at the end of 2006. The four largest banks make 61% or KM 1,3 billion of total banking system aggregate balance sheet. The assets of three banks exceed two billion KM, while the fourth bank based on the assets size is under integration process that is planned to be finalized in the first quarter of 2008. The assets of majority of banks (15) get below KM 500 million, while the assets of seven banks get below KM 100 million, and it is to expect the status of majority of these small banks should resolve soon either through integration processes with other banks or sale to strategic investors.

The aggregate balance sheet growth in the sources has been predominantly financed by deposit growth (by 17% or KM 1,4 billion), borrowings (by 22% or KM 306 million) and capital (by 17% or KM 212 million). In the assets, cash funds have increased by 16% or KM 666 million, and loans by 21% or KM 1,5 billion. In the liabilities structure of banks' balance sheet, from the aspect of the most important balance sheet categories, the trend of slight downfall in participation of deposits and credit commitments increase has continued. Significant credit growth of 21% has been recorded over the three quarters of 2007, which is primarily financed from deposit and credit sources, so gross loans amounted to KM 8,3 billion and participation of 60,8% as of 30.09.2007.

Banks have continued in 2007 with intensive lending to citizens, so the placements to this sector have had the highest increase of KM 781 million or 22%. Loans to finance consumer goods had the highest participation of approximately 70% (including card-based performance), housing loans 24%, and remaining 6% were loans to small craft industry, small business and agriculture. Loans to private companies had slightly lower growth of 20% or KM 611 million.

Deposit potential of KM 9,8 billion and participation of 72% is still the most significant financing source for banks in the Federation of BiH. Second significant financing source are credit funds, and banks' indebtedness over the observed period has increased by KM 306 million or 22%. Savings deposits, as the most significant segment of deposit and financial potential of banks, with their increase of 15,7% or KM 524 million in 2007, have reached the amount of KM 3,9 billion. Four largest banks in the system (holding 74,5% of total savings) make 68% or

KM 355 million of total increase generated. Besides, savings deposits in domestic currency represent 34%, and in foreign currency 66% of total savings.

Maturity structure of saving deposits, and total deposits, continues with positive trend of changes, resulting from constant improvement of the entire banking system condition and strengthening of its safety and stability.

Capital of banks in the FBiH, as of 30.09.2007., amounted to KM 1,7 billion. Over the observed period in 2007, the capital has increased by 18% or KM 265,4 million, of which core capital has increased by 17% or KM 182,2 million, and supplementary by 22% or KM 83,2 million. The growth of core capital has been significantly influenced by the inflow of new, green cash from external sources – additional capitalization of KM 109,8 million in six banks, while additional capitalization of one bank was performed from the surplus over the issue value in the amount of KM 3,8 million. Supplementary capital has significantly increased in the amount of KM 83,2 million, primarily due to the growth of subordinated debts and liabilities of permanent nature.

Involvement in the international financial performance and market will certainly make banks in future be more exposed to market risks: interest rate, foreign exchange and price, as well as indebtedness risk, which will require further stronger capital base of banks.

Over the nine months of 2007, banks in the Federation of BiH generated profit of KM 113,4 million, representing a significant increase on the system level of 55% or KM 40,2 million if compared to the same period in 2006. Positive financial result of KM 117,4 million was generated by 18 banks, which is higher by 46,8% or KM 37,4 million than in the same period in 2006. Total income of KM 592,9 million was generated on the system level, with growth rate of 21% or KM 103,8 million. It could be concluded that the system's profitability has improved, as a result of the overall trend of improvement and stabilization of the banking sector.

II. BUSINESS PERFORMANCE OF BANKS IN THE FEDERATION OF BIH

1. STRUCTURE OF THE BANKING SECTOR

1.1. Status, number and business network

As of 30.09.2007., there were 22 banks with the banking license issued in the Federation of BiH. Number of banks has decreased by one if compared to 31.12.2006. Approval was issued for a status change of integration of LT Gospodarska banka d.d. Sarajevo into UPI bank d.d. Sarajevo as of 31.07.2007., so as of 01. 08. 2007. there were 22 banks in the Federation of BiH. In addition, provisional administration in Poštanska banka BiH d.d. Sarajevo was terminated as of 01.07.2007.

As of 30.09.2007., there were three banks under provisional administration (UNA bank d.d. Bihac, Hercegovacka bank d.d. Mostar and Privredna bank Sarajevo d.d. Sarajevo).

Over the nine months of 2007, banks have continued expanding the network of their organization units. Banks from the Federation of BiH have founded 52 new organizational units, 35 in the Federation of BiH, 14 in Republic of Srpska and three in District Brcko. If

compared to 31.12.2006., when banks had 492 organizational units, this represents an increase of 10,6%.

As of 30.09.2007., seven banks from the Federation of BiH had 48 organizational units in Republic of Srpska, and 11 banks had 15 organizational units in District Brcko. Six banks from Republic of Srpska had 20 organizational units in the Federation of BiH.

The license for inter-bank-transactions in internal payment system was issued to all banks as of 30.09.2007. There were 14 banks with deposit insurance program.

1.2. Ownership structure

As of 30.09.2007., ownership structure in banks¹ was assessed based on the available information and on-site visits to banks², which is the following:

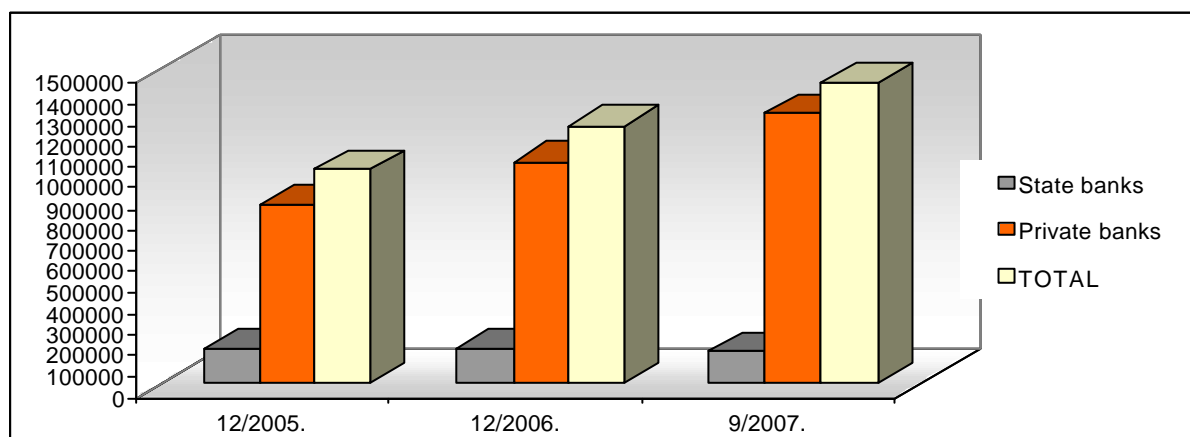
- Private and majority private ownership 19 banks (86%)
- State and majority state ownership³ 3 banks (14%)

The ownership structure could be viewed from the aspect of financial results, which is, by the value of total capital⁴.

Table 1: Ownership structure by total capital -in 000 KM-

| BANKS | 31.12.2005. | | 31.12.2006. ⁵ | | 30.09.2007. | | RATIO | |
|---------------|-------------|------|--------------------------|------|-------------|------|-------|-----|
| | 1 | 2 | 3 | 4 | 5 | 6 | 3/2 | 4/3 |
| State banks | 166.494 | 16% | 170.680 | 14% | 148.952 | 10% | 103 | 87 |
| Private banks | 850.223 | 84% | 1.055.905 | 86% | 1.289.197 | 90% | 124 | 122 |
| TOTAL | 1.016.717 | 100% | 1.226.585 | 100% | 1.438.149 | 100% | 121 | 117 |

Graph 1: Preview of ownership structure (total capital)



¹ Classification criteria of banks by type of ownership is ownership over share capital of banks.

² General overview of ownership structure of banks in the F BiH as of 12/31/05 resulted from received documentation, and registrations at authorized courts (changes in capital and shareholders structure).

³ State ownership refers to domestic state capital of BiH.

⁴ Information from balance sheet - FBA schedule: shareholders capital, premium issue, undistributed profit and reserves, and other capital (financial results of current period).

⁵ All data from this Information referring to 31.12.2006. come from the audited financial statements of banks (audit performed by an external auditor in 22 banks of the F BiH).

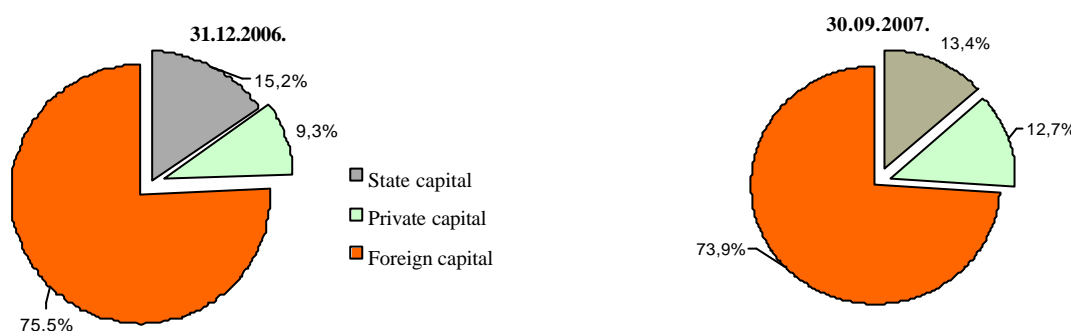
Analyzing participation of state, private and foreign capital in the share capital of banks, we get more precise picture of the capital ownership structure in banks of the Federation of BiH.

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

- in 000 KM-

| SHARE CAPITAL | 31.12.2005. | | 31.12.2006. | | 30.09.2007. | | RATIO | |
|---------------------------------|-------------|-----------|-------------|-----------|-------------|-----------|-------|-----|
| | Amount | Partic. % | Amount | Partic. % | Amount | Partic. % | 5/3 | 7/5 |
| 1 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| State capital | 135.344 | 16,9 | 135.019 | 15,2 | 133.582 | 13,4 | 100 | 100 |
| Private capital (residents) | 103.026 | 12,9 | 83.077 | 9,3 | 126.110 | 12,7 | 81 | 152 |
| Foreign capital (non-residents) | 561.117 | 70,2 | 670.695 | 75,5 | 734.621 | 73,9 | 120 | 110 |
| TOTAL | 799.487 | 100,0 | 888.791 | 100,0 | 994.313 | 100,0 | 111 | 112 |

Graph 2: Ownership structure (share capital)



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

Participation of state capital in total share capital, as of 30.09.2007., was 13,4 % and it was lower by 1,8% if compared to the end of 2006, due to loss coverage in one bank against state capital that afterwards in privatization through additional capitalization changed its ownership structure and became a bank with majority private capital.

If compared to the end of 2006, participation of private capital (residents) in total share capital of the banking sector has increased from 9,3% to 12,7%, that is, by KM 43 million, as a result of the following: share trading between residents and nonresidents (with seven banks) causing decrease by KM 4,1 million as net effect, purchase of shares through additional capitalization in six banks of KM 48,5 million by domestic buyers (of which two banks had „technical issue“ that is increase of share capital of KM 0,8 million from their provisions), upon which the ownership structure in four banks was changed (two with majority state capital and two with majority foreign capital into banks with majority private domestic capital), as well as decrease by KM 1,4 million during integration of two banks in the process of determining ratio for share exchange (provisions increased).

Participation of foreign capital decreased from 75,5% to 73,9%, although its nominal increase was KM 63,9 million as a result of additional capitalization performed in the amount of KM 67

million⁶ in eight banks (three foreign owned banks and five majority owned by residents), of the above mentioned share trading between residents and nonresidents in seven banks (net effect on foreign capital was increase by KM 4,1 million) and decrease of KM 7,2 million in integration process of two banks.

Changes in the ownership structure reflected on participation in share capital, that is, market share and position of banks grouped by majority ownership as criteria. Market share of banks with majority foreign ownership increased by 0,3%, representing 93,3% as of 30.09.2007. Market share of banks with majority domestic private capital was 3,9%, which is higher by 1% if compared to the end of 2006. Participation of state capital decreased from 4,1% to 2,8%.

Integration processes from the past period were performed with purpose of stronger market positioning, resulting by concentrations in the banking sector by largest banks becoming larger, decreased number of banks, and intensified competition. Over the observed period, one integration process has been finalized (status change of integration) as of 31.07.2007., and the other one, planned for the fourth quarter of 2007., was moved to the next year. This caused number of banks to decrease by one, and strengthening of the resulting bank and further concentrations in the banking sector of the Federation of BiH.

Table 3: Market share of banks by ownership type (majority capital)

- in %-

| BANKS | 31.12.2005. | | | 31.12.2006. | | | 30.09.2007. | | |
|--|--------------|--------------------------|-------------------------|--------------|--------------------------|-------------------------|--------------|--------------------------|-------------------------|
| | No. of banks | Partic. in total capital | Partic. in total assets | No. of banks | Partic. in total capital | Partic. in total assets | No. of banks | Partic. in total capital | Partic. in total assets |
| 1 | 2 | 2 | 3 | 7 | 5 | 6 | 10 | 8 | 9 |
| Banks with majority state capital | 6 | 16,4 | 4,5 | 5 | 13,9 | 4,1 | 3 | 10,4 | 2,8 |
| Banks with majority private domestic capital | 6 | 8,0 | 6,5 | 4 | 3,7 | 2,9 | 7 | 11,0 | 4,9 |
| Banks with majority foreign capital | 12 | 75,6 | 89,0 | 14 | 82,4 | 93,0 | 12 | 78,6 | 92,3 |
| TOTAL | 24 | 100,0 | 100,0 | 23 | 100,0 | 100,0 | 22 | 100,0 | 100,0 |

Graph 3: Market share by ownership type



⁶ Amount referring to nonresidents, while the overall increase of share capital based on additional capitalization – issue of shares, including the internal one – from provisioning of KM 1,4 million, amounting to KM 115,2 million in eight banks.

1.3. Staff

As of 30.09.2007., there were total of 7.200 employees employed by banks in the Federation of BiH, of which 5% by banks with majority state capital and 95% by private banks.

Table 4: *Bank employees in the FBiH*

| BANKS | NUMBER OF EMPLOYEES | | | | | | RATIO | |
|-----------------|---------------------|------|-------------|------|-------------|------|-------|-----|
| | 31.12.2005. | | 31.12.2006. | | 30.09.2007. | | 3:2 | 4:3 |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
| State banks | 475 | 8% | 423 | 6% | 350 | 5% | 89 | 83 |
| Private banks | 5.540 | 92% | 6.183 | 94% | 6.850 | 95% | 112 | 111 |
| TOTAL | 6.015 | 100% | 6.606 | 100% | 7.200 | 100% | 110 | 109 |
| Number of banks | 24 | | 23 | | 22 | | | |

Over the three quarters of 2007, number of employees increased by 9% or 594 employees, but only in private banks.

Table 5: *Qualification structure of employees*

| EDUCATION | NUMBER OF EMPLOYEES | | | | | | RATIO | |
|---|---------------------|-------|-------------|--------|-------------|--------|-------|-----|
| | 31.12.2005. | | 31.12.2006. | | 30.09.2007. | | 4:2 | 6:4 |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
| University qualifications | 2.165 | 36,0% | 2.408 | 36,5% | 2.651 | 36,8% | 111 | 110 |
| Two-year post secondary school qualifications | 642 | 10,7% | 714 | 10,8% | 783 | 10,9% | 111 | 110 |
| Secondary school qualifications | 3.102 | 51,6% | 3.391 | 51,3% | 3.684 | 51,2% | 109 | 109 |
| Other | 106 | 1,7% | 93 | 1,4% | 82 | 1,1% | 88 | 88 |
| TOTAL | 6.015 | 100% | 6.606 | 100,0% | 7.200 | 100,0% | 110 | 109 |

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

Table 6: *Assets per an employee*

| BANKS | 31.12.2005. | | | 31.12.2006. | | | 30.09.2007. | | |
|---------|--------------|-----------------|---------------------|--------------|-----------------|---------------------|--------------|-----------------|---------------------|
| | No. of empl. | Assets (000 KM) | Assets per an empl. | No. of empl. | Assets (000 KM) | Assets per an empl. | No. of empl. | Assets (000 KM) | Assets per an empl. |
| State | 475 | 422.680 | 890 | 423 | 474.793 | 1.122 | 350 | 388.044 | 1.109 |
| Private | 5.540 | 8.956.027 | 1.617 | 6.183 | 11.023.562 | 1.783 | 6.850 | 13.230.581 | 1.931 |
| TOTAL | 6.015 | 9.378.707 | 1.559 | 6.606 | 11.498.355 | 1.741 | 7.200 | 13.618.625 | 1.891 |

At the end of third quarter of 2007, there was KM 1,89 million of assets per an employee on the level of the banking system. This indicator is much better with the private bank sector, which is expected, having in mind stagnation or decreased volume of business activities of state banks, and, consequently, excessive number of employees.

Table 7: *Assets per an employee by groups*

| Assets (000 KM) | 31.12.2005. | 31.12.2006. | 30.09.2007. |
|--------------------|-----------------|-----------------|-----------------|
| | Number of banks | Number of banks | Number of banks |
| Up to 500 | 5 | 5 | 3 |
| 500 to 1.000 | 7 | 7 | 8 |
| 1.000 to 1.500 | 3 | 3 | 2 |
| 1.500 to 2.000 | 3 | 1 | 2 |
| Over 2.000 | 6 | 7 | 7 |
| TOTAL | 24 | 23 | 22 |

Analytical indicators of respective banks range from KM 310 thousand to KM 3,8 million of assets per an employee. The indicator of eight banks is better than the one for the whole banking sector, and the indicator for four largest banks in the system exceeds KM 2,5 million. And finally, we could say that conditions under which banks service their customers, both legal entities and citizens, as well as conditions under which banks offer their services and finance their customers, have improved.

2. FINANCIAL INDICATORS OF BANKS' PERFORMANCE

Examination of banks based on reports is performed in the way to use the reports prescribed by the FBA and the reports of other institutions, representing database of three groups of information:

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

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

In accordance with the provisions of Law on Opening Balance Sheet of Banks, banks with majority state owned capital have to report to the FBA “full” balance sheet divided into: passive, neutral and active sub-balance sheet. In order to get realistic indicators of banks' performance in the Federation of BiH, all further analysis of the banking system will be based on the indicators from the active sub-balance sheet of banks with majority state owned capital⁷.

⁷ Some state banks in their “full balance sheet” report passive and neutral items, which will be taken over by the state upon finalization of the privatization process. As of 30.09.2007., these items amounted to KM 618 million.

2.1. Balance sheet

Aggregate balance sheet of banks in the Federation of BiH, according to the balance sheets submitted as of 30.09.2007. amounted to KM 13,6 billion, which is higher by 18% or KM 2,1 billion than at the end of 2006. Growth rate of 15% or KM 1,4 billion was realized in the same period last year.

Table 8: *Balance sheet*

| DESCRIPTION | AMOUNT (in 000 KM) | | | RATIO | |
|--|--------------------|-------------------|-------------------|------------|------------|
| | 31.12.2005. | 31.12.2006. | 30.09.2007. | 3/2 | 4/3 |
| 1 | 2 | 3 | 4 | 5 | 6 |
| ASSETS : | | | | | |
| Cash funds | 3.533.700 | 4.286.202 | 4.952.373 | 121 | 116 |
| Securities ⁸ | 20.010 | 45.922 | 49.908 | 229 | 109 |
| Placements to other banks | 68.811 | 105.390 | 76.976 | 153 | 73 |
| Loans | 5.545.077 | 6.820.154 | 8.282.722 | 123 | 121 |
| Loan loss provisions (LLP) | 260.155 | 288.433 | 315.338 | 111 | 109 |
| Loans – net value (loans minus LLP) | 5.284.922 | 6.531.721 | 7.967.384 | 124 | 122 |
| Business premises and other fixed assets | 306.637 | 341.671 | 368.253 | 111 | 108 |
| Other assets | 164.628 | 187.449 | 203.731 | 114 | 109 |
| TOTAL ASSETS | 9.378.708 | 11.498.355 | 13.618.625 | 123 | 118 |
| LIABILITIES : | | | | | |
| LIABILITIES | | | | | |
| Deposits | 6.864.048 | 8.379.322 | 9.801.571 | 122 | 117 |
| Borrowings from other banks | 2.912 | 2.890 | 2.900 | 99 | 100 |
| Loan Commitments | 1.152.910 | 1.420.944 | 1.727.187 | 123 | 122 |
| Other liabilities | 342.121 | 468.614 | 648.821 | 134 | 138 |
| CAPITAL | | | | | |
| Capital | 1.016.717 | 1.226.585 | 1.438.149 | 121 | 117 |
| TOTAL LIABILITIES (LIABILITIES AND CAPITAL) | 9.378.708 | 11.498.355 | 13.618.625 | 123 | 118 |

Table 9: *Assets of banks by ownership structure*

| BANKS | 31.12.2005. | | 31.12.2006. | | 30.09.2007. | | RATIO | |
|---------------|------------------|-------------|-------------------|-------------|-------------------|-------------|------------|------------|
| | | | | | | | 3/2 | 4/3 |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | |
| State banks | 422.680 | 5% | 474.793 | 4% | 388.044 | 3% | 112 | 82 |
| Private banks | 8.956.028 | 95% | 11.023.562 | 96% | 13.230.581 | 97% | 123 | 120 |
| TOTAL | 9.378.708 | 100% | 11.498.355 | 100% | 13.618.625 | 100% | 123 | 118 |

After longer period of time, we can see some changes in the ownership structure of state banks, that is, two banks, upon additional capitalization being finalized, moved to the group of banks with majority private capital. This has led to a decrease of the state banks' assets by 18% or KM 87 million, so their participation (three banks) in aggregate assets of the banking sector is down to only 3%.

Over the observed period, majority of banks (16) have realized assets growth between 13% and 54% (of which seven relatively smaller banks realized growth higher than 30%).

⁸ Trading securities and securities held to maturity.

Assets growth of the four largest banks in the system ranged from 6% to 20,5%, and the largest bank in the system realized assets growth of 20,5%. Four largest banks in the system make 61% or KM 1,3 billion of total aggregate balance sheet growth of the banking sector.

If the banking system is analyzed from the aspect of assets size and certain groups within that frame, we can see there is still high concentration, that is, participation of four largest banks in the system of 67,8%. There have been some smaller changes within individual groups as for number of banks and their participation, which is the result of assets growth in majority of banks and finalization of integration processes in two banks. It should be pointed out that the assets of three banks exceed KM two billion, while the fourth bank, based on its assets size, is under integration process, which is planned to be finalized in the first quarter of 2008.

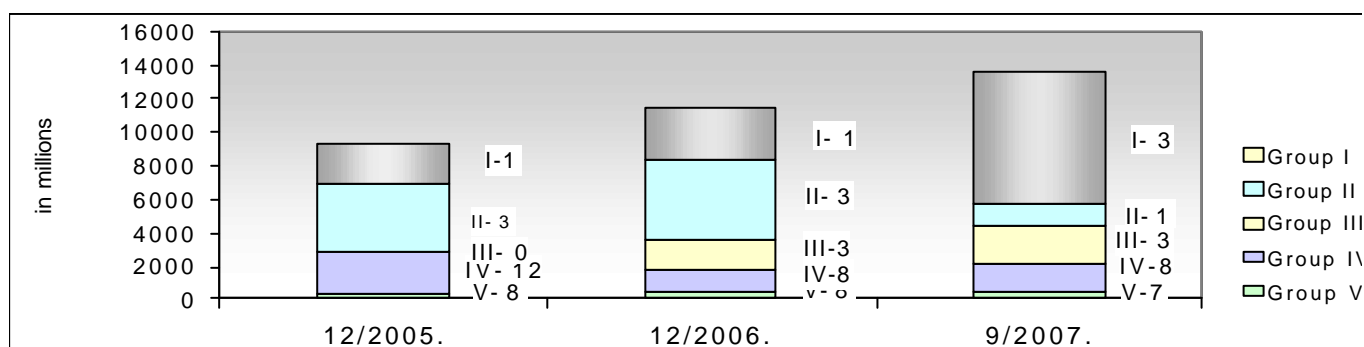
Majority of banks (15), with the assets below KM 500 million, participate with 15,2% in the overall banking system, of which seven banks with the assets below KM 100 million make only 3,1%. It is expected that the status of majority of banks should resolve by the end of 2007, through integration processes with other banks or sale to strategic investors, which will set out the preconditions for their further growth and development. In that regard, certain activities have already been undertaken and are implementing.

The following table presents amounts and participations of individual groups of banks⁹ in total assets in time line (amounts in million KM):

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

| ASSETS | 31.12.2005. | | | 31.12.2006. | | | 30.09.2007. | | |
|------------------|-------------|------------|--------------|-------------|------------|--------------|-------------|------------|--------------|
| | Amount | Particip % | No. of banks | Amount | Particip % | No. of banks | Amount | Particip % | No. of banks |
| I- Over 2.000 | 2.495 | 26,6 | 1 | 3.098 | 26,9 | 1 | 7.877 | 57,8 | 3 |
| II- 1000 to 2000 | 3.996 | 42,6 | 3 | 4.836 | 42,1 | 3 | 1.357 | 10,0 | 1 |
| III- 500 to 1000 | 0 | 0,0 | 0 | 1.723 | 15,0 | 3 | 2.318 | 17,0 | 3 |
| IV- 100 to 500 | 2.504 | 26,7 | 12 | 1.382 | 12,0 | 8 | 1.647 | 12,1 | 8 |
| V- Below 100 | 384 | 4,1 | 8 | 459 | 4,0 | 8 | 420 | 3,1 | 7 |
| TOTAL | 9.379 | 100,0 | 24 | 11.498 | 100,0 | 23 | 13.619 | 100,0 | 22 |

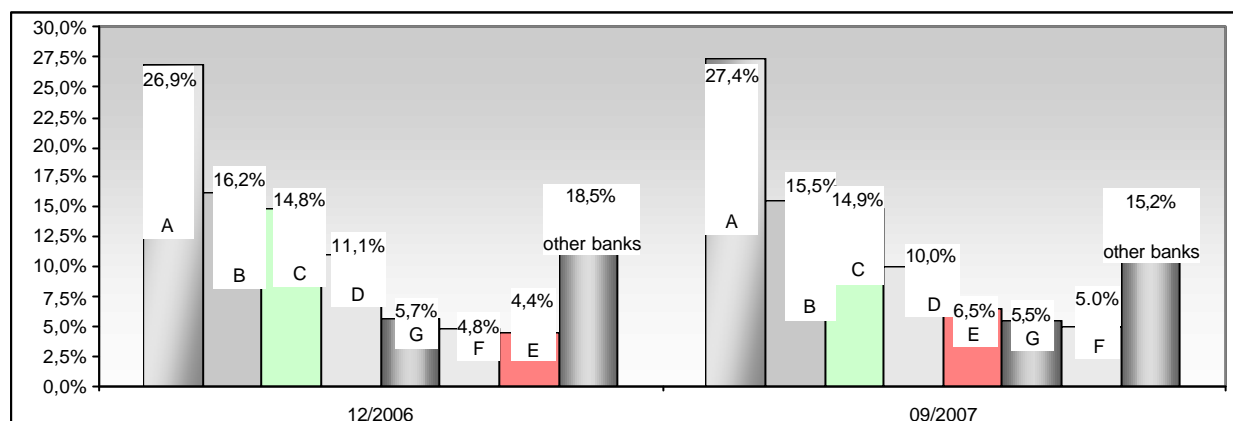
Graph 4 : Participation of individual groups of banks in total assets through periods



The following graph shows structure and trend of participation of seven largest banks¹⁰ in the banking system of the Federation of BiH:

⁹ Banks are divided into five groups, depending on the assets size.

¹⁰ Banks are marked with letters from A to F.

Graph 5 : Participation of seven largest banks in total assets

The aggregate balance sheet growth in sources has been financed mostly from deposit growth (by 17% or KM 1,4 billion), borrowings (by 22% or KM 306 million) and capital (by 17% or KM 212 million).

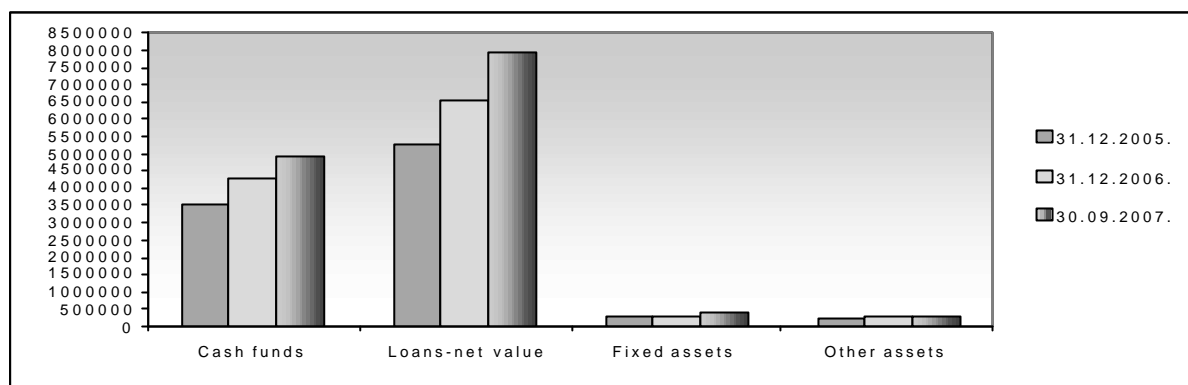
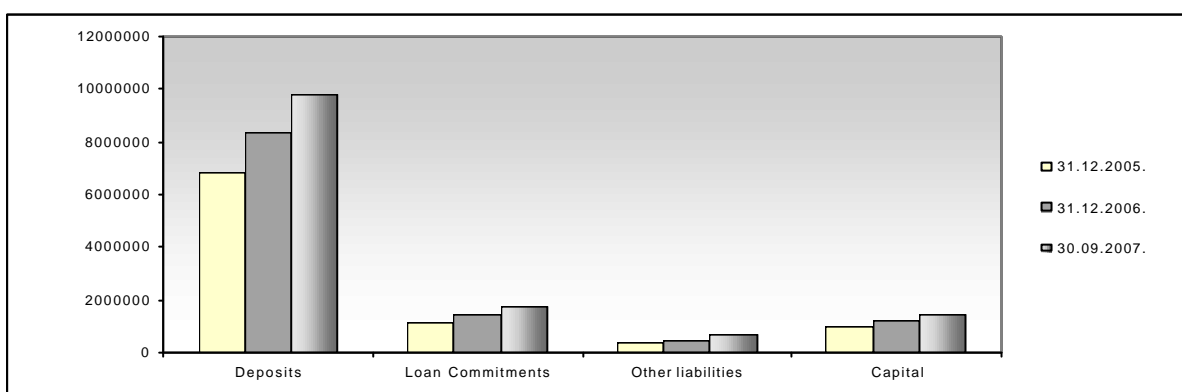
In the assets, cash funds increased by 16% or KM 666 million, and loans by 21% or KM 1,5 billion.

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

Table 11: Structure of balance sheet of banks

- in % -

| DESCRIPTION | PARTICIPATION | | |
|--|---------------|-------------|-------------|
| | 31.12.2005. | 31.12.2006. | 30.09.2007. |
| ASSETS: | | | |
| Cash funds | 37,7 | 37,3 | 36,4 |
| Securities | 0,2 | 0,4 | 0,4 |
| Placements to other banks | 0,7 | 0,9 | 0,6 |
| Loans | 59,1 | 59,3 | 60,8 |
| Loan loss reserves (LLR) | 2,8 | 2,5 | 2,3 |
| Loans- net value (loans minus LLR) | 56,3 | 56,8 | 58,5 |
| Business premises and other fixed assets | 3,3 | 3,0 | 2,7 |
| Other assets | 1,8 | 1,6 | 1,4 |
| TOTAL ASSETS | 100,0 | 100,0 | 100,0 |
| LIABILITIES: | | | |
| LIABILITIES | | | |
| Deposits | 73,2 | 72,9 | 72,0 |
| Borrowings from other banks | 0,0 | 0,0 | 0,0 |
| Loan commitments | 12,3 | 12,3 | 12,7 |
| Other liabilities | 3,7 | 4,1 | 4,7 |
| CAPITAL | | | |
| Capital | 10,8 | 10,7 | 10,6 |
| TOTAL LIABILITIES (LIABILITIES AND CAPITAL) | 100,0 | 100,0 | 100,0 |

Graph 6: Structure of the balance sheet assets of banks**Graph 7:** Structure of the balance sheet liabilities of banks

Similar trend from previous years has continued in the balance sheet liabilities structure of banks, from the aspect of the most significant balance sheet categories, which is the trend of slow downfall in participation of deposits and growth of loan commitments. Deposits in the amount of 9,8 billion and their participation of 72% represent a dominant source of financing.

Smaller changes have occurred in the assets structure. Although in the observed period cash funds increased by 16%, primarily as a result of moderate deposit growth, their participation has decreased from 37,3% to 36,4%. Reason for this is a significant credit growth of 21%, which is mainly financed from deposit and credit sources, so gross loans amounted to KM 8,3 billion with participation of 60,8% as of 30.09.2007.

Table 12: Cash funds of banks

| CASH FUNDS | 31.12.2005. | | 31.12.2006. | | 30.09.2007. | | RATIO | |
|---|------------------|--------------|------------------|--------------|------------------|--------------|------------|------------|
| | Amount | Partic. % | Amount | Partic. % | Amount | Partic. % | 4/2 | 6/4 |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
| Cash | 231.874 | 6,6 | 241.561 | 5,6 | 244.423 | 5,0 | 104 | 101 |
| Reserve accounts with CBBiH | 1.679.194 | 47,5 | 2.258.035 | 52,7 | 2.827.933 | 57,1 | 134 | 125 |
| Accounts with deposit institutions in BiH | 24.241 | 0,7 | 21.354 | 0,5 | 20.594 | 0,4 | 88 | 96 |
| Accounts with deposit institutions abroad | 1.596.932 | 45,2 | 1.764.210 | 41,2 | 1.858.381 | 37,5 | 111 | 105 |
| Cash funds in collection process | 1.459 | 0,0 | 1.042 | 0,0 | 1.042 | 0,0 | 71 | 100 |
| TOTAL | 3.533.700 | 100,0 | 4.286.202 | 100,0 | 4.952.373 | 100,0 | 121 | 116 |

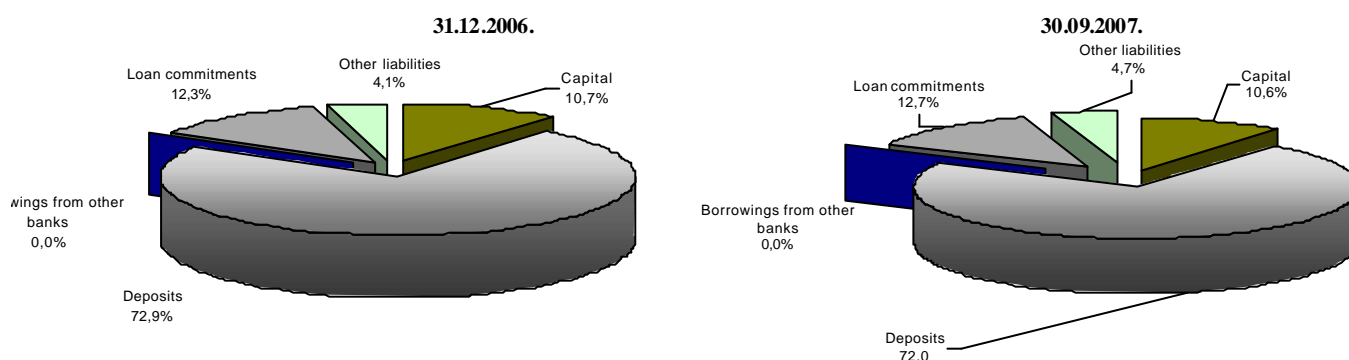
Over the three quarters of 2007, cash funds of banks in the Federation of BiH on the reserve accounts with the Central Bank of BiH increased by 25%, amounting to KM 2,8 billion or 57,1% of total cash funds as of 30.09.2007., which is higher by 4,4% if compared to the end of 2006. Banks held on the accounts with depository institutions abroad total of KM 1,9 billion (most of it in EUR) or 37,5% of total cash funds (41,2% at the end of 2006). Banks' funds held as cash in vaults and tellers amounted to KM 244 million as of 30.09.2007., representing 5% of total cash funds, and if compared to the end of 2006 the absolute amount remained almost the same, while participation decreased by 0,6%.

Currency structure changes in regard to further growth of domestic currency participation has continued in the observed period, that is, participation of domestic currency has increased from 56% to 60,8%, resulting by decrease in participation of funds in foreign currency.

2. 1. 1. Liabilities

Structure of liabilities (liabilities and capital) in the balance sheet of banks as of 30.09.2007. is presented in the following graph:

Graph 8: *Liabilities structure of banks*



Deposit potential in the amount of KM 9,8 billion and participation of 72% are still the most significant source of financing for banks in the Federation of BiH, although there is a slight trend of decrease in their participation (0,9% over the nine months of 2007). Second most important source of financing are credit funds, while banks' indebtedness in the observed period have increased by KM 306 million or 22%. These liabilities of KM 1,7 billion have reached 12,7% of participation in liabilities (0,3% higher than at the end of 2006). If we add up subordinated loans of KM 194 million to these liabilities, which banks have borrowed to strengthen their capital base and capital adequacy, then total credit funds in the sources participate with 14,1%. Significant growth of KM 212 million or 17% was recorded in capital, reaching KM 1,44 billion and participation of 10,6% as of 30.09.2007.

As of 30.09.2007., the highest bank commitments came from following creditors (seven of total 57), representing 73% of total credit commitments: Raiffeisen Zentralbank Osterreich A.G. (RZB), OEWAG Wien, European Investment Bank (EIB), European fund for Southeast Europe (EFSE), ComercBank AG Frankfurt, Bank Polska OPIEKI and International Finance Corporation (IFC).

Over the nine months of 2007, deposits have increased by KM 1,4 billion or 17%, closely reaching the figure of KM 10 billion. As earlier, the increase primarily comes from the private bank sector.

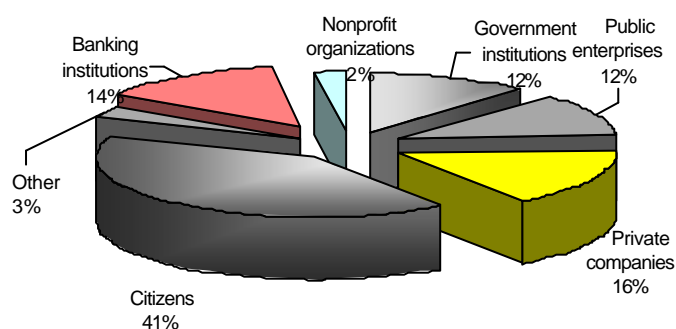
According to the data submitted by banks, out of total deposits only 4,4% were deposits collected by organizational units of banks from the Federation of BiH operating in Republic Srpska and Brcko District as of 30.09.2007.

Table 13: Deposit structure by sectors¹¹

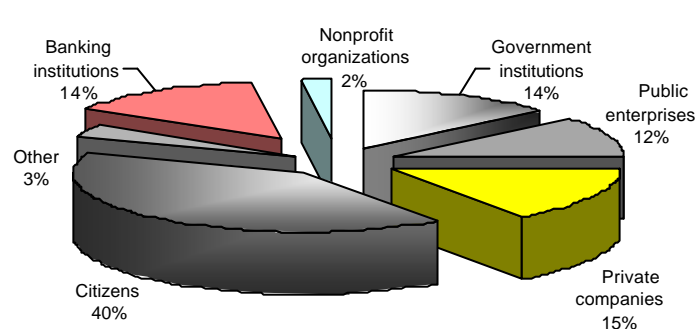
- in 000 KM -

| SECTORS | 31.12.2005. | | 31.12.2006. | | 30.09.2007. | | RATIO | |
|--------------------------------|------------------|--------------|------------------|--------------|------------------|--------------|------------|------------|
| | Amount | Partic. % | Amount | Partic. % | Amount | Partic. % | 4/2 | 6/4 |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
| Governmental institutions | 733.881 | 10,7 | 1.033.902 | 12,3 | 1.351.417 | 13,8 | 141 | 131 |
| Public enterprises | 806.321 | 11,7 | 996.110 | 11,9 | 1.123.404 | 11,5 | 124 | 113 |
| Private enterprises and assoc. | 1.066.022 | 15,5 | 1.342.538 | 16,0 | 1.473.207 | 15,0 | 126 | 110 |
| Non-profit. organizations | 169.005 | 2,5 | 193.009 | 2,3 | 210.826 | 2,2 | 114 | 109 |
| Banking institutions | 1.102.161 | 16,1 | 1.136.450 | 13,6 | 1.374.760 | 14,0 | 103 | 121 |
| Citizens | 2.717.081 | 39,6 | 3.403.443 | 40,6 | 3.942.623 | 40,2 | 125 | 116 |
| Other | 269.577 | 3,9 | 273.870 | 3,3 | 325.334 | 3,3 | 102 | 119 |
| TOTAL | 6.864.048 | 100,0 | 8.379.322 | 100,0 | 9.801.571 | 100,0 | 122 | 117 |

Graph 9: Deposit structure by sectors
31.12.2006.



30.09.2007.



Analysis by sectors shows that citizen deposits with the growth rate of 16% recorded the highest nominal growth of KM 540 million, reaching the amount of KM 3,9 billion and participation of 40,2%. The highest growth rate of 31%, representing nominal growth of KM 317 million, was recorded in government institutions deposits with participation of 13,8%, which made them closer to the sector of banking institutions (participation of 14%) and private companies (15%).

Currency structure of deposits has slightly changed in favor of domestic currency, that is, deposits in foreign currency (dominant participation of EUR) of KM 5,3 billion participated with 54% (55,8% at the end of 2006), while deposits in domestic currency arrived at KM 4,5 billion and participation of 46% (44,2% at the end of 2006).

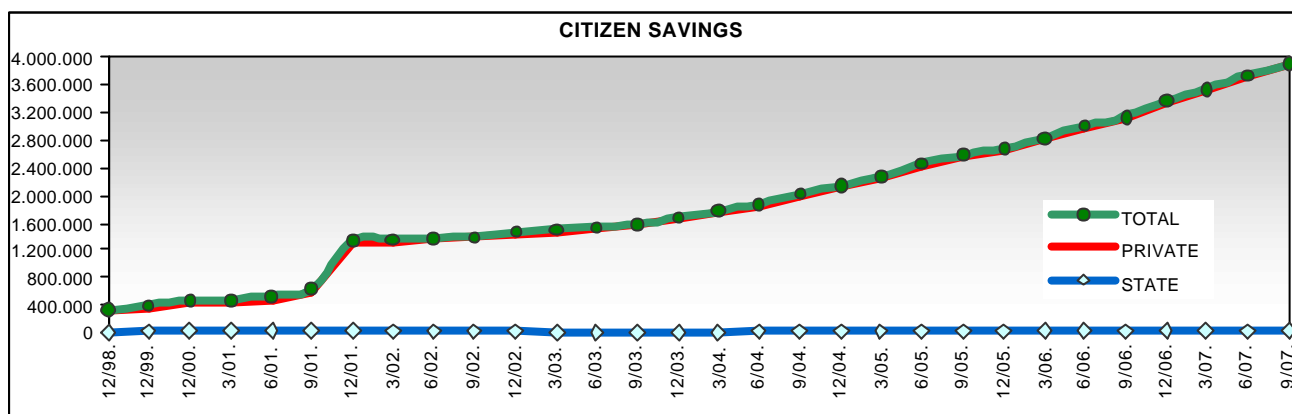
Savings deposits, as the most significant deposit and financial potential of banks, continued with moderate and stable growth in 2007, that is, their increase was 15,7% or KM 524 million, arriving at KM 3,9 billion. Of the overall increase generated, four largest banks in the system make 68% or KM 355 million.

¹¹ Information from the attached form BS-D submitted by banks each quarter with balance sheet - FBA format.

Table 14: New citizen savings by periods

- in 000 KM -

| BANKS | AMOUNT (in 000 KM) | | | RATIO | |
|---------|--------------------|-------------|-------------|-------|-----|
| | 31.12.2005. | 31.12.2006. | 30.09.2007. | 3/2 | 4/3 |
| 1 | 3 | 3 | 4 | 5 | 6 |
| State | 26.886 | 31.723 | 28.251 | 118 | 89 |
| Private | 2.638.391 | 3.308.413 | 3.853.533 | 125 | 116 |
| TOTAL | 2.665.277 | 3.340.136 | 3.863.784 | 125 | 116 |

Graph 10: New citizen savings by periods

As in other segments, there is an obvious strong concentration of savings in larger banks, since four largest banks hold 74,5% of total savings.

Out of total savings, 34% are saving deposits in domestic currency and 66% are saving deposits in foreign currency.

Table 15: Maturity structure of citizen saving deposits by periods

| BANKS | AMOUNT (in 000 KM) | | | RATIO | | | | |
|----------------------|--------------------|-------------|-------------|--------|-----------|---------|-----|-----|
| | 31.12.2005. | 31.12.2006. | 30.09.2007. | 3/2 | 4/3 | | | |
| 1 | 3 | 3 | 4 | 5 | 6 | | | |
| S-T savings deposits | 1.567.617 | 58,8% | 1.851.173 | 55,4% | 2.054.152 | 53,2% | 118 | 111 |
| L-T savings deposits | 1.097.660 | 41,2% | 1.488.963 | 44,6% | 1.809.632 | 46,8% | 136 | 122 |
| TOTAL | 2.665.277 | 100,0% | 3.340.136 | 100,0% | 3.863.784 | 100,0 % | 125 | 116 |

Maturity structure of savings deposits, as well as of the overall deposits, indicates a positive trend of changes, which is the result of permanent improvement of the banking sector's condition and strengthening of its safety and stability. This is especially reflected through the improvement of maturity structure of both savings and total deposits, and the emphasis should be on continuity and high level of growth rate of long term savings deposits, which caused that their participation in total savings deposits is closer to 50%.

Aside from a functional and effective banking supervision conducted by the FBA, deposit insurance system is also of significance for the growth of savings in banks of the FBiH, with their main goal being increase of stability of the banking, that is, financial sector and protection of savers. There is total 14 banks from the Federation of BiH accepted to the deposit insurance program, and according to the submitted data, there is total 96% of total deposits and 98% of total savings deposited in these banks. As for remaining banks, six of them cannot

apply to be accepted since they do not qualify with the criteria prescribed by the Deposit Insurance Agency: three state owned due to their ownership structure, one private banks with participation of state capital exceeding 10%, and two private banks under provisional administration, while two banks (a new bank that started operating as of October 2006 and one in which, after additional capitalization, provisional administration was terminated in July 2007) has to initiate the procedure to be accepted to the insurance program.

2.1.2. Capital – strength and adequacy

Capital¹² of banks in the FBiH, as of 30.09.2007., amounted to KM 1,7 billion.

Table 16: Regulatory capital

-in 000 KM-

| DESCRIPTION | 31.12.2005. | 31.12.2006. | 30.09.2007. | RATIO | |
|----------------------------------|-------------|-------------|-------------|-------|-----|
| | | | | 3/2 | 4/3 |
| 1 | 2 | 3 | 4 | 5 | 6 |
| STATE BANKS | | | | | |
| 1. Core capital before reduction | 166.737 | 169.829 | 145.588 | 102 | 86 |
| 2. Offsetting items | 4.200 | 5.034 | 1.585 | 120 | 31 |
| a) Core capital (1-2) | 162.537 | 164.795 | 144.003 | 96% | 87 |
| b) Additional capital | 7.107 | 9.370 | 3.202 | 4% | 34 |
| c) Capital (a + b) | 169.644 | 174.165 | 147.205 | 100% | 85 |
| PRIVATE BANKS | | | | | |
| 1. Core capital before reduction | 828.196 | 1.029.002 | 1.237.243 | 124 | 120 |
| 2. Offsetting items | 98.341 | 104.704 | 109.905 | 106 | 105 |
| a) Core capital (1-2) | 729.855 | 924.298 | 1.127.338 | 72% | 122 |
| b) Additional capital | 290.758 | 374.448 | 463.816 | 28% | 124 |
| c) Capital (a + b) | 1.020.613 | 1.298.746 | 1.591.154 | 100% | 123 |
| Total | | | | | |
| 1. Core capital before reduction | 994.933 | 1.198.831 | 1.382.831 | 120 | 115 |
| 2. Offsetting items | 102.541 | 109.738 | 111.490 | 107 | 102 |
| a) Core capital (1-2) | 892.392 | 1.089.093 | 1.271.341 | 75% | 117 |
| b) Additional capital | 297.865 | 383.818 | 467.018 | 25% | 122 |
| c) Capital (a + b) | 1.190.257 | 1.472.911 | 1.738.359 | 100% | 118 |

Over the observed period of 2007, capital¹³ increased by 18% or KM 265,4 million, of which core capital increased by 17% or KM 182,2 million, and supplementary capital by 22% or KM 83,2 million.

Growth of core capital primarily comes from the reallocated profit of 2006. Upon implementation of the official procedure for adoption of decision on allocation of audited profit by the assembly, profit generated in 2006 (17 banks) in the amount of KM 95,3 million was allocated 85% to core capital (reserves or retained-undivided profit). Five banks adopted decision to pay out dividend in total amount of KM 14 million, which is approximately 15% of the profit generated on the banking system level.

Increase of the core capital, apart from the above mentioned, has been significantly influenced by the increase of share capital based on the inflow of new, green capital – additional capitalization of KM 109,8 million in six banks, and one additional capitalization resulted by surplus over the issue value of KM 3,8 million. At the same time, share capital of one bank has decreased throughout the status change by KM 8,6 million, and capital provisions of the resulting bank have increased by the same amount.

¹² Regulatory capital is defined by Article 8 and 9 in the Decision on Minimum Standards for Managing Capital

¹³ Data source is quarterly Report on Capital Positions in Banks (Form I-Schedule A) regulated by the Decision on Minimum Standards for Managing Capital in Banks.

Offsetting items (causing decrease of core capital) have increased by KM 1,8 million (five banks covered their losses in total amount of KM 4,5 million, current loss was KM 4 million, and intangible assets increased by KM 2,3 million).

Supplementary capital increased by KM 83,2 million, along with some more significant changes in the structure: profit from 2006 of KM 85,7 million was transferred to core capital, and two banks included their current audited profit of KM 32,2 million in the supplementary capital, while the following supplementary capital items have increased: subordinated debts by KM 55,1 million (four banks), liabilities of permanent nature in one bank of KM 45 million, and general loan loss provisions by KM 36,6 million.

The mentioned changes influenced the structure of regulatory capital, so participation of core capital decreased from 74% to 73%, and supplementary capital increased from 26% to 27%.

Increase of regulatory capital of 18% positively reflected on net capital, which over the three quarters of 2007 has also increased by 18% or KM 266,6 million, amounting to KM 1,7 million as of 30.09.2007.

Capitalization rate of banks, expressed as ratio between capital and assets as of 30.09.2007., was 12,5%, at the same level as at the end of 2006.

One of the most significant indicators of capital strength and adequacy¹⁴ of banks is capital adequacy ratio calculated as ratio between net capital and risk weighted assets. As of 30.09.2007., this ratio at the system level was 17,1%, which is lower by 0,5% than at the end of 2006. This is not a significant downfall, and it was expected due to the following two reasons: higher growth rates of risk assets (22%) than net capital (18%), and calculation methodology for capital adequacy during the year, that is, the current profit generated not being included. If the unaudited profit for the nine months of 2007 is included in the calculation, capital adequacy would be 18%.

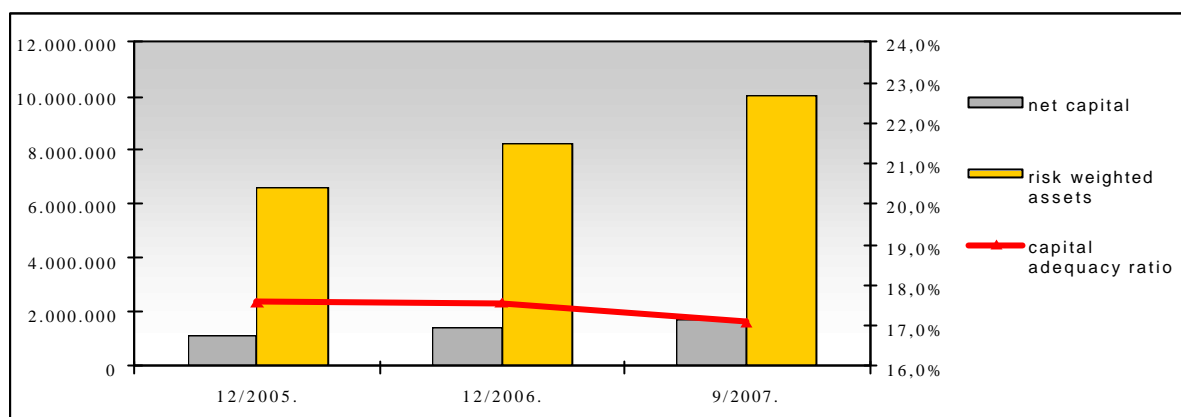
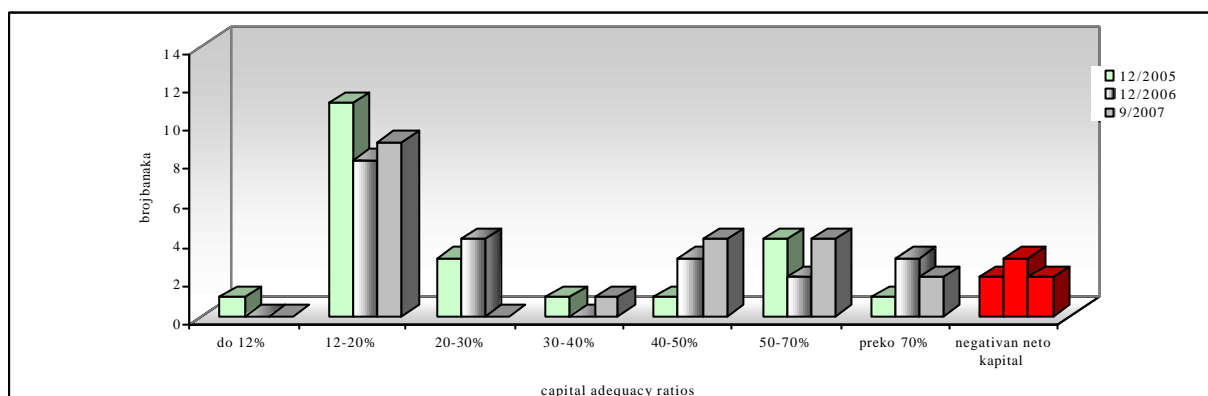
While conducting supervision of operations and financial positions of banks in the FBiH as regulated by the Law, the FBA has been issuing orders to banks to undertake actions for strengthening of capital base and provision of adequate capital in order to strengthen safety in banks individually and in the entire banking system, according to the level and profile of existing and potential exposure to all risks relevant to the banking operation.

Table 17: *Net capital, risk weighted assets and capital adequacy rate*

- 000 KM -

| DESCRIPTION | 31.12.2005. | 31.12.2006. | 30.09.2007. | RATIO | |
|---|-------------|-------------|-------------|-------|-----|
| | | | | 3/2 | 4/3 |
| 1 | 2 | 3 | 4 | 5 | 6 |
| NET CAPITAL | 1.173.022 | 1.455.675 | 1.722.323 | 124 | 118 |
| RISK WEIGTHED ASSETS AND CREDIT EQUIVALENTS | 6.681.510 | 8.282.086 | 10.066.842 | 124 | 122 |
| NET CAPITAL RATE (CAPITAL ADEQUACY) | 17,6% | 17,6% | 17,1% | 100 | 97 |

¹⁴ The Law prescribes minimum capital adequacy rate of 12%.

Graph 11: Net capital, risk weighted assets and capital adequacy rate**Graph 12:** Capital adequacy rate of banks

Of total 22 banks in the FBiH as of 30.09.2007., 20 banks had capital adequacy ratio higher than minimum prescribed by the law of 12%, and two banks, under provisional administration, had capital adequacy ratio below 12%, that is, negative adequacy ratio.

Preview of capital adequacy ratios of 20 banks in comparison to the minimum prescribed by the law of 12% is the following:

- Nine banks with the rate between 12,5% and 20%, and four largest banks from 12,6% to 15,8%,
- Five banks with the rate between 21% and 50%,
- Four banks have rate between 51% and 70%,
- Two banks have rate higher than 70%.

Further strengthening of capital base will be priority task in majority of banks, especially in the largest banks of the system, which is necessary to strengthen stability and safety of both banks and the banking system. Following bank expansion and performing regular supervision of this segment, when acting towards banks, depending on the evaluation of their capital adequacy and risk profile, the FBA takes different corrective and supervisory measures, such as: adoption of strategy to maintain certain level of capital and plan which will provide for quantity and quality (structure) of that capital in accordance with the nature and complexity of bank's present and future business activities and undertaken and potential risk, then intensified supervision and monitoring of bank, request to supply additional capital in order to strengthen capital base, limitation and decrease of credit risk exposure with some concentrations, monitoring of capital plan implementation, especially for additional capital supplied from

external resources, supervision of compliance and implementation of the ordered measures, etc.

All of the mentioned has contributed to the improvement of this segment, which is an assurance of stability and safety of the banking and overall financial system.

2.1.3. Assets and assets quality

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

Total assets with off-balance sheet items (assets)¹⁵ of banks in the FBiH, as of 30.09.2007., amounted to KM 16,3 billion, which is higher by 20% than at the end of 2006.

Gross assets¹⁶ of the balance sheet amounted to KM 13,9 billion, which is higher by 18% or KM 2,1 billion than at the end of 2006. Off-balance sheet risk items amounted to KM 2,4 billion, representing an increase of 29% or KM 525 million.

Table 18: *Assets, off-balance sheet items and potential loan losses*

-in 000 KM-

| DESCRIPTION | AMOUNT (in 000 KM) | | | | | | RATIO | |
|--|--------------------|--------------|-------------------|--------------|-------------------|--------------|------------|------------|
| | 31.12.2005. | Struct. % | 31.12.2006. | Struct. % | 30.09.2007. | Struct. % | 4:2 | 6:4 |
| 1. | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
| Loans | 5.326.900 | 55,2 | 6.609.302 | 56,0 | 8.044.575 | 57,7 | 124 | 122 |
| Interests | 37.531 | 0,4 | 36.210 | 0,3 | 49.025 | 0,4 | 96 | 135 |
| Past due claims | 214.045 | 2,2 | 206.720 | 1,8 | 234.212 | 1,7 | 97 | 113 |
| Claims for paid guarantees | 4.132 | 0,0 | 4.132 | 0,0 | 3.935 | 0,0 | 100 | 95 |
| Other placements | 23.950 | 0,2 | 47.739 | 0,4 | 59.742 | 0,4 | 199 | 125 |
| Other assets | 4.050.650 | 42,0 | 4.893.407 | 41,5 | 5.554.790 | 39,8 | 121 | 114 |
| TOTAL ASSETS | 9.657.208 | 100,0 | 11.797.510 | 100,0 | 13.946.279 | 100,0 | 122 | 118 |
| OFF-BALANCE SHEET | 1.391.183 | | 1.826.980 | | 2.352.026 | | 131 | 129 |
| ASSETS WITH OFF-BALANCE SHEET | 11.048.391 | | 13.624.490 | | 16.298.305 | | 123 | 120 |
| RISK ASSETS WITH OFF-BALANCE SHEET | 7.091.338 | | 8.871.314 | | 10.913.673 | | 125 | 123 |
| General loan risk and Potential loan losses | 313.873 | | 343.737 | | 387.159 | | 110 | 113 |
| General and Special loan loss reserves already established | 314.175 | | 345.067 | | 387.322 | | 110 | 112 |

Non-risk items amount to KM 5,4 billion or 33% of total assets with off-balance sheet, and they increased by 13% if compared to the end of 2006, which is primarily the result of the cash funds increase. On the other hand, risk assets with off-balance sheet items amount to KM 10,9 billion and they increased by 23% or KM 2 billion over the nine months of 2007.

Credit placements¹⁷, if compared to 2006, increased by 21% or KM 1,46 billion, arriving at KM 8,3 billion and participation of 60,8%. Past-due claims increased by 13%, and their participation in the assets structure decreased from 1,8% to 1,7%.

¹⁵ Assets defined by Article 2 of Decision on Minimum Standards for Loan Risk Management and Assets Classification of Banks.

¹⁶ Data source: Report on classification of balance sheet assets and off-balance sheet items of banks.

¹⁷ Short term and long term loans, past due claims and claims based on paid-called for payment guarantees.

Four largest banks in the FBiH increased their credit placements by KM 908 million, representing 62% of the overall increase on the banking system level. As of 30.09.2007., four largest banks with their credits amounting to KM 5,76 billion have participation of 70% of total loans on the system level.

In 2007, banks have continued with intensive lending to citizens, so the placements to this sector recorded the highest increase of KM 781 million or 22%, which has increased their participation from 50,9% to 51,3%. Slightly lower growth of 20% or KM 611 million was recorded by loans to private companies, while their participation decreased from 44,4% to 44%. According to the data submitted by banks, as of 30.09.2007., from the aspect of citizen loan structure by purpose, the highest participation of approximately 70% had loans originated to finance consumer goods¹⁸, 24% had housing loans, and remaining 6% had loans for SMEs and agriculture.

Other sectors recorded smaller changes in both nominal and relative amount.

Four largest banks in the system financed 69% of total loans originated to citizens, which is lower by 3% if compared to the end of 2006, while the same indicator for the private company sector is 71%, which is lower by 1% if compared to the end of 2006.

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

Table 19: *Structure of loans by sectors*

-in 000 KM-

| SECTORS | 31.12.2005. | | 31.12.2006. | | 30.09.2007. | | RATIO | |
|--------------------------------|------------------|--------------|------------------|--------------|------------------|--------------|------------|------------|
| | Amount | Partic. % | Amount | Partic. % | Amount | Partic. % | 4/2 | 6/4 |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
| Government institutions | 35.513 | 0,6 | 27.084 | 0,4 | 29.599 | 0,4 | 76 | 109 |
| Public enterprises | 188.143 | 3,4 | 192.394 | 2,8 | 211.178 | 2,5 | 102 | 110 |
| Private enterprises and assoc. | 2.446.358 | 44,1 | 3.029.964 | 44,4 | 3.640.867 | 44,0 | 124 | 120 |
| Non-profit organizations | 9.276 | 0,2 | 18.088 | 0,3 | 19.395 | 0,2 | 195 | 107 |
| Banking institutions | 33.123 | 0,5 | 28.445 | 0,4 | 24.043 | 0,3 | 86 | 85 |
| Citizens | 2.784.053 | 50,2 | 3.471.829 | 50,9 | 4.252.549 | 51,3 | 125 | 122 |
| Other | 48.611 | 1,0 | 52.350 | 0,8 | 105.091 | 1,3 | 108 | 201 |
| TOTAL | 5.545.077 | 100,0 | 6.820.154 | 100,0 | 8.282.722 | 100,0 | 123 | 121 |

Currency structure of loans has also been unchanged for longer period: loans financed with currency clause had the highest participation of 72% or KM 6 billion, and then loans in domestic currency of 25% or KM 2,1 billion, and loans in foreign currency had smallest participation of only 3% or KM 241 million.

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

¹⁸ Including card based operations.

Quality of assets and off-balance sheet risk items, general loan risk, potential loan losses by classification categories¹⁹ and off-balance sheet items are presented in the following table:

Table 20: *Assets classification, general loan risk (GLR), potential loan losses (PLL) and off-balance sheet items (assets charged off and suspended interest)*

- 000 KM -

| Classification category | AMOUNT (in 000 KM) AND PARTICIPATION (in %) | | | | | | | | | RATIO | |
|------------------------------------|---|-----------|---------|-----------------|-----------|---------|-----------------|-----------|---------|-------|-----|
| | 31.12.2005. | | | 31.12.2006. | | | 30.09.2007. | | | 5/2 | 8/5 |
| | Assets classif. | Partic. % | GLR PLL | Assets classif. | Partic. % | GLR PLL | Assets classif. | Partic. % | GLR PLL | | |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 |
| A | 5.943.367 | 83,8 | 118.864 | 7.513.553 | 84,7 | 150.390 | 9.335.155 | 85,5 | 186.803 | 126 | 124 |
| B | 831.403 | 11,7 | 62.512 | 1.073.906 | 12,1 | 79.451 | 1.303.827 | 11,9 | 95.948 | 129 | 121 |
| C | 157.310 | 2,2 | 41.915 | 147.718 | 1,7 | 36.574 | 158.717 | 1,5 | 39.222 | 94 | 107 |
| D | 159.224 | 2,3 | 90.551 | 135.980 | 1,5 | 77.181 | 115.893 | 1,1 | 65.166 | 85 | 85 |
| E | 34 | 0,0 | 31 | 157 | 0,0 | 141 | 81 | 0,0 | 20 | 462 | 52 |
| Risk assets (A-E) | 7.091.338 | 100,0 | 313.873 | 8.871.314 | 100,0 | 343.737 | 10.913.673 | 100,0 | 387.159 | 125 | 123 |
| Nonrisk assets²⁰ | 3.957.053 | | | 4.753.176 | | | 5.384.632 | | | 120 | 113 |
| TOTAL | 11.048.391 | | | 13.624.490 | | | 16.298.305 | | | 123 | 120 |
| OFF-BALANCE SHEET ITEMS | | | | | | | | | | | |
| E | 385.601 | 87,6 | | 409.108 | 89,7 | | 426.192 | 90,2 | | 106 | 104 |
| Suspended interest | 54.426 | 12,4 | | 46.546 | 10,3 | | 46.550 | 9,8 | | 86 | 100 |
| TOTAL | 440.027 | 100,0 | | 455.654 | 100,0 | | 472.742 | 100,0 | | 104 | 104 |

Risk assets with off-balance sheet items (A-E) amount to KM 10,9 billion. They increased by 23% or KM 2 billion. Non-risk items amount to KM 5,4 billion. They increased by 13% if compared to the end of 2006, which is primarily the result of the cash funds increase.

If quality of risk assets is analyzed, we can see there is still increase of classified assets (B-E) by 16% or KM 221 million, exclusively due to the growth of special mentioned placements (category B) by 21% or KM 230 million, so as of 30.09.2007., category B reached KM 1,3 billion, and classified assets KM 1,6 billion. Only poor quality assets (C-E) were lower by 3% or KM 9 million, amounting to KM 275 million at the end of third quarter of 2007. However, we have to say that in the same period the charged off assets (write off to the off-balance sheet) were KM 79 million. The assets quality indicators expressed as ratio, that is, participation of individual categories in risk assets have insignificantly changed to slightly better, as a result of the above mentioned. The ratio of classified assets and risk assets, if compared to the end of 2006, was lower by 0,8%, amounting to 14,5%, due to slightly faster growth of risk assets (23%) than classified assets (16%).

If we analyze the ratio and trend of only poor quality assets and risk assets, this ratio as of 30.09.2007. was 2,5%, which is relatively low ratio, but it has improved by 0,7% if compared to the end of 2006. However, if we take into account the increase of category B of 21% and its participation of 12% in the risk assets, expressing doubt that portion of placements reported under this category have worst quality and should be placed under the category of poor quality assets, that is, some banks practice not to timely establish adequate loan loss provisioning, we

¹⁹ 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 categories: A 2%, B 5% to 15%, C 16% to 40%, D 41% to 60% and E 100%.

²⁰ Assets items that are not, according to Article 22, Paragraph 7 of Decision on Minimum Standards for Bank Credit Risk and Assets Classification Management, subject to accrual of general loan loss provisions of 2%.

could make conclusion there is a slight trend of deterioration in the assets quality. That is why it is of key importance that banks more realistically evaluate the quality of placements and establish adequate loan loss reserves, especially for the fact that these are new loans with long maturity (especially citizen loans), so the issues related to the assets quality have not been timely detected, that is, they are in some way hidden through the highest increase of category B.

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

As of 30.09.2007., of total loans granted to legal entities in the amount of KM 4 billion, KM 1,1 billion or 26,2% were classified in the categories B to E (KM 950 million or 28,4% at the end of 2006), while of total loans granted to citizens in the amount of KM 4,3 billion, KM 243 million or 5,7% were classified in the categories B to E (KM 178 million or 5,1% at the end of 2006).

Poor quality assets granted to legal entities amount to KM 182 million or 4,5% of total loans granted to this sector (KM 206 million or 6,1% as of 31.12.2006.). Poor quality loans granted to citizens amount to KM 83 million or 2% of total loans granted to this sector (KM 69 million or 2% as of 31.12.2006.).

Although there is a trend of improvement in the two loan quality indicators observed (legal entities), while fairly deteriorated indicator of classified loans to total loans was noted with the loans granted to citizens, in order to get some more realistic assessment we should also take into account the amount of loans that banks, over the observed period, have charged off in the off-balance sheet. Over the nine months of 2007, banks charged off claims (primarily loans) of KM 71 million (citizen loans of KM 18,7 million) and suspended interest of KM 8 million (citizens KM 3,6 million). In the same period, there was also permanent charge off of the assets items of KM 10,6 million and suspended interest of KM 1,1 million. Banks succeeded in the same period to collect earlier charged off assets of KM 34 million and KM 5,5 million of suspended interest, which has positively reflected on their profitability.

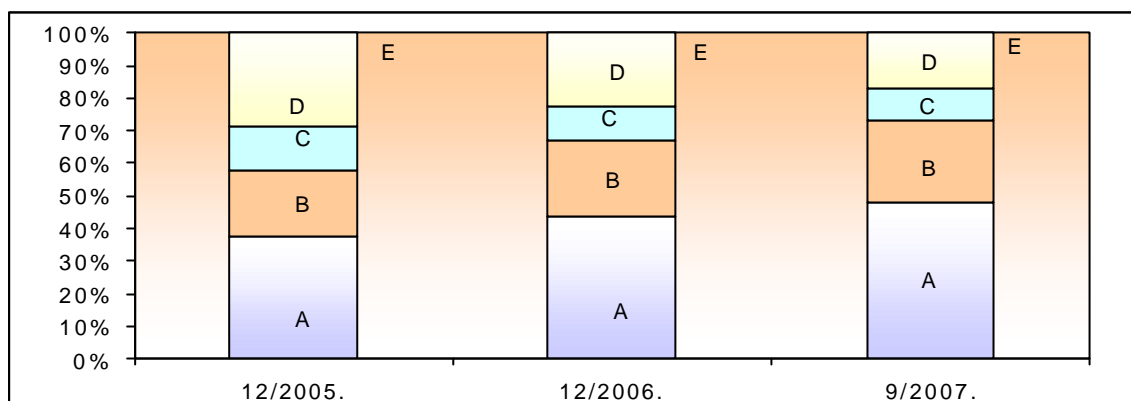
As of 30.09.2007., balance of the charged off assets was KM 426 million, representing an increase of 4% if compared to the end of 2006., while the balance of suspended interest was KM 47 million, which is at the same level as 2006.

Level of general loan risk and potential loan losses by classification categories, as determined in accordance with the criteria and methodology prescribed by the FBA's Decisions, their trend and structure on the level of banking sector are presented in the following table and graph.

Table 21: *Structure and trend of general loan risk and potential loan losses*

- 000 KM -

| Classification categories | AMOUNT (in 000 KM) AND STRUCTURE (in%) | | | | | | RATIO | |
|---------------------------|--|--------------|----------------|--------------|----------------|--------------|------------|------------|
| | 31.12.2005. | | 31.12.2006. | | 30.09.2007. | | 4/2 | 6/4 |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
| A | 118.884 | 37,9 | 150.390 | 43,8 | 186.803 | 48,2 | 127 | 124 |
| B | 62.517 | 19,9 | 79.451 | 23,1 | 95.948 | 24,8 | 127 | 121 |
| C | 41.954 | 13,4 | 36.574 | 10,6 | 39.222 | 10,2 | 87 | 107 |
| D | 90.465 | 28,8 | 77.181 | 22,5 | 65.166 | 16,8 | 85 | 84 |
| E | 31 | 0,0 | 141 | 0,0 | 20 | 0,0 | 455 | 14 |
| TOTAL | 313.851 | 100,0 | 343.737 | 100,0 | 387.159 | 100,0 | 110 | 113 |

Graph 13: Structure and trend of general loan risk and potential loan losses

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

Based on the analysis of the established provisions, in total amount and by classification categories, if compared to the end of 2006, general loan risk and potential loan loss provisions are higher by 13%, amounting to KM 387 million, that is 3,5% of risk assets with off-balance sheet, which is lower by 0,4% if compared to the end of 2006. As of 30.09.2007., banks in average allocated for category B 7,4%, for category C 24,7%, category D 56,2% and E 100%.

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

The FBA has ordered corrective measures to those banks whose assets quality was rated poor by the examination in sense of preparation of the operating program that has to contain action plan aimed to improve existing practices for loan risk management, that is, assets quality management, decrease of existing concentrations and resolution of the poor quality assets issue and prevention of their further deterioration. Implementation of the FBA's orders is continuously monitored in the follow-up procedure based on reports and other documentation submitted by banks, which are checked through targeted on-site examinations.

Transactions with related entities

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

In accordance with the Basle Standards, the FBA has established certain prudential principles and requirements related to transactions with related entities of banks²¹, which is regulated in Decision on Minimum Standards for Bank's Operations with Related Entities, prescribing requirements and method of operations with related entities. The Decision and Law on Banks regulate the duty of Supervisory Board of a bank, which has to adopt, upon the proposal of the

²¹ Article 39, Paragraph 2 of Law on Changes and Amendments to the Law on Banks defines term "entities related to a bank", excluding employees from this list.

General Manager, special policies regulating operations with related entities and to monitor their implementation.

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

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

Table 22: *Transactions with related entities*

-000 KM -

| Description | LOANS GRANTED | | | RATIO | |
|---|---------------|-------------|-------------|-------|-----|
| | 31.12.2005. | 31.12.2006. | 30.09.2007. | 3/2 | 4/3 |
| 1 | 2 | 3 | 4 | 5 | 6 |
| Shareholders over 5% of voting rights, subsidiaries and other enterprises related to a bank through capital | 28.520 | 21.333 | 35.899 | 75 | 168 |
| Supervisory Board members | 101 | 38 | 106 | 39 | 279 |
| Bank Management and employees | 2.663 | 1.962 | 2.283 | 74 | 116 |
| TOTAL | 31.284 | 23.333 | 38.288 | 75 | 164 |
| Potential and undertaken off-balance sheet liabilities | 911 | 1.072 | 1.886 | 118 | 176 |

Although in the three quarters of 2007, credit exposure of banks towards related entities has increased (loans of 64% or KM 15 million, and potential and undertaken off-balance sheet liabilities by 76% or KM 0,8 million), based on reporting data we can conclude this would be a small amount of loans granted to legal entities, and in general level of risk is low. The FBA pays a special attention (in on-site examinations) to banks' operations with related entities. The FBA on-site examiners issue orders for elimination of determined weaknesses within certain deadlines and initiate violation procedures, and part of the activity is also to monitor and supervise implementation of the issued orders in follow up procedure. This has had a positive influence on this segment of operations, since the risk management quality has improved, level of transactions with related entities has decreased, causing decrease in risk exposure to these entities.

2.2. Profitability

According to the income statement data, banks in the Federation of BiH, over the nine months of 2007, reported positive financial result/profit in the amount of KM 113,4 million, representing a significant increase on the system level of 55% or KM 40,2 million if compared to the same period in 2006, and arriving at 28% of profit generated in 2006.

Positive financial result of KM 117,4 million was generated by 18 banks, which is higher by 46,8% or KM 37,4 million than in the same period in 2006. At the same time, performance loss of KM 4,0 million was reported by four banks, which is lower by 41,4% or KM 2,8 million if compared to the same period in 2006.

More detailed information is presented in the following table:

Table 23: *Financial result reported: profit/loss*

-000 KM-

| Date/Description | Banking system | | Private banks | | State banks | |
|------------------|----------------|-----------------|---------------|----|-------------|-----------------|
| | Amount | Number of banks | Amount | | Amount | Number of banks |
| 30.09.2005. | | | | | | |
| Loss | -6.559 | 6 | -5.716 | 3 | -843 | 3 |
| Profit | 68.127 | 18 | 64.569 | 15 | 3.558 | 3 |
| Total | 61.568 | 24 | 58.853 | 18 | 2.715 | 6 |
| 30.09.2006. | | | | | | |
| Loss | -6.844 | 6 | -5.210 | 4 | -1.634 | 2 |
| Profit | 79.956 | 16 | 76.572 | 13 | 3.384 | 3 |
| Total | 73.112 | 22 | 71.362 | 17 | 1.750 | 5 |
| 30.09.2007. | | | | | | |
| Loss | -4.008 | 4 | -4.008 | 4 | - | - |
| Profit | 117.395 | 18 | 112.489 | 15 | 4.906 | 3 |
| Total | 113.387 | 22 | 108.481 | 19 | 4.906 | 3 |

Similar to other segments, there are concentrations in this segment too: of total profit generated (KM 117,4 million) 75,1% or KM 88,1 million was generated by four largest banks in the system, with 67,8% of assets participation in the system; while total loss (KM 4,0 million) was reported by four primarily small private banks (of which one under provisional administration) with only 2,3% of assets participation in the system. Financial results of state banks do not have any significant influence on the overall profitability of the banking sector.

Based on analytical data, as well as parameters for evaluation of profitability quality (level of realized financial result – profit/loss and ratios used for evaluation of profitability, productivity and effectiveness of performance, and other parameters related to evaluation of performance), we can conclude that improvement of the general profitability of the system comes from the overall increasing trend and stabilization of the banking sector.

Total income realized on the system level was KM 592,9 million with the growth rate of 21% or KM 103,8 million. Total noninterest bearing expenses amount to KM 479,5 million with growth rate of 15% or KM 63,6 million, which has positively reflected on the overall financial result of the sector.

If we analyze the structure of total income and changes in the most significant categories, we may conclude that participation of net interest income is still increasing, representing 62,8% of total income (57,7% in same period of 2006), while participation of operating income has decreased from 42,3% to 37,2%.

Total interest income amount to KM 603,2 million, and if compared to the same period last year, it has increased by 34% or KM 153,2 million. In the total income structure, their participation increased from 92% to 101,7%. Positive trend is the result of faster growth of interest income than the growth of average interest bearing assets, that is, a continuous growth of credit placements and their relatively good quality, improvement in practices of free cash funds management and, based on that, significant growth of interest rates on funds with depository institutions, as well as implementation of the IAS 18 provisions.

On the other hand, if compared to the growth rate of interest income, interest expenses recorded faster growth, that is, the rate of 37%, amounting to KM 230,9 million. In addition, their participation in the structure of overall income increased from 34,4% to 38,9% if compared to the same period last year. Interest expenses had faster growth as a result of

continuous growth of credit commitments (primarily foreign indebtedness) and term deposits, as well as trend of growth in interest rates on deposits and borrowings.

Due to faster growth interest expenses, net interest income of KM 372,3 million had slightly lower growth rate (32% or KM 90,3 million) than interest income. However, their participation in the structure of total income has increased from 57,7% to 62,8%.

Growth of the interest income participation in total income of banks is a positive indicator of the increasing trend and stability of earnings, since banks now realize more profit from their core activity, that is, their lending activity.

Operating income amount to KM 220,6 million and their growth was slower than net interest income, that is, they increased by 7% or KM 13,6 million if compared to the same period last year, and their participation in the structure of total income decreased from 42,3% to 37,2%. The growth rate of operating income was significantly influenced by decrease of fee income, as a result of changes in the accounting policies in the segment of treatment and recognition methodology for fee income related to loans (applied on all banks as of the end of 2006).

Positive trend is noted with total noninterest bearing expenses amounting to KM 479,5 million, which, if compared to the same period last year, increased by 15% or KM 63,6 million. At the same time, their participation in the structure of total income decreased from 85,1% to 80,9%.

Within noninterest bearing expenses, nominally the highest increase represented salary and contribution expenses of KM 20,5 million and rate of 15% (number of employees increased by 11%), then other operating expenses of KM 16,5 million and rate of 28% (largest bank in the system represents KM 8,4 million of this growth), and loan loss provisions of KM 12,1 million and rate of 12%.

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

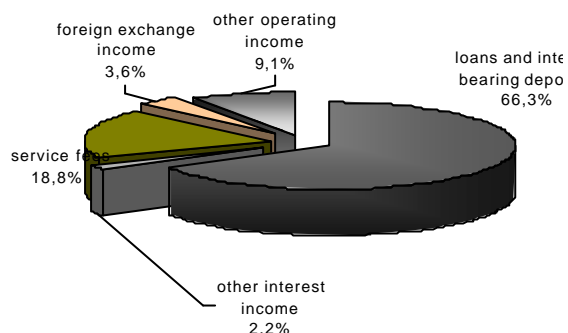
Table 24: *Structure of total income*

- in 000 KM -

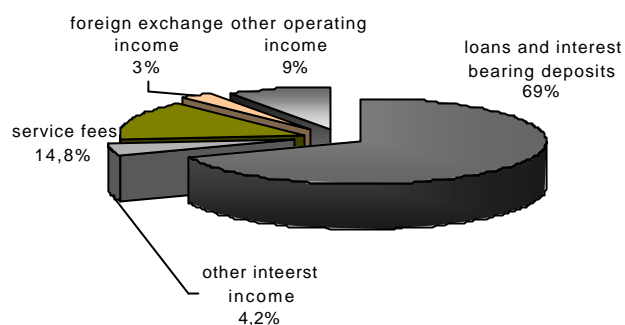
| Structure of total income | 30.09.2005. | | 30.09.2006. | | 30.09.2007. | | RATIO | |
|--|----------------|--------------|----------------|--------------|----------------|--------------|------------|------------|
| | Amount | % | Amount | % | Amount | % | 4/2 | 6/4 |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
| I Interest income and similar type of income | | | | | | | | |
| Interest bearing deposit accounts with depository institutions | 31.107 | 5,6 | 46.151 | 7,0 | 87.402 | 10,6 | 148 | 189 |
| Loans and leasing | 330.528 | 59,1 | 389.577 | 59,3 | 481.167 | 58,4 | 118 | 124 |
| Other interest income | 10.805 | 1,9 | 14.317 | 2,2 | 34.588 | 4,2 | 133 | 242 |
| TOTAL | 372.440 | 66,6 | 450.045 | 68,5 | 603.157 | 73,2 | 121 | 134 |
| II Operating income | | | | | | | | |
| Service fees | 113.616 | 20,3 | 123.289 | 18,8 | 121.960 | 14,8 | 109 | 99 |
| Foreign exchange income | 22.775 | 4,1 | 23.754 | 3,6 | 24.925 | 3,0 | 104 | 105 |
| Other operating income | 50.065 | 9,0 | 59.924 | 9,1 | 73.714 | 9,0 | 120 | 123 |
| TOTAL | 186.456 | 33,4 | 206.967 | 31,5 | 220.599 | 26,8 | 111 | 107 |
| TOTAL INCOME (I + II) | 558.896 | 100,0 | 657.012 | 100,0 | 823.756 | 100,0 | 118 | 125 |

Graph 14 : Structure of total income

30.09.2006.



30.09.2007.

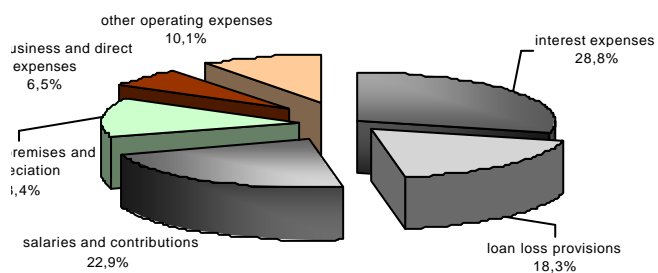
**Table 25: Structure of total expenses**

- in 000 KM-

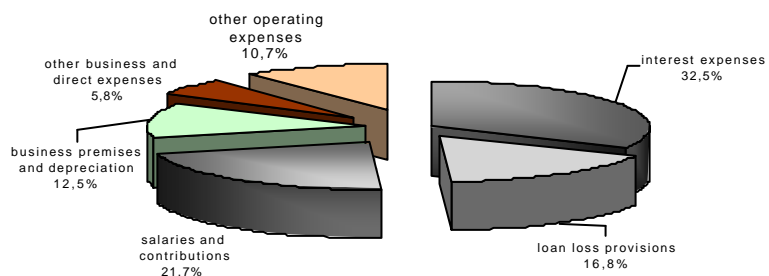
| Structure of total expenses | 30.09.2005. | | 30.09.2006. | | 30.09.2007. | | RATIO | |
|--|----------------|--------------|----------------|--------------|----------------|--------------|------------|------------|
| | Amount | % | Amount | % | Amount | % | 4/2 | 6/4 |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
| I Interest expenses and similar expenses | | | | | | | | |
| Deposits | 98.862 | 19,9 | 124.245 | 21,3 | 162.332 | 22,8 | 126 | 131 |
| Liabilities for borrowings | 24.920 | 5,0 | 36.829 | 6,3 | 59.478 | 8,4 | 148 | 161 |
| Other interest expenses | 4.493 | 0,9 | 6.933 | 1,2 | 9.062 | 1,3 | 154 | 131 |
| TOTAL | 128.275 | 25,8 | 168.007 | 28,8 | 230.872 | 32,5 | 131 | 137 |
| II Total non-interest bearing expenses | | | | | | | | |
| General loan risk and potential loan losses Provisioning | 95.683 | 19,2 | 106.991 | 18,3 | 119.073 | 16,8 | 112 | 111 |
| Salary expenses | 120.880 | 24,3 | 133.746 | 22,9 | 154.162 | 21,7 | 111 | 115 |
| Business premises and depreciation expenses | 70.744 | 14,2 | 78.003 | 13,4 | 89.211 | 12,5 | 110 | 114 |
| Other business and direct expenses | 27.592 | 5,6 | 37.895 | 6,5 | 41.270 | 5,8 | 137 | 109 |
| Other operating expenses | 54.154 | 10,9 | 59.258 | 10,1 | 75.781 | 10,7 | 109 | 128 |
| TOTAL | 369.053 | 74,2 | 415.893 | 71,2 | 479.497 | 67,5 | 113 | 115 |
| TOTAL EXPENSES (I + II) | 497.328 | 100,0 | 583.900 | 100,0 | 710.369 | 100,0 | 117 | 122 |

Graph 15: Structure of total expenses

30.09.2006.



30.09.2007



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

Table 26: Ratios of profitability, productivity and effectiveness by periods

-in %-

| RATIOS | 30.09.2005. | 30.09.2006. | 30.09.2007. |
|---|-------------|-------------|-------------|
| Return on Average Assets | 0,84 | 0,74 | 0,91 |
| Return on Average Total Capital | 7,17 | 6,91 | 8,61 |
| Return on Average Equity | 8,83 | 9,10 | 11,17 |
| Net Interest Income/Average Assets | 3,00 | 2,85 | 2,98 |
| Fee Income/Average Assets | 2,29 | 2,09 | 1,77 |
| Total Income/Average Assets | 5,30 | 4,94 | 4,75 |
| Operating and Direct Expenses ²² /Average Assets | 1,52 | 1,45 | 1,28 |
| Operating Expenses/Average Assets | 3,02 | 2,74 | 2,56 |
| Total Non-interest Expenses/Average Assets | 4,54 | 4,20 | 3,84 |

Table 27: Ratios of profitability, productivity and effectiveness as of 30.09. 2007.

-in %-

| RATIOS | 30.09. 2007. | | |
|--|--------------|---------------|---------------------|
| | STATE BANKS | PRIVATE BANKS | AVERAGE IN THE FBiH |
| Return on Average Assets | 1,30 | 0,90 | 0,91 |
| Return on Average Total Capital | 3,34 | 9,27 | 8,61 |
| Return on Average Equity | 4,04 | 12,14 | 11,17 |
| Net Interest Income/Average Assets | 3,17 | 2,98 | 2,98 |
| Fee Income/Average Assets | 3,02 | 1,73 | 1,77 |
| Total Income/Average Assets | 6,19 | 4,70 | 4,75 |
| Operating and Direct Expenses/Average Assets | 1,71 | 1,27 | 1,28 |
| Operating Expenses/Average Assets | 3,17 | 2,54 | 2,56 |
| Total Non-interest Expenses/Average Assets | 4,89 | 3,81 | 3,84 |

Analysis of some general parameters for assessment of profitability quality indicates that apart from higher amount of profit that has been realized in comparison to last year and ROAA (Return on Average Assets) of 0,91% and ROAE (Return on Average Equity) of 8,61%, productivity of banks, measured as ratio between total income and average assets (4,75%), has still not improved. On contrary, it has continued decreasing, due to, one side, faster growth of average total assets than average interest bearing assets, and, on the other side, slower growth of net interest income caused by growth of expenses for financing sources (both deposit and credit).

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

Profitability of banks in the upcoming period will mostly depend on assets quality, that is, banks' exposure to credit risk, and effective management and control of operating expenses of largest banks, especially those with joint expenses of the group (head office), which are very high and significantly effect financial result of those banks. That is why, the key factor of effectiveness and profitability of each bank is management quality and business policy the

²² Expenses include provisions for potential loan losses.

management is following and bank development and growth strategy, since that is the most direct way to influence its performance.

In addition, under the new market conditions, banks more adopt new concept of business policy aimed to market oriented banking in order to gain more profit, providing for bank stability and adequate management and control of all risks a bank is exposed to, and primarily credit risk. However, by entering international financial operations and market, banks in future will be more exposed to market risks: interest rate risk, foreign exchange and price risk, as well as indebtedness risk, which will require further strengthening of capital base, not only from internal sources through increase of retained income from profit, but from external sources, which is at the same time a precondition for further expansion and growth of banks.

2.3. Liquidity

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

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

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

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

In the structure of financing sources of banks in the Federation of BiH as of 30.06.2007., the highest participation of 72,5% still have deposits and borrowings (including subordinated debts²³) of 14,4% with longer maturity, representing quality sources for long term placements, and have made a significant contribution to maturity adjustment between assets and liabilities. On the other hand, majority structure of deposits is considerably unfavorable, although it has been some time that we have improving trend.

²³ Subordinated debts : borrowings and permanent liabilities

Table 28: Maturity structure of deposits

- in 000 KM-

| DEPOSITS | 31.12.2005. | | 31.12.2006. | | 30.09.2007. | | RATIO | |
|-----------------------------|-------------|--------------|-------------|--------------|-------------|--------------|-------|-----|
| | Amount | Partic. % | Amount | Partic. % | Amount | Partic. % | 4/2 | 6/4 |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
| Savings and demand deposits | 3.264.937 | 47,5 | 4.079.002 | 48,7 | 4.679.630 | 47,7 | 125 | 115 |
| Up to 3 months | 408.679 | 6,0 | 293.735 | 3,5 | 322.731 | 3,3 | 72 | 110 |
| Up to 1 year | 541.832 | 7,9 | 745.994 | 8,9 | 1.102.870 | 11,3 | 137 | 148 |
| 1. Total S-T | 4.215.448 | 61,4 | 5.115.731 | 61,1 | 6.105.231 | 62,3 | 121 | 119 |
| Up to 3 years | 1.709.665 | 24,9 | 2.212.076 | 26,4 | 2.540.837 | 25,9 | 129 | 115 |
| Over 3 years | 938.935 | 13,7 | 1.051.515 | 12,5 | 1.155.503 | 11,8 | 112 | 110 |
| 2. Total L-T | 2.648.600 | 38,6 | 3.263.591 | 38,9 | 3.696.340 | 37,7 | 123 | 113 |
| TOTAL (1 + 2) | 6.864.048 | 100,0 | 8.379.322 | 100,0 | 9.801.570 | 100,0 | 122 | 117 |

Analyzing maturity structure of deposits in two main groups, if compared to 2006, shows that short term deposits had fairly faster growth (19% or KM 990 million) than long term (13% or KM 433 million).

Within short term deposits, if compared to 2006, the highest nominal growth of KM 601 million (growth rate of 15%) was realized by demand deposits, while term deposits from 3 months to one year had the highest growth rate (48% or KM 360 million). The highest participation in total demand deposits is still maintained by citizen deposits (34,8%) that have increased by 15% or KM 217 million in comparison to 2006.

We should emphasize that in long term deposits, there are two sectors with dominant participation: citizens of 45,2% and banking institutions of 26,4%, with moderate trend of decrease of their participation due to increase of participation of public and private companies deposits (from 16,8% to 20,8%). Citizen deposits represent the highest participation of 62% of term deposits up to 3 years (58,4% at the end of 2006), while banking institutions deposits have the highest participation of 62,7% over three years (62,9% at the end of 2006).

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

Table 29: Maturity structure of loans

-in 000 KM-

| LOANS | 31.12.2005. | | 31.12.2006. | | 30.09.2007. | | RATIO | |
|---|-------------|--------------|-------------|--------------|-------------|--------------|-------|-----|
| | Amount | Partic. % | Amount | Partic. % | Amount | Partic. % | 4/2 | 6/4 |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
| Pastdue claims and paid off-balance sheet liabilities | 218.177 | 3,9 | 210.852 | 3,1 | 238.147 | 2,9 | 97 | 113 |
| Short term loans | 1.134.850 | 20,5 | 1.360.381 | 19,9 | 1.550.267 | 18,7 | 120 | 114 |
| Long term loans | 4.192.050 | 75,6 | 5.248.921 | 77,0 | 6.494.308 | 78,4 | 125 | 124 |
| TOTAL LOANS | 5.545.077 | 100,0 | 6.820.154 | 100,0 | 8.282.722 | 100,0 | 123 | 121 |

Over the three quarters of 2007, long term deposits increased by 24% or KM 1.245 million (loans originated to citizens represent 59% or KM 729 million of the generated growth), and short term by 14% or KM 190 million (private companies make 83,6% or KM 159 million).

Sectorial analysis by maturity indicates that long term loans represent 91% of total loans originated to citizens and 64,4% of loans originated to private companies, with increasing trend (62,7% at the end of 2006).

In the assets structure, as the most significant category, loans still have the highest participation of 60,8%, with constant increasing trend which has been supported by deposit growth (17%) and borrowings (26%).

In 2007, banks were regularly meeting required reserves with the Central Bank of BiH.²⁴ Through the required reserve as the most significant instrument of monetary policy, in BiH under the environment of Currency Board and relatively financially underdeveloped market, required reserve as the most significant instrument of monetary policy is used to meet a primary monetary purpose, that is, monetary control, in sense of stopping fast credit growth from the past years and decrease multiplications. On the other hand, implementation of regulation on foreign exchange risk and maintenance of currency adjustment within prescribed limits also significantly influence the amount of funds banks keep on the reserve account with the Central Bank in domestic currency, which provides for high liquidity of individual banks and the banking sector.

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

Table 30: *Liquidity ratios*

- in % -

| Ratios | 31.12.2005. | 31.12.2006. | 30.09.2007. |
|---|-------------|-------------|-------------|
| 1 | 2 | 3 | 4 |
| Liquid assets ²⁵ / Total assets | 37,8 | 37,4 | 36,4 |
| Liquid assets / Short term financial liabilities | 63,9 | 62,2 | 60,0 |
| Short term financial liabilities / Total financial liabilities | 66,9 | 68,0 | 68,7 |
| Loans / Deposits and borrowings ²⁶ | 69,2 | 69,6 | 71,8 |
| Loans / Deposits, borrowings and subordinated debts ²⁷ | 68,0 | 68,5 | 70,3 |

In the observed period, a trend of slight deterioration of general liquidity indicators quality has continued, primarily due to faster growth of credit placements, but could still say that liquidity position of the banking system of the Federation of BiH is good, with satisfactory participation of liquid assets in total assets and coverage of short-term liabilities by liquid assets, while structural indicator of participation of short term liabilities in total financial liabilities has slightly improved if compared to the end of 2006. The last two indicators, expressed as ratio between loans and financing sources (deposits and borrowings), are also very good and they are in accordance with feasible standard.

Regulatory requirements prescribed towards banks are quite restrictive, which resulted in good liquidity of banks individually and the entire banking system. All banks continuously meet

²⁴ At the end of 2005, there were some changes in the regulations based on which the required reserve increased from 10% to 15% as of 01.12.2005.

²⁵ Liquidity assets in the narrow sense: cash and deposits and other financial assets with maturity below three months, except inter-banking deposits.

²⁶ Empiric standards: below 70% -very sound, 71%-75% -satisfactory, 76% -80% -marginal to satisfactory, 81% -85% -insufficient, over 85% -critical.

²⁷ Prior ratio has been modified. Subordinated debts are included in the sources, which gives more realistic indicator.

prescribed minimum over the average, requirement of ten-day average of 20% in relation to short-term sources, and daily minimum of 10% according to the same basis, which is presented in the following table.

Table 31: *Liquidity position –ten-day average and daily minimum*

- in 000 KM -

| Description | 31.12.2005. | 31.12.2006. | 30.09.2007. | RATIO | |
|---|-------------|-------------|-------------|-------|-----|
| | Amount | Amount | Amount | 3/2 | 4/3 |
| 1 | 2 | 3 | 4 | 5 | 6 |
| 1. Average daily balance of cash assets | 2.687.043 | 3.478.292 | 3.913.278 | 129 | 113 |
| 2. Minimum total daily balance of cash assets | 2.371.336 | 3.201.670 | 3.634.087 | 135 | 114 |
| 3. Short term sources (accrual basis) | 4.165.268 | 5.135.086 | 6.045.689 | 123 | 118 |
| 4. Liabilities: | | | | | |
| 4.1. ten-day average 20% of Item 3 | 833.054 | 1.027.017 | 1.209.138 | 123 | 118 |
| 4.2. daily minimum 10% of Item 3 | 416.527 | 513.509 | 604.569 | 123 | 118 |
| 5. Meeting requirement :ten-day average | | | | | |
| Surplus = Item 1 – Item 4.1. | 1.853.989 | 2.451.275 | 2.704.140 | 132 | 110 |
| 6. Meeting requirement :daily minimum | | | | | |
| Surplus = Item.2 – Item 4.2. | 1.954.809 | 2.688.161 | 3.029.518 | 138 | 113 |

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

Table 32: *Maturity adjustment of financial assets and liabilities up to 180 days*

- in 000 KM -

| Description | 31.12.2005. | 31.12.2006. | 30.09.2007. | INDEX | |
|-------------------------------------|-------------|-------------|-------------|-------|-----|
| | Amount | Amount | Amount | 3/2 | 4/3 |
| 1 | 2 | 3 | 4 | 5 | 6 |
| I. 1- 30 days | | | | | |
| 1. Financial assets | 4.051.257 | 5.111.643 | 5.725.281 | 126 | 112 |
| 2. Financial liabilities | 3.668.868 | 4.626.466 | 5.201.855 | 126 | 112 |
| 3. Difference (+ or -) = 1-2 | 382.389 | 485.177 | 523.426 | 127 | 108 |
| <i>Accrual of requirement in %</i> | | | | | |
| a) Performed %= Item 1 / Item 2 | 110,4% | 110,50% | 110,1 % | | |
| b) Required minimum % | 100,0% | 100,00% | 100,00% | | |
| Surplus (+) or shortage (-) = a - b | 10,4% | 10,5% | 10,1% | | |
| II. 1-90 days | | | | | |
| 1. Financial assets | 4.559.015 | 5.622.709 | 6.278.381 | 123 | 112 |
| 2. Financial liabilities | 4.150.956 | 5.107.109 | 5.756.353 | 123 | 113 |
| 3. Difference (+ or -) = 1-2 | 408.059 | 515.600 | 522.028 | 126 | 101 |
| <i>Accrual of requirement in %</i> | | | | | |
| a) Performed %= Item 1 / Item.2 | 109,8% | 110,10% | 109,1% | | |
| b) Required minimum % | 100,0% | 100,00% | 100,00% | | |
| Surplus (+) or shortage (-) = a - b | 9,8% | 10,10% | 9,1% | | |
| III. 1-180 days | | | | | |
| 1. Financial assets | 5.091.381 | 6.245.949 | 6.980.816 | 123 | 112 |
| 2. Financial liabilities | 4.598.836 | 5.662.698 | 6.544.896 | 123 | 116 |
| 3. Difference (+ or -) = 1-2 | 492.545 | 583.251 | 435.920 | 118 | 75 |
| <i>Accrual of requirement in %</i> | | | | | |
| a) Performed %= Item 1 / Item.2 | 110,7% | 110,3% | 106,7% | | |
| b) Required minimum % | 95,0% | 95,0% | 95,0% | | |
| Surplus (+) or shortage (-) = a - b | 15,7% | 15,30% | 11,70% | | |

As presented in the schedule as of 30.09.2007., banks were compliant with the prescribed limits, and have realized better maturity adjustment between financial assets and liabilities in relation to the prescribed limits, but still slightly deteriorated if compared to the end of 2006. The main reason is stronger growth of credit placements (long term primarily) over the three quarters of 2007.

Liquidity of the banking system of the Federation of BiH, based on the presented indicators, is high, which is a result of existing restrictive regulation. Since this segment of performance and level of liquidity risk exposure is in correlation with credit risk, and having in mind increasing trend and level of credit risk, banks will in future have to pay more attention to liquidity risk management through establishment and implementation of liquidity policies, which will make sure that all matured liabilities of banks are timely realized, based on continuous planning of future liquidity needs and taking into account changes in operating, economic, regulatory and other segments of business environment of banks. The FBA will both through reports and on-site examination in banks monitor how banks manage this risk and if they acted in accordance with the adopted policies and programs.

2.4. Foreign exchange risk – foreign currency adjustment of balance sheet assets and liabilities and off-balance sheet

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

In order to enable implementation of prudential principles in foreign exchange activities of banks and to decrease influence of foreign exchange risk to their profitability, liquidity and capital, the FBA has issued Decision on Minimum Standards for Foreign Exchange Risk Management in Banks that regulates minimum standards for adoption and implementation of programs, policies and procedures for undertaking, monitoring, control and management of foreign exchange risk, and restrictions prescribed for opened individual and overall foreign exchange position (long or short), calculated in relation to the amount of bank's core capital.²⁸

Banks daily report to the FBA as part of the monitoring of prescribed limits. Based on examination, monitoring and analysis of submitted reports on foreign currency position of banks, we can conclude that banks meet prescribe limits and perform their FX activities within these limits.

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

According to the balance as of 30.09.2007., currency structure of banks' assets on the level of banking system recorded participation of items in foreign currencies of 16,6% or KM 2,3 billion (20,8% or KM 2,4 billion at the end of 2006). On the other hand, currency structure of

²⁸ Article 8 of Decision on Minimum Standards for Capital Management of Banks determines limits for individual foreign currency position in EUR up to 30% of core capital, for other currencies up to 20% and foreign currency of bank up to 30%.

liabilities is essentially different, since participation of liabilities in foreign currency is significantly higher of 53,3% or KM 7,3 billion (53,5% or KM 6,2 billion at the end of 2006).

The following table presents structure and trend of financial assets and liabilities and foreign currency position for EUR as the most significant currency²⁹ and total:

Table 33: *Foreign currency adjustment of financial assets and liabilities (EUR and total)*
-in KM millions-

| Description | 31.12.2006. | | | | 30.09.2007. | | | | RATIO | |
|--|-------------|-----------|--------|-----------|-------------|-----------|--------|-----------|-------|-------|
| | EUR | | TOTAL | | EUR | | TOTAL | | EUR | TOTAL |
| | Amount | Partic. % | Amount | Partic. % | Amount | Partic. % | Amount | Partic. % | 6/2 | 8/4 |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 |
| <i>I. Financial assets</i> | | | | | | | | | | |
| 1. Cash assets | 1.335 | 21,5 | 1.876 | 27,2 | 1.428 | 19,9 | 1.950 | 24,3 | 114 | 106 |
| 2. Loans | 325 | 5,2 | 376 | 5,5 | 152 | 2,1 | 228 | 2,8 | 45 | 57 |
| 3. Loans with currency clause | 4.434 | 71,4 | 4.507 | 65,3 | 5.544 | 77,2 | 5.776 | 71,8 | 118 | 120 |
| 4. Other | 117 | 1,9 | 138 | 2,0 | 59 | 0,8 | 89 | 1,1 | 68 | 81 |
| Total (1+2+3+4) | 6.211 | 100,0 | 6.897 | 100,0 | 7.183 | 100,00 | 8.043 | 100,00 | 113 | 112 |
| <i>II. Financial liabilities</i> | | | | | | | | | | |
| 1. Deposits | 3.951 | 68,5 | 4.576 | 71,1 | 4.367 | 65,7 | 5.227 | 69,2 | 106 | 109 |
| 2. Borrowings | 1.327 | 23,0 | 1.362 | 21,1 | 1.638 | 24,6 | 1.680 | 22,2 | 120 | 120 |
| 3. Deposits and loans with currency clause | 284 | 4,9 | 284 | 4,4 | 303 | 4,6 | 303 | 4,0 | 116 | 116 |
| 4. Other | 208 | 3,6 | 218 | 3,4 | 337 | 5,1 | 345 | 4,6 | 125 | 122 |
| Total (1+2+3+4) | 5.770 | 100,0 | 6.440 | 100,0 | 6.645 | 100,00 | 7.555 | 100,00 | 111 | 112 |
| <i>III. Off-balance sheet</i> | | | | | | | | | | |
| 1. Assets | 16 | | 20 | | 19 | | 84 | | | |
| 2. Liabilities | 377 | | 380 | | 457 | | 459 | | | |
| <i>IV. Position</i> | | | | | | | | | | |
| Long (amount) | 79 | | 97 | | 100 | | 112 | | | |
| % | 7,3% | | 8,9% | | 7,8% | | 8,8% | | | |
| Short | | | | | | | | | | |
| % | | | | | | | | | | |
| Limit | 30% | | 30% | | 30% | | 30% | | | |
| Below limit | 22,7% | | 21,1% | | 22,2% | | 21,2% | | | |

If we analyze the structure of foreign currencies, we see a dominant participation of EUR in the financial assets³⁰, which in 2007 was increased by 2,1 index points (from 74,4% to 72,3%), along with decrease of nominal amount from 1,8 billion to 1,6 billion. Participation of EUR in the liabilities has also decreased from 89,1% to 87,4%, even there has been increase of nominal amount from KM 5,5 billion to KM 6,3 billion.

However, the calculation of the FX risk exposure also includes the amount of indexed assets items (loans) and liabilities³¹, which is especially important in the assets (71,8% or KM 5,8 billion) with continuous increasing trend, which is partially the result of the increase of foreign borrowings as financing source in bank's liabilities structure (credit liabilities with subordinated debts amount to KM 1,9 billion with participation of 14,4%). Other foreign

²⁹ Source: Form 5-Foreign currency position.

³⁰ Source: Form 5-Foreign currency position: portion of financial assets (in foreign currencies denominated in KM). According to the methodology, financial assets are expressed based on net principle (reduced by loan loss reserves).

³¹ In order to protect from changes of the exchange rate banks contract certain items of assets (loans) and liabilities with currency clause (regulation allow only two-way currency clause).

currency assets items make 28,2% or KM 2,2 billion, of which EUR items make 20,4% or KM 1,6 billion, and other currencies 7,8% or KM 0,6 billion (at the end of 2006, loans contracted with currency clause amounted to KM 4,5 billion with participation of 65,3%, and other items in EUR of 25,8% or KM 1,8 billion). Of total net loans (KM 8 billion), 72,5% were contracted with currency clause (69% at the end of 2006), primarily tied to EUR (96%).

On the other hand, the structure of financial liabilities stipulates and determines the structure of financial assets, for each currency respectively. Items in EUR (primarily deposits) had the highest participation in foreign currency liabilities (KM 7,6 billion) of 83,9% or KM 6,3 billion, while participation and amount of indexed liabilities was at minimum, amounting to 4,0% or KM 0,3 billion (at the end of 2006, participation of liabilities in EUR was 85,2% or KM 5,5 billion, and indexed liabilities were 4,4% or KM 0,3 billion).

Observed by banks and overall on the level of the banking system of the FBiH, we can conclude that, over the three quarters of 2007, banks were exposed to the FX risk within prescribed limits.

As of 30.09.2007., there were 16 banks with long foreign currency position, and six with short position, so on the system level long foreign currency position represented 8,8% of banks' core capital, which is lower by 21,2% than the limit. Individual foreign currency position for EUR was 7,8% where financial assets items were higher than financial liabilities (long position), which is lower by 22,2% than the limit.

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

III. CONCLUSION

Consolidation and stabilization of banking sector of the Federation of BiH has reached an enviable level and upcoming activities should provide for further progress and development of the system. This implies a continuous engagement of all parts of the system, legislative and executive authorities in order to provide for the most favorable environment in economy, which would be stimulating to banks and to the economy.

In other to meet such goals, it is necessary to have further involvement of authorized institutions and bodies in Bosnia and Herzegovina and the Federation of BiH in order to:

- Realize the conclusion made by the Federation of BiH Parliament to establish banking supervision on state level;
- Finalize privatization process of two state banks;
- Initiate acceleration of the appointment process for the FBA Managing Board and management members;
- Define and build on regulation for financial sector related to the activity, status and performance of micro-credit organizations, leasing companies, insurance companies, transition of Investment Bank of the Federation of BiH d.d. Sarajevo into Development Bank, etc.;
- Accelerate implementation of economic reform in the real sector in order to reach the level of monetary and banking sector;

- Based on a documented material, specialized and professionally processed in the Banks Association of BiH, and through the Ministry of Finance of the Federation of BiH, it is necessary to accelerate the activities in order to:
 - Continuously build up legal regulation for banking sector and financial system based on Basle Principles and European Banking Directives,
 - Establish specialized court departments for economy,
 - Establish more efficient process for realization of pledges,
 - Adopt law on protection of creditors and full responsibility of debtors,
 - Adopt law or improve existing legislation regulating the area of safety and protection of money in banks and in transportation.

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

- Proceed with a continues supervision of banks through on-site and off-site examinations, emphasizing targeted examination of dominant risk segments of banking operations, which will make supervision more effective and in that regard to:
 - Continue systematic monitoring of banks' activities in prevention of money laundering and terrorism financing and improve cooperation with other supervisory and examination institutions,
 - Persist on capital strengthening of banks, especially those recording outstanding assets growth,
 - Continue permanent monitoring of banks with the highest concentration of savings and other deposits in order to protect depositors,
 - Continue working on development of regulation based on the Basle Principles and European Directives as part of preparation to join the European Union,
 - Maintain continuity in payment system examinations,
 - Establish and expand cooperation with home country supervisors of the investors present in the banking sector of the FBiH, and other countries in order to have more effective supervision,
 - Improve cooperation with the Banks Association in all banking performance segments, organization of counseling and professional assistance in the area of implementation of banking laws and regulations, etc.,
- Continuous operational development of the new IT system for early warning and prevention in elimination of weaknesses in banks,
- Work on continuous education and training of staff,
- Finalize remaining provisional administrations and liquidations based on the conclusion made by the Managing Board as of 29. 03. 2006.

Banks, as the most important part of the system, have to concentrate their actions to:

- Further capital strengthening, proportional to the growth of assets and risk, higher profitability, solvency, more consistent implementation of adopted policies and procedures in the area of prevention of money laundering and terrorism financing, and safety and protection of money in banks and in transportation, in accordance with laws and regulations,
- Strengthen internal control systems and establish internal audits, which will be fully independent in their work,
- Constant improvement of cooperation with the Banks Association in the area of professional development, change all laws and regulations which have become a limiting factor in bank development, introduction of new products, collection of claims and active

involvement in the establishment of unified registry of irregular debtors – legal entities and individuals;

- Regular and updated submission of data to the Central Loan Registry and Unified Central Account Registry with the Central Bank of BiH.

ATTACHMENTS

| | |
|-------------------|---|
| ATTACHMENT 1..... | General information about banks in the FBiH |
| ATTACHMENT 2..... | Balance sheet according to FBA Schedule |
| ATTACHMENT 3..... | Citizen savings in banks of the FBiH |
| ATTACHMENT 4..... | Report on changes in balance sheet assets and off-balance sheet risk items |
| ATTACHMENT 5..... | Income statement of banks |
| ATTACHMENT 6..... | Report on capital balance and adequacy |
| ATTACHMENT 7..... | Report on employees in banks of the FBiH |

| Banks in the Federation of Bosnia and Herzegovina - 30.09.2007. | | | | | |
|--|--|----------------|--------------------------|---------------------------|---|
| No. | BANK | Address | | Telephone | Director |
| 1 | ABS BANKA dd - SARAJEVO | Sarajevo | Traplina 12/VI | 033/277-060, fax:667-674 | ZUKIĆ ADNAN |
| 2 | BOSNA BANK INTERNATIONAL dd - SARAJEVO | Sarajevo | Trg djece Sarajeva bb | 033/275-100, fax:472-159 | AMER BUKVIĆ |
| 3 | BOR BANKA dd - SARAJEVO | Sarajevo | Obala Kullna bana 18 | 033/663-500, fax:278-550 | HAMID PRŠEŠ |
| 4 | FIMA BANKA dd - SARAJEVO | Sarajevo | Kolodvorska br. 5. | 033/720-070, fax:720-100 | EDIN MUFTIĆ |
| 5 | HERCEGOVAČKA BANKA dd MOSTAR | Mostar | Kneza Domagoja bb. | 036/332-901, fax:532-908 | Prov. Admin. - Nikola Fabijanić - 16.04.2007. |
| 6 | HVB CENTRAL PROFIT BANKA d.d. - SARAJEVO | Sarajevo | Zelenih beretki 24 | 033/533-688, fax:532-319 | ZVONIMIR JURJEVIĆ |
| 7 | HYPO ALPE-ADRIA-BANK dd - MOSTAR | Mostar | Kneza Branimira 2b | 036/444-200, fax:444-235 | PETAR JURČIĆ |
| 8 | INVESTICIJSKA BANKA FEDERACIJE BIH | Sarajevo | Paromilnska bb | 033/277-900, fax:668-952 | RAMID DŽAFEROVIĆ |
| 9 | INVESTICIONO-KOMERCIJALNA BANKA dd - ZENICA | Zenica | Trg B&H 1 | 032/401-804, fax:246-187 | Acting Director - SUVAD IBRANOVIĆ |
| 10 | KOMERCIJALNO-INVESTICIONA BANKA DD V.KLADUŠA | V.Kladuša | Ibrahima Mržijaka 3. | 037/771-253, fax:772-416 | HASAN PORČIĆ |
| 11 | NLB TUZLANSKA BANKA dd - TUZLA | Tuzla | Maršala Tita 34 | 035/259-259, fax:250-596 | ALMIR ŠAHINPAŠIĆ |
| 12 | POŠTANSKA BANKA BIH - SARAJEVO | Sarajevo | Branilaca Sarajeva 20/XI | 033/212-993, fax:210-007 | DŽENAMIR ABAZA |
| 13 | PRIVREDNA BANKA SARAJEVO dd - SARAJEVO | Sarajevo | Alipašina 6 | 033/277-700, fax:277-798 | Prov. Admin. - Maruf Burnazović - 17.07.2006. |
| 14 | PROCREDIT BANK dd - SARAJEVO | Sarajevo | Emerika Bluma 8. | 033/250-950, fax:250-971 | PETER MÖLDERS |
| 15 | RAIFFEISEN BANK dd BIH - SARAJEVO | Sarajevo | Danjela Ozme 3 | 033/287-100, fax: 213-851 | MICHAEL MÜLLER |
| 16 | TURKISH ZIRAAT BANK BOSNIA dd - SARAJEVO | Sarajevo | Ferhadija 29 | 033/254-050, fax: 254-051 | KENAN BOZKURT |
| 17 | UNA BANKA dd - BIHAĆ | Bihać | Bosanska 25 | 037/322-400, fax: 322-351 | Prov. Admin. - Stjepan Blagović - 01.05.2005. |
| 18 | UNICREDIT ZAGREBAČKA BANKA dd - MOSTAR | Mostar | Kardinala Stepinca bb | 036/312-121, fax:512-123 | BERISLAV KUTLE |
| 19 | UNION BANKA dd - SARAJEVO | Sarajevo | Dubrovačka 6 | 033/561-000, fax: 201-567 | ESAD BEKTEŠEVIĆ |
| 20 | UPI BANKA dd - SARAJEVO | Sarajevo | Obala Kullna bana 9a. | 033/497-555, fax:497-589 | ALMIR KRKALIĆ |
| 21 | VAKUFСКА BANKA dd - SARAJEVO | Sarajevo | M. Tita 13. | 033/280-100, fax: 663-399 | AMIR RIZVANOVIĆ |
| 22 | VOLKSBANK BH dd - SARAJEVO | Sarajevo | Fra Andela Zvizdovića 1 | 033/295-601, fax:295-603 | REINHOLD KOLLAND |

BALANCE SHEET OF BANKS IN THE FBiH ACCORDING TO THE FBA SCHEDULE

ACTIVE SUB-BALANCE SHEET

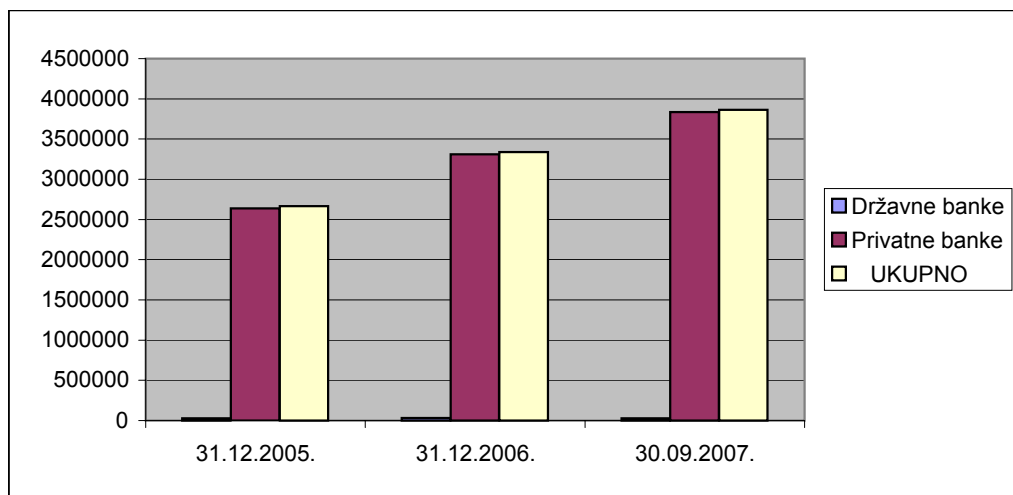
000 KM

| Ord.No | DESCRIPTION | 31.12.2005. | 31.12.2006. | 30.09.2007. |
|--------|--|-------------------|-------------------|-------------------|
| | ASSETS | | | |
| 1. | Cash funds and deposit accounts at depository institutions | 3.533.700 | 4.286.202 | 4.952.373 |
| 1a | Cash and non-interest deposit accounts | 1.167.310 | 1.514.758 | 271.972 |
| 1b | Interest deposit accounts | 2.366.390 | 2.771.444 | 4.680.401 |
| 2. | Trading securities | 13.625 | 41.121 | 45.358 |
| 3. | Placements in other banks | 68.811 | 105.390 | 76.976 |
| 4. | Loans, receivables in leasing and past due receivables | 5.545.077 | 6.820.154 | 8.282.722 |
| 4a | Loans | 5.326.708 | 6.609.122 | 8.044.404 |
| 4b | Receivables on leasing | 192 | 180 | 171 |
| 4c | Past due receivables - loans and leasing | 218.177 | 210.852 | 238.147 |
| 5. | Securities held until maturity | 6.385 | 4.801 | 4.550 |
| 6. | Premises and other fixed assets | 275.276 | 314.012 | 326.513 |
| 7. | Other real estate | 31.361 | 27.659 | 41.740 |
| 8. | Investments in non-consolidated related enterprises | 28.750 | 27.679 | 33.957 |
| 9. | Other assets | 154.222 | 170.492 | 182.090 |
| 10. | MINUS:Reserves for potential losses | 278.499 | 299.155 | 327.654 |
| 10a | Reserves on item 4 in Assets | 260.155 | 288.433 | 315.338 |
| 10b | Reserves on Assets except item 4 | 18.344 | 10.722 | 12.316 |
| 11. | TOTAL ASSETS | 9.378.708 | 11.498.355 | 13.618.625 |
| | LIABILITIES | | | |
| 12. | Deposits | 6.864.048 | 8.379.322 | 9.801.571 |
| 12a | Interest deposits | 6.114.978 | 7.529.517 | 8.982.762 |
| 12b | Non-interest deposits | 749.070 | 849.805 | 818.809 |
| 13. | Loans - past due | 8.308 | 7.802 | 7.485 |
| 13a | Balance of payable loans, unpaid | | | 0 |
| 13b | Unpaid - called for payment off-balance sheet items | 8.308 | 7.802 | 7.485 |
| 14. | Loans from other banks | 2.912 | 2.890 | 2.900 |
| 15. | Payables to Government | | | 0 |
| 16. | Payables on loans and other borrowings | 1.152.910 | 1.420.944 | 1.727.187 |
| 16a | payable within one year | 241.955 | 196.381 | 294.909 |
| 16b | payable longer than one year | 910.955 | 1.224.563 | 1.432.278 |
| 17. | Subordinated debts and subordinated bonds | 132.429 | 145.079 | 245.252 |
| 18. | Other liabilities | 201.384 | 315.733 | 396.081 |
| 19. | TOTAL LIABILITIES | 8.361.991 | 10.271.770 | 12.180.476 |
| | CAPITAL | | | |
| 20. | Permanent priority shares | 26.280 | 30.180 | 26.224 |
| 21. | Common shares | 773.205 | 858.610 | 968.089 |
| 22. | Shares issued | 29.975 | 71.130 | 74.948 |
| 22a | Permanent priority shares | 532 | 8.332 | 8.332 |
| 22b | Common shares | 29.443 | 62.798 | 66.616 |
| 23. | Undistributed income and capital reserves | 130.440 | 172.581 | 255.501 |
| 24. | Currency rate difference | 0 | 0 | 0 |
| 25. | Other capital | 56.817 | 94.084 | 113.387 |
| 26. | TOTAL CAPITAL (20. TO 25.) | 1.016.717 | 1.226.585 | 1.438.149 |
| 27. | TOTAL LIABILITIES AND CAPITAL (19+26) | 9.378.708 | 11.498.355 | 13.618.625 |
| | PASSIVE AND NEUTRAL SUBBALANCE | 680.040 | 641.164 | 618.212 |
| | TOTAL BALANCE SHEET IN BANKS | 10.058.748 | 12.139.519 | 14.236.837 |

NEW CITIZEN SAVINGS BY PERIODS

000 KM

| | 31.12.2005. | 31.12.2006. | 30.09.2007. |
|---------------|-------------|-------------|-------------|
| State banks | 26.886 | 31.723 | 28.251 |
| Private banks | 2.638.391 | 3.308.413 | 3.835.533 |
| TOTAL | 2.665.277 | 3.340.136 | 3.863.784 |



CLASSIFICATION OF ASSETS AND OFF-BALANCE SHEET RISK ITEMS
as of 30.09.2007.

- ACTIVE SUB-BALANCE SHEET -

000 KM

| Ord. No. | BALANCE SHEET ASSETS AND OFF-BALANCE SHEET ITEMS | CLASSIFICATION | | | | | TOTAL |
|-------------|--|----------------|-----------|----------|------------|----------|------------|
| | | A | B | C | D | E | |
| 1. | Short-term loans | 1.286.383 | 249.969 | 12.735 | 1.180 | 0 | 1.550.267 |
| 2. | Long-term loans | 5.600.425 | 712.823 | 119.287 | 61.773 | 0 | 6.494.308 |
| 3. | Other placements | 57.721 | 1.690 | 321 | 10 | 0 | 59.742 |
| 4. | Interest accrued | 37.375 | 11.650 | 0 | 0 | 0 | 49.025 |
| 5. | Past due receivables | 98.424 | 68.721 | 21.579 | 45.488 | 0 | 234.212 |
| 6. | Receivables on gurantees paid | 566 | 127 | 0 | 3.242 | 0 | 3.935 |
| 7. | Other assets | 5.543.889 | 7.446 | 780 | 2.655 | 20 | 5.554.790 |
| 8. | TOTAL ACTIVE BALANCE SHEET | 12.624.783 | 1.052.426 | 154.702 | 114.348 | 20 | 13.946.279 |
| 9. | a) Guarantees payable | 284.866 | 53.058 | 1.619 | 451 | 0 | 339.994 |
| | b) Performing guarantees | 436.313 | 109.252 | 1.262 | 188 | 59 | 547.074 |
| 10. | Unsecured LoC | 59.874 | 12.046 | 0 | 299 | 0 | 72.219 |
| 11. | Unrevokable loans | 1.312.775 | 77.045 | 1.134 | 607 | 2 | 1.391.563 |
| 12. | Other potential liabilities | 1.176 | 0 | 0 | 0 | 0 | 1.176 |
| 13. | TOTAL OFF-BALANCE SHEET | 2.095.004 | 251.401 | 4.015 | 1.545 | 61 | 2.352.026 |
| 14. | TOTAL BALANCE AND OFF-BALANCE SHEET (8+13) | 14.719.787 | 1.303.827 | 158.717 | 115.893 | 81 | 16.298.305 |
| 15. | General credit risk and potential loan losses (#14 x % of loss) | 186.803 | 96.067 | 39.103 | 65.166 | 20 | 387.159 |
| 16. | Allocated general reserves (A) and special reserves (B, C, D, E) | 186.765 | 96.060 | 39.103 | 65.374 | 20 | 387.322 |
| 17. | MINUS (PLUS) allocated reserves (#16 - 15) +or - | -38 | -7 | 0 | 208 | 0 | 163 |

INCOME STATEMENT

000 KM

| ELEMENTS | PERFORMED 30.09. 2006. | | PERFORMED 30.09.2007. | | RATIO 4 : 2 |
|-----------------------------------|---------------------------|----------------------------|--------------------------|------------------------------|----------------|
| | Amount | partic. in total income | Amount | partic.in total income | |
| 1 | 2 | 3 | 4 | 5 | 6 |
| INCOME | | | | | |
| Interest income | 450.045 | 92% | 603.157 | 102% | 134 |
| Interest expense | 168.007 | 34% | 230.872 | 39% | 137 |
| Net interest income | 282.038 | 58% | 372.285 | 63% | 132 |
| Fee income | 206.967 | 42% | 220.599 | 37% | 107 |
| TOTAL INCOME | 489.005 | 100% | 592.884 | 100% | 121 |
| EXPENSES | | | | | |
| Reserves for potential losses | 106.991 | 22% | 119.073 | 20% | 111 |
| Salaries and payables with salary | 133.746 | 27% | 154.162 | 26% | 115 |
| Fixed assets and overhead expense | 78.003 | 16% | 89.211 | 15% | 114 |
| Other expense | 97.153 | 20% | 117.051 | 20% | 120 |
| TOTAL EXPENSES | 415.893 | 85% | 479.497 | 81% | 115 |
| NET INCOME BEFORE TAXES | 73.112 | 15% | 113.387 | 19% | 155 |
| Taxes | 0 | | 0 | | |
| NET INCOME | 73.112 | 15% | 113.387 | 19% | 155 |

**COMPARABLE SCHEDULE OF CAPITAL BALANCE AND ADEQUACY
ACTIVE SUB-BALANCE SHEET**

000 KM

| Pos | DESCRIPTION | 12./2005. | 12./2006. | 09./2007. |
|-----------|---|------------------|------------------|-------------------|
| 1 | BANK'S CORE CAPITAL | | | |
| 1.a. | Share capital, reserves and income | | | |
| 1.1. | Share capital - common and perm. priority non-cumulat. shares - cash payments | 784.085 | 873.390 | 978.846 |
| 1.2. | Share capital - comm. & perm. prior. non-cumul. shares-invested posses. & rights | 12.550 | 12.550 | 12.550 |
| 1.3. | Issued shares income at share payments | 29.975 | 71.130 | 74.948 |
| 1.4. | General regulatory reserves (reserves as regulated by the Law) | 41.801 | 61.228 | 75.489 |
| 1.5. | Other reserves not related to assets quality assessment | 49.583 | 86.990 | 114.816 |
| 1.6. | Retained - undistributed income from previous years | 76.939 | 93.543 | 126.182 |
| 1.a. | TOTAL (from 1.1. to 1.6.) | 994.933 | 1.198.831 | 1.382.831 |
| 1.b. | Offsetting items from 1.a. | | | |
| 1.7. | Uncovered losses transferred from previous years | 34.741 | 62.603 | 65.104 |
| 1.8. | Losses from current year | 26.376 | 7.030 | 4.008 |
| 1.9. | Book value of treasury shares owned by the bank | | | 2 |
| 1.10. | Amount of intangible assets | 41.424 | 40.105 | 42.376 |
| 1.b. | TOTAL (from 1.7. to 1.10.) | 102.541 | 109.738 | 111.490 |
| 1. | AMOUNT OF CORE CAPITAL: (1.a.-1.b.) | 892.392 | 1.089.093 | 1.271.341 |
| 2 | BANK'S ADDITIONAL CAPITAL | | | |
| 2.1. | Share capital - common and perm. priority non-cumulat. shares - cash payments | 2.850 | 2.850 | 2.917 |
| 2.2. | Share capital - comm. & perm. prior. non-cumul. shares-invested posses. & rights | 0 | 0 | 0 |
| 2.3. | General reserves for losses on loans from class. A - performing assets | 119.163 | 150.200 | 186.765 |
| 2.4. | Accrued income for current year audited and confirmed by external auditor | 43.423 | 85.689 | 32.142 |
| 2.5. | Income under FBA's temporary restriction on distribution | 0 | 0 | 0 |
| 2.6. | Subordinated debts, the most 50% of core capital | 126.632 | 139.251 | 194.364 |
| 2.7. | Hybrid convertible items - the most 50% of core capital | 0 | 0 | 0 |
| 2.8. | Items-permanent liabilities without repayment duty | 5.797 | 5.828 | 50.830 |
| 2. | AMOUNT OF ADDITIONAL CAPITAL: (2.1. to 2.8.) | 297.865 | 383.818 | 467.018 |
| 3 | OFFSETTING ITEMS FROM BANK'S CAPITAL | | | |
| 3.1. | Part of invested share capital that according to FBA's assessment represents accepted a | 0 | 0 | 0 |
| 3.2. | Investments in capital of other legal entities exceeding 5% of bank's core capital | 17.235 | 17.236 | 16.036 |
| 3.3. | Receivables from shareholders for significant voting shares - approved aside from regu | 0 | 0 | 0 |
| 3.4. | VIKR to shareholders with significant voting shares in the bank without FBA's permis | 0 | 0 | 0 |
| 3. | AMOUNT OF OFFSETTING ITEMS FROM BANK'S CAPITAL (3.1. to 3.4.) | 17.235 | 17.236 | 16.036 |
| A | AMOUNT OF BANK'S NET CAPITAL (1.+2.-3.) | 1.173.022 | 1.455.675 | 1.722.323 |
| B. | RISK FROM RISK-WEIGHTED ASSETS AND LOAN EQUIVALENTS | 6.681.510 | 8.282.086 | 10.066.842 |
| C. | NET CAPITAL RATE (CAPITAL ADEQUACY) (A.:B.) X 100 | 17,6% | 17,6% | 17,1% |

ATTACHMENT 7

NUMBER OF EMPLOYEES BY BANKS

| No. | BANK | 31.12.2005. | 31.12.2006. | 30.09.2007. |
|-----|---|-------------|-------------|-------------|
| 1 | ABS BANKA dd SARAJEVO | 290 | 297 | 325 |
| 2 | BOSNA BANK INTERNATIONAL dd Sarajevo | 85 | 104 | 137 |
| 3 | BOR BANKA dd SARAJEVO | 37 | 40 | 42 |
| 4 | HVB CENTRAL PROFIT BANKA dd SARAJEVO | 451 | 476 | 470 |
| 5 | CBS BANK dd SARAJEVO | 130 | | |
| 6 | HERCEGOVACKA BANKA dd MOSTAR | 99 | 98 | 97 |
| 7 | HYPO ALPE ADRIA BANK dd MOSTAR | 431 | 492 | 540 |
| 8 | INVESTICIJSKA BANKA FBiH SARAJEVO | 75 | 84 | 105 |
| 9 | INVESTICIONO KOMERCIJALNA BANKA dd ZENICA | 165 | 163 | 157 |
| 10 | KOMERCIJALNO INVESTICIONA BANKA dd VELIKA KLADUŠA | 63 | 66 | 66 |
| 11 | LT GOSPODARSKA BANKA BANKA dd SARAJEVO | 186 | 196 | |
| 12 | LJUBLJANSKA BANKA dd SARAJEVO | 62 | | |
| 13 | NLB TUZLANSKA BANKA dd TUZLA | | 479 | 474 |
| 14 | TUZLANSKA BANKA dd TUZLA | 332 | | |
| 15 | PROCREDIT BANK dd SARAJEVO | 430 | 595 | 796 |
| 16 | POŠTANSKA BANKA dd SARAJEVO | 63 | 63 | 81 |
| 17 | PRIVREDNA BANKA dd SARAJEVO | 190 | 170 | 163 |
| 18 | RAIFFEISEN BANK BH dd SARAJEVO | 1.195 | 1.348 | 1.519 |
| 19 | TURKISH ZIRAAT BANK dd SARAJEVO | 95 | 108 | 125 |
| 20 | UNA BANKA dd BIHAĆ | 58 | 61 | 60 |
| 21 | UNION BANKA dd SARAJEVO | 180 | 175 | 185 |
| 22 | UPI BANKA dd SARAJEVO | 208 | 233 | 441 |
| 23 | UNI CREDIT ZAGREBACKA BANKA BH dd MOSTAR | 790 | 840 | 837 |
| 24 | VAKUFСКА BANKA dd SARAJEVO | 167 | 175 | 179 |
| 25 | VABA BANKA dd SARAJEVO | | 58 | 84 |
| 26 | VOLKSBANK BH dd SARAJEVO | 233 | 285 | 317 |
| | TOTAL | 6.015 | 6.606 | 7.200 |