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

INFORMATION
ON THE BANKING SYSTEM OF THE FEDERATION OF BOSNIA AND HERZEGOVINA AS OF 03/31/03

Sarajevo, May 2003

Banking Agency of the Federation of BiH, as regulatory institution performing supervision of banks, has completed information on the banking system in the Federation of BiH as of March 31st 2003 based on the reports of banks, and other reports and information submitted by banks. The information also includes findings and information attained during on-site examinations and analysis performed in the Agency (off-site financial analysis).

I. INTRODUCTION

Indicators of FBiH banks' operations for the first quarter of 2003 confirm the continued positive changes and continued process of stabilization and consolidation of this sector.

Financial results showed an increasing trend: assets increased by 95 million or 2.1% in relation to the end of 2002, deposits increased by 66 million or 2% and the total capital by 20 million or 3%.

If we look at the balance sheet items, there was a decrease of cash funds by 2% and an increase of loan portfolio by 6%. Practically this means that the increase of loans of 165 million was "covered" with the decrease of cash funds on accounts.

On the liabilities side, there were certain changes in the deposits structure by industry areas. Deposits of public enterprises increased by 80 million (21%), citizens deposits by 50 million (30%) and deposits of banking institutions by 29 million (10%), while the deposits of private enterprises decreased by 97 million or 15%. At the same time, participation of long-term deposits stated in percentages marked a slight increase – by 24.1% at the end of last year to 24.5% at the end of March this year.

Increase of total capital is the result of the increase in core capital by 17 million and additional capital by 3.6 million KM. Shareholders' capital remained unchanged and three banks paid out dividends in the total amount of 1.5 million KM.

Unfortunately, capitalization ratio remained unchanged (15.5%) and the capital adequacy ratio (19.3%) decreased by 0.3% in relation to the end of 2002. This is a direct consequence of a high increase of lending activities that were not accompanied with an appropriate increase of net capital. That was especially noted with four banks, which have the largest assets and the largest capital adequacy ratio between 12% and 15%. Obviously, further increase of risk-bearing assets will have to be accompanied with an adequate increase of capital and, in that sense, the Agency has undertaken certain activities prescribed by law.

According to the information stated in the income statement, 19 banks realized an income of 22.7 million KM. Loss of 2.4 million was stated by 7 banks. At the level of the banking system, realized income was 20.3 million, which is 38% more than at the end of same reporting period last year when the income was 14.7 million. Participation of expenses in the total income showed a decrease from 86% in the same period last year to 81% in the first quarter of this year. It is important to say that profitability indicators are improving as well. At the level of the banking system, ROA (Return on Assets) was 1.75% and ROE (Return on Equity) was 14.98%, which represents significant progress in relation to the previous year and this is found to be within the range of world recognized standards.

II. OPERATIONAL PERFORMANCE OF THE FBIH BANKS

As of 03/31/03, 27 banks in the Federation of BiH had banking licenses issued by the FBA and all of them have been performing banking operations. Regular reporting requirements were met by all banks except for Hercegovacka Bank dd Mostar whose financial indicators were not included in this Information. According to its legal authorities, FBA performed review of bank reports (off-site supervision) and on-site bank examinations.

1. STRUCTURE OF THE BANKING SECTOR

1.1. Licenses for inception and operations of banks and other approvals

In the first quarter of 2003, FBA revoked three banking licenses from Gospodarska Bank dd Sarajevo and LT Komercijalna Bank dd Livno (due to status changes related to their merger to LT Gospodarska Bank dd Sarajevo) and from Raiffeisen Bank HPB dd Mostar due to merger with Raiffeisen Bank dd BH Sarajevo. In this status change related to merger, we have issued a license for inception and operations to LT Gospodarska Bank dd Sarajevo.

As of 03/31/03, 8 banks in the Federation BiH had 9 organizational units in Republic Srpska and 8 in District Brcko. Also, 3 banks from Republic Srpska had 7 organizational units in the Federation BiH.

As of 03/31/03, 3 banks were under provisional administration:
- Gospodarska Bank dd Mostar;
- Hercegovaèka Bank dd Mostar; and
- UNA Bank dd Bihaæ.

With an exception of Hercegovacka Bank dd Mostar, in which the provisional administration was imposed by the decision of the High Representative to BiH, the reason for initiating provisional administration in all other banks was noncompliance with operating requirements prescribed by the law.

As of 03/31/03, 27 banks had the license for performing internal payment system transactions (for inter-bank transactions), out of which 26 banks actually performed the payment system services.

1.2. Ownership structure

As of 03/31/03, ownership structure in banks[1] was evaluated upon available information and insight in banks. This structure is as follows:

- Private and predominantly privately owned 21 banks (77.8%)
- State and predominantly state owned 6 banks (22.2%)

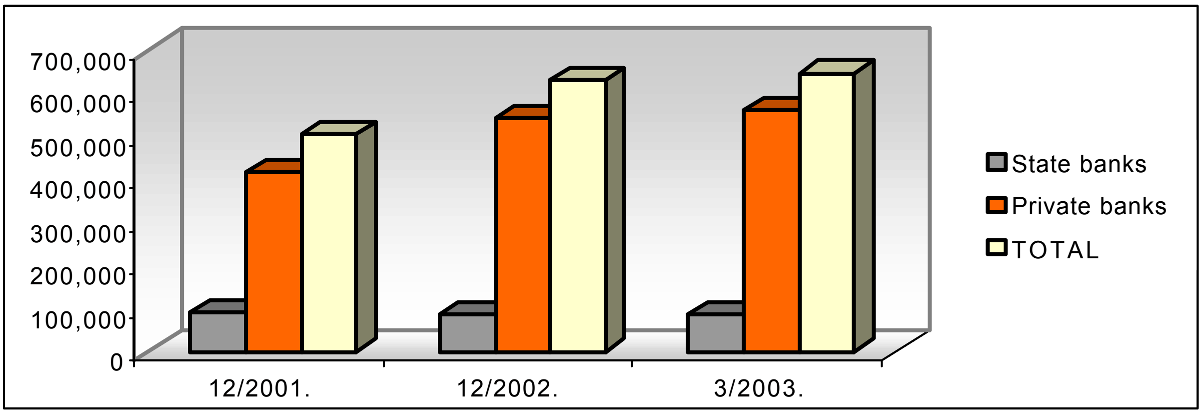
Ownership structure can be observed from the aspect of financial indicators, that is, by the value of total capital[2].

[1] Criteria for classification of banks by the type of ownership refers to ownership over shareholders' capital in banks.
[2] Information from the balance sheet – FBA schedule.

Schedule 1: *Ownership Structure by Total Capital (in 000 KM)*

BANKS	12/31/01[3]		12/31/02		03/31/03		RATIO	
							3/2	4/3
1	2		3		4		6	
State banks	90,800	18%	85,834	14%	85,761	13%	95	100
Private banks	413,691	82%	542,664	86%	560,590	87%	131	103
T O T A L	504,491	100%	628,498	100%	646,351	100%	122	103

Graph 1: *Overview of ownership structure (total capital)*

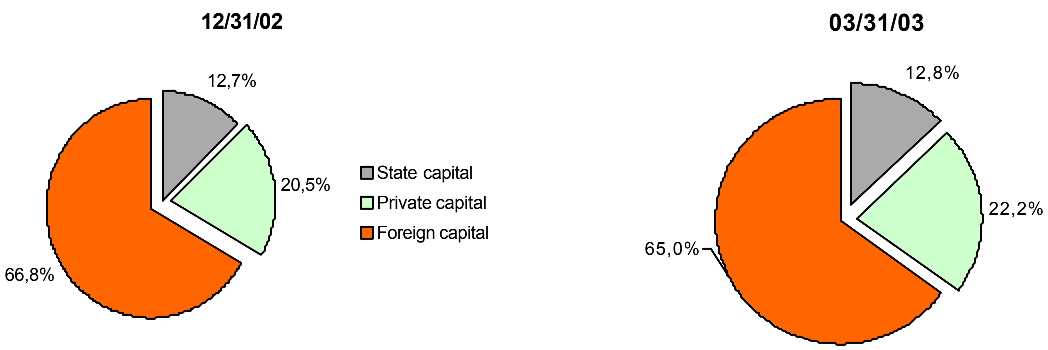


More detailed picture of ownership structure[4] of banks in the Federation BiH can be viewed from the analysis of participation of state, private and foreign capital in the shareholders' capital of banks.

Schedule 2: *Ownership structure by participation of state, private and foreign capital* (in 000)

SHAREHOLDERS' CAPITAL	12/31/01		12/31/02		03/31/03		RATIO	
	Amount	Particip. %	Amount	Particip. %	Amount	Particip. %	5/3	7/5
1	3	4	5	6	7	8	9	10
State capital	65,862	14.4	68,875	12.7	69,249	12.8	105	101
Private capital (residents)	102,943	22.4	110,605	20.5	119,844	22.2	107	108
Foreign capital (non-residents)	289,951	63.2	360,758	66.8	351,519	65.0	124	97
T O T A L	458,756	100.0	540,238	100.0	540,612	100.0	118	100

Graph 2: *Overview of ownership structure (shareholders' capital)*



[3] All schedules containing information as of 12/31/02 from the audited financial reports (after performed external audit).
[4] Ownership over shareholders' capital based on information received from banks.

Analysis of ownership structure in banks from the aspect of shareholders' capital shows in the best way the changes and trends in the FBiH banking system, especially in the segment of changes in ownership structure the inflow of foreign capital (mainly foreign banks).

Participation of state capital in total shareholders' capital as of 03/31/03 is the same as in the period of 12/31/02. In the structure of shareholders' capital as of 03/31/03, participation of remaining state owned capital in private banks is only 1% or 6.4 million KM.

Major changes in the ownership structure in 2003 were related to participation of private (local) capital.

In relation to 12/31/02, participation of private (residents) capital in the total capital of the banking sector increased from 20.5% to 22.2%, while at the same time there was a decrease in participation of foreign capital from 66.8% to 65.0%. These changes were related to mostly privately owned banks and resulted from the following: on one hand, foreign capital came into the system through purchase of shares from the existing owners (residents – legal entities and individuals) and, on the other hand, this was largely caused by additional capitalisation of 8 banks in foreign or majority foreign ownership.

Development of the reform and stabilisation of the banking system resulted in larger inflow of foreign capital, mainly by foreign banks. Positive trend of increase in participation of foreign capital in FBiH banks will probably continue in the future period.

1. 3. Staff

As of 03/31/03, in banks in the Federation BiH, there was total of 5,176 employees. Out of the total number, 11% worked in banks with majority state capital and 89% in privately owned banks.

Schedule 3 : *Staff in FBiH banks*

B A N K S	NUMBER OF EMPLOYEES			RATIO	
	12/31/01	12/31/02	03/31/03	3:2	4:3
1	2	3	4	5	6
State banks	554	558	547	101	98
Private banks	4.056	4.543	4.629	112	102
T O T A L	4.610	5.101	5.176	111	102
Number of banks	32	28	26		

During the first quarter of 2002, number of employees increased for 2% or 75 employees in private banks.

Increased number of bank employees was induced by new operations, that is, by increased scope of operations and extension of network of operational units.

Schedule 4: *Educational structure of staff*

EDUCATION	NUMBER OF EMPLOYEES			RATIO	
	12/31/01	12/31/02	03/31/03	3:2	4:3
1	2	3	4	5	6
University education – degree	1.434	1.683	1.735	117	103
Two-years post secondary education	467	533	533	114	100
High school	2.483	2.665	2.687	107	101
Other	226	220	221	97	100
T O T A L	4.610	5.101	5.176	111	102

In period observed, number of employees with university degree increased by 3% or 52 employees. However, the largest participation is still 52% of employees with high school degree.

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

Schedule 5: *Assets per employee*

BANKS	12/31/01			12/31/02			03/31/03		
	No. of staff	Assets (000 KM)	Assets per employee	No. of staff	Assets (000 KM)	Assets per employee	No. of staff	Assets (000 KM)	Assets per employee
State	554	378,256	684	558	345,592	619	547	346,083	632
Private	4,056	3,390,231	836	4,543	4,250,496	936	4,629	4,345,182	939
TOTAL	4,610	3,768,487	818	5,101	4,596,088	901	5,176	4,691,265	906

At the end of the first quarter of 2003, for each employee there was 906,000 KM at the level of the entire banking system, which is slightly better than at the end of 2002. As for state owned banks, this indicator was worse than the same in privately owned banks, that is, in the banking system as a whole.

Analytical indicators per individual banks were between 209,000 KM to 2,039,000 KM of assets per employee. 10 banks had the assets per employee ratio less than 500,000 KM, which indicates that the number of employees in relation to level of assets is too high, and in relation to that, high operating expenses had an adverse effect to the profitability of these banks. On the other hand, 10 banks had assets per employee ratio over 1 million KM.

2. FINANCIAL INDICATORS OF BANKS' OPERATIONS

Examinations of banks through analysis of reports is performed through the review of FBA prescribed reports and reports of other institutions, which make up a data base created from three sources:

1. Balance sheet information for all banks (in IMF and FBA format) submitted monthly, including quarterly attachments to balance sheet according to FBA format which contain more detailed information on cash funds, loans, deposits and off-balance sheet items;
2. Information on bank solvency, information on capital and capital adequacy, assets classification, concentrations of certain types of risk, liquidity position, FX risk exposure, (all based on FBA prescribed reports on quarterly basis);
3. Information on results of banks' operation (income statement in FBA format) and statements of cash flow submitted to the FBA on quarterly basis.

Aside from the above listed standardized reports, data base also includes the information from additional reports requested by the Agency from banks in order to have the best possible quality of monitoring of banks' operations in the Federation BiH. Also, database includes reports on audit of banks' financial statements by independent auditors, as well as other information relevant to the evaluation of individual bank performances and the performance of the banking system as a whole.

According to the provisions of the Law on the Opening Balance Sheet of Banks, banks with majority state capital are required to report to the FBA on the basis of the "complete" balance sheet divided into: passive, active and neutral sub-balance sheet items. In order have realistic indicators of banks' operations in the Federation BiH, all further analysis of the banking system will be based on information from the active sub-balance sheet from banks with majority state capital[5].

2.1. Balance sheet

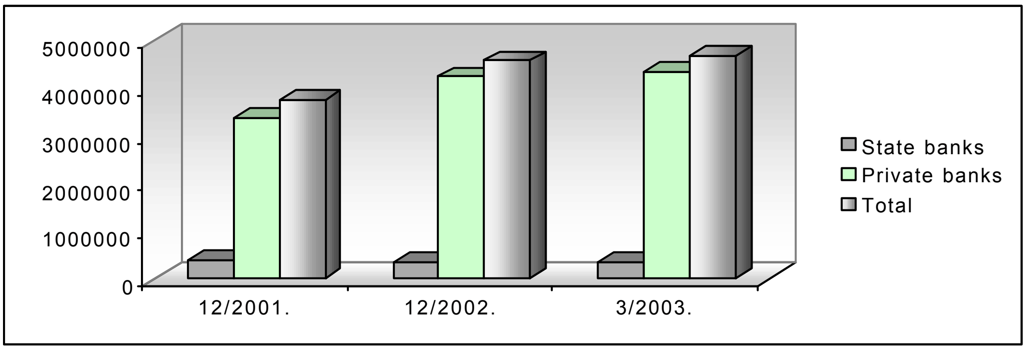
Based on the balance sheets submitted by banks as of 03/31/03, balance sheet total for the Federation of BiH was 4.7 billion KM, which is for 2.1% or 95 million KM more in comparison to 12/31/02.

Schedule 6 : *Balance sheet*

DESCRIPTION	AMOUNT (IN 000 KM)			RATIO	
	12/31/01	12/31/02	03/31/03	3/2	4/3
1	2	3	4	5	6
ASSETS :					
Cash funds	1,783,234	1,595,153	1,562,403	89	98
Securities	51,436	73,150	42,191	142	58
Placements to other banks	25,355	19,952	23,017	79	115
Loans – net	1,572,159	2,503,585	2,663,040	159	106
Premises and other fixed assets	273,981	299,250	300,406	109	100
Other assets	62,322	104,998	100,208	165	95
TOTAL ASSETS	**3,768,487**	**4,596,088**	**4,691,265**	**122**	**102**
LIABILITIES:					
OBLIGATIONS					
Deposits	2,900,613	3,528,209	3.594,391	122	102
Borowings from other banks	5,550	3,352	3,303	60	99
Obligations based on loans/	253,269	313,010	315,280	124	101
Othe obligations	104,564	123,019	131,940	118	107
CAPITAL					
Capital	504,491	628,498	646,351	125	103
TOTAL LIABILITIES (OBLIGATIONS AND CAPITAL)	**3,768,487**	**4,596,088**	**4,691,265**	**122**	**102**

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

Graph 3: *Assets in banks by ownership structure*



Analysis of individual bank data shows that changes in most of the banks are insignificant in comparison to the previous year and rates of increase/decrease of assets are between 0% to 5%. Only 3 banks had a growth rate between 10% to 20% and there was 1 bank with assets less than 28% in relation to the end of 2002.

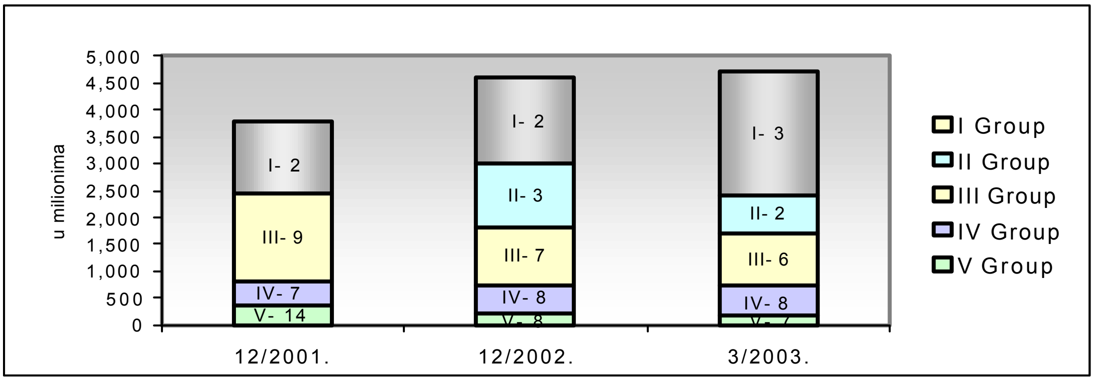
If we analyze the banking system from the aspect of assets size and particular categories within this aspect, changes in participation and number of banks in certain categories were the result of mergers/acquisitions of banks during the first quarter of 2003, while there was one bank that went from one category to another (assets over 500 million KM) based on its assets growth.

Following schedule represents amounts and participation of individual categories of banks[6] in the total assets through time periods (stated in millions of KM):

Schedule 7: *Participation of individual categories of banks in the total assets through time periods*

AMOUNT OF ASSETS	31.12.2001.			31.12.2002.			31.03.2003.		
	Amount	Part. %	No. of banks	Amount	Partic. %	No. of banks	Amount	Part. %	No. of banks
I- Over 500	1,315	34.9	2	1,606	34.9	2	2,269	48.4	3
II- 300 to 500	-	-	-	1,171	25.5	3	708	15.1	2
III- 100 to 300	1,632	43.3	9	1,072	23.3	7	969	20.6	6
IV- 50 to 100	460	12.2	7	543	11.8	8	573	12.2	8
V- Below 50	362	9.6	14	204	4.5	8	172	3.7	7
TOTAL	3,769	100.0	32	4,596	100.0	28	4,691	100.0	26

Graph 4: *Participation of particular categories of banks in total assets through time periods*



[6] Banks are divided into 5 categories by their assets size.

Participation of three largest banks in total assets at the level of the banking sector as of the end of the first quarter of 2003 was 48.4% or 2,269 million KM is an indicator of concentration of a smaller number of banks in the assets level (at the end of 2002 this was 34.9% or 1,606 million KM), while 11 banks from the first three groups have a participation of 84.1%.

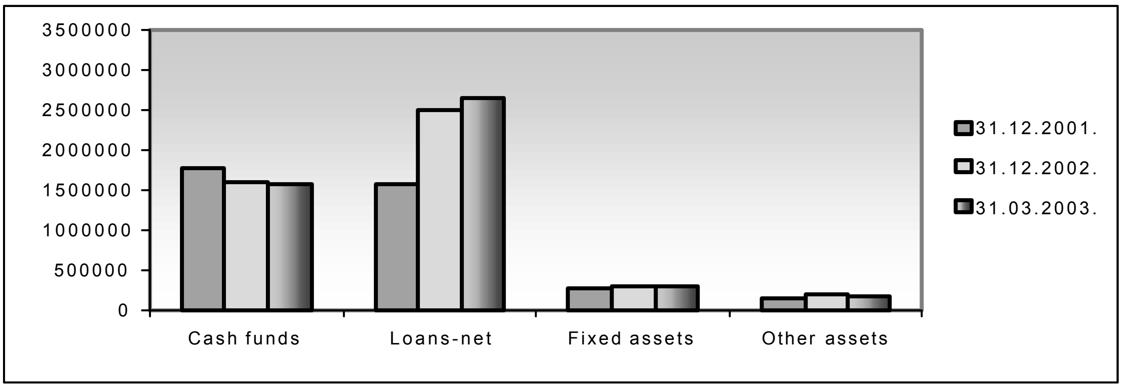
The growth of the balance sheet total was mainly the result of an increase in deposit potentials (by 2% or 66 million KM) and in capital (by 3% or 18 million KM).
On the other hand, in banks' assets, loans[7] continued to grow with a rate of 6% or 165 million KM, while cash funds decreased by 2% or 33 million KM.

The following schedule and graph show the comparative overview of the most significant balance sheet items within the banks' assets and liabilities:

Schedule 8: *Structure of the banks' balance sheets* *- in %-*

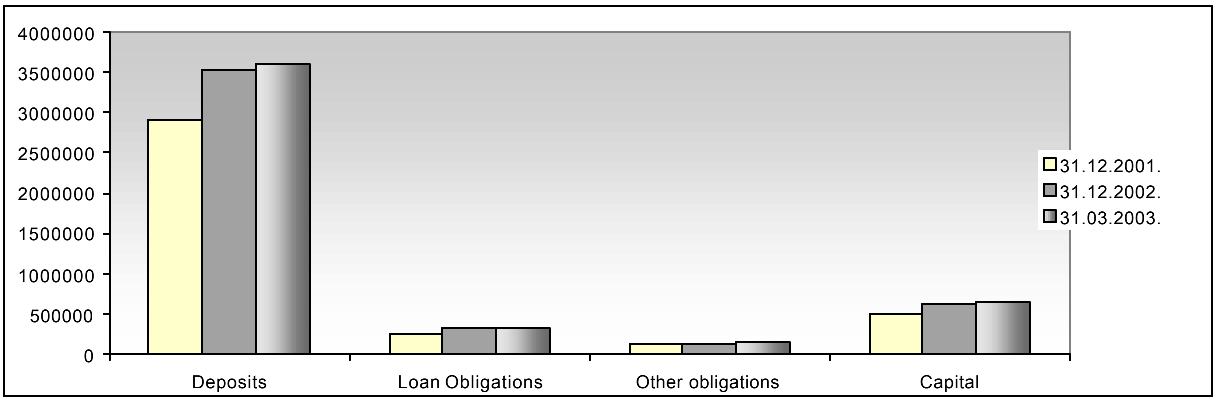
DESCRIPTION	PARTICIPATION		
	12/31/01	12/31/02	03/31/03
ASSETS :			
Cash funds	47.3	34.7	33.3
Securities	1.4	1.6	0.9
Placements to other banks	0.7	0.4	0.5
Loans – net	41.7	54.5	56.8
Premises and other fixed assets	7.2	6.5	6.4
Other assets	1.7	2.3	2.1
TOTAL ASSETS	100.0	100.0	1000
LIABILITIES :			
OBLIGATIONS			
Deposits	77.0	76.8	76.6
Borrowings from other banks	0.2	0.1	0.1
Obligations based on loans	6.7	6.8	6.7
Other obligations	2.7	2.6	2.8
CAPITAL			
Capital	13.4	13.7	13.8
TOTAL LIABILITIES (OBLIGATIONS AND CAPITAL)	100.0	100.0	100.0

Graph 5: *Structure of assets in the banks' balance sheets*



7 Gross loans (information from balance sheet)

Graph 6: *Structure of liabilities in the banks' balance sheets*



The liabilities structure in banks remained almost unchanged in relation to the end of 2002 and the deposits with the participation rate of 76.6% is still predominant in the financial resources of banks.

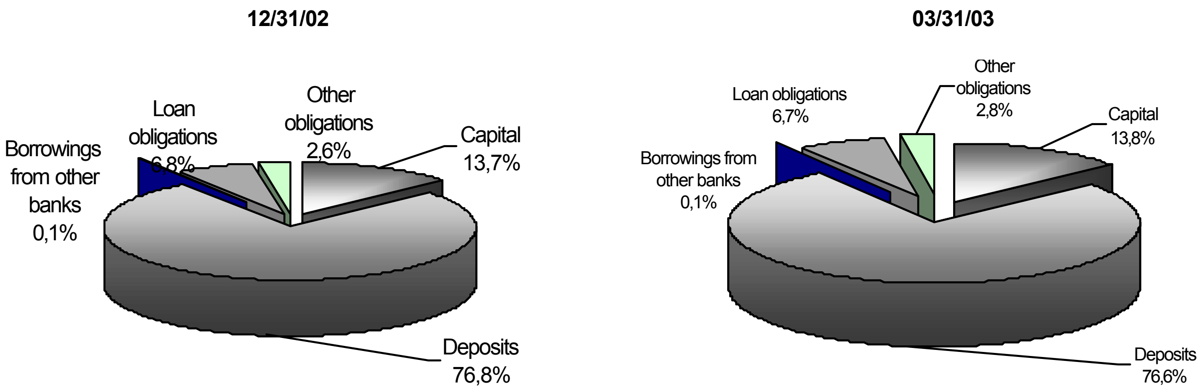
The most significant change in the assets structure was the increase of loans by 2.3%, so at the end of the first quarter of 2003, net loans represented 56.8% of banks' assets. At the same time, participation of cash funds decreased by 1.4% (from 34.7% to 33.3%).

Banks in the Federation BIH are still holding significant cash funds with depository institutions abroad. At the end of the first quarter of 2003, 71% or 1.1 billion KM of total cash funds was deposited with foreign banks, which, in relation to 2002, represents an increase of 8%. Participation of funds on reserve accounts with the Central Bank of BiH and in banks' vaults decreased in comparison to end of 2002 (from 12.6% to 10.6%, that is, from 23.3% to 18.8%).

2. 1. 1. Liabilities (obligations and capital)

Structure of obligations and capital of banks as of 03/31/03 can be observed from the following graph:

Graph 7: *Structure of banks' liabilities*



Liabilities structure remained almost unchanged, so that deposits are still a primary source of funding and have a largest participation of 76.6%.

During the first quarter of 2003, deposits increased by only 2% or 66 million KM, but this increase relates only to private banks (by 2% or 68 million KM), while in state banks, if compared to the end of 2002, deposits decreased by 0.8% or 2 million KM.

Maturity structure of deposits has slightly changed in favor of long-term deposits, but it is still not favorable enough since short-term deposits represent 75.5% of total deposits.

Schedule 9: *Maturity structure of deposits*

- in 000 KM-

DEPOSITS	12/31/01		12/31/02		03/31/03	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %
Savings and demand deposits	1,779,672	61.4	2,010,579	57.0	1,993,510	55.5
Up to 3 months	413,465	14.2	317,862	9.0	336,673	9.4
Up to 1 year	280,243	9.7	349,586	9.9	382,758	10.6
1. Total short-term	2,473,380	85.3	2,678,027	75.9	2,712,941	75.5
Up to 3 years	242,924	8.4	416,323	11.8	445,530	12.4
Over 3 years	184,309	6.3	433,859	12.3	435,920	12.1
2. Total long term	427,233	14.7	850,182	24.1	881,450	24.5
TOTAL (1 + 2)	2,900,613	100.0	3,528,209	100.0	3,594,391	100.0

Maintaining an adequate maturity structure of sources of funds and placements is one of the most important segments of risk management, that is, exposure of banks to liquidity risk. Any impairment of maturity adjustment would basically represent a danger to the future liquidity position, which could at the end jeopardize the entire financial condition of a bank and question its solvency and further operations.

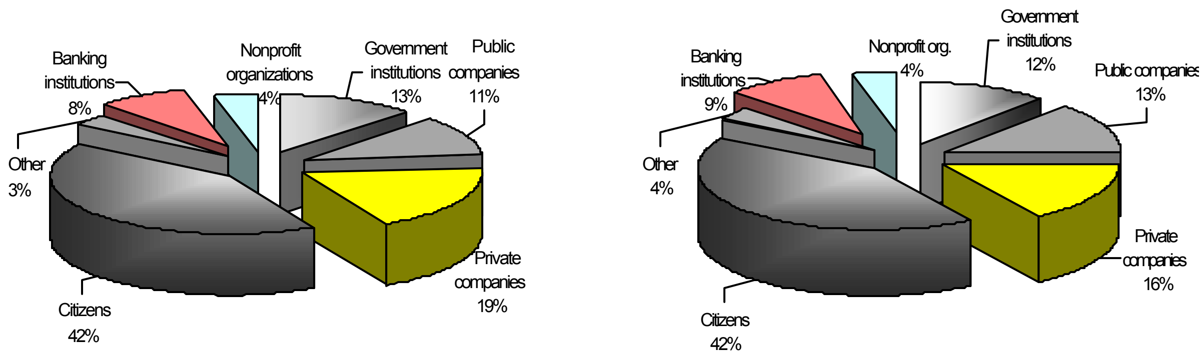
Schedule 10: *Deposits structure by industry areas*[8]

- u 000 KM-

INDSUTRY AREAS	12/31/01		12/31/02		03/31/03	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %
Government institutions	339,364	11.7	440,383	12.5	431,602	12.0
Public enterprises	359,390	12.4	388,271	11.0	470,138	13.1
Private enterprises	536,324	18.5	661,292	18.7	564,765	15.7
Non-profit organisations	132,452	4.6	135,849	3.9	138,817	3.9
Banking institutions	77,272	2.7	296,217	8.4	325,583	9.0
Citizens	1,334,337	46.0	1,482,313	42.0	1,531,877	42.6
Other	121,474	4.1	123,884	3.5	131,609	3.7
TOTAL	2,900,613	100.0	3,528,209	100.0	3,594,391	100.0

Graph 8 : *Deposits structure by industry areas*

12/31/02 **03/31/03**



8 Information from the supporting form BS-D which banks submit on a quarterly basis to the FBA along with the their balance sheets.

During the first quarter of 2003, and upon analysis of industry areas, the largest increase (in both absolute and relative amounts) was shown in the area of deposits of public companies (by 21% or 82 million KM), citizens area (by 3% or 50 million KM) and in the banking institutions area (by 10% or 29 million KM). At the same time, deposits of private companies decreased by 15% or 97 million KM.

As a results of the above mentioned, the most significant change in the deposits structure by industry areas, if compared to the end of 2002, was the increase of participation of public companies by 2%, that is, decrease of participation of private companies by 3%.

During the first quarter of 2003, savings deposits continued to have an increasing trend, that is, they have increased by 3% or 47 million KM. If we look at this from the perspective of industry areas, savings deposits in state banks decreased by 9% or 2 million KM and, at the same time, increased in private companies by 3% or 49 million KM.

As with other segments, we need to emphasize that there is a strong concentrations of savings with certain number of banks, since 67% of total savings is with 3 banks (covered with deposit insurance) in the FBiH (as of 12/31/02, it was 61%), that is, 89% of the total savings is with 8 private banks.

Schedule 11 : *New citizens savings by time periods* *- in 000 KM -*

BANKS	AMOUNT (IN 000 KM)			RATIO	
	12/31/01	12/31/02	03/31/03	3/2	4/3
1	3	3	4	5	6
State	28,787	22,072	19,987	76	91
Private	1,285,803	1,417,847	1,466,883	110	103
TOTAL	1,314,590	1,439,919	1,486,870	110	103

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

Aside from the activities performed by the FBA, what is important for the increase of savings in FBiH is the existence of the deposit insurance system as of January 2001, which is when the FBiH Deposit Insurance Agency estblished its operations. After that in August 2002, Deposit Insurance Agency at the level of BiH was founded based on the declared Law on Insurance of Deposits in BiH Banks. Until 03/31/03, 10 banks from the Federation BiH entered the deposit insurance program and received the certificates, and analytical information on the level of deposits by banks show an increasing trend of deposits in these banks. Their participation in total deposits as of 03/31/03 was 70% (as of 12/31/02 it was 68%), and the participation of savings was 82% (as of 12/31/02 it was 68%). Safety of deposits is the guarantee and a motive for the further increase of savings not only in these banks, but in all other banks.

2.1.2. Assets and Assets Quality

Decision on Minimum Standards for Bank Credit Risk and Assets Classification Management (the Decision) determines criteria for evaluation of banks' exposure to credit risk by rating their assets quality and adequacy of reserves for loan and other losses according to the risk of their placements and balance sheet assets items and off-balance sheet items.

Gross assets[9] in the balance sheet of banks in the FBiH as of March 31, 2003 amounted to 4,899 million KM, which is higher by 2% or 96 million KM than at the end of 2002. Off-balance sheet risk items amounted to 693 million KM and are increased by 3% or 20 million KM.

Total assets with off-balance sheet items (assets)[10] amounted to 5.6 million KM, which is higher by 2% than the end of 2002.

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

-in 000 KM-

DESCRIPTION	AMOUNT (in 000 KM)						RATIO	
	12/31/2001	Structure %	12/31/2002	Structure %	03/31/2003	Structure %	4:2	6:4
1.	2	3	4	5	6	7	8	9
Loans	1,526,178	38.7	2,525,337	52.6	2,690,726	54.9	165	106
Interest	17,646	0.4	25,697	0.6	28,133	0.6	146	109
Past-due receivables	189,630	4.8	158,084	3.3	157,218	3.2	83	99
Receivables on paid guarantees	7,853	0.2	7,110	0.1	7,291	0.2	91	103
Other placements	28,083	0.7	70,300	1.4	68,500	1.4	250	97
Other assets	2,177,185	55.2	2,016,606	42.0	1,946,795	39.7	93	97
TOTAL ASSETS	3,946,575	100.0	4,803,107	100.0	4,898,663	100.0	122	102
OFF-BALANCE SHEET ITEMS	495,029		673,498		693,174		136	103
ASSETS WITH OFF-BALANCE SHEET ITEMS	4,441,604		5,476,605		5,591,837		123	102
General credit risk and Potential loan losses	201,778		228,385		229,253		113	100
Already established general and special reserves for loan losses	198,234		224,987		228,643		113	102

In the first quarter of 2003 we have continuous growth in loan placements[11] by 6% or 165 million KM in relation to the end of 2002. At the same time, cash funds were decreased by 2% or 33 million KM. The same caused some changes in the assets structure, that is, increase of loan participation by 2.4% (from 58.5% to 60.9%), while participation of cash funds is decreased by 1.4% (from 34.7% to 33.3%).

Analytical data for banks indicate that only four banks had decrease in loan placements for the first quarter of 2003. In other banks, growth rate was from 0.5% to 28%, while three banks in the system had approximately 50% or 84 million KM out of total increase of loans (165 million KM).

Based on analysis of loans by industrial departments, we can make conclusion that the highest growth was in loans to citizens that in the first quarter of 2003 were increased by 8% or 100 million KM, so 48% of total loans was originated to citizens, and 40% to private companies.

Three largest banks have participation of citizens in total loans of approximately 58%, which is higher by the banking system average. These three banks have placed to the citizens department 63% out of total loan placements placed in this department. We can make conclusion that in some larger banks

[9] Source of data: Report on balance sheet assets and off-balance sheet items classification.
[10] Assets defined by Article 2 of Decision on Minimum Standards for Bank Credit Risk and Assets Classification Management.
[11] Loans with past-due receivables, receivables on paid guarantees and other placements.

there is a clear strategy on increase for lending volume for citizens, which is in relation to the rating that these loans are less risky, along with adequate loan policies that prescribe good quality collateral.

Schedule 13: *Loan Structure by Industrial Departments*

-in 000 KM-

DEPARTMENTS	12/31/2001		12/31/2002		03/31/2003		RATIO	
	Amount	Particip ation %	Amount	Particip ation %	Amount	Particip ation %	4/2	6/4
1	2	3	4	5	6	7	8	9
Government institutions	26,033	1.5	30,368	1.2	40,352	1.4	117	133
Public enterprises	246,437	14.3	248,852	9.2	242,601	8.5	101	97
Private companies and assoc.	770,703	44.7	1,078,651	40.1	1,155,544	40.5	140	107
Non-profit organizations	6,370	0.4	2,834	0.1	2,641	0.1	44	93
Banking institutions	42,480	2.5	46,439	1.7	31,540	1.1	109	68
Citizens	623,219	36.2	1,259,816	46.8	1,359,716	47.6	202	108
Other	8,422	0.4	23,571	0.9	22,840	0.8	280	97
TOTAL	1,723,663	100.0	2,690,531	100.0	2,855,234	100.0	156	106

As for maturity, we should emphasize that there is a continuous trend of increase in long-term loans (71% of total loans), especially in loans to citizens (as of 03/31/2003, 91% were long-term loans), while 56% of total loans to private companies were financed as long-term.

Schedule 14: *Maturity Structure of Loans*

-in 000 KM-

LOANS	12/31/2001		12/31/2002		03/31/2003		RATIO	
	Amount	Particip ation %	Amount	Particip ation %	Amount	Particip ation %	4/2	6/4
1	2	3	4	5	6	7	8	9
Past-due receivables and paid off-balance sheet liabilities	197,633	11.4	158,084	5.9	164,507	5.8	80	104
Short-term loans	459,617	26.7	650,570	24.1	667,286	23.4	142	103
Long-term loans	1,066,560	61.9	1,904,767	70.0	2,023,441	70.9	179	106
TOTAL LOANS	1,723,663	100.0	2,690,531	100.0	2,855,234	100.0	156	106

In some banks, we noted maturity inadjustment between financial assets and liabilities, that is, placements with longer term were financed from the short-term sources. This is basically the first sign that a bank could have some liquidity problems in future, especially if assets quality is undermined. That is why most of the banks have some problems to provide for long-term sources, including primary (deposits) and secondary (loans) sources and capital.

Since placements, that is, loans represent portion of bank's assets that carries most of the risk, their quality represents one of the most significant determinations for stable and successful performance. Assets quality rating is actually a rating of loan risk in bank's placements, that is, identification of potential loan losses recognized as provisioning for loan losses.

Assets quality of banks and off-balance sheet risk items and potential loan losses by classification categories are presented in the following table:

Schedule 15: *Classification of Assets and Off-Balance Sheet Risk Items from Active Balance sheet as of 03/3 1/2003*

-000 KM -

RECEIVABLES	CLASSIFICATION CATEGORY					
	A	B	C	D	E	TOTAL
Placements[12]	2,208,506	439,706	148,526	121,891	5,106	2,923,735
Interest	18,145	6,300	2,786	891	11	28,133
Total placements	2,226,651	446,006	151,312	122,782	5,117	2,951,868
Other assets	1,931,243	9,987	1,445	2,341	1,779	1,946,795
TOTAL ASSETS	4,157,894	455,993	152,757	125,123	6,896	4,898,663
OFF-BALANCE SHEET RISK ITEMS	615,176	68,688	4,511	4,294	505	693,174
ASSETS WITH OFF-BALANCE SHEET RISK ITEMS	4,773,070	524,681	157,268	129,417	7,401	5,591,837
General Credit Risk and Potential Loan Losses	59,934	43,249	42,677	75,992	7,401	229,253
Already established general ad special reserves for loan losses	60,665	43,647	42,783	79,236	2,312	228,643
Structure of established reserves by classification categories	26.5%	19.1%	18.7%	34.7%	1.0%	100.0%

Participation of non-performing assets (C-E) of 5.2% in total assets with off-balance sheet items remained the same as of 12/31/2002, although there is a nominal increase by 115 million KM, for which the banks have already established reserves for loan losses in accordance with the regulations and the amount of estimated loan risk.

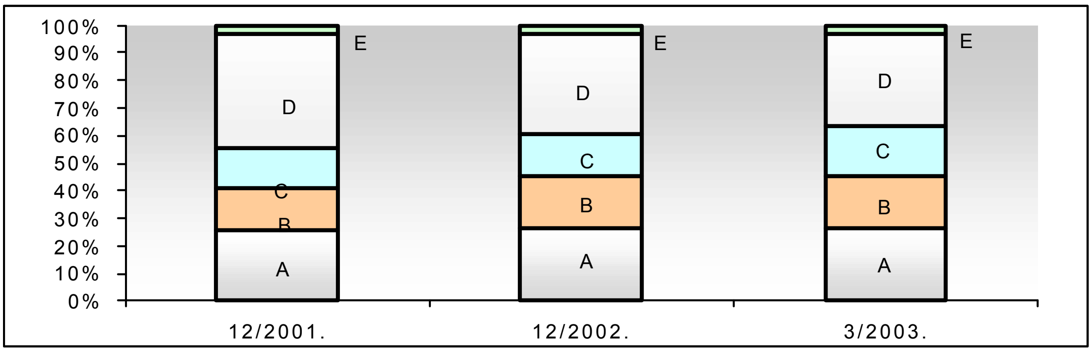
Amount of general loan risk and losses estimated by classification categories, determined in accordance with the criteria and methodology prescribed by the FBA Decisions, their trend and structure on the level of the banking system, is presented in the following table and graph:

Schedule 16: *Structure and Trend of General Credit Risk and Potential Loan Losses*

Classification category	AMOUNT (in 000 KM) AND STRUCTURE (in%)						RATIO	
	12/31/2001		12/31/2002		03/31/2003		4/2	6/4
1	2	3	4	5	6	7	8	9
A	51,377	25.5	60,296	26.4	59,934	26.2	117	99
B	31,339	15.5	42,537	18.6	43,249	18.8	136	102
C	28,852	14.3	35,977	15.8	42,677	18.6	125	119
D	84,429	41.8	81,871	35.8	75,992	33.2	97	93
E	5,781	2.9	7,704	3.4	7,401	3.2	133	96
TOTAL	201,778	100.0	228,385	100.0	229,253	100.0	113	100

[12] Placements include: loans, past-due receivables, receivables on paid guarantees and other placements.

Graph 10: *Structure and Trend of General Credit Risk and Potential Loan Losses*



General credit risk and potential loan losses of banks at the end of first quarter of 2003 were 229 million KM (4.1% of total assets with off-balance sheet items), which is on the same level as of 12/31/2002. Changes in the structure of loan losses indicate higher participation in categories B and C, and lower participation in category D by 2.3%, which is a result of the activities undertaken by banks to solve some problems related to non-performing loans and more consistent implementation of the FBA regulation. Assets quality analysis, that is, loan portfolio analysis by individual banks, as well as on-site examinations of banks, indicate that majority of banks still have loan risk (that is, existence of problem loans originated to legal entities – companies) as the key risk. The Agency has ordered enforcement actions to these banks in regard that they have to prepare program that has to include action plan to improve present practices in loan risk management, that is, to improve assets quality, decrease present concentrations, and solve problems in non-performing assets and stop any further deterioration. The FBA findings are being performed according to the determined schedule.

Transactions with Related Entities

In their performance, banks are exposed to a various types of risk, and special significance has the risk in transactions with related entities.

In accordance with the Basle Standards, FBA has established certain prudential principles and requirements for transactions with related entities[13], which is determined by Decision on Minimum Standards for Bank's Transactions with Related Entities. This Decision prescribes requirements and method for bank's performance with related entities. Based on the Decision and the Law on Banks, bank's supervisory board, upon general manager's proposal, is obliged to appoint special policies for bank's transactions with related entities and monitor their implementation.

FBA Decisions also prescribe a special set of reports that include transactions with one part of related entities, in the area of loans and potential and undertaken off-balance sheet liabilities (guarantees, letters of credit, undertaken liabilities), as most common transactions and transactions with the most risk between a bank and related entities. The prescribed set of reports include information on loans originated to the following categories of related entities:

- Bank's shareholders with over 5% of voting rights,
- Bank's supervisory board members and senior management and
- Subsidiaries and other companies related to the bank through capital.

[13] Article 39, Paragraph 2, Law on Changes and Amendments to the Law on Banks, defines this term "related entities" and it does not include bank's employees any more.

Schedule 17: *Transactions with Related Entities*

-000 KM -

Description	ORIGINATED LOANS		
	12/31/2001	12/31/2002	03/31/2003
Shareholders with over 5% of voting rights, subsidiaries and other companies related through capital	46,071	59,241	38,283
Supervisory Board members	48	315	105
Bank management and employees	3,580	2,699[14]	1,384
TOTAL	49,699	62,255	39,772
Potential and undertaken off-balance sheet liabilities	4,906	6,684	1,479

From the same reasons (in on-site examinations) FBA pays special attention to bank's transactions with related entities. FBA on-site examiners issue orders for elimination of determined irregularities with certain deadlines and initiate violation proceeding. Along with this, FBA performs monitoring over implementation of the issued orders and in practice we can see the results, because the amount of loans originated to related entities in the first quarter of 2003 was decreased by 22 million KM.

2.1.3. Capital – Strength and Adequacy

As of 03/31/2003, total capital[15] of the banks in the FBiH was 761,185,000 KM.

Schedule 18: *Regulatory Capital* -in 000 KM-

DESCRIPTION	12/31/2001		12/31/2002		03/31/2003		RATIO	
							3/2	4/3
1	2		3		4		5	6
STATE BANKS								
a) Core capital	83,505	93%	101,783	96%	101,846	96%	122	100
b) Additional capital	6,206	7%	3,925	4%	3,943	4%	63	100
c) Total capital (a + b)	89,711	100%	105,708	100%	105,789	100%	118	100
PRIVATE BANKS								
a) Core capital	475,845	86%	536,203	84%	553,333	84%	113	103
b) Additional capital	74,881	14%	98,476	16%	102,063	16%	132	104
c) Total capital (a + b)	550,726	100%	634,679	100%	655,396	100%	115	103
TOTAL								
a) Core capital	559,350	87%	637,986	86%	655,179	86%	114	103
b) Additional capital	81,087	13%	102,401	14%	106,006	14%	126	104
c) Total capital (a + b)	640,437	100%	740,387	100%	761,185	100%	116	103

Total capital[16] for the first quarter of 2003 was increased by 3% or 20.8 million KM in comparison to 2002, out of which core capital was increased by 17.2 million KM, and additional capital by 3.6 million KM.

The increase of core capital is based on the income included from 2002 (16 million KM to undistributed income and approximately 2 million KM to reserves), while equity capital remained without changes.

The changes mentioned for the first quarter did not have any influence to the changes of regulatory capital structure.

Capital/assets ratio, that is, capitalization rate of banks as of 03/31/2003 was 15.5% and not changed in comparison to 2002 due to proportional growth of capital and assets.

---

[14] Without loans originated to the employees, in accordance with the changes to the Law on Banks.

[15] Regulatory capital defined by Articles 8 and 9 of Decision on Minimum Standards for Capital Management.

[16] The data source is quarterly report on capital balance of banks (Form 1 – Table A) prescribed by Decision on Minimum Standards for Bank Capital Management.

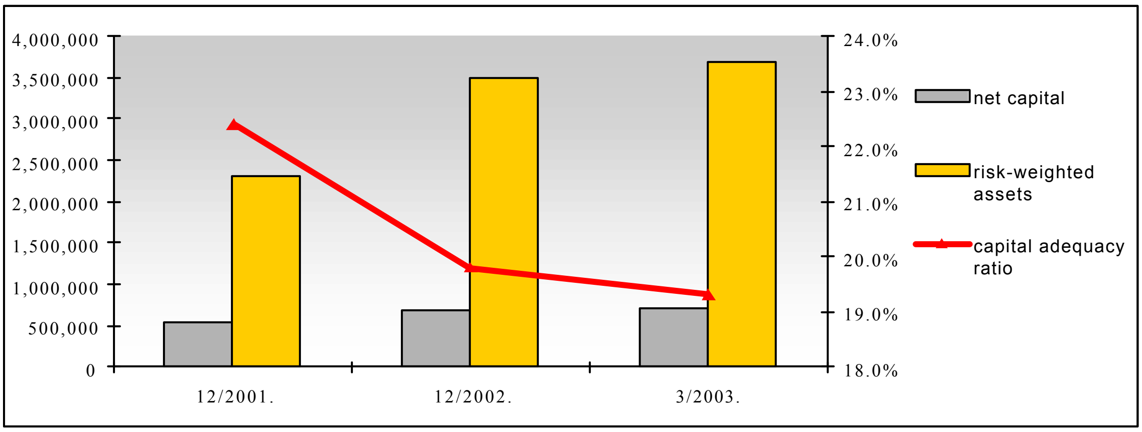
All the above mentioned had positive impact to net capital that in the first quarter of 2003 increased by 2.5% or 17.6 million KM, so as of 03/31/2003 it was 709 million KM (626 million KM in private banks and 83 million KM in state banks).

Capital adequacy ratio, calculated as ratio of net capital and risk-weighted assets, for the whole banking system was 19.3%, which is less if compared with 12/31/2002 due to the decrease of this ratio in private banks. High growth of lending activities in these banks increased the level of risk, which was not followed by adequate growth of net capital, and that is why the FBA ordered banks to take adequate activities to strengthen capital basis and provide for adequate capital.

Schedule 19: *Net Capital, Risk-Weighted Assets and Capital Adequacy Ratio*

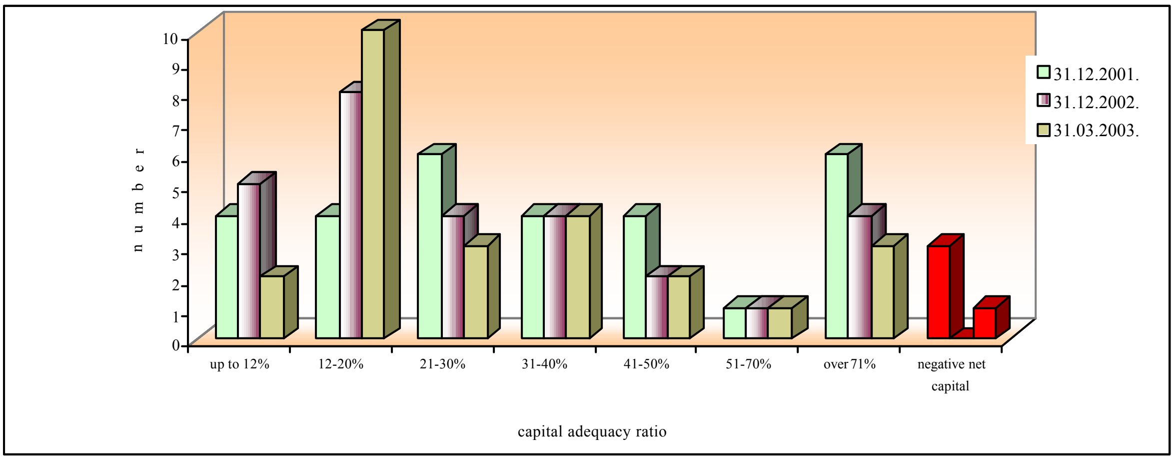
DESCRIPTION	12/31/2001	12/31/2002	03/31/2003	RATIO	
				3/2	4/3
1	2	3	4	5	6
NET CAPITAL	535,505	691,674	709,266	129	103
RISK WEIGHTED ASSETS AND CREDIT EQUIVALENTS	2,388,921	3,492,170	3,673,269	146	105
NET CAPITAL RATIO (CAPITAL ADEQUACY)	22.4%	19.8%	19.3%	88	98

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



Out of 26 banks in the FBiH as of 03/31/2003, 23 banks had capital adequacy ratio higher than 12% (two banks over 100%); two banks had the ratio below minimum prescribed by the law; and one bank had negative ratio. However, we express our concern that four largest banks (by their assets size) have adequacy ratio between 12% and 15% and any further growth of risk assets will have to be followed by adequate growth in capital. In that sense, banks are obliged to prepare a program for capital management and continuous monitoring of implementation in order to ensure and maintain quantity and quality of capital at least in accordance with the minimum standards prescribed by the law.

Graph 12: *Capital Adequacy Ratio of Banks*



Although the banking system in the Federation through periods shows capital strengthening, there is still this conclusion that it is made of many smaller banks, and that certain number of banks is undercapitalized, that is, it does not have a strong capital basis that would guarantee absorption of all potential losses in performance and a full safety to creditors, nor would support any further growth of risk assets and development of the performance. Strengthening capital basis will be a priority task for majority of banks in 2003, especially the largest banks in the system, which is necessary for strengthening stability and safety of banks themselves and the entire banking system. Thus, there is a task imposed on FBA to require by adequate decisions from banks to strengthen capital basis that will guarantee stability and safety of banks.

2.2. Profitability

Banks in the Federation of BiH, according to the information from income statement, for the first quarter of 2003, reported positive financial result of 20.3 million KM. This indicator is better compared to the same for the first quarter in 2002 when the profit was 14.7 million KM.

19 banks showed positive financial result of 22.7 million KM, and seven banks suffered loss of 2.4 million KM. Detailed information is presented in the following table:

Schedule 20: *Profit/Loss*

-000 KM-

Date/Description	Banking System		Private banks		State banks	
	Amount	No.of banks	Amount	No. of banks	Amount	No. of banks
03/31/2002						
Loss	-2,791	10	-2,355	8	-436	2
Profit	17,485	22	16,128	18	1,357	4
Total	14,694	32	13,773	26	921	6
03/31/2003						
Loss	-2,432	7	-1,938	3	494	4
Profit	22,739	19	21,977	17	762	2
Total	20,307	26	20,039	20	268	6

The same as in other segments of performance, this one also has some concentrations: a few banks have good profitability (4 private banks made 75% of total profit), than in higher number of banks profitability is not satisfactory both from the aspect of the financial result performed (insignificant profit was made) and the aspect of indicators or ratios used for profitability, productivity and efficiency ratings.

From one period to another, structure of total income has a slight trend of change in favor of net interest income that is 50% of total income (in the same period in 2002 it was 39%) as a result of increase in lending placements in the structure of total assets of banks and decrease in participation of operating income to 50% (for the same period in 2002 it was 61%) that also include collection of risk placements previously charged off.

Total expenses of banks participate with 81% in total income (for the same period in 2002 it was 86%). In the structure of total expenses, operating expenses participate the most with 54% (salaries and contributions with 27%, other operating expenses 11%, business premises expenses, other fixed assets and overhead with 16%), while provisioning for general loan losses and potential loan losses participate with 23% (for the same period in 2002 it was 27%).

In the following tables you can see the most significant ratios for profitability, productivity and efficiency ratings:

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

-in %-

RATIOS	12/31/2001	12/31/2002	03/31/2003[17]
Return on Average Assets	-1.18	0.41	1.75
Return on Average Total Capital	-5.62	3.04	12.64
Return on Average Equity	-6.15	3.56	14.98
Net interest income/ Average assets	5.26	4.50	4.75
Fee income / Average assets	7.64	5.50	4.74
Total income / Average assets	12.89	10.00	9.49
Business and direct expenses[18]/Average assets	6.54	3.73	2.63
Operating income / Average assets	7.40	5.80	5.11
Total noninterest bearing expenses/ Average assets	13.94	9.52	7.74

Schedule 20: *Profitability, Productivity and Efficiency Ratios as of 03/31/2003*

-in %-

RATIOS	03/31/2003		
	STATE BANKS	PRIVATE BANKS	AVERAGE FOR THE FBiH
Return on average assets	0.31	1.87	1.75
Return on average total capital	1.24	14.42	12.64
Return on average equity	1.49	17.04	14.98
Net interest income/ Average assets	3.90	4.82	4.75
Fee income / Average assets	9.57	4.35	4.74
Total income / Average assets	13.47	9.17	9.49
Business and direct expenses[19]/Average assets	7.98	2.20	2.63
Operating expenses/ Average assets	5.18	5.11	5.11
Total noninterest bearing expenses/ Average assets	13.16	7.31	7.74

In the observed period for 2003, the banking system, in comparison to the same period last year, performed better indicators, out of which we should emphasized two most significant profitability indicators: ROA (Return on Assets) of 1.75% and ROE (Return on Equity) of 14.98%, which is significantly better than the previous year, even on the level of the international standards from practice.[20]

[17] Recalculated on annual basis.
[18] Expenses include provisioning for potential loan losses.
[19] The same.
[20] The international standard for ROA is 1%, and for ROE 12-18%.

The financial results performed for the banking system as of 03/31/2003 represent yet another indicator of positive changes in the banking system, although it has primarily been the result of high profit made by the two largest banks in the system. Profitability of banks in the next period should primarily depend on assets quality, that is, approved loans and in that regard the level of bank's exposure to loan risk and provisioning for loan losses, and effective operating expenses management.

In further process of restructuring and reform of the banking system there will be resolution of banks under provisional administration, that already operate with loss, through merger or liquidation process. Other banks in the system will have to adopt the new concept of business policy adjusted to the market oriented banking in order to get better profit, providing for stability of banks and adequate management and control of all risks to which a bank is exposed in its performance, and primarily credit risk. With better profit, banks will, through retained income as internal source, also strengthen their capital.

III. CONCLUSION

Through consolidation and stabilization of the banking system in the Federation of BiH during the last year we have seen the new changes reflected in significant growth of assets and capital, larger banks, new products, new regulations that will provide for higher level of implementation of the international performance standards.

We have seen further improvement of financial results in comparison to the last year, but still seven banks suffered loss.

In the next period, FBA will emphasize the activities on risk control (primarily credit risk) and insist on adoption of stronger policies and procedures and their consistent implementation. At the same time, it will take measures to strengthen internal controls and internal and external audit, and capital strengthening of banks.

This continued positive trend means retained continuity in the activities for all the participants in the banking system reform and implementation of measures that will the transition process finalize in the shortest period possible.

As for further positive changes, it would be very significant to engage authorized institutions in Bosnia and Hercegovina to do the following:

- accelerate process of overall reform in the realistic department to make progress in monetary and banking system;
- finalize privatization process in state banks within the anticipated deadline;
- create legal framework that will support the process of further growth of banks;
- improve conditions for banks to operate in the whole area of Bosnia and Herzegovina;
- redirect funds from the succession to development, through commercial banks and repayment of old foreign currency savings;
- faster and consistent implementation of the law on collateral;
- acceleration of court proceedings, ruling process and their implementation;
- establish effective collateral performance process;
- adopt law on protection of creditors and more concrete responsibility for bank's debtors;
- further improvement of legal and institutional framework for the reform of banking and entire financial system with consistent compliance with Basle Principles and European Directives;
- support initiative to allow the Central Bank to issue bonds and teller's notes, etc.

Tasks for the FBiH Banking Agency for the next period are the following:

- continuous bank supervision in order to effectively protect depositors and eliminate weaknesses in performance of banks, timely reaction and ordering proper corrective actions;
- finalization of remaining provisional administrations and liquidations;
- special supervision of banks with high amount of savings (citizens savings) and banks with expansion rate over the average;
- continuous monitoring of capital adequacy in banks and implementation of the measures ordered in accordance with FBA decisions;
- special supervision of related entities in banks;
- examination for implementation of the new performance standards prescribed by the law on decisions;
- further development of regulations under the Agency's authority (foreign exchange risk, capital standards, etc.) in accordance with Basle Principles;
- further education and professional training of its own staff;
- intensify efforts on implementation of regulations on prevention of money laundering and financing terrorism and improve coordination with other supervision and control institutions;
- establish data base on non performing customers considered special credit risk for banks;

- improvement and practical application of the computer system that will allow an early warning and prevention in elimination of weaknesses in banks' performance;
- efficient cooperation with Bankers Association;
- initiation of cooperation with the supervisors of those countries that have investors in the FBiH banking system;
- organize consulting on implementation and development of regulations appointed by FBA, etc.

As the most important part of the system, banks should take the following actions:

- further capital strengthening in accordance with assets growth and risk;
- assets quality improvement;
- stronger internal controls and establishment of internal audit, providing their full independence;
- adoption and implementation of new principles in performance, policies and procedures in the environment of stronger market competition;
- information exchange about bad debtors, that is, reporting to FBA about non performing customers considered special credit risk for banks that will allow establishment of a special data base;
- faster development of credit/debit card operations and electronic banking;
- development of procedures for control and improvement of IT;
- stronger and consistent implementation of professional criteria and qualifications to perform management and governance functions in banks;
- personnel development and professional training to establish better relationship with customers, especially small and middle size enterprises, which includes new services, common in the world, that is, stronger development of financial management operations;
- effective involvement into the global process of combat against money laundering and terrorism financing, etc.

ATTACHMENTS