INFORMATION

ON BANKING SYSTEM OF
THE FEDERATION OF BOSNIA AND HERZEGOVINA
As of 06/30/02

Sarajevo, September 2002

Banking Agency of the Federation of BiH, as regulatory institution performing supervision of banks, has completed information on the banking system of the Federation of BiH as of June 30th 2002 based on the reports received from banks, and other reports and information submitted by banks. The information also includes findings and information attained during on-site examinations and analysis performed in the Agency (off-site examination).

I. INTRODUCTION

Banking sector of the Federation of Bosnia and Herzegovina has completed first semi year successfully and kept positive trends from previous year. According to data submitted by banks to the Banking Agency of the F BiH, at the end of first six months in this year, assets in the baking system amounted to KM 4.1 billion or nine percent higher in comparison to the end of last year. Further, loans increased by 30 percent, so total placements to citizens and enterprises amounted to more than KM 2 billion. Due to the increase of loans, money assets held in banks decreased from KM 1.78 billion at the end of last year to KM 1.58 billion at the last day of June.

It is especially important to mention that capital in banks has improved. During first six months of the year, total capital increased by KM 95.5 million or by 15 percent and it amounts to 736 million now. This effect resulted, mainly, from additional capital provided in two banks (KM 62.5 million) and distributing income from last year to core capital. Capitalization ratio in banks was increased and it amounts to 17.1 percent, which is more by 2.1 percent in comparison to the end of last year. But, capital adequacy ratio was worse by 2.2 percent and in the sector it amounted to 21.2 per cent.

At the same time, deposits increased by nine percent and totaled 3.15 billion. Among those, citizens savings were one billion and 349 million, and they increased by 2.5 percent in comparison to the end of last year. It is noticeable that maturity structure of savings is gradually improved - long-term deposits are 19.8 percent now out of total deposits - and earlier they were 14.7 percent.

Regarding ownership structure, there were no major changes although participation of foreign capital in total share capital in the system increased from 63.2 to 67.8 and it reached amount of KM 355 million. At the moment, six banks are hundred percent in foreign ownership, nine banks are in majority foreign ownership (60 to 99.7 percent) and in five banks foreign capital is only 2 to 42 percent.

Although profitability is improved, in majority of banks it is still not satisfactory. For the whole system, nine banks showed loss (eight million KM) while 21 bank operated with positive results of total income of 18.9 million. Therefore, for the whole system banks earned almost KM 11 million. Regarding the structure, total income of net interest margin was 41 percent (two percent more then earlier) and operating income now is 59 percent (or two percent less then before). Relation between expenses/total income got better too. Expenses are now 95 percent of total income, which is better by three percent in comparison to the previous period.

Analysis of banking system of the Federation of BiH, from the aspect of balance sheet growth and groups within the balance sheet, showed that 14 banks had less assets at the end of June in comparison to previous year, while in five banks assets increased by more then 20 percent. Almost half of total balance sheet growth in the system (162 million) is related to only one, the largest bank in the system.

There is very noticeable grouping of banks by size of assets. Two banks in the Federation of BiH had assets larger than KM 500 million, two next largest banks have assets between 300 and 500 hundred million and seven banks had assets between 100 and 300 million. Remaining 19 banks have assets less than 100 million (11 of them have assets below 50 million). Two largest banks hold 36.2 of total assets in the system, next two largest banks 16.3 percent. Practically, 11 largest banks hold assets of 3.3 billion or 81 percent of assets in the system, and banks with assets under 100 million participate with 19.3 percent. At the same time, 11 largest banks hold more than 84 percent of total deposits, and six banks have 74 percent of total income at the end of first six months.

The major change in the first half of the year happened in the size of total loans. The loans increased by KM 517 million or 30 percent in comparison to the end of last year. This trend brings danger of increased risk and managing and governing bodies should pay attention to that, since maturity adjustments of funds and placements are weakened. That is, size of long-term loans increased (66 percent of total), especially those approved to citizens (almost 91 percent of long-term loans were approved to citizens). In the whole view, 42.8 percent of total loans were approved to citizens, meaning that placements were increased by 54 percent or KM 336 million.

According to the reports submitted by banks, transactions with related entities increased. At the end of June this year, there was KM 61.9 million, which is in comparison to the end of last year increase of over 20 percent.

The Parliament of the Federation of BiH adopted the Law on Changes and Amendments to the Law on Banks in August, and the Law is already in effect. In short, changes and amendments to the existing Law on Banks serve further development of the legal framework for inception and operation of banks in the Federation of BiH. Rules for more prudent, safer, successful operations and for managing and governing are set in more detailed and precise manner with aim to solve problem situations in banks. It also includes protection mechanisms that are supposed to decrease deposit risk with source of funding from public income. All this gives presumptions for better implementation of international banking principles.

II. OPERATIONAL PERFORMANCE OF BANKS IN THE FEDERATION OF BiH

As of 06/30/2002, 31 banks in the Federation of BiH had banking licenses issued by the FBA. All banks have been performing banking operations and had duty to report to FBA. The FBA reviewed reports (off-site examination) and performed on-site examinations as the law regulates it.

1. STRUCTURE OF BANKING SECTOR

1.1. Licensing and Approvals

In the period until 06/30/02 the FBA revoked two banking licenses due to status changes in those banks (Depozitna Bank dd Sarajevo and Šeh in Bank dd Zenica). In the same period, the FBA received one application for inception of one bank. The license for inception and operation of HVB Bank BiH dd Sarajevo was issued in May 2002, but the bank was not registered in the court registry until 06/30/02.

Provisional administrator was governing four banks as of 06/30/02:

- Gospodarska Bank dd Mostar
- Mostarska Gospodarska Bank dd Mostar
- Hercegovaèka Bank dd Mostar
- UNA Bank dd Bihaæ and

Aside from Hercegovaèka Bank dd Mostar, where the High representative Office in BiH set provisional administration, other banks were put under provisional administration because they did not adjust to regulations on banking operations.

In the first six months of 2002, banks mainly complied their operations with the laws and regulations passed by the Agency regulating approvals, consents and licenses for status or statutory changes, appointment of General Manager, setting up new operational units, investing in other legal entities, issuance and purchase of shares, internal payment operations.

29 banks in the Federation of BiH had a license for internal banking operations as of 06/30/02, among those, two banks had approval for inter-banking transactions and 28 for intra-banking transactions. In comparison to 12/31/01, there is one bank more that was given license for intra-banking transactions - Bosnia Bank International d.d. Sarajevo. Applications for license for internal banking operations are still accepted by the FBA.

1.2. Ownership Structure

As of 06/30/02, ownership structure in banks[1] was evaluated upon available information and insight in banks and it was as follows:

[1] A classification criterion for banks by ownership type is ownership on shareholders capital in banks.

- Private and majority private owned 25 banks (80.6%)
- State and majority owned by state 6 banks (19.4%).

A special problem in the ownership structure definition in previous period was related to the changes of ownership structure in banks. More banks became privately owned, and it was necessary to determine ownership structure in "old state/social banks".

Based on the documentation received and interventions performed earlier and/or in the mean time, and based on the registrations at authorized courts related to changes of capital and shareholders, it is possible to determine that global ownership structure was changed in banks in the Federation of BiH as of 06/30/02.

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

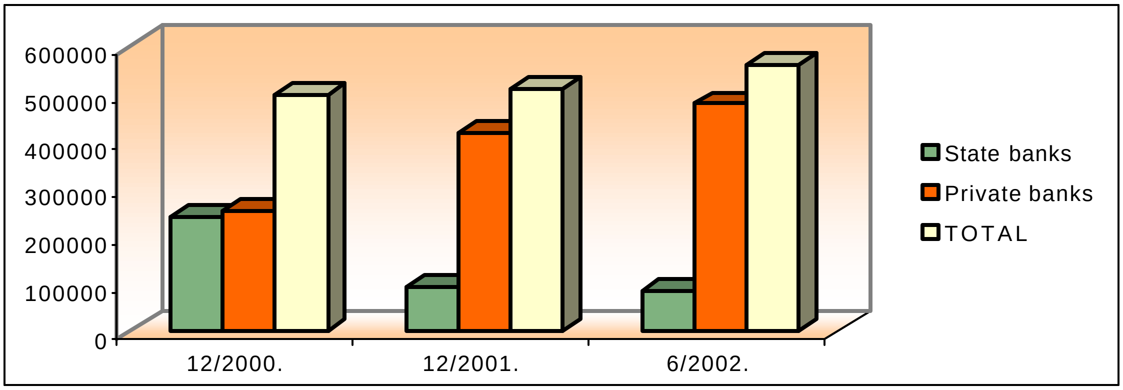
Schedule 1: *Ownership Structure by Total Capital*

-In mill. KM-

BANKS	12/31/00		12/31/01[3]		06/30/02		RATIO	
							3/2	4/3
1	2		3		4		5	6
State banks	240.139	48%	90.800	18%	84.332	15%	38	93
Private banks	255.135	52%	414.312	82%	477.545	85%	162	115
TOTAL	495.275	100%	505.112	100%	561.877	100%	102	111

[2] Information from Balance sheet - FBA schedule.
[3] All schedules contain information as of 12/31/01 were included after audit of financial reports (after external audit).

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



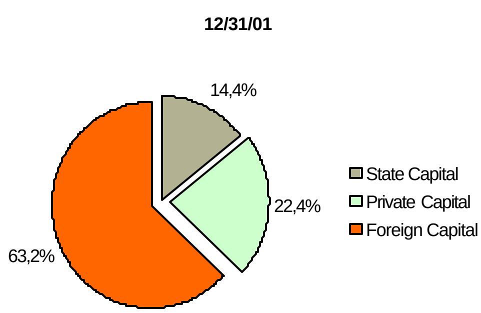
More detailed picture on capital ownership structure[4] of banks in the Federation of BiH can be viewed by analysis of participation of state, private and foreign capital in shareholders capital in banks.

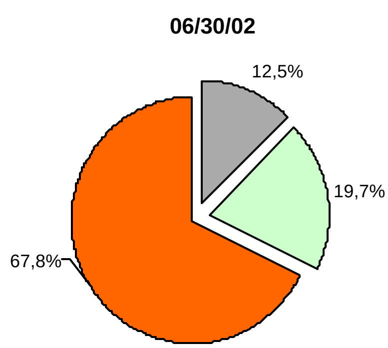
Schedule 2: *Ownership structure by participation of state, private and foreign capital*

-In 000 KM -

SHARE CAPITAL	12/31/00		12/31/01		06/30/02		RATIO	
	Amount	Participation %	Amount	Participation %	Amount	Participation %	5/3	7/5
1	3	4	5	6	7	8	9	10
State capital	220.847	42,9	65.862	14,4	65.457	12,5	30	99
Private capital (residents)	159.325	30,9	102.943	22,4	102.786	19,7	65	100
Foreign capital (non-residents)	135.201	26,2	289.951	63,2	354.516	67,8	215	122
TOTAL	515.373	100,0	458.756	100,0	522.759	100,0	89	114

Graph 2: *Ownership Structure (shareholders capital)*





Analysis of ownership structure in banks - shareholders capital - shows the best changes and trends occurred in the banking system in the Federation of BiH, it is visible in two segments: privatization of existing state capital in majority private owned banks and further inflow of foreign capital (majority foreign banks).

Participation of state capital in total shareholders capital in banks as of 06/30/02 is lower by 1.9% in comparison to 12/31/01. This resulted from increase of (absolute amount and in percentage) of foreign

[4] Ownership structure - shareholders capital (excluding capital related to apartments) as reported by banks.

capital. As of 06/30/02, participation of remnant, state owned capital, in privately owned banks was only 1% or KM 6.6 million.

Major changes in the ownership structure in first half of 2002 were related to participation of private (national) and foreign capital.

In comparison to 12/31/01, participation of privately owned capital (residents) in total capital for whole banking sector was decreased from 22.4% to 19.7%, while at the same time, participation of foreign capital increased from 63.1% to 67.8%. These changes relate mainly to privately owned banks, and it resulted due to two components: foreign capital came in to the system through purchase of shares (trading with shares) from existing owners (residents - institutions and citizens), and due to additional capitalization of two banks in foreign ownership.

Development of the reform and stabilization of banking system resulted in large inflow of foreign capital, mainly foreign banks. Probably, increasing of foreign capital investments in banks in the Federation will continue in future period.

1.3. Staff

As of 06/30/02 in banks in the Federation BiH, there were total 4,929 employees. Out of total number, 11% worked in banks with majority state capital and 89% in privately owned banks.

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

BANKS	NUMBER OF EMPLOYEES			RATIO	
	12/31/00	12/31/01	06/30/02	3:2	4:3
1	2	3	4	5	6
State banks	1.253	554	560	44	100
Private banks	3.036	4.056	4.369	134	108
TOTAL	4.289	4.610	4.929	107	107
Number of banks	37	32	30		

In comparison to 12/31/01, number of employees increased by 7% or 319 employees in privately owned banks.

Schedule 4: *Educational structure of staff*

EDUCATION	NUMBER OF EMPLOYEES			RATIO	
	12/31/00	12/31/01	06/30/02	3:2	4:3
1	2	3	4	5	6
University education - degree	1.334	1.434	1.585	107	110
University education	405	467	491	115	105
High school	2.331	2.483	2.616	107	105
Other	219	226	237	103	105
TOTAL	4.289	4.610	4.929	107	107

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

Schedule 5: *Assets/employees*

BANKS	12/31/00			12/31/01			06/30/02		
	Number of staff	Assets (000 KM)	Assets/ employee	Number of staff	Assets (000 KM)	Assets/ employee	Number of staff	Assets (000 KM)	Assets/ employee
State	1.253	772.559	616	554	378.256	684	560	376.525	672
Private	3.036	1.766.760	582	4.056	3.390.869	836	4.369	3.740.695	856
TOTAL	4.289	2.539.319	592	4.610	3.769.125	818	4.929	4.117.220	835

At the end of first half of 2002, for each employee there was KM 835 thousand of assets for whole banking system, which is slightly better in comparison to the end of 2001. The ratio in state banks was worse in comparison to the ratio for privately owned banks, or banking system in whole.

Individual analytical results for banks were between KM 129 thousand up to KM 1,933 thousand of assets per an employee. In seven banks assets per an employee were less then KM 350 thousand which implies that they have excessive number of staff in comparison to assets. That results in larger operational costs and has negative impact to profitability in those banks. On the other hand, the same ratio in nine banks was over one million of KM.

2. FINANCIAL INDICATORS OF BANKING OPERATIONS

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

1. Information on Balance sheet set for all banks (by IMF and FBA format) submitted monthly, including quarterly attachments to balance sheet - FBA schedule containing more detailed information on money assets, loans, deposits and off balance sheet items.
2. Information on solvency of banks, information on capital and capital adequacy, assets classification, risk concentration, liquidity, exposure to foreign currency risk, based on the reports regulated by the FBA (quarterly) and
3. Information on operational results in banks (balance sheet - FBA format) and reports on cash flows, submitted to FBA quarterly.

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

As it is regulated by the Law on Opening Balance Sheet in Banks, banks with majority state capital have to report to the Agency a full balance sheet which would be classified in passive, neutral and active sub-balance sheet items. In order to have realistic indicators of banks' operational results in Federation of BiH, all further analysis of banking system will be based on information from active sub-balance for banks with majority state capital[5].

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

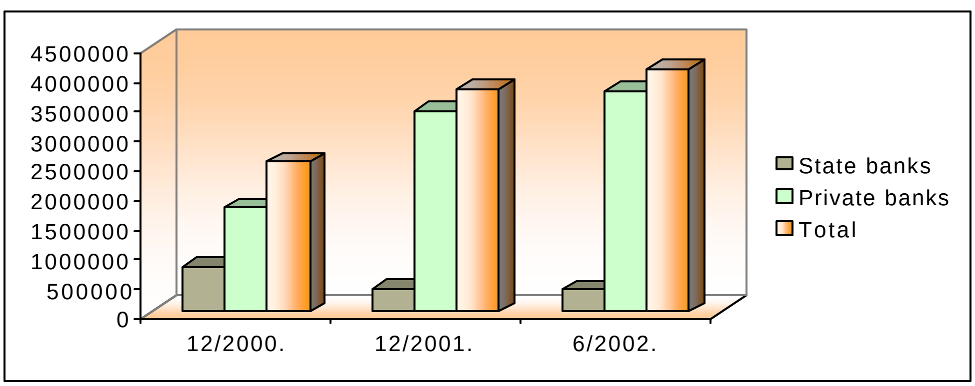
2.1. Balance sheet

Based on the balance sheets submitted by banks as of 06/30/02, total balance sheet for the Federation of BiH was KM 4.1 billion, which is more by 9% or KM 348 million in comparison to 12/31/01.

Schedule 6: *Balance Sheet*

DESCRIPTION	AMOUNT (in 000 KM)			RATIO	
	12/31/00	12/31/01	06/30/02	3/2	4/3
1	2	3	4	5	6
ASSETS:					
Money assets	1.025.813	1.783.234	1.583.320	174	89
Securities	3.912	47.192	46.790	1.206	99
Placements in other banks	20.311	25.355	13.125	125	52
Loans - net	1.142.651	1.572.692	2.074.184	138	132
Premises and other fixed assets	283.436	273.981	275.726	97	101
Other assets	63.195	66.671	124.075	105	186
TOTAL ASSETS	**2.539.318**	**3.769.125**	**4.117.220**	**148**	**109**
LIABILITIES:					
LIABILITIES					
Deposits	1.763.000	2.900.613	3.151.022	165	109
Borrowings from other banks	6.761	5.550	3.289	82	59
Loan liabilities	188.448	253.269	270.434	134	107
Other liabilities	85.835	104.581	130.598	122	125
CAPITAL					
Capital	495.275	505.112	561.877	102	111
TOTAL LIABILITIES (LIABILITIES AND CAPITAL)	**2.539.318**	**3.769.125**	**4.117.220**	**148**	**109**

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



The growth is related only to privately owned banks where assets were increased by 10% or 350 million of KM, while state banks (as a sector) had less assets by 1% or KM 2 million at the end of first half of 2002.

Although ratio for balance sheet for the whole system continued with growth, analysis of individual data in banks displayed that assets in 14 banks were smaller in comparison to previous year (2001), while assets of five banks increased by over 20%. For observed period, we should emphasize that out of total growth of balance sheet assets, almost half of the amount (KM 162 million) relates to only one bank, which is the largest bank in the system, by assets size.

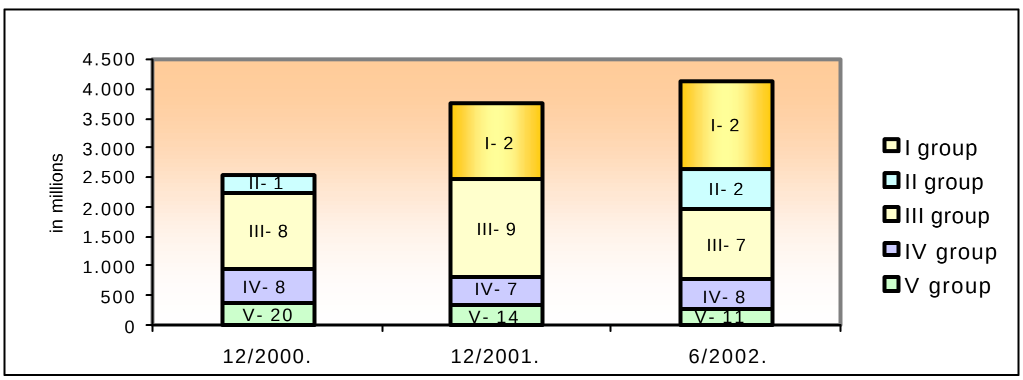
If we analyze banking system from the aspect of assets size and particular groups within this frame, it is possible to make conclusion that largest banks, from first two groups (with assets over 500 million that is, 300 million KM) still have growing trend. On the other hand, 19 banks have assets under KM 100 million, and total number of those banks is continuously decreasing as well as total assets in those banks, and relatively - participation of their assets in total assets for the whole banking system. This can be considered as positive trend.

Following schedule presents amount and participation of particular groups of banks[6] through periods (amounts are in millions of KM):

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

AMOUNT OF ASSETS	12/31/00			12/31/01			06/30/02		
	Amount	Particip. %	Number of banks	Amount	Particip. %	Number of banks	Amount	Particip. %	Number of banks
Over 500	-	-	-	1.315	34,9	2	1.490	36,2	2
300 to 500	309	0,1	1	-	-	-	673	16,3	2
100 to 300	1.272	50,2	8	1.632	43,3	9	1.160	28,2	7
50 to 100	576	22,7	8	460	12,2	7	522	12,7	8
Less then 50	382	15,0	20	362	9,6	14	272	6,6	11
TOTAL	2.539	100,0	37	3.769	100,0	32	4.117	100,0	30

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



Participation of 11 largest banks in total assets as of 06/30/02 was 81% or KM 3,323 million. At the same time, the group of banks with largest number of units (assets under KM 50 million) participates with only 7%.

The growth of balance sheet mainly resulted from growth of deposit potentials (by 9% or KM 250 million) and capital (by 11% or KM 57 million).

On the other hand, although the sources (deposits and capital) significantly increased, in assets (property) in banks, money assets decreased by 11% or KM 200 million due to intensified growth of loans[7] which had growth ration of 30% or KM 517 million during the first half of 2002.

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

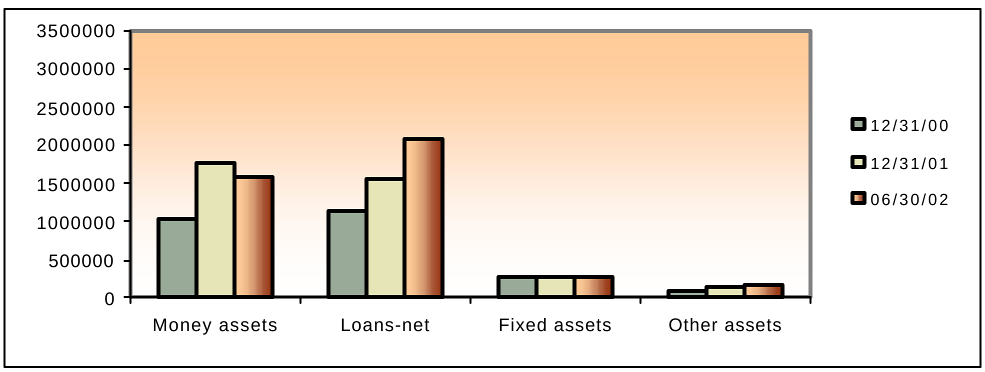
[6] Banks are divided in five groups, by size of assets.
[7] Gross loans (information from balance sheet).

Schedule 8: *Balance sheet structure*

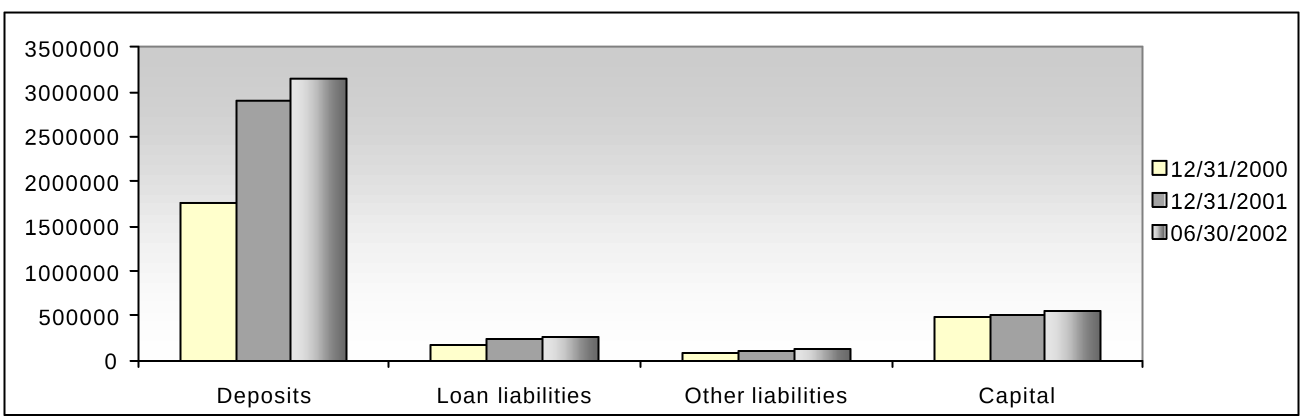
- In % -

DESCRIPTION	PARTICIPATION		
	12/31/00	12/31/01	06/30/02
ASSETS:			
Money assets	40,4	47,3	38,5
Securities	0,2	1,3	1,1
Placements in other banks	0,8	0,7	0,3
Loans – net	45,0	41,7	50,4
Premises and other fixed assets	11,2	7,2	6,7
Other assets	2,4	1,8	3,0
TOTAL ASSETS	100,0	100,0	100,0
LIABILITIES:			
LIABILITIES			
Deposits	69,4	77,0	76,5
Borrowings from other banks	0,3	0,2	0,1
Loan Liabilities	7,4	6,7	6,6
Other liabilities	3,4	2,7	3,1
CAPITAL			
Capital	19,5	13,4	13,7
TOTAL LIABILITIES (LIABILITIES AND CAPITAL)	100,0	100,0	100,0

Graph 5: *Balance Sheet Assets Structure in Banks*



Graph 6: *Balance Sheet Liabilities Structure in Banks*



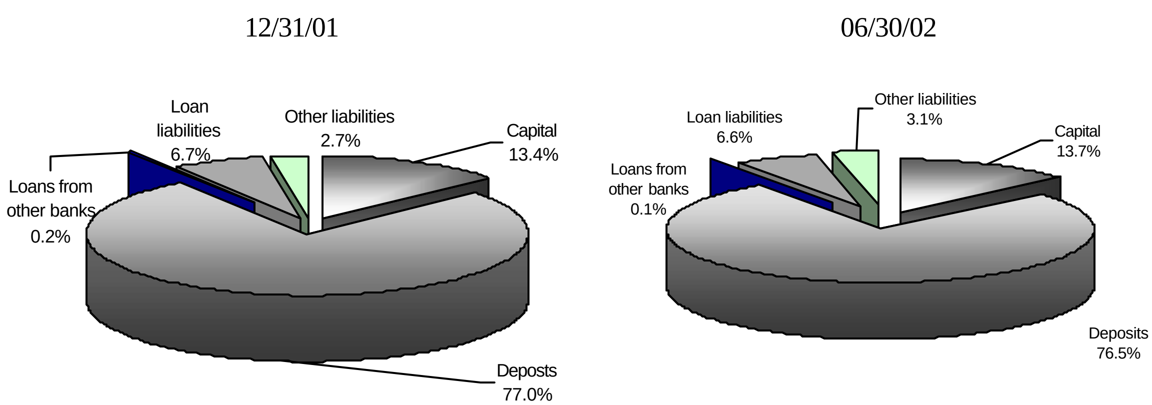
The assets structure in banks did not change significantly. But, within assets in banks, participation of loans increased by approximately 9%, so as of 06/30/02 net loans were 50% of banks' property. At the same time, participation of money assets was decreased by same percentage (from 47% to 38%).

As of 06/30/02, banks in the Federation of BiH still had significant amount of money assets deposited at depository institutions abroad, and at the mentioned date the amount of those deposits was 70% or KM 1.1 billion out of total money assets deposited, at the reserve account at Central Bank of BiH there was 18% or KM 277 million, and 12% or KM 193 million was in vaults of banks.

2.1.1. Liabilities (Liabilities and Capital)

Structure of liabilities and capital in balance sheet of banks as of 06/30/02 can be overviewed from following graph:

Graph 7: *Structure of liabilities in banks:*



Liabilities' structure was not significantly changed; therefore, major participation of 76.5% is still with deposits as primary source of funding.

In period observed, deposits increased by 9% or KM 250 million, but only in privately owned banks, while in state owned banks deposits slightly decreased (by 1% or KM 2 million).

The trend of concentration of deposits in banks, which are at the same time banks with largest assets, is continued, so as of 06/30/02 only five largest banks had held 66% of total deposits or KM 2,092 million. Also, the indicator of deposit concentration is data that 84% of total deposits is placed in only ten banks.

One of the indicators of positive trends in banking system is improvement of maturity structure of deposits, which is still not satisfactory, but it is slightly improved. In comparison to the end of 2001, participation of long-term deposits increased by five percent (from 15% to 20%), and at the same time, participation of short-term deposits decreased. It is possible to overview the situation in the following schedule:

Schedule 9: *Maturity structure of deposits*

DEPOSITS	12/31/01		06/30/02	
	Amount	Participation %	Amount	Participation %
Savings and demand deposits	1.779.672	61,4	1.880.238	59,7
Up to 3 months	413.465	14,2	345.147	10,9
Up to 1 year	280.243	9,7	301.835	9,6
1. Total short-term	2.473.380	85,3	2.527.220	80,2
Up to 3 years	242.924	8,4	293.866	9,3
Over 3 years	184.309	6,3	329.936	10,5
2. Total long-term	427.233	14,7	623.802	19,8
TOTAL (1 + 2)	2.900.613	100,0	3.151.022	100,0

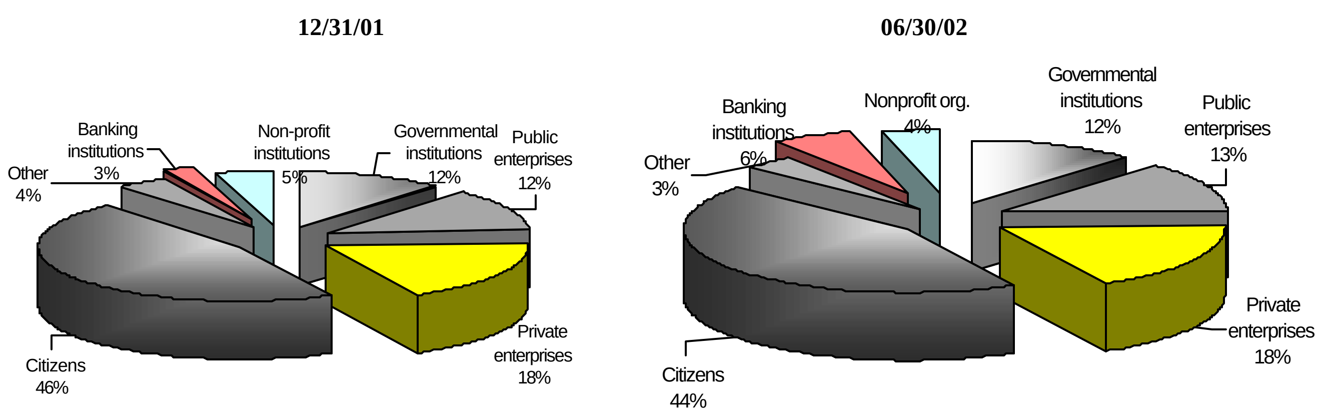
Banks have to give special attention to maintenance of adequate maturity adjustment of sources (before all, deposits as primary source of funds) and placements which is especially important from aspect of banks exposure to liquidity risk, that is, managing of the risk. That means that banks should establish appropriate systems for identification of risk, and measures to measure, control and monitor the risk. Each disorder in maturity adjustment represents danger for future liquidity, and finally, it can endanger financial position of the bank and question its further operations.

Schedule 10: *Structure of deposits by depositors*[8]

- u 000 KM -

DEPOSITORS	12/31/01		06/30/02	
	Amount	Participation %	Amount	Participation %
Government institutions	339.364	11,7	374.469	11,9
Public enterprises	359.390	12,4	393.862	12,5
Private enterprises and assoc.	536.324	18,5	563.417	17,9
Non-profit. Organizations	132.452	4,6	135.970	4,3
Banking institutions	77.272	2,7	180.500	5,7
Citizens	1.334.337	46,0	1.391.800	44,2
Other	121.474	4,1	111.004	3,5
TOTAL	2.900.613	100,0	3.151.022	100,0

Graph 8: *Structure of deposits by depositors*



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

If we make analysis by sections, out of total growth of deposits of approximately KM 250 million, the majority of growth relates to growth of banking institutions (approximately KM 103 million), which resulted from support of founder-shareholders (foreign banks) in providing additional source of funds for financing citizens and private enterprises sections. The mentioned deposits are long-term deposits, which is especially significant if we have in mind their purpose.

In comparison to the end of 2001, this resulted with the most significant change in the sectional structure of deposits - increased participation of banking institutions from three percent to six percent.

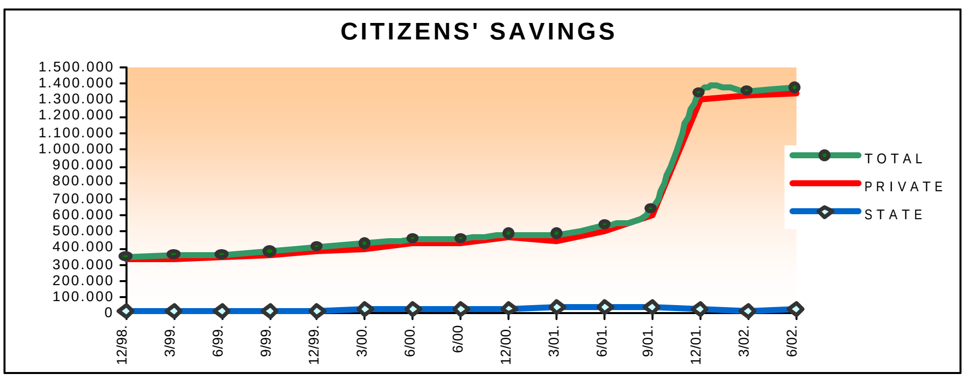
Although participation of citizens section in total deposits was decreased by two percent, savings still have increasing trend, so growth ratio amounted to three percent or KM 34 million in the first half of the year.

As in other sections, it is necessary to stress that there is large concentration of savings in few banks, since 61% of total savings are placed in three largest banks in the Federation of BiH (as of 12/31/01 this amount was 45%), that is, 85% of total savings is placed in 8 private banks.

Schedule 11: *New citizens' savings through periods*

BANKS	AMOUNT IN (IN 000 KM)			RATIO	
	12/31/00	12/31/01	06/30/02	3/2	4/3
1	2	3	4	5	6
State	34.841	28.787	25.445	83	88
Private	427.166	1.285.803	1.323.543	301	103
TOTAL	462.007	1.314.590	1.348.988	285	103

Graph 9: *New citizens' savings through periods*



2.1.2. Assets and Asset Quality

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

Total assets[9] in the balance sheet of banks in the Federation of BiH as of 06/30/02 were KM 4,322 million, which is higher by 10% or KM 376 million in comparison to end of 2001, while off-balance sheet risk items were KM 567 million and they increased by 15% or KM 72 million.

Total assets, including off-balance sheet items (assets)[10], were 4.8 billion of KM and they increased by 10% in comparison to year 2001.

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

DESCRIPTION	AMOUNT (in 000 KM)						RATIO	
	12/31/00	Structure %	12/31/01	Structure %	06/30/02	Structure %	4:2	6:4
1.	2.	3.	4.	5.	6	7	8	9
Loans	1.128.493	41,4	1.526.178	38,7	1.997.587	46,2	135	131
Interest	17.644	0,6	18.646	0,4	23.215	0,6	100	132
Past due receivables	168.567	6,2	192.020	4,8	234.220	5,4	113	123
Receivables on paid guarantees	10.913	0,4	7.853	0,2	9.257	0,2	72	118
Other placements	29.151	1,1	28.083	0,7	41.978	1,0	96	149
Other assets	1.372.554	50,3	2.176.795	55,2	2.016.101	46,6	159	93
TOTAL ASSETS	2.727.322	100,0	3.946.575	100,0	4.322.358	100,0	145	110
OFF BALANCE SHEET	435.095		495.029		567.345		106	115
BALANCE AND OFF BALANCE SHEET	3.162.417		4.441.604		4.889.703		140	110
General loan risk and potential loan losses	212.669		201.159		226.609		95	113
Allocated general and special reserves for loan losses	201.198		197.615		223.899		98	113

The most significant changes in assets of banks occurred in the first half of 2002 was continuing growth of placements[11], which were increased by 30% or KM 531 million. At the same time, money assets decreased by 11% or KM 200 million. This growth of loan portfolio means that at the same time loan risk in banks is increased, and this should be followed by implementation of adequate managing system, implemented by governing and managing entities in banks.

We should emphasize that ratio of placements to citizens is still growing (in the observed period, they were increased by 54% of KM 336 million), which is considered good from the risk aspect since experience showed that this part of the loan portfolio bears the least risk.

In the assets structure, the major change was increased participation of loan placements by 8.4% and decrease of participation of other assets by almost same percentage (other assets include money assets, fixed assets and other items which are relatively insignificant in size).

This trend, that is, growth of loans approved to citizens, resulted in changed participation of loans by sectors in comparison to the end of 2001.

[9] Source of information: Report on classification of balance sheet assets and off-balance sheet items.
[10] Assets, as defined in the Article 2 of the Decision on Minimum Standards for Managing Credit Risk and Assets Classification in banks
[11] Loans with interest, past due receivables, receivables on guarantees paid and other placements.

Schedule 13: *Structure of loans by sectors*

SECTORS	12/31/00		12/31/01		03/31/02		RATIO	
	Amount	Partici - pation %	Amount	Partici - pation %	Amount	Partici - pation %	4/2	6/4
1	2	3	4	5	6	7	8	9
Government institutions	20.428	1,5	26.033	1,5	34.436	1,5	127	132
Public enterprises	285.448	21,8	246.437	14,3	245.121	10,9	87	99
Private enterprises and assoc.	568.773	43,5	770.703	44,7	942.557	42,1	135	122
Non-profit. Organizations	4.995	0,4	6.370	0,4	5.043	0,2	128	79
Banking institutions	62.592	4,8	42.480	2,5	41.560	1,9	68	98
Citizens	362.370	27,7	623.219	36,2	959.542	42,8	172	154
Other	3.652	0,3	8.422	0,4	12.807	0,6	230	152
TOTAL	1.308.258	100,0	1.723.663	100,0	2.241.066	100,0	132	130

Regarding maturity structure, we should emphasize that growth of long-term loans remained (66% out of total loans) and especially loans approved to citizens (as of 06/30/02, 91% of those loans were long-term), while 50% of total loans approved to private enterprises were long-term.

If we analyze banks individually, it is obvious that certain banks did not adjust maturity between financial assets and liabilities, since long-term loans were financed from short-term sources. This is the first warning sign that those banks could have liquidity problems in future, especially if they experience deterioration of assets quality. Therefore majority of banks now face the problem of providing long-term source of funds, including primary (deposits) and secondary (loans) source of funds and capital.

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

Classification of balance sheet assets and off-balance sheet risk items and potential loan losses by classification categories as of 06/30/02 is presented in following schedule:

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

-000 KM -

RECEIVABLES	CLASSIFICATION					
	A	B	C	D	E	TOTAL
Placements[12]	1.696.545	323.777	117.657	139.929	5.134	2.283042
Interest	15.425	3.973	1.033	2.784	0	23.215
Total Placements	1.711.970	327.750	118.690	142.713	5.134	2.306.257
Other Assets	2.001.572	8.199	38	4.121	2.171	2.016.101
TOTAL ASSETS	3.713.542	335.949	118.728	146.834	7.305	4.322.358
OFF-BALANCE SHEET RISK ITEMS	501.684	54.911	4.196	6.049	505	567.345
BALANCE SHEET AND OFF-BALANCE RISK ITEMS	4.215.226	390.860	122.924	152.883	7.810	4.889.703
General credit risk and potential loan losses	69.131	30.993	32.981	85.694	7.810	226.609
Allocated general and special reserves for loan losses	69.462	30.949	32.963	87.802	2.723	223.899
Structure of allocated reserves by classification category	31,1	13,8	14,7	39,2	1,2	100,0

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

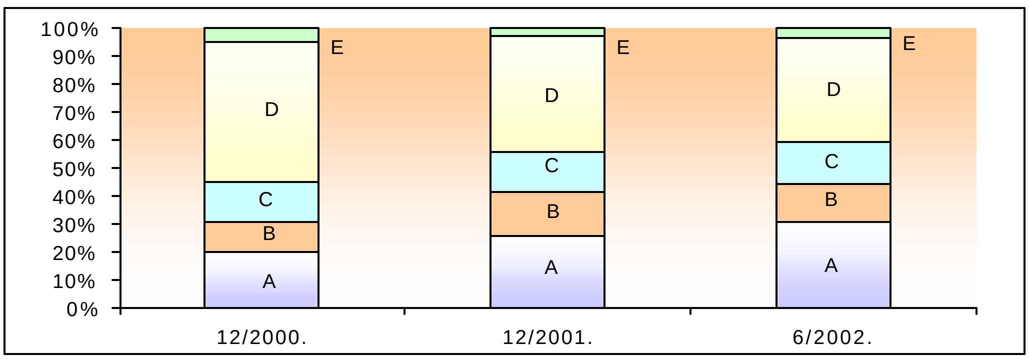
Participation of poor quality assets (C, D and E) of 5.8% in total assets was slightly decreased in comparison to the end of 2001 (6.0%).

Level of general loan risk and estimated loss by classification, determined upon criterion and methodology regulated by the FBA's decisions, their trends and structure for the whole banking sector are presented in the following schedule and graph:

Schedule 15: *Structure and Trend of General Loan Risk and Potential Loan Losses*

Classification	AMOUNT (in 000 KM) and STRUCTURE (in %)						RATIO	
	12/31/00		12/31/01		06/30/02		4/2	6/4
1	2	3	4	5	6	7	8	9
A	41.521	19,5	51.396	25,6	69.131	30,5	124	134
B	24.357	11,5	31.339	15,8	30.993	13,7	130	97,6
C	29.822	14,0	28.852	14,3	32.981	14,6	97	113
D	105.597	49,7	83.791	41,5	85.694	37,8	79	103
E	11.372	5,3	5.781	2,8	7.810	3,4	51	135
TOTAL	212.669	100,0	201.159	100,0	226.609	100,0	95	113

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



General loan risk and potential loan losses in banks were KM 227 millions as of 06/30/02 (4.6% of total assets including off-balance sheet), which is higher by 13% in comparison to the end of 2001. The largest growth of 35% is related to general loan risk, that is, classification "A", which resulted from growth of risk assets in banks.

Although, participation of classification "D" in the structure of loan losses has decreasing trend, it is still too high and it amounts to 37.8% for the whole banking sector and it proves poor quality of total loan portfolio, and it has negative effect on profitability and capital in banks.

Transactions with Related Entities

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

The Agency has set up, in accordance with the Basle Principles, some prudential principles and requirements related to the transactions with bank related entities[13], through appointment of Decision on Minimum Standards for Bank Operations with Related Entities, which prescribes requirements and way of operations with related entities. The Decision and the Law on Banks regulates the duty of the Managing Board of the Bank, which has to adopt, upon the proposal of the General Manager, special policies regulating operations with related entities and to monitor implementation of those policies.

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

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

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

- Shareholders with more than 5% of voting shares,
- Members of the Managing Board and senior management in the bank and
- Subsidiaries and other enterprises significantly related to the bank.

But, information reported by banks to the Agency should be taken with certain anticipation, since true state is possible to determine only by review of reports, on-site examination. Also, experience proved so far that these operations in majority of banks with certain financial problems bears the largest risk, resulting in vast loan losses, that is reserves for potential loan losses. This is mainly due to loan transactions with shareholders and their related entities (enterprises owned by them or with capital interests).

Schedule 16: *Transactions with Related Entities*

-000 KM-

Description	APPROVED LOANS		
	12/31/00	12/31/01	06/30/02
Shareholders with over then 5% of voting shares, subsidiaries and other significantly related enterprises	70.677	46.071	58.128
Members of the Managing Board	1.164	48	184
Managerial Staff and employees of the bank	4.537	3.580	3.588
TOTAL	76.378	49.699	61.900
POTENTIAL AND ACCEPTED OFF-BALANCE SHEET LIABILITIES	21.243	4.906	10.530

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

2.1.3. Capital - Strength and Adequacy

Total capital[14] in banks in the Federation of BiH was KM 736,788 thousand as of 06/30/02.

Schedule 17: *Regulatory capital in banks*

-In 000 KM-

DESCRIPTION	12/31/00		12/31/01		06/30/02		RATIO	
							3/2	4/3
1	2		3		4		5	6
STATE BANKS								
a) Core Capital	238.314	95%	83.505	93%	83.466	93%	35	100
b) Additional Capital	12.613	5%	6.206	7%	6.274	7%	49	101
c) Total capital (a + b)	250.927	100%	89.711	100%	89.740	100%	36	100
PRIVATE BANKS								
a) Core Capital	310.597	85%	475.845	86%	546.666	84%	153	115
b) Additional Capital	54.669	15%	75.660	14%	100.382	16%	138	133
c) Total capital (a + b)	365.266	100%	551.505	100%	647.048	100%	151	117
Total								
a) Core Capital	548.911	89%	559.350	87%	630.132	86%	102	113
b) Additional Capital	67.282	11%	81.866	13%	106.656	14%	122	130
c) Total capital (a + b)	616.193	100%	641.216	100%	736.788	100%	104	115

Information in schedule[15] above show growth of total capital during the first half of 2002 by KM 95.5 million or 15% in comparison to 12/31/01. The core capital was increased by KM 71 million, and additional capital by KM 25 million.

The most significant changes in core capital resulted from injection of capital in two banks (KM 62.5 million) and allocation of income to core capital after closing income statement in banks for 2001: undistributed income (4.5 million of KM), share capital (KM 1.7 million) and capital reserves (KM 2.5 million).

Changes in additional capital resulted from increased general reserves - 2% for performing assets by KM 17.5 million and included subordinated debt in one bank into additional capital of approximately KM 10 million, while current income decreased by KM 2.5 million in comparison to the same date of 2001.[16]

Aside from above-mentioned changes in the observed period, the structure of regulatory capital did not change due to growth of core and additional capital by approximately same rate. Also, there were not any significant changes in the structure of core capital.

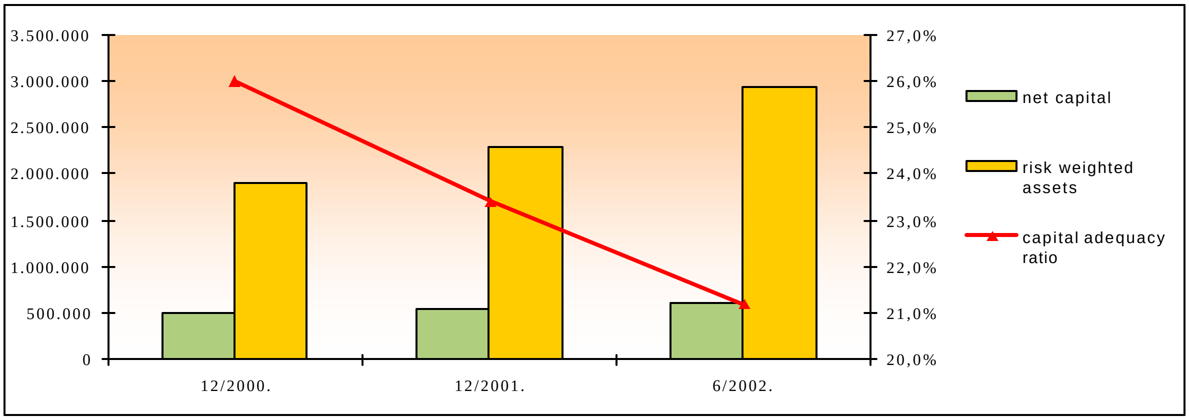
Ratio between capital and assets, that is capitalization ratio in banks as of 06/30/02, amounted to 17.1%, which is higher by 2.1% in comparison to the end of 2001.

Net capital for the six months in 2002 increased by 16% or KM 87 million, so on 06/30/02 it amounts to KM 623 million (private banks – KM 522 million, state banks – KM 71 million).

Capital adequacy ratio, calculated as net capital and risk weighted assets, for the whole banking sector was 21.2%, which is less by 2.2% than as of 12/31/01. In period of three past years, this ratio continuously decreases although capital grows and that implies that risk weighted assets grow faster then capital in banks.

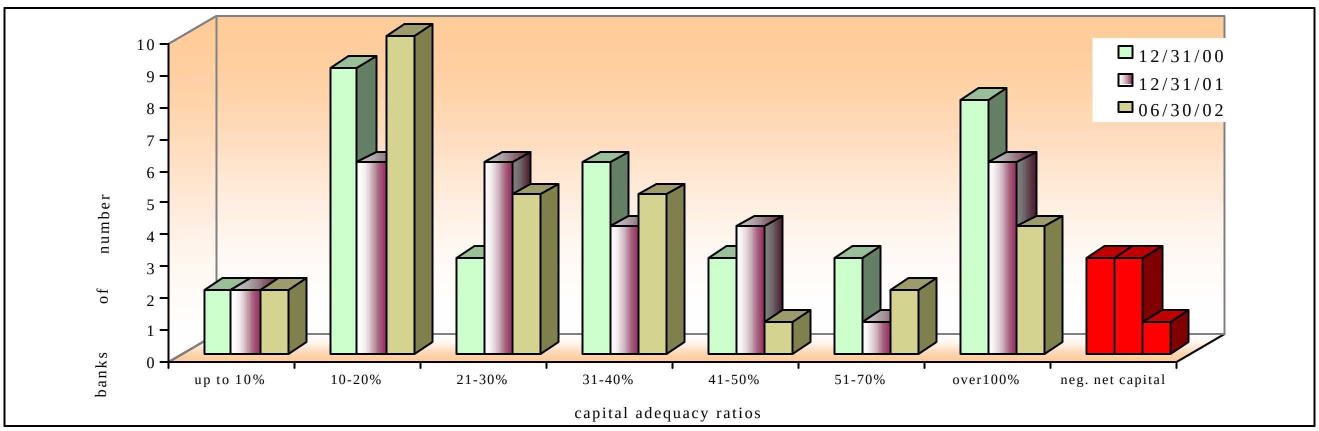
[14] Regulatory capital as defined by Article 8 and 9 in the Decision on Minimum Standards for Managing Capital
[15] Information are from quarterly Report on Capital Positions in Banks (Form 1-Schdule A) regulated by the Decision on Minimum Standards for Managing Capital in Banks.
[16] Part of income in 2001, which was corrected, was included to core capital in the reports for 2001.

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



Out of total 30 banks in F BiH, as of 06/30/02, 29 banks (97%) had capital adequacy ratio higher than 10% (some even over 100%), two banks had capital adequacy ratio under regulatory minimum (minimum 10%) and one bank (under provisional administration) had negative net capital and capital adequacy ratio.

Graph 12: *Capital adequacy ratio in banks*



We should emphasize that capital adequacy ratio is significantly higher in small banks, mainly due to fact that small banks did not completely develop their operations, primarily loan activities (there is recession or poor growth of balance sheet with major participation of money assets) and that resulted in decreased risk in assets in those banks.

Although banking system in the Federation of BiH experienced strengthening of capital through periods, the fact is that banking system still consists of too many small banks and that large number of banks still do not have adequate capital, that is, do not have strong capital base which would guaranty covering of all potential operational losses and safety to creditors. By the end of 2002, a few banks will have to meet new regulatory demands related to minimum share capital paid in cash (KM 15 million). Based on information as of 06/30/02 (for private banks), seven banks will have to provide additional capital, in July 2002, two banks had status change (liquidation and merging), and two banks will have status changes by the end of year, they will merge and procedures are in process (by this, three banks will resolve regulatory capital problem.)

Above presented leads to a conclusion that number of banks in the Federation of BiH will continue to decrease, which is necessary and positive from the aspect of strengthening and making larger banks in the banking system in the Federation of BiH. Strengthening of capital base will be necessary for banks, which had large growth of assets and expansion of loans, that is, larger exposure to credit risk. All of this is condition for stable and safe environment for banks and banking system in whole.

2.2. Profitability

As reported in income statement for first six months of 2002, banks in the Federation of BiH earned positive financial results of KM 10,836 thousand. This result is better in comparison to the earnings in same period in 2001, when banks had earned KM 4,200 thousand.

Positive financial result of KM 18,909 thousand was reported by 21 bank, while 9 banks reported loss of 8,073 thousand of KM. More detailed information is presented in the following schedule:

Schedule 18: *Reported Income/Loss*

- 000 KM-

Date/Description	Whole system		Private banks		State banks	
	Amount	Number of banks	Amount	Number of banks	Amount	Number of banks
06/30/01						
Loss	-13.705	13	-13.486	11	219	2
Income	17.905	22	13.222	17	4.683	5
Total	4.200	35	-264	28	4.464	7
06/30/02						
Loss	-8.073	9	-7.213	7	-860	2
Income	18.909	21	17.117	17	1.792	4
Total	10.836	30	9.904	24	932	6

Individual analytical information from banks leads to conclusion that profitability in majority of banks is not satisfactory, due to amount of earned financial results (income/loss) and to ratios used to determine profitability, productivity and efficiency of operations in banks. As in the other operational segments, this one includes concentrations: few banks have good profitability, while few banks earn operational loss. Out of total income, 74% was earned by six banks (one state and five privately owned banks), while 58% of total loss was reported in only one private bank.

In the structure of total income, net interest margin was 41% (in the same period in 2001, it was 39%), and operational income (income from banking fees and other income including collection of earlier written off risk placements) participates with 59% (in the same period last year it was 61%).

Total costs in this period participated with 95% in total income (in the same period in 2001 - 98%). In the structure of total expenses, the major expenses, with 55%, were operational costs (salaries and contributions were 26%, other operational expense were 14%, premises expense, other fixed assets and overhead expense participated with 15%), while reserves for general loan losses and potential loan losses were 32%.

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

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

-In % -

RATIOS	12/31/01	06/30/02[17]
Return on Assets	-0,66	0,42
Return on Total Capital	-6,16	3,75
Return on Share Capital	-7,01	4,15
Net Interest Income/Total Assets	3,05	3,30
Fee Income/Total Assets	4,43	6,17
Total Income/Total Assets	8,58	8,01
Operational and Direct Expenses[18]/Total Assets	3,78	3,15
Operational Expense/Total Assets	4,29	4,44
Total Non-interest Expense/Total Assets	8,07	7,59

Schedule 20: *Profitability, Productivity and Efficiency Ratios as of 06/30/02*

-In % -

RATIOS	06/30/02		
	STATE BANKS	PRIVATE BANKS	AVERAGE IN F BiH
Return on Assets	0,15	0,51	0,42
Return on Total Capital	1,87	4,15	3,75
Return on Share Capital	3,01	4,30	4,15
Net Interest Income/Total Assets	1,27	3,94	3,30
Fee Income/Total Assets	2,07	5,53	6,17
Total Income/Total Assets	3,33	9,46	8,01
Operational and Direct Expenses/Total Assets	0,97	3,82	3,15
Operational Expense/Total Assets	2,21	5,13	4,44
Total Non-interest Expense/Total Assets	3,18	8,95	7,59

At the end of first half of 2002, banking system in whole achieved better results in comparison to same period in 2001. We should emphasize the most significant indicators of profitability: ROA (return on assets) of 0.21% and ROE (return on equity/share capital) of 2.08% (as of 06/30/01, same indicators were 0.10% and 0.71% respectively). It is still significantly lower than international standards.[19]

Analysis of other indicators leads to a conclusion that in comparison to the end of 2001, productivity in banks, represented by smaller total income, is slightly worse, and also due to further growth of assets and structure of assets in banks, that is, significant participation of non-earning assets. At the same time, operational expense increased, by one unit of assets. That is mainly connected to dispersion of operational units net (increased number of employees, lease expenses, other operating costs etc) after transfer of internal payment system to banks.

At the end, it is possible to make conclusion that achieved financial results for the whole banking sector at the end of first half of 2002, proves again positive trend in banking system. In future period we should expect that banks in the Federation of BiH achieve even better financial results, since further reconstruction of banking system would provide elimination of banks which did not comply their operations to the Law (mainly problem of minimum regulatory capital) and which have operated with loss. Problem of those banks will be resolved through merging and liquidation procedures. Other banks in the system should adopt new concept of operational policies which should be better adjusted to competitive banking in order to achieve larger profit, while maintaining stability of banks and the same time, and preserving managing and control of

[17] Ratios were calculated annually.
[18] Expense includes reserves for potential loan losses.
[19] World standard for ROA is 1% and for ROE is 12-18%.

all risk to which a bank is exposed while operating, especially loan risk. By earning greater profit and distributing it to retained income, banks will strengthen their capital base.

III. CONCLUSION

Thankfully to continued activities of all participants in the banking system in the Federation of BiH, positive trends from last year have been preserved. Stabilization of the system has been continued, and operational results improved in first six months of 2002.

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

- finalization of privatization process in state banks within expected dead lines;
- establishing environment for more successful transformation in material sector, followed by changes in monetary and banking system;
- further strengthening of bank supervision;
- transferring assets from succession to development, through commercial banks;
- accelerating legal procedures, passing judgments and their implementation;
- establishing more efficient procedures for collection of collateral;
- adopting law on protection of creditors and increasing responsibilities of bank's debtors;
- setting up regulations which would direct duties of all institutions in the system in the combat against money laundering;
- further improvement of legal and institutional framework for reconstruction of banking system, with respect of Basle Principles etc.

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

- adjustment of regulations with the Law on Changes and Amendments to the Banking Law;
- continuing supervision of banks in order to protect depositors efficiently and eliminate weakness in banks;
- cooperation with other institutions, activities for prevention of money laundering, within authorizations of the Agency regulated by the Law;
- finalize provisional and liquidation administrations;
- special supervision of banks with large savings (citizens deposits) and banks with growth above average;
- special supervision of operations with related entities;
- examination of application of new operational standards for banks, as regulated by the law and other regulations;
- further development of regulations under authority of the Agency, related to Basle Principles;
- participation in preparations of new laws;
- further education and training of Agency staff;
- establishment of cooperation with supervisory institutions of countries whose investors are present in the banking system of FBiH, etc.

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

- further strengthen capital in correlation with growth of assets, especially in banks which recorded significant growth of assets;
- compliance of operations, policies and procedures with the Law on Changes and Amendments to the Law on Banks;
- undertaking measures for further improvement of profitability;
- managing risks in the situation of increased credit placements;
- continue expansion and development of internal payment system, including establishment of unified registry of accounts;
- improve quality of assets;
- strengthen internal control systems and establish internal audits;

- adopt and implement new principles for operations, policies and procedures in accordance with competitive market conditions;
- further develop policies and procedures in order to decrease transactions with related entities;
- development of credit/debit card operations and electronic banking;
- implement more austere criteria and their implementation in matter of competency and expertise of managerial staff in banks;
- improvement of staff and training in order to establish better relations with customers, especially small and middle sized enterprises, hence, this includes new services, common all over the world, that is, banks should develop financial management operations;
- finalize activities related to association of bank and banking institute;
- take part in global combat against terrorism;
- develop and implement regulations for prevention of money laundering activities as it is regulated by the law etc.