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

I N F O R M A T I O N

ON THE BANKING SYSTEM
OF THE FEDERATION OF BOSNIA AND HERZEGOVINA
31.03.2014

Sarajevo, May 2014

The Banking Agency of the Federation of B&H, as a regulatory institution conducting the bank supervision function, has prepared the Information on the Banking System of the Federation of B&H (as per data as of 31.03.14) based on financial statements and other information and data provided by banks. This also encompassed results and information obtained over the course of on-site examinations in banks and their off-site financial analysis.

I INTRODUCTION

For quite some time, operations of the banking sector in the Federation of B&H and B&H are characterised by effects of the economic and financial crisis, thus also reflecting upon most of business segments of banks. Changes related to the balance sheet total, as well as to key balance sheet items (loans, deposits, loan obligations, capital and, resultantly, cash funds), were insignificant, thus leading to a conclusion that the long period of the economic and financial crisis has caused a stagnation regarding growth and development of the banking sector. Over the past two years and with minor oscillations, key ratios of the banking system remained almost unchanged. Liquidity, profitability and capitalisation rate of the banking sector is deemed satisfactory, thus finding the banking sector to still be stable and safe.

As of 31.03.14, there were 17 licensed banks in the Federation of B&H. Headcount in the FB&H banks stood at 7,023 as of 31.03.14, slightly down by 28 employees or 0.4% vs. the YE2013.

The balance sheet total of the banking sector as of 1Q 2014 amounted KM 15.2 billion, which is 1.4% or KM 209 million less than as of YE2013. This decrease of the balance sheet total largely comes from lower volume of deposits and loan obligations.

Assets structure underwent minor changes related to two key assets items: increase of loans’ share from 70.3% to 71.9% and decrease of cash funds from 28.6% to 26,5%.

As of 1Q 2014, cash funds went down by 8.6% or KM 380 million, thus reaching an amount of KM 4 billion as of 31.03.14.

Loans posted a slight rise of 1% or KM 104 million and amount to KM 11 billion as of 1Q 2014. Total non-performing loans remained the same as at YE2013 and amount to KM 1.6 billion, thus holding a share of 14.5% in total loans volume. Out of the total value of corporate loans, 18.6% refer to non-performing loans, while their share in retail loans is 10%.

Liabilities structure of banks includes deposits of KM 11.3 billion and a share of 74.0%, thus still being a dominant source of financing for banks in the Federation of B&H. As of 1Q 2014, total deposits went down by 2.1% or KM 243 million. On the other hand, savings deposits (being the key segment of deposit and financial potential of banks) rose by 1.3% or KM 79 million in the 1Q 2014, thus arriving to an amount of KM 6.3 billion.

Loan obligations posted an amount of KM 1 billion as of 1Q 2014, thus going down by 3.4% or KM 35 million. However, their share in the liabilities structure remained almost the same as at YE2013. Over the past three years, as affected by the economic and financial crisis, banks incurred much lower level of foreign debts, while repayment of liabilities due dropped their amount by more than 50% (YE2008, they amounted KM 2.18 billion). Evidently, financial support by parent banking groups got significantly reduced, so credit growth in the FB&H over the forthcoming period would probably draw against growth of local sources of financing.

In the 1Q 2014, equity rose by 2.3% or KM 53 million, as largely prompted by current profit. Its amount as of 31.03.14 stood at KM 2.4 billion.

Regulatory capital as of 31.03.14 amounted to KM 2.3 billion, thus dropping by 2% or KM 37 million in the 1Q 2014.

One of key indicators of capital strength and adequacy in banks is the capital adequacy ratio. Its value at the banking sector level stood at 17.5% as of 31.03.14, 0.5% less than at YE2013. However, this is still much above the legal minimum (12%) and represents a satisfactory capitalisation rate of the overall system.

According to data from the income statement, banking system of the Federation of B&H posted a positive financial result as of 1Q 2014, i.e. posted a profit of KM 54 million.

II OPERATIONS OF BANKS IN THE FEDERATION OF B&H

1. BANKING SECTOR STRUCTURE

1.1. Status, Number and Network of Branches

As of 31.03.14, there were 17 banks holding the banking license in the Federation of B&H. This number is the same as at 31.12.13. A special law was enacted on 01.07.08 to regulate operations of the Development Bank of the FB&H dd Sarajevo, a legal successor of the Investment Bank of the FB&H dd Sarajevo.

During the 1Q 2014, there was no major expansion of the banks' branch network. This is to say that the expansion trend continued, but in much lesser extent than before, as chiefly attributable to the financial crisis. Banks have reorganised their branch networks in a way to have changed organisational form, membership or address of their organisational parts. This also entailed mergers and closures of some organisational parts, all for purpose of business rationalisation and operating cost reduction. There were a total of 20 such changes among banks in the FB&H (19 changes within the FB&H territory and 1 change within the RS territory): 4 new organisational units were established, 7 got closed and 9 underwent certain changes.

Subsequent to such changes, banks in the FB&H had a total of 576 organisational parts as of 31.03.14, down by 0.7% vs. 31.12.13.

There were 6 banks from the Republika Srpska with 31 organisational parts in the Federation of B&H, which is an increase compared to 31.12.13 (27).

As of 31.03.14, 8 banks from the Federation of B&H had 50 organisational parts in the Republika Srpska and 8 banks had 11 organisational parts in the Brcko District.

As of 31.03.14, all banks had licenses to effect interbank transactions within the domestic payment system and 16 banks were covered by deposit insurance.

1.2. Ownership Structure

Find below is the ownership structure of banks [1] as of 31.03.14, that was analysed on basis of available information and reviews conducted in banks:

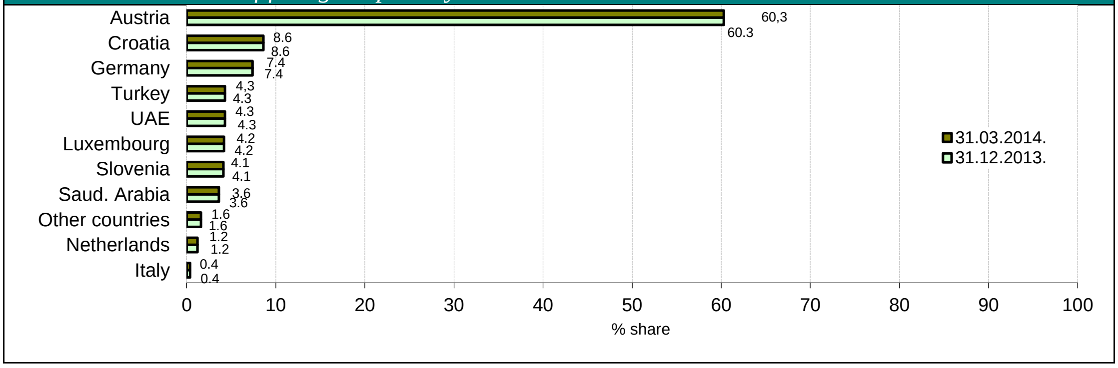
- In private or mostly private ownership: 16 banks (94.1%)
- In state or mostly state ownership: [2] 1 bank (5.9%)

Out of 16 banks in mostly private ownership, 6 are under majority ownership of local legal entities and private individuals (residents) and 10 are under majority foreign ownership.

[1] Criteria for this particular bank classification is ownership over shareholders capital in banks.
[2] State ownership refers to local state capital of B&H.

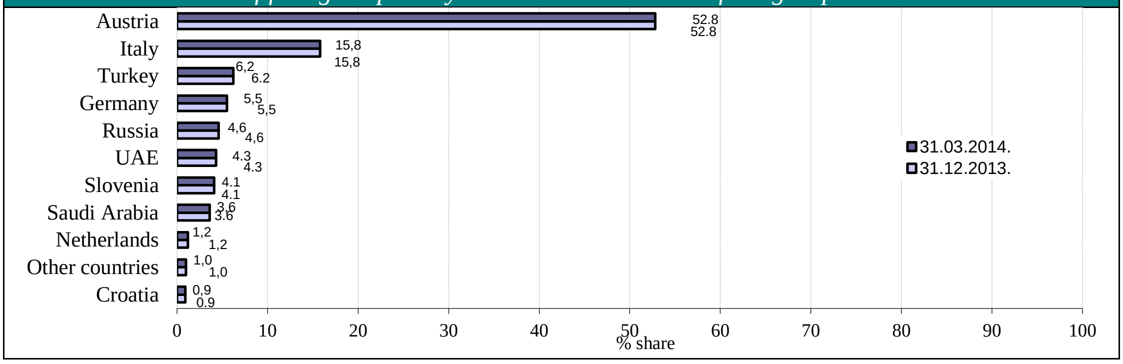
If observed solely from the perspective of capital, using the criteria of home country of shareholders, the conditions as of 31.03.14 changed only slightly compared to the one as of 31.12.13: the largest share of foreign capital of 60.3% refers to shareholders from Austria, followed by shareholders from Croatia with 8.6% and Germany 7.4%. Other countries hold individual share below 5%.

Chart 1: *Structure of foreign capital by countries*



However, if we account for capital relations, the structure of foreign capital may also be observed using the criteria of the home country of the parent bank or parent group holding majority ownership (direct or indirect via group members) in banks in the Federation of B&H. According to these criteria, the condition remained also unchanged vs. the YE2013: share of banking groups and banks from Austria was 52.8%, followed by Italian banks with the share of 15.8% and other countries with individual shares below 7%, plus the share of Russia[3] of 4.6% (appearing since 2012).

Chart 2: *Structure of foreign capital by home countries – seat of the group*[4]



The ownership structure may also be observed from the aspect of financial ratios, i.e. according to the total capital value[5].

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[3] In 2012, Sberbank from Russia purchased Volksbank International from Austria (under which ownership was also Volksbank BH d.d. Sarajevo).

[4] In addition to home countries of parent groups whose members are banks from the FB&H, the chart also outlines countries of all other foreign shareholders of banks in the FB&H.

[5] According to the balance sheet prepared on basis of the FBA model: starting from 31.12.11, loan loss provisions formed against profit became a part of the equity structure (in addition to shareholders capital, issue premiums, retained profit and reserves and other capital (financial resut of the current period)).

-in 000 KM-

Table 1: *Ownership structure according to the total capital*								
BANKS	**31.12.2012**		**31.12.2013**		**31.03.2014**		**INDEX**	
1	2		3		4		5 (3/2)	6 (4/3)
State-owned banks	51.114	2%	51.618	2%	51.778	2%	101	100
Private banks	2.166.261	98%	2.256.327	98%	2.309.202	98%	105	102
TOTAL	2.217.375	100%	2.307.945	100%	2.360.980	100%	105	102

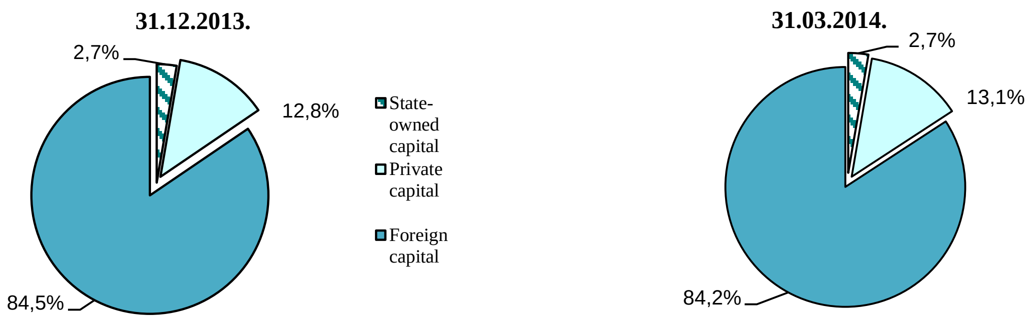
In 1Q 2014, total capital rose by 2% or KM 53 million, as largely based on current profit.

If observed from the perspective of the share of state-owned, private and foreign capital in shareholders capital of banks, the resulting picture of the capital ownership structure in FB&H banks is as follows:

- in 000 KM-

Table 2: *Ownership structure according to the share of state-owned, private and foreign capital*								
SHAREHOLDERS CAPITAL	**31.12.2012**		**31.12.2013**		**31.03.2014**		**INDEX**	
	Amount	**share %**	**Amount**	**share %**	**Amount**	**share %**	4/2	6/4
1	2	3	4	5	6	7	8	9
State-owned capital	33.096	2,8	32.364	2,7	32.364	2,7	98	100
Private capital (residents)	164.603	13,7	153.549	12,8	158.421	13,1	93	103
Foreign capital (non-residents)	1.003.907	83,5	1.017.822	84,5	1.017.807	84,2	101	100
TOTAL	1.201.606	100,0	1.203.735	100,0	1.208.592	100,0	100	100

Chart 3: *Ownership structure (by shareholders capital)*



In 1Q 2014, shareholders capital of banks in the Federation of B&H went up by KM 4.9 million or 0.4% vs. 31.12.13. Shareholders capital rose by KM 4.9 million in one bank after FBA withdrew its order for exclusion of the said amount from capital.

Equity-based analysis of the banks' ownership structure shows more details of changes and trends in the FB&H banking system, i.e. changes to its structure.

The share of state-owned capital in total shareholders capital as of 31.03.14 remained unchanged and stands at 2.7%.

The share of private capital (of residents) in total shareholders capital is 13.1%, up by 0.3% vs. 31.12.13, i.e. up by KM 4.9 million net due to revocation of the FBA order for exclusion of this amount from the capital.

The share of private capital (non-residents) in total shareholders capital dropped by 0.3% (i.e. from 84.5% to 84.2%), while the nominal amount remained the same.

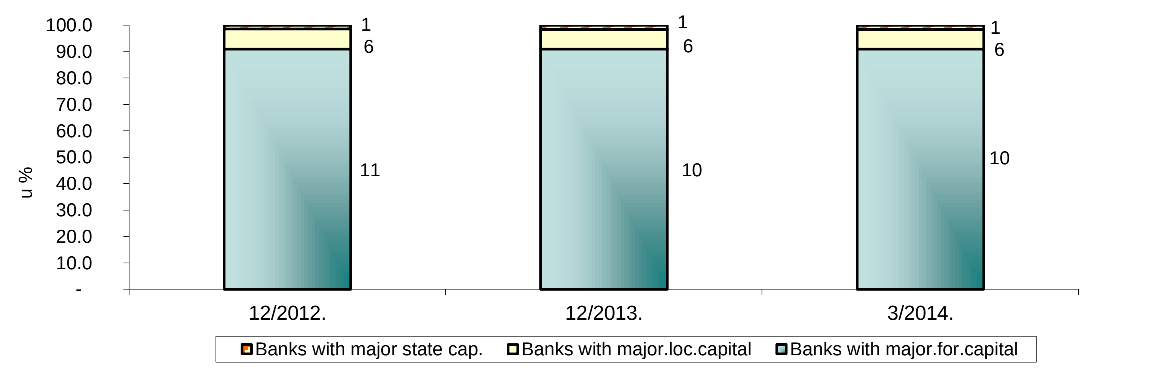
The market share of banks with majority foreign ownership as of 31.03.14 remained the same as at YE2013 and stood at high 91.0%, while banks with majority domestic private capital had the share of 7.4% and banks with majority state-owned capital 1.6% share.

- in % -

Table 3: *Market shares of banks according to ownership type (majority capital)*

BANKS	31.12.2012			31.12.2013			31.03.2014		
	Number of banks	Share in equity	Share in total assets	Number of banks	Share in equity	Share in total assets	Number of banks	Share in equity	Share in total assets
1	2	3	4	5	6	7	8	9	10
Banks with majority state-owned capital	1	2,3	1,4	1	2,2	1,6	1	2,2	1,6
Banks with majority private domestic capital	6	10,5	7,6	6	9,2	7,4	6	8,9	7,4
Banks with majority private foreign capital	11	87,2	91,0	10	88,6	91,0	10	88,9	91,0
TOTAL	18	100,0	100,0	17	100,0	100,0	17	100,0	100,0

Chart 4: *Market shares by ownership type*



1.3. Human Resources

As of 31.03.14, banks in the FB&H had a headcount of 7,023 employees, of which 3% are employed with state-owned banks and 97% in private banks.

Table 4: *Employees of FB&H banks*

B A N K S	HEADCOUNT						INDEX	
	31.12.2012		31.12.2013		31.03.2014		3/2	4/3
1	2		3		4		5	6
State-owned banks	183	3%	200	3%	197	3%	109	99
Private banks	6.947	97%	6.851	97%	6.826	97%	99	100
TOTAL	7.130	100%	7.051	100%	7.023	100%	99	100
Number of banks	18		17		17		94	100

Table 5: *Qualification structure of employees*

QUALIFICATION LEVEL	HEADCOUNT						INDEX	
	31.12.2012		31.12.2013		31.03.2014		4/2	6/4
1	2	3	4	5	6	7	8	9
University qualifications	3.479	48,8%	3.673	52,1%	3.678	52,4%	106	100
Two-year post secondary school qualifications	667	9,3%	601	8,5%	597	8,5%	90	99
Secondary school qualifications	2.949	41,4%	2.750	39,0%	2.717	38,7%	93	99
Others	35	0,5%	27	0,4%	31	0,4%	77	115

TOTAL	7.130	100,0%	7.051	100,0%	7.023	100,0%	99	100

In 1q 2014, banks' headcount dropped slightly (by 28 employees or 0.4%).
A trend of improved qualification structure by means of larger share of employees with university qualifications has continued in 1Q 2014 as well, mostly as a result of a reduction in number of employees with secondary school qualifications by 33 employees or 1%.

One of indicators affecting the performance evaluation of individual bank and banking system as a whole is staff efficiency expressed as a ratio between assets and headcount, i.e. assets per employee. Higher ratio means better efficiency of operations of banks and of the entire banking system.

Table 6: *Assets per employee*

BANKS	31.12.2012			31.12.2013			31.03.2014		
	Headcount	Assets (000 KM)	Assets per employee	Headcount	Assets (000 KM)	Assets per employee	Headcount	Assets (000 KM)	Assets per employee
State-owned	183	209.971	1.147	200	241.605	1.208	197	223.111	1.133
Private	6.947	14.780.795	2.128	6.851	15.204.945	2.220	6.826	15.014.884	2.200
TOTAL	7.130	14.990.766	2.102	7.051	15.446.550	2.191	7.023	15.237.995	2.170

At the end of the observed period, there was KM 2.2 million of assets per employee at the banking system level and this is much better than at the end of 2013.

Table 7: *Assets per employee – by groups*

Assets (000 KM)	31.12.2012	31.12.2013	31.03.2014
	Number of banks	Number of banks	Number of banks
Up to 1.000	3	1	1
1.000 to 2.000	10	8	9
2.000 to 3.000	4	7	6
Over 3.000	1	1	1
TOTAL	18	17	17

Analytical indicators for individual banks range from KM 910 ths to KM 3.7 million of assets per employee. There are 4 banks where this ratio is better than the one at the banking sector level, while 3 largest banks in the system have this ratio surpassing the figure of KM 2.5 million.

2. FINANCIAL RATIOS OF BANKS' OPERATIONS

Off-site bank examinations are performed by means of reports defined by the FBA and reports of other institutions, thus constituting a database resting on three sources of information:

1) Balance sheet information for all banks provided on a monthly basis and together with additional attachments on a quarterly basis. This information contains details of cash funds, loans, deposits and off-balance sheet items, as well as basic statistical data,
2) Information of solvency of banks, information on capital and capital adequacy, assets classification, concentrations of certain risk types, liquidity position, FX risk exposure, interest rates on loans and deposits, all based on reports prescribed by the FBA,
3) Information on business results of banks (income statement according to the FBA model) and statement of cash flows, all delivered to the FBA on a quarterly basis.

In addition to these standardised reports, the reporting database also consists of information obtained on basis of additional reporting requests by the FBA for purpose of ensuring quality monitoring and analysis of banks' operations, as well as reports on audit of financial statements of banks prepared by external audit firms and any other information of relevance for performance evaluation of individual bank and the banking system as a whole.

In line with provisions of the Law on Opening Balance Sheet of Banks, a bank under majority state ownership is required to report to the FBA on basis of the «full» balance sheet divided into: liabilities, neutral items and assets. In order to obtain more realistic indicators of banks' operations in the Federation of B&H, indicators from the assets side of the balance sheet of banks with majority state ownership.[6].

2.1. Balance Sheet

The balance sheet total of the banking sector as at 1Q 2014 stood at KM 15.2 billion, down by 1.4% or KM 209 million vs. YE2013. Changes in the balance sheet total, as well as in key balance sheet categories (loans, deposits, loan obligations, capital, and resultantly cash funds), are minor, so we conclude that the situations has been stagnant for an extensive period of time due to the effects of the financial and economic crisis. Key business indicators of the banking system, with minor oscillations, have maintained almost the same level as in the past two years.

- 000 KM-

Table 8: *Balance sheet*

DESCRIPTION	31.12.2012		31.12.2013		31.03.2014		INDEX	
	AMOUNT	Share %	AMOUNT	Share %	AMOUNT	Share %		
1	2	3	4	5	6	7	8 (4/2)	9 (6/4)
ASSETS:								
Cash funds	3.962.581	26,4	4.417.898	28,6	4.037.905	26,5	111	91
Securities[7]	548.467	3,7	562.513	3,6	598.034	3,9	103	106
Loans to other banks	78.522	0,5	51.960	0,3	100.398	0,7	66	193
Loans	10.666.124	71,1	10.852.400	70,3	10.956.079	71,9	102	101
Value adjustment	1.007.459	6,7	1.165.928	7,5	1.171.155	7,7	116	100
Loans- net (loans minus value adjust.)	9.658.665	64,4	9.686.472	62,8	9.784.924	64,2	100	101
Business premises and other fixed assets	521.493	3,5	512.985	3,3	510.242	3,3	98	99
Other assets	221.038	1,5	214.722	1,4	206.492	1,4	97	96
TOTAL ASSETS	**14.990.766**	**100,0**	**15.446.550**	**100,0**	**15.237.995**	**100,0**	**103**	**99**
LIABILITIES:								
LIABILITIES								
Deposits	10.961.001	73,1	11.523.849	74,6	11.280.987	74,0	105	98
Borrowings from their banks	2.000	0,0	0	0,0	0	0,0	n/a	0
Liabilities under loans taken	1.141.561	7,6	1.039.381	6,7	1.004.486	6,6	91	97
Other liabilities	668.829	4,5	575.375	3,7	591.543	3,9	86	103
EQUITY								
Equity	2.217.375	14,8	2.307.945	15,0	2.360.979	15,5	104	102
TOTAL LIABILITIES (LIABILITIES AND EQUITY)	**14.990.766**	**100,0**	**15.446.550**	**100,0**	**15.237.995**	**100,0**	**103**	**99**

- 000 KM-

Table 9: *Banks' assets according to ownership structure*

BANKS	31.12.2012			31.12.2013			31.03.2014			INDEX	
	Number of banks	Assets (000 KM)		Number of banks	Assets (000 KM)		Number of banks	Assets (000 KM)			
1	2	3		4	5		6	7		8 (5/3)	9(7/5)
State-owned	1	209.971	1%	1	241.605	2%	1	223.111	1%	115	92
Private	17	14.780.795	99%	17	15.204.945	98%	16	15.014.884	99%	103	99

[6] State-owned banks post the «full balance sheet», meaning liabilities and neutral items that are to be taken over by the state once their privatisation process gets finalised. As of 31.03.14, these items amounted to KM 641 million with regards to one state-owned bank.

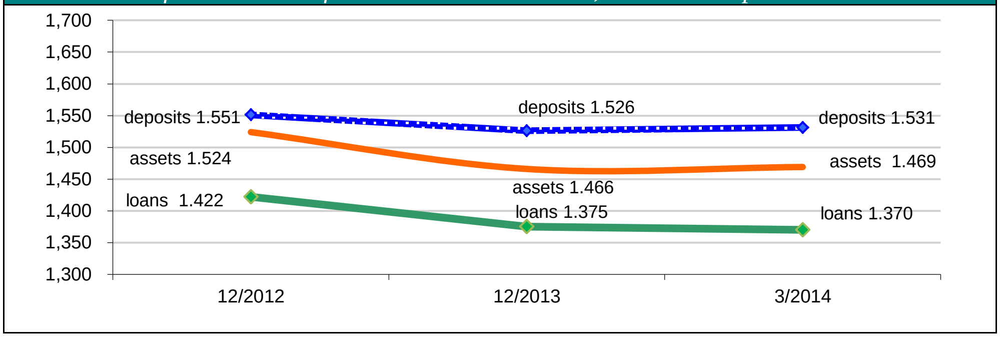
[7] Trading securities, securities available for sale and held to maturity securities.

TOTAL	18	14.990.766	100%	18	15.446.550	100%	17	15.237.995	100%	103	99

With most banks (11), assets is lower than as at YE2013, while other banks saw an assets' increase (noting therein that such changes are minimal).

Concentrations indicator we used for three key segments of the banking operations (assets, loans and deposits) is the Herfindahl index[8].

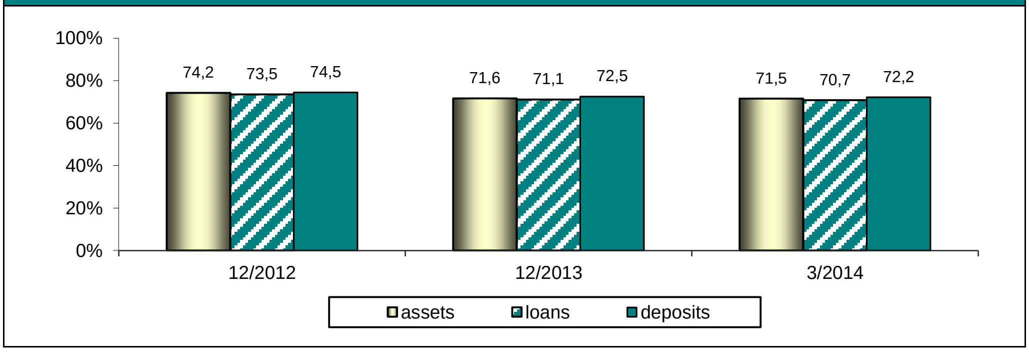
Chart 5: *Herfindahl index of concentrations in assets, loans and deposits*



In 2014, the Herfindahl index of concentrations in all three relevant categories (assets, loans and deposits) remained almost the same as at YE2013: so its level as of 31.03.2014 for assets stood at 1,469, for loans at 1,370 and for deposits at 1,531 units, which is indicative to a moderate concentration[9].

The second concentrations indicator for the banking system is a ratio of market concentrations, i.e. concentration rate[10] (hereinafter: the CR) showing a total share of largest institutions in the system and selected relevant categories: assets, loans and deposits. CR5 also changed only slightly and stood at 71.5% for the market share, 70.7% for loans and 72.2% for deposits. Over the past two years, the value of CR5 went down slightly across all three categories, but there is still evident domination of five largest banks in the system holding app. 72% of the market, loans and deposits.

Chart 6: *Concentration rates for 5 largest banks-CR5: assets, loans and deposits*



[8] This index is also called Hirschmann-Herfindahl index or HHI and is calculated according to this formula: $HI = \sum_{j=1}^{n} (S)_j^2$,
It represents a sum of squares of percentage share of specific element (e.g. assets, deposits, loans) of all market participants in the system. Of note, this index does not grow linearly and the value of e.g. 3,000 does not mean that the concentration within the system is 30%. Hypotethically, if there would be just one bank in the entire system HHI would be at maximum 10,000.

[9] If the value of HHI is below 1,000, this shows no presence of the concentration in the marketplace, while the index value between 1,000 and 1,800 shows moderate concentration and HHI value above 1,800 means high concentration in the market.

[10] Concentration ratio (CR) rests on the number of institutions included in the calculation.

The banking sector may also be analysed from the aspect of several groups formed according to the assets size[11]. Changes in the percentage share vs. the YE2013 were minor, as a result of slight changes related to assets of most of banks.

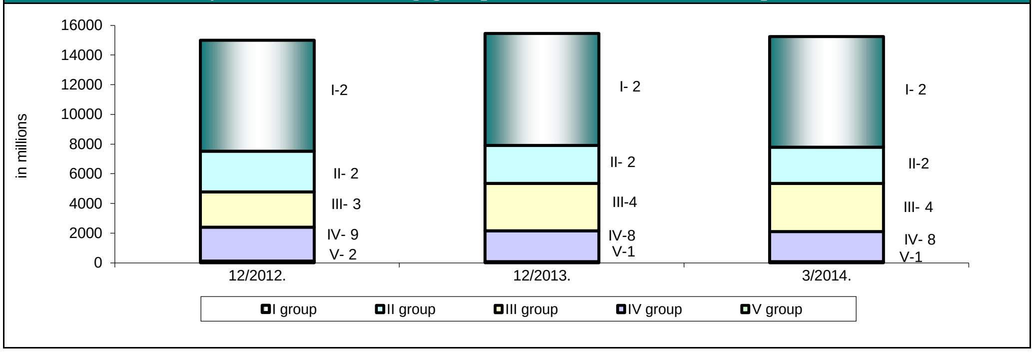
The banking system is still dominated by four largest banks with a share of 64.9%, of which I group (two largest banks in the system with assets over KM 3 billion) has a share of 48.9% and II group (two banks with assets amounting between KM 1 billion and KM 2 billion) has a share of 16.0%. The share of the III group (four banks with assets between KM 500 million and KM 1 billion) rose by 0.6%, i.e. by 21.3%, while the share in the IV group (eight banks with assets ranging from KM 100 million and KM 500 million) is 13.3%. Share of the last V group (one bank with assets below KM 100 million) has a share of negligible 0.5%.

The table below provides an overview of amounts and shares of individual groups of banks in total assets – across periods (in KM million).

Table 10: *Share of individual banking groups in total assets – across periods*

ASSETS	31.12.2012			31.12.2013			31.03.2014		
	Amount	% share	Number of banks	Amount	% share	Number of banks	Amount	% share	Number of banks
I- Over 2.000	7.476	49,8	2	7.546	48,8	2	7.455	48,9	2
II- 1000 to 2000	2.741	18,3	2	2.556	16,5	2	2.438	16,0	2
III- 500 to 1000	2.379	15,9	3	3.195	20,7	4	3.245	21,3	4
IV- 100 to 500	2.280	15,2	9	2.078	13,5	8	2.027	13,3	8
V- Below 100	115	0,8	2	73	0,5	1	73	0,5	1
TOTAL	14.991	100,0	18	14.991	100,0	17	15.238	100,0	17

Chart 7: *Share of individual banking groups in total assets – across periods*



The balance sheet total decrease by 1.4% or KM 209 million, i.e. to the level of KM 15.2 billion as at the end of the observed period is mostly a result of the deposit drop by 2.1% or KM 243 million (i.e. drop to the level of KM 11.3 billion), coupled with a reduction of loans by 3.4% or KM 35 million (i.e. to the amount of KM 1 billion). On the other hand, equity rose by 2.3% or KM 53 million, as originating mostly from profit of the current period. At the end of 1Q 2014, equity amounted to KM 2.4 billion.

After the said decrease of deposits and loan obligations, coupled with the increase of securities portfolio and facilities approved to other banks (as well as a very modest credit growth), cash funds dropped by 8.6% or KM 380 million and amounted to KM 4 billion as of 31.03.2014.

Growth rate of loans was 1.0% or KM 104 million and they amounted to KM 11 billion as of 1Q 2014.

[11] Banks are divided into 5 groups depending on the assets size.

Investments in securities posted an increase of 6.3% or KM 36 million (in 2013, their growth was 2.6% or KM 14 million) and arrived to an amount of KM 598 million as of 31.03.2014, thus having a share in assets of mere 3.9%.

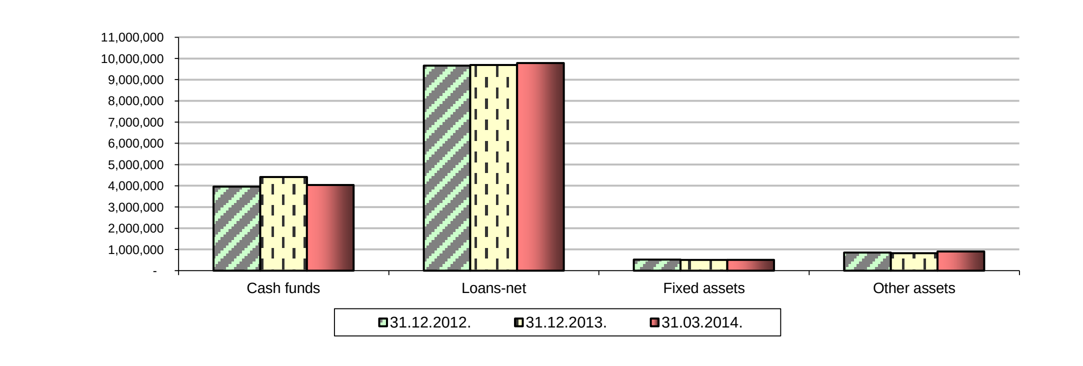
Portfolio of securities available for sale (where small part thereof refers to the trading portfolio) rose by 8.5% or KM 33 million and arrived to KM 415 million and value of securities held to maturity rose from KM 181 million to KM 183 million. Both portfolios include securities issued by the FB&H Government [12] of altogether KM 248 million as of 31.03.14, as well as securities issued by the Republika Srpska Government of KM 45 million. Also, trading portfolio includes shares issued by local companies totaling to KM 7 million. The remaining portion of the securities portfolio amounts to app. KM 298 million and refers mostly to bonds of EU countries.

In 1Q 2014, the FB&H Government issued three trenches of treasury bills: one in February 2014 of nominal value of KM 20 million maturing in May 2014 and the other two in March 2014 in respective amounts of KM 20 million (maturing in June 2014) and KM 20 million (maturing in June 2014). As of 31.03.14, treasury bills amounted to KM 80 million, i.e. their book value was KM 79.7 million. Also, securities portfolios of banks also include bonds issued by the FB&H Government (issued in 2012: first issue in May 2012 of KM 80 million maturing within 3 years, the second one in June and August of KM 30 million in total that mature within 5 years and the third issue in September of KM 20 million maturing within 2 years, as well as fourth issue from December 2013 of KM 40 million maturing within 3 years-where the total value of bonds purchased by banks was KM 17.5 million) of total nominal value of KM 140 million. Most of treasury bills and bonds with book value of KM 186 million were classified into the portfolio of securities available for sale, while the rest of KM 34 million is classified within the portfolio of securities held to maturity.

If we look at the overall securities portfolio (KM 598 million) from a perspective of exposures by countries, the largest share is with B&H (49.5%) (YE2013: 46.4%), followed by Romania (14.3%), Austria (8.0%), France (7.4%), etc.

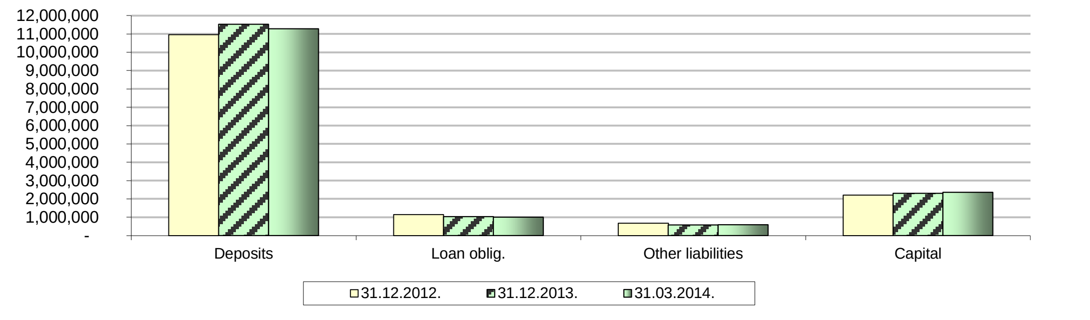
The charts below show the structure of key items of the banks' balance sheet.

Chart 8: *Structure of assets within the balance sheet of banks*



[12] All types of securities of the FB&H Government as the issuer.

Chart 9: *Structure of liabilities within the balance sheet of banks*



Within the liabilities structure of the banks' balances sheets, deposits still represent a dominant source of financing for banks in the FB&H (with an amount of KM 11.3 billion or 74.0% share). After further moderate decrease of 3.4%, the share of loan obligations of KM 1.0 billion remained almost the same (6.6%), while the share of capital rose from 15.0% to 15.5% (wherein, it amounted to KM 2.4 billion as of 31.03.14).

As with structure of assets, financing sources included slight changes related to two key assets items: increase of loan share from 70.3% to 71.9% and decrease of cash funds from 28.6% to 26.5%.

- in 000 KM-

Table 11: *Cash funds of banks*

CASH FUNDS	31.12.2012		31.12.2013		31.03.2014		INDEX	
	Amount	% share	Amount	% share	Amount	% share	4/2	6/4
1	2	3	4	5	6	7	8	9
Cash	411.726	10,4	431.592	9,8	400.084	9,9	105	93
RR with CB B&H	2.130.626	53,8	2.622.277	59,4	2.485.127	61,5	123	95
Accounts with deposit inst. in B&H	1.930	0,0	25.181	0,5	621	0,0	1305	2
Accounts with deposit inst. abroad	1.417.857	35,8	1.338.347	30,3	1.151.817	28,6	94	86
Cash in process of collection	442	0,0	501	0,0	256	0,0	113	51
TOTAL	3.962.581	100,0	4.417.898	100,0	4.037.905	100,0	111	91

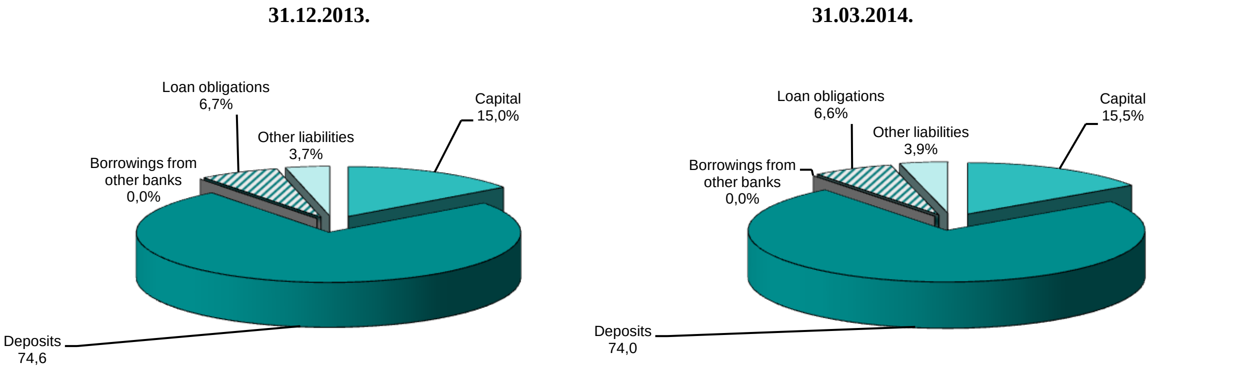
Two main changes related to cash funds are as follows: balances on the reserve account with CBBH and balances on banks' accounts abroad posted a decrease in the 1Q 2014. Cash funds of banks at the CBBH reserves account fell by 5% or KM 137 million, hence their amount as of 31.03.14 was KM 2.5 billion or 61.5% of total cash funds (vs. 59.4% as at YE2013). Banks' funds on accounts with deposit institutions abroad posted a decrease of 14% or KM 187 million. Resultantly, as of 31.03.14, their amount equaled KM 1.2 billion KM or 28.6% of total cash funds (vs. 30.3% as at YE2013). As for the cash funds held in vault and cash desks, after their decrease of 7% or KM 31 million, banks posted an amount of KM 400 million of such cash as of 31.03.14, which represented 9.9% of total cash funds.

These trends prompted a change of the currency structure of cash funds: in the observed period, the share of local currency rose from 66.4% to 69.1%, while cash in foreign currency declined by the same percentage.

2. 1. 1. Liabilities

Total liabilities structure (liabilities and equity) within the banks' balance sheet as of 31.03.14 is provided in the chart below.

Chart 10: *Structure of banks' liabilities*



During the observed period, the share of deposits (74.0%), as the most significant source of financing of banks, fell by 0.6%, while the share of loan obligations, the second largest source of financing, remained almost the same (6.6%).

The deposits decrease is a result of their decrease in 1Q 2014 by 2.1% or KM 243 million. Hence, as of 31.03.14 they arrived to KM 11.3 billion and are still the largest source of financing for banks in the Federation of B&H. Of note, in January 2014, B&H received the 4th tranche of funds based on the stand-by arrangement with the IMF of KM 61.7 million (in 2013, B&H received a total of app. KM 163 million and in 2012, KM 153 million).

The second largest source of financing are loans of KM 1.0 billion that banks received mostly from foreign financial institutions. In the past 3 years, due to the effect of the financial and economic crisis, banks incurred lesser loans abroad and, coupled with payment of matured liabilities, reduced these sources of financing by over 50% (YE2008, deposits amounted KM 2.18 billion). In 2012, the decrease amounted 13.5% or KM 178 million, in 2013 these sources dropped by 9% or KM 102 million, while in 1Q 2014 they dropped by 3.4% or KM 35 million. If we add subordinated debts of KM 169 million to loans, total loan funds hold a share in total sources of financing of 7.7%. The subordinated debt was incurred by banks to strengthen their capital base and improve capital adequacy.

As of 31.03.14, banks held the largest amount of liabilities towards the following creditors (6 out of total of 36 creditors) taking up 72% of their total loan obligations: European Investment Bank (EIB), TC ZIRAAT BANKASI A.S. (Turkey), UniCredit Bank Austria AG, European Fund for Southeast Europe (EFSE), EBRD and Council of Europe Development Bank.

As of 31.03.14, capital position stood at KM 2.4 billion and was by 2.3% or KM 53 million higher than as at YE2013. This growth entirely relates to the financial result (profit) achieved in the 1Q 2014.

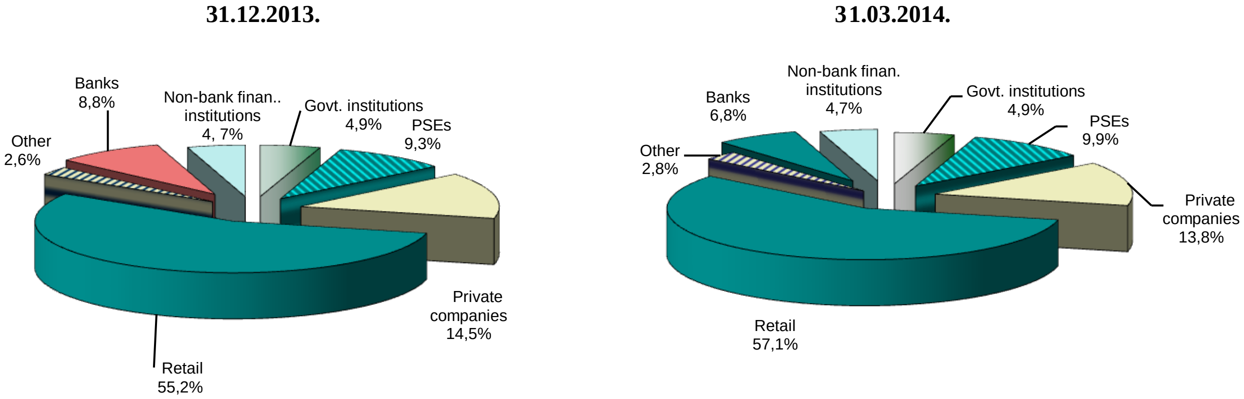
According to information provided by banks, out of the total deposit amount as of the observed period, only 5.8% relates to deposits collected in organisational parts of FB&H banks doing business in the Republika Srpska and the Brcko District.

- in 000 KM-

Table 12: *Deposit structure by industry sectors* [13]

SECTORS	31.12.2012		31.12.2013		31.03.2014		INDEX	
	Amount	% share	Amount	% share	Amount	% share	4/2	6/4
1	2	3	4	5	6	7	8	9
Government institutions	682.313	6,2	565.533	4,9	556.334	4,9	83	98
Public sector entities	1.090.870	10,0	1.076.527	9,3	1.114.431	9,9	99	104
Private companies and enterprises	1.501.232	13,7	1.668.034	14,5	1.553.874	13,8	111	93
Banking institutions	981.562	9,0	1.012.274	8,8	767.893	6,8	103	76
Non-banking finan.institutions	493.689	4,5	535.915	4,7	532.144	4,7	109	99
Retail	5.933.071	54,1	6.366.218	55,2	6.449.025	57,1	107	101
Other	278.264	2,5	299.348	2,6	307.286	2,8	108	103
TOTAL	10.961.001	100,0	11.523.849	100,0	11.280.987	100,0	105	98

Chart 11: *Deposit structure by industry sectors*



In 1Q 2014, minor changes occurred in the deposit structure by sectors that, on one hand, mostly relate to the deposit decrease of private companies and banks and, on the other hand, to slightly higher level of retail deposits and deposits of PSEs..

Retail deposits displayed a continuous growth over the past few years and they rose by 1% or KM 83 million in the 1Q 2014 and their share in total deposits rose from 55.2% to 57.2%, so the retail deposits are still the largest source of financing for banks. Analytical data indicate that 16 out of 17 banks have the largest share of retail deposits that ranges from 36% to 87%.

The second largest source of financing of the banking sector (based on the amount and the share) is with deposits of private companies. After their increase in Y2013 of 11% or KM 167 million, they fell by 7% or KM 114 million in the 1Q 2014 and their share dropped to 13.8% (-0.7%). Hence, their amount arrived to KM 1.6 billion.

PSEs deposits in the 1Q 2014 posted a rise of 4% or KM 38 million and their amount as of 31.03.14 was KM 1.1 billion with a share of 9.9% in total deposits.

From the end of 2007 until 3Q 2011, deposits of banking institutions were the second largest source among the deposit potential of banks. The growth trend was maintained by mid-2009 when they reached its peak of KM 2.3 billion and a share of 21.4% in total deposits. After that, due to the crisis,

[13] Information originate from the auxiliary form BS-D to the balance sheet that banks deliver on a quarterly basis to the FBA (as based on the FBA model).

reduced volume of lending and high liquidity, parent groups withdrew their deposits, thus resulting in the reduced share of these funds. Deposits of this sector dropped over the past four years by app. 52% or KM 1.1 billion. Negative trends of prior years (related to these funds at the sector level) are mostly a result of debt reduction, i.e. repayment of funds to groups – owners of banks in the FB&H.

In 1Q 20¸14, deposits of banking institutions fell by significant 24% or KM 244 million, thus arriving to an amount of KM 768 million as of 31.03.2014. This resulted in their share in total deposits going from 8.8% to 6.8%. These funds are by KM 237 million smaller than loans, which are the second largest source of funds in the FB&H, just after deposits. Based on mentioned information, we find that foreign debt level of FB&H banks is much lower, especially in terms of deposit funds of parent groups. Of note, app. KM 194 million or 27% of term deposits of groups mature by the end of 2014. Considering that the same reduction trend is present with regards to loan obligations, banks are once again facing the problem of maintaining their maturity matching, as caused by an unfavorable maturity of local deposit funds, due to which they are forced to obtain quality sources of funds in the period ahead in order to uphold the trend of increase in loans approved.

Also worth noting is that 95% or KM 718 million of deposits of banking institutions relates to deposits of banks from the group (shareholders mostly). Financial support by parent groups is present with regards to nine banks in the FB&H, wherein such financing is still concentrated among five large banks (94%). In this way, over the past periods, banks under majority foreign ownership had financial support and secured inflows of new funds by their foreign groups. If these funds are coupled with loan obligations and subordinated debts, the financing of banks from the group is still higher (with regards to 11 banks) and amounted to KM 1.1 billion as of 31.03.14 (or 7.4% of total liabilities of the banking sector (vs. KM 1.3 billion or 8.6% of liabilities as at YE2013). Within total deposits, funds of banking groups hold a share of 6.4% (vs. 8.0% as at YE2013), while loan obligations to the group represent 26.6% of total loan obligations (this share went up by 0.5%). Compared to the end of 2013, these funds dropped by 15.3% or KM 205 million, as largely based on regular maturities (deposits fell by 22.2% or KM 205 million, loan obligations dropped by 1.4% or KM 4 million, while subordinated debts went up by 5.0% or KM 7 million).

Considering that lending activities of banks got reduced significantly due to the economic crisis, thus resulting in high liquidity and good capitalisation rate of most of foreign-owned banks in the FB&H, the trend of the past couple of years is still present when it comes to reduced exposures towards groups. This primarily relates to the segment of deposit sources, while loan sources are reducing largely on basis of regular repayments of liabilities due. For reasons of unfavorable occurrences in the economies of home countries of owners of banks from the FB&H, problems these countries are facing and resultantly problems of their financial systems and banking groups, as well as measures taken in Austria to strengthen and ensure sustainability of business models of their large internationally active banking groups and to preserve its country credit rating[14], the financial support of parent banking groups got significantly reduced, so the loan growth in the following period in the FB&H will have to rely more on local sources of funds. It is especially important to underline that deposit funds that certain banks received from their parent groups over the past two years are mostly of short term character (from one month to one year) and serve a purpose of maintaining maturity matching within the defined limits, hence they are not quality source of long term financing.

At times of crisis and difficulties with accessing money markets and new funds, increase of liquidity risk as a result of impaired collection rate of loans and growth of uncollectable receivables, unsatisfactory maturity structure of local deposit sources and expected further reduction of foreign sources of financing, the problem with unfavorable maturity structure of sources of financing

[14] In essence, these measures mean that lending activities of subsidiaries of Austrian banks in the Central, Eastern and Southeastern Europe (CESEE) is conditioned by stronger and sustainable financing from local sources.

(deposits primarily) and their growth will be in focus of most of banks in the period ahead. Deposits of other sectors had negligible changes in terms of both, amount and share.

The currency structure of deposits as of 31.03.14 has slightly changed: deposits in foreign currency (with a dominant share of EUR currency) amount to KM 5.9 billion and their share rose from 51.9% to 52.4% and deposits in local currency amount to KM 5.4 billion and hold the share of 47.6%.

At the end of 1Q 2014, the structure of deposits by domicile status of depositors changed slightly: resident funds amounted to KM 10.2 billion and had a share of 90.8% (+2.1%) while non-resident deposits stood at KM 1 billion and represented 9.2% of total deposits. Resident deposits rose by 0.2% or KM 18 million, while non-resident deposits fell by 20.0% or KM 261 million. Over the past four years, non-resident deposits had continuously dropped, as a result of withdrawal, i.e. return of deposits to the parent bank or member of the banking group (where nonresident funds mostly refer to these entities). Non-resident deposits had the largest share of 22.1% and nominal amount of KM 2.31 billion at the end of 2008.

In 2014, savings deposits, as the most significant segment of deposit and financial potential of banks posted an increase of 1.3% or KM 79 million and amounted to KM 6.3 billion as of 31.03.14.

Table 13: *New retail savings by periods*

BANKS	AMOUNT (u 000 KM)			INDEX	
	31.12.2012	31.12.2013	31.03.2014	3/2	4/3
1	2	3	4	5	6
State-owned	58.050	65.179	66.123	112	101
Private	5.698.300	6.135.693	6.213.768	108	101
TOTAL	5.756.350	6.200.872	6.279.891	108	101

Chart 12: *New retail savings by periods*

Two largest banks hold 58% of savings, while NINE banks hold individual share of 2%, thus representing 10.7% of total savings at the level of the banking system

Out of the total amount of savings, 38% refers to saving deposits in local currency and 62% in foreign currency.

Table 14: *Maturity structure of retail savings deposits by periods*

BANKS	AMOUNT (IN 000 KM)						INDEX	
	31.12.2012		31.12.2013		31.03.2014		3/2	4/3
1	2		3		4		5	6
ST savings deposits	2.656.934	46,2%	2.911.827	47,0%	2.930.477	46,7%	110	101
LT savings deposits	3.099.416	53,8%	3.289.063	53,0%	3.349.414	53,3%	106	102
TOTAL	5.756.350	100,0 %	6.200.890	100,0%	6.279.891	100,0%	108	101

Compared to the end of 2013, maturity structure of savings deposits changed slightly through an increase of short term deposits by 1% or KM 19 million, while long term deposits grew by 2% or KM 60 million, thus resulting in slightly higher share of LT deposits from 53.0% to 53.3%.

Long standing continuous growth and positive trends in the savings segment of banks in the FB&H have resulted, on one hand, from better safety and stability of the overall banking system (as chiefly attributable to the functional, effective and efficient banking supervision implemented by the FBA) and, on the other hand, from existence of the deposit insurance segment whose primary objective is increased stability of the banking, i.e. financial sector, and protection of savers. In order to preserve and strengthen trust of citizens in safety and stability of the banking system in B&H, the deposit insurance level rose to KM 20,000 in 2008. After that, an initiative was taken to increase the insured deposit level. Accordingly, on 01.04.10, this level climbed to KM 35,000. According to the latest decision by the management board of the B&H Deposit Insurance Agency from December 2013, the insured deposit limit rose from the present KM 35,000 to KM 50,000, with the effect date starting from 01.01.14. All these actions are aimed towards limiting the effect of the global economic crisis in the banking and the overall economic system in the FB&H and B&H.

As of 31. 03. 2014, there were a total of 16 banks from the FB&H that are included in the deposit insurance program (i.e. holding licenses issued by the B&H Deposit Insurance Agency). There is one bank that is not eligible for this program as it does not meet the criteria defined by the B&H Deposit Insurance Agency (due to existing composite rating).

2.1.2. Capital – Strength and Adequacy

Capital position[15] in FB&H banks as of 31.03.2014 stood at KM 2.3 billion.

-in 000 KM-

Table 15: *Regulatory capital*

DESCRIPTION	31.12.2012		31.12.2013		31.03.2014		INDEX	
1	2		3		4		5 (3/2)	6 (4/3)
1.a.**Core capital before reduction**	1.913.841		2.155.188		2.188.104		101	102
1.1. Shareholders capital –common and permanent non-cumulative	1.198.516		1.200.644		1.205.501		100	100
shares	136.485		136.485		136.485		100	100
1.2. Issue premiums	578.840		818.059		846.118		141	103
1.3.Reserves and retained profit	191.304		294.629		297.552		154	101
1.b.Deductible items	120.740		112.610		253.055		93	225
1.1. Uncovered losses from previous years	17.818		140.445		3.087		788	2
1.2. Current year loss	156		156		156		100	100
1.3. Treasury shares	52.590		41.418		41.254		79	100
1.4.. Intangible assets								
	1.722.537	**79%**	**1.860.559**	**80%**	**1.890.552**	**83%**	108	102
1. Core capital (1a-1b)	**467.100**	**21%**	**457.047**	**20%**	**390.179**	**17%**	98	85
2. Supplementary capital	3.090		3.091		3.091		100	100
2.1. Shareholders capital-permanent preferred cumulative shares	211.433		215.083		216.003		102	100
2.2. General loan loss provisions	67.243		71.984		1.106		107	2
2.3Amount of audited profit	120.264		165.473		168.563		138	102
2.4. Subordinated debt up to 50% of the core capital	65.070		1.416		1.416		2	100
2.5. Permanent items	**2.189.637**	**100%**	**2.317.606**	**100%**	**2.280.731**	**100%**	106	98
3. Equity (1 + 2)								
4. Deductible items from the capital	**98.848**		**159.710**		**179.225**		162	112
4.1. Bank's share in capital of other legal entities above 5% of core	3.043		2.844		2.844		93	100
capital	95.720		156.866		176.381		164	112
4.2. LLP shortfall at the regulator's request	85		0		0		N/a	N/a
4.3. Other deductible items	**2.090.789**		**2.157.896**		**2.101.506**		103	97
5. Net capital (3- 4)								

[15] Regulatory capital is defined in Article 8 and 9 of the Decision on Minimum standards for Capital Management in Banks (Official Gazette of the FB&H No. 3/03, 18/03, 53/06, 55/07, 81/07, 6/08, 86/10, 70/11).

In 1Q 2014, capital[16] fell by 2% or KM 37 million, thus including a minor change in its structure (83% core capital and 17% supplementary capital). Core capital increased by 2% or KM 30 million, while supplementary capital dropped by 15% or KM 67 million.

The core capital increase mostly refers to the transfer of one part of profit earned in 2013 from supplementary to core capital (in an amount of KM 29 million).

Deductible items (from the core capital) rose by KM 3 million, as due to the current loss

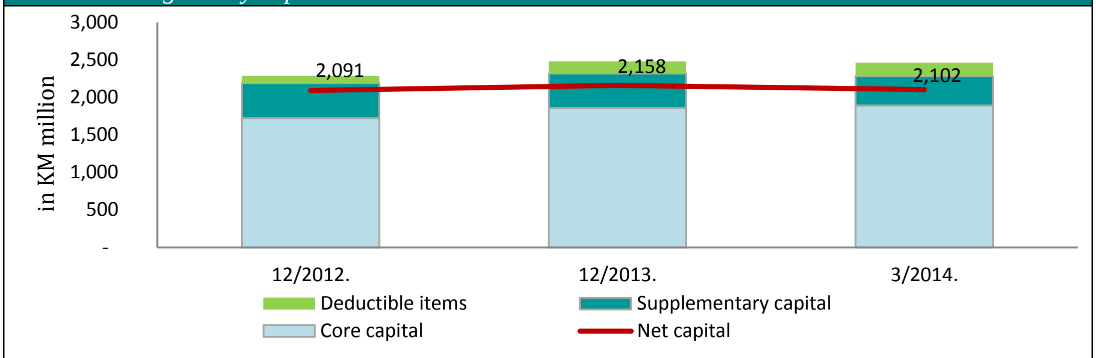
.
Supplementary capital dropped by 15% or KM 66.8 million, thus largely affected by the said transfer of audited profit to the core capital. Of note, there was one bank that did not include the audited profit in its core capital (i.e. it was part of the supplementary capital as of YE2013) due to intended dividends disbursement

It is pertinent to note that three banks did not include Y2013 profit to its capital (a total of KM 9 million) since they did not finalise audit activities and since their competent bodies did not make relevant decisions on profit allocation.

According to regulatory changes in late 2011, deductible items from capital include also LLP shortfall upon regulator's request (i.e. a difference between required regulatory loan loss provisions according to balance sheet and off-balance sheet items[17] and loan loss provisions formed against profit). As of 31.03.14, this item amounted to KM 176 million, up by 12% or KM 19 million than as at YE2013.

The chart below shows the regulatory capital structure.

Chart 13: *Regulatory capital structure*



As a result of the said changes, especially due to the negative effect of the increase of LLP shortfall (20% or KM 20 million), net capital fell by 3% or KM 65 million and amounted to KM 2.1 billion as of 31.03.14.

Capital adequacy of individual banks, i.e. the overall system, depends, on one hand, from the net capital level, and, on the other, from total risk weights (risk weighted assets and weighted operational risk).

The table below provides a structure of net exposures of banks according to credit risk weights, i.e. conversion ratios for off-balance sheet items.

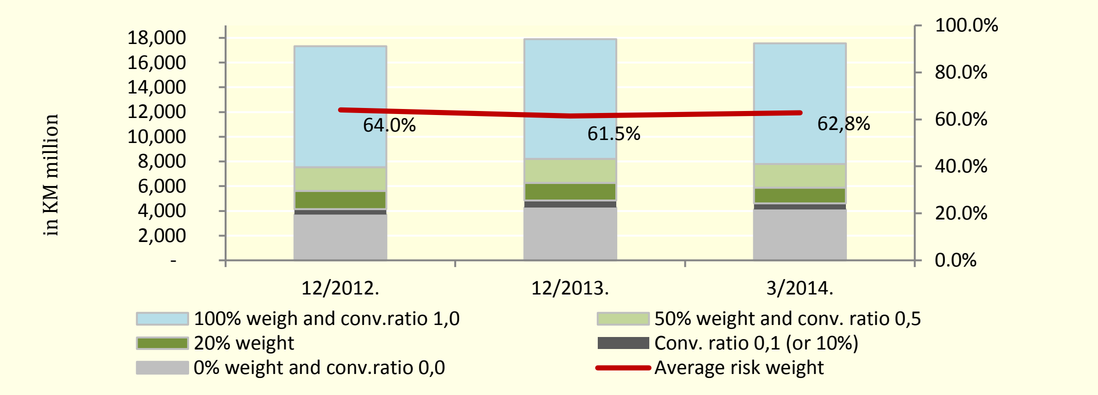
[16] Source of information: quarterly Report on Capital Condition in Banks (Form 1-Table A), as defined by the Decision on Minimum Standards for Capital Management in Banks.
[17] Banks recognise required regulatory reserves when the value adjustment (according to IAS) is below calculated regulatory reserves, as determined at the level of individual debtor. This methodology is in application since 30. 06. 2012.

-in 000 KM-

Table 16: *Structure of net exposure of banks according to credit risk weights*

DESCRIPTION	31.12.2012	31.12.2013	31.03.2014	INDEX	
1	2	3	4	5 (3/2)	6 (4/3)
TOTAL EXPOSURE (1+2):	**17.310.579**	**17.893.904**	**17.552.755**	103	98
1 Balance sheet assets	14.568.957	14.969.445	14.741.567	103	98
2. Off-bal.sheet items	2.741.622	2.924.459	2.811.188	107	96
DISTRIBUTION BY RISK WEIGHTS AND CONVERSION RATIOS					
0% weight	3.647.306	4.198.260	4.056.528	115	97
20% weight	1.460.689	1.424.069	1.289.476	97	91
50% weight	53.155	33.110	8.737	62	26
100% weight	9.407.807	9.314.006	9.386.826	99	101
0,0 conversion ratio	51.131	86.947	63.962	170	74
0,1 conversion ratio	449.627	550.966	479.746	123	87
0,5 conversion ratio	1.867.703	1.916.076	1.886.487	103	98
1,0 conversion ratio	373.161	370.470	380.993	99	103
RISK WEIGHTED ASSETS AND LOAN EQUIVALENTS	**11.078.498**	**10.998.977**	**11.021.299**	**99**	**100**
Average risk weight	**64,0%**	**61,5%**	**62,8%**	**96**	**102**

Chart 14: *Structure of net exposure of banks according to credit risk weights*



In 1Q 2014, total net exposure of banks (before being weighted) is lower by 2% or KM 341 million. Although assets items being weighted with 100% have increased slightly (1%), decrease of other assets items being weighted with 0%, 20% and 50% caused for the risk weighted assets and loan equivalents to remain the same (KM 11 billion) and for average risk weight to rise from 61.5% na 62.8%.

The same direction was seen with regards to the weighted operational risk (WOR) that also rose somewhat and stands at KM 982 million. All of this has resulted in unchanged amount of total risk weights.

As of 31.03.14, the share of risk weighted assets exposed to credit risk stood at 925 and to operational risk to 8%.

Banks’ capitalisation rate, expressed as a ratio between capital and assets, amounted 13.9% as of 31.03.14, which is the same as at YE2013.

One of key indicators of the capital strength and adequacy[18] of banks is the capital adequacy ratio representing a ratio between net capital and risk weighted assets. At the banking sector level, this ratio

[18] Legally defined minimum capital adequacy rate is 12%.

stood at 17.5% as of 31.03.14, up by 0.5% vs. YE2013. Out of the total profit of KM 138 million generated as of 31.12.13, the capital adequacy calculation accounted for KM 86 million or 63%.

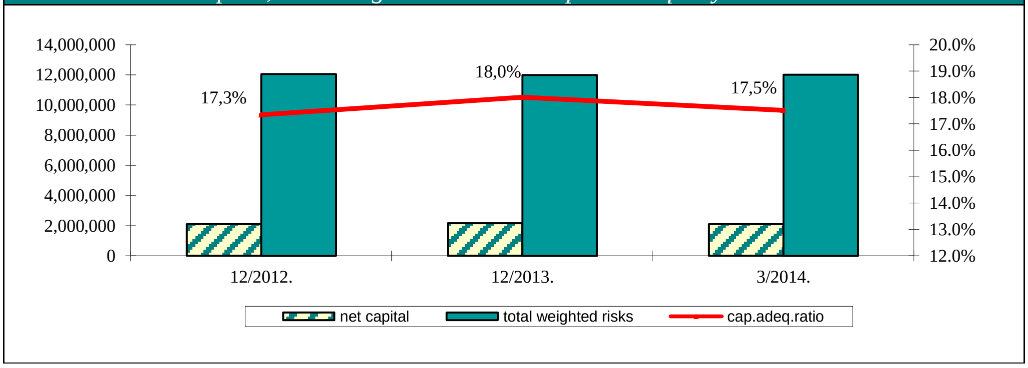
Although operations of the banking sector have been affected by the economic crisis for past couple of years, capital adequacy of the banking sector has been continuously maintained at the level above 16% and above 17% in the past three years. Reason to this is, on one hand, in the credit growth stagnation and in the decrease of overall weighted risks, and, on the other, in the fact the banks have maintained the largest share of profit from previous years within their capital and several banks have improved their capitalization rate by means of additional capital injections. However, problems related to the increase of non-performing loans and items not covered by loan loss provisions (net non-performing assets) may, in the period ahead, significantly impact and cause weakening of the capital base with several banks. This is conditioned by continued negative trends regarding the assets quality and by worsening and increase of non-collectable loans. This is illustrated by the following information: at the end of 2008, net non-performing assets stood at KM197 million and its ratio (vs. core capital) was 13.2%. At the end of 1Q 2014, net non-performing assets reached an amount of KM 441 million and the ratio was 23.3%. Also, according to the existing regulations, banks to not calculate the capital requirement for market risks, due to which the capital adequacy rate is higher.

-000 KM-

Net capital, total weighted risks and capital adequacy rate

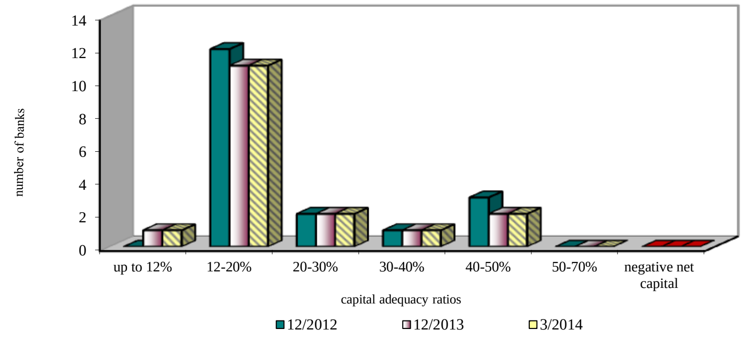
DESCRIPTION	31.12.2012	31.12.2013	31.03.2014	INDEX	
1	2	3	4	5(3/2)	6(4/3)
1. NET CAPITAL	2.090.789	2.157.896	2.101.506	103	97
2. RISK WEIGHTED ASSETS AND LOAN EQUIVALENTS	11.078.498	10.998.977	11.021.299	99	100
3. WOR (WEIGHTED OPERATIONAL RISK)	974.201	981.318	982.260	101	100
4. TOTAL WEIGHTED RISKS (2+3)	12.052.699	11.980.295	12.003.559	99	100
5. NET CAPITAL RATE (CAPITAL ADEQUACY) (1/ 4)	17,3%	18,0%	17,5%	104	97

Chart 15: *Net capital, total weighted risks and capital adequacy rate*



Capital adequacy rate of the banking system as of 31.03.14 was 17.5%, which is still quite above the legal minimum (12%) and represents a satisfactory capitalization rate of the overall system considering the existing level of risk exposure and poses strong basis and foundation for preservation of its safety and stability.

Chart 16: *Capital adequacy ratios of banks*



Out of the total of 17 banks in the FB&H as of 31.03.14, 16 banks had the capital adequacy ratio above the legal minimum of 12%, while one bank had this ratio below the legal minimum. According to analytical data, 9 banks had the capital adequacy rate below the rate as at YE2013 (ranging from 0.1% to 3.6%), 5 banks had improved this rate and 3 banks had the rate equivalent to the one at the end of 2013.

Find below is an overview of capital adequacy rates of banks vs. the legal minimum of 12%:

- 1 bank had the rate below 12% (11.8%),
- 7 banks had the rate between 13.1% and 15.5%,
- 4 banks had the rate between 16.0% and 19.4%,
- 2 banks had the rate between 20.1% and 20.3% and
- 3 banks had the rate between 35.9% and 47.7%.

By performing supervision of operations and financial condition of banks in the FB&H in line with its legal competencies and for purpose of improving safety of individual banks and the banking system as a whole, FBA instructed banks to take appropriate measures to strengthen their capital base and ensure capital adequacy in terms of level and profile of the existing and potential exposure to all risks inherent with the banking operations. One of measures taken by the FBA to preserve and strengthen capital base and safety and stability of banks is to adopt actions[19] on temporary restrictions and minimum requirements for dividends and discretionary bonus disbursement and repurchase of own shares by banks (with 31.12.12 as the effect date).

As insofar, the priority task of most of banks in the system is to further strengthen the capital base, wherein the focus is placed on large banks in the system, especially due to changes in the business and operating environment of the FB&H, actions caused by and negative effects of the global financial and economic crisis to our country, banking sector and the overall economy in B&H. Also, the focus is on banks with adverse trends regarding assets quality, which further negatively reflects upon the capital and represents a realistic possibility for additional weakening of the capital base. Under conditions of economic crisis and credit risk growth caused by the downfall of the loan portfolio quality (due to an increase of uncollectible receivables), this requirement has a high priority and the capital segment is therefore under a continuous reinforced supervision in order to prevent impaired stability of banks and erosion of the capital base to the level that may jeopardize bank operations and impact the stability of the entire banking system.

[19] Decision on Temporary Restrictions and Minimum Requirements for Dividends and Discretionary Bonus Disbursement and Repurchase of Own Shares by Banks (FB&H Official Gazette No. 15/13).

2.1.3. Assets and Assets Quality

The Decision on Minimum Standards for Credit Risk Management and Assets Classification in Banks defines criteria for an assessment of banks' exposure to credit risk by means of the assets quality assessment and assessment of adequacy of reserves for loan and other losses as per risk level of loans and balance sheet and off-balance sheet assets items.

With the effect date of the Law on Accounting and Audit in the FB&H, i.e. starting from 31.12.11, banks are required to prepare and present financial statements in line with the International Accounting Standards (IAS) and the International Financial Reporting Standards (IFRS), whereas recognition and measurement of financial assets and liabilities is subject to the IAS 39 – Financial instruments, recognition and measurement and the IAS 37 – Provisioning, contingent liabilities and contingent assets. This is to say that, during the assessment of banks' exposure to the credit risk, banks are required to continue calculating loan loss provisions in line with the criteria from the Decision on Minimum Standards for Credit Risk Management and Assets Classification in Banks, considering therein already formed value adjustments of balance sheet assets and loss provisions for off-balance sheet items carried on banks' books, as well as loan loss provisions formed against profit (found on capital accounts).

-in 000 KM-

Table 18: Assets *(BS and off-BS), LLP according to the regulatory body and value adjustments according to IAS*

DESCRIPTION	31.12.2012	31.12.2013	31.03.2014	INDEX	
1	2	3	4	5(3/2	6(4/3)
1. Risk-bearing assets [20]	13.286.676	13.517.944	13.629.344	102	101
2. Calculated regulatory reserves for loan losses	1.370.669	1.504.174	1.550.935	110	103
3. Value adjustment and reserves for off-balance sheet items	1.092.535	1.255.162	1.261.048	115	100
4. Required regulatory reserves formed against profit for assessed	411.077	411.515	449.144	100	109
5. Formed regulatory reserves for against profit for assessed	315.734	315.734	315.734	100	100
6. Shortfall of regulatory reserves formed against profit for	111.565	156.866	176.380	141	112
7. Non-risk bearing items	5.579.911	6.145.092	5.717.788	110	93
8. TOTAL ASSETS (1+7)	18.866.587	19.663.036	19.347.132	104	98

Total assets with off-balance sheet items (assets)[21] of banks in the FB&H amounted to KM 19.3 billion as of 31.03.14 and are higher by 2% or KM 316 million vs. YE2013. Risk-bearing assets amount to KM 13.6 billion and are up by 1% or KM 111 million.

Non-risk bearing items stand at KM 5.7 billion or 30% of total assets with off-balance sheet items, thus being down by 7% or KM 427 million vs. the YE2013.

Total calculated LLP based on regulatory requirements amount to KM 1.6 billion and formed value adjustments for balance sheet assets and provisions for losses under off-balance sheet items amount to KM 1.3 billion. Required regulatory reserves[22] amount to KM 449 million and went up by 9% or KM 38 million. Formed regulatory reserves against profit amount to KM 316 million and they remained at the same level as a result of changes in regulations, i.e. LLP shortfall being posted at the end of the business year (starting from 31.12.12) is not covered against profit, but still represents a deductible

[20] Does not include amount of facilities and contingent liabilities of KM 253 million that is secured with a cash deposit.

[21] Assets, as defined in Article 2 of the Decision on Minimum Standards for Credit Risk Management and Assets Classification in Banks (FB&H Official Gazette Nos. 3/03, 54/04, 68/05, 86/10, 6/11, 70/11, 85/11; 85/11-consolidated text; 15/13).

[22] Required regulatory reserves represent a positive difference between calculated LLP and value adjustments (calculated LLP are higher than value adjustments).

item from the capital and affects the capital adequacy calculation. Regulatory reserves shortfall[23] as of 31. 03.2014 stand at KM 176 million and posted a growth rate of 12% or KM 20 million vs. YE2013, as a result of continuous worsening of the loan portfolio quality.

Table 19: *Total assets, gross balance sheet assets, risk-bearing and non-risk bearing assets items*

DESCRIPTION	31.12.2012		31.12.2013		31.03.2014		INDEX	
	Amount	Struct. %	Amount	Struct. %	Amount	Struct. %		
1.	2	3	4	5	6	7	8 (4/2)	9 (6/4)
Loans	9.347.370	85,2	9.396.444	84,3	9.439.483[24]	83,6	101	100
Interest	86.650	0,8	81.456	0,7	81.909	0,7	94	101
Past due receivables	1.049.891	9,5	1.144.042	10,3	1.211.317	10,7	109	106
Receivables based on paid guarantees	24.360	0,2	31.783	0,3	33.065	0,3	130	104
Other facilities	172.479	1,6	201.786	1,8	262.192	2,3	117	130
Other assets	292.440	2,7	294.623	2,6	260.793	2,4	101	89
1.RISK-BEARING BALANCE SHEET ASSETS	10.973.190	100,0	11.150.134	100,0	11.288.759	100,0	102	101
2. NON-RISK BEARING BALANCE SHEET ASSETS	5.084.000		5.523.506		5.183.637		109	94
3.GROSS BALANCE SHEET ASSETS (1+2)	16.057.190		16.673.640		16.472.396		104	99
4.RISK-BEARING OFF-BAL.SHEET ITEMS	2.313.486		2.367.810		2.340.585		102	99
5.NON-RISK BEARING OFF-BAL.SHEET ITEMS	495.911		621.586		534.151		125	86
6.TOTAL OFF-BAL.SHEET ITEMS (4+5)	2.809.397		2.989.396		2.874.736		106	96
7.RISK-BEARING ASSETS WITH OFF-BAL.SHEET ITEMS (1+4)	13.286.676		13.517.944		13.629.344		102	101
8. NON-RISK BEARING ITEMS (2+5)	5.579.911		6.145.092		5.717.788		110	93
9. ASSETS WITH OFF-BAL.SHEET ITEMS (3+6)	18.866.587		19.663.036		19.347.132		104	98

Gross balance sheet assets [25] amount to KM 16.5 billion and it went down by 1% or KM 201 million, while risk-bearing balance sheet assets stand at KM 11.3 billion or 68% of gross balance sheet assets (thus being by 1% or KM 139 million higher than at the end of 2013). Non-risk bearing balance sheet assets amount to KM 5.2 billion and are by 6% or KM 340 million lower. Off-balance sheet risk-bearing items amount to KM 2.3 billion and are 1% or KM 27 million lower, while non-risk bearing items amount to KM 534 million and are 14% or KM 87 million lower than at the YE2013.

The economic crisis effect on the total economy and industry in B&H is still pronounced, as significantly impacting the key business segment of banks – the lending segment. In 1Q 2014, banks posted a moderate loan increase of 1% or KM 104 million. As of 31.03.14, loans stood at KM 11 billion and their share in assets rose by 1.6% and equals 71.9%.

However, based on analytical data, we find that this loan growth was largely generated from an increase of past due, uncollected receivables (default receivables). In 2013, their increase rate was 11% or KM 110 million, i.e. their overall amount was KM 1.1 billion, while they rose by 6% or KM 68 million in 1Q 2014 and achieved an amount of KM 1.2 billion as of 31.03.14. This leads to a conclusion that the real loan growth in the 1Q 2014 was negligible (app. 0.7% in 2013).

In 1Q 2014, a total of KM 1.6 billion of new loans was approved, which is 7% or KM 113 million higher than in the same period the year before. Out of the total loans approved, 67% relates to the corporate segment and 29% to the retail segment (as of 31.12.13: 67% corporate segment, 28% retail segment). The maturity structure of newly approved loans is the same as of YE2013: 44% long term and 56% short term loans.

[23] Shortfall of regulatory reserves represents a positive difference between required and formed LLP.
[24] This does not include the loan amount of KM 199 million secured with a cash deposit (included in non-risk bearing assets of the balance sheet).
[25] Data source: Report on classification of balance sheet assets and off-balance sheet items of banks.

Three largest banks in the FB&H have an aggregate amount of approved loans of KM 6.1 billion, thus holding a share of 56% in total loans at the banking system level.

The table below provides an overview of the trend and changes in shares of individual sectors regarding the total loan structure.

-in 000 KM-

Table 20: *Loan structure by industry sectors*

SECTORS	31.12.2012		31.12.2013		31.03.2014		INDEX	
	Amount	% share	Amount	% share	Amount	% share		
1	2	3	4	5	6	7	8(4/2)	9(6/4)
Government institutions	132.525	1,2	142.010	1,3	138.998	1,3	107	98
PSEs	251.233	2,4	259.769	2,4	263.057	2,4	103	101
Private companies and enterprises	5.141.359	48,2	5.202.269	47,9	5.278.243	48,2	101	101
Banks	11.177	0,1	6.671	0,1	6.237	0,0	60	93
Non-bank. finans.institutions	41.661	0,4	37.791	0,3	35.268	0,3	91	93
Retail	5.076.679	47,6	5.194.971	47,9	5.225.504	47,7	102	101
Other	11.490	0,1	8.919	0,1	8.772	0,1	78	98
TOTAL	10.666.124	100,0	10.852.400	100,0	10.956.079	100,0	102	101

In 1Q 2014, loan structure by industry sectors has slightly changed compared to the YE2013. Retail loans went up by 1% or KM 30 million and arrived to KM 5.2 billion, which is the same level as at YE2013. Loans to private companies posted an increase of 1% or KM 76 million and stand at KM 5.3 billion (vs. KM 5.2 billion at the end of 2013). Loan growth of private companies caused the increase of their share from 47.9% to 48.2%, while the share of private company loans dropped from 47.9% to 47.7%.

According to information delivered by banks (as of 31.03.14) regarding the retail loan structure by their purpose, it is the same as at YE2013: consumer loans[26] hold a share of 75%, followed by housing loans of 22%, while the rest of 3% refers to loans to small crafts, small businesses and agriculture.

Three largest banks in the system have approved 63% of retail loans and 48% of private company loans (31.12.13: 63% retail, 49% private companies).

Currency structure of loans: the largest share of 66% or KM 7 billion refers to currency clause loans (EUR: KM 7 billion or 97%, CHF: KM 235 million or 3%), followed by local currency loans with the share of 33% or KM 3.7 billion, while the smallest share of 1% or KM 89 million refers to FCY loans (thereof, almost entire amount refers to EUR: KM 80 million or 90%). Total amount of loans with the currency clause in CHF of KM 235 million or 2.1% of total loan portfolio refers almost entirely to one bank within the banking system.
Since loans are the highest risk category of banks' assets, their quality represents one of key factors determining stability and success of their operations. Assets quality assessment is in fact an evaluation of credit risk exposure for banks, i.e. identification of potential loan losses.

The table below provides an overview of the quality of assets and off-balance sheet risk-bearing items, general credit risk and potential loan losses per classification categories.

[26] Including cards business.

Table 21: *Assets classification, general credit risk (GCR) and potential loan losses (PLL)*

Classification category	31.12.2012 Classified assets	% share	GCR PLL	31.12.2013 Classified assets	% share	GCR PLL	31.03.2014 Classified assets	% share	GCR PLL	INDEX	
1	2	3	4	5	6	7	8	9	10	11(5/2)	12(8/5)
A	10.571.555	79,6	211.433	10.754.079	79,6	215.083	10.800.142	79,2	216.003	102	100
B	1.227.301	9,3	108.313	1.094.361	8,1	93.547	1.155.243	8,5	102.349	89	106
C	334.226	2,5	87.874	356.646	2,6	90.541	317.039	2,3	76.495	107	89
D	443.500	3,3	252.970	502.803	3,7	295.224	474.478	3,5	274.009	113	94
E	710.094	5,3	710.079	810.055	6,0	809.779	882.442	6,5	882.079	114	109
Risk-bear.assets (A-E)	13.286.676	100,0	1.370.669	13.517.944	100,0	1.504.174	13.629.344	100,0	1.550.935	102	101
Classified (B-E)	2.715.121	20,4	1.159.236	2.763.865	20,4	1.289.091	2.829.202	20,8	1.334.932	102	102
Non-performing (C-E)	1.487.820	11,2	1.050.923	1.669.504	12,4	1.195.544	1.673.959	12,3	1.232.583	112	100
Non-risk bear.assets [27]	5.579.911			6.145.092			5.717.788			110	93
TOTAL (risk and non-risk)	18.866.587			19.663.036			19.347.132			104	98

The first indicator and a warning sign of potential problems with loan repayment is the growth of past due receivables and their share in total loans. In 1Q 2014, past due receivables had a relatively high increase of 6% or KM 69 million (vs. 2013: 9% or KM 102 million) and their share rose by 0.5%, i.e. by 11.4%.

If we look into the quality of risk-bearing assets through trends and changes of key indicators, we can conclude that key indicators of assets quality remained almost the same as at YE2013. As for some banks, these indicators showed slight oscillations (upgrade or downgrade), i.e. there were eight banks with the ratio of classified assets and risk-bearing assets below the level of the overall banking sector, while seven banks had the share of non-performing assets vs. risk-bearing assets below the level of the banking sector.

As of 31.03.14, classified assets amounted to KM 2.8 billion and non-performing assets stood at KM 1.7 billion.

Classified assets (B-E) went up by 2% or KM 65 million: category B is by 6% or KM 61 million higher (in 2013: decrease by 11% or KM 133 million) and non-performing assets (C-E) remained the same as at YE2013 (i.e. in 2013, it rose by 12% or KM 182 million).

The ratio between classified assets and risk-bearing assets is 20.8%, which is an increase by 0.4% vs. YE2013.

The most significant indicator of assets quality is the ratio between non-performing assets and risk-bearing assets, which fell by 0.1% vs. YE2013 and now stands at 12.3% (whereas this ratio rose in 2013 by 1.2%). The main reasons for this rests with the slight increase of risk-bearing assets, while non-performing assets remained unchanged. However, this should not be taken lightly since the share of category B is 8.5% (YE2013: 8.1%) and since we doubt that a part of loans classified within this category are of poor quality and need to be classified as non-performing assets.

Sector-level data analysis is based on loan quality indicators for the two key sectors: corporate and retail. Two indicators for the said sectors show major deviation and point to higher exposure to credit risk, hence to potential loan losses regarding the corporate segment.

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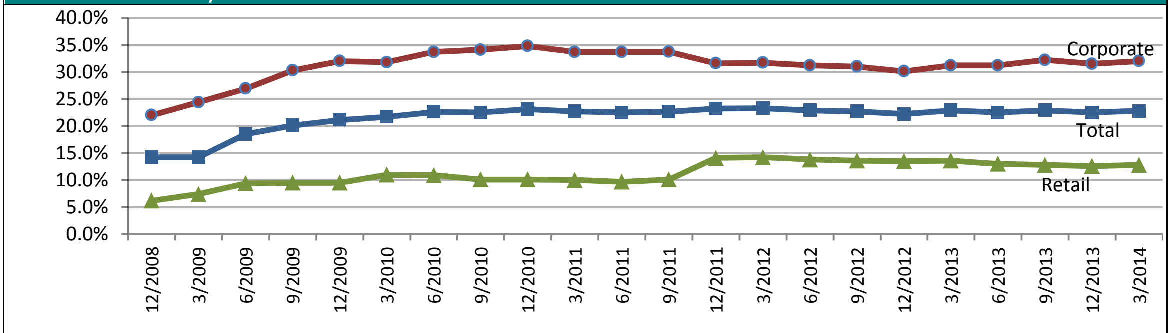
[27] In line with Article 2, Paragraph 2 of the Decision on Minimum Standards for Credit Risk Management and Assets Classification in Banks, not classified assets items and items for which no general loan loss provisions of 2% are being calculated (as per Article 22, Paragraph 8 of the same Decision).

Table 22: *Classification of corporate and retail loans*

Classification category	31.12.2013						31.03.2014						INDEX
	Retail	% share	Corporate	% share	TOTAL Amount	Share	Retail	% share	Corporate	% share	TOTAL		
1	2	3	4	5	6 (2+4)	7	8	9	10	11	12 (8+10)	13	14(12/6)
A	4.538.704	87,4	3.874.012	68,5	8.412.716	77,5	4.558.616	87,2	3.897.351	68,0	8.455.967	77,2	101
B	135.873	2,6	717.004	12,7	852.877	7,9	144.266	2,8	764.759	13,3	909.025	8,3	107
C	70.012	1,3	272.940	4,8	342.952	3,2	63.802	1,2	244.040	4,3	307.842	2,8	90
D	128.351	2,5	361.163	6,4	489.514	4,5	92.715	1,8	367.720	6,4	460.435	4,2	94
E	322.031	6,2	432.310	7,6	754.341	6,9	366.105	7,0	456.705	8,0	822.810	7,5	109
TOTAL	5.194.971	100,0	5.657.429	100,0	10.852.400	100,00	5.225.504	100,0	5.730.575	100,0	10.956.079	100,00	101
Class. loans-E	656.267	12,6	1.783.417	31,5	2.439.684	22,5	666.888	12,8	1.833.224	32,0	2.500.112	22,8	102
Non-perf. Loans C-E	520.394	10,0	1.066.413	18,8	1.586.807	14,6	522.622	10,0	1.068.465	18,6	1.591.087	14,5	100
		47,9		52,1		100,0		47,7		52,3		100,0	
Individual sector's share in classified loans, non-performing loans and category B:													
Categories B-E		26,9		73,1		100,0		26,7		73,3		100,0	
Non-performing C-E		32,8		67,2		100,0		32,8		67,2		100,0	
Category B		15,9		84,1		100,0		15,9		84,1		100,0	

Loan quality indicators changed only slightly vs. YE2013, where the share of non-performing loans fell by 0.1% and stood at 14.5%. Total non-performing loans remained the same, as well as corporate non-performing loans and retail non-performing loans. The share of classified loans rose to 22.8%, i.e. it rose by 0.3% as a result of an increase of the category B by 7% or KM 56 million (retail: up by 6.2% or KM 8 million and corporate: up by 6.7% or KM 48 million). This is an indicator of further impairment of the loan portfolio quality and poses a risk of transfer into non-performing loans in the period ahead.

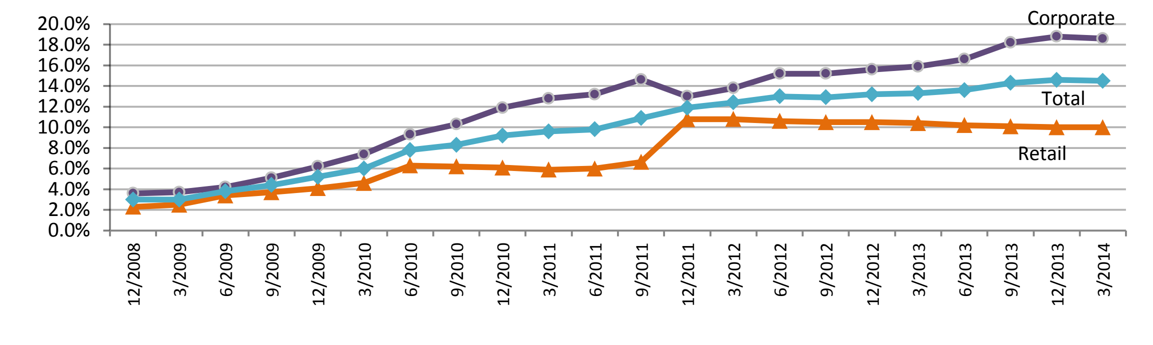
Chart 17: *Classified loans*



Out of the total loans approved to corporate customers of KM 5.7 billion as of 31.03.14, there was significantly high percentage of 32% or KM 1.8 billion of loans classified within categories B to E, which is an increase of 1.5% vs. YE2013 (in 2013, this share went up by 1.4%). Also, this indicator is much better for the retail segment. This is to say that out of the total approved retail loans of KM 5.2 billion, there was 12.8% or KM 667 million of loans classified in the said categories (vs. YE2013 when this share was 12.6% or YE2012 when it was KM 13.5%), but this is also high.

These trends result from the condition in the real sector and the economic crisis in B&H, due to which the corporate loan portfolio displays significantly lower quality than loans of the retail segment.

Chart 18: *Non-performing loans*



The most important indicator of the loan portfolio quality is the share of non-performing loans. Out of the total non-performing loans, corporate loans hold a share of 67% and retail loans a share of 33%, which is the same as at YE2013. In 1Q 2014, the share of non-performing loans of the corporate segment dropped slightly, while retail non-performing loans remained the same. Out of the total corporate loans approved, non-performing loans take up a share of 18.6% or KM 1.1 billion, which is 0.2% less than at the end of 2013 (in 2013, this share rose by 3.2%). This increase rate in the retail segment equals KM 523 million with the same share as at YE2013 (10%) (in 2013, the share dropped by 0.5%).

More detailed and comprehensive analysis is based on information on loan concentrations by industry sectors for corporate segment (by sectors) and for retail segment (by purpose).

Table 23: *Concentration of loans by industry sectors*

DESCRIPTION	31.12.2013				31.03.2014				INDEX	
	Total loans		Non-performing loans		Total loans		Non-performing loans			
	Amount	% share	Amount	% share	Amount	% share	Amount	% share		
1	2	3	4	5 (4/2)	6	7	8	9 (8/6)	10 (6/2)	11(8/4)
1. Corporate loans for:										
Agriculture (AGR)	112.695	1,0	30.608	27,2	112.980	1,0	29.989	26,5	100	98
Production (IND)	1.547.431	14,3	333.666	21,6	1.553.641	14,2	327.834	21,1	100	98
Construction (CON)	394.706	3,6	121.971	30,9	396.292	3,6	123.143	31,1	100	101
Trade (TRD)	2.298.260	21,2	392.161	17,1	2.366.639	21,6	394.936	16,7	103	101
Catering (HTR)	162.102	1,5	29.970	18,5	158.819	1,4	30.221	19,0	98	101
Other[28]	1.142.235	10,5	158.037	13,8	1.142.204	10,4	162.342	14,2	100	103
TOTAL 1.	5.657.429	52,1	1.066.413	18,8	5.730.575	52,3	1.068.465	18,6	101	100
2. Retail loans for:										
General consumption	3.906.142	36,0	310.450	7,9	3.951.162	36,1	311.681	7,9	101	100
Housing	1.148.230	10,6	170.282	14,8	1.135.319	10,4	170.781	15,0	99	100
Business activities (small	140.599	1,3	39.662	28,2	139.023	1,3	40.160	28,9	99	101
TOTAL 2.	5.194.971	47,9	520.394	10,0	5.225.504	47,7	522.622	10,0	101	100
TOTAL (1. +2.)	**10.852.400**	**100,0**	**1.586.807**	**14,6**	**10.956.079**	**100,0**	**1.591.087**	**14,5**	**101**	**100**

The largest share among total corporate loans refers to the trade sector (21.6%) and the production sector (14.2%), while the retail segment is dominated by general consumption loans (36.1%) and housing loans (10.4%), wherein these shares are almost the same as the year before.

For an extensive period of time, negative and strong effect of the economic crisis is especially pronounced within several key sectors (as evident from the indicator of the share of non-performing

[28] This includes the following sectors: traffic, warehouse and communications (TRC); financial mediation (FIN); real estate, renting and business services (RER); public administration and defence, mandatory social insurance (GOV) and other.

loans). The highest share in non-performing loans of 31.1% was with the construction sector, thus going up by 0.2% (in 2013, it rose by 5%), while its share in total loans stands at mere 3.6%. In 1Q 2014, this sector posted a slight rise of its non-performing loans of 1% or KM 1 million. Also, agricultural sector, despite the lowest share of 1%, had a share of its non-performing loans at high 26.5% (12/13: 27.2%). Therein, 1Q 2014, non-performing loans dropped slightly by 2%.

However, the focus is on the two sectors with the highest share in total loans – trade sector (22%) and production sector (14%). In 1Q 2014, the decrease of non-performing loans regarding the production sector (down by 2% or KM 6 million) caused their share to drop from 21.6% to 21.1% (in 2013, the growth rate was at high 37% or KM 90 million and the share rose by 5.7% and arrived to 21.6%). As for the trade sector, non-performing loans posted an increase by 1% or KM 3 million and their share fell by 0.4% and arrived to 16.7% (vs. 2013 when their growth was high 27% or KM 82 million and their share rose from 13.3% to 17.1%).

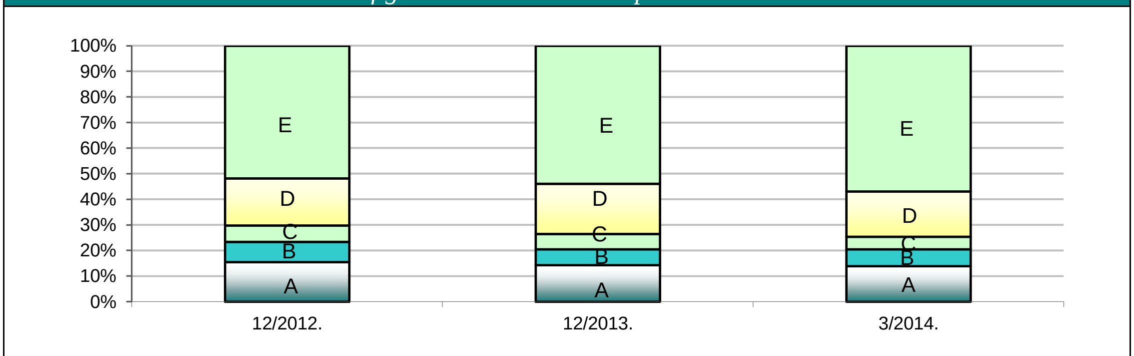
The retail sector displays no major changes, its indicators remained the same as YE2013. The lowest indicator of the NPL share of 28.9% (vs. 28.2% in YE2013) refers to loans to small entrepreneurs whose share in total loans is quite low 1.3%. Relatively high share of NPLs of 15% refers to housing loans (YE2013: 14.8%), while consumer loans (with the highest share in total loans of 36%) hold the lowest share of 7.9% (the same as at YE2013).

General credit risk level and estimated potential loan losses by classification categories, as determined in line with the criteria and methodology defined by the FBA decisions, plus their trend and structure at the banking sector level, is provided in the table and the chart below.

Table 24: *Structure and trend of general credit risk and potential loan losses*

Classification category	AMOUNT (in 000 KM) AND STRUCTURE (in%)						INDEX	
	31.12.2012		31.12.2013		31.03.2014			
1	2	3	4	5	6	7	8 (4/2)	9 (6/4)
A	211.433	15,4	215.083	14,3	216.003	13,9	102	100
B	108.313	7,9	93.547	6,2	102.349	6,6	86	109
C	87.874	6,4	90.541	6,0	76.495	4,9	103	84
D	252.970	18,5	295.224	19,6	274.009	17,7	117	93
E	710.079	51,8	809.779	53,9	882.079	56,9	114	109
TOTAL	1.370.669	100,0	1.504.174	100,0	1.550.935	100,0	110	103

Chart 19: *Structure and trend of general credit risk and potential loan losses*



Based on an analysis of the calculated LLP (in aggregate terms and by classification categories) vs. YE2013, reserves for general credit risk (category A) and potential loan losses went up by 3% or KM 47 million and stand at KM 1.5 billion. The reserves for general credit risk remained the same and stand at KM 216 million, while for potential loan losses went up by 4% or KM 46 million. Reserves for the category B increased by 9% or KM 9 million (due to the increase of this category by 6% or KM 61 million) and arrived to an amount of KM 102 million. Although non-performing assets remained the same, due to impaired classification categories and their migration to worse risk categories, reserves for non-performing assets rose by 3% or KM 37 million, i.e. arrived to the level of KM 1.2 billion. The largest relative and nominal growth of 9% or KM 72 million refers to reserves for the category E, while reserves for the category C dropped by 16% or KM 14 million, as also the reserves for the category D by 7% or KM 21 million. This trend of loan loss provisions indicates to a constant worsening of the loan portfolio, as stemming from further effect of the economic crisis on the real sector.

One of key indicators of assets quality is a ratio between potential loan losses (PLL) and risk-bearing assets with off-balance sheet items. This ratio stands at 9.8% and is higher by 0.3% than in the end of 2013.

As of 31.03.14, banks had an average calculated reserves for the category B of 8.9%, for the category C of 24.1%, for the category D 57.7% and for the category E 100% (vs. YE2013: 8.5% for B, 25.4% for C, 58.7% for D and 100% for E).[29]

In accordance with the IAS/IFRS, banks are required to book assets depreciation through expenses by forming value adjustments for balance sheet items and provisions for risk-bearing off-balance sheet items (previously called costs of loan loss provisions).

An overview of total assets items (balance sheet and off-balance sheet) and default items, as well as related value adjustments and provisions (defined in line with banks' internal methodology whose minimum contents are regulated by the FBA decisions) at the banking sector level is provided in the following table.

Table 25: *Assessment and valuation of risk-bearing items according to IAS 39 and IAS 37*

Description	AMOUNT (in 000 KM) AND SHARE (in%)				INDEX
	31.12.2013		31.03.2014		
	Amount	Share	Amount	Share	
1	2	3	4	5	6 (4/2)
1. RISK-BEARING ASSETS (a+b)	**13.517.944**	**100,0%**	**13.629.344**	**100,0%**	101
a) Default items	**1.886.251**	14,0%	**1.906.344**	14,0%	101
a.1. on balance default items	1.863.530		1.888.133		101
a.2. off-balance default items	22.721		18.211		80
b) Performing assets	**11.631.693**	86,0%	**11.723.000**	86,0%	101
1.1 TOTAL VALUE ADJUSTMENTS FOR RISK-BEARING ASSETS	**1.255.162**	**100,0%**	**1.261.048**	**100,0%**	100
a) Value adjustments for default	**1.110.375**	88,5%	**1.115.600**	88,5%	100
a.1. Value adjustments for BS items in default	1.105.059		1.110.422		100
a.2. Reserves for off-BS items in default	5.316		5.178		97
b) Value adjustments for performing assets (IBNR[30])	144.787	11,5%	145.448	11,5%	100
2. TOTAL LOANS (a+b)	**10.852.400**	**100,0%**	**10.956.079**	**100,0%**	101
a) Defaulted loans (non-performing loans)	1.799.777	16,6%	1.824.502	16,7%	101
b) Performing loans	9.052.623	83,4%	9.131.577	83,3%	101
2.1. VALUE ADJUSTMENTS FOR LOANS (a+b)	**1.165.928**	**100,0%**	**1.171.155**	**100,0%**	100
a) Value adjustments for defaulted loans	1.052.412	90,3%	1.056.050	90,2%	100
b) Value adjustments for performing loans (IBNR loans)	113.516	9,7%	115.105	9,8%	101
Coverage rate of default items	**58,9%**		**58,5%**		
Coverage rate of performing assets	**1,2%**		**1,2%**		
Coverage rate of risk bearing assets with total value adjustments	**9,3%**		**9,3%**		

[29] According to the Decision on Minimum Standards for Credit Risk Management and Assets Classification in Banks, banks are required to calculate loan loss provisions by classification categories bearing the following percentages: A-2%, B 5-15%, C 16-40%, D 41-60% and E 100%.

[30] IBNR (identified but not reported)-latent losses.

In 1Q 2014, default loans rose by 1% or KM 25 million (Y2013: up by 9% or KM 155 million). For comparison purposes, non-performing loans remained the same as at the YE2013. The share of defaulted loans in total loans increased by 0.1% and stands at 16.7% and the share of non-performing loans stands at 14.5%. The share of all default items in total risk-bearing assets is 14%, which is the same as at YE2013.

Coverage rate of default items with value adjustments fell from 58.9% to 58.5%, while the coverage rate of non-performing assets with provisions for loan losses for this asset type has only slightly risen from 71.6% to 73.6%. The coverage rate of performing assets remained at the same level of 1.2% and the coverage rate of risk-bearing assets with total value adjustments equals 9.3%. The coverage ratio of risk-bearing assets with total calculated regulatory reserves for loan losses (for general credit risk and special reserves for loan losses) has improved and amounts to 11.4% (vs. 12/13: 11.1%).

The increase trend among uncollectable receivables, i.e. posting of customer defaults in settlement of past due loan obligations, has caused activation of guarantees with certain number of defaulted loans (having this form of security), so the loan repayment went against guarantors. As of 31.12.09, FBA has defined a report on repayment of loans by guarantors in order to collect, monitor and analyse information on loans repaid by guarantors. According to the reports filed by banks in the FB&H as of 31.03.14, there was a total of 1,843 guarantors that repaid KM 12.2 million of total loans approved of KM 62 million (1,616 loan accounts), which is 4% less than as of 31.12.13 (KM 11.6 million repaid by 2,032 guarantors, while the amount of approved loans was KM 66 million and encompassed 1,785 loan accounts). The remaining debt amounts to KM 41 million (31.12.13: KM 43 million).

Based on mentioned information, we find that loan amount repaid by guarantors has dropped in 1Q 2014, as well as the balance of remaining debt and the amount of repayments by guarantors. The share of loans and number of loan accounts being repaid by guarantors vs. information at the overall system level is low and stand at mere 0.37% and 0.14%.

For purpose of mitigating adverse effects of the global financial and economic crisis and considering preservation of the banking sector's stability, in late 2009, FBA has adopted the Decision on Temporary Measures for Rescheduling of Credit Liabilities of Legal Entities and Private Individuals in Banks[31].

The primary objective of these temporary measures is to encourage banks to "boost" lending activities and restructure existing receivables without having to increase prices on loans and raise costs for existing debtors, as well as to help private individuals and legal entities to overcome the situation they have come to due to the economic crisis (lower payment capacity of private individuals due to loss of a job, late salaries, salary reductions, etc. and, with regards to legal entities - higher illiquidity, major reduction of business volume, very difficult condition in the real sector in general, etc.).

Acting upon the said Decision, in 1Q 2014, FB&H banks have received a total of 106 requests for loan restructuring and approved 101 requests in a total amount of KM 25 million or 95%, which is 3 times higher than in the same period in Y2013. Out of the total amount of approved restructured liabilities, KM 24 million refers to legal entities and KM 1 million to private individuals.

The net effect of loan loss provisions based on performed restructurings is an increase of KM 222 ths. Of note, there were also contrary trends in sense that there were both, increases and decreases of loan loss provisions on this basis, which finally resulted in the said net effect.

According to the said FBA Decision, restructured loans represented only 0.2% of total loans as of 31.03.14 (i.e. corporate restructured loans represented 0.42% of total corporate loans and retail restructured loans represented 0.01% of total retail loans).

[31] FB&H Official Gazette Nos. 2/10, 1/12, 111/12 and 1/14 .

Based on such information, we find that the result of restructured loans is relatively modest considering both, their number and amount, and even if compared against total loan portfolio and sector-level portfolio (for corporate and private individuals).

Although results and effects of the Decision are not that significant, we find that enactment of such a regulation was particularly important, meaning these temporary measures were truly necessary under conditions of the financial and economic crisis and their effects on the real sector in the FB&H and had positive effects for debtors (corporate and retail alike) by facilitating debt servicing in line with their payment capacities. Therefore, validity prolongation of the said Decision to 2014 was justified, especially due to the fact that the crisis effects are still evident.

An analysis of the assets quality, i.e. quality of the loan portfolio of individual banks, as well as on-site examinations in banks, have led to a conclusion that the credit risk is dominant risk with most of banks and another concerning fact is that some banks have inadequate practices for managing, i.e. assessing, measuring, monitoring and controlling credit risks and for classifying assets, which our on-site examiners determined on basis of major amounts related to shortfall of loan loss reserves (which was later on adequately formed as per FBA orders). Also, our analysis of the assets quality in banks grouped according to the ownership structure revealed that relevant ratios of banks in majority ownership of residents (6 local private banks) wore worse than those in banks under majority foreign ownership (10 banks).

After the significant increase of non-performing loans in local banks by 45% in 2013, the 1Q 2014 saw a slight decrease by 1% (regarding banks under majority foreign ownership show certain degree of stagnation, while growth of non-performing loans in 2013 was 9%). This is a result of inadequate and weak systems for credit risk management, especially in relation to the key stage of the process – at the time of loan approval. Major weaknesses and inefficient practices were also identified within the preventive actions stage, i.e. within the early recognition of problems with loan settlement (servicing) , as well as with handling of non-performing assets, whose objective was to reduce such assets through collection or sound restructuring.

With regards to banks where the FBA identified (through bank examinations) low level of assets quality and poor practices of credit risk management and/or where banks displayed adverse trends, meaning reduction of assets quality, such banks were ordered to apply corrective actions in sense of preparation of an operational program for management of non-performing assets to contain an action plan for improvement of existing practices of credit risk management, i.e. assets quality management, for reducing existing concentrations and for solving problems with non-performing assets and preventing their further impairment. Fulfillment of FBA orders is being continuously controlled through intensified follow-up process based on reports and other documentation delivered by banks, as well as through target on-site examinations. Supervision of this segment of operations has been intensified due to evident negative trends significantly affecting and causing deterioration of banks' profitability and weakening of capital base of certain banks, due to which banks need to take timely measures to obtain capital from external sources.

Transactions with Related Entitiees

In their operations, banks are exposed to different risks, of which special relevance is seen with the risk of transactions with their related entities.

In accordance with the Basel Committee standards, FBA has established prudential principles and requirements for bank transactions with related entities, as regulated by its Decision on Minimum Standards for Banks' Operations with Related Entities defining conditions and manner of banks' operations with related parties. Based on this Decision and the Law on Banks, a bank's supervisory board (acting upon the CEO proposal) is required to adopt special policies for operations with related entities and to ensure their implementation.

The FBA Decision also prescribes a special set of reports on transactions with one part of related entities, encompassing therein loans and contingent and assumed off-balance sheet liabilities (guarantees, letters of credit, assumed loan obligations) as the most frequent and most risky form of transactions between banks and their related entities.

The regulated set of reports includes information on loans extended to the following types of related entities:

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

-000 KM-

Table 26: *Transactions with related entities*

Description	LOANS APPROVED [32]			INDEX	
	31.12.2012	31.12.2013	31.03.2014	3/2	4/3
1	2	3	4	5	6
To shareholders with over 5% voting rights, subsidiaries and other related entities	156.861	123.889	119.214	79	96
Members of supervisory board and audit board	617	570	537	92	94
Management board of the bank	2.574	2.507	2.254	97	90
TOTAL	160.052	126.966	122.005	79	96
Contingent and assumed off-bal.sheet liabilities	21.800	16.046	10.040	74	63

During the observed period, loan exposures to related entities reduced by 4%, while contingent liabilities dropped by 37% due to reduced exposure related to one large bank. Based on presented information, we find that the volume of loans and guarantees with related entities is still low, as is also the level of inherent risk. FBA pays special attention (during its on-site examinations) to banks' operations with related entities, especially in terms of assessing their system of identification and monitoring of risk in transactions with related entities. FBA examiners give on-site orders for elimination of identified omissions within certain deadlines and also initiate violation proceedings, their integral part being monitoring and overseeing implementation of issued orders within the follow up examinations. This has positively reflected upon this segment of their operations since banks have significantly improved the quality of their risk management in this segment.

2.2. Profitability

According to information from income statement, positive financial result – profit of KM 54 million was posted at the level of the banking system in the FB&H in 1Q 2014. This is an increase by 26% or KM 11 million vs. the same period in 2013. Key contributor to this positive financial result at the system level is higher profit posted by 8 banks (also posting positive figures in the comparable period the year before). The positive effect is KM 14 million, of which KM 12 million refers to 3 banks of system relevance (of note, KM 7 million relates to the largest bank in the system). Another improvement is profit posted by 2 banks that had negative business result in Y2013 (profit of KM 2 million). On the other hand, negative effect of app. KM 5 million comes from lesser profit posted by 5 banks (KM 2 million) and loss (KM 3 million) posted by 1 bank (that posted slight profit in the comparable period the year before).

Key effect on improved profitability of most banks refers primarily to results of applied new methodological approach (implementation of IAS 37/39 starting from 31.12.11), which led to smaller value adjustment costs. Decrease of non-interest expenses, coupled with total income increase (largely based on other operating income related to income from reduced provisions), caused greater profit vs. the same period in 2013.

[32] In addition to loans, this includes other receivables, deposits and facilities to shareholders (financial institutions) with over 5% of voting rights.

Positive financial result of KM 57 million was posted by 15 banks and it is by 27% or KM 12 million higher than in the same period in the year before. At the same time, operating loss of KM 3 million was seen with regards to 2 banks and is by 42% higher or KM 1 million higher than in the comparable period in Y2013.

Relevant details are provided in the table below.

-000 KM-

Table 27: *Ostvareni finansijski rezultat: dobit/gubitak*

Description	31.03.2012		31.03.2013		31.03.2014	
	Amount	Number of banks	Amount	Number of banks	Amount	Number of banks
1	2	3	4	5	6	7
Loss	-4.654	7	-2.181	4	-3.087	2
Profit	35.600	12	44.710	14	56.727	15
Total	30.946	19	42.529	18	53.640	17

As in other segments, this segment also shows some concentrations: out of the total profit (KM 57 million), 71% or KM 40 million refers to two largest banks in the system with assets share in the banking sector of 49%, while the total loss of KM 3 million almost entirely refers to one bank. Analytical data indicate that a total of 11 banks have better financial result (by KM 16 million), while 6 banks have poor financial result (by KM 5 million).

Based on analytical data, as well as indicators for assessment of the profitability quality (i.e. level of achieved financial result – profit/loss and ratios used in evaluating profitability, productivity and efficiency of operations, as well as other parameters related to business result assessment), it is evident that total profitability of the system has improved, especially in relation to large banks that posted greater profit than in the same period last year. This is chiefly a result of implementation of a new methodological approach. However, a profitability assessment that is based solely on achieved financial result would not be an adequate assessment since one should consider other important factors to sustainability and quality of earnings, i.e. profit. Here, an outmost importance rests on the credit risk and negative trends within assets quality over the past five years, as evident from growth of non-performing and uncollectable loans that is not co-related with the reduction of value adjustment costs (subsequent to implementation of IAS 39 and 37), being the most important factor to improvement of the financial result in most banks in the past three years. This leads to a conclusion, as well as doubt, that value adjustments with some banks are underestimated and not at an adequate level.

At the system level, total income amounted to KM 214 million, up by 4% or KM 9 million compared to the samle period last year. This is mostly a result of an increase of operating income. Total non-interest bearing expenses stand at KM 161 million, down by 1% or KM 2 million vs. the comparable period last year. This has positively reflected upon total finacial result of the banking sector.

Despite the increase of average interest-bearing loans with most of banks by 2.5%, a decrease of average interest rate on loans (as a result of reduced loan interest and growth of non-performing loans) led to further reduction of interest-bearing income. Although some banks posted higher interest income vs. the previous year (as a result of intensified lending activities), much lower interest income of one small bank and three large banks (that are mostly leaders in the profitability segment) has caused the reduction at the system level. Interest income amounted to KM 193 million, down by 1% or KM 1 million than in the same period last year, also leading to its lower share in the structure of total income from 94.6% to 90.2%. The largest share among interest income refers to loan interest income that also posted the biggest nominal drop of KM 1.2 million or 1%, as a result of reduced average loan interest in the observed period (from 1.65% to 1.60%). Also, their share in total income went from 85.3% to 81.2%.

Compared to the same period last year, positive trends were evident with regards to interest expenses as their rate of decrease was higher (-6% or KM 4 million) than the rate of decrease of interest income (-1%). Average interest bearing deposits decreased by 1.4% and interest expenses related to deposit accounts amount to KM 49 million and are the biggest item in both, relative and nominal terms, in total interest expenses. This item went down by 6% or KM 3 million, as a result of the deposit base structure. Higher share of deposits with lower interest margin resulted from a reduction of average interest rates on deposits vs. the comparable period from 0.58% to 0.54%. Interest expenses on loans and other borrowings amount to KM 5 million and dropped by 19% vs. the same period in Y2013 (their share went from 2.9% to 2.3%).

As a result of decrease of both, interest income (-1%) and interest expenses (-6%), net interest income rose by 2% or KM 3 million, hence arriving to KM 136 million, but with lower share in the total income structure from 64.7% to 63.3%.

Operating income amounts KM 79 million and went up by 9% or KM 6 million vs. the Y2013 and their share in total income rose from 35.3% to 36.7%. Within operating income, the largest share refers to service fees going up by 7% or KM 3 million. The largest increase was seen with regards to other operating income of 49% or KM 5 million. This refers solely to higher income based on reduced provisions (only with regards to one large bank – KM 4 million).

Total non-interest bearing expenses amounted to KM 161 million and decreased slightly vs. the year before (1% or KM 2 million), which is mainly a result of lower value adjustment costs. At the same time, their share in the total income structure dropped from 79.3% to 75%. The value adjustment costs amounted to KM 21 million and are 28% or KM 8 million below the last year's level. This has positively reflected upon the decrease of their share in the total income from 14.3% to 9.8%. However, it is pertinent to note that, within business and direct expenses, items of other business and direct expenses rose by 44% or KM 7 million, thus significantly neutralising the effect of reduced level of value adjustment costs.

On the other hand, operating expenses of KM 116 million and the share of 54% in total income also posted a slight decrease of 1% or KM 1 million based on reduced costs of fixed assets. Costs of salaries and contributions, as the largest item among operating expenses, remained nearly the same and amount to KM 60 million (thus representing 28% of total income). Other operating expenses rose slightly by 1%. After the crisis emerged, banks took numerous measures to rationalise costs of operations, primarily to reduce operating expenses, as this has partly mitigated adverse effect of the interest income decrease caused by lower volume of lending activity and decrease of loan portfolio quality.

Trend and structure of total income and total expenses is provided in tables and charts below.

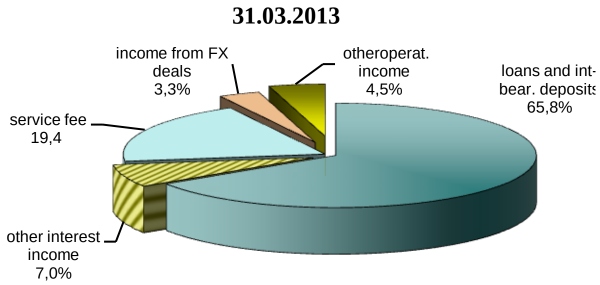
- in 000 KM-

Table 28: *Structure of total income*

Structure of total income	31.03.2012		31.03.2013		31.03.2014		INDEX	
	Amount	%	Amount	%	Amount	%		
1	2	3	4	5	6	7	8 (4/2)	9 (6/4)
I Interest and similar income								
Interest-bear.deposit accts. with dep.inst.	1.553	0,5	451	0,1	1.210	0,4	29	268
Loans and leasing facilities	183.981	66,9	175.149	65,7	173.913	64,0	95	99
Other interest income	18.099	6,6	18.611	7,0	18.108	6,7	103	97
TOTAL	203.633	74,0	194.211	72,8	193.231	71,1	95	99
II Operating income								
Service fees	49.859	18,1	51.736	19,4	54.981	20,2	104	106
Income from FX deals	8.629	3,2	8.631	3,3	8.678	3,2	100	101
Other operating income	12.997	4,7	12.025	4,5	15.018	5,5	93	125

TOTAL	71.485	26,0	72.392	27,2	78.677	28,9	101	109
TOTAL INCOME (I + II)	275.118	100,0	266.603	100,0	271.908	100,0	97	102

Chart 20: *Structure of total income*



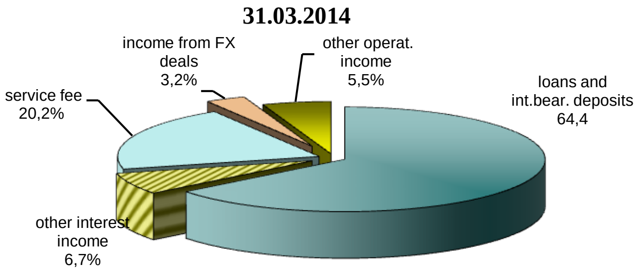
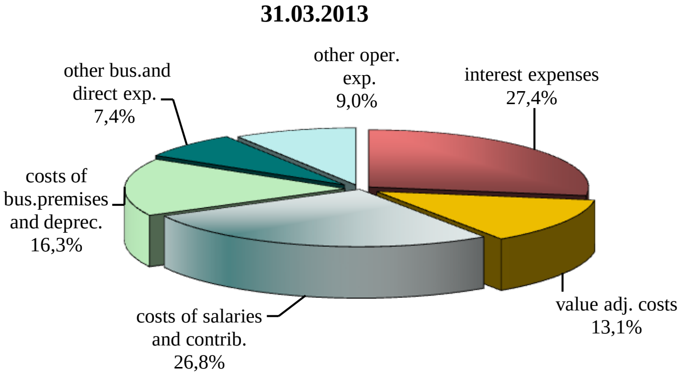
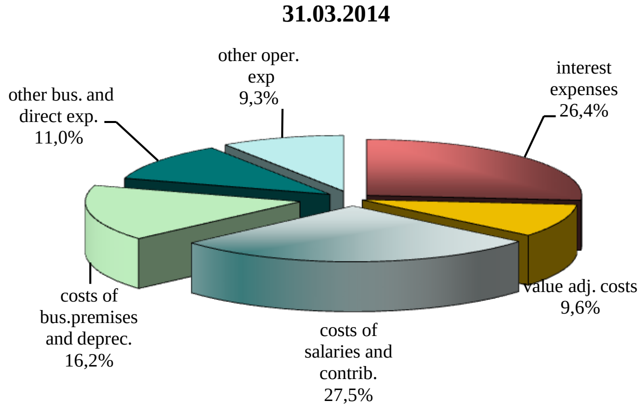


Table 29: *Structure of total expenses*

Structure of total expenses	31.03.2012 Amount	31.03.2012 %	31.03.2013 Amount	31.03.2013 %	31.03.2014 Amount	31.03.2014 %	INDEX	
1	2	3	4	5	6	7	8 (4/2)/	9 (6/4)
I Interest and similar expenses								
Deposits	54.352	22,3	52.428	23,4	49.146	22,5	96	94
Liabilities under loans and other borrowings	10.868	4,5	5.938	2,7	4.970	2,3	55	84
Other interest expenses	4.026	1,6	3.007	1,3	3.562	1,6	75	118
TOTAL	69.246	28,4	61.373	27,4	57.678	26,4	89	94
II Total non-interest bearing expenses								
Costs of value adjustment of risk.bear.assets and Provisions for conting.liab. and other value adjustments	36.098	14,8	29.273	13,1	20.988	9,6	81	72
Costs of salaries and contributions	61.225	25,1	60.053	26,8	59.901	27,5	98	100
Costs of bus.premises and depreciation	39.052	16,0	36.570	16,3	35.311	16,2	94	97
Other business and direct expenses	17.727	7,2	16.644	7,4	24.034	11,0	94	144
Other operating expenses	20.824	8,5	20.161	9,0	20.356	9,3	97	101
TOTAL	174.926	71,6	162.701	72,6	160.590	73,6	93	99
TOTAL EXPENSES (I + II)	244.172	100,0	224.074	100,0	218.268	100,0	92	97

Chart 21: *Structure of total expenses*





The table below provides an overview of key ratios relative to assessment of profitability, productivity and efficiency of banks.

- in %-

Table 30: *Ratios of profitability, productivity and efficiency by periods*

RATIOS	31.03.2012	31.03.2013	31.03.2014
Profit vs. average assets	0,2	0,3	0,4
Profit vs. average equity	1,5	1,9	2,3
Profit vs. average shareholders capital	2,6	3,5	4,4
Net interest income / average assets	0,9	0,9	0,9
Fee income/ average assets	0,5	0,5	0,5
Total income/ average assets	1,4	1,4	1,4
Business and direct expenses [33]/average assets	0,4	0,3	0,3
Operating expenses/ average assets	0,8	0,8	0,8
Total non-interest bear.expenses/ average assets	1,2	1,1	1,1

An analysis of key ratios for the profitability quality assessment has shown that, due to higher profit vs. The same period last year, ROAA (return on average assets) rose from 0.3% to 0.4% and ROAE (return on average equity) went from 3.5% to 4.4%. Banks' productivity indicator, measured as a ratio between total income and average assets (1.4%), maintained nearly the same level as a result of almost identical increase of total income and average assets.

Under negative conditions of banks' operations and prompted by effects of the economic and financial crisis on the FB&H banking sector, profitability of banks will continue to be mostly affected by and will depend on two key factors: a) further trend of the assets quality, i.e. level of loan losses and credit risk, and b) efficiency of management and control over operating income and operating expenses. On the other hand, evident slowdown and downward trend of economic activities caused lower demand for loans and more restrictive approach on the supply side (banks). This will directly reflect upon profitability of the entire banking sector in the period ahead. Also, profit of banks, i.e. their financial result, will be largely affected by the price and interest rate risk in terms of both, sources of financing and interest margin sufficient enough to cover for all non-interest bearing expenses and thus finally ensure satisfactory profit related to capital invested by bank owners.
Therefore, a key factor to efficiency and profitability of every bank is the quality of management and business policies since this directly reflects upon its performances.

2.3. Weighted Nominal and Effective Interest Rates

For purpose of greater transparency and easier comparability of banks' loan approval terms and deposit taking terms, as well as for purpose of customer protection by means of introducing transparent disclosure of loan approval costs, i.e. income earned of deposits, all in line with international standards, criteria and practices of other countries, on 01.07.07, FBA has prescribed a unified manner of calculation and disclosure of effective interest rate[34] for all banks seated in the Federation of B&H. Effective interest rate represents an actual relative loan price, i.e. income earned on a deposit, expressed as an annual percentage.

Effective interest rate is a decursive interest rate calculated on an annual level by applying complex interest calculation in a manner where discounted cash receipts are brought to an equivalent level with discounted cash expenditures related to the approved loan, i.e. related to the received deposit.

[33] Expenses also include value adjustment costs.
[34] Decision on Uniform Method of Calculation and Disclosure of Effective Interest Rate on Loans and Deposits (Official Gazette of FB&H No. 27/07).

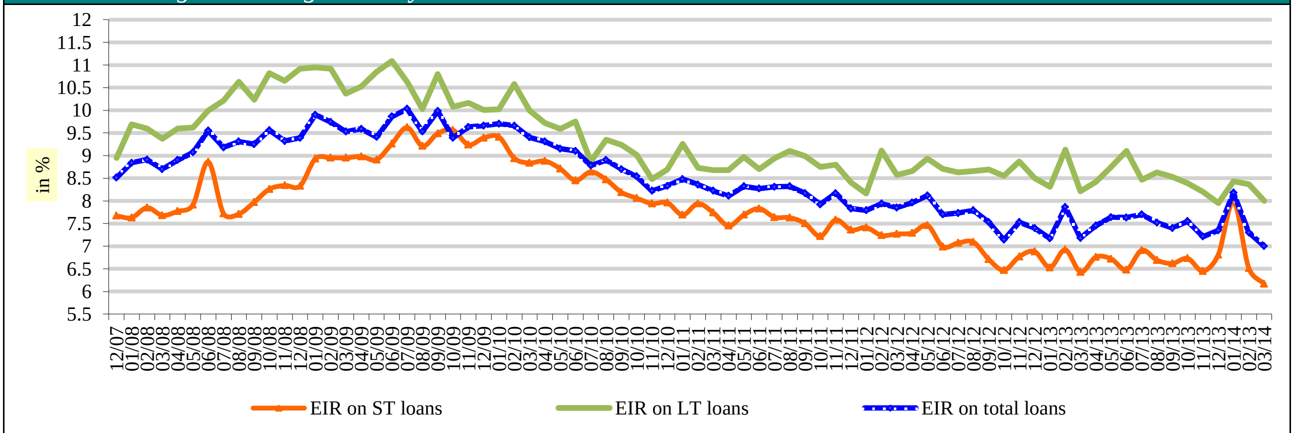
Banks are required to report to the FBA on a monthly level regarding weighted nominal and effective interest rates on loans and deposits approved/received within particular reporting month, all in line with regulated methodology[35].

The table below shows an overview of weighted nominal and effective interest rates (hereinafter: NIR and EIR) for loans at the banking sector level and for two key customer SEGMENTS (corporate and retail) for December 2012, March, June, September and December 2013 and March 2014.

Table 31 : *Weighted average NIR and EIR for loans e*

DESCRIPTION	12/2012		03/2013		06/2013		09/2013		12/2013		03/2014	
	NIR	EIR	NIR	EIR	NIR	EIR	NIR	EIR	NIR	EIR	NIR	EIR
1	2	3	4	5	6	7	8	9	10	11	12	13
1. Weighted IR on ST loans:	6,39	6,88	6,06	6,44	6,04	6,48	6,15	6,62	6,18	6,81	5,81	6,17
1.1. Corporate	6,39	6,86	6,12	6,46	6,09	6,47	6,15	6,55	6,21	6,79	5,77	6,06
1.2. Retail	8,46	10,89	8,58	10,90	7,92	10,91	8,29	11,82	6,42	8,51	8,27	11,80
2. Weighted IR on LT loans:	7,66	8,50	7,48	8,21	8,07	9,10	7,72	8,53	7,31	7,95	7,22	8,00
2.1. Corporate	6,73	7,22	6,40	6,72	6,94	7,40	6,71	7,21	6,83	7,17	6,72	7,18
2.2. Retail	8,48	9,59	8,37	9,47	8,52	9,79	8,34	9,35	7,93	8,95	7,64	8,64
3. Total weighted IR on loans:	6,80	7,40	6,66	7,18	6,93	7,63	6,79	7,40	6,72	7,35	6,45	7,00
3.1. Corporate	6,45	6,93	6,20	6,53	6,26	6,66	6,27	6,70	6,41	6,92	5,99	6,32
3.2. Retail	8,47	9,69	8,38	9,55	8,49	9,83	8,34	9,47	7,84	8,92	7,65	8,74

Chart 22: *Weighted average monthly EIR on loans*



During an analysis of interest rate trends it is important to monitor trends of the weighted EIR, wherein the difference between this interest rate and NIR represents a fee and commission paid to the bank for an approved loan (and this is factored in the loan price calculation). This is why EIR represents an actual price of a loan.

During 1Q 2014, there was an oscillation of weighted EIR on loans ranging within high 1.18%, wherein the highest rate was posted in January (8.18%) and the lowest in March (7%). This rate is lower by 0.35% than the one in December 2013.

Weighted interest rates on short term loans in 1Q 2014 saw higher oscillations within the range of 1.81% than those for long term loans (ranging withn 0.48%).

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[35] Instructions for Implementation of the Decision on Uniform Method of Calculation and Disclosure of Effective Interest Rate on Loans and Deposits and Instructions for Calculation of Weighted and Effective Interest Rate.

In March 2014, weighted EIR on short term loans stood at 6.17%, which is 0.64% below the rate in December 2013. Weighted EIR on long term loans stood at 8% in March 2014, slightly above the rate in December 2013 (7.95%).

Interest rates on loans approved to two key customer segments: corporate and retail [36] in 1Q 2014 saw a downward trend. Weighted EIR of corporate loans (which is still lower than EIR on retail loans) went down from 6.92% in December 2013 to 6.32% in March 2014. This reduction trend of weighted EIR on corporate loans was also seen with regards to short term loans (down from 6.79% to 6.06%), while EIR on long term loans stagnates (from 7.17% to 7.18%).

In March 2014, EIR on retail loans stood at 8.74%, 0.18% less than in December 2013. EIR on long term loans of this segment went from 8.95% in December 2013 to 8.64% in March 2014. EIR on short term loans stood at 11.80% in March 2014, up by 3.29% vs. December 2013.

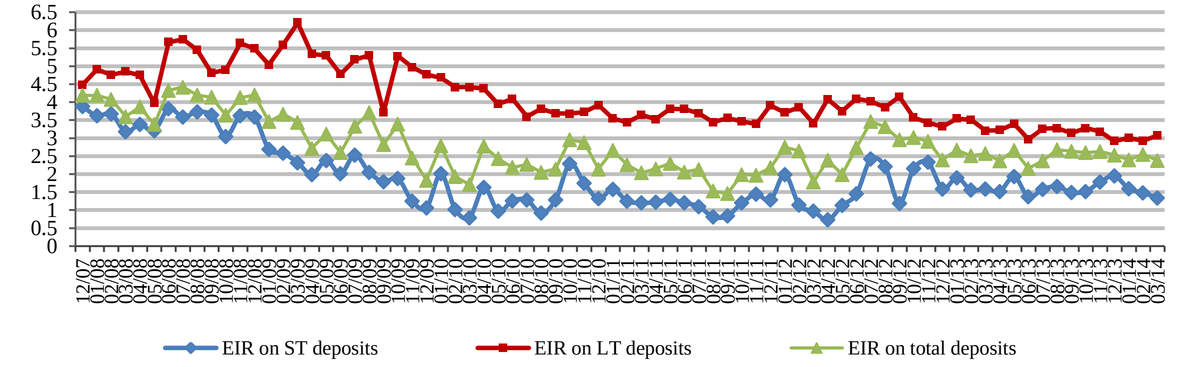
If compared to December 2013, the most significant decrease of EIR was seen in March 2014 with regards to long term retail loans – small business (from 13.77% to 9.15%), while the most significant increase was seen in relation to short term retail loans (general consumption) (from 8.16% to 11.73%).

Weighted NIR and EIR on term deposits (calculated on basis of monthly reports) at the banking sector level are provided in the following table.

Table 32 : *Weighted average NIR and EIR on deposits*

DESCRIPTION	12/2012		03/2013		06/2013		09/2013		12/2013		03/2014	
	NIR	EIR	NIR	EIR	NIR	EIR	NIR	EIR	NIR	EIR	NIR	EIR
1	2	3	4	5	6	7	8	9	10	11	12	13
1. Weighted IR on ST deposits:	1,59	1,59	1,57	1,59	1,35	1,37	1,48	1,49	1,94	1,95	1,31	1,34
1.1. up to three months	1,28	1,28	1,26	1,26	1,01	1,01	1,29	1,29	1,92	1,92	1,06	1,07
1.2. up to one year	2,53	2,55	1,98	2,02	1,80	1,86	1,58	1,61	1,99	2,01	1,60	1,65
2. Weighted IR on LT deposits:	3,30	3,32	3,18	3,21	2,95	2,97	3,11	3,14	2,89	2,92	3,04	3,08
2.1. up to three years	3,17	3,19	3,03	3,06	2,64	2,66	2,87	2,90	2,58	2,61	2,68	2,72
2.2. over three years	4,42	4,46	4,01	4,04	4,32	4,33	4,33	4,35	4,24	4,28	3,94	3,98
3. Total weighted IR on deposits	2,39	2,40	2,55	2,57	2,14	2,16	2,61	2,64	2,50	2,53	2,34	2,38

Chart 23: *Weighted average monthly EIR on deposits*



[36] According to the industry sector classifications, small entrepreneurs belong to the retail segment

As opposed to loans, where actual price is affected by costs related to approval and servicing of loans (on condition such costs are known at the time of approval), deposits almost show no difference between the nominal and effective interest rate.

Weighted EIR on total term deposits in March 2014 is 0.15% lower than in December 2013 (i.e. it dropped from 2.53% to 2.38%).

Weighted EIR on short term deposits has decreased. In March 2014, it stood at 1.34%, down by 0.61% vs. December 2013.

Weighted EIR on long term deposits saw minor oscillations in the 1Q 2014 and stood at 3.08%, which is slightly above the rate in December 2013 (12/2013:2.92%).

The largest decrease of interest rates refers to deposits with a term of up to one year and the largest increase refers to deposits with 3-year term (i.e. deposits of banks and other financial institutions) (from 1.83% to 3.69%).

Starting from the 2H 2012 until 1Q 2014, new corporate deposits decreased, especially those of short term nature. This has resulted in significant increase of interest rates on short term interest rates of the corporate segment and finally to average interest rates of the segment during the observed period being higher than average interest rates of the retail segment. As of March 2014, despite still evident trend of low growth rate of new corporate deposits, weighted EIR of corporate deposits got further reduced (from 3% to 1.58%). This refers to both, short term deposits (from 1.41% to 1.02%) and long term deposits (from 3.35% to 2.70%). Weighted EIR of retail deposits stood at 2.70%, which is somewhat higher than in December 2013 (2.65%). EIR dropped in relation to ST deposits (from 1.64% to 1.42%) and rose in relation to LT deposits (from 3.03% to 3.12%).

Weighted interest rates on loans, i.e. transaction account overdraft facilities, and demand deposits, as calculated on basis of monthly reports, are provided in the table below.

Table 33 : *Weighted average NIR and EIR on overdraft facilities and demand deposits*

DESCRIPTION	31.12.2012.		31.03.2013.		30.06.2013.		30.09.2013.		31.12.2013.		31.03.2014.	
	NIR	EIR	NIR	EIR	NIR	EIR	NIR	EIR	NIR	EIR	NIR	EIR
1	2	3	4	5	6	7	8	9	10	11	12	13
1. Weighted average IR on overdraft facilities	8,43	8,57	8,52	8,67	8,37	8,53	8,30	8,47	8,25	8,42	8,09	8,26
2. Weighted IR on demand deposits	0,19	0,19	0,19	0,19	0,18	0,18	0,15	0,15	0,15	0,15	0,14	0,14

As a rule, EIR on these assets and liabilities items is equal to the nominal interest rate. Weighted EIR on total overdraft facilities for the banking sector in March 2014 stood at 8.26% (down by 0.16% vs. December 2013) and at 0.14% on demand deposits (slightly lower than in December 2013).

2.4. Liquidity

Along with credit risk management, the liquidity risk management is one of the most important and the most complex segments of banking operations. Liquidity maintenance within the market economy is one of key preconditions to establishing and preserving trust in the banking system of any country. The same stands for its stability and safety.

Until emergence of the global financial and economic crisis, under normal operating conditions of banks and within a stable environment, the liquidity risk for banks was of a secondary importance, i.e. credit risk was the focal point and established management systems, i.e. systems for identification, measurement and control of this risk were under continuous supervision in order to improve and upgrade such systems.

When financial markets got disrupted due to the effect of the global crisis, the liquidity risk suddenly gained importance and management of this risk became a key factor to smooth operations, as well as timely reporting of liabilities due and preservation of long term position of the bank in sense of its solvency and capital base. In addition, it is worth noting that interdependence of all risks the bank is or may be exposed to in its operations has also came to light upon rising of the crisis.

During the last quarter of 2008, after expansion of the global crisis and its negative effect to the financial and economic system of B&H, the liquidity risk of banks in the FB&H has risen. Although one part of savings deposits got withdrawn and trust in banks got impaired, we find that liquidity of the banking system was never at stake since banks in the FB&H (due to regulatory requirements and defined limits based on a conservative approach) had significant liquid assets and good liquidity position.

In 2009, negative trends from the last quarter of 2008 have come to a halt and basic liquidity indicators improved (thanks mostly to reduced lending activity). In 2010, we saw a slight impairment of these indicators, continuing in 2011, but in lesser intensity. Somewhat greater impairment of these indicators was seen again in 1Q 2012, as a result of reduced cash funds related to slight increase of lending activity and investments in securities, reduced deposits, payments of loan obligations due and increase of uncollected receivables. This was a trend that, with minor oscillations, continued until the end of 2012. The first half of 2013 was characterized by continued mild worsening of these indicators, caused by the deposits outflow, payment of loan obligations due and continued growth of past due uncollected receivables, while the 2H 2013 was displaying slight improvement of indicators, as caused by an increase of deposits and cash funds.

Banks' efforts to achieve better profitability through better allocation of financial assets, changes in the structure of deposit sources, as well as long-present trend of reduction of loan obligations and obligations under subordinated debt, as well as effects of the mortgage crisis and recession in the Euro zone, have all led to faster decrease of liquid assets vs. the reduction of short term financial liabilities, decrease of share of liquid assets in total assets and worsened ratio of loans to deposits, loans taken and subordinated debt.

However, despite the evident negative trends, liquidity of the banking system in the Federation of B&H is still seen as sound, having satisfactory share of liquid assets in total assets, as well as very good maturity matching of financial assets and financial liabilities, plus a trend of moderate improvement starting from the end of 2010. Still, due to still present effect and impact of the global financial crisis, as well as mortgage crisis in the Euro zone (that has adversely reflected upon banking systems of certain European countries and parent banks of FB&H banks), we find that the liquidity risk should still be kept under close supervision. Also, we should bear in mind the still present effect of the crisis on the real sector, whose negative consequences reflected upon the overall industrial and economic environment in which B&H banks operate, thus resulting in defaults with settlement of loan obligations and increase of uncollectable receivables, i.e. reduction of inflows of liquid funds to banks and conversion of credit risk into liquidity risk. In that sense, one of key effects of the liquidity position of banks in the period ahead is seen with their capacity to adequately manage their assets, thus entailing obtaining assets with good performances and whose quality ensures that bank loans (and interest) are repaid in line with maturity dates

The Decision on Minimum Standards for Liquidity Risk Management defines minimum standards that a bank is required to ensure and maintain in the liquidity risk management process, i.e. minimum standards for development and implementation of the liquidity policy that ensures bank's capacity to fully and without a delay meet its obligations on the maturity date.

This regulation represents a framework for the liquidity risk management and encompasses qualitative and quantitative provisions and requirements for banks. It also defines limits that banks are to meet in relation to the average 10-day minimum and daily minimum of cash funds vs. short term sources of funds, as well as minimum limits for maturity matching of instruments of financial assets and financial liabilities (up to 180 days).

Within the structure of financing sources of banks in the FB&H as of 31.03.14, the largest share of 74.0% still refers to deposits, followed by loans taken (including subordinated debts[37]) of 7.7%. Loans taken bear longer maturities and represent quality source for approval of long term loans and improve maturity matching of assets and liabilities, although their reduction trend has been evident for an extensive period of time.

On the other hand, maturity structure of deposits is much more unfavorable[38]. After a longer period of improvement, in 2010 it slightly worsened and this trend (with minor oscillations) continued in 2011 and 1Q 2012, after which it still stopped and the structure modestly improved in late 2012 and continued to improve in 2013 and in 1Q 2014.

- in 000 KM-

Table 34: *Maturity structure of deposits by contractual maturity*

DEPOSITS	31.12.2012		31.12.2013		31.03.2014		INDEX	
	Amount	% share	Amount	% share	Amount	% share		
1	2	3	4	5	6	7	8(4/2)	9(6/4)
Savings and demand deposits:	4.805.480	43,8	5.233.356	45,4	5.158.264	45,7	109	99
Up to 3 months	267.199	2,5	365.229	3,2	151.914	1,4	137	42
Up to 1 year	709.620	6,5	668.142	5,8	662.515	5,9	94	99
1. Total ST deposits	5.782.299	52,8	6.266.727	54,4	5.972.693	53,0	108	95
Up to 3 years	3.576.903	32,6	3.541.354	30,7	3.454.843	30,6	99	98
Over 3 years	1.601.799	14,6	1.715.768	14,9	1.853.451	16,4	107	108
2. Total LT deposits	5.178.702	47,2	5.257.122	45,6	5.308.294	47,0	102	101
TOTAL (1 + 2)	10.961.001	100,0	11.523.849	100,0	11.280.987	100,0	105	98

As opposed to 31.12.13, total deposits fell by 2% or KM 243 million, as largely resulting from an decrease of deposits of banking institutions by 24% or KM 244 million and deposits of private companies by 7% or KM 114 and, on the other hand by an increase of retail deposits by 1% or KM 83 million and deposits of PSEs by 4% or KM 38 million. Maturity structure of deposits with contractual maturity is relatively good, wherein short term deposits hold a share of 53.0% and long term deposits a share of 47.0%, which is somewhat better than the condition as of 31.12.13.

Changes in the maturity structure stem from a decrease of short term deposits by 5% or KM 249 million, as largely related to the decrease of deposits of banking institutions (with a term up to 3 months) by KM 251 million and deposits of private companies by KM 110 million, as well as increase of PSEs by KM 57 million. Long term deposits rose slightly by 1% or KM 51 million, as a result of 8% rise of deposits with a term over three years (i.e. retail deposits mostly), while deposits up to three years posted 2% decrease (banking institutions mostly). Of note, long term deposits are still dominated by two segments: retail with a share increase from 63.6% to 64.1% and banking institutions with unchanged share of 12.3%, although deposits of PSEs also hold the significant share - however, going slightly down from 9.2% to 8.8%. Within deposits with a term from one to three years, the largest share of 68.7% is with retail deposits (slightly up by 1.3%), followed by PSE deposits of 12.9% (down by 0.3%). Deposits over three years mostly consist of retail deposits (55.6%, slightly down by 0.2%) and deposits of banking institutions with a share of 26.9% (showing a slight increase after a long trend of reduction) (YE2013: 25.6%, YE2012: 33.0%; YE2011: 46.9%, YE2010: 60.9%).

[37] Subordinated debts: loans taken and permanent items

[38] As per remaining maturity.

Although maturity structure of deposits with contractual maturity is relatively good, residual maturity of deposits is of greater relevance for the liquidity risk analysis since it includes deposit balances from the reporting period to the due date (as presented in the table below).

- in 000 KM-

Table 35: *Maturity structure of deposits by remaining maturity*

DEPOSITS	31.12.2012		31.12.2013		31.03.2014		INDEX	
	Amount	% share	Amount	% share	Amount	% share		
1	2	3	4	5	6	7	8(4/2)	9(6/4)
Savings and demand deposits (up to 7 days)	4.941.325	45,1	5.343.263	46,4	5.224.893	46,3	108	98
7- 90 days	908.834	8,3	920.951	7,9	769.033	6,8	101	84
91 days to one year	2.278.639	20,8	2.126.249	18,5	2.138.393	19,0	93	101
1. Total short term deposits	8.128.798	74,2	8.390.463	72,8	8.132.319	72,1	103	97
up to 5 years	2.609.727	23,8	3.002.846	26,1	3.003.688	26,6	115	100
over 5 years	222.476	2,0	130.540	1,1	144.980	1,3	59	111
2. Total long term deposits	2.832.203	25,8	3.133.386	27,2	3.148.668	27,9	111	100
TOTAL (1 + 2)	10.961.001	100,0	11.523.849	100,0	11.280.987	100,0	105	98

Based on the data above, we find that the maturity structure of deposits by remaining maturity is much worse due to high share of short term deposits of 72.1%. However, there is a trend of moderate improvement vs. YE2013. Short term deposits fell by 3% or KM 258 million, thus its share decreased by 0.7%, while long term deposits increased slightly by 0.5% or KM 15 million and its share went up from 27.2% to 27.9%. Looking into the structure of long term deposits, it is dominated by deposits with remaining maturity of up to 5 years (with a share of 95.4% in long term deposits and 26.6% in total deposits), while the negative trend is seen with regards to major reduction of deposits with remaining maturity of over 5 years (if observing the period of the past two years). This is despite a moderate increase in the 1Q 2014 of 11% or KM 14 million. We have compared information on deposit maturities by contractual and residual maturity and found that out of the total long term contracted deposits of KM 5.3 billion, there was KM 2.2 billion or somewhat above 40% of these deposits as of 31.03.14 that had the remaining maturity of one year.

Existing maturity structure of deposits (being the largest source of financing of banks in the FB&H) has become an increasingly limiting factor to the credit growth regarding most banks since they incline more towards approving long term loans. Therefore, banks are facing a problem of finding ways to obtain quality sources of funds in sense of maturity, especially because of considerable reduced inflow of financial assets (borrowings) from abroad, i.e. from parent groups and financial institutions-creditors, while local sources of funds are mostly of short term character.

In addition, supervisory concern is pronounced in relation to the fact that banks, due to lack of quality long term sources of funds and for purpose of ensuring compliance with legally defined limits related to maturity matching, resort to approving revolving short term loans, i.e. settlement of existing with new short term facilities, which basically means long term lending from short term sources of funds. In this way, they are not providing the real picture as to the loan maturity and its matching with sources of funds. This may pose a serious problem in the period ahead, as well as a potential threat to the banks' liquidity position.

For purpose of planning the required level of liquid assets, banks need to account for both, their sources of funds and the structure of an adequate liquidity potential, which is also tied to plans for their credit policy. Loan maturity, i.e. maturity of the loan portfolio, is in fact determined by maturity of sources of funds. Since maturity transformation of funds in banks is inherently related to functional characteristics of banking operations, banks are required to continuously control and maintain maturity mismatches between sources of funds and extended loans within the regulated minimum limits.

-in 000 KM-

Table 36: *Maturity structure of loans*								
LOANS	31.12.2012		31.12.2013		31.03.2014		INDEX	
	Amount	% share	Amount	% share	Amount	% share		
1	2	3	4	5	6	7	8(4/2)	9(6/4)
Past due receivables and paid off-balance liabilities	1.074.251	10,1	1.175.825	10,8	1.244.382	11,4	109	106
Short term loans	2.472.571	23,2	2.360.832	21,8	2.424.890	22,1	95	103
Long term loans	7.119.302	66,7	7.315.743	67,4	7.286.807	66,5	103	100
TOTAL LOANS	10.666.124	100,0	10.852.400	100,0	10.956.079	100,0	102	101

In 1Q 2014, long term loans remained the same, short term loans rose by 3% or KM 64 million, while past due receivables climbed by 6% or KM 69 million, which is yet another indicator of impaired collection rate of loans due and difficulties that debtors have in servicing liabilities towards banks (in the light of the economic crisis). Within the structure of past due receivables, 67% refers to private companies, 31% to the retail sector and 2% to other sectors.

An analysis of maturities of two key sectors shows that 84.4% of retail loans are of long term character, while this percentage among corporate loans equals 47.5%.

As the key assets category, loans still hold the largest share of 71.9%, down by 1.6% vs. YE2013 (although loans themselves have posted a slight increase by 1.0%). Cash funds dropped by 9% or KM 380 million and their share decreased from 28.6% to 26.5% vs. YE2013.

An overview of main liquidity ratios is provided in the table below. Banks have transitioned to new regulations as of 31.12.11, which led to a major increase of total assets, thus causing impairment of ratios: loans vs. deposits and loans taken (if observed across periods). In 2012, liquidity ratios got further impaired, as prompted by a reduction of cash funds through increased lending activity and settlement of loan obligations due, while the ratio of short term financial liabilities/total financial liabilities improved somewhat, as based on better maturity structure of sources of funds. This also continued in the 1H 2013. The increase of deposits and cash funds in 2H 2013 led to a moderate improvement of the ratios vs. 31.12.12. During 1Q 2014, ratios have worsened somewhat due to the deposits decrease and increase of overdue receivables.

- in % -

Table 37: *Liquidity ratios*			
Ratios	31.12.2012	31.12.2013	31.03.2014
1	2	3	4
Liquid assets[39] / total assets	26,8	28,9	27,0
Liquid assets / ST finan.liabilities	46,2	50,6	47,9
ST finan.liabilities/ total finan. liabilities	68,9	67,9	67,5
Loans / deposits and loans taken[40]	88,1	86,4	89,2
Loans / deposits, loans taken and subordinated debts[41]	86,8	85,3	88,0

In 2012, the ratio of loans vs. deposits and loans taken has worsened. The same trend continued in 1H 2013, but was stopped in the 2H 2013. As of 1Q 2014, this ratio worsened slightly. As of 31.03.2014, the ratio was above 85% (critical level) with regards to 11 banks. On one hand, this was a result of their liabilities structure (relatively significant share of capital) and, on the other hand, a result of high share of loans in assets. FBA paid special attention in its on-site examinations to banks with identified weaknesses in this business segment and instructed them to take actions and measures to improve the

[39] In more narrow sense, liquid assets are: cash and deposits and other financial assets with remaining maturity below 3 months (excluding interbank deposits).

[40] Empirical standards are: below 70%-very sound, 71%-75%-satisfactory, 76%-80%-marginally satisfactory, 81%-85%-insufficient, over 85%-critical.

[41] Previous ratio was expanded, sources now include subordinadet debts, thus providing a more realistic picture.

liquidity level and practices of sources of financing management in order to ensure satisfactory liquidity position.

In 2013, banks have duly fulfilled the requirement of maintaining the defined level of mandatory reserve with the Central Bank of B&H. The mandatory reserve, being the key instrument of the monetary policy in B&H under conditions of the Currency Board and financially undeveloped market, is the only instrument of the monetary policy that ensures monetary control in sense of prevention of rapid growth of loans and reduced multiplication, as well as increased liquidity in banks under conditions of the crisis and higher outflow rate of funds from banks (as compared to the situation in B&H as of 01.10.08). On the other hand, implementation of FC risk regulations and maintenance of currency matching within the defined limits has also significantly impacted the amount banks hold at their reserve accounts with the Central Bank of B&H (in LCY), thus ensuring high liquidity of banks individually and at the banking sector level.

All banks have been continuously meeting and exceeding the defined minimum of 10-day average of 20% of ST sources of financing and daily minimum of 10% of the same sources, as illustrated from the table below.

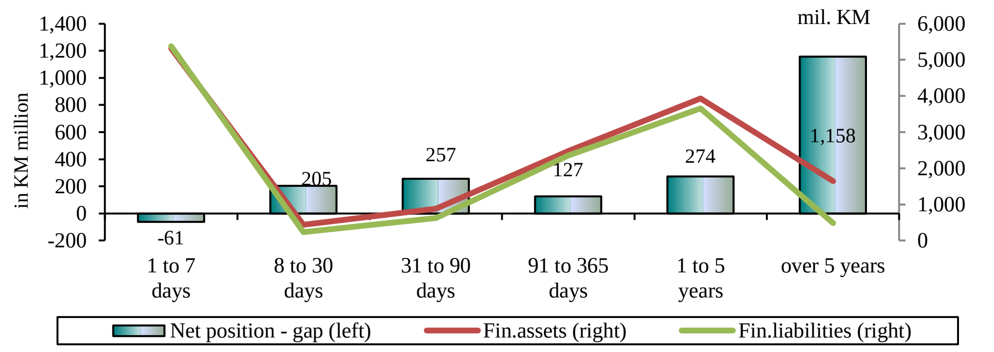
- in 000 KM-

Table 38: *Liquidity position—10-day average and daily minimum*

	31.12.2012 Amount	31.12.2013 Amount	31.03.2014 Amount	INDEX	
1	2	3	4	5(3/2)	6(4/3)
1. Average daily balance of cash	3.408.958	3.722.887	3.644.926	109	98
2. Lowest total daily cash balance	3.149.188	3.423.657	3.479.316	109	102
3. ST sources of funds (calculation basis)	5.631.431	5.887.967	5.953.590	105	101
4.Amount of liabilities:					
4.1. 10-day average 20% of the amount under item 3	1.126.286	1.177.593	1.190.719	105	101
4.2. daily minimum 10% of the amount under item No. 3	563.143	588.798	595.360	105	101
5.Performance of liabilities:10-day average					
Surplus = Item No. 1 – Item No. 4.1	2.282.672	2.545.294	2.454.207	112	96
6. Performance of liabilities : daily minimum					
Surplus = Item No. 2 – Item no. 4.2	2.586.045	2.834.859	2.883.956	110	102

Observing the maturity matching of remaining maturities of total financial assets[42] and liabilities, we find that the maturity rate is good, although somewhat lower than as of 31.12.12.

Chart 24: *Maturity matching of financial assets and financial liabilities as of 31.03.2014*



[42] Financial assets are posted on a net basis (deducted by value adjustments).

During 1Q 2014, short term financial assets of banks were higher than short term financial liabilities by KM 528 million. If compared to the YE2013 when the positive gap was KM 522 million, this represents a slight increase by KM 6 million or 1.0%, thus also leading to improvement of the coverage ratio of ST liabilities from 105.9% to 106.2%.

Short term financial assets dropped by 2.3% and short term financial liabilities by 2.5%. Within the structure of ST financial assets, an increase referred to cash borrowings to other banks (up by 92.9% or KM 48 million), net loans (2.2% or KM 93 million) and trading assets (8.6% or KM 33 million)., while a decrease was seen regarding cash funds (down by 8.6% or KM 380 million). Financial assets with remaining maturity over one year rose by 0.2% or KM 9 million.

As for liabilities with maturity up to one year, they have dropped by 2.5% or KM 217 million, wherein the largest increase refers to subordinated debts by 66.1% or KM 17 million and other financial liabilities by 16.7% or KM 30 million, coupled with reduction of deposits by 3.1% or KM 258 million and liabilities under loans by 2.5% or KM 5 million. Liabilities with maturity over one year declined by slight 0.6% or KM 27 million, as mostly a result of an increase of deposits by 0.5% or KM 15 million and a decrease of liabilities under loans by 3.6% or KM 29 million and liabilities under subordinated debt by 9.8% or KM 14 million.

In addition to the said prescribed minimum standard, a very important aspect of this increase and the analysis of the liquidity position is maturity matching of remaining maturities of financial assets and financial liabilities according to the time scale created to capture a time horizon of 180 days in line with the prescribed minimum limits[43].

- in 000 KM -

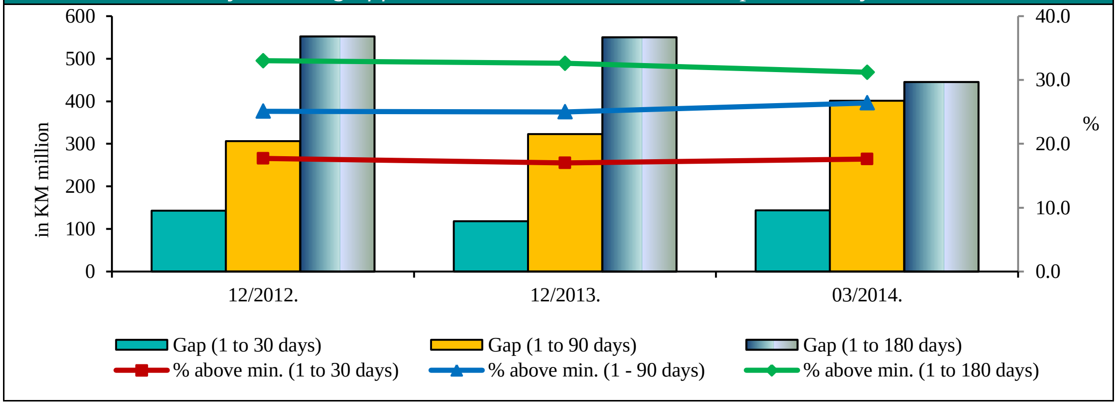
Table 39: *Maturity matching of financial assets and liabilities (up to 180 days)*

Description	31.12.2012 Amount	31.12.2013 Amount	31.03.2014 Amount	INDEX	
1	2	3	4	5 (3/2)	6(4/3)
I. 1- 30 days					
1. Financial assets	5.490.582	5.924.526	5.753.896	108	97
2. Financial liabilities	5.346.703	5.806.822	5.609.863	109	97
3. Difference (+ or -) = 1-2	143.879	117.704	144.033	82	122
Calculation of prescrib.requirement in %					
a) Actual %= No. 1 / No. 2	102,7%	102,0%	102,6%		
b) Prescribed minimum %	85,0%	85,0%	85,0%		
Plus (+) or minus (-) = a - b	17,7%	17,0%	17,6%		
II. 1-90 days					
1. Financial assets	6.355.017	6.809.340	6.636.879	107	97
2. Financial liabilities	6.048.777	6.485.914	6.235.555	107	96
3. Difference (+ or -) = 1-2	306.240	323.426	401.324	106	124
Calculation of prescrib.requirement in %					
a) Actual %= No. 1 / No. 2	105,1%	105,0%	106,4%		
b) Prescribed minimum %	80,0%	80,0%	80,0%		
Plus (+) or minus (-) = a - b	25,1%	25,0%	26,4%		
III. 1-180 days					
1. Financial assets	7.454.731	7.812.974	7.639.396	105	98
2. Financial liabilities	6.903.027	7.263.293	7.194.238	105	99
3. Difference (+ or -) = 1-2	551.704	549.681	445.158	100	81
Calculation of prescrib.requirement in %					
a) Actual %= No. 1 / No. 2	108,0%	107,6%	106,2%		
b) Prescribed minimum %	75,0%	75,0%	75,0%		
Plus (+) or minus (-) = a - b	33,0%	32,6%	31,2%		

[43] The Decision on Minimum Standards for Liquidity Risk Management in Banks defines these percentages for maturity matching of financial assets and financial liabilities: min. 85% of sources of financing with maturity up to 30 days must be used for facilites with maturity up to 30 days, min. 80% of sources of financing with maturity up to 90 days must be used for facilities with maturity up to 90 days, and min. 75% of sources of financing with maturity up to 180 days must be used for facilities with maturity up to 180 days.

Based on presented information, we find that, as of 31.03.14, banks have adhered to prescribed limits and achieved better maturity matching of financial assets and financial liabilities vs. such prescribed limits.

Chart 25: *Maturity matching of financial assets and liabilities – up to 180 days*



Over the past two years, there is an evident trend of improvement of maturity matching. Hence, as of 31.12.13, financial assets surpassed financial liabilities accross all three time intervals, along with somewhat greater improvement of liquidity positions in the time interval from 90 to 180 days. Also, positive gap in the time interval of 30 days was still slightly lower than as at 31.12.11. Maturity matching percentages were above the defined minimum by 17.7% in the first time interval, 25.1% in the second and 33.0% in the third time interval.

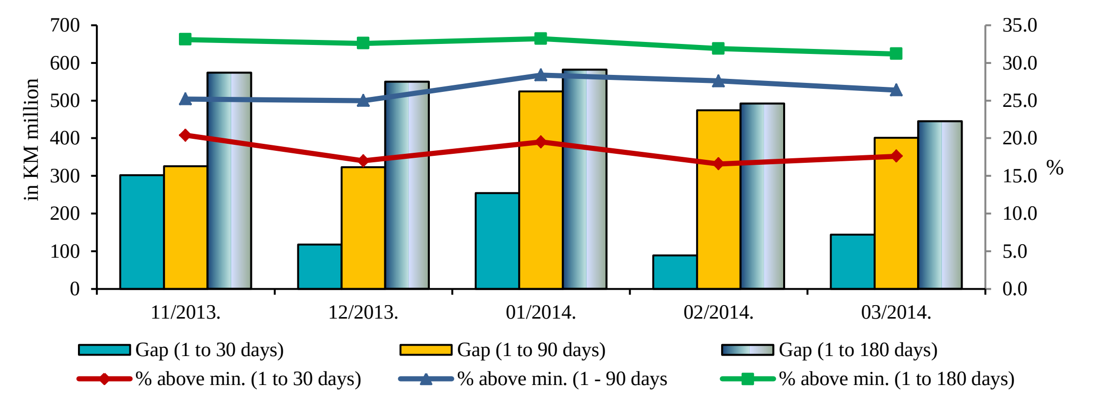
As of 31.12.13, the maturity matching percentage for all three time intervals is somewhat lower than as at YE2012, but is still much above the defined minimum (i.e. by 17.0% in the first interval, 25.0% in the second and 32.6% in the third time interval).

During the first quarter, a slight improvement was seen with regards to the time interval of 30 days due to higher reduction rate of financial liabilities (mostly deposits and liabilities under loans) vs. financial assets (primarily cash funds). This was partially compensated by an increase of loans and trading assets. Another improvement refers to the time interval of 90 days, because of somewhat more significant decrease of financial liabilities (deposits), while financial assets posted a minor decrease.
Somewhat lower positive gap was seen with the time interval of 180 days, due to reduction of cash funds.

All of this resulted in the maturity matching percentage for the first two time intervals being somewhat higher than as at YE2013, while in the third interval this percentage is slightly lower. However, this is still considerably above the defined minimum: for the first interval by 17.6%, for the second by 26.4% and for the third time interval by 31.2%.

The chart below shows the trend of maturity matching of financial assets and financial liabilities in the period from August to December 2013 (by time intervals and maturity matching percentages vs. the legally defined minimal standards).

Chart 26: *Maturity matching of financial assets and liabilities (up to 180 days) – by periods*



Based on all presented ratios, liquidity of the banking sector in the FB&H is still deemed satisfactory. However, since this business segment and the exposure level to the liquidity risk correlate with the credit risk and considering also effects of the financial crisis to B&H and the FB&H banking sector (primarily in sense of increased pressure to the banks' liquidity), we should underline that banks should pay even more attention to the liquidity risk management by means of establishing and implementing liquidity policies that would ensure timely performance of all liabilities due, as based on continuous planning of future liquidity needs factoring therein changes in operating, economic, regulatory and other conditions of the banks' business environment. On one hand, this rests on poor maturity structure of deposits, repayment of past due loans and much smaller debt rate with financial institutions (thus being the best source of financing for banks from the maturity perspective) and, on the other hand, on poor inflow of liquid funds due to declined collection rate of loans.

Through its off-site and on-site examinations of banks, FBA will continue to monitor and oversee the manner in which banks manage their risk and whether they act in accordance with adopted policies and programs.

2.5. FX Risk – Foreign Currency Matching of BS and Off-BS Assets and Liabilities

Banks' operations are exposed to major risks originating from possible losses related to balance sheet and off-balance sheet items, as incurred due to market price changes. One of these risks is a foreign currency risk arising as a result of changes in exchange rates and/or mismatches between assets, liabilities and off-balance sheet items denominated in the same currency – individual FX position or all currencies of the bank's operations together – total FX position of the bank.

In order to ensure implementation and realisation of prudent principles related to FX activities of banks and to reduce FX risk effects on their profitability, liquidity and capital, the FBA has adopted the Decision on Minimum Standards for FX Risk Management in Banks[44] that regulates minimum standards for adopting and implementing the program, policies and procedures for FX risk assumption, monitoring, control and management, as well as limits for the open individual and total FX position (long or short) calculated in relation to the core capital of the bank. [45]

In order for the FBA to monitor banks' compliance with the regulated limits and their exposure level to the FX risk, banks are required to perform daily reporting to the FBA. Based on a review,

[44] Official Gazette of the FB&H Nos. 3/03, 31/03, 64/03, 54/04.
[45] Article 8 of the Decision on Minimum Standards for Managing Banks' Capital defines the following limits: for the individual FX position – up to 30% of the core capital for EUR and up to 20% for other currencies and for the total bank position – up to 30%.

monitoring and analysis of delivered reports, we find that banks adhere to regulated limits and perform their FX activities within such limits.

Since the Central Bank of B&H functions as a currency board pegged to EUR, banks are not exposed to FX risk in their daily operations with EUR.

As of 31.03.14, the currency structure of banks' assets included 11.5% or KM 1.7 billion of foreign currency items (as at YE2013, these items stood at 12.6% or KM 1.9 billion). On the other hand, currency structure of liabilities is quite different since the share of FC liabilities is much higher and equals 46.8% or KM 7.1 billion (as at YE2013, this share was 46.7% or KM 7.2 billion).

The table below provides the structure and trend of financial assets and liabilities and FX positions for EUR as the key currency and for the total position.

-in KM million-

Table 40: *FC matching of financial assets and liabilities (EUR and aggregate)* [46]

Description	31.12.2013				31.03.2014				INDEX	
	EUR		TOTAL		EUR		TOTAL		EUR	TOTAL
	Amount	Share %	Amount	Share %	Amount	Share %	Amount	Share %	6/2	8/4
1	2	3	4	5	6	7	8	9	10	11
I. Financial assets										
1. Cash	996	13,0	1.516	18,0	817	10,9	1.294	15,8	82	85
2. Loans	40	0,5	44	0,5	37	0,5	40	0,5	93	91
3.Loans with a currency clause	6.285	82,2	6.465	76,9	6.264	84,0	6.437	78,7	100	100
4. Other	332	4,3	386	4,6	344	4,6	412	5,0	104	107
Total (1+2+3+4)	7.653	100,0	8.411	100,0	7.462	100,0	8.183	100,0	98	97
II. Financial liabilities										
1. Deposits	5.345	72,6	5.990	74,7	5.280	73,2	5.919	75,2	99	99
2. Loans taken	986	13,4	994	12,4	952	13,2	959	12,2	97	96
3.Dep. & loans with curr.clause	798	10,9	798	9,9	732	10,1	732	9,3	92	92
4. Other	226	3,1	237	3,0	250	3,5	261	3,3	111	110
Total (1+2+3+4)	7.355	100,0	8.019	100,0	7.214	100,0	7.871	100,0	98	98
III. Off-balance sheet										
1.Assets	80		80		50		62			
2.Liabilities	255		359		252		321			
IV.Position										
Long (amount)	122		113		46		54			
%	6,6%		6,1%		2,5%		2,8%			
Short										
%										
Allowed	30%		30%		30%		30%			
Less than the allowed level	23,4%		23,9%		27,5%		27,2%			

In terms of the structure of foreign currencies, dominant share among financial assets [47] is held by EUR with 68.7%, which is somewhat lower than as of 31.12.13 (70.3%) due to lower nominal amount (from KM 1.36 billion to KM 1.20 billion). The share of EUR in liabilities is 90.8%, which is the same as at YE2013, coupled with a slight decrease of the nominal amount by KM 75 million.

[46] Source: Form 5-FX position.
[47] Source: Form 5-FX position: one part of financial assets (FCYs denominated in KM). According to the calculation methodology, financial assets were posted according to the net principles until 31.12.2011 (i.e. after deductions for loan loss reserves), after which the new methodology entailed depreciation of fixed assets according to IAS, i.e. after deductions for value adjustments and reserves for contingent liabilities

However, FX risk exposure calculation also includes an amount of indexed assets items (loans) and liabilities items[48], which is quite significant on the assets side (78.7% or KM 6.5 billion) and, in nominal terms, remained almost the same as on 31.12.13 (76.9% or KM 6.5 billion). Other FX items on the assets side hold a share of 21.3% or KM 1.7 billion and bear the following structure: items in EUR 14.6% or KM 1.2 billion and other currencies 6.7% or KM 0.6 billion (at YE2013, loans with a currency clause amounted KM 6.5 billion and had a share of 76.9%, while other items in EUR had a share of 16.3% or KM 1.4 billion). Out of the total net loans (KM 9.8 billion), app. 65.8% have the currency clause (mostly pegged to EUR – 97.3%).

As for the sources of financing, financial liabilities determine the structure of financial assets for every currency respectively. The largest share among FX liabilities (KM 7.9 billion) is 82.3% or KM 6.5 billion and refers to EUR (deposits mostly), while the share and amount of indexed liabilities is at minimal 9.3% or KM 0.8 billion (at YE2013, share of liabilities in EUR was 81.8% or KM 6.5 billion, while share of indexed liabilities was 9.9% or KM 0.8 billion).

If observed by banks and at the FB&H banking sector level, we find that FX risk exposure of banks and of the banking system in 1Q 2014 was within the defined limits. As of 31.03.14, the long FX position was seen with 12 banks and the short position with 5 banks. At the system level, there is a long FX position of 2.8% of the total core capital of banks, which is by 27.2% below the allowed limit. Individual FX position for EUR was 2.5%, which is 27.5% below the allowed limit, wherein financial assets items were greater than financial liabilities (net long position).

Although the currency board protects banks from the FX risk exposure related to EUR, they are required to adhere to regulated limits for all currencies, as well as for the total FX position, and to perform daily risk management activities in line with the adopted programs, policies, procedures and plans.

III CONCLUSIONS AND RECOMMENDATIONS

During the reform period, the banking sector of the Federation of B&H achieved an enviable level of its development and it represents the most developed and the strongest part of the financial and the overall economic system in the FB&H. Future activities should be aimed towards preservation of its stability, meaning this should be a priority under present stressful conditions and considering therein the banking system's future progress and development. These targets are conditioned by a continuous and committed involvement of all elements of the system, as well as legislative and executive authorities, thus forming grounds for more favorable economic environment for banks and the real sector of the economy, as well as for the general population.

In order to further strengthen resilience of banks in the Federation of B&H to potentially more severe crisis situation, in early 2013, the FBA has adopted the Decision on Temporary Measures for Dividends and Discretionary Bonus Disbursement and Repurchase of Own Shares by Banks. This meant that disbursement of dividends is tied to existence of a capital buffer of 2.5% of the prescribed minimum capital adequacy rate and core capital rate of banks vs. risk-bearing assets. As a part of activities regarding implementation of the Strategy, i.e. Revised Strategy for introducing the International Convergence of Capital Measurement and Capital Standards (Basel II), the FBA has coordinated the matter with the Republika Srpska Banking Agency and USAID (providing technical assistance) to preparing the following draft papers: Decision on the Remuneration Policy and Practice

[48] In order to protect against foreign exchange rate changes, banks arrange certain assets items (loans) and liabilities items with a currency clause (regulations allow only for a two-way currency clause).

for Bank Employees, Decision on Suitability Assessment of Bank's Bodies and Decision on Diligent Behavior of Members of Bank's Bodies. These decisions were adopted in August 2013 (Official Gazette of the FB&H No. 60/13).

In the following period, the FB&H Banking Agency intends to:

- take measures and actions within its competencies to overcome and mitigate effects of the global financial crisis on the banking sector in the FB&H;
- continue with activities within its competencies to consolidate the supervision function on a state level;
- maintain continuous supervision of banks through on-site and off-site examinations, placing an emphasis therein on dominant risk segments of the banking business and aiming to improve efficiency by means of:
  - further insisting on capital strengthening in banks, especially for those banks with an above average assets growth and reduction of capital adequacy rate,
  - continued banking supervision mainly from the perspective of system relevance for the development of lending activities where large savings and other deposits are concentrated (all for purpose of depositors' protection),
  - continued system-based monitoring of banks' activities on prevention of money laundering and terrorism financing and improving of cooperation with other supervisory and regulatory institutions,
  - as so far, working on upgrades to legal regulations as based on Basel Principles, Basel Capital Accord and European Banking Directives, all as a part of preparations for B&H joining the European Union,
  - changing capital regulations for purpose of ensuring qualitative and structural strengthening of capital and alignment with capital requirements of the Basel II/III,
  - preparing and adopting a contingency plan (as a part of crisis preparations),
  - developing and implementing the Early Warning System tool (EWS) for purpose of an early identification of financial and operational inefficiencies and/or adverse trends in banks' operations,
  - establishing and expanding cooperation with supervisory authorities in home countries of investors in the FB&H banking sector, as well as in other countries – all for purpose of ensuring more efficient bank supervision function,
  - improving cooperation with the B&H Banks' Association across all segments of the banking business, organising consultations and providing professional assistance in implementation of banking laws and regulations, improving cooperation in sense of professional training, proposing amendments to all laws or regulations that have become a limiting factor to banks' development, introducing new products, collection of receivables and ensuring full involvement in development and functioning of a unified registry of non-performing customers – legal entities and private individuals (ensuring therein daily updates to relevant information).
- continue with efforts on improving the information system that would enable early warning and preventive actions with respect to elimination of weaknesses in banks' operations;
- continue with an on-going training and professional education of its staff;
- accelerate actions regarding finalisation of liquidation processes, as per Management Board conclusions.

Further strong engagement of other institutions and bodies of Bosnia and Herzegovina and the Federation of Bosnia and Herzegovina is also necessary with regards to the following:

- implementation of the Program of measures to mitigate results of the global economic crisis and improve the business environment (as accepted by the FB&H Economic-Social Council in

December 2008 and in line with relevant FB&H Government paper;
- implementation of conclusions reached by the FB&H Parliament regarding establishment of a state-level bank supervision function;
- creating and upgrading regulations pertaining to the financial sector that refer to actions, status and operations of banks, micro credit organisations, leasing companies, insurance companies, etc.;
- accelerated implementation of economic reforms in the real sector of the economy in order to ensure faster alignment with the level achieved in the monetary and banking sector;
- preparation and adoption of the new Law on Banks/Law on Credit Institutions;
- preparation and adoption of the Law on Asset Management Companies;
- preparations for drafting legal regulations of relevance for the banking sector and financial system based on Basel Principles, Basel Capital Accord and European Banking Directives;
- establishment of special commercial departments within courts;
- establishment of more efficient enforcement proceedings against pledged property;
- adoption of regulations of protection of financial service users and full liability of debtors;
- enactment of laws or improvement of existing legal regulations defining the segment of security and protection of money in the bank and in transit, etc.

As key segments of the banking system, banks should concentrate their efforts on the following activities:

- full commitment to quality and prudent operations and to combating the crisis effects presently posing the biggest threat to banks, real sector of the economy and general population;
- preparation of and updates to their contingency plans;
- further capital strengthening and ensuring solvency level proportional to an increase of assets and risk, greater profitability, more consistent implementation of adopted AML and CTF policies and procedures, security and protection of money in the bank and in transit, all in line with laws and regulations;
- strengthening the internal controls system and the internal audit function as segments that are fully independent in performance of their duties and roles;
- regular, timely and accurate delivery of information to the Central Loans Registry and the Uniform Registry of Accounts with the Central Bank of B&H.

No. U.O.-59-7/14.
Sarajevo, 30.05.2014

ATTACHMENTS

ATTACHMENT 1

Banks in the Federation of Bosnia and Herzegovina - 31.03.2014

No.	BANK	Address		Phone	CEO
1	BOR BANKA dd - SARAJEVO	Sarajevo	Obala Kulina bana 18	033/278-520, fax:278-550	HAMID PRŠEŠ
2	BOSNA BANK INTERNATIONAL dd - SARAJEVO	Sarajevo	Trg djece Sarajeva bb	033/275-100, fax:203-122	AMER BUKVIĆ
3	HYPO ALPE-ADRIA-BANK dd - MOSTAR	Mostar	Kneza Branimira 2b	070/340-341, fax:036/444-235	Privr.direktor - DRAGAN KOVAČEVIĆ
4	INTESA SANPAOLO BANKA D.D. BOSNA I HERCEGOVINA	Sarajevo	Obala Kulina bana 9a.	033/497-555, fax:497-589	ALMIR KRKALIĆ
5	INVESTICIONO-KOMERCIJALNA BANKA dd - ZENICA	Zenica	Trg B&H 1	032/448-400, fax:448-501	SUVAD IBRANOVIĆ
6	KOMERCIJALNO-INVESTICIONA BANKA DD V.KLADUŠA	V.Kladuša	Ibrahima Mržljaka 3	037/771-253, fax:772-416	HASAN PORČIĆ
7	MOJA BANKA dd - SARAJEVO	Sarajevo	Trg međunarodnog prijateljstva br. 25.	033/586-870, fax:586-880	MIRZA HUREM
8	NLB BANKA dd - TUZLA	Tuzla	Maršala Tita 34	035/259-259, fax:250-596	ALMIR ŠAHINPAŠIĆ
9	PRIVREDNA BANKA SARAJEVO dd - SARAJEVO	Sarajevo	Alipašina 6	033/277-700, fax:664-175	ADNAN BOGUNIĆ
10	PROCREDIT BANK dd - SARAJEVO	Sarajevo	Franca Lehara bb	033/250-950, fax:250-971	EDIN HRNJICA
11	RAIFFEISEN BANK dd BiH - SARAJEVO	Sarajevo	Zmaja od Bosne bb.	033/755-010, fax: 213-851	MICHAEL MÜLLER
12	RAZVOJNA BANKA FEDERACIJE BIH	Sarajevo	Igmanska 1	033/724-930, fax: 668-952	RAMIZ DŽAFEROVIĆ
13	SBERBANK BH dd - SARAJEVO	Sarajevo	Fra Anđela Zvizdovića 1	033/295-601, fax:263-832	EDIN KARABEG
14	SPARKASSE BANK dd - SARAJEVO	Sarajevo	Zmaja od Bosne br. 7.	033/280-300, fax:280-230	SANEL KUSTURICA
15	UNICREDIT BANK dd - MOSTAR	Mostar	Kardinala Stepinca bb	036/312-112, fax:312-121	IVAN VLAHO
16	UNION BANKA dd - SARAJEVO	Sarajevo	Dubrovačka 6	033/561-000, fax: 201-567	SENAD REDŽIĆ
17	VAKUFSKA BANKA dd - SARAJEVO	Sarajevo	M. Tita 13.	033/280-100, fax: 663-399	AMIR RIZVANOVIĆ
18	ZIRAATBANK BH dd - SARAJEVO	Sarajevo	Dženetića Čikma br. 2.	033/252-230, fax: 252-245	ALI RIZA AKBAŞ

ATTACHMENT 2

BALANCE SHEET OF BANKS IN THE FB&H ACCORDING TO THE FBA MODEL – ASSETS SIDE

in 000 KM

No.	DESCRIPTION	31.12.2012	31.12.2013	31.03.2014
	ASSETS			
1.	Cash and deposit accounts with deposit-taking institutions	3.962.581	4.417.898	4.037.905
1a	Cash and non-interest bearing deposit accounts	625.188	627.016	468.529
1b	Interest-bearing deposit accounts	3.337.393	3.790.882	3.569.376
2.	Trading securities	375.032	381.909	414.540
3.	Facilities to other banks	78.522	51.960	100.398
4.	Loans, receivables based on leasing facilities and past due receivables	10.666.124	10.852.400	10.956.079
4a	Loans	9.591.819	9.676.527	9.711.650
4b	Receivables based on leasing facilities	54	48	47
4c	Past due receivables based on loans and leasing facilities	1.074.251	1.175.825	1.244.382
5.	Held to maturity securities	173.435	180.604	183.494
6.	Business premises and other fixed assets	491.370	476.199	472.583
7.	Other real estate	30.123	36.786	37.659
8.	Investments in unconsolidated related companies	24.756	23.762	23.736
9.	other assets	255.247	252.122	246.002
10.	LESS: value adjustment	1.066.424	1.227.090	1.234.401
10a	Value adjustments for Item 4. of the Assets	1.007.459	1.165.928	1.171.155
10b	Value adjustments for Assets items, except for the Item 4	58.965	61.162	63.246
11.	**TOTAL ASSETS**	**14.990.766**	**15.446.550**	**15.237.995**
	LIABILITIES			
12.	Deposits	10.961.001	11.523.849	11.280.987
12a	Interest-bearing deposits	9.281.938	9.363.284	9.238.101
12b	Non-interest bearing deposits	1.679.063	2.160.565	2.042.886
13.	Borrowings - liabilities due	1.752	1.577	1.580
13a	Past due liabilities			
13b	Past due - invoked off-balance sheet liabilities	1.752	1.577	1.580
14.	Borrowings from other banks	2.000		
15.	Liabilities to the Government			
16.	Loan obligations and other borrowings	1.141.561	1.039.381	1.004.486
16a	with remaining maturity of up to one year	244.160	212.485	207.067
16b	with remaining maturity of over one year	897.401	826.896	797.419
17.	Subordinated debt and subordinated bonds	186.675	166.889	169.979
18.	Other liabilities	480.402	406.909	419.984
19.	**TOTAL LIABILITIES**	**12.773.391**	**13.138.605**	**12.877.016**
	EQUITY			
20.	Permanent preferred shares	26.059	11.959	11.959
21.	Common shares	1.175.547	1.196.633	1.196.633
22.	Issue premiums	136.485	136.485	136.485
22a	over permanent preferred shares	8.420	8.420	88
22b	over common shares	128.065	128.065	136.397
23.	Undistributed profit and capital reserves	453.269	649.879	646.603
24.	foreign exchange rate differences			
25.	Other capital	110.281	-2.745	53.565
26.	Loan loss provisions formed against profit	315.734	315.734	315.734
27.	**EQUITY (20 to 25)**	**2.217.375**	**2.307.945**	**2.360.979**
28.	**LIABILITIES AND EQUITY (19 +26)**	**14.990.766**	**15.446.550**	**15.237.995**
	LIABILITIES AND NEUTRAL ITEMS	**661.321**	**638.913**	**645.534**
	BALANCE SHEET TOTAL OF BANKS	**15.652.087**	**16.087.617**	**15.883.529**

ATTACHMENT 3

OVERVIEW OF ASSETS, LOANS, DEPOSITS AND FINANCIAL RESULTS OF BANKS IN THE FB&H as of 31.03.2014

in 000 KM

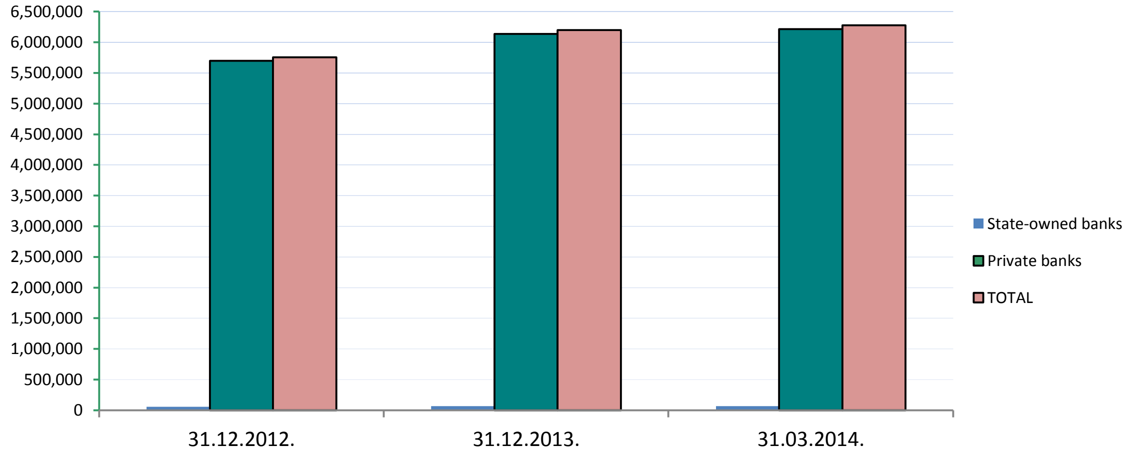
No.	BANK	Assets		Loans		Deposits		Financial result
		Amount	%	Amount	%	Amount	%	Amount
1	BOR Banka d.d. Sarajevo	234.971	1,54%	189.035	1,73%	123.349	1,09%	744
2	Bosna Bank International d.d. Sarajevo	541.534	3,55%	360.376	3,29%	367.637	3,26%	461
3	Hypo Alpe Adria Bank d.d. Mostar	1.095.619	7,19%	816.760	7,45%	716.962	6,36%	3.592
4	Intesa Sanpaolo banka d.d. Sarajevo	1.342.812	8,81%	1.116.777	10,19%	897.974	7,96%	5.195
5	Investiciono Komercijalna banka d.d. Zenica	190.683	1,25%	98.215	0,90%	134.868	1,20%	404
6	Komercijalno Investiciona banka d.d. Velika Kladuša	73.405	0,48%	38.869	0,35%	47.379	0,42%	295
7	Moja banka d.d.Sarajevo	185.268	1,22%	136.325	1,24%	153.232	1,36%	-59
8	NLB banka d.d. Tuzla	834.725	5,48%	617.730	5,64%	666.882	5,91%	1.461
9	Privredna Banka d.d Sarajevo	158.185	1,04%	121.195	1,11%	127.880	1,13%	233
10	ProCredit Bank d.d. Sarajevo	359.470	2,36%	308.831	2,82%	241.845	2,14%	32
11	Raiffeisen Bank dd Bosna i Hercegovina	3.793.057	24,89%	2.382.314	21,74%	2.935.680	26,02%	26.022
12	Sberbank BH d.d. Sarajevo	871.867	5,72%	733.889	6,70%	658.191	5,83%	923
13	Sparkasse Bank d.d. Sarajevo	996.438	6,54%	814.049	7,43%	839.979	7,45%	2.463
14	Union banka d.d. Sarajevo	223.111	1,46%	119.534	1,09%	168.108	1,49%	160
15	UniCredit bank d.d. Mostar	3.661.706	24,03%	2.611.745	23,84%	2.750.437	24,38%	14.084
16	Vakufska banka d.d. Sarajevo	282.080	1,85%	189.213	1,73%	228.410	2,02%	-3.028
17	Ziraatbank BH d.d. Sarajevo	393.064	2,58%	301.222	2,75%	222.174	1,97%	658
	TOTAL	**15.237.995**	**100%**	**10.956.079**	**100%**	**11.280.987**	**100%**	**53.640**

ATTACHMENT 4

NEW RETAIL SAVINGS IN THE FB&H BANKS

in 000 KM

	31.12.2012	31.12.2013	31.03.2014
State-owned banks	58.050	65.179	66.123
Private banks	5.698.300	6.135.711	6.213.768
TOTAL	**5.756.350**	**6.200.890**	**6.279.891**



ATTACHMENT 5

CLASSIFICATION OF BALANCE SHEET ASSETS AND OFF-BALANCE SHEET RISK-BEARING ITEMS as of 31.03.2014

- CLASSIFICATION OF BALANCE SHEET ASSETS ITEMS -

in 000 KM

No.	BALANCE SHEET ASSETS ITEMS	CLASSIFICATION					TOTAL
		A	B	C	D	E	
1.	Short term loans	2.124.800	269.825	21.972	6.187	2.106	2.424.890
2.	Long term loans	6.216.846	592.284	220.599	148.449	35.239	7.213.417
3.	Other facilities	257.042	2.275	80	940	1.855	262.192
4.	Accrued interest and fees	36.937	5.679	3.082	7.656	28.555	81.909
5.	Past due receivables	40.931	46.915	65.271	305.316	752.884	1.211.317
6.	Receivables based on paid guarantees				484	32.581	33.065
7.	Other balance sheet assets being classified	221.668	4.979	2.905	3.456	27.785	260.793
8.	**TOTAL BALANCE SHEET ASSETS BEING CLASSIFIED (sum of items 1 through 7 – calculation basis for regulatory loan loss provisions)**	**8.898.224**	**921.957**	**313.909**	**472.488**	**881.005**	**11.487.583**
9.	**CALCULATED REGULATORY RESERVES FOR LOAN LOSSES BASED ON BS ASSETS**	**173.989**	**88.093**	**75.867**	**272.935**	**880.642**	**1.491.526**
10.	**VALUE ADJUSTMENT FOR BS ASSETS**	**114.217**	**84.432**	**94.721**	**212.485**	**728.546**	**1.234.401**
11.	**REQUIRED REGULATORY RESERVES FORMED AGAINST PROFIT FOR PURPOSE OF ASSESSED LOSSES BASED ON BS ASSETS**	**97.838**	**48.474**	**20.854**	**91.342**	**153.069**	**411.577**
12.	**FORMEED REGULATORY RESERVES FORMED AGAINST PROFIT RELATED TO ASSESSED LOSSES BASED ON BS ASSETS**	**78.075**	**31.359**	**22.437**	**78.071**	**69.205**	**279.147**
13.	**SHORTFALL OF REGULATORY RESERVE FORMED AGAINST PROFIT RELATED TO ASSESSED LOSSES BASED ON BS ASSETS**						**172.877**
14.	**BALANCE SHEET ASSETS NOT BEING CLASSIFIED (gross book value)**						**4.984.813**
15.	**TOTAL BALANCE SHEET ASSETS (gross book value)**						**16.472.396**

OVERVIEW OF BALANCE SHEET ASSETS NOT BEING CLASSIFIED AND FACILITIES SECURED WITH A CASH DEPOSIT

14.a	Cash in cash desk and vault and cash funds at the account with the Central Bank of B&H, gold and other precious metals	2.885.744
14.b	Demand deposits and term deposits up to one month located on accounts of banks with defined investment rating	1.079.336
14.c	Tangible and intangible assets	490.360
14.d	Financial and tangible assets acquired in the process of collection of receivables (within one year upon such acquisition)	9.037
14.e	Own (treasury) shares	
14.f	Receivables based on overpaid taxes	11.905
14.g	Trading securities	133.489
14.h	Receivables from the B&H Government, FB&H Government and RS Government, securities issued by the B&H Government, FB&H Government and RS Government and receivables secured with unconditional guarantees payable upon the first call	374.942
	TOTAL Item 14	**4.984.813**
8a.	Facilities secured with a cash deposit	198.824

ATTACHMENT 5A

CLASSIFICATION OF BALANCE SHEET ASSETS AND OFF-BALANCE SHEET RISK-BEARING ITEMS
as of 31.03.2014

- CLASSIFICATION OF OFF-BALANCE SHEET ITEMS -

in 000 KM

No.	OFF-BALANCE SHEET ITEMS	CLASSIFICATION					TOTAL
		A	B	C	D	E	
1.	Payment guarantees	355.326	46.368	689	241		402.624
2.	Performance guarantees	494.590	87.199	1.492	906	262	584.449
3.	Uncovered letters of credit	40.924	2.856	214			43.994
4.	Irrevocably approved, but undrawn loans	1.253.421	96.576	735	842	1.056	1.352.630
5.	Other contingent liabilities of the bank	10.889	287		1	119	11.296
6.	**TOTAL OFF-BALANCE SHEDET ITEMS BEING CLASSIFIED (sum of items 1 through 5 – calculation basis for regulatory loan loss provisions)**	**2.155.150**	**233.286**	**3.130**	**1.990**	**1.437**	**2.394.993**
7.	**CALCULATED REGULATORY RESERVES FOR LOAN LOSSES RELATED TO OFF-BALANCE SHEET ITEMS**	**42.014**	**14.256**	**628**	**1.074**	**1.437**	**59.409**
8.	**LOSS RESERVES FOR OFF-BALANCE SHEET ITEMS**	**19.621**	**3.982**	**1.083**	**844**	**1.117**	**26.647**
9.	**REQUIRED REGULATORY RESERVES FORMED AGAINST PROFIT RELATED TO ASSESSED LOSSED BASED ON OFF.BAL.SHEET ITEMS**	**25.403**	**11.050**	**225**	**569**	**320**	**37.567**
10.	**FORMED REGULATORY RESERVES FORMED AGAINST PROFIT RELATED TO ASSESSED LOSSED BASED ON OFF.BAL.SHEET ITEMS**	**23.070**	**11.185**	**598**	**1.338**	**396**	**36.587**
11.	**SHORTFALL OF REGULATORY RESERVES FORMED AGAINST PROFIT RELATED TO ASSESSED LOSSED BASED ON OFF.BAL.SHEET ITEMS**						**4.461**
12.	**OFF-BALANCE SHEET ITEMS NOT BEING CLASSIFIED**						**479.743**
13.	**TOTAL OFF-BALANCE SHEET ITEMS**						**2.874.736**
6a.	**Contingent liabilities secured with a cash deposit**						**54.408**

ATTACHMENT 6

INCOME STATEMENT OF BANKS IN THE FB&H ACCORDING TO THE FBA MODEL

in 000 KM

No.		DESCRIPTION	31.03.2012	31.03.2013	31.03.2014
1.		**INTEREST INCOME AND EXPENSES**			
	a)	Interest income and similar income			
	1)	Interest-bearing deposit accounts with deposit-taking institutions	1.553	451	1.210
	2)	Loans to other banks	1.148	487	629
	3)	Loans and leasing facilities	183.981	175.149	173.913
	4)	Held to maturity securities	1.494	1.917	1.794
	5)	Equity securities	153	151	0
	6)	Receivables based on paid off-balance sheet liabilities	0	0	0
	7)	Other interest and similar income	15.304	16.056	15.685
	8)	**TOTAL INTEREST INCOME AND SIMILAR INCOME**	**203.633**	**194.211**	**193.231**
	b)	Interest expenses and similar expenses			
	1)	Deposits	54.352	52.428	49.146
	2)	Borrowing from other banks	1	31	157
	3)	Borrowing taken – liabilities due	0	0	0
	4)	Liabilities based on loans and other borrowings	10.867	5.907	4.813
	5)	Subordinated debt and subordinated bonds	3.001	2.270	2.985
	6)	Other interest and similar expenses	1.025	737	577
	7)	**TOTAL INTEREST EXPENSES AND SIMILAR EXPENSES**	**69.246**	**61.373**	**57.678**
	c)	**NET INTEREST AND SIMILAR INCOME**	**134.387**	**132.838**	**135.553**
2.		**OPERATING INCOME**			
	a)	FX income	8.629	8.631	8.678
	b)	Loan fees	1.388	1.546	1.618
	c)	Fees based on off-balance sheet items	5.885	6.026	6.041
	d)	Service fees	42.586	44.164	47.322
	e)	Trading income	164	2.155	275
	f)	Other operating income	12.833	9.870	14.743
	g)	**TOTAL OPERATING INCOME a) to f)**	**71.485**	**72.392**	**78.677**
3.		**NON-INTEREST BEARING EXPENSES**			
	a)	Business and direct expenses			
	1)	Costs of value adjustments, risk-bearing assets, provisions for contingent liabilities and other value adjustments	36.098	29.273	20.988
	2)	Other business and direct expenses	17.727	16.644	24.034
	3)	**TOTAL BUSINESS AND DIRECT EXPENSES 1) + 2)**	**53.825**	**45.917**	**45.022**
	b)	Operating expenses			
	1)	Costs of salaries and contributions	61.225	60.053	59.901
	2)	Costs of business premises, other fixed assets and utilities	39.052	36.570	35.311
	3)	Other operating expenses	20.824	20.161	20.356
	4)	**TOTAL OPERATING EXPENSES 1) to 3)**	**121.101**	**116.784**	**115.568**
	c)	**TOTAL NON-INTEREST BEARING EXPENSES**	**174.926**	**162.701**	**160.590**
4.		**PROFIT BEFORE TAXES**	**35.600**	**44.710**	**56.727**
5.		**LOSS**	**4.654**	**2.181**	**3.087**
6.		**TAXES**	**0**	**0**	**0**
7.		**PROFIT BASED ON INCREASE OF DEFERRED TAX FUNDS AD REDUCTION OF DEFERRED TAX LIABILITIES**	**0**	**0**	**0**
8.		**LOSS BASED ON REDUCTION OF DEFERRED TAX FUNDS AND INCREASE OF DEFERRED TAX LIABILITIES**	**0**	**0**	**0**
9.		**NET PROFIT 4. - 6.**	**35.600**	**44.710**	**56.727**
10.		**NET LOSS 4. - 6.**	**4.654**	**2.181**	**3.087**
11.		**FINANCIAL RESULT 9.-10.**	**30.946**	**42.529**	**53.640**

ATTACHMENT 7

REPORT ON CAPITAL CONDITION AND ADEQUACY OF BANKS IN THE FB&H
ASSETS SIDE OF THE BALANCE SHEET

in 000 KM

No.	DESCRIPTION	31.12.2012	31.12.2013	31.03.2014
1	**BANK'S CORE CAPITAL**			
1.a.	Shareholders capital, reserves and profit			
1.1.	Shareholders capital – common and permanent preferred non-cumulative shares – cash payments	1.185.966	1.188.094	1.192.951
1.2.	Shareholders capital – common and permanent preferred non-cumulative shares – investments in kind and in rights	12.550	12.550	12.550
1.3.	Amount of issue premiums earned upon payment of shares	136.485	136.485	136.485
1.4.	General mandatory reserves (reserves mandated by the law)	101.836	206.809	206.995
1.5.	Other reserves not related to the assets quality evaluation	309.179	362.349	362.098
1.6.	Retained – undistributed profit from previous years	167.825	248.901	277.025
1.a.	**TOTAL (1.1. to 1.6.)**	**1.913.841**	**2.155.188**	**2.188.104**
1.b.	Deductible items from 1.a.			
1.7.	Uncovered losses transferred from previous years	120.740	112.610	253.055
1.8.	Current year's loss	17.818	140.330	3.087
1.9.	Book value of own (treasury) shares of the bank	156	156	156
1.10.	Intangible assets	52.590	41.418	41.254
1.b.	**TOTAL (1.7. to 1.10.)**	**191.304**	**294.514**	**297.552**
1.	**CORE CAPITAL: (1.a.-1.b.)**	**1.722.537**	**1.860.674**	**1.890.552**
2	**SUPPLEMENTARY CAPITAL OF THE BANK**			
2.1.	Shareholders capital – common and permanent preferred cumulative shares – cash payments	3.090	3.091	3.091
2.2.	Shareholders capital – common and preferred cumulative shares – investments in kind and in rights			
2.3.	General loan loss provisions for the category A – performing assets	211.433	215.083	216.003
2.4.	Current year profit – audited and confirmed by an external audit	67.243	71.984	1.106
2.5.	Profit amount for which the FBA issues an order restricting its disbursement			
2.6.	Amount of subordinated debts representing max. 50% of the core capital	120.264	165.473	168.563
2.7.	Hybrid convertible items max. 50% of the core capital			
2.8.	Permanent, non-refundable items	65.070	1.416	1.416
2.	**AMOUNT OF SUPPLEMENTARY CAPITAL: (2.1 to 2.8)**	**467.100**	**457.047**	**390.179**
3	**DEDUCTIBLE ITEMS FROM THE BANK'S CAPITAL**			
3.1.	Portion of invested shareholders capital that, according to the FBA, represents a received, but over-appraised value			
3.2.	Capital contributions of other legal entities exceeding 5% of the bank's core capital	3.043	2.844	2.844
3.3.	Receivables from shareholders with significant voting rights – approved contrary to regulations	85		
3.4.	LCRE towards shareholders with significant voting rights in the bank (no FBA approval required)			
3.5.	LLP shortfall as per regulatory requirement	95.720	158.859	176.381
3.	**AMOUNT OF DEDUCTIBLE ITEMS FROM THE BANK'S CAPITAL: (3.1 to 3.5)**	**98.848**	**161.703**	**179.225**
A.	**NET CAPITAL OF THE BANK (1.+2.-3.)**	**2.090.789**	**2.156.018**	**2.101.506**
B.	**RISK WEIGHTED ASSETS AND LOAN EQUIVALENTS**	**11.078.498**	**10.999.406**	**11.021.299**

C.	**WEIGHTED OPERATIONAL RISK**	**974.201**	**981.318**	**982.260**
D.	**WEIGHTED MARKET RISK**			
E.	**TOTAL WEIGHTED RISKS B+C+D**	**12.052.699**	**11.980.724**	**12.003.559**
F.	**NET CAPITAL RATE (CAPITAL ADEQUACY) (A.:E.) X 100**	**17,3%**	**18,0%**	**17,5%**

ATTACHMENT 8

HEADCOUNT INFORMATION FOR BANKS IN THE FB&H

No.	BANK	31.12.2012	31.12.2013	31.03.2014
1	BOR Banka d.d. Sarajevo	62	64	64
2	Bosna Bank International d.d. Sarajevo	247	279	286
3	Hypo Alpe Adria Bank d.d. Mostar	579	517	529
4	Intesa Sanpaolo banka d.d. Sarajevo	537	528	525
5	Investiciono Komercijalna banka d.d. Zenica	166	164	161
6	Komercijalno Investiciona banka d.d. Velika Kladuša	71	71	70
7	Moja banka d.d.Sarajevo	151	156	156
8	NLB banka d.d. Tuzla	456	442	446
9	Poštanska banka d.d. Sarajevo	85		
10	Privredna Banka d.d Sarajevo	179	177	174
11	ProCredit Bank d.d. Sarajevo	344	333	315
12	Raiffeisen Bank dd Bosna i Hercegovina	1.552	1.531	1.516
13	Sberbank BH d.d. Sarajevo	360	411	408
14	Sparkasse Bank d.d. Sarajevo	452	462	465
15	Union banka d.d. Sarajevo	183	200	197
16	UniCredit bank d.d. Mostar	1.305	1.262	1.252
17	Vakufska banka d.d. Sarajevo	230	225	225
18	Ziraatbank BH d.d. Sarajevo	171	229	234
	TOTAL	**7.130**	**7.051**	**7.023**