

BANKING AGENCY OF
REPUBLIKA SRPSKA
BANJA LUKA

R E P O R T
ON CONDITION OF BANKING SYSTEM
IN REPUBLIKA SRPSKA AS OF THE END OF 1999

Banja Luka, March 2000

Translation
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ATTACHMENTS

I INTRODUCTION

The main characteristic of the banking system in Republika Srpska in 1999 was that of reform.

On July 15, 1999 a new Law on Banks was passed, creating a prerequisite for the establishment of a banking system based on the international standards. The Law has also clearly defined the role of the Banking Agency of Republika Srpska in creating and maintaining a sound and stable banking system as a basis for the economy in Republika Srpska. According to the Law the minimum amount of a bank's founding capital funds has been increased from an amount of US \$ 1,500,000 to KM 5,000,000.

Another significant change relates to the obligation of banks to provide for potential loan loss reserves either from banks' income or debiting their capital under condition that a bank's net capital must not be lower than KM 5,000,000. The Law also gives a special significance to the process of provisional administration and liquidation of problem banks with a goal to protect the overall banking system.

Banks have an obligation to adjust their operation in accordance with the new Law within a period of 6 months i.e. by January 2000.

Taking into consideration the above said the Agency was obliged to issue a number of decisions to complete the legal framework to enable functioning of a stable banking system.

In December 1999 the Managing Board of the Agency issued a set of Decisions and other regulations which were published in the Official Gazette and came into force in January 2000. They are the following:

1. Decision on Conditions and Criteria for Issuing Banking Licenses;

2. Decision on Formats and Contents of Banks' Reports to be Submitted to the Banking Agency of Republika;
3. Decision on Conditions when a Bank is Considered Insolvent;
4. Decision on Minimum Standards for Banks' Operation with Related Persons;
5. Decision on Minimum Standards for Banks' Capital Management;
6. Decision on Minimum Standards for Banks' Risk Concentration Management;
7. Decision on Minimum Standards for Banks' Credit Risk and Asset Classification Management;
8. Decision on Minimum Standards for Banks' Foreign Currency Risk Management;
9. Decision on Minimum Scope, Form and Contents of Scheduling of and Reporting on Economic-Financial Audit of Banks.

Besides the above Decisions, the Managing Board of the Banking Agency issued the first set of decisions back in March 1999 in the process of establishing bank supervision. That set of Decisions consisted of the following:

1. Decision on Bank Supervision;
2. Decision on Minimum Standards for Banks' Liquidity Risk Management;
3. Decision on Minimum Standards for Banks' Internal and External Audit;
4. Decision on Minimum Standards for Banks' Internal Control;
5. Decision on Minimum Standards for Documenting of Banks' Lending Activities;
6. Decision on Bad Clients.

Although it may seem that banks are overwhelmed by such voluminous regulations, it actually serves the goal of adjusting to the market based operation, and it assists banks in timely recognition of potential risks within a bank and establishment of efficient risk management, as well as the protection of depositors and the regular informing of banks' shareholders.

Apart from the Law on Banks, the Law on Accounting and the Law on Modifications and Amendments to the Law on the Payment System were issued (July 15, 1999). That marked the beginning of the payment system reform in Republika Srpska.

In December 1999, the Managing Board of the Agency issued the Decision on Minimum Standards to be established by Banks to Perform Internal Payment Transactions. This has created a legal possibility for banks to perform internal payment transactions when licensed for that operation by the Agency.

Following the idea of the reform of banking system, the process of banks' privatization and restructuring has been started. Though the process itself started back in 1998, after the Law on Privatization of State Owned Capital in Banks and the Law on Opening Balance Sheets in the Process of Privatization of State Owned Capital in Banks were passed, major preparation for privatization of banks was made in 1999. This has made an opening for the privatization in 2000 with a goal to establish a new quality banking in Republika Srpska. This is to be done by a modernization of banks, introducing a better management, providing for profitability and supporting overall development of the economy.

II REPUBLIKA SRPSKA BANKS' OPERATION

1. General Information

Seventeen banks and one Postal Savings were in operation in Republika Srpska in the course of 1999. In February 1999 Zepter Komerc banka a.d. Banja Luka started its operation. On December 28, 1999, the banking license was revoked from Gold bank a.d. Banja Luka. That means that the number of banks at the end of 1999 remained the same as in 1998, i.e. 16 banks and a Postal Savings.

It should be pointed out that based on a Court Decision after an approval given by the Agency the following banks have changed their names:

- Srpska drzavna banka a.d. Banja Luka into Razvojna banka a.d. Banja Luka,
- Komerc banka a.d. Banja Luka into Zepter-Komerc banka a.d. Banja Luka, and
- Export-import banka a.d. Bijeljina into Nova banka a.d. Bijeljina.

Based on the available data from balance sheets as of December 31, 1999, with regard to banks' ownership structure, 10 banks and the Postal Savings were state owned and 6 banks were privately owned.

Capital Structure of Banks involved in Privatization Process

BANKS	CAPITAL in %			
	State	Cooperative	Private	Total
Kristal banka a.d. B.Luka	75.55	4.84	19.61	100
Banjalucka banka a.d. B.Luka	93.5	3.0	3.5	100
Privredna banka a.d. Gradiska	74.2	20.4	5.4	100
Privredna banka a.d. Brcko	100.0			100
PBS a.d. Srpsko Sarajevo	85.0	1.0	14.0	100
Privredna banka a.d. Doboj	90.0	4.0	6.0	100
Prijedorska banka a.d. Prijedor	96.0		4.0	100
Postanska stedionica a.d. B.Luka	100.0			100
Semberska banka a.d. Bijeljina	90.28	6.80	2.92	100
Agroprom banka a.d. Banja Luka	65.0	15.38	19.62	100
Razvojna banka a.d. Banja Luka	100.0			100

In 1999 the Ministry of Finance approved opening balance sheets of 8 state-owned banks. After that the Banking Agency of Republika Srpska made an assessment of solvency and issued Decisions on solvency for the following banks:

- Kristal banka a.d. Banja Luka,
- Privredna banka a.d. Brcko,
- Banjalucka banka a.d. Banja Luka,
- PBS a.d. Sarajevo,
- Privredna banka a.d. Gradiska,
- Postanska stedionica a.d. Banja Luka,
- Privredna banka a.d. Doboj
- Prijedorska banka a.d. Prijedor.

In 1999 the Agency issued the following approvals based on the Law on the Agency:

- two approvals for a modification of Bank By-Laws and Agreement on Bank Founding;
- five approvals for share issue;
- two approvals for opening of branch office;
- an approval for a change of bank's premises;
- four approvals for election and appointment of a general manager;
- eighteen approvals for external auditor appointment;

- an authorization for operation with foreign countries.

Besides issuing licenses to new banks the Agency has not completed yet the process of issuing permanent licenses to banks which had been in operation before the Agency was established which, in the meantime, were licensed temporarily. The status of temporarily licensed banks will be resolved by privatization of banks with majority state owned capital.

1.1. STAFF

As of December 31, 1999 total number of banks' employees was 3,767 having the following professional qualification structure:

BANKS' EMPLOYEES PROFESSIONAL QUALIFICATION STRUCTURE

No.	Education	Statement Dec.31,1998	%	Statement Dec.31,1999	%	RATIO 99/98
1.	Non-skilled	272	7.64	275	7.30	101
2.	Skilled	95	2.67	101	2.68	106
3.	Highly-	33	0.93	36	0.96	109
4.	skilled	2,160	60.64	2,272	60.31	105
5.	Secondar.	402	11.29	416	11.04	103
6.	sch.	588	16.51	655	17.39	111
7.	2-year College College degree M.Sc.	12	0.34	12	0.32	100
	TOTAL:	3,562	100.00	3,767	100.00	106

Compared to the number of banks' employees as of December 31, 1998 the number increased by 205 or 6%, which resulted from Banjalucka Bank's taking over new branch offices, Razvojna Bank's newly employed staff and opening of Zepter-Komerc banka a.d. Banja Luka.

Banjalucka banka has taken over some branch offices of Invest banka a.d. Beograd together with offices and employed staff. That resulted in increasing the total number of employed staff by 41. Also, Razvojna banka has significantly increased the number of employees (by 63). Fifty employees of that bank are temporarily employed. Generally, Razvojna banka has the largest number of employees (1,362) who are mostly engaged in payment transactions. However, it should be pointed out that the separation of the bank and the Payment Bureau will significantly change the number and the structure of the bank's staff.

The majority of state owned banks are generally overstaffed, having an inadequate professional qualification structure. Nevertheless, in the course of 1999 they have employed new 136 employees. Out of the total number of all banks' employees these state-owned banks employed 96.7% employees.

More than a half of the total number of all banks' employees, 2,272 employees were secondary school graduated and only 17% were college graduated which is increasingly required due to a higher complexity of banking operation.

2. BANKS' OPERATION FINANCIAL INDICATORS

Supervision of banks' operation as one of the basic tasks of the Agency has been performed by on-site examinations and on-site examinations based on banks' reports submitted to the Agency, which are the following:

1. Balance-Sheet (monthly),
2. Re-Classified Balance Sheet and Income Statement (quarterly),
3. Report on Classification of Balance Sheet and Off-Balance Sheet Assets (quarterly)
4. Report on Capital Adequacy and Other Elements Required by Article 26 and 27 of the Law on Banks (quarterly).

Besides the above listed, all other available data, such as banks' daily liquidity report, auditor's and other institutions' reports are taken into consideration.

2.1 BALANCE SHEET

As of December 31, 1999, the total banks' assets reported amounted to KM 3.1 billion out of which balance sheet assets amounted to KM 2.7 billion and off-balance sheet assets to KM 337 million.

Banks' asset and liability structure is given in the following banks' reclassified balance sheet:

BANKS' RE-CLASSIFIED BALANCE SHEET
(in thousand of KM)

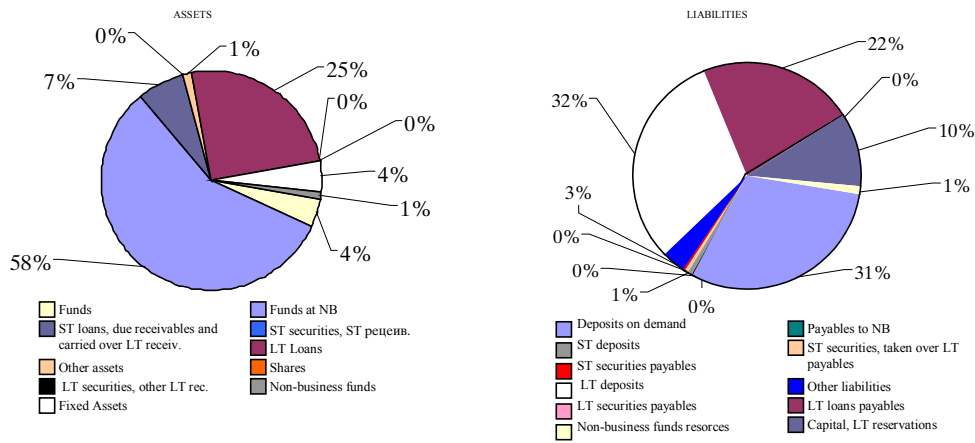
BALANCE SHEET ITEMS	Dec. 31,1998.		Dec. 31,1999.		RATIO 99/98
	Amount	%	Amount	%	
I ASSETS					
A-1 Funds	137,290	5	114,760	4	84
A-2 Funds at NB	1,530,873	59	1,563,908	57	102
A-3 ST loans, due receivables and carried over due LT receivables	0 134,390	 5	0 189,881	 7	 141
A-4 ST securities and receivables	19,454	1	4,026	0	21
A-5 Other assets	27,104	1	32,296	1	119
A-6 LT loans	616,246	24	686,705	25	111
A-7 LT securities and other receivables	1,500	0	1,409	0	94
A-8 Shares	2,428	0	1,895	0	78
A-9 Fixed assets	96,497	4	120,252	4	125
A-10 Non-business assets	24,730	1	32,760	1	132
TOTAL: (A-1 to A-10)	2,590,511	100	2,747,892	100	106
A-11 Off-balance sheet assets	172,945		336,938		195
GRAND TOTAL (balance sheet and off-balance sheet)	2,763,455		3,084,830		112
II LIABILITIES					
P-1 Deposits on demand	793,570	31	823,208	30	104
P-2 Payables to NB	2,588	0	812	0	31
P-3 ST deposits	10,186	0	12,926	0	127
P-4 ST loan and taken over LT payables	17,595	1	15,086	1	86
P-5 ST securities payable	10,030	0	8,415	0	84
P-6 Other liabilities	69,425	3	92,964	3	134
P-7 LT deposits	864,243	33	865,022	31	100
P-8 LT loan payables	564,494	22	615,837	22	109
P-9 LT securities payable	0	0	0	0	0
P-10 Capital and LT reserves	236,734	9	283,670	10	120
P-11 Non-business assets resources	21,646	1	29,952	1	138
TOTAL: (P-1to P-11)	2,590,511	100	2,747,892	100	106
P-12 Off-balance sheet liabilities	172,945		336,938		195
GRAND TOTAL: (balance sheet and off-balance sheet)	2,763,455		3,084,830		112

Banks' total balance sheet assets was higher by 321 million compared to the end of the year, though the asset structure was almost identical.

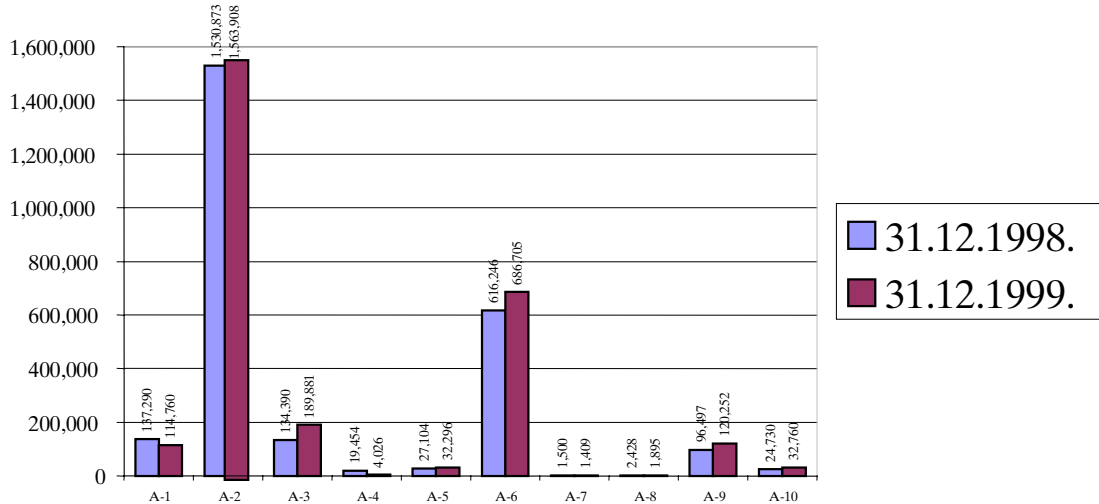
As for the asset structure it can be stated that short term loans increased by 2% and long term loans by 1%, which may be interpreted as a positive trend in development of lending as a basic banking activity.

In the course of 1999 banks' assets increased by 6% compared to the statement as of December 31, 1998. The increase is noted in the first and third quarter. Although short term lending relatively largely increased - 41% compared to the previous year - as well as some other items, such an increase of assets cannot be considered satisfactory.

BANKS' RECLASSIFIED BALANCE SHEET AS OF DECEMBER 31, 1999



ASSETS



- | | |
|-----------------------------------|--|
| A-1 Funds | A-6 LT Loans |
| A-2 Funds at the NB | A-7 LT Securities and other LT receivables |
| A-3 ST Loans and Due Receivables | A-8 Shares |
| A-4 ST Securities and Receivables | A-9 Fixed Assets |
| A-5 Other Assets | A-10 Off-Balance Sheet Assets |

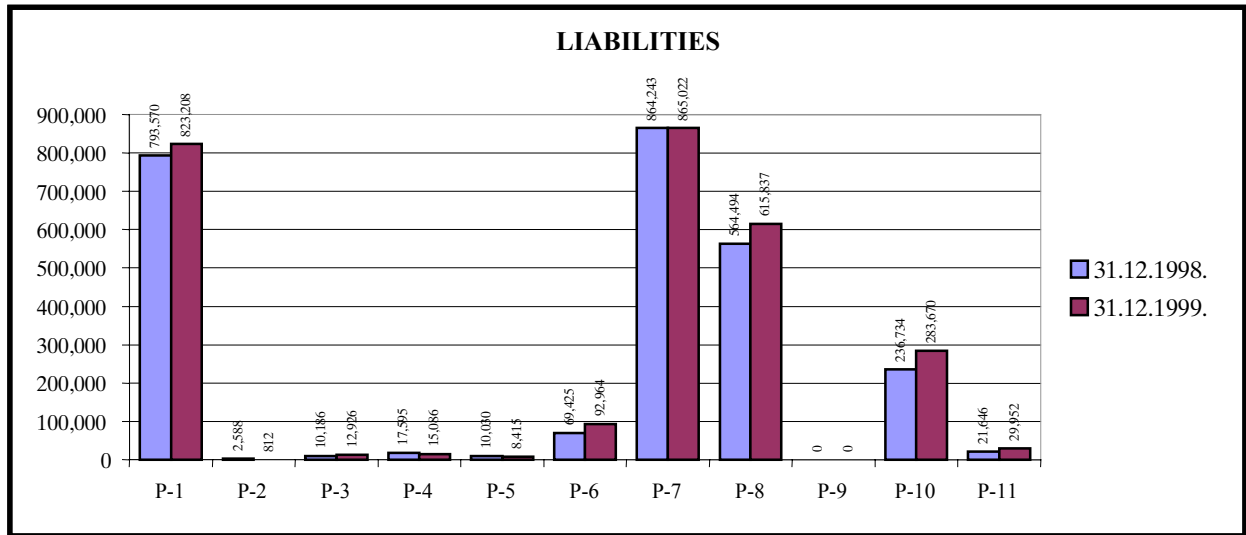
Structure of banks' balance sheets still showed outstanding the problem of frozen foreign currency savings since they represented the most significant item in balance sheets (57%), followed by long term foreign currency loans (22%). These two items together represented inactive assets amounting to 79% of the total assets. The major part of this asset will be taken over by the state as passive and neutral items under the adopted Privatization Program for Banks with Majority State-Owned Capital. This will result in realistic balance sheets of such banks of an incomparably better quality.

Total off-balance sheet assets amounted to KM 337 million showing an increase of 95% compared to the beginning of the year. The largest amount (KM 86.2 million) is to be associated with the bank whose license was revoked on December 28, 1999.

The liability structure was the same as of the end of the year. Neither quarterly reports showed any significant changes.

2.1.1. BANKS' LIABILITIES

The structure of liabilities is shown in the following graph:



P-1	Deposits on Demand	P-7	LT Deposits
P-2	Payables to the NB	P-8	LT Loan Payables
P-3	ST Deposits	P-9	LT Securities Payable
P-4	ST Loan, taken over LT Payables	P-10	Capital and LT Reservations
P-5	Other Liabilities	P-11	Non-Business Funds Resources

An item constantly present in banks' resources, i.e. liabilities, is deposits on demand representing, with capital, the only lending resource. After carving out frozen foreign currency savings (on demand) in an amount of KM 575 million from deposits on demand in an amount of KM 823 million it can be concluded that the liability structure is extremely unfavorable even with a relatively high increase of short-term deposits.

The banks' liabilities are burdened with frozen foreign currency savings and liabilities based on long-term loans. In the privatization process they are to be

taken out from banks' balance sheets. Only then, the banks' resources condition can be realistically assessed.

Condition and flow of deposits in internal payment system can be seen from the following table:

BANKS' DEPOSIT CONDITION
(in internal payment system)
for the period December 1998 to December 1999

No.	MONTH	DINAR	KM	TOTAL KM
1.	December 1998.	364,739,051	9,258,906	70,048,749
2.	January	428,680,248	17,970,029	89,416,737
3.	February	428,825,064	24,066,512	74,516,518
4.	March	402,293,550	44,320,580	91,649,233
5.	April	358,171,440	44,002,865	79,931,344
6.	May	372,254,277	53,885,935	89,338,723
7.	June	333,667,893	65,223,177	104,478,224
8.	July	332,006,751	74,636,662	106,256,353
9.	August	355,708,633	83,145,368	112,787,754
10.	September	340,446,492	81,607,862	105,925,468
11.	October	199,085,091	92,356,080	104,798,898
12.	November	173,698,133	99,449,421	110,305,554
13.	December	89,536,546	114,613,778	120,209,812

At the end of 1998 deposits amounted to KM 70,048,749 (total) out of which Dinar deposits amounted 364,739,051 Dinar (KM 60.7 million) and KM deposits amounted to 9,258.906.

According to that, in 1999 total deposits in internal payment system increased by 71.6% compared to the end of the year, where Dinar deposits decreased from KM 60.7 million to KM 5.6 million while KM deposits increased from KM 9.2 million to KM 114.6 million. That was the consequence of the known events related to the Dinar payment system and the war in FRY on one side, and on the other enlarged use of KM in the internal payment system and especially the final withdrawal of Dinar from the payment system.

During the war period some of banks' business activity sharply declined, one of which was retail banking (citizens).

Within that segment of activities banks stopped approving any loans to physical persons, operations with citizens' check-accounts and credit cards were limited and with high inflation made an additional impact which resulted in withdrawing savings from banks.

During that period and the period immediately after the war, saving deposits were reduced to a symbolic banks' resource consisting mainly in banks' servicing salaries and pension payments which stayed on banks' accounts for a very short period of time.

SURVEY OF NEW CITIZENS' SAVINGS IN RS BANKING
(in thousand of KM)

No.	DESCRIPTION	December 31,1998	March 31,1999	June 30,1999	September 30,1999	December 31,1999
1.	ON DEMAND					
	1. Dinar	14,039	6,038	7,669	4,924	3,961
	2. KM	177	567	3,563	2,759	14,895
	3. Foreign Currency	9,627	9,595	11,109	9,149	9,961
	TOTAL 1:	23,843	16,200	22,341	16,832	28,817
2.	TERMED					
	1. Dinar	50	42	1	12	1
	2. KM	0	1	43	53	254
	3. Foreign Currency	15	697	521	977	1,384
	TOTAL 2:	65	740	565	1,042	1,639
3.	TOTAL (1+2)	23,908	16,940	22,906	17,874	30,456

In the course of 1999 citizens' savings continued to increase slowly which slightly changed depositing structure in state owned and private banks shown in the table below:

	Dec. 31, 1998	%	March 31, 1999	%	June 30, 1999	%	Sept. 30, 1999	%	Dec. 31, 1999	%	Ratio 99/98
State-owned banks	22,584	94	14,659	87	20,538	90	14,495	81	26,418	87	116.98
Private banks	1,324	6	2,281	13	2,368	10	3,379	19	4,038	13	304.98
TOTAL:	23,908	100	16,940	100	22,906	100	17,874	100	30,456	100	127.39

Stable banking, as a support of total economic growth of Republika Srpska, will be possible only with a restoration of citizens' confidence in banks and significant increase of quality deposits.

Banks' liability structure is still unsatisfactory and has not significantly changed compared to the end of the year. There is no a significant increase of deposits while capital share and long term reserves are below the legally required minimum of 20% (the actual one is 10%).

2.1.2. ASSET QUALITY

Asset quality is determined based on the Decision on Classification of Balance Sheet and Off-Balance Sheet Assets. The assessment is made by banks themselves quarterly and resulting reports are submitted to the Agency. The Agency examiners make an appraisal of asset quality during their on-site examination. Also, an asset quality appraisal is made by auditors during banks' annual statement audit, a report which must be submitted to the Agency by all banks.

**BANKS' BALANCE SHEET AND OFF-BALANCE SHEET ASSET
CLASSIFICATION
AS OF DECEMBER 31, 1999
(in thousand KM)**

No.	Form KA Sheet Mark	TYPE OF RECEIVABLES	Not- Classified	CLASSIFICATION					TOTAL
				A	B	C	D	E	
1.	(A)	Loans	0	473,235	73,647	100,454	42,573	95,629	785,538
2.	(B)	Interests and Fees	0	8,045	4,637	962	1,059	627	15,330
3.	(C)	Total Placements (1+2)	0	481,280	78,284	101,416	43,632	96,256	800,868
4.	(D)	Risk Off-Balance Sheet Assets	0	111,014	6,942	2,221	7,583	14,985	142,745
5.	(E)	Total loan Risk Exposure (3+4)	0	592,294	85,226	103,637	51,215	111,241	943,613
6.	(III)	Other Risk Balance Sheet Assets	0	127,539	8,497	1,645	0	1,332	139,013
7.	(F)	Total Risk Balance Sheet and Off-Balance Sheet Assets (5+6)	0	719,833	93,723	105,282	51,215	112,573	1,082,626
8.	(G)	Total Not-Classified Assets	2,002,200	0	0	0	0	0	2,002,200
9.	(H)	Total balance Sheet and Off- Balance Sheet Assets (7+8)	2,002,200	719,833	93,723	105,282	51,215	112,573	3,084,826
10.	(V)	Potential Loan Loss Required Reserve	0	0	0	52,641	38,411	112,573	203,625

Classification Category	Dec.31,1998	%	Dec.31,1999	%	RATIO 99/98
A	438,873	15.9	719,833	23.3	164
B	231,143	8.4	93,723	3.0	41
C	90,218	3.3	105,282	3.4	117
D	36,981	1.3	51,215	1.7	138
E	96,240	3.5	112,573	3.6	117
Not-classified	1,870,001	67.7	2,002,200	64.9	107
TOTAL:	2,763,456	100.0	3,084,826	100.0	112
Potential Loan Loss Required Reserves	169,084		203,625		

The tables have been prepared based on reports submitted by banks.

Within the classification structure the group "A" made the biggest share which, compared to the previous year, increased by 64%. The increase resulted from classification of newly approved short-term loans and off-balance sheet assets. Also, a change of classification of a bank's group "B" into the group "A" based on long-term loans contributed to such an increase. At the same time, that is the major reason for a decrease of the amount of the group "B".

Groups "C", "D" and "E" having larger risk level also increased which actually means that the asset quality in 1999 deteriorated compared to 1998. Almost all placements, classified into category "E", were sued for being non-performing.

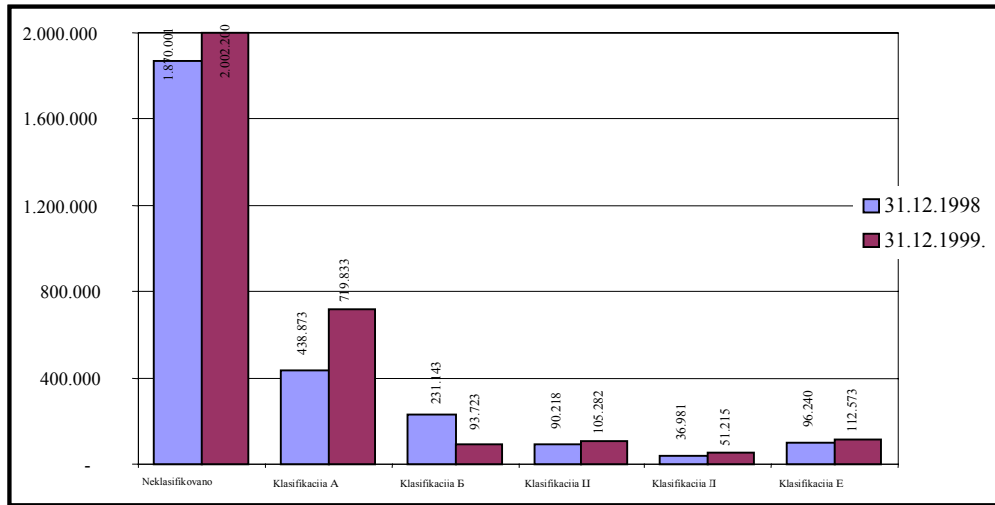
It should be noted that during an examination the Agency examiners make their own classification, which is in the majority of cases more rigorous than banks' classification.

Out of the total assets in an amount of KM 3,084 billion a major part (KM 2,002 billion) represented assets which are not classified.

The biggest portion of the non-classified assets represented frozen foreign currency savings (57% of the total assets) which shall be resolved by the state's taking over of the liability in the bank privatization process.

As of December 31, 1999 the classified assets amounted to KM 1,083 billion and consisted of off-balance sheet assets in an amount of KM 143 million and balance sheet assets amounting to KM 940 million.

BANKS' BALANCE SHEET AND OFF-BALANCE SHEET ASSET CLASSIFICATION



Non-classified, Classification A, Classification B, Classification C, Classification D, Classification E

As stated earlier, banks' asset quality is still non-satisfactory.

The asset quality structure will not significantly change until privatization of banks when, not only frozen foreign currency savings and loans will be carved out, but also bad quality placements (C, D and E).

Based on the actual review, potential loan loss required reserves amounted to KM 204 million, and were larger by 18% but still not sufficient.

Taking into consideration the fact, that up to now banks were not obliged to earmark those reserves debiting their incomes, as required by the international standards, banks' financial statements are not realistic.

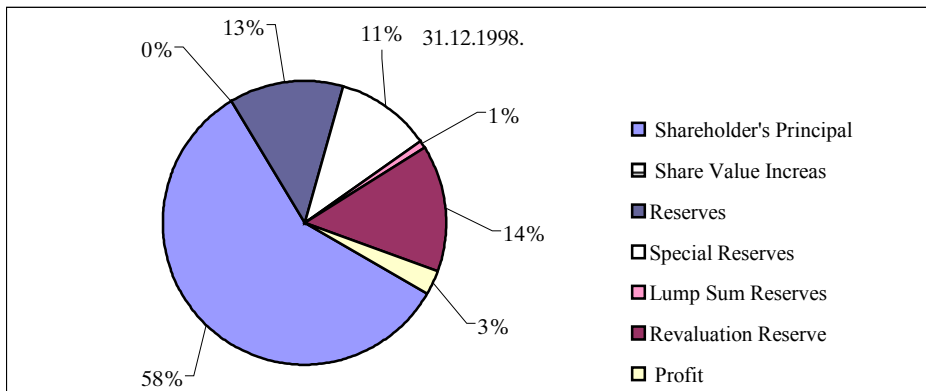
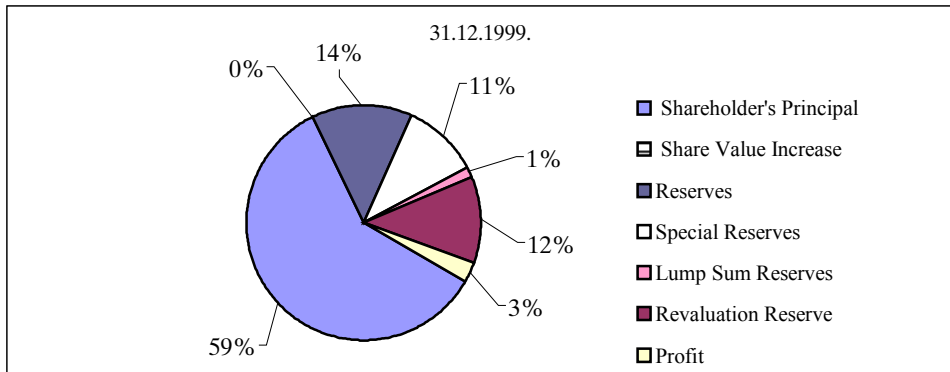
2.1.3. CAPITAL

As of December 31, 1999 the total banks' capital amounted to KM 270 million and was larger by 17% compared to the previous year end capital (KM 230 million). There were no essential changes in the capital structure.

BANKS' PERMANENT AND NET CAPITAL
(in thousand KM)

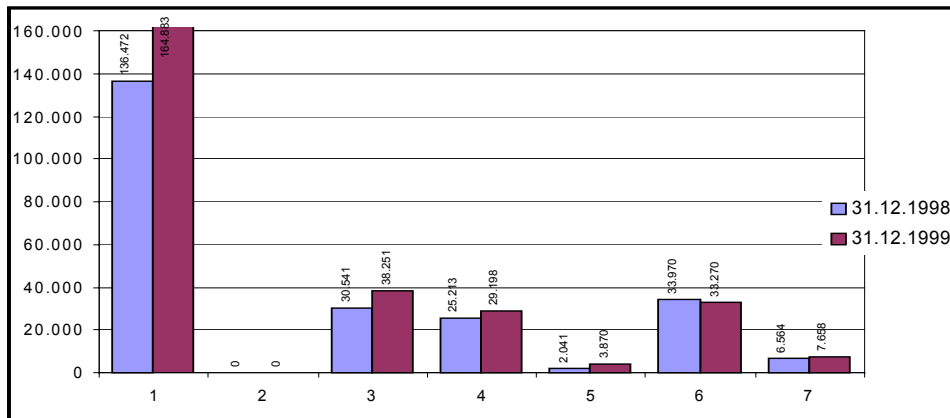
No.	ELEMENTS	December 31,1998		December 31,1999		RATIO 99/98
		Amount	%	Amount	%	
1	2	3	4	5	6	7
I	Permanent capital consisting of:					
	1. Shareholders' Principal	136,472	58	164,883	59	121
	2. Share Value Increase	0	0	0	0	0
	3. Reserves	30,541	13	38,251	14	125
	4. Special reserves	25,213	11	29,198	11	116
	5. Revaluation reserves	2,041	1	3,870	1	190
	6. Lump Sum Reserves	33,970	14	33,270	12	98
	7. Profit	6,564	3	7,658	3	117
	TOTAL:	234,801	100	277,130	100	118
II	Items to be Deducted:					
	1.Subscribed, Not-Paid In Capital	497	11	1,880	25	378
	2.Shares	2,428	54	1,895	25	78
	3.Own Shares	0	0	0	0	0
	4.Loss	1,555	35	3,756	50	242
	TOTAL:	4,480	100	7,531	100	168
III	Capital (I-II)	230,321		269,599		117
IV	Potential Loss Required Reserves	172,409		203,628		118
V	Net Capital (III-IV)	57,912		65,971		114
BANK'S RISK ASSETS AS OF DECEMBER 31,1999						
VI	Total Risk Assets					
	1.Total Balance Sheet Risk Assets	919,251	88	1,061,116	85	115
	2. Total Off-Balance Sheet Risk Assets	127,967	12	185,892	15	145
	TOTAL:	1,047,218	100	1,247,008	100	119
VII	Items to be Deducted:					
	1. Permanent Shares	2,428	1	1,895	1	78
	2.Potential Loss Required Reserve	172,155	99	203,628	99	118
	TOTAL:	174,583	100	205,523	100	118
VIII	Net Risk Assets (VI-VII)	872,635		1,041,485		119

BANKS' PERMANENT CAPITAL



An increase was recorded in the shareholders' capital since the number of banks increased by one and three private banks increased their capital. Also, there was an increase in reserves (25%), special reserves (16%) and revaluation reserves (90%). Total profit reported by banks for 1999 amounted to KM 7.7 million and was much higher than the profit reported for the first six months of the year.

BANKS' PERMANENT CAPITAL (in thousand KM)



- | | |
|----------------------------|-------------------------|
| 1. Shareholders' Principal | 5. Revaluation Reserves |
| 2. Share Value Increase | 6. Lump Sum Reserve |
| 3. Reserves | 7. Profit |
| 4. Special Reserves | |

Net capital in an amount of KM 65.9 million was bigger by KM 8 million compared to the previous year end (KM 57.9 million). Also, required reserves for potential loan loss were increased.

Banks are obliged to meet a requirement according to which a capital share in the total liability is not lower than 20%.

This requirement was met by nine banks and the average for all banks was 10%.

This problem will be also mostly resolved by cleaning balance sheets during the bank privatization as well as by the new law on Banks which stipulates grater required bank founding capital (KM 5 million, while up to now it was US \$ 1.5 million).

A very significant element in analyzing capital is the capital adequacy rate, which under the existing provisions must not be lower than 8%.

An average capital adequacy rate, as a ratio of net capital and total risk weighted assets amounted to 23 % in this period. In order to get as realistic a picture as possible of the capital adequacy in banks overall, this calculation did not take into consideration two banks having a negative net capital. The negative net capital resulted from the fact that required potential loan loss reserve amounts were higher than the capital itself. Four banks did not meet the requirement of 8% capital adequacy rate. The rest of the banks reported different rates starting from 16% up to 183%. Such high capital adequacy rates were reported by newly founded banks due to a low level of lending activities and low assets.

This analyses has been developed based on the capital adequacy reported by banks themselves while the final capital adequacy rate for each bank shall be determined by examiners during their on-site examinations.

The following table shows some relative ratios:

No.	RATIO	Dec. 31,1998.	Dec.31, 1999.
1.	Shareholders' Capital / Total Capital	59.23%	61.16%
2.	Total Capital / Total Assets	8.89%	9.81%
3.	Total Risk Assets /Total Capital	454.68%	462.54%
4.	Total Risk Assets / Total Assets	40.43%	45.38%

**BANKS' OPERATION RELATIVE INDICATORS
AS OF DECEMBER 31, 1999**

BANKS' OPERATION RELATIVE INDICATORS	Satisfactory Banks' Operation		Not-Satisfactory Banks' Operation	
	Number of Banks	%	Number of Banks	%
1. Capital Adequacy (minimum 8%)	14	78	4	22
2. Capital in Liabilities (minimum 20%)	9	50	9	50
3. Citizens' Funds in Liabilities (maximum 50%)	10	56	8	44
4. Short Term Placements/Short Term Resources (minimum 100%)	15	83	3	17
5. Foreign Currency Liabilities/Foreign Currency Assets (95%-105%)	8	44	10	56
6. Big Loans Ratio (maximum 80%)	12	67	6	33
7. Capital Investment into Enterprises (maximum 15%)	18	100	0	0
8. Capital Investment into Banks (maximum 51%)	18	100	0	0
9. Capital Investment into Fixed Assets (maximum 20%)	7	39	11	61

Based on the above survey it can be stated only two requirements were met by all banks.

The level of compliance of each bank's operation with the stipulated requirements is shown by the following:

- all requirements met: 1 bank;
- one requirement not met: 5 banks ;
- two requirements not met: 2 banks;
- three requirements not met: 4 banks;
- four requirements not met: 2 banks;
- five requirements not met: 3 banks;
- six requirements not met: 1 bank.

It should be pointed out that all or almost all requirements are met by newly founded banks which have not developed real banking activities and do not have inherited problems from the past.

2.2. INCOME STATEMENT

In 1999 banks' total income amounted to KM 199.6 million.

BANKS' INCOME STATEMENT (in thousand KM)

	DESCRIPTION	As of December 31,1998		As of December 31,1999		RATIO 99/98
		Amount	%	Amount	%	
I	INCOME					
	1. Operation income	50,409	24	71,875	36	143
	- fees PR-2	44,563	21	64,783	32	145
	- other PR-2 (1)	5,846	3	7,092	4	121
	2. Financing Income	129,174	60	76,845	38	59
	- Interest Income PR-1 (1)	80,401	38	54,261	27	67
	- FC Exchange Fluctuation Income	42,365	20	20,829	10	49
	- Other Financing Income PR-2 (3)	6,395	3	1,753	1	27
	- Revaluation Income PR-3	13	0	2	0	15
	3. Extraordinary Income PR-2 (4)	34,215	16	50,935	26	149
	4. Capital Income PR-2 (5)	23	0	19	0	84
	TOTAL INCOME	213,821	100	199,674	100	93
II	EXPENSES					
	1. Material Costs and Gross Salary RA-2 (1)	33,318	17	45,414	24	136
	2. Intangible Expenses	43,858	22	62,869	33	143
	- Banking Service Fees RA-1 (2)	5,774	3	6,769	4	117
	- Intangible Costs RA-2 (2)	31,032	15	47,045	25	152
	- Taxes and Contributions not depending on Income RA-5	7,052	4	9,055	5	128
	3. Financing Expenses	96,800	48	61,987	32	64
	- Interests RA-1 (1)	44,478	22	14,549	8	33
	- Negative FC Exchange Rates RA-2 (3)	0	0	1,747	1	
	- Write-Offs and Adjustments RA-3	28,261	14	32,191	17	114
	- Other Financing Expenses RA-2 (4)	714		889	0	125
	- Revaluation Expenses RA-4	23,348	12	12,611	7	54
	4. Extraordinary Expenses RA-2 (5)	27,453	14	20,705	11	75
	5. Capital Loss RA-2 (6)	5	0	64	0	1.280
	TOTAL EXPENSES	201,433	100	191,039	100	95
III	INCOME ALLOCATED TO SPECIAL RESERVES	7,312		2,000		27

Interest income, generated from a basic activity of banks', made 27% of the total income, which was less than at the previous year end (38%). That fact indicates that banks performed not only less lending as a primary activity, but also a negative trend, actually a decrease in that activity.

On the other hand fee income increased, so it amounted to 32% and was significantly higher than at the end of the previous year (21%).

Foreign currency fluctuation income was decreased from 20% to 10%, mostly because of a lower amount of Dinar in the payment system.

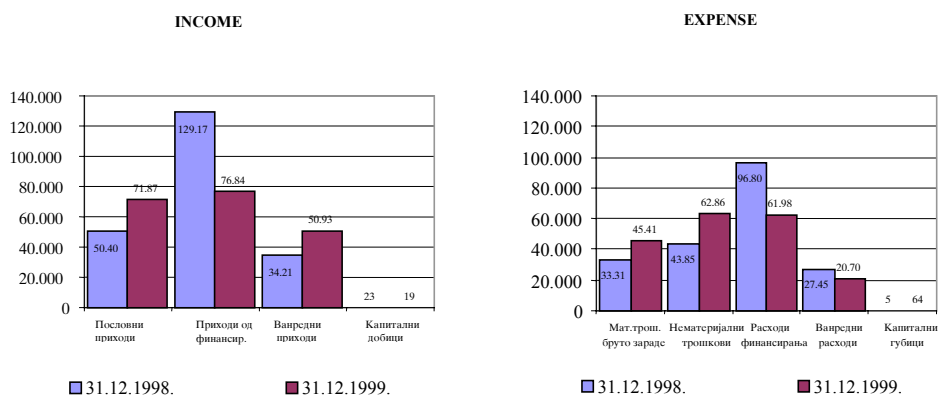
In this period total expenses amounted to KM 191 million. In the expense structure the biggest increase was in intangible expenses (from 22% to 33%). The largest portion of this amount was related to the calculated long-term reserves for intangible investments.

Both material costs and gross salaries indicated a high increase in the expense structure (from 17% to 24%) meaning that material conditions for work improved in banks. Interests as a portion of expenses were decreased (from 22% to 8%) indicating again that banks' were not engaged in their basic activities, i.e. deposit taking and lending.

The balance of income and expense after legal obligation deduction amounted to KM 8.6 million. Income earmarked into special reserves amounted to KM 2 million, while generated profit reached an amount of KM 6.6 million and was larger by KM 1.6 million or 31% compared to the previous year.

It should be pointed out, however, that two banks reported a loss in an amount of KM 2.1 million which is higher by KM 1.5 million or 3.5 times compared to the previous year.

BANKS' INCOME STATEMENT



SURVEY OF REPORTED AVERAGE RELATIVE INDICATORS

No	RATIOS	Dec.31,1998	Dec.31,1999
		%	%
1.	TOTAL INCOME/ TOTAL ASSETS	8.25	7.27
2.	NET INCOME/ TOTAL ASSETS	1.65	1.10
3.	NET INCOME/ TOTAL CAPITAL	18.57	11.24
4.	NET INCOME/ SHAREHOLDERS' CAPITAL	31.34	18.38
5.	INTEREST INCOME/ TOTAL ASSETS	3.10	1.97
6.	FEE INCOME/ TOTAL ASSETS	1.72	0.26
7.	MATERIAL COSTS AND GROSS SALARY/ TOTAL ASSETS	1.29	2.29

After the very first glance at the reported average ratios it can be noted that all of them are lower in comparison with the previous year except for material costs and gross salaries.

If return on assets is taken into consideration, as a basic indicator of profitability of an operation, it can be noted that at the end of the previous year it amounted to 1.65% while as of December 31, 1999 it was 1.1% showing a significant decrease.

Taking into consideration the international standard of 1%, our banks would be still profitable if the indicator had a positive trend of increase and if the banks had earmarked potential loan loss reserves debiting their income, which would be in compliance with international standards.

The net interest income/total asset ratio also had a deteriorating trend. At the end of 1998 it was 3.1% and as of December 31, 1999 it amounted to 1.97%. The fact that in accordance with the international standards it should be 4%-5% is again emphasizing the earlier statement that banks generated a majority of their income from fees and commissions instead from lending as a primary activity.

The shareholders' capital return rate had also a significant decrease. At the end of the previous year it was 31.34% while at the end of 1999 it amounted to 18.38%. Though this is still above the international standard requirement (12%-15%) it resulted from unrealistic bank financial statements.

III CONCLUSION

The same way as the reform of banking system in Republika Srpska was the main characteristic in 1999, the basic task in 2000 will be bank privatization and consistent implementation of the reform.

The fact that in the course of the bank privatization process the state will take over debt in an amount of KM 2.22 billion (frozen foreign currency savings and loans) is an indication of the importance of a stable banking system and the determination to continue in that direction.

Privatization of the state-owned capital in banks is also important because of the fact that out of 17 banks in Republika Srpska 11 of them are majority state owned and represent pillars of the banking system.

Due to the inherited burdens from the previous period, the banking system in Republika Srpska has been in a very difficult situation.

Basic characteristics are the following:

- The total balance sheet assets of KM 2.748 billion is still including the amount of KM 2.22 billion which will be taken over by the state in the privatization process. Thus the remaining active assets of KM 526 million is exceptionally low. Beside that the off-balance sheet asset is remarkably increasing and is by 95% higher in comparison to the end of the previous year, resulting in KM 336.9 million as of the end of 1999.

- Total capital amounts to KM 270 million and is higher by 17% in comparison to the last year. Though there are some positive trends in this segment - a nominal increase of shareholders' principal by KM 28 million - a number of banks do not have enough capital yet.

- An earlier statement regarding unsatisfactory asset quality is still valid. According to the actual review a required reserve for potential loan losses amounts to KM 204 million. That is only the estimated amount of loan losses, but not funds provided to cover the loss debiting income, which would comply with international standards. The new Law on Banks and the Agency's Decisions based on the Law, which will start to be implemented in 2000, will significantly change the calculation and earmarking of reserves for potential loan losses making an impact on results of operation and banks' net capital.

- Republika Srpska bank's profitability is unsatisfactory with a trend of deterioration. The generated profit to be distributed (retained earnings) in an amount of KM 9.7 million is not sufficient to support growth of the banking system, especially because two of the banks reported a loss in an amount of KM 1.3 million.

- Due to low earnings and poor assets some of the banks also have an unsatisfactory liquidity.

- In the course of the year 2000 the banks will have to adjust their operations to and implement the Agency's requirements (internal audit, internal control, liquidity, loan and other risk management) which will contribute to a faster identification of potential problems and their efficient solutions.

- In the following period the Agency will continue to insist on implementation of new legal provisions, especially the capital required in the amount of KM 5,000,000. Also, supervision of problem banks will have as a goal restructuring of their financial conditions

- Besides bank privatization, the year 2000 will be characterized by payment system reform where the Agency will have an important role as well.

In order to continue the reform in that segment it is necessary to pass the Law on Meeting Obligations based on Frozen Foreign Currency Citizens' Savings and the Law on Deposit Insurance as an important prerequisite for restoring confidence in the banking system of Republika Srpska.

[Translation completed: April 29, 2000.]

[This translation was performed by the USAID Bank Supervision Project and is provided as a convenience for interested parties. This is not an official translation and is subject to the usual errors, omissions, and variations that may be found in any translation. We encourage all users of this translation to compare it with results from their own translators, and we welcome any suggestions to correct errors or to provide greater clarity.]

ATTACHMENTS

Attachment No. 1	General Information on Banks in Republika Srpska
Attachment No. 2	Banks' Reclassified Income Statement
Attachment No. 3	Survey of Reported Average Indicators
Attachment No. 4	Information on Banks' Employees in Republika Srpska

LIST OF BANKS
December 31,1999

No.	BANK	LOCATION	ADDRESS	DIRECTOR	TELEPHONE	FAX	December 31,1999 (in thousand of KM)			Number of Employees
							ASSETS	CAPITAL	PROFIT	
1.	Banjalucka banka	Banja Luka	M.Bursac 7	Momcilo Poparic	051/212-140	212-830	607,062	57,202	247	665
2.	Agroprom banka	Banja Luka	Kwaza Milosa 19	Milenko Vracar	051/303-611	314-181	57,698	9,433	1,168	80
3.	Privredna banka	Gradiska	Vidovdanska bb	Momir Hrvacanin	051/813-333	813-205	78,416	10,214	2	92
4.	Kristal banka	Banja Luka	I.F.Jukica 9	Ljubomir Klincov	051/212-930	212-878	585,691	36,183	2,016	367
5.	Privredna banka	Doboj	Svetog Save 1	Ljubomir Kovacevic	053/241-544	241-662	574,105	35,906	11	166
6.	Prijedorska banka	Prijedor	Vozda Karadjordja 9	Mladen Kovacevic	052/212-311	211-840	325,703	13,001	-1,308	220
7.	Semberska banka	Bijeljina	Karadjordjeva 3	Cvijetin Nikic	054/471-588	472-247	77,607	5,436	16	140
8.	Razvojna banka	Banja Luka	Bana Milosavqevica 4	Ranko Travar	051/212-012	217-575	130,736	43,291	1,937	1,375
9.	VB banka	Banja Luka	K.P. Karadjordjevica 103	Radovan Bajic	051/212-678	212-078	12,757	5,980	580	28
10.	Privredna banka	Brcko	M.Aganovica 2	Nada Pavlovic	054/204-222	204-055	90,468	1,408	120	40
11.*	Gold banka	Banja Luka	Kraqa Alfonsa XIII/22	Andjelko Petkovic	051/312-114	307-100	91,292	4,896	2	7
12.	Nova banka	Bijeljina	Svetog Save 46	Milorad Andzic	054/471-094	401-410	15,296	5,298	549	31
13.	West banka	Laktasi	Karadjordjeva bb	Ranko Karapetrovic	051/832-174	832-042	4,254	3,207	7	4
14.	Privredna banka Sarajavo	Pale	Dobroslava Jevtica 14	Momcilo Mandic	057/786-809	786-805	384,478	18,770	1,086	446
15.	Ekvator banka	Banja Luka	M.Bursac 2	Dragoljub Jovanovic	051/217-920	211-757	17,380	5,470	43	19
16.	Bobar banka	Bijeljina	Filipa Visnjica 211	Dragan Radumilo	054/472-490	472-898	7,320	5,525	34	12
17.	Zepter komerc b.	Banja Luka	Brace Mazar 68	Djuro Beronja	051/215-755	215-771	7,458	3,490	121	22
18.	Postanska stedionica	Banja Luka	Karadjordjevica 61	Vlada Vasiljevic	051/211-433	211-555	17,109	4,889	-823	53
TOTAL:							3,084,830	269,599	5,808	3,767

* The Gold Bank's license has been revoked.

*Translation
USAID Bank Supervision Project
April 2000*

BANAK'S RECLASSIFIED INCOME STATEMENT
(in thousand KM)

Poz.	INCOME STATEMENT ITEMS	Dec.31,1998	Dec.31,1999	RATIO (4/3)
		Amount	Amount	
1	2	3	4	5
PR-1	Interest and Fee Income	124,964	119,044	95
RA-1	Interest and Fee Expense	50,251	21,317	42
	Net Interest and Fee Income	74,713	97,727	131
PR-2	Other Income	88,843	80,627	91
	TOTAL INCOME	163,556	178,354	109
RA-2	Other Expense	92,521	115,864	125
RA-3	Not Collected Receivables Write-off and Adjustment	28,261	32,191	114
	NET INCOME	42,774	30,299	71
PR-3	Revaluation Income	13	1	8
RA-4	Revaluation Expense	23,348	12,610	54
	Income minus Expense before legal obligations (taxes and contributions)	19,440	17,690	91
RA-5	Legal Obligations	7,052	0	0
	Income minus Expense after Legal Obligations	12,388	8,648	70
	Change of Inventory Value in the Period	0	0	0
	Income Allocated in Special Reserves	7,312	2,000	27
	Generated Profit	5,076	6,648	131
	Taxes and Contributions from Profit	540	855	158
	Profit to be Distributed (Retained)	5,162	7,939	154
	Loss	626	2,146	343

SURVEY OF REPORTED AVERAGE INDICATORS
ON THE LEVEL OF THE BANKING INDUSTRY

RELATIVE INDICATORS OF BANKS' OPERATION	Dec.31, 1998.	March 31,99.	June30, 1999	Sept.30, 1999	Dec.31, 1999
	%	%	%	%	%
1. Capital Adequacy (minimum 8%)	26	26	24	25	23
2. Capital in Liabilities (minimum 20%)	9	9	9	10	10
3. Citizens' Funds in Liabilities (maximum 50%)	57	56	56	55	57
4. Short Term Placements / Short Term Resources (minimum 100%)	205	203	203	186	185
5. Foreign Currency Assets / Foreign Currency Liabilities (95%-105%)	95	95	95	96	105
6. Big Loans Ratio (maximum 80%)	167	154	158	153	147
7. Permanent Investments into Enterprises Ratio (maximum 15%)	1.00	0.96	0.90	0.83	0.58
8. Permanent Investments into Banks Ratio (maximum 51%)	0.11	0.10	0.10	0.09	0.12
9. Investments into Fixed Assets Ratio (maximum 20%)	42	39	43	40	45

TOTAL NUMBER OF BANKS' EMPLOYEES AND
QUALIFICATION STRUCTURE
AS OF DECEMBER 31,1999

Red. br.	BANKS	QUALIFICATION STRUCTURE OF BANKS' EMPLOYEES							TOTAL	% in overall banking industry
		NS	KV	VKV	SSS	VS	VSS	MR		
1.	Banjalucka banka B.Luka	30	31	6	414	84	99	1	665	17.65
2.	Kristal banka B. Luka	30	5	4	231	23	74	0	367	9.74
3.	Agroprom banka B.Luka	3	3	0	38	10	25	1	80	2.12
4.	Semberska banka Bijeljina.	13	7	1	86	10	23	0	140	3.72
5.	Privredna banka Gradiska	6	1	0	58	6	21	0	92	2.44
6.	PBS Sarajevo	27	1	2	304	45	67	0	446	11.84
7.	Razvojna banka B.Luka	123	45	19	770	178	236	4	1375	36.50
8.	Privredna banka Doboj	16	2	1	106	15	25	1	166	4.41
9.	Prijedorska b. Prijedor	14	3	3	159	19	22	0	220	5.84
10.	Privredna banka Br~ko	5	3	0	16	4	12	0	40	1.06
11.	Nova banka Bijeljina	2	0	0	7	8	13	1	31	0.82
12.	West banka Laktasi	0	0	0	2	1	1	0	4	0.11
13.	Ekvator banka B.Luka	0	0	0	14	0	4	1	19	0.50
14.	Gold banka Banjaluka	0	0	0	3	0	4	0	7	0.19
15.	Postanska stedionica B.Luka	5	0	0	31	7	7	3	53	1.41
16.	Bobar banka Bijeljina	0	0	0	7	0	5	0	12	0.32
17.	VB banka Banjaluka	1	0	0	14	2	11	0	28	0.74
18.	Zepter-Komerc banka B.Luka	0	0	0	12	4	6	0	22	0.58
	TOTAL:	275	101	36	2272	416	655	12	3767	100.00
	%	7.30	2.68	0.96	60.31	11.04	17.39	0.32	100.00	

*As of December 31, 1999 Razvojna banka a.d. Banja Luka had 50 temporary employees.

NS = Not Skilled
KV = Skilled Worker
VKV = Highly Skilled Worker
SSS = Secondary School Education
VS = 2-Year Post-Secondary School Education
VSS = College Education
MR = Master of Science

Translation
USAID Bank Supervision Project
April 2000