

National Bank of Serbia

BANKING SECTOR IN SERBIA

Second Quarter Report 2006

August 2006

CONTENTS

I Banking Sector in the Second Quarter 2006	3
Structure of the Banking Sector in Serbia	3
Balance Structure	5
Lending Activity	6
Deposit Activity	7
Privatization in the Banking Sector	8
Takeover and Mergers	8
Risks in the Banking Sector	9
1. Credit Risk	9
2. Liquidity Risk	9
3. Currency Risk	10
Capital Adequacy	11
Profitability Indicators of Banking Sector Operations	12
Aggregate Report on Revenues and Expenditures	12
II NBS Regulatory Activity	13

I. Banking Sector in the Second Quarter 2006

Structure of the Banking Sector in Serbia

As reported on June 30, 2006 thirty-eight banks in Serbia have the NBS operating license. In the period under review (Q2 2006), Alpha Bank a.d. Beograd merged with Jubanka a.d. Beograd (the present name of the bank is Alpha Bank a.d. Beograd), while MB banka a.d. of Niš had its operating license revoked in Q1 2006, which is why the number of banks went two down from end-2005.

Number of banks

	Dec. 31, 2003	Dec. 31, 2004	Dec. 31, 2005	June 30, 2006
Number of banks	47	43	40	38
Number of OFI ¹	14	8	8	8

Organizational network of banks

Description	Dec. 31, 2003	Dec. 31, 2004	Dec. 31, 2005	March 31, 2006	June 30, 2006
Number of business units	97	124	114	91	93
Number of branches	292	300	327	355	393
Number of branch offices	774	1,010	1,162	1,211	1,233
Number of counters	302	275	264	251	257
Total	1,465	1,709	1,867	1,908	1,976

On June 30, 2006 the number of banking sector organizational units totaled 1,976 which implies an increase of 68 new organizational units in Q2 2006. The following banks contributed most to the expansion of banks' organizational network in Serbia: Meridian bank a.d. Novi Sad (12), National Bank of Greece a.d. Beograd (6), Raiffeisenbank a.d. Beograd (4), Vojvođanska banka a.d. Novi Sad (4) and ProCredit Bank a.d. Beograd (4).

Number of Banking Sector Employees

In the course of 2006, total number of employees in commercial banks went up by 1,214 i.e. from 25,680 at end-2005 to 26,894 – reported on June 30, 2006.

¹ Other financial institutions are: savings banks, savings-credit organizations and savings-credit cooperatives.

Bank ownership structure

The ownership structure of 38 banks on June 30, 2006 was as follows:

- 18 banks in majority ownership of foreign shareholders,
- 9 banks in majority ownership of domestic natural and legal entities,
- 11 in majority ownership of the Republic of Serbia.²

Market share

As of June 30, 2006, the market share of banks grouped according to balance sheet total was as follows:

Balance sheet total in CSD billion	Dec. 31, 2003			Dec.31, 2004			Dec. 31, 2005			June 30, 2006		
	Number of banks	In CSD million	Share (%)	Number of banks	In CSD million	Share (%)	Number of banks	In CSD million	Share (%)	Number of banks	In CSD million	Share (%)
Over 45	0	0	0.0	3	176,255	34.5	5	389,803	50.3	6	550,191	54.9
20–45	4	159,674	43.5	3	88,045	17.3	5	141,046	18.2	7	211,112	21.1
10–20	4	52,753	14.3	8	109,370	21.4	11	140,600	18.1	9	150,708	15.1
5–10	14	102,835	28.0	10	77,978	15.3	9	70,384	9.1	8	60,345	6.0
Up to 5	25	52,224	14.2	19	58,444	11.5	10	33,580	4.3	8	29,139	2.9
T	47	367,486	100.0	43	510,092	100.0	40	775,413	100.0	38	1,001,495	100.00

The share of six largest banks in the balance sheet total equaled 55%. Thirteen largest banks accounted for 76% of the balance sheet total.

As of June 30, 2006, banking sector balance sheet total reached CSD 1,001 billion, of which the share of banks in majority ownership of foreign entities was CSD 713 billion or 71.2%. The share of banks in majority ownership of the Republic of Serbia stood at CSD 213 billion or 21.3%, while banks in majority private ownership accounted for CSD 75 billion or 7.5%.

² Banks in which the Republic of Serbia is the largest majority or individual, direct or indirect shareholder.

Balance Sheet Structure**Banking sector balance sheet**

In CSD million

Position	31. 12. 2004.		31. 12. 2005.		30. 06. 2006.		Growth index in 2005	Growth index in 2006
	Amount	Share (%)	Amount	Share (%)	Amount	Share (%)		
ASSETS								
Cash and cash equivalents	62,837	12.3	72,781	9.4	66,786	6.7	116	92
Deposits and securities refinaceable with the central bank	23,002	4.5	150,827	19.4	246,484	24.6	656	163
Interest and fees receivable	2,047	0.4	3,197	0.4	3,789	0.4	156	119
Loans to and investments in banks	65,957	12.9	33,206	4.3	82,395	8.2	50	248
Loans to and investment to clients	290,799	57.0	426,528	55.0	504,367	50.4	147	118
Securities and other trading products	2,739	0.5	9,875	1.3	11,518	1.1	361	117
Securities held to maturity	8,301	1.6	8,467	1.1	5,808	0.6	102	69
Equity shares and other securities available for sale	10,116	2.0	10,494	1.3	12,764	1.3	104	122
Intangible investment	2,272	0.4	4,287	0.6	4,917	0.5	189	115
Fixed assets	32,364	6.3	41,385	5.3	47,128	4.7	128	114
Other assets and prepayment and deferred expenditures	9,011	1.8	12,844	1.7	14,004	1.4	143	109
Deferred tax assets	647	0.1	1,522	0.2	1,535	0.1	235	101
TOTAL	510,092	100	775,413	100	1,001,495	100	152	129
LIABILITIES								
Liabilities to banks	43,078	8.4	35,803	4.6	58,387	5.8	97	163
Liabilities to clients	345,705	67.8	580,715	74.9	728,124	72.7	166	125
Interest and fees payable	478	0.1	936	0.1	782	0.1	196	84
Liabilities on securities	284	0.1	7	0.0	6	0.0	2	86
Liabilities from profits	175	0.0	201	0.0	1,030	0.1	115	512
Other operating liabilities	6,777	1.3	7,277	1.0	9,866	1.0	107	136
Provisions	7,671	1.5	7,320	0.9	10,090	1.0	95	138
Other liabilities and accruals	6,415	1.3	17,125	2.2	37,956	3.8	267	222
Deferred tax liabilities	59	0.0	368	0.1	350	0.0	634	95
LIABILITIES	410,642	80.5	649,752	83.8	846,591	84.5	158	130
Capital	99,450	19.5	125,661	16.2	154,904	15.5	126	123
Share capital and other capital	97,220	19.1	106,832	13.8	144,160	14.4	110	135
Reserves	9,661	1.9	19,168	2.4	23,272	2.3	198	121
Accumulated profit/loss	-7,431	-1.5	-339	0.0	-12,528	-1.2	5	3,696
TOTAL	510,092	100	775,413	100	1,001,495	100	152	129
OFF-BALANCE SHEET ITEMS	510,889		726,007		1,024,963		142	141

On June 31, 2006 the banking sector balance sheet total amounted to CSD 1,001 billion, which implies a CSD 226 billion or 29.2% increase from end-2005.

Banks' off-balance sheet items reached CSD 1,025 billion, having climbed by CSD 299 billion or 41.2% compared to end-2005, Claims and liabilities from foreign currency savings bonds accounted for 26.0% of total off-balance sheet items.

On June 30, 2006 the greatest portion of banks' assets (59,0%) were claims on approved credits and lending (lending to banks, clients, interest and fees receivable), followed by deposits with the NBS and securities refinancable with the NBS (24,6%). Cash and cash equivalents made 6.7% of the banking sector balance sheet assets.

External or borrowed sources of financing made 84.5% of banking sector balance sheet liabilities, while capital and personal sources of financing accounted for 15,5%. Household, corporate and bank deposits had the greatest share in borrowed sources (56.4% of total liabilities),

Lending Activity

Composition of lending (credits and other lending)

The composition of lending as of June 30, 2006, end-2005 and end-2004 is shown in the table below:

In CSD million

POSITION	31, 12, 2004,		31, 12, 2005,		30, 06, 2006,		Growth index in 2005	Growth index in the first half of 2006
	Amount	Share in %	Amount	Share in %	Amount	Share in %		
CORPORATE	197,022	69.4	281,855	64.8	328,212	63.1	143	116
HOUSEHOLD	64,283	22.6	124,651	28.7	161,700	31.1	194	130
Housing construction	9,717	3.4	23,289	5.4	34,053	6.6	240	146
PUBLIC SECTOR	20,130	7.1	23,812	5.5	24,252	4.7	118	102
Serbia and Montenegro	738	0.3	981	0.2	375	0.1	133	38
Republic of Serbia	18,124	6.4	20,683	4.8	21,108	4.1	114	102
Local government	1,268	0.4	2,148	0.5	2,769	0.5	169	129
OTHER FINANCIAL ORGANIZATIONS	694	0.2	444	0.1	1,726	0.3	64	389
NON-PROFIT ORGANIZATIONS	1,702	0.6	3,765	0.9	4,174	0.8	221	111
TOTAL	283,832	100.0	434,527	100.0	520,064	100.0	153	120

The greatest amount of lending was extended to corporate sector (63.1%) and households (31.1%).

The first half of 2006 saw a CSD 86 billion or 19.7% rise in the overall banking sector lending.

Banks registered highest growth in lending to corporate sector (CSD 46 billion or 16.4%) and households (CSD 37 billion or 29.7%).

Deposit activity

Composition of deposits

Composition of deposits by sector as of June 30, 2006 and/or preceding years is presented in the table below:

In CSD million												
	31, 12, 2004,			31, 12, 2005,			30,06, 2006,			Growth in 2006		
	dinars	foreign currency	total	dinars	foreign currency	total	dinars	foreign currency	total	dinars	foreign currency	total
Total deposits	103,442	209,815	313,256	142,211	342,472	484,683	167,757	397,006	564,763	25,546	54,534	80,080
Banks	6,871	23,597	30,467	7,315	64,964	72,279	12,458	79,343	91,801	5,143	14,379	19,522
Domestic banks	6,851	8,158	15,009	7,249	11,672	18,921	12,024	24,931	36,955	4,775	13,259	18,034
Foreign banks	12	8,412	8,424	56	53,248	53,304	417	54,373	54,790	361	1,125	1,486
Subordinated and associated banks	8	7,026	7,034	11	44	55	18	40	58	7	-5	2
Public enterprises	14,947	8,464	23,411	18,468	13,058	31,526	17,150	11,531	28,681	- 1,318	- 1,527	- 2,845
Other companies	45,630	51,636	97,265	65,934	53,928	119,862	67,483	59,689	127,172	1,549	5,761	7,310
Public sector	10,552	584	11,136	14,082	946	15,028	22,997	1,771	24,768	8,915	825	9,740
Serbia and Montenegro	122	95	217	284	401	685	305	366	671	20	-34	-14
Republic of Serbia	1,250	468	1,718	2,370	506	2,876	4,804	1,392	6,196	2,434	886	3,320
Local government	9,180	22	9,202	11,428	39	11,467	17,888	12	17,900	6,460	-27	6,433
Other clients	6,502	2,447	8,949	9,193	3,324	12,517	10,157	2,728	12,885	964	- 596	368
Foreign legal and natural persons	1,246	12,223	13,469	1,578	16,334	17,912	7,398	19,472	26,870	5,820	3,138	8,958
Households	16,016	110,682	126,698	22,268	190,025	212,293	26,664	222,111	248,775	4,396	32,086	36,482
Natural persons	12,721	110,587	123,308	16,525	189,823	206,348	21,258	221,878	243,136	4,733	32,055	36,788
Entrepreneurs	3,295	95	3,390	5,743	203	5,946	5,406	233	5,639	- 336	30	-306
Other	1,667	295	1,962	3,474	343	3,817	3,449	361	3,811	- 25	18	- 7
Current maturities of long-term loans	9	-113	-104	-102	-450	-552	0	0	0	102	450	552
Banks	0	-135	-135	-1	-73	-74	0	0	0	1	73	74
Other clients	9	21	30	-101	-377	-478	0	0	0	101	377	478

The highest share of deposits was accounted for by household deposits (44.0%), followed by corporate deposits (27.6%) and bank deposits (16.2%),

Out of total deposits at the level of the banking sector, foreign exchange deposits accounted for 70.3%, dinar deposits for 29.7%, namely demand deposits 48.7%, and short-term time deposits 43.3%.

In the first half of 2006, total deposit potential growth of the banking sector was CSD 80 billion or 16.5%, Foreign exchange deposits rose by CSD 54 billion or 15.9%, and dinar deposits rose by CSD 26 billion or 18.0%.

Breakdown by sectors shows the strongest growth in household deposits (CSD 36 billion or 17.2%) and deposits of domestic banks (CSD 18 billion or 95.3%).

Privatization in the Banking Sector

Name of bank	RS share in %³	Note
Vojvođanska banka A,D, Novi Sad	99.43	Negotiations with the National Bank of Greece on the takeover of controlling stake are under way.
Panonska banka A,D, Novi Sad	87.39	By the end of July a sales contract was signed with Sao Paolo IMI.
Credy banka a,d, Kragujevac	72.36	The procedure is under way.

Takeover and Mergers

Budapest-based OTP Bank RT has become the owner of 89.39% of the share capital of Niška banka a.d. Niš,

In the second quarter of 2006, Alpha Bank A.D. Beogradska afilijacija Beograd merged with Jubanka a.d. Beograd, changing the name into Alpha Bank a.d. Beograd.

³ The Republic of Serbia's share is either direct or indirect. Indirect stake implies stake through banks undergoing bankruptcy proceedings, and/or companies and institutions where the Republic of Serbia is the majority owner.

Risks in the Banking Sector

1. Credit risk

Quality of assets in the Serbian banking sector

In CSD million

As of	Total balance assets and off-balance sheet items	Total calculated assets, calculated deductibles	Classified assets		Share of bad assets (C, D, E) in total classified assets, after deduction (%)
			A+B	C+D+E	
31,12,2003,	746,151	256,280	198,654	57,626	22.49
31,12,2004,	1,126,832	343,117	263,143	79,968	23.31
31,12,2005,	1,642,494	472,800	363,228	109,572	23.17
30,06,2006,	2,150,274	554,483	435,644	118,839	21.43

The share of bad assets in total classified assets and off-balance sheet items after the calculation of deductibles dropped relative to end-2005 and on June 30, 2006 stood at 21.4%. Bad assets are composed of assets classified into categories B, C and D according to the level of collectibility. The share of potential losses in the banking sector capital went down from 49.7% on December 31, 2005 to 37.3% on June 30, 2006.

2. Liquidity risk

Daily liquidity indicators as of June 30, 2006

In CSD thousand

Banks	Gyro account balances	Calculated required reserve	Column difference (2-3)	Deposited excess liquidity	Daily liquidity loans
Total in the Republic of Serbia	30,878,532	33,351,686	-2,473,154	2,321,000	1,190,000

Out of the total number of banks, 20 of them used required reserve funds in the total amount of CSD 3,066 million or 9.2% of total calculated required reserves, Three banks used daily liquidity loans,

During the observed three months, bank liquidity indicator ranged between 1.05 and 21.88.

Maturity matching of assets and liabilities

The table below illustrates the maturity matching of banking sector assets and liabilities at the end of the second quarter of 2006:

In CSD thousand						
1–7 days	8–15 days	16–30 days	31–90 days	91–180 days	181–365 days	over 366 days
-10,844,581	35,374,785	12,906,650	3,930,682	8,887,251	38,440,892	-88,695,671

The mismatch of assets and liabilities for the maturity 1-7 days is evident with 22 banks while mismatch for over 365 days is present with 27 banks.

3. Foreign exchange risk

In accordance with the Decision on Detailed Conditions for the Application of Articles 26 and 27 of the Law on Banks and Other Financial Organizations, the foreign exchange risk indicator was prescribed as a control measure of banks' foreign exchange risk. It was determined that a bank's total daily net foreign exchange risk position should not exceed 30% of capital. The total daily foreign exchange risk position represents the sum of long and short open net foreign exchange positions of a bank by all currencies and precious metals.

Analysis of the balance of daily foreign exchange positions of banks at the level of the banking sector as of June 30, 2006 showed that total daily open foreign exchange position stands at CSD 50.4 billion, which implies a CSD 0.2 billion increase compared to the value of total open foreign exchange position at end-Q1 2006. The foreign exchange risk indicator amounted to 30.3% (38.1% and 15.8% in the previous quarter and end-2005, respectively). As of June 30, 2006 five banks had their foreign exchange rate indicators higher than prescribed.⁴

Total long open foreign exchange position at the level of the sector reached CSD 47.7 billion, Total short open foreign exchange position was CSD 2.7 billion. Relative to the previous quarter there was an increase in total long open foreign exchange position by CSD 1.3 billion and a decrease in total short open foreign exchange position by CSD 1.1 billion.

⁴ As of June 30, 2006 banks are obliged to reduce the amount in excess of the foreign exchange risk indicator (arising from the inclusion of receivables that were up to now excluded) reduce by at least 50% and to bring it down to the prescribed 30% by December 31, 2006.

Open foreign exchange positions by currency at the level of the banking sector

In CSD thousand

Long open EUR position	Short open EUR position	Long open USD position	Short open USD position	Long open position in other currencies	Short open position in other currencies	Long open position, total	Short open position, total	Net short open position by all currencies	Total open foreign exchange position
43,418,690	1,211,871	3,104,831	1,121,743	1,130,657	350,153	47,700,282	2,683,767	373,878	50,384,049
								Total capital	166,435,372
								Fx risk indicator	30.27
Number of banks	Number of banks	Number of banks	Number of banks	Number of banks	Number of banks			Number of banks	
34	4	23	15	31	7			38	

Capital Adequacy

Banks are obligated to maintain the capital adequacy ratio at no less than 12% relative to risk weighted assets.

The table below shows capital adequacy ratios for 38 banks operating at the end of the second quarter of 2006:

Capital adequacy ratio	Number of banks	Share in total number of banks (in %)
up to 12%	2	5.3
from 12 to 20%	5	13.1
from 20 to 30%	10	26.3
over 30%	21	55.3
Total	38	100.0

The average value of adequacy ratio for total banking system equaled 28.9%,

Profitability Indicators of Banking Sector Operations

Profitability indicators of banking sector operations are presented in the table below:

Banking sector	PROFITABILITY INDICATORS					Financial result (in CSD thousand)
	Gross revenues/total assets (%)	Net revenues from interest/total assets (%)	Operational expenditures/total assets (%)	Net extraordinary revenues/total assets (%)	Operational expenditures/net revenues from interests and fees (%)	
Dec. 31, 2003	29.78	5.06	6.83	0.01	80.81	(1,055,152)
Dec. 31, 2004	37.72	4.66	6.27	0.02	84.52	(4,989,821)
Dec. 31, 2005	33.63	4.47	5.55	- 0.00	80.95	7,271,925
June 30, 2006	18.36	2.11	2.80	0.00	88.80	-3,769,755

Aggregate Report on Revenues and Expenditures

In CSD million

	01,01,- 31,12,2004	01,01,- 31,12,2005	01,01,- 30,06,2006
NET PROFIT/LOSS BASED ON INTEREST	23,787	34,654	21,170
Revenues from interest	32,171	49,015	33,452
Expenditures from interest	8,384	14,361	12,282
NET PROFIT/LOSS BASED ON FEES AND COMMISSIONS	14,050	18,469	10,436
Revenues from fees and commissions	18,189	23,478	13,359
Expenditures from fees and commissions	4,139	5,009	2,923
NET PROFIT/LOSS BASED ON INTEREST, FEES AND COMMISSIONS	37,838	53,123	31,606
NET PROFIT BASED ON SECURITIES SALE	958	1,592	- 8
Profit on the basis of securities	981	1,622	311
Losses on the basis of securities	23	30	319
NET FOREIGN EXCHANGE GAINS/LOSSES	11,202	9,978	2,657
Foreign exchange gains	86,156	122,529	99,904
Foreign exchange losses	74,954	112,551	97,247
REVENUES FROM DIVIDENDS AND SHARE	331	243	164
OTHER BUSINESS REVENUES	50,196	57,372	33,782
EXPENDITURES FROM PERMANENT WRITE-OFFS OF LOANS AND RESERVATIONS	55,978	73,396	44,976
OTHER BUSINESS EXPENDITURES	53,581	47,061	29,418
NET REVENUES/EXPENDITURES FROM CHANGE OF VALUE OF PROPERTY AND LIABILITIES	3,941	5,425	2,420
Revenues from change in value of property and liabilities	4,262	6,500	2,944
Expenditures from change in value of property and liabilities	322	1,075	524
PROFIT/LOSS FROM REGULAR OPERATIONS	-5,093	7,275	- 3,773
NET EXTRAORDINARY REVENUES/EXPENDITURES	104	-3	3
Extraordinary revenues	142	10	4
Extraordinary expenditures	38	13	1
GAIN/LOSS IN PERIOD PRIOR TO TAXATION	-4,990	7,272	- 3,770

In Q1 2006, the banking sector recorded a negative financial result in the amount of CSD 3,770 million, above all due to the disclosure of high expenditures arising from permanent write-offs of loans and provisions.

The most significant items in banking sector revenues in the second quarter of 2006 were the following: foreign exchange gains, with the share of 54.3% in total revenues, revenues from interest (18.2%), revenues from the abolishment of unused write-offs and provisioning (17.6%) and revenues from fees (7.3%). As regards the expenditures, foreign exchange losses participated with 51.8%, indirect write-offs of lending and provisioning with 24.0%, operational costs with 8.3% and wages with 6.6%.

II. NBS Regulatory Activity

During the second quarter of 2006, the National Bank of Serbia, within its regulatory competence (control and supervision of bank operations), issued the following secondary legislation (decisions and guidelines):

- ***Decision on Detailed Conditions and Manner of Conducting Bank Supervision by the National Bank of Serbia*** ("RS Official Gazette", no. 51/06). This Decision sets down the conditions and manner of conducting supervision, especially when it comes to the setting of measures and issuing orders that are at the disposal of the National Bank of Serbia. The Decision also specifies conditions and manner of instituting receivership in a bank, as well as the obligation of bank to classify, in the event of established irregularities in the classification of receivables, balance sheet assets and off-balance sheet items in line with the findings of conducted supervision and to accordingly calculate, enter into bookkeeping records and disclose in its reports the amount of provisioning for potential losses. The Decision shall be applied as of October 1, 2006.
- ***Decision on Implementing the Provisions of the New Law on Banks Relating to Granting of a Provisional Bank Founding Permit and Subsequent Issuing of a Full Operating License to a Bank, as Well as on Implementing Specific Provisions Relating to Granting Approvals of the National Bank of Serbia*** ("RS Official Gazette", no. 51/06). This Decision prescribes in more detail the conditions and manner of granting a provisional bank founding permit and full operating license, prior approval to the acquisition of own shares, approval regarding bank's articles of association, and/or amendments and supplements to the bank's articles of association and memorandum of association, approval of nominated members of the bank's managing and executive boards, approval of acquisitions and mergers of banks, and approval of status changes. The Decision also sets down the contents of evidence and data to be submitted by the bank founders together with the request for operating license. The Decision shall be implemented as of July 1, 2006, except for

the provisions relating to the granting of approval regarding the articles and memorandum of association, prior approval of nominated members of the bank's management and of the acquisition of own shares, as well as provisions pertaining to the issuing of operating license and approval of status changes (which shall be applied as of October 1, 2006).

- **Decision on Supplements to the Decision on Detailed Requirements in Implementing Articles 26 and 27 of the Law on Banks and Other Financial Organizations** ("RS Official Gazette", no. 49/06), As of September 30, 2006, banks shall be obliged to calculate risk-weighted balance sheet assets in their reports by applying the new 125% risk weighting rate on *"receivables in foreign currency or dinars indexed to a foreign currency clause or any other type of indexation that amount to no less than 10,000,000 dinars in the dinar equivalent value, and that have not been protected by the borrower against changes in the exchange rate of the dinar vis-à-vis other foreign currencies or changes in the value of any other type of indexation (by securing the receivables from such borrower under the same terms as the bank did, i.e. same foreign currency, and/or same foreign currency clause or any other type of indexation, same maturity and payment term and no less than the equal amount)"*,
- **Decision on Amendments to the Decision on Criteria for the Classification of Balance Sheet Assets and Off-Balance Sheet Items According to the Level of Collectibility and Special Provisions of Banks and Other Financial Organizations** ("RS Official Gazette", no. 49/06). Amendment to this Decision has supplemented the provision according to which receivables from natural persons, excluding housing loans, are classified into category D, if the monthly loan repayment installment, including repayment obligations in respect of the already used loans, is higher than 30% of net monthly income of such person, or if the deposit or down payment is lower than 20% of the amount of approved loan. Namely, in addition to the already used loans, the calculation of monthly repayment obligations shall encompass obligations with respect to revolving credit cards, activated warranties on loans, 50% of the amount of issued warranties on loans and obligations arising from financial lease contracts. This provision shall be implemented as of July 1, 2006.
- **Guidelines on Amendments and Supplements to the Reporting Guidelines for Banks and Other Financial Organizations** ("RS Official Gazette", no. 49/06), In line with amendments to the Decision on Detailed Requirements in Implementing Articles 26 and 27 of the Law on Banks and Other Financial Organizations, the following provision was added in the BVA form: *"Balance sheet assets with risk weighting rate of 125% - receivables in foreign currency or dinars indexed to a foreign currency clause or any other type of indexation"*

In the “RS Official Gazette“, no. 57/06, the National Bank of Serbia published decisions and guidelines for the implementation of the new Law on Banks (“RS Official Gazette“, no. 107/05) which shall be applied as of October 1, 2006.

- **Decision on Risk Management** sets down the criteria for identification, measurement, assessment and management of risks, and the manner of calculating specific indicators of bank's operations. The following risk are defined as those that the bank is particularly exposed to in its operations:
 - liquidity risk,
 - credit risk,
 - market risks (interest rate and foreign exchange risk),
 - bank exposure risk,
 - investment risk,
 - country risk,
 - operational risk.
- **Decision on Capital Adequacy Ratio of Banks** prescribes the manner of calculating bank's capital and its minimum amount (EUR 10 million in the dinar equivalent value), risk-weighted assets (increased by total open foreign exchange position of the bank), minimum level of capital adequacy ratio (12%), foreign exchange position of the bank and possibility for the capital adequacy ratio to be above the prescribed level.
- **Decision on the Classification of Balance Sheet Assets and Off-Balance Sheet Items** prescribes the conditions under which banks classify their balance sheet assets and off-balance sheet items, the manner of provisioning for potential losses (special provisions for potential losses – based on criteria set by the NBS, and provisions for general banking risks – calculated and disclosed in line with the bank's internal enactments), as well as mandatory documentation to be contained in the client credit file.
- **Decision on Terms and Conditions for Identification, Monitoring and Management of Compliance Risk** obliges banks to establish, through their internal enactments, an independent and efficient compliance supervision function of permanent nature with a view to averting risks from regulatory sanctions, material financial loss and damage to reputation.
- **Decision on External Audit of Banks** – this decision is aimed at improving cooperation with bank auditors, division of work and responsibilities. Apart from this, for the purpose of ensuring high-quality audit of the bank's financial statements, the Decision envisages the establishing of a List of External Auditors which shall include only the audit companies that meet the prescribed criteria. These auditors are expected to give, upon NBS request, a presentation of the auditing methodology used, and to submit a detailed plan for the auditing of

financial statements of each individual bank. The scope of activities of audit has also been expanded – in addition to the auditor's opinion on the main financial statements, the auditor is obligated to deliver the opinion on reports submitted by the banks to the National Bank of Serbia, as well as on the quality of internal audit, risk management system and internal control system. One of the novelties is also the obligation of auditor to enclose with the audit report a management letter and submit them to the National Bank of Serbia.

- ***Decision on the Uniform Manner of Calculating and Disclosing the Effective Interest Rate on Deposits and Loans*** – This Decision and the accompanying Guidelines prescribe the uniform manner of calculating and disclosing all costs relating to the disbursement of a loan and/or placement of a deposit, which will ensure that comparable and relevant information is available to the citizens – bank clients. The Guidelines envisage the obligation of banks to prepare and give to their clients an Overview of Basic Information on Deposits/Loans, which shall contain data both included and not included in the calculation of effective interest rate. In addition to this, banks are obligated to submit not only quarterly, but monthly reports on weighted nominal and effective interest rates on received deposits and approved loans, by type of credit/deposit bank products.