



STRENGTHENING BANK SUPERVISION IN BOSNIA-HERZEGOVINA FINAL REPORT

*Contract PCE-I-00-99-00006-00 TO 817
CTO Amy Meyers (preceded by Bryan Kurtz)
Period of Performance – July 2001 to February 2003*



FEBRUARY 28, 2003

PREPARED BY
Barent's Group of BearingPoint (formerly KPMG Consulting)
with information provided by our Advisor Team

TABLE OF CONTENTS

Executive Summary.....	2
I MAJOR ACCOMPLISHMENTS DURING CONTRACT TERM.....	7
A. Legal Framework / Crime and Corruption	7
B. Institutional Capacity.....	10
C. Early Warning System.....	11
D. Problem Banks.....	11
E. Hercegovacka Bank (HB).....	13
II HISTORICAL HIGHLIGHTS FOR THE TECHNICAL ASSISTANCE.....	16
A. Banking Sector: Two Banking Systems and One Economic Space.....	16
B. Banking Supervision: Building the Basic Regulatory and Supervisory System.....	20
Summary of Key Accomplishments for All Contracts.....	29
III ISSUES PENDING AND AREAS NEEDING ATTENTION	32
Role of the Central Bank in Banking Supervision	32
Further Depth and Institutional Capacity	33
Pro-active Approach to New Risk Areas.....	34
Advisory Role for Current Operations	35
IV. CONCLUSION: Banking System and Banking Supervision	37
ATTACHMENTS	38
USAID Task Order Requirements & Benchmarks	39
Training seminars organized by USAID Bank Supervision Project	59
U.S. Based Training arranged by Bank Supervision Project.....	60
Training Seminars and Conferences Attended by FBA in 2002-2003	61
Growth in New Currency (KM) – Acceptance of KM.....	63
Size and Growth Comparison of Two Banking Systems	64
Increased Confidence in Banks, DM Conversion to Euro	65
Growth in RS, but on a Smaller Scale	66
Participation in other Projects and Working Groups by the Advisory Team.....	67
Advisors Participation with Other Training Efforts:	68
Core Principles for Effective Banking Supervision Assessment	69
Banking Supervision Assessment Matrix (BSAM).....	73
Administrative Matters:	79
A. Project Team Staff:	79
B. Summary of Project Expenses:	81
C. Equipment Inventory at Conclusion of Contract -- February 28, 2003	84

Executive Summary

The banking sector was recently referred to as the shining star of economic reform in Bosnia and Herzegovina. This is largely due to the programs of the United States Agency for International Development, and especially this program “*Strengthening Bank Supervision*” implemented by Barents Group of BearingPoint (*formerly KPMG Consulting*). Close cooperation between the international resident advisors and the two banking agencies, Federation Banking Agency (FBA) and Banking Agency of Republika Srpska (RSBA), working in cooperation with others created a framework for sound banking and cleansing of the system. This has led to increased confidence in the changing banking system and is creating the opportunity for growth and the entry of strong foreign banks as evidenced by:

- Increased citizens deposits
- Increased in total assets of the banking system
- Trained core of banking supervision staff in both Agencies
- Successful prosecution in the courts for financial crimes
- Successful use of enforcement actions resulting in 22 reprimands and 68 monetary penalties totaling 660,800 KM.

USAID and Barents began the technical assistance in mid-1996 while Bosnia was still suffering from almost four years of war that had just ended. We have worked continuously since that time through various contracting vehicles and task orders building the basic bank supervision structures and expertise within the two entities. The current Task Order (TO) covered the period July 2001 through February 28, 2003 with its overall objective “to promote a sound, competitive, market oriented banking system”. The TO also established four specific Objectives:

1. to improve the legal and regulatory framework in which banks operate;
2. to promote the institutional development of the bank regulatory authorities in both entities and, to the extent possible, at State level;
3. to strengthen the bank regulatory authorities’ capacity to regulate and monitor the banking system and individual banks; and
4. to assist the bank regulatory authorities to establish supervisory policies and procedures and to deal with problem banks.

These objectives were to be met through the development and implementation of a full range of tools and techniques which would enable the bank regulatory authorities to regulate and supervise all Federation and Republika Srpska banking institutions. A full range of supervisory responses was also to be developed to allow them to supervise banks ranging from those fundamentally sound with only minor issues, to troubled banks where some form of official intervention may be required, to problem banks which may require closure and liquidation.

Even though the TO intended to build the overall capacity of the Banking Agencies, the level of problems in the banking system required the need to focus substantial efforts in resolving these institutions and cleansing the system. The Banking Agencies in Bosnia Herzegovina,

unlike some other transition countries, have taken decisive actions to increase the banking standards and eliminate problem situations and prosecute offenders.

The TO recognized that both the FBA and the RSBA had previously made significant progress in achieving the desired results in previous task orders which related to the basic building blocks of good bank supervision. However, since neither agency had met the international standards it was important during this TO's period of performance that appropriate policies and practices were further institutionalized and implemented. The TO was designed to further the overall capacity of the Agencies in all aspects of supervision. Specific Tangible Results that this follow-on task order focused on were:

1. The FBA will have revised and implemented a policies and procedures manual governing resolution /liquidation of problem/failed banking institutions.
2. The Federation legal/regulatory framework will have been revised to provide the FBA with appropriate authorities in problem bank resolution and liquidation.
3. The FBA and RSBA will have instituted a core in-house training program and begun the implementation of an accreditation process for examiners.
4. The FBA and RSBA will have implemented an early warning system with a functioning automated database and output capacity.

The TO was modified in July 2002 to add the provision of technical assistance to the FBA to assist the Office of the High Representative (OHR) – Provisional Administrator (PA-HB) in the resolution of Hercegovcka Bank (HB). The primary reason for intervention in this bank was that it was a key player in a conspiracy to segregate part of the country into a third entity in violation of the Dayton Peace Agreement. Only the OHR had the authority and enforcement resources to intervene and stop the movement. This modification provided resources considered necessary to assist the FBA in resolving a problem institution where pervasive insider relationships and potential fraud required expert understanding of the complex interrelationships between HB and its subsidiaries and included tasks where the FBA had not yet developed depth and expertise.

Under this modification the advisory team was to assist and guide the PA-HB and the FBA staff in achieving the following Tangible Results:

1. Resolution of the loan portfolio: The PA-HB and advisors will review and develop a resolution strategy for the loans in the commercial loan portfolio.
2. Final disposition of subsidiaries and affiliates: The technical assistance and guidance will focus on selling, merging, or liquidating remaining subsidiaries and affiliates to provide the bank with sufficient funds to payout the depositors as prescribed by law.
3. Repayment of depositors' funds: The Contractor will make a best effort to assist the PA-HB in aggressively pursuing collection on outstanding loans and the conversion of other assets to cash to allow the PA-HB to comply with the repayment of deposits following the deposit priorities set by the law.
4. Final liquidation of HB Bank: The Contractor will assist the HB-PA with a group of specialists/experts whom will provide the PA with the necessary guidance and tools to expedite the liquidation of the bank in a safe and sound manner without significantly impacting the banking system in the Federation.

We believe that the technical assistance Objectives and for the most part the Tangible Results in both the original contract and the July 2002 modification were met as demonstrated by the following:

- During the period of performance our advisors have worked with the agencies to strengthen and update the legal framework taking into account the changes in the banking sector environment. The overall goal was to assure that the laws and regulations were fully harmonized between the two agencies to create a “level playing field” for banks operating throughout the Bosnia-Herzegovina economic space. Strong efforts were made to focus the legal framework on: Basle Banking Committee guidelines, the European Union Directives, and International Best Practices. Specifically, our advisor team worked with the agencies in the following areas developing:
 - Several amendments to the Laws on the Banking Agencies to strengthen or clarify the sections pertaining to legal protection for the banking agencies and authorities on bank intervention and resolution;
 - Major amendments to further improve the Law on Banks in both entities, including changes to harmonize with other new laws, and substantial strengthening changes in many areas such as qualifying capital, investments and insider relationships and liabilities;
 - Regulations to implement the legal framework;
 - Draft and implementing changes in laws and regulations related to Anti-Money Laundering and Combating the Financing of Terrorism; and
 - Full harmonization of Laws and Regulations in both entities.
- One of the key items during this period of performance was to promote the institutional development of the bank regulatory authorities in both entities and, to the extent possible, at State level. Our advisory team has focused on harmonizing the processes, procedures and approach of both Agencies. Initial efforts also included the establishment of a performance management and examiner accreditation program. Work in the last two areas, however, was deferred as demands for FBA and RSBA senior management’s time were focused on the resolution of several severe problem bank situations. Additionally, the ongoing expectation for the structural relocation of the bank supervision function within the umbrella of the Central Bank made this a lesser priority. Once a final decision is made on the structural location, it will provide an opportunity to re-start this initiative and establish a performance management and examiner accreditation program that will foster excellence within the bank supervision staff.
- The advisory team has worked in both agencies to strengthen the bank regulatory authorities’ capacity to regulate and monitor the banking system and individual banks. Emphasis over the current contract has been focused on developing the offsite supervision function and the analysts skills. Offsite monitoring and analysis have been important in supporting and prioritizing the on-site examination process and in providing a continuous review of banks between examinations. Advisors have provided substantial classroom and on the job training from basic to more advanced analysis techniques, most recently focusing on evaluation of the level and trends, and differentiating between form and

substance. Offsite analysts from both agencies have developed considerable expertise and are properly detecting developing concerns.

- Substantial level of effort has been devoted to assist the bank regulatory authorities to establish supervisory policies and procedures and to deal with problem banks. Several intervened banks have been resolved with full payment of all deposits in cash or by transfer to another bank. This illustrates the competence and capability developed in the supervision, intervention and resolution processes. It also bodes well for sustainability of the recently established deposit insurance program.

Eight TDY advisors and resident advisors assisted at differing times in the development of comprehensive processes for identifying and supervising problem banks, intervention, management and resolution over a period exceeding three years. The processes developed include several distinct technical and procedural segments needed to complement and support the overall process, while providing options that can be tailored to the situation. Some advisors were more focused on the development of specific technical procedures while others carried the implementation forward by direct interaction and training of officials and examiners, and by acting as advisors during implementation in banks.

Over the past few year, the closing of the most problematic banks helped to change the image of the banking system and increased the level of confidence as reflected in the growth of citizens' savings which has been especially strong since the Euro conversion in late-2001. Also as a result of changing and cleansing of the system, strong well-known foreign owned banks entered and are making a significant beneficial impact.

The FBA has intervened in 20 banks and RSBA has intervened in 6 banks. Resident advisors and short-term experts provided close and active assistance on the early interventions and transitioned to providing advice as requested on the recent banks. Some intervened banks served as learning opportunities due to the intensive efforts required in their resolution. Several "lessons learned" have resulted in changes in laws, regulations and supervision procedures.

- The Modification to the Contract in July 2002 had two objectives. The first was to help train the FBA in complex resolutions, and the second was to further the resolution process at HB enough to prevent the FBA from becoming overwhelmed in the event that it had to assume full responsibility for the Provisional Administrator of HB (the "PA-HB"). The PA-HB had been appointed by the Office of the High Representative ("OHR") to resolve HB. HB was a bank that was problematic both because of political concerns and the complexity of its affiliate group. The FBA was under mandate from OHR to support the PA-HB, but had not fully developed expertise in complex resolutions involving operating subsidiaries.

Our advisor team worked with the PA-HB and FBA personnel to:

- Review and develop a resolution strategy for the loans in the commercial loan portfolio.— Our advisors evaluated the various loan portfolios and provided guidance in establishing restructuring and other collection efforts to ensure that the maximum cash was recovered for all loans. The evaluation and

documentation of new restructure plans also increased the potential value that this loans would generate in the sale process.

- Prepare the strategy and marketing efforts for final disposition of HB subsidiaries and affiliates -- Experts reviewed the various operating subsidiaries and affiliates of HB to establish a reasonable strategy for its sale or liquidation. The major assets in this endeavor included the insurance companies (Hercegovina Osiguranje) and the telecommunications company (Eronet). Specific action plans were proposed to the PA-HB for consideration and approval.
- Establish procedures and processes to pursue the collection of outstanding loans and the conversion of other assets to cash to allow the PA-HB funds to comply with the repayment of depositors' funds based on the priorities established by the Law. – Substantial collections were obtained as a result of our guidance and deposits of citizens up to 5,000 KM were paid. Currently, the PA-HB has sufficient funds to repay a substantial amount of the depositors' claims, while waiting for the final sale/liquidation of the major assets.
- Assist the PA with the necessary guidance and tools to expedite the liquidation of the bank without significantly impacting the banking system in the Federation. – We prepared the necessary marketing and database to allow the PA-HB to “tender the bank”. The final resolution and actual tender was halted by OHR in September 2002 and is currently programmed for first half of 2003. Although much of the marketing database and format can still be used, it will take time to update the financial information needed to go forward with the tender.

Although the final resolution of HB was not accomplished within the period of performance, the work performed by our advisory team will allow for a quick marketing period and more likely higher repayment of depositor funds.

In addition to the accomplishments and activities carried out by our advisory team in accordance with the TO, our resident advisors also participated in other major initiatives related to Financial Sector Reform. Their participation, with concurrence from USAID, in various interagency and multi-institutional working groups has been beneficial in the development and is contributing to a stronger banking system to facilitate a more vibrant economy with banks that can be trusted to return depositors funds when requested. The cleansing of the system by removing the worst banks and progressively raising the standards has provided an attractive bank market as indicated by the recent entry of strong, well-known foreign owned banks.

For additional information we refer you to the body of this Final Report which identifies both the Accomplishments of this contract and highlights those from prior contracts.

I MAJOR ACCOMPLISHMENTS DURING CONTRACT TERM

This project continued to focus on major functional areas of legal and regulatory framework, on-site examinations, offsite report surveillance and removal of problem banks from the system. These were accomplished through intensive technical assistance, including hands-on work, advice, and classroom and on-the-job training. Advisors, both resident and visiting, have had ongoing interaction with Agency counterparts, USAID, Central Bank and other members of the international community. Other related areas where support has been given include bank privatization, anti-money-laundering, preventing the financing of terrorist activities, SME lending programs and deposit insurance.

Barents' advisors have transferred the processes developed with FBA to RSBA through training, one-on-one efforts in the agency and in-bank OJT. Substantial resources were also devoted to the assistance to the FBA and the PA-HB to resolve the situation of Hercegovacka Bank. HB was a problematic institution both because of political concerns and the complexity of its affiliate group ownership structure. The lessons learned through the resolution of HB are already being incorporated by FBA in their procedures and will likely also be replicated in the RSBA, where problem bank resolution has not been as intensive to date.

This section describes the accomplishment of our advisory team during the period July 2001 through February 2003. As a result of the technical assistance the FBA and RSBA have benefited in the following:

- A harmonized legal regulatory framework that allows for a competitive banking system while providing the necessary safeguards to protect depositors funds.
- A strong core of examiners has been developed that can supervise the current banking system based on the level of risk in the banks operations.
- A highly competent bank supervision staff particularly in areas related to problem bank intervention and resolution.
- A supervision system that allows the Agencies to regulate and monitor the banking system and individual banks.
- An internal capacity within the Agencies to establish training targets and recognize that this capacity must further developed and supplemented with outside resources.

A. Legal Framework / Crime and Corruption

Over the period of performance advisors worked closely with the Agencies and other government representatives to assure full harmonization of the legal structure while at the same time providing the standards and safeguards that would encourage a competitive and vibrant banking environment.

Our work on legal framework focused on the following aspects:

- Several amendments were made to strengthen or clarify the laws particularly pertaining to legal protection being expanded to cover the banking agencies and their managing boards, and clarification and expansion of authorities on

bank intervention and resolution such as payment of deposits to small depositors. Some changes were considered urgent for enactment by Decree of the OHR.

- Major amendments were developed in 2001-02 to further improve the Law on Banks in both entities. Many of the changes during the complete review of the laws over the 16-months time period were to harmonize with other new laws, but substantial strengthening changes were made in many areas such as: qualifying capital, investments, and insider relationships and liabilities.
- Regulations were issued to implement the legal framework. The major changes in Law required a substantial effort to revise or draft new regulations. Representatives of the two banking agencies met at a remote location to work jointly in teams on the regulations. They completed 16 of the new regulations and since they produced a joint regulation, harmonization was not a problem. Advisors were present for consultation on new and unfamiliar areas.
- Many technical changes were made in the licensing procedures in late-2002 following the changes and amendments to the Law on Banks. FBA licensing officials presented the final draft of their revised procedures to the resident advisor in October 2002 for review before presentation to the Managing Board.
- RSBA officials presented essentially identical procedures to its Managing Board in March 2003. This is also an example of the cooperation and harmonization displayed between the two agencies.

Advisors, throughout the USAID funded assistance, have actively encouraged the bank supervision agencies to be alert for violations and suspicious activities, and to investigate, document and refer the information for (possible) prosecution. Initially, examiners were reluctant as they thought this beyond their authority and responsibility. And, they perceived this to be acting in a judgmental and accusatory fashion.

However, the damages done to banks and their depositors by the abuses and misapplication of funds demonstrated the need for examiners to be more proactive towards suspicious activities, especially involving related parties. It was obvious that the image of the banking system would not improve if such insider and related party abuses were allowed to continue or to go unpunished. The quality and thoroughness of the examiners documentation has allowed the prosecutors to be successful in pursuing charges on these individuals. This in turn, has provided the FBA with the necessary support to continue their efforts.

Investigative work performed by Examiners in one bank became the basis for eleven referrals by the Financial Police for prosecution. The cases include from 1 to 13 individuals each. Two cases have reached verdict with a total of 9.5 years against the former Director (tried in absentia), with 4 and 3.5 years for two other individuals. One case that was dismissed against two related parties has been ordered for retrial by a higher court. This bank fraud case achieved high publicity due the family's notoriety and connections with political figures. The

thefts and misuse of funds included the funds of major donor organizations providing aid to Bosnian citizens.

Examiners also provided documentation in another bank case that resulted in sentences against nine individuals ranging from 6 months (suspended) to 4.5 years in prison. The Director of the bank was stealing funds from depositors and he ordered employees to falsify documents on some thefts. Again, the thefts included the funds of major donor organizations.

Advisors also assisted the Agencies in a number of investigations that arose as a result of discoveries during examinations. Several examiners from the two agencies have developed a high level of expertise. Technical assistance is also being provided to the FBA on establishment of a separate department focused on these issues and financial crime. Enforcement and prosecutor bodies frequently call on the agencies for assistance in bank investigations. FBA examiners and officials are developing a training seminar on *“Financial Crime: Anti-Money Laundering and Combating the Financing of Terrorism”* for presentation to the newly formed Federation Intelligence and Security Service at their request. This reflects the respect developing for their competence in this area.

The sources of financial crimes did not only surface in existing bank operations, but also started in prospective activities. Banks that were having capitalization problems became targets for fraud schemes. Advisors spent a good deal of time educating the officials and examiners on the various schemes and their manner of operation. Several banks got involved but could not complete their part of the financial transactions; therefore the damage was not a significant cause in their demise.

Advisors had provided joint-agency classroom training on “Financial Crimes and Money Laundering” in 1998. Early in this period of performance (October 2001) Advisors also participated in drafting the initial Law for Anti Money Laundering and Preventing the Financing of Terrorist Activities. The initial draft was followed by ongoing advice and participation in Working Groups at the Agencies and government levels to draft the final Law. This renewed emphasis on Financial Crimes and the increased sources of activity prompted the need for additional Anti-Money Laundering training in June 2002.

The Bank Supervision Project and both banking agencies have also participated in an Anti-Money Laundering working group to develop information on the situation and problems, and to recommend changes to improve the level of compliance to prevent or detect money laundering. This includes a major role in a working group that produced a booklet on information and recommendations. This group plans to re-start its efforts in March 2003 by updating the status of the recommendations and determining additional actions needed.

The new Minister of Treasury (state level) has indicated an interest in getting a state level law enacted and the implementation of effective procedures for anti-money laundering and tax evasion. A long-awaited law for the state level has been drafted and is reported to be in the process of review through the government to Parliament. Advisors provided the Minister a copy of the Anti-Money Laundering booklet prepared by the working group.

Recent changes made in the entity Laws on Banks and Banking Agencies clarified authority and responsibility in this area. Advisors assisted the agencies in developing a comprehensive regulation that clarifies and expands the requirements for banks regarding “Know Your Customer” and “Report Suspicious Transactions”. It includes specific requirements for banks regarding an internal compliance system, designated compliance official, internal audit, external audit, training, etc. It also includes requirements for procedures for preventing the financing of terrorist activity.

Advisors assisted both Agencies in drafting examination procedures to test compliance. RSBA completed its first draft in October 2002. FBA is establishing a department within Bank Supervision to specialize in Anti-Money Laundering and Preventing the Financing of Terrorist Activities. These specialists will operate separately on Targeted Examinations and jointly with Onsite Examiners on Full-Scope Examinations. This will build expertise and focus the efforts while facilitating an increase in knowledge for all examiners.

B. Institutional Capacity

Initial guidance was provided to help develop the basic framework for Performance Management and Examiner Accreditation Programs. In late 2001, the possibility of consolidating the bank supervision function under the umbrella of the Central Bank surfaced and further actions in this area were deferred until a decision on the “structural location” was issued. To date, this issue is still not decided but several studies and Working Groups have been established to develop the transition process to make it happen.

Although the institutional capacity tangible results of the current task order were not fully met, several ongoing training initiatives have been met. Most importantly, the Agencies have taken the initiative to include and approve in their 2002 and 2003 Work Plans the need for ongoing training provided by foreign experts, training at in-country seminars and external seminars. The Plan also allotted one week per quarter for formal staff training and suggested the make up of examination teams be structured to spread the experience and to provide ongoing training. Also, the FBA has become a member of the Association of Banking Supervisors of Central and Eastern Europe and established contacts with other banking supervisors and sources of training.

Advisors arranged for two examiners and project associate to participate in a comprehensive “Train-the-Trainer” seminar presented by another USAID project. Advisors then presented a tailored “Train-the-Trainer” seminar for the two agencies. Advisors and project associate frequently assist officials to develop presentations for internal or external meetings and seminars.

Advisors also assisted officials to develop a general plan for internal training and established relationships for external training and seminars to continue the learning and development of staff competencies for sustainability after the advisors are gone. FBA has designated a position to research changing risks and threats and the development of counter measures so that the Agencies can remain abreast of current banking supervision techniques. This includes planning for the development and training of supervision staff and planning for the changes in

procedures in view of those changing activities and risks. This position has not been filled but two officials are performing preliminary work in this respect.

A listing of classroom and outside training is included in the Attachments to this Report.

C. Early Warning System

During this period of performance, Advisors jointly continued the development of the process for offsite review and analysis with the two agencies. Development of an automated database has been different in the Agencies, however, the analytical skills development and training has been provided jointly. Advisors have provided considerable classroom training and OJT from basic to more advanced analysis techniques, most recently focusing on efficiencies, significance and differentiating between form and substance. The offsite analysts from both agencies have developed considerable expertise and are properly detecting concerns from their analysis. As a result, although emanating from differing database systems, the quality of the analysis for individual banks at both Agencies is similar.

A PC-based database and analysis program was developed at the FBA to provide analysis capability until a more comprehensive database program is adopted. This PC program facilitates offsite analysis by providing bank trend and comparison analysis and indicating variances. Although the system is functional it could be improved substantially through upgraded IT structure. FBA planned a mainframe structure so they did not place as much emphasis on fully developing the PC-based programs. The FBA has invested substantial monies in the development of the mainframe application but has yet to be able to implement this version.

RSBA offsite department has developed its PC database automation to a higher degree than FBA due to a different objective in computerization plan. With consolidation of the bank supervision function, these systems are likely to be replaced with a modified and centralized bank database accessible to bank supervision, the Central Bank and the Deposit Insurance Agency.

D. Problem Banks

A major area that Barents advisors have been extremely active is the development of comprehensive processes to deal with problem banks. Examiners and officials were trained in risk identification, and in documenting, communicating, enforcing and resolving problems. Initially, advisors were actively involved in the process but this has transitioned in the Federation to providing advice on request for unusual or complicated situations. The FBA has demonstrated a high level of competency and performance in this area and the types of intervention have been very diversified. More assistance is needed in the RS as they have had less experience with problem banks and resolution, and their experience has been limited to very small or dead banks.

A key reason for the success of the process is that FBA implemented the use of a Supervision Review Board composed of the Director, the Deputy Director, and the Heads of: Supervision,

Onsite Supervision, Offsite Supervision, Licensing and Legal. The Director is a non-voting member but has final authority for decision. The SRB reviews the overall conclusions from the examination, the recommended ratings, supervision strategies and follow-on action plans prepared by the examination team and their supervisors. Preparing for presentation to the SRB also focuses the examination team and their supervisors on the more significant issues, needed corrective actions and strategy to reach objectives. They are integrated into the overall process.

This process primarily focuses on banks with identified concerns, trends or issues in an effort to take the most effective action appropriate to correct the problems before further deterioration, but the SRB is also the decision point for Provisional Administration. This process helps by sharing supervision knowledge, competence, decision-making and problem resolution while maintaining a high level of consistency in actions. It ties in all areas of supervision, licensing and legal to ensure all Agency areas are alerted and aware of the situation and plans, e.g., a branch application may be pending on a bank under review for an enforcement action. This process also promotes progressive administrative actions in relation to the degree of the problem and risk.

Advisors also developed comprehensive procedures for bank intervention and resolution from planning the take-over through temporary management, deposit pay-out, selling or merger, and liquidation. These procedures were mostly developed jointly with the FBA as the private banks in the Federation were the active and volatile banks during the 1998 – 2001 period. Some of these unstable banks became illiquid and insolvent, needing intervention. Many of these problem banks were the result of insider and related party abuses and misuse of bank funds.

The state-owned banks in the Federation and Republika Srpska were mostly illiquid and not active enough to have much volatility, but some did require intervention for lack of liquidity. As originally designed, the USAID Technical Assistance and Scope of Work had projected the resolution of the state banks to be the initial focus of attention. However, government officials in both entities resisted privatization or liquidation of state owned banks fearing a loss of control and a loss of jobs. They delayed the process, and state-owned banks remained in limbo for most of the technical assistance period.

However, over time, the state banks were being marginalized by the growth of private banks, and this accelerated when the large well-known foreign banks began entering in mid-2000 as the system was being cleansed of the worse banks. The well-known foreign-owned banks moved from entry to domination in two years with three now holding over 60% of total assets in the Federation banking system.

Resident Advisor and project staff continue to work with the Liquidator of BH Bank and the Coordination Support Group that supports the Liquidator by trying to remove the obstacles to liquidation and to resolve the situation. This Group is composed of Ambassadors and/or representatives from the U.S., Swiss and Malaysian Embassies, OSCE, Norway's Peoples Aid and Ombudsman's Office. The objectives of the Group are: recover the depositors' funds, punish the guilty, and change the system to prevent recurrence.

Resolving problem banks, including their liquidation or bankruptcy if a sale or merger did not occur, has been one of the most difficult issues for the Agencies. It was opposed and misunderstood, and there were multiple obstacles to overcome. The commonly held local view was that banks with problems should be rehabilitated or restructured, but not closed.

The agencies have developed considerable expertise in supervision and intervention as reflected in the following:

Federation Banking Agency:

20 banks have been intervened by FBA and provisional administrators appointed (*plus 1 intervention by OHR for Anti-Dayton activities*)

- 6 banks were merged with deposit liabilities transferred
- 6 banks went to the Bankruptcy Court (*1 sold, 30% deposit coverage*)
- 5 banks were liquidated by the FBA (*full or majority deposit payout*)
- 1 bank remains in FBA liquidation (*partial deposit payout*)
- 3 banks remain in Provisional Administration (*1 selling with deposits covered*)

In addition, FBA has used a range of administrative actions designed to obtain correction of problems or practices. The most common action is an Order requiring specific actions by the bank within certain timelines for each action. FBA also referred 111 cases to the Federal Violations Committee in the past four years. This resulted in 22 Reprimands and 68 Monetary Penalties totaling 660,800 KM (*534,000 on banks and 126,800 on individuals*). Most of the monetary penalties were appealed. The FBA and Violations Committee were upheld on all appeals, indicating the quality of case preparation and documentation. Several cases were suspended or withdrawn, most because the bank was no longer in operation.

Banking Agency of Republika Srpska:

6 banks intervened by RSBA

- 5 banks were sent to Bankruptcy Court
- 1 postal savings bank license revoked, discontinued commercial banking

The Republika Srpska banking system is much smaller than that of the Federation (about one-fourth the asset size). Thus, RSBA has not had as many nor the variety of problem banks as FBA. But the Agency has actively cooperated with advisors in the development of procedures to identify problem banks, intervene and resolve the banks. Additional assistance is needed at RSBA to further develop capacity.

E. Hercegovacka Bank (HB)

Hercegovacka Bank (intervened by Office of High Representative on April 6, 2001) also served as a special learning opportunity due to the intensive efforts required. It was intervened as the central part of an illegal political effort to form a “third entity” in violation of the Dayton Peace Accords. It illustrated serious problems similar to BH Bank and other problem banks though concentrated and to the extreme. It hid its wrongdoings under a veil of

outward progress and success. It has also provided “lessons learned” that have helped cause changes in laws, regulations and supervision procedures.

At the time initial assistance was provided in October 2001, HB consisted of a tangled structure of interlocking subsidiaries, many with outsider minority shareholdings. A number of subsidiaries held stakes in each other, and interlocking shareholdings existed at second- and third-tier subsidiaries. In an effort to streamline the corporate structure, and untangle the corporate ownership to permit resolution, a number of subsidiaries were sold, merged or wound down. In particular, as HO had minority shareholders who could block a distribution of proceeds from the sale of Eronet, advisors recommended a strategy giving PA-HB a super-majority of HO shares to permit PA-HB unfettered control of HO. Working closely with the loan restructuring department, PA-HB was able to increase its holdings from 66% of HO to in excess of 80% of HO, allowing super-majority rights.

The Task Order was modified in July 2002 to add provision of technical assistance to the FBA in its role of supporting the resolution of Hercegovačka Banka (“HB”). By July 2002, the PA-HB had determined that the best value for HB would be to allow investors to value the HB franchise as a whole, in line with the “bancassurance” model prevalent in Europe. Advisors devised a sales strategy that would allow bidders to either value the HB complex as a whole, or to pick and choose the components that fitted their needs. This flexibility would allow the marketplace to determine if the “bancassurance” model did indeed yield a higher value than the components separately, while still allowing investors the option to price assets on an individual basis.

Given the concern over delays in resolution of the Eronet licensing issues, advisors developed a plan to allow Eronet to be dividdened upstream to HB, without damaging the rights of minority shareholders, and without rendering HO insolvent. In the event that Eronet was not resolved by the scheduled marketing date, Eronet could be left in the corporate shell, along with any remaining depositor claims, for final resolution in the bankruptcy process.

As of September 30, 2002, advisors were ready to take HB to market. As OHR prerequisites to allow the sale to begin were not completed by September 30, USAID decided to delay further assistance until these prerequisites were met. As of September 30, 2002, assistance was suspended to PA-HB, preventing the implementation of the final action steps. However, significant achievements were made in the four key tangible results cited in the Task Order:

- Resolution of the loan portfolio – Our advisors guided and assisted the PA to review and develop a resolution strategy for the loans in the commercial and citizens loan portfolios. Our advisors evaluated the various loan portfolios and provided guidance in establishing restructuring and other collection efforts to ensure that the maximum cash was recovered for all loans. The evaluation and documentation of new restructure plans also increased the potential value that these loans would generate in the sale process. As of September 2002, advisors had resolved approximately KM56 million or 82% of the original portfolio amounts (KM 68 million) through either restructure or legal collection efforts.

- Final disposition of subsidiaries and affiliates – Experts assisted in the review of the various operating subsidiaries and affiliates of HB to establish a reasonable strategy for its sale or liquidation. The major assets in this endeavor included the insurance companies (Hercegovina Osiguranje) and the telecommunications company (Eronet). Specific action plans were proposed to the PA-HB for consideration and approval. All steps and marketing materials have been designed to allow for the “tender of the bank” as a whole or on an asset-by-asset basis.
- Repayment of depositors’ funds – Advisors guided in establishing the procedures and processes to pursue the collection of outstanding loans and the conversion of other assets to cash to allow the PA-HB funds to comply with the repayment of depositors’ funds based on the priorities established by the Law. Substantial collections were obtained as a result of our guidance. Currently, the PA-HB has sufficient funds to repay a substantial amount of the depositors, while awaiting for the final sale/liquidation of the major assets. The PA-HB made a determination to delay this distribution until the completion of the “tender” process to allow a purchaser to have the chance to retain depositors as customers.
- Final Liquidation of HB Bank – Our advisory team continued to assist the PA with the necessary guidance and tools to expedite the liquidation of the bank without significantly impacting the banking system in the Federation. We prepared the necessary marketing and database to allow the PA-HB to “tender the bank”. Much of the marketing database and format can still be used, it will take time to update the financial information needed to go forward with the tender.

Overall our “*Strengthening the Bank Supervision Program*” has been very successful. The Agencies have now, the basic tools to supervise their current banking system and in several areas, they have now taking ownership and leadership in the design and development of the supervisory function. There are still some other areas and new activities that merit further attention and are described in the later sections of this Report.

II HISTORICAL HIGHLIGHTS FOR THE TECHNICAL ASSISTANCE

A. Banking Sector: Two Banking Systems and One Economic Space

It is important to recognize that the past seven years have provided for major changes in the economic development of the banking system in Bosnia-Herzegovina. In order to fully understand the current banking system structure, however, we must recall the banking conditions that were inherited from the Socialist regime dating prior to the civil war of the 1990's. It is clear that some of the problems present in the banking system today have their roots in an era where State ownership and control did not require safe and sound banking practices or good corporate governance of the individual institutions. The Banking system can be segregated into three periods:

Historical Period	<i>Before the war (Pre-1992)</i>	<i>During the war (1992 – 1995)</i>	<i>Following the war (1996 - forward)</i>
Banking System Characteristics	<p><i>Weak banking system</i></p> <ul style="list-style-type: none"> ➤ State banks dominated ➤ State banks burdened by large debts due to foreign creditors for on-lending to state-owned enterprises ➤ Ownership shifting from State to state-owned-enterprises ➤ Largest borrowers and depositors became the primary owners ➤ Capital was often illiquid, consisting of fixed assets ➤ Some large branches converted to separate banks ➤ Private banks permitted with very low capital requirements. ➤ Private capital often existed because of the bank's own loans ➤ Most private banks facilitated the owner's needs ➤ Citizens and private business had little access to bank loans 	<p><i>Fragmented banking system</i></p> <ul style="list-style-type: none"> ➤ Branches in different ethnic areas from HQ broke away, formed new banks ➤ Most banks followed the old patterns of operation and relationships ➤ Owners were the largest borrowers and their loans were non-performing ➤ Banks had little liquidity and could not make new loans ➤ Three different currencies were used in the three ethnic areas ➤ Foreign currency deposits in State banks were transferred to Belgrade ➤ Hyper-inflation destroyed domestic currency savings ➤ Lending ability evaporated with the currencies ➤ Private banks varied a lot in quality of management, condition and operation 	<p><i>Influx of donor funds provided opportunities</i></p> <ul style="list-style-type: none"> ➤ Banks quickly moved to attract the new activities and funds ➤ Banks did not have funding for loans, so they focused on fee-based activities ➤ Some banks provided better and faster service than others, and were billed as the likely stars of the future in a market-oriented banking system ➤ Some bankers saw the influx of funds as an opportunity to build the bank, economy and community ➤ Unscrupulous bankers saw fresh money as funding for related businesses and investments, i.e., they used other people's monies for their own purposes ➤ Many banks did not have competent officials, systems or corporate governance ➤ Many private banks became volatile as they mismanaged the new funds and tried to conceal their actions as long as possible

The war ended with the signing of the Dayton Peace Accords - General Framework Agreement for Peace (GFAP) in November 1995. The agreement recognized the state of Bosnia and Herzegovina, made up of two entities, the Federation of Bosnia-Herzegovina (mostly Croat and Bosniak ethnicity) and Republika Srpska (mostly Serb ethnicity). The international community and Bosnian leaders tried to jump-start the economy while building a workable governmental framework.

The complicated structure of governments put much political power at the entity level, leaving a weakened State government. Although the entities are roughly equal in geographic size, the Federation contained about 60% of the population and proved to be much stronger economically, in part because of Sarajevo, the capital city. The international community’s initial focus was in Sarajevo, then it extended to other areas. The Federation also includes Mostar, which has historically had significant resources and wealth and Tuzla, an area of industry. The influx of international people, humanitarian aid and donor funds meant that lots of money began flowing into the country and within the country.

Ownership structure has also been a major factor in reform and performance differentiation between the two banking systems as illustrated in the following comparisons. Slow growth began in the private banks and then exploded in the well-known foreign-owned banks during conversion to Euro as the anchor currency for the KM. State banks remained in limbo, even those technically privatized but not materially changed.

Number & Ownership Structure of Banks

	YE-1998			NOW – February 28, 2003		
	State	Private	Total	State	Private	Total
Federation	11	44	55	6	21	27
RS	12	6	18	1*	10	11
Total Banks			72			38

**Note: Approved sale/merger in process.*

The privatization of state banks was delayed in both entities as government officials feared a backlash to bank closings and the loss of jobs. Some government officials also felt they had to retain some control over the state banks and their destiny. The reluctance of government officials to enforce deadlines for privatization left the banks waiting in limbo. Privatization laws were drafted in 1996-97 and enacted in 1998 with deadlines in 2000 for privatization or liquidation, subsequently extended to YE-2002. The delay in privatization had a more adverse impact in the RS due to the dominance of state banks in the system and the very small presence of private banks. The Federation banking system was much larger and even though dominated also by state banks, it contained more and larger private banks, therefore, it was more active. Meanwhile, the private banks had begun growing and marginalizing the state banks awaiting privatization. New savings deposits began increasing in private banks, especially in the Federation. Citizens’ confidence in banks began increasing, but the deposits were concentrating in a few private banks.

The entrance of large well-known foreign owned banks signaled the beginning of significant structural reform and changes in the sector. The domestic system lacked capital due to

economic weakness and lacked management expertise for a market-oriented economy due to the previous central planning system. Many of the new entrants were foreign owners with banks in neighboring countries that were filling in the economic territory to broaden their market areas across Central and Eastern Europe and to facilitate cross-border business. Additionally, strong deposit growth began in a few banks and increased sharply during currency conversion (*See graphs in Attachments*). Another beneficial impact of the new entrants was the reduction in fees and interest rates prompted by the increased competition.

Federation banking system selected data KM (000,000)

	YE-1998	YE-1999	YE-2000	YE-2001	YE-2002
Number of Banks	55	44	38	34	29*
Total Deposits	1,185	1,569	1,763	2,900	3,528
Citizens Deposits	332	388	462	1,334	1,482
Total Loans	1,214	1,160	1,308	1,727	2,691
Net Profit (Losses)	(5)	(69)	(43)	(27)	17

**Note: The number of banks decreased to 27 in early-2003.*

Profitability: Significant change has occurred. Heavy losses reported as the system was being cleansed of the worst banks. In 2001, 25 banks had Net Profits totaling 33 million KM and 7 banks had Net Losses totaling 60 million KM. In the year 2002, 20 banks had NP 40 million and 8 banks had a Net Loss of 22 million.

Republika Srpska is smaller, with a difficult political position in some areas, including the entity government often being non-cooperative with the Office of High Representative and international donors. The RS further suffered a major economic set-back during the conflict in Kosovo and Serbia as Serbia was their principal trading partner. Rapid inflation of the currency in use then (YD) was also a significant factor in the RS during that conflict.

New citizens and private business deposits went overwhelmingly to the new well-known foreign-owned banks. RS customers have deposited over KM 100 million or 16% of total RS deposits at branches of two well-known foreign-owned banks headquartered in the Federation. Less well-known foreign banks have not attracted new deposits and one in the Federation was liquidated.

Republika Srpska banking system selected data --KM (000,000)

	YE-1999	YE-2000	YE-2001	YE-2002
Number of Banks	17	15	15	11 *
Total Deposits	269	331	423	630
Citizens Deposits	30	54	107	146
Total Loans	295	344	377	523
Net Profits (Losses)	8	(3.2)	(3.3)	(29)

** Note: One bank is process of sale and merger.*

Profitability The RS Banking System has realized small losses on a low volume of activity. The loss reported for resulted almost totally from recognition of significant losses in one bank being acquired in privatization.

There have been some important factors that also spurred changes in the banking system in the period 2000 through 2001. These included:

- Conversion of the anchor currency: The conversion of the Deutsche Mark and hard currencies to Euro in late-2001 prompted a sharp increase in bank funds, especially citizens' savings deposits. The conversion was a stimulus for growth, for which groundwork had been laid by banking reforms that increased confidence in system. New deposits concentrated in a few well-known foreign owned banks and provided increased funds for lending. This led to rapid growth in loans to citizens and private business beginning in late 2001 that has continued strong, albeit at a slower rate into 2003. *See Graphs in Attachments.*
- Reform of the payments transfer system: The prior payments bureau, ZPP, centrally controlled the money flows within the former Yugoslavia and then within each independent successor state. As a result of the war, Bosnia had three separate payment bureaus each using a separate currency. The three payment bureaus did not interact directly on inter-entity transactions. This system stifled business operations and growth, while not preventing gray market activities. The elimination on 1/5/01 was a key step towards a market-oriented economy. The payments function was transferred to commercial banks and immediately banks noted increase in bank funds, fee income and better information on transactions and balances.
- Deposit Insurance initiated in February 2001: Although only 4 banks qualified at that time this has been a great step in building confidence in banks. Currently, 10 banks participate as of February 2003, still all in the Federation. One RS bank is projected to be qualified at the end of March. The signs are very positive as banks are required to join the insurance system by August 2003 if they want to retain their license. Overall, the deposit insurance benefits smaller domestic owned banks in competition.

The banking system in Bosnia-Herzegovina will continue to evolve with significant consolidation expected in 2003. It is estimated that the total banking system at YE 2003 will be approximately 18-20 institutions in the Federation and 7-8 in the RS. Most of the attrition will result from:

- Privatization deadline: The IMF Standby Agreement with governments requires compliance or intervention by March 31, 2003. Although this deadline was originally scheduled for year end 2002 and applies to 6 Federation banks (*5 included in 7 listed below, plus 1 bank in process of restructure and re-offering*). All Republika Srpska banks have been privatized or are in process with finalization expected before March 31, 2003
- Minimum Capital: The minimum regulatory capital was increased to KM 15 million by YE-2002. The IMF Standby Agreement with governments requires compliance or intervention by March 31, 2003. The resolution of 7 Federation banks (2 with exemption in law for possible transformation to development agencies, 1 exemption for bank restructure plan by international investor, 2 under provisional administration by FBA and remaining 2 in government assisted negotiation). It also applies to 2 RS banks in process of merger.

The above may trigger bank supervision interventions in April-June in the remaining state banks that fail privatization. As a result, the banking system in both entities will likely contract by YE 2003.

B. Banking Supervision: Building the Basic Regulatory and Supervisory System

The development of bank supervision in Bosnia-Herzegovina has closely followed and has been affected by the evolution of its banking system. Although progress has been made year-on-year, there have been periods of rapid changes followed by others where implementation and internalization of processes was more gradual. Recognizing the accomplishments of USAID's current Bank Supervision project must also acknowledge the intensive efforts of previous contracts' activities. The following section describes the accomplishments and challenges faced by our team during the entire tenure of the Technical Assistance.

Before the Bank Supervision Project

During the war years (1992-1995) three banking authorities were established along ethnic divisions. This resulted in banks licensed by one of three different authorities located in Sarajevo (National Bank - BiH), Mostar (Ministry of Finance) and Banja Luka (National Bank - RS). These regulatory authorities, however, had limited supervision authority and capability under these circumstances.

Following the Dayton Peace Accord in 1995, two banking agencies were created, one for each entity, though there was only one Central Bank, at the state level. The National Banks were replaced with a new Central Bank established in 1997 and operating on Currency Board principles. The new Central Bank had an IMF approved international banker as its Governor for the first six years or until August 2003. The Central Bank has maintained a stable currency and enjoys high public confidence. It also handles payments transfers in the commercial banking system. The Central Bank, however, cannot expand the money supply beyond hard currency reserves, provide liquidity to the banking system, act as a lender of last resort to banks or lend money to the government. These restrictions were initially perceived to be a handicap to the banking system, but it has been a positive resulting in stable currency, low inflation and resistant to pressures to rescue, rehabilitate and prop up weak banks.

In mid January 1996 USAID contracted Barents to perform Diagnostic Reviews of a sample of banks in the Federation of Bosnia-Herzegovina. The objective was to gather information about the banking system, existing banks, their financial condition, management and lending competencies for participation in an on-lending and bank development program being developed by USAID. A team of 10 people began an assignment of 4 weeks. Most of the members had banking, regulation or resolution experience, and one was a professor of anthropology with extensive experience in the Balkans. The team reviewed 18 banks through 1 to 3 days onsite visits. They developed a report on the banking system with separate sections for the individual banks.

USAID officials designed an on-lending program to provide banks a way to help their customers and the economy while earning fees for their services and improving their lending

expertise in new types of lending based on market principles. This assistance included components for classroom training in credit and in-bank training through the on-lending process. Another contractor implemented the program in June 1996.

During this same period of 1996, the new governments enacted weak laws from the old laws with quick, band-aid like changes so the government could function. Expert teams were formed with representatives from the three ethnic areas, Ministries of Finance, and the international groups. These Expert teams began working on a number of laws including:

- Law on Banks
- Law on Banking Agency
- Laws on Privatization and Opening Balance Sheets
- Law on Central Bank

The new Laws established the working framework to reactivate the banking system in Bosnia-Herzegovina. However, much work had to be done to implement the new laws and establish the new regulatory entities.

Initial Steps and Expansion into the RS

USAID's technical assistance program, "*Strengthening Bank Supervision*", began with two resident advisors located in Sarajevo to work with the FBA that had been enabled by laws enacted in June 1996. This Agency had to be built new and separate from the National Bank in Sarajevo and the Ministry of Finance in Mostar.

The new laws had been hastily modified from old laws and enacted in response to the requests of IMF, World Bank, USAID and others offering assistance. Advisors began their work by focusing on the legal framework, interim regulations, policies, procedures and organizational actions needed to build a completely new, competent bank supervision agency.

Three advisors from Barents arrived in July 1996 to begin technical assistance to strengthen bank supervision under contract with USAID. The timing of the project's start had been delayed for several weeks awaiting enactment of a new law in June 1996 establishing the Federation Banking Agency (FBA). Dale Wilson and Dan Berney were to be resident advisors and David Cooke, Senior Policy Advisor, came for 3 weeks to provide start-up guidance and returned periodically to monitor progress.

Advisors met with the recently named FBA Director. He was the only person in the FBA. There was no Deputy, Managing Board or examiners. The FBA was in its pre-formation stage, i.e., no staff, no office, no equipment and no budget (except for 50,000 marks committed by the government for initial start-up expenses). The Director and resident advisor met with USAID and The World Bank who entered into an agreement that USAID would continue their technical assistance for an extended period and The World Bank would shift its planned technical assistance funding to provide capital (computers, furniture, autos, etc.) and operating expenses (salaries, lease, etc.). This funding continued to YE-1998 when the FBA became self-financing through fees and assessments.

The government named a Deputy and Managing Board in August 1996. The Deputy became full-time in October after closing out his duties at the National Bank. Another person from the National Bank arrived shortly afterwards to head up Bank Supervision and Licensing. And, three examiners from the National Bank were transferred to FBA by agreement beginning the first of November 1996. Advertisements were placed for additional examiners and other staff.

The initiation of technical assistance in Republika Srpska lagged behind the Federation due primarily to political obstacles. USAID decided not to wait for the law establishing a new bank supervision agency. After several attempts at meetings and negotiations, advisors were able to reach agreement with officials of the National Bank - RS and diagnostic reviews of RS banks were performed in mid-1997. Greg Taber arrived and set up an office in the RS October 1997 as the resident advisor. Technical assistance followed a similar pattern to that of the Federation, with a mix of classroom training supplemented by advisor-directed examinations and in-bank training. These efforts were far along by the time the RS Banking Agency was legally established in May 1998.

Unlike the FBA that was built as a new agency, the RS Banking Agency inherited a large number of personnel (*but, also funding*) from the former National Bank. This situation presented some different training challenges initially, requiring an assessment of existing capabilities and some shifting of responsibilities. Staff has since been supplemented with additional persons who have applicable professional experience, but who also had to be subsequently trained.

Also unlike the FBA, the top officials and Managing Board members of RSBA have been replaced frequently. Advisors first worked with the Deputy Governor of the National Bank of RS, an institution being replaced by a new Central Bank, then advisors worked with three different Directors of RSBA. The present Director has been in “Acting” status for almost two years. This lack of continuity has hampered the development of supervision expertise, management competence and consistency of actions.

Advisors managed to keep the technical assistance progressing by focusing on the functional aspects, maintaining constructive working relationships with the supervision staff and adjusting to the changing officials. The political interruptions and three temporary travel bans also required adjustments and flexibility in the work plan to avoid adverse impacts.

One of the key Tasks in the first contract with USAID was the examination of the 2 largest state owned banks in the Federation (Privredna Bank, Sarajevo and Union Bank, Sarajevo). Advisors worked with FBA officials to plan the examinations with the key objectives being a determination of the financial condition of the banks, their projected viability and needed actions, plus basic on-the-job training for the examiners and officials.

Ten U.S. banking and supervision experts were involved in the examination of the two banks in November and December 1996, along with the three FBA examiners and their supervisor. Brief targeted training sessions were held during the two examinations to explain what was being done or planned. The examinations provided examples that would be tied into future training and development.

The examination model was designed to become the basic examination procedures and report format for use in future examinations. The reports presented the banks' balance sheets in accordance with the draft Laws on Bank Privatization and Opening Balance Sheet. This included three columns showing the balance sheets divided into Active, Neutral and Passive categories as the government planned to carve-out certain pre-war assets and liabilities, primarily the on-lending credits to state enterprises and the frozen deposits due on claims against the NB in Belgrade. Other losses and adjustments were shown against capital.

The Director was impressed by the examinations performed but was concerned that FBA's new examiners would get bogged down in problems in the banks and that could inhibit their development and respect by bankers. He met with the USAID Mission Director and presented his concerns for FBA's ability to address the problems fast enough and with adequate expertise. The Director asked for USAID Experts to lead the examinations of all or most of the banks in the Federation. He felt that this would create a good baseline for future examinations and be excellent training. Barents' advisors were asked to prepare three scenarios of additional assistance in view of the request balanced with projected cost.

The plan approved by USAID included bringing U.S. Experts to do examinations in the following manner.

Period 1	Period 2	Period 3
<ul style="list-style-type: none">➤ 2 weeks classroom training➤ 3 bank examination teams, 2 banks each<ul style="list-style-type: none">○ 9 US experts – 3 per bank○ 3 FBA examiners	<ul style="list-style-type: none">➤ 2 weeks classroom training➤ 3 bank examination teams, 2 banks each<ul style="list-style-type: none">○ 6 US experts – 2 per bank○ 3 – 4 FBA examiners	<ul style="list-style-type: none">➤ 2 weeks classroom training➤ 3 bank examinations teams, 2 banks each<ul style="list-style-type: none">○ 3-4 US experts – 1 per bank○ 3 – 4 FBA examiners

The U.S. Experts reinforced the classroom training with in-bank training during the examinations and with focused group discussions during and after the examinations. Additionally, the lead instructor for the classroom training rotated in the examinations to ensure consistency of the in-bank training.

This intensive training and examination program covered almost 6 months, mid-March through August 1997. One of the key objectives was to transition the FBA examiners from assisting and participating as trainees to the leading role at the end of the series of examinations. Conversely, the U.S. Experts transitioned from leading the examinations in the beginning to acting in an advisory role at the end of the examinations. This intense mixture of classroom and in-bank training worked well and moved the examiners through this phase of basic training quickly.

Meanwhile, USAID had requested Barents Group to expand the technical assistance program to Republika Srpska. An agreement to perform Diagnostic Reviews of the RS banks was

agreed with officials at the National Bank of RS. U.S. Experts and examiners from the NB-RS jointly began the reviews in July 1997.

The technical assistance in the RS continued in the same manner as in the Federation, and produced similar although delayed results in supervision capabilities. This was accomplished despite having four different individuals acting in the Director position and several changes in the Managing Board in the period of five and one-half years. Technical assistance was temporarily interrupted several times by suspension of travel to the RS (once for over two months). Success under these conditions is attributed to resident advisors focusing on building the function and process of bank supervision, and being able to adapt and innovate during the changes and disruptions.

The Building Blocks of Bank Supervision

The period 1998 through 2001 allowed the resident advisory team, and a complement of banking regulatory, accounting, and supervision experts, the opportunity to develop the basic legal framework, institutional capacity and supervisory processes within both agencies. Each agency was faced with important challenges during this period that also made them develop depth and expertise differently.

Legal framework

A review by Barents legal advisors identified serious flaws in The Law establishing the FBA in June 1996, examples:

- FBA could not manage, supervise or rehabilitate problem banks - this posed a serious dilemma, i.e., what to do with problem banks?
- FBA was stated to be temporary until new the Central Bank was established -- how could FBA attract qualified staff?
- FBA had no legal protection for performing its duties
- FBA did not have an adequate source of funding identified

During most of 1997, our experts worked with FBA officials and other government representatives to address the weaknesses in the initial law. Meanwhile, the new Law establishing the Banking Agency of Republika Srpska was passed in March 1998, the Managing Board was appointed in April and the Director and Deputy Director were appointed in May. The founding law for the RSBA included most of the changes needed in FBA Law, but specifically stated that RSBA officials were responsible for damages and could be sued and prosecuted while performing their authorized duties. These specifications weakened the overall effectiveness of the new Agency.

Most of the problems in the Federation Law on Banking Agency, except legal protection, were corrected by amendments in July 1998. The new laws and regulations in the Federation and RS in 1998 and 1999, respectively, were major steps forward in developing a sound legal framework for banking. They also provided authority to take administrative enforcement actions and to intervene in banks not in compliance with the new laws or not operating in a safe and sound manner.

Like the Law on Banking Agency, The Federation Law on Banks was also in need of revision which were enacted in October 1998 with a transition period to April 1999. New regulations were issued to replace the interim regulations. The new RS Law on Banks was enacted in July 1999 and closely followed the Federation format.

Major amendments were developed in 2001-02 to further improve the Law on Banks in both entities. Additional efforts related to the legal framework were still expended during the current contract as implementing regulations were needed to support the supervisory processes being instituted by the Agencies and to harmonize the regulatory framework of the two Agencies.

Throughout our technical assistance project, strong efforts were made to focus the legal framework on: the Basle Banking Committee guidelines, the European Union Directives, and International Best Practices.

Institutional capacity

During the period 1998 through 2001, the Barents advisory team focused on developing the necessary skills within the staff of the Agencies to enable them to properly supervise the existing banking system. We had key training initiatives to transfer knowledge and build necessary supervisory tools and processes.

A formal training program was developed in late 1996 to build a strong base of examiner core knowledge and skills. It was planned to start as soon as possible after the two examinations in order to build basic examination concepts and techniques that would be coupled with follow-on OJT through year 1998, and later to phase in more advanced and specialty training. This plan was altered slightly to meet the needs of the individual Agencies.

Several people were employed at FBA and began working in February and March 1997. The staff had a mixture of banking, enterprise accounting, National Bank and Financial Police backgrounds. The first classroom training was in late-March 1997. All the Supervisory staff of FBA attended, including the Director, Deputy and Chief Counsel. Advisors and FBA officials agreed on a plan to present training seminars then go with the examiners to the banks and provide in-bank training to implement the formal training.

Advisors provided extensive and progressive classroom training from 1997 through 1999, and targeted training afterwards. Comprehensive in-bank training complemented the classroom training courses. Examiner turnover has been almost non-existent; therefore, the need for repeat training courses has been limited since that time. We delivered modified introduction and intermediate courses for newer professional staff. Advanced and specialized training courses were delivered as needed to continue the progression of skill development to meet increasing challenges and changing risks.

Advisors began classroom training in the RS Banking Agency in late 1997 with an objective of catching up with FBA and then providing joint training. Advisors provided joint training for the two agencies beginning in March 1998 and harmonized technical assistance to the two agencies facilitating the development of their interactions and cooperation.

In addition, the project translated numerous documents for supervision staff to use for learning and reference. This includes documents from the Basel Banking Committee, U.S. and other banking regulators, international organizations, etc. A listing of the major documents is in the “Attachments” section.

The project also obtained a total of 64 textbooks for each agency in 1998 and 2000. These are University level major author books on banking, accounting, auditing, finance, etc. Some of the books were translated into the Serbo-Croat language.

Supervisory Processes

A major area in which Barents advisors achieved high results was the development of comprehensive processes to deal with problem banks and to cleanse the system of the most problematic banks. Examiners and officials were trained in risk identification, enforcement, communication and resolution of problems. This included procedures for bank intervention and resolution from planning the take-over through temporary management, deposit pay-out, selling, merger and liquidation. These processes were mostly developed in concert with the FBA as the private banks in the Federation were the active and volatile banks needing intervention during the 1999 – 2001 period.

➤ Bank Examinations

U.S. Experts assisted frequently during examinations following training with the objective of advancing the level of expertise and reinforcing training. Later, the emphasis would shift to advising on problem banks, interventions, financial crimes, money laundering, etc.

Technical assistance in Republika Srpska followed a similar pattern, though starting later. The RS banking system was also smaller and less active, with about one third the number of banks and one-fourth the assets of Federation banks. In addition, all larger banks in the RS were state-owned, encumbered by poor directed credit and fixed assets, and with little depositor confidence. The lack of any strong private banks hampered the system until privatization had any noticeable results much later, i.e., only very recently.

Seven visiting advisors examined two RS banks in November 1997, including one of the largest banks, with assistance from local examiners from the National Bank. During May-July 1998, seven visiting advisors examined five banks, including the other two largest, and resident advisors examined one additional bank in August. In 1999, the required number of visiting advisors was reduced, with two performing two examinations in February, and three performing three examinations in October-November. By 2000, two visiting advisors assisted local examiners with examinations of two of the largest banks in March and May, with local examiners performing all other examinations without significant assistance.

It is evident that the core bank examination skills have been applied by the two Agencies. The need for fine-tuning and focusing on a more pro-active supervision was evident at the end of 2000. This transition has been a key focus of the current contract in order to prepare the Agencies for the exit of the USAID technical assistance.

➤ **Problem Banks Resolution**

The first banks closed resulted in political threats for “destroying the banks instead of rehabilitating them” and charges by the Financial Police against Agency Officials as being responsible for the depositors’ losses and the jobs lost. Agency officials continue to be harassed by lawsuits and threats over some banks closed, however they have built respect from many for the positive outcome of several intervened banks and the strengthening of the banking system. Several amendments to laws were required to facilitate intervention, resolution and legal protection for carrying out their responsibilities. And, the international community had to provide considerable political support to enable the banking agencies, especially the FBA, to move forward in cleansing the banking system.

Some intervened banks were very difficult due to their complicated structure of related companies, the resistance and obstacles caused by owners and management, and the slow, ineffective legal process. BH Bank was a significant intervention. Examiners stayed in the bank from late 1998 until the bank was placed under Provisional Administration in June 1999. Efforts to re-capitalize and rehabilitate it failed as the owners had lent the bank’s funds to related companies, all being illiquid. The international community lost considerable operating and humanitarian funds. USAID authorized the project to put considerable effort into determining what when wrong, and how to: recover the funds to pay depositors, document the wrongdoings and change the system to avoid recurrence.

BH Bank became a “lessons learned” project as it moved from problem bank status to Provisional Administration and to Liquidation. Many problems occurred that prevented positive actions, including the destruction of records and database. The owners prevented the discovery of facts and resolution while claiming to help. Most of the Intervention and Resolution procedures were developed during this effort.

BH Bank illustrated many problems in banking, corporate governance, management competence, information systems, debt collection, judicial process and political relationships. Some of these problems existed in other banks, but to a lesser degree. FBA examiners provided documentation for several referrals for prosecution. Several representatives of the international community became actively involved in the resolution effort and efforts to make changes. Citizens with deposits up to 5,000 KM were fully repaid and 30.5% of deposits over 5,000 KM and legal entities have been repaid. An additional payment of 15% is projected in April 2003.

FBA officials now point to the intervention of Commercial Bank – Tuzla in August 2000 as their turning point in supervision, enforcement, intervention and resolution. The bank had the largest total amount of citizens’ savings accounts, over 18% of the total in Federation banks. This made the outcome especially important to the future of banking and the banking agency.

Orders issued by the FBA did not stop the unsafe and unsound practices, but illiquidity stopped the bank’s operation and problem loans caused massive losses. Two advisors assisted during the examinations while the bank was in problem status. Four advisors advised on the intervention. Resolution of the bank took several months. The bank was sold under a

Purchase and Assumption agreement with all citizens' savings deposits transferred and 85% of legal entities' deposits transferred. A number of lessons were learned and confidence grew at FBA. Future interventions became easier to plan and execute.

➤ **Bank Licensing**

One of the critical elements for a sound banking environment is the bank licensing process. This process should be clearly understood and transparent to the industry while at the same time assuring that the supervisor has sufficient information to prevent the entry of undesirable participants into the banking arena. Advisors led the development of comprehensive procedures for licensing and corporate applications in 1998 and 1999, but transitioned to an advisory and consultation role as the competency of the agencies improved. Their efforts in this area, have established a process to evaluate all entrants and new activities in a manner that is expeditious while at the same time comprehensive. Licensing officials now update the comprehensive procedures as changes occur in the law or related activities, as shown by the FBA officials updating the procedures in September-October 2002 following the numerous changes in law. They then asked the resident advisor to review the procedures before they presented to the Managing Board for approval.

The RSBA' regulation on bank licensing became effective in February 2000 and was revised after the recent changes in law and adopted by the Managing Board in March 2003.

It should be noted that this is an example where FBA has developed more capacity and proficiency due to a greater need (*i.e., more activities in this area*) and more resources (*its overall funding is much greater and it receives more fees from the higher number of activities*).

➤ **Bank Reporting and Offsite Supervision**

One of the Principles for Effective Banking Supervision requires that the banking supervisors have a means of collecting, reviewing and analyzing prudential reports and statistical returns from banks on a solo and consolidated basis. This requires both adequate information to be submitted by the individual institutions and also the timely analysis of the information by the bank supervisory. During the period 1998 through 2000, significant work was done to transition the bank's reporting and accounting records to become compliant with International Accounting Standards (IAS). This task required significant training of both the staff and the banking sector representatives on the application of IAS concepts and standards. Additionally, the advisors worked closely with Agency officials to develop standardized mandatory report formats to be submitted to the Agencies.

In order to address specific reporting requirements the advisors worked with FBA officials to issue a "Decision On Reporting Forms Which Banks Submit To The Federation Bosnia And Herzegovina Banking Agency" dated December 15, 1998 and the *Decision On Changes And Amendments To The Decision On Form Of Reporting That Banks Submit To The Banking Agency Of The Federation Of Bosnia And Herzegovina* dated June 29, 1999. A similar work was accomplished with the RSBA to issue the "Decision on Format and Contents of Bank's Reports Submitted to the BA-RS of the Republic of Srpska" dated December 28, 1999. These

Decisions stipulated the format and content of the monthly balance sheet and supporting schedules related to loans, deposits, and off-balance sheet items. And, it sets forth the requirements for quarterly Income Statement, Cash Flow, Capital, Asset Classification, Risk Concentrations, and Maturity Structure of Assets and Liabilities. Additionally, several other reports related to a daily liquidity and a semi-monthly foreign currency positions are also identified. Time deadlines for each of the above reports were also established. The above Decisions were complemented with other Decisions related to prudential standards and regulatory limits address the specific accounting treatment to be used, the formats to be submitted, and the submission deadline for the required information.

The next step initiated by our advisory team was to assist the Agencies in the creation of a system to gather all the information and prepare ongoing analysis for individual banks and the system as a whole. Work in this regard encompassed the creation of an automated database in each Agency and also trained the staff in the Offsite department on individual bank analysis skills. The work on both of these items although started under previous contracts, has continued through 2003.

➤ **Payment System Reform**

During the period 1998 through 2000 bank supervision advisors worked with other USAID and international donors in the dissolution of the ZPP payment bureaus and the transfer of the payment clearing mechanism to the commercial banks. Advisor Dan Berney was involved in the initial study while other short term advisors worked with the Agencies to assure that banks were ready to take on the new activity. Our advisors worked with Agency officials in establishing the ratings (Low, Medium and High Risk) that would be assigned to each commercial bank and that at the same time would clearly establish the level of transactions that they would be allowed to perform. Advisors provided initial training to the Agencies' staff and also participated in the evaluation of the individual commercial banks. The success of the payment system reform was evident when on 1/5/2001 the banks took over the activities with no disruption to the overall system.

**Summary of Key Accomplishments for All Contracts
“Strengthening Bank Supervision Program” – 1996 to 2003**

- Legal and Regulatory Framework:
A sound legal basis has been developed to facilitate effective banking supervision.
- Development of core examination skills:
Examiners in both agencies have a good understanding of basic examination skills and their roles for safe and sound banking.
- Problem bank supervision:
Both agencies are developing competency. FBA examiners have a high level of expertise in problem bank examinations, including effectively addressing the cause of the problems, communication of corrective actions and strategies for follow-on

supervision. RSBA examiners have developed moderate expertise in problem bank examinations.

- Bank Intervention – Takeover
High expertise in FBA, moderate in RSBA. FBA examiners and officials have a high level of expertise from 20 bank takeovers covering a wide array of problems. Comprehensive processes are in place to cover take-over through resolution. RSBA examiners are developing good expertise as indicated in 6 bank takeovers.
- Bank Resolution and Liquidation
High expertise in FBA, minimum in RSBA. FBA officials (including Dept. for Banks Under Administration) and appointed agents have developed considerable expertise in provisional administration, sales by purchase and assumption, mergers, deposit pay-outs and other actions in resolution. RSBA officials have only had experience in resolving by sending to Bankruptcy Court and will need assistance and guidance in other resolutions.
- Bank Reporting, Offsite Supervision Database and Analysis
Bank reports meet IAS in most respects, and are similar to U.S. Reports. Minor changes in computation of Core Capital to meet Basle Standards will be effective at YE-03. FBA database is not automated, requiring manual input to PC programs. RSBA database on PCs is automated. Both agencies Analysts have developed a high level of expertise in detecting and analyzing concerns and trends in reports.
- Referrals of Suspected Criminal Violations
Several FBA examiners have developed a high level of expertise in detecting and documenting suspected criminal violations for referral. They have also developed expertise in developing referrals to the Federal Violations Committee as illustrated by a very high success rate on 111 referrals in the last four years. RSBA has developed some expertise in investigating suspicious transactions but have limited experience in making referrals.
- Payments System Reform
Payments transfers are handled by the commercial banks and the Central Bank. Advisors actively involved in the successful conversion of payments transactions from the defunct Payments Bureaus to the commercial banking system. Advisors also assisted in the development and implementation of examination procedures and approval process for bank participation.
- Deposit Insurance
Deposit insurance is now a reality, with 10 banks participating. Advisors participated in the concept development and initial laws, then amendments and establishment of the Federation Deposit Insurance Agency. Advisors participated in the development of new law consolidating deposit insurance at the state level.

- Legal Protection for Banking Supervision
Legal protection is now in law for both agencies. Advisors worked with USAID, Central Bank, World Bank, IMF, UST, OHR, MOF representatives and FBA/RSBA officials to get amendments and OHR decrees in place. This has been a slow, grinding process as police and government officials misunderstand this issue and oppose such protection for the banking agencies.
- Coordination with Central Bank
A very positive relationship exists. Connecting the Agencies to the CBBH is under consideration to ensure greater protection of independence, sustainability, competence and funding.
- Bank Privatization
Substantially all of the banking system is under private ownership. Government delays in privatization allowed the state-owned banks to be marginalized by the entry of well-known foreign banks. Citizens have virtually all of their deposits in privately owned banks, mostly foreign owned. All RS banks have been privatized except one whose sale is approved and merger in process. Six Federation banks remain in government ownership. The remaining state-owned banks must be privatized, under provisional administration or licenses revoked on March 31, 2003 by agreement of the governments and IMF.
- Banking Sector Coordination Group
Advisor initiated discussions to get this ad hoc group formed in response to critical issues and threats that required a quick and unified response. Members include representatives of USAID, The World Bank, IMF, OHR and EU and chaired by CBBH Governor.

III ISSUES PENDING AND AREAS NEEDING ATTENTION

It is important to recognize that the bank supervision process is one that requires changes and adjustments to reflect the current and prospective banking environment of each country. Although the bank supervision cycle is one that moves from a reactive to a pro-active approach, the speed of the change will be determined by the economic environment and the ability of the supervisor to implement changes. At times, this ability is hampered by cumbersome legal structures and political interference. There has been consistent and ongoing progress made in establishing an independent regulatory structure in Bosnia-Herzegovina. Year on year, steps and milestones have been achieved that have tested the Agencies independence and qualifications. The achievements are many as previously stated, however, there are some additional challenges that both the FBA and the RSBA will face in the upcoming years that require additional attention.

Substantial program objectives have been accomplished. The two bank supervision agencies have made good progress and have a high level of competencies in most areas. However, there are two major obstacles to self-sustainability:

- the political threat to both agencies at the entity level
- inadequate funding for the RS agency.

USAID is considering funding support to alleviate the second issue for the near term, and several long-term solutions have been proposed over the past year but each implies changing the structural location of bank supervision. This is a challenge under consideration by the international community, the Agencies' officials and resident advisors. Bank supervision had to reside initially at the entity level for political reasons. However, the above cited obstacles and the rapid banking system consolidation into one, open financial space encompassing the whole country of Bosnia and Herzegovina and bank supervision should similarly adjust. Placing the two agencies under the umbrella of the Central Bank will alleviate both issues in the longer term. These two major issues and the other technical assistance areas listed below need additional effort before completing the transition to exit.

Role of the Central Bank in Banking Supervision

The Central Bank's role in bank supervision has been modest in relation to the two banking agencies and has been limited to coordination and harmonization of banking practices. However, the laws on the Central Bank and two banking agencies also refer to cooperation on licensing and supervision, reporting requirements, etc.

Most individuals involved in banking and supervision generally agree that placing bank supervision under the umbrella of the Central Bank would enhance the independence, authority, efficiency and effectiveness of bank supervision¹. The Governor of CBBH has

¹ An Occasional Paper by Professor Goodhart for Financial Stability Institute of BIS indicated that placing bank supervision under the Central Bank seemed to be the most effective structure in developing and emerging economies while an independent agency seemed the preferred structure in the most developed economies. Experience in Bosnia-Herzegovina supports that conclusion and the described problems that can occur with a separate independent agency in a developing country.

formed two working groups to accomplish this goal--a strategic working group to focus on the proper organizational restructure and necessary legal framework, and a technical working group to address operational issues.

The structural location of bank supervision will almost certainly be changed in the near future so that the two banking agencies are consolidated as one independent agency located at the state level with connections to the Central Bank or one of the following 3 options being reviewed by a Strategic Working Group:

- Leave the legal structure as it is, but fully implement the relationships and coordination activities stated in the laws.
- Change the legal status to make bank supervision a part of the Central Bank, but as a separate unit with its own managing board for bank supervision and isolated from other functions.
- Change the legal status to fully incorporate into the Central Bank as an operating unit.

This is expected to be a politically sensitive effort due to some political resistance against moving authorities to the state level. Several parties are working to gather unity in the determination of how and when to make the structural relocation.

Consolidating bank supervision into one body offers the potential for more efficiency and effectiveness while providing for more independence from political interference, financial sustainability (especially for RS, with its critical shortfall in funding), compliance with EU standards and the maintenance of competency in the rapidly changing banking system.

Ideally, Bank Supervision should be either a part of the Central Bank or as a unified independent body connected to the Central Bank. The banking system is rapidly consolidating. Regardless of the option used to change the structural location of the Banking Supervision function, there is a need to assure a smooth transition into the new structure. A determination of the specific organizational restructure is expected in mid-2003, with full implementation projected for early to mid-2004. Key objectives are: increasing the level of independence, competency, supervision effectiveness and efficiency. It is hoped that the funding concern at RSBA can be addressed in the interim.

Further Depth and Institutional Capacity

As previously stated, the two bank supervision agencies have made good progress and have a high level of competencies in most areas. The processes are in place to go forward and restart some of the initiatives that were not completed due to other priorities of the last few years. Specifically, training and development as well as the establishment of performance management system for the Agencies is essential. Additional work is also needed in refinements to the early warning process and the IT infrastructure for the two agencies to harmonize and make them more efficient.

All the basic training programs have been conducted and several specialty programs presented. The Agencies are now at a point where the type of training and development opportunities for the staff must target new activities and interaction with other Central and

Eastern European supervisors. Advisors to date have assisted the Agencies to find outside training and development opportunities for limited attendance and returning to share the experiences. It is also important to establish an ongoing training and development curriculum as the Agencies are employing additional examiners that will need the basic courses. One agency has approved but not yet implemented a special position of “Development Advisor” to focus on research and risks for the future and prepare for continuing development of staff and procedures. Additional assistance should be focused on the development of an ongoing training and development program.

Considerable TA effort was initiated on Performance Management and Examiner Accreditation during 2000 and 2001. This objective was suspended while the banking agencies focused on other priorities, especially problem and failing banks. The agencies are particularly interested in certification of skills in the near future. They want to continue this effort in relation to Training and Development noted. The establishment of an accreditation process for the examination staff will also provide further credibility for the staff.

Another area for institutional capacity development is the early warning process and IT system upgrading. The restructuring and relocation of the two banking agencies offers the opportunity to make substantial upgrading of the capability and usefulness of IT and a database that can serve the needs of bank supervision, deposit insurance and Central Bank. A more efficient early-warning system and better MIS are key objectives, but several other benefits can be achieved for the stakeholders named and later, more transparent data available to the public. The present Offsite Bank Analysis process was initially implemented as an interim PC-based process until a comprehensive database program was developed. This is a major effort that awaits decisions related to changes in structure.

Pro-active Approach to New Risk Areas

Both Agencies have spent the past few years focused on problem bank resolutions and interventions. It is now time to refocus supervision onto “good” bank supervision, i.e., strong banks in active competition and offering new and varied products. The changing banking system and the lessons learned from intervened banks also point to a need to begin development of consolidated supervision, expand supervision capacity in related, non-bank financial activities, e.g., insurance, investment banking and securities, and strengthen the anti-money laundering and anti-terrorist financing function. The latter will require significant coordination efforts among different constituencies in order to establish a program that works well within the Bosnia-Herzegovina environment.

The risks inherent in bank affiliates, subsidiaries and related parties need enhanced skills and procedures. Considerable “lessons learned” from certain problem banks have been partially integrated into examiner skills, but additional attention is needed on detecting, understanding and getting corrective actions before they become serious problems. Additional training has been discussed and is contemplated for 2003.

Non-bank financial institutions are increasing in scope and activities. This includes: insurance, securities, privatization investment funds and the brokers and managers of these activities. Many banks also have relationships with entities involved in these activities or

perform them through bank-owned subsidiaries. The lack of effective regulation and supervision is an increasing concern for the potential impact on the banking system, financial markets, customer confidence in financial markets and the economy. Advisors need to bring the potential impact forward and ensure that bank supervision does its part to ensure that banks and others understand the risks and take steps to protect against the risks. Some additional training in this area is needed for both Agencies and other regulatory entities.

One new area of evaluation for the bank examiners will be the investment portfolios of banks. There are no Bosnian government securities or other market instruments at present. A law is being drafted for the issuance of government securities with tight fiscal guidelines should IMF change its stance and allows new debt in its agreements with Bosnia. Banks can invest in other market instruments outside of Bosnia that can provide secondary liquidity to the individual bank. The new regulation on public deposits and increasing competition will also increase the amount of monies invested in these assets. This is an area with little past experience but is beginning to develop, and will receive additional attention. Examiners will require an increased knowledge of funds management and liquidity concepts and their application. They will also need more understanding of Rating Services (Fitch, Moodys', S&P) and the use of their ratings. To date, we have provided a limited amount of training in this area but recently provided information and limited one-on-one training to key officials. This needs to be expanded through classroom and on-the-job training for all the bank examination and offsite supervision staff to assure that risks are properly reviewed.

Since 2001 Advisors have worked in the Anti-Money Laundering and the Prevention of Financing of Terrorist Activities efforts of the Agencies. Advisors have been actively involved in the development of these areas, including training, developing procedures and interactions with others. The work in this area, however, is still not complete. Additional work related to the procedural and cooperative interaction among all the various government authorities (Central Bank, FBA, RSBA, Financial Police, and other judicial and supervisory authorities) will require substantial efforts.

Advisory Role for Current Operations

Continued advisory support will be needed as the Agencies face an increased workload due to the IMF requirements for minimum capital and inclusion in the deposit insurance program. Also, further refinements and work on the implementation of revised Decisions will likely be needed.

All banks are required to qualify for deposit insurance by August 2003. All non-member banks need to have current and satisfactory "Ratings" before they can be admitted. Agencies will have difficulty meeting the requirement for current ratings. Several banks are projected not to meet the deadline even if extended to YE-2003. License revocations and provisional administration are projected for those banks in late-2003 or early 2004. We have developed comprehensive procedures for bank intervention and resolution, but they have had limited implementation in the RS. These events will also occur as the bank supervision agencies are in the process of restructuring at the state level or in the Central Bank and may increase the stress of such actions. Enhancing the relationship with the Deposit Insurance Agency must be made concurrently with the change.

Further refinement is needed on existing laws and regulations (including collateral laws and judiciary enforcement). Many new and revised Decisions (regulations) have been enacted, but a few need additional work. Examples: a change in law for special reserves to secure public deposits has been problematic and time consuming; the modification of construction of items in the Decision on “Core Capital” is required by 3/31/03 with a planned education outreach during the transition period for banks until the effective date of YE-03. Also, the gathering of Foreign Exchange data is required by 3/31/03.

IV. CONCLUSION: Banking System and Banking Supervision

After a difficult preparatory period and many stresses for the newly developing bank supervision function, the banking system is rapidly being reformed, restructured and strengthened to function in a developing market-oriented economy.

Bank supervision advisors focused on getting a satisfactory legal framework in place to enable the implementation of sound supervision practices and processes that could take the necessary corrective actions to enforce sound banking. These processes had to be tailored to the local situation and harmonized with the legal framework to be effective and ongoing. Training began with the basics and evolved to emphasize processes to identify and remedy the deteriorating problems in many banks. This included intervention to take over management control and resolution by selling, merging, liquidation and bankruptcy when other administrative enforcement actions did not produce satisfactory results.

Banking supervision has steadily developed and is contributing to a stronger banking system to facilitate a more vibrant economy with banks that can be trusted to return depositors funds when requested. The cleansing of the system by removing the worst banks and progressively raising the standards has provided an attractive bank market as indicated by the recent entry of strong, well-known foreign owned banks.

Much progress has been made, but there are still a lot of problems and a lot to do to ensure continuation of the progress and to meet the new challenges. Primary attention now needs to be focused on achieving the most appropriate re-location of the bank supervision function to ensure independence from political interference and sustainability. Bank supervision will need to make changes and adjustments to function efficiently in the new environment. And, it will need to adapt and prepare for the new risks and challenges of the changing banking system and economic activity.

ATTACHMENTS

USAID Task Order Requirements & Benchmarks

Tangible Results and Benchmarks from Original Task Order dated July 25, 2001:

A/ Tangible Results By: 2/28/03

<i>Revised and implemented policies and procedures manual governing resolution/liquidation of problem /failed banking institutions.</i>		
---	--	--

Met	Partial	Not Met
X		

<i>Federation legal/regulatory framework revised to provide the FBA and RSBA with appropriate authorities in problem bank resolution and liquidation.</i>		
---	--	--

Met	Partial	Not Met
X		

<i>FBA and RSBA will have instituted a core in-house training program and begun the implementation of an accreditation process for examiners.</i>		
---	--	--

Met	Partial	Not Met
	X	

<i>FBA and RSBA will have implemented an early warning system with a functioning automated database and output capacity.</i>		
--	--	--

Met	Partial	Not Met
	X	

Overall we achieved substantial progress towards each of the tangible results taking into account the changes in priorities that developed during the period of performance. The key missing item is automation. Specific results are explained in the more detailed Tasks and Benchmarks cited below and are also described in the Accomplishments Section of this report.

B/ TA Planning:

By:

Completed:

<i>Draft FBA and RSBA work plans for YE 2001 to Oct. 14, 2002 and submit to USAID for concurrence.</i>	<i>3Q- 01</i>	<i>2/15/02</i>
--	---------------	----------------

Met	Partial	Not Met
X		

In December 2001 the work plans were revised after performing the next Task. Further changes in the Work Plan were made during the period of performance and submitted to



USAID for concurrence. Additional tasks and changes in priorities were also required and included in the TO Modification dated July 2002 and detailed subsequently in this section.

B/ TA Planning

By:

Completed:

<i>Update Bank Supervision Assessment (BSAM) and FBA/RSBA progress in achieving BASLE Core Principles and present an updated summary of Findings.</i>	<i>3Q-01</i>	<i>10/01</i>
---	--------------	--------------

Met	Partial	Not Met
X		

In October 2001, Short term advisors Gilliam and Raworth performed the BSAM and Assessment of Compliance with the Basle Core Principles. They presented to the Agencies' Officials and had two-way discussions on the results. Both agencies discussed areas needing improvement within their control and how to achieve the objectives. FBA appointed a working group to review the results and plan improvement actions. RSBA Director and other managers reviewed the report and held discussions on need to include improvement in work plans.

In February 2002, FBA summarized the Core Principles and their level of compliance in the YE-01 on the Banking System. And, they referenced needed actions in their Annual Work Plans.

In October 2002, at the request of the Agencies' officials, the recent changes in the Law on Banks for both entities includes a reference to the Agencies following the Core Principles in developing regulations and other guidance.

In February 2003, FBA included the Core Principles and self-assessment compliance in their Report on Federation Banking System.

C/ Supervisory Processes and Procedures

By:

Completed:

<i>1. Offsite Surveillance</i>		
<i>1.a. Provide training to FBA and RSBA on advanced offsite surveillance techniques.</i>	<i>1Q-02</i>	<i>1Q-02 & On-going</i>

Met	Partial	Not Met
X		



In Feb-March 2002 Advisors Mohler and Figueroa provided assistance for both Agencies by working jointly and parallel in each Agency. This was planned to ensure that assistance was consistent and harmonized. The Draft Procedures Manual was revised and used as a guide. The Manual puts in place risk profiling and ratio analyses designed to warn of deteriorating trends. It is compatible with Basle Bank Supervision standards. Advisors walked the analysts through the procedural steps using specific bank data and a template for analysis. Both Agencies used the Procedures Manual to guide the process for the 1st quarter’s bank data.

One objective of the effort was to focus the analyses on substance and not quantity of ratios or ones that provide little value. This is needed to improve effectiveness of the results and increase efficiency by reducing time-consuming nominal value activities.

Advisors also conducted workshop type training on accounting issues with both Agencies. The Agencies prepared examples of their problems prior to the training so that it could be tailored to their needs. Issues related to mergers and acquisitions were the most troubling for the Agencies. Bank consolidation and restructuring will continue and will entail unique and complicated accounting issues.

In June 2002, Advisors Mohler, Figueroa and Taber delivered 4 weeks of training that included a one-week workshop in Financial Analysis to off-site personnel of both agencies. (On-site examiners and Analysts from the 2 Deposit Insurance Agencies also attended the classroom session.)

Advisors worked with off-site personnel for 2 weeks on actual bank analyses using the procedures implemented for OJT and in preparation for workshop, and during the week following the course, advisors worked with off-site personnel as follow-up reinforcement of principles. Focus of training was on ratio and trend analysis, bank ratings, off-site manual, risk management, Basle principles, and use of early-warning-system type report for timely discovery of bank problems.

In October 2002, Advisor Mohler worked primarily in RSBA focused on reinforcement of prior training (*key supervisor missed prior training described due to illness and family issues*).

Advisor Mohler also met with the Head of Off-site Supervision at FBA in Sarajevo to review progress of Analysis activities. She has also begun developing solutions to related off-site issues for future implementation, including the areas of bank ratings, bank reporting forms revisions, and accounting standards.

C/ Supervisory Processes and Procedures **By:** **Completed:**

<i>1.b. Begin testing and refining of early warning indicator monitoring system in both FBA and RSBA.</i>	<i>2Q-02</i>	<i>June 2002, Oct-2002 & Ongoing</i>
---	--------------	--

Met	Partial	Not Met
X		



In June 2002, follow-on TA was performed in the 2nd quarter to determine the efficiency and effectiveness of the Manual’s procedures in actual use and the results of the process for 1st Quarter data. Both Agencies are performing analyses using a condensed report of key information in order to focus on significant problems and timeliness of recognition.

In October 2002, the process was tested in RSBA. The process demonstrated that it would assist in a timely warning of a problem. An automated screening process for a variety of risk measurements and potential “red flags” is the next step towards an effective “early warning system.”

C/ Supervisory Processes and Procedures **By:** **Completed:**

<i>1.c. Update risk based profiles and supervisory strategies for all banks.</i>	<i>2Q-02</i>	<i>Ongoing</i>
--	--------------	----------------

Met	Partial	Not Met
	X	

In June 2002 individual bank analyses were done using the new reporting and analysis format. The On-site supervision department used the reports in planning and assigning on-going on-site work. Supervisory strategies were a major element in the off-site and on-site classroom training in June and July 2002 and have been implemented as reviews and examinations preformed. Rated Partial as not all banks have a current risk profile and supervisory strategy.

C/ Supervisory Processes and Procedures **By:** **Completed:**

<i>2. Bank Rating</i>		
<i>2.a. Provide training to FBA and RSBA supervisors in the use of the internal bank rating system.</i>	<i>1Q-02</i>	<i>Ongoing</i>

Met	Partial	Not Met
X		

In Feb-March 2002 OJT training provided to Off-site Supervision staff using analyses of bank information. Resident Advisor reviewed and advised on selected FBA recommendations of bank ratings by the Examiner-in-Charge and the internal Supervision Committee. Classroom training previously provided to most Supervision staff.

In June 2002 classroom and OJT training in Off-site Analysis including some On-site staff.

July 2002 Bank Supervision Seminar included significant blocks devoted to determining bank ratings. Several case exercises required rating banks as part or objective of student analysis.



Planned repeat of classroom training delivered in January 2000 for all Supervision staff through the comprehensive seminar “Overall Conclusions and Bank Ratings” was postponed. Case studies are being updated and will use the current Off-site Analysis Formats.

C/ Supervisory Processes and Procedures **By:** **Completed:**

<i>2.b. Revise and update ratings of banks.</i>	<i>3Q-02</i>	<i>Ongoing</i>
---	--------------	----------------

Met	Partial	Not Met
X		

FBA assigns Bank Ratings at the conclusion of On-site examinations along with developing the Conclusion and Supervisory Strategy. Recommended Bank Ratings are developed by the Examiner-in-Charge in conjunction with supervisor, then reviewed by the internal Supervision Review Committee before presenting to Director for final decision. Off-site supervision now develops recommended ratings as part of the analysis process. Most banks have been rated within the year depending on perceived risk. RSBA began assigning ratings in a testing status and is exploring a similar process including the use of a Supervision Review Committee.

C/ Supervisory Processes and Procedures **By:** **Completed:**

<i>2.c. Assist the supervisory staff in designing and presenting Outreach Seminars for the banking community to introduce the Bank Rating System.</i>	<i>3Q-02</i>	<i>Ongoing</i>
---	--------------	----------------

Met	Partial	Not Met
X		

FBA’s Deputy Director and Communication Officer regularly provide information through the monthly magazine “BANKA”. The Deputy translates articles on banking and supervision issues and writes articles on changes and issuances. The Communication Officer provides articles for the magazine and oversees the development of the FBA newsletter that accompanies the magazine. Advisor has provided input for articles through the two officials. The July 2002 magazine included pictures and coverage of the 3 Bank Supervision training seminars. The December issue included 18 pages excerpted by FBA’s Communication Officer from the booklet prepared by the Anti-Money Laundering working group. FBA Director and President of Managing Board visited several banks to have two-way discussions on the changes in law and regulations, and to urge the bankers to activate the Bankers’ Association and participate in ongoing banking activities. The Bankers Association had an inauguration meeting in late-January 2003.

RSBA Director and two supervisory officials met with RS bankers to discuss the bank rating system being implemented.



C/ Supervisory Processes and Procedures **By:** **Completed:**

3.	<i>Onsite Supervision</i>		
3.a.	<i>Assist the FBA and RSBA in refining the examination schedule</i>	4Q-01	Ongoing

Met	Partial	Not Met
X		

Both Agencies develop annual schedules based on perceived risk and time interval. They update the schedule quarterly or in reaction to adverse information. This includes recognition of the Risk Profile and Supervisory Strategy approved for each bank, estimated risk exposure to the system and other important information on the future of the bank. The Bank Rating is an integral part of the determination of Supervisory Strategy and Planned Response Actions. Sophisticated planning methodologies are not necessary, especially with the small and declining number of banks, but continued refinement of the process is important.

C/ Supervisory Processes and Procedures **By:** **Completed:**

3b.	<i>Examination manual – adopt and revise. Training supervisors and other appropriate individuals on the use of the examination manual.</i>	1Q-02	Ongoing
-----	--	-------	---------

Met	Partial	Not Met
X		

FBA officials delayed their efforts to finalize and formalize the procedures into their work practices due to other priorities, especially problem banks and then, money laundering targeted examinations. Most experienced FBA examiners use the procedures as a draft reference source while carrying out their Scope of Work. New examiners use them for learning and guidance. FBA has not formalized procedures as examiners believe that formally adopting the procedures could be used against them by the Financial Police if a bank fails.

In March-April 2002 and ongoing: TDY Advisor Drake continued working with examiners in RS using the Draft Procedures as applicable for examinations being conducted. The deadline for implementation has been extended due to other priorities involving key individuals.

In October-November 2002 Advisor Drake continued the process in RSBA with emphasis on weak or problem bank supervision and refining examination procedures, especially follow-up and corrective actions.

Representatives of the 2 Agencies participated in a working group on Anti-Money Laundering (AML) and are developing AML procedures for examiners as part of their contribution.



These will become a section in the Examination Procedures Manual. Advisor Drake and the head of On-site Supervision in RSBA made a first draft of AML procedures during his Oct-Nov. 2002 visit.

C/ Supervisory Processes and Procedures **By:** **Completed:**

<i>3.c. Deliver at least four joint FBA and RSBA training sessions on advanced on-site supervision techniques reflecting new risks in the banking system.</i>	<i>2Q-02</i>	<i>Oct-2002</i>
---	--------------	-----------------

Met	Partial	Not Met
X		

In June and July 2002, advisors delivered three joint training sessions (Bank Examination, Advanced Financial Analysis, Anti-Money Laundering), see previous comments. In October 2002, advisors delivered “Train-the-Trainer” to the two agencies.

C/ Supervisory Processes and Procedures **By:** **Completed:**

<i>4. Supervisory Monitoring System/ Record keeping (SMS)</i>		
<i>4.a. Work with FBA and RSBA IT specialist to upgrade and refine initial database and reports.</i>	<i>2Q-02</i>	<i>Ongoing</i>
<i>4.b. Provide training to FBA and RSBA personnel on the use of the Monitoring System.</i>	<i>3Q-02</i>	<i>Ongoing</i>

Met	Partial	Not Met
	X	

This system originally envisioned a fairly comprehensive SMS/Record-keeping System. Directors and Managing Boards of both agencies believe the small and decreasing number of banks renders a complex system as not cost-beneficial. Thus it is unlikely to be implemented as originally planned. The agencies have developed PC based reports and record-keeping although some reports are downloaded from the central unit and available through the LAN system. Most MIS reports are satisfactory for the present needs although some improvement to the overall reporting would be considered once the decision on the Banking Supervision Agencies structures is determined in conjunction with other upgrades of the IT system.



C/ Supervisory Processes and Procedures **By:** **Completed:**

5.	<i>Problem Bank Supervisory Responses</i>		
5.a.	<i>Refine and present for adoption the FBA and RSBA Intervention and Liquidation Manuals.</i>	3Q-02	Ongoing
5.b.	<i>Training supervisors and other appropriate individuals on procedures and the use of the manual.</i>	3Q-02	Ongoing

Met	Partial	Not Met
X		

Ongoing: Advisors have instructed both Agencies on the procedures and by OJT in the banks. This included pre-entry preparation for Takeover through Managing and Liquidation, including resolutions by sale of parts using Purchase and Assumption contract models. The FBA has gained a lot of experience in their 20 Bank Interventions and have a high level of proficiency. They have used the procedures effectively and adapted the process as needed.

RSBA has also used the draft procedures in their Interventions and developed recommendations for changes. Their Interventions have been in small and uncomplicated banks that were turned over to Bankruptcy Courts so they have not used all of the procedures.

The numerous supporting documents developed by Advisors at Hercegovacka Bank in Provisional Administration for “Tendering for Sale” of the bank and its subsidiaries will be compiled to form an Annex to the Intervention and Resolution Procedures Manuals noted above.

D/ Examiner Training and Accreditation **By:** **Completed:**

1.	<i>In-house training for trainers on selected topics</i>	2Q-02	Ongoing
----	--	-------	---------

Met	Partial	Not Met
	X	

In May 2002 two FBA examiners and the Senior Program Associate for this project attended a comprehensive Train-the-Trainer course provided by another USAID project. One week focused on “How to Present Training” and one week focused on “How to Develop Training Courses”. The examiners prepared and presented an outline of training on “Bank Ratings”. Our project Associate prepared and presented an overview of a course we hope for her to develop for delivery to the Agencies on “Clear, Effective Written Communication”. One

Federation “Train-the-Trainer” candidate made a presentation during the Financial Analysis Off-site workshop.

In October 2002 five RSBA and seven FBA staff attended “Train-the-Trainer” seminar. Primary objectives were to improve the presentation ability of supervision staff and to introduce several of them to training as a part of their ongoing activities for the continuing training and development process in the Agencies.

Several FBA staff will be involved in developing and delivering a training seminar to another agency in late-March. Our Senior Project Associate will assist them in what we believe will be a great learning experience on training.

Ongoing: We are advising on external training options to consider as part of the overall training and development program. Officials of the Agencies recognize the need for ongoing training and plan to use a variety of sources to fill the need, including regional training centers, foreign sources, in-house for new staff and OJT by constructing examiner teams that maximize the use of experience and skills for development of new staff.

The Managing Board approved the annual Work Plans for 2002 and 2003 in December of the prior year. They recognized the need for continuing training in the development of banking supervision, specifically noting the original plan adopted in 1997 and recognized the need for postponing classroom training while emphasizing OJT and work priorities. The approved plans noted the need for on-going training provided by foreign experts, training at in-country seminars and external training sources. The Work Plan stated that one week per quarter should be planned for seminars and formal training. The Work Plan also suggested the make-up of examination teams be structured to spread the experience and to provide ongoing training to newer members.

The Agencies envision participation in regional training and local Bankers’ Institute training as part of their future options. FBA joined the Bank Supervisors’ Association of Central and Eastern Europe to broaden its contact activities and anticipates this and other regional associations as providing training in the future. They also plan to participate in the Training Institute co-sponsored by USAID and Toronto Centre at the National Bank of Poland.

The two Agencies and the Central Bank jointly signed a Cross-Border Supervision agreement with the Central Bank of Slovenia and conducted a joint examination of a Federation bank in June 2002. Officials discussed future training with Slovenia in joint or regional seminars and workshops. They believe that in-house training will involve limited in-house developed and delivered training based on this project’s contributed training courses. They will focus on coordinating attendance by staff at outside training and sharing of the training on their return.

The FBA has approved but not yet established a position of Development Advisor. This position will do research, analyze risks and threats, trends, new activities and develop countermeasures for the Agency including staff training and development to meet the challenges.



D/ Examiner Training and Accreditation

By:

Completed:

2.	<i>Restart and finalize the Accreditation process (tests, case exercises) and begin the formal Accreditation process for supervisors.</i>	2Q-02	Ongoing
----	---	-------	---------

Met	Partial	Not Met
	X	

As recognized in the Work Plan noted above, this was postponed due to other priorities of the Agencies. The Agencies’ Officials recognize the importance of Accreditation in the development process as is noted in their Work Plans and are eager to continue the development process in the near future. Timing of this process should be coordinated with the proposed consolidation of the two Agencies under the “umbrella” of the Central Bank, which should be accomplished during 2003 or early 2004.

E/ Licensing Activities & Corporate Activities

By:

Completed:

1.	<i>Provide training to FBA and RSBA staff on the draft Licensing and Corporate Activities manual and oversee pilot testing of the procedures.</i>	2Q-02	Ongoing
----	---	-------	---------

Met	Partial	Not Met
X		

In April and July 2002, the FBA Licensing Dept. completed the revision of the Corporate Procedures Manual. These included amendments to the Law current at that time. Resident Advisor provided limited guidance and advice. The Manual was provided to the RSBA.

In October 2002, FBA again revised the procedures due to the extensive changes to the Law on Banks and revision of regulations. The FBA has developed considerable experience and capability in this area. The person in charge has had this role for 6 years, and is assisted by an attorney with prior experience in corporate regulations. They now initiate revisions on their own in response to legal changes or to enhance the procedures as needed. They request advice from the advisor on new issues. RSBA has less activity in this area and less experience due to turnover of key officials. It needs more attention. Advisors are providing assistance to the process and harmonization of the revisions.



E/ Licensing Activities & Corporate Activities

By:

Completed:

2.	<i>Assist the supervisory staff in designing and presenting Outreach Seminars for the banking community to introduce the new Licensing and Corporate Activities process/requirements.</i>	3Q-02	Ongoing
----	---	-------	---------

Met	Partial	Not Met
	X	

As noted above, FBA communicates extensively and regularly through the magazine “BANKE”, its attached “Newsletter” and other written materials. This includes general articles about banking and banking supervision, specific articles on law, regulations and sound practices and other articles that represent continuing education, e.g., the “Core Principles for Effective Supervision”, “Analyzing Annual Financial Statements of Listed Companies” and a BIS Basle Committee issuance on Anti-Money Laundering.

RSBA and FBA have both held 1-day meetings with bankers on specific, targeted topics. RSBA demonstrated its active notifications to bankers by its prompt advisory letter to bankers on the Pyramid Scheme detected earlier in 2002.

The FBA previously hosted a 1-day Seminar for bankers on the process of the Violations Committee and provided a listing of the most common infractions.

Tangible Results and Benchmarks from Task Order Modification dated July 23, 2002:

The Task Order was modified in July, 2002 to add provision of technical assistance to the FBA in its role of supporting the resolution of Hercegovacka Banka (“HB”).

Tangible Results

Resolution of the loan portfolio: The PA-HB and the FBA with input from our advisors have reviewed and developed a resolution strategy for the majority of loans in the commercial loan portfolio. Those remaining loans with borrowers willing and capable of restructuring will be rewritten with new repayment schedules, and remaining loans will be outsourced for legal collection. Specific efforts will focus on maintaining the restructured portfolio, managing continuing parallel non-legal recovery efforts for loans in litigation, and focusing on the remaining 25 loans currently pending restructure. Primary focus for the remaining time period will be the preparation of the remaining portfolio in its entirety for sale.

- Advisors worked continuously with the FBA to identify weaknesses in regulation, law and training revealed by the continued “autopsy” of HB. Examiners reviewed files related to the loans that triggered HB’s collapse, and advisors recommended numerous changes to

laws and regulation to minimize the future likelihood of similar failures, or to catch those failures earlier on.

The advisory team reviewed the various commercial and consumer portfolio to determine the best strategies and procedures to maximize the recovery efforts for the loans. This task also allowed for increase cash flow to the PA and also a higher sales value.

Resolution of the Loan Portfolio **By:** **Completed:**

<i>1. The PA will have completed a Plan for final resolution of the restructured commercial loan portfolio.</i>	Sept 2002	Jul 2002
---	-----------	----------

Met	Partial	Not Met
X		

This benchmark was satisfied in July, 2002, with the creation of a “P&A” sales strategy. This strategy anticipated a sale of the major categories of assets of HB, with the form of payment to be made by assuming a proportionate share of deposits.

Resolution of the Loan Portfolio **By:** **Completed:**

<i>2. The PA will have prepared the portfolio for resolution, including “pre-sale” preparation to facilitate investor due diligence.</i>	Sept 2002	Sept 2002
--	-----------	-----------

Met	Partial	Not Met
X		

This task was completed in September, 2002, with the completion of a due diligence room containing twin working sets of all files for investor review, and completion of the electronic reports required for offsite analysis.

Resolution of the Loan Portfolio **By:** **Completed:**

<i>3. The PA will have an investor database prepared for sale of the loans on a whole-bank basis or individually .</i>	Sept 2002	Aug 2002
--	-----------	----------

Met	Partial	Not Met
X		

A database was prepared in August 2002 that contained every identified potential purchaser for the insurance company, the telephone company and the banking assets of HB. This database is more fully described under “Final Resolution of HB Bank” section.

Final disposition of subsidiaries and affiliates: The technical assistance and guidance will focus on developing an overall strategy and time frames with the PA and FBA to sell, merge, or liquidate remaining subsidiaries and affiliates to provide the bank with sufficient funds to payout the depositors as prescribed by law. This will include the preparation of individual marketing strategies, identifying potential purchasers, and conducting the sales effort. While no guarantees can be made, we anticipate concluding the sales process by November 30, 2002, either as part of a whole-bank sale, or individually.

- At the time initial assistance was provided in October 2001 under the original task order, HB consisted of a tangled structure of interlocking subsidiaries, many with outsider minority shareholdings. A number of subsidiaries held stakes in each other, and interlocking shareholdings existed at second- and third-tier subsidiaries. In an effort to streamline the corporate structure, and untangle the corporate ownership to permit resolution, a number of subsidiaries were sold, merged or wound down. In particular, as Hercegovacka Osiguranje (HO) had minority shareholders who could block a distribution of proceeds from the sale of Eronet, advisors recommended a strategy giving PA-HB a super-majority of HO shares to permit PA-HB unfettered control of HO. Working closely with the loan restructuring department, PA-HB was able to increase its holdings from 66% of HO to in excess of 80% of HO, allowing super-majority rights.

By July 2002, the PA-HB had determined that the best value for HB would be to allow investors to value the HB franchise as a whole, in line with the “bancassurance” model prevalent in Europe. Advisors devised a sales strategy that would allow bidders to either value the HB complex as a whole, or to pick and choose the components that fitted their needs. This flexibility would allow the marketplace to determine if the “bancassurance” model did indeed yield a higher value than the components separately, while still allowing investors the option to price assets on an individual basis.

Given the concern over delays in resolution of the Eronet licensing issues, advisors developed a plan to allow Eronet to be dividended upstream to HB, without damaging the rights of minority shareholders, and without rendering HO insolvent. In the event that Eronet was not resolved by the scheduled marketing date, Eronet could be left in the corporate shell, along with any remaining depositor claims, for final resolution in the bankruptcy process.

As of September 30, 2002, advisors were ready to take HB to market. As OHR prerequisites to allow the sale to begin were not completed by September 30, USAID determined to delay further assistance until these prerequisites were met. As of September 30, 2002, assistance was suspended to PA-HB, preventing the implementation of the final action steps described below.

The timelines, marketing materials, investor databases, resolution strategies and “pro-forma” legal documents that could be used for the “bank tender” were provided to USAID-Sarajevo during the project tenure. Additionally, the PA-HB and the FBA also have copies of these documents.



Final Disposition of Subsidiaries and affiliates

By:

Completed:

4. *The Advisor will have drafted and submitted to PA for approval the final plan for selling or merging of the insurance company (Hercegovina Osiguranje) and its related entities.*

Sep. 2002

July 2002

Met	Partial	Not Met
X		

This plan was completed in July 2002 with the decision to include HO as one of the “P&A” assets.

Final Disposition of Subsidiaries and affiliates

By:

Completed:

5. *The PA and advisor will have developed specific action plans for resolving and/or liquidating each subsidiary and affiliate, with a final target date for completion of action by November 2002.*

Aug. 2002

July 2002

Met	Partial	Not Met
X		

These action plans were completed in July, with the first stages of implementation in August and September.

Final Disposition of Subsidiaries and affiliates

By:

Completed:

6. *The PA will have taken all reasonable steps to determine the final resolution of the telephone affiliate, Eronet, and its potential impact on the final resolution of HB Bank..*

Aug. 2002

July 2002

Met	Partial	Not Met
X		

All reasonable steps were taken, but the controversy surrounding the license was not resolved until OHR adopted in February the plan suggested by PA-HB in August and September.

Repayment of depositors’ funds: Our advisors will assist the PA and FBA staff in pursuing collection on outstanding loans and the conversion of other assets to cash to allow the PA-HB to comply with the repayment of deposits following the deposit priorities set by the law. A repayment schedule will be drafted and implemented with initial payment made to depositors



based on priorities established in the law and the amount of available funds. Further, PA-HB and advisors have worked closely with governmental and OHR authorities to develop a revision to the Federation Banking Law to permit interim payouts pending final resolution.

- Advisors took direct action to supervise the recovery of commercial and citizen loans. At the beginning of assistance in October 2001, both portfolios were substantially non-performing, with most loans more than 180 days past due.

Commercial Loans: The Commercial Loan Portfolio, at time of seizure, had outstanding principal balances of approximately KM68 million. By September 2002, advisors had resolved approximately KM56 million. This resolution was accomplished as follows:

- KM15.7 million was collected in cash, and another KM12.5 million in deposit liability was offset.
- In excess of KM26 million was restructured (with realistic payment schedules ballooning in less than twelve months) or settled through the delivery of collateral (including delivery of shares of Hercegovina Osiguranje).
- The remaining loans, if in excess of KM10,000, were referred to outside counsel for an aggressive legal collection plan devised and implemented by Barents consultants. Any unrecovered loan below KM10,000 was fully reserved, and collection activities were referred to the branch managers to implement any possible recoveries.
- An additional KM2,000,000 in loans to HB subsidiaries was restructured, offset against deposits, or settled through the delivery of assets.

Citizen Loans: At the time advisors assumed control in February, 2002, the consumer loan portfolio had loans in excess of 95% by count more than 240 days past due. An aggressive collection plan was implemented by Barents consultants, which, by September 2002, had moved more than 95% of the loans into the performing category (no more than thirty days past the then-due installment’s due date).

Repayment of depositors’ funds	By:	Completed:
---------------------------------------	------------	-------------------

7. PA and the advisor will have prepared and tested the depositor database to allow for speedy payment to the 4,148 remaining depositors as described below.	Aug. 2002	Aug 2002
--	-----------	----------

Met	Partial	Not Met
X		

Database was developed and tested in July and August 2002. Advisors developed a download and verification system, with procedures and plans to contact each depositor to confirm the method and modalities of payment of any deposit, as well as to update contact information to allow bidders to place greater value upon it. Branch managers were trained in the use of the

verification system, and advisors developed a database to capture the information when verified.

Because of limited bank resources and competing projects, the PA-HB elected to defer implementation of the system beyond the September 30, 2002 suspension of further assistance.

Repayment of depositors' funds

By:

Completed:

<p>8. <i>The PA will be in a position to pay funds not needed for operations to depositors in accordance with the priorities identified in the Federation banking law.</i></p>
--

Sep 2002

Aug 2002

Met	Partial	Not Met
X		

After testing of the database, the PA-HB was in a position to pay funds not needed for operations to depositors. However, the PA-HB made a determination to delay this distribution until the completion of the P&A process to allow a purchaser to have the chance to retain depositors as customers.

Final liquidation of HB Bank: The PA-HB will be assisted by a group of specialists/experts whom will provide the PA with the necessary guidance and tools to expedite the liquidation of the bank in a safe and sound manner without significantly impacting the banking system in the Federation. Liquidation will either include a sale of all or part of the bank to another party by their purchase of certain assets and assumption of certain liabilities, or the assets may be sold on an individual basis, with depositors paid from the proceeds. The resolution strategy pursued will be determined primarily by the success rate for resolution of each of the components described above.

- Advisors provided all necessary guidance and established all the processes necessary to “tender the bank” for sale. As noted in the previous sections, our approach was to establish the processes needed to maximize the value of the HB assets and preserve the “franchise”. These two actions would allow for the orderly liquidation without significant negative influence to the banking system. The final resolution, however, depended on actions and decisions by OHR in allowing the sale to proceed and also in the actual timing of the sales effort. Additionally, these decisions could not be made until the final report of the PA-HB was received. Both of these actions delayed the overall strategy, as noted below, until year-end 2002. Many of the actions and timelines we originally established in July 2002 are expected to be carried out by mid-year 2003.



Final Liquidation of HB Bank

By:

Completed:

<p>9. <i>If Eronet is not successfully resolved, the PA will request the revocation of HB's banking license and commence preparation for formal procedures for liquidation stipulated in the banking law. The revocation is subject to consideration and influence by the OHR, and is subject to political concerns in relation to the Dayton Peace Accord. It is probable that the upcoming elections may affect the decision to revoke the license.</i></p>	<p>Sep 1, 2002</p>	<p>Pending</p>
---	--------------------	----------------

Met	Partial	Not Met
	X	

Advisors had recommended a course of action to facilitate the resolution of the license issues surrounding Eronet in July 2002. The concept was to accept Eronet's position as a third preferred carrier and right to the GSM license outside of bid, and calculate the fee to be paid for the license in accordance with an estimate of its value. This policy was not finally accepted in principle by OHR until late September 2002, and implementation did not begin until the first quarter of 2003.

As of September 30, 2002, the PA-HB had not completed the Final Report to the High Representative that would have allowed OHR to make the decision to revoke the banking license. This Final Report was delivered in December 2002, and the High Representative determined in late December 2002 to allow the sales process to continue in lieu of revocation, with a final determination to occur upon the conclusion of the marketing process.

Final Liquidation of HB Bank

By:

Completed:

<p>10. <i>The PA will have developed the strategy for final resolution of HB Bank.</i></p>	<p>Sep 2002</p>	<p>Jul 2002</p>
--	-----------------	-----------------

Met	Partial	Not Met
X		

As described previously, this was completed in July 2002.



Final Liquidation of HB Bank

By:

Completed:

11. <i>The PA and advisors will have prepared a marketing package and investor database for offering HB for sale.</i>	Sep 2002	Jul 2002
---	----------	----------

Met	Partial	Not Met
X		

A database of all likely purchasers, including telephone companies and insurance companies, was completed in August 2002. This database consisted of all operating phone companies in Europe and North America, as well as all licensed insurance companies and banks in BiH, and select companies identified as potentially interested in expanding to BiH from Austria, Germany, Italy, Hungary, Turkey, and Former Yugoslavia. Additionally, a number of international investors in distressed debt were identified.

The marketing process was intended to have several phases. First, a targeted mailing would go to all identified investors. Concurrently, advertisements would be placed in a number of national, regional and international newspapers where likely purchasers would be located. Three strategies, high, medium and low, were presented to the PA for advertising. At the same time, a website with all relevant public documentation was created that mirrored the paper documents.

Upon expressing interest, through any of the dedicated sales hotline, the website or email, in writing or by telephone or visit, the investor would be provided with a preliminary marketing package that provided all available public information on HB and its subsidiaries, a roadmap for the auction process, a confidentiality agreement and a package prepared in conjunction with relevant licensing authorities that would allow bidders to pre-qualify with the appropriate regulatory agency for a particular asset.

Once these documents were completed, and regulatory qualification completed, bidders could perform due diligence. The due diligence room was prepared and ready on September 30, 2002 to accommodate up to three bidders at any particular time.

Final Liquidation of HB Bank

By:

Completed:

12. <i>The PA and advisors will have commenced the auction process for HB, either on a whole-bank basis or the sale of individual assets.</i>	Oct 2002	Pending
---	----------	---------

Met	Partial	Not Met
		X



As described above, OHR and PA-HB were not able to complete certain prerequisite actions, such as final determination of the Eronet issues and a decision to permit sale of the bank, until after termination of activity on the task order. As described above, USAID elected to suspend support until these prerequisites were completed.

Final Liquidation of HB Bank

By: Completed:

<i>13. The PA and advisors will have concluded the marketing and sales process to determine whether there are any buyers for HB on a whole bank or asset-by-asset basis..</i>	Nov 2002	Pending
---	----------	---------

Met	Partial	Not Met
		X

As described above, OHR and PA-HB were not able to complete certain prerequisite actions, such as final determination of the Eronet issues and a decision to permit sale of the bank, until after termination of activity on the task order. As described above, USAID elected to suspend support until these prerequisites were completed.

Final Liquidation of HB Bank

By: Completed:

<i>14. If no market exists for HB on a whole-bank basis, the PA will have completed all feasible non-legal collection actions, and will be in a position to transfer management of legal collection actions and any remaining unresolved assets, such as claims in litigation, to a local Provisional Administrator/Liquidator for final resolution. In the event Eronet remains unresolved, it will be included in the package of remaining assets to be transferred to a local Provisional Administrator.</i>	Nov 2002	Pending
---	----------	---------

Met	Partial	Not Met
		X

As described above, OHR and PA-HB were not able to complete certain prerequisite actions, such as final determination of the Eronet issues and a decision to permit sale of the bank, until after termination of activities on the task order. As described above, USAID elected to suspend support until these prerequisites were completed.



Final Liquidation of HB Bank

By:

Completed:

<p><i>15. Preparation of documentation will occur for Final transfer to a local Provisional Administrator/ Liquidator for resolution and closeout of the project.</i></p>

Dec 2002

Pending

Met	Partial	Not Met
	X	

As described above, OHR and PA-HB were not able to complete certain prerequisite actions, such as final determination of the Eronet issues and a decision to permit sale of the bank, until after termination of activities on the task order. As described above, USAID elected to suspend support until these prerequisites were completed.

Although the final stages of the HB liquidation have not occurred several lessons learned are currently being incorporated in FBA procedures and processes for problem bank resolution.

Training seminars organized by USAID Bank Supervision Project

Training Materials for these courses are available in the project files and have previously been provided to CTO at USAID – Sarajevo subsequent to the training sessions.

Topic	Delivered to:	Date
Basic Bank Supervision	FBA	March 1997
	BARS	September 1997
Bank Accounting	FBA	June 1997
	BARS	October 1997
Introduction to Credit	FBA	March 1997
	BARS	October 1997
Asset/ Liability Management and Liquidity	FBA	June 1997
	BARS	April 1998
Introduction to Foreign Currency Markets	FBA	June 1997
	BARS	December 1999
Advanced Bank Supervision	FBA	September 1997
	BARS	December 1998
Internal Controls/ Audit	FBA	September 1997
	BARS	March 1998
White Collar Crime and Money Laundering	<i>Joint: FBA/ BARS</i>	March 1998
Supervising Troubled Banks	<i>Joint: FBA/ BARS</i>	September 1998
Ethics and Professional Conduct	<i>Joint: FBA/ BARS</i>	October 1998
	<i>Joint: FBA/ BARS</i>	January 1999
Information Technology (IT) for Examiners	<i>Joint: FBA/ BARS</i>	October 1998
Intermediate Credit	FBA	January 1999
	BARS	July 1998
Managing the Examination Process	<i>Joint: FBA/BARS</i>	August 1999
Offsite Bank Supervision	<i>Joint: FBA/BARS</i>	August 1999
Overall Conclusions & Bank Ratings	<i>Joint: FBA/BARS/DIA</i>	January 2000
Intermediate Offsite Analysis	<i>Joint: FBA/BARS/DIA</i>	June 2002
Anti-Money Laundering	<i>Joint: FBA/BARS/DIA</i>	June 2002
Basic & Intermediate Bank Supervision	<i>Joint: FBA/BARS/DIA/YNB</i>	July 2002
Train the Trainer	<i>Joint: FBA/BARS</i>	October 2002



U.S. Based Training arranged by Bank Supervision Project

Topic	Delivered to:	Date
Overview of bank supervision process, internal controls, audit, asset/liability & liquidity mgmt., CAMELS ratings	<i>Joint:</i> FBA/BARS (6 & 5) & Commercial Bankers (7)	July 1997 4 weeks
Effective supervision process, onsite & offsite supervision, risk mgmt., problem banks, corrective actions, enforcement, fraud	<i>Joint:</i> FBA/BARS (5 & 4)	August 1998 4 weeks
International Bank Supervision for non-American Regulators, Jt. by Federal Reserve Bank & IMF	FBA Director Bars	October 2000 3 weeks
Performance Management, Training and Development, Examiner Accreditation, Team-Building	<i>Joint:</i> FBA/BARS (4 & 4), & Senior Project Associate	November 2000 4 weeks

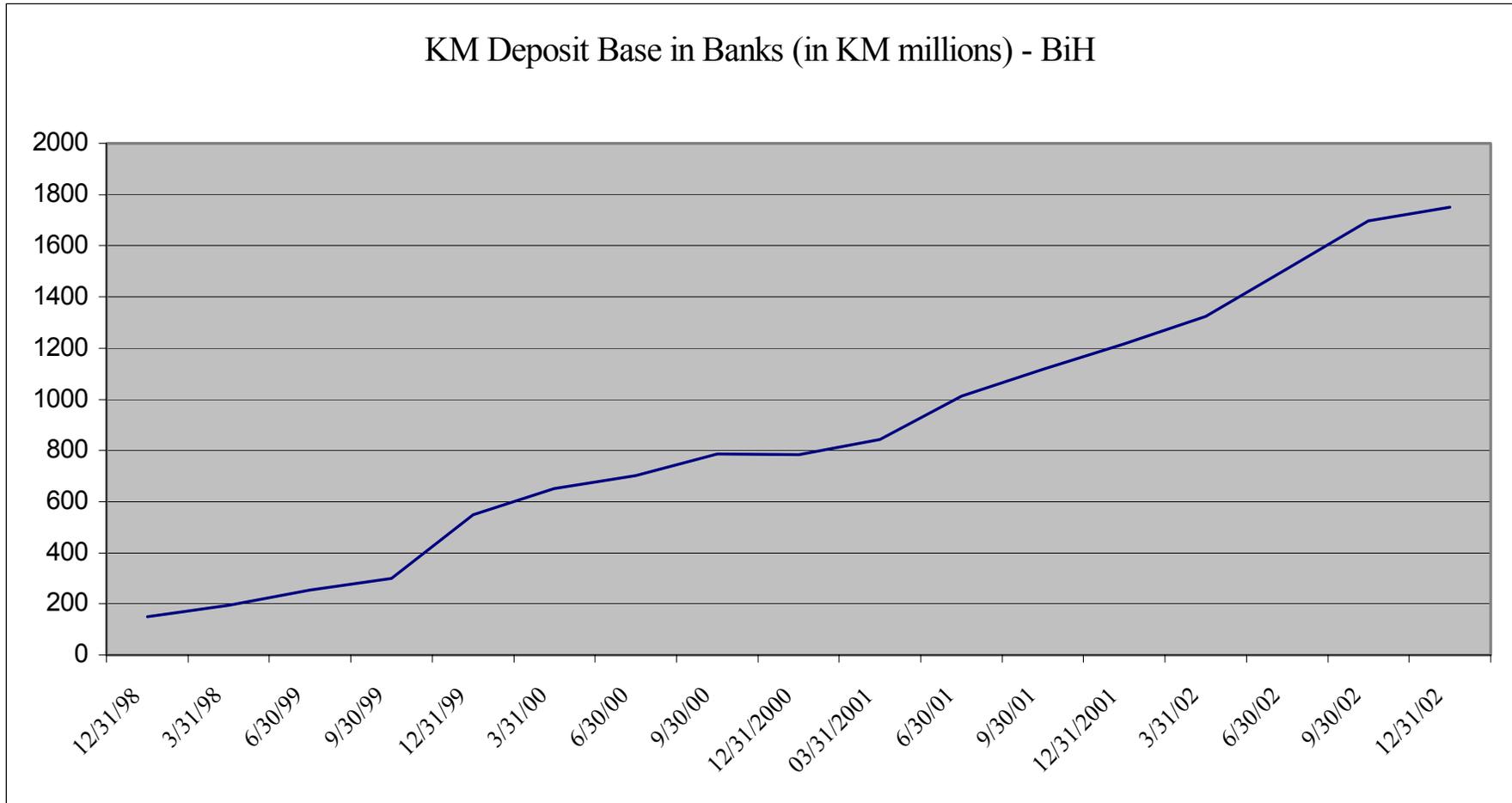
Training Seminars and Conferences Attended by FBA in 2002-2003

Topic/ Organizer	Location	Date	Name
USAID Conference: Financial Intermediation & Risks	Zagreb, Croatia	02/26/02	- Zlatko Bars - Mustafa Brkic
Banking System Presentations - Association of Bankers from Central and Eastern Europe	Budapest, Hungary	03/26/02	- Sanja Custovic
Cross Border Supervision - BIS, Basel	Basel, Switzerland	04/22/02	- Sanja Hussain - Spomenka Nikolic
Problem Bank Resolution - Toronto Center	Switzerland	05/21/02	- Zlatko Bars
EDP	KRK, Croatia	05/27/02	- Muhidin Suvalija
Banking System in Turkey - National Bank of Turkey	Ankara, Turkey	05/03/02	- Amra Limo - Jadranka Bicakcic
Optimal Bank Examinations - USAID/ Central Bank of Poland	Poland	06/01/02	- Edina Hondo - Mirza Ramic
Money Laundering - Bank of Slovenia/ BSCEE	Slovenia	06/17/03	- Mustafa Brkic - Sanja Custovic
BSCEE Conference	Bratislava, Slovak Republic	10/06/02	- Zlatko Bars - Mustafa Brkic
Round Table: Corporate Governance	Neum	10/10/02	- Feriha Drahotuski - Jadranka Bicakcic
IMF & World Bank Capital Accords	Armenia	10/28/02	- Sanja Custovic
BSCEE Conference Bank System Presentation	Budapest, Hungary	10/14/02	- Nerminka Hromic
Annual balance sheet 2001, Revicon	Sarajevo	11/11/02	- Fatima Piljevic
Balance Sheet 2002, Revicon	Sarajevo	12/10/02	- Zeljka Azinovic
USAID Conference, Mortgage Lending and Securitizations	Sofia, Bulgaria	02/05/03	- Zlatko Bars - Mustafa Brkic
US DOJ, Investigating Financial Crimes and Money Laundering	Sarajevo	02/24/03 03/03/03	- Ibrahim Sinanovic - Suada Saric - Ismail Hadziefendic

**LIST OF MAJOR REFERENCES TRANSLATED
FOR BANKING AGENCIES**
(excluding procedures manuals)

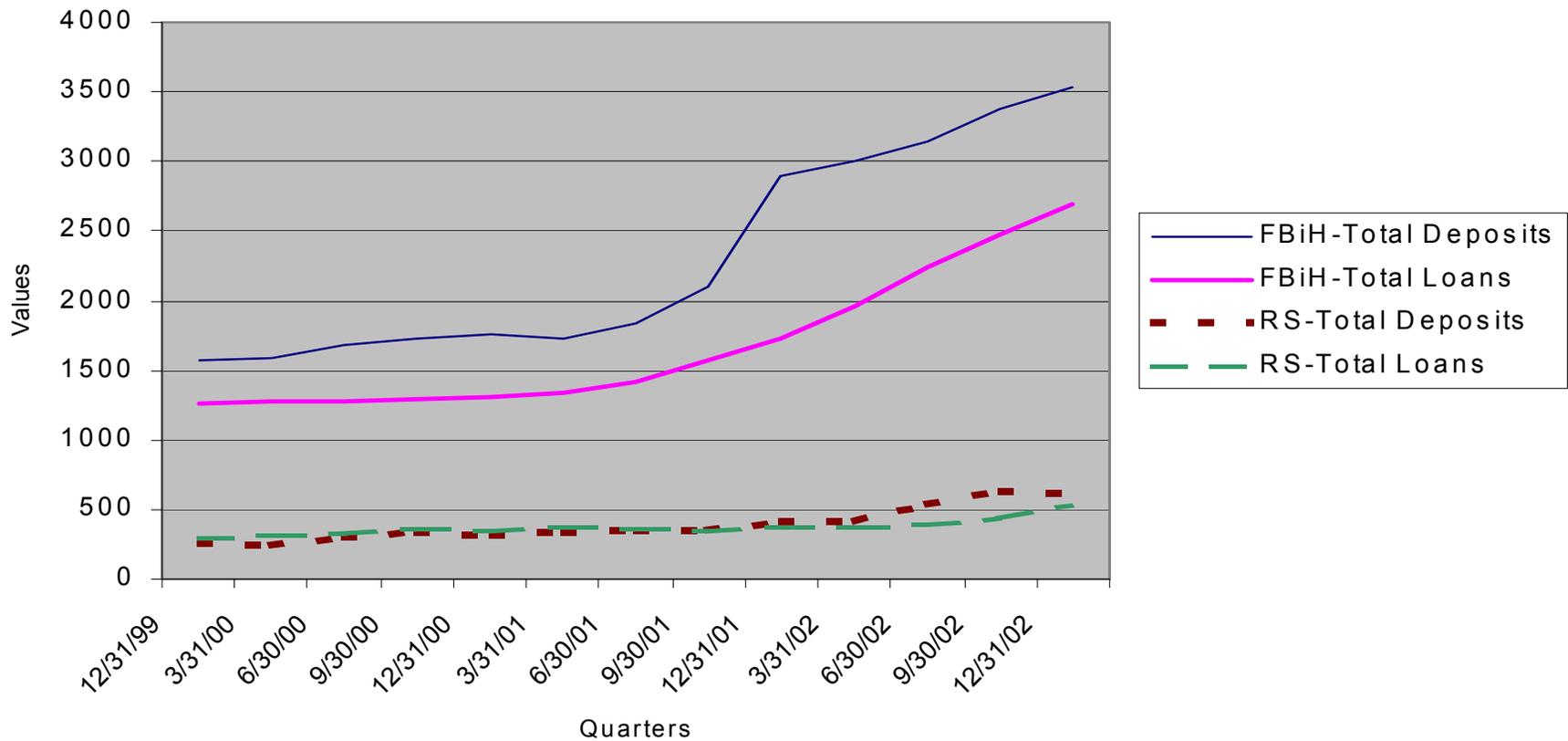
- 1) Basel: Core Principles For Effective Bank Supervision (1997)
- 2) Basel: Elements Of An Internal Control System
- 3) Basel: Enhancing Bank Transparency (September 1998)
- 4) Basel: Core Principles Methodology (2001)
- 5) Basel: Conducting A Supervisory Self-Assessment (2001)
- 6) Basel: Cross Border Supervision And Agreements
- 7) Basel: FSI Paper On Location Of Bank Supervision
- 8) Basel: Guidance On Dealing With Weak Banks (2002)
- 9) Basel: The Third Pillar – Market Discipline (2003)
- 10) FDIC: A Quick Guide For Bank Closing
- 11) OCC: An Examiner’s Guide To Problem Bank Identification, Rehabilitation And Resolution (2002)
- 12) OCC: Red Flags In Board Reports – Guide For Directors (2002)
- 13) OCC: Bc-256 - Enforcement Policy (1998)
- 14) OCC: Standards Of Ethics And Professional Conduct (1998)
- 15) Barents Group: Legal Protection For Bank Supervisors - Immunity Of Public Officials From Personal Lawsuits In The United States, United Kingdom And Germany (July 1999)
- 16) Barents Group: Achieving Supervisory Objectives In Transition Economies - Legal Impediments And Potential Solutions (July 1999)
- 17) EBRD: Building A Strong Banking Sector In Transition Economies – The Case Of Moldova (October 1997)
- 18) World Bank: On The Road To EU Accession:
 - Restructuring The Banking Sector
 - Evaluation Of The Methods Of Restructuring
 - Strengthening Bank Supervision And Intervention
 - Equity Markets
 - Financial Sector Integration - Central Europe And The EU (1998)
- 19) World Bank: Study On Statutory Protections For Banking Supervisors (1999)
- 20) Federal Reserve Bank: Code Of Conduct (1999)
- 21) Federal Reserve Bank: Coverage Of Sections 23a & 23b (1999)
- 22) USG: Political Activity And Federal Employees (1999)
- 23) Instructions: OGE Form 450 – Confidential Disclosure Report (1999)
- 24) Wolfsberg: Global Anti-Money Laundering Guidelines For Private Banking (2002)
- 25) UST: Bank Secrecy Act (And Money Laundering) (1998)
- 26) FATF: 40 Anti Money Laundering + 8 CFT Recommendations
- 27) FATF: Guidance For Financial Institutions In Detecting Terrorist Financing (2003)
- 28) FATF: Report On Money Laundering Typologies (2003)
- 29) Information Paper On Financial Intelligence Units And The Egmont Group (2002);
- 30) Booklet Of BiH Anti-Money Laundering Working Group

Growth in New Currency (KM) – Acceptance of KM

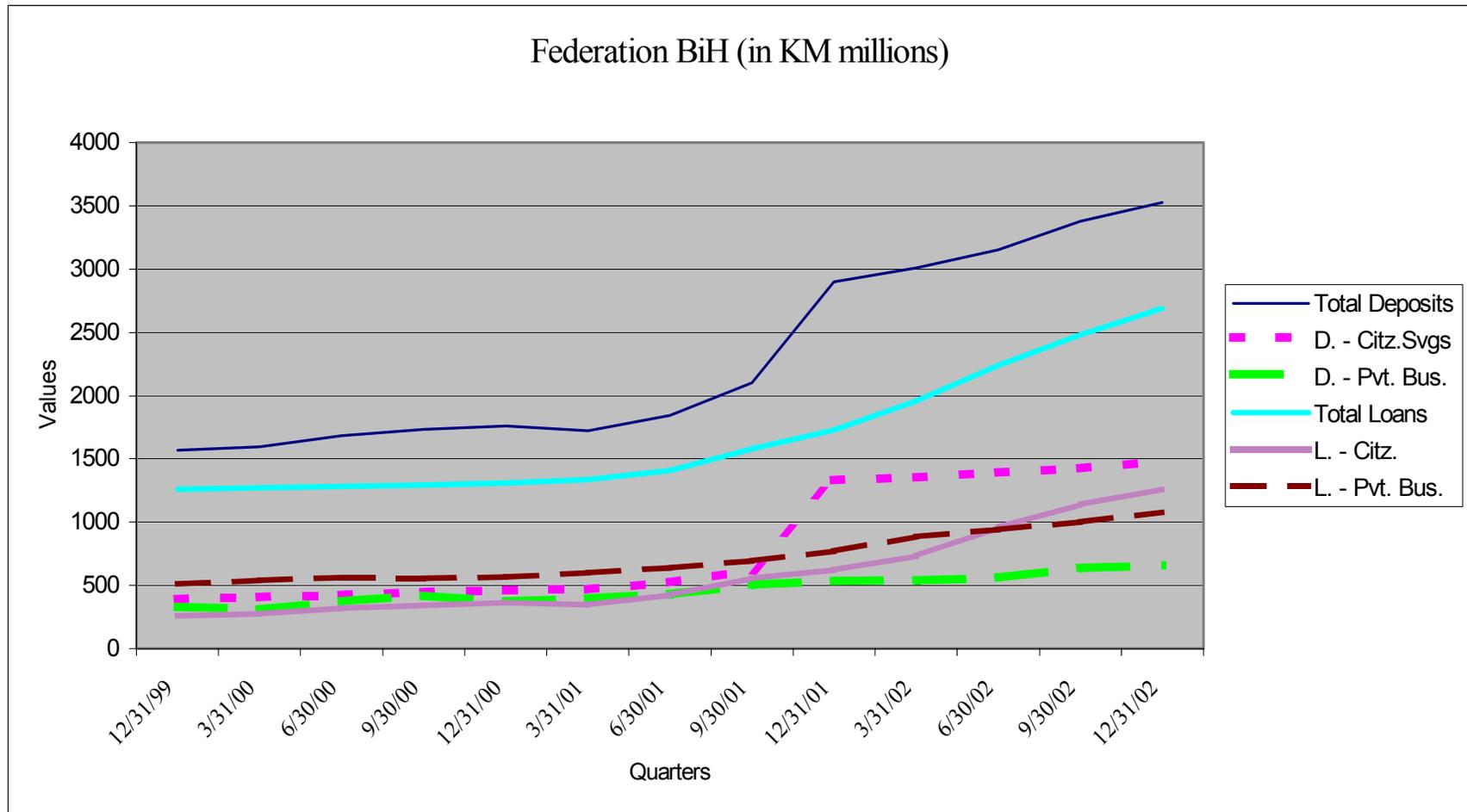


Size and Growth Comparison of Two Banking Systems

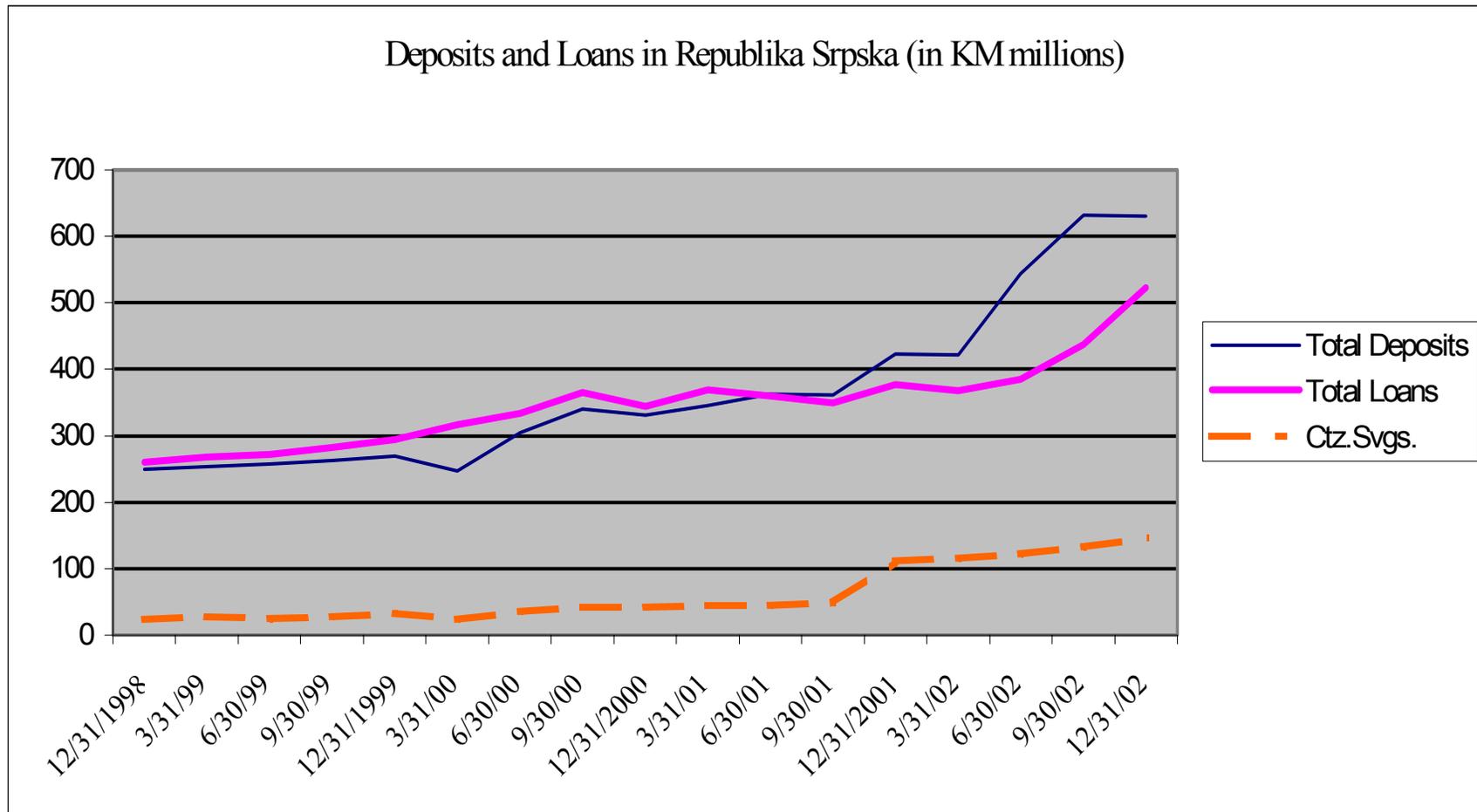
Federation BiH & Republika Srpska (in KM millions)



Increased Confidence in Banks, DM Conversion to Euro
Strong Deposit Growth followed by Strong Loan Growth



Growth in RS, but on a Smaller Scale



Participation in other Projects and Working Groups by the Advisory Team

The success of the project has been attained through cooperation and inclusion of other international institutions and local interested parties in the implementation of changes to the financial sector. Early on, USAID recognized the importance of the interaction and cooperation from these sources and the interdependence of the players in the success of a financial sector reform that could be sustained. Our advisory team also believes that this interaction is beneficial and essential in making sure that all transitions and changes in the environment, particularly those prompted by legal reform, are fully supported in the implementation phase.

As a result of their long tenure our advisors have been and continue to be involved in many tasks forces, working groups and ad-hoc advisory capacities with the concurrence of USAID. Examples of some of these groups include:

- Central Bank of BiH. Ongoing Bank Supervision Coordination meetings and working groups to discuss implementation of numerous initiatives affecting financial sector reform.
- USAID, U.S. Treasury and The World Bank to develop a deposit insurance concept and a draft of the Deposit Insurance Law from late 1997 through late-1998, and again with U.S. Treasury, GTZ and The World Bank through the enactment of an improved law at the state level in 2002.
- IMF, WB, U.S. Treasury and OHR on Bank Privatization Working Group and Opening Balance Sheets for Federation Banks from 1998 through 2001.
- RS Bank Privatization Unit Advisors from SIDA from 1998-2001.
- USAID Macro-Economic Project on the Payments System study and conversion to commercial banking system from late-1998 to Jan-2001. Advisor Berney was a major contributor to that project; other advisors assisted.
- The World Bank attorney to develop a Law on Micro-Credit in 1998-1999. Project attorney and advisors provided substantive input into the new Law.
- The World Bank & DFID in October 2001 plan for privatizing 2 RS banks. Advisor Dudley developed the “Trustee Plan” for privatizing the 2 banks. This forced out the issue of delay.
- Local Attorney and Prosecutor, Vildana Helic, training seminar March 1998.
- UST Advisor O’Brien on Seminars for Bankers on Internal Controls and Audit in September 1999.

- USAID Business Finance and Bank Development and Training projects included periodic meetings to discuss changes, trends and concerns in banking.
- Various regular IMF and World Bank missions, providing system data, translated reports, and other needed information.

Advisors Participation with Other Training Efforts:

- Advisors made presentations to USAID Bankers Training on “Internal Controls and Audit” in and on “Bankers Cooperation with Bank Examiners” 1997.
- Advisors made presentations to World Learning participants (Examiners and Bankers) in preparation for U.S. based training in 1997.
- Advisors made presentations to RS bankers in March 2000 on the process of qualifying for approval to perform payment transactions under the new system.

Cooperation with FSVC:

- Volunteer Borders assisted on Training Seminars on Bank Accounting for Examiners and Bank Accounting for Bankers in September 1997.
- Volunteers Davis and Zohab assisted in the first Joint-Agency Training Seminar on “Financial Crime and Money Laundering”. We also arranged for them to make presentations to Federation-MOJ Prosecutors and to the University of Sarajevo School of Criminal Law in March 1998.

Core Principles for Effective Banking Supervision Assessment
Summary

Prepared by: Claude Raworth and Haydée Gilliam,

October 2001

Background:

Over the past six years USAID has provided substantial technical assistance and donor funds to build the banking regulatory infrastructure in the Federation of Bosnia and Herzegovina and in the Republika Srpska. This assistance has included a resident advisor team in both entities as well as short-term advisors that have provided guidance and knowledge transfer in the areas of bank supervision, problem bank resolution, and bank supervisory infrastructure (organizational structure and personnel management areas). The majority of the initial efforts were for developing the legal framework, as well as to provide formal and on-the-job training for onsite bank supervisors. Over the past year, however, much of the technical assistance has been focused on the development of the institutional capacity for the problem bank resolution and provisional administration.

As part of the most recent Task Order signed by Barents Group of KPMG Consulting (Barents) with USAID, one of the initial tasks identified in the project was the Assessment of the current supervisory capacity to comply with the 25 Core Principles for Effective Banking Supervision established by the Committee on Banking Supervision of the Bank for International Settlements, Basel, Switzerland (Basel Committee). These Principles are deemed the international standards for “excellence in banking supervision”. Additionally, the Banking Supervision Assessment Matrix (BSAM) was used to identify direct and indirect impediments to bank supervision.

The assessment was performed during the period October 1 through October 26, 2001 by Mr. Claude Raworth and Mrs. Haydée Gilliam, both recognized international banking supervision specialists. Mr. Raworth and Mrs. Gilliam are both former examiners with the Office of the Comptroller of the Currency in the United States. Mr. Raworth has more than 30 years bank regulatory experience and has worked for the last six years with Central and Eastern European central banks in the strengthening bank supervision. Mrs. Gilliam has more than 25 years of experience with international banking regulatory and supervisory issues.

The evaluation was performed in both the Federation Banking Agency of Bosnia and Herzegovina and in the Banking Agency of Republika Srpska. Mr. Raworth and Mrs. Gilliam received substantial assistance from the current resident advisors to each of the Agencies, Mr. C. Dale Wilson and Mr. Greg Taber. Additionally, the assessment team interviewed members of the international community, local government and Banking Agencies staff to gain insight into matters affecting the banking supervisor’s performance. Additionally, the team reviewed applicable laws, regulations and Banking Agency records. Full cooperation and access was available to the assessment team.

The results of the assessments were issued to each Banking Agency separately and thoroughly discussed. This summary highlights the most significant conclusions of both reports, identifies areas of additional need and makes recommendations for future consideration by USAID as well as the Banking Agencies.

Conclusions:

There is still substantial need for strengthening efforts and technical assistance for the Banking Agencies of both the Federation and Republika Srpska. There has been substantial achievement noted, particularly as they relate to the legal and regulatory framework. However, staffing has not kept pace with the complexity and emerging issues experienced in the financial sector. Each Agency has been able to perform a “good job” with the limited resources but they may not be able to continue to “stretch” themselves to deal with the ever present crisis and perform continuing preventive supervisory functions.

Another area for improvement that is evident in both Agencies is the lack of perceived independence and credibility of the two institutions. Although the senior management of each Agency is considered professional and with substantial integrity, the overall perception is that their ability to act is limited due to either political pressure (RS) or unjustified lawsuits and investigations (FBiH). The proposal to place both Agencies under the scope of the Central Bank appears to be a solution that will eliminate or at a minimum reduce both of these concerns. It will additionally provide necessary funding for expansion in staff, training, and infrastructure needs.

As can be expected, neither Agency’s performance is considered fully compliant with all the Core Principles, however, a greater degree of compliance is evident in the FBA. This can be attributed to its longevity of operations and also a more robust banking system in the Federation with private and foreign bank ownership as well as deposit insurance. The RS still remains plagued by a troubled economic situation, large problem banks (primarily state-owned) and a shorter development history.

While the RS has been hampered by these problems, their smaller operations have also allowed them to develop more quickly in certain areas such as offsite tools and management information systems. These two areas could be replicated in the FBA and substantially increase the productivity of the overall staff. The FBA still maintains its idea of “creating” an internal MIS system but its development seems to be ineffective in meeting the FBA’s current supervisory needs. Waiting to build the “ideal” system has cost them years of inefficiency and poor “pro-active” supervision.

The banking system in both the Federation and the RS is changing rapidly and new entrants will also likely introduce new products, services and new areas of risk. Both agencies have focused on dealing with credit-related problems of the past (connected lending and insider abuse primarily) or with liquidity and payment system problems. There has been limited time to develop in other areas such as interest rate risk, country risk, information technology and other legal risks (money laundering and other criminal activities within bank).

Other specific items and recommendations are included in each of the Agency's individual reports. We have recommended to Director Bars (FBA) and Acting Director Novaković (RS) that they use these recommendations to work with their staff and the USAID resident advisors in developing an internal action plan. We have also provided them with the Basel Committee on Banking Supervision document "Conducting a Supervisory Self Assessment – A Practical Application" that identifies a clear methodology they can use to perform a self-assessment and create a work plan.

Recommendations:

The assessment team recommends that USAID focus the technical assistance in three key areas:

- Development of a strong organizational structure, including performance management processes and personnel development
- Institutional technical knowledge building efforts through both formal classroom training and on-the-job advisor guidance on specific areas.
- Staff support of regulatory experts to assist in on-site examinations.

Organizational structure

In order to be effective both Banking Agencies will need to develop adequate levels of staffing, appropriate job descriptions and a performance management process that will reward excellence while dealing with "poor performance". Some initial work and restructuring was done earlier in 2001, however, it has not been finalized. The implementation of the proposal to bring the two Agencies under the "umbrella" of the Central Bank, creates an excellent opportunity to revisit the current organizational structure and implement a sound performance management and remuneration process. This will allow both Agencies to attract and retain talented personnel and appropriately deal with poor performers. Training and coaching in this area will be necessary as these processes are implemented.

Institutional technical knowledge

There is a need to have training and knowledge transfer in new areas of risk for the Agencies such as country risk, market risk and information technology. Additionally, as new personnel is hired and a need for specialists becomes more pronounced, there needs to be some basic knowledge standards outlined. It is recommended by this assessment team that consideration be given to supporting training efforts in the following areas:

- Money laundering and other "white collar crimes"
- Advanced credit evaluation skills, focusing on cash flow evaluation
- International accounting standards and their implementation during both onsite and offsite processes, particularly as they apply to accounting for mergers, acquisitions and new products
- Information technology – data processing evaluation

- Market risk – interest rate, price and foreign exchange risks within the bank’s balance sheet and off-balance sheet operation
- Train the trainer course that will allow them to build internal capacity to train their new staff
- Managing the examination – including budgeting, planning and performance evaluation.

The above components should include both formal classroom training complemented with on-the-job application of the material.

Staff support

Additional experts are needed to ensure that the Agencies move from a “reactive” mode of supervision to one of being “pro-active”. The experts would be used in “targeted” examinations to identify emerging risks and threats and enable the Agencies to take timely corrective action. The staffing levels at both Agencies are too thin at present and for the immediate future to fulfill this goal. Staffing problems at the RS are even more acute.

Banking Supervision Assessment Matrix (BSAM)

The “Banking Supervision Assessment Matrix” (BSAM), provides a frame of reference to be used in determining the critical factors which need to be addressed in developing effective banking supervision in each separate country. In addition, the BSAM provides a tool in monitoring progress in achieving effective banking supervision over various time frames.

This tool is used to assess the impact of “direct” and “indirect” factors on existing bank supervision within any given country . The matrix list these factors and a numerical indicator which reflects whether they are considered to have a favorable or unfavorable impact. The perceived impact is rated from “1” to “5” with “1” representing a very unfavorable impact and “5” representing a very favorable impact; “3” would be neutral. Within each factor the elements are also rated.

All of these elements are generally required within the supervisory framework if supervision is to be effective. The information below presents the results of the BSAM during the assessment performed in October 2001 by Mr. Claude Raworth and Ms. Haydée Gilliam.

Country/Entity: Federation of Bosnia and Herzegovina, Sarajevo Bosnia

FACTORS DIRECTLY IMPACTING BANKING SUPERVISION

Factors	<u>Elements</u>	Sept 2001	Comments
Legal Framework	Banking Agency Law	3	Revisions Underway
	Banking Law	3	Revisions Underway
	Currency Laws	5	KM Very stable
	Deposit Insurance	4	Six Banks Approved
	Corporate Governance	3	Accounting Poor
Supervisory Powers	Licensing Activities	4	
	Enforcement Powers	4	
	Monetary Penalties	4	
Supervisory Laws/Regulations and Policy Statements	Liquidity / Reserve Requirements	4	
	Capital Adequacy	4	Requirements Transitioned
	Asset Classification/Loan Loss Provisions	4	
	Delinquency/Non-Accruals	4	
	FX Exposure Limits	3	
	Audit Requirements	4	
	Regulatory Reporting	4	
	Large Exposures	4	
	Insider/Related Transactions	3	
	Supervisory Structure	Independence	2
Corporate/compliance activities		3	
On-site Examination		3	Understaffed

Factors	<u>Elements</u>	Sept 2001	Comments
	Off-site-Analysis/Systemic Risk	3	Need Implement Database
	Problem Bank Unit	3	
	Provisional Administration	4	
Supervisory Process	Supervisory Goals & Objectives	2	
	On-site Exam Methodology	3	Not fully utilized
	Off-site Analysis Methodology	4	
	Bank Rating System	4	
	Supervising Problem Banks	3	Crisis Oriented
	Closing Insolvent Banks	4	
Organizational Development	Staffing Plan	3	Well-Understaffed
	Training	3	Very Limited Given Staffing
	Salary Administration/Performance Mgt.	3	Needs Implementation
	Technical Support-IT etc.	1	Poorly Oriented, Non-Supportive
Implementation of Supervisory Process	Timeliness/Accuracy of Data	3	
	Implementation of Off-site Supervision	4	
	Implementation of On-site Inspections	3	Need Consistency; Staffing
	Acceptance by banks of Supervision	3	
	Licensing Effective	4	
	Use of Enforcement Powers	3	
	Judicial Support of Supervision	1	Real Problem
Bank Portfolio Characteristics	Portfolio Quality	3	Moving into Consumer Credits
	Concentrations	3	Insider Problems
	State-owned vs. Private Borrowers	3	
	Reliability of borrower financials	2	
	Adequacy of credit analysis	2	

ENVIRONMENTAL FACTORS AFFECTING BANK SUPERVISION

Factors	<u>Elements</u>	Sept 2001	Comments
Banking Structure	<u>State-Owned Versus Private</u>	3	
	<u>Foreign Banks / Branches</u>	5	
	<u>Concentrations</u>	4	
	<u>Extent of Permissible Activities</u>	4	
	<u>Non-bank Competitors</u>	5	Very Little
	<u>Inter-bank Market</u>	1	

Factors	<u>Elements</u>	Sept 2001	Comments
	<u>Payment Systems/Clearings</u>	4	Through Banking System
	<u>Credit Bureaus</u>	1	Being Established
	<u>Bankers Associations</u>	1	Lacking
Socio/Economic Environment	<u>GDP Growth</u>	3	
	<u>Inflation</u>	3	
	<u>Extent of Privatization</u>	3	
	<u>Private Sector GDP</u>	3	
Economic Policy	<u>Monetary Policy Objectives / Tools</u>	3	
	<u>Government Budget Size/Financing</u>	3	
	<u>General Level of Nominal/Real Interest Rates</u>	3	Rates Declining
Taxation	<u>General Level/Trend of Taxes</u>	3	
	<u>Treatment of Provisions, non-accruals</u>	3	
Balance of Payments	<u>Current Account/GDP</u>	2	
	<u>Stability</u>	2	
	<u>Real Exchange Rate</u>	2	
	<u>Exchange Rate Mechanisms/Controls</u>	3	
	<u>Capital Controls</u>	3	
Political Environment	<u>Stability of Government</u>	3	
	<u>Government's Agenda Vs-a-Vs Supervision</u>	2	
	<u>Relationship MOF vs. FBA</u>	3	
Accounting Standards	<u>Bank Chart of Accounts/accounting standards</u>	3	Lack Full Implementation
	<u>Company Accounting Standards</u>	2	
Infrastructure	<u>Telecommunication Capabilities</u>	3	
	<u>Postal Service</u>	3	
	<u>Level of Technology</u>	4	
Legal Environment	<u>Securities Laws</u>	4	
	<u>Lien Perfection and Recording</u>	1	
	<u>Bankruptcy Law</u>	2	
	<u>Foreclosure Law</u>	2	
	<u>Laws Facilitating Privatization</u>	3	
	<u>Judicial System</u>	2	

Bank Supervision Assessment Matrix (BSAM)

Country/Entity: Republic of Srpska, Bosnia and Herzegovina

FACTORS DIRECTLY IMPACTING BANKING SUPERVISION

Factors	<i>Elements</i>	Sept 2001	Comments
Legal Framework	RSBA Law	3	
	Banking Law	3	
	Currency Laws	3	
	Deposit Insurance	1	Only Branches of 3 Banks Insured
	Corporate Governance	2	
Supervisory Powers	Licensing Activities	4	
	Enforcement Powers	4	
	Monetary Penalties	4	
Supervisory Laws/Regulations and Policy Statements	Liquidity / Reserve Requirements	3	
	Capital Adequacy	4	
	Asset Classification/Loan Loss Provisions	4	
	Delinquency/Non-Accruals	4	
	FX Exposure Limits	3	
	Audit Requirements	4	
	Regulatory Reporting	4	
	Large Exposures	4	
	Insider/Related Transactions	3	
	Supervisory Structure	Independence	2
Corporate/compliance activities		3	
On-site Examination		3	
Off-site-Analysis/Systemic Risk		4	
Problem Bank Unit		1	Planned to develop
Supervisory Process	Provisional Administration	3	Takes Supervision Staff
	Supervisory Goals & Objectives	4	
	On-site Exam Methodology	3	Need Adoption of Manual
	Off-site Analysis Methodology	3	
	Bank Rating System	3	
	Supervising Problem Banks	3	Supervision Begins too Late
	Closing Insolvent Banks	3	
Organizational Development	Staffing Plan	2	New Plan Jan 2002
	Training	2	
	Salary Administration/Performance Mgt.	2	

Factors	<u>Elements</u>	Sept 2001	Comments
	Technical Support-IT etc.	4	Bright Spot
Implementation of Supervisory Process	Timeliness/Accuracy of Data	3	
	Implementation of Off-site Supervision	3	
	Implementation of On-site Inspections	3	
	Acceptance by banks of Supervision	3	
	Licensing Effective	2	
	Use of Enforcement Powers	3	Need to be More Aggressive
	Judicial Support of Supervision	2	
	Bank Portfolio Characteristics	Portfolio Quality	1
	Concentrations	2	
	State-owned vs. Private Borrowers	2	
	Reliability of borrower financials	2	
	Adequacy of credit analysis	2	

ENVIRONMENTAL FACTORS AFFECTING BANK SUPERVISION

Factors	<u>Elements</u>	Sept 2001	Comments
Banking Structure	<u>State-Owned Versus Private</u>	2	
	<u>Foreign Banks / Branches</u>	4	
	<u>Concentrations</u>	3	
	<u>Extent of Permissible Activities</u>	4	
	<u>Non-bank Competitors</u>	4	Few, if any
	<u>Inter-bank Market</u>	1	
	<u>Payment Systems/Clearings</u>	2	Commercial Bank Handles
	<u>Credit Bureaus</u>	1	None
Socio/Economic Environment	<u>Bankers Associations</u>	1	None
	<u>GDP Growth</u>	1	
	<u>Inflation</u>	2	
	<u>Extent of Privatization</u>	1	
Economic Policy	<u>Private Section GDP</u>	1	
	<u>Monetary Policy Objectives / Tools</u>	2	
	<u>Government Budget Size/Financing</u>	2	
	<u>General Level of Nominal/Real Interest Rates</u>	2	
Taxation	<u>General Level/Trend of Taxes</u>	2	
	<u>Treatment of Provisions, non-accruals</u>	2	
Balance of Payments	<u>Current Account/GDP</u>	1	

Factors	<u>Elements</u>	Sept 2001	Comments
	<u>Stability</u>	2	
	<u>Real Exchange Rate</u>	3	
	<u>Exchange Rate Mechanisms/Controls</u>	4	
	<u>Capital Controls</u>	3	
Political Environment	<u>Stability of Government</u>	2	
	<u>Government's Agenda Vs-a-Vs Supervision</u>	1	
	<u>Relationship MOF vs. RSBA</u>	2	
Accounting Standards	<u>Bank Chart of Accounts/accounting standards</u>	3	
	<u>Company Accounting Standards</u>	1	
Infrastructure	<u>Telecommunication Capabilities</u>	3	
	<u>Postal Service</u>	3	
	<u>Level of Technology</u>	3	
Legal Environment	<u>Securities Laws</u>	2	
	<u>Lien Perfection and Recording</u>	2	
	<u>Bankruptcy Law</u>	2	
	<u>Foreclosure Law</u>	2	
	<u>Laws Facilitating Privatization</u>	2	
	<u>Judicial System</u>	2	



Administrative Matters:

A. Project Team Staff:

Resident Project Staff

Dale Wilson	Chief of Party, Resident Advisor: July 1996 to present
Dan Berney	Resident Advisor & Pmts. System: July 1996 to March 2001
Greg Taber	Resident Advisor: September 1997 to present
Daniela Gogic	Translator – June 1997 to present
Sabina Kavazovic	Translator and Office Assistant – May-97 to present
Stasa Perkin	Translator and Office Assistant – Feb-98 to present
Vildana Tuzovic	Sr. Project Associate and Office Mgr: Nov-1996 to present
Jasna Vijiuk	Translator and Office Manger – Oct-97 to present

Headquarters Project Staff

Lori Bittner	Managing Director, Project Manager – July 1996 to present
Francisco Figueroa	Project Coordinator, Manager – July 1996 to Sept-2002
Haydée Gilliam	Project Manager – 2001 - 2002
James J. Hightower	Managing Director – July 1996 to YE-2000

TDY Bank Supervision Experts & Principal Assignments:

Phil Anderson	Training, Supervision,
Jane Benson	Intervention, Liquidation, Deposit Pay-outs, Hercegovacka Bk
Lori Bittner	Project Manager, Training, Supervision, Core Principles
John Borders	Training, Supervision, Accounting, Reporting,
Dan Callis	Training, Supervision
Bob Carpenter	Regulatory Attorney, Micro-Finance Laws
Jerry Coleman	Examinations
David Cooke	Senior Policy Advisor, Planning
James Crozier	Examinations
John Demitrovic	Examinations
Ed Drake	Problem Bks, Intervention, Supervision, Money Laundering
Bill Dudley	Trusteeship, Resolution
John Ewald	MIS, Regulatory Reporting
Francisco Figueroa	Training, Supervision, Analysis, Problem Bks, Core Principles
Djevad Gazibegovic	Liquidation, Provisional Administration
Gary Gegenheimer	Regulatory Attorney, Administrative Enforcement
Haydée Gilliam	Supervision, Analysis, Training, Project Mgr, Core Principles
Gil Grey	Examinations, Intervention, Resolution
Jack Gushee	Examinations

Noel Hardin	Examinations
Gene Hollis	Examinations
Neil Isbrandtsen	Examinations
Clydell McSpadden	Supervision, Problem Banks, Enforcement, Intervention
Jimmy Mohler	Training, Accounting, Reports, Analysis
Wayne Owens	Examinations
Bill Pendleton	Examinations
Vicki Peterson	Supervision
Harold Poppa	Supervision, Problem Banks, Enforcement Review Process
David Parker	Asset Sales, Liquidation
Charles Ratliff	Examinations, Reports
Claude Raworth	Training, Supervision, Licensing, Core Principles Assessment
Bill Robertson	Supervision, Problem Banks, Performance Mgmt.
Toby Robinson	Problem Banks, Intervention, Provisional Administration
Don Ryan	Liquidation, Case Memo Process
Jimmy Satterfield	Examinations
Richard Stitche	Training, IT Exams, Y2K, Payment Transactions
Graciano Velez	Examinations, Accounting
Dave Weatherman	Examinations
Alan Whitney	Regulatory Communications
Jim Wright	Training, Anti-Money Laundering

Other Advisors**Assignments at Hercegovacka Bank – PA**

Jack Biggs	Asset Sales, Loan Collections, Resolution
Douglas Carpenter	Letters of Credit, Guarantees
James Hightower	MIS Reports
Marilyn Hill	Insurance, Affiliates
Diane Moore	Chief of Staff, Executive Assistant
Mike Rouswell	Asset Sales, Due Diligence, Liquidation
Steve Shippie	Affiliates, Subsidiaries, Asset Sales
Bob Webber	Banking, Supervision, Reports
Patrick Wiede	Administrative, Affiliates

B. Summary of Project Expenses:

Total Monies Utilized to Provide Technical Assistance in Strengthening Bank Supervision in Bosnia Herzegovina under each separate contracting vehicle and periods of performance.

Strengthening Bank Supervision – Omnibus B: Contract EPE-I-00-95-00048, Task Order No. 10 (December 1996 thru July 1999)

Labor	<u>Cost</u>
Professional Staff	\$4,853,477
TCN/CCN	<u>262,887</u>
Total Labor	\$5,116,364
Travel/Transportation	921,018
Other Direct Cost	266,748
Allowances	450,168
Equipment/Procurement	<u>0</u>
Total Other Costs	\$1,637,934
TOTAL MONIES UTILIZED	<u>\$6,754,298</u>
<i>Contract Ceiling Price</i>	<i>\$6,983,780</i>
<i>Contract Amount Obligated</i>	<i>\$6,983,780</i>



Strengthening Bank Supervision – CEE-NIS: Contract NIS-I-00-95-00001-00, Task Order No. 2 (July 1999 thru July 2001)

Labor (Includes Salary, OH, Fringe, Adm Rec)

Professional Staff	\$ 747,314
TCN/CCN	119,897
Fringe,OH, Admin Recovery	<u>1,845,334</u>
Total Labor Cost	\$ 2,712,545
Travel/Transportation	323,597
Other Direct Costs	122,322
Allowances	381,492
Equipment/Procurement	0
Consultants/Subcontractors	308,947
Local Hires	<u>0</u>
Total Other Cost	\$ 1,136,358
TOTAL Labor and Expenses	\$ 3,848,903
TOTAL Fee	288,668
Less: Amounts exceeding contract ceiling and Other disallowances	(16,868)
TOTAL MONIES UTILIZED	\$ 4,120,703
<i>Contract Ceiling Price</i>	<i>\$4,120,704</i>
<i>Contract Amount Obligated</i>	<i>\$4,120,704</i>



**Strengthening Bank Supervision – SEGIR –FS: Contract PCE-I-00-99-00006-00,
Task Order No. 817 (July 2001 thru February 2003)**

Labor	<u>Cost</u>
Professional Staff	\$2,307,101
TCN/CCN	<u>319,923</u>
Total Labor	\$2,627,024
Travel/Transportation	269,060
Other Direct Cost	208,734
Allowances	260,363
Equipment/Procurement	<u>26,446</u>
Total Other Costs	\$ 764,603
TOTAL MONIES UTILIZED	\$ 3,391,627
<i>Contract Ceiling Price</i>	<i>\$3,482,958</i>
<i>Contract Amount Obligated</i>	<i>\$3,482,958</i>

Summary of all Spending 1996 thru February 2003

Total Labor Costs	\$10,455,933
Total Other Costs	3,522,027
Total Fees	<u>288,668</u>
Total Costs	\$14,266,628

C. Equipment Inventory at Conclusion of Contract -- February 28, 2003

A. Bearing Point Project Items (Sarajevo and Banja Luka Office)			
No.	Item	Description	Location
1.	Compaq Armada M700 laptop	Office 2000 + External A-Drive (used by D. Wilson)	Sarajevo
2.	Compaq Armada M700 (laptop)	Office 97 + External D-drive (used by V.T.)	Sarajevo
3.	Compaq Armada M700 (laptop)	Office 97 + External D-drive (used by S.K.)	Sarajevo
4.	Satellite Pro 42- CDS laptop	Office 95 Broken (ex SP)	Sarajevo
5.	Satellite Pro 430 CDT laptop	Office 97 + External A-Drive Broken (ex VT)	Sarajevo
6.	Toshiba 4020CDT laptop	Office 97	Sarajevo
7.	Belinea 17" screen		Sarajevo
8.	HP LaserJet 6L	Office	Sarajevo
9.	HP DeskJet 340		Sarajevo
10.	HP DeskJet 340		Sarajevo
11.	HP DeskJet 340		Sarajevo
12.	HP DeskJet 340		Sarajevo
13.	HP DeskJet 340	Broken	Sarajevo
14.	ASK Impact 24	LCD OH Projector Screen	Sarajevo
15.	Toshiba Tecra 8000 PAT800U	Used by G.T	Banja Luka
16.	Compaq Armada M700	Office 97 +Internal A-drive (used by J.V.)	Banja Luka
17.	Toshiba Satellite 200 CDS/810	Viruses, serviceable	Banja Luka
18.	Toshiba Satellite Pro 400 CS	Broken	Banja Luka
19.	Toshiba Satellite Pro 440 CDX		Banja Luka
20.	IBM Think Pad	Broken	Banja Luka
21.	HP DeskJet 340 (<i>quantity = 4</i>)	Various degrees of serviceability	Banja Luka
22.	Projector ASK Impression 750	Padded Shipping Case/Accessories	Banja Luka

USAID Project Items used by USAID Bank Supervision Project (Sarajevo and Banja Luka)			
No.	Item	Description	Location
23.	Ford Explorer XL 4.0	Color: White/ Doors: 4+1	Sarajevo
24.	Ford Explorer XL 4.0	Color: White/ Doors: 4+1	Banja Luka
25.	<i>FORD EXPLORER XL 4.0*</i>	<i>Color: White / Doors: 4+1 From USAID Business Consulting</i>	<i>Banja Luka</i>
26.	<i>FORD EXPLORER XL 4.0*</i>	<i>Color: White / Doors: 4+1 From USAID Business Consulting</i>	<i>Banja Luka</i>
27.	Compaq Armada 1520D (laptop)	Office 95 +External mouse (used by SP) Received from Business Consulting	Sarajevo
28.	Extensa / Texas Instruments	Office 95 +External mouse	Sarajevo

USAID Project Items used by USAID Bank Supervision Project (Sarajevo and Banja Luka)			
	(laptop)	Received from David Whitehead	
29.	TeleFax Panafax-332	Received from Business Consulting	Sarajevo
30.	File cabinets	Two metal case cabinets: One smaller size, other medium	Sarajevo
31.	File cabinets (KING MEC)	Two black metal case cabinets	Sarajevo
32.	HP DeskJet 842C	Office	Sarajevo
33.	Canon C 300 Printer	D. Wilson's home	Sarajevo
34.	Cellular phone		Sarajevo
35.	Cellular phone		Sarajevo
36.	HP Deskjet 940c	Office	Banja Luka

* These two vehicles have been transferred to the IBTCI Privatization of Strategic Enterprises Project on April 3rd, 2003.

C. List of Items used by Hercegovacka Bank			
No.	Item	Description	Location
36.	CLONER IDE Duplicate and SCSI Duplicator	IM1000 – Image Master 1000 4 Drive SCSI Hard Drive Duplicating System	Sarajevo
37.	SCANNER HP Vectra VL 400 MT		Butmir
38.	Logicube Solitare Forensic Kit	Includes: rugged carrying case, portable full page printer,	Sarajevo
39.	Cheetah 36ES Hard Drives	3FE0ICQG; 3FE0INAL; 3FE0284N; 3FE01+NT; 3FE02912; 3FE01213	Sarajevo
40.	Cheetah 36ES Hard Drives	3FE02AVT; 3FE01KSL; 3FE01B6X; 3FE01C4R; 3FE028XS; 3FE028XG	Sarajevo
41.	Diamond Mix Hard Drives	+385152C; +3RS14RC	Sarajevo
42.	GP-405 Digital Laser Photocopier	Copies – UNY11114 Feeder – Z8D27708 Finisher – Z8V62856	Sarajevo
43.	Scuzzy Drives		Sarajevo

D. List of Items used by Banking Agencies (received from USAID Business Consulting)			
No.	Item	Description	Location
44.	Ford Explorer XL 4.0	Color: White/ Doors: 4+1	Sarajevo
45.	Acer Extensa 355 laptop		Sarajevo
46.	Acer Extensa 355 laptop	External CD Rom (Backpack 16650) Network PCMCIA Card (D-link DE660)	Sarajevo
47.	Compaq Deskpro EP	Color Monitor Compaq V500-15” Keyboard Compaq	Sarajevo
48.	Compaq Deskpro EP	Color Monitor Compaq V500-15” Keyboard Compaq	Sarajevo
49.	Compaq Deskpro EP	Color Monitor Compaq V500-15” Keyboard Compaq	Sarajevo



D. List of Items used by Banking Agencies (received from USAID Business Consulting)			
50.	Compaq Deskpro EP	Color Monitor Compaq V500-15"	Sarajevo
51.	Compaq Proliant 1600	Color Monitor Compaq V500-15" Keyboard Compaq	Sarajevo
52.	Printer – HP LaserJet 5N		Sarajevo
53.	UPS System (Model UST 1500)		Sarajevo
54.	UPS System (Model UST 1500)		Sarajevo
55.	Compaq Deskpro EP	Color Monitor Compaq V500-15" Keyboard Compaq	Banja Luka
56.	Compaq Deskpro EP	Color Monitor Compaq V500-15" Keyboard Compaq	Banja Luka
57.	Compaq Deskpro EP	Color Monitor Compaq V500-15" Keyboard Compaq	Banja Luka
58.	Compaq Proliant 1600	Color Monitor Compaq V500-a5" Keyboard Compaq	Banja Luka
59.	Printer – HP LaserJet 6P		Banja Luka
60.	UPS System (Model UST 1500)		Banja Luka
61.	UPS System (Model UST 1500)		Banja Luka
62.	Acer Extensa 355 laptop		Banja Luka