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Report of the Agent Bank Selection Team

Volume One
Report and Appendices

Contract No 168-0056-C-00-7104-00

September 1998

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REPORT OF THE AGENT BANK SELECTION TEAM

Volume One: Report and Appendices

Submitted by
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CHAPTER ONE
BACKGROUND

USAID Business Finance (BF) was requested by USAID to evaluate the performance and financial condition of each Agent Bank responsible for originating and servicing BF loans to Bosnian borrowers This evaluation was timed to occur during the final (1 June - 30 September 1998) option period of Contract No 168-0056-C-00-7104-00, and to coincide with an audit of all loans in the BF portfolio, a revision of the Agency Agreement, and an increase in resources dedicated to loan monitoring Together, these initiatives were designed to increase existing protections for the funds under BF management They were also intended to lay a foundation for improved BF portfolio quality—while maintaining BF's loan origination target of DM 17 5 million per month—prior to the initiation of a new contract for management of the USAID Business Finance project

A team of three was formed to conduct the Agent Bank evaluations, and make recommendations as to which banks should be offered the opportunity to sign revised Agency Agreements with BF BF attorneys and other staff members also contributed to the team's efforts

CHAPTER TWO
TASKS AND APPROACH

Six groups of tasks related to the Agent Bank selection process were carried out by members of the ABST in the period June-August 1998 These tasks are described below

EVALUATIONS

Three groups of banks were evaluated The first group consisted of 22 banks operating under existing BF Agency Agreements and servicing loans to one or more BF borrowers The second group consisted of seven banks operating under existing BF Agency Agreements, but not yet servicing any loans to BF borrowers The third group consisted of three banks applying for BF Agency Agreements for the first time Table 1 lists all 32 evaluated banks and their status with BF

For all banks in the first group, three sets of data were examined First, the ABST evaluated each bank's **past performance** in the origination and servicing of BF loans Data were collected on the quality, volume, and geographic and industry coverage of each bank's origination in the BF program Information was also gathered on each bank's compliance with BF closing and disbursement requirements, quality of loan monitoring, adherence to BF repayment procedures, staff quality, and overall level of cooperation with BF While some data were quantitative and obtained from reports generated by BF's loan and management information systems, other data were qualitative and derived from interviews with BF credit, audit, special assets, and operations staff A list of interviews conducted by the ABST is attached as Appendix 1

Second, the ABST evaluated each bank's **operations internal and external to the BF program** Data in this area were gathered from the Agent Bank application completed by each evaluated bank—a blank application is attached as Appendix 2—and from on-site reviews of each bank's operations At nearly every bank, the ABST met in person with the general director, the director of finance, the director of credit, the director of operations, and with other staff members charged with responsibilities for the BF portfolio Review questions followed a typical due diligence format for financial institutions, covering ownership, oversight, management structure and strategic planning, credit policies, procedures, and staffing, information technology and branch operations, and financial reporting, condition, and management The ABST's list of on-site review questions is attached as Appendix 3 On-site reviews were conducted at 30 banks by one or more members of the ABST, a schedule of the reviews is attached as Appendix 4

Third, the ABST evaluated the **financial condition** of each Agent Bank Data were obtained from the Agent Banks themselves, with each bank submitting 31 December 1997 and 30 June 1998 balance sheets and income statements Balance sheets from banks in the Federation, including Brcko, were obtained in a format prescribed by the IMF for reporting to the Central Bank and Federation Banking Agency Banks in the Republika Srpska have not converted their reporting to this format, and were analyzed based on their reporting to the tax authorities All income statement analysis was based on reporting to the tax authorities For each bank, financial

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Table 1 Agent Banks by Status

No	BANK	Active/ Inactive/ New
1	AGROPROM BANKA AD	A
2	AUROBANKA	N
3	BANJALUCKA BANKA DD	A
4	BH BANKA DD	A
5	CENTRAL PROFIT BANKA DD	A
6	DEPOZITNA BANK DD	I
7	EXPORT BANKA AD	A
8	GOSPODARSKA BANKA DD	A
9	HIPOTEKARNA BANKA DD	A
10	HRVATSKA POSTANSKA BANKA H B DD	I
11	INVESTICIONO KOMERCIJALNA BANKA	A
12	KOMERC BANKA DD	A
13	KOMERCIJALNA BANKA DD	A
14	KRISTAL BANKA	A
15	LJUBLJANSKA BANKA DD	A
16	MARKET BANKA DD	A
17	MO BANKA MOSTAR	I
18	POSTBANK BH	N
19	PRIVREDNA BANKA AD BRCKO	I
20	PRIVREDNA BANKA DD TRAVNIK	A
21	PRIVREDNA BANKA DD BIHAC	I
22	PRIVREDNA BANKA SARAJEVO DD	A
23	PROMDEI BANKA DOO	I
24	SAHINPASIC KOMERCIJALNA BANKA DD	A
25	SIPAD BANKA DD	I
26	SREDNJOBOSANSKA	N
27	TRGOVACKA BANKA DD	A
28	TUZLANSKA BANKA DD	A
29	UNION BANKA DD	A
30	UNIVERSAL BANKA DD	A
31	UPI BANKA DD	A
32	VAKUFSKA BANKA DD	A

ACTIVE 22 INACTIVE 7 NEW 3

data were analyzed prior to the on-site review, and ABST analyses were later adjusted based on clarifications provided by the banks

It is important to note that the ABST financial analyses were limited by the quality and type of information made available

- Only a few banks had externally audited financial statements for 1997,
- Financial statements prepared for Bosnian tax authorities are not conducive to analysis,
- An evaluation of Agent Bank asset quality was beyond the ABST scope of work, and
- Examination results and mapped off-site reporting data from the entity-level banking agencies could not be obtained, for reasons of confidentiality While (verbal) FBA opinions partially inform ABST's analyses, those opinions are based on data to which the ABST itself did not have access

Further complicating the financial analyses were uncertainties surrounding the privatization of state-owned banks, and the ultimate level of pre-privatization write-offs of assets and liabilities booked before 1 January 1993 Even the level of state ownership is uncertain at many financial institutions, pending completion of specialized audits Given that ownership audits are ongoing, and that all banks must secure external audits of their December 1997 and June 1998 financial statements by November, it may be advisable to revisit the financial analysis of BF Agent Banks at the end of the year In the interim, financial and ownership findings discussed in the attached Agent Bank Recommendations should be interpreted with care and some skepticism

As noted above, all three sets of data were evaluated for banks with existing BF portfolios Because past performance data were not available for inactive and new banks, the ABST focused its evaluations of these institutions on staff quality and capacity, market coverage, financial condition, and the strategy and abilities of bank management

RECOMMENDATIONS ON EACH BANK

Following the completion of the evaluation process, the ABST prepared BF's recommendation for each bank recommended to USAID for approval as a BF Agent Bank For each bank not recommended, the ABST prepared a letter to the bank providing BF's rationale for declining the bank's application These recommendations and letters were prepared in standard format and form the contents of Volume Two of this report

➢ **USAID approval of the BF recommendations is required** If approval cannot be completed before 21 November 1998, BF must notify its existing Agent Banks in writing that their current Agency Agreements will be extended beyond the 21 November termination date communicated to each bank in late August at the direction of USAID

GENERAL RECOMMENDATIONS TO ENHANCE SECURITY OF BF FUNDS

In addition to providing customized recommendations on each evaluated bank, the ABST recommended specific adjustments to BF's standard underwriting, disbursement, repayment, monitoring, and relationship management practices Risk is inherent in BF's use of Agent Banks as intermediaries The adjustments recommended by the ABST are designed to minimize that risk with limited additional efforts by BF staff The ABST's general recommendations are presented in Volume One, Chapter III of this report

MODIFICATIONS TO THE AGENCY AGREEMENT

A draft of the revised Agency Agreement was sent to each evaluated bank on 29 June 1998, along with notification that the Agency Agreements under which existing BF Agent Banks were presently operating would be terminated A review of the draft, however, found a number of legal inconsistencies and unresolved policy issues The ABST Team Leader was assigned responsibility to ensure appropriate modifications to the revised Agency Agreement As the authentic language of the Agency Agreement is English, a short-term expatriate legal expert was recruited to assist BF's (Bosnian) staff attorney in this effort

Additionally, several banks requested meetings with the ABST to discuss concerns regarding the draft revised Agency Agreement The ABST Team Leader and short-term attorney addressed these issues in the draft Agency Agreement dated 14 August 1998 and attached as Appendix 5

➢ **USAID approval of the draft Agency Agreement is required** If approval cannot be completed before 21 November 1998, BF must notify its existing Agent Banks in writing that their current Agency Agreements will be extended beyond the 21 November termination date communicated to each bank in late August at the direction of USAID

ANALYSIS OF AGENT BANK FEE STRUCTURE

BF currently pays its Agent Banks origination, quarterly monitoring, and timely repayment fees A variety of interested parties, including staff from USAID, DAI, and various Agent Banks have suggested changes to the present fee structure, arguing that BF fees are either inadequate or create incentives misaligned with those of BF The ABST assessed these arguments by

1 Analyzing the costs of servicing BF loans at a sample of BF Agent Banks Sample banks completed standardized estimates of their costs for labor and other direct expenses associated with the management and servicing of their BF portfolios,
2 Measuring historical Agent Banks fees paid—as a percentage of total Agent Bank Fees that could have been paid—as a basis for realistic projections of future BF Agent Bank fee revenue
3 Analyzing, as an external benchmark, the fee structure available to U S banks participating in the loan guarantee program of the U S Small Business Administration

Findings and recommendations based on this assessment are included in the general recommendations that form Volume One, Chapter III of this report They also inform the fee structure proposed in the Manual and submitted to USAID for approval as Volume III of this report

MODIFICATIONS TO AGENT BANK OPERATIONS AND PROCEDURES MANUAL

In April 1998, BF drafted the Agent Bank Operations and Procedures Manual (the Manual) as a detailed guide to the execution of Agent Bank responsibilities outlined in the draft Agency Agreement Failure to comply with procedures prescribed in the Manual is a condition of default under the draft Agency Agreement A copy of the Manual was sent to each bank applying for Agent Bank status at the end of June

A review of the Manual found a number of policies and procedures inconsistent with the revised Agency Agreement The ABST Team Leader was assigned responsibility to coordinate modifications to the Manual by various BF staff members and to secure BF approval for all changes Additionally, a number of banks requested meetings with the ABST to discuss concerns regarding the Manual These concerns were addressed in the version of the Manual dated 14 August 1998

➢ **USAID approval of the Manual is required, because it specifies the fees payable to Agent Banks** The Manual and its appendices (including all forms used by the Agent Banks in fulfilling BF responsibilities) form Volume Three of this report

CHAPTER THREE
GENERAL RECOMMENDATIONS

With over 70 institutions serving a population of 3 million, the Bosnian market is vastly overbanked Total system capital, however, falls short of the needs of Bosnian borrowers, and deposits are a small and unreliable source of funding Medium- and long-term debt cannot be financed Short-term maturities carry high rates of interest

These financial constraints are compounded by the banks' lack of experience in credit analysis, financial management, and strategic planning Some institutions appear more promising than others, but no bank has conclusively demonstrated its ability to supply consistently the products and services needed for economic growth

A bank does not need to be liquid—or even solvent—to fulfill the requirements of a servicing contract such as BF's Agency Agreement However, the greater the financial difficulties confronting a bank, the greater the incentive to misappropriate, even temporarily, the funds of others Should a bank fail while in possession of BF funds, it is not certain when or if BF funds would be restored These risks of misappropriation and failure are inherent in the use of Agent Banks as BF's intermediaries in all transactions

This report suggests six methods to reduce the risks posed by Agent Banks A large reduction in the number of Agent Banks is not among the methods suggested

THE NEED FOR MANY AGENT BANKS

Assuming USAID targets for loan volume and geographic coverage are not changed, reducing the number of Agent Banks would hamper the achievement of USAID objectives, with no compensatory reduction in the risk of BF operations Five reasons to retain most of BF's Agent Banks are delineated below

USAID Loan Volume Targets

BF's loan production target, set by USAID, averages DM 17 5 million per month A significant reduction in the number of Agent Banks would greatly increase origination, servicing, and monitoring responsibilities at the remaining institutions No evaluated bank has the short-run capacity to double or triple its current BF portfolio Rapid portfolio growth would likely be accompanied by a deterioration in asset quality, as loans recommended to BF are supported by less thorough analyses, and loans booked are monitored in an increasingly cursory manner

In the medium-term, additional Agent Bank staff could be trained to BF standards As discussed below, however, it is not clear that the current BF fee structure provides sufficient incentive for an Agent Bank to reallocate its staff from other profitable activities, or to locate, hire, and train new employees

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Table 2 Loans Requıred per Agent Bank

Assumıng Constant Lendıng Target of DM 17 5 mıllıon per Month
And Decreasıng Average Loan Sıze
Followıng Introductıon of Small Loan Program

	Average Loan Sıze									
	400,000 DM		**350,000 DM**		**300,000 DM**		**250,000 DM**		**200,000 DM**	
Number of Active Agent Banks	Loans per Month	Loans per Year	Loans per Month	Loans per Year	Loans per Month	Loans per Year	Loans per Month	Loans per Year	Loans per Month	Loans per Year
30	1 5	17 5	1 7	20 0	1 9	23 3	2 3	28 0	2 9	35 0
25	1 8	21 0	2 0	24 0	2 3	28 0	2 8	33 6	3 5	42 0
22	***2 0***	***23 9***	***2 3***	***27 3***	***2 7***	***31 8***	***3 2***	***38 2***	***4 0***	***47 7***
20	2 2	26.3	2 5	30 0	2 9	35 0	3 5	42 0	4 4	52.5
15	2 9	35 0	3 3	40 0	3 9	46 7	4 7	56 0	5 8	70 0
10	4 4	52 5	5 0	60 0	5 8	70 0	7 0	84 0	8 8	105 0
8	5 5	65 6	6 3	75 0	7 3	87 5	8 8	105 0	10 9	131 3
Total Loans from all Agent Banks	*44*	*525*	*50*	*600*	*58*	*700*	*70*	*840*	*88*	*1,050*

Constraints arising from BF's lending targets will be compounded as BF's average loan size continues to fall with the start-up of the small loan program Table 2 indicates the number of loans that will be required per month and per year from each Agent Bank, under scenarios that differ in average loan size and number of Agent Banks

BF's current deal flow is handled by 22 active Agent Banks, recommending loans that average approximately DM 400,000 Though activity levels vary, on average, each Agent Bank generates two fundable loan recommendations per month—a total of 24 new loans each year that must be monitored and serviced by Agent Bank staff Cutting the number of Agent Banks to 15 would require each bank to provide an average minimum of three fundable recommendations per month, or 35 loans per year Reducing the number of Agent Banks still further, to eight, would require each bank to provide between five and six fundable recommendations per month, or 66 loans per year

If the average loan size continues to fall, as expected with the introduction of the small loan program, Agent Bank responsibilities will increase substantially If average loan size falls to DM 250,000, each Agent Bank in a pool of eight would be required to produce nine fundable loan requests per month—a total of 105 new loans each year that must be originated, monitored and serviced by Agent Bank staff

No Agent Bank is prepared for such an expansion of responsibilities—especially of monitoring responsibilities The increased concentration of BF's portfolio would likely produce levels of risk greater than those faced at present

USAID Geographic Coverage Targets

Bosnia's banking market is fragmented and localized Most BF borrowers have only one banking relationship—nearly always at an institution located within a thirty-minute drive of the borrower's facilities As USAID expands its assistance to new areas, BF expands its distribution network of Agent Banks in order to reach potential new borrowers

As shown in Table 3, of BF's 29 current Agent Banks, 14 have locations that provide important market access to BF Eliminating these banks would entail—at the least—a slow-down in portfolio growth in areas targeted for assistance by USAID It should be noted that these 14 banks include only two institutions with facilities in Sarajevo Securing sound and adequate coverage of the Sarajevo market requires Agency Agreements with several Sarajevo banks

Unclear Pattern of Market Consolidation

As the Bosnian banking market consolidates through mergers, acquisitions, and closures, fewer BF Agent Banks will be necessary to ensure that USAID targets for lending volume and market coverage are met Consolidation should produce fewer, stronger institutions—with broader markets—thus reducing the demands of Agent Bank relationship management on BF

Table 3 Geographic Market Access through Agent Banks

Geo Market Access	No	BANK	CITY
●	1	AGROPROM BANKA AD	BANJA LUKA
●	2	AUROBANKA	VITEZ
	3	BANJALUCKA BANKA DD	BANJA LUKA
	4	BH BANKA DD	SARAJEVO
	5	CENTRAL PROFIT BANKA DD	SARAJEVO
	6	DEPOZITNA BANK DD	SARAJEVO
●	7	EXPORT BANKA AD	BIJELJINA
●	8	GOSPODARSKA BANKA DD	SARAJEVO
	9	HIPOTEKARNA BANKA DD	SARAJEVO
●	10	HRVATSKA POSTANSKA BANKA H-B DD	MOSTAR
●	11	INVESTICIONO KOMERCIJALNA BANKA	ZENICA
●	12	KOMERC BANKA DD	TESANJ
●	13	KOMERCIJALNA BANKA DD	TUZLA
●	14	KRISTAL BANKA	BANJA LUKA
	15	LJUBLJANSKA BANKA DD	SARAJEVO
	16	MARKET BANKA DD	SARAJEVO
	17	MO BANKA MOSTAR	MOSTAR
	18	POSTBANK BH	SARAJEVO
●	19	PRIVREDNA BANKA AD BRCKO	BRCKO
●	20	PRIVREDNA BANKA DD TRAVNIK	TRAVNIK
●	21	PRIVREDNA BANKA DD BIHAC	BIHAC
●	22	PRIVREDNA BANKA SARAJEVO DD	SARAJEVO, BUGOJNO
	23	PROMDEI BANKA DOO	SARAJEVO
	24	SAHINPASIC KOMERCIJALNA BANKA DD	SARAJEVO
	25	SIPAD BANKA DD	SARAJEVO
●	26	SREDNJOBOSANSKA	KISELJAK
	27	TRGOVACKA BANKA DD	VISOKO
●	28	TUZLANSKA BANKA DD	TUZLA
	29	UNION BANKA DD	SARAJEVO
	30	UNIVERSAL BANKA DD	SARAJEVO
	31	UPI BANKA DD	SARAJEVO
	32	VAKUFSKA BANKA DD	SARAJEVO

Unfortunately, the pattern of Bosnian bank consolidation is only beginning to emerge Rumors abound, but it is unclear which banks, particularly among the private banks, will still be operating 6, 12, or 24 months from today Several merger variants are possible, many were raised by bank managers in the course of the ABST's on-site reviews Both "good" banks and "bad" banks will consolidate, either by choice or as the result of regulatory action It is less useful to guess which banks will remain operational—and interested in the BF program—than it is to take steps to protect BF interests during the consolidation to come

A USAID decision to eliminate certain banks as BF Agents could also have the effect of driving market consolidation BF credits appear to be the medium-term product of choice in the Bosnian market place, and Agent Banks see the product itself, rather than the fees it generates, as the primary benefit of their participation in the BF program The ability to provide medium-term products makes BF Agent Banks "players" in the market Terminating their Agency Agreements may make them appear less attractive—or less secure—to clients and could spur their consolidation with other institutions While consolidation is needed, it is not desirable for USAID to have even an indirect responsibility for the specific mergers to come Market forces should determine the fallout of bank consolidation

BF's Agency Agreement is essentially a servicing contract The BF assets Agent Banks service will not necessarily deteriorate if servicing responsibilities are assumed by a new institution—unless those assets were already troubled, or in some significant manner affiliated with the original Agent Bank Aside from standard credit risk, the primary incidence of risk in the BF lending process occurs during the Agent Bank's handling of disbursements and repayments These risks can be limited in both scale and time of exposure, reducing the threat to BF funds posed by unexpected bank consolidation

Diversification of Risk

As can be seen in the Agent Bank recommendations that form Volume Two of this report, few Agent Banks were found to be solvent Virtually none has sufficient liquidity to cope with a rapid and substantial runoff of deposits In a trying circumstance, any of BF's Agent Banks could fail

As it is not feasible to concentrate BF's entire portfolio in the one or two banks that are relatively "strong," spreading risk widely is a safer alternative than creating very large portfolios in, for example, a group of ten banks In fact, all Bosnian banks are weak Any group of five banks or more will include several highly susceptible institutions

Present financial statements suggest that Bosnia's state-owned banks are among the weakest The extent to which the balance sheets of state-owned banks will be cleansed of directed credits is unclear, but consolidation in the state sector is certain However, one might reasonably expect closures and mergers of state banks to be more orderly than the consolidation of their private sector counterparts

Broad Compliance with BF Procedures and Requirements

In general, BF Agent Banks have complied with BF procedures and requirements Indeed, incidents of noncompliance appear more closely correlated with the size of a bank's portfolio than with any other factor While several "active" BF Agent Banks service only a handful of loans, BF Audit, Special Assets, and Operations staff report few problems with low-activity banks The small size of their portfolios poses little risk to BF, and there would seem little reason to eliminate these banks from the program Indeed, as detailed in Volume II, some low-activity banks appear to have excess origination, servicing, and monitoring capacity that could be exploited through intensified BF relationship management

Serious and repeated incidents of noncompliance have been concentrated in one institution, and, to a lesser extent, in two others These cases are discussed in the recommendations that form Volume Two of this report

REDUCING THE RISKS POSED BY AGENT BANKS

Given current USAID targets, the use of fewer Agent Banks cannot be shown to enhance the security of BF funds at an acceptable programmatic cost Accordingly, the ABST recommends terminating BF's relationship with only two Agent Banks Several other Agent Banks are recommended for approval with restrictions Three new banks are recommended for initial entry into the program If approved, these recommendations will leave BF with a total of 31 Agent Banks, but this number can be projected to change frequently with changes in USAID geographic focus and consolidation in the Bosnian banking sector

Risk is inherent in the use of Agent Banks as intermediaries in all BF transactions However, adjustments to existing BF policies and procedures could reduce these risks substantially The ABST recommends the following six adjustments to BF policies and procedures relating to Agent Banks

Dedicated Trustee Correspondent Accounts for Disbursements and Repayments

In a market poised for multiple bank closures and consolidations, BF must utilize strengthened methods to protect its funds under the temporary control of BF Agent Banks The simplest means available to provide additional protections to BF funds is to require each Agent Bank to use a dedicated trustee correspondent account for all disbursement and repayment transactions with BF

Currently, BF disburses loans in small amounts to the foreign correspondent accounts of its Agent Banks However, when a tranche is disbursed, the borrower does not always utilize all the funds that have been transferred to the Agent Bank's correspondent account When this occurs, unused BF funds are commingled with the banks own The bank has the ability to use such funds for its own liquidity management purposes Because of the liquidity position of some Agent

Banks, when a borrower needs the additional funds, he or she might have to wait until the bank has the ability to fund the customer's account or to pay for invoices that have been presented

The Agent Bank owns its correspondent bank accounts When money is transferred to the Agent Bank's correspondent account the funds become part of the Agent Bank's funds and are at risk If an Agent Bank were taken into receivership, funds in the correspondent account would be considered part of the institution's assets and would be settled according to the ranking of creditors by the receiver

Recommendation

The replacement of Agent Bank correspondent accounts with dedicated trustee accounts for all BF disbursements and repayments would ensure that BF funds are not commingled or used by the Agent Bank, but are held separate for use by the borrower The trustee accounts would be owned by BF but the Agent Bank would be authorized to draw funds from the trustee account for approved purposes At no time could funds in a trustee account be considered part of a failed bank's assets

Operationally, loans would continue to be disbursed to the trustee accounts in small amounts for transfer to the Agent Bank itself A procedure should be established under which all funds drawn from the trustee account but not disbursed to the borrower within a few days must be returned to the trustee account BF could then be assured that only a minimal amount of BF's funds would be at risk at any given moment Risk could be limited to a short interval between the Agent Bank's withdrawal of funds from the Trustee Account, and the transfer of those funds to the borrower or the borrower's suppliers

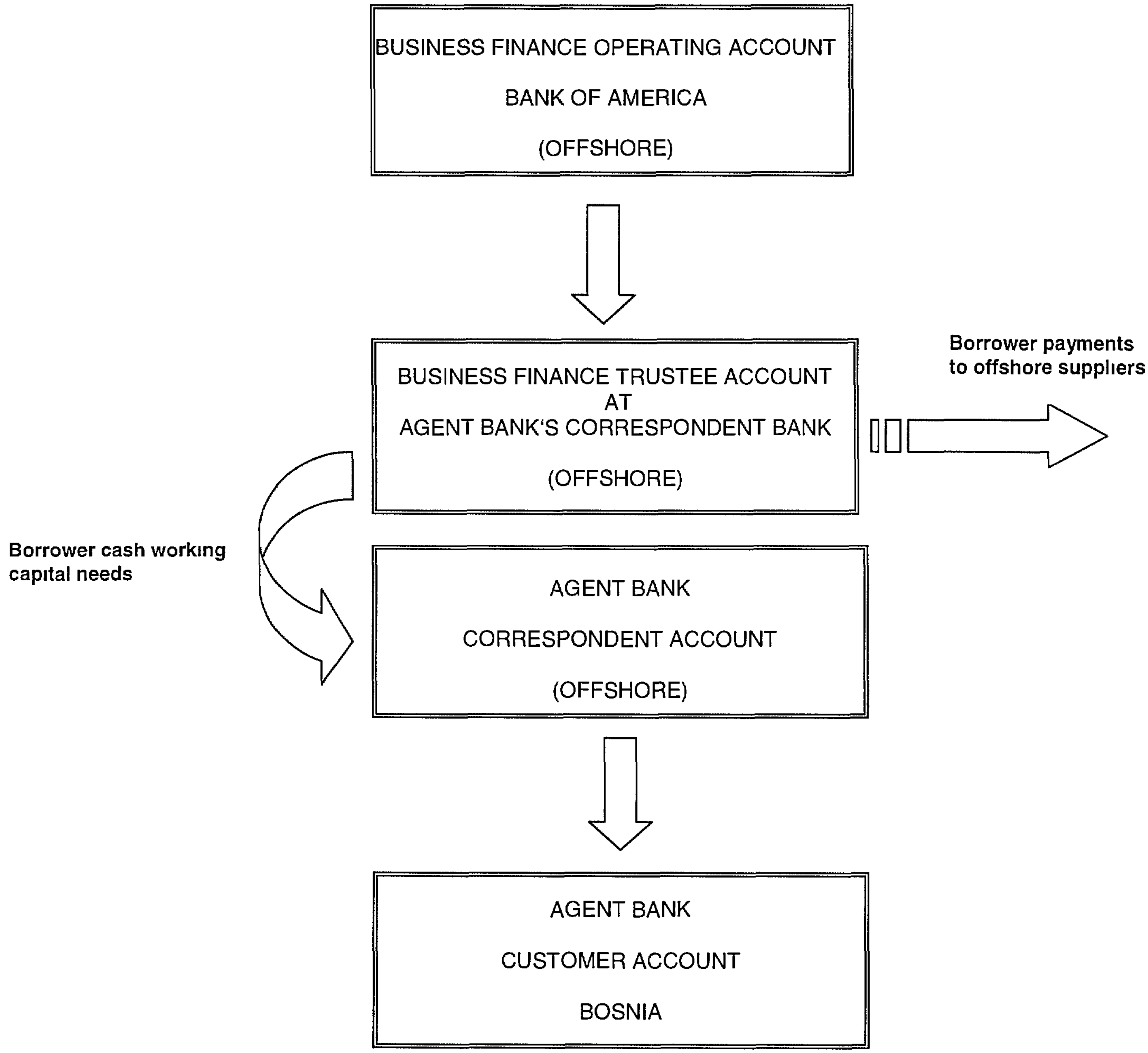
To monitor the trustee accounts, BF would receive bank statements on a daily or weekly basis These statements would then be reviewed by BF to ensure that drawdowns from the account were in accordance with those authorized by BF The reports would also serve to highlight potential liquidity crises at BF agent banks

Trustee accounts would be interest bearing, and could be set up in any correspondent that the Agent Banks are currently using The cost of these accounts would be minimal If multiple accounts were opened in one correspondent—as is likely, given that two-thirds of active Agent Banks use Deutsche Bank as their principal correspondent—a request for waiver of fees would be made

Because of the relatively small balances and interest paid on the accounts, there should be no cost to BF for setting up these accounts If anything, BF would probably earn a small amount of interest after any fees were paid

Figure 1 illustrates a potential structure for BF's use of trustee accounts and the resulting flow of funds to BF borrowers

Figure 1 Potential Structure for Use of Trustee Accounts



BF proposes to establish a trustee account owned by BF at each Agent Bank s correspondent bank BF will disburse in tranches to the trustee account upon advice of the Agent Bank Funds will remain in this account until they are transferred to pay the borrower's invoices or to fund working capital requirements for the borrower within Bosnia If the invoice is to a foreign supplier the transfer can be made by the Agent Bank directly from the Trustee Account thus preventing a large portion of BF funds from ever entering the books of an Agent Bank Alternatively to fund borrower needs for domestic cash expenses the Agent Bank can transfer funds to its own correspondent account at the same offshore bank disbursing to the borrower in Bosnia within a strictly controlled period of time

Use of the Trustee Account will

- Reduce BF funds at risk
- Allow tracking of all Agent Bank transactions through daily balance reports
- Prevent commingling of BF and Agent Bank funds and
- Provide seniority if BF funds are misappropriated by an Agent Bank that enters receivership

Full Disclosure of Agent Bank Recommendations on Affiliates

While BF is already aware of the extent of insider lending at BF's most problematic Agent Bank, the ABST found that

- Insider lending is common across the majority of BF Agent Banks, both in lending from the banks' own funds, and in recommending insiders to BF for funding by USAID, and
- No provision of the existing Agency Agreement or credit application requires disclosure of affiliations between an Agent Bank and the borrowers an Agent Bank recommends

The most common form of insider lending affecting the BF program is Agent Bank recommendations of credits to companies that are the Agent Bank's shareholders Less commonly, Agent Banks have recommended borrowers partially owned or controlled by the Agent Banks themselves

It is important to note that neither of these practices is considered unusual or suspect by the Agent Banks making insider recommendations In the absence of a requirement for disclosure, disclosure is unlikely to occur, because insider lending is considered routine Questions regarding insider lending were asked during each onsite review While many banks asserted that the terms they offered to insiders were identical to those offered to unaffiliated clients, most institutions also acknowledged that their own portfolios included significant concentrations (typically 10-30 percent) in insider loans

Given the size and fragmented nature of the Bosnian banking market, a blanket prohibition on Agent Bank recommendations of insiders is not suggested Insider loans can be good loans, and thin local markets for banking services may create situations in which a small but creditworthy borrower has no reasonable access to BF, other than through an Agent Bank that is the borrower's affiliate Further, a few BF Agent Banks have widely disbursed ownership, comprising hundreds of individual and corporate shareholders Small ownership interests may not compromise Agent Bank analysis, monitoring, or collection

Recommendation

In all cases, the ABST recommends that BF obtain disclosure of any affiliation between an Agent Bank and the borrowers that Agent Bank recommends The Credit Application should be amended with a question in which the borrower must disclose any linkages with the Agent Bank The Agent Bank Loan Recommendation should be amended in similar manner, requiring the Agent Bank to disclose any affiliation with the borrower it recommends The Agency Agreement should also include a provision requiring disclosure of any affiliations between an Agent Bank and a borrower, including such affiliations that may be formed after the closing of a BF loan These changes to BF documents have been made by the ABST in the attached drafts

BF's procedures should be amended to include a standard verification of the affiliate information disclosed by the Agent Bank and the recommended borrower BF has hardcopy files listing the shareholders of each Agent Bank However, these data are not available electronically for cross-references against recommended borrowers Further, the data generally date from 1995 and 1996, whereas bank ownership appears to change with moderate frequency, despite the absence of a formal market for shares Agent Banks should provide BF with updated lists of all shareholders, together with each shareholder's percentage ownership, on a semi-annual basis This disclosure should be provided electronically, and downloaded into a database for easy cross-references against recommended borrowers

Once disclosure is obtained, BF's credit policies should provide Lending Teams with guidance on action appropriate for loans Agent Banks recommend to their affiliates While each decision will be subjective, actions are likely to range from recommending the loan (with or without special conditions), to requiring that the borrower obtain the credit through an alternate Agent Bank, to rejecting the loan altogether

Given the potential that an Agent Bank's recommendation of an affiliate will be transferred to another Agent Bank or rejected, BF Lending Teams should stress to the Agent Banks they manage the importance of highlighting affiliate relationships early in a borrower's credit application process

Increased Use of Field Associates in Agent Banks

BF Field Associates perform several functions in BF's relationships with Borrowers and Agent Banks Most Field Associate activities are intended to ensure that Agent Banks properly disburse BF funds to BF borrowers, and that BF borrowers use BF funds for the purposes approved in their loan agreements

To a lesser extent, Field Associates are responsible for the monitoring of BF borrowers by Agent Banks Field Associates are the first to review Quarterly Monitoring Reports (QMRs) for thoroughness and accuracy Beginning in August, Field Associates are conducting training sessions at Agent Banks, in an effort to improve the quality of the QMRs the banks prepare

Recommendation

As BF Lending Teams strengthen their management of Agent Bank relationships—and Field Associates are more closely integrated with BF Lending Teams—additional Field Associates should be dedicated to overseeing the preparation of Agent Bank QMRs This oversight is becoming critical as Agent Bank BF portfolios grow at an average rate of twenty-four new loans each year Disbursement monitoring is also an increasingly large task, as BF lending continues at a rate of DM 17 5 million per month

The ABST recommends that one additional Field Associate be recruited for each Lending Team Lending Teams should use their Field Associates to create a regular, post-recommendation presence in each Agent Bank they manage, ensuring that

- Closing documents and certifications are gathered efficiently and that problems with closing documents are identified and resolved quickly,
- Disbursements are managed according to BF procedures, and
- Agent Bank monitoring reports become more, rather than less, analytical as the BF portfolio grows

While the allocation of Field Associate effort among Agent Banks should be determined by the Lending Team managing each Agent Bank relationship, it is recommended that a minimum of several Field Associate hours per week be spent with each moderately active Agent Bank More active banks may require greater attention, depending on the quality and efficiency of their staff Lending Teams with several highly active Agent Banks may require additional Field Associate resources

Regular provision of a small working area for a BF Field Associate should be a requirement of the Agency Agreement

Strengthened Relationship Management by BF Lending Teams

BF recently returned its Credit Department to a team structure in which each Lending Team is responsible for managing BF's relationship with 3 or more Agent Banks, from origination through monitoring Deals are removed from a Lending Team only if they become seriously delinquent

The effects of this reorganization should be positive, but they have yet to be experienced fully at the Agent Bank level In the on-site reviews, several Agent Banks expressed regret over what they saw as a breakdown in communication once a loan has been recommended and approved, but not yet disbursed The Agent Banks find the lack of communication in this period particularly frustrating, because they are pressured by would-be borrowers and believe they are inadequately informed of the causes of delay

Several Sarajevo banks complained about a lack of consistency in their overall contact with BF local and expatriate staff since the departure of BF's original expatriate lending team at the end of May 1997 While the banks are somewhat aware of USAID contracting procedures—i e , that BF has been operating with short-term expatriate staff since that date—this does not mitigate their need for a consistent expatriate point of contact, in addition to the various lending associates with whom they work Very few Bosnian banks are receiving any sort of foreign technical assistance, and many banks appeared to regret the loss of relationships they feel they once had with BF expatriate lenders

Banks served by BF's Tuzla and Banja Luka offices generally reported better and more consistent relationships with BF This geographic distinction seems attributable to greater expatriate and local staff stability in those offices, fewer banks, and a more consistent approach to relationship management Whereas BF lending officers and associates in Sarajevo have been rotated from bank to bank, BF staff in Tuzla and Banja Luka have developed long-term ties to the institutions with which they work While some Sarajevo banks also reported close working relationships with BF, a geographic distinction remains

The issue of relationship management is raised because of its impact on both asset quality and BF efficiency Several Sarajevo banks pointed out in their on-site reviews that they have more contact with BF's Special Assets group than with anyone involved in credit origination This lack of communication with BF lending officers and lending associates can be blamed for many misunderstandings, particularly those related to use of BF loan proceeds to repay short-term credits issued by the Agent Bank while awaiting BF disbursement BF will be informed of liquidity crises in its pre-disbursement borrowers only if communication between Agent Bank staff and BF lenders is regular and open

Improved relationship management can also boost the quality and speed of BF lending A few banks stand out in their ability to deliver thorough and high-quality applications In each such case, the banks and BF credit staff report a close working relationship and a mutual understanding of BF credit standards that developed over time BF credit staff report that these banks required significant up-front development efforts—as well as continued maintenance—but that those efforts have paid off in the quality and reliability of the banks' work

Recommendation

BF should continue to institutionalize its Lending Team structure In the opinion of the ABST, the development of consistent Agent Bank relationships will do as much to improve BF portfolio quality as industry specialization among Lending Associates Industry specialties will be helpful in some analyses, but their development should not detract from the responsibility to develop quality deal flow from the specific banks the Lending Teams manage If industry specialization's are maintained by the Lending Associates, more responsibility will fall on the Lending Officers to ensure that proper skills and procedures are developed by the Agent Bank staff that are responsible for generating BF deals

Senior BF management should continue to promote the importance of relationship management The previous organizational structure, in which Lending Officers were assigned to deals without regard to the recommending Agent Bank, did not effectively employ the Agent Banks as BF's distribution network, principal screening device, and analyst pool

Increased Monitoring of Agent Bank Finances, Performance with BF, and Market Strategy

In a consolidating market, BF must keep itself informed of financial and strategic developments in its Agent Banks

A fair amount of financial information is available By November, all BF Agent Banks are required to produce financials—audited by an external firm according to IAS—as of 31 December 1997 and 30 June 1998 Banks in the Federation are producing monthly balance sheets according to an IMF format that is conducive to analysis and available electronically, banks in the RS are expected to adopt this format soon

Working with BF's Operations and Credit Management departments, the ABST has developed some internal BF reports that would be useful to the Lending Teams as they strengthen their relationship management functions Reports can now be generated for

- past dues per Agent Bank
- fees earned per Agent Bank
- documentation deficiencies per Agent Bank

The past due report could be made more useful with summary lines for 30-, 60-, and 90-days past due, and it would be useful to see fees broken out on a per-loan basis

The ABST found the Agent Banks surprisingly eager to discuss strategic issues, including the rollout of new products and potential mergers and acquisitions These discussions could be continued on an informal, periodic basis the Lending Teams

Recommendations

Semiannual analysis of Agent Bank financials should be the responsibility of a senior BF manager, most likely the BF auditor, perhaps assisted by a dedicated audit associate Findings should be discussed with the Lending Team responsible for managing the Agent Bank in question, and consensus reached as to actions that may be necessary to protect BF borrowers and funds While BF lending and field associates working in the lending teams possess significant skills in the analysis of enterprise financial statements, they should be given a course on the analysis of financial institutions The course should be designed with cases from the Bosnian financial sector and more developed markets, to create an understanding of the impact of the financial condition of the banks with which the lending teams work

Audited statements for year-end 1997 and mid-year 1998 should be obtained by the manager responsible for reviewing Agent Bank finances Subsequently, Agent Banks should submit (on a semi-annual basis) their June and December IMF-formatted balance sheets, along with their mid-year payment bureau income statements, and audited year-end statements

Internal past-due reports sorted by Agent Bank should be generated on a no less than bi-weekly basis for discussion with Agent Bank staff by the Lending Teams At the same time, BF staff should inform the Agent Banks of the current status of all approved but undisbursed loans and discuss issues with any upcoming deals Highlights of strategic discussions can be recorded informally, as they occur

Specific Restrictions on Individual Agent Banks

In addition to the general recommendations provided above, the ABST recommends specific restrictions (and probationary periods of Agency) for particular Agent Banks These restrictions are customized to the experience and proclivities of the institutions concerned, and are discussed as part of the recommendation on each Agent Bank in Volume II

CHAPTER FOUR
MODIFICATIONS TO THE AGENCY AGREEMENT

The Agency Agreement governs the relationship between BF and its Agent Banks, setting out the particular rights and obligations of both parties Its terms are supplemented by the requirements of the Business Development Program and the procedures and guidelines contained in the Operations and Procedures Manual Essentially the Agreement provides for a commission arrangement under which the Bank performs certain tasks in return for a fee

With the development of BF's relationship with its Agent Banks over the life of the project, a clearer sense of the appropriate balance to be struck between the rights and obligations of the parties has emerged, along with a greater indication of where potential problems might lie

BF has therefore recently devoted considerable effort to reviewing the existing Agency Agreement A draft was given to USAID in May 1998 This draft has now been reworked with the assistance of BF's local staff attorney and an expatriate lawyer, the redraft forms Appendix 5 of this Report In this redraft, emphasis was given to both the form of the Agreement and to its content, particularly in terms of use and misuse of funds and in reinforcing the duties of the Agent Banks without being oppressive The May draft was given to the Agent Banks and their comments have been taken into account in this redraft where considered appropriate A number of those comments drew attention to what were, in fact, translation problems These problems are being addressed as the redraft undergoes translation

In redrafting the Agreement, we have tried to simplify it as much as possible Obligations are expressed in a clear, positive fashion and not consigned to brief mention in the default provisions We have also tried to eliminate repetition of obligations, which generally does not reinforce but only leaves room for doubt The basic terms of the Agreement are now defined in a definitions clause instead of being spread throughout the Agreement

In order to prevent confusion, references to the Grant Agreement and to the State as owner of the loan funds have been removed as much as possible The Agency Agreement is between BF and the banks Referring to the State as owner can only throw into doubt the ability of BF to be entering into this Agency Agreement, or any loan agreement, as principal Further, the reference does not give the State any standing to enforce these agreements The State derives that right and obligation from the Grant Agreement itself

Concerns have arisen to ensure that there is no collusion between Agent Banks and borrowers to the disadvantage of BF, to prevent misuse of loan funds by the Agent Banks, and to ensure that in the case of insolvency funds do not fall into the general pool available to all creditors These concerns have been dealt with in the redraft in a number of ways

A new provision (article 2) sets out the general duties of a bank as agent to act in the best interests of BF including full disclosure of all material information The specification of the Agreement as a commission agreement under local law (article 3) means that no property of BF becomes that of the Agent Bank, which is in turn supplemented by article 12 specifying that at no time do funds that are to be disbursed to a borrower or that are in repayment of a loan become those of the Agent Bank Time limits are placed on transfer of funds by the Bank

A new provision (the first paragraph of article 8) has been added to clarify the relationship of the Agent Bank and borrowers and to emphasis that in the case of any conflict of interest, the first loyalty of the bank is to BF

The payment of fees is dealt with in article 9 One issue that needs decision by USAID is whether the Agreement should provide, and how, for the payment of fees at any stage in KM A further consideration will be the anticipated replacement of the Deutsche Mark by the Euro in 2002

The Agreement leaves open the actual percentages to be given as fees, for specification in the Manual This is for the sake of convenience and because of the removal of the provision giving BF the unilateral right to amend the agreement

The previous draft of the Agreement gave BF the right to amend it without consultation with or even the agreement of the banks This is, at least, an unusual contractual provision It is considered that such a provision would not be looked on favorably by the courts and could result in the whole contract being declared void for unreasonableness In addition and more practically, as either party may cancel the Agreement on one month's notice, the bank can refuse to accept the amendments by exercising its right to cancel That would not necessarily be convenient or desirable from BF's point of view

However, BF has retained the right to amend the Manual without agreement, which means that the fees may be altered that way Some Agent Banks have raised concerns with this concept and we propose to offer them some comfort in the form of a letter stating that it is not our intention to lower the fees from the present level

The provisions on the cessation of the Agreement and on the transfer of borrowers to another bank are potentially the most complex Because all collateral secured under a loan is taken in the name of the Agent Bank, and because the securing of collateral requires at the least a court decision, transfer will require a substantial amount of effort and cooperation However, our experience so far indicates that each transfer is unique It is difficult to construct, in advance, rules about how a given transfer must proceed

We have therefore imposed an obligation on an Agent Bank to provide access to all records and documents and to cooperate with BF in establishing a procedure in each case of transfer (article 25) Until all borrowers are transferred, the Agent Bank must continue to comply with its obligations under the Agreement, even if the notice period has expired

Other changes have been made in order to make the provisions of the Agreement consistent either with practice, as in the case of reporting requirements, or with other documents such as the loan agreement Both that agreement and the Manual will be reviewed to ensure their consistency with the Agency Agreement as approved by USAID

CHAPTER FIVE
RECOMMENDED ADJUSTMENTS TO AGENT BANK FEES

BF currently pays its Agent Banks three types of fees When a loan is disbursed, BF pays the bank an origination fee equivalent to one percent of original principal Thereafter, the Agent Bank receives a quarterly monitoring fee, equivalent to 0 25 percent of original principal, for each submitted Quarterly Monitoring Report (QMR) (Unsatisfactory QMRs are not compensated, but this determination is based on the completeness of the QMR, not the condition of the monitored borrower) Agent Banks also receive timely repayment fees equivalent to 0 5 percent of each monthly principal and interest payment made by a borrower within ten days of its due date

There has been concern for some time that, with the decrease in BF's average loan size, BF's fee structure may no longer provide sufficient incentive for active Agent Bank participation in the BF program It has also been suggested that the current fees reflect BF's early priority on volume of origination, and reward insufficiently the recommendation and servicing of loans of good quality

The ABST's scope of work was amended in August 1998 to evaluate these concerns as part of its final report to USAID In addition to evaluating the incentives created by BF's fees themselves, the ABST evaluated cost data submitted by a sample of four banks Sample banks were chosen for their accumulated experience in the BF program, as well as their variety of backgrounds One sample bank is in the RS, one is in Tuzla, two are state-owned, and each serves a very different segment of the Bosnian market Reported cost data form Appendix 6 of this report

Each sample bank submitted standardized estimates of its costs for labor and other direct expenses associated with its management and servicing of a typical BF loan in its portfolio The blank cost questionnaire to which the sample Agent Banks responded forms Appendix 7 of this report

Finally, as an external reference, the ABST examined the fee revenue available to U S banks participating in the U S SBA 7(a) loan guarantee program

AGENT BANK COST ANALYSIS

Total Costs

Over the typical three-year loan, total costs reported by the sample banks average DM 17,125 per BF loan under management Unsurprisingly, the private banks reported higher labor costs than the state-owned banks sampled The highest cost bank (Gospodarska) reported overall costs of DM 19,746 while costs were 29 percent lower at the lowest cost bank (Tuzlanska), which reported a total cost of DM 14,118

BF loans are typically 36-month obligations, paying eight percent interest, with a six-month grace period on principal payments Under the present fee structure, such loans have the potential to provide fee revenue equivalent to 4 57 percent of the original principal amount This revenue is spread unevenly over the life of the loan, with approximately 50 percent of potential revenue accruing in the first year of the loan, and about 25 percent accruing in each of years two and three

Through June 1998, however, only 48 percent of potential timely repayment fees had been paid This performance has reduced the effective timely repayment fee to 0 24 percent of each principal and interest payment, and effective total fee revenue to 4 27 percent of original principal BF believes the large number of "untimely" payments is attributable partly to a mismatch between Agent Bank and borrower incentives Whereas Agent Banks receive fees from BF for all payments made within 10 days of their due dates, borrowers, until recently, were not penalized until their payments were more than thirty days past due Historically, a large number of payments have been made between 10 and 30 days past due

In a revision designed to improve performance, BF loan agreements now provide for penalties to be paid by borrowers on all payments made more than 10 days late The ABST analysis assumes that BF's change in policy will result in an increase in loan payments qualifying for timely repayment fees Table 4 presents the average Agent Bank's break-even loan size, based on the projection that 70 percent of timely repayment fees will actually be paid This projection raises the effective timely repayment fee to 0 35 percent of each principal and interest payment, and effective total fee revenue to 4 40 percent of original principal

Table 4 Break-even Loan Size

Current Fee Levels

Origination	1 00% on original principal at disbursement
Monitoring	0 25% on original principal on submission of Quarterly Monitoring Reports
Timely Repayment	0 35% (0 5 percent of the 70% of monthly principal and interest payments projected to be paid within ten days of their due dates)

Revenues and Profits over Life of a Three-year, 8 Percent, DM 389, 396 Loan with 6 Months Grace on Principal

Fee Type	Fee Amount	Ass % of Principal	As % of All Fees	Profit Analysis	
Origination	3,893 36 DM	1 00%	23%	Fee Revenue	17,125 00 DM
Repayments	1,549 15 DM	0 40%	9%	Costs	17,125 00 DM
Monitoring	11,681 89 DM	3 00%	68%	Profit	0 00 DM
Total Fees	17,125 00 DM	4 40%	100%	Margin	0 %

Based on the data reported by the sample banks, Table 4 suggests that BF fees cover Agent Bank costs on loan sizes down to DM 389,000 The average Agent Bank loses money on the origination, servicing, and monitoring of smaller BF credits

If a DM 389,000 BF credit produces a zero percent profit margin for the average Agent Bank, it is interesting to question how much of a margin would be necessary to stimulate the attention to volume and quality BF asks of its Agent Banks How much profit, for example, is necessary to prompt bank managers to assign Bosnia's relatively small number of skilled credit officers to BF loans? Anecdotally, BF credit staff report that the "better" banks (e g , Market, Kristal, Universal) have begun to allocate more junior staff to the BF portfolio as the other business activities of those banks expand

Based on the data reported by the sample banks, margins increase rapidly with loan size, rising to 35 percent on a loan of DM 600,000 However, given that BF lending is not a volume business for Bosnian financial institutions, the absolute level of profit is a more relevant indicator of stimulus than margin Assuming an average loan size of DM 600,000, a bank that originated, monitored, and serviced a twenty-five loan portfolio totaling DM 15 million could earn profits, over a three year period, of DM 232,000—approximately $44,000 per year If the same portfolio consists of thirty DM 500,000 loans, profit potential falls to $28,000 per year With forty loans of DM 375,000, the average bank loses $4,800 per year

Most BF Agent Banks with similarly sized portfolios service their BF credits with two to three loan officers, assorted operations and support staff, and at least the part-time attention of a credit manager Whether or not a given level of remuneration is attractive depends ultimately on the alternative uses to which the bank could put such a team Unfortunately, the profitability of other bank products is beyond the scope of this analysis

What is known is that BF's average loan size is falling rapidly Recent approvals have averaged DM 250,000—well below the loan size that represents break-even for the average Agent Bank BF can rely on momentum and its existing pipeline for deals over the next three to four months, but deal flow in the medium term should be expected to decline as the profitability of BF products falls

While it is difficult to measure dissatisfaction objectively, many banks are already complaining that they are inadequately compensated for BF procedures, which they find cumbersome Nothing suggests this trend will reverse, unless fees are increased or streamlined origination and monitoring procedures are introduced for smaller credits

The Agent Bank Selection Team recommends that BF modify its policies in both ways Some form of procedural streamlining should be adopted for smaller deals, and BF's fee structure should be adjusted to cover Agent Bank costs and provide stronger incentives for the recommendation of viable loans

The following sections of this analysis examine each BF fee in turn, making recommendations for adjustment where advisable

Loan Origination, Closing, and Disbursement Costs

The average reported cost to originate, close, and disburse a loan is DM 2,397, with a range from DM 2,126 at Gospodarska Banka to DM 2,625 at Kristal Banka With an origination fee set at one percent of disbursed principal, the fee covers the average bank's origination costs whenever a credit greater than DM 240,000 is disbursed

The current USAID priority on producing loans in the DM 30,000 to DM 150,000 range indicates that origination fees will soon be inadequate to cover Agent Bank costs on many BF loans It is not necessary for origination costs to be offset precisely by origination fees (indeed, the ABST recommends below that timely repayment fees should be the principal source of Agent Bank revenue from BF) It is important to recognize, however, that the origination fee comes early and in a lump sum, providing a strong production incentive to the Agent Bank Making it a "loss leader" is not advisable and would likely result in poor deal flow at the low end of BF's range of loan sizes

The ABST recommends that a floor be placed below the origination fee, guaranteeing that most of the average Agent Bank's origination costs will be covered BF's origination fee should be fixed at DM 2,000 , or 1 percent of the disbursed principal amount, whichever is greater

The ABST also recommends that the documentation on loans below DM 150,000 DM be reduced to give further incentive to the banks to seek and make smaller loans The current documentation for smaller loans is onerous and, based on the reported data, unprofitable for the Agent Bank

Quarterly Monitoring Costs

The average reported cost to review borrower financials and prepare Quarterly Monitoring Reports is DM 3,523 on an annual basis, or DM 881 per QMR The range of quarterly costs is significant, varying from DM 1,296 at Gospodarska to DM 625 at Tuzlanska With a Quarterly Monitoring fee of one quarter of one percent of original disbursed principal, the Quarterly Monitoring fee covers the average Agent Bank's monitoring costs, whenever the credit in question is greater than DM 352,000 Recent BF loan approvals have averaged below this break-even level Based on the reported data, Agent Banks will soon be losing money on most of the QMRs they are obligated by their Agency Agreements to complete

This phenomenon has not gone unnoticed by BF's Agent Banks Many banks are months behind in their submission of QMRs and one bank has unilaterally halted its preparation of QMRs over compensation issues The quality of QMRs is also disappointing Ironically, several banks with highly capable loan officers routinely submit hastily completed QMRs that are lacking in analysis, whereas the QMRs of some state-owned banks demonstrate greater insights and attention to detail It is suggested that this difference in quality may be attributable to the lower opportunity costs of QMR completion at state-owned banks

A problem with BF's procedures related to the payment of QMR fees should also be noted At present, QMR fees are paid to Agent Banks through authorized deductions from the payments of BF borrowers However, there is no method in place to invoice BF for quarterly monitoring fees due for the monitoring of delinquent borrowers An Agent Bank completing a monitoring report on a delinquent borrower is therefore not paid, creating a perverse incentive to eliminate information and communication channels at a time when BF is in considerable need of assistance and intervention from the Agent Bank

The ABST suggests that a floor be placed below BF's quarterly monitoring fees, ensuring that the average bank's monitoring costs are covered, even when the loan being monitored is small BF's quarterly monitoring fee should be fixed at DM 1000, or 0 25 percent of the disbursed principal amount, whichever is greater Additionally, BF should use its existing grading system for QMRs to create incentives for higher quality monitoring by its Agent Banks QMRs graded an A or B should be rewarded with a 0 1 percent increase in the payable fee, bringing potential fee revenue to 0 35 percent of the disbursed principal amount each quarter

Loan Servicing and Collection Effort Costs

The reported average annual cost for an Agent Bank to provide loan servicing and collection efforts for a BF credit is DM 1,386, or DM 116 per month The reported monthly range is fairly broad, from DM 58 at Gospodarska, to DM 152 at Market Banka [1]

With timely repayment fees set at 0 5 percent of each principal and interest payment—and, as explained above, an assumed 70 percent rate of timely repayment—BF fees for timely repayments cover servicing and collection costs only when the loan being serviced is greater than DM 1 05 million Obviously, few BF loans meet the break-even level It is probable that the fee was not designed to cover the cost of servicing, but to provide the Agent Bank with a small incentive to ensure that borrower payments were made in a timely fashion

BF's average loan size has been dropping steadily, and the ABST's suggestions for adjustment to the origination and monitoring fees are designed primarily to ensure that Agent Bank's can break even on their work in the BF program The need for a monetary incentive remains The ABST proposes that the timely repayment fee be increased to 3 percent to provide this incentive Table 5 breaks down Agent Bank compensation by type and timing of fee revenue, under the current and recommended fee structures

[1] The broader range of costs reported by the Agent Banks for monitoring and servicing relative to the range reported for originating is caused by different patterns of cost attribution Whereas Gospodarska classifies nearly all of its post-origination costs as monitoring the other sample banks attribute a greater level of post-origination costs to servicing " It may be most useful to examine these cost categories together Taken together, over the typical three year loan, Gospodarska reports monitoring and servicing costs of DM 17 620 compared to the 34 percent lower total of DM 11,676 reported by Tuzlanska

Table 5 Agent Bank Compensation by Type and Timing of Fee Revenue
Revenues over Life of a Three year 8 percent DM 400,000 Loan with Six Months Grace on Principal

	Current Fee Structure	Recommended Fee Structure
Origination	1 00%	1 00% (DM 2,000 minimum)
Monitoring	0 25% quarterly	0 25% quarterly (DM 1 000 minimum)
Timely Repayment	0 50% monthly	3 00% monthly

	By type of fee over life of loan (Current)			*By type of fee over life of loan* (Recommended)		
Fee type	**Fee Amount**	**As % of Principal**	**As % of All Fees**	**Fee Amount**	**As % of Principal**	**As % of All Fees**
Origination	4,000 00 DM	1 00%	22%	4,000 00 DM	1 00%	14%
Repayments	2,273 33 DM	0 57%	12%	13,640 00 DM	3 41%	46%
Monitoring	12,000 00 DM	3 00%	66%	12,000 00 DM	3 00%	40%
Total Fees	18,273 33 DM	4 57%	100%	29,640 00 DM	7 41%	100%
	By timing of fee revenue over life of loan			*By timing of fee revenue over life of loan*		
Year	**Fee Amount**	**As % of Principal**	**As % of All Fees**	**Fee Amount**	**As % of Principal**	**As % of All Fees**
Fees in Year 1	8,550 67 DM	2 14%	47%	11,304 00 DM	2 83%	38%
Fees in Year 2	4,893 33 DM	1 22%	27%	9,360 00 DM	2 34%	32%
Fees in Year 3	4,829 33 DM	1 21%	26%	8,976 00 DM	2 24%	30%
Total Fees	18,273 33 DM	4 57%	100%	29,640 00 DM	7 41%	100%

As shown by the comparison above, the current fee structure rewards BF Agent Banks for origination and the compilation of monitoring reports, but does little to tie bank income to loan performance Fees for timely repayments represent 12 percent of total fee income Further, fees in the current structure are front loaded, with nearly half of all fee income accruing to the bank in the first year of the loan

Current BF goals suggest that the fee for timely repayment be increased substantially By increasing the fee on timely repayments to 3 percent, nearly 50 percent of all fee income becomes tied to loan performance, while the original incentives for origination and monitoring remain in place Because the timely repayment fees accrue slowly, shifting the incentive structure also forces BF Agent Banks to remain vigilant throughout the maturity of the loan, by spreading the timing of total fee revenue more evenly across the term structure

In a typical BF credit, the proposed incentive structure could produce fees equivalent to 2 2 to 2 8 percent of original principal each year Over the full term, Agent Banks could realize fees equivalent to 7 4 percent of original principal—2 8 percent more than the 4 6 percent that can be obtained under the present incentive structure—providing that the loans the Agent Bank recommends are repaid according to schedule [2] The recommended incentive adjustments will

[2] As a percentage of original principal, the ABST recommendations for minimum origination and monitoring fee payments will produce higher fee income for small loans For banks that produce consistently superior monitoring reports (only 2 banks at present) the recommended incentive for high quality monitoring reports (i e , an additional 0 1 percent of original principal for all QMRs graded A or B) could produce additional fees equivalent to 1 2 percent of original principal over the term of the typical BF loan

reward banks according to their analytical and management skills, while encouraging stepped up participation in the BF program They will also reinforce an appreciation of repayment risk among Bosnian financial institutions, deepening the partnership of BF and its Agent Banks by linking Agent Bank cash flow directly to BF asset quality

SBA 7(A) LOAN GUARANTEE PROGRAM

The 7(a) Loan Guarantee Program is the SBA's primary business loan program, and it differs significantly from BF's Fee compensation under 7(a) is considerably higher than that available to BF Agents, but the banks extending SBA loans have a small portion of their own funds at risk, and the full principal balance of their loans tied up for a period determined by conditions in the secondary market for guaranteed debt Neither of these characteristics apply to BF lending in its present form

The program stimulates lending to small businesses requiring financing for working capital, plant and equipment, or leasehold improvements The loan amount can be as high as $1,000,000, with the SBA guaranteeing 80 percent of principal The repayment period for these loans is usually between five and ten years, but loans financing plant and equipment can have terms up to 25 years All loans are made from bank funds, remaining the asset of the bank until maturity or—more commonly—such time as the bank sells the guaranteed portion of the loan in the secondary market

7(a) Fee Structure

Banks are not paid an origination fee for extending 7(a) loans Nor can banks charge application fees, commitment fees, or prepayment fees to the SBA or 7(a) borrowers Banks are allowed a servicing fee, which could be as high as 1 percent of the outstanding balance per annum (2 percent for construction loans or loans collateralized by inventory or accounts receivable), but the typical servicing fee is 0 5% per annum

Participating banks derive their non-service fee 7(a) income from (1) the interest received on the loan, and (2) the profit realized from the sale to external investors of the SBA-guaranteed portion of the credit In a typical 7(a) loan, the interest rate charged might reflect a margin of 3 to 4 5 percent per annum over the bank's cost of funds As for sale revenue, depending on secondary market conditions, the bank could realize a return from sale of 8 percent of the guaranteed portion of the loan More typically, the return from sale hovers around 3 percent of the guaranteed portion of the loan

Table 6 presents three scenarios for the first-year fee income from a $500,000, 7-year, 7(a) equipment loan that is extended at 8 percent interest by a bank that sells the guaranteed portion of the credit at the end of 12 months

Table 6[3] Return Scenarios for 7(a) Loans

	Low %	Low Revenue	Typical %	Typical Revenue	High %	High Revenue
Service Fee	0 5%	$2,143	0 5%	$2,344	2 0%	$9,375
Interest Margin	3 0%	$12,855	3 8%	$17,578	4 5%	$21,094
Profit on Sale of Guaranteed Portion	1 0%	$3,428	3 0%	$10,284	8 0%	$27,424
Total	*3 7%*	*$18,426*	*6 0%*	*$30,206*	*11 6%*	*$57,893*

In the typical scenario, a bank could realize a return of 6 percent above cost of funds on the original principal balance in the first year of the 7(a) loan This is nearly three times higher than the fee income available to Agent Banks 2 8 percent in the first year of the typical loan, if the ABST recommendations are implemented, 2 1 percent if they are not However, this fee differential is attributable partly to the need to compensate the 7(a) banks for placing 20 percent of their principal balance at risk, and for tying up 100 percent of the funds they extend until such time as the guaranteed portion of the loan is sold[4]

CONCLUSION

BF fees provided sufficient incentive for active Agent Bank participation in the project's early days Because BF fees are calculated as a percentage of a loan's original principal, however, the fees have become less attractive as BF's average loan size has fallen Based on the cost data reported by a sample of four banks, the average bank loses money on the origination monitoring, and servicing of loans under DM 389,000 Most new BF loans fall below this break-even level

The ABST recommends establishing minimum origination and monitoring fees such that Agent Banks can at least break-even on the services they provide to BF Additional Agent Bank incentives should be provided through an increased timely repayment fee By increasing the timely repayment fee to 3 percent, BF can establish a strong incentive for Agent Bank participation, while rewarding only those banks able to analyze, recommend, monitor, and service good loans

A small additional incentive should be provided for superior quarterly monitoring reports, of which BF presently receives very few QMRs graded an A or B by BF staff should be compensated at a rate of 0 35 percent of original principal, rather than the standard 0 25 percent

If implemented, these recommendations will produce fees that pay Agent Banks an average of 2 5 percent per annum for each performing loan This level of fees is reasonable in comparison to

3 Revenue scenarios for service fees and interest margins reflect nominal percentages applied against average outstanding balance in first year Profit on sale of guaranteed portion assumes 80 percent guarantee of principal remaining after one year of amortization Totals reflect total revenue as percent of original principal

4 In practice, active 7(a) lenders often package and sell their 7(a) loans in far less than a year's time increasing the profitability of 7(a) lending

reported Agent Bank costs and to profits commonly available through other U S government programs designed to stimulate lending to small businesses

Finally, BF has recently proposed introduction of a new fee, payable to Agent Banks that accept the transfer of an existing BF borrower from another Agent Bank Most commonly, these transfers have been required by the failure of the original Agent Bank BF proposes limiting transfer fees to 0 25 percent of outstanding principal, and a maximum of DM 1,500

Many transferred loans are troubled, and the proposed transfer fee will only rarely be adequate to cover the costs of the new Agent Bank These costs include the transfer of liens from the original Agent Bank, frequent difficulties in collection, and overcoming borrower resistance to providing the new bank with the information required to complete monitoring reports

Banks that accept transferred borrowers are providing BF with a service The ABST recommends that the standard BF origination fee, calculated as a percentage of outstanding principal, be paid to banks that accept the transfer of existing BF loans By providing a fair level of compensation, BF can reduce the considerable persuasive efforts that have been required to secure new Agent Bank homes for transferred credits

APPENDIX 1

INTERVIEWS CONDUCTED BY ABST

INTERVIEWS CONDUCTED BY ABST

EXTERNAL

Bank Supervision Advisor	Dale Wilson	9 July 1998
USAID Auditor	Bill Murphy	24 July 1998
USAID Project Officer	John Glover	5 August 1998
USAID Evaluator	Chuck Taylor	16 July 1998
Bank Privatization Advisor	Mike Markels	19 August 1998

BF UNITS

BF Auditor	Michael Moore	24 June 1998, 11 July 1998
Audit Associate	Slobodan Brankovic	10 July 1998
Audit Associate	Tarik Ceric	11 July 1998
Special Assets Manager	Dan Glaspy	11 July 1998
Operations Manager	Jim Gomez	23 June, 14 July 13 Aug 98
Operations Assistant	Faruk Hujic	24 June,10 July, 14 July 98
Operations Assistant	Srdan Miladinovic	14 July 1998
Operations Assistant	Adi Juzbasic	14 July 1998
Staff Attorney	Boris Maslo	Multiple
Legal Assistant	Femil Curt	23 June 1998

BF CREDIT

Tuzla Team Leader	Jerry Lorenz	22 July 1998
Tuzla Lending Associate	Maida Berbic	22 July 1998
Tuzla Lending Associate	Meriha Manojlovic	22 July 1998
Brcko Lending Associate	Goran Gajic	30 July 1998
Banja Luka Team Leader	Lloyd Freeman	27 July 1998, 11 Aug 1998
Banja Luka Lending Assoc	Esma Mustajbasic	30 July 1998, 11 Aug 1998
Banja Luka Lending Assoc	Mirela Kelecevnic	30 July 1998, 11 Aug 1998

Sarajevo Team Leader I	Boris von Hoffmann	12 August 1998
Sarajevo Lending Associate	Sandra Cico	4 August 1998, 14 Aug 1998
Sarajevo Lending Associate	Serif Zvizdic	14 August 1998
Sarajevo Field Associate	Ibrahim Smajlagic	8 July 1998, 14 August 1998
Sarajevo Field Associate	Adisa Bavcic	14 August 1998
Sarajevo Team Leader II	Brian McGill	11 August 1998
Sarajevo Lending Associate	Lejla Music	14 August 1998
Sarajevo Lending Associate	Damir Coric	14 August 1998
Sarajevo Lending Associate	Adis Hodzic	14 August 1998
Sarajevo Field Associate	Goran Stefatic	14 August 1998
Sarajevo Field Associate	Nihad Taso	14 August 1998
Credit Manager	Terry Glossop	12 August 1998
Lending Manager	Jay Dyer	12 August 1998

APPENDIX 2

AGENT BANK APPLICATION FORM

AGENT BANK APPLICATION FORM

Part I: General Information

1 *Name and Address of bank*

____

____

____

2 *Principal contact for the Application*

____

(Name) *(Position/Title)*

3 *Telephone* ____________________

Fax ____________________

4 *Legal Form of the Institution* ____________________

Date Founded ____________________

Date of Court Registration or Last Amendment ____________________

5 *Please describe briefly the history of the bank, and its evolution to its current market strategy*

Part II: Lending Experience of the Bank

6 *Provide the following data on the Bank's annual lending activity in the years 1996 and 1997, and through June 1998 (or for whatever part of that time data is available)*

a *Number and value (DM) of loans outstanding at the end of each period*

	1996	1997	Jan - June 1998
Number of Loans at end of Period			
Value of Loans at end of Period			

b *Total number and value of new loans originated during the year*

	1996	1997	Jan - June 1998
Number of New Loans in Period			
Value of New Loans in Period			

c *Number and total value of delinquent loans at the end of each year*

	1996	1997	Jan - June 1998
Number of Delinquent Loans at End of Period			
Value of Delinquent Loans at End of Period			

d *Accounting standard for delinquency in use at the Bank How long past due is a loan before it is considered delinquent? Does the bank consider the total remaining loan value to be delinquent, or just the value of the payments delinquent to date?*

e *Number and value of loans written off at the end of each year*

	1996	1997	Jan - June 1998
Number of Loans Written Off at End of Period			
Value of Loans Written Off at End of Period			

f *Accounting standard for requiring a loan write off*

g *What is the approximate average term of loans in the portfolio, extended from the bank's own funds?*

7 *What is the geographic territory served by the Bank's lending program?*

8 *What are the principal business sectors to which the bank is currently lending (e g farming, agricultural processing, forestry, wood processing, textiles metalworking industry, retail trade, transport, etc) Please specify sector concentration of lending from bank's own funds, as well as of the bank's lending through internationally funded programs, such as BF*

9 *Approximately what percentage of the value of the current portfolio is in the following three categories*

	Portfolio Financed with Own Funds	Portfolio Financed (at least partially) by International Programs
Private Firms		
State-owned Enterprises		
Privatizing Firms		

10 *Describe briefly the type of market outreach your bank would undertake to expand BF lending, if selected as an Agent Bank*

11 *What is your estimate of the number and value of new loans you believe the Bank could produce as an Agent Bank over the next two years?*

	Sept 1998 – Aug 1999	Sept 1999 – Aug 2000
Number of New Loans		
Value of New Loans		

Rationale for projection

12 If the Bank is currently participating in the BF Program as an Agent Bank, what has been the experience of your bank with BF, in terms of number of loans recommended and disbursed, value of loans, and repayment performance of loans? How and why do you anticipate that experience will change over the next two years?

13 Describe your bank's participation in other credit initiatives supported by international development or reconstruction agencies

Part III: Financial Systems and Controls

14 *Describe the system of accounting and financial controls currently being used in your bank If the system is computerized, describe the types of accounting programs which are being used and the type and frequency of reports which are produced Describe the types of "checks and balances" that are in place to protect against misuse of funds*

15 *Under which accounting standards (international accounting standards (IAS) U S GAAP, and/or Bosnian Accounting Standards) does your bank prepare its financial statements?*

16 *Does your bank receive an independent, certified financial audit? If your Bank does not receive an independent financial audit, describe any steps which may be underway to institute such procedures*

17 *Does your bank have correspondent relationships with banks outside of Bosnia? Provide the name of each correspondent and the extent of your bank's relationship with each*

PART IV KEY PERSONNEL

Please complete the following table for all personnel in the Bank who will have a key role in the implementation of the BF Program For purposes of this application key personnel includes Senior Management, Chief Financial Officer or Treasurer Manager of Credit Department, Head of Operations, and Loan Officers assigned to the BF program Place an * after the name of each individual who is a shareholder in the bank Place a ** after the name of each individual who currently owes at least DM 10,000 to the bank

Position in Bank	Gross Monthly Compen-sation	Name (First and family name For married females, provide maiden name as well)	Place and Date of Birth (place day month year)	Permanent Address	Current Address (if same as permanent address please indicate "same")	Education (list degrees or education)	Years in Banking / With Your Bank	Father's Name
							/	
							/	
							/	
							/	
							/	
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							/	
							/	
							/	

PART V BOARD OF DIRECTORS								
Please complete the following table for all members of the bank s board of directors Place an * after the name of each director who is a shareholder in the bank Place a ** after the name of each director who currently owes at least DM 10 000 to the bank								
Position in Outside Company or Public Office, in Bank, or on Bank s Board of Directors	Gross Monthly Compen sation	Name (First and family name For married females provide maiden name as well)	Place and Date of Birth (place day, month, year)	Permanent Address	Current Address (if same as permanent address please indicate "same")	Education (list degrees or education)	Years in Banking / With Your Bank	Father's Name
							/	
							/	
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							/	

PART VI OWNERS

Please complete the following table for each person owning at least 10 percent of the bank Place a ** after the name of each owner who currently owes at least DM 10 000 to the bank If a **company** owns at least 10 percent of the bank, please list that company s name percentage ownership current address, and years of ownership only

Position in Outside Company or Public Office, in Bank or on Bank's Board of Directors	Percent Owner-ship of bank	Name (First and family name For married females, provide maiden name as well)	Place and Date of Birth (place, day month year)	Permanent Address	Current Address (if same as permanent address, please indicate same)	Background in Banking If Any	Number of Years as Owner of Bank	Father's Name

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Part VII: Bank Financial Attachments

Please attach to this Agent Bank Application an annual balance sheet, income statement, and (if prepared) statement of cash flow for the years 1995, 1996, and 1997 For the past year (i e , July 1997 - June 1998) attach copies of the **monthly** *financial reporting your bank provides to the FBA*

Part VIII: Certifications

Please return the following statements with the signature of the bank's director and (if applicable) chairman of the board

- We hereby certify that all of the information provided here is, to the best of our knowledge, true, correct and complete

- We hereby certify that we, our key personnel, and the bank's owners, managing board members, and members of the board of directors have reviewed all Agent Bank responsibilities, including those described in the Agency Agreement and the Agent Bank Operations and Procedures Manual We accept these responsibilities and are prepared to operate in accordance with the specified procedures

- We hereby certify that we, our key personnel, and the bank's owners, managing board members, and members of the board of directors have reviewed the Code of Ethics included in the Agent Bank Operations and Procedures Manual We are prepared to operate in accordance with the Code of Ethics and enforce it for all Covered Persons

Signed this day of ________________, 199_,

____________________________ Stamp

Chairman of the Board

____

Director

APPENDIX 3

ON-SITE REVIEW QUESTIONS

Managing Director

Board related

1 What is the ownership structure of the bank? State versus privately owned percentage?
2 Does the bank pay dividends to shareholders?
3 How often does the Board Meet?
4 Does the Bank have an attendance policy for meetings?
5 Does the Board receive monthly financial reports?
6 Does the Bank have an internal or external auditor?
7 Are loans made to directors or to companies that they have an interest in?

Management structure

8 Are frequent senior management meetings held?
9 What are the committee structures of both management and the Board of Directors? May we have an organization chart?
(a) Loan committee
(b) Alco Committee
(c) Audit committee
(d) Executive committee
10 Does the bank have a strategic plan that covers
(a) plans for mergers or expansion or contraction?
(b) plans for capital expenditures in the next three years?
(c) any new products being developed or considered?
(d) equity/capital growth in the next 3 years?

General

11 Does the Bank own or have any substantial interest in non bank companies?

Director of Credit

Policy

1 Does the bank have a loan policy approved by the Board? If yes, does it include?
(a) provisioning for loan losses
(b) the process for handling delinquencies
(c) charge off criteria
(d) a description of a loan rating system
(e) loan officer and loan committee lending limits
(f) policy on loans to insiders and the conditions for exceptions thereto

Loan administration

2 What is the past due or delinquency ratio for the bank's portfolio?
3 Are past due or delinquency reports reviewed daily?
4 Are loans that become past due transferred to a workout/collection officer?
5 Does the Bank maintain an internal Watch List of troubled loans?
6 Is lending centralized or are officers available to make loans at branches?
7 Are you concerned about concentrations within the portfolio?
8 How often do the credit officers review and update the credit files?
9 Are borrowers required to submit quarterly financial information?
10 Can liens be perfected and how?
11 Are collateral documents kept separate from the loan files?
12 Are loans disbursed before the required documentation is completed and collateral perfected?

Loan Administration – BF Loans

13 How many staff members are involved in administering BF loans? # of lenders? # of support personnel?
14 Who prepares the quarterly monitoring report?
15 What actions are taken based on the lender's analysis of the borrower's condition as evidenced in the quarterly monitoring report?
16 Are fees charged for loan applications?
17 Are fees charged for assisting the loan applicant in the preparation of the BF application?
18 Has the Bank charged fees or received commissions or other compensation for the preparation of strategic or business plans for the loan applicants?

Director of Operations

1 What computer systems are in use at the Bank?
2 What core software system is in use?
3 Describe the security in place to access the system information?
4 How much autonomy do your Branch Office operations have?

Director of Finance

Financial reporting

1 Do you prepare monthly financial statements in addition to those filed with the regulators?
2 What financial information do you file with the regulators?
3 Do you follow international accounting standards (IAS)?
4 What kind of financial ratios do you prepare and review with management and the Board of Directors?

(a) Capital Adequacy
(b) Leverage Ratio
(c) Loans to one borrower as a percentage of capital
(d) Risk based capital ratio
(e) Interest margin
(f) Loan loss coverage
(g) ROA and ROE

Correspondent accounts

5 Why do you have multiple correspondent relationships?
6 Are these correspondent accounts reconciled to date? If not when was the last reconciliation completed?
7 Do any of these correspondents grant lines of credit to the bank?

Policy

8 Do you have a comprehensive accounting policy?
9 Does the bank have an asset and liability policy?
10 Do you have a liquidity management policy?
11 How do you manage interest risk?
12 How do you manage maturity risk?

Treasury

13 Does the bank have a separate Treasury function? If so to whom does the Treasurer report?
14 How do you manage foreign exchange risk?
15 How do facilitate the transfer of funds both domestic and international?

Balance sheet and profit and loss

16 Are all general ledger accounts properly reconciled with supporting schedules by persons who do not have the capability to authorize, originate, or post transactions?
17 Does the Bank have any of balance sheet liabilities, such as guarantees, letters of credit, etc ?
18 Does the Bank have any borrowings for its own use with other banks, companies, or organizations?
19 Are there any assets not on the books or are any assets shown at substantially less than their realizable value?
20 Does the bank have any international investments?

APPENDIX 4

SCHEDULE OF ON-SITE REVIEWS

	BANK	Active/ Inactive/ New	CITY	DATE APP RECEIVED	DATE OF ON-SITE REVIEW	Evaluator	FINANCIAL ANALYSIS	NOTES
1	AGROPROM BANKA AD	A	BANJA LUKA	16 Jul 98	10 Aug 98	Z	X	Need FBA Financial Format
2	AUROBANKA	N	VITEZ		6 Aug 98	T	X	Signed new Agreement after 25 Jn w/Z got full app 27 Jly ETA 5 Aug
3	BANJALUCKA BANKA DD	A	BANJA LUKA	16 Jul 98	10 Aug 98	Z	X	Need FBA Financial Format
4	BH BANKA DD	A	SARAJEVO	17 Jul 98	23 Jul 98	Z A T	X	Extended to 3pm 17 July
5	CENTRAL PROFIT BANKA DD	A	SARAJEVO	30 Jul 98	5 Aug 98	T	X	LATE Will submit by 31 July
6	DEPOZITNA BANK DD	I	SARAJEVO	16 Jul 98	6 Aug 98	A	X	**New management**
7	EXPORT BANKA AD	A	BIJELJINA	17 Jul 98	29 Jul 98	A		Need FBA Financial Format
8	GOSPODARSKA BANKA DD	A	SARAJEVO	1 Aug 98	4 Aug 98	T	X	Legal concerns Met on 24 July w/Z S extended to 31 July
9	HIPOTEKARNA BANKA DD	A	SARAJEVO	15 Jul 98		Unassigned	X	Merging with BH according to BH
10	HRVATSKA POSTANSKA BANKA H B DD	I	MOSTAR	16 Jul 98	3 Aug 98	Z T	X	
11	INVESTICIONO KOMERCIJALNA BANKA	A	ZENICA	17 Jul 98	29 Jul 98	T	X	
12	KOMERC BANKA DD	A	TESANJ	15 Jul 98	31 Jul 98	A	X	
13	KOMERCIJALNA BANKA DD	A	TUZLA	16 Jul 98	28 Jul 98	A	X	
14	KRISTAL BANKA	A	BANJA LUKA	16 Jul 98	30 Jul 98	Z		Says IMF bal sheet not required or prepared Gave IAS audited statements
15	LJUBLJANSKA BANKA DD	A	SARAJEVO	17 Jul 98	5 Aug 98	A	X	
16	MARKET BANKA DD	A	SARAJEVO	22 Jul 98	10 Aug 98	T	X	Extended to 2pm 22 July
17	MO BANKA MOSTAR	I	MOSTAR		29 Jul 98	T		Late Delivering 29 Jly to BF
18	POSTBANK BH	N	SARAJEVO	16 Jul 98	4 Aug 98	Z	X	**NEW**
19	PRIVREDNA BANKA AD BRCKO	I	BRCKO	16 Jul 98	30 Jul 98	A		Need FBA Financial Format
20	PRIVREDNA BANKA DD	A	TRAVNIK	16 Jul 98	30 Jul 98	T	X	
21	PRIVREDNA BANKA DD	I	BIHAC	3 Aug 98	11 Aug 98	Z		Late Didn t get materials
22	PRIVREDNA BANKA SARAJEVO DD	A	SARAJEVO BUGOJNO	16 Jul 98	28 Jul 98	Z T	X	
23	PROMDEI BANKA DOO	I	SARAJEVO			Unassigned		LATE 28 Jly supposed to call to give date of submission
24	SAHINPASIC KOMERCIJALNA BANKA DD	A	SARAJEVO	16 Jul 98	5 Aug 98	A	X	
25	SIPAD BANKA DD	I	SARAJEVO	16 Jul 98	14 Aug 98	A	X	
26	SREDNJOBOSANSKA	N	KISELJAK	20 Jul 98	4 Aug 98	A		**NEW**
27	TRGOVACKA BANKA DD	A	VISOKO	16 Jul 98	11 Aug 98	A	X	
28	TUZLANSKA BANKA DD	A	TUZLA	16 Jul 98	22 Jul 98	Z A T	X	
29	UNION BANKA DD	A	SARAJEVO	22 Jul 98	31 Jul 98	Z	X	
30	UNIVERSAL BANKA DD	A	SARAJEVO	16 Jul 98	5 Aug 98	Z	X	
31	UPI BANKA DD	A	SARAJEVO	15 Jul 98	12 Aug 98	A	X	
32	VAKUFSKA BANKA DD	A	SARAJEVO	3 Aug 98	7 Aug 98	T	X	Late Turning in on 30 July 98

Active **22** **Inactive** **7** **New** **3**

APPENDIX 5

AGENCY AGREEMENT

Agency Agreement
(Draft of 14 August 1998)

This Agency Agreement ("the Agreement") is concluded on the day of 199 , between

USAID Business Finance, an organization established between the United States Agency for International Development to implement the provisions of Grant Agreement no 168L-601 dated May 7, 1996 concluded between the governments of Bosnia and Herzegovina and the United States of America establishing the Reconstruction Finance Facility Program and which was previously known as the On-Lending Management Unit (OMU) of the Bosnian Reconstruction Finance Facility (BRFF), located at Marsala Tita 25, Sarajevo ("the Lender") and

[**Name of Agent Bank**] located at [street address, city, territory] ("Agent Bank")

Article 1
Definitions

In this Agreement the following terms have the meaning assigned to them in this article

"Borrower" means a borrower, or, as the context requires, a prospective borrower or both, under a Loan Agreement with the Lender under the Program
"Business Plan" means the business plan provided by a Borrower when applying for a Loan
"Collateral" means the collateral to be taken as part of a Loan Agreement and which is listed in the Loan Agreement
"Credit Application" means the application by a Borrower for a Loan
"Day" means a working day, which, for the purposes of this Agreement means

(a) in respect of Agent Banks whose office is in the Federation of Bosnia and Herzegovina, a day that is neither Saturday nor Sunday, nor [list of days of public holiday], nor any day that is declared to be a public holiday for the whole of the Federation or for the whole of the Canton in which the Agent Bank has its office, by relevant legislature, and
(b) in respect of Agent Banks which office is in the Republika Srpska, a day that is neither Saturday nor Sunday, nor [list of days of public holiday], nor any day that is declared to be a public holiday for the whole of the Republika Srpska by the Parliament of the Republika Srpska

"Fraud" has the meaning given to it in the law
"Gross negligence" has the meaning given to it in the law
"Loan" means a loan granted by the Lender to a Borrower under the Program or a recommended Loan or both as the context requires
"Loan Agreement" means the loan agreement between the Lender and a Borrower
"Loan Funds" mean the funds advanced or to be advanced to a Borrower by the Lender under a Loan Agreement
"Manual" means the Lender's "Agent Bank Operations and Procedures Manual"

"Month" means calendar month
"Program" means the USAID Business Development Program for Bosnia and Herzegovina which is implemented as part of the provisions of Grant Agreement no 168L-601 ("the Grant Agreement") dated 7 May 1996 between the governments of the United States of America and Bosnia and Herzegovina
"USAID" means the United States Agency for International Development, an international organization established by the government of the United States of America

Article 2
Agency

The Lender appoints the Agent Bank and the Agent Bank agrees to act as the Lender's agent in marketing and managing loans made by the Lender to Borrowers under the Program as set out further in this Agreement

As agent of the Lender, the Agent Bank must act at all times in the best interests of the Lender and must fully disclose all material information to the Lender in respect of its functions performed under this Agreement

The Agent Bank may not perform actions or omit to perform actions, whether for consideration or not, which are inconsistent with its obligations under this Agreement

Article 3
Commission Agreement

The Lender and the Agent Bank agree that this Agreement is a commission agreement

Article 4
Obligations of the Agent Bank

The Agent Bank shall act on behalf of the Lender in marketing the Program, receiving and processing Credit Applications, analyzing and recommending Loans for approval, and documenting, securing, disbursing, monitoring, servicing, and collecting Loans and taking all necessary legal and other steps to enforce Loans as well as performing any other obligations arising from the law, this Agreement or the nature of business in respect of this agency relationship and in accordance with good business practices

In fulfilling its obligations under this Agreement, the Agent Bank shall act at all times in accordance with

(a) the policies, principles and procedures set out in the Manual
(b) prudent banking practices
(c) the relevant Loan Agreement

(d) the broad policies and operating procedures set out in the Program

The Agent Bank must at all times advise the Lender of all facts known to it which are material to any existing or proposed Loan

Article 5
The Manual

The Manual sets out the guidelines and procedures to be followed by the Agent Bank in implementing its obligations as agent of the Lender

The Lender shall provide the Agent Bank with a copy of the Manual and any revisions, amendments and additions to it and at all times shall keep and make available a master copy of the Manual at its offices

The Agent Bank shall update its copy of the Manual immediately upon receipt of any revisions, amendments or additions from the Lender

The Agent Bank shall take appropriate steps to ensure that its managers and lending staff are aware at all times of the contents of the Manual and any revisions, amendments and additions to it

The Lender may revise, amend or add to the Manual at any time without the consent of the Agent Bank

On receipt of any revisions, amendments or additions, the Agent Bank must implement those revisions, amendments or additions within 20 days

Implementation of revisions, amendments or additions to the Manual will not affect the obligations of the Agent Bank under this Agreement and will not affect the Lender's right to enforce the provisions of this Agreement

Article 6
Access to records

The Agent Bank must allow the Lender, a contractor of the Lender or the USAID Office of the Inspector General or Regional Inspector General to inspect, audit or review all books and records of the Agent Bank that pertain to Loans and the requirements of this Agreement on a regular and unhindered basis

Article 7
General duties of the Agent Bank

Owners, members of the Board of Directors or the Supervisory Board, managers and employees of the Agent Bank must not have been indicted for war crimes

The Agent Bank must at all times remain in good standing with all relevant regulatory agencies with jurisdiction over banks

The Agent Bank must support the principles of multi-ethnic employment and international efforts for repatriation of refugees and displaced persons

The Agent Bank may not discriminate against any loan applicant or otherwise engage in discriminatory actions on the grounds of ethnic origin, religion, race, gender or age

The Agent Bank must not engage in any behavior contrary to the objectives of the Program

Article 8
Relationship of Agent Bank and Borrowers

Notwithstanding the provisions of article 2 the Agent Bank may provide such assistance as necessary to Borrowers to enable completion of their Credit Applications and other relevant documentation, and in general, provided that such assistance does not conflict with the duty of the Agent Bank to act in the best interests of, and to provide full disclosure to, the Lender

This Agreement does not affect the right of the Agent Bank to charge a Borrower for normal banking services However, the Agent Bank may not charge a Borrower more than it charges its non-Borrower clients for comparable services

Notwithstanding the provisions of this article, the Agent Bank may not charge a Borrower

(a) any fee for processing a Borrower's Credit Application
(b) any fee for preparing a Borrower's Business Plan
(c) any Loan origination fee, or
(d) any other fee for obtaining or managing a Loan

The Agent Bank must disclose to the Lender any material interest that exists or arises on the part of the Agent Bank or on the part of any owner, employee, manager or member of the Board of Directors or Supervisory Board of the Agent Bank, in the business of a Borrower

Article 9
Fees payable by Lender

The Lender will pay the Agent Bank the origination and service fees as described below at the rates set out in the Manual

All fees payable under this article shall be paid in Deutsche Marks

The fees payable under this article are

(a) an origination fee to be calculated as a percentage of the total loan amount disbursed In the event of disbursement in tranches or parts, fees shall be paid based on the amount of the tranche or partial payment
(b) a quarterly monitoring fee to be calculated as a percentage of the total amount disbursed to the Agent Bank, for each Quarterly Monitoring Report Quarterly Monitoring Fees will be paid for reports received by their due dates and found to be satisfactory by the Lender No fee will be paid for Quarterly Monitoring Reports that are submitted late or that are found to be unsatisfactory by the Lender
(c) a timely repayment fee to be calculated as a percentage of the Borrower principal and interest payment for those payments made by the Borrower by the 10th of each month
(d) a fee for acceptance of transfer of a Borrower from another agent bank to be calculated as a percentage of each transferred Borrower's outstanding principal balance at the time of transfer, for each transferred Borrower
(e) a loan workout fee for Loans classified by the Lender as 'Loan Workout", the amount and method of calculation to be negotiated between the Lender and the Agent Bank in each case

The fees described in this article shall be paid at the times and in the manner set out in the Manual

Article 10
Collateral

The Agent Bank must take all necessary steps to secure to the maximum extent possible all Collateral to the satisfaction of the Lender

Collateral must be secured in the appropriate manner and in accordance with the relevant Loan Agreement in the name of the Agent Bank with a notification that it is on behalf of the Lender

The Agent Bank must provide the Lender with proof of the proper securing of the Collateral before the Lender disburses Loan Funds

Notwithstanding the provisions of paragraph 3 of this article, in the case of Loans to be secured by Collateral to be purchased with Loan Funds, the Agent Bank must take all necessary steps to secure that Collateral as soon as possible upon purchase by the Borrower

The Agent Bank must, at all times, take all necessary steps to protect the Lender's interests in all Collateral, whether secured or not

The Lender is not obliged to disburse Loan Funds and the Agent Bank is not entitled to fees under article 9 if Collateral is not secured to the satisfaction of the Lender

Article 11
Collateral obtained by fraud or gross negligence

If Loan Funds are disbursed by the Lender to the Agent Bank and the Lender subsequently discovers that a part of any relevant Collateral has not been properly secured due to fraud or gross negligence on the part of the Agent Bank, the Lender has the right to require the Agent Bank to purchase immediately the Loan in question from the Lender

The purchase price shall be equal to the principal balance outstanding, accrued interest and unpaid Borrower fees and payment of it may be obtained by the Lender by means of signed, blank acceptance drafts to be provided by the Agent Bank prior to initial disbursement of a Loan

In addition, the Lender may require the Agent Bank to return all fees paid to it by the Lender in respect of that Loan

The exercise by the Lender of its rights under this article does not prevent it exercising any other rights it may have by law or under this Agreement in respect of the fraud or gross negligence of the Agent Bank or breach of this Agreement

Article 12
Agent Bank duties in respect of Loan Funds held

Loan Funds held by the Agent Bank prior to disbursement to the Borrower and funds received by the Agent Bank from or on behalf of a Borrower in payment of amounts owing by that Borrower under a Loan Agreement belong at all times to the Lender and are not the property of the Agent Bank and may not be mingled with the Agent Bank's own funds or the funds of other clients of the Agent Bank

The Agent Bank acts at all times in a fiduciary capacity in respect of any funds referred to in paragraph 1 of this article held by it and must exercise all due care and attention in the safekeeping and deposit of those funds and in their disbursement to Borrowers or transfer to the Lender

Under no circumstances may the Agent Bank use Loan Funds for its own purposes or permit them to be used in circumstances where it knows or ought to know that they are being used other than as explicitly authorized under this Agreement and the relevant Loan Agreement

In particular, and without limiting the duty imposed under paragraph 3 of this article, the Agent Bank must not disburse Loan Funds for any purpose other than those permitted by the relevant Loan Agreement and must not permit a Borrower to misuse Loan Funds in any way including those specified in article 15 in circumstances where the Agent Bank knows or ought to know of the misuse

The Agent Bank must disburse Loan Funds to the Borrower within two days of receiving those Loan Funds from the Lender

The Agent Bank must disburse all Loan payment remittances to the Lender within two days of receipt from the Borrower or on the Borrower's behalf

The Agent Bank must transfer any funds belonging to the Lender immediately on receiving a written request from the Lender

Article 13
Credit Risk

The Lender shall bear the credit risk of all Loans

Article 14
Disbursement

The Agent Bank shall ensure that all disbursements of Loan Funds are properly documented and authorized under the relevant Loan Agreement

The Agent Bank will verify, against third party invoices, all disbursement of Loan Funds by the Borrower

The Agent Bank must verify that the Loan Funds are used only for the purposes permitted by the
relevant Loan Agreement prior to disbursement

Article 15
Misuse of Loan Funds by a Borrower

The Agent Bank must immediately advise the Lender of any suspected misuse of funds by the Borrower

The Agent Bank must immediately advise the Lender of any suspected forged, fraudulent or inflated invoices submitted by the Borrower

The Agent Bank must not permit the Borrower to use Loan Funds to pay interest or principal on the Borrower's obligation to the Lender in circumstances where it knows or ought to know of that use unless that use is identified and specifically permitted by the Loan Agreement

The Agent Bank must not permit the Borrower to use Loan Funds to pay interest or principal on non-Lender debts, in circumstances where it knows or ought to know of that use, even if those debts were incurred for items specified in the Loan Agreement, unless that use is permitted by the Loan Agreement In particular, but without otherwise limiting the provisions of this article, the Agent Bank must not permit the use of Loan Funds to repay amounts owing to it by the Borrower without the written authorization of the Lender

The Agent Bank must not permit the Borrower to use the Loan Funds to pay debts of any kind in circumstances where the Agent Bank knows or ought to know of that use without written authorization of the Lender

Article 16
Monitoring

During the term of a Loan Agreement, the Agent Bank must monitor each Borrower's repayment performance and compliance with the Loan Agreement

The Agent Bank must at all times employ sufficient qualified personnel to adequately monitor each Loan

Article 17
Enforcement

The Agent Bank is responsible for enforcing Loans on behalf of the Lender and must respond in a timely, appropriate and adequate manner to all breaches and anticipated breaches of their Loan Agreement by Borrowers and their guarantors

Article 18
Reporting

The Agent Bank must provide the following reports in respect of Loans to the Lender on a timely basis

(a) a monthly report of all disbursements made to Borrowers, all undisbursed funds held by the Agent Bank and all Loan payments received from Borrowers, with confirmation of the date payments were transferred to the Lender
(b) quarterly monitoring reports on each Loan serviced by the Agent Bank prepared for each calendar quarter (i e 1 January to 31 March, 1 April to 30 June, 1 July to 30 September and 1 October to 31 December) that a Loan is outstanding, beginning in the first quarter in which Loan Funds are disbursed from the Lender to the Agent Bank

The time for and method of preparation and presentation of these reports and other matters related to them shall be governed by the provisions of the Manual

The Agent Bank must also provide the Lender with copies of its June and December International Monetary Fund formatted balance sheets and measures of capital adequacy as reported to the Banking Agency of the entity in which the Agent Bank has its head office and to the Central Bank at same time as those documents are presented to those institutions

The Agent Bank must also provide the Lender with copies of its privatization plans and opening balance sheets as required by any relevant legislation on the privatization of banks, as well as advising the Lender on any restructuring or merger proposals affecting the Agent Bank

In addition, the Agent Bank must provide the Lender with other reports and documentation as the Lender may from time to time require

Article 19
Evaluation

During the term of the Agreement, the performance of the Agent Bank will be subject to periodic review by the Lender

The Agent Bank must remain in good standing, which means complying with the terms and objectives of the Grant Agreement, the Program this Agreement, and the Manual

The result of the performance review will be reported to the Agent Bank

Article 20
Transfer of Borrowers to Agent Bank

The Lender may request the Agent Bank to accept a Borrower from another agent bank

If the Agent Bank accepts a Borrower, the Agent Bank will fulfill its responsibilities as outlined in this Agreement and the Manual and will attempt in good faith to establish a positive banking relationship with the Borrower

Article 21
Transfer of Borrowers from Agent Bank

The Lender has the right to remove a Borrower from the Agent Bank if the Agent Bank does not comply with the Loan Agreement with that Borrower, this Agreement or the Manual

The Lender must notify the Agent Bank in writing of the transfer and the Agent Bank must take all steps to facilitate the transfer without delay, including, but not limited to, the transfer of security over Collateral into the name of the new agent bank on behalf of the Lender

In particular, the Agent Bank will make available to the Lender and to the new agent bank, all ledgers, payment records, monitoring reports, financial records, and other documents, including Collateral documentation, related to this Agreement and to the Loan Agreement in respect of that Borrower

The Agent Bank must ensure that the Lender's interests are protected during the transfer to the new agent bank

Article 22
Power of Attorney

The Agent Bank grants the Lender a general power of attorney to take any and all actions necessary to protect the Lender's interests in connection with the Loans serviced by the Agent Bank

This power of attorney authorizes actions that include, but are not limited to, the signing of legal documents necessary to record, transfer, or release the security over Collateral held by the Agent Bank, the transfer of a Borrower-Agent Bank relationship to a new agent bank, and the direct assignment of a Borrower's accounts receivable

The Agent Bank agrees that the Lender may present this Agreement to any third party, and that this Agreement shall serve as legal authorization (as power of attorney) from the Agent Bank No additional approvals of documents are necessary from the Agent Bank in order to allow the Lender to exercise these powers

Article 23
Breach of Agreement

Breach of the Agreement means any breach of any term of this Agreement including those provisions requiring compliance with the terms of other agreements, documents or programs

If the Agent Bank is in breach of the Agreement, the Lender may

(a) waive the default in writing
(b) terminate the Agreement immediately by giving written notice to the Agent Bank, or
(c) require the Agent Bank to purchase one or more Loans serviced by the Agent Bank if the Agent Bank breached the terms of this Agreement by means of fraud or gross negligence and if that breach caused a Borrower to breach the terms of its Loan Agreement

The purchase price of the Loan will be determined by the Lender and paid by the Borrower using the method set out in article 11

In addition, the Lender may require the Agent Bank to return all fees received under this Agreement for those Loans in which the default occurred as a result of fraud or gross negligence on the part of the Agent Bank

This provision is a contractual penalty for fraud or gross negligence The Agent Bank must also compensate the Lender for any additional losses caused by the Agent Bank

No delay in exercising or omission to exercise its rights under this article and no continued dealings with the Agent Bank shall impair the Lender's ability to exercise its rights under this article at any time or shall constitute a waiver of any of its rights, powers and remedies

On termination of the Agreement under this article, the procedures set out in article [] will apply as appropriate and the Agent Bank must also compensate the Lender for all losses caused by its breach

Article 24
Cessation of agreement

This Agreement shall cease

(a) in the circumstances set out in paragraph 2 of article 26
(b) on termination of the Agreement for breach by the Agent Bank as set out in article 23
(c) if the Agent Bank and the Lender enter into a further agency agreement
(d) on cancellation of the Agreement as set out further in this article
(e) in any other way determined by law

Either party may cancel the Agreement by giving 20 days written notice of cancellation to the other party

Article 25
Procedure on cancellation or termination of Agreement

If the Agreement is cancelled under article 24 or 26 or terminated under article 23, the parties shall cooperate to establish a procedure for the orderly transfer of Borrowers to other agent banks The transfer shall take place as soon as possible in the case of termination and no sooner than the expiry of the notice period in the case of cancellation

Until such time as all Borrowers have been transferred to other agent banks, the obligations of the Agent Bank under this Agreement shall continue

In all cases of cessation of the Agreement, the Agent Bank shall continue to protect the Lender's interests at all times and shall facilitate the transfer of Borrowers to new agent banks, and in particular shall make available without delay to the Lender and any new agent bank all ledgers, payments records, monitoring reports, financial records, all other documentation including collateral documentation related to each loan and to this Agreement

In the case of termination for breach, the Agent Bank shall immediately on receipt of notice of termination under article 23 and without further notice transfer all funds belonging to the Lender including undisbursed Loan Funds and amounts repaid by or on behalf of a Borrower to the Lender

The Agent Bank must take all necessary steps to ensure that all security over collateral is transferred into the name of the new agent bank as soon as possible

Article 26
Term of agreement

The term of this agreement shall be for a period of one year from the date of the Agreement

At the date of expiry and at each subsequent date of expiry, the Agreement shall be automatically renewed for a further one year period unless either party notifies the other in writing that the Agreement will be cancelled

Article 27
Confidentiality

All information related to a particular Borrower, including all Credit Applications, Business Plans and Loan Agreements may be released by the Lender or the Agent Bank to that Borrower

However, all information on actions or contemplated actions taken or to be taken against a Borrower is confidential and may not be disclosed by the Agent Bank to the Borrower or anyone else

The obligations of the Agent Bank under this article shall continue regardless of the cessation of this Agreement

Article 28
Transfer of the agreement

At any time and for any reason, the Lender may transfer its rights and obligations under this Agreement to a third party Any such transfer does not require the approval of the Agent Bank but the Lender must inform the Agent Bank of the transfer

The Agent Bank may not transfer its rights or obligations under this Agreement to a third party

Article 29
Change to legal and political systems

The parties agree that any changes in the legal or political systems of any kind within Bosnia and Herzegovina occurring after the conclusion of this Agreement will not affect the obligations of the Agent Bank under the Agreement

If a procedure or obligation of the Agent Bank becomes prohibited or expressly forbidden by law, the parties will attempt in good faith to reach agreement on an alternative method of fulfilling the Agent Bank's obligations while remaining in compliance with the law

Article 30
Applicable law

This Agreement shall be governed by the law in force at the place where the Agent Bank has its head office

Article 31
Resolution of disputes

The court with territorial jurisdiction to hear disputes under this agreement is the appropriate court at Sarajevo if the Agent Bank is located in the Federation of Bosnia and Herzegovina and the appropriate court at Banja Luka if the Agent Bank is located in the Republika Srpska

Article 32
Language of the agreement

The English language text of this agreement shall prevail in the case of a discrepancy between the English and Bosnian texts

Article 33
Severability of agreement

In the event that part of this Agreement is determined to be invalid by a court, all remaining articles and paragraphs shall remain valid and binding

Article 34
Notices

Any notice required to be given or document required to be delivered or other communication under this Agreement shall be given in writing and delivered by registered mail in the following manner

Notices to the Lender shall be addressed to USAID Business Finance, Marsala Tita 25 Sarajevo 71000

Notices to the Agent Bank shall be addressed to

Article 35
Number of originals

This agreement shall be executed in two originals

APPENDIX 6

COST DATA FROM SAMPLE AGENT BANKS

SCHEDULE ONE
LOAN ORIGNATION CLOSING AND DISBURSEMENT COSTS

	TUZLANSKA BANKA	GOSPODARSKA BANKA	MARKET BANKA	KRISTAL BANKA	HIGH	LOW	AVERAGE
LABOR COSTS							
CREDIT OFFICER	1 500	738	1 292	600	1 500	600	1 033
CREDIT ASSITANT	0	255	433	360	433	0	262
OTHER CREDIT STAFF	0	0	52	360	360	0	103
OPERATIONS OFFICER	350	38	173	390	390	38	238
OPERATIONS CLERK	120	0	98	450	450	0	167
OTHER STAFF	12	0	17	360	360	0	97
TOTAL LABOR	1 982	1 031	2 065	2 520	2 520	1 031	1 900
MATERIALS COST	100	0	50	20	100	0	43
OFFICE SUPPLIES	150	72	30	0	150	0	63
COMPUTER EXPENSES	150	0	250	20	250	0	105
TRAVEL COSTS	60	100	0	40	100	0	50
OTHER COSTS	0	923	0	25	923	0	237
TOTAL MATERIALS	460	1 095	330	105	1 095	105	498
TOTAL LABOR AND MATERIAL COST	2 442	2 126	2 395	2 625	2 625	2 126	2 397
Over a 3 year loan	*2 442 DM*	*2 126 DM*	*2 395 DM*	*2 625 DM*	*2 625 DM*	*2 126 DM*	*2 397 DM*

SCHEDULE TWO
LOAN SERVICING INCLUDING COLLECTION EFFORTS WITH BORROWERS

	TUZLANSKA BANKA	GOSPODARSKA BANKA	MARKET BANKA	KRISTAL BANKA	HIGH	LOW	AVERAGE
LABOR COSTS							
CREDIT OFFICER	360	154	554	288	554	154	339
CREDIT ASSITANT	0	128	623	346	623	0	274
OTHER CREDIT STAFF	0	0	52	288	288	0	85
OPERATIONS OFFICER	240	53	277	0	277	0	143
OPERATIONS CLERK	0	0	118	0	118	0	30
OTHER STAFF	72	0	17	0	72	0	22
TOTAL LABOR	672	335	1 641	922	1 641	335	892
MATERIALS COST	360	0	120	240	360	0	180
OFFICE SUPPLIES	360	26	60	170	360	26	154
COMPUTER EXPENSES	0	0	0	140	140	0	35
TRAVEL COSTS	0	0	0	170	170	0	43
OTHER COSTS	0	330	0	0	330	0	82
TOTAL MATERIALS	720	355	180	720	720	180	494
TOTAL LABOR AND MATERIAL COST	1 392	690	1 821	1 642	1 821	690	1 386
Over a 3 year loan	*4 176 DM*	*2 071 DM*	*5 463 DM*	*4 926 DM*	*5 463 DM*	*2 071 DM*	*4 159 DM*

SCHEDULE THREE
QUARTERLY LOAN MONITORING

	TUZLANSKA BANKA	GOSPODARSKA BANKA	MARKET BANKA	KRISTAL BANKA	HIGH	LOW	AVERAGE
LABOR COSTS							
CREDIT OFFICER	1 600	2 362	1 477	n/a	2 362	1 477	1 813
CREDIT ASSITANT	280	0	554	n/a	554	0	278
OTHER CREDIT STAFF	0	0	0	n/a	0	0	0
OPERATIONS OFFICER	0	0	231	n/a	231	0	77
OPERATIONS CLERK	0	0	0	n/a	0	0	0
OTHER STAFF	160	0	104	n/a	160	0	88
TOTAL LABOR	2 040	2 362	2 366	2 256	2 366	2 040	2 256
MATERIALS COST	80	0	80	n/a	80	0	53
OFFICE SUPPLIES	80	146	40	n/a	146	40	89
COMPUTER EXPENSES	220	0	400	n/a	400	0	207
TRAVEL COSTS	80	800	0	n/a	800	0	293
OTHER COSTS	0	1 875	0	n/a	1 875	0	625
TOTAL MATERIALS	460	2 821	520	1 267	2 821	460	1 267
TOTAL LABOR AND MATERIAL COST	2 500	5 183	2 886	3 523	5 183	2 500	3 523
Over 3 year loan	*7 500 DM*	*15 549 DM*	*8 658 DM*	*10 569 DM*	*15 549 DM*	*7 500 DM*	*10 569 DM*
Total Monitoring and Servicing Labor and Material over 3 Year Loan	***11,676 DM***	***17 620 DM***	***14,121 DM***	***15,495 DM***	***17,620 DM***	***11 676 DM***	***14,728 DM***
Total labor and material over 3 year loan	***14 118 DM***	***19 746 DM***	***16,516 DM***	***18,120 DM***	***19,746 DM***	***14,118 DM***	***17 125 DM***

*At the date of reporting Kristal Banka (like other RS banks) had yet to submit a QMR It was assigned the average monitoring costs of the other three banks in the sample

APPENDIX 7

COST QUESTIONNAIRE
(Translated)

In an effort to review the fee structure BF offers to its Agent Banks, we would like to gain a better understanding of the costs that Agent Banks incur for originating and servicing BF Loans, and for the preparation of Quarterly Monitoring Reports Your assistance in this effort is appreciated

The costs borne by your bank in the BF program may be broken into two major components labor and materials Labor should be priced using an hourly wage that includes all social taxes and benefits If an individual is paid an annual salary, please divide the annual salary by 2,080 hours to determine an hourly wage

Materials would include such things as the cost of a client visit, computer time and general office supplies Please be detailed in your analysis If there are other items that should be considered please list these items and give your best estimate of their cost Costs of both labor and materials should be quoted in DM

Please complete your analysis for *a typical BF loan serviced by your bank*, not for the entire portfolio of BF loans your bank has originated When completing your analysis, please estimate annual costs by multiplying the cost of each task by the number of times it is performed in a year For example, the time spent by a credit officer updating borrower financials for a Quarterly Monitoring Report should be multiplied by four to obtain an annual estimated cost for that task

Thank you for responding to our survey

1 LOAN ORIGINATION, CLOSING, AND DISBURSEMENT

	ESTIMATED HOURS SPENT	HOURLY WAGE	COST	TIMES PER YEAR	Annual Cost
Labor Cost					
Credit Officer				1	
Credit Assistant				1	
Other Credit Staff				1	
Operations Officer				1	
Operations Clerk				1	
Other Staff				1	
Total Labor				1	
Materials Cost					
Office Supplies				1	
Computer Expenses				1	
Travel costs				1	
Other costs (specify)				1	
Total Materials				1	
Total Labor and Material Cost					

Notes

2 LOAN SERVICING, INCLUDING COLLECTION EFFORTS WITH BORROWER

	ESTIMATED HOURS SPENT	HOURLY WAGE	COST	TIMES PER YEAR	Annual Cost
Labor Cost					
Credit Officer					
Credit Assistant					
Other Credit Staff					
Operations Officer					
Operations Clerk					
Other Staff					
Total Labor					
Materials Cost					
Office Supplies				12	
Computer Expenses				12	
Travel costs				12	
Other costs (specify)				12	
Total Materials				12	
Total Labor and Material Cost					

Notes

3 QUARTERLY LOAN MONITORING

	ESTIMATED HOURS SPENT	HOURLY WAGE	COST	TIMES PER YEAR	Annual Cost
Labor Cost					
Credit Officer					
Credit Assistant					
Other Credit Staff					
Operations Officer					
Operations Clerk					
Other Staff					
Total Labor					
Materials Cost					
Office Supplies				4	
Computer Expenses				4	
Travel costs				4	
Other costs (specify)				4	
Total Materials				4	
Total Labor and Material Cost					

Notes

4 OTHER COSTS (PLEASE SPECIFY NATURE OF TASKS BELOW)

	ESTIMATED HOURS SPENT	HOURLY WAGE	COST	TIMES PER YEAR	Annual Cost
Labor Cost					
Credit					
Operations					
Bank Management					
Other Staff					
Other Staff					
Other Staff					
Total Labor					
Materials Cost					
Office Supplies					
Computer Expenses					
Travel costs					
Other costs (specify)					
Total Materials					
Total Labor and Material Cost					

Notes

PN-ACD-989

Report of the Agent Bank Selection Team

Volume Two
Recommendations on Each Bank

Contract No 168-0056-C-00-7104-00

September 1998

Zan Northrip
Thomas Chmelik
Alfred Dostie

DAI

7250 Woodmont Avenue, Suite 200, Bethesda, MD 20814

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REPORT OF THE AGENT BANK SELECTION TEAM

Volume Two: Recommendations on Each Bank

Submitted by
Development Alternatives, Inc
25 September 1998

Zan Northrip
Thomas Chmelik
Alfred Dostie

Submitted in fulfillment of various Scopes of Work originating from Contract No 168-0056-C-00-7104-00

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Recommendations on Each Bank

N B BF's original, signed recommendations on each bank were submitted to USAID with the ABST's draft report of 14 August 1998

I Recommendations on Each Agent Bank

[5] Meeting with managers only, not recommended

[6] Not reviewed, not recommended

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AGENT BANK RECOMMENDATION

BANK	AGROPROM BANKA AD BANJA LUKA
US SFOR (Y/N)	N
CANTONS	REPUBLIKA SRPSKA
MUNICIPALITIES	BANJA LUKA, GRADISKA, PRIJEDOR, LAKTASI
HEADQUARTERS	BANJA LUKA

Date	14 Aug 98	**AB Rec #**	1
Ownership (%)			
Private	60 %	**State**	40 %
Existing Agency Agreement?			
Yes	x	**No**	

Number of Outstanding BF Loans	7	**BF Market Coverage —Geographic**	Western Republika Srpska
Balance on Outstanding BF Loans	DM 2 87 million		
Range of Loan Sizes	DM 228 000 - DM 742 000		
Number of Loans 60+days past due	0		
Balance on Loans 60+days past due	0		

Owners holding more than 10 percent of the bank and percentage ownership	1 NO OWNER CONTROLS MORE THAN 5 % OF THE BANK S SHARES 2 3 4 5 6 7	1 2 3 4 5 6 7

RECOMMENDATION SUMMARY

Agroprom Banka AD Banja Luka was founded in 1990 with 88 shareholders primarily agricultural cooperatives Today there are 290 shareholders two-thirds of which are companies with at least some state ownership An audit is underway to determine the percentage of private ownership in the bank and whether the bank must pass through the first phase of privatization The ownership figures cited above are management estimates They likely overestimate the existing percentage of private ownership The bank operates in the Western part of the RS through its Banja Luka headquarters and five branches

After a slow start with BF the bank has accelerated its rate of recommendations The bank presently has seven loans outstanding Another 8 loans are approved and pending disbursement The first loan was disbursed in February as yet there are no delinquencies in the bank s portfolio BF credit staff are pleased with the progress of the bank and expect continued growth in the quality and volume of Agroprom deal flow There are no reported problems with disbursements

BF s Operations Department reports mismanagement in the bank s processing of BF payments but these problems appear headed toward resolution after repeated visits by BF staff members These staff members attribute Agroprom s difficulties to disorganization and inexperience not to an attempt to misappropriate BF funds

The bank is smaller, but better capitalized and more liquid than most BF agent banks Total assets are reported at DM 21 million, supported by DM 7 2 million in capital Cash and equivalents are equal to 42 percent of total assets Management is active and is given broad authority by the Board of Directors Based on Agroprom s improving performance, growing relationship with the BF/Banja Luka office, and strong market coverage in the Western RS approval is recommended

Recommended Restrictions on Participation

No restrictions are recommended at this time

Bank Selection Team Member Zan Northrip		**Date** 14 Aug 98
BF Chief of Party Bruce Spake		**Date** 14 Aug 98
USAID Director CRAIG G BUCK		**Date**

STATUS AND QUALITY OF BF PORTFOLIO

The bank's portfolio is in a phase of rapid growth DM 3 1 million has been disbursed for 7 borrowers, on which DM 2 8 million is outstanding Another 8 loans have been approved for DM 5 8 million, but not yet disbursed These approved loans cover a broader range of loan sizes than those shown on the cover sheet of this recommendation, and include approvals from DM 110,000 to DM 1 8 million The portfolio is young but performing well The first disbursement occurred in February, and there were no past due payments at the time of this writing

A recently completed evaluation of the loan portfolio and loan ratings resulted in the following

- 1 downgrade from 5 to 6 on a loan totaling DM 600,000

The resulting loan rating dispersion was as follows

RATING	# OF LOANS	AMOUNT
5	6	DM 2 27 million
6	1	DM 0 6 million

The loan rating dispersion is somewhat better than the average of banks in the BF program, but Agroprom's portfolio is still quite young

QUALITY OF BF ORIGINATION

BF credit staff report strong improvement in the quality of Agroprom recommendations since becoming a BF Agent Bank The bank assists its clients in presenting data to BF, and responds quickly to BF requests for additional information

COMPLIANCE WITH BF CLOSING REQUIREMENTS

No reported problems in closing documents

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

No reported violations of BF disbursement procedures

COMPLIANCE WITH BF MONITORING REQUIREMENTS

Because of the timing of the disbursements of Agroprom loans, the bank's first quarterly monitoring reports are due in mid-August

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

There have been a number of problems with the bank's compliance with BF repayment procedures, requiring repeated visits to the bank by BF's Sarajevo-based operations staff These problems have included the use of incorrect wire instructions, the transmittal of payment advice without SWIFT confirmation, and the imposition of fees by Agroprom's correspondent bank in Germany (LHB), reducing repayments forwarded to BF's account with Bank of America/Frankfurt Recently, the bank's performance has improved BF operations staff attribute Agroprom's difficulties to errors and mismanagement, rather than an intent to deceive Agroprom operations staff appear committed to complying with BF procedures

PROJECTED LOAN VOLUME

The bank projects the ability to recommend 30 bankable credits next year, with an average value of DM 200,000, producing portfolio growth of DM 6 million in the year ending August 1999 DM 10 million, in larger credits, is projected for the year ending August 2000 These projections are based on assumptions regarding the continued growth in the size range and sector of credits eligible for BF funding

QUALITY AND SUFFICIENCY OF STAFF

Overview and Staffing

Three staff members are assigned to origination and monitoring responsibilities for the BF portfolio This number includes one manager, whose role is generally limited to initial client visits Actual applications are the responsibility of two staff members reporting to him These same lending officers are responsible for BF quarterly monitoring reports, as well as for some short-term lending from the bank's own funds The burden of managing the BF portfolio is likely to outgrow these staff members within 12 months, if growth occurs as projected Management appears committed, however, to the identification and training of new staff as warranted

The bank is not yet working with other credit programs, but has signed an agreement with the World Bank that could become active in the future

Senior Management

The General Director was traveling at the time of the on-site review, but meetings were held with the following individuals

NAME	TITLE/POSITION
Miroslav Soldat	Assistant Dir , Economy (does LT credits)
Mico Vracar	Assistant Dir , Foreign Currency Operations

Vesna Grozdanic	Lending Officer
Biljana Savic	Lending Officer
Not recorded	Manager, Information technology

The senior managers met have over 15 years of banking experience each, and have been with Agroprom since its founding One of the lending officers has 7 years of experience, and the other has been working in banking for less than one year The managers explained clearly the bank's financial situation, plans for privatization, and plans for new products

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

Agroprom's financial statements present an institution that is small but liquid and well capitalized The bank reported DM 21 million in assets in June 1998, supported by DM 7 2 million in capital 42 percent of the bank's assets were in cash and cash-equivalents, a fact the bank ascribes to a conservative lending policy Retained earnings are an important source of new capital

The bank is one of few that appears to write off loans aggressively In its current portfolio, the bank reports a delinquency rate of 9 8 percent, calculated as the total outstanding balance of loans more than 90 days past due The portfolio is extended primarily in short-term credits to a variety of firms Approximately 60 percent of the portfolio by value is in credits to private and mixed-ownership firms Credits range up to 6 months in maturity

The banks information system is being upgraded Some branches are presently on line with headquarters, while others transmit data in batches on a daily basis The bank uses a mainframe, but is gradually adding to a network of PCs that are now used primarily for administrative functions and credit analysis

Financial reports are generated for (and used by) management and the Board of Directors on a fixed schedule, and as needed The bank has contracted with Deloitte & Touche for an independent external audit according to IAS

OWNERSHIP

The bank has 290 shareholders, of which about two-thirds have at least some state ownership Management estimates that the percentage of private ownership is between 60 and 65 percent, if calculated as the shares held by fully private firms plus the "private portion" of shares held by companies of mixed ownership However, the ABST understands that, under the law on bank privatization, the private percentage of Agroprom will be calculated in a manner that will result in higher state ownership A full audit of the bank's ownership is under way

The bank estimates that up to 30 percent of its portfolio is in loans to shareholders This may not give rise to insurmountable conflicts of interest, as no single shareholder controls more than 5 percent of the firm All but nine shareholders control less than 2 percent of the firm

AGENT BANK RECOMMENDATION

BANK	AUROBANKA DD VITEZ
US SFOR (Y/N)	N
CANTONS	SREDNJEBOSANSKI
MUNICIPALITY	VITEZ
HEADQUARTERS	VITEZ

Date	14 Aug 98	**AB Rec #**	2
Ownership (%)			
Private	100%	**State**	0%
Existing Agency Agreement?			
Yes	X	**No**	

Number of Outstanding BF Loans	0	**BF Market Coverage Geographic**	Vitez Kresevo and Gornji Vakuf
Balance on Outstanding BF Loans	0		
Range of Loan Size	N/A		
Number of Loans 60+days past due	0		
Balance on Loans 60+days past due	0		

Owners holding more than 10 percent of the bank and percentage ownership	1 HZN (CITIZENS ASSOCIATION) 2 P P STANIIC KRESEVO 3 P P HEREX VITEZ 4 5	1 22 5% 2 15% 3 15% 4 5

RECOMMENDATION SUMMARY

Aurobanka DD (AB) Vitez was signed up as an agent bank as of June 30 1998 The bank had previously applied but was rejected because of the location of the bank The sector in which they operate has just recently been opened

The bank began operations in December 1996 The total capitalization of the bank was 6 6 million-dm They plan to raise an additional 3 3 million dm in capital by December 1998 A well qualified senior management team operates the bank The general director Ivan Miletic was with Privredna Banka/Sarajevo since 1980 where he eventually became the bank's deputy director The other senior managers also have substantial banking experience The Deputy Director and Director of Finance each spent more than 15 years at Privredna /Travnik The Manager of the credit department was previously with a Croatian bank The bank staff has been participating in the USAID training programs

The bank operates in a modern facility located in Vitez It has two additional branch offices in Kresevo and Gornji Vakuf The bank has a computer system that was procured from a Croatian Bank The system provides all the necessary modules required to operate a retail bank and is fully integrated to the general ledger Also all branches are on line to the head office

At this time their application is recommended for approval without any restrictions

Recommended Restrictions on Participation

There are no restrictions recommended at this time

Bank Selection Team Member Thomas Chmelik		**Date** 14 Aug 98
BF Chief of Party Bruce Spake		**Date** 14 Aug
USAID Director CRAIG G BUCK		**Date**

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STATUS AND QUALITY OF BF PORTFOLIO

This is not applicable to the bank The bank has made no loans

QUALITY OF BF ORIGINATION

This is not applicable to the bank The bank has made no loans

COMPLIANCE WITH BF CLOSING REQUIREMENTS

This is not applicable to the bank The bank has made no loans

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

This is not applicable to the bank The bank has made no loans

COMPLIANCE WITH BF MONITORING REQUIREMENTS

This is not applicable to the bank The bank has made no loans

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

This is not applicable to the bank The bank has made no loans

PROJECTED LOAN VOLUME

AB projects that they will be able to generate 10 new loans for 5,000,000DM from September 1998 to August 1999 For the same period in 1999 to 2000 they project 20 loans for 20,000,000DM Management indicated they plan to hire to additional economists to handle the workload for the BF program and insure that all staff members are properly trained to achieve these levels of projected loan volume

QUALITY AND SUFFICIENCY OF STAFF

Overview and staffing

The bank has 18 employees Of these twelve have B A 's Two (2) staff members will be involved to support the BF Lending program in the beginning – One lender and one support staff They plan to hire two economists to help on the lending side Per the BF Lending Associate additional resource is needed for preparation of monitoring reports

Senior Management

Meetings with the General Director and key members of executive and senior management were held as part of the due diligence process Management attending meetings

NAME	TITLE/POSITION
Ivan Miletic	General Manager
Velimir Didak	Deputy Director
Stipo Strbac	Manager of Credit Department

Management would like very much to participate in the BF program Lending management who would be handling the BF appeared knowledgeable They understand how the BF program operates and the mission of the program They have a good understanding of their market,

Sufficient contributions were made by the members of senior management to determine that they were well-organized and knowledgeable bankers They understand the concept of market principals and believe that favorable opportunities lay in front of the bank

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

An external-auditing firm has not audited the bank They believe that their financial statements conform to International Accounting Standards (IAS) They were examined by the Federal Banking Agency in 1997 and agreed with their findings The findings that were brought to the attention of management have been corrected The internal control systems within the bank are adequate at this time The bank settles its books on a daily basis and can easily reconcile all accounts to ensure their accuracy

The financial statements showed total assets of 16,229,000DM as of June 30, 1998, an increase of 4,035,000DM from the December 31, 1997 total Deposits increased 3,751,000DM during the same period The loan to deposit ratio has decreased to 161 71% from 189 86% The bank needs to concentrate on generating new deposits to continue to fuel its loan demand A marketing strategy was being draw up by senior management and they hoped it would be in place by the fourth quarter Cash to total assets was 8 08% This is not a comfortable position at this time and bank management is aware of the situation Management is prudently making new loans and will restrain if the deposit levels do not increase Off balance sheet liabilities were negligible

The loan portfolio has increased 3,802,000 DM or 39 58% for the period ending June 30, 1998 The loan loss provision was 3 3% to total loans The delinquency rate for the loan portfolio was in the range of 2 52% as of June 30, 1998 Based on the newness and the clients of the bank this ratio is probably realistic at this time Management said that the Federal Banking Agency was comfortable with its loan loss provision allowance

The Bank's capital has remained at 6,666,0000 DM for the period under review The bank has plans of raising an additional 3 3 million-DM by December 1998 The total capital to assets ratio was 38 57% as of June 30, 1998 With the earnings growth and additional capital the bank is well positioned for future asset growth

Net income for the year ended December 31, 1997 was 119,000DM Internal profit and loss data for the period ending June 30,1998 indicated net profit of 181,000DM The bank's efficiency ratio has improved from 68 53% to 67 34% for the six-month period under review Management is very cautious of the expense levels of the bank They are determined to run a very efficient operation

Based on discussions with management concerning the Bank's computer system the current system is considered adequate The core system and equipment is Year 2000 compatible The system is fully integrated and the branches are online Standard password access to systems is used with multiple levels of security

Loan officers do not have lending limits, however, all loans are presented to and approved in a committee setting Also, all loans that are originated at the branch offices have to be brought to the head office for approval

OWNERSHIP

Aurobanka DD is 100% privately owned The following are significant shareholders and together control 52 50% of the bank

1 HZN (CITIZENS ASSOCIATION)	22 5%
2 P P STANIIC KRESEVO	15%
3 P P HEREX VITEZ	15%

AGENT BANK RECOMMENDATION

BANK	BANJALUCKA BANKA DD
US SFOR (Y/N)	Y (BRANCHES)
CANTONS	REPUBLIKA SRPSKA
MUNICIPALITIES	BANJA LUKA, CELINAC, PRNJAVOR, LAKTASI, TESLIC, KNEZEVO, MRKONJIC GRAD SIPOVO KOTOR VAROS, SRBAC, KOZRSKA DUBICA
HEADQUARTERS	BANJA LUKA

Date	14 Aug 98	**AB Rec #**	3
Ownership (%)			
Private	80%	**State**	20%
Existing Agency Agreement?			
Yes	X	**No**	

Number of Outstanding BF Loans	1	**BF Market Coverage —Geographic**	Western Republika Srpska
Balance on Outstanding BF Loans	DM 320 000		
Range of Loan Sizes	N/A		
Number of Loans 60+days past due	0		
Balance on Loans 60+days past due	0		

Owners holding more than 10 percent of the bank and percentage ownership	1 MINISTRY OF FINANCE 2 NO OTHER SHAREHOLDER HAS MORE THAN 5 % OF THE BANK S SHARES 3	1 80 % 2 3

RECOMMENDATION SUMMARY

Banjalucka Banka is a successor institution of Privredna/Sarajevo, and has been operating independently under its current name since 1990 The bank operates throughout the RS through a network of 11 branches The bank s performance in BF deal flow has been disappointing relative to that of the other two Agent Banks in Banja Luka The bank s first loan was disbursed last week, though 7 others have been approved and are pending disbursement BF s credit staff find the bank unwilling to provide much assistance to would-be borrowers resulting in weak applications that must be returned for lack of information This performance has improved of late, and the bank is reported to be doing better screening and up-front work with potential borrowers though it remains much slower than its counterparts in gathering closing documents BF audit and operations staff have no negative reports on the bank s disbursement or repayment procedures given the bank s limited experience in the BF program

The bank s financials are presently burdened by frozen loans and deposits offset by frozen foreign liabilities and consumer savings After removing these items from the June 98 balance sheet, the bank shrinks in asset size from DM 480 million to DM 78 million It is not clear how much of a loss will be realized against capital as these assets and corresponding liabilities which are not perfectly matched, are removed In all likelihood capital will be reduced much further by a realistic appraisal of asset quality, which is beyond the scope of this review The bank reported a profit of DM 228 000 in 1997 primarily from interest income

The bank anticipates that BF s expansion into the small loan market will enable the bank to accelerate its rate of recommendations to BF, and the bank's overall activity in the BF program picked up with the deals underwritten by BF s RS "SWAT Team" earlier in 1998 Given that BF s other two banks in Banja Luka have rapidly expanding portfolios approval of Banjalucka Banka is recommended primarily to ensure origination and servicing capacity in the Western RS but also to provide access to the Eastern RS, should that market become eligible for USAID assistance

Recommended Restrictions on Participation

No restrictions are recommended at this time

Bank Selection Team Member Zan Northrip		**Date** 14 Aug 98
BF Chief of Party Bruce Spake		**Date** 14 Aug 98
USAID Director CRAIG G BUCK		**Date**

STATUS AND QUALITY OF BF PORTFOLIO

Banjalucka Banka has one disbursed loan, rated a 5, totaling DM 320,000 There are no delinquencies

QUALITY OF BF ORIGINATION

BF credit staff report frequent weaknesses in the applications recommended to BF The bank is reluctant to devote substantial effort to assisting potential borrowers with the application Borrowers recommended by the bank have, in general, been less sophisticated than those recommended by other institutions Early in the program, several applicants were rejected because of high levels of existing debt owed to Banjalucka Banka Since that time, the bank has become more accustomed to BF underwriting standards, and members of the bank's credit staff now check on the eligibility of clients before recommending them The bank was helpful and cooperative with the BF "SWAT Team" that recommended several RS loans earlier in 1998

COMPLIANCE WITH BF CLOSING REQUIREMENTS

No documentation exceptions have been noted, but the bank is slow in gathering closing documents, such as collateral registrations

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

No reported violations of BF disbursement procedures

COMPLIANCE WITH BF MONITORING REQUIREMENTS

No quarterly monitoring reports have yet come due

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

No reported violations of BF repayment procedures

PROJECTED LOAN VOLUME

In keeping with its expectations of generating a large number of small loans, the bank projects recommending 50 bankable credits with an average size of DM 90,000 in the year ending August 1999, producing portfolio growth of DM 4 5 million In the year ending August 2000, the bank projects recommending 60 bankable credits with an average size of DM 133,000, producing portfolio growth of DM 8 million

QUALITY AND SUFFICIENCY OF STAFF

Overview and Staffing

Eight staff members are available to work on BF loans, so there is no immediate concern over staff numbers Given the weaknesses in Banjalucka Banka applications, however, there is reason for concern that the bank's quarterly monitoring reports will be substandard without substantial intervention by BF staff In general, the bank has not met BF's expectations for analysis Several of the bank's lenders have lengthy banking experience, but only a few appear strongly motivated to produce quality loans for BF

Senior Management

Meetings were held with the following individuals

NAME	TITLE/POSITION
Momcilo Poparic	General Director
Dimitrije Bojic	Director, Deposit and Loan Department
Zorica Mrdja	Manager, Loan Approval Department
Smilija Jokic	Manager, Planning and Accounting
Milos Ubovic	Manager, Computer Center

The senior managers have between 15 and 30 years of banking experience each Many have been with Banjalucka Banka their entire careers The managers spoke clearly about privatization and strategic planning, but were less expansive on the bank's underwriting standards and procedures

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

The bank's financials are presently burdened by frozen loans and deposits, offset by frozen foreign liabilities and consumer savings After removing these items from the June 1998 balance sheet, the bank shrinks in asset size from DM 480 million to DM 78 million It is not clear how much of a loss will be realized against capital as these assets and corresponding liabilities, which are not perfectly matched, are removed In all likelihood, capital will be reduced much further by a realistic appraisal of asset quality, which is beyond the scope of this review The bank reported a profit of DM 228,000 in 1997, primarily from interest income

The bank's active loan portfolio had a reported value of DM 28 6 million at the end of June, and had a reported delinquency rate of 12 percent, calculated as the total balance of all active loans more than 60 days past due Most of the portfolio is outstanding to state-owned companies, on average terms of 5 months Loans to insiders constitute 62 percent of the portfolio The bank maintains that insiders are given preferential access to available funds, but must meet the same terms and conditions as unaffiliated borrowers However, the largest owner is also a major delinquent borrower

The bank is using a mainframe computer system, with the branches communicate through batched data transmission once daily No PCs are in use, and bank staff must request the computer department to prepare any unscheduled reports Regular financial reports are generated for (and used by) management and the Board of Directors The bank has contracted with Deloitte & Touche for an independent external audit according to IAS

OWNERSHIP

Until mid-1998, the bank had 300 shareholders About eighty percent of bank shares were held by state-owned firms, until the recent transfer of state shares to the Ministry of Finance The membership of the Board of Directors has not changed since the share transfer occurred, and "former" shareholders appear to have continued influence within the bank

The largest former shareholder is MDP Incel Holding, a state-owned firm that, until recently, held 13 percent ownership of Banjalucka Banka Incel has about DM 2 million in short-term debt from Banjalucka Banka, most of which is delinquent

In total, the bank has made about 62 percent of its loans (by value) to insiders, and 49 percent of shareholders have loans from the bank With the exception of Incel, however, ownership is widely dispersed and may not prejudice the bank's credit decisions or pursuit of delinquencies After Incel, the next largest shareholder has holdings representing less than 5 percent of the bank Only the nine largest shareholders have holdings in excess of 2 percent

AGENT BANK RECOMMENDATION

BANK	BH BANKA DD
US SFOR (Y/N)	Y (Branches)
CANTONS	SARAJEVO, ZENICA-DOBOJ, TUZLA-PODRINJE
MUNICIPALITIES	Multiple
HEADQUARTERS	SARAJEVO

Date	14 Aug 98	**AB Rec #**	4
Ownership (%)			
Private	98%	**State**	2%
Existing Agency Agreement?			
Yes	X	**No**	

Number of Outstanding BF Loans	18	**BF Market Coverage Geographic**	Sarajevo Zenica Doboj Tuzla Podrinje
Balance on Outstanding BF Loans	15 547 200DM		
Range of Loan Sizes	300 000DM to 1 900 000DM		
Number of Loans 60+days past due	5		
Balance on Loans 60+days past due	5 222 000DM		

Owners holding more than 10 percent of the bank and percentage ownership	1 TOBACCO FACTORY - SARAJEVO 2 CENTRALEXPORT D J L - SARAJEVO 3 BH OSIGURANJE DD - SARAJEVO (BH INSURANCE) 4 5	1 29 89% 2 12 01% 3 11 22% 4 5

RECOMMENDATION SUMMARY

BH Banka has paid off existing loans at BH with BF loan funds and engaged in other potential conflicts of interest however The Bank Evaluation Team recommends that BH Banka continue to participate as a BF Agent Bank under four restrictive conditions listed below The alternative, terminating BF s Agency Agreement with BH would expose BF to risks equal to or greater than the risks entailed in a restricted relationship

If implemented the recommended restrictions on BH would lower the risk to which the BH relationship exposes BF For practical purposes, BF's risk could be limited to the value of the repayments BH holds temporarily before remitting them to BF These funds tend to be small at any given point in time Further BF s Operations Unit reports no significant past or present problems in BH s timely remittance of repayments from BF borrowers

In contrast terminating the Agency Agreement with BH could cause a significant deterioration in the quality of BF loans originated by BH Because many of these loans are to BH affiliated firms the prospect of securing any level of repayment if the loans were transferred to another Agent Bank for servicing would be reduced Further given the current state of BF-BH relations the process of transferring BH-originated loans to other banks is unlikely to be smooth or orderly Terminating the Agency Agreement would also send a signal to the market of serious problems at BH and could lead to the bank s failure A BH failure would consume the funds of many individual depositors and foreign organizations, and further reduce the quality of BF loans originated by BH

Recommended changes in BF deposit relationship with BH

A review of BH financial statements and off the-record discussions with persons familiar with the results of the examination of BH by the FBA reveal that the institution is stretched thin A sudden withdrawal of deposits by BF (and presumably USAID) would cause the bank serious difficulties As news of such withdrawals could not be stopped from spreading to other foreign depositors there is a real risk that a BF withdrawal could lead to the bank s failure Such a failure would not be in the interest of BF It could also cause adverse publicity for USAID

We recommend that BF open and begin funding one or more deposit accounts with another institution If a decision is made to reduce BF balances at BH, BF funds should be drawn down slowly

Recommended Restrictions on Participation

1 **Reduce and monitor closely undisbursed BF funds held at BH** BH presently holds DM 672 000 in undisbursed funds destined for six BF borrowers These borrowers should be contacted to determine the drawdown schedule of such funds Funds not required within two weeks should be wired back to BofA

2 **Require the use of a trustee correspondent account** for future BH disbursements This account would be dedicated to transactions supporting BF loans It could not be commingled with the bank s own funds and would require BF consent on every withdrawal If BH misused the funds and then failed BF might be compensated ahead of other creditors, because BH's misuse of the funds would constitute fraud

3 **Require certification** that all borrowers recommended by BH to BF have no linkages (supplier equity or otherwise) to BH Bank its managers, or its directors This disclosure has not previously been a requirement of the BF Agency Agreement Credit Application, or Loan Agreement The Bank Evaluation Team is recommending that this restriction be placed on all BF Agent Banks, it is particularly important in the case of BH In practice, this restriction will result in a reduction of BF's deal flow from BH BH itself estimates that 1/3 of its clients are in some way affiliated with BH, its managers, or directors

4 **Increase surveillance by BF Field Associates** Several BH loans are currently in disbursement They should be watched closely to ensure that funds are used only for purposes specified in the Credit Application and Loan Agreement All disbursements should be properly documented with invoices If an invoice is in question BF field associates or audit staff should follow up with the supplier

Bank Selection Team Member Alfred Dostie, Thomas Chmelik, Zan Northrip		Date 14 Aug 98
BF Chief of Party Bruce Spake		Date 14 Aug 98
USAID Director CRAIG G BUCK		Date

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STATUS AND QUALITY OF BF PORTFOLIO

An audit in 1998 of BH Banka's participation in the BF lending program disclosed lending irregularities and conflicts of interest Detailed information is presented in the confidential BF Audit Report

BH Banka DD (BH) has been an active participant in the BF program BH had eighteen (18) loans active in August 1998 for a total of 15,547,200DM Of these, five (5) totaling 5,222,000DM were 60 or more days overdue as of August 10, 1998 This is a 34% overdue ratio based on the volume of loans

A recently completed evaluation of the loan portfolio and loan ratings resulted in the following

- 4 downgrades from 5 to 6 on loans totaling 4,005,000DM
- 2 downgrades from 5 to 7 on loans totaling 1,500,000DM
- 2 downgrades from 6 to 7 on loans totaling 3,150,000DM
- 1 upgrade from a 5 to 4 on a loan totaling 1,500,000DM

The resulting loan rating dispersion was as follows

RATING	# OF LOANS	DISBURSED AMOUNT
4	3	2,870,000DM
5	3	1,420,000DM
6	8	8,175,000DM
7	4	4,650,000DM

TB's loan rating dispersion is typical for banks in the BF program

QUALITY OF BF ORIGINATION

Based on discussions with BF Operations and the Lending Associates, applications and loan files are considered acceptable in quality Applications did not disclose conflicts of interest existing in the borrowing arrangements, which is cause for concern In some cases, however, a name check of companies in which insiders had an interest would have disclosed the conflict of interest BF procedures should include a cross check to determine if conflicts of interest exist Loans to members of the governing boards of banks or companies in which they have interests are not inherently improper Many times they are the best loans a bank can make They do, however, require special procedures to make certain that such transactions are done at "arm's length" and do not provide preferential treatment to the Board member

COMPLIANCE WITH BF CLOSING REQUIREMENTS

Only one loan documentation exception was noted on the BF Operations exception report Minutes for a court resolution were not on file

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

Discussions with the BF Lending Associates and BF Audit revealed instances of self-dealing and serious conflicts of interest

COMPLIANCE WITH BF MONITORING REQUIREMENTS

Technical quality of monitoring reports is acceptable per the Lending Associates (average of 2 33 on BF's five-point scale), but the substance of the information rendered has been questionable for several borrowers

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

No timely repayment issues were raised by BF Audit

PROJECTED LOAN VOLUME

BH projects in the application that they will be able to generate 1200 new loans for 51,000,000DM from September 1998 to August 1999 For the same period in 1999 to 2000 they project 1500 loans for 60,000,000DM These estimates were not supported by any data and appear unreasonable

QUALITY AND SUFFICIENCY OF STAFF

Overview and staffing

Five staff are assigned to BF credits – three loan officers and two support personnel

Senior Management

Meetings with the General Director and key members of executive and senior management were held as part of the due diligence process Management attending meetings

NAME	TITLE/POSITION
Mirsad Delimustafic	General Director
Edina Danovic	Deputy General Manager
Fadila Saric	Chief of Long Term Credit Department

The General Director spoke in generalities about the direction of the Bank and banking philosophy His comments were very positive regarding the future of the Bank The most useful information he disclosed was BH was actively seeking a merger by year end with Hipotekarna Banka DD

Edina Danovic, Deputy General Manager, was very vocal during the meeting She carried the discussion She appears to be an accomplished banker She was careful to avoid discussion of the Bank's weaknesses

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

BH showed total assets of 69,337,000DM as of June 30, 1998, a decline from the December 31, 1997 total of 62,720,000DM Deposits decreased 6,975,000DM during the same period despite reported increases in humanitarian aid deposits from Saudi Arabia and Kuwait Loans to deposits are 117 27% and indicate a highly illiquid condition at BH Short term loans decreased 7,663,000DM and long term loans increased by 7,304,000DM further exacerbating the Bank's illiquid condition Off balance sheet liabilities for guarantees totaled 25 million DM, further increasing the exposure level at the Bank

Net income for the year ended December 31, 1997 was 1,008,000DM Profit and loss data for the period ending June 30,1998 was requested, but had not been received as of the date of this writing Verifying the solvency of the Bank was impossible without the FBA examination results, which were not made available From the application BH indicated that delinquent loans totaled 870,364DM or 2 5% of total loans at June 1998 The amount of loans written off during this same period totaled 326,379DM

Based on discussions with management, core data systems offer basic reporting The Bank has plans to modernize and expand its systems in anticipation of the merger with Hipotekarna Bank They are not currently Year 2000 compatible Standard password access to systems is used

Loan officers do not have lending limits, however, all loans are presented and approved in a committee setting Problem loans are reviewed by the lending committee and actions are approved at that level

OWNERSHIP

Although the Bank lists ownership as primarily Private, The Ministry of Finance (MF) and several state owned companies own stock in the bank This is "indirect" state ownership BH management indicated that all such companies are in process of being privatized Also, management indicated that the MF ownership was less than 2%

AGENT BANK RECOMENDATION

BANK	CENTRAL PROFIT BANKA DD SARAJEVO
US SFOR (Y/N)	N
CANTONS	SARAJEVO
MUNICIPALITIES	SARAJEVO
HEADQUARTERS	SARAJEVO

Date	14 Aug 98	**AB Rec #**	5
Ownership (%)			
Private		**State**	100%
Existing Agency Agreement?			
Yes	X	**No**	

Number of Outstanding BF Loans	5	**BF Market Coverage Geographic**	Visoko Fojnica Breza, Vares Olovo Hadzici and Vogosca
Balance on Outstanding BF Loans	3 348 333 DM		
Range of Loan Size	540 000 DM – 1 000 000 DM		
Number of Loans 60+days past due	2		
Balance on Loans 60+days past due	1 456 667 DM		

Owners holding more than 10 percent of the bank and percentage ownership	1 MINISTRY OF FINANCE 2 3 4	1 100% 2 3 4

RECOMMENDATION SUMMARY

Central Profit Banka is a state owned bank headquartered in Sarajevo The bank has 7 branches in the following towns Visoko Fojnica Breza Vares Olovo Hadzici and Vogosca

Price Waterhouse was engaged to audit the financial statements for years 1996 and 1997 This audit should be completed by the end of the third quarter At which time BF could have more confidence in the financial picture of the bank However based on the information BF has at this time the financial condition of the bank is unsatisfactory

The bank has transferred all shares to the Ministry of Finance The bank has written a privatization plan and will submit it to the Board of Directors in September After which it will be forwarded to the Ministry of Finance for concurrence and approval The bank shows a total capital position including reserves of 83 504 000 DM This has been inflated due to the revaluation of fixed assets according to Bosnian accounting standards With various adjustments the capital position of the bank would be 13 724 000 DM The adjusted asset base would then be 117 759 000 DM This would give the bank a capital to total assets ratio of 11 65%

For the period ending December 31 1997 the bank earned 453 000 DM Internal financial statements show earnings for the six months ended June 30 1998 were 586,000 DM The loan portfolio has grown only 2 686 000 DM or 3 36% for the six-month period under review All of the increase in loans was to state owned enterprises The bank appears to continue to lend to these struggling and most likely bankrupt entities The delinquency rate as of June 30 1998 was 4 61% The loan loss allowance to total loans was 39 86% These two ratios are not in agreement and should show some correlation It would appear that the bank does not properly classify delinquent loans This should be a concern to the bank Expense control must be monitored closely The bank's efficiency ratio was 95 84% and 92 52% for the periods ending December 31 1998 and June 30, 1998, respectively This is not an acceptable ratio and the bank is on the verge of showing significant losses

Based on the Central Profit Banka's performance in the BF lending program and the Bank's financial condition continued participation in the USAID Business Finance program is recommended with conditions

Recommended Restrictions on Participation

The bank is to submit to BF, on a quarterly basis, a complete set of financial statements These statements will be analyzed by BF If the bank s progress and growth are not inline with BF s standards then all future lending activities are to be suspended

Bank Selection Team Member Thomas Chmelik		Date 14 Aug 98
BF Chief of Party Bruce Spake		Date 14 Aug 98
USAID Director CRAIG G BUCK		Date

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STATUS AND QUALITY OF BF PORTFOLIO

As of July 1998 Central Profit Banka (CP) DD has done five (5) loans totaling 3,348,333 DM CP had two (2) loans that total 1,457,000DM that were more than 60 days delinquent as of 7-22-98 This is a 43 50% delinquency ratio based on the total volume of loans

A recently completed evaluation of the loan portfolio and loan ratings resulted in the following

- 1 downgrade from 5 to 8 on a loan totaling 1,000,000DM

The remaining four loans were all classified as 6 This would be considered doubtful

The resulting loan rating dispersion was as follows

RATING	# OF LOANS	AMOUNT
6	4	3,400,000DM
8	1	1,000,000DM

The downgrade into the Loss category of "8" is a substantial amount The overall quality of the portfolio is poor at best Given the current delinquency rate the entire portfolio could be classified an 8

QUALITY OF BF ORIGINATION

Based on discussions with BF Lending Associates, applications and loan files are considered acceptable in quality Speed of processing applications is sometimes slow No loans have been originated since November 11, 1997

COMPLIANCE WITH BF CLOSING REQUIREMENTS

Loan documentation exceptions on BF loans initiated by CP were minimal Any issues with closing have been rectified

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

Discussions with BF the Lending Associates and BF Audit revealed no significant concerns Disbursements are made in a timely fashion and given the financial condition and liquidity condition of the bank there is no need for concern

COMPLIANCE WITH BF MONITORING REQUIREMENTS

The overall quality of the monitoring reports is generally good CP has four loan officers who are required to prepare the monitoring reports CP has the highest grade of any bank for the quality of their monitoring reports Analysis could be a little more in-depth but is adequate at this time But with additional training they should be able to overcome this shortfall

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

BF operations voiced no concerns over the repayment performance of this bank The bank has sufficient liquid resources and does not need to hold BF's funds

PROJECTED LOAN VOLUME

CP did not give any indication of the volume and number of loans that they would originate in the next two years They voiced concern that BF was reluctant to make loans to state owned enterprises Because of this restriction they would probably submit very few applications The majority of their client base is state owned companies that will soon be privatized

QUALITY AND SUFFICIENCY OF STAFF

Overview and staffing

Six (6) staff members are dedicated to support of the BF Lending program – Four lenders and two support staff

Senior Management

A meeting were held with the following individuals

NAME	TITLE/POSITION
Aida Nuhic	Director for Planing and Accounting
Enes Merzic	Director of Investments (Loans)
Fikreta Uzunovic	Chief Manager for Investments

Management was very committed to continuing with the BF program Management appeared knowledgeable of the program and would like to see the scope of loans increased to include more public enterprises

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

The bank is in the process of having Price Waterhouse audit the books for 1996 and 1997 CP's financial statements showed total assets of 346,183,000DM as of June 30, 1998 Included in these assets are frozen deposits at the National bank of Yugoslavia totaling 170,479,000 DM When the time comes to make an adjustment to write off these assets against the corresponding liability the bank will have to show a net loss of 11,835,000 DM from this transaction The government has given no assurances that it will make up the loss The loan portfolio increased 2,686,000 DM during the six months ended June 30, 1998 Total deposits have decreased 2,809,000 DM during the same period The loan to deposit ratio has increased to 112 08% as of June 30, 1998 Cash to total assets was 10 51%, this includes foreign cash, as of June 30, 1998 However, if the asset base was adjusted for the frozen deposits the cash to asset ratio would be 20 71% CP is very mindful that it cannot continue to grow its loan portfolio without growing its deposit base Off balance sheet liabilities were negligible

The Bank's capital including reserves was 83,504,000 DM as June 30, 1998 The total capital to assets ratio, including reserves was 7 55% as of June 30, 1998 This has been inflated due to the revaluation of fixed assets according to Bosnian accounting standards With various adjustments the capital position of the bank would be 13,724,000DM The adjusted asset base would then be 117,759,000 DM This would give the bank a capital to total assets ratio of 11 65%

Problem loans per the Bank's Agent Bank Application were 3,813,000DM at June 30, 1998 The delinquency rate as of June 30, 1998 was 4 61% The loan loss allowance to total loans was 39 86% These two ratios are not in agreement and should show some correlation It would appear that the bank does not properly classify delinquent loans This should be a concern to the bank

Net income for the year ended December 31, 1997 was 453,000DM Internal profit and loss data for the period ending June 30,1998 indicated a net profit of 586,000DM The bank's efficiency ratio for the period ending December 31, 1997 was 95 84% This ratio has decreased to 92 52% as of June 30, 1998 This is not a good indication of effective expense control Bank management acknowledged the situation and said that they had a business plan that included the retrenchment of approximately 200 employees or 64% of the workforce

The general ledger, accounting, loan, deposit and foreign payment modules have been installed at the head office and branches However, the system is not integrated at this time and management does not have a schedule for integration Currently information from the branches is either faxed or sent in the mail

All loans are brought to loan committee at head office for approval Senior Loan officers do not have lending authority

OWNERSHIP

State owned 100%

AGENT BANK RECOMMENDATION

BANK	DEPOZITNA BANKA DD SARAJEVO
US SFOR (Y/N)	Y (Branches)
CANTONS	SARAJEVO - ZENICA/DOBOJ
MUNICIPALITIES	Sarajevo, Ilijas, Vares
HEADQUARTERS	SARAJEVO

Date	14 Aug 98	**AB Rec #**	6
Ownership (%)			
Private	99 2%*	**State**	0 8%*
Existing Agency Agreement?			
Yes		**No**	X

Number of Outstanding BF Loans	0	**BF Market Coverage Geographic**	Sarajevo Ilijas Vares
Balance on Outstanding BF Loans	0		
Range of Loan Sizes	0		
Number of Loans 60+days past due	0		
Balance on Loans 60+days past due	0		

Owners holding more than 10 percent of the bank and percentage ownership	1 EUROINVEST DOO SARAJEVO	1 13 73%
	2 KA PROFARM DJL SARAJEVO	2 13 73%
	3 YASSIN & CO	3 13 73%
	4 KA STAN SARAJEVO	4 9 15%
	5	5

RECOMMENDATION SUMMARY

Depozitna Banka is a new applicant to the BF lending program Based on the Bank s ability to generate capital the quality of its management and its commitment to generating loans for BF participation in the BF program for Depozitna Banka is recommended Conditions related to participation in the program are discussed in the Restrictions section of this report

Depozitna Banka was the Sarajevo branch office of Investbanka of Belgrade prior to the war DB was formed in March 1993 by new Bosnian founders The Bank has since been re capitalized with a capital injection of 2 500 000DM The Bank s liquidity is marginally adequate The Bank inherited 23 057 000DM in frozen deposits at the former National Bank oy Yugoslavia These deposits and the corresponding asset claim were deducted from the balance sheet for the purpose of this analysis The Bank appears solvent based on a significant capital ratio and the review of a report of the Bank s internally rated loans however these numbers are unaudited

The Bank s management appears well trained, knowledgeable and committed to operating a strong and aggressive bank The new President, Sohail Siddiqi is Pakistani by birth He previously worked at Bank of America The Bank has strong connections to Saudi Arabia Kuwait and Tunisia The largest stockholder and a key member of the Board is Chafik Ayadi a Tunisian born Bosnian National

The Bank is operating primarily in Sarajevo and is in the process of rebuilding and refurbishing its branches in Ilijas and Vares The Main Office is located in the western section of the Sarajevo business district at Vrazova 9

Recommended Restrictions on Participation

A clause requiring disclosure of Bosnian versus foreign ownership of the Bank should be inserted in the Agency Agreement Depozitna Banka should be required to disclose proposed changes in ownership that might lead to the Bank becoming a primarily foreign owned institution

Bank Selection Team Member Alfred Dostie		**Date** 8 14 98
BF Chief of Party Bruce Spake		**Date**
USAID Director CRAIG G BUCK		**Date**

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STATUS AND QUALITY OF BF PORTFOLIO

Not Applicable The bank is applying for Agent Bank status

QUALITY OF BF ORIGINATION

Not applicable The bank is applying for Agent Bank status

COMPLIANCE WITH BF CLOSING REQUIREMENTS

Not applicable The bank is applying for Agent Bank status

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

Not applicable The bank is applying for Agent Bank status

COMPLIANCE WITH BF MONITORING REQUIREMENTS

Not applicable The bank is applying for Agent Bank status

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

Not applicable The bank is applying for Agent Bank status

PROJECTED LOAN VOLUME

DB projects that they will be able to generate 325 new loans for 19,350,000DM from September 1998 to August 1999 For the same period in 1999 to 2000 they project 400 loans for 23,950,000DM These projections are based on management's aggressive posture to become one of the major banks in the area The Bank's new President is an experienced international banker and he is supported by Saudi, Kuwaiti, Tunisian, and Turkish financial interests Management indicated they would provide staffing resources and the training necessary to achieve these levels of projected loan volume

QUALITY AND SUFFICIENCY OF STAFF

Overview and staffing

The Bank has 29 employees with plans for expansion The new President is restructuring the Bank into retail and commercial banking sections Staff will be added to achieve the Bank's expansion plans into other geographic and lending sectors

Senior Management

Meetings with the President, the General Director and key members of executive and senior management were held as part of the due diligence process Management attending meetings

NAME	TITLE/POSITION
Sohail Siddiqi	President
Rizvanbegovic Omer	Director of the Bank
Mezet Adil	Accounting Manager
Sijamhodzic Vildana	Credit Expert Associate
Bajrovic Elvedina	Officer for Resources and Investments (Loans)
Milosevic Maja	Secretary to the President

President Siddiqi spoke fluent English and dominated the discussion when questions were asked He was born in Pakistan He worked for Bank of America and other international banks for eleven years

Sufficient contributions were made by the members of senior management to determine that they were well organized and knowledgeable bankers President Siddiqi appears to have been appointed by the new owners to provide strong direction in competitive banking concepts to this institution While the local Bosnian managers and staff may not have operated under such conditions before, they did appear receptive and capable of implementing a new direction for the Bank

President Siddiqi spoke at length regarding outside sources of additional capital that are available to margin the Bank's planned growth Saudi, Kuwaiti, Turkish, Slovene, and Tunisian interests reportedly will support the Bank's fast track plans Mr Siddiqi has been with the Bank just two months, so a written strategic plan was not in place as yet

The Director and the President are very committed to using the BF lending program

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

Total assets adjusted for claims for frozen foreign exchange deposits were 7,869,000DM as of June 30, 1998, a decrease of 59,000DM from the December 31, 1997 total Deposits decreased 872,000DM during the same period Loans to adjusted deposits were 103% Cash to total adjusted assets was 12 49% at 990,000DM Off balance sheet liabilities in the form of guarantees were 1,000,000DM, but were covered by foreign currency deposits so no exposure is evident

Net income for the year ended December 31, 1997 was 33,000DM Internal profit and loss data for the period ending June 30,1998 indicated net profit of 93,000DM The total capital to adjusted assets ratio was 39% at June 30, 1998 Overdue loans listed in the Agent Bank Application were actually loans in litigation A write off of accrued interest on four (4) loans deemed problematic occurred in the first half of 1998 for 110,835DM A review of the Bank's FBA ratings for its loan portfolio indicated required reserves of 450,000DM This amount can be covered by existing equity New management has hired an attorney to assist lenders on problem credits

The Bank plans to introduce a variety of consumer products including credit and debit cards, lease financing, and personal secured loans This will be done, per management, once staffing and systems are in place to support the anticipated new business

Lending authorities were created since the new President joined the Bank Director Omer Rizvanbegovic, who joined the Bank four months ago, may make loans up to 50,000DM The President may approve loans up to 100,000DM Any loans in excess of this amount go to a five (5) member lending committee New loan reporting and loan performance reporting is reviewed with the Board of Directors weekly

Based on discussions and a physical review of the Bank's computer resources the current system is considered marginally adequate The core system and equipment is not Year 2000 compatible Management is making additional changes to upgrade its systems and provide better financial reporting by year end 1998 Individual databases for loans, deposits, and foreign exchange are maintained on separate PCs The accounting system is on a stand alone PC A networked system is being sought

Depozitna Banka is the successor to the former Investbanka of Belgrade DB occupies Investbanka's former Sarajevo office site, but legal ownership to the facility is in question The building and other fixed assets of Investbanka are not on DB's books Only leasehold improvements to this and other branch locations are booked as fixed assets The Bank operates out of three offices with the Main Office located at Vrazova 9 in the outer western section of Sarajevo's business district Other branches are located in Ilijas, Vares, and Sarajevo Centar The Bank is looking to expand its trade area to Visoko, Tuzla, and Mostar as part of a longer term growth strategy

OWNERSHIP

The Bank has Middle Eastern connections and per President Saddiqi has ready sources of additional capital to expand

NOTE The companies listed 1,2,3 in the Owners holding more than 10% of the Bank's stock section of this report, per President Siddiqi, are controlled by Chafik Ayadi, a Tunisian born Bosnian National Mr Chafik is also Director of KA Stan Sarajevo which gives him a total of 41% direct and 9% indirect control of the Bank

AGENT BANK RECOMMENDATION

BANK	EXPORT BANKA AD BIJELJINA
US SFOR (Y/N)	Y
CANTONS	REPUBLIKA SRPSKA
MUNICIPTALITIES	Bıjeljına, Pale, Zvornık
HEADQUARTERS	BIJELJINA

Date	14 Aug 98	**AB Rec #**	7
Ownership (%)			
Private	92 5%*	**State**	7 5%*
Existing Agency Agreement?			
Yes	X	**No**	

Number of Outstanding BF Loans	2	**BF Market Coverage Geographic**	Bıjeljına, Pale Zvornık
Balance on Outstanding BF Loans	810 000DM		
Range of Loan Sizes	310 000DM to 500 000DM		
Number of Loans 60+days past due	0		
Balance on Loans 60+days past due	0		

Owners holding more than 10 percent of the bank and percentage ownership	1 ARDEA COMPANY IS LOCATED IN PALE 2 AMBALAZERKA 3 UPI SIRMUM 4 5	1 21 49% 2 20 75% 3 19 95 % 4 5

RECOMMENDATION SUMMARY

Export Banka AD Bıjeljına (EB) has been active in the BF program both directly and through a surrogate relationship with Komercıjalna Banka DD Tuzla A total of thirty five (35) loans have been proposed with ten (10) approved thus far for a total of 4 280 000DM Based on Export Bank s performance in the BF lending program and the Bank s commitment to generating further loans, continued participation in the USAID Business Finance program is recommended with conditions The Bank is significantly illiquid and nearly insolvent as indicated by available financial information and an EBRD Ernst & Young due diligence study conducted in 1997 Also the relationship of the Head Office in Bıjeljına to the Bank s branches in Beograd and Pale is unclear Export Bank has an agreement with Serb Banka in Beograd that allows the entities to provide services for each other A transfer of assets and deposits from Export Bank to Serb Bank occurred in 1996 and 1997 The Branch Manager of Export Bank s Beograd office is also the Branch Manager for Serb Bank All of these situations will require closer BF monitoring of the Bank Specific restrictions to safeguard BF assets are listed in the Restrictions section below

The Bank s head office occupies three rooms on the lower floor of what appears to be a two story residence on a side street near the business district in Bıjeljına The address is Svetog Save br 46

Recommended Restrictions on Participation

Close monitoring of compliance with the Agency Agreement s requirement for timely forwarding of payments is recommended due to the Bank s liquidity situation This will probably require the addition of one support staff to the Tuzla office as other banks in this area may require similar coverage

BF should create portfolio monitoring reports for this agent bank These reports should be designed to provide encapsulated data of trends in the Bank's BF portfolio by tracking overdue status and migration of the loan ratings Similar reporting for the Bank's own portfolio should be requested This should serve as an early warning system on deterioration of the overall BF and Bank loan portfolios

Adequate financial information in the prescribed format should be obtained from EB and analyzed on an annual basis Continued participation in the BF program should be evaluated annually

Bank Selection Team Member Alfred Dostie		**Date** 14Aug 98
BF Chief of Party Bruce Spake		**Date**
USAID Director CRAIG G BUCK		**Date**

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STATUS AND QUALITY OF BF PORTFOLIO

Export Banka (EB) AD Bijeljina was the first participant in the BF program from Republika Srpska EB has made two loans directly and five (5) loans indirectly through Komercijalna Banka Tuzla There are sixteen (16) prospects in the pipeline Neither of the two loans made directly by EB are overdue 60 or more days

A BF Audit evaluation of the loan portfolio and loan ratings conducted in July 1998 resulted in the following

The loan rating dispersion was as follows

RATING	# OF LOANS	DISBURSED AMOUNT
5	1	500,000DM
6	1	310,000DM

The loan rating dispersion is typical of banks in the BF program

QUALITY OF BF ORIGINATION

Based on discussions with BF Lending Associates and Audit staff, applications and loan files are now considered acceptable in quality Initial applications were poorly prepared New, experienced staff were hired and the quality improved markedly

COMPLIANCE WITH BF CLOSING REQUIREMENTS

No loan documentation exceptions on BF loans initiated by EB were listed on BF Operations reports

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

Discussions with BF Lending Associates and BF Audit did not reveal any issues related to disbursements

COMPLIANCE WITH BF MONITORING REQUIREMENTS

Monitoring reports are generally good quality, per the Lending Associate working with the Bank

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

BF Operations voiced no concerns over the repayment performance at this bank

PROJECTED LOAN VOLUME

EB projects that they will be able to generate 15 new loans for 6,000,000DM from September 1998 to August 1999 For the same period in 1999 to 2000 they project 10 loans for 4,000,000DM Management indicated they would provide staffing resources and the training necessary to achieve these levels of projected loan volume

QUALITY AND SUFFICIENCY OF STAFF

Overview and staffing

Two lenders (2) and one (1) support staff are involved in the BF Lending program This level of support is sufficient for current volumes

Senior Management

A meeting with the General Director and key members of management were held as part of the due diligence process Management attending meetings

NAME	TITLE/POSITION
Dobrivoje Tukic	General Director
Ljubica Graonja	Lending Officer
Vasilic Senka	Lending Officer
Ranka Buha	Interpreter

Management was very committed to continuing with the BF program Lenders appeared knowledgeable

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

EB did not prepare financial information in IMF format Internal statements were provided for 12-31-97 EB's financial statements showed total assets of 25,954,000Din as of December 31, 1997 and 29,765,000Din as of June 30, 1998 Capital was 3,401,000 Din at year end 1997 and 4,777,000Din at June 30, 1998

An in depth due diligence report dated September 1997 prepared by Ernst & Young (E&Y) International for the EBRD indicated Export Bank needed formal policies, more qualified staff, and better procedures The loan portfolio was significantly downgraded and three loans to companies, which were interests of shareholders, were classified loss for 2 145,000Din Per the General Director of EB the EBRD is interested in providing technical and monetary assistance to the Bank He mentioned a pass-through loan in the amount of 30,000,000DM, which he stated was to be used for reconstruction of lower cost housing in Bijeljina

EB has made some progress in addressing the concerns noted in the E&Y due diligence report More formal loan policies and a strategic plan were formulated The Bank reached an agreement with the shareholders whose loans were severely delinquent and classified Loss by E&Y to offset loan balances against the shareholders capital contribution, if the loans are not repaid This would still adversely impact capital however, it was seen as a justifiable means of "collecting" some of the loans The remaining exposure after applying the shareholders stake to the loans was 480,000Din

Net income for the year ended December 31, 1997 was 97,000DM Internal profit and loss data for the period ending June 30,1998 indicated net income after tax of 42,699Din

EB has branch offices in Beograd, Pale, and Zvornik The Bank has a mutual cooperation agreement in respect to the Beograd Branch with Serb Banka AD, Beograd The agreement provides for each bank to perform banking activities on each other's behalf Serb Banka can therefore perform banking activities in the former Yugoslavia on behalf of Export Bank and vice versa As of the September 1997 date of the E&Y report, the General Manager of Serb Bank in Beograd was also the General Manager of the Beograd Branch of Export Bank The E&Y report noted that there had been several transfers of loans between the two entities in 1996 and 1997 In January 1997 Export Bank's Beograd Branch transferred 2,053,000Din in loans to Serb Banka and deposits with a total value of 1,761,000Din The net amount of 292,000Din was partially offset by the payment of 50,000Din to Export Bank from Serb Banka The current balance of 245,000Din was left on the Export Bank balance sheet as a receivable E&Y was unclear about the underlying nature of the transaction

E&Y also noted that there was very little reporting of the activities of the Beograd Branch of Export Bank to the Head Office in Bijeljina General Director Tukic stated that the offices in Beograd and Pale operate autonomously and that they have a relatively minor impact on the Bank's balance sheet Separate asset and liability data were not available General Director Tukic assured that under no circumstances would loans be proposed from companies operating in areas where the BF lending program does not wish to do business

General Director Tukic was listed in the E&Y report as manager of legal and retail banking Miladin Vidic (Age 47) was listed as General Manager It appears that Mr Tukic does operate the Bijeljina Head Office as General Manager The organizational structure of the Bank was not clarified further by Mr Tukic An organization chart was requested, but we were informed one did not exist at this time as changes were being made Mr Tukic was insistent that the Pale and Beograd operations of the Bank would have no impact on the BF lending program activities in Bijeljina As the situation regarding the Bank's activities in areas not designated as BF lending zones are unclear, loans presented for BF consideration from Export Bank will have to be closely scrutinized

Export Bank maintains a manual subsidiary ledger system on handwritten cards and only has one microcomputer which is used to maintain a printable balance sheet using Microsoft Word The new lending officer indicated that they are looking for bank accounting software to run on their PC The Bank plans to purchase more PCs as the volume of transactions increases

Loan officers do not have lending limits Previously, all loans were approved by the General Manager, however, they are now presented to and approved in a committee setting

The Bank has generated other BF loans through the Komercijalna Banka DD Tuzla These loans are serviced by Komercijalna Banka DD Tuzla Five (5) loans were made in this manner totaling 4,279,000DM Export Bank currently has sixteen (16) prospects with a total value of 5,334,000DM

OWNERSHIP

Foreign entities in Croatia own 18 27% of the shares in the bank Please refer to the listing of 10% or more ownership on page one of this report for greater detail

AGENT BANK RECOMENDATION

BANK	GOSPODARSKA BANKA DD SARAJEVO
US SFOR (Y/N)	N
CANTONS	SARAJEVO
MUNICIPALITIES	SARAJEVO
HEADQUARTERS	SARAJEVO

Date	14 Aug 98	**AB Rec #**	8
Ownership (%)			
Private	100%	**State**	
Existing Agency Agreement?			
Yes	X	**No**	

Number of Outstanding BF Loans	15	**BF Market Coverage Geographic**	Sarajevo Zepce Ilidza, Novi Travnik Ravno Brcko and Usora
Balance on Outstanding BF Loans	6 255 256 DM		
Range of Loan Size	200 000 DM to 1 000 000 DM		
Number of Loans 60+days past due	3		
Balance on Loans 60+days past due	2 151 589 DM		

Owners holding more than 10 percent of the bank and percentage ownership	1 HKD NAPREDAK 2 ARCHBISHOPRIC ORDINARIAT 3 CROATIAN ELECTRICAL COMPANY 4 HNZ 5 WORLD CONSULTING COMPANY SA 6 FRANCISCAN PROVINCE ADMINISTRATION	1 23 18% 2 12 75% 3 12 53% 4 20 67% 5 12 40% 6 10 83%

RECOMMENDATION SUMMARY

Gospodarska Banka is a privately owned bank headquartered in Sarajevo The bank was founded and began operations in 1993 The bank has 5 branches in the following towns Zenica Zepce Ilidza Novi Travnik Ravno Brcko and Usora

The bank has six major shareholders that control 92 36% of the bank Included in the six major shareholders there are two foreign shareholders that control 24 93% of the institution The bank s capital position is satisfactory at this time The total capital for the bank including reserves is 8 676,000 DM Capital to total assets as of June 30 1998 was 24 12%

The financial condition of the bank is satisfactory For the period ending December 31 1997 the bank earned 535 000 DM This is a return or 1 71% and 6 33% on assets and equity respectively The positive earnings trend has continued for the six months ended June 30, 1998 Internal financial statements showed earnings of 259 000 DM for the six month period ending June 30 1998 The loan portfolio has seen modest growth for the period under review Loans grew 1 816 000 DM or 11 15% The delinquency rate as of June 30 1998 was 7 32% The loan loss allowance to total loans was 4 4% This might be a concern to the bank in the future If the delinquency rate does not decrease then additional funds need to be provided which would decrease the current earnings trend Expense control must be monitored closely during this expansion phase the bank is experiencing The bank s efficiency ratio was 89 0% for the period ending December 31 1998 This is a marginal ratio and should be monitored very closely

Based on the Gospodarska Banka s performance in the BF lending program and the Bank s commitment to generating further loans continued participation in the USAID Business Finance program is recommended with the condition that the bank provides quarterly financial information to BF

Recommended Restrictions on Participation

The bank is to provide to BF, on a quarterly basis a complete set of financial statements These statements will be analyzed by BF If the bank's progress and growth are not inline with BF s standards then all future lending activities are to be suspended

Bank Selection Team Member Thomas Chmelik		**Date** 14 Aug 98
BF Chief of Party Bruce Spake		**Date** 14 Aug 98
USAID Director CRAIG G BUCK		**Date**

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STATUS AND QUALITY OF BF PORTFOLIO

Gospodarska Banka (GB) DD was one of the first participants in the BF program and has produced a reasonable volume of loans GB had fifteen (15) loans active in July 1998 for a total of 6,255000 DM GB had three (3) loans that total 2,152,000DM that were more than 60 days delinquent as of 7-22-98 This is a 40 53% delinquency ratio based on the total volume of loans However, a loan in the amount of 1,000,000 DM to Integral po was originated by Hippo Banka and is now serviced by GB If the delinquencies are adjusted for this loan than their delinquency ratio is 27 06%

A recently completed evaluation of the loan portfolio and loan ratings resulted in the following

- 2 downgrades from 5 to 8 on loans totaling 1,500,000DM
- 1 downgrade from 5 to 7 on a loan totaling 277,000DM
- 2 downgraded from 6 to 7 on loans totaling 770,000DM
- 1 downgrade from 5 to 6 on a loan totaling 310,000DM

One loan downgraded from 5 to 8 was to Integral po Hippo Banka originated this loan

The resulting loan rating dispersion was as follows

RATING	# OF LOANS	AMOUNT
3	1	300,000DM
4	2	1,000,000DM
5	5	1,670,000DM
6	2	560,000DM
7	3	1,047,000DM
8	2	2,000,000DM

The downgrade into the Loss category of "8" is a substantial amount However, 1,000,000DM is for Integral po The overall downgrades make up a significant portion of the GB portfolio GB's loan rating dispersion is typical of banks in the BF program

QUALITY OF BF ORIGINATION

Based on discussions with BF Lending Associates, applications and loan files are considered acceptable in quality Speed of processing applications is sometimes slow

COMPLIANCE WITH BF CLOSING REQUIREMENTS

Loan documentation exceptions on BF loans initiated by GB were minimal Any issues with closing have been rectified

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

Discussions with BF Lending Associates and BF Audit revealed no significant concerns Disbursements are made in a timely fashion and given the financial condition and liquidity condition of the bank there is no need for concern

COMPLIANCE WITH BF MONITORING REQUIREMENTS

The overall quality of the monitoring reports is below average Some reports have been filed and graded a "F" GB has three loan officers and a manager who is required to prepare the monitoring reports As their BF Portfolio continues to grow they have committed to additional personnel to fulfill the necessary reporting requirements Typical of most monitoring reports created by the Agent Banks, true analysis is sometimes lacking It is recommended that those who prepare the monitoring report be given remedial training to improve the quality

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

BF operations voiced no concerns over the repayment performance of this bank The bank has sufficient liquid resources and does not need to hold BF's funds

PROJECTED LOAN VOLUME

GB projects that they will be able to generate 10 new loans for 1,500,000DM from September 1998 to August 1999 For the same period in 1999 to 2000 they project 10 loans for 1,500,000DM Management indicated they would provide staffing resources and the training necessary to achieve these levels of projected loan volume

QUALITY AND SUFFICIENCY OF STAFF

Overview and staffing

Six (6) staff members are dedicated to support of the BF Lending program – Four lenders and two support staff GB plans to increase this to 8 as the BF portfolio grows

Senior Management

A meeting were held with the General Manager and the Director of Investments (Loans)

NAME	TITLE/POSITION
Mijo Misic	General Manager
Ivana Pranjic	Director of Investments (Loans)

Management was very committed to continuing with the BF program Management appeared knowledgeable of the program and would like to see the scope of loans increased to include more of the service sector

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

W2

An external audit firm has not audited GB They have contracted with Price Waterhouse (PW) to perform their annual audit PW is schedule to begin the audit in the third quarter and will cover 1997 and 1998

GB's financial statements showed total assets of 35,977,000DM as of June 30, 1998, an increase of 4,725,000DM from the December 31, 1997 Total loans have increased 1,816,000 DM for the period ending June 30, 1998 Deposits increased 1,155,000DM during the same period, however, loans to deposits increased to 95 43% Cash to total assets was 45 10%, this includes foreign cash, as of June 30, 1998 GB is very mindful that it cannot continue to grow its loan portfolio without growing its deposit base Off balance sheet liabilities were negligible

The Bank's capital including reserves was 8,676,000 DM as June 30, 1998 The total capital to assets ratio, including reserves was 24 12% as of June 30, 1998 Problem loans per the Bank's Agent Bank Application were 1,326,000DM at June 30, 1998 This is a delinquency rate of 7 32% The loan loss coverage to problem loans was 60% It appears that that the bank is not making adequate provision at this time If proper provisioning was being done the bank would show a net loss

Net income for the year ended December 31, 1997 was 535,000DM Internal profit and loss data for the period ending June 30,1998 indicated a net profit of 204,000DM The bank's efficiency ratio for the period ending December 31, 1998 was 89% This ratio has increased to 91 90% as of June 30, 1998 This is a unhealthy sign The bank management must vigorously control expenses as the bank expands

Based on discussions with management and consultants the Bank's computer system is being installed at this time The general ledger, accounting, loan, deposit and foreign payment modules have been installed at the head office and 1 branch They expect to have this project completed by November The goal is to have the system fully integrated and all branches connected to the head office The core system and equipment is Year 2000 compatible Management is making additional changes to upgrade its systems and provide better financial reporting Technical assistance is in place to achieve these goals Standard password access to systems is used

All loans are brought to loan committee at head office for approval Senior Loan officers do not have lending authority

OWNERSHIP

Foreign entities own 24 93% of the shares in the bank as follows

HKD Napredak	23 18%
Archbishopric Ordinariat	12 75%
Franciscan Province Administration	10 83%
Croatian Electrical Economy (Foreign)	12 53%
HNZ	20 67%
World Consulting Company SA (Foreign)	12 40%

AGENT BANK RECOMMENDATION

BANK	HIPOTEKARNA BANKA DD SARAJEVO
US SFOR (Y/N)	N
CANTONS	SARAJEVO
MUNICIPALITIES	SARAJEVO
HEADQUARTERS	SARAJEVO

Date	14 Aug 98	**AB Rec #**	9
Ownership (%)			
Private	94 5%	**State**	5 5%
Existing Agency Agreement?			
Yes	X	**No**	

Number of Outstanding BF Loans	3	**BF Market Coverage Geographic**	Sarajevo
Balance on Outstanding BF Loans	1 153 700DM		
Range of Loan Sizes	321 000DM to 657 000DM		
Number of Loans 60+days past due	0		
Balance on Loans 60+days past due	0		

Owners holding more than 10 percent of the bank and percentage ownership	1 BH BANKA DD SARAJEVO	1 16 8%
	2 BH OSIGURANJE DD SARAJEVO	2 15 9%
	3 CENTRALEXPORT DJL SARAJEVO	3 10 1%
	4	4
	5 TOTAL BH AFFILIATED OWNERSHIP INCLUDING THE ABOVE IS 57%	5

RECOMMENDATION SUMMARY

Based on Hipotekarna Bank s (HB) relative strength as a banking institution in BiH its relatively stronger financial position than other Agent Banks and the Bank s willingness to work with BF continued participation in the USAID Business Finance program is recommended

Bank management is considered very capable

The Bank operates solely from its Main Office located at Ul Branislava Djurdjeva 8 Sarajevo This is a side street location on the western edge of Sarajevo s business district

The Bank s senior management was not comfortable with the ownership position in HB by BH Banka BH Osiguanje and Cenex (controlled and predominantly owned by BH Banka) It was apparent senior management would like the Bank to remain independent

Hipotekarna Banka owns approximately 5 to 6 % of BH Banka It was unclear why the purchase of 300 000DM in BH banka stock occurred as management did not appear interested in a merger or any formal affiliation with BH

Recommended Restrictions on Participation

No restrictions or conditions other than those generally included in the standard Agent Bank Agreement are considered necessary at this time however, frequent contact with the Bank is suggested to determine if the BH Bank, BH Osiguranje and Cenex ownership position is influencing Hipotekarna s BF lending program decisions

Bank Selection Team Member Alfred Dostie		**Date** 14 Aug 98
BF Chief of Party Bruce Spake		**Date**
USAID Director CRAIG G BUCK		**Date**

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STATUS AND QUALITY OF BF PORTFOLIO

HB Banka DD Sarajevo (SKB) DD Sarajevo has produced three (3) loans for the BF program None of the current loans is overdue One loan was fully paid off by the Bank when it had payment problems, but the Bank did recover its funds from this loan

A recently completed evaluation of the loan portfolio and loan ratings resulted in no changes to ratings

The loan rating dispersion was as follows

RATING	# OF LOANS	AMOUNT
4	1	657,000DM
6	1	321,000DM

Performance overall is similar to other banks in the BF program

QUALITY OF BF ORIGINATION

Based on discussions with the BF Lending Associates, applications and loan files are considered acceptable in quality

COMPLIANCE WITH BF CLOSING REQUIREMENTS

The Legno loan file documentation was missing as of the date of this report

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

Discussions with the BF Lending Associates and BF Audit indicated acceptable performance in this area

COMPLIANCE WITH BF MONITORING REQUIREMENTS

Monitoring reports are generally acceptable quality per Lending Associates

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

BF Operations voiced no concerns over the repayment performance of this Bank

PROJECTED LOAN VOLUME

Hipotekarna Banka projects that they will be able to generate 30 new loans for 10,000,000DM from September 1998 to August 1999 For the same period in 1999 to 2000 they project 45 loans for 15,000,000DM Management indicated they would provide staffing resources and the training necessary to achieve these levels of projected loan volume Management's commitment to the BF program is very good

QUALITY AND SUFFICIENCY OF STAFF

Overview and staffing

The Bank has twenty-eight (28) employees No specific lenders or support staff devote all of their time to BF loans, however, the Director and the chief lender take a personal interest in BF loans and lending and support staff are assigned as needed This is sufficient for the current volume

Senior Management

Meetings with the General Manager and key members of executive and senior management were held as part of the due diligence process A walkthrough conducted throughout the Bank provided the opportunity to meet and question various employees about their work, bank operations, and information processing Management attending meetings

NAME	TITLE/POSITION
Dozo Dzemaludin	General Manager
Foco Fatima	Deputy General Manager
Mulaosmanovic Belma	Director of Foreign Currency Operations

Management was very knowledgeable in all aspects of banking The Bank's systems appear to be Year 2000 compatible

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

HB's financial statements showed total assets of 11,901,000KM as of June 30, 1998, an increase of 2,305,000KM from the December 31, 1997 total Deposits increased 1,072,000KM during the same period Foreign assets are more than adequate to cover foreign liabilities Loans to deposits are 101%, however, liquid assets are adequate at 29% of total assets Off balance sheet liabilities do not represent a significant risk to the Bank

The capital ratio at June 31, 1998 was 30 8% This level of capital is considered adequate

Net income for the year ended December 31, 1997 was 142,000KM Internal profit and loss data for the period ending June 30,1998, indicated net profit of 117,500KM pre tax The Bank's FBA loan rating report indicates an exposure of 1,458,000KM, which is adequately covered by 3,195,000KM in capital and reserves

Based on discussions with the information technology manager and a physical review of the Bank's computer center the current system is considered adequate The core software system is Year 2000 compatible Standard password access to systems is used

Loan officers do not have lending limits All loans are approved by a lending committee comprised of the General Manager, the Deputy General Manager, and the Credit Manager

OWNERSHIP

The Bank's stock is held by 170 stockholders BH Bank and BH Osiguranje with other affiliates, such as Cenex, own a 57% stake in HB HB management was not comfortable with the takeover implications of such a heavy concentration in ownership It appeared that management would prefer to remain an independent bank

AGENT BANK RECOMMENDATION

BANK	HRVATSKA POSTANSKA BANKA DD MOSTAR
US SFOR (Y/N)	N
CANTONS	NERETVA, WEST HERZEGOVINA AND MIDDLE BOSNIA
CITY	MOSTAR
MUNICIPALITY	MOSTAR

Date	14 Aug 98	**AB Rec #**	10
Ownership (%)			
Private	69%	**State**	31%
Existing Agency Agreement?			
Yes	X	**No**	

Number of Outstanding BF Loans	0	**BF Market Coverage Geographic**	Middle Bosnia
Balance on Outstanding BF Loans	0		
Range of Loan Size	N/A		
Number of Loans 60+days past due	0		
Balance on Loans 60+days past due	0		

Owners holding more than 10 percent of the bank and percentage ownership	1 PUBLIC COMPANY PT 2 HRVATSKA POSTANSKA BANKA DD ZAGREB 3 MONDO DOO MOSTAR 4 5	1 31% 2 20% 3 19% 4 5

RECOMMENDATION SUMMARY

Hrvatska Postanska Banka (HPB) was signed up as an agent bank as of July 16 1997 The area of Mostar in which they are headquartered has not been opened for lending from the BF program They were allowed to participate because of their presence in Middle Bosnia However during this period the bank has not submitted one application for approval The participation of HPB is now not critical for additional coverage in Middle Bosnia Also there is reason to believe the bank discriminates in its lending practices At this time their application is not recommended for approval

The Bank at this time has some liquidity, but this is due to a line of credit of 4 200 000 DM from Union Bank of Switzerland This a one year loan that the bank entered into during the period under review The bank has spent lavishly on renovating its branch office in Mostar and building a new Head Office Building The bank has invested more than 100% of its capital into fixed assets

Recommended Restrictions on Participation

Bank Selection Team Member Thomas Chmelik & Zan Northrip		**Date** 14 Aug 98
BF Chief of Party Bruce Spake		**Date** 14 Aug 98
USAID Director CRAIG G BUCK		**Date**

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STATUS AND QUALITY OF BF PORTFOLIO

This is not applicable to the bank The bank has made no loans

QUALITY OF BF ORIGINATION

This is not applicable to the bank The bank has made no loans

COMPLIANCE WITH BF CLOSING REQUIREMENTS

This is not applicable to the bank The bank has made no loans

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

This is not applicable to the bank The bank has made no loans

COMPLIANCE WITH BF MONITORING REQUIREMENTS

This is not applicable to the bank The bank has made no loans

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

This is not applicable to the bank The bank has made no loans

PROJECTED LOAN VOLUME

HP projects that they will be able to generate 20 new loans for 5,000,000DM from September 1998 to August 1999 For the same period in 1999 to 2000 they project 30 loans for 7,500,000DM Management indicated they would provide staffing resources and insure that all staff members are properly trained to achieve these levels of projected loan volume

QUALITY AND SUFFICIENCY OF STAFF

Overview and staffing

The bank has 55 employees Four (4) staff members will be involved to support the BF Lending program – Two lenders and two support staff Per the BF Lending Associate additional resource is needed for preparation of monitoring reports

Senior Management

Meetings with the General Director and key members of executive and senior management were held as part of the due diligence process Management attending meetings

NAME	TITLE/POSITION
Davor Simic	Director
Miljenko Vidacak	Deputy Director
Vlado Divkovic	Manager of Vitez
Ivan Poljak	Lending Officer

Management would like very much to participate in the BF program Lending management, in Middle Bosnia, who would be handling BF loans appeared knowledgeable and open to lending to all communities However, the bank's Deputy Director made ethic slurs towards the Muslims, which we found to be offensive He stated that the loans to Croat firms were better than the majority of loans in the BF program and that Croat-managed banks were stronger and more knowledgeable than their Bosniac-managed counterparts Because of this attitude, the bank could be considered to be promoting and cultivating discriminatory practices in its lending

Sufficient contributions were made by the members of senior management to determine that they were well-organized and knowledgeable bankers

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

An external-auditing firm has not audited the bank They believe that their financial statements conform to International Accounting Standards (IAS) They were examined by the Federal Banking Agency in July 1997 and agreed with their findings The findings that were brought to the attention of management have been corrected The internal control systems within the bank are adequate at this time

The financial statements showed total assets of 42,046,000DM as of June 30, 1998, an increase of 1,794,000DM from the December 31, 1997 total Deposits decreased 2,563,000DM during the same period The loan to deposit ratio has increased to 76 75% from 58 47% The bank needs to concentrate on generating new deposits to continue to fuel its loan demand It should not continue to borrow funds off shore in order to meet its loan demand Cash to total assets was 20 19% This is a comfortable position at this time but could deteriorate quickly if the bank is not prudent in the management of its loan growth Off balance sheet liabilities were negligible

The loan portfolio has increased 5,194,000 DM or 22 66% for the period ending June 30, 1998 The loan loss provision was 7 12% to total loans The delinquency rate for the loan portfolio was 4 85% as of June 30, 1998 This rate seems suspect considering the situation in Mostar at this time It appears that they are not providing an adequate reserve for loans According to Federal Banking Agency guidelines the minimum would probably be 15% to 20% of the total portfolio

The Bank's capital has remained at 5,000,0000 DM for the period under review The bank has no plans of raising additional capital at this time The total capital to assets ratio was

11 91% as of June 30, 1998 With the continued growth of the bank, and the lack of significant earning, and the quality of the bank's loan portfolio, the bank capital adequacy is questionable Consequently, the thin capital margin is cause for concern regarding the Bank's solvency This coupled with the liquidity issues at the Bank will require close control of BF loan disbursements and payments to reduce risk to the program

Net income for the year ended December 31, 1997 was 14,000DM Internal profit and loss data for the period ending June 30,1998 indicated net profit of 8,000DM

Based on discussions with management concerning the Bank's computer center the current system is considered adequate The core system and equipment is Year 2000 compatible Management is making additional changes to upgrade its systems and provide better financial reporting Technical assistance may be needed Standard password access to systems is used The system is not integrated at this time Each branch operates independently and information is relayed via fax or mail to the head office

Loan officers do not have lending limits, however, all loans are presented to and approved in a committee setting Also, all loans that are originated at the branch offices have to be brought to the head office for approval

OWNERSHIP

Hrvatska Postanska Banka DD located in Zagreb, Croatia own 20% of the shares in the bank Also, the Post office, which is a state owned entity, owns 31% of the bank

21 August 1998

Davor Sımıc
Dırector
Hrvatska Postanska Banka D D Mostar
Kneza Domagoja b b
Mostar

Re Applıcatıon for USAID Busıness Fınance program

Dear Mr Sımıc

We regret to ınform you that Hrvatska Postanska Banka's applıcatıon for partıcıpatıon ın the USAID Busıness Fınance program has been declıned pendıng the openıng of the Mostar area to USAID assıstance Your ınterest ın the Busıness Fınance program ıs apprecıated

When the Mostar area ıs opened to the Busıness Fınance program, we hope you wıll resubmıt an applıcatıon for consıderatıon

Sıncerely,

AGENT BANK RECOMMENDATION

BANK	INVESTICIONO-KOMERCIJALNA BANKA DD ZENICA
US SFOR (Y/N)	Y
CANTONS	ZENICKO - DOBOJSKI
MUNICIPALITIES	ZENICA
HEADQUARTERS	ZENICA

Date	14 Aug 98	**AB Rec #**	11
Ownership (%)			
Private	67 4%	**State**	32 6%
Existing Agency Agreement?			
Yes	X	**No**	

Number of Outstanding BF Loans	14	**BF Market Coverage Geographic**	Zenica Busovaca Zavidovici and Zepce
Balance on Outstanding BF Loans	8 241 320DM		
Range of Loan Size	264 000DM – 1 000 000 DM		
Number of Loans 60+days past due	0		
Balance on Loans 60+days past due	0		

Owners holding more than 10 percent of the bank and percentage ownership	1 IP KRIVAJA ZAVIDOVICI (CONSORTIUM OF STATE COMPANIES) 2 3 4	1 32 6 2 3 4

RECOMMENDATION SUMMARY

Investiciono – Komercijalna Banka (IKB) is primarily privately owned The bank is headquartered in Zenica The bank has 3 branches in the following towns Busovaca Zavidovici and Zepce

Price Waterhouse has been engaged to audit the financial statements for years 1997 and 1998 This audit for 1997 should be completed by the end of the third quarter at which time BF could have more confidence in the financial picture of the bank However based on the information BF has at this time the financial condition of the bank is unsatisfactory

The bank has developed a strategic plan that is to cover the next three years of operations A key focus within the plan is the capitalization plan The bank is seeking at this time an additional 3 000 000 DM in new capital The bank shows a total capital position including reserves of 42 209 000 DM The amount of reserves for bad loans is 30 511 000 DM If the loan loss reserve amount is not included in the capital the capital to asset ratio is 9 12% as of June 30 1998

For the period ending December 31 1997 the bank earned 19 000 DM Internal financial statements show earnings for the six months ended June 30 1998 were 69 000 DM Expense control must be monitored closely The bank s efficiency ratio was 75 13% and 81 36% for the periods ending December 31 1998 and June 30 1998 respectively This is not an acceptable ratio and the bank must take measures to reverse this trend Management did acknowledge the problem and pledge a reduction in staff of 30% The loan portfolio has grown only 1 964 000 DM or 3 27% for the six-month period under review The delinquency rate as of June 30, 1998 was 53 82% The loan loss allowance to total loans was 49 14% It appears that the bank has adequately provided for the problem loans in the loan portfolio

Based on Investiciono – Komercijalna Banka's performance in the BF lending program and the Bank's financial condition continued participation in the USAID Business Finance program is recommended with conditions and restriction

Recommended Restrictions on Participation

The financial condition of IKB must be monitored on a quarterly basis IKB is to provide to BF quarterly financial statements Their participation should be on a probationary basis until such time their financial condition has improved

Bank Selection Team Member Thomas Chmelik		Date 14 Aug 98
BF Chief of Party Bruce Spake		Date 14 Aug 98
USAID Director CRAIG G BUCK		Date

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STATUS AND QUALITY OF BF PORTFOLIO

As of July 1998 IKB has done fourteen (14) loans totaling 8,241,320 DM IKB has no loans that were more than 60 days delinquent as of 7-22-98 However, one loan to Best Product has been restructured, it was 338 days past due when it was restructured As of August 8, 1998 the Best Product loan is 35 days past due

A recently completed evaluation of the loan portfolio and loan ratings resulted in the following

- 1 downgrade from 6 to 8 on a loan totaling 1,000,000DM
- 2 downgrades from 6 to 7 on loans totaling 664,000DM
- 1 downgrade from 5 to 7 on a loan totaling 903,000DM
- 1 downgrade from 4 to 6 on a loan totaling 800,000DM
- 1 downgrade from 4 to 5 on a loan totaling 1,000,000DM

The classification of the remaining eight loans was unchanged

The resulting loan rating dispersion was as follows

RATING	# OF LOANS	AMOUNT
4	2	930,000DM
5	4	2,685,000DM
6	4	3,700,000DM
7	3	1,567,000DM
8	1	1,000,000DM

The downgrades to "7" and "8" are significant The overall quality of the portfolio is poor However, given the current delinquency rate it appears that most of the borrowers are able to meet the payment schedules

QUALITY OF BF ORIGINATION

Based on discussions with BF Lending Associates, applications and loan files are considered acceptable in quality Speed of processing applications is sometimes slow IKB has dedicated qualified staff for the BF program and take it very seriously

COMPLIANCE WITH BF CLOSING REQUIREMENTS

Loan documentation exceptions on BF loans initiated by CP were minimal Any issues with closing have been rectified

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

Discussions with BF Lending Associates and BF Audit revealed no significant concerns Disbursements are made in a timely fashion and given the financial condition and liquidity condition of the bank there is no need for concern

COMPLIANCE WITH BF MONITORING REQUIREMENTS

The overall quality of the monitoring reports is generally good IKB has four loan officers in the Department of Realization and Monitoring who are required to prepare the monitoring reports Typical of most monitoring reports created by the Agent Banks, true analysis is sometimes lacking But with additional training they should be able to overcome this shortfall

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

BF operations voiced no concerns over the repayment performance of this bank The bank has sufficient liquid resources and does not need to hold BF's funds However, after paying the account they are late in notifying BF that a payment has been made BF is working with them to rectify this problem and ensure timely notification

PROJECTED LOAN VOLUME

IKB projects they will be able to generate 30 – 50 new loans for 20,000,000DM from September 1998 to August 1999 For the same period in 1999 they project 40 – 60 loans for 30,000,000DM Management has indicated they would provide staffing resources and the training necessary to achieve these levels of projected loan volume

QUALITY AND SUFFICIENCY OF STAFF

Overview and staffing

Six (10) staff members are dedicated to support of the BF Lending program – Four lenders and six support staff

Senior Management

A meeting were held with the following individuals

NAME	TITLE/POSITION
Uzeir Fetic	General Manager
Milena Mujbegovic	Assistant of General Manager
Ana Svajger	Manager Loan Division

Management was very committed to continuing with the BF program Management appeared knowledgeable of the program and was happy to see the loan size has been decreased to 30,000DM This will give it more opportunities to make loans to small businesses in Zenica

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

The bank is in the process of having Price Waterhouse audit the books for 1997 and begin interim work for the 1998 audit
IKB's financial statements showed total assets of 128,220,000DM as of June 30, 1998 Included in these assets are frozen deposits at the National Bank of Yugoslavia (NBY) totaling 32,150,000 DM During the period under review 18,520,000 DMhave been transferred to The Central Bank for resolution IKB showed no loss on this transaction However, there will be 1,360,000-DM loss from the remaining deposits that have to be transferred They believe that this loss will have to taken by the bank Appropriate provisions have been set aside for this amount The government has given no assurances that it will make up the loss The loan portfolio increased 1,964,000 DM during the six months ended June 30, 1998 Total deposits have decreased 2,005,000 DM during the same period The loan to deposit ratio has increased to 92 54% as of June 30, 1998 Cash to total assets was 14 92%, this includes foreign cash, as of June 30, 1998 However, if the asset base were adjusted for the frozen deposits the cash to asset ratio would be 20% IKB is very mindful that it cannot continue to grow its loan portfolio without growing its deposit base Off balance sheet liabilities were negligible

The Bank's capital including reserves was 42,209,000DM as June 30, 1998 The total capital to assets ratio, including reserves was 9 12% as of June 30, 1998 If IKB were to charge off it bad loans and adjust for the remaining frozen deposit the capital to assets ratio would be approximately 17%

Net income for the year ended December 31, 1997 was 19,000DM Internal profit and loss data for the period ending June 30,1998 indicated a net profit of 69,000DM The bank's efficiency ratio for the period ending December 31, 1997 was 75 13% This ratio has decreased to 81 36% as of June 30, 1998 This is not a good indication of effective expense control Bank management acknowledged the situation and said that they had a business plan that included the retrenchment of 30% of the workforce

Problem loans per the Bank's Agent Bank Application were 33,414,000DM at June 30, 1998 The delinquency rate as of June 30, 1998 was 53 82% The loan loss allowance to total loans was 49 14% The bank has taken the necessary step to provide for the bad loans Management was sure that they have identified all problem loans and provided according to FBA standards When provisioning they did not take into consideration collateral values Management believed that they had made a very prudent and conservative allowance for loan losses

The bank is currently computerized The computer system is seven years old and IKB is in the process of updating the system Completion time is projected by December 1998 All branches are online and all modules are integrated The security in the system is multi – level and is adequate

All loans are brought to loan committee at head office for approval Senior Loan officers do not have lending authority The board is informed on all loans after they are made

OWNERSHIP

The bank is 67 4% and 32 6% owned privately and by state companies, respectively IP "Krivaja" Zavidovici in a consortium of state owned companies that own 32 6% No private individual or companies own more than 6 2% of the bank

AGENT BANK RECOMMENDATION

BANK	KOMERC BANKA DD TESANJ
US SFOR (Y/N)	Y
CANTONS	ZENICA-DOBOJ
MUNICIPALITIES	Tesanj, Maglaj, South and East Doboy, Usora, Zavidovici
HEADQUARTERS	TESANJ

Date	14 Aug 98	**AB Rec #**	12
Ownership (%)			
Private	59 49%*	**State**	40 51%*
Existing Agency Agreement?			
Yes	X	**No**	

Number of Outstanding BF Loans	2	**BF Market Coverage Geographic**	Tesanj Maglaj South and East Doboy Usora Zavidovici
Balance on Outstanding BF Loans	2 533 300DM		
Range of Loan Sizes	200 000DM to 2 333 300DM		
Number of Loans 60+days past due	1		
Balance on Loans 60+days past due	2 333 300DM		

Owners holding more than 10 percent of the bank and percentage ownership	1 TVORNICA CARAPA – TESANJ 2 ENKER TESANJ DD 3 4 5	1 10% 2 10% 3 4 5

RECOMMENDATION SUMMARY

Based on the Komerc Banka DD Tesanj s performance in the BF lending program and the Bank s commitment to generating further loans continued participation in the USAID Business Finance program is recommended with conditions The Bank s liquidity is weak The Bank however appears solvent based on a significant capital ratio Specific restrictions to safeguard BF assets are listed in the Restrictions section below

The Bank s management appears well trained knowledgeable and committed to operating a strong bank for the betterment of the community They are very aware of expense control

The Bank is located in the Bosnian Federation very near the Republika Srpska in North central BiH The trade area for this one-office institution located in the center of Tesanj is Tesanj Doboj – south and east Usora Maglaj and Zavidovici The Bank would like to open three (3) branch offices in contiguous areas in the next five years but management is cautious about their ability to do so It will depend on availability of funds

Recommended Restrictions on Participation

A review of the BF loans indicated that the larger loan was made to a Bank director s company This loan was recently restructured due to payment problems however the loan is considered quite good by BF staff and the restructuring was brought about by the failure of a Malaysian firm to pay a receivable Two other director or owner related loans proposed by the Bank were rejected by BF The General Manager noted that some members of the Board of Directors unduly influenced lending decisions in that past, but these directors are no longer on the Board

Compliance with the Agency Agreement clause requiring disclosure of and special consideration of insider loans should be closely monitored for this Bank

Adequate and audited financial information including loan quality data on the Bank s own loan portfolio should be required as a condition of participating in the BF program This information should be analyzed on an annual basis and continued participation in the BF program should be evaluated annually

Bank Selection Team Member Alfred Dostie		**Date** 14 Aug 98
BF Chief of Party Bruce Spake		**Date**
USAID Director CRAIG G BUCK		**Date**

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STATUS AND QUALITY OF BF PORTFOLIO

Komerc Banka has only made two loans through BF, but the Bank's management is very committed to continuing in the program and additional loans have been submitted for consideration They have participated in most of the training provided through USAID and other agencies and consider the BF program as a source of learning for their institution

The larger of the two loans was made to Pobjeda DD and was 65 days overdue as of August 10, 1998 Total loan balance was 2,333,333DM This loan is to a Bank director's interest

A recently completed evaluation of the loan portfolio and loan ratings resulted in the following

- 1 downgrade from 4 to 5 on a loan totaling 2,333,333DM

The resulting loan rating dispersion was as follows

RATING	# OF LOANS	AMOUNT
5	1	2,333,333DM
6	1	200,000DM

This dispersion is better than most Agent Banks in the BF program

QUALITY OF BF ORIGINATION

Based on discussions with BF Lending Associates and BF Audit staff, applications and loan files are considered acceptable in quality

COMPLIANCE WITH BF CLOSING REQUIREMENTS

There were no loan documentation exceptions listed on the BF Operations report

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

Discussions with BF Lending Associates and BF Audit did not indicate problems with disbursements made through KB

COMPLIANCE WITH BF MONITORING REQUIREMENTS

BF Lending Associates indicated monitoring reports were generally good quality

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

BF Operations voiced no concerns over the repayment performance of this Bank

PROJECTED LOAN VOLUME

KB projects that they will be able to generate 12 new loans for 3,500,000DM from September 1998 to August 1999 For the same period in 1999 to 2000 they project 10 loans for 6,000,000DM These projections are based on management's knowledge of the loan demand in their trade area Management indicated they would provide staffing resources and the training necessary to achieve these levels of projected loan volume

QUALITY AND SUFFICIENCY OF STAFF

Overview and staffing

Four (4) staff members are involved in the BF Lending program – Three lenders and one support staff This appears sufficient for current and near term projected volumes of activity

Senior Management

Meetings with the General Director and key members of executive and senior management were held as part of the due diligence process Management attending meetings

NAME	TITLE/POSITION
Rasim S Korajlic	General Director
Emko Dizdarevic	Deputy General Manager
DzEmil Didic	Manager of Accounting Department (Also seems to run the lending function de facto)
Berberovic, Erduana	Manager Foreign Exchange Department
Ahmetovic, Hasan	Manager of internal control

Management was very committed to continuing with the BF program Management appeared knowledgeable in banking and in lending Mr Korajlic mentioned that the bank had problems with some Board members and their attempts to influence lending decisions Some Board members did not get re-elected as part of a program by Mr Korajlic to restructure the Board and the Bank He has implemented an employee stock ownership plan whereby the employees must buy the equivalent of ten percent of their salaries in bank stock monthly Additionally, new shareholders are being sought and some success has resulted in changes in the Bank's ownership Mr Korajlic noted further that an injection of additional capital is being sought Mr Korajlic appears to be a knowledgeable and decisive banker

The Bank has strong expense control and a better efficiency ratio than most US banks at 51%, however, Mr Korajlic kept stressing that expenses had to be controlled further

The Bank had allowed the chief lender to make the final decisions on loans and a number of loan problems resulted The Bank now uses a Committee decision format and Mr Didic chairs the Committee It appears that the chief lender has been demoted

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

Total assets at KB were of 4,782,000DM as of June 30, 1998 This was a decrease of 834,000DM from the December 31, 1997 total Deposits increased 701,000DM during the same period Loans to deposits are 83% Cash to total assets was 6 57% at 314,000DM Turkish interests have deposited foreign currency with the bank and are active in new or revived businesses in the area Off-balance sheet liabilities were negligible

Other assets and liabilities decreased significantly From year-end 1997 to June 30,1998 due to an accounting interpretation The Bank had previously been including the grossed-up balance of BF loans in other assets and other liabilities

Net income for the year ended December 31, 1997 was 51,000DM Internal profit and loss data for the period ending June 30,1998, indicated net profit of 25,000DM The total capital to assets ratio was 65% at year-end 1997 Overdue loans fifteen(15) or more days late were 680,000DM at June 30, 1998, as noted on the Bank's Agent Bank Application

Based on discussions and a physical review of the Bank's computer resources the current system is considered adequate The core system and equipment is not Year 2000 compatible Management is making additional changes to upgrade its systems and provide better financial reporting Password access to systems is used

Loan officers do not have lending limits, however, all loans are presented to and approved in a committee setting Previously, the chief lender was authorized to approve all loans, but his authority has been transferred to the Committee after problem loans increased significantly in the Spring of 1998

The Bank operates out of one office located at Neuha Mesica 3 in the center of Tesanj The Bank's trade area includes Tesanj, Doboj-south, Usora, Doboj-east, Maglaj, Zavidovici

OWNERSHIP

The Bank is seeking new shareholders and additional capital in several ways Employees are required to invest 10% of their monthly salary in Bank stock Potential shareholders are being contacted by the General Manager Customers who obtain loans are asked to invest in the Bank's stock All of this is part of a strategy to diversify the ownership of the Bank and lessen the negative influence of certain directors, per the General Director

AGENT BANK RECOMMENDATION

BANK	KOMERCIJALNA BANKA DD TUZLA
US SFOR (Y/N)	Y
CANTONS	TUZLA-PODRINJE & ZENICA-DOBOJ
MUNICIPALITIES	Tuzla (5 Locations), Banovici, Gracanica, Gradacac, Jelah, Kalesija, Kladanj, Lukavac, Srebrenik, Tecak, Zivinice
HEADQUARTERS	TUZLA

Date	14 Aug 98	**AB Rec #**	13
Ownership (%)			
Private	61 5%*	**State**	20 23%*
Existing Agency Agreement?			
Yes	X	**No**	

Number of Outstanding BF Loans	45	**BF Market Coverage Geographic**	Tuzla, Banovici Gracanica Gradacac Jelah Kalesija Kladanj Lukavac Srebrenik Tecak Zivinice
Balance on Outstanding BF Loans	24 273 800DM as of 7 13 98		
Range of Loan Sizes	70 000DM to 1 500 000DM		
Number of Loans 60+days past due	7		
Balance on Loans 60+days past due	5 815 500DM		

Owners holding more than 10 percent of the bank and percentage ownership	1 INA BIH - SARAJEVO 2 LIDO OSIGURANJE 3 HALIL DULIC - LIDO OSIGURANJE TUZLA 4 5	1 11 42% 2 11 28% 3 11 28% 4 5

RECOMMENDATION SUMMARY

Based on the Komerccijalna Banka s performance in the BF lending program and the Bank s commitment to generating further loans continued participation in the USAID Business Finance program is recommended with restrictions to control undesirable activity by the Bank The Bank is significantly illiquid and nearly insolvent as indicated by available financial information The BF Audit group found instances of the bank delaying disbursements Various excuses were used however it is apparent the Bank has liquidity problems and these may have provided the incentive for delaying disbursements Forwarding of payments was also problematic at times This will require closer BF monitoring of the Bank Specific restrictions to safeguard BF assets are listed in the 'Restrictions section below

The Bank entered into a strategic arrangement with Export Bank AD to provide BF loan services to the Bijeljina area KB operates 15 branch offices covering Tuzla Podrinje and Zenica Doboj Cantons The Bank s Main Office is located in the central area of Tuzla in a modern building

Recommended Restrictions on Participation

Close monitoring of compliance with the Agency Agrrement s requirement for timely forwarding of payments is recommended This will probably require the addition of one support staff to the Tuzla office as other banks in this area are exhibiting the same traits and must be closely monitored for compliance with the Agreement Additionally use of a trustee account for disbursements as required by the Agency Agreement is especially critical for this relationship

Adequate and audited financial information should be required from KB as a condition of participating in the BF program This information should be analyzed on an annual basis and continued participation in the BF program should be evaluated annually

Bank Selection Team Member Alfred Dostie		**Date** 14 Aug 98
BF Chief of Party Bruce Spake		**Date**
USAID Director CRAIG G BUCK		**Date**

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STATUS AND QUALITY OF BF PORTFOLIO

Komercijalna Banka (KB) DD Tuzla was one of the first participants in the BF program and has been the most prolific in producing loans KB had forty-five (45) loans active in July 1998 for a total of 24,274,000DM Seven (7) totaling 5,815,000 were 60 or more days overdue as of 7-22-98 This is a 24% overdue ratio based on the total loan portfolio

A recently completed evaluation of the loan portfolio and loan ratings resulted in the following

- 1 downgrade from 5 to 8 on a loan totaling 900,000DM
- 1 downgrade from 6 to 8 on a loan totaling 1,210,000DM
- 2 downgrades from 6 to 7 on loans totaling 860,000DM
- 5 downgrades from 5 to 6 on loans totaling 3,464 000DM
- 4 upgrades from 6 to 5 on loans totaling 805,000DM

The resulting loan rating dispersion was as follows

RATING	# OF LOANS	DISBURSED AMOUNT
4	3	1,857,000DM
5	12	6,290,000DM
6	25	12,322,000DM
7	3	1,695,000DM
8	2	2,110,000DM

While the downgrades into the Loss category of "8" involve a substantial amount, KB's loan rating dispersion is typical of banks in the BF program

QUALITY OF BF ORIGINATION

Based on discussions with BF Lending Associates and BF Audit staff, applications and loan files are considered acceptable in quality Speed of processing applications is sometimes slow

COMPLIANCE WITH BF CLOSING REQUIREMENTS

Loan documentation exceptions on BF loans initiated by KB were listed on four (4) loans Three exceptions were primarily a failure to properly register mortgage liens These are reportedly being remedied One document file was missing and is being researched

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

Discussions with BF Lending Associates and BF Audit revealed some concern regarding recent slowness of disbursements Excuses offered appeared plausible, but monitoring is necessary, as the Bank is illiquid and could be tempted to slow payments and disbursements as a result

COMPLIANCE WITH BF MONITORING REQUIREMENTS

Monitoring reports are good quality, however, many were not completed per the Lending Associate Now that additional staff has been hired, 80% of monitoring reports are received Typical of most monitoring reports created by the Agent Banks, true analysis is sometimes lacking

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

BF Operations voiced no concerns over the repayment performance of this bank BF Audit is concerned about the Bank's liquidity and the potential for slowing of payments as a result

PROJECTED LOAN VOLUME

KB projects that they will be able to generate 30 new loans for 18,000,000DM from September 1998 to August 1999 For the same period in 1999 to 2000 they project 40 loans for 26,000,000DM Management indicated they would provide staffing resources and the training necessary to achieve these levels of projected loan volume

QUALITY AND SUFFICIENCY OF STAFF

Overview and staffing

Nine (9) staff members are dedicated to support of the BF Lending program – Five lenders and four support staff Per the BF Lending Associate, additional resources are needed for preparation of monitoring reports

Senior Management

Meetings with the General Director and key members of executive and senior management were held as part of the due diligence process Management attending meetings

NAME	TITLE/POSITION
Predrag Pavlovic	Director of Legal and General Business
Nedim Ibrahimovic	Legal Counsel
Asima Pracic	Manager of Credit
Dejneta Sakic	Lending Officer
Nihada Hodic	Accountant

Management was very committed to continuing with the BF program Lending management appeared knowledgeable

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

KB's financial statements showed total assets of 94,836,000DM as of June 30, 1998, an increase of 761,000DM from the December 31, 1997 total Deposits increased 6,657,000DM during the same period, however, loans to deposits are 122% and indicate a highly illiquid condition at KB Cash to total assets was 1 82% and also signaled liquidity problems KB is attempting to obtain a line of credit with a Slovene bank for 2-4 million DM Off balance sheet liabilities were negligible

Net income for the year ended December 31, 1997 was 1,052,000DM Internal profit and loss data for the period ending June 30,1998 indicated net profit of 1,594,000DM While the data submitted by the Bank showed net income, an audit report by Price Waterhouse done as of December 31, 1998 showed a net loss of 2,684,000DM This was the result of provisions for bad debts of 5 4 million DM The Bank's capital declined from 1996 to year end 1997 by 1,393,000DM to a total of 3,699,000DM The total capital to assets ratio was 3 4% at year end 1997 Problem loans per the Bank's Agent Bank Application were 4,570,000DM at June 30, 1998 This is an internal bookkeeping figure for the Bank and it was unclear whether some of the Price Waterhouse report asset write downs for 1997 were rolled forward by the Bank into 1998 It is apparent, however, that the Bank continues to experience declining loan quality Consequently, the thin capital margin is cause for concern regarding the Bank's solvency This coupled with the liquidity issues at the Bank will require close control of BF loan disbursements and repayments to reduce risk to the program

Based on discussions and a physical review of the Bank's computer center the current system is considered adequate The core system and equipment is Year 2000 compatible Management is making additional changes to upgrade its systems and provide better financial reporting Technical assistance may be needed Standard password access to systems is used

Loan officers do not have lending limits, however, all loans are presented to and approved in a committee setting Branch offices have similar committees but are limited to smaller loans Most of the loans are approved at the main office of the Bank located at Dzafer Mahala 67 in central Tuzla

The Bank has participated in generating loans with and servicing BF loans for the Export Bank located in Bijeljina

OWNERSHIP

Foreign entities in Croatia own 18 27% of the shares in the bank

AGENT BANK RECOMMENDATION

BANK	KRISTAL BANKA AD BANJA LUKA
US SFOR (Y/N)	Y (BRANCHES)
CANTONS	REPUBLIKA SRPSKA
MUNICIPALITIES	DOBOJ, BRCKO, TREBINJE, BILECA, NEVESINJE MODRICA, TESLIC GRADISKA LAKTASI, VISEGRAD, ZVORNIK, PRIJEDOR, SRBINJE, NOVI GRAD BROD, PRNJAVOR, BIJELJINA, DREVENTA
HEADQUARTERS	BANJA LUKA

Date	14 Aug 98	**AB Rec #**	14
Ownership (%)			
Private	24 %	**State**	76 %
Existing Agency Agreement?			
Yes	x	**No**	

Number of Outstanding BF Loans	16	**BF Market Coverage —Geographic**	Republika Srpska
Balance on Outstanding BF Loans	DM 10 7 million		
Range of Loan Sizes	DM 165 000 – DM 1 8 million		
Number of Loans 60+days past due	0		
Balance on Loans 60+days past due	0		

Owners holding more than 10 percent of the bank and percentage ownership	1 MINISTRY OF FINANCE 2 NO OTHER OWNER HAS MORE THAN 5 PERCENT OF THE BANK S SHARES 3 4 5 6 7	1 76 % 2 3 4 5 6 7

RECOMMENDATION SUMMARY

Kristal Banka AD Banja Luka is together with Union Banka DD Sarajevo the successor institution of Jugobanka Jubbanka DD Sarajevo The division of Jugobanka assets and liabilities between Union Banka and Kristal Banka has yet to be concluded but an unofficial agreement on the division was reached in 1992 the same year in which Kristal Banka became independent The name Kristal Banka was adopted only in 1997, and the bank operated as Jugobanka DD Banja Luka until that time The bank operates through an extensive branch network that gives it the broadest market coverage in the RS

Kristal Banka was the first bank to originate and service BF loans in the Republika Srpska It is the most active of BF's RS Agent banks with 16 loans disbursed for DM 10 7 million There were no delinquencies as of early August and 16 additional loans for DM 6 8 million were recommended or approved and awaiting disbursement In general BF credit audit and operations staff have been pleased with the volume and the quality of the bank s performance Management and staff are considered dynamic and responsive to BF needs

Kristal Banka's own portfolio is weak and suffers from high delinquency rates

Approval of Kristal Banka is recommended

Recommended Restrictions on Participation

No restrictions are recommended at this time

Bank Selection Team Member Zan Northrip		**Date** 14 Aug 98
BF Chief of Party Bruce Spake		**Date** 14 Aug 98
USAID Director CRAIG G BUCK		**Date**

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STATUS AND QUALITY OF BF PORTFOLIO

Kristal Banka was the first bank to originate and service BF loans in the Republika Srpska It is the most active of the RS banks, with 16 loans disbursed for DM 10 7 million An additional 16 loans have been either recommended or approved, but not yet disbursed, for DM 6 8 million, and 7 deals for DM 1 6 million are currently being analyzed by BF staff as Kristal Banka prospects The range of loan sizes is broad Several credits in the pipeline and already disbursed are DM 200,000 or below, while the largest Kristal Banka loan is DM 1 8 million

As of 6 August, no Kristal Banka loans were past due

A recently completed evaluation of the loan portfolio and loan ratings resulted in the following

- 2 downgrades from 5 to 6 on loans totaling DM 1,075,000
- 1 downgrade from 3 to 4 on a loan totaling DM 580,000

The resulting loan dispersion was as follows

RATING	# OF LOANS	AMOUNT
4	1	580,000
5	13	9,089,000
6	2	1,075,000

The dispersion of Kristal Banka loans is superior to that of most Agent Banks This may result partly from the younger age of its portfolio, relative to the ages of portfolios of BF Agent Banks in the Federation

QUALITY OF BF ORIGINATION

BF Credit staff report high quality applications from Kristal Banka While the bank makes the borrowers do most of the work, it provides guidance, and assists borrowers with constructing their financials in the requested format The bank screens applicants well, goes on site visits, and turns down several applicants for each one they recommend to BF Some applicants rejected by Kristal Banka later turn up as recommendations from other banks The bank is considered cooperative in meeting BF requests for additional information

However, one case has been reported in which the bank failed to disclose material information in recommending a borrower affiliated with the bank

COMPLIANCE WITH BF CLOSING REQUIREMENTS

No documentation exceptions have been noted by BF staff BF staff note that the bank is efficient in the gathering of closing documents, particularly in the registration of collateral

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

No reported violations of BF disbursement procedures

COMPLIANCE WITH BF MONITORING REQUIREMENTS

No reported violations of BF monitoring requirements Audit staff note that the bank keeps good credit files

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

BF's Operations Department reports that the bank complies with all BF repayment procedures Problems were fixed early in the relationship, and the bank is now one of the best of the large-portfolio banks in adhering to BF repayment procedures

PROJECTED LOAN VOLUME

The bank expects to expand its present rate of recommendations to USAID Business Finance, on the assumption that new geographic areas served by Kristal Banka will become eligible for USAID financing, and that BF loan structures will become more flexible The projection presented by the bank in its application, however, appears unrealistically high

QUALITY AND SUFFICIENCY OF STAFF

Overview and Staffing

While the quality and number of Kristal Banka staff servicing BF credits has been satisfactory to date, continued portfolio growth and the reassignment of a key staff member give reason for concern

Until August 1998, BF loans were serviced by the Manager of Long-term Loans and four loan officers reporting to him The manager is not an experienced banker and did little actual work on BF deals, but was supported by two very good loan officers Two weeks ago, one of these loan officers was promoted to a position in another Kristal Banka department One experienced lender remains, the other two loan officers are young and ambitious, but significantly less experienced While a replacement loan officer is being recruited, one loan officer bears primary responsibility for both managing the BF portfolio and training her colleagues This burden is unlikely to be sustainable as increasing numbers of quarterly monitoring reports come due

Senior Management

Meetings were held with the following individuals

NAME	TITLE/POSITION
Ljubomir Klincov	General Director
Vojin Peuraca	Manager, Long-term Loans
Olgica Djekanovic	Director, Finance

The General Director is an active manager who appears to have the confidence of the bank's Board of Directors He has over twenty years of banking experience The senior management team was selected by the General Director, seem committed to his vision of the bank, and, with the exception noted above, are generally experienced and capable managers in their own right Management is articulate regarding both strategic plans and details of the bank's day-to-day operations The General Director has been to a number of foreign countries for seminars and training, and encourages his staff to take advantage of training opportunities provided by BF and other institutions

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

The bank's assets are of poor quality At the end of 1997, Kristal Banka reported a 74 percent delinquency rate, calculated as the balance on loans more than 120 days past due as a percentage of total loans outstanding Over DM 11 million was written off in 1996 and 1997 The bank reports that all its loans were classified by the banking agency as C, D, or E

Lending officers in the headquarters and branches do not have individual lending authorities, and all loans are approved by a headquarters-based credit committee Branch transactions are primarily retail After significant information technology expenditures over the past year, all branches are expected to be online with headquarters by the end of September The bank is computerized with networks of PCs, and additional PC purchases are anticipated While all staff working on BF credits have their own PCs—used for both credit analysis and portfolio tracking—this is not the case for other departments The bank plans to make PCs available to all staff members, raise efficiency, and reduce costs Support staff positions have been reduced with computerization

The bank's computer systems produce regular and on-demand reports on the bank's financial condition for review by the Board and active management by the General Director's staff The bank has had its 1996 and 1997 annual financials audited according to IAS by Deloitte & Touche

OWNERSHIP

Until recently, the bank had 398 shareholders Shares held by 234 state-owned firms represented 71 6 percent of shareholder capital, and those shares have now been transferred to the Ministry of Finance Among "former" shareholders, only one firm, Energoinvest Termoaparati Ilidza held more than 10 percent of the bank, with shareholdings equivalent to 10 4 percent of shareholder capital

An additional 4 5 percent of shareholder capital was held by 9 mixed-ownership firms, the level of actual state ownership in the mixed firms is being audited Once these firms transfer the proper percentage of shares to the Ministry of Finance, somewhere between 72 and 76 percent of the bank's shares will be held by the Ministry for eventual sale

Kristal Banka management is hopeful that international banks will purchase some or all of the shares to be sold by the state The bank also intends to issue new shares to private buyers, once the bank's opening balance sheet is approved In the meantime, bank management is confident that the bank's existing private owners will restrain any poor decisions the Ministry of Finance might attempt to implement

Shares held by 155 private firms currently represent 24 percent of shareholder capital Among the bank's private owners, the largest shareholder is PP LA IM/EX of Novi Grad, with 4 4 percent of total shareholder capital

A crosscheck of shareholders determined that, of Kristal Banka's recommendations to BF, 7 have been recommendations of Kristal Banka shareholders However, only one of these recommended borrowers has owned a significant percentage of the bank No approved or disbursed BF borrower owns more than one percent of Kristal Banka One recommendation that was withdrawn was for a company that was a 3 5 percent owner of the bank

AGENT BANK RECOMMENDATION

BANK	LJUBLJANSKA BANKA DD SARJEVO
US SFOR (Y/N)	Y (Branch)
CANTONS	Sarajevo and Zenica-Doboj
MUNICIPALITIES	Sarajevo, Zenica
HEADQUARTERS	SARAJEVO

Date	14 Aug 98	**AB Rec #**	15
Ownership (%)			
Private	3%*	**State**	97%*
Existing Agency Agreement?			
Yes	X	**No**	

Number of Outstanding BF Loans	6	**BF Market Coverage Geographic**	Sarajevo Zenica Doboj Tuzla Middle Bosnia
Balance on Outstanding BF Loans	5 143 000DM as of 7 13 98		
Range of Loan Sizes	450 000DM to 1 103 000DM		
Number of Loans 60+days past due	2		
Balance on Loans 60+days past due	1 591 948DM		

Owners holding more than 10 percent of the bank and percentage ownership	1 MINISTRY OF FINANCE	1 97%
	2	2
	3	3
	4	4
	5	5

RECOMMENDATION SUMMARY

Ljubljanska Banka appears insolvent Liquidity is also an issue as in most other BiH banks The current BF loan portfolio generated by the Bank was generally downgraded by a recent BF audit however, the portfolio remains typical of the risk levels for other Agent Bank BF portfolios The Bank's management appears competent but the Bank s financial condition is cause for concern The Bank s management indicated a strong desire to remain in the BF program and the Bank's geographic coverage is a significant consideration if the now closed branches are rebuilt and reopened Also the Bank must await the BiH Ministry of Finance s and the FBA's guidance for privatization Privatization could re-capitalize the Bank if new shares are issued and the MF does not require any payment of equity funds presumably owned by the State The contingencies on the continuation of this Bank as a viable entity are many, however terminating the Agent Bank Agreement would be premature at this time and could result in adverse impact to the Bosnian banking system Also management s dedication to the BF program has been excellent Accordingly continued participation in the USAID Business Finance program is recommended with Specific restrictions to safeguard BF assets as listed in the Restrictions section below

The Bank has operating offices in Sarajevo and Zenica Offices not currently in operation were located in Gorazde Mostar Bugojno Cazin and Citluk The Bank s Main Office is located at Kaptol br 4 adjacent to the Centralna Banka in the center of the Sarajevo business district

Recommended Restrictions on Participation

Adequate financial information including audited financial statements should be required to monitor the Bank s condition This information should be analyzed on an annual basis and continued participation in the BF program should be evaluated annually

BF Lending and Field Associates should be alerted regarding the condition of the Bank and extra care taken in underwriting loans presented by the Bank for the BF program

Bank Selection Team Member Alfred Dostie		**Date** 14 Aug 98
BF Chief of Party Bruce Spake		Date
USAID Director CRAIG G BUCK		Date

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STATUS AND QUALITY OF BF PORTFOLIO

Ljubljanska Banka (LB) DD Sarajevo produced six loans for the BF program Two of the six loans are over sixty days overdue for an overdue ratio of 31% based on total balance due

A recently completed evaluation of the loan portfolio and loan ratings resulted in the following

- 2 downgrades from 5 to 6 on loans totaling 1,970,000DM
- 1 downgrade from a 6 to a 7 on a loan totaling 620,000DM
- 1 downgrade from a 6 to an 8 on a loan totaling 1,000,000DM

The resulting loan rating dispersion was as follows

RATING	# OF LOANS	AMOUNT
5	1	1,103,000DM
6	3	2,420,000DM
7	1	620,000DM
8	1	1,000,000DM

The overdue status of the LB originated loans is typical for BF program loans, however, the recent loan review of this portfolio indicated a decline in the quality of these loans If LB is accepted for continuing in the BF lending program, rigorous underwriting standards will have to be followed prior to the approval of any loans

QUALITY OF BF ORIGINATION

Based on discussions with the BF Lending Associate and Audit Staff applications and loan files are considered acceptable in quality

COMPLIANCE WITH BF CLOSING REQUIREMENTS

There were no loan documentation exceptions listed on BF loans initiated by LB, however, the credit report by BF Audit indicated that site visits should continue to verify the existence of the collateral and that additional collateral should be sought as part of a loan restructure being considered by BF The Lending Associates characterized the Bank as being very compliant with closing procedures

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

Discussions with the BF Lending Associates and BF Audit indicated good performance in this area

COMPLIANCE WITH BF MONITORING REQUIREMENTS

Monitoring reports are generally very good quality per the Lending Associate

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

BF Operations voiced no concerns over the repayment performance of this Bank

PROJECTED LOAN VOLUME

LB projects that they will be able to generate 30 new loans for 10,000,000DM from September 1998 to August 1999 For the same period in 1999 to 2000 they project 50 loans for 20,000,000DM Management indicated they had experienced staffing resources available to meet these levels of projected loan volume Management's commitment to the BF program is strong as the Bank is severely illiquid and the BF program is seen as a way of generating fee income and continuing to offer loans to customers

QUALITY AND SUFFICIENCY OF STAFF

Overview and staffing

Three lenders and one support staff work on the BF credits Additional staff are available as many of the Bank's employees are relatively idle The General Director noted the Bank is keeping these employees in hopes that once the branch system is reconstructed they can all be put back to work

Senior Management

Meetings with the General Director and key members of executive and senior management were held as part of the due diligence process Management attending meetings

NAME	TITLE/POSITION
Camil Bavcic	General Director
Anisa Masic	Director's Counselor
Fatime Tvico	Director – Funds and Investments
Azra Jazic	Chief of Department for Long Term Loans

Management appeared knowledgeable in all aspects of banking

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

LB's financial statements showed total assets adjusted for claims for frozen foreign exchange deposits of 16,688,000DM as of June 30, 1998, a decrease of 334,000DM from the December 31, 1997 total Domestic deposits decreased 2,373,000DM during the same period Foreign deposits increased 120,000DM Foreign assets of 663,000DM are severely deficient to meet foreign liabilities of 11,018,000DM Fixed assets include the value of defunct branches that the Bank hopes to reopen in Gorazde, Bugojno, Cazin, Mostar, and Citluk Deducting fixed asset values from capital would significantly reduce total capital The deduction of fixed asset values coupled with the likelihood that the Bank will not collect any funds from frozen foreign exchange deposits results in insolvency for the Bank Loans to deposits are 178% at May 31, 1998 and indicate an illiquid condition at LB Liquid assets were 4 4% and also signaled liquidity problems Off balance sheet liabilities were 4,500,000DM with most covered by cash offsets

LB was founded as a branch of Kreditna Banka Ljubljana of Slovenia in 1970 In 1975 it became a branch of Ljubljanska Banka of Slovenia The Bank is attempting to benefit from its historical connection with Slovenia by pursuing a possible affiliation with a Slovene bank

Net income for the year ended December 31, 1997 was 52,000DM Internal profit and loss data for the period ending June 30,1998 indicated a profit of 68,000DM pre tax Problem loans per the Bank's Agent Bank Application were 621,000DM at June 1998 These figures are unaudited and we did not have the benefit of reviewing the FBA report on this Bank due to confidentiality reasons

Based on discussions with management the Bank's computer systems need upgrading Management is planning to upgrade its systems Standard password access to systems is used

Loan officers do not have lending limits, except small loans of 3,000DM may be made with subsequent approval of the loan committee

OWNERSHIP

The Bank is a state owned enterprise and is awaiting final instructions from the FBA and Ministry of Finance prior to beginning privatization efforts The Bank hopes to revitalize the Bank through an infusion of capital by privatization or an affiliation with a Slovene bank

AGENT BANK RECOMENDATION

BANK	MARKET BANKA DD SARAJEVO
US SFOR (Y/N)	Y
CANTONS	SARAJEVO AND PODRINE-DOBOJ
MUNICIPALITY	SARAJEVO, TUZLA, VISOKO, MOSTAR,GORAZDA AND BIHAC
HEADQUARTERS	SARAJEVO

Date	14 Aug 98	**AB Rec #**	16
Ownership (%)			
Private	100%	**State**	
Existing Agency Agreement?			
Yes	X	**No**	

Number of Outstanding BF Loans	20	**BF Market Coverage Geographic**	Sarajevo and Tuzla
Balance on Outstanding BF Loans	14 983 553DM as of 7 31 98		
Range of Loan Size	233 000 dDM- 3 000 000 DM		
Number of Loans 60+days past due	5		
Balance on Loans 60+days past due	3 904 739DM		

Owners holding more than 10 percent of the bank and percentage ownership	1 EBRD 2 FUTURA INVESTMENT LTD 3 SOROS ECONOMIC DEVELOPMENT FUND 4 5	1 18 5% 2 18 5% 3 16 5% 4 5

RECOMMENDATION SUMMARY

Market Banka is a privately owned bank headquartered in Sarajevo The bank was founded in 1992 and began operations in 1993 The bank has 5 branches in the following towns Gorazda Visoko Tuzla Mostar and Bihac

The bank has three major shareholders that control 53 5% of the bank These shareholders are not citizens or companies of BiH This control technically violates USAID policies In conjunction with these major shareholders the bank has entered into a twinning arrangement with Bank of Ireland and Glendale Consulting LTD to provide technical assistance to the bank The consultants along with management have developed and are implementing a comprehensive strategic business plan The major thrust of the plan will be fully implemented by the end of 1998

The financial condition of the bank is satisfactory The bank s capital including reserves is 24 73% of total assets The major shareholders have shown a strong financial commitment to the bank The earnings trend for the bank is positive Based on the six months financials provided by management earnings have increased 34% This includes a charge for loan losses of 2 499 000 DM in the first six months Without this charge earnings would have been significantly higher This provisioning is in full compliance with the provisioning rules laid down by FBA The delinquency rate as of June 30 1998 was 10% The loan loss allowance to total loans was 15 63% The bank has been able to effectively control its expenses and has increased its efficiency ratio from 62 96% to 50 17% for the six-month period ending June 30 1998 This is a very positive trend

Based on the Market Banka s performance in the BF lending program and the Bank s commitment to generating further loans continued participation in the USAID Business Finance program is recommended with conditions

Recommended Restrictions on Participation

Ownership of the bank exceeds the 50% citizen or company of BiH USAID policy requirement USAID should allow this exception explicitly

Bank Selection Team Member Thomas Chmelik		**Date** 14 Aug 98
BF Chief of Party Bruce Spake		**Date** 14 Aug 98
USAID Director CRAIG G BUCK		**Date**

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STATUS AND QUALITY OF BF PORTFOLIO

Market Banka (MB) DD was one of the first participants in the BF program and has produced a large volume of loans MB had twenty (20) loans active in July 1998 for a total of 14,984,000DM MB had five (5) loans that total 3,905,000DM which were 60 or more days delinquent as of 7-22-98 This is a 26% delinquency ratio based on the total volume of loans

A recently completed evaluation of the loan portfolio and loan ratings resulted in the following

- 1 downgrade from 4 to 8 on a loan totaling 748,000DM
- 3 downgrades from 5 to 6 on a loan totaling 2,460,000DM
- 2 downgrades from 6 to 7 on loans totaling 1,500,000DM
- 1 downgrade from 4 to 5 on loans totaling 500,000DM
- 1 upgrade from 5 to 4 on loans totaling 300,000DM

The resulting loan rating dispersion was as follows

RATING	# OF LOANS	AMOUNT
4	6	6,069,000DM
5	4	2,900,000DM
6	7	6,116,500DM
7	2	2,500,000DM
8	1	748,000DM

The downgrade into the Loss category of "8" is not a substantial amount, but the overall downgrades do make up a significant portion of the MB portfolio MB's loan rating dispersion is typical of banks in the BF program

QUALITY OF BF ORIGINATION

Based on discussions with BF Operations and the Lending Associates, applications and loan files are considered acceptable in quality However, as new people are hired they are not properly trained and the quality of the applications has declined There is a need for additional training, which has been offered, to the MB Speed of processing applications is sometimes slow

COMPLIANCE WITH BF CLOSING REQUIREMENTS

Loan documentation exceptions on BF loans initiated by MB were minimal Loan document exceptions were usually concerning properly register mortgage liens These are reportedly being remedied

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

Discussions with BF Operations, the Lending Associates, and BF Audit revealed no significant concerns Disbursements are made in a timely fashion and given the financial condition and liquidity condition of the bank there is no need for concern

COMPLIANCE WITH BF MONITORING REQUIREMENTS

The overall quality of the monitoring reports is below average MB has dedicated the required number of staff for the program They are going to make an additional commitment of personal to the program and have request in house training at BF to ensure full compliance as they grow their BF portfolio Typical of most monitoring reports created by the Agent Banks, true analysis is sometimes lacking MB staff needs additional training and they should be able to overcome this shortfall

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

BF operations voiced no concerns over the repayment performance of this bank The bank has sufficient liquid resources and does not need to hold BF's funds

PROJECTED LOAN VOLUME

MB projects that they will be able to generate 15 new loans for 7,500,000DM from September 1998 to August 1999 For the same period in 1999 to 2000 they project 20 loans for 12,000,000DM Management indicated they would provide staffing resources and the training necessary to achieve these levels of projected loan volume

QUALITY AND SUFFICIENCY OF STAFF

Overview and staffing

Seven (7) staff members are dedicated to support of the BF Lending program – Five lenders and two support staff MB plans to increase this to 10 after the reorganization in September

Senior Management

Two meetings were held with the Executive Manager and the Deputy Manager as part of the due diligence process Management attending meetings

NAME	TITLE/POSITION
Dino Osmanbegovic	Executive Manager
Munir Cengic	Deputy Management

Management was very committed to continuing with the BF program Management appeared knowledgeable of the program and would like to see the scope of loans increased to include more of the service sector

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

MB's financial statements showed total assets of 75,789,000DM as of June 30, 1998, an increase of 9,417,000DM from the December 31, 1997 Deposits increased 6,513,000DM during the same period, however, loans to deposits increased to 111 92% Because of the MB's large capital base they are able to work with this high level Cash to total assets was 23 22% as of June 30, 1998 MB is very mindful that it cannot continue to grow its loan portfolio without growing its deposit base Off balance sheet liabilities were negligible

Net income for the year ended December 31, 1997 was 724,000DM Deloitte Touche has audited these numbers Internal profit and loss data for the period ending June 30,1998 indicated a net profit of 486,000DM The Bank's capital including reserves has increased from December 1997 to June 1998 by 3,428,000DM to a total of 18,744,000DM The total capital to assets ratio, including reserves was 24 73% as of June 30, 1998 Problem loans per the Bank's Agent Bank Application were 5,358,000DM at June 30, 1998 The loans loss coverage to problem loans was 155%

Based on discussions with management and consultants the Bank's computer system is being developed at this time The general ledger and accounting module are up and running at this time They believed they would have the loan and deposit modules fully operating by December 1998 The goal is to have the system fully integrated and all branches connected to the head office The core system and equipment is Year 2000 compatible Management is making additional changes to upgrade its systems and provide better financial reporting Technical assistance is in place to achieve these goals Standard password access to systems is used

Branch managers have lending limits up to 20,000 DM All other loans are brought to loan committee at head office for approval Senior Loan officers have similar lending limits as the branches managers Most of the loans are approved at the main office of the Bank located in Sarajevo

OWNERSHIP

Foreign entities own 53 5% of the shares in the bank as follows

EBRD	18 5%
Futura Investment LTD	18 5%
Soros Economic Development Fund	16 5%

This foreign ownership technically violates USAID policy on foreign ownership However, the ownership of EBRD could be considered an exceptional case in the redevelopment of BiH This must be clarified with USAID, as to whether this ownership is considered foreign or not

MO BANKA D.D. MOSTAR

21 August 1998

Kurtovic Zijadeta
Director
Mo Banka D D Mostar
Mala Tepa Street No 28
Mostar 88000

Re Application for USAID Business Finance program

Dear Mr Zijadeta

We regret to inform you that Mo Banka's application for participation in the USAID Business Finance program has been declined pending the opening of the Mostar area to USAID assistance Your interest in the Business Finance program is appreciated

When the Mostar area is opened to the Business Finance program, we hope you will resubmit an application for consideration

Sincerely,

AGENT BANK RECOMMENDATION

BANK	POSTBANK BH DOO SARAJEVO
US SFOR (Y/N)	Y (BRANCHES)
CANTONS	MULTIPLE
MUNICIPALITIES	MULTIPLE
HEADQUARTERS	SARAJEVO

Date	14 Aug 98	**AB Rec #**	18
Ownership (%)			
Private		**State**	100%
Existing Agency Agreement?			
Yes		**No**	X

Number of Outstanding BF Loans	0	**BF Market Coverage —Geographic**	Bosniac areas of Federation
Balance on Outstanding BF Loans	0		
Range of Loan Sizes	N/A		
Number of Loans 60+days past due	0		
Balance on Loans 60+days past due	0		

Owners holding more than 10 percent of the bank and percentage ownership	1 MINISTRY OF FINANCE 2 3 4 5 6 7	1 100 % 2 3 4 5 6 7

RECOMMENDATION SUMMARY

Postanska Banka Bosne i Hercegovine DOO Sarajevo (PostBank BH) began operations in 1997 following its founding by JP PTT BiH the bank's 100 percent owner and provider of post and telecoms services to Bosnian citizens The bank took over DM 1 3 million in assets from a predecessor institution Postanska Stedionica but the majority of the bank s DM 27 million in assets has been created in the past year The bank is well capitalized and very liquid has an excess capacity of lenders with experience gained at other banks and is eager to become a BF Agent Bank

PostBank's strategy is to serve the retail and small business markets through a contractual relationship with PTT that permits exclusive access to PTT offices throughout BiH This strategy has yet to be implemented largely because of a pending procurement of banking software In the meantime the bank is doing standard commercial lending on a conservative basis generating a portfolio that is small but of good quality PostBank is also a significant lender to a handful of other BF Agent Banks

The bank s relationship with PTT has been troubled Even after the transfer of PTT shares to the Ministry of Finance PTT managers serving on the Board continue to exert heavy influence on the bank s operations and strategic direction The Board is excluded from credit decisions however and PostBank credit staff appear competent and impartial

Given the bank's capacities and market coverage, approval of PostBank is recommended

Recommended Restrictions on Participation

PTT s continued exclusion from credit decisions should be monitored through periodic discussions with management and lending officers

Bank Selection Team Member Zan Northrip		**Date** 14 Aug 98
BF Chief of Party Bruce Spake		**Date** 14 Aug 98
USAID Director CRAIG G BUCK		**Date**

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STATUS AND QUALITY OF BF PORTFOLIO

Not applicable The bank is applying for a BF Agency Agreement for the first time

QUALITY OF BF ORIGINATION

Not applicable The bank is applying for a BF Agency Agreement for the first time

COMPLIANCE WITH BF CLOSING REQUIREMENTS

Not applicable The bank is applying for a BF Agency Agreement for the first time

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

Not applicable The bank is applying for a BF Agency Agreement for the first time

COMPLIANCE WITH BF MONITORING REQUIREMENTS

Not applicable The bank is applying for a BF Agency Agreement for the first time

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

Not applicable The bank is applying for a BF Agency Agreement for the first time

PROJECTED LOAN VOLUME

The bank's projections for loan recommendations to BF are unrealistically large However, PostBank BH has distinct market and structural advantages that could make it an important source of BF deal flow, particularly in small credits First, the bank's contract with PTT gives it an omnipresent distribution network with unique access to retail and small-business users Second, the bank is presently managing a very small loan portfolio and has excess Loan Officer capacity that could be tapped by BF

QUALITY AND SUFFICIENCY OF STAFF

Overview and Staffing

All credits are handled by the bank's headquarters, which is staffed with four Loan Officers With a loan portfolio of DM 5 1 million, there is significant excess capacity that could be tapped by the BF program As the bank is new, most staff have been with PostBank for less than one year, but three of the lending officers have 14-15 years of experience at other financial institutions Additionally, staff members have attended several BF training seminars

Senior Management

Meetings were held with the following individuals

NAME	TITLE/POSITION
Enver Ibragic	General Director
Nadza Muharemovic	Director, Accounting
Kimeta Avdagic	Loan Officer
Not recorded	Director, Operations

The General Director has little experience in banking, all of it acquired in his 1 5 years with PostBank He previously worked for the Ministry of Finance and the PTT The director of accounting has long experience, but is also relatively new to banking The bank's credit and forex staff and managers have significantly more banking experience than PostBank's senior management

The bank's assembly and board exert heavy influence on strategic and operating issues, including decisions surrounding the bank's privatization The Board sometimes announces decisions without prior consultation with management Comments made by the bank director suggest that he may have little more than ceremonial authority at the bank

Credit decisions are made exclusively by the bank's Credit Committee, with no Board involvement While the General Director is the President of the Credit Committee, he follows the recommendations of his Lending Officers who appear to be competent underwriters The bank is one of few active lenders to other financial institutions, and the lending officer interviewed discussed clearly the issues she analyzes prior to extending short-term loans to Bosnian banks The bank presented copies of its loan recommendations and credit files

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

PostBank is a young bank poised for significant portfolio growth Total assets are 27 million, including DM10 8 million in domestic cash and cash equivalents, DM 10 6 million in foreign bank deposits, and DM 5 1 million in loans These assets are supported largely by DM 22 million in deposits, a figure that has increased 50 percent since December 1997 Total bank capital stands at DM 4 6 million, or 17 percent of total assets and 90 percent of loans Capital less provisions is DM 3 6 million Given the bank's high liquidity, it would greatly benefit from a treasury policy that maximized returns on its cash and cash equivalents

The bank is one of few that appears to be realizing the interest rates it charges its customers 1997 interest income was DM 1 1 million on a small average portfolio Non-interest income provided 38 percent of revenues Expenses are high, but not unusual for a start-up bank building capacity for future growth The bank's efficiency ratio is 87 percent

Pending full implementation of the bank's retail strategy, PostBank has adopted a very conservative approach to commercial lending The bank lends primarily to the Pension

Insurance Fund, typically on 10-day terms with rates equivalent to 2 2 percent per month The bank is also lending to selected commercial banks, at 2-3 percent per month, following specific policies that have forced the bank to drop some institutions as their financial conditions deteriorated The bank had about DM 1 million outstanding to other BF Agent Banks at the time of the on-site review

The bank inherited DM 1 4 million of its present loans from a predecessor bank, Postanska Stedionica These loans are all delinquent The largest is a credit of DM400,000, and PostBank's special assets officer is negotiating with this borrower—an equipment supplier—to resolve his debts through barter The bank reports that all of the loans originated by PostBank itself were classified as A or B on the official A through E scale

The bank's retail strategy has not yet been implemented partly because the procurement of a retail banking information system is not yet completed Presently, the bank uses a Siemens server and a 20-PC LAN in its headquarters, through which internal financial reports are generated on a regular schedule for the bank's management and board (The bank is presently deciding between bids from Deloitte & Touche and Price Waterhouse Coopers for an external audit of its year-end 1997 and June 1998 financials)

When the retail network is launched, the bank plans to have direct on-line transactions in the largest PTT offices (two in Sarajevo, and one each in other large towns) Other markets would be covered by regional on-line centers into which the smallest PTT offices would report Two software providers are in the best-and-final-offer stage, and the bank expects the system to be rolled out to the largest PTT offices by the end of the year

OWNERSHIP

The bank's one shareholder, JP PTT BiH, recently transferred its shares to the Ministry of Finance, in accordance with the law on privatization Despite the transfer of shares, PTT continues to exert heavy influence on the bank The Ministry of Finance recently placed two more PTT managers on the bank's board of directors, a development that occurred without the prior knowledge of bank management

According to bank management, the FBA examination revealed interest-free loans the bank had been obliged to make to PTT Similarly, PTT had pressured the bank to extend guarantees without paying customary fees or providing security The PTT loans were called following the examination, and there is no longer a credit relationship between PTT and PostBank PTT continues to keep large deposits at the bank

Given the tensions that have arisen in the PTT—PostBank relationship, management is eager for the bank to be privatized From management's perspective, the relationship with PTT must be maintained, but should be limited to minority ownership ("ideally 20 percent") and the existing contract in which PostBank has access to PTT offices and the services of PTT staff, in exchange for fees Management would like to see other shareholders control 80 percent of the bank However, management is largely excluded from privatization decision making Such decisions are controlled by the Board, on which PTT managers continue to form an overwhelming majority

AGENT BANK RECOMMENDATION

BANK	PRIVREDNA BANKA BIHAC DD
US SFOR (Y/N)	N
CANTONS	UNA SANA
MUNICIPALITIES	BIHAC
HEADQUARTERS	BIHAC

Date	14 Aug 98	**AB Rec #**	21
Ownership (%)			
Private	10 %	**State**	90 %
Existing Agency Agreement?			
Yes	X	**No**	

Number of Outstanding BF Loans	0	**BF Market Coverage —Geographic**	Una Sana canton (7 branches)
Balance on Outstanding BF Loans	0		
Range of Loan Sizes	N/A		
Number of Loans 60+days past due	0		
Balance on Loans 60+days past due	0		

Owners holding more than 10 percent of the bank and percentage ownership	1 MINISTRY OF FINANCE 2 3 4 5 6 7	1 90 % 2 3 4 5 6 7

RECOMMENDATION SUMMARY

Privredna Banka Bihac was founded in 1957 and joined the Privredna system as a branch in 1971 The bank has operated independently of Privredna/Sarajevo since 1992 The bank has 8 branches in the Una Sana canton but no operations or clients outside the canton

Una Sana canton is not eligible for USAID assistance The bank has no active loans in the BF program but remains eager to act as a BF agent Seven credit applications from Una Sana businesses have been submitted by the bank and rejected by BF because of the locations of the applicants Privredna Bihac staff participate actively in BF training seminars

Privredna/Bihac took few assets and liabilities in its split from Privredna/Sarajevo so the balance sheet is small The bank reports assets—after removal of frozen deposits—of approximately DM 20 4 million of which the loan portfolio is DM 16 2 million An adequate examination of loan quality is beyond the scope of this review Cash and equivalents are approximately 5 percent of total assets which are supported by a reported DM 9 8 million in capital

The bank systems and staff are adequate to service BF loans The application of Privredna Bihac is recommended for approval as the bank s agency will speed the start up of USAID assistance, if and when it is extended to Una Sana

Recommended Restrictions on Participation

No lending in Una Sana without explicit USAID approval

Bank Selection Team Member Zan Northrip		**Date** 14 Aug 98
BF Chief of Party Bruce Spake		**Date** 14 Aug 98
USAID Director CRAIG G BUCK		**Date**

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STATUS AND QUALITY OF BF PORTFOLIO

Not applicable BF has recommended no loans from Privredna Bihac, because companies based in the bank's geographic market are not eligible for USAID assistance

QUALITY OF BF ORIGINATION

Not applicable BF has recommended no loans from Privredna Bihac, because companies based in the bank's geographic market are not eligible for USAID assistance

COMPLIANCE WITH BF CLOSING REQUIREMENTS

Not applicable BF has recommended no loans from Privredna Bihac, because companies based in the bank's geographic market are not eligible for USAID assistance

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

Not applicable BF has recommended no loans from Privredna Bihac, because companies based in the bank's geographic market are not eligible for USAID assistance

COMPLIANCE WITH BF MONITORING REQUIREMENTS

Not applicable BF has recommended no loans from Privredna Bihac, because companies based in the bank's geographic market are not eligible for USAID assistance

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

Not applicable BF has recommended no loans from Privredna Bihac, because companies based in the bank's geographic market are not eligible for USAID assistance

PROJECTED LOAN VOLUME

If Una Sana canton is made eligible for BF lending, the bank estimates it could produce DM 8 million in bankable recommendations in its first year as a BF agent, primarily in smaller credits Management indicated it would provide the necessary staff and training to support this level of lending and servicing Subsequently, the bank anticipates the ability to produce DM 12 million per year in bankable recommendations

QUALITY AND SUFFICIENCY OF STAFF

Overview and Staffing

Initially, in addition to senior management, 3 staff members would be devoted to the BF program The head of the long-term loan department attended the on-site review meeting and appeared knowledgeable of the standards and criteria for BF lending He and two of his lending officers have attended a number of BF training sessions

Though the staff have no hands-on experience with BF credits, they have managed a number of loans funded through other credit programs The bank has 13 PCU loans for a total of DM 2 6 million, 25 TAC loans for a total of DM 4 2 million, and 2 GTZ-funded loans for a total of DM 200,000

Senior Management

The General Director was traveling at the time of the on-site review, but meetings were held with the following individuals

NAME	TITLE/POSITION
Sakib Hadzic	Deputy General Director
Muhamed Talakic	Assistant General Director (Finance)
Asim Salihodzic	Manager, Long-Term Lending
Not recorded	Manager, Information Technology

The senior management have substantial banking experience, all of it with Privredna Bihac Staff in the credit department are less experienced, due to a management decision to hire (and train) recent University graduates, as opposed to individuals with past experience in lending to state-owned companies The managers explained clearly the bank's financial situation and plans for privatization

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

Privredna/Bihac took few assets and liabilities in its split from Privredna/Sarajevo, so the balance sheet is small The bank reports assets—after removal of frozen deposits—of approximately DM 20 4 million, of which the loan portfolio is DM 16 2 million Cash and equivalents are approximately 5 percent of total assets, which are supported by a reported DM 9 8 million in capital

Most of the bank's deposits come from government sources Since the separation, the bank has attracted over 3,000 household deposits, but these amount to little more than DM 1 million Additionally, the bank has access to a small revolving credit line from an Italian correspondent bank

Given the scarcity of liability funding, the bank is pursuing a plan to attract an additional DM 6 million in capital from a variety of private companies in the canton The bank also reports potential investments from Bosnian citizens resident in Austria, Italy, and Turkey, and from a company in Germany The bank's strategy in its capitalization and privatization plans, however, is to prevent the control of more than 15% of the bank by any one shareholder

An adequate examination of loan quality is beyond the scope of this review No earning assets were created earlier than 1995, as the bank took no loans in its separation from Privredna/Sarajevo, and pursued only service-fee business during the war The bank reports an 11% delinquency rate This calculation is based on payments more than 90 days past due, but only the past-due portion of loan balances is included in the ratio This suggests the capital base would shrink substantially if appropriate writeoffs were taken The portfolio is extended primarily to trade, wholesale, retail, manufacturing, and wood processing firms Most credits are 30-90 days, and 59% of the portfolio by value is in loans to state-owned firms

Branch operations are restricted to consumer deposit/withdrawal transactions, marketing, and assistance to headquarters in relationship management All credit decisions are made at headquarters The bank's only involvement in consumer lending is in a low volume of commission loans

During the week of the on-site review, the bank was launching a new information system that will integrate fully its branch operations with those of headquarters The IT director was present for the on-site review and explained the new system, which is PC based and will operate over 35 continuously open lines

Financial reports are generated for (and used by) management and the Board of Directors on a fixed schedule, and as needed The bank has contracted with Price Waterhouse Coopers for an independent external audit according to IAS

OWNERSHIP

Of 151 founders, 79 were private firms Together, however, private firms represent only 10 percent of the bank's ownership Shares of the 72 state-owned firms (90 percent of the total ownership) were recently transferred to the Ministry of Finance, in accordance with the law on privatization

AGENT BANK RECOMMENDATION

BANK	PRIVEDNA BANKA AD BRCKO
US SFOR (Y/N)	Y
CANTONS	TUZLA-PODRINJE
MUNICIPALITIES	Brcko, Pelagicevo, Samac, Modrica, Bijeljina, and Srpsko Orasje
HEADQUARTERS	BRCKO

Date	14 Aug 98	**AB Rec #**	19
Ownership (%)			
Private	0%*	**State**	100%*
Existing Agency Agreement?			
Yes	X	**No**	

Number of Outstanding BF Loans	0	**BF Market Coverage Geographic**	Brcko Pelagicevo Samac Modrica, Bijeljina, and Srpsko Orasje
Balance on Outstanding BF Loans	0		
Range of Loan Sizes	0		
Number of Loans 60+days past due	0		
Balance on Loans 60+days past due	0		

Owners holding more than 10 percent of the bank and percentage ownership	1 O D P BIMEKS INTEREST OF DIRECTOR MARKOVIC	1 13 9%
	2 O D P BIMAL INTEREST OF DIRECTOR KARANOVIC	2 13 0%
	3	3
	4	4
	5	5

RECOMMENDATION SUMMARY

Based on Privedna Banka s cooperation and the Bank s commitment to generating loans continued participation in the USAID Business Finance program is recommended with conditions The Bank s liquidity is weak The Bank does not appear solvent based on a capital ratio of 7% however the financial information presented for review was unaudited and was not presented in IMF format making appropriate analysis difficult The Bank may benefit from privatization depending on how the Central Bank and the Ministry of Finance design the process Specific restrictions to safeguard BF assets are listed in the Restrictions section below

The Bank s management appears well trained knowledgeable and committed to operating a strong bank for the betterment of the community They are very aware of expense control

The Bank is located in Brcko in Northeastern BiH The trade area for this one office institution located in the center of Brcko is Brcko, Pelagicevo Samac Modrica, Bijeljina and Srpsko Orasje The Bank would like to open limited service branch offices in its trade area in the next five years

Recommended Restrictions on Participation

Adequate and audited financial information including loan quality data on the Bank s own loan portfolio should be required from this agent bank as a condition of participating in the BF program This information should be analyzed on an annual basis and continued participation in the BF program should be evaluated annually

Close monitoring of compliance with the Agency Agreement s requirement for timely forwarding of payments is recommended due to the Bank s liquidity situation This will probably require the addition of one support staff to the Tuzla office as other banks in this area may require similar coverage

Bank Selection Team Member Alfred Dostie		**Date** 14 Aug 98
BF Chief of Party Bruce Spake		**Date**
USAID Director CRAIG G BUCK		**Date**

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STATUS AND QUALITY OF BF PORTFOLIO

Privedna Banka AD Brcko (PB) is relatively new to the BF program and has three (3) loans in the pipeline None were disbursed as of August 10, 1998

QUALITY OF BF ORIGINATION

Based on discussions with the BF Lending Associate, applications and loan files are considered acceptable in quality

COMPLIANCE WITH BF CLOSING REQUIREMENTS

Not applicable

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

Not applicable No disbursements made as yet

COMPLIANCE WITH BF MONITORING REQUIREMENTS

Not applicable No loans disbursed as yet

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

Not applicable No loans disbursed as yet

PROJECTED LOAN VOLUME

PB projects that they will be able to generate 30 new loans for 5,000,000DM from September 1998 to August 1999 For the same period in 1999 to 2000 they project 50 loans for 10,000,000DM These projections are based on management's knowledge of the loan demand in their trade area and indications they have received that BF is launching a small loan program Management indicated they would provide staffing resources and the training necessary to achieve these levels of projected loan volume

QUALITY AND SUFFICIENCY OF STAFF

Overview and staffing

The bank has thirty-seven (37) employees Four (4) staff members are involved in the BF Lending program – one lender and three support staff who work part time on the BF program This appears sufficient for current and near term projected volumes of activity

Senior Management

Meetings with the General Director and key members of executive and senior management were held as part of the due diligence process Management attending meetings

NAME	TITLE/POSITION
Nada Pavlovic	Director
Solaja Novak	Member of the Board of Directors
Jelka Antic	Chief of Investment Sector
Gordana Kosutic	Director of Legal Operations
Zivkovic Miodrag	Loan Officer

Management was very committed to continuing with the BF program Management appeared knowledgeable in banking and in lending Ms Pavlovic directed the meeting, however, most persons attending contributed to the discussions

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

PB did not provide financial information in IMF format nor were audited financials available Internal financial information as of June 30, 1998 showed a marked increase in total assets from 261,514,000Din as of December 31, 1997 Total assets were 485,068,000 on June 30, 1998 Capital increased from 2,742,100Din at December 31, 1997 to 3,419,400Din Net profit after taxes was 23,401Din for the year ended 1997 and 7,082 Din for the period ending June 30,1998 The Bank is probably insolvent with a 70% total capital ratio

Based on discussions and a physical review of the Bank's computer resources the current system is considered outdated The core system and equipment is not Year 2000 compatible Management is making changes to upgrade its systems and provide better financial reporting Password access to systems is used

Loan officers do not have lending limits All loans are presented to and approved in a committee setting Problem loans are reviewed by the Bank's counsel and the loan committee for appropriate action

The Bank operates out of one office located at Kralja Petra Prvog Oslobodioca 1 in the center of Brcko The Bank's trade area includes Brcko, Pelagicevo, Samac, Modrica, Bijeljina, and Srpsko Orasje Limited service branch offices are planned for the future in these areas

OWNERSHIP

The Bank's stockholder companies are State owned at this time They are awaiting privatization

AGENT BANK RECOMMENDATION

BANK	PRIVREDNA BANKA DD SARAJEVO
US SFOR (Y/N)	Y
CANTONS	SARAJEVO
CITY	SARAJEVO
MUNICIPALITY	SARAJEVO

Date	14 Aug 98	**AB Rec #**	22
Ownership (%)			
Private	0%	**State**	100%
Existing Agency Agreement?			
Yes	Yes	**No**	

Number of Outstanding BF Loans	9	**BF Market Coverage —Geographic**	Sarajevo and Bugojno
Balance on Outstanding BF Loans	4 603 000 DM		
Range of Loan Size	195 000 DM to 1 000 000 DM		
Number of Loans 60+days past due	5 (to four borrowers)		
Balance on Loans 60+days past due	2 839 000 DM		

Owners holding more than 10 percent of the bank and percentage ownership	1 MINISTRY OF FINANCE	1 100%
	2	2
	3	3
	4	4
	5	5
	6	6

RECOMMENDATION SUMMARY Formerly the largest bank in Bosnia Privredna Banka (PB) was divided geographically into several state owned institutions following the war This recommendation concerns Privredna/Sarajevo and its one remaining integrated branch Privredna/Bugojno Deal flow from Privredna has slowed since project inception Seven of the bank's 9 BF loans were disbursed over a year ago However the bank's tenth loan has been approved and is presently awaiting disbursement Five of Privredna s early BF loans to four state owned firms are troubled Three more recent loans are to private firms and are already repaying principal Of these two are current and one is 60 days past due In general BF staff believes Privredna is too lenient on its state-owned borrowers, placing a greater value on keeping its traditional clients afloat than on ensuring the quality of BF assets In some cases the bank has failed to disclose fully what it knows about the condition of BF state-owned borrowers However no such reports exist with respect to the private clients Privredna has recommended Compliance with BF procedures has been adequate despite the bank s lack of liquidity there are no reported cases of Privredna s mishandling BF disbursements or repayments Management appears competent and the bank s knowledge of accounting procedures is superior to that of most banks evaluated Though skills in credit analysis are deficient the bank s staff is experienced in banking procedures and is adequate in number to manage Privredna s BF portfolio Privredna is financially stretched and faces numerous structural issues including both the unresolved distribution of liabilities to the independent Privredna s and an uncertain outcome from privatization Given the ability to protect undisbursed funds in a trustee account, the bank's history of compliance with repayment procedures the improving quality of its recommendations, and the critical access the bank provides BF to the Bugojno market continued BF agency is recommended

Recommended Restrictions on Participation Require use of trustee account for future disbursements Offer in-house training in BF credit application and analysis Exclude from recommending state owned clients or evaluate such recommendations with extra care even if the USAID restriction on such borrowers is lifted

Bank Selection Team Member Thomas Chmelik		Date 14 Aug 98
BF Chief of Party Bruce Spake		Date 14 Aug 98
USAID Director CRAIG G BUCK		Date

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STATUS AND QUALITY OF BF PORTFOLIO

As of July 1998 PB has done nine (9) loans totaling 4,603,000 DM PB has five (5) loans that totaled 2,839,000 DM that were more than 60 days delinquent as of 7-22-98 This is a 60 86% delinquency ratio based on the total volume of loans

A recently completed evaluation of the loan portfolio and loan ratings resulted in the following

- 2 downgraded from 6 to 8 on loans totaling 990,600DM
- 1 downgrade from 7 to 8 on a loan totaling 956,000DM
- 1 downgrade from 6 to 7 on a loan totaling 1,000,000DM

Of the remaining 5 loans 3 were classified as 6 and 2 were classified as 5

The resulting loan rating dispersion was as follows

RATING	#OF LOANS	AMOUNT
5	2	1,330,000DM
6	3	950,000DM
7	1	1,000,000DM
8	3	1,946,600DM

The Downgrade into the Loss category of "8" is a substantial amount The overall quality of the portfolio is poor at best Given the current delinquency rate the entire portfolio could be classified an "8"

QUALITY OF BF ORIGINATION

Based on discussions with BF Lending Associates, applications and loan files are considered acceptable However, the lending associates felt the bank does not a very good job with the analysis Their customers have outsiders to the business plans The speed of processing applications is sometimes slow

COMPLIANCE WITH BF CLOSING REQUIREMENTS

Loan documentation exceptions on BF loans initiated by PB were minimal Any issues with closing have been rectified

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

Discussions with BF operations, the Lending Associates and BF Audit revealed no significant concerns Disbursements are made in a timely fashion However, given the financial condition of the bank BF needs to monitor this very closely There are concerns that PB could be liquidated

COMPLIANCE WITH BF MONITORING REQUIREMENTS

Based on a review of the grades given for monitoring reports the overall quality of them is average The bank does not do a good job when analyzing the loans on a quarterly basis Additional training in this area is needed

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

BF operations voiced no concerns over the repayment performance of the bank Despite the financial position of the bank, customer payments are remitted in a timely fashion

PROJECTED LOAN VOLUME

PB projects that they will be able to generate 4 new loans for 2,500,000DM from September 1998 to August 1999 For the same period in 1999 to 2000 they project 5 loans for 3,500,000DM

QUALITY AND SUFFICIENCY OF STAFF

Overview and Staffing

Four (4) staff members are dedicated to support the BF Lending Program – Two (2) lenders and two (2) support staff

Senior Management

A meeting with the Executive Director and key members of senior management were held as part of the due diligence process Management attending meetings

NAME	TITLE /POSITION
Dorde Zaric	Deputy General Manager
Salihovic Ferid	Executive Manager for EDP and MIS
Samir Lacevic	Assistant Executive Manager International Div

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

An external-auditing firm has not audited the books of the bank They believe that the financial statements conform to International Accounting Standards (IAS) They were examined by the Federal Banking Agency in 1997 and agreed with their findings Management is working on the issues that were brought to their attention The bank does have a separate internal audit function and prepares reports to the Board of Directors on a regular basis

The financial statements show total assets of 400,853,000DM as June 30, 1998, a decrease of 8,761,000DM from December 1997 Included in total assets are frozen deposits of 49,834,000DM The corresponding assets are funds frozen at the Central Bank of 51,362,000DM When these are resolved the bank will have to absorb a loss of 1,528,000DM Also, included in total assets are loans made to state owned enterprises that were funded with loans from the government It is proposed that 63% of these loans and their correspondent liability be written off After making these appropriate adjustments the total Assets of the bank are 195,973,000DM

The loan portfolio has decreased 9,475,000DM for the six-month period ending June 30, 1998 The majority of this decrease is from short-term loans The bank has been actively trying to collect bad loans The loan loss provision to total loan, excluding those funded by the government was 18 69% The delinquency ratio as of June 30, 1997 was approximately 30% Considering the delinquency rate the allowance for total loans is not adequate at this time

Deposits have decreased 5,545,000DM during the six-month period ending June 30, 1998 The loan to deposit ratio, excluding long term loans to state enterprises funded by the government loan and frozen deposits, is 64%

Cash, including foreign assets, to total assets is 13 75% Management is mindful of the liquidity position and monitors it on daily basis

The bank's capital including reserves to is 46,399,000DM as of June 30, 1998 The capital net of reserves to total adjusted assets is 19 06% Even with an additional write – down of assets the capital levels for the bank is adequate

Net income for the year ending December 31, 1997 was 1,205,000DM Internal profit and loss data for the period ending June 30, 1998 indicated net profit of 516,000DM The bank's efficiency ratio has declined from 80 40% to 81 78% for the six month period under review Management is being cautious with the expense of the bank They are looking at ways to cut additional expense The bank is planning to retrench approximately 100 employees or 34% of the work force This process should be completed by December 1998

Based on discussions with management the bank has all systems computerized However, the systems are not networked This is a project that will be undertaken in the next 12 months The security on the system is multi-level and passwords are required for all employees

Loan officers do not have lending limits All loans are presented to approved by the loan committee Also, loan originating from the branch must come to the head office for approval

OWNERSHIP

Privredna Bank Sarajevo is 100% controlled by the State All shares have been transferred to the Ministry of Finance

USAID/BUSINESS FINANCE

AGENT BANK RECOMMENDATION

BANK	PRIVREDNA BANKA DD TRAVNIK
US SFOR (Y/N)	N
CANTONS	SREDNJOBOSANSKI
MUNICIPALITIES	TRAVNIK
HEADQUARTERS	TRAVNIK

Date	14 Aug 98	**AB Rec #**	20
Ownership (%)			
Private	37%	**State**	63%
Existing Agency Agreement?			
Yes	X	**No**	

Number of Outstanding BF Loans	1	**BF Market Coverage Geographic**	Travnik Bugojno Gornji Vakuf Donji Vakuf Vitez, Novi Travnik Busovaca, Fojnica and Zenica
Balance on Outstanding BF Loans	1 711 000DM		
Range of Loan Sizes	711 000 DM to 1 000 000 DM		
Number of Loans 60+days past due	0		
Balance on Loans 60+days past due	0		

Owners holding more than 10 percent of the bank and percentage ownership	1 MINISTRY OF FINANCE 2 3 4	1 63% 2 3 4

RECOMMENDATION SUMMARY

Privredna Banka's Travnik (PBT) ownership is 63% state and 37% private The bank is headquartered in Travnik The bank has 3 branches in the following towns Busovaca, Zavidovici and Zepce
The financial statements have not been audited The bank is currently in the process of selecting an auditing firm but will comply with the November 8, 1998 deadline, at which time BF could have more confidence in the financial picture of the bank However based on the information BF has at this time the financial condition of the bank is marginal

The bank has developed a privatization plan that is to be submitted to the Ministry of Finance for concurrence and approval The plan calls for a capital injection of 5 000 000 DM They do not plan to open any new branches but have two branches in Croatian Territory they plan to re-opened The bank shows a total capital position including reserves of 17,528 000 DM The amount of reserves for bad loans is 2,661 000 DM If the loan loss reserve amount is not included in the capital the capital to asset ratio is 29 12% as of June 30 1998

For the period ending December 31, 1997 the bank earned 260 000 DM Expense control must be monitored closely The bank's efficiency ratio was 85 78% for the period ending December 31 1998 This is not an acceptable ratio and the bank must take measures to reverse this trend Management did acknowledge the problem and have a plan to reduce staff by 37% The loan portfolio has decreased 1 591,000 DM or 8 25% for the six-month period under review The delinquency rate as of December 31, 1997 was 37 67% The loan loss allowance to total loans was 14 04% It appears that the bank has not adequately provided for the problem loans in the loan portfolio

Based on PBT's performance in the BF lending program, geographic location and the Bank's financial condition continued participation in the USAID Business Finance program is recommended with conditions and restrictions

Recommended Restrictions on Participation

The financial condition of PBT must be monitored on a quarterly basis PBT is to provide to BF quarterly financial statements Their participation should be on a probationary basis until such time their financial condition has improved

Bank Selection Team Member Thomas Chmelik		**Date** 14 Aug 98
BF Chief of Party Bruce Spake		**Date** 14 Aug 98
USAID Director CRAIG G BUCK		**Date**

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STATUS AND QUALITY OF BF PORTFOLIO

As of July 1998 PBT has done two (2) loans totaling 1,711,000 DM PBT has no loans that were more than 60 days delinquent as of 7-22-98

A recently completed evaluation of the loan portfolio and loan ratings resulted in the following

- 1 downgrade from 6 to 7 on a loan totaling 1,000,000DM
- 1 downgrade from 5 to 6 on a loan totaling 711,000DM

The resulting loan rating dispersion was as follows

RATING	# OF LOANS	AMOUNT
6	1	711,000DM
7	1	1,000,000DM

The downgrades to "6" and "7" are significant The overall quality of the portfolio is poor However, given the current delinquency rate it appears that most of the borrowers are able to meet the payment schedules

QUALITY OF BF ORIGINATION

Based on discussions with BF Lending Associates, applications and loan files are considered acceptable in quality Speed of processing applications is sometimes slow

COMPLIANCE WITH BF CLOSING REQUIREMENTS

Loan documentation exceptions on BF loans initiated by PBT were minimal Any issues with closing have been rectified

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

Discussions with BF Lending Associates, and BF Audit revealed no significant concerns Disbursements are made in a timely fashion and given the financial condition and liquidity condition of the bank there is no need for concern

COMPLIANCE WITH BF MONITORING REQUIREMENTS

The overall quality of the monitoring reports is generally good PBT has two loan officers who are required to prepare the monitoring reports Typical of most monitoring reports created by the Agent Banks, true analysis is sometimes lacking But with additional training they should be able to overcome this shortfall

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

BF operations voiced no concerns over the repayment performance of this bank The bank has sufficient liquid resources and does not need to hold BF's funds

PROJECTED LOAN VOLUME

PBT projects they will be able to generate 10 new loans for 3,000,000 DM from September 1998 to August 1999 For the same period in 1999 they project 10 loans for 3,000,000 DM Management has indicated they would provide staffing resources and the training necessary to achieve these levels of projected loan volume

QUALITY AND SUFFICIENCY OF STAFF

Overview and staffing

Five (5) staff members are dedicated to support of the BF Lending program – two lenders and three support staff

Senior Management

As part of our due diligence process a meeting were held with the following individuals

NAME	TITLE/POSITION
Leko Alija	General Director
Ibrisimbegovic Sead	Deputy of General Director
Zolota Izet	Director of Department for Economy
Islamovic Abdulah	Director of Accounting
Gerin Aida	Chief of Credit Department

Management was very committed to continuing with the BF program Management appeared knowledgeable of the program and was happy to see the loan size has been decreased to 30,000dm This will give it more opportunities to make loans to small businesses in Travnik

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

The bank is in the process of selecting and outside auditing firm to audit the books for 1997 and 1998

PBT's financial statements showed total assets of 49,429,000DM as of June 30, 1998 Included in these assets are frozen deposits at the National Bank of Yugoslavia (NBY) totaling 24,397,000 DM PBT has not received notification to transfer this amount However, they expect to have this amount transferred by December 1998 When transfer of such funds is complete there will be a 2,049,000-DM loss from the transaction They believe that this loss will have to taken by the bank Appropriate provisions have not been set aside for this amount The government has given no assurances that it will make up the loss

The loan portfolio decreased 1,591,000 DM during the six months ended June 30, 1998 Total deposits have decreased 1,441,000 DM during the same period The loan to deposit ratio has increased to 338 83% as of June 30, 1998 This ratio is a function of the frozen deposits and will not improve in the near future Cash to total assets, including foreign cash, was 6 68% as of June 30, 1998 However, if the asset base were adjusted for the frozen deposits the cash to asset ratio would be 13 19% PBT is very mindful that it cannot grow its loan portfolio without growing its deposit base Off balance sheet liabilities were negligible

The Bank's capital including reserves was 17,528,000 DM as June 30, 1998 The total capital to assets ratio, including reserves was 35 46% as of June 30, 1998 If PBT were to adjust for the remaining frozen deposit the capital to assets ratio would be approximately 70%

Problem loans per the Bank's Agent Bank Application were 7,265,365 DM at December 31, 1997 Which is 37 67% of total loans The loan loss allowance to total loans was 15 04% It appears the bank has not made a large enough provision If the bank has to make an additional provision this will adversely effect earnings

Net income for the year ended December 31, 1997 was 260,000 DM The bank's efficiency ratio for the period ending December 31, 1997 was 85 78% This is not a good indication of effective expense control Bank management acknowledged the situation and said that they had a business plan that included the retrenchment of 37% of the workforce

The general ledger is the only system in the bank that is currently computerized They have plans to computerize the rest of the operations but will wait until new capital is raised Branches are not online and information is received via fax or modem

All loans are brought to loan committee at head office for approval Senior Loan officers do not have lending authority The board is informed on all loans after they are made

OWNERSHIP

The state owns 63% and 37% is controlled privately Of the private ownership no one individual controls more than 10% All state owned shares have been transferred to the Ministry of Finance awaiting privatization

PROMDEI BANKA DOO SARAJEVO

21 August 1998

Ibrahim Dedic
Director
Promdei Banka DOO Sarajevo
Vladimira Skarica 8
Sarajevo

Re Application for USAID Business Finance program

Dear Mr Dedic

We did not receive Promdei Banka's application for renewal of participation in the USAID Business Finance program Accordingly, Promdei Banka's participation privileges in the program terminate as of August 21, 1998

Should you wish to be considered as an Agent Bank for the Business Finance program in the future, you will have to reapply for participation

Sincerely,

AGENT BANK RECOMMENDATION

BANK	SAHINPASIC KOMERCIJALNA BANKA DD SARAJEVO
US SFOR (Y/N)	Y and N see Cantons below
CANTONS	Sarajevo, Zenica-Doboj, Neretva, Tuzla-Podrinje, Upper Drina
MUNICIPALITIES	Sarajevo, Tuzla, Zenica, Mostar, Gorazde,
HEADQUARTERS	SARAJEVO

Date	14 Aug 98	**AB Rec #**	24
Ownership (%)			
Private	100%*	**State**	0%*
Existing Agency Agreement?			
Yes	X	**No**	

Number of Outstanding BF Loans	3	**BF Market Coverage Geographic**	Sarajevo Zenica Doboj Neretva, Tuzla Podrinje Upper Drina
Balance on Outstanding BF Loans	1 400 000DM		
Range of Loan Sizes	300 000DM to 700 000DM		
Number of Loans 60+days past due	0		
Balance on Loans 60+days past due	0		

Owners holding more than 10 percent of the bank and percentage ownership	1 AIDA (SAHINPASIC) PECAR 2 SENAD SAHINPASIC 3 ZLATKO PECAR 4 5	1 39% 2 36% 3 22 5% 4 5

RECOMMENDATION SUMMARY

Based on the Sahinpasic Komerccijalna Banka s (SKB) relative strength as a banking institution in BiH its territorial coverage throughout BiH the Sahinpasic family s financial means to support the Bank and the Bank s indication that it will generate loans continued participation in the USAID Business Finance program is recommended with conditions The Bank is illiquid and solvency will possibly have to be supported with an infusion of capital in the future Specific restrictions to safeguard BF assets are listed in the Restrictions" section below

Bank management is considered capable

The Bank has offices in Sarajevo, Tuzla Mostar, Zenica and Gorazde giving it significant coverage throughout the Federation The Bank s Main Office is located at Titova 29/I in the center of the Sarajevo business district The Bank has plans to build the largest banking facility in Sarajevo The new banking offices are being funded by a 10 000 000DM loan from Hipo Bank – Munich directly to the General Director of SKB SKB will lease the building once it is complete

Recommended Restrictions on Participation

Adequate financial information, including audited financial statements, should be required This information should be analyzed on an annual basis and continued participation in the BF program should be evaluated annually Disclosure requirements on insider loans included in the Agency Agreement should be closely monitored for compliance

Close monitoring of compliance with the Agency Agreement s requirement for timely forwarding of payments is recommended due to the Bank's liquidity situation This will probably require the addition of one support staff to the Sarajevo office as other banks in this area may require similar coverage

Bank Selection Team Member Alfred Dostie		**Date** 14 Aug 98
BF Chief of Party Bruce Spake		**Date**
USAID Director CRAIG G BUCK		**Date**

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STATUS AND QUALITY OF BF PORTFOLIO

Sahinpasic Komercijalna Banka (SKB) DD Sarajevo has produced only three (3) loans for the BF program None of the loans is overdue

A recently completed evaluation of the loan portfolio and loan ratings resulted in the following

- 2 downgrades from 5 to 6 on loans totaling 900,000DM

The resulting loan rating dispersion was as follows

RATING	# OF LOANS	DISBURSED AMOUNT
4	1	300,000DM
6	2	1,100,000DM

While two loans initiated by the Bank were downgraded, performance is typical for banks in the BF program

QUALITY OF BF ORIGINATION

Based on discussions with BF Lending Associates and Audit staff, applications and loan files are considered acceptable in quality

COMPLIANCE WITH BF CLOSING REQUIREMENTS

There were no loan documentation exceptions noted on BF loans initiated by SKB, however, a report by BF Audit regarding one loan indicated that site visits should continue to verify the existence of the collateral once the machinery is fully installed

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

Discussions with BF Lending Associates and BF Audit indicated acceptable performance in this area

COMPLIANCE WITH BF MONITORING REQUIREMENTS

Monitoring reports are generally good quality per Lending Associates

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

BF Operations voiced no concerns over the repayment performance of this bank

PROJECTED LOAN VOLUME

SKB projects that they will be able to generate 10 new loans for 6,000,000DM from September 1998 to August 1999 For the same period in 1999 to 2000 they project 15 loans for 10,000,000DM Management indicated they would provide staffing resources and the training necessary to achieve these levels of projected loan volume Management's commitment to the BF program is soft at best It appears the Bank will use the BF program only when its own resources for some customers are pressed or when particular customers need the benefit of a lower interest rate to meet cash flow projections The General Director was mildly critical of costs associated with the BF program, such as wire transfer fees for disbursements that she felt should be borne by the program She also was concerned that most of SKB's customers could not wait as long as six months for approval of credit

QUALITY AND SUFFICIENCY OF STAFF

Overview and staffing

One lender and two support staff work part time on the BF credits This is sufficient for the current volume and management stated additional staff would be provided as needed

Senior Management

Meetings with the General Director and key members of executive and senior management were held as part of the due diligence process Management attending meetings

NAME	TITLE/POSITION
Aida Pecar	General Director
Azra Coric	Director of Resources and Investments
Emina Coric	Director – Currency
Medina Imamovic	Director – Operations and retail banking
Hidajeta Sahinovic	Deputy Director- Resources and Investments
Lejla Pesto	Deputy Director – Accounting
Safeta Arnautlija	Loan officer – Administrator USAID BF loans

Management was very knowledgeable in all aspects of banking

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

SKB's financial statements showed total assets of 16,016,000DM as of June 30, 1998, an increase of 1,797,000DM from the December 31, 1997 total Domestic deposits increased 265,000DM during the same period Foreign deposits increased 2,282,000DM Foreign assets increased 2,154,000DM to 5,083,000DM The Bank has a foreign currency exposure of 2,323,000DM as liabilities exceed assets in this category Loans to domestic deposits are 113% and indicate an illiquid condition at SKB Liquid assets were 4 8% and also signaled liquidity problems Off balance sheet liabilities were 1,500,000DM with approximately 30% covered by cash offsets

The capital ratio at June 30, 1998 was 17 1% This level of capital is marginal considering the complexity of activities and exposures affecting the Bank

Although the Bank is illiquid and capital is considered marginal, the Sahinpasic family appears to be a group with substantial means to help the Bank The General Director, Aida (Sahinpasic) Pecar, obtained a 10,000,000DM loan from Hipo Bank - Munich This funding is being used to build a new main office for the Bank Mrs Pecar will lease the building to the Bank when it is completed Hipo Bank of Munich is SKB's primary corespondent SKB has a 1,000,000DM line of credit at Hipo secured by a $5,000,000 Sahinpasic family deposit at Hipo Mrs Pecar's brother is a major stockholder of the Bank and owns a series of bookstores and other businesses throughout BiH Her husband is the other major stockholder and owns and operates Bosna Leasing

Net income for the year ended December 31, 1997 was 23,000DM Internal profit and loss data for the period ending June 30,1998 indicated net profit of 56,000DM pre tax Problem loans per the Bank's Agent Bank Application were 100,000DM at June 1998 Total capital was 2,743,000DM or 17% at June, 1998 and appears sufficient to cover the Bank's recent loan write off experience and overdue loan total These figures are unaudited and we did not have the benefit of reviewing the FBA report on this Bank due to confidentiality reasons

Based on discussions with the information technology manager and a physical review of the Bank's computer center the current system is considered adequate The core software system is not Year 2000 compatible, however, the newer hardware is compliant Management is making software changes to upgrade its systems Standard password access to systems is used

Loan officers do not have lending limits All loans are approved by the General Director and subsequently ratified by the Board of Directors The Bank has a loan workout officer to whom problem loans are transferred for appropriate action Loans from the branch offices are referred to the main office for final approval

OWNERSHIP

The Bank is a closely held, family enterprise For greater detail refer to the prior section's discussion of capital adequacy

AGENT BANK RECOMMENDATION

BANK	SIPAD BANKA DD SARAJEVO
US SFOR (Y/N)	N
CANTONS	SARAJEVO
MUNICIPALITIES	Sarajevo
HEADQUARTERS	SARAJEVO

Date	14 Aug 98	**AB Rec #**	25
Ownership (%)			
Private		**State**	100%
Existing Agency Agreement?			
Yes	X	**No**	

Number of Outstanding BF Loans	0	**BF Market Coverage Geographic**	Sarajevo and all of BiH
Balance on Outstanding BF Loans	0		
Range of Loan Sizes	0		
Number of Loans 60+days past due	0		
Balance on Loans 60+days past due	0		

Owners holding more than 10 percent of the bank and percentage ownership	1 MINISTRY OF FINANCE	1 100%
	2	2
	3	3
	4	4
	5	5

RECOMMENDATION SUMMARY

Sipad Banka (SB) is a state owned bank which formerly serviced Sipad Group companies throughout Yugoslavia The Bank s expertise in lending to larger enterprises may prove useful to BF once privatization occurs and continued participation in the program is recommended on that basis The Bank appears to be in reasonable financial condition however its future is clouded by the potential effects of privatization on state owned banks

The Bank s management appears knowledgeable and committed to operating a sound bank However management is concerned that the future of the Bank is subject to forces beyond their control Management was also critical of the BF program for not lending to particular industry segments and for limiting lending to certain territory The Bank has not had a good experience with BF The only two loans submitted were denied and there appears to have been an unfortunate misunderstanding between the Bank and BF regarding areas of geographic eligibility which has left the Bank wondering about its relationship with BF

The Bank is operating throughout BiH from its on office in Sarajevo located at Trampina br 12/6 SB is located on the fifth floor of a newer buidling

Recommended Restrictions on Participation

None other than the standard conditions included in the Agency Agreement for Trustee accounts for disbursements and for submission of financial information in acceptable formats

Bank Selection Team Member Alfred Dostie		**Date** 14 Aug 98
BF Chief of Party Bruce Spake		**Date**
USAID Director CRAIG G BUCK		**Date**

STATUS AND QUALITY OF BF PORTFOLIO

Not Applicable The Bank has no loans approved or in the pipeline

QUALITY OF BF ORIGINATION

Not applicable The Bank has no loans approved or in the pipeline

COMPLIANCE WITH BF CLOSING REQUIREMENTS

Not applicable The Bank has no loans approved or in the pipeline

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

Not applicable The Bank has no loans approved or in the pipeline

COMPLIANCE WITH BF MONITORING REQUIREMENTS

Not applicable The Bank has no BF loans

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

Not applicable The bank has no BF loans

PROJECTED LOAN VOLUME

SB projects that they will be able to generate 5 new loans for 5,000,000DM from September 1998 to August 1999 For the same period in 1999 to 2000 they project 7 loans for 7,000,000DM SB is a State controlled bank and is associated with the Sipad consortium of companies Management is comfortable with lending to larger, mostly state owned enterprises and may be useful in lending to these companies once they are privatized Their lending expertise is centered in the wood products and processing industry and in lending to larger organizations

QUALITY AND SUFFICIENCY OF STAFF

Overview and staffing

The Bank has 17 employees with no plans for expansion at this time The Bank is waiting for a clear indication of the direction of privatization in BiH prior to committing to a long range strategy of expansion The same staff making loans for the Bank's own portfolio will work on any BF program loans

Senior Management

Meetings with the General Director and key members of executive and senior management were held as part of the due diligence process Management attending meetings

NAME	TITLE/POSITION
Muhamed Mahmutovic	General Director
Veskovic Emira	Assistant to the General Director
Kovac Olga	Director – Credit
Osman Kamarasevic	Counsel

The General Director was very frustrated with the BF program The Bank had spent a significant amount of time working with two companies preparing applications and both of these were turned down as they were to enterprises in the Bihac area Sipad Bank has not submitted any applications since these first attempts The General Director indicated they knew that Bihac was not in BF's lending territory at the time, but he stated the Bank was encouraged to continue the application process by BF staff who told him that territory would be open to financing by the time the applications were completed

The other attendees at the meeting supported the General Director's view that the BF program was unresponsive to the banks' and their customers' needs They did make some positive suggestions among the complaining One suggestion was for better communication to the Agent Banks of BF rule changes through frequent contact and formal memos Another suggestion involved a pre-application review by a BF Loan Associate and the Bank This would include an initial site visit to the potential borrower's business and a quick review of financials to determine early in the process whether to proceed with a full application This latter suggestion appears to have some merit as it could save everyone involved, BF and the banks and the prospective borrower, significant time and effort

The General Director stressed the Bank's good working relationship with the Sipad Group and the terrible impact the war had on the Bank and on Sipad Group He felt that lending to large industries, such as Sipad, was critical to a revival of the BiH economy

There was some paranoia at Sipad Bank that BF for some unknown reason does not want to work with the Bank The Bank's counsel read a list of BF loans made to Sipad Group enterprises in BiH through other banks The implication was that Sipad Bank provides most of Sipad Group's banking services and knows Sipad better than any other financial institution, yet the Bank was not included in the credit process

It is unlikely that Sipad Bank will be an active Agent Bank in the near future due to the above mentioned Also, the Bank is not certain of the evolving process of privatization Again, there was some paranoia that the BiH government will strip away some of Sipad Bank's assets, especially some off balance sheet values in the RS and some investments Sipad Bank had in other banks The General Director stated that the future of the Bank was uncertain and a direction could not be set until greater certainty was assured

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

The Bank had a relatively "clean" balance sheet All valueless assets have been cleared from the balance sheet and appropriate provisions for possible loan losses have been created SB's submission to FBA regarding its loan grading and loan loss provisions related thereto was reviewed The Bank appears to have adequate loan loss provisions The FBA report showed a loan loss provision required of 912,000KM Total capital and reserves at June 30, 1998 were 4,747,000KM

Total assets were 6,404,000KM as of June 30, 1998, a decrease of 655,000KM from the December 31, 1997 total Deposits increased 324,000KM during the same period The Bank has over 65% capital to total assets and loans are obviously funded from these funds A loan to deposit rate is not meaningful in this circumstance Off balance sheet liabilities in the form of guarantees were 1,500,000KM

Net income for the year ended December 31, 1997 was 114,000KM Internal profit and loss data for the period ending June 30,1998, indicated a pre tax profit of 206,000KM

The General Director has a lending authority of 10,000Km In practice he rarely approves loans Larger loans are approved by a Three (3) member lending committee

Based on discussions and a physical review of the Bank's computer resources the current system is considered adequate The core system and equipment is not Year 2000 compatible Management has not made plans to upgrade its systems as they are awaiting privatization instructions before proceeding with any capital expenditures Individual databases for loans, deposits, and foreign exchange are maintained on separate PCs The accounting system is on a stand alone PC

Sipad Banka was a "company bank" providing services to the Sipad Group of companies throughout the former Yugoslavia

OWNERSHIP

The Bank is 100% state owned

AGENT BANK RECOMMENDATION

BANK	SREDNJOBOSANSKA BANKA DD KISELJAK
US SFOR (Y/N)	N
CANTONS	SARAJEVO - ZENICA/DOBOJ
MUNICIPALITIES	Kiseljak, Fojnica, Kresevo
HEADQUARTERS	KISELJAK

Date	14 Aug 98	**AB Rec #**	26
Ownership (%)			
Private	100%*	**State**	0 %*
Existing Agency Agreement?			
Yes		**No**	x

Number of Outstanding BF Loans	0	**BF Market Coverage Geographic**	Kiseljak Fojnica, Kresevo
Balance on Outstanding BF Loans	0		
Range of Loan Sizes	0		
Number of Loans 60+days past due	0		
Balance on Loans 60+days past due	0		

Owners holding more than 10 percent of the bank, and percentage ownership	1 KOVPROMET KRESEVO 2 ASFALT CESTE GOJEVICI FOJNICA 3 CALTEKS KRESEVO 4 INTERIJER KISELJAK 5 VENCO COMMERCE KISELJAK 6 BRAJKOVIC COMMERCE KISELJAK	1 24% 2 20% 3 12% 4 12% 5 10% 6 10%

RECOMMENDATION SUMMARY Srednjobosanska Banka is a new applicant to the BF lending program Based on the Bank's ability to augment capital its positive liquidity, the quality of its management, its location in Central Bosnia and its commitment to generating loans for BF participation in the BF program for SB is recommended Conditions related to participation in the program are discussed in the Restrictions section of this report

The Bank s management appears well trained knowledgeable and committed to operating a strong bank

The Bank is operating primarily in Kiseljak Fojnica and Kresevo The Bank plans for cautious expansion southward as its customer base in the area increases The Bank s management is also interested in an affiliation with foreign banks

If chosen to participate in the BF program the Director stated he would like to have a formal televised signing in Kiseljak He will arrange for television coverage for all of Central Bosnia He intends to market the BF program via television advertising highlighting the formal signing ceremony

Recommended Restrictions on Participation

A clause requiring disclosure of Bosnian versus foreign ownership of the Bank should be inserted in the Agency Agreement Srednjobosanska Banka should be required to disclose proposed changes in ownership that might lead to the Bank becoming a primarily foreign owned institution

The Agency Agreement should also include a requirement for submission to BF of audited financial information on an annual basis

Bank Selection Team Member Alfred Dostie		**Date** 14 Aug 98
BF Chief of Party Bruce Spake		**Date**
USAID Director CRAIG G BUCK		**Date**

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STATUS AND QUALITY OF BF PORTFOLIO

Not Applicable The bank is applying for Agent Bank status

QUALITY OF BF ORIGINATION

Not applicable The bank is applying for Agent Bank status

COMPLIANCE WITH BF CLOSING REQUIREMENTS

Not applicable The bank is applying for Agent Bank status

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

Not applicable The bank is applying for Agent Bank status

COMPLIANCE WITH BF MONITORING REQUIREMENTS

Not applicable The bank is applying for Agent Bank status

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

Not applicable The bank is applying for Agent Bank status

PROJECTED LOAN VOLUME

SB projects that they will be able to generate 10 new loans for 5,000,000DM from September 1998 to August 1999 For the same period in 1999 to 2000 they project 20 loans for 10,000,000DM These projections are based on management's knowledge of their trade area and plans to expand the portfolio Management indicated they would provide staffing resources and the training necessary to achieve these levels of projected loan volume

QUALITY AND SUFFICIENCY OF STAFF

Overview and staffing

The Bank has 13 employees The President is moving cautiously into any expansion and is attempting to open new avenues for capital augmentation to margin any growth Staff will be added to achieve the Bank's expansion plans into other geographic and lending sectors

Senior Management

A meeting with the General Director and the Deputy Director was held as part of the due diligence process Management attending meeting

NAME	**TITLE/POSITION**
Ivaca Trava	Director
Ivan Protruder	Deputy Director and primary lender

Mr Trava is an experienced banker and spoke of efforts to increase capital He stated that the Bank is seeking a merger of equals with banks in the Croat controlled areas of Hercegovina Three foreign banks are being approached for a possible infusion of 10,000,000DM in capital or to provide debt equity He indicated that a large German bank is interested in SB as a means to facilitate the purchase of larger enterprises by some of the German bank s commercial clients Specifically, the German bank's clients are interested in the power generating company in Tuzla Per the Director the German bank's client is Media Film Trade, a finance and trade company

The Director was very committed to using the BF lending program He saw it as a means of better serving his trade area in Central Bosnia, since it would provide the potential for larger loans to customers SB's largest loan thus far was a 300,000DM facility

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

Financial statements in IMF format were not available An English language version of an IAS style, shortened financial statement was available This is the information that is being presented to potential equity investors in the Bank The Bank is also contracting for an outside audit to support its efforts to attract foreign and domestic capital

Total assets were 21,225,000Kuna as of June 30, 1998, a decrease of 430,000Kuna from the December 31, 1997 total Cash to total adjusted assets was 14 6% at 12-31-97 and 10% at 6-30-98 Off balance sheet liabilities in the form of guarantees were 200,000DM

Net income for the year ended December 31, 1997 was 49,000Kuna Internal profit and loss data for the period ending June 30,1998 indicated net profit of 39,000Kuna The total capital to adjusted assets ratio was 43% at June 30, 1998 The capital does not include an off balance sheet value of 600,000-700,000DM, as estimated by the Director, for an asphalt plant taken by the Bank in foreclosure Per the Director the Bank now owns a 70% interest in the asphalt plant

No overdue loans were listed in the Agent Bank Application

No lending limits are accorded to the Director or his Deputy All loans are reviewed and approved by the shareholders on a pro rata basis to their ownership with a 15% maximum vote for any one shareholder A two-thirds majority is needed to approve a loan

The Bank's record keeping system is entirely manual and appears sufficient for the current level of activity During our visit no customers were noted in the lobby and the Deputy Director was not working on any loans per our observation A walk through of the Bank's bookkeeping and accounting processes was done Seven employees were questioned about their functions All seven, especially the accountant and a very competent elder assistant, were very knowledgeable of proper bookkeeping practices The Bank intends to modernize its system and purchase microcomputers only when transaction volume warrants No microcomputers of any sort were observed during the walkthrough

SB was founded de novo in July, 1994 to serve the communities of Kiseljak, Kresevo, and Fojnica The Director noted that the Bank sees its future as moving more towards doing business in the Sarajevo Canton rather than Zenica-Doboj Canton He noted that he is more familiar with business conditions in Sarajevo Canton and he noted it is more contiguous to the Bank's current trade area than other populated areas

OWNERSHIP

Ownership is concentrated in eight owners These owners also serve as the Board of Directors and the Loan Committee of the Bank The Bank is 100% privately owned per the Director None of the shareholders nor their companies are state owned in any manner per the Director

Additional capital is being sought so the Bank can expand its lending activities and facilitate foreign investment in Bosnian companies seeking capital The Bank expects a large volume of such business through its connections with German banks

AGENT BANK RECOMMENDATION

BANK	TRGOVACKA BANKA DD VISOKO
US SFOR (Y/N)	Y (Branches)
CANTONS	Central Bosnia and Zenica-Doboj
MUNICIPALITIES	Visoko, Fojnica, Vares
HEADQUARTERS	VISOKO

Date	14 Aug 98	**AB Rec #**	27
Ownership (%)			
Private	79%	**State**	21%
Existing Agency Agreement?			
Yes	X	**No**	

Number of Outstanding BF Loans	1	**BF Market Coverage Geographic**	Visoko Fojnica Vares Breza Kakanj Olovo
Balance on Outstanding BF Loans	185 100DM		
Range of Loan Sizes	Not applicable		
Number of Loans 60+days past due	0		
Balance on Loans 60+days past due	0		

Owners holding more than 10 percent of the bank and percentage ownership	1 GACAN MENSUR	1 10 49%
	2 MUJEZINOVIC DZEVAD	2 10 49%
	3 MUJEZNIOVIC ALMEIDA	3 10 49%
	4 SULEJMANOVIC AVDIJA	4 10 49%
	5	5

RECOMMENDATION SUMMARY

Trgovacka Banka DD Visoko appears financially stronger than its peers and is located in a desired area of BF loan expansion Management was very knowledgeable Also management expressed an interest in becoming more involved in the BF program Accordingly continued participation in the USAID Business Finance program is recommended

The Bank operates offices in Kisovo Fojnica and Vares Future plans are for expansion into the Sarajevo and Mostar market areas A new main office building is being constructed in the center of Visoko The Bank currently leases space in an office building on the outskirts of the city at Musala 21

Recommended Restrictions on Participation

Adequate financial information including audited financial statements should be required to monitor the Bank s condition This information should be analyzed on an annual basis and continued participation in the BF program should be evaluated annually

Bank Selection Team Member Alfred Dostie		**Date** 14 Aug 98
BF Chief of Party Bruce Spake		**Date**
USAID Director CRAIG G BUCK		**Date**

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STATUS AND QUALITY OF BF PORTFOLIO

Trgovacka Banka (TB) DD Visoko was assigned one BF loan from the failed Hippo Bank This loan is paid current

A BF Audit evaluation of the loan portfolio and loan ratings conducted in July 1998 resulted in the following

- 1 downgrade from a 5 to a 6 on the loan totaling 500,000DM Amount shown is the original disbursed amount

QUALITY OF BF ORIGINATION

Not applicable Loan was originated by Hippo Bank and subsequently transferred to Trgovacka Banka

COMPLIANCE WITH BF CLOSING REQUIREMENTS

Not applicable Loan was originated by Hippo Bank and subsequently transferred to Trgovacka Banka

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

Not applicable Loan was originated by Hippo Bank and subsequently transferred to Trgovacka Banka

COMPLIANCE WITH BF MONITORING REQUIREMENTS

Monitoring reports appeared acceptable

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

BF operations voiced no concerns over the repayment performance of this bank

PROJECTED LOAN VOLUME

TB projects that they will be able to generate approximately 20 new loans for 2 to 3,000,000DM from September 1998 to August 1999 For the same period in 1999 to 2000 they project over 20 loans for 3 to 4,000,000DM Management indicated they had experienced staffing resources available to meet these levels of projected loan volume

QUALITY AND SUFFICIENCY OF STAFF

Overview and staffing

Two lenders and general support staff are designated to work on the BF credits A walkthrough performed during the on site visit revealed that the bank is using sophisticated credit review software for analysis of borrower financial information A department of two people performs such analyses on all loans submitted It appears that the Bank is appropriately structured to properly analyze and book loans

Senior Management

The General Director and the Deputy Director were on vacation during the site visit Meetings were held with key members of executive and senior management as part of the due diligence process Management attending meetings

NAME	TITLE/POSITION
Zecevic Zinaida	Director of Legal
Limo Amra	International Department Manager
Buric Amina	Director of Bookkeeping
Zukic Adnan	Loan analysis

Management appeared very knowledgeable in their particular aspects of banking Amra Limo is head of the International Department and also head of the Loan Committee She was particularly impressive in her understanding of the Bank and banking in general

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

TB's financial statements showed total assets of 7,079,000DM as of June 30, 1998, an increase of 1,224,000DM from the December 31, 1997 total Domestic deposits increased 1,217,000DM during the same period Foreign assets decreased 151,000DM, however, the Bank has no foreign liabilities shown on the books Exposure to foreign currency fluctuations is insignificant Fixed assets included amounts recently spent to refurbish an older building in the center of Visoko Once completed this location will be the permanent headquarters of the Bank The Bank currently occupies leased space on the outskirts of Visoko Loans to deposits were 152% at June 30, 1998 Capital accounts totaled 3,609,000DM Liquid assets were 5 7%, which appeared sufficient for the level of deposits held Off-balance sheet liabilities were negligible Guarantees were covered by cash offsets

Net income for the year ended December 31, 1997 was 64,000DM Internal profit and loss data for the period ending June 30,1998, indicated a pre tax profit of 53,000DM No problem loans were listed on the Bank's Agent Bank Application and no loans were written off during 1996 and 1997 and for the first half of 1998 These figures are unaudited and we did not have the benefit of reviewing the FBA report on this Bank due to confidentiality reasons

Based on a walkthrough and discussions with management the Bank's computer systems need upgrading Management is planning to upgrade its systems once the move to a new facility is made later this year Accounting uses a basic purchased software package Subsidiary ledgers for loans and deposits are maintained on Excel spreadsheets developed in house The Foreign exchange record keeping and calculations are done using purchased software The credit analysis software is a package developed for Croatian banks and provides all the elements for financial statement analysis Although basic, the systems suit the current level of activity in the Bank Personnel appeared very computer literate

Loan officers do not have lending limits All loans are approved y a three member Lending Committee

The Bank was formed in December 1993

OWNERSHIP

The Bank is primarily privately owned State owned companies account for approximately 22% of the ownership, but these are being privatized The Bank has also issued non-voting Preferred Stock with a predetermined 14% dividend rate This form of Capital amounts to only 50,000DM, however, it shows the creativity of the Bank's management in attracting capital The Bank intends to issue more common stock in the future as part of its growth strategy

AGENT BANK RECOMMENDATION

BANK	TUZLANSKA BANKA DD TUZLA
US SFOR (Y/N)	Y
CANTONS	TUZLA-PODRINJE
MUNICIPALITIES	Tuzla Banovici, Brcko, Celic, Gracanica, Kalesija, Kladanj, Lukavac, Srebenik, and Zivinice
HEADQUARTERS	TUZLA

Date	14 Aug 98	**AB Rec #**	28
Ownership (%)			
Private	83 211%	**State**	16 789%*
Existing Agency Agreement?			
Yes	x	**No**	

Number of Outstanding BF Loans	20	**BF Market Coverage Geographic**	Tuzla Banovici Brcko Celic Gracanica Gradacac Kalesija Kladanj Lukavac Nad Tuzla Srebenik And Zivinice
Balance on Outstanding BF Loans	12 842 100DM		
Range of Loan Sizes	220 000DM to 1 400 000DM		
Number of Loans 60+days past due	6		
Balance on Loans 60+days past due	5 941 300DM		

Owners holding more than 10 percent of the bank and percentage ownership	1 NO SHAREHOLDER OWNS MORE THAN 8% 2 3 4 5	1 2 3 4 5

RECOMMENDATION SUMMARY

Based on Tuzlanska Banka s performance in the BF lending program and the Bank s commitment to generating further loans continued participation in the USAID Business Finance program is recommended with conditions Suggested restrictions are listed below Overall TB has performed acceptably in the program and is one of the top producers of loans In general TB meets most of its commitments for reporting and the quality of applications and monitoring is considered acceptable The Bank appeared solvent based on our review, however we did not have the benefit of the FBA examination results and these could disclose adverse conditions

TB was a former State bank and has operated in the Tuzla-Podrinje Canton for over 100 years The main office of the bank is located in a large reasonably modern building on a major avenue Marsala Tita 34 in Tuzla The Bank's market area covers 11 municipalities in northeastern Bosnia Branch offices are located in Banovici Brcko Celic Gracanica Gradacac Kalesija Kladanj Lukavac Srebrenik Zivinice, Nad Tuzla Lending to local companies involved in the chemical and energy is the primary non BF business of the bank

Recommended Restrictions on Participation

During the interview process, management disclosed loan application fees of 300DM are charged on all loans including BF loans The BF position regarding loan application fees was explained to the Bank's lending management Incorporating a clear statement regarding the prohibition against charging application fees on BF program loans in the renewal Agency Agreement for this Bank may be advisable

Additionally, the Bank's management stated emphatically that loans are not made to directors or to companies controlled by directors of the Bank No instances of such conflicts of interest were found The review did indicate that loans were made to companies that have an ownership interest in the bank BF should monitor such activity at this Bank

Bank Selection Team Member Alfred Dostie,Thomas Chmelik, Zan Northrip		**Date** 14 Aug 98
BF Chief of Party Bruce Spake		**Date**
USAID Director CRAIG G BUCK		**Date**

STATUS AND QUALITY OF BF PORTFOLIO

Tuzlanska Banka (TB) has been one of the more active participants in the BF program TB had eighteen (18) loans active in July 1998 for a total of 15,666,000DM Of these six (6) totaling 5,941,300 were 60 or more days overdue as of August 5, 1998 This is a 46% overdue ratio based on dollar volume of loans

A BF Audit evaluation of the loan portfolio and loan ratings conducted in July resulted in the following

- 3 downgrades from 5 to 6 on loans totaling 3,525,000DM
- 1 downgrade from 5 to 7 on a loan totaling 600,000DM

The resulting loan rating dispersion was as follows

RATING	# OF LOANS	DISBURSED AMOUNT
4	3	4,240,000DM
5	5	4,200,000DM
6	7	5,395,000DM
7	3	1,831,000DM

TB's loan rating dispersion is typical of banks in the BF program

QUALITY OF BF ORIGINATION

Based on discussions with the BF Lending Associate, applications and loan files are considered acceptable in quality

COMPLIANCE WITH BF CLOSING REQUIREMENTS

Loan documentation exceptions on BF loans initiated by TB were listed on three (3) loans The exceptions were primarily a failure to properly register mortgage liens These are reportedly being remedied

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

Discussions with the BF Lending Associate and BF Audit revealed no issues related to disbursements

COMPLIANCE WITH BF MONITORING REQUIREMENTS

Monitoring reports are generally on time and contain the requested information Typical of most monitoring reports created by the Agent Banks, true analysis is sometimes lacking The Bank received an average score of 2 15 on BF's 5 point scale for monitoring reports

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

Other than the overdue situation noted earlier in this report, BF repayment requirements are generally being met BF operations voiced no concerns over the repayment performance of this bank nor were there any negative audit issues

PROJECTED LOAN VOLUME

TB projects that they will be able to generate 25 new loans for 12,000,000DM from September 1998 to August 1999 For the same period in 1999 to 2000 they project 30 loans for 15,000,000DM Management indicated they would provide staffing resources and the training necessary to achieve these levels of projected loan volume

QUALITY AND SUFFICIENCY OF STAFF

Overview and staffing

Nine (9) staff members are dedicated to support of the BF Lending program An additional three (3) are being considered to achieve the projected loan volume mentioned above Per the BF Lending Associate additional resource is needed for collection activities at TB

Senior Management

Meetings with the General Director and key members of executive and senior management were held as part of the due diligence process Management attending meetings

NAME	TITLE/POSITION
Abdurahmanovic Muharem	General Director
Hasanovic Dzemal	Deputy General Manager
Olic Dijana	Department Manager for Credit Approval
Topcic Rajka	Senior Executive Consultant of General Manager
Dzafic Jusuf	Assistant General Manager
Gajic Tatjana	Department Manager for Legal Affairs

Management was very committed to continuing with the BF program Dijana Olic personally delivered the application to BF on the date due and a short meeting was also held at that time

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

TB showed total assets of 309,438,000DM as of June 30, 1998 This was adjusted for frozen deposits at the National Bank of Yugoslavia resulting in a truer picture of the Bank's balance sheet position Adjusted assets were 53,000,000DM Total capital was 42,815,000DM The Bank declined to provide the reviewers with a copy of the FBA report Verifying the solvency of TB was impossible without the FBA examination results on non BF loans made by the Bank TB indicated in the application that delinquent loans totaled 9,010,000 at June 1998 The amount of loans written off during this same period totaled 1,470,000 A 100% loss of the total overdue figure of 9,010,000DM would not result in an insolvent bank, however, liquidity would be adversely impacted from the decline in cash flow

Based on discussions with management core data systems offer basic reporting They are not currently Year 2000 compatible Management is aware of the need to make necessary changes to its systems Executive information in the form of concise reporting for managing the Bank needs enhancement Standard password access to systems is used with the exception that passwords are changed every ten days This is far more rigorous a standard than in western systems

Loan officers do not have lending limits, however, all loans are presented to and approved in a committee setting Branch offices have similar committees but are limited to smaller loans Ninety percent (90%) of loans are approved at the main office of the Bank located at Marsala Tita 34 in Tuzla

OWNERSHIP

Although the Bank lists ownership as primarily Private, The Ministry of Finance (MF) and several state owned companies own stock in the bank TB management indicated that all such companies are in process of being privatized Also, management indicated that the MF ownership was less than 2%

AGENT BANK RECOMMENDATION

BANK	UNION BANKA DD SARAJEVO
US SFOR (Y/N)	Y (BRANCHES)
CANTONS	SARAJEVO
MUNICIPALITIES	SARAJEVO
HEADQUARTERS	SARAJEVO

Date	14 Aug 98	**AB Rec #**	29
Ownership (%)			
Private	8 %	**State**	92 %
Existing Agency Agreement?			
Yes	X	**No**	

Number of Outstanding BF Loans	4	**BF Market Coverage —Geographic**	Federation of BiH
Balance on Outstanding BF Loans	DM 2 3 million		
Range of Loan Sizes	DM 360 000 – DM 1 0 million		
Number of Loans 60+days past due	1		
Balance on Loans 60+days past due	DM 875 000		

Owners holding more than 10 percent of the bank and percentage ownership	1 MINISTRY OF FINANCE 2 NO OTHER OWNER HAS MORE THAN 1 PERCENT OF THE BANK S SHARES 3 4 5 6	1 92 % 2 3 4 5 6

RECOMMENDATION SUMMARY

Union Banka DD Sarajevo is, together with Kristal Banka AD Banja Luka the successor institution of Jugobanka Jubbanka DD Sarajevo The division of Jugobanka assets and liabilities between Union Banka and Kristal Banka has yet to be concluded but an unofficial agreement on the division was reached in 1992 the same year in which Union Banka became an independent state owned bank For now these assets and liabilities remain on the Union Banka balance sheet The bank operates in the Federation through its Sarajevo headquarters and a network of 7 branches

Union Banka was one of the first banks to originate and service BF loans in Bosnia disbursing a credit in November 1996 for DM 1 million Following this early start however, loan volume from the bank has been low Union Banka s primary client base of state-owned firms is not eligible for USAID financing Four Union Banka loans have been disbursed another is approved and awaiting disbursement, and one application is currently being analyzed by BF staff The bank projects an increase in its BF activity as a result of USAID s expansion into Middle Bosnia and the anticipated privatization of state owned firms In the past the bank has produced applications of acceptable but not superior quality The bank s monitoring reports, however are among the best produced by any BF Agent Bank

Union Banka's balance sheet is burdened with frozen assets and liabilities These will be removed with privatization producing an asset size (without regard to loan quality) of DM 134 million—a reduction of 88 percent against the December 1997 financial statements The bank's solvency is not clear and liquidity is inadequate Despite these difficulties, BF's audit and operations staff report no mishandling of BF disbursements or repayments There are sometimes delays in obtaining information from Union Banka but the bank adheres strictly to BF procedures

Given the bank s expectations of increased BF lending, adherence to BF procedures and market coverage in Middle Bosnia USAID approval is recommended

Recommended Restrictions on Participation

No restrictions are recommended at this time periodic monitoring of the bank s solvency and privatization plans is advisable

Bank Selection Team Member Zan Northrip		**Date** 14 Aug 98
BF Chief of Party Bruce Spake		**Date** 14 Aug 98
USAID Director CRAIG G BUCK		**Date**

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STATUS AND QUALITY OF BF PORTFOLIO

Union Banka was one of the first banks to originate and service BF loans in Bosnia, disbursing a credit in November 1996 for DM 1 million Following this early start, however, loan volume from the bank has been low Union Banka's primary client base of state-owned firms is not eligible for USAID financing Four Union Banka loans have been disbursed, another is approved and awaiting disbursement, and one application is currently being analyzed by BF staff

A recently completed evaluation of the loan portfolio and loan ratings resulted in no upgrades or downgrades Loan dispersion is as follows

RATING	# OF LOANS	AMOUNT
4	1	1,000,000
5	0	0
6	2	989,000
7	1	1,000,000

The dispersion of Union Banka loans is typical of that at other BF Agent Banks

QUALITY OF BF ORIGINATION

In the past, the bank has produced applications of acceptable, but not superior quality

COMPLIANCE WITH BF CLOSING REQUIREMENTS

No documentation exceptions have been noted by BF staff

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

No reported violations of BF disbursement procedures

COMPLIANCE WITH BF MONITORING REQUIREMENTS

No reported violations of BF monitoring requirements BF credit staff note that the bank's quarterly monitoring reports are consistently superior, relative to those of other banks On BF's five-point scale, the bank's monitoring reports have averaged 4 43

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

BF's Operations Department reports no violations of BF's repayment procedures

PROJECTED LOAN VOLUME

The bank projects an increase in its BF activity as a result of USAID's expansion into Middle Bosnia and the small business market The bank projects recommending 15 bankable credits for DM 5 million in the year ending August 1999 Based on the anticipated privatization of state-owned firms, Union Banka projects recommending 30 bankable credits for DM 15 million in the year ending August 2000

QUALITY AND SUFFICIENCY OF STAFF

Overview and Staffing

Union Banka is overstaffed for the size of its own active portfolio Nine lenders are available to work on BF loans—more than enough for the bank's current and projected portfolios with BF Based on the quarterly monitoring reports, the staff have analytical abilities However, these abilities have not been applied consistently to BF Credit Applications The bank appears to recommend borrowers based more on past relationships than on financial analysis and the outlook for a borrower s business

Senior Management

Meetings were held with the following individuals

NAME	TITLE/POSITION
Abdulaziz Mahmutovic	Executive Manager (Sr Manager for BF)
Mujo Dragolj	Assistant Executive Manager
Abdulah Mutapcic	Advisor to General Director
Andjelko Krasic	Director, Finance
Not recorded	Director, Operations

The General Director was absent at the time of the on-site review, but meetings were held with seven other staff members The senior staff generally have 10-30 years of banking experience, and some have spent their entire careers with Union Banka The staff were articulate about their individual responsibilities The bank has prepared a privatization plan, but seems to be taking a passive, reactive approach to the process An audit is being conducted to determine the bank's solvency Assuming positive findings, buyers for the state's shares will be sought There is a general hope that a foreign bank buyer will emerge and put new capital into the bank

While awaiting privatization, the bank is focusing on the reintroduction of various consumer products that were suspended during the war The bank has several thousand consumer loans, after relaunching a consumer loan product last year This portfolio is performing well, and the bank specified several additional products (primarily funded through outside credit lines) planned for introduction

In commercial credits, Union Banka expressed a preference for state over private clients The primary reason for this preference is the bank's attribution of superior financial management skills to state-owned firms The bank reports that it receives many applications for loans from its own and BF funds from young, private firms Often these private clients have been rejected because of a lack of knowledge of finance and inexperience in working with banks In the bank's view, these factors outweigh potentially greater flexibility and dynamism in private borrowers Union Banka expressed the belief that the best prospects for BF will come from privatized state-owned firms, because they will combine experience with flexibility and rapid decision making

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

Much of the bank's balance sheet will be eliminated by the transfer of the bank's frozen assets and liabilities to the state The impact of this transfer on Union Banka capital is unclear If all frozen assets and liabilities are removed, the bank could shrink from DM 1 18 billion in assets, as reported in December 1997, to DM 134 million Liabilities would also shrink, but by less than assets Assuming the bank must fund this difference with a reduction in capital, the bank's capital accounts could fall DM 33 million to DM 58 million

The quality of the bank's remaining loan portfolio cannot be determined by a review of this scale, and examination results are not available to the ABST In its application, the bank reports a delinquency rate of 2 9 percent, but only the past-due portion of delinquent loan balances is included in this calculation Doubtless, capital should be further reduced, perhaps making the bank insolvent Even after the downward adjustment of 90 percent of bank assets, cash and cash equivalents are only 1 32 percent of total assets The bank will remain extremely illiquid, no matter what the final determination of its asset size

Operating profits cannot be relied on to increase bank capital The bank is able to report profits only because it is not provisioning adequately Union Banka's 1997 and mid-1998 financials are presently being audited by Price Waterhouse Coopers, according to IAS

Lending officers in the headquarters and branches do not have individual lending authorities, and all loans, except consumer loans, are approved by a headquarters-based credit committee Branch transactions are primarily retail Consumer lending up to DM 4,000 does not have to be approved by the Credit Committee

The bank's branches are inadequately integrated with the headquarters computer system Both the headquarters and the branches have software, but there is no interface between them Data is transmitted from the branches by fax at the end of each day, and manually entered by headquarters staff the next morning The system in use was created after the war, but staff were uncertain as to its Year 2000 compliance

Regular financial reports are generated by the bank's computer system for review by management and the board It appears that reports are not available on demand without assistance from the computer department BF staff have commented that it is sometimes difficult to obtain information from Union Banka, because of the bank's inadequate computer technology

OWNERSHIP

The bank's ownership is 92 percent state, with a few shares being held by individuals and mixed-ownership firms The bank would like a foreign buyer to purchase the holdings recently transferred to the Ministry of Finance

AGENT BANK RECOMMENDATION

BANK	UNIVERSAL BANKA DD SARAJEVO
US SFOR (Y/N)	Y (BRANCHES)
CANTONS	SARAJEVO, ZENICA-DOBOJ, WEST HERZEGOVINA, NERETVA, UNA SANA
MUNICIPALITIES	SARAJEVO TESANJ MOSTAR, BIHAC VELIKA KLADUSA
HEADQUARTERS	SARAJEVO

Date	14 Aug 98	**AB Rec #**	30
Ownership (%)			
Private	94%	**State**	6%
Existing Agency Agreement?			
Yes	X	**No**	

Number of Outstanding BF Loans	19	**BF Market Coverage —Geographic**	Federation of BiH
Balance on Outstanding BF Loans	DM 12 7 million		
Range of Loan Sizes	DM 200 000 – DM 1 9 million		
Number of Loans 60+days past due	4		
Balance on Loans 60+days past due	DM 2 5 million		

Owners holding more than 10 percent of the bank and percentage ownership	1 NO OWNER HAS MORE THAN 10 PERCENT OF THE BANK S SHARES 2 3 4 5 6 7	1 2 3 4 5 6 7

RECOMMENDATION SUMMARY

Universal Banka began operations as a commercial bank in 1993 and has been an active agent bank for nearly two years The bank is privately owned and lends primarily to private firms in the Federation through its Sarajevo headquarters and 4 branches Universal reports DM 71 million in assets supported by DM 8 8 million in capital

Universal is presently servicing 19 BF borrowers, an additional 6 loans are recommended or approved and pending disbursement Repayment performance of credits serviced by Universal has been typical of the loans serviced by other BF agents No major compliance problems are reported by BF staff regarding Universal origination closing disbursement monitoring, or repayment The bank has been more cooperative than most in pursuing delinquent borrowers produces high quality monitoring reports, and has accepted problem loans transferred from other BF agent banks Staff are adequate to handle current BF portfolio volume, but additional staff will need to be retained if growth occurs as the bank projects

Management is active and has the confidence of the board The bank is experiencing rapid asset growth and is attempting to increase its capitalization and manage its cost of funds through additional investments and mergers The bank has also increased substantially its deposits from both businesses and individuals Universal s rapid growth can be expected to expose the institution to greater levels of risk and the bank is attempting to raise its provisioning to 5 percent of all loans The bank s information technology is more flexible and comprehensive than that of most BF agent banks and is actively used in the bank's financial management

Universal is recommended for approval

Recommended Restrictions on Participation

No restrictions are recommended at this time

Bank Selection Team Member Zan Northrip		**Date** 14 Aug 98
BF Chief of Party Bruce Spake		**Date** 14 Aug 98
USAID Director CRAIG G BUCK		**Date**

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STATUS AND QUALITY OF BF PORTFOLIO

Universal Banka was among the large group of early participants in the BF program, disbursing its first loan in November 1996 The bank now services 19 BF credits, including one seriously delinquent loan, categorized as a loss, taken over by Universal after the failure of Hippo Bank

Including the Hippo loan, the bank had a delinquency rate of 28 percent, calculated as the balance of all loans more than 60 days past due Removing the Hippo loan (which was seriously delinquent at the time Universal accepted its transfer) produces a delinquency rate of 20 percent

A recently completed evaluation of the loan portfolio and loan ratings resulted in the following

1 downgrade from 5 to 8 on a loan with an outstanding balance of DM 1 million
3 downgrades from 5 to 7 on loans with outstanding balances of DM 2 2 million
2 downgrades from 6 to 7 on loans with outstanding balances of DM 1 6 million
1 downgrade from 4 to 5 on a loan with an outstanding balance of DM 344,000
1 upgrade from 6 to 5 on a loan with an outstanding balance of DM 180,000
1 upgrade from 7 to 5 on a loan with an outstanding balance of DM 780,000

The resulting loan dispersion was as follows

RATING	# OF LOANS	DISBURSED	BALANCE
4	1	540,000	518,000
5	7	3,814,000	3,774,000
6	5	3,853,000	3,640,273
7	5	3,791,452	3,754,737
8	1	1,000,000	1,000,000

The dispersion of Universal loans is typical of that of other Agent Banks

QUALITY OF BF ORIGINATION

BF credit staff report that Universal prepares quality applications and conducts pre-recommendation borrower visits However, like other dynamic private banks, fast growth and new hires are detracting from the quality seen in the bank's early days as a BF Agent Bank

COMPLIANCE WITH BF CLOSING REQUIREMENTS

Four documentation exceptions have been noted in the credit files of borrowers serviced by Universal All are related to collateral registration requirements

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

BF Field Associates report one delayed disbursement to a BF borrower, who waited two weeks before receiving funds that had been transferred to Universal by BF This appears to have been an isolated incident

COMPLIANCE WITH BF MONITORING REQUIREMENTS

The bank submits monitoring reports that are considered average in quality (2 23 on BF's 5 point scale) relative to other BF agent banks In addition, the bank has been cooperative with BF's special assets group in taking actions such as blocking the accounts of delinquent borrowers

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

BF's Operations Department characterizes Universal's compliance with repayment procedures as excellent

PROJECTED LOAN VOLUME

The bank projects an acceleration in its rate of recommendations based on its past cooperation with BF, and potential expansions of the geographic areas eligible for USAID-funded lending The bank expects to continue its focus on the middle market, recommending 15 loans for DM 10 million in the year ending August 1999, and 20 loans for DM 15 million in the year ending August 2000

QUALITY AND SUFFICIENCY OF STAFF

Overview and Staffing

Universal's BF loans are recommended and serviced by 5 loan officers Two of the officers are based in Tesanj and 3 are based in Sarajevo The bank's branches are more full-service than those of most other Bosnian banks, and about a third of Universal's BF loans have been generated by Loan officers at the Tesanj branch Loan officers are also responsible for the quarterly monitoring reports on each borrower The quality of both applications and monitoring reports tends to be average or better, and the number of staff seems sufficient for the time being In the opinion of some BF staff, however, fast growth and new hires at Universal are detracting from the quality seen in the bank's early days as a BF Agent Bank Management appears committed to hiring and training additional staff as warranted by the size of the bank's BF portfolio Presently, however, additional new hires are constrained by a shortage of office space

Senior Management

Meetings were held with the following individuals

NAME	TITLE/POSITION
Alma Smailbegovic	General Director
Josip Balic	Director, Finance
Amela Zaciragic	Loan Officer
Ermin Begoli	Contractor (Designer, Bank Operations System)
Esad Nozic	Operations—General Ledger
Alma Nalo	Operations—Teller Transactions

The senior managers have between 15 and 30 years of banking experience each Most have been with Universal for a long period The managers spoke clearly about privatization and strategic planning, the bank's finances and cost of capital, and underwriting standards The General Director is clearly an active manager, driving most decisions at the bank The Board seems to have confidence in her leadership, with most shareholders increasing their investments over the past year

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

Universal Banka is growing very quickly, funded by a combination of capital and deposits Loans grew DM 10 million (20 percent) in the period December 1997 to June 1998, matched by an additional 12 5 million in deposits and 2 million in capital

The bank is attempting to manage its cost of funds through a capitalization drive focused largely on existing private shareholders The bank is also considering merger and acquisition strategies to increase its capital base to a minimum of DM 10 million This level is likely still inadequate, given potential losses in the portfolio and planned capital expenditures The bank is provisioning 2 percent of all loans, and plans to increase provisioning to 10 percent Total capital now stands at DM 8 8 million, or 12 3 percent of total assets Capital less reserves and provisions is 9 8 percent of total assets

Liquidity has decreased as the bank expands Cash to total assets fell from 6 percent to 5 percent in the six-month period

The bank's loan portfolio was valued at DM 54 million at the end of June A useful delinquency rate cannot be calculated because of the bank's extensive use of subjective criteria in classifying loans The bank classifies only 1 3 percent of the portfolio as delinquent Substantial write-offs occurred in 1996, since that time, write-offs have averaged 1-2 percent per year on an annualized basis

Among BF's agent banks, Universal has one of the more modern and comprehensive information systems The system is newly developed by a private firm, for which Universal was the first client, but other sales are taking place at banks in Croatia The contractor has been working on site for several months, converting prior databases, and training staff The bank is pleased with the system, which is Year 2000 compatible and includes modules for General Ledger, various credit products, retail transactions, Treasury, and the Foreign Department The system is Windows based, with 40 workstations in the bank's headquarters The branch in Tesanj is on line 24 hours a day Other branches are transmitting data in batches, but will be on line before the end of the year In addition to regular financial reporting, various reports can be generated by users on demand The bank believes the system represents a competitive advantage with room for substantial expansion

OWNERSHIP

The bank has 178 shareholders, including both companies and individuals No owner controls more than 10 percent of the bank State ownership is 6 percent, and managers of the bank have small personal holdings About 10 percent of the bank's portfolio is in loans to corporate insiders One BF loan recommended by Universal and currently awaiting disbursement is to a significant Universal shareholder

AGENT BANK RECOMMENDATION

BANK	UPI BANKA DD SARAJEVO
US SFOR (Y/N)	Y (Branches)
CANTONS	Sarajevo, Zenica-Doboj, Tuzla-Podrinje, Unsko-Sanski
MUNICIPALITIES	Sarajevo, Gracanica
HEADQUARTERS	SARAJEVO

Date	14 Aug 98	**AB Rec #**	31
Ownership (%)			
Private	90 8%	**State**	9 2%
Existing Agency Agreement?			
Yes	X	**No**	

Number of Outstanding BF Loans	7	**BF Market Coverage Geographic**	Sarajevo Zenica Doboj Tuzla Podrinje Unsko Sans
Balance on Outstanding BF Loans	4 559 800DM		
Range of Loan Sizes	300 000DM to 1 600 000DM		
Number of Loans 60+days past due	0		
Balance on Loans 60+days past due	0		

Owners holding more than 10 percent of the bank and percentage ownership	1 GLUMINA BANKA ZAGREB 2 GLUMINA DOO ZAGREB 3 4 5	1 12 4% 2 12 4% 3 4 5

RECOMMENDATION SUMMARY

Based on UPI Bank's relative strength as a banking institution in BiH its territorial coverage throughout BiH and the Bank s willingness to work with BF continued participation in the USAID Business Finance program is recommended

Bank management is considered very capable

The Bank s Main Office is located at Branilaca Sarajevo directly across from the National Theatre The Bank is refurbishing a three floor section of a ten story office building for its new headquarters The Bank has only one operating branch office at this time but has a wide market area throughout BiH

UPI also owns a controlling interest in FEC, a company offering legal and financial consulting services The Bank has formed a leasing subsidiary UB Leasing which should be in operation by year end 1998 Additionally the Bank plans to start an investment brokerage subsidiary, when the BiH capital markets are established

Recommended Restrictions on Participation

No restrictions or conditions other than those generally included in the standard Agent Bank Agreement are considered necessary

Bank Selection Team Member Alfred Dostie		**Date** 14 Aug 98
BF Chief of Party Bruce Spake		**Date**
USAID Director CRAIG G BUCK		**Date**

STATUS AND QUALITY OF BF PORTFOLIO

UPI Banka DD Sarajevo (SKB) DD Sarajevo has produced seven (7) loans for the BF program None of the loans are sixty (60) or more days overdue

A recently completed evaluation of the loan portfolio and loan ratings resulted in the following

- 1 downgrade from 3 to 4 on a loan totaling 300,000DM
- 1 downgrade from 5 to 6 on a loan totaling 350,000DM
- 1 downgrade from 5 to 7 on a loan totaling 1,600,000DM

The resulting loan rating dispersion was as follows

RATING	# OF LOANS	DISBURSED AMOUNT
3	1	750,000DM
4	1	300,000DM
5	2	1,825,000DM
6	2	1,350,000DM
7	1	1,600,000DM

While one loan initiated by the Bank was downgraded two grades, performance overall is relatively better than other banks in the BF program

QUALITY OF BF ORIGINATION

Based on discussions with the BF Lending Associates, applications and loan files are considered acceptable in quality

COMPLIANCE WITH BF CLOSING REQUIREMENTS

Two (2) loan documentation exceptions were noted on BF loans initiated by UPI Court resolutions were filed, however, mortgages were missing

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

Discussions with the BF Lending Associates and BF Audit indicated acceptable performance in this area

COMPLIANCE WITH BF MONITORING REQUIREMENTS

Monitoring reports are generally good quality per Lending Associates

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

BF Operations voiced no concerns over the repayment performance of this Bank

PROJECTED LOAN VOLUME

UPI projects that they will be able to generate 15-20 new loans for 10,000,000DM from September 1998 to August 1999 For the same period in 1999 to 2000 they project 20-25 loans for 10,000,000DM Management indicated they would provide staffing resources and the training necessary to achieve these levels of projected loan volume Management did note in its application that they are ready to participate heavily in the BF small loan program During the on site review management stated the Bank was ready to share some or all of the risk on the small loan program by guaranteeing payment on loans they would make This was contingent on the process being streamlined for quicker decision making and processing Management's commitment to the BF program is considered excellent

QUALITY AND SUFFICIENCY OF STAFF

Overview and staffing

The Bank has sixty-two (62) employees One lender, three support staff and the General Director work on the BF program credits This is sufficient for the current volume and management stated additional staff would be provided as needed

Senior Management

Meetings with the General Director and key members of executive and senior management were held as part of the due diligence process Management attending meetings

NAME	TITLE/POSITION
Letic Mirsad	General Director
Nazif Kurtovic	Assistant General Director – Credit
Tanovic Hajrija	Assistant to the Director
Branko Ekert	Secretary – Attorney
Ganiba Adilovic	Manager – Foreign Exchange
Danijela Mirvic	Manager BF Lending

Management was very knowledgeable in all aspects of banking A walkthrough was done in several departments and systems were observed The Bank's older Honeywell Bull system has already been converted to be Year 2000 compliant by an internal staff that appears to have superior information technologies background The Bank is planning on introducing new systems in parallel with the old system once the move to a renovated facility is completed

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

UPI's financial statements showed total assets of 42,360,000KM as of May 31, 1998, an increase of 2,543,000KM from the December 31, 1997 total Deposits increased 1,444,000KM during the same period Foreign assets are more than adequate to cover foreign liabilities Loans to domestic deposits are 103%, however, liquid assets are adequate at 24% of total assets Off balance sheet liabilities do not represent a significant risk to the Bank

The capital ratio at May 31, 1998 was 25 1% This level of capital is considered adequate

Net income for the year ended December 31, 1997 was 904,000KM Internal profit and loss data for the period ending June 30,1998, indicated net profit of 531,000KM The Bank's FBA loan rating report indicates an exposure of 2,336,000KM, which is adequately covered by 9,074,000KM in capital and reserves Data for 1997 was audited by Ernst & Young – Zagreb

Based on discussions with the information technology manager and a physical review of the Bank's computer center the current system is considered adequate The core software system is Year 2000 compatible Standard password access to systems is used

Loan officers do not have lending limits, however, loans are approved using a tiered system Lending Managers have a 50,000KM lending limit The Director of Lending may approve loans to 100,000 KM The Assistant General Director of the Bank may approve loans to 300,000KM Loans above these amounts are approved by a Lending Committee

OWNERSHIP

The Bank's stock is widely held by more than 1,000 stockholders Croatian Banks own a 28 5% stake in UPI The Bank has a capital augmentation strategy that includes foreign ownership of the Bank up to a level of 25%

AGENT BANK RECOMMENDATION

BANK	VAKUFSKA BANKA SARAJEVO
US SFOR (Y/N)	N
CANTONS	SARAJEVO
MUNICIPALITIES	SARAJEVO
HEADQUARTERS	SARAJEVO

Date	14 Aug 98	**AB Rec #**	32
Ownership (%)			
Private	81%	**State**	19%
Existing Agency Agreement?			
Yes	X	**No**	

Number of Outstanding BF Loans	2	**BF Market Coverage Geographic**	Sarajevo Tesanj Gracanica, Zenica, Bihac Bugojno and Cazin
Balance on Outstanding BF Loans	4 705 244 DM		
Range of Loan Sizes	1 260 000 dm to 3 900 000 DM		
Number of Loans 60+days past due	1		
Balance on Loans 60+days past due	1 260 000 DM		

Owners holding more than 10 percent of the bank and percentage ownership	1 MINISTRY OF FINANCE 2 3 4	1 19% 2 3 4

RECOMMENDATION SUMMARY

Vakufska Banka s Sarajevo (VB) ownership is 81% private and 19% state The bank is headquartered in Sarajevo The bank has 7 branches in the following towns Sarajevo Tesanj Gracanica Zenica Bihac Bugojno and Cazin In addition to the branches they have field offices in Bugojno and Cazin

The financial statements for 1997 have not been audited The bank is currently in the process of selecting an auditing firm They will comply with 11/8/98 deadline set by FBA At which time BF could have more confidence in the financial picture of the bank However based on the information BF has at this time the financial condition of the bank is satisfactory

The bank has developed a five year strategic business plan which it is currently implementing This plan was approved December 1996 The capital plan is an integral part of the strategic plan The bank is currently trying to raise 6 000 000 DM by the end of the year EBRD is interested in making an investment of 2 000 000 DM They plan to open additional offices after the new capital has been raised The bank shows a total capital position including reserves of 3 397 000 dm The amount of reserves for bad loans is 287 000 DM The capital to asset ratio including reserves is 17 26%

For the period ending December 31, 1997 the bank earned 254 000 DM Earning for the six-month period ending June 30, 1998 was 55 000 DM The bank s efficiency ratio has increased to 67 23% from 81 22% for the periods ending June30 1998 and December 31, 1997 respectively This ratio has improved due to increase net interest income and non-interest income The bank has been able to control expense effectively The loan portfolio has increased 175 000 DM or 1 92% for the six-month period under review The delinquency rate as of December 31, 1997 was 2 15% The loan loss allowance to total loans was 3 09% as June 30, 1998

Based on VB s performance in the BF lending program geographic location and the Bank s financial condition continued participation in the USAID Business Finance program is recommended with conditions and restrictions

Recommended Restrictions on Participation

The financial condition of VB must be monitored on a quarterly basis VB is to provide to BF quarterly financial statements

Bank Selection Team Member Thomas Chmelik		**Date** 14 Aug 98
BF Chief of Party Bruce Spake		**Date** 14 Aug 98
USAID Director CRAIG G BUCK		**Date**

STATUS AND QUALITY OF BF PORTFOLIO

As of July 1998 VB has done two (2) loans totaling 4,705,000 DM VB has one loan that were more than 60 days delinquent as of 7-22-98 This is a 26 78% delinquency ratio based on the total volume of loans

A recently completed evaluation of the loan portfolio and loan ratings resulted in the following

- 1 downgrade from 5 to 7 on a loan totaling 1,260,000DM

The resulting loan rating dispersion was as follows

RATING	# OF LOANS	AMOUNT
6	1	3,900,000DM
7	1	1,260,000DM

The downgrade to "7" is significant The overall quality of the portfolio is poor If the one loan is not addressed it will probably have to be restructured

QUALITY OF BF ORIGINATION

Based on discussions with BF Lending Associates, applications and loan files are considered acceptable in quality Speed of processing applications is sometimes slow

COMPLIANCE WITH BF CLOSING REQUIREMENTS

Loan documentation exceptions on BF loans initiated by VB were minimal Any issues with closing have been rectified

COMPLIANCE WITH BF DISBURSEMENT REQUIREMENTS

Discussions with BF Lending Associates and BF Audit revealed no significant concerns Disbursements are made in a timely fashion and given the financial condition and liquidity condition of the bank there is no need for concern

COMPLIANCE WITH BF MONITORING REQUIREMENTS

The overall quality of the monitoring reports is generally good VB has two loan officers who are required to prepare the monitoring reports Typical of most monitoring reports created by the Agent Banks, true analysis is sometimes lacking But with additional training they should be able to overcome this shortfall

COMPLIANCE WITH BF REPAYMENT REQUIREMENTS

BF operations voiced no concerns over the repayment performance of this bank The bank has sufficient liquid resources and does not need to hold BF's funds

PROJECTED LOAN VOLUME

VB projects they will be able to generate 12 - 15 new loans for 15,000,000 DM from September 1998 to August 1999 For the same period in 1999 they project 20 – 25 loans for 30,000,000 DM Management has indicated they would provide staffing resources and the training necessary to achieve these levels of projected loan volume

QUALITY AND SUFFICIENCY OF STAFF

Overview and staffing

Six (6) staff members are dedicated to support of the BF Lending program – three lenders and three support staff

Senior Management

As part of our due diligence process a meeting were held with the following individuals

NAME	TITLE/POSITION
Nurudin Kusturica	General Director
Amir Rizvanovic	Investment Sector Director
Habiba Tufo	Loan Officer
Mirsad Hodzic	Accounting & Bookkeeping Director
Naila Hadzic	Director of Sarajevo Branch Office

Management was very committed to continuing with the BF program Management appeared knowledgeable of the program and was happy to see the loan size has been decreased to 30,000 DM This will give it more opportunities to make loans to small businesses in locations where they have branches

FINANCIAL CONDITION, SYSTEMS AND INTERNAL CONTROL

The bank is in the process of selecting and outside auditing firm to audit the books for 1997 and 1998

VB's financial statements showed total assets of 14,415,000DM as of June 30, 1998 The loan portfolio increased 175,000 DM or 1 92% during the six months ended June 30, 1998 Total deposits have decreased 355,000 DM during the same period The loan to deposit ratio has increased to 136 53% as of June 30, 1998 The bank is aware that this is an unacceptable ratio and is taking action to try to increase deposits through its branch network Cash to total assets, including foreign cash, was 24 11% as of June 30, 1998 Off balance sheet liabilities were negligible

Problem loans per the Bank's Agent Bank Application were 196,212 DM at December 31, 1997 Which is 2 15% of total loans The loan loss allowance to total loans was 3 09%

The Bank's capital including reserves was 3,397,000 DM as June 30, 1998 The total capital to assets ratio, including reserves was 17 26% as of June 30, 1998 VB is trying to raise an additional 6,000,000-DM by December 1998 EBRD has expressed interest in making an investment in VB

Net income for the year ended December 31, 1997 was 254,000DM The bank's efficiency ratio for the periods ending December 31, 1997 and June 30, 1998 was 81 22% and 67 23% This positive trend in the efficiency ratio is mainly due to increased revenues However, they have also been able to maintain expenses at previous year's level

All systems within the bank are computerized However, the systems are not integrated at this time The have not made a schedule as to when this integration will take place Branches are not online and information is received via fax or modem

All loans are brought to loan committee at head office for approval However, there is one branch manager that has a 20,000-DM lending authority The board is informed on all loans after they are made

OWNERSHIP

The state owns 19% and 81% is controlled privately Of the private ownership no one individual controls more than 10% All state owned shares have been transferred to the Ministry of Finance awaiting privatization