

**STRENGTHENING BANK SUPERVISION
BOSNIA-HERZEGOVINA**

Report to USAID Mission, Sarajevo, Bosnia-Herzegovina

Cumulative For Contract Period Ending July 15, 1999

**To: Craig Buck, Mission Director
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**(USAID - ENI/PER,
Initial Contract #EPE-0005-I-00-5048-00 Period Beginning 7/96,
Modified and Extended 5/97 through 7/15/99)**

Project Title:

**Bosnia-Herzegovina, NBBH/Federation Banking Agency:
Strengthening Bank Supervision**

Contractor(s):	Timeframe(s):
KPMG, Barents Group	May, 1997-July 15, 1999

Overall Objective:

Promote a sound, competitive, market-oriented banking system.

The specific objectives of this Task Order are to:

- (1) Improve the legal and regulatory framework in which banks operate;
- (2) Promote the institutional development of the bank regulatory authorities in both entities;
- (3) Strengthen the bank regulatory authorities' capacity to regulate and monitor the banking system and individual banks; and
- (4) Assist the bank regulatory authorities to establish supervisory policies and procedures to deal with problem banks.

The objectives will be met through the development and implementation of a full range of tools and techniques that will enable the bank regulatory authorities to regulate and supervise all Federation and RS banking institutions. A full range of supervisory responses will be developed to allow them to supervise banks ranging from those which are fundamentally sound with only minor issues, to troubled banks where some form of FBA or RS bank supervision intervention may be required, to problem banks which may require closure and liquidation.

KEY EVENTS AND ACCOMPLISHMENTS DURING QUARTER

Economic Growth:

Increased economic activity since 1995 has been due largely to the impact of reconstruction projects and economic reactivation operations funded by the international community and the very low level of economic activity at the end of the war. The donor-funded projects are expected to have a continuing inflow of capital for the next 3-4 years, but at declining amounts. Both entities comprising Bosnia-Herzegovina are projected at 15% growth for 1999 and 2000, but dropping to single digit growth afterwards.

The recent conflict over Kosovo caused a major disruption of the economy in the Republika Srpska due to their significant trading relationship with Yugoslavia. Most indicators showed serious declines in economic activity and trading of goods. Political reactions over the conflict, decision on Brcko and arrests of indicted war criminals also impacted the activities of the international donors in Republika Srpska for a period of time.

The internal conflict and instability of the RS government has resulted in a tenuous situation that hampers outside investment. The Republika Srpska also experienced serious currency strains due to the devaluation and flight of the Yugoslavian Dinar, and the lack of hard currency reserves for the purchase of BH Konvertible Marka. A number of measures taken by the government in conjunction with the international community have moderated the pressures. This situation did have a favorable aspect; it gave impetus to the conversion to the Konvertible Marka. The Bosniac segments of the Federation had already made the conversion and the Croat areas still use the Kuna as one of the acceptable monies.

Only nominal impact was indicated on the economy in the Federation from the conflict over Kosovo. However, flatness and stagnation were noted in several parts of the Federation's economy. This appears due largely to investor hesitation caused by uncertainty around the delays in sector and enterprise restructuring efforts.

Banking

The legislation and timetable for restructuring and reform of the banking system is in place. Deadlines in April required the Federation's banks to begin the privatization or liquidation period for state owned banks. Legislation also required increased capitalization for banks, and new regulations became effective to change banking practices and strengthen supervision capability. Similar legislation and deadlines are trailing by about six months in the Republika Srpska. Despite delays and missed deadlines, these required actions should dramatically alter the banking system in 1999 and 2000.

Public confidence in banks remains very low as evidenced by a very low total of individual deposit accounts. This is not expected to improve significantly in the near term. The actions to reform the banking systems (intervention, closing, liquidation, etc.) are likely to contribute to a delay in confidence building until most of the restructuring is completed, insolvent/illiquid banks are

eliminated and unsound practices are changed. There also needs to be evidence of the strengthening and reliability of banks and a believable deposit insurance scheme in place.

Reform of the Payments System is also underway. This will eliminate a major economic and banking handicap. Representatives of the two banking agencies and Central Bank-BH, with assistance of USAID bank supervision advisors, have drafted a regulation and criteria for banks to begin handling payment transfers and clearing functions. These will be finalized in August 1999. The objective is to phase in participation by banks according to their capacity and the level of risk being undertaken. Higher risk activities will require specific licensing authorization by the banking agencies.

FEDERATION specific:

The banking system continues to be weak, illiquid, undercapitalized and lacking public confidence. However, differences in bank performance and customer selection are beginning to emerge. Five banks out of the 46 remaining reflect over 60% of the system's growth in deposits, profits and new lending. This concentration of confidence and performance is expected to intensify as the restructuring occurs and the ability to make informed decisions on bank selection improves later this year and next year.

The number of licensed banks peaked at 55 and is now declining. The new minimum capital level is 5 million KM core and net capital. Banks that did not meet the minimum capital on the March 31st reports were advised on or about April 23rd (end of 6 months transition period) that they had one week to inform the FBA of their capital adequacy. Some banks increased their capital, some merged and others have been taken over by a Provisional Administrator appointed by the FBA to conserve the bank until a resolution is determined. Several more mergers and interventions are projected.

Bank reports for December 31, 1998 indicated that 22 banks did not have adequate core capital and 36 banks did not meet the net capital minimum. Several banks that have since indicated they had increased their capital to meet the new minimums are believed to have used "creative techniques" to make capital appear to have increased. FBA examiners are conducting targeted examinations of capital to determine adequacy. The first round will concentrate on adequacy determined by a limited review of the bank's records. Some banks may pass the first capital review but be found deficient of the net capital minimum when a full examination is conducted. This includes a credit review with determination of losses and provisions needed and other tests.

The minimum capital requirement is expected to increase to KM 7.5 million within one year, most likely in conjunction or following the implementation of deposit insurance. A proper deposit insurance scheme is considered essential for building confidence in banks and attraction of household deposits. Amendments have been put forth to the existing law to improve its feasibility and limit risks to the insurance fund that will initially be funded by donors then maintained by premiums on the insured deposits.

Required audits and opening balance sheets were submitted by majority state owned banks. The opening balance sheets of three state banks were approved in mid-April, followed by development of

their privatization plans. Thusfar, there have been no outside investors that have indicated a serious interest. EBRD is working with one bank to develop its privatization plan and is trying to attract outside investors.

Seven formerly related state banks (two claim to be self-privatized) are in a state of limbo due to joint and several liability on large unpaid guarantees. Government officials are attempting to negotiate the obligations down and find a resolution to avoid closure of the banks. A possibility is the combination of parts of the seven banks into one or two units in a way to establish privatization plans. Hopefully, the resolution won't result in some manner of propping up the banks or in a substantial delay of the needed restructuring.

One state bank is in limbo due to a dispute between Bosnia and Slovenia on settlement of the bank's status. Several former state banks claim to have self-privatized prior to the law's effective date. Resolution of these situations will take time, but most should happen by mid-2000.

Legal Framework

The combination of banking law and regulations provide a legal framework comparable to western standards and the Core Principles for Effective Bank Supervision issued by the Basle Committee. The FBA is also building its capabilities for appropriate application and enforcement. The transition period for the new Law on Banks and Regulations ended April 23, 1999. Many banks have not met the requirements and the FBA has initiated several administrative and enforcement actions to obtain compliance or resolution. This should substantially improve banking practices, and the safety and soundness of the banking system over the next several years. FBA officials conducted training on the new regulations and bank reports for staff members, and then a seminar on reports for bankers on July 12-14, 1999.

The FBA also issued new regulations on licensing of banks, audit report standards and solvency. A short term UST advisor has proposed internal procedures for banks on Internal Control systems and Audit. We provided our training materials for his review to ensure that the proposed procedures were compatible with training and procedures provided the agencies' examiners. Bankers' training in the procedures will be conducted in both entities in late-September.

Problem Bank Intervention and Resolution

The first Letter of Agreement with a bank was signed in January 1999. The first conservatorship of a bank began in March 1999 with the appointment of a Provisional Administrator. While these two actions were not as successful as hoped, they provided valuable lessons and began building the role of the FBA in enforcement and resolution actions. The FBA has appointed 6 additional Provisional Administrators to takeover banks and revoked 3 additional licenses. In total, 10 banks have been intervened and taken over.

A total of 10 banks have been intervened, most for not meeting the minimum requirement for capital. The first bank intervened since the new law was declared insolvent and referred to a Bankruptcy Court for liquidation. This has since become a concern as the court appointed official has indicated that his role is to try to resolve the situation in a way that allows the bank to restart operation (but compromises depositors and creditors). The FBA is presenting its concerns to the government and

international community (USAID, World Bank, IMF, OHR, EU). This is to obtain support to head off such actions as they violate the Law on Banks and would be a serious impediment to correction of problems in the banking system. FBA officials recognize that the primary objective of problem bank resolution is to facilitate a financial system in which banks are trusted to perform their economic function in a safe and sound manner. The FBA is gaining experience and building its expertise in resolving banking problems.

Unified Bank Reporting

The bank reporting forms and detailed instructions have been thoroughly reviewed and approved. FBA officials held a training seminar for bankers on July 12-14, 1999 to discuss the instructions and further explain the reports. The FBA plans to issue a report with condensed financial reports for all banks using a common presentation with comparable ratios of strength and performance. The first such report available is will likely contain year-end 1999 data. A number of issues are yet to be determined on format, content, secrecy/confidentiality, accuracy, reliability of data, etc.

Uniform Chart of Accounts

Banks are required to implement the UCOA during 1999. This is a slightly modified version of the IMF designed COA. Some guidance and assistance is needed to ensure implementation is in compliance with standards as this is outside the current knowledge of most banks. FBA officials are planning some training seminars for bankers.

Funding of Agency by Assessments and Fees

The FBA was funded primarily by the World Bank for its first two and one-half years. This was by agreement with USAID to provide Technical Assistance. It became self-funded in late 1998 by implementation of fees and assessments for licensing and supervision. A concern that the Agency was required to pay taxes (30%) on the revenues received from banks in the form of fees and assessments was discussed with the tax authorities. The MOF has indicated that he will sponsor an amendment exempting the FBA and 5 similar regulatory agencies from such taxation. He has asked for some supporting analysis and reasoning. (Note: another issue on allowable tax deductions for bank loan loss provisions was resolved as being compatible with FBA regulations on loan loss provisioning.)

REPUBLIKA SRPSKA specific:

There are 17 licensed banks and 1 postal savings house. Most of the larger banks are state-owned, and most of the privately owned banks are small and inactive. Two applications for new banks are being reviewed. Eight banks and the postal savings house are undergoing privatization, and two other banks are being reviewed for their eligibility for privatization. Most privatizing banks have submitted their opening balance sheets. They are being reviewed for correctness and solvency.

The Banking Agency was formed March 1998. Prior to then, the supervisory function was provided by the former National Bank of Republika Srpska. The Managing Board, Director and Deputy Director were appointed in May and June 1998.

The agency has been operating on a partial budget on assets and income remaining from the predecessor NB-RS. The government's budget is the most likely initial source before banks can afford to pay, but the Director has avoided that source due to potential problems affecting Agency independence and sufficiency of funding. World Bank Credits to the government contain a requirement for funding the banking agency. Other funding from international donors appears unlikely at this point.

Legal Framework:

Six new or revised regulations on such subjects as internal control, internal and external audits, liquidity, lending limits and loan documentation were issued in March 1999.

A comprehensive banking law was passed on July 9, 1999. Provisions include higher capital requirement (5 million Konvertible Marks), license granting/revocation, measures for corrective action, and provisional administration of failed banks.

The remaining important laws in process are: Deposit insurance, micro-credit and other financial institutions, accounting and chart of accounts. Additional regulations will be issued as follow-on to new banking law.

It is anticipated that the legal framework will mirror the Federation when completed. Officials of the two agencies are very cooperative and constructive in their efforts. Consistent efforts are given to harmonize regulations and supervision.

Bank Supervision:

Full-scope on-site examinations have been performed on nine banks, using U.S. advisors as team leaders. These examinations provide comparable data for all state-owned banks. Only one mid-sized bank has not received a full-scope examination. This is because it is in the process of being split from the central payment system (SPP). Limited scope diagnostic reviews have been performed on all but the newest banks, which are as yet small and inactive. The Agency has begun performing full-scope examinations on small banks also.

A remaining issue: Short-term U.S. advisors will be needed to a limited extent on examination of the payment-system bank (Razvojna), re-examinations of the largest banks, and for specific problem banks. An effort will be given to coordinate this with training on standard examination procedures and further development of the Examiners Manual.

The Agency requires several periodic reports from banks, including some adopted from the Federation Banking Agency, but the system is not comprehensive and no analysis is done. The Director and Deputy Director have stated their intent to adopt the same reporting system and chart of accounts as used in the Federation.

Remaining: Adopt the reporting and monitoring system in Republika Srpska, carry out training in use of the system and in analysis of data. Training on analysis and supervision scheduled for end of August with implementation of the new reports projected for year-end 1999.

Training:

Eleven seminars (plus one repeated) on bank supervision subjects have been delivered, most of them a week in duration and several conducted jointly with the Federation Banking Agency. Eleven senior staff members have attended tailored comprehensive bank supervision training in the United States. A few official have also participated in training in Europe to a limited extent.

OTHER: Both banking agencies:

Coordination between the Central Bank and the two banking agencies

We have facilitated several meetings of the full Coordination Group and Working Groups. The key items addressed have been exchange of information, coordinated requests for bank information, disclosure and reports to outside parties, confidentiality, payment system changes and regulations, and banks' failure to meet reserve balance requirements.

Micro-Finance Regulatory Structure

A follow-on working session and seminar was held in February 1999. The proposed law and regulatory structure have been submitted for further review. Minor changes are projected. Representatives of the MOF have been involved and foresee little opposition to enactment in a reasonable period of time. The proposed regulatory authorities would be under the banking agencies in the Federation and Republika Srpska.

The general concept is for different categories of licensed units to receive different levels of regulation depending on risks posed to the public through deposits or other liabilities. It would allow evolution into a fully licensed and supervised commercial bank if substantial growth occurred and acceptable qualifications were achieved.

USAID / BOSNIA
Performance/Planning Document

July 15, 1999

PERFORMANCE DATA: <u>(Federation Banking Agency)</u>		
Expected Results	By Date:	Current Status:
A. Legal/Regulatory Framework		
Regulations drafted for laws enacted.	3Q97 - 3Q99, ongoing	Law on Banks (commercial banking law) enacted 10/15/98 with 6 months transition period. Twelve key regulations were issued 1/5/99. Revised Regulations on Licensing, Audit Report Standards and Solvency Determination have since been issued. All regulations are in process of being implemented. The basic legal framework is sound & meets Basle Committee Standards for Effective Bank Supervision. Primary emphasis now is on obtaining compliance and refinement of legal issues.
Training materials for staff on laws, regs. & changes during prior qtr.	3Q97 - 3Q99, ongoing	Substance covered in training seminars on all above except licensing. FBA has conducted in-house training for staff on the new regulations. Training for bankers is being planned (Limited training in May 1998 and July 1999).
Suggest & participate in seminars for bankers on legal & regulatory topics.	4Q97 - 3Q99 ongoing	We participated in Privatization & Opening Balance Sheet Seminar for bankers and CPAs; also the bank seminar above.
B. Regulatory Oversight		
<u>1. Supervisory Activities</u> Review/update Mission Stmt., Strategic Objective, & Supervisory Policy	3Q97 & 4Q97	Done. These are informally applied. Additional effort will be needed.
Licensing policy and procedures drafted and submitted to FBA for approval. Tested and modified.	3Q97--1Q98	Done. Recommended Policy & Procedures previously submitted were converted to a regulation at request of FBA. The regulation and procedures were revised after the new banking law was enacted.

Federation - continued

<p><u>2. Risk Monitoring</u> a) Onsite Examinations <i>Examination Manual Policies and Procedures</i></p> <p>50% of the basic exam. Manual chapters (related to CAMEL) and standardized workpaper and report formats will be completed, tested and implemented.</p> <p>75% of the basic exam. manual will be completed, tested and implemented.</p> <p>100% of the basic exam. manual will be completed, tested and implemented.</p> <p>New advanced chapters will be drafted, tested and implemented and revisions to basic chapters.</p> <p><i>Training</i> Evaluation of training needs for the upcoming quarters and time tables identified. Classroom training in basic examination techniques to all new bank suprv. personnel, and on-the-job training to all participants in advisor assisted examinations.</p> <p>Classroom and on-the-job training in the use of the exam. manual procedures and standardized formats and supervisory methodologies presented. Developed and carried out a program to ensure that 100% of the bank supervision staff attend/receive core training. Trainers identified.</p> <p>Developed a training schedule for the remainder of 1998/99. Bank supervision department trainers scheduled as instructors.</p>	<p>3Q97</p> <p>4Q97</p> <p>1Q98</p> <p>2Q98-4Q98</p> <p>3Q97</p> <p>4Q97; 1Q98-4Q98</p> <p>3Q98</p>	<p>A basic/standard examination manual was completed and provided to FBA. Use is limited. Modifications and additional training are needed. A detailed examination procedures manual for training and reference is in process. Workpaper and ROE formats modified from proposed by advisors.</p> <p>As above.</p> <p>As above.</p> <p>As above.</p> <p>Evaluation done, updated in June & December 1998, July 1999. All basic and substantial advanced training conducted, plus OJT in banks with advisors in 21 banks.</p> <p>As above, use of supervisory methodologies & exam. procedures were reinforced by inbank OJT and advisory sessions related to ongoing bank exams. Additional training to reinforce these concepts planned in Oct. 1999. Potential trainers identified.</p> <p>Completed through 1999, projected beyond. FBA trainers projected to be co-instructors beginning in late-99 or early-2000.</p>
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Federation - continued:

<p><i>Advisor Assisted Examinations</i> 50% of the banks, mainly the largest institutions, will be examined. Reports of findings drafted.</p>	<p>3Q97</p>	<p>Advisors provided major assist on 21 of largest, most problematic banks covering 90% of system assets. Advisors have provided as needed assistance on other banks. All banks received some supervisory review in 1997 (several were limited scope).</p>
<p>100% of the banks will be examined with advisor assistance. Reports of findings drafted.</p>	<p>4Q97</p>	<p>32 of 50 banks had full scope exams in 1998; others had limited reviews.</p>
<p>Examination reports finalized and concerns communicated to the respective bank management</p>	<p>1Q98</p>	<p>Done.</p>
<p>b) Offsite Surveillance The advisor will review existing regulatory reports, chart of accounts, and MIS reports. Based on this review and on their observations of bank activities, recordkeeping and accounting practices during the training examinations, the advisors will identify deficiencies and present recommendations to FBA management.</p>	<p>3Q97</p>	<p>Completed 2Q97, updated 3Q97 & additional work done in 1Q98, & ongoing as reports modified. Accuracy and usefulness of reports improved substantially during this time. Database output reports also improved. Model was modified to improve ease of use (Menu driven), & additional training provided. Major changes to bank reports for 6/99 required additional changes to database and output reports. To be completed 9/99.</p>
<p>The advisor will complete assessment of offsite reporting and analysis requirements and will assist in drafting recommd. modifications of the regulatory reports, acctn. standards, MIS reports.</p>	<p>4Q97</p>	<p>As above. Completed project to map reports from all banks, developed written instructions on revised reports and presented to 2 banks to for input before final issuance. Revised reports developed, Unified reporting implemented for June 1999 reports (to IAS standards, very similar to U.S. Bank Call Reports). Addl. training and revised procedures planned for late August 1999.</p>
<p>c) Systemic Analysis The concept of a systemic analysis process to measure risks in the financial sector will be introduced, i.e., economic factors, systemic issues.</p>	<p>1Q98</p>	<p>Previously discussed with Suprv. staff & FBA officials, overview in training courses. Training planned for August 1999 will include systemic analysis, with addl.</p>

	training planned Feb. 2000 using YE-99 reports.
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Federation - continued

<p><u>3. Supervisory Responses</u></p> <p>a) Remedial Actions The advisors will review enforcement and compliance provisions for troubled bank resolution and will draft recommended policies and procedures.</p> <p>b) Bank closure/liquidation Develop policies, procedures</p>	<p>1Q98</p> <p>3Q98</p>	<p>Drafts presented. Processes for effective remedial actions discussed extensively with senior officials. 6 licenses revoked for non-compliance or insolvency, 5 revoked due to merger, several agency orders, and multiple letters and “moral suasion” visits. Covered briefly in several basic supervision courses. Specifically covered in <i>Supervision of Problem Banks</i> conducted 9/29-30/98 for senior examiners, officials & attorneys. Also covered in <i>Advanced Bank Supervision & Financial Crimes</i>.</p> <p>Letter of Agmt. developed for bank with liquidity crisis & other problems. Conservatorship Manual developed for takeover, closing bank & liquidation by Provisional Administrator. 10 banks placed under conservatorship.</p>
<p><u>4. Supervisory Processes/Structure</u> Evaluate organizational structure, lines of authority & effectiveness, make recommendations.</p>	<p>1Q99</p>	<p>Minor recommendations made, some changes made. Addl. review to be done.</p>
<p><u>5. Organizational Development</u></p> <p>a) Staffing -- Refer to B.1 (a) Organizational structure review/development will be accomplished as part of the Mission Statement, Strategic Objective and Supervisory Policy development/implementation.</p> <p>b) Training A formal mechanism to ensure appropriate training is provided to FBA personnel and will be institutionalized under all components, i.e., onsite, offsite, licensing etc. The program will have incorporated</p>	<p>2Q98</p> <p>Ongoing</p>	<p>Recommended that a small expansion of onsite supervision staff be considered and cross training of on-offsite staff so as to make maximum uses of resources. Later Recommendations made in Supervision, including additional staff, revised structure, with objective of completing more examinations, dedicating more resources to problem banks and using offsite staff for more efficient surveillance of banks.</p> <p>All basic training courses are retained in library for future FBA use. Train-the-trainer and institutionalization of courses delayed due to no turnover & small</p>

<p>'train the trainer' concept.</p>		<p>number of new staff (2) from initial training thru mid-1999, then 4 new examiners. Training projected for Dec. 99 or Feb. 00 in Train-the-Trainer.</p>
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Federation - continued.

<p><u>6. Management Processes</u></p> <p>a) Planning/Scheduling A staffing assessment/needs model will be used to assist in scheduling examinations. Risk based concepts of scheduling will introduced as a more complex method of scheduling.</p>	<p>1Q98</p>	<p>Concept accepted, but model not used by FBA. Banks scheduled by informal risk projections. FBA agreed to develop more formalized risk process. We recommended cross-training of on-offsite staffs to better incorporate off-site reviews into planning & scheduling, also more attorney involvement on higher priority & problem banks. Agency will get additional training on risk ratings in Aug. & Oct. 99 training.</p>
<p><u>7. Supervisory Tools</u></p> <p>A draft bank rating system policy based on risks will be drafted.</p> <p>The draft rating policy will be presented to FBA management and recommendations for changes implemented and finalized.</p> <p><i>Analytical Tools</i> Recommendations for the development of computer models (projections, capital adequacy analysis, etc.) will be suggested to FBA senior management.</p>	<p>1Q98</p> <p>2Q98</p> <p>1Q99</p>	<p>Has been drafted, discussed and preliminary implementation work done. Ratings are still informal, not officially used. Officials agree on rating system, but tend to emphasize more fixed ratios in the process. Current practice is to document CAMEL by narrative comments using ratios as basis, but not assign numerical rating.</p> <p>Final draft of risk rating policy expected to be presented to Mgn. Bd. in Oct. 99. FBA officials agreed to implement by YE-99.</p> <p>Partially completed. Compliance tests were incorporated into Offsite monitoring model. All ratios required by law/reg. are calculated & evaluated; however, a process for effective followup action is not practiced. Addl. early warning indicators requested by mgmt. prepared by Licensing and Suprv. Dept. Addl. recommendations in process due to changes to reports and database.</p>
<p><u>8. Other Supervisory Activities</u></p> <p>Benchmarks will be developed as appropriate based on the assistance requested.</p>		

NOTE: This section specific to Banking Agency of Republika Srpska

PERFORMANCE DATA: (Republika Srpska)		
Expected Results	By Date:	Current Status:
A. Legal/Regulatory Framework		
Regulations drafted for laws enacted.	3Q 1998	Law established Agency April 1998. Bank Privatization Laws passed July 1998. 6 Regulations issued March 1999. Also, 2 Regulations on guaranties issued. Law on Banks passed July 99. Copies of FBA law & regulations were used as reference on above. Other regulations are being readied.
Training materials for staff on laws, regs. & changes during prior qtr.	Ongoing	Incorporated in training.
Suggest & participate in seminars for bankers on legal & regulatory topics.	Ongoing	Advisors Taber & Berney participated in an Agency sponsored seminar 12/28/98 on Privatization & Opening Balance Sheet Laws. BA-RS sent representatives to FBA's seminar on bank reporting.
B. Regulatory Oversight		
<u>1. Supervisory Activities</u> Review/update Mission Stmt., Strategic Objective, & Supervisory Policy	3Q 1998	Done. Ongoing discussions with officials. Informally done.
Licensing policy and procedures drafted and submitted to BA-RS for approval. Tested and modified.	3Q 1998	Recommended Policy & Procedures previously submitted and Regulation drafted. We plan to assist on revision projected in late-1999.

Republika Srpska - continued.

<p>2. Risk Monitoring</p> <p>a) Onsite Examinations <i>Examination Manual Policies and Procedures</i></p> <p>50% of the basic exam. manual chapters (related to CAMEL) and standardized workpaper and report formats will be completed, tested and implemented.</p> <p>75% of the basic exam. manual will be completed, tested and implemented.</p> <p>100% of the basic exam. Manual will be completed, tested and implemented.</p> <p>New advanced chapters will be drafted, tested and implemented and revisions to basic chapters.</p> <p><i>Training</i> Evaluation of training needs for the upcoming quarters and time tables identified. Classroom training in basic examination techniques to all new bank superv. Personnel, and on-the-job training to all participants in advisor assisted examinations.</p> <p>Classroom and on-the-job training in the use of the exam. manual procedures and standardized formats and supervisory methodologies presented. Developed and carried out a program to ensure that 100% of the bank supervision staff attend/receive core training. Trainers identified.</p> <p>Developed a training schedule for the remainder of 1998/99. Bank supervision department trainers scheduled as instructors.</p>	<p>1Q 1999</p> <p>1Q 1999</p> <p>2Q 1999</p> <p>3Q 1999</p> <p>Ongoing</p> <p>Ongoing</p> <p>July, 1998</p>	<p>Standard examination manual developed for FBA modified & provided to examiners during onsite work for review. Selected sections tested. To follow up with working group after Oct. 1999 training.</p> <p>As above. Detailed manual for basic areas to be developed following above standard procedures revision.</p> <p>As above.</p> <p>Initial evaluation completed. Updated 6/98 & 12/98. Revised July 1999. Plan update Jan. 2000. All basic courses conducted. OJT in banks on Diagnostic Reviews and full-scope exams.</p> <p>As above. Twelve classroom courses have been provided on specific examination activities presented.</p> <p>Updated each 6 mos. or as needed, now through early 2000.</p>
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Republika Srpska - continued.

<p><i>Advisor Assisted Examinations</i> 50% of the banks, mainly the largest institutions, will be examined. Reports of findings drafted.</p> <p>100% of the banks will be examined with advisor assistance. Reports of findings drafted.</p> <p>Examination reports finalized and concerns communicated to the respective bank management</p> <p>b) Offsite Surveillance The advisor will review existing regulatory reports, chart of accounts, and MIS reports. Based on this review and on their observations of bank activities, recordkeeping and accounting practices during the training examinations, the advisors will identify deficiencies and present recommendations to BA-RS management.</p> <p>The advisor will complete assessment of offsite reporting and analysis requirements and will assist in drafting recommend modifications of the regulatory reports, acc. standards, MIS reports.</p>	<p>3Q 1998</p> <p>mid-1999</p> <p>3Q 1998</p> <p>4Q 1998</p>	<p>Full-scope examinations of 9 banks completed, about 80% of Active Assets in RS. Only 1 significant bank not included (bank joint with payments system unit). Diagnostic Reviews completed on 15 banks (all but newest).</p> <p>As above.</p> <p>Reports finalized on all banks done. Exit meetings included communication of concerns by Advisors and RS officials.</p> <p>Discussed with officials. The same process as in FBA will be followed, including Offsite Monitoring and Analysis model. Presentation done in December. Uniform Chart of Accounts (fka IMF) modified and to be implemented for 1999 as in Federation. Implementation of Unified Bank Reports delayed until YE-99. An advisor is projected in October to replicate work as in Federation, and reports will meet IAS.</p> <p>In process as above. Bank performance reports were translated for mapping and establishing database for offsite model. Revision of database according to new Unified Bank Reports projected Oct. 99. Training on analytical and variance tests will be provided in Aug. 1999.</p>
<p>c) Systemic Analysis The concept of a systemic analysis process to measure risks in the financial sector will be introduced.,i.e. economic factors, systemic issues.</p>	<p>1Q 1999</p>	<p>Introduced in prior training courses, to be expanded in specific Offsite Bank Report training in Aug.-1999.</p>

Republika Srpska - continued.

<p><u>3. Supervisory Responses</u></p> <p>a) Remedial Actions The advisors will review enforcement and compliance provisions for troubled bank resolution and will draft recommended policies and procedures.</p> <p>b) Bank closure/liquidation Policies, procedures, process developed.</p>	<p>4Q 1998</p> <p>4Q 1998</p>	<p>Policies, procedures and regulations will be replicated from FBA. Specific training was presented Sept. 29-30th 1998.</p> <p>Procedures, process & manual developed for FBA to be shared, guidance provided on use. Conservatorship and Resolution Manual provided.</p>
<p><u>4. Supervisory Processes/Structure</u></p> <p>Evaluate organizational structure, lines of authority, & effectiveness. Review, recommendations</p> <p><u>5. Organizational Development</u></p> <p>a) Staffing -- Refer to B.1 (a) Organizational structure review/development will be accomplished as part of the Mission Statement, Strategic Objective and Supervisory Policy development/implementation.</p> <p>b) Training A formal mechanism to ensure appropriate training is provided to BA-RS personnel and will be institutionalized under all components, i.e., onsite, offsite, licensing etc. The program will have incorporated 'train the trainer' concept.</p>	<p>4Q 1998</p> <p>4Q 1998</p> <p>1Q 1999</p>	<p>Basic table for organization is on paper, to be completed on funding. Advisors have had several discussions with officials on organization and staffing.</p> <p>Agency law passed, capital and operating budgets were prepared using FBA experience as reference. Advisors have been in contact with govt. & donors re: funding.</p> <p>Initial training needs were assessed based on assumptions. Updated June, Dec. 1998 and revised July 1999. "Train the Trainer" postponed, projected for Dec. 1999 or Feb. 2000. Other classroom training scheduled through early 2000. Update & Revision of Training Plans planned for mid-1999.</p>
<p><u>6. Management Processes</u></p> <p>a) Planning/Scheduling A staffing assessment/needs model will be used to assist the BA-RS in preparing the schedule of examinations. Risk based concepts of scheduling will introduced as a more complex method of scheduling.</p>	<p>1Q 1999</p>	<p>Agency formed, but organization remains tentative. Schedule based on projected priorities of privatization and restructuring process. Risk based concepts presented in training will be implemented later.</p>

Republika Srpska - continued.

<p><u>7. Supervisory Tools</u></p> <p>A draft bank rating system policy based on risks will be drafted.</p> <p>The draft rating policy will be presented to BA-RS management and recommendations for changes implemented and finalized.</p> <p><i>Analytical Tools</i> Recommendations for the development of computer models (projections, capital adequacy analysis, etc.) will be suggested to BA-RS senior management.</p>	<p>3Q 1998</p> <p>4Q 1998</p> <p>4Q 1999</p>	<p>Was discussed in training presented, will be covered in Off-site & Managing Exam. training (Aug. 1999 & Oct. 1999).</p> <p>To be presented later, following issuance of regulations and procedures. To discuss with training above.</p> <p>To replicate from FBA model implemented. To be covered in Aug. & Oct. 1999 training. Addl. training to be provided in early 2000 using YE-99 bank report data.</p>
<p><u>8. Other Supervisory Activities</u></p> <p>Benchmarks will be developed as appropriate based on the assistance requested.</p>		

TANGIBLE RESULTS

The Task Order defines several Tangible Results to be achieved during the period of performance. The Results were developed with the understanding that due to the dynamics of the situation, some flexibility in achieving the Results and Benchmarks may be necessary. To address this, the contract provided for the following:

In evaluating the progress and achievement of the Tangible Results and Benchmarks within the task order, three factors must be considered:

- the dynamic environment in which the TA will be provided;
- the desire to provide TA as rapidly as the absorption capacity of counterparts allows; and
- the need to ensure coordination with other donor organizations to avoid duplication and create synergy to the extent possible.

These factors may impact the timing and sequencing of efforts. In addition, the dynamic situation may result in the need to redefine the desired goals. Therefore, the Tangible Results and Benchmarks presented below are subject to change as our counterparts' needs change. Because of the situation in B-H and RS, a periodic Benchmark will be to reassess the current situation and needs and to present modified Benchmarks to USAID for their consideration. The periodic reevaluation of Benchmarks is anticipated to occur during 4Q97 and 4Q98. Additionally, the Benchmarks will be revisited during review of the new contract being beginning in July 1999.

Tangible Results:

1. The bank supervision authorities in the Federation and RS will have begun to examine licensed banks according to an annual schedule based upon perceived risk which banks pose to the overall banking sector.

	FBA	<u> X </u>	Achieved	<u> </u>	Not Achieved	<u> </u>	In Process	
	RS	<u> </u>	Achieved	<u> </u>	Not Achieved	<u> </u>	<u> X </u>	In Process

(FBA has scheduled based on perceived risk, but is now unable to meet annual plan due to problem banks increasing and staff limitations.)

2. The bank supervision authorities in the Federation and RS will have developed an on-site examination manual based upon CAMEL components (Capital adequacy, Assets, Management, Earnings and Liquidity) and a risk management assessment that is used during onsite inspections.

	FBA	<u> </u>	Achieved	<u> </u>	Not Achieved	<u> </u>	<u> X </u>	In Process
	RS	<u> </u>	Achieved	<u> </u>	Not Achieved	<u> </u>	<u> X </u>	In Process

(Standard Manual developed , but not full implemented.)

3. The bank supervision authorities in the Federation and RS will have developed a training program and training materials for both onsite inspection and offsite analysis and examiners will have been trained based on a predetermined core curriculum.

FBA	<u> X </u>	Achieved	<u> </u>	Not Achieved	<u> </u>	In Process
RS	<u> X </u>	Achieved	<u> </u>	Not Achieved	<u> </u>	In Process

(Officials accepted the Training Program presented, agreed to transfer responsibility for program maintenance to them in future.)

4. The bank supervision authorities in the Federation and RS will have developed standardized documents relating to onsite examinations, e.g., request letters to bank management, reports of examination and formatted working papers and examination staff will have received training in the use of these documents.

FBA	<u> X </u>	Achieved	<u> </u>	Not Achieved	<u> </u>	In Process
RS	<u> X </u>	Achieved	<u> </u>	Not Achieved	<u> </u>	In Process

(Standardized documents exist, used informally.)

5. The bank supervision authorities in the Federation and RS will have established an organizational structure which supports effective and efficient bank supervision -- position descriptions which reflect duties and responsibilities and reporting requirements.

FBA	<u> </u>	Achieved	<u> </u>	Not Achieved	<u> X </u>	In Process
RS	<u> </u>	Achieved	<u> </u>	Not Achieved	<u> X </u>	In Process

(Effectiveness and efficiency are improving.)

6. A revised Chart of Accounts and regulatory reporting based on International Accounting Standards will have been developed.

FBA	<u> X </u>	Achieved	<u> </u>	Not Achieved	<u> </u>	In Process
RS	<u> </u>	Achieved	<u> </u>	Not Achieved	<u> X </u>	In Process

(Developed & required during 1999; banks will need assistance in implementation.)

7. The bank supervision authorities in the Federation and RS will have developed an offsite surveillance policy and procedures manual.

FBA	<u> </u>	Achieved	<u> </u>	Not Achieved	<u> X </u>	In Process
RS	<u> </u>	Achieved	<u> X </u>	Not Achieved	<u> </u>	In Process

(BA-RS has agreed to implement similar policy/manual by YE-99.)

8. The bank supervision authorities in the Federation and RS will have implemented standardized formats for offsite analyses of financial institutions and summary reports and the examiners will have been trained in their use.

FBA	<u> </u> Achieved	<u> </u> Not Achieved	<u> X </u> In Process
RS	<u> </u> Achieved	<u> X </u> Not Achieved	<u> </u> In Process

(Training planned for August & October 1999 that will further the effort .)

9. The bank supervision authorities in the Federation and RS will have adopted policies for supervisory responses (i.e., enforcement actions) and problem bank resolution.

FBA	<u> X </u> Achieved	<u> </u> Not Achieved	<u> </u> In Process
RS	<u> </u> Achieved	<u> X </u> Not Achieved	<u> </u> In Process

(FBA has initiated several such actions, additional effort needed for promptness and efficiency of actions.)

10. The bank supervision authorities in the Federation and RS will have developed policies and processes to draft and implement banking regulation and methods to communicate practices/decisions to the banking industry.

FBA	<u> X </u> Achieved	<u> </u> Not Achieved	<u> </u> In Process
RS	<u> </u> Achieved	<u> </u> Not Achieved	<u> X </u> In Process

(Improvement needed, especially in effectiveness and proactive nature.)

11. The bank supervision authorities in the Federation and RS will have adopted policies to ensure the proper oversight of supervisory activities (i.e., a Mission Statement, Supervisory Policy, Licensing Policy).

FBA	<u> X </u> Achieved	<u> </u> Not Achieved	<u> </u> In Process
RS	<u> </u> Achieved	<u> </u> Not Achieved	<u> X </u> In Process

(Mission Statement is informal.)

To date, our Residents supported by short-term experts have been able to substantially achieve the Tangible Results as outlined. Our advisors have assisted in designing and implementing the foundation for a basic supervisory process at the Federation Banking Agency and at the more recently established Banking Agency of Republika Srpska. Tangible Results in BA-RS have been impacted somewhat by erratic actions and periodic delays by a government that has ongoing internal stresses, impacts by the problems with Yugoslavia, conflict in Kosovo, travel restraints on Americans, etc.

The supervision staff has been provided guidance in the development of policies and procedures, in the performance of examinations from both an onsite and offsite basis, and in the implementation of a comprehensive financial reporting function. Substantial classroom and on the job training has also been provided. These achievements and the willingness and efforts of our counterparts have allowed us to remain on track for achievement of the Results and Objectives of this Task Order.

It is anticipated that by the current contract end, all Tangible Results will have been achieved or will be in process of fulfillment in the Federation and substantial progress made in the Republika Srpska. Achievement of the desired Results will signify that the counterparts have achieved the initial phases of building a banking supervision culture.