

In 1999, the banking system of the Republic of Croatia consisted of 53 banks (including one branch of a foreign bank) and 34 savings banks (including four housing savings banks). Total assets of the banking sector¹ were 95.2 billion kuna at the end of 1999, with those of banks amounting to 98.45 percent and those of savings banks to 1.55 percent.

1999 was the first year in which a decrease was recorded in the number of institutions operating in the banking system: 7 banks and one savings bank went bankrupt, and only one new housing savings bank was established.

The Croatian banks are of the universal type. Banks and savings banks that prior to the introduction of the new Banking Law had the legal status of 'd.o.o' were required to transform themselves into 'd.d.'s by the end of 1999. All banks, except one savings bank, met this requirement. 48 banks had full authorization, meaning that they fulfilled the conditions for making external payments and entering into credit arrangements abroad, while only 5 banks had limited authorization. The four largest banks accounted for 57.71 percent of total bank assets, compared to 53 percent in 1998.

At the end of 1999, 8 banks were in majority state ownership, but this number decreased to 5 as early as January 2000, after the sale of Privredna banka Zagreb and its subsidiaries (Krapinsko-zagorska banka d.d., Krapina and Laguna banka d.d., Poreč). Splitska banka and Riječka banka, which are the third and the fourth largest in terms of assets, are in the process of privatization. 13 banks were in majority foreign ownership at the end of 1999.

In 1999, drastic market exit measures had to be taken against several banks with risky operations (high interest rates, loans granted to connected persons, inadequate guarantees and lack of concern for recoverability of claims) that became incapable of fulfilling their obligations. Bankruptcy proceedings were initiated against 7 banks and one savings bank (Ilirija banka, Glumina banka, Gradska banka, Komercijalna banka, Županjska banka, Neretvansko gospodarska banka, Promdei banka and Invest štedionica). Proposals were submitted to the Commercial Court for the initiation of bankruptcy proceedings in Trgovačko-turistička banka, Štedionica Mediteran and Štedionica Gold. The proposal for the initiation of bankruptcy proceedings in Trgovačko-turistička banka is still being considered by the High Commercial Court. The Commercial Court rejected proposals for the initiation of bankruptcy proceedings in Štedionica Mediteran and Štedionica Gold; their operating licenses were withdrawn in 2000.

At the end of 1999, two banks were still undergoing the rehabilitation process. The rehabilitation of Dubrovačka banka started back in 1998, and the decision to rehabilitate Croatia banka was passed during 1999.

1999 saw the beginning of the implementation of the new Banking Law. Pursuant to this Law, the Croatian National Bank was authorized to appoint temporary administrators and commissioners to banks with operating difficulties. During 1999, temporary administrators were appointed to several banks (one bank is still undergoing rehabilitation and the others

¹ All data in this section are preliminary.

went bankrupt). At the end of 1999, temporary administrators were appointed to two banks (Hrvatska gospodarska banka and Agroobrtnička banka). The temporary administrator is appointed to a bank when its potential losses exceed its risk-based capital and when it is incapable of making payments. The proposal for the initiation of bankruptcy proceedings in both banks was submitted to the Commercial Court in 2000. CNB commissioners were appointed to several banks with heavy operating losses.

After the elimination of certain unsound financial institutions from the Croatian banking system, a slight stabilization trend again became observable in the system in 1999. After losses incurred in 1998, the profit earned in the overall banking system (banks and savings banks) in 1999 was 633 million kuna, and, after a decrease in the first half of 1999, deposits started to increase slightly but steadily in the second half of the year. The decrease in interest rates was also a favourable trend. With regard to the relatively unfavourable trends in the Croatian economy and the depth of the banking crisis, it is not realistic to expect a rapid and easy recovery of the banking system as a whole and its transformation into a modern banking system.

After solving the current crisis, emphasis was laid on long-term solutions, such as the banking system restructuring and its recapitalisation, first and foremost by attracting strategic investors who would bring new technology and improve the operating quality. Slavenska banka and Privredna banka Zagreb were successfully privatized, while other major banks, which have been rehabilitated, are preparing for privatization.

4.1 Structure of Banks' Balance Sheet

At the end of 1999, total bank assets were 93.8 billion kuna, a decrease of 9.1 percent compared to the 103.2 billion kuna at the end of 1998. This decrease in assets resulted not only from the reduction in the number of banks but also from the implementation of the new banking regulations on reporting in 1999. The new banking regulations, which comply almost fully with the reporting requirements laid down by the International Accounting Standards, were implemented for the first time in 1999. This resulted in a change in policy for reporting single asset items (such as, for example, loans and interest). These are currently reported as adjusted for (decreased by) specific reserves for identified losses. In addition, specific reserves for unidentified losses form an item that is deducted from total assets. If these changes were excluded, the fall in assets would amount to around 2.5 percent.

4.1.1 Structure of Banks' Assets

Table IV.1 Aggregated Banks' Balance Sheet, December 31, 1999, million kuna and %

	AMOUNT	SHARE		AMOUNT	SHARE
ASSETS			LIABILITIES AND CAPITAL		
Money assets	1,248.3	1.3	Loans from financial institutions	5,328.7	5.7
Deposits with the CNB	8,535.6	9.1	Gyro and current account deposits	9,173.7	9.8
Deposits with banking institutions	10,316.9	11.0	Savings deposits	13,845.2	14.8
Treasury bills and CNB bills	3,147.9	3.3	Time deposits	34,425.2	36.7
Trading portfolio of securities	1,102.4	1.2	Other loans	15,055.3	16.0
Loans to financial institutions	1,247.2	1.3	Debt securities issued	36.7	0.0
Loans to other clients	45,459.9	48.5	Subordinated instruments issued	102.3	0.1
Investment portfolio of securities	15,409.9	16.4	Hybrid instruments issued	79.4	0.1
Investments in subsidiaries and companies	1,771.9	1.9	Interests, fees and other liabilities	4,820.2	5.1
Foreclosed and repossessed asstes	429.4	0.5	TOTAL LIABILITIES	82,866.7	88.3
Tangible assets and software	3,268.3	3.5	Sahre capital	8,285.0	8.8
Interests, fees and other assets	2,666.2	2.8	Profit or loss for the current year	704.2	0.7
Specific reserves for unidentified losses	-783.5	-0.8	Profit (loss) brought forward	-250.6	-0.2
			Reserves	2,215.1	2.4
			TOTAL CAPITAL	10,953.7	11.7
TOTAL ASSETS	93,820.4	100.0	TOTAL LIABILITIES AND CAPITAL	93,820.4	100.0

Loans to other clients (non-banking sector) amounted to 45.4 billion kuna or 48.5 percent of bank assets, a decrease compared to the previous year when they were 48.5 billion kuna or 51 percent of total assets. This decrease in loans was caused partly by the transfer of refinanced loans from Privredna banka's balance sheet to the Republic of Croatia and partly by the decrease in the number of banks. In terms of maturity, 45 percent of these loans had a maturity term of up to one year, while 55 percent were long-term loans. The investment portfolio of securities had the second-largest share in total assets, 16.4 percent; it comprised money market instruments, bonds and shares. Bonds of the Republic of Croatia accounted for 14.1 percent of total assets. Deposits with banking institutions accounted for 11.0 percent of total assets, with deposits with foreign banks accounting for 8.85 percent. Deposits with the CNB accounted for 9.1 percent of total assets, with obligatory reserves accounting for 8.8 percent. Tangible assets comprised 3.5 percent and Ministry of Finance treasury bills and CNB bills 3.3 percent of total assets. According to the currency structure, foreign currency assets comprised 27.5 percent of total assets. The share of interest-bearing assets amounted to 87.9 percent, while the remaining 12.1 percent were tangible, foreclosed and repossessed and other assets, as well as trading and investment portfolios.

4.1.2 Structure of Banks' Liabilities

Liabilities accounted for 88.3 percent and capital for 11.7 percent of total liabilities. Deposits (gyro and current accounts, savings and time deposits) accounted for 61 percent of total liabilities; time deposits comprised 60 percent of deposits, and 76 percent of all deposits were foreign currency deposits. Loans received (loans from financial institutions and other loans) accounted for 21.6 percent of total liabilities; of these, 26 percent were granted by domestic financial institutions (HBOR, CNB and other financial institutions), 12 percent by the Republic of Croatia and 62 percent by foreign entities (mostly by foreign

financial institutions). 81.5 percent of received loans had a maturity term longer than 1 year. Interests, fees and other obligations amounted to 5.1 percent of total liabilities.

Share capital amounted to 8.3 billion kuna, a fall of 11 percent compared to 1998 due to the reduction in the number of banks. In addition, its share in liabilities decreased from 9.9 percent in 1998 to 8.8 percent in 1999. At the end of 1999, total capital (share capital, reserves and profit or loss) amounted to 10.9 billion kuna, an increase of 11 percent compared to 1998 due to the profit earned in 1999.

4.2 Risk-Based Capital and Capital Adequacy

Risk-based capital is composed of core capital and supplementary capital, which must not exceed the amount of core capital. Banks are obliged to maintain their risk-based capital at a level that enables them to cover potential losses at any time. At the end of 1999, risk-based capital in the overall banking system stood at 10.4 billion kuna, whereas it amounted to 9.5 billion kuna at the end of 1998. Four banks reported negative risk-based capital at the end of 1999 (7 banks at the end of 1998).

The capital adequacy ratio is a measure of a bank's stability and liquidity. It is the ratio between risk-based capital and risk-weighted assets. According to the Banking Law, a bank is required to adjust the volume of its operations so that the capital adequacy ratio does not fall below 10 percent.

At the level of the banking sector, the capital adequacy ratio was 19.3 percent in 1999, whereas it was significantly lower (12.6 percent) at the end of 1998 due to a relatively large number of banks with negative risk-based capital. This increase in the capital adequacy ratio was also influenced by the implementation of the new banking regulations in 1999 whose weighting resulted in lowered risk assets; for example, large and maximum loans were no longer assigned the weight of 200 and 300 percent, as was required in 1998. All banks had a relatively high capital adequacy at the end of 1999 apart from four that reported negative risk-based capital and one that failed to comply with the capital adequacy requirement.

4.3 Banks' Asset Quality

Asset quality analysis is the most important segment in the evaluation of the operational stability of a bank and it has a significant impact on a bank's business output. The CNB decisions passed on a basis of the Banking Law regulate in detail the classification of bank's placements by the degree of risk and the calculation of the required specific reserves for identified potential loss; the specific reserves are an expenditure and asset items are decreased by this amount. The assessment of asset quality is carried out for bank's placements (loans and placements to banks and the central bank, off-balance sheet items, receivables based on interest income, investment portfolio of debt securities). Certain securities are not classified into a risk category but are assessed in accordance with the Law

on Accounting and the International Accounting Standards. Items that do not incur risk (banknotes and coins, premises and equipment) are classified into non-risk categories.

Risk placements are classified into risk categories A, B, C, D and E according to the degree of risk. Placements that do not include the risk of non-payment are classified into category A and specific reserves are not set aside for these placements. Specific reserves corresponding to the risk grade are calculated for the other categories. Placements classified into risk categories A and B are performing assets, while placements classified into risk categories C, D, and E are non-performing assets, i.e., revenues generated on the basis of these placements are excluded from income. They may be included in income only if they are collected.

Table IV.2 Classification of Risk Assets of Banks, December 31, 1999, million kuna

	A	B	C	D	E	Total	Specific reserves
Deposits with banks and the CNB	18,718.1	35.7	4.2	9.8	36.5	18,804.3	50.0
Loans	41,556.7	3,284.5	2,993.7	3,005.2	3,844.0	54,684.1	7,794.9
Investment portfolio of debt securities	16,553.9	6.6	7.8	6.1	2.7	16,577.1	12.2
Total other claims	1,151.2	21.8	34.4	17.0	67.6	1,292.0	118.5
Receivables based on interest income	1,172.3	254.0	14.6	31.0	10.1	1,482.0	80.0
Off-balance sheet items	14,151.0	601.8	411.4	326.7	284.4	15,775.3	786.1
Total placements	93,303.3	4,204.3	3,466.2	3,395.8	4,245.2	108,614.8	8,841.8
Non-classified securities						3,130.8	
Non-classified other assets						7,559.1	
TOTAL	93,303.3	4,204.3	3,466.2	3,395.8	4,245.2	119,304.7	8,841.8

At the end of 1999, category A risk assets accounted for 85.9 percent of total risk assets, the other categories together accounting for 14.1 percent. Performing assets (categories A and B) comprised 89.8 percent of total risk assets and non-performing assets (categories C, D, E) 10.2 percent. At the end of 1998, category A risk assets comprised 86.3 percent of total risk assets and other categories for 13.6 percent.

Specific reserves for identified potential losses were 8.8 billion kuna at the end of 1999, or 8.1 percent of total risk assets. In 1998, they were 7.8 billion kuna, or 6.4 percent of total risk assets.

The increase in the share of specific reserves for identified potential losses in total risk assets from 6.4 percent in 1998 to 8.1 percent in 1999 resulted from the application of more stringent assessment criteria (the new CNB decisions) and the cautious policies pursued by banks.

In addition to specific reserves for identified losses, banks are also required to set aside specific reserves for unidentified losses amounting to 1 percent of placements and off-balance sheet items classified into risk category A.

4.4 Limitations Decreasing Operational Risk

Banks are obliged to comply with maximum ratios and maximum levels of exposure regulated by the Banking Law.

4.4.1 Bank Exposure to a Single Borrower

Bank exposure to a single borrower or group of connected borrowers may not exceed 25 percent of its risk-based capital. The calculation of this exposure does not include exposures covered by first-class collateral instruments such as money deposit, securities or guarantees of the Republic of Croatia. At the end of 1999, 21 banks reported a total of 57 cases of exposure to a single borrower larger than the allowed maximum of 25 percent of risk-based capital. According to the Banking Law, a limited number of banks were allowed to gradually harmonize their operation and to adjust them to the prescribed conditions. Legal proceedings were initiated against those banks that failed to meet the stated requirement. Four banks with negative risk-based capital also failed to meet the requirements imposed by this regulation.

4.4.2 Large Exposure

Large exposure is exposure to a single borrower or group of connected borrowers that exceeds 10 percent of the risk-based capital of a bank. A large exposure requires unanimous approval by the bank's supervisory board. The calculation of this exposure does not include exposures covered by first-class collateral instruments. The total amount of all bank exposures may not exceed 400 percent of its risk-based capital. A total of six banks (including four banks with negative risk-based capital) violated this provision. In the overall banking system, large exposures totalled 20.6 billion kuna.

4.4.3 Exposure to Bank Shareholders

Exposure to a single shareholder with more than 3 percent of a bank's shares (and their related persons) may not exceed 5 percent of the bank's risk-based capital. Total exposure to bank's shareholders with more than 5 percent of a bank's core capital may not exceed 25 percent of the bank's risk-based capital. At the end of 1999, 22 banks reported 55 cases of exposure that were to a single shareholder with more than 3 percent of bank's shares and that exceeded the allowed 5 percent of risk-based capital. Therefore, the CNB and the banks jointly took action aimed at decreasing the exposure. Legal proceedings were also initiated. Total exposure to shareholders with more than 5 percent of the bank's core capital and that exceeded the allowed amount of 25 percent of risk-based capital occurred in 9 banks.

4.4.4 Exposure to Persons in Special Relationship with a Bank

Persons in special relationship with a bank are shareholders with more than 5 percent of shares, members of the bank's management and supervisory board and its procurators,

persons who concluded with the bank a contract on work under special conditions, spouses and children of all those listed above, legal entities in which those listed hold more than 20 percent of voting shares and legal entities in which the bank itself has more than 20 percent of voting shares. Exposure to persons in special relationship with the bank requires unanimous approval by the bank's supervisory board.

In the overall banking system, exposure to persons in special relationship with a bank was 2.9 billion kuna on December 31, 1999.

4.4.5 Investment Restrictions

A bank's investment in tangible assets (land, buildings, equipment and business premises' refurbishment) may not exceed 30 percent of its risk-based capital, and together with equity participation in companies, may not exceed 70 percent of its risk-based capital. Banks may be allowed temporary non-compliance with these percentages. Tangible assets and equity participation acquired in bankruptcy and seizure proceedings as compensation for unsettled claims are not included in this calculation for the period of one year following the date of their acquisition. Total investments in banks' tangible assets was 3.2 billion kuna, representing 30.6 percent of the risk-based capital of the banks. Investments in tangible assets and equity participation were 6.6 billion kuna or 62.6 percent of the risk-based capital of the banking system.

At the end of 1999, 17 banks reported investments in tangible assets exceeding the allowed 30 percent of risk-based capital; these banks are currently implementing measures aimed at adjusting to the prescribed amounts. 13 banks reported investments in tangible assets and equity participation exceeding the allowed 70 percent of risk-based capital; nine of these banks were allowed temporary non-compliance, while legal proceedings were initiated against the remaining four.

4.5 Banks' Income Statement

In 1999, the overall banking system returned a profit of 704.2 million kuna. This shows that the banking system is stabilizing after a loss of 1.3 billion kuna in 1998. Of the 53 banks, 41 returned a profit totaling 1.2 billion kuna, while 12 banks reported a loss totaling 526.4 million kuna. The largest losses were reported by banks that had conducted risky operations in earlier years and had experienced liquidity problems in the previous year. Four banks reported a loss that was larger than their capital.

Interest income in the overall banking system was 8 billion kuna, a decrease of 11.5 percent compared to the 1998 figure of 8.6 billion kuna. This decrease was caused by a reduction in the number of banks in 1999 and the tendency to reduce interest rates and concentrate on less risky areas. Interest expenses were 3.9 billion kuna, a decrease of 7.1 percent compared to the 1998 figure of 4.2 billion kuna. Net interest income was 3.8 billion kuna, a decrease of 11.6 percent compared to the 1998 figure of 4.3 billion kuna. Non-interest

income was 2.8 billion kuna, while non-interest expenses were 0.9 billion kuna. Net non-interest income amounted to 1.9 billion kuna.

Table IV.3 Banks' Income Statement for 1999, million kuna

TOTAL INTEREST INCOME	7,865.3
TOTAL INTEREST EXPENSES	3,975.8
NET INTEREST INCOME	3,889.5
TOTAL NON-INTEREST INCOME	2,858.2
TOTAL NON-INTEREST EXPENSES	912.2
NET NON-INTEREST INCOME	1,946.0
GENERAL ADMINISTRATIVE EXPENSES AND DEPRECIATION	3,240.5
NET OPERATING INCOME BEFORE PROVISIONS	2,595.0
LOAN LOSS PROVISION EXPENSES	1,868.5
PRETAX INCOME (LOSS)	726.5
PROFIT TAX	22.3
PROFIT OR LOSS FOR THE CURRENT YEAR	704.2

General administrative expenses and depreciation were 3.2 billion kuna, slightly lower than the 1998 figure of 3.4 billion kuna. Loan loss provision expenses amounted to 1.8 billion kuna, down from 4.6 billion kuna in 1998. 1998 was a year of a large increase in provision expenses. In 1999, the exit of risky banks from the market was followed by a decrease in loan loss provision expenses, showing a tendency towards less risky operations.

In 1999, interest income accounted for 73.4 percent and non-interest income for 26.6 percent of total income of the Croatian banking industry. Interest expenses accounted for 40.1 percent of total expenses, non-interest income for 8.9 percent, general administrative expenses for 32.7 percent and loan loss provision expenses for 18.3 percent. As in previous years, interest income accounted for the largest share in total income, while general administrative expenses represented the largest item in total expenses. This indicates the relative underdevelopment of our banking system compared to global trends.

4.6 Performance of Savings Banks

34 savings banks, including four housing savings banks, were in operation at the end of 1999, compared to 35 savings banks at the end of 1998. Invest štedionica went bankrupt, and Istranova štedionica merged with a bank. One housing savings bank was established.

Savings banks that were founded prior to the Banking Law (and so hold operating licenses granted on the basis of the Law on Bank and Savings Bank) must increase the amount of their paid-in core capital to at least 20 million kuna by the end of 2001.

All savings banks are in full private ownership. In 2000, the Croatian National Bank withdrew the operating licenses of six savings banks (Štedionica za obnovu i razvoj, Gold štedionica, Štedionica Mediteran, Investiciono-komercijalna štedionica, Štedionica Dugi pogled i Zagrebačka štedionica) because, despite warnings, they had acted contrary to the regulations and measures of the Croatian National Bank for a lengthy period and because there was the danger that, due the risky and inappropriate nature of their operations, they would not be able to fulfil their obligations to their creditors in a timely manner.

4.6.1 Structure of Savings Banks' Balance Sheet

Table IV.4 Aggregated Savings Banks' Balance Sheet, December 31, 1999, million kuna and %

	AMOUNT	SHARE		AMOUNT	SHARE
ASSETS			LIABILITIES AND CAPITAL		
Money assets	24.3	1.6	Loans from financial institutions	30.7	2.1
Deposits with the CNB	68.5	4.6	Gyro and current account deposits	6.8	0.5
Deposits with banking institutions	96.0	6.5	Savings deposits	39.0	2.6
Treasury bills and CNB bills	92.2	6.2	Time deposits	792.2	53.6
Trading portfolio of securities	3.1	0.2	Other loans	10.6	0.7
Loans to financial institutions	52.3	3.5	Debt securities issued	0.1	0.0
Loans to other clients	800.4	54.2	Subordinated instruments issued	12.7	0.8
Investment portfolio of securities	66.7	4.5	Hybrid instruments issued	47.3	3.3
Investments in subsidiaries and companies	1.5	0.1	<u>Interests, fees and other liabilities</u>	68.4	4.6
Foreclosed and repossessed asstes	28.0	1.9	TOTAL LIABILITIES	1,007.7	68.2
Tangible asstes and software	71.7	4.9	Share capital	530.1	35.9
Interests, fees and other assets	181.5	12.3	Profit or loss for the current year	-70.0	-4.7
Specific reserves for unidentified losses	-9.2	-0.6	Profit (loss) brought forward	-45.5	-3.1
			<u>Reserves</u>	54.6	3.7
			TOTAL CAPITAL	469.2	31.8
TOTAL ASSETS	1,477.0	100.0	TOTAL LIABILITIES AND CAPITAL	1,477.0	100.0

4.6.2 Structure of Savings Banks' Assets

At the end of 1999, savings banks' assets amounted to 1.4 billion kuna, 2 percent down on 1998 on a net basis. Loans to clients accounted for the largest share (54 percent) in total assets. Deposits with banking institutions and loans to financial institutions accounted for 10 percent of savings banks' assets, while placements in securities and investments accounted for 4.8 percent. Tangible and foreclosed and repossessed assets accounted for 6.8 percent of total assets. The share of interests, fees and other assets was relatively large in total assets (12.3 percent). Savings banks had a similar structure of assets in 1998, except that the share of loans to other clients in total assets was larger (60 percent), while the share of other items was lower.

4.6.3 Structure of Savings Banks' Liabilities

On 31 December 1999, time deposits accounted for 53.6 percent of sources of funds of savings banks, capital for 35.9 percent and all other sources together for 14.6 percent. Savings banks' capital decreased from 521 million kuna in 1998 to 469 million kuna in 1999 due to operating losses incurred by savings banks in 1999.

4.6.4 Savings Banks' Risk-Based Capital

Savings banks' risk-based capital was 518 million kuna on 31 December 1999 and 557.4 million kuna on 31 December 1998. This decrease was a result of a reported loss. In accordance with the Banking Law, savings banks included hybrid and subordinated instruments in the amount of 59.9 million kuna in their risk-based capital. The capital adequacy ratio was 54.9 percent at the consolidated level. Only two savings banks reported a capital adequacy ratio lower than the minimum 10 percent. However, in order to form a true picture of the stability of the savings banks' operations, it is necessary to take into consideration not just the capital adequacy ratio but also other indicators, such as analysis of asset quality and the income statement.

4.6.5 Analysis of Asset Quality of Savings Banks

Table IV.5 Classification of Risk Assets of Savings Banks, December 31, 1999, million kuna

	A	B	C	D	E	Total	Specific reserves
Deposits with banks and the CNB	124.4	0.0	0.0	0.7	0.9	126.0	1.2
Loans	682.9	63.9	158.5	36.4	61.3	1,003.0	149.5
Investment portfolio of debt securities	145.2	0.0	0.0	0.0	5.3	150.5	5.3
Total other claims	55.5	17.3	4.5	0.4	0.1	77.9	6.4
Receivables based on interest income	38.9	9.9	7.1	3.6	6.0	65.4	1.8
Off-balance sheet items	7.7	0.0	1.1	0.0	0.3	9.2	0.4
Total placements	1,042.6	87.8	171.2	38.7	73.9	1,414.2	162.8
Non-classified securities	0.0	0.0	0.0	0.0	0.0	15.2	0.0
Non-classified other assets	0.0	0.0	0.0	0.0	0.0	173.0	0.0
TOTAL	1,042.6	87.8	171.2	38.7	73.9	1,602.3	162.8

Savings banks are required to analyze their asset quality in the same manner as banks. At the end of 1999, savings banks classified into risk category A (specific reserves for unidentified losses are not set aside for this category) a total of 1,042.8 million kuna or 73.7 percent of total risk assets. Savings banks classified a total of 371.6 million kuna into risk categories B, C, D and E or 26.3 percent of total risk assets (specific reserves are calculated and reported for these categories). Specific reserves for identified losses amounted to 162.8 million kuna or 11.5 percent of total risk assets on 31 December 1999. It should be noted that the share of category A in total risk assets decreased compared to the previous year, when 86.5 percent of total risk assets were classified into category A, while the share of specific reserves for identified losses of savings banks increased compared to 1998, when it amounted to 5.9 percent of total risk assets.

4.6.6 Limitations Decreasing Operational Risk

Like banks, savings banks are obliged to comply with the maximum ratios and maximum levels of exposure regulated by the Banking Law.

At the end of 1999, 13 savings banks reported a total of 29 cases of exposure to a single borrower larger than the allowed maximum of 25 percent of risk-based capital. A limited number of these banks, which had inherited large exposure from the previous year, were allowed, in accordance with the Banking Law, to gradually harmonize their operations and to adjust them to the requirements; legal proceedings were initiated against the other savings banks.

Three savings banks reported a total large exposure that exceeded the allowed 400 percent of risk-based capital. The total large exposure of savings banks amounted to 298 million kuna.

7 savings banks reported a total of 8 cases of exposure to one shareholder with more than 3 percent of shares that exceeded 5 percent of risk-based capital at the end of 1999. Total exposure to single shareholders with more than 5 percent of shares exceeded the allowed amount of 25 percent in 3 savings banks.

The exposure of savings banks to persons in special relationship with the bank amounted to 29.2 million kuna on 31 December 1999. Persons in special relationship with the bank are shareholder with more than 5 percent of voting shares, members of the bank's management and supervisory board and its procurators, persons who concluded with the bank a contract on work under special conditions, spouses and children of all those listed above, legal entities in which those listed hold more than 20 percent of voting shares and legal entities in which the bank has more than 20 percent of voting shares.

At the end of 1999, 7 savings banks reported investments in tangible assets that exceeded the allowed 30 percent of risk-based capital. 3 savings banks reported investments in tangible assets and equity participation that exceeded the allowed 70 percent of risk-based capital. Total investments in savings banks' tangible assets amounted to 73.8 million kuna or 14.2 percent of risk-based capital of the overall banking system. Savings banks' investments in tangible assets and equity participation amounted to 86.6 million kuna or 16.7 percent of the savings banks' risk-based capital.

4.6.7 Savings Banks' Income Statement

Savings banks reported an operating loss of 71.2 million kuna in 1999, which, after a loss of 2.3 million kuna in 1998, shows that there is a further deterioration in savings banks' operations. 13 savings banks reported losses totaling 105.8 million kuna, while 21 savings banks reported profits totaling 34.6 million kuna.

Table IV.6 Savings Banks' Income Statement for 1999, million kuna

TOTAL INTEREST INCOME	278.2
TOTAL INTEREST EXPENSES	137.4
NET INTEREST INCOME	140.8
TOTAL NON-INTEREST INCOME	59.0
TOTAL NON-INTEREST EXPENSES	37.5
NET NON-INTEREST INCOME	21.5
GENERAL ADMINISTRATIVE EXPENSES AND DEPRECIATION	123.5
NET OPERATING INCOME BEFORE PROVISIONS	38.8
LOAN LOSS PROVISION EXPENSES	108.4
PRETAX INCOME (LOSS)	-69.6
PROFIT TAX	1.6
PROFIT OR LOSS FOR THE CURRENT YEAR	-71.2

Savings banks' interest income was 278.2 million kuna in 1999, 11 percent higher than the previous year. Savings banks' interest expenses were 137.4 million kuna in 1999, 26.8 percent higher than the previous year. Net interest income of savings banks was 140.8 million kuna in 1999, 0.9 percent lower than in 1998. Net non-interest income amounted to 21.5 million kuna in 1999, approximately the same as in 1998. General administrative expenses and depreciation were 123.5 million kuna, 19 percent higher than the previous year. Loan loss provisions expenses amounted to 108.4 million kuna, an increase of 97 percent compared to 1998, when they were 55 million kuna. A large increase in provision expenses was reported in 1999, which had a negative effect on the savings banks' operating results.

4.7. Measures taken by the Croatian National Bank in 1999

The Banking Law sets out the measures that the Croatian National Bank may take against a bank found to be violating regulations or operating improperly or at risk; measures were taken against 31 banks and savings banks in 1999. When the Croatian National Bank establishes that a bank's capital adequacy has fallen 3/4 below the required minimum, it will appoint a commissioner in that bank; a commissioner was appointed in three banks in 1999. When the potential losses of a bank, arising from risky placements, exceed the bank's risk-based capital and when the bank is incapable of making payments, the Croatian National Bank may, in accordance with the provisions of the Law, appoint a temporary administrator in such a bank; the CNB Council appointed a temporary administrator in Croatia banka (before rehabilitation), Agroobrtnička banka and Hrvatska gospodarska banka. In addition to these banks, a temporary administrator was appointed in several banks that later went

bankrupt (Gradska banka, Županijska banka, Komercijalna banka, Glumina banka and Promdei banka).

If the said measures fail to give the expected results, the Croatian National Bank is obliged by the provisions of the Law to submit to the competent court a proposal for initiating bankruptcy proceedings against a bank. The Croatian National Bank submitted to the Commercial Court proposals for initiating bankruptcy proceedings against seven banks and three savings banks; bankruptcy proceeding were initiated against seven banks and one savings bank.

According to the Law on Bank Rehabilitation and Restructuring, the Croatian National Bank may propose bank rehabilitation to the Government of the Republic of Croatia. The decision on rehabilitation is passed by the Government if it considers that the rehabilitation is of special state interest and if it determines that all other possibilities for preventing further impairment of the stability of the banking system stability have been explored. The decision to rehabilitate Croatia banka was passed in 1999.

4.8 Supervision of Banks and Savings Banks

The Area of Control and Supervision was established as an organizational unit and staffed in 1993.

The Area of Control and Supervision of the Croatian National Bank comprises:

On-Site Supervision Department,
Off-Site Supervision Department,
Department for Improving Bank Supervision,
Department of Foreign Exchange Records Control.

At the end of 1999, the Bank Supervision Area had 76 employees. A reorganization was made at the beginning of 1999, and the Department for Inspection of Compliance with Measures of Monetary and Foreign Exchange Policies merged with the On-Site Supervision Department. During 1999, 24 new employees, including experienced bankers and auditors, were hired. The training of employees is conducted on an ongoing basis by external advisors and trainers; it also includes attendance at seminars, training courses, postgraduate studies and various training programs carried out by international financial organizations (IMF, World Bank and others).

75 examinations were conducted in 1999: 47 examinations of bank operations, 10 examinations of the implementation of issued measures, 10 examinations of foreign representative offices, and 8 examinations were conducted together with temporary administrators. 57 decisions were issued, 26 dealing with liquidity problems and 31 aimed at improving bank performance and correcting irregularities and illegal actions.

In 1999, 43 charges were brought against banks (16 citations for business violations, 16 citations for violations of foreign exchange regulations and 11 requests for initiating legal

procedures). The intervention of criminal and financial investigators was required in six banks.

Numerous regulations (ten decisions, seven instructions for the implementation of these decisions and two rulebooks) were enacted in 1999 on the basis of the new Banking Law that became effective in 1998.

The following regulations and rulebooks were issued:

Decision on the Methodology for Calculating Bank's Capital (Official Gazette, No. 32/99), Decision on the Methodology for Calculating Capital Adequacy and Risk-Weighted Assets of Banks (Official Gazette, No. 32/99), Decision on the Classification of Placements and Risky Off-Balance Sheet Items and Assessment of Bank Exposure (Official Gazette, No. 32/99), Decision on the Amount and Method of Forming Specific Reserves to Ensure Against Potential Losses of Banks (Official Gazette, No. 32/99), Decision on the Chart of Accounts for Banks (Official Gazette, No. 32/99), Decision on Restriction of Investment in Tangible Assets and Equity Participation (Official Gazette, No. 38/99 and 64/99), Decision on Reporting to the Croatian National Bank on Single Borrower Indebtedness with Banks to an Amount Exceeding Five (5) Million Kuna (Official Gazette, No. 51/99), Decision on Detailed Conditions for the Establishment and Operation of Representative Offices of Foreign Banks in the Republic of Croatia (Official Gazette, No. 32/99 and 99/99), Rulebook on the Banking Exam (Official Gazette, No. 32/99), Rulebook on the Procedure and Criteria for Granting Prior Approval for the Appointment of the Chairman and Members of a Bank's Management Board (Official Gazette, No. 32/99), Decision on the Statistical Report for Banks and Instructions for Completing the Statistical Report (Official Gazette, No. 57/99 and 72/99), Decision on the Form and Minimum Scope and Content of Bank Audit and Audit Report (Official Gazette, No. 64/99), Decision on the Form and Content of the Application for Granting a Bank Operating License (Official Gazette, No. 99/99).

The strategic goal of the Croatian National Bank is to further strengthen and develop banking supervision. The supervision of banks and saving banks has been continuously improved. Special efforts are being made to strengthen the application of the currently used CAMEL method (the more sophisticated CAMELS method has not yet been applied). Further adjustment to the BIS Core Principles that lay down the minimum requirements for effective banking is also in progress.