

## **VII. Supervision of Banks and Savings Houses**

### **7.1. Supervision of banks**

During 1998, the activities of NBRM directed towards the completion of the regulatory framework of the supervision of banks continued, aimed at strengthening the prudent rules of conduct of the financial agents, with the final goal of building a sound, stable and effective banking system. The changes and additions to the National Bank of the Republic of Macedonia Act ("Official gazette of the Republic of Macedonia" No.29/96 and 37/98 - updated version), the Banks and Savings Houses Act ("Official gazette of the Republic of Macedonia" No.29/96 and 37/98 - updated version) and certain decision from the supervision aspect meant further implementation of international standards of supervision and "the 25 basic principles of effective supervision of banks" in particular, agreed on by the Basle Committee for Banks' Supervision at the Bank for International Settlements (BIS).

In accordance with the National Bank of the Republic of Macedonia Act and the Banks and Savings Houses Act, as well as other prudent supervision standards of regulation and established procedures for on-site and off-site examinations, NBRM conducts permanent surveillance and control over banks and savings houses in the Republic of Macedonia.

On the basis of the Annual Plan for banks and savings houses controls made by the Governor of NBRM, during 1998, a total of 92 on-site examinations of banks and savings houses were executed. Full scale controls were performed at 15 banks and 14 savings houses, while all banks and 4 savings houses were subjects of partial control. Compared to 1997, when a total of 55 on-site examinations were conducted, this represents a significant increase in the control activities covering all banking institutions in the Republic of Macedonia. In this manner, the Annual Plan for banks and savings houses controls was fully accomplished. The controls over the three biggest banks in the Republic of Macedonia denote the fulfillment of the accepted obligations under the arrangements with the international financial institutions. Also in 1998, 18 authorized exchange offices were subject to the control activities.

### **7.2. Structure of the banking system**

At the end of 1998, the banking system of the Republic of Macedonia was comprised of 22 banks, 2 branches of foreign banks and 18 savings houses. This year was marked by the entrance of 3 new financial institutions in the banking system;

- "Macedonian Bank for Development Promotion" a.d. - Skopje with equity capital in the amount of DEM 30 million in Denar value;

- the branch of T.C. "Ziraat Bankasi" from the Republic of Turkey with equity capital of DEM 21 million in Denar value; and
- "FULM" dooel. savings house, with equity capital of DEM 1 million in Denar value.

During the same period the operating licenses of three savings houses were withdrawn: "Rudarski Institut" d.o.o. - Skopje, "Kontinental" d.o.o. - Bitola and "AMSM" d.o.o. - Skopje.

In the last year there were no major changes in the structural shares of the two main segments of the banking system of the Republic of Macedonia - the banks and the savings houses. Hence, relative to the end of 1997, the share of banks in the total financial potential remained at the level of 98.7%, which confirmed their structural domination in the banking system of the Republic of Macedonia. The marginal role of the savings houses, besides through their share in the total financial potential, is clearly visible through few other indicators, which in 1998 experienced slight declines:

- the share of credits extended by savings houses to households is 9.6% of total credits of the banking system to the population, and relative to December 1997 is by 2.4 percentage points lower;
- even though one of the basic functions of savings houses is the collection of savings deposits from households, still, savings houses account for only 3.3% of the total savings deposits of households. Compared to the end of 1997, this is a 0.7 percentage points fall. If only the Denar savings deposits are taken into account, than the share of savings deposits of households to the savings houses is 5.9% and relative to December 1997 is by 1.1 percentage points lower
- the capital strength of savings houses is another indicator of their marginal role. As of December 31, 1998, savings houses account for only 1.9% of the total own potential of the banking system, which relative to the same period of the previous year represents a 0.3 percentage points decline.

The above indicators that illustrate the marginal role of savings houses, point out the need for reasserting the role of this segment of the banking system of the Republic of Macedonia.

The analysis of the structure of the banking system according to the size of the financial potential, the market share and banks' own assets, shows the asymmetrical structure of the banking sector. Namely, the three largest banks in the Republic of Macedonia account for 63.1% of the total volume of banking operations, as well as 58.9% of the collected financial potential. According to capital strength, the three largest banks have a 39.5% share, which relative to December 1997 is a 4.4 percentage points decline.

Through the process of privatizing the shareholders in the Macedonian banks, as well as through the sale of new shares, the banks in the Republic of Macedonia are gradually being privatized. These processes proceeded during 1998 as well. Thus, as of December 31, 1998, the average rate of privatization of banks is 77.2%.

The average share of foreign capital in the total equity capital of Macedonian banks as of December 31, 1998 is 15.5%. Out of the total number of banks, there is foreign capital in 14 of them, while the remaining banks have only domestic capital.

The unfavorable structure of the banking system in the Republic of Macedonia is confirmed from a regional aspect, too. Namely, only 6 banks and 4 savings houses are located out of Skopje. The potential of financial institutions located out of the capital Skopje, account for only 12.8% of the total financial potential. This disproportion in the supply of financial services is partly being alleviated by the relatively extended network of branches, subsidiaries, windows, operational units and representative offices. At the end of 1998, banks in the Republic of Macedonia had 20 branches, 81 subsidiaries, 95 windows, 4 operational units and 5 representative offices. "Postenska stedilnica" (postal savings house) should also be mentioned, which has a wide network of windows (a total of 600 through out the whole territory of the Republic of Macedonia).

### **7.3. Analysis of the performance of the banking sector**

#### **7.3.1. Assets quality**

The banking system of the Republic of Macedonia disposes with a relatively poor quality of assets. As of December 31, 1998, all claims classified in the C, D and E categories accounted for 32.9%, which leads to the conclusion that there are problems in the collection in one third of the credit portfolio. However, it should be considered that this indicator in 1998 experienced significant decline relative to previous years (44.4% in 1995, 42.8% in 1996 and 35.6% in 1997). If the claims ranked in the E risk category, which are 100% provisioned, are taken out of the analysis, the share of the claims classified in the C and D categories in the total credit portfolio would amount to 29.8%. On the other hand, the claims classified in the C and D categories alone, which according to the supervision standards are non-performing claims, account for 17.3% of the total credit exposure. If the analysis is continued and the amount of negatively classified claims (C, D and E) is calculated over the adequate amount of provisions, the uncovered part of these claims would account for 18.8% in the total credit portfolio of banks.

As of December 31, 1998, the average rate of risk on the credit portfolio of banks, expressed as a ratio between the observed amount of potential losses and the total credit exposure, is 17.5%, which corresponds to the B and C risk categories. Compared to December 31, 1998, this indicator is 6.2 percentage points lower, with the decline in the last six months of the year alone being 2.8 percentage points. The credit portfolios of 10 banks show a higher rate of risk than the average rate, with three of these banks having a rate of risk on the credit portfolio higher than 25%, which corresponds to the C and D risk categories, while the remaining seven have rates of risk in line with the B and C risk

categories. Seven banks have rates of risk lower than 10%, which corresponds to the A and B risk categories.

### 7.3.2. Capital adequacy

As of December 31, 1998, banks' and savings houses' own assets were Denar 15.1 billion, or DEM 487.4 million in Denar value (calculated by the average exchange rate of NBRM on December 31, 1998). All banks fulfilled the capital requirement for executing banking operations in the country, while 16 banks were licensed to conduct international operations and credit operations.

If banks' and savings houses' own assets are compared to the total amount of assets of the banking sector, the average level of capitalization of the banking sector on December 31, 1998, was 25.2%. This indicates that more than one quarter of total banking activities of banks and savings houses are financed with their own assets, which is significantly higher than the corresponding coefficient in other countries.<sup>20</sup> If, in addition, the off-balance-sheet activities are considered, the rate of coverage of the total operations with banks' own assets is 20.1%.

On average, the guarantee capital of banks is Denar 578.4 million, or DEM 18.7 million in Denar value. If the three largest banks are excluded, the average guarantee capital of banks is Denar 385.7 million, or DEM 12.4 million in Denar value.

The guarantee capital of banks, compared with the risk weighted assets, which are Denar 51.4 billion as of December 31, 1998, gives the capital adequacy ratio of the banking sector being 25.9% (including the savings houses, this ratio is 26.2%), which is three times higher than the minimum of 8% proposed by the Basel committee for banks supervision, which is accepted in the legislative framework in the Republic of Macedonia.

The analysis of the trend of this ratio shows a permanent decline in its value, from 33% as of December 31, 1996, to 28.3% as of December 31, 1997 and 25.9% as of December 31, 1998.

### 7.3.3. Profitability

With the final financial statement for 1998, the banking system in the Republic of Macedonia showed a net profit of Denar 1.1 billion, which is almost at the same level with the financial result the year before. In addition, the financial statements of all banks

<sup>20</sup> Comparison: Belarus 10.7%; Bulgaria 12.3%; Czech Rep. 6.3%; Hungary 10.2%; Latvia 12.9%; Lithuania 9.9%; Moldova 26.9%; Russia 21.7%; Slovenia 11.3% - December 31, 1997. Source: Report by the Group of banks supervisors from Central and eastern Europe.

show positive financial result. Compared to 1997, the financial results were worse in 14 banks, while the others showed improved financial results.

The profitability ratios of banks in the Republic of Macedonia, calculated on the basis of the presented net profit for 1998, as well as the average assets and average equity during 1998 are in the range of the internationally accepted standards.

Thus, the rate of Return on Assets (ROA) is 2%, which shows that 100 units of assets of Macedonian banks generate 2 units of net profit per annum. Compared to December 1997, this ratio declined by 0.2 percentage points. However, relative to the end of 1998 it increased by 0.8 percentage points.

The rate of Return on Equity (ROE) is 8.2%, which indicates that 100 units of capital of the Macedonian banks generate 8.2 units of net profit, compared to 9.3 units in 1997 and 4.3 units in 1996.