

## **1. BANKING SUPERVISION**

### **1.1. CHANGES IN THE REGULATIVE FRAMEWORK OF BANKING SUPERVISION**

One of the main preconditions for establishing a sound, stable and efficient financial system in the Republic of Macedonia, is the existence of an appropriate, modern and efficient legal framework, which regulates the operations of financial entities. For this purpose, during the first half of 2000, intensive activities were conducted with respect to revising and upgrading the existing legal regulations, which resulted in passing important laws covering this area: Banking Law, Deposit Insurance Fund Law, Securities Law, Law on Collateral and the Law on amendments and modifications to the Law on Executive Procedure.

#### **1.1.1. Review of the contents of the Banking Law**

From the aspect of banks' operations and conduct of the supervisory function of the National Bank of the Republic of Macedonia, the Banking Law is of special importance. This Law contains solutions which are directed towards approaching the European legal systems and the European Union Directives, as well as achieving higher compliance with the so-called Core Basle Principles for Efficient Banking Supervision.

Main principles on which the new Banking Law is based are the following:

- Precise definition of the term bank, which simultaneously represents basic and only entity regulated by this Law;

- Establishment of a new approach in licensing the new entities in the banking system of the Republic of Macedonia, which is solely based on the evaluation of future possibilities of the new entity for safe and efficient operations, as well as the evaluation of the integrity of the executive body, other persons with special rights and authorizations and banks' shareholders;

- Strengthening the supervisory standards which regulate the operations of banks towards their full compliance with the international supervisory standards;

- Strengthening the corporate governance in banks and precise definition of the relations between the executive body and other managing bodies, internal audit and external control and a regulatory bodies, such as the authorized external auditor and the supervisory body;

- Establishing a system of efficient measures for monitoring and sanctioning of banks and especially for increasing the efficiency of the exit policy, i.e. when a bank in bankruptcy "exits" the banking system of the Republic of Macedonia.

1. The Banking Law regulates the establishment, operations and supervision solely of banks, with a precise definition of the term bank and minimum banking activities conducted by a single entity in order to be established and to operate as a bank. Also, this Law stipulates that legal persons and households which have not obtained an operating license from the National Bank of the Republic of Macedonia shall not collect deposits and place them as credits or investments. Further on, the Banking Law makes a clear distinction between banking operations and other financial activities, which could be conducted by non-banking financial institutions.

All these provisions are aimed towards fulfilling all criteria stipulated hit by the Basle Committee for Banking Supervision, in order to achieve full compliance with Basle Principle No. 2.

Having in mind the aforementioned, the Banking Law excludes all provisions referring to operations of savings houses and their further existence is regulated by the transitional and closing provisions according to which the existing savings houses continue their operations according to the provisions of the new Banking Law within the framework of the issued operating license, until new legal forms for their transformation are designed.

Also, all provisions pertaining to the Deposit Insurance Fund and the Bank Rehabilitation Agency of the Republic of Macedonia have been deleted. Deposit Insurance is regulated by a special Law on the Deposit Insurance Fund, passed simultaneously with the Banking Law. On the other hand, it is planned that the Bank Rehabilitation Agency of the Republic of Macedonia will be transformed into a legal entity which will manage the property and collect the claims of the government. Meanwhile, until the Agency is transformed, the transitional and closing provisions stipulate that the provisions of the old Banks and Savings Houses Act will be applied.

2. The Banking Law incorporates new elements also with respect to the procedure of licensing banks in the Republic of Macedonia and acquiring voting shares. In general, this Law offers solutions which to a large extent liberalize the licensing procedure, especially having in mind the following amendments:

- decline in the amount of the minimum capital requirement for conducting payment operations, credit and guarantee operations abroad, from a denar equivalent of DEM 21 million to the amount of denar equivalent of EURO 9 million;

- the share of a single shareholders is restricted to 1/3, instead of the 20 percent of the total number of voting shares, applied so far. This amendment is aimed towards gradual adjustment to the European legislation, where in general there is no legal restriction of the share of a single shareholder in the bank's capital. At this moment, it is estimated that in the Republic of Macedonia there are still no preconditions for removing the restrictions on the share of a single shareholder in the bank's capital. According to the Law, this restriction will cease to be effective after January 1<sup>st</sup>, 2003.

- the legal obligation of banks applied so far regarding the application for prior approval by the National Bank of the Republic of Macedonia when changing the ownership structure of the voting shares of over three percent is replaced by the provision for requesting the prior approval in the cases of gradual or one-time acquisition of shares with total cumulative amount of 10 percent, 20 percent, 33 percent, 50 percent and 75 percent. For all other cases of changing the ownership structure of voting shares (in between the aforementioned percentages) banks are obliged to inform the National Bank of the Republic of Macedonia within five working days. This amendment to the Banking Law is conducted in accordance with the European Union Directives for Banking. The European and international experience have so far shown that reaching some of the aforementioned percentages (10 percent, 20 percent, 33 percent, 50 percent and 75 percent) has a crucial influence on the level and quality of the management the particular shareholder participation in the process of bank management. Hence, the supervisory authority re-evaluates the integrity of the shareholder when reaching any of the aforementioned percentages.

Despite the fact that numerous elements liberalize the licensing procedure, it must be emphasized that the new Banking Law introduces a completely new approach from the aspect of evaluating the justification for establishing a new banking entity in the Republic of Macedonia. The decision to issue a license for establishing and operating of a bank is solely

based on the evaluation of the future possibilities of the bank to work in compliance with the legal regulations and prescribed supervisory standards, as well as evaluation of the integrity of the executive body, other persons with special rights and responsibilities and bank's shareholders. Thus, in case the complete submitted documentation does not provide sufficiently accurate and convincing information regarding the justifications for establishing a new bank, the National Bank of the Republic of Macedonia, as an authorized supervisory body, shall not issue a founding and operating license. Also, if the National Bank of the Republic of Macedonia is not satisfied with the integrity of proposed candidates for an executive body, as well as the persons with special rights and responsibilities, or bank's shareholders, it will not issue a founding and operating license to that bank. With that respect, in order to provide all necessary information, the new Banking Law introduces a two-stage licensing procedure. Namely, in the first stage, on the basis of evaluating the contents of the submitted documentation, a temporary license is issued, whereas for obtaining a final license, during the second stage, the bank is obliged to fulfill additional conditions such as preparation of all written procedures and policies, engaging an external auditor, payment of capital, etc.

All these amendments are aimed toward achieving full compliance with Basle principles No. 3 and 4.

3. A third area in which significant changes are made is the part pertaining to the supervisory standards on the basis of which banks' operations are regulated. In this respect, the following changes are made:

- credit exposure toward a single borrower is reduced from 30 percent to 25 percent with respect to the guarantee capital of the bank, which is in compliance with the European Union Directives of Banking;

- credit exposure toward single persons with special rights and responsibilities increased from 1 percent to 3 percent in relation to the bank's guarantee capital;

- the aggregate amount of the bank's immovable property and capital investments in other legal entities increased from 25 percent to 60 percent of the guarantee capital. The aggregate amount of capital investments in other legal entities is limited to 30 percent of the guarantee capital, whereas a single capital investment of the bank in another non-financial entity is restricted to the level of 15 percent of the guarantee capital. With respect to bank's share in the capital of the other entity, there is no restriction, which practically means that the bank may own another legal entity up to one hundred percent. In this way conditions are created for promotion of investment banking. European Union Directives in this area are more liberal. Bank's immovable property and capital shares in another entity could be up to one hundred percent of the bank's capital, whereas only the aggregate amount of the capital shares in other entities could be up to 60 percent of the bank's capital;

- the new Law opens an opportunity for purchasing own shares up to 10 percent of the total bank's shares, which is in compliance with the European Union Directives.

4. The Banking Law stipulates strengthening of corporate governance in the bank. In this sense, the Banking Law precisely defines the relations among bank's ' managing bodies, internal audit, authorized external auditor and supervisory authority. More significant changes in this area are the following:

- introducing the so-called four-eye principle, which means that the executive function in the bank shall be conducted by at least two persons. This means that at least two persons are equally responsible for managing the bank and for the obligations that the bank undertakes. The bank's Statute clearly defines which of the members could represent the bank in which cases. This principle is an integral part of the European Union Directives, and it

precisely defines that the conduct of the policy and efficient decision making on day to day basis will be conducted by at least two persons.

- strengthening the role and responsibility of the Managing Board, through extending its responsibility and competence. Certain members of the Managing Board shall establish the Risk Management Committee, which is responsible for several activities such as: establishing and monitoring the implementation of policies and procedures for credits risk evaluation, interest rate risk and other market risks, establishing and monitoring the implementation of policies and procedures for asset and liability management, insight in the classification of riskiness of assets and adequacy of allocated special reserves, proposing measures for collection of non-performing claims of the bank. Such competence requires high level of expertise of the Managing Board members, which is simultaneously one of the main objectives which should be achieved by this Law. The implementation of the new model of corporate governance is aimed toward incurring shareholding in the real sense of the word, by minimizing the passive role which the Managing Board has so far had in most of the banks in the Republic of Macedonia and by increasing the responsibility and skill which is expected to not only from direct executives and managers of the bank, but also from the members of the Managing Board.

In this context, another new managing body should be mentioned which should be obligatorily established in the banks in order to set up one of the elements for efficient corporate governance in banks. That is the Audit Committee, which is responsible for establishing certain accounting procedures and control of the compliance of these procedures with the Banking Law and other regulations. This body comprises of external members who are not members of the Managing Board of the bank. However only one member could be an employee of the bank, excluding the persons with special rights and responsibilities.

Also, the new Banking Law precisely defines the place, role and authorizations of the internal audit division. In that sense, the internal audit division is intended to be an independent organizational part, organized by the Managing Board. This division directly informs the Managing Board about all conducted controls and possible risks which could have an impact on the financial position of the banks. Due to frequent misunderstanding regarding the role and authorizations of the internal audit, this Law precisely defines that this organizational part conducts permanent control of the legitimacy, rightfulness and accuracy of the bank's operations through: monitoring the implementation of the internal procedures and policies, evaluation of the general efficiency of the operations and monitoring the compliance with the legal regulations. This means that the main function of this division is not to conduct inspection controls and verification of the situation in the bank, but permanent monitoring of the bank's operations in order to identify weaknesses which could jeopardize the stability and efficiency of the bank as a whole. Also, according to the new Law at least majority of the employees in this organizational part should be authorized auditors.

The Banking Law contains provisions, which more closely regulate the relations among the bank, supervisory authority and the external authorized auditor. Financial reports and books are checked and evaluated by an authorized auditor for which an auditing report is prepared. The authorized auditor simultaneously submits the auditing report to the National Bank of the Republic of Macedonia, to the executive body of the bank, to the Managing Board of the bank and to the Ministry of Finance. In case the National Bank of the Republic of Macedonia identifies that the auditing report is not based on objective facts with relation to the financial position of the bank, it shall not accept the auditing report prepared by that particular authorized auditor in the following three years. In that case, the bank is obliged to appoint a new authorized auditor, who will conduct an audit of the bank's financial operations. The bank should publish an extract of the auditing report alongside the opinion of the authorized auditor in the media within 15 days after the report is adopted by the Bank

Assembly, i.e. after it was previously submitted to all aforementioned entities, including the National Bank of the Republic of Macedonia.

5. The Banking Law offers a wide variety of corrective actions undertaken against banks which do not operate in compliance with this Law and other regulations. The mechanism of undertaking actions could range from a written warning to the bank; convening a meeting of the Managing Board or Bank Assembly; written order for compliance with the provisions of this Law and other regulations, signing of a protocol, implementing actions with a decision, revoking the approval for appointing an executive body, appointing a conservator, receiver and revoking an operation license.

This Law gives a special treatment to the prompt corrective actions undertaken in case when the capital adequacy ratio is reduced below the prescribed minimum of 8 percent. The types of prompt corrective actions are defined at three levels, i.e. in cases when capital adequacy is reduced below 6 percent, 4 percent and 2 percent.

In case the bank's operations reflect continuous noncompliance with the provisions of this Law and other regulations, besides the aforementioned actions, the National Bank may appoint a conservator, who is obliged to prepare a plan of actions and activities for achieving compliance with the regulations within 30 days after he is appointed. The conservator has the right and duty to attend the sessions of the bank's managing bodies and to participate in their operations, without having a voting right.

When the bank is insolvent, the National Bank may appoint a receiver or may initiate a bankruptcy procedure. By appointing the receiver, all rights of the managing bodies of the bank are suspended. In this context, it should be mentioned that the Banking Law introduces a new definition of insolvency (in accordance with international practices), according to which a bank is considered insolvent on several basis, such as: negative net value, capital adequacy ratio below 2 percent and non-settlement of due liabilities.

As for the bankruptcy procedure certain changes are introduced aimed toward increasing the efficiency of the implementation of the bankruptcy procedure, by excluding all provisions from the existing Law on Bankruptcy, which would postpone the bankruptcy procedure. Also, the authorization of the National Bank in these areas is increased, so that from the date of passing the decision for fulfillment of the conditions for introducing a bankruptcy procedure until the decision of the court for introducing bankruptcy procedure becomes final, the National Bank appoints an authorized employee in order to maintain the bank's property. So far, the competence of the National Bank ceased at the moment when the Governor's decision for fulfilling the conditions for introduction of a bankruptcy procedure becomes final.

Penalty clauses treat criminal acts of the executive body, members of the Managing Board and other persons with special rights and responsibilities in cases when throughout their operations they violated the provisions of this Law or contributed to the introduction of a bankruptcy procedure in the bank. In such cases a person may be sentenced to 3 – 10 years of imprisonment.

### **1.1.2. Review of the changes in other regulations**

As it was mentioned in the beginning of this chapter, simultaneously with the Banking Law other significant Laws from the area of finance and banking were also passed. These are not directly included in the regulatory framework of the banking supervision, but their contents should reflect significant effects on the stability and efficiency of the banking

and financial system as a whole as well as increased confidence of the citizens in domestic saving. More significant Laws past during this period are the following:

The **Law on the Deposit Insurance Fund** introduces significant news with respect to the deposit insurance scheme, operations and organization of the Deposit Insurance Fund. As it was the case with the previous regulations, the new Law also regulates the existence of an explicit deposit insurance scheme in the Republic of Macedonia. Banks and savings houses are obliged to insure their deposits in the Deposit Insurance Fund, which according to the Law shall be established and owned by the Republic of Macedonia. Subjected to insurance are the denar and foreign currency deposits, as well as the current accounts of households, deposits related to credit cards issued by banks established on the territory of the Republic of Macedonia and foreign currency inflows of households. In case of a risky event, the Fund compensates the households in the amount of:

- 100% of the deposit of each natural person in a single bank or savings house up to the amount of a denar equivalent of EUR 1,500 and

- 90% of the deposit of each natural person in a single bank or savings house up to the amount of a denar equivalent between EUR 1,500 and EUR 7,500, however not more than EURO 7,500.

Compensation to households shall commence within three months from the date the decision on revoking the operating license was passed, or when majority of the members of the Managing Board decide that the bank has in generally stopped paying the deposits to households.

The main objective of the new **Law on Securities** is to protect the interests of the investor and to increase the stability, safety and confidence in the securities market. More significant amendments to the new Law on Securities are the following:

- introduction of the principle of complete dematerialization of securities. Accepting this principle bears multiple advantages, such as: decline in the costs for physical printing of securities, their safe-keeping, securing and transfer, and it also enables fast and efficient transfer in the trading process;

- establishment of a central securities depository, which represents a central information base and contains electronic data on the issued securities;

- trade with publicly offered securities may be conducted by brokerage houses and banks, which is in accordance with the European Union Directives, etc.

Long and exhausting court procedures for collection of bad debts, as well as the difficulties in the proces of foreclosures, represent one of the main problems in the operations of banking institutions, which is simultaneously one of the main reasons for the high percentage of bad loans in banks' balance sheets. With that respect, the new **Law on Collateral and the Low on Amendments to the Law on Executive Procedure** are aimed toward protecting the creditors' rights by increasing the efficiency of the court procedure in the collection of collateral.

### **1.1.3. Review of the changes in the other supervisory regulations**

During the first half of 2000, within the framework of the activities of the National Bank of the Republic of Macedonia related to the revision of the supervisory regulations, a new decision on determining and calculating open foreign exchange positions of banks, which

prescribes the manner of calculating the open foreign exchange positions of the bank by separate currencies, the open aggregate denar position, open aggregate foreign exchange position and the relation between the open foreign exchange positions and bank's guarantee capital. More significant changes in the new decision pertained to:

- a decline in the open foreign exchange position ratios by separate currencies from 30 percent to 20 percent, decline in the aggregate denar position ratio from 50 percent to 30 percent, and a decline in the open aggregate foreign exchange position from 60 percent to 40 percent;

- besides the foreign currency denominated active and passive balance sheet positions, denar denominated positions with a foreign currency clause, i.e. those positions which according to the book-keeping rules are valued at an exchange rate and reflect exchange rate differentials, are also included in the calculation of the open foreign exchange positions;

- introduction of an obligation for the banks to submit daily reports to the National Bank of the Republic of Macedonia regarding the latest developments in their open foreign exchange positions.

All these changes are aimed toward achieving greater compliance with the European Union Directives of Banking and Basle Principles for Efficient Banking Supervision. On the other hand, the conducted comparative analysis of the amount of the open exchange positions in other countries, shows that almost all countries, including the countries in transition have lower foreign exchange position ratios. With the conducted changes in the new decision, the foreign exchange position ratios are adjusted to the international prudential limits for control of the exchange rate risk.

## **1.2. SUPERVISORY FUNCTION OF THE NATIONAL BANK OF THE REPUBLIC OF MACEDONIA**

The supervisory function of the National Bank of the Republic of Macedonia is conducted throughout the following three aspects:

- function of licensing, i.e. processing of the submitted applications for granting licenses and approvals, in accordance with the regulations;

- supervisory examination and off-site surveillance of banks and savings houses; and

- undertaking corrective actions against banking institutions in which irregularities in their operations have been identified.

### **1.2.1. Processing of applications for granting licenses and approvals according to the Banks and Savings Houses Act**

Within the framework of the licensing activities of the National Bank of the Republic of Macedonia, during the first half of 2000, founding licenses were issued to two savings houses: "Možnosti" Ltd. Skopje savings house and "Zegin Viktorija i drugi" Ltd. Skopje savings house. In the analyzed period, a license for opening a representative office of the International Commercial Bank of the Republic of China was also issued.

During the first half of the year, a final decision was passed for revoking the operating license of "Almako Banka" a.d. Skopje, and a bankruptcy procedure was introduced in this bank.

With regard to granting approvals on various bases, during the first six months of 2000 the National Bank of the Republic of Macedonia conducted the following activities:

- granted approvals upon three submitted applications for opening windows of domestic banks (“Radobank” a.d. Skopje, “Tutunska Banka” a.d. Skopje and “Stopanska Banka” a.d. Skopje);

- 11 applications were submitted for appointment of an executive body, 8 of which were approved, 1 was rejected, and 2 are currently being processed;

- from the total number of 43 applications for change in the ownership structure of the voting shares, a 28 were approved, for 3 applications a partial approval was granted, 2 applications were rejected, 8 applications were withdrawn, and 2 applications are currently being processed;

- from the total number of 11 applications for issuing approvals for change in the Statute, the National Bank of the Republic of Macedonia granted an approval for 10 applications, whereas 1 application was withdrawn;

- an approval was granted for the application of the “FULM” Ltd. Skopje savings house for opening a branch;

- an approval was granted for 1 application for establishing a banking consortium;

- an approval was granted for access to a report from conducted supervisory control (2 banks).

### **1.2.2. Supervisory examinations and off-site surveillance**

In accordance with the National Bank of the Republic of Macedonia Act (“Official Gazette of RM” No. 29/96, 37/98 – clean copy) and the Banks and Savings Houses Act (“Official Gazette of RM” No. 29/96, 37/98 – clean copy)<sup>1</sup>, and the by-laws which more precisely regulate the supervisory examinations and the adequate supervisory procedures, the National Bank of the Republic of Macedonia conducts an on-going supervision of banks and savings houses in the Republic of Macedonia through:

- on-site (full-scope or targeted) examination of the operations of banks and savings houses;

- on-going off-site monitoring of the operations of banks and savings houses.

During the first half of 2000, a total number of 29 on-site supervisory examinations were conducted, 15 of which were full-scope supervisory examinations, 13 were targeted supervisory examinations and 1 examination was in process at the end of June, 2000. Full-scope examination of the overall operations was conducted in 8 banks and 7 savings houses, whereas an examination of separate segments of the operations was conducted in 10 banks and 3 savings houses.

During the first half of this year, upon request of the World Bank, in the framework of the FESAL II arrangement, the Arthur Andersen auditors conducted a diagnostic study of

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<sup>1</sup> The new Banking Law was passed in July, 2000. Hence, the conduct of the supervisory function of the National Bank of the Republic of Macedonia until this period was regulated by the Banks and Savings Houses Act, which was in force at that time.



the four largest banks in the Republic of Macedonia, following “Stopanska Banka”, a.d. Skopje. The fact that these are banks with a share in the total scope of activities of 34 percent of the banking system, leads to the conclusion that this project covered a significant part of the total banking system of the Republic of Macedonia.

The conduct of the on-site full-scope supervisory examinations of banks and savings houses is based on the application of the CAMEL rating system, which includes analysis and evaluation of five critical areas of the operations of banking institutions. Such are: capital adequacy, asset and credit portfolio quality, management and internal control, profitability and liquidity.

On the basis of quantitative and qualitative analysis of each of these areas, a composite rating of the banking institution is determined, which may vary from “1” to “5”. Thus the composite rating “1” presents a rating which identifies safe and efficient operations and adequate risk management in accordance with the size and complexity of the institution. The institution which was given this rating is a sound institution and it shows high responsiveness with respect to compliance with the regulations. On the other hand, the institution evaluated with a composite rating “5” is extremely unsafe, reveals critical deviations in the course of its operations, applies inadequate risk management, and represents a serious risk for the banking system as a whole.

Banking institutions examined throughout the first half of 2000 were rated as follows: one bank and two savings houses were rated with a composite rating “2”, three banks and two savings houses received a composite rating “3”, three banks and one savings house were rated with composite rating “4”, and two savings houses were given the lowest rate “5”. In one bank the examination was still in process.

During the first half of the year, since the National Bank of the Republic of Macedonia did not issue an approval for an executive body as a result of identified problems in the liquidity area, and as a result of monitoring the application of the decisions with corrective actions passed by the Governor, authorized supervisors from the National Bank of the Republic of Macedonia verified the payment orders and conducted permanent supervisory control of the operations of one bank and two savings houses.

The control function of the National Bank of the Republic of Macedonia includes the inspection control for application of the regulations from the foreign exchange operations. Thus for the first six months of 2000, a total number of sixty-two controls were conducted. Six controls covered the overall foreign exchange operations of banks, seven controls covered separate areas of foreign exchange operations, two controls were related to the operations of savings houses, fourteen controls were related to foreign currency savings deposits, and in the rest of thirty-three controls pertained to the operations of authorized exchange offices. Mostly, subject of targeted controls of institutions was the compliance with the decisions with actions issued by the Governor of the National Bank of the Republic of Macedonia, control of the operations with credit cards, foreign exchange market, non-resident accounts, transformation of old to new foreign currency saving, control of the foreign currency savings deposits, etc.

The second aspect of the control function of the National Bank of the Republic of Macedonia is the permanent off-site monitoring of the operations of banking institutions. The surveillance of these institutions is conducted on the basis of monitoring and regular analysis of the reports submitted by banks and savings houses, as well as on the basis of the information received from on-site examinations. Such a monitoring represents a starting point for establishing a system of the early warning signals, which should alert on the possible problems in their initial stadium. Conducted monthly and quarterly analysis of the operations of separate banking institutions represent a basis for evaluating the performances of the entire

banking system, which represent a feedback for the comparative analysis of each of the separate institutions within the framework of the banking system.

The experience of other countries has shown that when in the banking system of a certain country several problem banks are identified, the most efficient method for their treatment, from an organizational point of view, it is to locate them in a separate unit. Within the framework of the Supervision Department this method gives an opportunity to the supervisors involved in the operations with problem banks to acquire experience and to specialize for operations with such institutions. The establishment of the Problem Bank Unit, enables the other units within the Supervision Department not to disturb the established regular manner of operations, which may not respond to the needs for a reinforced monitoring of the operations of problem institutions. On the basis of the practical experience with problem banking institutions so far, the following criteria according to which a bank receives the status of a problem bank have been identified: composite rating “4” or “5” determined by the latest on-site examination, capital adequacy ratio below 12 percent, identified serious violation of the legal regulations, liquidity problems of the institution reflected through permanent illiquidity.

As of June 30, 2000, eight banks which received aggregate composite rating “4” or “5” at the latest full-scope on-site examination, and revealed significant concentration of risks, were transferred to the Problem Banks Unit. The reinforced permanent monitoring of these banks is conducted on the basis of an analysis of regular reports and a number of extraordinary reports submitted by the banks, as well as by on-site examinations, in order to identify all changes in the operations of these institutions in a more efficient and prompt manner and undertake additional corrective actions on time, if necessary.

The experience acquired by conducting the supervisory function of the National Bank of the Republic of Macedonia, with relation to the most significant problems with which banks and savings houses in the Republic of Macedonia face, showed that the problematic segments in the operations of banking institutions from the previous period also remain in 2000. Thus most distinctive are the problems connected with the poor asset quality, primarily the credit portfolio, which is a result of weak credit procedures and policies of banks, long court procedures in undertaking of collateral and difficulties in its collection. Such problems significantly determine the liquidity position of institutions, which brings of the need of additional liquidity by using the secondary sources of financing. On the other hand, the poor quality of credit portfolio also strikes the profitability of banks, which is a result of the insufficient volume of revenues generated from the credit activity of banking institutions, and simultaneously of the higher costs related to the legal obligation for allocation of special reserve for potential losses from non-performing loans. The inadequate internal policies and procedures for identification and control of the operational risks, as well as the inadequate management information systems cause problems related to the liquidity and solvency of banks.

### **1.2.3. Undertaking corrective actions**

Having in mind the findings from conducted on-site examinations and off-site surveillance, the National Bank of the Republic of Macedonia is authorized to undertake corrective actions and activities against banks and savings houses, in which irregularities during their operations have been identified. Thus the variety of actions which the National Bank of the Republic of Macedonia is authorized to apply, is quite broad and primarily depends on the type and scope of identified irregularities during banks' operations.

Undertaking corrective actions and activities may range from giving suggestions and recommendations for removal of irregularities, and directions in which the institution should move, by decisions with actions issued by the Governor, even by revoking the operating

license as an ultimate option, if the irregularities are of such nature that they cause serious financial and operative difficulties, and if all previous actions and activities have not given the expected result.

In the first half of 2000, the National Bank of the Republic of Macedonia issued thirty-five decisions with corrective actions, submitted three applications for pressing civil charges (against two banks and 1 savings house) and 1 criminal charge. On the basis of the supervisory findings in the first half of 2000, the following actions against banking institutions were undertaken:

- action for revoking the approval for an executive body was undertaken against one savings house;

- action for verification of payment orders by authorized employees of the National Bank of the Republic of Macedonia was undertaken against two savings houses;

- action for prohibited extension of credits and conduct of other placements, except for placements in securities based on sale of deposits to the National Bank of the Republic of Macedonia was undertaken against two banks;

- action for freezing the denar placements was undertaken against three banks;

- prohibition of all or particular banking operations for a certain period of time was undertaken against two savings houses;

- prohibited collection of deposits of legal entities was undertaken against one savings house;

- action for reclassification of allocation of the additionally determined loan loss provisions in accordance with the supervisory findings was undertaken against seven banks and one savings house;

- action for implementation of the Decision on the supervisory standards for regulating arrears was undertaken against five banks and one savings house;

- action for reducing the share of a single shareholder to 20 percent of the founding capital was undertaken against one bank, and a action for reducing the amount of preferential shares to 20 percent of the founding capital was undertaken against one bank;

- action for reducing the limit of 65 percent of the founding capital for a single shareholder – foreign bank, was undertaken against one bank;

- action for transfer of own shares was undertaken against one bank;

- action for exclusion from participation in the foreign exchange market was undertaken against one bank;

- action for reducing the credit exposure to the legally prescribed limits was undertaken against one bank;

- action for exclusion of the net debtors from the Managing Board was undertaken against one bank;

- action for provision of funds on the basis of used compulsory reserve of banks was undertaken against one bank;

- action for reducing the property in land, buildings, equipment and capital parts to the level of 25 percent of the founding capital of the bank was undertaken against 3 banks;

- other actions: compliance with the Law on Accounting (three banks and two savings houses), compliance with the Law on Foreign Exchange Operations (four banks), compliance with the Law on International Credit Relations (two banks), termination of the activities of parallel payment operations (two banks), updating of the shareholders' book (2 banks), preparation of a plan by the Managing Board for compliance with the undertaken actions (three banks), regular meetings of the Managing Board (one bank), termination of the extension of new credits for the purpose of closing old claims (one bank), preparation of an auditing report and publishing of annual statement (one bank).