

1. BANKING SUPERVISION

1.1. Legislative of the Banking Supervision

In 2000, within the commenced reforms of the banking system of the Republic of Macedonia, important laws in the area of banking and finances were adopted, such as:

1. Banking Law (Official Gazette of the Republic of Macedonia no. 63/2000);
2. Deposit Insurance Fund Law (Official Gazette of the Republic of Macedonia no.63/2000);
3. Securities Law (Official Gazette of the Republic of Macedonia no.63/2000);
4. Law on Consensual Mortgage (Official Gazette of the Republic of Macedonia no.59/2000, 86/2000);
5. Law on Amendments to the Law on Executive Procedure (Official Gazette of the Republic of Macedonia no.59/2000);
6. Other by-laws: Decision on Determining and Calculation of Banks' Open Foreign Exchange Positions (Official Gazette of the Republic of Macedonia no.33/2000, 77/2000, 79/2000), Decision on Methodology for Determining the Banks' Guarantee Capital (Official Gazette of the Republic of Macedonia no.77/2000), Decision on Documentation for Issuing Licenses in Accordance with the Banking Law (Official Gazette of the Republic of Macedonia no.111/2000), Decision on Documentation for Issuing Approvals and Submitting Notifications in Accordance with the Banking Law (Official Gazette of the Republic of Macedonia no.111/2000), Decision on Manner of Conducting Supervisory Examination of Banks and Procedure for Undertaking Measures for Elimination of the Identified Irregularities (Official Gazette of the Republic of Macedonia no.111/2000).

1.1.1. Review of the Contents of the Banking Law and Other Supervisory Regulation Adopted in 2000

After long and intensive preparatory activities, in consultation with the World Bank, the new Banking Law was adopted in mid-2000. This Law contains solutions directed towards compliance with the European legislative and the European directives in the area of banking, as well as compliance with the Basle Core Principles for Effective Banking Supervision.

The amendments to the Banking Law can be summarized in the following areas:

- precise definition of the terms “bank” and “banking operations”, with the bank being the only entity regulated by this Law;
- establishing new approach to the licensing of new entities in the banking system of the Republic of Macedonia;
- strengthening the supervisory standards which regulate the banks' operation aimed at achieving financial reliability and establishing sound, stable and effective banking system;
- strengthening the corporate governance in the banks, through institutionalization of new bodies in the bank and precise definition of the relation between the

Assembly, Management Board, Executive Body, Risk Management Committee and Auditing Committee;

- establishing wide range of corrective actions for supervision and sanctioning of banks with identified irregularities, as well as improvement of the efficiency when a bank is no longer a part of the banking system in the Republic of Macedonia.

Considering the major amendments to the Banking Law, which significantly affected the banks' operations, there was 6-month time period in which the banks were to comply with the provisions of the Law, which expired on February 5, 2001.

a. Definition of Entities Regulated by the Banking Law

As mentioned above, the Banking Law closely defines the term "banks" and the minimum banking activities that one entity is to perform to be able to establish and run a bank. The bank is defined as a legal entity which performs at least the following banking activities: taking deposits, placement of the deposits in loans and other investments for the account of the bank, as well as other activities prescribed by the law to be performed exclusively by the banks (such as carrying out domestic payment operations). On the other hand, the Banking Law defines the non-banking financial institutions which perform one or more financial activities (other than banking activities), such as economic and financial consulting, factoring, financial leasing, issuance of payment cards, extension of loans etc.

Additionally, it is clearly prescribed that the legal entities and natural persons that are not granted a license by the National Bank of the Republic of Macedonia may not take deposits and to place them as credits or investments. Also, it is prescribed that the National Bank of the Republic of Macedonia is authorized to issue founding and operating license of a bank i.e. license for performing banking activities. The term "bank" or the terms derived from the term "bank" may not be used in the name of the Trade Company or legal entity, which is not granted a license for performing banking activities.

Each provision is directed towards fulfillment of the criteria established by the Basle Committee for Banking Supervision, in order to fully comply with the Basle Principle no.2.

b. Licensing New Entities in the Banking System of the Republic of Macedonia

The Banking Law introduces novelties regarding the Core Principles and the procedure of licensing new entities in the banking system of the Republic of Macedonia. The basic provisions of the Banking Law are completed also in the respective by-laws regulating the procedure and the minimum required documents for founding a bank, as well as for obtaining approvals by the National Bank of the Republic of Macedonia according to strictly determined legal bases, such as change in the ownership structure, appointing executive body, founding a bank and opening branch, subsidiary or representative office if a bank abroad, founding a brokerage house authorized for operations on its behalf and for its account and founding other financial institutions.

The novelties in the area of licensing can be summarized, as follows:

- Two-stage licensing procedure has been established, denoting gradual fulfillment of range of preconditions as a basis for issuing temporary license, as a first step and then issuing

a final license (by completing the licensing procedure). Based on the submitted documentation (elaborate on operations including projection for financial statements for the following three years, documentation for education, experience and professional history of the persons with special rights and duties for the previous three years, financial and other data on the potential bank's shareholders, adequacy of the bank's written operation policies and procedures etc.), the National Bank of the Republic of Macedonia particularly assesses:

- whether the bank is organized and equipped to operate in accordance with the regulations and prescribed supervisory standards. This represents an assessment on whether the bank is actually capable to success on a long run or whether it operates in profitable, secure and liquid manner;
 - skills, experience and integrity of the executive body, the other persons with special rights and duties and the shareholders. The integrity of the executive body, the other persons with special rights and duties and the shareholders is assessed through the following elements: honesty, competence, capability for judgment, hardworking, non-conviction, belief that in the bank's operations s/he will not act towards destruction of the financial stability, reputation and confidence of the deponents, responsiveness to the corrective actions imposed by the National Bank etc. In this light, the identity of the shareholder and their possible affiliation is examined, with special attention paid to their financial reliability and the source of capital.
- However, generally speaking, it should be underlined that this Law offers solutions which extensively liberalize the licensing terms, particularly taking into account the following:
 - the minimum capital requirement for international payment operations and credit guarantee operations has been reduced from DEM 21 million (according to the previous Law on Banks and Savings Houses) to Denar equivalent of EURO 9 million;
 - the share of each shareholder in the ownership structure of the bank with managing right has been increased from 20% to 1/3. This constraint ceases to be valid on January 1, 2003, which will allow the bank to be established by only one shareholder. On the other hand, based on the assessment made by the National Bank of the Republic of Macedonia, if a bank wants to establish a bank, the share of capital may be unlimited. With these amendments, under the given circumstances, at least three shareholders are required to found a bank and if the shareholder is a bank, than its share in the bank's capital may be unlimited;
 - the procedure for requiring prior approval by the National Bank of the Republic of Macedonia when there is a change in the ownership structure of the bank with managing right has been liberalized. The previous legal obligation of the banks for requiring prior approval by the National Bank of the Republic of Macedonia when there is a change in the ownership structure of the shares with managing right of above 3%, is replaced by the provision for requiring prior approval in cases when the shares are acquired gradually or concurrently with total cumulative amount of 10%, 20%, 33%, 50% and 75%. As for all other cases of change in the ownership structure of the shares with managing right (among aforementioned percentages), the banks are required to notify the National Bank of the Republic of Macedonia within 5 working days.

Each provision is aimed at fulfillment of the criteria established by the Basle Committee for Banking Supervision, in order to achieve full compliance with the Basle Principles no.3 and 4.

c. Supervisory Standards

Additionally, considerable amendments to the Banking Law were adopted regarding the supervisory standards that underlie the regulation of the banks' operations. Therefore, after the adoption of the Banking Law, there was a revision of the other supervisory regulation covering the capital adequacy, exchange rate risk, credit risk and country risk (by classifying the risk of the particular balance and off-balance sheet items and allocation of adequate special reserve for covering the potential losses, as well as regulating the concentration of credit exposure by entities), the liquidity risk (by prescribing a requirement for maturity compliance between the banks' assets and liabilities), affiliated entities etc.

The revision of the supervisory regulation is expected to be completed in 2001.

In 2000, the following changes in the area of supervisory standards should be particularly emphasized:

- The credit exposure to a single debtor has been decreased from 30% to 25% relative to the bank's guarantee capital (incorporated in the Banking Law);
- The credit exposure to single persons with special rights and duties has been increased from 1% to 3% relative to the bank's guarantee capital (incorporated in the Banking Law);
- The aggregate exposure of a bank in real estate and capital parts in other legal entities has been increased from 25% to 60% relative to the bank's guarantee capital. Thus, only the aggregated amount of capital investments of the bank in other legal entities may not exceed 30% of the guarantee capital, while individual capital investment of the bank in other non-financial entity is limited relative to the guarantee capital of the bank at a level of 15%. These amendments to the Banking Law enable the development of the investment banking, which was impossible with the previous Law on Banks and Savings Houses. According to the previous Law, the capital investment of a bank in other legal entity was limited to 20% of the capital of the legal entity, whereas the new Law overcame this obstacle, meaning that the bank may be 100% owner of other legal entity;
- In accordance with the new methodology for determining and calculating the guarantee capital, the banks are given a possibility to include other external sources of funds aimed at support of the bank's activities. The amendments lead to introduction of new components when calculating the guarantee capital, such as hybrid capital instruments and subordinated debts. Consequently, the capital base increases, which on the other hand has positive effect, through the following:
 - possibility to increase the capital adequacy ratio (this is especially important for banks which face certain difficulties when preserving their solvent position);
 - possibility to increase the absolute amount of credit exposure to a borrower, considering the fact that the existing prudent limits are being implemented at higher base of the guarantee capital.
- In the area of regulating the exchange rate risk of the banks, also the new regulation should be mentioned that prescribes the method of calculating the open foreign exchange positions of the bank by currencies, the open aggregate Denar position, the open aggregate foreign

exchange position and the relation between the open foreign exchange positions and the bank's guarantee capital. Therefore, the following changes should especially be mentioned:

- decrease in the ratios for open foreign exchange positions by currencies from 30% to 20%; ratio for open aggregate Denar position decrease from 50% to 30%, while the ratio for open aggregate foreign exchange position decrease from 60% to 40%;
- decrease in the time period within which the banks are required to notify the National Bank of the Republic of Macedonia on their open foreign exchange positions. The obligation of the banks for monthly reporting has been replaced with the obligation for 10-day reporting, which on January 1, 2002 will be replaced with obligation for daily reporting on the open foreign exchange positions.

The amendments to this supervisory regulation are directed towards approximation to the international supervisory standards and practices, although the comparison analysis of the regulation of the other countries indicates that almost all countries have lower ratios for open foreign exchange positions. These amendments, as well as all others, which will follow in the forthcoming period are aimed at gradual compliance with the international prudent limits for control of the exchange rate risk.

d. Corporate Governance in Banks

The Banking Law establishes the basic principles of effective corporate governance in banks. Thus, the establishment of solid fundamentals of the corporate governance is not only a legal requirement, but should be comprehended primarily as a good business practice of the banks.

The National Bank of the Republic of Macedonia has particularly been interested in establishing solid fundamentals of corporate governance of banks, since the effective performance of the supervisory function of the National Bank interactively relates to the solid system of corporate governance.

The following are the considerable amendments to the Banking Law:

- Introduction of so-called four-eye principle, meaning that the management function will be performed by at least 2 persons. The top management of the bank is a key component of the corporate governance. The four-eye principle is required to be followed when adopting the "major management decisions", however, it should be delegated to lower decision-making levels;
- Strengthening of the role and responsibilities of the Management Board of the bank through extension of its competencies. The performance of the prescribed legal competencies by the Management Board of the bank includes higher skillfulness, professionalism and higher active approach of the members of the Management Board when performing the prescribed functions. This is especially important if the fact that the Risk Management Committee is formed from among the members of the Management Board is taken into a consideration. This is a brand new body institutionalized with the Banking Law and according to the prescribed scope of competencies it is a high professional body in the bank. The Risk Management Committee is also responsible for establishing and monitoring

- the application of the policies and procedures for assessment of credit risk, liquidity risk, interest rate risk and other market risks;
- The Auditing Committee is required element of the corporate governance, introduced as a legal requirement with the Banking Law. This Committee is responsible for establishing adequate accounting procedures and assessment of their compliance with the established legal framework in this area;
 - Within the framework of the corporate governance system, special attention is paid to the Internal Audit Department, which role, place and competencies are precisely defined in the Banking Law. The need of precise definition of this legal requirement of the banks arose from certain misunderstanding of the interpretation of the provisions of the previous Law on Banks and Savings Houses and their practical application, which especially refer to the differences between the internal control systems and the role and place of the internal audit, as well as the lines of responsibilities between this organizational segment and the management of the bank. These changes made it clear that this department is an independent organizational part that permanently controls the legitimacy, regularity and accurateness in the bank's operations by monitoring of the implementation of the internal procedures and policies, assessment of the general effectiveness in the bank's operations and monitoring of the adherence to the regulations. The Department informs the Management Board of the bank on the performed examinations and identified operational risks.

Besides defining the internal audit, the Banking Law contains solutions that refer to the place, role and competencies of the external audit and particularly defining the relation between the external audit, the management of the bank and the Supervision Department. The Banking Law defines the framework of activities and scope of audit, which is to be carried out by the external auditor. Moreover, the role of the supervisory body has been strengthened, meaning that if the National Bank of the Republic of Macedonia finds that the audit report on the bank is not based on objective facts regarding the financial standing of the bank, it is entitled to disregard the report and will not approve an audit report prepared by that particular authorized auditor in the next three years. Additionally, the Banking Law includes provisions, which increase the obligations of the bank regarding the disclosure of financial data in the public. The bank is required to publish an excerpt of the audited financial statement, including judgment of the authorized auditor, in at least one daily newspaper, within 15 days after the adoption of the statement by the bank's assembly.

e. Corrective Measures and Actions against Banks

The Banking Law defines wide range of corrective measures and actions that may be taken against banks, with identified operational irregularities and difficulties. In that light, this Law prescribes all possible mechanisms of imposing measures, as well as numerous corrective actions with different content, depending on the identified difficulties and inconsistencies in the banks' operations.

From aspect of possible mechanisms of imposing measures, the Banking Law distinguishes measures such as submission of written warning, request for convening a meeting of the Management Board or Shareholder Assembly, aimed at reviewing the standing and

achieving agreement for the measures for improving the bank's standing, issuing written order for compliance with the regulatory framework, summarized in protocol signed by the National Bank of the Republic of Macedonia and the bank.

The corrective actions imposed by the National Bank of the Republic of Macedonia can be of different nature, such as further capitalization of the bank, ban on payment of dividend or other payment of gain, ban on taking saving deposits, ban on acquiring ownership in other legal entities, establishing parts of banks or representative offices or otherwise to extend the operating network, ban on increase of credit exposure to borrowers classified in risk categories C, D and E, restriction on the salaries and fees of the members of the Management bodies and bank's employees, annulment of the approval for appointing executive body of the bank, appointing a conservator, receiver, as well as revocation of the bank's founding and operating license and other measures.

Also, the Banking Law contains provisions for taking prompt corrective actions, if the capital adequacy ratio is below 6%, or 4%. The process of undertaking actions is accompanied by adoption of a plan for further capitalization by the bank.

If the bank is in permanent noncompliance with the provisions of the Banking Law and other regulations, the National Bank of the Republic of Macedonia can appoint a conservator in the bank. The conservator is required to prepare and propose to the National Bank of the Republic of Macedonia a plan including measures and actions for compliance of the bank's operations with the regulatory framework, within 30 days after the appointment. If the authorized bodies of the bank refuse the plan, the National Bank of the Republic of Macedonia can take a decision on revocation of the founding and operating license.

If it is determined that the bank is insolvent, the National Bank of the Republic of Macedonia can appoint a receiver or to submit a proposal to the authorized court for introduction of bankruptcy proceeding in the bank. The rights and management bodies of the bank are suspended after the appointment of a receiver. Therefore, the Banking Law stipulates several bases which indicates bank's insolvency: negative net value, capital adequacy ratio below 2% and unsettlement of due liabilities.

Bankruptcy proceeding is introduced in a bank when it is found that the bank is not possible to be rehabilitated or the rehabilitation is not economically justified and if the bank is incapable of settling the due liabilities within the period of 10 consecutive days. The National Bank appoints an authorized employee in the bank on the date of adoption of the decision on fulfillment of the conditions for introduction of bankruptcy proceeding. Consequently, the competencies of the National Bank increase in the area of bankruptcy proceeding, which, so far, were ceasing at the moment of finalization of the decision of the Governor on fulfillment of the conditions for introducing bankruptcy proceeding.

The Banking Law includes penalty provisions such as criminal acts for the executive body, the members of the Management Board and other persons with special rights and duties in cases when they violate the provisions of this law or contributed to introduction of bankruptcy proceeding in the bank.

1.1.2. Review of the Modifications in the Other Regulations

Besides the Banking Law, other legal acts in the finance and banking sector adopted in 2000 were incorporated in the beginning of this chapter, which content reflects significant effects on the stability and effectiveness of the overall banking and financial system, as well as the increase of the confidence of the citizens in the domestic saving. Important laws that were adopted in this period are the following:

Law on Deposit Insurance Fund requires from the banks and savings houses to insure their deposits in the Deposit Insurance Fund established and owned by the Republic of Macedonia. Therefore, the Government guarantees the payment of the citizens' deposits, thus providing higher security and influencing the increase in the confidence in the domestic saving.

The Law defines explicit scheme of deposit insurance, where subjects to insurance are the Denar and Foreign Exchange deposits and current account of natural persons, the deposits related to payment cards issued by the banks established in the Republic of Macedonia and foreign exchange inflows of natural persons. In case of occurrence of risky event, the Fund indemnifies the natural persons in the amount of:

- 100% of the deposit of each natural person in one bank or savings house to the amount of Denar equivalent of EURO 1,500 and
- 90% of the deposit of each natural person in one bank or savings house to the amount of Denar equivalent of EURO 1,500 and EURO 7,500, however not to exceed Denar equivalent of EURO 7,500.

The Law on Deposit Insurance Fund prescribes the indemnification of the natural persons to begin within three months after the date when the decision on revocation of the operating license was adopted or when the majority of the Management Board members find that the bank generally ceased to pay out deposits to natural persons.

The Law on Securities provides a basis for investor protection by arranging the relations for the types of securities, the manner of their issuance and terms of trading, which provide and strengthen the stability, security and the confidence in the securities market. The basic novelties contained in the new Law on Securities are the following:

- Definition of the terms and manner of establishing and operating the Central Depository, as a central information base containing computer data on the issued securities;
- Full de-materialization of the securities, thus providing decrease in expenses of printing of securities, their keeping, security and transfer and also providing expeditious and effective transfer in the trading process;
- The issuance of securities carried out within six months will be deemed successful, regardless of the percentage of realization of issuance i.e. it is necessary at least one newly issued security to be purchased;
- Brokerage houses and banks may carry out the trading with securities offered publicly, which is in compliance with the European Union Directives.

The provisions of the new Law on Consensual Mortgage and the Law on Amendments to the Law on Executive Procedure are important for improvement of the efficiency in the operation of the banking institutions. These provisions provide larger protection of the creditor rights by acceleration of the court procedures for collection of the bad placements, as well as reduction of the difficulties related to realization of the mortgages.

1.2. Supervisory Function of the National Bank of the Republic of Macedonia

The National Bank of the Republic of Macedonia, as an authorized supervisory body, performs its supervisory function at the following levels:

- Licensing function, by processing the submitted applications for issuing licenses and approvals, in compliance with the regulations;
- Examination of the operations of the banks and savings houses and
- Undertaking corrective actions against banks and savings houses.

1.2.1. Licensing Function

Within the framework of the licensing activities in 2000, the National Bank of the Republic of Macedonia issued a license for founding a savings house “Moznosti” ltd. Skopje and savings house “Zegin Viktorija i drugi” ltd. Skopje. A license for opening a representative office of the International Commercial Bank of the Republic of China –Taiwan was issued in the same period.

In the area of issuing approvals on various bases in 2000, the National Bank of the Republic of Macedonia performed the following activities:

- total number of 26 applications for issuing approvals for appointing a executive body were submitted in 2000, for 17 of which an approval was granted, 1 application was discarded, 1 application was revoked, while for 7 applications the procedure of processing was underway;
- total number of 49 applications for change in the ownership structure of the share with management right were submitted, for 32 of which an approval was granted, 4 applications were issued a partial approval, 3 applications were discarded, 9 applications was revoked, while 1 application is deemed a notification;
- total number of 34 applications for issuing approvals for changes in the Statute were submitted. The National Bank of the Republic of Macedonia granted an approval for 23 of them, 2 applications were revoked, while for 9 applications the procedure of processing was underway, at the end of 2000;
- approvals were granted for 3 applications for opening sub-branches of domestic banks (Radobank a.d. Skopje, Tutunska Banka a.d. Skopje and Stopanska Banka a.d. Skopje);
- 2 applications for issuing approvals for purchasing shares in other bank were submitted, for 1 of which an approval was granted, whereas the other application was disregarded;

- an approval was granted for the application for opening a branch submitted by savings house FULM ltd. Skopje;
- an approval was granted for the application for establishing a brokerage company submitted by Postal Savings House ltd. Skopje;
- an approval was granted for 3 applications for insight in the report on conducted on-site examination;
- 2 applications for issuing approval for change in the name were submitted, for 1 of which an approval was granted, while for 1 application the procedure of processing was underway;
- an approval was granted for the application for issuing an approval for forming a banking consortium;

After the enactment of the new Banking Law in July 2000, as well as due to the need of registering the banks in the Trade Registry, in the second half of 2000, the activities for issuing approvals for new Statute, as well as for appointing management bodies of the banks were intensified.

1.2.2. Examination of the Operations of the Banks and Savings Houses

In accordance with the Law on National Bank of the Republic of Macedonia (Official Gazette of the Republic of Macedonia no. 29/96, 37/98 - revised text) and the Banking Law (Official Gazette of the Republic of Macedonia no. 63/2000), as well as the by-laws and the respective supervisory procedures, the National Bank of the Republic of Macedonia permanently supervises the operations of the banks and savings houses through:

- On-site (full-scope and partial) examination of the operations of banks and savings houses;
- On-going off-site (regular and strengthened) monitoring of the operations of banks and savings houses.

Within the framework of the on-site examination in 2000, 55 on-site supervisory examinations were carried out, out of which 23 full-scope supervisory examinations and 32 partial supervisory examinations. The on-site examinations covered the overall operations of 14 banks and 9 savings houses, while partial examination was carried out in all banks and 8 savings houses. The partial supervisory examinations of the operations of banks and savings houses are aimed at checking and verifying the findings obtained through the off-site surveillance, as well as checking the implementation of the corrective actions imposed by the National Bank of the Republic of Macedonia.

The on-going off-site surveillance of the operations of the banking institutions is other aspect of the supervisory function of the National Bank of the Republic of Macedonia. The supervision of these institutions is carried out through monitoring and regular analysis of the reports submitted by the banks and savings houses, but also on basis of findings obtained through on-site full-scope and partial supervisory examinations. The regular off-site surveillance is a starting point for establishing an early warning system, which has to alarm on possible problem at the beginning of its occurrence. The monthly and quarterly analyses of the operations of the banking institutions are basis for determination of the

performances of the overall banking system, which on the other hand are a feed back for the comparative analysis of each of the institutions within the banking system.

In the first half of the year, the independent auditing house Arthur Andersen prepared diagnostic studies for the four largest banks in the Republic of Macedonia, after Stopanska Banka a.d. Skopje, upon request of the World Bank, within the framework of FESAL II arrangement. Based on these studies, the banks were given certain recommendations, which implementation should improve their operational practices and procedures.

The supervision of the operations of the banks and savings houses in the Republic of Macedonia is based on the application of CAMEL rating system i.e. analysis and assessment of five most important areas in the operations of the banking system:

- capital adequacy;
- assets and credit portfolio quality;
- management and internal control;
- earnings and
- liquidity.

The analysis of each of these five areas result in determination of the quantitative rating ranging from 1 to 5. The composite rating for the operations of the banking institution is based on the ratings for each area, which reflects the institution's finance and operation.

The table below presents the structure of the banks and savings houses in the Republic of Macedonia according to their composite rating on December 31, 1999 and December 31, 2000.

Table 1
Structure of Banks and Savings Houses According to Their Composite Rating

Composite rating	31.12.1999		31.12.2000		Comparison 2000/1999	
	banks	savings houses	banks	savings houses	banks	savings houses
1	-	-	-	-	-	-
2	5	1	5	3	-	2
3	6	9	7	9	1	-
4	9	3	7	1	-2	-2
5	1	2	1	2	-	-
No rating	2	1	2	4	-	3
Total	23	16	22	19		

The comparative analysis of the structure of banks and savings houses, according to their composite ratings, indicates that in 2000 the total number of banks with composite rating 3 increased by 1 bank, while, simultaneously, the number of banks with composite rating 4 decreased by 2 banks. In the analyzed period, there is no change in the number of banks with rating 1, 2 and 5. In the same period, on the other hand, the total number of savings houses with composite rating 2 increased by 2 savings houses, whereas the number of savings houses with composite rating 4 decreased by 2 savings houses. At the end of 2000, the number of savings houses with composite rating 1, 3 and 5 remained unchanged.

The bank-by-bank analysis of the institutions with composite rating 3 in 1999, in 2000 the composite rating of 2 banks deteriorated into 4, whereas in 2 saving houses it improved to 2. In the same period, 3 banks and 2 savings houses with composite rating 4 in 1999, improved their rating to 3, while the composite rating of 1 bank deteriorated from 4 to 5. In 2000, bankruptcy proceeding was initiated against 1 bank with composite rating 5.

The on-site supervisory examinations and on-going off-site surveillance of the banks and savings houses in the Republic of Macedonia in 2000 confirms the already identified problem segments in their operations. The difficulties related to the low assets quality continues to be the largest ones, primarily as a result of the weak credit procedures and practices of the banks, as well as the unfavorable external movements. The problem related to the credit portfolio can have adverse effects on the liquidity of the institutions, thus inducing need of usage of secondary sources of funding. The non-performing credit portfolio also affects the banks' profitability, due to the inadequate amount of income, generated from the credit activity of the banking institutions, contrary to the high costs related to bad loans, relative to the legal requirement for allocation of special reserve for potential losses.

In addition to the supervision of banks and savings houses, the National Bank of the Republic of Macedonia performs inspection for the application of the regulations in the area of foreign exchange operations. Thus, 130 inspections were carried out in 2000, 14 of which covering the overall foreign exchange operations of the banks, 10 inspections covered certain segments of the foreign exchange operations of the banks, 14 inspections covered the deposited foreign exchange savings, while the remaining 90 inspections referred to the operations of the authorized exchange offices. The most frequent subject to the partial inspections in the institutions was their adherence to the actions imposed by the National Bank, fulfillment of the terms for conducting exchange operations, inspection of the operations with payment cards, foreign exchange market, non-resident accounts, transformation of old into new foreign exchange savings, inspection of the deposited foreign exchange savings, inspection of the deposited foreign exchange funds, etc.

1.2.3. Undertaking Corrective Actions against banks and savings houses

The National Bank of the Republic of Macedonia is mandated to undertake corrective actions against banks and savings houses, in which certain irregularities have been identified based on on-site and off-site supervisory activities, in order to protect the stability and soundness of particular banking institutions, as well as the stability and soundness of the overall banking system. According to the Banking Law, the National Bank of the Republic of Macedonia applies wide range of corrective actions, which can be undertaken individually or in combination with others depending on the type of irregularity in the banks and savings houses, in order to reach best results in the corrective action and to overcome the problems which can endanger the stability and the soundness of the banking institution.

In 2000, the National Bank of the Republic of Macedonia imposed 38 decisions with corrective measures against 14 banks and 5 savings houses, filed 5 offenses and 2 criminal charges. Each imposed action and the number of banks and savings houses they refer to are shown below:

- action for revocation of an approval for executive body and authorization of National Bank of the Republic of Macedonia employee to organize the operations, was imposed against 1 savings houses;
- action for verification of orders of authorized employees of the National Bank of the Republic of Macedonia was imposed against 1 savings house;
- action for ban on extending credits and operating with placements other than placements in securities based on sale of deposits of the National Bank of the Republic of Macedonia was taken against 2 banks;
- action for cessation of crediting of certain shareholders was imposed against 1 bank;
- action for cessation of capital paid on a basis of extended credit for purchasing shares was imposed against 1 bank;
- action for freezing the Denar placements was imposed against 3 banks;
- ban for performing all or certain banking operations within a certain period of time was imposed against 1 bank and 2 savings houses;
- ban for taking deposits of legal entities was imposed against 1 savings house;
- action for adherence to the Decision on supervisory standards for regulation of overdue was imposed against 8 banks and 1 savings house;
- action for adherence to the Decision on classification of assets balance and off-balance sheet items of banks and savings houses according to their risk level, was imposed against 10 banks and 1 savings house;
- action for adherence to the Decision on determining and calculating open foreign exchange positions was imposed against 5 banks;
- action for reducing the credit exposure within the prescribed limits was imposed against 3 banks and 1 savings house;
- action for alienation of own shares was imposed against 1 bank;
- action for exclusion from foreign exchange market was imposed against 2 banks;
- action for exclusion of the net debtors from the Management Board was imposed against 2 banks;
- action for ban on crediting clients classified in risk categories C, D and E was imposed against 1 bank;
- action for allocation of compulsory reserve of banks aimed at preserving the daily liquidity was imposed against 1 bank;
- other measures: compliance with the Accounting Law (7 banks and 2 savings houses), compliance with the Law on Foreign Exchange Operations (5 banks), compliance with the Law on International Credit Relations (2 banks), compliance with the Law on Level of Late Interest Rate (1 savings house), termination of performing parallel payment operations (3 banks), updating the Shareholder Book (4 banks), preparation of plan by the Management Board for compliance with the imposed measures (3 banks), regular convening of meetings of the Management Board (1 bank and 1 savings house), termination of extending new loans in order to settle old claims (1 bank), preparation of auditing report and publishing the Annual account (1 bank) etc.

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The experience indicates that whenever several banks in the banking system are identified with difficulties in their operations, the most efficient method for supervising,

from organizational aspect, is to locate them in special unit. The establishment of the Unit for Conservatorship, Monitoring and Enforcement Actions enables other units, within the Supervision Department, to continue operating in a regular manner, which can not meet the needs of strengthened monitoring of the operations of the institutions which require special supervision. The Unit performs strengthened monitoring of the operations of these banks and proposes corrective measures and actions aimed at quantitative and qualitative improvement of their performances, as well as actions for their effective and efficient transfer from this unit.

Based on the previous practical experience and the Manual for regulating the operations of the Unit for Conservatorship, Monitoring and Enforcement Action, several criteria has been established, according to which a bank could become a subject to special, strengthened supervision, as follows:

- composite rating 4 or 5, determined in the latest on-site examination;
- capital adequacy ratio below 12%;
- identified serious violation of the regulations;
- liquidity problem in the institution, manifested in permanent illiquidity.

At the end of 2000, 8 banks were placed in this Unit, which registered considerable risk concentration and based on the aforementioned criteria, it was found that they should be subject to strengthened supervision. In the second half of 2000, full-scope on-site examinations were carried out in all banks, subject to strengthened supervision. Improvement in the overall performances was identified in 3 of them, thus, their composite rating being improved from 4 to 3. If this upward trend continues in 2001 and these banks show that they operate in compliance with the principles of stability and soundness and in compliance with the supervisory standards they will be transferred to the Off-site Unit i.e. the special supervision will be replaced with regular one. The strengthened on-going monitoring of these banks is implemented on a basis of analysis of the regular and special reports submitted by banks, as well as on-site examination reports, aimed at more effective and timely monitoring of all changes in the operations of these institutions and undertaking additional corrective actions on time, if necessary.