

MINUTES OF THE 29th MEETING OF THE EBF ASSOCIATES

- 3 December, 2009 @ 10.00 -

The Meeting was chaired by Ms Ariane OBOLENSKY, Chair of the EBF Executive Committee

Participants: see list enclosed

ITEM	DISCUSSION
<p>1. WELCOME</p>	<p>Chair of the EBF Associates and the EBF Executive Committee, Ms Ariane OBOLENSKY, welcomed the participants to the meeting. Special welcome was extended to Mr Dino OSMANBEGOVIC, Chairman, and Mr Samir LASEVIC, Head of Banking Operations, Education and Training from the Banks Association of Bosnia and Herzegovina; as well as to Ms Endrita XHAFERAJ, the new Secretary General of the Albanian Association of Banks.</p>
<p>2. MINUTES OF THE PREVIOUS MEETING (Ref: D1165d-2009)</p>	<p>Minutes of the 28th Associates Meeting held in Monaco on 18 June 2009 were adopted.</p>
<p>3. THE ECONOMY AND BANKING SECTOR OF BOSNIA AND HERZEGOVINA (see (1990C) – Item 3)</p>	<p>Mr Dino OSMANBEGOVIC, Chairman of the Banks Association of Bosnia and Herzegovina, presented the geographical characteristics, economic and banking situation in Bosnia and Herzegovina (see EBF Ref: 1990C-Item 3).</p> <p>The presentation was followed by a lively debate, focusing on the following issues:</p> <ul style="list-style-type: none"> • Micro-lenders are supervised separately from the rest of the financial sector. The regulatory rules are slightly different, but principles for e.g. provisioning are similar. • Loans are extended at high interest rates, but so are the savings rates. Current average savings rate on retail side is between 4-6%, depending on the term. On corporate side they can reach over 8% for some tender procedures. External funding is very expensive too (from the EBRD, WB, etc, as well as from commercial mother banks). • Structure of the country (two entities) mirrors the infrastructural solutions, this is why there are two banking supervisors in B&H. • Decision-making process in B&H is very lengthy (particularly taking into account the size of the country and the limited significance of the matters being decided upon. The EU funds have not been used in the B&H yet, the first funds have only been allocated recently.

	<ul style="list-style-type: none"> • The Central Bank of Bosnia and Herzegovina is efficient, operational and well functioning. For a long time since its establishment, the governors were from other countries, and only in the past four years this post has been occupied by a local. • The Banking Association of Bosnia and Herzegovina is non-commercial. It is funded by the contributions of member banks according to two criteria: (a) fixed amount, and (b) variable amount, depending on the size of assets of a bank. Historically, the USAID played an important role in formation of the Association.
<p>4. ECONOMIC AND FINANCIAL / BANKING SITUATION IN THE EBF ASSOCIATE COUNTRIES (see (1990C) – Item 4)</p>	<p>A number of the EBF Associates presented the economic and financial situation in their countries (see 1990C-2009 – Item 4: Albania, Russia, Serbia, Turkey). For a summary of the round table discussion, please refer to the Annex I.</p>
<p>5. OUTCOME OF THE G20 SUMMIT IN PITTSBURGH AND POSSIBLE CONSEQUENCES FOR BANKS</p>	<p>Mr Guido RAVOET, EBF Secretary General, informed the participants about the EBF work streams, stemming from the conclusions of the G20 leaders who met in Pittsburgh in September 2009. For a summary of his presentation, please refer to Annex II.</p>
<p>6. OPTIONAL APPLICATION OF VAT ON FINANCIAL SERVICES (see (1990C) – Item 6)</p>	<p>Mr Roger KAISER, EBF Senior Adviser, introduced the subject of optional application of Value Added Tax (VAT) on Financial services.</p> <p>In particular, he said that a couple of years ago, EBF created a task force with the aim to follow up on the Financial Services Action Plan (FSAP) work stream on taxation, with a strong focus on Better Regulation. The EU heavily stressed the importance of the impact studies, so the EBF Executive Committee decided to undertake a pilot study on VAT option to tax. The issue at stake is that banking services are exempt from tax, therefore, institutions do not charge tax on services, and therefore cannot recover the VAT from customers.</p> <p>In summer 2007, the Commission put forward proposals for reform of the VAT in the European Union. The EBF assigned the task of investigating alternative variants for the Option to tax model and analysing the impact assessment to Mr Satya PODDAR, a well known expert from a consulting company Ernst&Young, who designed a theoretical</p>

	<p>model on VAT application. The final E&Y report, prepared for the EBF, was released at the end of October 2009 (available on the EBF website, under Publications).</p> <p>Mr Francisco SARAVIA, EBF Adviser, presented the main ideas of the report on the Option to Tax (see EBF Ref: 1990C – Item 6)</p> <p>Mr KAISER added that the presented report’s conclusions have been drawn by E&Y. The VAT WG holds some conclusions of their own, namely that at this point of time we need a straight forward system, indicating a preference for Variant A (presented in the PowerPoint), but in the longer term the WG could support the system of zero-rating on B2B transactions (indicating preference for Variant D).</p>
<p>7. LATEST DEVELOPMENTS IN EU LEGISLATION IN FINANCIAL SERVICES (see (1990C) – Item 7)</p>	<p>Ms Viktorija PROSKUROVSKA, EBF Adviser, made a summary presentation of the developments in the legislation in financial services over the past six months. (See the PowerPoint presentation and the extended document EBF Ref: 1990C – Item 7). She mentioned that the classification of items has been altered, now following the new classification adopted by the EBF Secretariat earlier this year.</p>
<p>8. SPI PLATFORM TOOLKIT (see (1990C) – Item 8)</p>	<p>Mr Luigi PASSAMONTI, Head of Convergence Program, Financial and Private Sector, World Bank, presented the outcome of the informal meeting that focused on creation of a project consortium to apply for a grant under a DG ENLARGEMENT Programme for Civil Society Organisations in the Western Balkans and Turkey, that took place on 2 December 2009 at the EBF premises (see 1990C – Item 8). At the meeting on 2 December 2009, Croatia, Albania, Montenegro and Turkey have expressed their desire to take part in this project. Mr Pierfrancesco GAGGI, on behalf of ABI, expressed the willingness to support the EBF in running the project on the EU side. At the margin of the meeting of the 29th Associates, the representatives from Bosnia and Herzegovina also expressed interest in joining the consortium.</p> <p>The Commission offers a grant up to EUR 5 million for a three-year project to strengthen the role of Civil Society Organisations (CSO), banking associations being part of them, in upgrading the regulatory environment of candidate countries, including adoption of the <i>EU acquis</i>. Banking associations are eligible for the grant to cover the costs of strengthening their capabilities (through seminars and workshops) and of preparing concrete reform proposals for discussion with authorities. For the latter activity, the SPI Platform, which was formally transferred to the EBF from</p>

the World Bank's Convergence Program on 3 December 2009, offers an attractive programmatic approach to (i) strengthening the CSOs and their role vis-à-vis the domestic authorities, (ii) cooperation between CSOs within the Balkan region, and (iii) strengthened CSO role in applying the *EU acquis* within their countries and bringing them closer to the EU. Representatives of Serbia, who could not attend the meeting, sent a communication to the EBF, stating that the usefulness of the SPI Platform is limited in Serbia, given the existence of other institutional arrangements to process large financial sector reforms that are satisfactory from the point of view of the banking community.

The Commission is expected to publish the Request for Proposals for the attribution of the grant before the end of December 2009, from which moment there will be a maximum of two months to distribute the roles of the project consortium and prepare a grant application. Therefore, time is of the essence. A consultant, who would do the practical job of coordination and preparation of the grant application, needs to be identified and hired to start in January 2010.

Mr Guido RAVOET, the EBF Secretary General, invited the EBF Members and Associates to take part in this project. In response, Mr Bernd BRABAENDER (BDB) responded by saying that BDB would take part in the project if this can increase the chances of success of this EBF-led project. Ms Ariane OBOLENSKY, Chair of the meeting, concluded by thanking Mr PASSAMONTI for the work that the Convergence Program has done to strengthen the policy dialogue between banking associations and authorities in South-East Europe.

It was concluded that the EBF has a maximum of two months to take action and prepare a project proposal. The Secretariat stands ready to answer Members' and Associates' questions related to the project, involvement, participation, benefits. The Secretariat will liaise with Mr PASSAMONTI to ensure the necessary follow-up activities during the preparation of the project proposal.

The SPI Platform Toolkit, formally transferred to the EBF on 3-Dec-09 to better service its Associates, can be found here: <http://www.ebf-fbe.eu/content/Default.asp?PageID=250>

<p>9. ANY OTHER BUSINESS</p>	<p>Mr Zoran BOHACEK congratulated the Bosnian colleagues on joining the EBF.</p> <p>He also added that for the 10th anniversary of the Croatian Banking Association, instead of larger event, they decided to take a low key presentation of a study, analysing the last decade in Croatian banking and justifying some of preconceived perceptions of banking in the region: foreign ownership, rapid credit growth, financing consumption vs. real sector. The full study (in Croatian) is available from their website: http://www.hub.hr. The executive summary (also in English) is published in the CBA brochure, also available on their website.</p>
<p>10. DATE OF NEXT MEETING</p>	<p>Madam Chair announced that the 30th Meeting of the EBF Associates will take place in Baku (Azerbaijan) on 28 May, 2010. The day before, on 27 May 2010, the Azerbaijan Banks Association together with the EBF will organise a joint conference <i>Inter-Regional Banking Cooperation: Solid Financial Future</i>, to which everybody is cordially invited.</p>

29th MEETING OF THE ASSOCIATES

– Brussels, 3 December 2009 – 10h00

LIST OF PARTICIPANTS

<u>Chair</u>	Ms	Ariane OBOLENSKY
<u>Secretariat</u>	Mr	Guido RAVOET
	Ms	Viktorija PROSKUROVSKA
	Mr	Roger KAISER
	Mr	Francisco SARAVIA
<u>Albania</u>	Ms	Endrita XHAFERAJ
<u>Andorra</u>	Ms	Claudia CORNELLA DURANY
<u>Azerbaijan</u>	Mr	Nazim IMANOV
	Mr	Eldar ISMAYILOV
<u>Austria</u>	Ms	Maria GEYER
<u>Bosnia and Herzegovina</u>	Mr	Dino OSMANBEGOVIC
	Mr	Samir LASEVIC
<u>Croatia</u>	Mr	Zoran BOHACEK
<u>Cyprus</u>	Mr	Michael KAMMAS
<u>Czech Republic</u>	Mr	Petr SPACEK
<u>Estonia</u>	Ms	Katrin TALIHARM
<u>France</u>	Mr	Jean-François PONS
<u>Germany</u>	Mr	Bernd BRABÄNDER
<u>Hungary</u>	Mr	Rezso NYERS
<u>Liechtenstein</u>	Mr	Michael LAUBER
<u>Monaco</u>	Mr	Jean DASTAKIAN
<u>Montenegro</u>	Mr	Nebojsa DJOKOVIC
	Mr	Mirko RADONJIC

Norway

Mr Arne SKAUGE

Russia

Mr Konstantin N. MOZEL
Mr Oleg PREKSIN

Sweden

Ms Kerstin AF JOCHNICK

Switzerland

Mr Urs P. ROTH

Turkey

Ms Melike MUMCU

ANNEX I
SUMMARY OF A ROUND TABLE DISCUSSION UNDER ITEM 4
ECONOMIC AND FINANCIAL / BANKING SITUATION IN THE EBF ASSOCIATE
COUNTRIES

ALBANIA

General economic performance:

- Albania's *GDP growth* has been robust during these last years, and it has had a positive growth even during 2009, with main contributors being construction and services.
- *Inflation* has been stable since 2002 in the interval of 2-4%, which has been the target of Bank of Albania. However, since summer 2008 it started increasing, mostly driven by the increase in raw material prices during 2007-2008 the latest administrative rise in the energy price. The average inflation marked again 2.0 percent in January to September 2009.
- *Current account deficit* has been widening as a share of GDP, however narrowed slightly by 1 percentage point y-o-y in the second quarter of 2009, reflecting slower imports and exports in the Albanian economy.
- *Capital accounts* have shown positive developments reflecting developments in FDI, mostly driven by privatisation and private investment; the foreign borrowing of banks; and the increase of foreign public debt.
- Cost of finance of the *deficit* has been declining from 2002 until recently, but during 2009, interest rate of government paper has increased reflecting liquidity problem and high financing need of the government.
- The *exchange rate* (Lek / Euro) has been appreciating since year 2002, however it has shown strong depreciating movements during 2009.
- Until 2007, the government had been committed to a minimum level of *fiscal balance* to GDP. Consequently, public debt had been declining until 2007, but from 2008 onwards, the tendency reversed (reaching 58% in Q4 2009). Recently, deficit reached -6.2% of GDP because of acceleration in fiscal expenditure.

Banking:

- Banking sector has been expanding since 2004, when Raiffeisen privatised the biggest bank in the country. Many *foreign banks* entered Albania since then (Turkish, Italian, Greek, etc.), and recently shares in the last local bank was bought by a foreign bank (so, every bank in Albania has a certain share of foreign stake). Banking sector is one of the best performing sectors in the economy.
- There are a total of 16 banks in Albania, and they are expanding branches all over the country, consequently increasing the number of employed in the sector. Banks are increasing the services coverage.
- *Assets* have been increasing, also as a share of GDP.
- Albanian banks enjoy ample *liquidity*.
- *Capital adequacy ratio* is at 17%. Banks are well capitalised and are still profitable.
- *Return on assets* and *equity* ratios in 2008 were somewhat declining but still at a good level.
- *Credit boom*: over the past 5 years credit grew at 50% p.a., while deposits only at a rate of 17%.
- *Non-performing loans* have been lower than 5% from 2002 to June 2008, but started

increasing since (rising up to 9% in June 2009, which is still considered acceptable). The data reported are calculated based on Bank of Albania's accounting methodology, which is somehow more prudent than the IFRS, therefore the figures are higher than what they would be on IFRS basis.

CROATIA

General economic performance:

- GDP will contract by 5-6% in 2009.
- Little deflation was observed in the past few months.
- Foreign debt is ballooning (100% of DGP) also due to contraction in GDP.
- Croatia experiences a stable exchange rate.
- The real sector is in pain, unemployment is rising.

The Croatian *government* has not shown any support to the economy. Instead, they introduced a new "crisis tax" on all incomes above EUR 420 per month and increased the VAT rate (from 22% to 23%), which will lead to a further fall in domestic consumption. Government is in pursuit of short term money to finance their growing expenditure (so government budget is considered non-credible), overlooking the longer term perspective. This suggests that further rebalances will have to take place.

Bank situation:

- Situation with banks in Croatia is stable.
- Assets are growing at a pace of 2% p.a.
- Bank loans are still at a level of 10% of annual growth. It must be noted that loans to the Croatian government were growing very fast, over 80% yoy (at close to 7% interest rate), while loans to private sector were stagnating at around 3% (focusing mainly on housing loans, while car loans and credit-card loans are on the decline). Fortunately, Central Bank of Croatia injected some liquidity, preventing the government from squeezing out the private sector.
- Capital adequacy ratio is at 15%.
- Non-performing loans are growing, now approaching 5% of the total loan portfolio.
- Central Bank of Croatia undertook bank stress tests, and results showed that banks are safe and can survive further deterioration of the loan portfolio.
- Bank profits are still healthy, even though they declined by 20% yoy (good for banks' reputation).
- Interest income is decreasing yoy, because even as interest revenue grew by 9%, interest expense jumped over 20%. Non-interest income compensated for this decrease, but with higher provisioning overall profits are reduced.

The *Association* is extremely busy with discussing and later legislation, including Consumer Credit Directive and Payment Systems Directive. Banks are entering the VAT system, but the implications of that have not yet been assessed. The Association is very present in the media to respond to questions, represent the banking sector and inform the general public.

RUSSIA

Bank situation:

- Number of banks is gradually reducing (by 3% in 2009), partly due to the crisis, but also because of bank consolidation. Bank closures are under strict control, monitored by the special body which guarantees public deposits in banks. Most banks were finally absorbed by the rivals (either directly or through breach financing, provided by the regulatory authorities). It is a well administered process, which helped to avoid panic and bank runs. A major step at the end of last year was a three-fold increase of level of guaranteed deposits in the country.
- Assets are still growing at a high but slowing rate (39% in 2009); however total bank assets in Russia are still very low compared to the G8 countries.
- Deposits are growing too, both from population, and from the corporate sector. Deposit rates are high: it is still possible to have a one-year deposit in roubles in Russia at a rate of 17%, and in EUR or USD at 10% p.a. One problem of the country is high cost of funding. About 50% of all banks' deposits are with Sberbank (savings bank).
- Growth of new bank loans, especially to industry, is very low. This situation appears to be also in China, and other emerging and even developed markets.
- Figures for non-performing loans are quite low (less than 5%) due to special accounting procedure used by the Central Bank, i.e. non-performing loans are calculated on the basis of actual over-due payments. According to the international standards, used by Ministry of Finance, the actual figures are between 10-12% of total loan portfolio. However, not all debts are really bad debts: some refinanced enterprises can improve their situation after the crisis, this year particularly (thanks to the Government support of the real sector).
- Legislation on *increased minimum capital requirements* for the banks was adopted this year: From 1-Jan-09, each bank must have a minimum capital of over USD 3 million; about 100 banks still have to meet this new level of capital. Since this is a recent decision, in order to comply, banks are using part of their own resources to increase capital (especially smaller banks). From 1-Jan-12 the capital requirement doubles to USD 6 million. For comparison, in the EU, the minimum capital requirement stands at EUR 5 million. Mr Alexey KUDRIN, Deputy Prime-Minister and Minister of Finance of the Russian Federation, suggested that minimum capital requirement for a bank should be EUR 25 million. That is a very high figure; only some 200 Russian banks could meet this criterion.

General economic performance:

- Government substantially supports the country in crisis (using the substantial State sovereign funds accumulated in the previous years). According to the recently approved *State budget*, 2010 will bring a number of changes to the structure of the government support, which will shift from the banking sector to the real economy, partly because the government share of leading enterprises in the economy is high. The government's main task will be to upgrade the enterprises with new equipment / technology.
- At last, Russia achieved a single-digit *inflation* figure (this year; 9%), compared with last year's 14-15%. Effect of the increase of the prices for raw materials is perceived as a temporary one.
- While still hovering in quite high levels, a certain decrease of *unemployment* was observed. Related to that, number of expatriates working in Russia has not changed: millions of people have been coming from the Soviet Union Republics to work in Russia.

- *Rouble* is still quite strong.
- Central Bank of is lowering its *refinancing rate*, which has been double-digit for years. It is not the growth of money supply (M2) but the growth of the tariffs that leads to price growth. For example, the energy prices are still substantially lower than in the world. The government policy is to increase the tariffs to the international level, which will cause further inflation.
- One of the major problems in Russia is *limited long-term resources* that could be used by the economy. To illustrate, public pension reserve funds are 10 times less than in the USA or in Europe. The same situation is in the insurance sector (which is still quite weak). Government prefers to keep the funds in Federal Reserve T-bills.
- *Economic growth* in 2010 is expected to be driven by innovation, increased research and development financing. A lot of emphasis is put on developing incubators for innovation in universities in Russia and Central Russia, western Siberia... Venture financing is being expected, with the Government-supported Institute on Venture Financing being operational, the effects will soon take place. Additional effects will come from Housing (still undeveloped in Russia) with the support of the local industry, rather than foreign construction material and work force, as was the case before.

SERBIA

For information on Serbia, please refer to (1990C) – Item 4 – Serbia.

TURKEY

For information on Turkey, please refer to (1990C) – Item 4 – Turkey.

ANNEX 2

SUMMARY OF THE PRESENTATION ON THE OUTCOME OF THE G20 SUMMIT IN PITTSBURGH AND POSSIBLE CONSEQUENCES FOR BANKS

Mr RAVOET focused on the G20 conclusions in the field of financial services. He started by stressing that the enhanced role of the Group of 20 nations is one of the most important outcomes of the crisis. Even though the frequency of the G20 meetings will diminish in the future, this group will take some of the most important decisions, this is why the EBF is channelling its energies towards following up on their work and lobbying them for the banking matters.

One major work stream is on capital requirements, involving a lot of elements for the time being dealt with by the Basel Committee, as delegated by G20. The main issues for the Basel Committee are: enhanced requirements for trading books, securitisation, stricter real estate lending, leverage ratio. Big banks might be asked to ensure additional capital requirements. All these requirements are a cause for concern: the cumulative impact on banks, the cost for banks, as well as the impact on banks' ability to lend to the real economy.

“One sterling put into capital is one sterling you cannot lend” - is what is at stake now. Basel Committee is expected to yield liquidity measures (if before there were just quality measurements, now its ratios: one for long term liquidity and another one for stress coverage).

The EBF is in the throes of preparing an impact assessment on the upcoming enhanced capital liquidity measures. The final format of these measures is yet unknown, but we can start with assumptions to calculate the impact on capital charges for banks. Then, the EBF will make an impact study on the lending capacity of banks. Basel Committee is expected to come up with the package of capital requirements by end-December 2009. It will be followed by a rather long consultation and assessment period, where Basel Committee will make an impact assessment of proposed measures.

Another major work-stream is on crisis resolution with regard to systemically relevant banks. A whole new stream of political thinking and action has developed with regard to how to deal with the *systemically important financial institutions* (SIFI's). These institutions are defined by size, business models, markets they operate in and the interconnectedness (e.g. Lehman Brothers was a very interconnected bank). In fact, SIFI's are not about size, and even the Basel Committee accepts the fact that *interconnectedness* is an important criterion.

Such banks will be subject to special treatment i.e. they will be required to prepare *living wills*. These living wills are not yet fully defined, however it is already now clear that it will be sort of a contingency plan, specifying how this bank will exit the market in times of crisis, in order not to destabilise the market. While the main purpose of the exercise is noble and clear, there are still gaps in understanding how markets will react when banks communicate the living will and measures announced in it? It is not clear what living wills have to look like.

There's a consensus on *resolution funds for big cross-border banks*. However, current debate revolves around the question whether the banks will fund it, or also public will fund them too?

At any rate, complexity of big systemic banks will have to be reduced, although so far no concrete proposals were made. Related to that is a problem of ring-fencing: supervisors are not prepared to take responsibility for subsidiaries in other countries. The supervisors' tendency is to push for *subsidiarisation*, which implies each element of the group to be considered as an autonomous entity (economically, not necessarily legally). This solution is costly for banks, and is completely against the principle of integration of the financial market, as advocated by the EBF.

A third work stream is on risk-based remuneration policies. The Financial Stability Board (FSB) within the International Monetary Fund framework and the G-20 framework, made recommendations/principles on sound bank remuneration. In different constituencies (EU and national level) the policy makers go further and come up with their own remuneration regulation. In most cases it is done through self-regulation, and the banking communities accept it. The EBF is taking stock of these measures and at present conducts a peer review in the EU Member States and evaluates the compliance with the FSB principles.

Last important work strand is on the accounting standards. The EBF strongly defends the position of *one set* of international accounting standards, however, not at the expense of workable standards. Accounting must reflect the business models of the industry, and not the theoretical convictions.

IASB board was asked to come up with the standards for IAS 39, which is now called IFRS 9, a valuation system for financial services. The new standard, IFRS 9, has a number of positive aspects: it accepts explicitly the fixed-measurement model (fair value and amortised cost are both possible). The difficulty with this new standard is that more fair value is brought in than the IAS 39, and that causes a downward spiral in times of crisis; mark-to-market approach proved difficult in crisis because the market itself did not exist.

The EBF will not endorse for the time being the proposed standard of IFRS 9 both for reasons of fragmentation of the process (only one third of the task was delivered) and those of the content (IFRS 9 introduces a new category allowing for more fair value). The European Commission asked IASB to work further on their proposal before endorsement takes place.