CBAK

CENTRAL BANKING AUTHORITY OF KOSOVO
AUTORITETI QENDROR BANKAR I KOSOVËS
CENTRALNI BANKARSKI AUTORITET KOSOVA

CBAK BULLETIN

(Structure of Financial Sector)

Research
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ABBREVIATIONS:

ATM	Automated Teller Machine
CAR	Capital Adequacy Ratio
BOP	Balance of Payments
BR	Branch
CBAK	Central Banking Authority of Kosovo
GDP	Gross Domestic Product
HQ	Headquarter
HHI	Herfindahl-Hirschman Index
IBNR	Incurred But Not Reported
IMF	International Monetary Fund
IT	Information Technology
ITRS	International Transactions Reporting System
MU	Mobile Unit
NFC	Non-Financial Corporations
NIM	Net Interest Margin
NPISH	Non-Profit Institutions Serving Households
POS	Point of Sales
RWA	Risk Weighted Assets
ROAA	Return on Average Assets
ROAE	Return on Average Equity
SB	Sub-branch
TPL	Third Party Liability
UNMIK	United Nations Mission in Kosovo.

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1. INTRODUCTION

The Creation of the Central Banking Authority of Kosovo

The Banking and Payments Authority of Kosovo (BPK) has been re-designated as the Central Banking Authority of Kosovo (CBAK) by UNMIK Regulation No.2006/47 on The Central Banking Authority of Kosovo, effective from 24 August 2006. The new Regulation has been prepared in cooperation with International Financial Institutions (namely the IMF), the Ministry of Economy and Finance, different components of UNMIK and Kosovo institutions. The Regulation is aimed at increasing the role of Kosovans and strengthening both independence and capacities of the newly established CBAK.

The new regulation asserts the role of the CBAK in the financial sector through two principal objectives:

1. Fostering the soundness, solvency and efficient functioning of a stable market-based financial system, encouraging market emergence of safe financial instruments; and
2. Supporting general economic policies in Kosovo with a view to contribute to an efficient allocation of resources in accordance with the principles of an open market economy.

The tasks of the CBAK are clearly defined in the areas of financial supervision, payments system, economic studies, and participation and membership in international financial institutions, organizations and councils which fall within the CBAK fields of competence.

The CBAK will contribute to monetary stability through its role in protecting the financial stability. Moreover, the CBAK can influence money supply through the liquidity reserves required from banking institutions, and more generally, through prudential regulations. Nevertheless, it is clear that CBAK will not conduct a direct monetary policy through the traditional monetary instruments since Kosovo is using Euro and, consequently, strongly benefits from the monetary policy performed by the European Central Bank.

Contents of the bulletin

The Research and Statistics Directorate of the CBAK publishes the fourth issue of CBAK Bulletin, which covers the developments in the commercial banking sector and the developments related to other financial corporations (insurance companies, pension funds and other financial intermediaries) operating in Kosovo.

The CBAK Bulletin no.4 is structured in four main chapters. Chapter 2 (*Financial Sector in Kosovo)* describes general trends in the Kosovo financial sector, showing the developments in money supply and money demand of financial sector. Using sectoral approach, we present the financial sector net position with the domestic economy and rest of the word. Chapter 3 (*Commercial Banks*) provides more details related to the commercial bank activities. By using some selected indicators we highlight the latest trends in the commercial banking industry such as its network, market concentration, performance, etc. Apart from the developments in commercial banking, this issue also covers the developments of other financial corporations operating in Kosovo currently representing around 12% of total assets of the financial sector. Subsequently, chapter 4 provides more details related to the activity of insurance industry, pension funds and microfinance institutions.

Kosovo financial sector (excluding CBAK) is dominated by commercial banks, whose assets at end June 2006 accounted for 88% of the total financial sector assets. The share of insurance companies, pension funds and other financial intermediaries share in the total assets of the financial sector accounts for 5%, 1%, and 6%, respectively. From the semi-annual perspective (June 2006 compared with December 2005), overall assets of the financial sector grew by 7.3%. In particular, total banking sector assets grew by 7.9%, insurance companies by 0.5%, pension funds by 25.3% and other financial intermediaries by 1.3%.

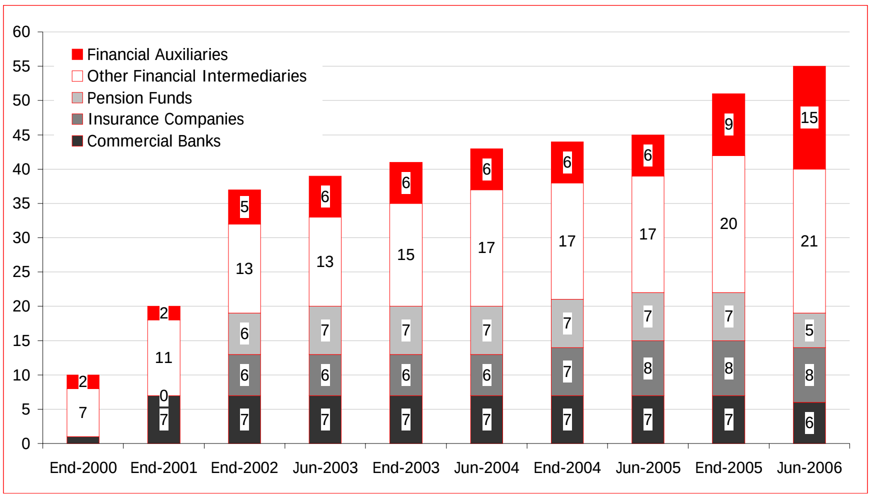
2. FINANCIAL SECTOR IN KOSOVO

2.1. General Characteristics of the Financial Sector

Dominated by commercial banks, as of June 2006 the total assets of the financial sector (excluding CBAK) amounted to euro 1.2 billion (52% of projected 2006 GDP[1]). Net Foreign Assets (NFA), including those of CBAK continued to increase, being the main component of the financial sector (euro 835.5 million). At the same time, mainly due to the privatization process, the central government deposits at financial sector (mainly CBAK) amounted to euro 437.9 million, while financial sector loans totaled at euro 672.8 million.

The overall number of financial corporations[2] reached 55 in June 2006 (45 in June 2005), excluding the Central Banking Authority of Kosovo. The number of commercial banks (Other Depository Corporations) decreased from 7 to 6, due to the CBAK decision to revoke the license to one commercial bank in March 2006. In terms of the structure of other financial corporations, the most important component is represented by other financial intermediaries (micro finance institutions) whose activities are mainly supported by international development agencies. Since June 2005, other financial intermediaries and financial auxiliaries (mainly money transfer agencies) have increased their representation by 15 entities (out of which 9 are classified as financial auxiliaries). At the same time, the number of pension funds has decreased from 7 to 5, whereas the number of insurance companies remains the same (8).

Figure 1. Number of individual financial corporations (excluding CBAK)

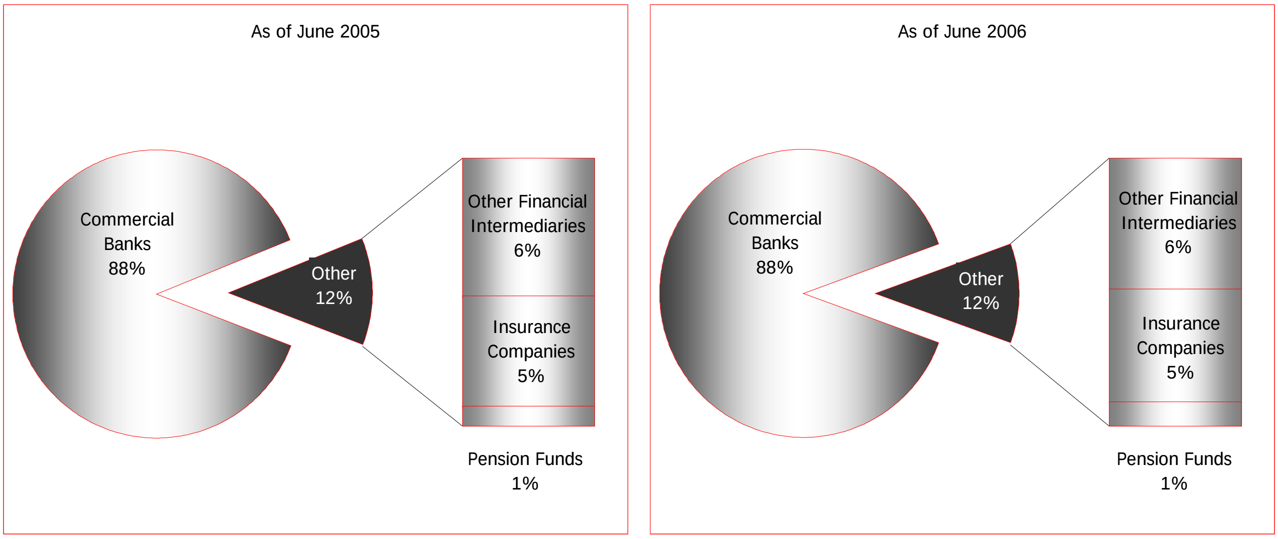


Source: CBAK (2006)

[1] IMF Aide Memoire, May 2006.
[2] For definitions (sectorisation) used, see Box 1.

From the balance sheet perspective, as of June 2006 total assets of the financial sector (excluding CBAK) continued with increasing trend amounting at euro 1.163,1 million (51.7% of GDP). Nevertheless, in terms of semi-annual trend, this increase (7.3%, June 2006 compared with December 2005) has slowed down, decelerating for 4.9 percentage points (pp) compared to the increase of 12.2% during the period December-June 2005. The same can be noted regarding the annual growth of the assets, which in June 2006 grew by 20.3%, whereas in June 2005 by 28.1%. As shown in Figure 2, the financial sector in Kosovo is dominated by commercial banks representing 88% of its total assets. Consequently, the evolution in commercial bank assets continues to have a dominant impact in the growth of total assets. With regard to the other financial corporations, in June 2006 they represent the same share to the total assets as year before (12%).

Figure 2. The structure of the financial sector in Kosovo (excluding CBAK)



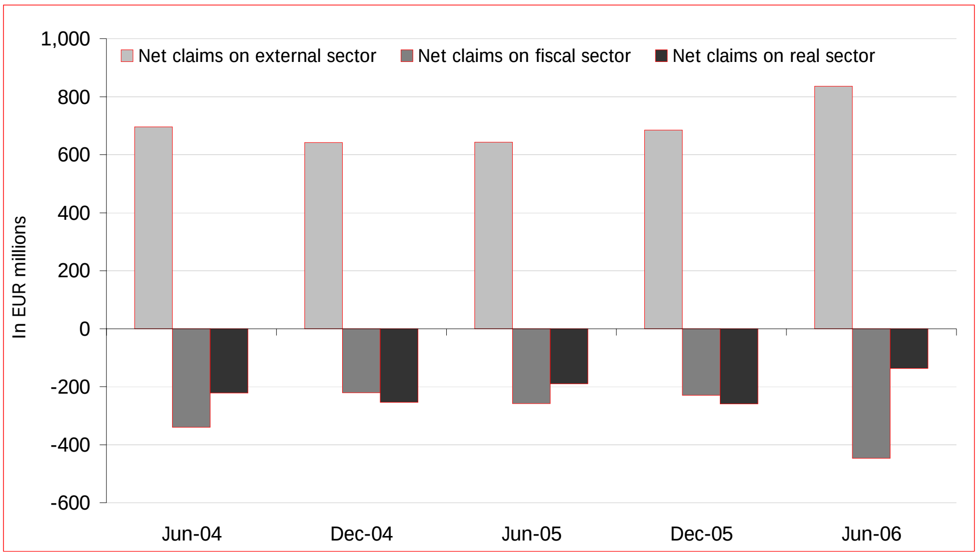
Source: CBAK (2006)

There are no sub-sectoral links between the commercial banks and other financial corporations in Kosovo. However, there is a considerable level of asymmetric exposure when comparing commercial banks versus other financial corporations. In one hand, commercial bank liabilities to other financial corporations account for around 2% (euro 22.3 million), as of June 2006, compare to 3.2%, as of June 2005. On the other hand, other financial corporations claims on commercial banks accounted for 17.1% (June 2006) compared with 24.4% (June 2005) of the total assets of other financial corporations (mainly due to deposits of insurance companies).

Financial sector claims on real sector in June 2006 amounted to euro 684.1 million. The claims are composed mainly from loans extended to nonfinancial corporations and households (euro 672.8 million). The annual growth of loans (June 2006 over June 2005) depicts an increase by 30.3%, decelerating from June 2005 – June 2004 growth by 47.5%. Yet, loans extended account for not more than 30% of GDP. On the other hand, deposits at financial sector amounted at euro 826.8 million (37% of GDP), which represents an increase of 14.6% over the twelve-month period to June 2006. The increase of deposits is attributed mainly to the increase in other (time and saving) deposits by 11.3pp, while transferable deposits contributed with 3.3pp. In June 2006, the share of other deposits increased to 60.1% from 57.6% in June 2005. Household deposits (transferable and other deposits) continued to account for 57.9% of total deposits (56.5% in June 2005), which marks a contribution of 9.8pp compared to 18.2pp in June 2005, while corporate deposits (public and other non financial corporations) had a 39.4% share[3]. Over the twelve-month period, corporate deposits continued to contribute to the increase of total deposits by 4.8pp compared with their contribution of 6.1pp for the same period in June 2005. The corporate and household deposits make the highest share (around 97%) of total deposits at financial sector. The rest belong to the local government, the social security scheme and the NPISH.

As of June 2006, mainly due to the ongoing privatization process, government deposits at the financial sector represent an annual increase by 75.9%, totaling at euro 437.9 million. However, the government deposits excluding those collected through privatization process in June 2006 amounted to euro 185.0 million, a 5.4% decline over June 2005 (euro 175.5 million). As of June 2006, the amounts collected through the privatization process reached euro 250.5 million or 57.4% of government deposits at the CBAK. However, a year earlier, this ratio accounted for not more than 20.5% of government deposits, underlining the impact of the privatization process on the government balances at CBAK.

Figure 3. Financial sector net claims



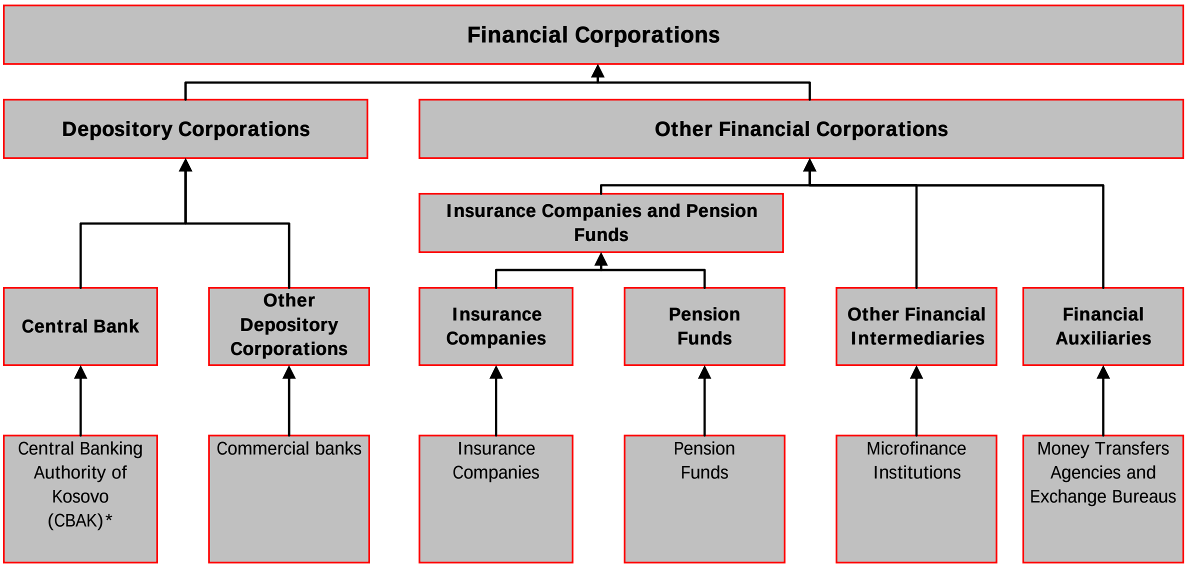
Source: CBAK (2006)

As of June 2006, the financial sector NFA amounted at euro 835.5 million. The financial sector NFAs, expanded at a faster pace of 30.1% over the twelve-month period to June 2006, compared with the decline

[3] About 24.7% of total deposits are of public corporations (such as PTK, KEK, etc)

of 7.7% for the same period in 2005. Claims on nonresidents has been the main driver of net foreign assets growth, experiencing an increase of 29.1% over the twelve-month period to June 2006, whereas compared for the same period in 2005 there was a decline of 2.7%. However, this increase of claims on non-residents is partially explained by the rapid growth of funds collected through privatization process, being the main driver of the increase in the financial sector NFAs. Following the UNMIK Regulation, the CBAK cannot credit the domestic commercial banks, consequently almost all financial assets available to the CBAK are invested abroad (mainly in the Eurozone). Deposits with the share of 61.5% and investments in securities other than shares with the share of 29.3% make the highest share to total claims on nonresidents. Although liabilities to non-residents grew by 19.0% over the twelve-month period to June 2006, they still account for 7.7% of total claims on non-residents.

Box 1. The structure of financial corporations in Kosovo



* CBAK performs some of the non-monetary policy functions of a central bank.

The financial corporations sector consists of all resident corporations or quasi-corporations principally engaged in financial intermediation or in auxiliary financial activities, which are closely related to financial intermediation. They can be split into sub-sectors according to their specific activities. Financial Corporations (FC) comprise Depository Corporations (DC) and Other Financial Corporations (OFC).

(Continued)

Other Depository Corporations (ODC) consist of all resident financial corporations, except the central bank (CBAK), whose principal activity is financial intermediation and which have liabilities in the form of deposits or financial instruments that are close substitutes for deposits.

Other Financial Corporations (OFC) comprise Insurance Companies, Pension Funds, Other Financial Intermediaries (Microfinance Institutions) and Financial Auxiliaries (money transfer agencies and exchange bureaus). Insurance companies (IC) consist of incorporated, mutual and other entities whose principal function is to provide life, accident, sickness, fire or other forms of insurance to individual institutional units or groups of units.

In the category of Pension Funds (PF) are included the institutions that are constituted in such a way that they are separate institutional units from the units which create them. They are established for purposes of providing retirement benefits to specific groups of employees. They have their own assets and liabilities and they engage in financial transactions in the financial market through their own account.

Other financial intermediaries (OFI) consist of all resident corporations engaged in financial intermediation except depository corporations, insurance corporations and pension funds. The financial corporations included in this breakdown are those that raise funds on the financial markets, but not in the form of deposits, and use them to acquire other kinds of financial assets. These include those engaged in financial investment or capital formation, investment corporations, corporations engaged in financial leasing, corporations engaged in the provision of personal finance or consumer credit. Those financial institutions are engaged in lending activities to small-size businesses and individuals mainly in rural areas with donor involvement.

3. COMMERCIAL BANKS

The financial sector in Kosovo continues to be dominated by commercial banks. During the course of 2005 and the first half of 2006, banks expanded their branching network, improved the services provided and increased their intermediation role. In general, the Kosovo banking sector maintained its financial strength and the CBAK, as the supervisor and regulator of the banking sector, is persistent in developing sound and efficient financial system. Consequently, in March 2006 the CBAK revoked the license of one domestic commercial bank (CBP – Credit Bank of Pristina) due to non-compliance with the preset rules and regulations. The prompt action was taken in order to protect depositors from losses, and up to the end of June 2006, the liquidation process of the BKP is successfully being carried out with about 89.45% of all BKP depositors being entirely refunded.

3.1. The Structure of Commercial Banking Sector

During the five-year period (2001-2005) the population of banking sector in Kosovo remained the same, totaling 7 commercial banks. In 2006, after the intervention of CBAK in closing down one commercial bank, 6 commercial banks are operating, 2 with full foreign ownership and the remaining 4 with domestic majority ownership. The foreign banks are also the two largest banks in the sector. Throughout the chapter, apart from the general analysis of the banking sector, we will also focus in examining some issues for foreign and domestic banks separately. The acronyms used for this distinction will be Group I - meaning foreign banks, and Group II for domestic banks (see Box 2).

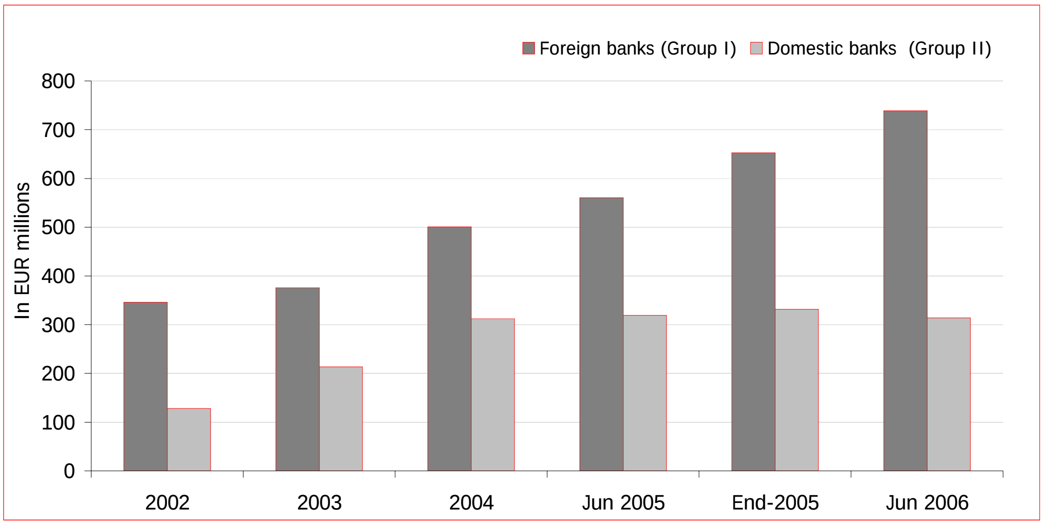
Box 2. Composition of bank groups, breakdown by ownership

Group I	Group II
ProCredit Bank (PCB)	New Bank of Kosovo (BRK)
Raiffeisen Bank of Kosovo (RBKO)	Bank for Business (BpB)
	Economic Bank (BE)
	Kasabank (KSB)

As of end-2004 the increase in the total assets meant also increase of the share of the Group II assets to total banking sector assets, while from end-2005 and up to June 2006 the trend was the opposite (Figure 4).

Banks with foreign ownership constantly are managing most of the total banking assets in Kosovo (70% by the end of June 2006).

Figure 4. Commercial bank assets, by ownership



Source: CBAK (2006)

3.1.1. Geographical distribution of banking units

During 2006 the banks continued their branching expansion by opening new operating units. By June 2006, the commercial banks in Kosovo were operating with totally 214 units (43 branches – including 6 head offices – and 171 sub-branches) meaning reduction by 16 units compared to June 2005. However, this figure is as a result of closure of BKP. Without taking into account this bank, units increased by 18 units.

The banking network is continuously increasing its regional coverage. Compared to year 2001 (when almost all the banks started their operation) the regional coverage is in a far better position by the end-Jun 2006 when banks are being represented in almost all municipalities in Kosovo (Table 1). In 5 major districts, Pristina region (being the largest region) houses the largest number of banking units (29.4% of total) followed by Gjilani/Gnjilane region with almost 23.0%, Peja/Pec region with 19.2%, Prizren region with 16.8% and Mitrovica region with 11.7%.

Table 1. Commercial banks network, by region

Description	2001	2002	2003	2004	Jun-05	2005	Jun-06
Prishtina							
HQ	6	7	7	7	7	7	6
BR	0	1	1	1	1	1	1
SB	1	16	31	52	58	60	56
Prizreni							
BR	3	8	8	9	8	8	6
SB	2	10	16	28	29	31	30
Peja							
BR	5	13	13	13	13	13	12
SB	2	10	14	28	31	31	29
Gjilani							
BR	5	14	14	14	14	14	12
SB	0	20	25	36	39	40	37
Mitrovica							
BR	2	5	6	6	6	6	6
SB	1	11	16	24	24	26	19
TOTAL							
HQ	**6**	**7**	**7**	**7**	**7**	**7**	**6**
BR	**15**	**41**	**42**	**43**	**42**	**42**	**37**
SB	**6**	**67**	**102**	**168**	**181**	**188**	**171**

Source: CBAK (2006)

Increase of the banking units was followed with the further development of the overall banking system in Kosovo aiming to offer clients easy access to banking services. In line with this, banks increased the number of their Automated Teller Machines (ATMs) and Point of Sale (POS) terminals. At the end of June 2006, the number of ATMs reached 110, more than double compared to the same period of the previous year. ATMs were firstly introduced by foreign banks, but as of today, also 2 domestic banks are offering their services through ATMs.

Over the same period, the number of POS increased even more. In June 2006, the number of POS terminals was 1,446 against 1,231 in June 2005. During the first half year of 2006 the number of POS increased for 40 units. Yet, only clients of the two foreign banks can make their payments through POS terminals. In addition, three banks (of which the two foreign banks) introduced e-banking. Through e-banking clients can check their balance statements, operate with their accounts and make transfers domestically and internationally.

3.1.2. Employment in the banking sector

Evidently, the expansion of the branching network brought about an increase in employment in the banking sector, totaling 2,289 persons by the end of June 2006. Despite the fact that in this figure the employees of

BKP were not included, the number shows an increase by 64 persons in the overall banking employment during the course of one year.

Table 2. Commercial banks productivity and accessibility indicators

Description	2002	2003	2004	Jun-05	2005	Jun-06
No. of employees	1,393	1,676	2,066	2,225	2,341	2,289
No. of banking units (including HQs)	115	151	218	230	237	214
Assets						
Per banking unit, in EUR thousand	4,307	4,008	3,816	3,874	4,119	4,758
Per employee, in EUR thousand	340	352	393	395	421	445
Loans						
Per banking unit, in EUR thousand	786	1,583	1,754	2,054	2,150	2,755
Per employee, in EUR thousand	62	139	181	210	220	258
Deposits						
Per banking unit, in EUR thousand	3,884	3,497	3,262	3,270	3,501	3,950
Per employee, in EUR thousand	307	307	336	334	357	369
Bankarization						
Number of citizens per banking unit	17,273	13,145	9,226	8,806	8,364	9,500
Number of citizens per employee	1,364	1,153	951	898	854	888

Source: CBAK (2006)

It is interesting to notice that in general banks are constantly increasing their productivity (Table 2). While by the end of June 2005 the amount of the assets managed by an employee was about euro 395.000, within a year this amount increased by 12.5%. A similar productivity improvement can be observed since the deposit and loan portfolio managed by an employee increased.[4]

Besides geographical distribution of the banking units and the productivity indicators, another valuable indicator is the indicator expressing the number of inhabitants served per banking unit and/or employee. This shows the serviceability the banking sector is proposing to the population. In doing so, the banks contribute to the accessibility of the financial system.

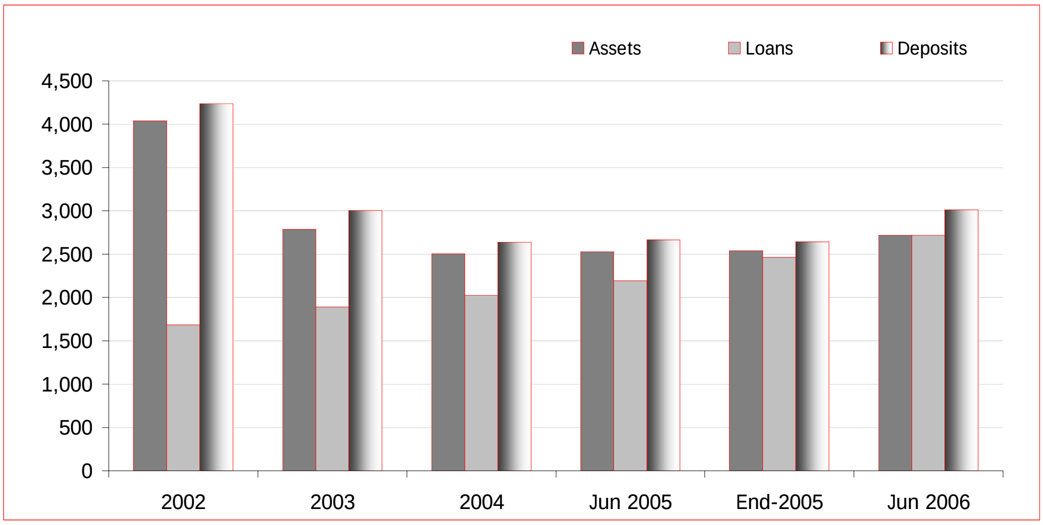
Furthermore, as an indicator of the banking expansion is also the considerable increase of the overall number of accounts that reached 731,712 in June 2006, 92,159 more than by the end-2005. Of these accounts, 673,965 are held by individuals and expressed as ratio against the total population, this means that 33.7% of the population[5] is equipped with a bank account (against 22.2% in June 2005)

[4] Figures for 2006 might be influenced by effect induced through the closure of BKP in March 2006.
[5] Making an abstraction of accounts held by foreigners and resident units more than one account.

3.1.3. Concentration in the banking activity

The concentration of the banks in Kosovo is measured by using the Herfindalh-Hirschman Index (HHI).[6] The HHI takes into account the relative size and distribution of the firms in a market. The HHI for banking activity decreases both as the number of banks in the market increases and as the disparity in size among them decreases.

Figure 5. Commercial banks Herfindahl-Hirschman Index



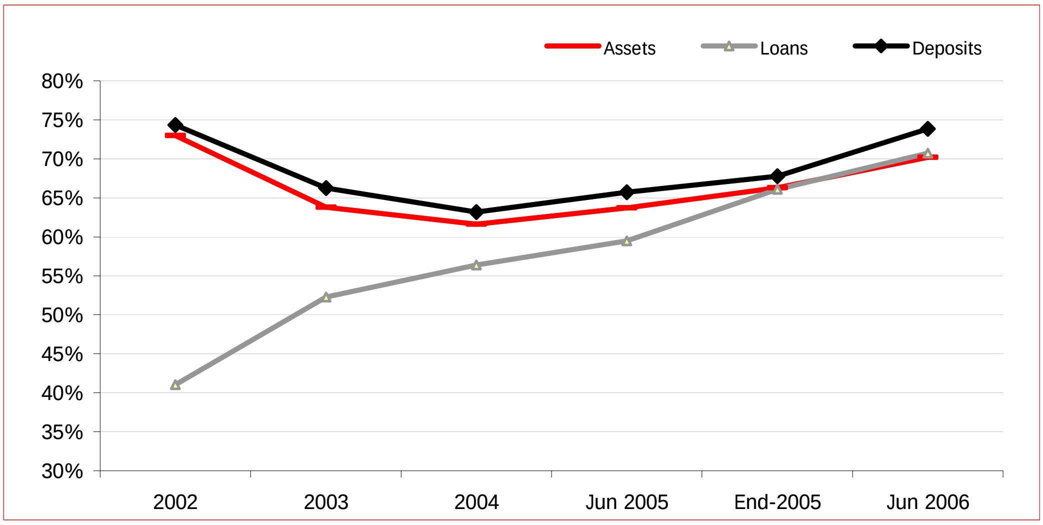
Source: CBAK (2006)

As Figure 5 reveals, in June 2006 with the increase of HHI the concentration of the banking sector demonstrates an increase with respect to assets, especially in lending activity, and deposits. The HHI of more than 2500 points for all considered categories indicates that the banking market in Kosovo regained concentration. It is interesting to note that the banking sector reached the peak in competitiveness in 2004 regarding the overall assets and deposits with HHI of 2,504 and 2,640 points, respectively. While with respect to the lending activity the banks were more competitive in 2002 with HHI of 1,683 points – what indicates a moderate concentration of the loans within banks operating in Kosovo.

The HHI value is almost completely determined by the developments of the market share of two foreign banks as can be seen in Figure 6. By June 2006 the 2 foreign banks, in terms of deposits and loans represented the market share of around 70%, which is obviously an evidence of a market concentration.

[6] See notes on methodology for the calculation of this indicator.

Figure 6. The share of Group I banks in total assets, loans, and deposits[7]



Source: CBAK (2006)

3.2. The structure of Commercial Banks Balance Sheet

3.2.1. Structure of Assets

At the end of June 2006, the total banking assets, amounting to euro 1,053 million, grew 19.7% against the previous year. The Table 3 gives the detailed structure of the banking assets together with their share. Rationally with the constant increase in assets, the share of 'cash and balances with CBAK' decreases gradually since the banks are adapting their asset composition for profitability reasons. Hence, in June 2006 the 'cash and balances with CBAK' hold bout 12.5% of the banking assets or 1.9pp lower than in June 2005. Over the same period the 'balances with other banks', i.e., non-resident banks, increased their share by 1.1pp from 16.5% in June 2005.

[7] In 2000 only one bank was active. As new banks were licensed, the activity has started gradually to increase in 2001.

Table 3. The structure of commercial banks assets (in euro thousand)

Description	Jun-05		End-2005		Jun-06	
	Amount	Share (%)	Amount	Share(%)	Amount	Share (%)
Cash and balances with BPK	126,282	14.4	131,738	13.4	131,751	12.5
Cash	50,545	5.7	50,101	5.1	50,513	4.8
Balances with BPK	75,736	8.6	81,637	8.3	81,239	7.7
Balances with commercial banks	144,958	16.5	221,936	22.5	184,824	17.6
Securities	111,721	12.7	82,946	8.4	81,233	7.7
Gross loans and lease financing	466,249	**53.0**	513,856	**52.2**	616,948	**58.6**
Fixed assets	16,753	1.9	16,933	1.7	23,264	2.2
Other assets	13,533	1.5	17,003	1.7	14,453	1.4
Total assets	**879,497**		**984,412**		**1,052,473**	

Source: CBAK (2006)

Opposed to that it appears that banks prefer to increase their loan portfolio rather than investing in securities abroad (characteristic of one foreign bank), mainly investing their excess liquidity. In June 2006 loans accounted for 58.6% of the total banking sector assets (5.6pp higher than in June 2005), while investments in foreign securities[8], showing a reduction in outstanding value, represent only 7.7% of the assets (5.0pp lower than in June 2005). The remaining banking assets are composed of fixed and other assets, jointly representing euro 37.7 million or 3.6% of total assets. When considering the structure of assets by banking groups Group I banks hold the major shares in all of the asset categories (Table 4).

Table 4. Share to total assets, by banking groups (in percentages)

Description	Jun-05		End-2005		Jun-06	
	Group I	Group II	Group I	Group II	Group I	Group II
Cash and balances with BPK	7.8	6.5	7.2	6.2	7.8	4.7
Cash	2.6	3.2	3.0	2.1	3.1	1.7
Balances with BPK	5.3	3.3	4.2	4.1	4.7	3.0
Balances with commercial banks	10.0	6.5	14.5	8.0	11.0	6.5
Securities	12.7	0.0	8.4	0.0	7.7	0.0
Gross loans and lease financing	31.5	21.5	34.5	17.7	41.5	17.2
Fixed assets	0.9	1.0	0.8	0.9	1.3	0.9
Other assets	0.8	0.8	0.9	0.9	0.9	0.5
Total assets	**63.7**	**36.3**	**66.3**	**33.7**	**70.2**	**29.8**

Source: CBAK (2006)

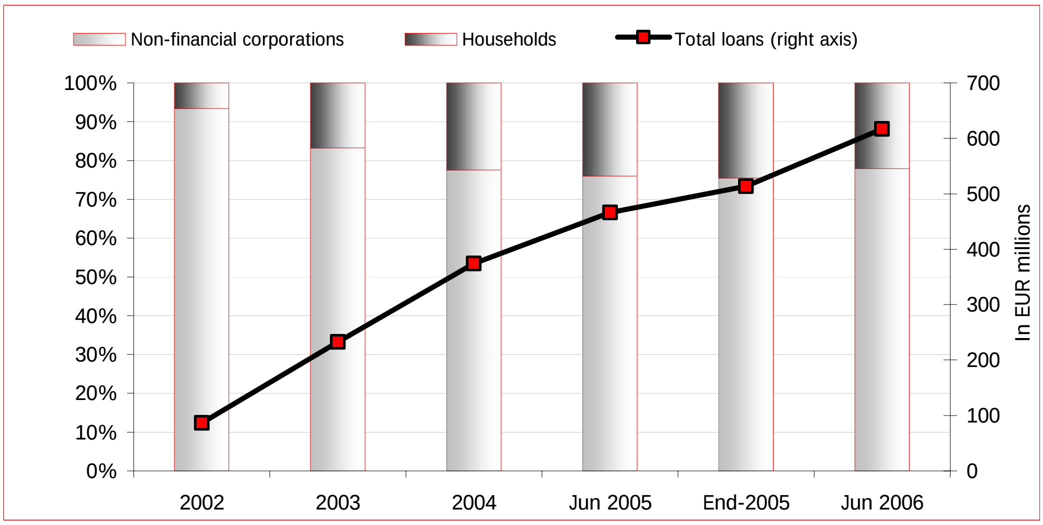
[8] Currently no domestic securities are issued.

3.2.1.1. Loans of the commercial banks

In June 2006, the amount of loans granted by commercial banks attained euro 617.0 million – a year-on-year increase of 32.3% – and in relation to GDP reaching 28%.

Loans by sector. Non-financial corporations (NFCs) continue to benefit from the commercial banks, by absorbing the largest share (78%) of the loans granted. This share was similar one year earlier (76%). The amount of loans to NFCs in June 2006 reached euro 480.5 million. After decreasing their share in total loans to the benefit of households, they took in larger part of loan volume as of June 2005 (Figure 7).

Figure 7. Banking sector loans by sector

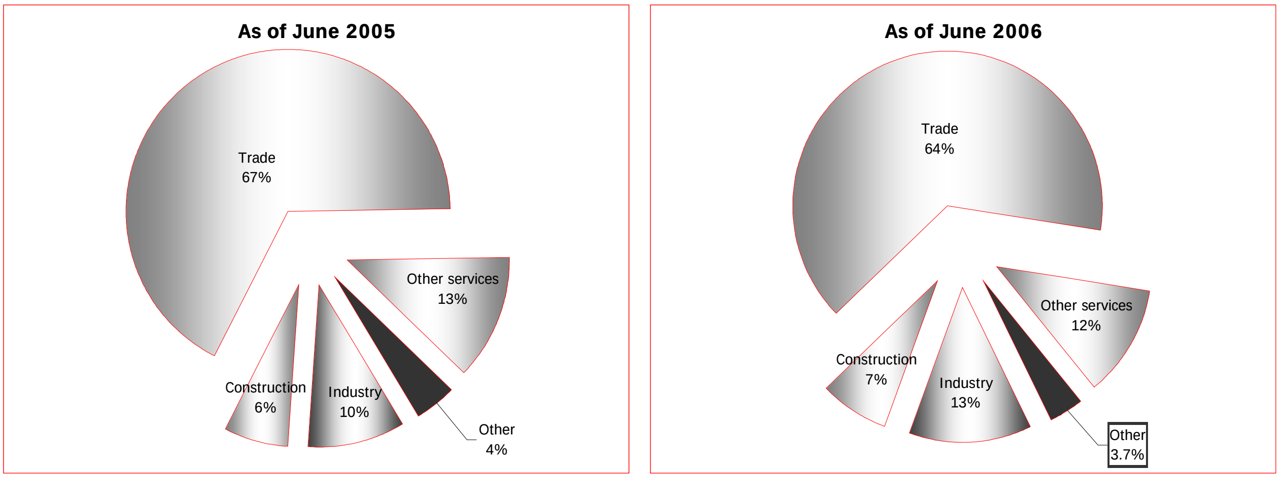


Source: CBAK (2006)

The domestic household sector outstanding loans granted by commercial banks reached euro 136.5 million as of end June 2006 or 22.2% more than in June 2005. This percentage change is moderate compared to the year-on-year change of 50.5% observed in December 2005. Household loans contributed with 5.3pp in the total yearly growth of loans, against 27.0pp for loans to NFCs.

Loans by industry. The amount of euro 480.5 million of loans granted to NFCs was allocated in different types of economic activity (see Figure 8). Despite some moderate changes in the overall share structure of the 'loans by industry', the services sector (especially trading activity) remains the main beneficiary of loans to NFCs (76.5% of total).

Figure 8. Banking sector loans by industry

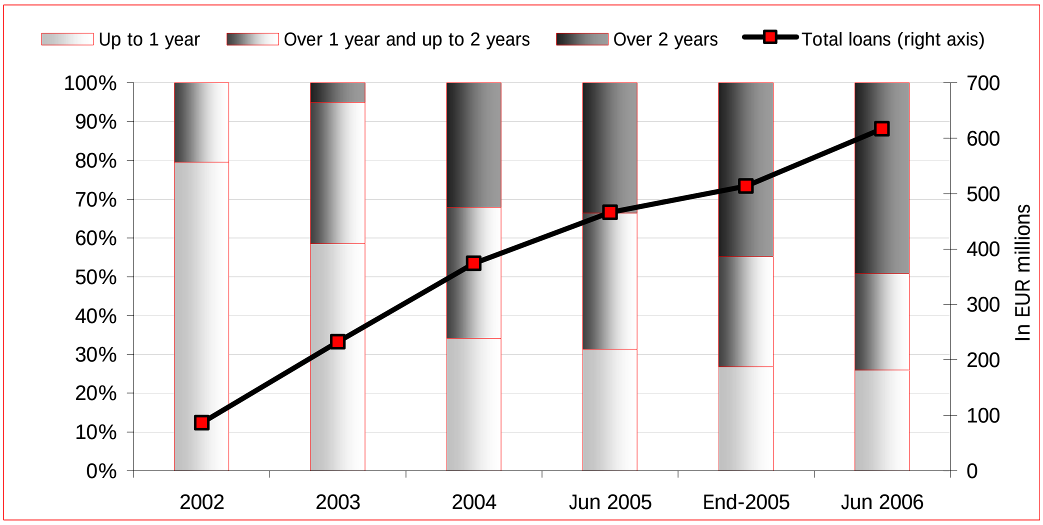


Source: CBAK (2006)

The category 'industry, energy and construction' absorbs about 20.0% of total loans to NFCs, of which 13% 'industry'. After a drop in 2005, the industry sector recovered in its share to total loans in 2006. The least financed by the banking sector loans remains agriculture sector with euro 16.4 million or 3.4% of total loans to the NFCs.

Loans by maturity. During the period since 2002 the average maturity of banking sector loan portfolio increased gradually in favor of longer-maturity loans. In 2002, loans granted by commercial banks had a maximum maturity of up to 2 years and 79.5% of them were in the maturity 'up to 1 year'. In 2003 domestic banks introduced loans with maturities longer than 2 years representing 5.1% of total granted loans. In 2004 foreign banks operating in Kosovo joined this policy and dedicated about 48.0% of their total loan portfolio to loans with a maturity 'over 2 years' and became market leader (with 84.5% share) in that segment. This indicates that banking sector was increasing its maturity transformation role. From end 2004 where the loan maturity segments showed an equal part in total bank lending, the maturity of over 2 years took the leadership at the expense of the loans with shorter maturity and forms now 50% of the market (Figure 9).

Figure 9. Banking sector loans by maturity

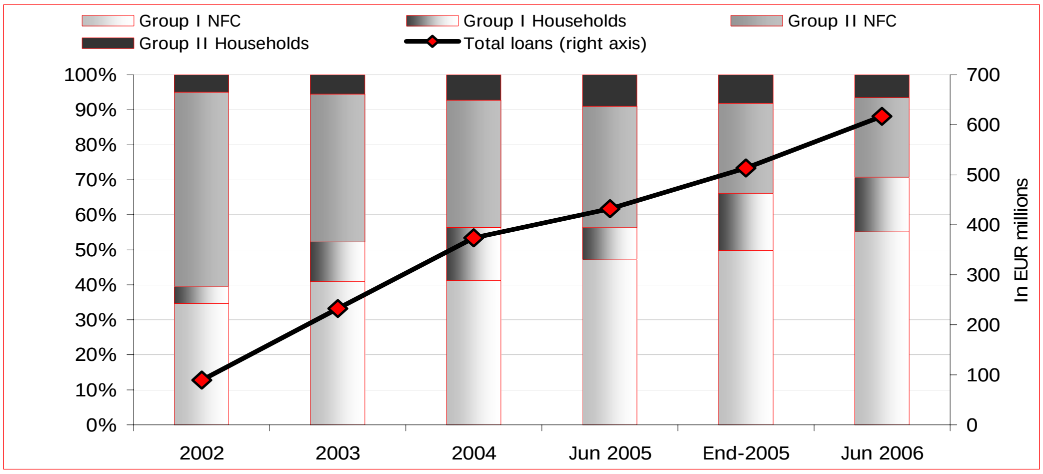


Source: CBAK (2006)

Box 3. Loans by banking groups

In managing 70.7% of the total loans, Group I banks are also determining the overall orientation of the banking sector loans. This is an increase in share, compared to the same period last year (June 2005), when the Group I managed 59.5% of the total loans.

Figure 10. Loans by banking groups



Source: CBAK (2006)

Compared to June 2005, Group I banks increased by 57.3% their total amount of loans granted, while the domestic banks loan portfolio declined by 4%. The domestic banks brought down their loans to NFCs while granted more credit to households.

3.2.2. Structure of Liabilities

As of end June 2005, bank deposits composed about 80.8% of total liabilities representing a lowest share compared to the previous periods. However, the decline in share does not prevent deposits to grow in volume (13.5% on a year-on-year basis). Despite their short-term maturity, deposits remain by far the main source of funding for the banks. Apart from the minor item 'other borrowings', all other components of the bank liabilities contributed positively to its growth.

Table 5. The structure of commercial banks liabilities (in euro thousand)

Description	Jun-05		End-2005		Jun-06	
	Amount	Share (%)	Amount	Share(%)	Amount	Share (%)
Balances from other banks	18,684	2.1	23,034	2.3	27,879	2.6
Debts to clients	749,770	85.2	843,048	85.6	850,901	80.8
Deposits	742,212	84.4	836,657	85.0	845,351	80.3
Other borrowings	7,558	0.9	6,391	0.6	5,550	0.5
Other liabilities	36,804	4.2	37,344	3.8	84,104	8.0
Subordinated debt	7,045	0.8	6,999	0.7	7,001	0.7
Own resources	67,193	7.6	73,988	7.5	82,590	7.8
Total liabilities	**879,497**		**984,413**		**1,052,473**	

Source: CBAK (2006)

Following the total liabilities development, equity capital reaching the amount of euro 82.6 million by end of June 2006, increased with 22.9% on a year-to-year basis. The ratio of capital to total assets increased slightly to 7.8%, from 7.5% one year earlier.

As it was the case for assets, Group I banks hold close to 70% of total liabilities (Table 6) and the increase as of June 2006 compared to earlier is partly attributed to the closure of the bank belonging to Group II.

Table 6. Share in total liabilities, by banking groups (in percent)

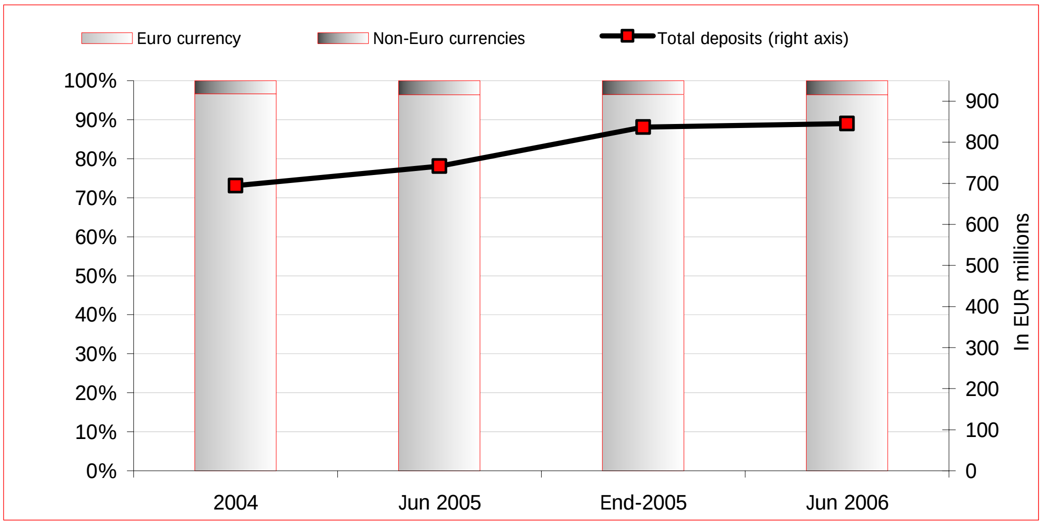
Description	Jun-05		End-2005		Jun-06	
	Group I	Group II	Group I	Group II	Group I	Group II
Balances from other banks	1.4	0.8	2.0	0.3	2.3	0.4
Debts to clients	55.5	29.8	57.6	28.1	59.3	21.5
Deposits	55.5	28.9	57.6	27.4	59.3	21.0
Other borrowings	0.0	0.9	0.0	0.6	0.0	0.5
Other liabilities	1.6	2.6	1.5	2.3	1.2	6.8
Subordinated debt	0.8	0.0	0.7	0.0	0.7	0.0
Own resources	4.1	3.5	4.2	3.4	5.6	2.2
Total liabilities	**63.4**	**36.6**	**66.0**	**34.0**	**69.1**	**30.9**

Source: CBAK (2006)

3.2.2.1. Deposits of the commercial banks

As of June 2006, the client deposits in commercial banks accounted for 37.9% of the projected GDP for 2006 or about euro 845.4 million and grew 13.9% on a year-on-year basis.

Figure 11. Deposits by currency



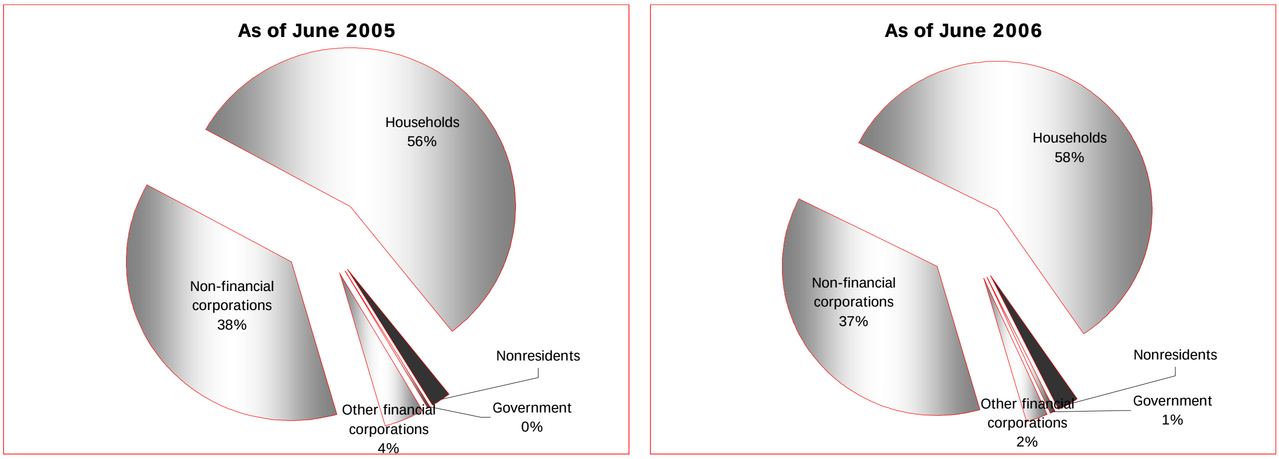
Source: CBAK (2006)

Deposits in the banks operating in Kosovo are mainly held in euro (about 96%), while only a minor part of 4% is held in foreign currency (mainly US dollars).[9] Transferable deposits are still growing by reasonable pace (6.7%) fluctuating from 9.9% in June 2005 (see Figure 13). All other deposits, with different maturities, are growing more rapidly (19.0% compared to June 2005) and they do compose the major share of the total deposits (61.3%).

Deposits by sector. While loans are largely granted to NFCs, the principal depositors are the households with about 56.7% of the total deposits, followed by NFCs (37.0%) and the remaining share of 6.4% held by other financial corporations, nonresidents and government. Compared to June 2005, households increased their deposits by 17.4%, contributing the most (by 9.6pp) to the total deposits growth. A comparable growth rate occurred in deposits of NFCs (by 12.2%) that amounted euro 312.5 million at end-Jun 2006. Almost 61.0% of the NFCs deposits are held by Public NFCs and the overall growth of the NFC deposits (12.2%) was mainly originated by Other (mainly private) NFCs deposits (by 11.1pp), since they increased significantly by 34.1%. In general, the overall structure of the deposits did not experience any significant change with respect to the share of depositors (see Figure 12) and almost all depositors increased their amount of the deposits compared to June 2005. However, other financial corporations (OFC) decreased their deposits with banks by 29.3%, explaining a decrease of their share by 1.4pp as well as negative contribution (by 1.1pp) to the total deposits growth.

[9] The data on foreign currency deposits for the period 2002-2003 are not available.

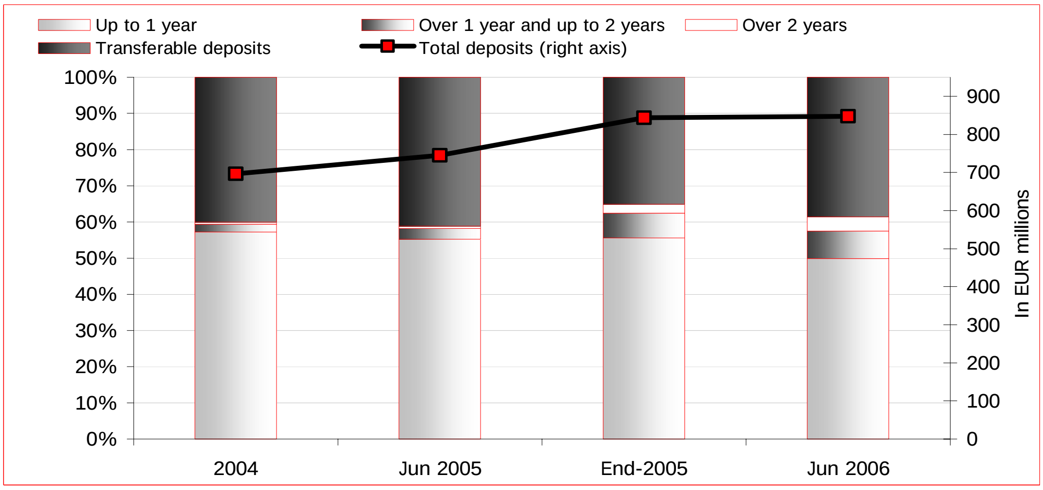
Figure 12. Deposits by sector



Source: CBAK (2006)

Deposits by maturity. Transferable deposits continuously decreased their share to total deposits. By holding 69.3% of the deposits at end-2002, transferable deposits dropped their share to 38.7% in June 2006. This suggests that bank depositors started to prefer deposit accounts with different maturities. Other deposits (saving and time deposits) as of end June 2006 amounted of euro 518.5 million. Nevertheless, when paying attention to the overall structure of these other deposits it appears that the longer-maturity deposits are not yet strongly demanded. About 87.8% of these other deposits have a maturity 'up to 1 year', 15.2% are deposits with maturity 'over 1 year and up to 2 years' and 7.0% with a maturity of 'over 2 years'. However, a shift to longer maturity in the 'other deposits' category is observed as of end-June 2005 where almost 94% of the other deposits were at a maturity of maximum 1 year, 6.4pp higher when compared with end June 2006 (Figure 13).

Figure 13. Deposits by maturity



Source: CBAK (2006)

The mismatch between deposits and loans regarding maturity will be dealt in the part discussing the overall performance of the banking sector.

Box 4. Deposits by banking group

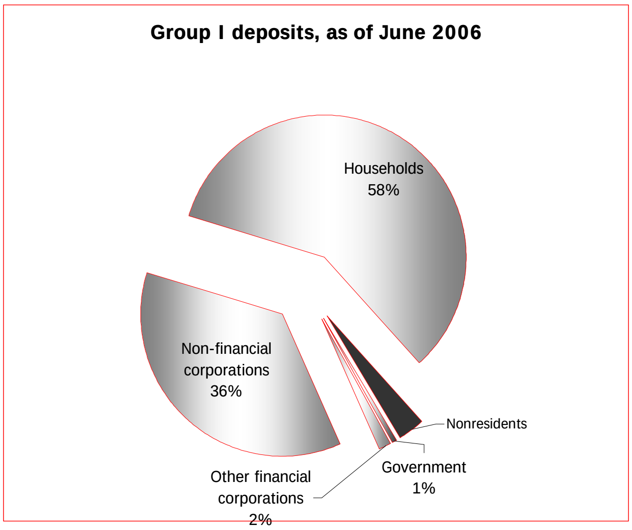
The dominant players in the banking sector, Group I banks, manage about 73.9% (the highest share since 2003 when it stood at 66.3%) of the total banking deposits or euro 624.3 million. Deposits with the Group I banks experienced a considerable increase by 28.0%, while those managed by Group II banks showed a decrease (13.1%) and amounted to euro 221.0 million as of end June 2006.

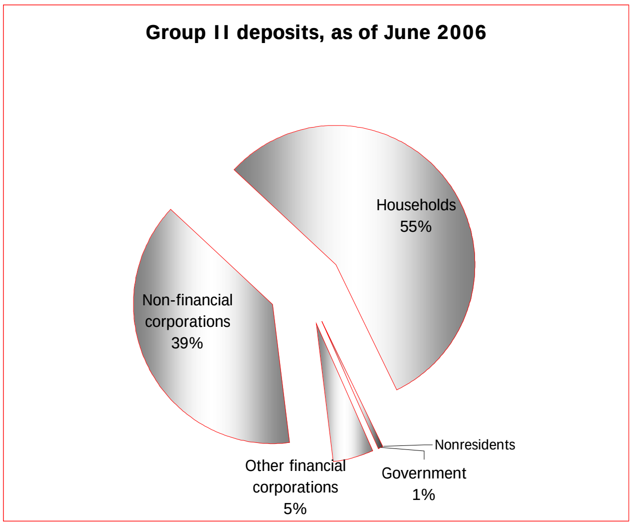
With respect to the sectors holding deposits at commercial banks, both groups correspond to a similar situation with households being the largest depositors (57.5% for Group I deposits and 55.2% for Group II deposits), and NFCs being the second largest depositors by making up 36.2% of Group I and 18.8% of Group II deposits.

It is interesting to note that on a yearly basis (compared to June 2005) all groups of depositors at Group I banks increased their deposited amounts, while Group II banks experienced a slightly different development. Apart from the increase in deposits held by households and government (1.6% and 4.3%, respectively), a drop in the deposits held by NFCs (by 22.2%) and OFCs (by 47.4%) supported the overall decrease in the deposited amounts in domestic banks (13.1%). Also can be observed that nonresidents, as minor depositors, prefer Group I banks.

(Continued)

Figure 14. Deposits by banking groups





Source: CBAK (2006)

Group I banks, as of June 2006, are managing 78.1% of total transferable deposits and 71.2% of total other deposits. The decrease was observed in the transferable deposits of the Group II banks (by 10.3%), and other deposits (3.5%) that effected the overall drop of their deposits. Clients with Group II banks hold 67.6% of their deposits as other deposits (saving and time deposits of different maturities), while 59.1% of Group I deposits opt for other deposits. Yet, in both banking groups majority of these deposits are with maturity 'up to 1 year' (80.2% and 83.6%, respectively).

3.3. Performance of Commercial Banks

This part focuses on the overall performance of the banking sector in Kosovo. First, the structure of the aggregated income statement is described. Second, some profitability and efficiency indicators are presented, followed by liquidity and solvency measures.

3.3.1. The structure of the banking sector Income and Expenditures

The first half of 2006 performance seems promising for the commercial banks in Kosovo with euro 10.8 million retained profit or, tripling the level obtained by June 2005 (Table 7). That level is solely due to the substantial increase in the net interest income (difference between interest income and interest expenditures).

Table 7. Commercial banks income statement, in thousands of EUR

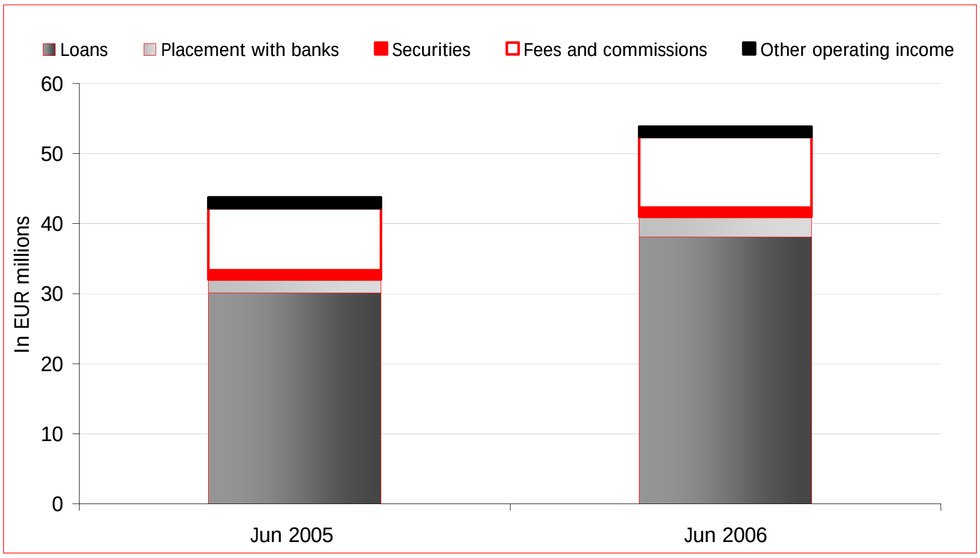
Description	Jun-05	Jun-06
INCOME		
Interest Income	33,361	42,276
Non-interest income	10,410	11,573
Total income	**43,771**	**53,849**
EXPENDITURES	**0.0**	**0.0**
Interest expenditures	6,975	9,028
Non-interest expenditures	11,956	9,856
General and administrative expenses	20,504	21,830
Total expenditures	**39,435**	**40,714**
NET INCOME	0.0	0.0
Net operating income	4,336	13,134
Net income before tax	4,573	13,198
Provisions for taxes	1,464	2,416
Net profit/loss for period	3,109	10,783
Retained profit	**3,109**	**10,783**

Source: CBAK (2006)

Net interest income attained euro 33.2 million, an increase by 26.0% against June 2005. Total expenditures remained approximately at the same level as the previous year. However, the higher interest expenditures are neutralized by the reduced non-interest expenditures.

Structure of Income. By June 2006, total income of the banking sector was euro 53.8 million, a 23% increase against June 2005. Interest income explains 78.5% of the total income and remains the largest contributor to the income increase (22.4pp). Interest income is mainly originated by loans (90%). The remainder of interest income is generated by placements with other banks (6.8%) and investments in securities (3.1%). These developments reflect the balance sheet structure of the banks. Interest produced by placements with banks increased by 50.0% compared to June 2005, while interest income related to investments in securities dropped by 0.6%. The latter type of income is a feature of the income statement of the Group I banks.

Figure 15. Structure of income

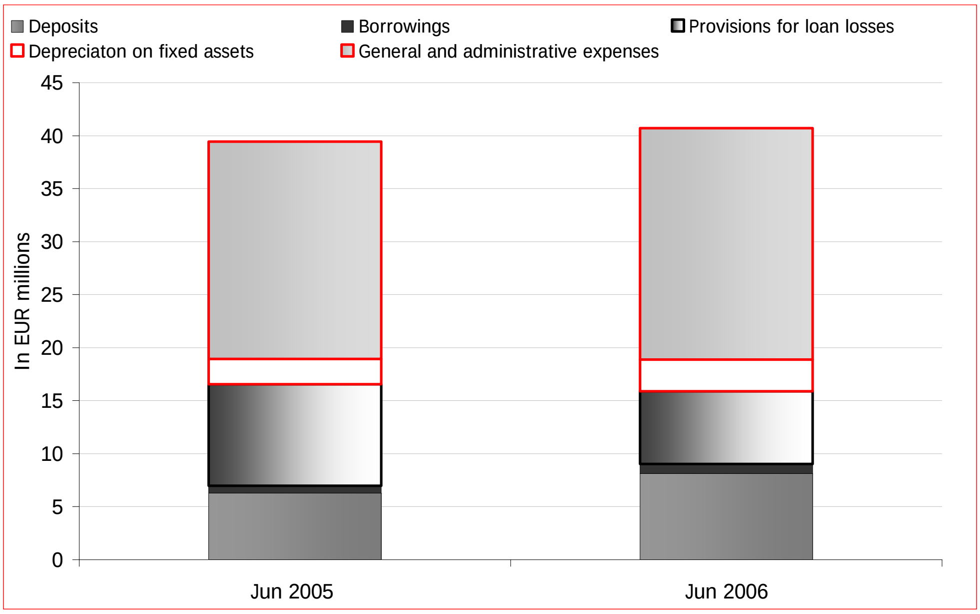


Source: CBAK (2006)

The non-interest income consists mainly of ‘fees and commissions’. With an amount of euro 10.1 million it explains 18.7% of the total income. The second source of non-interest income, the ‘other operating income’, fell by 5.5% compared to June 2005 and constitutes 12.8% of the total non-interest income.

Structure of Expenditures. By June 2006 total expenditures reached euro 40.7 million, of which more than 50.0% was related to ‘general and administrative expenses’ and the remaining part mainly to interest expenditures and loan provisioning.

Figure 16. Structure of expenditures



Source: CBAK (2006)

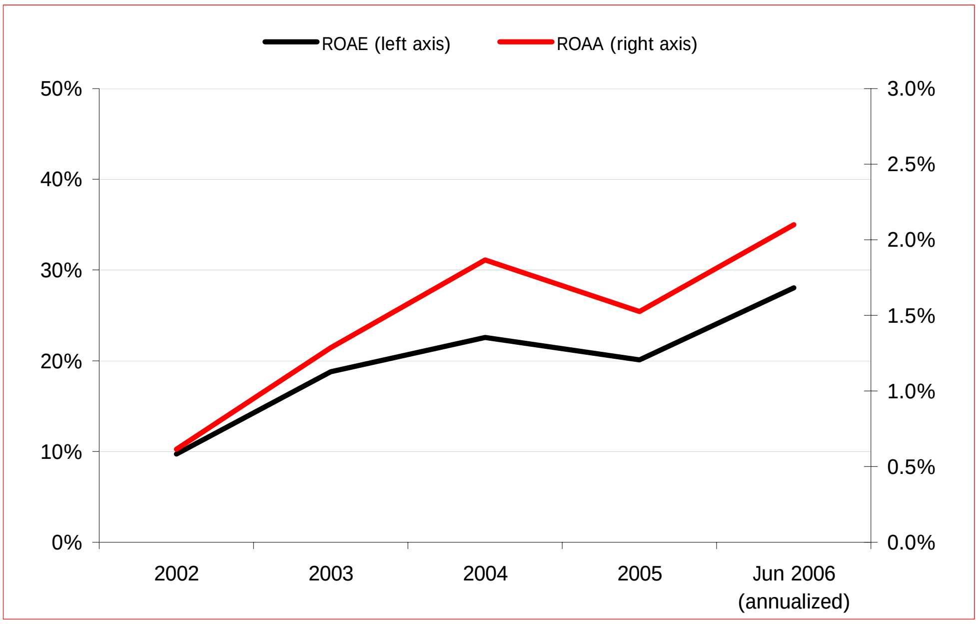
As of June 2006, general and administrative expenses grew with 6.5% on yearly basis, interest expenditures grew by 29.4% and amounted to euro 9.0 million. Although they do form the smallest part of the expenditures (22.2%) their contribution to the total increase of the expenditures was the highest (5.2pp). About 90.0% of the interest expenditures consist of interest paid to depositors. The remaining 10% 'interest paid to other borrowers' increased by 31.1%. The reduction in loan provisioning (28.3% on a year-to-year basis) is one of the main explanations for the quasi-unchanged level of total expenditures.

3.3.2. Profitability and Efficiency

Banks profitability remained stable during the first half of 2006 and seems slightly to extend the level of the previous years.[10] As illustrated in Figure 17 below, up to end-2005, profitability indicators had their peak performance in 2004 with slight downward evolution in 2005. Indicator measuring the Return on Average Assets (ROAA) reached the peak of 1.9% in 2004 and then experienced a small decrease to 1.5% in 2005. The current year shows improvement with annualized ROAA reaching 2.1% as of end June 2006. Similar to ROAA development, the indicator measuring the Return on Average Equity (ROAE) increased constantly over 2002-2004 (22.6% in 2004). By the end-2005, the ROAE dropped slightly to 20.1%, but the ROAE, after annualized, approaches 28.0% in June 2006 – which is quite high and shows a good profitability.

[10] Please note that the performance indicators are annualized for June 2006, so they can differ up to end-2006.

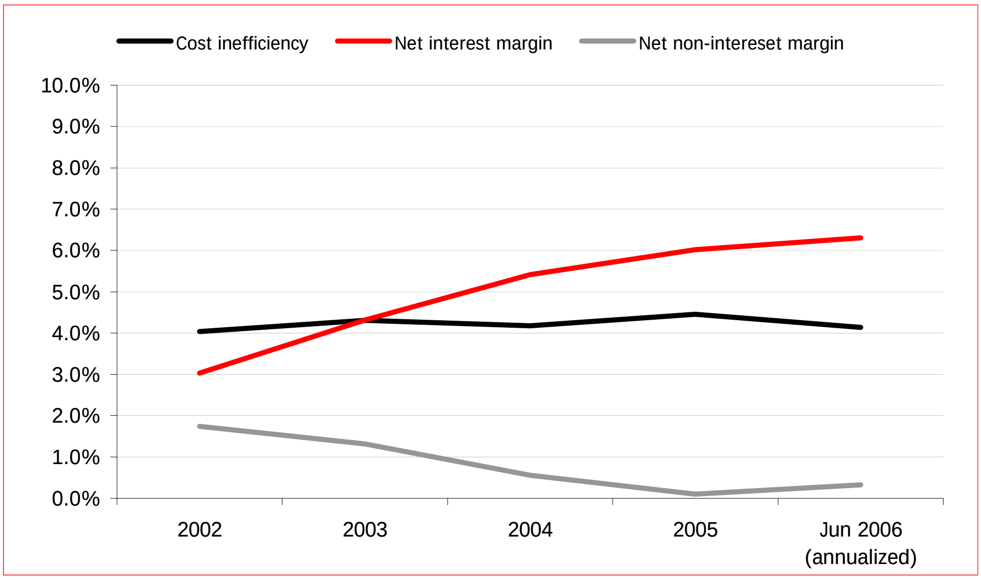
Figure 17. Return indicators (ROAA and ROAE)



Source: CBAK (2006)

Figure 18 represents the efficiency indicators, with focus on net margins, both interest and non-interest income/expenditures, as well as cost inefficiency related to operational expenses. Net interest margin (NIM), expressed as the difference between interest income and interest expenditures and related to the total assets, increased continuously since 2002 and reached the ratio of 6.0% at end-2005. Additionally, the annualized NIM of 6.3% for June 2006 expresses the similar growth pace to the previous years. On the other hand, the net non-interest margin, expressed as the difference between non-interest income and non-interest expenditures and related to the total assets, remained broadly stable up to end-2005 when it approached its level value of 0.1%. For the current year, the non-interest expenditures seem to grow slower than the non-interest income, bringing the ratio to 0.3% as of June 2006.

Figure 18. Efficiency indicators



Source: CBAK (2006)

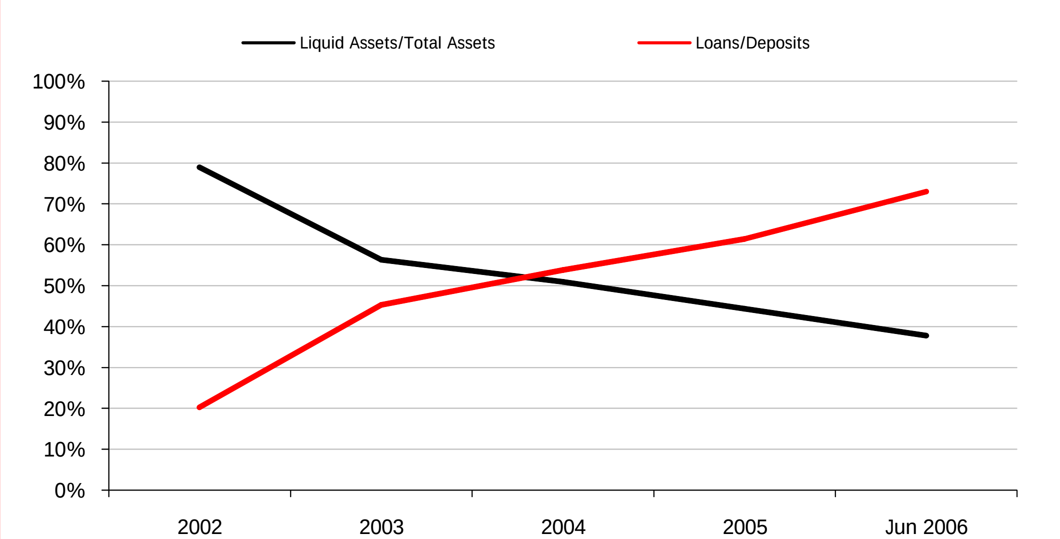
The cost inefficiency indicator, expressed as the ratio of general and administrative expenses to total assets, is quite stable in its evolvement. Since 2002 and up to 2005 this indicator fluctuates within the range of 4.0% - 4.5%. The annualized data of this indicator for June 2006 reveal a ratio of 4.1%, which also fits to this range. This evolvement of the cost inefficiency indicator indicates that the general and administrative expenses are in line with the growth and evolvement of the total assets of the banking sector.

3.3.3. Liquidity and Solvency

The faster growth of the banks lending activity is obviously affecting the liquidity ratios measured. It is interesting to highlight the mirror image of the liquid assets to total assets ratio versus loans to deposits ratio (Figure 19). While the indicator measuring the share of liquid assets to total assets is declining continuously, the loans to deposits ratio is increasing. Increase of the financial intermediation since 2002 and consequently more expanded balance sheet of the banks indicates the coherent decline of the overall liquidity position in banks of Kosovo.

As of June 2006, liquid assets to total assets ratio of the banking sector in Kosovo dropped to 37.8%, from 44.4% in 2005 and 50.9% in 2004. The composition structure of the liquid assets remained the same, with placements with other banks accounting for 46.5% or 4.4pp less than in 2005. On the other hand, three other components: cash, balances with CBAK and securities increased slightly their share to total liquid assets.

Figure 19. Liquidity indicators

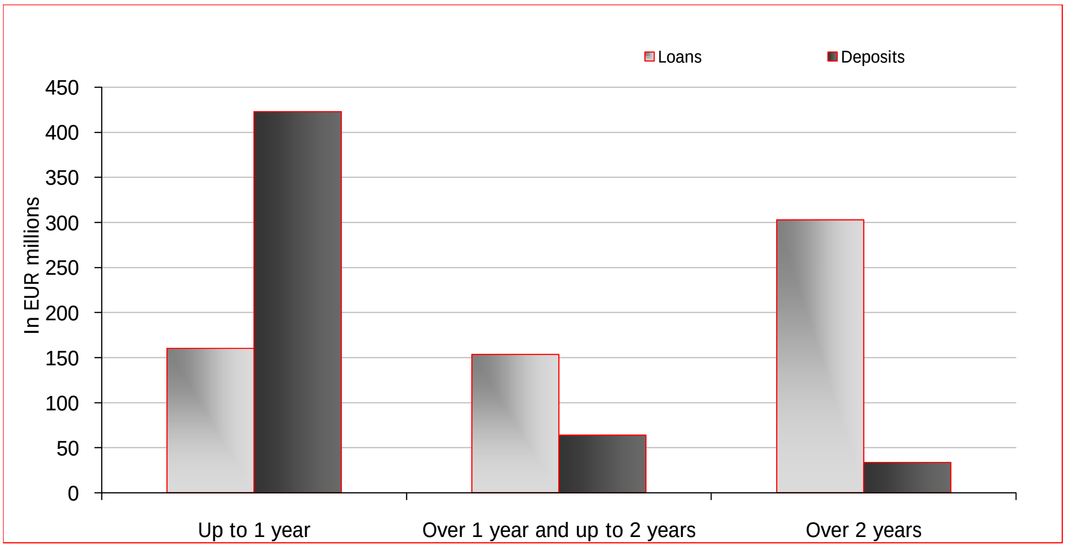


Source: CBAK (2006)

The second liquidity indicator, ratio of loans to deposits, increased to 70.6% in June 2006 from 61.4% in 2005 and 53.8% in 2004. Growth of this ratio indicates the extension of the banks lending activity.

With regard to maturity structure, there is inconsistency if compared loans to deposits of the same maturity level. Loans are mainly concentrated toward the longer maturities, whereas depositors prefer shorter maturities. This maturity mismatch changed to some extent by improving slightly during the last period. At end-June 2006, the ratio of loans to deposits with maturity of ‘up to 1 year’ was 37.9% (against 29.3% in 2005). Loans with maturities of ‘over one year and up to two years’ amounted to euro 153.5 million, more than double compared to deposits with same maturity (euro 66.4 million). However, about half of the total amount of loans is granted as loans with maturity of ‘over 2 years’ (euro 303.0 million), while corresponding deposit amount is euro 33.9 million. So, in June 2006 the ratio of deposit to loans with maturities of over 2 years was 11.2%, an increase compared to previous periods (3.2% in June 2005 and about 9.0% in December 2005).

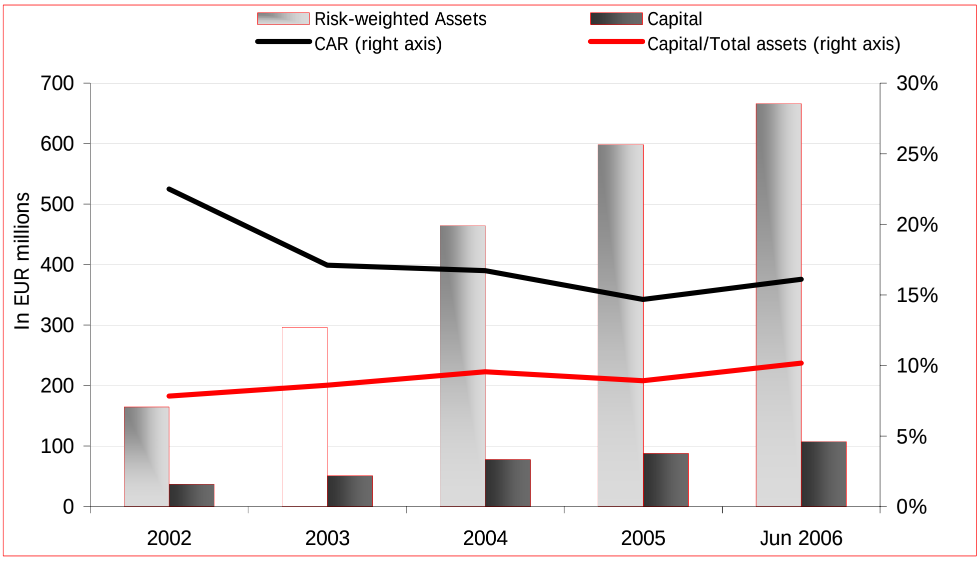
Figure 20. Loans versus deposits with regard to maturity structure



Source: CBAK (2006)

Capital adequacy ratio (CAR), expressed as the ratio of Tier I and II capital to RWA, declined since 2002, and stood at 14.7% in 2005. However, during the first half of 2006, the CAR increased and in June 2006 a value of 16.1% was observed. This improvement of the capital adequacy occurred due to the increase in the total capital that amounted to euro 107.2 million at June 2006, triggered by the modified rule on minimum capital (set at euro 5 million). For existing banks this capital limit should be attained by December 2006. Risk-weighted assets in Jun 2006 reached the amount of euro 666.2 million and they grew with slower pace than capital.[11]

Figure 21. Capital Adequacy Ratio (CAR) and Capital to total assets ratio



Source: CBAK (2006)

[11] For more information on risk categories and risk weights consult the CBAK Rule I on Capital Adequacy.

With respect to the banking groups, Group I banks recorded CAR of 14.9%, while domestic banks or Group II banks had a CAR of 19.3%. However, both banking groups are well above 12% that is the minimum required level of capital adequacy.

4. OTHER FINANCIAL CORPORATIONS

4.1. Insurance Companies

As of June 2006, eight insurance companies operating in Kosovo accounted for 45% of total assets of all other financial corporations or 6% of financial sectors assets. Since June 2005, the outstanding number of companies, both domestic and foreign owned remains unchanged. The ownership structure of insurance industry as of June 2006 was as following: 3 domestic companies and 5 foreign branches of foreign companies (see Box 5).

Box 5. Composition of insurance companies groups, breakdown by ownership

We use the ownership criteria to categorize insurance companies established as branches of foreign insurance companies and those established domestically. Group I insurance companies represent foreign companies or branches of foreign companies, while Group 2 covers domestic insurance companies.

Group I	Group II
Insig	Dukagjini *
Kosova e Re	Siguria
Sigal-Drini	Dardania
Sigma	
Croatia Osig.	

* Since September 2006 DUKAGJINI is bought from foreign company, decreasing to 2 the number of domestic insurance companies as of September 2006.

As regards to asset size, as of June 2006, there are 3 insurance companies that fit in the group of assets up to euro 5 million, 4 insurance companies that fit in the range of assets from euro 5 million up to euro 10 million, while only 1 insurance company exceeds the level of euro 10 million (see Table 8). At end 2005, there were 5 companies ranging between euro 5 million up to euro 10 million in assets. Following the ownership criteria, it can be observed that Group I insurance companies continued to stay mainly within the range up to euro 5 million (3 companies, as of June 2006), including one insurance company with assets over euro 5 million up to euro 10 million and another one over euro 10 million. At the same time, Group II insurance companies - fit in the range of assets over euro 5 million up to 10 million.

Table 8. Insurance companies number, asset size and ownership

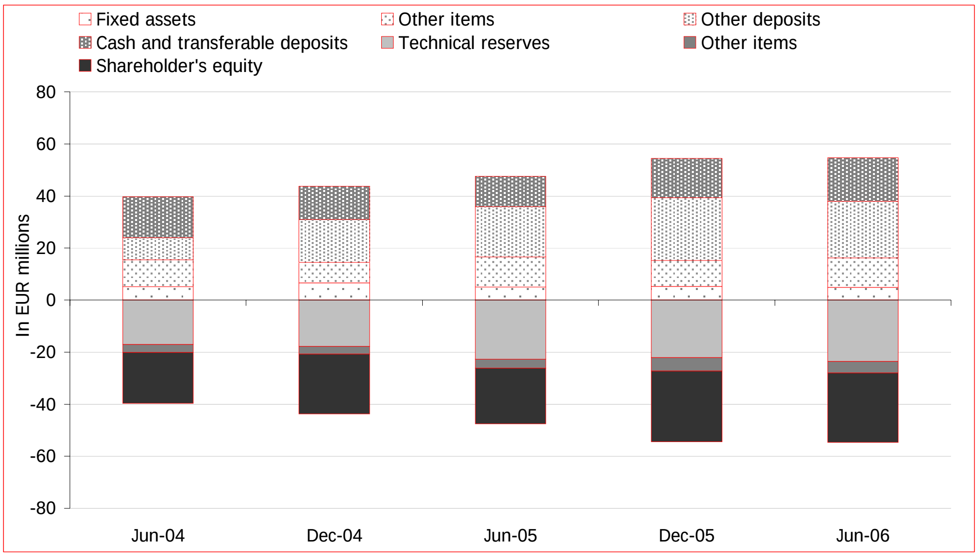
Description	Dec-02	Jun-03	Dec-03	Jun-04	Dec-04	Jun-05	Dec-05	Jun-06
Over 10 million	**1**	**1**	**2**	**0**	**1**	**1**	**1**	**1**
Group I	1	1	2	0	1	1	1	1
Group II	0	0	0	0	0	0	0	0
Over 5 - up to 10 million	**2**	**4**	**3**	**5**	**5**	**5**	**5**	**4**
Group I	1	1	0	2	2	2	2	1
Group II	1	3	3	3	3	3	3	3
Up to 5 million	**3**	**1**	**1**	**1**	**1**	**2**	**2**	**3**
Group I	0	0	1	1	1	2	2	3
Group II	3	1	0	0	0	0	0	0
Total number of insurance companies	**6**	**6**	**6**	**6**	**7**	**8**	**8**	**8**
Group I	2	2	3	3	4	5	5	5
Group II	4	4	3	3	3	3	3	3
Total assets of insurance companies	**51,623**	**42,589**	**47,783**	**39,658**	**43,798**	**47,520**	**54,424**	**54,691**
Group I	25,055	21,243	29,588	20,720	25,916	26,852	33,279	31,943
Group II	26,568	21,346	18,194	18,938	17,881	20,668	21,144	22,748

Source: CBAK (2006)

As of June 2006, group I companies accounted for 58.0% of total assets of all insurance industry amounting to euro 32.0 million. In June 2006, the year-on-year growth of the assets of insurance industry was 15.1%, while the contribution of Group II insurance companies into this growth was 6.3pp. As Table 8 shows, the share of assets of Group I insurance companies to total assets of insurance industry was mainly over 50%, while it reached its peak at end-2003 with 61.9%.

The core activity of insurance companies in Kosovo is TPL insurance. Concerning the structure of the balance sheet, deposits at commercial banks represent dominant item on the asset side, while technical reserves prevail on the liability side (unearned premium reserves and claims reserves compose almost half of insurance companies liabilities). As of June 2006, cash and deposits (only transferable deposits) amounted to euro 16.7 million (30.6% of assets), compared with euro 11.6 million or 24.4% of assets in June 2005. Other deposits (time and saving deposits) are representing the main item in the balance sheet of the insurance companies, accounting for around 40% of assets in June 2006, almost the same level as in June 2005. The overall high ratio of cash and deposits to total assets (70.4%) shows that these items are used primarily to cover technical reserves (Figure 22). Shareholders equity and technical reserves are main items within the structure of liabilities (91.7% share). In fact, shareholders equity turn out to be the biggest item, amounting to euro 26.6 million in June 2006 (48.7% of liabilities), compared to euro 21.3 million (44.8% of liabilities) in June 2005. Besides shareholders equity, technical reserves accounted for 43% of liabilities (euro 23.5 million), as of June 2006.

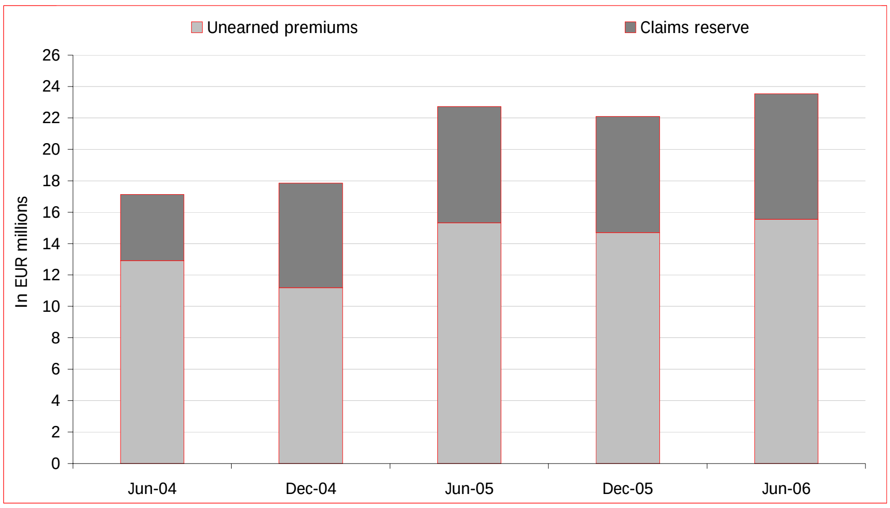
Figure 22. Structure of insurance companies balance sheet



Source: CBAK (2006)

Contributed mainly from claims reserve (2.6pp), technical reserves in June 2006 over June 2005 grew with 3.6% (Figure 23). However, this growth is significantly smaller compared to the period June 2005 – June 2004, when it accounted for 32.7% and was supported mainly from claims reserve (18.6pp). Besides the recent trend in claims reserve, unearned premiums representing 66.0% of the total technical reserves stood broadly stable seen from the year-on-year perspective. Based on the CBAK rules for insurance companies, claims reserve are composed from (1) Settled Claims But Not Paid, (2) Known Claims But Not Yet Settled, (3) Incurred But Not Reported (IBNR). The sizeable decline in the category Known Claims But Not Yet Settled as a share to total claims reserve (from 35.1% in June 2005 to 6.5% in June 2006), is offset by the increase in the category Settled Claims But Not Yet Paid within total claims reserve (from 50.7% to 71.3%). However, claims reserve in Jun 2006 (year-on-year perspective) grew with 8.0%.

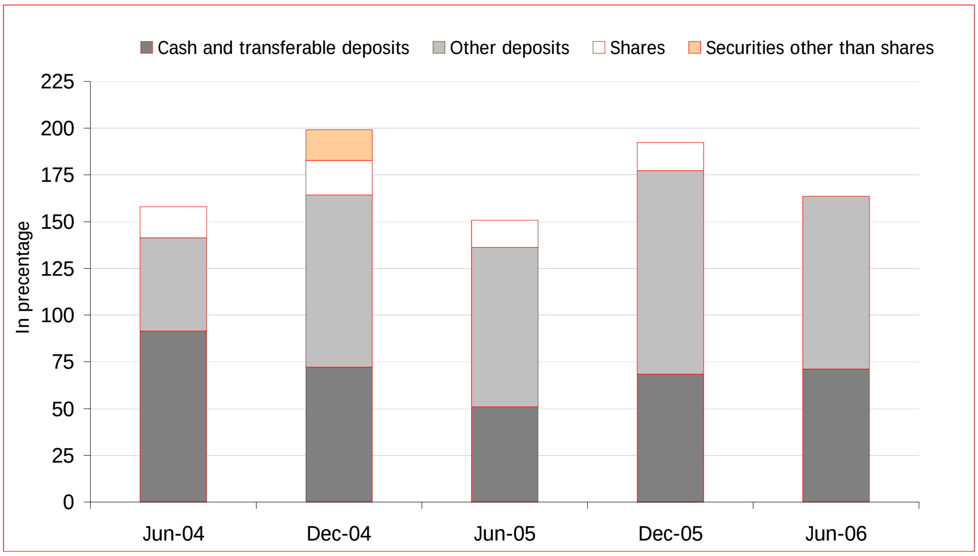
Figure 23. Structure of the insurance companies technical reserves



Source: CBAK (2006)

As Figure 24 shows, insurance companies operating in Kosovo are exceeding the threshold of 100% of coverage of their technical reserves by using mainly cash at hand and their deposits at banks - both the transferable and other (time and saving) deposits. Actually, the lowest level of technical reserves coverage is at the level 150% in June 2005. It is obvious that, due to its liquidity, cash and transferable deposits are used always as main instrument with respect to technical reserves coverage. Other deposits (time and saving) did represent important instrument as well.

Figure 24. Technical reserves coverage



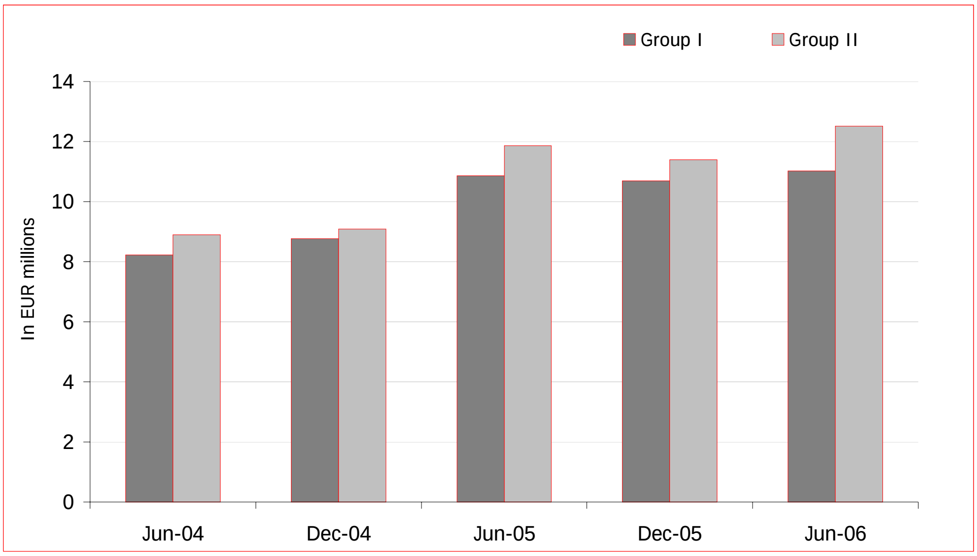
Source: CBAK (2006)

Box 6. Insurance companies technical reserves by group

Total technical reserves of Group I insurance companies in June 2006 stood at euro 11.0 million versus euro 12.5 million of Group II insurance companies (Figure 25). The technical reserves of Group I of insurance companies increased with 1.5% (year-on-year basis), a sizeable lower compared with Group II increase by 5.5%. Within the structure of both, Group I and Group II, the unearned premiums are much higher compared with reserve claims. While unearned premiums of Group I compose 64% of technical reserves, this ratio for Group II stays even higher, 68% of the technical reserves. In general there is year-on-year growth of the technical reserves by 3.6% (June 2006-June 2005) against 32.7% (June 2005-June2004).

continued

Figure 25. Insurance technical reserves by group

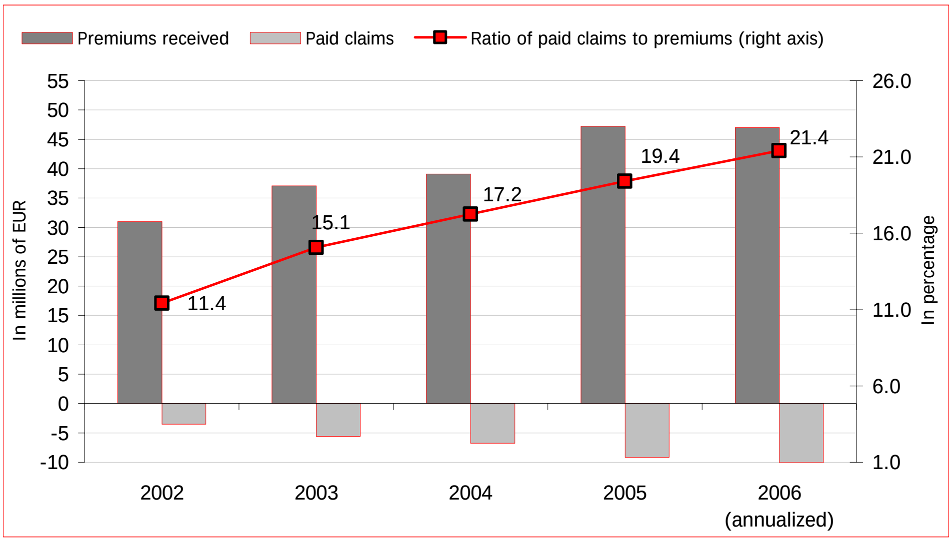


Source: CBAK (2006)

With the premiums received and paid claims in amount of euro 47.2 million and euro 9.2 million, respectively, in 2005, the ratio of paid claims to premiums received for entire insurance industry accounted for 19.4% which is for 4.3pp higher compared with end 2004, when the ratio accounted for 15.1%. Year 2006 (annualized ratio) seems to promise a increase of this ratio, reaching the level of paid claims to premiums received at 21.4%, mainly due to the faster increase in the paid claims rather than increase in the premiums (see Figure 26).

Premiums received are composed from (1) TPL policies, (2) border policies and (3) other categories. The share of TPL insurance to total premiums received remains relatively stable. After its peak in 2002 (87.9 %), but as well its drop in 2005 (70.6%), this ratio seems to improve again in 2006 (76.9%). During the period 2002-2005, border policies have increased their share to premiums from 11.9% (in 2002) to 15.0% (in 2005). Within the structure of the paid claims, we observe that TPLs are representing a major part of it (95.8% in 2005), showing continuous increase from 90% in 2002. The very low ratio of paid claims to premiums have consequently high level of technical reserves coverage.

Figure 26. Insurance companies activity

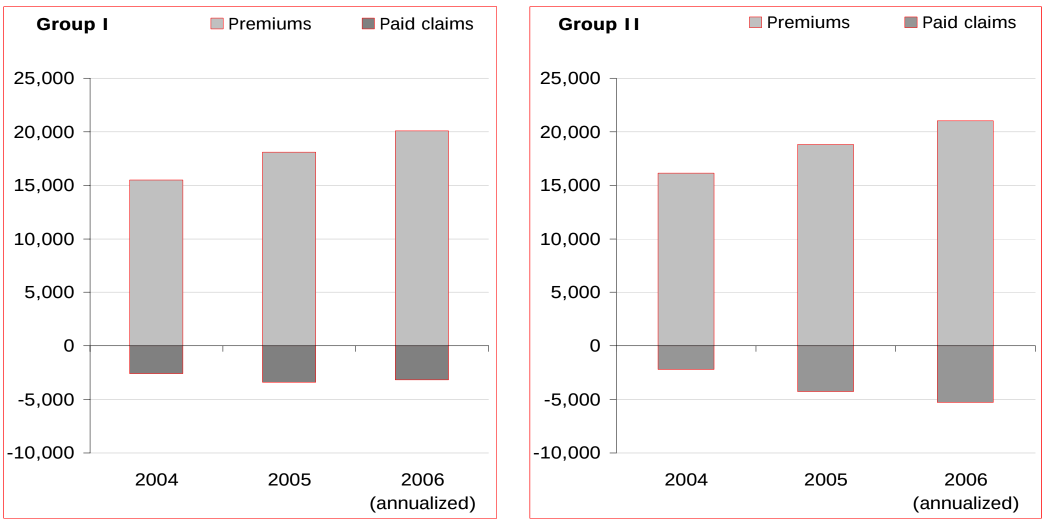


Source: CBAK (2006)

Box 7. Insurance companies activity, by groups

Amounting to euro 15.5 million (premiums received), the ratio of paid claims to premiums, for Group I insurance companies, accounted for 15.8% in 2006. Even their premiums received totaled to euro 21.0 million, the ratio of claims to premiums, for Group II of insurance companies, is higher for 9.2pp (25.0%). While the ratio of Group I premiums received to total premiums of insurance companies accounts for 48.9%, Group I paid claims accounts for 37.6%.

Figure 27. Insurance companies activity, by groups

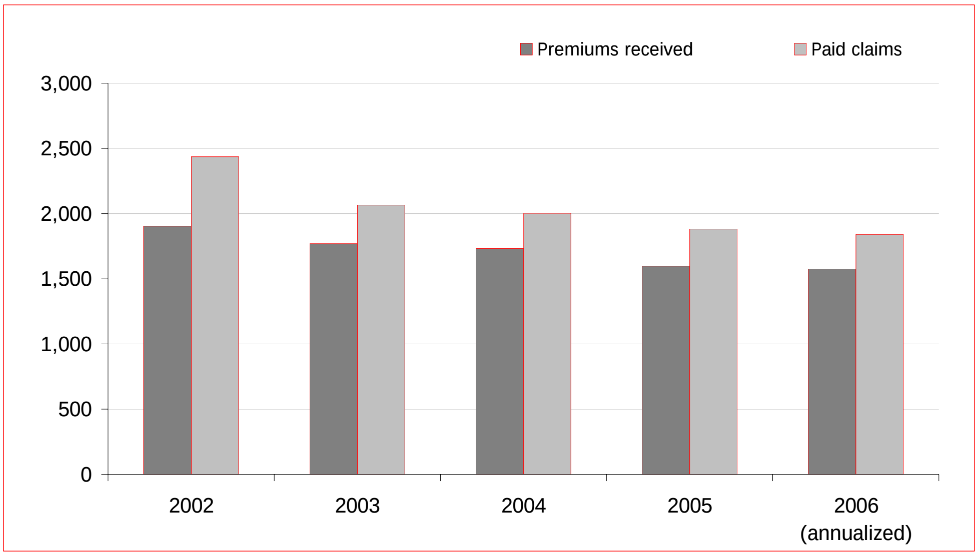


Source: CBAK (2006)

Using Herfindahl-Hirschman Index (HHI), but excluding border policies - since TPLs compound for a major part of premiums received, - we look at premiums received and paid claims aimed to assess the level of competition in market of insurance industry. As presented in Figure 28, there is increase in competition among companies with regard to premiums received and claims paid as well.

Specifically, the HHI index of premiums received in 2005 stood at 1598 points over 1905 points in 2002. This shows that there are no single companies or group of companies that are strongly leading in terms of premiums. Even behind, the paid claims are following the path of the premiums received, narrowing of the gap between the HHI between these two items. While in 2002 the gap stood at 530 points, in 2005 it squeezed to 266 points, which might be as aftermath of the increase in the ratio of paid claims over premiums received.

Figure 28. Herfindahl-Hirschman Index (HHI)



Source: CBAK (2006)

4.2. Pension Funds

Amounting to euro 10.9 million as of June 2006 from euro 7.6 million in Jun 2005, pension funds assets compose for not more than 1% of total assets of the financial sector assets. In this category of pension funds are not included basic pension schemes (mandatory scheme managed by the Kosovo Pension Savings Trust and financed through compulsory minimal contributions of employers and employees). Actually, above-mentioned pension funds are composed only from funds collected through supplementary scheme, when pension is provided to the employee form its employer.

Box 8. Definition of the pension funds operating in Kosovo

In Kosovo the pension schemes are defined at three levels:

1) Basic pension - as mandatory scheme, paid by the Pension Administration financed through Consolidated Budget of Kosovo;
2) Individual Savings Pension - as mandatory scheme, managed by the Kosovo Pension Savings Trust (KPST) and financed through compulsory minimal contributions of employers and employees.
3) Supplementary schemes consist of three sublevels: a. Individual Savings Pension (managed by KPST complemented with additional voluntary contributions paid by the employer or the employee, or both); b. Supplementary Employers Pensions (provided to employees by their employer); c. Supplementary Individual Pensions, provided to natural persons from licensed pension provider.

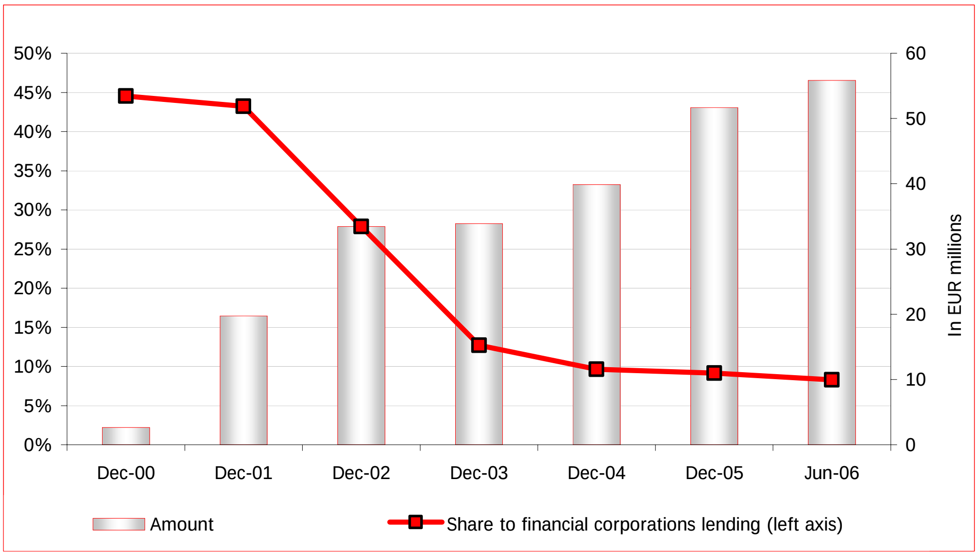
The two mandatory schemes (basic and individual savings pension), based on international practices and definitions do not form part of the sub-sector of pension funds, but belong to the central government and social security sector respectively.

Regarding the mandatory schemes, currently in Kosovo there is only fund (Kosovo Pension Saving Trust) supervised from the CBAK, dealing with the management of the individual pensions. The amounts collected through this scheme (individual savings pension), in Jun 2006 they amounted to euro 172.2 million (around 7% of GDP). Excluding the negligible amount that remains at CBAK, the major part, around euro 166.6 million is invested abroad in mutual funds, while the interest received from the invested amounts sweeps into the individual accounts of contributors.

4.3. Other Financial Intermediaries

Standing at euro 55.8 million other financial intermediaries lending to the private sector grew with 11.7%, a lower growth against 37.4% in period June 2005-June 2004. From December 2005 until June 2006 new lending of other financial intermediaries amounted to euro 4.1 million, against euro 10.1 million in the same band for 2005 (December 2004 until June 2005). As presented in Figure 29, the current pace of other financial intermediaries' loans growth since December 2004 assures a broadly stable share to total lending of the financial corporations. Namely, this ratio of in June 2005 accounted for 8.3% against 9.1% in December 2005.

Figure 29. Lending activity of other financial intermediaries



Source: CBAK (2006)

In June 2006, number of other financial intermediary loans reached 32.6 thousand from 24.4 thousand a year before. Average amount of loans granted in June 2006 stood at euro 1,712, 10.2% lower compared to December 2005. However, the highest amount of loans per borrower reached euro 2,035 in December 2002, 18.9% higher than in June 2006. The other financial intermediaries are composed mainly from micro-financial institutions whose source of funding remains to be from external donors.

5. NOTES ON METHODOLOGY

Figure 1. Number of individual financial corporations (excluding CBAK)

The figure shows types of financial corporations licensed from CBAK, and operating in Kosovo. Terminology used in the figure is based on the "Manual on Monetary and Financial Statistics" IMF 2000. CBAK as institution is not included in the presentation. Source for the number on individual types of financial corporations are banking, insurance, and pension supervision directorate.

Figure 2. Structure of the financial sector in Kosovo (excluding CBAK)

Figure 2 is compiled using consolidated balance sheet of all financial corporations except CBAK. Removing all their capital and non-capital links (consolidated figure) between the financial corporations, the ratio of each type of financial corporations to total assets of the financial sector in Kosovo is presented. Source for the data are Statistical Bank Report, insurance companies and pension funds supervision directorate of the CBAK.

Figure 4. Commercial bank assets, by ownership

The figure shows the comparison between asset size of group of banks with respect to their ownership structure. Banks are divided into two groups according to their ownership. The assets by bank group are summed up and their share to total banking sector assets is calculated. The source of data is BS schedule (Statistical Bank Report, CBAK)

Table 1. Commercial banks network, by region

The table presents the distribution of commercial banks headquarters, branches, sub-branches, and mobile units among the regions of Kosovo on annual and semiannual basis.

Table 2. Commercial banks productivity and accessibility indicators

The banking sector productivity is measured on the year-on-year basis using the number of employees, volume of assets/loans/deposits managed by employee and banking unit. The number of employees per banking unit was calculated as the ratio between the number of employees for the total banking sector and the total number of banking units for the total banking sector. The ratio of total assets managed by the banking unit and by an employee is calculated in the same manner. Total banking sector loans per employee/banking unit and deposits per employee/banking unit are measured as the ratio between total banking sector loans (deposits) and total number of employees/banking units.

The ratio between the number of citizens[12] and the number of banking units and/or number of employees is calculated to capture the "bankarisation" degree in Kosovo. The schedule Balance Sheet (Statistical Bank Report) is the source for data on the amount of assets, loans, and deposits whereas Banking Supervision Directorate is the source of data on the number of banking units and the number of employees.

Figure 5. Commercial banks Herfindahl-Hirschman Index (HHI)

The concentration of assets, loans and deposits for the each bank is calculated using the formula of HHI. This formula is calculated as follows:

$$HHI = \sum_{i=1}^{7} \left(\frac{Assets_i \ (deposits_i, loans_i)}{Total\ banking\ sector\ assets\ (deposits, loans)} \cdot 100 \right)^2$$

Where i represents the number of banks. The HHI is calculated by squaring the market shares of each bank and then summing the results. Schedule BS is the source for the data on the amounts of assets, deposits, and loans.

Figure 6. The Share of Group I banks in total assets, loans, and deposits

The criterion of banks ownership was used for grouping the banks. Accordingly, the share of the Group I banks assets to total assets was calculated as a ratio between the sum of assets of Group I banks to the total banking sector assets (consolidated figure). The same was applied for calculating the share of the the Group I banks to total deposits and total loans. The schedule BS is the source of data on the assets, deposits and loans (Statistical Bank Report, CBAK).

Table 3. Structure of commercial banks assets

The table presents each item (category) of assets in volume and their share in total assets for the particular period. In addition, the share of each item in the total assets is calculated, and when comparing the periods it shows the change in their share to total assets. Schedule BS is the source for the data on the amount of assets for the banking sector in Kosovo.

[12] The data for the number of citizens is taken from the IMF staff estimates.

Figure 7. Banking sector loans by sector

The sectoral diversification of the loan exposure is presented by the type of beneficiaries such as non-financial corporations and households. First, the share of loans for each category in total banking sector loans is calculated and presented by bars in the figure. Then, total loans for each sector are added up and presented with a line which corresponds to the right axis of the figure. The schedule BS/LBM is the source of loans by institutional sectors.

Figure 8. Banking sector loans by industry

The table shows the industrial diversification of loan exposure during the course of 2004 and Jun 2005. Total loans extended by industrial sector of each bank are added up and then the share of loans extended to each industry in total loans extended is calculated for each year. Schedule BS/LBI (Loans By Industry) is the source of data for the amounts of loans extended.

Figure 9. Banking sector loans by maturity

The maturity structure of loans is reported for the period 2001-Jun 2005 for the total banking sector in Kosovo. Loans are split up by their maturity and presented by bars which represents their shares in total loans, whereas the line corresponds to the total banking sector loans presented in volume. Schedule BS/LBM (Loans by Maturity) is the source of data for the maturity structure of loans.

Table 5. The structure of commercial banks liabilities

The calculation of commercial banking sector liabilities is made in the same manner as the calculation of assets. First, each category of the liability side of balance sheet is stated in volume. Second, for each category of balance sheet the share in balance sheet total is stated in the second column of the corresponding year. Finally, the change in balance sheet categories indicates their percentage change relative to their balance recorded in the preceding year. Schedule BS is the source of data on the amount of the liability side of total banking sector balance sheet.

Figure 12. Deposits by sector

The distribution of deposits is presented with charts for the three periods, on the semiannual basis. The deposits of each sector for each bank are added up and thus calculated as a share in total deposits in commercial banks.

Table 7. Commercial banks income statement

Each category of the income statement is summed up for the total banking sector. Additionally the change in the income statement is the percentage change for the each item in comparison to the statement recorded in the preceding year. Schedule IS (Income Statement) banking supervision department is the source of the data on the amounts of income statement items for the banks.

Figure 15. Structure of Income

The figure plots the structure of the particular component of income for the total banking sector. It shows the amounts for the total income represented by the line and corresponds to the right axis and the share of each component of the income structure to the total income presented by bars. The Schedule IS the source of data on the banks' income.

Figure 16. Structure of expenditures

Same as in the previous figure, the structure of expenditures for the total banking sector is plotted, with interest expenditures, non interest expenditures, and the general and administrative expenses presented by bars. The bars in the figure show the share of each expenditure component while the line presents total expenditures stated in volume. Schedule IS is the source of data on the expenses of banking sector.

Figure 17. Return indicators

Return On Average Assets (ROAA)

The ratio between the after-tax profit and the average assets is calculated for each group of banks as follows. First, the after tax profit for each bank recorded for the particular period is added up for all banks in the group of banks. Than the banks' assets are added up for each group. Then the amounts thus calculated are divided and multiplied by 100. The same applies for the total banking sector. The total average assets are calculated as the average of the monthly total banking assets for the particular year. Schedule IS is the source of data for the profit after tax whereas BS is the source for the amount of assets for the banking sector.

Return On Average Equity (ROAE)

The ratio between after tax profit and average equity for each group of banks is calculated as follows. First, the after tax profit for the particular period is added up for each defined group of banks. Then the average equity is calculated and added up for each group. The summed amounts are thus divided and multiplied by 100.

The average equity is calculated as the average of the monthly total banking equity for the particular year. Schedule IS is the source for data on the banks' profits and schedule BS is the source for data on equity.

Figure 19. Liquidity indicators

Each bank ratio between liquid assets and total assets is calculated as follows. First, liquid assets of each bank are added up in the banks group. Second Total assets for each bank group are added up. The sum of liquid assets of each bank group and total assets of each banks group are expressed as a ratio and thus multiplied by 100.

Liquid assets are calculated as the sum of the cash, balances with CBAK, accounts with other banks, placements abroad and security investments. Schedule BS is the source for data on liquid assets and for total assets for each bank and thus bank group.

<u>Loan to deposit ratio</u>

The ratio between loans granted and customer deposits received is calculated as follows. First, total loans granted by each bank are added up for the particular group and for the particular period. Second, the customer deposits received for each bank in the bank group are added up for the specific period. The totals then are expressed as a ratio and multiplied by 100. The ratio for the total banking sector is calculated in the same manner. Schedule BS/LBM is the source for the data on loans granted whereas schedule BS/DBM is the source for the data on deposits.

Table 8. Insurance companies number, asset size and ownership

The table on insurance companies assets illustrates the comparison between categories of the companies based on the size of the number, asset size and ownership. Apart from that, there is distinction regarding the ownership criteria. Thresholds used are based on functional approach. The source of data is balance sheet of insurance companies reported to the insurance companies supervision department of the CBAK.

Figure 29. Lending activity of other financial intermediaries

As stated, except commercial banks, also other financial intermediaries, known as micro financial institutions, are lending to the domestic economy, mainly to the households. Using the data from banking supervision department, in the figure 26 is presented the outstanding amount of their loans to the domestic economy, and the share of their lending to total loans extended from financial sector.

6. LIST OF FINANCIAL CORPORATIONS IN KOSOVO[13]

[13] Ordering of financial corporations within a sub-sector is made based on the date of establishment;

Commercial banks

(As of June 2006)

PROCREDIT BANK

Address: Skenderbeu Street, Pristina

Phone: ++381 38/ 240 248

Fax: ++38138/ 248 777

E-mail: info@procreditbank-kos.com

Website: www.procreditbank-kos.com

Balance Sheet

(Outstanding amounts, end of period, in thousands of EUR)

Assets	Amount
Cash on hand and balances with BPK	49,304
Securities	81,233
Deposits and placements with commercial banks	49,151
Net loans to non-financial institutions	213,259
Fixed assets	10,052
Other assets	6,152
TOTAL ASSETS	**409,151**

Liabilities	Amount
Balances from other banks	7,152
Costumer deposits	367,371
Borrowings	...
Other liabilities	13,551
Total liabilities	388,074
Equity	21,076
TOTAL LIABILITIES	**409,151**

NEW BANK OF KOSOVO

Address: Mother Teresa No. 54, Pristina

Phone: ++381 38/223 976

Fax: ++381 38/225 871

E-mail: brk-bank@brk-bank.com

Website: www.brk-bank.com

Balance Sheet

(Outstanding amounts, end of period, in thousands of EUR)

Assets	Amount	Liabilities	Amount
Cash on hand and balances with BPK	10,406	Costumer deposits	49,643
Deposits and placements with commercial banks	20,301	Borrowings	450
Net loans to non-financial institutions	27,528	Other liabilities	1,417
Fixed assets	531	Total liabilities	51,510
Other assets	378	Equity	7,634
TOTAL ASSETS	**59,144**	**TOTAL LIABILITIES**	**59,144**

BANK FOR BUSINESS

Address: UÇK Street, no.41, Pristina
Phone: ++381 38/ 244 666
Fax: ++38138/ 243 656, 243 657
E-Mail: hq@bpb-bank.com
Website: www.bpb-bank.com

Balance Sheet

(Outstanding amounts, end of period, in thousands of EUR)

Assets	Amount
Cash on hand and balances with BPK	10,196
Deposits and placements with commercial banks	10,795
Net loans to non-financial institutions	21,037
Fixed assets	1,810
Other assets	1,251
TOTAL ASSETS	**45,089**

Liabilities	Amount
Costumer deposits	38,173
Borrowings	81
Other liabilities	516
Total liabilities	38,770
Equity	6,319
TOTAL LIABILITIES	**45,089**

ECONOMIC BANK

Address: UCK Street No. 5, Pristina
Phone: ++381 38/248 997
Fax: ++381 38/229 253
E-mail: -
Website: www.bankaekonomike.com

Balance Sheet

(Outstanding amounts, end of period, in thousands of EUR)

Assets	Amount
Cash on hand and balances with BPK	8,578
Deposits and placements with commercial banks	12,808
Net loans to non-financial institutions	21,708
Fixed assets	1,708
Other assets	343
TOTAL ASSETS	**45,145**

Liabilities	Amount
Costumer deposits	38,269
Borrowings	...
Other liabilities	584
Total liabilities	38,853
Equity	6,292
TOTAL LIABILITIES	**45,145**

RAIFFEISEN BANK OF KOSOVO

Address: UÇK Street 51, Pristina

Phone: ++381 38/ 226 400, 401

Fax: ++38138/ 226 408

E-mail: info@raiffeisen-kosovo.com

Website: www.raiffeisen-kosovo.com

Balance Sheet

(Outstanding amounts, end of period, in thousands of EUR)

Assets	Amount
Cash on hand and balances with BPK	33,009
Deposits and placements with commercial banks	67,116
Net loans to non-financial institutions	211,362
Fixed assets	3,550
Other assets	2,986
TOTAL ASSETS	**318,023**

Liabilities	Amount
Balances from other banks	16,722
Costumer deposits	256,491
Other liabilities	6,174
Total liabilities	279,836
Equity	38,187
TOTAL LIABILITIES	**318,023**

KASABANK

Address:	Rexhep Luci No. 5, Pristina
Phone:	++381 38/246 180
Fax:	++ 381 38/543 699
E-Mail:	-
Internet:	www.kasabank.com

Balance Sheet

(Outstanding amounts, end of period, in thousands of EUR)

Assets	Amount
Cash on hand and balances with BPK	18,226
Deposits and placements with commercial banks	23,061
Net loans to non-financial institutions	72,324
Fixed assets	4,442
Other assets	1,184
TOTAL ASSETS	**119,237**

Liabilities	Amount
Balances from other banks	4,005
Costumer deposits	94,954
Borrowings	5,019
Other liabilities	2,066
Total liabilities	106,044
Equity	13,193
TOTAL LIABILITIES	**119,237**

Insurance Companies

DARDANIA
Pristina
Mother Teresa str.

DUKAGJINI
Pristina
Bulevardi i Dëshmorëve str.

KOSOVA E RE
Pristina
Fazli Graiqevci str. No.5

SIGURIA
Pristina
Qamil Hoxha str No.15

INSIG - Tirana
Branch “INSIG”
Pristina
Pejton str. No.4

SIGAL - Tirana
Branch “Sigal - Drini”
Prizren
Vellusha e Poshtme str. No.16

SIGMA - Tirana
Branch "SIGMA"
Pristina
Pashko Vasa str.

CROATIA OSIG.
Pristina
Str.Fehmi Agani, str. No 69, D/1-2

SIGKOS[14]
n/a

[14] Recently established.

Pension funds

KEK
Pristina
Nena Tereza str. No.36

PTK[15]
Pristina
Dardania str.

CBAK
Pristina
Garibaldi str. No.33

PCB
Pristina
Skenderbeu str.

KOSOVA
Pristina
Nena Terezë str

Other financial intermediaries

ABU APMP
Pristina
Bedri Shala str, 38C

FINCA Kosovo
Prizren
Rrasat e Kosharës str No.

KEP Kosovo
Pristina
Bedri Pejani str. No.4

Beslidhja
Pristina
Lidhja e Prizrenit str. No.15

Agency for Finance in Kosovo
Pejë
M.Popoviq str. No.150/3 67/A

BALKANACTIE
Shtime
Tirana str.

START
Drenas
Rasim Kiqina str. No. 5

Kosovo Grameen – Missione Arcobaleno Microcredit Fund
Pejë
Marshal Tito str. No.122

CORDAID
Gjakovë
Nena Terezë str.

MFI – Qelim Kosovo
Gjakovë
UCK str. No 5.

KosInvest /World Vision
Podujevë
"Qyteza Pejton" 2A-2, Prishtinë

KREDITIMI RURAL I KOSOVES
Pristina
Procredit Bank Building 3rd Floor

PERSPEKTIVA 4
Klinë
Lidhja Mahalla str.

MESHTEKNA
Dragash

Komiteti i Botes Islame
Podujevë
Skënderbeu no.266

Financial auxiliaries

ProCredit Bank Western Union
Pristina
Skenderbeu str.

Unioni Financiar Prishtina
Pristina
Pejton, Perandori Justinian str. No.1E

ABD
Pristina
19 Nentori str. No.8

Euro-Cufa
Pristina
Vushtrria str. No.43

NBS
Pristina
Marevci str. No.45

AGIMI
Ferizaj
Zenel Hajdini str.

GIPA
Pristina
Vushtrria str, No 2

XENI
Ferizaj
Dëshmorët e Kombit str.

INDRITI
Pejë
Eliot Engel str.

AGONI
Ferizaj
Dëshmorët e Kombit str.

XIMI
Ferizaj
Dëshmorët e Kombit str.