

## Analytical review on activities of the banking system for the 1st quarter of 2012

### 1. About the condition and development of the banking system.

#### 1.1. Basic indicators of credit institutions

Table 1

#### Indicators of the activities of credit institutions for the 1st quarter of 2012

(thousand rbl)

Indicators	as at 01.01.2012	as at 01.04.2012	GROWTH RATE,%
Number of operating credit institutions	15	15	100,0
including:			
Clearing nonbank credit organizations (CNCO)	2	2	100,0
Equity capital*	557 192	556 053	99,8
including:			
- Authorized capital	536 854	527 249	98,2
Currency of the summary balance sheet	6 757 228	7 318 407	108,3
Loan arrears and other arrears equated to them **	3 014 474	3 291 864	109,2
- share of total (assets), %	44,6	45,0	100,9
- prolonged loans	524 041	575 660	109,9
- share of total (credit exposure), %	17,4	17,5	100,6
- credit arrears	521 105	604 240	116,0
- share of total (credit exposure), %	17,3	18,4	106,4
Loan loss provisions	627 118	680 107	108,4
Deposits ( private individuals)	511 880	514 483	100,5
- share of total (russian rubles), %	83	83,5	100,6
- share of total (foreign currency), %	17	16,5	97,1
Deposits (legal entities)	43 180	3 184	7,4
	for 1 <sup>st</sup> quar- ter of 2011	for 1 <sup>st</sup> quar- ter of 2012	
Financial results	- 20 640	- 54 844	265,7
a) profit***	26 900	10 447	38,8
Number of profitable credit institutions	10	6	60,0
b) loss	47 540	65 291	137,3
Number of unprofitable credit institutions	5	8	160,0

\*) the sum of equity capital is shown taking into account the updated corrections in the procedure of calculation; according to statutory acts of the Bank of Abkhazia.

\*\*) taking into account guarantees and interbank deposits

\*\*\*) the profit sum is shown without consideration of corrections for losses.

According to the data displayed in Table 1, there were some changes in the activities of credit institutions in the first quarter of 2012, in comparison with indicators at the beginning

of the year. So, as at April 1st, 2012 there was an insignificant decrease in the total amount of equity capital of credit institutions of 1,139 thousand rbl., and also an authorised capital of 9,605 thousand rbl.

The currency of the summary balance sheet as a whole of credit institutions has increased by 8.3% or 561.2 million rbl., and the sum of credit investments has increased by 277.4 million rbl., achieving a growth rate of 109.2%.

The financial results as a whole for credit institutions have proved to be negative by the sum of 54.8 million rbl., which exceeds the loss in the first quarter of 2011 by a factor of 2.7. Among 15 credit institutions a loss has been made by 8 institutions.

The unfavourable situation regarding repayment of credits, observed at the beginning of the year, continues to worsen. The sum of prolonged loans has increased by 51.6 million rbl., and credit arrears have increased by 83.1 million rbl., so their fractions of the sum of credit investments have increased by 0.1 and 1.1 percentage points accordingly. Also there was an increase in the sum of loan loss provisions, in comparison with the beginning of the year, of 8.4%.

## 1.2. The structure of credit investments in borrowers and the categories of quality of the loan arrears accrued by them.

1.2.1. The presence of arrears for the extended credits in a list of borrowers is shown in Table 2.

Table 2

### Condition of credit investments by the credit institutions in borrowers without guarantees or interbank deposits

(thousand rbl)

№ SN	Borrowers	as at January 1, 2012		as at April 1. 2012		Growth rate (%)
		sum	share of total (%)	sum	share of total (%)	
1.	Government enterprises	70 377	2,3	113 470	3,4	161,2
	<i>of which:</i>					
	arrears	9 951	0,3	10 481	0,3	105,3
2.	Non-governmental economy (legal entities)	1 677 642	55,7	1 923 383	58,5	114,6
	<i>of which:</i>					
	arrears	202 217	6,7	258 665	7,9	127,9
3.	Credit institutions	15 098	0,5	22 098	0,7	146,4
	<i>of which:</i>					
	Arrears	208	0,00	15 098	0,4	7258,7
	<b>Total: legal entities</b>	<b>1 763 117</b>	<b>58,5</b>	<b>2 058 951</b>	<b>62,6</b>	<b>116,8</b>
	<i>of which:</i>					
	arrears	212 376	7,0	284 244	8,6	133,8
4.	Private entrepreneurs	178 605	5,9	196 938	6,0	110,3
	<i>of which:</i>					
	arrears	6 820	0,3	5 426	0,2	79,6
5.	Private individuals	1 069 878	35,6	1 033 319	31,4	96,6

№ SN	Borrowers	as at January 1, 2012		as at April 1. 2012		Growth rate (%)
		sum	share of total (%)	sum	share of total (%)	
	<i>of which:</i>					
	arrears	301 909	10,0	314 570	9,6	104,2
	<b>Total:</b>	<b>3 011 600</b>	<b>100,0</b>	<b>3 289 208</b>	<b>100,0</b>	<b>109,2</b>
	<i>of which:</i>					
	arrears	521 105	17,3	604 240	18,4	116,0

Table 2 data testify to the growth of credit investments in the republic's economy. For the 1st quarter of 2012 a high rate of increase is observed for credit investments in the government enterprises, in which the increase has been 61.2%.

In the non-governmental economy, credit investments have increased by 14.6% or 245.7 million rbl., and arrears in this given sector have increased by 8.7%.

The credits which have been extended to individual entrepreneurs have increased by 10.3% and have reached the sum of 197 million rbl, and as at April 1st, 2012 loan arrears have decreased by 20.4% in comparison with the beginning of the year.

A decrease in the arrears of private individuals of 3.4% is observed, also, the loan arrears have increased by 4.2%.

Interbank credit arrears have essentially increased by a factor of 72.6, which is connected with an increase in the arrears registered for the commercial bank "Invest-Bank".

### 1.2.2. Data on the categories of quality of the extended credits.

Table 3

#### Quality of the credit portfolio of credit institutions with consideration of arrears on guarantees and interbank deposits

INDICATOR	As at January 1, 2012		As at April 1, 2012		Growth rate, %
	Sum (thousand rbl)	Share of total (%)	Sum (thousand rbl)	Share of total (%)	
<b>Standard loans</b>	1 595 314	52,9	1 787 596	54,3	112,1
<b>Non-standard loans</b>	604 768	20,1	627 965	19,1	103,8
<b>Doubtful loans</b>	215 869	7,2	248 725	7,6	115,2
<b>Non-performing loans</b>	71 152	2,4	51 739	1,6	72,7
<b>Uncollectible loans</b>	527 371	17,4	575 839	17,4	109,2
<b>Total:</b>	<b>3 014 474</b>	<b>100,0</b>	<b>3 291 864</b>	<b>100,0</b>	<b>109,2</b>

According to the data as at April 1, 2012 on form 115-A about the quality of loans, loan arrears and other arrears equated to them, shown in Table 3, the quality of credit portfolios of credit institutions has worsened. The growth rate of depreciated loans as at April 1, 2012, in comparison with the beginning of the year, reached 106%, although their share in the credit portfolio decreased by 1.4 percentage points to 45.7%. The total sum of depreciated loans as

at April 1, 2012 reached 1,504.3 million rbl. This all leads to a growth of allowances for loan loss provisions and testifies to an inefficiency of active operations executed by the credit institutions which finally leads to unprofitable activity.

## **2. About the financial results of activities of the credit institutions**

The financial condition of the credit institutions directly depends upon received incomes and the expenses incurred.

According to the data as at April 1, 2012 on form f-102, in comparison with a similar date last year the increase in the sum of incomes is 19.3%. The basic component of incomes is interest yields, and their proportion in the general structure of incomes is 38.4%, which makes an increase of 0.4 percentage points. The growth rate of interest incomes exceeds the growth rate of credit investments for banks on the whole by 12.1 percentage points.

The most considerable expenses in the general structure of expenses of the credit institutions are the expenses connected with the creation of required reserves, with their proportion being 52.5% of all expenses. In comparison with the similar period of last year the given item of expenses has increased by 70.6 %. Such growth is mainly connected with deterioration of the credit portfolio of credit institutions.

12.7% of expenses are due to the interest paid on debt credits.

The financial result as a whole according to form f-102 is negative, and the total excess of expenses over incomes has reached 54 845 thousand rbl.

Unprofitable activities of credit institutions are explained by the unsecured return of loans by borrowers and non-payment of interest by them which testifies to the absence of an accurate estimation of creditworthiness (trustworthiness) of borrowers in the course of granting them credit and, as a consequence, inefficient use of bank credit, growth of prolonged and delayed loans and non-payment of interest. This all leads to the depreciation of bank loans and a high growth of allowance for loan loss provisions, and testifies to inefficiency in the active operations. The pure interest margin for credit institutions as a whole, taking into account the risk as at April 1, 2012, gave a negative showing of 0.8%.

In the view of the considerable sum of credit investments in the Republic's economy - over 3.2 billion rbl., and with a considerable proportion of them being prolonged and delayed loans, it is necessary to take measures for securing the return of credits with borrowers in terms established by contracts. Also, it is necessary to raise the quality of studying the financial condition of potential borrowers (legal entities or private individuals) and, accordingly, to competently define their creditworthiness and not allow credit granting without correspondingly securing its return.

The financial result of the activities of a credit institution in many respects depends on the quality of condition of its credit portfolio, and consequently in order to make a decision on granting credit to a borrower his creditworthiness should be taken into consideration. In essence, according to the requirements of article 1 of the Law of the Republic of Abkhazia "On banks and banking", credit granting should be made subject to conditions of redemption, payment and promptness.

At the same time, the factors reflecting sums of the generated loan loss provisions testify to a tendency of their growth, and, hence, to the growth of the depreciated loans.

As at April 1, 2012, in comparison with the beginning of the year, the total sum of the reserves generated by the credit institutions increased by 8.5%, although for separate credit institutions the growth ranged from 10% to 93%. This increase occurred, according to data from f-102 for the 1st quarter of 2012, as a result of the considerable excess of sums remitted in loan loss provisions over the sums charged to restoration incomes from reserve accounts. Over credit institutions as a whole, this excess has increased by a factor of 2.2, but for some credit institutions this factor has been from 3 to 60.

This all testifies that for earlier allotted loans (as well as for newly allotted loans) the category of quality has decreased, which is in essence caused by an absence of the due analysis of the financial condition of borrowers and of their creditworthiness.

The National Bank suggests an enhancement of the responsibility of corresponding office workers of credit institutions who are engaged in drawing up a professional judgment on borrowers, taking into account conditions for the granting of credits, as defined by article 1 of the Law of the Republic of Abkhazia "On banks and banking" and corresponding statutory acts of the Bank of Abkhazia (in particular Regulations 12-P and 20-P, etc.).

In view of the fact that, according to banking legislation, the purpose of the activity of credit institution is profit-making, it is necessary to apply all possible measures for the recovery of borrowers' arrears in overdue loans and interest, and not to allow the prolongation of terms of credit payment without careful study of the reasons which have caused a delay in its return according to the terms defined in the credit contract. All of this will encourage a decrease in the sums which are registered to accounts of loan loss provisions, and, accordingly, to increase the income and profit of credit institutions.