



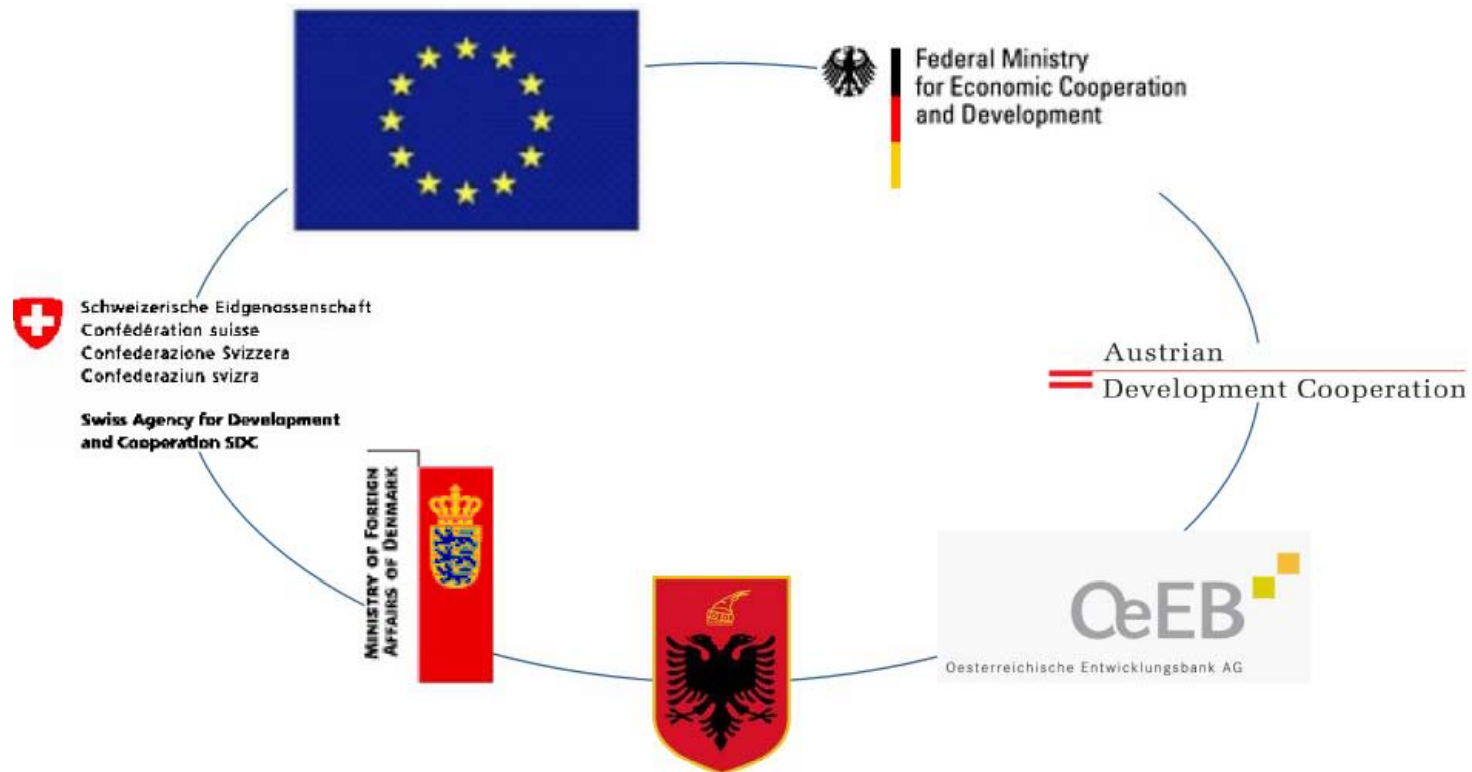
EUROPEAN FUND FOR SOUTHEAST EUROPE

ENHANCING CRISIS RESILIENCE OF FINANCIAL INSTITUTIONS AND ITS MANAGEMENT



Istanbul,
February 18, 2010

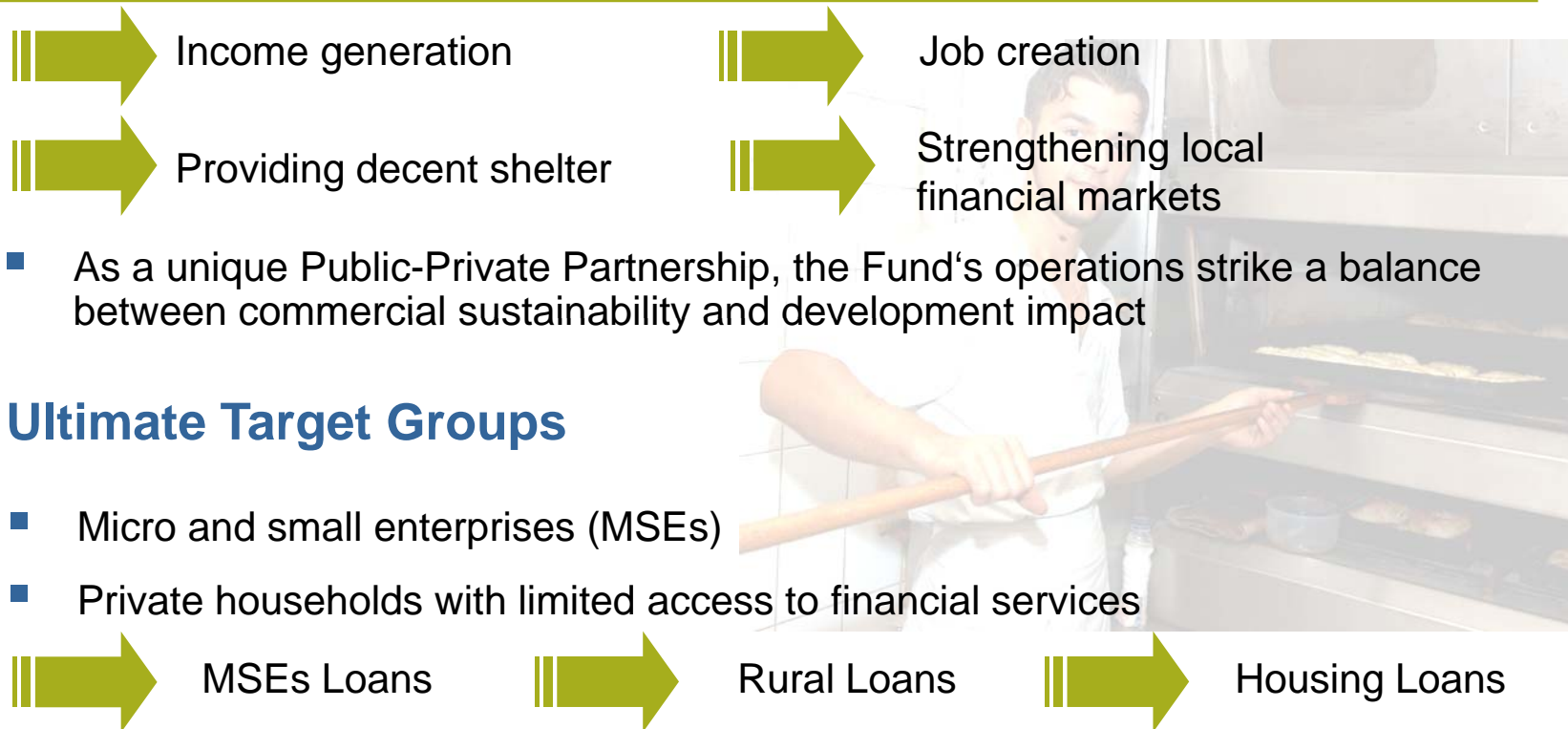
EFSE - A Development Finance Initiative supported by



Objectives, Products & Services

Mission

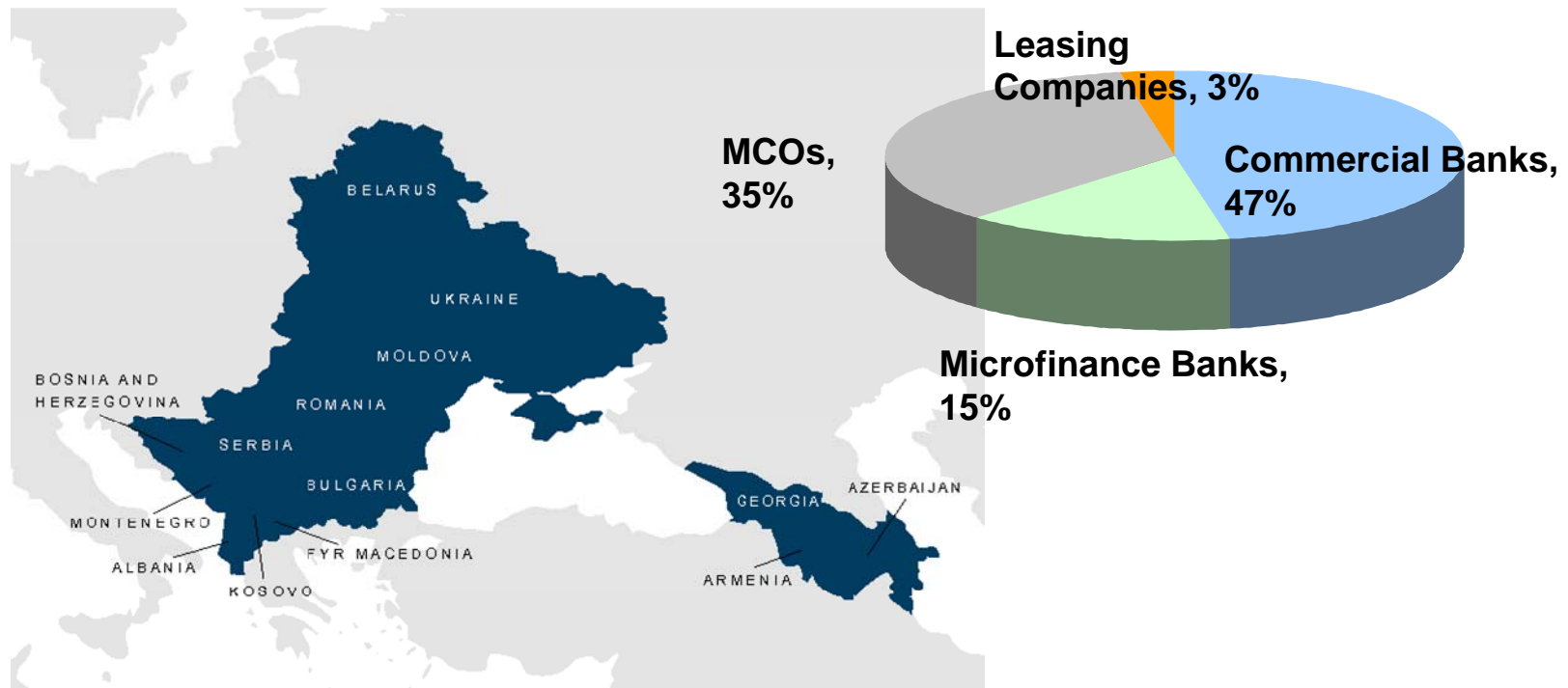
- EFSE aims to foster economic development and prosperity in the Southeast European region through the sustainable provision of additional development finance via qualified financial institutions.



Objectives, Products & Services

Financial Institution Universe

- EFSE offers long term funding to 57 qualified partner institutions (PLIs) in 10 markets
- Investment portfolio: EUR 579 million



Scope of the Presentation

Objective

Present the ability and limitations of Financial Institutions' management to identify and mitigate adverse impacts of the crisis in a region severely affected: Southeast Europe

Data Monitoring

- Quarterly PLI ratings/Special monitoring on monthly basis
 - Capital
 - Asset quality
 - Profitability and efficiency
 - Liquidity
 - Financial risks (FX, interest rate risk)
- Quarterly country reviews

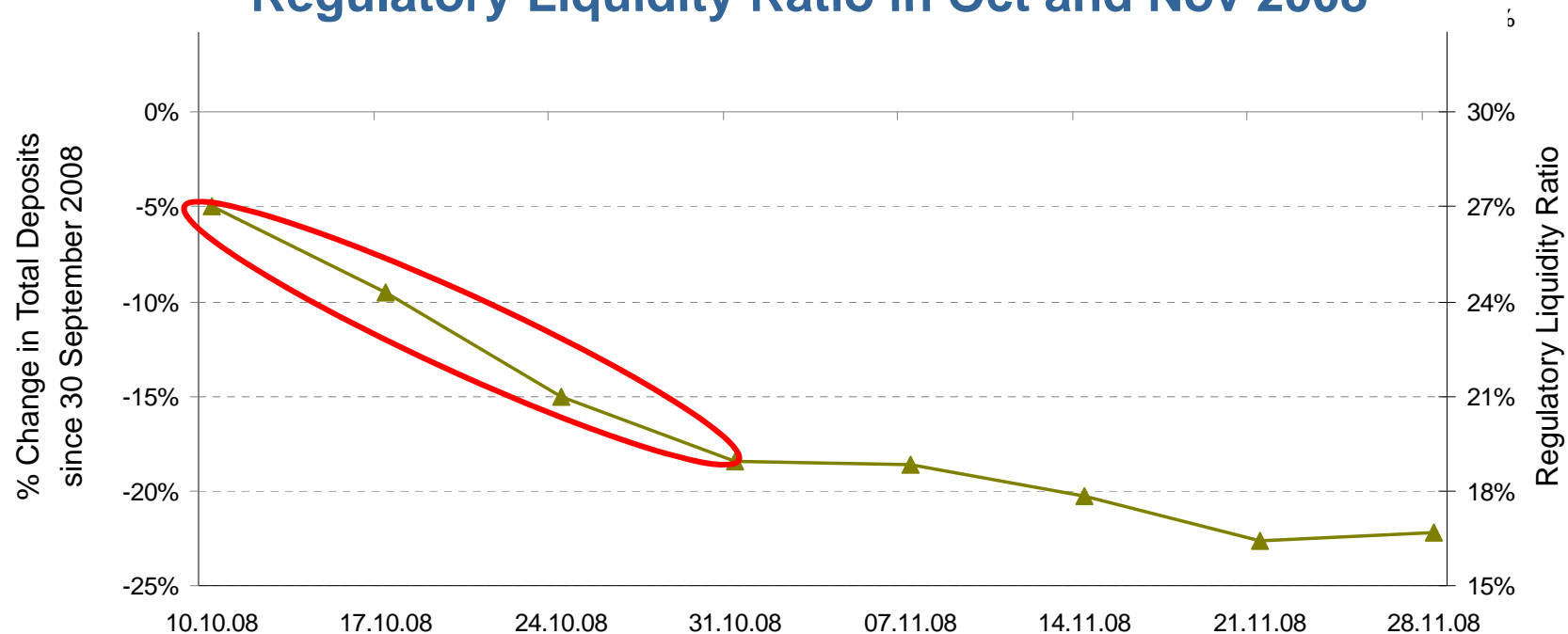
Outline Overview

- Managing Liquidity
- Asset Quality Management & Provisioning Policies
- Managing Maturity Mismatches
- Managing Open Currency Positions
- Managing Interest Rate & Repricing Risk
- Managing Profitability

MANAGING LIQUIDITY

Liquidity Crisis: Bank's Strategies in one selected County

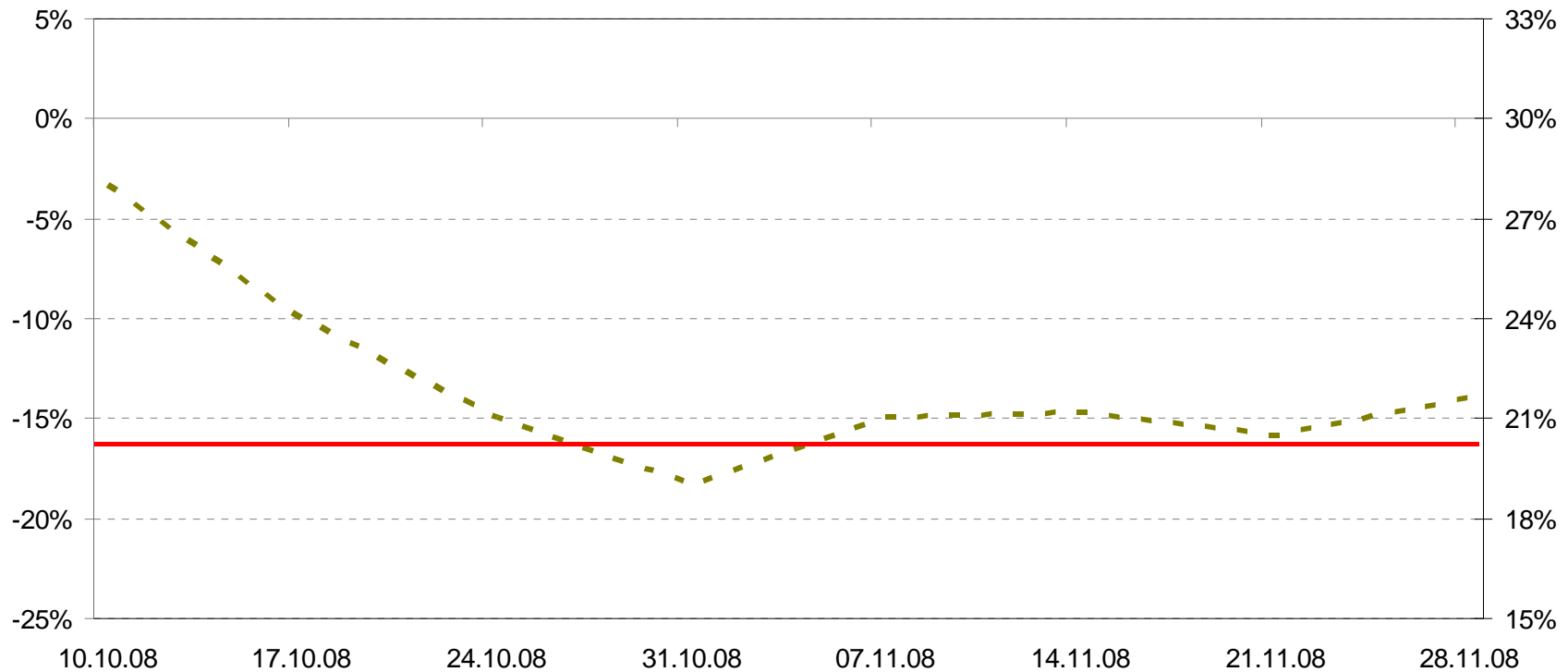
Regulatory Liquidity Ratio in Oct and Nov 2008



Source: EFSE PLIs

Liquidity Crisis: Bank's Strategies in one selected County

Regulatory Liquidity Ratio in Oct and Nov 2008

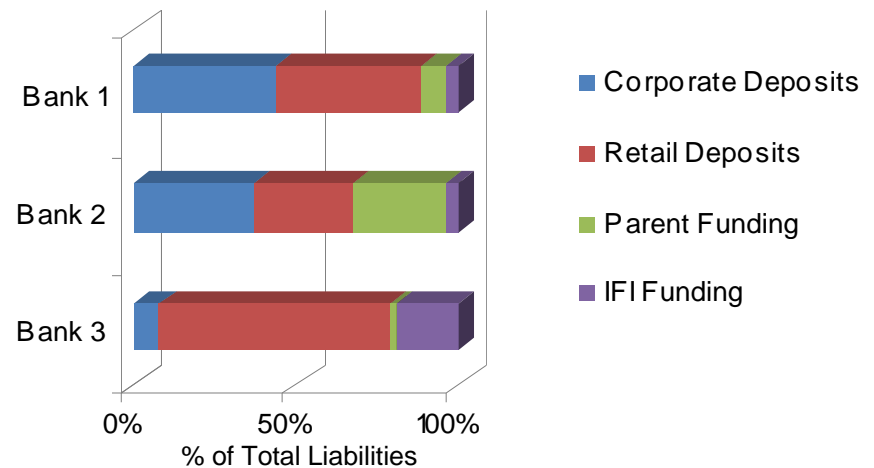


Source: EFSE PLIs

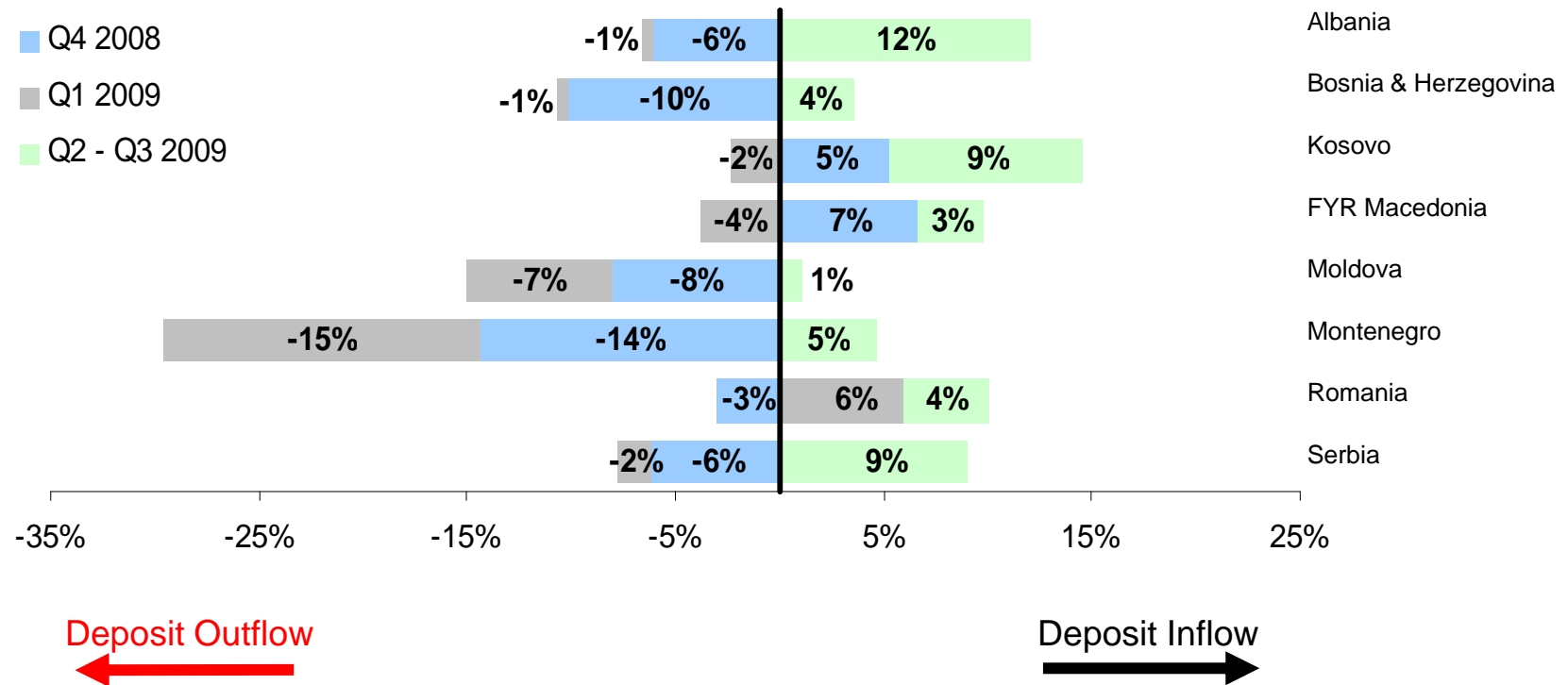
Liquidity Crisis: Managing Deposits

Take-Away 1 – Deposit Structure and active Management critical

- Corporate deposits show generally greater stability
- KYC particularly critical for retail deposits
- In times of crisis: continue paying out and get engaged in an active dialogue with clients



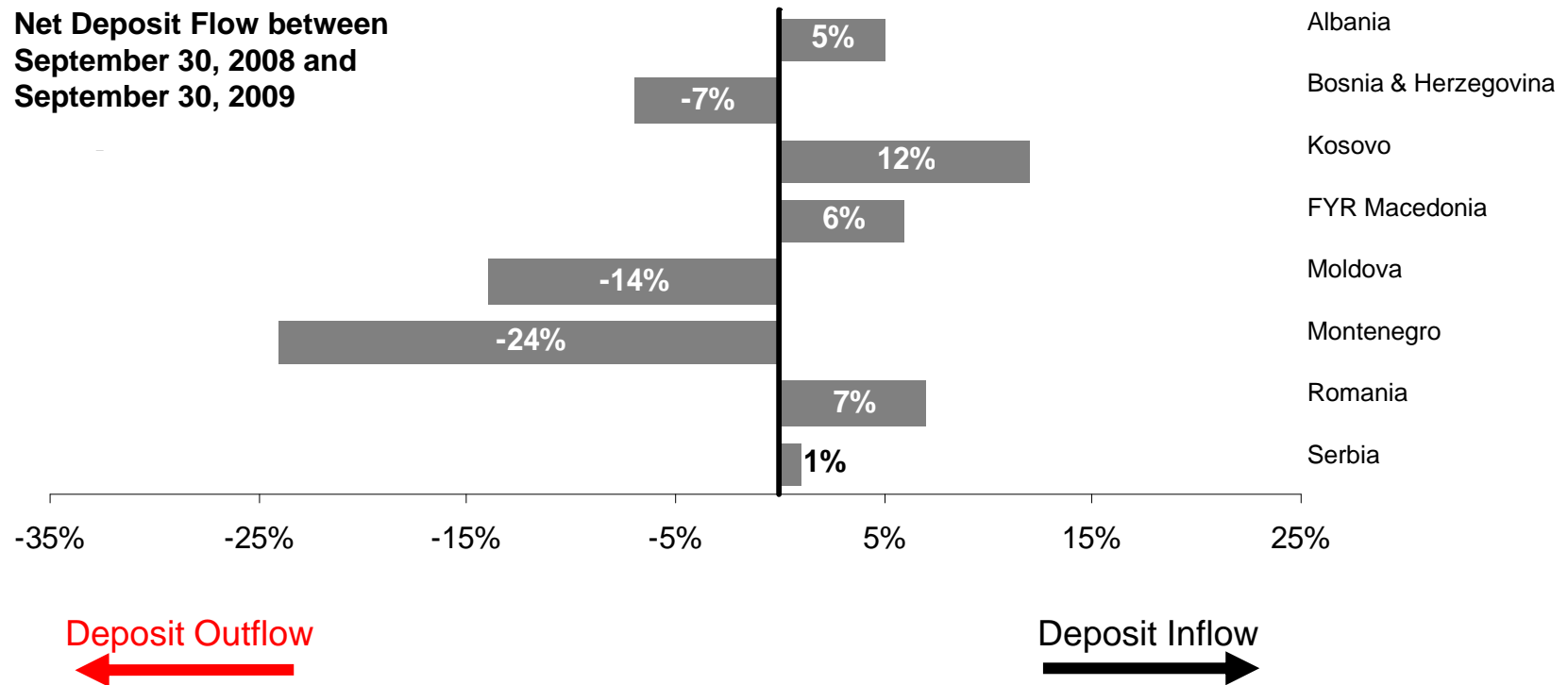
Outflow of Deposits: Q4 2008 – Q2 2009



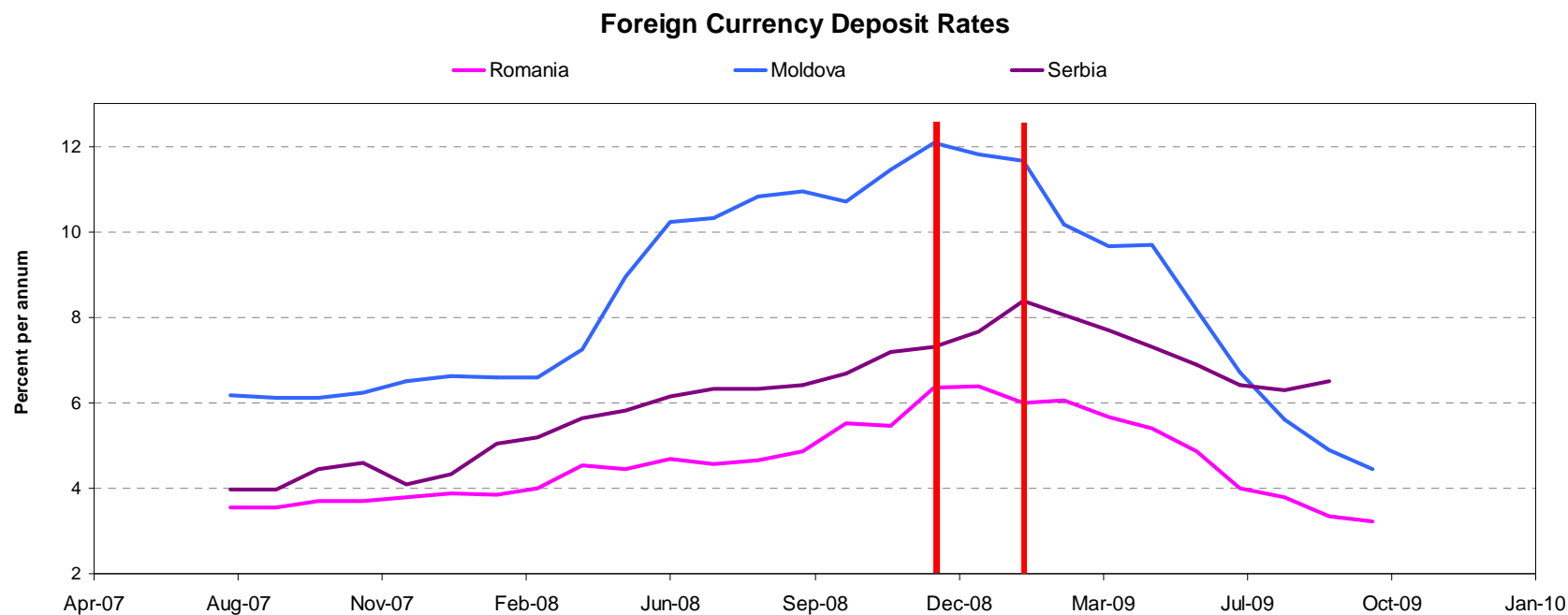
Source: EFSE PLIs

Outflow of Deposits: Q4 2008 – Q2 2009

Net Deposit Flow between
September 30, 2008 and
September 30, 2009



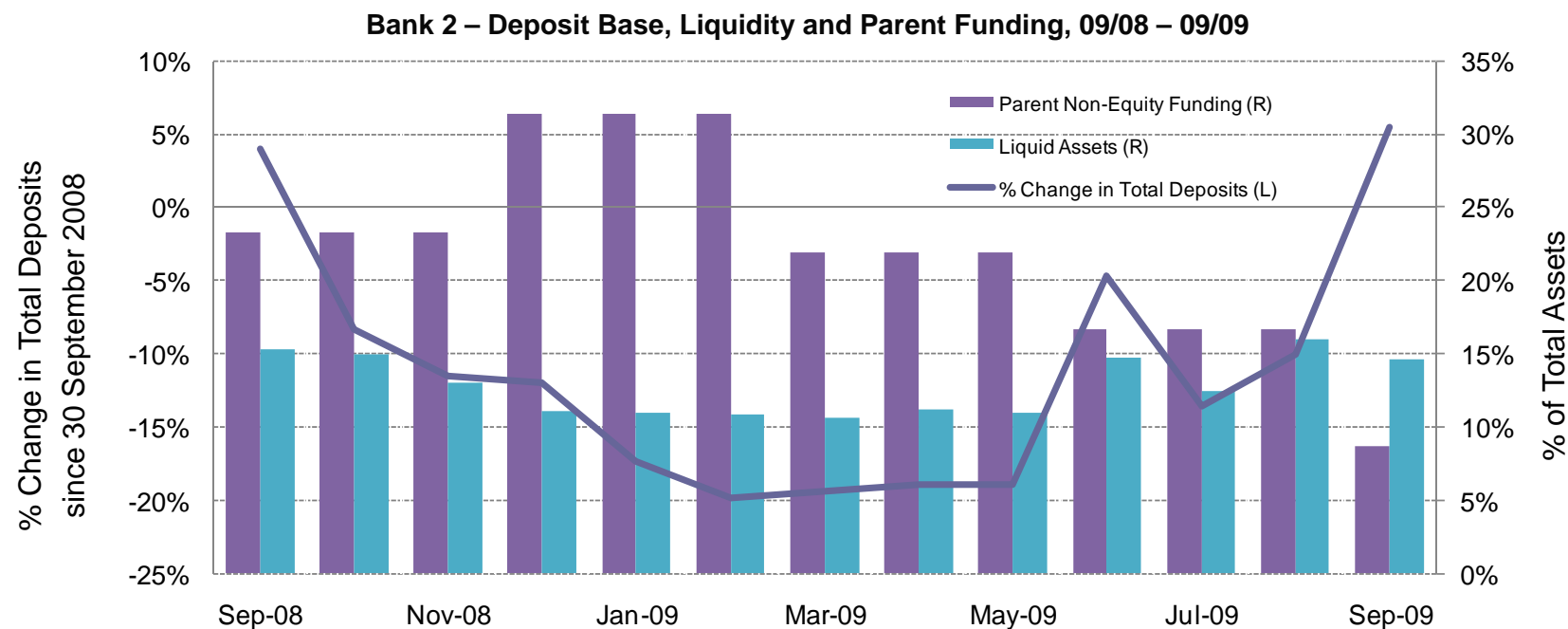
Deposit Rates Dynamics in the Region



Take-Away 2 – Restored Trust primary Driver for recovered Deposits

- Little to no correlation between deposit increase and deposit rates

Role of Parent Funding



Take-Away 3 – Parent Funding = Lender of Pre-last Resort

- Parent funding played a very important role to keep satisfactory liquidity levels: group liquidity management and own core liquidity
- Parent's own liquidity even more critical as group liquidity systems got impaired

Liquidity Management in MFIs

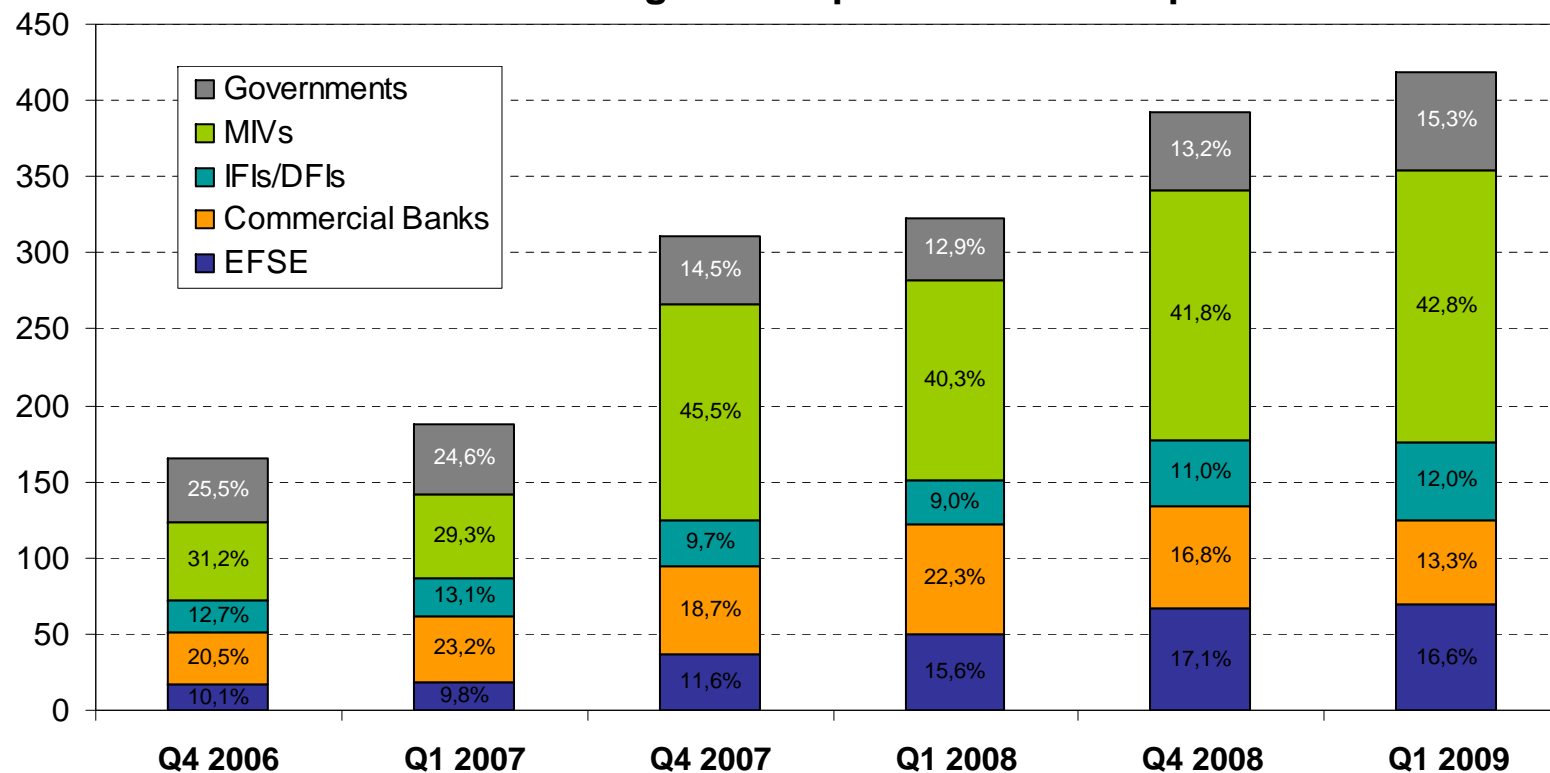
Take-Away 4 – More Luck than proper Liquidity Management

- Funding strategy for growth not for actively managing liquidity under stress
- Limited to no liquidity risk monitoring
- No liquidity contingency plan
- Limited to no funding made available from MFI networks
- Well performing MFIs had already locked in funding for Q4 2008 and Q1 2009 under the assumption of future growth
- While funding from local commercial banks collapsed, private individual Funds and IFIs stepped up to the plate

Bosnia and Herzegovina

Total Funding Volume Composition to MFIs

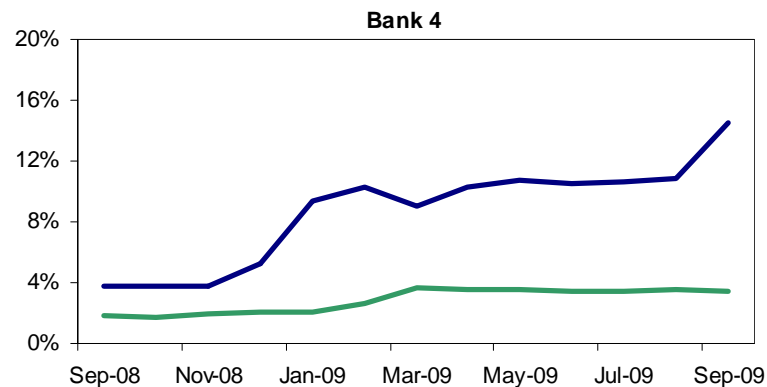
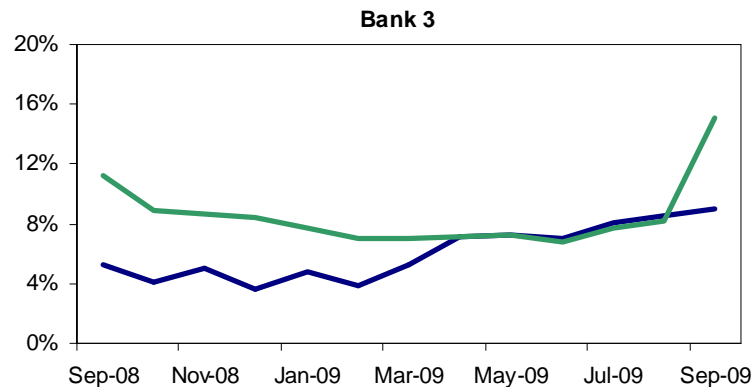
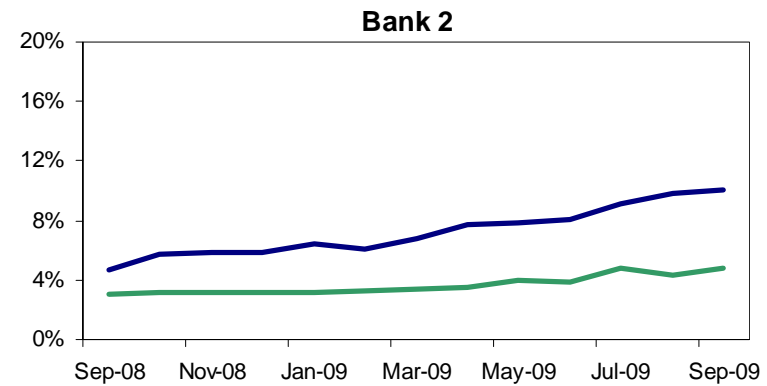
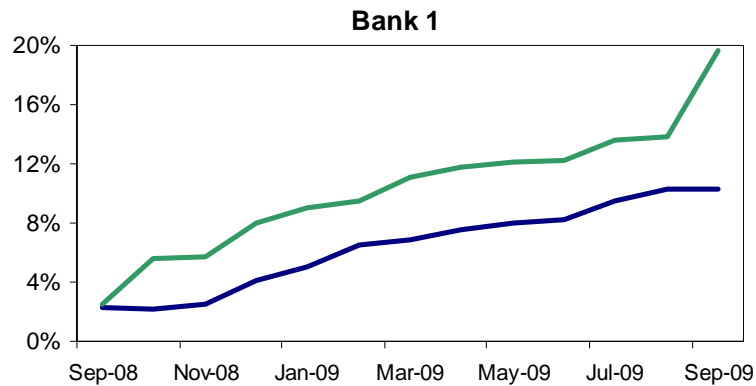
Total Funding Volume per Investor Group



Source: EFSE PLIs

ASSET QUALITY MANAGEMENT & PROVISIONING POLICIES

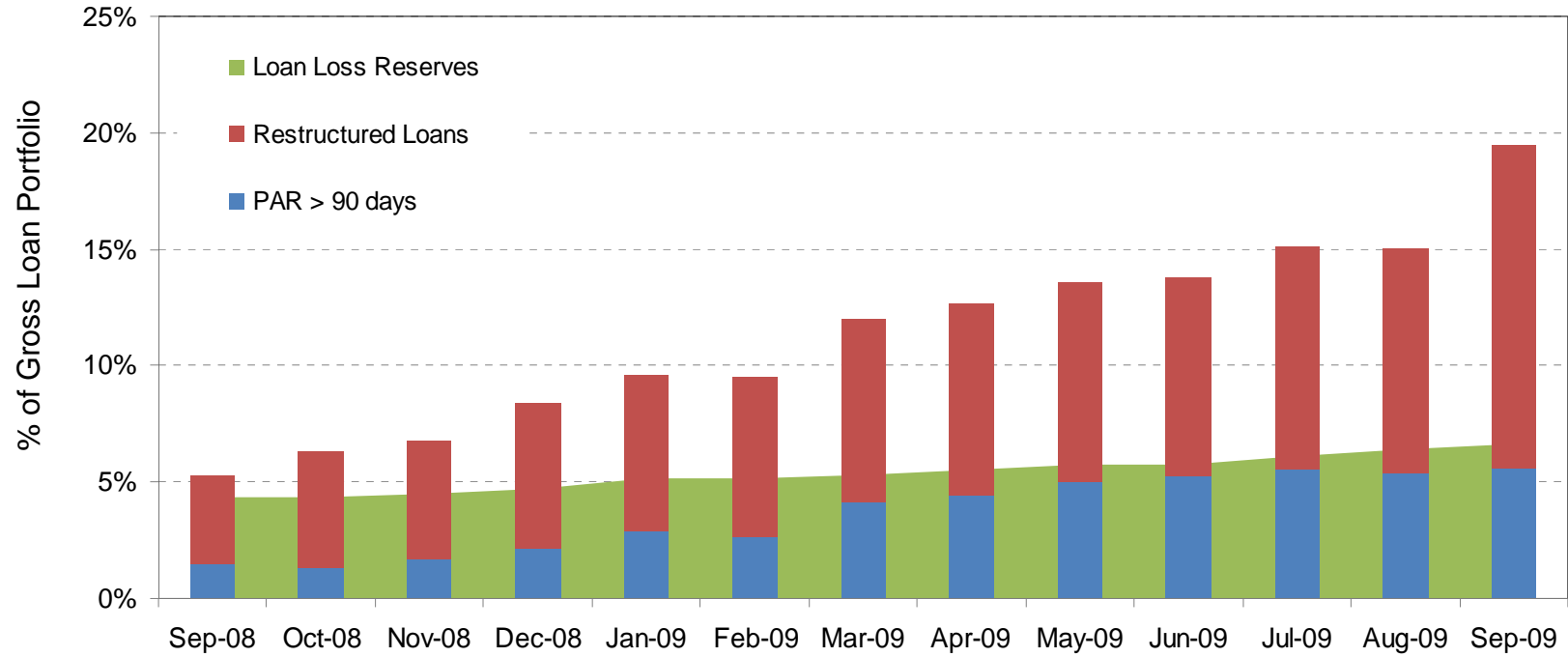
Different Strategies by individual Banks in one selected County in dealing with Asset Quality



— NPLs as % of Gross Loan Portfolio
— Restructured Loans as % of Gross Loan Portfolio

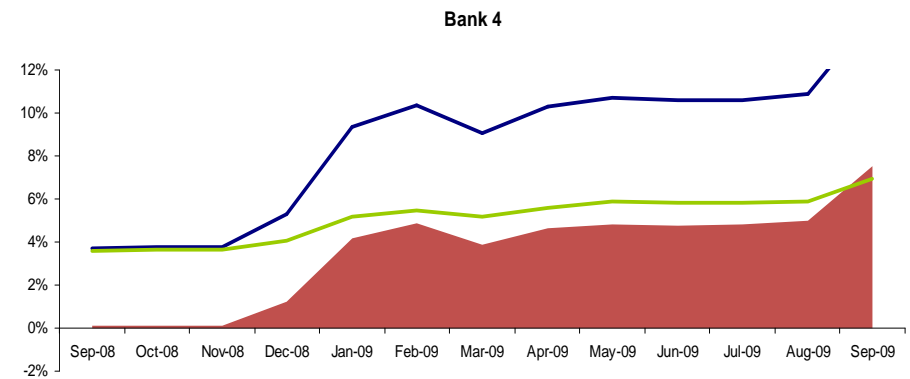
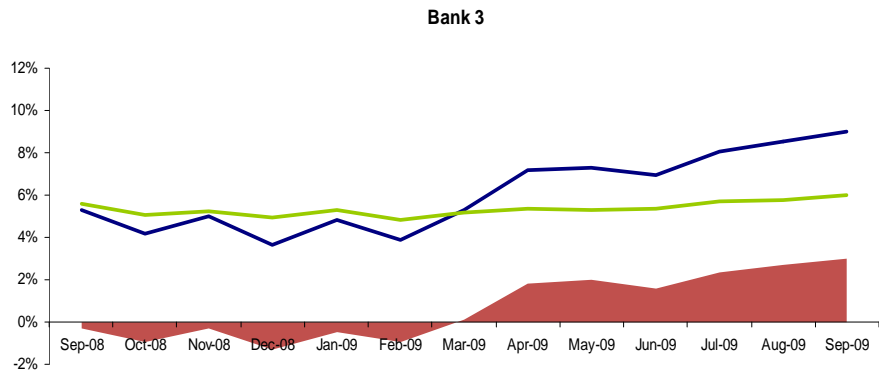
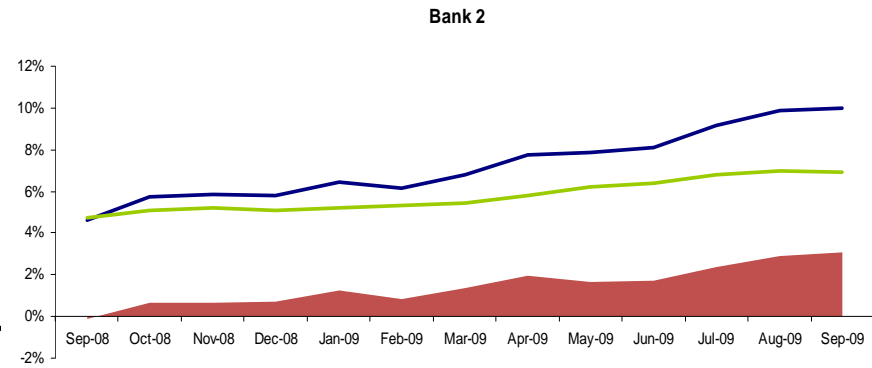
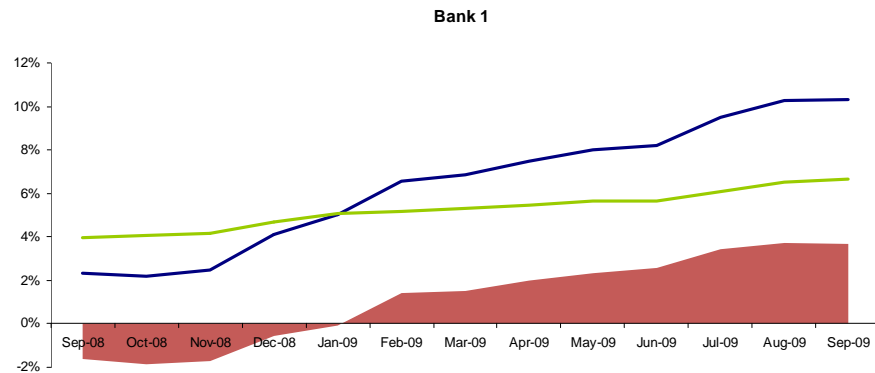
Source: EFSE PLIs

Loan Loss Reserves Coverage of Problem Loans



Source: EFSE PLIs

...varying Provisioning Policies



- Uncovered NPL Ratio/Provisioning Shortfall
- Total NPL Ratio
- LL Reserves as % of Gross Loans

Asset Quality Management Banks

Take-Away 5 – Credit Management for the bad Times ... some mixed Results

- Experienced credit managers and adequate systems in place
- Restructuring actively used as a commonly acceptable tool
- Collection and work-out divisions

However

- Rating tools and scoring tools not crisis-proven
- Loan classification system not properly reflecting probability to default and potential loss
- Often too lax provisioning

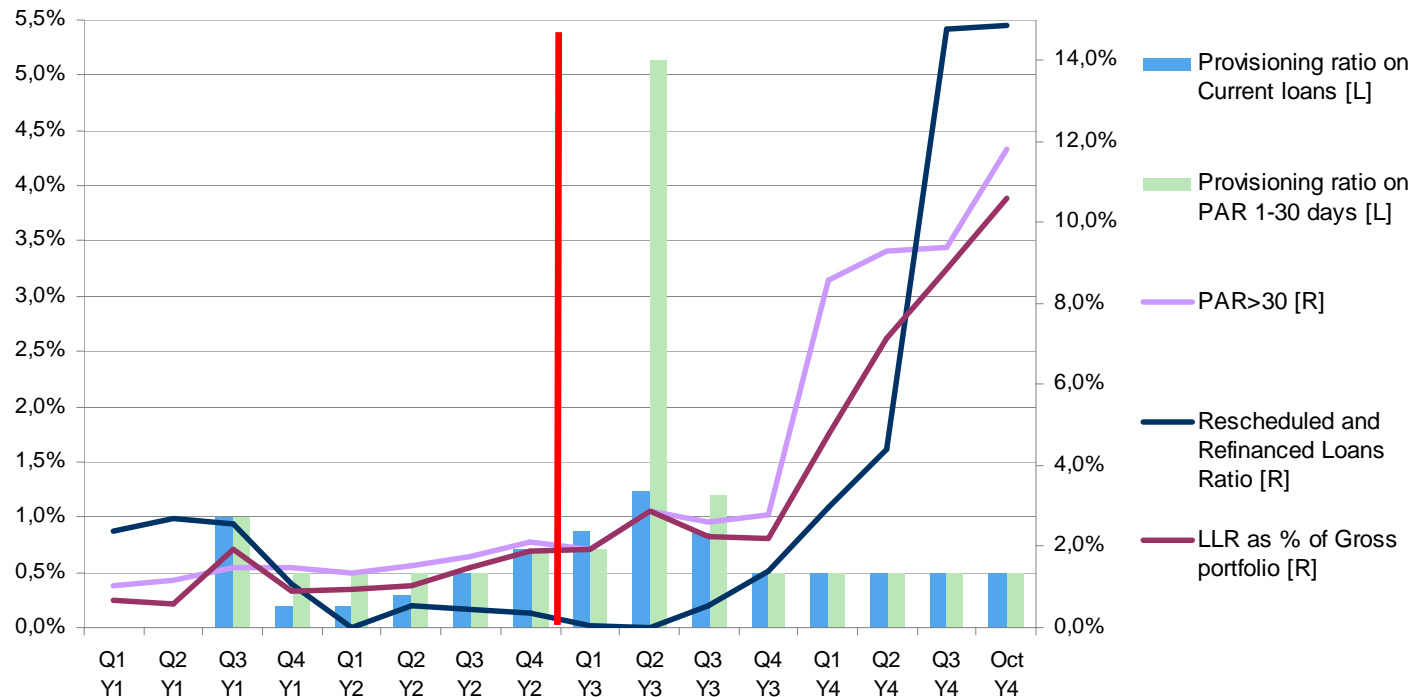
Asset Quality Management MFIs

Take-Away 6 – One-eyed Credit Management ... for good Times

- Thorough understanding of the credit risk basics
- MFIs in the region: bonanza manager generation
- Limited forward looking trend/stress analysis
- Restructuring sometimes still considered a „no go“
- Delinquency management/collection new feature
- Rapid historic growth cum decentralization cum economic crisis = fraud-conducive environment
- Strive for efficiency left little extra resources to cope with the crisis

An MFI Example: Managing Asset Quality & Provisioning

Asset Quality and Provisioning Policy



Take-Away 7 – Commercial Shareholders no Guarantee for sound Asset Quality Management

- Risk appetite, provisioning and capital levels do not always match
- Profit maximization vis-à-vis maximization of risk mitigation

MANAGING MATURITY MISMATCHES

Maturity Mismatch

Take-Away 8 – Managing Maturity Mismatches least of Concerns

- Maturities on bank loans are shortening with the majority of long-term funding being parent and IFI funding

EFSE Subloan Portfolio by Maturity Buckets *

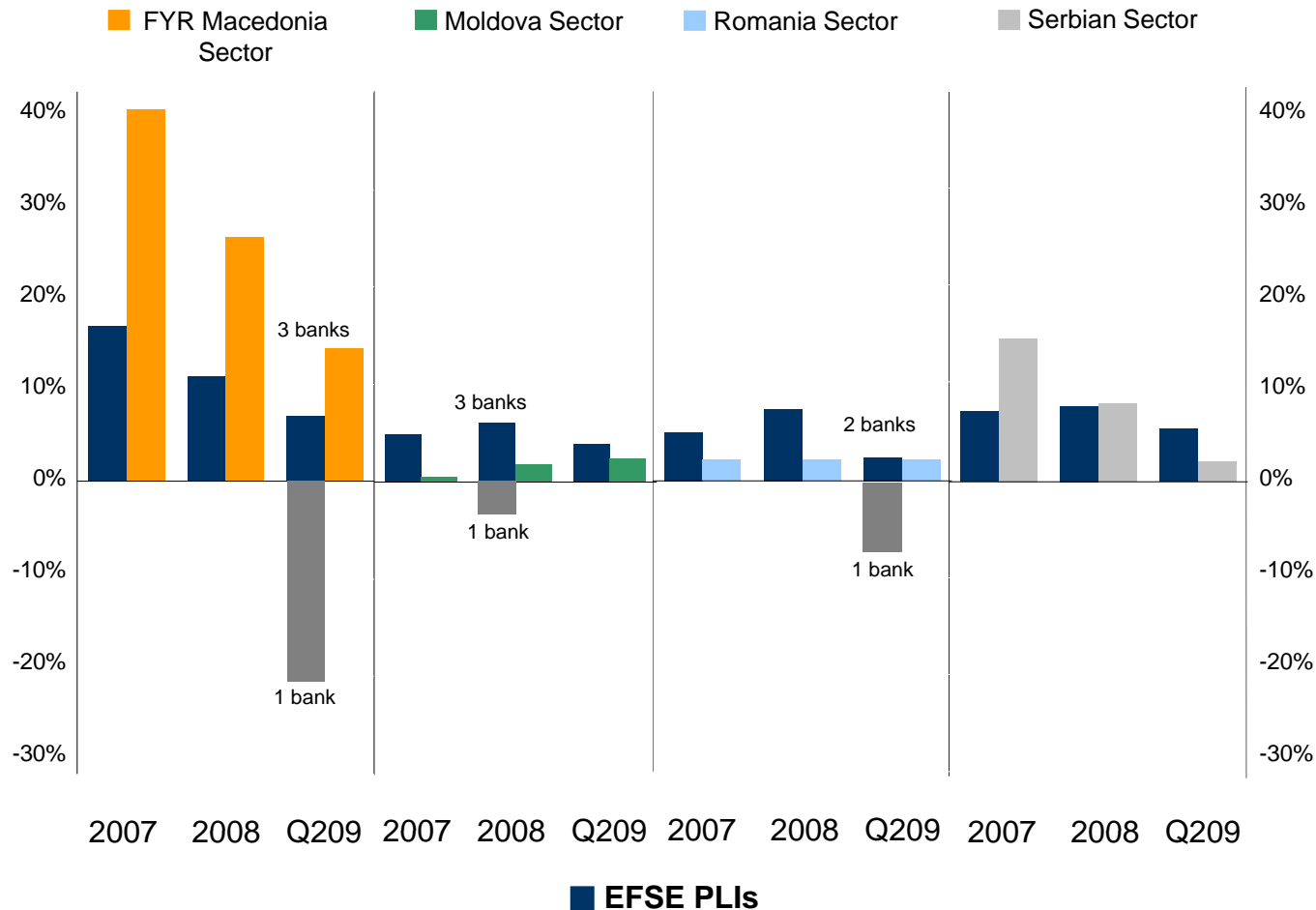
MSE	< 1 year	1-3 years	3-5 years	> 5 years
Q1 - Q3 2008	31,7%	39,5%	23,8%	5,0%
Q1 - Q3 2009	44,2%	34,1%	16,5%	5,2%

* Subloans disbursed during the period

MANAGING OPEN CURRENCY POSITIONS

Direct Exposure to FX Risk in Banking Sector

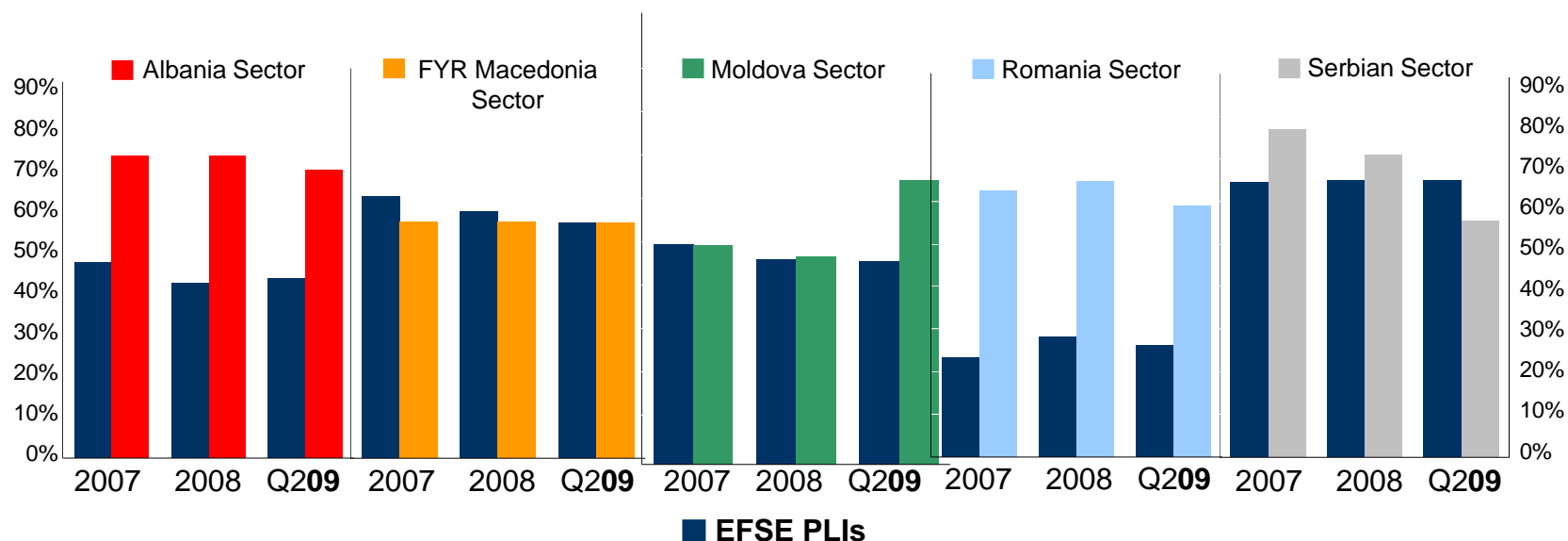
Foreign Exchange Open Position as % of Regulatory Capital



Source: EFSE PLIs, Central Banks' data, Thomson Datastream

Indirect FX-induced Credit Risk in Banks

Foreign Currency Lending as % of Gross Loan Portfolio



Currency Depreciation (positive change indicates depreciation)										
	ALL-USD	ALL-EUR	MKD-EUR	MKD-USD	MDL-EUR	MDL-USD	RON-CHF	RON-EUR	RSD-CHF	RSD-EUR
APR 08 - MAR 09	25.50%	6.85%	1.63%	19.37%	-10.42%	5.39%	19.30%	14.09%	21.52%	16.21%
OCT 08 - MAR 09	12.07%	6.27%	1.23%	6.75%	1.68%	7.93%	17.69%	13.20%	28.45%	23.55%
MAR 09 - SEP 09	-11.64%	1.78%	-0.39%	-13.31%	15.84%	4.91%	-4.23%	-1.79%	-3.25%	-0,93%

Source: EFSE PLIs, Central Banks' data, Thomson Datastream

Take-Away 9 – Limited FX Gap at the cost of large FX-induced credit risk

- FX gaps have been declining
- Strategic long EUR positions are often used to protect equity position in countries with expected depreciation
- VaR calculations general standard for international banks
- Very limited FX swap market – if FX swaps are available, only for short-term
- FX gaps closed primarily via FX-denominated lending
- **However** – hidden beast of FX-induced credit risk given large portion of FX or FX-indexed loans

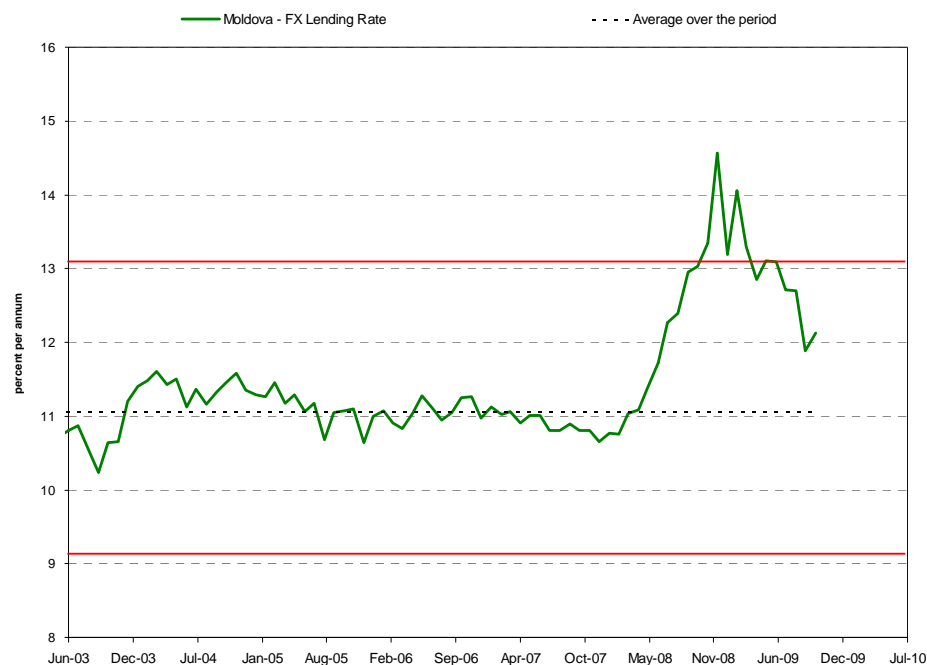
MANAGING INTEREST RATE & REPRICING RISK

Interest Rate Risk

Take-Away 10 – Not systematically on the Radar Screen

- Basic interest rate risk mitigation strategy in the absence of derivative instruments
- Banks regularly undertake interest rate risk analysis, however, often with standard parameters

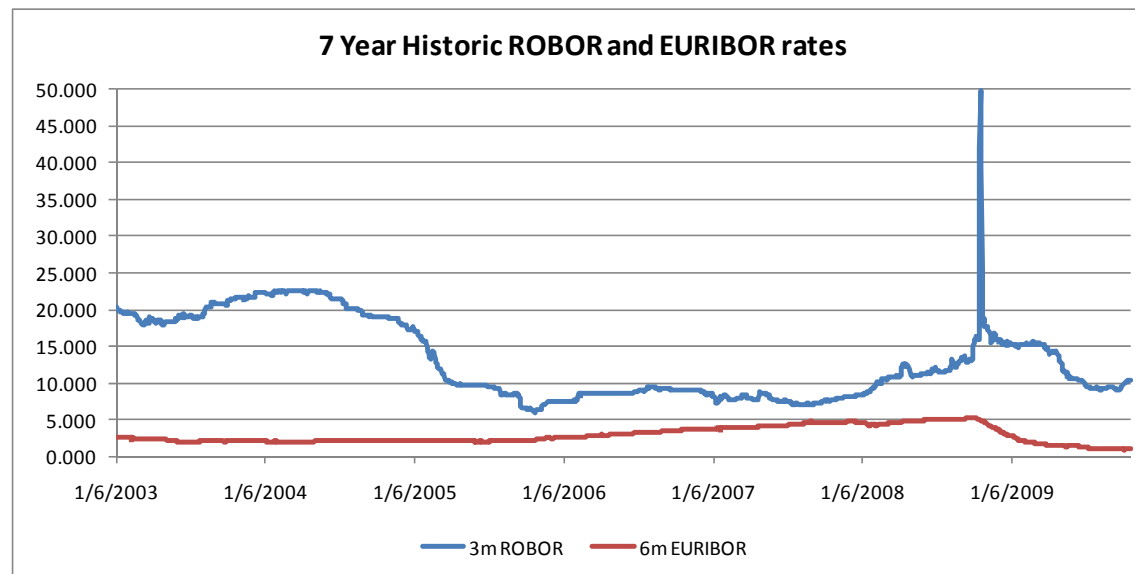
Moldovan Average Lending Rates



Interest Rate Risk

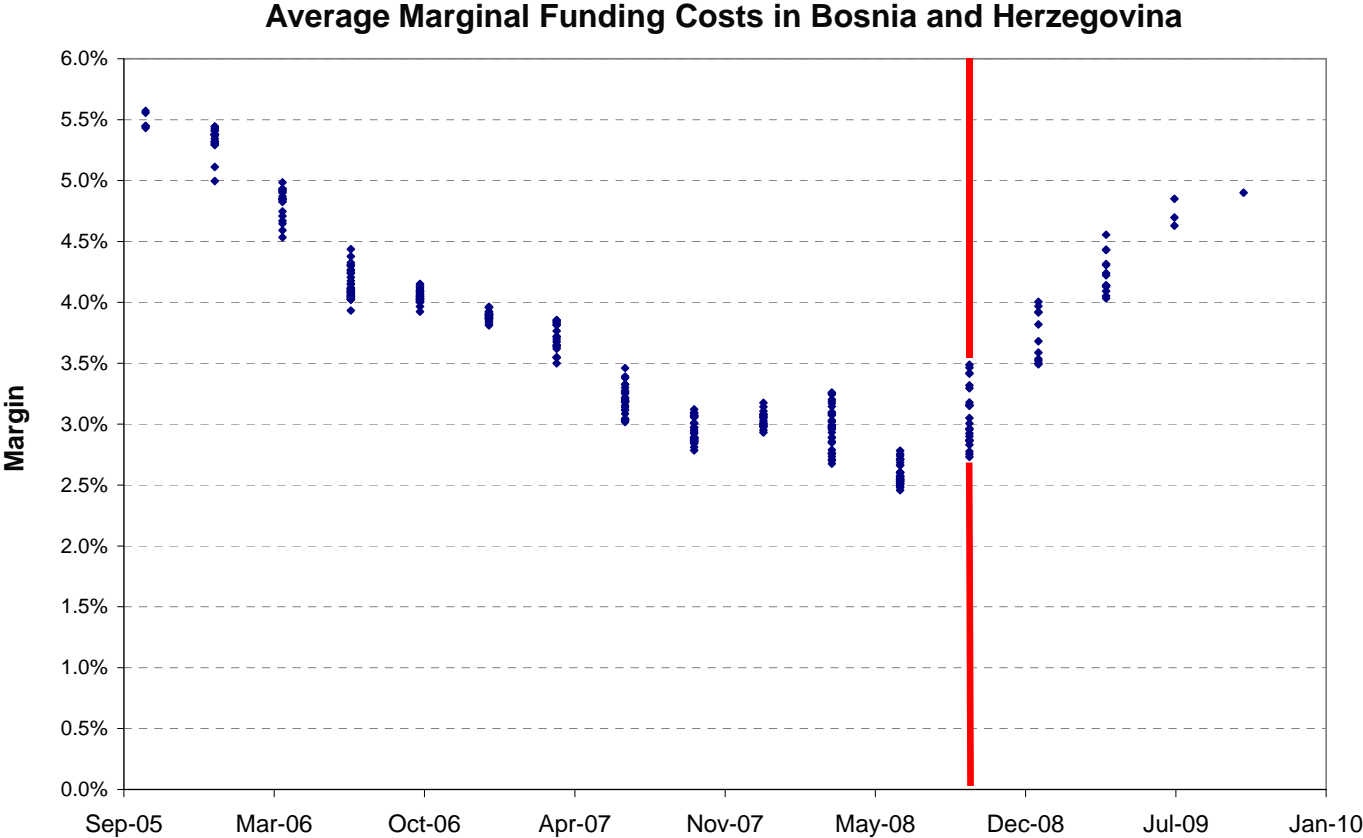
Take-Away 11 – Not systematically on the Radar Screen

- MFIs do generally not measure interest rate risks
- Interest rate risk on long-term funding often not addressed



MANAGING PROFITABILITY

Importance of Refinancing Costs on Profitability



But ...

Importance of Refinancing Costs on Profitability

Average Nominal Funding Costs in Bosnia and Herzegovina



Take-Away 12 – Profitability benefits from declining funding costs in nominal terms

Take-Away 13 – Creative Profitability Management

- Refinancing costs are not the driving factor for low/negative profitability
- High liquidity levels, sluggish lending activity and limited fee/other business activities hurt profitability
- Attempts to increase loan rates for current loans often failed
- In some countries even lower interest rates on new loans
- Main measures to actively manage profitability levels: provisioning, operational costs

Thank you for your attention!



SAL. OPPENHEIM



OMIDYAR-TUFTS
MICROFINANCE FUND



ERSTE
SPARINVEST

NORD/LB **Horizont**

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