

Report on the National savings banks

The Anti-Corruption Council has undertaken the task to gather the publicly disclosed facts, as well as the data The Anti-Corruption Council has undertaken the task to gather the publicly disclosed facts, as well as the data obtained by the state authorities, in connection with the National Savings Bank, which was mentioned in a negative context in a number of occasions.

At first, the public was alarmed because business premises of the National Bank of Yugoslavia were placed at the disposal of the National Savings Bank free of charge. Then, during the parliamentary election campaign at the end of 2003, a debate regarding the accountability of certain politicians for the loss of the Government over the Bank got into full swing. At the time, the general impression was that it was a national institution; therefore, the transformation of this Bank into a private bank was regarded with disapproval.

The National Savings Bank was mentioned for the third time in March this year, during the work of the Parliamentary Investigation Committee established to determine the facts and circumstances related to the trade in electric power- and financial-banking transactions in connection with this trade. Although many serious questions were raised at the time as well, the whole matter was not brought to a logical conclusion and the public was denied the information on the real developments regarding this Bank.

The Council forwards the present Report to the Government as an incentive to undertake all necessary steps in order to determine in a legal way whether regulations were violated in the mentioned banking transactions and whether high government officials were involved in corruption.

The Report first analyses the structure of the ownership over the National Savings Bank from its founding till present, and then it lists the privileges it was assigned by the Government, which inevitably calls for an explanation of the role of the Moscow EuroAxisBank. Conclusions and recommendations are given at the end of the Report.

The Ownership Structure

The Memorandum of Association of the National Savings Bank, Joint Stock Company (hereinafter referred as the Bank) was signed on 25 December 2001, by the representatives of thirteen legal entities. The Constituent Meeting was held on the next day, on 26 December 2001, when the decision on the first issue of shares in an amount of YU Dinars 364 million was brought. The Yugoslav Bank for the International Economic Cooperation (YUBIEC) became the major shareholder with 38.46 % of the shares, three founders got 9.62% of the shares (Beopetrol, the Yu Garant banka, and the Joint Stock Company Toza Markovic), three founders got 4.81% of

the shares (The Apatin Brewery, the C-Market, and the DDOR Novi Sad), two founders got 3.85% of the shares (The Kopaonik Insurance and Sintelon), three founders got 2.88 % of the shares (The Savings and Loan Cooperative of Self-employed Entrepreneurs, Energoprojekt Holding, and Energoprojekt Civil Engineering), while Eurosalon got the rest of the shares (1.92%).

At the session held on 20 May 2002, the Bank's Meeting brought a decision on the second issue of shares in an amount of YU Dinars 180 million. Most of the issued shares, over 80%, were bought by Belgrade companies: Skvadra, Pima, Principal Export-Import, and the Diners Club. A number of facts stated in the Report of the Office for Prevention of Money Laundering indicate that these companies are interconnected. Interconnected persons carried out the purchase of the shares through a foreign currency account of the National Savings Bank opened with the EuroAxisBank from Moscow.

The founders of the mentioned interconnected companies are domestic natural and foreign legal persons, and the domestic persons have a smaller share in these companies than the foreign persons. Typical is the case of the Pima Joint Stock Co., Ltd., registered with the District Commercial Court of Belgrade under number Fi. 14621/95 of 3 April 1995, with Ms Jelena Lazarevic and Mr. Zoran Stankovic from Belgrade as its founders, who hold 5% of the equity each, while the Pluto International LTD from St. Vincent and Grenadines, hold 90% of the equity share. On the other hand, the founders of the Pluto International Co. are Vladan, Olivera, and Vojin Lazarevic, all from Kotor, Montenegro.

At the end of 2002, and at the beginning of 2003, there was a secondary sale of shares. In mid-November, the Republic of Serbia repurchased 21 shares from the YUBIEC Bank, and became the owner of 13.83% of the shares, and YUBIEC's share fell to 9.88%, while the four interconnected companies (Skvadra, Pima, Principal and Diners) owned 37 % of the shares.

It is worth mentioning that in the same year (2002), the Bank granted a loan to at least one of the buyers of the shares, who were buying shares both on the primary and secondary markets. The Council is not aware whether the loans were used for the purchase of shares, but, if they were – it would be a serious violation of the Law on Banks and Other Financial Organizations, which stipulates in Article 19a that such legal transactions are null and void. The auditors' report for 2002, conducted by the National Bank, shows that the Diners Club Co. took large amounts of short-term loans in that year, although it was a questionable client (low individual capital, poor liquidity and turnover). "In spite of the fact that the Risk Management Department, the Loan Risk Service, estimated that the client was not operationally and financially stable, that it had poor liquidity of the first, second, and third degrees, and inadequate credit-worthiness, the Bank classified the claims from the mentioned client in the A category."

On 27 February 2003, the Bank's Meeting (in presence of representatives of the Republic) unanimously brought a decision on a third issue of shares in an amount of YU Dinars 300 million. Till the conclusion of the issue, shares were bought only by two companies: Mali kolektiv (Small Company) from Belgrade, and Elim from Vienna – which paid for the shares through EuroAxisBank from Moscow. After the payment for the shares of the third issue, the

equity of the Republic of Serbia fell to 10.05 % and of YUBIEC to 7.18 %, while the four interconnected companies owned 26.88 % of the share capital of the Bank. The share of these shareholders in the ownership of the Bank has not changed till the present day.

The buyers of the third issue of shares (Mali kolektiv /Small Company/ and Elim) became major individual shareholders of the Bank with 13.67 % of the share. Mali kolektiv was founded by Mr. Milan Skoric, with 9 % of the initial capital, and the Anglo European Marketing Co. from the British Virgin Islands, holding 91 % of the initial capital. The owner and the director of the Anglo European Marketing Co. is Mr. Vuk Hamovic from Belgrade. Mr. Aleksej and Mr. Igor Gorohov are registered as the founders of the Elim Company, and this company is represented in the Management Board of the National Savings Bank by Mr. Jovan Mitrovic. SEE APPENDICES 2 and 4.

Privileges in Work

The National Bank of Serbia issued a work permit to the Bank on the same day when the Constituent Meeting was held, on 25 December 2001.

The institution of bankruptcy procedure over the major banks disabled the payment of the “old foreign exchange savings” deposited with them. The bankruptcy/liquidation procedures of the Commercial Bank from Novi Sad, the Slavia banka, and the Valjevo banka were instituted on 10 October 2001, while the bankruptcy procedures of the four largest banks (Beogradska banka, Beobanka, Yugobanka, and Investbanka) were instituted on 3 January 2002. On 16 January 2002, the Governor of the National Bank sent a letter to the Agency for Deposit Insurance, Financial Rehabilitation, Bankruptcy and Liquidation of Banks, asking them to “undertake legal actions so that the courts in charge render relevant acts in the emergency procedure, authorizing the National Savings Bank to deliver bonds, and carry out other activities in discharging the obligations of the mentioned banks deriving from the Law”.

Accepting the proposal, the competent panels of judges brought decisions by which they authorized the Bank to perform the stated activities. Thus, without a tender, the National Savings Bank was assigned the job of servicing about 84% of the old foreign exchange savings (total amount of EUR 4.5 billion).

By the Governor’s decision on the transfer of the accounts to the commercial banks of 25 December 2001, a vista deposits of the National Bank were opened with 18 commercial banks. On 9 January 2002, the funds of the National Bank of Yugoslavia – the Main Office, the National Bank of Yugoslavia – the Money Coinage and Printing Office, the Money Transfer Service – the Main Office in Belgrade, the Money Transfer Service – the Main Branch for the Republic of Serbia, the National Bank of Yugoslavia – the Main Republic Branch were placed at the disposal of the National Savings Bank, while the funds of the National Bank of Yugoslavia – the Kragujevac Branch were transferred as of 1 January 2003. These funds were deposited with

the Bank interest-free, and by the end of the year they amounted over YU Dinars 797 million, which represented 60% of the Bank's YU Dinar deposits.

Within less than two months from its founding (on 20 February 2002), the Bank got the authorization to carry out money transfer operations, and crediting activities abroad (the large authorization).

On the next day, 21 February 2002, the National Bank – the Money Transfer Service (MTS /ZOP/), and the Bank concluded a contract on business cooperation setting out the obligations of the training and takeover of the employees. By the Contract the National Savings Bank undertook the training of the employees of the Money Transfer Service (who were still on the payroll of the National Bank of Yugoslavia – the Money Transfer Service) for the work at the counter, with a possibility of taking over of the employees if they finish the training successfully. Following the Contract on Business Cooperation, the National Bank and the Bank made an Agreement on 28 October 2002, according to which the Bank was entitled to use free of charge in the course of the next three years 60 branch offices, including 271 counters, and 7200 meters square of furnished and equipped business premises. The Agreement was concluded by Governor of the National Bank and the Director General of the National Savings Bank, contrary to Article 5 of the Law on Funds Owned by the Republic of Serbia, which regulates the use of state-owned real-estate property, and according to which transfer of the right to use such real-estate property cannot be made to beneficiaries which are not state owned, nor can state-owned property be sublet. At the moment of the conclusion of the Agreement, a majority share of the National Savings Bank was already privately - owned.

Pursuant to the Article 8 of the Law, a decision on the use or lease of state-owned real-estate property must be brought by the Government. The same Article envisages that the use or the lease of such premises may be realized only upon the acquisition of an approval by the Republic Office for the Property of the Republic of Serbia. The Report made by the Office for Prevention of Organized Crime shows that such an approval from the Republic Office had not been requested.

EuroAxis (Weksim) Bank

EuroAxisBank from Moscow plays a very important role in business operations of the National Savings Bank. A large number of Bank's shares were purchased precisely through foreign currency accounts with the EuroAxisBank.

Surely, the most interesting transactions were carried out on 13 September, 2002. Then, in one day alone, four interconnected companies received USD 1,200,000 and EUR 1,200,000 from the Coprom Company from Vienna, at the Bank's foreign currency account opened with the EuroAxisBank, and then sold immediately that money to the National Savings Bank which paid the equivalent value in YU Dinars to the Atlas and Societe General Bank. These two banks returned the same amount to the National Savings Bank in the name of recapitalization to the

benefit of the mentioned companies. Finally, the National Savings Bank transferred the paid amount to its account with the EuroAxisBank. By this complex operation, in which there was no actual transfer of money, but papers only, the interconnected companies acquired 88.16% of the second issue of the shares and thus gained the possession of 37% of the share in the capital of the Bank. The initial payment order was issued by the Coprom Company, which also has a foreign currency account with the EuroAxisBank, and the funds were paid as an advance payment for export of corn, which never took place. Also, one of the two presently largest individual shareholders of the Bank, Elim from Vienna, paid its shares through the EuroAxisBank.

The EuroAxisBank was established in the nineties with the aim to avoid the sanctions imposed on the Federal Republic of Yugoslavia by the United Nations. Two large state banks were the founders. According to the testimony of Mr. Veroljub Dugalic, the Secretary General of the Association of Banks, given to the Parliamentary Investigation Committee, the EuroAxisBank had annual transactions with domestic banks exceeding four billion dollars in the past few years. Mr. Vojin Lazarevic said to the same Parliamentary Investigation Committee, that his share, together with the share of Mr. Vuk Hamovic in the share capital of the bank amounted to 28%.

During the nineties this bank received foreign-currency funds from the National Bank of Yugoslavia and used them for financing imports and exports. This practice, contrary to all the regulations of the work of the central bank, might have been partly justified at the time of the sanctions against Yugoslavia. The Federal Government imposed restrictions on the Governor disabling him to place more than 5% of the foreign-currency reserves with mixed-ownership banks (in the nineties, the EuroAxisBank was called Weksim Bank). In October 2000, the deposit of the National Bank with the EuroAxisBank was USD 4.6 million.

Instead of withdrawing all the deposits of the National Bank from the EuroAxisBank, and their placing with a first-class bank, the Governor, appointed by the democratic authorities after the fall of Slobodan Milosevic's regime, made a three-month fixed-term deposit in an amount of USD 10 million as early as on 13 December 2000, with the minimum (LIBOR) interest rate, in order to "improve liquidity of the bank". This has been probably a unique case in the history that a central bank of one state invests foreign-currency funds, legally collected from domestic commercial banks, with a foreign private bank in order to improve its liquidity. Over the following months, the deposit was continually increased. By his decision the Governor loosened the previous 5% restriction of foreign currency reserves to 7%, and, as of March 2003, the placed deposits were maintained up to an amount of USD 60 million.

Even more peculiar is the fact that the EuroAxisBank was returning the funds of the National Bank into the country, financing domestic commercial banks, for this rendered the system of the foreign-currency reserves meaningless. Namely, if it had been assessed that the commercial banks did not have sufficient foreign currency funds, high amounts of compulsory reserves should not have been prescribed. Moreover, the commercial banks converted the received foreign-currency loans into Dinars, thus increasing the quantity of the money in circulation. The whole operation was performed through agreement between the EuroAxisBank and the National

Bank, as not only an interest rate on deposits of the National Bank was agreed on, but also an interest on loans to commercial banks, as well as an interest to be paid by end users of the loans.

To make the things more absurd, the commercial banks took loans from the EuroAxisBank using their foreign currency reserves with the National Bank as a guarantee (security) for the repayment of the loans, which, once again confirms the participation of the central bank. Associate workers from the Department for the Foreign Business Transactions warned timely of the damage and illegality of such Governor's practice.

On the basis of the presented facts it can be concluded that the EuroAxisBank was a privileged bank all the time because it operated in close cooperation with the National Bank and was not exposed to any risks as the repayment of the loans was always covered by the deposits of the National Bank.

Moreover, the state financed the imports of electrical power through this Bank, which was verified by supporting documents by the Parliamentary Investigation Committee. With time, the London Energy Financing Team Company (EFT) took over an increasing share in the electrical power trade. Thus, this Company, which was at the same time a client of the EuroAxisBank, received 34% of the funds for the import of electrical power in 2002, and even 82 % in 2003. A significant part of that money was paid into the account of the Energy Financing Team with the EuroAxisBank. The owner of the Energy Financing Team Company is Mr. Vuk Hamovic.

Conclusions and recommendations

The stated facts indicate a major violation of the legality and the standard operating principles of the National Bank. It cannot be denied that the National Bank:

1. Placed at the disposal, free of charge, the use of the facilities and business premises to a predominantly privately-owned business, without a public tender, and contrary to the regulations in force;
2. Disposed with the state-owned property beyond its authority, and therefore the contracts concluded by the Governor and the Director of the Money Transfer Service were signed by an unauthorized person, which makes them null and void. Notwithstanding the autonomy of the National Bank and a certain degree of its autonomy in the use of the property, the National Bank has to use the property for the business operations of the National Bank;
3. Failed to establish that interconnected persons gained the control package of the shares of the National Savings Bank;
4. Failed to notice that, in one day alone, a significant amount of foreign currency funds was transferred from Vienna, through Moscow to Belgrade on account of a cover business transaction (a supposed export of corn which never took place), and that in the end of the transaction the shares of the Bank were bought, which indicates that the whole operation was fabricated;

5. Did not act according to the warning of the bank auditors concerning the insolvency of the Bank's client the Diners Club, which, at the same time, was acquiring shares of the Bank;
6. Transferred a large part of its funds to a private bank upon the closure of the Money Transfer Service, without a public tender or charging any interest, although, at the same time, it was possible to perform the payment transactions through the state-owned Postal Savings Bank;
7. Awarded the Bank, which had just been founded, without a public tender either, the job to carry out the payment of a large part of the old foreign-currency savings, placing thus other domestic banks in an unequal position;
8. Placed the funds of the compulsory foreign-currency reserves with a foreign bank of doubtful liquidity, owned by domestic legal and natural persons.
9. Allowed a foreign bank to return to the country deposited funds as foreign currency loans to commercial banks, which were then converted into YU Dinar loans under the conditions determined by the foreign bank,
10. Guaranteed foreign bank loans to commercial banks with foreign currency reserves deposited with the same bank.

The name "Nacionalna štedionica-banka a.d." /The National Savings Bank, Joint Stock Co."/ includes an adjective which may be used for a form of business organization in which the state is the majority owner (for instance, the National Cooperation for Insurance of Housing Loans, where the state is a hundred percent owner of the capital). In this case the state was not a founder of the Bank, and it acquired its share capital only in the secondary sale. Moreover, the word "national", since it implies the state ownership, suggests risk-free business operation, and saving with such a bank. Thus, the Council believes that the National Bank should not have issued an approval pursuant to the Articles 8 and 9 of the Law on Banks and Other Financial Organizations, and that the Governor should have not brought a decision licencing the operation of the bank under such a name.

The presence of the high state officials at the opening of the Bank, as well as the subsequent awarding of the servicing of a large part of the old foreign-currency savings to this Bank, only enhanced the misleading impression among the members of the public, giving this Bank a privileged position in the market, which must have resulted in unlawful gain of profit.

The Anti-Corruption Council believes that the domestic legal regulations must be amended within the shortest possible time with recommendations stated in the Anti-Corruption Convention of the United Nations, as well as the provisions contained in the Criminal Law Convention on Corruption, and the Civil Law Convention on Corruption by the Council of Europe. Corruption, both active and passive, is considered by these conventions as a criminal act, and participants from the public or private sectors, are fully responsible for the indemnification of damages to all those who sustained a material or immaterial loss due to corruption.

Besides amendments of the law regulating criminal and civil accountability, it is necessary to review in this case the regulations related to the National Bank, the banking system and its operation. Some very important elements of this system are regulated by sub-laws and they should be incorporated in the wording of the law. Thus, for instance, the credit worthiness of a bank founder, or interconnected persons is defined by an act brought by the Governor, which has changed on a number of occasions, i.e. the “Decision on the Method of Enforcing of Articles 8, 9, 10a, 12, 15, 19b, 19e, 28,29, and 59 of the Law on Banks and Other Financial Organizations”. At the moment, this Decision has 44 articles, with numerous paragraphs and points, and once printed it has 14 A4-format pages, while the Law itself has 23 pages. In a democratic society, the Governor should not be entitled to give authentic interpretation of the law through his decisions, nor to bring decisions with legal force.

Central banking is based on well-known principles and it is possible that the authors of the Law on the National Bank considered that these principles are implicit. The business transactions of the National Bank with the EuroAxisBank show that principles are not implicit and that they should be included in the Law.

While amending the Law internationally standardized terms should be used. The fifth issue of the International Monetary Fund (IMF) Manual on balance of payments gave a clear definition of foreign-currency reserves, which was elaborated later on in the Guidelines for Statistical Follow-up of Reserves (International Reserves and Foreign Currency Liquidity: Guidelines for a Data Template). According to the definitions from paragraphs 64 to 74 of the Guidelines, it is clear that the compulsory foreign-currency reserves placed by the state with the EuroAxisBank could not be considered as foreign-currency reserves of the country (“effective auditing”, solvency, and investment in banks owned by non-residents are necessary). According to the IMF criteria our foreign-currency reserves, after being placed with the EuroAxisBank, were used for an inappropriate purpose.

Legislation is but the first step in the fight against abuses and corruption, which encourages them. It is necessary to establish bodies able to recognize abuses and prosecute the perpetrators. The present financial crime is highly sophisticated and the prosecution authorities established in the previous regime are not always able to deal with the new circumstances. The Report made by the Office for Prevention of Organized Crime, which was at the disposal of the Council, represents a clear example. The Report contains well-stated facts, whose reading gives an impression that it was not clear the author of the Report whether any laws were violated at all (except the Law on the Assets of the Republic of Serbia, concerning the renting of the facilities and business premises to the Bank). Therefore, according to the opinion of the Council, it would be necessary to organize additional training of the state authorities for the prosecution of financial crime, where the cooperation with international organizations (OSCE, OECD) and/or European Union institutions (OLAF), the Council of Europe institutions (GMC, GRECO) and of the United States (Department of Justice) could be used.

As to the concrete accountability of individuals in the case of the National Savings Bank, the Council recommends the Government to forward gathered information to the Prosecutor's Office,

so that all the aspects of this problem could be cleared. Investigation authorities should investigate which regulations were violated, and which persons were involved, and whether there is any evidence of corruption. In the meantime, the Government must undertake actions to protect the state property which, at the moment, and contrary to the law, is being used by a private entity. As a process of the alienation of state property is going on, the Council recommends the Government to suspend the sale under the public announcement published in daily newspapers on 24 November 2004, until all the facts concerning the establishment of the National Savings Bank are brought to light. Consequently, the Conclusion made by the Government on 27 May 2004, should be put aside.

The Council recommends an investigation of the interconnection and financial standing of the shareholders of the National Savings Bank, pursuant to the legal authorizations and the Decision on the Method of Enforcing of Articles 8, 9, 10a, 12, 15, 19b, 19e, 28, 29, and 59 of the Law on Banks and Other Financial Organizations. Likewise, all placed funds should be withdrawn from the EuroAxisBank as soon as possible, and placed in accordance with the international principles of the central bank operation and the IMF Guidelines.

The Agency for Insurance of Deposits, Rehabilitation, Bankruptcy and Liquidation of Banks should initiate a procedure for the review of the awarding of the servicing of the old foreign-currency savings to the National Savings Bank. All commercial banks should be able to apply for that job on equal terms.

The Council is aware that the case of the National Savings Bank represents a rather delicate matter for the Government. Some of its distinguished members were, directly or indirectly, involved in the establishment of this institution and the creation of an impression that it was a state bank. Therefore, the Council finds that, if the Government intends to fight the corruption seriously, it must first investigate the political accountability of its own members, and put the public interests before its own.

Belgrade, December, 7th 2004

Appendices

1. "Determining the origin of the payments for the share capital of the National Savings Bank, Joint Stock Co., Belgrade", the Office for Prevention of Money Laundering, No. 19/04 of 3 February 2004.
2. The Report of the Ministry of Internal Affairs of Serbia, the Office for Combating Organized Crime of 24 February 2004, registered with the Government Registry Office on 12 July 2004 under No. 07-5135/2004.
3. Transcript from the Record on Auditing of the National Savings Bank of 24 April 2003.
4. Internet data from the web presentation of the National Bank of Serbia.
5. "Information on the authorization of the National Savings Bank to carry out transactions in connection with the execution of the obligations of banks subjected to

bankruptcy/liquidation procedure”, the Agency for Insurance of Deposits, Rehabilitation, Bankruptcy and Liquidation of Banks.

6. Reply to the point 3 of the Conclusion of the Government of the Republic of Serbia No. 422-850/2003-04, the Governor of the National Bank of Serbia of 17 February 2004 (K.G. No. 27/2004)
7. Transcript from the Report by the Auditing Sector of the National Bank of Serbia, No. III/142-2037/1 of 19 November 2003.
8. Governor’s letter to the President of the Wexim Bank of 13 December 2000, Vice-Governor’s letter to the Governor, dated 23 March 2001, letters of the Sector for Foreign-currency Transactions Abroad, the Committee for Investments of 22 April 2002, 9 January 2003, and 26 March 2003.
9. Letter by the President of the Wexim Bank to the National Bank of 18 April 2001.
10. “Memo concerning the request of the Beogradska banka, Joint Stock Company, Belgrade, to conclude short-term finance loans with the Wexim Bank, Moscow, on behalf of the Cacanska banka, Joint Stock Company, and Agrobanka, Joint Stock Company, Belgrade, to convert them into YU Dinars”; Letter of the Beogradska banka of 30 May 2001, and “The Program of Letters of Credit for Yugoslav Banks” of 5 October 2001
11. “Payment for the import of electric power in 2002”, and “Review of the realized imports of electrical power in 2003 and payments”.