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FINANCIAL SECTOR REVIEW OF THE SLOVAK REPUBLIC

Note prepared by the Slovak Delegation

This document is prepared by the Slovak authorities for consideration under item 8 of the Agenda. Part of the document also aims to respond to issues raised in the related document, DAF/CMF(2000)16, prepared for the meeting by the Secretariat.

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INTRODUCTION

1. The last review of the Financial sector of the Slovak Republic been with the Committee on Financial Markets was held on 17 June 1996. At that time the main objective of the meeting was to present the OECD Member countries whole range of the financial markets and its development, aiming to present all its main components: development of the money and capital markets which were undergoing the transition towards full fledged market economy design. Institutional framework, main objectives and perspectives of financial market were presented and described at that time.

2. Since then the recent developments of the Financial Market, and in particular its Banking sector and Capital Markets cannot be properly focused without regarding to overall macroeconomic and structural developments of the Slovak economy.

3. After the initial period of macroeconomic imbalances which had occurred in the course of 1998 and characterised by the excessive twin deficits, the macroeconomic situation has been gradually stabilising and improving due to two austerity packages approved by the Government in January and in May 1999 respectively. There were introduced stringent measures aiming to squeeze excessive government and domestic consumption by means of launching the deregulation of remaining part of relative prices, increasing fiscal revenues and tightening public administration expenditures and social benefits. Whereas the macroeconomic situation in Slovakia at the end of 1998 had become unsustainable, the program of macroeconomic stabilisation had succeeded in 1999. The output in comparison with preceding years, albeit in a more moderate rate of 1.9 per cent in 1999, had not been stalled.

4. The current objectives of the economic policies of the Government is to gain from the undertaken period of macroeconomic stabilisation which laid the ground for streamlining structural changes in the banking and corporate sector which would better respond on the need of strong recovery and sustainability of growth in the real economy over medium-term. The policies, adopted by the Government in closed co-operation with the National Bank of Slovakia, and outlined in the document, are concentrated on fundamental issues related to the stability and proper efficiency of the banking sector to be able to support the real changes in the process of restructalisation of the corporate sector. The Slovak Government is determined to privatise the banking sector in the course of 2000, and began to implement the changes in the regulatory, and supervisory policies base on the stable and predictable legal environment. Those accompanying reform in the regulatory and supervisory framework, in which financial sector operates, are also envisaged to be passed during the first half of 2000. In light of a progress achieved in the macroeconomic stabilisation, the Slovak authorities may wish to move ahead with liberalisation of capital movements and cross-border financial services, reviewed under the OECD accession process.

I. THE BANKING SECTOR

1. Development of Slovak Banking System and Banking Reform

5. The reorganisation of banking implemented on 1 January 1990 established architecture of a two-tier banking system composed of a central bank and commercial banks. This change was enabled by Banking Savings Institutions Act No.158/1989 Coll. of Laws. On the basis of this act the former State Bank of Czechoslovakia in Slovakia was divided into the central bank and the newly formed Všeobecná úverová banka (General Credit Bank) and Investičná a rozvojová banka (Investment and Development Bank). Slovenská štátna sporiteľňa (Slovak State Savings Bank) was transformed into a universal bank.

6. Following independence in 1993, substantially all commercial banks have been established as joint stock companies and most are privately owned. Only two commercial banks are wholly state-owned financial institutions, which are special-purpose banks. Konsolidácia banka was set up in 1991 (and split in 1992 into separate Czech and Slovak institutions, KBP and KBB, respectively) to take over poorly performing loans inherited by VÚB and its Czech counterpart from the pre-1990 period. Slovenská záručná a rozvojová banka (SZRB) supports small and medium-sized enterprises in Slovakia.

7. Commercial banks are the primary financial institutions in the Slovak banking system. At 31st December 1999, there were 23 domestic commercial banks, two branches and 10 representative offices of foreign banks operating in Slovakia. 15 financial institutions are licensed to conduct the full range of foreign exchange activities. The other banks have a banking licence that is limited in the area of foreign exchange transactions according to the requirements and conditions for trading in foreign exchange.

8. At 31st December 1999, subscribed capital in the banking sector, including the initial capital provided to branches of foreign banks (excluding the NBS), has reached SK 52.8 billion. The percentage of subscribed foreign capital in the Slovak-banking sector represented 24.6 per cent of the total capital invested in the Slovak-banking sector. Controlling foreign capital participation (ownership of more than 50 per cent of the bank's share capital) was reported in ten commercial banks, which were all medium-sized banks with share capital of at least SK 500 million. Of the total volume of foreign capital in the Slovak banking sector at 31st December 1999, Austria accounted for 23.5 per cent, the Czech Republic for 20.0 per cent, The Netherlands for 19.6 per cent, the United States for 12.8 per cent, Germany for 13.2 per cent. Minor stakes belonged to EBRD (2.9 per cent), France (3.5 per cent), Italy (2.7 per cent), and the Russian Federation (1.0 per cent), as well as other countries accounting for insignificant amounts.

9. The three largest Slovak banks together accounted for 45.5 per cent of total bank assets at 31st December 1999. The largest is the former savings bank Slovenská sporiteľňa, which was the only savings institution for private deposits prior to 1990 and still has a dominant role in this area. The second largest bank is VUB, which inherited a large part of the commercial portfolio of the former Czechoslovak State Bank (which formerly fulfilled both central and commercial banking functions). Both banks have been restructured as commercial banks with an universal banking licence. The third bank, IRB, inherited a large portion of former low-interest loans (typically for housing and large construction projects with Government support). VUB and IRB resulted from the split in 1990 of the Czechoslovak State Bank. VUB and IRB were partially privatised in the first wave of coupon privatisation in 1992-93, but 84.5 per cent of the VUB shares and 22.9 per cent and 65.5 per cent of the IRB shares at 31st December 1999 are still owned by the NPF and the Ministry of Finance (MOF), respectively. The NPF owns 29.7 per cent and MOF owns 67.5 per cent of shares of Slovenská sporiteľňa, with the remaining 2.8 per cent owned by the Restitution Fund.

10. In December 1999, the NBS cancelled forced administration in IRB. The forced administration has been terminated of the decision of National Bank of Slovakia because reason for its imposition has been passed away.

11. In the course of 1999, banks began to give priority to less risky deals, especially trading on the inter-bank market and trading in state bonds. The relatively healthy banks reacted in this way to the complex development of the economy, slowing of economic growth and growth of the budget deficit. This consequently led to a slowing of financial flows to the entrepreneurial sphere. The continuing decline in effectiveness of the entrepreneurial sphere, accompanied by the growth of inter-company debt and the loss of ability (especially of engineering and agricultural companies) to repay previously granted loans, influencing the liquidity of the banks, especially of those undergoing transformation. These factors were also manifested in the worsened results of other banks.

2. Banking Reform

12. At the beginning of the nineties, it was already clear that state assistance would be necessary to solve the problem of risky loans, originating mainly from the centrally directed economy. Therefore, financial assistance was granted from the resources of the National Property Fund, for the capital strengthening of the Vseobecna uverova banka and the Investicna and rozvojova banka, and some of the defaulted loans were written off. In the Slovak Republic, this involved a sum of SK 14.6 billion. Apart from this, some loans, amounting to SK 30.4 billion, including cheaper resources to finance them, were transferred to the Konsolidacna banka. This solved only a small part of the problem. This complex situation and the need to restructure the Vseobecna uverova banka and the Investicna a rozvojova banka arose mainly because these banks took over as assets, all the loans granted to the enterprise sector before 1990. As a result of the political and economic changes, a significant proportion of these loans became risky or unrecoverable. The Slovenska statna sporitelna was transformed into a universal bank, and it granted a series of unrecoverable loans to support the process of lesser privatisation.

13. The bad debt problem, particularly as far as long-term loans are concerned, stems largely from earlier requirements of the state-controlled banks to provide credits to state-owned enterprises (especially prior to 1990, but also in the 1990-1992 period). Two additional factors have contributed to increased bad debt levels. First, there was a sharp rise in lending in 1991 and 1992 connected both with the initial rounds of small-scale and mass privatisation, and with the establishment of many new private businesses. Inexperience on the part of both lenders and borrowers contributed to what turned out to be many poorly-judged decisions and led to the NBS imposing credit limits on individual banks in 1993 (these credit limits were abolished as of 1st January 1996). Secondly, especially in the early 1990s, certain major banks continued lending to a limited group of long-established clients (especially to large, state-owned companies); despite some having very poor business prospects.

14. The basic changes in economic, legal and political conditions, associated with the transformation of the economy, and the lack of experience of the activity of banks in a market environment, caused a further growth in risky receivables, especially loans.

15. It was objectively impossible to solve the situation in 1993, when there were other more urgent tasks, in the conditions of the origin of the new state. In this period, the National Bank of Slovakia, in co-operation with advisors from the International Monetary Fund began to prepare new measures of the NBS on prudent behaviour by banks. It also began to concern itself with the quantification of the risks associated with the loan portfolios of banks. An analysis of the loan portfolios of Slovak banks, produced in co-operation with the internationally recognised auditing company McKinsey, showed that 91 per cent of the total amount of bad loans was concentrated in the four largest banks. The NBS initiated partially

successful talks with the Ministry of Finance of the Slovak Republic and proposed solving this problem by requiring higher coverage of risks and reducing the tax burden concerning the creation of resources for the coverage of loan risks.

16. The previous Government undertook a number of measures to restructure the banking sector. Initial steps included:

- (i) an amendment to the Act on Banks passed in January 1996 providing the legal framework for State participation in the process of restructuring bank portfolios and for banks to perform mortgage lending services;
- (ii) an act on the deposit guarantee system passed in March 1996;
- (iii) an amendment to bankruptcy laws passed by the National Council in early 1998; and
- (iv) an amendment to the Act on Banks passed in February 1998, which aimed to simplify licensing procedures.

17. The programme of the previous Slovak government, which had to solve the problematic situation, the effects of which unfavourably influenced the development of the banking sector and the economy of Slovakia, was specified in the aims of the Government expressed in resolution No.170 from 1995. The resolution resulted in an amendment to Banking Act No. 21/1992 Coll. of Laws. This took the form of Act No. 58 of 31st January 1996, which created the formal legal basis for restructuring the loan portfolios of banks (article 44a). This possibility, established by the act, as well as various other tasks from this resolution, was not implemented and remained on in declarative form. The aims of the Government expressed in resolutions No. 311 and No. 657 from 1996, and No. 541 from 1997 were also unfulfilled.

18. In recognition of the bad debt problem, the new Government in close co-operation with National Bank of Slovakia has adopted a comprehensive restructuring programme. This programme aiming to reduce the level of classified loans recorded on the balance sheets of state-owned banks from the current average more than 40 per cent of the total assets, to a more sustainable level of 20 per cent of total assets and improve capital level of these banks.

19. The process of restructuralisation was intensifying at the end of year 1999. To the end of the year 1999 it has been realised capital injection to VUB (Sk 8.9 bill.), Slovenska sporitelna (Sk 4.3 bill.) and Investicna a rozvojova banka (Sk 5.7 bill.). Ministry of Finance has provided this capital injection from central bank reserves and provisions via increasing capital.

20. Until December 1999 have been realised transfers of bad loans from VUB (Sk 45 bill.), Slovenska sporitelna (Sk 22.8 bill.) and IRB (Sk 14.5 bill.) to the special agency and Konsolidacna banka.

21. The first stage of restructuralisation of large banks was finished at the December 1999. Now these banks significantly improve its financial position and fulfil capital adequacy prudential limit.

22. The largest Slovakian banks, VÚB, Slovenska sporitelna and IRB are currently being prepared for privatisation. The Government decided to sell 84.5 per cent of the share capital of VÚB; 66.6 per cent of the share capital of Slovenska sporitelna, and 69.5 per cent of the share capital of Investicna a rozvojova banka. In addition to the privatisation of VUB, Slovenska sporitelna and IRB, the Government decided to include in its bank privatisation programme Banka Slovakia, and to sell 60.1 per cent of its share capital. For being advised and conducting the privatisation in a proper manner, the Government has selected and appointed J.P. Morgan, Ltd. its financial adviser for privatisation. The Government expects privatisation to be completed within the next 18 months.

3. Banking Regulation

3.1. Amendments to Banking Laws

23. In 1999, the National Council of the Slovak Republic (NC SR) passed three important amendments to the country's banking laws:

a) Amendment to the Banking Act No. 21/1992 Coll. passed by SNC with subsequent amendments (hereinafter referred to as 'Banking Act'), which became effective on 11 October 1999.

The amendments are based on experience of the above laws in practice, on related EU directives, and relevant legal regulations in other countries of the world. In general, it is possible to say that the above amendments are not isolated pieces of legislation, but are consistent with the actual procedures commonly applied in regulating the functioning of a banking system,

b) Amendment to Act No. 118/1996 Coll. of NC SR on the Protection of Bank Deposits with Amendments to Other Related Laws (hereinafter referred to as 'Deposit Protection Act'), which became effective on 1 July 1999; and

c) Amendment to Act No. 310/1992 Coll. of the Slovak National Council (SNC) on Home Savings as amended by Act No. 386/1996 Coll. of NC SR (hereinafter referred to as 'Home Savings Act'), which became effective on 1 October 1999.

24. *Amendment to the Banking Act.* The Banking Act, as the most comprehensive basic banking regulations, was amended and augmented in 1999 by Act No. 252/1999 Coll. of Laws.

The above Amendment to the Banking Act was designed to facilitate the achievement of the following objectives:

- a) to make it possible for more citizens to obtain a mortgage loan;
- b) to create legal conditions for the provision of legal aid in criminal matters;
- c) to ensure increased protection for the clients of local banks and branches of foreign banks;
- d) to increase the level of payment discipline among the debtors of banks and branches of foreign banks;
- e) to improve and strengthen the performance of banking supervision.

25. *Amendment to the Deposit Protection Act.* The Deposit Protection Act of 1996, which is based on Directive No. 94/19/EC of the European Parliament and the Council of the EU on deposit protection schemes (dated 30 May 1994), has been amended and augmented by Act No. 154/1999 Coll. of Laws (hereinafter referred to as "Amendment to the Deposit Protection Act"). The Deposit Protection Act is based on the principle of solidarity and collective responsibility of all banks and branches of foreign banks for inaccessible deposits. This Act is one of the basic legal pillars on which the stability of the banking system rests in the Slovak Republic. The Amendment to the Act does not interfere with the above principle or other principles on which the said Deposit Protection Act is based. In the light of the Background to the Revised Act, the Amendment to the Deposit Protection Act was passed with the following chief objectives:

- a) to shorten the time limit set for the payment of compensation for inaccessible deposits;
- b) to make the activity of the Deposit Protection Fund more effective;
- c) to maintain the stability of the banking system during payment of compensation for inaccessible deposits.

26. *Amendment to the Home Savings Act.* The Home Savings Act was amended and supplemented by Act No. 242/1999 Coll. of Laws in 1999. This law regulates the legal position of banking institutions specialising in accepting deposits from and granting loans to home-savers, i.e. home savings banks, which are not universal banks. The law was designed to create a legal framework for financing the housing needs of individual savers from the resources of the Home Savings Fund, specially formed for that purpose.

The Amendment to the Home Savings Act of 1999 was passed (as laid down in the Background to the Act) with the following objectives in mind:

1. to remove the existing barriers hindering the application of the system of home savings and loans;
2. to create legal conditions for the entry of corporate entities into the system of home savings and loans;
3. to create conditions for the return of 'friendly savers';
4. to open up new possibilities for utilising the free resources of the Home Savings Fund;
5. to exert a positive influence on the economy of Slovak Republic.

27. *Favourable tax treatment of reserves and provisions.* Prior to 1st January 1997 there was no tax deductibility of loan-loss provisions and banks (and other creditors) were required to pay taxes on accrued income (whether or not received) on non-performing loans. By making it more expensive for banks to build reserves, these factors tended to slow even further the adjustment processes taking place in the Slovak economy. However, on 1st January 1997, the 1997 Act on the State Budget was amended allowing tax deductibility of the provision for interest on bad loans. At the end of December 1999 new Act about taxation of provision have been enforced, this Act reduces tax base by part of created provision and reserves.

28. *Bankruptcy Law Amendments.* Pursuant to current bankruptcy laws, State budget and contribution entities, municipalities and certain legal entities established directly by the National Council of Slovakia, such as, *inter alia*, the NPF and the NBS, are immune from Slovak bankruptcy laws and, therefore, bankruptcy proceedings in Slovakia. The originally available immunity to entities designated as strategic enterprises under the Law on Strategic Enterprises was abolished on 1st February 1998 by an amendment to the Bankruptcy and Composition Law. The amendments were made more effective by the introduction of measures which have cancelled the obligatory negotiations procedure following the submission of a bankruptcy writ, introduced a 60-day announcement requirement and generally simplified and accelerated the administration procedure. In addition, the Slovak Constitutional Court issued a ruling, which became effective on 3rd April 1998, that the other immunity provisions of the bankruptcy laws contradict the Constitution of Slovakia. No substantial amendments have been passed to bankruptcy law during the year 1999.

3.2. Prudential Standards

29. Slovakia's banking industry is regulated by the Act on Banks No. 21/1992 Coll. of Laws as amended. The NBS is the primary supervisory authority with respect to all Slovak banks and issue licences and consents with respect to bank operations. The NBS supervises banks through regular inspections and reviews of accounting documents and reports submitted by the banks in accordance with the NBS regulations governing capital adequacy, credit risk exposure, liquidity ratio, classification of claims and off-balance sheet liabilities and regulation of the foreign exchange position.

30. On 31st January 1994, the NBS introduced capital adequacy, liquidity, credit exposure and foreign exchange position requirements based on the Basle standards. Until then the National bank of Slovakia used prudential rules issued by the Czechoslovak State Bank. During 1995, the NBS introduced

regulations regarding the compulsory evaluation and risk assessment of outstanding debts, the creation of provisions against these risks and the reporting of this information in banks' annual accounts. An 8 per cent capital adequacy ratio was imposed on banks established after 31st December 1991. The minimum capital adequacy ratio has been raised in a series of steps, and all banks were required to reach the current minimum capital adequacy ratio of 8 per cent by no later than 31st December 1996.

31. In 1999, as in previous years, the prudential banking behaviour was regulated by five National Bank of Slovakia decrees, all decrees are based on international standards and recommendations of the Basle Committee on Banking Supervision. Starting point in evaluation of compliance with the prudential decrees for the Banking Supervision Division was analyse and work-up of accounting data and information provided in regular reports of banks on capital adequacy, credit exposure, liquidity, regulation of foreign exchange positions, and on rules for evaluation of claims and off-balance sheet liabilities of banks according to the risks involved, and for the creation of provisions to cover such risks (classification of claims and off-balance sheet liabilities). The Banking Supervision Division utilises an information system based on assessing early-warning and financial ratios in evaluating developments and trends in individual banks, groups of banks, and the entire banking sector. Assessment of prudential behaviour in the banking sector is conducted systematically also via on-site inspections carried out by the Banking Supervision Division of the NBS.

32. *Capital Adequacy.* NBS decree No. 5 of May 16, 1997 on capital adequacy requires all banks to maintain a minimum level of capital adequacy of 8 per cent. As at 31 December 1999 deductible items exceeded capital in one commercial bank and one state financial institution, whilst three banks were found not to have complied with the obligatory capital adequacy limits. Capital adequacy of evaluated banks operating in the banking sector of the Slovak Republic at the end of the year 1999 reached 13,7 per cent (without Konsolidacna banka, including this bank aggregate capital adequacy of the whole banking sector reached 5.4per cent). This positive trend (at September 1999 CA reached -0.07 per cent) result from an increasing capital applied to the calculation of capital adequacy and decreasing risk-weighted assets (see "Banking reform" above).

33. *Credit Exposure.* Under the NBS Decree No. 3/1994, banks are required to carry out a monthly monitoring of their credit exposure to potential loss caused by high credit exposure to a single borrower, or an economically linked group of borrowers. Net credit exposure to non-bank customers must not exceed 25 per cent of a bank's capital, or to other banks 80 per cent, and the total amount of individual net credit exposures, which in each case exceed 15 per cent of the bank's capital must not exceed 800 per cent of the bank's capital.

34. *Liquidity.* Apart from the monetary instruments applied by the National Bank of Slovakia, liquidity was influenced by the actual situation and market developments, characterised by a continuing shortage of mainly long-term, and to a lesser extent, medium-term funds, chronic problems of the capital market, insufficient number of powerful investors, tax legislation, etc. The combination of these factors was reflected in the shortage of liquid funds and the subsequent failure of certain banks to comply with the minimum reserve requirement, in miss-match in maturities of resources and their use. The Decree No. 7/1997 of the NBS tightened the rules of liquidity management, by requiring banks and branches of foreign banks to maintain a 100 per cent ratio of assets against liabilities with maturity within one month. Six banks failed to meet these requirements at the end of December 1999.

35. *Foreign Exchange.* The NBS Decree No. 11/1997, pertaining to regulation of open foreign exchange positions of the banks, sets out rules for prudent banking operations in foreign currencies. For the difference between assets and liabilities in individual currencies calculated in Slovak crowns, the Decree sets the limit of 10 per cent in relation to the bank's capital, and for the aggregate open foreign exchange position, the limit of 25 per cent. Following the adoption of banking supervision measures against banks

failing to meet the required limits, except for banks undergoing transformation, risks taken in open positions in the course of the year were mostly short-term in nature, and the number of banks failing to meet this requirement showed substantial decrease.

36. *Classification of Claims.* Decree No. 3/1995 sets out uniform requirements for reporting and evaluating claims and off-balance sheet liabilities held by banks and branches of foreign banks, with respect to the risks involved and the need to set aside funds to cover those risks. The development of classified assets showed a marked deterioration in 1998. This trend of deterioration of assets has been continued until the November of the year 1999. As a result of first stage of restructurisation of these three banks was decreasing of amount of uncovered estimated losses. The banking sector of Slovakia as a whole reached uncovered estimated losses at the end of December 1999 approximately SK 13.2 billion.

37. Total banking sector claims and off-balance sheet items (from principal and interest) as at 31st December 1999 and their breakdown into risk categories ranging from standard to loss are set forth in the table below. Total balance sheet claims were Sk 556.1 billion. Of these, classified claims (generally with payments overdue by more than 90 days) totalled Sk 125.1 billion (22.5 per cent), including SK 98.2 billion (17.7 per cent) in the loss category. A further SK 38.2 billion (6.9 per cent) of claims were in the "special mention" category, indicating some deterioration in quality (such as payment delays of 30 to 90 days), but where full repayment is still expected.

4. Bad Debts

38. The Slovak economy suffers from extremely high internal indebtedness. Enterprises have an unsustainable level of debts and the major banks hold a huge portfolio of classified loans on their books (25 per cent of GDP). In order to cope with this impediment to economic growth in Slovakia the Government, with support from the World Bank, has designed a comprehensive Programme of restructuring for banks and enterprises. The approval of the Programme by the Slovak Cabinet in August 1999 opened the way for completion of the design of a work-out scheme and elaboration of several pieces of legislation, including bankruptcy law, and necessary amendments in other relevant legislation.

4.1. Restructuring programme

39. The institutional infrastructure for the restructuring and privatisation of banks has been set up and a Steering Committee has been established in order to take decisions on the implementation of the Programme. Consequently, a Co-ordination Unit for restructuring and privatisation (BPU) has been charged with carrying out the decisions of the Steering Committee and also management of day-to-day activities.

40. The Government programme for the restructuring of both the three largest state-owned banks and the enterprise sector focuses on three basic issues; reform of the bankruptcy system, the design of a work-out scheme and the financial restructuring of enterprises. The adopted scheme for bank restructuring is based on a bad-assets swap in which the doubtful and loss categories in the loan portfolio of the three troubled banks are carved out and transferred into a special loan rehabilitation agency which was established to serve this purpose. An important step in the implementation of the programme was completed in December 1999 when a substantial portion of classified assets from the portfolio of the three major state-owned banks was carved out at a nominal value of (based on the Government decree No. 908 of 21 October 1999 and No. 1133 of 22 December 1999); 45.0 billion Sk from General Credit Bank (hereinafter VUB), 22.8 billion Sk from the Slovak Savings Bank (hereinafter SLSP), 6.4 billion Sk from the Investment and Development Bank (hereinafter IRB) and transferred to the recently established Slovak Consolidation Agency (67 billion Sk) and to the state-owned Consolidation Bank Bratislava (8 billion Sk).

The carved out amounts were swapped for the loans with a state guarantee from individual banks to the Slovak Consolidation Agency and to Consolidation Bank Bratislava.

41. The banks used the accumulated provisions and reserves for covering the outstanding amounts of classified loans held in their portfolios. The Ministry of Finance used funds withdrawn from the National Bank of Slovakia (as a result of the issuance of a state guarantee, which released reserves held by NBS) and re-capitalised the two banks – 10.1 billion Sk was injected into the equity of VUB and 4.9 billion Sk to SLSP. The objective of this first phase of bank restructuring was the proper clean up of the banks' balance sheets in order to increase their capital adequacy ratio to the minimum standard level (8 per cent) and to improve their profitability and value prior to privatisation.

42. A second carve out of around 31 billion Sk is currently being prepared and should occur in April-May 2000. The loans carved out within this second wave should be of “better” quality, being rated as watch and doubtful loans (the restructuring of debtors is possible). The loans will not be carved out at their nominal value, but the value should reflect the provisions and reserves created. The second carve out is based on the results of diagnostic audits carried out in individual banks and the selected bank privatisation advisor is assisting in this process. This will complete the clean up of the banks prior to privatisation, so they may be privatised as quickly and for as much value as possible. The banks themselves will work out about 15-20 per cent of classified but still recoverable loans, which remain in the banks' portfolios. Investors should provide further skills and training to improve restructuring capacity within the banks.

4.2. Slovak Consolidation Agency

43. The Slovak Consolidation, j.s.c. (hereafter the Agency) was legally established on October 25, 1999. The initial shareholder structure includes: Ministry of Finance of the SR (24 per cent), Consolidation Bank Bratislava (19 per cent), VUB (19 per cent), SLSP (19 per cent), Investment and Development Bank (IRB) 19 per cent. During the year 2000 the shareholders' shares will be transferred to the Government through the provision of coverage for the bad loans by the issuance of government bonds. The Agency will then be a fully state-owned company.

44. The Government approved the working scheme and the institutional design of the Agency on March 15, 2000 and consequently will select, based on public tendering, the chief executive officers of the Agency. This scheme establishes an orderly, transparent and fair system of efficient in dealing with cases being processed through the Slovak Consolidation Agency. The institutional structure ensures the separation of the executive and control competencies. There will be a Supervisory Board (representatives of relevant state authorities), a Board of Directors (selected through public tender appointed by the Supervisory Board) and an Investment Board (5 reputable specialists with international experience) established. The Agency should be of limited life span whereas the sunset is foreseen within 3-5 years.

45. The Slovak Consolidation Agency has been made responsible for the workout of the majority of the recently carved out non-performing loans and for elaborating the sales&outsourcing scheme. These loans are of poor quality – in about 90 per cent of cases bankruptcy has already been declared. A further carve-out of classified loans will be carried out during the first quarter of 2000. Then the Slovak Consolidation Agency will manage a loan portfolio of around 100 billion Sk. Recoveries are estimated at around 10 per cent and will be used to offset both the costs of the Slovak Consolidation Agency and the costs of servicing government bonds issued to finance the carve-outs from the banks. The majority of claims will have to be covered by budgetary provisions. Government bonds will be issued to the equity of the Agency in exchange for the carved out claims from mother banks, through which the Government will become exclusive owner of the Agency and loans from the mother banks will be paid back. Should this

operation not be carried out prior to March 2001 the exception to the Bankruptcy Code granted to the Agency (Article 66 g) will expire and the Agency will declare the own bankruptcy.

46. The Slovak Consolidation Agency will analyse and structure the portfolio of classified loans, auction selected bundles or pools of loans and will oversee the process of restructuring within the portfolio. The crucial issue is the availability of technical expertise through the provision of external workout specialists as well as through building the Agency's own restructuring capacity. The Agency will be focussed on the pooling and packaging of loans and assets either for immediate sale to investors or, where an immediate sale is not possible, the pools of loans will be restructured and managed by private sector asset management firms. The Agency will not itself attempt to restructure loans or the underlying borrowers, and the Agency will not act as a source of finance for restructuring.

47. The Agency will initiate a pilot programme directed at assets already in bankruptcy proceedings from the first carve out. This pilot programme, which will essentially consist of competitive tendering for law firms to carry out legal activities related to the bankruptcy proceedings, should be underway by Summer 2000 and will provide valuable experience in developing asset management contracts, contract administration, and tender administration procedures. However, assets transferred in the second round of carve-outs from the banks are expected to be more appropriate for sale or asset management activities rather than simple legal management and will therefore require extensive work to prepare due diligence and information packages and the development of sophisticated marketing and auction techniques.

48. The Ministry of Finance is recently preparing Phare 2000 project devoted to bad debts restructuring issues. The technical assistance for the Agency in preparing due diligence information packages on individual cases and in actual restructuring and outsourcing activities – pooling and auctioning is envisaged. The legal advice will be provided as well. There is a request, within the project, for financing an independent foreign expert with extensive experience in the field to be a member of the Investment Board in the Agency.

4.3. Consolidation Bank Bratislava

49. The Consolidation Bank Bratislava (KBB, s.p.u.) is the state financial institution specialising since 1993 in the rehabilitation of sensitive loans such as loans to enterprises which have undergone a conversion from military to civil production, municipal loans, some agricultural loans and claims guaranteed by the Slovak Guarantee and Development Bank.

50. About 20 per cent of the recently carved-out classified loans were transferred to the Consolidation Bank Bratislava. The specific nature of those claims is that they can be resolved only by liquidation of the debtor. The Bank has been charged with the restructuring of claims relating to economically and socially important debtors.

4.4. Privatisation of selected banks

51. The three major and one minor state-owned banks are to be privatised during the year 2000. The VUB, SLSP and small Banka Slovakia were involved to the privatisation programme supported by Phare funds. The pre-privatisation audits are recently being finalised (Arthur Andersen, Deloitte & Touche), upon which the due-diligence packages will be produced. The privatisation advisors were selected in December 1999 through international public tender, White&Case for legal issues and J. P. Morgan as financial advisor. The privatisation of IRB is running separately, the financial advisor (Creditanstalt Investment Bank) was appointed recently (March 2000). The banks should be preferably sold to foreign

strategic investors being able to transfer know-how and good practice, to bring in additional capital and being interested in developing business in Slovak market.

4.5 Legislative framework of the restructuring process

52. The most important assumption for ensuring sustainable economic growth and cleaning-up the economy is to create an appropriate legislative environment. Several pieces of legislation are to be adopted and a number of provisions are being amended in order to make bank the restructuring feasible.

53. The vital piece of legislation for bad-debt recovery is the Bankruptcy Code. On February 25, 2000 the Draft amendment of the Bankruptcy Code was approved by the Legislative Council of the Government. On March 22, 2000 the Government approved this amendment. The Code is expected to become effective as of May 1, 2000.

54. This comprehensive amendment of the Bankruptcy Code introduces new features; strengthens creditors' rights and facilitates fast track bankruptcy and debt-equity swap. Several provisions relating to working with claims institute the possibility of forgiving claims and related tax treatment, write-off claims and related tax treatment, receivable assignment with/without discount and collateral and security. The bankruptcy procedures period is shortened to 18 months and the possibility for creditors to initiate a change in the bankruptcy estate administrator is introduced. Tax, insurance and other related legislation is also to be amended.

55. In order to comprehensively prepare the appropriate environment for restructuring of the enterprise and public sector, further legislative changes are envisaged. The Slovak Consolidation Agency itself should also contribute to this process. Through these changes the Tax Authorities, Social Insurance Fund, National Labour Office and Health Insurance Companies (i.e. public sector funds) will be given the possibility to pool – with other debtors – claims against the debtor in order to strengthen their position in particular cases and facilitate the restructuring of enterprises.

56. The Corporate Governance provisions, together with further adjustments in the Bankruptcy Code (introduction of Fast Track facility) and adjustments in Collateral Law, are to be introduced. These changes should further strengthen the position of banks as creditors and help to avoid a repetition of the bad debts problem. This requires changes at two levels. The responsibility of management to the supervisory board, shareholders/owners and creditors is to be strengthened whereas, at the second level, public awareness relating to these issues should rise.

4.6 Total Banking Sector Claims and Off-Balance Sheet Items (“OBSI”)

SUMMARY OF SLOVAK COMMERCIAL BANKS AND FOREIGN BRANCHES

The analysis of the risk claims coverage based on the NBS Provision n.

3/1995

according to the report on categorization of claims and off-balance sheet liabilities as of 31.12.1999 thousand Sk (preliminary data)

Categories of balance sheet items	Principal	Interest	Total	Collateral	Provisions required		Created provisions		Difference
					total claims	on interest	total claims	on interest	
Claims									
Total claims	526461737	28933472	556060363	32514280	88054217	26874104	46439724	21220080	42154116
Standard	391122784	921856	392044640	x	x	x	x	x	x
Special mention	37071953	1137511	38209464	x	1907172	x	x	x	1907172
Substandard	11828994	814451	12643445	6707363	1838795	814451	1458739	624336	422755
Doubtful and litigious	12611638	1723511	14335149	6429198	4846606	1723510	4829991	1715730	471541
Loss	73826368	24336143	98162511	19377719	78799031	24336143	40150994	18880014	38690036
Deferred income from classified claims	x	x	665154	x	662612	x	x	x	662612
Disposable reserves and reserve fund								(-)	28967859
Uncovered expected loss from balance sheet items									13192198

Total off-balance sheet liabilities	76879922	x	76879922	2442892	x	x	x	x	657713
Standard	73664629	x	73664629	x	x	x	x	x	x
Substandard	930854	x	930854	844993	x	x	x	x	17207
Doubtful and litigious	631852	x	631852	531802	x	x	x	x	50025
Loss	1652587	x	1652587	1066097	x	x	x	x	590481
Disposable reserves and reserve funds								(-)	657714
Uncovered estimated loss from off-balance sheet items									0

Total of uncovered estimated loss									13192198
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Notes:

Risk categories (the following time criteria generally apply, although other considerations also affect the classification):

“standard”: payments have been made on time;

“special mention”: payments overdue by up to 90 days, past due loans which are totally collateralised by cash, State guarantees or State and certain other securities;

“substandard”: payments overdue by at least 90 days but not more than 180 days;

“doubtful and litigious”: payments overdue by 180-359 days;

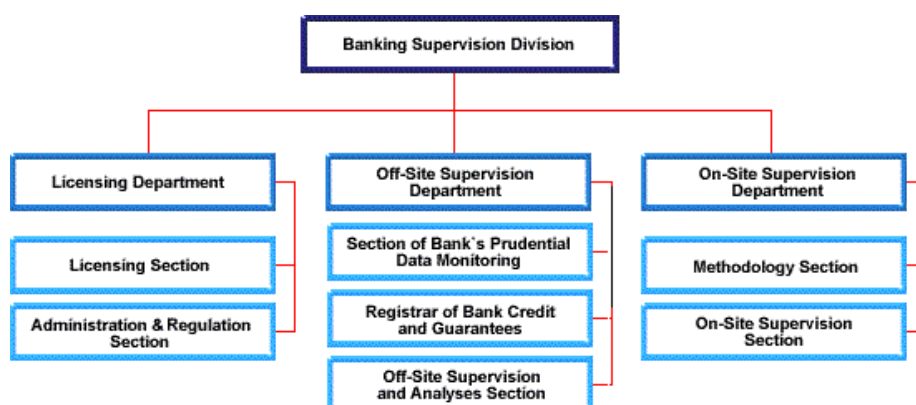
“loss”: payments overdue by at least 360 days.

Source: The National Bank of Slovakia

5. Banking Supervision Division

57. The Banking Supervision Division (the “BSD”) is the department of the NBS responsible for overseeing all areas of domestic and branches of foreign banks in Slovakia.

Organisational structure of Banking Supervision Division



Number of employees:

14 employees	26–employees	18 employees
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58. The construction of the banking supervision division was influenced by developments in legislation, in particular the most recent revision of Law 21/1992 Coll. on Banks as well as the gradual fulfilment of basic principles of banking supervision known as the Basle Core Principles.

The Activities of the Banking Supervisory Authority

59. Licensing Department of the Banking Supervision Division

Licensing Department of the Banking Supervision Department currently consists of two Sections: Licensing Section and Administrative and Regulatory Section.

- a) Licensing Section is mainly involved in licensing procedure of new banks and also in reviewing applications for branch licences of foreign banks. It also registers foreign banks and foreign financial institution representation offices. Another important task of the Licensing Section is to review applications for so called „prior approval“ procedures. In fact it means regulation of the shareholders changes in existing banks and effective control of banks investment into non-bank entities. Also mergers and acquisitions taking place in the banking sector of the Slovak Republic have to be approved by this particular Section of the Banking Supervision Division. Accordingly this Section takes part in issuing secondary legislation for licensing, prior approvals, mergers and acquisition and rep offices registration procedures.

b) Administrative and Regulatory Section participates in all above mentioned tasks from the point of view of valid legislation in banking and actively takes part in corrective actions procedures. Above that it also is involved in imposing forced administration regime to a certain bank and the resolution to withdraw a banking license is made at this Section as well. This Section - as mentioned above - is involved in issuing secondary legislation for its respective field of responsibility and as it consists of lawyers it also takes part in proposing amendments of banking laws from the supervisory point of view.

60. The supervision of banks is exercised by combining off-site monitoring and on-site inspections.

Off-site Monitoring Department

61. Banking Supervision Division systematically monitors and analysis the financial condition and performance of banks. For this purpose, it has created, and constantly improves, a Banking Supervision Information System, as an early warning system, aimed at monitoring the risks underwent by commercial banks in their activities. The assessment is done through three viewpoints of a commercial bank's financial situation:

- Through the structure of assets and liabilities;
- Through the quality of assets and liabilities;
- Through the performance of a commercial bank's different types of activities.

Data are analysed from the point of view of the evolution dynamics, i.e. comparison in the available time series, complexity of the followed phenomenon, i.e. in connection with related indicators and the assessment of the risk evolution tendency.

On-site Department

62. On-site supervision section makes comprehensive and target oriented examinations of banks. The main goal is to focus on the credit portfolio of the banks, connected lending, management of assets and liabilities, on assessment of management, on the adequate amount of creation of reserves and provisions, on categorisation of the assets.

II. THE CAPITAL MARKET

6. Slovak Capital Market developments

63. The Slovak capital market may not be considered as functioning one with respect to performance of its fundamental functions: allocation and economic signal. Even if the Slovak capital market belongs among the emerging markets in Central and Eastern Europe and has a lot of common features with them, specific problems exist as well. These difficulties are closely related to capital market structure having the following features:

1. Many shareholders calculated per number of citizens
2. Investors are less active
3. Lack of liquid securities
4. Existing non-standard entities on the capital market – investment funds
5. Absence of some types of institutional investors (first of all pension funds).

64. Also non-transparent mode of privatisation through direct sales negatively affected the capital market in the Slovak Republic as well, when in many cases the domestic entities were preferred to foreign investors, whereby the conditions were created to hidden the real owners of the privatised companies. These factors strengthened a tendency towards non-transparent property and personal relations followed by negative impact on transparency on the capital market.

65. Analysed situation on the capital market in the recent periods indicated a need for its fundamental reform. In order to overcome the present difficulties the Slovak Government approved the Concept of Capital Market Development in August 1999, which set forth a major task to harmonise a legal and regulatory framework of the capital market with that applied in the OECD and EU-Member Countries, to achieve compatibility between the institutions on the Slovak capital market and settlement and clearing systems with similar institutions and systems on the developed capital markets and to establish a special regulatory institution of the financial market to be able to become an authority ensuring adequate ethical, prudential and systematic supervision over the capital market along with liberalisation of capital movements.

66. In order to re-gain a confidence of the investors the Slovak Government has already taken some steps aimed at higher level of transparency on the capital market. Adopted Acts No. 127 and 128/1999 Coll., which amended the Commercial Code and the Securities Act and became effective as of 1st July presented important measures in this regard. Their aim was to make the property of the privatised assets more transparent, especially through abolition of dematerialised bearer's shares, and to increase protection of minority shareholders. Moreover, foreign security dealers were allowed to perform their activities in the Slovak Republic through their branches in order to meet the requirements by the OECD.

67. Amendment of the VAT Act removed a negative impact from the VAT Act concerning performance of the investment services. Taxpayers who are not security dealers will be allowed to use only 1 per cent in denominator of ratio with respect to sale of securities (instead of 10 per cent) which will positively influence the amount of demanded deduction of tax at the entry. Amendment of the Income Tax Act made investments to listed securities more advantageous with respect to tax compared to the investments to other types of securities. With respect to a higher attractiveness of our market for both domestic as well as foreign investors we may consider as important, that in relation to the adopted Act Amendment on Large Privatisation a relaxation of trading with bonds of the National Property Fund on the public market is under preparation and possible partial privatisation of some enterprises is also considered

through the capital market, especially through exchange of the shares of these enterprises for bonds of the National Property Fund.

68. In December 1999 the Act on Collective Investment No. 385/1999 Coll. of Laws was adopted and became effective as of 1st January 2000. This act is aimed at higher protection of participants of the collective investment and at harmonisation of rules for collective investment with those applied in Europe. In order to make the environment readable and after having examined the experiences obtained from execution of state supervision the requirements for capital adequacy for the trust companies and for performance of depository activities became more stronger. Along with the Act on Collective Investment the Act No. 361/1999 Coll. of Laws was also adopted, that amended the Debt Securities Act, and thus in accordance with the requirements by the OECD the conditions were liberalised for issue of debt securities with maturity of more than 1 year.

69. Expected reform of the legal and regulatory framework for the Slovak capital market will continue under the following steps:

70. In accordance with the Plan of Legislative Tasks for the Government draft of new Securities Act is under preparation. In accordance with the principles contained in the Concept mentioned above this Act will:

- allow new financial instruments (in particular derivatives) and procedure for trading on the public markets,
- specify the rules for provision of investment services and rules for capital adequacy for security dealers,
- specify unambiguously the scope and form of information provided by the issuers of securities and impose more stronger sanctions due to failure to perform the information requirements,
- specify in details and extend the provisions concerning protection of minority shareholders,
- make the measures more severe against misuse of confidential information in case of trading,
- remove great number of non-liquid securities from the market due to rules to be specified for departure of issuers from public market.

71. Along with new Securities Act a new Act on Stock Exchange will be prepared. This Act will adjust in particular the conditions for acceptance of the securities for trading on the Stock Exchange and will make the conditions for listing of securities more severe.

72. According to the valid legislation the Ministry of Finance is responsible for the regulation of the capital market, which shall grant the permissions for security dealers, brokers, entities of collective investment, public market organisers, print houses of securities, issuers of public trading securities and bonds and will impose the sanctions for breach of legal regulations concerning capital market.

7. Principles of the Act on Financial Market Authority

73. One of the tasks mentioned in the Slovak Government Memorandum is to establish a common institution for supervision over the banks, saving banks, collective investment, insurance companies and security dealers, and thus to ensure more effective regulation of the financial market.

74. Establishment, position and competencies of special regulatory institution – Financial Market Authority, its operating structure, procedure applied for state supervision and granting of permission by the Authority and making decision on sanctions are regulated by the draft of the Act on Financial Market Authority and amendment and completion of some acts, whose effectiveness is expected as of 1st July 2000.

75. As the financial market is currently regulated by two institutions – Ministry of Finance of the Slovak Republic and National Bank of Slovakia as well as due to larger difficulties connected with regulation of the capital market and insurance industry than in the banking sector, we consider as convenient to establish a regulatory institution for the financial market under two steps. The first step consists of expected separation of supervision over the capital market and commercial insurance from the competencies of the Ministry of Finance of the Slovak Republic and establishment of self-regulated Financial Market Authority (hereinafter referred to as „the Authority“) during 2000. The proposed legal adjustment is a prerequisite for the first step to be taken as well as for fulfilment of the task to establish a special regulatory institution for the capital market and commercial insurance as it was encored in the Concept of the Slovak Capital Market Development in 1999. The second step, a separation of supervision over the banks from the competencies of the National Bank of Slovakia and shift of its performance to the Authority are expected during 2001-2002.

76. Draft of the Act is based on the recent practical experiences obtained from state supervision and reflects necessary prerequisites for its performance on a high quality level. Newly established Financial Market Authority will benefit from effective instruments and competencies to prevent loss of property of private persons.

77. According to the submitted draft of the Act the Authority as regulatory institution will fulfil the tasks of state administration to the extend of the competencies entrusted to the Authority by this Act as well as special factual and legal regulations relating to the capital market. (e.g. Securities Act No. 600/1992 Coll. in wording of the latest regulations, Debt Securities Act No. 530/1990 Coll. in wording of the latest regulations, Act on Collective Investment No. 385/1999 Coll.) and commercial insurance (Act No. 24/1991 Coll. on Insurance in wording of the latest regulations).

78. The Authority will apply new procedure to inspect the entities operating on the capital market and insurance industry as well as acting of the Authority, i.e. procedure for granting permissions and imposition of penalties. Proposed legal adjustment is based on the recent practical experiences obtained from state supervision and reflects the necessary prerequisites and conditions for its effective performance on a high quality level. New legal adjustment is aimed to provide the Authority with flexible mechanisms in order to prevent from lost property of private persons. Legal adjustment by a separate Act will benefit from the same regulation of controlling and court procedures for implementation of several factual and legal regulations relating to the capital market and insurance industry.

79. The Authority will perform the following activities within its competencies:

- State supervision over the entities on the capital market (e.g. Stock Exchange, security dealers, brokers, entities of collective investment, central depository of securities, issuers of public trading securities),
- State supervision over the entities on the insurance market (e.g. commercial insurance companies),
- Co-operation with the Ministry of Finance relating to elaboration and implementation of financial strategy,

- Co-operation with the Ministry of Finance relating to elaboration of generally binding legal regulations with respect to the capital market and insurance industry,
- Co-operation with foreign supervisory bodies with respect to the capital market and insurance industry,
- Performance of other activities stipulated by the Act and special regulations.

80. Council and its chairman, who will lead the Authority, will be the decision-making bodies. The council will decide as appeal body in the second range proceeding as well as in other professional matters connected with activity of the Authority.

81. In order to ensure the activities of the Authority relating to inspected observance of the special regulations on the capital market and insurance and examined performance of the measures to correct the discovered shortcomings the Act regulates the respective compulsory instruments and mechanisms including controlling procedures and special adjustment of acting of the Authority.

82. When establishing the Authority, use of present capacities of the respective units at the Ministry is expected. Expected number of employees is 100 persons, of which approximately 70 employees will come from the respective units of the Ministry.

III. INSURANCE MARKET

8. Situation on the Slovak Insurance Market and Supervision

83. The state supervision over commercial insurance business is ensured by the Ministry of Finance of the Slovak Republic in terms of the Insurance Act No. 24/1991 Coll. in wording of the latest regulations.

84. Legal and natural persons conducting business in the insurance sector on the Slovak territory are subject to supervision.

85. Supervisory activities include control over observance of the different provisions of the Insurance Act: insurance activity (granting licences for insurance business and change in scope of business activities of the insurance company, approval of the terms of insurance and their amendments and supplements) as well as issue of permission to perform inter-mediation activities.

86. Supervision consists of control over observance of:

- i) provisions of the Insurance Act and other generally binding legal regulations (Civil Code, Commercial Code, etc.) and implementation of measures issued by the Supervisory Authority,
- ii) principles for management of the insurance companies to ensure performance of their commitments,
- iii) scope of performed activities in accordance with the granted permission,
- iv) principles for building-up and use of the reserves.

87. As of 31st December 1999, 28 insurance companies operated in the insurance sector, of which 18 insurance companies are with foreign participation and foreign shareholders are prevailing or as the case may be held 100 per cent in 16 insurance companies.

List of the insurance companies is provided in Annex 1.

Development in Number of Insurance Companies Operating in Slovakia in Respective Years

Year	Number of Insurance Companies
1991	9
1992	6
1993	9
1994	11
1995	15
1996	19
1997	23
1998	26
1999	28

Source: Ministry of Finance of the Slovak Republic

Dynamic development in performance of the insurance companies is considerably expressed also in the amount of prescribed premiums.

Year	Prescribed Premium (in SKK bill.)	GDP in current prices (in SKK bill.)	Share of prescribed premium at GDP
1993	8,399	369,1	2,27 per cent
1994	9,193	440,5	2,09 per cent
1995	10,732	516,8	2,08 per cent
1996	14,041	575,7	2,44 per cent
1997	17,087	653,9	2,61 per cent
1998	21,424	717,4	2,99 per cent

Source: Ministry of Finance of the Slovak Republic

Development in total prescribed premium is provided in Annex 2.

88. Due to development of competitive environment on the Slovak insurance market share of the Slovak Insurance Company, Inc. (Slovenska , a.s.) is decreasing at total volume of prescribed premium. The Slovak Insurance Company, Inc. was the only insurance company operating on the Slovak insurance market till 1991.

Year	Share
1994	83.10 per cent
1995	78.78 per cent
1996	67.82 per cent
1997	62.30 per cent
1998	58.59 per cent

Source: Ministry of Finance of the Slovak Republic

89. Following the tendencies in the world a mutual relation between life and non-life insurance is subject to adjustment in favour of life insurance.

*Share of Life and Non-life Insurance on the Market According to Prescribed Premium
(in SKK mill.)*

	Life insurance	Share	Non-life insurance	Share	Total	Increase on year-to-year basis
1993	1 973	23.47 %	6 432	76.53 %	8 405	
1994	2 154	23,43 %	7 039	76,57 %	9 193	109,38 %
1995	2 554	23,81 %	8 178	76,19 %	10 732	116,74 %
1996	3 537	25,16 %	10 503	74,81 %	14 041	130,83 %
1997	4 603	26,94 %	12 484	73,06 %	17 087	121,70 %
1998	6 297	29,39 %	15 127	70,61 %	21 424	125,38 %

Source: Ministry of Finance of the Slovak Republic

90. Development in costs connected with insurance benefits in life and non-life insurance did not record any significant fluctuation with respect to reinsurance by prestigious reinsurance companies abroad to larger extend. Development in costs connected with insurance benefits in the Slovak Republic is provided in Annex 3.

91. Considering the necessary legal adjustments in the insurance industry as required by changed conditions on the Slovak insurance market in 1999 the Insurance Act Amendment of the Slovak National Council No. 24/1991 Coll. In wording of the latest regulation was elaborated as the Act No. 101/2000 dated 9 February 2000. The Act Amendment is focused on a progressive fulfilment of the OECD requirements:

- i) it allows another liberalisation of the insurance services, establishment of branches of foreign insurance companies, insurance of risks not covered by domestic insurers,
- ii) it ensures a principle for division the insurance companies to life and non-life insurance companies in case of new insurance companies, whereby insurance types and classes were introduced,
- iii) it specifies in details the insurance intermediary and terms for granting a permission for independent intermediary - broker,
- iv) for the first time it imposes a duty for the insurance company to employ an actuary.

92. The draft significantly strengthens the competencies of the Supervisory Authority, in particular:

- i) with respect to permission granted for performance of the activities in the insurance sector,
- ii) with respect to broader reporting and information requirements,
- iii) with respect to broader competencies of the Supervisory Authority to impose the penalties and sanctions,
- iv) with respect to broader scope of keeping secrecy relating to confidential documents and information for persons and institutions, which deal with such information.

93. In 2000 a new stage of development in the insurance sector is expected, which will be ensured by new Insurance Act and will make the insurance laws valid in the Slovak Republic fully compatible with those in Europe. Thus, another liberalisation of capital movement in the insurance sector will be ensured and rules will be harmonised with respect to investment of the reserves. After having achieved the integrated internal market and full harmonisation of the legal standards with those applied in Europe, a single passport will be introduced for the insurance companies.

IV. RESPONSE OF THE SLOVAK AUTHORITIES ON THE ISSUES RAISED BY THE SECRETARIAT DOCUMENT DAFFR/CMF(2000)16

Part: Banking supervision

The analysis of implementation of the Basle Core Principles of Effective Banking Supervision, into the Slovak legislation, performed in 1999 by the Banking Supervision Division of the National Bank of Slovakia (BSD NBS) has shown that most of the Core Principles have been implemented into the Slovak legal standards and the principles are applied during the supervisory process. The analysis has identified areas that need to be implemented into the laws and by-laws in the near future while the purpose is to achieve effective banking supervision in the Slovak Republic. It concerns mainly banking supervision on a consolidated basis, introduction of monitoring and evaluation of other market risks and to enable the exchange of information among NBS BSD and other institutions responsible for the supervision of the financial market. Dates for the preparation of proposals concerning legislation modifications and relevant NBS regulations amendments, set in the timetable, were determined by NBS for the preparation of its own proposals; however they are subject to an approval within the legislation process of the SR (regarding NBS' limited powers for submitting such law amendment proposals). Since the beginning of 2000, BSD NBS has been reviewing the level of implementation of the Core Principle of Effective Supervision into the Slovak law in compliance with the detailed methodology published by the Basle Committee on Banking Supervision in October 1999.

Questions:

Point 3.

3.1 What can be considered a realistic timetable for introducing supervision on a consolidated basis?

A PHARE project (No. 97050101) is currently realised at BSD NBS. The objective of the project is to provide technical assistance and consulting in the development proposals for the amendment of legislation and NBS regulations, necessary for the implementation of supervision on a consolidated basis. The project will be completed in July 2000. Based on the its results, BSD NBS will prepare in the course of the second half of 2000 specific drafts of legislation amendments and subsequently it will prepare proposals for amendment of relevant prudential banking regulations.

3.2. In the meantime, to what extent have supervisors developed methods of ongoing supervision aimed at assessing the whole spectrum of risks incurred by Slovak banking institutions?

The amendment of the Banking Act of October 1999 has specified certain provisions, enabling NBS to issue regulations concerning the monitoring of risks connected with banking activities. BSD NBS continues to prepare their publishing in the course of 2000. In compliance with the timetable, which a part of the NBS evaluation document concerning the implementation of the Core Principles of Effective Banking Supervision into the Slovak law, this area will be implemented in 2002.

Within the scope of its supervisory activities, BSD NBS is limiting and monitoring also the following risks:

- credit risk exposure to a single debtor as well as to interconnected groups;
- capital adequacy;

- liquidity management;
- the risk of opened foreign exchange positions;
- and the quality of the loan portfolio.

Through its on-site examinations, BSD NBS verifies operations realised by banks with their subsidiaries, with banks within one group but also with related persons and evaluates the degree of risk connected with such operations.

3. 3. *What is the role of external auditors in this regard?*

The increasing range of banking products increases also requirements for risks monitoring. For the purpose of ensuring a uniform approach to the evaluation of risks from banking activities, the contents of an unabridged audit report was set up. BSD NBS has presented a draft of an unabridged audit report, based on the Banking Act. Following a mutual agreement of NBS, the Chamber of Auditors as well as representatives of other Slovak audit firms, such unabridged audit reports will be prepared already for the year 1999.

Unabridged audit reports are focused mainly at evaluating the quality of accounting systems, management information systems, credit risks, their concentration as well as the evaluation of risks pertaining to economically interconnected groups, liquidity risk, risks arising from opened foreign exchange positions, evaluation of security portfolios quality, bank's financial condition, its internal controls and audit. Once the measures for the preparation and implementation of a consolidated supervision are in place, requirements for content of unabridged audit reports will be extended.

Point 4.

4. 1., 4. 2. The NBS has proposed new wording in section IV of the Banking Act for empowerment to evaluate and set limits and acceptable procedures for market risk as well as other claims and off-balance sheet engagements. Has this proposal been accepted? Has the proposed timing for introducing this important reform been moved forward from the year 2002 as originally proposed?

In compliance with the planned amendment of the Banking Act in December 2000, BSD NBS will propose amendments empowering it to monitor market risks. After this approval the NBS proposal will anticipate modification of the originally planned date.

4. 3. To what extent are the supervisory authorities currently empowered to monitor and control risks associated with country and transfer risk in banks' international borrowing and lending activities?

BSD NBS can monitor and evaluate all risks incurred by banks and simultaneously close co-operation with external auditors has resulted in a mutual agreement on the content of unabridged audit reports for 1999 that will include also an evaluation of banks' country and transfer risks their international borrowing and lending activities. NBS performs also targeted on-site examinations, focused on the evaluation of risks in a specific area.

Point 5.

5. 1. What are the measures adopted for recovering the situation when the Act on NBS does not provide for any system to exchange information with other bodies supervising other financial market participants?

The new wording of the Banking Act of October 1999 imposes an obligation for the Securities Centre to provide NBS with information necessary for banking supervision purposes. The draft of the Law No. 566/1992 Coll. on NBS in wording of later regulations contains provisions enabling NBS to establish an information exchange system with other bodies responsible for supervising other financial market participants. The draft of the Financial Market Authority Act provides a balanced, mutual exchange of information for banking supervision purposes between the Financial Market Authority and NBS. NBS expects to specify the information exchange through bilateral agreements.

5. 2. *In the absence of formal powers for information exchange, are there modalities for co-operation in the supervisory field between the NBS and other Slovak official bodies tasked with the oversight of non-bank financial institutions?*

The co-operation of NBS with other government bodies tasked with the oversight of other financial market participants is ensured on the basis of appropriate provisions of the Banking Act (e.g. in the licensing process or when considering an application for preliminary approval of a change in shareholders' structure in an existing bank, it collaborates with the appropriate departments at the Ministry of Finance).

5. 3. *What is the situation with regard to co-operation with foreign bank supervisors as well as capital market regulators?*

In July 1999, NBS has updated the agreement of 1993 on co-operation in the area of banking supervision, concluded with the Czech National Bank. Currently, negotiations with the Austrian banking supervision have started. The reason is the share of Austrian capital on the Slovak-banking sector. Gradually, agreements will be concluded with other banking supervisory bodies of countries having a significant portion on the Slovak-banking sector.

The capital market is currently regulated by the appropriate unit of the Ministry of Finance of the Slovak Republic. In its licensing activity, BSD NBS collaborates with the above department (e.g. in licensing securities trading).

Point 6.

6. 1. *Could the Slovak delegation comment on the issue of the planned consolidation of BSD with the Financial Market Authority?*

The institutional arrangement of banking supervision is currently discussed in many developed markets (Great Britain, Germany, Austria, USA) but also in the „emerging markets“ countries. The draft of the Financial Market Authority Act, which should enter into force in July 2000, provides in a first stage the oversight of capital and insurance market. The law defines the principles of co-operation between NBS and the Financial Market Authority.

6. 2. *Pending the consolidation of banking supervision with the new Authority, which principles and modalities will govern the relations between the NBS and the Authority?*

The draft of the Financial Market Authority Act defines the following principles of co-operation with NBS:

- principle of mutual exchange of information concerning supervisory activities;
- principle of passing the findings in compliance with powers and responsibilities;
- principle of mutual exchange of formal decisions.

Point 7.**7. 1. *Are there plans to transfer this responsibility to NBS?***

According to the timetable which is a part of the evaluation document prepared by NBS on the implementation of the Core Principles of Effective Banking Supervision into to the Slovak legislation, this area will be transferred to the responsibility of NBS in 2002 by amending the appropriate laws and by-laws (e.g. Banking Act, Act on NBS, Accounting Act).

The Ministry of Finance of SR has not had any material remarks when it was submitted for comment the document on the implementation of Basle Core Principles, prepared by NBS.

NBS has concluded a general agreement on co-operation with the Slovak Chamber of Auditors - the law empowers NBS to refuse an external auditor selected by a bank and it determines requirements for the scope of audits.

7. 2. *How adequate are Slovak accounting standards applying to banks in light of the development of new instruments in the marketplace?*

At present, all the powers for the area of accounting standards are with the MF SR. However, the view of NBS is that the valid legislation in this area allows the accounting units (i.e. also banks) to create and utilise a chart of accounts, establishing in principle all the prerequisites for recording performed activities. NBS co-operates with the Ministry of Finance on the preparation of the accounting methodology for banks.

7. 3. *How confident are Slovak supervisors about the quality and accuracy of banks' financial statements and banks' internal management information systems?*

BSD NBS is focusing on the quality of internal management information systems of any new bank already at the stage when its application for a banking license is reviewed. Statistical reports from banks are subject to controls effected through the information system of the NBS Department of Statistics. Such controls are cross controls within the report itself as well as in connection to other reports. Prudential reports from banks are normally subject to a two-step control; first at the level of the off-site surveillance staff and subsequently in a special information system of BSD (early warning system). During comprehensive on-site examinations in individual banks, both the form and the content of their information systems are verified.

7. 4. *Is the process of public disclosure currently in place timely and sufficient for market participants to assess the risks carried by Slovak banking institutions?*

The amended Banking Act of October 1999 imposes an obligation for banks and foreign banks branches to disclose publicly, on a quarterly basis, in a determined scope (not only financial data but also changes in shareholders' structure in case of banks, foreign banks' branches are obliged to inform also about the differences in the accounting rules in their country of origin compared to Slovakia). Banks are also obliged to inform in their operations premises about the deposit insurance scheme and to for all deposit products to indicate specifically if it is an insured deposit or not. Pursuant to this amendment of the Banking Act, NBS is empowered to issue a regulation establishing the scope of information that banks must disclose on a quarterly basis. Such regulation will be issued on the course of 2000.

Point 8.

8.1. *The last amendment of the Banking Act limits possibilities of non-banking entities to carry out banking activities. Could the Slovak delegation comment on this situation and inform the Committee about any further measures that are being undertaken?*

The purpose of amending Article 2 of the Banking Act (mainly the new paragraph 3, as expressed in point 8 below) was to restrict even more the legal possibilities with respect to illegal business activities exercised by non-banking entities, and thereby to limit their actual performance. There are approximately 15 non-banking entities in the Slovak Republic, out of which 5 with a countrywide activity. The reason for the amendment was that non-banking entities take advantage of the existing legal context for taking deposits (e.g. provisions of the Civil Code on silent partnership or provisions of the Notes and Cheques Act on notes) with no banking license. By doing that, they are deliberately avoiding the ban of illegal deposit taking stipulated in Article 2, paragraph 1 of the Banking Act.

Another factor restricting the activities of non-banking entities was the adoption and entry into force (1st January 2000) of a new law on Collective Investment. These law conditions collective investment of funds collected from the public on the basis of a public appeal by a license granted by the Ministry of Finance of SR.

Police (financial police and departments of economic criminality of the Police Corps) started to investigate the activity of certain non-banking entities and several persons were accused and are investigated in connection with fraud (Article 250 of the Criminal Act), speculation (Article 248 of the Criminal Act) and illegal business enterprise (Article 118 of the Criminal Act).

8.2. *Yet, there is reportedly a significant amount of deposit-taking and lending activity being carried out in the Slovak market both by non-bank corporate entities and natural persons on the basis of open appeal to the general public. ? Is there evidence that the importance of such “illegal” practices has been growing recently?*

The National Bank of Slovakia is collaborating with authorities involved in criminal proceedings and based on the information available, it is not aware that the importance of illegal practices carried out by non-banking entities would be growing in the recent period.

8.3. *Is there a risk of the development of large-scale pyramid schemes, as it was experienced in other countries in transition?*

We believe that the risk and probability of large-scale pyramid schemes is low. Such schemes and games appeared soon after 1990, when there were no legal obstacles for such financial schemes. Currently, the Slovak law is restricting financial schemes (games) mainly in Article 250g of the Criminal Act (Conducting of dishonest games and bets) and Article 250h of the Criminal Act (Illegal conducting of lotteries and similar games).

Annex 1

Insurance Company	Licence granted on	Basic capital * as of 31st Dec. 1999 (in SKK ths.)	Share of foreign capital as of 31st Dec. 1999 (in per cent)
1.Slovenská , a.s.	06.03.91	1 500 000	0.76
2.KOOPERATIVA , a.s.	20.03.91	345 000	84.93
3.Poistovna Otčina, a.s.	15.04.91	300 000	99.13
4.Ergo poistovna, a.s.	12.05.92	190 000	49.47
5.QBE – Slovenska investicna poistovna, a.s.	25.05.92	143 360	99.50
6.Union poistovacia a.s.	24.09.92	200 000	82.02
7.Allianz poistovna a.s.	26.01.93	370 000	100
8.Česká poistovna - Slovensko, a.s.	24.03.93	210 000	100
9.Komunálna poistovna, a.s.	13.10.93	136 000	-
10.POISTOVNA GERLING Slovensko, a.s.	29.09.94	75 000	100
11.VZAJOMNA ZIVOTNA POISTOVNA, a.s.	17.10.94	120 000	-
12.Univerzálna bankova poistovna, a.s.	27.03.95	300 000	-
13.Prvá cesko-slovenska poistovna, a.s.	30.05.95	230 700	9.53
14.Hasičská poistovna, a.s.	21.08.95	138 426	-
15.Prvá americko-slovenska poistovna, a.s.	19.09.95	147 200	100
16.Europska Cestovna Poistovna, a.s.	05.01.96	52 030	100
17.Dopravná poistovna, a.s.	18.01.96	91 816	-
18.Nationale-Nederlanden poistovna, a.s.	22.03.96	438 000	100
19. Poistovna TATRA, a.s.	25.06.96	91 000	-
20.Generali Poistovna , a.s.	22.01.97	145 000	100
21.KONTINUITA - Slovenska zivotna poistovna, a.s.	13.02.97	80 000	-
22.Všeobecná ľudová poistovna, a.s.	17.07.97	4 932 597	-
23.D.A.S. poistovna pravnej ochrany, a.s.	17.10.97	30 000	100
24.Wüstenrot, zivotna poistovna, a.s.	09.07.98	80 000	90
25.R+V Poistovna, a.s.	20.07.98	140 000	100
26.Poistovna AIG Slovakia, a.s.	14.09.98	70 000	100
27.Zurich Poistovna, a.s.	01.07.99	60 000	100
28.VICTORIA - VOLKSBANKEN Poistovna, a.s.	02.11.99	130 000	90

* Basic capital as indicated in extract from Business Register

Source: Ministry of Finance of the Slovak Republic

Annex 2

Year 1998 Insurance company	Written Premium (in thousand of currency)								1 US\$ = 42,665
	LIFE		Market Share (in %)	NON-LIFE		Market Share (in %)	TOTAL		Market Share (in %)
	Sk	US\$		Sk	US\$		Sk	US\$	
Slovenska poistovna, a.s.	3 397 652	79 636	53,95	9 155 029	214 579	60,53	12 552 681	294 215	58,59
KOOPERATIVA poistovna, a.s.	345 865	8 107	5,49	1 333 992	31 267	8,82	1 679 857	39 373	7,84
Poistovna OTČINA, a.s.	130 447	3 057	2,07	668 015	15 657	4,42	798 462	18 715	3,73
ERGO poistovna, a.s.	126 205	2 958	2,00	140 331	3 289	0,93	266 536	6 247	1,24
Slovenska investing poistovna, a.s.	335 749	7 869	5,33	255 906	5 998	1,69	591 655	13 867	2,76
Union poistovacia a.s.	3 537	83	0,06	382 563	8 967	2,53	386 100	9 050	1,80
Allianz poistovna a.s.	233 928	5 483	3,71	1 314 148	30 802	8,69	1 548 076	36 284	7,23
Ceska poistovna - Slovensko, a.s.	18 262	428	0,29	547 325	12 828	3,62	565 587	13 256	2,64
Komunalna poistovna, a.s.	27 139	636	0,43	184 103	4 315	1,22	211 242	4 951	0,99
POISTOVNA GERLING Slovensko, a.s.	-	-	-	63 449	1 487	0,42	63 449	1 487	0,30
VZÁJOMNÁ ŽIVOTNÁ POISTOVNA, a.s.	0	0	0,00	14 897	349	0,10	14 897	349	0,07
Univerzalna bankova poistovna, a.s.	34 958	819	0,56	201 981	4 734	1,34	236 939	5 553	1,11
Prva česko-slovenska poistovna, a.s.	100 090	2 346	1,59	991**	23	0,01	101 081	2 369	0,47
Hasicska poistovna, a.s.	32 400	759	0,51	411 413	9 643	2,72	443 813	10 402	2,07
Amslico, Prva americko-slovenska poistovna, a.s.	746 122	17 488	11,85	146 480	3 433	0,97	892 602	20 921	4,17
Europska Cestovna Poistovna, a.s.	-	-	-	13 199	309	0,09	13 199	309	0,06
Dopravna poistovna, a.s.	-	-	-	88 896	2 084	0,59	88 896	2 084	0,41
Nationale-Nederlanden poistovna, a.s.	629 577	14 756	10,00	64 235**	1 506	0,42	693 812	16 262	3,24
Poistovna TATRA, a.s.	4 129	97	0,07	53 639	1 257	0,35	57 768	1 354	0,27
Generali poistovna, a.s.	17 997	422	0,29	52 172	1 223	0,34	70 169	1 645	0,33
KONTINUITA – Slovenska zivotna poistovna, a.s.	113 001	2 649	1,79	11 644	273	0,08	124 645	2 921	0,58
Vseobecna ludova poistovna, a.s.	-	-	-	8 331	195	0,06	8 331	195	0,04
D.A.S. poistovna pravnej ochrany, a.s.	-	-	-	7 992	187	0,05	7 992	187	0,04
Wuestenrot, zivotna poistovna, a.s.	810	19	0,01	30**	0,7	0,0002	840	20	0,004
R+V poistovna, a.s.	36	0,8	0,001	4 770	112	0,03	4 806	113	0,02
Poistovna AIG Slovakia, a.s.	-	-	-	247	6	0,002	247	6	0,001
Total	6 297 904	147 613	100	15 125 778	354 524	100	21 423 682	502 137	100

** life insurance companies - written premium for supplementary non-life insurance

Annex 3

Costs Connected With Insurance Benefit (in SKK ths.)						
Insurance Company	1996	Market share (in per cent)	1997	Market share (in per cent)	1998	Market share (in per cent)
Slovenská poisťovňa, a.s.	6 273 570	86,81	7 875 541	81,62	8 668 751	76,38
Kooperatíva poisťovňa, a.s.	267 279	3,7	572 471	5,93	647 503	5,71
Poisťovňa Otčina, a.s.	248 607	3,44	295 372	3,06	404 389	3,56
Ergo poisťovňa, a.s.	1 625	0,02	28 127	0,29	38 117	0,34
Slovenská investičná poisťovňa, a.s.	48 279	0,67	89 017	0,92	199 668	1,76
Union poisťovňa a.s.	83 378	1,16	94 038	0,97	142 999	1,26
Spol. pre poisťenie export. úverov	1 266	0,02	-	-	-	-
Allianz poisťovňa a.s.	182 718	2,53	458 107	4,75	638 849	5,63
Česká poisťovňa - Slovensko, a.s.	98 219	1,36	142 500	1,48	224 226	2,15
Komunálna poisťovňa, a.s.	12 660	0,18	31 673	0,33	36 725	0,32
Poisťovňa Gerling Slovensko, a.s.	1 027	0,01	3 297	0,03	5 510	0,05
Vzájomná životná poisťovňa, a.s.	1 299	0,02	2 497	0,03	5 187	0,05
Univerzálna banková poisťovňa, a.s.	4 562	0,06	22 749	0,24	165 933	1,46
Prvá česko-slovenská poisť., a.s.	40	0	579	0,010	1 579	0,01
Hasičská poisťovňa, a.s.	645	0	15 669	0,16	71 408	0,63
Prvá americko-slovenská poisť., a.s.	303	0	3 407	0,04	13 733	0,12
Europská cestovná poisťovňa, a.s.	1 168	0,02	521	0,01	3 875	0,03
Dopravná poisťovňa, a.s.	123	0	3 901	0,04	15 172	0,13
Nationale-Nederlanden poisť., a.s.	0	0	4 690	0,05	15 617	0,14
Tatra poisťovňa, a.s.	79	0	4 913	0,05	7 513	0,07
Generali poisťovňa, a.s.	-	-	232	0,00	19 270	0,17
Slovenská životná poisťovňa, a.s.	-	-	2	0,00	1 617	0,01
Všeobecná ľudová poisťovňa, a.s.	-	-	0	0,00	510	0,00
D.A.S. poisť. právnej ochrany, a.s.	-	-	0	0,00	1 355	0,01
Wuestenrot, životná poisťovňa, a.s.	-	-	-	-	0	0,00
R+V poisťovňa, a.s.	-	-	-	-	0	0,00
Poisťovňa AIG Slovakia, a.s.	-	-	-	-	0	0,00
Total	7 226 847	100	9 649 303	100	11 349 506	100

Source: Ministry of Finance of the Slovak Republic