C. Banking Supervision

1. DEVELOPMENT OF THE BANKING SECTOR

In the course of 1996 (1 March 1996), Amendment No. 58/1996 Z.z. to the Banking Act (Act No. 21/1992 Zb.) took effect. The amendment introduced several substantial changes which: strengthened the central bank's banking supervision function, set up a registry of bank loans and guarantees, created a legal framework for mortgage banking, changed the system of licensing in the area of mortgage banking, changed the system of granting banking licences, imposed an obligation to re-licence the already active banks and branches of foreign banks whereby each of them had had to apply for a banking operations licence pursuant to the amended Banking Act.

In compliance with the Banking Act, the National Bank of Slovakia issued a number of regulations and applied them already in the course of 1996 in connection with applications for permission to establish a bank or a branch of a foreign bank, carry out banking operations, take equity participation in banks, sell a bank or branch of a foreign bank, and in certain other matters pertaining to banking.

The licensing policy of NBS was characterised by stricter requirements in terms of quality of investor, credibility, transparency, the contribution of the bank to the market in terms of banking products and know-how. The quality and preparedness of each applicant interested in entering the Slovak banking sector is carefully evaluated with regard to the business plan, clarity of banking goals, transparency of origin and the sufficiency of deposited capital. The strategic intention of the National Bank of Slovakia, rather than to encourage the formation of additional small universal banks, was to create favourable conditions necessary to attract potential investors to make capital participations in existing banks.

As at 31 December 1996, there were 24 banks and 5 branches of foreign banks operating in Slovakia. In terms of type, 22 banks were incorporated as joint-stock companies and two banks were registered as state financial institutions.

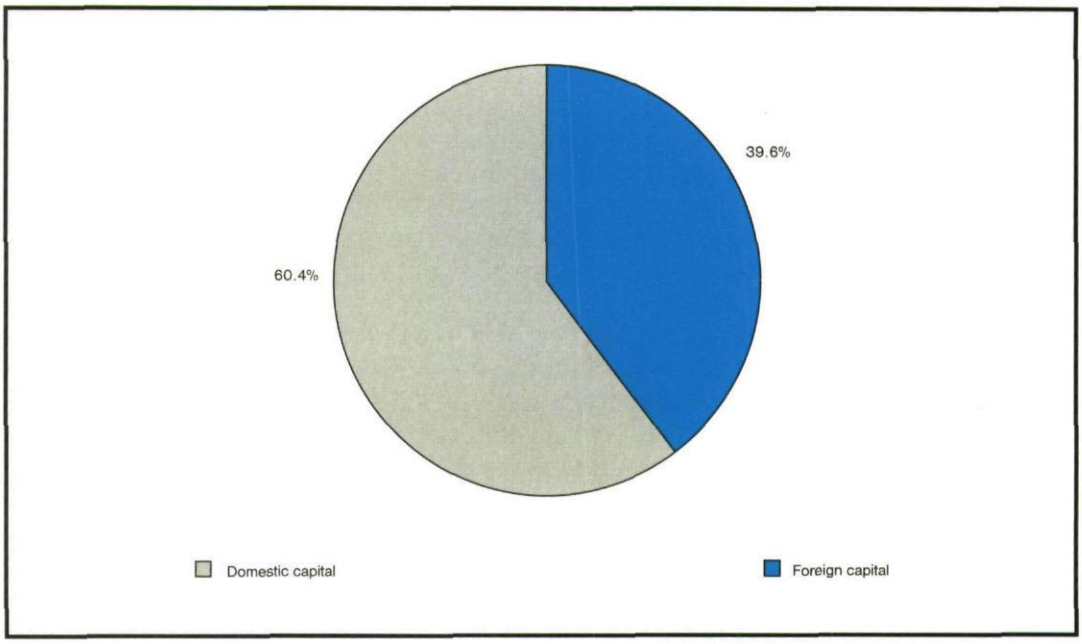
Two banks, granted a banking license in 1995, commenced operations in 1996: Banka Slovakia, a. s. Banská Bystrica (on 1 June 1996) and HYPO-BANK Slovakia, a. s. Bratislava (on 1 July 1996).

The sale of two bank entities took place in 1996. The Bratislava branch of COOP BANKA, a. s. Brno (a foreign bank) was - in compliance with the prior consent of the National Bank of Slovakia - sold to Dopravná banka, a. s. Banská Bystrica, with effect from 1 September 1996. Similarly, the same bank purchased the Piestany-based branch of another foreign bank - Ekoagrobanka a. s., Ústí nad Labem, with effect from 2 October 1996. At the same time, the NBS withdrew the branch bank's operating licence.

As of 31 December 1996, there were 12 representative offices of foreign banks in Slovakia, of which five with head offices in the Czech Republic, two in France, two in Germany, and one each in Austria, Hungary and Great Britain. One of these representative offices was registered in 1996, namely the Bratislava office of Živnostenská banka a. s. Prague, with effect from 3 May 1996.

Foreign capital participation in the equity of commercial banks in Slovakia is fairly substantial. Of a total of 24 active banks, five banks are 100% controlled by foreign entities, foreign capital participation in nine banks is over 10% and - in three banks - under 10% of the share capital. The remaining seven banks are fully controlled by domestic entities. The total share of foreign capital (including funds permanently committed to branches of foreign banks) in the subscribed capital of resident banks, represents 39.6%.

Structure of capital and permanently committed funds of banks and branches of foreign banks in the SR (as at 31 December 1996)



In 1996, Slovakia adopted two additional laws which have a substantial impact on the functioning of financial markets and the strategic goals of the banking sector development.

Act No. 118/1996 Z.z. introduced the establishment of a Deposits Protection Fund, which provides, as of 1 July 1996, a protection coverage for non-anonymous deposits of private individuals with banks and branches of foreign banks up to a maximum amount equal to 30 times the average monthly wage.

The process of privatisation in the banking sector was influenced by an amendment to Act No. 92/1997 Z.z. (which secures the strategic interests of the State in the privatisation of important state-owned companies and corporations), as subsequently construed by Ruling No. 135/1996 Z.z. of the Constitutional Court of the SR, under which Slovenská sporiteľňa, a.s. was put on the list of entities whose assets are effectively excluded from the process of privatisation.

2. EVALUATION OF PRUDENTIAL BANKING

The prudence of banking operations of commercial banks is evaluated on the basis of NBS provisions prepared in conformity with the international standards and recommendations of the Basle Committee for Banking Supervision. The evaluation is based on the processing of data from banks' accounts, submitted to the NBS in the form of reports on capital adequacy, credit exposure, liquidity ratios, regulation of currency positions and classification of claims. Provided that it complies with the prescribed limits and regulations, a bank may undertake risks adequate to the level of its capital adequacy according to international standards.

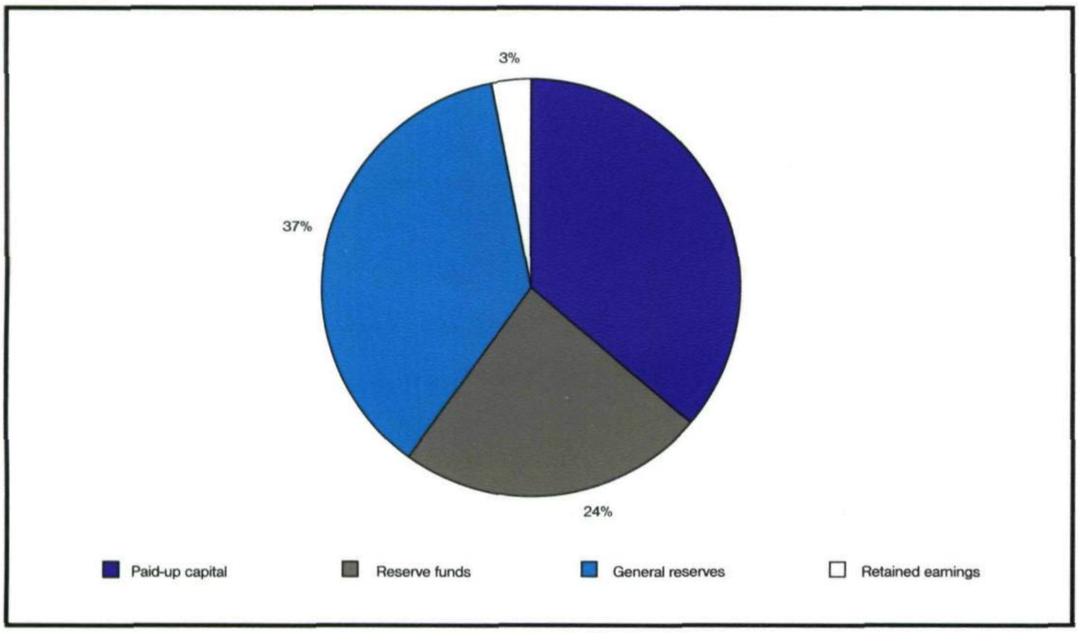
2.1 Capital Adequacy of Banks

2.1.1 Own Resources

Over the course of 1996, the volume of resources (included in the banks' capital) in the banking sector of Slovakia increased by 18.9% (Sk 9.8 billion), to Sk 62 billion.

The increase was accompanied by a change in structure. During 1996, the level of general reserves rose by Sk 5.8 billion, paid-up capital by Sk 2.5 billion, reserve funds by Sk 0.5 billion, and retained earnings from previous years by Sk 1.0 billion.

Structure of resources in the banking sector



2.1.2 Capital Adequacy

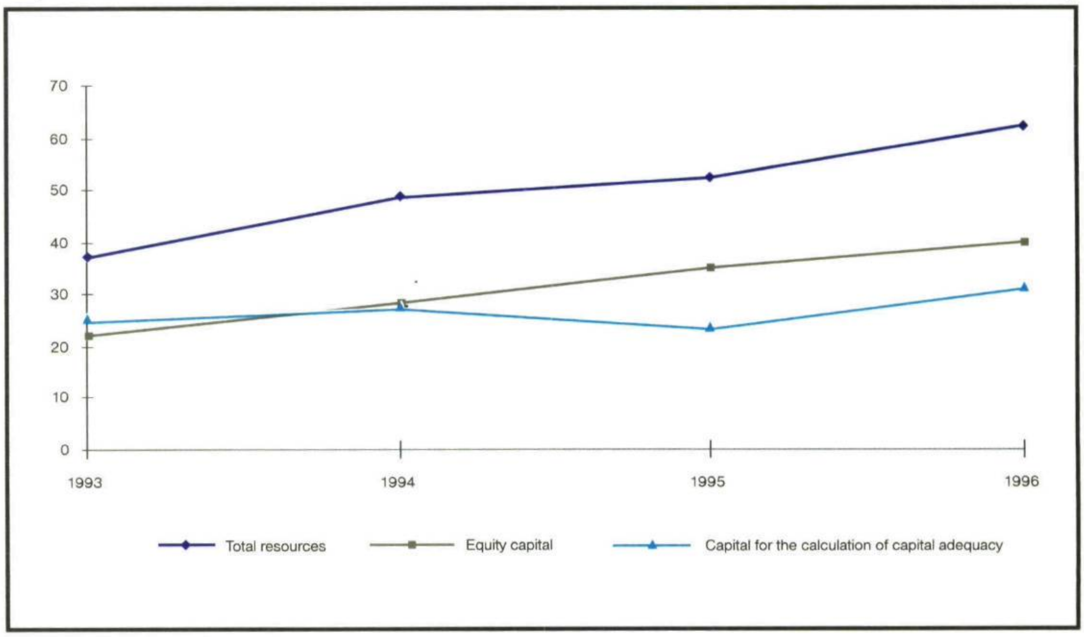
Provision No. 2/1994 of NBS on capital adequacy obliged all banks to attain a capital adequacy limit of at least 8% by the end of 1996. Of 24 commercial banks in Slovakia, four failed to meet the limit (three banks in the process of transformation and one state-owned special-purpose financial institution). When applying the exception valid in 1996 for the three transforming banks regarding the creation of provisions for classified claims, the minimum limit of capital adequacy was attained by only one of these banks, which means that a total of three banks had failed to achieve the prescribed level of capital adequacy by the end of 1996.

As at 31 December 1996, the banking sector achieved a capital adequacy ratio of 7.73%, which is by 0.64 points lower than the level of 1995.

The level of capital adequacy fell as banks intensified their lending activities in the entrepreneurial sector, which was reflected in a growth in the amount of their risk-weighted assets corresponding to the volume of capital in the newly established and emerging banks on one hand, and, on the other hand, to the failure to attain the minimum level of capital adequacy by banks undergoing transformation, particularly due to capital reductions equal to the amount of expected loss from classified receivables. The insufficient capital adequacy of the banks in the process of transformation was partially offset by subordinated debt.

The volume of capital applied for the calculation of capital adequacy in 1996 amounted to Sk 26.4 billion, or - after taking the exception valid for transforming banks into account - Sk 31.4 billion (these figures do not include the capital of Konsolidačná banka, š.p.ú., where deductibles exceed the volume of capital). This development was positively influenced by an increase in the amount of paid-up capital (including that of new banks) by Sk 2.5 billion, reserve funds by Sk 0.5 billion, retained earnings by Sk 1.0 billion, and additional capital by Sk 5.9 billion (where subordinated debt represents Sk 6.4 billion with capital reserves reduced by Sk 0.5 billion which can be included in the form of additional capital, in the total capital of banks). The increase in the amount of capital deductibles, particularly the loss from the previous and current years in the amount of Sk 4.4 billion (which occurred owing to the creation of provisions for the classified claims of some banks), had a negative impact.

Capital ***(Sk billions)***



2.2 Credit Exposure

In 1996, the NBS tightened the limit for net credit exposure to one or several major borrowers forming an economically interconnected group of debtors. Unless the borrower is a bank, the limit for the lender's net credit exposure to the borrower was reduced to 25% (from 40% in 1995) of the capital used for the calculation of capital adequacy. The credit exposure limit is in full compliance with international standards.

If the borrower is a bank, the limit of the lender's net credit exposure remains unchanged at the level of 80% of the bank's capital. For the aggregate amount of large credit exposures of an individual bank (that over 15% of its capital), a limit of 800% applies.

The lower limit and the fact that the banks partially expanded their lending, were the main reasons behind the growth in the number of violations of the net credit exposure limit in 1996.

Compared with 1995, the number of banks exceeding their limit for net credit exposure to non-bank clients increased by five. On the other hand, three banks fewer trespassed their limits for credit exposure to customers. The limit applied to the aggregate amount of total net credit exposure (exceeding 15% of the bank's capital) was exceeded by three banks. In response to this, the Banking Supervision Division of the NBS applied remedial measures towards the offending banks.

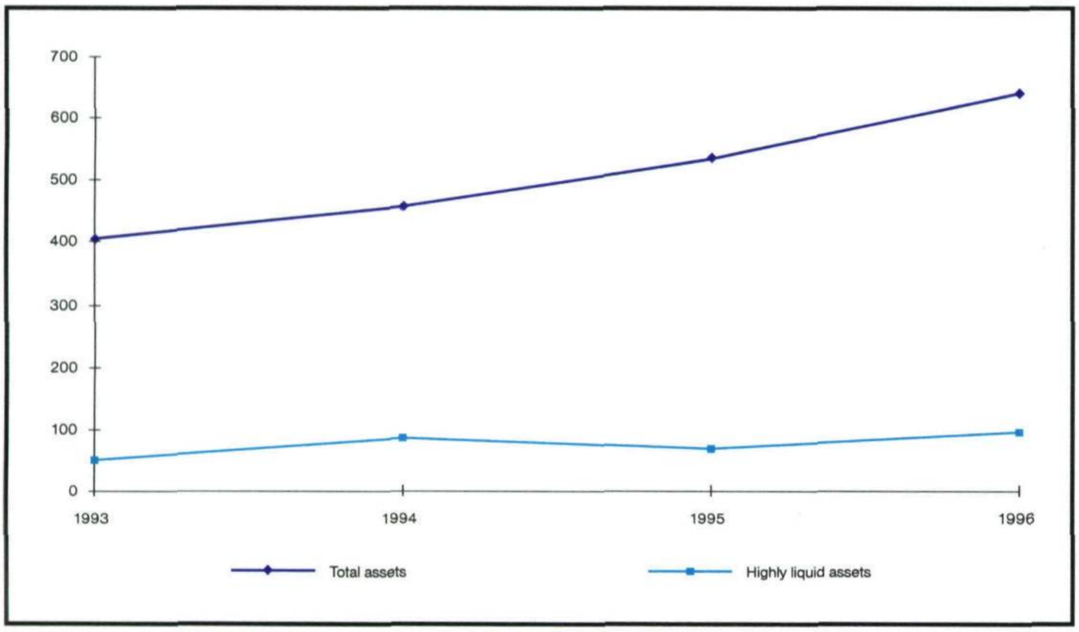
2.3 Liquidity

Commercial banks in Slovakia experienced no serious liquidity problems in 1996. The level of liquidity in the banking sector was affected by a chronic lack of long-term and, to a certain degree, medium-term funds, as well as by changes in the volume of classified claims which caused a mismatch between the demand and supply of liquidity at most banks, particularly those undergoing transformation.

2.3.1 Highly Liquid Assets

As at 31 December 1996, highly liquid assets accounted for 14.7% of total assets of banks, which was 1.9 points more than in 1995. The holdings of highly liquid assets by individual banks, as a percentage of the total volume of highly liquid assets in the banking sector, were fairly different, due mainly to differences in the nature of their banking operations and the duration of existence.

Total assets and highly liquid assets ***(Sk billions)***



2.4 Monetary Positions

By the end of the period under review, the applicable limit of 25% stipulated by Provision No. 5/1994 pertaining to the regulation of monetary positions, had not been attained by only one bank. However, transgressions of limits for individual currency positions were of short-term nature, and applied mainly to the US$, DEM and CZK positions, that is in currencies used for most cross-border payments. Individual limits were exceeded mostly by transforming banks (75% of all cases). Nevertheless, these transgressions had no substantial impact upon the position of the banking sector.

2.5 Classification of Claims

In 1996, the NBS paid close attention to the development of classified claims evaluated pursuant to Provision No. 3/1995 of the NBS stipulating the "Rules for Evaluating Claims and Off-balance Sheet Liabilities According to Risks Contained Therein and for Reserving Funds in Order to Provide Against Those Risks" which reflect the risk of non-collectible principal and interest on loans.

As at 31 December 1996, the reported uncovered loss from claims and off-balance sheet liabilities fell by Sk 3.7 billion and totalled - for the entire banking sector including the branches of foreign banks - Sk 13.1 billion (or Sk 6.8 billion, taking the exception valid for transforming banks into account). As a result of increase in banks' total claims towards other banks, customers, public and self-governing authorities, the percentage of classified claims reached 21.16%, for the entire banking sector.

The total volume of funds earmarked for the coverage of potential losses reached Sk 73.9 billion, exceeding the previous year's level by Sk 11.2 billion. Of this amount, provisions represented Sk 32.4 billion (an increase of Sk 6.8 billion, year-on-year) and reserves accounted for Sk 27.0 billion (an increase of Sk 2.6 billion).