C. BANKING SUPERVISION IN 1999

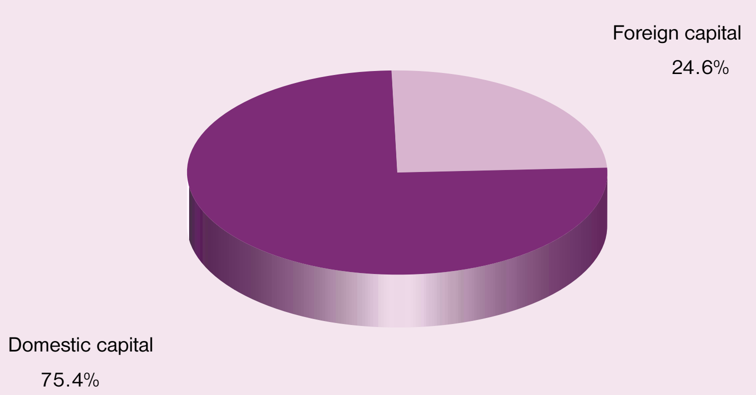
1. DEVELOPMENT OF THE BANKING SECTOR

On 31 December 1999, twenty-five banking entities were active in the banking sector of the Slovak Republic – twenty-three banks and two branch offices of foreign banks. On 1 January 1999, a merger of two banks, Bank Austria (SR), a.s. Bratislava and Creditanstalt, a.s. Bratislava, took place. A representative of Bank Przemyslowo-Handlowy SA from Poland started its activities on 1 January 1999. At the end of 1999, ten representative offices of foreign banks were active in the Slovak Republic.

The total subscribed capital in the banking sector of the Slovak Republic, including funds permanently provided to branch offices of foreign banks (excluding the NBS), increased from 31 December 1998 to 31 December 1999 by Sk 18.2 billion, i.e. from 34.6 to Sk 52.8 billion. An increase in registered capital took place in Tatra banka, a.s. Bratislava of Sk 522 million in assets; of Sk 5.7 billion in Investičná a rozvojová banka, a.s. Bratislava via a subscription of new shares; in Priemyselná banka, a.s. Košice of Sk 598.9 million via a subscription of new shares; in Slovenská záručná a rozvojová banka, š.p.ú. Bratislava of Sk 120 million in assets; in Slovenská sporiteľňa, a.s. of Sk 4.3 billion via a subscription of new shares, and in Všeobecná úverová banka a.s. Bratislava of Sk 8.9 billion via a subscription of new shares. On the other hand, a reduction of Sk 2.0 billion resulted from the sale and subsequent withdrawal of the banking license of Priemyselná banka, a.s. Košice.

The share of foreign investors in the total subscribed registered capital and funds permanently provided to branch offices of foreign banks was substantially reduced by the increased capital of the Ministry of Finance of the Slovak Republic in restructured banks, i.e. Všeobecná úverová banka, Slovenská sporiteľňa, and Investičná a rozvojová banka. From a maximum share of 38.3% in the second quarter of 1999, it fell to 24.6% in the fourth quarter of 1999. This development was not associated with an absolute reduction in foreign investment in the banking sector of the Slovak

Structure of capital and permanently provided funds of banks and branches of foreign banks in the Slovak Republic as at 31 December 1999



Republic, but was caused by the process of restructuring, which included the aforementioned capital input of the Ministry of Finance of the Slovak Republic.

Important amendments to three banking laws came into force in 1999:

An amendment to the Act on Banks 21/1992, Zb. in the wording of subsequent regulations, with effect from 11 October 1999:

- made it possible for more citizens to obtain mortgage loans,
- established legal conditions to provide mutual legal assistance in criminal matters,
- increased protection of clients of banks and branch offices of foreign banks,
- contributed to improved payment discipline of debtors of banks and branch offices of foreign banks,
- improved the effectiveness and reinforced the operations of bank supervision.

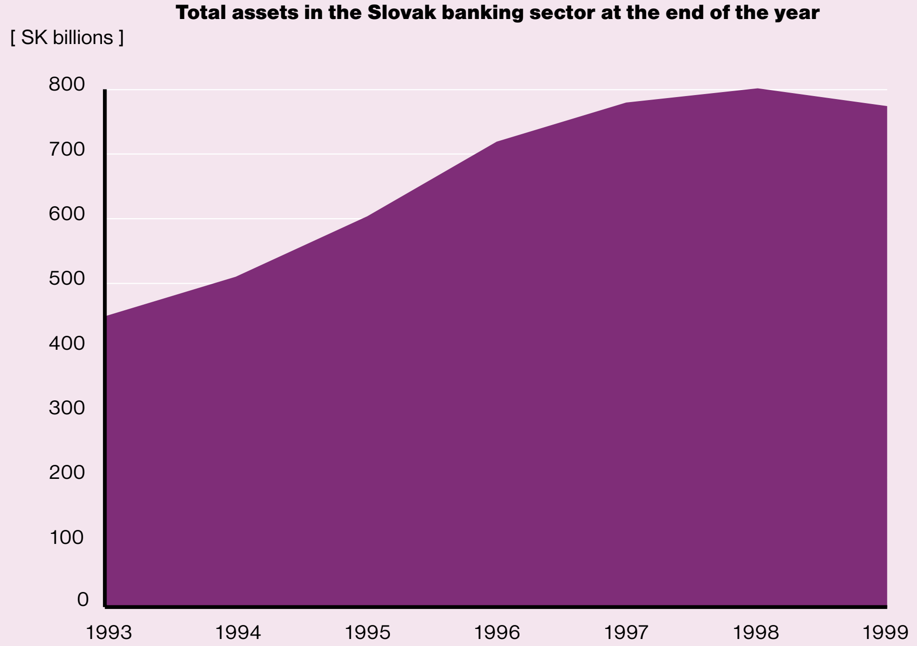
An amendment to Act 310/1992, Zb. of the National Council of the Slovak Republic on home savings in the wording of Act 386/1996, Z.z. with effect from October 1, 1999 was passed in order to:

- eliminate existing barriers to comprehensive implementation of the system of home savings,
- constitute legal conditions for the entry of corporate bodies into the system,
- encourage the return of so-called solidarity depositors,
- widen the possibility to use available resources from the home savings fund.

Among the most significant changes enacted in the amendment to Act 118/1996, Z.z. on the protection of deposits and on changes and amendments to some other laws with effect from 1 July 1999 can be summarized as follows:

- acceleration of the payout of compensation for inaccessible deposits,
- improving the effectiveness of the Deposit Protection Fund,
- preventing instability in the banking system at a time when compensation is being paid for inaccessible deposits.

Total assets in the Slovak banking sector at the end of the year



2. CHARACTERISTICS OF THE BANKING SECTOR

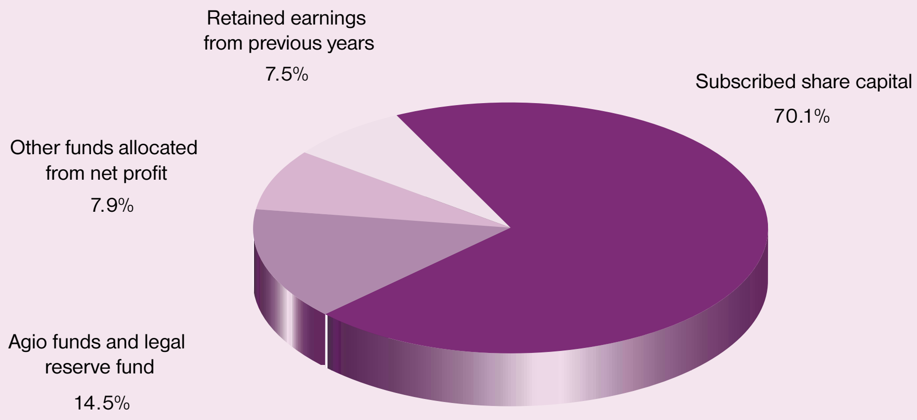
The year 1999 may be considered a breakthrough in the development of the banking sector, above all, because after years of effort on the part of the National Bank of Slovakia, the first tangible steps were made in restructuring the loan portfolio of the largest banks. In accordance with a decision of the government and the set timetable, the first two steps were taken in pre-privatisation restructuring. The capital in these banks was reinforced towards the end of 1999. In this operation, the Ministry of Finance of the Slovak Republic and the National Property Fund of the Slovak Republic acquired 84.5% in VÚB, 97.2% in Slovenská sporiteľňa, and 69.6% in Investičná a rozvojová banka. In the second phase, approximately Sk 82.3 billion of bad loans of these banks was transferred, thereof Sk 62.7 billion from outside the banking sector, into a specialized state agency, Slovenská konsolidačná, a.s., and the rest to Konsolidačná banka, š.p.ú.

In December 1999, based on results of an international tender announced by the government of the Slovak Republic, the long-term advisors for the privatisation of VÚB, Slovenská sporiteľňa, and Banka Slovakia, were selected. They are J. P. Morgan as financial consultants and White & Case as legal advisor. At the same time, audit began in the banks with the aim to prepare them for strategic foreign investors before the end of the year 2000.

Total assets of banks in the Slovak financial market on 31 December 1999 totalled Sk 769.8 billion with a year-on-year decline of 3.3% (SK 26.5 billion). The decrease in total assets is to some extent ascribable to cancellation of the measure on the foreign exchange position of banks for monetary purposes and the aforementioned transfer of non-performing loans. The share of banks undergoing transformation in the total volume of total assets has not significantly changed and at 31 December 1998 was 45.8%.

In the course of the period under review, banks concentrated on less risky transactions.

Structure of capital applied in the calculation of capital adequacy at 31 December 1999



Continuing deterioration of the financial situation of entrepreneurial entities had its effect on the growth of non-performing loans with a negative impact on the quality of the loan portfolio of banks. Lending activity is only slowly recovering, and mostly only for existing clients. This is due to concern over the high level of risk and a shortage of available resources in the first half of the year in particular.

Deterioration in the structure of assets of the banking sector starting in 1998, continued throughout 1999. The volume of classified assets increased in several banks, above all in the second half of the year, and the creation of reserves and provisions lagged behind the needs ensuing from growth of non-performing loans. This development stemmed mainly from more precise classification of claims in banks undergoing restructuring. This was clearly reflected in the results for September, when the volume of classified claims reached Sk 174.5 billion. At the end of the year the volume decreased to Sk 129.7 billion, primarily as a result of the transfer of a portion of the claims to Slovenská konsolidačná. In the fourth quarter, the share of classified claims in total claims decreased from 32.3% to 23.0%.

The share of primary and secondary resources placed in current performing assets had been on the decrease, but this slowed down after the transfer of the bad loans and its development has since improved. From 91.8% of resources allocated to income yielding assets in December 1998 this share dropped to 88.1% on 30 September 1999 and at the end 1999 had climbed to 95.7%.

The banking sector reported a loss at 31 December 1999 of Sk 29.5 billion year-on-year. This development was essentially influenced by the transforming banks that have created the full volume of required provisions and they report no uncovered presumed loss from loan classification. However, the creation of provisions led to an operating loss. The problem of high operating costs persisted in some banks.

3. EVALUATION OF PRUDENTIAL BANKING BEHAVIOUR

In 1999, as previously, the prudential conduct of banks was governed by five decrees of the National Bank of Slovakia, based on international standards and recommendations of the Basle Committee for Banking Supervision.

Evaluation is based on the processing of bank accounting data as well as on bank reports on capital adequacy, credit exposure, management of liquidity, open FX positions, and classification of claims and off-balance sheet commitments of banks according to risks involved, and the creation of provisions to cover risks (classification of claims and off-balance sheet commitments), submitted to the Banking Supervision Division of the NBS.

The information system of Banking Supervision Division serves to evaluate and monitor tendencies in individual banks, groups of banks, and the banking sector of the Slovak Republic as a whole, using a set of indicator-ratios.

With regard to compliance with prudential standards, improvement was recorded in 1999 in the banking sector of the Slovak Republic as a whole, in observing liquidity limits and open foreign exchange positions. Assessment of prudential behaviour in the banking sector is the responsibility of the Banking Supervision Division of the NBS and is carried out by systematic on-site inspections.

3.1. Capital Adequacy

NBS Decree No. 5/1997 on capital adequacy requires banks to maintain a minimum level of capital adequacy of 8%.

At 31 December 1999, four banks had failed to meet the capital adequacy level. These included one state financial institution and two commercial banks where the deductible items exceeded the value of capital. Compared with December 1998, the funds needed to achieve capital adequacy of 8% in these banks decreased to Sk 27.5 billion.

Capital adequacy in banks operating in the banking sector of the Slovak Republic increased, compared with 1998, by 2.2 points and reached 5.3%. This positive trend results from an increase in the capital base for the calculation of capital adequacy and a decrease in the volume of risk weighted assets, which was plainly due to restructuring of the largest Slovak banks.

Capital for the calculation of capital adequacy at 31 December 1999, increased year-on-year by approximately Sk 6.5 billion to Sk 19.4 billion. Risk weighted assets of banks in the banking sector of the Slovak Republic decreased by Sk 43.2 billion to Sk 363.7 billion. The increase in capital for calculation of capital adequacy of the banking sector resulted primarily from the increase in registered capital in restructured banks and a decrease in deductible items, above all uncovered presumed loss.

3.2. Credit Exposure

Under NBS Decree No. 3/1994, banks are required to monitor their loan risk in terms of potential loss caused by high credit exposure to one or several debtors constituting an economically linked group of borrowers. Net credit exposure in respect of non-bank clients must not exceed 25% of a bank's capital, and 80% in respect of bank clients, and the total amount of net loan exposure over and above 15% of the bank's capital must not exceed 800% of the bank's capital.

During 1999, nineteen banks were found to have overstepped the net credit exposure limit for non-bank borrowers and fourteen banks had broken the limit for lending to other banks. The limit on aggregate amount of reported loans was broken by eleven banks. Failure to comply with limits was due mainly to insufficient capital strength and high loan exposure inherited from the past. However, development was on the whole positive and the number of banks overstepping limits was less then in the previous year.

3.3. Liquidity

The Banking Supervision Division of the NBS introduced stricter rules for bank liquidity in Decree No. 7/1997, whereby banks and branch offices of foreign banks are required to achieve the ratio of assets and liabilities payable within one month to be equal to or exceeding 100%. The development of the set liquidity limit in 1999 was positive compared with the preceding year. The number of banks that failed to meet this requirement during the year fell to thirteen, whereof five failed to meet the limit only once.

Apart from application of monetary instruments by the National Bank of Slovakia, liquidity was also influenced by the current situation and market developments. This amounted to the persisting shortage of mainly long-term and to a lesser extent medium-term funds, chronic problems of the capital market, insufficient number of large investors, tax legislation, etc. These factors resulted in a shortage of liquid funds and subsequent failure of certain banks to comply with the minimum reserves requirement and a mismatch in maturity of resources and their application.

3.4. Open Foreign Exchange Positions

The NBS Decree No. 11/1997 on limitations pertaining to open foreign exchange positions of banks governs rules for prudential banking operations in foreign currencies. The Decree sets a limitation on the difference between assets and liabilities in individual currencies converted to Slovak crowns to 10% of the individual currency positions, and for aggregate open foreign exchange positions, 25% of the bank's capital. From 1 January 1999, the common European currency, the euro, has been included in the reports on open foreign exchange positions. With the exception of banks undergoing transformation, pursuant to the procedure adopted by the Banking Supervision Division for banks exceeding the set limits, risks ensuing from open foreign exchange positions were mostly of short-term character and the number of banks contravening the provisions of the Decree has declined.

3.5. Classification of Claims

Decree No. 3/1995 sets out uniform rules for reporting and evaluating the claims and off-balance sheet commitments of banks and branch offices of foreign banks with respect to risks involved, specifying the need to set aside funds to cover such risks.

An important breakthrough took place in the development of classified claims in 1999, when, after years of effort on the part of the National Bank of Slovakia, the first tangible steps were taken towards restructuring the loan portfolios of the largest banks. Towards the end of 1999, the capital of these banks was increased and bad loans were transferred to a state-owned financial institution and to a specialized agency outside the banking sector. As a result of these steps, the uncovered presumed loss from claims and off-balance sheet commitments of banks for the banking sector as a whole fell year-on-year by Sk 18.7 billion, i.e. by 96.9% to Sk 603.2 million.

The priorities which the NBS will have to concentrate on in the near future include addressing the problems of certain small banks in Slovakia; it will be necessary to cooperate on the preparations to complete the restructuring of banks with majority state ownership and prepare prerequisites for their privatisation in line with Government plans; and also to actively contribute to negotiations on Slovakia's accession to European structures. Achieving this goal will require full implementation of 25 basic principles for effective functioning of banking supervision, and necessitate further adaptation of the rules for prudential banking behaviour and changes to the Act on Banks, the NBS Act, and other statutes.