Report on the Results of the Slovak Financial Sector Analysis 2006

NÁRODNÁ BANKA SLOVENSKA

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Address:

Národná banka Slovenska
Imricha Karvaša 1
813 25 Bratislava
Slovakia

Regulatory and Risk Management Methodology Department
and Communication Section
Tel.: +421/2/5787 2141, 5787 2146
Fax: +421/2/5787 1128

http://www.nbs.sk

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Introduction

Introduction

The report for the year 2006 follows on from the Report on the Results of the Slovak Financial Sector Analysis for the First Half of 2006. The aim of this analysis is to describe and evaluate the development in the financial sector, with special focus on the assessment of risks which are financial institutions exposed to.

The analysis is divided into two parts. The first part is an analysis of the financial sector itself. It describes in detail the individual sectors of the financial market. The second part focuses on some specific subjects meriting special attention. Both parts of the analysis are based on various information sources.

Financial information on particular institutions is primarily obtained from the banking supervision information system MIM, the system STATUS, and documents processed by the departments of the Financial Market Supervision Unit. Additional sources included the Statistical Office of the Slovak Republic, Eurostat, the European Central Bank (ECB), and other external sources and commercial information systems.

The logical structure, definition of terms and overall character of the analysis has been inspired by analyses made by several central banks of European Union Member States and by the ECB. Unless stated otherwise, all financial amounts are given in SKK.

Executive summary

Executive summary

The year 2006 was another year of positive trends in the Slovak financial sector. Amid strong economic growth and the improving financial position of the economy's main non-financial sectors, growth was reported in almost all financial sector segments.

Economic progress was most marked in the banking sector. Banks' growth was driven mainly by lending to customers, which in December 2006 was up by 20% year-on-year and accounted for 46% of total assets. The increase was concentrated in loans to households and loans to enterprises. Lending to households was dominated by loans for house purchase. Corporate demand for loans was mainly related to the financing of developments in commercial real estate and residential real estate.

Loans to other sectors had a declining share in 2006, and in December they accounted for 15% of the total amount of loans to customers.

The volume of banks' investment in securities also recorded a slight decrease. This was largely caused by the redemption of restructuring government bonds held by the two largest banks. Most banks recorded either no change or a slight increase in their securities holdings. The share of foreign equity and debt securities declined.

The main conclusion from the analysis of liabilities is that a majority of domestic banks, and the Slovak banking sector as a whole, disposes of sufficient amount of stable domestic funds for the time being. In addition, the increasing trend observed in recent years in the loan-to-deposit ratio has slowed down, or rather stopped. In this respect, the Slovak banking sector remains less sensitive than certain other new Member States to any drop-off in investors' interest in the local currencies.

The main pillar of funds continues to be household deposits, which increased in 2006 in terms of amount and share in balance sheet total. A similar conclusion applies to corporate deposit accounts.

Several banks continued to issue bonds, especially mortgage bonds, which supported not only the predominance of stable funds in the banking sector but also the liquidity risk situation in the longest maturities.

The development of the interbank market reflected the raising of the NBS base rate by a total of 1.75 percentage points over the course of 2006. In connection with expectations for future developments and with the situation in the foreign exchange market, there was growth in interest rates, especially on longer maturities, and this resulted in a parallel shift in the yield curve to a higher level. Towards the end of the year, however, the prevailing view was that interest rates would decline, and rates on longer maturities came down again. The amount of funds deposited with NBS or invested in the purchase of NBS bills fell sharply year-on-year, following the NBS's intervention in the foreign exchange market. At the same time, deposits of foreign banks also declined markedly, as did the underlying instruments of currency derivatives traded on the interbank market.

Developments in the interbank market were also closely related to developments in the off-balance sheet of banks. Whereas the first half of 2006 was marked by a growing trend (month-on-month) culminating in highest ever figures in June (off-balance-sheet assets) and July (off-balance sheet liabilities), subsequent months saw a decline in the amount on both sides of the off-balance sheet. As reverse repo transactions declined quite markedly year-on-year, there was a fall in the volume of securities accepted as collateral in these transactions. Nevertheless, collateral in the form of real estate continued to increase. The decline in reverse repo transactions was also behind the fall in currency swaps used to hedge open currency positions arising in sterilization transactions with NBS.

The banking sector reported a net profit of SKK 17.8 billion for 2006, with an ROE of 21%. In comparison with December 2005, the net profit rose 28%, although the year-on-year comparison proved to be more difficult due to changes in banks' accounting procedures.

Net interest income recorded a particularly sharp rise in comparison with 2005, related mainly to the continuing increase in the volume of lending and the growth in banks' interest rate margins. Income from trading decreased year-on-year. The growth in interest rates had a negative impact, primarily on revaluation of debt securities. Income from foreign exchange operations and received dividends increased. Operating

efficiency in the banking sector increased, as the ratio of operating expenses to gross income from banking activities declined.

The continuing fast growth in lending was reflected in a decline in the capital adequacy ratio at most banks. As at the year-end, banks with capital adequacy ratio below 12% were managing more than half of the sector's total assets. It should be noted that this fall in capital adequacy was in line with the stipulated regulatory rules, since all banks, throughout the year, had at their disposal sufficient own funds to meet the 8% capital adequacy requirement. The high quality of banks' capital, almost all of which was Tier I, the highest category of capital quality, may also be seen as a positive factor.

The risk profile of the banking sector did not change significantly in 2006. The trend of structural changes to banking sector's assets continued, mainly with the increasing credit exposure to households and enterprises. Assuming loans to households and enterprises will have an increasingly important position in banks' assets, there is a potential risk in the very close dependence of banks on the domestic economic cycle. At present, the favourable trends in banks are to a large extent related to the strong economic growth and positive trends in the household and corporate sectors. A downturn in economic growth, or a recession in the domestic economy, would to some extent adversely affect the financial position of enterprises and households, which in turn would expose banks to a greater credit risk. It should, however, be pointed out that the degree and significance of that adverse effect is very difficult to estimate, given the insufficient experience with regard to the link between an economic downturn and the performance of the banking sector. For the moment, however, only certain banks are diversifying their assets and income in geographical and product terms.

The structure of growth in customer loans is raising the significance of developments in real estate prices. The risk lies mainly in the financing of commercial real estate, where the rate of return is closely connected with price developments.

The riskiness of loans is largely related to the financial position of borrowers. Last year, the economy's positive trends were reflected in higher household income and a decline in unemployment. Households maintained a sufficiently large amount of liquid financial assets. The financial position of enterprises also improved, with mainly small and medium-sized enterprises showing an increase in profitability. The corporate sector reported a relatively low level of indebtedness.

The current quality of banks' credit portfolios is relatively good. During 2006, non-performing loans to households remained substantially unchanged as a share of total loans to households. Although the amount of non-performing loans increased, the strong growth in new loans contributed to the fact that this increment was only minimal. The worst quality was reported in consumer loans. Last year saw a substantial improvement in the quality of the corporate loan portfolio as measured by the proportion of non-performing loans, mainly owing to the write-off of loans by banks.

The credit risk of securities at the banking sector level declined in 2006. In the structure of securities, the share of government bonds and bank bonds increased, while the share of riskier foreign securities, especially corporate bonds and equity securities, fell.

The banking sector's exposure to foreign exchange risk was negligible in 2006. Open short positions on the balance sheet were closed with off-balance-sheet derivative transactions. The overall foreign exchange position was almost completely closed. The foreign exchange risk was likewise minimal in regard to positions in particular currencies, their mutual correlations and the development of exchange rates. For most banks during 2006, the VaR did not exceed 2% of own funds.

Although the direct exposure of banks to exchange rate movements was negligible, banks were exposed to indirect foreign exchange risk mainly through corporate loans denominated in foreign currencies. Despite a shortage of relevant data, it is assumed that a large proportion of enterprises use natural hedging, where foreign currencies loans are hedged by income in foreign currencies. Since an insignificant amount of loans to households are in foreign currencies, the foreign exchange risk of households is minimal.

The interest rate risk in the banking sector arose mainly in the banking book. In the event of a change in interest rates, however, this risk would not affect banks' profitability or capital adequacy. Interest rate positions in the trading book were practically closed, partly owing to the hedging of balance sheet positions with off-balance-sheet positions. This applies above all to positions with longer fixed rate periods, which generally carry a greater interest rate risk. The aggregated results of VaR figures show that with this loss taken into account, the median capital adequacy ratio would fall from 18.8% to 18.4%.

As a share of total loans secured by real estate, new loans with a fixed rate period of up to one year declined during 2006. Their fall was mainly related to the raising of interest rates in that year. For households, the decision on the choice of a fixed rate period was therefore based on the current difference between rates fixed for a short period and rates fixed for a long period, rather than on their potential development.

As regards liquidity risk, customer deposits typically increased at a faster pace than did liquid assets and this was reflected in the decline in the quick ratio. What is significant, however, is that term deposits, which are relatively less volatile, accounted for most of the growth. The relative stability of liquidity up to 7 days and up to 3 months indicates a rather stable development, which last year was also confirmed by the slight increase in the ratio of the liquidity cushion to total assets. The liquidity risk in individual banks is increasingly becoming a matter concerning the core of deposits.

The results of stress testing the credit risk may be evaluated as generally satisfactory insofar as they have not demonstrated that the sector is substantially more exposed to risks arising from the inability of counterparties to meet their liabilities towards banks. Even so, it should be added that the simulated effects of certain specific scenarios on certain banks have also sent several warning signals. The scenario that had the most adverse impact was the first one representing an increase in non-performing loans from the existing portfolio accompanied by a credit crunch: in that event, the selected banks may have had relatively serious difficulties in meeting the capital adequacy requirement.

Stress testing the exceptional effects of foreign exchange risk confirms that the banking sector's direct exposure to this risk is relatively low. In any bank other than certain branches of foreign banks, neither simulated exceptional depreciation nor exceptional appreciation of the koruna would result in the loss of more than 3% of own funds, assuming that the portfolio is held unchanged for a period of 10 days.

The effects of interest rate movements would be rather unfavourable. Most banks would be exposed to an adverse effect in the event of an increase in rates, largely because of the relatively high interest rate risk in the banking book. The revaluation of these securities, however, only affects a change in the net present value and would not in fact affect the reported financial results or the capital adequacy ratio. Most banks have not been using interest rate derivatives to hedge interest rate risk. If NBS were to raise its base rate by 2 percentage points, the median capital adequacy ratio, taking into account the impact on net interest income and on the revaluation of the fair value of securities and interest rate derivatives, would decline over a single year from 18.8% to 17.9%.

From the view of liquidity, the riskiest scenario appears to be an unexpected withdrawal of a large percentage of customer deposits. This is related to the fact that certain banks, in financing long-term low-liquidity assets, are increasingly dependent on funds that are potentially highly volatile. The sensitivity of certain banks to this scenario increased during the second half of the year. There was, by contrast, a decline in sensitivity to a stress scenario in which 90% of the deposits of non-resident banks are withdrawn. This reflects a decline in the amount of foreign banks' deposits and in funds deposited with NBS in July 2006. In both cases, however, the liquidity cushion in a majority of banks would have been sufficient.

In order to identify the structure of the domestic interbank market in regard to the degree of diversification of deposits and loans and to potential problems in the event of the collapse of certain banks, the stress testing of contagion risk was carried out. The results show that as at the end of each month in 2006, the sector included no more than four banks whose capital adequacy ratio would fall below 8% in the event of another bank failing to meet its liabilities.

Premium written in 2006 amounted to SKK 53.6 billion, of which life insurance accounted for SKK 25.3 billion and non-life insurance for SKK 28.3 billion. These figures cannot, however, be compared with premium written in 2005, owing to a methodological change in the reporting of premium written made in connection with the application of International Accounting Standards. Analyses of the market shares by technical premium written shows a continued trend of gradual decline in market concentration. As at 31.12 2006, the market share of the three largest insurance companies, measured by technical premium written, declined further, from 63.6% to 61.5%. Thus, the trend of gradual decline in market concentration continued. Claims incurred rose 24% in comparison with the same period of the previous year to stand at SKK 21.2 billion. The profits of insurance companies for 2006 totalled SKK 4.5 billion, representing a rise of 61% on 2005. This growth was achieved despite a sharp increase in operating expenses (up by 20% in life insurance and by as much as 41% in non-life insurance), which largely resulted from the creation of fewer technical provisions in life insurance and from higher earnings on other activities not further specified. The allocation of technical provisions remained substantially unchanged and they continued to be placed in low-risk assets.

In 2006, the total amount of customer transactions made under services provided by securities dealers was SKK 1 810 billion, which represented an increase of 10% year-on-year. Fully 95% of these transactions were made through banks. The proportion of transactions made on the customer's account increased significantly in comparison with 2005. The most traded instruments were bonds and forward contracts.

As for managed assets, their amount rose 57% year-on-year; this development was to a large extent caused by a single company. Other companies reported a decline or modest growth.

The net asset value of open-end mutual funds increased by 4% in 2006. For foreign mutual funds, the increment was SKK 3.1 billion, and for Slovak funds SKK 2.1 billion. A majority of the assets in domestic mutual funds (82%) comprised fund shares purchased by households. After several years of increase, the growth in investment in mutual funds slowed down significantly last year. For 2005, total net sales of fund shares came to SKK 38.7 billion, whereas the figure for 2006 was negative – investors sold SKK 2.6 billion worth of fund shares more than they bought. The redemption of fund shares over the course of 2006 occurred mainly in bond funds and money market funds. This money was then transferred mainly into funds of funds and equity funds.

All the larger asset management companies reported a profit for 2006. The average ROE of asset management companies, weighted by capital, came to 21.84%.

The performance of open-end mutual funds reported as at the year-end was lower year-on-year. The rise in interest rates during 2006 brought down bond prices, which in turn was reflected mainly in the performance of bond funds and mixed funds. At the same time, however, riskier groups of funds (especially equity funds) profited from the performance of European stock markets, which continued to rise, albeit more slowly than in 2005. The performance of funds was to a large extent affected by the strengthening of the Slovak koruna against foreign currencies as well. Just on the exchange rate as at 31 December 2006, US dollar-denominated securities lost 17.8% of their value year-on-year and euro-denominated securities depreciated by 8.7%.

The new pension system had its first year of practical operation in 2006, with the end of June marking the deadline for voluntary entry into the second pillar of pension insurance. As at the end of December 2006, pension fund management companies (PFMCs) had 1.54 million registered savers and the assets in their pension accounts amounted to SKK 28 billion. The market share of each PFMC remained, however, largely unchanged. The three largest PFMCs manage 73% of all pension fund assets.

Most pension fund savings are held in growth pension funds, which offer a higher-risk investment method and promise the highest appreciation of pension savings in the long run. Balanced funds are used to a lesser extent and conservative funds least of all.

Although most pension savings are managed in growth funds, the investment structure is still quite conservative. As much as 86% of pension savings are invested in bank accounts and in bonds.

The annual returns on pension funds as at 31 December 2006 ranged between 2.8% and 3.7% for conservative funds, 3.2% and 4.8% for balanced funds, and 3.1% and 5.2% for growth funds. From simulations based on historical interest-rate, share--price and exchange-rate data clearly follows that in the event of an adverse market situation, the decline in net asset value over a period of 10 days would, with a likelihood of 99%, not be more than 0.5% for conservative funds or more than 1.5% for balanced funds and growth funds. Equity risk and interest rate risk would have the most significant impact, while foreign exchange risk would be negligible.

The third pillar, operated through three supplementary pension companies and one untransformed supplementary pension insurance company, had a participation of 856 000 Slovak citizens and the amount of their savings came to SKK 21.3 billion. As with pension fund savings, the majority of these funds are invested in bank accounts and bonds.

Box 1 The macroeconomic environment in Slovakia

The Slovak economy as measured by gross domestic product grew by 8.3% in real terms in 2006. In comparison with the previous year, GDP growth was higher by 2.3 percentage points. GDP in nominal prices rose 11.2%. GDP growth was supported by both domestic and foreign demand.
The average monthly wage increased by 8% in nominal terms and by 3.3% in real terms.
The average rate of unemployment in the fourth quarter stood at 12%, its lowest level since 1998. According to a labour force sample survey, the number of employed in 2006 rose 3.8% year-on-year.
Consumer prices as measured by the HICP increased by 3.7% in 2006 in comparison with the previous year.
NBS raised the base rate on four occasions during 2006, by a total of 1.75 percentage points. Long-term interest rates also increased, and as at December 2006 the yields to maturity of ten-year, five-year and two-year government bonds rose year-on-year by 0.97 of a percentage point, 0.79 of a percentage point and 0.53 of a percentage point, respectively.

Characteristics of the Slovak financial sector

Characteristics of the Slovak financial sector

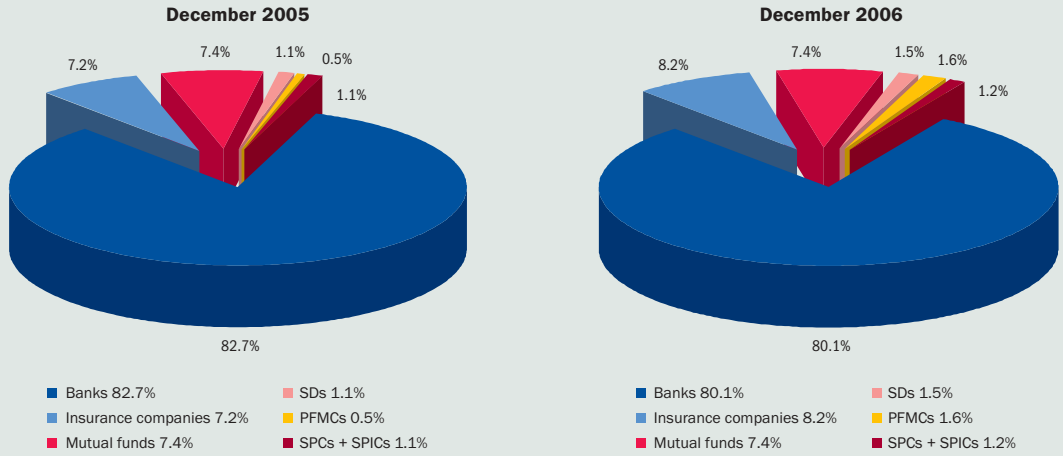
Assets and managed assets of the financial sector

In December 2006, the Slovak financial sector[1] comprised mainly banks, insurance companies, asset management companies (collective investment), pension fund management companies, supplementary pension companies (insurance companies[2]) and securities dealers (SDs).

As at 31 December 2006, these institutions managed assets worth almost SKK 1 759 billion, which represented nearly 107% of GDP in current prices. For the year from December 2005, the amount of managed assets and assets increased by SKK 62.5 billion, or 3.7%. That represented a slowdown in comparison with the 12 months of 2005, when the financial sector reported growth of SKK 318 billion, or 23%. The main change occurred in banks' assets, which increased by only SKK 4 billion (since the total amount of assets was SKK 1 409 billion, that figure represents a minimal rise) owing to an outflow of short-term capital, especially foreign capital, in the second half of 2006.

Although the banking sector recorded minimal growth in 2006, it maintained its dominant position in the Slovak financial sector. As at the end of 2006, banks held assets worth SKK 1 409 billion (net), representing 80.1% of the assets and managed assets in the financial sector (Chart 1 and Chart 2). Overall, the long-term trend of decline in the share represented by the banking sector's assets is continuing (its share stood at 85% in 2004). The prominent position of the banking sector is largely the result of an historical development in which banks acted as the principal financial intermediary. Such a model based on the

Chart 1 **Financial institutions by share of assets and managed assets of the financial sector, in December 2005 and in December 2006**

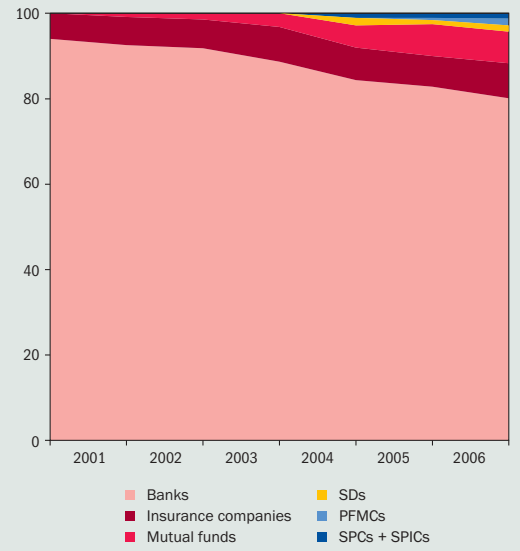


Source: NBS.
Note: For banks and insurance companies, the share is evaluated using net assets, and for other sectors, by the value of managed assets.
SDs – securities dealers other than banks, PFMCs – pension fund management companies (2nd pillar), SPCs – supplementary pension companies (3rd pillar), SPICs – supplementary pension insurance companies (untransformed 3rd pillar), The figures for SPICs are estimated.

[1] *The financial sector is understood to mean financial companies subject to regulation by NBS.*

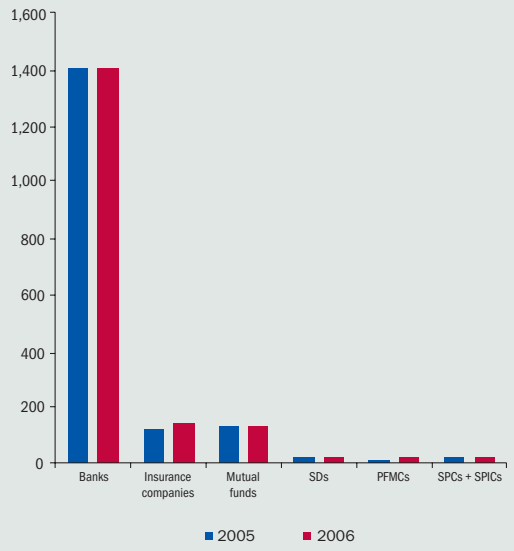
[2] *In 2006, the transformation of three supplementary pension insurance companies into supplementary pension companies was completed; as at the year-end there remained one supplementary pension insurance company operating on the market, and its figures for December 2006 are estimated.*

Chart 2 **The financial sector broken down by institutions (December 2000 and 2006) (%)**



Source: NBS.
Note: Data for SDs in 2001– 2003 and for PFMCs in 2001 – 2002 were not available.
SDs – non-bank securities dealers, PFMCs – pension fund management companies, SPCs – supplementary pension companies, SPICs – supplementary pension insurance companies, The SPIC figures are estimated.

Chart 3 **Amount of assets managed by different financial institutions (December 2005 and 2006) (SKK bln.)**



Source: NBS.
Note: The data represent the net asset value of each sector in SKK billion.
SDs – non-bank securities dealers, PFMCs – pension fund management companies, SPCs – supplementary pension companies, SPICs – supplementary pension insurance companies, The SPIC figures are estimated.

dominant position of the banking sector is typical in most European economies.

Insurance companies constituted the second most important segment of the financial sector, accounting for 8.2% of its assets and managed assets. In comparison with December 2005, their share of the financial sector's assets recorded a relatively high increase, returning to growth after a slight decline in 2005.

As for collective investment through mutual funds, its share of the financial sector's assets in 2006 remained at the 2005 level of 7.4% after rising in previous years. In 2004 that share stood at 5.3%. The growth in 2004 and 2005 was mainly related to low interest rates on financial markets and customers' efforts to increase the value of their disposable funds through riskier investment. By contrast, a combination of growth in interest rates during 2006 and a decline in returns on certain funds once again encouraged households to keep their disposable funds in bank term deposits.

Non-bank securities dealers account for a relatively small share of managed assets. After declining in 2005, their share increased in the first half of 2006 owing to a sharp rise in the amount of managed assets.

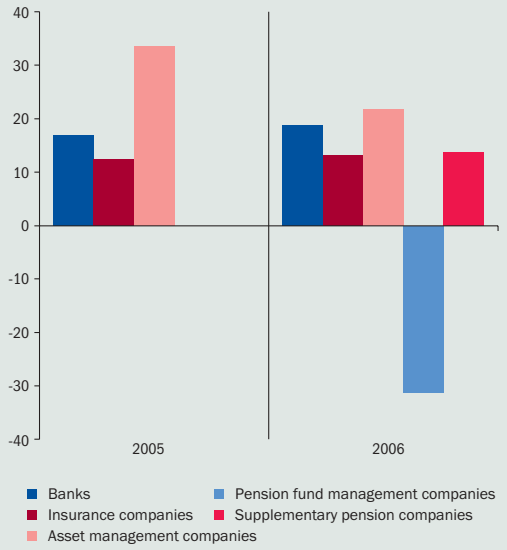
Assets managed by pension fund management companies increased during 2005 from zero to SKK 9 billion and grew by a further SKK 19 billion in 2006. Customer assets managed under the 2nd pillar of the pension system were therefore the fastest growing segment of the Slovak financial sector – their share of the sector's assets trebled in 2006. Assets managed under the 3rd pillar of the pension system also increased, as did their share of the managed assets.

Profitability of the financial sector

For comparing the profitability of different financial market sectors, a unifying approach can be taken by comparing the return on equity (ROE) and return on assets (ROA) of each sector's institutions.

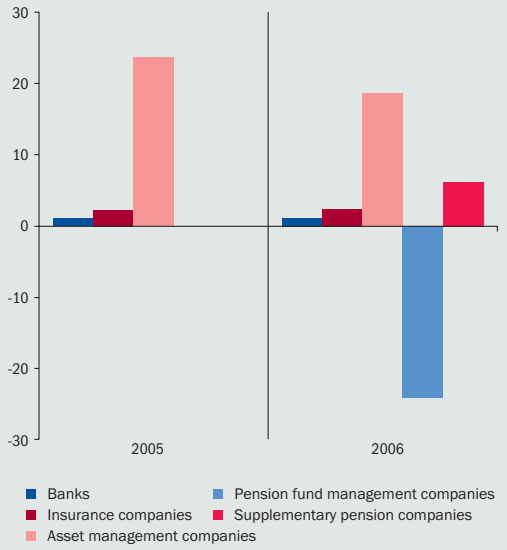
As an indicator of yield on shares, ROE is of particular interest to company owners. This ratio was highest in the collective investment sector, and since domestic banks are the major owners of asset management companies, it is they that collected most of the profits. In ROE terms, the advantage of asset management companies over banks and insurance companies lessened in 2006. That was because of the relative increase in the profitability of banks and insurance companies and the decrease in the profitability of asset management companies. The lower pace of profit generation in asset management companies last year was probably related to the negative sales of funds during that period. In terms of the pace of ROE growth in 2006, banks outperformed insurance

Chart 4 **Return on equity (ROE) in the financial sector (December 2005 and 2006)**



Source: NBS.
Note: Data for SPCs and SPICs in 2005 are not available.

Chart 5 **Return on assets (ROA) in the financial sector (December 2005 and 2006)**



Source: NBS
Note: Data for SPCs and SPICs in 2005 are not available.

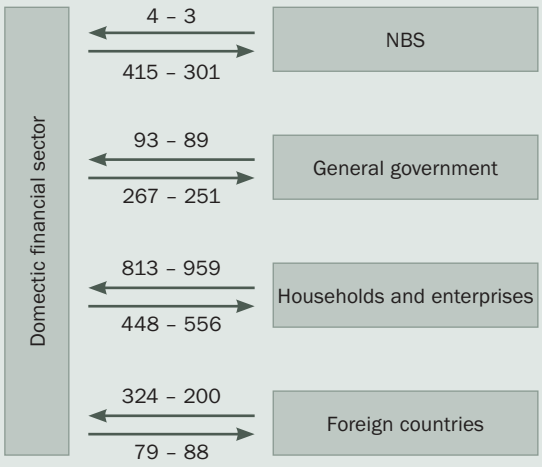
companies. Pension fund management companies reported a large negative ROE for 2006. With PFMCs in the process of starting up, the loss they made was expected and it reflected the high costs related to the acquisition of customers.

Return on assets, on the other hand, indicates the overall efficiency with which a given institution generates profit. Unlike the ROE, which allows the profitability of different financial sectors to be compared through the prism of earnings per share, the ROA ratio represents something different in each of the financial sectors. In the case of banks, whose assets consist predominantly of financial investment, it is an indicator of overall efficiency of investment. It is different with asset management companies, pension fund management companies and supplementary pension companies, which only manage funds and do not themselves hold financial assets. This is also why their return on assets approximates to their return on equity, and it is not significant for a financial company. As far as insurance companies are concerned, this ratio indicates above all the profitability of the assets in which technical provisions are invested and the profitability of other financial assets. The ROA in comparison with 2005 remained unchanged in the banking sector and rose slightly among insurance companies.

Financial intermediation

The main function of the financial sector is financial intermediation between entities that have disposable funds and those requiring disposable funds. The depiction of these relationships indicates the character of the respective financial sector. An overview of the relationships in the domestic financial sector and selected aggregates is shown in Scheme 1, and more detailed information on the relationships between the different economic entities is given in matrix form (Table 1).

Scheme 1 **Selected relationships between the financial sector and other sectors (December 2005 and 2006) (SKK billion)**



Source: NBS.
Numbers above the arrows: first from left – December 2005, second from left – December 2006.
Note: The general government data include government bonds and Treasury bills. The NBS data include NBS bills.

Chart 6 **Average interest rates on retail deposits** (%)

Source: NBS.

Flows between the financial sector and non-financial sector entities (households and enterprises) rose in value in 2006. There was an increase both in funds from non-financial sector entities, the largest generators of the financial sector's funds, and in claims against these entities. By contrast, flows between the financial sector, on the one hand, and NBS and general government, on the other hand, decreased. Funds from abroad recorded a substantial decrease, while claims against foreign obligors rose moderately. At the end of 2005, the deposits of the household sector, corporate sector and general government held in the financial sector amounted to SKK 906 billion, a majority of which (SKK 733 billion) were held with banks. In December 2006, that amount stood at fully SKK 1 048 billion, of which SKK 835 billion was placed in banks. Banks are therefore maintaining their dominant position in the raising of funds.

As at December 2006, financial companies had around SKK 556 billion invested in the household sector and corporate sector. The financing of the different sectors of the non-financial sector was carried out mainly through banks. Other financial intermediaries also performed activities in this field. Information about the total amount of loans provided by these companies is not at present available, since these entities are not subject to any reporting obligation towards NBS. Approximate information is obtainable only from banks' reporting, showing that banks had lent financial intermediaries SKK 55.3 billion by the end of 2005, and SKK 64 billion as at December 2006. It may be assumed that the loans provided to financial intermediaries went in large part to other financial intermediaries, which then used them for lending purposes, e.g. in the form of leasing or hire purchase. In addition to these funds, several other financial intermediaries are obtaining funds from foreign banks, or from their own financial groups.

Transactions with NBS remain of great importance to the financial sector. Although the amount of interbank market funds sterilized by NBS declined year-on-year (from SKK 415 billion to SKK 301 billion), as did their share of the banking sector's total assets (from 33% to 23%), their amount remains relatively significant.

The relationship with foreign financial entities in 2006 was marked by an outflow of funds from domestic banks to foreign banks, the reverse of what happened in 2005. There was, however, an increase in the volume of lending to foreign banks in 2006.

The main economic entities (households, enterprises, and also general government) keep a substantial proportion of their financial assets in banks, which are at the same time their principal creditors. With their capacity to collect deposits and make loans, banks represent the main link between the non-financial sector and the financial sector. This exclusive role of banks is reflected in their share of the total assets managed by financial market institutions (Chart 1).

The financial sector also receives money through mutual funds, which popularity in Slovakia has been on the rise in recent years, largely in relation to the decline in interest rates. Interest rates on savings deposits began to increase in the second half of 2005, and so did term deposit rates by the end of the year. It was a trend that continued during 2006 (Chart 6). This was one reason for a change in the trend of households moving their money from bank accounts to mutual funds. Whereas mutual funds stagnated in 2006 (their assets increasing by only SKK 5 billion), bank account balances grew substantially. Households also keep a proportion of their financial assets in the form of investment and capital life insurance and pension savings; the growth in these investment did not, however, adversely affect bank deposits.

The importance of banks within the financial sector is highlighted by the fact that other financial market institutions, including insurance companies and foreign banks, keep their assets with them. Banks may therefore mediate financial flows not only between non-financial sector entities and the financial sector but also between different financial institutions.

Insurance companies have a special place in the financial system since their insurance activities contribute to the diversification of risks. In addition, they offer households the possibility of long-term investment through investment and capital life insu-

Table 1 **Selected financial relationships between economic entities (December 2005 and 2006)** **(SKK billion)**

	NBS	Domestic financial sector						Domestic non-financial sector			Foreing countries			
		Domestic banks	Insurance companies	PFMCs	SPCs	AMCs	Other financial companies	House-holds	Enterpri-ses	General govern-ment	Foreing banks	Foreing AMCs	Foreing general governments and int. institutions	Other
NBS		4 – 3	0 – 0	0 – 0	0 – 0	0 – 0	0 – 0	0.2 – 0.2	0.1 – 0.1		315 – 107		367 – 196	49 – 32
Domestic banks	415 – 301	76 – 63	0.04 – 0.04			0 – 0	55 – 64	167 – 221	281 – 335	267 – 251	39 – 55		4 – 3	36 – 30
Insurance companies	0 – 0	39 – 45				5.5 – 3.2								
PFMCs + SPCs	0 – 0													
AMCs	0 – 0	20 – 23				6 – 12								
Other financial companies	0.1 – 0.1	23 – 26												
Households	0.5 – 0.7	376 – 439	54 – 74	9 – 28	18 – 21	91 – 89						21 – 24		
Enterprises	0 – 0	264 – 307				0.8 – 0.9								
General government	4 – 0	93 – 89				0 – 0								
Foreing banks	164 – 9	300 – 182				0.6 – 0.8								
Foreing AMCs														
Foreing general governments and int. institutions	2 – 3	2 – 3												
Other		20 – 14												

Source: NBS
Legend: – no direct relationship creditor – obligor, – data not available. First from left – December 2005, second from left – December 2006.
Rows: overview of financial assets (loans, deposits made, and securities) invested in the institutions named in the columns. Columns: overview of liabilities (deposits and loans received) towards institutions named in the rows. Regarding insurance companies, the figure represents technical provisions for life insurance.

Table 2 **Ownership structure of the financial sector broken down by country, in December 2006** (%)

	Banks	Insurance companies	Pension fund management companies	Supplementary pension companies	Asset management companies[1]	Securities dealers[1]
Slovakia	10.44	8.09	44.24	20.00	78.47	8.56
EU (excl. Slovakia)	85.82	90.04	28.01		21.53	87.41
Czech Republic	7.85	1.13	6.48		10.34	6.91
France	0.63	1.23	0			0.68
Netherlands	1.38	13.14	18.75	40.00		1.52
Luxembourg	28.21	0.00	2.78			31.67
Hungary	4.52	3.21	0			5.04
Germany	1.94	3.21	0			
Austria	35.83	55.78	0			35.77
Italy	5.32	0.00	0			5.80
Portugal	0.08	0.00	0			
United Kingdom	0.07	7.51	0			0.02
Other		4.83	0		11.20	
Non-EU countries	3.74	2.63	27.75[2]	40.00[2]		4.03

Source: NBS.
Note: The ownership structure represents the principal owners of companies; their interests are measured as a percentage of capital.
1) Data for 2005. 2) Switzerland.

rance, which account for most of the written premium in the household sector.

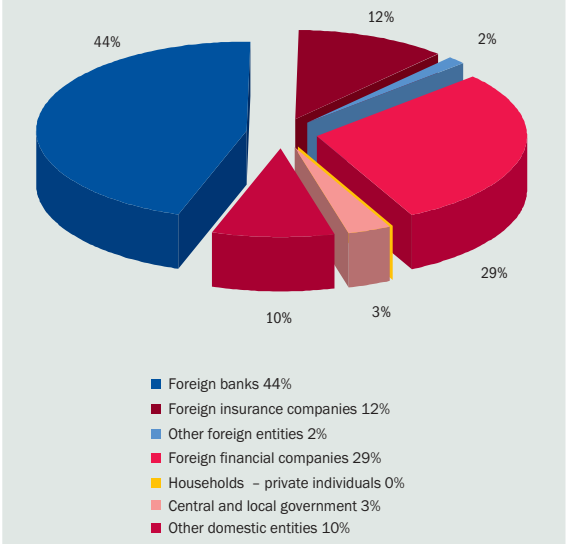
An overview of household financial assets is also provided schematically in Table 1. In addition to standard bank deposits and the mentioned life insurance, mutual funds represent a significant item. Based on their share in domestic funds, households may also be assumed to have a high share in foreign funds (though the respective data are not available). The growth of household financial assets in pension saving can also be observed and it has overtaken the amount of investment in foreign mutual funds. Table 1 also shows fields indicating where a financial relationship exists between entities, but for which data are not available. A typical example is the activity of foreign banks and foreign asset management companies. The relations between households, enterprises and general government fall outside the scope of the financial sector analysis and therefore these data are not given in the lower right section of the table.

Ownership structure

A majority of institutions of the Slovak financial sector are owned by foreign companies, most of which are from EU Member States. Banks and insurance companies are typically owned directly by foreign financial groups, while asset management companies and pension fund management companies are often owned through banks or insurance companies.

According to the beneficial-owner criterion, foreign companies held 85% of the financial sector's assets and the rest was owned by domestic capital. The

Chart 7 **Ownership structure of the financial sector** (%)



Source: NBS.
Note: Interests are measured as a percentage of capital. Ownership structure by beneficial owner; in the case of indirect control, only a financial institution may be treated as the beneficial owner. Group of foreign financial companies, including entities performing both banking and insurance activities to a significant extent.

Table 3 **Ownership ties in the Slovak financial sector in December 2006** (%)

	Banks	Insurance companies[1]	Asset management companies[1]	Pension fund management companies	Supplementary pension companies	Securities dealers[1]
Households	0.1			0.3		
State and local administration	4.8					0.3
Other domestic entities	5.4	3.1	31.4	2.7		98.5
Foreign banks	68.6	0.6	18.1	2.7	20.0	
Foreign insurance companies	0	37.8	14.2	49.3	40.0	0.5
Foreign financial companies	20.5	58.5	25.2	42.2	40.0	
Other foreign entities	0.5		11.2	2.8		1.5

Source: NBS.
Note: Interests are measured as a percentage of capital. Ownership structure by beneficial owner; in the case of indirect control, only a financial institution may be considered to be the beneficial owner.
1) Data for 2005.

largest share of the financial sector's asset structure is held by foreign banks. They reported significant holdings in the domestic banking and collective investment sectors, and a somewhat smaller share in the assets of institutions in the pension saving sector.

Foreign insurance companies invested mainly in pension fund management companies and domestic insurance companies.

When judging the character of a financial group, it is increasingly difficult to draw a distinction between an insurance group and a banking group. The amalgamation of banking and insurance groups is resulting in the establishment of groups in which both banking and insurance are significant activities. That also explains the appearance of a new group in our analysis, a group of financial companies which includes institutions whose parent entity is a major banking and insurance group. They accounted for a major share in the insurance companies sector, but they also have significant positions in other sectors.

The leading position among domestic entities was held by the category of 'other domestic entities'. This mainly includes financial companies with a significant interest in collective investment. As regards the ownership of securities dealers, domestic capital is dominant.

Box 2 Comparison between the banking sectors in Slovakia and in other Member States in December 2005

Each year the European Central Bank publishes a Report on EU Banking Structures, including a section on Structural Indicator (SIs). On the basis of these indicators, some basic comparisons may be made between the banking sectors of EU Member States.
The core indicator of banking sector development is the comparison between the banking sector's total assets and GDP in current prices. In Slovakia, this ratio remains among the lowest in the EU even though it has risen over the past three years. It stood at 95% in December, compared to an EU average of 304% and an EMU average of 283%. Only Hungary, Poland and Lithuania reported a lower figure than Slovakia, while the comparable Czech Republic had 107%. Slovakia is even further behind if GDP is compared only with customer loans, in other words, assets excluding activities in securities and in the interbank market. In Slovakia, the ratio of customer loans to GDP is only 39%, which is the second lowest figure in the EU, after Poland. The EU average is 126%. In general, it may be said that although customer lending by Slovak banks is adequate for the sector's balance sheet size, the total assets, and therefore the total loans in comparison with GDP, are among the lowest in the EU.
The relatively low lending figure is also related to the debt service liabilities towards banks in Slovakia, which represented EUR 887 per capita in 2005, the lowest figure of any EU Member State except Lithuania. The figure was also higher among countries whose GDP per capita is lower than Slovakia's, such as Latvia and Poland. The EU average is EUR 13 371.

The nature of the Slovak banking sector is also indicated by the branch network. On the one hand, each bank has an average of 50 branches, which is the third highest average in the EU after Spain and Greece (the EU average is 23), and, on the other hand, the number of citizens per branch (4 717) is the fourth highest in the EU after the Czech Republic, Estonia and Poland (the EU average is 2 297). The basic explanation is that Slovakia has the lowest number of banks per person. In other words, banks in Slovakia have on average a more than usually developed branch network, but, because of their low number, the number of branches they can provide per person is less than half of the EU average. That explanation can, however, also relate to branches' significance in the provision of banking services in the respective country. For example, Sweden has almost the same number of branches per person as Slovakia, but that does not mean that the Swedish banking sector is underdeveloped. Rather, it points to the use of distribution channels other than "physical" branches, in this case the internet. It is also true that Europe's average number of branches per person need not be a good measure for effectiveness.

Although the Slovak banking sector has the fewest banks in relative terms, its concentration is not among the highest. The five largest banks do have an above-average market share, but it is not as dominant as that of the leading five banks in seven other Member States. According to the Herfindahl index, which takes into account the shares of all banks in a given market, the Slovak banking sector has the median position in the EU (12 Member States have higher concentration, and 12 a lower concentration).

Slovakia also trails other Member States in the percentage of the population employed in the banking sector. After Lithuania, where the banking sector employs only 0.22% of the population, Slovakia has the second lowest figure of 0.37% (together with the Czech Republic, Hungary and Estonia). The EU average in this respect is 0.64%, which is again related to the fact that the amount of assets, or loans, in Slovakia (in ratio to GDP or to population) is substantially lower.

Banking sector

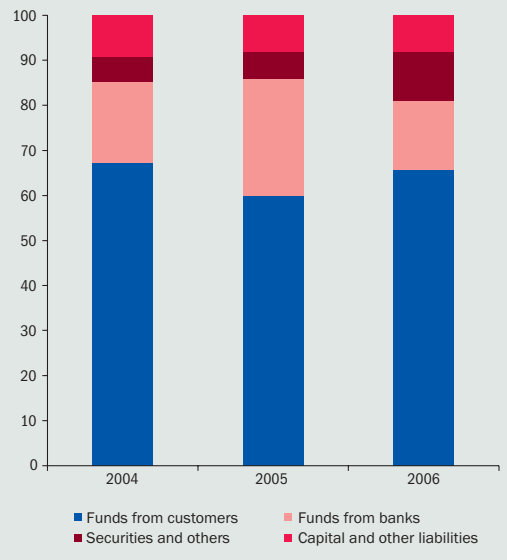
1 Banking sector

1.1 Main changes and trends in banks' liabilities

The main conclusion to be drawn from the analysis of liabilities is that a majority of domestic banks, and the Slovak banking sector as a whole, are for the time being sufficiently provided with stable domestic funds. In addition, the rising trend of the loan-to-deposit ratio in recent years has slowed down or rather stopped. Compared to certain other new Member States where loans to domestic customers are financed also with deposits of foreign banks, the Slovak banking sector remains less sensitive to any drop-off in the investment that these financial groups make in the local currencies.
The main pillar of funds continues to be household deposits, which increased in 2006 in terms of both their amount and their ratio to total assets. A similar conclusion applies to corporate deposit accounts. If the continuing rise in loans to enterprises and households is taken into account, the simultaneous accumulation in the banking sector of funds from the non-financial sector (i.e. growth in their financial assets) represents a positive sign for the growth of the financial sector.
Several banks continued to issue bonds, especially mortgage bonds, as a result of which their share of the banking sector's balance sheet almost doubled year-on-year. A positive aspect of this development is the increase in less volatile funds within overall liabilities, in other words, a shift towards a more stable balance sheet as well as an improvement in the outlook for liquidity risk in long maturities.

The structure of liabilities in the Slovak banking sector changed during the course of 2006. The change in the structure was largely affected by July's sharp decline in deposits of foreign banks, which resulted in a sudden rise in the proportion of claims against customers and in liabilities arising from securities issues, the amount of which recorded a linear increase. The banking sector's balance sheet of December 2006 (in terms of structure) therefore compares more closely with that of December 2004 (Chart 8).

Chart 8 **Structure of liabilities at the end of 2004, 2005 and 2006** **(%)**



Source: NBS.

The structure of liabilities is viewed mainly in regard to the structure of assets, especially as it relates to transactions with customers. The basic indicator is the loan-to-deposit ratio, a ratio of the amount of deposits and loans that indicates to what extent customer loans are secured with customer funds.

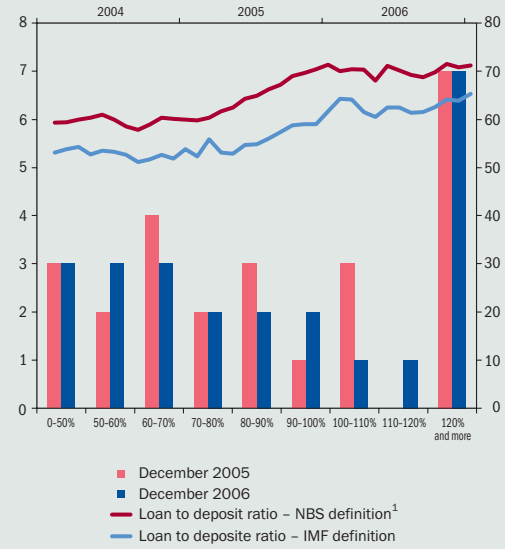
For both the banking sector as a whole and for individual banks, it is positive that lending growth in 2006 was accompanied by an increase in customer deposits (retail and corporate) and in the issuance of bonds. Most banks reported a slight decline in the loan-to-deposit ratio in 2006, and its average figure ended a rising trend that dated back to 2005.

Therefore the Slovak banking sector, in comparison with other EU countries, has at its disposal a sufficient amount of customer funds and funds from bond issues, and the expected trend decline in their share of customer loans in 2006 did not continue as it had 2005.

Funds from customers

Liabilities towards customers constitute the largest share of the banking sector's liabilities. In the first half of 2006, their share fluctuated between 59% and

Chart 9 **Loan-to-deposit ratio: development and distribution**



Source: NBS.
Note: The lower horizontal scale shows the ratio's intervals, and the left-hand vertical scale the number of banks with the given figure. The upper horizontal scale shows the date of the ratio's average figure, and the right-hand vertical scale the average figure. In the NBS's definition of the loan-to-deposit NBS, deposits of the DLMA are deducted from the deposit figure and therefore the ratio is higher.

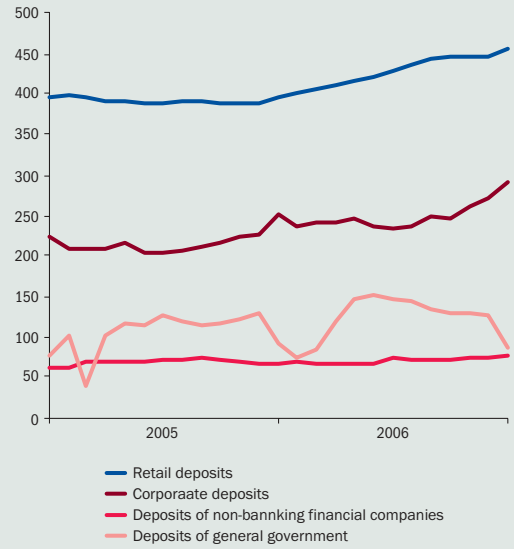
63%, and from July 2006 it increased to 66%. This was also a consequence of a decline in the amount of foreign banks' deposits placed in sterilization repo tenders with NBS, by SKK 98 billion. From the view of the banking sector's balance sheet structure, the increase in retail and corporate deposits and the rise in their share of total liabilities represents, in general, a shift towards a more stable form of asset financing (Chart 8). Given how the structure of assets has developed, in particular, the decline in funds sterilized at NBS, this is a rather neutral change (see the chapter Stress Testing). This fact is also reflected in the stable development of the loan-to-deposit ratio (Chart 9).

In December 2006, the largest segment of customer funds comprised retail deposits, which as a share of total customer deposits increased to 49.2%. The proportion of both corporate deposits and deposits of non-banking financial companies also rose, to 31.2% and 8.3%, respectively. The share of general government deposits fell, over a volatile course, to 9.5%, and deposits of non-residents also declined, to 1.8%.

Retail deposits

Retail deposits, after many years of decline, began to increase substantially from December 2005. Among the main reasons is probably the rise in interest rates.

Chart 10 **Main aggregates of customer deposits (SKK billion)**

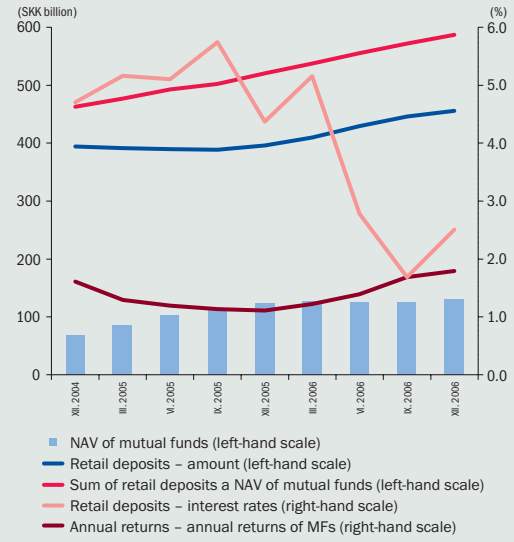


Source: NBS.

The correlation between month-on-month movements in average interest rates on retail deposits and the fluctuation in their amount in 2005 and 2006 represented 70%.

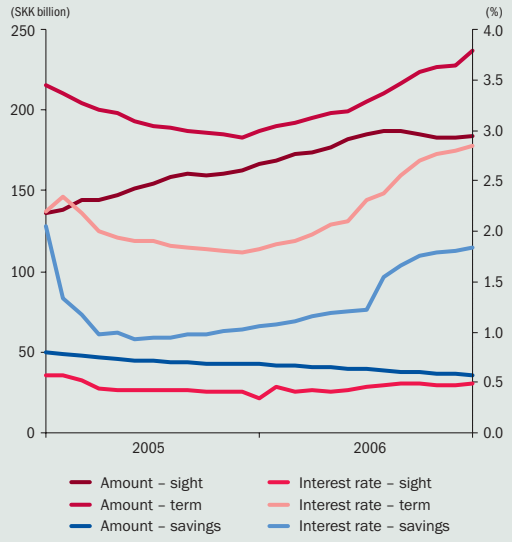
Since the amount of retail deposits is determined by household deposits and the net asset value of mutual funds, it is also dependent above all on household investment; the comparison of both aggregates covers a substantial part of household financial assets. Their

Chart 11 Retail deposits, interest rates and investment in mutual funds



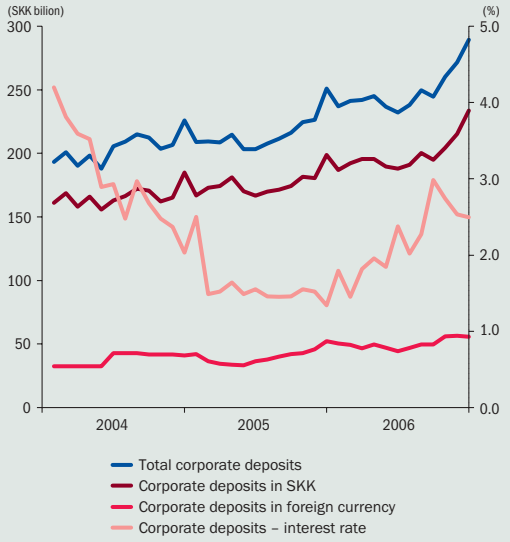
Source: NBS.
NAV – net asset value.

Chart 12 **Retail deposits and interest rates**



Source: NBS.
Note: The chart is restricted to koruna loans and interest rates on koruna loans.

Chart 13 **Corporate deposits**
(mld. Sk)



Source: NBS.

sum has recorded linear growth over the last two years. (Chart 11).

On the one hand, a relatively strong correlation can be seen between the amount of retail deposits and the interest rate on these deposits; on the other hand, there is a certain negative correlation between the net asset value of mutual funds and the returns on these funds, which in the case of bond funds is related to interest rates. All the indications are that the amount of household financial assets, and especially its growth, depends on interest rates on investment in banks or mutual funds. As far as the banking sector is concerned, this is a largely neutral development, since the asset management companies managing mutual funds with the largest market share are owned by banks. During 2004 and 2005, when mutual fund assets recorded their largest growth and retail deposits in the banking sector declined slightly, there was an increase in deposits made by mutual funds in the banking sector (Chart 15).

Retail deposits increased by 15% year-on-year, from SKK 396 billion to SKK 456 billion. The breakdown of retail deposits into sight, term, and savings deposits indicates that the main changes in retail deposits occurred in term deposits. At the same time, term deposits reacted most quickly to interest rates (Chart 12) and represent the most logical alternative to investment in mutual funds. The long-term decline in savings deposits is understandable (despite the growth in the respective interest rates) given that term deposits attract higher interest.

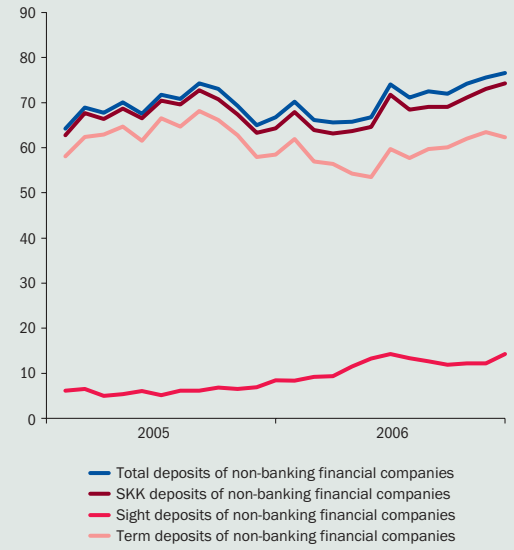
From the view of currencies and counterparts, the increase in retail deposits was almost exclusively confined to koruna deposits of households. Movements in foreign exchange deposits and deposits of non-profit organizations and sole traders were insignificant in terms of the stated trends. Over the previous thirteen months (the period of growth in retail deposits), the share of household deposits in retail deposits rose from 90.1% to 91.8% and the ratio of koruna retail deposits to non-retail deposits went up from 89.4% to 90.1%.

Corporate deposit accounts

Liabilities towards enterprises (non-financial companies) are the second most important component of funds from customers. Whereas term deposits of households react, at the sector level, relatively well to interest rates with the effect of savings creation, such a link is not apparent in the case of corporate deposits.

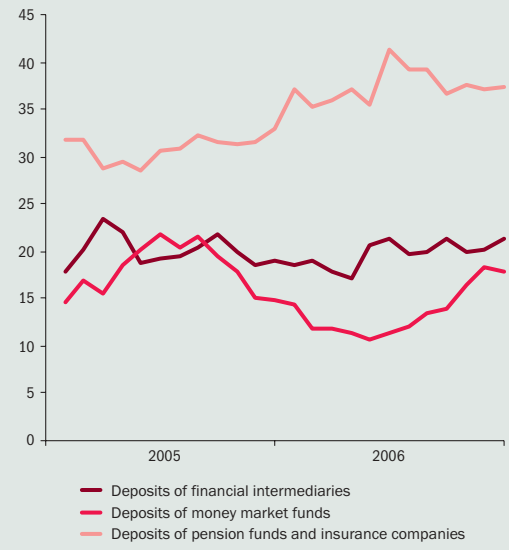
In the previous three years, the correlation between month-on-month changes in the amount of deposits and the interest rate on term deposits was close to zero, and in regard to total deposits it was even slightly negative. Given the approximately constant number of enterprises, the growth in their deposit account funds has more to do with the expansion of their activities or with surplus liquidity.

Chart 14 **Deposits of non-banking financial companies by currency and term (SKK billion)**



Source: NBS.

Chart 15 **Deposits of financial companies by counterparty (SKK billion)**



Source: NBS.

Deposits of non-banking financial companies

Deposits of non-banking financial companies (mainly financial intermediaries, insurance companies, mutual funds and pension funds) constitute a specific type of liabilities. They mostly comprise koruna funds held in term deposits. For funds and insurance companies, in particular, they represent a quite natural investment, since part of the assets of funds, or the technical provisions of insurance companies, must be invested in financial instruments. How the amount of these deposits has developed cannot therefore be explained by the development of interest rates.

After rising sharply in 2004, deposits of non-banking financial companies remained between SKK 64 billion and SKK 77 billion in the years 2005 and 2006 (Chart 14). In this period, their share of total liabilities towards customers fluctuated between 7.4% and 9.3%.

Deposits of non-banking financial companies constitute significant funds, especially in certain corporate banks and branches of foreign banks.

The breakdown by counterparty does not show any clear-cut trends (Chart 15). Nor is movement in the amount of deposits of mutual fund confirmed by the development of the net asset value of the funds or by the development of household deposits.

General government deposits

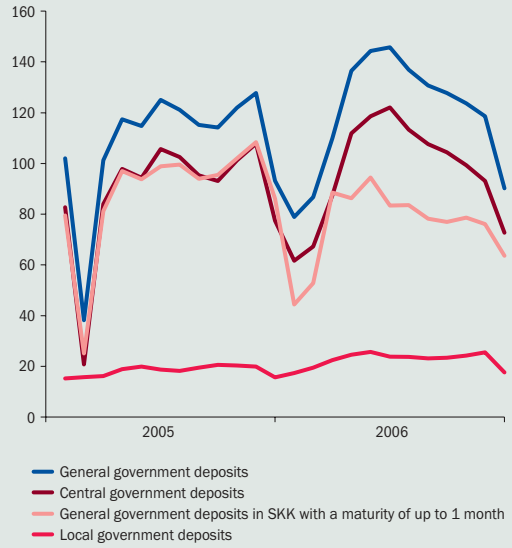
General government deposits comprise two separate categories. One includes the deposits of central government (mainly the Debt and Liquidity Management Agency), which in most months accounted for more than 80% of general government deposits. These largely consist of koruna deposits, mostly having a maturity of up to 1 month and following a considerably volatile course. In their nature and behaviour, these

Table 4 Comparison between interest rates on customer deposits and the one-month interbank market rate (p.p.)

	Average spread for the years 2004, 2005 and 2006
Deposits of non-banking financial companies	0.65
Deposits of general government	1.12
Corporate deposits	1.71
Retail deposits	2.39

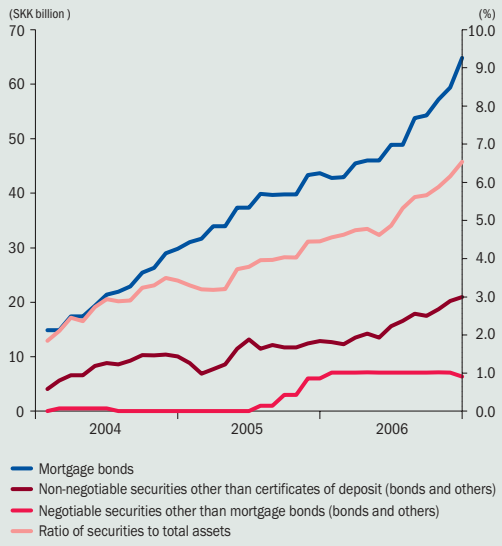
Source: NBS.
Note: The interest rates are monthly averages of total koruna deposits in specific categories, irrespective of maturity. The monthly BRIBOR was chosen owing to the prevalence of general government deposits with a maturity of up to 1 month.

Chart 16 **General government deposits (SKK billion)**



Source: NBS.

Chart 17 **Issuance of securities and their ratio to total assets**



Source: NBS.

funds are more akin to deposits of financial companies, or to funds obtained from the interbank market, than to corporate and household deposits. This can also be confirmed by their strong correlation with asset transactions made by commercial banks with NBS and the relatively small difference in comparison with the one-month interbank market rate (Table 4).

These funds, almost exclusively term deposits denominated in either SKK or EUR, are primarily placed in two-week repo transactions with NBS, and they cannot be considered a stable source of financing for lending activity. That is also why they are not included in the NBS's definition of the loan-to-deposit ratio (Chart 16) and why they reduce liquidity.

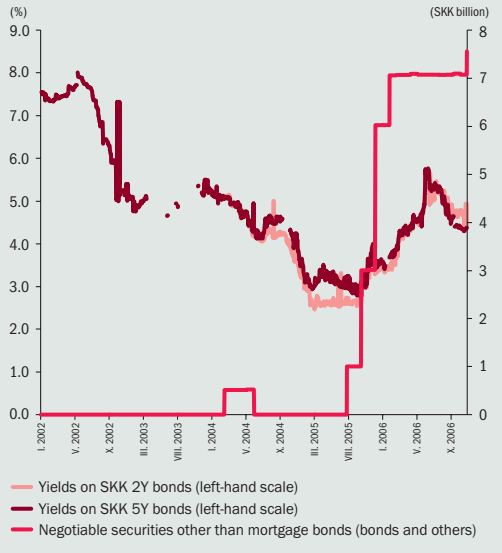
The second category comprises local government deposits. Unlike general government deposits, they are relatively stable, denominated almost exclusively in Slovak korunas, and held predominantly in current accounts. Deposits of general government include a relatively high concentration. In December 2006, three banks held 85% of all general government deposits, compared to 71% in December 2005. In the case of local government deposits, the concentration is higher still.

Funds raised from securities issues

As regards maturity match between assets and liabilities, the issuance of bonds in 2005 and 2006 proved to be an important source of financing long-term loans.

In 2006, liabilities arising from debt securities continued to be the fastest growing aggregate of liabilities. Although their rising amount slowed naturally their rate of growth, they stood at 47% in December 2006. This was to a large extent supported by mortgage bonds, which in December 2006 must have accounted for at least 90% of issued mortgage bonds (SKK 9.7 billion) denominated in EUR. An important point in regard to mortgage bond issuance is that in 2006

Chart 18 **Issuance of bonds and yield curves**



Source: NBS, Reuters.

a majority of banks ceased increasing the amount of purchases of mortgage bonds issued by other banks, so that they could to a greater extent fulfil the function of stable long-term funds.

Bank bonds, an instrument similar to mortgage bonds, were issued only by certain banks. That they were issued in the second half of 2005 may have been because of the lowest ever 5-year yield curves, or the expectation for their growth (Chart 18). The reason for the issuance of notes was related not to interest rate developments, but rather to their position as an alternative to customer term deposits.

Box 3 Effect of demographic changes on banking services in the EU

A study on the effect of population ageing on the banking sector was made in 2006 by the ECB's Working Group on Developments in Banking (WGBD). The purpose of the study was to respond to current demographic trends in the EU and to estimate the reaction of banks. The results were published in the Report on EU Banking Structures in November 2006.

The overall effect of Europe's ageing population on banking sectors is, according to the report, very complicated to estimate since several effects and counter effects imply from the report. The adverse effects can include potentially weaker interest in consumer loans and loans for house purchase, which in turn would lead to a drop in interest income. This points to a decline in the mediation function of banks. On the other hand, banks have already begun to provide products tailored to older generations, for example, the reverse mortgage. This is a loan amounting to the difference between the current price of the real estate and the outstanding amount of loans secured against the real estate. It is basically taking advantage of rising property prices, or rather a situation where the loan-to-value ratio is less than 1. This product may partially offset the decline in traditional products. As the demographic structure changes, so it is expected that asset management and advisory services will expand, which should see an increase in income from fees and trading.

On the whole, therefore, non-interest income is expected to become gradually predominant, largely because of the change in products and services offered. As banks focus on the other products and services mentioned above, distinctions between banks, insurance companies and asset management companies could disappear, and therefore the contagion risk between the sectors has the potential to increase. A new risk for banks could be longevity risk, or the increasing dependence of the banking sector on real estate prices. As for internationally active banks, they face the question of whether to strengthen expansion in regions with a different demographic structure.

1.2 Main changes and trends in banks' assets

The continuing growth in loans to customers has had the largest effect on structural change in the banking sector's assets. In 2006, the volume of lending in the banking sector rose 20% year-on-year and accounted for 46% of total assets as at December. Most of the growth was in loans to households and enterprises. Household lending was dominated by loans for house purchases. Corporate lending in 2006 increased mainly because of loans for commercial real estate and house purchases. Loans made in the domestic currency constituted more than 98% of total loans to households. In the case of corporate lending, loans denominated in foreign currencies accounted for 33% of the total. Loans to other sectors saw their share decline in 2006 and as at December they represented 15% of total loans to customers.
Banks' investment in securities also declined, largely caused by the maturing of restructuring government bonds at the two largest banks. The share of foreign equity and debt securities also declined.

In 2006, the major part of the banking sector's assets was invested in loans to customers. At the same time, customer loans continued the previous years' trend of being the fastest rising item of assets. During the year, claims against customers increased as a share of total assets, from 38% to 46%. Investment in the interbank market recorded a declining trend, especially in the case of banks' assets held with NBS and investment in securities.

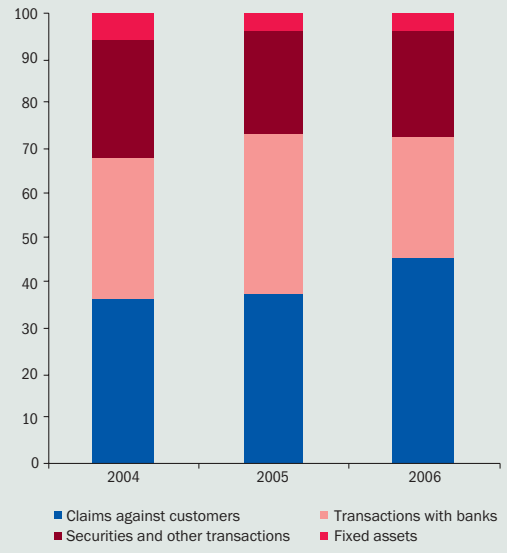
Customer loans

The amount of customer loans in the banking sector rose 20% in 2006, with an increase in all the principal lending aggregates except for loans to general government.

Retail loans recorded the largest increase in absolute terms, which was reflected in the rise of their share in total loans. Retail loans accounted for 36% of total lending, and corporate loans – the most significant aggregate – for 49%. Despite growing in absolute terms, loans to enterprises and to non-banking financial companies saw no change in their share in total loans.

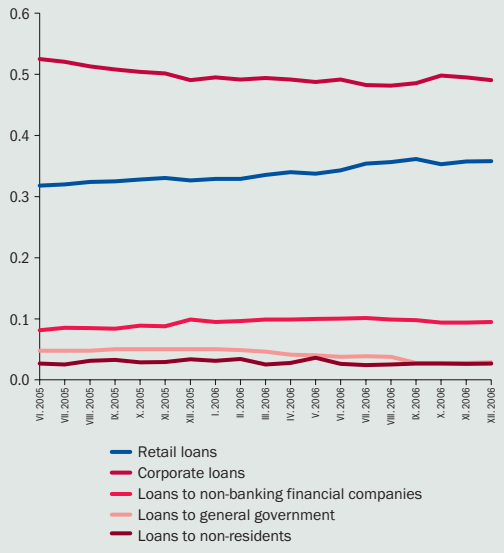
The dynamic rise in lending affected almost all banks. The rate and structure of the increase was, however, different from one bank to another. From the view

Chart 19 **Asset structure of the banking sector** **(%)**



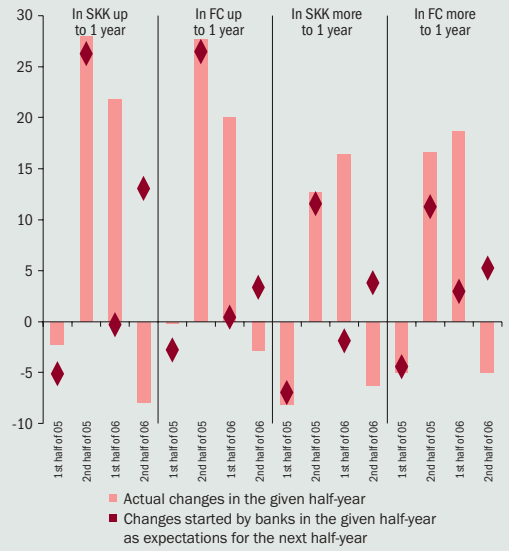
Source: NBS.
The vertical scale shows the shares of individual aggregates of assets in total assets.

Chart 20 **Credit portfolio of the banking sector** **(%)**



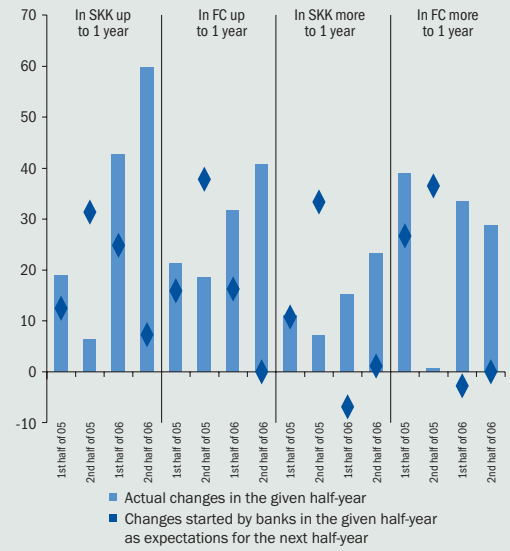
Source: NBS.
The vertical scale shows the shares of each loan category in total loans.

Chart 21 **Changes in credit standards for loans to large enterprises**[3]



Source: NBS – Questionnaire on Supply and Demand in the Lending Market.
Note: Data are given as a net percentage share, with a positive figure indicating the relaxation of standards. Changes in standards reflect subjective view of banks.

Chart 22 **Changes in credit standards for loans to small and medium-sized enterprises**



Source: NBS – Questionnaire on Supply and Demand in the Lending Market.
Note: Data are given as a net percentage share, with a positive figure indicating an easing of standards. Changes in standards reflect the subjective view of banks.

of lending, trends affecting certain groups of banks could be observed in 2006.

The concentration of loans in the two most important sectors – corporate and retail – continued to increase. Of the total amount of loans to enterprises in 2006, more than 86% was extended by the four largest banks in the given segment. It was a similar case with retail loans, where fully 83% of the respective market was covered by the five most involved banks.

Corporate loans

Corporate demand for bank loans continued to rise in 2006; mainly with reference to small and medium-sized enterprises. Some banks also saw increased demand from large enterprises. The primary reason for the demand rise was the financing of long-term investment and also operating capital. Another factor was the improving financial position of the corporate sector and the decline, at selected banks, of interest rate margins and fees. According to banks, corporate demand for bank loans should continue to rise in the first half of 2007.

The increase in the volume of lending to enterprises was also affected by banks' credit policy. As regards changes in credit standards, a distinction needs to be drawn between developments concerning large enterprises and small and medium-sized enterprises. For loans to large enterprises, banks tended not to change their standards, but some did tighten standards in response to the riskiness of selected industries and changes in the risk management system.

By contrast, credit standards for small and medium-sized enterprises were eased, especially by large banks in reaction to competition from other banks.

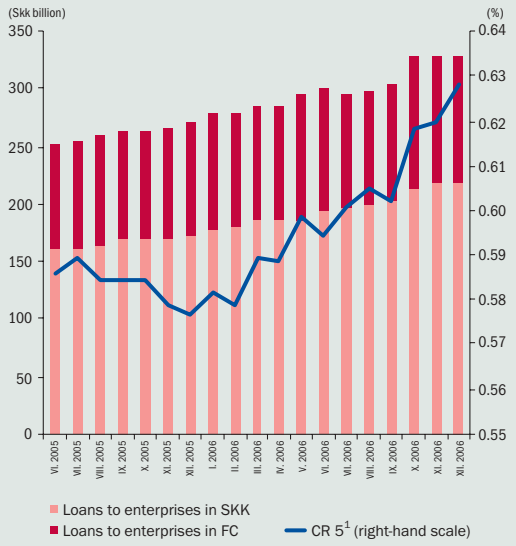
Several banks noted a reduction in lending margins and fees. Banks also eased limits on the required degree of co-financing and some banks lowered limits on the value and quality of collateral.

The amount of corporate loans extended in 2006 increased by 20%, and the proportion of them denominated in the domestic currency rose 25% year-on-year, to 67%. Foreign currency loans also increased but to a lesser extent than koruna loans.

The increase in corporate lending was distributed relatively unevenly across the sector. Three banks accounted for 75% of the sector's total growth in corporate lending in absolute terms.

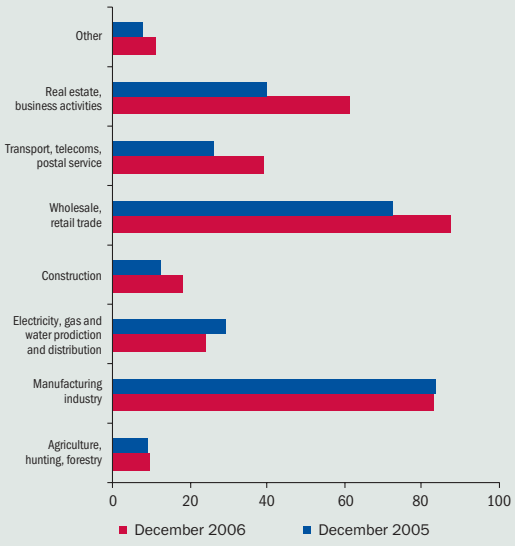
[3] *The data in the charts are given as a 'net percentage share'. For example, the net percentage share of banks that eased credit standards for household loans is calculated by taking the household loans extended by banks which eased lending standards and the household loans of those which tightened lending standards and finding the difference between the percentage share of each in total loans to households.*

Chart 23 **Growth and concentration in the corporate lending market**



Source: NBS.
CR 5 – the five largest banks by share of the corp. lending market.

Chart 24 **Corporate lending broken down by industry (SKK billion)**



Source: NBS.

Since the said banks had extended the most corporate loans during the previous period as well, there was naturally an increase in the concentration of this lending. At the end of 2006, the five banks with the largest corporate loan portfolios by amount accounted for 63% of the total amount of corporate lending in the sector.

Broken down by industry, the growth in corporate lending was driven mainly by loans for the real estate development (up by SKK 15 billion year-on-year), loans for retail and wholesale trading (SKK 13 billion), loans in the transport field (SKK 10 billion) and loans in the construction sector (SKK 6 billion).

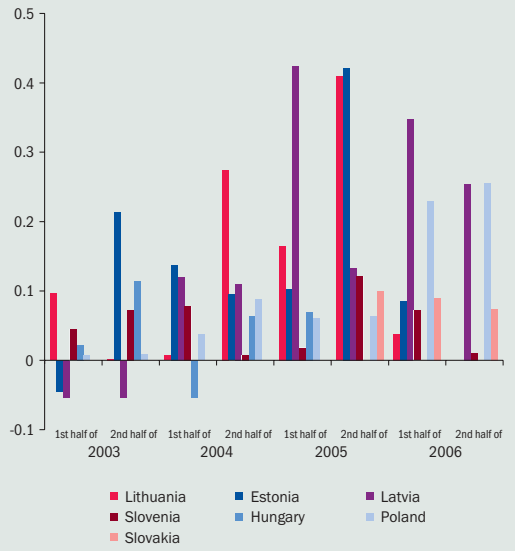
Retail loans

As with corporate loans, demand for retail loans continued to rise in 2006.

More than 92% of retail loans were extended to households. Although demand for all types of loans to households increased, the growth was sharpest in special-purpose and any-purpose loans secured by real estate. Demand for credit cards, current account overdrafts and other (especially consumer) loans increased to a lesser extent. The demand rise was driven mainly by the positive macroeconomic development and growth in household income, as well as by positive expectations for future development.

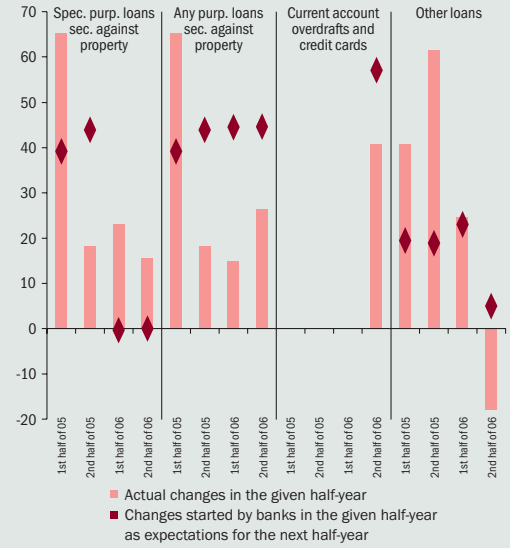
Another key factor in the high demand were the rising prices of real estate and the related change in spending on property purchases. For banks, it is also relevant that as property prices increase, so too does the value of collateral. The growth in property prices slowed down during the course of 2006. In the second half of 2006, the price per square meter of residential real estate in Slovakia increased by 7%. Among the new EU Member States, the sharpest rise in residential real estate prices was recorded in the Baltic States.

Chart 25 **Residential real estate prices (%)**



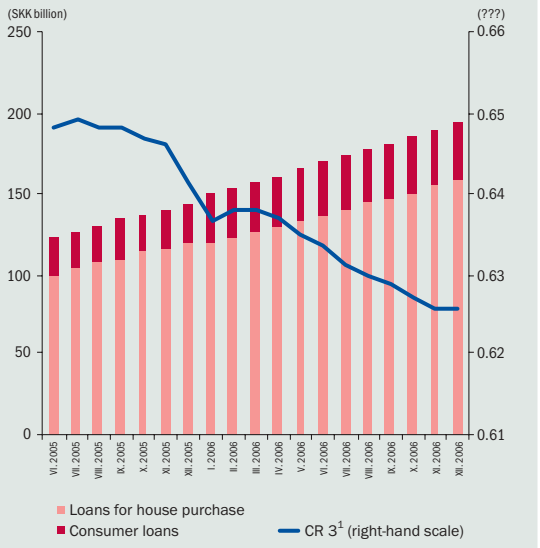
Source: National Association of Real Estate Offices of Slovakia, national central banks.
Note: The percentage changes are calculated from prices per square meter of residential real estate.

Chart 26 **Changes in credit standards for household loans**



Source: NBS – Questionnaire on Supply and Demand in the Lending Market.
Note: Data are given as a net percentage share, with a positive figure indicating an easing of standards. Changes in standards reflect the subjective view of banks.

Chart 27 **Growth and concentration in the retail lending market (SKK billion)**



Source: NBS.
CR 3 – the share of the three banks with the largest share in retail lending market.

In the second half of the year, some banks eased credit standards especially for house purchase loans. This was largely related to competition from other banks and banks' expectations for an increase in property prices.

Certain banks tightened standards for consumer loans as well as for house purchase loans. This was mainly because of changes in the quality of the portfolio and in the risk appetite of the banks.

The easing of standards typically took the form of raising maturity limits and limits on the value and quality of the collateral, and a greater degree of discretion in decision-making.

On the other hand, certain banks increased the financial-standing requirements for customers. At some banks, the credit rating required for inclusion in price bands rose slightly.

Retail lending increased year-on-year by almost SKK 58 billion, or 32%. A majority of banks reported an increase in assets in the retail sector, more than 98% of which were loans denominated in the domestic currency. The foreign currency loans were concentrated in certain banks.

The growth in retail lending was led mainly by large banks. The first five banks accounted for 83 percent of the year-on-year rise in the sector's retail lending. House purchase loans, in particular, continued to rise, and at the end of 2006 they made up 71% of retail loans. Consumer loans were the second most significant item in the retail lending portfolio with a share of 16%.

Lending to other sectors

Lending to other sectors as a share of banks' total credit portfolio declined year-on-year. At the end of 2005 they constituted 18% of the total amount of loans to customers, but one year later that figure was down to 15%. Whereas banks increased financing of non-banking financial companies, the amount of loans extended to general government and non-residents declined.

Lending to non-banking financial companies accounted for 10% of total loans. Banks lent to financial intermediaries, especially leasing companies and hire purchase companies.

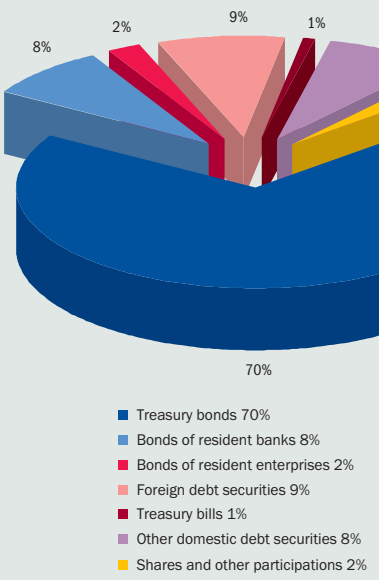
Loans to general government fell by 32% year-on-year, and banks reduced their lending to central government. On the other hand, lending to local authorities continued to rise, with the leading bank in this segment maintaining its dominant position.

Investment in securities

The amount of securities held in the banking sector continued to decline[4] in 2006. The decrease was

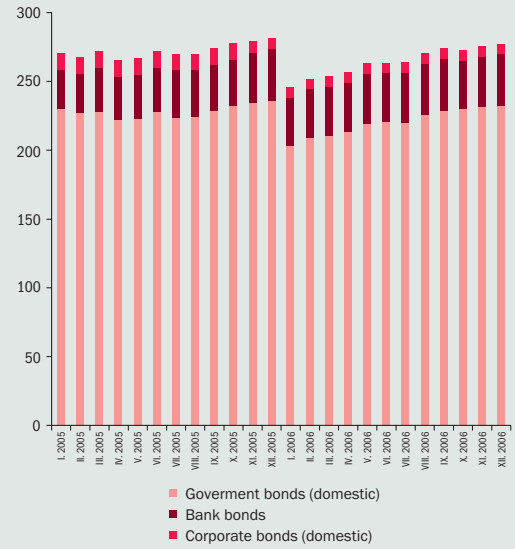
[4] *The year-on-year rise in the item of securities and other transactions (Chart 19) was caused by an increase in the positive figures of fixed forward transactions and options.*

Chart 28 **Portfolio structure of securities owned by the banking sector in December 2006**



Source: NBS.
Note: The chart shows the main categories of securities by their share of the total amount of securities.

Chart 29 **Structure of domestic debt securities (SKK billion)**



Source: NBS.

caused mainly because bonds which banks had acquired from the state under the credit portfolio restructuring of 2000 and 2001 matured in January. In comparison with the end of 2005, the amount of securities holdings in December 2006 was down by 3.8%. The structure of the securities portfolio also changed partially. The amount of foreign securities declined sharply, and the structure of domestic securities also altered: banks increased their holdings of securities attracting a low risk weight (government bonds, bank bonds and Treasury bills). By contrast, the amount of riskier securities, mainly corporate bonds, declined.

Any changes in the amount and structure of the banking sector's securities were to a large extent affected by changes at the three largest banks, which owned almost 76% of the sector's securities holdings.

Debt securities

At the end of 2006, debt securities accounted for 20% of the banking sector's assets. Five banks report having a significant share of debt securities in their assets, ranging between 25% and 40%, while at eleven other banks debt securities make up less than 10% of the total assets.

Debt securities constituted more than 97% of the total amount of securities at the end of 2006. That represented a decline year-on-year, largely owing to the lower amount of government bonds.

The structure of debt securities was dominated by domestic government bonds, which represented 72% of total debt securities. The three largest banks owned as much as 76% of the total amount of the domestic government bonds held in the sector. At two of these banks, holdings of government bonds declined year-on-year, which caused a decrease in the sector as a whole. The decline at the beginning of the year was caused by the maturing of restructuring bonds held in banks' portfolios. As the year progressed, banks again raised the amount of government bonds.

The banking sector saw continued growth in domestic bank bonds, albeit slower than in 2005: their amount increased by SKK 2.2 billion in 2006, compared to SKK 5.7 billion in 2005. The increase was mainly in mortgage bonds and other bank bonds.

Foreign debt securities comprised mostly securities issued by banks and other financial institutions. In this case, the three largest banks held 77% of the total amount of foreign debt securities in the sector.

Equity securities

Compared with debt securities, equity securities represent a substantially smaller share of the total amount of securities held in banks, only 3.3% at the end of 2006. During the year, they decreased both in absolute terms and as a share of securities.

The amount of foreign equity securities declined by 40% year-on-year. Most of that decrease was recorded by the two leading banks in this segment.

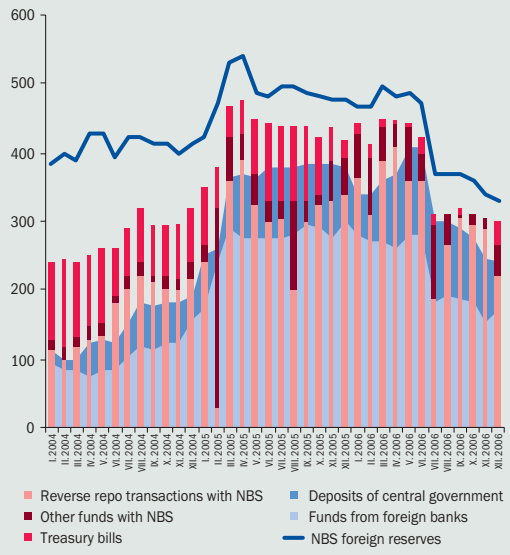
1.3 Interbank market

The development of the interbank market reflected the raising of the NBS base rate by a total of 1.75 percentage points during 2006. In connection with expectations for future developments and with the situation on the foreign exchange market, interest rates rose over the year, especially on longer maturities, followed by a parallel shift in the yield curve to a higher level. Towards the end of the year, however, the prevailing view was that interest rates would decline, and therefore rates on longer maturities came down again. The amount of funds deposited with NBS or invested in the purchase of NBS bills fell sharply year-on-year, following the NBS's intervention in the foreign exchange market. At the same time, deposits of foreign banks also declined significantly, as did the underlying instruments of currency derivatives traded on the interbank market.

In regard to interbank market transactions, the year 2006 could be divided into two quite distinct periods – the first and the second half.

As a share of the banking sector's balance sheet total, neither asset nor liability transactions conducted in the interbank market recorded a significant change during the first half of 2006, especially in comparison with the substantial increase in these transactions during the first half of 2005. In July of 2006, however, both asset and liability transactions declined by more than SKK 100 billion, and by the year-end they had fallen slightly further, to stand at their lowest figures for two years. The amount of interbank assets[5] declined in comparison with December 2005 by SKK 115.4 billion (a relative decrease of 22%) and the amount of interbank liabilities[6] fell by SKK 151.1 billion, or 41%.

Chart 30 **Interbank assets and liabilities and funds of general government (SKK billion)**



Source: NBS.
Note. The chart does not include transactions between domestic banks.

These transactions likewise declined as a share of total assets. The funds which were sterilized by NBS from the Slovak interbank market and those which banks deposited with and lent to other commercial banks decreased as a share of the banking sector's total assets, from 35% in December 2005 to 27% as at 31 December 2006 (by 8 percentage points). By comparison, from June 2005 to June 2006, that share ranged between 35% and 39%. The decline was caused mainly by the group of banks tied to parent banks, which saw its interbank assets decrease by SKK 143 billion, or 49%. Within this group, interbank assets declined as a share of total assets, from 66% in December 2005 to 44% in December 2006. The group of building societies also reported a year-on-year drop in interbank assets, and although large and medium-sized banks increased their share, the rise was confined to the first half of the year. In the second half, interbank assets declined among all groups of banks.

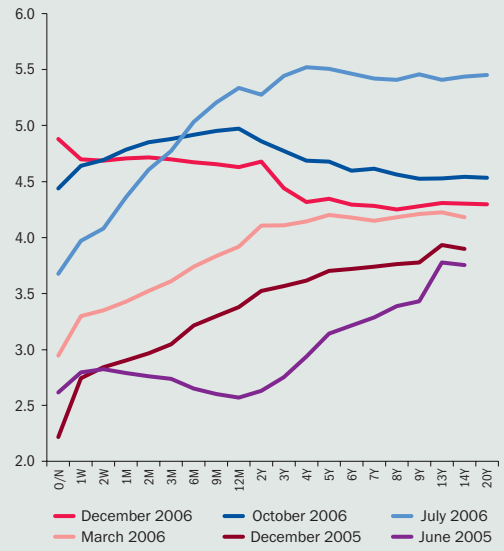
The largest component of the decline in interbank assets was the decrease in funds which NBS sterilized through deposits and loans from commercial banks, through minimum reserves, or through the issuance of NBS bills for banks' portfolios. The average sterilization position of NBS stood at SKK 301 billion as at December 2006.

The amount of foreign reserves (converted into Slovak koruna at the current exchange rate) declined from

[5] *Interbank assets represent the sum of claims against the NBS, domestic and foreign banks, and Treasury bills other than treasury bills held to maturity.*

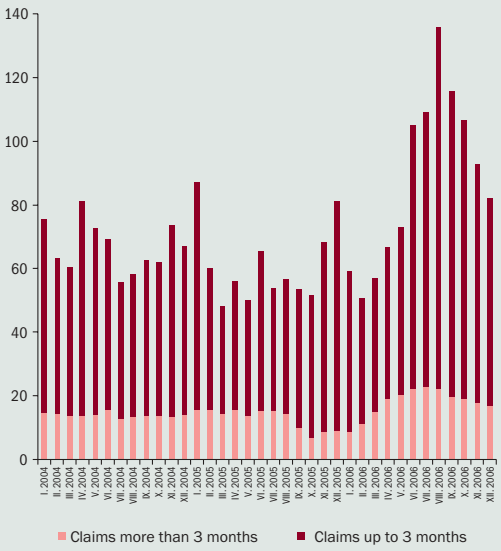
[6] *Interbank liabilities represent the sum of deposits and loans received from the NBS, domestic and foreign commercial banks.*

Chart 31 **Yield curves of BRIBOR rates (%)**



Source: NBS, Reuters.
Data on the vertical scale are in percentages and express the average figure in the given month as calculated from daily data. O/N – overnight. Maturity: W – weeks, M – months, Y – years.

Chart 32 **Amount of loans and deposits extended to commercial banks (SKK billion)**



Source: NBS.

SKK 474 billion to SKK 330.5 billion, including a drop of SKK 97 billion during June and July. NBS made two interventions in the foreign exchange market in June (amounting to EUR 1 335 million), one in July 2006 (EUR 1 750 million) and one in December (EUR 485 million)[7]. As far as the Slovak banking sector was concerned, the 2006 interventions reduced the amount of Slovak korunas that banks could deposit with NBS or spend on the purchase of NBS bills. For its part, NBS conducted regular weekly repo tenders in 2006 and each time accepted the entire demand of banks.

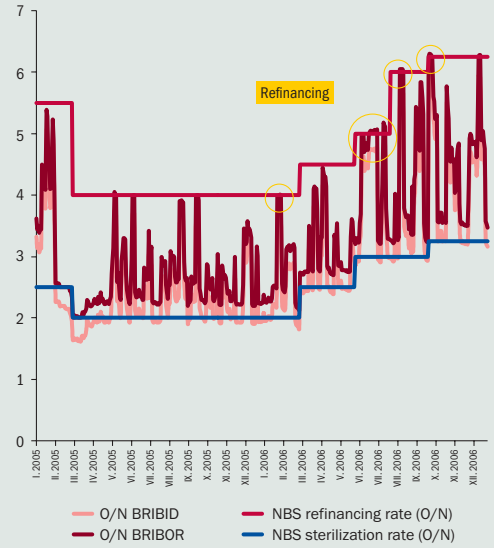
Bills issued by NBS declined in significance in comparison with 2005 (not rising again until December, to SKK 35.3 billion), as did Treasury bills. In fact, owing to the favourable development of government debt, a large amount of State Treasury bills remained after their primary issue in the portfolios of the DLMA (during the second half of the year, the figure was even 100%)[8].

On the other hand, the absolute decline in NBS bills held in banks' portfolios is a consequence of lower demand, or rather an increase in the yields required by banks (higher than the yields in sterilization repo tenders). This was reflected in the changing yield curve of interest rates (Chart 31). With market participants expecting interest rates to go up, rates were indeed raised significantly on longer maturities. Whereas the interest rate curve was inverse in June 2005 – reflecting expectations for a decline in interest rates – it tilted during the second half of that year and in the first half of 2006 there was a parallel shift upwards. This was because the base rate was raised on three occasions by a half of one percentage point (on 1 March, 31 May and 26 July 2006) and by a quarter of one percentage point on 27 September. Therefore, owing to their longer maturity, the required yields on NBS bills were higher than the required yields in sterilization repo transactions, which was not accepted by NBS. By the end of 2006, however, the prevailing expectations were for a cut in interest rates (supported by the schedule for euro adoption) and the yield curve regained its inverse shape. As a result, the required yield on NBS bills fell to the level of the NBS base rate, and the demand accepted at December's auction of NBS bills amounted to SKK 36.1 billion.

The decrease in the amount of Treasury bills (considered by the interbank market as a liquid instrument) was offset in the first half of the year by the growth in funds deposited with NBS under a very short maturity (1 day). These funds failed to reach such a high level in the second half, and a shortage of liquidity also resulted in refinancing from NBS (Chart 33).

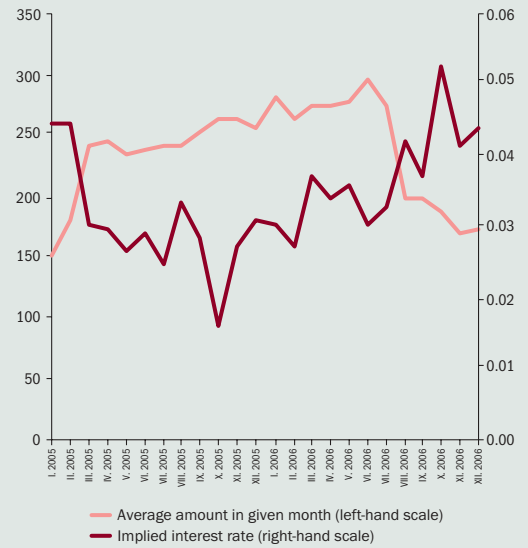
[7] *Source: NBS Monetary Survey.*
[8] *Source: www.ardal.sk. As at 31 December 2006, the amount of Treasury bills issued for the own portfolio of the Slovak Ministry of Finance amounted to SKK 62 billion.*

Chart 33 **Overnight interest rates in the interbank market** (%)



Source: NBS.

Chart 34 **Deposits of non-resident banks and the implied interest rate** (SKK billion)



Source: NBS.
Note: The implied interest rate was calculated as 12 times the share of interest expenses in non-resident banks' deposits for a given month, plus the average amount of these deposits in that month as calculated on a daily basis.
The calculation of the implied interest rate did not take into account banks which did not report any expenses for deposits of non-resident banks.

Claims against domestic banks declined temporarily in the first quarter of 2006, but for the rest of the year they fluctuated around their 2005 level. In the period from June to August 2006, claims against foreign banks rose sharply, especially those denominated in foreign currency (from SKK 17 billion in May to SKK 63 billion in August 2006). The funds concerned may have been purchased by banks during the NBS's interventions in June and July. Although these funds declined until the end of the year, down to SKK 27.7 billion, they remained substantially higher than in 2004 and 2005.

Overall, however, the amount of claims against banks as at 31 December 2006 was the same as that as at 31 December 2005, namely SKK 82 billion.

Alongside the increase in longer-term interest rates, the amount of longer-maturity loans and deposits extended to banks rose year-on-year. The amount of loans and deposits with a residual maturity of more than 3 months, which had decreased in the third quarter of 2005 to SKK 6.8 billion (October 2005), increased steadily to reach SKK 22.7 billion (July 2006), before declining towards the end of the year, to SKK 16.8 billion. At the same time, the approach of the year-end saw a slight increase in the liquidity of longer-term deposits and loans in the domestic interbank market. The spread between the BRIBOR and BRIBID rates for maturities of between 6 months and 1 year narrowed by 3 basis points (i.e. by 10% in relative terms). Another reason, apart from the rise in longer-term interest rates, may have been substitution for the reduced amount of Treasury bills in banks' portfolios.

Several times during 2006, banks used refinancing transactions with NBS in response to a temporary shortage of liquidity. The banking sector experienced such a shortfall at the end of January and in June, August and October. This situation was characterized by an increase in the overnight interest rates in the interbank market to above the level of the NBS's overnight refinancing rate (Chart 33). On the days when banks did not need short-term refinancing from NBS, the amount of deposits and loans from NBS varied between SKK 3.3 billion and SKK 4.7 billion.

The amount of deposits from domestic banks did not change significantly, fluctuating at 2005 levels and averaging SKK 42.5 billion for the full year.

As for deposits from foreign banks, the amount in the first half of the year remained around the same level as it ended 2005, at an average of SKK 275 billion. In July, however, these deposit declined by SKK 98 billion, to SKK 184.5 billion. This drop occurred despite the fact that from 31 May the differential between the base rates of NBS and the ECB fluctuated in a range from 1.25 to 1.75 percentage points, which was more than the interest rate differential of 1 percentage point recorded for almost the entire period from the beginning of 2005 to 31 May 2006.

Overall, deposits of foreign banks amounted to SKK 170.4 billion as at 31 December 2006, which represented a decline of SKK 131 billion year-on-year, or 43%. Along with the growth in interest rates in the Slovak interbank market, there was also an increase in the rates on these funds.

As has already been mentioned, a large proportion of the funds acquired from foreign banks were placed by banks in two-week sterilization repo transactions with NBS. A relatively high share of these funds (between 54% and 80%) were in foreign currency, and therefore banks first had to convert them into the domestic currency using currency instruments. Most of these currency conversions were carried out through currency swaps, which explain why currency--swap transactions accounted for more than half of the total volume of interbank transactions. For foreign banks with positions in Slovak korunas, such transactions offer indirect access to transactions with NBS, at lower credit risk in comparison with the unsecured depositing of such funds with a Slovak bank.

1.4 Off-balance sheet

From the aggregate view, off-balance-sheet assets and liabilities underwent a change in the second half of 2006. Whereas the first half of 2006 was marked by a growing trend (month-on-month) culminating in highest ever figures in June (off-balance-sheet assets) and July (off-balance sheet liabilities), subsequent months saw a decline in the amount on both sides of the off-balance sheet. Although the year-end figures for assets and liabilities declined to SKK 2 508 billion and SKK 2 351 billion, respectively, they still increased year-on-year by 9% and 21%. The amount of off-balance-sheet assets therefore represented 178% of the sector's total assets. The dominant item of the off-balance sheet were fixed-term contracts (mainly interest-rate and currency transactions) which decisively determined the trend of the off-balance sheet as a whole. With reverse repo transactions declining quite markedly year-on-year, there was a fall in the volume of securities accepted as collateral in these transactions. Nevertheless, collateral in the form of real estate continued to increase. The decline in reverse repo transactions was also behind the fall in currency swaps used to hedge open currency positions arising from sterilization transactions with NBS. The amount of off-balance-sheet items denominated in foreign currencies rose last year at the same pace as the total amount of items, and so the share of foreign-currency items stayed practically unchanged, at almost one third. The risk profile of the off-balance sheet remained the same, since a large majority of transactions were still either performed for customers and followed by matching contracts on the interbank market, or used to hedge open balance sheet positions.

Derivatives

Derivatives are the most important category of the off-balance sheet, accounting for 60% of off-balance-sheet assets. The amount of derivative transactions as measured by the value of the underlying instruments came to SKK 1 510 billion as at 31 December 2006, which is equivalent to 107% of the balance sheet size.

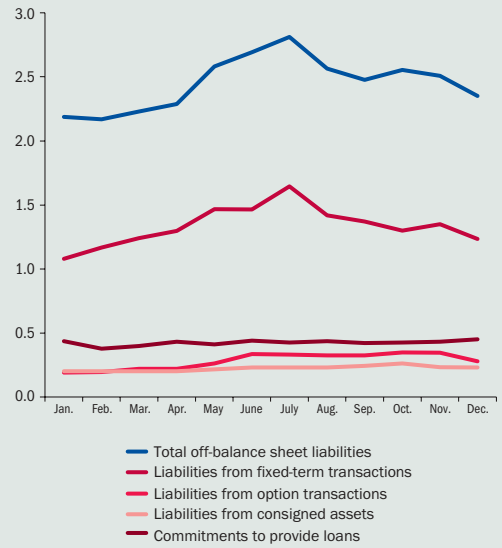
The structure of derivative instruments can be looked at in at least two ways. First, they can be categorised according to the type of derivative transaction, meaning whether it is fixed-term or option transaction. The second way of distinguishing derivatives is by the type of their underlying instrument (interest-rate, currency, equity, etc.). A majority of the derivative portfolio (82% in December) comprised fixed-term transactions. In the second half of 2006, the underlying instruments

Table 5 **Year-on-year changes in derivative instruments** **(SKK million)**

	Value of underlying assets					Positive fair value XII.2006	Negative fair value XII.2006
	XII.2006	VI.2006	XII.2005	Year-on-year change	Change since VI.2006		
Fixed-term contracts	1,231,443	1,466,313	1,036,630	19%	-16%	25,901	27,047
– interest-rate	547,735	564,920	387,166	41%	-3%	8,029	7,609
– currency	683,708	901,394	649,443	5%	-24%	17,872	19,439
– equity, commodity and interest-rate (claims)	0	0	21	-100%	0%	0	0
– equity, commodity and interest-rate (liabilities)	25	25	44	-43%	0%	0	0
Options	278,193	334,122	194,943	43%	-17%	4,213	4,164
– interest-rate	13,500	8,262	3,817	254%	63%	68	57
– currency	263,397	325,352	190,741	38%	-19%	3,743	3,703
– equity, commodity and currency	1,296	508	385	237%	155%	401	404

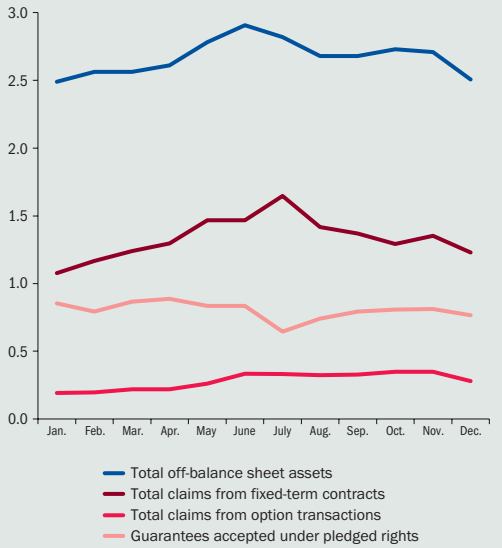
Source: NBS.
Note: The figures in the table represent off-balance sheet claims; off-balance sheet liabilities differ from claims by up to 0.1%.

Chart 35 **Amount of off-balance-sheet liabilities in the sector (SKK thousand billion)**



Source: NBS.

Chart 36 **Amount of off-balance-sheet assets in the sector (SKK thousand billion)**



Source: NBS.

of these derivatives were almost exclusively interest--rate and currency instruments. Of particular interest was the amount of fixed-term currency transactions, which declined from SKK 1 000 billion in July, its highest figure of the year, to SKK 683 billion at the year-end. This drop could be explained by the reduction in the amount of swaps concluded for the hedging of foreign exchange risk in reverse repo transactions, as a result of July's decline in sterilization operations. By contrast, the amount of interest rate futures was very stable, remaining close to SKK 550 billion for the whole of the second half of the year.

At the end of 2006, the vast majority (83.5%) of future-dated transactions concluded in the banking sector comprised swaps. Almost all of the rest (except for an insignificant part) consisted of forward contracts.

The second group of derivative instruments are options. The total amount of option contracts concluded in the sector did not fluctuate significantly between July and November 2006. The last month of the year saw a decline of around SKK 70 billion to a year--end figure of SKK 278 billion, which nevertheless represented an increase of 43% year-on-year. The predominant option transactions are options for currency instruments. Apart from them, only interest rate options are represented to a significant extent. Although two of the sector's banks were holding an equity option position in the second half of the year, the amount and importance of these contracts was negligible. Most of the option transactions entered into by banks were concluded for customers. Banks immediately closed these positions by means of option contracts with third parties. An exception were the currency options of two banks, which may have been used to hedge the foreign exchange position arising from fixed-term currency instruments.

As mentioned in the introduction of this chapter, the structure of derivatives may also be viewed in terms of underlying assets. In this respect, currency instruments were the most utilized in 2006 and as at the year-end accounted for 63% of all derivatives. The traded currencies comprised mainly euros and US dollars. The off-balance-sheet position of these two currencies was long and it therefore hedged the short foreign exchange position on the balance sheet. As well as currency derivatives, interest rate derivatives have a significant position in the off-balance sheet of banks, while equity and commodity derivatives have no more than symbolic status. That said, the position of equity derivatives more than doubled in size in comparison with the end of 2005. In December of last year, the Slovak banking sector used commodity-based derivatives for the first time, in the form of commodity options. Credit derivates were therefore the only group that reported a zero balance throughout the second half of the year.

Other off-balance-sheet transactions

Guarantees constitute the largest non-derivative item on the off-balance sheet. Securities received as collateral declined substantially, by more than 40% year-on-year. Nevertheless, these securities, used as collateral in reverse repo transactions, continue to make up a significant share of all collaterals. The said decline was mostly the result of a large one-time drop

Table 6 **Year-on-year changes in other off-balance-sheet instruments** **(SKK million)**

	XII.2006	VI.2006	XII.2005	Year-on-year change	Change since VI.2006
Guarantees					
Issued guarantees including documentary credits	69,935	91,887	65,589	7%	-24%
Received guarantees including documentary credits	859,131	921,675	951,509	-10%	-7%
of which: real estate	342,749	290,324	281,929	22%	18%
of which: securities under repo transactions	231,462	390,994	386,487	-40%	-41%
Loan commitments					
Commitments to provide loans	230,128	230,916	192,392	20%	0%
Commitments to receive loans	30,875	28,094	32,488	-5%	10%
Assets in safe custody					
Assets received for safe custody	450,534	438,258	393,520	14%	3%
Assets provided for safe custody	3,309	6,051	3,100	7%	-45%

Source: NBS.

in reverse repo transactions (and the closely related reduced amount of received collateral) in July 2006. This was caused mainly because three banks each reduced their position towards NBS during this period by several tens of billions of SKK. Collateral in the form of real property increased by 22% in comparison with December 2005, as the ongoing credit boom included many loans secured in this way.

Loan commitments, too, were an increasing item of the off-balance sheet, as they rose by one fifth over the course of the year. It is worth noting in regard to loan commitments that no less than one quarter of them is denominated in a foreign currency. The high customer demand for foreign-currency loans is probably based on the expectation for entry into the euro area, the interest rate differential, or the natural hedging of exporters that have income denominated in euros.

Some other off-balance-sheet items also reported relatively growth last year, such as issued documentary credits and liabilities from consigned assets. The increased amount of documentary credits can almost certainly be ascribed to the burgeoning foreign trade of Slovak companies and the related need to secure payments with foreign partners.

1.5 Profitability

The banking sector reported a net profit of SKK 17.8 billion for 2006, representing an increase of almost 27.7% year-on-year. The sector's ROE stood at 21.2%. The concentration of profits in the three largest banks continued in 2006.
Net interest income recorded a particularly sharp rise, related to the continuing increase in the volume of lending and the growth in banks' interest rate margins. Income from trading decreased year-on-year, while the increase in interest rates was adversely reflected mainly in the revaluation of debt securities. Income from foreign exchange transactions and dividends rose.
Although operating expenses in the banking sector continued to increase, the efficiency of banking operations rose, too, as the ratio of operating expenses to gross income from banking activities declined.

The profitability of the banking sector continued to show the positive trends seen in previous years. The average ROE, weighted by capital, stood at almost 21.2% in December 2006, compared with 16.9%[9] in the same period of 2005.

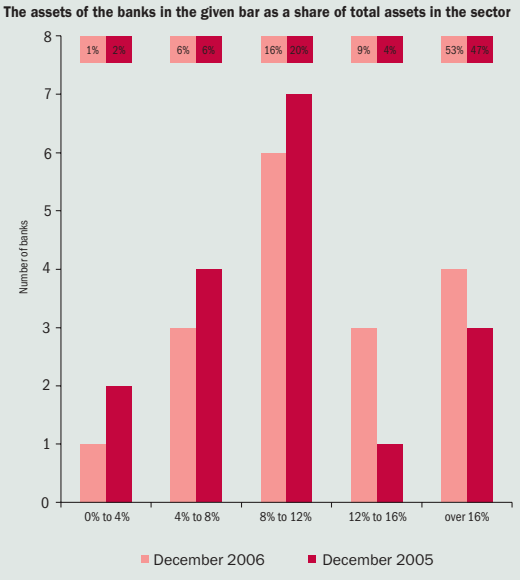
Leaving aside branches of foreign banks, the profitability of banks expressed as ratio of net profit to own funds decreased year-on-year in only five banks. Only one bank reported a loss for 2006.

The situation in branches of foreign banks was different. Since some of them were only commencing operation, their profitability was lower, that is, negative.

The three largest banks by profits generated in 2006 accounted for 57% of the banking sectors total profits, but only for 52% of its assets. The relationship between banks' share of the assets and their ROE is shown in Chart 38. The share of the three largest banks in the total profits of the banking sector declined year-on-year, which was caused, on the one hand, by one of them recording only a slight rise in profits, and, on the other hand, by the sharp rise in the net profit of two medium-size banks.

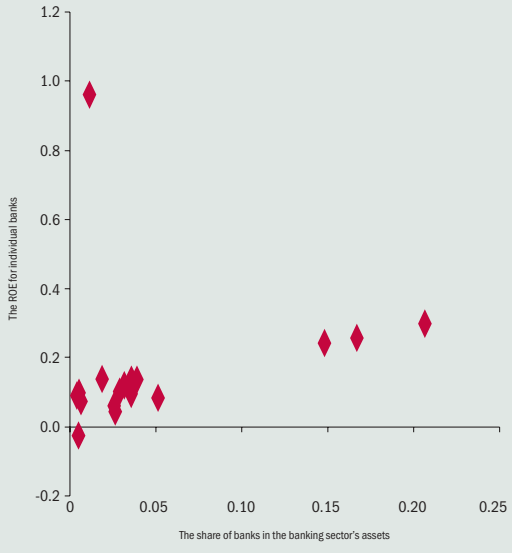
The after-tax profit generated by the banking sector in 2006 rose 27.7% in comparison with 2005. The sharp growth in net income, i.e. in income from banking

Chart 37 **Distribution of ROE in the banking sector (%)**



Source: NBS.
Note: The calculation does not include branches of foreign banks.

Chart 38 **Relationship between bank size and ROE in December 2006**



Source: NBS.

[9] *The year-on-year comparison of banks' profitability is complicated by the implementation of International Accounting Standard and other changes in the accounting procedures of banks.*

Table 7 **Year-on-year changes in basic categories of expenses and income** **(SKK billion)**

	December 2005	December 2006	Change in %
Operating expenses	28.01	30.04	7
Gross income	42.67	55.08	29
Net interest income	29.69	34.59	16
Net non-interest income	12.98	20.49	58
Net income (b – a)	14.66	25.04	71
Net profit after tax	13.92	17.78	28

Source: NBS.

activities after the deduction of operating expenses, was a positive factor. Net income increased by 71% year-on-year, indicating that banks were able to raise profitability on primary banking activities.

The year-on-year comparison of profit generation in certain banks was affected by the write-off or sale of claims in 2005. In the year-on-year comparison, this was reflected in a decline in expenses related to the write-off or sale of claims and a reduction in income from the use of provisions.

For all but one of the branches of foreign banks, the development of profitability was more negative than positive. This was mainly affected by relatively short time that some branches had been operating in the market, a fact reflected in operating costs being higher than operating income.

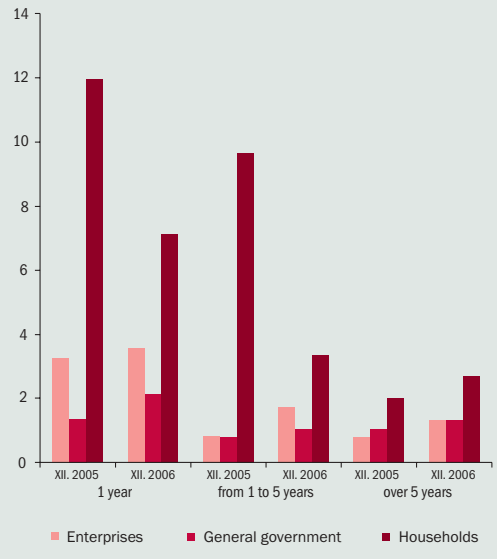
Net interest income

The importance of interest income in total gross income remained largely unchanged, and by the end of 2006 it was hovering at around 63% of the gross figure. Some banks reported a relatively strong dependence on net interest income, with their shares ranging from 82% to 100%.

The net interest income of the banking sector rose by 16% year-on-year. Even so, at the year-end the sector reported a drop of 6% year-on-year. The return to growth has been driven by the continuing increase in the volume of lending and the rise in interest-rate margins.

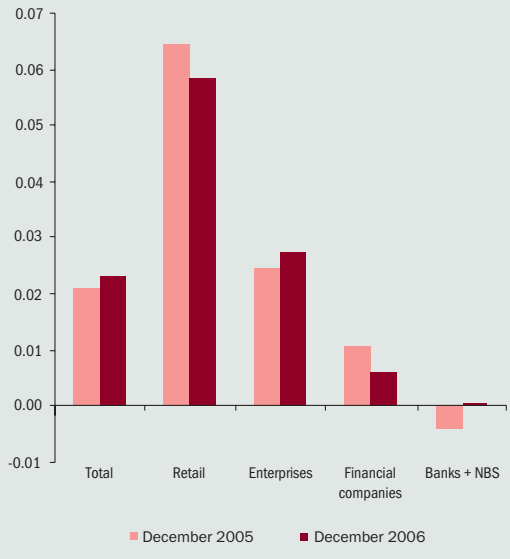
The structure of interest income was dominated by income from loans and other claims, which as at

Chart 39 **Difference between lending rates and risk-free interest rates** **(%)**



Source: NBS.
Note: Figures on the vertical scale are in percentages and express the difference between, on the one hand, lending rates on new loans with an agreed maturity of up to 1 year, 5 years or more than five years, and, on the other hand, income from the 1-year interbank rate and from 5-year and 10-year government bonds.

Chart 40 **Interest rate spread**



Source: NBS.
The interest rate spread represents the difference between, on the one hand, the share of cumulative interest income in the average value of selected assets provided to a given counterparty, and, on the other hand, the share of cumulative expenses in the average value of selected liabilities provided to this counterparty.

December accounted for 82% of interest income. Given the large amount of assets invested with NBS, as much as 25% of the interest income from claims consisted of income from NBS. Approximately 30% of interest income came from loans to households.

The proportion of income from securities continued to decline, particularly at those banks which in January redeemed a large part of their restructuring government bonds.

Interest expenses comprised mainly interest on deposits. Most of the interest expenses on securities was accounted for by expense related to mortgage bonds.

In comparison with the previous year, banks increased the difference between interest rates on interbank deposits and loans, or government bond income, and interest rates on the majority of loans to customers. For households, that difference declined in respect of loans with an agreed maturity of up to five years, but loans for more than five years increased in absolute terms. For enterprises, an increase was reported in all maturities.

The development of interest income reflects the development of the interest rate spread. The banking sector's interest rate spread rose year-on-year in respect of the corporate sector and financial sector, and declined for the retail sector.

Net non-interest income

Like interest income, non-interest income in the banking sector continued to increase in 2006, and as at December accounted for 37% of the sector's gross income. Its share of the absolute growth in gross income was even higher than 60%.

Trends in the development of particular items of non-interest income changed in comparison with 2005. Unlike in previous years, income from trading declined year-on-year and income from participations increased. The net fee income hardly changed at all. Other income developed positively, particularly with the decline in expenses related to the assignment of claims. When assessing the impact of this item on overall profits, however, it is necessary to take into account the change in provisions.

Dividend income was for most banks in the sector a negligible part of income. A larger part of the sector's year-on-year growth was accounted for by three banks.

Net fee income recorded only a minimal rise year-on--year. Because of changes in the charging of fees, however, it is difficult to assess the real development of fee income for the whole banking sector.

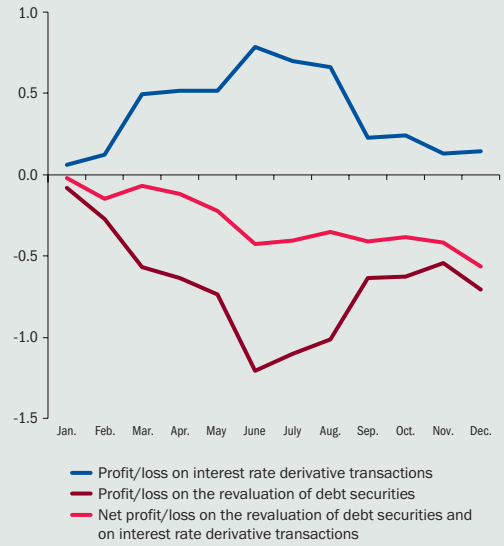
Fee-related expenses rose almost SKK 1 billion. More than two thirds of that increment was reported by two banks. Fee income increased by more than SKK 800 million, of which one bank accounted for over SKK 700 million. That case, however, concerned a

Table 8 **Changes in fee amounts in the second half of 2006**

	Index of change from VI.06 to I.07	Number of banks increasing fees	Number of banks reducing fees
Maintaining a current account in SKK or FC	103.6	2	1
Maintaining a deposit account in SKK or FC	100.0	0	0
Charging account transactions made electronically (Home Banking, Telephone Banking, Internet Banking)	91.0	1	2
Charging account transactions made by payment card	88.3	2	2
Charging account transactions made at the bank's point of sale	90.4	3	1
Cash withdrawal by payment card at an ATM machine of another bank which is a member of the Bank Cards Association (ZBK)	116.8	4	0
Loan provision	91.5	2	1
Maintaining a loan account	109.8	3	0
Mortgage loan provision	106.6	2	0
Maintaining a mortgage loan account	103.8	1	0

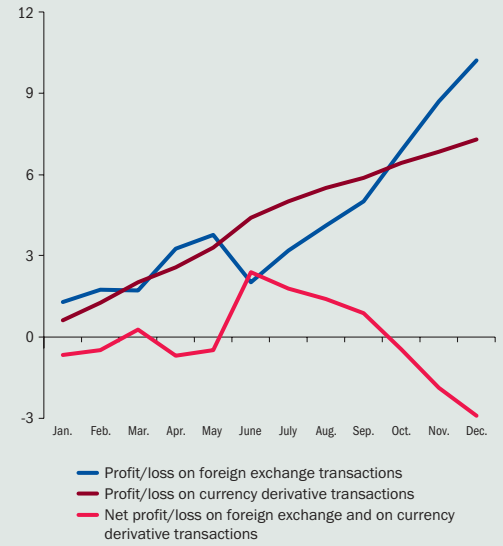
Source: NBS.

Chart 41 **Profit and loss on the revaluation of debt securities and interest rate derivative transactions (SKK billion)**



Source: NBS.
Note: The chart shows cumulative figures from the beginning of 2006.

Chart 42 **Profit and loss on foreign exchange transactions and on currency derivative transactions (SKK billion)**



Source: NBS.
The chart shows cumulative figures from the beginning of 2006.

change in methodology where fee income was taken to include selected income items (e.g. depository service fees).

Overall, as many as ten banks recorded a decline in fee income year-on-year, mostly owing to a drop in fee income from customers.

Changes in banks' fees for selected services in the second half of 2006 are shown in Table 8.

Income from trading developed negatively. Income from securities transactions declined at almost all banks, by a total of SKK 1.3 billion year-on-year. A substantial part of income from securities transactions comprised income from the revaluation of securities. The rise in interest rates was adversely reflected in the revaluation of debt securities to fair value. A loss on transactions in debt securities was reported by as many as eight banks. Some banks used derivative transactions to close out open interest-rate positions in debt securities.[10] On the revaluation of securities, the banking sector as a whole made a loss of SKK 540 million.

Income from foreign exchange and foreign exchange-based derivative transactions must be evaluated together, since a majority of banks use derivative transactions to hedge their open foreign exchange positions. With most banks reporting a profit, net income from these transactions rose more than SKK 700 million year-on-year. As at December 2006, the sector reported a net gain on foreign exchange operations (after taking into account currency derivative positions) of almost SKK 7.4 billion.

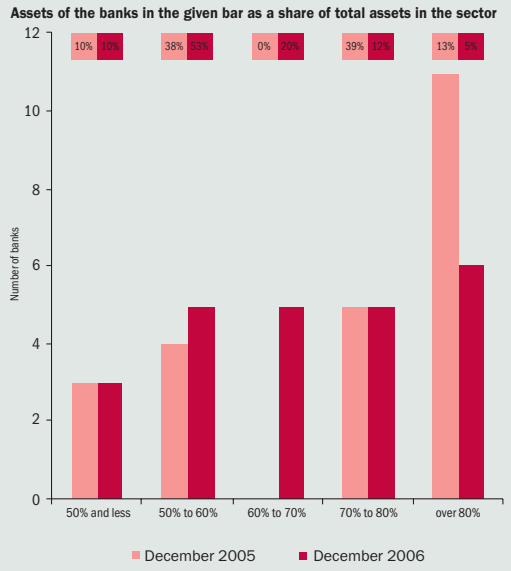
The year-on-year growth in non-interest income reflected the reduction in the net loss on the assignment of claims.[11] That year-on-year drop in the net loss on assigning claims was caused partly by lower expenses related to the sale of claims and partly by the higher rate of returns on the sale of claims, with income from the assignment of claims rising. The net loss from the sale of claims declined year-on-year by almost SKK 2 billion. If non-interest income excluded the net profit or loss on the sale of claims, it would have risen by 15% year-on-year.

The reduction of the net loss on other operating activities had a similarly positive effect on the year-on-year growth in non-interest income. Whereas most banks reported a decline in expenses, only one had a substantial rise in income.

[10] *See the section Interest rate risk.*

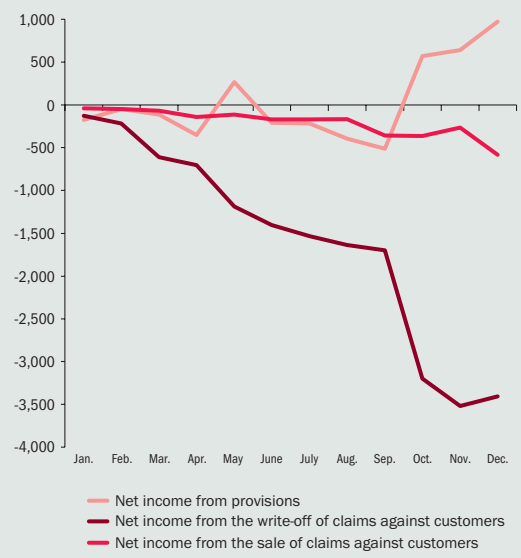
[11] *When evaluating the development of this item, it is also necessary to take account of changes in the amount of provisions not included in non-interest income. In the accounts of banks, the sale of claims is reflected in higher expenses (most sold loans are defaulted to varying degrees and therefore their price is lower than their book value) or higher income from sales, and in increased income on provisions which are used when defaulted loans are sold.*

Chart 43 **Distribution of operational efficiency in the sector (December 2005 and 2006)**



Source: NBS.

Chart 44 **Net creation of provisions and the write-off and sale of claims against customers (SKK million)**



Source: NBS.

Operating expenses

The operating expenses of banks rose 7% year-on-year. Of operating costs as at the year-end, personnel costs accounted for a significant part (45%). These were also the largest component of the year-on-year increase in operating costs. Several banks saw a decline in operating expenses, which may be related to the rationalization of operations; this is even a long-term trend in one bank.

Despite the rise in operating expenses, operational efficiency as measured by the ratio of operating expenses to gross income improved. As at December 2006, the operating expenses of the whole banking sector were equivalent to 54.5% of its gross income. In 2005, that ratio fluctuated at around 65.6%. There was notably a decline in the number of banks in which this ratio represented more than 80%.

Net income from the write-off of claims and provisions

In comparison with 2005, the banking sector wrote-off claims to an increasing extent, and expenses related to such write-offs increased by more than SKK 1 billion.

Claims were sold to a lesser extent, which was reflected in the year-on-year decline in income from the use of provisions. The drop in income happened despite the year-on-year increase in claim write-offs.

As with income (down by SKK 6.7 billion year-on-year), expenses related to the creation of provisions decreased, albeit to a lesser extent. The amount of provisions created in the sector declined by SKK 4.2 billion year-on-year. The total net income from the creation of provisions (the difference between income from the use of provisions and expenses related to their creation) fell by SKK 2.6 billion year-on-year.

The significance of net income from the creation of provisions and of the write-off and sale of claims is shown in the following chart. The overall gain in 2006 was adversely affected by the high costs related to the write-off of claims.

The positive effect that the net creation of provisions had on the banking sector's profitability declined year-on-year. In 2006, some banks saw an increase in costs related to the creation of provisions as well as a decline in income from the creation of provisions. Year-on-year growth in income from the reversal of provisions was recorded mainly in two banks.

1.6 Capital adequacy

As double-digit percentage growth in risk-weighted assets continued, on the one hand, and own funds increased by less than 2%, on the other hand, the capital adequacy of the Slovak banking sector reported a further decline. A majority of banks recorded a drop, and those with capital adequacy ratio under 12% were, by the year-end, managing more than half of the total assets. It should be noted that this fall in capital adequacy occurred within the stipulated regulatory rules, since all banks, throughout the year, had at their disposal sufficient own funds to easily meet the 8% minimum regulatory requirement. The high quality of banks' own funds, almost all of which was Tier I capital, may also be seen as strength.

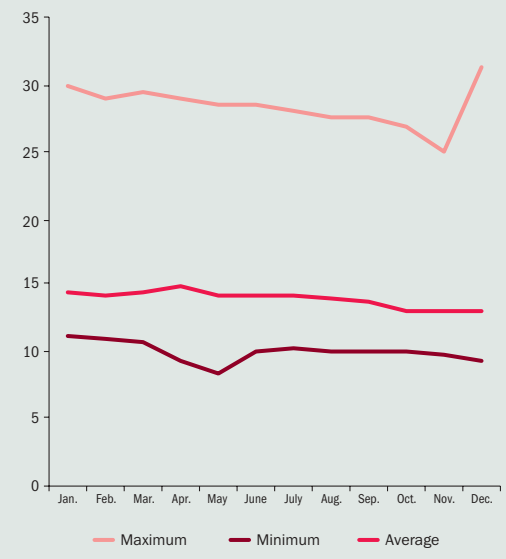
As regards capital adequacy, the long-term trend of convergence towards the conditions prevailing on advanced financial markets continued in the second half of the year. Within this process, banks mostly reported a gradual decline in their capital adequacy ratio. The weighted average ratio in the sector (weighted by size of risk-weighted assets) stood at 13% in December 2006, which represented a year-on-year decline of 1.8 percentage points. Not only did the sector's average ratio come down, so did its highest ratio, while the lowest figure hovered between 1 and 2 percentage points above the capital adequacy requirement of 8%. During the year, the individual capital adequacy ratios of banks fluctuated within a band of 9% to 30%, which was relatively narrow in comparison with the past. The only exception to that level occurred in December, when one bank recorded a sharp rise in its ratio caused by an increase in additional own funds. As a result, the capital adequacy ratios ranged from 9.1% to 32.1% in December.

The most comprehensive information on the capital adequacy situation is given in Chart 46 on the distribution of the ratio (for December 2005 and 2006).

This chart clearly shows the declining trend in the capital adequacy ratios, as the whole distribution has shifted to the left, towards lower figures. As at the end of 2006, the lowest band (8% to 12%) included banks managing more than 50% of the sector's total assets, which in comparison with the end of the previous year represents an almost twofold rise in the percentage of assets managed by this group of banks.

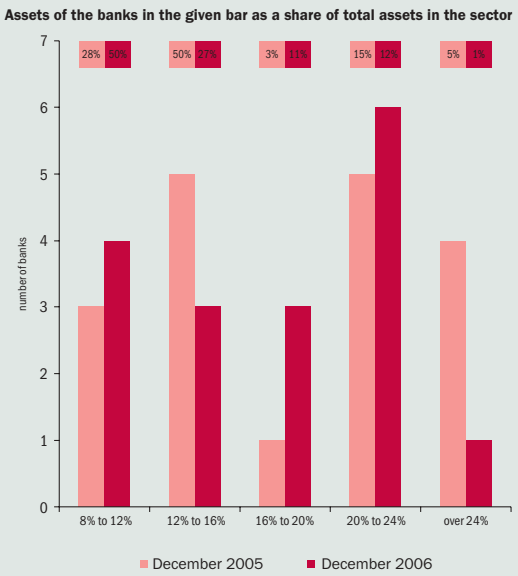
Although we have so far focused mainly on the decline in capital adequacy ratios, there are several banks

Chart 45 Capital adequacy ratios in the banking sector



Source: NBS.
Note: The average in this case means the average weighted by RWAs.

Chart 46 Distribution of capital adequacy ratios in the banking sector



Source: NBS.

which recorded a rise in their ratio over the past year. The reasons for these changes varied from one bank to another, and included growth in retained earnings, a higher amount of subordinated debt, and a capital increase.

The amount of own funds held by banks to cover particular risks rose 1.9% year-on-year. Most of these funds come out of capital or profits. Only two banks reported a change in their capital in 2006. The quality of own funds in the Slovak banking sector is very high with almost 97% classified as Tier I, the highest quality category. The share of Tier II capital is, from the aggregate view, insignificant, and it represents no more than one third of the own funds at any of the banks in which it is held. Tier III capital is only used by one Slovak bank and accounts for around 5% of its own funds.

Another factor relating to the calculation of the capital adequacy ratio, apart from own funds, are risk weighted assets (RWAs). RWAs can be understood as the total size of the risk attached to a bank's assets. Because banks last year increased the proportion of their asset positions that carry greater risk weights at the expense of those with smaller risk weights, the sector's RWAs rose 15%, and since own funds grew at a substantially lower pace, this translated into a decline in the capital adequacy ratio. The bulk of RWAs are classified in the banking book. The sectoral rise in RWAs included a rise in RWAs at almost all banking entities in the market. The largest increase in RWAs reported by a single bank was 48%. Three banks saw a slight drop in RWAs, none of which exceeded 6%.

1.7 Risks in the banking sector

The trend change in the banking sector's asset structure continued in 2006 and also affected risk assessment. As well as the decline in the importance of securities, the amount of transactions made with banks and NBS decreased. By contrast, loans to customers continued to increase their share of the sector's assets, and accounted for 46% of the total as at December 2006.

The main increase came in credit exposure to households and enterprises, which at the end of the year accounted for 37% of the banking sector's assets.

Assuming loans to households and enterprises will have an increasingly important position in banks' assets, there is a potential risk in a very strong dependence of banks on the domestic economic cycle. The current positive trends in banks are to a large extent related to the strong economic growth and favourable developments in the household and corporate sectors. A downturn in economic growth, or a recession in the domestic economy, would to some extent be adversely reflected in the financial position of enterprises and households, which in turn would expose banks to a greater credit risk. It should, however, be pointed out that the degree and significance of that adverse effect is very difficult to estimate, given the insufficient experience of the link between an economic downturn and the performance of the banking sector. For the moment, however, only certain banks are diversifying their assets and income in geographical and product terms.

The quality of the household loan portfolio as measured by the percentage of non-performing loans remained largely unchanged. Although the amount of non-performing loans rose, the strong growth in new loans ensured that the increment was only minimal. As the difference between variable interest rates and longer fixed interest rates narrowed, so the provision of loans with a short fixed rate period declined, especially in the case of real estate loans. Nevertheless, a relatively large proportion of loans to households still carry a variable rate or short-term fixed rate, which means households are exposed to the risk of a sharp rise in interest rates. Loans denominated in foreign currency accounted for an insignificant share.

Non-performing corporate loans declined as a percentage of total loans in 2006, largely owing to the write-off of loans by banks. More than 33% of corporate loans were denominated in foreign currencies. These loans typically had a short fixed rate period.

The riskiness of loans is largely related to the financial position of borrowers. Last year, the economy's positive trends were reflected in higher household income and a decline in unemployment. Households maintained a sufficiently large amount of liquid financial assets. The financial position of enterprises also improved, with mainly small and medium-sized enterprises showing an increase in profitability. The corporate sector reported a relatively low level of indebtedness.

The credit risk of securities at the banking sector level declined in 2006. In the structure of securities, the share of government bonds and bank bonds increased, while the percentage of riskier foreign securities, especially corporate bonds and equity securities, fell.

The banking sector's exposure to foreign exchange risk was negligible in 2006. Open short positions on the balance sheet were closed with off-balance-sheet derivative transactions. The overall foreign exchange position was almost completely closed. The foreign exchange risk was likewise minimal in regard to positions in particular currencies, their mutual correlations and the development of exchange rates. For most banks during 2006, the VaR did not exceed 2% of own funds.

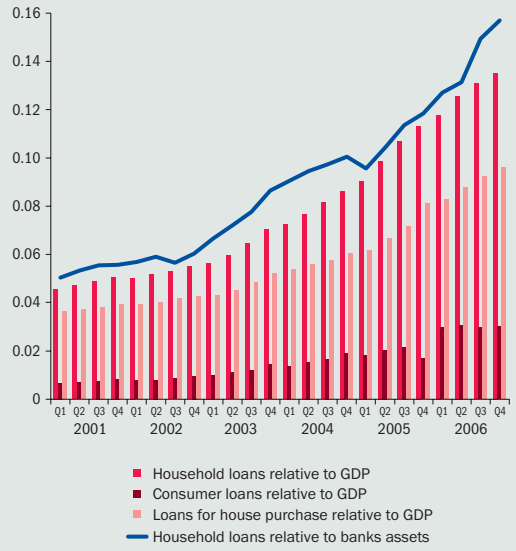
Although the direct exposure of banks to exchange rate movements was negligible, banks were exposed to indirect foreign exchange risk mainly through corporate loans denominated in foreign currencies. Despite a shortage of relevant data, it is assumed that a large proportion of enterprises use natural hedging, where foreign exchange loans are hedged by income denominated in foreign currencies.

The interest rate risk in the banking sector arose mainly in the banking book. In the event of a change in interest rates, however, this risk would not affect banks' profitability or capital adequacy. Interest rate positions in the trading book were practically closed, partly owing to the hedging of balance sheet positions with off-balance-sheet positions. This applies above all to positions with longer fixed rate periods, where the interest rate risk generally has a greater impact. The aggregated results of VaR figures show that with this loss taken into account, the median capital adequacy ratio would fall from 18.8% to 18.4%.

As regards liquidity risk, customer deposits typically increased at a faster pace than did liquid assets and this was reflected in the decline in the quick ratio. What is significant, however, is that term deposits, which are relatively less volatile, recorded growth. The relative stability of liquidity ratios for up to 7 days and up to 3 months indicates a rather stable development, which was again confirmed last year by the slight increase in the ratio of the liquidity cushion to total assets. The liquidity risk in individual banks is increasingly a matter concerning the core of deposits.

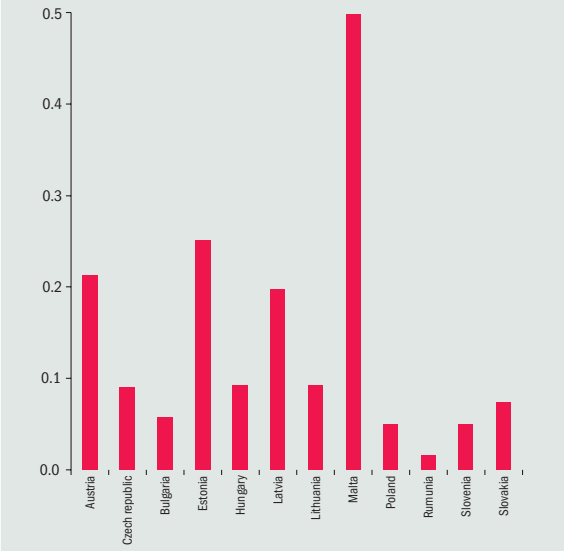
Chart 47 **Household loans relative to GDP and banks' assets**

(%)



Source: NBS; Statistical Office of the Slovak Republic.
Note: The percentages represent the ratio of household loans to GDP in current prices.

Chart 48 **Household loans secured by real estate relative to GDP in selected EU countries in 2005**



Source: Central banks of EU countries.
For the Czech Republic, 2004 data are used.

Credit risk

Household credit risk

As the volume of lending increased, so did the exposure of banks to credit risk. The size of the risk varies, however, from loan to loan and may be related to, for example, the counterparty to which the bank extends the loan, the type of loan, or the conditions under which the loan is extended.

Households are generally considered to be a less risky segment. That is particularly the case with loans for house purchase, since households may be expected to do their utmost to avoid losing their property. The various types of consumer loan are seen as riskier, owing to the weaker motivation to meet the repayments and the lower quality of the security.

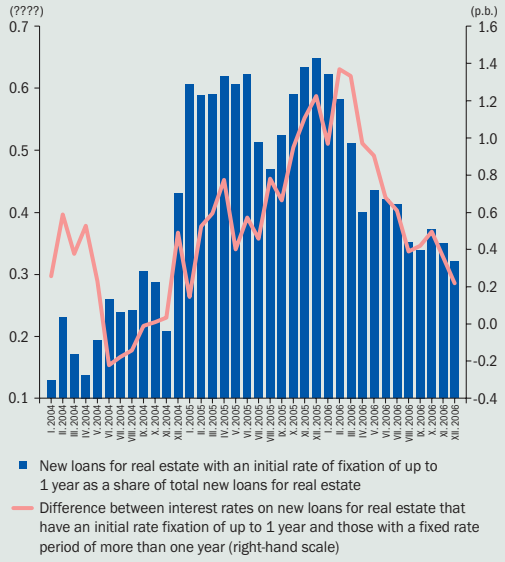
In the Slovak banking sector, lending for house purchase and other forms of lending to households continued to increase substantially in 2006. At the year-end, loans to households represented 14% of GDP and 15% of the banking sector's assets. Loans for house purchase were the most significant item of household lending, amounting to 10% of GDP as at December 2006. The amount of consumer loans represented 3% of GDP.

One of the reasons for the continuing strong growth in lending to households is the 'convergence effect' related to the still small importance of these loans. In comparison with other EU Member States, Slovakia reports a low level of household borrowing, and therefore the rise in these loans is likely to remain high.

Another factor relevant to the strong growth in loans to households is the positive economic development. The rise in GDP and employment was reflected in higher real wages as well as in favourable expectations for future developments. The growth in lending to households was also supported by rising property prices.

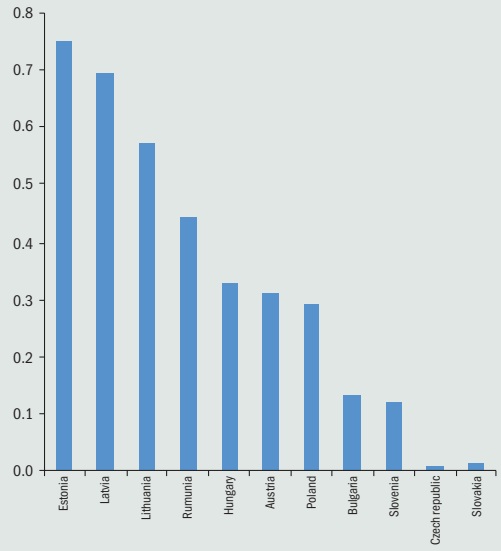
Again in 2006, the new loans provided in each month were predominantly loans with a variable rate or an initial rate fixation of up to 1 year. As at December they accounted for 81% of the total amount of new loans to households. It should be noted, however, that more than two thirds of these loans are in the form of credit card lending and current account overdraft facilities. As regards loans for real estate, the situation is slightly different. Mainly because of the rise in short-term interest rates last year, banks recorded a narrowing of the difference between, on the one hand, their lending rates on real-estate loans that have a variable rate or an initial rate fixation of up to 1 year, and, on the other hand, their rates on loans with a fixed-rate period longer than 1 year. That difference decreased year-on-year from 1.0 percentage point to 0.2 of a percentage point. At the same time, the total of new household loans for real estate in 2006 included a gradually declining share of loans that have a variable rate or an initial rate fixation of up to 1 year (Chart 49). That share fell from 67% to 34%

Chart 49 New loans to households by fixed interest rate period



Source: NBS.

Chart 50 Foreign currency loans to households as a share of total loans to households in selected countries in December 2005

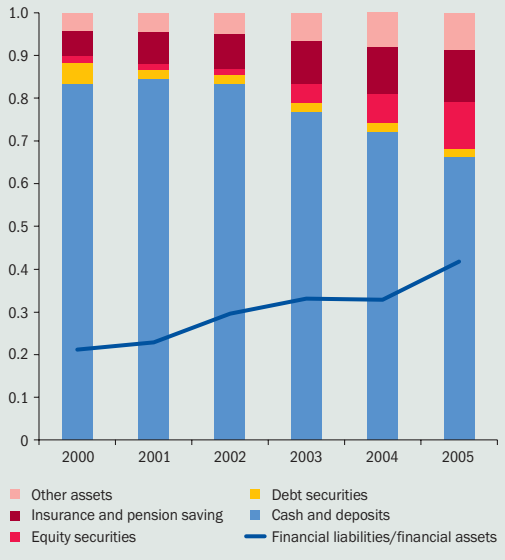


Source: NBS, central banks of EU countries.

year-on-year, and was relatively high until the period when interest rates were raised. This may mean that the said difference between rates in the time when loans were provided has a relatively significant effect on household decisions regarding interest rate fixation, whereas its expected development is substantially less relevant to them. With such short-sighted behaviour from households, the potential credit risk attached to any rise in interest rates is increasing.

That said, the results of a stress test performed on a sample of households and published in the Report on the Results of the Slovak Financial Sector Analysis for the first half of 2006 indicate that an increase in rates would not, for the time being, pose a significant threat.

Chart 51 Structure of financial assets and the ratio of financial liabilities to assets

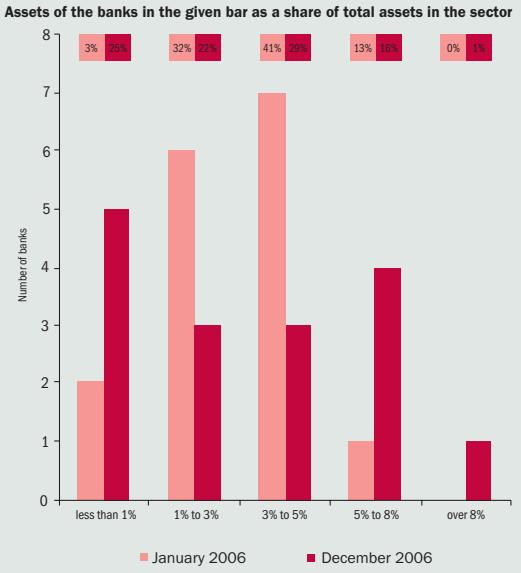


Source: Statistical Office of the Slovak Republic.

Chart 52 Household debt service burden in relation to household income

Source: Statistical Office of the Slovak Republic, NBS, own calculations.
Note: The debt service burden is the ratio of loan repayments to gross disposable income; it is calculated from the amount of household loans broken down by maturities and interest rates.

Chart 53 **Distribution of non-performing loans by share of total loans to households**



Source: NBS.

Table 9 **Non-performing loans by share of total loans in the household sector** (%)

	I. 2006	XII. 2006
Loans to households	3	3.1
Loans for real estate	1.6	2.1
Mortgage loans	1	1.3
Consumer loans	5.6	6.0
Credit cards	7.4	1.9
Intermediate loans	3.4	4.3
Building loans	0.9	1.6
Current account overdraft	3.6	3.6

Source: NBS.

The foreign exchange risk of households is minimal at present, reflecting the relatively small uptake of loans denominated in foreign currencies. As at December 2006, foreign currency loans accounted for 1.5% of household lending. Only a few banks provide foreign currency loans.

Financial position of households

Despite the sharp rise in household financial liabilities, largely through bank loans, households retained a sufficient amount of financial assets. In terms of structure, they comprise mainly liquid deposits held with banks, although the share of equity securities in the form of mutual fund shares has been rising since 2003.

At the end of 2006, bank loan repayments accounted for 4.6% of gross disposable income. Although this information is not a direct indicator of household indebtedness, the development of the ratio is important. The ratio of loan repayments to disposable income continued to rise in 2006, owing to the increase in the volume of lending and in interest rates.

Credit portfolio quality – households

Of the total loans to households in the banking sector as at the end of 2006, non-performing loans accounted for a relatively low share of 3.1%. This ratio hardly increased during the year, from its level of 3% in January. But although the aggregate ratio remained almost flat, a number of banks did record a change in this figure.

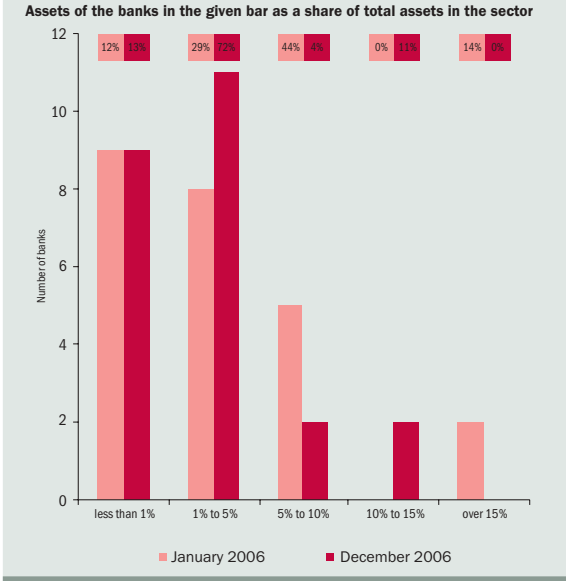
The highest loan default rate was reported for consumer loans (Table 9). Within this group, special purpose loans had a higher loan default rate (7.0%) in comparison with any purpose loans (5.1%).
Loans secured by real estate had a low default rate. The percentage of mortgage loans that are non-performing recorded a slight rise.

The ratio of non-performing loans to total loans in the sector remained largely unchanged, also because of the continuing growth in the volume of lending. The amount of loans rose in 2006 at a similar pace (33% year-on-year) as did the amount of non-performing loans (36%).

Corporate credit risk

Loans to enterprises rose 20% in 2006, at a slightly faster pace than in 2005 (17.5%). Their share of total loans remained stable throughout the year, and ended the period at 49.1%.

Chart 54 **Distribution of corporate portfolio quality in the banking sector**



Source: NBS.

Table 10 **Quality of corporate lending by industry as at 31 December 2006**

Industry	Share of industry in total corporate loans	Proportion of loans to industry which are non-performing	Change in proportion of non-performing loans from January 2006
Manufacturing industry	24.2%	6.8%	-2.8 p.p.
Wholesale and intermediary trade	17.2%	5.7%	-3.0 p.p.
Real estate activities	10.1%	1.4%	-0.1 p.p.
Retail trade	7.5%	2.3%	-0.1 p.p.
Land and pipeline transport	6.3%	0.5%	0.1 p.p.
Electricity generation and distribution	5.9%	0.0%	0.0 p.p.
Construction	5.7%	3.9%	-2.1 p.p.
Auxiliary transport activities	3.0%	0.4%	-0.4 p.p.
Agriculture and hunting	2.8%	8.6%	-5.0 p.p.
Motor vehicles and motorcycles	2.2%	3.1%	-1.4 p.p.
Hotels and restaurants	1.6%	8.1%	-9.3 p.p.
Other industries[1]	12.4%	3.4%	-2.1 p.p.

Source: NBS.
1) Other industries include: Forestry, Fishing, Mining and quarrying, Gas production, Production and distribution of steam and hot water, Water treatment and distribution, Water transport, Air transport, Posts and telecommunications, Rental of machines and goods for personal consumption, Computer activities, Research and development, and other business services.

Credit portfolio quality – enterprises

The proportion of non-performing loans in the corporate portfolio continued to decline in 2006, by a total of 2.1 percentage points to 4.0% as at 31 December 2006. Not only did the share of non-performing loans decrease, so did their amount, by almost SKK 4 billion over the year. This was mainly because of the write-off of non-performing loans for which provisions had already been created.

Table 10 shows the breakdown by industry of the proportion of non-performing loans.

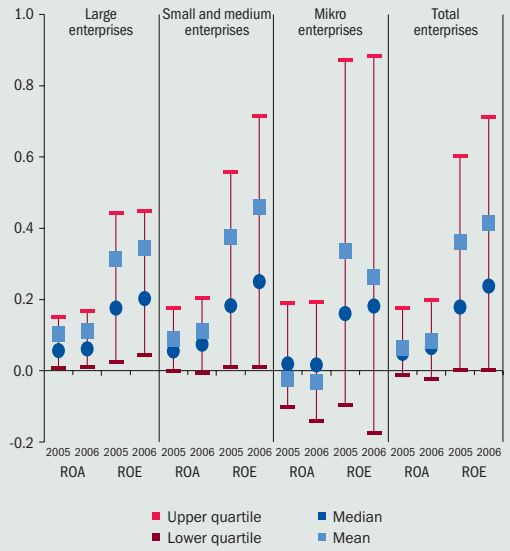
Financial position of enterprises

The financial position will be analysed in regard to the size[12] of enterprises and the comparison between the years 2005 and 2006. The focus will be mainly on their profitability, capitalization and indebtedness, efficiency, and liquidity. Testing has confirmed that all the differences mentioned in this section have a statistical significance of 5%. Each chart should therefore be interpreted with caution in view of the fact that the differences presented may not be statistically significant. Regarding the analysis, the more important statistical results are stated in the text.

Profitability

In 2005 and 2006, the mean and median return on assets were the same for large and small and medium-sized enterprises, and they were also higher than for micro-enterprises. In the year-on-year comparison, only small and medium-sized enterprises saw a significant rise in return on assets, while for

Chart 55 **Profitability of enterprises according to size** **(%)**



Source: Statistical Office of the Slovak Republic, own calculations.
Note: Data for 2006 were annualized from the data for the first three quarters of the year. Exceptional ROA figures were adjusted to the quartile figure with a probability of 0.1%. Exceptional ROE figures were adjusted to the quartile figure with a probability of 0.5%.

[12] *The statistical sample of 6,000 enterprises was divided into three groups according to revenue (t): large enterprises: t ≥ SKK 1 bn, small and medium-sized enterprises: SKK 30 m ≤ t < SKK 1 bn, micro-enterprises: t < SKK 30 m.*

Table 11 **Profitability of enterprises according to size** (%)

Podniky	Median ROE		Mean ROE		ROE[1)]		Median ROA		Mean ROA		ROA[1)]	
	2005	2006	2005	2006	2005	2006	2005	2006	2005	2006	2005	2006
Large	17.6	20.3	31.3	34.5	1.23	1.07	5.6	6.2	10.3	11.3	0.18	0.21
SMEs[2)]	18.3	25	37.8	46	1.65	1.85	5.6	7.5	9	11.3	0.24	0.3
Micro	16.1	18.2	33.7	26.5	2.48	2.97	2	1.7	-2.3	-3.2	0.57	0.69
Total	17.9	23.8	36.3	41.5	1.82	2.02	4.9	6.5	6.37	8.5	0.35	0.41

Source: Statistical Office of the Slovak Republic.
1) Standard deviation.
2) Small and medium-sized enterprises.

large enterprises and micro-enterprises it remained unchanged year-on-year.

The situation in regard to return on equity is slightly different. In 2005 and 2006, the mean and median return on equity were the same for large enterprises and micro-enterprises, and remained largely unchanged year-on-year. The return on equity of small and medium-sized enterprises (both the mean and median figures) rose sharply last year in comparison with 2005, and whereas their ROE was the same as that of other enterprises in 2005, it was significantly higher in 2006.

It is also important that in both years, and for all types of enterprises, the median profitability figures were positive. This means that in all categories of enterprises there were more profitable enterprises than loss-making ones.

The variance of profitability depends mainly on the size of enterprises. The smallest variance was in the sample of large enterprises, and the largest variance was recorded for micro-enterprises. The variance represents a risk which in this case is indirectly proportional to enterprise size. Such a statement is consistent with the fact that loans to large enterprise carry a lower risk margin than do loans to small and medium-sized enterprises.

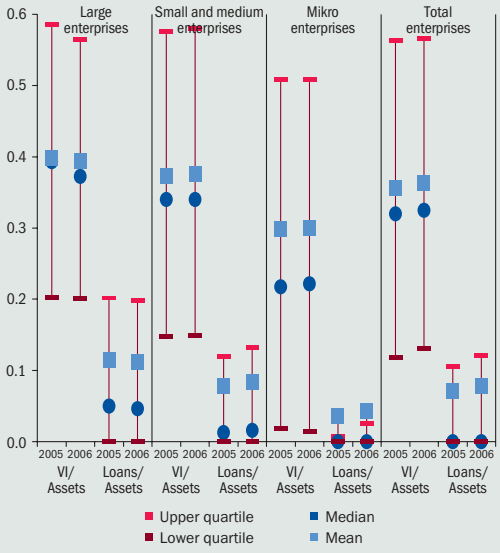
In 2006, the variance for large enterprises did not change, whereas the variance for small and medium-sized enterprises and for micro-enterprises became greater.

Indebtedness and capitalization

The analysis of capitalization (the ratio of shareholders' equity to total assets)[13] confirmed the greater extent of own funds in larger enterprises. Capitalization was lower in SMEs (median) and micro-enterprises (median and mean). In 2006, neither the capitalization of enterprises nor its variance changed in comparison with 2005.

The median ratio of bank loans to total assets showed that all three categories include a number of enterprises which either do not have bank loans or are only marginally indebted. In the micro-enterprises category, enterprises which do not have bank loans even outnumber those which do (the median is 0%). The relatively low degree of bank loans among large enterprises may be because large enterprises have more options for financing (e.g. issuing bonds, funds from a parent company, ...) and, unlike SMEs, are not directly reliant on bank loans. Like capitalization, the indebtedness of enterprises did not change significantly year-on-year.

Chart 56 **Capitalization and indebtedness of enterprises by size** (%)



Source: Statistical Office of the Slovak Republic, own calculations.
Note: The values of balance-sheet items for the respective year were calculated as the arithmetic average of the respective quarterly values. The chart covers a complete statistical sample of enterprises, and therefore includes those which do not have bank loans. If an enterprise reported negative equity, the ratio of equity to assets was treated as 0%.

[13] *Reference capitalization values: where the ratio of own funds to total assets is greater than 40%, the capitalization may be considered very good, whereas a figure of less than 10% is insufficient.*

Table 12 **Capitalization and indebtedness of enterprises according to size** (%)

Podniky	SE/Assets median		SE/Assets mean		SE/Assets st. deviation		Loans/Assets median		Loans/Assets mean		Loans/Assets st. deviation	
	2005	2006	2005	2006	2005	2006	2005	2006	2005	2006	2005	2006
Large	39.3	37.3	39.8	39.4	0.24	0.24	5	4.7	11.4	11.2	0.14	0.14
SMEs	34	34	37.3	37.6	0.27	0.27	1.3	1.6	7.8	8.4	0.12	0.13
Micro	21.8	22.2	30	30	0.29	0.29	0	0	3.5	4.4	0.09	0.11
Total	32	32.5	35.7	36.3	0.27	0.27	0	0	7.1	7.9	0.12	0.13

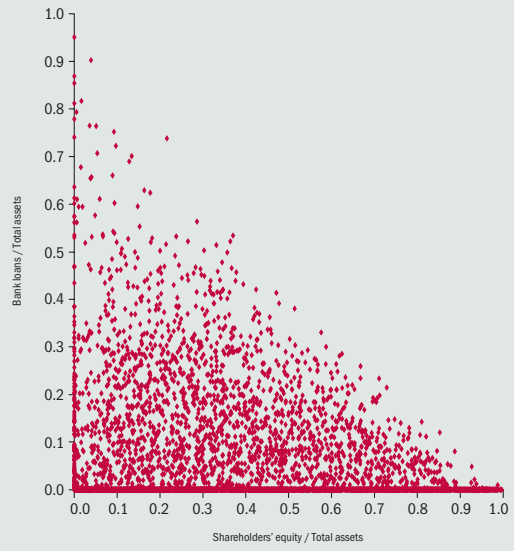
Source: Statistical Office of the Slovak Republic, own calculations.
Note: The table covers a complete statistical sample of enterprises, and therefore includes those which do not have bank loans.
SE – shareholders' equity.

Overall, smaller enterprises may be said to have lower indebtedness and weaker capitalization, which leads to the thesis about a higher degree of business liabilities.

The comparison between the ratio of bank loans to total assets and the ratio of shareholders' equity to total assets does not demonstrate any correlation between the value of shareholders' equity and bank loans. The ratio of shareholders' equity to total assets cannot therefore be treated as a main criterion for bank lending.

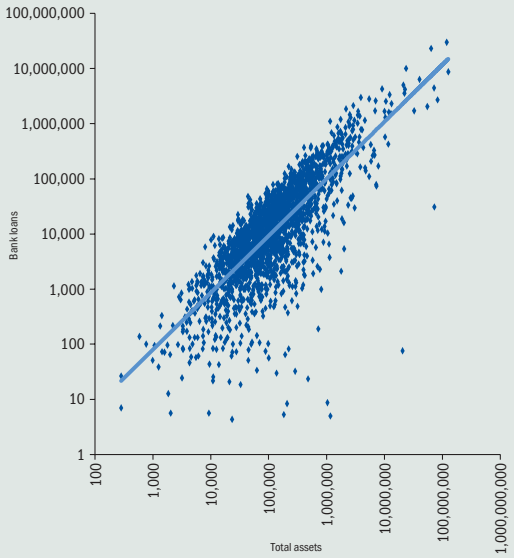
In comparing the ratio of bank loans to total assets, a relatively strong, almost linear, dependence can be observed between the amount of loans and the amount of total assets.[14] This is further demonstrated by the relatively small variance of this ratio in each of the three enterprise samples (Table 12). In general, therefore, differences in the indebtedness of various enterprises exist not in the ratio of bank loans to total assets, but in the ratio of bank loans to shareholders' equity. That is why the ratio of bank loans to shareholders' equity is a better indicator of the rate of bank lending. In the given sample of enterprises, this ratio exceeded 1.5% for 7.6% of enterprises, and a further 10% of enterprises reported negative shareholders' equity.[15]

Chart 57 **Shareholders' equity and bank loans in comparison with total assets** (%)



Source: Statistical Office of the Slovak Republic, own calculations.
Note: The values of balance-sheet items for the respective year were calculated as the arithmetic average of the respective quarterly values.

Chart 58 **Bank loans and total assets** (SKK thousands)

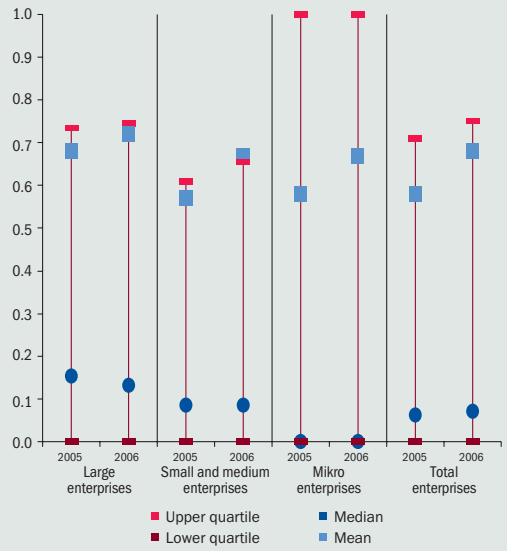


Source: Statistical Office of the Slovak Republic, own calculations.
Note: The chart includes only enterprises which have bank loans. The values of balance-sheet items for the year were calculated as the arithmetic average of the respective quarterly values.

[14] *In the sample of enterprises including only enterprises with bank loans, the average for 2006 was 15.7% and the spread was 0.019.*

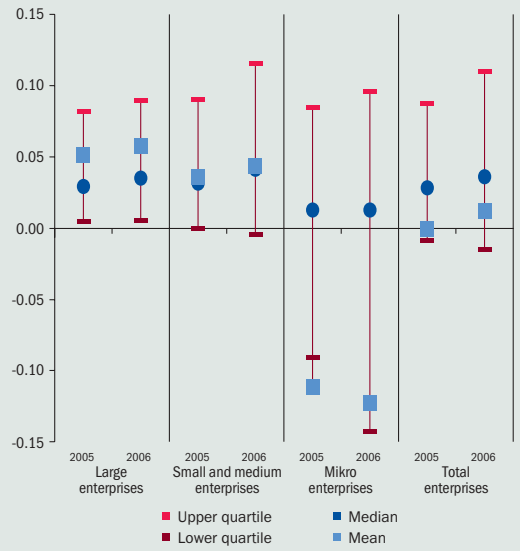
[15] *If the ratio of bank loans to shareholders' equity is greater than 1.5, it is considered to be excessive indebtedness.*

Chart 59 **Ratio of bank loans to shareholder's equity** (%)



Source: Statistical Office of the Slovak Republic, own calculations.
Note: The chart covers a complete statistical sample of enterprises, and therefore includes those which do not have bank loans. If an enterprise reported negative shareholders' equity, the ratio of bank loans to shareholders' equity was treated as 150%. The values of balance-sheet items for the year were calculated as the arithmetic average of the respective quarterly values.

Chart 60 **Profit to sales ratio by enterprise size – efficiency** (%)



Source: Statistical Office of the Slovak Republic, own calculations.
Note: Data for 2006 were annualized from the data for the first three quarters of the year. Exceptional figures were adjusted to the quartile figure with a probability of 0.1%.

Efficiency

The efficiency of enterprises measured as the ratio of the profit for the current period to sales for that period is worst among micro-enterprises. This was seen in their lower mean and median values and particularly in their substantially greater variance. The only material difference between large enterprises and SMEs is the greater variance among SMEs.

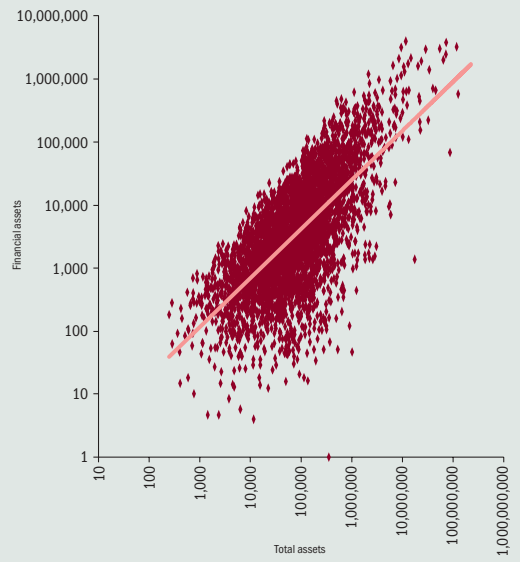
For micro-enterprises and SMEs, the mean and median values did not change in the year-on-year comparison. Large enterprises reported a slight improvement, as the median increased. Across the full range of enterprises, the variance for 2006 declined in comparison with 2005. Chart 60, however, shows an increase in the quartile spread. It can be concluded from this that the efficiency variance increased among enterprises whose ratio was around the median, but that the extreme efficiency values declined.

Liquidity

The liquidity ratio – the ratio of financial assets (especially bank accounts and vault cash) to total assets – shows a clear trend: the larger the enterprise, the lower the liquidity ratio and the lower the variance. The simple explanation for this situation is that larger companies are able to negotiate more flexible repayment of their liabilities and can, if necessary, acquire funds immediately; they are therefore allowed to hold a lower amount of financial assets.

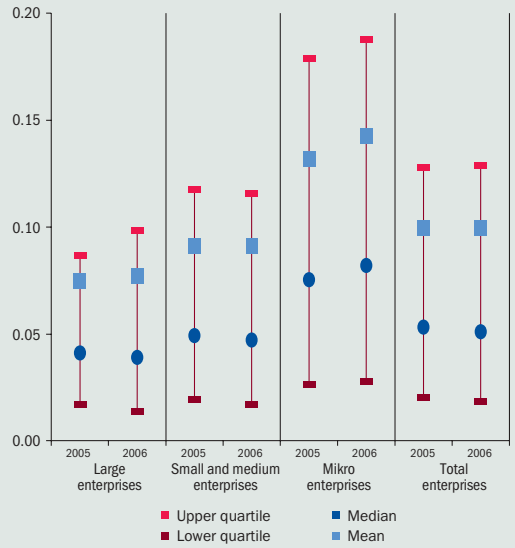
Although Chart 61 seems to show a linear dependence between the amount of financial assets and total assets, the dependence is in fact exponential with an exponent of 0.8. Its main feature is a declin-

Chart 61 **Financial assets and total assets (SKK thousands)**



Source: Statistical Office of the Slovak Republic, own calculations.
Note: The values of balance-sheet items for the year were calculated as the arithmetic average of the respective quarterly values.

Chart 62 **Ratio of financial assets to total assets by enterprise size – liquidity (SKK thousands)**



Source: Statistical Office of the Slovak Republic, own calculations.
Note: The values of balance-sheet items for the year were calculated as the arithmetic average of the respective quarterly values.

ing marginal increase, which means that the increase in financial assets per each additional unit of assets is diminishing.

The development of liquidity over time is stable. The only change between 2005 and 2006 was the increase in the variance for micro-enterprises.

Credit portfolio quality in other sectors[16]

The banking sector reported a relatively high quality in its loans to other sectors.

Loans to sole traders had the worst quality, with a 6.4% share of non-performing loans as at the end of 2006, which represented an improvement of 0.4 of a percentage point over the course of the year.

The quality of loans to non-residents declined during the year.

Market risks

Foreign exchange risk

When assessing the exposure of banks to foreign exchange risk, it is important to look at how the values and volatility of exchange rates have developed and at the size of banks' open positions in different currencies.

Developments in the foreign exchange market during 2006 were marked by strengthening of the Slovak koruna. In the first half of the year, the Slovak koruna appreciated slightly against both the euro and the US dollar, and lost a little value against the Czech koruna. It was in the second half that the domestic unit strengthened substantially, gaining against the euro (6.8%), US dollar (10.7%) and Czech koruna (4.6%). Although, in general, exchange rate volatilities did not change significantly, they did rise moderately in July and December.

The balance-sheet foreign exchange position at the level of the whole banking sector remains substantially short and mainly comprises a large amount of foreign exchange deposits from foreign banks and short-term foreign currency deposits of the general government – banks have deposited a sizeable share of them in SKK with NBS. By contrast, the short foreign exchange position arising from interbank deposits and loans (including deposits of the Slovak Ministry of Finance deposited with banks through the DLMA) was sharply reduced in comparison with December 2005, from SKK 152 billion to SKK 83 billion. That decline was mainly related to the fall in foreign bank deposits in July 2006.[17] The actual amount of the DLMA's foreign exchange deposits fell to SKK 23 billion in the second half of the year, after rising from SKK 6 billion to SKK 49 billion in the first half. Another significant change in the structure of the foreign exchange position was

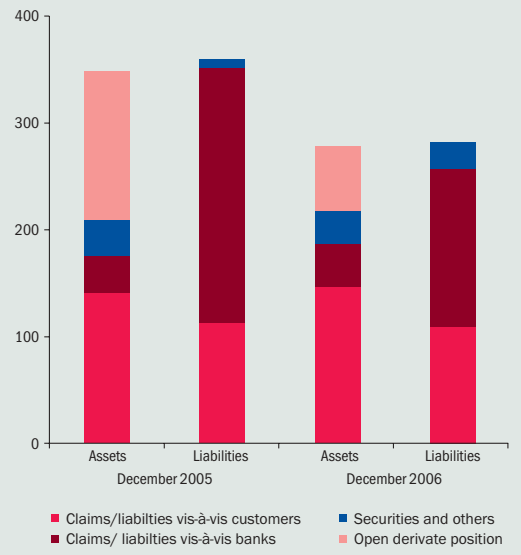
Table 13 **Credit portfolio quality for other sectors** (%)

	Share of the sector's loans which are non-performing		Share on total loans to customers	
	I.06	XII.06	I.06	XII.06
Loans to sole traders	6.8	6.4	2.4	2.3
Loans to non-banking financial companies	0.1	0.1	9.55	9.55
Loans to general government	0	0	5	2.8
Loans to non-residents	0.2	4	3.7	2.7

Source: NBS.

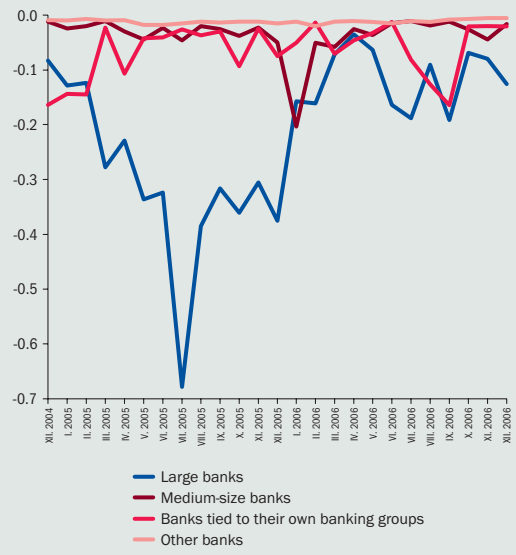
[16] *The amount of non-performing loans may be affected by additional methodological changes on a bank to bank basis.*
[17] *See the chapter Interbank Market.*

Chart 63 **Structure of assets and liabilities denominated in foreign currency (SKK billion)**



Source: NBS.
Note: Liabilities towards banks include funds of the Slovak Ministry of Finance deposited with banks through the DLMA, since these are similar in character to banks' deposits.

Chart 64 **The 10-day VaR (99%) for different groups of banks (SKK billion)**



Source: NBS, own calculations.
Note: The chart does not show VaR figures for branches of foreign banks. Other banks also include home savings banks.

the issuance of euro-denominated mortgage bonds in a total amount of SKK 9.7 billion. The assets side did not report a significant change in 2006, and the growth in foreign currency loans to customers slowed down to only 4% for the year. A balance-sheet open position was established at the level of approximately 5% of total assets.

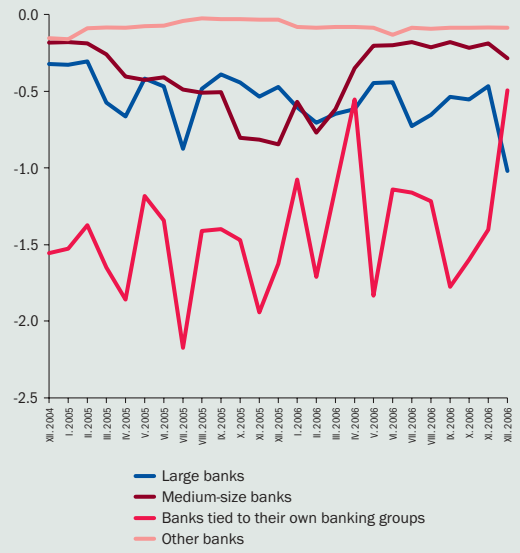
Banks used derivative transactions to close the open foreign exchange position on the balance sheet. Overall, therefore, the foreign exchange position was basically closed. That was the case not only with the aggregate foreign exchange position for the whole banking sector, but also with a majority of banks in the first half of the year, where the position did not exceed 2% of total assets. The exposure of banks to foreign exchange risk therefore appears insignificant.

The analysis based on the open foreign exchange position does, however, pose several problems which need to be examined in greater detail. First, the closed foreign exchange position does not exclude inconsistency in terms of matching of foreign currencies. Given the low correlation between different exchange rates, banks could incur a loss even on a closed foreign exchange position. By breaking down the foreign exchange position into component currencies, it is possible to calculate the loss (VaR) which should not be exceeded with a likelihood of 99%. At the same time, it is assumed that the distribution of future exchange rate changes may be simulated by distribution of the changes over the past year (250 business days) and that the portfolio will remain unchanged for a period of 10 days.[18] The calculated VaR is shown in Chart 64. For most banks, the VaR as at the end of each month in 2006 did not exceed 2% of own funds. It should be noted, however, that this analysis does not take into account the time consistency of individual instruments used to close currency positions, and it is therefore based on the assumption of high liquidity in the foreign exchange market.

The calculation of the foreign exchange position also includes positions arising from currency options. It is assumed that each option will be exercised, although the validity of this assumption cannot be validated owing to a shortage of detailed data on individual option transactions. That said, foreign exchange positions arising from underlying option instruments were basically closed during 2006. It may therefore be assumed that banks are hedging their option positions by making reverse transactions in the interbank market. This assumption is also confirmed by the fact that around 50% of the total amount of underlying instruments for option contracts pertains to transactions with monetary financial institutions. That applies to both the banking sector as a whole and to individual banks.

[18] *For the VaR calculation, only overnight losses were simulated and the resulting figure was then multiplied by* $\sqrt{10}$.

Chart 65 **Time development of VaR taking into account loan commitments and guarantees** **(SKK billion)**



Source: NBS, own calculations.
Note: The chart does not show VaR figures for branches of foreign banks. Other banks also include home savings banks.

Chart 66 **Time development of interest rates in 2006** **(%)**

Source: NBS, Reuters.

The nominal amount of underlying instruments in option transactions remained stable in the second half of 2006, after rising sharply in the first half.

While affirming that the banking sector has little exposure to foreign-exchange risk on balance sheet transactions (since it hedges them with currency derivatives), the above analysis omits three types of instruments which banks report on their off-balance sheets: commitments to extend or receive loans, guarantees issued or received, and assets received into safe custody.

The open foreign exchange position arising from these loan commitments was long (commitments to extend foreign exchange loans were higher than commitments to receive foreign exchange loans), representing between 2% and 4% of the banking sector's total assets during 2006. Banks typically left this position unhedged. Since it is not revalued in response to the movement of exchange rates, it does not affect the foreign exchange loss or gain. According to data on the hedging of balance-sheet positions, however, it may be assumed that a majority of banks probably hedge these open positions when they are transferred to the balance sheet. The foreign exchange risk arising from loan commitments is therefore related above all to the risk of illiquidity in foreign exchange markets.

There was likewise no hedging of positions arising from guarantees issued or received in foreign currencies. Overall, this position was short, at the level of 1% of total assets. This relates to the link between foreign exchange and credit risk – banks can be exposed to foreign exchange risk only when a credit event occurs.

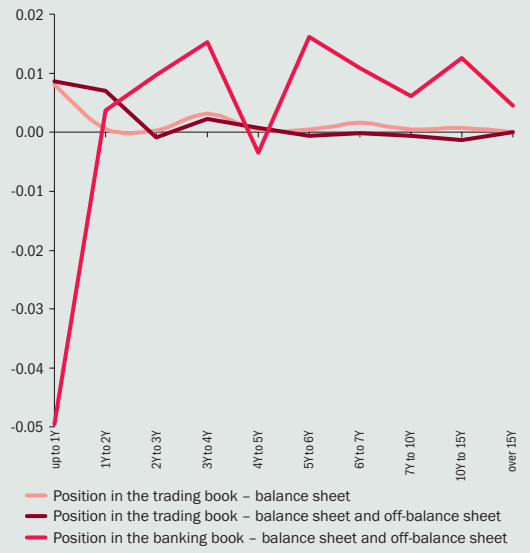
Apart from their direct exposure to foreign exchange risk, which appears to be insignificant, banks are indirectly exposed to the effects of exchange rate fluctuations. As mainly enterprises and financial companies receive a rising amount of foreign currency loans, their repayment ability could come under threat in the event of weakening of the domestic currency. However, the data needed to make a more detailed analysis of this situation are not available.

Interest rate risk

The exposure of banks to interest rate risk depends on how sensitive the various financial instruments in their portfolios are to interest rate movements, as well as on the development of interest rates in financial markets.

NBS raised its base rate on four occasions in 2006, by a total of 1.75 percentage points. In the second half of the year, however, long-term interest rates declined. As at the year-end, the interest rate curve was inverse and the market was expecting a reduction in rates. That contrasted with the situation in the first half of the year, when growth in long-term rates and the rising interest-rate curve reflected market expectations for a further increase in rates. July saw a more significant change in the volatility of interest rates.

Chart 67 **Net position of interest-rate sensitive assets and liabilities** (%)



Source: NBS, Reuters
The horizontal scale shows the periods of the residual fixation of interest rates or remaining maturity. The vertical scale shows the ratio of open positions to total assets.

Chart 68 **Liquidity ratios in 2005 and 2006** (%)

Source: NBS.

Since assets outweigh liabilities in the longer time buckets, it should be the case that rising interest rates, especially for longer maturities, adversely affect banks by reducing net economic value. As Chart 67 shows, interest rate risk arises mainly from positions in the banking book comprising mainly balance-sheet instruments. In the event of a change in interest rates, however, this risk would not affect the reported gain or loss, and therefore not the capital adequacy ratio, either. By contrast, interest rate positions in the trading book are basically closed positions, partly owing to the hedging of on-balance-sheet positions with off-balance-sheet positions. This is mainly the case with positions that have longer fixed interest rate periods, where the interest rate risk generally has a greater impact.

At the majority of banks, however, off-balance-sheet positions arising from interest rate derivative contracts in the trading and banking books are closed. This means that all the closed interest-rate derivatives are hedged with reverse transactions, mostly made with foreign banks.

The level of interest rate risk may be assessed using VaR. As with foreign exchange risk, this figure was calculated as the largest loss over a period of 10 days that a bank should not exceed with a likelihood of 99% (assuming an unchanged portfolio). This loss was calculated as a negative change in net economic value, and not as an impact on the financial results reported in the accounts. The aggregation of the results for each bank shows that, with this loss taken into account, the median capital adequacy ratio of the banking sector declined from 18.8% to 18.4%.

Liquidity risk

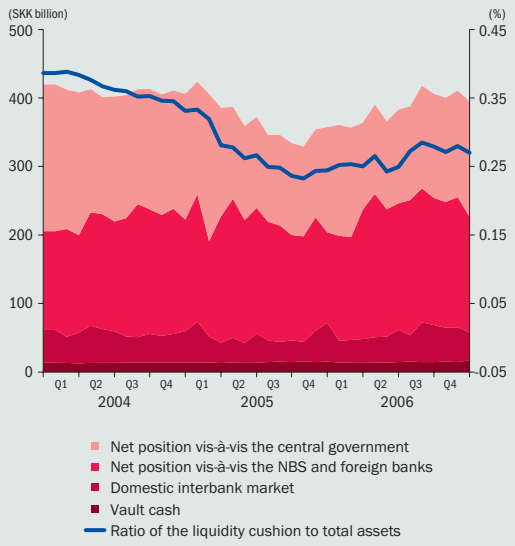
In 2006, liquidity risk in the Slovak banking sector was affected by two principal activities: first, transactions with customers, and second, to a lesser extent, transactions with NBS, foreign banks, the DLMA and in securities.

Simply put, liquidity risk in the Slovak banking sector was (from the view of objective factors that are only part of the risk) determined by the extent to which the open position in liquidity – a priori arising from transactions with customers – is covered by the liquidity cushion, which is typically established in transactions with NBS, foreign banks, the DLMA and in securities (Chart 71).

This means, in fact, that changes in the volume of lending or in the amount of deposits are continually opening a liquid position, whereas purchased securities and funds sterilized at NBS (even after deducting the deposits of foreign banks and the DLMA) are creating a liquidity cushion for the possible coverage of an open position.

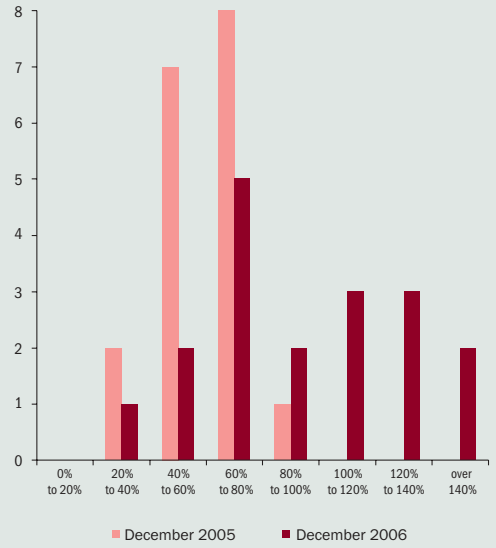
The continuing decline in the quick ratio basically means that customer deposits (regardless of type and maturity) increased more sharply than did the liquid assets that banks may use to meet any immediate

Chart 69 **Liquidity cushion – composition and ratio to total assets**



Source: NBS.

Chart 70 **Distribution of the 3-month liquidity ratio, December 2005 and 2006**



Source: NBS.
Note: The chart does not show banks in which the ratio is negative.

deposit withdrawals (Chart 68). When interpreting this ratio, it is important to note that the main increase was recorded by household term deposits, which are less volatile than current accounts and are more responsive to interest rates.

In 2006, the median values of the 7-day liquidity ratio and the 3-month liquidity ratio reflected the fact that this year was less hectic than 2005. It was important for the banking sector that the median of the indicators fluctuated at above 90% (7-day) and around 80% (3-month) in a majority of months. This means that the banking sector was able, in theory, to use quick assets and assets maturing within 7 days or 3 months to cover 90% or 80% of deposits falling within the respective maturity. A more precise answer to this question is provided by stress testing.

It was positive for the banking sector that the liquidity cushion and its ratio to total assets ended several years' of decline in 2005 and increased during 2006.

As regards the structure of the liquidity cushion, investment in securities continue to be an important pillar along with the fact that the banking sector places in sterilization repo tenders a greater amount of funds than foreign banks and the DLMA deposits with the banking sector.

Exposure to liquidity risk varies from one bank to another, although Chart 70 shows a contraction of the ratio's distribution in the banking sector.

The comparison between the liquidity cushion[19] and the open position for up to 3 months[20] at individual banks (Chart 71) illustrates the extent to which a given bank can use the liquidity cushion to cover the time inconsistency arising from transactions with customers. In the chart, both quantities are calculated as a share of total assets so that their significance in the particular bank is apparent. If, for example, the ratio of the open position arising from transactions with customers to total assets is the same as the ratio of the liquidity cushion to total assets, it means that the bank is able to cover the entire open position with the liquidity cushion. That situation is depicted in the upper half of the chart. These banks not only have a sufficient liquidity cushion, they also have a very small open position arising from transactions with customers.

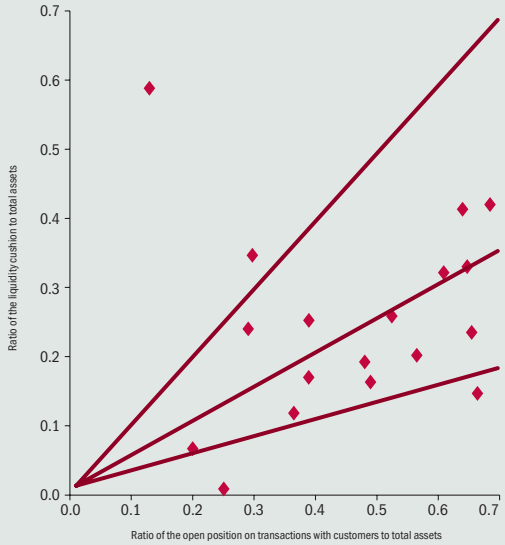
[19] *The liquidity cushion is the sum of vault cash, government bonds, Treasury bills, NBS bills, deposits with the NBS and current accounts with other banks, after deducting banks' liabilities (except long-term liabilities) towards foreign banks and the DLMA and assets provided as collateral.*

[20] *The open position for up to 3 months is the difference between, on the one hand, the sum of claims against customers and debt securities issued by banks and enterprises which have a residual maturity of up to 3 months, and, on the other hand, the sum of liabilities towards customers and issued securities which have a residual maturity of up to 3 months.*

The central band includes banks whose liquidity cushion is sufficient to cover more than half of the open position on transactions with customers. Within this group, it is necessary to distinguish between banks according to the ratio of the open position to total assets.

The majority of banks are concentrated below the line marking 50% coverage of the open position of up to three months in transactions with customers.

Chart 71 **Comparison between the liquidity cushion and the open position for up to 3 months** **(%)**



Source: NBS.
Note: The chart does not show banks in which the open position with customers or the liquidity cushion is negative.

1.8 Stress testing

The previous section identified some of the risks to which the banking sector is exposed. The main focus of this section is therefore on estimating the sensitivity of the banking sector to exceptional but plausible changes in market conditions from the view of such risks. The stress testing was conducted on the basis of estimating the impact of stress scenarios on individual banks, and these impacts are presented in aggregate form. The data are given in Table 15. When interpreting individual results, however, the assumptions and restrictions of the methodology used in the particular type of stress test need to be taken into account. These are set out in Part 1 of the Annex to this Report, published on the NBS website.

The results of stress testing the credit risk may be evaluated as generally satisfactory insofar as they have not demonstrated that the sector is substantially exposed to risks arising from the inability of counterparties to meet their liabilities towards banks. It should be added, however, that the simulated effects of certain specific scenarios at certain banks have sent several warning signals. The scenario that had the most adverse impact was the first one representing an increase in non-performing loans from the existing portfolio alongside a credit crunch: in that event, the selected banks may have had relatively serious difficulties in meeting the capital adequacy requirement.

Stress testing of the exceptional impacts of foreign exchange risk confirms that the banking sector's direct exposure to this risk is relatively low. In the majority of banks, neither simulated exceptional depreciation nor exceptional appreciation of the koruna would result in the loss of more than 3% of own funds, assuming that the portfolio is held unchanged for a period of 10 days.

The effects of interest rate movements would be more unfavourable. Most banks would be exposed to an adverse effect in the event of an increase in interest rates, largely because of the relatively high interest rate risk in the banking book. The revaluation of these securities, however, only affects a change in the net present value and would not in fact affect the reported financial results or the capital adequacy ratio. Most banks have not been using interest rate derivatives to hedge interest rate risk. If NBS were to raise its base rate by 2 percentage points, the median capital adequacy ratio, taking into account the impact on net interest income and on the revaluation of the fair value of securities and interest rate derivatives, would decline over a single year from 18.8% to 17.9%.

From the view of liquidity, the riskiest scenario appears to be an unexpected withdrawal of a large percentage of customer deposits. This is related to the increasing dependence of certain banks in financing long-term low-liquidity assets with potentially highly volatile funds. The sensitivity of certain banks to this scenario increased during the second half of the year. There was, by contrast, a decline in sensitivity to the stress test scenario in which 90% of the deposits of non-resident banks are withdrawn. This concerns a decline in the amount of foreign banks' deposits and in funds deposited with NBS in July 2006. In both cases, however, the liquidity cushion in a majority of banks would have been sufficient.

In order to identify the structure of the domestic interbank market in regard to the degree of diversification of deposits and loans and potential problems in the event of the collapse of certain banks, the stress testing of contagion risk was carried out. The results show that as at the end of each month in 2006, the sector included no more than four banks whose capital adequacy ratio would fall below the 8% requirement in the event of another bank failing to meet its liabilities.

Credit risk

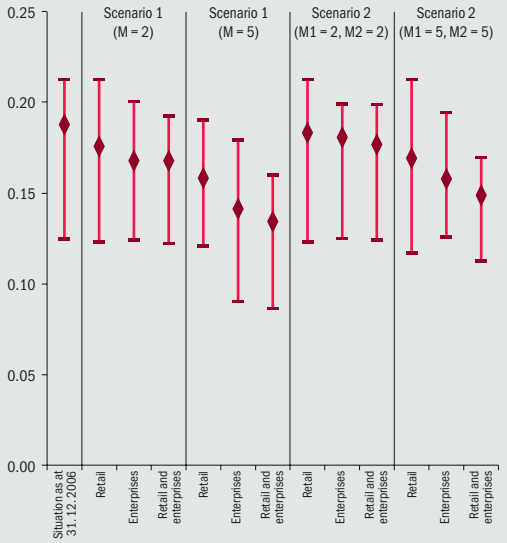
When evaluating the effects of stress test scenarios, it is worth noting that that the values of individual output quantities (capital adequacy ratio after the occurrence of the stress event, change in the proportion of non-performing loans) may only be treated as a guide, since all the tracked scenarios include a substantial simplification of reality. It makes far more sense to analyze the test results by comparing the sensitivity of changes in these quantities to shocks in the test input parameters.

The stress testing of credit risk was performed using five scenarios:

1. a credit crunch;
2. the provision of loans with a higher default rate;
3. a decline in the prices of real estate used to secure loans;
4. an increase in unemployment;
5. an increase in unemployment combined with a decline in real estate prices.

Moreover, scenarios 1 and 2 were each carried out in two variants. A more detailed description of all the

Chart 72 **Comparison of the effects of the first variant of scenarios 1 and 2 on the distribution of capital adequacy in the banking sector (%)**



Source: NBS, own calculations.
Note: The chart shows the lower quartile, median, and upper quartile of the distribution of estimated capital adequacy ratios in the sector following the application of the first variant of scenarios 1 and 2.

mentioned scenarios may be found in Part 1 of the Annex to this Report, published on the NBS website.

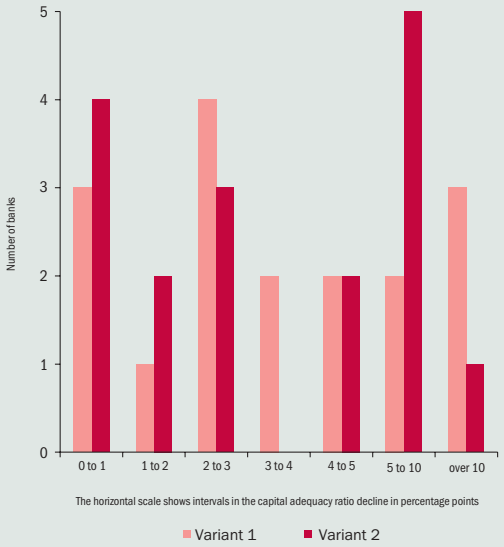
As regards the overall assessment of the results of credit risk stress testing, it should be noted that the different scenarios had their most marked impact on different groups of banks. For that reason, no specific banks that would react adversely to all the tests were identified – it is highly probable that any such banks would have a relatively high exposure to credit risk.

The first scenario simulates an increase in the default rate for old loans, combined with a credit crunch. The impairment of credit portfolios is based on either the historically largest rise in non-performing loans in the given bank (variant 1), or the existing default rates obtained from the Register of Bank Loans and Guarantees (RBUZ)[21] (variant 2); the respective values are further stressed by the factor M. The meaning of this multiplier varies between variants. In variant 1, M can be understood as the number of months in which there would be a repetition of the largest increase, but in the second variant it should be interpreted as a coefficient of the rise in the loan default rate. The evaluation of the effects of both versions of the first scenario is based mainly on the results obtained for the selection of multiplier M=2 or M=5. Whereas the lower parameter value represents a slight and sufficiently probable impairment of the portfolio, the higher one should cover the situation of an exceptionally unfavourable development in the bank. The distribution of capital adequacy ratios in the sector corresponding to both of these selections is shown in Chart 72.

Under both variants for the calculation of loan default growth, the effect of scenario 1 in its more moderate version (M=2) turned out to be insignificant, which means that banks are able to absorb without severe consequences a doubling of the historically worst increase over the course of one month. The only exception is one bank whose capital adequacy ratio would be adversely affected by such an event (especially under the second variant). However, if the past situation were to be repeated with a fivefold increase, or for a period of at least five months, it could cause complications in several banks. In that case, the median capital adequacy ratio would decline by more than 5 percentage points, to 13.4% (variant 1) or 12.0% (variant 2), which can still be considered a relatively safe level.

The overall effect of the simulated scenario may be seen in Chart 73, which shows the distribution of the decline in capital adequacy ratios across the sector, for both variants of the test and the given selection of parameter M. For four banks (variant 1) or five banks (variant 2), the scenario would result in the capital adequacy ratio dropping to below 8% (in one case, the ratio would even be negative). In the case of

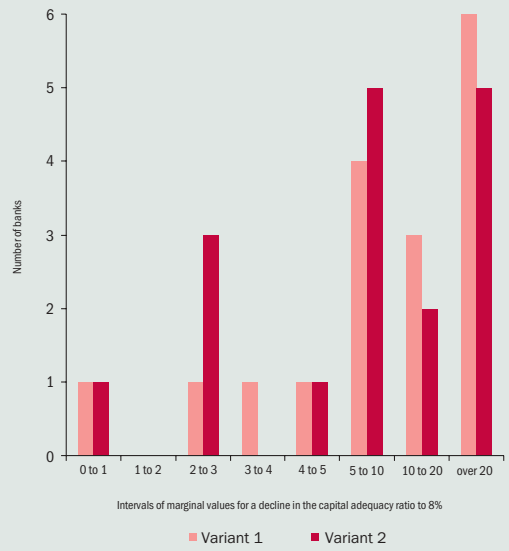
Chart 73 **Distribution of capital adequacy ratio decline in the sector, under Scenario 1 with the selection of parameter M=5**



Source: NBS, own calculations.

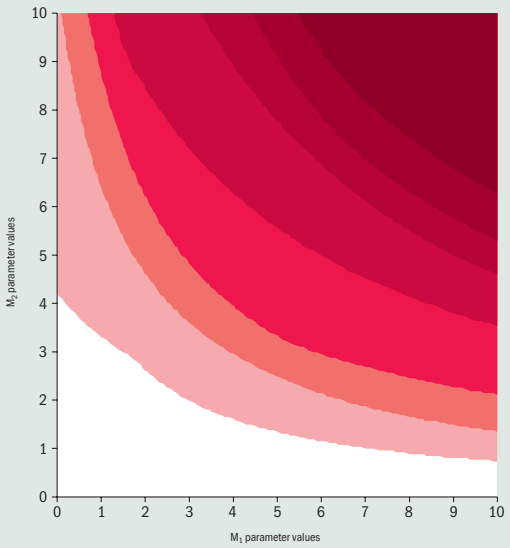
[21] *Register of Bank Loans and Guarantees.*

Chart 74 **Distribution of marginal values of both variants of scenario 1 in the sector, for the capital adequacy ratio to decline to 8%**



Source: NBS, own calculations.

Chart 75 **Effect of the first variant of scenario 2 on the median capital adequacy ratio under the selection of parameters M_1 and M_2**



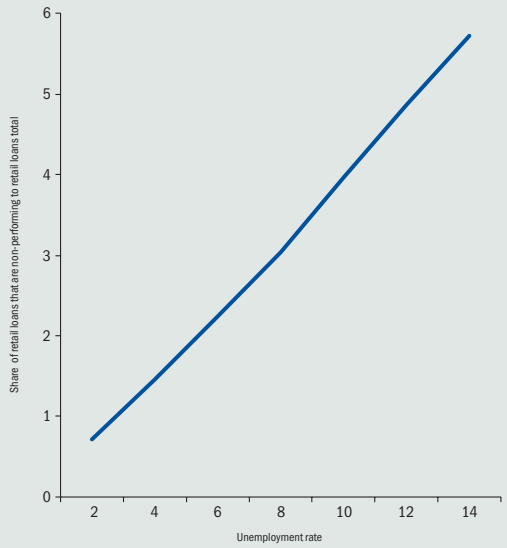
Source: NBS, own calculations.
Note: The coloured areas of the graph indicate the median of banks' capital adequacy ratios, from the range 17%-18% (bottom left) to the range 10%-11% (top right). Each strata indicates a change of 1 percentage point in the capital adequacy ratio.

one bank, even M marginal values below 1 constitute warning signals (in both variants), because its capital adequacy ratio would in this case decline to the 8% limit. This would mean that a single repetition of a past increase in the loan default ratio could create a problem to the bank. When assessing the results of this scenario, especially in the first variant, it should be noted that, in the case of some banks, the increase in the loan default item on which the test's results are based does not necessarily indicate the impairment of the bank's portfolio. Instead of this, it may arise from a standard change in the classification of a group of loans.

Scenario 2 depicts a situation in which banks seeking to increase their market share offer an abundance of new loans; in doing so, they also lend to less solvent entities, which leads to these loans having a higher default rate. This scenario is also realized in two variants, and uses a pairing of multipliers, M_1 and M_2, each of which has the same meaning in both variants. Multiplier M_1 expresses the relationship between, on the one hand, maximum share of non-performing loans to total loans, and, on the other hand, the proportion of new loans that will in future be non-performing. Multiplier M_2 is used for simulating an increase in bank lending with respect to the average month-on-month relative changes in the lending volume over the past year. The second interpretation involves extending the time period during which the stress test scenario applies. The analysis of the second scenario is similar to that of the first scenario, based on two simulations capturing the more moderate (M_1=2, M_2=2) and more adverse (M_1=5, M_2=5) development of credit risk indicators. In general, the effects of this scenario are smaller than those of scenario 1. That is also because the second scenario assumes an increase in the default rate only among new loans, which constitute a relatively small base. In the second variant of the scenario, banks showed a very low sensitivity. Even with the selection of the multipliers M_1=M_2=5, the consequences would be almost negligible. Here, again, it is a factor that the calculation is restricted to corporate loans. The more severe effects were only revealed in variant 1 in combination with the larger multipliers. Such inputs would see the median capital adequacy ratio fall from 18.8% to 14.9%. According to the results, the ratio of the most heavily affected bank would decline by 8.4%.

The next pair of stress tests is aimed at assessing the effects of changes in real estate prices and the rate of unemployment. In both cases they are based on detailed microeconomic data. One scenario looks at the potential effect that a decline in the prices of real estate serving as collateral would have on the additional creation of provisions and, subsequently, on the capital adequacy ratio. This scenario of a drop in real estate prices works on the assumption that the unsecured parts of loans in three different credit categories are covered by provisions to the extent of 0%, 10% and 100%. The decrease in prices on the

Chart 76 **Increase in the default rate of retail loans in relation to a rise in the unemployment rate** **(p.p.)**



Source: NBS, own calculations.

property market is set at 30% or 50%. Despite the relatively exceptional values, the effect on the vast majority of banks was minimal. The only notable result was that two banks recorded a fall of 2 percentage points in the capital adequacy ratio when the prices were halved.

In the fourth scenario, the object of evaluation is the effect of increased unemployment on the ability of households to meet their liabilities. The output indicator is the increase in the proportion of retail loans that are non-performing. Given the data[22], the simulation of unemployment growth was produced only for the sector as a whole. For that reason, it is not possible to assess the sensitivity of individual banks to the scenario. Chart 76 shows the resulting change in the proportion of non-performing loans under selected increases in unemployment, ranging from 2 to 14 percentage points in two-point increments. The results show that each rise in the unemployment rate by one percentage point means an increase of 0.4 of a percentage point in the proportion of non-performing loans.

The last stress test scenario combines elements of the previous scenarios, as its assumption includes both an increase in unemployment and a decline in real estate prices. The scenario assumes that the unemployment rate rises by 10 percentage points, which according to the results of the previous test would mean a rise of 4 percentage points in the proportion of non-performing loans. It also assumes that real estate prices decline by 50% and that provisions are created for the entire unsecured amount of non-performing loans (i.e. in the amount of 100%). Even in this case, the effect can be described as insignificant, with the exception of three home savings banks that would see their capital adequacy ratios decline by around 5%.

Market risks

Equity risk

Since most banks in Slovakia have minimal holdings of shares, equity risk does not represent a substantial risk to the sector. As at the end of 2006, only three banks had an equity position of any significance and in none of these cases did the ratio of shares to assets exceed 2.5%. Nevertheless, stress testing was performed for these banks, using the standard VaR method based on historical observations. The considered confidence interval was 99%. Since the identification of the specific shares held by individual banks was precluded by the availability of data, the historical development of share prices was approximated using time series of the share indices of the national stock exchanges on which the shares are listed. Fortunately, information on the composition of equity portfolios by country of origin was obtainable from the statement on the breakdown of balance-sheet items according to countries of non-residents. The actual values at risk in the tested banks indicate that the risk arising from equity positions is low. The effect on the capital adequacy ratio was calculated to be a decline of only tenths of a percentage point.

Foreign exchange risk

Stress testing has shown that the direct effect of foreign exchange risk on banks' own funds – through the revaluation of balance-sheet and off-balance-sheet items – does not represent a threat to the banking sector. This effect can be assessed by two approaches:

- an approach that assumes a repetition of the historically "worst" ten-day fluctuations in exchanges rates recorded in 2005 or 2006;
- an approach based on simulated changes in exchange rates, where the simulation uses an expert estimate of the development of one exchange rate and of the mutual correlations between exchanges rates in periods of stress, which are estimated from historical data.

The banking sector as a whole would suffer the largest loss in the event of a repeat of the exchange rate devel-

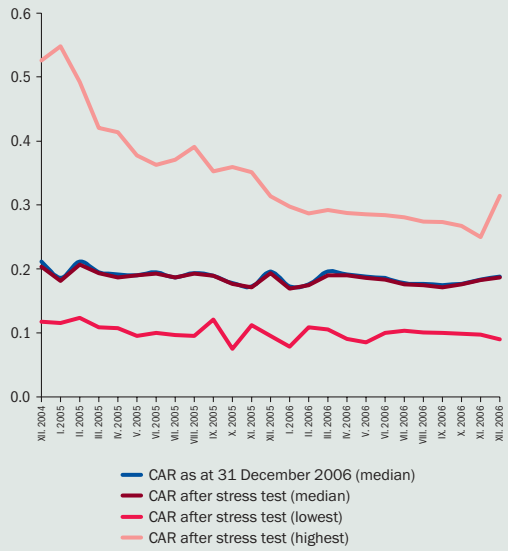
[22] *The data was drawn from the Survey of Income and Living Conditions of Households (EU SILC 2005) conducted by the Statistical Office of the Slovak Republic.*

opment recorded in the period from 23 November to 7 December 2006. This loss would, however, stand at only SKK 76.8 million, or 0.5% of the banking sector's net profit for 2006. Although that period saw substantial appreciation of the Slovak currency, particularly against the US dollar (by 3.5%) as well as other currencies, it cannot be concluded from this that a majority of banks would be sensitive to strengthening of the domestic currency. The second option is to select the ten-day tracking period on a bank-by-bank basis. A ten-day period was selected for each bank on the basis that the exchange rate movement during this period would cause that bank the largest loss under foreign exchange positions as at 31 December 2006. The effects of this historical scenario are shown in Table 15.

The resilience of the banking sector to direct foreign exchange risk is also confirmed by the simulation of exceptional movements in exchange rates. Table 14 shows two extreme fluctuations in particular exchange rates. These scenarios were calculated on the assumption of a 15% shift in the SKK/EUR exchange rate, and changes in other exchange rates were worked out using an estimate of correlations in the periods of stress, which in general are higher than the correlations in quiet periods (with some currencies the difference is twofold).

As Chart 77 shows, the conclusion regarding the low effect of exceptional changes was valid not only at the end of 2006, but also during 2005 and 2006. The stress testing of foreign exchange risk performed at the end of each month in 2006 using the simulated exceptional movements in exchanges rates stated in Table 14 did not reveal any potential decline in the capital adequacy ratio to below the 8% minimum requirement.

Chart 77 **Time series of the effect of the exchange rate movements stated in Table 14 (%)**



Source: NBS, own calculations.
Note: For each bank, the change in the capital adequacy ratio was estimated for that exchange rate movement which would have an adverse effect on the bank. The calculation did not cover branches of foreign banks.

Interest rate risk

Two approaches were used for the stress testing of interest rate risk: an approach expressing the immediate effect on net economic value, and an approach measuring the effect on net interest income and income from the revaluation of interest-rate sensitive financial instruments.

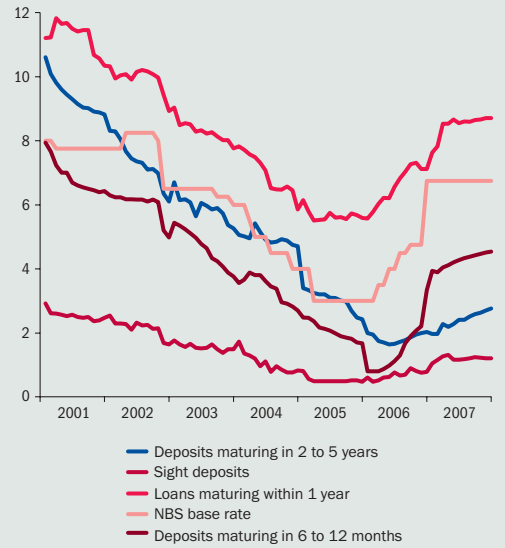
The first approach assesses the sensitivity of interest rates in terms of changes in the economic value of

Table 14 **Simulated movements in exchange rates, obtained by estimating mutual correlations in stressed periods (%)**

Currency	Estimated change upon the koruna weakening against the euro by 15%	Estimated change upon the koruna strengthening against the euro by 15%
CHF	16	-16
CZK	8	-8
DKK	15	-15
EUR	15	-15
GBP	14	-14
HUF	4	-4
JPY	15	-16
PLN	2	-2
SEK	14	-14
SIT	15	-15
USD	16	-17

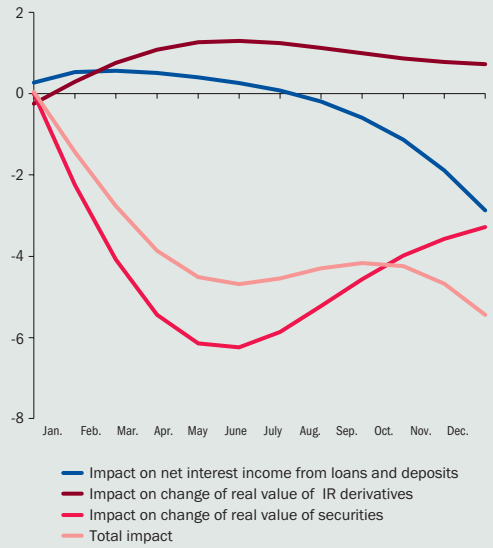
Source: NBS, own calculations.

Chart 78 **Time development of selected interest rates up to 2006 and the estimate for 2007 under an interest shock (%)**



Source: NBS, own calculations.
Note: Figures for 2007 are estimated using an error correction model, assuming that the NBS base rate will increase by 2 percentage points.

Chart 79 **Estimate of the effect of a base rate increase of 2 percentage points in a time horizon of 1 year (SKK billion)**



Source: NBS, own calculations.
Note: The data express the estimated loss or gain resulting from an increase in the NBS base rate by 2 percentage points. Deposits and loans include, in addition to transactions with customers, interbank deposits and loans.

all interest-rate sensitive assets and liabilities on the balance sheet. Under this approach, sensitivity is therefore not assessed in terms of its effect on financial results. Indeed, it takes into account the change in the revaluation of all assets and liabilities to fair value, including those which are not in fact revalued to fair value (financial instruments classified in portfolios of deposits and loans and held to maturity). The advantage of this approach is that it also captures any changes in the net economic value of instruments held to maturity in the event that the bank decides to sell them.

The second approach assumes that a change in the NBS base rate is gradually translated into individual interest rates on deposits, loans and interbank transactions and on income from securities. This serves as the basis for estimating the gradual effect on net interest income from deposits and loans, on the one hand, and on the change in the fair value of securities and interest rate derivatives, on the other hand. At the same time, it is expected that fluctuations in the amount of deposits and loans maintain the existing trend and that portfolios of securities and interest rate derivatives remain unchanged. An advantage of this approach, apart from its modelling of the gradual translation of an interest rate shock into other rates, is that it aims to capture more reliably the effect of shocks on the reported profit or loss and to do so sequentially over the period of one year. The problem remains, however, that all securities and derivatives, including those which a bank holds to maturity, are revalued to fair value.

Both approaches are described in detail in Part 1 of the Annex to this Report, published on the NBS website.

Given the structure of the net position of interest-rate sensitive assets and liabilities, a majority of banks should be affected more by an increase in interest rates than by their reduction. The size of this effect on net economic value was estimated in two versions of the shock – moderate (a parallel rise in interest rates of 2 percentage points), and crisis (a parallel rise in interest rates of 5 percentage points). The effects of these scenarios are stated in Table 15. It should be noted, however, that this estimate does not take into account off-balance-sheet transactions.

The sensitivity to interest rate increase is also confirmed by the second approach to estimating the effect of interest rate shocks. This approach also provides for the tracking of the time development of this effect. The development of interest rates was estimated in the context of both an unexpected base rate increase (Chart 78) and without such increase, using a model that is also described in detail in Part 1 of the Annex to this Report, published on the NBS website. The estimated development of other inter-

est rates under an unexpected rise in the NBS base rate is easy to interpret economically: all interest rates were projected to rise. On the other hand, the size of that increase and the period during which rates will rise vary between different types of rates. Whereas, for example, interest rates on outstanding term deposits maturing in 6 to 12 months would in practice rise relatively quickly and almost to the full extent of 2 percentage points, interest rates on current accounts would not reflect the increase in rates. It would also take more time for the increase to be passed on to deposits with longer maturities.

Given that an interest rate shock is not, in reality, immediately passed on to individual interest rates (especially not long-term ones), the effect would steadily rise over the course of the first five to six months (Chart 79). This would be caused mainly by a revaluation of the debt securities portfolio, which includes both purchased and issued securities. Because the residual maturity of these securities is shortening, the effect would gradually decline and the impact of the fall in net interest income would become more apparent. After around one year, this impact would have the more significant influence on the change in the financial results. This confirms the previous conclusion on the significance of interest rate risk in the banking book.

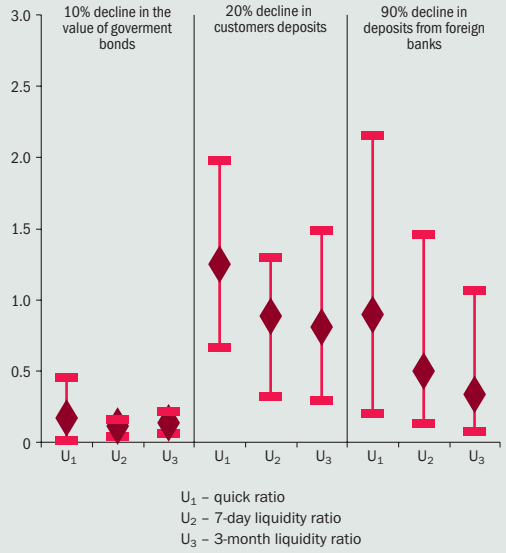
In summary, therefore, it can be said that an unexpected rise in the NBS base rate by 2 percentage points would have approximately the same effect on net interest income from deposits and loans as on the fair value of debt securities in the horizon of one year. Each of these effects would amount to around SKK 3 billion. Although interest rate positions arising from derivatives are included in this approach, in most banks they would not have a significant effect on reducing interest rate risk arising from balance-sheet transactions.

It should be pointed out that these general conclusions on the decline in the net interest income and fair value of securities apply only to the banking sector as a whole, but the situation in certain banks appears to be relatively different.

Equity risk

Since most banks in Slovakia have minimal holdings of shares, equity risk does not represent a substantial risk to the sector. The ratio of shares to assets does not exceed 2.5% in any bank. As the Table shows, the decline in the median capital adequacy ratio over a period of 10 days should not exceed 0.1 of a percentage point with a likelihood of 99%.

Chart 80 **Comparison of the effects of different scenarios of liquidity risk**



Source: NBS, own calculations.
The chart shows the lower quartile, median, and upper quartile of the distribution of the share of liquidity ratio changes after applying the individual scenarios to the average month-on-month changes during 2006.

Liquidity risk

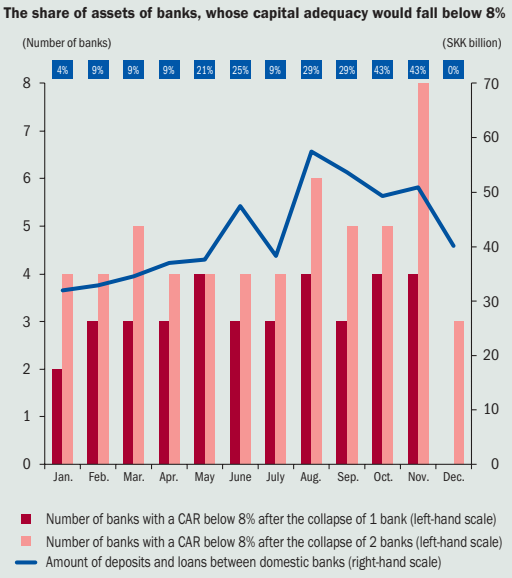
The stress testing of liquidity risk faces the problem that the link between this risk and capital adequacy is ambiguous. Even if a bank incurs a loss related to liquidity problems (for example, the rapid selling of securities), it is not easy to simulate this situation. That is why the test is performed not on the capital adequacy ratio, but on three selected ratios of liquidity (the quick ratio, 7-day ratio, and 3-month ratio).[23] Each indicator is calculated as a share of the liquid assets and volatile funds in the respective category. The size of the shock was considered in regard to the absolute value of the average month-on-month change in these ratios. For the stress testing of liquidity risk, three basic scenarios were selected:

- a decline in the value of government bonds by 10%;
- a decline in the amount of customer deposits by 20%; and
- a decline in the amount of foreign banks' deposits by 90%.

The first scenario would not have a significant effect on banks. A decrease in the value of government bonds by 10% would have its greatest effect on banks that include a high share of government bonds in their total assets.

[23] *A definition of the ratios is given in the section Liquidity Risk.*

Chart 81 **The effect of stress testing the contagion risk on the domestic interbank market in 2006**



Source: NBS, own calculations.
CAR – capital adequacy ratio.

In comparison with the situation in June 2006, the banking sector's sensitivity to the second scenario increased. Of the three scenarios, it is this one that would have the greatest effect on the banking sector. This may be related mainly to the increase in deposits as a share of total assets. By contrast, impacts of the scenario in which deposits of non-resident banks decline by 90% were less significant when applied to the second half of 2006. This effect would mainly be reflected in a decline in the quick ratio. The effect on the 3-month liquidity ratio would be relatively small.

Contagion risk

In this analysis, contagion risk denotes the risk that the collapse of one domestic bank brings about a deterioration in the situation, or even collapse, of other banks. The principal reason for this may be the links between banks in the form of deposit and loan transactions in the interbank market. If one bank were unable to meet its liabilities, other banks could suffer a loss related to the drop in their capital adequacy ratio. In this respect, therefore, contagion risk is related to the credit risk arising from interbank claims and it depends on the diversification of the portfolio of claims in the interbank market.

Chart 81 shows the number of banks whose capital adequacy ratio could fall below the 8% minimum requirement in the event of the failure of one or two banks. During 2006, this number fluctuated between 2 and 8. In the second half of the year, the contagion risk rose slightly, mainly as a share of the assets of those banks whose capital adequacy would be reduced to below the 8% limit in the event of another bank's collapse. This is related to the rise in the total amount of deposits and loans in the domestic interbank market.

In regard to contagion risk, it is important to track the consequent domino effect, i.e. the failure of one or more banks, also in its later stages. The analysis of the Slovak banking sector shows, however, that although the failure of one bank can lead to a reduction in capital to below the stipulated limit, the probability of the failure spreading further is very small, provided that certain other conditions do not also deteriorate. Even if a bank's capital adequacy ratio were to decline following the collapse of another bank, the ratio would remain above 4%. This is connected with the relatively low share of banks' claims against other domestic or foreign commercial banks in the total assets of the banking sector. During 2006, this share fluctuated between 4% and 10%.

Table 15 **VaR figures and the effects of stress test scenarios on the capital adequacy ratio**

Capital adequacy ratio	Level as at 31 December 2006	Ratio of profit to own funds	Foreign exchange risk[1]				Interest rate risk				Equity risk	Market risks – total	Credit risk			Contagion risk
			VaR[2]	Historical scenario[3]	EUR/SKK +15%[4]	EUR/SKK -15%[5]	VaR[2]	Parallel rise of 2 p.p.[6]	Parallel rise of o 2 p.p.[7]	Parallel rise of o 5 p.p.[6]	VaR[2]	VaR[2]	Scenario 1[8]	Scenario 2[9]	Scenario 5[10]	Failure of 1 bank
Lower quartile	12.5	1.4	12.5	12.5	12.5	12.5	11.9	9.8	11.2	6.3	12.5	11.3	12.2	11.3	11.7	9.0
Median	18.8	1.9	18.8	18.8	18.7	18.8	18.4	15.7	17.9	14.3	18.8	18.2	16.8	14.9	16.7	13.5
Upper quartile	21.3	2.7	19.9	19.9	19.9	19.9	21.0	19.0	19.4	17.5	21.3	19.8	19.2	16.9	19.3	16.8

Source: NBS, own calculations.

Key to figures:

1) The calculation of the foreign exchange position includes only balance-sheet assets and liabilities (with the exception of positive and negative values of derivatives) and the nominal values of spot and forward transactions and option transactions.

2) The capital adequacy ratio after taking into account the highest loss that a bank will suffer over a period of 10 business days with a likelihood of 99% (calculated on the basis of historical simulations using data for one year).

3) The capital adequacy ratio after taking into account the highest loss that a bank could suffer in the event of a repetition of the exchange rate development which occurred between 23 November and 7 December 2006.

4) The capital adequacy ratio after taking into account revaluation under a simulated depreciation of the Slovak koruna against the euro of 15%; the movements of other exchange rates were estimated on the basis of correlations in the stress test periods and they are stated in Table 14.

5) The capital adequacy ratio after taking into account revaluation under a simulated appreciation of the Slovak koruna against the euro of 15%; the movements of other exchange rates were estimated on the basis of correlations in the stress test periods and they are stated in Table 14.

6) The capital adequacy ratio after taking into account the immediate change in the net economic value of balance-sheet items, occurring upon a parallel rise in the whole interest rate curve by 2 or 5 percentage points.

7) The capital adequacy ratio after taking into account changes in net interest income and revaluation of the portfolio of debt securities and interest rate derivatives, in a time horizon of one year from when the base rate is raised by 2 percentage points.

8) A credit crunch with the assumption that the increase in non-performing loans recorded in 2006 will double (1-month time horizon).

9) The provision of loans with a higher default rate together with the assumption that the proportion of new non-performing loans to total loans increases by five times in comparison with the existing proportion of non-performing loans and that the average month-on-month increase in lending volume rises fivefold (1-month time horizon).

10) The unemployment rate rises by 10 percentage points and real estate prices decline by 50% (1-month time horizon, taking into account only the effect on retail loans).

Insurance sector

2 Insurance sector

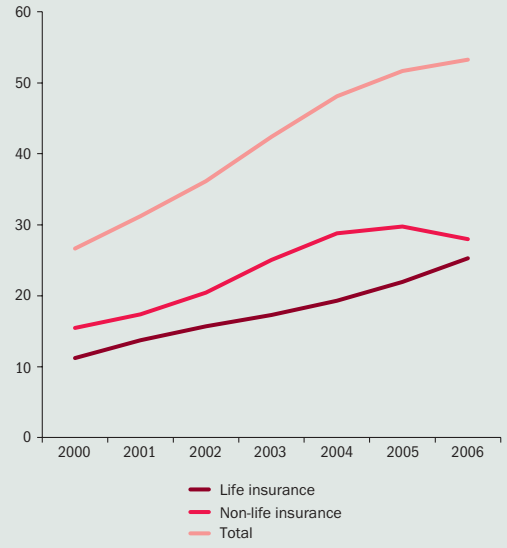
Premium written in 2006 amounted to SKK 53.6 billion, of which life insurance accounted for SKK 25.3 billion and non-life insurance for SKK 28.3 billion. These figures cannot, however, be compared with premium written in 2005, owing to a methodological change in the reporting of premium written made in connection with the application of International Accounting Standards. The analysis of the market shares by technical premium written shows a gradual declining trend in market concentration. As at 31 December 2006, the market share of the three largest insurance companies in terms of technical premiums written declined from 63.6% to 61.5%. Claims incurred rose 24% in comparison with the same period of the previous year, to stand at SKK 21.2 billion. The profits of insurance companies for 2006 totalled SKK 4.5 billion, representing a rise of 61% on 2005. This growth was achieved despite a sharp increase in operating expenses (up by 20% in life insurance and by as much as 41% in non-life insurance), which largely resulted from the creation of fewer technical provisions in life insurance and from higher earnings on other activities not further specified. The investment of technical provisions remained substantially unchanged and they continue to be placed in low-risk assets.

Premiums written and technical premium written

Gross premium written, as defined by IAS/IFRS standards, amounted to SKK 51.3 billion as at 31 December 2006, which is equivalent to 3.1% of GDP (insurance penetration). Gross premium written in life insurance and in non-life insurance stood at SKK 23 billion and SKK 28.2 billion, respectively. Because premium written were reported in accordance with Slovak accounting standards up to the end of 2005, NBS, for the purposes of this report, analyzed technical premium written, which may be defined as the price agreed in individual insurance contracts without regard to the method of their financial reporting. Technical premium written came to SKK 53.6 billion in 2006, of which life insurance accounted for SKK 25.3 billion and non-life insurance SKK 28.3 billion.

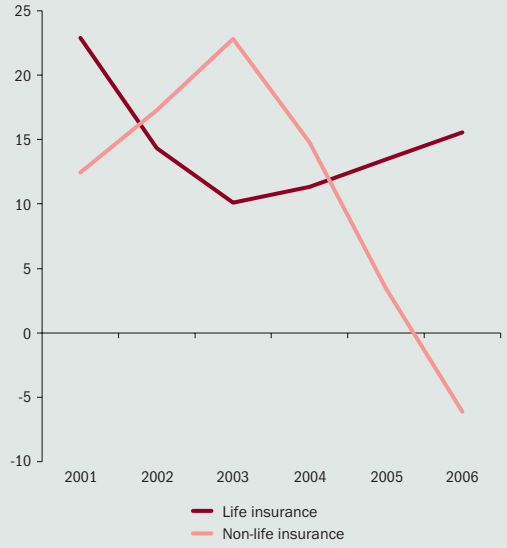
In life insurance, technical premium written rose 15.6% in 2006, confirming the growing trend in this area. In non-life insurance, technical premium written declined by 6.2%. That was the first decline in this indicator since it started to be tracked; it is consistent with the trend of recent years and can be put down to a methodological change in the reporting of bonuses.

Chart 82 **Technical premium written (SKK billion)**



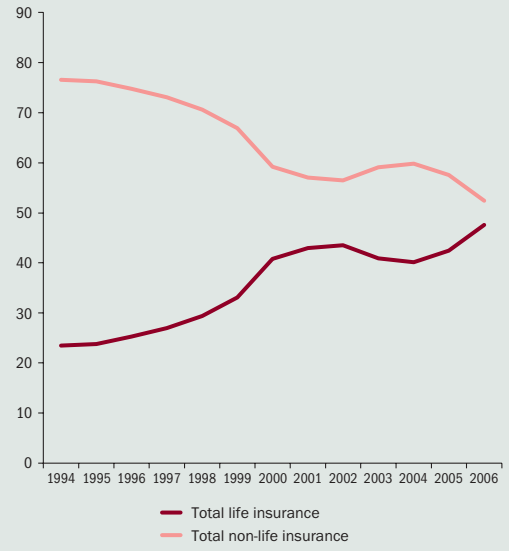
Source: NBS.

Chart 83 **Rate of increase in life and non-life premium written (%)**



Source: NBS.

Chart 84 **Share of life insurance and non-life insurance in total technical premium written (%)**



Source: NBS.

Total technical premium written rose 3.1%, the year 2006 was the third consecutive year in which their growth has declined.

Given that technical premium written rose in life insurance and declined in non-life insurance, life insurance naturally increased its share of total technical premium written (from 42% in 2005 to 48% in 2006), which is consistent with expectations and the long-term trend.

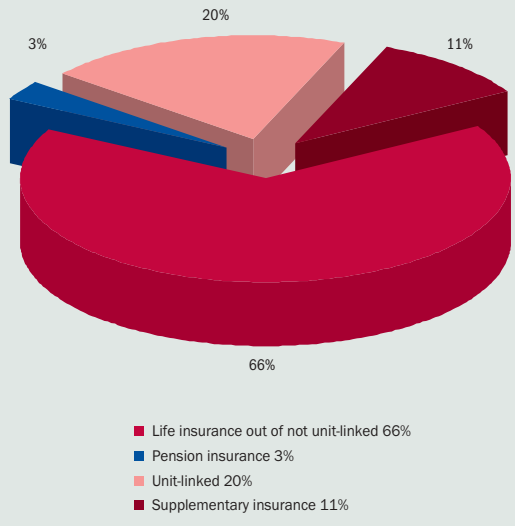
Insurance groups

As of 31 December 2006, Národná banka Slovenska changed how insurance companies and branches of foreign insurance companies are to report data on their activities. Reporting based on insurance classes as defined in the Insurance Act was replaced by reporting based on groups of insurance classified by risk. Under this reporting method, 4 insurance groups were established in life insurance and 11 in non-life insurance. A complete list of these 15 groups is provided in the chapter 'Terminology and Abbreviations Used'. For the sake of clarity, the names of certain insurance groups are abbreviated (a list of the abbreviations can likewise be found in the chapter 'Glossary and abbreviations').

In life insurance, the long-time largest share of technical premium written is accounted for by the insurance group 'Life insurance other than insurance linked to an investment fund' (i.e. 'unit-linked insurance'), which includes such products as assurance on death, assurance on survival to a stipulated age, combinations of assurance on death and assurance on survival to a stipulated age, and various endowment policies. Technical premium written in this insurance group amounted to SKK 16.7 billion as at 31 December 2006, which represents an increase of 12.2% in comparison with 2005.

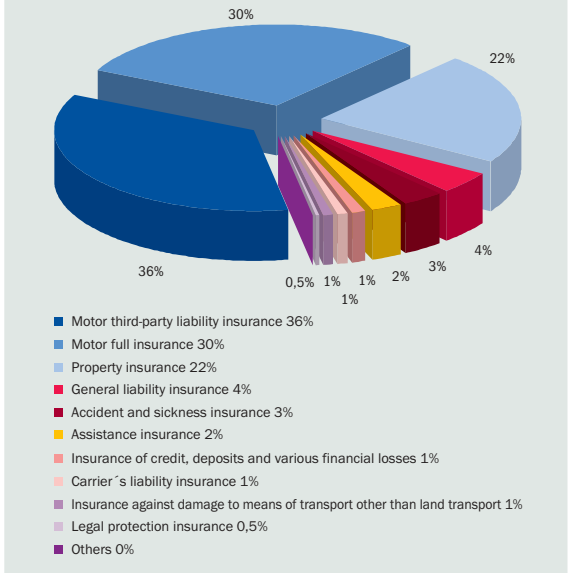
Compared with the previous period, unit-linked insurance recorded the largest rise in technical premium written, increasing by 36.1% to SKK 5.2 billion. Unit-linked insurance has been showing a steadily rising

Chart 85 **Life insurance groups broken down by amount of technical premium written as at 31 December 2006 (%)**



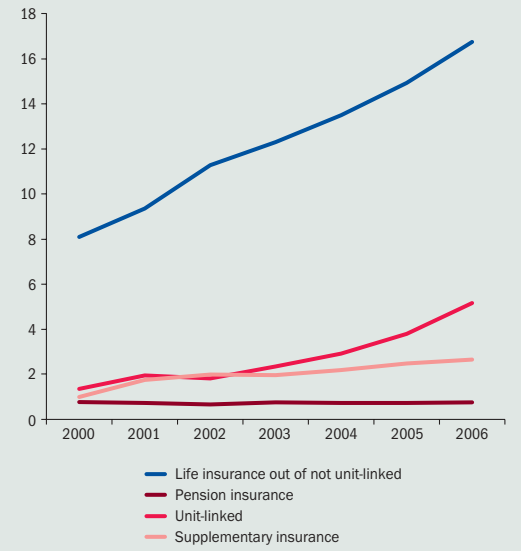
Source: NBS.

Chart 86 **Non-life insurance groups broken down by amount of technical premium written as at 31 December 2006 (%)**



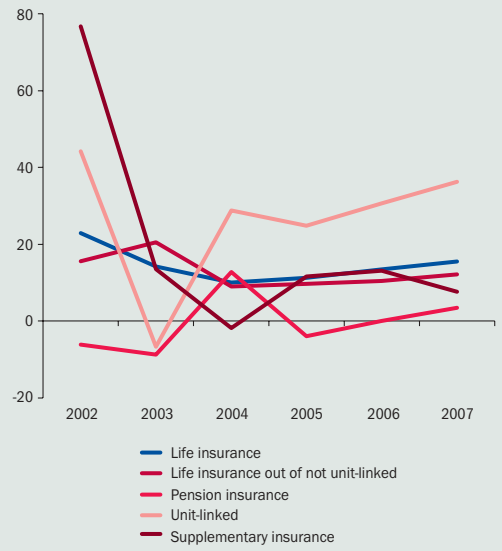
Source: NBS.

Chart 87 **Technical premium written in life insurance (SKK billion)**



Source: NBS.

Chart 88 **Rate of increase in technical premium written in life insurance (%)**



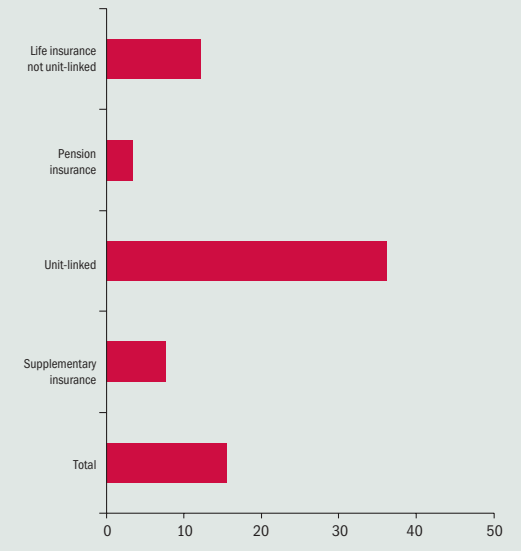
Source: NBS.

trend in recent years, which mirrors the development in European markets.

Pension insurance continues to report the lowest amount of technical premium written, as well as the slowest increase in them. The amount for 2006 was SKK 748 million, which represents 3% of total technical premium written in life insurance and an increase of 3.5% compared with 2005.

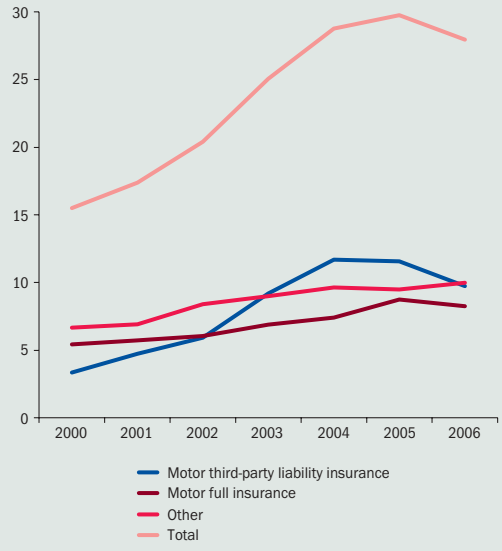
Technical premium written in non-life insurance amounted to SKK 28.3 billion in 2006. That represents a year-on-year decline of SKK 1.5 billion, or 5.1%. As regards particular groups of non-life insurance, the decline in technical premium written was affected mostly by the fall in these premium in motor third-party liability insurance. This insurance group reported a year-on-year decline of SKK 1.8 billion, to SKK 9.7 billion. Nevertheless, 64% of technical premium written in non-life insurance are accounted for by motor insu-

Chart 89 **Year-on-year change in technical premium written in life insurance groups (%)**



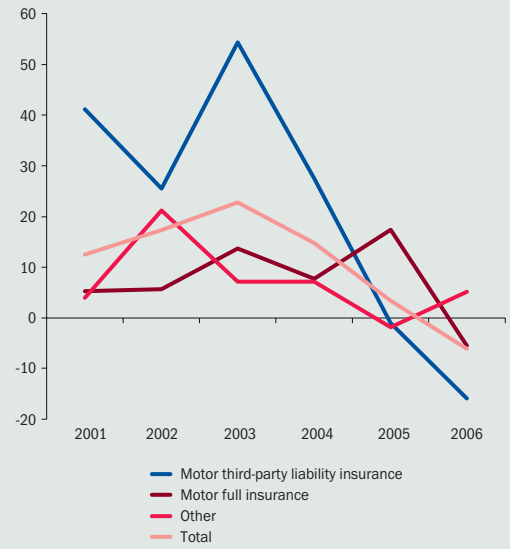
Source: NBS.

Chart 90 **Technical premium written in non-life insurance (SKK billion)**



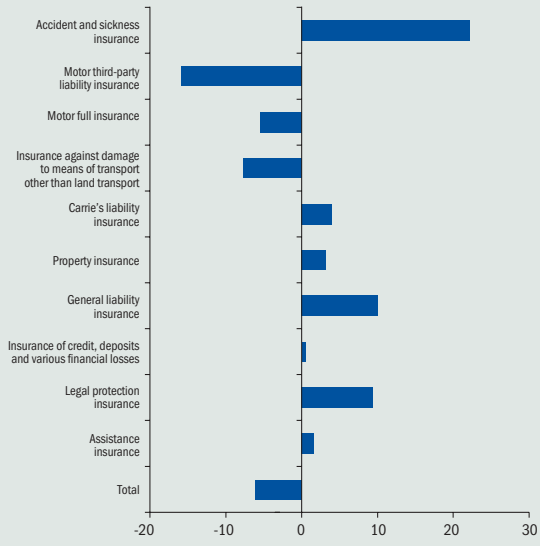
Source: NBS.

Chart 91 **Rate of increase in technical premium written in non-life insurance** (%)



Source: NBS.

Chart 92 **Year-on-year change in technical premium written in non-life insurance groups** (%)



Source: NBS.

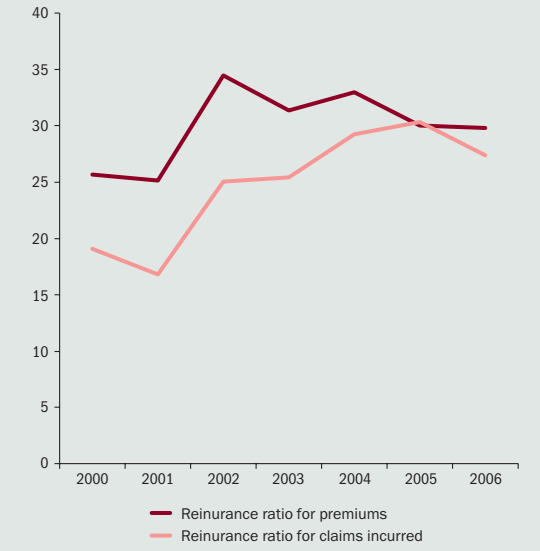
rance – motor third-party liability insurance and motor full insurance. Motor insurance therefore constitutes a substantial part of technical insurance in non-life insurance, although its share of these premium is declining – down from a highest ever figure of 68% in 2005. In the other insurance groups, technical premium written basically stagnated. Technical premium written in these non-motor insurance groups (i.e., excluding motor third-party liability insurance and motor full insurance) increased by 5.2% in comparison with 2005, after reporting a decline of 1.9% in that year.

Reinsurance

Of the total technical premium written in 2006, premium worth SKK 10.2 billion (18.2%) were ceded to reinsurance companies. That represents a decline of 1.8% year-on-year.

The vast majority of the ceded technical premium written (86.6%) pertained to non-life insurance. Of the total technical premium written in non-life insurance 31.4% were ceded.

Chart 93 **Reinsurance ratios for technical premium written and claims incurred – non-life insurance** (%)



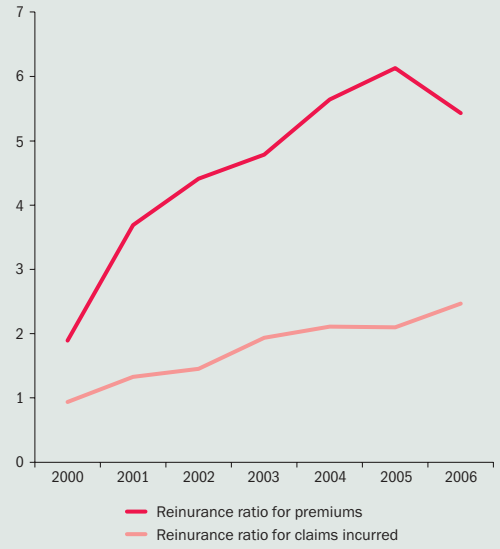
Source: NBS.

Table 16 **Ceding of technical premium written to reinsurers** (SKK billion)

	2006	2005	Change	Share of premium written 2006	Share of premium written 2005
Total	10.2	10.4	-1.8%	19.1%	20.2%
Life insurance	1.4	1.3	3.5%	5.4%	6.1%
Non-life insurance	8.9	9.1	-2.6%	31.4%	30.6%

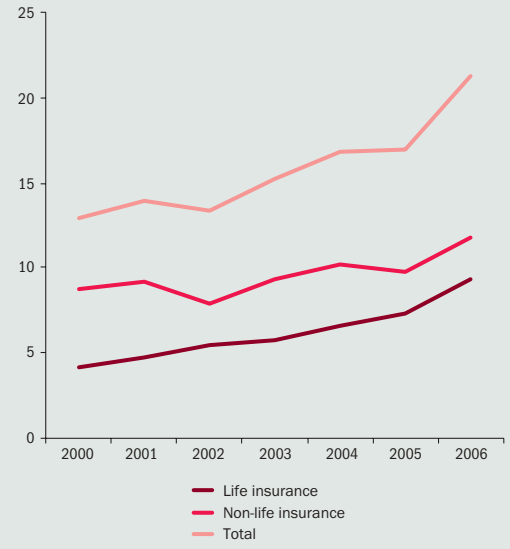
Source: NBS.

Chart 94 **Reinsurance ratios for technical premium written and claims incurred** **(%)**



Source: NBS.

Chart 95 **Claims incurred** **(SKK billion)**



Source: NBS.

The proportion of reinsurance in life insurance is neither significant nor negligible. Of the total technical premium written in life insurance in 2006, SKK 1.4 billion (5.4%) were ceded to reinsurance. Even so, reinsurers covered SKK 177 million of insurance claim payments, which represents 2.5% of the total.

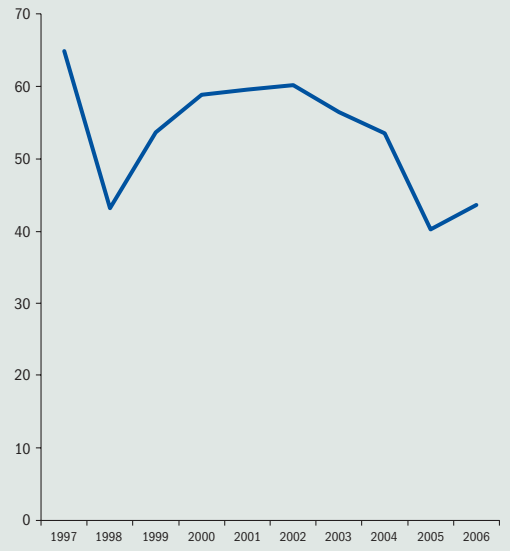
Claims incurred

Claims incurred as defined by IAS/IFRS standards amounted to SKK 19.8 billion, including SKK 9.1 billion in life insurance and SKK 10.7 billion in non-life insurance. As it did with technical premium written, NBS, for the purposes of this report, analyzed technical claims incurred (in this report 'claims incurred' shall be understood to mean 'technical claims incurred'). Claims incurred in 2006 increased by 24.0% in comparison with the previous year, and amounted to SKK 21.2 billion. Claims incurred in life insurance rose rapidly by 29% against 2005, to SKK 9.4 billion. In non-life insurance claims incurred rose sharply by 21.3%, to SKK 11.8 billion. But although claims incurred in non-life insurance increased by substantially more than the long-term average of 10%, this indicator is very volatile and, furthermore, the rise last year followed a decline of 4.7% in 2005 – in other words, the average rise in claims incurred over the last two years is only 5%, far below the long-term average.

When analyzing the development of claims incurred in non-life insurance, it is necessary to consider not only the development of this indicator, but also the development of technical premium written, changes in the gross technical provision for claims (PC) and changes in the gross technical provision for unearned premium (PUP) – i.e. premium earned. This makes it possible to calculate the loss ratio, which is the percentage ratio of:

- the sum of claims incurred and the change in the gross technical provision for claims (PC), to
- gross technical premium written after deducting the change in the gross technical provision for unearned premium (PUP) – i.e. premium earned.

Chart 96 **Loss ratio since 1997** **(%)**



Source: NBS.

Chart 97 **Loss ratio, cost ratio and combined ratio** (%)

Source: NBS.

The loss ratio for the whole of non-life insurance in 2006 stood at 45.75% (an increase of 7 percentage points). Despite the decline in technical premium written, that figure is one of the lowest ever recorded.

Technical provisions and their investment

As insurance products develop and the liabilities of insurance companies rise, so the amount of technical provisions is increasing. The technical provisions of insurance companies as at 31 December 2006 totalled SKK 103.7 billion, representing a year-on-year increase of 15%. Provisions in life insurance came to almost SKK 76 billion, or 73% of total technical provisions. The net technical provisions of insurance companies represented nearly SKK 95 billion as at 31 December 2006, meaning that the share of reinsurers in technical provisions was SKK 8.7 billion or 8.4% of gross technical provisions (an increase of 2.2 percentage points compared with 2005).

Table 17 **Loss ratio of the largest groups of non-life insurance** (%)

	XII. 2006	XII. 2005
Total non-life insurance	46	39
Motor third-party liability insurance (B10a)	38	42
Insurance against damage to means of transport (B3)	72	46
Insurance against damage to property (B8 + B9)	37	27
Others	23	29

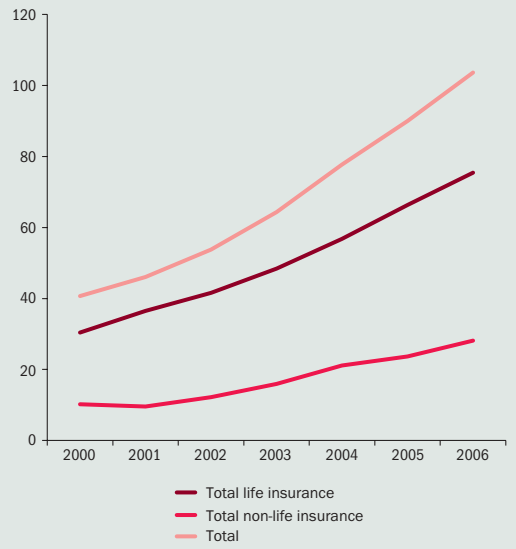
Source: NBS.

Table 18 **Loss ratio, cost ratio and combined ratio of non-life insurance groups** (%)

	Loss ratio	Cost ratio	Combined ratio
Life insurance – supplementary insurance	18.37	35.08	53.45
Accident and sickness insurance	21.49	46.20	67.69
Motor third-party liability insurance	38.22	25.01	63.23
Motor insurance	71.59	26.48	98.07
Other motor insurance	-16.29	25.08	8.80
Carrier's liability insurance	36.47	34.65	71.12
Property insurance	37.25	34.38	71.63
General liability insurance	27.33	28.33	55.65
Insurance of credit, deposits and various financial losses	21.02	34.65	55.67
Legal protection insurance	-17.12	31.31	14.19
Assistance insurance	36.05	44.62	80.67
Others	97.34	0.52	97.87
Total	45.75	29.04	74.78

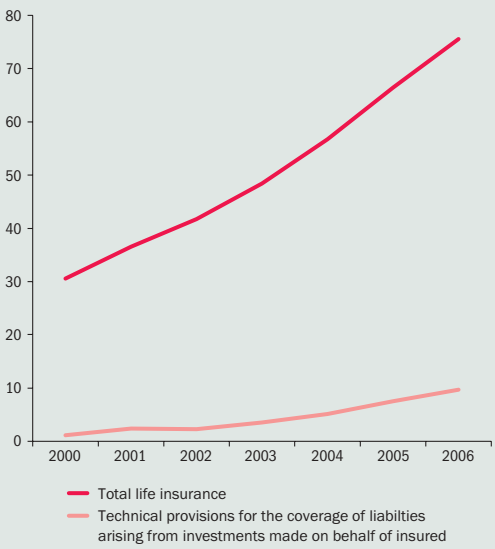
Source: NBS.

Chart 98 **Gross technical provisions since 2000** **(SKK billion)**



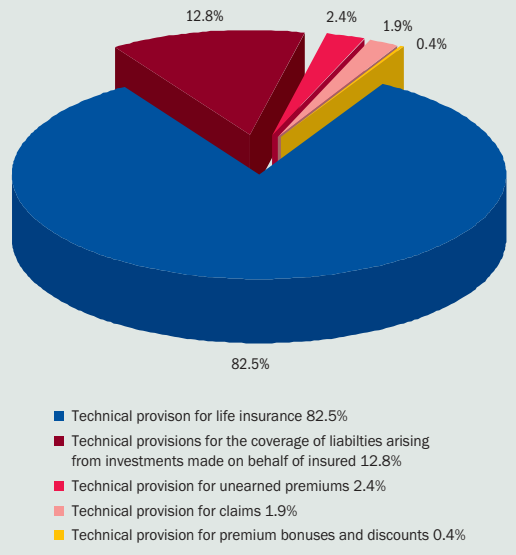
Source: NBS.

Chart 99 **Technical provisions in life insurance** **(SKK billion)**



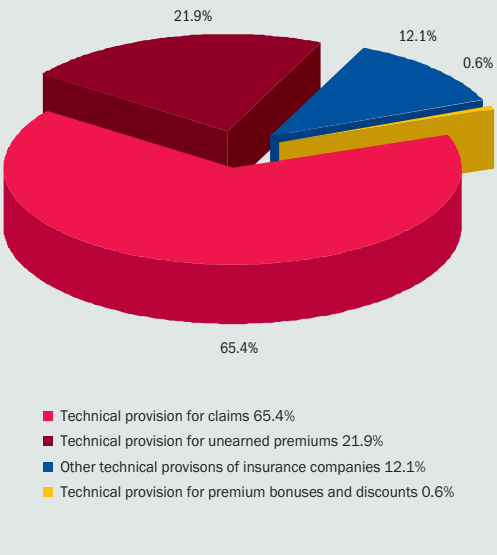
Source: NBS.

Chart 100 **Structure of technical provisions in life insurance** **(%)**



Source: NBS.

Chart 101 **Structure of technical provisions in non-life insurance** **(%)**



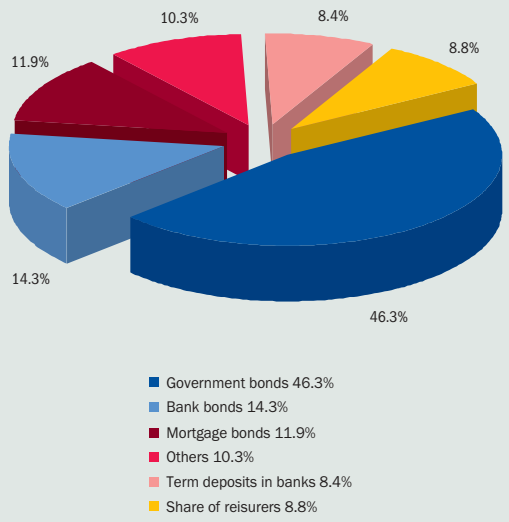
Source: NBS.

The development of technical provisions in life insurance and technical provisions for the coverage of risk on behalf of the insured mirrors the development of the technical premium written in life insurance. The technical provisions in life insurance increased by 13.9% on the previous year to stand at SKK 65.3 billion. A sharper rise of 29.7% was recorded by provisions for the coverage of risk on behalf of the insured, which amounted to SKK 9.7 billion.

Technical provisions less technical provisions for the coverage of liabilities arising from investment made on behalf of the insured[24] (the 'unit-linked provision') amounted to SKK 94 billion as at 31 December 2006.

[24] *This is a technical provision created under unit-linked insurance. Since the policyholder bears the economic risk of the investment, the investment of the technical provisions is monitored after deducting the unit-linked provisions.*

Chart 102 **Investment of technical provisions** **(%)**



Source: NBS.
Note: The term 'government bonds' means bonds issued by the Slovak or other EU governments, bonds issued by NBS or other central banks, bonds guaranteed by Slovakia, and bonds issued by the EIB, EBRD or IBRD.

Chart 103 **Changes in the investment of technical provisions between 30 June 2006 and 31 December 2006** **(%)**

Source: NBS.

They were covered by assets worth SKK 99 billion in total, therefore representing 105.3% of the created technical provisions excluding the unit-linked provision. The share of provisions invested in bonds issued by the Slovak or other EU governments, bonds issued by NBS or other central banks, bonds guaranteed by the Slovak Government, and bonds issued by the EIB, EBRD or IBRD declined slightly, by 1.5 percentage points, to 46.3%. The proportion of provisions invested in term deposits also decreased, by 5.1 percentage points, to 8.4%. By contrast, there was a moderate rise in the share of provisions invested in bank bonds and mortgage bonds, which increased by 1.6 and 2.5 percentage points, to 14.3% and 11.9%, respectively. Most provisions, therefore, continue to be invested in low-risk assets.

Chart 104 **Total profit of insurance companies** **(SKK billion)**

Source: NBS.
Note: Cumulative profit for the previous 12 months as at the given date.

Financial position of the insurance sector

The profits of insurance companies for 2006 amounted to SKK 4.5 billion, an increase of 61% in comparison with 2005. The sector's ROA rose from 2.25% in 2005 to 3.05%, and its ROE increased from 12.46% to 15.87%.

Although insurance companies continue to report a loss in the technical account of life insurance, in 2006 it stood at SKK 1.1 billion. The technical account of non-life insurance ended the year with an overall gain of SKK 2.2 billion, down by 21% on 2005.

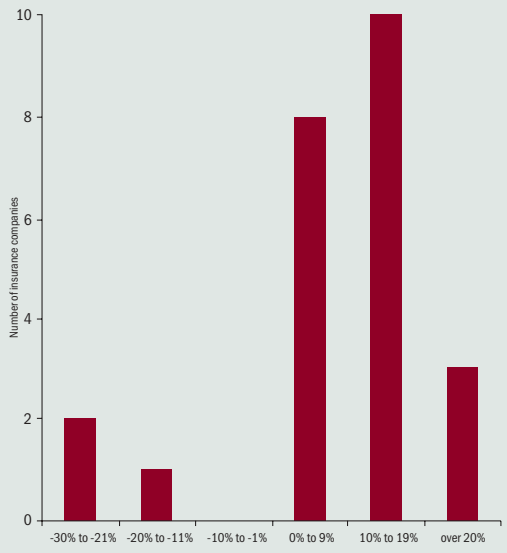
Three of the 24 insurance companies reported a loss. As many as 14 insurance companies, i.e. more than half, made a loss on the technical account (the technical result does not include the profit or loss).

Table 19 **Insurance companies – year-on-year changes in basic income categories (SKK million)**

		XII. 2006	XII. 2005	Change
(a)	Profit after tax (b+c)	4,464	2,766	61%
(b)	Tax	-1,263	-1,077	17%
(c)	Profit before tax (d+n+x)	5,727	3,844	49%
(d)	Gross profit from non-life ins. (e+h)	2,230	2,707	-18%
(e)	Income (f+g)	21,038	18,698	13%
(f)	Premiums earned[1]	18,554	17,978	3%
(g)	Other income	2,484	719	245%
(h)	Expenses (I+j+k+l)	-18,807	-15,991	18%
(i)	Claims incurred[1]	-7,971	-7,666	4%
(j)	Operating expenses[2]	-8,083	-5,742	41%
(k)	Other expenses[1]	-2,192	-2,516	-13%
(l)	Change in the balance of other technical provisions[3]	-561	-67	737%
(m)	Gross profit from life ins. (n+q)	-1,197	-1,554	-23%
(n)	Income (f+g)	22,917	21,098	9%
(o)	Premiums earned[1]	21,574	20,441	6%
(p)	Other income	1,343	657	104%
(q)	Expenses (I+j+k+l)	-24,114	-22,652	6%
(r)	Claims incurred[1]	-8,806	-7,318	20%
(s)	Operating expenses[2]	-6,959	-5,698	22%
(t)	Other expenses[1]	-834	-852	-2%
(u)	Change in the balance of other technical provisions[3]	-7,515	-8,784	-14%
(v)	Gross profit from other activities (w+x)	4,758	2,690	77%
(w)	Profit or loss	4,758	4,152	15%
(x)	Profit or loss from other activities	-63	-1,461	-96%

Source: NBS.
1) Excluding reinsurance.
2) Net operating expenses, i.e., after deducting the commissions of reinsurers and shares in profit.
3) Change in the balance of technical provisions excluding the change in the technical provision for unearned premium (its change is included in the item 'Premiums earned') and the change in the provision for claims (its change is included in the item 'Claims incurred').

Chart 105 **Distribution of ROE in the insurance sector**



Source: Statistical office of the Slovak Republic.

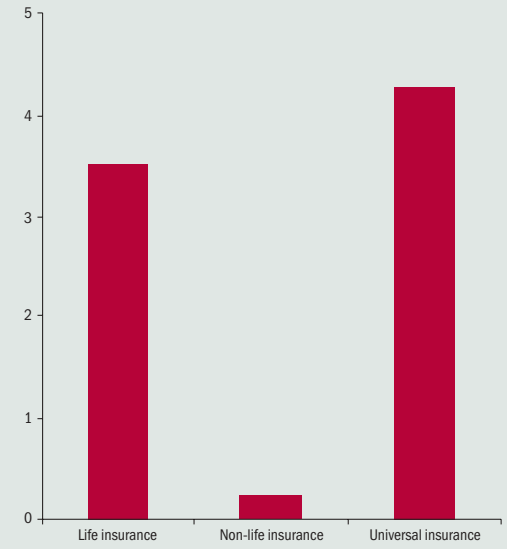
Risks in the insurance sector

The analysis of risks in the insurance sector is based on positions arising from the investment of technical provisions. Since their structure indicates the dominant position of interest rate instruments, the analysis is confined to interest rate risk. This risk is measured in a standard way using value-at-risk (VaR) calculated on the basis of an historical simulation method. It proceeds on the assumption that all interest rate instruments are revalued to fair value. The calculation of a 10-day VaR at the level of 99% was made as at 31 December 2006. The VaR for individual insurance companies are calculated separately for life and non-life insurance.

The VaR results obtained do not indicate that insurance companies have a substantial exposure to interest rate movements. In life insurance,[25] the median

[25] *In this case, the category of life insurance includes all insurance companies that are engaged in life insurance, whether exclusively or in combination with non-life insurance.*

Chart 106 **Share of VaR in interest rate instruments in each category of insurance company** **(%)**



Source: Statistical Office of the Slovak Republic.

decline in the value of interest-rate sensitive assets was 3.5%, and in non-life insurance it was only 2.4%. This means that the interest rate sensitivity of life insurance provisions was higher than that of non-life provisions. On the other hand, the effect in non-life insurance is less evenly distributed.

When insurance companies are broken down by activity – life (operating only in life insurance), non-life (operating only in non-life insurance) and universal (operating in both types of insurance) – it is shown that the most at risk are universal insurers, followed close behind by life insurers. Insurance companies specializing in non-life insurance face the smallest threat of decline in the value of their provisions.

Securities dealers

3 Securities dealers

In 2006, as in 2005, as much as 95% of customer transactions in securities were made through banks. The total amount of these transactions rose year-on-year by 10%, to SKK 1 810 billion. The most traded instruments were bonds and forward contracts. The amount of assets under management rose 57%, to SKK 28 billion. The capital adequacy ratio of Slovak securities dealers met the prescribed minimum requirement by a sufficient margin.

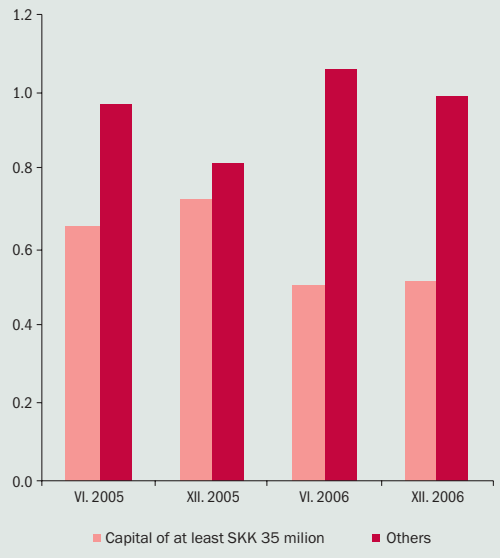
Capital adequacy

During 2006, the capital adequacy ratio of all non-bank securities dealers fluctuated above the statutory minimum requirement of 8% (among securities dealers with capital of at least SKK 35 million, the lowest ratio was 22%, and among others it was 36%).

Investment services and asset management

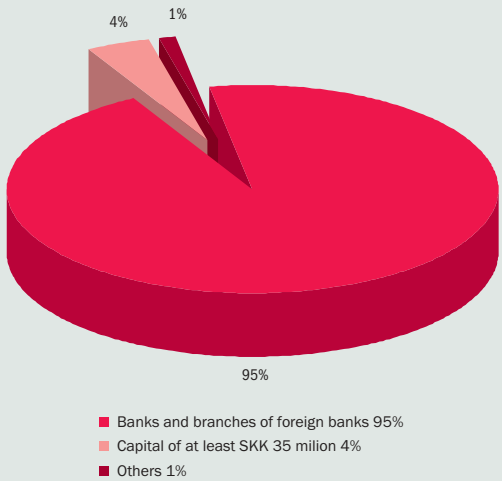
The total amount of customer transactions made under investment services IS-1 to IS-3[26] stood at SKK 1 810 billion for 2006. Fully 95% of these transactions were performed through banks. Compared with 2005, the total volume of transactions rose 10%.

Chart 107 **Average capital adequacy ratio of non-bank securities dealers** **(%)**



Source: NBS.

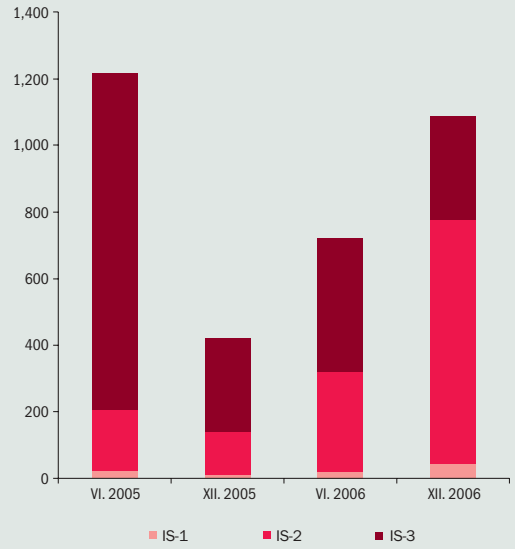
Chart 108 **Types of securities dealers by share of customer transactions for the first half of 2006** **(%)**



Source: NBS.

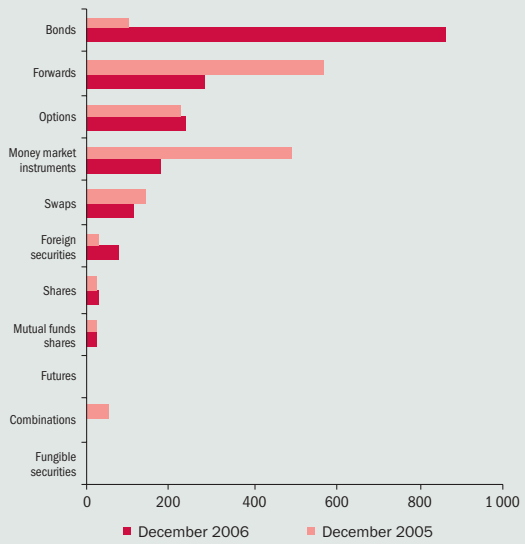
[26] *IS-1= investment service as defined in Article 6(2)(a) of the Securities Act, i.e. acceptance of a customer's instruction to buy, sell or otherwise use investment instruments and the subsequent forwarding of the customer's instruction for the purpose of its execution.*
IS-2 = investment service as defined in Article 6(2)(b) of the Securities Act, i.e. the acceptance of a customer's instruction to buy or sell an investment instruments and its execution for an account other than the account of the service provider.
IS-3 = investment service as defined in Act 6(2)(c) of the Securities Act, i.e. the acceptance of a customer's order to buy or sell an investment instrument and its execution for own account.

Chart 109 **Amount and structure of customer transactions by type of investment service (SKK billion)**



Source: NBS.

Chart 110 **Structure of transactions by investment instruments (SKK billion)**



Source: NBS.

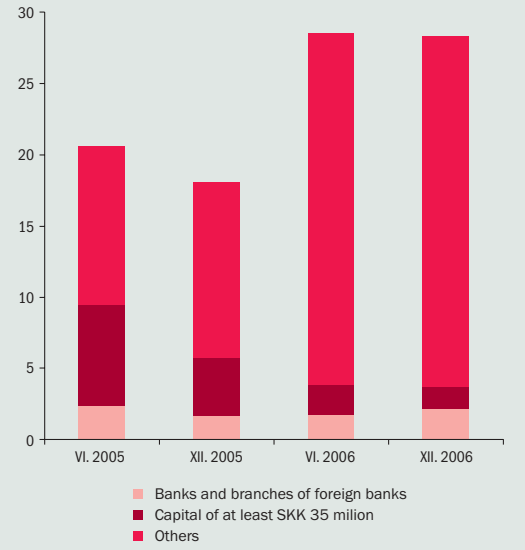
In 2006, only 39% of transactions were performed for the account of the investment service provider (under IS-3), whereas in 2005 the figure was as high as 75%. The proportion of transactions made for the customer's account rose sharply, from 19% in 2005 to 57% in 2006. As much as 81% of these transactions was in bonds.

The structure of traded instruments also changed significantly. In 2005, the most traded instruments were forward contracts (SKK 570 billion) and money market instruments (SKK 492 billion), but in 2006 most of the trading was in bond instruments (SKK 857 billion). Other instruments were traded in smaller volumes (including forward contracts worth SKK 284 billion and options worth SKK 242 billion).

The majority of transactions made for the account of the investment service provider (the bank or securities dealer) were in financial instruments and money market instruments. In fact, IS-3 transactions accounted for 78% of the trading in forward contracts, 84% in options, 76% in swaps and 98% in money market instruments. Transactions made for the customer's account (IS-2) included the majority of transactions in bonds (97%), shares (63%) and foreign securities (59%). All customer instructions for the use of futures contracts and the majority of transactions in mutual funds certificates (77%) were assigned to other entities under IS-3.

The amount of customer assets managed by securities dealers (including banks) rose during 2006 from SKK 18 billion to SKK 28 billion. That entire growth was, however, accounted for by a single company, which as at 31 December 2005 did not report any managed assets and as at 31 December 2006 reported SKK 10 billion worth. Most other companies reported a decline or very slight increase in managed assets.

Chart 111 **Amount of customer assets managed by securities dealers (SKK billion)**



Source: NBS.

Collective investment

4 Collective investment

The net asset value of open-end mutual funds increased by 4% in 2006, which marked an end to its rapid growth of previous years. The raising of interest rates at the beginning of the year adversely affected the performance of bond funds, and money market funds likewise lost their edge over term deposits. The biggest-selling funds in the first half of the year were the riskier ones, mainly share funds, but by the year-end money market funds had reclaimed this position. The performance of funds that invest in foreign securities was very negatively affected by the appreciation of the Slovak koruna's exchange rate against the euro (by 9%) and against the US dollar (by as much as 18%).

Assets in open-end mutual funds

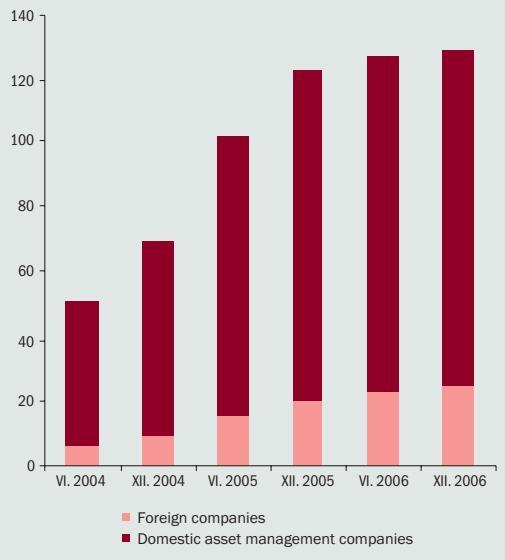
The total net asset value of domestic open-end mutual funds and foreign mutual funds, insofar as they pertain to sales to investors in the Slovak Republic, increased by 4.2% last year. That represented a rise from SKK 124 billion as at 31 December 2005 to SKK 129 billion as at 31 December 2006. Of that growth, sales of foreign mutual funds to investors in Slovakia accounted for SKK 3.1 billion and Slovak open-end mutual funds for SKK 2.1 billion.

Most of the money invested in domestic mutual funds (82%) comprised purchases of mutual fund shares by households. That percentage was, however less than at the end of 2005, when household investment accounted for 92% of all investment in domestic mutual funds. The share of non-residents' deposits was a negligible 0.7%.

After lasting for several years, the growth in investment in mutual funds slowed down sharply in 2006. For 2005, total net sales of fund shares came to SKK 38.7 billion, but the figure for 2006 was negative – investors sold SKK 2.6 billion worth of fund shares more than they bought.

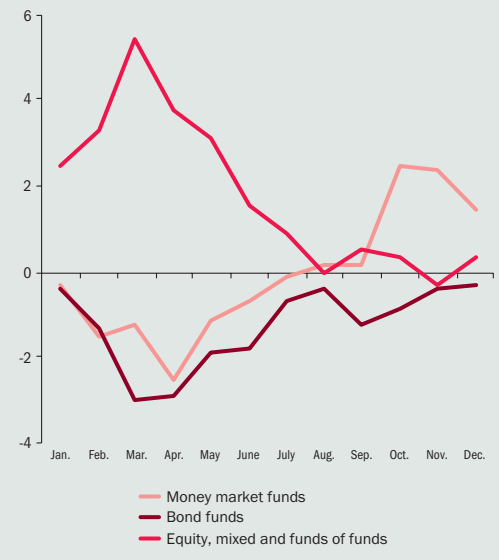
The redemption of fund shares over the course of 2006 occurred mainly in bond funds and money market funds, from which investors took out SKK

Chart 112 **Amount invested in open-end mutual funds sold in Slovakia (SKK billion)**



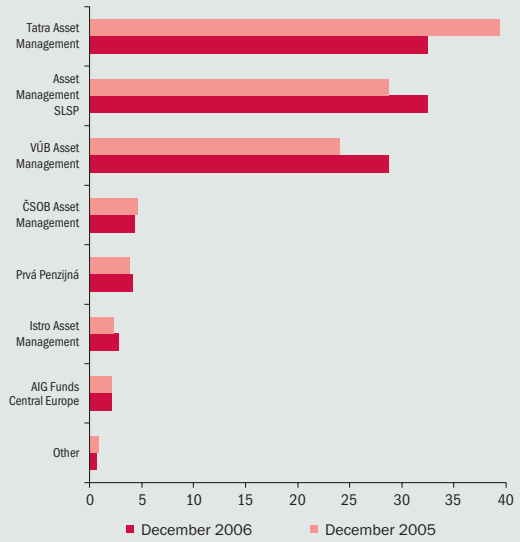
Source: NBS.

Chart 113 **Monthly net sales of open-end mutual funds in Slovakia (SKK billion)**



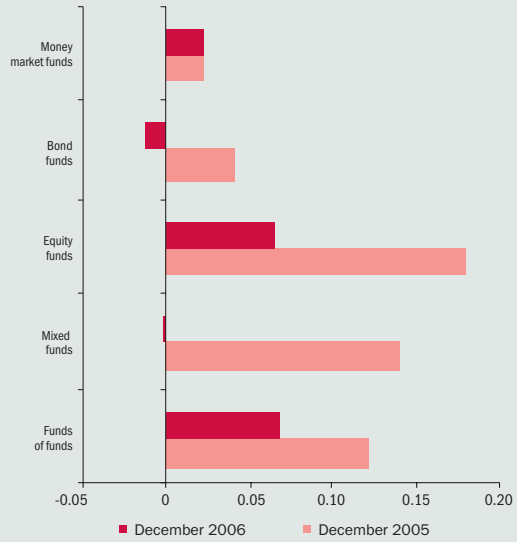
Source: Association of Asset Management Companies (AAMC).

Chart 114 **Net asset value of mutual funds managed by domestic asset management companies (SKK billion)**



Source: NBS.

Chart 115 **Comparison of average annual performances of open-end mutual funds according to fund type (in % per year)**



Source: NBS.
Note: Funds are weighted by net asset value pertaining to sales in Slovakia.

16.8 billion and SKK 5.3 billion, respectively. This money was then transferred mainly into funds of funds, whose net sales for 2006 stood at SKK 9 billion, and equity funds, with net sales of SKK 7.4 billion for the same year.

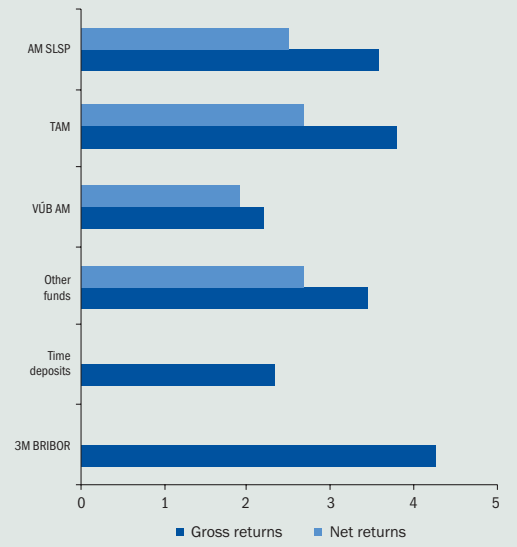
The redemption of fund shares was not reflected equally in all asset management companies. The market leader, Tatra Asset Management, správ. spol., strengthened its position: the net sales of shares in its open-end mutual funds came to SKK 8.1 billion, despite the generally negative trend. No other Slovak asset management company recorded notably positive net sales. On the contrary, investors withdrew SKK 7.2 billion from mutual funds managed by VÚB Asset Management and SKK 4.9 billion from those of Asset Management SLSP. Other companies did not report a substantial change in the amount of assets invested in their open-end mutual funds.

All the larger asset management companies, reporting net managed assets of more than SKK 1 billion, made a profit in 2006. The average ROE for asset management companies, weighted by capital, was 21.84%.

Performance of open-end mutual funds

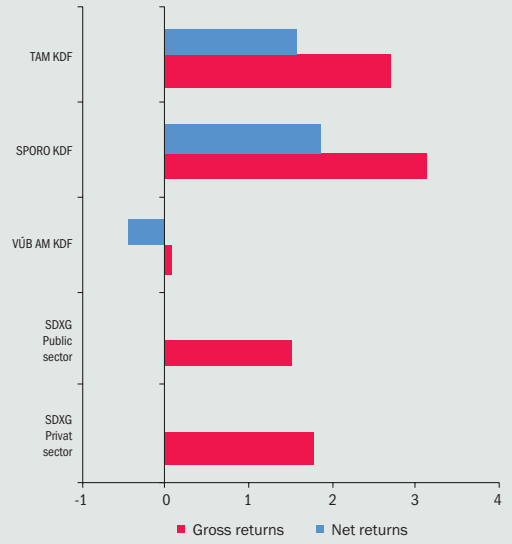
Open-end mutual funds reported a lower year-on-year performance as at 31 December 2006 than as at the end of 2005. The rise in interest rates during 2006 put a downward pressure on bond prices, which in turn was reflected mainly in the performance of bond funds and mixed funds. At the same time, however, riskier groups of funds (especially equity funds)

Chart 116 **Comparison between one-year returns on money market funds in Slovak korunas, the interbank rate and term deposits (in % per year)**



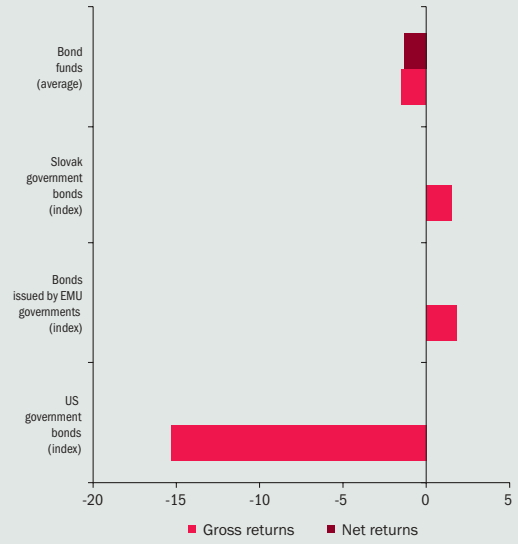
Source: NBS, AAMC.
Note: The rate on term deposits is the average rate for the past 12 months. Other funds are weighted by amount of assets pertaining to sales in Slovakia.

Chart 117 **Comparison between returns on the three largest bond funds in Slovak korunas and Slovak bond indices (in % per year)**



Source: NBS, AAMC.

Chart 118 **Comparison between one-year returns on all bond funds and the development of market indices (in % per year)**



Source: NBS, SASS
Note: The returns on Slovak bonds are determined according to the SDX Group Public Sector (a development index), the returns on bonds issued by EMU governments according to the MSCI EMU Sovereign TR, and the returns on US government bonds according to the MSCI US Treasury TR.
Funds are weighted by amount of assets pertaining to sales in Slovakia.

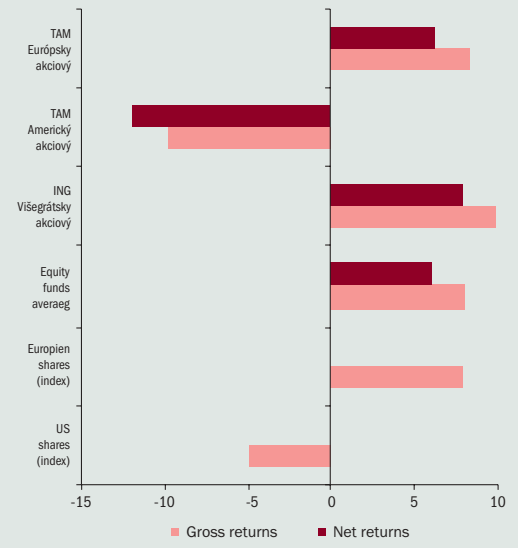
profited from the performance of European stock markets, which continued to rise, albeit more slowly than in 2005.

The performance of funds was also affected to a large extent by the strengthening of the Slovak koruna against foreign currencies. Just on the exchange rate as at 31 December 2006, US dollar-denominated securities lost 17.8% of their value year-on-year and euro-denominated securities depreciated by 8.7%. As much as 39% of investment in mutual funds is made in money market funds denominated in Slovak korunas, including 79% in the three largest funds. The gross returns of these funds should be comparable with the interbank rate (BRIBOR in the case of SKK).

The gross returns on money market funds in 2006 were between 0.5% and 0.8% lower than the three--month interbank rate. Compared with the appreciation of term deposits, the average net returns on money market funds denominated in Slovak korunas were only 0.04% higher, although for some funds the difference was more than 0.5%.

Almost a fifth of the total amount of assets was invested in bond funds, the largest of which (with assets of more than SKK 1 billion) can be divided into two categories. First are those funds which invest in bonds that are denominated in SKK or hedged against a currency risk. The gross returns on these funds should compare with the Slovak Bond Index

Chart 119 **Comparison between one-year returns of the three largest equity funds and the development of market indices (in % per year)**



Source: NBS, AAMC.
Note: The returns on European shares are measured by the DJ Euro Stoxx 50 TR and the returns on US shares by the S&P 500 TR.
Funds are weighted by amount of assets pertaining to sales in Slovakia.

(SDX Group) of bonds listed on the Bratislava Stock Exchange (BSSE).

The year-on-year returns on these indices fluctuated around 1.7%, and the two largest bond funds even outperformed the indices.

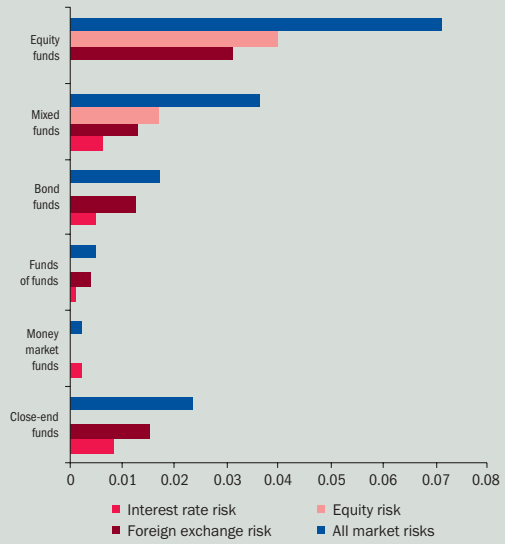
Other bond funds invest in a wide range of mainly European and US bonds. Since the main adverse effect on these funds was exerted by exchange rates in 2006, their performance for that year was negative.

A total of SKK 22 billion was invested in equity funds. The returns on these funds were largely affected by prices on European and US stock exchanges, since hardly any trading takes place on the Slovak bourse.

Box 4 Risks in collective investment

The analysis of risks focused on market risks (equity, foreign exchange and interest rate), since this is the most significant type of risk to which mutual fund investment are exposed. The risks are examined through their effect on funds' net fair value, which corresponds to the assessment of risks in regard to the funds' investors and not the asset management companies. Another limitation of the analysis is that data on the portfolios of individual asset management companies were not available as at 31 December 2006, and therefore the risks were assessed as at 31 January 2007. Even as at this date, however, data were only available for funds whose combined net asset value represented around two thirds of the net asset value of domestic mutual funds. The effect of each risk was estimated using value-at-risk (VaR) calculated by an historical simulation method. This figure expresses the loss over a period of 10 days that mutual funds would not exceed with a likelihood of 99% (assuming an unchanged portfolio).

Chart 120 **VaR in collective investment by type of fund, as at 31 January 2007** **(%)**



Source: NBS, Reuters, own calculations.
Note: The horizontal scale shows the ratio of the VaR for the given risk to the net asset value

The most significant risk to which mutual funds are exposed is foreign exchange risk (especially in the case of equity, bond, mixed and closed-end funds). In no fund, however, did the VaR for foreign exchange risk exceed 5% of the net asset value. The second greatest risk is equity risk, with the VaR in individual funds representing between 0% and 6% of the net asset value, or 0% and 11% of the value of shares. Overall, the ratio of VaR for equity risk to the value of shares was 4% in equity funds and 5% in mixed funds. Interest risk appears to be less significant, even in the case of bond funds. That may be down to the rise in interest rates in 2006 (both koruna and euro rates), when it was more advantageous to reduce the duration of bonds and thereby mitigate their exposure to interest rate risk. In none of the funds for which data was available did the VaR for interest rate risk exceed 3% of the net asset value of the given fund.

Pension saving

5 Pension saving

The new pension system had its first year of practical operation in 2006, with the 30 June marking the deadline for voluntary entry into the second pillar of pension insurance. As at 31 December 2006, pension fund management companies (PFMCs) had 1.54 million registered savers and the assets in their pension accounts amounted to SKK 28 billion. The third pillar, operated through three supplementary pension companies and one untransformed supplementary pension insurance company, had a participation of 856 000 Slovak citizens and their savings under this pillar stood at SKK 21.3 billion.

Money invested in pension funds

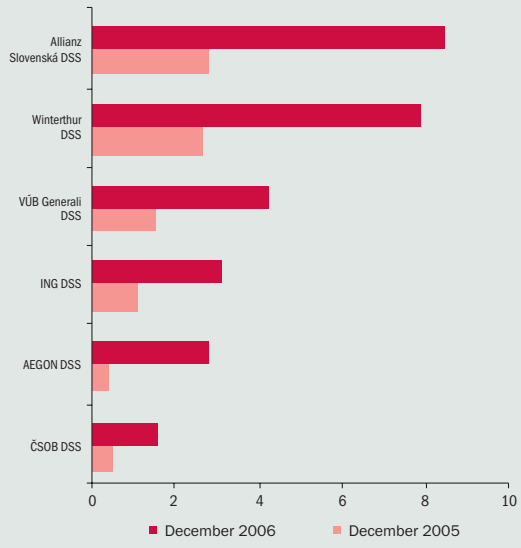
During the first half of 2006, when voluntary entry into the second pillar of pension insurance was still possible, PFMCs signed up 279 000 customers. In the second half of the year, after this deadline had passed, the Social Insurance Agency registered an additional 149 000 new savers. Overall, therefore, 1.54 million people were enrolled in pension saving as at 31 December 2006.

The assets managed in pension accounts by PFMCs increased by more than threefold in comparison with the end of 2005, to stand at SKK 27.9 billion. The market shares of each PFMC remained, however, substantially unchanged. The three largest PFMCs manage 73% of all pension fund assets (compared to 78% as at 31 December 2005).

Most pension fund savings (66%) are held in growth pension funds, which offer a higher-risk investment method and promise the highest appreciation of funds over the long-term. Balanced funds cater for 30% and conservative funds for only 4% of the total savings.

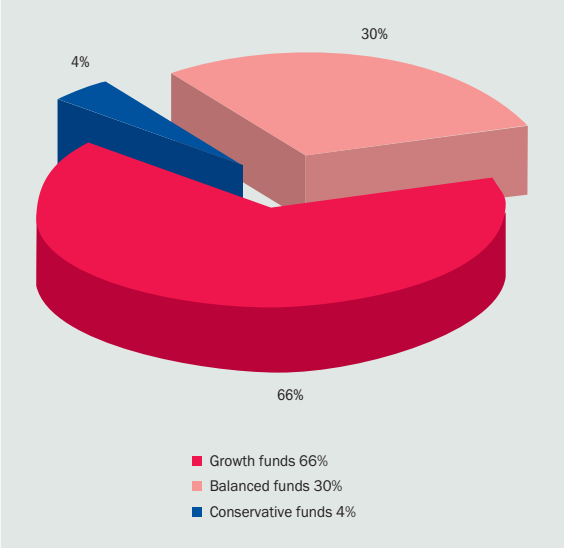
Although most pension savings are managed in growth funds, the investment structure is still quite conservative. As much as 48% of the money is invested in bank accounts and 38% in bonds. Only the ratio of bonds to total assets recorded a substantial increase during 2006, up from 12% as at 31 December 2005.

Chart 121 **Net asset value of pension funds for individual pension fund management companies (SKK billion)**



Source: NBS.

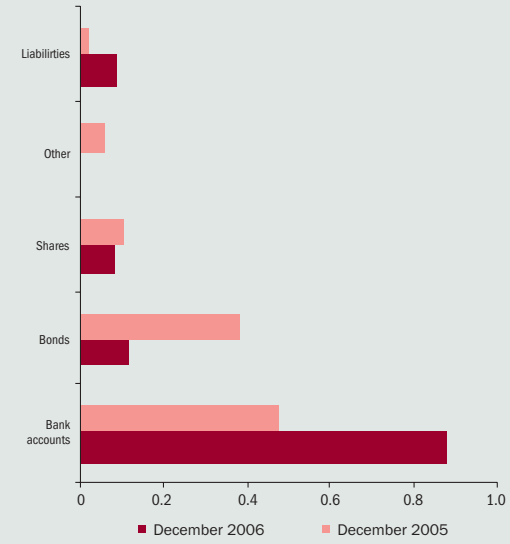
Chart 122 **Pension fund assets by share of each fund type (%)**



Source: NBS.

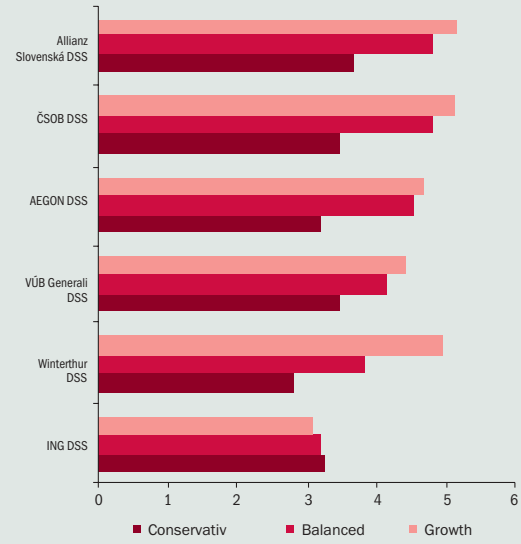
Chart 123 **Total managed assets by share of investment type**

(%)



Source: NBS.

Chart 124 **Returns on pension funds since their creation, broken down by pension fund management company and type of fund** (%)



Source: NBS.
Note: The horizontal scale shows the annual returns on the fund from 31 December 2005 to 31 December 2006, determined according to the size of the pension unit.

Performance of pension funds

The annual returns on pension funds as at 31 December 2006 ranged between 2.8% and 3.7% for conservative funds, 3.2% and 4.8% for balanced funds, and 3.1% and 5.2% for growth funds.

The strengthening of the Slovak koruna against foreign currencies affected the performance of pension funds less adversely than it did the performance of mutual funds, since up to 99% of bonds are denominated in Slovak korunas and other investment in foreign currency securities are hedged against exchange rate risk using financial derivatives.

In 2006, as in 2005, all pension fund management companies made a loss, owing to the high start-up costs in the pension saving market.

Supplementary pension saving

Three supplementary pension companies (SPCs) operated in the supplementary pension market during 2006, while the transformation of DDP Stabilita into an SPC is due to be completed on 1 April 2007.

The number of savers registered with the three supplementary pension companies was 716 000 as at 31 December 2006, and the money saved in their funds stood at SKK 17 billion. The investment of these savings is similar to that of pension fund savings: 37% was invested in bank accounts and 56% in bonds.

By 31 December 2006, the untransformed DDP Stabilita had concluded more than 140 000 occupational and policyholder contracts and as at that date had assets worth more than SKK 4.3 billion under management.

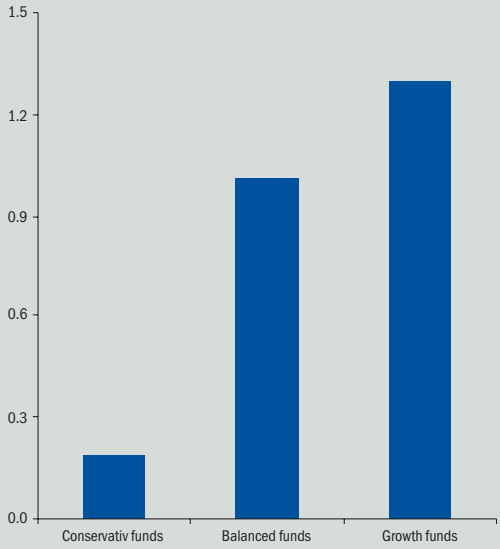
Box 5 Risks in pension saving

Like the assessment of risks in collective investment, the analysis of risks in pension saving focused on market risks (interest rate, equity and foreign exchange). These risks are again analysed through the effect on the net asset value (NAV) of pension funds; the distribution of the potential loss among customers and pension fund management companies (owing to the minimum rate of return requirement in regard to other funds) is not analysed. Another limitation of the analysis is that data on the portfolios of individual PFMC were not available as at 31 December. The risks were therefore assessed as at 21 March 2007, when data from five PFMCs were available. The effect of particular risks was estimated using value-at-risk (VaR) calculated by an historical simulation method. This figure expresses the loss over a period of 10 days (assuming an unchanged portfolio) that pension funds would not exceed with a likelihood of 99%.

The VaR figures indicate that over the 10-day period, the rate of return on balanced and growth funds should not fall by more than 2 percentage points with a likelihood of 99% and the rate of return on conservative funds by not more than 5 percentage points. The riskiness of balanced funds was only slightly lower than that of growth funds. This is because individual PFMCs have not so far taken full advantage of the legally permitted upper limit on the proportion of shares in the portfolio of pension funds; the ratio of shares to net asset value differs only slightly between balanced funds and growth funds.

Chart 125 **VaR for each type of pension fund as at 21 March 2007**

(%)



Source: NBS, Reuters, Bloomberg, own calculations.
Equity, interest-rate and foreign-exchange risks were taken into account.

The ratio of VaR for market risk to the total net asset value of the said five PFMCs is 1.3%. The most significant risk here is equity risk, with a ratio of 1.2%. For interest rate risk and foreign exchange risk, the figures were 0.4% and 0.0%, respectively.

Only balanced funds and growth funds are exposed to equity risk. The riskiness of equity portfolios of individual funds fluctuated in a range from 3% to 9% (ratio of VaR for equity risk to value of shares).

The exposure of balanced and growth funds to interest rate risk varies between pension fund management companies. The most significant effect of this risk (measured as the ratio of VaR to the NAV of the funds), at the level of 0.4% to 1.1%, would be reflected in three companies. The risk attached to the respective funds of the other two companies is negligible (the VaR to NAV ratio is 0.1%). In the conservative funds of all five PFMS, interest rate risk is the only risk affecting change in the net asset value. As for foreign exchange risk, it would be negligible across all 12 pension funds.

Financial market infrastructure

6 Financial market infrastructure

Stock exchange

Market capitalization and new issues

The total market capitalization of securities listed on markets of the Bratislava Stock Exchange (BSSE) amounted to SKK 581.7 billion as at the last day of 2006 (a rise of 1.4% in comparison with 2005). Of that amount, bonds accounted for 74%.

During 2006, no companies were admitted to a listing on BSSE markets and nor did any listed company increase its listed capital. Over the 12 months, 32 new issues of domestic debt securities (worth SKK 28.7 billion) were admitted to a listing on BSSE markets. Apart from new bond issues, the inflow of capital in BSSE markets included the admission of new tranches of already listed government bonds. In this way, the issued amount of four government bonds was raised and the total nominal value of the increase was SKK 26.2 billion.

Altogether, the capital newly admitted to BSSE markets in 2006 amounted to SKK 54.9 billion. Of the newly admitted issues, 31 were admitted to the markets of listed securities (including 1 government bond, 5 corporate bonds, 3 bank bonds and 22 mortgage bonds) and one new corporate bond issue was admitted to the regulated open market.

Trading on the stock exchange

The amount of transactions closed in 2006 did not exceed SKK 1 000 billion (as it had previously done) and ended the year just below that level, at SKK 992.1 billion. In comparison with 2005, the total traded amount was marginally lower (by 1%), although the number of transactions increased by 126.8%. The rise in trading activity was mainly related to the successful completion of takeover bids announced during 2006. To illustrate this point, the number of transactions made under takeover bids rose 16.8 times year-on-year and the share of these transactions in total transactions came to 58.9%.

Fully 99.2% of all transactions were in government bonds, with the amount of these transactions representing SKK 984.6 billion. Trading in other bonds amounted to 4.9 billion. Investors hardly did any share trading in 2006. The value of their share transactions was SKK 2.6 billion, which represented 0.3% of total transactions.

Of the total turnover on transactions in 2006, the turnover on transactions made by non-residents accounted for 49.4% (SKK 490.1 billion), of which 50.2% were purchase transactions and 48.6% sale transactions.

The Slovak share index SAX gained 0.6% during 2006. The SDXG group of bond indices rose 1.6% (public sector) and by 1.8% (private sector).

Central Securities Depository

The total nominal value of book-entry securities credited to owners' accounts as at 31 December 2006 was SKK 1 025 billion; of that total, shares accounted for the highest proportion, SKK 540 billion.

In comparison with the end of 2005, the total amount of book-entry securities held with the CSD rose year-on-year SKK 21.5 billion (in nominal terms), or 2.18%. Within that figure, bonds recorded the largest increase, 5.26% year-on-year, and book-entry mutual fund shares declined by the largest margin, 32.9% year-on-year.

In 2006, the total market value of delivery-versus--payment transfers of securities performed by the CSD through the clearing and settlement system was SKK 800.5 billion. In comparison with 2005, the amount of securities transferred by the CSD within the clearing and settlement increased by SKK 89.4 billion or 12.6%. The nominal value of free-of-payment transfers of securities made in 2006 stood at SKK 422.5 billion, representing a year-on-year decline of 221.8 billion, or 34.4%.

Deposit Protection Fund

The Deposit Protection Fund is authorized by statute to ensure and perform activities related to the protection of deposits which natural persons, or legal persons defined by law, hold with banks or branches of foreign banks that are participants in the deposit protection system in Slovakia.

The participants in Slovakia's deposit protection system comprise banks (including home savings banks) and branches of foreign banks in the territory of Slovakia which are authorized by Národná banka Slovenska to perform banking activities, with the exception of Slovenská záručná a rozvojová banka, a.s. and Eximbanka, a.s., neither of which collect deposits protected by the Deposit Protection Act.

Banks and branches of foreign banks are required to pay the following contributions to the fund: an initial contribution, an annual contribution and an extraordinary contribution. The amount of the annual contribution is set by the Board of the Deposit Protection Fund, at between 0.1% and 0.75% of the amount of bank deposits protected by the Deposit Protection Act, a figure that is based on the average amount of deposits for the previous quarter. For the years during which the Fund repays the credit provided for the purpose of ensuring the payment of compensation for inaccessible deposits, the annual contribution is set by the Board at not less than 0.35% or, with prior approval from Národná banka Slovenska, 0.2% of the amount of bank deposits protected by the Deposit Protection Act. The amount of the contribution is based on the average amount of deposits for the previous quarter. In accordance with a decision of the NBS Bank Board, the amount of the annual contribution of banks and branches of foreign banks for 2006 was set by the Fund's board at 0.2% of the amount of bank deposits protected by the Deposit Protection Act, as based on the average amount of outstanding deposits for the previous quarter.

By 2004, the Fund had paid compensation for inaccessible deposits held with the following banks: AG Banka, a.s. (SKK 1.7 billion), Slovenská kreditná banka, a.s., Bratislava (SKK 4.3 billion), Dopravná banka, a.s., Banská Bystrica (SKK 2.2 billion) and Devín banka, a.s., Bratislava (SKK 11.6 billion). In 2006, the Fund was not required to pay compensation for inaccessible deposits at any bank.

Investment Guarantee Fund

The Investment Guarantee Fund was established in 2002 in accordance with Act No. 566/2001 Coll. on securities and investment services, including amendments to certain laws, as amended.

The Fund collects monetary contributions from securities dealers, branches of foreign securities dealers, asset management companies and branches of foreign asset management companies for the purpose of providing compensation in the event that any assets which such companies have received from customers, for the performance of an investment service, become inaccessible; the Fund uses these contributions in accordance with the Securities Act. The Fund's activities are supervised by Národná banka Slovenska.

Customer assets are protected to the extent set out in the Securities Act. The maximum amount of compensation for inaccessible customer assets has been set at EUR 16 000 until 30 April 2007 and at EUR 20 000 as of 1 May 2007. The said amount is to be converted to SKK according to the exchange rate published by Národná banka Slovenska as at the date on which the customer assets become inaccessible. During 2006, there was no event that required the Fund to pay compensation.

The annual contribution of securities dealers to the Investment Guarantee Fund for 2006 was set by the Board of the Fund as follows:

a) for a securities dealer which is authorized to provide core investment services only to the extent set out in Article 6(2)(a), (b) or (d) and which may not use the customer's funds or investment instruments when providing investment services – 0.91% of the annual amount of fees charged to customers for investment services, but not less than the amount stated in Article 84(7)(a) of the Securities Act;
b) for a securities dealer authorized to provide core investment services only to the extent set out in Article 6(2)(a), (b) or (d) – 1.85% of the annual amount of fees charged to customers for investment services, but not less than the amount stated in Article 84(7)(b) of the Securities Act;
c) for other securities dealers – 2.8% of the annual amount of fees charged to customers for investment services, but not less than the amount stated in Article 84(7)(c) of the Securities Act.

In 2006, the Investment Guarantee Fund did not make any compensation payments for inaccessible customer assets.

Slovak Insurers' Bureau

The Slovak Insurers' Bureau was established by Act of the National Council of the Slovak Republic No. 381/2001 Coll. on motor third-party liability insurance, including amendments to certain laws.

The Slovak Insurers' Bureau is an association of insurance companies that are authorized to provide motor third-party liability insurance in Slovakia.
The Insurance Guarantee Fund comprises contributions made by the Bureau's members, extraordinary contributions, and premium defined in the Act on motor third-party liability insurance. The annual contribution is set as a percentage based on the number of insured motor vehicles for the previous calendar quarter.

Selected topic

7 Selected topic

Leasing companies in 2006

Recent years have seen a growing trend in the leasing market both in Slovakia and other European countries. We expect that the importance of leasing as a form of financing for enterprises and households will continue to rise in the years ahead.
Since leasing companies are not regulated by NBS, they are not usually included in the Report on the Results of the Slovak Financial Sector Analysis. The aim of this selected topic is to provide an overview of the significance of leasing companies in the Slovak financial sector as well as current trends in the leasing field.

Leasing as a form of financing

Leasing in Slovakia is not at present regulated by Národná banka Slovenska – the financial market's supervisory authority – and therefore NBS does not have access to data on individual leasing companies. The only available data is that which is publicly available, published either by leasing companies themselves or through the Association of Leasing Companies in the Slovak Republic (ALC SR). In September 2006, however, NBS issued Decree No. 6/2006 on the submission of reports for statistical purposes by factoring companies, hire-purchase finance companies and leasing companies, which entered into force on 1 January 2007. Under this Decree, a leasing company may, at the written request of Národná banka Slovenska, submit statistical reports on a quarterly basis. NBS thereby obtains data on claims arising within the scope of leasing and on other claims (including claims arising from hire purchase or from consumer loans), denominated in Slovak korunas or euros, for residents and non-residents. Under the breakdown into residents and non-residents, data is also obtainable for monetary financial institutions and non-financial institutions (general government, other financial intermediaries and financial auxiliaries, insurance companies and pension funds, non-financial corporations, households, and non-profit institutions serving households).

Position of leasing in the Slovak financial sector

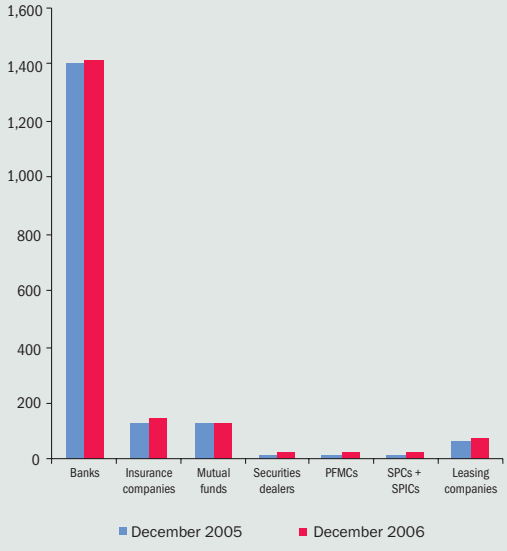
Although banks dominate financial intermediation in Slovakia, alternative methods of financing are steadily strengthening their position.

At the end of 2006, leasing companies held around 4% of the assets in the financial sector (compared with 3.3% in 2005). Apart from banks, the positions of insurance companies and mutual funds were more significant.

Transactions made by leasing companies amounted to SKK 72.5 billion at the end of 2006, which represented an increase of 26% year-on-year.

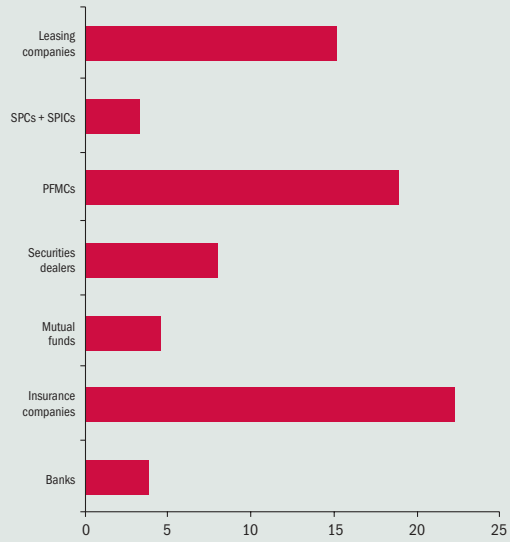
In terms of the year-on-year rise in assets, leasing companies were the third fastest growing segment, as their assets rose more than SKK 15 billion.

Chart 126 **Financial sector institutions by amount of assets managed (SKK billion)**



Source: NBS, ALC SR.

Chart 127 **Financial sector institution by year-on-year change in amount of assets managed (year-on-year changes, SKK billion)**



Source: NBS, ALC SR.

Leasing market in Slovakia

The activities of leasing companies increased markedly in 2006. Members of the Association of Leasing Companies concluded transactions worth SKK 72.5 billion last year, representing an increase of 26.4% on 2005. Of that total, transactions in movables accounted for as much as 95.3%, and those in immovables 4.7%. Altogether, 93 775 leasing contracts were concluded, which was 26.7% more than in 2005.

The most common forms of financing used by leasing companies are financial leasing, consumer loans, operational leasing and hire purchase, while some companies also offer leaseback products. All types of financing reported a sharp rise in absolute terms. Although financial leasing saw its share of total transactions declined in 2006, the share remained high, at 74%. The largest increase was reported by consumer loans, which rose more than SKK 4 billion year-on-year.

Table 21 **Financing by type of lessee (SKK million)**

	Year 2006	
	Amount	**Market share (%)**
Private sector-enterprises	58,206	84.3
General government	513	0.7
Consumers	8,999	13.0
Others	1,406	2.0

Source: ALC SR.

The major group of lessees are private sector-enterprises (covering agriculture, industry, construction, services, sole traders), which represented 84.3% of the market in 2006. The sector of consumers is the next largest (13%), while general government constitutes an insignificant share.

More than 78% of the financing provided to the corporate sector was used to finance machines, goods vehicles and passenger cars. Among consumers, more than 95% of the total financing was used for passenger cars. Although financial leasing was the predominant form of financing among consumers (55% of consumer financing), consumer loan financing saw its share rise substantially in 2006, to 40%.

Leasing companies mainly financed movables: more than 95% of the amount of their transactions concerned these items. Passenger cars accounted for more than 30%. In terms of year-on-year growth, the financing of commercial vehicles and goods vehicles attracted the greatest interest (with respective increases of 63% and 31%).

In 2006, ten members of the ALC SR provided lease financing of immovables. Altogether, 110 contracts

Table 20 **Type of financing (SKK million)**

	Transactions by amount		Increase in %
	year 2006	**year 2005**	
Financial leasing	51.057	44.230	15.4
Operational leasing	4.893	2.959	65.4
Hire purchase	3.134	1.656	89.3
Consumer loans	10.040	5.826	72.3
Total	69.124	54.671	26.4

Source: ALC SR.

Table 22 **Financing of movables**

	Share in %	
	year 2006	**year 2005**
Machinery and industrial equipment	23.9	25.5
Computers and office equipment	1.0	1.1
Goods vehicles, tractor units, trailers	23.2	22.3
Passenger cars	32.9	36.7
Commercial vehicles	15.8	12.3
Ships, aeroplanes, rolling stock	1.3	0.6
Others	1.9	1.5

Source: ALC SR.

were concluded in this area and the amount of transactions in immovables rose 26.7% in comparison with 2005 (to SKK 3 377 billion)[27]. In Slovakia, leasing for this purpose is used mainly by large companies for multi-million koruna investment in industrial and logistics premises. The financing of industrial buildings, retail buildings and supermarkets accounted for almost 78% of the total financing of immovables in 2006.

Leasing companies in Slovakia

The majority of leasing companies in Slovakia are members of the Association of Leasing Companies in the Slovak Republic, founded in 1992. Since membership of the ALC of the SR is voluntary, not all leasing companies belong to it. Members of the ALC of the SR do not just include leasing companies but also companies whose activities are related to leasing. At present, the ALC of the SR has 38 member companies, including practically all leasing companies that have a significant position in the market, as well as most of the medium-sized and smaller companies.

As regards legal form, every leasing company in Slovakia is either a joint stock company, limited liability company, or an organizational unit of a foreign company.

Leasing companies are to a large extent owned by a banks or financial groups. The following table shows which banks operating in Slovakia hold participations in which leasing companies.

Of the total value of financed assets in 2006, the ten largest companies accounted for as much as 86%, and the two largest companies for 36%.

Table 23 **Banks with participations in leasing companies**

Leasing company	**Bank**
CAC Leasing Slovakia	HVB Bank Slovakia
ČSOB Leasing	ČSOB
Leasing Slovenskej sporiteľne	Slovenská sporiteľňa
OTP Leasing	OTP Banka
Tatra Leasing	Tatra banka
VB Leasing SK	Ľudová banka
VÚB Leasingová	VÚB

Source: NBS, ALC of the SR.

[27] *According to ALC of the SR sources.*

Tables

8 Tables

8.1 Information on the structure of the financial market

Data on numbers of institutions

Table 24 **Number of financial institutions as at 31 December 2006**

	Number of institutions	Number of institutions	Change
Number of banks in the SR	17	18	-1
Building societies	3	3	0
Banks holding mortgage licence	9	9	0
Other banks	5	6	-1
Number of branches of foreign banks in the SR	7	5	+2
of which: on the basis of an NBS licence	1	1	0
on the single banking passport principle	6	4	+2
of which: branches of foreign banks holding mortgage licence	1	1	0
Number of branches of foreign banks contributing to Deposit Protection Fund	2	2	0
Number of foreign bank representative offices in the SR	10	9	+1
Number of branches (organisational units) of banks in the SR	715	692	+23
Number of lower organisational units in the SR	460	457	+3
Number of branches of Slovak banks in other countries	1	1	0
Number of Slovak banks' representative offices in other countries	1	1	0
Number of foreign entities freely providing cross-border banking services	131	104	+27
of which: banks	123	99	+24
electronic money institutions	3	2	+1
foreign financial institutions	3	3	0
credit unions	2	0	+2
Slovak banks providing free cross-border banking services abroad	1	1	0
of which: electronic-money institutions	0	0	0
Number of employees of banks and branches of foreign banks	19,525	19,850	-325
Number of insurance companies in the SR	24	25	-1
of which: insurance companies providing only life insurance	5	5	0
insurance companies providing only non-life insurance	6	4	+2
insurance companies providing both life and non-life insurance	13	16	-3
Insurance companies providing services on the basis of the freedom to provide services	296	200	+96
of which: without establishing a branch	289	196	+93
of which: via a branch	7	4	+3
Number of insurance companies in the SR providing motor third-party liability insurance	9	8	+1
Number of employees of insurance companies		6,253	
Number of pension fund management companies	6	8	-2
Number of supplementary pension companies	3	0	+3
Number of supplementary pension insurance companies	1	5	-4
Number of domestic asset management companies in the SR	10	10	0
of which: asset management companies with an extended licence under § 3 (3) of Act on collective investment (ACI)	7	7	0

Table 24 **Number of financial institutions as at 31 December 2006 (continuation)**

	Number of institutions	Number of institutions	Change
Number of domestic mutual funds:	109	100	+9
of which: open-end mutual funds	62	51	+11
closed mutual funds	44	49	-5
special mutual funds	3	0	+3
Number of foreign asset management companies and foreign entities of collective investment operating in the SR on the basis of a licence under § 75 of the ACI:	3	3	0
of which: via a branch in the SR	2	2	0
without establishing a branch	1	1	0
Number of foreign asset management companies and foreign entities of collective investment operating in the SR on the basis of a single European passport:	21	14	+7
of which: foreign asset management companies	7	4	+ 3
of which: foreign investment companies	14	10	+ 4
within which: number of foreign mutual funds and sub-funds of foreign investment companies	360	294	+66
Number of foreign asset management companies providing services according to Art. 3 paragraph 3 ZKI	6	3	+ 3
Number of securities dealers	33	36	-3
of which: banks and branches of foreign banks	18	18	0
Number of foreign entities operating in the SR as securities dealers	304	204	+100
of which: via branch in the SR	2	2	0
without establishing a branch	302	202	+100
Number of Slovak securities dealers providing services abroad	7[1]	5[1]	+2
Number of investment service brokers in the SR	888	756	132
of which: legal persons	55	37	18
natural persons	833	719	114

Source: NBS.
1) 5 entities in nine countries (as at 31. 12. 2005) and 7 entities in eleven countries (as at 31. 12. 2006)

The banking sector and stock broking

On 10 February 2006, Národná banka Slovenska registered a representative office of foreign bank, BANCA MONTE DEI PASCHI DI SIENA SPA, Italy. The total number of representative offices of foreign bank offices thus rose to six.

On 1 March 2006, J&T BANK a.s. commenced activity on the basis of a "single passport". Deposits of the branch are insured in the Deposit Insurance Fund, Prague, the Czech Republic.

In its decision of 15 May, Národná banka Slovenska granted preliminary consent to the winding up of CALYON BANK SLOVAKIA a.s., as a result of bank enterprise's sale, which was purchased by foreign bank CALYON S. A., France. The company decided to change operation of CALYON BANK SLOVAKIA a.s. controlled by it, in the SR, and to transfer all its activities to newly created branch of CALYON S. A. At the same time, NBS granted prior consent for the sale of the bank enterprise and for sale of the securities dealer-company to the seller, CALYON BANK SLOVAKIA a.s., and to the acquirer, CALYON S. A. France.

In its decision of 31 May 2006, Národná banka Slovenska granted a licence to provide investment services to Money Market Brokers, o.c.p., a.s., Bratislava.

In its decision of 29 June 2006, Národná banka Slovenska granted a preliminary consent to Stredoeurópsky maklérsky dom, o.c.p., a.s. for return of its licence for provision of investment services.

Národná banka Slovenska granted consent for return of licence for provision of investment services to Stredoeurópsky maklérsky dom, o.c.p., a.s. (on 29 June 2006), EURÓPSKA KAPITÁLOVÁ o.c.p., a.s. (16 August 2006) and Capital Partners, o.c.p., a.s. (16 October 2006).

In its decision of 31 May 2006, Národná banka Slovenska granted licence for provision of investment services to Money Market Brokers, o.c.p., a.s., Bratislava.

On 12 October 2006, Národná banka Slovenska granted licence for provision of investment services to ACTIVE FINANCE o.c.p., a.s. Košice.

Insurance sector

Through the winding up of two insurance companies and the establishment of one insurance company declined the number of insurance companies by one: Vzájomná životná poisťovňa Sympatia, a.s. (VŽP) was wound up, its licence was returned on 30 January 2006, and its non-life insurance portfolio was transferred to the Poisťovňa Union, and the life insurance portfolio to ING Životná poisťovňa and Winterthur poisťovňa, a.s.; the latter returned its licence on 26 May 2006 and transferred its insurance portfolio to Credit Suisse Life & Pensions Pojišťovna, a.s., operating in the Slovak Republic via its branch Winterthur pojišťovna a.s. Conversely, on 6 February 2006, AEGON Životná poisťovňa, a.s. was licensed for the first half of 2006, though it has yet to report a premium written. The establishment of AEGON Životná poisťovňa, a.s. cannot, however, be seen as the arrival of a new entity on the Slovak insurance market, since AEGON Levensverzekering, N. V. has already provided its services in the SR on the basis of free provision of services via a branch; therefore, this represents only a change to its form of operation on the Slovak insurance market. In the first half of 2006 preparations were being made to transfer the insurance portfolio from AEGON Levensverzekering, N. V., to AEGON Životná poisťovňa, a.s.

In its decision of 10 May 2006, based on request of QBE poisťovňa, a.s., NBS changed its licence for provision of insurance services. Provision of life insurance was taken out of the licence.

Number of insurance companies in the Slovak Republic operating on the basis of a „single passport" has been rising since the integration of the Slovak Republic into the EU. During 2006, one universal insurance company (Zavarovalnica Triglav, d.d.) and two non-life insurance companies (Europäische Reiseversicherung AG and AIG EUROPE S.A.) from other EU member countries were established on the Slovak market via their branches, and 15 life insurance, 56 non-life insurance and 8 universal insurance companies from other EU member countries were established on the basis of free provision of cross-boarder services. As at 31 December 2006, there were no branches of insurance companies from third countries.

Table 25 **Number of insurance companies from other member countries of the EU or EEA that expressed their interest in the provision of insurance services in the SR via a branch or on the basis of free provision of cross-boarder services as at 31 December 2006**

Domestic country of insurance company	Life		Non-life		Universal		Total	
	P	SPS	P	SPS	P	SPS	P	SPS
Belgium				10				10
Czech Republic				7	1	6	1	13
Denmark				6				6
Estonia				2				2
Finland				4		1		5
France		2	1	11		2	1	15
Gibraltar				1				1
Netherlands	1		1	12			2	12
Ireland		3		33				36
Lichtenstein		4		2				6
Lithuania				2		1		3
Latvia				1				1
Luxembourg		9		9				18
Hungary				8		1		9
Malta				1				1
Germany	1			19			1	19
Poland		3		8				11
Austria		2	1	9		11	1	22
Slovenia		1		1	1	2	1	4
Spain				2				2
Sweden				8				8
Italy				7		8		15
United Kingdom		7		61		2		70
Total	2	31	3	224	2	34	7	289

Source: NBS.
„P" – via a branch, „SPS" – on the basis of free provision of cross-boarder services.

Table 26 **Individual countries' shares in the registered capital of individual types of financial institutions as at 31 December 2006** (%)

	Banks	Insurance companies[1]	Pension fund management companies	Supplementary pension companies	Asset management companies[1]	Securities dealers[1]
Slovakia	10.44	8.47	44.24	20.00	78.47	8.56
EU states (excl. SR)	85.82	87.67	28.01		21.53	87.41
Czech Rep.	7.85	1.21	6.48		10.34	6.91
France	0.63	0.99	0			0.68
Netherlands	1.38	13.38	18.75	40.00		1.52
Luxembourg	28.21	0.00	2.78			31.67
Hungary	4.52	1.26	0			5.04
Germany	1.94	40.43	0			
Austria	35.83	17.53	0			35.77
Italy	5.32	0.00	0			5.80
Portugal	0.08	0.00	0			
United Kingdom	0.07	8.07	0			0.02
Other		4.80	0		11.20	
Countries outside EU	3.74	3.86	27.75[2]	40.00[2]		4.03

Source: NBS.
Data in the table represent individual countries' shares in the registered capital of financial institutions according to the prime owner.
1) Data as at 31.12.2005.

Equally as insurance companies from other member countries are allowed to provide services in the SR, Slovak insurance companies are allowed to provide services in the territory of any of the EU or EEA member countries. Three insurance companies (Wüstenrot poisťovňa, a.s., QBE poisťovňa, a.s. and ING Životná poisťovňa, a.s.) provided services via their branches in the Czech Republic (this number has not changed during 2006). Ten Slovak insurance companies (in 2006, there were notifications by two insurance companies) are allowed to provide services in one or more countries of the EU on the basis of free provision of cross-boarder services. However, this services were in fact in the first three quarters provided (in the Czech Republic) only by five insurance companies (QBE poisťovňa, a.s., via its branch and on the basis of free provision of cross-boarder services, Wüstenrot poisťovňa, a.s., via its branch, ČSOB Poisťovňa, a.s., on the basis of free provision of cross-boarder services, Allianz – Slovenská poisťovňa, a.s., on the basis of free provision of cross-boarder services, and Union poisťovňa, a.s., on the basis of free provision of cross-boarder services).

The insurance sector also includes insurance intermediaries and re-insurance intermediaries. During 2006, a fundamental change took place in the sector of insurance and re-insurance intermediaries. On 1 September 2006, Act No. 340/2005 on insurance mediation and re-insurance mediation and on amendments to certain laws ("Act on insurance mediation and re-insurance mediation") came into force. This Act required insurance intermediaries to provide for their harmonisation with this Act by 31 December 2006 at the latest. At the same time, Register of Insurance and Re-insurance Mediation ("Register") was established. In this Register, all entities providing insurance and re-insurance intermediation according to Act on insurance mediation and re-insurance mediation are recorded. These entities provide services on the basis of a NBS licence (insurance agent, insurance broker, re-insurance intermediary) or without such a licence. In the latter case, services are provided exclusively for insurance companies (by an insurance intermediary) or exclusively for insurance intermediaries (by a subordinate insurance intermediary). Insurance intermediaries from other member countries that provide insurance mediation in the SR via branches or on the basis of free provision of cross-boarder services are registered as well. As at 31 December 2006, 12 267 insurance intermediaries were listed in the Register; 10 876 of which were registered during 2006. At the end of 2006, 16 008 subordinate insurance intermediaries were registered, 14 403 of which during this year. Altogether 304 entities requested for a licence to provide insurance-intermediation services in 2006, and the number of registered entities reached 307 at the end of the year. During 2006, 12 entities requested for a licence to provide insurance-broker services, and the number of registered insurance agents reached 13 at the end of the year. Only one entity requested for a licence to provide re-insurance intermediation services by the end of the year. At the end of 2005, 494 entities operated in the insurance market on the basis of a licence according to Art. 13 of Act No. 95/2002 Coll. on insurance and on amendments and supplements to certain laws ("Act on insurance"), and 4 entities that already provided

services according to the Act on insurance mediation and re-insurance mediation. Till the end of 2006, 316 entities have requested for a licence for provision of insurance-mediation services according to the Act on insurance mediation and re-insurance mediation. It should be noted that 178 entities did not request for a licence for provision of insurance-mediation services according to the above mentioned Act. The registration of insurance intermediaries from other member countries are for information purposes only, and these entities must be registered in their domestic country. The actual number of these entities is available on the NBS web site.

The main aim of the Act on insurance mediation and re-insurance mediation was to bring clarity to the structure of entities providing insurance intermediation. Issuing new licences for insurance agents and brokers put the number of intermediaries on insurance market down and it has become more transparent, which entities in fact provide these services. The registration of insurance intermediaries and subordinate insurance intermediaries has provided for their exclusivity, i.e. these entities are not allowed to provide the above mentioned services for more than one insurance company without additional licences. The Act on insurance mediation and re-insurance mediation enabled intermediaries from other member countries to operate in the Slovak insurance market, and enabled Slovak intermediaries to operate in the EU and EEA market. In addition, this Act regulates the conditions for the performance of activities of insurance agents and brokers (which have previously not been stipulated in provisions of the Act on insurance mediation and re-insurance mediation).

Ownership structure of supervised entities

Banking sector

As at 31 March 2006, Tatra banka, a.s. reported registered capital reduced by the value of priority shares (SKK 47.5 million) in accordance with adopted International Accounting Standards.

At Istrobanka, a.s., a change of shareholder was recorded – Bank für Arbeit und Wirtschaft und Österreichische Postsparkasse, AG, Austria - in accordance with the prior consent granted by Národná banka Slovenska, and which arose through the merger of Bank für Arbeit und Wirtschaft Aktiengesellschaft Österreichische Postsparkasse Aktiengesellschaft and Kapital & Wert Bank Aktiengesellschaft, Austria.

Istrobanka, a.s. reported as at 30 June 2006 registered capital increase of SKK 225.0 million and Tatra banka, a.s. of SKK 71.3 million.

The share of banks' registered capital held by foreign investors was reduced through the winding up of Calyon Bank Slovakia a.s., as a consequence of the bank enterprise's sale.

8.2 Analytical data

Banks and branches of foreign banks

Table 27 **Asset and liability structure of banks and branches of foreign banks**
(thousands of SKK)

	Total volume (as at 31.12.2006)	Share of a foreign currency	y/y change	Share in balance--sheet total	CR3	CR5	HHI
TOTAL ASSETS	1,466,136,833	15%	0%	100%	52%	67%	1,140
TOTAL LOANS TO CUSTOMERS	668,076,596	22%	20%	46%	47%	62%	1,009
Retail loans	239,308,511	2%	32%	16%	63%	81%	1,588
of which: loans to households	221,094,199	2%	33%	15%	64%	82%	1,639
Loans to enterprises	328,156,102	33%	20%	22%	43%	63%	981
Loans to non-banking financial companies	63,640,911	19%	15%	4%	47%	67%	1,081
Loans to general government	18,918,534	33%	-32%	1%	74%	87%	3,769
Loans to non-residents	18,052,538	77%	-2%	1%	47%	72%	1,228
TOTAL OPERATIONS ON THE INTERBANK MARKET	397,759,602	10%	-22%	27%	49%	67%	1,111
of which: operations with NBS and foreign issuing banks (incl. NBS bills)	298,782,885	0%	-28%	20%	52%	70%	1,251
TOTAL SECURITIES	329,821,465	9%	2%	22%	72%	80%	1,861
Securities issued by residents	272,094,462	4%	-1%	19%	76%	81%	2,030
Bills and bills of exchange held to maturity	2,409,394	11%	11%	0%	99%	100%	6,956
Government bonds	209,077,761	5%	3%	14%	76%	81%	2,182
Corporate bonds	6,977,846	16%	-10%	0%	67%	88%	1,824

Table 27 **Asset and liability structure of banks and branches of foreign banks (continuation)**
(thousands of SKK)

	Total volume (as at 31.12.2006)	Share of a foreign currency	Y/y change	Share in balance--sheet total	CR3	CR5	HHI
Bank bonds	24,860,356	0%	10%	2%	69%	83%	1,907
Other debt securities	23,099,281	0%	-31%	2%	100%	100%	10,000
Asset securities	5,669,824	0%	-6%	0%	82%	92%	3,434
Securities issued by non-residents	27,613,560	55%	-23%	2%	76%	88%	2,310
Debt securities	25,787,024	54%	-21%	2%	77%	90%	2,331
of which: issued by banks	13,067,060	23%	-12%	1%	78%	94%	3,023
of which: issued by general government	2,693,206	100%	-27%	0%	76%	100%	2,342
of which: other issuers	10,026,758	83%	-30%	1%	82%	96%	3,629
Asset securities	1,826,536	63%	-40%	0%	97%	100%	4,703
of which: issued by banks	20,936	44%	1355%	0%	100%	100%	4,584
of which: other issuers	1,805,600	64%	-41%	0%	97%	100%	4,705
Derivatives – positive fair value	30,113,443	7%	123%	2%	68%	87%	1,784
TOTAL LIABILITIES	1,407,956,850	20%	0%	100%	52%	67%	1,133
TOTAL DEPOSITS AND LOANS ACCEPTED FROM CUSTOMERS	925,952,293	13%	12%	66%	58%	69%	1,294
of which: deposits insured at the Deposit Protection Fund	482,331,232	10%	15%	34%	61%	75%	1,544
Retail deposits and loans accepted	455,922,545	9%	15%	32%	62%	76%	1,621
Deposits and loans accepted from households	418,411,818	9%	16%	30%	62%	76%	1,636
Deposits and loans accepted from enterprises	289,365,986	19%	15%	21%	53%	69%	1,344
Deposits and loans accepted from fin. co's other than banks	76,652,700	3%	15%	5%	47%	68%	1,081
Deposits and loans accepted from general government	87,726,600	27%	-6%	6%	85%	94%	2,771
Deposits and loans accepted from non-residents	16,284,462	51%	-27%	1%	51%	68%	1,180
TOTAL RESOURCES FROM BANKS	213,854,260	58%	-41%	15%	53%	68%	1,256
Resources from NBS and foreign issuing banks	3,294,623	1%	-46%	0%	98%	100%	7,754
Resources from non-resident banks	170,420,762	68%	-43%	12%	58%	72%	1,448
TOTAL SECURITIES ISSUED	123,322,814	13%	47%	9%	55%	74%	1,374
Mortgage bonds	64,822,536	15%	49%	5%	68%	84%	1,908
Bills of exchange	20,990,066	8%	63%	1%	56%	78%	1,445
Other securities issued	6,298,457	0%	4%	0%	84%	100%	2,827
Derivatives – negative fair value	31,211,755	16%	115%	2%	69%	88%	1,848
Risk-balanced assets of the banking book	690,764,161		18%	49%	51%	65%	1,078
Risk-balanced assets of the trading book	32,889,631		32%	2%	68%	85%	1,951
Other risk-balanced assets	5,560,261		-80%	0%	70%	84%	2,193
Own funds	79,756,246		2%	6%	48%	66%	1,059

Source: NBS.
Note: The calculation of CR 3, CR 5 and HHI covers only those institutions having a positive value of the given item. In the case of all institutions having an equal share, the HHI value would be 417, were the number of institutions is 24. Assets are expressed in the gross value; equality with liabilities is achieved by deducting the value of depreciation charges and provisions.

Table 28 **Revenue and expenditure of banks and branches of foreign banks**

(thousands of SKK)

		Value (as at 31.12.2006)	Value (as at 31.12.2005)	CR3	CR5	HHI
(a)	TOTAL OPERATING COSTS (b + e + f)	30,040,716	28,010,473	56%	68%	1,229
(b)	Administrative costs (c + d)	25,724,828	23,489,515	56%	68%	1,213
(c)	Purchased production	12,177,498	11,360,542	52%	66%	1,130
(d)	Staffing costs	13,547,330	12,128,973	59%	71%	1,304
(e)	Depreciation/amortisation of movable and immovable assets	4,116,558	4,393,253	60%	72%	1,439
(f)	Taxes and fees	199,330	127,705	64%	75%	2,372
(g)	GROSS INCOME (h + l)	55,081,640	42,673,741	56%	69%	1,240
(h)	Net interest income (j – i)	34,591,970	29,693,682	59%	70%	1,348
(i)	Interest costs	33,456,498	24,823,777	49%	69%	1,146
(j)	Interest yields	68,048,468	54,517,459	53%	67%	1,190
(k)	of which: interest yields from securities	12,636,611	16,255,412	71%	78%	1,800
(l)	Net non-interest income (m + n + o + p)	20,489,670	12,980,059			
(m)	Revenue from shares and ownership interests	456,330	98,091	87%	99%	3,172
(n)	Net income from fees	11,250,599	11,242,961	66%	77%	1,634
(o)	Net income from trading	7,463,565	8,060,150	49%	72%	1,309
(p)	Other net operating income	1,319,176	- 6,421,143			
(q)	NET INCOME (g – a)	25,040,924	14,663,268			
(r)	Net creation of prov's and net income from deprec. of receivables	2,496,483	- 1,037,336			
(s)	Net creation of reserves	146,591	- 541,976	162%	167%	274,087
(t)	NET PRE-TAX PROFIT (q – r – s)	22,397,850	16,242,580	59%	80%	1,499
(u)	Extraordinary profit	0	0			
(v)	Income tax	4,622,047	2,321,382	62%	83%	1,638
(w)	NET PROFIT AFTER TAX (t + u – v)	17,775,803	13,921,198	58%	79%	1,467

Source: NBS.
Note: The calculation of CR 3, CR 5 and HHI covers only institutions having a positive value of the given item. In the case of all institutions having an equal share, the HHI value would be 417, were the number of institutions is 24.

Table 29 **Profitability indicators of banks and branches of foreign banks and their distribution in the banking sector** (%)

	Denomina-tor- weighted average (31.12.2006)	Denominator weighted average (31.12.2005)	Average weighted by the volume of assets	Minimum	Lower quartile	Median	Upper quartile	Maximum
ROA	1.27	1.05	1.31	-34.57	0.23 (3)	0.66 (25)	1.16 (13)	19.11 (59)
ROE (excl. branches)	21.23	17.71	21.42	-2.86	7.71 (7)	10.04 (10)	14.26 (14)	98.35 (55)
Cost-to-income ratio	54.54	65.64	58.98	7.92	56.15 (46)	64.52 (34)	80.26 (15)	271.94 (5)
Relative significance of interest income	62.80	69.58	64.90	-7.25	58.92 (23)	69.87 (20)	79.06 (45)	124.58 (12)
Net interest spread	2.34	2.11	2.45	-0.16	1.38 (16)	2.12 (10)	2.91 (44)	10.06 (30)
Retail	5.81	6.44	5.96	-1.83	2.63 (10)	4.39 (18)	6.01 (9)	14.59 (62)
Enterprises	2.73	2.42	2.92	0.67	1.99 (26)	2.88 (21)	4.16 (22)	6.13 (30)
Financial companies	0.63	1.03	1.73	-1.34	-0.12 (21)	0.80 (9)	1.45 (26)	12.24 (38)
Banks incl. NBS and bills	0.08	-0.36	0.20	-6.07	-0.61 (28)	0.31 (20)	0.75 (29)	2.63 (22)
Net interest margin	2.42	2.15	2.51	-0.07	1.79 (15)	2.37 (12)	2.96 (42)	12.74 (30)

Source: NBS.
Note: Figures in brackets below the quartile values represent the share of banks (measured by volume of net assets) for which the value of the indicator lies between the value of the given quartile and the previous quartile.

Table 30 **Risk and capital adequacy indicators of banks and branches of foreign banks and their distribution in the banking sector** (%)

	Denominator--weighted average (31.12.2006)	Denominator--weighted average (31.12.2005)	Average weighted by volume of assets	Minimum	Lower quartile	Median	Upper quartile	Maximum	Number of breaches
CREDIT RISK									
Share of defaulted loans in the total volume of loans to customers	3.26	3.74	3.26	0.00	0.44 (9)	2.89 (44)	5.32 (31)	13.87 (16)	
Retail (share in loans to retail)	3.30	2.50	3.17	0.00	0.20 (6)	2.24 (43)	6.04 (43)	16.65 (8)	
Enterprises (share in loans to businesses)	4.00	5.93	3.71	0.00	0.00 (9)	2.64 (38)	4.46 (35)	15.92 (17)	
Financial companies (share in loans to financial companies)	0.10	0.13	0.11	0.00	0.00 (53)	0.00 (0)	0.01 (20)	2.43 (21)	
Share of provisions in the volume of defaulted loans to customers	101.68	84.03	131.10	65.11	79.05 (10)	95.53 (32)	129.47 (13)	537.45 (39)	
Large asset exposure (weighted)/ own funds (excl. branches)	216.43	160.34	232.60	0.00	120.56 (8)	262.32 (42)	329.75 (24)	398.18 (10)	
Large asset exposure within groups (number of breaches)									1
Share of claimable value of securities in the total volume of defaulted loans to customers	23.45	14.79	26.16	0.00	4.66 (28)	26.20 (14)	64.51 (28)	96.92 (21)	

Table 30 **Risk and capital adequacy indicators of banks and branches of foreign banks and their distribution in the banking sector (continuation)** (%)

	Denominator--weighted average (31.12.2006)	Denominator--weighted average (31.12.2005)	Average weighted by volume of assets	Minimum	Lower quartile	Median	Upper quartile	Maximum	Number of breaches
CURRENCY RISK									
Forex open balance-sheet position/ own funds (excl. branches)	0.49	-19.51	-3.16	-80.61	-1.63 (56)	0.00 (9)	20.99 (11)	103.25 (9)	
Forex open off-balance-sheet positi-on/own funds (excl. branches)	37.04	-32.86	51.39	-172.74	-32.66 (15)	0.00 (12)	45.28 (3)	277.49 (55)	
Total forex open position/own funds (excl. branches)	37.53	-52.38	48.23	-122.01	-2.14 (13)	9.93 (7)	54.26 (28)	196.88 (37)	
Total forex open position/own funds (excl. branches)	37.45	-68.98							
VaR/own funds (excl. branches)	-129.19	-19.51	-92.68	-3876.27	-5.69 (41)	0.00 (26)	10.75 (8)	77.33 (10)	
INTEREST RATE RISK									
Total interest-rate open position up to 1 month/own funds (excl. branches)	-63.92	-160.20	-46.98	-882.24	-283.33 (26)	-82.41 (10)	87.09 (10)	254.00 (39)	
Total interest-rate open position up to 1 year/own funds (excl. branches)	-52.25	-131.99	-43.66	-364.71	-58.11 (25)	-10.18 (20)	15.77 (7)	270.52 (33)	
Total interest-rate open position up to 5 years/own funds (excl. branches)	7.22	-64.06	1.83	-976.13	-47.09 (44)	33.33 (10)	72.05 (5)	548.80 (26)	
LIQUIDITY RISK									
Share of liquid assets in highly volatile funds	12.54	9.26	18.63	0.26	5.41 (24)	6.70 (27)	22.07 (30)	223.30 (15)	
Share of liquid assets (incl. collateral from reverse repo trades) in volatile funds	50.30	65.98	53.03	0.11	32.50 (13)	41.56 (25)	61.34 (46)	129.73 (16)	
Indicator of fixed and illiquid assets (excl. branches)	45.90	46.31	50.04	5.61	15.41 (10)	36.37 (21)	59.68 (23)	85.99 (30)	0
Share of loans in deposits and issued securities	63.67	61.42	72.14	32.11	55.38 (43)	72.47 (33)	98.11 (13)	703.67 (11)	
Total current liquidity position up to 7 days/assets	-38.54	-32.66	-38.54	-66.86	-44.82 (48)	-26.71 (35)	-1.28 (6)	192.86 (11)	
Total estimated liquidity position up to 7 days/assets	-4.38	-2.04	-4.38	-47.74	-18.40 (17)	-5.19 (45)	2.67 (11)	192.86 (27)	
Total current liquidity position up to 3 months/assets	-43.24	-36.12	-43.24	-65.16	-43.54 (51)	-31.32 (31)	-6.93 (8)	198.32 (10)	
Total estimated liquidity position up to 3 months/assets	-9.17	-4.23	-9.17	-43.27	-19.49 (29)	-7.69 (33)	2.39 (26)	198.32 (12)	
CAPITAL ADEQUACY									
Capital adequacy (excl. branches)	12.98	14.79	12.88	9.12	12.15 (46)	18.76 (25)	21.28 (7)	32.11 (7)	0
Share of Tier I in own funds (excl. branches)	94.41	90.27	94.04	63.23	91.33 (27)	99.36 (40)	100.00 (9)	100.00 (9)	
Share of own funds in balance-sheet total (excl. branches)	7.93	7.42	6.69	4.13	6.10 (59)	9.10 (10)	10.38 (10)	19.23 (6)	
Share of potential losses in own funds when reaching 8% capital adequacy (excl. branches)	38.38	42.21	31.49	12.26	34.15 (46)	57.35 (25)	62.41 (7)	75.09 (7)	

Source: NBS.
Note: Figures in brackets below the quartile values represent the share of banks (measured by the volume of net assets) for which the value of the indicator lies between the value of the given quartile and the previous quartile.

Insurance companies

Table 31 **Net profit and profitability indicators of insurance companies** **(thousands of SKK)**

	Value as at 31.12.2006	Value as at 31.12.2005	Y/y change	Share in total premium written	CR3	HHI 31.12.2006	HHI 31.12.2005
Total net profit	4,463,660	3,125,332	61%	8.33%	81%	2,530	4,854
Gross profit from non-life insurance	2,229,990	3,598,636	-37%	4.16%	99%	4,610	9,941
Gross profit from life insurance	-1,198,056	1,540,869	-173%	-2.24%	65%	6,776	3,892
Gross operating expenses to premium written	37.49%	27.30%					
ROA	3.05%	2.53%					
ROE	15.87%	13.75%					

Source: NBS.
Note: The calculation of CR 3, CR 5 and HHI covers only institutions having a positive value of the given item. In the case of all institutions having an equal share, the HHI value would be 417, were the number of institutions is 24.

Table 32 **Premium written** **(thousands of SKK)**

	Value as at 31.12.2006	Value as at 31.12.2005	Y/y change	Share in total premium written	CR3	HHI 31.12.2006	HHI 31.12.2005
Total	53,584,089	51,678,114	3.69%	100.00%	61%	1,770	1,921
Life insurance	25,331,849	21,916,397	15.58%	47.27%	57%	1,415	1,391
Total life and endowment assurance (A1)	16,748,967	14,921,419	12.25%	31.26%	61%	1,431	1,462
Insurance connected with an investment fund (A4)	5,173,038	3,800,689	36.11%	9.65%	36%	3,395	2,738
Accident or sickness insurance (A6)	2,661,665	2,471,093	7.71%	4.97%	68%	1,684	1,678
Other	748,179	723,196	3.45%	1.40%	76%	6,007	4,669
Non-life insurance	28,252,240	29,761,716	-5.07%	52.73%	65%	2,403	2,677
Motor third-party liability insurance (B10a)	9,740,670	11,576,274	-15.86%	18.18%	71%	2,685	3,253
Motor-full insurance (B3)	8,222,664	8,716,195	-5.66%	15.35%	66%	2,483	2,700
Property damage insurance (B8+B9)	6,236,000	6,041,322	3.22%	11.64%	65%	2,657	2,645
Other	4,052,906	3,427,925	18.23%	7.56%	50%	2,068	1,725
Share of premium written to GDP	3.27%	3.59%					

Source: NBS.
Note: The calculation of CR 3, CR 5 and HHI covers only institutions having a positive value of the given item. In the case of all institutions having an equal share, the HHI value would be 417, were the number of institutions is 24.

Table 33 **Premium written ceded to reinsurers** **(thousands of SKK)**

	Value as at 31.12.2006	Value as at 31.12.2005	Y/y change	Share in total premium written
Total	10,236,541	10,280,871	-0.43%	19.10%
Life insurance	1,375,022	1,343,203	2.37%	5.43%
Non-life insurance	8,861,519	8,937,668	-0.85%	31.37%

Source: NBS.
Note: The calculation of CR 3, CR 5 and HHI covers only institutions having a positive value of the given item. In the case of all institutions having an equal share, the HHI value would be 417, were the number of institutions is 24.

Table 34 **Indemnity costs** **(thousands of SKK)**

	Value as at 31.12.2006	Value as at 31.12.2005	Y/y change	Share in total premium written	CR3	HHI 31.12.2006	HHI 31.12.2005
Total	21,198,896	17,416,128	21.72%	39.56%	67%	2,573	2,599
Life insurance	9,374,002	7,267,476	28.99%	17.49%	67%	3,806	3,252
Whole life and endowment assurance (A1)	7,500,440	5,620,874	33.44%	14.00%	69%	4,146	3,241
Insurance connected with an investment fund (A4)	832,574	749,201	11.13%	1.55%	36%	6,420	5,953
Accident or sickness insurance (A6)	556,269	433,514	28.32%	1.04%	66%	2,292	1,760
Other	484,719	463,886	4.49%	0.90%	86%	6,978	7,476
Non-life insurance	11,824,894	10,148,653	16.52%	22.07%	68%	2,488	2,499
Motor third-party liability insurance (B10a)	3,648,460	3,140,434	16.18%	6.81%	74%	2,837	3,089
Motor-full insurance (B3)	5,407,483	4,201,731	28.70%	10.09%	64%	2,315	2,335
Property damage insurance (B8+B9)	1,861,402	1,509,647	23.30%	3.47%	75%	3,169	2,829
Other	907,549	1,296,840	-30.02%	1.69%	55%	2,481	1,951

Source: NBS.
Note: The calculation of CR 3, CR 5 and HHI covers only institutions having a positive value of the given item. In the case of all institutions having an equal share, the HHI value would be 417, were the number of institutions is 24.

Table 35 **Loss ratio in non-life insurance** **(%)**

	Values as at 31.12.2006	Values as at 31.12.2005
Total	45.75	38.85
Motor third-party liability insurance (B10a)	38.22	42.07
Motor-full insurance (B3)	71.59	46.17
Property damage insurance (B8+B9)	37.25	26.62
Other	23.05	28.73

Source: NBS.

Table 36 **Technical provisions structure of insurance companies** **(thousands of SKK)**

	Value as at 31.12.2006	Value as at 31.12.2005	Y/y change	Share in total provisions
Total	103,821,428	89,995,824	15.36%	100.00%
Life insurance	65,820,081	58,946,297	11.66%	63.40%
Reserve for covering payables from financial placement on behalf of the insured	9,675,955	7,460,748	29.69%	9.32%
Non-life insurance	28,325,392	23,588,780	20.08%	27.28%
Share of technical provisions to GDP	5.80%	5.84%		

Source: NBS.
Note: The calculation of CR 3, CR 5 and HHI covers only those institutions having a positive value of the given item. In the case of all institutions having an equal share, the HHI value would be 417, were the number of institutions 24.

Table 37 **Allocation of insurance companies' technical provisions except for provisions for covering payables from financial placement on behalf of the insured** **(thousands of SKK)**

	Value as at 31.12.2006	Value as at 31.12.2005	Y/y change	Share in total provisions
Total	90,476,298	83,694,862	8.10%	104.00%
Government and central bank bonds of SR/EU states or guaranteed by the SR, EIB, EBRD and IBRD bonds	45,789,758	42,696,436	7.24%	52.63%
Bank bonds	14,191,292	11,448,181	23.96%	16.31%
Term accounts at banks	8,350,477	12,140,888	-31.22%	9.60%
Mortgage bonds	11,735,595	8,389,370	39.89%	13.49%
Other	10,409,175	9,019,987	15.40%	11.96%

Source: NBS.
Note: The calculation of CR 3, CR 5 and HHI covers only institutions having a positive value of the given item. In the case of all institutions having an equal share, the HHI value would be 417, were the number of institutions is 24.

Old-age pension saving

Table 38 **Pension fund management companies as at 31 December 2006** **(thousands of SKK)**

	Market share[1]	NAV of funds	Number of customers
Allianz – Slovenská DSS	30%	8,452,009	461,535
Winterthur DSS	28%	7,827,543	416,340
VÚB Generali DSS	15%	4,228,487	199,971
ING DSS	11%	3,074,588	158,381
AEGON DSS	10%	2,774,414	201,763
ČSOB DSS	6%	1,590,419	101,541

Source: NBS.
1) Market shares are calculated according to the total net asset value (NAV) of funds of the given pension fund management company.
NAV – Net Asset Value

Table 39 **Financial results of pension fund management companies as at 31 December 2006** **(thousands of SKK)**

	Revenue	Expenditure	Profit/loss	ROA	ROE
Allianz – Slovenská DSS	112,148	368,302	-256,154	-15%	-14%
Winterthur DSS	168,655	385,873	-217,218	-	-
VÚB Generali DSS	66,233	-169,762	-103,529	-35%	-37%
ING DSS	62,399	321,204	-258,804	-36%	-49%
AEGON DSS	35,194	1,134,539	-1,099,345	-	-
ČSOB DSS	26,518	-167,129	-140,611	-31%	-32%

Source: NBS.

Table 40 **Pension funds** **(thousands of SKK)**

	NAV as at 31.12.2006
Total	27,947,460
Conservative	1,134,044
Balanced	8,410,626
Growth	18,402,790

Source: NBS.
NAV – Net Asset Value

Table 41 **Structure of pension funds' investment** **(thousands of SKK)**

	Value as at 31.12.2006	Share of EUR	Share of other foreign currencies
Total	27,947,460	9.12%	6.95%
Bank accounts	13,323,069	0.10%	0.10%
Bonds	10,684,821	0.00%	1.07%
Shares	2,813,408	49.30%	50.49%
Other	1,618,870	71.00%	24.41%
Payables	-492,708	0.00%	0.00%

Source: NBS.

Table 42 **Supplementary pension companies as at 31 December 2006** **(thousands of SKK)**

	Market share[1]	NAV of funds	Number of customers
ING Tatry – Sympatia, d.d.s., a.s.	42%	9,046,181	395,447
Doplnková dôchodková spoločnosť Tatra banky, a.s.	26%	5,454,756	187,333
DDP Stabilita[2]	20%	4,300,000	140,395
Winterthur d.d.s., a.s.	12%	2,542,813	133,603

Source: NBS.
1) Market shares are calculated according to the total net asset value (NAV) of funds of the given pension fund management company.
2) Data for DDP Stabilita are estimated as it has not finished its transformation yet.
NAV – Net Asset Value

Table 43 **Financial results of supplementary pension companies as at 31 December 2006** **(thousands of SKK)**

	Revenue	Expenditure	Profit/loss	ROA	ROE
ING Tatry – Sympatia, d.d.s., a.s.	272,666	248,706	23,960	6%	14%
Doplnková dôchodková spoločnosť Tatra banky, a.s.	67,332	58,790	8,542	7%	13%
Winterthur d.d.s., a.s.	46,011	46,276	-265	-	-

Source: NBS.

Table 44 **Supplementary pension funds** **(thousands of SKK)**

	NAV as at 31.12.2006
Total	17,043,750
Contribution	16,458,918
Payroll	584,832

Source: NBS.
NAV – Net Asset Value

Table 45 **Investment structure of supplementary pension funds** **(thousands of SKK)**

	Value as at 31.12.2006	Share of EUR	Share of other foreign currencies
Total	17.043.750	3.82%	3.31%
Bank accounts	6,325,419	0.08%	0.17%
Bonds	9,584,018	0.00%	0.00%
Shares	1,057,890	54.35%	45.65%
Other	150,076	47.55%	46.61%
Liabilities	-73,654	0.00%	0.16%

Source: NBS.

Collective investment

Table 46 **Asset management companies as at 31 December 2006** **(thousands of SKK)**

Asset management company	NAV of mutual funds	Market share
Total	106,148,934	100.00%
Tatra Asset Management	39,362,628	37.08%
Asset Management SLSP	28,794,430	27.13%
VÚB Asset Management	24,053,348	22.66%
ČSOB Asset Management	4,643,643	4.37%
Prvá Penzijná	3,926,375	3.70%
Istro Asset Management	2,336,592	2.20%
AIG Funds Central Europe	2,166,504	2.04%
OTP Asset Management	350,678	0.33%
Investičná a dôchodková	301,588	0.28%
KD Investments	213,149	0.20%

Source: NBS.
NAV – Net Asset Value

Table 47 **Expenditure, revenue and profitability indicators of domestic asset management companies as at 31 December 2006** **(thousands of SKK)**

Asset management company	Revenue	Expenditure	Profit/loss	ROA	ROE
Total	1 568 636	1 326 334	242 302	18,64 %	21,84 %
AIG Funds Central Europe	52 205	51 034	1 171	1,54 %	1,84 %
Asset Management SLSP	434 275	373 946	60 329	26,84 %	36,77 %
ČSOB Asset Management	105 645	67 084	38 561	25,28 %	28,45 %
Investičná a dôchodková	11 601	11 978	-377	-0,54 %	-0,55 %
Istro Asset Management	41 868	34 012	7 856	9,14 %	9,96 %
KD Investments	12 343	26 896	-14 553	-26,26 %	-29,14 %
OTP Asset Management	4 512	12 150	-7 638	-20,58 %	-21,56 %
Prvá Penzijná	75 297	52 467	22 830	19,95 %	22,74 %
Tatra Asset Management	507 901	394 528	113 373	30,28 %	34,86 %
VÚB Asset Management	322 989	302 239	20 750	18,93 %	23,56 %

Source: NBS.

Table 48 **Structure of mutual funds as at 31 December 2006** **(thousands of SKK)**

Fund type	Market share	Net asset value	Number of funds	CR3[1]	CR5[1]	HHI[1]	HHI if uniform distribution
Total mutual funds	100.00%	130,120,404	467	31%	40%	460	21
Domestic	81.58%	106,148,934	107	38%	49%	678	93
Money market funds	36.72%	47,782,622	9	84%	96%	2,581	1,111
Bond funds	15.50%	20,163,062	12	73%	89%	2,090	833
Equity funds	9.48%	12,334,351	13	64%	93%	1,828	769
Mixed funds	5.78%	7,523,504	12	60%	81%	1,570	833
Funds of funds	11.93%	15,528,859	14	55%	80%	1,435	714
Other funds	1.03%	1,343,098	2	100%	100%	9,947	5,000
Special funds	0.42%	543,671	1	100%	100%	10,000	10,000
Closed funds	0.71%	929,767	44	-	-	-	-
Foreign[2]	18.42%	23,971,469	360	24%	33%	320	28
Money market funds	2.79%	3,626,104	23	84%	94%	5,153	435
Bond funds	3.20%	4,159,281	88	45%	63%	1,061	114
Equity funds	7.57%	9,845,651	169	43%	55%	820	59
Mixed funds	0.76%	984,363	31	82%	88%	2,601	323
Funds of funds	0.75%	972,197	23	91%	96%	3,844	435
Other funds	3.37%	4,383,874	26	29%	44%	642	385

Source: NBS.
Note: The calculation of CR 3, CR 5 and HHI covers only those institutions having a positive value of the given item. In the column "HHI if uniform distribution" the HHI value is that which would express the concentration in the case of a uniform distribution of the net asset value in the given group of funds.
1) Market concentrations are calculated only for open-end mutual funds (do not include closed and special funds).
2) For foreign mutual funds, the net asset value represents units sold in the Slovak Republic.

Table 49 **Net sales of open-end mutual funds as at 31 December 2006** **(thousands of SKK)**

	3 months	1 year	Cumulative	Number of funds	CR3	CR5	HHI	HHI if uniform distribution
Total open-end mutual funds	4,351,525	-2,607,189	114,573,938	423	76%	83%	2,507	24
Domestic	4,220,872	-4,775,500	92,700,335	63	87%	92%	3,255	159
Money market funds	6,060,398	-4,156,891	45,222,816	9	99%	100%	4,214	1,111
Bond funds	-1,804,383	-14,516,729	18,963,193	12	100%	100%	10,000	833
Equity funds	152,819	2,814,034	10,851,690	13	92%	99%	3,416	769
Mixed funds	-397,720	1,033,425	1,017,074	12	100%	100%	4,129	833
Funds of funds	198,904	8,787,884	14,869,264	14	75%	92%	2,250	714
Other funds	10,854	1,262,776	1,276,298	2	100%	100%	10000	5,000
Special funds	0	0	500,000	1	-	-	-	10,000
Foreign	130,653	2,168,311	21,873,603	360	51%	59%	1,368	28
Money market funds	343,276	-1,133,734	3,370,879	23	100%	100%	7,189	435
Bond funds	-88,916	-2,332,167	2,791,526	88	78%	89%	2,378	114
Equity funds	-216,623	4,623,810	9,960,411	169	42%	48%	1,144	59
Mixed funds	108,667	288,696	983,275	31	49%	70%	1,223	323
Funds of funds	27,231	198,058	808,868	23	90%	100%	3,555	435

Source: NBS.
Note: The calculation of CR 3, CR 5 and HHI covers only institutions having a positive value of the given item. In the column "HHI if uniform distribution" the HHI value is that which would express the concentration in the case of a uniform distribution of the net asset value in the given group of funds.

Table 50 **Average performances of open-end mutual funds as at 31 December 2006** **(% p.a.)**

	3 months			1 year			3 years		
	Min.	Average	Max.	Min.	Average	Max.	Min.	Average	Max.
Total open-end mutual funds	-14.98	0.84	11.04	-18.90	2.47	36.39	-21.59	4.09	44.14
Domestic	-10.85	0.86	9.62	-16.43	2.00	13.14	-5.39	3.68	11.81
Money market funds	-0.92	1.09	1.31	-0.08	2.37	2.69	1.28	3.12	3.23
Bond funds	-10.85	0.16	1.65	-16.43	-0.90	1.90	-5.39	3.62	6.88
Equity funds	-7.91	-1.38	9.62	-15.46	-1.55	6.23	-1.49	6.30	11.81
Mixed funds	-2.62	-0.47	3.91	-4.40	1.39	13.14	1.89	4.54	6.87
Funds of funds	1.55	3.17	4.78	2.77	6.93	10.26	-	-	-
Other funds	2.97	2.97	2.97	-	-	-	-	-	-
Special funds	4.47	4.47	4.47	-	-	-	-	-	-
Foreign	-14.98	0.74	11.04	-18.90	4.44	36.39	-21.59	5.82	44.14
Money market funds	-14.55	-0.55	1.19	-15.60	0.69	2.92	-19.89	0.03	3.16
Bond funds	-14.98	-1.96	5.10	-18.27	-3.63	12.64	-20.03	-5.21	4.47
Equity funds	-11.72	2.50	11.04	-18.90	11.88	36.39	-21.59	16.07	44.14
Mixed funds	-10.19	-3.99	0.62	-9.19	-3.17	3.85	-17.97	-10.07	-5.59
Funds of funds	-6.45	-5.23	-2.74	-9.46	-4.74	0.41	-16.22	-10.34	-4.54
Other funds	-8.57	3.04	6.81	-13.62	1.16	12.19	5.84	10.02	10.02

Source: NBS.
p. a. – per annum

Table 51 **Asset structure of domestic mutual funds as at 31 December 2006 (thousands of SKK)**

	Money market funds	Other funds
Total	48,698,891	60,561,239
Bank deposits	17,959,445	5,639,995
Securities other than shares and mutual fund certificates	30,062,736	27,391,878
Shares and mutual fund certificates	0	15,522,253
Shares and other ownership interests	0	10,811,579
Financial derivatives	32,101	979,265
Other assets	644,609	216,270

Source: NBS.

Securities dealers

Table 52 **Basic characteristics of securities dealers as at 31 December 2006** **(thousands of SKK)**

	Volume of trades	Market share	Volume of assets managed	Market share
Banks and branches of foreign banks	1,712,486,379	95%	2,170,306	8%
SD with capital over SKK 35 mil.	78,951,462	5%	1,519,170	5%
Others	18,239,432	1%	24,629,504	87%

Source: NBS.
Note: Securities dealers are divided in the table by the size of their registered capital.

Table 53 **Market concentrations by securities dealers' trading volumes[1]** **(thousands of SKK)**

	Number of traders	CR3	CR5	HHI
Total	34	75%	84%	3,078
Banks and branches of foreign banks	16	80%	90%	3,500
SD with capital over SKK 35 mil.	8	94%	98%	3,791
Others	10	74%	100%	2,251

Source: NBS.
Note: The calculation of CR 3, CR 5 and HHI covers only institutions having a positive value of the given item.
1) Market concentrations are calculated from data for the second quarter of 2006.
2) Securities dealers that are not banks and have a minimum registered capital of SKK 35 or 6 million. The difference between these two categories of securities dealers lies in the fact that the securities dealers with minimum registered capital of SKK 6 million are not licensed for providing IS-3 investment services (accepting a customer's instruction for the acquisition or sale of an investment instrument and its execution on the own account).

Table 54 **Volume of trades by individual investment services as at 31 December 2006** **(thousands of SKK)**

	IS – 1	IS – 2	IS – 3
Total trades	64,224,435	1,031,565,264	713,887,574
Shares	9,498,151	17,288,568	841,593
Bonds	1,344,886	835,637,772	20,421,652
Mutual fund certificates	17,019,121	4,959,057	0
Fungible securities	0	0	0
Foreign securities	23,662,059	47,512,702	9,247,156
Money market instruments	2,058,085	744,554	173,508,690
Futures	9,201,335	0	0
Forward	0	61,776,312	221,993,205
Swaps	1,440,798	25,551,549	83,451,551
Options	0	38,094,751	203,721,249
Combinations	0	0	702,478

Source: NBS.
IIS-1 – acceptance of a customer's instruction to acquire, sell or otherwise handle the investment instrument and the subsequent forwarding of the customer's instruction for the purpose of its realisation.
IS-2 – acceptance of a customer's instruction to acquire or sell the investment instrument and its realisation on an account other than the provider's account.
IS-3 – acceptance of a customer's instruction to acquire or sell the investment instrument and its realisation on own account.

Table 55 **Capital adequacy** **(%)**

	Min	Median	Max
Registered capital of SKK 35 mill.	22	65	171
Registered capital of SKK 6 mill.	36	97	491

Source: NBS.

Stock exchange

Table 56 **Market capitalisation as at 31 December 2006** **(thousands of SKK)**

	Listed	Open market	Total	Proportion to GDP
Total securities	494,416,551	87,328,386	581,744,937	36%
Shares	85,541,616	67,469,709	153,011,325	9%
Bonds	408,874,935	19,858,677	428,733,612	26%

Source: NBS.

Table 57 **Volume of trades** **(thousands of SKK)**

	Listed	Not listed	Total
Total securities	991,077,537	978,276	992,055,814
Shares and mutual fund certificates	1,631,443	969,038	2,600,481
Price-setting trades	830,474	407,813	1,238,287
Direct trades	800,969	561,225	1,362,194
Bonds	989,446,094	9,238	989,455,332
Price-setting trades	5,655,360	8,491	5,663,851
Direct trades	983,790,734	747	983,791,481

Source: NBS.

Table 58 **Development of market indices**

Date	SDX Group – public sector	SDX Group – private sector	SAX
23.12.2004	110.16	109.48	326.63
31.03.2005	115.22	111.30	448.69
30.06.2005	117.81	113.21	436.11
30.09.2005	118.95	114.73	459.74
23.12.2005	117.06	115.60	413.31
31.03.2006	114.94	116.28	417.17
30.06.2006	111.93	115.67	377.21
29.09.2006	115.89	115.16	406.50
22.12.2006	118.88	117.66	415.61

Source: NBS.

Central Securities Depository

Table 59 **Number of registered issues and issuers by individual types of securities**

Securities type	Number of issues	Number of issuers[1]	Volume[2]
Securities in total	3,329	2,366	1,025,336,103
Shares	2,292	1,658	540,602,895
Bonds	360	195	471,787,932
Mutual fund certificates	64	61	741,646
Cooperative shares	612	509	11,903,539
Other securities	1	1	300,090

Source: NBS.
1) The sum of issuers according to individual types of securities does not correspond to the total number of issuers, since some issuers issued several types of securities (shares, bonds).
2) The volume of securities in thousands of SKK, converted at the NBS official rate.

Investment Guarantee Fund

Table 60 **Basic characteristics of the Investment Guarantee Fund**

(thousands of SKK)

Date	Fund's yields[1]	Fund's expenses	Fund's cumulative value	Customer assets	Maximum level of compensation
30.6.2006	11,456	2,148	26,694	9,257,913	1,598,459
31.12.2006	15,689	15,689	37,841	13,165,794	2,226,497

Source: NBS.
Note: The Investment Guarantee Fund gathers financial resources of securities dealers, foreign securities dealers, and asset management companies providing selected investment services for the purpose of providing compensations for inaccessible customer assets accepted by a securities dealer, foreign securities dealer, or asset management company for performance of an investment service, and handles the funds acquired in accordance with the Securities Act. The Investment Guarantee Fund was established by the Act on Securities. The activity of the Investment Guarantee Fund is governed in the Securities Act, Articles 80 to 98.
1) Comprising the received contributions paid to the IGF and revenue from interest on current and term IGF account.

Glossary and abbreviations

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Glossary

Households – the population, i.e. individuals' accounts

Retail – households, sole traders and non-profit companies serving prevailingly households

Enterprises – non-financial companies

Non-banking financial companies (NBFCs) – other financial companies, financial intermediaries, pension and mutual funds, insurance companies

General government – central and local government bodies

Quick liquidity ratio – liquid assets/highly volatile funds

Total net position – the sum of the net balance-sheet position and net off-balance-sheet position

CR n index – the concentration of the *n* largest banks, i.e. the sum of the shares of their assets in total assets

Net balance-sheet position – the difference between forex assets and liabilities in the balance sheet

Net off-balance-sheet position – the difference between forex assets and liabilities in the off-balance sheet

Cost-to-income ratio – the share of total operating costs and net income from banking activities (purchased production + staff costs + social costs + depreciation of tangible and intangible assets + taxes and fees/ revenue from shares and ownership interests + net income from fees and commissions + net income from the securities operations + net income from derivatives operations + net income from the forex operations + net income from other operations)

Household disposable income – is calculated as the sum of the components of gross personal income of all household members (gross financial income from employment and closely related income, and gross non--financial income from employment, gross financial gains or losses from self-employment (including royalties and fees), unemployment benefits, old-age pension benefits, the survivor's pension benefits, sickness benefits, invalidity benefits and contributions for education) plus components of the gross income at the household level (income from rented assets or land, family benefits and allowances paid to families with children, the social exclusion not classified elsewhere, housing benefits, regularly received financial transfers between households, interest, dividends, profit from capital investment in a non-registered business, income of persons younger than 16 years of age, less regular property taxes, regularly paid financial transfers between households, income tax, and social insurance contributions)

Long position – a position in which assets outweigh liabilities

Herfindahl index – the sum of the squares of the shares of individual banks' assets in total assets

Short position – a position in which liabilities outweigh assets

Cumulative gap – the sum of open positions (long or short) in certain time bands

Liquidity up to 7 days and up to 3 months – the share of liquid assets and volatile funds, where liquid assets include cash in hand, the bank's current accounts at other banks and all Treasury bills and government bonds on which no charge is established, including those that the bank acquired in reverse repo trades, all claims against customers and banks with a residual maturity of up to 7 days, or up to 3 months and volatile funds are the sum of payables towards banks and customers up to 7 days, or 3 months

Liquidity cushion – the sum of cash in hand, government bonds, Treasury bills and NBS bills, loans to foreign banks, deposits at NBS and the volume of assets on the domestic interbank market after deducting banks' payables towards NBS, foreign banks and the DLMA (Public Debt and Liquidity Management Agency)

Loan-to-deposit – the share of loans to customers in the sum of deposits from retail, enterprises and financial companies plus issued mortgage bonds

Loan-to-value ratio – the proportion of the volume of a provided loan and the value of its security

Default rate – expresses the percentage of loans defaulting over the period monitored

The open position for up to 3 months – the difference between, on the one hand, the sum of claims against customers and debt securities issued by banks and enterprises which have a residual maturity of up to 3 months, and, on the other hand, the sum of liabilities towards customers and issued securities which have a residual maturity of up to 3 months

Unit-linked provision – technical provision that is created for life insurance linked with investment fund in insurance branch A4

Defaulted loans – loans in the case of which the bank has identified a loss in value of more than 50% or where the debtor is in more than 90 days' arrears with payment

List of insurance categories

A. Life insurance

1. Whole-life insurance, pure endowment insurance or whole-life and endowment insurance (A1)
2. Child's deferred insurance, insurance of funds for child's maintenance (A2)
3. Insurance connected with capitalisation policies (A3)
4. Insurance according to points 1 and 3 connected with an investment fund (A4)
5. Pension insurance (A5)
6. Accident or sickness insurance, if it is an additional insurance according to a type stated in points 1 to 4 (A6)

B. Non-life insurance

1. Accident insurance (B1)
2. Sickness insurance (B2)
3. Non-rail land vehicle-full insurance (B3)
4. Rail vehicle-full insurance (B4)
5. Aircraft insurance (B5)
6. Watercraft insurance (B6)
7. Transportation and baggage insurance (B7)
8. Insurance of property other than that stated in points 3 to 7, caused by fire, explosion, storm, natural hazards other than storms, nuclear energy and land slide (B8)
9. Insurance of other damage to property than that stated in points 3 to 7, arisen through hailstorm or freezing, or other causes (e.g. theft), unless these causes are included in point 8 (B9)
10. a) Motor third-party liability insurance (B10a)
10. b) Carrier liability insurance (B10b)

11. Liability insurance for ownership or use of aircraft, including carrier's liability (B11)
12. Liability insurance for ownership or use of watercraft, including carrier's liability (B12)
13. General liability insurance for damage other than stated in points 10 to 12 (B13)
14. Credit insurance (B14)
15. Surety insurance (B15)
16. Insurance of various financial losses resulting from performing an occupation, insufficient income, poor weather conditions, loss of profit, permanent general costs, unexpected business expenditure, loss of market value, loss of regular income, other indirect commercial financial loss and other financial losses (B16)
17. Legal protection insurance (B17)
18. Travel assistance insurance (B18)

Abbreviations

Countries

AT	Austria
BE	Belgium
CY	Cyprus
CZ	the Czech Republic
DE	Germany
DK	Denmark
EE	Estonia
ES	Spain
FI	Finland
FR	France
GR	Greece
HU	Hungary
IE	Ireland
IT	Italy
LT	Lithuania
LU	Luxembourg
LV	Latvia
MT	Malta
NL	the Netherlands
PL	Poland
PT	Portugal
SE	Sweden
SI	Slovenia
SK	Slovakia
UK	the United Kingdom

Others

AAMC	Association of Asset Management Companies
ALC	Association of Leasing Companies
ALCO	Assets and liabilities committee
AM	asset management
BIS	Bank for International Settlement
BRIBID	Bratislava interbank bid rates
BRIBOR	Bratislava interbank offered rates
BSSE	Bratislava Stock Exchange
CSD	Central Securities Depository
DLMA	Debt and Liquidity Management Agency
FC	foreign currency
CPI	consumer price index
EBOR	European Bank for Reconstruction and Development
ECB	European Central Bank
EIB	European Investment Bank
EMU	European Monetary Union
EU	European Union
EUR	euro
GDP	gross domestic product
HHI	Herfindahl index
IBRD	International Bank for Reconstruction and Development
IFRS	International Financial Reporting Standards

IGF	Investment Guarantee Fund
IMF	International Monetary Fund
MIM	metainformation system
NAV	net asset value
NBS	Národná banka Slovenska (National Bank of Slovakia)
O/N	overnight interest rate
p. p.	percentage point
PC	provision for claims
PUP	provision for unearned premium
ROA	return on assets
ROE	return on equity
RWA	risk weighted assets
SAX	Slovak Stock Index
SD	securities dealer
SDX	Slovak Bond Index
SKK	Slovak koruna
SME	Small and medium-sized enterprises
SR	Slovak Republic
VaR	value at risk

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