NBS Monetary Operations

3 NBS Monetary Operations, Foreign Exchange Operations and Investment Activities in Foreign Exchange Reserve Management

3.1 Monetary policy operations

Monetary policy implementation underwent several changes in 2005. They mainly applied to the decision-making process used in monetary policy operations and the terms and conditions of specific NBS transactions.

The first significant change introduced by the NBS in February 2005 was target-based decision-making on monetary policy implementation. Decisions are taken at dates fixed in advance according to the plan of Bank Board meetings. This method is based on the directed monitoring of economic and monetary developments, including the price transmission mechanism and its impact on domestic financial markets. The qualitative evaluation of data obtained from such monitoring and the causes of changes in price developments on domestic financial markets are decisive factors in the process of decision-making by the Bank Board of the NBS.

Chart 36 **Required reserves and autonomous liquidity factors in 2005 (SKK millions)**

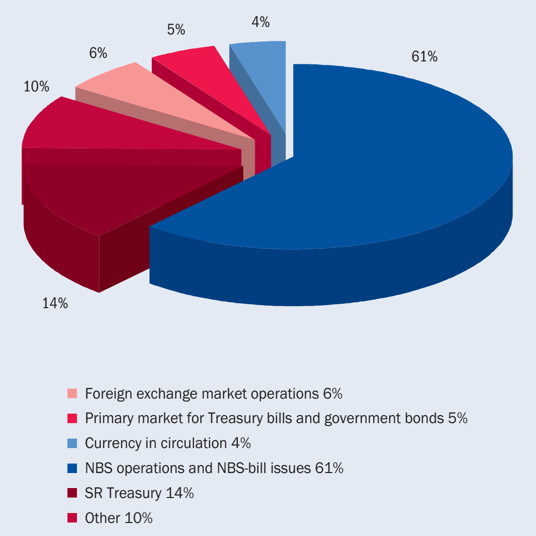
Source: NBS.

arising from ESCB membership, the NBS decided to modify the rules governing the conduct of monetary policy operations and the payment and securities settlement of such operations (with effect from January 2005). Subject to change were, for example, the selection of banks or other financial institutions for selected monetary policy operations and the selection of financial assets that are eligible in operations for monetary purposes. The NBS also decided to change the rules of risk management, including the rule prohibiting monetary financing of the public sector (Articles 101 and 102 of the EU Treaty). All these changes were published in NBS directives No. 1/2005 and 2/2005. With effect from 2005, the NBS also decided to make adjustments affecting the quality and price of services related to the central register of short-term securities, which is kept at the NBS.

Banking system liquidity management

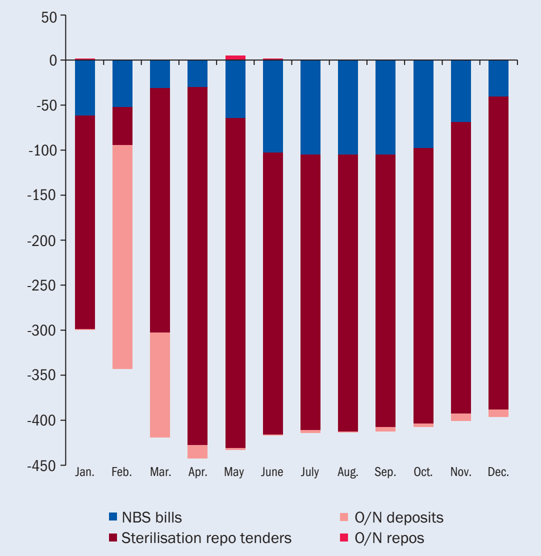
The monitoring of supply and demand in the banking sector in connection with operations with the central bank is subject to daily liquidity assessment in this sector and is also subject to the decisions of the Bank Board concerning the scope of interventions and the types of operations. Required reserves, currency in circulation, and autonomous factors – financial flows within the SR Treasury and net foreign assets – influence the daily volume of liquidity in the banking sector. In 2005, as in the previous year, the banking sector had a marked excess of liquidity. Its average daily amount sterilised through monetary policy operations stood at SKK 399.2 billion. This liquidity surplus was SKK 172.6 billion higher than in 2004. The average monthly amount of excess liquidity ranged during the year from SKK 298.6 billion to SKK 442.1 billion. The most significant increases in excess liquidity were caused by foreign exchange market interventions, the transfer of funds managed by the SR Treasury from the NBS to commercial banks, and the value of redeemed government securities exceeding the value of new issues.

Chart 37 **Structure of effects on daily changes in required reserves in 2005** (%)



Source: NBS.

Chart 38 **Developments in open market operations in 2005 by type** (SKK millions)



Source: NBS.

Main monetary policy operations

In 2005 the main monetary policy operations continued to be 14-day sterilisation repo tenders held on a weekly basis. The volume of these operations, aimed at sterilising the excess liquidity in the banking sector, was high throughout the year. The only exception was February 2005, when the NBS decided to accept no bids from banks at sterilisation repo tenders and thus prevent the Slovak koruna from appreciation, including impact of the exchange rate on interest rates on the domestic money market. Developments in BRIBOR rates were rather volatile over the course of January 2005 and the yield curve became markedly inverse. After the NBS had intervened in the foreign exchange market and rejected the bids of banks at sterilisation repo tenders at the beginning of 2005, money market rates ceased to have an adequate expressive power about this market. They regained this power in March 2005, after the NBS had lowered its basic interest rates (including the refinancing and sterilisation rates for O/N operations) and renewed its main monetary policy operations – sterilisation repo tenders.

Longer-term operations

During 2005 the NBS issued central bank bills (NBS bills) with a maturity of 84 days. The only time when there were no auctions of these bills was a period at the beginning of the year when the NBS reacted to the excessive appreciation of the Slovak koruna. The NBS issued bills with the aim of directly sterilising the excess liquidity of banks. At the same time, however, the NBS also issued these instruments for its own portfolio and used them in main monetary policy operations for sterilisation purposes. In total, the NBS held 11 auctions of NBS bills on the primary market and issued NBS bills in the total amount of SKK 290.0 billion.

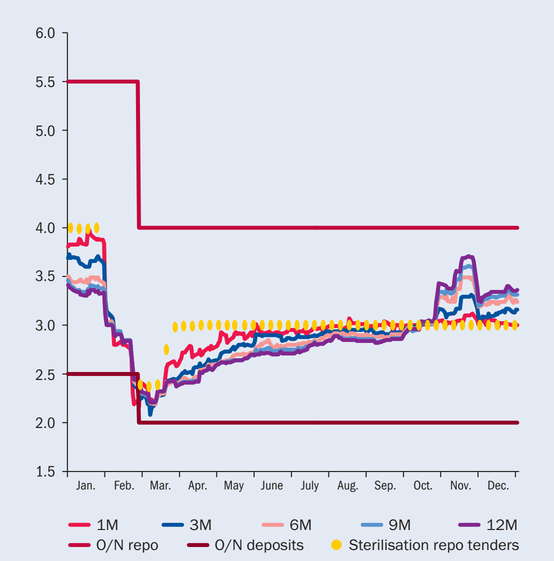
Standing facilities

With regard to the character of the banking sector's liquidity position (ample liquidity), overnight deposit operations with the NBS were frequent, though in terms of value less significant than the main operations. The only exceptions were February and March, the months in which the NBS decided to accept no bids from banks at sterilisation repo tenders. On the other hand, overnight refinancing operations with the NBS were sporadic. For example, an average monthly volume exceeding SKK 1.0 billion was registered only in three months within the first half of 2005. In the following months, the average monthly value of overnight refinancing operations did not exceed SKK 0.6 billion. A supplement to overnight refinancing operations was the possibility to draw intra-day credit via the money reserve account within the SIPS payment system. This possibility was utilised in 2005 by 8 counterparts of the NBS.

Reserve requirements

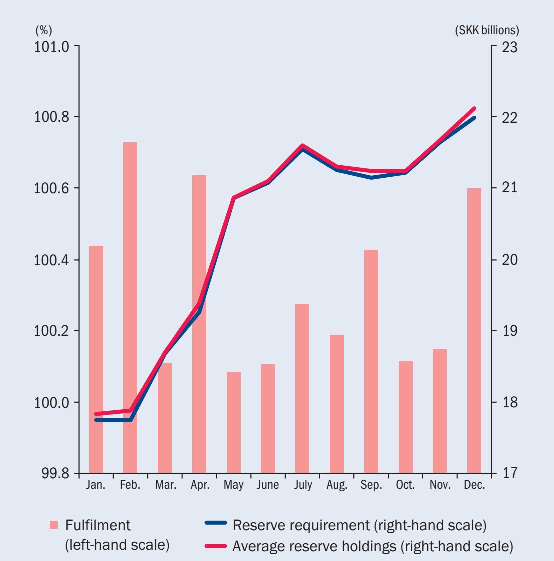
Required minimum reserves are held, in accordance with the relevant NBS decrees and EC directives, by banks, branches of foreign banks, and electronic money institutions. The function of the minimum re-

Chart 39 **BRIBOR in 2005**
(in % p. a.)



Source: NBS.

Chart 40 **Required reserves in 2005**



Source: NBS.

serve system ensure the maintenance of short-term liquidity within the banking system. The averaging provision enables banks to adequately regulate the volume of their transactions on the domestic money market within the reserve maintenance period. In 2005 minimum reserves were held by 18 banks and 5 branches of foreign banks, including 2 branches that commenced banking operations in Slovakia on the basis of a single banking licence valid in the EU Member States. The conditions for holding of required reserves remained unchanged in 2005, at the 2004 level, i.e. a reserve ratio of 2% of specific liability items, a reserve maintenance period of one month, and interest at a fixed rate of 1.5%. The value of the total reserve requirement showed a rising trend during the year: it increased by SKK 4.2 billion from January to December 2005. Although there were large fluctuations in the actual reserve holdings in some of the months (e.g. May, June, September, and December 2005), the reserve requirement was fulfilled by the banking sector in each month.

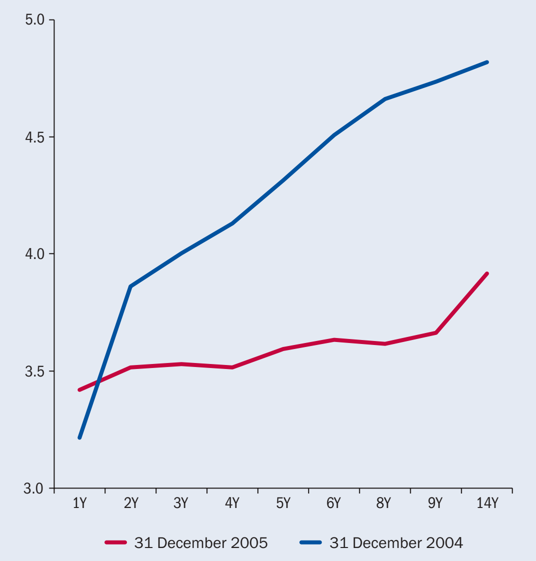
Risk management

Credit, market, and operating risks are monitored and managed within the central bank according to standard risk management practices. These practices refer primarily to the counterparts involved in monetary policy operations and the financial assets used by these parties in such operations. As other central banks belonging to the ESCB, the NBS sets and applies rules for risk management in accordance with the statutes of the ESCB and the ECB. Although the system of credit risk assessment has not yet been fully harmonised with the criteria of the ECAF (Eurosystem Credit Assessment Framework), the NBS has developed an appropriate method, which was used effectively during 2005. Since not only the counterparts of the central bank, but also their financial assets must be eligible in terms of risks, the NBS applies a system for the selection of eligible assets, including a system for their market-based valuation (from 2004 onwards). In refinancing operations, the NBS also applies the system of reduction (haircuts) to market prices. In addition, the NBS is making preparations for the harmonisation of procedures to be followed in selecting and valuating financial assets so as to comply with the conditions imposed by the Eurosystem. This mainly includes preparations for the actual use of assets, which will be included in the so-called Single List, for monetary policy operations. These assets are expected to be used starting from the year when Slovakia enters the Eurosystem. The Single List will be introduced by the ECB in 2007. It will mainly cover debt securities and bank loans classified as eligible by both national central banks and the ECB.

Benchmark bond yield curve

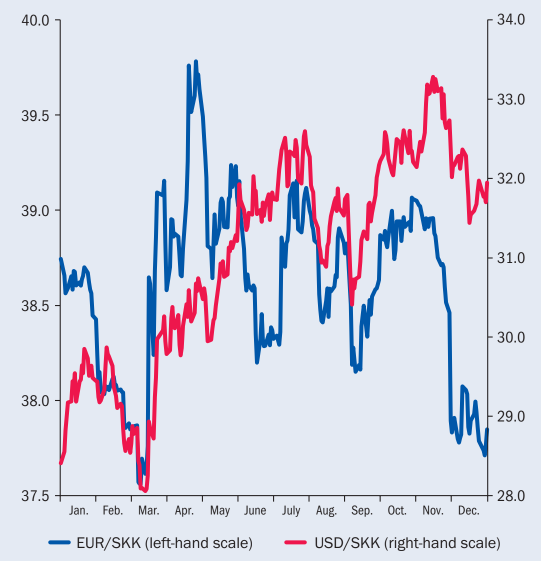
In 2005 the NBS continued to coordinate the quotations of prices for benchmark government bond portfolios by commercial banks and to create a benchmark yield curve from these quotations. This project, aimed at obtaining more reliable information on price developments on the domestic bond market, was launched in 2004 on the background of the low volumes of price-setting transactions on bond markets and the

Chart 41 **Benchmark government bond yield curve** **(%)**



Source: NBS.

Chart 42 **Exchange rates of the Slovak koruna against the euro and the dollar in 2005**



Source: NBS.

inadequate frequency of trading. The NBS monitors and duly updates the structure of the benchmark portfolio in cooperation with commercial banks. Such an update of the benchmark bond portfolio was applied at the beginning of June 2005. It aimed at broadening the term structure of listed government bonds. One of the criteria for the inclusion of a bond in the benchmark portfolio is a minimum issue-amount of SKK 5 billion. At present, the portfolio includes bonds with a maturity of 1 to 9 years, as well as 14-year bonds. The prices are quoted by eight commercial banks that are active on the market. The publication of indicative bond prices via REUTERS (SKBMK page) takes place on a daily basis, always at 15:00 CET on the relevant trading day. As commercial banks, the NBS also uses indicative benchmark curve prices for the theoretical valuation of financial assets. In the case of the NBS, subject to valuation are assets classified as eligible for use in monetary policy operations.

Movements in the benchmark curve were less volatile in 2005 then in the previous year. Price movements were mostly influenced by developments in the euro area, information about reduced need for government borrowing trough bond issues, the ratings of Moody's, fluctuations in the exchange rate of the Slovak koruna, and the decisions of the NBS concerning the basic interest rate. In addition, the Slovak bond market was significantly affected by the entry of the Slovak koruna into the Exchange Rate Mechanism II (ERM II), which attracted the interest of foreign investors in Slovak financial assets, while positively influencing the stabilising level of bond market yields at the end of 2005.

3.2 Foreign exchange operations

Foreign exchange market operations

During 2005, the exchange rate of the Slovak koruna against the euro appreciated by 2.44 percentage points (from SKK/EUR 38.796 at 31 December 2004 to SKK/EUR 37.848 at 31 December 2005). The average exchange rate was SKK/EUR 38.593, representing an appreciation of 3.6 percentage points compared with the figure for 2004. During last year, the exchange rate of the koruna against the US dollar weakened by 12.11 percentage points (from SKK/USD 28.496 at 31 December 2004 to SKK/USD 31.948 at 31 December 2005). The average exchange rate was SKK/USD 31.022, representing an appreciation of 3.8 percentage points compared with the figure for 2004. In relation to the Czech koruna, the Slovak koruna depreciated by 2.9 percentage points.

With regard to the rapid changes in the exchange rates of the Slovak koruna, the NBS intervened on several occasions in 2005 to dampen the unreasonably fast appreciation of the domestic currency. Since the interest of investors in the Slovak koruna, arising from certain facts (e.g. the expected smooth fulfilment of the Maastricht criteria in 2008, strong economic growth, and gradual improvement in the trade balance that began as early as at the end of 2004), continued in the first quarter of 2005, the NBS made further interventions against the excessive strengthening of the domestic currency. These interventions had so far been the most extensive in the Slovak foreign exchange market. During two months (at the end of 2004 and the beginning of 2005), the NBS purchased EUR 3.62 billion (ca. SKK 138 billion) on the foreign exchange market. The fragility of the Slovak foreign exchange market and its correlation with the markets of neighbouring countries became apparent during the period of weakening of the Polish currency. The warning of the NBS that the appreciation of the Slovak koruna at the beginning of the year was unreasonably fast, also proved justified. During 2005, the NBS purchased EUR 3.02 billion and sold EUR 535 million through foreign exchange market interventions, which resulted in a balance of EUR 2.49 billion.

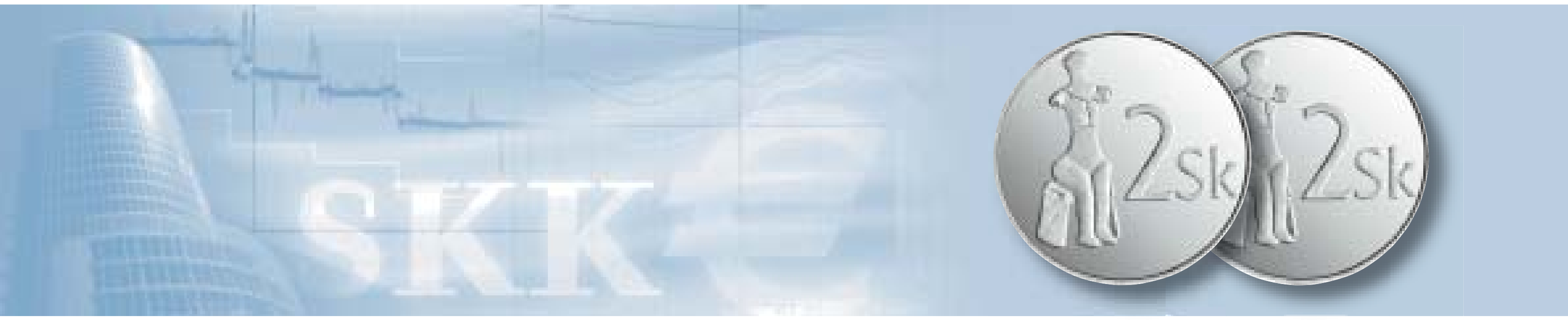
The expectation that the Slovak foreign exchange market would break away from its strong correlation with the Polish and Czech currencies was not confirmed, even after the entry of Slovakia into ERM II. Such expectations may become more realistic in the period before the country's entry into the euro area.

Investment activities in foreign exchange reserve management

In 2004 the NBS approved an update for the investment strategy pursued in the area of foreign exchange reserve management. The updated strategy delimited the range and limits of investment in international financial markets with respect to the credit, interest rate, and exchange rate risks, as well as the liquidity risk. As a part of investment policy, the structure of decision-making in foreign exchange reserve management was defined. This set of rules continued to be applied in 2005.

The marked appreciation of the Slovak koruna at the beginning of the year led to an increase in foreign exchange reserves. Thus, the intervention and investment portfolios increased in volume. The value of foreign exchange assets at the given exchange rates and market prices increased, from USD 14.9 billion at the end of 2004 to USD 15.5 billion at the end of 2005. In the area of foreign exchange reserve management, the yields ranged from 2.074% for euro-denominated investment portfolios to 3.120% for dollar-denominated investment portfolios. Interest yields earned in the area of foreign exchange reserve management totalled approximately SKK 10.6 billion in 2005.

Banking Supervision



4

4 Banking Supervision

4.1 Development of the banking sector

Conditions in the banking sector were favourable in 2005. Trends in the banking sector were influenced by positive developments in the economy. The volume of managed assets increased, their structure underlay changes and the profitability of the banking sector improved. The underlying factors in the strong increase in the volume of loans provided were robust economic growth and the improved financial situation of businesses. These positive trends were evidenced by increases in loans provided to almost all of the sectors.

As at 31 December 2005, the following entities operated in the Slovak banking sector:
- 18 banks headquartered in the SR,
- 5 branches of foreign banks in the SR,
- 104 entities freely providing cross-border banking services (99 banks, two electronic money institutions and three financial institutions),
- nine representative offices of foreign banks in the SR.

Of the eighteen banks headquartered in the SR, three were home-savings banks (ČSOB stavebná sporiteľňa, a. s., Prvá stavebná sporiteľňa, a. s. and Wüstenrot stavebná sporiteľňa, a. s.). As at 31 December 2005, licences for the provision of mortgage services were held by nine banks and one branch of a foreign bank (HVB Bank Slovakia, a. s., Dexia banka Slovensko, a. s., ISTROBANKA, a. s., ĽUDOVÁ BANKA, a. s., OTP Banka Slovensko, a. s., Slovenská sporiteľňa, a. s., Tatra banka, a. s., UniBanka, a. s., Všeobecná úverová banka, a. s. and Československá obchodní banka, a. s., branch office of foreign bank).

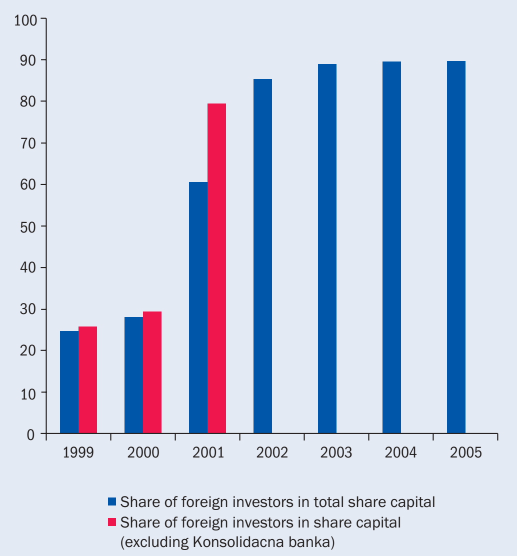
Compared to the end of the previous year, the share of foreign investors in the total subscribed share capital of banks and funds provided by foreign banks to their branches increased only slightly in 2005, from 89.60% to 89.65%. In ĽUDOVÁ BANKA, a. s., changes in the foreign shareholder structure were registered; nevertheless, the share of foreign investors in the total share capital of the above stated banks remained unchanged. In CALYON BANK SLOVAKIA, a. s., the share of Calyon Global Banking (previously named Credit Lyonnais Global Banking S. A.) in the bank's share capital increased from 90% to 100%, due to the acquisition of the 10% share held by VÚB, a. s.

Licensing activity

Banks

In March 2005, the National Bank of Slovakia adopted several decisions amending the banking licences previously granted to all banks (except for home-savings banks) and a branch of a foreign bank providing banking services on the basis of the banking licence issued by the National Bank of Slovakia. By virtue of Act No. 603/2003 Coll. and Act No. 554/2004 Coll. amending Act No. 483/2001 Coll. on banks and on amendments to certain laws, as amended (hereinafter referred to as the "Act on banks"), concepts referred to in the Act on banks and in the Act on the payment system were harmonised, and, in the same vein, activities referred to in the Act on banks were harmonised with activities referred to in the Act on securities and investment services. In order to harmonise the activities described in banking licences with banking activities referred to in the valid Act on banks, the National Bank of Slovakia introduced necessary changes to the banking licences on the basis of the above stated legal provisions.

Chart 43 **Share of foreign investors in the share capital and funds provided by foreign banks to their branches** **(%)**



Source: NBS.

By the decision of the National Bank of Slovakia of 14 October 2005, prior approval pursuant to Article 28, paragraph 1, letter e) of the Act on banks was granted to ISTROBANKA, a. s., allowing the bank to become a subsidiary of another parent company, which would come into existence under the name of Bank für Arbeit und Wirtschaft und Österreichische Postsparkasse Aktiengesellschaft by merging Bank für Arbeit und Wirtschaft Aktiengesellschaft Österreichische Postsparkasse Aktiengesellschaft with Kapital & Wert Bank Aktiengesellschaft.

By its decision of 18 October 2005, in accordance with Article 2, paragraph 3, letter d) of the Home Savings Act, the National Bank of Slovakia expanded the banking licence granted to Prvá stavebná sporiteľňa, a. s. By this expansion and pursuant to Article 11, paragraph 1, the NBS allowed the bank to provide home savings loans out of its home savings funds, provided that the liabilities resulting from the home-saving agreements concluded are secured and that neither the time periods for home-loan repayments are shortened nor the periods for the provision of home-savings loans are prolonged.

By the decision of the National Bank of Slovakia of 21 October 2005, prior approval pursuant to Article 28, paragraph 1, letter e) of the Act on banks was granted to HVB Bank Slovakia, a. s., to become a subsidiary of UniCredito Italiano S.p.A., Italy.

In its decision of December 2005, the National Bank of Slovakia supplemented the banking licences to provide mortgage services for Všeobecná úverová banka, a. s., Tatra banka, a. s., Československá obchodní banka, a. s., Praha (through its branch office), OTP Banka Slovensko, a. s., UniBanka, a. s., Slovenská sporiteľňa, a. s., ĽUDOVÁ BANKA, a. s., ISTROBANKA, a. s. and HVB Bank Slovakia, a. s. by stipulating specific conditions for mortgage loan financing. According to this, at least 90% of mortgage loans provided by these banks as of 31 December 2006 must be financed through issuing mortgage bonds.

In 2005 the National Bank of Slovakia granted prior approval for a change in the headquarters of three banks: Banka Slovakia, a. s. (22 February 2005), Citibank (Slovakia), a. s. (25 April 2005) and UniBanka, a. s. (18 August 2005).

On 1 November 2005 the extraordinary general meeting of Banka Slovakia approved the changes in the articles of association of the bank and the change in its name, from Banka Slovakia, a. s. to Privatbanka, a. s.

Branch offices of foreign banks

Following the Slovak Republic's accession to the European Union, credit institutions registered in the European Economic Area may conduct banking activities without a banking licence granted by the National Bank of Slovakia, provided the bank has a banking licence in its home state (the principle of a single banking licence "single passport").

On the basis of the single banking licence, two notifications by foreign supervisory authorities regarding the notification of two foreign entities to perform banking activities in the Slovak Republic were delivered to the National Bank of Slovakia. As a result, the number of branch offices of foreign banks increased from three to five.

On the basis of the single banking licence granted to HSBC Bank plc registered in London, the bank started to conduct banking activities through its organisational unit, HSBC Bank plc, branch office of foreign bank, on 1 June 2005. The Slovak Deposit Protection Fund protects deposits accepted by this branch office.

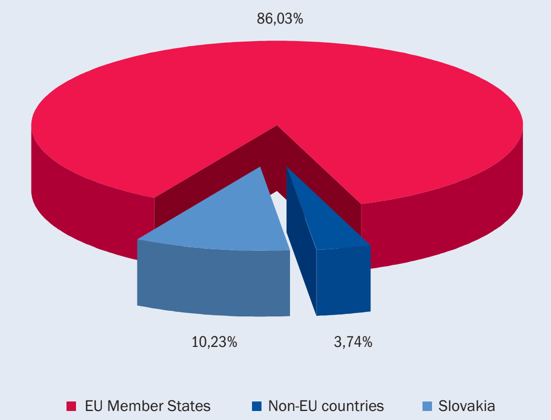
A branch office of another foreign bank, Banco Mais, S. A., opened for business on 19 September 2005. Deposits in this branch office are protected by the Portuguese Deposit Protection Fund.

Table 26 **List of providers of cross-border banking services**

	Banks	Electronic money institutions	Foreign financial institutions
Cyprus	2		
The Czech Republic	2		
Denmark	2		
France	8		
the Netherlands	2		
Ireland	5		
Iceland	1		
Liechtenstein	1		
Luxembourg	5		
Hungary	3		2
Germany	16		
Norway	1		
Poland	1		
Austria	23		
the United Kingdom	23	2	
Spain	1		
Sweden	1		
Italy	2		1
Total	99	2	3

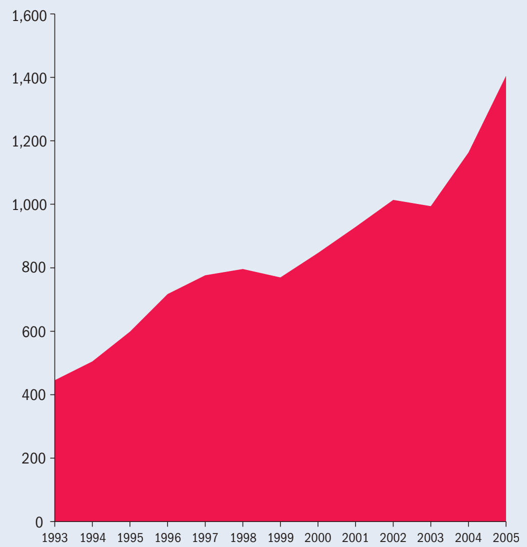
Source: NBS.

Chart 44 **Share of investors in the share capital and funds provided by foreign banks by the country of origin[1)] (%)**



Source: NBS.
1) EU Member States include the Czech Republic (7.86%), France (1.13%), the Netherlands (1.39%), Luxembourg (28.26%), Hungary (4.53%), Germany (1.94%), Austria (35.38%), Italy (4.27%), Portugal (0.13%), and the United Kingdom (1.14%). Non-EU (foreign) states include the United States and Switzerland.

Chart 45 **Development of the Slovak banking sector's total assets (as at 31 December) (SKK billions)**



Source: NBS.

On 4 November 2005, the National Bank of Slovakia informed J&T, BANKA, a. s. in writing of the conditions for branch offices of foreign banks to conduct banking activities in the SR on the basis of the single banking licence. This foreign branch office will be a contributor to the Czech Deposit Protection Fund.

Representative offices of foreign banks

In January 2005, the National bank of Slovakia registered the representative office of BANQUE PRIVEE EDMOND DE ROTHSCHILD EUROPE, a. s., Luxemburg in Slovakia. In April 2005, the National Bank of Slovakia acknowledged the receipt of a notification of the establishment of the representative office in Slovakia by Niederösterreichische Landesbank-Hypothekenbank Aktiengesellschaft, Austria. Henceforth, the number of foreign representative offices in Slovakia increased from seven to nine in 2005.

In 2005 the Banking Supervision Division issued 114 decisions related to banking licence expansions, changes of members of statutory body, supervisory boards, bank officers, amendments to articles of association, expansions of banking licences to provide mortgage loans by stipulating conditions for mortgage loan financing, the conduct of non-banking activities related to day-to-day operation of banks, the registration of representative offices of foreign banks and changes to bank headquarters.

4.2 Economic results of the banking sector

The Slovak financial sector experienced positive trends in 2005. Despite its shrinking share, the banking sector continued to dominate the market and managed as much as 84% of the total volume of assets and administered property of the financial sector. During the period under review, the structure of managed assets was changing and the banking sector profitability increased.

As at 31 December 2005, in comparison with the end of 2004, the total assets (total net assets) of the Slovak banking sector (18 banks and 5 branch offices of foreign banks) had grown by SKK 242 billion (20.8%) to SKK 1,405 billion.

The development of the banking sector's total assets was influenced by growth in both secondary funds (SKK 138 billion) and primary funds (SKK 64 billion). The volume of non-anonymous deposits declined by SKK 3 billion (0.8%) to SKK 420 billion, as a result of the amendment to the Act on the protection of deposits.

The volume of earning assets reported by the banking sector grew in comparison with the end of 2004 by SKK 239 billion to SKK 1,330 billion. The share of earning assets in total assets increased moderately over the course of 2005 and reached 94.7%, which is almost 1% more than at the end of 2004.

Table 27 **Banking sector of the SR**

	31.12.2004	31.12.2005	Difference Dec. 05/Dec. 04	Change in % Dec. 05/Dec. 04
Number of employees	19,720	19,850	130	0.66
Number of banks in the SR	18	18	0	0.00
Number of branches of foreign banks in the SR	3	5	2	66.67
of which: on the basis of a NBS licence	1	1	0	0.00
under the single licence regime	2	4	2	100.00
Number of representative offices of foreign banks in the SR	7	9	2	28.57
Number of branches in the SR	587	685	98	16.70
Number of sub-branches in the SR	526	457	-69	-13.12
Number of branches in other countries	1	1	0	0.00
Number of sub-branches in other countries	0	0	0	0.00
Number of representative offices in other countries	1	0	-1	-100.00
Number of entities freely providing cross-boarder banking services	48	104	56	116.67
of which: electronic money institutions	0	2	2	0.00
foreign financial institutions	0	3	3	0.00
Slovak banks freely providing cross-border services abroad	1	1	0	0.00
of which: electronic money institutions	0	0	0	0.00
Total assets (in SKK thousands)	1,162,935,361	1,404,762,510	241,827,149	20.79
Earning assets (in SKK thousands)	1,090,962,975	1,329,618,719	238,655,744	21.88
Total interbank assets (in SKK thousands)	378,117,213	497,667,795	119,550,582	31.62
Total foreign exchange assets (in SKK thousands)	167,212,165	209,621,933	42,409,768	25.36
Securities (in SKK thousands)	377,791,590	332,151,813	-45,639,777	-12.08
Total loans (in SKK thousands)	442,361,143	558,532,224	116,171,081	26.26
of which: classified loans (in SKK thousands)	31,703,394	30,836,078	-867,316	-2.74
loans to households (in SKK thousands)	116,806,841	165,057,419	48,250,578	41.31
loans to non-financial corporations (in SKK thousands)	225,925,388	266,747,351	40,821,963	18.07
Share of classified loans in total loans	7.17	5.52	-1.65	–
Uncovered expected loss (in SKK thousands)	10,355	30	-10,325	-99.71
Provisions for loan losses (in SKK thousands)	25,489,675	23,141,657	-2,348,018	-9.21
Legal reserves (in SKK thousands)	6,961,072	7,219,488	258,416	3.71
Share capital (in SKK thousands)	41,433,475	41,450,201	16,726	0.04
Own funds (in SKK thousands)	100,626,465	107,153,990	6,527,525	6.49
Secondary funds (in SKK thousands)	183,301,896	321,557,694	138,255,798	75.43
Primary funds (in SKK thousands)	791,384,116	855,135,745	63,751,629	8.06
of which: non-anonymous deposits (in SKK thousands)	423,290,430	419,980,621	-3,309,809	-0.78
Current profit (in SKK thousands)	12,287,442	13,911,615	1,624,173	13.22
Current loss (in SKK thousands)	6,614	19,444	12,830	193.98
Net profit/loss (in SKK thousands)	12,280,828	13,892,171	1,611,343	13.12
Cumulative profit/loss (in SKK thousands)	37,722,258	39,878,594	2,156,336	5.72
Adequacy of own funds ratio (%)	18.68	14.79	-3.89	-0.21

Source: NBS.

Table 28 **Number of inspections in 2005**

	1st quarter		2nd quarter		3rd quarter		4th quarter		1st – 4th quarter	
	Commenced	Concluded	Commenced	Concluded	Commenced	Concluded	Commenced	Concluded	Planned	Concluded
Inspections										
– full-scope	0	0	0	0	0	0	0	0	0	0
– follow-up	0	0	0	0	0	0	3	3	3	3
– targeted	2	0	3	2	3	4	1	3	9	9
Total	2	0	3	2	3	4	4	6	12	12

Source: NBS.

Total loans reported by the banks as of 31 December 2005 were SKK 559 billion. Classified loans fell by SKK 0.9 billion to SKK 31 billion (2.7%). Banks created SKK 23 billion in provisions. Coverage of classified loans by created provisions stood at 75% at the end of the reference period. The share of classified loans among total loans fell to 5.5%.

As at 31 December 2005, banks reported a net profit of SKK 14 billion. This represents a year-on-year growth of SKK 1.6 billion (15.9%). Three banks reported a loss for the current period as at 31 December 2005 (at 31 December 2004, one bank reported a loss).

4.3 Banking supervision performance and evaluation of the prudential conduct of business by banks

The main task and remit of banking supervisors is to promote stability and sound development of banks and the banking system and to protect the interests of depositors.

In 2005 as a part of its pro-active supervision and in accordance with Article 23, paragraph 1 of the Act on banks, the Banking Supervision Division published methodological instruction No. 3/2005 on the internal control system and procedures to be applied by banks and branches of foreign banks. These methodological instruction stipulated the common rules governing the structure of the internal control system of banks and branches of foreign banks. It can be found on the NBS web site and in the Official Journal of the NBS.

In supervising the banking sector, both forms of supervision, i.e. on-site and off-site inspections, were applied. On-site inspections were primarily focused on adherence to regulations, credit, market and operational risks and the assessment of requests to apply internal models for the measurement of capital to cover market risks.

The number of inspections conducted by the Banking Supervision Division in 2005 is presented in Table 28.

The basic banking supervisory instruments are the rules regulating the prudential conduct of banking business and the limits they define.

Banking entities as well as all other businesses are exposed to a variety of risks related to the conditions in their business areas. The basic rules and limits aimed at limiting exposure to risks and the provision of funds to meet possible losses are outlined in the decrees of the banking supervisor. Prudential rules to be applied to bank management as a whole and to individual bank operations as well as the methods of identification, monitoring and control of individual risks remain the basic preconditions for the successful functioning of a bank.

The adequacy of the own funds ratio of the Slovak banking sector reached 14.79% as of December 2005. In a year-on-year comparison with the figure for 31 December 2004 this represents a decline of 3.89%. All banks complied with the limit for own funds adequacy of 8% during 2005, since own fund adequacy ratios ranged from 9.5% to 31.7%.

In addition, banks are subject to certain other asset exposure limits.

In 2005 one bank failed to comply with the limit on its large exposure towards a parent or subsidiary or towards a group of economically connected persons in which the bank is a member (20% of own funds).

Concerning the limit on bank's large exposure towards another person, a group of economically connected persons or countries and central banks (25% of own funds), seven cases of non-compliance were recorded in five banks.

All banks complied with the limit on the sum of a bank's large exposures (800% of own funds) in 2005.

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Furthermore, all banks in 2005 complied with the ratio of large exposure towards a natural person to the bank's own funds (at most 2%).

Likewise, all banks complied with the ratio of exposure towards a legal person other than a bank headquartered in a zone A country to the bank's own funds (maximum 10 %) in the period under review.

Similarly, the ratio of exposure towards all persons with a special relation to the bank, to its own funds (at most 40%) was complied with by all banks in 2005.

The limit of the ratio of a bank's fixed and non-liquid assets to its own funds and reserves (maximum 1) was also complied with by all banks in 2005.

4.4 International cooperation

The basic framework for the international cooperation of supervisors of all Member States of the European Union is the arrangement established at Level 2 by the European Supervisory Committee and at Level 3 by the Committee of European Banking Supervisors. The long-term objective is the achievement of the risk-oriented conduct of supervision of the entire financial market.

Bilateral cooperation agreements in the field of banking supervision

In order to exchange information between supervisory bodies of two different countries and to support the secure and sound functioning of financial institutions, the Banking Supervision Division cooperates with foreign supervisory authorities.

The Memorandum of Understanding on Co-operation between the Banking Supervisors, Central Banks and Finance Ministries of the European Union in Financial Crisis Situations entered into effect on 1 July 2005. The Memorandum was concluded in order to improve the stability of financial systems.