

# Supervision of the Financial Market





## 4 Supervision of the Financial Market<sup>5</sup>

### 4.1 Financial market regulation in Slovakia

In exercising supervision of the financial market – in banking, the capital market, the insurance industry and pension saving – the Národná banka Slovenska follows general procedural rules laid down in Act No. 747/2004 Coll. on financial market supervision and on amendments to certain acts as amended. This Act entered into force on 1 January 2006, the date when Národná banka Slovenska assumed the competences of an integrated financial market regulator. Until 31 December 2005, the said powers with respect to the insurance sector, capital market and pension saving had been exercised by the Financial Market Authority.

The aim of financial market supervision (responsibility for which lies with a Vice-Governor of Národná banka Slovenska) is to support both the stability of the financial market as a whole and its secure and smooth operation. Based on this fact, the financial market supervision unit conducts financial market regulation, involving mainly the following activities:

- rulemaking activities (it produces draft generally binding legal regulations of Národná banka Slovenska in the financial market field, in particular, draft prudential regulation, operational security rules and other requirements for the conduct of business by supervised entities, it participates in the preparation of generally binding legal regulations issued by central government bodies),
- licensing activities (it conducts proceedings, takes first-instance decisions, issues authorizations, approvals and prior approvals, and imposes sanctions and corrective measures),
- supervision activities (it supervises financial market entities through on-site and off-site supervision),
- analytical activities (it produces analyses of the financial market as a whole, as well as of individual financial entities).

A new area, falling within the competence of the financial market supervision unit from February 2007, is consumer protection by virtue of Art. 3(1) of Act of

the National Council of Slovakia No. 566/1992 Coll. on NBS as amended.

The financial market comprises four sectors – the banking sector (principally represented by banks and branches of foreign banks), the capital market (principally represented by investment firms, management companies, the stock exchange, the central securities depository, issuers and intermediaries of investment services), insurance sector (principally represented by insurance companies and branches of foreign insurance companies) and the pension savings market (principally represented by pension fund management companies and supplementary pension companies).

Slovakia's membership of the European Union means that foreign regulated entities may operate in the country without an authorization from Národná banka Slovenska, provided that they are authorized to conduct such activities in another EU Member State (the single passport principle).

### 4.2 Rulemaking activities of the supervision unit

In the field of financial market regulation, several acts, regulations, methodological instructions and recommendations governing the legal environment of regulated entities were adopted in 2007. The purpose of this part is not to enumerate these measures, but rather to draw attention to those which have had the greatest effect on the activities of regulated entities in individual financial market sectors in Slovakia.

The main tasks of acts and regulations adopted in the banking sector in 2007 were an improvement of the criteria for prudential behaviour for banks and investment firms, as well as the criteria for the conduct of business and for keeping records of the conduct of business in the single market in the European Union. The most important legal regulation for the banking sector and the investment services sector was the adoption of Act No. 209/2007 Coll. amending Act No. 566/2001 Coll. on securities and investment

<sup>5</sup> A detailed report for 2007 is published on the NBS website [www.nbs.sk/Financial Market Supervision/Banking Sector and Securities Dealers Supervision/Statistical Data and Analyses/Analysis of the Slovak Banking Sector](http://www.nbs.sk/Financial%20Market%20Supervision/Banking%20Sector%20and%20Securities%20Dealers%20Supervision/Statistical%20Data%20and%20Analyses/Analysis%20of%20the%20Slovak%20Banking%20Sector).



Table 23 **Number of supervised entities as at 31 December 2007**

	Number of institutions as at 31 December 2007	Number of institutions as at 31 December 2006	Change
Number of banks in Slovakia	16	17	-1
Home savings banks	3	3	0
Mortgage-lending banks	8	9	-1
Other banks	5	5	0
Number of branches of foreign banks in Slovakia	10	7	3
of which: authorized by NBS	1	1	0
on the single European passport principle	9	6	3
of which: branches of foreign mortgage-lending banks	1	1	0
Number of foreign banks branches' contributing to the Deposit Protection Fund	2	2	0
Number of foreign banks' representative offices in Slovakia	9	10	-1
Number of branches (organizational units) of banks in Slovakia	738	715	23
Number of lower organizational units in Slovakia	431	460	-29
Number of branches of Slovak banks in other countries	1	1	0
Number of representative offices of Slovak banks in other countries	1	1	0
Number of foreign entities freely providing cross-border banking services	190	131	59
of which: Banks	178	123	55
Electronic money institutions	6	3	3
Foreign financial institutions	4	3	1
Credit cooperatives	2	2	0
Slovak banks providing free cross-border banking services abroad	1	1	0
of which: Electronic money institutions	0	0	0
Number of staff of banks and branches of foreign banks	19,779	19,525	274
Number of insurance companies in Slovakia	23	24	-1
of which: Insurance companies providing only life insurance	5	5	0
Insurance companies providing only non-life insurance	5	6	-1
Insurance companies providing life or non-life insurance	13	13	0
Insurance companies providing services on a freedom to provide services basis	370	296	74
of which: without establishing a branch	360	289	71
of which: through branches	10	7	3
Number of insurance companies in Slovakia providing compulsory contractual third-party liability insurance for motor vehicles	9	9	0
Number of pension fund management companies	6	6	0
Number of supplementary pension companies	5	3	2
Number of supplementary pension insurance companies	0	1	-1
Number of domestic management companies in Slovakia	10	10	0
of which: management companies with an extended licence under Article 3(3) of the Collective Investment Act	6	7	-1
Number of domestic mutual funds	118	109	9
of which: Open-end mutual funds	72	62	10
Closed-end mutual funds	41	44	-3
Special mutual funds	5	3	2
Number of foreign management companies and foreign collective investment undertakings operating in Slovakia on the basis of an authorisation issued under Article 75 of the Collective Investment Act	2	3	-1

Table 23 Number of supervised entities as at 31 December 2007 (continuation)

	Number of institutions as at 31 December 2007	Number of institutions as at 31 December 2006	Change
of which: through a branch in Slovakia	0	2	-2
without establishing a branch	2	1	1
Number of foreign management companies and foreign collective investment undertakings operating in Slovakia on the basis of a single European passport	43	21	22
of which: With a branch of foreign management companies under Art. 28 of the Act	2	0	2
Foreign management companies without a branch under Art. 29 of the Act on collective investment	10	5	5
European Funds under Art. 61			
- foreign management companies	11	7	4
- foreign investment companies	19	14	5
within which: Number of foreign mutual funds and sub-funds of foreign investment companies	617	360	257
Number of foreign management companies performing activities under Article 3(3) of the Act on Collective Investment	11	5	6
Number of investment firms	32	33	-1
of which: Banks and branches of foreign banks – investment firms with a NBS licence	13	14	-1
Branches of foreign banks – investment firms with a licence of the home authority	6	4	2
Number of foreign entities operating in Slovakia as investment firm	582	304	278
of which: through a branch in Slovakia	3	2	1
without establishing a branch	579	302	277
Number of Slovak investment firms providing services abroad	7	7	0
Number of investment services intermediaries in Slovakia	937	888	49
of which: Legal persons	61	55	6
Natural persons	876	833	43

Source: NBS.

services and on amendments to certain acts (the Securities Act) as amended and on amendments to certain acts. This act has implemented the directive No. 2004/109/EC on the harmonization of transparency requirements (the Transparency Directive) and directive No. 2004/39/EC on markets in financial instruments (the MiFID directive). The most important regulation is NBS Decree No. 4/2007 on own funds for the financing of banks and capital requirements for the financing of banks and investment firms and on capital requirements for the financing of investment firms. The decree's purpose is to make the capital requirements match true risks, to which banks and investment firms are exposed, and to prevent that groups providing financial services in more than one country are subject to an excessive burden resulting from several levels of legal regulation and supervision. The newly regulated prudential rules, which, in this case, are represented by provisions on capital require-

ments and rules for the restriction of exposures, are also aimed at reinforcing the risk sensitivity, take into account the risk reduction resulting from the context, in which the individual exposures have arisen, and take into account the considerable progress in the measuring procedures and risk management procedures, which will enable reactions to market innovations and will contribute to the creation of a situation where the financial services of the EU continue to be effective and competitive. For the same reasons, provisions regulating the keeping of the trading book have been rendered more precisely and provisions on the treatment of credit derivatives and other financial instruments have been introduced.

Within legislation regulating the capital market, several EU directives were transposed to the legal system of the Slovak Republic, e.g. directive No. 2004/25/EC on takeover bids, the MiFID directive



and the Transparency Directive. The result of the implementation of the directive on takeover bids (by Act No. 644/2006 Coll.) has been the regulation of the conditions and procedures for performing a takeover bid, an extension of the definition of the term “concerted action”, the regulation of duties of the bodies of the target company after the announcement of the takeover bid and cooperation between the supervisory bodies regarding takeover bids, when the securities are accepted for the regulated market in one or more Member States. The MiFID directive has been implemented in the Securities Act and in Act No. 429/2002 Coll. on the Stock Exchange as amended. The amendment regulates above all the legal framework of financial market regulation, the conditions for performing investment services, ancillary services and for performing investment activities of investment firms in connection with the development of the financial markets of the European Union, it adds further types of financial instruments, it introduces the new concept of tied agents, abrogates restrictions related to the access to regulated markets and sets a regime for the organization of markets in financial instruments on a multilateral trading facility. The implementation of the MiFID directive relates primarily to investment firms and markets; however, it also has an impact on management companies performing further activities (the so-called trader activities) under Art. 3(3) of Act No. 594/2003 Coll. on collective investment and on amendments to certain acts as amended (the Act on Collective Investment). In connection with the Transparency Directive, the amendment sets above all the basic principles of harmonization of transparency requirements in connection with the ownership of shares, debt securities or voting rights, sets the minimum requirements for information dissemination, extends the content of published annual and semi-annual financial reports on issuers, introduces a central register of regulated information at Národná banka Slovenska, or a person authorized thereby, and between supervisory bodies of the Member States. The Act on Collective Investment has also been amended by Act No. 209/2007 Coll. The main purpose of that amendment has been to eliminate some legislative barriers in the part regulating real-estate special funds, as well as some provisions related to a single passport. In 2007, in the area of regulations, the NBS Bank Board discussed and approved NBS Decree No. 3/2007 on the submission of statements by entities ensuring the distribution of securities issued by foreign management companies and foreign investment companies based on a public offer to investors in the territory of the Slovak Republic for statistical purposes, NBS Decree No. 16/2007 on the submission of statements by the Stock Exchange and the Central Securities Depository for the purposes of financial market supervision, and NBS Decree No. 17/2007 on the submission of statements by management companies and mutual

funds depositories for the purposes of financial market supervision.

In the insurance sector, fundamental changes to the legislation regulating the activities of insurance companies, branches of foreign insurance companies, reinsurance companies and branches of foreign reinsurance companies in the Slovak Republic have been carried out in 2007 by the adoption of Act No. 8/2008 Coll. of 28 November 2007 on insurance and on amendments to certain acts. This act has changed the definition of insurance and reinsurance activity, the possibility to outsource some activities to another person and the definition, status and responsibilities of the internal audit unit within the organizational structure of an insurance company, reinsurance company, branch of a foreign insurance company and branch of a foreign reinsurance company. In the area of technical provisions, the provision for unexpired risks, as a part of the technical provision for unearned premium, and the equalisation reserve have been defined. The new legal regulation enables an insurance company, provided it has fulfilled the set conditions, to conduct insurance and reinsurance activity simultaneously without demanding a higher registered capital. The act has also introduced an exception from the compliance with the maximum level of the technical interest rate in the case of life insurance products with a single premium with a maximum period of insurance of 5 years, added a requirement on the quality of assets covering the guarantee fund or the possibility to have more than one responsible actuary in the case of an insurance company or a branch of a foreign insurance company that simultaneously carries on life and non-life insurance, or of a reinsurance company or branch of a foreign reinsurance company that simultaneously carries on reinsurance of life and non-life insurance. In December 2007, the Bank Board of NBS approved NBS Decree No. 15/2007 on the submission of statements, notifications, reports and other information by the Slovak Bureau of Insurers (Slovenská kancelária poisťovateľov) for the purposes of financial market supervision and for statistical purposes, which will enable to collect data needed for the purposes of off-site supervision and for statistical purposes by means of the STATUS DFT application program system.

As for changes of generally binding legal regulations in the area of pension savings, the most important step has been the adoption of Act No. 555/2007 Coll. amending Act No. 461/2003 Coll. on social insurance as amended and on amendments to certain acts. The act has amended Act No. 43/2004 Coll. on retirement pension saving and on amendments to certain acts as amended, as well as Act No. 650/2004 Coll. on supplementary pension saving and on amendments to certain acts as amended. The NBS has proposed several changes to increase system security, which are implementation of risk management aspects to

the regulation, more stringent conflict of interest rules, extension and strengthening of the internal control and a definition of the right of NBS to intervene in the selection of external auditors for companies and pension funds. The purpose of the changes has been to strengthen the core corporate governance of companies so as to enable, later on, a better implementation of new regulatory principles in the investment of individual pension fund management companies and supplementary pension companies.

### 4.3 Licensing activities of the supervision unit

Within its licensing activities regarding financial market entities, the financial market supervision unit of NBS issued a total of 905 decisions in 2007, which can be subdivided as follows.

**Table 24 Number of decisions issued by the financial market supervision unit of Národná banka Slovenska in 2007**

Financial sector	Number
Banking sector and investment firms	181
Capital market	329
Insurance sector	228
Pension saving	120
Foreign exchange licences	47
Total	905

Source: NBS.

The most important activities of Národná banka Slovenska related to the licensing activity of entities of the Slovak financial market in 2007 included the following decisions:

- Under the Decision of Národná banka Slovenska of 12 January 2007, Všeobecná úverová banka, a.s. received prior approval to use an internal model for the calculation of market risk.
- Granting of a prior approval for a merger to UniBanka, a.s., and HVB Bank Slovakia, a.s. of 15 January 2007.
- Granting of a prior approval of 5 June 2007 to PENTA INVESTMENTS LIMITED, Cyprus to exceed the limit of a 66% share of the registered capital and voting rights in Privatbanka, a.s.
- Granting of a prior approval of 18 September 2007 to the company ISTROKAPITAL SE, Cyprus to exceed the limit of a 66% share of the registered capital and voting rights in Poštová banka, a.s.
- Granting of a prior approval to Tatra banka, a.s. to become a subsidiary of the company Cembra Beteiligungs GmbH, Republic of Austria, of 2 October 2007.
- Granting of a banking licence to Československá obchodná banka, a.s. of 19 November 2007.
- Under its decision of 21 December 2007, Národná banka Slovenska granted to the investment firm AMSLICO AIG Securities o.c.p., a.s., a prior approval to return of its licence for the provision of investment services.
- On 22 May 2007, Allianz Asset Management, správ. spol., a.s. was granted a licence for the incorporation and activities of a management company.
- In 2007, OTP Asset Management, správ. spol., a.s. decided to terminate its activities; as a first step, the company transferred the management of its two open-end mutual funds to Investičná a Dôchodková, správ. spol., a.s. (decision of 27 April 2007) and, later on, it ceased to exist by a merger with the Investičná a Dôchodková, správ. spol., a.s., (decision of 23 May 2007).
- In 2007, the following companies received 19 licences for the creation of an open-end mutual fund:
  - Asset Management Slovenskej sporiteľne, správ. spol., a.s. (7 open-end mutual funds)
  - Allianz Asset Management, správ. spol., a.s. (4 open-end mutual funds)
  - Tatra Asset Management, správ. spol., a.s. (4 open-end mutual funds)
  - Investičná a Dôchodková, správ. spol., a.s. (2 open-end mutual fund)
  - VÚB Asset Management, správ. spol., a.s. (1 open-end mutual funds)
  - AIG Funds Central Europe správ. spol., a.s. (1 open-end mutual fund)
- A prior approval to a merger of closed-end mutual funds and subsequently a prior approval to a conversion of the closed-mutual fund to an open-end mutual fund have been granted to PRVÁ PENZIJNÁ správ. spol., a.s.
- A prior approval to entrust the performance of activities specified in Art. 3(2a) of the Act on Collective Investment has been granted to ISTRO ASSET MANAGEMENT, správ. spol. a.s. In this prior approval, the performance of activities was entrusted to BAWAG P.S.K. INVEST GmbH, with reference to the open-end mutual fund ISTRO ASSET MANAGEMENT, správ. spol., a.s., and equity open-end growth fund EUROPA).
- On 13 December 2007, VERITAS SG INVESTMENT TRUST GmbH was granted a prior approval for a return of the licence under Art. 75 of the Act on Collective Investment.
- A prior approval for the acquisition of a 6.69% share of voting rights associated with shares of BCPB, a.s., Patria Finance, a.s. pursuant to Article 6(a) of Act No. 429/2002 Coll. on the Stock Exchange (in the wording valid until 31 October 2007). Národná banka Slovenska decided to grant the prior approval on 12 October 2007.



- On 5 March 2007, based on a request, QBE poisťovňa, a.s. was extended its licence for the conduct of insurance activities to include the following classes of non-life insurance: class B5 – Aircraft insurance and B11 – Insurance of the liability arising out of the ownership and use of aircraft including carrier's liability.
- On 14 May 2007, based on a request, Poisťovňa AIG Slovakia, a.s. was granted a prior approval for the sale of the enterprise to AIG EUROPE S. A. acting by its organizational component AIG Europe S.A. (branch for the Slovak Republic).
- On 31 July 2007, based on a request, HDI Hannover Versicherung Aktiengesellschaft was granted a prior approval to acquire a share of the registered capital of POISŤOVŇA HDI-GERLING Slovensko, a.s., to such an extent that it will, for the first time, exceed the 66% share of the registered capital of the insurance company.
- KOMUNÁLNA poisťovňa, a.s., Vienna Insurance Group was granted a prior approval to conduct intermediary activities for a financial institution.
- On 22 October 2007, ING Životná poisťovňa, a.s. was granted a prior approval to a merger with ING Management Services Slovensko spol. s r.o.
- On 14 November 2007, based on a request, Assicurazioni Generali S.p.A. was granted a prior approval to the acquisition of a 100% share of the registered capital of Generali Poisťovňa, a.s.
- Under its decision of 6 March 2007, NBS granted ČSOB d.s.s., a.s. a prior approval to UniBanka a.s. becoming the depository of the company.
- Under its decision of 7 March 2007, NBS granted AXA, d.s.s., a.s. a prior approval to UniBanka a.s. becoming the depository of the company.
- Under its decision of 9 March 2007, NBS granted VÚB Generali dôchodková správcovská spoločnosť, a. s. a prior approval to ING Bank N. V., pobočka zahraničnej banky becoming the depository of the company.
- Under its decision of 8 January 2007, NBS granted Tatra banka, a.s. a prior approval to DDS Tatra banka, a.s. becoming a subsidiary of Tatra banka, a.s.
- Under its decision of 30 March 2007, NBS granted AXA, d.d.s., a.s., a prior approval to UniBanka a.s. becoming the depository of the company.
- Under its decision of 7 May 2007, a licence for incorporation and activities of the supplementary pension company was granted to AEGON, d. d. s., a.s.
- Under its decision of 13 December 2007, NBS granted prior approval to Winterthur Life Switzerland to AXA, d.d.s., a.s. to become a subsidiary of Winterthur Life by a merger of AXA, d.d.s., a.s. with AXA Slovensko, a. s.
- NBS granted a prior approval to Slovenské investičné družstvo to exceed the share of registered capital and voting rights in Stabilita, d.d.s., a.s. in the amount of 10%.
- Národná banka Slovenska has granted a prior approval to LOREA INVESTMENTS LIMITED Republic of Cyprus to exceed the share of registered capital and voting rights in Stabilita, d.d.s., a.s. in the amount of 20%.
- In 2007, based on a legal and factual assessment of requests and attached documents, Národná banka Slovenska granted a total of 45 foreign exchange licences for money exchange activities, namely for buying and selling funds in a foreign currency for the Slovak currency in cash to natural and legal persons.
- In 2007, 2 foreign exchange licences for non-cash funds transactions, which authorise the holder of those licences to conduct non-cash foreign currency transactions consisting in buying and selling foreign currency conducted for own account or for account of another by means of a non-cash transfer.

#### 4.4 Consumer protection

The responsibilities of NBS in the field of consumer protection result from Art. 3(1) of Act of the National Council of the Slovak Republic No. 566/1992 Coll. on Národná banka Slovenska as amended. 380 petitions, the content of which is discontent of natural and legal persons with the procedure of financial services providers, were submitted to the department from the creation of the client's protection section in the financial market supervision unit in February 2007. 357 files could be completed and closed out of that number, which corresponds to a 93.95% success in processing petitions. Out of the total number of 380 petitions, 107 concerned the banking sector, 154 the insurance sector and 119 other areas of the financial market (e.g. investment firms, retirement pension saving, etc.). In the field of insurance, the clients of insurance companies seek mainly a new reassessment of the attitude of an insurance company regarding the provision of insurance benefits after the event insured. A considerable number of petitions were petitions, the content of which was the clients' discontent in the area of payment transactions. For other fields of the financial market, it is not possible to say in general terms, which type of petitions prevailed, because the activity of the client protection department in this field focused on a great number of financial market entities and a part of the activities of the client protection department was also devoted to entities that are not supervised by NBS.

#### 4.5 Supervision activities of the supervision unit

In conducting supervision of the supervised entities, Národná banka Slovenska ascertains important facts on the supervised entities and their activity,



**Table 25 Number of on-site supervisions conducted in supervised entities of the financial market in 2007**

On-site supervision	Comprehensive	Thematic	Follow-up	Total
Banks	-	10	4	14
Investment firms which are not banks	3	1	1	5
Management companies	4	2	-	6
Pension fund management companies and supplementary pension companies	1	-	-	1
Insurance companies	5	1	-	6
Insurance, reinsurance and investment services intermediaries	9	-	-	9
Entities subject to foreign exchange supervision	8	-	-	8
Supervisions total	30	14	5	49

Source: NBS.

especially deficiencies in their activity, the reasons of the detected deficiencies, the consequences of the detected deficiencies and the persons responsible for the detected deficiencies.

Supervision of the supervised entities is performed as supervision on an individual basis for the supervision of individual supervised entities, as supervision on a consolidated basis for the supervision of groups of persons and special-purpose asset pools, part of which are also the supervised entities, and as supplementary supervision for the supervision of financial conglomerates.

In 2007, 49 on-site supervisions were conducted in the supervised financial market entities and they can be subdivided as follows:

19 on-site supervisions were conducted in the banking sector and at investment firms in 2007. The comprehensive on-site supervisions at investment firms were primarily focused on the organization, management, the way of entering into transactions, professional care of clients and reporting, on the fulfilment of provisions of the Securities Act and on the fulfilment of special acts to the extent resulting from them, and of generally binding regulations issued to implement them, and on the fulfilment of the conditions set by the licence for the provision of investment services. In banks, thematic supervisions, focused on selected activities of the supervised institutions or on evaluation of a selected risk, and follow-up supervisions, focused on the assessment of the fulfilment of measures adopted by the supervised institution on the basis of comprehensive and thematic supervision, were conducted. The subject of thematic supervisions was the evaluation of the use of the IRB model or a pre-validation evaluation of the bank's rating system due to an intention to apply for an approval of the IRB model, the evaluation of credit risk, the credit risk

management system, the operational risk management system and of the information systems used and their security, and the evaluation of the activity of a investment firm and depository; the supervisions having also focused on the verification of selected statistical statements and prudential reports and on the verification of the provision of investment services to the clients. In addition to the said supervisions, pre-validation meetings focusing on the evaluation of the internal models of credit and operational risk took place in some banks. Within off-site supervision, an analysis of the credit portfolio in selected entities, in which no on-site supervision was conducted within the supervision plan, was drawn up in 2007.

On-site supervision in regulated capital market entities in 2007 concentrated on companies, in which no on-site supervision had been conducted yet, as well as on the importance of the companies in the sector. In some cases, an informative visit in the companies took place. The specific focus of the supervisions conducted was: the assessment of the activity of the management company in performing the management of mutual funds managed by the company, of the organization and management of the company, of its internal rules, system of entering into transactions, system of portfolio management, risk management in mutual funds and internal audit system in the company; the assessment of the process of issuing shares of the management company, the fulfilment of the conditions of capital adequacy of a management company, operational risk management, selected accounting and reporting procedures, the process of issuing and paying out unit certificates and of the valuation of the assets of a management company and of mutual funds managed by the management company; the verification of the fulfilment of the statutes of mutual funds and of by-laws of the management company, as well as the fulfilment of the conditions, under which the company was granted licences. In



2007, supervision over the activities of the Bratislava Stock Exchange Plc. (BCPB) consisted mainly in the conduct of ongoing monitoring of the concluded securities transactions accepted for the individual BCPB markets within the modules of the stock exchange's trading system. Until the end of April 2007, Národná banka Slovenska also performed off-site supervision over the fulfilment of the reporting duty of issuers of securities issued based on a public offer, or issuers whose securities have been accepted for trading on the stock exchange market and over the reporting duty of announcers of a public offer of assets who have raised funds from the public based on a public offer under Article 130 of the Securities Act.

In the insurance sector, 5 comprehensive supervisions and 1 thematic on-site supervision were conducted over the course of 2007. The supervisions focused on the verification of the settlement of claims by an insurance company, requirements of file documentation to events insured and adequacy of technical provision for outstanding claims, verification of the handling of client complaints within time periods prescribed by law and of reporting of those complaints, as well as verification of whether the insurance company carries on its activities in line with its licence for the performance of insurance activities, or whether the insurance company was granted the necessary prior approvals, on the organization and management of an insurance company, the legal framework of the functioning of the insurance company, its internal rules and regulations, information system, its trading activities, accounting and reporting, insurance management, technical provisions checks and the placement of these provisions. In the field of off-site supervision, standard statements and reports of insurance companies for late 2006 (audited) and for all quarters of 2007 (ongoing), as well as reports of insurance companies sent ad-hoc via the application program system STATUS DFT, were verified. On-site supervision at insurance and reinsurance intermediaries concentrated on the fulfilment of the provisions of generally binding legal regulations; in 2007, informative talks with commercial insurance companies aimed at the verification of the way the commercial insurance companies conduct one of the insurance activities – the conclusion of contracts with an exclusive insurance intermediary, insurance agent and insurance broker, the content of which is insurance mediation, the conduct of activities associated with the registration of an exclusive insurance intermediary, special training of insurance intermediaries, as well activities to prevent damages.

In the area of pension saving, one comprehensive on-site supervision was carried out in 2007. It focused on

the organization and management of a pension fund management company, internal regulations, the system of doing deals, the portfolio management system, risk management in pension funds and the company's internal audit system. Off-site supervision in 2007 concentrated primarily on retirement pension saving. The operation of the application program software STATUS DFT was launched in 2007, and the supervised entities started to send reports to Národná banka Slovenska by means of this software. From 1 January 2007, the pension fund management companies and pension fund depositories have the additional duty to inform Národná banka Slovenska not only on each transaction conducted with the assets in a pension fund, but also on the level of assets in the pension fund on a daily basis. Thus, as a first step, off-site supervision involved checks of the fulfilment of reporting duties of pension fund management companies and pension fund depositories under Decree of Národná banka Slovenska No. 567/2006 Coll. and, based on information obtained in this way, the riskiness of the individual transactions and their impact on the riskiness of pension fund portfolios was evaluated.

Foreign exchange supervision focused on the fulfilment of the reporting obligation, above all based on an inducement by the statistics department of NBS. In all cases of the conducted foreign exchange supervision focusing on the fulfilment of the reporting obligation, it was established that the obligation is not fulfilled. Foreign exchange supervision focusing on money exchange activities verified primarily the keeping of prescribed, special records (the issuing of purchase or sale statements, foreign exchange bookkeeping, etc.).

## 4.6 Analytical activities of the supervision unit

A part of the work of the NBS financial market supervision unit is dedicated to analytical activities. The supervision unit prepares the Analysis of the Slovak Financial Sector on a semi-annual basis. The report is submitted to the Bank Board of NBS and is published in a shortened form<sup>6</sup>. Another regular analysis with semi-annual periodicity is the Report on the State and Development of the Slovak Financial Market, submitted for meetings of the government and of the National Council of the Slovak Republic under the Act on financial market supervision. The main content of the said reports is a description of the most important trends and an evaluation of risks resulting from them. Within market risks, this evaluation, including stress testing, has been extended to also include insurance companies, pension funds of pillar II and III and mu-

<sup>6</sup> The 2007 Analysis of the Slovak Financial Sector has been published on the NBS website [www.nbs.sk/Financial Market Supervision/Banking Sector and Securities Dealers Supervision/Statistical Data and Analyses/Analysis of the Slovak Banking Sector](http://www.nbs.sk/Financial%20Market%20Supervision/Banking%20Sector%20and%20Securities%20Dealers%20Supervision/Statistical%20Data%20and%20Analyses/Analysis%20of%20the%20Slovak%20Banking%20Sector).

tual funds. In addition, a macro-stress testing model has been created, by means of which it is possible to estimate the impact of a possible slowdown of the growth of the Slovak economy on the financial sector by means of credit risk, foreign exchange risk and interest rate risk channels.

In 2007, within its analytical activities, the supervision unit also dealt with the impact of the adoption of the euro on the financial sector. The analysis has been also published on the website of NBS in a shortened form<sup>7</sup>.

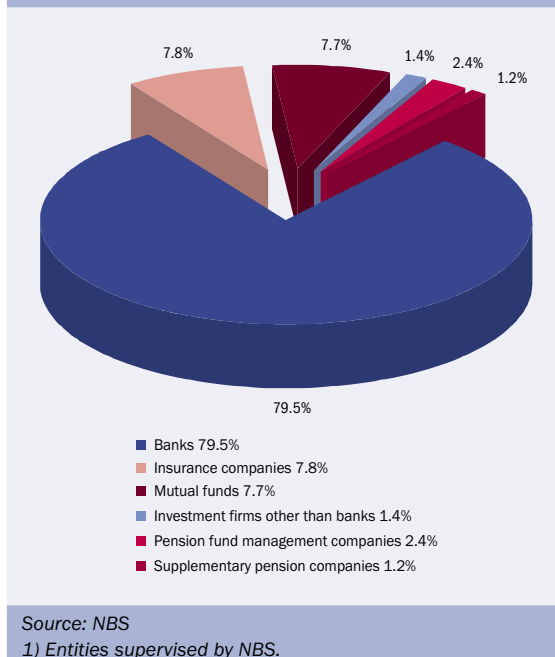
Special attention has been given to the fast growth of loans provided by banks, and to an analysis of the risks and performance of pillar II and III pension funds. Extensive analytical activities have been carried out in examining the impacts of amendments of specific legal regulations on the financial market. It primarily related to amendments to the Act on voluntary auctions, Act on consumer credits (introduction of an interest rate cap), Income Tax Act, Act on pension saving and the Home Savings Act.

## 4.7 Financial market developments in 2007

In 2007, the total value of the assets and managed assets of financial institutions regulated by Národná banka Slovenska increased by SKK 342.5 billion (19.5%) to SKK 2.088 billion at the end of the year. The increase in assets slowed down slightly in several segments of the financial market in the second half of the year, which, in some cases, might be associated with a lower performance of the world financial markets.

Pillar II pension funds reached the highest asset growth. Over 2007, their assets rose 83.5% and reached the value of SKK 51.3 billion. Their importance grew not only in the context of the pension scheme, but also in terms of important accumulation of resources in the economy at a time where the overall economic boom and interest environment motivates Slovak households rather to create debts than to save. The growth of the assets of supplementary pension funds by 18.7% to a level of SKK 25.3 billion is a positive trend in this context. Mutual funds recorded the second fastest growth (24.5%), constituting a revival after stagnation in 2006. As opposed to 2006, investments of households in such funds grew faster than the volumes on bank accounts in 2007. This development was reflected in an increase in deposits by mutual funds in banks.

Chart 38 The structure of assets and managed assets of the financial market<sup>1)</sup> (%)



The asset growth in the banking sector was more moderate than that of pension and mutual funds, as a result of which its share of the assets of the entire financial market fell slightly against 2006. At the end of 2007, the banking sector assets reached a value of SKK 1,660 billion. The dominant trend in the banking sector in 2007 was a continuing growth of loans to customers. Banks financed mainly the household and business sector, above all small and medium sized enterprises. The volume of corporate loans for real estate financing also continued to go up. Loans to households maintained their high growth rate, the household demand for loans having been influenced mainly by the growth of real estate prices. Banks decreased their investment in securities comparing to the previous year. Holdings of domestic government bonds were the main group to decrease; investment in foreign securities, on the other hand, rose.

In 2007, the growth of loans to customers was predominantly financed from the resources of clients or by issuing debt securities. The Slovak banking sector is thus one of the few banking sectors in EU countries not to be dependent on short-term interbank resources in financing loans to customers. Deposits of the retail continued to go up despite a reduction of interest rates; deposits in the domestic currency having grown the most. Deposits of businesses and financial companies except banks also continued to grow.

<sup>7</sup> The Analysis of the Impact of the Euro Introduction on the Slovak Financial Market has been published on the NBS website [www.nbs.sk/Financial Market Supervision/Banking Sector and Securities Dealers Supervision/Statistical Data and Analyses/Analysis of the Slovak Banking Sector](http://www.nbs.sk/Financial%20Market%20Supervision/Banking%20Sector%20and%20Securities%20Dealers%20Supervision/Statistical%20Data%20and%20Analyses/Analysis%20of%20the%20Slovak%20Banking%20Sector).



In 2007, the banking sector maintained its high profit generation level, the number of banks with a year-on-year profit growth increased, although the net profit of the banking sector fell by 1% against the previous year in 2007 to a level of SKK 17.6 billion as at 31 December 2007. Interest income made up the greatest share of bank income in 2007. Their share of gross income moved up from 63% in 2006 to 70% in 2007. Interest income grew mainly in large banks, because the banks have taken advantage of their market position and increased the interest income by means of a higher volume of loans; the growth of interest income was more moderate in other banks. Non-interest income fell off against the previous year. Income from trading, above all income from debt securities trading, decreased in several banks. The ROE<sup>8</sup> of the banking sector declined from 22% in 2006 to 20% in 2007. In addition to profitability, the development of this indicator was negatively affected by an increase of own funds in several banks.

In 2007, capital adequacy in all banks was above the set level of 8%. The trend towards a gradual decline of the average capital adequacy value (an average weighted by the volume of risk-weighted assets) abated in 2007. This value decreased from 13.0% to 12.8% against 2006; in some banks, however, it fell below 9%. Several banks have increased the volume of their own funds by drawing a subordinated debt or from the profit generated in 2006.

In 2007, the written premium reached a value of SKK 54.1 billion. This amount consisted of SKK 25.3 billion in life insurance and SKK 28.8 billion in non-life insurance. The technical premium, which includes investment contracts reported according to the IFRS, reached SKK 28.5 billion in life insurance. In 2007, the difference between the technical premium in life and non-life insurance was the lowest in the history of Slovakia. If the faster growth of technical premium in life insurance comparing to the non-life insurance continues, the technical premium in life insurance can be expected to reach a higher value than the technical premium in non-life insurance. The expenses for claims increased by 13% to a level of SKK 24 billion against 2006. The profit of insurance companies grew by 25% to SKK 5.6 billion as a result of a higher growth of technical revenues as compared to technical expenses. The return on assets and return on equity also grew slightly. No substantial changes occurred in the investment of the technical provisions, they continue to be invested in low-risk assets.

The amount of customer securities transactions carried out by investment firms virtually did not

change, changes occurred only in the structure of traded instruments. The amount of bond transactions decreased by more than 50%, derivative instrument transactions, on the other hand, increased. The amount of customer assets managed by these entities rose 7% against 2006 to a level of SKK 30 billion. The capital adequacy of Slovak investment firms fulfilled the prescribed minimum level with a sufficient tolerance.

The net asset value managed in open-end mutual funds grew by 25% in 2007 after moderate stagnation in 2006. Both investments of resident entities in foreign mutual funds, and the net asset value managed by domestic management companies, went up. Capital shifts from equity and bond funds to money market, mixed and other funds, especially to the so-called guaranteed funds, occurred. Stagnation of the world financial markets caused a lower average performance of share funds and similar funds. Higher yields compared to 2006 were achieved by funds investing predominantly in debt securities.

For pillar II of pension saving, the year 2007 was the first comprehensive calendar year, in which the system was closed for voluntary entries and new savers entered the system only on the basis of fixed age-related rules (automatic enrolment). The amount of assets in the funds of pension fund management companies almost doubled in a year. Pillar III of pension saving also grew in a relatively dynamic way in terms of net asset value growth. In both pillars, the structure of the aggregated portfolio was changing over 2007. In the funds of pillar II, the structure developed towards slightly less risky assets and in the supplementary pension system in the opposite direction. Compared to previous years, the balanced and growth funds recorded a decline of annual performance to a level of 3.8% and 3.6%, respectively, which brought them below the performance level of conservative funds, whose performance was 4.1% in 2007<sup>9</sup>.

The riskiness of the financial sector was partly influenced by the negative developments on the global financial markets. Direct exposure of the financial sector to subprime loans by means of securities holdings or generally structured products was only minimal. In the case of financial institutions holding such instruments, the credit quality, liquidity and valuation of such instruments remain an issue.

The total increase in volatility and uncertainty in the capital markets enhanced the equity risk. The equity risk went up mainly in some funds of pension fund management companies, supplementary pension

<sup>8</sup> Capital weighted.

<sup>9</sup> Weighted average of performance as at 31 December 2007 weighted by the NAV of funds in the given group. This is no average performance (moving average) pursuant to Act on retirement pension saving and on amendments to certain acts No. 43/2004 Coll.



companies and in mutual funds. The global decrease in liquidity, accompanying the current development in financial markets, has not affected the domestic financial sector considerably. The banking sector – in general the sector being most sensitive to the level of liquidity – showed a sufficient level of domestic primary resources.

In the banking sector, the high growth of loans to households continued, which also increased the exposure of banks to credit risk resulting from those loans in 2007. However, the amount of debt of the household sector at the macro level reached a low level in 2007. The interest rate risk of the banking sector did not change considerably in 2007. In terms of liquidity risk, the situation in 2007 was character-

ized by a high proportion of funds sterilized in NBS, as well as of other liquid assets.

The most important type of risks, to which insurance companies are exposed, are insurance risks. In addition, insurance companies are exposed to market risks, which can cause an unexpected decrease in the value of assets covering the technical provisions. The most important market risk is interest rate risk. The insurance market as a whole was exposed to a relatively low equity risk.

Funds of pension fund management companies and supplementary pension companies are exposed primarily to market risks. Balanced and growth funds are exposed mainly to equity risk.