



# SUPERVISION OF THE FINANCIAL MARKET





## 4 SUPERVISION OF THE FINANCIAL MARKET<sup>1</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 – Národná banka Slovenska follows general procedural rules laid down in Act No. 747/2004 Coll. on supervision of the financial market and on amendments to certain laws, as amended. This Act came into effect on 1 January 2006, 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, which falls under the authority of a Deputy Governor of Národná banka Slovenska, is to support both the stability of the financial market as a whole and its safe and sound operation. In line with this, the financial market supervision unit conducts financial market regulation, involving mainly the activities below:

- Rulemaking activities (it drafts generally binding legal regulations of Národná banka Slovenska in the financial market field, in particular concerning prudential regulation, operational security rules and other requirements for the conduct of business by supervised entities, participates in preparing generally binding legal regulations issued by central government bodies and, in addition, issues methodological guidelines and recommendations for supervised entities in the financial market);
- 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 supervisions);
- Analytical activities (it prepares analyses of the financial market as a whole as well as of its individual entities).

The client's protection section, as part of the financial market supervision unit (tasked with

consumer protection in accordance with the National Bank of Slovakia Act and the Act on Supervision of the Financial Market) handles petitions from the customers of financial institutions that Národná banka Slovenska supervises on the basis of the above Acts and the organizational rules of Národná banka Slovenska.

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

Slovakia's membership in the European Union means that foreign-regulated entities may operate in the country also without a licence from Národná banka Slovenska, provided 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 2008. In this section, we do not provide a complete list of these measures, but rather point to those which have had the greatest impact on the activities of regulated entities in individual financial market sectors in Slovakia.

One of the main tasks of the acts and regulations adopted in 2008 was to establish the legal prerequisites for problem-free changeover to a new currency – the euro – as of 1 January 2009. With this intention, the financial market supervision unit established a working group to draft

<sup>1</sup> A detailed report on the activities of the financial market supervision unit for 2008 is published on the Národná banka Slovenska's website at <http://www.nbs.sk/sk/dohladnad-financnym-trhom/publikacie-spravy-a-analyzy/sprava-o-cinnosti-dohlada-nad-financnym-trhom>.



**Table 22 Number of supervised entities as at 31 December 2008**

	Number of in-stitutions as at 31 December 2008	Number of in-stitutions as at 31 December 2007	Change
Banks in Slovakia	17	16	+1
Home savings banks	3	3	0
Mortgage banks	9	8	+1
Other banks	5	5	0
Branches of foreign banks in Slovakia	11 <sup>1)</sup>	10	+1
of which: NBS-authorized	0	1	-1
on the single European passport principle	11	9	+2
of which: branches of foreign mortgage banks	0	1	-1
Foreign banks contributing to the Deposit Protection Fund	0	2	-2
Representative offices of foreign banks in Slovakia	7	9	-2
Branches (organizational units) of banks in Slovakia	857	738	+119
Lower organizational units in Slovakia	401	431	-30
Branches of Slovak banks in other countries	1	1	0
Representative offices of Slovak banks in other countries	1	1	0
Foreign entities freely providing cross-border banking services	252	190	+62
of which: Banks	231	178	+53
Electronic money institutions	12	6	+6
Foreign financial institutions	7	4	+3
Credit cooperatives	2	2	0
Slovak banks providing cross-border banking services abroad	2	1	+1
of which: Electronic money institutions	0	0	0
Number of staff in banks and branches of foreign banks	20,598	19,779	+819
Insurance companies in Slovakia	23	23	0
of which: Insurance companies providing only life insurance	5	5	0
Insurance companies providing only non-life insurance	4	5	-1
Insurance companies providing life and non-life insurance	14	13	+1
Insurance companies providing services on a freedom to provide services basis	419	370	+49
of which: without an established branch	406	360	+46
through branches	13	10	+3
Insurance companies in Slovakia providing compulsory contractual third-party liability insurance for motor vehicles	9	9	0
Pension funds management companies	6	6	0
Supplementary pension funds management companies	5	5	0
Supplementary pension funds insurance companies	0	0	0
Domestic management companies in Slovakia	10	10	0
of which: management companies with an extended licence under Art. 3 of the Act on collective investment (ACI)	5	6	-1
Domestic mutual funds	114	118	-4
of which: Open-end mutual funds	68	72	-4
Closed-end mutual funds	41	41	0
Special mutual funds	5	5	0

**Table 22 Number of supervised entities as at 31 December 2008 (continuation)**

	Number of institutions as at 31 December 2008	Number of institutions as at 31 December 2007	Change
Foreign management companies and foreign collective investment undertakings operating in Slovakia and authorized under Art. 75 of the ACI:	4	2	+2
of which: through a branch in Slovakia	2	0	+2
without a branch established	2	2	0
Foreign management companies and foreign collective investment undertakings operating in Slovakia on the single European passport principle:	46	43	+3
of which: with a foreign management company branch, established under Art. 28 of the ACI	2	2	0
without a foreign management company, established under Art. 29 of the ACI	12	10	+2
European funds under Art. 61 – foreign management companies	13	11	+2
– foreign investment companies	19	19	0
within which: foreign mutual funds and sub-funds of foreign investment companies	816	617	+199
Foreign management companies doing business under Art. 3 para. 3 of the ACI	11	11	0
Investment firms under the Securities Act	18 <sup>2)</sup>	32	-14
Banks doing business under the Securities Act and NBS-licensed	13	13	0
Branches of foreign banks – investment firms licensed by their home authorities	6	6	0
Foreign entities operating in Slovakia as an investment firm	890	582	+308
of which: through a branch in Slovakia	5	3	+2
without a branch established	885	579	+306
Slovak investment firms providing services abroad without establishing a branch	7	7	0
Investment service intermediaries in Slovakia:	978	937	+41
of which: legal persons	73	61	+12
natural persons	905	876	+29
Other legal persons licensed by Národná banka Slovenska who can only issue electronic means of payment	1	0	+1
Stock exchanges	1	1	0
Central securities depositories	1	1	0
Securities issuers whose securities are traded on a regulated market	144	173	-29
Issuers of public offerings	4	4	0

Source: NBS.

1) As of 31 December 2008, the following foreign credit institutions had not begun banking activities: UNIBON, spořitelni a úvěrní družstvo, a foreign organizational unit, and Oberbank AG, a branch office of a foreign bank.

2) SFM Group, o. c. p. a. s., had not begun operating as of 31 December 2008 and started to operate on 15 January 2009.

regulations related to adopting the euro for all regulated financial market entities. The supervision unit issued, for example, NBS Decree No. 24/2008 governing the change in currency in all existing reports from supervised entities, NBS Decree No. 221/2008 Coll., laying down rules for dual display of some prices, payments and other values in the areas of the financial market and

services of financial institutions and NBS Decree No. 240/2008 Coll., determining the number of decimal places when rounding certain securities to be redenominated from Slovak currency to the euro.

The most important legal regulation for the banking and investment services sectors in 2008



was the adoption of Act No. 552/2008 Coll. of 26 November 2008, amending Act No. 566/2001 Coll. on securities and investment services and on amendments to certain acts (the Securities Act) as amended, and on amendments to certain acts. In addition, Directive 2007/44/EC of the European Parliament and of the Council of 5 September 2007 amending Council Directive 92/49/EEC and Directives 2002/83/EC, 2004/39/EC, 2005/68/EC and 2006/48/EC regarding procedural and evaluation criteria for the prudential assessment of acquisitions and increase of holdings in the financial sector was transposed by the above Act. The Act contained several modifications resulting from application practise in the supervision of financial market entities. The Act also amended several acts regulating other financial market sectors. In connection with the deepening crisis in the financial sector, the adoption of NBS Decree No. 18/2008 on liquidity of banks and branch offices of foreign banks in the Slovak banking sector through management of their assets and liabilities was the most significant among the regulations adopted in 2008 for the banking sector. Another important regulation was Decree No. 17/2008, amending NBS Decree No. 4/2007 on banks' own funds of financing and banks' capital requirements and on investment firms' own funds of financing and investment firms' capital requirements, as amended by NBS Decree No. 10/2007. Proposed amendments to a provision determining applicable collateral to mitigate credit risk, including a definition of terms for independent valuers, calculations of large exposures and risk-weighted exposures to other public authorities and legal persons other than corporates, resulted from application practise, findings made by NBS in supervision and several discussions with representatives of the Slovak Banking Association and the Slovak Association of Securities Dealers.

In collective investment sector, Act No. 552/2008 Coll. amended Act No. 594/2003 Coll. on collective investment and on amendments to certain acts, as amended, to incorporate new provisions involving prior approval for an acquisition and increase of qualifying holding in a management company, to eliminate some supervision problems that were discovered, and also to eliminate problems relating to management company activities resulting from application practice. In the capital market field, several decrees were

adopted by Národná banka Slovenska over the course of 2008. For example, the NBS Bank Board approved Decree No. 125/2008 Coll., implementing certain provisions of the Collective Investment Act. This provision fully implements Commission Directive 2007/16/EC of 19 March 2007 implementing Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards the clarification of certain definitions. The aim of adopting NBS Decree No. 357/2008 Coll. on exposures relating to financial derivative transactions was to determine details for calculating exposure when a mutual fund's assets are invested into financial derivatives in order to calculate risk-diversification limits under the Collective Investment Act. The supervision unit also issued two methodological instructions in the collective investment field: Methodological instruction of the financial market supervision unit of NBS No. 2/2008 amending previous Methodological instruction of the financial market supervision unit of NBS No. 4/2007, more precisely laying down the obligations of notified entities, and Methodological instruction of the financial market supervision unit of NBS 4/2008 on rules for asset investments in mutual funds, where the unit reacted to the issue of NBS Decree No. 125/2008 Coll. of 1 April 2008 implementing certain provisions of the Collective Investment Act. The aim of adopting NBS Decree No. 64/2008 Coll., laying down equal requirements for issuers whose registered office is in a non-Member State and whose securities are admitted to trading on a regulated market, was to ensure full implementation of Commission Directive 2007/14/EC laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market.

Most of the changes that occurred in the regulation of the insurance sector in Slovakia during 2008 were effected by coming into force of Act No. 8/2008 Coll. on insurance and on amendments and supplements to certain laws; in the course of 2008, for the purposes of practical application, two amendments to this Act were adopted. In connection with European legislation, this Act amended legislation on the activities



of insurance companies, branches of foreign insurance companies, reinsurance companies and branches of reinsurance companies in Slovakia. The first amendment, incorporated into Act No. 270/2008 Coll. amending Act No. 510/2002 Coll. on the payment system and on amendments to certain acts, as amended, and on amendments to certain acts as amended, especially governs the solvency of insurance companies, branches of foreign insurance companies, reinsurance companies and branches of foreign reinsurance companies. The second amendment, incorporated into Act No. 552/2008 Coll., particularly lays down provisions for internal audits at insurance companies, prior approvals of NBS and some aspects of changeover to the euro. Within the context of the Insurance Act entering into effect, a large number of legal regulations had to be issued in a relatively short period of time pursuant to enabling clauses. Národná banka Slovenska issued twelve decrees for the insurance sector in 2008. For example, NBS Decree No. 1/2008, laying down the maximum technical interest rate, NBS Decree No. 4/2008 on submitting statements, reports, summaries and other disclosures by insurance companies and branches of foreign insurance companies, NBS Decree No. 5/2008, laying down requirements for prior approval under Art. 45 para. 1 of Act No. 8/2008 Coll. on insurance and amendments and supplements to certain laws, NBS Decree No. 6/2008 on submitting statements, reports, summaries and other disclosures by reinsurance companies and the branches of foreign reinsurance companies, NBS Decree No. 7/2008, laying down limits on insurance technical provisions, NBS Decree No. 10/2008, laying down the method of defining the value of securities and real estate being part of the insurance industry's technical reserves, NBS Decree No. 14/2008, laying down the means for demonstrating fulfilment of conditions for receiving a licence to conduct insurance activities and receiving a licence to conduct reinsurance activities, and NBS Decree No. 25/2008 on solvency and the minimum capital in the guarantee reserves of insurance companies, branches of foreign insurance companies, reinsurance companies and branches of foreign reinsurance companies.

In pension savings, Act No. 43/2004 Coll. on retirement pension savings was amended several times in connection with the opening of Pillar II

pension funds. Act No. 62/2008 Coll. made exiting easier, allowing a pension saver to terminate participation in retirement pension savings scheme (in that time, the period for leaving the pillar was limited until 30 June 2008), and without having an officially certified signature. Act No. 434/2008 Coll. again put an option in place to withdraw from the capitalization pillar (however, such withdrawal would come into effect on 1 January 2009 at the earliest). The Act's sponsor claimed the adoption had been necessitated by developments in the world financial markets, which were causing the savings of people participating in retirement pension scheme to depreciate. However, the Act concurrently allowed those who were not in the system to enter it. Act No. 449/2008 Coll., which amended the Social Insurance Act, changed the regulatory framework for investing assets into retirement savings and supplementary pension savings plans. The supervision unit was, to a significant degree, directly involved in drafting this change in the regulatory framework. Amending the regulation had special significance primarily in regard to repealing the obligation to invest 30% of pension funds assets in the Slovak Republic. Other adopted limits ensure a better risk diversification in pension funds, especially concerning limits for the value of a single issue, for a finance group (consolidated unit) and for deposits in a single bank. A new element in the regulation is detailed criteria for utilizing ratings. A pension funds management company and its depository are required each working day to provide Národná banka Slovenska with information on asset transactions and pension fund assets, via a secure communication through electronic data transfer. In this respect, NBS Decree No. 91/2008 Coll. was issued. NBS Decree No. 101/2008 Coll. of 18 March 2008 on own funds of a pension fund management company laid down in particular the definition of own funds with which a pension fund management company is obliged to maintain; the calculation of own resources; a definition of general operating expenses, liquid assets, liabilities and claims; the calculation of liquid assets and a method of demonstrating whether conditions for capital adequacy have been met. At the close of 2008, drafts of an NBS regulation on notification of cases when limits set for assets in a pension fund and supplementary pension fund are exceeded and reconciled and a regulation on providing information on net asset value in supplementary pension funds were prepared.





### 4.3 LICENSING ACTIVITIES OF THE SUPERVISION UNIT

In 2008, the financial market supervision unit of NBS issued 987 decisions on licences, where a majority of them related to the capital market and banking sector. A breakdown by individual sector is presented in the Table 23.

Decisions by Národná banka Slovenska related to the licensing of financial market entities in 2008 include, for example, the following:

- In a NBS decision of 25 March 2008, J&T SECURITIES (SLOVAKIA), o. c. p., a. s., received prior approval for the return of its licence to provide investment services.
- Granting prior approval to ČSOB, a. s., to acquire a share in the registered capital and voting rights of ČSOB stavebná sporiteľňa, a. s., on 14 January 2008.
- Granting prior approval for ČSOB stavebná sporiteľňa, a. s., to become a subsidiary of ČSOB, a. s., on 14 January 2008.
- Granting prior approval to Slovenská sporiteľňa, a. s., to utilize internal rating-based approach for credit risk, on 28 July 2008.
- Granting prior approval for the merger of Citibank Europe, plc., Ireland and Citibank (Slovakia), a. s., on 17 September 2008.
- Granting prior approval to Tatra banka, a. s., to utilize internal rating-based approach for credit risk, on 29 December 2008.
- The following companies received 9 licences to create open-ended mutual funds:
  - Asset Management Slovenskej sporiteľne, správ. spol., a. s. (3 open-ended mutual funds),
  - ISTRO ASSET MANAGEMENT, správ. spol., a. s. (1 open-ended mutual fund),
  - Tatra Asset Management, správ. spol., a. s. (2 open-ended mutual funds),
  - VÚB Asset Management, správ. spol., a. s. (3 open-ended mutual funds).
- Two foreign investment companies received licences to publicly offer securities of foreign collective investment entities they manage through their organizational units:
  - AXA investiční společnost, a. s., Prague, Czech Republic (3 mutual funds),
  - ČP INVEST investiční společnost, a. s., Prague, Czech Republic (6 mutual funds).
- The following companies received 8 prior approvals to merge open-ended mutual funds:
  - IAD Investments, správ. spol., a. s. (2 decisions – to merge the following wound-up mutual funds: Európa, o. p. f., Investičná a Dôchodková správ. spol., a. s., and Sprint, o. p. f., Investičná a Dôchodková, správ. spol., a. s.),
  - ISTRO ASSET MANAGEMENT, správ. spol., a. s. (1 decision – to merge the following wound-up mutual funds: ISTRO ASSET MANAGEMENT, správ. spol., a. s., Globálny technologický otvorený podielový fond and ISTRO ASSET MANAGEMENT, správ. spol., a. s., Rastový akciový otvorený podielový fond EURÓPA),
  - PRVÁ PENZIJNÁ správ. spol., a. s. (2 decisions – to merge the following wound-up mutual funds PRVÁ PENZIJNÁ správ. spol., a. s., Renta III-10, o. p. f., and Globálny akciový o. p. f. RENTA – PRVÁ PENZIJNÁ správ. spol., a. s.),
  - Tatra Asset Management, správ. spol., a. s. (2 decisions – to merge the following wound-up mutual funds: Tatra Asset Management, správ. spol., a. s., dolárový dlhopisový o. p. f. Tatra Asset Management, správ.

**Table 23 Number of decisions issued by the financial market supervision unit of Národná banka Slovenska in 2008**

	Number of decisions
Banking sector and investment firms	203
Capital market	488
Insurance sector	159
Pension saving	103
Foreign exchange activities	34
<b>Total</b>	<b>987</b>

Source: NBS.





- spol., euro dlhopisový o. p. f., Tatra Asset Management, správ. spol., a. s., fond korporátnych dlhopisov, o. p. f., and Tatra Asset Management, správ. spol., a. s., medzinárodný akciový-dlhopisový o. p. f.),
- o VÚB Asset Management, správ. spol., a. s. (1 decision – to merge the following wound-up open-ended mutual fund VÚB AM Dlhopisový korunový fond, open-ended mutual fund VÚB Asset Management, správ. spol., a. s.).
  - NBS certified PRVÁ PENZIUNÁ, správ. spol., a. s., in accordance with Art. 60 para. 1 of Act No. 594/2003 Coll. on collective investment, in respect of the company's intention to publicly offer shares in open-ended mutual funds it manages in the Czech Republic.
  - On 25 January 2008, based on a request from Wüstenrot poisťovňa, a. s., the transfer of part of the life insurance stock belonging to its Wüstenrot poisťovňa, pobočka pro Českou republiku, branch to Wüstenrot, životní poisťovňa, a. s., was approved.
  - On 27 March 2008, based on a request, Wüstenrot Verwaltungs- und Dienstleistungen GmbH, Austria, was granted prior approval to acquire a share in the registered capital and voting rights of Wüstenrot poisťovňa, a. s. to directly obtain for the first time more than 33% of the insurance company's registered capital and voting rights.
  - On 2 May 2008, based on a request, Poštová banka, a. s., was granted prior approval to acquire a share in the registered capital of Poisťovňa TATRA, a. s., to obtain for the first time more than 50% of the insurance company's registered capital.
  - On 17 June 2008, prior approval was granted to merge POISŤOVŇA HDI-GERLING Slovensko, a. s., and HDI Hannover Versicherung Aktiengesellschaft, Austria. By merging, HDI Hannover Versicherung Aktiengesellschaft, Austria Rakúsko, became the legal successor to POISŤOVŇA HDI-GERLING Slovensko, a. s.
  - On 21 August 2008, prior approval was granted to merge Generali Poisťovňa, a. s., and Česká poisťovňa – Slovensko, akciová spoločnosť (abbr.: ČPS, a. s.). By merging, Generali Poisťovňa, a. s., became the legal successor to Česká poisťovňa – Slovensko, akciová spoločnosť (abbr.: ČPS, a. s.).
  - On 28 August 2008, based on a request, WIENER STÄDTISCHE Versicherung AG Vienna Insurance Group was granted prior approval to acquire a share in the registered capital of Poisťovňa Slovenskej sporiteľne, a. s., to obtain for the first time more than 50% of the insurance company's registered capital.
  - On 3 September 2008, based on a request, GROUPAMA INTERNATIONALE Sociétés anonymes was granted prior approval to acquire a share in the registered capital of OTP Garancia životná poisťovňa, a. s., to obtain for the first time more than 50% of the insurance company's registered capital.
  - On 3 September 2008, based on a request, GROUPAMA INTERNATIONALE Sociétés anonymes was granted prior approval to acquire a share in the registered capital of OTP Garancia poisťovňa, a. s., to obtain for the first time more than 50% of the insurance company's registered capital.
  - On 25 November 2008, based on a request, KOOPERATIVA poisťovňa, a. s., Vienna Insurance Group and I.V. s. r. o. were granted prior approval for their merger, and, within the merger, Vienna Insurance Group became the legal successor to I.V. s.r.o.
  - On 26 November 2008, based on a request, GROUPAMA Sociétés anonymes was granted prior approval to acquire a share in the registered capital of OTP Garancia životná poisťovňa, a. s., to obtain for the first time more than 50% of the insurance company's registered capital.
  - On 26 November 2008, based on a request, GROUPAMA Sociétés anonymes was granted prior approval to acquire a share in the registered capital of OTP Garancia poisťovňa, a. s., to obtain for the first time more than 50% of the insurance company's registered capital.
  - On 4 December 2008, KONTINUITA poisťovňa, a. s., Vienna Insurance Group was granted prior approval to conduct intermediary activities for a financial institution, Slovenská sporiteľňa, a. s.
  - In a decision of 18 January 2008, NBS granted ČSOB, d. s. s., a. s., prior approval to obtain 66% of the registered capital and voting rights of ČSOB d. s. s., a. s., a pension funds management company, in order for ČSOB, d. s. s., a. s. to become a subsidiary of Československá obchodná banka, a. s.
  - In a decision of 28 April 2008, NBS granted ČSOB d. s. s., a. s., prior approval to ING Bank N. V., a branch of a foreign bank, to become the company's depository.



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- In a decision by NBS on 17 June 2008, the licence for the incorporation and activities of a supplementary pension fund management company, STABILITA, d. d. s., a. s., was amended.
- In March 2008, a decision was issued to amend the licence for the incorporation and activities of a stock exchange, which amended the purpose of business for BCPB, a. s., regarding the organization of a multilateral trading system.
- Národná banka Slovenska decided in April 2008 on the amendment of a licence for the incorporation and activities of the central depository.
- In 2008, two prior approvals were issued for CDCP membership (Patria Finance, a. s., and Citibank Europe plc.).

In addition to issuing the above decisions, the supervision unit in 2008 received for all financial market sectors a number of notices from supervised entities, approved security prospectuses and take-over bids and issued 34 other decisions related to foreign exchange activities. In the banking sector, 64 credit institutions and 318 investment firms informed of their intention to provide cross-border banking activities and investment services in Slovakia.

The financial market supervision unit is the competent body of NBS to conduct proceedings and decide in the first instance. In 2008, within these activities, 51 proceedings against supervised financial market entities were held by the supervision unit. In this year, 46 of them were opened and 31 concluded. The proceedings related mainly to the insurance, banking and investment firms sectors.

### 4.4 CONSUMER PROTECTION

The financial market supervision unit is also tasked, in accordance with the National Bank of Slovakia Act and the Act on Supervision of the Financial Market, with protecting customers of the financial market entities and, with handling petitions from customers of the financial institutions which Národná banka Slovenska supervises. In 2008, the financial market supervision unit received 871 petitions from clients of financial market institutions (both natural and legal persons) who were dissatisfied with the practices

of financial services providers. Of the number received, the unit managed over the course of 2008 to close out 830 files, representing a 95.29% success factor in processing petitions. Most of the petitions received (561) concerned the insurance sector. The clients' protection section, in fulfilling the consumer protection role assigned to Národná banka Slovenska by the National Bank of Slovakia Act and the Act on Supervision of the Financial Market and respecting the competence of Národná banka Slovenska in the above field, guaranteed dissatisfied clients of insurance companies, banks and other supervised entities, in many cases, so-called "remedy mediation", for example change in the decision the insurance company had made not to pay benefits on an insurance claim, without having to seek relief in the courts. Financial market entities cooperating with Národná banka Slovenska provide it with information about their clients' petitions, respect the opinion presented by Národná banka Slovenska and are willing to compromise, and, in some cases, to reevaluate their decision. Petitions from clients of supervised entities are a source of information about the methods supervised entities use in conducting their activities and this information is used by the financial market supervision unit in on-site supervisions conducted at specific institutions.

### 4.5 SUPERVISION ACTIVITIES OF THE SUPERVISION UNIT

One of the most important roles the financial market supervision unit of Národná banka Slovenska plays is the supervision of financial market entities in the form of on-site and off-site supervisions. In conducting supervisions at supervised entities, NBS ascertains important facts about the supervised entities and their activities, especially weaknesses, the reason for them, their consequences and the persons responsible for them. A supervision is conducted on an individual or consolidated basis, including supervision of consolidated groups of entities and special-purpose asset pools, which also includes supervised entities, and in supplemental supervisions of financial conglomerates.

In 2008, the financial market supervision unit conducted a total of 65 on-site supervisions (Table 24).



On-site conduct of supervisions follows an annual supervision plan, which is determined by a schedule and the main focus of the supervision.

In total, 28 on-site supervisions were conducted in the banking sector and at investment firms in 2008. In the case of banks, thematic supervisions dominated, while comprehensive supervisions were conducted at non-bank investment firms. Supervisions conducted on-site at banks concentrated e.g. on validating the IRB model – verifying the quality of the data used to calculate and measure credit risk on the basis of advanced internal rating-based approach – in the scope necessary to issue prior approval to utilize internal rating-based approach in credit risk measurement in accordance with the Act on Banks. Another aim was to review management systems for operational risk, market risk, liquidity risk and credit risk, selected reports on prudential business and reports on information system, anti-money laundering and anti-terrorist financing systems, depository activities and bank-provided investment services and system for evaluating internal capital adequacy – the system was verified on the basis of a review of a bank's strategy for managing internal capital and of implementation of that strategy, an assessment of the bank's organization and management and the information and communications system put in place by the bank within the ICAAP (internal capital adequacy assessment process) framework, in relation to the scope and complexity of the bank's activities. The supervisions also evaluated methodology and the system of identification and measurement of significant risks and their incorporation into the bank's governance framework. In the case of investment firms, on-site supervisions focused on the following areas: company organization and management, the company's activities as an investment firm in connection with Act No. 566/2001 Coll. on securities and investment services, compliance with the terms and conditions laid down in their investment services licences, maintaining commercial documentation and adherence to professional standards in providing investment services and reporting and communicating a company's obligation as an investment firm – i.e. the objective accuracy of submitted reports and reports linked to the company's accounting and internal control systems, internal regulations governing the company's activities, information

systems security, data protection, data backup and anti-laundering safeguards.

On-site supervisions at regulated capital market entities in 2008 concentrated on the activities of management companies and the mutual funds they manage, compliance with provisions of Act No. 594/2003 Coll. on collective investment, Act No. 566/2001 Coll. on securities and investment services and special laws and generally binding legal regulations issued to implement them, and with statutes on mutual funds and the management companies' by-laws, as well as compliance with the terms and conditions under which the companies were granted licences and the terms and conditions presented in other NBS decisions, a review of the objective accuracy of selected reports and disclosures, and an evaluation of the principal activities of management companies in the administration of mutual funds, in particular, company organization and management, internal regulations, the system of concluding transactions, the portfolio management system, risk management in mutual funds and the internal control system in the companies.

In the insurance sector, six supervisions were conducted on-site at insurance companies during 2008, of which three were comprehensive and three were thematic. A further ten comprehensive supervisions were conducted at insurance and reinsurance intermediaries and at investment services intermediaries. Comprehensive on-site supervisions at insurance companies focused on compliance with provisions of Act No. 95/2002 Coll. on insurance, Act No. 8/2008 Coll. on insurance, special laws to the extent resulting from them and the generally binding regulations issued to implement them, and the terms and conditions set in licences issued in pursuance of the Act on Insurance. Thematic on-site supervisions at insurance companies focused, in particular, on adherence to currently valid internal regulations at the insurance companies in the compliance area, the system of conducting internal audits and fulfilment by the insurance companies of their reporting obligations to NBS, the concluding and administering of insurance policies and associated relationships with insurance intermediaries, the establishment of technical provisions, supporting documents for establishing technical provisions and accounting for those technical reserves, General Insurance



**Table 24 Number of on-site supervisions conducted at supervised financial market entities in 2008**

	Comprehensive	Thematic	Follow-up	Total
Banks	-	21	1	22
Non-bank investment firms	6	-	-	6
Management companies	3	2	1	6
Pension funds management companies and supplementary pension funds management companies	5	2	1	8
Insurance companies	3	3	-	6
Insurance, reinsurance and investment services intermediaries	10	-	-	10
Entities subject to foreign exchange supervisions	7	-	-	7
Total supervisions	34	28	3	65

Source: NBS.

Note: Not included in the table are on-site supervisions which were conducted in connection with fulfilling legal and contractual conditions for frontloading euro-currency at banks and legal persons.

Terms and Conditions for coverage, acceptance of an insured risk by an insurance company and the administration of insurance policies, management of claims and claims payment in accordance with Act No. 8/2008 Coll. on insurance.

In the area of pension saving, eight on-site supervisions were conducted, focusing on the following activities: organization, management and the legal framework for the companies' operations and contracts concluded by companies; management of investments and activities related to appreciation of the assets in pension funds, including transaction settlement, risk management and compliance with legal limits related to asset composition in pension funds; company information system and information flows; valuation of assets in pension funds, calculation of net asset value and the present value of pension units, pension fund fees, accounting and reporting; managing individual pension accounts for savers; crediting contributions and revenues; stopping fees; retirement pension savings agreements; internal controls and complaints; advertising and promotions; and compliance with the Retirement Pension Savings Act, other generally binding legal regulations, the pension fund statutes and the by-laws of pension funds management companies, as well as on compliance with the terms and conditions for which licences were granted and the terms and conditions of other

decisions by Národná banka Slovenska and a review of the objective accuracy of selected reports and disclosures. In supplementary pension saving, supervisions concentrated on reviewing requirements for personal accounts of participants and recipients of benefits and personal account statements for participants and recipients of benefits, checking and becoming familiar with a company's arrangements for transforming a supplementary pension funds insurance company to a supplementary pension funds management company, an inspection of how the company settles its beneficiaries' claims to supplementary pension insurance benefits, a review of procedures for redistributing revenues to the company's customers, valuing assets in supplementary pension funds the company administers and calculating the net asset value in supplementary pension funds, a review of the accounting method for expenses connected with administering assets in supplementary pension funds in accordance with the Supplementary Pension Savings Act and a review of procedures and methods for handling complaints from supplementary pension savings participants.

Foreign exchange supervisions focused on the fulfilment of reporting obligations by supervised entities. Foreign exchange supervisions focusing on currency exchange activities primarily verified the keeping of prescribed special records



(the issuing of purchase and sale statements, foreign exchange bookkeeping, etc.).

In 2008, the supervision unit also verified the preparedness of supervised entities for introduction of the euro, primarily focusing on dual display requirements resulting from Act No. 659/2007 Coll. on the introduction of the euro in the Slovak Republic. In this case, all supervised entities were reviewed: i.e. banks, branches of foreign banks, credit cooperatives, insurance companies, investment firms, management companies, pension funds management companies, supplementary pension funds management companies, the stock exchange and the central securities depository. After evaluating documents the supervising entities had sent, the commercial locations of 42 entities were visited during the fourth quarter of 2008, including 16 banks, 9 branch offices of foreign banks, 12 management companies, 5 pension funds management companies and 5 supplementary pension funds management companies. Individual entities were subsequently advised of weaknesses that had been found and requested to take immediate corrective action. 18 investment firms, as well as the Bratislava Stock Exchange and the Central Securities Depository received visits regarding preparedness for changeover to the euro on 1 January 2009. The supervisions showed that the supervised entities were organizationally, technically and professionally prepared to ensure problem-free changeover to the euro. The supervisions also verified preparedness at insurance companies for introduction of the euro, particularly in the scope of required dual display at insurance companies. The reviews were conducted from October to December 2008 and included both an evaluation of supporting documents which had been sent and verification that obligations at selected commercial locations of insurance companies had been fulfilled.

In addition to processing statements from supervised entities and supporting on-site supervisions at the preparation stage and during their on-site conduct, important tasks of off-site supervisors included, for example, preparation of analyses of individual financial market entities; designing stress scenarios concentrating on simulated growth in non-performing loans in a bank's loan portfolio, reflecting the impact of the current deepening financial crisis on pen-

sion funds; interim monitoring of concluded securities transactions at the BCPB stock exchange; and reviewing petitions related to the disposal of shares at CDCP filed by its clients. In connection with the financial markets turbulences and the deepening economic crisis, a meeting with insurance companies was organized. Their representatives informed in detail about the current impacts of the crisis on functioning and financial management of insurance companies. In addition, in connection with the financial crisis, daily monitoring of liquidity at banks and branches of foreign banks was put into place at the end of September 2008, based on a Decision on the imposition of a preliminary NBS measure requiring banks to maintain a minimum amount of liquid assets on a daily basis, set in consideration of specific situation of individual banks. Banks were required to ask Národná banka Slovenska for prior approval if a decline in assets below the defined minimum value was expected.

#### 4.6 ANALYTICAL ACTIVITIES OF THE SUPERVISION UNIT

A significant part of the analytical activities of the supervision unit is focused on quantifying risks in the financial sector in connection with developments in the financial market and in the domestic and foreign economies. The aim of the analysis performed is especially to identify both medium- and long-term risks and the connection to regulatory changes.

In addition to regular assessment through selected indicators of trends and risks in the domestic and foreign financial markets, a large part of the work focuses on semi-annual Analyses of the Slovak financial sector. This report is submitted to the NBS Bank Board and published in a shortened form<sup>2</sup>. At the same time, the report is an important underlying document for the Financial Stability Report. The analysis includes a deep and comprehensive evaluation of trends in the entire financial sector, risk identification and a quantification of the ability of individual financial entities and of the entire sector to be able to manage the risks to which they are exposed. Another regular analysis is a six-month report on the state and development of the Slovak financial market submitted under the Act on Supervision of the Financial Market for the Government

<sup>2</sup> <http://www.nbs.sk/en/publications-issued-by-the-nbs/nbs-publications/analysis-of-the-slovak-financial-sector>





and National Council of the Slovak Republic sessions.

Analytical activities in 2008 were influenced to a great degree by the ongoing financial crisis. In connection with negative developments in world financial markets during 2008, analyses of the crisis's impact on the Slovak banking sector and Pillar II pension funds were conducted during the first phase of the mortgage slump. These analyses were focusing in detail on the sensitivity of the security portfolios of entities concerned to a decline in value of selected groups of financial assets. In terms of assessing the effects of the crisis, attention was also paid to systemic risk assessment and the exposure of institutions operating in the Slovak financial market to counterparties whose risk had increased in this crisis, as well as monitoring various market indicators (e.g. share and credit derivatives prices). Special attention was paid to improving models and the risk assessment system, particularly concentrating on stress testing. In assessing the risk, the impact of two macroeconomic scenarios on the entire financial market was stress-tested and published, utilizing several econometric models.

In the supervision unit, the introduction of the common European currency was reflected at several levels. As part of the supervision unit's analytical activities, an analysis of the effects of adopting the euro on the financial sector was prepared.

Analytical activities were, to a large extent, also utilised in the preparation of new regulations, particularly when analyzing the consequences of legislative changes.

In respect of the ongoing crisis, greater attention was paid to crisis management. At the international level, the supervision unit cooperated, in particular, in the preparation of joint analytical instruments for crisis situations and several meetings were held with central bank representatives from neighbouring states to discuss this area.

#### 4.7 FINANCIAL MARKET DEVELOPMENTS IN 2008

The deepening financial crisis, the start of the economic crisis and preparations for entering the euro area were the main moving forces shaping

developments in the Slovak financial sector during 2008. The world financial crisis, which started at the beginning of the second half of 2007, caused during the year 2008 significant global turbulences, particularly becoming increasingly grave at the end of the third and beginning of the fourth quarters and reaching a degree that threatened the very existence of the world financial system.

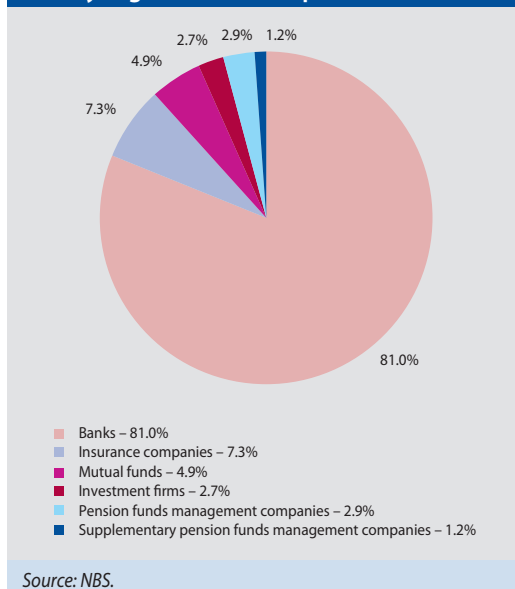
Considering the crucial role the Slovak financial sector plays in the domestic economy, the economic crisis, whose first signs were being observed in Slovakia at the beginning of the final quarter of 2008 and whose effects had already been felt by the end of the year, for example, in a decrease in loan activity in the dominant banking sector, constituted a very serious threat to financial stability.

Changeover to the euro caused balance sheets in the financial sector to expand in 2008, particularly due increases in bank deposits, which especially had a positive impact on bank liquidity.

Assets in all regulated financial institutions grew by 11% in 2008. Expressed in absolute numbers, they increased by SKK 230.77 billion (EUR 7.66 billion) to SKK 2,336.58 billion (EUR 77.56 billion) by the end of 2008.<sup>3</sup> Compared to a 20% rise in the previous year, this was a relatively sharp slowdown in the growth rate of the sector's balance sheet total. The contribution of the banking sector to the rise in assets in the entire financial sector was dominant, and the banking sector's balance sheet total reached SKK 1,893.1 billion (EUR 62.84 billion) at the end of 2008. A large part of a 14% year-on-year increase in assets was concentrated in the second half of the year, when the banks cashed in on the supply of Slovak korunas which had been deposited mostly by households, mainly to ensure a smooth conversion to the euro once the common currency is introduced. The investment firm sector showed double-digit growth, as well as both pension scheme pillars. The insurance sector also grew, although at a slower rate, at a level of around 5%. There was not much positive in 2008 for the collective investment sector, which found itself in the final months under strong pressure to redeem unit certificates. This was the main cause for a 30% drop in the net value of assets managed in mutual funds over the course of the year.

<sup>3</sup> Data for 2008 are final only for the banking sector.

**Chart 37 Share on assets and managed assets by segments: NBS-supervised entities**



In 2008, the crisis had already partially affected the financial sector's profitability. Return on equity (ROE) declined in almost all segments except for Pillar II pension funds, which was the only segment to register a negative value of this indicator. At the year-end, banking sector earned profits of SKK 15.83 billion (EUR 525.47 million). In the capitalized pension fund pillar, however, high initial costs, which companies spread out over several years, had an increasingly negative impact on financial performance. Profits earned in individual segments slowed mainly in the second half of 2008.

Negative developments in world stock markets were also reflected in a fall in the values, in particular, of share issues on the Bratislava Stock Exchange. Both as a result of these developments and the termination of regulated trading in 35 share issues, market capitalization on this exchange significantly declined. At the close of 2008, it stood in proportion to GDP at the lowest level in minimally seven years. As the direct financing already had relatively little significance, it fell even more. Credit financing, whether through banks or entities in an unregulated market, as a percentage of GDP grew in the first half of the 2008, but stagnated in the second half.

The financial crisis was locally most evident in a sharp decline in the performance of most fi-

ancial products. Money investments, including demand and term deposits in banks and money market mutual funds, continued on average to have positive nominal yields in 2008, and conservative funds in Pillar II pension funds also finished higher, while year-on-year performance in other investments increasingly fell into the red during the year. Considering the predominantly longer investment horizon and fixed nature of many of these investments, this decline does not have to mean future realisation of losses for households.

Negative developments in the financial markets also affected the ability of banks to issue bonds, particularly mortgage bonds. Both an increase in the costs of funds and the low availability of long-term funding limited the ways of financing using these resources. As a whole, however, the financial crisis did not more pronouncedly affect the banking sector in terms of resources. As opposed to other sectors in the EU Member States, the Slovak banking sector reported a high percentage of customer deposits, which significantly exceeded customer loans. Therefore, domestic banks were less exposed to the risk of high volatility in the financial markets.

In terms of assets, the financial crisis became more distinctly evident in the third quarter of 2008. Worsening economic indicators and particularly outlooks for their future course caused banks to tighten lending standards. At the same time, demand for corporate loans, especially for longer-term loans, fell. As a result, lower growth in total corporate loans was recorded in 2008 compared with previous periods. The market for household loans began to show negative trends related to the financial crisis as late as the final quarter of 2008. The falling pace of loan growth was reflected more in a drop in household demand than in tighter lending standards of banks. This development was fuelled by negative expectations of future economic developments, and also by continued decline in residential property prices. Decreasing prices, already registered in the second quarter of 2008, generated further deflationary expectations, and real estate purchases were being put off until a later period.

Despite the continuing financial crisis, a majority of banks increased their own funds, mainly by retaining profits from previous years. As of De-





December 2008, own funds in the banking sector reached SKK 115.35 billion (EUR 3.83 billion).

In 2008, the financial crisis also began to be apparent in the insurance sector. As a consequence of the reduction in return on assets, total insurance company profits fell by almost a half, compared to the previous year, to SKK 3.26 billion (EUR 110 million). Technical premium reached SKK 63.26 billion (EUR 2.1 billion); in life insurance it was SKK 33.14 billion (EUR 1.1 billion) and in non-life insurance SKK 30.13 billion (EUR 1.0 billion). The trend towards higher growth in life insurance compared to non-life continued, and as a result, the technical premium ratio in 2008 swung toward life insurance for the first time. Once again, unit-linked insurance recorded the strongest growth among individual insurance coverage groups (37.7%).

There was no significant change during 2008 in the amount of securities transactions carried out by investment firms. Bonds, shares and unit certificates in a total value of SKK 421.76 billion (EUR 14 billion) were traded. The amount of customer assets managed by licensed investment firms grew year-on-year by 41% to SKK 63.26 billion (EUR 2.1 billion). The prescribed level of capital adequacy of these entities was comfortably met.

Growth of managed assets in collective investment observed in previous periods came to a standstill in the first half of 2008 and net asset value in mutual funds actually fell sharply in the second half of the year. This development was primarily a result of the financial crisis; – on the one hand it reflected mass redemptions caused by uncertainty in light of further developments in the value of investments, and, on the other hand, albeit to a lesser degree, it reflected the decline in value of certain portfolio assets. Year-on-year performance fell across the entire spectrum of mutual funds and only money market funds managed to deliver on average positive nominal yields to unitholders. Nevertheless, the largest redemptions were documented by money market funds, also due to the impact of a rise in the limit of customer deposits protected by law in banks to 100%.

The global financial crisis also affected the pension fund sector of the financial market. A price

decline in certain asset funds consequently diminished income from these funds, and within the Pillar II pension funds, positive numbers were achieved in conservative funds only. A fall in performance also affected supplementary pension saving, where only 3 of the 10 funds financed by contributions achieved positive figures. In addition to performance, the crisis in the financial markets also affected the structure of portfolios in both Pillar II and Pillar III pension funds in 2008. Bond-type investments prevailed, especially in government bonds, while the amount of shares in the assets of pension funds and supplementary pension funds decreased almost by a half. Another significant factor influencing the activities of the pension fund sector in 2008 was the double opening of Pillar II pension funds allowing entrance or withdrawal for savers.

In recent years, household indebtedness had markedly risen, and exposure by the banks to credit risk from these loans also increased. Significant growth was documented, in particular, in long-term mortgage loans. Despite their volume increased in absolute terms, the share of household loans in total bank loans and their proportion in GDP remained relatively low, especially in comparison with similar indicators in other countries. In terms of the riskiness of household loans, the indebtedness of individual households, particularly in relation to their income, is substantial. The value of this ratio is important, especially in times of crisis. The year-on-year average ratio of loan instalments to disposable income moderately increased by 3 percentage points to 33%. The population group who were provided with loans in 2007-2008 is at more risk. However, developments in non-performing loans in 2008 had not indicated a worsening in the quality of loan portfolios.

In light of the worsening economic situation in the last quarter of 2008 and a markedly negative outlook for 2009, credit risk resulting from corporate loans constitute the greatest threat to the banking sector's stability. Bank loans to non-financial corporations rose in 2008, which was reflected in a growth of corporate indebtedness. The credit quality of corporate loan portfolios did not significantly change in 2008. Throughout 2008, the largest amount of non-performing corporate loans remained in the wholesale and retail sectors, followed by the manufacturing sector.



Direct exposure of the banks to foreign exchange risk was negligible as at of 31 December 2008. In relation to the approaching euro adoption on 1 January 2009 and the related significant decrease in SKK/EUR exchange rate volatility, banks were only exposed to changes in exchange rates of other foreign currencies. In the short-term outlook (i.e. a time horizon of several weeks), profitability at most banks should not be affected more sharply by interest rate movements. The reason is that only a small part of the assets and liabilities (approximately 10%) is revaluated at fair value against profit and loss. An increase in rates should have negative impacts since part of these assets comprised longer-duration bonds, whereas liabilities consisted mainly of short-term deposits.

The most important risks insurance companies are exposed to are insurance risks. In addition, insurance companies are exposed to market risks, which can cause an unexpected decrease in the value of assets covering technical provisions. However, most insurance companies are at almost negligible market risk which could have a direct impact on the earnings they report.

An overwhelming majority of conservative fund portfolios at pension funds management companies had no open currency positions and

included neither shares nor unit certificates. Therefore, they were not exposed to either foreign exchange risk or equity risk. The portfolios' sensitivity to changes in interest rates is greater, i.e. the interest rate risk is higher in comparison with the previous year. In balanced and growth funds, a trend towards a decreased percentage of shares and unit certificates in net asset value prevailed. Foreign exchange risk is relatively low since foreign exchange positions in the funds are to a large extent closed. In the period under review, euro positions constituted the largest percentage of open positions. Nevertheless, with the euro adoption in 2009 they no longer represent a risk. Aside from this, pension funds are the most exposed to risks resulting from exchange rate changes in the US dollar and Polish zloty. Similarly as pension funds management companies, supplementary pension funds management companies are also exposed mainly to market risks.

Developments in the riskiness of mutual fund investments were influenced to a large extent by a distinct increase in volatility, especially in stock markets. Money market and bond funds were exposed to interest rate risk, though more from a long-term point of view. Following a further cut in the ECB's base rate, interest income decreased.