CRONYISM AND PERSONS WITH A SPECIAL RELATIONSHIP TO THE BANK

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Principle no. 10 of the "Core Principles for effective Banking Supervision" concerns the issue of preventing the emergence of cronyism, i.e. the application of the policy "You scratch my back and I'll scratch yours", or in other words "a nepotistic policy", which can lead to the collapse of a bank or a banking licence being revoked.

The stated principle lays down the following requirement for the efficient conduct of bank supervision: "With the aim of preventing abuse arising in the lending connection, bank supervision authorities must set a requirement that a bank grants credit to a connected or affiliated company and individuals on an objective basis (objectively determined market prices), and also that such lending be effectively monitored and also that there be accepted other appropriate measures for the management (monitoring), or reduction (amelioration) of risk connected with this."

This principle may be incorporated into a range of principles aimed at defining and adhering to clear rules and requirements for bank conduct. Its application requires:

a) the non-provision of loans to such persons under privileged conditions (e.g. a more advantageous interest rate, more advantageous or no surety, more advantageous repayment terms, etc.),

b) the approval of some loans (above a certain amount) by the bank's board of directors,

c) objective decision making in the provision of loans,

d) setting limits for loans provided to connected or related persons, which are deducted from capital (equity) in determining capital adequacy (equity adequacy) or the requirement for guarantees for such loans,

e) the creation of objective information systems for monitoring such loans,

f) defining the term "connected or related persons",

g) the monitoring or evaluating of such loans through bank supervision,

h) setting limits of credit exposure (asset exposure) to such entities.

The content of principle no. 10 is governed by the new Act on Banks no. 483/2001, in particular in provisions Articles 35 and 36. In accordance with them, the limitations (e.g. of the total amount of the loans provided by the bank to its employees) and a stricter regime (e.g. a decision-making process) relate to some bank clients (e.g. persons with a special relationship) or to some types of deals (e.g. the provision of loans). The requirement for the application of this principle is contained also in the provision Article 27 para. 5 of the new act, in accordance with which a bank or branch or a foreign bank may not conclude contracts (including lending) under apparently disadvantageous conditions for itself, particularly such contracts binding it to an economically unjustified performance or to a performance apparently not corresponding to the consideration provided, or through which its receivables are insufficiently secured.

The new Act on Banks differentiates between entities with a special relationship to the bank according to whether it is a relationship to a bank or the branch of a foreign bank, where these are listed in detail. According to the new Act on Banks persons having a special relationship to a bank are considered to be:

a) members of the statutory body of the bank, managing employees of the bank defined in Article 27 para. 5 of the Labour Code, other employees specified by the articles of the bank and the bank's chief officer,

b) members of the bank's supervisory board,

c) entities having control (the term control is defined very broadly in Article 7 para. 19 of the new Act on Banks) over the bank, members of the statutory bodies of such legal entities and managing employees of such entities,

d) entities close (defined in Article 116 of the Civil Code) to members of the statutory body of the bank, to the bank's supervisory board, to managing employees of the bank or natural persons having control over the bank,

e) legal entities in which some of the entities stated in points (a), (b), (c), or (d) have a qualified stake (the term qualified stake is defined in Article 8 para. 11),

f) shareholders who have a qualified stake in the bank and any legal entity which is under their control or which has control over them,

g) legal entities under the control of the bank,

h) members of the Bank Board of the National Bank of Slovakia,

i) an auditor or natural person who conducts auditing activity on behalf of an auditing company in the bank,

j) a member of a statutory body of a different bank or the manager of the branch of a foreign bank,

k) during forced administration the appointed administrator of the bank, his deputy and chosen professional advisor.

The new Act on Banks includes among entities having a special relationship to the branch of a foreign bank:

a) the manager of the branch of the foreign bank,

b) members of the statutory body or supervisory board of the foreign bank,

c) entities having control over the foreign bank, members of the statutory bodies of these legal entities,

d) entities close to persons stated in points (a) or (b) or natural persons having control over the foreign bank,

e) legal entities in which some of the persons stated in points (a), (b), (c), or (d) have a qualified stake,

f) shareholders who have a qualified stake in the foreign bank and any legal entity which is under their control or which has control over them,

g) legal entities under the control of the foreign bank,

h) members of the Bank Board of the National Bank of Slovakia,

i) an auditor or natural person who conducts auditing activity on behalf of an auditing company in the branch of the foreign bank,

j) the manager of a different branch of the foreign bank or a member of the statutory body of the bank,

In contrast to the original Act on Banks, the new Act on Banks incorporates explicitly among those persons with a special relationship to the bank also auditors, members of the statutory body of a different bank and the manager of the branch of a foreign bank, the appointed receiver during forced administration, his representatives or chosen professional advisor. In the case of the branch of a foreign bank this is the auditor and manager of a different branch of the foreign bank and a member of the statutory body of the bank.

With regard to the ambiguousness of the original wording of the Act on Banks, there is stated in the new Act on Banks the duty according to which within 30 days following the elapsing of the calendar year every person stated in Article 35 para. 4 subsections (a), (b), (c) and (f) and para. 5 subsections (a), (b), (c) and (f) is obliged to notify the bank or branch of a foreign bank in writing of all information necessary for ascertaining other entities, which on the basis of their relationship to the informant have a special relationship to the bank or branch of the foreign bank. From this text it is obvious that not all persons stated in the cited section are subject to the imposed duty. This duty does not relate to entities stated in Article 35 para. 4 subsections (d), (e), (g), (h), (i), (j) and (k) and in para. 5 subsections (d), (e), (g), (h), (i), and (j). This concerns for example members of the Bank Board of the National Bank of Slovakia and auditors. The information obligation does not relate to the mentioned persons for the reason that the bank or branch of the foreign bank knows from its activity about these persons, and it is not necessary to introduce such an information duty.

Persons with a special relationship to the bank are in a special position, on the basis of which they are limited in some respects in their commercial relations with the bank. The particularity of the standing reflected in the legal regulation is justified primarily by the fact that they can have a direct or indirect influence on the bank's decision making on individual deals and these could be unilaterally advantageous for them.

The provision of section 35 of the new Act on Banks therefore defines the conditions that banks must adhere to in making bank deals with persons having a special relationship to the bank. The new Act on Banks understands under the term 'deal' the arising, change or lapsing of liability relations (for example in accordance with Article 497 to 507 and Article 708 to 719 of the Commercial Code, Article 778 to 787 of the Civil Code) between a bank or branch of a foreign bank and their client and any operations including deposit handling. According to this provision a bank or branch of a foreign bank may not execute deals with persons having a special relationship to it, which in view of their nature, purpose or risk they would not execute with other clients.

Also banks and branches of foreign banks are obliged, also prior to executing a deal to verify whether the person with whom they are executing the deal does not have a special relationship to it and to ensure the truthfulness of this information in a written contract with the sanction of invalidity of the legal act in respect of the client.

The new Act on banks solves separately, though not in all cases of deals, also the manner of providing and approving loans or guarantees (procedural issues). A bank and a branch of a foreign bank will provide loans or guarantees to persons with a special relationship to the bank, only if the statutory body of the bank or the manager of the branch of the foreign bank unequivocally decides on this on the basis of a written analysis of the respective deal (this will concern only a loan or guarantee) and of the financial situation of the applicant. In this matter, the entity that is the subject of the decision-making is excluded.

In provision Article 36 para. 1 the new Act on Banks says that the total value of loans not secured by right of lien on real estate (a special type of deal) provided by a bank to its employees or other entity that has a special relationship to the bank according to Article 35 para. 4 subsections (a), (b), (c), (d) and (f) of the new Act on Banks (e.g. entities close to members of the statutory body of the bank) may not exceed the total gross income of this entity for the directly preceding 24 months. It is assumed that the bank should manage to resolve within two years the potential risk from a deal unsecured in this way. The total value of loans provided by a bank to its employees under advantageous conditions may not exceed 5% of the bank's equity capital. This condition then does not relate to the above-mentioned persons with a special relationship to the bank. In the given case privileged conditions will apparently mean loans that were provided without surety through the right of lien on real estate property. The new Act on Banks does not directly or indirectly mention other privileged terms.

The Act governs also limitations concerning the purpose of providing a loan, where from the wording of Article 36 para. 2 of the new Act on banks it results that this limitation results to any client, thus also to persons with a special relationship to the bank. According to this provision a bank may not provide a loan or secure liabilities from a loan for any:

a) acquisition by it of issued shares, i.e. by whomsoever,

b) acquisition of shares issued by an entity having a qualified stake in the bank,

c) acquisition of shares issued by legal entities which have control over entities or which are under the control of entities having a qualified stake in the bank,

d) acquisition of shares issued by legal entities which are under the control of the bank,

e) repayment of loans provided for any acquisition of shares pursuant to points (a) to (d) or for securing liabilities from such a loan.

A new provision in Article 36 is paragraph 3, in accordance with which a bank or branch of a foreign bank may not acquire from an entity with a special relationship to it a receivable in the case of which it is justifiably assumed that it will not be settled properly and in time and neither to take over a liability from such an entity. Each contract concluded in conflict with the mentioned paragraphs 2 and 3 is invalid under the Act on Banks.

A bank may neither according to the new provision (Article 36 para. 5) provide a loan or secure liabilities from a loan provided to an employee or an entity having a special relationship to the bank in the case that the bank does not fulfil the obligation according to Article 30 para. 1 of the new Act on Banks, i.e. it does not maintain capital adequacy of at least 8% or, if an entity with a special relationship to the bank does not fulfil the obligation according to § 35 para. 3 of the new Act on Banks, i.e. it does not fulfil its notification duty in respect of the bank.

In accordance with the requirement of principle no. 10 a bank and the branch of a foreign bank are obliged to process all information notified pursuant to Article 35 para. 3 into a summary of entities with a special relationship to it and upon request hand it over to the NBS for the purposes of bank supervision, as well as to the Deposit Protection Fund for purposes in accordance with Act NR SR no. 118/1996 on Deposit Protection as amended. The content of a notification, which should assist the application of the cited provisions of the new Act on Banks, is to be stipulated by measures of the NBS. For non-fulfilment of the notification duty a fine may be imposed under conditions stated in Article 50 para. 2 of the new Act on Banks.