Investment Policy Statement of the National Bank of Slovakia

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Address
Národná banka Slovenska
Imricha Karvaša 1
813 25 Bratislava

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Investment Policy Statement (hereinafter referred to as the „IPS") is the main guiding and communication document identifying the key parameters of reserve management at the National Bank of Slovakia (hereinafter referred to as the „NBS"). Reserve management, for the purpose of this document, represents the management of investment reserves that include foreign exchange reserves, EUR-denominated non-monetary policy portfolios, as well as gold holdings allocated at foreign depositors.

Legal framework

The legal framework for the execution of reserve management is set forth in the Act of NBS No 566/1992 Coll. as amended. [1] *Národná banka Slovenska shall hold in custody and manage foreign reserve assets in gold and in foreign exchange assets, shall use these reserves, and shall conduct foreign exchange operations; when conducting operations within the Eurosystem, it shall proceed in accordance with the rules applicable to Eurosystem operations* as well as other rules set by the Eurozone accession agreements[2].

Purpose of holding investment reserves

NBS has identified multiple objectives of reserve management:

1) The objective of the reserve management is to generate highest possible long-term returns, within the risk tolerance and on an investment horizon defined herein. The purpose of these returns is contribution to covering the operational costs and strengthening of the capital position of NBS, thus reinforcing the independence of the NBS as the central bank. Specific goals are set forth in accompanying documents.
2) The objective of holding foreign exchange reserves is to meet the tentative obligation to provide additional (USD) liquidity required for potential foreign exchange intervention of the ECB in the volume defined in the documents

[1] Act No 566/1992 Coll. on Národná banka Slovenska
[2] Protocol (No 4) ON THE STATUTE OF THE EUROPEAN SYSTEM OF CENTRAL BANKS AND OF THE EUROPEAN CENTRAL BANK

outlining the Accession of Slovakia to the Eurozone[3] in an economical and efficient manner. This task results from the membership of the NBS in the Eurozone.

3) Gold reserves are managed with the aim of ensuring safety and cost-efficiency of the holdings. There is no intention to change the current amount of gold reserves.

Safety must be guaranteed by application of appropriate rules and limits combined with prudent execution of risk management and audit process.

Investment horizon and risk tolerance

Based on its legal status, access to stable funding resulting from its membership of the Eurosystem and other institutional arrangements, the bank considers itself a long-term investor with investment horizon longer than 5 years. The part of foreign exchange reserves designated to meet latent intervention requirements of the ECB represents an exception in this regard. The risk tolerance corresponds to the long investment horizon and is defined twofold –primarily by a maximum loss constraint measured on a horizon corresponding to the investment horizon set above, using mainly the metric of Expected Shortfall (with 95% confidence level) for investment reserves, combined with other relevant supportive measures (e.g. 1Y ES (95), maximum drawdown, volatility). The degree of risk tolerance is set by the Bank board, the acceptable level of other supportive measures is qualitatively assessed by the Bank Board based on return distribution projections. As an additional consideration, the impact of investment reserves on financial results reported on a yearly basis may be taken into account.

Liabilities

The reserve assets are associated with certain liabilities on the NBS's balance sheet, and this represents the cost of holding the reserve assets. The return targets specified in this document and the Strategic Asset Allocation (thereinafter referred to as the "SAA") shall take this cost into consideration and therefore, the return projections are net of financing costs. The standard rate applied as the cost of these liabilities is in general the Main Refinancing Operations rate of the ECB and this should be used in the asset allocation.

Size and tranching of the investment reserves

While specified parts of investment reserves are considered fixed in size (e.g., the foreign exchange reserves determined for potential interventions and gold reserves), the total size of the investment reserves portfolio can fluctuate in response to change in market conditions and the NBS' view of expected returns and risks in the capital

[3] Council Regulation (EC) No 1010/2000 of 8 May 2000 concerning further calls of foreign reserve assets by the European Central Bank

markets. To support the achievement of defined goals, the total portfolio is split in two tranches:

1) Fixed size - Index based investment tranche
   The size of this tranche is fixed with the exact amount specified in the SAA document. The SAA of this part of the portfolio shall be based on well-established global financial market indices, taking into account long-term capital market expectations for returns and risks of these markets.
2) Variable size - Rules based tranche
   The size of the tranche can fluctuate due to market conditions and availability of investment opportunities between lower and upper limit set forth in the SAA document. The SAA for this part of reserves should consider the excess returns available on global credit markets and their correlation with the rest of the total reserve's portfolio (including gold and foreign exchange reserves). The asset allocation of the portfolio shall conform to a set of rules and guidelines specified in supporting documents.

Types of risks

The bank is following the principles of prudent investor, i.e., it invests only in assets and instruments whose risks are properly identified, measured, monitored, managed, controlled, and reported. The bank undertakes market and credit risk in a controlled manner with the aim of collecting market risk premiums. The management of credit risk is based on a diversification, investment grade preference and single-name default avoidance. Counterparty risk shall be minimized by strict selection criteria and proper compliance procedures.

The foreign exchange risk is also unavoidable when acting as investor in the international markets. NBS does not intend to exploit the currency volatilities as a source of speculative income. In principle, NBS prefers hedging its foreign currency exposure. However, certain currency exposures can be included due to their diversification benefits or where currency hedging is deemed too costly and operationally inefficient to execute.

Among other risks, that are inevitably associated with reserve management, specific role plays liquidity, counterparty, and legal risk.

Appropriate level of liquidity shall be guaranteed in the foreign exchange reserves dedicated to cover potential intervention liquidity needs of ECB. For the rest of the reserves, the moderate liquidity requirement is satisfactory.

Legal risk shall be minimized by using standard legal documentation.

Investment beliefs

To foster discipline of the investment process, the bank has formulated series of investment beliefs that represent specific collective assumptions. These beliefs facilitate communication with all stakeholders and support the consistency of processes across investment universe. The key set of beliefs includes, but not exhaustively, the following:

- The investment is considered to be constantly long-term.
- The combination of a long investment horizon and the specific position of the central bank backed by the law, makes it possible to operate without fundamental restrictions even in a negative equity environment. The mere existence of negative equity does not represent a significant limiting obstacle for accepting investment risks in the management of reserves nor imposes undue shortening of the investment horizon.
- The numeraire used for the assessment of overall efficiency of the investment strategy is the local currency – euro. Performance and risk measurement shall be performed frequently as a vital tool of ensuring transparency and risk management. The performance of reserve management is in principle assessed on the basis of market prices.
- NBS believes, on long enough investment horizon, capital markets are efficient and broad market exposure is desired. The SAA shall maximize the benefits of diversification taking into account idiosyncratic requirements of the bank.
- The bank believes that on shorter horizons there can be significant dislocations in capital markets and thus the risk - return profile can be enhanced by active management, provided proper preparation and adequate capacities are in place. The overall risk budget of the reserve management dedicated to active risk taking on tactical and operational level is decided by Bank board and is specified in respective documents.
- Consideration of environmental, social and governance (ESG) factors, including but not limited to environmental practices, worker safety and health standards, and corporate governance, can enhance the investment process through a better understanding of risks and opportunities, and therefore may affect the risk and return characteristics of investments. NBS shall respect the international commitments of the Slovak republic and its own policies related to these areas in its investment process.
- NBS believes in the necessity of long-term continuity in professionalism and expertise in internal asset and risk management and market knowledge.
- It is important to carefully manage the trading procedures in order to achieve the outlined goals while minimizing transaction costs.

Governance

Institutionally, the governance of the reserve management function is organized by the policy agreed by the Bank board. Main decision-making bodies beside the Bank board include the Risk Committee and Investment Committee with clear separation of duties.

The portfolio management execution and the risk management function are carried out by separate departments/divisions supervised by distinct members of Bank board.
The reserve management framework is structured into three layers – top layer represents the decisions on SAA and other key principles taken by Bank board supported by the input of Risk Committee. The Tactical layer is managed by the Investment Committee which is responsible for the choice of tactical benchmarks and use of active risk budget. The operational layer consists of portfolio management execution with defined level of active risk vs tactical benchmarks.

While the strict separation of monetary policy operations and reserve management operations must be guaranteed, the SAA process considers all publicly known information material for enterprise-wide balance sheet approach.

Eligible asset classes

Authorized asset classes include gold, fixed income securities, money market instruments and public equities. Derivative instruments are used to gain or to hedge respective exposure.

SAA, reviews of SAA and rebalancing policy

Investment universe is decided by the Bank board in the process of SAA. The decision is formulated primarily by setting the strategic benchmark, composed of market, or customized indices and set of high-level rules and guidelines for the rule-based part of reserves. The SAA decision is based on the results of optimization process that comprises the capital market expectations and the specific requirements of the bank. SAA assumptions are reviewed usually on yearly basis. These reviews offer the opportunity for dynamic adjustments to SAA. However major updates are performed on longer time intervals to enable the realization of the expected returns. From the rebalancing policy perspective, the actual portfolio weights are readjusted to neutral weights set in the strategic asset allocation based on rules specified in accompanying documents.

Portfolio management

Reserve management is executed primarily internally. In cases when required capacities (e.g., special qualification or skills) are not available internally or the internal management would be not economical, mandate of external management can be considered. Employment of different investment strategies via external mandates may provide desired additional diversification benefits. Active management using passive instruments (e.g., ETFs and Total return swaps) represents a baseline of portfolio management. The extend of active management shall be decided by Investment committee on risk/return consideration and level of specialization of the internal portfolio management team in respective market segment, while respecting any constrains set forth by Risk management committee.

Reporting framework

Reserve management is supported by reporting framework providing overview of the main parameters online on daily basis to all stakeholders/specific stakeholders. The Risk management department is in charge of timely and accurate reflection of performance and risk profile.