C. BANKING SUPERVISION IN 2000

1. SLOVAK BANKING SECTOR DEVELOPMENT IN 2000

During 2000, the Slovak Banking sector was faced with the first effects of Banking reform in three main areas:

1) Restructuring and privatisation of the country's three largest state-owned banks,
2) Programme and strategy of handling small and medium-sized banks,
3) Improvements in regulation and carrying out of banking supervision.

In the largest state-owned banks, some crucial steps were taken in the second half of 1999 and the first half of 2000 to bolster capital adequacy levels and improve loan portfolios. These measures enabled the banks to reach common capital adequacy standards and reduce the share of classified loans below 20%.

The restructuralisation of the three biggest banks involved decisive and vital steps; in addition to an Sk 18.9 billion of fresh capital injected into the banks, they were helped by a two-step transfer of risky loans valued at total of Sk 105 billion. However, restructuring will not be complete before the banks' corporate clients have also been through the process of restructuring, and this has only just begun.

Slovakia's economic performance and bank restructuring efforts have already resulted in an upgrade in its long-term forex and koruna liabilities (FITCH rating agency).

The restructuring process is continuing hand-in-hand with privatisation, which is the next step in the banking sector reform with the assistance of J.P. Morgan financial consultants and legal advice from the White & Case agency. Over the year, the pre-conditions were created for a strategic investor to step into Slovenská sporiteľňa and into Všeobecná úverová banka.

The strategy of the Banking Supervision of the National Bank of Slovakia concerning small and medium-sized banks is based on a financial analysis of the situation and trends in individual banks during 1999, as well as on their track records in complying with the NBS regulations and positions demonstrated by their investors in 2000. The strategy quantified and suggested solutions to accumulated problems, in particular the following:

1) a large and still rising share of classified loans inadequately covered by provisions and reserves,
2) growing credit loss depleting banks capital and affecting their performance,
3) valuing collateral and guarantees for loans,
4) compliance with prudential banking regulations and deteriorating liquidity in some banks.

The measures adopted by the Banking Supervision of the NBS were preceded by an assessment of the situation in individual banks through on-site supervision and external audit. Their inspection prompted the NBS to put Slovenská kreditná banka, a.s., Bratislava, and Dopravná banka, a.s., Banská Bystrica under forced administration on 19 April 2000 and 1 July 2000, respectively. Together with AG Banka, a.s., Nitra, whose license was revoked on 13 April 2000, the mentioned banks were put under special regime of operation. On 13 April 2000, the Bratislava Regional Court opened bankruptcy proceedings involving AG Banka's assets. On 4 July 2000, Slovenská kreditná banka was declared bankrupt what meant the end of the forced administration and the loss of its banking license. Before long, the forced administration period at Dopravná banka, also came to an end, when bankruptcy proceedings were opened by Banská Bystrica Regional Court on 22 August 2000.

Reinforcement of Regulation and of Banking Supervision Conduct

In the year 2000 the preparations for amendments to existing legislation started to take place, leading to the adoption of, or proposals for, brand-new legislation or revisions to existing laws.

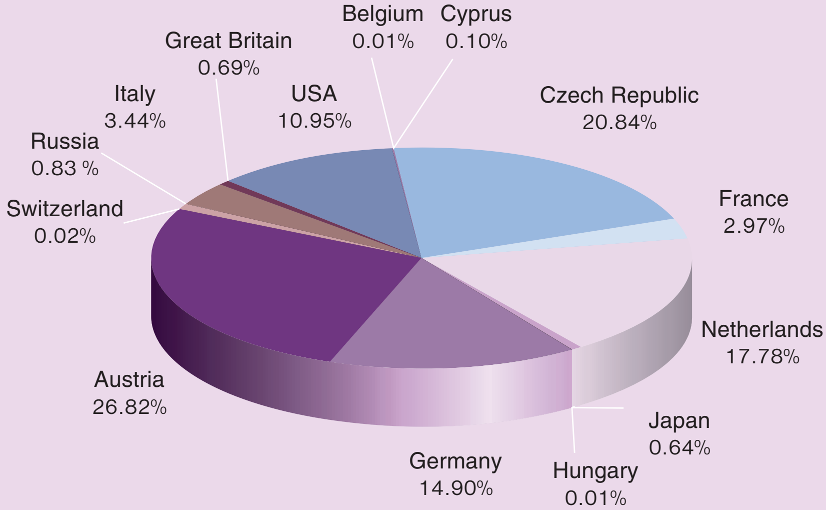
In September 2000, the National Council of the Slovak Republic passed the Act on the Financial Market Authority, amending certain other laws (No. 329/2000 Z.z.). Apart from the establishment of a government agency – the Financial Market Authority – to supervise the capital market and the insurance industry, the Act defines its scope of activity and the procedures to be followed in performing state supervision. The Authority reports to the Slovak Government, presenting activity reports for the previous calendar year together with an analysis of the current state of Slovakia's capital market and insurance sector. As the law stipulates, the Authority will work together with the Ministry of Finance to create and implement financial policy, in particular to prepare capital market and insurance sector analysis, their development planning, and generally binding secondary legislation concerning this particular area. The Act came into force on 1 November 2000.

On 8 December 2000, the Bank Board of the National Bank of Slovakia approved a new Banking Act proposal drawn up with the assistance of responsible Ministry of Finance departments.

The new Banking Act aims at harmonising the Slovak banking legislation with relevant EU directives, at implementing the World Bank and the International Monetary Fund recommendations and at increasing the National Bank of Slovakia's banking supervisory authority.

The law incorporates the Core Principles of effective banking supervision specified by the Basle Committee for Banking Supervision. Further, it sets out requirements for the operation of banks and branches of foreign banks, including prudential rules, and extends the

Share of individual countries in foreign capital



liability of supervisory board members and directors for poor economic performance of their banks. A legislative framework for banking supervision on a consolidated basis is also included. The law makes it easier to impose prompt corrective action on problem banks, for instance if their capital adequacy falls below the specified limit, and is more specific about forced administration matters. In addition, the law specifies stricter requirements for bank auditors to co-operate with the National Bank of Slovakia. The law incorporates proven standards of accounting, protection of bank secrecy and disclosure of banking information, and lays down the rights and obligations of banks regarding protection against illegal bank operations. Also included are provisions designed to promote mortgage banking.

Secondary Legislation – the NBS Decrees

The NBS issued six new or revised decrees last year, coming into effect on 31 March 2000, to enforce prudent banking behaviour by regulating capital adequacy, credit exposure, and liquidity in banks and branches of foreign banks, open foreign exchange positions in banks, procedures for classifying claims and off-balance sheet liabilities, and the submission of regulatory reports of banks and branches of foreign banks to the NBS.

In December 2000, the NBS Bank Board adopted a decree specifying the criteria and details of applications for prior approval under Article 16, paragraph 1, of the Banking Act, to acquire or increase the specified thresholds in the bank's registered capital or voting rights, for the acquisition, merger, spin-off or closure of a bank; for an increase or decrease in a bank's registered capital other than a loss-related decrease, and for the sale of a bank or a branch of a foreign bank, which took effect on 1 February 2001.

Co-operation with Foreign Banking Supervisors

During 2000, the NBS banking supervisors took part in several events organised by the regional group of banking supervisors of Eastern and Central Europe (e.g. the seminar in Bratislava in June 2000 to discuss the 25 Basle Core Principles of effective banking supervision). The NBS banking supervisors also regularly attend conferences organised by this particular regional group (May 2000 in Prague).

Negotiations are now underway with German banking supervisors, as part of the bilateral agreements on co-operation in banking supervision. A working meeting also took place in November 2000 in Rome with Italy's banking supervisors. Meetings with Austrian supervisors were held in August 2000 in Vienna and March 2001 in Bratislava. In late March 2001, NBS supervisors met their counterparts from the Czech National Bank at a regular meeting held under a Banking Supervision Co-operation Agreement signed by both central bank Governors in July 1999.

2. BANKING SECTOR PERFORMANCE IN 2000

At 31 December 2000, the Slovak banking sector consisted of 23 banking entities (21 banks and 2 branches of foreign banks) and 10 representative offices of foreign banks. Of the 21 banks, two are state financial institutions, three are specialised banks - home savings banks and six banks are authorised to conduct a mortgage business.

According to its application, the NBS granted ČSOB stavebná sporiteľňa, a.s. (a home savings bank) a banking license, effective from 24 October 2000, to perform activities defined in Article 4, paragraph 3, of Act No. 21/1992 as amended, and Article 2, paragraph 2, of Act No. 310/1992 on home savings schemes as amended. ČSOB stavebná sporiteľňa, a.s., opened for business on 1 December 2000.

The Bratislava representative office of the Prague-based J&T Banka, a.s. was registered in April 2000. On the request of ČSOB, a.s., Prague, which had acquired Investiční a poštovní banka, a.s., Prague, the representative office of the latter was cancelled on 30 September 2000.

Total subscribed equity in the Slovak banking sector (excluding the NBS), including permanently provided funds of branches of foreign banks, totalled Sk 53,997.6 million on 31 December 2000, with subscribed equity capital accounting for Sk 49,169.4 million and funds permanently provided by foreign head offices to their branches in Slovakia representing Sk 4,828.2 million. The share of foreign investors in the total subscribed equity of banks and permanently provided fund to branches of foreign banks totalled Sk 15,153.4 million on 31 December 2000, equal to a slight annual increase of 3.5 percentage points, from 24.6% to 28.1%. The increase resulted from both new foreign investors entering the banking sector and existing investors increasing their shares in banks, with the State progressively reducing its holdings.

In the banking sector, 2000 was marked as a year of recovery in most financial indicators, including improvement in compliance with prudential rules, as compared to the end of 1999 and earlier.

The total assets of banks operating in the Slovak money market recorded a rise in 2000, an increase of Sk 77.2 billion (10.03%) to Sk 847 billion from the previous year.

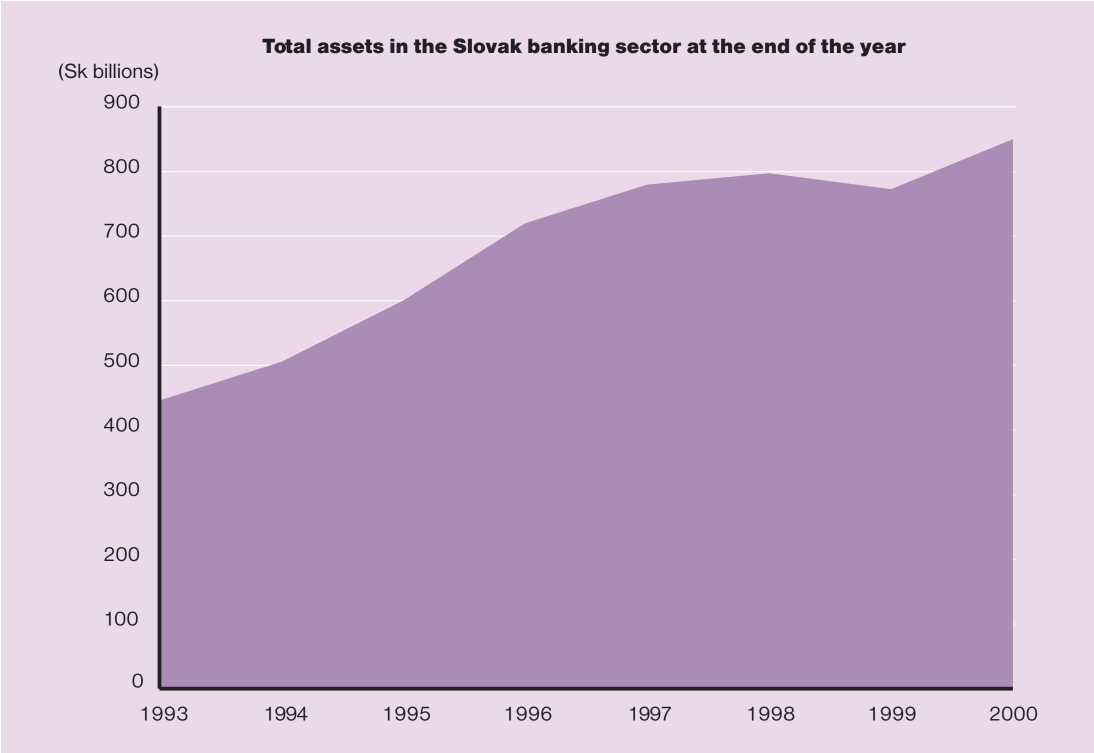
The quality of the banking sector's loan portfolio had improved by the end of the year. Classified loans fell by Sk 30.7 billion and totalled Sk 88.6 billion (a decline of 25.74%). A considerable improvement was also recorded in the share of classified loans to total outstanding loans, which fell year-to-year from almost 40% in September 1999 to 21.70% on 31 December 2000. Excluding Konsolidačná banka (state financial institution), classified loans fell by Sk 31.7 billion and totalled Sk 56.5 billion (a decline of 35.92%), which represents a 15.32% share on total loans.

Structure of capital and permanently provided funds of banks and branches of foreign banks in the Slovak Republic as at 31 December 2000

Slovak banking sector performance (in Sk thousands)

Slovak banking sector	31.12.1999	30.6.2000	31.12.2000	Year-on-year change	Year-on-year change in %
Number of employees	23,727	22,785	22,332	-1,395	-5.88
Number of banks in Slovakia	23	22	21	-2	-8.70
Number of foreign bank branches in Slovakia	2	2	2	0	x
Number of foreign bank representative offices in Slovakia	10	11	10	0	x
Number of branches in Slovakia	305	290	291	-14	-4.59
Number of sub-branches in Slovakia	924	863	810	-114	-12.34
Number of branches in other countries	1	1	1	0	x
Number of sub-branches in other countries	1	1	1	0	x
Number of representative offices in other countries	6	6	7	1	16.67
Total assets	769,764,045	798,532,915	846,954,662	77,190,617	10.03
Earning assets	632,811,207	684,811,707	749,110,627	116,299,420	18.38
Total interbank assets	216,680,752	286,771,455	347,925,147	131,244,395	60.57
Total foreign exchange assets	122,865,360	123,828,906	155,146,071	32,280,711	26.27
Securities	80,058,539	118,412,359	136,464,924	56,406,385	70.46
Total loans	411,357,286	412,083,298	408,229,708	-3,127,578	-0.76
Of which: classified loans	119,271,144	99,797,232	88,573,806	-30,697,338	-25.74
Share of classified loans on total loans (%)	28.99	24.22	21.70	-7.29	x
Uncovered estimated loss	603,183	8,700,160	11,291	-591,892	-98.13
Provisions for loan losses	50,661,571	54,485,987	69,431,148	18,769,577	37.05
Legal reserves	31,250,480	14,284,983	5,498,288	-25,752,192	-82.41
Equity capital	48,241,771	51,379,771	49,169,329	927,558	1.92
Own funds	137,678,624	131,862,566	115,726,128	-21,952,496	-15.94
Secondary funds	154,323,881	142,168,743	158,219,633	3,895 752	2.52
Primary funds	506,989,377	546,644,884	596,300,597	89,311 220	17.62
Of which: non-anonymous deposits	269,255,386	290,321,930	312,545,469	43,290,083	16.08
Current profit	3,766,769	4,032,230	15,795,169	12,028,400	319.33
Current loss	33,288,485	4,645,325	11,417,609	-21,870,876	-65.70
Net profit/loss	-29,521,716	-613,095	4,377,560	33,899,276	-114.83
Cumulative profit/loss	-49,772,135	-50,119,330	-43,383,062	6,389,073	-12.84
Capital adequacy ratio (in %)	5.34	0.68	2.44	-2.90	x

Slovak banking sector excluding Konsolidačná banka, š.p.ú.Ú	31.12.1999	30.6.2000	31.12.2000	Year-on-year change	Year-on-year change in %
Total assets	738,669,416	778,905,958	834,037,808	95,368,392	12,91
Earning assets	623,307,070	675,444,532	739,359,190	116,052,120	18,62
Total interbank assets	215,495,227	285,228,877	346,721,301	131,226,074	60,90
Total foreign exchange assets	122,865,360	123,828,906	155,146,071	32,280,711	26,27
Securities	80,058,539	118,412,359	136,464,924	56,406,385	70,46
Total loans	37,1876,193	372,839,130	368,694,649	-3,181,544	-0,86
of which: classified loans	88,124,134	68,404,591	56,473,028	-31,651,106	-35,92
Share of classified loans on total loans (%)	23.70	18.35	15.32	-8.38	x
Uncovered estimated loss	297,529	6,619,832	11,291	-286,238	-96,21
Provisions for loan losses	37,491,155	30,298,363	38,470,793	976,638	2,61
Legal reserves	20,048,378	14,147,990	5,331,586	-14,716,792	-73,41
Equity capital	45,884,832	49,022,832	46,812,390	927,558	2,02
Own funds	123,793,912	129,693,754	120,277,991	-3,515,921	-2,84
Secondary funds	117,610,489	106,412,403	123,460,346	5,849,857	4,97
Primary funds	506,876,158	546,527,043	596,184,865	89,30,707	17,62
Of which: non-anonymous deposits	269,255,386	290,321,930	312,545,469	43,290,083	16,08
Current profit	3,766,769	4,032,230	15,795,169	12,028,400	319,33
Current loss	20,533,234	3,381,465	4,016,473	-16,516,761	-80,44
Net profit/loss	-16,766,465	650,765	11,778,696	28,545,161	-170,25
Cumulative profit/loss	-24,396,924	-23,480,150	-10,606,715	13,790,209	-56,52
Capital adequacy ratio (in %)	12.63	11.72	12.48	-0.15	x



The progress of restructuralisation of banking sector (in particular the transfer of non-performing loans from restructured banks), capital market transactions and a reduction in bank lending activity resulted in increase of the share of earning assets on total assets (year-to-year by Sk 116.3 billion to Sk 749.1 billion). Earning assets made up 88.45% of total banking sector assets on 31 December 2000. Share of earning assets increased on year-to-year basis by 6.24%.

The liability side reported notable growth in primary funds by Sk 89.3 billion, i.e. 17.62%, which almost covered the asset expansion.

The banking sector as a whole recorded a return to profit, amounting to Sk 4.4 billion in the year ending 31 December 2000, after reporting a sizeable loss of Sk 29.5 billion on 31 December 1999. The rebound in 2000 was due mainly to the completed restructuring of Všeobecná úverová banka, Slovenská sporiteľňa and Investičná a rozvojová banka. These three banks were able to transfer to their earnings a considerable part of their provisions and reserves formerly held for transferred loans, thereby improving the result of the sector as a whole.

Financial result – loss at 31 December 2000 was reported by five banks, i.e. four less than a year ago (nine banks recorded a loss in 1999).

Financial result of banking sector at 31 December 2000 and its development are determined by return ratios calculated on the basis of profit and loss compensation, average asset value and equity capital.

Return on equity (ROE) in %	31.12.1999	31.12.2000
banking sector as a whole	-61.20	8.90
banking sector excluding Konsolidačná banka	-36.54	25.16

Return on assets (ROA) in %	31.12.1999	31.12.2000
banking sector as a whole	-3.99	0.54
banking sector excluding Konsolidačná banka	-2.34	1.48

3. REVIEW OF PRUDENTIAL BANKING BEHAVIOUR

Currently, there are five NBS decrees in place, which regulate prudential banking behaviour; all are based on the internationally recognised principles and recommendations of the Basle Committee for Banking Supervision.

This review draws on information from bank accounting records and their regulatory reports on capital and reserves, capital adequacy, asset and liability classification, credit exposure, liquidity and open foreign exchange positions, submitted to the NBS Banking Supervision Division.

The information system of the Banking Supervision Division applies a set of indicator ratios to evaluate and monitor tendencies in the performance of individual banks, groups of banks and the banking sector as a whole.

Assessment of the banking sector development and compliance with prudential banking rules is conducted by the Banking Supervision of the NBS also by ongoing on-site inspections. In 2000, seven on-site inspections were carried out (four overall, and three targeted inspections).

Capital and Capital Adequacy

According to Article 3 of the NBS Decree No. 6/2000 of 14 February 2000, requiring banks and branches of foreign banks to submit certain information to the National Bank of Slovakia, banks must file quarterly reports on capital and reserves and monthly capital adequacy reports. The NBS Decree No. 2/2000 of 14 February 2000 on capital adequacy of banks, replacing the NBS Decree No. 5 of 16 May 1997, requires banks to maintain a minimum capital adequacy ratio of 8%.

The Slovak banking sector's capital adequacy ratio has stabilised over the year and, excluding Konsolidačná banka, reached 12.48% on 31 December 2000. Two banks fell short of the determined capital adequacy ratio at the end of the year.

Classification of Bank Assets

The NBS Decree No. 6/2000, which stipulates information to be reported by banks and branches of foreign banks to the National Bank of Slovakia, introduced a revised form of reports on asset and liability classification. Classification reports must now contain information about existing provisions as at the date of preparation of financial statements. The amount of provisions may decrease during the year due to their release, cession or pay-off of claims, and the like. Additional provisions may also be set aside during a year to account for accrued interest, past-due interests or other expenses incurred in claim enforcement process, and the like. Legal reserves cannot be applied to cover credit risks, as they are a capital component. Other reserves may be used to cover off-balance sheet liabilities in favour of debtors, local government authorities or other funds.

The uncovered estimated loss of the Slovak banking sector fell by Sk 591,892 thousand (down by 98.13%), from Sk 603,183 thousand at 31 December 1999 to the amount of Sk 11,291 thousand at 31 December 2000. Two banks reported uncovered estimated loss for the period under review.

Credit Exposure

The revised NBS Decree No. 3/1994 on the credit exposure of banks, as amended by the NBS Decree No. 4 of 14 February 2000, sets the following bank exposure limits: 25% of a bank capital for exposure to a single customer or a group of economically related customers; 125% of a bank capital for exposure to a Slovak bank or a bank incorporated in a zone A country; 20% of a bank capital for exposure to persons with a special relationship to the bank, and the aggregate amount of all net individual exposures greater than 10% of the reporting bank's capital not to exceed 800% of its capital. The revised NBS decree stipulates that credit risk be measured by reference to capital calculated on the basis of the annual financial statement.

Compared to 1999, there was a general improvement in compliance with applicable credit exposure limits, resulting in less non-complying banks. As at 31 December 2000, ten banks violated the limits on exposure to non-bank customers; two were overexposed to other banks, and ten exceeded the limit for persons with a special relationship to the bank. The aggregate net exposure limit was breached by three banks.

Liquidity

The NBS Decree No. 3/2000 on the liquidity of banks and branches of foreign banks lays down two limits – the monthly liquidity in a bank or a branch of a foreign bank must not fall below 0.9, and the ratio of the sum of fixed and non-liquid assets to a bank's own funds and reserves must not exceed 1.0.

Development of compliance with monthly liquidity limits has been improving throughout the year. The number of banks failing to meet the monthly liquidity limit (excluding Konsolidačná banka) was falling progressively to one at 31 December 2000. Eight banks have not complied with the limit for the ratio of the sum of fixed and non-liquid assets to a bank's own funds and reserves.

Open Foreign Exchange Positions

The NBS Decree No. 5/2000 on limits on open foreign exchange positions in banks sets a limit of 10% of a bank's capital on positions in euro, British pound, U.S. dollar, Swiss franc and Czech crown, and a 5% limit on other foreign currencies, and the overall open foreign exchange position must not exceed 25% of a bank's capital.

Compliance with limits of open foreign exchange positions has improved; as at 31 December 2000, the overall open foreign exchange position limit was exceeded by two banks, selected currencies limits (EUR, GBP, USD, CHF, CZK) by four banks, and limits on other currencies by one bank.