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TECHNICAL NOTE ON REGULATION AND SUPERVISION OF LESS SIGNIFICANT INSTITUTIONS

This paper on the Slovak Republic was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on March 24, 2025.

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TECHNICAL NOTE

REGULATION AND SUPERVISION OF LESS SIGNIFICANT INSTITUTIONS

Prepared By
Monetary and Capital Markets Department

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program mission in the Slovak Republic. It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations. Further information on the FSAP can be found at http://www.imf.org/external/np/fsap/fssa.aspx

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Glossary

AML	Anti-Money Laundering
AMLSS	Anti-Money Laundering Supervision Section
BCBS	Basel Committee on Banking Supervision
BCP	Basel Core Principles for Effective Banking Supervision
BI	Business Intelligence
BRRD	Banking Recovery and Resolution Directive
BSD	Banking Supervision Department
CTF	Counter Terrorist-Financing
COREP	Common Reporting (ECB)
CRD V	Capital Requirements Directive V (EU)
CRR	Capital Requirements Regulation (EU)
C&E	Climate-Related and Environmental Risks
CCyB	Counter-cyclical capital buffer
CVA	Credit Valuation Adjustment
DORA	Digital Operational Resilience Act
EA	Euro Area
EBA	European Banking Authority
ECL	Expected credit losses
ECB	European Central Bank
EU	European Union
EC	European Commission
EUR	Euro
EVE	Economic Value of Equity
FATF	Financial Action Task Force
FINREP	Financial Reporting (ECB)
FIU	Financial Intelligence Unit
FSAP	Financial Sector Assessment Program
GDP	Gross Domestic Product
HI	High Impact
HR	High Risk
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards
ILAAP	Internal Liquidity Adequacy Assessment Process
IRRBB	Interest Rate Risk in the Banking Book
ITS	Implementing Technical Standards
LCR	Liquidity Coverage Ratio
LSI	Less Significant Institution
LTD	Loan to Deposit
ML	Money Laundering

MoF	Ministry of Finance
NBS	Národná banka Slovenska
NCA	National Competent Authority
NII	Net Interest Income
NPL	Non-Performing Loan
NSFR	Net Stable Funding Ratio
O-SII	Other Systemically Important Institution
P2G	Pillar 2 guidance
P2R	Pillar 2 requirement
RC	Resolution Council
RCAP	Regulatory Consistency Assessment Program
ROA	Return on Assets
SI	Significant Institution
SNCI	Small and Non-Complex Institution
SREP	Supervisory Review and Evaluation Process
SSM	Single Supervisory Mechanism
TF	Terrorist-Financing

EXECUTIVE SUMMARY

The FSAP conducted a targeted assessment of the effectiveness of banking regulation and supervision in the Slovak Republic focusing on less significant institutions (LSIs). In scoping this review, the 2007 FSAP recommendations as well as relevant Euro-Area (EA) and global regulatory and market developments were taken into account. The review focused on selected areas including the supervisory independence and powers of Národná banka Slovenska (NBS), corrective and sanctioning measures, its supervisory strategy and approach for LSIs, oversight of key risks including credit, liquidity, interest rate risk in the banking book (IRRBB), operational/IT and climate related financial risks, governance and the strength of the LSI's risk management policies and practices. The assessment also reviewed NBS' approach to supervising AML/CTF risk for banks.

Since the 2007 FSAP update, the Slovak Republic authorities and the European Union (EU) have significantly strengthened the regulatory and oversight framework for EA banks. The wider EU legislative framework is now setting the main requirements for banks, where the Slovak Republic has both transposed the EU requirements into its national law, as well as adapting certain aspects of the framework to local circumstances. In addition, the Single Supervisory Mechanism (SSM) assigns the European Central Bank (ECB) with the responsibility to directly supervising significant banking institutions (SIs) in the EA. The National Competent Authorities (NCAs) are responsible for the direct supervision of less significant institutions (LSIs) under the indirect oversight of the ECB. NBS has chosen to harmonize its requirements and approach for LSI supervision with the SSM approach adopted for SIs with some caveats for proportionality.

Although NBS' range of corrective powers is broad, there are a few areas where supervisory powers can be strengthened to ensure its ability to act independently. Slovak Republic laws enable banks to challenge NBS' prudential decisions prior to the finalization of inspection reports together with the ability to appeal decisions regarding sanctioning and other corrective measures. NBS' operational independence would be increased by removing the ability of banks to challenge or appeal prudential supervisory decisions prior to being finalized. Further, laws in the Slovak Republic need to be enhanced to ensure adequate legal protection of the supervisor and staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith. Last, NBS Act should be changed to limit or prohibit the participation of Government representatives at Bank Board meetings.

NBS' supervisory approach focuses on LSI risks and vulnerabilities however streamlining some of the off-site activities while enhancing on-site inspections will increase its overall effectiveness of assessments of LSI's risk management practices across key risk areas. NBS' approach to off-site supervision of LSIs is commendable in that the Supervisory Review and Evaluation Process (SREP), carried out annually on all LSIs, regardless of classification, are treated equally. However, the depth, breadth and frequency of off-site activities (including SREP) should align with the LSI's impact and overall risk profile. In addition, NBS should update the risk profile of an LSI, including the classification, after material deficiencies are discovered. Further, NBS should enhance its model for LSIs to include periodic engagement with banks' independent or non-executive board members (supervisory board) and heads of control functions, especially for high impact (HI) or high risk (HR) LSIs. Last, NBS should develop a formal internal escalation process to deal with problem LSIs and make use of formal corrective measures and powers when needed.

Although NBS undertakes on-site inspections across several subject areas, the focus on the effectiveness of LSIs' risk management practices needs to be enhanced as well as an augmentation of supervisory resources. Planning of NBS´ on-site inspection program is developed in cooperation with/direction of the off-site supervisory teams. Although the program includes on-site inspections and horizontal thematic reviews, NBS is not necessarily assessing the effectiveness of LSI' risk management practices covering key risk areas on a supervisory cycle, including: credit, liquidity, IRRBB and IT risk. Vacancies in the Banking Supervision Division should be addressed and there is evidence that additional technical expertise needs to be onboarded in the following risk areas: Cyber, AML, IT Risk and Liquidity.

NBS' capital requirements for LSIs follow the EU framework, including the assessment of capital buffers established in the EU Capital Requirement Regulation (CRR). NBS assesses LSIs' capital buffers as well as Pillar 2 capital add-ons annually, regardless of LSI SSM classification. LSI's total capital ratios remain strong on average of 14 percentage points above total minimum capital regulatory requirements of 8 percent. Monitoring the strength of LSI's capital ratios will be critical considering the bank levy that was recently introduced by the State beginning 2024.

Although NBS is proactively addressing several key supervisory priorities simultaneously, there is room to enhance certain regulatory gaps with the Basel framework. NBS strives to address ECB requirements in advance of implementation timetables (e.g.,, IT risk operational resilience initiatives in advance of the Digital Operational Resilience Act (DORA), collection of key IRRBB data, assessment of key credit risk default definitions, etc.) However, NBS needs to update its regulations and or prudential requirements: to broaden the definition of a related party transaction and other related prudential requirements; develop notification and reporting protocols to ensure LSIs effectively deal with Cyber risk events; and take into account excessive concentration risk to include a broader range of exposure types (e.g., sovereign risk concentration) when setting Pillar 2 capital requirements.

Although NBS has made progress to assess climate-related financial risks, it needs to continue to evolve its supervisory practices to adequately assess these risks in LSIs. NBS has communicated its expectations to industry, using various forums, and has undertaken thematic reviews regarding LSI's climate-related financial risk management practices. Learnings to date should be incorporated into its overall supervisory activities on a gradual basis.

NBS undertakes on-site inspections and off-site monitoring of LSI's compliance with AML/CTF regulatory and supervisory requirements. NBS has an effective off-site monitoring tool to address certain aspects of AML/CTF risks in LSIs. NBS, however, should re-assess the frequency of on-site inspections as well as communicating with independent board members when necessary. Further, NBS should ensure that material AML/CTF non-compliance deficiencies have an impact on the overall view of the risk profile of the LSI. Last, NBS should finalize the update of the Cooperation Agreement between NBS and the Financial Intelligence Unit (FIU), to eliminate overlap of duties or responsibilities.

Table 1. Slovak Republic: Key Recommendations

	Recommendations[1]	Priority	Timeframe
NBS' Supervisory Powers and Independence			
1)	Confine banks' appeal powers to finalized supervisory prudential decisions and sanctions.	H	NT
2)	Enhance the legal protection of the supervisor and staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith.	H	NT
3)	Ensure attendance at NBS' Bank Board meetings is limited to non-government or non-political representatives to ensure independence.	H	NT
4)	Augment technical capabilities of supervisors to ensure adequate coverage of risk areas (cyber, IT, liquidity and AML risk) as well as fill BSD vacancies.	H	NT
Supervisory Approach and Tools			
5)	Review the off-site supervision program to tailor the depth, breadth and frequency of off-site activities (including SREP) to align with the LSI's impact and overall risk profile.	H	I
6)	Update the risk profile of an LSI, including classification, after material deficiencies are discovered.	H	I
7)	Enhance the mix, type and frequency of on-site inspections undertaken to assess the adequacy of LSI's risk management practices in key risk areas (e.g., credit, liquidity, IRRBB and IT) and ensure inspection reports are completed and shared on a timely basis.	H	I
8)	Enhance the minimum engagement model for LSIs to include periodic engagement with banks' independent board members and heads of control functions, especially for high impact or high-risk LSIs.	M	I
9)	Develop a formal internal escalation process to deal with problem LSIs and make use of corrective measures and powers when needed.	M	I
Regulation and Oversight of Key Risks			
10)	Ensure the risk management function of banks reports directly not only to management board but to the supervisory board.	H	I
11)	Align the framework on related party transactions with the BCPs in relation to the definition of a related party transactions, arms' length and conflict of interest rules, and broaden the definition on aggregate exposures limits.	H	NT
12)	Take into account excessive concentration risk for a broader range of exposure types, including sovereign risk concentration, when setting P2R.	M	NT

Table 1. Slovak Republic: Key Recommendations (Concluded)			
13)	Enhance the oversight of climate-related financial risks to ensure it is gradually integrated into supervisory processes; augment dedicated resources accordingly.	M	NT
14)	Increase the frequency of AML/CFT risk-based targeted inspections for LSIs; ensure AML resourcing is adequate to enable NBS to deliver on its mandate; update the Cooperation Agreement between NBS and the FIU to eliminate overlap of duties or responsibilities.	H	I

[1] Recommendations pertaining to changes of the primary legislation would be the responsibility of the MoF.

Note: In terms of priorities, H, M, and L stand for high, medium and low. In terms of time frame, I, NT, and MT stand for immediate (within one year), near-term (within 2–3 years), and medium-term (within 3–5 years).

INTRODUCTION[1]

A. Context

1. **The Slovak Republic's economy and financial system have shown resilience following several consecutive global shocks over the past few years.** The recovery of the pandemic was interrupted by the shock of the war in the Ukraine, negatively impacting disposable income and supply chains in Europe and globally resulting in record high inflation rates. These tighter global financial conditions could pose challenges to the banking sector in the Slovak Republic due to high interest rate risk combining with a potential reduction in borrowers' repayment capacity. Although the EA and the banks that operate in the Slovak Republic have weathered the events over the past few years, demonstrating continued strong capital, earnings and liquidity positions, additional risks associated with a sluggish global economy, geopolitical tensions, commodity price volatility and higher-for-longer interest rates may continue to pose challenges in the banking sector.

2. **The 2007 FSAP Update regarding the Slovak Republic's compliance with the Basel Core Principles (BCP) for effective banking supervision indicated NBS' compliance with previously identified weaknesses[2].** The 2004 BCP assessment methodology, which is now outdated, was utilized for the previous FSAP assessment. The 2024 FSAP will utilize the 2012 BCP assessment methodology[3] as the latest update to the international standards was effective only in April 2024 after the FSAP process began.

[1] This Technical Note was prepared by Geraldine Low (IMF, External Expert) with administrative support from Vanessa Guerrero and David Ramirez.

[2] The results of the previous FSAP focused on four areas of weakness, which NBS/MoF adequately addressed, relating to: providing clearer statutory power to NBS on assessing additional capital when needed; ensuring adequate segregation of duties between NBS and external auditors; the need for prudential guidance on interest rate risk in the banking book (IRRBB); giving NBS the power to remove persons subject to fit and proper requirements and strengthening coordination and communication between NBS and home country supervisors.

[3] Note: Although this TN is a targeted review, making use of the 2012 BCP methodology, it is not a complete BCP assessment.

3. Since the 2007 FSAP Update, the EU regulatory framework and the oversight framework for EA banks has been significantly strengthened. While there are some areas where the NCAs can adapt the framework to national discretions, the wider EU legislation is now setting the main requirements for banks. In addition, the SSM assigns the European Central Bank (ECB) with the responsibility to directly supervise SIs in the EA. The NCAs are responsible for the direct supervision of LSIs under the indirect oversight of the ECB. In view of these arrangements, the IMF and ECB/SSM have agreed to focus on the regulation and supervision of LSIs as part of EA member country FSAPs.

B. Scope

4. In this context, the FSAP conducted a targeted assessment of the effectiveness of banking regulation and supervision in the Slovak Republic focusing on LSIs. In scoping this review, the 2007 FSAP recommendations as well as relevant EA and global regulatory and market developments were taken into account. The targeted review focused on selected BCPs, including, NBS' supervisory independence and powers, corrective and sanctioning measures, its supervisory strategy and approach for LSIs, oversight of key risks including credit, liquidity, IRRBB, operational and climate-related financial risk, governance and the strength of the risk management policies and practices. The assessment also reviewed NBS' approach to supervising AML/CTF risk for banks.

5. The findings of this review were guided by the BCPs and build on the most recent assessment of the EA framework. This review leveraged off of the areas of weakness previously identified by the 2018 EA FSAP, as applicable to the supervision and regulation of LSIs. In addition, the FSAP took into consideration the Basel Regulatory Consistency Program (RCAP) for the EU which provided relevant context for this review.[4]

6. The IMF team appreciated NBS' extensive cooperation and professionalism demonstrated throughout this review process. NBS provided a self-assessment of compliance with the 2012 BCPs (building on the most recent EA BCP self-assessment) and responses to a complementary questionnaire. The ECB has also provided responses to a dedicated questionnaire. The team greatly benefitted from the inputs and views expressed in meetings with NBS, the Ministry of Finance (MoF), ECB/SSM and the private market participants. The team sincerely thanks NBS staff for making enormous efforts to respond to the team's requests and overcome logistical challenges involved in the mission.

MARKET STRUCTURE

7. The banking sector accounts for the largest part of the Slovak Republic's financial system. At the end of 2023, banks account for 78.7 percent of financial sector assets representing 98.8 percent of GDP. The remaining financial market sectors assets within the financial system

[4] The first BCP Detailed Assessment Report of EA bank regulation and supervision was published in July 2018. In addition, the Basel Committee on Banking Supervision published several RCAPs for the EU, including on risk-based capital standards, liquidity coverage ratio (LCR), net stable funding ratio (NSFR) and the large exposure framework.

include pensions (11 percent), investment funds (6.2) and insurance (3.6 percent). See Table 3 for more detail. The majority of the banking sector assets are directly supervised by the SSM, which included 4 SIs and 8 branches of the SIs, together accounted for 84 percent of total banking assets. See Table 2 for more detail.

Table 2. Slovak Republic: Banks Operating in the Slovak Republic 2023

	# of institutions.	% of Banking Assets
SIs	4	71.4
Other SSM SIs via branch	8	12.5
High Impact LSIs	3	11.6
Other LSIs	3	1.4
Branches of other SSM LSIs	2	2.5
Branches of non-SSM banking groups	4	0.6
Total	**24**	**100.0**

Source: NBS.

Table 3. Slovak Republic: Structure of Financial System

	2006Q4				2023Q4			
		Assets				Assets		
	Number of institutions	(in millions of SKK)	(in percent of financial system)	(in percent of GDP)	Number of institutions	(in millions of Euros)	(in percent of financial system)	(in percent of GDP)
Banks	**24**	**1,408,610**	**80**	**83.0**	**24**	**121,306**	**78.7**	**98.8**
Commercial banks	17	1,192,211	67.8	70.2	10	102,343	66.4	83.3
Private	16	1,176,273	66.9	69.3	9	101,744	66.0	82.8
Domestic	1	26,415	1.5	1.6	2	7,094	4.6	5.8
Foreign	15	1,149,858	65	67.7	7	94,650	61.4	77.1
State-owned	1	15,938	0.9	0.9	1	600	0.4	0.5
Branches of foreign banks	7	216,399	12	12.7	14	18,963	12.3	15.4
Insurance companies	**24**	**146,471**	**9**	**8.6**	**9**	**5,578**	**3.6**	**4.5**
Life insurance companies	5	17,112	1.0	1.0	2	737	0.5	0.6
General insurance companies	5	2,003	0.1	0.1	0			
Composite insurance companies	14	127,356	7.2	7.5	7	4,841	3.1	3.9
Pension funds	**24**	**44,991**	**3**	**2.6**	**36**	**17,516**	**11**	**14.3**
Pension funds 2nd pillar	18	27,947	1.6	1.6	16	13,997	9.1	11.4
Pension funds 3rd pillar	6	17,044	1.0	1.0	20	3,519	2.3	2.9
Investment funds					**100**	**9,630**	**6.2**	**7.8**
Others (securities companies)	**44**	**159,198**	**9**	**9.4**	**20**	**54**	**0.0**	**0.0**
Crowdfunding providers					**3**			
Total financial system	**116**	**1,759,270**	**100**	**104**	**192**	**154,084**	**100**	**125**

Source: NBS.
Note: Data on Others cover on-balance sheet assets of non-bank investment firms.

8. **The LSIs operating in the Slovak Republic have very different business models.** There are 6 LSIs that predominantly perform retail activities, but they also include other banking activities and non-banking entities with other business models that cater for specific market niches. See Box 1 for more details.

Box 1. Slovak Republic: LSI Business Models and Classification Criteria

The Slovak Republic LSI business models and classification are varied and include:

- **Three LSIs, two of which are classified as HI LSIs as well as "other systemically important institution"[1] (O-SII), have universal banking licenses** offering mostly retail with some corporate banking. The third LSI, which is a sister bank to one of the HI LSIs, offers specialized investment banking to its clients. One of the HI LSIs has several entities under the bank that have non-banking activities (e.g., insurance, mutual funds, card processing, etc.) some of which are regulated and supervised by the other financial market departments in NBS. LSIs classified as O-SII are subject to additional requirements, such as from a corporate governance perspective or the requirement to maintain an O-SII capital buffer.
- **Two LSIs, one of which is a HI LSI, are building societies** with special licenses wherein they offer special-purpose savings to help support the financing of housing needs. For example, a building saver enters into a contract with the building society and when the saver has accumulated enough funds (e.g., usually for a specified period of time, or saved to a certain percentage of a target amount or benchmark and/or has met certain conditions) the saver qualifies to obtain a construction loan. Further, a state premium (e.g., a sum of money that the state contributes to a building society's account to support housing and construction) is credited to the client's building savings account once a year (for 2023, 70 EUR) according to the amount of deposits in the relevant calendar year (e.g., for 2023, this was 2,800 EUR; for 2024 this has dropped to 1,000 EUR). Last, a building society may extend intermediate credit to a saver to bridge the time period until the target amount on the building savings contract is allocated.
- **One LSI is a state-owned bank with the MoF as the sole shareholder,** operates under a universal banking license targeting small and medium-sized enterprises in Slovakia. Important partners of this bank are the Council of Europe Development Bank and the European Investment Bank. This bank is classified as Small and Non-Complex Institution (SNCI) according to Capital Requirements Regulations (CRR).

[1] One LSI, designated as a O-SII, will lose such classification beginning January 1, 2025, as publicly announced by NBS.

9. **The prudential indicators of the LSI sector showed continued strength in capital and liquidity over the last few years.** On average, LSIs' capital and liquidity levels have been comfortably above minimum regulatory requirements and profitability has steadily increased. Although non-performing loan (NPL) levels have shown a slight improvement, NPL coverage has dropped over the past several years. See Table 4 for more detail.

Table 4. Slovak Republic: LSI Key Financial Indicators
(In percent, unless otherwise noted)

	2021	2022	2023
Total Capital Adequacy	21.6	22.9	22.2
Total Assets (EUR million)	14,809	15,362	15,727
Total Loans (gross, customer) (EUR million)	11,279	12,249	12,312
Total Retail Loans (gross, households) (EUR million)	8,405	9,705	10,228
Total Corporate Loans (gross) (EUR million)	1,954	1,839	1,382
Total Deposit Liabilities (customer) (EUR million)	11,303	11,053	11,169

Table 4. Slovak Republic: LSI Key Financial Indicators (Concluded)			
Loans to Deposits	96.0	112.3	111.8
Liquidity Coverage Ratio (LCR)	236	230	282
Net Stable Funding Ratio (NSFR)	139	125	131
Non-Performing Loans Ratio (NPL)	4.2	3.5	3.5
NPL Coverage	72.4	65.1	56.8
ROA	0.7	0.9	1.2
ROE	5.4	6.8	9.2
Source: NBS (million EUR/percent)			

INSTITUTIONAL SETTING

A. Supervisory Responsibilities

10. The institutional framework for the supervision of banks in the EA is reflected in the composition and operation of the SSM.[5] Together the ECB and the NCAs form the SSM. The ECB, working closely with NCAs, is directly responsible for the supervision of SIs. LSIs are under the direct supervision of NCAs while the ECB is responsible for exercising oversight for the functioning of the system.[6] In addition to its oversight role for LSI supervision, the ECB has direct responsibility over approvals (for proposals drafted by the NCA) for licensing, withdrawal of licenses, and qualifying holdings in LSIs. Authorization and supervision of non-European Economic Area bank branches and AML/CFT supervision (for SIs as well as LSIs) are the responsibility of the NCAs.

11. NBS is the Central Bank for the Slovak Republic and is the financial sector supervisory authority responsible for the prudential supervision of banks and the stability of the financial markets. Act n. 566/1992 Coll. on NBS[7] (NBS Act) outlines NBS' responsibilities, objectives and powers of the central bank. Act. n. 483/2001 Coll. on banks (Act on Banking) and the Act n. 747/2004 Coll. on financial market supervision (Act on financial market supervision), together with other binding laws and non-binding instruments provide the legal basis for NBS' authority and power to supervise banks. Further, Sec. 2(3) of the NBS Act indicates that NBS shall contribute to the stability of the financial system as a whole and to secure the sound functioning of the financial market, with the aim of ensuring financial market credibility, the protection of financial consumers and other financial market customers, and compliance with competition rules.

[5] The SSM Regulation and the SSM Framework Regulation set out the fundamental principles governing collaboration within the SSM.

[6] Although the ECB has the authority to take enforcement action and take over the direct supervision of an LSI, it in practice so far has relied on the NCAs and only in exceptional circumstances assisted in onsite inspections or taken over supervision of certain institutions at the request of NCAs (e.g.,, assisting in stressed situations and circumstances in which NCAs were resource constrained). The ECB has not taken over the direct supervision of an LSI in Slovakia.

[7] In the event of any conflict between the English version of all Slovakian laws stated in this Technical Note (TN) and the Slovak Republic version, the Slovakian version shall prevail.

12. The supervision of other areas of the financial market is also under the responsibility of NBS. NBS supervises several other areas of the financial market including: the supervision of insurance, securities market, digital operational resilience, collective investment schemes, the pension system, financial intermediaries and financial advisory services, payment services and electronic money, crypto-assets and foreign exchange business.

13. NBS is responsible for the administration of AML/CTF requirements for not only banks, but for the other areas of the financial market it supervises. Act No 297/2008 Coll. on protection against money laundering and terrorist financing (AML Act) provides the legal powers to NBS that govern the rights and obligations of legal entities and natural persons in preventing and detecting the legalization of proceeds of crime (money laundering) and financing of terrorism. Further, NBS' Methodological Guidelines of NBS No 3/2019 on protection of banks and branches of foreign banks from legalization of proceeds from criminal activity and financing of terrorism (MG NBS No 3/2019 on AML for banks) provides banks with additional guidance on the administration of the AML Act. The MG NBS No 3/2019 provides banks with explanatory material for performing their duties arising from legal regulations concerning the prevention of money laundering and terrorist financing in the financial system, which are based not only on binding Slovak legislation, but also on international standards.

B. NBS' Internal Structure and Decision-Making Processes

14. The Banking Supervision Department (BSD) is the organisational unit within NBS responsible for banking supervision. The BSD is organized into six sections including[8]: Proceedings and Methodology; Banking Analysis and SSM Coordination; On-going Supervision, SI On-site Supervision, LSI On-site Supervision and AML Supervision. On-going Supervision is responsible for both SI and LSI SREP processes. Further, Banking Analysis and SSM Coordination provides the off-site quantitative analysis used in the SREP Process for all banks including horizontal team risk experts (capital and solvency assessment, business model analysis, credit, IRRBB, market, liquidity and IT risk). Although the BSD has approved resources for its staff, it is currently operating below full capacity due to vacancies (e.g., LSI on-site inspection team) or various leaves (including resources assigned to ECB SSM).[9] Further, there is evidence that the BSD needs additional technical expertise in the following risk areas: Cyber, AML, IT Risk and Liquidity. It is noted however, that there is difficulty in recruiting key risk expertise in Slovakia as there is either a lack of existing technical experts or challenges due to language barriers.

15. NBS' internal structure consists of the governing body, the Bank Board, as well as several committees and advisory bodies, all laid down in the NBS Act and organisational regulations. The governing body of NBS is the Bank Board, made up of 6 representatives, including the Governor, two deputy governors and three members of executive staff. The Bank Board is responsible for, among other things, approving the principles governing the implementation and

[8] The BSD undertook a re-organization in 2020 to provide greater harmony between the supervision of SIs and LSIs.

[9] NBS inspectors are formally excluded from NBS's status during performing an On-site inspection in another SSM country.

organization of financial market supervision, including those rules of organization (e.g., appeals against first instance decisions of NBS) in matters of financial market supervision. Several committees/bodies pertaining to banking supervision of the Bank Board exist including:

- the **Executive Board** provides advisory support to the Bank Board on areas of proposed legislation and other matters of NBS.
- the **Financial Market Supervisory Committee (Supervisory Committee**) is the organisational and advisory body for the relevant senior management staff of NBS regarding the supervision of all financial markets. It is tasked with ensuring the coordination of the supervisory, financial stability sector and the supervision and protection of the financial consumer. The Supervisory Committee is not empowered to discuss or comment on supervisory proceedings conducted in individual financial market supervisory units.
- the **Macroprudential Policy Committee** is an advisory committee to the Bank Board dealing with technical issues relating to the administration of macroprudential policy measures (e.g., use of instruments to mitigate systemic risk, etc) to ensure the stability and resilience of the financial system.

16. NBS' organizational structure ensures that both the Bank Board and the Committees of the Bank Board are kept legally independent from other NBS organizational units, including the BSD. NBS is governed by its own internal legal system; the Organizational Regulations (NBS No. 87/2006) outlines the rules of procedure to regulate the various organizational units within NBS, including the roles and legal responsibilities of the various committees of the Bank Board and the individual departments. This legal internal structural separation is to ensure no conflict of interest exists when deciding on specific prudential decisions pertaining to second instance challenges by banks regarding the administration of proceedings (e.g., the challenge by banks of a first instance decision taken by the Director, BSD[10] (see ¶17 for more detail) or in consideration of the administration of corrective measures).

17. Although supervisory decisions ultimately rests with the Bank Board of NBS, the Director of the BSD has the delegated authority for making all first instance decisions regarding banks. With respect to the issuance of individual supervisory decisions, NBS is the competent authority tasked to conduct proceedings and issue formal individual supervisory decisions, such as approvals of bylaws, prior approvals relating to fit and proper assessments, and imposing sanctions. (Sec(1)(3)(a)(3) of Act on financial market supervision). Within the proceedings, the fulfilment of the conditions required by law is assessed and a draft decision is prepared. These first instance decisions in the context of banking supervision are approved by the Director of the BSD. Within this process, the banks are entitled, by law, to challenge the banking supervisors' prudential decisions throughout the process (e.g., during the completion of an on-site inspection

[10] For example, the decision the Director has taken in the first instance (e.g., regarding a bank's challenge regarding an inspection report or interim or partial report) is then further challenged by the bank. This secondary challenge goes to NBS' Bank Board for a final prudential decision.

report or during the assessment and administration of corrective measures). NBS needs full discretion to take any supervisory actions or decisions on banks under its supervision including no government or industry interference which comprises the operational independence of the supervisor.

C. Cooperation and Information Exchange

18. The Resolution Council (RC), with representation from several national agencies, is the designated resolution authority in the Slovak Republic. The RC was established on January 1, 2015, and with effect from August 12, 2022, was the designated resolution authority for the Slovak Republic. Representation on the RC is composed of ten members and comprises: 4 managerial staff members of NBS and 4 from the MoF (one of which is the State Secretary, acting as Chair of the RC), the Director of the Debt and Liquidity Management Agency and the Director of the State Treasury. The institutions that fall within the competence of the RC are credit institutions and those investment firms with share capital of at least 750,000 EUR. Oversight and implementation of resolution measures are entrusted to the RC, however, to support the execution of the RC's responsibilities, a dedicated organizational unit within NBS has been established and tasked with ensuring the proficient and organized execution of the RC's competencies and powers.

19. NBS is a member of the National Expert Group on the Prevention and Combating of Money Laundering and Terrorist Financing (NES-LP). The group is chaired by the Managing Director of the FIU and the members are representatives from: FIU, NBS, Ministry of Justice, Ministry of Interior, MoF, Slovak Information Service, Customs Office, Gambling Regulatory Authority, General Prosecutor´s Office of the Slovak Republic, and other authorities if needed. NES-LP coordinates the cooperation of domestic authorities in strategic horizontal projects (National Risk Assessment, MONEYVAL, etc.).

20. NBS has the power to share confidential information with other regulatory authorities, including EU member states as well as non-member states. Sec. 6(13) Act on Banking gives NBS the power to share confidential information as well as stating that such information shall be used only when performing its tasks and duties. NBS acts as a host supervisor regulator to several LSIs which are part of banking groups, where NBS cooperates with other regulators by participating in colleges held by the home regulator. NBS acts also as host supervisor to several branches of EU banks wherein the cooperation and collaboration are covered under legislation and the passport arrangements with member states. NBS has entered into several memorandums of understanding with foreign regulatory authorities – such MoU's are posted on NBS' website. Further, NBS also undertakes consolidated supervision based on consolidated reporting (as stipulated in Sec. 44-49 of Act on Banking) for two LSI wherein all non-banking operations are located in the Slovak Republic.

SUPERVISORY POWERS AND INDEPENDENCE

A. Prudential Powers

21. **Although the MoF is responsible for primary financial market legislation, NBS works closely with the MoF in the development or drafting of the primary laws pertaining to banking legislation.** The MoF is responsible for many different areas within its' remit including the development of financial market policy in the areas of banking, insurance, and capital markets, consumer protection in the provision of financial services and the provision of macro-economic and fiscal projections. The MoF is also responsible for the setting of accounting standards for the State. The Secretary of State of the MoF acts as the Chairman of the Supervisory Board for the state owned LSI.

22. **NBS has the authority to issue legislation of a general application[11] and is responsible for the setting of some binding and non-binding secondary legislation with prudential supervision legislation.** This includes issuing regulations for the enforcement of laws concerning the financial market, and the production and publication of methodological guidelines, opinions and recommendations to explain the application of laws and other generally binding regulations relating to supervised entities and their activities. In accordance with Sec. 2 (9) of the Act on financial market supervision, NBS is also mandated to transpose guidelines and recommendations of the European Banking Authority[12] (EBA), unless it does not intend to comply with such guidelines or recommendations. Last, NBS follows internal Regulation of NBS No. 20/2021 on the rules of policy-setting, when NBS issues legally binding decrees or when NBS only takes part in the legislative procedure of other authorities.

23. **NBS has the power to administer supervisory measures and sanctions to banks using a broad variety of legislative powers.** Where NBS finds any shortcomings in the operations of a bank or a violation of an obligation stipulated by the legal acts, it has available a wide range of corrective measures and sanctions to take, at an early stage depending on the seriousness, scope, duration, consequences, and nature of detected shortcomings. These corrective measures and sanctions are stipulated in Sec. 50(1)(2) and (3) of the Act on Banking (see Paragraph 41 for more detail).

24. **Given the national transposition and application of the EU prudential regulatory framework, NBS' powers to set prudential requirements for banks is mostly relevant for areas not harmonized at the EU level.** The legal and regulatory framework for banks (including LSIs) is based on EU regulation and a transposition of the European Capital Requirements Directive (CRD V).

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[11] Sec 1(3) of the NBS Act states: *NBS shall have the authority to issue legislation of general application within the limits prescribed by this Act or another act.*

[12] The **EBA** is an independent EU Authority which works to ensure effective and consistent prudential regulation and supervision across the European banking sector. The main task of the EBA is to contribute to the creation of the European Single Rulebook in banking supervision for NCAs. EBA also plays an important role in promoting convergence of supervisory practices and is mandated to assess risks and vulnerabilities in the EU banking sector.

Hence, banking regulations and requirements in the Slovak Republic law mirror European requirements with the exception of national discretion items and areas not covered by the EU framework. These areas include, for example, requirements for related party transactions, and fit and proper procedures applied outside the context of licensing and qualifying holdings.

B. Supervisory Independence

25. NBS has both operational and financial autonomy. Specifically, NBS shall fulfil its tasks independently of instructions from state authorities, self-government bodies, any other public authorities and from legal persons and natural persons. (Sec. 12(1) NBS Act). The Governor or a member of the Bank Board delegated by the Governor shall inform the Government of the conclusions from meetings of the Bank Board and on the adopted decisions (Sec. 12(2)). Further, NBS has a degree of financial autonomy, which supports its operational independence in allocating resources and budget for supervisory activities. NBS has discretion over the allocation of resources within its approved budget. Adequate funding is essential for NBS to fulfil its supervisory responsibilities effectively. NBS is self-sufficient in financing and is not linked to the state budget, thus it is independent of political and governmental powers.

26. NBS must have the operational independence to administer prudential decisions related to the supervision of banks without the ability of banks to challenge NBS prior to the finalization of such decisions. NBS, together with the MoF, should remove from the legislation the ability of the credit institutions to challenge the work of the prudential supervisors, either prior to the BSD's inspection report being finalized or during the process of assessing corrective measures.

27. Although with no voting rights, a representative of the Government of the Slovak Republic may attend a meeting of the Bank Board of NBS. The NBS Act (Sec. 8(4)) allows for the Bank Board meetings to be attended by a government member authorized by the government, persons designated in the Bank Board's rules of procedure, and other persons invited by the Bank Board. Although the authorities indicated that such participation has not occurred in practice, the attendance could be seen as a form of potential government interference. Further, given the MoF is the shareholder of the state-owned LSI, it is critical NBS maintain its independence with respect to making prudential decisions.

28. It is critical that the law provides adequate protection to the supervisor and its staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith. Sec. 2(4) of Act on financial market supervision indicates that NBS and the employees of NBS authorised to conduct supervision in its name are vested with powers under this Act and other legislation. The responsibility for the exercise of supervision lies with NBS. Authorised supervisors are not accountable to third parties for the consequences arising from the conduct of supervision; this is without prejudice to their liability to NBS as employees or to their criminal liability. NBS as the supervisor and its staff should be adequately protected against the costs of defending their actions and/or omissions made while discharging their duties in good faith. This includes adequate protection against the costs of defending their actions and/or omissions. In ongoing criminal proceedings, NBS makes use of its in-house counsel as well as ensuring the presence of an attorney at the employee's request in dealing with criminal matters. This protection of the supervisor and staff should be enhanced and enforced in the law, especially given what has occurred in practice in the Slovak Republic.

C. Recommendations

29. NBS's powers and independence should be further reinforced through:

- Confining banks' appeal powers to finalized supervisory prudential decisions and sanctions.
- Ensuring that participation at NBS' Bank Board meetings is limited to non-government or non-political representatives to ensure operational independence.
- Ensuring that the law is enhanced to adequately protect NBS and its staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith. This includes adequate protection against the costs of defending their actions and/or omissions.

SUPERVISORY APPROACH AND TOOLS

A. Supervisory Approach and Tools

30. NBS sets supervisory priorities by drawing on an assessment of the main risks and vulnerabilities for the Slovak banking sector. The priorities for 2024 set by NBS include a focus on: IRRBB, governance (operational resilience), credit risk (staging practices) and liquidity risk. The priorities for 2023 focused on business model profitability, credit risk (definition of NPLs), and governance (risk management practices). The priorities also included consideration of the EBA and ECB priorities set for the EU banking sector.

31. NBS determines supervisory activities based on the annual priorities. NBS utilizes the SSM approach regarding for LSIs planning for the Supervisory Examination Programme and minimum engagement level of ongoing activities with the banks. Annual planning starts at the beginning of the year by defining the priorities and together with specific actions to be taken which are approved by the Director of BSD, noted by the Supervision Committee and shared with the ECB. NBS utilizes a similar approach for LSIs.

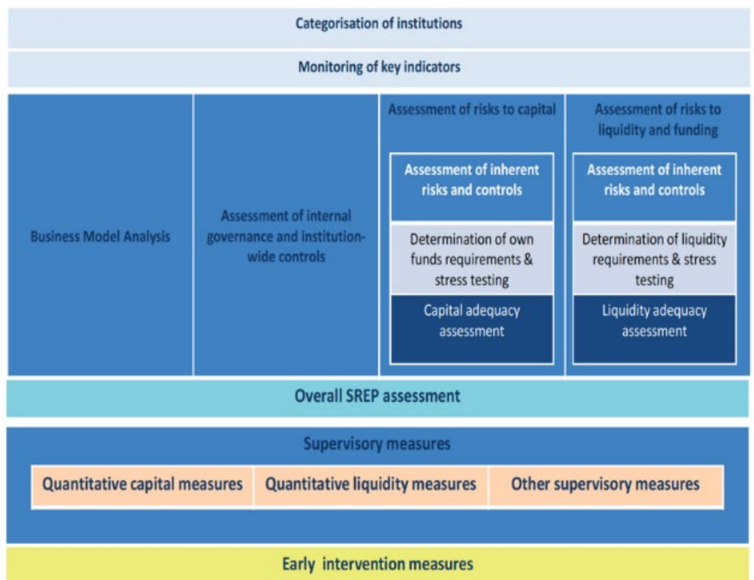
Offsite Supervision

32. NBS utilizes SREP for LSIs under the SSM[13] overseen by the ECB. NBS completed the roll-out of the EU harmonized LSI SREP methodology in 2021 (gradual implementation since 2015). The Figure provides a high-level overview of the EBA's Guideline on the SREP, depicting

[13] The **SSM,** composed of the ECB and the NCAs, is the legislative and institutional framework that grants the ECB a leading supervisory role over banks in the EU. The ECB, working closely with the NCAs, is directly responsible for the supervision of SIs and oversees the supervision of LSIs as conducted by the NCAs.

the general phases of assessment, including: i) classification or categorization of the LSI; ii) monitoring of key financial indicators; and iii) an assessment of the business model analysis, strength of internal governance, and the overall assessment of the impact of all risks to the LSI's capital and liquidity.

Table 5. Slovak Republic: EU LSI SREP Methodology



33. NBS has harmonized its approach to the SSM SREP processes to align the supervisory approach adopted for SIs to LSIs. The LSI SSM SREP methodology indicates that the NCA should allocate more time to HI or HR classification for banks. Further, the frequency of the SREP assessment, together with the minimum engagement model should also reflect the risk classification of the LSIs. For example, the framework distinguishes between a full SREP (including an assessment of the Pillar 2 capital add-on (P2R)) and a summary SREP (updating the risk score, but no reassessment of the P2R). In addition to the P2R, LSIs are also subject to Pillar 2 Guidance (P2G), which is an additional buffer that is determined based on the NCA's stress-testing results. The assessment/review of the P2G is conducted every year according to the Act on Banking and based on the SSM methodology. NBS treats all LSIs to a full SREP assessment annually, including assessing the qualitative capital (the calculation of P2R and P2G) and liquidity (buffers) supervisory measures every year. Although NBS' approach to harmonizing the LSI off-site processes with the SI processes is commendable, there is a benefit to streamlining some of the off-site supervisory processes (e.g., the need to review all policies and procedures in every risk area annually as part of the SREP process) to ensure a more risk based and proportionate approach to LSI supervisory oversight.

34. Banking Analysis undertakes quarterly monitoring of key financial data which is presented to the Director of the BSD. This offsite monitoring entails a quarterly analysis utilizing the newly developed Business Intelligence (BI) tools. Further, the Banking Analysis unit carries out additional analysis when needed (e.g., bank's exposures in Ukraine) wherein this analysis is shared with and continuously monitored by senior executives within NBS. Further, although the Financial Stability Department undertakes deep stress testing analysis, together with the release of a semi-annual Financial Stability Report, the BSD staff would greatly benefit from the additional sharing of information, even on an informal basis (e.g., quarterly), to gain an additional risk perspective on emerging risk factors in the banking sector that could potentially have a negative impact on a LSI's financial health.

35. NBS undertakes several horizontal/thematic reviews, the results of which are included in the annual SREP assessment of LSIs by the On-going Supervision Section. NBS has undertaken horizontal/thematic reviews, using questionnaires and in some cases involving On-site supervisors, in the areas of credit risk focusing on the definition of default, internal governance and IT risk (carried out in 2022), business model and IRRBB (2023) and climate and environment risk (C&E 2022-23) and data aggregation (planned for 2024). Reviews generally include all banks and, in many cases, reflect the horizontal/thematic reviews being undertaken at the ECB.

36. Although NBS engages with members of senior management and the statutory board of LSIs at least annually, it should meet with independent (non-executive) supervisory board members. NBS' supervisors are in close contact with the LSIs and meet with senior management when needed. NBS meets the statutory board annually to present the results of the SREP, including the results of the capital (P2R and P2G) and liquidity assessment. Although NBS also meets with heads of the control functions when needed, it does not typically meet with the independent board members of the supervisory board. Further, NBS has a model which outlines the engagement with LSIs, however it should be enhanced, linking it to the HI/HR classification and risk profile of the bank as well as frequency. This engagement model should specify how often NBS should engage with the control functions, the statutory board as well as members of the supervisory board (see Paragraph 48 for more details).

Onsite Inspection

37. On-site inspections, carried out mostly at the request of on-going supervision and in accordance with the inspection plan, are tied to supervisory priorities and planning processes. NBS' inspections usually cover a specific risk area with a scope covering several themes at once (e.g., the on-site inspection will examine an LSI's risk management practices pertaining to the focus of that specific review), not necessarily achieving adequate coverage of the material aspects of the risk. Further, NBS typically does not carry out thematic on-site inspections covering a particular risk area horizontally across the LSIs (this is carried out by on-going supervision through questionnaires). In general, off-site analysis will only provide a certain level of assurance regarding LSI's policies and reporting practices and not necessarily provide assurance regarding the effectiveness of LSI's risk management practices. NBS' awareness of the effectiveness of LSI's risk management practices is generally enhanced through on-site inspections. Therefore the mix, type and frequency of on-site inspections could be re-balanced somewhat to ensure adequate oversight of LSI's risk management practices, over the supervisory cycle, in key risk areas. Last, a certain level of capacity of LSI on-site supervisors should be saved each year in the supervisory plan for additional on-site inspections to take place, especially to deal with unexpected weaknesses that come to light for an LSI wherein an on-site inspection is needed.

38. The frequency of on-site inspections may be constrained by available resources. Although the LSI on-site inspection team have suitable risk experience, the unit is challenged to carry out on-site inspections at the frequency outlined by NBS (e.g., every 2 years for all LSIs) potentially due to a lack of resourcing. LSI on-site inspection unit can draw on the resources of the SI on-site inspection unit, however this is often difficult to accomplish in practice given the SSM priorities for SIs.

39. Supervisory decisions are open to challenge by banks typically relating to on-site inspection reports or interim or partial reports which can impede the finalization of such reports. In accordance with sec 10(5) of the Act on financial market supervision[14], NBS' inspection report is not finalized until the report is signed by the Head of On-site Mission, approved for release to the bank by the Director, BSD and the bank has not lodged a challenge to the inspection report until the "challenge" period has past (please see ¶17 for a description of how NBS deals with first and second instance challenges/decisions). The finalization of the inspection report is therefore considered overly long. In addition, Sec 9(1) of the same Act[15], indicates that a bank may challenge NBS on interim or partial reports. A bank should be provided with an overview of findings of material gaps, etc, however a bank should not have the ability to comment on a partial or interim or draft of the inspection report prior to being finalized. NBS has indicated that in practice, it does not provide a draft report to the bank. The completion of the on-site inspection reports by the on-site team takes approximately 4-5 months (up to a year during COVID). Furthermore, NBS' internal quality assurance processes (with several reviews internally), although understandable given the need to be adequately equipped to deal with challenges from the bank, leads to an overly long process to get the report signed off. While the bank management is aware of the findings (verbally prior to completing the on-site portion), the length of time to formalize the report results can lead to somewhat obsolete findings. Last, the inspection reports should be provided to a member of the supervisory board (non-executive member), not just the statutory board (which is made up of management alone).

[14] Sec 10(5) of the Act on financial markets supervision states that "*If a supervised entity has lodged a challenge to information contain in an on-site inspection report, the inspection is not completed until the supervised entity has been notified of the results of the review of that challenge; otherwise, on-site inspections are completed when the time limit for the supervised entity to lodge such a challenge passes without any challenge being lodged.*"

[15] Sec 9(1) of the Act on financial markets supervision states that "*supervised entities may, within a specified time limit, lodge a written challenge to information contained in an on-site inspection report or a written challenge to information contained in an interim or partial report on an on-site inspection, if such report has been produced*."

40. Although general findings are shared verbally by on-site inspectors, the final report is not shared internally with the On-Going Supervision Section until it is signed, which could take more than 6 months to complete (over a year during COVID). This lack of sharing of key prudential assessments is problematic as the necessary evidence regarding an LSI's material risks and weaknesses, specifically in an LSI's risk management practices, should be shared, when available, with on-going supervision who is tasked with articulating the overall risk profile of the bank and with the planning of supervisory priorities. In general, on-going supervisors take into consideration what the on-site examiners have found, but this is done verbally. It is not necessary for on-going supervision to have "drafting" input into the finalization of the report, but to made aware of the on-site inspector's views, in detail, is critical.

Interaction with the ECB

41. The ECB performs a risk-based oversight of LSIs mostly relying on information and views exchanged with the NCAs. The ECB is provided with views on individual supervisory cases, through notifications of financial deterioration cases, and, for HR/ HI LSIs, via notifications of NCAs' material supervisory procedures and draft decisions. The ECB also performs thematic reviews, mostly offsite, to identify different practices and promote high supervisory standards. Moreover, the ECB conducts its oversight via the interaction between the country desk and the NCA senior management visits as well as bilateral technical calls or visits.

B. Corrective Action Powers and Processes

42. NBS has a wide range of supervisory tools to enforce corrective measures for banks when needed. These tools, outlined in Sec. 50(1) of the Act on Banking, include, but not limited to, NBS requiring a bank to: adopt recovery measures; submit special statements; returns, and reports with increased frequency, including reports on own funds, liquidity and leverage; terminate an unauthorised activity; assess a fine or sanction; in the event of a recurrent or grave default, limit or suspend the conduct of certain banking activities or certain types of transactions; revoke the banking authorisation; place a bank or a foreign bank branch under receivership; adopt measures to improve its risk management system; impose upon a bank a specific own funds requirement; special procedures taking into account the impairment of its assets and expected losses on off-balance sheet items; reduce the level of significant risks it incurs during the course of its activities, including outsourced activities; restrict the provision of flexible remuneration; use its profits to maintain its own funds at a level exceeding the capital requirement; require a bank to release a public statement as to which bank is responsible for the deficiency in its activities, as well as the nature of the deficiency; impose upon a bank additional liquidity requirements; and require a bank to transfer a covered bond program or a part thereof to a third party in full. Sec. 65(a)(1)(d) of the Act on Banking empowers NBS to remove a member of the supervisory board or statutory board, the authorised representative or manager, when needed.

43. Although NBS has a well-defined sanctioning regime embedded in the legislation, this process is hampered by the bank's ability to challenge the prudential decision thereby having a "suspensive" impact on administration of the fine. NBS makes use of both its powers (Sec. 50(19) Act on Banking) to take corrective actions as well as assessing sanctions in the supervisory framework. However, the use of the sanctions is very much driven by the results of the on-site inspection process (e.g., ensuring NBS has "adequate" evidence to assess such sanctions). Implementing sanctions is somewhat problematic as it allows banks to appeal prudential decisions during the process for assessing sanctions (e.g., before the finalization of the prudential decision) having a "suspensive" effect on the administration of the fine. Further, the Bank Board, who is responsible for dealing with challenges by banks in the second instance (see ¶16 and 17 for more detail), does not have a specified time limit in the legislation by which it must make a decision regarding the second instance decision. In general, the ability of the bank to challenge a prudential decision, prior to being finalized[16], impedes NBS' ability to take a supervisory action at its full discretion and to act quickly, and operationally independent of the bank, when dealing with a problem financial institution. The ECB also has the ability to address a sanction to an LSI for breaches of ECB regulations or decisions that impose obligations on LSIs vis-à-vis the ECB.[17]

44. NBS makes effective use of informal intervention measures by utilizing the EBA Guidelines[18] on triggers for the use of early intervention measures, however certain processes should be formalized. For example, when a deficiency is noted, NBS acts quickly to engage with senior management, requests a detailed action plan with timelines for implementation etc. However, when there is a situation where an LSI has breached or is about to breach a minimum regulatory requirement (technically or otherwise), NBS should ensure it formally communicates (e.g., in writing) with both the statutory board and the supervisory board to articulate its expectations of how the LSI will address deficiencies or weaknesses as well as making use of its formal corrective measures in its legislation when necessary.

45. NBS does not necessarily update its views of the overall risk profile (e.g., SREP score) of an LSI when a material deficiency has been observed. NBS assesses a SREP score annually, however it should have the ability to update this risk assessment when needed and not wait until the next annual SREP assessment. In addition, NBS should have the ability to place a

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[16] As per sec 10(5) of the Act on financial markets supervision

[17] The ECB tracks all sanctions administered in the EU and publishes aggregate statistics on the sanctioning activities carried out by the ECB and the NCAs in relation to breaches of prudential requirements (ECB: Annual Report on Sanctioning Activities in the SSM in 2023). The ECB also publishes on its website the types of sanctions imposed on SIs and LSIs by the ECB directly and whether such sanctions are successful or held up in external judicial proceedings. as well as the sanctions imposed by NCAs in proceedings opened at the ECB's request in accordance with their respective allocation of sanctioning tasks. More specifically, it can also impose pecuniary penalties on less significant institutions (LSIs) for breaches of ECB regulations or decisions that impose obligations on those entities vis-à-vis the ECB. In case of breaches of national law implementing Union directives, breaches committed by natural persons, or when a non-pecuniary penalty has to be imposed, the ECB may request the relevant NCA to open national sanctioning proceedings pursuant to Article 18(5) of the SSM Regulation.

[18] EBA/GL/2015/03 pursuant to Art. 27(4) of Directive 2014/59/EU.

problematic LSI on an internal watchlist, even if the SREP score does not tally to reflect a downgraded SREP score. For example, if a deficiency arises that does not quite fit the change in a classification of an LSI to the high risk category (e.g., deterioration in liquidity not explicitly listed as part of the criteria[19]) an alternative for NBS would be to simply ensure that the LSI was monitored carefully, that material weaknesses are articulated in writing and addressed on a timely basis. Further, if BSD does not wish to open its annual formal SREP assessment process, it should develop another means of updating the overall risk profile of a bank that explicitly demonstrates a material risk.

46. Although NBS relies on the guidelines from the ECB, it should have an internal guideline that encompasses how the BSD escalates an issue with an LSI within NBS. This includes the requirement for staff to monitor and report, as needed internally, together with guidelines on when more formal intervention measures should be utilized, including making use of formal corrective powers. These processes do exist within NBS; however they should be formalized. This internal guideline will ensure that NBS has in place appropriate and effective crisis management operational arrangements, for when a problem bank occurs (especially given its history of very few problem LSIs). A problem LSI will not necessarily become a bank that will need the attention of the Resolution Unit that sits inside NBS and supported by the Crisis Management Handbook.

C. Recommendations

47. NBS should continue enhancing its risk-based supervisory approach to LSIs by:

- Augmenting technical capabilities of supervisors to ensure adequate coverage of key risk areas (Cyber, IT Risk, Liquidity and AML).
- Ensuring the mix, type and frequency of on-site inspections are carried out to ensure adequate oversight of LSI's risk management practices in key risk areas.
- Introducing a protocol for the LSI on-site inspection program to set internal performance measures to ensure the timely sharing and completion of on-site inspection reports as well as fill vacancies in the team to ensure delivery on the Department's mandate.
- Reviewing the off-site supervision program to tailor the depth, breadth, and frequency of off-site activities (including SREP) to align with the LSI's impact and overall risk profile and leverage off the financial stability assessments regarding emerging risk analysis.

[19] HR LSI classification criteria including, but not limited to: a) financial deterioration (e.g., refers to capital deterioration: CET1 ratio ≤ 4,5%+P2R, Tier 1 Ratio ≤ 6,0% + P2R, Total Capital Ratio ≤8,0% + P2R); b) LSIs subject to the Crisis Management Cooperation Framework, overall SREP score of 4 or 3 (with deterioration in one area overall rating of 4) and c) NCA has initiated early intervention measures to avert a bank failure.

- Ensuring the necessary classification of LSI's meets the criteria outlined in the LSI SSM SREP methodology requirements (e.g., what constitutes a HR LSI) or create an internal watchlist category for LSIs that do not necessitate a reclassification to a HR category.

- Ensuring the overall risk profile including the classification of an LSI is updated after material deficiencies are found (e.g., annual SREP/risk assessment).

- Enhancing the minimum engagement model for LSIs to ensure NBS meets periodically with external representatives of the supervisory board (independent board members) and heads of control functions (internal audit, risk management, compliance) especially for HI and HR LSIs.

- Ensuring internal processes are formalized for the escalation as well as the actions taken by NBS are commensurate with the risk profile of the bank and that the supervisory actions and measures get more and more intrusive as the situation digresses. Create an internal guideline that encompasses how the BSD escalates an issue with a problem LSI both within the Department and within NBS.

- Ensuring on-going supervision makes use of both informal but also formal written communication with the bank when a problem or deficiency is detected outlining NBS' expectations with respect to the LSI's addressing deficiencies on a timely basis.

- Ensuring NBS formally communicates with both the statutory board and the management board outlining NBS' expectations with respect to an LSI addressing as well as making use of its formal corrective measures in its legislation, when necessary.

REGULATION AND OVERSIGHT OF KEY RISKS

A. Corporate Governance and Risk Management

48. Banks in Slovak Republic have a two-tier board structure with some difference from the Basel standards. The Act on Banking, NBS' Decree No 4 /2015 on risk management and the EBA/GL/2021/05 Final Report on Guidelines on internal governance under Directive 2013/36/EU (EBA's internal governance guideline) are the main corporate governance and risk management requirements for LSIs that take proportionality into consideration when setting requirements. EBA's Guideline on Internal governance addresses both a one tier and a two tier board of directors structure, as envisioned in the Slovak Republic. Sec. 23 of the EBA guidelines on internal governance indicates that the management body, as defined in Points (7) and (8) of Article 3(1) of Directive 2013/36/EU, should be understood as having management (executive) and supervisory (non-executive) functions. The BCP on corporate governance (CP14 EC3) as well as the BCBS Guidelines on Corporate governance principles for banks, dated July 2015, also acknowledges that jurisdictions will have varying structures. The BCP however envisages non-executive members of the board to oversee certain aspects of the bank's activities, including committees where appropriate based on the size of bank and having the internal control functions (e.g., internal audit, risk management and compliance) report directly to the

Board/Committee with the non-executive board members. For example, non-executive board members should oversee the internal control functions of the bank and fulfill the Chair role of the committees of the board. In the Slovak Republic, the two tier board system includes the management board or statutory board with "executive" members and the "supervisory board" with both non-executive members plus a representative of the employees on a ratio of 2:1. Although the internal audit function has a dual reporting structure to both boards, the risk management function only reports to the executive board.

49. The Slovak Republic allows proportionality with respect to the number and type of committees of the board, as well as reporting lines of internal control functions mainly being overseen by the statutory board. The Act on Banking require committees of the supervisory board members to be composed of non-executive members (at least one formal independent board member). For O-SII classified banks, they are required to have a risk, remuneration, and an audit committee. For other LSIs, they may have the audit committee fulfill the role of the risk management committee or have the supervisory board fulfill the role of the audit committee. Typically, the supervisory board meet formally on a quarterly basis.
The statutory board (usually 3 members of management) has continuous communication with the internal control functions as they report to the management board on an on-going basis; internal audit has a dual reporting line to both the statutory and supervisory board. The risk management control function has a responsibility to make a presentation of an activity report in writing to the bank's statutory body and supervisory board at least once a year (sec 27(4) of Act on Banking) and to inform the supervisory board of any shortcomings that arise (sec 27(5). The risk management control function should have unimpeded access to the non-executive board members (e.g., a dual reporting line to both the statutory board and the supervisory board, which goes beyond annual reporting requirement, or to the supervisory board (Sec. (4(a),(b)) of the Act on Banking) and in accordance with paragraph 180 of the EBA's internal governance guideline as it is key to ensuring that critical checks and balances are in place for the supervisory board to effectively oversee the executive management activities. Last, NBS' minimum engagement model does not include meeting with the external representatives of the supervisory board (independent or non-executive board members[20]) on occasion, for example upon completion of on-site inspections nor finalization of SREP results.

50. LSIs' corporate governance policies and practices are assessed through both offsite and onsite processes. NBS off-site monitoring extensively reviews LSI's policies and procedures, board packages and minutes, and many other aspects of corporate governance as part of its annual SREP process when assessing the internal governance component. Further, NBS carried out sufficient on-site inspections to examine corporate governance over the past 4 years as well

[20] BCBS's Guidelines: Corporate principles for banks, July 2015, paragraph 52 states that: Board candidates should not have any conflicts of interest that may impede their ability to perform their duties independently and objectively and subject them to undue influence from: other persons (such as management or other shareholders); past or present positions held; or personal, professional or other economic relationships with other members of the board or management (or with other entities within the group).

as undertaking a thematic review of internal governance for all banks in 2022.

51. NBS' on-site inspection program regarding LSI' risk management practices across key risk areas needs to be augmented on a proportional basis. This recommendation is also highlighted throughout this report in each of the risk areas. NBS could enhance its on-site inspection program using targeted on-site reviews that would benefit NBS' ability to assess the effectiveness of LSI's risk management policies and process in practice, for a number of material risk areas, including credit, liquidity, IRRBB and IT risk, potentially across several banks, in an efficient manner.

52. NBS undertakes a macro stress testing program as well as instructing the banks to run specified scenarios each year. It is critical that the banks' own stressing testing programs include assumptions for material risks (e.g., material changes in interest rates (beyond just parallel shifts in +/- 200 bps), assumptions with respect to the quality of certain loans (e.g., NPLs, collateral valuation discount, real estate backed loans), and realistic assumptions regarding the behavior of the deposit liability holders (demand, versus term deposits).

B. Capital

53. NBS' capital requirements for LSIs follow the EU framework, including the assessment of capital buffers established in the EU CRR. The capital buffers as well as Pillar 2 capital add-ons have been transposed into Slovak law. NBS allocates: the capital conservation buffer (set for both SIs and LSIs), the counter-cyclical buffer (CCyB), and the buffers for O-SIIs. The CCyB is currently set at 150 basis points made by NBS public announcement.

54. The EU capital framework includes some material deviations from Basel III but some of these are not material given the LSIs' business models and the approaches used for their risk-based capital requirements. In 2014, the RCAP carried out by the BCBS, assessed the EU capital framework to be materially non-compliant[21] with the minimum capital standards in the Basel framework. Some of those deviations may not be particularly relevant for Slovakian LSIs, particularly those related to CVA capital charges and the fact that no LSIs currently use the IRB approach.

55. NBS assesses LSIs' P2R and forward-looking capital targets (P2G). The SREP methodology takes into account several factors in assessing P2R including an LSI's business model, IRRBB risk, governance, and capital adequacy (credit, market, operational and IRRBB) with concentration risk assessed in all areas. The P2R surcharges applied by NBS are based on a set of minimum surcharges applied by the ECB for each SREP category. NBS makes use of a range of additional capital requirements (P2R) based on the SREP score. To assess forward-looking capital

[21] The main areas of divergence include among others: permanent partial use of exemptions for various types of credit exposures in the IRB approach for credit risk; concessionary risk weights extended to small and medium enterprise exposures; the splitting of residential mortgage loans into lending qualifying for 35 percent risk weight and lending not qualifying for this preferential treatment; and credit valuation adjustment (CVA) exemptions provided for various exposures.

needs of supervised institutions, NBS carries stress testing exercises using different macroeconomic scenarios, which is conducted on an annual basis. LSI's P2G, which began in 2019, is assessed every year, regardless of LSI classification, and making use of new assessment methodology based on NBS' stress test results since 2023.

56. The Slovak Republic introduced a special levy for credit institutions beginning 2024, which effectively increases the tax rate on the net profits before tax of banks who earn greater than 3 million EUR annually. ECB's opinion[22] on the special levy for credit institutions in the Slovak Republic indicated that the effective tax burden for credit institutions will increase from the corporate tax of 21 percent to: 44.7 percent in 2024, 40.7 percent in 2025, 36.8 percent in 2026, 32.9 percent in 2027 and 24.4 percent in 2028. NBS has stated that although all LSIs will be impacted by this special levy, it does not expect a negative impact on LSI's capital positions. NBS should monitor potential impacts on LSI's capital levels/buffers, especially given the current macroeconomic environment.

C. Credit Risk and Problem Assets

57. NBS' Decree No 4/2015 Art. 11 outlines requirements for LSIs regarding credit risk management policies and procedures including: the LSI having a credit risk management strategy; an appropriate organization of risk management. Further the LSI is required to have an appropriate business system for credit risk management purposes for credit granting process; establishing and ensuring compliance with the rules for credit approvals; the establishment of procedures for the modification, renewal and refinancing of loans. In addition, it specifies trading in money market financial instruments, equity financial instruments market and securitization positions giving rise to credit risk as well as requiring the LSI to have internal regulations for the purpose of credit risk management/strategy. Last, it specifies the required scope and complexity of the credit risk measurement system and methods that shall define the minimum requirements for the credit risk monitoring and the credit risk mitigation. Further, NBS has also issued acts and decrees focused specifically on housing and consumer credits, which inter alia specify thresholds related to overall indebtedness, the so-called Borrower Based Measures including requirements outlined for Loan To Value, Debt To Income, Debt Servicing to Income.

58. The Slovak Republic is in compliance with IFRS 9 reporting requirements for all banks and NBS subjected LSIs to numerous thematic reviews and horizontal analysis related to credit risk as well as conducting on-site inspections at select LSIs. NBS requires banks to be in compliance with the EBA guidelines on management of non-performing and forborne exposures. NBS has carried out in depth reviews, which were incorporated into the SREP assessment and P2R assessment of credit risk. The reviews included:

[22] (CON/2024/4)

- In 2020, after the outbreak of the COVID-19 pandemic, NBS established specialized teams to closely monitor different risk aspects of the pandemic also covering credit risk area, with loan moratoria, state guarantees, impacted economic sectors, development of default rates and NPLs.

- In early 2022 the war in Ukraine triggered a specific monitoring of the credit risk by the on-going supervision. NBS requested the banks to carry out an analysis of their loan portfolios in order to submit information regarding direct and indirect exposures which could be negatively affected by the war in Ukraine. At that time, none of the LSIs reported any direct exposures towards the affected countries. Majority of the identified indirect exposures were allocated in Energy, Transportation, Chemistry, Metallurgy, Natural Resources & Commodities or Automotive sector.

- In 2022, on-site supervision department in accordance with ECB and NBS strategic supervisory priorities carried out targeted review focused on the compliance of the LSIs' processes with the EBA/GL/2020/06 on loan origination and monitoring.

- In 2023, as part of the SREP assessment, all LSI banks were asked to complete a questionnaire focused on the verification of compliance with the definition of default, non-performing and forborne exposures.

- In the 2024 SREP cycle, the on-going supervision plans to focus on the horizontal review of LSIs' non-performing exposures strategies, which is in line with the ECB priorities for 2024 for the LSI sector.

D. Related Parties and Concentration Risk

59. Concentration risk is mainly conducted in the context of the LSI SREP process. LSI banks in Slovakia are required to have policies and processes for LSI's management of concentration risk in compliance with CRR (Art. 1, 4(1)(37)-(39), 387-403), the transposition of CRD into Slovak law and as related NBS Decree No 1/2023 on national discretions (Art. 5, 6). Geographical and sectoral concentration is taken into account in both the credit risk and business model risk assessment as part of SREP. Further, concentration risk (both individual and sectoral) is taken into account as part of the LSI's ICAAP assessment[23] and in the process of determining the bank's P2R. However, the assessment of excessive concentration risk is limited to corporate exposures and does not include sovereign exposures.

60. The large exposure framework for LSIs is an application of the EU regulatory framework, notably CRR. According to the CRR, an institution's exposure to a client or a group of connected clients is considered as a large exposure where its value equals or exceeds ten percent of its eligible capital. The large exposure limit to a client or a group of connected clients

[23] Based on the LSI SREP methodology, the assessment of concentration risk as a sub-category of credit risk is mandatory for HI-LSI when conducting a comprehensive SREP assessment. For non-HI-LSIs it depends on the application of the multi-year approach (e.g., when conducting a base assessment, it is not needed).

is 25 percent of an institution's eligible capital. The CRR defines the economic or control relationships under which counterparties can be considered as one group of connected counterparties. As per NBS's Decree No 1/2023 on national discretions, a single large exposure limit has been set by NBS at 50 million EUR. Although this limit is not in line with Basel's definition of a large exposure, it appears to be more conservative for LSIs. However, NBS allows a partial exemption regarding large exposures and the risk weighting of assets guaranteed by member states, governments, etc.[24] The BCBS RCAP on the large exposure (LEX) regulations in the EU concluded that the EU framework is largely compliant with the Basel large exposure standard(s). The main material finding relates to trading book exposures, as EU regulations allow for the LEX limit to be exceeded up to 600 percent of a bank's Tier 1 capital while the Basel LEX framework sets a 25 percent limit. This deviation is not material for Slovakian LSIs since their trading book exposures are negligible.

61. The definition of related party transactions in the legal and regulatory framework is narrower than the definition set in the BCPs. As per Sec. 35(2) of Act on Banking, although the definition of a related party in the Act appears to meet the definition outlined for Basel, the definition of a related party transaction (sec. 5(i), 35 and 36 of Act on Banking), which is either too broadly defined[25] or only indirectly refers to loans and guarantees, is not broad enough and therefore does not necessarily capture all related party exposures[26].

62. The laws and regulations pertaining to related party transactions, do not encompass all prudential requirements in accordance with the BCPs. Given that the framework for related party transactions is still not harmonized at the EU level, the requirements for such transactions are mainly based on national laws and regulations. Laws and regulations in the Slovak Republic should explicitly require banks to ensure that: (i) related party transactions should not be undertaken on more favorable terms than corresponding exposures to non-related counterparties; (ii) transactions with related parties and the write-off of related party exposures exceeding specified amounts or posing special risks are subject to prior approval by the Bank's board; and (iii) board members[27] with conflict of interest are excluded from the

[24] In relation to Art. 400(2)(a),(b) NBS allows a partial exemption to the extent of 80 percent of the nominal value of the covered bonds falling within the terms of Art. 129(1),(3),(6) and to the extent of 80 percent of the value of the asset items constituting claims on regional governments or local authorities of Member States and other exposures to or guaranteed by them with a 20 percent risk weight assigned.

[25] The definition of a banking transaction outlined in Sec 5(i) of Act on Banking which states: 'banking transaction' means the formation, alteration or termination of relationships established under the law of obligations between a bank or a foreign bank branch and its client, and any operation related to the banking business, including the handling of deposits.

[26] Related party transactions: include on-balance sheet and off-balance sheet credit exposures; dealings such as service contracts, asset purchases and sales; construction contracts; lease agreements; derivative transactions; borrowings; and write-offs. The term "transaction" should be interpreted broadly to incorporate not only transactions that are entered into with related parties but also situations in which an unrelated party (with whom a bank has an existing exposure) subsequently becomes a related party (definition BCP20).

[27] Although Sec. 35(2) Act on Banking requires that material transactions be subject to the unanimous approval of the statutory body and the exclusion of members from such board with a conflict of interest, this does not pertain to the supervisory board with independent board members overseeing such transactions.

approval process of granting and managing related party transactions. In addition, although Sec. 36(1) Act on Banking[28] does provide aggregate limits to employees and special relationships, there are no aggregate limits imposed on related party exposures or a requirement that such exposures be deducted from capital when assessing capital adequacy or be collateralized.

E. Liquidity and Funding Risk

63. LSIs in the Slovak Republic are subject to LCR and NSFR as applied in the EU framework. The LCR requirement came into force since January 2018 and the regulation incorporating NSFR entered into force in June 2021. LSIs report LCR on a monthly basis and NSFR on a quarterly basis. The 2017 BCBS RCAP assessment of LCR regulations in the EU concluded that the framework is overall largely compliant with the Basel LCR standard. The report identified one material deviation and four potentially material deviations that significantly overstate or may significantly overstate LCR for some banks in the EU.[29] The 2022 BCBS RCAP assessment of EU NSFR regulations assessed those regulations as largely compliant with the Basel NSFR standard. The main driver of that grade relates to the treatment of required stable funding which included nine not material findings. In general, LSI's LCR and NSFR levels in the Slovak Republic are well above minimum liquidity requirements, however NBS' calculation of high-quality liquid assets (HQLA) for LSIs (total 2.6 billion EUR at December 2023) includes a material percentage of sovereign bonds (1.24 billion EUR) for a total of 47 percent of total HQLA at December 2023.

64. Liquidity risk management requirements for LSIs are outlined in the banking laws and regulations. NBS refers to the EU regulations, NBS Decree No 4/2015 on risk management and NBS Decree No 18/2008 on liquidity, together provides guidance to LSI's on NBS's expectations regarding liquidity risk management policies and practices as well as the requirement to develop contingency plans. The EU has implemented additional monitoring metrics for liquidity, including the maturity ladder, concentration of funding by counterparty, and concentration of funding by product type.

65. NBS reviews LSIs' liquidity ratios and some aspects of their liquidity and funding risk management as part of SREP as well as undertaking on-site inspections periodically. NBS offsite supervisors monitor regulatory liquidity requirements of LSIs on a continuous basis. Off-site supervision reviews LSI's liquidity and funding policies, ILAAP and the liquidity contingency plans as part of SREP. This process checks the quality of the plans to assess if the plan adequately specifies the policies and action plans for responding to severe potential funding disruptions and if those action plans are feasible given the established stress scenarios.

[28] a) Sec 36(1) of BA sets a 20 percent aggregate limit of the LSIs capital regarding related party transactions on preferential terms to employees). b) Sec 36(1) indicates that "unsecured loans" from both "employees and special relationships with individuals" shall not exceed their income for 24 months).

[29] The material finding concerns the possibility of including certain financial instruments (such as high-quality covered bonds and assets issued by certain EU credit institutions) that do not fulfil the HQLA requirements in the Basel LCR standard. The potentially material findings relate to treatment of asset backed securities and covered bonds, the symmetrical treatment of operational deposit inflows and outflows, and the disclosure basis for LCR levels.

Very few on-site inspections have taken place to assess the strength of LSI's liquidity risk management practices over the past few years.

F. Interest Rate Risk in the Banking Book (IRRBB)

66. NBS monitors LSI's statement of sensitivity to changes in IRR as part of its off-site monitoring which is incorporated into the SREP assessment. Off-site supervision monitors LSI's maturity/repricing schedules, analysis of the bank's "weighted cumulative gap analysis", together with an assessment of the economic value of equity (EVE) and net interest income (NII) sensitivity to an assumed parallel shift of 200 basis all monitored in the analytical tool. The collection of these reports began in December 2021 and contain several metrics related to Δ EVE and Δ NII as well as implements the requirements of EBA/GL/2018/02. These are considered temporary measures to enable monitoring until the ITS on IRRBB reporting (Commission Implementing Regulation (EU) 2024/855) are implemented (expected September 2024); quarterly monitoring will begin after the implementation of this ITS. More granular data related to IRRBB exposure is provided by the banks at least on annual basis via SSM Short Term Exercise (STE) report which is used also for quantitative inputs into the SREP assessment.

67. NBS has undertaken a targeted horizontal review of IRRBB risk management policies involving all LSIs in 2023 given the importance of the IRR environment. Typically, NBS undertakes an annual horizontal analysis of IRRBB exposures of LSIs, however a deeper thematic review was undertaken in 2023 to assess all LSI's practices in IRRBB. The aim of this activity was also to find out the state of alignment with the current guidelines and level of implementation readiness for the new legislation which was going to enter into force. The thematic review revealed several potential shortcomings in several areas of LSI's IRRBB risk management framework, namely in measurement, internal governance, internal reporting, model validation, IRRBB strategy and internal documentation. NBS needs to undertake on-site inspections to determine the effectiveness of LSI's IRRBB risk management practices. Based on the results of the thematic review, two on-site inspections are planned for 2024 in LSIs where the identified deficiencies were of a higher severity. In addition, the information gathered from the thematic review serves as an important source for a deeper understanding of how IRRBB exposure is managed in a particular institution.

G. Operational Risk

68. NBS reviews LSI's operational risk management frameworks through its off-site and on-site activities, including the use of thematic reviews. Operational risk is mainly reviewed and assessed as part of the SREP process under the internal governance component. Over the past several years, LSI on-site inspections were carried out that focused on organizational framework, policies and procedures, risk strategy, risk identification, measurement and management of risks, operational risk event database, reporting and disclosure requirements. Further, a horizontal review was undertaken that focused on the internal governance/control environment and IT risk through the use of a questionnaire.

69. NBS' assessment of IT risk and protocols for dealing with cyber incidents should be enhanced. IT risk has recently been separated out from operational risk in the SREP and is mainly assessed through the use of questionnaires carried out by off-site supervision. NBS should undertake on-site inspections to determine whether LSIs have adequate IT systems in place to address data integrity and security issues. Further, NBS should determine whether LSI's IT infrastructure is capable of identifying, assessing, monitoring and managing technology risk and whether resilient under stressed conditions. Although there is a national authority (National Security Office) that is responsible for the oversight of cyber risk, NBS, in its capacity of bank supervisor, should have a distinct protocol in place that LSIs follow whenever a cyber event occurs to ensure that it is fully aware of the potential impact on the LSI's ability to continue to carry out its business activities and to manage the IT data security breach in an effective manner.

70. NBS is proactively implementing additional IT supervisory capacity that will address the implementation requirements of the EU Regulation 2022/2554 on the DORA. In preparation for the implementation of DORA, two selected HI-LSI entities underwent a third-party questionnaire administered by EBA, involving approximately 900 financial entities in the EA, aiming to gather insights into potential critical third-party providers and their concentrations. The participating banks collaborated closely, sharing extensive data about their IT outsourcing service providers. The results of the questionnaire provided valuable insights into the landscape of third-party providers. Further initiatives are planned as part of the phased implementation of DORA. Currently, efforts are underway to develop a reporting interface for banks to comply with EBA requirements regarding third-party providers. This interface aims to facilitate data collection once DORA becomes enforceable on January 17, 2025. The designated reporting date for banks is set for January 31, 2025.

H. Climate-Related Financial Risk

71. Since 2022, NBS has undertaken several initiatives to communicate its supervisory expectations regarding climate-related financial risks as it pertains to the financial markets it regulates. Since the ECB published its Guide to climate related and environmental risk in November 2020[30] (ECB's Guide on C&E), NBS has participated in or conducted several thematic reviews with the banks, utilizing the ECB's questionnaires in 2022/2023 and 2023/2024.

- The 2022 thematic review, covering the SIs and HI LSIs, focused on assessing preparedness to mitigate climate-related and environmental risks, identifying any differences between current practices and those outlined in the ECB guide on climate-related and environmental risks, as well as providing information on planned corrective measures for any identified differences. Results were provided back to the participating banks via anonymized benchmarking.

- The second thematic review, wherein NBS requested all banks to participate in a Climate Benchmark, wherein the banks were requested to conduct a self-assessment of their strategy, internal governance, risk management practices, and disclosures to evaluate compliance with

[30] ECB Guide on climate-related and environmental risk.

the expectations outlined in the ECB's Guide on C&M. Results were provided back to the participating banks.

Consequently, NBS tasked banks with updating or drafting their action plans to demonstrate their timelines for achieving compliance with supervisory expectations. Last, NBS has undertaken to meet several times with the Slovak Bank Association (SBA) Committee for ESG and sustainability as well as participate on key international (ECB committees) and NBS internal committees (working group/round table).

72. In 2022, the ECB undertook an EA climate stress test[31] focused on SIs and the EBA is currently developing the EBA climate stress testing framework[32]. The overall aim of the ECB is to assess the resilience of the EU banking system to the potential impact of climate risk. Such analysis has been undertaken at the highest consolidated level for SIs, therefore NBS' SI banks will be incorporated through their parent companies and no Slovakian LSIs were included in the exercise. To date, NBS's macroprudential stress tests do not have a dedicated climate-related risk scenario analysis, however NBS' Working Paper dated July 2023[33], provides a view on transition risks of loan portfolios for Slovakian banks.

73. NBS expects LSIs to adhere to the ECB's Guide on C&E, on a proportional basis, allowing for a gradual implementation of these regulatory expectations. To date, the findings from the thematic review have been incorporated into the LSI SREP process on light touch basis, which includes having discussions with the banks and sharing results on the thematic reviews. Although no on-site inspections have taken place to date nor planned for 2024 to assess C&E risk, SI on-site examiners will participate in a SSM on-site inspection which will greatly enhance NBS' level of expertise for supervision. Further, NBS is working towards the ECB's stance and priorities with respect to the supervisory expectation on climate-related risks[34]. Going forward, NBS should establish an overall approach to better incorporate, on a gradual basis, the supervision of climate-related financial risks into its supervisory processes for LSIs on a proportional basis (e.g., incorporate this more formally into the SREP process and on-site and off-site activities) as well as ensure adequate resources are dedicated that effectively transfers knowledge across teams.

[31] ECB Climate Stress-test.

[32] EBA Climate Stress Testing framework.

[33] NBS working paper

[34] ECB's stance and priorities

I. AML/CFT Supervision

74. NBS administers Act 297/2008 (AML Act) on the prevention of the legalization of proceeds of crime and the financing of terrorism for banks and other financial markets it supervises. Further, in collaboration with the Ministry of Interior of the Slovak Republic, NBS has issued the Methodological Guideline of the Financial Market Supervision Unit of NBS No 3/2019 of 29 April 2019 on the prevention of money laundering and terrorist financing at banks and branches of foreign banks (MG No 3/2019)[35]. NBS has adequate powers to sanction banks for non-compliance with the AML legislative requirements and publishes all its sanctioning decisions on its website. Although there have been no pecuniary sanctions imposed by NBS on a bank or branch of the foreign bank in the area of AML/CFT in the last five years, it has made use of its powers to do so in the past. NBS tries to ensure alignment of FIU sanctions to avoid double sanctioning of banks.

75. The FIU and NBS have a Cooperation Agreement[36] which governs the coordination and exchange of information regarding banks' compliance with AML/CTF regulatory and prudential requirements. The AML Act outlines the requirement for the FIU and NBS regarding the cooperation and exchange of information (Sec. 29 (4-6)), the FIU's role in international cooperation (Sec 28) and Sec. 26(a)(4)) describes the requirement for domestic competent authorities, including NBS, regarding the framework of the National Risk Assessment program. This Cooperation Agreement is currently in the process of being updated to help clarify the roles of both the FIU and NBS, including how to help reduce the overlap pertaining to the supervisory oversight of banks in the Slovak Republic (e.g., common risk assessment methodology, joint on-site inspections or placing reliance on the work of NBS as the FIU carries out its own risk assessment processes and undertakes on-site inspections of banks).

76. Although the AML Supervision Section (AMLSS) in the BSD was created in 2020, NBS' AML/CTF supervision program for banks began more than 10 years ago. The AMLSS has the responsibility of not only AML/CTF supervisory coverage of approximately 24 entities in banking supervision (e.g., SIs, LSIs, branches) but providing support to the AML staff who reside in the other financial market supervisory departments within NBS. The contingent of AML experts should be augmented to ensure NBS can deliver on its mandate regarding AML/CTF regulation and supervision of LSIs.

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[35] Further to recent consultation with the industry, NBS is working towards replacing MG No 3/2019 with an AML/CTF questions/answers program (Q/A) on its website to help clarify its expectations regarding bank's requirements to comply with AML/CTF regulation and supervision requirements, including any EBA/ECB requirements.

[36] The Cooperation Agreement dated November 2013 between NBS, regarding its responsibilities for the supervision of the financial market, and the Ministry of the Interior of the Slovak Republic specifies the cooperation between NBS and the Financial Intelligence Unit of the Police Force Presidium's National Crime Unit (FIU), for the purpose of preventing and detecting money laundering (ML) and terrorist financing (TF).

77. AMLSS undertakes off-site monitoring using a new BI tool that processes data, **including making an automatic calculation of the ML/TF risk assessment of LSIs.** This off-site risk assessment results in banks being classified into 4 risk categories, including various levels of ML/TF risk: low, medium, high risk or critical. In addition, AMLSS has internal procedures for off-site and on-site supervision as well as an Internal Instruction No 4/2022 risk assessment module for the banking sector. AMLSS' annual analysis feeds into the on-going LSI supervision assessment of the SREP process under the block of internal governance. AMLSS explained that all 24 entities are treated equally, however the result of the risk assessment is the basis for the creation of a supervision plan in terms of the frequency and type of supervision (e.g., whether an on-site inspection will be carried out) based on the overall ML/TF risk of the bank. Banks are not aware of the specific results of the risk assessment on an annual basis as this is communicated through a meeting with the Slovak Bank Association on an annual basis in aggregate.

78. Within the SREP, assessment of AML/CTF feeds into the internal governance element where findings may point to material weaknesses in a LSI's AML/CFT systems and controls. AMLSS cooperates with LSI on-going supervision annually (and with greater frequency if necessary) wherein it provides an overview of its risk assessment results stemming from AMLSS' off-site analysis. Where the SREP assessment indicates the shortcomings in a bank's internal controls and governance framework and institution-wide controls give rise to prudential concerns related to ML/TF risk this can be factored into the SREP assessment. When an LSI is sanctioned by either the FIU or NBS, it should have a material impact on the overall risk assessment of the LSI. Although the LSI SREP methodology does not necessarily allow the NCA supervisor within IMAS (SSM system) the ability to provide greater weight to a material deficiency in AML/CTF, BSD could utilize expert supervisory judgement to potentially change the overall rating for internal governance should a material AML/CTF shortcoming be identified. As this has not been utilized in the past, a material AML/CTF deficiency should not be lost amongst the many layers of the assessment of internal governance within SREP.

79. AMLSS carries out both thematic reviews and on-site inspections from time to time. NBS applies the basic principle for AML/CFT in performing AML/CFT supervision for both LSI and SI banks: a risk-based approach. The legislative framework (AMLD and Slovak Act No. 297/2008) uses the term "obliged entity" when fulfilling obligations in AML/CFT, which applies to all banks (LSI and SI). AMLSS has undertaken on-site inspections of LSIs, however the frequency is somewhat dated (none carried out in the past 5 years which is somewhat explained given the state of emergency due to COVID and the inability to go on-site which was replaced by remote supervision). In addition, the AMLSS on-site inspections and subsequent sanctions are also open to the challenge/appeal by the banks which can prolong the finalization of findings or the inspection report. The ability to appeal NBS' prudential findings should be restricted to finalized prudential decisions (see ¶17 more details). Further, it is suggested that AMLSS put in place a protocol with minimum performance turnaround times to ensure the results are finalized and formally communicated on a timely basis to banks to ensure findings continue to be relevant. Once an AMLSS on-site inspection is completed, it is critical for NBS to provide the results to not only the LSI statutory board members but with the supervisory board members (independent or non-executive board members), especially given any material findings that result in sanctions, either by NBS or the FIU.

80. As per the AML Act, banks are only required to report suspicious transactions to the FIU. Banks should also be required to report to NBS any suspicious activities and incidents of fraud when such activities/incidents are material to the safety, soundness or the reputation of the bank.

81. The latest MER follow-up report on the Slovak Republic indicated that progress was made in addressing the AML/CTF technical compliance deficiencies regarding the regulation and supervision of financial institutions. The Mutual Evaluation Report (MER) of the Slovak Republic was adopted in September 2020 wherein the country was placed in enhanced monitoring. The MER, together with the follow-up reports (FURs), prepared by the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorist[37] (MONEYVAL) dated November 2022 and December 2023, indicated that although recommendation 26 pertaining to the regulation and supervision of financial institutions was re-rated from partially compliant to largely compliant the following deficiencies pertaining to banks remain: NBS needs to check the suitability of the "associates" of criminals upon licensing, the increase in significant interest in a bank (20 percent) or those of financial groups pertaining to a major events or developments[38]; the FIU does not have any procedures for reviewing the assessment of the ML/TF risk profile of a financial institution in general and to use that assessment to drive the frequency and intensity of the on-site inspection of banks; and the FIU is to conduct "off-site" supervision.

J. Recommendations

82. To ensure a more effective regulation and supervision of key LSIs' risks, NBS and the authorities should:

- Ensure the risk management function of banks reports not only to management but to the non-executive board members (e.g., the supervisory board).
- Strengthen NBS on-site inspection activities, on a periodic basis, regarding LSI's risk management practices for the key risk areas of credit, liquidity, IRRBB and IT.
- Take into account excessive concentration risk for a broader range of exposure types, including sovereign risk concentration, when setting P2R.

[37] The Financial Action Task Force on Money Laundering (FATF), an intergovernmental body, has primary responsibility for developing worldwide standards for AML/CFT. It works closely with other organizations, including the IMF, the World Bank, the United Nations, and FATF-style regional bodies (FSRBs). MONEYVAL is a permanent monitoring body for the Council of Europe which assesses compliance of National Authorities with international standards to counter ML and TF.

[38] NBS indicated that it has addressed this remaining gap since the December 2023 FUR was published.

- Expand the definition of related party transactions to align with Basel and ensure such transactions are conducted on arms' length basis, subject to strict rules on avoidance of conflict of interest and introduce an overall limit on exposures to related parties that is at least as strict as the large exposure limit.

- Update necessary data collection regarding IRRBB and BI tool to ensure that NBS can adequately monitor potential negative impacts on LSIs due to changes in interest rates.

- Introduce a distinct protocol that LSIs follow whenever a cyber event occurs to ensure that NBS is fully aware of the potential impact on the LSI's ability to continue to carry out its business activities and to manage the IT data security breach in an effective manner.

- Enhance climate risk oversight to ensure it is gradually integrated into supervisory processes, augment resources accordingly.

- Ensure AML resourcing is adequate to enable NBS to deliver on its mandate including reassessing the frequency of on-site inspections for LSIs and communicating where necessary with supervisory board members. Ensure material AML/CTF non-compliance deficiencies have an impact on the overall view of the risk profile of the LSI. Finalize the updating of the Cooperation Agreement between NBS and the FIU to eliminate overlap of duties or responsibilities.

Table 6. Slovak Republic: Financial Soundness Indicators (2018-2023)

	2018	2019	2020	2021	2022	2023
Core FSIs for Deposit takers						
Regulatory capital to risk-weighted assets	18.3	18.2	19.7	19.8	19.6	20.5
Tier 1 capital to risk-weighted assets	16.6	16.6	18.1	18.3	18.0	19.0
Nonperforming loans net of provisions to capital	9.0	9.5	8.3	6.7	6.7	8.8
Common Equity Tier 1 capital to risk-weighted assets	...	...	...	17.0	16.9	17.6
Tier 1 capital to assets	7.4	7.3	7.3	7.6	7.3	7.6
Nonperforming loans to total gross loans	3.1	3.0	2.6	2.1	1.9	2.0
Loan concentration by economic activity	...	...	...	56.1	54.8	65.5
Provisions to nonperforming loans	70.8	67.4	66.7	68.9	65.3	55.7
Return on assets	1.1	1.0	0.7	0.9	1.0	1.3
Return on equity	7.8	7.5	5.1	7.6	8.2	11.2
Interest margin to gross income	72.8	71.5	63.9	61.8	60.6	65.9
Noninterest expenses to gross income	59.6	60.9	63.7	61.2	57.2	50.4
Liquid assets to total assets	26.8	23.9	27.3	30.0	29.5	31.9
Liquid assets to short-term liabilities	35.4	31.9	37.7	43.7	39.7	43.4
Liquidity coverage ratio	...	...	...	186.2	180.0	200.1
Net stable funding ratio	...	...	...	131.3	130.2	133.7
Net open position in foreign exchange to capital	0.7	5.1	0.5	0.2	2.2	3.2
Large exposures to capital	...	...	...	55.0	...	...
Geographic distribution of total loans						
Geographic distribution of total loans: Domestic economy	88.6	91.1	89.6	88.5	90.9	89.9
Geographic distribution of total loans: Advanced economies	11.0	8.5	10.1	11.2	8.8	9.8
Geographic distribution of total loans: Emerging market and developing economies	0.4	0.4	0.4	0.3	0.3	0.3
Gross asset position in financial derivatives to capital	3.9	5.4	7.2	4.2	15.0	9.5
Gross liability position in financial derivatives to capital	4.4	5.4	7.0	4.2	15.7	11.5
Trading income to total income	2.7	1.8	3.5	3.7	4.7	4.2
Personnel expenses to noninterest expenses	44.7	46.4	41.0	41.8	42.5	44.2
Spread between reference lending and deposit rates (base points)	...	...	...	203.3	244.0	248.0
Spread between highest and lowest interbank rates (base points)	...	...	...	70.0	478.0	493.0
Customer deposits to total (noninterbank) loans	93.4	92.1	95.5	93.3	87.8	89.0
Foreign-currency-denominated loans to total loans	4.3	2.4	2.9	2.4	2.2	2.5
Foreign-currency-denominated liabilities to total liabilities	3.2	2.9	2.8	2.5	3.3	3.4
Credit growth to private sector	...	...	...	...	10.7	3.5
Other Financial Corporations						
OFCs' assets to total financial assets	...	...	...	...	...	...
OFCs' assets to total financial system assets: total OFCs	29.8	30.6	30.7	30.3	27.8	28.0
Real Estate Markets						
Commercial real estate prices (Percentage change/last 12 months)	...	...	...	...	...	...
Residential real estate loans to total gross loans	43.92	46.46	47.45	48.57	49.92	50.85
Commercial real estate loans to total gross loans	...	...	...	...	...	...

Source: IMF Financial Soundness Indicators.