Recommendation No 1/2012
of the Financial Market Supervision Unit of Národná banka Slovenska
of 16 January 2012
on supporting the stability of the banking sector

In accordance with the third point of Article 1(3)(a) of Act No 747/2004 on financial market supervision and on amendments to certain laws (as amended), the Financial Market Supervision Unit of Národná banka Slovenska makes the following Recommendation:

Article I

For a long period of time now, Národná banka Slovenska has evaluated the Slovak banking sector and found it to be stable, creditworthy and well-functioning. The central bank's analyses of the domestic financial sector have often emphasised that the average core Tier 1 capital ratio of the banking sector in Slovakia is one of the highest in the European Union, which means the sector is resilient to any adverse developments at the macroeconomic level or in financial markets. The banking sector also reports a high degree of self-sufficiency in regard to liquidity. Banks in Slovakia obtain the bulk of their financing from the deposits of residents, and to a lesser extent from deposits of non-resident parent undertakings and from the wholesale financial markets, which are regarded as less stable sources.

The recent period has seen downward revisions to economic growth forecasts in both Slovakia and its main trading partners, as well as a number of adverse trends in the euro area which could have repercussions also for the stability of the Slovak banking sector. The negative trends have been most apparent in financial markets and are especially marked in the euro area sovereign debt market.

A further development is the mounting concerns about the stability of banking sectors in central and east European countries, owing to the close links between subsidiary banks in this region and their parent undertakings.

Given that the stability of the Slovak banking sector could in future also be affected by these risks, Narodná banka Slovenska, represented by its Financial Market Supervision Unit, recommends – with regard to the provisions of Article 27 of the Act on banks (No 423/2001 Coll.) – that all banking institutions in Slovakia proceed in accordance with the following Articles II to V. The main purpose of this Recommendation is to strengthen the stability and self-sufficiency of the banking sector in Slovakia.

At the same time, Národná banka Slovenska hereby gives notice that in the light of the elevated risks of financial market shocks, it will for the time being be paying particular attention to whether banks, when conducting new transactions (including intra-group transactions), are taking due consideration of the risks which they undertake and are expected to mitigate (in accordance with Article 27 of the Banking Act and with related implementing regulations), as well as the impact of such transactions on their overall liquidity.

Article II

Národná banka Slovenska recommends that banks maintain a core Tier 1 capital ratio of at least 9%, which, for the purposes of this Recommendation, represents the ratio between a bank's core equity capital[1)] and capital requirements multiplied by 12.5.[2)]

In the view of Národná banka Slovenska, banks that satisfy this ratio will be better able to comply with the obligations arising under Article 27(3) of the Banking Act and thus to prevent a situation in which they may otherwise be subject to remedial measures or fines under Article 50 of the Banking Act.

Národná banka Slovenska recommends that banks, when distributing profits not included in equity capital or when making a distribution related to Tier 1 capital, have regard to the mounting concerns about economic developments and therefore maintain an adequate capital buffer against potential losses, while proceeding in accordance with Annex 1 of this Recommendation. Banks whose core Tier 1 capital falls short of ensuring such a buffer should limit their distribution of profits. In respect of their dividend policies, banks are therefore expected to take into consideration the potential adverse effects of a slowdown in economic growth and other risks to their profitability and stability in the years ahead.

Article III

In order for banks to continue maintaining their stability and independence and to strengthen their stable funding, it is recommended that their loans-to-stable funds ratios do not exceed 110%. Any bank exceeding this ratio will be expected to submit to Národná banka Slovenska a plan for complying with it. For this purpose, stable funds are understood to mean the sum of deposits received from customers and issued debt securities.

Article IV

If any bank needs to strengthen its capital adequacy ratio (CAR) up to the recommended levels, it should do so by means of current earnings and/or a share capital increase. Banks should avoid tightening lending conditions as a means of bringing their capital ratios into line with the regulatory requirements or with the level recommended in Article II of this Recommendation, or in order to bolster their stable funding ratio (under Article III). Nor should banks reduce their lending activity in order to maintain a sufficient level of capital ratios while reducing the amount or quality of their equity capital. Any widespread restriction of lending to the real economy would be expected to have wider macroeconomic repercussions, creating a negative feedback loop between the economy and the financial position of the banking sector.

Article V

In regard to the management of their short-term liquidity over the next 12 months, banks should adopt measures and procedures which respond to their constrained access to funding from wholesale markets or from the possible issuing of debt securities on the primary market.

[1)] The numerator of this ratio is calculated as the amount of the bank's core equity capital as defined in Article 4 of Decree No 4/2007 of Národná banka Slovenska on banks' own funds and banks' capital requirements and on investment firms' own funds and investment firms' capital requirements (as amended), adjusted in accordance with Article 6(3) of this Decree.
[2)] Article 30(5) of the Banking Act.

In order to stabilise their sources of funding, banks should adopt measures and procedures concerning the adjustment of their asset and liability structures, and particularly measures to increase their stocks of long-term deposits and stable deposits. Deposits are considered to be long-term if their agreed maturity is over one year, while stable deposits are those that, according to the bank's observations, have been stable over a long period.

Article VI

The recommendations made in Articles II to V shall remain in effect until such time as Národná banka Slovenska judges that the risks referred to in Article I have passed.

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Annex

Národná banka Slovenska recommends that banks restrict the distribution of profits that have not yet been included in equity capital, in accordance with Table 1 as follows:

Table 1

Line number	Value of core Tier 1 capital when the decision of profit distribution was taken	Percentage of profits that should be used to increase equity capital instead of being distributed
1	Less than 9.625%	100%
2	At least 9.625%, but less than 10.25%	at least 80%
3	At least 10.25 %, but less than 10.875%	at least 60%
4	At least 10.875%, but less than 11.5%	at least 40%
5	More than 11.5%	no limit

If a bank increases its core Tier 1 capital ratio to the level stated in line 5 of Table 1 by retaining a percentage of profits smaller than the percentage stated in the previous Table, its retention of a smaller percentage of profits is in this case in line with the recommendation.

Národná banka Slovenska recommends that banks make distributions related to core Tier 1 capital only if their core Tier 1 capital ratio exceeds the level stated in line 5 of Table 1 and, in that case, only to an extent that does not result in the ratio falling below this level.