5

May 2010
Volume 18

BANKING
JOURNAL

BIATEC

NÁRODNÁ BANKA SLOVENSKA

Naïve paintings from Kovačica at NBS for the second time

Oil paintings by naïve artists from the Serbian village of Kovačica are globally renowned as part of Europe's cultural heritage. Naïve art is interesting especially for its uniqueness, understanding, peculiar and unchangeable loveliness, sensitivity, strength of illusion, and of course a certain naivety.

Photo: Pavel Kochan

The exhibition was opened by NBS Governor Jozef Makúch (first right in the photo). The Deputy Prime Minister of the Slovak Republic, Dušan Čaplovič (centre), and the Ambassador of the Republic of Serbia to the Slovak Republic, Danko Prokić (first left), addressed the assembled guests at the exhibition opening.

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The naïve art of Slovak people living in the district of Banát, and especially in the villages of Kovačica and Padina passed on from one generation to the next. Young naïve artists follow the traditions of their parents and continue portraying the chronicles of their villages with a paintbrush.

An exhibition of paintings for purchase from Kovačica was held for the second time in the premises of the NBS. In June 2008, visitors could view the exhibition and buy paintings and other artefacts from the Kovačica "***Galéria Babka***" gallery. Just as previous years, the objective of the central bank was to encourage and support the promotion of this world-famous fine art of Slovaks from abroad. The exhibition, Naïve Paintings from Kovačice, is open at NBS headquarters (Imricha Karvaša 1, Bratislava) till 28 May 2010. Admission to the exhibition is free.

Detail from the picture of Pavol Lavroš.

Visitors found the naïve paintings compelling.

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BIATEC

Banking journal

May 2010

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Graphic design: Bedrich Schreiber
Typo&lito: AEPress, s.r.o.
Printing: Dolis, s.r.o.

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Evidence number: EV 2817/08
ISSN 1335 – 0900

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Current developments in the area of European financial market regulation

Tomáš Ambra, Andrea Málišová, Štefan Nebeský,
Peter Paluš, Peter Pénzeš and Ľuboš Šesták
Národná banka Slovenska

As a result of the financial crisis, activities of EU institutions in the area of adjusting existing financial market regulations to meet the challenges brought by the negative development on the financial market have significantly increased since September 2008. The aim of this article is to provide readers with a basic overview of this area. For the sake of clarity, the individual European initiatives are divided depending on their current legislative status to those documents regarding which discussions at an European level are underway, to documents that are subject to legislative procedures of the EU, and to adopted acts ready to be implemented by Member States.

Regulatory initiatives at the stage of discussions

With regards to the financial crisis, the European Commission (hereinafter referred to as the "Commission") has started to work on two areas of legislative changes aimed at adjusting the approach to the supervision of financial institutions. Specifically, it involves what is called the new supervisory architecture and crisis management of banking groups. While the first initiative is currently (May 2010) as far as at the stage of legislative proposals being discussed in the European Parliament, the issue of crisis management has so far been subject to discussions in various forums (especially in working groups of the Commission, the Council of the EU, CEBS[1]). Specific legislative proposals are expected only in the second third of 2010.[2]

For this area, the Commission is proposing measures with potentially a great impact on the existing regulation, specifically on the powers of authorities in what are called the host countries[3] when performing supervision of daughter companies of European banking groups. The aim of this initiative is to propose a modification of the existing instruments, or to create new instruments for the supervisory authorities and other state institutions (e.g. bankruptcy courts) applicable for the purposes of crisis management of banking groups. These instruments are divided into three areas depending on the stage of crisis for which they are to be applied:

a) Instruments of early intervention are to be used at a stage when the bank still complies with regulatory requirements. On the EU level, the discussion concerns especially the following instruments: modification of preventive powers of the supervisory authority in the Credit Institutions Directive (hereinafter referred to as the "CRD")[4, 5], introducing the requirement for banks to prepare so-called *living wills* in which the bank preventively stipulates a procedure to deal with a crisis situation, liberalisation of intergroup asset transfers, and the strengthening of competencies of supervisory authorities in host countries in relation to subsidiaries of foreign banks.

b) Instruments to deal with a bank crisis *(resolution)* – this stage should follow if the bank is not able to comply with the conditions based on which it was granted authorisation. Preliminarily, creating or modifying the harmonised legislative framework is expected concerning corporation sale, the so-called *bridge bank* owned by the state, the transfer of "toxic" assets, and the transfer of bank ownership to another corporation within the private sector. When it comes to banking groups, individual national authorities are to use the indicated instruments either based on the principle of an integrated approach (creating a unified European crisis body) or a coordinated approach (through the so-called *cross-border stability groups* consisting of relevant authorities of all concerned Member States).

c) Modification of bankruptcy of banking groups *(insolvency)* – this stage follows in the case of bankruptcy of a bank. Two options of how to mitigate the insolvency of banking groups are being considered: coordination of bankruptcy courts and other authorities participating at this stage, or creating a whole new legislation at the EU level applying only to the bankruptcy of banking groups.

The majority of mentioned instruments are, in our view, controversial, however several EU Member States expressed their serious objections to

1 *Committee of European Banking Supervisors, www.c-ebs.org.*
2 *More information about the current development of this initiative at http://ec.europa.eu/internal_market/bank/crisis_management/index_en.htm.*
3 *For the purposes of this article, a host country is understood as a country of the registered office of the subsidiary or a branch of a financial institution.*
4 *Directive 2006/48/EC of 14 June 2006 relating to the taking-up and pursuit of the business of credit institutions (OJ L 177, 30.6.2006) – consolidated version.*
5 *Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 on the taking up and pursuit of the business of credit institutions (OJ L 177, 30.6.2006) – revised version.*

the liberalisation of the current regime of intergroup asset transfers, because this mechanism may have a very negative impact on subsidiaries in the host countries. In this regard, the initiative has a significant impact on the powers of Národná banka Slovenska as the supervisory body for the financial market in the Slovak Republic.

The issue of crisis management of banking groups is connected with a revision of the legislative framework of banking guarantee schemes (in the Slovak Republic this involves the Deposit Protection Fund). In the summer of 2009, public consultations of proposals of the Commission to revise the Directive on deposit guarantee schemes took place.[6] The Commission is currently returning to this topic and proposes the use of guarantee schemes not only to pay compensation for inaccessible deposits, but also to fund the rescue of banks. The establishment of a Europewide fund is also being considered (the so-called Pan-European Guarantee Scheme) which would collect bank contributions.

While the crisis management of banking groups and the revision of banking guarantee schemes lead to the management and funding of a crisis from market resources, there are also attempts to create a legislative framework to fund the rescue of financial institutions from public funds. Using those would, however, only come into consideration when private funds are insufficient for the rescue. The aim of this initiative is eventually to create an ex ante framework for sharing fiscal costs to provide aid to significant financial groups at a time of crisis. The burden currently carried by the EU Member States of the parent company[7] is to be divided also to Member States of subsidiaries. It is being considered that a so-called *Pan-European Resolution Fund* would be established that would collect contributions of financial institutions determined for the purposes to provide a capital injection at a time of crisis. In the case such funds would not be sufficient, the EU Member States should provide further funds. This topic is politically highly sensitive and very closely followed especially by the EU host countries.

The development of European proposals significantly influences also world development, especially in the U.S.A. Special attention is paid to the new regulatory initiatives announced in January 2010 by President Obama, the legislative form of which is currently under negotiations. The aim is to prevent the establishment of entities which would have serious impacts on the public budget in case of their collapse (referred to as being 'too big to rescue'). The instrument to achieve this aim is supposed to be the limitation of market share size of financial institutions and the tightening of the possibility to invest into hedging funds and private equity firms,the so-called Volcker rule. Another aim is to raise funds to cover the costs of the TARP[8] program through which the U.S. government rescued banks using public resources. The most important financial groups are to be levied a tax (the *financial crisis responsibility fee*) calculated based on the size of their obligations as a share of their consolidated base. The EU evaluates these initiatives and consults them with the Member States.

Apart from the mentioned initiatives in the area of crisis management and the funding of banking group rescue, the Commission is also actively working on the modification of the legislative framework for the banking sector. At the end of February 2010, a document was provided for public consultation[9] on the Commission's webpage presenting opinions and asking questions regarding proposed amendments of various areas of banking regulation contained in CRD. Thus, this is the first step towards publishing a further amendment of this Directive, which is referred to as CRD IV. As part of the public consultation, the Member States, public administration authorities, and market participants had the possibility to express their position by 16 April 2010.

Based on the results of the public consultation, the Commission plans to present an extensive proposal of amendments to CRD in the second half of 2010 concerning especially:

- Liquidity standards
- Definition of capital
- Leverage ratio that, depending on the presented proposals, may substantially change the philosophy of adequacy of own funds
- Counterparty credit risk
- Countercyclical measures
- Systemic importance of financial institutions
- Intention to introduce the highest possible level of harmonisation of rules in the banking sector (single European rulebook)

From the positions of the Commission as expressed in the document provided for public consultations, it is clear that the implementation of proposals in the above mentioned areas will present a significant change in the functioning of credit institutions and the role of supervisory authorities. At the same time these changes will influence the possibility of national regulators to apply their own sets of regulatory instruments adjusted to specific conditions of supervised credit institutions.

If the Commission publishes a legislative proposal in the second half of 2010 proposing the amendment of CRD, we can expect it to be approved in the middle of 2011. Since CRD represents a legal act in the form of a directive, Member States will be obliged to implement the CRD amendment into their national legal order within a deadline estimated based on the scope of the proposed changes to be between 18 to 24 calendar months. At the same time, we suppose that the directive will enable entities whose rights and responsibilities are to be modified to adjust their activity to the new legal definition.

In the insurance sector, a discussion in the area of insurance guarantee schemes is being prepared. The Commission plans to issue a White Paper on insurance guarantee schemes with the aim to harmonise this area of consumer protec-

6 Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit guarantee schemes (OJ L 135, 31.5.1994).
7 For instance, in the case of the ING, Dexia, KBC and RBS groups.
8 Troubled Asset Relief Program.
9 http://ec.europa.eu/internal_market/consultations/docs/2010/crd4/consultation_paper_en.pdf.

tion that is currently not covered by European legislation.

In the Slovak Republic, there are no insurance guarantee schemes implemented and the situation in other EU Member States is very varied (of 27 Member States, 12 have one or more insurance guarantee schemes covering life insurance or non-life insurance or both types of insurances). We may expect that the relevant European initiative will have a significant impact on the insurance sector in the Slovak Republic.

The Commission sent to CEIOPS[10] a Call for advice[11] regarding the revision of the Insurance Mediation Directive (IMD). It has not yet been decided if the current IMD is to be amended or if a completely new directive is to be prepared. The main aim of the IMD revision is to eliminate identified flaws causing application problems in praxis, and to increase consumer protection. Especially the following areas will be subject to IMD revision:

- System of notifications in the EU
- General good – no harmonisation exists
- The effort to ensure equal consumer protection when distributing insurance products by an insurance undertaking or insurance mediator
- Information requirements
- Conflict of interests
- Disclosure of remuneration of mediators
- Mutual acknowledgement of qualifications
- Delegation of activity performance

Another initiative in the area of strengthening the protection of financial consumer is the establishment of inter-sector legislative regulation of retail investment product sales (Packaged Retail Investment Products – PRIPs). Its aim is to increase information awareness and the protection of clients' of financial institutions during sales of investment products. The instrument to achieve this goal is to be the development of certain principles of protecting financial consumer from the capital market sector to other sectors of the financial market (banking, insurance industry). Specifically, preparing a relatively large regulation on disclosing information regarding investment financial products is expected (inspired by a similar governing in the UCITS[12] Directive), as well as on the rules of negotiations between sellers/mediators of financial products and potential clients (inspired by a similar definition in the MiFID Directive[13]). Originally, the consideration was that the new regulation would also apply to the pension sector. The Commission, however, realised that with regards to the complexity of this whole issue, pension products would remain as of now outside the PRIPs framework, however, a regulation based on the same principles would be created concurrently with the PRIPs initiative. This initiative will have a significant impact on national legal regulations of the banking and insurance sector.

The Commission also prepares a revision of the MiFID Directive. Currently, this initiative is only at its initial stage in which the Commission still cooperates, apart from others, also with CESR[14] that in order to prepare a report for the Commission including recommendations for particular areas, published several consultation papers in which it presents individual proposals for potential regulations and also asks questions with the aim to receive the opinions of all involved parties. At the end of 2010 the Commission itself also plans to publish a consultation document that is to be followed by a proposal of the amendments of the MiFID Directive.

In the area of occupational pension saving (in Slovakia, the supplementary pension saving), a Green Paper on Pensions is being prepared that is to be published in the middle of 2010. It will be a document which will identify problems that in the near future will be dealt with by the Commission. We may preliminarily expect that the subject of the document will cover the following areas: extending the coverage of the existing pension directive also to the 2nd pension pillar, preparing rules of solvency for pension institutions, eliminating barriers of pension rights assignability, proposing issues of the sustainability and adequacy of the current pension systems in the EU.

In this area, what is referred to as the *holistic approach* is to be applied, meaning that the Commission will try to intervene at least indirectly also in areas in which it has so far acknowledged the exclusive jurisdiction of the Member States (e.g. the 2nd pension pillar).

Finally, the revision of the directive on conglomerates[15] is currently at the discussion phase. On 6 November 2009, the Commission published a consultation document with the aim to learn about the opinions of involved authorities with regard to some of the areas in the legal regulation of financial conglomerates. The proposal of the amendment of the relevant directive will be prepared based on this document.

Regulatory initiatives in the legislative process at EU level

On 23 September 2009, the Commission published the proposals for regulations changing the structure of supervision and regulation in the EU. These changes are known as the new supervisory and regulatory architecture in the EU. We wrote about the discussion preceding the publication of the proposals for legislative texts in the 9th edition of the journal of BIATEC in 2009[16], therefore we will deal in this article only with the current developments in this area.

The proposal for the new architecture consists of three areas:

- The establishment of the European Systemic Risk Board (ESRB)[17]
- The establishment of the European Supervisory Authorities (jointly called – ESA):
  - The European Banking Authority (EBA)[18]
  - The European Insurance and Occupational Pension Authority (EIOPA)[19]
  - The European Securities and Markets Authority (ESMA)[20]

10 Committee of European Insurance and Occupational Pensions Supervisors, www.ceiops.eu.

11 http://www.ceiops.eu/media/files/requestsforadvice/EC-Jan-10--IMD/20100127-Commission-Call--for-advice-IMD-revision.pdf.

12 Directive 2009/65/EC of the European Parliament and of the Council of 13 June 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (OJ L 302, 17.11.2009).

13 Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments (OJ L 145, 30.4.2004).

14 Committee of European Securities Regulators, www.cesr.eu.

15 Directive 2002/87/EC of the European Parliament and of the Council of 17 November 2009 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (OJ L 312, 22.11.2008).

16 Financial Market Supervision Unit: The new system of financial market supervision and regulation according to the de Larosière Group, BIATEC, volume 2009, No. 9, p. 16-23.

17 Proposal for a Regulation of the European Parliament and of the Council on Community macro-prudential oversight of the financial system and establishing a European Systemic Risk Board, COM (2009) 0499, available on the Internet: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2009:0499:FIN:EN:PDF.

18 Proposal for a Regulation of the European Parliament and of the Council establishing a European Banking Authority, COM(2009) 0501, available on the Internet at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2009:0501:FIN:EN:PDF.

19 Proposal for a Regulation of the European Parliament and of the Council establishing a European Insurance and Occupational Pension Authority, COM(2009) 0502, available on the Internet: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2009:0502:FIN:EN:PDF.

20 Proposal for a Regulation of the European Parliament and of the Council establishing a European Securities and Markets Authority, COM(2009) 0503, available on the Internet at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=-COM:2009:0503:FIN:EN:PDF.

- The OMNIBUS Directive[21] which presents a compilation of amendments of individual directives and formulates empowerments for the European Supervisory Authorities allowing them to exercise their powers.

The background idea of the new regulation is the creation of regulation as homogeneous as possible, uniform for all Member States (the single European rulebook), its uniform application throughout the EU and to establish a comparable approach of the supervisory authorities when performing supervision. This model is to ensure equal opportunities in the single market for EU financial institutions, regardless of the fact which Member State they use as registered office.

The new authorities should replace the current consulting committees of the Commission – CEBS, CESR and CEIOPS. The establishment of the new authorities is planned for 1 January 2011, which is in our opinion very ambitious goal considering the status of the legislative process.

The ESRB shall be responsible for the macro-prudential supervision in the EU. It is to monitor systemic risks and issue warnings and recommendations. The ESRB should contribute to the financial stability of the EU as a whole. The definition of financial stability on the EU level remains, however, unclear. In our opinion, a prerequisite for the overall financial stability of the EU is the financial stability of individual Member States. It is also necessary to create rules of procedure governing the functioning of ESRB and the participation of national experts in the preparation of ESRB analyses.

The ESA are to be responsible for micro-prudential supervision in the EU. They are to propose technical standards[22], to enforce convergence when performing supervision and uniform application of EU law, settle disagreement between supervisory authorities, and to supervise the activities of colleges of supervisors. An important related question is the division of powers in the case of supervision of cross-border financial groups between the ESA, the home supervisory authority, and the host supervisory authority.

With regards to the need to ensure financial stability at the national level, we consider to be important that the host supervisory authority shall possess adequate powers when dealing with entities performing their business activities in its territory. From this point of view, we support maintaining the status quo as far as the division of powers when performing supervision between home and host supervisory authorities is concerned. The transfer of powers from national supervisory authorities to the ESA should be allowed only if the responsibility for financial stability is simultaneously also shifted to the European level and burden sharing of the costs related with a crisis situation is agreed too. However, this issue in our opinion has not yet been solved satisfactorily.

The proposals for regulations were approved in December 2009 by the Council of the EU and submitted for discussions to the European Parliament, during which a large number of amendments were raised. In the case of the ESRB, a greater influence of the European Parliament is proposed and freer access of ESRB towards to individual data of financial institutions as well as changes in the composition of governing and advisory bodies of the ESRB where independent external experts shall be members in a greater extent.

In the case of the ESA, the proposal of the European Parliament significantly differs from the original proposal of the Commission and the compromise proposal of the Council of the EU. It contains a direct supervisory powers over cross-border acting institutions within the EU, while the Národná banka Slovenska would become only a "branch" of ESA performing their decisions. The power to issue technical standards and to solve disputes between supervisory authorities is to be unlimited, i.e. no empowerment in the relevant directives concerning financial markets are to be needed. However, the issue of the transfer of fiscal responsibility for the failure of financial institutions is dealt with insufficiently and proposals are not consistent for individual ESA.

The new supervisory architecture will mean for the Národná banka Slovenska, and especially for the Financial Market Supervision Unit of the NBS, an enormous increase in regulation created at EU level and the need for increased participation in the activity of working groups, either within the ESRB or the ESA. The new supervisory architecture can have a significant impact on the powers of the Národná Banka Slovenska to perform supervision financial market.

On 17 December 2009, the Solvency Directive II[23] was published in the Official Journal of the EU. The main aim of this new regulation in the insurance sector is to increase the protection of the insured and recipient of insurance claims, and to support the financial stability of the insurance market. The aim of this European initiative was to achieve what is referred to maximum level harmonisation within the EU. Some areas of regulation of prudential business in the insurance sector will remain unharmonised also after the transposition of the Solvency II Directive, and it will be the right of the Member State to adjust it. As an example, the principle of a responsible actuary and the regulation of "small" insurance undertakings, i.e. insurance undertakings the activity of which will not fall under the provisions of the Solvency II Directive. The Directive should be transposed into the national legislations of Member States by 31 October 2012.

Due to the implementation of the new supervisory and regulatory architecture in the EU, the Solvency II Directive is to be amended in the course of 2010. The aim of this initiative should mainly be the implementation of binding mediation between the supervisory authorities of Member States, and the implementation of binding technical standards. The amendment should

21 Proposal for a Directive of the European Parliament and of the Council amending the Directives 1998/26/EC, 2002/87/EC, 2003/6/EC, 2003/41/EC, 2003/71/EC, 2004/39/EC, 2004/109/EC, 2005/60/EC, 2006/48/EC, 2006/49/EC, and 2009/65/EC in respect of powers of the European Banking Authority, the European Insurance and Occupational Pension Authority and the European Securities and Markets Authority, COM(2009) 0576, available on the Internet: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2009:0576:FIN:EN:PDF.

22 According to the proposals for regulations establishing ESA, technical standards shall be part of the European legislation, while their focus is to be dealing with technical issues related to the activities of regulated entities as well as national regulatory authorities. The proposals for technical standards are to be drafted by the ESA. Following potential modifications, they are to be issued by the Commission in the form of regulations, either as delegated acts or as implementing acts (i.e. non--legislative acts) according to Article No. 290 and No. 291 of the Treaty on the Functioning of the European Union. Technical standards are not to include important elements that are reserved to legislative acts, thus they are not to reflect politically motivated decisions.

23 Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking up and pursuit of the business of insurance and reinsurance (Solvency II) (OJ L 335, 17.12.2009).

be carried out through what is referred to as the OMNIBUS II Directive, while this directive could also be used for amending certain currently valid articles of the Solvency II Directive.

As part of the Solvency II project, the discussion regarding the working documents of the Commission is currently underway, representing a basis for proposals of a performance standard for the second level of the Lamfalussy process. The discussion is underway in the working group established by the Commission. On the level of CEIOPS, proposals for regulations on the third level within the Lamfalussy process (Level 3 Guidance) are being worked on and technical specification to the fifth quantitative impact study has been prepared that should test the proposed regulatory quantitative requirements for insurance and reinsurance undertakings. The fifth quantitative impact study should be carried out in the third quarter of 2010.

As will be indicated in the further text, in the sector of collective investment the implementation of the UCITS IV Directive[24] is currently underway. Increasing the level of harmonisation of regulations of the collective investment sector is especially a result of the practices of the UCITS IV Directive (on the second level of the Lamfalussy process) that are currently being prepared at the European level.

National regulations for transposing the new legislative modification (the Directive and the practices) will have to be created by 30 June 2011 at the latest.

In July 2009, the Commission published the proposal of the CRD Directive amendment[25] known under the working title of the CRD III Amendment.

With the indicated proposal, the Commission plans to adjust issues related to:

- Capital requirements for risk coverage resulting from re-securitisation businesses
- The extent of disclosure requirements related to the engagement of credit institutions in businesses with complex instruments
- Risk management related to portfolio administration
- Remuneration policy in order to prevent inadequate risk-taking by management and employees of credit institutions
- Technical changes in risk calculation (in trading book) in order to better reflect the risk of loss connected to market risk
- Transitory provisions of implementing Basel II

At the level of the Council of the EU, a general agreement on the compromised wording of CRD III Directive amendment[26] was reached in November 2009, and negotiations at the level of the European Parliament are currently underway. In December 2009, the position of the European Central Bank to the proposal of the Commission[27] was published in the Official EU Publication.

The issue of modification in the area of remuneration policy in credit institutions was subject to negotiations at the CEBS, EBC[28] and EFC[29] level. In April 2009, CEBS published a document regarding the principles of remuneration.[30] In line with this document, the Methodological guideline of the Department for financial market supervision of the Národná banka Slovenska of 3 May 2010 No. 3/2010 was published.

Since negotiations connected to the CRD III have not been completed so far in the European Parliament and will be followed by negotiations between the European Parliament, the Commission, and the Council of the EU, we can only estimate the time of approval of the Directive proposal to be in the second half of 2010. Due to the extent of provisions to be amended by the CRD III Directive, it is estimated that the transposition period within which the Member States will be obliged to realise the implementation of passed provisions of the CRD III Directive into the national legal order will continue until the second half of 2011.

On 30 April 2009, the Commission published the proposal for the Directive on alternative investments fund managers, the aim of which is to create a European legislative framework for prudential regulation in this segment (it does not concern product regulation). It includes initiatives directly connected to the financial crisis, the originators of which are said to also be hedge funds. Based on this Directive, all funds that are not within the scope of the UCITS IV Directive are to be regulated, including hedge funds and private equity funds, but also commodity and real estate funds. The protection of investors is to be achieved through placing requirements on the performance of the activity of alternative investment funds managers that include, apart from others, also standard prudential rules of conduct, principles of transparency, and information obligations towards supervisory authorities through which potential systemic risk is to be monitored. The Directive will provide the advantage of a unified European passport for alternative investment fund managers to offer funds managed by them to the professional investors in other EU Member States.

In the European Parliament, the Directive proposal is a greatly discussed issue. In spite of this, the aim is the Directive to be adopted during 2010 and the deadline for transposition is expected between 2012 and 2013.

Depending on the final version of the adopted wording, the Directive on alternative investment funds may have a negative impact on the collective investment sector in the Slovak Republic. Following the adoption of the UCITS IV Directive, it is expected that the segment of non-harmonised funds may be a source of competitive advantage for Slovak managers. However, additional authorisation and legal regulation that would not be consistent with the applied standards of the UCITS Directive and would bring additional costs, could mean the cessation of the management of such funds in our territory.

On 24 September 2009, the Commission submitted a proposal for the revision[31] of the

24 Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (OJ L 302, 17.11.2009).

25 Proposal for a Directive of the European Parliament and of the Council amending Directives 2006/48/EC and 2006/49/EC on capital requirements for business book and re-securitisation and verification of remuneration policies by supervisory authorities, the COM document (2009) 362 in its final wording, available on the Internet at: http://eur-lex.europa.eu/LexUriServ.do?uri=COM:2009:0362:FIN:SK:PDF.

26 The EU Council: 2,972nd meeting of the Council – Economic and Financial issues, Press Release 14637/09 (Presse 297), [online], Brussels, 10 November 2009, [quote 2010-03-28], available on the Internet at: http://register.consilium.europa.eu/pdf/en/09/st14/st14637.eng09.pdf.

27 ECB: CON/2009/94, Frankfurt am Mein, 12 November 009, In Official Journal of EU 2009/C 291 p. 1 [on--line],[quote 2010-03-28], available on the Internet at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2009:291:0001:0006:SK:PDF.

28 European Banking Committee.

29 European Financial Committee.

30 CEBS: High-level principles for Remuneration Policies, London, 20 April 2009, [online], [quote 2010-03-28], available on the Internet at: http://www.c-ebs.org/getdoc/34beb2e0-bdff-4b8e-979a-5115a482a7ba/High-level-principles-for-remuneration-policies.aspx.

31 Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and the Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, COM (2009) 491, available on the Internet at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2009:0491:FIN:EN:PDF.

Prospectus Directive[32] and partly also of the Transparency Directive[33]. Five years after the Prospectus Directive's entry into force, in spite of its positive overall impact and general success it was labelled as one of the areas containing several legal uncertainties and unjustified burdensome requirements. The aim of the published proposal was to simplify and improve the application of the Prospectus Directive, to increase its efficiency, and improve the international competitiveness of the EU with regards to the importance of enhancing the level of investor protection. This task is also linked to the European Economic Recovery Plan and the financial services reform announced in the Communication of 4 March 2009[34] for the Spring meeting of the European Council, together with the Action Programme for reducing administrative burdens.

The main areas stipulated in the proposal of the Directive are:

- Harmonising the definition of qualified investors in the Prospectus Directive and of definition of professional clients in the MiFID Directive,
- Clearer definition of certain requirements and exceptions (retail cascades, the employee share schemes, less comprehensive disclosure requirements regarding certain types of issues or issuers, as well as the government guarantee schemes, etc.),
- Accuracy improvement of the form and content of the summary as well as of responsibility attaching to the summary,
- Repeal of double requirements for transparency,
- The option to determine the home Member State also for issuers of non-equity securities,
- Defining the manner of calculating limits of maximum amount of offer,
- Length of validity of the prospectus, base prospectus and registration document,
- Accuracy improvement of the requirement for the prospectus supplementing and length of the period with the right to withdraw the acceptances.

The proposal was a result of the dialogue and consultations with the involved parties including regulators, market participants, and consumers. It was based on the comments and analyses contained in reports published by CESR, ESME[35] and CSES[36]. The European Parliament is currently commenting on the proposal and its approval is expected by the end of June 2010.

Regulatory initiatives in the phase of implementation at the national level

In September 2009, the Directive on the taking up and pursuit of activities and on the supervision of prudential business of electronic money institutions (hereinafter referred to as the "EMD")[37] was passed, replacing the previous Directive.[38]

When compared to the previous Directive, EMD extends the circle of legal entities entitled to provide electronic money. According to the Commission, an increase of the electronic banking industry may be expected when it comes to electronic money in circulation (potential increase up to EUR 10 billion) and the number of institutions (up to 120 institutions of the electronic banking industry).[39]

In connection to extending the circuit of entities entitled to provide electronic money, the European Central Bank pointed out the possible negative consequences of the EMD modification in the area of monetary policy and liquidity management.[40]

The Slovak Republic is obliged to implement the EMD into the national legal order by 30 April 2011, while in the case of the EMD Directive the principle of complete harmonisation is applied.

As a result of the new EMD being effective, we may expect an increase of entities willing to provide services connected to issuing electronic money and consequently an increase in the activity of the Národná banka Slovenska in the area of the methodology, licensing, and supervision of electronic money institutions.

In November 2009, the Directive known under the label of CRD II was published in the Official EU Journal amending several directives including the CRD.[41]

The most important changes involve:

- Principles and rules not formally defined at EU level, such as treatment of hybrid capital instruments within original own funds
- Clarification of the framework for supervision of crisis management
- Formalising the establishment of colleges of supervisors for the purposes of increasing the effectiveness of performed supervision
- Limiting the exposures especially in terms of large exposures and the modification of deviations from the requirements of prudential regimes.

The Slovak Republic is obliged to transpose the CRD II into the national legal order by 31 October 2010, that so the new provision comes into force as of 31 December 2010.

In the area of collective investment, on 17 November 2009 the new Directive, referred to as the UCITS IV[42] Directive, was published in the Official EU Journal. It involves the re-codified wording (recast) of the previous directive[43] that is also being cancelled as of 30 June 2011. It maintains all areas of so far very successful regulation of open-ended collective investment funds creates in the EU more than 20 years ago. The aim of the new regulation is also the elimination of remaining barriers of a unified EU market collective investment sector, and supporting the more efficient and flexible management of assets in the EU.

The UCITS IV Directive for the Slovak sector of collective investment will mean a significant increase in cross-border competition leading to pressure on cost efficiency. A higher level of harmonisation will bring changes to the internal processes of the management companies. For the Národná banka Slovenska, new cross-border regu-

32 Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC (OJ L 345, 31.12.2003).

33 Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and on amending Directive 2001/34/EC (OJ L 390, 31.12.2004).

34 COM (2009) 114, final version, 4 March 2009.

35 European Securities Markets Expert Group.

36 Centre for Strategy and Evaluation Services.

37 Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking, pursuit, and prudential supervision of the business of electronic money institutions (OJ L 267, 10.10.2009).

38 Directive 2000/46/EC of the European Parliament and of the Council of 18 September 2000 on the taking, pursuit, and prudential supervision of the business of electronic money institutions (OJ L 275, 27.10.2000).

39 The EU Commission: 2008/0190 (COD) in its final version, 9 October 2008, p. 5, Brussels, [online], [quote 2010-03-28], available on the Internet at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2008:0627:FIN:SK:PDF.

40 ECB: CON/2008/84 Frankfurt am Mein, 5 December 2008, [online], [quote 2010-03-28], available on the Internet: http://www.ecb.int/ecb/legal/pdf/c_03020090206sk00010009.pdf.

41 Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009 amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management (OJ L 302, 17.11.2009).

42 Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities – referred to as the UCITS IV Directive (OJ L 302, 17.11.2009).

43 Directive 85/611/EEC of the Council of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (OJ L 375, 31.12.1985).

latory mechanisms such as cross-border mergers or cross-border administration of funds present a challenge in the area of supervisory cooperation with other authorities of EU Member States.

In the mid-term, a wide scope of technical standards to the UCITS IV Directive are to be expected. Regulations to transpose the new legal regulation will need to be prepared by 30 June 2011.

In November 2009, the Regulation on credit rating agencies was published (hereinafter referred to as the "Regulation on CRA").[44] Measures to be taken by the Slovak Republic in line with the regulation on CRA have been implemented in the form of amendments of several acts.[45]

In the Slovak Republic, the supervisory and registering authority for activities of the rating agencies is the Národná banka Slovenska that will participate through colleges of supervisors of the supervisory authorities in the process of registering rating agencies such as Moody's Investors Service Ltd, UK, Fitch Ratings, UK, McGraw-Hill International (U.K.) Limited, and Standard&Poor´s Ratings Services.

From 7 June 2010 to 7 September 2010, the existing rating agencies, the activity of which is subject to regulation by CRA, have an obligation to submit an application for registration (license).

Currently, CESR finalises the proposal of legally non-binding guidelines that it is obliged to publish in accordance with the regulation on CRA to help unify the process of the registration of rating agencies.

In terms of the proposal of the regulation establishing ESMA and replacing CESR, rating agencies shall as of 1 January 2011 fall under the jurisdiction of ESMA that is to perform supervisory activities.

In the near future, the Commission is to introduce a proposal of the amendment of regulation of CRA defining the jurisdiction of ESMA, as well as the rights and responsibilities of national regulators that are to realise the process of registration based on the currently valid regulation on CRA.

44 Regulation of the European Parliament and of the Council (EC) No. 1060/2009 of 16 September 2009 on rating agencies (OJ L 302, 17.11.2009).

45 Amendment of the Act No. 747/2004 Coll. on financial market supervision, Act No. 566/2001 Coll. on securities and investment services and Act No. 455/1991 Coll. on trade business by the Act on consumer and other loans and credits for consumers of 9 March 2010.

Activities of the Deposit Protection Fund and current legislation changes

Ing. Rudolf Šujan
Chairman of the Presidium of the Deposit Protection Fund

The Deposit Protection Fund[1] (DPF) provides the protection of deposits of natural persons and legal entities specified by law that are deposited in banks and branches of foreign banks participating in the deposit protection system in Slovakia.

According to the Deposit Protection Act, participation in the Slovak deposit protection system is obligatory for banks from the day of accepting the first deposit. Foreign bank branches performing their activities based on a single licence according to EU law may participate voluntarily in the deposit protection system in the Slovak Republic under the terms as stipulated by the law.

The DPF is still a participant to three bankruptcy proceedings due to the payment of compensations in the period between 2000 and 2004, namely over the assets of AG Banka, Slovenská kreditná banka, and Devín banka.

In bankruptcy proceedings that started in 2000 and 2001 and that were blocked in the first three years by the objections of parti pris, process changes have occurred in previous years although from the point of creditors the proceedings are still slow.

The first bankruptcy over a bank's property, namely Dopravná banka, was completed in 2008. The DPF obtained the first fulfilment from it in the amount of EUR 26.2 mil. (SKK 789.4 million). The property in remaining bankruptcies is currently encashed, it is necessary to complete several legal disputes so that the individual bankruptcy proceedings may reach the final stage which will be the approval of the final report and an allocation measure.

The DPF's incomes from the bankruptcy over the property of Dopravná banka and bank contributions into the DPF resulted from the fact that in April 2009 the DPF paid the balance of credit it received in the period between 2000 and 2001 in the amount of SKK 16.9 billion (EUR 561.67 million). This debt position became a history in 2009, from which time the Fund again cumulates its own resources.

As at 31 December 2009, DPF assets represented EUR 75,764,008 including receivables for compensations paid in the amount of EUR 50,917,459, and loss amounts of EUR 442,661. At the same time, from 1 January 2009 the method of recording bank's contributions that were recorded and reported as revenues till 31 December 2008 changed, and from 1 January 2009 these do not influence the economic result of the DPF, but are recorded directly to the contributions fund as the source for potential compensation payment.

By the end of 2009 banks in Slovakia were administering deposits in the total amount of EUR 43.06 billion, including protected deposits in the amount of EUR 23.01 billion, i.e. 53.4%. When compared to 2008 a slight decrease of protected deposits was recorded, namely by EUR 549.7 million (2.3%). In 2009, contributions were paid to the DPF according to the Deposits Protection Act in the total amount of EUR 45.86 million (EUR 37.24 million in 2008).

In 2009, the DPF continued to pay compensations for deposits in Devín banka, namely to those depositors who claimed the payment within the statutory period (till 5 November 2004). To date, 204 depositors of this bankrupted bank have not taken over their compensation.

The year 2009 was significant for the DPF and the deposit protection system in Slovakia also in the legislation area. In 2009 its activities also reflected legislative measures and changes focusing on alleviating the impacts of turbulence on the financial markets that had already been accepted at the end of 2008.

An especially important change was the amendment to the Deposit Protection Act issued by Act No. 421/2008 Coll.[2] assuming effect on 1 November 2008, following which the Slovak Republic acceded to a full, i.e. unlimited, protection of deposits entrusted to banks by depositors – natural and legal entities whose deposits are protected according to the Deposit Protection Act. The amendment cancelled the upper limit of fulfilment provided from the DPF in the case of bankruptcy of any of the banks, and also the depositor's retention at the deposit's protection which previously represented 10% of the potential compensation for inaccessible deposit.

Another amendment to the Deposit Protection Act executed by Act No. 552/2008 Coll.[3] assuming effect on 13 December 2008 created conditions for voluntary ancillary participation of foreign

1 The Deposit Protection Fund (DPF) was established by the Act of the National Council of the Slovak Republic No. 118/1996 Coll. on protection of deposits and on amendments and supplements to certain laws of 20 March 1996 assuming effect on 1 July 1996.

2 Act No. 421/2008 Coll. amending and supplementing the Act of the National Council of the Slovak Republic No. 118/1996 Coll. on protection of deposits and on amendments and supplements to certain laws as amended and on amendment to Act No. 659/2007 Coll. on the introduction of the euro in the Slovak Republic and on amendments and supplements to certain laws as amended.

3 Act No. 552/2008 Coll. amending and supplementing Act No. 566/2001 Coll. on securities and investment services and on amendments and supplements to certain laws (Securities Act) as amended and on amendments and supplements to certain laws.

4 *Act No. 276/2009 Coll. on measures to mitigate the effects of the global financial crisis on the banking sector and on amendments and supplements to certain laws.*

bank branches from EU countries in the banking deposit protection system in Slovakia. This means that a foreign bank branch enjoying the benefits of a single licence may voluntarily participate in the deposit protection system in the Slovak Republic, with the objective of providing improved (ancillary) deposit protection within the scope of deposit protection that according to the deposit protection system rules in the Slovak Republic exceeds deposit protection according to the deposit protection system rules in the Member State on the territory of which the relevant foreign bank has its seat. For the purpose of such participation, a written contract is required with the DPF, the institute of the home system of bank deposit protection, and the foreign bank the branch of which operates on the territory of the Slovak Republic.

The foreign bank branch voluntarily participating in the deposit system protection in the Slovak Republic is subject to the appropriate provisions of the Deposit Protection Act. Such a branch is obliged, for instance, to pay an initial fee to the DPF, it is also obliged to publish information in its operations in Slovak about deposit protection according to the home deposit protection system including the rules of the home deposit protection system and information about providing compensation for inaccessible deposits. If deposits in foreign bank branches with ancillary protection in the deposit protection system in the Slovak Republic become inaccessible, the depositors must have the option to exercise their claim for compensation and payment of compensation on the territory of the Slovak Republic.

By the beginning of 2009, the deposit protection system in Slovakia covered 15 banks and 2 foreign bank branches, while in 2009 Istrobanka merged with ČSOB.

At present, the deposit protection system participants in Slovakia include the following banks:

- Československá obchodná banka, a. s.
- ČSOB stavebná sporiteľňa, a. s.
- Dexia banka Slovensko a. s.
- Komerční banka Bratislava, a. s.
- OTP Banka Slovensko, a. s.
- Poštová banka, a. s.
- Privatbanka, a. s.
- Prvá stavebná sporiteľňa, a. s.
- Slovenská sporiteľňa, a. s.
- Tatra banka, a. s.
- UniCredit Bank Slovakia, a. s.
- VOLKSBANK Slovensko, a. s.
- Všeobecná úverová banka, a. s.
- Wüstenrot stavebná sporiteľňa, a. s.
- Slovenská záručná a rozvojová banka, a. s.

Among 11 foreign bank branches now providing banking services based on a single licence in Slovakia, two are participants of the deposit protection system in Slovakia, namely the branch of the foreign bank Citibank Europe plc and the foreign bank branch of J & T BANKA, a. s.

In reality it means that deposits in these branches are protected up to the amount of EUR 100,000 by the deposit protection system in Ireland (branch of Citibank) and up to EUR 50,000 by the deposit protection system in the Czech Republic (branch of J&T Banka) and at the same time, the deposits in both these branches exceeding the home state limit are protected by the deposit protection system in Slovakia.

The request for voluntary participation by means of an ancillary protection of deposits in the Slovak Republic was also filed by mBank, the branch of foreign bank BRE Bank SA with the seat in Poland. From 2008 negotiations have been underway between the DPF and the Polish Bank Guarantee Fund about the contract that is the statutory condition of access into the deposit protection system in Slovakia within the ancillary deposit protection. The signing of the contract and thus also the access of mBank, foreign bank branch, into the deposit protection system in Slovakia has so far been prevented by differences in legislative regulation on the Polish side, especially with respect to the position of guarantee schemes in potential bankruptcy proceedings.

In principle this means that the deposits in this branch are protected by the deposit protection system in the Republic of Poland, i.e. up to EUR 50,000.

The legislative conditions of countries in which foreign banks with their branches operating in Slovakia have their seats also govern other areas of deposit protection (contributing to guarantee schemes, scope of deposit protection, informing depositors, exercising claims of clients at the payment of compensation in the case of bank's bankruptcy, etc.). It applies at the same time that detailed information about deposit protection must be provided to its clients by every bank or foreign bank branch either within the bank's operations, on its web sites, or the information about deposit protection must form a part of the contract and/or business terms between the bank or branch and the client.

In 2009, EU Regulation 19/1994 on the deposit protection system was amended. With effect from 11 March 2009 the possibility to extend the period of compensation payment (three months) was removed. At the same time, the deposit protection limit in EU countries - in the interest of harmonising the conditions of deposit protection – should be unified by the end of 2010 to EUR 100,000. At present, the impact of this regulation change is being assessed, and based on the assessment the European Commission will submit a proposal for an amendment and supplement to this Regulation to the European Parliament and Council by the end of this year.

These changes were reflected in 2009 by Act No. 276/2009 Coll.[4], according to which from 10 July 2009 the possibility of the DPF to extend the period of three months for the payment of compensation for inaccessible deposits was removed. In the interest of depositors, the Fund still has the option to pay compensation based on a written request of a depositor delivered within three

years from the occurrence of a bank's incapacity to pay the deposits.

The recent change of the Deposit Protection Act was performed by Act No. 70/2010 Coll. of 11 February 2010[5]. The change is represented inter alia by the fact that the account owner of the residential building (either the account established by the residential building administrator or the community of owners of flats and non-residential spaces) are the owners of flats and non-residential spaces in the relevant residential building, while the account founder (administrator or community) is authorised to dispose with the funds on the residential building account and also to execute rights and obligations of the depositor with respect to the residential building account according to the Deposit Protection Act. The Deposit Protection Act has also been amended in the sense that it expressly protects also bank deposits on the accounts of residential buildings established by residential buildings administrators.

This amendment to the Deposit Protection Act also put joint stock companies on an equal footing with other business companies in respect to the legal protection of bank deposits, namely in respect of the equalisation of joint stock companies with other business companies for an obligatory audit of their financial statements according to the amended Accounting Act and amended Commercial Code.

5 Act No. 70/2010 Coll. of 11 February 2010 amending and supplementing with effect from 1 April 2010 the Act of the National Council of the Slovak Republic No. 182/1993 Coll. on ownership of flats and non-residential spaces as amended and amending the Act of the National Council of the Slovak Republic No. 118/1996 Coll. on deposit protection and on amendments and supplements to certain laws as amended.

Investing in capital market through supervised subjects within the perspective of Acts regulating the capital market

Ľubomír Čunderlík, Martin Šimkovič
Národná banka Slovenska

Considering the large movement of financial means within it, an effective set of legislative tools is needed to protect the capital market. That is why economically developed countries set up regulatory bodies exercising capital market regulation mechanisms and influencing the course of events on the market so that the stability, effectiveness, security and trustworthiness of the whole capital market are ensured in an appropriate way. However, under the influence of their historical, political, cultural and economic experience, each country approaches securing the protection of its market in a different way. The capital market can, consequently, be regulated by different regulatory bodies and therefore also by different legislative standards.

Regulation represents restriction of the activities of subjects through legislation, whereas its purpose also consists in the protection of these subjects. Supervision is directly connected to regulation, because legal restriction of the activities of the regulated subjects is enforced by state supervisory authorities.[1]

Legislation in force in the Slovak Republic does not recognize legal enactment that only organizes the regulation of the capital market or regulation of its subjects. Regulation in the conditions of the Slovak Republic legislative environment is understood as a legal restriction of the activities of the regulated subjects, whereas its purpose is the protection and maintenance of the stability of the regulated subject. This restriction is enforced by state bodies by means of supervision, which is first of all regularized through Act No. 747/2004 Coll. on Supervision of the Financial Market and on amendments and supplements to certain laws as amended by later Acts (Act on Supervision) and further legal enactments regularizing the supervision of capital market subjects [2].

Regulatory powers over capital market supervision in the Slovak Republic are entrusted to the Národná banka Slovenska (NBS). The NBS is, in accordance with Art. 56 of the Constitution of the Slovak Republic, an independent central bank which is entitled to issue generally binding legal acts within the scope of its activities if so empowered by an Act. The above Article stipulates that further details are stipulated by the legal Act, which is Act No. 566/1992 Coll. on the National Bank of Slovakia, as amended by later regulations (Act on NBS). This Act, in the stipulation of its Article 2 par. 3, defines that, in the field of the financial market, the NBS contributes to the stability of the financial system as a whole as well as to the secure and sound functioning of the financial market and, namely in the interest of maintaining the trustworthiness of the financial market, the protection of the client and respect for the rules of competition. The NBS at the same time executes supervision of the financial market including the capital market, in accordance with the Act on NBS and in accordance with special regulations, to which belong, first of all, the Act on Supervision, Act No. 483/2001 Coll. on Banks and on the changes and amendments to certain Acts as amended by later Acts (Act on Banks), Act No. 594/2003 Coll. on Collective Investment and on the changes and amendment to certain Acts as amended by later Acts (Act on Collective Investment) etc., and it performs further activities in the field of the financial market in accordance with this Act and special regulations[3]. It is possible to invest in the capital market just by means of the legal institutions regularized by the above special regulations. The possibilities of investing in the capital market by means of "classical subjects" of the financial market do not belong to the subject of our explanation : banks performing investment activities and providing investment services (investment banking), banks authorised to perform mortgage trades (mortgage banking) and insurance undertakings providing investment life insurance (investment insurance), nor the investment of their technical provisions into the financial market instruments permitted by law, not even the investing of equities of pension funds and supplementary pension funds.

1 *More on regulation as well as on supervision of financial market see: Jílek, J.: Finanční trhy a investování. Praha: GRADA Publishing 2009, s. 137 – 177.*
2 *E.g Act No. 566/2001 Coll on Securities and Investment Services and on changes and amendment to certain Acts (Act on Securities) as amended by later Acts; Act No. 530/1990 Coll. on Bonds as results from amendments by later regulations.*
3 *within the framework of supervision of financial market, NBS performs supervision of capital market subjects which provide appreciation of money assets or of subjects with special tasks authorized by the Acts regulating the capital market (Stock Exchange, central depository, enunciator of public offering of securities and asset values, issuer of securities, Investment Guarantee Fund, financial intermediary in the sector of capital market, financial advisor in the sector of capital market, subjects of collective investment, or its administrators)*

Regulated capital market subjects

Stock Exchange

The Stock Exchange belongs to the regulated subjects of the capital market in the Slovak Republic, which is in accordance with Act No. 429/2002 Coll. on the Stock Exchange as amended by later regulations (the Stock Exchange Act) a joint-stock company with its registered office in the territory of the Slovak Republic which operates a regulated market and ensures related activities. At present, there is only one stock exchange within the scope of NBS regulation and that is the Bratislava Stock Exchange, j.s.c.

Stock exchange activities are based on the membership principle where only an entity which is a stockbroker, fund management company, foreign stockbroker or foreign fund management company may become a member of the stock exchange and perform transactions.

A stock exchange member always acts in his own name and on his own account or on account of his client when concluding stock exchange transactions and is obliged to proceed according to the stock exchange rules and the relevant generally binding legal regulations.

Regulation of the stock exchange in accordance with the stipulations of Article 58 of the Stock Exchange Act and supervision of the stock exchange itself, of stock exchange members, of issuers of securities admitted to the stock exchange market and of persons who issued other financial instruments admitted to trading in the stock exchange is performed by the NBS in accordance with the above Act on Supervision and in accordance with the Stock Exchange Act.[4]

Central Securities Depository

Another subject of the capital market which is subject to the regulation and supervision of the NBS is the Central Securities Depository of the Slovak Republic, j.s.c., which is in accordance with Act No. 566/2001 Coll. on Securities and Investment Services and on changes and amendments to certain Acts (The Securities Act) as amended by later regulations (The Securities Act) a joint-stock company having its registered office in the territory of the Slovak Republic. The status and activity of the Central Securities Depository of the Slovak Republic, j.s.c. is regulated by the stipulations of Article 99 through Article 111 of The Securities Act.

The main scope of activities of the Central Depository is the recording of book-entry securities and provision of services connected to this recording. The recording itself consists mainly in the recording of book-entry securities in the issuers' registers and subsequently in particular securities accounts. The Central Depository also ensures the clearing and settlement of stock exchange transactions in financial instruments and maintains a register of rights of lien.

Stock brokerage firm

The Securities Act in its fourth part regulates the activities of stock brokerage firms (stipulations of Article 54 through Article 79a). This concerns the capital market subject, whose activities are regulated by NBS, as imposed on it by the Act on Supervision and the Securities Act.

A stock brokerage firm is a joint-stock company in accordance with the Securities Act, which has its registered office in the territory of the Slovak Republic and whose scope of business comprises the provision of investment services to clients or the performance of investment activities on the basis of an investment services licence issued by the Národná banka Slovenska. Within the framework of capital market regulation grants, the NBS specifically licenses the pursuit of activities and provision of investment services by the stock brokerage firms in the territory of the Slovak Republic and the establishment and operation of a branch office of a foreign stock brokerage firm in the territory of the Slovak Republic.

Unlike the other institutionalized financial intermediaries, the share capital of the stock brokerage firm is differentiated according to the scope of the licence to perform investment activities and provide investment services. It is, therefore, worth mentioning the amount of share capital which is required for each particular scope of the licensed activities and services.

The share capital of the stock brokerage firm shall be at least EUR 730,000 unless the Securities Act stipulates otherwise. The share capital of a stock brokerage firm which provides investment services such as receipt and delegation of the order of the client referring to one or more financial instruments, execution of the order of the client on his own account or portfolio management, but which, at the same time, is not licensed to provide the trading investment service on its own account or to underwrite financial instruments based on a firm obligation, shall be at least EUR 125,000. The share capital of such a stock brokerage firm in the event that it is not authorized, when providing investment services, to keep the funds of the client or financial instruments of its client, shall be at least EUR 50,000. If the stock brokerage firm provides only investment services – such as the receipt and delegation of the order of the client referring to one or more financial instruments or investment advice – and at the same time it is not licensed to keep funds or financial instruments of the client, its share capital shall be at least EUR 50,000. This share capital requirement may be substituted by a professional indemnity insurance for damage caused by performing the activity or a combination of initial capital and insurance in a ratio approved by the NBS at the request of the stock brokerage firm. The Act then deals separately with the case where a stock brokerage firm also performs insurance mediation.

The Securities Act also stipulated in great detail the organizational conditions for the execu-

4 In the field of regulation, the Stock Exchange itself has created its own department for inspection of stock exchange trades, which carries out supervision and monitoring of the closed trades. For more information see http://www.bsse.sk/.

5 NBS examines them separately also in the course of its licensing process, following the provision of Article 55, par. 7 of The Securities Act.

6 *It is a similar legal person as for the Deposits Guarantee Fund in the banking sector. Both funds can, upon request, grant credits to one another as their supplementary sources.*

tion of activities for a stock brokerage firm. The stock brokerage firm is obliged, appropriately to the nature, scope and complexity of its subject of activities investment services provided, ancillary services and execution of investment activities, to introduce, exercise and maintain decision processes and organizational structure, in which the relations of subordination are specified unambiguously and demonstrably, with distributed roles and responsibilities. In addition to this, the stock brokerage firm must ensure that its competent persons are acquainted with the processes that must be maintained for the correct execution of their duties. At the same time, it must introduce, exercise and maintain an appropriate mechanism of internal controls for securing conformity with the decisions and processes on all its organizational levels. Among its duties in organizing and management is also the obligation to employ employees with the experience, knowledge and professional competence needed for complying with the assigned duties. Besides this, it must introduce, exercise and maintain an effective system of internal reporting and information-distribution on all of its organizational levels, keep proper records on its own activity and internal organization and finally secure that the execution of several tasks by competent persons in no way potentially prevents them from fulfilling any of the particular tasks in compliance with the principles of fair trade practices and professional care in the interest of its clients. Besides the above general duties imposed on the stock brokerage firm, the Securities Act regulates a whole array of various duties, which the firm must fulfil (information duties towards the NBS, duties during contact with the client, property engagement etc.)

Within the framework of organization and management of the stock brokerage firms, the Securities Act introduced "outsourcing" or delegation (entrusting) of execution of stock brokerage firms' activities to other persons, which may be considered for three activities: for the function of compliance in accordance with the stipulation of Article 71a, for risk management in accordance with the stipulation of Article 71b a and finally for the internal audit, which is regulated by the stipulation of Article 71c.

Stock brokerage firms and foreign stock brokerage firms (through the intermediary of their branch offices), in accordance with the stipulation of Article 80 of the Securities Act, participate in the protection of investments provided by a separate guarantee scheme in the field of the capital market – Investment Guarantee Fund[6].

Financial intermediation and financial counselling

In the Slovak Republic, financial intermediation and financial counselling also belong to the regulated and supervised capital market organisations which are regulated by Act No. 186/2009 Coll. on Financial Intermediation and Financial Counselling and on the amendments and supplements to certain laws (Act on Financial Intermediation). The above Act regulates financial intermediation, financial counselling, the Register of Financial Agents, Financial Advisors, and Financial Intermediaries from another Member State within the Insurance or Reinsurance Sector and Bound Investment Agents and also the supervision of financial intermediation and financial counselling.

In accordance with Article 6 of the Act on Financial Intermediation, the Financial Agent is a person having its office or place of business located within the territory of the Slovak Republic and pursuing financial intermediation upon a written contract concluded with a financial institution or upon a written contract concluded with an independent financial agent. The above Act stipulates at the same time that the financial agent is not allowed to pursue financial counselling. In the Slovak Republic, financial intermediation may only be performed by a financial agent, being an independent financial agent, a bound financial agent or a subordinate financial agent.

An independent financial agent in accordance with Article 7 of the Act on Financial Intermediation pursues financial intermediation upon a written contract concluded with a financial institution; the independent financial agent may conclude written contracts with several financial institutions concurrently.

A bound financial agent in accordance with Article 8 of the Act on Financial Intermediation pursues financial intermediation upon a written contract concluded with a financial institution; the bound financial agent may conclude written contracts concurrently with no more than one financial institution within any one sector. This shall not apply to the insurance or reinsurance sector within which the bound financial agent may conclude a written contract with not more than one insurance corporation pursuing life assurance and concurrently with not more than one insurance corporation pursuing non-life insurance.

Finally, in accordance with Article 9 of the Act on Financial Intermediation, a subordinate agent also pursues financial intermediation upon a written contract with an independent financial agent or financial intermediary from another Member State within the insurance or reinsurance sector. The subordinate financial agent may conclude a written contract concurrently with not more than one independent financial agent or financial intermediary from another Member State within the insurance or reinsurance sector.

This Act also stipulates that, besides the person mentioned above, a subordinate agent may also be a person pursuing financial intermediation upon a written contract concluded with a financial institution being granted a licence to pursue the activities of an independent financial agent; this shall not apply if such a person pursues financial intermediation upon a written contract concluded with the financial institution in question exclusively in relation to the financial services provided by the said financial institution under

the licence granted in accordance with a separate regulation.

Of special interest is the fact that the Act on Financial Intermediation, Article 10 , also defines a person as a financial advisor which is a person having its office or place of business located within the territory of the Slovak Republic and pursuing financial counselling upon a written contract for the provision of financial counselling concluded with a client. Nevertheless, the Act strictly stipulates that the financial advisor is not allowed to pursue financial intermediation.

For the sake of completeness, it is necessary to note that the Act on Financial Intermediation also introduced the institution of bound investment agent; in accordance with the provisions of Article 12, this is a person, on the full and unconditional responsibility of a stock brokerage firm, a foreign stock brokerage firm with its registered office in another Member State of the European Economic Area (EEA), a bank or a foreign bank with its registered office in another EEA Member State holding the authorisation to pursue investment services, investment activities and secondary services, upon a written contract, pursuing financial intermediation within the capital market sector and further activities in accordance with a separate regulation. At the same time, it is necessary to note that a bound investment agent may pursue financial intermediation only for one of the persons referred to above.

Financial intermediation represents, in accordance with the provisions of Article 2 of the Act on Financial Intermediation, the pursuance of at least one of the activities having a trading character and which are: submission of offers to conclude a contract for the provision of a financial service, conclusion of the contract for the provision of a financial service and pursuance of further activities leading to the conclusion or to the amendment of the contract for the provision of a financial service, provision of expert assistance, information and advice to a client in order to conclude or terminate a contract for the provision of a financial service, cooperation in the administration of a contract for the provision of a financial service where the character of the financial service makes such cooperation possible, or cooperation in the handling and settlement of claims arising to a client from a contract for the provision of a financial service, in particular in connection with the events being crucial for the occurrence of such claims where the character of the financial service renders such cooperation possible. Besides the above activities, financial intermediation within the capital market sector also includes the provision of investment service, receipt and delegation of the client's instructions concerning negotiable securities, mutual fund allotment certificates and securities of foreign subjects of collective investment and their promotion, as well as the provision of the investment service of investment counselling in relation to negotiable securities and mutual fund allotment certificates and securities issued by foreign subjects of collective investment.

Financial counselling is regulated by the provisions of Article 3 of the Act on Financial Intermediation, where it is defined as the provision of expert assistance, information, opinions, advice and individual financial plans to a client in relation to one or more financial services based on an objective analysis of a due number of available financial services, including the subsequent conclusion or amendment of a contract for the provision of a financial service at the client's request, on behalf of the client and at the client's expense. Besides the above activities, financial counselling within the capital market sector also includes the provision of the investment service of investment counselling in relation to negotiable securities and mutual fund allotment certificates and to securities issued by foreign subjects of collective investment. As with financial intermediation, financial counselling pursued in accordance with the Act on Financial Intermediation also constitutes a business activity.

Issuers of securities

Within the capital market in the Slovak Republic, there are also issuers of securities, whose securities are accepted for trading on the regulated capital market. An important part of their activities is the reporting duties which are regulated in Articles 34 through 37d of the Stock Exchange Act. From the perspective of capital market regulation, those provisions of the Securities Act are important which impose reporting duties on the issuers of securities as well as on those who announce public offerings in securities.

Regulation of the activities of issuers (with the exception of the issuers of State bonds) or their supervision is regulated by Act No. 530/1990 Coll. on Bonds, as amended by later regulations in Article 21a. Supervision is imposed, besides on bonds issuers, also on the activity of mortgage administrators and persons authorised to issue or pay out bonds. The subject of such supervision, carried out by the NBS, is compliance with the conditions for issuing bonds laid down by this Act and special acts in the scope resulting from them, as well as compliance with the generally binding legal regulations issued for their implementation.

Offer of securities to the public

Within the framework of capital market regulation in the Slovak Republic, special attention is directed towards the offer of securities to the public, which is directly connected to the activities of issuers of securities. The Securities Act defines in Article 120 (2) the offer of securities to the public as any communication to a wider group of persons in any form and by any means, presenting adequate information on the terms of the securities offer and on the offered securities, so as to enable an investor to decide whether to purchase or underwrite these securities. An offer of securities to the public shall also be understood to include

7 It may concern, for example, payment of revenues from business or other gainful activity of the announcing entity, which corresponds to the amount of funds invested.

the placing of securities through stock brokerage firms or foreign stock brokerage firms. By taking advantage of an offer of securities to the public, the investor appreciates his funds on the basis of purchase of the securities on offer and the subsequent payment of their revenues (regular or irregular).

A public offering of securities to the public may only be performed on the basis of a prospectus of security, which was approved by the NBS and subsequently made public.

In the provisions of Article 126 and later of the Securities Act, one further way of investing in the capital market is a regulated: Public Offer of Assets. A public offer of assets makes possible the raising of money from the public with the objective of carrying out a business or other profitable activity by the natural or legal person who pursues it with this aim. There is no participation in the business undertaking of the said subject, as is the case with commercial corporations. Between the investor and the entity making the public offer of assets, there arises a relationship of obligation, in which the entity commits himself to provide property rights and assets other than securities and the investor commits himself to pay out financial means for these purposes.[7] It is not permitted to provide credit and loans from the financial means pooled in this way from the public. Assets may only be publicly offered if the NBS made the approved prospectus of investment, which contains the basic information on assets on offer, on the entity making the public offer of assets, on his financial condition, on the subject of his business activities and similar, public. A public offer of asset promotion must contain a warning that there is a risk associated with this investment and that past or advertised gain does not guarantee future gains. At the same time, it must not withhold facts important for the decision of the public, and, in particular, to quote first of all information on the future appreciation of the financial means which may not reasonably be expected.

A particular group which invests extraneous assets in the capital market, being entrusted to administration in the form of a particular asset community (most mutual funds) are the subjects of collective investment. The Act on Collective Investment differentiates several kinds of collective investment subjects and proceeds on the basis of the different legal regime of their functioning within our territory. In summary, these are management companies, mutual funds being administered by them (without legal subjectivity), foreign collective investment subjects (foreign mutual funds, foreign investment companies, European funds) and foreign management companies.

IPO as an opportunity for Slovak enterprises

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IPO (Initial Public Offering) is one of the tools for obtaining the capital for further enterprise development, and at the same time offers the possibility for pursuing ambitious plans and visions. It is represented by listing enterprise stock on the stock exchange and subsequently by underwriting a part of stock determined in advance to individual institutional and retail investors. Trading on a stock exchange with the stock of a listed company starts by the so-called ceremonial "debut". The IPO is considered as a top objective in the history of a company, as such it is linked with the confirmation of high quality and major strategic importance of the company as the listing process will examine its maturity and modus operandi.

However, before starting to trade stock on the stock exchange, the company must undergo a demanding process of preparation for the IPO.

Company listing on the stock exchange

The process of IPO preparation lasts from the moment when the shareholders decide about the stock listing up to the debut; a period of about five to six months (this preparation period may be extended depending on the degree of company development or delaying the decision about listing).

Proceedings start with a general assembly where company shareholders approve the resolution about listing the stock on the stock exchange, and determine the amount of stock to be offered to investors for underwriting, as well as the specific stock exchange where the stock will be listed. One of the options is, for example, dual listing, whereby the stock is listed simultaneously at two or sometimes even three exchanges. From this moment, the company management is subject to an additional load exceeding the scope of their former operating duties. This load is shared with the management to a great extent by IPO consultants: legal consultants, accounting and tax consultants, auditors, economic consultants, consultants of the investment bank performing the stock underwriting, and by the end of the process also consultants for public and investor relations.

Due diligence

The first important step is performing due diligence to examine the company's status from all points: legal, economic, HR, and process. Based on data obtained in this way, the preparation of the "issuer's prospectus" commences: this represents the most important document for investors because it describes in detail the company's position as well as the risks associated with investing in the company's stock. This is the stage of the preliminary valuation of the company and making the proposal of stock offering structure.

Equity story formulating

Another stage of IPO preparation is educating analysts and formulating an "equity story" describing the company's strategic objectives with the financial means raised by stock underwriting on the stock exchange. The approval of the issuer's prospectus by the financial market authority (in the Slovak Republic this function is fulfilled by the Národná banka Slovenska) and its publication is followed by the investors' education and "pre-marketing". Shortly before the final stage – the underwriting of stock – top management undertakes a road show during which they personally meet investor representatives and by way of presentation and interviews they compile a general picture of the company as the potential investment title for their portfolio. The final stage of listing is opening the book of stock underwriting and final selection of investors (separately the institutional and retail ones) from the applications for underwriting that are submitted to the underwriter until book closing. The issuer, i.e. the listed company, has the option to choose what proportion of stock underwriting they would allocate to an investor – worries of company control by competitors or speculative investors are therefore unjustified from this point. However, the process does not end with the stock underwriting by investors. After the stock debut, i.e. the start of trading with the stock, the listed company is subject to exchange rules including obligatory reporting and informing of investors: the regular publishing of quarterly financial results or other facts, and ad hoc publishing of precisely defined matters.

New activities of companies following the IPO also include the defining of new internal process-

es leading to ensuring the fulfilment of disclosure requirements and the management of investor relations.

IPO benefits

To a listed company, the IPO especially raises funds for the performance of its strategic objectives, while unlike a bank loan it is not needed to repay the means to the creditor. The capital obtained from investors remains in the company, while from the moment of stock acquisition the investors share profit in the form of dividends and voting rights corresponding to the amount of owned shares. Moreover, a publicly traded company has quite easy access to capital from investors by means of the repeated underwriting of newly issued stock – the SPO (Secondary Public Offering).

The IPO has an additional positive externality: presentation in media and prestige. A listed company's image is often associated with terms such as stability, success and transparency. In addition, a publicly traded company enjoys media attention, especially at press conferences at the start of stock trading or upon the publication of quarterly or annual financial results.

From a shareholder's perspective, the IPO has the following benefits:

- The IPO is a great opportunity for shareholders to perform ambitious plans for company growth either in the form of acquisitions, investments into technologies, or other strategic objectives. In many instances, such visionary plans would not receive a positive response from banks, or the capital volume could be too risky considering the size of strategic objectives.
- Another benefit of company listing for its owners is the liquidity of the stock listed on the stock exchange. This benefit is evident especially when compared to publicly non-tradable companies: if the owner decides to sell his share of a publicly non-tradable company, the negotiations with the buyer may take several months till they reach an agreement about the purchase price of the stock being sold. However, listed stock price is set by market forces, i.e. by interaction of supply and demand, and as such is publicly known.
- This is also linked with another IPO benefit for the shareholder, the "valuation gap" represented by the higher valuation of listed stock by analysts and investors on the stock exchange when compared to the valuation of stock of a company not listed on the stock exchange. This applies especially at the time of positive growth trends of stock prices index at stock exchanges.
- Another indisputable benefit of company listing for the shareholder is definitely a much higher rate of company's management transparency, to which the listed company is committed by stock exchange rules. At present, many Czech and Slovak shareholders who incorporated their companies in the period following 1989 are reaching retirement age and are thus considering means to secure further company operation after their retirement. One of the options of ensuring the control and discipline of management without the owners' presence is listing the company on the stock exchange, however, this alternative is conditioned by the sufficient size and maturity of the company for the IPO.
- The IPO also provides benefits to the company management especially by providing the opportunity to obtain a participating interest in the company either by acquiring managerial stock or options, or purchasing shares on the stock exchange. Managing a publicly tradable company is clearly prestigious for managers and a great opportunity to heighten their profiles.

Load for company and risks linked with the IPO

On the other hand, the IPO represents a load that can only be borne by developed companies ready for such an important and strategic milestone as a company's stock listing on the stock exchange.

- First of all, the process of IPO preparation itself is unusually demanding, requiring lots of time and energy from the company's employees beyond their everyday operating duties. To avoid the adverse effect of such preparation on company business activities, a high level of co-ordination with several third parties (consultants, capital market bodies, or investment bank) is required. It is appropriate to ensure this function by means of an IPO manager: an internal employee whose main duty will be preparing the company for stock exchange entry.
- The fact that the financial results published in the issuer's prospectus must be transformed in accordance with international financial reporting standards is often considered an additional load over the accounting department that had been maintaining accounting up to that time only according to Slovak accounting standards. On the other hand, a transition to the accounting in accordance with IFRS represents a certain benchmarking, also on an international scale, and at the same time is an opportunity for the company to get adjusted to the trend of transition to the IFRS.
- After the start of stock trading, a new era of company existence commences that is influenced to a great extent by stock exchange rules. This means rules applying to meeting disclosure requirements which requires setting internal company processes and creating a department devoted to investor relations. These obligations arising from the IPO represent an opportunity, on the other hand, to improve and make internal processes more efficient. Moreover, the publishing of obligatory data from the side of the company may be used for managed publicity and media presentation.
- IPO is also linked with the risk that not all stock offered for underwriting by investors will be

successfully underwritten. However, this risk may be treated by an Underwriting Agreement, an agreement with the underwriter who undertakes to underwrite the stock for a price determined in advance if not all the stock is underwritten. However, not underwriting all of stock is an important signal for the listed company that the intended investment strategy is neither credible nor realistic from the view of independent persons (analysts and investors). So the IPO represents a mirror against the company reflecting its maturity and the credibility of corporate strategy in the public eye.

- Finally, there is the risk of unwanted stock price development on the stock exchange, for example linked with the indices decrease on capital markets. Except for the fact that company value falls with market capitalisation, the unfavourable situation on capital markets should not be reflected in the ordinary business activities of the company.

Situation on BSE and neighbouring stock exchanges

The awareness of IPO as an option for raising capital for company development is quite poor in Slovakia. It is the consequence of few IPOs performed on the Bratislava Stock Exchange (BSE) and low activity on the Slovak capital market. This fact is reflected by an international comparison of performance on neighbouring stock exchanges (Table 1).

The BSE significantly lags behind stock exchanges in neighbouring states in all compared categories: amount of market capitalisation, volume of deals during 2009, and number of transactions performed.

A way of reviving the dormant Slovak capital market is not simple; the problem with the market is both on the side of demand and supply. Investors´ demand for stock listed on the BSE is poor as a result of the low number of attractive issues on the domestic exchange. However, potential issuers worry to make the IPO on the BSE, because under Slovak conditions they do not identify sufficient interest nor demand from analysts or investors (neither institutional nor retail). This creates a vicious circle that can only be broken by radical change either on the side of demand or supply (and ideally on both sides).

Help on the side of supply would be an initial public offering of several big companies controlled by the state on the BSE. Trading on the stock exchange in Prague was started in a similar way. But also mid-size private companies could be inspired by the successful story of Asseco Slovakia, a. s. which on the stock exchange in Warsaw was able to strengthen its position in Slovakia and expand to neighbouring countries (Czech Republic, Austria and Hungary) by means of acquisitions thanks to funds raised from IPO and SPO (about EUR 60 million in total). The pursuance of such an ambitious strategy from own resources or by means of bank loans would not be possible.

Table 1 Performance of stock exchanges in Central Europe

	Market capitalisation in EUR billion	Volume of deals in EUR billion in 2009	Number of transactions
Warsaw	174.2	41.4	13,278,395
Vienna	98.6	36.4	5,067,313
Prague	49.0	17.6	1,571,767
Budapest	21.1	18.7	3,350,274
Bratislava	3.6	0.1	2,012

Source: FESE.

Since the domestic environment of the capital market has definitely a positive impact on listed companies due to better promotion of investment titles and may be reflected in higher interest and demand for such stock, potential issuers could profit from dual listings – via the IPO on the BSE and additionally on a more efficient foreign stock exchange. Recently (March 2010), the plans of several companies to make an IPO on the BSE within the next three years were presented during the Conference on Capital Market Revival in Slovakia. They will follow two companies Tatry Mountain Resorts, a.s. (TMR) and Best Hotel Properties, a.s. (BHP) listed on the BSE last year, and applying for the favour of Slovak investors. If the interest in such titles is sufficient, it may be an indication of better times for the BSE and the Slovak capital market.

However, on the demand side there is great need for the improvement of informing about opportunities for retail investors investing in stock listed on the BSE. The change of retail investors' behaviour would also be supported by the decrease of fees for establishing a securities account owner, and such account administration by securities dealers.

However, the biggest challenge remains the change of investment behaviour and the approach of Slovaks to investments on the stock exchange. Just as all nations in Western Europe and neighbouring countries, Slovak people should also start treating investing in stock listed on the stock exchange as a natural form of investment.

The Slovak capital market's revival may lead to the improvement of the current situation of economic entities and the public. Slovak companies that are sufficiently mature have the opportunity by means of capital raised from the IPO on the stock exchange to undertake ambitious plans to secure their further development. For many Slovak enterprises, this may be the only option to withstand the tough competition of global companies and not become an acquisition target swallowed into a global structure. Although the IPO preparation is a non-trivial matter, it is a good opportunity for a company to improve its internal processes and make business activities more efficient.

For shareholders, the IPO is an opportunity to appreciate their assets, to obtain a more liquid

form of stock, and ensure correct company operation after the retirement of shareholders from company operation.

Finally, an efficiently operating capital market with a sufficient number of interesting stocks on the stock exchange is a benefit for the public because it offers and provides another form of property investment and appreciation.

'De lege lata' collective investment in the Slovak Republic

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Entities pursuing a collective investment represent a non-banking financial mediator; in theory they are also known as institutional or portfolio investors.[1] The basic difference between individual and collective (institutionalized) investment lies in the fact that while individual investors shape their investment aims as well as their preferences themselves, there is a 'collective investor' in the collective investment shaping the preferences according to aims which the particular collective investment participants agree upon.[2]

Different general names have been created around the world, such as Collective Investment Vehicles, Undertakings for Collective Investments in Transferable Securities (UCITS), which, however, do not indicate their particular national legal form. It was European law that started to use the general term of UCITS introduced in this area.[3]

The European Union members recognise many legal forms of collective investment. Our legal system has to take this fact into account, specifically in the legal regulations enabling foreign entities to operate in this area. Collective investment entities issue equity securities; consequently, we generally consider the collective investment as an investment within a direct participation in the business activity of the collective investment entities or as an investment without this participation to which property rights are attached.

The collective investment in the territory of the Slovak Republic is legally regulated by Act No. 594/2003 Coll. on collective investment and on amendments and supplements of certain laws (hereinafter referred to as 'the Act on Collective Investment'). This legal enactment in its provision in Article 2 (1) defines a collective investment as raising funds from the public on the basis of a public offering, the objective being to invest the funds so raised in liquid financial assets and in the assets as stipulated by this Act on the principle of risk limitation and distribution (so-called 'risk diversification'). It is a form of management of foreign assets for remuneration with the aim of their valorization.[4] In Article 5 (a) the Act on Collective Investment delimits a public offering as 'any announcement, offer or recommendation in respect of the raising of funds which is made by a legal or natural person for their own benefit or for the benefit of a third party, through any distribution channel, to a group of natural persons who are more than fifty in number'.[5] This activity requires substantial costs related to addressing the investor public, information costs related to obtaining optimum investment possibilities and finally costs incurred in the investment of the funds itself.[6] This is the reason why the Act on Collective Investment strictly delimited which entities may make a collective investment. To put it more simply, we may state that there are two forms of pursuance of collective investment within the territory of the Slovak Republic, depending on whether this activity is performed by a domestic or a foreign entity.

Domestic entity

Domestic entities may undertake a collective investment only by creating and managing mutual funds, while such an entity is called 'management company'[7] and its requisite legal form is a joint-stock company. It may pursue its activity on the basis of a license allowing the establishment and activity of a management company which is granted by the Národná banka Slovenska. The initial capital of a management company has to be at least EUR 1,000,000. Apart from creating and managing mutual funds, a management company, on the basis of a special license for the creation of mutual funds, may also pursue other activities if these are included in the license authorising its establishment and activity and if it manages at least one open mutual fund. These are investment services in accordance with the Act on Collective Investment.[8]

A 'mutual fund' represents a set of assets of unit holders (investors in the collective investment) of a particular mutual fund raised by a management company by issuing unit certificates[9] and assets investment. The means which create a mutual fund are the common property of all the owners (unit holders) of unit certificates of the particular mutual fund; however, they represent a special community of persons and property to which the civil law co-ownership regulation does not apply.[10] The Net Asset Value in a mutual fund has to reach at least EUR 1,500,000 by issuing unit certificates. The assets gathered in the mutual fund are not the property of the management company. Even though the mutual fund is a collective investment entity and at the same time a super-

1 E.g. Veselá, J.: Investování na kapitálových trzích (Investing at Capital Markets). Prague: ASPI, a.s., 2007, 632 p. and Pavlát, V. et al.: Kapitálové trhy (Capital Markets). Professional Publishing, 2005, 182 p.

2 Pavlát, V. et al: the above work, ibid.

3 The so-called undertakings for collective investment in transferable securities (UCITS).

4 Czech literature says it is trading with the use of property investments collected from the public. See: Subjekty kolektivního investování (Collective Investment Entities), In: Eliáš, K., Bartošíková, M., Pokorná, J. et al.: Kurs obchodního práva (Commercial Law Course). Právnické osoby jako podnikatelé (Legal Persons as Entrepreneurs). Fifth edition, Prague: C.H. Beck, 2005, 557 p.

5 Delimitation of a public offering for the purposes of the Act on Collective Investment represents a separate legal enactment of an offer to invest in securities, i.e. unit certificates, and it is not to be confused with the public offering of securities as stipulated in Article 120 and subs. of Act No. 566/2001 Coll. on securities and investment services and on amendments and supplements of certain laws (the Securities Act) as amended.

6 Czech literature also refers to other kinds of costs of collective investment: financial, time and personal (costs of professional knowledge of financial markets). See: Subjekty kolektivního investování (Collective Investment Entities), In: Eliáš, K., Bartošíková, M., Pokorná, J. et al, quoted work, ibid.

7 The stated denomination is, in accordance with the provision of Article 3 (9) of the Act on Collective Investment, an mandatory part of the business name, while there is also an English equivalent of the collective investment ('Asset Management') used in practice in business names. There are many names used abroad corresponding to the legal status of an entity making a collective investment in a particular country; which, however, need not correspond to the legal

vised entity, it is not a legal person, i.e. it has no legal personality.[11] This is why the management company performs all the acts related to the activity of the mutual fund. The business name of the management company which manages the mutual fund is a mandatory part of the name of the mutual fund. Our legal system distinguishes three kinds of mutual funds: *open*[12], *closed*[13] *and special.*[14] The special fund may be created as a *higher-risk* special fund, *diversified* special fund and a *real-estate* special fund.[15]

Foreign entity

Foreign entities may make a collective investment in the legal status of a foreign collective investment undertaking or of a foreign management company.

A 'foreign management company' is a legal person with its registered seat outside of the territory of the Slovak Republic which establishes and manages a foreign collective investment entity and has a license allowing it to pursue this activity within the country of its residence. A foreign management company may have its seat in the states of the European Economic Area; in this case, it pursues its activity within the territory of the Slovak Republic on the basis of a European license by means of a branch office or based on the right to enjoy the free provision of services. However, it may also be a company seated in one of the states outside the European Economic Area while it bears none of the advantages of the common European license.

A 'foreign collective investment undertaking' may have the form of a *foreign mutual fund or a foreign investment company.*

A 'foreign mutual fund' may be a mutual fund created and managed outside of the Slovak Republic by a foreign management company, or it may be a different collective investment entity with no legal personality, created or managed by a foreign management company.

A 'foreign investment company' is a foreign legal person which is a collective investment entity in accordance with the legal system of the country of its residence.[16]

If the foreign collective investment entities meet the conditions of the EU legal regulation governing the collective investment, it is a European fund.

Collective investment securities may be publicly offered by a foreign management company or a foreign investment company within the territory of the Slovak Republic solely on the basis of the license granted by the Národná banka Slovenska, unless they are the European fund's securities for which this special license is not required.

In accordance with the provisions of Article 80 of Act No. 566/2001 Coll. on Securities and Investment Services and on amendments and supplements of certain laws (the Securities Act) as amended, management companies and foreign management companies (by way of their branch offices) participate in the investment protection provided by the Investment Guarantee Fund. Their participation is conditioned on providing the investment services referred to above in accordance with the Act on Collective Investment and the protection relates only to client assets of those investors to whom they provide such investment services.

status of a Slovak asset management company, e.g. Management Company, Investment Company, Kapitalanlagegesellschaft, Investmentgesellschaft, société d'investissement, etc.

8 *Legal enactment of investment services in accordance with the provision of Article 3 (3) (a), (b) and (c) of the Act on Collective Investment represents a special legal regulation of investment services and activities in accordance with the provision of Article 6 of the Securities Act.*

9 *Unit certificates as collective investment securities may also be considered as equity (unit holder's) securities as they bear the share of its holder on the assets of the relevant mutual fund. Despite that, the Slovak legal regulation of the collective investment does not relate the unit certificates to the right to participate in the business activity of the management company, as is the case for shares. This results from a strict separation of the manager's property from the mutual fund assets ordered by the Act on Collective Investment.*

10 *Similarly in: Kotásek, J., Pihera, V., Pokorná, J., Raban, P., Vítek, J.: Kurs obchodního práva. Právo cenných papíru. (Commercial Law Course. The Securities Lawright of securities). Fifth edition, Prague: C.H. Beck, 2009, 333 p.*

11 *Given the definition of the legal person as stated in Article 18 (2) (a) and (b) of the Civil Code which also describes it as associations of natural or legal persons or as specific assets association, the provisions of Article 4 (2) of the Act on Collective Investment exclude the legal personality of the mutual fund ex lege, stating that the mutual fund is not a legal person.*

12 *Provision of Article 35 and subs. of the Act on Collective Investment.*

13 *Provision of Article 62 and subs. of the Act on Collective Investment.*

14 *Provision of Article 69 and subs. of the Act on Collective Investment.*

15 *With this list, the Act on Collective Investment makes numerus clausus for legal forms of creating a special asset association within the legal framework of the collective investment. It does not allow investments to be realised in a capital market within the legal framework of the collective investment by means of Alternative Investment Funds (AIF)*

16 *In contrast with the provisions for a foreign asset management company, the provisions for a foreign investment company presume the existence of such collective investment entities abroad enabling the direct capital participation in the business activities of this entity by means of owning the securities issued by itself. A foreign management company may publicly offer securities of foreign collective investment entities managed by it, while it has to possess a license, as stated in the provisions of Article 75 (1) of the Act on Collective Investment, for a public offering of securities of each foreign collective investment entity managed by it.*

Financial derivatives as investment tools of the financial market

(selected economic and legal characteristics)

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The reason for investing available financial resources is an initiative to maximize revenues while minimizing the possible risks[1] attached to the particular investment opportunity. Traditionally, financial derivatives, as financial market contracts, originated as a result of cautious investors' efforts to further minimize the risk when pursuing a new investment opportunity in the market on the one hand; on the other hand, it was also a speculative endeavour to rapidly boost their profit by means of a future price development estimate of various commodities. It is precisely due to this characteristic feature of derivatives – that they facilitate "economic gambling" –that derivatives and their massive development are now viewed as one of the triggers of the financial crisis.[2]

Even though the massive development of a sophisticated financial derivatives market started only recently, people were familiar with their principle from ancient times. Based on Aristotle's records, the first derivative deals were made by Thales of Miletus, who, as suggested by Aristotle, was able to correctly forecast the quality of future olive crops. Thales, confident of his expectations, was eager to enter into contracts with olive oil producers even before the season started, and this ensured him an exclusive right to buy the production for a price agreed upon beforehand – which was relatively low, reflecting the risk of a bad crop and the time-value of money – but still profitable for the olive producers also, as they had their sales guaranteed at agreed prices in advance.

This is how the first option and forward transactions were undertaken, albeit in their simplest form.

Several variants of financial derivatives, now in a more advanced form, began to be used about one hundred years ago, when, for example, at the end of the 19th century, London bankers, cooperating to obtain investment resources, would get credits whose coupons evolved independently of a future cotton price.

Current financial derivatives, which are more complex, challenging and exact, originated mainly due to inflationary pressures and changes in inflation rates, accompanied by a greater instability in exchange and interest rates. Their origin is obviously dated as late in the period when the modern developed financial markets came into existence. The start of derivatives trading at the Chicago Board of Trade (CBOT) in 1975, or the establishment of LIFE in London, being the first exchange aimed at trading in futures, are two of the milestones in their modern history.

Currently there are about 100 derivative exchanges; some of the most important ones are: CME Group, ICE Futures Europe, NYSE Euronext, South African Futures Exchange, Sydney Futures Exchange, Tokyo Stock Exchange, Tokyo Commodity Exchange, Tokyo Financial Exchange, Osaka Securities Exchange, London Metal Exchange, ICE Futures U.S., New York Mercantile Exchange, Dubai Mercantile Exchange, Korea Exchange and Singapore Exchange.

So it was in late 70s and early 80s when the generally changeable conditions in the world financial markets led to the creation of the new financial market transactions and tools which today are simply and appropriately called 'financial derivatives'. As results from the name itself, their value is derived from the value of the underlying assets representing the subject of a derivative contractual relationship, e.g. treasury bills, government bonds and bills, equity shares, corporate bonds, community bonds, foreign currencies, EUA and CER licenses, commodities such as crude oil, coal, electricity, etc.

The market price of any derived contract is therefore derived from the market price of its basic, i.e. underlying asset. So *financial derivative* is a complex name for a financial product or operation which makes it possible to fix or agree a price at a particular point of time for which the asset related to the contract may be bought or sold at a future date.

Depending on whether the contract is traded *on exchanges* (public market) or *off exchanges* (among private subjects), it is governed by a different degree of legal regulation; in the case of *on exchanges,* the legal regulation is extended mainly by the separate internal rules of each publicly tradable market.

A derivative is a financial tool which, within the

1 'Risk' can be defined as a probability of the occurrence of a loss or a negative variance from the expected revenues level in the investment made.

2 Derivatives operations are also the underlying cause of the bankruptcy of Barings Bank, Long Term Capital Management (with two Nobel laureates, Myron Scholes and Robert C. Merton, as partners of the company), Enron etc..

context of current legislation, may be defined as follows:

a) its value changes depending on the underlying asset change;

b) it requires no or only a low initial investment in comparison with other investment contracts;

c) it is settled on a particular future date.

It results from the above characteristics that a common feature of all types of derivatives is the existence of a contractual relationship between the financial investors.[3] Its content is a future execution but under the conditions agreed at the time that the contractual relationship was established. This contractual relationship, i.e. a derivative, has its own value[4], which predetermines it for its becoming a subject of supply/demand on a financial market, just like its underlying assets.

Apart from classifying derivatives on the basis of their underlying asset type (interest, credit, share, currency, weather derivatives, etc.), they can be grouped into two groups, according to the nature of the contractual relation created by the derivative:

1. unconditional – fixed-term operations;
2. conditional – future option operations.

1. Unconditional derivatives

Forward

Financial theory often understands 'forward' as two synthetic options – its buyer obtains the right to sell or buy it at a price determined in the future, while there is no inverse relation for the seller. However, lawyers have a very different understanding of the obligations of the parties in relation to an option and a forward. On the one hand, a forward means an obligation on the part of one contracting party to supply a particular commodity, security or other asset at a predetermined price on a predetermined date (often also at a predetermined location); on the other hand, it represents an obligation on the part of the other contracting party to pay a purchase price for the asset, regardless of whether the contract is or is not "in the money"[5]. This runs counter to the option, which has no obligation to effect the payment. E.g. wheat is bought on commodity markets at a predetermined price, in a predetermined volume and at a previously determined date of supply in a particular place. Up to the date of execution of the contract (during which period the wheat has to be grown, harvested and supplied) the wheat price can change considerably. The contract for the wheat delivery – for a predetermined price, predetermined date and at a predetermined place –may be sold to other parties for a higher or lower price compared to the one paid initially.[6] The same is also more or less true in the case where such a forward contract is concluded between private parties.

A forward thus represents a contractual relationship where the contracting parties commit themselves to buy/sell a certain underlying asset at an agreed future date and to pay a previously determined price.

Depending on the type of the underlying asset, there are several forwards used in practice:

- *currency* – a forward to exchange a fixed cash amount predetermined in one currency for a fixed cash amount predetermined in a different currency at a predetermined future date; the exchange rate of the two currencies is called a forward exchange rate;
- *interest rate* –this includes perhaps the best known contract – a forward rate agreement (FRA); FRA buyers secure their obligations with changeable interest against a rise in interest rates and FRA sellers secure their claims with changeable interest against a fall in interest rates; in practice a fixed interest rate and a future spot interest rate are established at the beginning of the interest period; it is also necessary to establish on what basis the future interest rate will be determined; the interest period length and its start need also to be determined;
- *share* – a forward to exchange a fixed amount of cash for predetermined shares at a predetermined future date;
- *commodity* – a forward to exchange a fixed amount of cash for a predetermined commodity at a predetermined future date.

This is a seller-buyer deal about the conditions of a transaction to be made on the stated future date. With a forward, both the contracting parties are obliged to meet the conditions of the contract, i.e. the seller is to deliver the underlying asset at a predetermined time, amount, quality and price; while the buyer is to take it over and pay the agreed purchase price.

Forwards have the advantage of being "tailor-made" only between the two contracting parties; this means that they perfectly fit the requirements of both parties. It is thus a direct contractual relationship concluded outside of a publicly organized market and sometimes even without any mediator (bank or other financial institution).

However, there are disadvantages too, namely that it is difficult to trade with forwards, resulting in their non-liquidity. This characteristic of forwards results from the fact that both parties have specific rights and obligations and it is difficult to delegate contractual obligations onto a different subject which would have identical needs. Another disadvantage is related to the guarantee of meeting the contractual obligations. As it is solely a two-partner deal, there is no third-party guarantee that the parties will meet their obligations. The point is that the greater the price differences at a prompt market in comparison with fixed-date contracts, the greater the likelihood of one of the partners failing to meet the agreed conditions. Because, if the prompt market price is higher at the time of the contract execution than the agreed realisation price of the forward contract, it is logical that this is a great advantage to the buyer while the seller will experience a huge loss. A mirror investment position can result in the loss-making party not meeting its contractual obligations, e.g. also due to objective insolvency caused by an ex-

3 When entering derivative contractual relations, the subjects involved usually pursue the following aims: i) trading, i.e. making a speculative profit, usually without its physical settlement; ii) hedging, i.e. risk elimination by providing against losses caused by unexpected changes in the underlying asset markets. This approach is then related to strategic risk management and not to the investor's speculation and usually ends with a physical settlement.

4 The value of a forward is influenced by the expected supply/demand development of the underlying asset, risk-free rate of return or perhaps the warehousing costs of the underlying asset related to the period between the conclusion of the contract up to its execution (warehousing costs of an underlying asset as a part of the forward price are especially significant for commodity derivatives).

5 From the English term 'contract in the money', expressing a positive financial position of the investor who, performing the obligation, makes a profit from a derivative transaction on the date of its obligation maturity.

6 Actually it is a delegation of rights and obligations resulting from a contract concluded to another subject for a reward (change of the original creditor, cession, or a change of the original debtor, privative intercession).

treme and unexpected price counter-movement in the market of the underlying asset.

When thinking of buying an underlying asset, subjects entering a forward obligation relationship are taking a so-called *long-term position* which protects them against a potential underlying asset price increase at the time of execution resulting from the forward contract so concluded. When thinking of selling an underlying asset, subjects entering a forward obligation relationship are taking a so-called *short-term position* which protects them against a potential basic asset price drop at the time resulting from the forward contract so concluded.

Futures

This kind of contract represents a typical on-exchange derivative. It is a standardized forward form traded on specialized option and forward exchanges. Regulation of their trading is influenced by the rules of the particular exchange. Standardization relates mainly to the underlying tool type, delivery dates and the manner of trade collateralization (securing). Even though a high standardization reduces the freedom to enter into tailor-made relationships, it is a source of liquidity for the futures – thanks to the possibility to trade them on publicly regulated financial markets. With the exchange entering an initially bilateral financial relation, usually the trading conditions of futures are modified, in contrast to OTC transactions. These changes are mainly related to:

- the involvement of a clearing centre, i.e. an accounting centre of the exchange assuming the function of a mediator and a financial guarantor for executing the contracts so concluded. By means of the clearing centre, the exchange is a contracting party of each transaction when trading futures (in contrast to a direct forward seller-buyer relation).
- the application of a mark to market settlement in the futures relation. In contrast to forwards where profits/losses are realised only once, on the maturity date of the contracts, with futures profits/losses are accounted from the contract price change on a daily basis. The total daily futures profits/losses equal the total contractual profit/loss.
- the introduction of compulsory advance deposits (and the resulting potential margin calls, in the case of crossing a fixed border – the so-called *threshold*, with a negative financial exposure for either party). Their application regime is determined by a public organizer of financial derivatives trading and they ensure the liquid coverage of losses which are incurred naturally as a result of price changes on the underlying asset spot market with regular recalculations of the financial positions of the parties involved. These deposits have to be settled at the very start of concluding each contract. If the underlying asset price development on a spot market is negative for one of the parties for a long time, the initial deposit is usually exhausted. This situation is dealt with by way of subsequent margin calls, in order to prevent the credit risk of one party from rising to a disadvantaged position compared with the exchange.
- adopting exchange rules for a system of price limits regulating movements within a predetermined price zone which must not be transgressed on a trading day.

Swap

A swap basically represents a deal on cash flows exchange, with one party entering the deal with an obligation which it is not interested in, and so, by means of a swap agreement, the party replaces it with a different party's obligation which, for various economic reasons, it finds easier to fulfil. The point of a swap contractual obligation is therefore an exchange on the fulfilment of financial obligations of a forward nature at a specific point of time by two parties, with a contractual partner preferring to fulfil the obligation of a contracting partner rather than their own obligation.

Historically, what came first were currency swaps serving as an efficient legal method of evading the strict exchange regulations of individual states. In their effort to do business abroad, investors were restricted by the exchange regulations of the country in the currency of which they wanted to borrow. They would resolve this by way of swap structures where a subject from country A, interested in investing in business in country B, would borrow on the basis of a credit relation from a local bank in the local currency; and through a financial mediator (investment bank) the A-country subject would address the B-country subject with the same need, but in connection with the investment in country A. Following an exchange of their rights and obligations from the credit contracts so concluded, both subjects secured the funding of their investment projects in the currency of the country of their investment projects, without recourse to a cross-border foreign exchange flow. The first ever swap agreement was concluded between IBM and the World Bank in August 1981.[7]

Besides currency swaps, interest rate swaps are mainly used in practice. They are based on parties concluding a contract, the subject of which is the payment of a regular net cash flow in the currency of either contracting party depending on the actual situation in the development of the parameter which has an impact on the final foreign resources cost at a fixed future point of time. The idea of concluding such a contract is to receive funding under conditions advantageous for both the contracting parties, while here also (just as with any derivatives relations) the principle of identical motives of two contracting parties pertains, but with reverse subjective expectations of the evolution of the parameter.

Some specific kinds of swap derivatives are a credit default swap and a total return swap.

Credit default swap represents derivative tools for a credit risk transfer. This derivative is a special

7 *Currency swaps are currently mainly used for optimizing the costs of foreign resources, based on the premise that a local subject will always receive better borrowing conditions in his/her home country than abroad.*

kind of swap contract with the underlying asset in the form of a debt tool (e.g. bond) where the contract buyer is obliged to pay regular money instalments to the seller over the contract life or credit event[8] of a reference entity; and the seller is obliged to provide a settlement[9] only in the event that, during the contract duration, the bond issuer comes to a default or their solvency, as expressed in their credit rating decrease[10], drops. This kind of derivative is criticized for representing a potential evasion of insurance relations that are subject to strict regulation everywhere around the world, yet with the difference that the CDS derivative buyer is usually not the owner of the underlying asset – the debt instrument – to which a default of the issuer's payment – the assecuration payment – is bound. It is, therefore, also common that CDS contract sellers are not subjects liable to the typical strict regulation of insurance services providers (so the typical insurance protection mechanisms, such as the creation of technical provisions, are missing here, being replaced by hedging of the counter-positions with CDS derivative contract sellers).[11] The price paid by the CDS buyer for protection against a negative credit event on the part of the reference entity is established by means of a CDS spread rate of the nominal value of the given debt tool in the CDS derivative contract. CDS spreads are currently seen as an excellent indicator of the potential default of financial market subjects around the world (the greater the spread rate, the greater the likelihood of the ultimate credit default of the given subject, the reference entity).

In contrast to CDS contracts, the *total return swap* derivative enables the buying subject to transfer a risk resulting not only from a reference entity credit default but also from a market risk of underlying asset devaluation caused by market volatility. On the one hand, the buyer in the total return swap is obliged to make regular payments depending on the underlying asset's economic potential (mainly debt financial tools, e.g. bonds), i.e. especially interest revenues and positive changes of the underlying asset's market value; on the other hand, the seller of such a derivative contract is obliged to pay a precisely defined cash flow to the buyer, depending on an interbank interest rate (e.g. EURIBOR, LIBOR) and possibly to settle any losses incurred due to a decrease in the market price of the underlying asset of the reference entity.

2. Conditioned derivatives

Option

'Option' refers to a derivative contract with a unilateral right (not an obligation) to sell/buy a particular underlying asset for a previously agreed price on a predetermined future date. The buyer pays an option premium for this right to the seller, which represents the cost for an investor of entering into an option contractual relationship with the subject putting out the option. We distinguish between a 'call option' consisting of the right to buy the underlying asset for a previously agreed strike price and a 'put option' which, by contrast, represents the right of its holder to sell the underlying asset. Thus, the option premium is an expression of the maximum loss for the option-holder (the so-called 'long-term position') in the event that they decide not to exercise their right, as a result of the underlying asset's spot price being better at the time (or up to) its expiration.

Basic legal framework for regulating derivatives as financial tools

Public legal regulation

From the perspective of their national legal regulation, financial derivatives are defined in Act No. 566/2001 Coll. on securities and investment services and on amendments and supplements of certain laws (Securities Act).[12] This Act understands the term 'derivative' as a money-rateable right or obligation related to shares or derived from shares, commodities, interest rates, exchange indices of funds in the Slovak or a foreign currency, or of other assets used in business relations for this purpose. A derivative is also a money-rateable right or obligation related to securities contracts or derived from such contracts; in particular, the financial tools stated in Article 5 (1) (d) through (j) of this Act are understood to be derivatives. Derivatives defined as financial tools in this way are the subject of the investment services (main and additional) provided under the conditions stipulated by the Act.

In addition to the basic normative legal Act as stated, there are many relevant legal enactments governing the use of financial derivatives as financial tools by single financial market subjects, mainly Act No. 483/2001 on banks and on amendments and supplements of certain laws as amended, Act No. 594/2003 Coll. on collective investments and on amendments and supplements of certain laws, Act No. 429/2002 Coll. on the stock exchange, as amended. The legal enactment (of a subordinate character) of financial derivatives, from the perspective of their public regulation, is represented mainly by different rules of practice, such as NBS measures, regulations of the Ministry of Finance of the SR regarding the accounting principles for entrepreneurs, etc.

Private legal regulation

Contractual documentation on financial derivatives has been of a specific nature, depending on the character of the jurisdiction of the derivatives business of the contracting parties involved. As the variety of contractual documentation caused by the differing nature of the legal regulation of derivatives as financial tools has always been a major obstacle in the intensive development of derivative operations in the world, the International Swaps and Derivatives Association (ISDA)[13] drafted a clear legal standardization of contractu-

8 International Swaps and Derivatives Association (ISDA) formalized definitions of credit events for credit derivatives. In accordance with these definitions, a credit event is a bankruptcy, failure to meet one's obligation, payment failure, refusal or restructuring.

9 I.e. physical settlement or cash settlement.

10 Even though the CDS contract buyer "ensures" their exposure to the reference entity's credit default with the CDS contract seller, ultimately the buyer transfers it to the CDS contract seller; it is therefore important to have the lowest possible correlation between the likelihood of final default on the part of both subjects.

11 However, hedging only shifts forward the total credit risk of default of the CDS contract settlement to a similarly "weak element" in the chain of derivative relations concluded on the market.

12 As stipulated in Article 8 (d) of Act No. 566/2001 Coll. as amended.

13 ISDA, this international association representing participants of OTC derivatives market is one of the biggest financial associations as by the number of its members. ISDA was established in 1985 and now comprises more than 830 members from over 58 countries. These members are mainly financial institutions and government organizations involved in the so-called OTC derivatives transactions, i.e. privately negotiated financial derivatives relations (some of its first members were Bankers Trust, Citicorp, First Boston, Goldman Sachs, Kleinwort Benson, Merrill Lynch, Morgan Guaranty Trust, Morgan Stanley, Salomon Brothers and Shearson Lehman Brothers). Since its establishment, the organization has aimed to unify private legal regulations of various kinds of transactions with the aim of minimizing both the legal and market risks of its members resulting from derivatives operations. One of the most significant actions in this regard is certainly the adoption of the ISDA Master Agreement laying down the basic contractual relations of private subjects involved in derivative operations.

al documentation related to financial derivatives relations being concluded. The result of a gradual unification of contractual documentation was the so-called ISDA Master Agreement (first version dated in 1992) built on the pillars of the British legal system and the legal system of the State of New York.

It is precisely this unilateral (though natural from the practical point of view) orientation on these legal systems which gives rise to significant problems for subjects governed by different legal systems in adopting the ISDA conditions to the legal environment of their domestic jurisdiction in such a way that derivatives relations concluded with an international element are not in contravention in their basis with the relevant valid legal regulation governing the activity of one of the contracting parties. The ISDA Master Agreement, as an agreement for derivatives operations, incorporates four inseparable parts:

a) confirmation, i.e. a template for mutual identification and confirming the conditions of each derivatives deal made within the ISDA Master Agreement;
b) the ISDA Master Agreement itself;
c) an annex on changes in the provisions of the ISDA Master Agreement ('schedule');
d) credit support documentation, mainly in relation to collateral and guarantees, i.e. documentation aimed at guaranteeing the fulfilment of the obligations of the subjects involved which result from the derivative relation so concluded.

Legal risks of OTC derivatives operations

The basic legal risk attached to the derivatives contract so concluded is its impracticability due to shortcomings in the legal documentation, a public obstacle preventing one of the parties from entering a derivative contract or wilful non-execution, or an obstruction on execution by one of the parties having made a huge loss. The main material factors increasing the risk of final default of execution of the derivative contractual relation so concluded are the following:

- permanent dynamic status of bilateral financial exposure for the parties involved;
- general absence of a potential loss limit for the party "unsuccessful" in the contract;
- significant international element present in the contractual relationship complicating the status of legal security, e.g. from the perspective of the legal capacity acknowledged to the parties in a derivative contractual relation or in a subsequent legal protection when making claims resulting from the mature claims of the 'successful' party against the other party with its domicile abroad;
- inadequate and unclear tax legislation for taxing the economic benefits from such complicated financial operations;
- professional incompetence of courts in determining on the cases arising;
- innovation and dynamic development of the world's derivatives markets on the one hand and tardy development of the legal regulation of these transactions on the other.

Apart from the reasons stated above making the legal regime of derivatives transactions more complicated, there is also a legal opinion present in several countries on the basis of which no legal protection applies to rights resulting from contractual relations establishing derivative financial operations, due to their legal categorization as 'bets and games'[14], as it inherently places the parties involved in financial derivatives relations at the price level of the underlying assets and subsequently deduces further rights and obligations for all the subjects involved.

14 A similar legal regulation of bets and games is also in force in the Slovak Republic– Act No 40/1964 Coll. Civil Code as amended; provision of Article 845 (1): "Winnings from bets and games cannot be recovered, neither claims on loans provided knowingly for the purpose of a bet or a game. Nor can such winnings and claims be legally secured."

International investment position

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International investment position represents the balance (sum) of foreign financial assets and liabilities. It serves as the indicator of the financial openness index of a country and the sustainability of foreign debt, and as an ancillary tool for financial stability monitoring.

The international investment position (hereinafter referred to as the IIP) represents quite a new indicator because up to the issuing of the fifth issue of the Balance of Payment Manual of the International Monetary Fund in 1993, there was no complete international methodology for its preparation. Even at present, only a few countries are able to submit the IIP to international institutions on a quarterly basis. Quite a slow development of IIP statistics relates to many methodological problems at its preparation, considering problematic issues relating to the method of financial positions' valuation and their harmonisation with financial flows.

The extensive growth of international financial private transactions relating to the general tendency of capital markets liberalisation over the last thirty years points to the necessity of preparing detailed IIP statistics as an indicator of financial development both from the functional structure point (direct investments, portfolio investments, credits, deposits, etc.) and from the sector structure point (government, central bank, commercial banks, enterprises, etc.). In spite of that, the IIP as a significant financial indicator does not have any major use in economic analyses, and is often quite a poorly known economic term. Although the need and helpfulness of IIP data is indisputable, the situation described is in fact caused by objective causes:

- IIP data in fact represents a short time sequence (absence of historic data)
- limited possibility of higher periodicity of IIP reporting (annually or quarterly)
- complicated procedures of IIP preparation and the resulting significant lag of data publishing
- significant differences in reporting methodology significantly complicate data interpretation and international comparison.

IIP structure and its standard components

The basic methodological regulation for IIP preparation is the fifth issue of the Balance of Payments Manual issued by the IMF in 1993. The IIP data classification and its changes have two dimensions. In rows there is a primary distribution to assets and liabilities and their difference represents a net position. In columns there are factors having an impact on the position change.

The IIP represents an additional balance of payments statistics, and because of that the structure of the standard IIP components is equal with the structure of the financial account of the balance of payments, i.e. it includes direct investments, portfolio investments, financial derivates, other investments divided into assets and liabilities, and reserve assets.

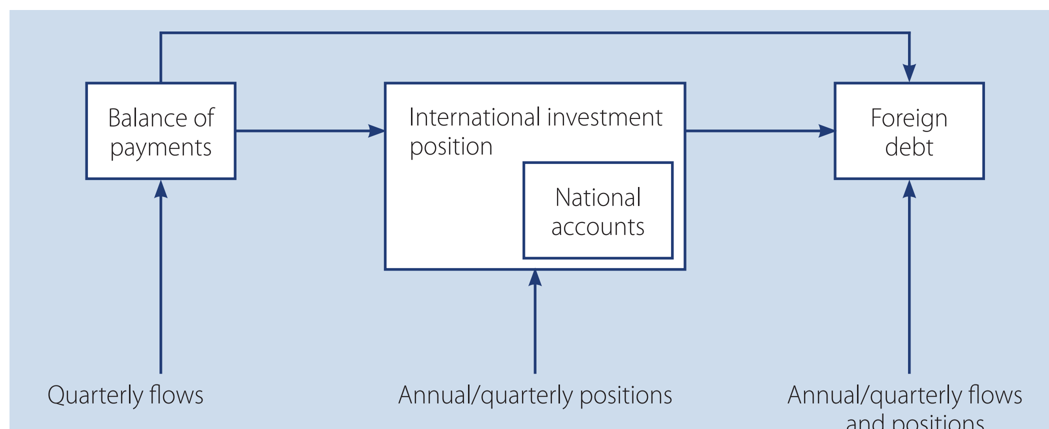
Direct investments are classified primarily based on the investment's direction, i.e. direct investments to abroad under assets, and direct investments from abroad under liabilities. The portfolio and other investments are divided in terms of sectors into: central bank, government, commercial banks, and other sectors.

The columns structure includes items with an impact on position change:

- transactions – representing in fact transactions recorded on the financial account of the balance of payments
- exchange-rate differences – representing the impact of exchange-rate changes on the position of assets and liabilities compared to the previous period
- price differences – representing differences in the prices of tradable securities. A significant change in the position of individual IIP items may occur without the performance of financial transactions as a result of significant price changes on the market
- other differences – representing recording of reclassification of financial assets and liabilities, SDR allocation, or potential debt cancellation without any compensation.

All foreign financial assets and liabilities should in principle be valued at market price, i.e. based on the current market price applicable on the appropriate day of the IIP preparation. However, in reality this principle is often avoided and for the needs of assets and liabilities valuation it is needed to estimate the market price and/or replace it by the accounting value. The problem of market price determination applies especially to the valuation of non-tradable securities and financial derivates. The valuation disunity and complicated market price determination for the property part of direct investments leads in practice to using the accounting value for the valuation of direct investments, when the market price estimate is used as ancillary information.

Relation between the balance of payments, the IIP and national accounts



IIP preparation includes the use of data from many various resources including the central bank, government, commercial banks, securities dealers, management companies, the non-financial sector, etc. and brings about similar problems as the preparation of the balance of payments but in a more extensive scope.

The main issue when preparing the IIP from the point of data resources is accuracy, availability, and the timeliness of data for non-financial sectors.

In addition to the balance of payments, the IIP also has close links to other main statistical aggregates. Foreign debt is in fact a subgroup of IIP data and includes all liabilities of the IIP except for investments in direct and portfolio investments, reinvested profit, and liabilities in financial derivates. Considering the need for improved transparency and the legibility of foreign debt structure also from the point of maturity, the international institutions also require reporting foreign debt as a separate category.

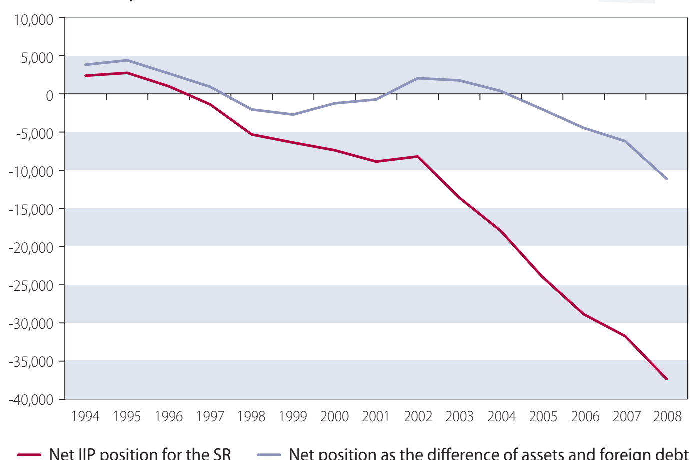
IIP data is also integrated into the national accounts system for the preparation of the financial account of "the rest of the world", although institutional structure by sectors provides more detail in national accounts and is not in full compliance with the data on balance of payments and the IIP.

IIP of the Slovak Republic

The NBS has prepared the IIP for the Slovak Republic from 1994 on an annual basis. The data is prepared in compliance with the methodology of the fifth issue of the Balance of Payments Manual of the IMF. In 2001, the Slovak Republic fulfilled the criteria relating to the structure, scope, periodicity, and deadlines for publishing the statistical indicators within the SDDS IMF Project. The IIP is one of 17 basic statistical aggregates included in this project. The SDDS represents a special format of statistical data publishing in which the countries undertake to comply with the required structure, periodicity, and timeliness of the relevant data and publishing the metadata for the relevant categories.

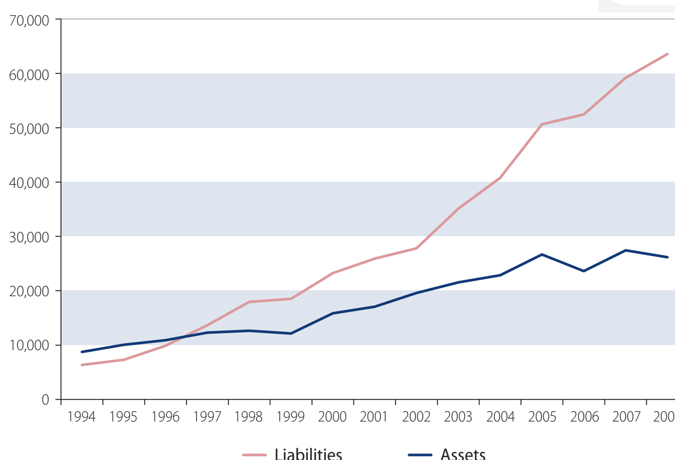
From 2001, the NBS has prepared and published the IIP in compliance with SDDS requirements on a quarterly basis 6 months after the end of the reported period. A part of data published is also the site of metadata describing the basic

Chart 1 Net position of the SR (in EUR millions)



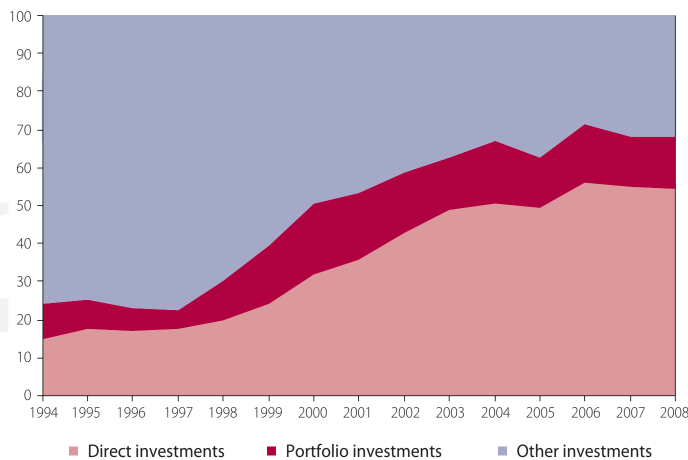
Source: NBS.

Chart 2 Development of the position of foreign financial assets and liabilities of the SR (in EUR millions)



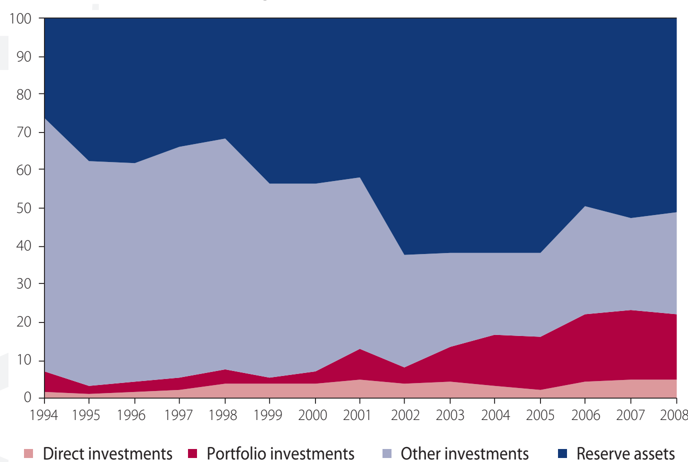
Source: NBS.

Chart 3 Structure of financial liabilities in the SR (in %)



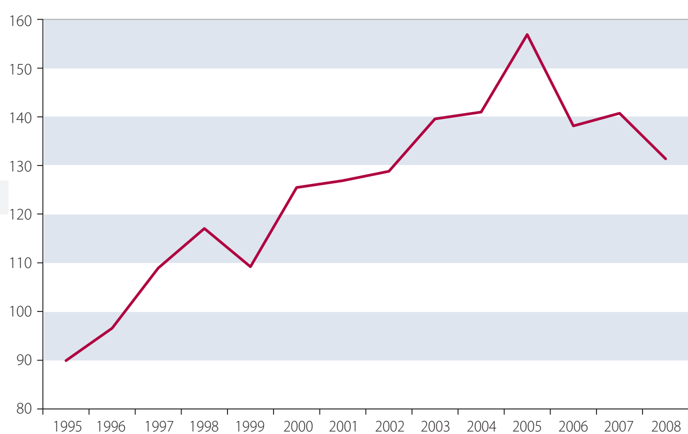
Source: NBS.

Chart 4 Structure of foreign financial assets of the SR (in %)



Source: NBS.

Chart 5 Gross assets and liabilities / GDP (in %)



Source: NBS.

characteristics of data, methodology applied, basic data resources, periodicity, and deadlines for publishing.

In respect to the SR access into the euro area the necessity emerged to fulfil the ECB requirements also in the field of the IIP statistics, which causes higher demands on the scope and quality of statistics presented.

The basic change is represented by the requirement of reducing the deadline for preparation and publishing to three months after the end of the reported period, and preparing the IIP in geographical structure. The quarterly IIP is prepared in addition to the overall position against abroad also separately for countries outside the euro area, which is an essential condition of preparing the euro aggregates of the ECB against the rest of the world. The annual IIP for ECB needs is also prepared separately for selected countries outside the euro area representing the major economic parties to the euro area or risk areas (the U.S.A., Russia, Canada, China, Japan, Switzerland, Norway, Brazil, Hong Kong, India, offshore centres, Great Britain, Sweden, Denmark and other EU countries outside the euro area). The fulfilment of the above criteria required major changes in the system of IIP preparation and represented a significant increase of activities relating to data collection and processing, and especially the preparation and control of the required statistics.

An essential condition were the major changes in the statistical reports for respondents in the area of commercial banks, securities dealers, and management companies, but also for the non-financial sector that significantly increased workload in the area of statistics. The NBS fully complies with ECB requirements relating to the scope, structure, periodicity, and timeliness of data in the area of IIP statistics.

Basic analytic view of IIP

IIP data provides for analysis both from the point of gross position and the analysis of net items. The difference between foreign financial assets and liabilities in the IIP represents the net position of the economy which in fact shows what the relevant economy owns against what it owes. To describe the net position, the term net debtor or net creditor is often used in respect to non-residents. Although the stated term may be useful in some instances, for analytical purposes for the calculation of the net position it is more appropriate to understand as a debt only the non-equity items of the position, i.e. to determine the net position as a difference of financial assets and foreign debt. In the case of the SR, the difference between the net position of the IIF and the net position counted to the foreign debt in 2008 represents the value of EUR 26 billion.

Over the last 15 years, the foreign financial assets of the Slovak Republic increased three-fold and liabilities almost ten-fold. The most significant share of the growth of liabilities was the increase of the position of direct foreign investments, the position of which increased up to 35 times and in the structure of liabilities represents 55% (15% in 1994). At present, direct foreign investments – as can be seen from Chart 3 – represent the main foreign resource of economy financing– unlike in

1994 when up to 76% of liabilities were foreign credits. From the point of economy financing the resources structure has improved significantly, because direct foreign investments do not put pressure on increasing foreign indebtedness.

On the side of assets, the most significant increase was recorded in reserve assets and it related to the sterilisation of foreign exchange incomes from privatisations and the NBS intervention policy on the foreign exchange market.

IIP as the economy's financial openness index

IIP data represents one of the most significant indices of the economy's financial openness index. Considering the significant growth of international financial transactions of the private sector over the last thirty years, the ratio of gross foreign financial assets and liabilities to GDP in the economically most developed countries has been rising sharply (in the Economic and Monetary Union countries several times).

A similar development was also recorded in the case of the SR, where in spite of a short time sequence the trend of the economy's financial openness growth is evident, as the ratio of gross foreign assets and liabilities to GDP increased from 89% in 1995 to 135% in 2008.

Conclusion

The IIP provides a complex database about international financial relations in a detailed structure. The practical problems of preparing it and the missing detailed geographical and especially monetary structure, make its use for analytical purposes in the monetary policy area more difficult.

IIP analysis provides for better ex post identification of the occurrence and development of financial crises caused by the insufficient monitoring of financial openness or non-sustainable level of foreign debt. It is still a question whether this aggregate can be used ex ante as the indicator for corrective measures' implementation.

Practical experience shows that the IIP is more useful for reverse analyses and explanation of past events than for predicting future economic development or implementation of economic and monetary decisions, which is significantly influenced by the low periodicity of preparing and the significant time lag of final data publishing.

It is clear that the expected or real steps of monetary institutions influence the investment behaviour of individual entities and their net foreign asset position. It is quite difficult to estimate the size of this impact considering the necessity to consider several parameters. Monetary policy influences more gross financial assets and liabilities than the net position. Moreover, such influences must be differentiated from the point of length and liquidity of relevant investments and type of economic entity.

From the point of IIP use in the monetary policy area, the analysis of gross assets and liabilities (especially their individual sub-items) is much more significant than the value of net IIP position, also because of the fact that its value and trend can be hardly predicted. More serious inclusion of the IIP among operating indicators is conditioned in addition to the already fulfilled condition of data timeliness within the Economic and Monetary Union countries (months after the end of the quarter), especially by the improvement of comparability between the aggregates of individual countries relating mostly to the harmonisation of the method of investment valuation and the better quality and accuracy of data.

The ECB therefore stresses the data quality improvement of euro area Member States, harmonisation of methodology of preparing and valuating individual IIP items especially in the area of direct and portfolio investments, and the implementation of a more detailed graphical structure of data as well as structuring data according to the currency at least for the main counter parties which gives better options for the analytical application of the IIP.

BIATEC

New world economy leaders

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The changing global financial architecture also brings some surprises in the distribution of economic power between the countries of the world. The global crisis is deepening the differences between economies even further. The crisis is a result of the global imbalance which can be seen in the evolution of savings and investment, the current account balance as well as in the evolution of exchange relations and the resulting foreign exchange reserves. The International Monetary Fund regularly classifies countries into groups (advanced, developing and emerging economies) and this classification[1] enables us to better understand the relations that are created between economies and to reveal potential future risks.

Assessing the global economy evolution[2], we can say that, since 2000, the advanced economies have seen a current account balance deficit while the emerging economies, by contrast, a current account balance surplus. Exchange relations evolution in the advanced economies is more stable in comparison with the emerging economies (as the international trade of emerging countries is significantly influenced by the prices of commodities with lower added value on the world market which prevail in their international trade structure), while savings in the emerging countries are considerably higher and, in comparison with the advanced economies, they are not fully used for investment.

Thanks to their lower development level, the emerging countries create a basis for the supply of new investment. They create higher savings than they can consume or invest, a cheap labour force in these countries implies the lower production cost utilized by foreign companies, their international trade is growing, the economies are becoming more open, new and more foreign exchange reserves are being created which need to be invested reasonably. This is why the emerging economies are becoming the 'driving engines' of the current global economy.

Speaking of the new world economy leaders, we could say that the following economies, called BRIC, Next 11, MENA and VISTA, will potentially play a significant role in international financial relations in the future.

NEXT 11 GROUP

It was the chief economist of the Goldman Sachs investment bank, Jim O'Neil, who first used the name of BRIC in his study in 2001; four years later (12 December 2005) he further developed the idea and came up with a new abbreviation, N-11. We have spoken about the BRIC countries in this magazine this year; let us therefore focus on the other leaders.

The following countries are part of the Next Eleven (N-11): Bangladesh, Egypt, Indonesia, Iran, Mexico, Nigeria, Pakistan, Philippines, South Korea, Turkey and Vietnam. According to analysis made by O'Neil, the order of the countries included in the list of the economically most powerful countries will change considerably in 2050. China will rocket to first place from fourth, India to second from eleventh; similar 'leaps' will be made by Brazil and Russia.

When choosing countries to include in this group, the criteria of the so-called *Growth Environment Score (GES)* were used, such as the inflation rate, state budget deficit, public debt, volume of investment, openness of the economy, education level and quality, political stability, corruption rate, legislation power, use of modern technologies (the Internet, mobile communication, computers), etc.

Even though the N-11 as a whole will not have a global economic influence, it is an interesting destination for conservative investors to locate their investments.

It is clear at first sight that the economies that have found their place in the group are really varied. Nonetheless, we could summarize the differences between the N-11 countries in the following way:

a) various geographical areas are represented;
b) they are countries with different levels of economic capacity value. Mexico, South Korea, to a smaller extent also Turkey and Vietnam, have the potential to become competitors to the advanced economies. Other countries may play a significant role too if they maintain their economic growth in the future. Maybe they will not compete with the BRIC countries, but they can certainly do so with the G7 countries. For example, Bangladesh is one of the poorest countries in the world but on the other hand, 4 out of the 11 countries have a higher foreign trade turnover than China – the most open of the BRIC economies;

1 *World Economic Outlook October 2009 – Sustaining the Recovery. Washington, D.C.: IMF 2009, 208 p. [quoted on April 1 2010] available at http://www.imf.org/external/pubs/ft/weo/2009/02/pdf/text.pdf.*

2 *Kotlebová, J. – Chovancová, B.: Medzinárodné finančné centrá – zmeny v globálnej finančnej architektúre (International Financial Centres – Changes in the Global Financial Architecture). First edition, Bratislava, Iura Edition, 2010, 484 p.*

c) the number of inhabitants in the N-11 countries is significantly different. E.g. the population of South Korea is about 50 million, of Indonesia about 200 million;
d) economies with different levels of development of financial markets are a part in the group.

From the results shown in Chart 1, the highest standard of living can be seen in South Korea; by contrast, Bangladesh is the poorest economy with about USD 500 GDP per capita. At the same time, we can see a gradual increase in the capacity value of these economies from 2005. This is even more significant taking into account that the population of all these countries is high and it keeps on increasing. Between 1980 and 2008, the greatest increase was seen in Pakistan (110.8%) and the lowest in South Korea (28.4%). In 2008 Indonesia had the biggest population (228.9 million), South Korea the smallest (47.6 million).[3] Population growth suggests the rise of the consumer market, the rise of the demand for goods and services, so it is a mobilizing factor for economic growth.

All the N-11 economies are emerging market economies. We can divide them into emerging, developing and newly industrialized economies. The IMF places newly industrialized economies among the advanced economies. From the N-11 group, South Korea is considered to be a newly industrialized economy; Bangladesh, Iran, Nigeria, Pakistan and Vietnam are ranked among developing countries, while the others (except for South Korea) are ranked among emerging economies. With its high industrialization rate and relatively stable macroeconomic environment, South Korea is one of the top N-11 countries. It is largely characterized by modern technologies while its export is focused on high-quality products and related sophisticated services. On the other hand, we may mention Bangladesh which is focused on the export of primary products in its international trade, while Nigeria is a significant exporter of oil and semi-products. Turkey has good prospects, being an EU-associated country.

According to the IMF, only South Korea and the Philippines will have a positive current account balance in 2009 and 2010. In the past it was mainly Nigeria and Iran, thanks to their strong exports.

Any further rapid advance of the N-11 economies may be obstructed by political problems, e.g. in Pakistan or Bangladesh, by terrorist activities in Philippines, but also by instability in Nigeria and Turkey. Nigeria is politically the least stable country but, if the government is successful in pursuing its plans, it can be an example for other African countries thanks to its size.

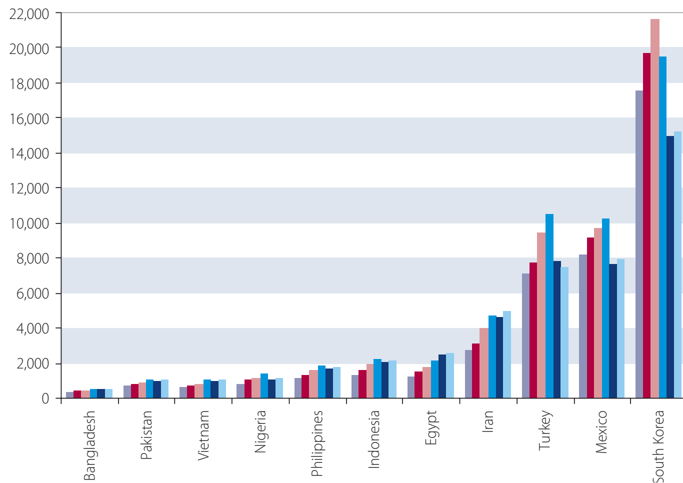
VISTA GROUP

The following countries are part of the so-called VISTA group: Vietnam, Indonesia, South Africa, Turkey and Argentina. The name was created by putting together the first letters of the English names of its member countries. Vietnam, Indonesia and Turkey have already been mentioned in relation to the Next-11 group.

The VISTA countries represent a bloc of economies with different geographic locations and different economic development. The strongest economy of the group is Turkey, followed by Argentina and South Africa. Taking into account the GDP per capita, Vietnam is the weakest member of the grouping. The performance of these economies has been stable in the last five years and, in spite of the current financial crisis, this group has managed to maintain its economic growth rate. In general, GDP per capita of these countries ranges from USD 636 (Vietnam) to just over USD 10,000 (Turkey).

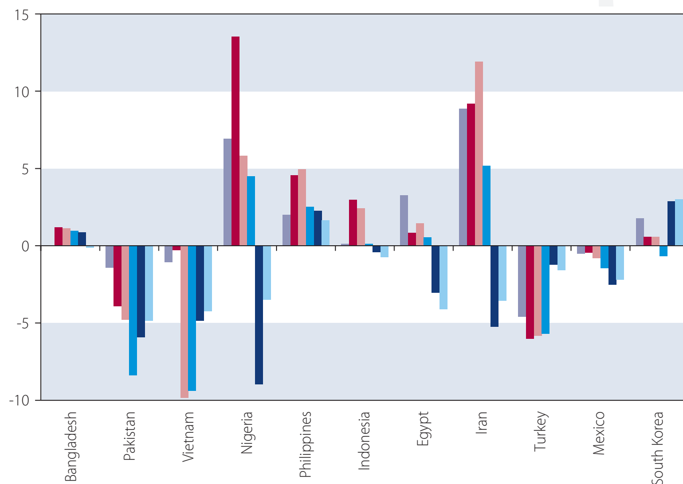
Out of all the VISTA group members, only Argentina maintains a surplus current account balance; the other countries see more or less a deficit in their current accounts, while the biggest deficit growth has recently been seen in Vietnam; in the

Chart 1 GDP per capita in N-11 countries in USD in 2005–2010 (in USD)



Source: Collated by the author; www.imf.org data used.

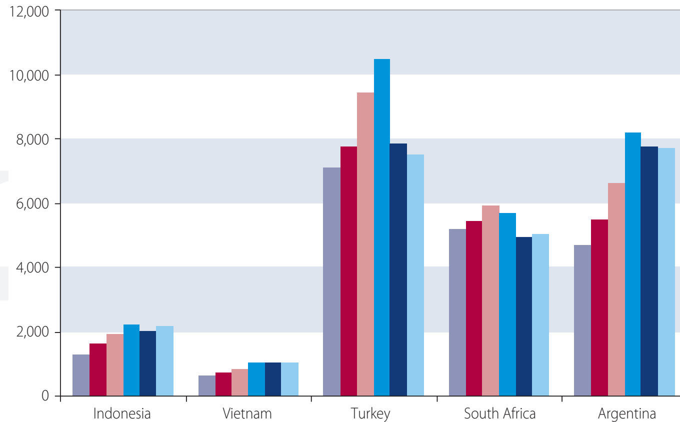
Chart 2 Current account balance in N-11 countries in 2005–2010 (in % GDP)



Source: Collated by the author; www.imf.org data used.

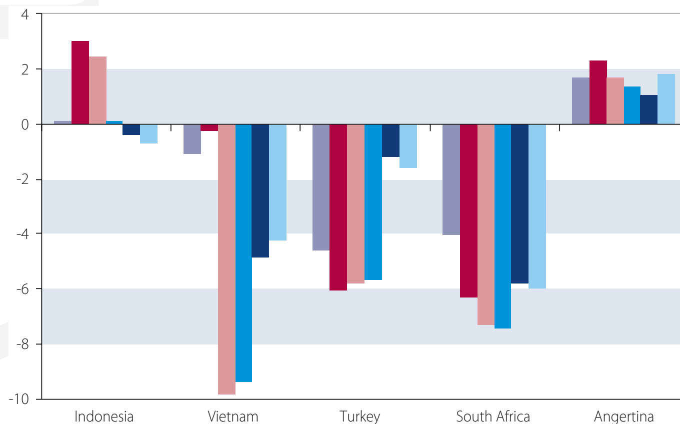
3 MEDIA EGHBAL. 2008. The Next 11 emerging economies. [quoted on April 1 2010]. Available at http://www.euromonitor.com/Articles.aspx?folder=The_Next_11_emerging_economies&print=true.

Chart 3 GDP per capita in VISTA countries in USD in 2005–2010 (in USD)



Source: Collated by the author; www.imf.org data used.

Chart 4 Current account balance in VISTA countries in 2005–2010 (in % GDP)



Source: Collated by the author; www.imf.org data used.

case of Turkey and South Africa we can refer to a long-term problem.

From the global economy perspective, the greatest potential of the VISTA countries is their strong and steady economic growth, and the richness of their natural resources; they enjoy a young labour force, attractive investment opportunities, political stability and growing home consumption. On the other hand, some problems may arise as a result of high inflation and an inadequate infrastructure development. However, potentially high investment revenues in comparison with US markets may be accompanied by a higher risk rate resulting from the lower development of financial tools. Compared to the BRIC countries, they are interesting destinations for investment, but not as attractive. It is very difficult to find common features for the VISTA countries; a growth in bilateral cooperation would be a factor strengthening this bloc. This market is able to accept large investment; however, it must also strengthen its independent financial consultancy and inform potential investors of the investment possibilities in these countries.

MENA GROUP

The following countries are members of the so-called MENA group, whose name was created from the English name of the particular geographic area (Middle East and North Africa): Algeria, Bahrain, Djibouti, Egypt, Iran, Iraq, Israel, Jordan, Kuwait, Lebanon, Libya, Morocco, Oman, Palestinian areas (West Bank and Gaza Strip), Qatar, Saudi Arabia, Syria, Tunisia, the United Arab Emirates and Yemen.

The inhabitants of the MENA region account for 6% of the world's population, which is about one third of the population of China. The number of inhabitants is probably close to that to the European Union and is about 1.25 times higher than the USA. The main resources of the region come from oil and gas. According to the Oil and Gas Journal dated 1 January 2007, this region contains 70% of world oil reserves (797.04 billion barrels) and 46% of world gas reserves. Eight of the 12 OPEC members are part of the MENA region.

From the point of view of GPD per capita, Qatar is undoubtedly the richest economy of the bloc, followed by the United Arab Emirates, Kuwait and Israel.

Looking at their resources, integration in the world economy and macroeconomic conditions, these countries can be divided into four groups:[4]

1. Members of the Cooperation Council for the Arab States of the Gulf (GCC) – characterized by a high 'hydrocarbon' income per capita, adequate public resources and a strong institutional capacity for implementing macroeconomic and structural policies;
2. Other oil exporters with a relatively lower 'hydrocarbon' income per capita, scattered population, limited public resources and a limited institutional capacity for implementing macroeconomic and structural policies;
3. non-oil exporters with significant financial flows with GCC countries or dependent on foreign development aid;
4. non-oil exporters with diversified economy and a strong trade with the EU. Even if their public resources are limited, they have a good institutional capacity for implementing macroeconomic and structural policies.

We further divide them into three groups according to their resource base and their labour force:[5]

- RPLA (resource poor, labour abundant): Djibouti, Egypt, Jordan, Lebanon, Morocco, Tunisia, Palestine;
- RRLA (resource rich, labour abundant): Algeria, Iran, Iraq, Syria, Yemen;
- RRLI (resource rich, labour importing): Bahrain, Kuwait, Libya, Oman, Qatar, Saudi Arabia, the United Arab Emirates.

The global financial crisis has had no significant impact on the macroeconomic development of this region. This is caused by several factors, among the most important being high oil prices (their export article) which can compensate for potential losses in economic growth. The financial

4 http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/MENAEXT/
5 MENA Economic Developments and Prospects: Regional Integration for Global Competitions. 2008. www.worldbank.org.

markets of the MENA countries are not closely integrated with the American or European markets; the better macroeconomic results of this region in the past, compared to other countries, created a strong base.

The average GDP growth rate of these countries since 2005 has been about 5% (except for Qatar with 15%).

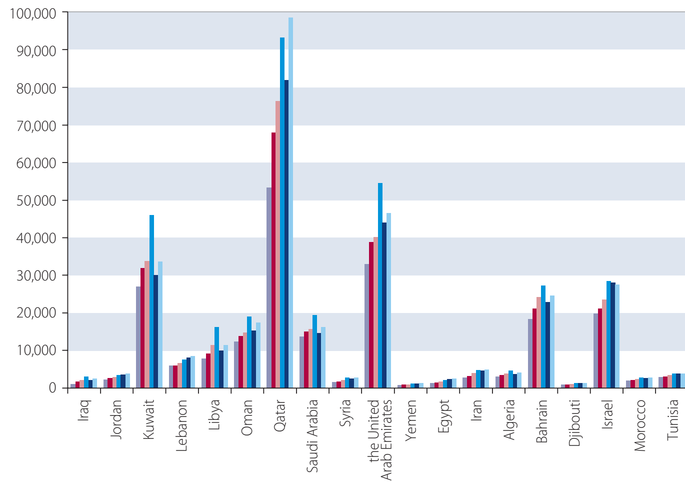
The biggest current account balance surpluses are seen in Kuwait, Libya, Qatar, the United Arab Emirates and Algeria; on the other hand the biggest deficits can be seen in Djibouti, Jordan and Lebanon.

In this bloc it is interesting to watch the economic integration of the members of the Cooperation Council for the Arab States of the Gulf (GCC) – Bahrain, Kuwait, Qatar, Oman, Saudi Arabia and the United Arab Emirates. In 1983 a free trade area was created among the member countries, in 1999 the member states representatives adopted a plan to establish a customs union up to 2005. In 2000 the member states signatories agreed to 'peg' the different currencies of the member states to the US dollar as a first step towards the creation of a monetary union and the adoption of a single currency in 2010. The customs union was created as early as 2003 and in 2007 the common market creation was completed.

According to unofficial information, a common central bank of the union should have its seat in the United Arab Emirates, but the final decision has not yet been made. As for the currencies of these countries, they were pegged to the US dollar (except for Kuwait -using a basket of eight currencies with the US dollar dominating). Oman and the United Arab Emirates have withdrawn from the monetary union project. Several studies have been made of the success of this monetary union, e.g. Laabas, B. and Limam, I.[6] state that the mutual trade among GCC member countries is somewhat limited, slowing the integration process. On the other hand, the countries should enhance their specialization and make their industrial sectors, not just the oil derivatives industry, more technically sophisticated, which could then boost their mutual trade. A high level of control is also applied on incoming direct investment, having a different form (e.g. limited capital ownership, limiting certain activities). According to the authors referred to above, the business cycles in the GCC countries are not quite synchronized; different countries respond asymmetrically to the same oil shocks. As for the convergence criteria, they should be based on the criteria valid for the economic and monetary union of Europe. However, Sturm, M. and Siegfried, N.[7] claim that, in the case of the GCC countries, there will be no criteria for joining the monetary union, as the countries have much in common in the currency issues given their foreign exchange regime, but they will be the criteria for higher convergence in the public finance area.

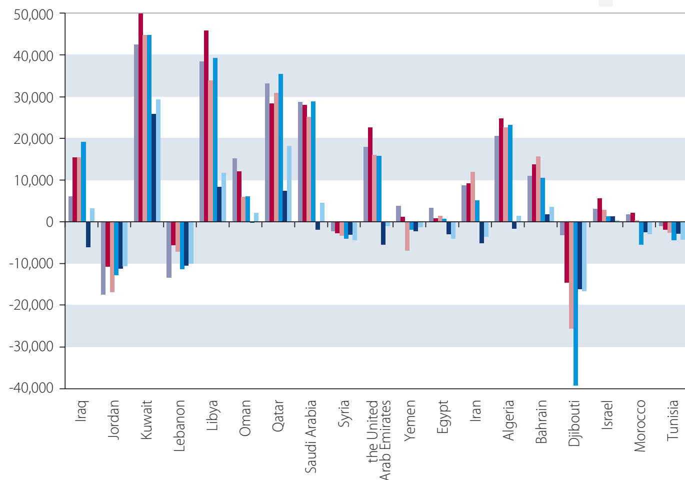
Bearing in mind that they are countries rich in oil and that oil, as a physical commodity as well as

Chart 5 GDP per capita in MENA countries in USD in 2005–2010 (in USD)



Source: Collated by the author; www.imf.org data used.

Chart 6 Current account balance in MENA countries in 2005–2010 (in % GDP)



Source: Collated by the author; www.imf.org data used.

a paper investment asset, is currently a very interesting article, the change in its price has a direct impact on the price level on a global scale (not only in the automobile industry but also in other areas of economic life). It will be very interesting to watch the policy of this monetary union, the exchange rate evolution of their new currency (a currency basket is being considered), but in particular its impact on the oil market evolution and on the development of international monetary relations. At the moment, the GCC countries are largely trying to eliminate the impact of the volatility of the US dollar exchange rate on the oil price.

Summary

Due to the restricted size for this contribution, it was not feasible to perform deeper analysis of these economies. Nevertheless, we can even now see certain trends which will have a significant

6 *Belkacem Laabas – Imed Limam: Are GCC Countries Ready for Currency Union? Economists at the Arab Planning Institute. Kuwait April 2002, available at: http://www.arab-api.org.*

7 *Sturm, M. – Siegfried, N.: Regional Monetary Integration in the Member States of the Gulf Cooperation Council. ECB Occasional Paper Series No. 31. Frankfurt am Main. June 2005.*

impact on the world economy development. The global crisis is also playing with the extent and intensity of global imbalance. Currently, the emerging economies see a higher average inflation rate in comparison with the advanced economies. Higher interest rates have an impact on investment growth; on the other hand, the currency depreciation resulting from higher inflation is pushing savings creation to decrease at the benefit of an increase in consumption. In the advanced economies the current account balance deficit is often linked to the public finance deficit (*'twin deficits'*), while more of these economies are going through a disinflation or even a deflation process. Interest rates, influenced by the easing monetary policy, are low; still they are not a sufficient stimulus for investment growth. Short-term expectations of a price decrease cause consumption to be postponed. On the other hand, the deepening public finance deficits for the future will cause inflation to rise. It is a paradox that, after an exhausting struggle against inflation in the past years, it is precisely inflation that could trigger the economic recovery.

Silver collector coin

Martin Kukučín – 150th birth anniversary

Ing. Dagmar Flaché
Národná banka Slovenska

In May of this year, Národná banka Slovenska issued a silver collector coin on the occasion of the 150th anniversary of the birth of Martin Kukučín, an important representative of Slovak literature, a prose-writer, dramatist and publicist.

Martin Kukučín (17 May 1860 – 21 May 1928) is one of the most important and, at the same time, one of the most popular of Slovak writers. His prose works of art manage to engage even the contemporary reader with their lively, natural language as well as with their timeless topics. He introduced the characters of ordinary rural people to Slovak literature, with their everyday life and folk language, which was a breakthrough event, influencing the further development of Slovak prose and literary language. Kukučín's most widely known works are the short humorous prose works from the village environment (*Rysavá Jalovica*) or from the student milieu (*Mladé letá*). His other works are also important – the psychologically incisive novelette *Neprebudený*, the novelette *Dve cesty* with death and the search for an explanation for earthly existence as its theme or even the novelette *Dies irae*, where the problem of guilt in human relations is addressed. His best known novel *Dom v stráni* originated during his lengthy occupation as a physician in Selce on the island of Brač. After fourteen years on Brač, he decided to work as a physician in the colony of Croatian immigrants in Punta Arenas in Chile, where, as well as travel sketches, he also wrote his most extensive novel *Mať volá.*

Národná banka Slovenska announced an anonymous public tender for the art design of the coin. NBS cooperated in preparation of the tender with the Institute of Slovak Literature of the Slovak Academy of Sciences, whose employee, PhDr. Marcela Mikulová, CSc., also acted as an expert consultant in the tender evaluation process. A great deal of valuable information and photographic documentation relating to the life and work of Martin Kukučín was provided by the Archives of Literature and Arts in Martin.

Eleven authors took part in the tender, submitting twelve competitive proposals. The commission of the NBS governor on assessment of the art proposals for Slovak euro coins concluded that the most appropriate outcome for the coin realization is a combination of the proposals from two authors, the obverse from Miroslav Rónai and the reverse from Mag. Art. Peter Valach. Both proposals were awarded the second prize as equals. What the commission assessed as positive on the obverse they selected was a fine expression of the given theme and a balanced composition with a depiction of the typical environment on the island of Brač, where Kukučín spent a great part of his life, as well as an authentic "house on the hillside" from his best-known novel with the same title. In the commission's judgment, the portraits on the reverse submitted as an alternative were not altogether persuasive, and they did not fully embody the personality of Martin Kukučín. What impressed the commission on the reverse they selected was the sculptural quality of the portrait, which the commission appraised as succinct and characteristic. The inclusion of a cuckoo, as a reference to the assumed name of the writer, was also appreciated by the commission. The composition is appropriately completed with a facsimile of the author's signature with his civil name: Dr. Matej Bencúr. According to the commission, the animal motifs on the obverse do not fully represent Kukučín's vast work and are narrowly focused on one part of it only. Following the recommendation of the commission, the author of the reverse adjusted the writing in his proposal to the writing included on the winning obverse and he inserted the inscription MARTIN KUKUČÍN in the circular script.

The third prize in the tender went to Mária Poldaufová. Her proposal attracted interest by the realistic portrait shown on the reverse. For the obverse, the author selected the motif of the writer's birthplace.

The silver collector coin, in a nominal value of 10 euro, with a diameter of 34 mm and weight of 18 g was minted from silver with a purity of 900/1000 in the Kremnica Mint. Deeply engraved on the edge is the inscription "PROZAIK – DRAMATIK – PUBLICISTA" (prose writer – dramatist – publicist). Within the limited number of 30,000 pieces, 7,500 pieces have been minted in brilliant uncirculated quality execution and 9,300 pieces in proof quality.

Coin produced on the basis of the design of the obverse by Miroslav Rónai and the reverse by Mgr. art. Peter Valach.

Second prize
Reverse by Miroslav Rónai

Second prize
Obverse by Mgr. art. Peter Valach

Third prize
Mária Poldaufová

Photo: Ing. Štefan Fröhlich

B I A T E C