C. BANKING SUPERVISION IN 1998

1. DEVELOPMENT OF THE BANKING SECTOR

At the end of 1998, Slovakia's banking sector comprised twenty-seven bank entities (twenty-five banks and two branch offices of foreign banks) and nine representative offices of foreign banks. Compared with 1997, the number of branch offices decreased by two owing to the sale of the Nitra branch of Banka Haná, a.s. Brno, and the Žilina branch of Moravia Bank, a.s. Frýdek Místek, to AG Banka, a.s. Banská Bystrica. The number of banks licensed by the NBS to conduct mortgage transactions was increased from three to four. ISTROBANKA, a.s. was added to the list of already licensed Všeobecná úverová banka, a.s., Slovenská sporiteľňa, a.s., and HypoVereinsbank Slovakia, a.s. At the end of the first half of 1998, the NBS approved the merger of two banks: Bank Austria (SR), a.s. Bratislava, and Creditanstalt, a.s. Bratislava, which took effect on 1 January 1999.

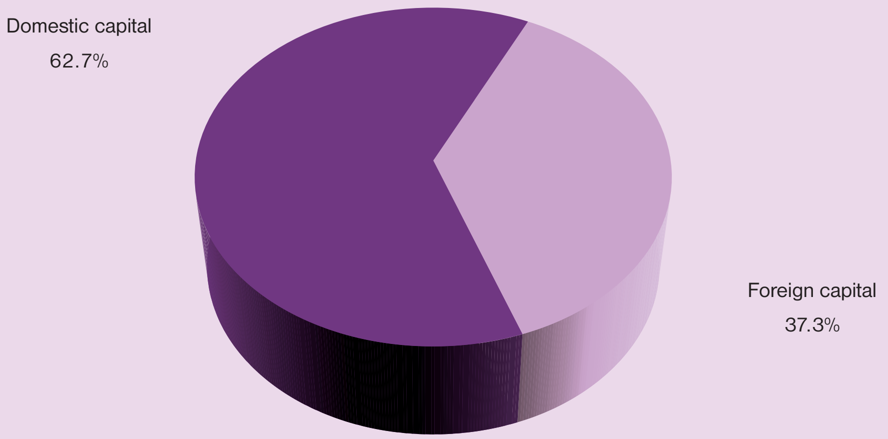
The total subscribed capital in the Slovak banking sector, including funds permanently provided to branch offices of foreign banks (excluding the NBS), grew from 31 December 1997 to 31 December 1998, with approval of the NBS in the course of 1997 and 1998, and by changes in volume of permanently provided funds, by Sk 2.6 billion, i.e. from Sk 32.0 billion to Sk 34.6 billion. Five banks increased their registered capital in 1998.

The share of foreign capital in the total subscribed capital of banks and funds permanently provided to branches of foreign banks ranged between 35.5 and 39.2% during the year.

2. CHARACTERISTICS OF THE BANKING SECTOR

The banking sector as a whole developed at a slower rate than in previous years. The annual growth rate of total assets, primary and secondary resources, and loans fell by over half. The complicated development of the banking sector was reflected in its results. In the course

Structure of capital and permanently provided funds of banks and branches of foreign banks in the Slovak Republic as at 31 December 1998



of the year, banks focused mainly on transactions on the interbank market and trading in government securities, as a response to the general state of the economy, decelerated economic growth, and increased budget deficit.

The total assets of banks operating in the Slovak money market amounted to Sk 799.9 billion, representing a year-on-year growth of 2.9%, and the share of total assets of banks undergoing transformation in the cumulative volume of total assets had fallen by the end of 1998 to 45.8%, representing a year-on-year decrease by 6.9%. The volume of primary resources in the banking sector increased by Sk 14.5 billion (3.3%) to Sk 462.3 billion. The volume of secondary resources increased by Sk 8.8 billion (4.2%) to Sk 221.6 billion.

Total receivables from loans to customers amounted to Sk 585.1 billion, representing an increase by Sk 16.7 billion (2.9%). Of this total, classified claims accounted for Sk 145.1 billion, up Sk 25.0 billion year-on-year (20.8%) and special mentioned loans fell by Sk 7.1 billion (9.8%) to Sk 65.6 billion.

In 1998, the banking sector reported a profit of Sk 0.4 billion, which may be considered a positive development when compared with the aggregate loss of the previous year.

3. EVALUATION OF PRUDENTIAL BANKING BEHAVIOR

In 1998, as in previous years, the prudential conduct of banks was governed by the five decrees of the National Bank of Slovakia, based on international standards and recommendations of the Basle Committee on Banking Supervision. In evaluating compliance with the prudential regulations, the Banking Supervision Division of the NBS relied on analysis of accounting data and information provided in the regular reports of banks on capital adequacy, credit exposure, liquidity, regulation of foreign exchange positions, and on rules for evaluation of claims and off-balance sheet liabilities of banks according to the risks involved, and for the creation of provisions to cover such risks

Development of total assets in the Slovak banking sector

(classification of claims and off-balance sheet liabilities). The Banking Supervision Division utilises a banking information system based on early-warning financial ratios in evaluating developments and trends in individual banks, groups of banks, and the entire banking sector. With regard to the compliance with prudential standards in the banking sector as a whole improvement was recorded in 1998, first and foremost in the ratios of credit exposure and open foreign exchange position. Assessment of prudential behavior in the banking sector is conducted systematically also via on site inspections carried out by the Banking Supervision Division.

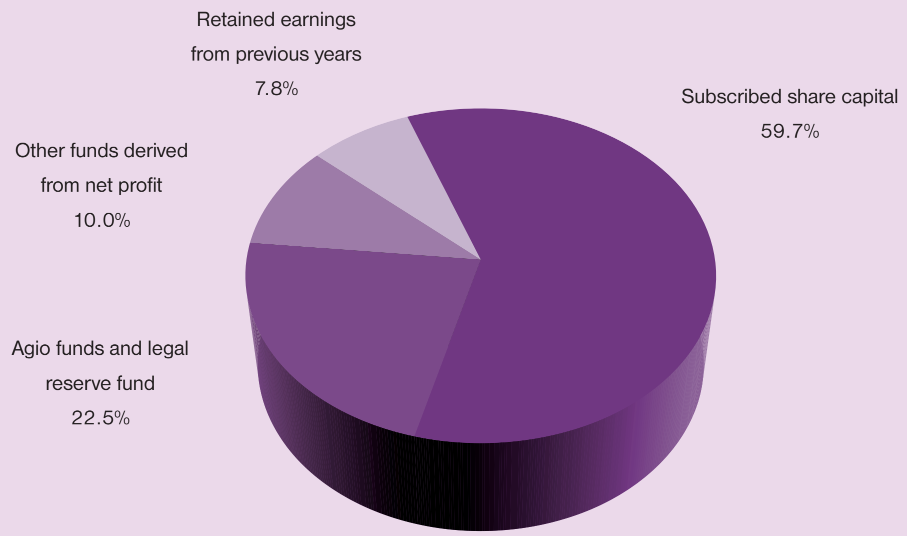
3.1. Capital Adequacy

NBS Decree No. 5/1997 on capital adequacy requires banks to maintain a minimum level of capital adequacy of 8%. As at 31 December 1998 deductible items exceeded capital in one commercial bank and one state financial institution, whilst five banks were found not to have complied with the obligatory capital adequacy limits.

Capital adequacy of evaluated banks operating in the banking sector of the Slovak Republic, decreased by 1.3 points over the year, to reach 8.7%. This negative trend results from a decline in capital applied to the calculation of capital adequacy, in contrast to the dynamic growth in volume of risk weighted assets.

The total capital applied in the calculation of capital adequacy to 31 December 1998, decreased year-on-year by about Sk 3 billion (8.6%) to Sk 32.4 billion. Risk-weighted assets of banks in the banking sector of the Slovak Republic increased by Sk 19.4 billion (5.5%) to Sk 372.1 billion. The decline in capital applied in the calculation of capital adequacy in the banking sector as a whole, was due primarily to growth in deductible items, particularly uncovered estimated loss, while the increase in general reserves set aside to cover losses resulting from banking activities including subordinated debts, was insufficient to eliminate the effect of growth in deductible items.

Structure of capital applied for the calculation of capital adequacy (at 31 December 1998)



3.2. Credit Exposure

Under the NBS Decree No. 3/1994, banks are required to carry out a monthly monitoring of their credit exposure to potential loss caused by high credit exposure to a single borrower, or an economically linked group of borrowers. Net credit exposure to non-bank customers must not exceed 25% of a bank's capital, or 80% to other banks, and the total amount of individual net credit exposures, which in each case exceed 15% of the bank's capital, must not exceed 800% of the bank's capital.

During 1998, eighteen banks were found to have overstepped the net credit exposure limit applied to non-bank borrowers, while sixteen had broken the limit for lending to other banks. The limit on the aggregated amount of reported loans was exceeded by nine banks. Failure to meet this limit was due mainly to insufficient capital strength, inherited high loan exposure from the past, higher level of lending activity of some banks, and the change in methodology contained in the amendment to the decree on capital adequacy. However, development was on the whole positive, and the number of banks exceeding the limit was less than in the previous year.

3.3. Liquidity

Apart from the monetary instruments applied by the National Bank of Slovakia, liquidity was influenced by the actual situation and market developments, characterised by a continuing shortage of mainly long-term, and to a lesser extent, medium-term funds, chronic problems of the capital market, insufficient number of powerful investors, tax legislation, etc.

The combination of these factors was reflected in the shortage of liquid funds and the subsequent failure of certain banks to comply with the minimum reserve requirement, in mismatch in maturities of resources and their use, resulting in a significant increase in interest rates on the interbank money market. The most serious problems with liquidity and, subsequently, with meeting minimum reserve requirements, occured in banks undergoing transformation. By December 1998, however, all banks had met the prescribed minimum reserve requirement.

The NBS Decree No. 7/1997 tightening the rules of liquidity management, required banks and branch offices of foreign banks to maintain a 70% ratio of assets to liabilities due within one month (by September 1997), and to increase the coverage to 85% (by February 1998), and to 100% (since March 1998). Eighteen banks failed to meet these requirements in 1998.

3.4. Foreign Exchange Positions

The NBS Decree No. 11/1997, pertaining to the regulation of open foreign exchange positions of banks, sets out the rules for prudent banking operations in foreign currencies. For the difference between assets and liabilities in individual currencies calculated in Slovak crowns, the Decree sets a limit of 10% in relation to the bank's capital, and for the aggregate open foreign exchange position, a limit of 25%. Following the adoption of banking supervision measures against banks failing to meet the required limits, except for banks undergoing transformation, risks taken in open positions in the course of the year were mostly short-term in nature, and the number of banks failing to meet this requirement showed marked a decrease.

3.5. Classification of Claims

Decree No. 3/1995 sets out uniform requirements for reporting and evaluating the claims and off-balance sheet liabilities of banks and branches of foreign banks, with respect to the risks involved and the need to set aside funds to cover those risks.

The development of classified assets showed a marked deterioration in 1998, but banks failed to create sufficient amounts of provisions. The volume of uncovered estimated losses of bank claims and off balance sheet liabilities increased year-on-year by approximately Sk 11,1 billion (91,9%) to Sk 23.3 billion. The volume of cumulative uncovered estimated losses in the Slovak banking sector laid primarily in banks undergoing transformation (Sk 19.8 billion, i.e. 85.1%) and one state financial institution (Sk 3.5 billion, i.e. 14.9%).