EUROPEAN BANKING DIRECTIVES AND THEIR IMPLEMENTATION IN THE SLOVAK REPUBLIC

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One of the basic conditions for successful transformation of a centrally planned economy into a market economy is creation of an appropriately developed competitive financial sector. In order to achieve successful transformation, this process needs to be implemented gradually. One of the essential conditions for the entry of the SR into the European Union (EU) is creation of a comparable legal environment regulating the banking sector

The white book divided the decisive directives of the EU in the area of financial services into two stages.

This division derives from the logic of the adoption of the legal norms of the EU and serves as a guide to harmonization of the legal order in the given area. The EU directives contained in the first stage are regarded as a general framework for working out and applying a more detailed legal order and contain basic principles, conditions and procedures in the given area, thus creating conditions for the effective functioning of a unified financial market. The EU directives assigned to the second stage are intended to lead to harmonization of the legal norms for the area of the financial market.

However, in practice individual countries consider for themselves which directives are advantageous for them to implement and when they should be implemented. For example, the Slovak Republic has partially dealt with all the directives of the first stage, while some belonging to the second stage have been dealt with more (for example, the Second Directive, which can be appropriately implemented together with the First) and some hardly at all.

The first stage of harmonization in the area of the financial market contains the following EU directives:

1. The First Directive of the Council no.77/780/EEC of 12th December 1977 on the coordination of the laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions (below only the „First Banking Directive“),

2. Directive of the Council no.89/299/EEC of 17th April 1989 on the credit institutions' own funds,

3. Directive of the Council no.89/647/EEC of 18th December 1989 on a solvency ratio for credit institutions,

4. Directive of the European Parliament and Council no.94/19/EEC of 30th May 1994 on deposit-guarantee schemes (below only the „Directive on Protection of Deposits“),

5. Directive of the Council no.91/308/EEC of 10th June 1991 on the prevention of use of the financial system for the purpose of money laundering (below only the „Directive against Money Laundering“).

The second stage of harmonization in the area of the financial market contains the following EU directives:

1. The Second Directive of the Council no.89/646/EEC of 15th December 1989 on coordination the coordination of the laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions, amending the First Directive (below only the „Second Banking Directive“),

2. Directive of the Council no.86/635/EEC of 8th December 1986 on annual accounts and consolidated accounts of banks and other financial institutions,

3. Directive of the Council no.93/6/EEC of 15th March 1993 on the capital adequacy of investment companies and credit institutions,

4. Directive of the Council no.92/121/EEC of 21th December 1992 on monitoring and controlling large exposures of credit institutions,

5. Directive of the Council no.92/30/EEC of 6th April 1992, on supervision of credit institutions on a consolidated basis.

The following directives in the given area are also part of the screening in the framework of the pre-accession negotiations with the SR:

1. Directive of the European Parliament and Council no.96/10/ES of 21st March 1996, which amended Directive no.89/647/EEC, where recognition of contractual settlement (netting) by the appropriate authorities is concerned,

2. Directive of the European Parliament and Council no.95/26/ES of 29th June 1995, which amended Directive no.77/780/EEC, Directive no.89/646/EEC, Directive no.73/239/EEC, Directive no.92/49/EEC, Directive no.79/267/EEC, Directive no.92/96/EEC, Directive no.93/22/EEC and Directive no.85/611/EEC with a view to reinforcing prudential supervision (worked out on the basis of an analysis of the causes of failure of supervision on a consolidated basis in the case of the collapse of the Bank of Credit and Commerce International (BCCI) in 1991, and therefore often called the „Post BCCI“ Directive (below only the „Post BCCI Directive“),

3. Directive of the Council no.89/117/EEC of 13th February 1989, which sets the obligations of the branches of credit and financial institutions established in a member state, but with their headquarters situated outside the member states, concerning publication of their annual account documents.

The subject of this article is to review the progress in dealing with the following EU directives in the area of the banking supervision:

1. The First Banking Directive,
2. the Second Banking Directive,
3. the Post BCCI Directive,
4. the Directive on Protection of Deposits,
5. the Directive against Money Laundering.

1. The First Banking Directive regulates the area of the adoption of regulations, norms and procedures, which remove obstacles to the provision of services across the borders of member states and to the establishment of branches. It also harmonizes the rules and conditions for issuing a licence to operate as a bank (minimal level of own funds, the requirement that the bank should be managed by at least two persons, who are fit and proper, submission of a business plan, concerning the activities to be carried out and the organizational structure of the bank), and defines the authorities which supervise banks and branches of foreign banks, as well as the procedures for cooperation among these authorities. It also regulates the relations of member states to third countries in this area.

This directive is mostly covered by act no.21/1992 Col. on Banks as amended by later legislation (below only the „Act on Banks“) and by decrees of the National Bank of Slovakia nos.5 and 6/1998, which regulate the process of applying for a licence to operate as a bank for a new bank or branch of a foreign bank and other matters. The areas which will need to be covered in future by the Act on Banks or the Act on the National Bank of Slovakia, with the aim of including all aspects mentioned in the directive in the Slovak legal order, are as follows:

1. To give further reasons or more precise reasons for the withdrawal of the licence to operate as a bank, including:

a) failure to start activity for 12 months from the issuing of the licence to operate as a bank,

b) failure to perform the licenced banking activity for a period of more than 6 months,

c) failure to observe the conditions stated in the licence to operate as a bank, which are the pre-condition for granting the licence to operate as a bank,

d) decline of the bank's own funds below the level of the initial capital required before granting the licence,

e) loss of ability to fulfill its obligations towards its creditors and especially insufficiently safe dealing with its assets.

2. Decisions about granting or not granting the licence to operate as a bank must be issued within 12 months from receipt of the application, regardless of whether the application is complete.

3. To emphasize the requirement that a bank or branch of a foreign bank should be managed by at least two persons.

4. To define the term „branch of a foreign bank“ as a legally dependent part of a foreign bank, which directly performs all or some commercial activities of a foreign bank, with any number of branches in one member state regarded as one branch.

5. To express the requirement of close cooperation among the authorities supervising banks (credit institutions).

2. The part of the Second Banking Directive, which sets the conditions for licencing a new bank, is included in the Act on Banks and in Decree of the NBS no.5/1998.

In the Slovak legal order, it is first of all necessary to completely harmonize the terms used in the First and Second Banking Directives, for example:

1. licenced banking activities in the Act on Banks, with activities subject to mutual recognition according to Annex to the Second Banking Directive, for other activities it will be necessary to obtain a licence from the host country,

2. a credit institution as a company, the commercial activity of which is receiving deposits or other repayable funds from the public and providing credits on its own account,

3. a financial institution as a company other than a credit institution, of which the main activity is acquiring shareholdings or performing one or more of the activities mentioned in points 2 to 12 of the Annex to the Second Banking Directive, that is apart from receiving deposits and other repayable funds from the public,

4. control, which is defined as the relationship between a parent company and subsidiary companies in the sense of the definition in article 1 of directive no.83/349/EEC from 13th June 1983 on consolidated accounts (below only the „Directive on Consolidated Accounts“). This relationship exists if the parent company:

a) owns the majority of voting rights of shareholders or members in another company (associated or subsidiary company),

b) has the right to appoint or dismiss the majority of members of the administering, directing or supervising body of another company (associated or subsidiary company, and is also a shareholder or member of such a company,

c) has the right to dominant control of a company (associated company) of which it is a shareholder or member, as a result of a contract concluded with such a company or some rule in its articles of asociation or a joint agreement in the event that the legislation by which such an associated company is directed enables it to submit to such agreements or regulations. A member state does not have to require that a parent company be a shareholder or member of an associated company, or

d) is a shareholder or member of a company and the majority of members of the directing or administering body of such a company (associated company), who were in their functions during the given financial year, during the previous financial year and up to the time when the consolidated accounts were compiled, were elected to their function only thanks to its voting rights; or it controls the majority of voting rights of the shareholders or members of such a company as a result of agreement with the other shareholders or members of the company (associated company),

5. qualifying holding, which is direct or indirect property participation in a company, representing 10% or more of the capital or voting rights or which enables the exercise of significant influence on the running of the company in which such property participation is found,

6. parent company, defined in articles 1 and 2 of directive no.83/349/EEC (according to art.2 for the purposes of article 1 point 1 a),

7. subsidiary company, which is a subsidiary company according to art.1 and 2 of directive no.83/349/EEC. In addition any subsidiary company can be regarded as a subsidiary company of the parent company which directs it,

8. home member state is the member state in which a credit institution obtained authorisation for its activity,

9. host member state is a member state in which a credit institution has a branch or in which it provides services, but did not obtain authorisation.

According to this directive, banks are obliged to maintain their own funds at the same level set on issuing the licence to operate as a bank. This requirment needs to be included in the Act on Banks.

After acceptance of the SR as a member of the EU, it will be necessary to consistently apply the principle of mutual recognition of bank licences, that is the host member state gives up the possibility to decide about granting a bank licence in favour of the home member state.

It will also be necessary to regulate the establishment of branches in the territory of other member states of the EU, in harmony with art.19 and 20 of the Second Banking Directive, that is, for example:

- to introduce an obligation to inform about this fact,
- to regulate the content of such an information (designation of members, address in the host member state, names of directors, plan of activity),
- to regulate the procedure of the home member state for dealing with such information (for example, setting of a three month deadline for declaring the position of the home member state according to the above mentioned article, to the host member state).

It will also be necessary to introduce an obligation to inform the European Commission in accordance with art.8 and art.9 of the Second Banking Directive. For example, this will concern information about all approved subsidiary companies directly or indirectly subordinate to one or more parent companies, which are directed by the laws of a third country, and cases in which such a parent company obtains property participation in an EU credit institution, so that this institution becomes its subsidiary. On the basis of such information, observance of the principle of national treatment and effective entry to the markets of third countries will be assessed.

Where setting the conditions for issuing a licence for a branch of a foreign bank is concerned, the Second Banking Directive abolished the possibility of requiring capitalization of the branch. Decree of the NBS no.6/1998 sets a level of permanently entrusted financial resources for a branch of a foreign bank, but this is not in harmony with the Second Banking Directive. To satisfy this demand of the Second Banking Directive, it is necessary to amend the Act on Banks and the above mentioned decree. Before accession to the EU, it will be necessary to abolish the special regulation of the licencing of branches of credit institutions from the countries of the EU.It is also clearly necessary to amend § 16 of the Act on Banks in accordance with the Second Directive, so that the case of a bank becoming a subsidiary company of another entity is subject to the prior approval of the supervising authority. In this context, it is appropriate to reconsider the possibility of introducing sanctions against the directors and leading employees of a bank, if not only the cited regulation, but also other regulations of the appropriate legal norm are violated. In this case, it is necessary to change the Act on Banks and decree of the NBS no.7/1998.

Regulation § 17 of the Act on Banks must also be harmonized with the Second Directive, in relation to the fact that the present Slovak legislation requires a procedure to obtain prior approval to acquisition of property participation in a non-bank entity, when surpassing set limits in relation to the equity of the non-bank company or the capital and reserves of a bank. However, the directive contains a prohibition of acquisition of qualified property participation exceeding certain limits (15 % and 60% of a credit institution's own funds in a company, which is not a credit or financial institution or a company performing activity according to the second section of art. 43 of directive 86/635/EEC, with the possibility of their being surpassed in certain exceptional cases. However, in such cases, the credit institution increases its own funds or adopts other appropriate measures. Article 12 point 8 also enables the application of a different solution, if the procedure briefly described above is not applied. Amendments to the Act on Banks and Decree of the NBS no.9/1998 are necessary for this purpose.

Slovak banking legislation will also need to include art.18 point 2 of the Second Banking Directive, on the basis of which the principle of mutual recognition of licences is applied in the case of financial institutions, which are subsidiary companies of credit institutions with their headquarters in the EU and fulfill other conditions mentioned in the cited article.

In the interest of applying the principle of free provision of banking services, the principle of control by the home member state will have to be introduced into the Slovak legal order before accession to the EU. According to this principle, supervision of the activity of a credit institution, including its activity outside the territory of its home state, will be carried out by the home member state. The host member state will give up some legal powers in harmony with art.14 point 2 of the Se cond Banking Directive, for example, supervision of the liquidity of branches of foreign banks.

A further area, which is not regulated on the necessary level in the Slovak legal order, is the area of mutual exchange of information during banking supervision. We are promoting legal setting of the conditions for data protection (it is necessary to precisely state that exchandet information will be used solely for the purpose of supervision, it cannot be given to a third party without the agreement of the provider of the information, and the information is subject to special protection) and exchange of all information, that is, not only that which is subject to banking secrecy, anong banking supervisors, auditors and other authorities, which supervise the financial market (for example the Office of State Supervision of the Capital Market) and the authorities responsible for bankruptcy and settlements procedures.

The directive recommends securing this requirement by concluding bilateral agreements (known as „Memorandum of Understanding" or „MoUS") in this area. It is also necessary to determine what information the appropriate authorities of the home member state and the host member state will provide according to art.7 point 1 of the First Banking Directive (for example, about the ownership structure of a bank, about the conditions of the issued licence, solvency and liquidity, credit exposure, internal control, accounting procedures).

3. The Post BCCI Directive, sometimes also called the Third Banking Directive (because it amends numerous provisions of the first two banking directives), which not only regulates the area of banking, but the whole financial market, strengthens the principle of prudential supervision of underlying institutions. The „close links" defined by the directive are those links among two or more physical or legal persons, which arise on the basis of:

1. participation – that is direct or indirect control of 20% or more of the voting rights or capital,

2. control – that is the relationship between a parent and subsidiary company (defined in art.1 points 1 and 2 of the Directive on Consolidated Accounts), or the similar relationship between physical or legal persons and a company, by which a subsidiary company of another subsidiary company is also regarded as a subsidiary company of the original parent company. A situation in which two or more persons are connected on a permanent basis to the same person by a control relationship is also regarded as a close link.

The directive also identifies cases where it is necessary to refuse to grant a licence to operate as a bank:

1. if particular close links hinder effective supervision,

2. if legislation and other legal norms or their application by a non-member state, regulating the activity of one or more persons with which a financial company has close links, hinders the effective supervision.

The supervisory authorities are also given the obligation to demand the provision of information required for tracing close links.

One of the further principles of this directive determines that the headquarters of a bank must be situated in the state, in which it was granted a licence to operate as a bank, and in which it actually carries out a substantial part of its activities. It also widens the circle of bodies, which exchange information for the purpose of effect ive supervision of banking (the clearing and accounting centre, central banks, authorities responsible for supervision of payment systems etc.). The conditions for exchange of information are precisely defined:

- the information must be used only for supervisory purposes,
- it must be subject to special protection,
- it cannot be published without the explicit permission of the party which provided it.

A further requirement relates to auditors, who are obliged to inform the bank supervision authority of the violation of legislative or other norms, which could lead to material losses, violation of the conditions set in the licence to operate as a bank, and any facts which could have a serious impact on the financial situation of the bank or on the management and accounting of the bank, as well as facts which could result in the auditor refusing to verify the accounts of the bank or having reservati ons over their verification. This obligation also applies to those auditors who supervise entities with close links to a bank.

This directive is only marginally covered by the appropriate Slovak banking norms, for example, the Act on Banks contains a requirement concerning the obligations of an auditor to declare facts, which could threaten the activity of the bank. It also introduces a definition of an economically connected group of clients, but it does not satisfy all requirements of the directive.

4. Directive on Protection of Deposits is included in act no.118/1996 Col. on protection of deposits and about amending and supplementing several Acts in accordance with act no.154/1999 Col.

The main differences, which need to be removed, are:

1. It is necessary to include in the Slovak legal order, the principle of protection of the deposits of legal persons (the system of gradually widening the range of legal persons subject to protection will be chosen. For example, first small businesses and tradesmen, later middle sized companies, and finally all legal persons). In connection with the widened circle of persons, whose deposits will be subject to protection, it will be necessary to precisely determine, which legal persons do not receive this protection, for example, this will concern the deposits of other banks, insurance companies, government bodies, local authorities, pension funds, closed funds.

2. Determination of the maximum level of coverage provided in the case of inaccessible deposits (the required level of refunding of an inaccessible deposit is 20,000 EURO) at the same level as in the EU. The system of gradual raising of the level of refunding of inaccessible deposits is justified by the economic environment in the SR (otherwise the aspect of moral hazard could come into the foreground). It would also be appropriate to consider more exact definition of the term „inaccessible deposit" in accordance with the directive, that is, as follows: „the appropriate authorities will determine that in their view, for reasons directly connected with its financial situation, a credit institution appears to be unable to repay a deposit, and at present it appears that it will not be able to in future. At the same time, the appropriate authority will act sooner, but not later than 21 days after it first became convinced that the credit institution has not repaid deposits, which are repayable and which will become repayable."

3. If the limits or extent, including the percentage, of protection provided by the guarantee system of a host member state exceed the limit or extent of protection provided in the member state, in which the credit institution has authorisation to operate, the host member state will ensure that an officially recognized system of guaranteeing deposits functions in its territory, and a branch of a foreign bank can voluntarily join it, and so supplement the guarantee, which its depositors receive, that is the guarantee, which its depositors already have from participation in the system, which exists in their home state. To fulfill this requirement, in harmony with this directive, it is necessary for rules and procedures to be worked out between host and home states for the payment of refunds, for example:

- the procedure for providing and verifying the necessary information,
- declaration of the appropriate authorities of the home state of the branch of the foreign bank about the inaccessibility of deposits,
- the principles of cooperation between home and host member states.

4. In this context, it is necessary to point to the fact that in the SR, refunding of inaccessible deposits is done differently according to whether the deposits are in a building society (in Slovak: stavebná sporiteľňa) (sixty times the average monthly salary in the SR) or in a bank (thirty times the average monthly salary in the SR). This is intended to support the development of building societies and the resulting construction of housing. However, the directive does not suppose different rules for different entities operating in the framework of the banking sector.

5. It is also necessary to exclude some other persons from the system of protection of deposits, in accordance with the Annex to the directive (for example: auditors, third parties, who act in the name of persons with a special relationship to the bank according to the Act on Banks during the period of one year before the day on which the deposits became inaccessible).

5. Directive against Money Laundering is a horizontal directive, which not only regulates the activities of banks, but also of other entities operating on the financial market.

This directive is partially included in act no.249/1994 Col. on the struggle against legalization of income from the most serious, especially the organized forms of criminal activity (below only the „Anti-Money Laundering Act") as amended by act no.58/1996 Col., and in the Act on Banks and with already mentioned decrees of the NBS nos.5 and 6 from 1998.

The following areas from this directive must be implemented to the appropriate legal norms in future:

1. The identification obligation, according to the directive, requires that banks and branches of foreign banks verify the identity of their clients:

– at the beginning of any commercial relationship, especially when opening an account or savings account for a new client or when providing use of a safe deposit box,

– if it is a matter of a transaction with a client exceeding 15,000 EURO. This sum need not be a result of one transaction, but may be the total from a series of transactions,

– in the event that a transaction with a client does not reach the above mentioned sum, but the bank or branch of a foreign bank suspects that the transaction with the client is connected with laundering of dirty money.

The identification obligation also applies to so-called „beneficial owners".

The Slovak legislation according to the Act on Banks gives banks and branches of foreign banks the obligation to demand proof of the identity of a client in the case of every transaction. A transaction is understood as an action of the bank, which leads to the origin, exchange or ending of an obligation between the bank or branch of a foreign bank and its client, apart from dealing with accounts in bearer passbooks in cash, deals with accounts in the form of bearer securities in cash, and activities performed by means of ATM's.

Therefore, the Act on Banks in harmony with the Civil Code and Declaration of the Ministry of Finance no.47/1964 Col. on financial services, makes it possible to offer citizens the product „bearer passbook", and in this case it is not necessary to verify the identity of the client. The identification obligation is also not imposed in the case of deals with deposits in the form of securities for the bearer in cash.

These facts are in conflict with the directive. Their removal requires amendment of the appropriate legal norms, for example the Act on Banks and the Civil Code. It is also necessary to extend the identification obligation in the Act on Banks to „beneficial owners".

3. According to the directive, the obligation to archive evidence of the identity of a client or about a transaction applies to documents verifying the identity of a client, which have to be archived for a period of at least 5 years after the termination of the commercial relationship with the client, and to documents connected with the transaction (these are defined as originals or copies, which could be accepted in judicial proceedings), which have to be preserved for at least 5 years after the completion of the transaction. According to the Act on Banks, banks and branches of foreign banks are obliged to archive documents about transactions for at least 5 years only in cases exceeding 100,000 Sk. Therefore, the Act on Banks needs to be amended to bring it into harmony with the requirements of the directive.

4. The directive imposes an obligation to cooperate with the law enforcement authorities (in the SR: the Office of the Financial Police of the Police Force), and the forms of such cooperation are described in detail. It unambiguously requires banks and branches of foreign banks to take the initiative in reporting suspicious banking operations. This obligation also applies to institutions entrusted with supervision, by means of on-site inspections. If they discover facts during an on-site inspection, which could indicate money laundering, they must inform the appropriate authorities.

According to the Act on Banks, a bank or branch of a foreign bank is obliged to provide information about a client, which is subject to banking secrecy, only on the written application of clearly defined persons (for example: an authority active in criminal proceedings or the Office of the Financial Police of the Police Force for the purpose of fulfilling their roles set by legislation). The present legal norms do not require Banking Supervision Division of the NBS to report suspicious facts discovered during on-site inspections of banks. The Act on Banks needs to be amended in this area, to fully harmonize it with the directive. In this context, it is also necessary to take into account Act no.249/1994 Col. as amended by act no.58/1996 Col., which gives banks and branches of foreign banks (but not the National Bank of Slovakia) the obligation to take the initiative in reporting suspicious banking operations (which is in harmony with the directive).

5. The appropriate requirements of the directive also need to be added to the Act on the National Bank of Slovakia, for example, the obligation to identify clients, and the duty to report and to keep records, which should also fully apply to the central bank.