




Weekly Briefing

**Slovakia economy briefing:
Changes in the banking sector of Slovakia
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Changes in the banking sector of Slovakia

Overview

Slovak banking sector may be characterized as a two-level banking system with superior position of central bank – the National Bank of Slovakia (NBS) and commercial banks that are typical legal entities oriented on profit-making.

The NBS is an independent institution whose main task is to maintain price stability. Since it has a superior position over commercial banks, it is often called the “bank of banks”. The NBS is the supreme subject of monetary policy and the instrument of regulation of the banking system in Slovakia. It performs several functions: 1. Participating in monetary policy management, 2. Issuing cash money, 3. Performing foreign exchange operations, 4. Contributing to financial stability within the euro area, 5. Acting as a representative of the state in the monetary area, 6. Enabling system of payment, and 7. Cooperating with other central banks of the EU. The NBS, as the central bank of Slovakia, has a unique role within all banks operating in Slovakia – the NBS is the only bank to issue banknotes and bank reserves, and at the same time determines the rules and conditions for trading of commercial banks. The task of the NBS is therefore mainly to monitor and control the complex Slovak financial market in the area of banking, pension savings, insurance, and the capital market. The supreme governing body of the NBS is the five-member Bank Board of the NBS. The Bank Board consists of governor, vice-governor and three other members. The governor and vice-governor are appointed by the President, other members are appointed by the Government. The headquarters of the NBS are located in Bratislava. In addition, the NBS has also branches in the following cities: Nové Zámky, Banská Bystrica, Žilina, Košice, Poprad. After joining the euro area on 1 January 2009, the NBS became part of the Euro system. Together with the other central banks of the EU and the European Central Bank (ECB), it ensures price stability throughout the EU. The monetary policy within the EU is determined by the Board of Governors of the ECB, including the governor of the NBS. The Board meets twice a month and decides on interest rates on major refinancing operations and automatic operations.

Commercial bank is a legal entity with its registered office in the territory of Slovakia established as a joint-stock company, which accepts deposits and provides loans and is granted a banking license to perform these activities. In addition to these activities, the bank may carry out other banking activities, provided that it is specified in the banking license. One of the basic conditions for granting a banking license is a cash deposit in the bank’s equity capital of at least

EUR 16.6 million and a cash deposit in the equity capital of a bank that carries out mortgage transactions of at least EUR 33.2 million. Commercial banks are specific business entities oriented on profit-making with following main functions: 1. Mediation of cash and non-cash payments to clients, 2. Acceptance of deposits, 3. Lending, 4. Securing system of payment. Based on the data from NBS (2019b), currently there are 12 banks and 15 subsidiaries of foreign banks operating in Slovakia. For a complete list of all the banks and subsidiaries of foreign banks as well as banks and subsidiaries of foreign banks no longer active, see NBS (2019b). Even though the banks operate in Slovakia, they are not Slovak banks per se. According to Mittaš (2019), their real owners are often foreign or international companies. The share of domestic capital in the banks operating in Slovakia is rather low and foreign capital from Austria, Belgium, and Italy prevails. As Mittaš (2019) puts it, while in 1998, domestic equity capital of banks levelled at 63%, by the end of 2018 this share dropped significantly to only 5%. Based on the development of the banking sector in Slovakia, we can attribute this, rather drastic, change in the share of domestic equity capital to the privatization of Slovak banking sector that took place at the turn of the centuries. In 2001, two largest banks were privatized with foreign owners as majority shareholders: 1. Slovenská sporiteľňa (currently 100% owned by Austrian Erste Group Bank AG) and 2. Všeobecná úverová banka (VÚB) (currently owned by Italian bank group Intesa Sanpaulo holding 97% of the shares with 3% owned by various natural and legal entities). According to BnS (2016), commercial banking sector in Slovakia may be divided into 3 main groups: 1. Classic banks (subdivided into 2 groups: a. universal, and b. specialized), 2. Internet banks, and 3. Foreign bank subsidiaries. Regarding the net profit of banking sector, according to NBS (2019a), by the end of 2018, net profit reached EUR 640 million which was a 6.9% year-on-year change even though the interest rate margins were falling.

In recent weeks, three major changes to Slovak banking sector emerged: 1. Electronic payment security and consumer protection, 2. Changes in the business model, and 3. Withdrawal of one of the banks from the Slovak market.

Electronic payment security and consumer protection

New European regulation based on second Payment Services Directive (PSD2) increases the safety and consumer protection in all electronic payments, especially in contactless payment. After September 14th, 2019, the client will be required to enter the PIN code for contactless payment by credit card through a payment terminal if he/she pays five times in a row less than EUR 20 or if the total volume of transactions up to EUR 20 regardless of their

number exceeds EUR 150 (SBA, 2019). Delegated regulation on strong customer authentication and secure communication introduces also two-factor authentication meaning that client authentication must be performed by combining at least two authentication elements coming from the categories: knowledge (password or PIN), ownership (mobile phone, tablet, card, etc.) and inherence (biometrics: fingerprint, iris scan, etc.). Since the PSD2 is in force from January 2018, banks in Slovakia were preparing for the changes and were implementing strong authentication even before the official date.

Changes in the business model

Štefanides and Lehuta (2019) note that low interest rates in Slovakia force banks to keep their costs at bay to achieve required profitability which is currently still higher than the EU average, however, banks must look for ways to maintain the current trend. They suggest as one of the possible options for this changing their business model which is currently focused on traditional arranging of loans and deposits. The difference between interest income and expense, i.e. net interest income, accounts for the majority of income of banks reaching 77% in the first half of 2019 (in 2014, it was more than 80%). Since the net interest income is declining, banks are trying to find new ways to increase the profitability, mainly through the increase of fees and commissions. Regarding fees and commissions, their share on total income in the sector increased to 26% in 2019 compared to 21% in 2014.

OTP bank withdrawal from the Slovak market

According to media coverage, the Slovak daughter of the Hungarian OTP Bank is for sale even though the bank as well as the potential buyers did not want to comment on the sale nor indicate that the information is untrue nor confirm the information. Currently, OTP Bank ranks ninth in the market with almost 2% market share (Haluza, 2019). Several reasons for sale may be identified, like losing the position at the market in recent years and falling of its own assets. Experts say that banks in Slovakia are currently facing several challenges, especially survival in a highly competitive environment, retaining clients, and the decline in revenue. The market could thus be consolidated even more in the future with some smaller banks acquired by larger ones. According to TASR (2019a), banking sector profitability is expected to decline, thus it is expected that sales in the banking sector will continue in the future. One of the reasons of the probable OTP withdrawal from the Slovak market is also probable different client portfolio of the bank consisting mostly of conservative clients not who are not so eager for bank innovation

and are more interested in consumer loans (TASR, 2019a). Among the other reasons we may include (Haluza, 2019):

- Losing the market position – when entering the EU, the market share was 2.9%, but fell to 1.8% in 2018,
- Falling of own assets – in 2018, own assets fell year-on-year by EUR 46 million to EUR 1.4 billion (year-on-year change of -3%),
- In the last five years the bank did not record profit with the exception of 2015,
- Market overheating – new crisis is probably coming soon with prices falling down hence the sale before the crisis breaks out,
- OTP Slovakia composes only a small part of the whole OTP bank group with 62 branches and 660 employees compared to total of 1,500 branches in the region of East Europe with 36 thousand employees.

Conclusion

We identified three major changes in the Slovak banking sector in recent weeks. Firstly, new regulations in electronic payments and consumer protection based on the PSD2 that entered into force in September 2019, especially contactless payments and strong, two-factor, customer authentication based on knowledge, ownership, and inherence. Slovak banks claim they are ready for implementing these regulations immediately. Secondly, possible changes in the business model of banks operating in the Slovak market focusing on maintaining their profitability in the future because of falling net interest income. Main changes in order to maintain the profitability will probably include: 1. Increased fees and commissions (already proposed by some of the banks), 2. Changes in the productivity and economies of scale, 3. Trading on the financial markets, 4. Saving on costs (size and effectiveness of the distribution network – number of branches declined by 9% over the last 5 years), and 5. Process automation. Thirdly, consolidation of banking sector in Slovakia with one of the banks possibly withdrawing from the Slovak market which is, according to experts, oversaturated with more than 20 financial institutions so more consolidation is expected to be happening in the future.

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