Macro prudential regulation in slovakia

According to NBS, macro prudential policy can be defined as " an ongoing process of identifying, monitoring, assessing and mitigating risks that pose a threat to financial stability". Macro prudential policy can be considered as the main reason for the powerful and well built financial system. The macro prudential policy identifies, monitors and mitigates the systemic risks in the economy. One of the main objectives of the macro prudential policy is to maintain the stability of the financial system. National Bank of Slovakia has implemented the macro prudential policy in Slovakia. This power was vested in the NBS by way of an amendment to the Financial Market Supervision Act of 15 March 2013. Macro prudential Policy Department holds the responsibility in implementing polices whereas NBS Bank Board has the authority/power in taking the decisions. Whenever necessary, ECB also has the authority to impose the policy setting stricter than those polices applied by NBS. There are many instruments and approaches that play an important role in policy implementation out of which the application of legislative instruments is the strongest form that respond to the existence of risks.

In Slovakia macro prudential policy is laid down mainly in the following laws:

1. " Act No 747/2004 Coll. on financial market supervision requires that macro prudential supervision be performed by the NBS and that the NBS, in the framework of this supervision, identify, monitor, assess and mitigate risks"
2. " Act No 566/1992 Coll. on the National Bank of Slovakia sets the NBS the general task of contributing to financial stability"
3. " The amendment to Act No 483/2001 Coll. on banks, implementing the CRD IV Directive and the CRR Regulation into Slovak legislation,

grants the NBS powers to use legislative macro prudential policy instruments"

The analysis of systemic risks and the actual implementation of policy in the form of risk mitigation are the two stages in the conduct of macro prudential policy. Legislative macro prudential policy instruments are currently available in the banking sector. Most of the instruments are defined directly in the CRR Regulation and CRD IV Directive, which is implemented in Slovakia in the Banking Act. The main macroprudential tools that are used by Slovakia are –

1. The capital conservation buffer
2. The countercyclical capital buffer
3. The systemic risk buffer
4. Capital buffers for systemically important institutions

Some of the other tools are –

1. Loan maturity and Loan amortisation
2. Loan-To-Value (LTV)
3. Debt Service to Income (DSTI)
4. Loan-To-Income (LTI)

The key macro prudential tools in Slovakia and the reasons for introduction of these tools are explained as below.

1. Capital Conservation Buffer (CCB)

Basel III has introduced 2 additional capital buffers and one among that is Capital Conservation Buffer. The main objective of this tool is to conserve bank's capital. The CCB is subject to a 3-year phase in period from 1 January

2016 to 1 January 2019. According to Bank for International Settlements (BIS), " Capital (CET1) is built up outside of periods of stress to be drawn down as required". Capital conservation buffer play a major role in the macro prudential policy. The capital requirements of the banks have been increased by NBS with the introduction of the capital measures. The main reason of these buffers is to increase the banks' elasticity to the unlikely events. After introduction of these buffers, many banks have changed the dividend polices. If the buffers were not introduced, the banks would have had lower capital ratios. A CCB is fully phased in since 1 October 2014. The current setting of the CCB rate in Slovakia is 2. 5%. According to Article 331, if banks fail to meet the requirement of the buffer, then they must prepare capital conservation plan and submit it to NBS within five working days. Estimation of income and expenditure, forecast of balance sheet, increasing the capital ratios of banks and setting a timeframe for increasing own funds are some of the inclusions in the capital conservation plan and these have the objectives to meet the requirements. After the submission, NBS assesses the plan and will approve only if the plan, if implemented, will help to increase or preserve adequate capital for banks and this is to meet the requirements of the buffer in a given period of time and it is appropriate according to NBS. If the plan is rejected by NBS, then banks are notified by NBS to raise the funds to a defined level and within a given period and/or use the powers to force strict controls on distributions.

2. Systemic Risk Buffer

The focus of capital buffer should be focused on risks on non-cyclical and for a longer term. Such a buffer gives a lot of discretion to authorities and is not defined strictly. This buffer can be either applied to an entire financial sector or to a particular part. The national authorities should review the level of systemic risk buffer at least every other year. Unlike O-SII this buffer need not be fixed. The duplicate coverage risk should be avoided by monitoring the banks requirement for additional capital as under pillar 2 since a capital might already be allocated to the risk. As the level of Systemic risk buffer is not clearly defined or when to activate SRB the national authorities have much more discretion in making decisions. The first proposal of indicators has been drawn by a group at European Systemic Risk Board which can serve as an aid in making SRB related decisions. The proposal indicators include: The significance of the monetary framework for the economy, structural shortcomings of the economy, changes in regulations, regular exposures toward a specific hazard, money related advancements, interlinkage, non-repeating dangers from the real estate market, exchange rate, business model of individual organizations and market focus in the banking sector. The systemic risk buffer is an addition to capital buffer and accommodates risks which are not recognised by capital buffer. Systemic risk buffer helps identify risk related to housing credit or prices, identifies the size, complexity and interconnectedness between important institutions in Slovakia and also reduces excessive growth rate increasing reliance on banks. And the report has to be shared with banks and borrower to mitigate procyclicality. Current Systemic buffer for Slovakia is 1%.

3. Capital Buffers for Systemically Important Institutions

(a)The most important reason for introducing the macro-prudential tool G-SII is that there are too many procyclical factors in the normal macroeconomic operation process, while it is necessary to introduce a so-called counter-cyclical policy tool (Amorello, 2015). Before the financial crisis, the policy framework of the Slovak National Bank focused on monetary policy and stabilized prices as policy objectives.

However, the international financial crisis shows that only monetary policy is not enough to maintain the stability of the financial system, because market behaviour has obvious procyclicality, cross-market risk is more contagious (Amorello, 2015). The main source of financial system risk is financial procyclicality and cross-market risk contagion. The introduction of G-SII, which is regarded as the " stabilizer" of global finance, can well mediate financial procyclical and cross-market risk.

(b) The Global Systematic Integrity Insurance Agency (G-SII) refers to an insurance institution that has a global function in a financial market. These institutions pose systemic risks to the global economic and financial system in the event of a major risk event or operational failure. After the financial crisis, the EU actively developed G-SII and established a multi-level regulatory framework covering macro-prudential supervision and micro-prudential supervision (Amorello, 2015). In order to solve the domestic financial problems and make up for a lack of domestic supervision and coordination, Slovakia participated in the G-SII (Amorello, 2015).

If only adopting G-SII, the systemic financial risks currently existing in Slovakia cannot be completely solved. To further solve the problem, Slovakia chose to establish other systemically important institutions (O-SII buffer). In addition, Slovakia, under the auspices of the National Financial Supervisory

Authority, revised the additional capital requirements of municipal finance companies as credit institutions of importance to the Slovak financial system. Then, Slovakia's new O-SII buffer requirement was increased by 0. 5% and will take effect on January 1, 2019. Slovakia's O-SII buffer requirement is currently 0. 5%. However, according to the EU FIN-FSA decision of December 2017, the buffer requirement will increase to 1. 0% from July 1, 2018. The Slovak Financial Services Authority also decided to implement a systemic risk buffer requirement for the financial industry based on the structural characteristics of the Slovak financial system by June 2019.

4. Countercyclical Capital Buffer [CCyB]

The Countercyclical capital buffer [CCyB] is a capital requirement which is applicable to financial institutions such as banks and investment-related firms. It's a time-changing capital requirement. The main goal of CCyB is to provide to the economies a reliable and sustainable provision of credit by making the banking system resilient. The Countercyclical capital buffer is one of the most important parts in a macroprudential policy. The main objective is to ensure that economies have a sufficient capital buffer to negate any losses during stress periods or periods of high economic growth. The increase in credit and changes in the credit-to GDP ratio and any other variable related to the financial industry would be considered to calculate the amount of the CCyB. Taking the long-term trend into consideration, the Basel Committee on Banking Supervision [BCBS] has developed a methodology for calculating the credit-to-GDP ratio. This can be considered as a starting point for the national authorities, but it should not lead to automation of decisions for determining the level of CCyB. The credit cycle and risks resulting from excessive credit growth should be reflected meaningfully in the CCyB, while taking into consideration the specific features of the national economy. A guided judgement and a decision, as well as the mandatory methodology in calculating the credit-to-GDP ratio, other variables may also be used. Given the problems in the calculation of the credit-to-GDP for countries such as Slovakia and taking other countries experience with introducing CCyB, it can be assumed that the other variables in picture will form the centre of decision making. In this case, it is very important that analysis of these other variables is performed with regard to the background to any credit growth. In other sense, the presence of excessive credit growth remains a perquisite remains a perquisite for raising the CCB requirement even though other variables indicate an economic balance. The methodology for calculating CCyB is published on NBS website. Current Countercyclical buffer for Slovakia is 1. 25% but it is to be raised to 1. 5% by august 2019.

Some of the other macroprudential measures that are explained below are to target the systemic risks that arise in the real estate sector and it is taken from Articles 124 and 164 of CRR (Capital requirements Regulation). These measures are not harmonised by Union law. The other macroprudential policies used in Slovakia are:

1. Loan Maturity and Loan amortisation

The objective of the above mentioned tools is Credit growth and leverage. The loan amortisation was initiated in the year 2014 and the recommendation was the loan that has partial deferred payment of interest or principal should not be granted. However few exceptions are allowed and those are specified. This measure was notified to ESRB on 7th November 2014 and became active on 1st March 2015. NBS introduced maturity limits for housing loan in 2016 and maturity limits for consumer loans in 2017. Loan maturity measure was initiated in 2014 and the recommendation was that for any new housing loans can have a maturity of maximum of 30 years and it should not be more than 10% and should not exceed the limit. Other new loans can have a maximum maturity of 9 (ultimately 8) years and not more than that. Housing loans which are secured by RRE can have a maximum maturity limit up to 30 years and it has an exemption of 10% (of the new loans). This recommendation was transferred from 2014 to 2016. In 2016, some of the measures were introduced for the loans that were unsecured by RRE. In this measure, they got a maximum share of new loans over 25 years and 20 years with new loans exceeding the limit of 10% and 20% respectively. Consumer loan's maturity limit was 8 years for the ones which were approved by non-building societies i. e., financial institutions and as of 2017 there was no changes in the maturity limit for the loans that is approved by the building societies.

2. Loan to value

LTV ratio = amount of debt / collateral value. Loan to value ratio is an assessment tool used to assess the risk associated with lending. It is a tool used by financial institutions to examine and approve mortgages. The main objective of imposing a limit on loans with high LTV is so that there is a sustainable and healthy development of housing loan market and so that it reduces the risk of imbalance in property market. LTV ratio cannot exceed

90% since 1 July 2018. Maximum share of new loans with LTV between 80% and 90% will gradually decrease to 20% since 1 July 2019. (Slovenska, 2018)

3. Debt Service to Income (DSTI) –

The Debt Service to income or Debt-to-Income ratio is a method to calculate an individual’s ability to manage monthly payment and repay debts. DTI is expressed in percentage. It is calculated by dividing monthly debts by gross monthly income. From 1st July 2019, the share of new loans whose Debt-to-income exceeds 8 would be reduced to 10%. Previously, for the period 1st July 2018 to Sept 2018, it was 20% which was gradually reduced to 15% for the period 1st October 2018 to 31st December 2018, which again would be reduced to 10% starting from 1st Jan 2019. The main goal to limit the ratio is to reduce the risks occurring due to rapid growth of household indebtedness.

4. Loan-To-Income (LTI)

Loan-to-income (LTI) is also a measure added by Slovakia in 2018. The borrower’s total indebtness cannot exceed 8times of his/her yearly income, but the policy permits the share of new loans with DTI > 8 can exceed 5%-10% only for loans granted to young clients (no more than 35 years old, income <1. 3x Average), with DTI <9. From 1 July to 31 Sept 2018, the percentage increased to 20%, 15%for 1 Oct – 31 Dec, and 10% for 1 Jan 2019 -30 Jun 2019. Generally speaking, 43% is the highest DTI figure that borrower can still have the access to get loans, the lower the DTI is, more opportunities of acquiring loans people are.

Conclusion and Recommendations –

Národná banka Slovenska (NBS) focuses mainly on maintaining the financial stability in Slovakia. NBS thinks that its contribution to the financial stability is mainly to notify regularly to the public about the stability in the financial sector and it is notified through the Financial Stability Report. This report majorly aims at finding out the risks to the financial stability in Slovakia and it is published twice a year. The main objective of polices is to accord with the current state and the risks that can arise over the years. The above policies allow transparency and contribute to the robustness of the whole financial system.

- https://www. nbs. sk/en/financial-market-supervision1/macroprudential-policy/about-the-policy
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