



EUROPEAN CENTRAL BANK

## OPINION OF THE EUROPEAN CENTRAL BANK

of 22 September 2004

**at the request of Národná banka Slovenska on a draft law on supervision of the financial market  
and on amendments to certain laws**

(CON/2004/31)

1. On 5 August 2004, the European Central Bank (ECB) received a request from Národná banka Slovenska (NBS) for an opinion on a draft law on supervision of the financial market and on amendments to certain laws (hereinafter the 'draft law').
2. The ECB's competence to deliver an opinion is based on the third and sixth indents of Article 2(1) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions<sup>1</sup>, as the draft law contains provisions concerning the Slovak national central bank and rules applicable to financial institutions that materially influence the stability of financial institutions and markets. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.
3. The main purpose of the draft law is to establish the legal framework for integrated supervision of the financial market by NBS. Under the draft law, the responsibility of the Slovak Financial Market Authority (FMA) for supervision of the non-banking financial market (capital markets, insurance business and pension schemes) will be transferred to NBS on 1 January 2006. Currently NBS is only responsible for the supervision of credit institutions. If the proposal goes ahead, the FMA will be dissolved on 1 January 2006.
4. As explained in the reports of the expert commissions established by the Slovak Government to prepare the draft law<sup>2</sup>, the existence of a relatively small financial market in the Slovak Republic led to the proposal to make a single authority responsible for financial market supervision. Various options were considered. The decisive reason for allocating this task to NBS was its independence, which is guaranteed by Article 56 of the Constitution of the Slovak Republic<sup>3</sup>. Other essential reasons taken into consideration were: (i) NBS's credibility; and (ii) the experience of its staff,

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<sup>1</sup> OJ L 189, 3.7.1998, p. 42.

<sup>2</sup> Four expert commissions have been established under the Financial Market Integrated Supervision Implementation Plan adopted by the Slovak Government pursuant to Resolution No 775 of 21 August 2003.

<sup>3</sup> No 460/1992 Coll. as last amended by Constitutional Act No 323/2004 Coll.

acquired in carrying out its current tasks and more particularly through prudential supervision of credit institutions on the basis of Act No 483/2001 Coll. on banks.

5. As previously stated, NBS is currently responsible for supervising credit institutions only. The draft law will therefore considerably broaden its existing supervisory powers. NBS will become the competent authority for supervision of the entire Slovak insurance sector including reinsurance companies and of the capitalisation pillar of compulsory pension insurance (i.e., old age pension savings). NBS will also assume all of the FMA's current powers in the field of capital market supervision. It will therefore become the competent authority for supervision of investment firms, stock exchanges, central securities depositories, asset management companies and mutual funds. It will also be designated as the competent authority within the meaning of a number of recently adopted Community Directives which have not yet been transposed into Slovak law, in particular the Market Abuse Directive<sup>4</sup>, the Prospectus Directive<sup>5</sup>, the Takeover Bids Directive<sup>6</sup> and the Markets in Financial Instruments Directive<sup>7</sup>. NBS's regulatory powers will also be broadened. Its existing power to issue decrees and measures in the field of banking will be extended to the capital market and to the insurance and pensions sectors. After the reform, NBS will be able to adopt implementing regulations: (i) for the capital market and the insurance sector in cooperation with the Slovak Ministry of Finance; and (ii) for the pension savings sector in cooperation with the Ministry of Finance and the Ministry of Labour, Social Affairs and the Family.
6. The ECB notes that the specific laws governing supervision of each financial market sector will be amended pursuant to the draft law. The provisions currently conferring supervisory and regulatory powers on the FMA will be amended in order to transfer these powers to NBS. Transitional provisions forming part of the amendments to these specific laws expressly indicate that the NBS will complete any administrative proceedings started by the FMA.
7. The ECB notes that the draft law, when adopted, will establish a structure that is currently unique within the European Union by making a national central bank directly and fully responsible for supervision of a Member State's entire financial market. The ECB understands that in Member States with a relatively small financial market, such as the Slovak Republic, there are good arguments for concentrating supervisory responsibilities in the hands of a single authority. The ECB welcomes the fact that NBS's independence, credibility and experience have been considered as decisive reasons for the Slovak Government to propose appointing it for this task.

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<sup>4</sup> Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse) (OJ L 96, 12.4.2003, p. 16).

<sup>5</sup> 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, p. 64).

<sup>6</sup> Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids (OJ L 142, 30.4.2004, p. 12).

<sup>7</sup> Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (OJ L 145, 30.4.2004, p. 1).

8. Under Article 14.4 of the Statute of the European System of Central Banks and of the European Central Bank, the national central banks may perform functions other than those specified in the Statute unless the Governing Council of the ECB finds, by a majority of two thirds of the votes cast, that these interfere with the objectives and tasks of the European System of Central Banks (ESCB). Such functions are performed on the responsibility and liability of the national central banks and are not regarded as being part of the functions of the ESCB.
9. Without prejudice to the Governing Council's powers to take action under Article 14.4 of the Statute, the ECB considers that the proposed extension of NBS's supervisory tasks is compatible with its ESCB-related tasks. In particular, the ECB welcomes the fact that the task of performing prudential supervision of all financial intermediaries will be allocated to NBS. The proposed institutional framework for prudential supervision has the potential to cope with increasing cross-sectoral interlinkages in the financial system. Indeed, the nature and scope of risk in the financial sector is widening due to closer links between credit institutions, insurance companies, investment firms and pension funds. The traditional borders between the banking, securities and insurance sectors of the financial market are becoming increasingly blurred, as demonstrated by the emergence of hybrid financial products, the increased use of risk transfer instruments and distribution agreements between the three sectors, and the growing role of financial conglomerates<sup>8</sup>.
10. The ECB takes note that the draft law is oriented towards recognising the essential role to be played by NBS in safeguarding the stability and credibility of the financial market, as well as in protecting clients. While the ECB's overall assessment of this structure is positive, it favours recognising in the supervisory framework the clear distinction between the two goals of financial stability and investor protection. In particular, the draft law should clearly emphasise the importance of: (i) the safety and soundness of financial institutions; and (ii) the stability of the entire financial system. The micro-prudential approach in the draft law could be coupled with a macro-prudential dimension, which might result in more effective monitoring of systemic risk. There is a close relationship between prudential controls applied to individual intermediaries and the assessment of risks for the financial system as a whole. Therefore, the ECB would welcome it if the draft law explicitly recognised, as is the case in the statutes of other Member States' national central banks, that NBS has the task of contributing to the stability of the financial system as a whole<sup>9</sup>. Central banks' focus on systemic stability means that they can better assess not only the likelihood and the potential impact of macro-shocks or disturbances in domestic and international capital markets, but also the operation of common factors affecting the stability of groups of intermediaries.

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<sup>8</sup> See also paragraph 5 of ECB Opinion CON/2004/16 of 11 May 2004 at the request of the Italian Ministry of Economic Affairs and Finance on a draft law on the protection of savings.

<sup>9</sup> Also the current wording of Articles 2(2)(d) and 36(1) of Act No 566/1992 Coll. on Národná banka Slovenska, as amended, refers to the safe operation of the banking system.

11. The draft law provides for an organisational unit of NBS, established in accordance with NBS's organisational rules and designated as the 'financial market supervision unit' (hereinafter the 'supervision unit') to carry out on and off-site supervision and, as a rule, also to act as the decision-making body in the first instance. The supervision unit will exercise its tasks under the managerial responsibility of the Vice-Governor of NBS, who will also adopt its decisions. § 2(10) of the draft law explicitly states that in supervising supervised entities, the supervision unit will act 'separately, independently and impartially, in accordance with the draft law and specific laws'. NBS's Bank Board (hereinafter the 'Bank Board') will rule on appeals against the supervision unit's first instance decisions. The supervision unit will be bound by decisions of the Bank Board and in turn by court decisions taken on administrative review of such decisions.
12. The ECB has examined the provisions of the draft law relating to the supervision unit particularly with a view to avoiding ambiguity with regard to allocation of responsibilities for supervision. The ECB understands that the draft law will not establish a body responsible for supervision functioning autonomously within the framework of NBS. Instead, the aim is to establish NBS itself as the competent authority directly and fully responsible for supervision of the entire Slovak financial market. This approach implies that the Bank Board is ultimately responsible for supervision. NBS's internal governance structure should therefore appropriately reflect the fact that the exercise of supervisory tasks is under the ultimate control of the Bank Board. Ambiguity in this respect could impinge on NBS's institutional and financial independence as well as its reputation.
13. The ECB understands from the explanations provided by the supporting documents to the draft law and by NBS itself that the draft law together with Act No 566/1992 Coll. on Národná banka Slovenska ensure that the Bank Board will have the power to issue general guidelines on the exercise of supervisory tasks by the supervision unit as well as to any of NBS's other business units. It also understands that the Bank Board will have access, where necessary, to all information concerning the financial situation of supervised entities and supervised transactions on the capital markets. In addition, the draft law explicitly provides that the Bank Board may issue warnings to the supervision unit if it fails to commence proceedings when it is under an obligation to do so, or fails to take a decision within the time limit prescribed by law. If the supervision unit still fails to take a decision in accordance with such a warning, the Bank Board may appoint another NBS organisational unit to take the decision concerned.
14. The ECB considers that the proposed system of warnings coupled with the ability to transfer decision-making power from the supervision unit to another NBS organisational unit fails to recognise the prominent role that the Bank Board should play in some situations, particularly in crisis situations threatening the stability of the financial system. The proposed system could prove too cumbersome in such situations, where important decisions must sometimes be taken rapidly. The Bank Board must be in a position to manage such situations effectively and efficiently. The ECB therefore recommends clarifying in the draft law that the Bank Board will have full power to

intervene, if necessary directly, in the decision-making process relating to NBS's performance of its supervisory tasks.

15. The ECB has also examined the possible impact of the proposed reform on NBS's financial situation. In this respect, the ECB notes that NBS will no longer have to fully fund prudential supervision of the banking sector. After the reform, supervised credit institutions will be asked to contribute to supervision costs in accordance with the provisions of an NBS decree adopted in agreement with the Ministry of Finance. The ECB also notes that supervision of the insurance sector and of the capital market has until now been fully funded by market participants and that this financing system will be maintained after the reform. Finally, the ECB notes that the Slovak State is liable for all possible claims arising due to damage caused by activities performed by the FMA in the exercise of its supervisory tasks<sup>10</sup>.
16. The ECB would appreciate being provided, for information purposes, with: (i) any proposed amendments to the draft law in relation to the issues addressed in this opinion; and (ii) a detailed description of the proposed organisational scheme and division of supervisory powers both within the supervision unit and within NBS as a whole from 1 January 2006.
17. This opinion will be published on the ECB's website.

Done at Frankfurt am Main, 22 September 2004.

[signed]

*The President of the ECB*

Jean-Claude TRICHET

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<sup>10</sup> Pursuant to Article 4(1)(c) of Act No 514/2003 Coll. on liability for damage caused by discharge of public authority.