3.31 SLOVAKIA

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I. FRAMEWORK

With the aim to improve the covered bond legislation and get closer to EBA recommendations, the new legislation was adopted at the end of year 2017 and it is effective from 1st of January 2018. The main changes are:

> abolishment of the special license granted by National Bank of Slovakia ("NBS") for conducting the mortgage business and its replacement by prior approval of NBS,

> abolishment of financing ratio,

> stipulation of the minimum requirements for overcollateralisation,

> inclusion of hedging derivatives into the cover pool,

> obligation of keeping the liquidity buffer,

> obligatory stress testing,

> special maturity extension of covered bonds in case of bankruptcy of the issuer,

> new requirements for disclosure.

Covered bonds are regulated by the Act on Bonds (Act No. 530/1990 Coll., Part Four, Article 20b); by the Act on Banks (No. 483/2001 Coll., Part 12); by the Insolvency Act (Act No. 7/2005 Coll., Part 6); by five new Decrees of the NBS for covered bonds programme, for example: stipulating the details of an application for prior approval of the NBS and the Decree of the NBS stipulating Covered Bond Register, reporting and disclosure (currently in process of its defining).

According to Act on Banks, covered bond is a secured bond under a special regulation (Act on Bonds) the nominal value and aliquot interest income of which are fully covered by assets or asset values in a cover pool and correspond to the value of assets which, for the whole period of validity of the covered bond, are preferentially intended to satisfy claims arising from this covered bond and these assets, in case the bank issuing these bonds, is not able to properly and timely pay its liabilities arising from them, will be preferentially used to pay the nominal value of the covered bond and aliquot interest income. The covered bond can be issued only by a bank with granted prior approval from NBS to perform activities related to covered bonds programme and the title must include the words "covered bond" ("krytý dlhopis").

Cover pool consist of primary assets representing residential mortgage loans with a maximum loan-to-value (LTV) of 80% of the value of the mortgaged real estate, substitution assets amounting maximum of 10% of the total value of the cover pool, hedging derivatives and buffer of liquid assets.

The coverage ratio, calculating the value of the cover pool and the total of the values of liabilities of covered bonds and operational costs over the next year incurred by the issuing bank, must be kept at the minimum level of 105%. In individual terms and conditions of the issuance of the covered bonds, the bank can determine a higher coverage ratio than 105% and from this moment the bank is obligated to maintain such a higher coverage ratio until the full repayment of the covered bond issuance for the entire relevant covered bonds programme. If the bank determines several higher coverage ratios for different issuances, it is obligated to maintain the highest coverage ratio for the entire relevant covered bonds programme until the full repayment of the covered bonds issuance with such highest coverage ratio, while the bank is also obligated to immediately replenish and continuously replenish the cover pool to the extent corresponding to such highest coverage ratio.

The bank is obligated to calculate the coverage ratio as of the last day of the relevant month.

Covered bond holders have recourse to the issuer as well as a preferential claim on the cover pool. The collateral in the cover pool is recorded in a special register of covered bonds and overseen by a cover pool administrator. The special public supervision is divided between the special administrator and banking supervision performed by the NBS.

II. STRUCTURE OF THE ISSUER

The covered bond in Slovakia can be issued only by a bank with granted prior approval from the NBS to perform activities related to covered bonds programme.

The issuer of covered bonds owns the cover assets and keeps them on its balance sheet. The holder of the covered bond has a direct recourse to the issuing bank.

III. COVER ASSETS

Covered bond is a secured bond the nominal value and aliquot interest income of which are fully covered by assets or asset values in a cover pool.

Mortgage loan according to Act on Banks is a loan secured by a lien or other security right to real estate, including building under construction, apartment, including apartment under construction or non-residential premises, including non-residential premises under construction (hereinafter the "real estate"), a part of real estate or future real estate and granted by a bank, foreign bank or a branch of a foreign bank.

Cover pool consists of the following parts:

a) primary assets – consist of the receivables of the issuing bank from mortgage loans with a maturity period not longer than 30 years granted only to retail consumers under a special regulation which are secured by liens to real estate and which are registered by the bank in the register of covered bonds at its discretion. The primary assets include, in addition to the receivables also the liens to real estate used to cover these receivables. The primary assets must account for at least 90% of the total value of the cover pool. The value of the primary assets is calculated on the basis of a residual nominal value of individual receivables together with aliquot interest income. The primary assets in relation to which the debtor is considered defaulted (under Article 178 (1) of Regulation (EU) No. 575/2013) must be deleted from the register of covered bonds.

b) substitution assets – must meet conditions under a special regulation (Article 129 (1)(c) of Regulation (EU) No. 575/2013). The substitution assets can account for not more than 10% of the total value of the cover pool. The value of the substitution assets will be determined on the basis of their real value.

c) hedging derivatives – consist of derivatives the purpose of which is to manage and mitigate currency risk or interest rate risk connected with issued covered bonds. The hedging derivatives are included into the calculation of the value of the cover pool as follows:

   i) the hedging derivatives used to mitigate the currency risk are measured at fair value,

   ii) the hedging derivatives used to manage and mitigate the interest rate risk of the substitution assets are measured at fair value,

   iii) the hedging derivatives used to mitigate the interest rate risk of the primary assets and the covered bonds are not included into the calculation of the value of the cover pool.

d) liquid assets – consist of assets of level 1 assets, level 2A assets (under Articles 10 and 11 of Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 supplementing Regulation (EU) No 575/2013) except own covered bonds issued by the bank issuing the covered bonds and exposure toward institutions (Article 129 (1)(c) of Regulation (EU) No. 575/2013).

If the bank has not aligned the maturities of positive and negative cash flows within the covered bonds programme in every moment during the following 180 days then, in order to cover all expected negative cash flows from the covered bonds programme, it is obligated to cover them from a buffer of liquid assets at least in the value of uncovered negative cash flows. These assets are a part of the cover pool. The value of securities entering the buffer of liquid assets shall be determined on the basis of their fair value including an aliquot interest income. The value of the buffer of liquid assets is a part of the coverage ratio.

Assets and other asset values become a part of the cover pool when registered in a register of covered bonds and are a part of the cover pool until they are deleted from the register.

The cover pool can be used to cover only:

a) the liabilities of the issuing bank in order to pay the nominal value and aliquot interest income from all covered bonds issued by this bank until they are fully repaid,

b) the estimated liabilities or costs of the issuing bank (operational cost of covered bonds programme) which arise and are immediately connected with the management thereof and settlement toward persons that conduct activities under the Act, or arising from issuance conditions especially toward the administrator of the covered bonds programme, payment service agents, administrators, representatives of the owners of the covered bonds and other persons performing similar activities at least for twelve months,

c) the liabilities of the issuing bank which arise from the hedging derivatives included in cover pool.

Assets and other asset values constituting a part of the cover pool are used by the bank preferentially to cover the bank's liabilities mentioned above and the bank must not dispose of them or use them to secure other liabilities until they are deleted from the register of covered bonds.

IV. VALUATION AND LTV CRITERIA

The legislation sets an 80% loan-to-value (LTV) limit for the eligibility of residential mortgage loans. The LTV limit is a soft one, meaning that in case a mortgage loan exceeds 80%, the loan is included into the primary assets only up to the amount that does not exceed 80% of the value of the pledged property. If the value of the pledged property drops below the amount of the outstanding principal of the mortgage loan, such mortgage loan must be immediately deleted from the register of covered bonds.

The value of the property will be determined by the bank based on an overall assessment of the property and the bank is bound solely by own assessment of the property. The bank is obligated to continuously monitor and regularly reappraise the value of the pledged property according to Decree of NBS No.10/2016 at least once in three years.

The lien on the real estate securing the mortgage loan is established by its recording in the Land Register (Act No. 162/1995 Coll.; Cadastre Law) on the basis of a proposal of the bank and owner of the real estate.

V. ASSET – LIABILITY MANAGEMENT

There is a mandatory minimum overcollateralisation of 5% stipulated by the law.

The bank is obliged to keep liquidity buffer in order to cover the liquidity gap for the following 180 days. If the principle of the covered bond issuance becomes due during the following 180 days, the difference between positive cash flows and negative cash flows shall be calculated as follows:

a) for the period of the following 30 days the calculation includes positive cash flows and negative cash flows in full amount,

b) for the period of the following 31 to 180 days the calculation includes positive cash flows and negative cash flows from interests and principal in full amount with three year adaptation period:

(i) as from 1 January 2018, the calculation includes positive cash flows and negative cash flows from interests in full amount and negative cash flows from principal multiplied by a coefficient of 0.6;

(ii) as from 1 January 2019, the calculation includes positive cash flows and negative cash flows from interests in full amount and negative cash flows from principal multiplied by a coefficient of 0.8;

(iii) as from 1 January 2020, the calculation includes positive cash flows and negative cash flows from interests in full amount and negative cash flows from principal in full amount.

Liquid assets that are a part of the buffer of liquid assets can be included for the purposes of the fulfilment of liquidity requirements during the period of thirty days under a special regulation (Articles 10 and 11 of Commission Delegated Regulation (EU) 2015/61, supplementing Regulation (EU) No. 575/2013) only to the extent of coverage of uncovered negative cash flows from covered bonds during the period of the following thirty days.

If the bank makes transactions in order to mitigate the currency or the interest rate risk arising from a net open currency position or an interest rate position between the issued covered bonds and the assets making up the cover pool, it is obligated to include these hedging derivatives and financial flows from them, together with their security, into the cover pool. The hedging derivatives must meet qualification criteria of an effective hedging relation.

The bank shall carry out yearly stress tests as part of its covered bonds programme. The stress test shall be set in line with the stress test performed to evaluate the appropriateness of the internal capital and include test for credit risk, interest rate risk, currency risk, liquidity risk, counterparty risk, operational risk and immovable property prices decline risk. The bank is required to prove in the stress test that it is able to keep the coverage ratio also during the stress test period.

VI. TRANSPARENCY

The bank issuing covered bonds shall publish:

a) the structure of covered bonds, maturity thereof, the number and volume of the covered bond issuance, the currency and the interest rates thereof,

b) the value, type and asset ratio in the cover pool and important changes in it,

c) the volume according to the currency of the monetary nominal value, weighted average residual maturity, weighted average interest rate and weighted average value of primary assets security indicator in the cover pool,

d) the proportional geographical distribution of the primary assets and real estate which secure them and constitute the cover pool,

e) other documents and information related to the covered bonds programme.

New extended duties for the administrator:

Until 30 April of a current calendar year, the administrator shall submit to the NBS a report on the covered bonds programme covering the preceding year and containing:

a) number, volume, revenues and maturity dates of the issued covered bond issues,

b) volume of assets in the cover pool and covered bonds issued in euros or foreign currency,

c) structure of the cover pool,

d) coverage indicator,

e) average value, maturity of the primary assets, as well as the fixation period and weighted interest rate,

f) volume of failed and eliminated mortgage loans from the cover pool,

g) reasons of material changes in replenishing, or elimination of assets from the cover pool,

h) structure of immovable property securing the primary assets, broken down by family houses, flats, building land and unfinished structures,

i) the relative situation of immovable properties securing the primary assets according to territorial division of the Slovak Republic and the LTV ratio,

j) method for calculation and amount of the estimated liabilities or costs incurred by the bank,

k) methodology and results of stress tests,

l) activities of the administrator, and the supervision carried out by the NBS in relation to the covered bonds programme,

m) other factors related to the activities of the bank.

The bank shall publish this report on its website.

VII. COVER POOL MONITOR AND BANKING SUPERVISION

The NBS shall appoint the covered bonds programme administrator and his deputy, who shall supervise compliance with the conditions related to the covered bonds programme set out in the Act on Banks and other generally binding legal regulations.

The administrator shall perform his activities individually, independently and impartially. Prior to any issue of covered bonds, the administrator is required to prepare a written certificate evidencing that coverage of those covered bonds is secured in line with the legislation and that an entry in the covered bonds register has been made.

The administrator checks and verifies whether:

a) the aggregate nominal value of the issued covered bonds, and the corresponding interest revenues, is covered by the assets comprising the cover pool at least at the coverage indicator value;

b) the bank complies with the requirements for structure of the cover pool,

c) the assets comprising the cover pool and registered in the register of covered bonds comply with the Act on Banks,

d) the agreement dealing with the securing derivatives comprising the cover pool contains provisions pursuant to Section 73(5),

e) the estimated liabilities are justified,

f) the immovable property securing the primary assets meet the legal requirements,

g) the bank keeps the register of covered bonds and documentation serving as basis for making entries in the register separately from other documents, and whether the bank has secured the same against misuse, destruction, damage, theft or loss,

h) the bank keeps in its accounting records separate analytical records of related transactions.

The bank must allow the administrator to perform his activities; in particular to allow him to inspect accounting records, documents relating to the cover pool and covered bonds programme. Activities of the administrator and his deputy are subject to supervision by the NBS.

VIII. SEGREGATION OF COVER ASSETS AND BANKRUPTCY REMOTENESS OF COVERED BONDS

In the event the bank issuing covered bonds is declared bankrupt (such declaration being made in form of a resolution of a bankruptcy court and made known to all creditors via publication in the Official Journal), the assets and asset values comprised in the cover pool are fully segregated from the general insolvency estate of the bankrupt bank. The trustee of the bankrupt bank is obliged to manage those assets and asset values as a special separate bankruptcy estate for the benefit of the covered bond holders having, by operation of law, a preferential claim and first priority perfected security interest in the cover pool. This means – as the law explicitly states – that the assets and asset values comprised in the cover pool serve the primary purpose of securing the claims of the covered bond holders against the issuing bank. A segregated nature of the cover pool is further emphasised by the legislation in two more aspects.

Firstly, it imposes the obligation on the issuing bank to establish and maintain the special separate evidentiary database where the assets in the cover pool are registered, i.e. the covered bond register. Only the assets and asset values included in this register may serve as collateral for the benefit of the covered bond holders and be used to satisfy their claims in the event of the issuing bank's bankruptcy.

Secondly, special procedures must be observed by the bankruptcy trustee regarding the administration and management of the overall covered bonds programme upon declaration of the issuer's bankruptcy. These procedures seek the ultimate purposes of extending the original maturities of the covered bonds in the event of bankruptcy as well as postponement of immediate acceleration of the covered bonds upon the declaration of bankruptcy. In particular, it is the responsibility of the bankruptcy trustee to asses, with a due and professional care, whether further administration of the covered bonds programme is feasible and does not result in reduction of the covered bond holders' claims.

Once the trustee ascertain that a possible reduction may threaten, he shall cooperate with the special covered bonds programme administrator in the process of notification to the NBS regarding the intention to transfer the entire covered bonds programme to one or more solvent banks. The performance of the transfer of the covered bonds programme is subject to the prior approval by the NBS and must be completed within one year following the date of its notification. The NBS may grant extension to the original period by additional one year in case the transfer has failed to be executed within the original one year's period and it can be presumed that its later performance will result in higher degree of satisfaction of the covered bond holders' claims. During both original as well as additional period for the transfer of the covered bonds programme, the issuer is obliged to make postponement of payments of principals and is allowed to make only yield payments pertaining to the covered bonds within their original maturities.

The payments of principals are allowed only in respect of the issuances with original maturities falling due within the first month of the original period for the transfer of the covered bonds programme. For the issuances which mature later but still anytime during the original or additional period for the transfer of the covered bonds programme, the payments of principals are postponed until the expiry date of the relevant period. In addition, there is also no acceleration of the issuer' liabilities relating to the covered bonds during the period for the transfer of the covered bonds programme. The mechanics of the transfer adopts the features identical to the sale of the company's enterprise or its part on a solvent basis ("predaj podniku") and shall include the transfer and assumption of the whole portfolio of claims and liabilities pertaining to the covered bonds and to the assets in the cover pool from the bankrupt issuer to one or more transferee banks. If the trustee has failed to successfully transfer the entire portfolio within the relevant period for the transfer of the covered bond programme, then the acceleration of the issuer´s liabilities relating to the covered bonds is triggered immediately following after the trustee has terminated the operation of the covered bond issuer´s business.

IX. RISK-WEIGHTING & COMPLIANCE WITH EUROPEAN LEGISLATION

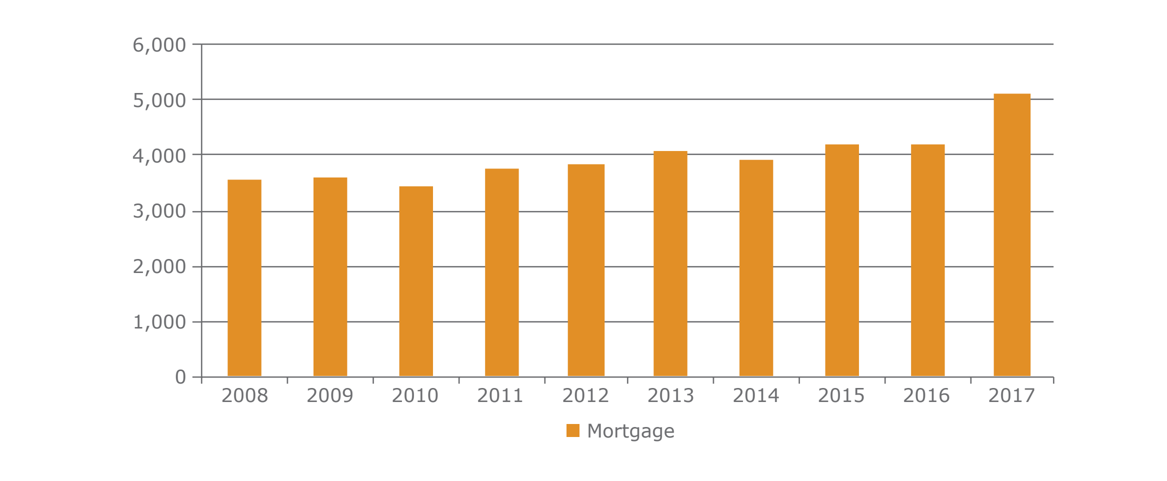
Slovak "Krytý dlhopis" comply with the requirements of Article 52(4) UCITS as well as of Article 129 of Regulation (EU) No. 575/2013.

The listed covered bonds are eligible for repo transactions with the central bank.

1 Please click on the following link for further information on the UCITS Directive and the Capital Requirements Regulation (CRR): https://hypo.org/ecbc/covered-bonds/.

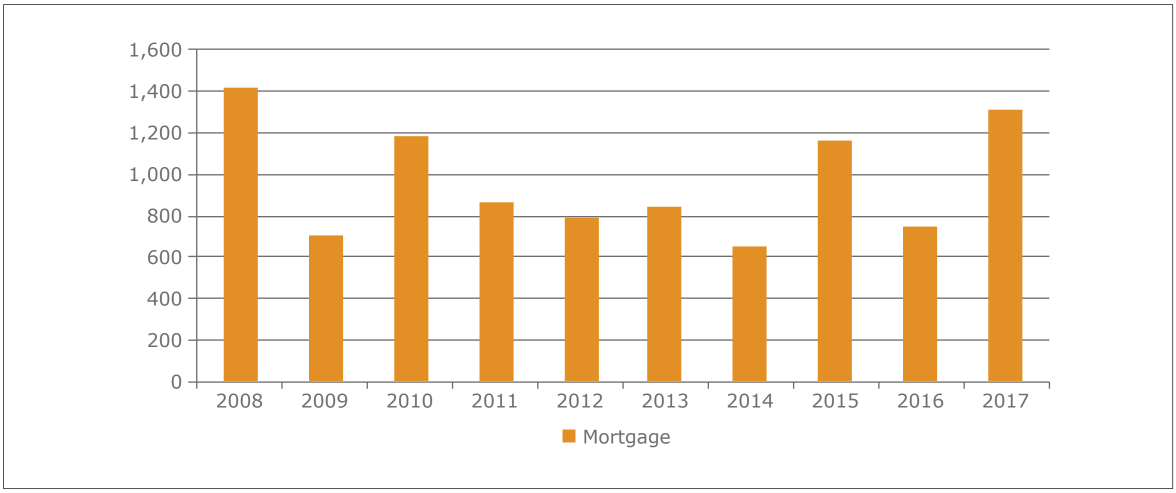
X. ADDITIONAL INFORMATION

> Figure 1: Covered Bonds Outstanding, 2008-2017, EUR m



Source: EMF-ECBC

> Figure 2: Covered Bonds Issuance, 2008-2017, EUR m



Source: EMF-ECBC

Issuers: each bank that applies for and obtain prior approval from NBS (as it is a new obligation, as of publication of this book only Všeobecná úverová banka and Slovenská sporiteľňa has applied).

ECBC Covered Bond Comparative Database: http://www.ecbc.eu/framework/42/Slovakian_Covered_Bonds.