

3.34 SLOVAKIA

By Slavomíra Páleníková, Andrej Zeher, Všeobecná úverová banka, Slovak Republic and Matej Krčmár, National bank of Slovakia

I. FRAMEWORK

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 Decrees of the National Bank of Slovakia (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. The entire legal framework has recently been updated by the Act No. 454/2021 implementing the EU Directive 2019/2162 on the issue of covered bonds and covered bonds public supervision (the "CBD Act").

According to the Act on Banks, a 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 included in the relevant cover pool (the "Cover Assets") 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. In the case of the resolution of the bank issuing the covered bonds or if it is not able to properly and timely pay its liabilities, the Cover Assets (including any collateral securing those assets) will be preferentially used to meet the issuing bank's Covered Bond Liabilities (see Section III. "Cover Assets" below).

Cover pool consists of primary assets, substitution assets, hedging derivatives and buffer of liquid assets.

The Bank can manage a single covered bonds programme individually for each of the following types of primary assets:

- (1) assets eligible pursuant to Article 129(1), let. (a) of Regulation (EU) No 575/2013 (the "CRR") i.e. exposures to or guaranteed by central or regional governments, ESCB central banks and public sector entities or local authorities in EU;
- (2) assets eligible pursuant to Article 129(1), let. (d) and (f) of CRR i.e. residential (or commercial) mortgage loans with a maximum loan-to-value (LTV) of 80% (or 60-70%) of the value of the mortgaged real estate (the assets referred to in points (1) and (2) commonly as the "CRR Assets");
- (3) other high-quality cover assets consisting of residential (or commercial) mortgage loans with a maximum LTV of 70% of the value of the mortgaged real estate or LTV of 100% in the case of real estate according to CRR (the "HQ Assets");
- (4) loans to or guaranteed by public undertakings majority owned by the state or regional authorities which provide essential public services and are subject to public supervision (the "PU Loans").

The bank shall include the words "covered bond" ("krytý dlhopis") in the title of the security which may also be labelled "European Covered Bond Premium" ("európsky krytý dlhopis (prémiový)") if secured by CRR Assets and meeting all conditions under article 129 of CRR or "European Covered Bond" ("európsky krytý dlhopis") if secured by HQ Assets or PU Loans.

The coverage ratio calculates the total of the values of Cover Assets towards the total of the values of Covered Bond Liabilities. The bank must maintain the minimum level of 5 % of overcollateralization for each relevant covered bonds programme that includes CRR Assets in the cover pool and 10 % for each that includes HQ Assets or PU Loans. In individual terms and conditions of the issuance of the covered bonds, the bank can determine a higher coverage ratio than 105 % resp. 110 % 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 issu-

ances, 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 and counterparties of derivative contracts have recourse to the issuer as well as a preferential claim on the cover pool. The Cover Assets are recorded in a special register of covered bonds (the "CB Register") and monitored by a cover pool administrator. The special public supervision is performed by the banking supervision of the NBS.

The claims attached to the Cover Assets, or any part thereof, in relation to which the debtor is considered defaulted (under Article 178 (1) of CRR) shall not be accounted for in calculating the coverage ratio and must be deleted from the CB Register.

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 keeps the Cover Assets on its balance sheet separately from the other banking assets.

III. COVER ASSETS

Cover pool consists of the following Cover Assets:

- a) primary assets that include CRR Assets, HQ Assets and PU Loans. Certain special conditions apply to CRR Assets and HQ Assets that consist of the receivables of the issuing bank from mortgage loans. 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. The mortgage loan must be secured by liens to residential or commercial real estate located in Slovakia and registered by the bank in the CB Register at its discretion. All primary assets include, in addition to the receivables, also the liens to real estate or other forms of collateral used to cover these receivables. The CRR assets must account for at least 90% and HQ Assets or PU Loans for at least 80% of the total nominal value of the covered bonds to which such relevant primary assets form coverage under the relevant covered bonds programme. For the purpose of coverage ratio, the value of the primary assets is calculated on the basis of a residual nominal value of individual receivables. For other purposes, the calculation of the value shall include also aliquot interest income. The CBD Act allows the bank to use as primary assets the assets originated by its own subsidiaries or by other banks, which it acquired by purchase or as a result of the transfer by way of financial collateral arrangement. The bank is then obliged to assess the credit-granting standards of the subsidiary or perform itself a thorough assessment of the borrower's creditworthiness.
- b) substitution assets that may include assets meeting conditions under CRR. The substitution assets can account for not more than 10% of the total nominal value of the covered bonds to which such assets form coverage in the cover pool including CRR Assets and not more than 20% of the value of the total nominal value of the covered bonds in the cover pool including HQ Assets or PU Loans. For the purpose of coverage ratio, the value of the substitution assets is determined on the basis of the lower of their real value (including an aliquot interest income) and nominal value. For other purposes the real value of securities and nominal value of other substitution assets is considered together with the aliquot interest income.

- c) hedging derivatives the purpose of which is to manage and mitigate currency risk or interest rate risk connected with issued covered bonds and which shall form part of the cover pool until such risks cease to exist. 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 consisting of assets of level 1 assets, level 2A assets or level 2B assets (under Articles 9 to 13 of Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 supplementing CRR) except own assets issued by the bank issuing the covered bonds or its affiliates and exposures toward institutions (Article 129 (1)(c) of CRR).

In every moment the bank must cover net liquidity outflow (i.e. all payment outflows of the covered bonds programme falling due on one day) from a buffer of liquid assets at least in the value of the maximum cumulative net liquidity outflow over the next 180 days. The value of the buffer of liquid assets is a part of the coverage ratio and, for that purpose only, the value of securities entering the buffer of liquid assets shall be determined on the basis of the lower of their nominal value and real value (including an aliquot interest income). Otherwise, the real value of securities (including an aliquot interest income) and nominal value of other assets are considered when entering the buffer of liquid assets.

Assets and other asset values become a part of the cover pool and are considered Cover Assets when registered in the CB Register. They are a part of the cover pool until they are deleted from the CB 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 and termination 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,
- c) the liabilities of the issuing bank which arise from the hedging derivatives included in cover pool. (all liabilities in preceding let. a) to c) together the "Covered Bond Liabilities").

Cover Assets are used by the bank preferentially to cover the Covered Bond Liabilities and the bank must not dispose of them or use them to secure other liabilities until they are deleted from the CB register.

IV. VALUATION AND LTV CRITERIA

The CBD Act sets a 70% LTV limit for the eligibility of HQ Assets consisting of mortgage loans. The LTV limit is a soft one, meaning that in case a mortgage loan exceeds 70%, the loan is included into the primary assets only up to the lower of (i) the amount that does not exceed 70% of the value of the pledged property or (ii) the value of the actual and earlier registered pledge rights. If the value of the pledged property drops in any case below the amount of the outstanding principal of the mortgage loan, such mortgage loan must be immediately deleted from the CB Register.

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 mortgage 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

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, among others:

- a) the structure of covered bonds, maturity thereof, the number and volume of the covered bond issuances, the currency and the interest rates thereof,
- b) the value of the cover pool, value, type, proportion, maturity structure and asset evaluation method 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 possibility of maturity extensions, the level of required and available coverage, the statutory or contractual level of overcollateralization, the percentage of the loans where it is presumed that the borrower is defaulted and of the loans overdue for more than 90 days;
- e) other documents and information related to the covered bonds programme.

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, among others, the following information:

- a) number, volume, revenues and maturity dates of the issued covered bond issues,
- b) volume of Cover Assets 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) structure of immovable property securing the primary assets, broken down by family houses, flats, building land and unfinished structures,
- h) method for calculation and amount of the estimated liabilities or costs incurred by the bank,
- i) 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 appoints the covered bonds programme administrator and his deputy on its own initiative or on the proposal of the bank issuing covered bonds, whereas in the latter case NBS makes also its own suitability assessment of the bank's nominee. The administrator shall monitor 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. The administrator shall immediately inform NBS in writing if he finds any deficiencies or breaches in relation to the covered bond programme. Based on such findings NBS shall take appropriate remedial measures.

The administrator's duties include, among others, to check and verify whether:

- a) the aggregate nominal value of the issued covered bonds, and the corresponding interest revenues, is covered by the Cover Assets at least at the coverage indicator value,
- b) the bank complies with the requirements for structure of the cover pool,
- c) the Cover Assets registered in the CB Register comply with the Act on Banks,
- d) the agreement dealing with the hedging derivatives comprising the cover pool contains provisions pursuant to Section 73(5),
- e) the immovable property securing the primary assets meet the legal requirements.

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 Cover Assets are fully segregated from the general insolvency estate of the bankrupt bank. The trustee of the bankrupt bank is obliged to manage those Cover Assets as a special separate bankruptcy estate for the benefit of the covered bondholders and the counterparties of hedging derivatives having, by operation of law, a preferential claim and first priority perfected security interest in the cover pool. A segregated estate represented by a relevant cover pool is created separately for each individual covered bonds programme.

Only the Cover Assets included in the CB Register may serve as collateral and be used for satisfying the claims against the bankrupt issuing bank and its estate.

The bankruptcy trustee must observe special procedures regarding the administration and management of the overall covered bonds programme upon declaration of the issuer's bankruptcy. In particular, it is the responsibility of the bankruptcy trustee to assess, 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 covered bonds programme (or its part) 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, 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 maturity extensions for another 12 month apply and payments of principals are postponed until the expiry date of the relevant extended period. There is also no acceleration of repayment of the issuer' liabilities relating to the covered bonds during these periods. The transfer procedure features identical mechanics as the sale of the company's enterprise or its part on a solvent basis ("predaj podniku"). It includes the transfer and assumption of the whole portfolio of claims and liabilities pertaining to the covered bonds and to the Cover Assets 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, then the acceleration of repayment 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 CRR. The listed covered bonds are eligible for repo transactions with the central bank.

X. ADDITIONAL INFORMATION

Issuers: Československá obchodná banka, Prima banka Slovensko, Slovenská sporiteľňa, Tatra banka, VÚB – Všeobecná úverová banka, 365.bank, UniCredit Bank Czech Republic and Slovakia, foreign bank branch (this entity is not the issuer of the new covered bonds (CBs) but only administers the originally issued mortgage-backed bonds (HZL) which were predecessors of CBs under former legislation).



COVERED BOND LABEL : Prima banka Slovensko (1 pool).

For the most up-to-date information, please consult the new ECBC Covered Bond Comparative Database webpage on the Covered Bond Label website www.coveredbondlabel.com.

In the context of the transposition of the Covered Bond Directive (the final deadline for which was 8 July 2022), the ECBC has undertaken a full review and update of the Covered Bond Comparative Database to take account of the latest regulatory developments. This unique reference tool can be accessed via the link hosted on the Covered Bond Label website (www.coveredbondlabel.com/legislation/comparative_database).

For further national information on the Slovak market, please see compare.coveredbondlabel.com/frameworks. To access the "Country Comparison" feature of the database, please see compare.coveredbondlabel.com/compare/select/frameworks.

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