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Strengthening Corporate Governance Process in Slovak Banks

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ABSTRACT: *The main motivation for this article was the high topicality of the corporate governance issue in the wake of the applied risk culture in banks from Slovak authors. The primarily focus is on the literature review and level of the application of the corporate governance principles and up to now applied risk culture in Slovak commercial banks. The bank´s experience in Slovak banks over the period 2014 - 2016 reinforce, that risk management structures as the part of corporate governance process should be strengthened and deeply embedded in a banks culture to be avoid of the financial crisis problems. The way of corporate governance´s defining in Slovak banks and its strengthening, can contribute to reach efficiency objectives and to increase banking performance. This study increases the understanding of how closely is risk management associated with the implementation of corporate governance principles in Slovakia´s banks. The findings encourage effective knowledge of corporate governance principles and risk culture applicable to higher levels of risk management implementation.*

KEYWORDS – *banking, corporate governance, financial crisis, risk management, risk culture, regulation*

I. INTRODUCTION

A bank´s culture is based not only on overt rules and regulations but also on shared, often invisible, assumptions, which sometimes may even conflict with the espoused values of the bank. Organizational theorists argue that because an organizational culture is based on the deep, often-unconscious assumptions that are taken for granted in daily decision-making it is difficult to change a culture. (Schein, 1990) Without understanding of these assumptions, changes to a prevailing culture will be difficult to make stick.

The aim of the new regulatory requirements, as European market infrastructure regulation (EMIR), Basel III and its implementation into the EU law, Bank Recovery and Resolution Directive (BRRD, 2014/59/EU), is to avoid a similar crisis, as the financial crisis of the past years, as well as to restore public trust in the banking system and to enhance financial stability. To detect and forecast of the risk determination key factors is important for maintaining financial stability through the effective risk culture. At this stage, key factors of financial instability must be revealed. Once the key factors of financial instability are detected, more effective measures can be taken. Financial Stability Board's works on improving the effectiveness of supervision and incorporating risk culture as a key dimension. The concept of risk culture, which is mainly behavioral, continues to evolve and as a result, there will be further adjustments and evolutions in different financial institutions and jurisdictions over time, to enhance risk culture effectiveness based on experiences in the past, business models and circumstances. (FSB, 2014) The report from BCBS states: "An effective risk governance framework includes a strong risk culture; a well-developed risk appetite articulated through the risk appetite statement and well-defined responsibilities for risk management and control functions in general." (BCBS, 2015)

Poor corporate governance can increase risks by affecting the quality of bank assets and causing financial volatility, and are often associated with lack of transparency. (Claessen and Yurtoglu, 2013) With recessions, even perfectly healthy banks can suddenly find themselves with high non-performing assets, losses and low capital.

Some signs typical for pre-crisis period in the U.S. were also recognized in Slovakia: real estate housing prices bubble, and high growth of the household financing 2008/2002 housing price index soared up to 270% and household and non-profit institutions annual loans growth was more than 20% in this time framework. (Pilková, 2010) Slovak banks survived the European debt crisis with no need for any state aid and with sufficient capital levels. (Financial Observer, 2016) Slovakia's banking sector was resilient to potential shocks, thanks to its high capital adequacy ratios and its ability to generate net interest income and values within the organization and ensuring effective organizational performance of risk management. (NBS, 2016)

The main objective of this paper is to identify key factors that affected the risk´s culture in Slovak commercial banks during the financial crisis as the part of their governance behavior and to assess the achieved level of corporate governance in commercial banks in Slovakia regarding the EU program to reform the corporate governance rules and practices in financial institutions.

Our main goal is to identify the key factors of the risk´s management in Slovak banking sector as a part of risk´s culture that will help to characterize the future evolution and development of the supervisory function of the management body in risk oversight.

This paper is organized as follows. Part I offers an insight on bank corporate governance features in literature review. Part II reviews the methodology, structures and brief information about analyzed data and part III considering national and cultural specifics of bank governance in Slovakia. Finally, this case study concludes with an overview of main and most important specifics of Slovak corporate governance, especially of risk culture.

II. LITERATURE REVIEW

1.1. Corporate Governance abroad and in Slovakia

The concept of corporate governance was defined in many definitions by several authors. Sir A. Cadbury defined the report of the company as "a system of governance and control" (Cadbury, 1992). Sir Adrian Cadbury defines corporate governance as “the system by which companies are directed and controlled”. It will also lay down the rules and procedures for decision-making within the organization. Putting the right controls and making sure they work has always been in the heart of corporate governance.

B. I. Tricker (1993) defines corporate governance as the branched-chain relations of critical stakeholders.

The authors Keasey, Thompson and Wright believe that "from a closer perspective, the message can be the company understood as the formal system of accountability of senior management in relation to the shareholders. The essence of the whole issue of corporate governance lies in the separation of ownership and executive decision-making in a public company“ (Keasey K. et al., 1997).

Cochran and Watrick (1998) define the message of the company as "the relationship between shareholders, administrative bodies, top management and other financially interested parties, the lenders, the banks and other entities".

In 1999, the OECD published corporate governance codex, which is created on the principles of openness, accountability and honesty. It must avoid non-ethical behavior, the submission of false financial statements, not taking responsibility of the board of directors and the supervisory board for their actions.

In 2002, the OECD issued a document intended for public´s comment with the aim of safe and healthy management of the company. This effort should also contribute to the development of a culture of values, professional and ethical behavior on which well-functioning markets depend.

According to the definition by the OECD, corporate governance includes "a group of relations between the company's management, its board of directors, shareholders and other stakeholders“.

“Corporate governance also establishes the structure by means of which the company goals are set and the means to achieve them are determined. Corporate governance should establish appropriate incentives to the

board and management for promoting the goals which are in the interests of the company and shareholders, and should facilitate effective supervision or inspection, and thus facilitate more efficient use of resources on the part of the bank." (Klimiková, 2012)

Okruhlica (2013) stated the most appropriate characteristics as the approach to the definition of Tricker - it is the issue of "property relations and systems, such owners exercise their rights of ownership and control towards the management area of the company. At the same time, corporate governance includes processes, structures and relationships through which authority oversees the activities of its executive's workers. Scope of the subject matter of corporate governance is defined by the two approaches:

- The protection of the owner´s rights;
- The analysis of the models of the administrative bodies;
- The relationship of formal and informal institutions (rules);
- Responsibility of the administrative authorities;
- Measure the enterprise performance and risk management.

The second approach, the stakeholder approach, extends the relations between the owners and the management of other stakeholders, which are employees, creditors, investors, analysts, state authorities, customers, suppliers, the media, etc. It goes not only about the exchange of information, but about corporate social responsibility too."

The corporate governance principles, as the basis for the guidelines on corporate governance of banks, have been issued by the Basel Committee on Banking Supervision (BCBS, 2015). The corporate governance principles, adopted as one of the Financial Stability Board´s key standards for sound financial systems, have been used by the World Bank Group in more than 60 country reviews worldwide. The corporate governance principles were drawn up in 1998 by representatives of the central banks affiliated with BIS and previously revised in 2006 and 2010. The third revision was published on 8 July 2015. The revised corporate governance principles are part of a broader trend towards an increased focus on the governance of financial institutions. This is one of the pillars of CRR/CRD IV, the European project which as at 1 January 2014 raised the Basel III agreements to the level of legislation. A significant rethink about the way in which banks are governed is required. The structure and function of bank boards, the compensation of bank executives and the function of risk management within organizations needs careful crafting if governance reforms are to address not exacerbate bank failures. (Armour et al., 2016)

1.2 Risk culture

The lived culture of an organization affirms every task that should be done, every decision should be made. It also determines the meaning of risk and how to handle it. (Muchová and Klimiková, 2016) There is an overall accepted definition of risk as a deviation of a target value.

The Basel Committee on Banking Supervision (BCBS) who plays a major role in improvement the quality of banking supervision worldwide, deals with the question of the risk culture in bank institutions. In the GL 328 (2015, p. 2) the term risk culture is defined as: "A bank's norms, attitudes and behaviors related to risk awareness, risk-taking and risk management, and controls that shape decisions on risks. Risk culture influences the decisions of management and employees during the day-to-day activities and has an impact on the risks they assume." The aim of the Basel Committee on Banking Supervision Guidelines, GL 328 (BCBS, 2015), is to underline some important components of risk governance, as risk appetite, but also to reinforce risk governance responsibilities of the board, its specific role, board risk committees, senior management and the control functions. GL 328 describes 13 principles, where the increased focus on responsibilities of different parts of bank for addressing and managing risk and the compliance function are highlighted.

The Financial Stability Board (FSB, 2014, p. 1) highlights the connection between the risk culture and an effective risk management: "A sound risk culture consistently supports appropriate risk awareness, behaviors and judgements about risk-taking within a strong risk governance framework. A sound risk culture bolsters effective risk management, promotes sound risk-taking, and ensures that emerging risks or risk-taking activities beyond the institution's risk appetite are recognized, assessed, escalated and addressed in a timely manner."

Consequently, risk culture supplements the quantitative risk management framework with behavior-related components. (Schmitt, 2017)

II. RESERARCH METHODOLOGY

Research methodology comprises both inductive and deductive research which helps to obtain a certain knowledge regarding the corporate governance principles, particularly corporate culture, in Slovak banking system in the period of 2014-2016 (Muchová, 2018). In this respect, study clarifies the past, present and configuring the future of research in this area. To achieve of goals, some theoretical concepts are described, drawn from various scientific articles, relevant legislations and standards that regulate and coordinate the work of this field.

This study investigates the level of application of corporate governance in banks performance in a sample of 27 Slovak banks over the period 2014 – 2016. To obtain relevant data, there was distributed the author´s questionnaire with a cover letter to the selected respondents with the confidentiality. Along with the questionnaire, personal meetings were realized. The questionnaire included a total of 17 questions. Twelve questions were opened. All respondents could answer on these questions up their own wording. For example, some of the focusing areas are: the principles of constitution of bank´s administrative bodies, methods of the real-world performance, decision-making process and evaluation, the impact and contribution of independent and non-executive members of the administrative bodies, principles of remuneration. All questions of the author´s questionnaire was analyzed by using appropriate statistical methods and by creating of graphs. On this base, the real situation of the corporate governance in Slovak banks was evaluated. The other areas of research would be presented in author's dissertation work in 2018. (Muchová, 2018)

III. FINDINGS AND ANALYSIS

3.1 The Institutional Framework supporting Corporate Governance in Slovakia

The primary sources of corporate governance legislation in the Slovak Republic are:

(1) the Commercial Code;
(2) the Accounting Act;
(3) the Securities Act.

The development of the national Code of Corporate Governance for Slovakia is closely related to the world´s developments in corporate governance. The first Code issued in the year 2002, which had been initiated by the Bratislava Stock Exchange, was already based on the principles of corporate governance issued in 1999 by the Organization for Economic Co–operation and Development (OECD).

The need to update the then-effective Code raised relating to the issue of revised OECD Principles in 2004, as well as the EC´s recommendation for corporate governance and subsequent changes in the relevant legislation in Slovakia. To cooperate on updating the Code, Central European Corporate Governance Association (CECGA) invited experts from National Bank of Slovakia, Ministry of Finance of the Slovak Republic, Ministry of Justice of the Slovak Republic, Ministry of Economy of the Slovak Republic and the Slovak Banking Association (Muchová and Klimiková, 2016). A draft of the new Code was placed on CECGA´s website in October 2007. A broad discussion within the expert community resulted in a new Code of Corporate Governance in Slovakia, which came into effect on 1 January 2008.

Another milestone in development of the nation Code was the approval of the G20/OECD Principles in September 2015 in Ankara. The starting point for the revision of the national Code was not only the new G20/OECD Principles, but also the EC´s recommendation for corporate governance applying to independent members of company boards, remuneration and reporting on the "comply or explain" basis. Once comments from various professional groups and associations as well as companies whose securities are admitted to trading on the Stock Exchange were incorporated, the Code of Corporate Governance for Slovakia was issued.

Companies should start to comply with the Code from 1 January 2017, and begin reporting according to the Code from 2018 (CECGA, 2016).

Many principles are already in law, or will be so soon. Some of them are binding for all companies, some only for companies traded on the regulated market; some only for banks, insurance companies and other types of partnerships. For completeness, the Code specifies all important principles even though the obligation to observe some of them is for liable companies stipulated directly by law and laws are often changed at the time of crisis. The principles of good corporate governance should be stable in nature. The institutional framework supporting corporate governance practices in the Slovak banking system seems to be moderately well developed regarding to EU requirements in accordance with the result of our research. Nevertheless, space for improvement exists. (Cigna, Kobel and Sigheartau, 2016)

3.2 Financial Crisis and Slovak Banking Sector

Slovak commercial banks survived the European debt crisis with no need for any state aid and with sufficient capital levels. Slovakia's banking sector was resilient to potential shocks, thanks to its high capital adequacy ratios and its ability to generate net interest income (Financial Observer, 2016). The central bank said in its yearly financial stability report that banks could post losses under its crisis scenarios and some could also see their capital drop under the 8% minimum in the worst of its two stress scenarios.

According to the central bank, there were 27 banking institutions active in Slovakia as of December 31, 2015. They included 10 banks, 13 branches of foreign banks, 3 building savings banks and 1 savings and loan association, an organizational unit of a foreign entity. Hence, it can be stated that the banking sector is relatively saturated and stable from the view of number of entities concerned. The amount represented 90% of GDP in the given year (GDP of Slovak Republic amounted EUR 76,521 mil. in 2015). Cumulated profit generated by the banking sector in 2015 amounted EUR 626 mil., as follows from the available data. The shown profit reached the second highest level since 2009, with the profit for the current period having increased in 2015 by 13.1% compared to the previous period of the year 2014. ***The major Slovak banks are*** ČSOB, Poštová banka, Slovenská sporiteľňa, Tatra Banka and VÚB. The banking sector makes up around 70% of the financial sector. The banking sector has been impacted mainly through real economy.

Sector entered into crisis with almost 98% banks owned by foreign capital; highly concentrated (more than 60% of assets owned by 3 largest banks); highly competitive (15 fully licensed banks and 11 branches of the foreign banks operating on 1 license); sufficiently capitalized and liquid; core business activities are focused mainly on commercial banking and special activities in the area of financing housing construction; local banks operate mainly in Slovakia; banks operate under Basel 2 regulation since January 1st, 2008. Basel 2 has been extended on area of strengthen role of supervisors in relation to the bank risk management and duties of banks to provide sufficient information to the market.

Impact of the crisis on the Slovak banking sector had a few specifics, some of which were identified as the key factors of the risk´s management in Slovak banking sector as a part of risk´s culture:

(1) thanks to approaching Euro adoption, Slovak banking sector **hasn´t been influenced** by liquidity crisis **directly.** However, liquidity crisis had indirectly influenced sector through increased costs of funds (liquidity margins applied on international financial markets). Bank liquidity drops mainly because of the financial crisis. Bank liquid assets, or more precisely the share of liquid assets in total assets, and in deposits and short-term funding, decreases also with higher bank profitability, higher capital adequacy and bigger size of bank. Big banks rely more on the interbank market or on a liquidity assistance of the Lender of Last Resort. Despite the crisis, all banks (with the only exception of OTP Banka Slovensko) even increased their lending activity and thus lower their liquidity. It is possible that the increase in their lending activity was a reaction on growing demand for loans. Liquidity measured by the share of loans in total assets and in deposits and short term borrowing increases with the growth of gross domestic product: borrowers reduce their debt during expansionary phases and increase the demand for loans in recessions. This fact is also the reason why banks tend to lend more (and thus decrease their liquidity) even in periods of higher unemployment and lower profitability.

(2) "Setting up" of the financial crisis was positive for Slovakia in three ways in *a preventing of the Slovak banking sector from* deeper problems related to credit losses from *aggressive lending* due to:

(a) over liquidity in the market which has continued after January 1st, 2009,
(b) highly conservative securities portfolio with approx. 76% government bonds and
(c) absence of toxic assets i.e. Slovak banking sector was not involved into the doubtful businesses with credit derivatives. These businesses were not infected from other banks.

Positive "setting up" impact was also due to short-term period since the previous banking crisis in 1998 and in 2001 the privatization and restricting of the major Slovak banks had been completed. In that period, "non-performing loans ratio" reached 30%, 4 banks (out of 25) bankrupted and one was restructured and then sold. Owners of the newly privatized banks introduced more *conservative approach towards credit risk* – to be in line with the best banking principles. *Slovak banking sector* was *well capitalized* (with high quality Tier 1 capital close to 90%) *and profitable* before crisis.

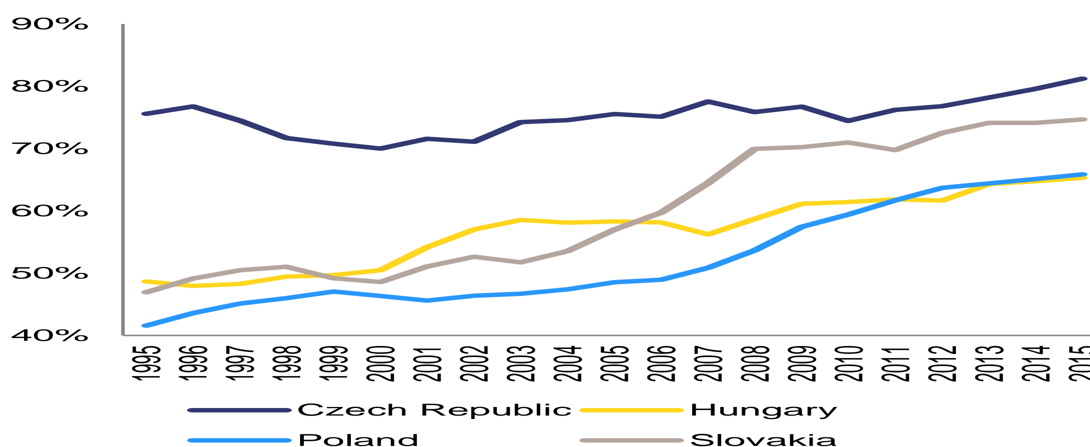
(3) most of foreign owners belong to more conservative groups which strategy have been focused mainly on traditional commercial bank business model not on speculation or modern business model focus on "origination and distribution".

(4) National Bank of Slovakia as the strict local regulator was alert and since the beginning of crisis in the U.S. and Western Europe applied stricter regular monitoring of each banking institutions through reporting (introduction of the new daily reports) focusing mainly on short-term and long–term liquidity. At the same time regulator seriously focused also on monitoring Basel 2, Pillar 2 implementation by the local banks. However, 2009 banking activities and results have reflected crisis impact. (Pilková and Pätoprstý, 2002)

Due to increased credit risk lending activities and investment into the Slovak Republic state bonds and state bonds of surrounding countries grew. While volume of corporate loans decreased (2009/2008 -3%), retail segment financing still grew (+10%). Slovakia remains among Europe's stronger economies, with growth continuing to pick up in 2015, driven by strong domestic demand.

The banking sector has sound capital and liquidity buffers and private debt is limited, but household borrowing has been rising rapidly. On the other side the banking sector achieved quite high level of capital adequacy ratio (12, 6% /increased by 1.4% during year)[1], good liquidity position (e.g. loans to deposit ratio was 77%) and manageable market risk.

Figure 1: *GNI per capita (in PPP, EU28 = 100)*



Source: *European Commission*

Available at: European Commission: Country Report Slovakia 2017, Brussels, 27.2.2017; SWD (2017) 90 final/2; Available at: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52017SC0090R(01)

[1] Level of minimum capital adequacy required by regulator is 8%.

3.3 Risk Management in Slovak Banks

An effective risk management system enhances the reliability of forecasts and planning. As an integral part of executive management, it helps identify unexpected deviations from corporate goals at an early point in time, focus on the future and enable the board of directors to reduce complexity to the essential issues (KPMG, 2016). Since taking risks is the core of the bank business, the first step to imbed the risk management into a risk culture is to define risk on the organizational level. As a part of the business strategy should be designated, which risks the company intends to take and which are not wanted. The risk appetite, the optimal risk-return profile and the proper optimal risk level should be set by the executives. Instead of risk mitigation, the risk optimization should be targeted. (Schmitt, 2017)

Risk managers must remain vigilant to the challenges posed by the risks associated with new products, processes and markets. Risk governance must adapt ahead of, or at least abreast of, change. One of the lessons learnt from the banking sector, financial crisis that started in 2007 onwards was that certain "risk takers" can't be left to the control of the CEO or senior management, they must report directly to the board or one of its committees. This includes chief risk officers, chief financial officers, and chief auditors. Recent bank collapses clearly indicated that it is way too risky for the CEO or top management to be in control of these functions (Gamal, 2015). The use of various committees can lead to a fragmented and silo-driven approach, which can result in critical risks being omitted from consideration. That is why the risk oversight approach should be carefully orchestrated at the full board level (Tonello, 2016).

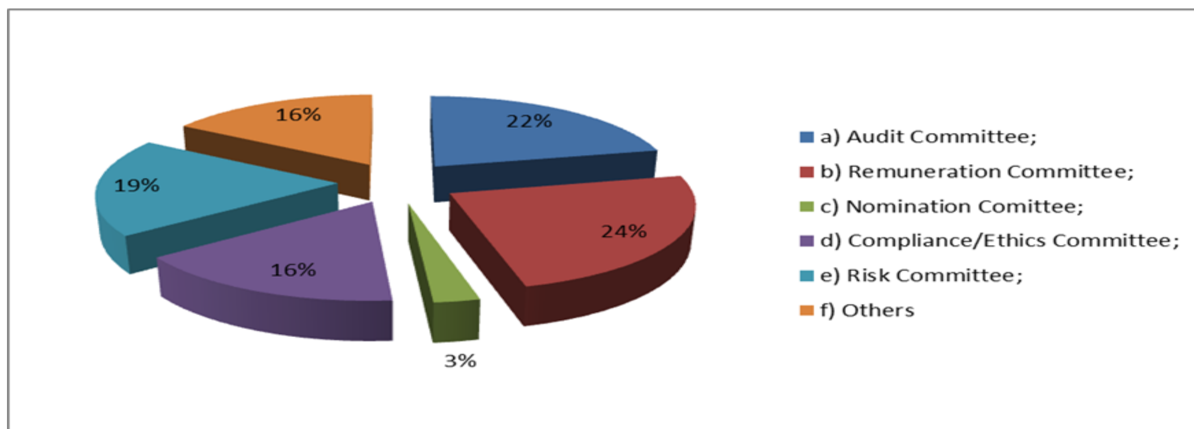
Effective risk governance within financial institutions requires several actions on the part of boards and management teams:

(1) Establish ***a Risk Committee*** that supports the board's role in approving the bank´s risk appetite and that oversees the risk professionals and infrastructure (G30, 2012). Slovak commercial banks are required to establish a Remuneration Committee and a Committee for Risk Management (e.g. Risk Committee), but they can opt. The Corporate Governance Code recommends companies to establish a Nomination and Remuneration Committee. The law and the Code are silent on the minimum number of meetings of the board and the committees. The Code only recommends that the Audit Committee should report to the supervisory board at least every 6 months. Risk committees play a very important part in the financial institution´s control network by improving the focus and dialogue on risk. The Risk Committee's core mission should be to shape, and then present to the full Board for approval, the bank's risk appetite within the context of the bank's chosen strategy. It should ensure the risk culture supports the desired risk profile and that risk leaders and professionals are capable, empowered, and independent. Risk Committees should play an active role in driving the bank's risk agenda. Risk committees need a mix of skills. Some committee members should have relevant financial service - sector experience or technical risk expertise, so that they have sufficient understanding of the underlying concepts when approving risk appetite frameworks and risk limits. There is great value in having generalists from outside the industry on the Risk Committee. They often ask basic questions and force executives to be more articulate in explaining the bank's risks and risk approach (EBA, 2011).

Drawing on insights from recent survey work and interaction with bank directors and leaders over the period of 2014 – 2016 confirmed that commercial banks in Slovakia have set up various committees. Respondents were asked to provide information on the legislation and on how they believe the legislation is implemented. Most banks have established Audit Committees, Risk Committees, Remuneration Committee, or Committee for Compliance/Ethics (Fig. 2).

Based on our analysis using 2014 and 2016 data collected from commercial banks in Slovakia, it is encouraging to note that Slovak commercial banks have taken steps to improve their corporate governance practices. Our research confirmed that the situation in Slovak banks regarding to relevant existence of committees is in line with international trends. The number of requirements and recommendations related to the key risk issues is particularly dynamic. OECD identified risk management and remuneration policy as two weaknesses that contributed to the global financial crisis. Our findings follow the OECD Corporate Governance Fact book 2017 common findings, which provide the first comparative report on corporate governance across all OECD, G20 and Financial Stability Board member jurisdictions. (Blume, 2016)

***Figure 2:** Committees established and formally defined the Responsibilities in The Procedure Rules in Slovak banks*

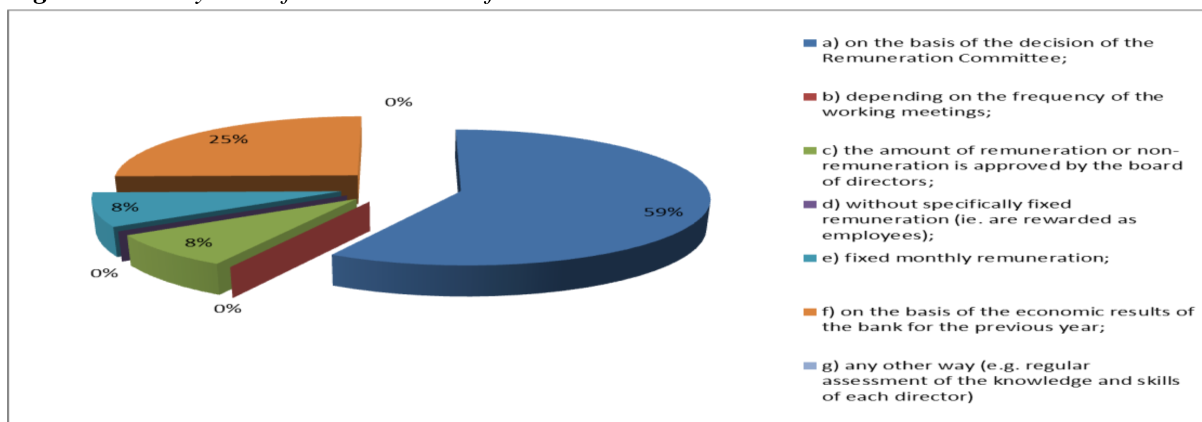


***Source**: Author´s own processing*

(2) Ensure ***the presence of a Chief Risk Officer*** who is independent, has stature within the management structure and unfettered access to the Risk Committee, and has the authority to find the appropriate balance between constraint and support of risk taking (EBA, 2011). Since the financial crisis, much attention has been paid to the governance of the remuneration of board members and key executives. The Chief Risk Officer's compensation should be recommended by the Chief of Economic Officer and reviewed and approved by the Risk Committee, in consultation with the Compensation Committee.

In some of the major financial institutions that failed or suffered badly in the crisis, the Chief Risk Officers and risk professionals struggled to properly influence their bank's risk-taking activities. They lacked sufficient independence from and credibility with the bank's top management and business units. That situation can be avoided by ensuring the Chief Risk Officer has the independence, skills and stature to influence the bank's risk-taking activities, directly and through the risk professionals who the Chief Risk Officer oversees. The remuneration of Board members in Slovak banks is solved as follows:

***Figure 3**: The System of Remuneration of the Board Members in Slovak Banks*



***Source**: Author´s own processing*

As we found, up to 59% of the banks reported that the remuneration of Board members is dealt with based on the decision of the Remuneration committee (Fig. 3). The results indicate that the Remuneration Committee assesses the overall results of the bank only formally, because 25% of the respondents stated that the system of remuneration depends on the economic results of the bank for the previous period, however, no respondent has put forward that would regularly assess the abilities and skills of each director (member of the Board). In comparison with the Code of Ethics, that the good practice considers the introduction of provisions for potential refund and the gradual withdrawal of performance bonuses in banks, such provisions are mentioned only rarely, as we are not considered it as the correct deviation.

The delicate balancing act between independence and collaboration in the board's relationship with management is especially evident in the operation of the risk function. Financial institutions differ on whether the Chief Risk Officers should have absolute veto power. Under that approach, the Chief Executive Officer must accept the risk function's view (Jackson, 2015). The National bank of Slovakia, as the national regulator, also monitors the occurrence of moral hazard in the management of financial institutions or in settings of cooperation with financial intermediaries in their regular quarterly evaluation of development in area of financial stability (NBS, 2017).

Open dialogue with senior management ensures that everyone understands how risk decisions are being made and that consideration is given to any Chief Risk Officers concerns. The Chief Risk Officers should play a key role in major risk decisions. The risk function should be facilitating decision making and not strictly as compliance function.

Chief Risk Officers need the following characteristics and conditions to be successful (EBA, 2011):

- business acumen so they can balance risk mitigation and business exigencies and command the respect of the board, management, and employees at large;
- be a good communicator, because they need to be able to tell a compelling narrative to people who are often less qualified in technical risk matters;
- courage and conviction, and they should be willing to walk away from their job if their judgment on major issues is ignored;
- the right stature in the organization;
- be a member of the senior management team and should report to the chief executive officer;
- high visibility in the boardroom and should have unfettered access to the chairman of the Risk Committee and the full Board when necessary.

Based on our research, up to 50% of the sample in Slovak banks has evidence about proactive approach and engagement of the supervisory board what shows a high visibility and live communication in the board room as they responded on the question "How would you evaluate the impact of the supervisory board in your bank?" (Muchová, 2018)

Effective risk management in Slovak banking sector, in a form of conservative approach toward credit risk and strategy focused on traditional business model, helped Slovak banks to go through the period of financial without excessive financial damages.

3.4. Risk Culture in Slovakia

Practical experiences from managing risk in the commercial banks in Slovakia during the period of financial crises helped to identify key success factors. They can also be considered as a basis for further discussion how to build efficiently operating commercial bank risk management system which could serve both for prevention of crisis and for management if crisis occurs. Slovak banking sector was very stable with slow growth and we call this period as a "period of new challenges." Situation has changed – new opened subsidiaries in Slovakia were in most cases in a better position than their banking group. A new risk culture was incorporated into management of the Slovak commercial banks through the implementation of comprehensive and complex regulation (Basel II, January 2008). Now there was a need of changing risk management´s role from loss decreasing to value adding, both on the level of the bank as whole and individual business units and which role risk management plays in strategic and operational decisions making processes.

Corporate scandals continue around the globe, increasing pressure on all organizations to review their governance and their culture (Harrington, 2016). According to the definition of risk culture suggested by the Financial Stability Board (FSB, 2014) and the Basel Committee (BCBS, 2015), just a risk culture affects the decisions of management and employees during day-to-day activities and impacts, the risks they are exposed to (Schmitt, 2017). A sound and consistent risk culture throughout bank is a key element of effective risk management (EBA, 2011). A strong risk culture is essential for effective risk management and in the long run global financial stability. If management cannot see risks building or cannot see where behavior is moving away

from the desired profile, then the culture cannot be proactive. The European directive Capital Requirements Directive IV (CRD IV), recital 54, claims the introduction of standards for an effective risk control through the executives. These principles, as a part of risk management, should promote a sound risk culture. The role of risk management is also one of the objectives of BCBS GL 328.

Risk culture cannot be influenced by the risk management function alone. While executive leaders can authorize resources, empower people, and reward achievements, an effective risk culture requires commitment of all levels in the bank. In a strong risk culture, all members of the workforce understand that managing risk is part of their daily responsibilities. (Hindson, 2012)

3.5 Strengthening Risk Culture in Slovak Banks

Sound risk culture and a proper risk-taking behavior are supported by an effective risk control function, a framework for an appropriate risk appetite and remuneration practices (FSB, 04/2014). As time passes experience has been gained both, nationally and internationally, in respect of what functions and what does not function. Some of the elements that have had greatest positive impact on strengthening risk culture of Slovak banks are, in our opinion, the following:

- Having regard to developments in the principal indicators of excessive credit growth and leverage, the Bank Board of National Bank of Slovakia decided to issue the Recommendation in response to developments in the retail loan market, after having repeatedly drawn attention to several risks in this market (NBS, 2016). Risk transparency played a central role, especially from the position of NBS as central regulator. The strong reaction during the financial crisis shows how crucial central bank communication is in turbulent times (Hayo et. al, 2012). Conservative approach toward risk and strategy and decisions in macro prudential policy had positive impact on risk behavior in Slovak banks;

- Boards and senior management should have reviewed risk culture thoroughly, defined the desired behavior, and put in place the right mechanisms to achieve lasting change (Jackson, 2015). In Slovak banking sector we have mentioned also the other aspect – not only thoroughly, but together with this systematically. Because risk culture often evolves as the banks evolves, it may make sense for banks to use self-assessment techniques, internal surveys, focus groups and other techniques to understand the current state of risk culture.

For Slovak banks that are addressing cultural weaknesses and regulatory expectations, there is much opportunity to act and adapt to the new risk management order or trends. To strengthen the risk culture banks are encouraged to enhance:

(1) *Direction and "relentless" communication from the top of the bank.* The board and senior management are the starting point for setting the financial institution's core values and expectations for the risk culture of the institution, and their behavior must reflect the values being espoused.

(2) *The risk appetite that is embedded into business strategy and planning.* The optimal risk level must be defined by executives, the measurement and monitoring of risks is the purpose of risk management. (BIS, 2010: BCBS 176, p. 18.) Hence, the task of a risk management is not to mitigate risks in general. It has to measure risk and compare it to the optimal risk level. (Schmitt, 2017) A sound risk culture promotes an environment of open communication and effective challenge in which decision-making processes encourage a range of views; allow for testing of current practices; stimulate a positive, critical attitude among employees; and promote an environment of open and constructive engagement.

(3) *Clearly define roles, responsibilities and accountability of employees at all levels of the bank.* Employees at all levels understand the core values of the bank and its approach to risk, can perform their prescribed roles, and are aware that they are held accountable for their actions in relation to the bank's risk-taking behavior. Staff acceptance of risk related goals and a related value is essential;

(4) *Strong consequences for misbehavior through performance management, compensation and disciplinary actions.* Performance and talent management encourage and reinforce maintenance of the bank's desired risk management behavior. Financial and non-financial incentives support the core values and risk culture at all levels of the bank.

Regulators enforced, among others, rules for sanctioning excessive risk-taking behavior, as cutting bonus payments (a part of CRD IV) and the reversal of proof for senior management, who have to prove they have done everything to ensure a rule-consistent behavior of their staff. The assumption for these rules to work is that sanctioning of misbehavior leads to improvement of risk culture.

Much of this is still work-in-progress. For some Slovak banks, making risk is everyone's business, from the top ranks down to the front-line staff, represents a significant shift in mind set, policies, systems and processes and requires an ongoing, long-term commitment and investment. As a good sign of Slovak bank´s direction since the financial crisis is the 15. Place in the scale of the most stable and most trusted banks as rewarded by the World Economic Forum in his recently-released Global Competitiveness Survey in October 2017.

IV. CONCLUSION

Slovak banking sector was strongly influenced by the Communist past. In Slovakia was found the one of the highest percentage of foreign ownership by the middle of the first decade of transition - the country that opened to foreign bank penetration rapidly after the Velvet Divorce. Fortunately, Slovakia has the benefit of laws and institutions pre-dating communism, easing the transition from one system to the other. Past influences are still strong: centralization, strong controls, and a uniform system of accounting based on a chart of accounts.

Using manually collected data of Slovak banks in this article, we analysed the most important factors, which helped Slovak banking system to "stay alive" in the time of financial crisis without any large-scale damages. The response for rebuilding trust and ensuring long-term sustainability in the banking system of Slovakia is effective corporate governance with strengthening risk culture. The need of changing risk management´s role to value adding, widespread and deeper regulation and the granting of greater powers to supervisors should be a part of the work done ahead.

In fact, that not only Slovak banks, but the "financial world" is trying to put more emphasis on the duties and responsibilities of the management body in its supervisory function in risk oversight, including the role of their committees, the European banking association prepared a new guideline, which will apply by June 30, 2018 to competent authorities across the European Union. We would like to close by suggesting that banks should focus more closely on culture, especially on strong and risk governance structures.

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