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1 INTRODUCTION

In Slovenia economic growth declined throughout the year, while it was still relatively favourable in the euro area in the first half of 2011. The main factor in the slowdown in the second half of the year was the dynamics of growth in the euro area, with several countries slipping back into recession as problems with the debt crisis in certain euro area countries mounted and uncertainty rose on the financial markets.

GDP fell by 0.2% in Slovenia in 2011, but rose in the euro area by 1.4%. Construction was the main factor in the slowdown in economic growth, reducing it by 1.2 percentage points. The crisis in domestic demand deepened in 2011, as government consumption declined alongside the contraction in investment and household consumption. Value-added in the majority of branches of the private sector declined in the final quarter. After stagnating in 2010, gross investment was down sharply again last year as a result of the accelerated contraction in construction investment. The contribution of inventories to year-on-year GDP growth in 2011 turned negative, while growth in investment in machinery and equipment picked up in the second half of the year, despite weaker export demand and a deterioration in financing conditions. The largest contribution to GDP growth came from export-oriented manufacturing industries. The high contribution to GDP growth made by net trade was also partly the result of weak domestic demand. The main factor contributing towards narrowing of the current account deficit was an increase in the contributions from trade in services and current transfers.

The main factors in inflation in 2011 were changes in oil and commodity prices, fluctuations in the prices of seasonal products, the contributions made by prices of services and non-energy industrial goods, and weak domestic demand. Average core inflation was low, and below the euro area average. The harmonised index of consumer prices rose by 2.1% in 2011. The decline in domestic consumption limited the opportunities for corporates to raise prices. Although wage growth slowed, unit labour costs have remained at the elevated levels seen at the very end of 2008 and beginning of 2009. The labour market is adjusting primarily via job losses, and less via adjustments in labour costs.

The crisis hit the performance of the banking sector. The deterioration in the economic situation reduced demand for loans, as a result of the worsening European debt crisis, a decline in economic growth in Slovenia and its trading partners, the relatively high indebtedness of the corporate sector, the adverse situation on the labour market and a decline in the value and liquidity of eligible collateral. The banks adjusted by reducing investments in securities and loans to non-banking sectors. The main reasons for the decline in the banking system's total assets were the continuing reduction of debt to the rest of the world, a decline in liabilities from issued debt securities and a decline in equity as a result of losses. The banks compensated for the decline in liabilities from issued securities and liabilities to the rest of the world by means of long-term funding obtained from the Eurosystem. The stock of loans to non-banking sectors was down 4.2% by the end of 2011. The supply of loans was restricted by a decline in funding, high funding costs, a deterioration in the quality of the credit portfolio and a decline in the banking system's capital adequacy relative to the requirements, even though the ratio of own funds to total assets at banks in Slovenia is relatively satisfactory. The current year is again expected to be one of the more difficult for the normalisation of lending activity, and will require considerable effort from the banks to improve organisation, performance and profitability.

Central banks responded to the deterioration in the economic situation by maintaining low interest rates and through other measures to stimulate the economy. The European Central Bank prepared a liquidity injection via full allotment instruments, and expanded the range of securities eligible as collateral for raising loans.

Economic policymakers are facing major challenges in fiscal consolidation. Significant action must be focused on promoting structural reforms, maintaining a sustainable wage and cost policy, and on creating the conditions for strengthening capital in the real sector.

Ljubljana, April 2012

Marko Kranjec
Governor of the Bank of Slovenia

1.1 Implementation of the Bank of Slovenia's strategy

The Bank of Slovenia reviews, on an ongoing basis, the implementation of the strategy defined in 2008 in the Strategic Plan for 2009 to 2011. At the forefront of the Bank of Slovenia's activity is the pursuit of one of its core objectives, the concern for financial stability. Given the reforms in the financial sector, and as a result of the creation of new European supervisory arrangements and a new European mechanism of economic governance, in 2011 the Bank of Slovenia defined its priority directions, thus identifying its priorities in the period to 2013. The priorities identified relate primarily to the maintenance of financial and economic stability.

The Bank of Slovenia's priority directions are defined in close liaison with the tasks and functions of the ECB/ESCB, as the core competencies and thus the tasks are derived from the Statute of the ESCB and of the ECB and from the Bank of Slovenia Act. The most noteworthy of the priority directions are tasks related to the preparation of decisions and the implementation of monetary policy, the creation of a stable banking system and the assurance of the conditions therefor, the prudential supervision of banks, financial stability, deposit guarantee scheme, and business continuity. The implementation of these tasks is also related to the appropriate establishment of business processes at the Bank of Slovenia, cost-effective organisation, and the monitoring and assessment of the effectiveness and efficiency of the implementation of the priority directions. The priority directions also form the basis for the annual planning of key tasks, and thus the financial plan, to maintain its stabilising focus.

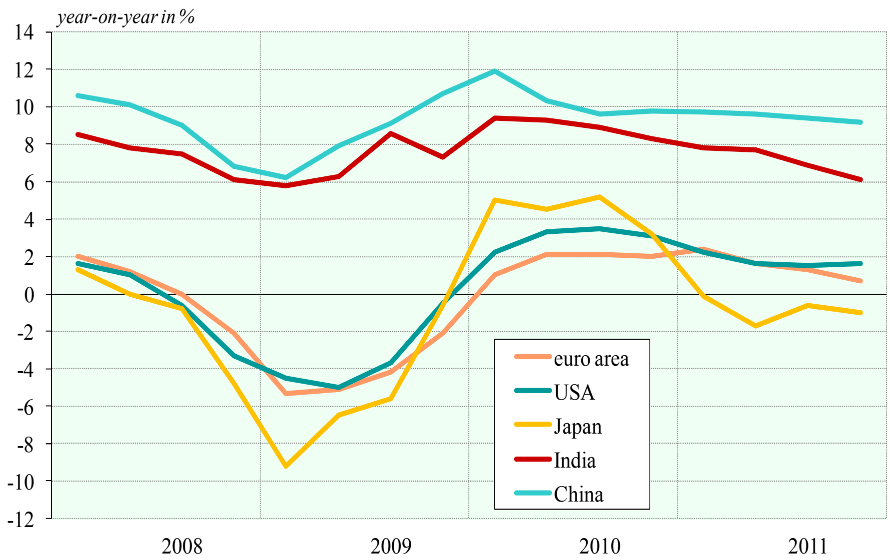
1.2 The economic environment and the banking system in 2011[1]

Economic environment

The global economy recorded growth of 3.8% in 2011, despite high uncertainty.

The global economy was under great uncertainty in 2011. The debt crisis in euro area countries worsened in the second half of the year. Global economic growth in 2011 nevertheless stood at 3.8% according to the IMF's initial estimates, while the global trade increased by 6.9%, primarily as a result of high economic growth in emerging countries. Economic growth stood at 1.5% in the euro area and 1.7% in the US, albeit with different dynamics. Growth increased in the second half of the year in the US, but slowed in the euro area, primarily as a result of the debt crisis[2] in certain euro member states. The main factors in the higher growth in the US in the second half of the year were the gradual improvement in the situation on the labour market and increased household consumption. The mounting debt crisis has so far not had a significant impact on growth in emerging economies. According to the IMF's initial estimates, economic growth in 2011 stood at 9.2% in China and 7.4% in India. Estimated growth in Brazil and Russia was lower, at 2.9% and 4.1% respectively.

Figure 1: **GDP growth in selected major economies**



Note: Seasonally and working days adjusted data for euro area, US and Japan.
Sources: Eurostat for euro area, US and Japan, www.tradingeconomics.com for India, www.tradingeconomics.com and National Bureau of Statistics of China for China.

The debt crisis in certain euro area countries mounted in 2011, which required additional international assistance.

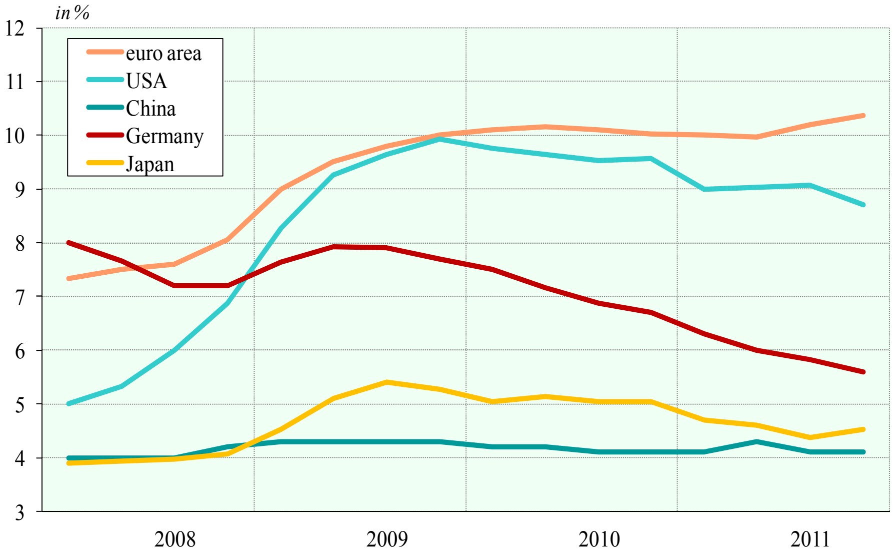
Economic growth in the most advanced economies in 2011 was too weak to bring a significant improvement in the situation on the labour market. The unemployment rate remained high in the vast majority of advanced economies, and rose even further in the euro area towards the end of the year, reaching 10.4% in December. The situation on the US labour market was slightly better: the unemployment rate fell from 9.1% in January to 8.5% in December. The high unemployment rate and low wage growth in the euro area were factors in the decline in final household consumption in the final quarter. Weak economic activity is also limiting growth in tax revenues. As a result the fiscal crisis deepened in certain euro area countries, where there was also a significant increase in sovereign borrowing costs. The IMF, the EU

[1] A detailed illustration of macroeconomic trends and projections is given in the April 2012 Price Stability Report. Detailed analysis of the banking system is given in the May 2012 Financial Stability Review (http://www.bsi.si/en/publications.asp?MapaId=712).

[2] The general government debt in the euro area averaged 66.3% of GDP in 2007, but was expected to have risen to 88.0% of GDP by the end of 2011 according to the European Commission forecasts of October 2011. The growth in deficits was the result of a decline in GDP. At the same time growth in expenditure was sustained by the automatic stabilisers, statutory obligations from the pre-crisis period and economic stimulus measures. Interest payments also rose in the more indebted countries.

and the ECB are using various instruments to help address the situation in Greece, and also in Ireland, Portugal and Spain.

Figure 2: **Unemployment rates in selected major economies**

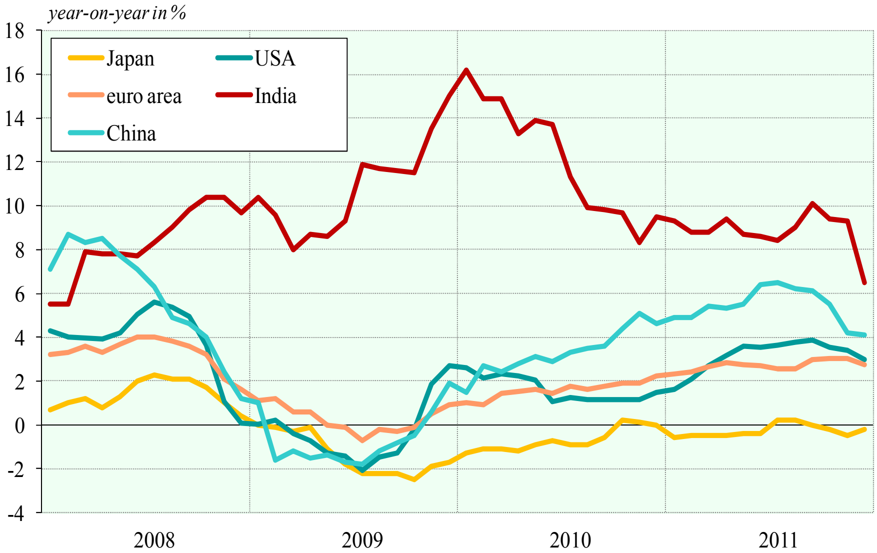


Note: Harmonised and seasonally adjusted quarterly unemployment rate for euro area, US, Japan and Germany.
Sources: Eurostat, www.tradingeconomics.com for China.

Energy prices were the main factor in higher inflation in advanced economies, while core inflation was curbed by low consumption.

Relatively weak domestic consumption in advanced economies again curbed core inflation in 2011, but there was a rise in headline inflation, primarily as a result of higher energy prices. Inflation averaged 2.7% in the euro area, and 3.2% in the US. Energy prices were up 11.9% in the euro area and 15.4% in the US. Prices fell by 0.3% on average in Japan, and rose by 5.5% in China and 8.9% in India.

Figure 3: **International comparison of consumer price indices**

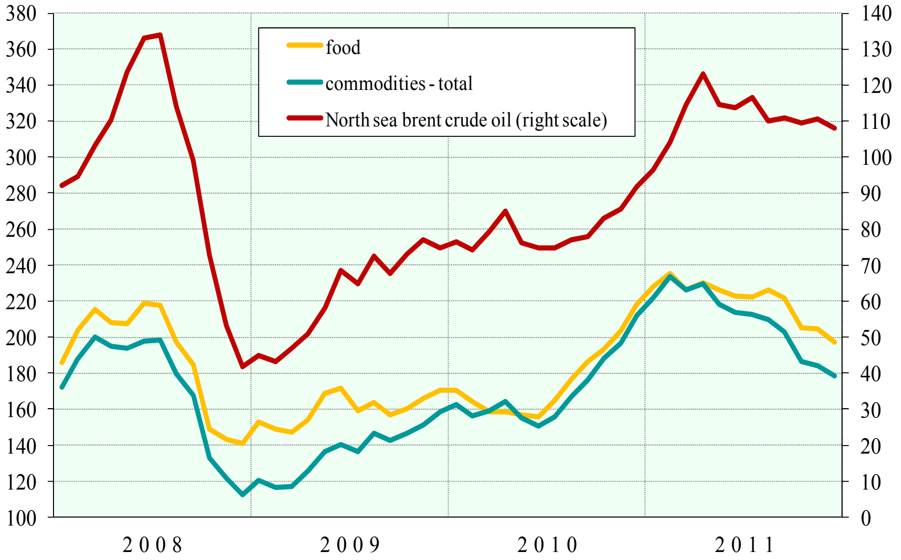


Sources: Eurostat for euro area, U.S. Bureau of Labor Statistics for US, www.tradingeconomics.com for India, China and Japan.

Prices of oil and commodities rose sharply in the first months of 2011, but then fell as a result of poor growth prospects in the major economies.

US dollar prices of oil and other primary commodities rose in early 2011 as a result of expectations of an improvement in the economic climate and political uncertainty in North Africa and the Middle-East. They began falling in the second quarter, as economic growth was relatively low in the majority of advanced countries, while GDP growth forecasts in the major global economies were lowered. The price of a barrel of Brent crude averaged USD 111 during the year, up USD 31. Commodity prices rose until April, then began falling. They nevertheless recorded a rise of 23% in 2011. Food prices were up slightly more, recording average

Figure 4: **Prices of commodities and oil on the global market**



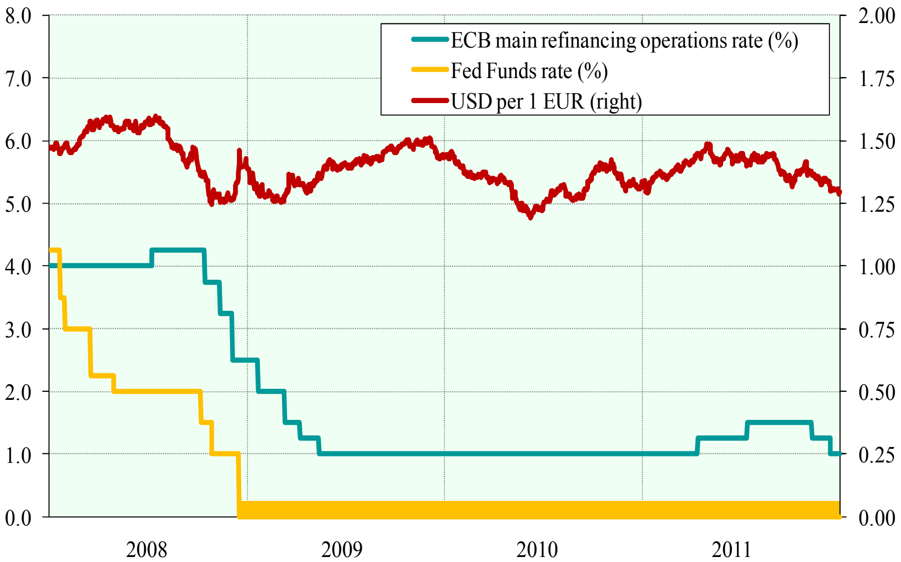
Note: Indices (2000 = 100); oil: price of Brent crude, USD per barrel.
Sources: The Economist, London; Bloomberg.

growth of 26% in 2011. The great uncertainty on the financial markets also saw prices of precious metals reach record highs. The largest rise was recorded by gold, the price of which passed USD 1,900 per ounce for a few days in September.

The main influence on the euro / US dollar exchange rate was the mounting debt crisis in the euro area, while weak growth led central banks to continue with monetary policy stimulus in the advanced economies.

The euro / US dollar exchange rate fluctuated sharply in 2011 as a result of the debt crisis in the euro area. The euro rose in the first half of the year, primarily as a result of relatively favourable economic results in the euro area, and fell in the second half of the year as a result of the mounting debt crisis and economic weaknesses in the euro area. The euro averaged USD 1.39 in 2011, up 4.9% on 2010. The ECB raised its interest rates in April and July, each time by 0.25 percentage points, in order to maintain price stability. It lowered the rate again in November and December in view of the deterioration in the economic situation in the second half of the year and the weaker economic outlook. The key interest rate stood once again at 1.00% at the end of 2011. The ECB also took a number of measures in 2011 to improve the functioning of the transmission mechanism, and worked with the IMF and the EU to address the debt crisis in the euro area. The Fed made no changes to its key interest rate in 2011, leaving it at the interval between zero and

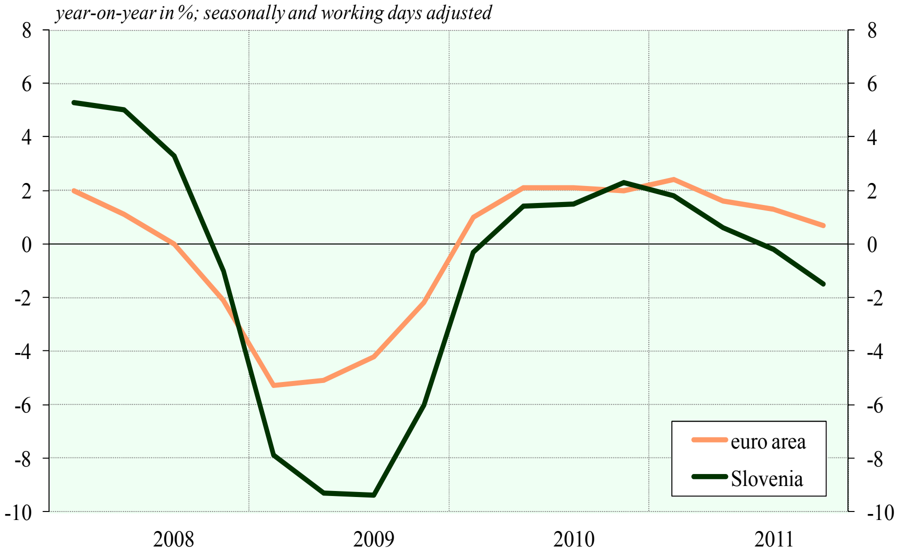
Figure 5: **Euro-US dollar exchange rate and key ECB and Federal Reserve interest rates**



Sources: ECB, Federal Reserve.

0.25%. The second round of quantitative easing also ended in June. The Japanese yen and the Swiss franc both rose, primarily as a result of the economic uncertainty in the euro area, as a result of which the two central banks made frequent interventions in the foreign exchange markets. The Swiss central bank even set a ceiling of EUR 1.20 for the franc. The Bank of England also took additional measures to stimulate the economy.[3]

Figure 6: **GDP growth in Slovenia and the euro area**



Source: Eurostat.

The deterioration in the economic situation in Slovenia in 2011 was mostly due to the deepening crisis in domestic demand.

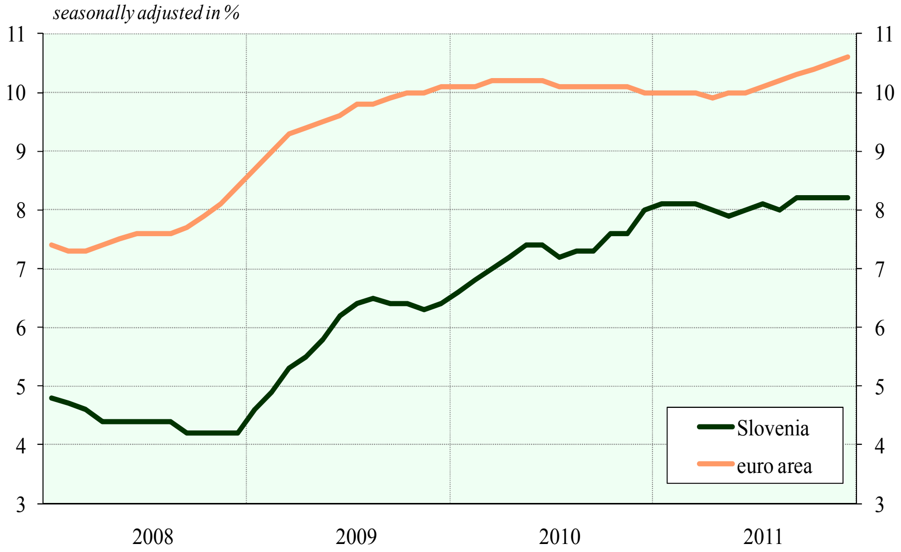
According to the figures adjusted for the season and the number of working days, economic growth in Slovenia was significantly below the euro area average in 2011 at 0.2%. Before the number of working days was allowed for, GDP actually recorded a decline of the same magnitude. The deteriorating economic situation is for the most part the result of a decline in domestic demand, which was particularly pronounced in the second half of the year. Confidence on the international markets also declined at this time, primarily as a result of the deepening fiscal crisis in the most vulnerable members of the euro area. This led to a deterioration in the business conditions of the export sector, but its momentum nevertheless remained positive in 2011. Value-added in manufacturing increased by 3.0% in 2011, 3.5 percentage points less than in 2010. Construction investment declined by 25%, and remained the main brake on economic activity. This was related to the continuing sharp contraction in construction, which reduced economic growth by 1.2 percentage points in 2011. Growth in investment in machinery and equipment increased to 7%, despite tighter financing conditions and lower growth in foreign demand. Final household consumption recorded a gradual decline for the third consecutive year, as unemployment continued to rise and consumer purchasing power continued to decline. As a result of the austerity measures related to fiscal consolidation, the contribution made to GDP growth by final government consumption was also negative in 2011. The majority of forecasts for 2012 envisage a stagnation of economic activity in the EU. At the same time there is little possibility of growth in domestic consumption, in the context of a continuing cost adjustment in the private sector and the urgency of fiscal consolidation. The economic situation will therefore remain poor in 2012.

The decline in employment slowed in 2011.

Employment continued to fall in 2011 because of unfavourable economic situation. Employment was down 1.7%, considerably less than in the previous year. At the end of 2011 employment approached its level of 2006, while real value-added was also at that level. This partially explains the slowdown in the decline in employment in 2011, as the majority of adjustments to the lower level of economic activity had already been made in 2009 and 2010. Employment fell solely in the private sector in 2011, and actually rose by 0.8% in the public sector, despite the government's plan to cut jobs. Employment rose in the education and health sectors, but

[3] A description of the Bank of England's monetary policy measures can be found at www.bankofengland.co.uk/markets/Pages/apf/default.aspx.

Figure 7: **Harmonised unemployment rate in Slovenia and the euro area**



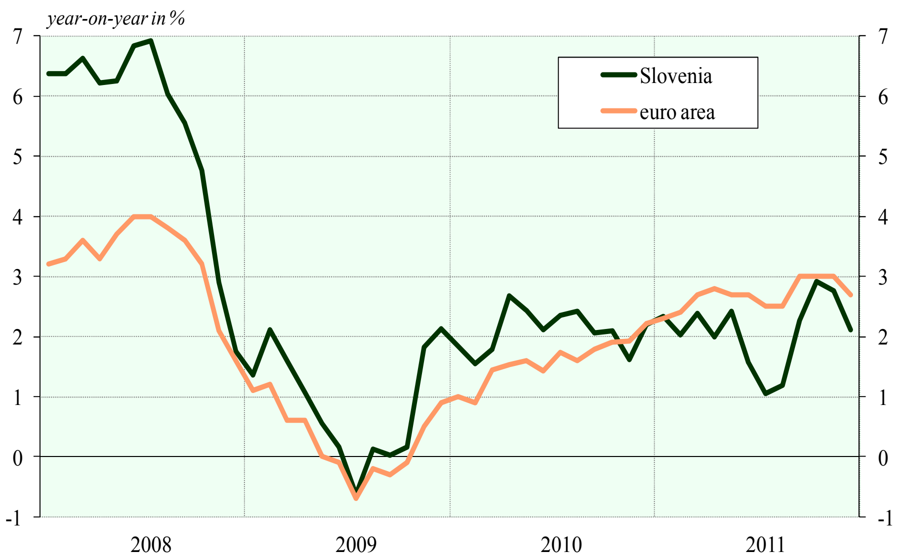
Source: Eurostat.

fell in the sectors of public administration and cultural activities. The number of registered unemployed rose by around 10% in 2011, to pass 112,000 by the end of the year. Despite this, the gap between the number of newly registered as unemployed and the number of deregistrations narrowed in 2011. The proportion of long -term unemployed also increased, approaching half of the total number of unemployed by the end of the year. This highlights the importance of addressing structural unemployment. The harmonised unemployment rate in Slovenia was reasonably stable, and stood at 8.2% at the end of 2011. The situation is relatively favourable compared with developments in the euro area, where the harmonised unemployment rate rose significantly in the final quarter.

Inflation stood at 2.1% in Slovenia in 2011, 0.6 percentage points lower than the euro area average, primarily as a result of internal factors.

Average inflation as measured by the harmonised index of consumer prices stood at 2.1% in 2011, unchanged from 2010, although its structure altered somewhat. The most notable increase was in the contribution made by food prices, while energy prices still accounted for more than half of inflation, despite a decline in their contribution. The high contribution by these two categories was mostly the result of the pass-through of the sharp growth in commodity prices on global markets in 2010 and early 2011 into final consumer prices. Average annual inflation in Slovenia was significantly below the euro area average of 2.7%.

Figure 8: **Inflation in Slovenia and the euro area**

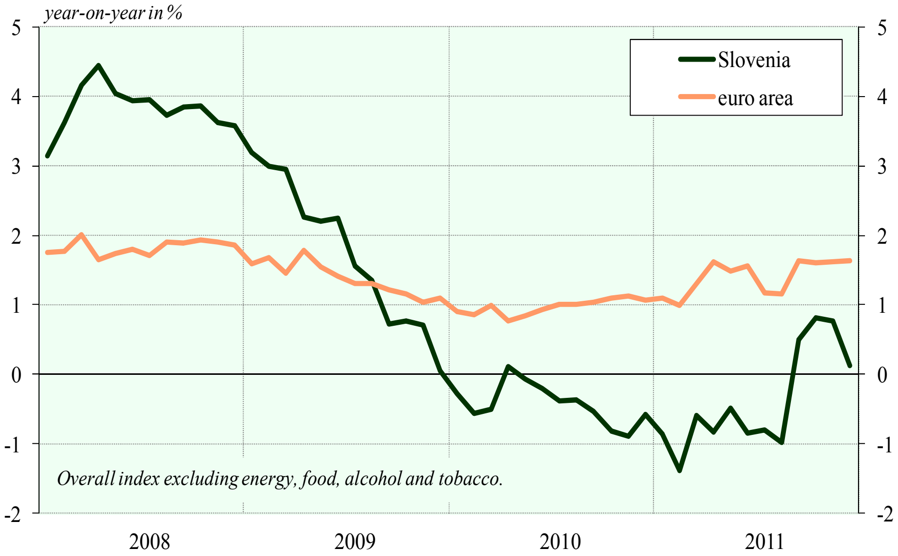


Source: Eurostat.

Core inflation in Slovenia remains under the influence of the adverse economic situation.

The core inflation indicators remained low or negative, primarily a reflection of the stagnation in economic activity and low household consumption. Core inflation as measured by the HICP excluding energy, food, alcohol and tobacco stood at -0.4% in 2011, the same as in 2010, and 1.0 percentage points below the euro area average. The two other indicators of core inflation (excluding energy and excluding energy and unprocessed food) remained below the euro area average in 2011, by around 0.8 percentage points. In addition to the worse economic situation, there were certain one-off factors[4] in the gap. The contribution made to inflation by services prices was neutral in 2011, while the contribution made by prices of non-energy industrial goods was again negative.

Figure 9: **Core inflation in Slovenia and the euro area**



Sources: Eurostat, Bank of Slovenia calculations.

Unit labour costs (ULC) were unchanged on average in 2011. Unit labour costs fell gradually in the first half of 2011, but rose again in year-on-year terms in the second half of the year, first as a result of a slowdown in productivity growth and then as a result of a decline in productivity. Productivity increased in the first three quarters of the year, but at diminishing rates. The decline in productivity in the final quarter was mainly the result of a decline in economic activity at the end of the year, while the fall in employment gradually slowed throughout the year. Average compensation per employee increased throughout the year, but at diminishing rates since mid-2010, an indication that firms are making adjustments to the decline in economic activity by reducing wage growth and not merely through lay-offs of workers. The average gross wage was unchanged in real terms from 2010.[5] Real wages rose by 0.6% in the private sector, but fell by more than 2% in the public sector.

The price and cost competitiveness of the Slovenian economy improved in 2011.

In 2011, Slovenia's real indicators of price and cost competitiveness remained unfavourable relative to the average of other euro area countries. The changes in the two indicators were nevertheless better than in the previous year, the slowdown in the appreciation of the two indicators in 2010 being followed by depreciation in 2011. This indicates a narrowing of the gap by which Slovenia's competitiveness trails the euro area average. The price competitiveness indicator improved relative to the euro area average as a result of lower inflation in Slovenia, while the cost competitiveness indicator improved as a result of slower growth in unit labour costs than in the key trading partners.

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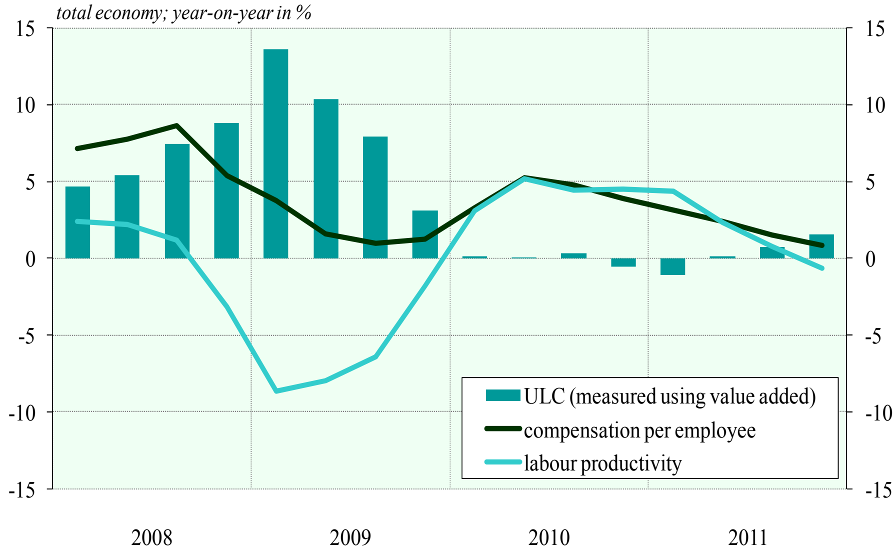
4 Core inflation was also reduced in 2011 by the base effect caused by a change in prices of school meals in September 2010 and the temporary cut in the RTV licence fee in February 2011.

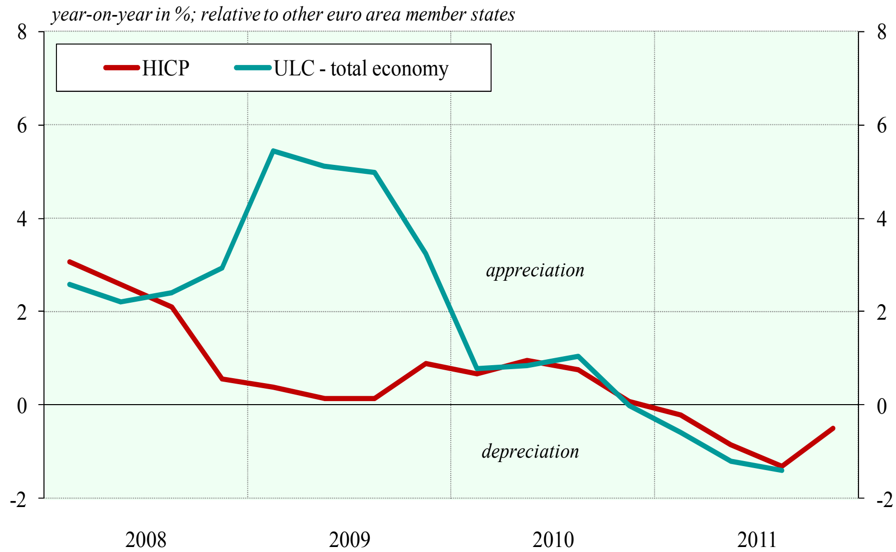
5 Inflation-adjusted using the HICP.

Figure 10: **Labour productivity, unit labour costs and compensation per employee in the Slovenian economy**



Sources: Eurostat, Bank of Slovenia calculations.

Figure 11: **Harmonised competitiveness indicator adjusted for inflation using the HICP and ULC**

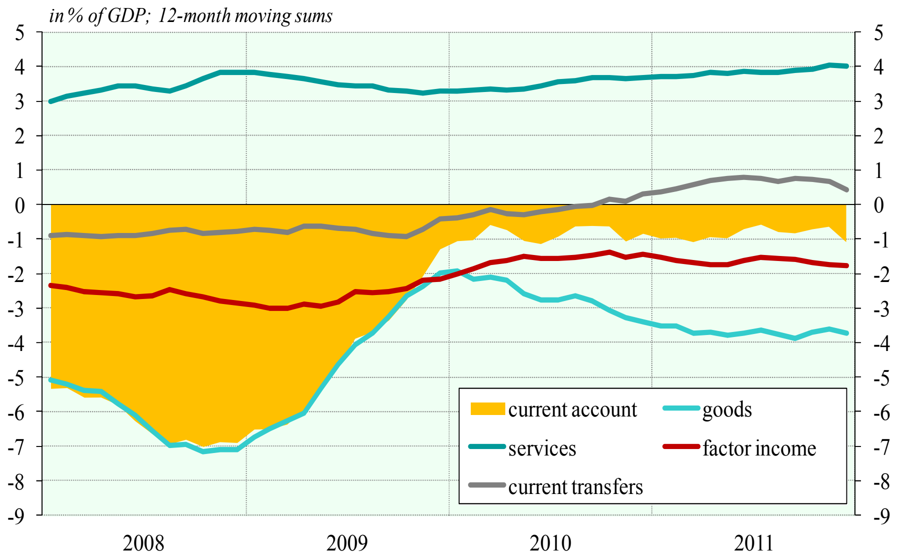


Source: ECB.

The negative terms of trade were a major factor in the widening of the current account deficit in 2011.

The current account deficit widened in 2011. It amounted to EUR 385 million or 1.1% of GDP, 0.3 GDP percentage points more than in the previous year. The merchandise trade deficit remained the main factor in the current account deficit. Growth in merchandise trade slowed sharply last year as a result of the rapid decline in growth in foreign demand in the second half of the year and the decline in domestic consumption. Merchandise imports increased by 5.7% in 2011, while merchandise exports increased by 7.7%, but the terms of trade were also negative. Although the gap between year-on-year growth in import prices and export prices narrowed during the year, import prices rose by 6.2% in 2011 while export prices rose by 4.5%. The terms of trade thus deteriorated by 1.6%, which contributed 1.1 GDP percentage points to the merchandise trade deficit. The merchandise trade deficit was up 0.3 GDP percentage points on 2010 at 3.7% of GDP. In 2011, growth in trade in services was again lower than growth in merchandise trade. As a result of weak domestic demand, the gap between growth in imports and exports of services widened. Imports of services were up 1.9% in nominal terms in 2011, while exports of services were up 4.0%. The surplus of trade in services thus in-

Figure 12: **Components of the current account**



Source: Bank of Slovenia.

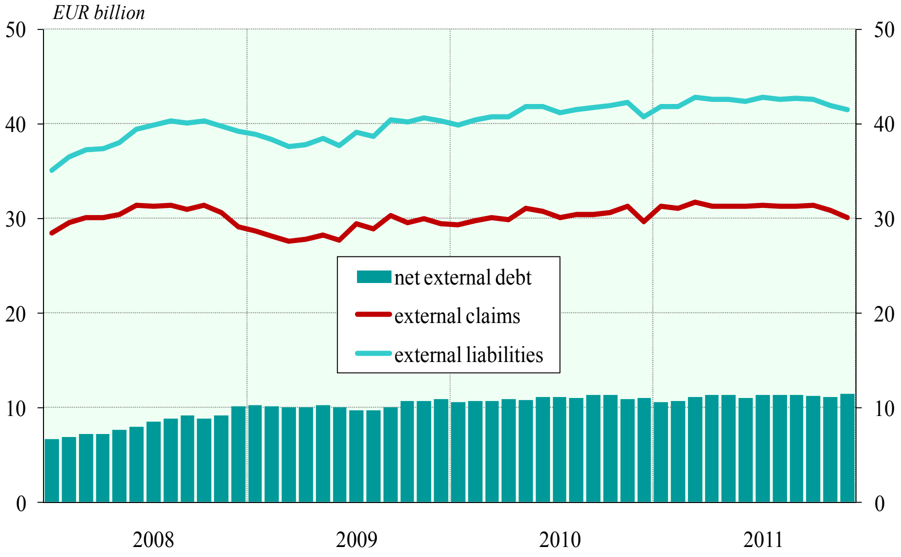
creased from 3.7% of GDP to 4.0% of GDP, mainly as a result of an increased surplus in travel services. The deficit in factor income widened by 0.4 GDP percentage points to 1.8% of GDP. As a result of the adverse situation on the domestic labour market, the surplus in labour income increased again, but the deficit in capital income also widened to 2.3% of GDP. Growth in net interest payments on loans raised in the rest of the world and in net payments of investments in securities' income were the main factors in this. There was a surplus of 0.4% of GDP in current transfers, as a result of the successful disbursement of EU funds.

The private sector financed the rest of the world in 2011, while the government sector recorded an increase in debt.

Last year's net outflow of funds from the private sector[6] stood at more than EUR 2 billion, which means that the private sector financed the rest of the world. The private sector's claims against the rest of the world increased by EUR 971 million overall in 2011, primarily as a result of increases in claims from currency and deposits and in capital transfers. In contrast to 2010, the private sector reduced its investments in foreign securities, primarily money-market instruments. The banks made the most notable reductions. The domestic banks reduced their stock of loans to non-residents for the second consecutive year, by EUR 172 million in 2011. The private sector's liabilities to the rest of the world declined by almost EUR 1.1 billion last year, primarily as a result of a reduction in debt to the rest of the world and a decline in non-residents' portfolio investments in domestic securities. The stock of non-residents' investments in private sector securities declined by EUR 133 million in 2011. The main factor in this was the banks, which made prepayments of their own bonds. The domestic banks' debt to the rest of the world continued to decline. The banks reduced their liabilities from foreign loans by EUR 1.46 billion. The majority of the repaid loans were long-term loans. Corporates last year recorded net borrowing in the rest of the world for the first time since 2009, as the banks made debt repayments in the rest of the world and the European Banking Authority (EBA) issued requirements to raise original own funds. The gross external debt increased by EUR 858 million last year to stand at EUR 41.6 billion at the end of the year. Gross external claims stood at EUR 30.1 billion at the end of the year, up EUR 436 million on the end of 2010. The net external debt thus increased by EUR 421 million. The main contributions to the increase in net debt came from the government sector and the Bank of Slovenia, while other sectors, the banking sector in particular, significantly reduced their net debt to the rest of the world. The banks reduced their net external debt by EUR 1.86 billion. The government issued EUR 3 billion of government bonds last year, thereby increasing its net external debt by EUR 1.5 billion.

[6] The private sector is defined as the total economy excluding the Bank of Slovenia and the government sector.

Figure 13: **Slovenia's external debt**

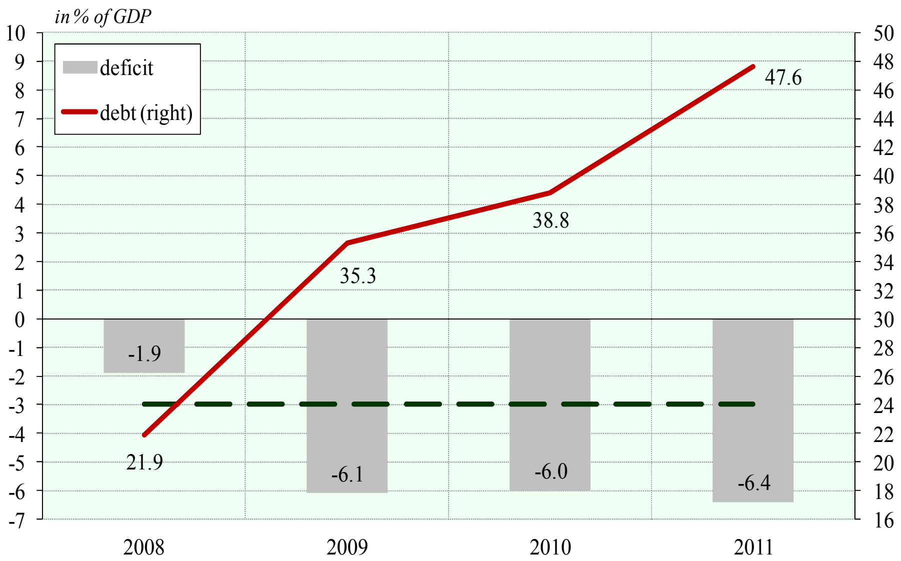


Source: Bank of Slovenia.

There was a large general government deficit in 2011 for the third consecutive year, partly due to one-off factors.

The general government deficit according to the ESA 95 methodology widened by 0.4 GDP percentage points in 2011 to 6.4% of GDP. This was the third consecutive year with a large general government deficit. In addition to the adverse economic situation, which was reflected in general government revenues, three major transactions of a one-off nature contributed 1.2 GDP percentage points to the deficit. These were the recapitalisations of NLB d.d. and Adria Airways, and a transfer to Slovenian Railways. General government revenues were up 1.2%, although the trend was unfavourable in the second half of the year in particular. Growth in social security contributions was low, as a result of the situation on the labour market, while there was no change in personal income tax in year-on-year terms. Direct taxation was up 0.4% on the previous year, while indirect taxation was down almost 1%. The latter is a reflection of the ongoing low household consumption, while the inflow of excise duties on fossil fuels was also down on 2010. General government expenditure was up 2.0% in 2011, in particular because of the aforementioned developments of a one-off nature. Measures aimed at curbing growth in expenditure were taken: as in previous years they restricted growth in expenditure on wages, pensions and social transfers. There was an even sharper decline in expenditure on investment in 2011, while subsidies were also down significantly.

Figure 14: **General government deficit and debt according to ESA95 methodology**



Source: SORS.

Growth in expenditure on interest and the unemployed was extremely high for the third consecutive year.

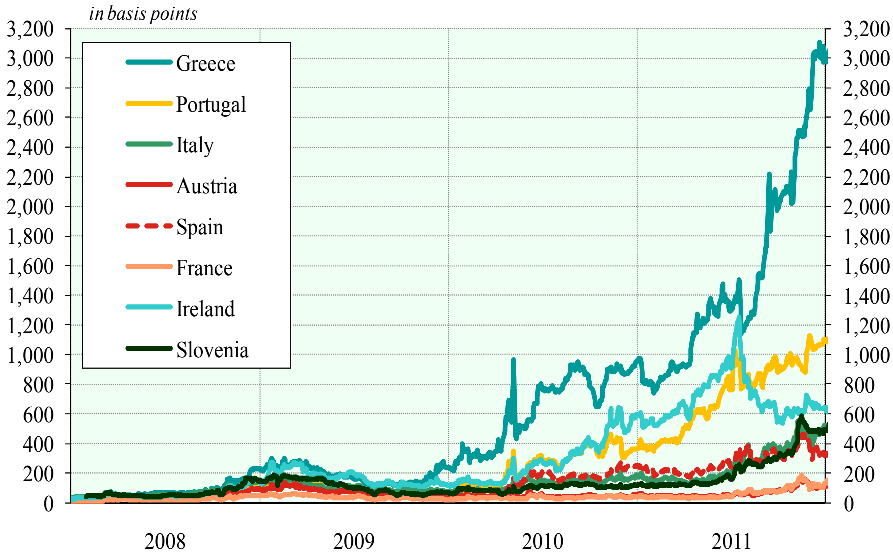
The general government debt increased again in 2011, but will still remain significantly below the euro area average. The stock of government sureties and guarantees declined.

The general government debt stood at EUR 16,954 million at the end of 2011, or 47.6% of GDP. The rise in the ratio of debt to GDP is a reflection of the financing of the deficit, but also of advance borrowing for the repayment of debt maturing at the beginning of 2012. Borrowing was mostly undertaken in the first quarter of 2011 via the issue of long-term bonds in the amount of EUR 3.0 billion, and in December via the issue of 18-month treasury bills in the amount of EUR 0.9 billion. Slovenia also approved EUR 140.6 million in loans in 2011 as part of the financial assistance for Greece, while the stock of government guarantees had reached EUR 118.5 million by the end of the year on the basis of the Republic of Slovenia Guarantee for Maintaining Financial Stability in the Euro Area Act. These are guarantees for financial instruments issued by the EFSF,[7] the funds from which were disbursed to Ireland and Portugal last year. Government sureties and guarantees amounted to EUR 6,996 million at the end of the year, or 19.6% of GDP. The decline from a year earlier is primarily a reflection of the banks making prepayments of their own government-guaranteed bonds.

Spreads on Slovenian 10-year government bonds over the benchmark German bonds increased in the second half of 2011.

The spreads of Slovenian 10-year government bonds over the benchmark German bonds have primarily risen since the middle of 2011. There has also been a rise in the spreads in certain other euro area countries. Having mostly fluctuated around 120 basis points in the first half of the year, the spread of Slovenian bonds had reached almost 500 basis points by the end of the year. The rise in the required yield on Slovenian bonds was the result of the mounting debt crisis in certain euro area countries (the momentum from the periphery and core countries was also transferred to Slovenia), the increased uncertainty in the international financial environment, the poor expectations for domestic economic growth, the low liquidity of Slovenian government bonds, political uncertainty, and the lack of credibility of fiscal consolidation and structural reforms. Standard & Poor's, Moody's and Fitch all downgraded Slovenia's long-term sovereign debt in November, and all maintained a negative outlook, which means the possibility of further downgradings. Successful and timely implementation of fiscal consolidation is thus vital to preventing further downgradings and a rise in financing costs.

Figure 15: **Spreads of 10-year government bonds over benchmark German bonds**



Sources: Bloomberg, Bank of Slovenia calculations.
Note: Spread is calculated as a difference between yield of 10-year government bond and the yield of reference German bond on a daily basis and is used as a measure of country's credit risk. In the picture SLOREP 01/21 is used after 11. January 2011.

[7] European Financial Stability Facility.

Slovenia has been undergoing an excessive deficit procedure since December 2009. Slovenia must reduce its deficit to below 3% of GDP by 2013. The general government deficit and debt in 2011 exceeded the forecasts in the April 2011 update to the Stability Programme. Fiscal consolidation is vital to Slovenia, and is a priority of the government. The preparation and implementation of appropriate structural reforms will also be vital to achieving long-term sustainable economic growth.

Consistent implementation of fiscal consolidation in line with the commitments is vital.

Banking system

There was no change in the number of credit institutions in Slovenia in 2011. At the end of the year the Slovenian banking system comprised 19 banks (including eight subsidiary banks), three branches of foreign banks and three savings banks. The banks accounted for 99.0% of the total assets of the Slovenian banking system. In terms of ownership structure, the banking system comprises eight banks under majority domestic ownership, three banks under 100% domestic ownership and eight banks under majority foreign ownership. The proportion of the banks' equity held by non-residents increased by 2 percentage points in 2011 to 39%. Recapitalisations raised the government's holding of the banking system's total equity by 2.7 percentage points to 22.7%.

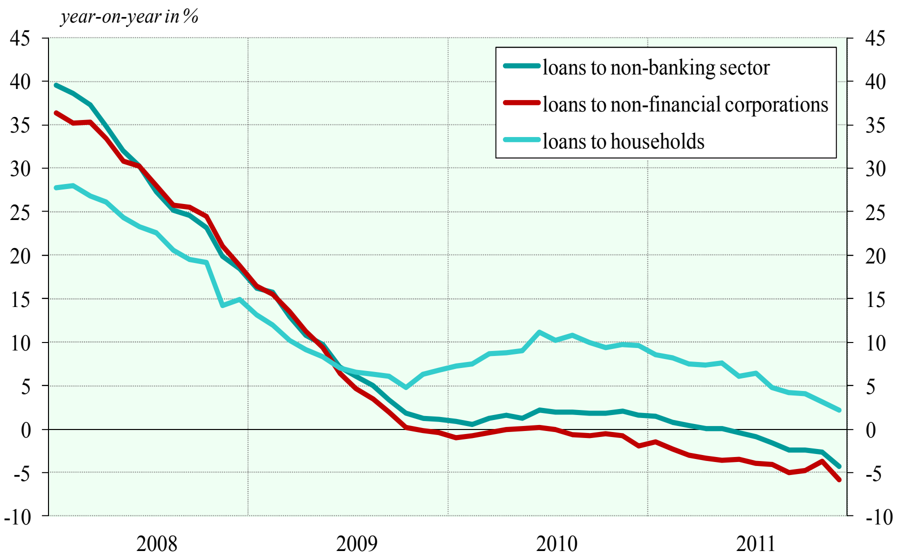
The banking system's total assets amounted to EUR 48.8 billion at the end of 2011, having declined by EUR 1.5 billion or 3.1% during the year. The main reasons for the decline in the banking system's total assets were the continuing reduction of debt to the rest of the world, a decline in liabilities from issued debt securities and a decline in equity as a result of losses. The banks compensated for the decline in liabilities from issued securities and liabilities to the rest of the world by means of long-term funding obtained from the Eurosystem. On the investment side they primarily reduced loans to non-banking sectors and investments in securities. There was primarily a decline in loans to the corporate sector and an increase in loans to households, but considerably less than in 2010.

The Slovenian banking system's total assets declined by EUR 1.5 billion in 2011 to EUR 48.8 billion.

There was a notable decline in year-on-year growth in loans to non-banking sectors in 2011 at all the bank groups. The stock of loans to non-banking sectors had declined by 4.3% by the end of the year, the domestic banks recording the largest decline. Lending to non-financial corporations was down 5.9%, the domestic banks again recording the largest decline. The main factors in the decline in demand for bank loans were the worsening of the European debt crisis, downgradings and higher funding costs, the slowdown in economic growth in Slovenia and its most important trading partners, the adverse situation in certain sectors, the relatively

Year-on-year growth in loans to non-banking sectors declined at all the bank groups in 2011.

Figure 16: **Lending to non-banking sectors**



Source: Bank of Slovenia.

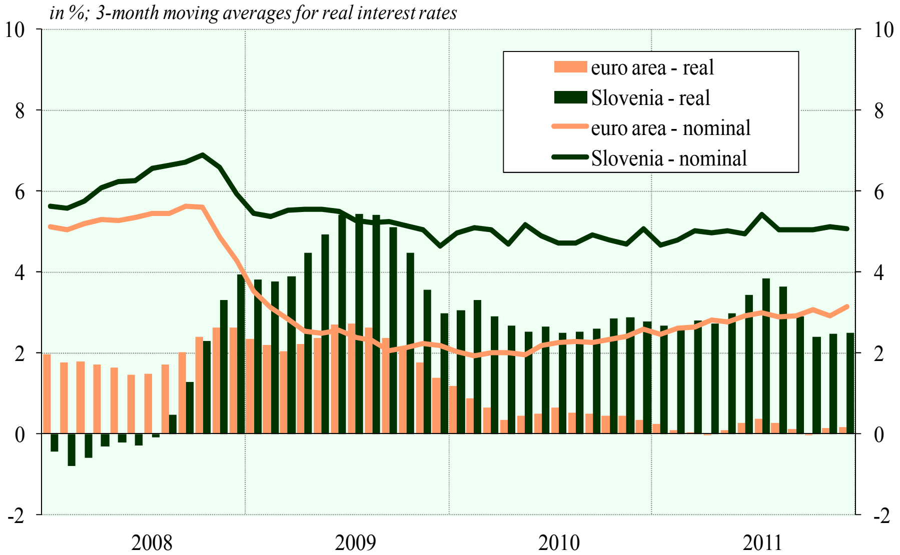
high indebtedness of the corporate sector, payment indiscipline, the adverse situation on the labour market, and a decline in the value and liquidity of free eligible loan collateral. On the supply side, lending activity was restricted by a decline in bank funding, high funding costs, a deterioration in the quality of the credit portfolio and a decline in the banking system's capital adequacy relative to the EBA's requirements and methodology, even though the ratio of own funds to total assets at banks is sufficient.

The main contribution to the increase in loans to households in 2011 came from the banks under majority foreign ownership.

The stock of loans to households increased by EUR 198 million in 2011, mostly as a result of the banks under majority foreign ownership. Growth in loans to households stood at 2.3%, but was lower than in 2010 at all the bank groups. Housing loans accounted for the majority of the increase in loans to households, while consumer loans and other household loans recorded a decline. In household lending the banks responded to the adverse economic situation by reducing short-term loans. They continued to reduce loans in foreign currencies.

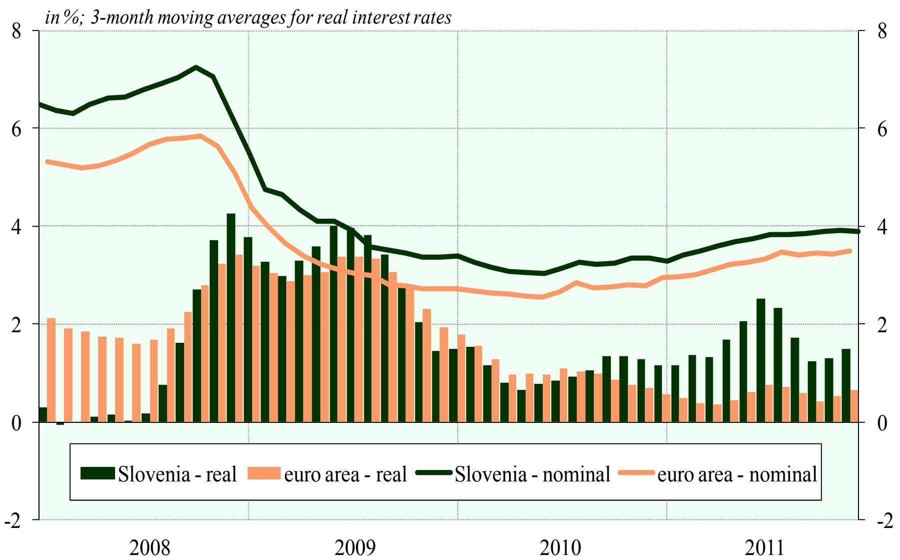
Variable interest rates on housing loans rose to 3.9% in 2011, 0.4 percentage points higher than in the euro area at the end of the year. Interest rates on consumer loans

Figure 17: **Interest rates on loans of more than EUR 1 million for non-financial corporations**



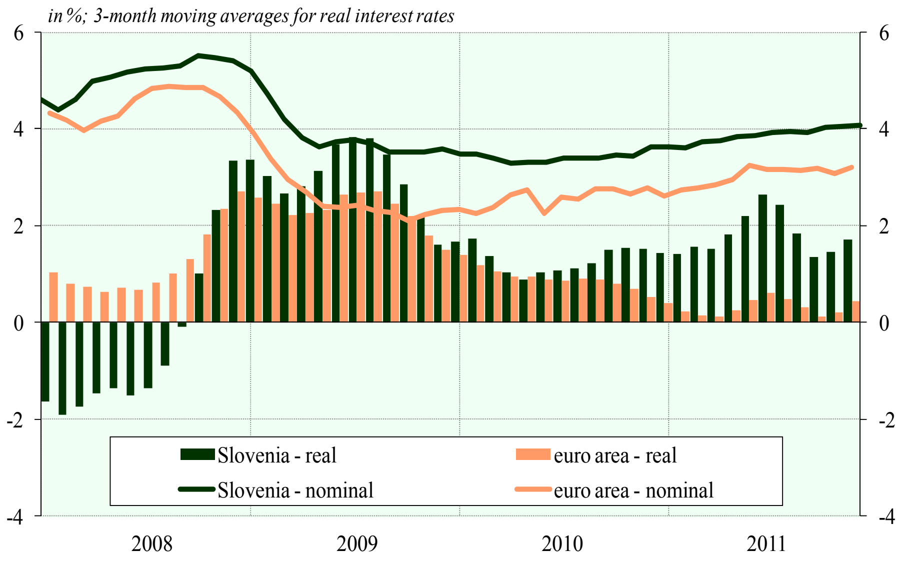
Sources: ECB, Bank of Slovenia.

Figure 18: **Interest rates on housing loans to households**



Source: ECB, Bank of Slovenia.

Figure 19: **Interest rates on household deposits of 1 to 2 years**



Source: ECB, Bank of Slovenia.

rose, but remained below the euro area average. The spread over euro area interest rates on corporate loans declined slightly in 2011, primarily as a result of a rise in interest rates in the euro area overall, and reached around 2 percentage points. Interest rates on corporate loans stood at around 6% on loans of up to EUR 1 million and at 5% on loans of more than EUR 1 million at the end of the year. The spread between offered interest rates at individual banks also widened.

With refinancing risk increasing, the banks increasingly funded themselves via favourable long-term Eurosystem resources.

Refinancing risk has also increased since the middle of 2011, in line with the situation on international financial markets, Slovenia's downgrading and the rising cost of funding on the market. The banks therefore turned to the relatively favourable long-term loans of the Eurosystem. The banking system's liabilities to the Eurosystem increased by EUR 1.1 billion in 2001 to EUR 1.7 billion. The banks partly used the long-term loans raised to reduce debt to the rest of the world. The banks reduced their debt to the rest of the world by EUR 2.2 billion in 2011.

Deposits by non-banking sectors remain the most important element of bank funding. The proportion of the banking system's total funding that they account for stood at 49.6% at the end of 2011, up 2.9 percentage points on a year earlier. Year-on-year growth in deposits by non-banking sectors averaged 3.1% on a monthly basis in 2011, down slightly from 2010. In the sectoral breakdown the largest increases were recorded by government deposits and household deposits, while deposits by non-financial corporations remained almost unchanged. In the maturity breakdown the largest increases were recorded by long-term deposits of between 1 and 2 years and sight deposits, both in domestic currency. Interest rates on household deposits of up to 1 year again remained below the euro area average in 2011, and rose at a much slower pace, while household deposits of more than 1 year increased significantly faster than in the euro area overall as a result of the higher interest rates caused by the banks' need for stable long-term funding.

As the stock of lending contracted, the banking system recorded a loss in 2011 for the second consecutive year, as a result of rising impairment and provisioning costs.

The Slovenian banking system was exposed to significant credit risk and income risk in 2011. Net interest in 2011 was down 2.9% on the previous year, primarily as a result of the increase in interest expenses outpacing that of interest income. With the number of bankruptcies rising and the situation in the sector of non-financial corporations deteriorating, growth in impairment and provisioning costs remained above-average last year. The banking system's performance thus worsened significantly, as it recorded a loss after taxation of EUR 411 million, according to unaudited and unconsolidated figures.

Table 1: **The banking system's income statement**

	Amount (EUR million)				Growth rate (%)				Proportion of gross income (%)			
	2008	2009	2010	2011	2008	2009	2010	2011	2008	2009	2010	2011
Net interest	944.6	932.2	1,037.8	1,007.2	15.7	-1.3	11.3	-2.9	69.4	65.4	70.4	70.3
Net non-interest income	415.6	493.1	436.6	425.0	-32.6	18.7	-11.5	-2.7	30.6	34.6	29.6	29.7
Gross income	1,360.2	1,425.3	1,474.4	1,432.2	-5.1	4.8	3.4	-2.9	100.0	100.0	100.0	100.0
Operating costs	776.0	765.2	765.9	762.8	2.7	-1.4	0.1	-0.4	57.1	53.7	51.9	53.3
Labour costs	412.1	415.5	413.3	408.4	2.6	0.8	-0.5	-1.2	30.3	29.1	28.0	28.5
Net income	584.2	660.2	708.5	669.4	-13.7	13.0	7.3	-5.5	42.9	46.3	48.1	46.7
Net provisioning and inpairments	277.9	499.6	809.7	1,169.1	70.5	79.8	62.1	44.4	20.4	35.1	54.9	81.6
Pre-tax profit	306.3	160.5	-101.2	-499.7	-40.4	-47.6	-163.0	393.7	22.5	11.3	-6.9	-34.9
Taxes	58.6	38.7	-3.1	-88.5	-42.8	-33.9	-108.0	2,761.3	4.3	2.7	-0.2	-6.2
Net profit	247.7	121.8	-98.1	-411.2	-39.8	-50.8	-180.6	319.1	18.2	8.5	-6.7	-28.7

Source: Bank of Slovenia.

Table 2: **Bank performance indicators**

In %	2008	2009	2010	2011
ROA	0.67	0.32	-0.20	-1.00
ROE	8.14	3.85	-2.36	-11.74
Interest margin on interest-bearing assets	2.20	1.99	2.13	2.13
Interest margin on total assets	2.08	1.88	2.02	2.02
Non-interest margin	0.92	0.99	0.85	0.85
Gross income on average assets	3.00	2.87	2.87	2.87

Source: Bank of Slovenia.

The quality of the credit portfolio continued to deteriorate in 2011.

The deterioration in the quality of the credit portfolio continued in 2011, as reflected by the two indicators below. The proportion of all classified claims classed as bad claims increased by 2.5 percentage points to 6.2%. The proportion of firms more than 90 days in arrears in settling their liabilities to banks increased by 2.0 percentage points to 14.7%. The proportion of classified corporate assets more than 90 days in arrears increased by 6.2 percentage points to 18.5%. The most prominent sectors are construction (49.6% of the total) and information and communication activities (25.5%).

The liquidity of the banking system was satisfactory in 2011. The solvency ratios were lower than the average of comparable banks in the EU.

The liquidity of the banking system as measured by the liquidity ratio remained at a satisfactory level last year, although the differences between individual banks widened. The decline in funding via securities issues and borrowing in the rest of the world exposed the banks to refinancing risk, which they partly mitigated by borrowing from the Eurosystem. Interest rate risk increased slightly last year. The banks' exposure to a rise in interest rates thereby increased, particularly in the 3 months to 1 year segment. The solvency of the banking system remains the key issue for their owners from the point of view of improving performance. From the point of view of regulatory requirements, the banking system maintained a satisfactory capital adequacy in 2011. The ratio of own funds to total assets was also favourable. Despite the capital increases in the first half of 2011, the two solvency ratios remained below the average of comparable banks in the EU. The capital adequacy ratio stood at 11.7% in December 2011, up 0.4 percentage points on a year earlier. The Tier 1 capital ratio increased by 0.6 percentage points over the same period to stand at 9.6%.

Table 3: **Ratings breakdown of classified claims and coverage of claims by impairments and provisions**

	31. Dec 2009			31. Dec 2010			31. Dec 2011		
	Classified assets	Impairments	Coverage of claims by impairments (%)	Classified assets	Impairments	Coverage of claims by impairments (%)	Classified assets	Impairments	Coverage of claims by impairments (%)
Total in EUR million	49,257	1,823	3.7	49,766	2,422	4.9	49,467	3,230	6.5
	Structure (%)			Structure (%)			Structure (%)		
A	70.5	7.1	0.4	70.6	5.7	0.4	66.0	3.3	0.3
B	24.7	30.7	4.6	21.3	20.0	4.6	22.7	14.7	4.2
C	2.6	16.2	23.3	4.3	22.3	25.1	5.1	21.1	26.8
D	1.5	24.8	62.9	2.9	35.5	59.8	5.5	50.4	60.3
E	0.8	21.3	100.0	0.8	16.5	100.0	0.7	10.5	100.0

Source: Bank of Slovenia.
Note: Coverage of non-performing claims in Slovenia in the entire period was among the highest in euro area.

2 BANK OF SLOVENIA ACTIVITIES

2.1 Tasks in the scope of the ESCB

2.1.1 Institutional framework

The European Central Bank, the Eurosystem and the European System of Central Banks

With the introduction of the euro in Slovenia on 1 January 2007, the Bank of Slovenia became a part of the Eurosystem, which comprises the European Central Bank (ECB) and the national central banks (NCBs) of the euro area countries. Since the introduction of the euro in Slovenia, as a member of the Governing Council of the ECB the Governor of the Bank of Slovenia has attended meetings of the aforementioned body, which normally take place twice a month. The Governing Council of the ECB comprises the six members of the Executive Board and the governors of the NCBs of the euro area countries. The responsibilities of the Governing Council of the ECB include defining the monetary policy for the Eurosystem. The Governor of the Bank of Slovenia is also a member of the General Council of the ECB, its third decision-making body, which meets four times a year. The General Council comprises the President and the Vice-President of the ECB and the governors of the NCBs of all EU Member States.

Bank of Slovenia representatives attended sessions of committees and their working groups in 2011, when meetings were conducted in the wider composition of the European System of Central Banks (ESCB), which comprises the ECB and the NCBs of all EU Member States, and in the narrower composition of the Eurosystem. The committees support the work of ECB decision-making bodies, which can request expert and technical advice from the committees.

The NCBs are the sole subscribers to and holders of the capital of the ECB. Pursuant to the Statute of the ESCB and ECB, the NCBs' shares in the ECB's capital key are weighted according to the respective Member States' shares of the total population and gross domestic product of the EU. The NCBs of the Member States that have introduced the euro have paid up their entire shares of the ECB's capital, whereas the NCBs of EU Member States that have not yet introduced the euro have not paid up their entire share, but only a certain percentage of the amount that they would have to pay up had they introduced the euro.

The key for subscription to the ECB's capital for the Bank of Slovenia is 0.3288%.

The Bank of Slovenia's key for subscription to the ECB's capital is 0.3288%. The total amount of ECB capital paid up by the NCBs stood at EUR 6,484 million as at 28 December 2011.

2.1.2 Implementation of the Eurosystem's monetary policy

A gradual improvement in the situation in the first half of the year.

The situation in the euro area capital and money markets gradually improved in early 2011, even though tension remained on the sovereign debt markets of certain euro area countries. The counterparties did not replace the LTROs[8] maturing at the end of 2010 by making use of the remaining (shorter-term) Eurosystem refinancing operations.[9]

The excess liquidity in the banking system thus declined sharply in the first half of the year, for which reason the use of the deposit facility also declined. This decline can be explained by the decline in the banks' precautionary liquidity reserves and the improvement in the functioning of the capital and money markets. The Eonia

8 The last of the three 1-year LTROs executed by the Eurosystem in 2009 to ensure banks' access to longer-term liquidity under the conditions of impaired functioning of the money market matured in December 2010. A total of EUR 614.4 billion from all three 1-year LTROs matured in the second half of 2010.

9 Although in 2011 the Eurosystem continued its policy of free access to loans, i.e. by executing operations in the form of tenders with a fixed interest rate and full allotment.

thus again approached the key interest rate (see Figure 20), and actually exceeded it on certain days. There was also an increase in its fluctuation, as it once again became dependent on liquidity management within the reserve maintenance period. The Eurosystem twice raised its interest rate by 25 basis points, to 1.25% in April and to 1.50% in July 2011.

A renewed deterioration in the situation on the money market and additional non-standard monetary policy measures.

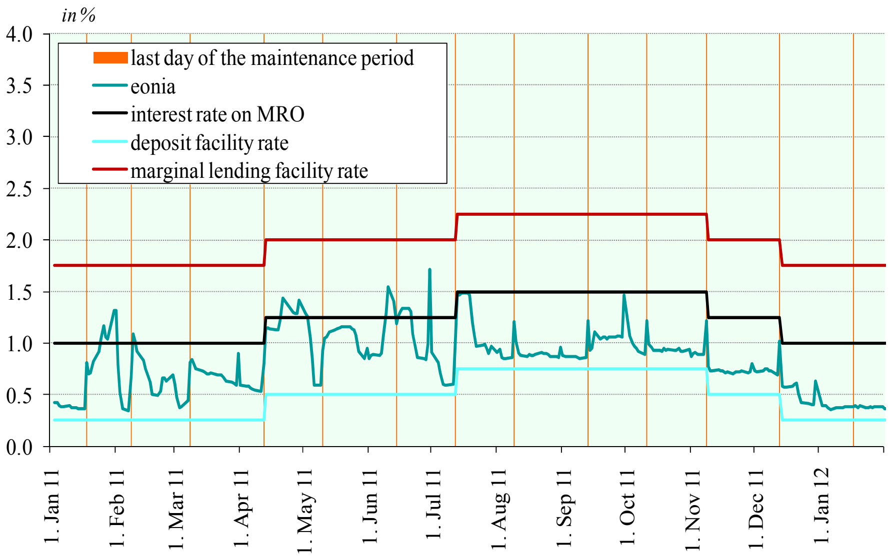
The euro area debt crisis mounted again in the second half of the year. The bad news from the hardest-hit euro area countries and increased expectations of a slowdown in global economic growth led to increased risk-aversion and lower confidence in the financial system.

The tensions were also seen strongly on the money market, despite the policy of free access to Eurosystem loans. In the autumn the spreads between unsecured and secured interest rates, which reflect tension on the money market, again approached their record levels seen after the collapse of American investment bank Lehman Brothers in the autumn of 2008. European banks' funding costs in US dollars via swaps with the euro also rose sharply. Banks from the affected euro area countries often found it difficult or even impossible to access funding on the money market.

The Eurosystem responded with non-standard measures aimed at curbing the expansion of the debt crisis to interest rates on the money market, and preventing the emergence of a credit crunch. The non-standard measures can be divided into the following:

- *Operations in euros*: the Eurosystem repeatedly extended the policy of free access to loans, most recently in December, when it undertook to maintain the policy until July 2012 at least, and in addition announced additional LTROs.
- *Collateral for monetary policy operations*: the Eurosystem has somewhat relaxed the eligibility criteria for collateral for monetary policy operations.
- *Minimum reserve ratio*: the Eurosystem reduced the reserve ratio from 2% to 1%.
- *Operations in US dollars*: to facilitate access to funding in US dollars, the Eurosystem extended the availability of refinancing operations in US dollars, introduced additional US dollar refinancing operations with maturities of 3 months, and reduced their price.
- *Bond purchase programmes*: the Eurosystem again increased its purchases of debt securities within the Securities Markets Programme (SMP), and introduced a second round of purchases of covered bonds, a new covered bond purchase programme, the CBPP2.

Figure 20: **ECB interest rates and Eonia**



Source: ECB.

The first three packages of measures led to a significant increase in excess euro liquidity, an increase in the use of the deposit facility to record levels, and a fall in short-term interest rates on the money market. The Eonia thus again approached the interest rate on the deposit facility in the second half of the year, and became inelastic to the level of excess liquidity. In addition, the Eurosystem cut its key interest rate to 1.25% in November and to 1.00% in December.

The changes in the use of monetary policy instruments are described in detail below, and their relative use in 2011 is quantified. The use of collateral for monetary policy loans is also explained.

Eurosystem monetary policy instruments in 2011

The three basic categories of monetary policy instrument are open market operations, standing facilities and minimum reserves. The Eurosystem uses minimum reserves to stabilise demand for liquidity, open market operations (reverse MROs and LTROs, and fine-tuning operations [FTOs]) to provide the adequate amount of liquidity, and the deposit facility and marginal lending facility to smooth out any mismatches between supply of and demand for liquidity under normal circumstances, thereby stabilising the Eonia in the corridor around the key interest rate.

A renewed increase in excess liquidity, and a policy of free access to loans.

While under normal circumstances the amount and maturity of the operations is determined by the Eurosystem, given the continuation of the policy of free access to loans, the lending to banks in 2011 was again primarily dependent on demand from the banks. Banks borrowed a total of EUR 550 billion via supplementary non-standard LTROs (with maturities from 6 months to 3 years) in August, October and December 2011. At the aggregate level, the borrowed liquidity was returned back to the Eurosystem as a (overnight) deposit, which was again used on a daily basis in 2011 as a result of excess liquidity. The liquidity arising from the SMP increased by EUR 150 billion in 2011 to EUR 211 billion, but was fully absorbed via the weekly tenders of fixed-term deposits, and there was therefore no change in liquidity following from the SMP.

Open market operations: MROs, LTROs and FTOs

Main refinancing operations (MROs) are regular loans with a typical maturity of 1 week. They are tendered weekly according to a calendar announced in advance. The Eurosystem executed 52 tenders in 2011, all with full allotment at a predetermined fixed interest rate. The average volume of the MROs was EUR 159.0 billion (compared with EUR 133.8 billion in 2010). Slovenian banks and savings banks also participated in the tenders, and their average MRO volume was EUR 14.1 million.

In normal circumstances *longer-term refinancing operations* (LTROs) are tendered on a monthly basis with a usual maturity of 3 months to provide banks with additional longer-term refinancing. The Eurosystem continued to execute regular monthly LTROs with a maturity of 3 months in 2011, with full allotment at a fixed rate, calculated as the average of the MRO minimum bid rates during the period of the operation, i.e. indexed to the ECB's key interest rate. In addition, the Eurosystem also executed monthly tenders of LTROs with a maturity equal to the reserve maintenance period, with full allotment at an interest rate equal to the MRO minimum bid rate, for the third consecutive year in 2011.

Introduction of additional LTROs with maturities of 6 months, 1 year and 3 years.

As a result of the mounting debt crisis in Europe in July and the resulting spill-over of tension onto the money market, the Eurosystem executed an additional LTRO with a maturity of 6 months in early August. A further deterioration in the situation on the money market in October encouraged the Governing Council of the ECB to introduce two additional LTROs with a maturity of 1 year with allotment in October and December. In December the maturity of the 1-year LTROs was extended to 3 years: the previously announced December 1-year LTRO became a 3-year opera-

Table 4: **Open market operations in 2011**

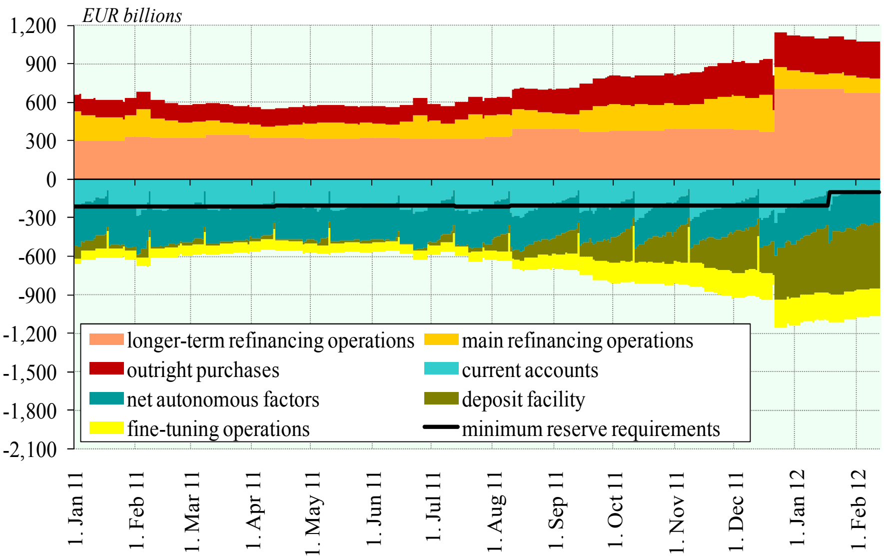
Month	1	2	3	4	5	6	7	8	9	10	11	12	Total
Fixed-rate, full allotment liquidity provision tenders at:													
- main refinancing operations	4	4	5	4	5	4	4	5	4	5	4	4	**52**
- longer-term refinancing operations	2	2	2	2	2	2	2	3	2	4	2	2	**27**
special term operations with a maturity of one maintenance period	1	1	1	1	1	1	1	1	1	1	1	1	*12*
operations with a maturity of 3 months with a fixed rate at the average rate of the MROs	1	1	1	1	1	1	1	1	1	1	1	1	*12*
additional operation with a maturity of 6 months								1					*1*
additional operation with a maturity of 1 year										1			*1*
additional operation with a maturity of 3 years												1	*1*
Variable rate tenders at fine-tuning operations:													**65**
liquidity absorbing operations with a maturity of 1 day	1	1	1	1	1	1	1	1	1	1	1	1	*12*
liquidity providing operations with a maturity of 1 day												1	*1*
liquidity absorbing operations with a maturity of 7 days	4	4	5	4	5	4	4	5	4	5	4	4	*52*
US-dollar liquidity providing operations with a maturity of 7 days	4	4	5	4	4	5	4	5	4	4	5	3	**51**
US-dollar liquidity providing operations with a maturity of 84 days										1	1	1	**3**
Covered Bond Purchase Programme 2 (CBPP2)													
Securities Markets Programme (SMP)													

Note: Shaded fields indicate periods when the programme was carried out. Both programmes are executed in the form of bilateral transactions.
Source: ECB.

tion, and the counterparties in the operation also had the option of extending the maturity of the total amount drawn in the October 1-year LTRO to 3 years. The second 3-year operation was executed in February 2012. All additional LTROs in 2011 were executed with full allotment at an indexed interest rate.

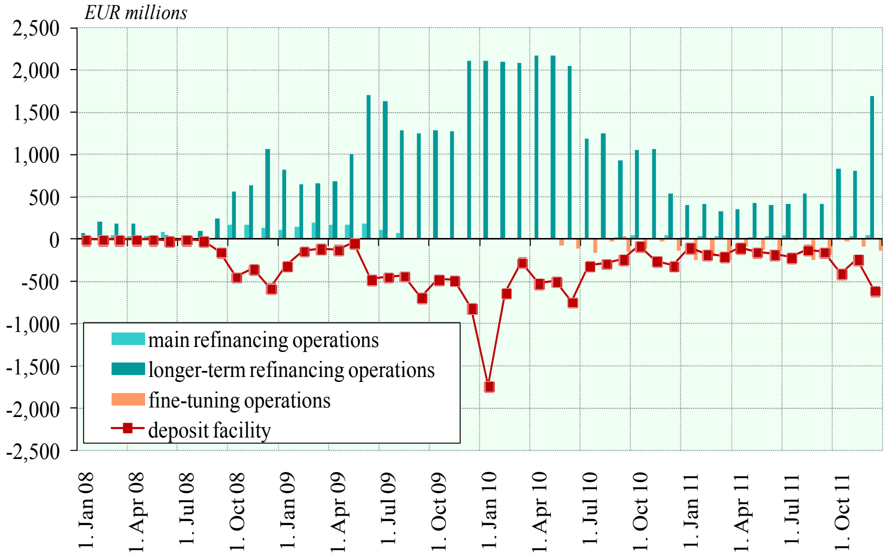
The outstanding amount of the LTROs averaged EUR 353.8 billion in 2011, down from EUR 524.9 billion in 2010. The reason for the decline in amount was that all additional LTROs with a maturity of 1 year, where banks' participation was large, matured already in 2010. The ratio of liquidity allotted through MROs and LTROs therefore changed in 2011. The proportion of liquidity allotted through LTROs declined from 80% in 2010 to 69% in 2011. A decline in the outstanding amount of LTROs is also evident at Slovenian banks and savings banks, whose average amount stood at EUR 513.9 million in 2011, down from EUR 1,596.4 million in 2010. As a result of the additional LTROs, in particular the 3-year LTROs in December, the outstanding amount of LTROs as at the final day of 2011 was significantly higher than the outstanding amount a year earlier. The outstanding amount

Figure 21: **Supply of (+) and demand for (–) Eurosystem liquidity**



Source: ECB.

Figure 22: **Outstanding amounts of Eurosystem monetary policy instruments, 2008 to 2011: Slovenian banks and savings banks (at month-end)**



Source: Bank of Slovenia.

at Eurosystem level increased from EUR 298.2 billion at the end of December 2010 to EUR 703.9 billion at the end of December 2011, while the outstanding amount at Slovenian banks and savings banks increased from EUR 539.0 million to EUR 1,687.0 million.

A total of EUR 489.2 billion was allotted to 523 counterparties in the first 3-year LTRO executed in December, together with the extension of the maturity of loans previously provided in the 1-year LTRO. This was the largest Eurosystem operation to date in terms of volume. The banks that participated in the October 1-year LTRO were allowed to modify the entire allotment to a maturity of 3 years. A total of 123 counterparties took this option, in the amount of EUR 45.7 billion, while 58 counterparties decided to leave EUR 11.2 billion in the 1-year LTRO. Counterparties simultaneously reduced their funding in MROs and 3-month LTROs. The overall effect was therefore an increase in liquidity of EUR 210 billion on the settlement day of December's 3-year LTRO.

FTOs at the end of the reserve maintenance period, for sterilisation of securities purchases and bridging of date mismatches in operations.

Fine-tuning operations (FTOs) are executed by the Eurosystem on an ad hoc basis with the aim of managing liquidity situation in the market and steering market interest rates. These operations were used in three forms in 2011. First, they were used as tenders of fixed-term overnight deposits on the final day of the reserve maintenance period to counter liquidity imbalances arising during the reserve maintenance period. The average allotment in the 12 operations stood at EUR 153.7 billion. Slovenian banks and savings banks also participated in the tenders, depositing EUR 317 million on average. December's tender was the last such tender, as the Eurosystem decided to suspend these operations from January 2012. In an environment of high excess liquidity these operations do not reduce the volatility of the Eonia during the reserve maintenance periods; in contrast, they actually increase it on the final day.

Second, to offset the increased liquidity resulting from purchases of securities in the SMP, the Eurosystem executed weekly tenders of 1-week fixed-term deposits. There were 52 such operations in 2011. The amount offered was equal to the cumulative amount of securities purchases settled by that time, and stood at EUR 73.5 billion at the beginning of the year and EUR 211 billion at the end of the year. Banks submitted a total volume of bids that was higher than the amount offered by the Eurosystem in all but four of the tenders. Slovenian banks and savings banks also participated in the tenders, depositing EUR 140 million on average.

Third, in December the Eurosystem executed a bridging fine-tuning operation to provide overnight liquidity, which was aimed at bridging the gap between the settlement dates of the MRO and the additional 3-year LTRO.

Other open market operations: CBPP, SMP, lending in foreign currencies

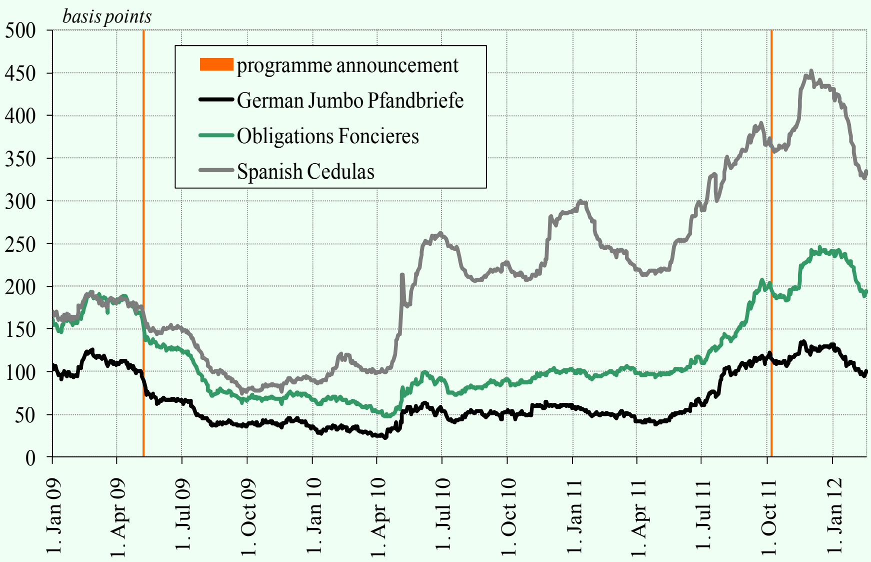
Introduction of a second covered bond purchase programme and resuming the SMP.

In accordance with the decision of May 2009 to introduce a covered bond purchase programme (CBPP), the Eurosystem ended the programme in 2010, and in November 2011 introduced an additional covered bond purchase programme (CBPP2), described in Box 1.

Box 1: **Covered bond purchase programme (CBPP2)**

When the covered bonds market stalled again in the second half of 2011 after a record volume of primary issues of covered bonds in the first half of the year, in October 2011 the Eurosystem announced a new covered bond purchase programme (CBPP2) in the amount of EUR 40 billion over a period of 12 months beginning in November 2011 and ending in October 2012. The aim of the programme is to ease the funding conditions of credit institutions and to encourage lending to non-banking sectors. In the programme the Eurosystem purchases covered bonds in the primary and secondary markets.

Figure 1: **Yield spreads of 5-year covered bonds over German government bonds**



Source: Bloomberg.

In the CBPP2 the Eurosystem purchases covered bonds that meet the following criteria: (i) they are eligible as collateral for monetary policy loans; (ii) they are denominated in euros; (iii) they are issued and settled in the euro area; (iv) they are either covered bonds issued in accordance with Article 52(4) of the UCITS Directive, or structured covered bonds with similar safeguards; (v) they have an issue volume of at least EUR 300 million; (vi) they have a rating of at least BBB-/Baa3; (vii) they are subject to the legal system of a euro area country; (viii) they have a residual maturity of no more than 10.5 years.

By 31 December 2011 the Eurosystem had purchased covered bonds with a nominal value of EUR 3.1 billion. In contrast to the announcement of the first covered bond purchase programme in May 2009, no major impact was discernible immediately after the announcement of the CBPP2 (see Figure 1), since issues of covered bonds on the primary market are traditionally smaller at the end of the year, while trading on the secondary market at that time was also being adversely affected by the worsening situation on the sovereign debt markets, which was particularly pronounced in November. The spreads of covered bonds over the benchmark German government bonds declined in January 2012, when there was also a slight revival in the primary market, although it did not reach the record levels seen in January 2011.

In contrast to the SMP, the Eurosystem did not sterilise the liquidity created by the covered bond purchases.

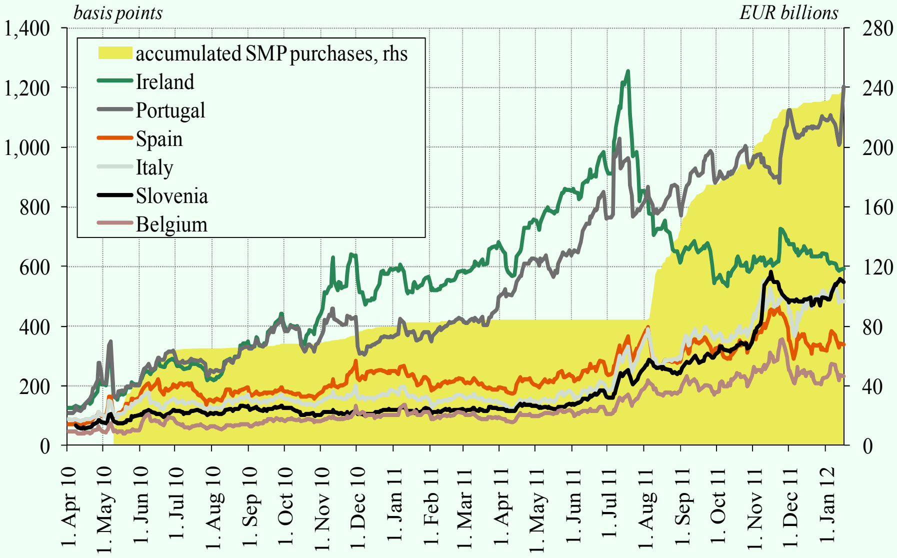
The key measure that the Eurosystem used to tackle the consequences of the mounting debt crisis in euro area countries in 2010 was the Securities Markets Programme (SMP), which was continued in the 2011. The programme is described in Box 2.

Box 2: **Securities Markets Programme (SMP) and sterilisation of liquidity**

Since 10 May 2010 the Eurosystem has been making interventions in the form of purchases on the markets for government and private debt securities of the euro area. Under this programme, the Eurosystem may intervene on the markets of public and private debt securities in the euro area to ensure the depth and liquidity of non-functioning market segments and to restore the proper functioning of the monetary policy transmission mechanism. The programme focuses on those bond markets that are particularly affected by the situation caused by the fiscal difficulties of individual euro area countries.

The Eurosystem was practically inactive in the SMP in the first half of 2011. At the end of July and in early August, given the mounting debt crisis and concerns about the cooling of the global economy, yields increased sharply in the majority of the euro area periphery countries, most notably Spain and Italy, while the liquidity of the market for their bonds deteriorated sharply. The Eurosystem therefore again strengthened its intervention via bond purchases in August 2011. Figure 1 shows the cumulative amount of the purchases since the beginning of the programme.

Figure 1: **Accumulated SMP purchases and yield spreads of certain euro area government bonds over German government bonds of comparable maturity**

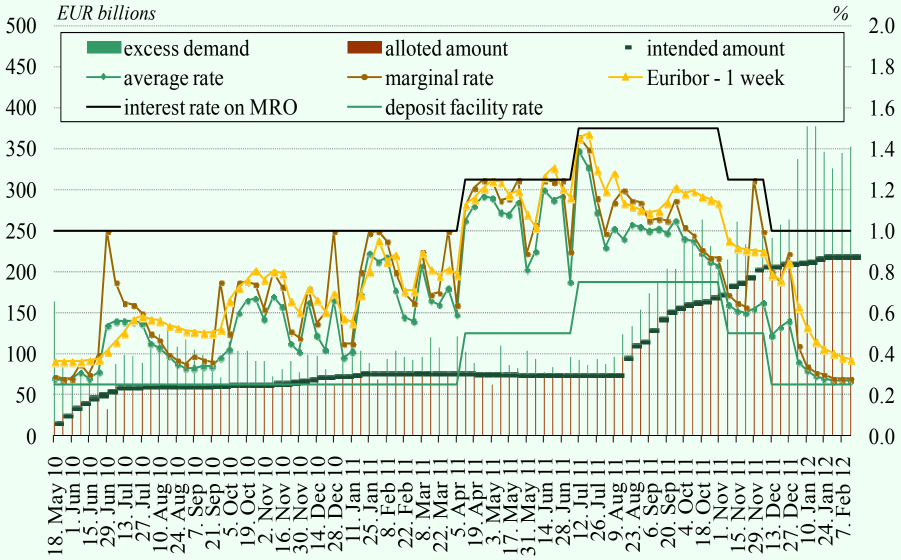


Source: Bloomberg.

Like the CBPP2, the SMP is a temporary monetary policy instrument. In contrast to the CBPP1 and CBPP2, the Eurosystem did not specify the volume or endpoint of the SMP. The Eurosystem sterilises the increase in liquidity caused by the purchases via special weekly fine-tuning operations for absorbing liquidity. This ensures that interventions do not affect the level of liquidity in the system or interest rates on the money market. This sterilisation is what distinguishes the SMP from the securities purchase programmes of other central banks, for example the Bank of England and the Federal Reserve.

Because fixed-term funds at the ECB carry a lower risk than lending on the interbank market, the average allotment interest rates of these operations are lower than market interest rates. The spread between the market interest rates and the interest rates on the operations depends on the quantity of excess liquidity in the system and the banks' readiness to participate in operations. Greater excess liquidity also increases the likelihood that the Eurosystem will sterilise the liquidity in full. In the first half of 2011, when excess liquidity gradually declined, the excess demand in the operations also declined. In four cases the liquidity was not fully removed, which was mostly related to banks' liquidity management during holidays. The decline in excess liquidity also brought a rise in the interest rate on the operations (see Figure 2): the marginal rate in the period between April and July approached the minimum bid rate. The situation reversed again after the second wave of purchases in the SMP, which began in August 2011 and coincided with other non-standard monetary policy measures that increased excess liquidity. The banks' participation in the operations increased strongly, which pushed the marginal and average interest rates on the operations down towards the deposit facility rate, where they remained in early 2012, at a level a few basis points above it.

Figure 2: **Results of weekly fine-tuning absorbing operations**



Source: Bloomberg.

An increase in lending in US dollars.

The Eurosystem continued its operations to provide US dollar liquidity to European banks in 2011, extending the agreement between central banks in cooperation with the Federal Reserve System (and the Canadian, UK, Japanese and Swiss central banks) under which they provide US dollar refinancing operations to banks. The Eurosystem executes US dollar refinancing operations, based on eligible collateral, at a pre-determined fixed interest rate with full allotment. There were 51 tenders for US dollar refinancing operations with a maturity of 7 days executed in 2011, but the average number of Eurosystem banks participating in the tenders was just two. The average allotment was EUR 918 million. As a result of rising tension on the US dollar refinancing market, in the coordinated action with the Federal Reserve System the central banks announced the execution of three additional monthly US dollar refinancing operations with a maturity of 3 months in the final quarter of 2011. The average allotment in the longer-term operations was EUR 17 billion, with an average of 15 banks participating. Towards the end of the year the central banks agreed to reduce the price of these loans and to reduce the required margin for the 3-month operations. The purpose of the required margin is to protect the Eurosystem against the risk of a change in the exchange rate during the operation, and the reduction in the margin was compensated for by means of a more active weekly valuation of exposures at the market exchange rate. As in 2010, Slovenian banks and savings banks did not participate in US dollar refinancing operations in 2011.

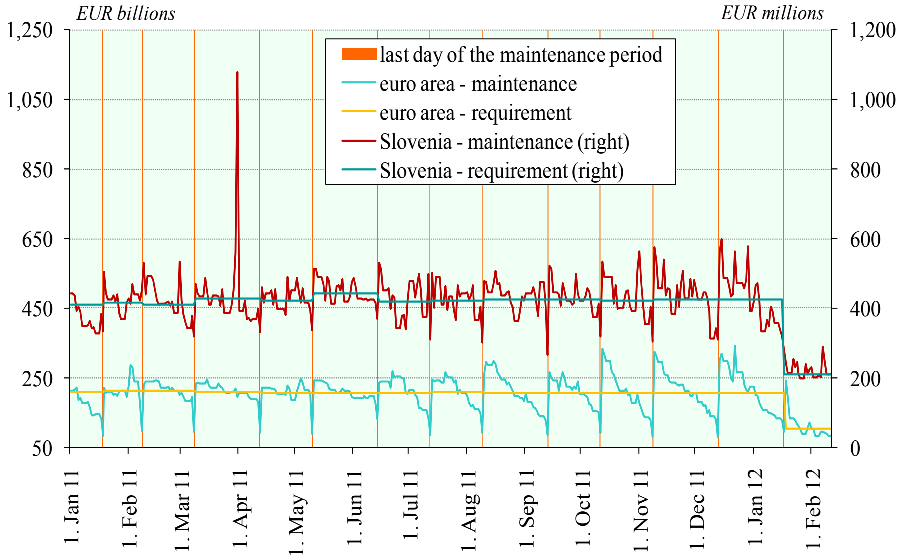
Furthermore, at the end of November the central banks agreed to establish temporary liquidity lines in other foreign currencies (Japanese yen, pound sterling, Swiss franc and Canadian dollar), via which it will be possible for every central bank to provide loans in these currencies to its counterparties. The option will be activated as necessary; there was no activation in 2011.

Standing facilities and minimum reserves

Record highs in the use of the deposit facility in December 2011.

The use of the deposit facility at the Eurosystem averaged EUR 102.0 billion in 2011, compared with EUR 145.9 billion in 2010. As Figure 21 makes clear, the maturing of the additional 1-year LTROs in 2010 significantly reduced the level of the deposit facility in the first half of 2011. In the second half of 2011, the renewed

Figure 23: **Minimum reserve requirement and maintenance**



Sources: Bank of Slovenia, ECB.

worsening of the debt crisis and the situation on the money markets, with central banks again using additional non-standard measures, led to an increase in excess liquidity and banks' increased use of the deposit facility, which towards the end of the year reached a record level of around EUR 450 billion. The use of the deposit facility by Slovenian banks and savings banks was similar to that of other euro area banks, and averaged EUR 160.8 million (compared with EUR 368.7 million in 2010).

The use of the marginal lending facility increased slightly in 2011. Euro area banks drew a daily average of EUR 1.9 billion (compared with EUR 0.6 billion in 2010), with a daily high of EUR 17.3 billion (EUR 5.2 billion in 2010). Slovenian banks and savings banks did not draw on the marginal lending facility in 2011.

Euro area credit institutions were required to hold minimum reserves in 2011 in the amount of 2% of certain liability items on their balance sheets. The average minimum reserve requirement in 2011 was EUR 208.3 billion across the Eurosystem (compared with EUR 211.9 billion in 2010), and EUR 423.3 million in Slovenia (EUR 423.7 million in 2010). The account holdings used to meet the requirement amounted to EUR 211.3 billion in the Eurosystem in 2011, and EUR 429.7 million in Slovenia. As has been typical since the outbreak of the financial crisis, in 2011, with the exception of the January period, banks met the reserve requirements relatively early in the maintenance period, i.e. at the beginning of each period they held significantly more reserves than required in accounts at central banks and then reduced the holdings throughout the period.

A reduction in the minimum reserve ratio.

The Eurosystem cut its minimum reserve ratio from 2% to 1% in December. The measure entered into force in 2012 with the January maintenance period, and further increased the excess liquidity in the euro area (by around EUR 100 billion; see Figure 21). The purpose of the measure was to reduce banks' need for liquidity, and hence release some of the eligible collateral. The measure also aimed to stimulate activity on the euro money market by encouraging lending by banks with excess liquidity to other banks, as surplus holdings in banks' settlement accounts at the central bank are not remunerated.

Collateral in Bank of Slovenia credit operations

In accordance with the Statute of the ESCB and the ECB, all Eurosystem monetary policy credit operations and intraday loans must be based on adequate collateral. This must meet the eligibility criteria, which are the same across the euro area.

Eligible collateral is divided into marketable assets (debt securities) and non-marketable assets (primarily credit claims and fixed-term deposits at the Eurosystem).[10]

Changes to the criterion of the rating of eligible assets in particular.

As a result of the banks' increased borrowing from the Eurosystem seen since the autumn of 2008, when full allotment in refinancing operations was introduced, the eligibility criteria have been modified several times since that time. Since October 2008 securities (except asset-backed securities) and non-marketable assets rated between BBB+/Baa1 and BBB-/Baa3 were added to the existing list of eligible collateral. To allow the Eurosystem to reduce the credit risk of this expanded collateral, since 1 January 2011 the graduated valuation haircuts are applied to the collateral, depending on its rating.[11] Lower haircuts are used for assets rated between AAA/Aaa and A-/A3 than for those rated between BBB+/Baa1 and BBB-/Baa3.

As a result of the approval of the economic and financial adjustment programmes coordinated with the EU and the IMF, the implementation of which is being monitored also by the ECB, the Eurosystem has suspended the requirement of a rating of at least BBB-/Baa3 for securities issued or guaranteed by certain countries until further notice, namely from 3 May 2010 for Greece, from 31 March 2011 for Ireland and from 7 July 2011 for Portugal.

After the expiry of grandfathering provisions, a requirement was introduced on 1 March 2011 that all asset-backed securities must have a second-best rating of at least A-/A3 (previously the requirement for such securities issued up to and including 28 February 2010 was for just a single rating at this level), and their second-best rating at issuance must be AAA/Aaa, except for securities issued before 1 March 2010. With these requirements the Eurosystem aims to help make asset-backed securities more attractive to investors, as investors lost confidence in these securities at the outbreak of the financial crisis in 2007.

To the same end, the Eurosystem announced at the end of 2010 that it will establish loan-by-loan information requirements for asset-backed securities as an eligibility requirement for them. The requirement, which demands regular dissemination of information on individual underlying assets of asset-backed securities, relates to an initiative supported by market participants that aims to provide investors, rating agencies and other interested parties with access to information of key importance to assessing the quality of asset-backed securities. In April 2011 the Governing Council of the ECB announced that the requirement would first be introduced for commercial mortgage-backed securities (CMBSs) and small- and medium-size enterprise (SME) transactions. The requirement will be introduced when the technical infrastructure is available for the regular collection and distribution of this data.

In the package of measures to support bank lending to non-banking sectors and activity on the money market, on 8 December 2011 the Eurosystem announced an increase of collateral availability, by (i) reducing the rating threshold for asset-backed securities whose underlying assets comprise residential mortgages and loans to SMEs (the second-best rating at issuance must be A-/A3, instead of the previous AAA/Aaa) as of 19 December 2011, and (ii) temporarily allowing NCBs to accept as collateral additional performing credit claims (i.e. bank loans) that satisfy eligibility criteria set out by the relevant NCB and approved by the Governing Council of the ECB. The implementation of the second measure is linked to the adoption of legal acts in the relevant countries.

As of 1 January 2012 the Eurosystem has abolished the eligibility requirement that debt securities issued by credit institutions are only eligible if they are traded on regulated markets.

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10 Eligible assets are described in Chapter 6 of the guideline on monetary policy instruments and procedures of the Eurosystem (http://www.ecb.int/ecb/legal/1002/1014/html/act_11559_amend.en.html).

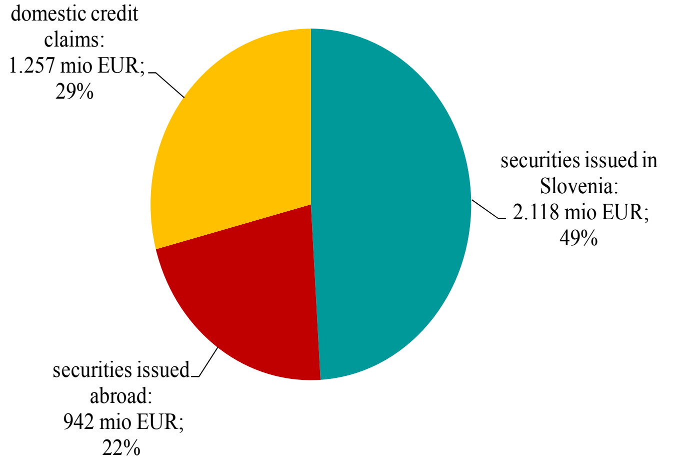
11 Haircuts were previously independent of the credit rating of the assets.

The Bank of Slovenia's pool of eligible collateral began increasing towards the end of the year.

As collateral for borrowing money from the Bank of Slovenia, Slovenian banks used securities issued at the Central Securities Clearing Corporation (KDD), securities issued in the rest of the world, fixed-term deposits with the Bank of Slovenia and credit claims granted to domestic debtors held in the pool of eligible assets at the Bank of Slovenia. Assets in the pool are pledged in favour of the Bank of Slovenia or provided to it as collateral otherwise.

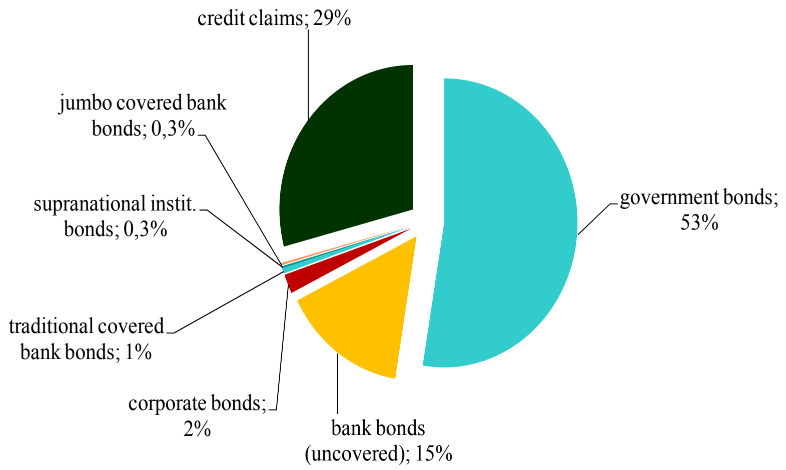
Having been relatively stable in 2010 at between EUR 3.8 billion and EUR 4.1 billion, the total pool of eligible collateral of all Slovenian banks and savings banks first declined in 2011 from EUR 3.9 billion at the beginning of the year to EUR 3.5 billion in April, when it reached its low, before beginning to increase again, primarily in the final months of the year, reaching EUR 4.5 billion towards the end of December. The banks' need for collateral declined in the first part of the year as a result of the maturing of the last of the three additional 1-year LTROs in December 2010, in which Slovenian banks participated heavily. The increase in the pool coincided with the October's 1-year LTRO and December's 3-year LTRO.

Figure 24: **Pool of collateral at the Bank of Slovenia as at 31 December 2011: breakdown by place of issue**



Source: Bank of Slovenia.

Figure 25: **Pool of collateral at the Bank of Slovenia as at 31 December 2011: breakdown of securities by type and bank loans**



Source: Bank of Slovenia.

The surplus of the collateral in the pool over the Bank of Slovenia's loans to banks was nevertheless always considerable: the average utilisation of the collateral was just 16% excluding intra-day loans and 22% including them. The average size of the pool was EUR 3.7 billion in 2011, EUR 0.3 billion less than the average of the previous year. The pool amounted to EUR 4.3 billion on the final day of 2011, of which EUR 2.1 billion comprised securities issued in Slovenia (the same as at the end of 2010), EUR 0.9 billion securities issued in the rest of the world (EUR 0.3 billion more than at the end of 2010), and EUR 1.3 billion domestic bank loans (EUR 0.1 billion more than at the end of 2010). The banks also occasionally transferred fixed-term deposits to the pool.

2.1.3 Bank of Slovenia as a lender of last resort

Article 4 of Bank of Slovenia Act states that one of the Bank of Slovenia's objectives is to strive to ensure financial stability. On the basis of point 14 of Article 12 of the law, the Bank of Slovenia may therefore act as the lender of last resort, i.e. in exchange for appropriate collateral it lends to a solvent bank or savings bank that could find itself in sudden liquidity difficulties. The Bank of Slovenia did not approve any such loans in 2011.

2.1.4 Payment and settlement systems

Payment and settlement systems are a vital part of the financial infrastructure of market economies, as their secure and efficient functioning allows for the reliable, timely and cost-effective settlement of financial transactions, most notably transactions arising in the execution of monetary policy by the central bank. Because they contribute to the general stability and efficiency of the economy, payment and settlement systems are a vital part of the economic and financial infrastructure. The Bank of Slovenia, as the central bank, therefore acts in several roles with regard to payment and settlement systems: it ensures the stability of individual payment system participants, it oversees the security and efficiency of payment and settlement systems, and it manages a payment system that facilitates the settlement of transactions in central bank money. Also of importance is its role as a catalyst and promoter of the activities of market participants, with the aim of improving competition and promoting development. Notwithstanding, in which of the before mentioned roles the Bank of Slovenia acts, its objective is to ensure transparent functioning and the clarity of its basic guidelines for all payment and settlement system participants.

TARGET2

TARGET2 is the pan-European payment system that allows the prompt settlement of individual payments. It is operated overall by the Eurosystem, and works on a single shared technical platform, but in formal legal terms each central bank connected to TARGET2 operates its own national component. The Slovenian component is called TARGET2-Slovenija.

Upgrade of the TARGET2 in November 2011.

Within the framework of Eurosystem activities the development of the functionality of the TARGET2 payment system continued in 2011. An upgrade was made in November that included modifications to the TARGET2 technical platform to improve the user interface that participants use to monitor their transactions in the payment system. The Bank of Slovenia organised testing for all TARGET2-Slovenija participants in connection with the upgrade. The purpose was to allow them to test the adaptations in their internal applications required by the upgrade.

Revision of the General Conditions for Participation in TARGET2-Slovenija.

The rules for granting intraday credit were updated at the Eurosystem level in the TARGET2 payment system. New procedures to be carried out by central banks connected to TARGET2 and participants in the payment system in connection with payments crediting or debiting Iranian entities have also been introduced. The implementation of these procedures proceeds from EU Council Regulation No. 961/2010. The Bank of Slovenia accordingly updated the *General conditions for participation in the TARGET2-Slovenija* in November, and drew up detailed instructions for payment system participants in connection with the implementation of the general conditions in relation to payments crediting or debiting Iranian entities.

Given the planned introduction of the TARGET2-Securities (T2S) system, the Eurosystem drew up a proposal in 2011 to upgrade the TARGET2 payment system and submitted it to all participants for discussion. Discussions of the proposal in Slovenia proceeded within the framework of the National TARGET2 User Group, which acts under the aegis of the Bank of Slovenia. The proposal will be updated in 2012 on the basis of participants' responses, and the technical platform of the TARGET2 payment system will be upgraded accordingly in 2013. The upgrade will also take account of participants' requirements in respect of the further development of the payment system itself, as expressed at a consultation organised in 2011. In Slovenia this consultation was also carried out within the framework of the National TARGET2 User Group.

TARGET2-Securities

TARGET2-Securities (T2S) is a Eurosystem project with the aim to set up a single technical platform for the settlement of securities, to which central securities depositories will transfer the function of securities settlement and central banks will transfer the function of cash settlement of the securities transactions. The primary aim of T2S is to consolidate securities settlement infrastructures in the EU, which are currently fragmented and locally focused, thereby increasing the effectiveness and security of securities settlement, which will ensure greater global competitiveness on the part of European securities markets. The decision to build T2S was taken in July 2008, with the central banks of France, Italy, Germany and Spain responsible for the construction and operation of the system.

Postponement of the deadline for launching T2S and approval of the T2S Framework Agreement.

The preparation of key technical documentation and the formulation of an agreement on the use of T2S to regulate relations between the Eurosystem on one side and the central securities depositories and central banks outside the Eurosystem on the other side (the T2S Framework Agreement) continued in 2011. The key decisions by the Governing Council of the ECB in 2011 related to the nine-month delay in the go-live date of T2S (now June 2015) and approval of the T2S Framework Agreement, which is the result of the Eurosystem's protracted negotiations with central securities depositories and entails a basis for the formalisation of cooperation between the two sides.

Maintenance of active dialogue within the National T2S User Group.

The Bank of Slovenia's activities in relation to T2S in 2011 comprised work with the relevant entities at Eurosystem level and in the national environment. The Bank of Slovenia continued with the chairing of the T2S National User Group in 2011, whose primary duties are to examine the possibility of including the Slovenian market in T2S, to exchange information and views on the T2S project and to draw up comments and positions in consultation with the ESCB from the point of view of the needs of the Slovenian market.

Cooperation in the harmonisation of the Slovenian environment.

Inclusion in T2S envisages the technical adaptation of existing securities settlement systems and payment systems, and the harmonisation of market practices, technical standards and legal arrangements. In this context the Bank of Slovenia was involved in the adaptation of the relevant legislation (the Financial Instruments Market Act and the Book-Entry Securities Act), within the framework of an inter-institutional group involving representatives of the Bank of Slovenia, the Ministry of Finance, the Central Securities Clearing Corporation (KDD) and the Securities Market Agency. The aim of the group is (was) to draw up the proposed legislative changes to give KDD a sufficient degree of legal security to sign the T2S Framework Agreement in 2012. The amendments to relevant legislation in the area were approved by the National Assembly in September 2011. The Bank of Slovenia also continued with harmonisation activities of market practices and technical standards in 2011, and worked intensively with the ECB in various consultations involving the identification of obstacles to the implementation of the envisaged common standards in the Slovenian environment.

Adjustments at the Bank of Slovenia.

The T2S concept envisages the transfer of the function of the cash settlement of the securities transactions from the environment of the TARGET2 payment system to the T2S environment. In this regard the Bank of Slovenia in 2011 started with the activities to set up the Slovenian cash component of T2S, which will provide domestic market participants with internationally comparable management of the cash settlement of securities transactions.

Collateral Central Bank Management (CCBM2)

The Collateral Central Bank Management (CCBM2) system was envisaged as a Eurosystem project to build a common platform for managing the collateral used for all credit operations of Eurosystem central banks.

Restructuring of the project.

The project was restructured in 2011 with intention to offer a narrower but more harmonised services for Eurosystem counterparties in connection with collateralisation of central bank credit operations. These services are expected to be available to counterparties before T2S begins its operations and will not encompass the harmonised use of non-marketable assets (bank loans). In any case by 2014 the Eurosystem will eliminate the existing restrictions on the repatriation of securities, which are preventing the effective cross-border use of securities by means of the Correspondent central banking model. The use of central securities depositories' triparty services will also be supported, allowing the Eurosystem and counterparties to manage assets more effectively.

Single euro payments area (SEPA)

The aim of the establishment of the Single Euro Payments Area (SEPA) is to introduce harmonised basic payment instruments (credit transfers, direct debits and payment cards) and common standards to enable (for all non-cash payments in euros) payments to be made and received under the same basic conditions, with the same rights and obligations within the entire area. In an integrated European payments market in euros, the distinction between payments within a country and cross-border payments will be abolished, effective competition will be established between payment service providers and there will be an opportunity to develop and introduce payment innovations of a pan-European nature. The establishment of the SEPA in Slovenia is managed by the Bank Association of Slovenia (BAS), which is also a member of the European Payments Council (EPC).

The Bank of Slovenia's participation in the SEPA project is in the role of coordinator and guide of the banking sector.

The Bank of Slovenia, as part of the Eurosystem and in its role as a catalyst also supports the SEPA project at the national level. In this role it coordinates and guides the activities of the banking sector in the implementation of the SEPA, pursuing the objectives of security and efficiency in payments in so doing.

Also in 2011 Bank of Slovenia representatives actively participated as an observers in the working and support groups of the SEPA project established under the aegis of the BAS. The Bank of Slovenia also participates in the work of the National SEPA Implementation Committee, which represents a higher level of decision-making in the structure of the SEPA project in Slovenia. In this committee it has the opportunity to present its views and to influence key decisions in the introduction of the SEPA in the domestic environment.

Monitoring of progress in the implementation of SEPA solutions in the domestic environment.

The Bank of Slovenia regularly monitored progress in 2011 in the introduction of SEPA solutions in the domestic environment in relation to SEPA credit transfers, SEPA direct debits and SEPA card payments.

A second progress report modelled on ECB reports (*SEPA Project in Slovenia - Second Progress Report*) was also drawn up in 2011, and describes the situation and key activities of the Slovenian banking sector in the establishment of the SEPA in 2010 and 2011. Released in early 2012, the report contains recommendations for key stakeholders in the project in relation to activities in connection with the establishment of the SEPA in the domestic environment. It also forms the starting point for further work by Bank of Slovenia observers in the project's working and decision-making bodies at the BAS.

SEPA infrastructure management and the settlement function

Provision of cross-border reachability in the SEPA credit transfer and SEPA direct debit schemes.

The Bank of Slovenia provides a link between the systems operated by Bankart d.o.o. for the execution of SEPA credit transfers and SEPA direct debits to the pan-European payment systems for these payment instruments operated by EBA Clearing. As a direct participant in pan-European payment systems, in 2011 the Bank of Slovenia provided banks and savings banks (as indirect participants) with cross-border reachability for bank accounts in Slovenia for SEPA credit transfers and SEPA direct debits, thereby allowing the exchange of SEPA credit transfers with more than 4,500 payment service providers and the exchange of SEPA direct debits with more than 3,900 payment service providers across Europe.

Provision of settlement in risk-free central bank money.

In 2011 the Bank of Slovenia also acted as the settlement agent for various Slovenian payment systems, namely the SEPA Internal Credit Transfers, ATM Settlement and Card Settlement (operated by Bankart), Activa Multilateral Clearing (operated by Banka Koper) and MasterCard Multilateral Clearing (operated by MasterCard International), which means that in accounts of participants in these payment systems with Bank of Slovenia it provides for the settlement of claims and liabilities in risk-free central bank money. It has also provided this function for two other payment systems since their introduction on 19 November 2011, namely the SEPA IDD Core and SEPA IDD B2B (operated by Bankart).

Payment and settlement systems oversight

Oversight of payment and settlement systems is a central bank function. The aim of the oversight function is to ensure safety and efficiency in payment and settlement systems by monitoring, analysing and inducing changes (by taking measures when payment and settlement systems fail to meet the prescribed requirements and standards), thereby contributing to ensuring systemic stability and to mitigating systemic risk, and maintaining public confidence in these systems.

Payment systems oversight.

Under the *Bank of Slovenia Act* and the *Payment Services and Systems Act*, the Bank of Slovenia is competent and responsible for oversight of payment systems. Another basis for oversight is the *Regulation on payment systems*, which was adopted on the basis of the *Payment Services and Systems Act*. The regulation sets out detailed rules for the criteria for defining an important payment system, requirements for managing financial, operational and other risks in payment systems, and reporting on the functioning of payment systems. When conducting oversight the Bank of Slovenia also follows Eurosystem guidelines, and international standards, principles and expectations.

In 2011, in accordance with its powers and responsibilities, the Bank of Slovenia oversaw the functioning of payment systems on the basis of analysis of the regular and ad hoc reports that payment system operators are obliged to submit to the Bank of Slovenia. The operators' reports relate to the regular functioning of the payment systems and the operations of the payment system operators, to all planned or unplanned deviations from regular operations, and to changes in the functional concepts of payment systems.

Granting of authorisations and on-site examinations.

In accordance with its legal powers, the Bank of Slovenia processed numerous authorisation requests in 2011, issuing authorisations to participants in three payment systems for the amendment of payment system rules, three authorisations for the establishment of a payment system and three authorisations for the provision of payment system operation services. As part of the authorisation issuance process Bank of Slovenia also carried out on-site examinations at the headquarters of two payment system operators, and one regular on-site examination of the functioning and operation of a payment system.

The Bank of Slovenia also participated in the oversight of payment systems and other arrangements in this area (payment instruments/schemes, correspondent banking, third-party service providers) conducted at the Eurosystem level.

Another important function of central banks is the oversight of the design and functioning of securities settlement systems as the infrastructure of the securities market that provides settlement of securities and corresponding cash payments. Since central bank are particularly interested in general stability of the financial markets and prevention of systemic risk in the settlement segment of the securities market, they regularly monitor and induce changes in securities settlement systems in order to ensure safe, reliable and efficient functioning of securities market.

The Bank of Slovenia is competent and responsible for oversight the functioning of securities settlement systems on the basis of the *Bank of Slovenia Act*, while its responsibility is further complemented by the *Financial Instruments Market Act*, which empowers the Bank of Slovenia with the responsibility for conducting oversight of central securities depository in respect of the systemic risk of the settlement system. The oversight activities are also conducted in cooperation with the Securities Market Agency. The Bank of Slovenia is accordingly active in identifying changes in the functioning of securities settlement systems and legislative changes, in determining the impact of these changes on the functioning of the settlement of securities transactions and consequently on the occurence of new risk (operational and financial) and related risks management procedures.

Assessment of the Eurosystem regarding compliance of the securities settlement system operated by the KDD and cross-border links with foreign securities settlement systems.

The oversight function also includes performing user assessments of the compliance of the securities settlement system operated by the KDD against the requirements of the Eurosystem as a user of KDD services in its credit operations. In this regard, the Bank of Slovenia prepared an assessment of the securities settlement system operated by the KDD and its cross-border links with foreign securities settlement systems operated by the central securities depositories Clearstream Banking Luxembourg and Clearstream Banking Frankfurt.

Supervision of payment institutions, electronic money institutions and currency exchange offices

Payment institutions in Europe are non-banking legal entities that may provide payment services on the basis of an authorisation from the competent national authority. Under the *Payment Services and Systems Act*, the Bank of Slovenia is competent and responsible for the supervision of payment institutions with regard to the provision of payment and ancillary services provided in Slovenia, in another Member State or in a third country. Under the same law the Bank of Slovenia is also responsible for issuing authorisations to business entities to provide payment services as (hybrid) payment institutions.

First authorisations issued to payment institutions.

The Bank of Slovenia spent a good deal of effort in the first half of 2011 on processing applications for authorisations to provide payment services that it received in late 2010 and early 2011. The procedures were successfully completed, and the Bank of Slovenia thus issued authorisations to provide payment services to four hybrid payment institutions in 2011: three for mobile payment services, and one for services related to the issue and use of payment cards.

In accordance with its legal requirements, the Bank of Slovenia publishes and updates a register of payment institutions on its website, which is a centralised database of payment institutions and waived payment institutions, of their agents in Slovenia and host countries, and of their branches in host countries and third countries. On the website the Bank of Slovenia administers and updates a list of payment institutions from the countries of the European Economic Area that may provide payment services in Slovenia via a branch, via an agent or directly, on the basis of notification of Bank of Slovenia by the competent supervisory authority of the home country (notification of payment institutions). There had been 45 such notifications by the end of 2011.

Examinations of payment institutions.

Having already conducted on-site examinations when issuing the authorisations to the first four hybrid payment institutions, at the end of 2011 the Bank of Slovenia also conducted the first on-site examination of a hybrid payment institution to check whether the subject of supervision had been meeting the statutory and regulatory requirements throughout its operation. In the event of any breach of regulations, the Bank of Slovenia is also responsible for imposing the adequate supervisory measures.

Under the *Payment Services and Systems Act*, the Bank of Slovenia is also competent and responsible for issuing authorisations to issue electronic money and for the supervision of electronic money institutions. No company has obtained such an authorisation to date in Slovenia, but the Bank of Slovenia nevertheless carefully monitors developments in the market and business models that could entail the issuance of electronic money.

Under the *Foreign Exchange Act,* the Bank of Slovenia is competent and responsible for supervising non-banking entities that provide currency exchange services (currency exchange offices). This encompasses on-site examinations of currency exchange offices at the point of exchange, and off-site supervision via reports on operations submitted to the Bank of Slovenia by individual exchange offices.

Examinations conducted on all currency exchange offices.

The Bank of Slovenia conducted on-site examinations of all currency exchange offices at the point of exchange in 2011. The purpose of the examinations was to check whether the exchange offices are providing currency exchange services in accordance with the relevant regulations.

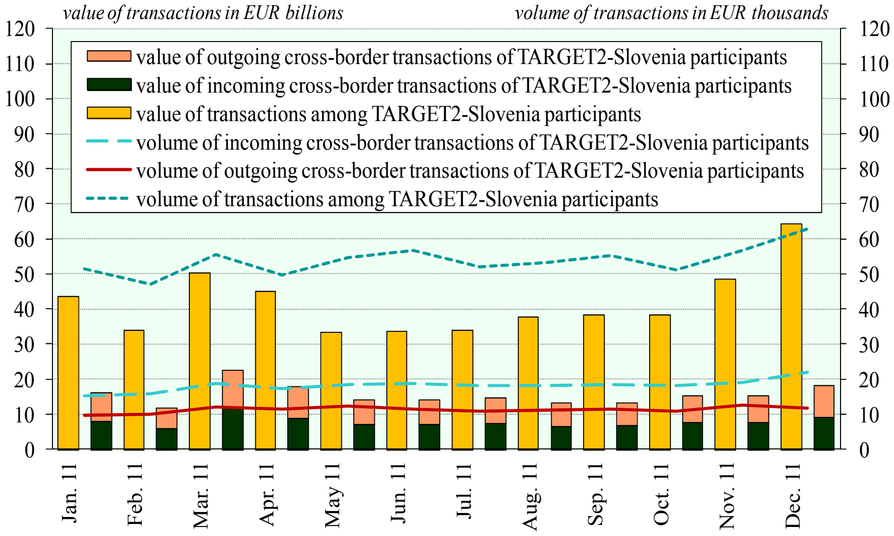
Statistics for payment systems operated by the Bank of Slovenia

The Bank of Slovenia operates the TARGET2-Slovenija payment system for the settlement of high-value and urgent payments in euros.

The number of transactions between TARGET2-Slovenija participants was down 0.17%, while the value of transactions was down 5.49% compared to 2010. Cross-border transactions increased.

In 2011 there were 646,138 transactions settled between participants in the TARGET2-Slovenija payment system with a total value of EUR 500,980.19 million, a decline of 0.17% in the number of transactions and a decline of 5.49% in the value of transactions compared to 2010. Between participants in the TARGET2-Slovenija system and participants in other national components of the TARGET2 system 217,880 incoming cross-border transactions were settled, up 13,94% compared to 2010, with a total value of EUR 92,887.30 million, up 43,58% compared to 2010, and 134,820 outgoing cross-border transactions, up 5,93% compared to 2010, with a total value of EUR 93,521.25 million, up 47.42% compared to 2010.

Figure 26: **Number and value of transactions via the TARGET2-Slovenija system by month in 2011**



Source: Bank of Slovenia.

2.1.5 Joint management of the ECB's foreign reserves

Upon the introduction of the euro on 1 January 2007, the Bank of Slovenia transferred a portion of its foreign currency assets in US dollars and gold to the ECB. The main purpose of the international monetary reserves is to ensure adequate liquidity for ECB interventions on the currency market. All euro area central banks have contributed their shares to the ECB's foreign reserves, which they manage jointly with the ECB. Since 1 January 2007 the Bank of Slovenia and the Central Bank of Luxembourg have jointly managed their share of the ECB's international monetary reserves. In addition to the international monetary reserves transferred to the ECB, the Bank of Slovenia also holds a portion of its investments in foreign currency in case the ECB calls for additional monetary reserves, which is in accordance with Article 30 of the Protocol on the Statute of the European System of Central Banks and the European Central Bank (see also Section 2.2.3).

2.1.6 Cash operations

Since the introduction of the euro in 2007, the Bank of Slovenia has issued a net total of EUR 1.42 billion in cash.

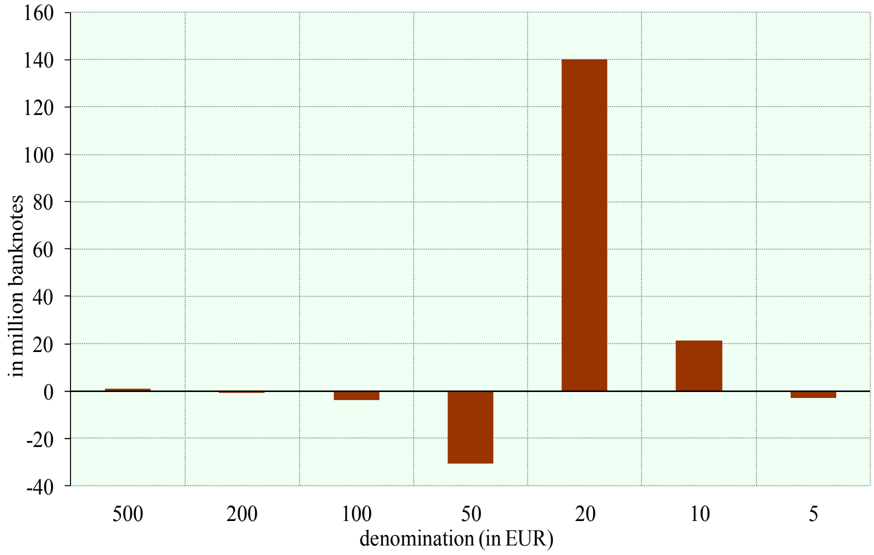
A net total of EUR 1.42 billion of cash had been released into circulation via the Bank of Slovenia by the end of 2011, of which banknotes accounted for EUR 1.37 billion (124.35 million banknotes) and coins for EUR 49.24 million (186.08 million coins). In terms of quantity, the EUR 20 note was the most heavily issued (140.11 million banknotes), followed by the EUR 10 note (21.29 million banknotes) and the EUR 500 note (0.78 million banknotes). In the case of all other denominations (EUR 200, EUR 100, EUR 50 and EUR 5), there was a negative net issuance (the number of banknotes issued was lower than the number returned to the Bank of Slovenia). The coins that were issued most heavily in terms of net quantity were the 1-cent (49.20 million coins) and 2-cent (37.00 million coins), while the lowest net quantity of issued coins was recorded by the 1-euro (6.76 million coins).

The Bank of Slovenia organised the issuance, distribution and storage of general circulation and commemorative coins for the Republic of Slovenia.

Commemorative coins issued in 2011.

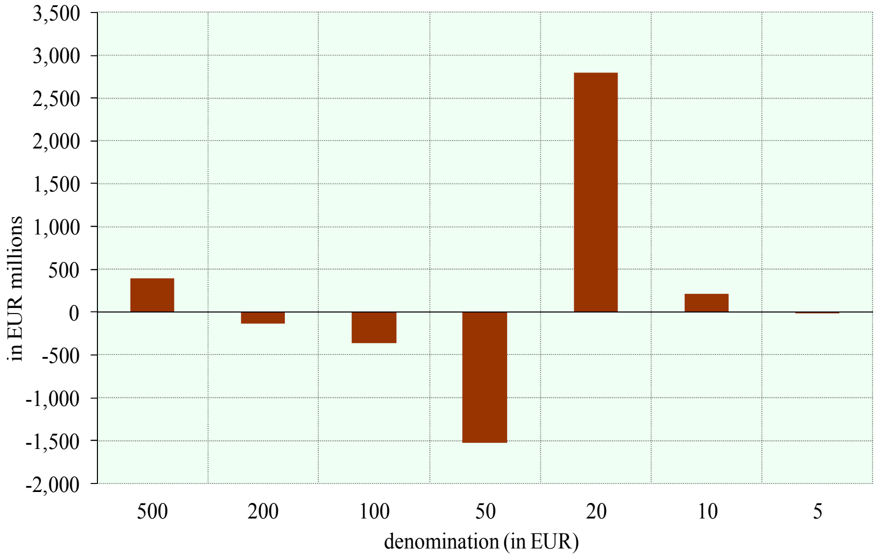
In March 2011 the Bank of Slovenia issued into circulation one million 2-euro commemorative coins to mark the 100th anniversary of the birth of national hero Franc Rozman - Stane. Collector coins issued by Slovenia were made available for sale and issued into circulation by the Bank of Slovenia to mark the World Rowing

Figure 27: **Quantitative breakdown of net issued euro banknotes**



Source: Bank of Slovenia.

Figure 28: **Value breakdown of net issued euro banknotes**



Source: Bank of Slovenia.

Championships in Bled (2,500 gold coins and 3,500 silver coins), and to mark the 20th anniversary of Slovenia's independence (2,500 gold coins, 3,500 silver coins and 300,000 bi-coloured 3-euro coins).

For the collector market the Bank of Slovenia also issued a collection of euro coins minted in 2011, a card with a commemorative 2-euro coin and a card with a 3-euro collector coin.

The total value of the tolar banknotes, coins and payment notes still in circulation is EUR 43.48 million.

As at 31 December 2011 there were still 46.81 million tolar banknotes in circulation (worth SIT 7.85 billion), 445.23 million tolar coins (worth SIT 2.17 billion) and 20.92 million payment notes (worth SIT 404.14 million). Compared with circulation at the end of 2005, 58.65% of the tolar banknotes have been returned from circulation (96.33% of the total value of the tolar banknotes), while 13.58% of the tolar coins have been returned (37.57% of the total value of the tolar coins).

Tolar banknotes, coins and payment notes can be exchanged at the Bank of Slovenia.

The payment notes and tolar banknotes are exchangeable at Bank of Slovenia counters with no time limit, while coins must be exchanged by 31 December 2016.

A total of 5,301 treasury receipts and outlays of euro cash (2010: 5,452) and 3,967 incoming and outgoing payments of cash for the needs of government bodies were made in 2011 (2010: 3,949), while there were 3,863 exchanges of tolar banknotes and coins.

The money counting unit processed 37.19 million banknotes and coins.

The Bank of Slovenia cash processing unit sorted 37.19 million banknotes and coins (2010: 79.00 million), comprising 36.77 million banknotes and 0.42 million coins (2010: 38.64 million banknotes and 40.36 million coins). A total of 11.09 million euro banknotes (compared with 10.77 million banknotes in 2010) were taken out of circulation and destroyed in order to maintain an appropriate quality for banknotes in circulation.

Euro cash was supplied nationally via depots at banks.

Euro cash was supplied through the Bank of Slovenia's banknote depots at five commercial banks, whose operations were monitored by the Bank of Slovenia on a daily basis.

The expert committee for testing, verifying and setting up machines to handle euro banknotes and coins, which is composed of employees of the Bank of Slovenia and the Ministry of the Interior, conducted 46 monitoring tests in 2011 in line with their powers to verify that banknote handling machines at commercial banks were working accurately and properly. The Bank of Slovenia drew up a timetable for the testing on the basis of data (number and type of sorting systems) obtained from cash handlers. It was appropriately taken into account that in Slovenia the majority of activities in connection with the fitness and authenticity of euro banknotes are carried out at the five Bank of Slovenia banknote depots (NLB, NKBM, Banka Celje, Gorenjska banka and Banka Koper), where most testing was also conducted. In 2011 all the tests were successful.

Decree on the implementation of Regulation 1338/2001.

In 2011, in conjunction with specialist departments at the Ministry of Finance and the Ministry of the Interior, the Bank of Slovenia drew up a Decree on the implementation of Council Regulation 1338/2001, by which the government defines misdemeanours resulting from breaches of the aforementioned regulation and the competent authority for supervising the implementation of the regulation.

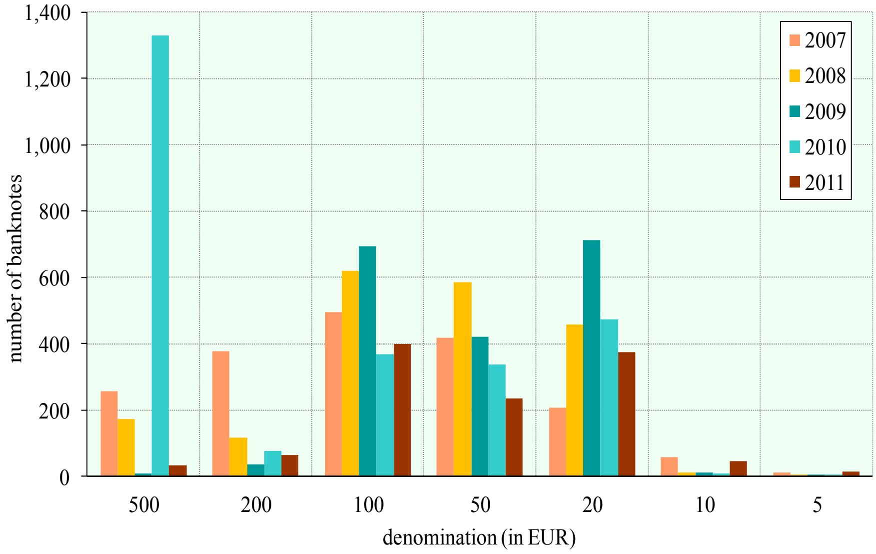
Regulation on the rules for reporting in accordance with Regulation and compensation for the costs associated with the procedure of returning and replacing euro coins unfit for circulation.

On the basis of Regulation 1210/2010, the Bank of Slovenia issued the Regulation on the rules of reporting in accordance with Regulation 1210/2010/EU and on the fees for the procedure of returning and replacing euro coins unfit for circulation, thereby setting out detailed rules for reporting and the amount of the fee that the relevant parties are obliged to pay for services associated with the procedure of returning and replacing euro coins unfit for circulation. In conjunction with the government, the Bank of Slovenia also drafted a decree on the implementation of Regulation 1210/2010/EU defining the misdemeanours resulting from breaches of the aforementioned regulation and the competent authority for supervising the implementation of the regulation.

The value of the euro counterfeits declined.

According to the figures of the National Analysis Centre (NAC) and the Coin National Analysis Centre (CNAC), 1,174 counterfeit euro banknotes and 1,459 counterfeit euro coins were withdrawn from circulation in 2011, compared with 2,603 banknotes and 1,518 coins in 2010. The numbers of counterfeit euro banknotes and euro coins identified in Slovenia thus declined in 2011, by 54.9% and 3.9% respectively. The value of the counterfeits identified in 2011 was EUR 92,543, compared with EUR 746,323 in 2010. The decline of 87.6% was the result of two major cases of counterfeiting involving EUR 500 notes in 2010 (1,320 notes in total). EUR 100 notes accounted for the largest proportion of counterfeit banknotes in terms of quantity (34.0%), while 2-euro coins accounted for largest proportion of counterfeit coins (61.1%). The number of euro counterfeits identified in Slovenia is not a matter of dispute for now. Eurosystem data in this area ranks Slovenia in the lowest quartile of countries in terms of the amount of counterfeit cash withdrawn from circulation per 1,000 inhabitants (0.6 counterfeits).

Figure 29: **Counterfeit euro banknotes discovered in Slovenia**



Source: Bank of Slovenia.

Other foreign currency counterfeits were also discovered.

There were 639 foreign currency counterfeits identified in 2011 (US dollars, Bosnian convertible marks, Croatian kuna), compared with 138 in 2010. The quality of foreign currency counterfeits has improved over time, making it more difficult for users to identify them, particularly US dollar counterfeits.

Control of the authenticity of euro cash has been organised.

Under Regulation (EC) No. 1338/01, the NAC and CNAC are responsible for issuing expert opinions on the authenticity of euro banknotes and coins respectively. These agencies operate under the aegis of the Centre for Forensic Investigation (CFI) at the Ministry of the Interior. Supervision of the activities of the aforementioned centres, in connection with the work of the Counterfeit Monitoring System at the ECB, is carried out at the Bank of Slovenia by the National Counterfeit Centre (NCC). The NCC is actively involved in a system of data and information exchange on counterfeiting with the ECB's Counterfeit Analysis Centre (CAC), other national counterfeit centres and the European Technical and Scientific Centre for the analysis of euro banknotes.

2.1.7 Statistical system

Concern for monetary and financial statistics, statistics of financial accounts and external relations.

The Bank of Slovenia is responsible for the implementation of integral statistical processes in monetary and financial statistics, the external statistics and the statistics of the national financial accounts. This entails the collection and processing of data, its dissemination to users and/or the publication of aggregated data. The Bank of Slovenia also carries out certain tasks with regard to other economic and fiscal statistics.

The implementation of statistical functions is based on membership in the ESCB in accordance with the Statute of the ESCB and of the ECB, on the tasks of the statistical research programme under the National Statistics Act, and on other authorisations.

The Bank of Slovenia's statistical activities are used to inform the domestic and foreign public of the financial and macroeconomic trends in Slovenia, and also provide data support for the realisation of targets related to price stability, economic policy and the financial stability of the Slovenian economy within the framework of the EMU.

The Bank of Slovenia works together with international organisations and institutions, particularly the ECB, the IMF, Eurostat (the European Statistical Office within the European Commission), the World Bank, the BIS and the OECD on the development of statistical requirements, methodologies and standards. Bank of Slovenia representatives sit on the ESCB's Statistics Committee and the regular working groups for external statistics, general economic statistics, general government statistics, monetary and financial statistics, euro area (national) accounts, and statistical information systems, and also on occasional task forces. The organisation of the Financial Statistics Department has been aligned with the need to cooperate within the ESCB.

Comprehensive international statistical cooperation in the ESCB, and with other international organisations and institutions.

Bank of Slovenia representatives also attend regular meetings of the relevant Eurostat working groups and regular plenary sessions of the Committee on Monetary, Financial and Balance of Payments Statistics (CMFB), which is the main body for coordinating strategic issues about European macroeconomic statistics between representatives of European central banks (including non-EU countries), statistical offices, Eurostat and the ECB.

The most notable form of cooperation with national statistical institutions is with the Ministry of Finance and the Statistical Office of the Republic of Slovenia (SORS), based on a Memorandum of Understanding in the area of macroeconomic and financial statistics, signed in 2004 and last updated in 2009. The MoU was modelled on a similar document agreed between the ECB and Eurostat. It applies to the coordination of powers and responsibilities because of the increased burden of statistical requirements and co-dependency of particular statistics, thereby easing compliance with international statistical requirements.

MoUs with the Ministry of Finance and the SORS are a significant basis for the coordinated fulfilment of obligations in the area of macroeconomic and financial statistics.

The MoU sets out the responsibilities of the signatories and the manner of their cooperation in the provision of Slovenian macroeconomic and financial statistics to the European Commission (Eurostat), ECOFIN, the ECB and the OECD. The MoU also covers cooperation in maintaining the register of standard classification of institutional sectors, as particularly important statistical infrastructure for the provision of coherent macroeconomic and financial statistics. The official sector classification is managed by the Agency for Public Legal Records and Related Services (AJPES) as part of the Business Register of Slovenia.

The basic data sources for the Bank of Slovenia for the comprehensive and complex sets of financial accounts, and monetary, financial and external statistics are direct and indirect reports from financial institutions and non-financial corporations and data on merchandise trade prepared by the SORS in conjunction with the Customs Administration. The Bank of Slovenia also collects, compiles and/or publishes statistics on payment instruments and financial markets, and general economic and public finance statistics.

The Bank of Slovenia compiles annual and quarterly financial accounts. The primary source for compiling Slovenia's financial accounts are the quarterly reports of individual institutional units (non-financial corporations, financial corporations and government units) intended for financial account statistics, which are collected by the AJPES for the Bank of Slovenia.

The sources for financial account statistics are quarterly reports collected by AJPES.

Aggregate quarterly financial accounts statistics were submitted to the ECB in accordance with Guideline ECB/2005/13, while aggregates of quarterly financial accounts for the government sector were submitted to the ECB and Eurostat in accordance with Regulation (EC) No. 501/2004 and aggregates of annual financial accounts were submitted to Eurostat in accordance with Regulation (EC) No. 2223/96.

The publication Financial Accounts of Slovenia 2005-2010 was released in November 2011, and alongside tables of financial accounts and the compilation methodology it also contained analysis of financial accounts data in individual sectors and a comparison with the euro area.

The comprehensive production of monthly, quarterly and annual monetary and financial statistics continued in 2011 in accordance with the methodological requirements of the ECB, the OECD and the IMF, and the internal needs of the Bank of Slovenia. In addition to the balance sheet and interest rate statistics of monetary financial institutions (MFIs), the data pursuant to Regulations ECB/2001/18 and ECB/2008/32 and Guideline ECB/2007/9 also includes data on non-monetary financial intermediaries, securities and payment systems, and structural data from the banking system.

Major integration of statistical and supervisory data requests to credit institutions successfully completed.

The supervisory requirements on the statement of comprehensive income were also included into the multipurpose report by credit institutions in June 2011. This successfully completed the major integration of statistical and supervisory data requirements in accordance with the principle of multipurpose simultaneous reporting, thereby reducing the reporting burden on credit institutions in accordance with the adopted recommendations of the Governing Council of the ECB.

In 2011 the Bank of Slovenia continued its activities to introduce multipurpose reporting of data in the subsector of insurance corporations and pension funds (S.125) in conjunction with the Insurance Supervision Agency (ISA) and the Slovenian Insurance Association (SIA).

Comprehensive balance of payments and international investment position data, including external debt, FDI figures and international monetary reserves, was produced regularly in 2011.

Activities were also undertaken in the area of external statistics to implement the methodology of the sixth edition of the IMF's balance of payments manual (the BPM6), and other minor adjustments to data sources. These activities include changes in the aggregation of securities data, the expansion of central bank data sources, updates to the report on lending to non-residents (with short-term maturity of long-term instruments) and the breakdown of merchandise data for processing for the previous period.

First survey on corporate access to financing conducted.

In the autumn of 2011 the Bank of Slovenia conducted its first survey of corporate access to financing, comparable to the survey conducted by the ECB on a sample of SMEs in larger euro area countries every half-year since 2009 (the data is available in the ECB's Statistical Data Warehouse [SDW]). The ECB and the European Commission began conducting such surveys in all European countries every two years from 2009, although the number of respondents in Slovenia is small, at just 100.

In 2011 the Bank of Slovenia processed data from a new survey of household finance and consumption, which is conducted by all euro area countries in a standardised form coordinated by the ECB. The field part of this extensive survey was conducted in the autumn of 2010.

The Bank of Slovenia also sends the ECB certain data in the areas of fiscal and general economic statistics, such as data for the Maastricht economic criteria on long-term interest rates, the general government budget position, the general government debt and the HICP, other figures from the national accounts statistics, labour statistics, and data on the excessive deficit procedure. This data is compiled by the SORS and/or the Ministry of Finance in accordance with the aforementioned MoU.

The Bank of Slovenia releases key macroeconomic data on Slovenia on its website in accordance with the IMF's Special Statistical Data Dissemination Standards. These standards require the regular publication of methodologically sound macroeconomic figures according to an advance release calendar. The Ministry of Finance and the SORS also contribute relevant data for publication in accordance with these standards.

The key financial and macroeconomic data for Slovenia is published in a monthly bulletin and in annual publications on direct investments and financial accounts. As of the spring of 2011 the Bank of Slovenia bulletin is no longer being released in printed form, but is nevertheless available on the Bank of Slovenia's website. All publications, along with information on the longer data series from the bulletin and certain other important data, are also available on the Bank of Slovenia's website. In addition to domestic recipients, the more important direct recipients of the statistical data are the ECB, Eurostat, the IMF and the BIS.

Expert assistance for statistics specialists at the central banks of Serbia and Montenegro.

In 2011 the Bank of Slovenia provided expert assistance in the field of statistics to the central banks of Serbia and Montenegro. The professional delegations that visited the Bank of Slovenia received presentations on the areas of monetary and financial statistics, balance of payments statistics and the statistical information system.

2.1.8 Information system

The Bank of Slovenia is connected to the ESCB's information system.

Article 55 of the Bank of Slovenia Act (Official Gazette of the Republic of Slovenia, No. 72/06 [official consolidated version]) stipulates that as of the day that Slovenia joined the European Union, the Bank of Slovenia is to cooperate with the ECB in accordance with the Statute of the ESCB and of the ECB in respect of the recording, collection, processing and disclosure of data and information relevant to the performance of its functions.

ESCB information system infrastructure.

The Bank of Slovenia is technically linked to the information system of the ECB and ESCB via the ESCB physical network infrastructure system,[12] the ESCB application network infrastructure system,[13] the ESCB's system for the secure exchange of email[14] and via a teleconferencing system. Infrastructure equipment is situated at primary and backup locations at the Bank of Slovenia.

The link to the ECB is provided using the ESCB physical network infrastructure system. It is a high-availability secure private network that links the individual NCBs with the ECB. The ECB is responsible for the system administration of this network, including equipment installed on-site at the NCBs.

The ESCB application network infrastructure system forms part of the infrastructure used to link the NCBs with the ECB. It comprises several multipurpose servers, firewalls, network switches, etc. All equipment is duplicated to ensure a high level of availability. Some of the equipment is at the Bank of Slovenia's backup computer centre, which allows the link to the ECB to be maintained without disruption in the event of a total disaster at the Bank of Slovenia's primary computer centre. All of the equipment of this network that is located at Bank of Slovenia sites falls under its administrative domain.

The aforementioned infrastructure equipment must be upgraded regularly with regard to technological advances, increases in the quantity of data and the increased requirements of commercial users. In 2011 we conducted regular annual upgrades of the ESCB-Net system. The ECB's maintenance contractor for the Core Network upgraded the encryption devices at the Bank of Slovenia's primary and backup locations. TLS-encrypted email was also introduced.

ESCB information system applications.

A number of applications via which data is exchanged between the NCBs and the ECB and ESCB run on the aforementioned infrastructure. A good deal of activity in the ESCB system in 2011 was devoted to providing application support for the implementation of crisis measures. The Bank of Slovenia was therefore also obliged to modify and provide application support, most notably in support for the acceptance of disaggregated data on the use of collateral across the entire Eurosystem (data for marketable assets and data for disbursements in credit operations). We also provided support for the changes to the weekly reporting of data on loan collateral at the Bank of Slovenia. Preparations and adaptations were also required in the exchange of statistics, in terms of both content and technological solutions.

ESCB information system security.

Security is vital in the ESCB information system. In 2011 work was done to establish an organisational framework for the centralised administration of identities and access rights in the ESCB information system.

[12] Core Network.
[13] ESCB-Net.
[14] ESCBMail.

2.2 Other tasks

2.2.1 Banking supervision and ensuring financial stability

Licensing

In its role as the supervisor of the banking system the Bank of Slovenia is competent and responsible for conducting comprehensive supervision of banks, part of which is the granting of authorisations for various banking operations. Supervision begins at each credit institution, i.e. bank, with the issue of the requisite legally prescribed authorisations to pursue business activities, to hold significant (qualifying) holdings and to hold office as a management board member. The decision to grant or refuse an authorisation is made by the members of the Governing Board of the Bank of Slovenia.

Authorisations to hold office as a member of the management board were the most frequently issued of all authorisations.

In 2011 the Bank of Slovenia issued authorisations to acquire a qualifying holding in a bank, to provide ancillary financial services and to merge a legal entity with a bank, and to hold office as a member of a bank's management board. The Bank of Slovenia issued a total of 14 authorisations in 2011, and suspended the authorisation procedure for two applications. Nine of the authorisations issued in 2011 were to hold office as a member of a bank's management board, four were to provide ancillary financial services, and one was to merge a legal entity with a bank. The number of authorisations issued in 2011 was the same as in 2010, when eight of the 14 authorisations were to hold office as a member of a bank's management board. The Bank of Slovenia revoked one authorisation to acquire a qualifying holding in a bank in 2011, because the holder no longer satisfied the conditions defined by regulations that owners of a significant holding should permanently satisfy.

The Bank of Slovenia received 22 notifications in 2011 of the direct provision of services in Slovenia by banks of Member States.

Pursuant to Directive 2006/48/EC (previously: Directive 2000/12/EC) and Annex I (List of activities subject to mutual recognition), a Member State bank that is entitled to provide banking services and other (mutually recognised) financial services may also provide these services in Slovenia. It may provide them via a branch (*in the case of permanent pursuit of business activities*) or directly (*in the case of occasional provision of services without elements of permanent presence in Slovenia*) without an authorisation from the Bank of Slovenia, which must be provided with a written notification by the relevant supervisory authority in the home Member State. The Bank of Slovenia received 22 notifications of the direct provision of banking and other mutually recognised financial services in 2011, the same as in the previous year. A list of banks of EU Member States that have carried out the notification procedure for the provision of banking services and other financial services in Slovenia via their home banking supervisors is available on the Bank of Slovenia's website. Different arrangements apply to banks of third countries. Banks from third countries may only provide banking and other financial (mutually recognised) services via a branch, where the authorisation of the Bank of Slovenia is required for the establishment of a branch. When granting such authorisation, the Bank of Slovenia may request that a bank of a third country deposit a specific sum of cash or other eligible collateral in Slovenia, or provide other appropriate collateral as a guarantee for the settlement of liabilities from transactions concluded in Slovenia.

Examinations of banks and savings banks

In light of the adverse corporate business conditions and the prevailing lack of confidence on the financial markets, credit risk and refinancing risk are the most pressing issues at banks.

The Banking Supervision Department conducted *regular prudential examinations of banks and savings banks* in 2011, based on an assessment of risks and the quality of the control environment for risk management. Examinations of specific areas were prevalent among the examinations and reviews conducted, practice having shown that shorter and thus more frequent and more detailed examinations of specific areas are more significant and thus more needed than comprehensive reviews (examinations of all areas of operations). Due to the development of the macroeconomic situation , the greatest emphasis was placed on credit risk, liquidity risk and capital risk. In accordance with the Basel core principles for effective banking supervision, the Banking Supervision Department consistently monitors the implementation of all measures via specific follow-up reviews. It also maintains continuous contacts with banks and savings banks at a number of hierarchical levels, primarily via shorter visits and/or regular annual meetings at the completion of a review or otherwise. These meetings focus on assessing the capital adequacy, performance and current financial position of the banks and savings banks in question, and learning about their strategy for the bank's future development. The regular exchange of opinions and information between supervisors and the management of banks or savings banks is also a prerequisite for timely and appropriate action with the aim to prevent operating difficulties.

On the basis of the powers of the Governor of the Bank of Slovenia, there were *32 supervisory review procedures initiated* in 2011. The time required for an examination or review is determined with regard to the scope and content of the examination or review, which primarily depend on the material significance of a particular risk at the bank, and the size and importance of the bank relative to the banking system as a whole. In the procedures initiated in the current year and the procedures initiated in previous years, the Banking Supervision Department carried out:

- 10 prudential examinations which covered 27 specific risk areas and the control environment,
- 26 follow-up examinations to review the implementation of measures.

In addition to the above, the Banking Supervision Department also conducted *thematic examinations* of compliance with legislation on the prevention of money laundering and terrorist financing, banks' ability to provide information about guaranteed deposits, banks' readiness to use bank loans as collateral for Eurosystem claims and other narrower areas of banking operations. There were 23 such examinations.

Based on the findings of examinations and reviews at banks and savings banks, the Bank of Slovenia may issue recommendations, admonishments or orders, or another measure in accordance with the Banking Act. There were 14 orders to eliminate violations in 52 points issued in 2011, along with 100 admonishments and 121 additional reporting requirements, recommendations to improve operations and conditions for the granting of authorisations. The majority of measures were issued in the area of credit risk, followed by liquidity risk, capital risk and interest rate risk. Numerous measures were also issued because of breaches of legislation on the prevention of money laundering and terrorist financing. All of the measures in respect of banks were discussed and approved by the Governing Board of the Bank of Slovenia.

The continuous process of risk assessment and determination of capital adequacy, and its verification on at least an annual basis is part of the regular activity at banks and at the supervisor, and contributes to better risk management at banks.

Another very important element of banking supervision is the regular annual review of the calculation of capital requirements, which banks draw up during the internal capital adequacy assessment process (ICAAP) in accordance with the rules and procedures set out in the European Directive and the ZBan-1. The *Supervisory Review and Evaluation Process (SREP)* applied to the calculation of a bank's capital requirements is based on an active dialogue with each bank with a view to the timely detection of any deficiencies in the ICAAP itself, and in the actual amount of the capital requirements calculated and the adequacy of the own funds to cover the requirements, and with a view to rapid action to mitigate risks at the bank and to ensure an adequate level of capital. Intensive communication was undertaken with certain banks to this end, while specific reviews were also conducted. The main result of the SREP is that the supervisor determines a *minimum level of capital adequacy* for each bank with regard to the scope and level of the risks that it is exposed to. The Bank of Slovenia expects banks to maintain this level of capital adequacy at all times in their operations.

For the banks under majority foreign ownership, frequent and ongoing cooperation with foreign supervisors has been established within supervisory colleges, which have recently assumed an increasingly important role in the exchange of information of relevance to supervisors of an individual banking group, and in the coordi-

Mutual cooperation strengthened notably via the supervisory colleges, which are becoming the central point of joint action by supervisors of individual banking groups.

nation of supervisory activities. Managing supervisors and examiners responsible for individual banks regularly participate in supervisory colleges for individual international banking groups. The basic purpose of the supervisory colleges is to achieve more thorough, better-coordinated supervision of international banking groups. The Bank of Slovenia participates in six colleges for banking groups that also operate in Slovenia. For the operational functioning of these colleges the Bank of Slovenia has signed the relevant multilateral agreements with all other supervisors involved in supervision of the group. In accordance with a European directive, procedures to assess the overall capital adequacy of the banking group were conducted for the first time in the supervisory colleges, headed by the supervisors of the parent bank in the banking group. In these cases the Bank of Slovenia participates as a host supervisor responsible for a subsidiary bank. A joint decision on capital adequacy was reached by all supervisors for all six foreign banking groups.

The Bank of Slovenia is responsible for the organisation and chairing of the supervisory colleges for the Slovenian banking groups of Nova Ljubljanska banka and Nova kreditna banka Maribor. The meetings of the colleges in November involved representatives of the supervisory institutions from all the countries where the two banks have subsidiaries. The Bank of Slovenia also conducted the capital adequacy assessment process for the two banking groups. A *joint decision on capital adequacy* was reached and signed by all the competent supervisors. In addition to cooperating with supervisors from other countries within the framework of the supervisory colleges, the Banking Supervision Department also maintained bilateral contacts with certain supervisors on the basis of bilateral memorandums of understanding (the Bank of Slovenia has 12 MoUs with foreign supervisory institutions) with the aim of directly exchanging information on individual subsidiaries, and participated in two supervisory reviews of a subsidiary bank.

The Bank of Slovenia approved seven requests in 2011 for authorisations relating to elements in the calculation of own funds, in particular the repayment of subordinated debt classified as additional capital, the inclusion of subordinated debt in additional capital, the redemption of a hybrid instrument, and the inclusion of a hybrid instrument in Tier 1 capital.

Cooperation with the other two Slovenian supervisory institutions for financial services (the Securities Market Agency and the Insurance Supervision Agency) proceeded on the basis of the Rules on mutual cooperation by supervisory authorities, and took the form of regular meetings, exchanges of information between the aforementioned institutions, and examinations and reviews of banks and related parties coordinated in terms of theme and timing. The Banking Supervision Department participated in three joint reviews in 2011. Under the rules, the supervisory institutions are required to inform one another when they identify any irregularities that fall under the auspices of another supervisory institution.

Certain changes were made to the operation of the Banking Supervision Department in 2011 with the aim of ensuring the most proactive and effective possible supervisory process in the altered economic circumstances and in the business climate faced by the banks. The changes provide for more in-depth and systematic preparations for examinations and reviews, based on monitoring and consideration of the impact of macroeconomic and systemic developments on the risk exposure of the individual bank, the distinctive nature of each bank's business model being taken into account. This has ensured faster, more effective detection of changes in the risk exposure of the banking system, and has strengthened the preventive and counter-cyclical work of the supervisor. The demarcation of competencies at all levels of supervisory activity has also been made clearer, while inter-departmental and inter-sectoral cooperation has been enhanced with the aim of better horizontal transparency, objectivity and efficiency.

Changes to banking regulations in 2011

Most of the changes to banking regulations in 2011 related to the transposition of the CRD III into the Slovenian legal system.

Most of the changes to banking regulations in 2011 were related to the transposition of Directive 2010/76/EU of 24 November 2010 amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies (the CRD III). Some of the provisions of this directive were transposed into the Slovenian legal system by the amendment of the Banking Act, the ZBan-1G (Official Gazette of the Republic of Slovenia, No. 59/11), while the remaining provisions were transposed by the amendment ZBan-1H (Official Gazette of the Republic of Slovenia, No. 85/11). The majority of the Bank of Slovenia regulations cited below were also adopted on the basis of these two amendments of the Banking Act. Certain regulations adopted last year arose on the basis of the amendment ZBan-1F (Official Gazette of the Republic of Slovenia, No. 35/11), which intervenes in the area of ethics of governance, and other changes in legislation or findings from supervisory practice.

The *Regulation on the documentation for demonstrating fulfilment of the conditions for performing the function of a member of the management board of a bank or savings bank* was amended in February. The amendment requires the submission of a photocopy of evidence of the candidate's professional qualifications and notification of the Bank of Slovenia of any proceedings for an economic offence or misdemeanour that could be initiated against the candidate, while a broader description of the bank management strategy is also required.

A new *Regulation on the amounts of annual fees for supervision and fees for decisions regarding requests for the granting of authorisation* was adopted in April. All provisions relating to electronic money institutions have been removed from the regulation, because as of the end of April 2011 a change of definition means that these institutions are no longer regulated by the Banking Act (they are no longer defined as credit institutions).

The *Regulation on large exposures of banks and savings banks* was updated in May. In the determination of maximum allowable exposure banks are now granted more favourable treatment for their exposures to other banks established in the EU that are members of the same banking group as the bank and are included in supervision on a consolidated basis. Reason being, banks in the EU are subject to stricter regulatory requirements and supervision on an individual and consolidated basis than other companies. Such exposures are still subject to restrictions: banks may exclude no more than 50% of the amount from the calculation of exposure.

The new ZBan-1F, published in May 2011, instructed the Bank of Slovenia to prescribe detailed rules for the conduct of members of management boards and supervisory boards in performing their functions in accordance with the relevant standards of professional diligence and the highest ethics of governance, with regard to conflicts of interest and the criteria for defining a significant business contact. The aforementioned rules and criteria were the subject of August's updated *Regulation on the diligence of members of the management and supervisory boards of banks and savings banks*. The ZBan-1F also expands the range of disclosures to be made by banks, who must now also disclose information on all significant business contacts that members of their management boards and supervisory boards and their immediate family members have had with the bank or a subsidiary of the bank. In addition, banks must disclose information on compliance with regulations, other rules as well as internal rules that govern conflicts of interest involving the members of the management and supervisory bodies of subsidiary financial corporations established outside Slovenia. It was necessary to revise the *Regulation on disclosures by banks and savings banks* to define the aforementioned disclosures in greater detail.

The two aforementioned regulations also had to be updated for reason of the new ZBan-1G published in July. The important new features brought by the ZBan-1G included new powers and duties for members of a bank's supervisory board in connection with remuneration policy, the obligation to appoint a remuneration committee at systemically important banks of the Slovenian banking system, and additional disclosures on the remuneration system and the earnings of employees with jobs of a specific nature (i.e. employees whose duties allow them to have a significant impact on the bank's risk profile).

The remuneration system, which should encourage appropriate and effective risk management, includes remuneration policies and practice, in respect of which the Bank of Slovenia defines detailed rules.

In accordance with the CRD III, the ZBan-1G introduces a remuneration system as a mandatory component of the governance system at each bank. The remuneration system, which should encourage adequate and effective risk management, includes remuneration policy and practice, in respect of which the Bank of Slovenia must prescribe detailed rules. These rules are set out in the new *Regulation on risk management and implementation of the internal capital adequacy assessment process for banks and savings banks* published in August. The new regulation also defined terms in the area of remuneration, the internal audit department's obligations in respect of the remuneration system, the application of the principle of proportionality and the conditions for exemption of certain rules, and the general and specific requirements regarding the adjustment of remuneration to risk. It was also necessary to revise the *Regulation on the reporting of individual facts and circumstances of banks and savings banks* on the basis of the ZBan-1G to provide a more detailed definition of the information to be reported to the Bank of Slovenia in relation to employee remuneration.

Two other regulations were issued in August, namely the *Regulation on the calculation of capital requirements for credit risk under the standardised approach for banks and savings banks* and the *Regulation on the calculation of capital requirements for credit risk under the internal ratings-based approach for banks and savings banks*, which brought minor changes for Slovenian banks deriving from the CRD III.

The *Regulation on the minimum requirements for ensuring an adequate liquidity position at banks and savings banks* was amended in September. The amendment improved the treatment of sight deposits of households and non-financial corporations in the calculation of the liquidity ratios in accordance with their intended treatment within the LCR (*liquidity coverage ratio*) standard. The results of a quantitative impact study showed that banks with a strong deposit base score very high LCRs, as in this instance it is a relatively fixed source of liquidity. The proportion of stable sight deposits of households and non-financial corporations is 60% in the first bucket and 65% in the second bucket (previously 50% and 55%).

In November the *Regulation on the documentation for the granting of authorisations to provide banking and financial services and for status transformations* was amended. The new ZBan-1G introduced the remuneration system as a mandatory component of the governance system of each bank, as a result of which it was necessary to amend the aforementioned regulation, which includes documentation about the governance system in the documentation to be enclosed with the application for an authorisation to provide banking services.

A broad package of regulations was adopted in December to transpose the remaining provisions of the CRD III into the Slovenian legal system. These comprised updates to the Regulation on the calculation of the own funds of banks and savings banks, the Regulation on the calculation of capital requirements for credit risk in securitisation and the rules on the exposure of banks and savings banks to transferred credit risk, the Regulation on the calculation of capital requirements for market risks for banks and savings banks and the Regulation on disclosures by banks and savings banks. The major changes to the aforementioned regulations are described below.

The *Regulation on the calculation of the own funds of banks and savings banks* was primarily amended in the part relating to deductions in the calculation of own funds. The main change relates to the requirement for the prudential valuation of all financial assets measured at fair value, irrespective of whether they are in the banking book or the trading book. If the valuation yields a value lower than the carrying amount of the financial assets, the difference is deducted from the bank's original own funds.

The most significant change brought in accordance with the CRD III by the new *Regulation on the calculation of capital requirements for credit risk in securitisation and the rules on the exposure of banks and savings banks to transferred credit risk* is the stricter treatment of re-securitisation positions relative to "ordinary" securitisation positions via a higher risk weight for the purpose of calculating capital requirements. The CRD III now requires the calculation of capital requirements for securitisation positions in the trading book, which equalises the treatment of positions with regard to the banking book.

The *Regulation on the calculation of capital requirements for market risk for banks and savings banks* was primarily amended in the part relating to the calculation of capital requirements for position risk, currency risk and commodity risk using an internal approach. Banks will therefore have to comply with stricter quantitative and qualitative standards in the calculation of value-at-risk, and calculate additional capital requirements based on the calculation of value-at-risk for stress situations. Banks that use an internal approach to calculate separate position risk will have to calculate an additional capital requirement for excess default and migration risks, while the model can also capture price risks in the trading portfolio with a correlation.

The main changes to the *Regulation on disclosures by banks and savings banks* relate to the expansion of disclosures in the area of securitisation and the use of internal approaches for calculating capital requirements for position risk, currency risk and commodity risk.

Given the amendments to the regulations governing the calculation of own funds and capital requirements, it was also necessary by the end of the year to amend the *Regulation on the reporting of the own funds and capital requirements of banks and savings banks*, and the *Guidelines for the electronic submission of reports on own funds and capital requirements*, which regulates the form and method of electronic reporting.

The Regulation (EC) on credit rating agencies (No 1060/2009/EC) primarily governs the pursuit of the activities of credit rating agencies in the EU, but also affects the use of credit assessments by credit institutions and recognition of the eligibility of external credit assessment institutions by banking supervisors. As a result of the amendment of this regulation, which transferred all duties and responsibilities in connection with decisions on the registration and supervision of credit rating agencies, and in connection with decisions on the use of their credit assessments to the European Securities and Markets Authority (ESMA), it was necessary to also amend the *Regulation on the recognition of external credit assessment institutions* and the *Regulation on the calculation of capital requirements for credit risk under the standardised approach for banks and savings banks*. The two regulations were published in December.

In December the *Regulation on the reporting of individual facts and circumstances of banks and savings banks* was amended, by virtue of which the Bank of Slovenia prescribed the reporting of exposures of banks and savings banks to members of their management boards and supervisory boards and their immediate family members, and exposures to other persons in a special relationship with the bank. The purpose of the new half-yearly report solely covering exposures in excess of EUR 20,000 is the uniform of data on the actual stock of exposures to which particular attention must be given by banks, in addition to large exposures.

The Bank of Slovenia prescribed the reporting of exposures of banks and savings banks to members of their management boards and supervisory boards and their immediate family members, and exposures to other persons in a special relationship with the bank.

Financial stability

The Bank of Slovenia continued its regular monitoring and analysis of the financial stability of the Slovenian financial system in 2011. In May's Financial Stability Review it published comprehensive analysis of the Slovenian financial system, with an emphasis on risk exposure. Autumn's Macro Stress Tests for the Slovenian Banking System used simulations to test the stability of the Slovenian financial system in the event of possible shocks. This was followed in December by the publication of analysis entitled Stability of the Slovenian Banking System. In addition to the aforementioned analyses, which the Financial Stability Department usually conducts once a year, the Bank of Slovenia continued its established regular monthly analysis of the performance of the banking system in 2011, and continued to act within the European Systemic Risk Board.

Financial Stability Review, May 2011: a contraction in the banking system's total assets, a decline in lending and increasing risks.

The *Financial Stability Review* primarily analysed the changes in the financial system in 2010 and early 2011, with an emphasis on systemic risks. The key findings were that the Slovenian economy's dependence on foreign debt financing remained a significant structural feature, and that the adverse situation in the economy was being reflected in the banking system. After many years of growth, the banking system's total assets declined for the first time in 2010. The banking system continued to reduce its debt to the rest of the world in 2010. The banks reduced their exposure to the Eurosystem and liabilities to foreign banks, while government deposits simultaneously declined. Refinancing risk was high, particularly at the banks under majority domestic ownership, despite relatively successful securities issues. Credit risk increased. As the economic situation and corporate creditworthiness deteriorated, the quality of the banking system's credit portfolio also deteriorated, while impairment and provisioning costs increased. The tighter credit standards and collateral conditions for loans and the relatively high lending rates resulted in a decline in lending to non-banking sectors. Together with rising funding costs, this had an adverse impact on the banks' lending activity and terms. In light of the increase in credit risk, income risk and refinancing risk, interest rate risk also increased. The capital adequacy of Slovenian banks declined in 2010, while the EU average remained unchanged. The performance of insurance corporations was analysed in the publication, while the developments on the capital markets and the performance of leasing companies were also examined. The functioning of payment and settlement systems was also examined, from the point of view of risk management.

The *Macro Stress Tests for the Slovenian Banking System* presented forecasts for the banking system's balance sheet until the end of 2013. An integrated approach was used to analyse the banking system's sensitivity to the external shocks of a rise in interest rates and a decline in GDP growth. The credit risk analysis investigated the impact of the shocks of a decline in economic growth, a rise in interest rates, increased indebtedness and a decline in corporate liquidity, while the liquidity risk analysis investigated the shock of a freeze in funding on the wholesale markets.

Stability of the Slovenian banking system, December 2011: a continuing increase in credit risk, income risk, interest rate risk and refinancing risk at banks.

The *Stability of the Slovenian Banking System* focused on analysis of the performance of the banking system in the first three quarters of 2011 from the point of view of the interaction of risks between the banking system and the real sector. The main findings of the analysis were based on the adverse situation on the international financial markets, the increased dependence on funding from the rest of the world, and the tighter financing conditions, related in part to the downgradings of sovereign debt and certain banks. The economic situation in Slovenia was also examined, with the following findings: excess indebtedness in the sector of non-financial corporations, low capital adequacy in the banking system compared with the euro area overall, a deterioration in the quality of the banks' investments and a decline in lending, a lack of competitiveness in the business environment, cross-ownership between the real sector and financial holding companies, and insufficient pace in the implementation of structural reforms. The previously identified adverse developments in credit risk, income risk, refinancing risk and interest rate risk continued in the first three quarters of 2011. The notable increase in credit risk was reflected in several indicators, including an increase in the proportion of claims against non-financial corporations more than 90 days in arrears, which increased by 6.3 percentage points over the first nine months of 2011 to 18.6%. The adverse impact of the deterioration in the quality of the credit portfolio was expressed in increased income risk, which was also partly the result of a decline in creditworthy demand and the stock of lending. The banks also recorded a loss. The banks partly succeeded in mitigating their rising refinancing risk in the second half of 2011 by obtaining loans from the Eurosystem. The banking system's liquidity risk remained moderate.

The capital adequacy of the Slovenian banking system had increased by September 2011, while capital quality structure had also improved, although it remained lower than the average of comparable banks in the EU.

2.2.2 Payment services for Bank of Slovenia clients

Administration of budget user accounts

The Bank of Slovenia administers the government's single treasury account and 197 standard municipal treasury accounts, open in a number of currencies. The accounts of direct and indirect spending units of the state budget and municipal budgets, the Health Insurance Institute and the Pension and Disability Insurance Institute (included in the single treasury account system as set out in the Public Finances Act) were opened as sub-accounts of the government or municipal treasury accounts. The sub-accounts are administered by the Public Payments Administration, to which direct and indirect spending units of the state budget and municipal budgets submit payment orders and from which they receive the full set of feedback about payments transacted.

In 2011 there were EUR 51.844 billion of inflows and EUR 51.841 billion of outflows processed through the government's single treasury account, and EUR 35.506 billion of inflows and EUR 35.503 billion of outflows processed through municipal treasury accounts.

In addition to the single treasury accounts, the Bank of Slovenia also administers 36 special-purpose accounts for the government and other budget spending units.

Administration of accounts for the KDD and KDD members

The Bank of Slovenia administers a guarantee fund cash account and a fiduciary account for the custodian services of the Central Securities Clearing Corporation (KDD). In addition, the Bank of Slovenia also administers the accounts of KDD members via which cash settlements are made for securities transactions. At the end of 2011, there were 22 KDD members, namely 14 commercial banks and eight investment firms, with open transaction accounts for customer funds and clearing accounts at the Bank of Slovenia.

EUR 5.984 billion of inflows and EUR 5.984 billion of outflows were processed through the accounts of the KDD and its members in 2011.

Administration of accounts for foreign financial institutions and EU institutions

The Bank of Slovenia also administers accounts for foreign financial institutions and EU institutions, via which inflows of EUR 887.0 million and outflows of EUR 900.0 million were processed in 2011.

2.2.3 Management of the Bank of Slovenia's financial investments

The Bank of Slovenia's financial investments include all of its financial assets not related to the implementation of monetary policy. They comprise financial investments denominated in domestic and foreign currencies. The value of the Bank of Slovenia's financial investments as of 31. December 2011 stood at EUR 5,591.5 million, of which EUR 4,824.7 million were financial instruments, which are either claims against euro area residents or claims against non-euro residents denominated in euro. These include EUR 3,914.2 million of investments in capital market instruments, EUR 359.1 million in money-market instruments and EUR 551.4 million in cash and deposits. In addition, EUR 766.7 million was invested in financial

Table 5: **Balance of the Bank of Slovenia's financial investments**

In EUR million	Financial investments of the Bank of Slovenia		
Balance as of:	Investments in euros and all investments in instruments of euro area issuers	International monetary reserves	Total
31. Dec 2008	4,667.7	687.2	5,354.9
31. Dec 2009	4,118.7	749.1	4,867.7
31. Dec 2010	4,242.5	803.2	5,045.7
31. Dec 2011	4,824.7	766.8	5,591.5

Source: Bank of Slovenia.

instruments, which are claims against non-euro area residents denominated in non-euro currencies and meet the criteria of international monetary reserves.

According to the IMF's definition, foreign currency cash and foreign exchange holdings abroad, investment-grade securities of foreign issuers, monetary gold, holdings of SDRs and the reserve tranche position at the IMF are classified as international monetary reserves. Since 1. January 2007 the Republic of Slovenia has applied the definition applied by all other euro area Member States in the statistical treatment of international monetary reserves. In addition to monetary gold, the reserve tranche position and SDRs, the portion of foreign currency reserves not denominated in euro and placed outside the euro area is also classified as international monetary reserves. The methodology is explained in detail in the article entitled *Statistical Treatment of International Monetary Reserves Following Slovenia's Entry to the Euro Area* (Surveys and Analysis, May 2007).

The management of the Bank of Slovenia's financial investments is based on a three-level decision-making process.

The management of the Bank of Slovenia's financial investments is based on a three-level decision-making process. The Governing Board of the Bank of Slovenia sets out the *Guidelines for managing the Bank of Slovenia's financial investments*, which prescribe the long-term management policy and define the management objectives. The second level of the management process is represented by the Investment Committee, which prescribes the *Criteria for managing the Bank of Slovenia's financial investments*, thereby restricting the exposure to various types of risk. The Investment Committee further defines the methodology for measuring the performance and quantification of risks. At the third level, portfolio managers carry out the operational aspect, within set tolerances.

The credit risk management criteria allow investments in financial instruments carrying sovereign and bank risk issued by institutions with an internal rating of at least A-. The ratio of the size of investments exposed to sovereign and bank risk is also prescribed. Investment exposure is limited to a list of eligible issuers, whereby there is also an upper limit per individual sovereign issuer or per individual banking group. The upper exposure limit depends on the entity's internal rating.

The currency exposure of the Bank of Slovenia's financial investments and the limits on permitted deviations are prescribed by the criterion for managing currency risk. The currency structure criterion lays down a target currency structure for Bank of Slovenia investments. In 2007 the foreign exchange swap was added to the list of eligible instruments which allows for exposure to instruments denominated in foreign currencies, while hedging against changes in the exchange rate itself. In this manner, the Bank of Slovenia hedged its foreign currency exposure in January 2008, with the exception of the portion of investments representing the amount potentially activated into international monetary reserves by the ECB. The criterion for managing interest rate risk specifies the modified duration and lays down the maximum deviation from its target value. The criterion for managing liquidity risk specifies a minimum amount of liquid assets. The *Criteria for managing the Bank of Slovenia's financial investments* also set out the terms for securities lending and other activities. The Bank of Slovenia's investment policy must comply with the Article 123 of the Treaty on the Functioning of the European Union, which prohibits the monetary financing of EU public sector institutions. The prohibited forms of financing include investment deposits, reverse repos and purchases of primary-issue securities, commercial papers and certificates of deposit if the issuer is an EU public sector institution, while investments with those institutions are permitted on the secondary market within a prescribed limit for each country. The management of the Bank of Slovenia's financial investments was carried out in line with both the *Guidelines for managing the Bank of Slovenia's financial investments* and the *Criteria for managing the Bank of Slovenia's financial investments* in 2011. More detailed information on the structure of the international monetary reserves as of 31. December 2011 is given in the section on the financial statements.

2.2.4 International cooperation

European Union

The Governor of the Bank of Slovenia participated in informal sessions of ECOFIN (meetings of finance ministers, with the governors of the central banks of EU Member States in attendance) in 2011.

Bank of Slovenia experts also attended sessions of committees, working groups and other bodies that are active within the institutions of the EU with a focus on financial and monetary matters: meetings of the Economic and Financial Committee (EFC) and its sub-committees, meetings of the EBA and its working groups, meetings of the Committee on Monetary, Financial and Balance of Payments Statistics and other working groups in the relevant area that operate within the framework of the European Commission and the EU Council.

The European Systemic Risk Board (ESRB) is a new EU authority established on 16 December 2010 as part of the reforms of the supervision system for the financial sector in the EU. It is responsible for the macro-prudential supervision of the financial system of the EU as a whole, and for monitoring and assessing risks to its stability. The Governor and the vice-governor responsible for banking supervision and financial stability are members of the ESRB's General Board, which takes the decisions necessary to the performance of the duties entrusted to the ESRB. The ESRB is chaired by the President of the ECB.

The ESRB is responsible for the macro-prudential supervision of the financial system of the EU as a whole, and for monitoring and assessing risks to its stability.

International Monetary Fund

Under Slovenian law, the Bank of Slovenia is responsible for Slovenia's cooperation within the IMF, and the Governor of the Bank of Slovenia is a member of the IMF Board of Governors.

In order to provide the IMF with additional funding in light of the global financial and economic crisis, the level of Slovenia's participation in the IMF's financial arrangements was enhanced again in 2011.

Slovenia's quota at the IMF had reached SDR 237.7 million by March 2011. Resolution 63-2 on the reform of quotas and voting shares adopted in April 2008 then entered into force, having received the requisite ratification by three-fifths of the Member States with at least 85% of the voting power. On this basis, in March 2011 the Bank of Slovenia paid in Slovenia's increased quota, which has since stood at SDR 275 million, or 0.12% of the voting power at the IMF.

In March 2011 the Bank of Slovenia paid in Slovenia's increased quota, which now stands at SDR 275 million.

Since 1998 Slovenia has contributed to the financing of IMF loans under the Financial Transaction Plan (FTP). Slovenia contributed funds for lending to Ireland, Greece and Portugal in the total amount of SDR 46.8 million as part of the FTP in 2011. It also received a proportion of repaid IMF loans from previous years from Turkey in the total amount of SDR 12.4 million. Slovenia's reserve tranche position at the IMF increased during 2011 to stand at SDR 85.5 million at the end of the year.

SDR 9.7 million was drawn in 2011 under a bilateral loan agreement signed in September 2010 between the Bank of Slovenia and the IMF. Such agreements to increase their funding of the IMF had already been signed by most European countries in 2009. The amount of Slovenia's bilateral loan is EUR 280 million, with a disbursement period of no more than four years. In December 2011 EU finance ministers agreed to further strengthen the IMF's lending capacity by means of increased contributions from euro area countries in the form of bilateral loans.

IMF representatives held their annual consultations with Slovenia under Article IV of the IMF Statute in March 2011. The members of the mission met representatives of the Bank of Slovenia and the Ministry of Finance, who presented Slovenia's macroeconomic and fiscal position to them, along with the measures that the government has taken and envisaged for fiscal consolidation. Interviews were conducted with the relevant ministries, government offices and representatives of major institutions in the banking and financial sector. The report of the IMF mission was discussed by the IMF's Executive Board in mid-May, and was published on 31 May.

Bank for International Settlements

The Governor of the Bank of Slovenia participated in meetings of central bank governors of BIS members, which are organised every two months. The meetings discussed developments in the global economy and on the financial markets. The governors' meetings are also an opportunity to exchange views on various central banking issues, most notably on changes on the global financial markets in 2011.

The Bank of Slovenia is a shareholder in the BIS and its representatives participated in the annual general meeting of the BIS in Basel.

Organisation for Economic Cooperation and Development

Slovenia became a member of the OECD in July 2010. In 2011 two Bank of Slovenia representatives played active roles as members of the interdepartmental working group, while Bank of Slovenia representatives also sat on other committees and working groups (the Economic Policy Committee, the Committee on Financial Markets and the Working Group on International Investment Statistics).

Technical assistance

The Bank of Slovenia cooperates with other central banks as part of central bank technical assistance.

In 2011 the Bank of Slovenia received technical assistance in the area of banking supervision on the topic of *Supervisory practice in the evaluation of own estimates of LGD and CF*. This technical assistance was provided by the Austrian national bank.

The Bank of Slovenia also participated in Eurosystem technical assistance programmes, namely the technical assistance programme for the central bank of the Federation of Bosnia and Herzegovina, the central bank of Serbia, and in a regional Eurosystem programme entitled *Strengthening macro-and micro-prudential supervision in EU candidates and potential candidates*.

The Bank of Slovenia provided technical assistance to central banks in south-eastern Europe in 2011, in the four countries (Serbia, Montenegro, Kosovo and Macedonia) that responded to the proposal for cooperation. Study visits were undertaken in the areas of monetary policy, legal affairs, financial statistics, information technology, banking supervision, payment and settlement systems, public procurement, accounting, cash operations, international relations and internal auditing.

A one-month study practice was also provided for a representative of the Serbian central bank. A seminar was held in June 2011 for representatives of the central banks of Serbia and Montenegro on the subject of integration into the EU.

3 ORGANISATIONAL STRUCTURE OF THE BANK OF SLOVENIA

Governing Board of the Bank of Slovenia

The Bank of Slovenia's decision-making bodies are the Governor of the Bank of Slovenia and the Governing Board of the Bank of Slovenia.

The Governing Board comprises five members: the Governor and four vice-governors. The Governor acts as the president of the Governing Board. The Governor may authorise one of the vice-governors to be his/her deputy. As at 31 December 2011, the make-up of the Governing Board was as follows:

- Marko Kranjec, Ph.D., Governor
- Darko Bohnec, Vice-Governor
- Janez Fabijan, MSc, Vice-Governor and Deputy-Governor
- Mejra Festić, Ph.D., Vice-Governor
- Stanislava Zadravec Caprirolo, MSc, Vice-Governor

The following changes were made to the make-up of the Governing Board of the Bank of Slovenia in 2011:

- At its session of 11 January 2011 the National Assembly adopted a resolution appointing Mejra Festić as a vice-governor and member of the Governing Board of the Bank of Slovenia for a term of six years. Her term began on 1 March 2011.

Organisational structure of the Bank of Slovenia

All of the Bank of Slovenia's work is carried out by employees at various organisational units, namely sectors, departments, sections and offices (see the organisational chart).

Work between departments is coordinated within the individual sector. The sectors are typically coordinated by the Governor, the vice-governors and the director (coordinator).

Operational tasks and work of similar content are carried out within the departments. The Bank of Slovenia has 14 departments, which may be divided into smaller organisational units, sections and offices.

Commissions, committees and working bodies of the Bank of Slovenia

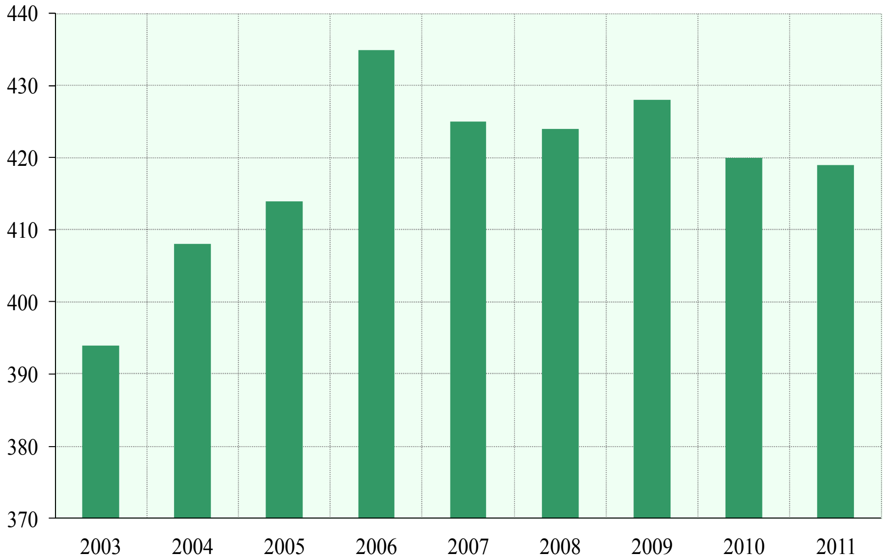
There are a total of 17 commissions, five committees and seven working groups in various areas of operation functioning at the Bank of Slovenia. The most important working bodies are:

- Operational Risk Committee (president: Darko Bohnec)
- Audit Committee (president: Dušan Zbašnik, Ph.D.)
- Investment Committee (president: Ernest Ermenc)
- Commission of the Governing Board of the Bank of Slovenia for the Preparation of Opinions for the Issue of Authorisations to Hold Office as a Member of a Bank's Management Board (president: Darko Bohnec)
- Licensing Commission (president: Stanislava Zadravec Caprirolo, MSc)
- Research Commission (president: Mejra Festić, Ph.D., as of 2 August 2011)
- Liquidity Commission (president: Tomaž Košak, MSc)
- Violations Commission (president: Jasna Iskra)
- Crisis Management Group (president: Stanislava Zadravec Caprirolo, MSc)

Employees

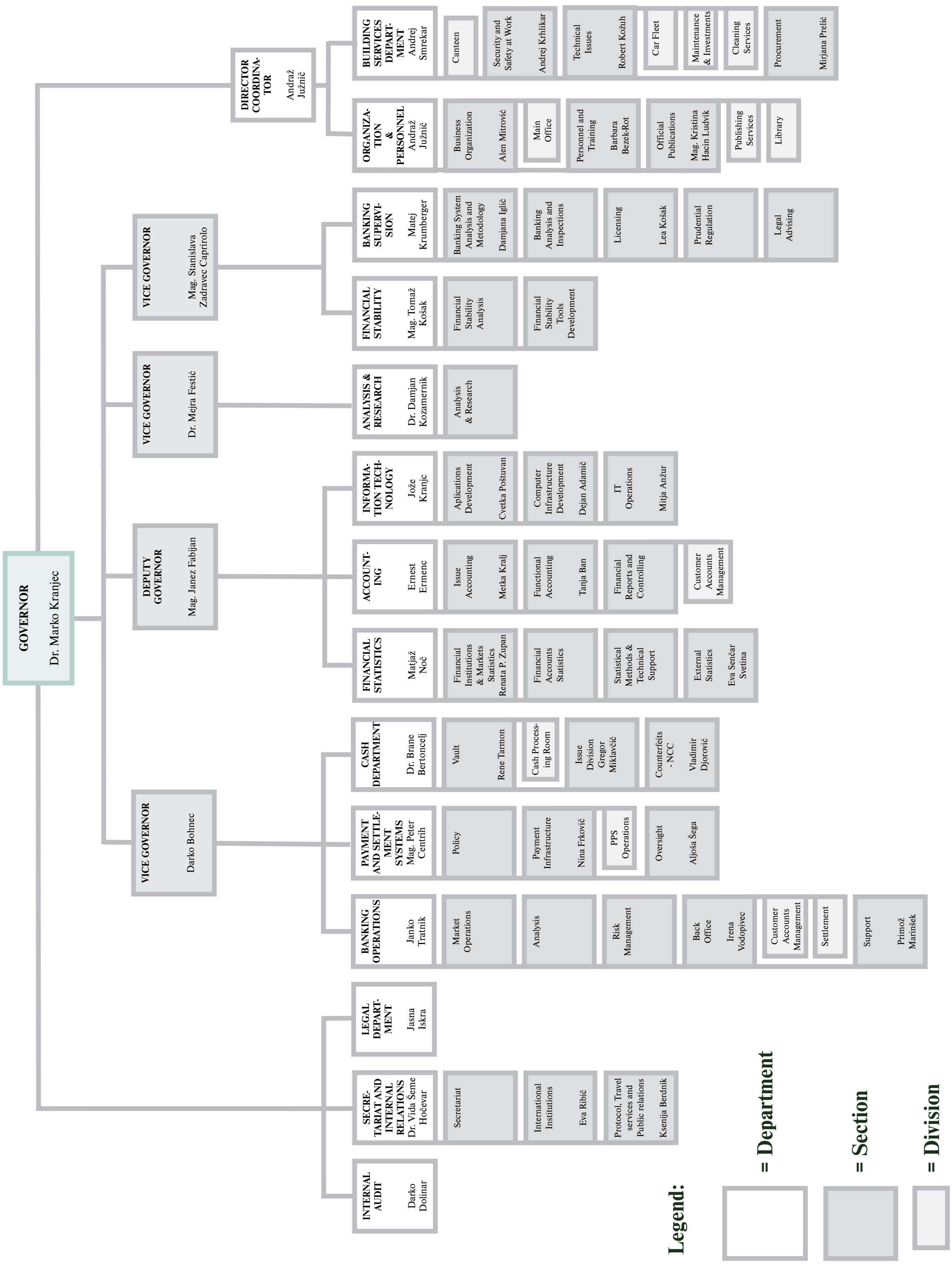
The Bank of Slovenia had 419 employees as at 31 December 2011.

Figure 30: **Number of employees at the Bank of Slovenia as at the final day of the year**



Source: Bank of Slovenia.

Organisational structure of the Bank of Slovenia as at 31 December 2011



4 FINANCIAL STATEMENTS

Financial statements of the Bank of Slovenia for 2011

Statement of responsibilities of the Governing Board

The Law on the Bank of Slovenia (the Bank) and the Statutes of the Bank require the Governing Board to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Bank and the surplus or deficit of the Bank for that period. In preparing those financial statements the Governing Board is required to:

. Select suitable accounting policies and then apply them consistently;

. Make judgements and estimates that are reasonable and prudent;

. State whether applicable accounting standards have been followed; and

. Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Bank will continue in business.

The Governing Board has a general responsibility for taking such steps as are reasonably open to it to safeguard the assets of the Bank.

INDEPENDENT AUDITOR'S REPORT

To the Governing Board of the Bank of Slovenia

Report on the Financial Statements

We have audited the accompanying financial statements of Bank of Slovenia (the 'Bank'), which comprise the balance sheet as at 31 December 2011 and the income statement for the year then ended and a summary of significant accounting policies and other explanatory notes.

Responsibility for the Financial Statements

The Governing Board is responsible for the preparation and fair presentation of these financial statements in accordance with the Guideline of the European Central Bank of 11th November 2010 on the legal framework for accounting and financial reporting in the European System of Central Banks (ECB/2010/20) and articles of Law on Bank of Slovenia that are applicable for financial reporting. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of Bank of Slovenia as of 31 December 2011, and of its financial performance for the year then ended in accordance with the Guideline of the European Central Bank of 11th November 2010 on the Legal Framework for Accounting and Financial reporting in the European System of Central Banks (ECB/2010/20) and articles of Law on Bank of Slovenia, applicable for financial reporting.

DELOITTE REVIZIJA d.o.o.

Katarina Kadunc
Certified auditor

Yuri Sidorovich
President of the board

Ljubljana, 16 March 2012

For signature please refer to the original Slovenian version.

Deloitte.
DELOITTE REVIZIJA D.O.O.
Ljubljana, Slovenija 1

FOR TRANSALTION ONLY – SLOVENE ORIGINAL PREVAILS

Constitution

The Bank of Slovenia (the Bank) was constituted by the Law on the Bank of Slovenia dated 25 June 1991. The Bank is a legal entity, governed by public law, which independently disposes of its own property. The Bank is wholly owned by the state and is autonomous as regards its finances and administration. The Bank is supervised by Parliament. The Bank shall take care of the stability of domestic prices and of general liquidity of the financial system. According to the Bank of Slovenia Act (Official Gazette of the Republic of Slovenia No. 58/02, No. 72/06 and No. 59/11), from the day of introduction of the euro, the Bank shall begin to perform the tasks in accordance with the Treaty establishing the European Community and in accordance with the Statute of the ESCB and the ECB[1].

Accounting policies

Introduction of euro
Republic of Slovenia introduced the euro as a new legal tender on the 1 January 2007. The Bank became part of the Eurosystem and took over joint responsibility for monetary policy and for exercising the common strategic goals of the European System of Central Banks (ESCB)[2].

Accounting principles and standards
The Bank applies the Guideline of the European Central Bank of 11 November 2010 on the legal framework for accounting and financial reporting in the European System of Central Banks (recast) (ECB/2010/20)[3] (Accounting Guideline) as the legal basis for the accounting and reporting. According to the Bank of Slovenia Act and according to the Statute of the ESCB and the ECB, this legal framework was adopted by the Governing Board of the Bank at its 343rd meeting on 20 December 2006.

Financial statements are presented in accordance with the valuation rules as defined by the Accounting Guideline.

In cases that are not covered by the Accounting Guideline or are governed by non-mandatory provisions, the valuation principles in accordance with International Financial Reporting Standards valid in EU and with the Bank of Slovenia act are applied.

Basic principles
The financial statements are prepared in conformity with the provisions governing the Eurosystem's accounting and reporting operations, which follow accounting principles, harmonized by Community law and generally accepted international accounting standards valid in EU and with the Bank of Slovenia act.

The following fundamental accounting principles have been applied:

- economic reality and transparency: the accounting methods and financial reporting shall reflect economic reality and shall be transparent;
- prudence: the valuation of assets and liabilities, as well as the recognition of income, shall be carried out prudently. In the context of the Accounting Guideline, this implies that unrealised gains are not recognised as income in the profit and loss account, but are transferred directly to a revaluation account;

[1] Protocol (No. 18) (ex No. 3) on the Statute of the European System of Central Banks and of the European Central Bank (Protocol annexed to the Treaty establishing the European Community, OJ C 191, 29.07.1992).

[2] The term 'European System of Central Banks (ESCB)' refers to the twenty-seven National Central Banks (NCBs) of the member states of the European Union on 31 December 2011 plus the European Central Bank (ECB). The term 'Eurosystem' refers to the seventeen NCBs of the member states participating in the Monetary Union, plus the ECB on the same date.

[3] OJ L 35, 09.02.2011, p. 31-68. The Accounting guideline is amended by the Guideline of the European Central Bank of 21 December 2011 (ECB/2011/27), OJ L19, 24.01.2012, p. 37-50.

- post-balance-sheet events: assets and liabilities shall be adjusted to take into account events that occur between the end of financial year and the date on which the annual accounts are approved by the Governing Board, if they materially affect the fair presentation of assets or liabilities at the balance sheet date;
- materiality: deviation from the accounting rules shall not be allowed unless they can reasonable be judged to be immaterial in the overall context and presentation of the financial statements;
- going concern basis: when assessing assets and liabilities, it must be assumed that the activities will continue;
- the accruals principle: income and expenditure shall be recognised in the accounting period they were earned or incurred, regardless of when the payment is made or received;
- consistency and comparability: the criteria for balance sheet valuation and income recognition shall be applied consistently to ensure comparability of data in the financial statements.

Recognition of assets and liabilities
An asset or liability is only recognised in the Balance Sheet when it is probable that any associated future economic benefit will flow to or from the Bank, substantially all of the associated risks and rewards have been transferred to the Bank, and the cost or value of the asset or the amount of the obligation can be measured reliably.

Economic approach
On the basis of definition of alternative economic approach in the Accounting Guideline, transactions in financial assets and liabilities are reflected during the year in the accounts on the basis of the date on which they were settled.

For transactions in foreign currency, agreed in one year but maturing in a subsequent year, the trade date approach is applied. Transactions are recorded in off-balance sheet accounts on the trade date. On the settlement date, the off-balance sheet entries are reversed and transactions are booked on-balance sheet. Purchases and sales of foreign currency affect the net foreign currency position on the trade date and realised results arising from sales are also calculated on the trade date.

Securities transactions are recorded according to the cash/settlement approach. Accrued interest, premiums and discounts related to financial instruments in foreign currency are calculated and booked daily from the settlement date, and the foreign currency position is also affected daily by these accruals.

Conversion of foreign currencies
Foreign currency transactions whose exchange rate is not fixed against the euro are recorded in the balance sheet at market rates prevailing on the day of the transaction. At year-end, both financial assets and liabilities are revalued at current market rates of the last day of the year, as derived from the ECB's daily quotation of reference exchange rates. This applies equally to on balance-sheet and off-balance-sheet transactions. The revaluation takes place on a currency-by-currency basis.

Income and expenses are converted at the exchange rate prevailing on the recording date.

Gold and gold receivables
Gold and gold receivables are valued at market price prevailing at the year-end. No distinction is made between the price and currency revaluation differences for gold. Instead, a single gold valuation is accounted for on a basis of the price in euro per fine ounce of gold, derived from the gold price in US dollar as at the balance sheet date.

Securities
Marketable securities (other than those classified as held-to-maturity) are valued at the market prices prevailing at the balance sheet date, on a security-by-security basis. Investments in securities are included in the balance sheet items 'Claims on non-euro area residents denominated in foreign currency', 'Claims on euro area residents denominated in foreign currency', 'Claims on non-euro area residents denominated in euro', and 'Securities of euro area residents denominated in euro'.

Marketable securities classified as held-to-maturity, non-marketable securities and illiquid equity shares are valued at amortised cost and are subject to impairment.

Securities lending transactions under automated security lending contracts are concluded as part of the management of Bank's own assets. Securities lent by the Bank are collateralised. Income arising from lending operations is included in the profit and loss account. Automated security lending is conducted via agent and custodian banks. Transactions outstanding at year-end are recorded off-balance sheet.

Tangible fixed assets
Depreciation is calculated on a straight line basis, beginning in the month after acquisition so as to write off the cost of the assets over their estimated economic lifetime at the following annual percentage rates:

Buildings	1.3 – 1.8 %
Computers	20 – 33 %
Other equipment	10 – 25 %

Gains and losses on disposal of fixed assets are determined as the difference between net disposal proceeds and the carrying amount of the asset and are recognised as income or expense in the statement of income and expenditure.

Properties located in Austria are included in Bank's fixed assets. They are carried at fair value and are not depreciated. The fair value is demonstrated as half of appraisal value, obtained by an external certificated valuer (the Bank revalues these properties once every 5 years; the last revaluation was performed in year 2009). This revaluation method represents the deviation from generally accepted accounting principles. In its prudent concept it reduces the volatility of the financial statements.

ESCB capital key
The capital key is essentially a measure of the relative national size of EU member countries and is a 50:50 composite of GDP and population size. The key is used as the basis of allocation of each NCB's share capital in the ECB and must be adjusted every five years under ESCB statute and every time when a new country joins EU.

The Eurosystem key is an individual NCB's share of the total key held by Eurosystem members and is used as the basis for allocation of monetary income, banknotes in circulation, ECB's income on euro banknotes in circulation, ECB's (net) income arising from SMP securities and the ECB's profit/loss.

Banknotes in circulation
The ECB and the seventeen euro area NCBs[4], which together comprise the Eurosystem, issue euro banknotes[5]. The total value of euro banknotes in circulation is allocated on the last working day of each month in accordance with the banknote allocation key[6].

The ECB has been allocated a share of 8% of the total value of euro banknotes in circulation, whereas the remaining 92% has been allocated to NCBs according to their weightings in the capital key of the ECB. The share of banknotes allocated to the Bank is disclosed under the balance sheet liability item 'Banknotes in circulation'.

The difference between the value of the euro banknotes allocated to each NCB in accordance with the banknote allocation key and the value of the euro banknotes that it actually puts into circulation also gives rise to remunerated intra-Eurosystem balances. These claims or liabilities, which incur interest[7],

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[4] Central bank of Estonia has only participated in the Eurosystem since 1st January 2011.

[5] Decision of the European Central Bank of 13 December 2010 on the issue of euro banknotes (recast) (ECB/2010/29), OJ L 35, 09.02.2011, p. 26-30.

[6] Banknote allocation key means the percentages that result from taking into account the ECB's share in the total euro banknote issue and applying the subscribed capital key to the NCBs' share in such total.

[7] Decision of the European Central Bank of 25 November 2010 on the allocation of monetary income of the national central banks of Member States whose currency is the euro (recast) (ECB/2010/23), OJ L 35, 09.02.2011, p. 17-25, amended by the Decision of the European Central Bank of 3 November 2011 (ECB/2011/18), OJ L 319, 02.12.2011, p. 116.

are disclosed under the sub-item 'Net claims/liabilities related to the allocation of euro banknotes within the Eurosystem' (see 'Intra-ESCB balances' in the notes on accounting policies).

From the cash changeover year[8] until five years following the cash changeover year the intra-Eurosystem balances arising from the allocation of euro banknotes are adjusted (smoothing mechanism) in order to avoid significant changes in NCBs' relative income positions as compared to previous years. The adjustments are effected by taking into account the differences between the average value of banknotes in circulation of each NCB in the reference period[9] and the average value of banknotes that would have been allocated to them during that period under the ECB's capital key. The adjustments are reduced in annual stages until the first day of sixth year after the cash changeover year when income on banknotes is allocated fully in proportion to the NCBs' paid-up shares in the ECB's capital. For the Bank of Slovenia, the adjustment period will end on 31 December 2012. In the year under review the adjustments also resulted from the accession of Central Bank of Cyprus and Central Bank of Malta (in 2008), Národná banka Slovenska (in 2009) and Eesti Pank (in 2011) and will terminate at the end of 2013, 2014 and 2016, respectively.

The interest income and expense on these balances is cleared through the accounts of the ECB and is disclosed under 'Net interest income' in the Profit and Loss account.

Interim profit distribution
The Governing Council of the ECB has decided that the seigniorage income of the ECB, which arises from the 8% share of euro banknotes allocated to the ECB, and the ECB's (net) income arising from SMP securities shall be due in full to the NCBs in the same financial year it accrues. The ECB shall distribute this income in January of the following year in the form of an interim distribution of profit[10]. The amount of the ECB's income on euro banknotes in circulation may be reduced in accordance with any decision by the Governing Council in respect of expenses incurred by the ECB in connection with the issue and handling of euro banknotes. Before the end of the year the Governing Council decides whether all or part of the ECB's income arising from SMP securities and, if necessary, all or part of the ECB's income on euro banknotes in circulation should be retained to the extent necessary to ensure that the amount of the distributed income does not exceed the ECB's net profit for that year.

The Governing Council may also decide to transfer all or part of the ECB's income arising from SMP securities and if necessary, all or part of the ECB's income on euro banknotes in circulation to a provision for foreign exchange rate, interest rate, credit and gold price risks. The amount distributed to NCBs is disclosed in the Profit and Loss account under ‘Income from equity shares and participating interest’.

Provisions
Provisions for legal claims are recognised when the Bank has a present legal or constructive obligation as a result of past events, when: it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount can be reliably estimated.

In compliance with Article 49a of Bank of Slovenia Act, after introduction of the euro as the Republic of Slovenia’s currency, the Governing Board of the Bank may, with the intention of maintaining the real value of assets, take a decision to create provisions for anticipated exchange rate, interest rate and price risks. Provisions may not be created if, together with the unrealised exchange rate differences, securities’ valuation effects and gold valuation effects, they exceed 20% of established net income. The relevant amount of provision for such risks is determined annually on the basis of Value-at-Risk (VaR) method. VaR is defined as the maximum loss of portfolio with a given diversification of that

[8] Cash changeover year refers to the year in which the euro banknotes are introduced as legal tender in the respective Member State, for Bank of Slovenia this is 2007.

[9] The reference period refers to the 24 months which start 30 months before the day on which euro banknotes become legal tender in the respective Member State, for Bank of Slovenia this is the period from July 2004 to June 2006.

[10] Decision of the European Central Bank of 25 November 2010 on the interim distribution of the income of the European Central Bank on euro banknotes in circulation and arising from securities purchased under the securities markets programme (ECB/2010/24), OJ L 6, 11.01.2011, p. 35-36.

portfolio at a certain level of probability (95%) and for a given holding period (one year). The provision will be used to fund future unrealised losses not covered by the revaluation accounts.

Intra-ESCB balances
Intra-ESCB transactions are cross-border transactions that occur between two ESCB central banks. These transactions are processed primarily via TARGET2[11] and give rise to the daily net bilateral position. This position in the books of the Bank represents the net claim or liability of the Bank against the rest of the ESCB members connected to TARGET2.

Intra-Eurosystem balances arising from the allocation of euro banknotes within the Eurosystem are included as a net single asset under 'Net claims related to the allocation of euro banknotes within the Eurosystem' (see 'Banknotes in circulation' in the Accounting policies).

Income recognition
Income and expenses are recognised in the financial year in which they are earned or incurred. Realised gains and losses are taken to the Profit and Loss account.

From the beginning of 2007, the foreign exchange and price valuation is performed on a quarterly basis in accordance with the Accounting Guideline. Net unrealised valuation gains which arose before the euro adoption are separated from the unrealised valuation gains recorded after that date. They are considered as a ‘pre-Stage Three’ revaluation reserves and are included into the liability balance sheet item ‘Reserves’.

At the end of year, unrealised gains are not recognised as income in the Profit and Loss account but are recorded on the revaluation accounts on the liabilities side of the balance sheet.

Unrealised losses are taken to the Profit and Loss account if they exceed previous revaluation gains registered in the corresponding revaluation account. Such losses cannot be reversed against any future unrealised gains in subsequent years. Unrealised gains and losses in respect of securities and foreign currency denominated items are entered on an item-by-item basis and a currency-by-currency basis. Netting is not allowed.

Premiums and discounts arising on purchased securities are calculated and presented as part of interest income and are amortised over the remaining life of the security according to the internal rate of return (IRR) method.

Cost of transactions
With regard to gold, foreign currencies and securities, the average cost method as defined in the Accounting Guideline is used daily to establish the acquisition cost of items sold when calculating effects of exchange rates and prices.

When net acquisitions of currency (or gold) are made, the average acquisition cost for the day's acquisition with regard to each individual currency is added to the previous day's holdings to obtain a new weighted average of the exchange rate (or gold price) respectively. In case of net sales, the realised result is calculated on the basis of the average acquisition cost of the previous day for the respective foreign currency position.

Gains and losses on disposals of securities are calculated on the basis of the weighted average price of individual security.

The market prices and rates applied in the opening balance sheet as at 1 January 2007 were considered as the opening average cost of Bank's assets and liabilities. In case of foreign currency positions and gold, the opening costs were the exchange rates prevailing on 1 January 2007, communicated by the ECB. For securities investments, the securities prices as at 31 December 2006 represented the opening average prices, which served as a starting-point for premium and discount amortisation and calculation of realised gains and losses in case of their sale.

[11] Trans-European Automated Real-time Gross settlement Express Transfer system 2

Off-balance-sheet instruments
Forward legs of foreign exchange swaps are disclosed off-balance-sheet and are included in the net foreign currency position for the purpose of calculating the average cost of currencies and foreign exchange gains and losses. Gains and losses arising from the forward legs are recognised and treated in a similar manner to on-balance sheet instruments. Unrealised valuation gains are not recognised as income but are transferred to the revaluation accounts. Unrealised valuation losses are taken to the Profit and Loss account when exceeding previous revaluation gains registered in the revaluation accounts. Unrealised valuation gains/losses of the forward legs of foreign exchange swaps are recorded from the trade date to the settlement date under 'Other assets/liabilities'.

Since spot and forward amounts in foreign currencies are converted to euro at the same exchange rate, foreign exchange swaps do not influence Profit and Loss accounts or the revaluation accounts on the liability side.

Post-balance-sheet events
Assets and liabilities are adjusted for events that occur between the annual balance sheet date and the date on which the Governing Board approves the financial statements, if such events materially affect the condition of assets and liabilities on the balance sheet date.

Cash flow statement
Taking account of the Bank's role as a central bank, the publication of a cash flow statement would not provide the readers of the financial statements with any additional relevant information. Therefore, such a statement is not included as part of these statements.

Taxation
The Bank is not subject to Slovenian corporate income tax.

Appropriations
In accordance with the Bank of Slovenia Act, net profit is allocated to general reserves and the Budget of the Republic of Slovenia. Unrealised income deriving from exchange rate and price changes is allocated in its entirety to the revaluation accounts and it is not included in a net profit available for distribution. Revaluation accounts may only be used to cover a shortfall deriving from unrealised losses as a result of exchange rate and price movements.

A net loss of the Bank is covered from general reserves. In case that the net loss arises from unrealised exchange rate and price changes, it shall be covered from the special reserves created for that purpose. Any net loss which cannot be covered from general reserves is covered by the budget of the Republic of Slovenia.

Auditing of financial statements
The financial statements were audited by Deloitte revizija d.o.o., Ljubljana, who was appointed as the external auditor of the Bank for the financial years 2009 to 2011.

Balance Sheet as at 31 December 2011

ASSETS (thousands of euro)		31 December 2011	31 December 2010
1	**Gold and gold receivables**	**124,527**	**108,005**
2	**Claims on non-euro area residents denominated in foreign currency**	**641,012**	**691,714**
	2.1 Receivables from the IMF	388,161	315,306
	2.2 Balances with banks and security investments, external loans and other external assets	252,852	376,408
3	**Claims on euro area residents denominated in foreign currency**	**245,901**	**259,369**
4	**Claims on non-euro area residents denominated in euro**	**785,954**	**767,535**
	4.1 Balances with banks, security investments and loans	785,954	767,535
	4.2 Claims arising from the credit facility under ERM II	-	-
5	**Lending to euro area credit institutions related to monetary policy operations denominated in euro**	**1,740,000**	**602,000**
	5.1 Main refinancing operation	53,000	53,000
	5.2 Longer-term refinancing operations	1,687,000	539,000
	5.3 Fine-tuning reverse operations	-	10,000
	5.4 Structural reverse operations	-	-
	5.5 Marginal lending facility	-	-
	5.6 Credits related to margin calls	-	-
6	**Other claims on euro area credit institutions denominated in euro**	**289,450**	**94,954**
7	**Securities of euro area residents denominated in euro**	**3,444,066**	**3,096,428**
	7.1 Securities held for monetary policy purposes	1,165,377	668,500
	7.2 Other securities	2,278,689	2,427,928
8	**General government debt denominated in euro**	**-**	**-**
9	**Intra-Eurosystem claims**	**2,735,650**	**2,727,519**
	9.1 Participating interest in ECB	69,300	63,820
	9.2 Claims equivalent to the transfer of foreign reserves	189,410	189,410
	9.3 Claims related to promissory notes backing the issuance of ECB debt certificates*	-	-
	9.4 Net claims related to the allocation of euro banknotes within the Eurosystem	2,476,940	2,474,289
	9.5 Other claims within the Eurosystem (net)	-	-
10	**Items in course of settlement**	**-**	**-**
11	**Other assets**	**211,213**	**213,728**
	11.1 Coins of euro area	1,557	2,149
	11.2 Tangible and intangible fixed assets	22,285	22,336
	11.3 Other financial assets	50,921	56,396
	11.4 Off-balance sheet instruments revaluation differences	42	242
	11.5 Accruals and prepaid expenses	73,939	73,141
	11.6 Sundry	62,469	59,463
12	**Loss for the year**	**-**	**-**
Total assets		**10,217,773**	**8,561,253**

* Only an ECB balance sheet item

LIABILITIES (thousands of euro)		31 December 2011	31 December 2010
1	**Banknotes in circulation**	**3,843,316**	**3,640,108**
2	**Liabilities to euro area credit institutions related to monetary policy operations denominated in euro**	**1,125,711**	**882,037**
	2.1 Current accounts (covering the minimum reserve system)	393,225	442,137
	2.2 Deposit facility	602,486	304,900
	2.3 Fixed-term deposits	130,000	135,000
	2.4 Fine-tuning reverse operations	-	-
	2.5 Deposits related to margin calls	-	-
3	**Other liabilities to euro area credit institutions denominated in euro**	**15,158**	**14,191**
4	**Debt certificates issued**	**-**	**-**
5	**Liabilities to other euro area residents denominated in euro**	**890,334**	**288,298**
	5.1 General government	872,041	269,821
	5.2 Other liabilities	18,293	18,476
6	**Liabilities to non-euro area residents denominated in euro**	**20,807**	**33,368**
7	**Liabilities to euro area residents denominated in foreign currency**	**71,410**	**75,639**
8	**Liabilities to non-euro area residents denominated in foreign currency**	**-**	**-**
	8.1 Deposits, balances and other liabilities	-	-
	8.2 Liabilities arising from the credit facility under ERM II	-	-
9	**Counterpart of special drawing rights allocated by the IMF**	**256,187**	**249,818**
10	**Intra-Eurosystem liabilities**	**2,727,622**	**2,092,831**
	10.1 Liabilities equivalent to the transfer of foreign reserves*	-	-
	10.2 Liabilities related to promissory notes backing the issuance of ECB debt certificates	-	-
	10.3 Net liabilities related to the allocation of euro banknotes within the Eurosystem	-	-
	10.4 Other liabilities within the Eurosystem (net)	2,727,622	2,092,831
11	**Items in course of settlement**	**-**	**-**
12	**Other liabilities**	**107,703**	**112,779**
	12.1 Off-balance sheet instruments revaluation differences	17,754	23,999
	12.2 Accruals and income collected in advance	8,176	5,385
	12.3 Sundry	81,773	83,395
13	**Provisions**	**149,029**	**143,905**
14	**Revaluation accounts**	**162,727**	**188,068**
15	**Capital and reserves**	**830,665**	**802,027**
	15.1 Capital	8,346	8,346
	15.2 Reserves	822,319	793,681
16	**Profit for the year**	**17,105**	**38,184**
Total liabilities		**10,217,773**	**8,561,253**

* Only an ECB balance sheet item

Profit and Loss Account for the year ended 31 December 2011

thousands of euro	2011	2010
1.1 Interest income	153,464	145,458
1.2 Interest expense	-41,243	-42,864
1 Net interest income (expenditure)	**112,221**	**102,594**
2.1 Realised gains/losses arising from financial operations	51,225	31,208
2.2 Write-downs on financial assets and positions	-131,463	-59,087
2.3 Transfer to/from provisions for foreign exchange risks, price risks and other operational risks	-10,928	-33,635
2 Net result of financial operations, write-downs and risk provisions	**-91,167**	**-61,514**
3.1 Fee and commission income	8.039	7,434
3.2 Fee and commission expense	-1,939	-1,698
3 Net fee and commission income	**6,101**	**5,736**
4 Income from equity shares and participating interests	4,327	7,844
5 Net result arising from allocation of monetary income	8,572	8,071
6 Other operating income	4,202	4,140
Total net income	**44,256**	**66,871**
7.1 Staff costs	-17,911	-18,644
7.2 Administrative expenses	-5,491	-5,890
7.3 Depreciation of tangible and intangible fixed assets	-1,736	-1,946
7.4 Banknote production services	-1,393	-1,679
7.5 Other expenses	-620	-528
7 Total operating expenses	**-27,151**	**-28,687**
8 Profit (Loss) for the year	**17,105**	**38,184**

The notes on pages 14 to 33 form an integral part of the financial statements.

The unaudited financial statements were approved by the Governing Board on 28 February 2012 and these audited financial statements were approved by the Governing Board on 17 April 2012 and were signed on its behalf by:

Marko Kranjec, Ph. D.
President of the Governing Board and
Governor of the Bank of Slovenia

In accordance with Article 49 of the Bank of Slovenia Act, the Bank of Slovenia shall inform the National Assembly of the Republic of Slovenia of these annual financial statements.

Notes to the balance sheet

Assets

1. Gold and gold receivables

With the exception of gold stocks held in the Bank, the Bank's gold holdings consist of deposits with foreign banks. In the annual accounts gold has been valued on the basis of the euro price per fine ounce (ozf) derived from the quotation in USD established at the London fixing on 31 December 2011. This price, notified by the ECB, amounts to EUR 1,216.864 per ounce of fine gold compared with EUR 1,055.418 on 31 December 2010. Unrealised valuation gains of EUR 75.1 million (of which EUR 8.8 million from year 2007, EUR 5.5 million from year 2008, EUR 14.8 million from year 2009, EUR 29.6 million from year 2010 and EUR 16.5 million from year 2011) were disclosed under the liability balance sheet item ‘Revaluation accounts’.

	000 EUR	**Fine troy ounces**
Balance as at 31 December 2010	108,005	102,334
Revaluation of gold stock as at end of 2011	16,521	-
Balance as at 31 December 2011	124,527	102,334

2. Claims on non-euro area residents denominated in foreign currency

This item includes holdings of Special Drawing Rights (SDRs) allocated by the International Monetary Fund (IMF) and foreign currency claims on non-euro area residents included in the Bank's foreign reserves.

The sub-item 2.1 'Receivables from the IMF' consists of drawing rights within the reserve tranche, loans to the IMF and special drawing rights. They are remunerated by the IMF at a remuneration rate that is updated weekly.

The reserve tranche corresponds to the difference between Slovenian’s quota in the IMF and the IMF’s holdings of EUR with the Bank. The tranche is usually used for the purpose of financing the balance of payments deficit in the member countries.

Loans to the IMF are based on the loan agreement between the Bank and IMF, dated 1 September 2010. Borrowed funds give IMF the possibility to ensure timeliness and effective assistance to the member countries in case of balance of payments difficulties.

SDRs are reserve assets created by the IMF and allocated by it to its members in order to increase international liquidity. They are used in transactions between official monetary authorities. The SDR is defined in terms of a basket of currencies. Its value is determined as the weighted sum of exchange rates of four currencies (USD, GBP, JPY and EUR).

Both claims are shown in the balance sheet on the basis of the market rate of SDR 1 = EUR 1.1867 (31 December 2010: SDR 1 = EUR 1.1572) calculated by the ECB at the end of the year for all central banks participating in the Eurosystem. At the balance sheet date, the market rate of SDR was above the average cost and valuation gains were therefore recognised in accordance with the accounting rules in the liability balance sheet item ‘Revaluation accounts’.

	31 December 2011		31 December 2010	
	000 SDR	000 EUR	000 SDR	000 EUR
Quota	275,000	326,343	231,700	268,123
Less IMF holdings of EUR	-189,450	-224,820	-180,607	-208,998
Reserve tranche in the IMF	85,550	101,522	51,093	59,125
Loan to the IMF	32,900	39,042	23,200	26,847
SDR Holdings	208,642	247,596	198,180	229,334
Total	327,092	388,161	272,473	315,306

The sub-item 2.2 'Balances with banks and security investments, external loans and other external assets' includes the foreign currency assets held with non-euro area residents (including international and supranational organisations). Foreign currency assets are shown under this sub-item at their euro equivalent as calculated on the basis of market exchange rates on 31 December 2011.

Breakdown of foreign currency assets by type of investment:

	31 December 2011	31 December 2010
	000 EUR	000 EUR
Current accounts	1,149	1,020
Time deposits	-	58,374
Securities	251,703	317,014
Total	252,852	376,408

Breakdown of foreign currency assets by currency:

	31.12.2011	31.12.2010
	000 EUR	000 EUR
USD	228.545	294,252
AUD	23,803	75,668
GBP	96	5,889
Other currencies	407	599
Total	252,852	376,408

Breakdown of securities according to their residual maturity:

	31 December 2011	31 December 2010
	000 EUR	000 EUR
≤ 1 year	116.806	133,045
>1 year and ≤5 years	130,919	176,163
> 5 years	3,978	7,805
Total	251,703	317,014

3. Claims on euro area residents denominated in foreign currency

The foreign currency assets held with euro area residents are invested in sight deposits, time deposits and securities in foreign currencies. Foreign currency assets are shown at their euro equivalent as calculated on basis of market exchange rates on 31 December 2011.

Breakdown of foreign currency assets by type of investment:

	31 December 2011	31 December 2010
	000 EUR	000 EUR
Current accounts	221	179
Time deposits	70,794	17,213
Securities	174,886	241,978
Total	245,901	259,369

Breakdown of foreign currency assets by currency:

	31.12.2011	31.12.2010
	000 EUR	000 EUR
USD	245.827	236,173
AUD	45	11,510
GBP	29	11,684
Total	245,901	259,369

Breakdown of securities according to their residual maturity:

	31 December 2011 000 EUR	31 December 2010 000 EUR
≤ 1 year	92,288	77,953
>1 year and ≤ 5 years	82,598	164,025
Total	174,886	241,978

4. Claims on non-euro area residents denominated in euro

The claims on non-euro area residents denominated in euro included under this balance sheet item are invested in sight deposits and securities.

Breakdown of euro denominated assets by type of investment:

	31 December 2011 000 EUR	31 December 2010 000 EUR
Current accounts	2,425	1,956
Securities	783,529	765,579
Total	785,954	767,535

Breakdown of securities according to their residual maturity:

	31 December 2011 000 EUR	31 December 2010 000 EUR
≤ 1 year	111,156	124,339
>1 year and ≤ 5 years	646,156	559,775
> 5 years	26,217	81,465
Total	783,529	765,579

5. Lending to euro area credit institutions related to monetary policy operations in euro

This item shows operations carried out by the Bank within the framework of the single monetary policy of the Eurosystem and reflects the volume and pattern of the Bank's refinancing of the Slovenian credit institutions.

The total Eurosystem holding of monetary policy assets amounts to EUR 863,568 million, of which the Bank holds EUR 1,740 million. In accordance with Article 32.4 of the Statute, any risks from monetary policy operations, if they were to materialise, should eventually be shared in full by the Eurosystem NCBs, in proportion to the prevailing ECB capital key shares.

Main refinancing operations are regular liquidity-providing operations which are conducted with a weekly frequency in the form of reverse transactions and executed through standard tenders. In 2011 the main refinancing operations were conducted as fixed rate tender procedures with full allotment.

Longer-term refinancing operations are regular liquidity-providing reverse transactions with a maturity of one, three, six or twelve months. In December 2011 the three-year operation was conducted the first time. In the year under review longer-term refinancing operations provided the bulk of refinancing to the banking sector. They were conducted as fixed rate tender procedures with full allotment. For some operations the rate was fixed at the average minimum bid rate of the MROs over the life of this operation. In the year 2011, regular one- and three-month operations existed, conducted with a monthly frequency. During the year also one six-month, one twelve-month and one three-year operation were conducted.

Fine-tuning reverse operations are not conducted regularly by the ECB. They were performed four times in 2011 at the maturity of six- and twelve- month longer-term refinancing operations with the aim to overcome the liquidity until the subsequent main refinancing operation. Maturity of these transactions was between 6 and 13 days. They were conducted as fixed rate tenders with full allotment.

	31 December 2011	31 December 2010
	000 EUR	000 EUR
Main refinancing operations	53,000	53,000
Longer term refinancing operations	1,687,000	539,000
Fine-tuning reverse operations	-	10,000
Total	1,740,000	602,000

6. Other claims on euro area credit institutions denominated in euro

This item comprises claims on credit institutions which do not relate to monetary policy operations. Claims consist almost entirely of fixed-term euro-denominated deposits which are held at euro area credit institutions.

	31 December 2011	31 December 2010
	000 EUR	000 EUR
Current accounts	1,412	1,585
Time deposits	288,038	93,369
Total	289,450	94,954

7. Securities of euro area residents denominated in euro

This item includes securities held for monetary policy purposes and other securities issued by euro area residents denominated in euro.

The sub-item 7.1 'Securities held for monetary policy purposes' contains securities acquired by the Bank within the scope of the purchase programme for covered bonds (CBPP)[12], and public debt securities acquired in the scope of the securities market programme (SMP)[13]. The securities are classified as held-to-maturity.

The total Eurosystem NCB's holding of SMP securities amounts to EUR 211.947 million, of which the Bank holds EUR 992 million. In accordance with Article 32.4 of the Statute, any risks from holdings of SMP securities, if they were to materialise, should eventually be shared in full by the Eurosystem NCBs, in proportion to the prevailing ECB capital key shares.

As a result of an impairment test conducted as at 31 December 2011, the Governing Council decided that all future cash flows on these securities are expected to be received.

Breakdown of securities held for monetary policy purposes per portfolio:

	31 December 2011	31 December 2010
	000 EUR	000 EUR
CBPP securities	173,077	266,219
SMP securities	992,299	402,281
Total	1,165,377	668,500

Breakdown of securities held for monetary policy purposes according to their residual maturity:

	31 December 2011	31 December 2010
	000 EUR	000 EUR
≤ 1 year	100,020	96,012
>1 year and ≤ 5 years	827,657	411,316
> 5 years	237,699	161,173
Total	1,165,377	668,500

The sub-item 7.2 'Other securities' covers the portfolio of marketable securities, issued by governments and credit institutions of the euro area.

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12 Decision of the European Central Bank of 2 July 2009 on the implementation of the covered bond purchase programme (ECB/2009/16), OJ L 175, 04.07.2009, p. 18-19.

13 Decision of the European Central Bank of 14 May 2010 establishing a securities markets programme (ECB/2010/5), OJ L 124, 20.05.2010, p. 8-9.

Breakdown of securities per portfolio:

	31 December 2011	31 December 2010
	000 EUR	**000 EUR**
Marketable securities other than those held to maturity	2,261,675	2,427,928
Held-to-maturity securities	17,014	-
Total	2,278,689	2,427,928

Held-to-maturity securities are securities with fixed or determinable payments and a fixed maturity for which the Bank has the positive intent to hold them until maturity.

Breakdown of other securities according to their residual maturity:

	31 December 2011	31 December 2010
	000 EUR	**000 EUR**
≤ 1 year	846.546	610,523
>1 year and ≤ 5 years	1,215,883	1,695,261
> 5 years	216,259	122,144
Total	2,278,689	2,427,928

9. Intra-Eurosystem claims

Sub-item 9.1 shows the Bank's participating interest in the ECB. Pursuant to Article 28 of the Statute of the ESCB and the ECB, the ESCB national central banks are the sole subscribers to the capital of the ECB. Subscriptions depend on shares which are fixed in accordance with Article 29.3 of the Statute and which must be adjusted every five years. The most recent such adjustment took effect on 1 January 2009.

In accordance with the legal acts adopted by the Governing Council on the increase of the subscribed capital of the ECB in December 2010 and the pay-up of the increase via three instalments[14], the Bank has paid up additional EUR 5,480,000 to the ECB at the end of 2011, representing the second instalment of its contribution to the increase in the ECB's capital.

[14] Decision ECB/2010/26 of 13 December 2010 on the increase of the European Central Bank's capital, OJ L 11, 15.01.2011, p.53; Decision ECB/2010/27 of 13 December 2010 on the paying-up of the increase of the European Central Bank's capital by the national central banks of Member States whose currency is the euro, OJ L 11, 15.01.2011, p. 54-55.

The subscribed and paid up capital of the 27 European central banks in the capital of the ECB on 31 December 2011 is as follows:

	Capital key per cent	EUR	Of which fully paid up	Eurosystem key
Nationale Bank van België/ Banque Nationale de Belgique	2.4256	261,010,385	220,583,718	3.4666
Deutsche Bundesbank	18.9373	2,037,777,027	1,722,155,361	27.0647
Eesti Pank	0.1790	19,261,568	16,278,234	0,2558
Central Bank and Financial Services Authority of Ireland	1.1107	119,518,566	101,006,900	1,5874
Bank of Greece	1.9649	211,436,059	178,687,726	2,8082
Banco de España	8.3040	893,564,576	755,164,576	11,8679
Banque de France	14.2212	1,530,293,899	1,293,273,899	20,3246
Banca d’Italia	12.4966	1,344,715,688	1,136,439,021	17,8598
Central Bank of Cyprus	0.1369	14,731,333	12,449,666	0,1956
Banque centrale du Luxembourg	0.1747	18,798,860	15,887,193	0,2497
Central Bank of Malta/Bank Ċentrali ta’ Malta	0.0632	6,800,732	5,747,399	0,0903
De Nederlandsche Bank	3.9882	429,156,339	362,686,339	5,6998
Oesterreichische Nationalbank	1.9417	208,939,588	176,577,921	2,7750
Banco de Portugal	1.7504	188,354,460	159,181,126	2,5016
Banka Slovenije	**0.3288**	**35,381,025**	**29,901,025**	**0,4699**
Národná banka Slovenska	0.6934	74,614,364	63,057,697	0,9910
Suomen Pankki-Finlands Bank	1.2539	134,927,820	114,029,487	1,7920
Total euro-area NCBs	**69.9705**	**7,529,282,289**	**6,363,107,289**	**100.0000**
Bulgarian National Bank	0.8686	93,467,027	3,505,014	
Česká národní banka	1.4472	155,728,162	5,839,806	
Danmarks Nationalbank	1.4835	159,634,278	5,986,285	
Latvijas Banka	0.2837	30,527,971	1,144,799	
Lietuvos bankas	0.4256	45,797,337	1,717,400	
Magyar Nemzeti Bank	1.3856	149,099,600	5,591,235	
Narodowy Bank Polski	4.8954	526,776,978	19,754,137	
Banca Naţională a României	2.4645	265,196,278	9,944,860	
Sveriges Riksbank	2.2582	242,997,053	9,112,389	
Bank of England	14.5172	1,562,145,431	58,580,454	
Total non-euro area NCBs	**30.0295**	**3,231,370,113**	**121,176,379**	
Total euro area and non-euro area NCBs	**100.0000**	**10,760,652,403**	**6,484,283,669**	

In accordance with Article 49.2 of the Statute of the ESCB and the ECB and the legal acts adopted by the Governing Council of the ECB, the Bank also made a contribution in year 2007 of EUR 36.7 million to the ECB's foreign exchange, gold and security price revaluation accounts and to the ECB's provision for foreign exchange rate, interest rate and gold price risks. The payment was made in two parts. As a result of a difference between the euro equivalent of FX reserves to be transferred to the ECB at current exchange rates and the claim of the Bank in accordance with its capital key (disclosed under asset item 9.2), the amount of EUR 7.6 million was used as the advance contribution to the ECB reserves, provisions and provisions equivalent to reserves on 3 January 2007. The rest of the contribution was paid after the approval of the ECB 2006 Annual Accounts by the Governing Council of the ECB in March 2007.

Due to a change in the ECB's capital key on 1 January 2009, the additional contribution to the ECB's net equity was made on 9 March 2009.

	31 December 2011
	000 EUR
Contribution to revaluation accounts	
- paid on 3 January 2007	7,647
- paid on 12 March 2007	18,105
Contribution to provisions	
- paid on 12 march 2007	10,947
Contribution paid on 9 March 2009	2,700
Total	39,399

Sub-item 9.2 contains the Bank's claims arising from the transfer of foreign reserve assets to the ECB. The claims are denominated in euro at a value fixed at the time of their transfer. They are remunerated at the latest available marginal rate for the Eurosystem's main refinancing operations, adjusted to reflect a zero return on the gold component.

Sub-item 9.4 'Net claims related to the allocation of euro banknotes within the Eurosystem' consists of the claims and liabilities of the Bank vis-à-vis the Eurosystem relating to the allocation of euro banknotes within the Eurosystem which arise from applying the euro banknote allocation key (see 'Banknotes in circulation' and 'Intra-ESCB balances' in the notes on accounting policies)[15]. The net position, taking into account the adjustment as a result of smoothing mechanism, which reduces the interest bearing claim for the compensatory amount of EUR 584.9 million (2010: EUR 877.7 million), is remunerated at the marginal interest rate applying to the main refinancing operations.

11. Other assets

The Bank's holding of coins, issued by Republic of Slovenia, are shown in sub-item 11.1 'Coins of euro area'.

Sub-item 11.2 'Tangible and intangible fixed assets' comprises land and buildings, computer hardware and software, furniture and other equipment.

[15] According to the accounting regime chosen by the Eurosystem on the issue of euro banknotes, a share of 8% of the total value of the euro banknotes in circulation is allocated to the ECB on a monthly basis. The remaining 92% of the value of the euro banknotes in circulation are allocated to the NCBs also on a monthly basis, whereby each NCB shows in its balance sheet a share of the euro banknotes issued corresponding to its paid-up share in the ECB's capital. The difference between the value of the euro banknotes allocated to the NCB according to the aforementioned accounting regime, and the value of euro banknotes put into circulation, is recorded as a 'Net Intra-Eurosystem claim/liability related to the allocation of euro banknotes within the Eurosystem'.

	Land and buildings	Computers & equipment	Total
	000 EUR	000 EUR	000 EUR
Cost or valuation			
At 31 December 2010	**22,014**	**20,226**	**42,240**
Additions	136	1,571	1,707
Disposals	-	215	215
At 31 December 2011	**22,150**	**21,582**	**43,732**
Depreciation			
At 31 December 2010	**3,457**	**16,447**	**19,904**
Disposals	-	209	209
Charge for the year	182	1,569	1,751
At 31 December 2011	**3,639**	**17,807**	**21,446**
Net book value			
At 31 December 2010	**18,557**	**3,779**	**22,336**
At 31 December 2011	**18,511**	**3,775**	**22,285**

As at 31 December 2011 an amount of EUR 8.0 million relating to investment properties in Austria is included in land and buildings (2010: EUR 8.0 million).

Sub-item 11.3 'Other financial assets' contains the Bank's participating interests in international financial organisations and other financial assets.

Sub-item 11.4 'Off-balance sheet instruments revaluation differences' includes the positive revaluation effect arising from the forward legs of foreign currency swaps, which are recorded on off-balance-sheet account.

Sub-item 11.5 'Accruals and prepaid expenses' contains the accrued income identified at 31 December 2011. This consists mainly of interest income which is due in the new financial year.

Sub-item 11.6 'Sundry' consists of fiduciary and other assets.

Liabilities

1. Banknotes in circulation

This item consists of the Bank's share of the total euro banknotes in circulation (see 'Banknotes in circulation' in the notes on accounting policies).

The total value of euro banknotes issued by the central banks in the Eurosystem is distributed among these banks on the last day of each month in accordance with the key for allocating euro banknotes (see Accounting policies). In accordance with the banknote allocation key applying on 31 December 2011, the Bank has a 0.4325% (2010: 0.4335%) share of the value of all euro banknotes in circulation. During the year 2011 the total value of banknotes in circulation within the Eurosystem rose from EUR 839,702 million to EUR 888.628 million. In accordance with the allocation key, the Bank shows holdings of euro banknotes amounting to EUR 3,843.3 million at the end of the year 2011 (2010: EUR 3,640.1 million). The value of the euro banknotes actually issued by the Bank was EUR 1,366.4 million (2010: EUR 1,165.8 million). As this was less that the allocated amount, the difference of EUR 2,476.9 million (2010: EUR 2,474.3 million) is shown in asset sub-item 9.4 'Net claims related to the allocation of euro banknotes within the Eurosystem'.

	31 December 2011	31 December 2010
	000 EUR	000 EUR
EUR 5	-14,793	-9,819
EUR 10	212,946	148,319
EUR 20	2,802,208	2,391,334
EUR 50	-1,529,938	-1,360,001
EUR 100	-360,635	-215,193
EUR 200	-134,061	-103,813
EUR 500	390,650	314,993
Total euro banknotes actually put into circulation by the Bank	1,366,376	1,165,819
Redistribution of euro banknotes in circulation within the Eurosystem	2,811,002	2,790,767
Euro banknotes issued by the ECB (8%)	-334,062	-316,479
Total EUR banknotes according to the Bank's banknote allocation key	3,843,316	3,640,108

2. Liabilities to euro area credit institutions related to monetary policy operations denominated in euro

These interest bearing liabilities arise from the monetary policy conducted by the Bank on behalf of the ESCB.

Sub-item 2.1 'Current accounts' contains the deposits of credit institutions, which are used to meet the minimum reserve requirements and to settle payments. The main criterion for including these deposits in this sub-item is that the respective institution is subject to the Eurosystem minimum reserve system. Reserve requirements have to be fulfilled on average over the reserve maintenance period, which lasts approximately one month, in accordance with the schedule published by the ECB. Banks' reserve balances up to calculated reserve requirements have been remunerated at the prevailing interest rate for the Eurosystem's main refinancing operations.

Sub-item 2.2 'Deposit facility' contains overnight deposits placed with the Bank by slovenian counterparties at a predetermined interest rate (standing facility).

Sub-item 2.3 'Fixed term deposits' contains operations, performed by the ECB usually on the last day of the reserve maintenance period. Maturity of these operations is one day; they are conducted as variable rate tenders. Conducting of those operations on the last day of the reserve maintenance period will be abolished in January 2012. Since the establishment of the securities markets programme in May 2010, also fixed term deposit operations are conducted with a weekly frequency and maturity of one week, with the aim to sterilise liquidity issued using this programme. Fixed term deposit operations are conducted as variable rate tenders.

	31 December 2011	31 December 2010
	000 EUR	000 EUR
Current accounts (covering the minimum reserve system)	393,225	442,137
Deposit facility	602,486	304,900
Fixed term deposits	130,000	135,000
Total	1,125,711	882,037

3. Other liabilities to euro area credit institutions denominated in euro

This balance sheet item contains other credit institutions' accounts unrelated to the monetary policy operations.

5. Liabilities to other euro area residents denominated in euro

Sub-item 5.1 'General government' encompasses the balances of the government sight and fixed-term deposits and its special funds in euro. The deposits of other public depositors constitute balances held by local communities.

Sub-item 5.2 Other liabilities' includes among other also stock exchange market customers' accounts and fixed term deposit of Guarantee fund of Central Securities Clearing Corporation.

6. Liabilities to non-euro area residents denominated in euro

Balance sheet item 'Liabilities to non-euro area residents denominated in euro' contains euro balances of international and supranational organisations and non-Eurosystem central banks. The IMF account No. 2 is also included in this balance sheet item.

7. Liabilities to euro area residents denominated in foreign currency

This item contains the foreign currency sight and fixed-term deposits of central government and its special funds.

9. Counterpart of special drawing rights allocated by the IMF

This item represents the liability of the Bank towards IMF which corresponds to the allocation of SDRs to the Republic of Slovenia as a result of its membership in the IMF. The liability is shown in the balance sheet at the end of 2011 on the basis of the market rate of SDR 1 = EUR 1.1867 (31 December 2010: SDR 1 = EUR 1.1572) calculated by the ECB at the end of the year for all central banks participating in the Eurosystem. The increase in the amount of this liability in 2011 is solely due to valuation effects, i.e. the depreciation of the euro against the SDR.

10. Intra-Eurosystem liabilities

Sub-item 10.4 'Other liabilities within the Eurosystem (net)' includes net position of 'Other claims/liabilities within the Eurosystem (net). This item consists of a net TARGET2 balance, arising from cross-border transfers via TARGET2 with other NCBs in the ESCB and the ECB, the claim arising from the allocation of monetary income to the national central banks (see profit and loss item 5 'Net result arising from allocation of monetary income') and the claim arising from the distribution of

ECB's income on euro banknotes in circulation (see profit and loss item 4 'Income from equity shares and participating interests').

The net TARGET2 balance is remunerated at the latest available marginal rate for the main refinancing operations. The settlement takes place monthly on the second business day of the month following that to which the interest relates. The creation of this liability reflects outflows of funds from domestic credit institutions to other euro area countries. These funds came from the gradual release of credit institutions' deposits with the Bank after Slovenia joined EMU on 1 January 2007.

12. Other liabilities

Sub-item 12.1 'Off-balance sheet instruments revaluation differences' includes the negative revaluation effect arising from the forward legs of foreign currency swaps, which are recorded on off-balance-sheet account.

Sub-item 12.2 'Accruals and income collected in advance' contains the accrued expenses identified at 31 December 2011. This consists mainly of interest expenditure which is due in the new financial year but was incurred in the financial year just ended.

Sub-item 12.3 'Sundry' consists mainly of fiduciary liabilities and non-returned tolar banknotes.

13. Provisions

	31 December 2011	31 December 2010
	000 EUR	000 EUR
Provisions for employees and for known risks	81,183	80,654
Provisions for general risks	63,497	53,137
Provision in respect of monetary policy operations	4,349	10,114
Total	149,029	143,905

Provisions for employees and for known risks

Provisions for post-employment benefits are calculated in accordance with IAS 19 – Employee benefits on the basis of actuarial assumptions as at 31.12.2011. The latter consider the stipulations of the Bank collective agreement, expected future salary increase and a rate of 4.85% used to discount the future obligations, determined by reference to 10-years high quality corporate bonds in the euro area. Considering the fact that assumptions used in the calculation are not changing significantly in the individual year and that they remain inside the corridors set by the aforementioned standard, the decision was taken that the actuarial calculation is performed every five years.

Provisions for known risks relate to potential liabilities of the Bank towards creditors of several Savings and Loan Undertakings and to the potential liabilities streaming from off-balance sheet positions.

Provisions for general risks

Taking into account the Bank's exposure to interest rate, exchange rate and price risks, provisions for future unrealised interest rate, exchange rate and price change losses could be created. In 2010, the Bank created additional general provisions amounting to EUR 33.1 million and in 2011 in the amount of EUR 10.4 million.

Provisions in respect of monetary policy operations

In accordance with Article 32.4 of the Statute, the provision against counterparty risks in monetary policy operations is allocated between the national central banks of participating Member States (NCBs) in proportion to their subscribed capital key shares in the ECB prevailing in the year when the defaults have occurred. In accordance with the general accounting principle of prudence, the Governing Council has reviewed the appropriateness of the volume of this provision and decided to reduce the provision from a total amount of EUR 2,207 million as at 31 December 2010 to an amount of EUR 949 million as at 31 December 2011. The Bank's share in this provision amounts to EUR 4.3 million (2010: EUR 10.1 million). The respective adjustments are reflected in the NCB's profit and loss accounts. In case of Bank of Slovenia the resulting income amounted to EUR 5.8 million in 2011 (see Profit and loss account item 5 'Net result of pooling of monetary income').

14. Revaluation accounts

The positive difference between the market value and the average acquisition costs in the case of gold holdings, net positions in each foreign currency and securities portfolio is shown in this balance sheet item.

In case of valuation of securities, gains of EUR 57.1 million arose from the valuation of EUR denominated portfolio (2010: EUR 95.5 million), EUR 2.9 million from the valuation of USD denominated assets (2010: EUR 8.9 million) and EUR 2.2 million from AUD denominated securities portfolio (2010: EUR 4.9 million). At the end of 2011, the Banks has no GBP denominated portfolio (2010: valuation gains amounting to EUR 0.4 million).

In case of foreign currency positions, gains of EUR 17.2 million arose from the valuation of USD position and EUR 8.1 million from the valuation of SDR position (2010: EUR 11.0 million from the valuation of USD position EUR 5.6 million from the valuation of CHF position, EUR 3.2 million from the valuation of SDR position).

In case of gold the acquisition cost is EUR 482.688 per fine ounce of gold (2010: EUR 482.688), comparing with market price at the end of 2011, which was EUR 1,216.864 per fine ounce of gold (2010: EUR 1,055.418). Market value of gold position exceeded its acquisition price and resulted in a revaluation gain amounting to EUR 75.1 million (2010: EUR 58.6 million).

	31 December 2011	31 December 2010
	000 EUR	000 EUR
Price effect	62,255	109,715
- securities in foreign currencies (asset items 2 and 3)	5,148	14,252
- securities in euro (asset items 4 and 7)	57,108	95,463
Exchange rate effect	25,340	19,743
Gold value effect	75,131	58,610
Total	162,727	188,068

15. Capital and reserves

In accordance with the Article 5 of the Bank of Slovenia Act, the capital of the Bank was created from the general reserves in the amount of EUR 8.3 million in year 2002. Banka Slovenije's initial capital may be increased by allocating of funds from the general reserves in an amount to be determined by the Governing Board.

The reserves of the Bank of Slovenia are composed of general reserves and special reserves. General reserves serve to cover general risks associated with the operations of the Bank of Slovenia. Special reserves serve to cover exchange rate and price risks. Special reserves are equal to the amount of unrealised income deriving from exchange rate and price changes until the end of 2006. Investment properties revaluation reserve are created out of the valuation gains arising from the appraisal of the investment properties in Austria, performed by the independent real estate assessor.

	31 December 2011	**31 December 2010**
	000 EUR	**000 EUR**
Composition of reserves:		
Initial capital of the Bank of Slovenia	8,346	8,346
General reserve	390,330	361,692
Special reserve for foreign exchange differences	380,714	380,714
Special reserve – price risk (gold)	43,236	43,236
Revaluation reserve	8,039	8,039
Total reserves	830,665	802,027

Notes to the off-balance-sheet items

Foreign currency swaps

As at 31 December 2011, the forward foreign currency position arising from EUR/foreign currency swap transactions amounts to EUR 223.2 million (2010: EUR 365.6 million).

The forward claims and forward liabilities in foreign currencies were revalued at the same exchange rates as those used for spot holdings in foreign currencies.

	31 December 2011		31 December 2010	
	000 Foreign currency	**000 EUR**	**000 Foreign currency**	**000 EUR**
Forward liabilities in AUD	30,100	23,658	114,800	87,393
Forward liabilities in GBP	-	-	15,500	18,008
Forward liabilities in USD	258,200	199,552	347,700	260,216
Total	**-**	**223,210**	**-**	**365,617**

Securities lending

As at 31 December 2011, securities with a market value of EUR 371 million (31 December 2010: EUR 650 million) were lent under automated security lending contracts with the agents, which were, in case of collateral, reinvested into reverse repo transactions, prime asset backed securities, bank bonds and certificates of deposits.

Other off-balance-sheet items

The following other financial liabilities of the Bank were stated off-balance-sheet as at 31 December 2011:

- obligation under the IMF's statutes to provide currency on demand in exchange for SDRs up to the point at which the Bank's SDR holdings are three times as high as the amount it has received gratuitously from the IMF, which was equivalent to EUR 521.0 million as at 31 December 2011 (31 December 2010: EUR 520.1 million);

- a contingent liability of EUR 164.4 million, equivalent to the Bank's share of the maximum of EUR 50 billion reserve assets that the ECB may require the euro area NCBs to transfer under Article 30.1 ESCB Statute (31 December 2010: EUR 164.4 million);

- a future liability of EUR 5.5 million, which corresponds to the Bank's unpaid contribution to the ECB's capital[16] (see section on asset item 9 'Intra-Eurosystem claims) (31 December 2010: contingent liability EUR 11.0 million).

Notes to the profit and loss account

1. **Net interest income (expenditure)**

Interest income

Net interest income consists of interest income on foreign reserve assets and euro-denominated portfolio and interest income on euro-denominated claims. Euro-denominated claims include monetary policy instruments, foreign reserve assets transferred to the ECB and net claim arising from the allocation of banknotes within the Eurosystem.

[16] Decision of the European Central Bank of 13 December 2010 on the paying-up of the increase of the European Central Bank's capital by the national central banks of Member States whose currency is the euro (ECB/2010/27), OJ L 11, 15.01.2011, p. 54-55.

	31 December 2011	31 December 2010
	000 EUR	000 EUR
Interest income		
Gold	**-**	**146**
Current accounts and deposits	**3,828**	**1,693**
- In foreign currency	421	241
- In euro	3,407	1,452
Securities	**115,382**	**108,529**
- In foreign currency	10,261	16,741
- In euro	105,121	91,788
IMF	**1,305**	**786**
Monetary policy operations	**6,726**	**16,248**
- Main refinancing operation	282	54
- Longer-term refinancing operations	6,442	16,185
- Other refinancing operations	1	9
Intra Eurosystem claims	**24,930**	**17,744**
- Claims arising from the transfer of foreign reserves to the ECB	2,039	1,632
- Net claims related to the allocation of banknotes within the Eurosystem	22,891	16,111
Foreign currency swaps	**1,259**	**279**
Other interest income	**34**	**33**
Total	**153,464**	**145,458**

Interest expense

Interest expense arises from the liabilities in form of government accounts and deposits and monetary policy operations with the aim to absorb liquidity. The latest mainly concerns interest paid on banks' minimum reserves and overnight deposits. Interest expense also includes interest paid on TARGET2 balances.

	31 December 2011	31 December 2010
	000 EUR	000 EUR
Interest expenditure		
Current accounts and deposits	**2,685**	**2,189**
- In foreign currency	54	180
- In euro	2,632	2,009
IMF	**851**	**635**
Monetary policy operations	**7.449**	**5,547**
- Minimum reserves	5.365	4,296
- Overnight deposits	810	935
- Fixed term deposits	1,274	316
Intra Eurosystem liabilities	**28.055**	**30,000**
- TARGET balances	28.055	30,000
Foreign currency swaps	**2.193**	**4,488**
Other interest expense	**10**	**4**
Total	**41,243**	**42,864**

2. Net result of financial operations, write-downs and risk provisions

The net income shown in sub-item 'Realised gains/losses arising from financial operations' arose from the sale of currency positions and securities.

Write-downs of financial assets and positions reflect the decline in market prices of balance sheet items as at 31 December 2011 below the average cost of the respective currencies or securities. The valuation losses in 2011 occurred mostly in EUR denominated securities (the same as in 2010).

Transfer to provisions for special risks amounting to EUR 10.4 million represents the amount of provisions, created for potential losses from interest rate, price and exchange rate risks.

According to the Governing Board decision, additional provisions have been made for the certain legal claims pending, in the amount of EUR 0.6 million.

	31 December 2011	31 December 2010
	000 EUR	000 EUR
Realised gains/losses		
Currency position	284	3,038
Securities	50,940	28,169
Total	51,225	31,208
Write-downs		
Currency position	-304	-476
Securities	-131,159	-58,611
Total	-131,463	-59,087
Transfer to/from provisions for foreign exchange risks, price risks and other operational risks		
Provisions for specific risks	-568	-535
Provisions for general risks	-10,360	-33,100
Total	-10,928	-33,635
Total	-91,167	-61,514

3. Net fee and commission income

Fees and commissions receivable mainly arise from payment and settlement service, supervisory and regulatory functions and security lending transactions.

4. Income from equity shares and participating interests

This item represents the Bank's dividends received on Bank's shares in the international financial institutions and the ECB.

Also included under this caption is the distribution of the ECB's income on euro banknotes amounting to EUR 3.1 million (2010: the income was fully retained by the ECB) (see 'Interim profit distribution' in the notes on accounting policies). In 2011 the ECB's income on euro banknotes in circulation was partially retained and on SMP securities was fully retained by the ECB in accordance with a decision of the Governing Council with respect to the establishment of a provision for foreign exchange rate, interest rate, credit and gold price risks. The retained amount not distributed to the Bank amounts to EUR 5.7 million (2010: EUR 5.2 million).

5. Net result of pooling of monetary income

The monetary income of the Eurosystem national central banks is allocated in accordance with the decision taken by the Governing Council of the ECB[17]. The amount of each Eurosystem NCB’s monetary income is determined by measuring the actual annual income that derives from the earmarkable assets held against its liability base.

Any interest paid on liabilities included within the liability base is to be deducted from the monetary income to be pooled by the NCB.

Where the value of a NCB’s earmarkable assets exceeds or falls short of the value of its liability base, the difference shall be offset by applying to the value of the difference the latest available marginal rate for the Eurosystem’s main refinancing operations. At the end of each financial year the total monetary income pooled by the Eurosystem is allocated among the NCBs according to the subscribed ECB capital key. The difference between the monetary income pooled and that reallocated to the individual NCB constitutes the net result arising from the calculation of monetary income recorded in the Profit and Loss account.

In the year 2011 the allocation of monetary income resulted in a net claim of EUR 2.8 million for the Bank (2010: net liability amounting to EUR 0.2 million). This net claim consists of the claim for year 2011, which represents the difference between the EUR 71.1 million (2010: EUR 49.1 million) of monetary income paid by the Bank into the common pool and the Bank's claim of EUR 73.7 million (2010: EUR 49.3 million) on the common pool, corresponding to the Bank's share in the ECB's paid-up capital, and of claims resulting from subsequent adjustment for years 2008, 2009 and 2010.

This item also includes the net result of the provisioning against counterparty risks in monetary policy operations of the Eurosystem amounting to an income of EUR 5,8 million (2010: income of EUR 8.3 million; see section on liability item L13 on provisions).

6. Other operating income

Other operating income includes income from non-bank services like rental income, income from confirmations issued, numismatics and other income.

7. Operating expenses

Staff costs

Staff costs include salaries and other staff costs together with the related taxes and contributions.

The Bank employed 419 employees as at 31 December 2011 (31 December 2010: 420 employees).

In accordance with the contract between the Bank and the Trade union from March 2002 Bank employees have been included into Voluntary supplementary pension insurance, which is defined as a contribution plan. Staff costs include contribution of the Bank for Voluntary supplementary pension insurance of EUR 0.5 million (2010: EUR 0.5 million).

In 2010 the remuneration of the Governing board members of the Bank was of EUR 670 thousands (2010: EUR 693 thousands).

[17] Decision of the European Central Bank of 25 November 2010 on the allocation of monetary income of the national central banks of member states whose currency is euro (ECB/2010/23), OJ L 35, 09.02.2011, p. 17-25, amended by the Decision of the European Central Bank of 3 November 2011 (ECB/2011/18), OJ L 319, 02.12.2011, p. 116.

Other operating expenses

This item consists mainly of expenses relating to the building and equipment maintenance, renting expenses, business travel and training costs, communication and energy costs, IT related expenses (software maintenance, system assistance), expenses for services outsourced, expenses for small goods and materials and other office expenses.

Depreciation of tangible and intangible fixed assets

Depreciation of buildings, furniture and office equipment, computer hardware and software was performed according to the adopted depreciation rates.

Banknote production services

Expenses for banknotes production services include mainly the expenses related to the production and transportation. The additional quantity of banknotes to be printed is determined on the basis of assessed needs for banknotes in circulation and for the maintenance of adequate volume of stock in the Eurosystem, distributed to individual NCB according to its capital key and denomination structure.

Other expenses

Other expenses consist mainly of contributions of the Bank, taxes and other operating expenses.

8. Profit for the year

According to the Accounting Guideline, to which the unrealised valuation losses shall be covered from the current financial result, whilst the unrealised valuation gains are transferred directly to revaluation accounts, the Bank shows the profit amounted to EUR 17.1 million (2010: EUR 38.2 million). In accordance with the second paragraph of the Article 50 of the Law on the Bank of Slovenia, 25% share of the financial result (EUR 4.3 million) will be transferred to the Republic of Slovenia budget. The remaining amount will be allocated to the Bank's general reserves.

5 APPENDICES

5.1 Publications and website

Title and basic information	Contents
Bilten [Monthly Bulletin] • monthly • in Slovene and English	Macroeconomic statistics with an emphasis on monetary statistics, exchange rates and economic relations with the rest of the world. Economic and financial developments; methodological appendix; review of Slovenian banks, calendar of data releases.
Letno poročilo [Annual Report] • annual (released in spring) • in Slovene and English	Report by the Bank of Slovenia to the National Assembly of the Republic of Slovenia. Description of economic developments, monetary policy, operations of banks and the Bank of Slovenia, and other activities of the Bank of Slovenia.
Neposredne naložbe [Direct Investment] • annual • in Slovene and English	Statistical review of direct and portfolio investment vis-à-vis Slovenia, both inward and outward (on an annual basis).
Finančni računi Slovenije [Financial Accounts of Slovenia] • annual • in Slovene and English	Comprehensive review of unconsolidated and consolidated sectors of the financial account of the Republic of Slovenia in an internationally comparable manner.
Prikazi in analize [Surveys and Analyses] • in Slovene and English	Analytical and methodological working papers from macroeconomic and other areas.
Poročilo o cenovni stabilnosti [Price Stability Report] • half-yearly • in Slovene and English	Publication focuses on projections of basic macroeconomic indicators for Slovenia for the next two years with accompanying risk factors. The publication also assesses movements in macroeconomic aggregates in the domestic and international economic environments with an emphasis on inflation trends. It illustrates movements in competitiveness indicators of the Slovenian economy and monitors country's fiscal position. It assesses the impact of financing conditions on the real sector with an overview of the main types of financing.
Poročilo o finančni stabilnosti [Financial Stability Review] • annual • in Slovene and English	The Financial Stability Review is intended primarily for the analytical monitoring of developments in the banking sector, and articles by experts on maintaining financial stability.
Website • index of Slovenian pages http://www.bsi.si/ … … /html/kazalo.html • index of English pages http://www.bsi.si/… … /eng/index.html	Website of the Bank of Slovenia with information about the institution, banknotes and coins, laws and regulations governing the work of the central bank, and other useful information. Current data on exchange rates, interest rates and securities, and major publications available for download in electronic form.

5.2 Secondary legislation affecting banking supervision

February 2011

- Regulation amending the regulation on the documentation for demonstrating fulfilment of the conditions for performing the function of a member of the management board of a bank or savings bank

April 2011

- Regulation amending the regulation on the amounts of annual fees for supervision and fees for decisions regarding requests for the granting of authorisation

May 2011

- Regulation amending the regulation on large exposures of banks and savings banks

August 2011

- Regulation on the diligence of members of the management and supervisory boards of banks and savings banks
- Regulation amending the regulation on disclosures by banks and savings banks
- Regulation amending the regulation on risk management and implementation of the internal capital adequacy assessment process for banks and savings banks
- Regulation amending the regulation on the reporting of individual facts and circumstances of banks and savings banks
- Regulation amending the regulation on the calculation of the capital requirements for credit risk under the internal ratings-based approach for banks and savings banks
- Regulation amending the regulation on the calculation of capital requirements for credit risk under the standardised approach for banks and savings banks

September 2011

- Regulation amending the regulation on the minimum requirements for ensuring an adequate liquidity position at banks and savings banks

November 2011

- Regulation amending the regulation on the documentation for the granting of authorisations to provide banking and financial services and for status transformations

December 2011

- Regulation amending the regulation on the calculation of the own funds of banks and savings banks
- Regulation amending the regulation on the calculation of capital requirements for credit risk in securitisation and the rules on the exposure of banks and savings banks to transferred credit risk
- Regulation amending the regulation on the calculation of capital requirements for market risk for banks and savings banks
- Regulation amending the regulation on disclosures by banks and savings banks
- Regulation amending the regulation on the recognition of external credit assessment institutions
- Regulation amending the regulation on the calculation of capital requirements for credit risk under the standardised approach for banks and savings banks
- Regulation amending the regulation on the reporting of individual facts and circumstances of banks and savings banks
- Regulation amending the regulation on the reporting of the own funds and capital requirements of banks and savings banks
- Guidelines amending the guidelines for the electronic submission of reports on own funds and capital requirements

5.3 Glossary of selected terms

Money market - The market for trading in short-term (up to one year) securities and the transfer of savings via short-term loans.

Eonia (Euro OverNight Index Average) - The reference rate for overnight unsecured interbank lending in euros. It is calculated daily as the weighted average interest rate on lending by banks from a pre-selected group. The panel includes major banks operating on the euro interbank market.

ESCB - The European System of Central Banks, which comprises the ECB and the NCBs of EU Member States.

Euro area - The area encompassing the EU Member States that have adopted the euro as their single currency in accordance with the Treaty and in which a single monetary policy is conducted under the responsibility of the Governing Council of the ECB.

Eurosystem - Comprises the ECB and the NCBs of the euro area countries.

ECB key interest rate - The minimum bid rate on main refinancing operations. It is the interest rate used by the Eurosystem to signal the monetary policy stance.

Covered bond - A bond issued by a bank and secured by all its assets. In the event of the bank's bankruptcy the bond holder has the right of priority in repayment through the sale of a specific assets of the issuer (e.g. mortgage loans) that were provided as collateral for the bond. In the case this do not suffice to cover the claim, the holder has a claim on the bank's remaining assets alongside bank's other creditors.

Deposit facility - A standing facility of the Eurosystem that counterparties may use at any time to make overnight deposits at an NCB at an interest rate that is lower than the ECB's key interest rate and is usually lower than the market interest rate (Eonia).

Marginal lending facility - A standing facility of the Eurosystem that counterparties may use at any time to receive overnight credit from an NCB at an interest rate that is higher than the ECB's key interest rate and is usually higher than the market interest rate (Eonia).

National central bank (NCB) - Any of the central banks of the euro area. In Slovenia it is the Bank of Slovenia.

Minimum reserves - The minimum amount of money that credit institutions (banks and savings banks) are required to maintain in their accounts at a central bank on average over the reserve maintenance period. The amount is calculated by multiplying the reserve base (i.e. selected liabilities on credit institutions' balance sheets) by the minimum reserve ratio. The minimum reserve ratio in the euro area is 2% (1% as of 18 January 2012) for liabilities with a contractual maturity of up to 2 years, and 0% for liabilities with a maturity of more than 2 years and for liabilities created by repo transactions. Liabilities to the Eurosystem and other institutions subject to the Eurosystem's minimum reserve system are not included in the reserve base. The reserve maintenance period typically starts on the Wednesday following the meeting of the Governing Council of the ECB, when the latter makes decisions regarding the ECB's key interest rate, and ends on the Tuesday prior to the corresponding Wednesday in the next month.

Standing facility - A central bank lending or deposit facility available at all times to counterparties at their own initiative. The Eurosystem offers the marginal lending facility and the deposit facility.

Full allotment - The allotment procedure in Eurosystem open market operations, where the Eurosystem allots the full amount that a bank bids for in a tender, without regard to the total demand of all banks in that tender. It has been used since October 2008.

Reverse transaction - An operation whereby an NCB simultaneously buys and sells (or vice-versa) financial assets under a repo or reverse repo agreement, i.e. temporarily buys or sells financial assets, with different settlement dates. A loan agreement may also be concluded, where the claim is secured by eligible collateral. The opposite is an outright transaction comprising only one part (there is no reverse part), i.e. an NCB buys or sells financial assets (typically securities) on the market.

Excess liquidity - See the explanation under Structural position of the money market.

Structural position of the money market or structural liquidity position - The difference between the autonomous items on the right (asset) and left (liability) side of the balance sheet of a central bank. When the right side of autonomous items is greater (or less) than the left side, the result is a deficit (surplus) structural position of the money market. The structural position of the money market of the euro area is in deficit. The autonomous items in a central bank's balance sheet are those items that did not arise as the result of monetary policy measures. The amount of base money, and thus the liquidity of banks, changes autonomously, i.e. even when this is not the central bank's aim, and when the central bank uses monetary policy measures to that end. Examples of autonomous items from a central bank's balance sheet are banknotes in circulation, government deposits with the central bank, items in the course of settlement, foreign exchange reserves and other assets of the central bank, as well as its own funds and reserves. These are items that cannot be directly linked to the conduct of monetary policy. The structural liquidity position indicates to what extent (e.g. just right, too little or too much) banks are being provided with liquidity, i.e. the autonomous supply of base money to banks in the absence of central bank monetary policy measures.