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Frequently asked questions and answers regarding the reorganisation of the Slovenian banking system

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I. RESULTS OF STRESS TESTING (ST) AND METHODOLOGY APPLIED

1. What will happen to the deposits of (ordinary) depositors at banks that have performed inadequtely in the comprehensive reviews? Are their deposits safe?

Savers' deposits at banks are completely safe. All banks will continue to operate normally even after the results of the stress tests are announced. Banks that achieve inadequate results in the stress tests will adopt and implement all the requisite measures in time to ensure that their operations are undisrupted and their performance successful. It should also be noted that in the event of the bankruptcy of a particular bank, deposits of up to EUR 100,000 are guaranteed by banks in Slovenia and/or by the government under the law governing banking. The only deposits that are entirely excluded from the guarantee scheme for a bank bankruptcy are deposits of other banks, government deposits, deposits of persons that are direct or indirect spending units of the state budget or local government budgets, deposits of shareholders of the bank with a participating interest of more than 5%, deposits of legal entities that are controlled by the bank, deposits of legal entities that are classed as medium-size or large enterprises, and deposits of collective investment undertakings.

2. Why were an additional external bank asset quality review (AQR) and stress tests (STs) required?

Speculation as to the total cost of the recapitalisation of banks in Slovenia has been circulating for a number of years. In light of the above, and the European Commission recommendation in the scope of proposed measures to reduce structural imbalances in Slovenia (European Council report of ………..), the Bank of Slovenia and the Slovenian government opted for a comprehensive review of the banking system with the aim of overseeing the implementation of measures to ensure financial stability. In order to provide an independent assessment of the current situation, external consultants with experience in assessments in other EU Member States were engaged at the recommendation of the European Commission. The credibility and transparency provided by experienced independent consultants who have conducted AQRs and STs contribute to a relatively precise assessment of the size of non-performing loans (shortage) at banks, the value of pledged collateral, and the assessment of the deterioration of the situation in the banking system in conditions of further adverse shocks to the economy and the requirements for additional capital increases at the banks. These procedures are nothing new in EU Member States. On the contrary, all European countries will have to undergo similar AQR and ST exercises next year with the aim of providing a precise picture of the situation in the European banking system. It is precisely the method for restructuring government-owned banks in Slovenia – which we aim to undertake via the Bank Asset Management Company (BAMC) – that necessitated the early performance of this assessment, which will provide a sound platform for the review that will be conducted again next year, albeit on a smaller portion of the banking system (e.g. the three largest banks). These particular rules were adopted in May 2004 when Slovenia joined the EU and in January 2007 when it adopted the euro.

3. Why were these consulting companies chosen?

These companies were chosen because they posses the best experience in the areas where they provide consulting services. They also conducted comprehensive reviews of the banking systems in Spain, Ireland and Portugal, and will likely conduct them in 2014 in all countries of the euro area upon the establishment of the Single Supervisory Mechanism under the auspices of the ECB and national banking supervisors.

4. Who selected them?

The scope, conditions and contractor for the AQR and STs were determined by an inter-departmental committee (appointed by the government and composed of representatives of the Bank of Slovenia, the Ministry of Finance, the Ministry of Economic Development and Technology and the Office of the Prime Minister) after consultations with the European Commission (EC), the European Central Bank (ECB) and the European Banking Authority (EBA).

5. What is the cost of the review?

The contracting authority for the AQR for seven banks and the STs for all ten banks is the Bank of Slovenia, which is also covering the costs. The banks included in measures under the ZUKSB (three banks) cover the costs of the asset quality review themselves.The Bank of Slovenia concluded four contracts with the contractors conducting the stress tests (bottom-up and top-down), including two with the contractors for the AQR that also cover the area of real estate valuation. The total contractual value of all the contracts is EUR 21 million.

6. **What were they tasked with? What exactly did they do?**

The AQR includes verification of data completeness and integrity, a review of individual loans, collateral valuation and identification of the adequacy of impairments. The objective of the stress tests is the assessment of the eventual capital requirements under the conditions of the baseline scenario (more favourable) and the adverse scenario (or the scenario of sharply increased macroeconomic imbalances) over a three-year projection period, i.e. 2013 to 2015.

7. **Who supervised the comprehensive reviews?**

The STs and the AQR were supervised by a steering committee comprising the Bank of Slovenia, the Ministry of Finance and observers from the European Commission, the ECB and the European Banking Authority (EBA).

8. **Who participated in the AQR and STs?**

A representative sample of ten banks was created, covering 70% of the banking system and various structures such as domestic and foreign banks, large, small and medium-size banks. The set of 10 banks was agreed upon in conjunction with the Commission and the European Central Bank. Alongside the three systemically important banks (NLB, NKBM and Abanka), the review also covers Banka Celje, Gorenjska banka, Probanka, Factor banka, UniCredit Banka Slovenija, Hypo Alpe Adria Bank and Raiffeisen banka on the basis of set criteria.

9. **Did domestic authorities and institutions (Ministry of Finance, Bank of Slovenia, etc.) have any influence over the process? Did they actively participate in the process?**

The STs and the AQR were supervised by a steering committee comprising the Bank of Slovenia, the Ministry of Finance and observers from the Commission, the ECB and the European Banking Authority. All of them participated actively in the process.

10. **What do the stress tests tell us?**

Stress tests (STs) are used to ascertain whether banks are capable of performing their activities and maintaining sufficient capital for doing so even if conditions (primarily economic conditions, GDP developments, economic growth and employment) were to deteriorate significantly.

11. How are AQRs and stress tests linked?

The fundamental objectives of the AQR conducted at the banks were:

- getting to know the composition and quality of the credit portfolio,
- assessing the correctness of asset categorisation (non-performing/performing loans) and the need for additional adjustments,
- the results of the AQR serving as input data for bottom-up stress tests when calculating the capital deficit/surplus of the banks under scenarios of different economic developments.

AQRs and stress tests are linked with one another via two results:

- a review of individual credit files (based on samples) containing information on the debtor, its transactions and the corresponding collateral;
- the valuation of a large share of real estate in the banks' portfolios.

Using these results, the stress test providers adjusted the loss forecasting model.

12. What does the term banking system “hole” mean?

The term “hole” (used colloquially) refers to the size of the estimated capital deficit at the banks included in the comprehensive review (representative sample – i.e. 70% of the banking sector). The results do not cover banks not included in the stress tests and their potential capital deficit.

13. Does the deficit (capital requirement) in the banking system mean that any other bank will be closing down?

The capital deficit is ascertained in conditions of an adverse economic scenario that, while possible, is unlikely to occur. The results of the stress tests do not automatically imply that bankruptcy or closure would be trigerred in case of banks with a larger capital deficit, but rather that the owners of such banks should provide additional capital so that the banks are able to continue lending even in a less favourable economic situation.

14. What are the main conclusions from the stress tests conducted?

The main result of the stress tests is the established capital deficit at the relevant banks that would be required in the event of the negative economic scenario being realised in the 2013 to 2015 period.

15. Do the results mean that the Slovenian banking system will not see positive operating results over the next three/five years?

The banks’ performance over recent years has to a large extent been defined by high impairments of non-performing loans/claims. The AQR identified additional non-performing loans at the banks, which will in a relatively short period require additional impairments, which in turn causes losses. As a consequence these new impairments will not entail such a large burden on the banks’ operating result and capital over the coming years.

16. How will the results of stress tests affect bank lending?

It is assumed that the capital increases to be undertaken after the stress test results will have a favourable impact on future bank lending. The AQR and stress tests conducted at the banks were required by European institutions as a mandatory condition prior to the transfer of claims to the Bank Asset Management Company

(BAMC). Through the identification of all non-performing claims at the banks and their (partial) exchange for government bonds, bank portfolios will be relieved. The detoxification of bank portfolios and recapitalisations can contribute to a return of investor confidence and easier access to funding abroad/on foreign capital markets, which will in turn increase the options for lending to the economy and reduce borrowing costs for banks and the entire economy.

17. What is the length of the period covered by the stress tests? Why did you decide on such a period?

The stress tests cover a period of three years, i.e. from 2013 to the end of 2015. A three-year period was also used in the stress tests conducted in Spain, and will presumably also be used in the comprehensive assessment of the state of the European banking system next year.

Two macroeconomic scenarios were used. The baseline (base) scenario entails the most likely macroeconomic developments by 2015. The adverse scenario entails a further sharp deterioration in the adverse economic situation in Slovenia. The adverse scenario is intended for the assessment of the robustness of the banking system or its ability to maintain stability in even the most unfavourable conditions.

18. Who defined the macroeconomic scenarios?

The two scenarios were defined by the European Commission and the ECB.

19. How reasonable are the two scenarios and the hypotheses applied in the stress tests?

The adverse scenario was defined highly conservatively. It assumes a cumulative 9.5% fall in GDP growth rate in the period from 2013 till 2015, which is 1 percentage point higher than the realised fall in the period from 2009 to 2012. The scenario is even more adverse with regard to private consumption and investment. The cumulative fall of private consumption in the period from 2013 till 2015 by 18% greatly exceeds the 2.5% fall in the period 2009-2012.

When conducting the tests, those conducting them followed this concept of conservativeness throughout.

20. What is the likelihood of one of the scenarios actually being realised?

The probability of the baseline scenario being realised is high. The probability of the adverse scenario by its very definition is low, while in the case of Slovenia this probability is additionally reduced in light of the distinctly more adverse scenario relative to those used in other countries facing economic difficulties.

21. What is the difference between bottom-up and top-down reviews and stress tests?

The stress tests assess potential future losses and the capital surplus or deficit under the baseline and adverse macroeconomic scenarios.

A bottom-up stress test assesses losses at the level of an individual credit transaction at a bank, which leads to the system-wide level in subsequent steps. This type of test is generally more reliable and yields more accurate results.

A top-down stress test is based on more aggregated data at the level of the entire banking system and banks without an insight into the detailed data on individual transactions.

22. Which part of the portfolio was included in the stress tests?

The stress tests included the credit portfolio and the securities portfolio of the individual institutions. The banks' claims against the government, banks and savings banks were excluded.

23. How did the stress tests take account of the trends and the behaviour/response of the Slovenian economy?

Certain stress test assumptions were set up very conservatively and are based on the previously established trends and structures in other countries where stress tests have already been conducted. The limiting factor in the stress tests in Slovenia was the data time series (insufficient length of history) or incomplete data, which could have a material impact on the final results.

24. Which assumptions or scenarios were used in the stress tests?

Two macroeconomic scenarios were used. The baseline scenario entails likely macroeconomic developments by 2015. The adverse scenario entails a further sharp deterioration in the adverse economic situation in Slovenia. The adverse scenario is intended for the assessment of the robustness of the banking system and the ability to survive even in the most unfavourable conditions.

The baseline scenario is also conservative, which is indicated by the latest forecasts of the European Commission that project a decline in GDP of 1.5% for Slovenia in 2014 and growth of 0.7% in 2015. The figures for both years are more favourable than those assumed in the baseline scenario of the stress tests (-1.5% and 0.1%).

When conducting the tests, those conducting them followed this concept of conservativeness throughout.

25. Who ensures that input data for the AQR is actually correct?

One of the most important aspects of the AQR was data integrity verification (DIV). The objective of DIV was to ascertain whether there are any questions as to the accuracy of the banking data that could result in an adjustment of the AQR assessment. Here key data from bank reports was compared with the banks' original documentation. The results of this review were taken into account in the stress tests. The independent data quality review was conducted by external contractors (auditors, real estate appraisers, stress test providers) and the entire process was monitored by international institutions (ECB, European Commission, EBA).

26. Will the international community and international institutions (European Commission, ECB, EBA, IMF, etc.) recognise the results of these tests?

International institutions have participated in the entire process of the AQR and stress tests, and thus it is to be expected that the results will also be relevant to them.

27. Does the Bank of Slovenia also conduct such reviews itself?

The Bank of Slovenia does conduct stress tests twice a year (except in 2013 when it engaged independent providers for this purpose), and it regularly conducts AQRs, albeit smaller in scope and detail.

28. Why are the stress tests conducted in past years not sufficient? Why did we require additional stress tests?

It is normal banking supervision practice to have various stress tests conducted. The economic environment changes constantly, which is why scenarios are defined anew for each stress test, meaning that the most probable changes to the macroeconomic environment are determined. In so doing, the response of the banks/banking system to such changes is ascertained. Various stress situations are tested, while the calculation of the effects of the scenarios can take account of the impact of the change of a single factor at a time or the overall impact of several factors on the performance of an individual bank (e.g. the bank’s response to changes in real estate prices, a fall in interest rates, reduced exports, a deterioration in the credit portfolio, a deterioration in the liquidity position, etc.).

29. What are the differences between the results of the tests conducted by the Bank of Slovenia and those that have just been completed?

The results of the stress tests cannot be directly compared, because they were based on different assumptions. The stress test just completed took account of the liquidation value of real estate, and not the market value, while the creditworthiness of debtors was assessed based on the new EBA standard that now applies for all EU Member States.

30. Why must the Slovenian banking system go through a process of restructuring that is conducted by international institutions?

The European Commission was obliged (pursuant to legislation) to express its opinion on the appropriateness of the transfer non-performing bank assets to the Bank Asset Management Company (BAMC). The Brussels-based Directorate-General for Competition of the European Commission suspended the transfer process a while ago so as to verify the value of all bank assets envisaged for transfer and to prevent banks from receiving state aid for which they were not eligible. For this reason the quality of bank assets needed to be verified and stress tests conducted before the transfer of assets to the BAMC.

31. Will similar tests also be performed in other countries?

The single supervisory mechanism (SSM) in the euro area is expected to bolster supervision of the banking sector. With the introduction of the SSM next year, similar stress tests and AQRs will also be conducted in other euro area countries (130 banks). These tests will, however, not be directly comparable to those just completed in Slovenia because the changing economic situation will almost certainly warrant the use of different assumptions about economic developments.

32. Will the entire methodology used be published and explained?

The methodology report is an integral part of the final (published) report.

33. How was equal treatment of all banks ensured during stress testing?

Equal treatment of all banks during stress tests was ensured by using a single methodology for the AQR and stress tests, which was regulated by the signing of the Terms of Reference (TOR). The entire process of conducting the stress tests was supervised by international institutions.

34. Which banks were included in the AQR and STs?

The AQR included the following banks (ten banks or 70% of the assets of the banking system): NLB d.d., NKBM d.d., Abanka Vipa d.d., Banka Celje d.d., Gorenjska Banka d.d., Probanka d.d., Factor banka d.d., Raiffeisen banka d.d., Hypo Alpe-Adria-Bank d.d., and UniCredit banka d.d. The stress tests included eight banks (excluding Factor banka and Probanka, which have been undergoing an orderly wind-down process since the autumn of 2013).

35. Why weren't all banks in Slovenia included?

Conducting the AQR and STs requires the participation of extensive financial and human resources both on the part of the contractors and the banks themselves. For this reason the Bank of Slovenia in conjunction with international institutions designated ten banks based on three criteria: share of risk weighted assets (size), capital adequacy, share of defaulters (non-performing loans). The banks chosen on the above basis make up a representative sample of the banking system, which is why it is possible to draw conclusions from the results as to the situation in the entire Slovenian banking system. The banks not included in the review will be reviewed by the Bank of Slovenia as part of its regular supervisory function.

36. Who determines the final size of the required capital increase?

The size of the capital increase for an individual bank will be determined by the Bank of Slovenia based on calculations performed in the stress tests, and the individual banks will be required to submit an action plan for the capital increase. In the case of banks that had already received state aid (NLB and NKBM) or requested it (Abanka), the Bank of Slovenia immediately determined the size of the required capital increase that will be provided by the Republic of Slovenia.

37. What do these results mean for owners of hybrid instruments (subordinated bonds, etc.)?

Based on the results, the Bank of Slovenia will make a decision within the scope of its statutory powers as to the measures it will take for each bank. In so doing, it will take particular account of the ability of the bank and its owners to take measures to stabilise the bank in due time, including a capital increase. The use of emergency measures, including the possibility of winding-up or the conversion of the bank's subordinated bonds, is solely envisaged as a measure of last resort to be taken in cases where a bank (and its owners) are unable to apply other solutions for the restructuring of the bank. Another condition for taking such measures is that in the absence of such measures the bank would have its authorisation to provide banking services withdrawn, and the subsequent bankruptcy of the bank could threaten the stability of the financial system. In such an event, the position of all of the bank's creditors, its depositors in particular, would be significantly worse, while the holders of subordinated debt would most probably not be repaid.

II. SHORT-TERM MEASURES

38. What will happen to banks after the comprehensive review?

The independent bank asset quality review and the stress tests will reveal the capital requirements of the Slovenian banking system and individual banks included in this review. At banks where the tests reveal a deficit in available capital relative to the capital requirements and where based on their reorganisation plan it will at the same time be determined that they can establish conditions for the long-term viability of their performance by an appropriate deadline, measures will be taken to strengthen their stability.

39. What are/will be the implications of the stress test results for the banks?

Banks whose stress test results will reveal capital inadequacy will have to prepare a reorganisation plan as soon as possible; the plan will have to include a description of the measures to eliminate capital inadequacy, including measures under the

Government Measures to Strengthen the Stability of Banks Act (ZUKSB), a definition of the deadlines by which the measures will be carried out and an estimate of the costs of implementing these measures.

40. What are the next steps that individual banks/bank groups should take?

Depending on the results of the independent bank asset quality review and the stress tests, the banks included in this review will be classified into four groups. The first group will include banks whose stress test results reveal sufficient capital adequacy, without the need for any capital increase.

The second group will include banks for which it was known even before the review that they would receive state aid (capital increases) in accordance with the ZUKSB. These banks have already prepared a reorganisation plan that will be complemented depending on the test results, including with measures that envisage the participation of owners and holders of subordinated financial instruments in covering the bank's loss.

The third group will include banks whose independent asset quality review and stress tests will reveal a deficit in available capital relative to the capital requirements. These banks will also have to prepare a reorganisation plan that will include a description of the measures to eliminate capital inadequacy. If the required additional capital is not provided by private investors, these banks will also be granted state aid in accordance with the relevant rules. The latter means that the banks' losses will be covered first and foremost by its shareholders and holders of subordinated financial instruments.

The fourth group will include banks already in the process of orderly wind-down.

Banks that were excluded from the aforementioned tests will have to close their 2013 balance sheets by applying the methodology used in the asset quality review (AQR) and the stress tests. If the tests reveal a capital deficit, they will also have to disclose it at the end of the year.

41. How has the bank restructuring process taken place to date and how it will take place in the future?

To date, all of the processes of restructuring banks under partial government ownership have taken place by increasing the banks' capital, whereby the majority of funds have been provided by the government from the revised state budget. In contrast to the partial capital increases to date, on this occasion a comprehensive and independent estimate of the capital needs was performed before implementing the measures to increase banks' stability, which will improve financial market confidence.

In 2012 the Government Measures to Strengthen the Stability of Banks Act (ZUKSB) was adopted to preserve the stability of the financial system in Slovenia. The measures defined in the ZUKSB will also be used as part of the current restructuring of the banking system; they refer to the purchase or takeover of bank assets in return for consideration, government guarantees for strengthening bank stability and for increasing the original capital of banks, and the paying-up of other capital instruments issued by a bank that are taken into account in the calculation of a bank's original paid-up share capital in accordance with the law governing banking. With the recent amendment of the law governing banking, in the event of bank restructuring the banks' losses will have to be fully covered first and foremost by its shareholders and holders of subordinated financial instruments, which will decrease the need for state aid in the future. In addition, the law also envisages a gradual government withdrawal from direct bank ownership, which will further reduce the probability of the government having to participate in any further bank restructuring.

42. How much will bank restructuring cost?

The cost of restructuring the banking system depends on the stress test results, which will identify the deficit in available capital relative to the capital requirements. The ZUKSB defines several measures for strengthening bank stability, which have various financial impacts on the state budget. In addition, any banks' losses will have to be fully covered first and foremost by bank shareholders and holders of subordinated financial instruments which will reduce the budget funds required for restructuring the banking system.

When the size of the required capital increase is known, a fast capital increase will be required to prevent the lack of confidence in the banking sector from growing. A fast capital increase requires sufficient available funds and a clear legal basis for their use and acquisition. Slovenia has ensured this flexibility by adopting amendments to the Public Finance Act, which enables the following for the purposes of implementing the necessary measures: (i) additional borrowing, (ii) allocation of existing assets without a prior budget revision and (iii) a capital increase via a non-cash contribution.

Another measure for strengthening bank stability is also the transfer of non-performing claims to the BAMC. The BAMC will issue government-guaranteed bonds to finance the purchase of bank claims, which are valued at real economic value for the purposes of the transfer. The majority or all of the borrowing is expected to be refunded through the professional management of the transferred assets and the proper assessment of the transfer value.

43. In which cases will state aid / capital increases be required?

A bank whose stress test results reveal a deficit in available capital relative to the capital requirements will be required to draw up a reorganisation plan. Measures envisaged by the ZUKSB, which entail state aid, could be part of such a plan. A bank is eligible for such measures if the reorganisation plan makes it evident that it is capable of independent viable performance without further state aid in the future. If a bank is not capable of independent viable performance, measures on the basis of the ZUKSB may be taken for the purpose of orderly wind-down.

The decision to use measures envisaged by the ZUKSB is adopted by the Slovenian government, taking into account the importance of the bank in question to financial stability, the burden of risk items on the bank itself, the urgency of measures to ensure the bank’s capital stability, and the most effective and efficient use of the resources of the Bank Stabilisation Fund at the disposal of the BAMC. The government adopts the aforementioned decision on the basis of the proposal by inter-departmental committee specified in Article 20 of the ZUKSB.

44. Will renewed borrowing be required for the purposes of capital increases?

In connection with the current process of strengthening and restructuring the banking system, it is assessed that there will be no need for additional borrowing to realise the measures set out by the ZUKSB. In the case of capital increases at banks via bonds, the public debt will increase. The public debt will also increase with the issue of BAMC bonds, which will bear a government guarantee.

45. Where will the government get the money for capital increases? Will it come from taxpayers?

The majority of the funding for measures set out by the ZUKSB (e.g. an increase in a bank's original capital) comprises Slovenian government deposits at commercial banks and the proceeds of Slovenian government bond issues. Government money will also be refunded to a certain extent via the sale of participating interests in the banks.

46. Will the banks have to provide capital with regard to the baseline scenario or the adverse scenario? Why is that?

The aim of the stress tests is to assess the potential capital needs of the Slovenian banking system and individual banks under a baseline scenario and an adverse scenario. The banks will have to cover any deficit in available capital under the adverse scenario, which assumes a further deterioration in the macroeconomic situation in Slovenia. The reason for applying this scenario is to provide a robust and reliable assessment of the Slovenian banking system in an adverse, albeit hypothetical, situation.

47. What conditions must be met for a bank to obtain state aid / a capital increase?

The government measures to strengthen bank stability and the conditions for the approval of such measures are set out in the ZUKSB. The measures aimed at strengthening bank stability include the purchase or takeover of bank assets in return for consideration, government guarantees for strengthening bank stability and increasing the original capital of banks, and the paying-up of other capital instruments issued by a bank that are taken into account in the calculation of a bank's paid-up share capital in accordance with the law governing banking. As stated above, the decision to use measures envisaged by the ZUKSB is adopted by the Slovenian government, taking into account the importance of the bank in question to financial stability, the burden of risk items on the bank itself, the urgency of measures to ensure the bank's capital stability, and the most effective and efficient use of resources. In addition, it should be noted that new European Commission rules on eligibility for state aid for banks in distress have been in force since 1 August 2013, and stipulate that state aid cannot be given unless equity, hybrid capital and subordinated debt instruments are contributing in full to offsetting any losses (burden sharing). State aid must be approved in advance by the European Commission.

48. Are the banks' capital needs the same as the capital increases? If not, what is the difference?

Yes, the banks' need for additional capital to ensure minimum capital adequacy is equal to the requisite capital increase. The decision on the amount of the capital increase is explained in detail in subsequent answers.

49. What has the Bank of Slovenia been doing for all these years, if it now needs foreign experts to identify that bank performance has been inadequate?

Since 2005 the Bank of Slovenia has conducted stress tests as an integral part of its regular supervisory process, although they have primarily served for internal use by the supervisor. After being discussed by the Governing Board of the Bank of Slovenia, the results of the stress test are presented to the banks with the aim of drawing attention to their sensitivity to individual types of potential shock, and have been directly applied as one of the indicators of the risk profile of the particular bank, and thus as the basis for determining higher capital needs for the bank. The Bank of Slovenia conducted its most recent stress tests in 2012, using a macroeconomic scenario based on forecasts for developments in macroeconomic aggregates in 2013 and 2014.

Under European Commission state aid rules, the capital deficit is determined by means of an asset quality review and stress tests. In other countries where state aid measures have already been taken, the tests were conducted by independent external contractors. Asset quality reviews and stress tests will be conducted at banks in other EU Member States, for instance for the purpose of establishing a banking union. To ensure that the results are comparable, the methodology for these reviews is set out by the ECB.

50. Why did the Bank of Slovenia not embark on comprehensive reviews of individual banks (when it became clear that bank undercapitalisation and private sector indebtedness would see the financial crisis continue)?

The Bank of Slovenia has conducted stress tests as an integral part of its regular supervisory process since 2005. The independent asset quality review and the stress tests are the result of the June 2013 Recommendation for a Council Recommendation on Slovenia's 2013 National Reform Programme and delivering a Council Opinion on Slovenia's Stability Programme for 2012-2016, which recommended an independent asset quality review and stress tests for the restructuring of the Slovenian banking system to continue. The Bank of Slovenia therefore embarked on the independent review in August 2013, in conjunction with the Ministry of Finance, and it represents a major element of the process of strengthening and restructuring the Slovenian banking sector.

51. Approach to bank recapitalisation

The state aid rules for measures to support banks during the financial crisis were adopted on the basis of Article 107 of the Treaty on the Functioning of the European Union, which exceptionally allows state aid to rectify serious disruptions to the economies of EU Member States. The European Commission can approve recapitalisation measures and measures for impaired assets when the Member State proves that it has previously used all measures to limit aid to the lowest possible amount.

The new Banking Act (ZBan-1L) allows holders of hybrid and subordinated instruments to contribute to bank rescues by means of forcible write-downs or conversion of the instruments. The ZBan-1L introduces a mechanism for securing a bank's capital by using private funds, namely the assets of the bank's shareholders and certain categories of creditors, thereby reducing the requirement for public funds to rescue banks in difficulty. Before any government-funded capital increases, a bank's qualified liabilities will either be written off or converted into the highest-quality form of capital, i.e. ordinary shares. The decision depends on the results of the asset quality review. The remainder of the capital deficit will be covered by the government by means of cash contributions (including conversion of deposits) or by bond payments.

The table below gives the amounts of the capital increases and the write-downs at the banks already known to be future recipients of state aid under the ZUKSB.

Bank	**Total capital increase**	**Capital increase via cash**	**Capital increase via bonds**	**Contribution by holders of qualified instruments**	**Overall capital adequacy**
NLB d.d.	1.551	1.140	411	257	15,0 %
NKBM d.d.	870	619	251	64	16,8 %
Abanka d.d.	591	348	243	120	20,5 %

The basis for determining the amounts of the capital increases is the results of the stress tests under the adverse scenario (the scenario of a pronounced increase in macroeconomic imbalances) for the three-year projection period (2013-2015). The capital increases will be carried out in an amount that ensures that a CT1[1] capital ratio of 6% would be met by the end of 2015 should the adverse scenario be realised. As a result of this approach, immediately after the capital increase the CT1 capital ratios under the bank reorganisation plan will be significantly higher than 6%, an additional indication of the robustness of the measures adopted, and are expected to remain so.

[1] CT1: Core Tier 1, a bank's highest-quality capital.

III. LONG-TERM MEASURES TO PREVENT THE SITUATION RECURRING

52. How will the Bank of Slovenia and the Ministry of Finance ensure that the situation does not recur?

In addition to the short-term measures aimed at restoring bank stability, a range of other measures to ensure the safety and solidity of the financial system in the long term are also envisaged.

The key long-term measures that have already been adopted include:

- an expansion of the Bank of Slovenia's powers to act, particularly in the event of breaches and risks in managerial practice at banks;
- strengthening of supervisory measures, including the power to enforce burden sharing in a bank restructuring by the bank's owners and creditors;
- a more-precise definition and strengthening of the Bank of Slovenia's everyday supervisory powers;
- debt-to-equity conversions for easier corporate restructuring.

The following long-term measures are planned:

- the establishment of a financial stability committee to be responsible for formulating macroprudential policy in Slovenia, which will contribute to protecting the stability of the entire financial system, including increased robustness in the financial system and the prevention or reduced accumulation of systemic risks. This will ensure that the financial sector makes a lasting contribution to economic growth;
- the use of a new supervisory model, based on the separation of prudential supervision and supervision of the conduct of market participants. Prudential supervision will pursue the supervision of all risks, while supervision of the actions of market participants is aimed at protecting users of financial services via the use of good practices;

- the gradual withdrawal of the government from direct ownership of the banks by means of the privatisation of the government-owned banks and the introduction of more effective governance;
- the initiation of extra-judicial measures to restructure large and medium-size enterprises that are facing imminent bankruptcy;
- incentives for household lending.

53. Do you envisage any new legislation or amendments?

Legislation is always tailored to developments in society. To ensure the long-term stability of the financial system, several regulations have been adopted or amended recently that in the long term will introduce additional assurances of long-term financial stability, while specific normative acts are still in the process of being adopted or are being planned.

To strengthen the legal framework for bank management and supervisory bodies, autumn 2013 saw the adoption and amendment of the Regulation on the diligence of members of the management boards and supervisory boards of banks and savings banks[2], which transposes the EBA guidelines[3] on the assessment of the suitability of members of the management and supervisory body and key function holders, while the Regulation on the documentation for proving that the conditions for holding office as a member of the management boards of banks and savings banks[4] was issued at the same time.

This year has also seen the adoption of the new Financial Conglomerates Act,[5] which has partly implemented Directive 2011/89/EU of the European Parliament and of the Council of 16 November 2011 amending Directives 98/78/EC, 2002/87/EC, 2006/48/EC and 2009/138/EC as regards the supplementary supervision of financial entities in a financial conglomerate.

The Macroprudential Supervision Act is also before the National Assembley, and will regulate the status, powers, responsibilities and operation of the financial stability

[2] Official Gazette of the Republic of Slovenia, Nos. 62/11 and 74/13.
[3] EBA/GL/2012/06 of 22 November 2012.
[4] Official Gazette of the Republic of Slovenia, No. 74/13.
[5] Official Gazette of the Republic of Slovenia, No. 56/13 (ZFK-B).

committee, the implementation of macroprudential supervision in Slovenia, and the tasks and operation of the relevant institutions and bodies in the area of prudential supervision once approved.

A new banking act is expected to be adopted by autumn 2014, and the transposition of the latest directive on the supervisory framework for financial services[6] is also planned.

In addition, at EU level two more directives are in the process of being adopted, and will be transposed into Slovenian law after adoption in accordance with the approved timetables. They are a draft directive establishing a framework for rescuing and restructuring credit institutions and investment firms, and a draft directive on deposit guarantee schemes.

In the long term, reform of the supervisory model is envisaged to introduce the separation of prudential supervision and supervision of the actions of market participants. It is expected to be enacted in 2016 with the new laws governing insurance, banking and the market in financial instruments.

54. What role will the Slovenian Sovereign Holding Company Act and governance at the banks under government ownership have in the process of restructuring the banking system?

The Slovenian Sovereign Holding Company Act (ZSDH) was adopted in 2012. It is based on the transfer of investments owned by the Republic of Slovenia to the Slovenian Sovereign Holding Company (SSHC). Until the establishment of the SSHC, which is to be achieved by means of the conversion of Slovenska odškodninska družba (SOD), the majority of government-owned investments are still managed by SOD.

The purpose of this governance structure is to separate the function of the government as the owner of capital investments from other functions of government, thus preventing conflicts of interest, distortions of competition and unequal treatment

[6] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.

of companies. The concentrated management of investments is also very important, with the aim of achieving stable ownership, optimising management costs and maximising the return and value of these investments over the long term to achieve the commercial and development objectives and the public-interest objectives.

To achieve the efficient management of the investments, the proposed arrangements pursue the objective of the clear segregation of powers and responsibilities and constraints on the risk of corruption. The sustained increase in the value of the investments, the maximisation of returns for the owners and other potential objectives are to be achieved by pursuing an Investment Management Strategy, and by following Slovenian and international guidelines for good practice in the management of government-owned investments and corporate governance in general.

The government-owned investments managed by SOD include participating interests in banks, which will further increase with the implementation of measures to strengthen bank stability.

55. Do you intend to sell off the banks under government ownership?

In accordance with Article 38 of the Slovenian Sovereign Holding Company Act, the National Assembly gave its consent this year to the sale of investments owned by the Republic of Slovenia, i.e. Kapitalska družba pokojninskega in invalidskega zavarovanja, Slovenska odškodninska družba, Modra zavarovalnica, DSU, družba za svetovanje in upravljanje and Posebna družba za podjetniško svetovanje. Sales procedures have either already begun or will begin at 15 companies, one of which is also a government-owned bank (NKBM).

Over the coming years, the government will gradually withdraw from the ownership of other banks in accordance with the prescribed procedures and rules. The objective of the sale is to attract a strategic investor that will enable the long-term viability of individual banks.

56. How will the BAMC manage the transferred assets and non-performing claims?

One of the measures for strengthening bank stability that is laid down in the ZUKSB is the transfer of assets to the Bank Asset Management Company (BAMC). The BAMC will thus acquire – in return for consideration – bank assets that are rated D or E pursuant to the regulation governing the assessment of credit risk losses of banks and savings banks and claims against creditors that are not settling their liabilities to the bank within the agreed deadlines as established in the comprehensive review.

The transfer of the aforementioned assets, which represent major risk for the banks, will make bank balance sheets more transparent. Non-performing loans will be replaced by risk-free bonds of the BAMC guaranteed by the government, which will reduce capital requirements.

An additional advantage of the BAMC is the concentrated management of assets, as the BAMC will become the majority lender or owner of individual companies. This will also facilitate corporate restructuring, because protracted and inefficient negotiations between different banks that each pursue their own interests will be avoided. As part of the debt restructuring, the BAMC will assess the independent viability of companies, which it will do based on detailed analysis of the companies' business strategies. The restructuring will have to follow the rules on state aid set by the European Commission.

The BAMC must manage the assets according to the principle of the due diligence of a good manager and the corporate governance principles set out in international standards. When managing and disposing of assets, the BAMC must pursue the objective of maximising value and exiting investments as soon as this is possible under acceptable commercial terms. The BAMC may sell assets when favourable commercial terms have been achieved, whereby it must strive to attract new owners who can contribute to the development of the Slovenian economy with their expertise and experience.

57. How are bank assets classified? Which categories are they classified into and what do individual categories mean?

A bank must classify its financial assets (claims) into categories according to the level of risk in accordance with the Regulation on the assessment of credit risk losses of banks and savings banks.[7] The ratings classification is based on the assessment of the debtor's ability to settle its liabilities to the bank upon maturity as well as the assessment of the quality of collateral. Financial assets are classified into Categories A through E based on an assessment and evaluation of the debtor's ability to settle its liability to the bank upon maturity, which is ascertained based on an assessment of an individual debtor's financial standing, its ability to secure a sufficient cash flow for the regular settlement of liabilities to the bank in the future, the types and amount of collateral for the financial asset of an individual debtor and the settlement of liabilities to the bank in the past.

Detailed conditions for the classification of a bank's financial assets are laid down in Article 13 of the aforementioned regulation. Assets that are suitable for transfer to the BAMC are assets that a bank can classify into Categories D or E as well as claims against debtors that were established in the asset quality review as unable to settle their liabilities within contractual deadlines. Financial assets classified into Category D are claims against debtors who pay their liabilities 90 to 180 days in arrears, and occasionally 181 to 360 days in arrears, who are insolvent, for whom an application for the initiation of composition or bankruptcy proceedings has been lodged with the competent court or who are undergoing composition or bankruptcy proceedings.

Financial assets classified into Category E are claims against debtors that have the same attributes as debtors whose financial assets and/or commitments have been classified into Category D, but for whom it is assessed that the claims against them will not be repaid, those with a disputed legal basis or those that pay their liabilities more than 360 days in arrears.

[7] Official Gazette of the Republic of Slovenia, Nos. 28/07, 102/08, 3/09, 29/12 and 12/13.

IV. ACCOUNTABILITY

58. Did the Bank of Slovenia find any irregularities or unlawful acts at banks that underwent the AQR or stress tests?

Yes.

59. If yes, what measures will you take?

When fulfilling its duty of reporting criminal offences to prosecution authorities, the Bank of Slovenia acts in accordance with the provisions of the Criminal Procedure Act. It is obliged to report criminal offences for which the offender is prosecuted *ex officio* if it is informed of such offences or learns of them in any other way.

Pursuant to the Banking Act, the Bank of Slovenia cooperates with other competent authorities and institutions, i.e. the Police, the National Bureau of Criminal Investigation, the State Prosecutor's Office, the Commission for the Prevention of Corruption, etc.

The Bank of Slovenia is also a misdemeanours authority that rules on offences and imposes fines pursuant to the Banking Act and other acts in its sphere of competence (primarily the Payment Services and Systems Act and the Consumer Credit Act).

Pursuant to Article 11 of the ZUKSB, the BAMC must – based on violations found in audits – communicate a petition to the competent court within three business days for the latter to issue an interlocutory injunction to prevent the disposal of the offender's property. In the procedure for taking evidence, the owner must prove the acquired ownership within six months of the expropriation. Unproven assets from unlawfully gained material benefits become resources for the restructuring of non-performing investments at banks. Article 33 of the ZUKSB stipulates that the members of the board of directors of the BAMC are obliged to report to the responsible authorities in an appropriate manner without delay any suspicion of criminal activity by members of the management and supervisory bodies of banks and bank supervisory authorities that they learn of in the course of their duties, particular when reviewing credit files.

In addition to the above, the most recent amendment of the Banking Act (ZBan-1L) contains certain measures for the assurance of accountability that will enable prosecution authorities to discharge their powers more effectively, i.e. those relating to the prosecution of criminal offences committed in the area of banking operations. This amendment of the act now gives a clearer definition of the exemptions from the obligation to protect confidential information if a bank is disclosing information to the relevant authorities on the grounds of a suspected criminal offence. Similarly to the ZUKSB, the ZBan-1L also extends the general statute of limitations periods relating to criminal liability and liability for damages associated with holding office as a member of a bank’s management or supervisory body to four times their previous length, and stipulates that a special administration must immediately inform the Bank of Slovenia, the Commission for the Prevention of Corruption and law enforcement authorities of any suspected corruption and criminal offences that it detects or is informed of within the scope of its work.

In its special administration orders for Factor banka and Probanka, the Bank of Slovenia expressly charged the two special administration bodies with ensuring that any suspected criminal offence, especially on the part of former members of the management boards or supervisory boards of the banks, of which they learn when performing their function of special administration is reported to the competent authorities in an appropriate manner.

60. What about the other banks?

In the event of irregularities or unlawful acts being identified at any bank, the Bank of Slovenia will act in accordance with its statutory powers, which are explained in detail in the previous answer

61. What supervisory measures will be introduced by the Bank of Slovenia after the results of the AQR and stress tests are published?

The Bank of Slovenia will issue an order instructing banks to cover the capital needs arising from the findings of the stress tests.

62. Has the Bank of Slovenia already taken any measures? Has it filed any criminal complaints? How many has it filed?

Whenever the Bank of Slovenia has identified a suspected criminal offence when conducting prudential supervision, it has filed criminal complaints before the relevant prosecution authorities, which is evident from the attached table on the statistics on the criminal complaints filed with prosecution authorities over the last five years:

Table: Criminal complaints filed by the Bank of Slovenia by year

Year	Authority	Number of complaints
2013[8]	National Bureau of Criminal Investigation / Ministry of the Interior	**4**
	District State Prosecutor's Office	**1**
2012	Ljubljana Police Directorate	**1**
	National Bureau of Criminal Investigation	**3**
2011	District State Prosecutor's Office in Ljubljana	**2**
	District State Prosecutor's Office in Maribor	**1**
2010	Ljubljana Police Directorate	**1**
2009	Office of the State Prosecutor General of the Republic of Slovenia	**1**
TOTAL		**14**

In addition to the above complaints filed with the prosecution authorities directly by the Bank of Slovenia, in its reviews the Bank of Slovenia also identified examples of bad practice in governance and decision-making where criminal offences could possibly have been committed. In several cases during its supervision of banks the Bank of Slovenia has imposed a measure ordering a bank to conduct a special investigation with the aim of ascertaining damage and criminal offences in the bank's operations, and any criminal liability on the part of individuals, and to take the requisite action based on the findings.

[8] Data until 30 September 2013

63. **Will you disclose irregularities and unlawful acts identified at NLB, NKBM and Abanka?**

The stress tests and comprehensive reviews did not attempt to identify violations of regulations at banks in connection with individual transactions, which is why it will not be possible to directly draw conclusions with regard to irregularities or individual liability on this basis. In cases of violations identified in ordinary supervision at banks that in its opinion show signs of a criminal offence having been committed, the Bank of Slovenia will file the relevant criminal complaints or notify the relevant authorities of such findings as it did in such cases up until now.

64. **Will you require suspicious transactions/operations/loans to be clarified and explained before the capital increase?**

The investigation of potentially suspicious transactions can only be carried out at individual banks by the competent authorities, and the Bank of Slovenia will continue to actively cooperate as it has to date with the aforementioned authorities in order to uncover all elements of a transaction and the persons responsible.