BANKA SLOVENIJE

BANK OF SLOVENIA

REPORT

ON SUPERVISION OF BANKING OPERATIONS IN THE YEAR 1998 AND THE FIRST HALF OF 1999

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In accordance with the third paragraph of Article 54 of the Law on the Bank of Slovenia (Official Gazette of the Republic of Slovenia, No. 1/91 – I) and Article 2 of the Decision on the Enforcement of Supervision of the National Assembly of the Republic of Slovenia on Operations of the Bank of Slovenia (Official Gazette of the Republic of Slovenia, No. 7/99), we hereby submit to the National Assembly of the Republic of Slovenia this Report on the Supervision of Operating Activities of Banks and Savings Banks in the year 1998 and the first half of 1999.

In our efforts to promote general stability of the banking system, and to encourage transparency of operations provided by banks and savings banks, as well as of products and services offered by them and standards they adhere to, we are releasing the Report to the general public.

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I. ENHANCING BANKING SUPERVISION

1. PRUDENTIAL SUPERVISION OF FINANCIAL INSTITUTIONS IN SLOVENIA

Three supervisory authorities conduct prudential supervision of financial institutions in Slovenia.

A number of supervisory authorities are responsible for individual segments of Slovenia's financial system. The Bank of Slovenia, the central bank of Slovenia with the primary role to look after monetary policy and the national banking system, is a primary supervisory authority. The responsibility for the execution of the Bank of Slovenia's supervisory function rests with Bank Supervision Department. The Department is authorised to supervise banks (including the Slovene Export Corporation – Banking Operations), and savings banks. Prudential supervision of savings and loan undertakings established prior to the entry into force of the new Law on Banking will gradually be taken over by the Bank Supervision Department of the Bank of Slovenia. Savings and loan undertakings have a transitional period of five years after the entry into force of the Law on Banking to align their operating activities with provisions laid down in the Law on Banking.

The Securities Market Agency is self-governing and independent in its decision-making and supervising of brokerage firms, management companies, investment funds, and some other institutions such as the Central Securities Clearing Corporation, the Ljubljana Stock Exchange, etc.

The Insurance Supervisory Authority of the Republic of Slovenia supervises insurance companies, re-insurance companies, and individual agents who engage in insurance-related activities, as well as some other institutions such as the Institute for Health Insurance – Voluntary Health Insurance Unit, the Supplementary Pension Fund, and the Slovene Export Corporation–Insurance Operations.

Unlike the Bank of Slovenia and the Securities Market Agency, the Insurance Supervisory Authority of the Republic of Slovenia is not an independent institution but it operates within the framework of the Ministry of Finance.

To facilitate the comparison of the scope of supervisory activities, the figures relevant to the size of individual segments of the financial system are given below.

Total assets of banks and savings banks accounted for 73% of GDP at end-1998.

At the end of 1998, there were 24 banks in Slovenia with total assets of SIT 2,350 billion, and 6 savings banks with total assets of SIT 9.5 billion. The share of aggregate total assets of banks and savings banks in Slovenia's gross domestic product (hereinafter referred to as GDP) was 72.8 per cent as at 31 December 1998. If total assets of savings and loan undertakings are added, then the percentage rises to 74.1 per cent of GDP. Prudential supervision during the period under review was conducted by 38 employees working in the Bank Supervision Department operating within the framework of the Bank of Slovenia.

At the end of 1998, the Securities Market Agency supervised 42 brokerage companies[1] , 23 management companies, 46 authorised investment funds, and

[1] 10 banks authorised for trading operations with securities are included in the figure.

15 mutual funds. Audited data for the year ended 31 December 1998 show that brokerage companies had SIT 108.9 billion in own assets (3.4 per cent of GDP), SIT 13.1 billion in assets under management (0.4 per cent of GDP), and SIT 416.5 billion in agency business (12.8 per cent of GDP). Total assets of authorised investment funds in the amount of SIT 593 billion accounted for 18.3 per cent of GDP (including unutilised privatisation vouchers), while total assets of mutual funds equalled SIT 4 billion at the end of 1998 and accounted for 0.1 per cent of GDP.

At the end of 1998, the Securities Market Agency had staff of 23 persons.

The figures for the insurance sector recorded at the end of 1998 reveal that 10 insurance companies operated in Slovenia plus the Institute for Health Insurance, the Supplementary Pension Fund, the Slovene Export Corporation, three re-insurance companies, and 235 small companies and agents were engaged in insurance-related business. Supervising of the insurance sector was carried out by 8 employees working in the Insurance Supervisory Authority of the Republic of Slovenia. Total assets of 10 insurance companies, the Institute for Health Insurance, and the Supplementary Pension Fund (excluding the Slovenian Export Corporation) according to unaudited data reported on 31 December 1998 amounted to SIT 179 billion, or 5.5 per cent of GDP. Increased by total assets of three re-insurance companies, aggregate total assets according to unaudited data reported on 31 December 1998 amounted to SIT 217 billion.

Table 1: Number of financial institutions in Slovenia

Type of financial institution	31 Dec 1995	31 Dec 1996	31 Dec 1997	31 Dec 1998
Banks	33	31	28	24
Savings banks	10	7	6	6
Savings and loan undertakings	72	71	70	70
Brokerage companies*	44	46	43	42
Management companies	28	26	26	23
Investment funds	68	72	60	46
Mutual funds	18	15	15	15
Insurance companies**	12 +2	12 +2	12 +2	10 + 3
Re-insurance companies	2	2	2	3

* Including 10 banks authorised to carry out transactions involving securities trading.

** The added figure refers to the Institute for Health Insurance, the Slovenian Export Corporation, and for the year ended 31 December 1998 the figure includes the Supplementary Pension Fund.

Source: The Bank of Slovenia, the Securities Market Agency, the Insurance Supervisory Authority of the Republic of Slovenia

2. REVIEW OF COMPLIANCE WITH THE CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

Core Principles set standards for banking regulators and supervisors.

The core principles for effective banking supervision (hereinafter referred to as: “the Core Principles”) have become the most important global standard for regulations and supervision of safe and sound bank operations. The Core Principles which represent minimum requirements for the implementation of effective banking supervision and consequently a basis of evaluation of the effectiveness of banking supervisory regimes are a result of the work of the Basle Committee and bank supervisory authorities from other (non-G-10) countries.

The need for the strengthening of banking supervision became even more obvious after a number of financial crises in the past few years of which the underlying cause were, in the opinion of the majority, the weaknesses in the banking systems of individual countries. As the banking and broader financial crises are not limited only to the country which represents the centre of such crisis but may also affect all other countries in the area, the monitoring of banking systems and early detection of signs of crisis has become of key importance to the supervisors. All countries, either developed or those in transition or under development, must strive for an early and thorough implementation of the Core Principles and therefore for an effective application of internationally recognised and proven methods of supervision, which represents the best precautions for the purpose of ensuring banking systems safety and stability.

The adoption of financial reforms and the development of an effective banking supervision are two processes whose implementation takes a longer period of time. Nonetheless, the supervisory bodies must find the deficiencies in their supervisory systems without delay, identify the most problematic ones and finally strive for the adoption of all necessary measures in order to eliminate such deficiencies.

The Core Principles may be divided into seven chapters:

I. **Preconditions for Effective Banking Supervision** (1 principle)
II. **Licensing and structure** (4 principles)
III. **Prudential Regulations and Requirements** (10 principles)
IV. **Methods of Ongoing Banking Supervision** (5 principles)
V. **Information Requirements** (1 principle)
VI. **Formal Powers of Supervisors** (1 principle)
VII. **Cross-Border Banking** (3 principles)

To assess current situation and convergence with Core Principles is the first step

The first step to a full Core Principles implementation in each country is the estimation of the current situation regarding the level of harmonisation of a country’s banking regulations and supervisory system with these principles, This estimation serves as a basis for the adoption of measures aimed at eliminating the discrepancies, i.e. deficiencies within the existing regulations and banking supervision. The compliance assessment may be made by the countries themselves or by various outside assessors (e.g. the World Bank, International Monetary Fund).

In less than two years which have passed since the publication of the Core Principles[2] , a need arose for the preparation of en even more precise methodology of their implementation. As a matter of fact, the Core Principles should allow a certain degree of flexibility in the planning and implementation of the concrete action necessary for their practical implementation; however, their interpretation must be at least basically uniform. The very nature of the Core Principles requires a qualitative estimation of their implementation, which cannot be entirely objective. It should be borne in mind that the estimation of the Core Principle implementation is not an end in itself but represents a means for the attainment of a very important goal: the devising of a strategy of improvement of the banking supervision system.

Banking supervision shall be assessed in the light of macroeconomic indicators.

The preconditions for effective banking supervision include consistent and sustainable macroeconomic policies, a well developed public infrastructure, market discipline, procedures of successful solving of problems of banks, and mechanisms ensuring adequate protection from systemic risks. Although the compliance with the above-mentioned conditions cannot be influenced by bank supervisors, the deficiencies, i.e. the weaknesses in these areas may significantly reduce the possibility of effective core principle application. The estimation of the effectiveness of banking supervision therefore also requires a judgement of a country's broader macroeconomic environment.

The first assessment of the compliance with the Basle Core Principles in Slovenia was made at the time when the first banking legislation after gaining independence was still in force (the Law on Banks and Savings Banks). The compliance assessment was presented to the Governing Board of the Bank of Slovenia on 23 June 1998 and eventually incorporated in the Report on Supervision of Banking Operations in the Year 1997 and the First Half of 1998. Banks were notified about the progress made towards in the implementation of the Core Principles in a letter dated 14 October 1998. In line with provisions of the new Law on Banking, an updated assessment of the implementation of the Core Principles was made and submitted to the Governing Board of the Bank of Slovenia and included in the agenda of the session held on 24 August 1999. A comparison made between the first and the second convergence assessment with the aim to benchmark the progress achieved in the implementation and enforcement of core principles shows that convergence in sensitive areas gained momentum after the adoption of the Law on Banking and the passing of secondary legislation deriving from the Law. Certain differences arise from a more elaborate assessment methodology, which is more thorough and calls for more critical approach to the assessment of the degree of alignment of the banking regulatory framework and prudential supervision with individual principles.

In the majority of principles, which have been complied with to a large or limited extent in accordance with the applied methodology, the reasons for the lack of full compliance are mainly of an objective nature. These are the cases where a principle has been complied with on a declaratory level; however, its practical implementation is hindered by the factors like foreigners' restraints

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[2] The Core Principles were published by the Basle Committee in September 1997 and were endorsed by the international financial community during the annual International Monetary Fund meeting in Hong Kong in October 1997. In April 1998, the Basle Committee proceeded with the research of the Core Principles compliance level by individual countries. The research involved active participation of more than 120 countries, including Slovenia. The results of the research were the central topic of the discussion at the International Conference of Banking Supervisors which was held in Sydney in October 1998.

due to Slovenia's treatment as a "third" (i.e. non-EU) country, a short period of time given to banks after the enactment of the new legislation in order to adapt and implement individual provisions of the law, etc.

At all events, there is still a lot to be done in the sphere of preparations and practical implementation of the new secondary legislation in areas which are in our banks still under development or which have been subject to insufficient supervision so far (market and operational risks, consolidated supervision...). A review of the Principle compliance as an indicator of the actual situation in our banking system may serve as a reliable guideline for our future supervisory actions.

Compliance with the Core Principles shall guide banking supervisors.

2.1. Preconditions for Effective Banking Supervision

Principle 1(1): An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks.

Assessment:
Compliant. The Bank of Slovenia (hereinafter: BS) achieves the objectives defined by its mission by carrying into effect its competencies and responsibilities. The scope of BS activity is determined by the Law on the Bank of Slovenia, the Law on Banking and the relevant secondary legislation. An open andregular communication with commercial banks contributes to the broadening of ethical principles of operation at all decision-making levels, higher bank competitiveness and financial system stability.

Principle 1(2): Each such agency should possess operational independence and adequate resources.

Assessment:
Largely compliant. BS in an independent, autonomous institution which has the necessary financial resources in order to carry out its tasks and exercise its powers in the sphere of banking supervision, while the provision of adequate professional staffing represents a permanent problem due to a staff turnover and somewhat lower wages as compared with some other financial institutions. Nevertheless, the supervision department has been considerably strengthened by new professional staff.

Principle 1(3): A suitable legal framework for banking supervision is also necessary, including provisions relating to authorisation of banking organisations and their ongoing supervision.

Assessment:
Compliant. The Law on Banking governs the rules of licensing and supervisions of banking organisations and thus defines the framework of BS activities.

Principle 1(4): A suitable legal framework for banking supervision is also necessary, including... powers to address compliance with laws as well as safety and soundness concerns.

Assessment:
Compliant. A legal framework enabling BS supervision of the banks' compliance with the risk management rules and the adoption of measures in the event of violation of such rules is in place.

Principle 1(5): A suitable legal framework for banking supervision is also necessary, including... legal protection for supervisors.

Assessment:
Compliant. Legal protection of supervisors is based on the general principles of compensation law. However, BS has no additional security measures to protect its activities in the event of the defence thereof. By taking into consideration the legal practice and the rule of the law in the country, no additional security measures are necessary.

Principle 1(6): Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.

Assessment:
Largely compliant. The sharing of information between supervisors is legally regulated by the Law on Banking provisions relating to the co-operation between local and foreign supervisory bodies. A preliminary condition for such sharing of information is the obligation of protecting the confidentiality of such shared information. In practice, the sharing of information with foreign supervisory bodies is not satisfactory since BS has signed no co-operation agreements as a legal basis for such co-operation with foreign supervisors due to the various legal obstacles imposed by foreign authorities.

2.2. Licensing and Structure

Banking supervisors shall monitor how the name »bank« is used.

Principle 2: The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined and the use of the word "bank" in names should be controlled as far as possible.

Assessment:
Compliant. The Law on Banking clearly defines banking and other services and restricts the provision of banking services to banks, which is subject to BS licence as well as an ongoing BS supervision.

Principle 3: The licensing authority must have the right to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the banking organisation's ownership structure, directors and senior management, its operating plan and internal controls, and its projected financial condition, including its capital base; where the proposed owner or parent is a foreign bank, the prior consent of its home country supervisor should be obtained.

Assessment:
Compliant. BS issues banking licences, lays down detailed terms and conditions which must be complied with in order to obtain a licence, decides on the reasons for the rejection of applications or withdrawal of licences and in some cases has the right to withdraw the licence to a bank and/or its directors. The licensing process prevents the banks which are incapable of providing sophisticated financial transactions and unprepared to pursue prudential and fair banking operations from entering the Slovenian banking market. As far the licensing of foreign bank branches is concerned, the opinion of the competent supervisory authority, which estimates whether the organisation of such branch,

its management and financial position corresponds to its planned volume of transactions, is of crucial importance.

Principle 4: **Banking supervisors must have the authority to review and reject any proposal to transfer significant ownership or controlling interests in existing banks to other parties.**

Assessment:

Compliant. BS influences the management structure of banks by issuing licences for the acquisition of a qualifying holding. The law does not require the obtaining of the BS prior consent for the acquisition of a qualifying holding in banks or for the exceeding other statutory limits on holdings in capital or voting rights but sanctions the unlawful acquisition of shares by prohibiting the exercise of the voting rights resulting from such shares. In this way, BS effectively prevents situations of abuse of the voting rights based on the shares constituting a qualifying holding, by which a bank would be led to operate in opposition to the risk management rules, i.e. by which any supervision over such bank would be made impossible or considerably more difficult.

Principle 5: **Banking supervisors must have the authority to establish criteria for reviewing major acquisitions or investments by a bank and ensuring that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.**

Holding companies shall not expose banks to excessive risk or impede effective supervision.

Assessment:

Compliant. BS has an influence on the banks' investment policy by virtue of legal authority. Equity holdings in non-financial organisations and investments in real estate are restricted by law which also prohibits cross-shareholdings of banks and other financial institutions. Capital and management links among banks are subject to BS judgement in its decision to issue licences for the acquisition of a qualifying holding; this decision is based on two fundamental criteria: impact on the bank's operational risk and its supervision.

2.3. Prudential Regulations and Requirements

Principle 6: **Banking supervisors must set minimum capital adequacy requirements for banks that reflect the risks that the bank undertakes, and must define the components of capital, bearing in mind its ability to absorb losses. For internationally active banks, these requirements must not be less than those established in the Basle Capital Accord.**

Assessment:

Largely compliant. The setting of capital requirements for credit risk in Slovenia is in line with the international practice. Although the newly adopted Law on Banking also gives BS the authority to lay down capital requirements for foreign exchange and other market risks, BS has, for the time being, defined only the methodology of determining the capital necessary to offset foreign exchange risks. The application of the provisions concerning foreign exchange risks has been put off until 30 June 2000 since new capital requirements represent an additional burden for banks. A short transitional period thus enables the banks to adapt to the new requirements and gives them the possibility to set up the necessary information support which is indispensable to the daily monitoring of foreign exchange positions and risk valuation.

Capital requirements for market risks will be set by BS in the year 2000. A small volume of trading and consequently also the relating market risks in our banks for the time being does not justify the requirement for the use of a standardised model of monitoring of capital requirements relating to market risks and costly investments in information systems of banks, especially in view of the other new requirements that must be complied with by banks after the adoption of the new banking legislation. A consolidated supervision of capital and capital adequacy has also been regulated by the new Law on Banking, and its implementation is dependent upon the adoption of secondary legislation on consolidated supervision.

Principle 7: **An essential part of any supervisory system is the independent evaluation of a bank's policies, practices and procedures related to the granting of loans and making of investments and the ongoing management of the loan and investment portfolios.**

Assessment:
Compliant. The banks' policies, practices and procedures related to the granting of loans and making of investments are subject primarily to legal provisions and then to risk assessments and the possibility of obtaining collateral against such risks as required by the secondary regulations adopted by the Bank of Slovenia and finally to the banks' internal guidelines adopted for the purpose of operational safety and profitability. The same also applies to the current management of the loan and investment portfolios. Owing to a high proportion of lending in the overall operations of Slovenian banks, it is one of the major objects of on-site BS supervision.

Principle 8: **Banking supervisors must be satisfied that banks establish and adhere to adequate policies, practices and procedures for evaluating the quality of assets and the adequacy of loan loss provisions and reserves.**

Assessment:
Compliant. The implementation of policies, practices and procedures for evaluating the quality of assets is monitored by checking the reports received by BS from the banks and the examinations of banking operations. The same applies to the determining of adequacy of established specific provisions for risks to which the banks are exposed. There is a very close connection between legal requirements relating to the evaluation of the quality of claims and provisioning.

Principle 9: **Banking supervisors must be satisfied that banks have management information systems that enable management to identify concentrations within the portfolio and supervisors must set prudential limits to restrict bank exposures to single borrowers or groups of related borrowers.**

Assessment:
Compliant. By monitoring the loan portfolio management and by means of loan portfolio control, banking supervisors may become familiar with the adequacy of the banks' information systems which must enable them to identify concentrations of risks within the portfolios. Limitation of maximum exposures is in line with the international practice since the new Law on Banking also extended the monitoring of the exposure to groups of related borrowers and set the maximum limit of the sum of large exposures in respect

of the banks' capital. BS has a legal authority to carry out consolidated supervision, which will be implemented after the adoption of the relevant secondary regulation.

Lending to connected persons shall be at arm's length.

Principle 10: **In order to prevent abuses arising from connected lending, banking supervisors must have in place requirements that banks lend to related companies and individuals on an arm's-length basis, that such extensions of credit are effectively monitored, and that other appropriate steps are taken to control or mitigate the risks.**

Assessment:

Largely compliant. A restrictive treatment of loans granted to persons having a special relationship with the bank and persons connected to them is provided subject to a previous discussion of such lending by the banks' supervisory boards. The law itself as well as the relevant BS secondary legislation bind the banks to an effective monitoring of related-borrower lending and proper risk management. BS does not require the banks to implement any special procedure which would deprive them of the benefits derived from the preparation, i.e. granting of loan requests.

Principle 11: **Banking supervisors must be satisfied that banks have adequate policies and procedures for identifying, monitoring and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining appropriate reserves against such risks.**

Assessment:

Compliant. The country risk controlling procedures are subject to legal regulation, secondary legislation, the banks' internal regulations and BS supervision which determines whether the risk measurement and the relating provisioning rules are observed in practice.

Principle 12: **Banking supervisors must be satisfied that banks have in place systems that accurately measure, monitor and adequately control market risks; supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposures, if warranted.**

Assessment:

Materially non-compliant. BS has a legal authority to impose market risk-related capital requirements; however, BS has not yet exercised this option (with the exception of foreign exchange risks). Market risk supervision by BS is in place but lacks all the necessary elements. Owing to the Slovenian banks' small volume of trading activities, BS has issued recommendations for the carrying out of trading activities and laid down the method of marketable securities valuation within its current regulations. Additional training of supervisors in this area will be required in future.

Banks shall ensure ongoing comprehensive risk management policies and practices.

Principle 13: **Banking supervisors must be satisfied that banks have in place a comprehensive risk management process (including appropriate board and senior management oversight) to identify, measure, monitor and control all other material risks and, where appropriate, to hold capital against these risks.**

<u>Assessment:</u>
Largely compliant. The new Law on Banking regulates the monitoring of risks and the obligation of providing security against such risks. In addition to the secondary legislation of a compulsory nature which mainly relate to the quantitative risk management, BS also issued comprehensive recommendations to banks relating to credit, liquidity, interest, exchange and some other risks. The recommendations include essential qualitative elements which should be observed by the banks in the devising of their policies and procedures of controlling all kinds of risks and at the same time represent guidelines to supervisors in their work. For the time being, BS requires the banks to hold capital against credit risk only (capital requirement will also apply to the foreign exchange risk after 30 June 2000).

Principle 14: **Banking supervisors must determine that banks have in place internal controls that are adequate for the nature and scale of their business. These should include clear arrangements for delegating authority and responsibility: separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities, reconciliation of these processes: safeguarding its assets; and appropriate independent internal or external audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.**

<u>Assessment:</u>
Compliant. BS recommends and also requires the banks within its legal authority for the regulation of individual segments of banking operations to have in place fully and effectively organised internal control mechanisms. Within its managerial powers and responsibilities determined by law, the bank's management must see to the risk identification, monitoring and supervision, setting up of effective internal control procedures an their wide observance in the bank's day-to-day operations, and timely identification and analysis of adverse effects on banking operations. BS does not issue any secondary legislation regulating the internal audit operations; however, in the event of discovered irregularities within its supervisory actions, it requires the banks to set up effective mechanisms of internal supervision in accordance with the Law on Banking provisions. BS has also made recommendations to the banks for the setting up and implementation of internal control systems.

Principle 15: **Banking supervisors must determine that banks have adequate policies, practices and procedures in place, including strict "know-your-customer" rules, that promote high ethical and professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements.**

<u>Assessment:</u>
Compliant. In addition to the estimation of the banks' ethical and professional standards, BS primarily pursues the goal of setting up internal control and examines the findings of internal and external auditors. Various laws require BS to take appropriate action in the event of suspected money laundering and commitment of other criminal offences.

2.4. Methods of Ongoing Banking Supervision

Crucial combination of on-site and off-site supervision

Principle 16: An effective banking supervisory system should consist of some form of both on-site and off-site supervision.

Assessment:
Compliant. BS performs an integral banking supervision which consists of both on-site and off-site supervision which interact upon and complement each other. This is also the way in which the strategy of the Banking Supervision Department and its strategic goals are implemented.

Principle 17: Banking supervision must have regular contact with bank management and thorough understanding of the institution's operations.

Assessment:
Compliant. BS supervisors are aware that their permanent co-operation with the banks' management is not an obligation prescribed by law but a necessity which belongs to the standards of effective supervision. The supervisors' understanding of the bank's operations is a basis for taking preventive and corrective actions and measures.

Principle 18: Banking supervisors must have a means of collecting, reviewing and analysing prudential reports and statistical returns from banks on a solo and consolidated basis.

Assessment:
Compliant. The BS' legal authority to collect and review reports received from banks is defined in greater detail in secondary legislation with regard to deadlines, contents and reporting methods. Bank reports provide BS with a huge data base and the processing of such data into information designed for a specific purpose represents a basis for the understanding of the banks' situation and the taking of supervisory action when necessary. Consolidated reports on capital, capital adequacy, large exposures, unreconciled items and equity investments of non-financial organisations will follow after the adoption of the decree on the consolidated bank supervision.

Principle 19: Banking supervisors must have a means of independent validation of supervisory information either through on-site examinations or use of external auditors.

Assessment:
Compliant. BS obtains and validates the information on the banks' operations through on-site and off-site supervision. Once a year, the banks send in their audited annual reports. BS is thus independent in its validation of information obtained by means of the two original (on-site and off-site) supervisory methods and it entirely independent in the validation of information obtained from auditors' reports.

Essential role of consolidated supervision

Principle 20: **An essential element of banking supervision is the ability of the supervisors to supervise the banking group on a consolidated basis.**

Assessment:
Materially non-compliant. On the adoption of the decision on consolidated banking supervision, the parent bank will have to make up consolidated financial statements and provide consolidated prudential reports. The consolidated banking supervision is supplemented by the Law on Banking with the provision on the supervision of corporate borrowers connected to the bank. The supervision of foreign corporate entities connected to the bank is not yet possible in practice, primarily because of obstacles imposed by foreign legislation. Consolidated supervision is one of the most demanding tasks of banking supervision; therefore, supervisor training represents a priority activity in this area.

2.5. Information Requirements

Principle 21: **Banking supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with consistent accounting policies and practices that enable the supervisor to obtain a true and fair view of the financial condition of the bank and the profitability of its business, and that the bank publishes on a regular basis financial statements that fairly reflect its condition.**

Assessment:
Compliant. The legal and secondary regulation of dealing with the banks' operations from the accounting point of view represents a basis for the shaping of the banks' accounting policies and practices. BS supervision and external auditors check the consistency and regularity of applied accounting policies and procedures as well as the fairness and authenticity of the banks' financial statements.

2.6. Formal Powers of Supervisors

Principle 22: **Banking supervisors must have at their disposal adequate supervisory measures to bring about timely corrective action when banks fail to meet prudential requirements (such as minimum capital adequacy ratios), when there are regulatory violations, or where depositors are threatened in any other way. In extreme circumstances, this should include the ability to revoke the banking licence or recommend its revocation.**

Assessment:
Compliant. BS has two instruments at its disposal by which it ensures the observance of the rules of safe and sound operations. BS's regulatory activities include the adoption of secondary regulations by which it defines the method and procedures of implementation of legal provisions in greater detail. The other part of BS activities is of a supervisory nature. BS performs banking supervision a part of which is also the taking of supervisory measures which range from the issuing of orders to remedy the violations to the withdrawal of banking licences.

2.7. Cross-Border Banking

Principle 23: **Banking supervisors must practise global consolidated supervision over their internationally active banking organisations, adequately monitoring and supplying appropriate prudential norms to all aspects of the business conducted by these banking organisations world-wide, primarily at their foreign branches, joint ventures and subsidiaries.**

Assessment:
Materially non-compliant. BS has the possibility to supervise Slovenian banks' foreign branches and subsidiaries by reviewing their reports and other documentation required from the parent bank by the central bank's supervisors and partly also by means of an inspection performed abroad on the basis of informal co-operation agreements concluded with foreign supervisory bodies. Global consolidated supervision is not yet practicable due to the legal and statutory impediments in other countries as well as because of the inadequate qualification of BS's supervisors to carry out this type of tasks.

Acute need for co-operation and information flows between supervisory authorities

Principle 24: **A key component of consolidated supervision is establish ing contact and information exchange with the various other supervisors involved, primarily host country supervisory authorities.**

Assessment:
Largely compliant. Co-operation with foreign supervisory institutions in the supervision of banks abroad has not yet been formally established in spite of BS efforts. The new Law on Banking has eliminated all major barriers to the free exchange of information between BS and foreign supervisory bodies; its provisions practically mean a mandate to set up the home country supervision principle, which will become fully effective with Slovenia's full EU membership. Its full implementation is at the moment still hindered by host country legislation.

Principle 25: **Banking supervisors must require the local operations of foreign banks to be conducted to the same high standards as are required of domestic institutions and must have powers to share information needed by the home country supervisors of those banks for the purpose of carrying out consolidated supervision.**

Assessment:
Compliant. Foreign banks' subsidiaries in Slovenia must observe the same rules that apply to Slovenian banks. They are also subject to BS supervision, which is a guarantee for a non-discriminatory treatment of both home and foreign banks operating in Slovenia. Once Slovenia is admitted to full EU membership, subsidiaries of banks from EU member countries will be subject to the single banking licence and home country supervision principles which ensure the observance of the uniform European banking standards by foreign banks in Slovenia. In the meantime, foreign countries' legal impediments to the co-operation with their supervisors should be also formally eliminated.

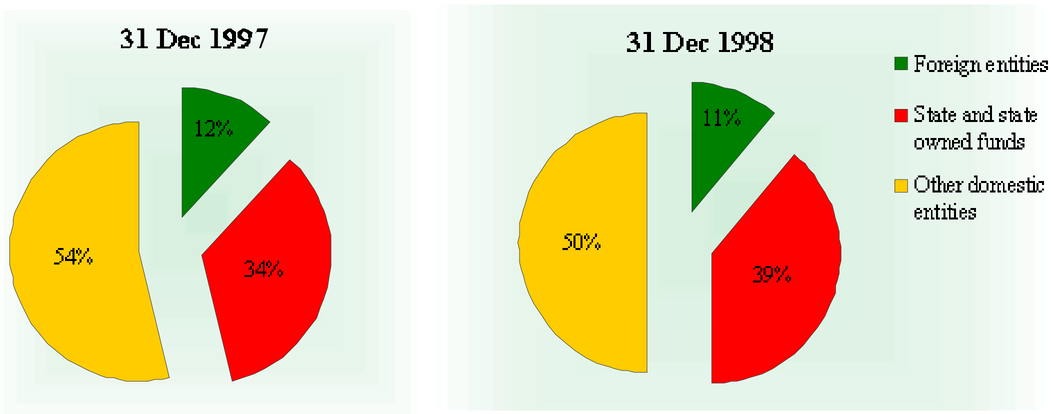
3. OWNERSHIP STRUCTURE AND PRIVATISATION OF SLOVENIAN BANKS

Slovenian banks are mostly in private hands.

Generally speaking, banks in Slovenia are in private hands. The exception is the largest and the third largest bank (ranked in terms of total assets) - Nova Ljubljanska banka (hereinafter referred to as NLB), and Nova Kreditna banka Maribor (hereinafter referred to as NKBM). Both banks came under state ownership when they were placed in the bank rehabilitation programme. In addition, there is also Slovenska investicijska banka, d.d. (the Slovenian Investment Bank) with a stake of almost 21 per cent directly held by state, and Poštna banka Slovenije, d.d. (Slovenian Post Office Bank) indirectly controlled by state.

Savings banks are entirely owned by private domestic shareholders.

Figure 1: Ownership structure of the banking sector as at 31 December 1997 and 31 December 1998 measured by shareholders' equity[3]



Source: The Bank of Slovenia

The amount of equity held by foreign shareholders totalling SIT 26.6 billion as at 31 December 1997 increased to SIT 28.6 billion as at 31 December 1998 (7.5 per cent in nominal terms). Entire shareholders' equity (domestic plus foreign shareholders' equity) rose from SIT 226.0 billion as at 31 December 1997 to SIT 255.0 billion as at 31 December 1998 (12.8 per cent in nominal terms).

The faster growth of entire shareholders' equity in comparison with the growth of foreign-owned shareholders' funds was mirrored in the falling share of Slovenian banks held by foreign shareholders, even though the drop fell short of 1 per cent.

Indirect government stake in shareholders' equity has grown.

The value of state-owned equity (taking into account also equity indirectly held by state) increased from SIT 77.1 billion to SIT 99.8 billion as at 31 December 1997 and 31 December 1998, respectively – a nominal increase of 29.5 per cent. Namely, shareholders' equity grew at 12.8 per cent, while the state-owned

[3] Shareholders' equity is a sum of subscribed capital and foundation capital of savings banks, share premium account, general reserves, capital revaluation adjustment, net profit or loss brought forward, net profit or loss for the current financial year less subscribed capital unpaid and redeemed own shares.

share in shareholders' equity as at 31 December 1998 with respect to 31 December 1997 increased at a faster pace. Due to the increased share of the state-controlled banks in the two banks, the indirect state share in shareholders' equity in the two banks rose in each one by approximately 20 percentage points.

Privatisation of state-owned banks will be gradual.

As over the last five years, the combined market share of the two state-owned banks has accounted for almost 40 per cent of total banking assets, the successful completion of the rehabilitation programme in July 1997 was a long-awaited signal that two major banks were ready for privatisation. Privatisation of NLB and NKBM will be carried out in several stages. The first phase envisages the privatisation of both banks up to 30 per cent of the state-owned equity holding. Concrete privatisation steps will be tailor-made to meet particular requirements of each bank, but in both cases a 10 per cent stake held by the Republic of Slovenia in NLB and NKBM will be transferred to the Capital Investment Fund of Pension and Disability Insurance (also referred to as the Pension Investment Fund), and to the Slovenian Compensation Fund.

In addition to the transfer of shares to the First Pension Fund established under the law promulgated in June 1999 with the aim to close the so-called privatisation gap, NLB is planning to sell state-owned shares on foreign financial markets by issuing Global Depository Receipts (GDRs) against deposited shares. In addition, the recapitalisation of NLB will be done by issuing new shares to be offered to domestic investors.

Contrary to NLB, which is endeavouring to consolidate its banking group in the course of the privatisation process, NKBM has opted for selling 20 per cent of capital to a strategic partner.

4. ORGANISATIONAL STRUCTURE AND TASKS OF THE BANK SUPERVISION DEPARTMENT

The Bank Supervision Department was established early in April 1992 within the framework of the Bank of Slovenia. The Department comprises three separate units:

Bank Supervision Department discharges three core functions.

- Licence granting
- Off-site supervision of banking operations
- On-site supervision of banking operations

The initial staff of 15 more than doubled by the end of June 1999. Out of 36 employees working for the Bank Supervision Department on the last date of June, six are in the executive and administrative section of the Department, 13 people including the head of off-site supervision were engaged in off-site supervision at the end of June 1999, 15 employees were working as on-site bank examiners (including the head of on-site examination), while two people were in charge of issuing licences. After the entry into force of the new Law on Banking, the supervisory authority vested in the Bank Supervision Department was expanded to savings and loan undertakings and business operations of other legal persons connected with banks if necessary for the supervision of the bank's activities within the framework of consolidated supervision.

In line with its policy to handpick new recruits from the ranks of dedicated professionals, the Bank Supervision Department pursues an extensive programme of vocational training for its staff. It is worth mentioning that 27 employees of the Bank Supervision Department are university graduates well equipped to face new challenges and rising standards followed in an ever-changing business environment. The training encompasses a combination of practical insight and the latest theoretical knowledge acquired either at post-graduate studies or at intensive courses. Seminars, workshops and working visits to foreign institutions were the most frequent forms of professional training in the period under review.

New tasks for Bank Supervision Department under the new Law on Banking

Principal tasks of the Bank Supervision Department:

Licence granting

- Preparation of secondary legislation regulating granting authorisations,
- Advising on the implementation of secondary legislation regulating granting authorisations,
- Processing applications and the preparation of reports on authorisations granted,
- Drafting decisions to grant a licence and explaining grounds for the decision,
- Monitoring of the enforcement of the issued decisions, etc.

Off-site supervision of banking operations

- Drawing up of the legal framework for the supervision of banks and savings banks,
- Implementation of recommendations made by relevant international institutions,
- Counselling on the enforcement of legislation regulating the area of finance,
- Preparation of instructions on how to apply accounting standards and advising in the field of accounting,
- Supervision of operating activities of banks and savings banks based on the examination of statutory returns and other documents submit ted,
- Analysing results of business operations of banks and savings banks,
- Taking measures aimed at correcting irregularities in operating activities of banks and savings banks and monitoring the enforcement of such corrective measures,
- Co-operation with domestic and foreign institutions,
- Participation in the preparations for on-site examinations in banks and savings banks,
- Legal counselling,
- Electronic data processing and other related services.

On-site supervision of banking operations

· Preparatory activities leading to on-site examination based on reports and other statutory returns submitted by banks and savings banks available in the Department,
· On-site examinations of business operations of banks and savings banks,
· Taking measures in order to remedy irregularities revealed in operating activities of banks and savings banks,

- Monitoring of the enforcement of corrective measures taken against banks and savings banks,
- Advising within on-site supervising function on the way to improve operations of banks and savings banks,
- Monitoring banks and savings banks,
- Preparation of measures aimed at preventing the financial position of banks and savings banks to be impaired,
- Co-operation in assessing conditions for instituting special administration in banks and savings banks,
- Co-operation in assessing conditions for liquidation of banks and savings banks,
- Co-operation in assessing conditions for bankruptcy of banks and savings banks,
- Governing and managing banks and savings banks in special cases,
- Co-operation with domestic and foreign supervisory authorities,
- Co-operation with foreign chartered accountants/certified auditors.

5. GRANTING AUTHORISATIONS

The establishment of a bank is governed by requirements laid down in directives promulgated by the European Union (First Banking Directive (77/780/EEC), Second Banking Directive (89/646/EEC), and Post BCCI Directive (95/26/EC).

The scope and definition of financial services in general designates as specific banking operations taking of deposits from private individuals and legal persons and granting credits for its own account.

Initial capital threshold for banks 1 billion Tolars

The amount of initial capital is set to SIT 1 billion, and it applies to all banks irrespective of the type of product and service a particular bank offers. In other words, several types of licences existing under the old Law on Banks and Savings Banks have been abolished. The minimum amount of initial capital for savings banks is SIT 186 million, while savings and loan undertakings have a five-year transitional period to comply with the capital requirements.

A bank is a joint-stock company with a registered office in the Republic of Slovenia, with an authorisation issued by the Bank of Slovenia to render banking services.

Mandatory conditions for obtaining authorisation for the provision of banking services are laid down in the Law on Banking. The Bank of Slovenia is, however, independent in formulating conditions regarding senior staff policy ("fit and proper"), as well as organisational and technical issues essential to the provision of banking and other other financial services. Under the Law on Banking, the so-called universal banking licence issued by the Bank of Slovenia is the authorisation given to banks to engage in banking business and to provide all kinds of banking services and selected financial services.

Banks provide all kinds of banking and selected financial services.

The following financial services are banking services:

- Taking deposits from private individuals and legal persons and granting credits for its own account, and
- Services which under the Law may be provided only by banks.

Banking services may be provided only by:

1. A bank, i.e. a savings bank, duly authorised by the Bank of Slovenia to perform banking operations,
2. A branch of a foreign bank duly authorised by the Bank of Slovenia to be set up,
3. A bank from a Member State, which in accordance with the Law on Banking establishes a branch on the territory of the Republic of Slovenia, i.e. which has been authorised in accordance with the said law to directly provide banking services on the territory of the Republic of Slovenia.

Banks may also provide other financial services, subject to the authorisation issued by the Bank of Slovenia, and provided they meet the requirements stipulated under the Law governing designated other financial services.

Other financial services foreseen under the Law on Banking are the financial services set forth below:

1. Factoring,
2. Financial leasing,
3. Issuing of guarantees and other commitments,
4. Lending operations including consumer credits, mortgages, and financing of commercial transactions,
5. Trading in foreign means of payment, including foreign exchange transactions,
6. Trading in financial derivatives,
7. Collection, analysis and dissemination of information on credit rating of legal persons,
8. Mediation in sales of insurance policies in accordance with the law governing the insurance sector,
9. Issuing and administering of payment instruments (e.g. payment and credit cards, travellers' cheques, bills of exchange),
10. Safe custody service,
11. Mediation in the conclusion of loan and credit transactions,
12. Services in connection with securities in accordance with the law governing the securities market,
13. Management of pension or investment funds in accordance with the law governing pension and investment funds, and
14. Performance of payment transactions.

A bank may engage in other ancillary banking services provided these services are:

- Directly connected with the providing of banking services, and
- Connected with real estate management, management or the administration of data processing systems, i.e. with similar data and being of the nature of auxiliary activity in relation with core business of one or more banks.

A bank may not engage in any other activities.

Foreign banks shall apply for Bank of Slovenia's authorisation to open a branch.

During the transitional period, a foreign bank may perform banking services and other financial services on the territory of the Republic of Slovenia only through a branch. A foreign bank may set up a branch on the territory of the Republic of Slovenia subject to an authorisation issued by the Bank of Slovenia. The Bank of Slovenia may require that a foreign bank, which has requested to open a branch on the territory of the Republic of Slovenia, has to make an endowment capital or pledge another type of financial asset or other adequate collateral as a security that liabilities arising from business transactions concluded on the territory of the Republic of Slovenia will be duly settled.

As at 30 June 1999, 15 banks had unlimited licences for banking services for 1999 issued in accordance with provision of the Law on Banks and Savings Banks and referred to as the full licence – one more than for the year ended 31 December1998. This number may be split into nine banks authorised to provide all types of operations within the framework of commercial and investment banking, and other six banks authorised for all types of operations within the scope of commercial banking.

The members of the Governing Board of the Bank of Slovenia decide upon granting authorisations on the basis of opinion endorsed by the Committee of the Governing Board of the Bank of Slovenia. The Committee is responsible for the evaluation of applications and preparation of opinions in regard of authorisations for business operations of banks and savings banks. Such opinions are issued in line with the Law on Banking for the following cases:

- Authorisation for the provision of banking services,
- Authorisation for the provision of other financial services,
- Authorisation for the acquisition of a qualifying holding,
- Authorisation for discharging tasks and duties of a member of the bank's management board,
- Authorisation for mergers or acquisitions,
- Authorisation to establish a branch abroad,
- Authorisation to establish a branch of a foreign bank on the territory of the Republic of Slovenia, and
- Authorisation to establish a representative office of a foreign bank.

Another Committee of the Governing Board of the Bank of Slovenia prepares the opinion in regard of the authorisation for a designated member of the management board to discharge his/her tasks and duties and send it to the Governing Board of the Bank of Slovenia.

Several kinds of authorisations for banks and savings banks

In the course of 1998, one licence for banking operations was issued, while in the first half of 1999, no licence was granted. In the period under review, not a single application to set up a savings banks was received. In the first half of 1999, the Bank of Slovenia granted authorisation for the opening of one branch of a foreign bank. In addition, three take-overs were authorised (all in the course of 1998). In 1998 and the first half of 1999, three foreign banks were granted authorisation to set up representative offices in Slovenia (one in 1998 and two in 1999).

Until the entry into force of the Law on Banking on 20 February 1999, one application for the licence to perform ancillary banking service was issued to banks and savings banks in 1999. In addition, two licences for securities trading were issued – one in 1998, and the other in the first half of 1999.

In 1998, two approvals were issued to a domestic bank shareholder to increase his holding by more than 15 per cent, while in the first half of 1999 seven approvals were issued to domestic shareholders for a 15 per cent stake of a bank, i.e. an authorisation to acquire a qualifying holding in excess of 10 per cent of bank capital was given.

Whereas the bulk of authorisations granted in 1998 went to foreign shareholders who wanted to acquire a stake in Slovenian banks (namely, fifteen such approvals were granted[4] in 1998 and none in 1999), in the first half of 1999 authorisations were mostly issued to banks' managing directors, i.e. to members of management boards (thirteen). In 1998, six candidates for the post of the managing director or a member of management board were endorsed.

6. BANKING GROUPS

Banking groups lead the way to banking sector consolidation.

The Report on Supervision of Banks and Savings Banks in the Year 1997 and the First Half of 1998 highlighted the formation of banking groups in the course of 1997 as the first step in the direction of the consolidation of the banking sector. It was not before the third quarter of 1998, however, that more progress was achieved toward the goal to slim down the banking sector. The last four months of 1998 saw most of the action when Creditanstalt d.d was taken over by Bank Austriia d.d. Ljubljana, and two take-overs took place within already existing banking groups. As the result of this reshuffle, from 31 December 1998 onward, only two banking groups have operated in Slovenia.

Under the Law on Banks and Savings Banks, the formation of a banking group required the holding by one bank of a direct or indirect interest of at least 40 per cent in the capital of another bank, i.e. it required direct or indirect control over another bank. As a result of the consolidation of the banking sector, four banking groups were created in 1997:

- Banking group headed by Banka Celje, comprising Banka Celje and Hmezad banka d.d. Žalec,
- Banking group headed by Nova Ljubljanska banka (NLB), comprising NLB, Pomurska banka d.d., Murska Sobota; Koroška banka d.d., Slovenj Gradec; Banka Velenje d.d., Velenje; Banka Zasavje d.d., Trbovlje, and Banka Domžale d.d., Domžale,
- Banking group headed by SKB comprising SKB and UBK banka d.d, and
- Banking group headed by Banka Koper, comprising Banka Koper d.d. and M banka d.d..

On 30 September 1998, Hmezad banka, d.d. Žalec was taken over by Banka Celje d.d., while on 30 December 1998, UBK banka d.d. Ljubljana was taken over by SKB banka d.d. Ljubljana.

Among the most frequently quoted reasons for pooling resources in banking groups is the commitment to be more cost-effective as financial intermediaries coupled with market-driven desire to be more competitive, but actions occasionally launched by the Bank of Slovenia have been encouraging, as well.

The Bank of Slovenia has laid down minimum requirements for the establishment of banking groups. Banks – members of a banking group–enter into a legally binding contract to reconcile their policies of daily operations and further development in the area of international operations, marketing, developing new products, information technology, lending operations, ATM network,

[4] In accordance with the Europe Agreement, foreign and domestic shareholders are treated equally from 1 February 1999 onward.

etc. Risk-management policy issues are also addressed at the level of the banking group. A bank faced with liquidity problems having previously exhausted regular ways to borrow funds in the money market or within the framework of accommodation provided by the Bank of Slovenia, gets funds from other banks – members of the banking group under terms and up to the limits agreed upon in advance. Should a bank be faced with solvency problems, other members of the banking group shall take steps aimed at mitigating solvency risk on terms and up to the limits agreed upon in advance. The parent bank plays a leading role within the banking group. The same accounting standards are uniformly and consistently applied on all banks – members of the banking group. An independent internal control and audit function responsible for the banking group shall be set up in accordance with standards adhered by internal control and audit of the parent bank. In conformity with terms and conditions of the contract regulating the establishment of banking groups, the same external auditor conducts audit both in the parent bank and all member banks.

The definition of a banking group under the Law on Banking is more flexible than it was the case under the Law on Banks and Savings Banks. A banking group exists when a bank or a financial holding company with the registered head office in the Republic of Slovenia controls one or more banks or other financial institutions or a company providing auxiliary banking services.

Banking supervisors of the Bank of Slovenia conduct prudential supervision of a bank – member of banking group – also on the basis of the consolidated financial position of the respective banking group.

A bank or a financial holding is considered to be a parent undertaking (sometimes referred to as controlling entity) if fulfils one of the criteria listed below:

- To have direct or indirect majority holding, or
- To have direct or indirect majority of voting rights, or
- To have the right to appoint the majority of the members of the management or supervisory board, or
- To have the right to exercise dominant influence, or
- To actually exercise dominant influence, or
- To be duly authorised under a binding contract concluded with one or more shareholders or partners in the controlled undertaking to exercise their voting rights, so as to obtain in combination with its own voting rights the majority necessary for the appointment of the members of the management or supervisory board, or
- To hold directly or indirectly at least 20 per cent of voting rights or participation in the capital of the controlled undertaking, and to exercise this participation jointly with one or more legal persons who are not members of the banking group.

Law on Banking promulgates consolidated supervision.

In addition to consolidated financial statements required under the Law on Banks and Savings Banks, the new Law on Banking lays ground for consolidated supervision of banks defined as an assessment of the overall strength of a banking group made in order to evaluate if risk management rules are duly observed.

7. EFFECTIVE SUPERVISION OF BANKS AND SAVINGS BANKS

Full-scope examinations in up to 15 banks annually

The continuity of the supervisory process is built upon access to timely and reliable information provided by banks and savings banks, prudential reports and statutory returns to the supervisory authority on regular basis. Banking supervisors analyse prudential reports and statistical returns (off-site supervision) submitted by banks and savings banks to assess the condition of individual banks and the entire banking system. Every year, around fifteen banks and savings banks are scheduled for full-scope examinations. When targeted examinations are added (such inspections target one or more segments, i.e. areas of banking operations), then up to twenty banks and savings banks are examined annually. Although each bank or a savings bank is scheduled for a full-scope examination at least every two years, prompt identification of risk-prone areas has been facilitated by targeting at least once a year individual areas of banking business. The risk assessment of matters relating to information technology is a separate area of examinations.

Regular contacts are maintained with directors and senior management of banks and savings banks, either within the framework of full-scope examinations or through meetings convened with the aim to evaluate the results of business operations, the current position of banks, as well as to discuss the development strategy of a particular bank. The exchange of opinions and information between banking supervisors and management of banks and savings banks is prerequisite to take timely and adequate actions in the direction of averting threats to safety and soundness of operating activities of a bank or a savings bank. Furthermore, tools for monitoring of the enforcement of mandated corrective actions have been provided within the framework of mechanism designed to ensure compliance with the Bank of Slovenia disclosure standards. The bottom line is that in a regulated environment with adequate ongoing disclosure, it is easier to recognise when a bank or a savings bank is in a weak condition; hence, timely actions can be take to remedy the situation and possibly avert a full-size crisis.

»Four-eye principle« as the basis of supervision

The Bank Supervision Department has been following the so-called four-eye principle. This approach combines off-site analysis and on-site examination as part of the ongoing prudential supervision of banks and savings banks. How many banks and savings banks are to be covered by an analyst-examiner team depends on the scale of operations conducted by individual banks and savings banks.

Off-site analysts take part in the assessment of operating results of banks and savings banks, they are involved in granting authorisations and endorsing changes relating to authorisations for the provision of banking and other financial operations, they test new system solutions, and advise on implementation of principles for safe and sound operations. In addition, analysts monitor if limits imposed with the aim to enhance safe and sound operations are adhered to, and they monitor profitability on regular basis by analysing statutory returns and prudential reports at least once a month. Should any infringements of operating standards be revealed, analysts take corrective actions and monitor their implementation. In like manner, they participate in the preparations for examinations planned in banks and savings banks, and they attend meetings held with banks and other institutions. In-depth knowledge relating to various aspect of banking industry is incorporated in a wide range of written materials prepared for bodies of the Bank of Slovenia, and other authorities. One of the tasks is also to pass on all information pertinent to any irregularity or infringement discovered in connection with operating activities conducted by an individual bank or a savings bank. Acting upon such notification, persons responsible shall decide if bank examiners should schedule an on-site examination and check upon that bank or a savings bank.

In 1998, examiners carried out thirty examinations on behalf of the Bank of Slovenia in banks and savings banks: fourteen full-scope examinations and sixteen targeted examinations). **Banks** were probed in twenty-six cases, while four full-scope examinations were conducted in **savings banks**. The central bank's examiners performed in 1998 the first on-site examination of a branch of a Slovenian bank abroad (namely, in Italy). In response to the request made by Slovenska izvozna družba d.d. Ljubljana (the Slovene Export Corporation), an area of operations of that institution was examined in the first half of 1998 with particular attention being paid to information technology.

In the case where a bank failed to adhere to mandatory requirements relating to operating activities, liquidation procedure was instituted in the second half of 1998.

In the first half of 1999, examiners carried out sixteen inspections in banks and savings banks: six full-scope and three targeted inspections relating to **bank** operating activities, as well as seven examinations relating to specific areas of operating activities of **savings banks**.

Top priority given to preparations for the year 2000

Thus in 1998, as well as in the first half of 1999, a special emphasis was given to checks of information technology and activities undertaken by banks and savings banks with the aim to prepare for year 2000. How well are banks and savings banks prepared for year 2000 and the so-called millennium bug has been tested on site and assessed on the basis of quarterly reports prescribed to banks and savings banks as mandatory information on the progress of preparations addressed to the Bank Supervision Department. During the period under review, banks identified and addressed all problems arising from Y2K. All signs indicate that by the end of the third quarter of 1999 most banks (approximately 90 per cent and more) will have completed system conversions necessary for smooth continuation of operations beyond year 2000. By year-end, all banks should be in line with Y2K compliance benchmarks.

Full-scope on-site examinations conducted in designated banks and savings banks focused on the following areas of banking business:

- Credit portfolio,
- Trading portfolio,
- Capital adequacy,
- Risk management policies,
- Profitability benchmarks,
- Liquidity and deposit operations,
- Internal controls system,
- Capital investments and fixed assets,
- Corporate governance and internal audit function,
- Information technology in the light of the readiness for the year 2000, etc.

Targeted examinations were concerned primarily with the following segments:

- Credit portfolio – corporate entities, sole traders, and private individuals checking credit classification criteria, assessment made with respect to adequate provisions earmarked for credit and country risks)
- Trading portfolio,
- Risk management policies designed for connected persons,
- Checking of internal audit department,
- Adequacy and efficiency of internal controls system,
- Correctness of disclosing accounting information,
- Fulfilment of mandated corrective measures,
- Information technology, etc.

8. ASSESSING INTERNAL CONTROLS SYSTEMS AND INTERNAL AUDIT DEPARTMENT

Sound and comprehensive internal controls systems and internal audit function are regarded as crucial elements of risk management systems designed to monitor effectiveness and proper functioning of risk management practices put in place as incentives to banks to behave in a prudent and efficient manner.

The promulgation of the Law on Banking was another step taken in the direction of the full alignment of the Slovenian banking system with public disclosure and supervisory requirements that promote safety and soundness of banking industry. By identifying the place, role and competence of internal audit department, the implementation of effective banking supervision relying on the appropriate functioning of internal controls system has been facilitated. It is essential that a bank has put in place an adequate internal controls system which is fully operational, while the driving power for the effective internal controls function is the need to maintain sound risk management systems and practices set up to avert or curtail excessive exposure banks face by definition in the course of routine business. Provided that internal audit function meets all regulatory requirements, and that internal auditors discharge their duties in banks in compliance with internal audit standards and professional code of practice, then sound basis have been created for central bank's supervisors to enforce principles required for safe and sound banking operations.

Assessment of effectiveness of internal controls systems as part of examinations

Assessing the adequacy and effectiveness of internal controls system is in the spotlight of full-scope on-site examinations. Considering the importance of internal controls function, it is due to attract more attention as the implementation of the Core Principles for Effective Banking Supervision in the Slovenian environment has gained momentum. Principle 14 refers to internal controls and the role of banking supervisors in determining whether or not internal controls match the nature and scale of business conducted by the bank subject to examination.

The role of banking supervisors is essential in the process of identifying the business or inherent risks of a bank, as they are in a position to demand that all banks, irrespective of the scale of their business, have in place effective internal controls systems to reflect the risk to which they are exposed. Each bank shall apply risk evaluation factors on its on- and off-balance sheet business and respond quickly to changes happening in banking environment and market volatility. In the case where banking supervisors determine that the internal controls system is not adequate, they shall take immediate corrective actions and demand from the bank to improve its internal controls system.

Although management and supervisory board are responsible for effective internal controls function, it is up to banking supervisors to benchmark the internal controls system against a particular bank's risk profile within the framework of their current supervisory function. It is essential to determine whether management of a particular bank pay due and prompt attention to the problems identified through internal audit function. Even more crucial is that banking supervisors should not evaluate how effective the entire internal controls system is, but also how individual controls incorporated primarily in the areas associated with high level of risk function (e.g. in the areas characterised by particularly high profitability, fast growth, or in the case where new business has been launched). Banking supervisors shall make sure that banks have in place adequate policies and practices issued in writing which are in line with effective requirements laid down by banking regulators.

Furthermore, banking supervisors must have a means of reviewing findings and recommendations made by external auditors as regards effectiveness of internal controls. Banking supervisors must also check if the bank's directors and management have taken any remedial actions in an effort to abide by recommendations made by external auditors. Banking supervisors should take into account the scale and nature of problems in connection with control procedures identified by external auditors when they assess the effectiveness of the bank's internal controls.

Although there is still room for improvement in the area of internal audit, so as to boost the scope and effectiveness, it would not be premature to claim that the level of quality and professional skills exhibited by staff working in the departments which carry out internal audit have been consistently rising. Standardisation of policy and practice has been enhanced by the fact that an ever increasing number of auditors has obtained certificates awarded by the Slovenian Institute of Auditing. There are still rather significant differences from one bank to another in terms of the number of internal auditors and their professional skills. What human resources can a bank recruit depends on its size and resources it allocates to internal audit function as one of the most important functions in banking operations. It is essential, however, that each bank's management acknowledges how important and beneficial internal audit – after all, internal auditors are responsible for safe and sound, but also profitable banking operations. Hence, internal audit function shall be regarded as a tool for achieving the set goals through monitoring of the implementation of mandatory measures in a timely manner, an instrument put in place with the aim to safeguard banks from jeopardising their position.

9. LIAISON WITH SUPERVISORY AUTHORITIES

9.1. Liaison with domestic supervisory institutions

Effective supervision calls for harmonised actions of all supervisory authorities.

Universal banks authorised to provide all services and products falling within the scope of both commercial and investment banking predominate in Slovenia. Contractual and capital links tie banks and insurance firms together, thus blurring the demarcation line between the two types of businesses. Since banking and insurance fall under the jurisdiction of different supervisory authorities, effective supervision of financial institutions calls for tight cooperation between all supervisory authorities.

In 1999, legal basis for the issuing of the Code of Practice for the Co-operation between Supervisory Authorities (Official Gazette of the Republic of Slovenia, No. 55/99) was found in provisions laid down in the Law on Banking relating to this issue. Prior to the effectiveness of the Code of Practice, terms of co-operation between supervisory authorities were stipulated in protocols concluded between the Bank of Slovenia and other supervisory authorities.

Code of Practice lays grounds for co-operations amongst supervisory authorities.

The Code of Practice defines terms and conditions of co-operation among the Bank of Slovenia, the Securities Market Agency and the Insurance Supervisory Authority of the Republic of Slovenia. The co-operation encompasses the following areas:

- Strategic development issues, annual planning of joint activities to be endorsed by the steering committee, as well as monitoring of the implementation of the signed agreements,
- Exchange of information relevant for the supervision of financial institutions,
- Exchange of information necessary for the issue of authorisations,
- Exchange of information relating to facts and events relating to related persons and likely to affect position or operations of the undertaking, which is the subject of supervision conducted by other supervisory authority,
- Dissemination of information necessary for decision-making regarding other issues,
- Planning of joint examinations,
- Notification on irregularities and infringements revealed by supervisory authority during examination if such findings are deemed to be relevant for activities of other supervisory authorities,
- Other jointly conducted activities, which contribute to harmonised su pervisory actions, improved effectiveness of activities conducted by supervisory authorities, as well as to enhanced effectiveness of financial market.

The Code of Practice provides for the establishment of steering committees bodies, which report to the finance minister. The governor of the Bank of Slovenia and the president of the board of the Securities Market Agency will sit on such committees. The co-operation also envisages the conclusion of agreements between supervisory authorities. The purpose of such agreements is to align previously signed protocols with the Code of Practice, while the next milestone scheduled for the last quarter of 1999 when these agreements are expected to be signed, and when detailed contents of these agreements including concrete forms of collaboration and tools for exchanging information, will be agreed upon. A liaison group will take care of the implementation of agreements concluded between supervisory authorities and tasks to be adopted by the steering committee. The liaison group will meet every three months and its members will include deputy governor of the Bank of Slovenia, i.e. the director of the Bank Supervision Department, the director of the Securities Market Agency, and the director of the Insurance Supervisory Authority of the Republic of Slovenia.

The co-operation between supervisory authorities is running smoothly but there is room for improvement on the basis of the new agreements waiting to be signed. As a result of these agreements, the flow of information on regular basis and the release of designated information upon request lodged by another supervisory authority will be facilitated. Under the Law on Banking, an essential prerequisite for the dissemination of information is to bind supervisors by a code of conduct to protect confidentiality of information and business secret. Supervisory institutions are also legally bound to notify another supervisory authority on findings concerning infringements falling within the province of work of that particular institution. Future co-operation will extend to joint examinations when deemed necessary.

The Code of Practice is seen as a formal basis for drawing up new and upgrading the existing protocols on co-operation entered into by the Bank of Slovenia, of the one side, and the Securities Market Agency, i.e. the Insurance Supervisory Authority of the Republic of Slovenia, of the other.

9.2. Cross-border co-operation

As a supervisory authority, the Bank of Slovenia is a member of the Group of Banking Supervisors from Central and Eastern Europe; hence, the professionals from the Bank Supervision Department regularly attend meetings, seminars, workshops, and conferences pooling supervisors from member countries.

In September 1999, the Bank of Slovenia hosted for the first time the Annual Conference of the Group of Banking Supervisors from Central and Eastern Europe. Among participants of the Annual Conference which was 12th in a row, there were professionals from the Basle Committee on Banking Supervision and the Financial Stability Institute. From June 1999 onward, invitations to take part in conferences and seminars organised by the Financial Stability Institute are addressed to the Bank Supervision Department.

No formal agreements for co-operation with foreign supervisory authorities

Since no co-operations with supervisory authorities from foreign countries has been formally[5] established, activities are going on in order to make formal arrangements as regards relations with central banks, i.e. with other supervisory authorities, which are responsible for the supervision of cross-border branches or subsidiaries of Slovenian banks. Honing of specialist skills has been boosted by fostering relations with some European supervisory institutions - De Nederlandsche Bank, Deutsche Bundesbank, Landeszentralbank im Freistaat Bayern, National Bank of Belgium, Belgium's Banking and Finance Commission, Banco de Portugal, Oesterreichische Nationalbank, Austria's Federal Ministry of Finance, France's Commission Bancaire, Banque de France, Banco d'Italia, Central Bank of Malta, Bank of England, Central Bank of Ireland and Danish Financial Supervisory Authority. Among the institutions from the United States there are Federal Reserve Bank of New York, State of New York Banking Department, and Federal Deposit Insurance Corporation.

[5] The part describing the implementation of the Core Principles for Effective Banking Supervision addresses problems in more details, *viz.* in Principles Nos. 1(6), 20, 23, 24 and 25.

Eligible as a country in the phase of the Accession Membership with the European Union, Slovenia's banking supervisors from the Bank Supervision Department of the central bank took part in meetings of the Sub-Committee for Financial Services within the framework of the European Commission, participated in the talks with the mission of the World Bank and the International Monetary Fund, and met with representatives of leading international rating agencies and other professionals from foreign countries.

Feeding through a pro-active stance toward meetings and conferences organised mainly for the CEE countries, the staff of the Bank Supervision Department has regularly attended such events. In addition, senior officers of the Bank Supervision Department have often been delivered lectures at some forums.

10. LIAISON WITH AUDITORS

Financial statements of banks operating in Slovenia for the financial year ended 31 December 1998 were audited by three registered auditors/chartered accountants: PriceWaterhouseCoopers d.d. for the majority of banks, KPMG Slovenia, d.o.o. for one bank, and Deloitte & Touche, d.o.o. for two banks. External audit of all Slovenian savings banks was carried out by ITEO - Revizija d.o.o. Ljubljana.

Annual accounts of banks and savings banks give a true and fair view.

Auditors' opinion expressed on all banks and savings banks is positive, meaning that in the opinion of external auditors, financial statements of Slovenian banks and savings banks give a true and fair view of the financial position, operating results, and cash flow in the preceding year. External auditors have responsibility for forming and expressing their independent opinion on balance sheet, profit and loss account, and cash flow statement and the management of the respective bank, i.e. savings bank, are responsible to keep the adequate accounting records.

A meeting with auditors is held once a year as a forum to express opinion on audited banks and savings banks and auditors' reports. In the case a severe non-compliance or heavily impaired position of a bank or a savings bank has been identified, meetings with auditors may be organised more often. Contacts between the Bank Supervision Department and auditors regarding unresolved professional matters arising in the course of daily business are more frequent.

The Bank Supervision Department strives to contribute to comprehensive efforts aimed at developing audit profession further. It is primarily done through the co-operation with the Slovenian Institute of Auditing and the Internal Audit Board operating within the framework of the Bank Association of Slovenia. The Department has a pro-active stance toward working out practical solutions to problems arising in accounting principles and it participates in activities handled by the Accountancy Board operating within the framework of the Bank Association of Slovenia.

II. RESULT OF OPERATIONS OF BANKS AND SAVINGS BANKS IN 1998 AND THE FIRST HALF OF 1999[6]

1. BANKING SECTOR STRUCTURE

Consolidation of banking sector in Slovenia

The number of banks operating in Slovenia has been declining since the end of 1994. The formation of four banking groups in 1997 was a significant step made in the direction of the consolidation of the banking sector. The process gained momentum in the last four months of 1998 when three mergers plus one liquidation took place.

As the result of mergers and one liquidation, the Slovenian banking sector ended 1998 with four banks less than at the end of the previous year. Namely, Banka Celje d.d. took over Hmezad banka d.d. Žalec, Bank Austria d.d. Ljubljana acquired Creditanstalt d.d., and UBK univerzalna banka d.d. Ljubljana joined SKB banka d.d. Ljubljana. In the same period, Hipotekarna banka d.d. Brežice was liquidated[7] .

The number of banks operating in Slovenia's banking environment as at 31 December 1998 stood at 24 (and 2 banks set up under the Constitutional Law), 6 savings banks, and 70 savings and loan undertakings.

25 banks, 6 savings banks, 69 savings and loan undertakings operate in Slovenia.

When on 31 March 1999, a new bank - Hypo Alpe Adria banka d.d. Ljubljana – was entered into the court register, the total number of banks rose to 25. The number of savings banks has remained unchanged since the end of 1997, while the number of savings and loan undertakings was reduced by one in the first half of 1999.

Alongside 25 banks, 6 savings banks, and 69 savings and loan undertakings, 9 representative offices of foreign banks (two representative offices were registered in 1999) operated in Slovenia as at 30 June 1999. The first foreign bank to be granted the authorisation to operate through a branch office in Slovenia has not yet activated the branch.

Out of 25 operating banks, there were 11 banks in the hands of domestic owners and 4 banks with total or majority control of foreign shareholders at the end of June 1999. The remaining 10 banks were controlled by domestic shareholders and in less than a half of these banks, foreign shareholders had a stake of under 1 per cent.

6 Data for the first half of 1999 i.e. for the period ended 30 June 1999 are not audited.

7 Since Hmezad banka d.d. Žalec and UBK univerzalna banka d.d. Ljubljana were each a member of the respective banking group set up in 1997, the number of banking groups was halved following M&A finalised in the second half of 1998. As at 1 October 1999, Banka Koper d.d. took over M banka d.d. Ljubljana, hence only one banking group – Nova Ljubljanska banka banking group - is left in Slovenia after 1 October 1999. The banking group parented by NLB encompasses Banka Velenje d.d., Velenje, Koroška banka d.d. Slovenj Gradec, Banka Domžale d.d. Domžale, Banka Zasavje d.d. Trbovlje, and Pomurska banka d.d. Murska Sobota.

Small market share of savings banks and savings and loan undertakings

The figures for the end of June 1999 illustrating the market share of banks, savings banks, and savings and loan undertakings (measured by total assets) remain unchanged. Thus the market share of savings banks and savings and loan undertakings was mere 2.0 per cent (namely, savings banks and savings and loan undertakings accounted for 0.4 and 1.6 per cent, respectively). The savings banks' market share has not changed since the end of 1997, while the share held by savings and loan undertakings has been oscillating (at the end of 1998 it recorded 1.8 per cent).

That banking sector has been developing at fast pace is mirrored in the share of banks' total assets in gross domestic product. At the end of the first half of 1999, aggregate total assets of banks operating in Slovenia accounted for over 71 per cent of gross domestic product, or a 1.3 percentage point less than at the end of 1998. If total assets of savings banks and savings and loan undertakings were added to total assets of banks, the grand total of total assets reported for the first half of 1999 would be almost 73 per cent of gross domestic product.

Table 2: Number of business units, headcount, total assets of banks and gross domestic product

	31 Dec 1994	31 Dec 1995	31 Dec 1996	31 Dec 1997	31 Dec 1998	30 Jun 1999
Number of business units	538	558	577	590	644	n.a.
Number of employees	9,752	10,137	10,317	10,410	10,394	n.a.
Total assets (in millions of Tolars)	1,183,423	1,497,544	1,729,083	2,022,037	2,350,358	2,558,562
Total assets/Number of employees (In millions of Tolars)	121.4	147.7	167.6	194.2	226.1	n.a.
GDP at current prices (in millions of Tolars)	1,852,997	2,221,459	2,552,668	2,906,687	3,243,490	3,592,000*
Total assets/GDP (in %)	63.9%	67.4%	67.7%	69.6%	72.5%	71.2%

* Estimate for 1999.
Source: The Bank of Slovenia

2. BALANCE SHEET

Banks' total assets grew in 1H99 by over 5% in real terms.

As at 31 December 1998, total assets of all Slovenian **banks** amounted to SIT 2,350.4 billion – a nominal growth of 16.2 per cent or 9.2 per cent in real terms[8] in comparison with 31 December 1997. Total assets of all banks (including NLB branch in Italy) as at 30 June 1999 increased in nominal terms by 8.9 per cent (this growth was 6 per cent in real terms) or by SIT 208.2 billion. Three banks reported on 30 June 1999 lower total assets in nominal terms, two banks experienced real decrease in total assets, one bank kept the volume of operations at the same level in real terms. Growth rate of total assets held by individual banks varies from one bank to another. No bank, however, had growth rate in excess of 16 per cent.

Market share of largest banks practically unchanged

The market share of the three largest banks in terms of total assets has been in the range from 51 to 53 per cent since the end of 1994, five largest banks

8 To compute real growth rates, consumer price index (CPI) was applied. For the first six months of 1999, CPI was 2.7%, in 1998 it was 6.5% (December-December), and from June 1998 to June 1999 it was 4.3%.

have held between 62 and 63 per cent, seven largest banks have controlled between 71 and 73 per cent, and the leading ten have had between 80 and 82 per cent of the market.

Total assets as at 30 June 1999 ranged from SIT 120 bn to SIT 713 bn for largest seven banks.

Although the keynote feature of the banking sector in Slovenia over the past few years has been the stable position of seven largest banks ranked on the basis of market share in the order that has practically remained unchanged, considerable differences one bank to another have remained. Thus total assets of the Slovenian largest bank reported as at 30 June 1999 equalled approximately SIT 713.0 billion, with total assets of the second largest bank were less than a half of total assets of the largest bank. The bank ranked seventh reported SIT 120 billion – only a sixth of total assets of the largest bank.

Table 3: Total assets, growth rates and market share of seven largest banks

Bank	Total Assets (in millions of Tolars)		Nominal Growth (in %)		Market Share (in %)	
	31 Dec 1998	**30 Jun 1999**	**1998/1997**	**Jun 1999/ 1998**	**31 Dec 1998**	**30 Jun 1999**
NLB*	648,595	713,051	18.1	9.9	**27.6**	**27.9**
SKB banka	281,184	318,093	16.7	13.1	**12.0**	**12.4**
NKBM	285,029	300,300	19.9	5.4	**12.1**	**11.7**
Banka Koper	137,190	148,776	14.0	8.4	**5.8**	**5.8**
Banka Celje	135,094	146,487	23.6	8.4	**5.7**	**5.7**
Abanka	123,151	139,995	19.5	13.7	**5.2**	**5.5**
Gorenjska banka	108,041	120,257	19.1	11.3	**4.6**	**4.7**
Total - top 7 banks	1,718,284	1,886,959	18.4	9.8	**73.1**	**73.8**
Total - all banks	2,350,359	2,558,562	16.2	8.9	**100.0**	**100.0**

* Consolidated figures including NLB branch in Italy.
Source: The Bank of Slovenia

If we take into account that NLB and Banka Koper are parent undertakings in their respective banking groups (the only two left after two banks were taken over), the market share of NLB banking group in particular is even bigger.

NLB banking group measured by total assets is more than five times larger than the banking group parented by Banka Koper.

Table 3a: Total assets, growth rates and market share of banking groups

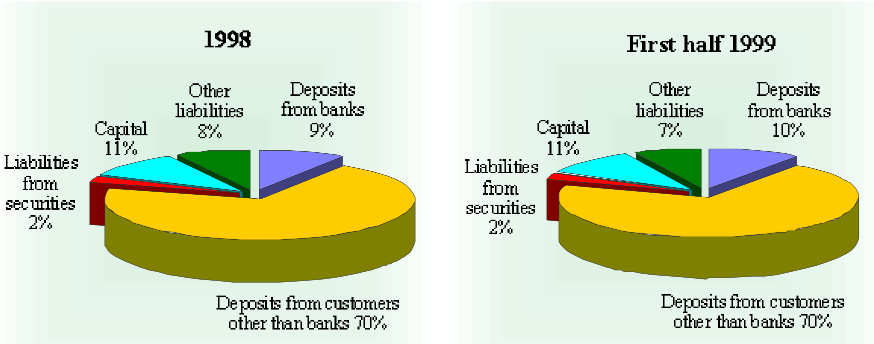
Banking groups	Total Assets (in millions of Tolars)		Nominal Growth (in %)		Market Share (in %)	
	31 Dec 1998	**30 Jun 1999**	**1998/1997**	**Jun 1999/ 1998**	**31 Dec 1998**	**30 Jun 1999**
NLB	829,543	906,313	17.6	9.3	**35.3**	**35.4**
Banka Koper	151,417	163,218	13.2	7.8	**6.4**	**6.4**

Source: The Bank of Slovenia

Deposits from non-bank customers accounted for 70% of liabilities.

Deposits from clients other than banks account for the heftiest share in the average **structure of liabilities** (70 per cent). Deposits placed by the banking sector accounted for far smaller share, after several years of decrease it started to grow again.

Figure 2: Average structure of liabilities of banks



Source: The Bank of Slovenia

Table 4: Principal balance-sheet items at end-year (nominal growth rates included)

in millions of Tolars / in %

	Amount			Nominal Growth		
	31 Dec 1997	31 Dec 1998	30 Jun 1999	1997/1996	1998/1997	30 Jun 1999/ 30 Jun 1998
Cash with Central Bank	73,888	84,696	85,991	26.4	14.6	1.5
Loans and advances to banks	214,874	227,331	242,363	-30.7	5.8	6.6
Loans and advances to customers other than banks	862,406	1,108,798	1,237,456	18.9	28.6	11.6
Securities	689,622	714,566	729,066	44.1	3.6	2.0
Other assets	181,247	214,968	251,151	15.8	18.6	16.8
Total assets	**2,022,037**	**2,350,359**	**2,546,027**	**16.9**	**16.2**	**8.3**
Capital	228,360	256,281	258,698	15.3	12.2	0.9
Subordinated liabilities			18,072			
Deposits from banks	204,085	223,738	279,238	-4.6	9.6	24.8
Deposits from customers other than banks	1,412,196	1,667,695	1,751,358	20.8	18.1	5.0
Liabilities from securities	52,418	57,649	46,629	41.4	10.0	-19.1
Other liabilities	124,978	144,996	192,032	13.0	16.0	32.4
Total liabilities	**2,022,037**	**2,350,359**	**2,546,027**	**16.9**	**16.2**	**8.3**

Source: The Bank of Slovenia

Deposits from banks increased.

In comparison with the average structure for 1998, the share of household deposits (private individuals and sole traders are treated as one category) and of bank's deposits in the structure of total liabilities in the first half of 1999, has grown. The former increased from 38.5 per cent to 38.9 per cent, while the latter rose from 9.2 per cent to 10.0 per cent. The increase in both categories was at the expense of the share of deposits placed by the corporate sector, which shrank from 16.2 per cent to 15.3 per cent, and at the expense of the share of deposits placed by government, which dropped from 8.4 per cent to 8.2 per cent. Deposits placed by corporate sector in banks rose by 0.6 per cent (11.6 per cent as at 31 December 1998). The growth of deposits placed by households was more sluggish than as at 31 December 1998: 7.4 per cent (as opposed to 21.9 per cent as at 31 December 1998). Banks borrowed abroad and from other banks more heavily (this figure grew by 24.8 per cent).

Banks diminished liabilities deriving from issued securities in the first half of 1999 as can be seen in growth rates (-19.1 per cent), and the share in average total liabilities in the structure of banks, which was slightly lower (from 2.4 per cent at the end of 1998 to 2.2 per cent in mid-1999). In the first half of 1999, capital did not increase in real terms. Nevertheless, it maintained its share (10.5 per cent) in average structure of banks' liabilities. If the share deriving from subordinated liabilities[9] were added to capital, then banks' capital in the first half of 1999 would increase in nominal terms by 8 per cent. Above-average nominal growth of other liabilities can be noticed in the first half of 1999: by 32.4 per cent (including accruals and deferred income, payables to suppliers in the home country, and liabilities for dividends). The share of other liabilities in the average structure of total liabilities has decreased from 7.9 per cent in 1998 to 7.1 per cent at mid-1999.

Table 5: Average structure of assets and liabilities and nominal growth per sector

in %

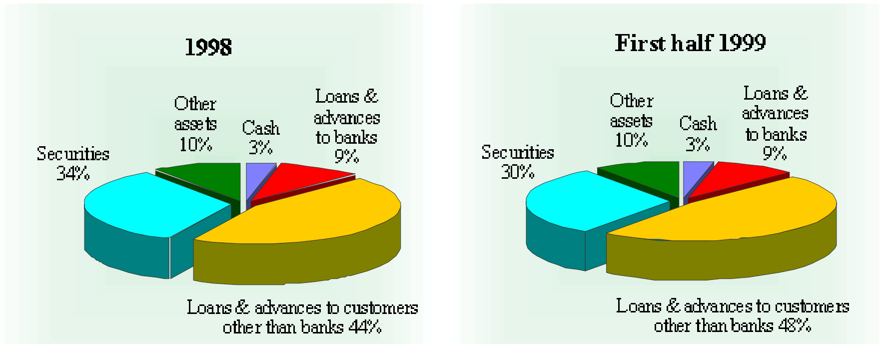
	1997		1998		Jan - Jun 1999	
	Average Structure	Nominal Growth	Average Structure	Nominal Growth	Average Structure	Nominal Growth
Loans and advances						
Corporate sector	**25.8**	13.2	**27.1**	26.8	**27.2**	0.5
Households*	**11.7**	15.8	**12.2**	26.6	**14.1**	34.7
Government	**2.8**	70.1	**3.5**	50.4	**4.5**	0.1
Deposits						
Corporate sector	**16.4**	14.3	**16.2**	11.6	**15.2**	0.6
Households*	**36.2**	22.7	**38.5**	21.9	**38.2**	7.4
Government	**8.6**	15.8	**8.4**	18.4	**8.0**	-11.2

* Under the new classification, households include individuals and sole traders.
Source: The Bank of Slovenia

Lending to non-bank customers accounted for almost one half of total banks' assets.

Loans and advances granted to non-bank customers in the first half of 1999 accounted for the largest share of average **assets structure** – with 47.8 per cent, they represented almost one half of all assets. The share of loans and advances to non-bank customers increased by four percentage points at the expense of investments made in securities.

Figure 3: Average structure of banks' assets



Source: The Bank of Slovenia

9 Subordinated debt instruments comprise hybrid instruments and subordinated debt. Hybrid instruments have characteristics both of capital and common debt; hence, subordinated debt instruments are very similar to shareholders' equity. Maturity of subordinated debt is known in advance and it serves to cover loss in the case of bankruptcy or liquidation of banks.

Increased lending to non-bank customers due to corporate investments and Value Added Tax

In the first half of 1999, loans and advances to customers other than banks increased by 11.6 per cent in comparison with the end of 1998 due to vigorous demand for loans and advances on the eve of the enforcement of Value Added Tax, as well as the result of stronger investment activities in the corporate sector.

The share of securities in average structure of banks' assets was decreasing and at the end of the second quarter of 1999 equalled 30.2 per cent of all assets (at the end of 1997 this figure was 34.5 per cent, while at the end of 1998 it was 33.5 per cent). Out of investments in securities, almost one half of investments is in short-term securities issued by the Bank of Slovenia (bills mostly in foreign currency), slightly less went to long-term securities issued by the Republic of Slovenia. The share of investment securities, which account for the major part of investments in securities, has been decreasing (from 29.1 per cent at the end of 1998 to 25.5 per cent in mid-1999), while the share of trading securities has been rising (from 4.4 per cent at the end of 1998 to 4.7 per cent at mid-1999).

The share of lending to the banking sector continued to decrease in 1998. Thus in the middle of 1999, lending to the banking sector accounted for 9 per cent share in average assets. The share of cash in hand and balances with the Central Bank in average assets has been around 3 per cent for some years, while the share of other assets has been around 10 per cent of total assets.

Table 6: Maturity structure of loans and deposits

	in millions of Tolars		in %		in %	
	Amount		Nominal Growth		Share	
	31 Dec 1998	30 Jun 1999	Jun 1998/ Dec 1997	Jun 1999/ Dec 1998	31 Dec 1998	30 Jun 1999
Short-term loans and advances to non-banking sector	633,927	684,239	10.5%	7.9%	57.2%	55.3%
Long-term loans and advances to non-banking sector	472,577	550,835	14.8%	16.6%	42.6%	44.5%
Receivables arising from guarantees issued	2,295	2,383	-4.7%	3.8%	0.2%	0.2%
Total loans and advances to non-banking sector	**1,108,798**	**1,237,456**	**12.3%**	**11.6%**	**100.0%**	**100.0%**
Deposits from non-banking sector repayable on demand	554,896	654,771	5.8%	18.0%	33.3%	37.4%
Short-term deposits from non-banking sector	966,327	959,392	8.7%	-0.7%	57.9%	54.8%
Long-term deposits from non-banking sector	146,472	137,195	10.9%	-6.3%	8.8%	7.8%
Total deposits from non-banking sector	**1,667,695**	**1,751,358**	**7.9%**	**5.0%**	**100.0%**	**100.0%**

Source: The Bank of Slovenia

Maturity structure of liabilities worsened as at 30 June 1999.

The maturity structure of **banks' liabilities** in the first half of 1999 deteriorated in comparison with the end of 1998, mainly due to the rise in the share of deposits payable on demand in total deposits. Demand deposits have been growing since the end of 1998 from 33.3 to 37.4 per cent, at the expense of short-term deposits (a fall from 57.9 to 54.8 per cent). The trend of shortening maturity was especially strong from April 1999 onward – the same trend present throughout 1998. The share of long-term deposits dropped in comparison with the end of 1998 and landed at 7.8 per cent (a fall of 1 percentage point). On the assets side, lending to non-bank counterparties recorded a substantially higher growth in long-term lending (16.6 per cent) than it was the case with short-term lending (7.9 per cent), irrespective of the general shortening of the deposit maturity structure.

The share of average assets and liabilities of banks *in foreign currency* has been falling since 1997. In June 1999, assets and liabilities of banks in foreign currency increased again due to rising exchange rates. The share of banks' assets in foreign currency as at 30 June 1999 averaged 29.2 per cent, while the share of liabilities was 30.3 per cent.

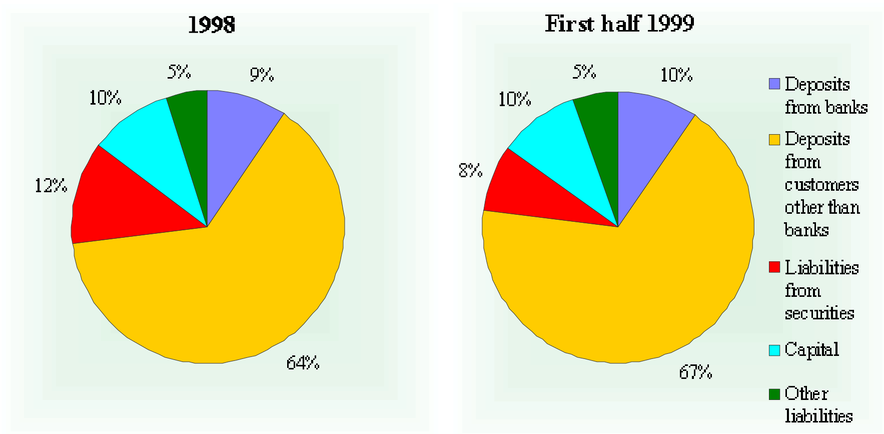
Total assets of savings banks increased 4.7% in real terms.

Total assets of **savings banks** grew in 1998 by 31.7 per cent and at the end of the year equalled 9.5 billion. At the end of June 1999, total assets of savings banks amounted to 10.2 billion – a 7.5 per cent growth in nominal terms (real growth of 4.7 per cent) with respect to 31 December 1998. Thus the growth of savings banks' total assets with record high in 1997 notching 42.6 per cent has been curbed. One half of savings banks (three out of six) control 73.2 per cent of the market (measured in terms of total assets). As at 30 June 1999, total assets of two savings banks decreased for the first time since the end of 1996.

The share of deposits from households (private individuals and sole traders), which make up for the most important part of liabilities for savings banks, decreased from 42.7 per cent in 1998 to 36.0 per cent in the first half of 1999. The share of deposits from the banking sector has remained at the same level as in the previous year. On the other hand, the share deposits from the corporate sector increased substantially (from 15.9 per cent in 1998 to 21.4 per cent at mid-1999). Fluctuations of shares could be observed also in growth rates of different kinds of liabilities. Thus deposits placed by the corporate sector rose by as much as 61.6 per cent in the first half of 1999, while deposits from households registered a 34.6 per cent increase.

Liabilities of savings banks for securities issued decreased by four percentage points.

Figure 4: Average structure of liabilities of savings banks

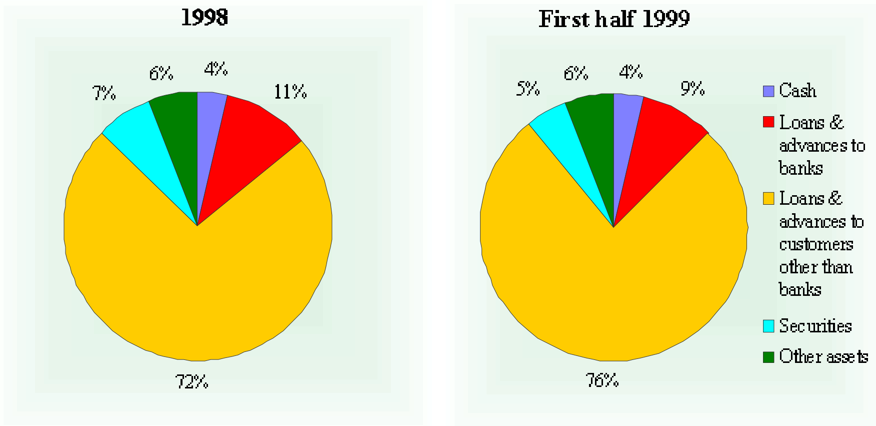


Source: The Bank of Slovenia

Savings banks' receivables mostly derive from retail lending.

Retail lending accounted for the bulk of assets made by savings banks. Thus the share of loans and advances to households rose from 57.1 per cent in 1998 to 63.1 per cent in the first half of 1999. The increase was at the expense of corporate lending which shed 1.8 percentage points, and landed at 12.7 per cent of assets. Lending to banks shrank by the same percentage points and notched 9.1 per cent. Thus retail lending grew by 25.7 per cent, the volume of loans and advances to the corporate sector shrank by 31.2 per cent, while loans and advances to banks decreased by 42 per cent or SIT 470 million.

Figure 5: Average structure of savings banks lending



Source: The Bank of Slovenia

3. PROFIT AND LOSS ACCOUNT

Banks' earnings shrank in real terms in 1H99.

In the first half of 1999, Slovenian **banks** generated SIT 13.4 billion in profit before taxes. This figure was in nominal terms by 5.4 per cent lower than in the same period in 1998 when it equalled SIT 14.2 billion, while the drop in real terms was 9.3 per cent. Revaluation gain accounted for SIT 11.4 billion or 85.1 per cent of total earnings, meaning that the share of revaluation gain in profit fell since 1998 when it equalled 91 per cent.[10] In 1998, banks' profit before taxes totalled SIT 26.0 billion – 23.2 per cent nominal growth with respect to 1997 (15.7 per cent real growth). Net profit of banks generated in 1998 after the deduction of corporate tax and the tax on total assets equalled SIT 16.1 billion. (The aggregate tax amount was SIT 9.9 billion).

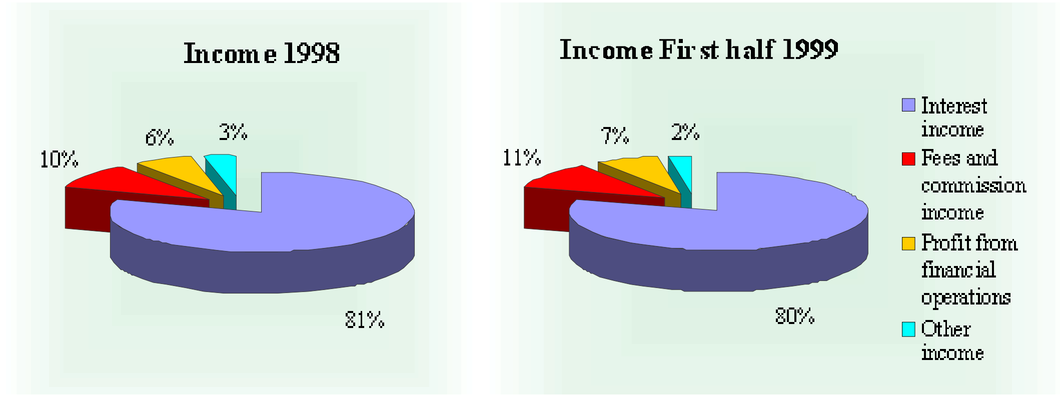
In 1998 and in the first half of 1999, two banks reported losses, whereas at the end of 1997 four banks were in red figures.

Interest income accounted for 80% of banks' earnings.

In the structure of total **earnings,** interest income accounted for the biggest share (approximately 80 per cent), fees and commission income notched approximately 10 per cent during the period under review, profit from financial operations accounting from 6 to 7 per cent took the third place, while other income (gains from dealing securities, extraordinary income and other operating income) accounted for approximately 3 per cent of total earnings.

[10] The implementation of nominal interest rates for all short-term government securities, as well as for all bills issued by the Bank of Slovenia, has triggered a decrease in revaluation gain since nominal interest rates paid on bills of the Bank of Slovenia with the maturity of 270 days are fed through to the real part of the profit and loss account.

Figure 6: Structure of income of banks in 1998 and the first half of 1999

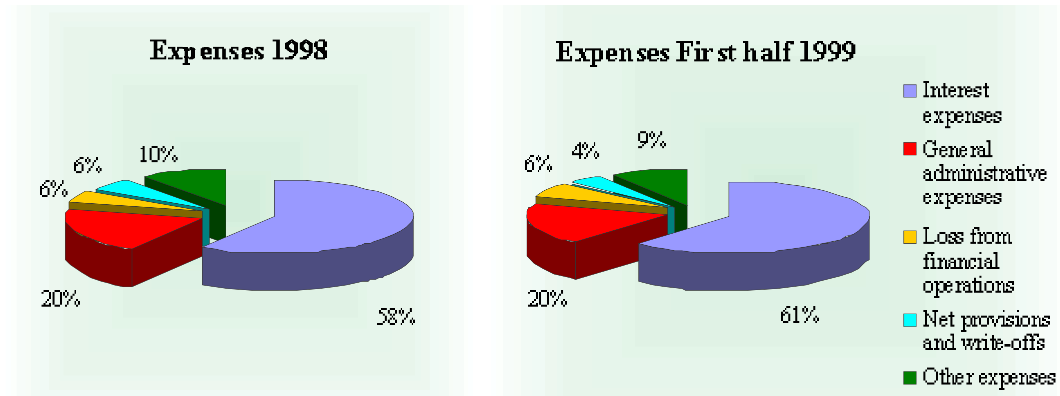


Source: The Bank of Slovenia

Interest expense accounted for 61% of banks' expenditures.

Interest expenses accounted for the fattest slice in the **structure of banks' expenditures** and the share of these expenses in the first half of 1999 grew by 3 percentage points. General administrative expenses accounted for approximately 20 per cent share in expenses, loss from financial operations accounted for 6 per cent, while the share of other expenses (fees and commissions paid, depreciation, net revaluation of capital, fixed assets and capital investments, extraordinary expenses and other operating expenses) ranged during the period under review from 9 to 10 per cent. On the other hand, net expenses incurred by write offs and setting aside funds for provisions decreased by 2 percentage points.

Figure 7: Structure of banks' expenses in 1998 and in the first half of 1999



Source: The Bank of Slovenia

Table 7: Adjusted profit and loss account[11] of banks for 1998 and the first half of 1999 including growth rates

in millions of Tolars / in %

	Amount			Nominal Growth	
	1997	1998	Jan-Jun 1999	1998/1997	Jan-Jun 1999 / Jan-Jun 1998
Net interest income	84,512	90,153	44,092	6.7	-6.4
-real part	54,936	57,384	29,176	4.5	3.9
-revaluation part	29,576	32,769	14,916	10.8	-21.5
Net fees and commissions	26,923	30,206	16,761	12.2	16.5
Net financial operations	7,462	6,691	3,054	-10.3	-32.5
Net other*	-6,725	-3,726	-135	-44.6	-97.0
Gross income**	112,173	123,324	63,773	9.9	3.8
Operating costs	68,846	78,542	42,568	14.1	11.3
- general administrative expenses	58,111	65,808	34,941	13.2	14.7
- depreciation	7,393	8,203	4,690	11.0	6.0
- taxes, levies and other	3,342	4,531	2,937	35.6	-12.1
Net income	43,327	44,782	21,205	3.4	-8.7
Net provisions and write-offs	-22,240	-18,806	-7,776	-15.4	-13.8
Profit before taxation	21,087	25,976	13,430	23.2	-5.4

* Net other = Other operating profit + extraordinary income - other revaluation expenses - revaluation of capital, fixed assets and capital investments - extraordinary expenses

** Gross income = Net interest income + net fees and commissions + net financial operations + net other

Source: The Bank of Slovenia

Banks' net interest income decreased in real terms.

Net interest income received accounted for 69 per cent of gross income which banks operating in Slovenia earned in the first half of 1999, even though in comparison with the first six months of 1998, interest rates were lower in nominal terms by 6.4 per cent (10.3 per cent in real terms), due to a decrease in the revaluation part of net interest income in the first place. The revaluation element of net interest dropped by as much as 21.5 per cent in nominal terms.[12] The real part of net interest, accounting for the larger share of total net interest income (66.2 per cent), increased in the first half of 1999 (June-on-June) by 3.9 per cent and thus slowed down falling of net interest.

Net fees and commissions accounted for 26.3 per cent of gross banks' earnings in the first half of 1999 and recorded the highest growth in all sources of net income. A comparison with the first half of 1998 shows that fees and commissions received increased by 16.5 per cent in nominal terms (11.7 per cent in real terms). Such an increase was triggered by fees and commissions charged for lending operations (rising 20.4 per cent in comparison with the first half of 1998) and charges for rendering administrative services (21.8 per cent growth with respect to the first half of 1998). Fees and commissions received increased by SIT 2.9 billion, whereas fees and commissions paid grew by only SIT 549 million.

11 The format of the profit and loss account has been adjusted to meet specific analytical requirements; hence, it slightly differs from the layout and terminology of the profit and loss account prescribed under Slovenian Accounting Standards.

12 The decrease is mainly a result of the application of nominal interest rates on all bills of the Bank of Slovenia (including 270-day bills).

Similarly to net interest income, net financial operations[13] generated lower yield in the first half of 1999 in comparison with the first half of 1998. Although the decrease was 32.5 per cent, it was mainly due to an increase in expenses incurred by valuation of dealing securities (valuation expenses rose by more than three times in comparison with the first half of 1998).

Gross earnings of banks have been reduced mostly due to operating costs[14] incurred by banks. These costs totalled SIT 42.5 billion for the first six months of 1999. Although operating costs rose in absolute figures, their share in average total assets of banks is falling.

Lower provisions earmarked by banks

In the first half of 1999, banks earmarked SIT 7.7 billion for net provisions and net write offs - less than in the same period of 1998 when this figure was SIT 8.9 billion. When this amount is added to gross profit earned in the first half of 1999 (SIT 13.4 billion), then net provisions and net write-offs represent accumulated banks' assets, which in the first half of 1999 equalled SIT 21.2 billion.

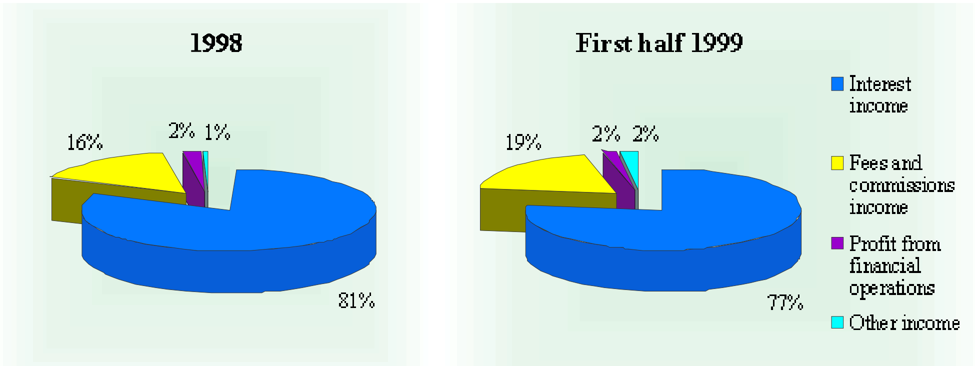
In the first half of 1999, **savings banks** generated profit in the amount of SIT 146.8 million. This figure means a rise of SIT 66 million with respect to the same period in 1998. Profit before tax earned by savings banks in 1998 amounted to SIT 40.1 million – a nominal fall of as much as 40.7 per cent with respect to 1997 (SIT 67.6 million). Profit after tax (tax on profit and tax on total assets amounted to SIT 22.8 million) totalled SIT 17.2 million.

All savings banks made profit in 1H99.

All savings banks reported profit in the first half of 1999, after one savings bank ended 1998 with a loss.

A glance at the **structure of earnings** generated by savings banks shows that just like in banks, interest income earned by savings banks accounted for the biggest share of all earnings, even though the share of interest decreased by 4 percentage points with respect to 1998. Hence, savings banks had in the first half of 1999 a smaller income share derived from interest received than banks. Fees and commissions received followed with a rising share in total earnings (a similar trend was observed in banks). Earnings arising from financial operations in the first half of 1999 remained at same level as in the first half of 1998 (slightly under 2 per cent of total earnings).

Figure 8: Structure of income of savings banks in 1998 and in the first half of 1999



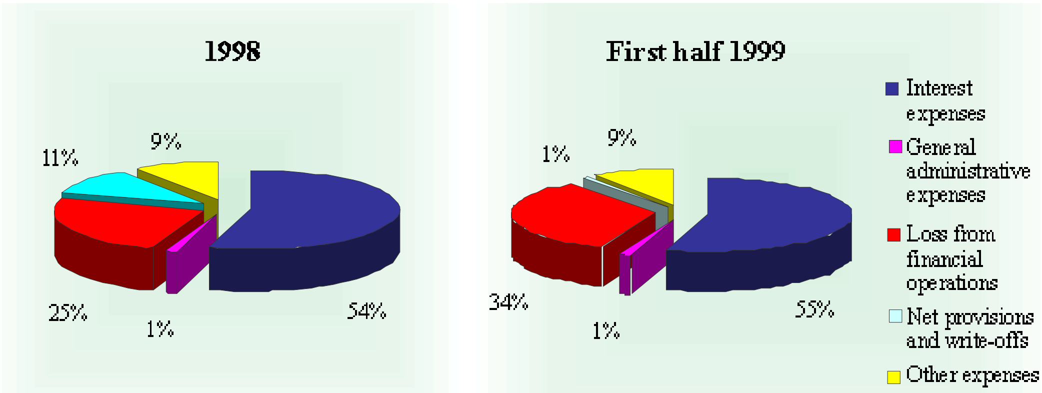
Source: The Bank of Slovenia

[13] Net financial operations are presented as a sum of income from dealing securities and profit from financial operations minus a loss from financial operations.

[14] Operating expenses comprise general administrative expenses (labour costs, material costs, and services costs), depreciation, and other operating expenses (taxes, levies, and other).

By analysing the **structure of expenses** of savings banks, one will notice that the share of interest expenses increased during the period under review. The share of general administrative expenses swelled as well (the rise was as much as 9 percentage points). The composition of general administrative expenses shows that costs for service, as well as for wages and salaries, increased. On the other hand, the share of net write offs and provisions decreased (from 11 per cent in 1998 to 1 per cent in mid-1999). Since the figures released for the first six months of 1999 are not audited results, it is likely that the share of provisions at the end of the year will be higher.

Figure 9: Structure of expenses of savings banks in 1998 and the first half of 1999



Source: The Bank of Slovenia

Net fees and commissions charged by savings banks increased.

Net fees and commissions acted as a spur for the rise in profit generated by savings banks in the first six months of 1999. The net fees and commissions rose by SIT 24.2 million (a rise of 20.4 per cent) due to the increase in fees and commissions received in the amount of SIT 21.7 million (a rise of 17.1 per cent), and the decrease in fees and commissions paid by SIT 2.4 million (a rise of 28.4 per cent). Fees and commissions charged on lending operations outpaced other fees and commissions received.

Interest income accounted for a solid portion of higher earnings (mainly interest charged on long-term loans). June-on-June figures show that interest income increased by almost SIT 18 million or by 4.9 per cent in nominal terms (even though the share of interest income in total earnings decreased). As regards interest expense, this item slightly decreased (from SIT 178.4 million in the first half of 1998 to SIT 173.4 million in the first half of 1999).

Stronger profit figures reported in the first half of 1999 were partly a result of changes of the amount of net provisions.

4. PROFITABILITY RATIOS

Banks' profitability deteriorates.

Profitability reported by **banks** for the first half of 1999 was lacklustre in comparison with 1998. Return on average assets (ROAA) in banks slightly rose in 1998, but then fell down again in the first half of 1999 to the level recorded in 1997 when it was 1.1 per cent. Return on average equity (ROAE) decreased to 10.8 per cent – still above the level recorded in 1997.

The share of operating costs incurred by banks in average total assets has been going down since end-1997 (3.7 per cent) to end-1998 (3.6 per cent), and at the end of June 1999 this figure was 3.5 per cent. The decrease is a result of lower labour costs, while the share of other operating expenses remained unchanged.

Table 8: Profitability ratios

in %

	1997	1998	Jan - Jun 1999
Return on average assets	1.1	1.2	1.1
Return on average equity	10.3	11.3	10.8
Net interest margin*	4.9	4.5	4.1
Labour cost/Average assets	1.9	1.8	1.7
Other operating expenses/ Average assets	1.8	1.8	1.8

Source: The Bank of Slovenia

Net interest margin continues to decrease.

As regards net interest margin, it was rising from 3.7 per cent in 1994 to 5.6 per cent in 1996. From 1997 onward, net interest margins have been going down. In 1998 this trend continued and persisted in the first half of 1999 (net interest margins fell from 4.9 per cent in 1997 to 4.5 per cent in 1998, and averaged 4.1 per cent for the first half of 1999).

The interbank agreement on ceiling interest rates paid on deposits by banks and savings banks had a significant influence on the level of interest rates in 1998 and in the first two months of 1999. The agreement effective from April 1995 was amended several times until 1 March 1999 when its validity expired. Prior to that date, the Bank Association of Slovenia issued a recommendation to member banks as to the interest rates paid on deposits in Tolars and foreign currencies. These caps on deposit interest rates were recommended after 1 March 1999, and the purpose of issuing such a recommendation was to avert a hike in interest rates.

In order to provide incentives for long-term savings, the Bank Association of Slovenia amended the above-mentioned recommendation in June 1999 and rose the ceiling interest rates for deposits with maturity of more than 181 days with effect from 1 August 1999.

The fall in interest rates paid on deposits in 1998 and in the first half of 1999, which also affected lending interest rates charged in 1998, may be observed in average declared and effective[15] interest rates in banks. In June 1999, interest rates charged on loans and advances to the corporate sector slightly increased owing to stronger demand for borrowed funds, partly spurred by the introduction of value added tax scheduled for 1 July 1999.

[15] Average declared and effective interest rates are calculated on the basis of interest rates actually effected over the designated period under the respective loan agreement.

Table 9: Average real effective interest rates in banks

in %

Year		Lending interest rates				Deposit interest rates (time deposits)			
		Short term loans		Long term loans		31 days to 1 year		Over 1 year	
		r (T)	r (D)	r (T)	r (D)	r (T)	r (D)	r (T)	r (D)
1997	1Q	10.4	9.6	10.5	8.4	5.8	5.1	7.1	6.8
	2Q	10.0	8.4	9.7	9.2	4.9	5.1	6.9	6.5
	3Q	9.4	8.7	9.7	8.6	4.7	3.8	6.7	6.5
	4Q	9.0	8.1	9.4	8.6	4.5	5.0	6.7	6.5
1998	1Q	8.3	7.4	9.0	7.5	4.3	4.4	6.3	6.0
	2Q	7.3	7.0	8.1	8.4	3.4	3.9	6.1	5.9
	3Q	6.7	7.0	7.5	6.9	2.4	2.3	5.7	5.9
	4Q	5.9	6.9	6.8	7.5	2.0	1.4	5.4	5.8
1999	1Q	5.5	6.5	6.6	6.9	1.9	1.7	5.1	5.3
	2Q	5.1	6.1	6.4	7.0	2.0	1.4	4.9	5.3

Source: The Bank of Slovenia

As a consequence of the falling inflation and base interest rate (referred to as TOM), nominal interest rates also went down during the period under review.

Interest spread narrows.

Interest spread calculated as the difference between average nominal interest rate charged on loans and average nominal interest rate paid on deposits in Tolars from non-bank customers decreased in 1999, and in the second quarter of 1999 recorded the record low since the first quarter of 1997: 5.6 percentage points (in the first quarter of 1998, it was 7.5 percentage points). Interest spread between real lending and real deposit interest rate for Tolar-denominated loans to and deposits from non-bank customers fell from 4.5 (first quarter of 1998) to 3.4 percentage points (second quarter of 1999).

Savings banks' profitability increases in 1H99.

Profitability in **savings banks** compared favourably with banks' profitability in the first half of 1999. High profit figures at mid-1998, however, deteriorated considerably in audited annual accounts for the 1998.

Return on average assets of savings banks, which at the end of 1998 equalled 0.5 per cent (at the end of June 1998 this ratio was 2 per cent), continued to grow and notched 2.9 per cent at the end of June 1999. This indicator was at half-year considerably better in savings banks than in banks, but these figures have to be checked by auditors. Return on average equity in savings banks was at the end of 1998 considerably lower than return on average equity in banks – 4.7 per cent. Interim results for 1999 reported return on average equity of 32.9 per cent.

Operating costs reported by savings banks, which at the end of 1998 equalled 5.4 per cent of average total assets of savings banks, decreased to 5.1 per cent of average assets at the end of June 1999. This item has to be cut down if competitiveness is to be improved.

Net interest margin has been going down in savings banks just like in banks. At the end of 1998, net interest margin equalled 5.6 per cent, while in June 1999 it was 5.5 per cent. As regards interest spread, savings banks fared just like banks during the period under review. Thus interest spread has been squeezed: as nominal interest spread for Tolar-denominated loans/deposits to non-bank customers dropped from 7.6 percentage points in the first quarter of 1998 to 5.7 at mid-1999.

5. CREDIT RISK

For banks operating in Slovenia, credit risk is regarded as the most significant risk along with operational risk. Since 30 June 1999, banks disclose credit risk along the lines of the criteria laid down in the Decree on the Classification of On-balance Sheet Assets and Off-balance Sheet Items of Banks and Savings Banks (Official Gazette of the Republic of Slovenia, No. 32/99). The Decree passed in 1999 supersedes the Decree of the same description passed in December 1996 and amended in July 1998. The “new” Decree did not introduce any major changes.

The criteria for the classification of receivables in categories ranging from A to E have become more stringent in 1993 (in 1991 and 1992 only past-due payments were taken into account). The unchanged classification criteria remained effective from the end of 1993 until the end of 1996. As from 1 January 1997, more comprehensive criteria were introduced. While the methodology effective between 1993 and 1996 was built upon creditworthiness of banks’ counterparties, it was still allowed under certain circumstances to classify assets collateralised by pledging moveable property or real estate in the best category – category A – irrespective of the borrower’s creditworthiness. Since January 1997, receivables secured by pledging property may be classified only one step higher than the ranking awarded on the basis of the counterparty’s credit standing. Phasing in more stringent criteria helped to avert an immediate deterioration of banks’ loan portfolios. In addition, banks were given time to allocate additional provisions until the end of 1997.

In spite of bleak prospects, banks’ loan portfolios did not deteriorate at the end of 1997. A number of banks took timely steps and other banks applied classification criteria exclusively on the basis of the assessment of counterparties’ creditworthiness. The array of collaterals was rather wide proved to be irrelevant, and the share of bills of the Bank of Slovenia (graded as category A) subscribed by banks increased.

Performing assets account for approximately 95% of assets.

Over the last three and a half years, the share of performing assets (receivables classified in categories A and B) at year-end has been between 94 and 95 per cent. On the other hand, the share of non-performing assets has ranged between 5 and 6 per cent, and the share of bad assets (receivables classified in categories D and E) has been between 3 and 4 per cent.

At the end of 1998, performing assets in banks, which include on- and off-balance sheet items, totalled slightly above the figure recorded a year earlier – 94.6 per cent. At the end of June 1999, performing assets accounted for 95.1 per cent of aggregate total assets of banks classified in categories A to E. The increase reported as at 30 June 1999 was at the expense of the share of bad assets (categories D and E), falling by 0.4 percentage points from 3.3 per cent to 2.9 per cent.

Table 10: Classification of on- and off- balance sheet items in banks

in %

Category	31 Dec 1993	31 Dec 1994	31 Dec 1995	31 Dec 1996	31 Dec 1997	31 Dec 1998	30 Jun 1999
A	81.1	86.1	89.4	89.5	90.1	89.6	89.6
B	6.6	5.7	4.8	4.2	4.4	5.0	5.5
C	4.7	2.5	1.9	2.4	2.3	2.1	2.0
D	3.2	2.6	2.1	2.2	1.8	1.8	1.5
E	4.3	3.1	1.8	1.6	1.4	1.5	1.4

Source: The Bank of Slovenia

Independent of collateral pledged, performing assets account for 93% of assets.

If assets were graded only on the basis of counterparties' creditworthiness without taking into account that certain kinds of security could improve classification of assets, then as at 30 June 1999 there would be 83.8 per cent of receivables classified in category A (4.6 percentage points more than as at 31 December 1998), 9.6 per cent of receivables would be in category B (1.6 percentage points less than at the end of 1998), 2.6 per cent of receivables would be in category C (1.5 percentage points less than as at 31 December 1998), 2.1 per cent of receivables would be in category D (0.4 percentage points less than at the end of 1998), and 1.9 per cent of receivables would be in category E (1.1 percentage points less than as at 31 December 1998).

Net aggregate exposure to credit risk (on- and off- balance sheet items) as at 31 December 1998 amounted to SIT 2,727.0 billion, whereas as at 30 June 1999, this figure was SIT 2,988.8 billion – nominal growth of somewhat less than 10 per cent (6.7 per cent in real terms) with respect to the end of 1998.

Together with suspended income, exposure reported as at 31 December 1998 totalled SIT 2,775.4 billion (composed of SIT 2,271.7 billion in risk-weighted assets and SIT 503.7 billion in risk-weighted off-balance sheet items). As at 30 June 1999, this figure was SIT 3,043.7 billion (composed of SIT 2,466.3 billion in risk-weighted assets and SIT 577.4 billion in risk-weighted off-balance sheet items).

The highest growth rate was recorded in category B (19.4 per cent). Above average growth was accounted for as at 30 June 1999 with respect to 31 December 1998 in the case of receivables classified in category A, while receivables classified in category C reported below average growth (5.6 per cent) and E (3.8 per cent). Receivables classified in category D decreased during the period under review.

The volume of adjustments and provisions at mid-1999 in comparison with 1998 went up by 3.4 per cent, and reflected the stabilisation of growth recorded in the preceding period when growth rate was 14.9 per cent. The volume of adjustments and provisions exceeded mandatory thresholds.

Table 11: Exposure of banks per category and adjustments and provisions made

in millions of Tolars

Category	Aggregate Exposure	Adjustments, Provisions	Aggregate Exposure	Adjustments, Provisions	Aggregate Exposure	Adjustments, Provisions
	31 Dec 1997		31 Dec 1998		30 Jun 1999	
A	2,067,463	1,325	2,442,371	683	2,677,141	197
B	100,241	11,772	137,094	15,613	163,699	18,884
C	53,040	17,386	56,335	16,780	59,516	18,625
D	40,352	27,925	50,155	30,774	45,829	28,194
E	32,885	32,877	41,023	41,035	42,573	42,516
TOTAL	2,293,981	91,285	2,726,979	104,885	2,988,758	108,415

Source: The Bank of Slovenia

Substandard receivables are well covered by earnings.

The share of bad and doubtful receivables in gross assets increased as at 31 December 1998 year-on-year from 9.4 to 10.9 per cent. The share of value adjustments in gross assets of banks increased from 5.2 to 6.1 per cent. As at 30 June 1999, the share of bad and doubtful receivables in gross assets slightly decreased again and notched 10.7 per cent. On the other hand, the share of value adjustments in gross assets remained unchanged. The coverage of bad and doubtful assets by value adjustments as at 31 December 1998 was 56.1 per cent, and increased further to 57.2 per cent as at 30 June 1999. Such a volume of value adjustments indicates that substandard receivables are well secured in line with principles of safe and sound banking operations.

The volume of bad and doubtful receivables of banks in 1998 grew at a faster pace than the total volume of operations. Between 31 December 1997 and 31 December 1998, the growth rate of bad and doubtful receivables was 34.6 per cent, while the growth rate of the volume of operations was 16.2 per cent. In the first half of 1999, bad and doubtful receivables increased by 6.7 per cent, while the volume of operations grew by 8.3 per cent.

Lending structure per sector practically unchanged.

The structure of banks' assets per sector in the first half of 1999 in comparison with the previous year did not undergo essential changes. The bulk of assets was invested in financial services[16] (17.5 per cent), despite the fact that the share of financial services in total assets has decreased (at end-1998 it equalled 18.1 per cent). Lending to processing industries ranked second (13.1 per cent), with chemical, metal processing and machine industry in the lead. Since the end of 1998, the share of lending to processing industries has decreased by 0.4 percentage points. Exposure to public authorities, defence and social security[17] ranked third and at mid-1999 accounted for 12.9 per cent of all assets. Their share dropped in comparison with the end of 1998 when it stood at 13.3 per cent. Exposure to clients involved in trade and repairs of motor vehicles accounted for 10.3 per cent, followed by financing of real estate, leasing and business services (5.4 per cent). Transport, warehousing and communications notched 4.7 per cent.

Exposure to the corporate sector accounted for over three quarters of assets (76.0 per cent), followed by lending to individuals which grew by 0.7 percentage points and notched 14.5 per cent, and exposure to non-residents which equalled 9.6 per cent.

Savings banks do not classify receivables on the basis of collateral.

Over the last two and a half years, performing assets in **savings banks** ranged between 94 in 95 per cent at year-end, while non-performing assets accounted for 5 to 6 per cent. Unlike banks, savings banks seldom benchmark their loan portfolio against the quality of security (if any). Secured or unsecured, classification of assets has almost identical result. This indicates that a counterparty's creditworthiness is decisive for classification purposes. More stringent criteria for the classification of receivables in 1997 did not affect the quality of savings banks' asset portfolio.

At the end of June 1999, the share of receivables classified in category A increased to 90.2 per cent of all classified assets and off-balance sheet items. The increase was mainly at the expense of the declining share of receivables graded in B category. Over the past years this share was around 6 per cent, and at mid-1999 it plunged below 5 per cent. The share of receivables classified in categories C, D and E also dropped.

16 Financial intermediation includes also claims on the Bank of Slovenia, which as at 30 June 1999 accounted for 64% of aggregate exposure inherent in financial services.

17 This group also comprises securities issued by the government.

Table 12: Classification of on- and off- balance sheet items in savings banks

in %

Category	31 Dec 1993	31 Dec 1994	31 Dec 1995	31 Dec 1996	31 Dec 1997	31 Dec 1998	30 Jun 1999
A	89.8	91.6	86.2	85.8	88.7	88.6	90.2
B	5.9	4.1	7.2	6.3	6.5	5.5	4.7
C	1.0	2.2	3.4	3.7	1.3	1.8	1.6
D	0.3	0.5	1.3	2.3	1.8	2.3	1.8
E	3.0	1.6	1.9	1.9	1.7	1.9	1.8

Source: The Bank of Slovenia

With SIT 9.7 billion as at 30 June 1999 (together with suspended income SIT 9.9 billion), net aggregate exposure increased with respect to 31 December 1998 by mere 6.4 per cent in nominal terms, whereas at the end of 1998 it increased by hefty 34 per cent with respect to the end of 1997.

The volume of earmarked adjustments and provisions was in savings banks at mid-1999 lower than at the end of 1998 by 5.4 per cent – contrary to banks.

Table 13: Exposure of savings banks per category and adjustments and provisions made

in millions of Tolars

Category	Aggregate Exposure	Adjustments, Provisions	Aggregate Exposure	Adjustments, Provisions	Aggregate Exposure	Adjustments, Provisions
	31 Dec 1997		31 Dec 1998		30 Jun 1999	
A	6,059	0	8,113	0	8,784	0
B	443	39	503	47	462	46
C	89	23	162	41	156	39
D	120	60	209	110	172	91
E	119	119	170	170	171	171
TOTAL	6,830	241	9,156	367	9,744	347

Source: The Bank of Slovenia

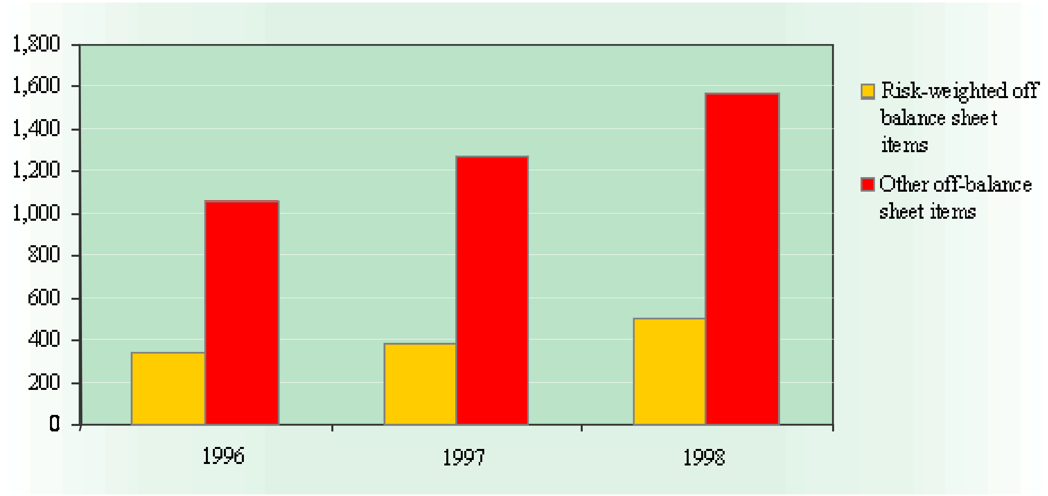
6. OFF-BALANCE SHEET ITEMS

Risk-weighted off-balance sheet items are defined in the Decree on the Classification of On-balance Sheet Assets and Off-balance Sheet Items of Banks and Savings Banks (Official Gazette of the Republic of Slovenia, No. 32/99) as guarantees issued, uncovered letters of credit, endorsed and accepted bills of exchange, irrevocable commitments assumed under credit facilities granted and undrawn standby facilities and overdrafts under credit lines, as well as other commitments, which may result in a liability to effect a payment. As in the case of on-balance sheet receivables, off-balance sheet items are classified in categories ranging from A (standard) to E (loss).

Risk-weighted off-balance sheet items account for 26.1% of total off-balance sheet items.

As at 31 December 1998, aggregate off-balance sheet items (risk-weighted and off-balance sheet items) totalled SIT 2,075.4 billion (as at 30 June 1999 this figure was SIT 2,214.0 billion), and accounted for 88.3 per cent (86.5 per cent as at 30 June 1999) of total assets of all Slovenian banks. Risk-weighted off-balance sheet items accounted for 24.3 per cent at end-1998 (26.1 per cent at end-June 1999) of total off-balance sheet items.

Figure 10: Off-balance sheet items in banks (in billions of Tolars)



Source: The Bank of Slovenia

Considerable rise in risk-weighted off-balance sheet items in the past few years.

Over the past couple of years, risk-weighted off-balance sheet items in **banks** have increased. At the same time, the percentage of risk-weighted off-balance sheet items with respect to total assets has been rising. After a slight drop in 1997, this percentage started to rise and at the end of 1998 reached 21.4 per cent.

Banks recorded a dramatic growth in the total amount of risk-weighted off-balance sheet items as at 31 December 1998 in comparison with 31 December 1997 (an increase of 31.6 per cent), mainly due to a substantial rise in irrevocable commitments[18] and guarantees. Each of the three largest banks ranked in terms of total assets reported growth rates of risk-weighted off-balance sheet items in excess of 40 per cent. Not only were risk-weighted off-balance sheet items growing at an exceptionally high rate, but also the currency and type structure of these items underwent considerable changes.

As regards the change of the currency structure of risk-weighted off-balance sheet items, commitments and contingent liabilities denominated in Tolars as at 31 December 1998 exceeded items in foreign currency by almost SIT 69 billion. Thus after several years, the scales tipped in favour of the domestic currency. Commitments and contingent liabilities in foreign exchange increased by mere 5.8 per cent, while the same groups of items in Tolars bounced by 61.6 per cent. Such a dramatic rise was primarily due to a considerable increase in Tolar-denominated guarantees (by 69.4 per cent), and irrevocable commitments denominated in Tolars (by 59.5 per cent).

The share of guarantees denominated in foreign currencies in total guarantees decreased from 73 per cent in 1997 to 64 per cent in 1998. Unlike guarantees, irrevocable commitments denominated in foreign currencies account for less than 10 per cent of all irrevocable commitments.

The structure composed of individual kinds of risk-weighted off-balance sheet items also underwent changes during the period under review. The share of irrevocable commitments in total risk-weighted off-balance sheet items increased from 32.9 per cent in 1997 to 40.5 per cent at the end of 1998 – faster than all other risk-weighted off-balance sheet items (an increase of 62.1 per cent with respect to 1997).

[18] Irrevocable commitments mostly consist of undrawn credit facilities granted to legal and natural counterparties.

Guarantees account for a hefty portion of commitments and contingent liabilities.

As at 31 December 1998, guarantees also increased in comparison with 31 December 1997 – by 28.4 per cent – still holding a leading position in the structure of all risk-weighted off-balance sheet items with a hefty share of 52 per cent (1997: 53.3 per cent). Irrevocable commitment account for as much as 40 per cent of the risk-weighted off-balance sheet structure, as at 31 December 1998, uncovered letters of credit, endorsed and accepted bills of exchange, and other items (forward transactions, etc.) accounted for more than 7 per cent of the structure.

All other items with the exception of guarantees and irrevocable commitments have decreased. The most dramatic fall during the period under review was "other items" where forward transactions of one bank are included. Since this figure as at 31 December 1998 with respect to 31 December1997 was halved, it triggered a drop in the share of the item in the entire banking system.

Table 14: Risk-weighted off-balance sheet items in banks

in thousands of Tolars — in %

Off-balance sheet items		Amount 31 Dec 1996	Amount 31 Dec 1997	Amount 31 Dec 1998	Share 31 Dec 1998	Nominal Growth 1998/1997
Guarantees	SIT	44,532,754	55,386,363	93,840,581	18.6	69.4%
	Forex	159,562,393	148,814,408	168,415,420	33.4	13.2%
Total		204,095,147	204,200,771	262,256,001	52.1	28.4%
Letters of credit	SIT	6,290	0	0	0.0	-
	Forex	19,966,868	20,956,537	18,230,916	3.6	-13.0%
Total		19,973,158	20,956,537	18,230,916	3.6	-13.0%
Endorsed and accepted bills of exchange	SIT	58,221	13,191	10,362	0.0	-21.4%
	Forex	1,770,479	1,483,613	1,431,119	0.3	-3.5%
Total		1,828,700	1,496,804	1,441,481	0.3	-3.7%
Irrevocable commitments assumed	SIT	90,899,522	118,549,408	189,055,981	37.5	59.5%
	Forex	2,931,638	7,389,435	15,124,366	3.0	104.7%
Total		93,831,160	125,938,843	204,180,347	40.5	62.1%
Other	SIT	2,065,607	3,261,470	3,433,449	0.7	5.3%
	Forex	17,061,695	26,789,602	14,142,226	2.8	-47.2%
Total		19,127,302	30,051,072	17,575,675	3.5	-41.5%
TOTAL	SIT	137,562,394	177,210,432	286,340,373	56.8	61.6%
	Forex	201,293,073	205,433,595	217,344,047	43.2	5.8%
TOTAL		338,855,467	382,644,027	503,684,420	100.0	31.6%

Source: The Bank of Slovenia

Risk-weighted off-balance sheet items of savings banks tripled.

All risk-weighted off-balance sheet items in **savings banks** were denominated in Tolars, and although in the course of 1998 these items grew almost twice, they failed to reach the level reported at the end of 1996.

Guarantees issued by savings banks accounted for the fattest slice of risk-weighted off-balance sheet items – an even bigger share than in banks – almost 72 per cent. The remaining part of risk-weighted off-balance sheet items were irrevocable commitments, as savings banks do not carry out other operations.

Table 15: Risk-weighted off-balance sheet items in savings banks

Off-balance sheet items		Amount (in thousands of Tolars) 31 Dec 1996	31 Dec 1997	31 Dec 1998	Share (in %) 31 Dec 1998	Nominal Growth 1998/1997
Guarantees	SIT	95,415	12,153	66,784	72.0	449.5%
	Forex	0	0	0	0.0	0.0%
Total		95,415	12,153	66,784	72.0	449.5%
Irrevocable commitments assumed	SIT	26,615	23,551	25,962	28.0	10.2%
	Forex	0	0	0	0.0	0.0%
Total		26,615	23,551	25,962	28.0	10.2%
TOTAL	SIT	122,030	35,704	92,746	100.0	159.8%
	Forex	0	0	0	0.0	0.0%
TOTAL		122,030	35,704	92,746	100.0	159.8%

Source: The Bank of Slovenia

7. COUNTRY RISK

In accordance with The Decree on the Classification of On- and Off-balance Sheet Items of Banks and Savings Banks (Official Gazette of the Republic of Slovenia, No. 32/99), banks are obliged to incorporate country risk in receivables due from non-resident counterparties. Country risk is defined as an exposure to potential losses associated with the debtor's country of origin. Banks must earmark provisions to act as a buffer against this kind of exposure at least in the amount stipulated by the Bank of Slovenia on the basis of risk assessments made for designated countries.

Banks are not required to make provisions for country risk in the following cases:

- for receivables to non-residents with contractual maturity up to 6 months,
- for receivables to branches of investment grade banks,
- for receivables collateralised by first class security[19], and
- for receivables collateralised by joint and several surety issued by blue chip domestic counterparties.

Exposure to non-residents less than 10% of total exposure.

Aggregate exposure of banks to non-resident counterparties has been slightly rising since 1997. It is, however, still below the 1996 level when it totalled SIT 318.7 billion. As at 30 June 1999, exposure to non-resident counterparties (on-balance sheet assets and off-balance sheet items) amounted to SIT 290.7 billion. This amount accounted for less than 10 per cent of total on- and off-balance sheet exposure of Slovenian banks, which as at 30 June 1999 equalled SIT 3.043.7 billion.

[19] First-class security (also referred to as collateral) comprises a bank deposit readily available for the repayment of loans and advances, securities issued by the Republic of Slovenia, Bank of Slovenia, EEA countries, and comparable OECD countries, irrevocable guarantees payable on first demand of banks authorised by the Bank of Slovenia and investment grade foreign banks, blue-chip debt securities issued by banks and traded in financial markets (excluding subordinated and perpetual securities), and irrevocable guarantees issued by the Slovene Export Corporation and the Republic of Slovenia.

Table 16: Aggregate exposure of banks to groups of countries, share of exposure in aggregate exposure and nominal growth

in millions of Tolars, in%

	Amount	Share	Amount	Share	Nominal Growth	Amount	Share	Nominal Growth
	31 Dec 1997		31 Dec 1998		1998/ 1997	30 Jun 1999		1999/ 1998
EU	199,059	**74.9%**	206,179	**74.9%**	3.6	221,640	**76.2%**	7.5
EFTA	22,747	**8.6%**	21,082	**7.7%**	-7.3	17,562	**6.0%**	-16.7
Former YU Republics	15,535	**5.8%**	17,026	**6.2%**	9.6	17,912	**6.2%**	5.2
CEFTA	1,229	**0.5%**	1,658	**0.6%**	34.9	1,485	**0.5%**	-10.4
Other	27,198	**10.2%**	29,417	**10.7%**	8.2	32,141	**11.1%**	9.3
Total	**265,768**	**100.0%**	**275,362**	**100.0%**	**3.6**	**290,740**	**100.0%**	**5.6**

Source: The Bank of Slovenia

Highest exposure to counterparties from EU Member States

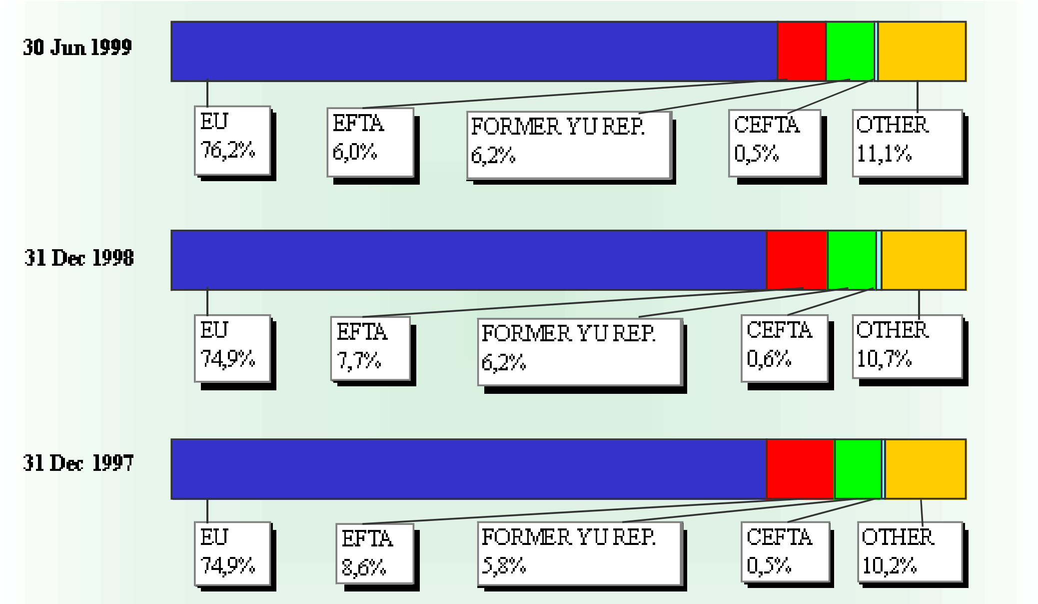
Banks are most exposed to counterparties from the European Union, since as at 30 June 1999 as much as 76.2 per cent of aggregate exposure to foreign counterparties was exposure to counterparties from the EU (SIT 221.6 billion). Growth rate exposure to counterparties from EU Member States was in the first half of 1999 slightly above average growth in exposure to non-resident counterparties and above total growth rate recorded in 1998.

Exposure to counterparties from former Yugoslav republics was in the first half of 1999 higher than exposure to counterparties from the EFTA countries for the first time since the Bank of Slovenia required credit risk to be assessed. The growth in exposure to counterparties from former Yugoslav republics was slightly below average figures (5.2 per cent in nominal terms). On the other hand, exposure to counterparties from the EFTA countries plunged by almost 17 per cent in the first half of 1999. As a result, the share of exposure to counterparties from former Yugoslavia exceeded the share of exposure to the EFTA countries.

Exposure to counterparties from the CEFTA countries as at 30 June 1999 decreased considerably (a drop of more than 10 per cent), a huge difference in comparison with the end of 1998 when year-on-year growth was almost 35 per cent with respect to the end of 1997. On the whole, exposure to counterparties from the CEFTA countries accounted for a tiny share of aggregate exposure of Slovenian banks to foreign counterparties (mere 0.5 per cent or slightly less than SIT 1.5 billion).

At the end of June 1999, exposure of Slovenian banks to counterparties from other countries was the highest in the case of the U.S.A. (SIT 26.3 billion or 9 per cent of aggregate exposure to non-resident counterparties), followed by the Russian Federation (SIT 3.5 billion or 1.2 per cent of aggregate exposure to non-resident counterparties). Exposure to counterparties from East Asia and South America is low and remained below 1 per cent (as at 30 June 1999, exposure to counterparties from East Asia amounted to SIT 193 million, i.e. 0.07 per cent of aggregate exposure to foreign counterparties, while exposure to counterparties from Latin America notched SIT 19 million, i.e. 0.01 per cent of aggregate exposure to foreign counterparties).

Figure 11: Banks' exposure to foreign counterparties



Source: The Bank of Slovenia

Since savings banks are not authorised to conduct cross-border payment transactions and lending operations, they are not exposed to country risk.

8. LIQUIDITY RISK

In 1998 and in the first half of 1999, all banks fulfilled the requirements for mandatory reserves and foreign currency minimum. In February and April 1999, liquidity fluctuated in the Slovenian banking system as banks pursued in the first place high yield over a short period of time and neglected long-term needs for the provision of liquid assets. The rise in liquidity risk was evident in liquidity ratios - deposits repayable on demand were less covered by liquid assets (this ratio fell from 26.8 per cent at the end of 1998 to 25.4 per cent at mid-1999). Furthermore, there was a considerable decrease in funding referred to as secondary liquidity with respect to the amount of deposits repayable on demand (from 63.4 per cent to 56.3 per cent).

Compliance with mandatory reserves and foreign currency minimum

Banks maintain mandatory reserves.

In 1998, all **banks** complied with the requirement regarding mandatory reserve on monthly basis, while in the case of **savings banks** one failed to achieve the mandatory reserve level for three months. In the first half of 1999, all banks and savings banks allocated sufficient funds to mandatory reserves on monthly basis. The percentage showing the level of compliance achieved by banks in the first half of 1999 was 102.6 per cent, whereas savings banks achieved 134.2 per cent.

Banks set aside in 1998 reserves, which exceeded mandatory levels by 4.1 per cent on average. In the first half of 1999, mandatory levels of reserves were exceeded on average by 2.8 per cent.

In February and April 1999, Slovenia's banking system experienced rather large amplitudes in liquidity levels. Thus at the end of January, banks' liquidity reserves hit rock bottom (SIT 55 billion of average liabilities totalling around SIT 70 billion), to climb to a record high a month later. The reasons for such boom-and-bust cycles were mainly in changing circumstances on the currency market, and also due to banks failing to obtain comprehensive information[20]. As a consequence, funds invested in secondary liquidity instruments (bills issued by the Bank of Slovenia) were too high contrary to the future needs of banks for liquid funds.

As from January 1999, *foreign currency minimum* prescribed for bank is computed in line with the new methodology. Foreign currency minimum has been determined on the basis of savings in foreign currency of individuals, savings in Tolars with special covenants, and funds placed by non-resident counterparties in foreign currency[21]. Banks must keep at least 60 per cent of mandatory foreign currency minimum in bills of the Bank of Slovenia denominated in foreign currency.

Banks complied with foreign currency minimum.

In 1998 and in the first half of 1999, banks fulfilled the requirement regarding foreign currency minimum. Foreign currency minimum increased in the first half of 1999 from SIT 362.4 billion reported at the end of 1998 to SIT 490.8 billion reported at the end of June 1999. A number of factors spurred the increase: changes of the methodology, rising exchange rates, and rising deposits repayable on demand and time deposits with maturity up to three months. For several years, banks have comfortably exceeded mandatory foreign currency minimum (by 18.9 per cent at the end of 1997, by 23.3 per cent at the end of 1998, and by 22.3 per cent at mid-1999).

Short-term planning of Tolar-liquidity flows and maturity structure

Although banks are expected to have funds available to meet commitments and avert liquidity risk, the Bank of Slovenia exercises continuing vigilance over daily cash flows on the basis of statutory planning of Tolar liquidity submitted by banks daily for the current day and the following one. Most banks have improved planning their available liquid assets, and the gap between planned and actual flows has narrowed.

In accordance with the Decree on the Required Adjustments of the Maturity Structure between Assets and Liabilities, banks must adjust asset maturity with liabilities graded in three classes. Hence, banks and savings banks had to provide assets at least in the amount of liabilities held in designated classes[22]. As at 31 December 1998, all banks fulfilled the requirements, while as at 30 June 1999 all banks[23] complied except one, which failed to meet the second grade. Savings banks had more difficulties with fulfilling the stipulated criteria.

[20] Having identified the problem, the Bank of Slovenia started to inform banks about current level of mandatory reserves in the banking system, total amounts of underwritten bills of the Bank of Slovenia, achieving open foreign currency position, and exceeded mandatory foreign currency minimum.

[21] Foreign exchange minimum amounts to 100% of demand deposits, 95% of time deposits with maturity up to three months, 75% of time deposits with maturity from three months to one year, and 35% of time deposits with maturity over one year.

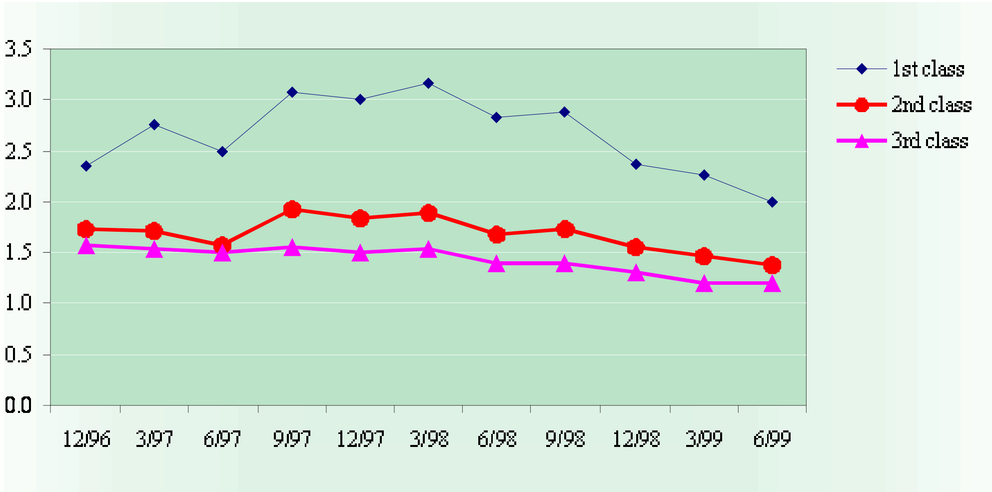
[22] The Decree classified assets and liabilities into the first, second and third classes. Grading depends on the maturity structure.

[23] Banks – members of a banking group - may include liquidity loans provided by the parent bank in any of three classes as asset.

Sound asset – liability management.

Since third quarter of 1998, banks have narrowed maturity mismatch and improved liquidity in all classes. The ability to generate liquidity and avoid maturity mismatch in the second and third class came close to mandatory minimum stipulated under the Decree (100 per cent coverage), while at the end of June 1999 coverage in the first class fell below 200 per cent for the first time since the minimum was set.

Figure 12: Quality of assets and liabilities



Source: The Bank of Slovenia

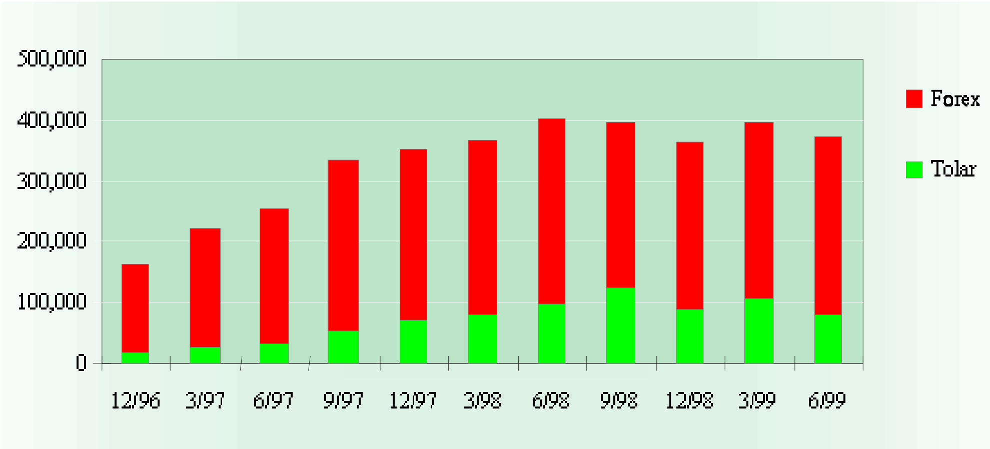
Secondary liquidity

Secondary liquidity is composed of bills issued by the Bank of Slovenia in domestic and foreign currency, and of T-bills and bonds issued by the Republic of Slovenia. Such a portfolio functions as the bank's liquidity safety net. These securities may be pledged as a collateral when applying for credits necessary to bridge liquidity problems. Banks may also obtain liquidity loans from the Bank of Slovenia against such securities.

Secondary liquidity growth stabilises.

Secondary liquidity of **banks** was still low in 1996 (SIT 163.8 billion), but then it eventually started to grow until mid-1998, so that at the end of June 1998 it reached a record high of SIT 401.5 billion. The trend was reversed in April and May 1999, and at the end of June 1999 it went up again and amounted to SIT 372.9 billion. Since the end of 1998, when secondary liquidity of banks totalled SIT 363 billion (15.5 per cent of total assets) it increased only by SIT 9.9 billion. Over a number of years, foreign currency secondary liquidity (at the end of June 1999 almost 80 per cent of secondary liquidity was in foreign currency and slightly over 20 per cent was denominated in Tolars). At the end of June 1999, secondary liquidity accounted for 14.6 per cent of total assets of the banking system.

Figure 13: Secondary liquidity of banks (in million)

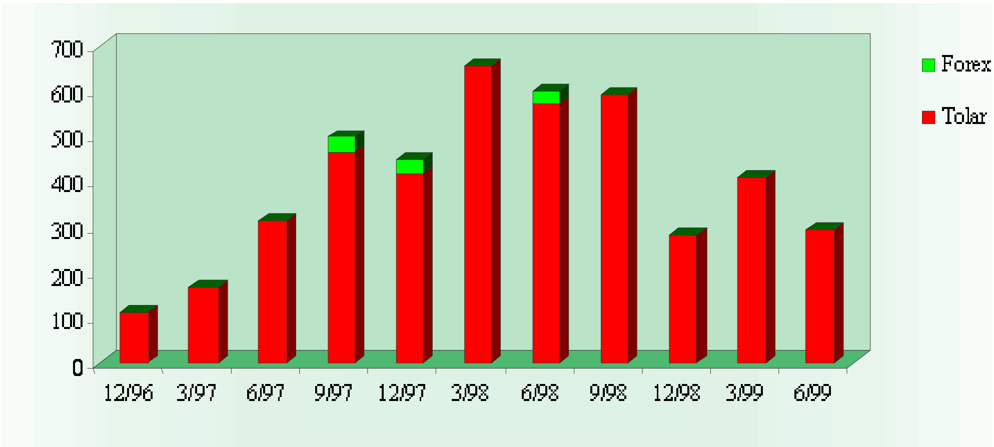


Source: The Bank of Slovenia

Savings banks invest in Tolar-denominated securities.

Secondary liquidity of **savings banks** at the end of June 1998 amounted to SIT 602.4 million. The situation changed in the second half of 1998 when this figure started to plunge. In the first half of 1999 the fall continued and the figure for the end of June 1999 was SIT 295 million. Contrary to banks, savings banks hold mostly or entirely securities denominated in Tolars as secondary liquidity instruments.

Figure 14: Secondary liquidity of savings banks (in million)



Source: The Bank of Slovenia

Major depositors

Banks' dependence on few major depositors diminishes.

Banks' statutory returns listing thirty largest depositors indicate that banks relied on few major depositors during the period under review, although there is a trend for dispersion. High level of dependence on few depositors increases liquidity risk especially as maturity dates of placed deposits were not evenly spread.

The concentration of funding varies considerably from one bank to another. The share held by thirty largest depositors as a percentage of aggregate deposit amount of the entire banking system (excluding banks and individuals) was at the end of June 1999 by 1 percentage point lower than at the end of 1998 when it stood at 51.5 per cent.

Management of liquidity risk within banking groups

Facilities available to a bank – member of a banking group – to bridge fluctuations in funding are defined in a binding agreement concluded between member banks. Such agreements on financial assistance to a bank within the banking group confronted with liquidity problems foresee financial instruments in the regular course of business (regular interbank lending), and the accommodation designed to overcome liquidity problems when banks–members of a banking group – resort to lending to the member with liquidity problems.

For the purpose of regular interbank lending, members of a banking group agree to look first for funding required to mitigate their liquidity problems within their respective banking group, and then to turn to the interbank market.

The parent bank shall notify the Bank of Slovenia about all cases of mutual funding outside the regular interbank money market. Fixing the ceiling of accommodation within the banking group, as well as other terms and conditions pertinent to such funding, is laid down in the agreement, which is binding upon all member banks.

A bank member of a banking group which fails to reach mandatory amount prescribed for the first, second and third class, may include upon the authorisation of the Bank of Slovenia in any of the three asset classes the funds agreed upon within the banking group under a binding agreement to be made available by the members of the banking group should liquidity problems arise.

9. SOLVENCY RISK

Capital adequacy ratio decreased as a result of methodology changes.

Until 1995, the ratio demonstrating capital adequacy[24] in Slovenia's banking system was getting stronger and stronger in response to capital requirements introduced by the Bank of Slovenia. Operating banks are required to maintain capital adequate to support core business and any other operations for which the respective bank holds a licence. After 1995, when capital adequacy of **banks** reached the peak value of 21.5 per cent, the curve that was steadily rising started to go down. This falling trend persisted mostly due to risk-weighted assets growing faster than regulatory capital. Thus, as at 31 December 1998 capital adequacy of Slovenian banks equalled 16.0 per cent, while as at 30 June 1999 capital adequacy ratio decreased to 14.6 per cent (the same level as at 31 December 1993 before capital adequacy started to rise).

The lower capital adequacy ratio is mainly the result of changes in the methodology prescribed for reporting on capital adequacy ratio implemented in order to improve convergence with European directives. Bank capital (also referred to as own funds) composed of core capital and supplementary capital[25] was lower with respect to the figures reported on 31 December 1998

[24] In accordance with the Law on Banking, capital adequacy ratio is calculated as bank capital (referred to in the Law on Banks and Savings Banks as regulatory capital) divided by risk-weighted assets (in the Law on Banks ad Savings banks referred to as risk-adjusted as sets) increased by adding other risk-adjusted items. Capital adequacy ratio shall at all times be at least 8 per cent.

[25] When calculating bank capital, core (tier I) capital is added to supplementary (tier II) capital less deductions.

when a bank's capital was still calculated in accordance with the »old« methodology. In line with provisions laid down in the new Decree on the Calculation of Capital, Capital Requirements and Capital Adequacy of Banks and Savings Banks (Official Gazette of the Republic of Slovenia, No. 32/99), supplementary capital does not include any more provisions earmarked for receivables classified in category A, profit for the current financial year (up to 50 per cent after deducting taxes and other levies) is included in core capital only if the amount of profit has been certified by an independent auditor, a provision not a single bank decided to apply. Another novelty is that the entire item »intangible long-term assets« shall be deducted from capital.

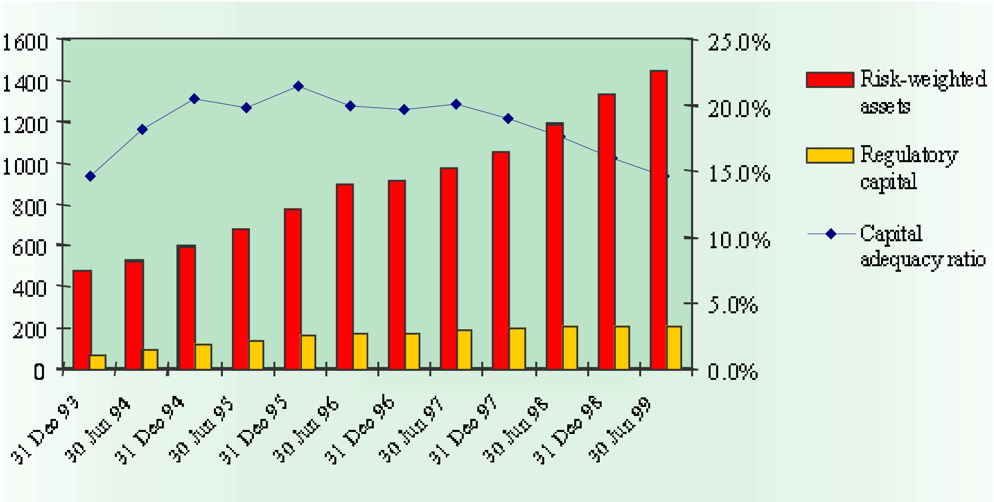
As regards the most important changes introduced under the new methodology in connection with risk-weighted assets are more stringent weightings applied to exposure to banks, inclusion of derivative financial instruments, and tighter criteria for risk-weighted assets collateralised by property (weighting is lower only if real estate is pledged as collateral).

Risk-weighted assets[26] continued to grow (the growth reported as at 30 June 1999 in comparison with risk-weighted assets as at 31 December 1998 was 8.1 per cent), and alongside lower capital, had an adverse impact on capital adequacy ratio. During the period from 31 December 1997 to 30 June 1999, capital adequacy ratio plunged by 4.4 percentage points. On the other hand, capital grew over the same period by 5.8 per cent,[27] while risk-weighted assets increased by 37.0 per cent.

Capital adequacy ratio varies from one bank to another.

Capital adequacy ratios differ considerably from one bank to another. At the end of June 1999, capital adequacy ratio ranged from 9.4 per cent to as much as 47.1 per cent (the new bank was not included). Generally speaking, larger banks have lower capital adequacy ratio.

Figure 15: Changes in risk-weighted assets and regulatory capital (in billion), and in capital adequacy ratio



Source: The Bank of Slovenia

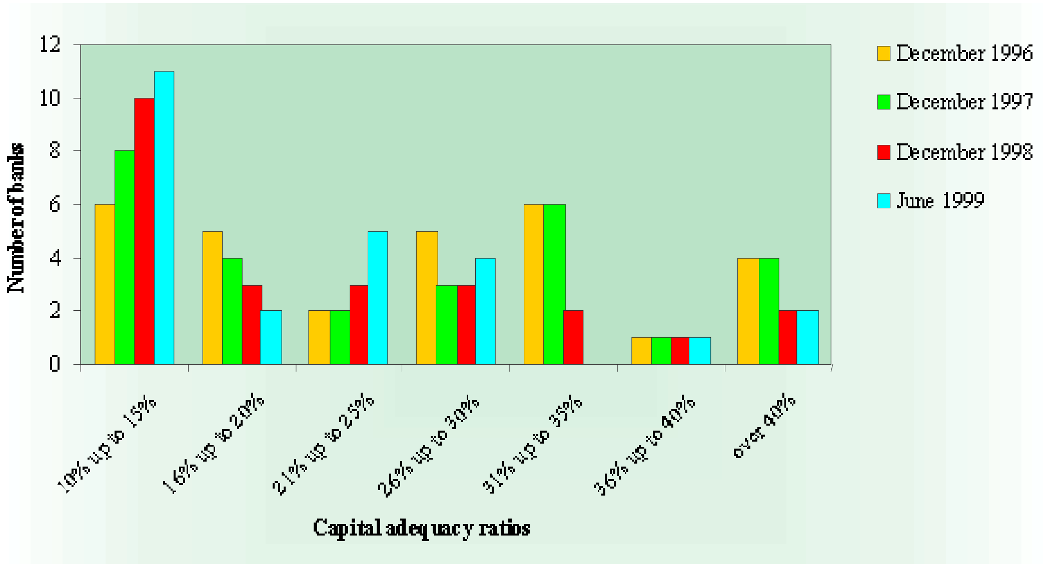
26 Risk-weighted assets is a sum of book values of all on-balance sheet assets and off-balance sheet items less specific provisions earmarked for respective items with weightings for credit risk.

27 Certain cases of decrease in banks' capital were effected by withdrawing shares, covering of losses, etc.

When all banks operating in Slovenia are classified in groups on the basis of capital adequacy ratio, it is clearly seen that the number of banks in the group of banks with the lowest capital adequacy is growing, while the number of banks in other groups which boast higher capital adequacy is falling. Thus, at the end of June 1999 almost a half of all banks (11) were in the group where capital adequacy ratio ranged between 10 and 15 per cent, five banks had capital adequacy ratio between 21 and 25 per cent, and four banks were in the group where capital adequacy ratio was between 26 and 30 per cent. No bank qualified for the capital adequacy bracket from 31 to 35 per cent. Only five banks (including the new entrant in the Slovenian banking system) had capital adequacy over 35 per cent.[28]

More banks fall into the lowest capital adequacy ratio bracket.

Figure 16: Distribution of banks in terms of capital adequacy ratios



Source: The Bank of Slovenia

Capital adequacy ratios deteriorated in **savings banks** in the first half of 1999, although it never attained capital adequacy levels reported by banks. At the end of June 1999, capital adequacy ratios in savings banks notched mere 11.6 per cent, as opposed to the end of 1998 when this figure was 13.4 per cent. Capital adequacy ratios achieved by savings banks at mid-1999 ranged between 5.4 per cent (as a consequence of the implementation of the new methodology for the calculation of capital adequacy ratio; transitional period is by 20 August 2000) and as much as 52 per cent.

10. CURRENCY RISK

Foreign currency mismatch in banks

At the end of 1998, **banks** reported as in previous year short foreign currency position in the so-called foreign currency sub-balance. Banks' sub-balance in foreign-currency as at 31 December 1998 show that liabilities in foreign currency exceeded assets by SIT 31.4 billion despite the fact that this kind of

Short position in banks' sub-balance sheets in foreign currrency.

28 When analysing the distribution of banks in capital adequacy ratio brackets on annual basis, fluctuations in the total number of banks has to be taken into account. The analysis made as at 30 June 1999 was based on the total number of 25 banks.

banks' net exposure with respect to the end of 1997 decreased by 39.5 per cent. (as at 31 December 1997 liabilities in foreign currency were higher than foreign currency assets by SIT 51.8 billion).

Out of SIT 702.0 billion of aggregate receivables denominated in foreign currency, more than a half was denominated in D-marks (67 per cent), there was a portion in US dollars (19.5 per cent), while other receivables were denominated in other currencies. Liabilities denominated in foreign currency followed a similar pattern. The major part of liabilities was denominated in D-marks (66.3 per cent); a smaller portion was in US dollars (18.3 per cent), while the portion of liabilities denominated in other currencies was slightly higher (15.4 per cent).

The Decree on the Mismatch between Assets and Liabilities of Banks in Foreign Currency (open foreign exchange position in banks) (Official Gazette of the Republic of Slovenia, No. 37/99), which became effective on 19 May 1999 and superseded the Decree bearing the same title and passed on the basis of the Law on Banks and Savings Banks, stipulates that daily short or long foreign currency position (also referred to as forex position) shall not exceed 20 per cent of bank capital, average monthly open foreign exchange position in banks shall not exceed 10 per cent of bank capital.

While as at 31 December 1997 open position in foreign currency exceeded 20 per cent of capital in nine banks, as at 31 December 1998 and 30 June 1999 no bank reported open position in foreign currency in excess of 20 per cent of bank capital.

Aggregate open position of all banks computed in line with the above-mentioned Decree, accounted as at 30 June 1999 for 5.5 per cent of bank capital.

Mismatch in transactions with foreign currency clause

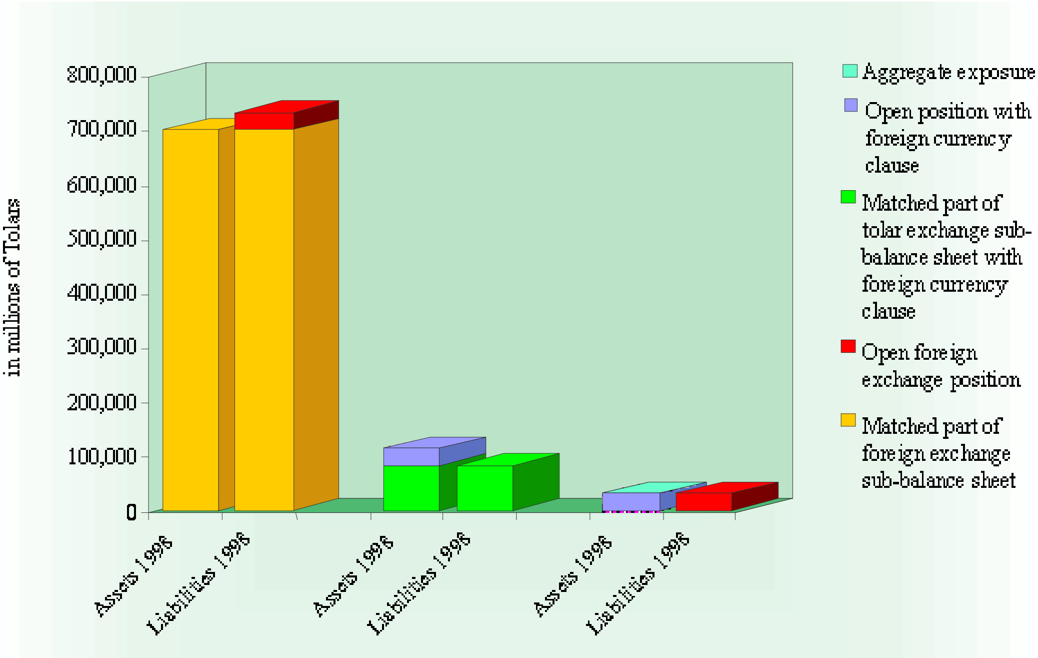
As opposed to banks' sub-balance in foreign currency, sub-balance in Tolars pegged to a foreign currency (referred to as foreign currency clause) as at 31 December 1998 showed long position. Asset items with foreign currency clause exceeded items on the liability side by SIT 31.4 billion. In comparison with balance as at 31 December1997 when this surplus totalled SIT 44.7 billion, the decrease was 29.8 per cent.

Aggregate exposure to currency risk

Banks not overexposed to currency risk.

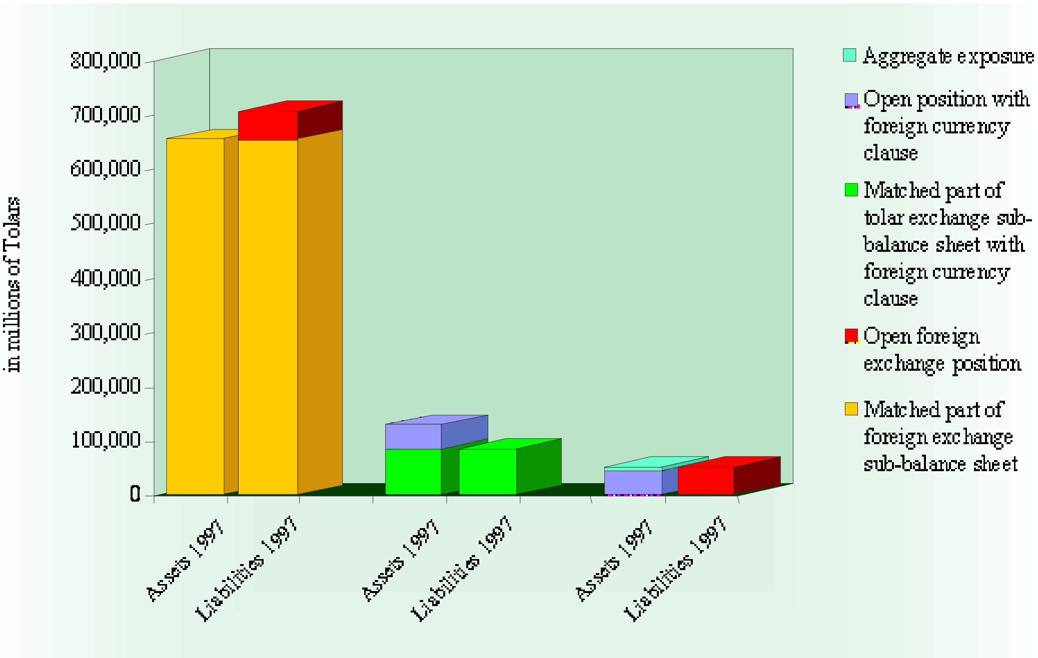
Banks' aggregate net exposure to currency risk takes into account both currency mismatch and mismatch derived from items with foreign currency clause as at 31 December 1998 equalled SIT 27.6 million – a rather insignificant mismatch. Aggregate position, which was short at the end of 1998 in comparison with the end of 1997 when aggregate net exposure to currency risk amounted to SIT 7.2 billion (the position was short, too), it decreased and practically eliminated foreign currency mismatch.

Figure 17: Exposure of banks to foreign currency risk as at 31 December 1997



Source: The Bank of Slovenia

Figure 18: Exposure of banks to currency risk as at 31 December 1998



Source: The Bank of Slovenia

Currency mismatch in savings banks

Unlike banks, **savings banks** reported as at 31 December 1998 long foreign exchange position, as on the reporting day they had SIT 10.2 million in receivables denominated in foreign currency and no liabilities in foreign currency. As at 31 December 1997, savings banks SIT 19.5 million in receivables in foreign currency and no liabilities in foreign currency.

Mismatch in transactions with foreign currency clause

As regards liabilities pegged to exchange rates, savings banks had on their books figures completely different from those reported by banks. Namely, as at 31 December 1998 Tolar liabilities with foreign exchange clause exceeded by SIT 24.7 million Tolar receivables with foreign currency clause (short position). Year-on-year analysis shows that the difference with respect to 31 December 1997 amounted to SIT 76.5 million, while receivables with foreign currency clause exceeded liabilities by SIT 51.9 million.

Aggregate exposure to currency risk

Savings banks reveal short aggregate position in foreign currency.

Aggregate exposure to currency risk (foreign currency mismatch and mismatch in transactions with foreign currency clause) was reported by savings banks as at 31 December 1998 to amount to SIT 14.5 million. As opposed to 31 December 1997 when net exposure to currency risk totalled SIT 71.4 million, the foreign currency position was short, while aggregate exposure to currency risk was lower than on 31 December 1997 in savings banks as well as in banks.

11. INFORMATION TECHNOLOGY RISK

The measurement and monitoring of risk inherent in information systems specially tailored for banking operations is a demanding multidisciplinary process. The risks inherent in a bank not being Y2K compliant is regarded as a subcategory of operational risk and may affect a number of areas such as technology and data-interchange systems. Effective risk management requires in-depth knowledge of the functioning of the IT system at the micro level of a particular bank, as well as at the macro level of the entire banking environment. To keep abreast with changes and upgrades also means to incorporate innovations in order to boost own operating results and sharpen competitive edge, but also with the aim to ensure the highest possible level of safety and stability of the information system.

Risk inherent in a bank’s information system may be dissected into mission-critical external and internal potential threats looming over the banking sector.

External threats come from outside the banking system and mainly derive from external interfaces of banks’ systems (a myriad of interbank and international networks such as the Internet). The list of potential dangerous include natural disasters such as floods, earthquakes, wars, and similar events, as well as possible thefts and damages inflicted on information resources.

Risk factors which are internal to a bank and which pose a threat to its information system are errors in application packages and system software, incorrect data input, defective planning of application packages, flawed or irregular implementation of prescribed procedures, outdated or worn-out hardware, harmful or bad contracts with suppliers of IT equipment, inadequate or sub-standard control over IT systems, and the last but not the least, human resources.

Information system breakdown still poses serious threat to banking sector.

Information system breakdowns have always posed the biggest threat to business continuity of banks' operations or any segment of banking activities in Slovenia's banking sector. The number of banks that have set up redundant[29] IT systems and IT systems at stand-by locations is still low. There is new kind of risk unknown until recently: risk inherent in electronic banking. This kind of risk combines several better-known risks such as unauthorised breaking into the IT system, and some completely new kinds of risk such as risk triggered by not responding to clients' requests for information or personal contacts, risk associated with using electronic banking facilities to pay for services via the Internet, etc.). In 1999, the activities aimed at boosting risk management practices with regard to the year 2000 problem have to be intensified.

11.1. Y2K preparedness of the banking sector

One may wonder what is it that makes the year 2000 so special that the date change calls for such comprehensive preparations.

Concerns over year 2000 computer mishaps feed on the possibility that computer systems, which for date record use two digits for year (e.g. date 15.12.1999 is entered in database as 151299).

Problems arise from the fact that quite a lot of software running on a variety of mainframes as well as on personal computers was developed years ago when storage modules and data processing cost a lot of money. Electronic data processing (EDP) of "old" generation had to be thrifty with core memory and computer capabilities; therefore, data formats for year used to be two digits only under the assumption that the first two places always stood for »19«. This line of thinking was often followed even later on when there were no more reasons for economising with storage capacities. A plausible explanation was that it was hardly to be expected that the same software would be used beyond the year 2000. Hence, such problems are likely to pop up in application packages developed in house, system and application software developed by external service providers, as well as in other software composed of elements with incorporated date functions. Exposure to IT risk surges with electronic exchange of data, which have not been written in the appropriate format; hence, such data cannot be received.

Another peculiarity of the year 2000 is that it is a leap year. A widespread opinion is that a leap year is every year, which can be divided by 4 and cannot be divided by 100. According to that criterion, the year 2000 is not a leap year and there the advocates of such theory drew a wrong conclusion. The correct formula for the calculation of a leap year has an appendix, which reads that a

29 Redundant systems are computer systems where routines are checked by two systems (also a group of systems). In the case of a breakdown of one system, the other one carries out checking routine.

year shall be treated as a leap year if it can be divided by 400. Year 2000 fulfils the last requirement.

Computer systems which use two-digit formats for year designation, or which incorporate a calendar not able to recognise the complete formula for the calculation of leap years, will function erratically and incorrectly, or will collapse, if it is not Y2K compliant. Troubled or disrupted operations justify an early involvement to ensure the Y2K compliance of banks.

Life of change-management projects tailored to ensure the Y2K compliance and envisage that banks and financial institutions will be in a position to continue with business as usual after 1 January 2000. As of the project completion date, hardware, software and other equipment will be Y2K compliant. The time between the completion of the project and the end of 1999 – this period may last a month or more– has been declared »frozen time«. In other words, no changes, upgrades or modifications meant to reduce risks inherent in the switch over to the year 2000 are allowed. Risk associated with the turn to the year 2000 are as follows: flawed functioning of software due to two-digit year formula (the year 2000 will be presented as 00), improper functioning of hardware (Run Time Clocks in conjunction with firmware or BIOS-es that cannot handle dates rolled over to year 2000), incorrect handling of year 2000 being a leap year).

Build-up of preparedness for the year 2000 according to milestones.

Examiners of the Bank Supervision Department monitor the progress of banks and savings banks in ensuring their readiness for the date change along with all other kinds of risks within the framework of regular and random target examinations of banking system. Generally, management of individual banks is responsible for the Y2K compliance. Examinations of banks in the build-up to the year 2000 started two years ago, they are conducting on continuing basis, and the intensity of such examinations is being stepped up. The latest statutory reports submitted by banks and savings banks indicate that preparedness has been increasing in accordance with project milestones. Preparedness of sixteen out of twenty-five banks as at 30 July 1999 was in excess of 85 per cent, in six banks it was over 75 per cent, and in three banks it was below 75 per cent. Exchange of information between banks on the level of preparedness has been going on via electronic networks such as Extranet and Internet).

It is reassuring to report that Slovenia's banking sector makes the grade to be included among the best-prepared sectors in connection with functioning throughout the changeover period.

11.2. Bank of Slovenia's own Y2K preparedness

The Bank of Slovenia is aware of and concerned about the impact and the risks of the Year 2000 on and for its IT systems.

The Bank of Slovenia's business functions are highly automated and information system is consequently exposed to a higher potential risk because of the year 2000 problems that may arise if the information and other electronic systems are unable to correctly process date references.

The Bank of Slovenia began with its activities related to the Year 2000 issues in March 1997. A project team, composed of representatives of IT department as well as of representatives of other departments of the Bank was set up in order to make a detailed analysis of the Year 2000 problem and its impact on the operational functioning.

The overall impact of Y2K on the Bank of Slovenia is relatively small.

The analysis showed that the overall impact of Year 2000 on the Bank is relatively small, since there have been coding standards in place for almost ten years and the Bank usually keeps up to date with the latest software and hardware releases. Nevertheless, some renovations of applications were still deemed necessary to ensure their Year 2000 compliance. In order to achieve this goal, inventories have been prepared and the effort necessary to renovate the applications was estimated. The renovations were undertaken and are completed and so is the »present date« and integral testing (in separate, specially designed testing environment, with system date shifted to year 2000). In June the testing of RTGS system and mandatory SWIFT testing were successfully performed. Some external testing (by suppliers) was carried out from April till March and some more were carried out in September 1999, mostly of the non-critical equipment. The rest of 1999 will be dedicated to observation and eventual additional corrections and testing. There are however a few outstanding compliance issues depending on external suppliers and these are planned to be compliant by the end of September 1999.

The Bank of Slovenia tested software changes well in advance.

The Bank of Slovenia defined December 1999 as the »frozen-time zone«. During this time no decisions will be implemented that could cause changes in information systems of its customers. The Bank of Slovenia also adopted an initiative that 30 December 1999 will be the last business day in 1999 and 4 January 2000 the first business day in 2000. This initiative was forwarded to various institutions (Ministry of Finance, The Bank Association of Slovenia, Agency of the Republic of Slovenia for Payments,...).

We have obtained certificates on Y2K compliance from our hardware, software and suppliers of other equipment. Most of the equipment was Y2K ready, some upgrades or installations were required and have been performed.

All around the world, as well as in Slovenia, the demand for banknotes and coins tends to increase significantly around the end of the year. The Bank of Slovenia has a sufficient stock of banknotes and coins of all face values so that it can meet a substantial increase in demand. The Banknote Department monitors the cash flows and through appropriate distribution system ensures availability of cash throughout the country.

The first part of contingency plan prepared by the project team (covering the period from 30 April 1999 to 31 December 1999) was adopted by the Board of Directors and the Governing Board according to the project plan. The second part of the contingency plan (covering the period after 31 December 1999) is prepared and was presented to the Board of Directors and the Governing Board. It will be tested and refined by the end of the 1999. The organisational preparations for the changeover weekend are in progress.

Monthly reports on the status and activities related to the Year 2000 are provided to the Vice Governor in charge and quarterly to the Board of Directors and the Governing Board. From September 1999 the reporting to the the Board of Directors and the Governing Board will be on a monthly basis. The Year 2000 project was reviewed by external and internal auditors.

Due to increased interest in Bank of Slovenia's readiness for the year 2000, a designated working group "Year 2000 and Bank of Slovenia's relations with domestic and foreign institutions" was set up.

Testing of the Real Time Gross Settlement System (RTGS)

In June 1999 the Bank of Slovenia (Payment Systems Department) together with individual member institutions carried out mandatory Y2K testing of SWIFT as well as testing of Y2K compliant version of CAS software. Testing was performed in the special testing environment in the Bank of Slovenia as well as in the RTGS member institutions

Testing was divided into two cycles:

- the first cycle was performed from 8 June to 11 June and covered SWIFT dates from 30 December 1999 to 2 January 2000
- the second cycle was performed from 23 June to 24 June and covered SWIFT dates from 29 February 2000 to 1 March 2000.

All RTGS members received special scenarios for each cycle. The following critical dates were tested:

- 8 June 1999 Y2K CTS (Year 2000 Customer Test System) SWIFT date 30 December 1999
- 9 June 1999 Y2K CTS (Year 2000 Customer Test System) SWIFT date 31 December 1999
- 10 June 1999 Y2K CTS (Year 2000 Customer Test System) SWIFT date 1 January 2000
- 11 June 1999 Y2K CTS (Year 2000 Customer Test System) SWIFT date 2 January 2000
- 23 June 1999 Y2K CTS (Year 2000 Customer Test System) SWIFT date 29 February 2000
- 24 June 1999 Y2K CTS (Year 2000 Customer Test System) SWIFT date 1 March 2000

The main purpose of this testing was end-to-end testing by all member institutions. In the Bank of Slovenia the testing included all applications that are used in daily business.

Good results of SWIFT tests connected with Y2K

The testing both in the Bank of Slovenia, the Payment Agency and commercial banks was very successful and no significant errors occurred.

III. DEVELOPMENTS IN THE LEGAL FRAMEWORK AND THE PAYMENT SYSTEMS REFORM

1999 marked by the promulgation of the Europe Agreement and the Law on Banking.

The fundamental act to govern the banking sector in Slovenia is the Law on Banking being prepared by the Ministry of Finance in co-operation with the Bank of Slovenia. The Law on Banking entered into force on 20 February 1999 – only three weeks after the Europe Agreement became effective.

A wide range of novelties entered the banking sector under the new Law, generally bringing Slovenia's banking industry in line with European. The bulk of secondary legislation deriving from the new Law was in place by the end of May 1999.

The most important novelties implemented under the new Law are summarised below.

- Initial capital required for a bank set at one billion Tolars (approximately EUR 5 million) irrespective of the extent of banking operations implies that the previous classification of banking licenses has been abolished. The reduced amount of initial capital of 186 million Tolars (approximately EUR 1 million) is allowed only when establishing a savings bank or a savings and loan undertaking (savings and loan undertakings have been granted a five-year transitional period).
- The requirements to be complied with when applying for the authorisation to carry out banking operations are listed in the Law. The Bank of Slovenia has been vested with power to lay down criteria regarding staff, organisational and technical issues applicable when banking, i.e. other financial services are provided.
- The duties of members of management board have been elaborated under the new Law to the larger extent in comparison with the old Law on Banks and Savings Banks.
- Foreign banks may open a branch office in Slovenia on the basis of an authorisation to be issued by the Bank of Slovenia.
- The Law has wiped out all differences in the treatment of domestic and foreign shareholders with respect to the acquiring of shares of Slovenian banks (an authorisation is required for a qualifying holding).
- Safe and sound operations of banks are provided for by means of capital requirements calculated with respect to the extent and nature of operating activities performed by the respective bank, and risk management for all kinds of exposure within limits laid down by the Law.
- One of the novelties introduced under the Law is also a fund set aside for general banking risk. The general banking risk fund is not obligatory for banks as a cushion for potential operating losses.
- The Law has introduced consolidated supervision of banks, in other words, supervision of all members of a banking group with the aim of establishing if the banking group operates in line with prudential rules.
- The authorisation to discharge the supervisory function has been extended to legal persons connected with the bank and other persons as well, in the case of grounded suspicion that such a person carries out banking services without authorisation of the Bank of Slovenia.

- The definition of a banking group is wider than under the old Law on Banks and Savings Banks, since not only banks but also other financial institutions, financial holding companies, as well as companies which engage in ancillary banking services have been included.
- The Law envisages a combination of off-site (statutory returns, analysis, reports) and on-site supervision (on-site examinations).
- The Bank of Slovenia will gradually start to supervise savings and loan undertakings, which have been granted a five-year transitional period to align their operating activities with provisions applicable to banks and savings banks.
- The Law envisages the collaboration between the Bank of Slovenia and other domestic and foreign supervisory authorities on the basis of the exchange of information and through direct supervisory co-operations. The precondition for the exchange of information is that bank supervisors have to comply with rules applying to keeping business secret and confidentiality of information.
- Deposit insurance under the Law covers deposits placed by individuals and small-size legal persons up to the amount of 3,700,000 tolars per depositor.
- The Bank of Slovenia is vested with power to put the special administration in place should the bank fail to keep the minimum required capital, and/or when to continue with operations may result in threatening the bank's liquidity, i.e. solvency.

1. SECONDARY LEGISLATION DERIVED FROM THE LAW ON BANKING

Secondary legislation derived from the Law on Banking addresses several practical issues.

As under the Law on Banking, the Bank of Slovenia has been given a mandate for drawing up by-laws which elaborate on stipulations set forth in the Law on Banking, major efforts were directed in 1998 and in the first half of 1999 to the preparation of a whole series of banking regulations. The by-laws that regulate supervision and surveillance of banks and savings banks adopted after the effectiveness of the Banking Law are presented hereunder in the chronological order of their publishing in the Official Gazette of the Republic of Slovenia.

Decree on the Calculation of Own Funds, Capital Requirements and Capital Adequacy of Banks and Savings Banks

The Decree elaborates on the calculation of own funds and minimum capital requirements banks and savings banks have to fulfil in order to maintain solvency, i.e. to cover risks banks and savings banks are exposed to in the ordinary course of banking business. Under this Decree, only capital requirements in connection with credit and currency risks, as well as for exceeding limits imposed on capital holdings in non-financial institutions, have been set forth. The enforcement of the provisions laid down in the Decree in regard of foreign currency risk has been deferred until 30 June 2000. Banks and savings banks shall calculate capital (own funds) on regular basis and shall submit quarterly reports to the Bank of Slovenia on prescribed forms.

Decree on Large Exposure of Banks and Savings Banks

The purpose of the provisions of the Decree is to safeguard banks and savings banks against risk inherent in excessive concentration of credit exposure. To this end the Decree caps the maximum allowed exposure to a single client, i.e. to a group of connected clients, as well as the maximum allowed exposure to other members of the banking group. Furthermore, the Decree defines also what is regarded as large exposure and sets limits on aggregate large exposures in regard of the bank's capital (own funds).

Decree on the Classification of On-Balance Sheet Assets and Off-Balance Sheet Items of Banks and Savings Banks

The Decree sets forth methods for monitoring and evaluating credit and country risks banks are exposed to in the course of business. In addition to elaborate criteria for the classification of on-balance sheet assets and off-balance sheet items in categories according to creditworthiness, the Decree also stipulates rules for the assessment of potential losses, suspension of income, and keeping of credit files.

Decree on Establishing Specific Provisions of Banks and Savings Banks

The Decree stipulates how specific provisions against potential losses arising from credit and country risk are earmarked. Under provisions laid down in the Decree, banks shall make provisions for other types of risk they are exposed to in the normal course of business. Since banks take on risks when providing services, a portion of earnings banks generate shall be set aside to absorb potential losses.

Decree on the Implementation of Article 127 of the Law on Banking

In accordance with Article 127 of the Law on Banking, banks shall report on certain significant facts and circumstances arising from their operations. The Decree sets forth the requirements for more elaborate contents of reports.

The Decree on Foreign Currency Mismatch (open position in foreign currency)

The Decree stipulates that a bank authorised to make transactions involving foreign means of payment shall calculate on daily basis its open position in foreign currencies as a part of practices put in place with the aim to safeguard sound banking operations. Short or long position in foreign currency shall not exceed 20 per cent of bank capital daily, while the average open forex position shall not exceed 10 per cent of capital (own funds).

The Decree on Business Books and Annual Accounts of Banks and Savings Banks

The Decree stipulates the format for the chart of accounts for banks, types and layouts for financial statements produced by banks and savings banks, more elaborate contents of annual reports and appendixes to such reports, more elaborate methodology for the valuation of business book items, as well as the preparation of financial statements and their contents. Additionally, how and when monthly prudential reports and/or statutory returns, as well as any other reports on book balances of the bank's accounts, shall be submitted

The Decree on the Minimum Scope and Content of Audit and Auditor's Report

The Decree stipulates provisions as regards more elaborate form and the minimum scope and contents of auditor's examination and auditor's reports. Audit of business activities encompasses audit of annual report and of consolidated annual report drawn up in accordance with the Decree on Business Books and Annual Accounts of Banks and Savings Banks and appendices stipulated under this Decree. The auditor shall examine and provide in the report detailed information regarding financial statements, changes in capital, provisions and write-offs, consolidation effects, fulfilment of prudential rules, internal audit function, keeping of business books, quality of information system, compliance and effectiveness of notifications and reports presented to the Bank of Slovenia, valuation of on- and off-balance sheet items, as well as accounting policies of a bank.

The Decree on the Required Adjustments of the Maturity Structure between Assets and Liabilities

The Decree sets forth provisions in connection with requirements that banks and savings banks must balance maturity dates of assets with those of liabilities. For this purpose the Decree stipulates three classes of assets with known maturity dates. The proportion between assets and liabilities for each class with respect to maturity structure has been defined.

Decree on Detailed Method for the Calculation of Liabilities, Claims and Holding for the Purpose of Determining Net Indebtedness

The Decree sets forth more details for the calculation of net indebtedness of a designated counterparty of a bank or a savings bank being one of the elimination criteria when the persons referred to as the net debtor fails to qualify for the appointment to supervisory board of the respective bank or a savings bank.

Decree on Determining and Prudential Reporting of Value of Holdings of Banks and Savings Banks in Non-financial Institutions and Investments in Tangible Fixed Assets

The Law on Banking limits holdings of a bank in capital of non-financial institutions and tangible fixed assets. The value of a bank's aggregate investments in capital of non-financial institutions shall not exceed 60 per cent of its capital, while individual investments in non-financial institutions shall not exceed 15 per cent of its capital. Total value of all investments made by a bank in land, buildings, business equipment and capital of non-financial institutions shall not exceed its capital. Banks shall send prudential reports as regards such investments on quarterly basis. All exceeded limits in holdings in non-financial institutions' shall have adequate capital coverage.

The Decree on the Annual Fee and Lump-Sum Charges for Prudential Supervision

The Decree stipulates the amount of annual fee for discharging prudential supervision and lump-sum charges for procedures carried out by the Bank of Slovenia. Exact amounts due from banks and savings banks for annual fee depends on the amount of risk-weighted assets of the respective bank or a savings bank. Lump-sum fees are due as a compensation for the passage of a supervisory corrective measure. The amount of such lump-sum fees is computed by taking into account the number of examiners engaged in the examination, number of hours required for the examination, and hourly fee for examiners.

The Instructions for Reports on Largest Depositors

The Instructions stipulate that banks shall report on monthly basis on deposits of thirty largest depositors. In addition to the amount of deposits placed by an individual depositor, these reports shall encompass data on the currency in which the deposit was made, initial and maturity date, the method of the calculation of interest, as well as the calculation of interest rates accruing on that deposit.

The Instructions for the Implementation of the Decree on the Classification of On-balance Sheet Assets and Off-balance Sheet Item, and the Decree on Establishing of Specific Provisions of Banks and Savings Banks

The Instructions stipulate the contents, form and the manner of filling in and submitting of prudential reports on the classification of on-balance sheet assets and off-balance sheet items, as well as earmarking of specific provision banks and savings banks. Bank shall report on quarterly basis on the classification of on-balance sheet assets and off-balance sheet items, including earmarking of specific provisions.

The Instructions for Preparation of Reports on Movements in Tolar-liquidity

In accordance with this Instructions, banks report daily of envisaged flows of liquid funds in Tolars for the current and following working day, as well as of envisaged inflows and outflows in Tolars for top five depositors. Banks are required to plan flows of liquid funds in Tolars in line with standards and principles of prudent banking. Hence, banks may include only inflows realistically expected to be effected on the maturity day, whereas outflows shall comprise all liabilities that are due for payment on a particular day.

Instructions for the Calculation of Key Deposit and Lending Interest Rates in Banks and Savings Banks

The Instructions stipulate quarterly calculation of certain more significant interest rates banks and savings banks charge on deposits and loans classified according to maturity and separated into banking and non-banking sector, i.e. further divided within these sector into deposits and loans and advances in domestic currency that earn base interest rate or include foreign currency clause.

Instructions for the Restructuring of Assets of Banks and Savings Banks

The Instructions stipulate what assets are eligible for restructuring, methods applied in the course of the restructuring, and accounting standards and policies used in the process of the restructuring and valuation of assets. In the case where lending terms and conditions have been changed, the Instructions set forth guidelines for earmarking provisions and write-offs, as well as suspension of income and classification of assets into categories on the basis of creditworthiness. The Instructions set lines for the valuation of tangible fixed assets and financial investments, or a combination of both, when such assets have been received for the purpose of full or partial claims settlement. To facilitate handling of such cases, the Instructions elaborate on methods for writing off bad assets, earmarking provisions, and suspending income. The Instructions define how banks shall act in the case where in the course of restructuring claims, such claims are converted from claims on the debtor to claims on third parties.

Instructions for the Implementation of the Decree on Business Books and Annual Accounts of Banks and Savings Banks

The Instructions stipulate the methodology applied on drawing up financial statements (balance sheet and profit and loss account) of banks and savings banks.

Instructions for the Preparation of Reports on Balances on Bank Account Submitted Every Ten Days

The Instructions stipulate the methodology applied on drawing up reports submitted every ten days as regards designated accounting data provided by banks with respect to lending to non-banking sector, as well as deposits received from non-banking sector. Banks draw up these reports every ten days and disclose balances as at the tenth, twentieth and the last day of a month.

The Instructions on Submitting Monthly Reports on Balances on Accounts of Banks and Savings Banks

The Instructions elaborates on the contents, filling in the forms and sending these statutory forms, including checking of data which disclose balances on accounts on business books kept by banks and savings banks.

2. DEPOSIT GUARANTEE SCHEME

Limited scope of deposit guarantee scheme under the Law on Banking

The setting up of the new system put in place in order to guarantee for deposits has been done in line with general efforts to converge fully with provisions laid down in European directive 94/19/EC, passed with the aim to provide protection to small depositors and thus contribute to the continuing stability of the financial system. The deposit guarantee scheme (also referred to as deposit insurance scheme) is dealt with in Section 12 of the Law on Banking and includes deposits from individuals and small-size legal persons in the amount of 3,700,000 Tolars per individual depositor. The Law explicitly defines exceptions, i.e. lists which persons are not covered by the scheme. In order to back the payment of deposits covered by the deposit guarantee scheme in the case where a bank goes bankrupt, banks shall invest a part of funds in gilt-edge securities in order to provide for liquid funds and thus contribute to liquidity of the banking sector (Securities issued by the Bank of Slovenia as the central bank and the government of the Republic of Slovenia are liquid instruments).

Unlimited guarantee for most deposits will expire on 1 January 2001.

Provisions laid down in Section 12 of the Law on Banking will enter into full force and effect as from 1 January 2001, except for such deposits which on the effective date of the Law on Banking (20 February1999) were underwritten for a period maturing after 1 January 2001. Provisions laid down in Section 12 will apply on such deposits as from the maturity date defined in contractual terms and conditions.

Provisions of the Law on Banking also stipulate that as from the day provisions set forth in Section 12 of the Law, the present guarantee scheme provided by the Republic of Slovenia and the Bank of Slovenia for deposits placed by individuals in banks and savings banks shall become null and void. The provision laid down in Article 12 of the Law on the Agency of the Republic of Slovenia for the Insurance of Deposits in Banks and Savings Banks will also become null and void. Since provisions set forth in Section 12 of the Law on Banking will be phased in, the current guarantee scheme provided by the Republic of Slovenia and the Bank of Slovenia for retail deposits kept in banks and savings banks will be phased out so as to cover different deposit maturity dates.

As regards the second paragraph of Article 37 of the Law on Banks and Savings Banks, the Agency of the Republic of Slovenia for the Insurance of Deposits in Banks and Savings Banks was the competent institution for the insurance of bank deposits. The Law on the Agency of the Republic of Slovenia for the Insurance of Deposits in Banks and Savings Banks reads in Article 12 that until the Agency for the Insurance of Deposits is not established, the institution competent for the insurance of deposits in banks and savings banks is the Bank of Slovenia in the name and on behalf of the Republic of Slovenia. Since the Agency has not been established yet, and in the light of the fact that the effectiveness of Article 12 of the Law on the Agency is extended until 1 January 2001, i.e. even beyond that date for certain deposits, the Bank of Slovenia remains in charge of insuring deposits placed with banks and savings banks on behalf and for the account the Republic of Slovenia.

Pursuant to Article 5 of the Law on the Bank of Slovenia, the power of supervisory authority over banks and savings banks, as well as of promulgating regulations for safeguarding retail deposits, is vested in the Bank of Slovenia.

3. PAYMENT SYSTEMS REFORM

The Real Time Gross Settlement and the Giro Clearing system were set up in 1998.

As for the implementation of payment systems reform, major progress was made in 1998 when accounts of legal persons and transactions made through these accounts were transferred from the Agency for Payments to the banking sector. After the accounts of banks, savings banks and savings and loan undertakings for mandatory reserve migrated to the Bank of Slovenia in March 1997, the system set up for payments settlement (hereinafter referred to as the Real Time Gross Settlement, also abbreviated to RTGS or BPRČ in the Slovenian language) was commissioned in April 1998. Momentum continued and in October 1998 the Giro Clearing system was in place.

These events marked the completion of the second and the launch of preparations for the third phase of the payment systems reform. To illustrate the progress made so far – phases 3 to 6 comprise steps to be taken by banks towards providing payment transactions for their clients. The final phase envisages that all corporate accounts are handled by commercial banks resulting in the winding up of the Agency for Payments (often referred to as APP) due to be made redundant as a provider of payment transactions. The remaining phases of the payment system reform are directly linked to the implementation of the sub-projects listed below:

- The launch of the integral small value payment system (ISVPS or ISPMV in the Slovenian language),
- The establishment of internal payment information systems designed pri marily to put in place adequate accounting systems in banks, as well as pipelines for the communication between clients and banks (at first conceived as pilot payment transactions for legal persons through commercial banks), and
- The setting up of a system of vaults or depots with cash available for distribution.

Consolidation of the RTGS and Giro Clearing Systems

The Real Time Gross Settlement system has been designed for settlement of interbank payments of high value.

The RTGS system has been designed in the first place for the real-time and individual settlement of interbank payments of high value (above 3 million Tolars), while the Giro Clearing system is to be used for other payments. Clearing of payments is done in determined time cycles and to effect settlement, the RTGS system is used. Subscribers to both systems are banks referred to as participating banks and several savings banks. Savings and loan undertakings use the settlement systems as indirect participants. In March 1999 a few innovations were introduced into the settlement systems. Namely, payments debiting accounts of legal persons and credited by the Agency for Payments to banks and/or savings banks, i.e. their clients migrated to the RTGS and Giro Clearing systems. As a consequence, the number of transactions to be settled through the two systems went up significantly, and called for the Giro Clearing system to prolong working hours and introduce afternoon shift reserved exclusively for the Agency for Payments. Other participating banks may end their orders in the morning cycle only. Along with the implementation of that step, preparations for the subsequent phase started: to include orders made out in favour of legal persons, i.e. the Agency for Payments. In July 1999, the Agency for Payments and the Bank of Slovenia reached an agreement to include payments crediting legal persons' accounts starting with the month of September. By the end of October 1999, the migration of these payment transactions should be completed.

Government Bank Account

Government single account with the Bank of Slovenia

In 1999, preparations aimed at opening an integral government account with the Bank of Slovenia gained momentum. On 24 June 1999 this account was actually in function and first transactions through the RTGS system were made when payments and withdrawals were made in connection with treasury bills. In addition to payments made between the Bank of Slovenia and the Ministry of Finance, i.e. the Agency for Payments (to be transformed into Public Authority for Payments) through SWIFT Network, the transmission of information to the Ministry of Finance, i.e. Treasury, regarding balances on the government transaction account (recording every change), as well as regarding balances on account 630 (the accounted is balanced every fifteen minutes) has been ensured.

Integral Small Value Payment System (ISVPS)

Within the framework of the preparations made with the aim to set up the Integral Small Value Payment System (ISVPS in English or ISPMV in Slovenian), in October 1998 three companies presented their vision of the implementation of the subsequent phase. In February 1999, two full-time outcontracted consultants joined the team and in July this year presented a feasibility study. The study focuses on key issues and requirements in connection with defining of the role and setting up of the ISVPS system. Furthermore, the study provides the basis for the preparation of an elaborate plan for the implementation of the ISVPS system and for the organisation of a clearing company to act as an umbrella organisation. A study has also been made to outline legislative framework and guidelines to be adhered to when setting up the clearing system in Slovenia. A decree entrusting the Bank of Slovenia with the task of drawing up common standards based upon Lamfalussy's standards expected to become mandatory clearing standards for all operating clearing firms.

Pilot bank-training programme

Pilot projects at the launch of third phase

In January 1999, the Governing Board of the Bank of Slovenia endorsed the concept providing for pilot training programme for banks. The programme has been designed as the basis for the launch of the third phase of the payment systems reform project. Under the programme, legal entities selected for pilot training send their payment orders to a bank, which has opened a special transaction account for that purpose. The bank passes such payment orders on to the Agency for Payments as for the time being, the Agency for Payments keeps accounts of legal entities. Therefore, for the time being, there are only information flows, while financial flows are still handled by the Agency for Payments. An interface installed in the Bank of Slovenia handles payment procedures and dispatches information via electronic devices so that there is communication between the Agency for Payments and banks. In April and May 1999, the efficiency of the interface was tested by sending payment orders within the test environment (without sending test payment orders to be processed by the Agency for Payments – without incurring financial consequences by transmitting orders). As from 14 June 1999, pilot testing designed to train banks through real payment orders started. In other words, payment orders issued by legal entities entail financial consequences. The involvement of legal entities is scheduled to be phased in depending upon the level of preparedness. Hence, pilot training for banks within the closed test environment still goes on.

Cash operations

The concept that envisages the migration of cash payment transactions to the banking addresses direct and indirect supply of banks with banknote, as well as the transfer of payment transactions from the Agency for Payments to banks.

The Bank of Slovenia will be in charge of the distribution of banknote through authorised banks who will keep vaults as depots for banknote

The Governing Board of the Bank of Slovenia has selected locations and has completed open public bidding for the appointment of commercial banks which will act as depositors and will manage such depots.

Eight depots are spread across Slovenia.

As from 1 July 1999, there are eight depots across Slovenia for banknote placed with seven commercial banks on different locations in addition to a treasury (storage) for coins. These vaults exclusively serve the purpose of supplying banks with banknote.

To control and monitor operations of each bank-run depot, a central application package has been set up in the Bank of Slovenia on the one side, and each vault on the other. Balances are monitored on the basis of aggregate amounts and for each denomination. For the purpose of exchanging prudential reports between the depositor (the Bank of Slovenia), the depot as the depository and banks, the BSNet has been set up. Payments are effected through the RTGS and SWIFT network following the standard course of business.

Guided by rationalisation reasons, coins are supplied from one place, separately from the banknote supply system. By setting up the central depot for the distribution of coins, the organisation, technology, logistic and security of coin-related operations have been improved.

Banks and savings banks do not have to turn to the branches of the Agency for Payments in order to obtain cash. During the transitional period, i.e. until 30 September 1999, banks and savings banks can obtain cash from the Agency for Payments. After that day, above-mentioned depots and the central coin distribution depot will be at disposal for banks and savings banks.

A working group composed of the representatives of the Agency for Payments, commercial banks, and the Bank of Slovenia was set up and entrusted with the task of making a model for the migration of cash transactions of legal entities to commercial banks. Trial periods for testing operational features of the new system were foreseen for:

- Collecting cash from legal entities to banks successfully completed on 28 February 1999 when the transactions was integrated into banking operating activities, and
- Cash pay outs to legal entities through banks currently in the testing phase.

In addition to the above-mentioned activities, the preparations of a central register of account holders are in progress. At the same time, activities on defining payment messages exchanged between a bank and its client on the basis of EDIFACT are going on, and the new Law on Payment Transactions is in the pipeline.

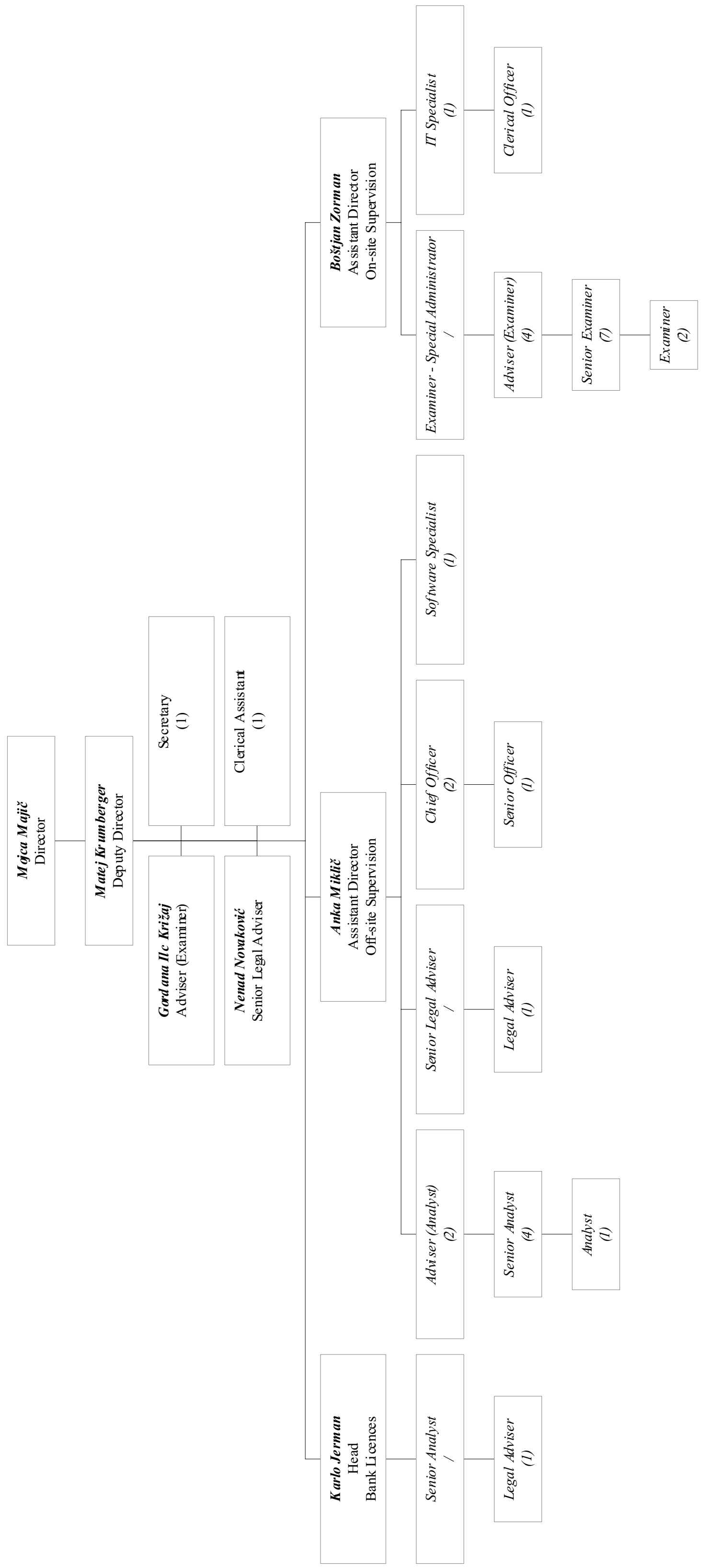
With cash transactions carried out on behalf of legal persons ready to migrate to banks, the position of the Agency for Payments of the Republic of Slovenia should be redefined in line with the payment systems reform.

Samo Nučič
Deputy Governor

Mojca Majič, M.A.
Director
Banking Supervision

APPENDIX 1

ORGANISATIONAL STRUCTURE OF THE BANK SUPERVISION DEPARTMENT AS AT 31 AUGUST 1999



APPENDIX 2

TOTAL NUMBER OF BANKS AND SAVINGS BANKS AND OWNERSHIP STRUCTURE

1. Number of operating banks and savings banks

Year[1]	1991	1992	1993	1994	1995	1996	1997	1998	1999
Banks	26	30	32	33	31	29	28	24	25
Savings banks	14	15	13	11	10	7	6	6	6

2. Number of banks with majority foreign share[2]

Year[1]	1991	1992	1993	1994	1995	1996	1997	1998	1999
Banks	1	2	5	6	6	4	4	3	4

3. Number of banks with majority state share[3]

Year[1]	1991	1992	1993	1994	1995	1996	1997	1998	1999
Banks	0	1	3	3	3	3	3	3	3

1 End-year except half-year figures for 1999.

2 Foreign-owned stake over 50%; all savings banks are owned by domestic shareholders.

3 State ownership over 50%; Poštna banka Slovenije d.d. (Slovenian Post Office Bank) is included in the figures. From the establishment until 31 December 1994 fully owned by PTT company, from 1 January 1995 to 20 December 1996 fully owned by the Republic of Slovenia, since 21 December 1996 owned by Pošta Slovenije d.o.o., Maribor (established by the Republic of Slovenia).

APPENDIX 3

TOTAL ASSETS AND OFF-BALANCE SHEET ITEMS OF BANKS AND SAVINGS BANKS

4. Total assets

in billions of Tolars

Year[1]	1991	1992	1993	1994	1995	1996	1997	1998	1999
Banks	327.2	627.9	937.2	1,183.4	1,497.5	1,729.0	2,022.0	2,350.4	2,558.6
Savings banks		2.6	2.1	2.7	4.4	5.1	7.2	9.5	10.2

4.a. Growth rate of total assets

in %

Year[1]	1991	1992	1993	1994	1995	1996	1997	1998	1999
Banks		91.9	49.3	26.3	26.5	15.5	16.9	16.2	8.9
Savings banks			-19.2	28.6	63.0	15.9	41.2	31.9	7.4

5. Risk-weighted off-balance sheet items[2]

in billions of Tolars

Year[1]	1991	1992	1993	1994	1995	1996	1997	1998	1999
Banks			288.7	292.5	347.0	338.9	382.6	503.7	577.4
Savings banks			0.059	0.004	0.027	0.122	0.036	0.093	0.116

5.a. Growth rate of risk-weighted off-balance sheet items

in %

Year[1]	1991	1992	1993	1994	1995	1996	1997	1998	1999
Banks				1.3	18.6	-2.3	12.9	31.7	14.6
Savings banks				-93.2	575.0	351.9	-70.5	158.3	24.7

1 End-year except half-year figures for 1999. Figures as at 30 June 1999 are unaudited.

2 Risk-weighted off-balance sheet items include guarantees, letters of credit, endorsed and accepted bills of exchange, irrevocable commitments and other.

APPENDIX 4

LENDING OF BANKS AND SAVINGS BANKS TO CUSTOMERS AND DEPOSITS FROM CUSTOMERS

6. Lending to non-banks

in billions of Tolars

Year[1]	1991	1992	1993	1994	1995	1996	1997	1998	1999
Banks	126.1	226.2	347.3	416.4	607.9	725.6	862.4	1,108.8	1,237.5
Savings banks		1.6	1.4	1.9	3.2	4.0	5.2	7.1	8.2

6.a. Growth rate of lending to non-banks

in %

Year[1]	1991	1992	1993	1994	1995	1996	1997	1998	1999
Banks		79.4	53.5	19.9	46.0	19.4	18.9	28.6	11.6
Savings banks			-12.5	35.7	68.4	25.0	30.0	36.5	15.5

7. Deposits from non-banks

in billions of Tolars

Year[1]	1991	1992	1993	1994	1995	1996	1997	1998	1999
Banks	132.8	299.8	492	712.6	916.6	1,169.4	1,412.2	1,667.7	1,751.4
Savings banks		2.2	1.6	1.7	2.8	3.2	4.6	6.0	7.0

7.a. Growth rate of deposits from non-banks

in %

Year[1]	1991	1992	1993	1994	1995	1996	1997	1998	1999
Banks		125.8	64.1	44.8	28.6	27.6	20.8	18.1	5.0
Savings banks			-27.3	6.3	64.7	14.3	43.8	30.4	16.7

1 End-year except half-year figures for 1999.
Figures as at 30 June 1999 are unaudited.

APPENDIX 5

TOTAL ASSETS AND MARKET SHARE OF SLOVENIAN BANKS

in millions of Tolars / in %

	Banks	Total Assets			Market Share		
		31 Dec 1997	31 Dec 1998	30 Jun 1999[2]	31 Dec 1997	31 Dec 1998	30 Jun 1999[1]
1	Nova Ljubljanska banka d.d. Ljubljana[2]	549,225	648,595	713,051	28.0	27.6	27.9
2	SKB d.d. Ljubljana	241,010	281,184	318,093	12.3	12.0	12.4
3	Nova Kreditna banka d.d. Maribor	237,654	285,029	300,300	12.1	12.1	11.7
4	Banka Koper d.d. Koper	120,299	137,190	148,776	6.1	5.8	5.8
5	Banka Celje d.d. Celje	109,246	135,094	146,487	5.6	5.7	5.7
6	Abanka d.d. Ljubljana	103,055	123,151	139,995	5.2	5.2	5.5
7	Gorenjska banka d.d. Kranj	90,706	108,041	120,257	4.6	4.6	4.7
8	Bank Austria Creditanstalt d.d. Ljubljana	49,808	83,379	82,208	2.5	3.5	3.2
9	Dolenjska banka d.d. Novo mesto	64,675	77,476	79,552	3.3	3.3	3.1
10	Pomurska banka d.d. M. Sobota, Bs NLB	51,426	55,936	58,989	2.6	2.4	2.3
11	Krekova banka d.d. Maribor	40,092	50,868	54,040	2.0	2.2	2.1
12	Banka VIPA d.d. Nova Gorica	43,378	49,446	52,378	2.2	2.1	2.0
13	Poštna banka Slovenije d.d. Maribor	24,927	37,500	43,377	1.3	1.6	1.7
14	Probanka d.d. Maribor	29,434	34,204	37,854	1.5	1.5	1.5
15	Koroška banka d.d. Sl. Gradec, Bs NLB	29,351	33,493	36,949	1.5	1.4	1.4
16	Banka Domžale d.d. Domžale, Bs NLB	27,852	32,967	36,767	1.4	1.4	1.4
17	SZKB d.d. Ljubljana	29,263	36,930	35,889	1.5	1.6	1.4
18	Banka Velenje d.d. Velenje, Bs NLB	27,505	32,395	34,971	1.4	1.4	1.4
19	Banka Zasavje d.d. Trbovlje, Bs NLB	19,921	26,157	25,586	1.0	1.1	1.0
20	S I B d.d. Ljubljana	20,137	21,249	22,334	1.0	0.9	0.9
21	Volksbank-Ljudska banka d.d. Ljubljana	17,149	19,730	22,154	0.9	0.8	0.9
22	Factor banka d.d. Ljubljana	13,450	14,913	15,220	0.7	0.6	0.6
23	M Banka d.d. Ljubljana, Bs Banke Koper	13,501	14,227	14,442	0.7	0.6	0.6
24	Banka Societe Generale d.d. Ljubljana	10,649	11,205	12,916	0.5	0.5	0.5
25	Hypo Alpe Adria banka d.d. Ljubljana			5,977			0.2
	Total	**1,963,713**	**2,350,359**	**2,558,562**	**100.0**	**100.0**	**100.0**

1 Figures as at 30 June 1999 are unaudited.

2 Figures including NLB branch in Italy.

APPENDIX 6

BALANCE SHEET OF SLOVENIAN BANKS

in millions of tolars

Item. No.	Balance Sheet Designation	DESCRIPTION	31 Dec 1998
1	A. I.	Cash in hand and balances with Central Bank	84,696
2	A. II.	Government securities and other bills eligible for discount by Central Bank	0
3	A. III.	Loans and advances to banks and savings banks	227,331
4	A. IV.	Loans and advances to customers	1,108,798
5	A. V.	Investment securities	615,876
6	A. VI.	Securities held for dealing purposes	98,690
7	A. VII.	Investments in non-associated companies	16,173
8	A. VIII.	Investments in associated companies	31,479
9	A. IX.	Intagible assets	5,011
10	A. X.	Tangible fixed assets	77,863
11	A. XI.	Subscribed capital unpaid and own shares	2,026
12	A. XII.	Other assets	67,979
13	A. XIII.	Prepayments and accrued income	14,437
		TOTAL ASSETS	**2,350,359**
14	P. I.	Deposits and borrowings from banks and savings banks	223,738
15	P. II.	Deposits and borrowings from customers	1,667,695
16	P. III.	Liabilities evidenced by paper	57,649
17	P. IV.	Other liabilities	22,595
18	P. V.	Accruals and deferred income	79,958
19	P. VI.	Provision for liabilities and charges	30,201
20	P. VII.	Subscribed capital and foundation capital of savings banks	54,925
21	P. VIII.	Share premium account	7,681
22	P. IX.	Reserves	94,882
23	P. X.	General provisions	12,242
24	P. XI.	Capital revaluation adjustment	76,154
25	P. XII.	Net profit or loss brought forward	6,578
26	P. XIII.	Net profit or loss for the financial year	16,061
		TOTAL LIABILITIES	**2,350,359**

Total assets - average of the year[1]	2,184,297
Number of banks	24
Number of employees at the year-end	10,394

[1] Calculated as average balance at month-end.

APPENDIX 6a

BALANCE SHEET OF SLOVENIAN BANKS

in millions of Tolars

Item. No.	Balance Sheet Designation		DESCRIPTION	30 Jun 1999[1]
1	A.	I.	Cash in hand and balances with Central Bank	85,991
2	A.	II.	Government securities and other bills eligible for discount by Central Bank	0
3	A.	III.	Loans and advances to banks and savings banks	242,363
4	A.	IV.	Loans and advances to customers	1,237,456
5	A.	V.	Investment securities	613,861
6	A.	VI.	Securities held for dealing purposes	115,205
7	A.	VII.	Investments in non-associated companies	17,898
8	A.	VIII.	Investments in associated companies	32,611
9	A.	IX.	Intagible assets	7,386
10	A.	X.	Tangible fixed assets	85,857
11	A.	XI.	Subscribed capital unpaid	0
12	A.	XII.	Own shares	3,210
13	A.	XIII.	Other assets	88,639
14	A.	XIV.	Prepayments and accrued income	15,550
			TOTAL ASSETS	**2,546,027**
15	P.	I.	Deposits and borrowings from banks and savings banks	279,238
16	P.	II.	Deposits and borrowings from customers	1,751,358
17	P.	III.	Liabilities evidenced by paper	46,629
18	P.	IV.	Other liabilities	49,234
19	P.	V.	Accruals and deferred income	96,454
20	P.	VI.	Provision for liabilities and charges	44,864
21	P.	VII.	General banking risks	1,480
22	P.	VIII.	Subordinanted liabilities	18,072
23	P.	IX.	Subscribed capital	59,685
24	P.	X.	Share premium account	7,957
25	P.	XI.	Reserves	99,990
26	P.	XII.	Capital revaluation adjustment	80,998
27	P.	XIII.	Net profit or loss brought forward	9,659
28	P.	XIV.	Net profit or loss for the financial year	409
			TOTAL LIABILITIES	**2,546,027**
			Total assets - average of the year[2]	2,184,297
			Number of banks	24

1 Figures as at 30 June 1999 are unaudited.

2 Calculated as average balance at month-end.

APPENDIX 7

COMPOSITION OF THE BALANCE SHEET OF BANKS

as % of total assets at month-end

Item. No.	Balance Sheet Designation		DESCRIPTION	30 Jun 1999[1]
1	A.	I.	Cash in hand and balances with Central Bank	3.4
2	A.	II.	Government securities and other bills eligible for discount by Central Bank	0.0
3	A.	III.	Loans and advances to banks and savings banks	9.5
4	A.	IV.	Loans and advances to customers	48.6
5	A.	V.	Investment securities	24.1
6	A.	VI.	Securities held for dealing purposes	4.5
7	A.	VII.	Investments in non-associated companies	0.7
8	A.	VIII.	Investments in associated companies	1.3
9	A.	IX.	Intagible assets	0.3
10	A.	X.	Tangible fixed assets	3.4
11	A.	XI.	Subscribed capital unpaid	0.0
12	A.	XII.	Own shares	0.1
13	A.	XIII.	Other assets	3.5
14	A.	XIV.	Prepayments and accrued income	0.6
			TOTAL ASSETS	**100.0**
15	P.	I.	Deposits and borrowings from banks and savings banks	11.0
16	P.	II.	Deposits and borrowings from customers	68.8
17	P.	III.	Liabilities evidenced by paper	1.8
18	P.	IV.	Other liabilities	1.9
19	P.	V.	Accruals and deferred income	3.8
20	P.	VI.	Provision for liabilities and charges	1.8
21	P.	VII.	General banking risks	0.1
22	P.	VIII.	Subordinanted liabilities	0.7
23	P.	IX.	Subscribed capital	2.3
24	P.	X.	Share premium account	0.3
25	P.	XI.	Reserves	3.9
26	P.	XII.	Capital revaluation adjustment	3.2
27	P.	XIII.	Net profit or loss brought forward	0.4
28	P.	XIV.	Net profit or loss for the financial year	0.0
			TOTAL LIABILITIES	**100.0**

[1] Figures as at 30 June 1999 are unaudited.

APPENDIX 7a

COMPOSITION OF THE BALANCE SHEET OF BANKS

as % of total assets at month-end

Item. No.	Balance Sheet Designation	DESCRIPTION	30 Jun 1999[1]
1	A. I.	Cash in hand and balances with Central Bank	3.4
2	A. II.	Government securities and other bills eligible for discount by Central Bank	0.0
3	A. III.	Loans and advances to banks and savings banks	9.5
4	A. IV.	Loans and advances to customers	48.6
5	A. V.	Investment securities	24.1
6	A. VI.	Securities held for dealing purposes	4.5
7	A. VII.	Investments in non-associated companies	0.7
8	A. VIII.	Investments in associated companies	1.3
9	A. IX.	Intagible assets	0.3
10	A. X.	Tangible fixed assets	3.4
11	A. XI.	Subscribed capital unpaid	0.0
12	A. XII.	Own shares	0.1
13	A. XIII.	Other assets	3.5
14	A. XIV.	Prepayments and accrued income	0.6
		TOTAL ASSETS	**100.0**
15	P. I.	Deposits and borrowings from banks and savings banks	11.0
16	P. II.	Deposits and borrowings from customers	68.8
17	P. III.	Liabilities evidenced by paper	1.8
18	P. IV.	Other liabilities	1.9
19	P. V.	Accruals and deferred income	3.8
20	P. VI.	Provision for liabilities and charges	1.8
21	P. VII.	General banking risks	0.1
22	P. VIII.	Subordinanted liabilities	0.7
23	P. IX.	Subscribed capital	2.3
24	P. X.	Share premium account	0.3
25	P. XI.	Reserves	3.9
26	P. XII.	Capital revaluation adjustment	3.2
27	P. XIII.	Net profit or loss brought forward	0.4
28	P. XIV.	Net profit or loss for the financial year	0.0
		TOTAL LIABILITIES	**100.0**

[1] Figures as at 30 June 1999 are unaudited.

APPENDIX 8

PROFIT AND LOSS ACCOUNT OF BANKS

in millions of Tolars

		1998	Jan - Jun 1999[1]
1.	Interest income	280,785	152,093
2.	Interest expense	190,632	108,001
3.	Net interest income	90,153	44,092
4.	Net other income	20,437	12,054
	- net fees and commisions	30,206	16,761
	- net financial transactions	6,691	3,054
	- other income[2]	-16,460	-7,762
5.	Gross income (3+4)	110,590	56,146
6.	General administrative expenses	65,808	34,941
	- labour costs	38,343	20,958
7.	Net income (5-6)	44,782	21,205
8.	Net provisions and write-offs	-18,806	-7,776
9.	Profit before taxation (7-8)	25,976	13,430
10.	Taxation	9,915	
11.	Profit after taxation (9-10)	16,061	
12.	Profit avaible for appropriation	5,492	
13.	Retained profit[3]	11,153	

1 Figures for the period Jan - Jun 1999 are unaudited.

2 Other operating profit + extraordinary income - depreciation and amortization - other operating expense - revaluation of capital, fixed assets and capital investments - extraordinary expense.

3 Reserves, fund for own shares and retained profit.

COMPOSITION OF THE PROFIT AND LOSS ACCOUNT OF BANKS

as % of average total assets

		1998	Jan - Jun 1999[1]
1.	Interest income	12.9	6.2
2.	Interest expense	8.7	4.4
3.	Net interest income	4.1	1.8
4.	Net other income	0.9	0.5
	- net fees and commisions	1.4	0.7
	- net financial transactions	0.3	0.1
	- other income	0.8	0.3
5.	Gross income (3+4)	5.1	2.3
6.	General administrative expenses	3.0	1.4
	- labour costs	1.8	0.9
7.	Net income (5-6)	2.1	0.9
8.	Net provisions and write-offs	0.9	0.3
9.	Profit before taxation (7-8)	1.2	0.5
10.	Taxation	0.5	
11.	Profit after taxation (9-10)	0.7	
12.	Profit avaible for appropriation	0.3	
13.	Retained profit [2]	0.5	

1 Figures for the period Jan-Jun 1999 are unaudited.

2 Reserves, fund for own shares and retained profit.

APPENDIX 10

ITEMS FROM THE PROFIT AND LOSS ACCOUNT IN BANKS' INCOME

in %

		1998	Jan - Jun 1999[1]
	% of gross income		
1.	Net interest income	81.5	78.5
2.	Net non-interest income	18.5	21.5
	- net fees and commissions	27.3	29.9
	- net financial transactions	6.1	5.4
	- other	14.9	13.8
3.	General administrative expenses	59.5	62.2
	- labour costs	34.7	37.3
4.	Net income[2]	40.5	37.8
5.	Net provisions and write-offs	17.0	13.8
6.	Profit before taxation	23.5	23.9
7.	Taxation	9.0	
8.	Profit after taxation	14.5	
	% of net income		
1.	Net provisions and write-offs	42.0	36.6
2.	Profit before taxation	58.0	63.3
3.	Taxation	22.1	
4.	Profit after taxation	35.9	

[1] Figures for the period Jan - Jun 1999 are unaudited.

[2] Net income = Gross income - general administrative expenses

APPENDIX 11

RATIOS IN THE SLOVENIAN BANKING INDUSTRY

in %

			31 Dec 1998	30 Jun 1999[1]
I.	Capital adequacy	1. Regulatory capital / Risk-weighted assets	16.0	14.6[2]
		2. Core capital / Risk-weighted assets	15.6	14.6[2]
II.	Assets quality	1. Value adjustments / Bad and doubtful claims	56.1	57.2
		2. Bad and doubtful claims / Gross assets	10.9	10.7
III.	Profitability	1. Net interest margin[3]	4.5	4.1
		2. Return on average assets	1.2	1.1
		3. Return on average equity	11.3	10.8
		4. Net provisions and write-offs / Net income	42.0	36.7
IV.	Liquidity	1. Average liquid assets / Average demand deposits	26.8	25.4
		2. Average demand deposits / Average total liabilities (capital excl.)	27.1	28.3
V.	Operating expenses	1. Labour costs / Average total assets	1.8	1.7
		2. Net non-interest income / Operating costs	42.2	46.2

1 Figures for the period ended 30 June 1999 are unaudited.

2 Capital adequacy ratio has decreased as a result of the new methodology set forth in the Law on Banking.

3 Net interest margin is calculated as the ratio between net interest income (real and revaluation interest) and average gross interest - bearing assets.

APPENDIX 12

NON-PERFORMING ON- AND OFF-BALANCE SHEET ITEMS IN BANKS

Non-performing on- and off-balance sheet items

All banks	31 Dec 1994	31 Dec 1995	31 Dec 1996	31 Dec 1997	31 Dec 1998	30 Jun 1999[1]
Non-performing assets[2] (in millions of Tolars)	91,638	80,169	104,118	107,969	126,651	130,305
Non-performing assets / Total assets	8.1%	5.8%	6.4%	5.6%	5.7%	5.4%
Non-performing assets and off-balance sheet items[3] (in millions of Tolars)	115,837	101,603	124,386	126,240	147,514	147,918
Non-performing assets and off-balance sheet items / Total assets and off-balance sheet items	8.2%	5.8%	6.2%	5.5%	5.4%	4.9%

Bad on- and off-balance sheet items

All banks	31 Dec 1994	31 Dec 1995	31 Dec 1996	31 Dec 1997	31 Dec 1998	30 Jun 1999[5]
Bad assets[4] (in millions of Tolars)	62,026	55,402	64,315	64,120	81,545	79,780
Bad assets / Total assets	5.5%	4.0%	4.0%	3.3%	3.7%	3.3%
Bad assets and off-balance sheet items[5] (in millions of Tolars)	80,723	68,560	76,921	73,246	91,179	88,402
Bad assets and off-balance sheet items / Total assets and off-balance sheet items	5.7%	3.9%	3.8%	3.2%	3.3%	3.0%

1 Figures as at 30 June 1999 are unaudited.

2 Non-performing assets are defined as all on-balance sheet items classified in groups C (substandard), D (doubtful) and E (loss).

3 Non-performing assets and off-balance sheet items are defined as all on- and off-balance sheet items classified in groups C (substandard), D (doubtful) and E (loss).

4 Bad assets are defined as all on-balance sheet items classified in groups D (doubtful) and E (loss).

5 Bad assets and off-balance sheet items are defined as all on- and off-balance sheet items classified in groups D (doubtful) and E (loss).

APPENDIX 13

STRUCTURE OF AGGREGATE EXPOSURE OF BANKS PER TYPE OF ACTIVITY

in millions of tolars

ACTIVITY	31 Dec 1998	%	30 Jun 1999[1]	%
1. Agriculture, hunting and forestry	17,708	0.6%	18,290	0.6%
2. Fishing	306	0.0%	342	0.0%
3. Mining and quarrying	4,874	0.2%	6,014	0.2%
4. Manufactoring	375,851	13.5%	398,724	13.1%
4.1. Manufacture of food products; beverages and	46,547	1.7%	48,212	1.6%
4.2. Manufacture of textiles and textile products and manufacture of leather products	39,195	1.4%	40,695	1.3%
4.3. Manufacture of wood and wood products and manufacture of paper and paper products	41,509	1.5%	45,284	1.5%
4.4. Manufacture of chemical, chemical products and man made fibres	76,783	2.8%	78,721	2.6%
4.5. Manufacture of basis metals and fabricated metal products and manufacture of machinery and	79,926	2.9%	87,878	2.9%
4.6. Manufacture of electrical and optical equipment	40,564	1.5%	43,213	1.4%
4.7. Manufacture of transport equipment	35,450	1.3%	37,155	1.2%
4.8. Manufacture of furniture, manufacturing not classified and recycling	15,877	0.6%	17,565	0.6%
5. Electricity, gas and water supply	109,242	3.9%	113,124	3.7%
6. Construction	76,047	2.7%	93,042	3.1%
7. Wholesale and retail trade; repair of motor vehicles, personal and household goods	269,595	9.7%	314,645	10.3%
8. Hotels and restaurants	24,423	0.9%	26,634	0.9%
9. Transport, storage and communications	108,732	3.9%	143,473	4.7%
10. Public administration and defence; compulsory social security	368,947	13.3%	393,395	12.9%
11. Health and social work	9,786	0.4%	11,173	0.4%
12. Education	1,278	0.0%	1,465	0.0%
13. Other community, social and personal service	13,226	0.5%	17,044	0.6%
14. Financial services[2]	502,291	18.1%	531,173	17.5%
15. Real estate, leasing and business activities	147,848	5.3%	163,027	5.4%
16. Other items[3]	87,830	3.2%	80,582	2.6%
A. COMPANIES AND SOLE TRADERS	2,117,983	76.3%	2,312,148	76.0%
B. NATURAL PERSONS	381,693	13.8%	440,412	14.5%
C. FOREIGN ENTITES	275,728	9.9%	291,116	9.6%
TOTAL (A+B+C)	2,775,404	100.0%	3,043,676	100.0%

1 Figures as at 30 June 1999 are unaudited.

2 Claims on the Bank of Slovenia totalling SIT 349,003 million as at 31 December 1998, i.e. SIT 340,799 million as at 30 June 1999 included.

3 Off-shore companies and associations included.

APPENDIX 14

BANKS AND SAVINGS BANKS IN SLOVENIA AUTHORISED BY THE BANK OF SLOVENIA TO CONDUCT BANKING ACTIVITIES AS AT 30 JUNE 1999

I. BANKS

1. Banks holding the full licence for commercial and investment banking (all activities listed in Article 2 of the Law on Banks and Savings Banks and in Article 39 of the Law on the Securities Market):

ABANKA d.d. Ljubljana
Slovenska 58
1517 LJUBLJANA
Tel.: +386 61 1718-100

BANK AUSTRIA d.d. Ljubljana[1]
Wolfova 1
1000 LJUBLJANA
Tel.: +386 61 1777-600

BANKA KOPER d.d.
Pristaniška 14
6502 KOPER
Tel.: +386 66 451-100

BANKA VIPA, d.d. Nova Gorica
Kidričeva 7
5000 NOVA GORICA
Tel.: +386 65 12-850

GORENJSKA BANKA, d.d., Kranj
Bleiweisova 1
4000 KRANJ
Tel.: +386 64 28-40

NOVA LJUBLJANSKA BANKA d.d., Ljubljana
Trg republike 2
1520 LJUBLJANA
Tel.: +386 61 1250-155

PROBANKA d.d.
Gosposka 23
2000 MARIBOR
Tel.: +386 62 220-500

[1] The new registred name entered into the court register on 21 July 1999 is BANK AUSTRIA CREDITANSTALT d.d. Ljubljana.

SKB BANKA d.d. Ljubljana
Ajdovščina 4
1513 LJUBLJANA
Tel.: +386 61 1332-132

SLOVENSKA ZADRUŽNA KMETIJSKA BANKA d.d. Ljubljana
Miklošičeva 4
1000 LJUBLJANA
Tel.: +386 61 1727-100

2. Banks with full licence for commercial banking:

BANKA CELJE d.d.
Vodnikova 2
3000 CELJE
Tel.: +386 63 431-000

DOLENJSKA BANKA d.d.
Seidlova cesta 3
8000 NOVO MESTO
Tel.: +386 68 316-500

HYPO ALPE ADRIA BANKA d.d. Ljubljana
Dunajska cesta 103[2]
1000 LJUBLJANA
Tel.: +386 61 30 04 400

KREKOVA BANKA d.d.
Slomškov trg 18
2000 MARIBOR
Tel.: +386 62 222-261

NOVA KREDITNA BANKA MARIBOR d.d.
Vita Kraigherja 4
2505 MARIBOR
Tel.: +386 62 229-229

VOLKSBANK - LJUDSKA BANKA d.d.
Miklošičeva 30
1101 LJUBLJANA
Tel.: +386 61 1311-009

[2] As from 19 July 1999 at Trg Osvobodilne fronte 12, 1000 Ljubljana.

APPENDIX 14

3. Banks with full licence for commercial banking (excluding personal foreign currency deposits, custody accounts of foreign persons, and accounts of foreign persons, unless these are current or giro accounts of foreign banks and financial organisations dealing in international payments) and with licence for stockbroking and dealing in securities:

SLOVENSKA INVESTICIJSKA BANKA, d.d.
Čopova 38
1101 LJUBLJANA
Tel.: +386 61 1261-181

4. Banks with full licence for commercial banking (excluding personal deposits, custody accounts for foreign persons, and accounts of foreign persons, unless these are current or giro accounts of foreign banks and financial organisations dealing in international payments) and full licence for investment banking, except safekeeping of securities not publicly offered:

FACTOR BANKA d.d.
Železna 16
1000 LJUBLJANA
Tel.: +386 61 1311-136

5. Banks with full licence for commercial banking (excluding personal foreign currency deposits, custody accounts of foreign persons, and accounts of foreign persons, unless these are current or giro accounts of foreign banks and financial organisations dealing in international payments):

M BANKA d.d.[3]
Dunajska cesta 107
1000 LJUBLJANA
Tel.: +386 1682-282

6. Banks with licence for all domestic commercial banking operations (excluding personal foreign currency deposits and custody accounts of foreign persons):

BANKA SOCIETE GENERALE LJUBLJANA d.d.
Trg republike 3
1000 LJUBLJANA
Tel.: +386 61 1262-214

3 As at 1 October 1999, M BANKA d.d. joined BANKA KOPER d.d..

APPENDIX 14

7. Banks with licence for all domestic commercial banking operations and international payments:

BANKA VELENJE d.d., Velenje
Bančna skupina Nove Ljubljanske banke
Rudarska 3
3320 VELENJE
Tel.: +386 63 854-251

KOROŠKA BANKA d.d. Slovenj Gradec,
bančna skupina Nove Ljubljanske banke
Glavni trg 30
2380 SLOVENJ GRADEC
Tel.: +386 602 42-371

BANKA DOMŽALE d.d., Domžale
Bančna skupina Nove Ljubljanske banke
Ljubljanska 62
1230 DOMŽALE
Tel.: +386 61 715-422

BANKA ZASAVJE d.d. Trbovlje
Bančna skupina Nove Ljubljanske banke
Trg revolucije 25 c
1420 TRBOVLJE
Tel.: +386 601 21-233

POMURSKA BANKA d.d. Murska Sobota
bančna skupina Nove Ljubljanske banke
Trg zmage 7
9000 MURSKA SOBOTA
Tel.: +386 69 32-710

8. Banks with full licence for all domestic commercial banking operations (excluding personal foreign currency deposits, custody accounts of foreign persons, and accounts of foreign persons, unless these are current or giro accounts of foreign banks and financial organisations dealing in international payments) and for international payments with international postal instruments:

POŠTNA BANKA SLOVENIJE d.d.
Vita Kraigherja 5
2000 MARIBOR
Tel.: +386 62 22-88-202

APPENDIX 14

9. Banks with licence granted under the Constitutional Law:

KREDITNA BANKA MARIBOR d.d.
Trg republike 3
1000 LJUBLJANA
Tel.: +386 61 1257-350

LJUBLJANSKA BANKA d.d., Ljubljana
Trg republike 3
1000 LJUBLJANA
Tel.: +386 61 1257-350

II. SAVINGS BANKS

HRANILNICA LON d.d. Kranj
Bleiweisova 2
4000 KRANJ
Tel.: +386 64 380-077

HRANILNICA IN POSOJILNICA KGP KOČEVSKE d.d.
Roška cesta 8
1330 KOČEVJE
Tel.: +386 61 853-777

MARIBORSKA HRANILNICA IN POSOJILNICA d.o.o.
Partizanska 3-5
2000 MARIBOR
Tel.: +386 62 222-135

LLT HRANILNICA IN POSOJILNICA d.d. Murska Sobota
Staneta Rozmana 11/a
9000 MURSKA SOBOTA
Tel.: +386 69 27-800

DELAVSKA HRANILNICA d.o.o. Ljubljana,
Dalmatinova 4
1000 LJUBLJANA
Tel.: +386 61 3000-200

POTEZA-HRANILNICA d.o.o.
Dunajska 22
1000 LJUBLJANA
Tel.: +386 61 3070-880

APPENDIX 14a

REPRESENTATIVE OFFICES OF FOREIGN BANKS IN SLOVENIA AS AT 30 JUNE 1999

1. Cassa di Risparmio di Trieste
2. Cassa di Risparmio di Udine
3. Die Kärntner Sparkasse
4. European Bank for Reconstruction and Development
5. Magyar Külkereskedelmi Bank Rt.
6. LHB Internationale Handelsbank
7. Raiffeisen Zentralbank Österreich
8. Bank für Kärnten und Steiermark
9. Bank für Arbeit und Wirtschaft

APPENDIX 15

CHANGES IN LEGAL STATUS OF SLOVENIAN BANKS AND SAVINGS BANKS IN THE PERIOD FROM 1 JANUARY 1998 TO 30 JUNE 1999

Bank / Savings bank	Event	Effective date
Hmezad banka, d.d. Žalec, Bančna skupina Banke Celje	Taken over by Banka Celje	30 September 1998
Hipotekarna banka d.d. Brežice	Liquidation proceeding started	12 October 1998
Banka Creditanstalt d.d.	Taken over by Bank Austria d.d. Ljubljana	2 November 1998
UBK banka d.d. Ljubljana, bančna skupina SKB	Taken over by SKB banka d.d. Ljubljana	30 December1998

APPENDIX 16

LEGISLATION REGARDING REGULATION OF BANKING SUPERVISION

1. **Law on the Bank of Slovenia**
(Official Gazette of the Republic of Slovenia/I, No. 1/91)

2. **Law on Banking**
(Official Gazette of the Republic of Slovenia/I, No. 7/99)

3. **Law on Savings and Loan Undertakings**
(Official Gazette of the Republic of Slovenia, Nos. 14/90, 30/90, 17/91, 55/92, 66/93, 7/99)

4. **Decree on Supervision of Operating Activities of Banks and Savings Banks**
(Official Gazette of the Republic of Slovenia, Nos. 55/92, 89/98)

5. **Decree on the Calculation of Own Funds, Capital Requirements and Capital Adequacy of Banks and Savings Banks**
(Official Gazette of the Republic of Slovenia, No. 32/99)

6. **Decree on Large Exposure of Banks and Savings Banks**
(Official Gazette of the Republic of Slovenia, No. 32/99)

7. **Decree on the Classification of the On- and Off-balance Sheet Items of Banks and Savings Banks**
(Official Gazette of the Republic of Slovenia, No. 32/99)

8. **Instructions for Implementation of the Decree on the Classification of the On- and Off-balance Sheet Items of Banks and Savings Banks**
(issued on 10 May 1999)

9. **Instructions for Restructuring Claims of Banks and Savings Banks**
(issued on 20 May 1999)

10. **Decree on Establishing Specific Provisions of Banks and Savings Banks**
(Official Gazette of the Republic of Slovenia, No. 32/99)

11. **Decree on the Implementation of Article 127 of the Law on Banking**
(Official Gazette of the Republic of Slovenia, No. 32/99)

12. **Decree on Business Books and Annual Accounts of Banks and Savings Banks**
(Official Gazette of the Republic of Slovenia, Nos. 39/99, 50/99, 63/99)

13. **Instructions for Implementation of the Decree on Business Books and Annual Accounts of Banks and Savings Banks**
(issued on 27 May 1999, amended on 22 June 1999)

14. **Instructions for Submitting Monthly Reports on Balances on Banks' Accounts**
(issued on 27 May 1999)

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15. **Decree on the Minimum Scope and Content of Audit and Auditor's Report**
(Official Gazette of the Republic of Slovenia, No. 39/99)

16. **Decree on the Detailed Method for the Calculation of Liabilities, Claims and Holdings for the Purpose of Determining Net Indebtedness**
(Official Gazette of the Republic of Slovenia, No. 42/99)

17. **Decree on Determining and Prudential Reporting of Value of Holdings of Banks and Savings Banks in Non-financial Institutions and Investments in Tangible Fixed Assets**
(Official Gazette of the Republic of Slovenia, No. 42/99)

18. **Decree on the Required Adjustments of the Maturity Structure between Assets and Liabilities**
(Official Gazette of the Republic of Slovenia, No. 40/99)

19. **Instructions for Preparation of Monthly Reports on Effective Proportion between Assets Graded as First, Second and Third Class**
(issued on 10 March 1999, amended on 21 July 1999)

20. **Decree on Granting Special Liquidity Loans in Co-operation with Banks**
(Official Gazette of the Republic of Slovenia, Nos. 25/97, 37/98 in 31/99)

21. **Instruction for Preparation of Reports on Major Depositors**
(issued on 25 March 1999)

22. **Instructions for Preparation of the Reports on Movements in Tolar Liquidity**
(issued on 20 May 1999)

23. **Law on the Agency of the Republic of Slovenia for Insurance of Deposits Gathered by Banks and Savings Banks** (article 12)
(Official Gazette of the Republic of Slovenia/I, No. 1/91)

24. **Decree on the Provision of Integral Data on Balances on Customer Accounts of Banks and Savings Banks**
(Official Gazette of the Republic of Slovenia, No. 85/98)

25. **Instructions for Calculation of some Common Interest Rates on Deposits and Loans** (20 May 1999)

26. **Decree on the Mismatch between Assets and Liabilities of Banks in Foreign Currency (open foreign currency position)**
(Official Gazette of the Republic of Slovenia, No. 37/99)

27. **Recommendations for Trading Activities in Banks**
(issued in April 1997)

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28. **Recommendations for Capital Management in Banks**
(issued in October 1998)

29. **Recommendations for Credit Risk Management in Banks**
(issued in October 1998)

30. **Recommendations for Liquidity Risk Management in Banks**
(issued in October 1998)

31. **Recommendations for Currency Risk Management in Banks**
(issued in October 1998)

32. **Recommendations for Internal Controls Function in Banks**
(issued in October 1998)

33. **Operational Risk Management,** Basle Committee on Banking Supervision
(issued in September 1998)

34. **Enhancing Bank Transparency,** Basle Committee on Banking Supervision
(issued in September 1998)

35. **Decree on the Annual Fee and Lump-sum Charges for Prudential Supervision**
(Official Gazette of the Republic of Slovenia, No. 42/99)

36. **Code of Practice on the Co-operation between Supervisory Authorities**
(Official Gazette of the Republic of Slovenia, No. 55/99)

37. **Instructions for Setting Criteria Regarding Other Financial Services**
(Official Gazette of the Republic of Slovenia, No. 55/99)

38. **Decree on Tariffs for Services Rendered by the Bank of Slovenia**
(Official Gazette of the Republic of Slovenia, Nos. 23/91, 3/92, 44/92, 3/94, 4/94, 5/94, 73/94, 27/98, 76/98, 19/99, 27/99, 53/99)

APPENDIX 17

RATINGS OF SLOVENIAN BANKS AND SLOVENIA AS AT 31 AUGUST 1999

Fitch IBCA

Rated banks	Short-term rating	Long-term rating	Individual rating
Nova Ljubljanska banka	F2	BBB+	C
Nova Kreditna banka Maribor	F3	BBB	C/D
Banka Celje	F3	BBB	C
Gorenjska banka	F3	BBB	C
Banka Koper	F3	BB+	
Abanka	F3	BBB-	C/D

Country rating	Long-term forex rating	Short-term forex rating	Local currency rating
Slovenia	A-	F1	AA-

Moody's

Rated banks	Bank deposits - short-term	Bank deposits - long-term	Financial strength
Nova Ljubljanska banka	P-3	Baa3	D+
SKB banka	P-3	Baa3	D+

Country rating	Long-term foreign currency bonds	Long-term domestic currency bonds
Slovenia	A3	Aa3

Standard & Poor's

Rated banks	Short-term counterparty rating	Long-term counterparty rating	
		Local currency	Foreign currency
Nova Ljubljanska banka	A-3	BBB-	BBB-
Nova Kreditna banka Maribor		BB-pi	
Banka Celje		BB-pi	
Gorenjska banka		BB-pi	
Banka Koper		B-pi	
Abanka		B-pi	

Country rating	Outstanding sovereign rating	
	Foreign currency	Local currency
Slovenia	A/Stable/A-1	AA/Stable/A-1+

APPENDIX 17

Thomson Financial BankWatch

Rated banks	Short-term rating	Senior debt rating	Intra-country issuer rating
Nova Ljubljanska banka	LC-1	A-	IC-B
SKB banka	LC-1	BBB+	IC-B
Nova Kreditna banka Maribor	LC-1	BBB	IC-B/C
Banka Celje	LC-2		IC-C
Abanka	LC-2		IC-C

Country rating	Sovereign risk
Slovenia	A-

Capital Intelligence

Rated banks	Short-term rating	Long-term rating
Nova Ljubljanska banka	A-1	BBB+
SKB banka	A-2	BB+
Nova Kreditna banka Maribor	A-2	BB+
Banka Celje	A-2	BBB-
Gorenjska banka	A-2	BBB-
Banka Koper	B	B+
Abanka	A-3	BB-

Country rating	Long-term rating	Short-term rating
Slovenia	A-	A2