BANKA SLOVENIJE
EVROSISTEM

Session 4
Monetary and financial stability

The crisis in 2013 and current developments

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Second wave of recession in 2013: causes

MACROECONOMIC ENVIRONMENT

Weaker domestic economic activity

↓ consumption

↓ investment

↓ purchasing power, high unemployment, fiscal consolidation

limited demand, high corporate indebtedness and constraints on financing

BANKING SYSTEM

High dependence to foreign wholesale funding

Process of MBOs financed by banks' loans, banks with large exposures to fin. holdings with no or poor collateral

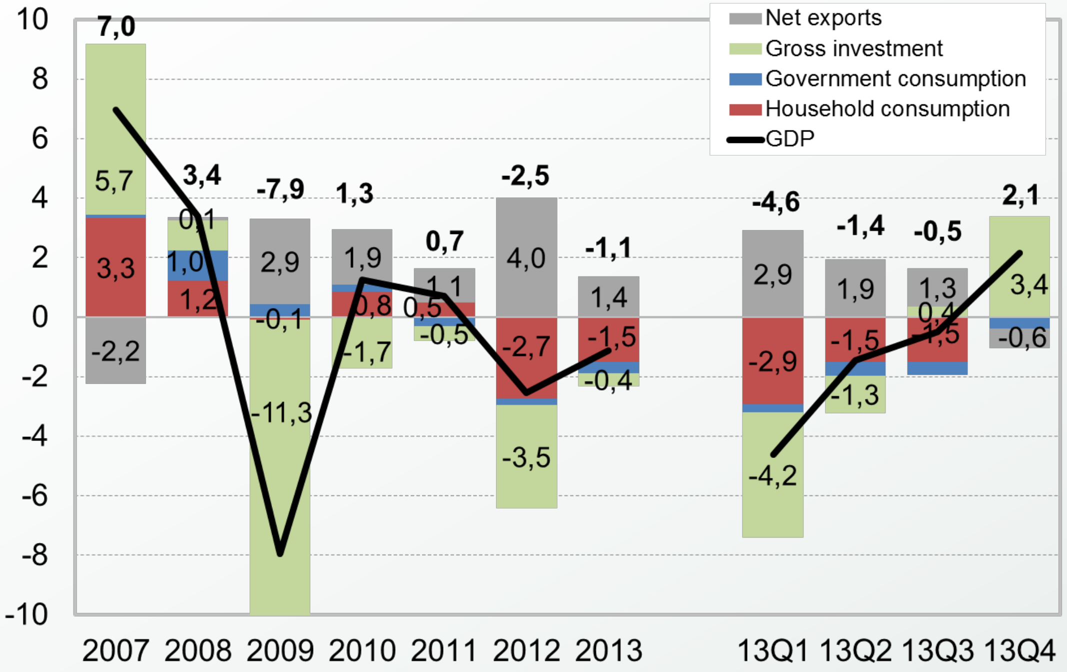
Cheap funding by subsidiaries and branches of foreign large banks

2/3 of the market share by balance sheet held by 3 state owned banks

Late and inadequate response of the owners of the banks; banks borrowed in the international wholesale markets with very limited opportunities

GDP and corporate financing flows

Year-on-year growth in GDP in percentages and contributions by components of demand to GDP growth in percentage points



Source: SORS

Corporate financing flows (total, via loans and via trade credits) in EUR million

	Flow			Stock		Growth
	2011	2012	2013	2012	2013	2013
	(EUR million)					(%)
Total	194	-1.181	-1.424	86.056	82.160	-4,5
- growth, %	-21,6	-707,3	20,6	-1,6	-4,5	
Loans	704	-944	-1.345	33.043	29.323	-11,3
- business-to-business	609	-137	-241	4.261	3.963	-7,0
- from banks	-559	-846	-2.606	19.090	14.329	-24,9
- from NMFIs	-348	-163	-4	2.251	2.178	-3,2
- from rest of the world	1.095	167	596	6.536	7.058	8,0
- of which: from corporates	5	298	-35	1.470	1.450	-1,4
- from foreign banks[1]	830	-153	56	3.018	3.088	2,3
- from IFIs	223	28	505	1.995	2.426	21,6
Trade credits	-441	136	-508	11.806	11.189	-5,2
- business-to-business	-343	-29	-410	6.420	6.072	-5,4
- from rest of the world	-33	276	-94	4.483	4.238	-5,5

Source: Bank of Slovenia

Banks' own deficiencies in pre-crisis period

- Loose credit approval process and underestimation or neglecting (credit) risk factors also due to fierce competition in domestic market caused by little good investment opportunities;
- Shortage of industry experts in credit approval process for targeted client groups (for example construction, renewable energy projects);
- Over-confidence in (property, real estate) collateral and neglecting warnings of risk management departments;
- Credit approval decisions not always made (only) on the economic fundamentals of the borrower, but influenced by third ("VIP") party;
- Under-developed loan portfolio analysis and quantitative tools in banks;
- Short-sighted remuneration practices for commercial units / employees focusing mainly on sales quantities instead on (credit) quality.

The key steps to address the deficiencies on country level

- Amendment of Solvency Legislation – May 2013 (simplified compulsory settlement) and December 2013 (preventive restructuring)
- "Institutional" changes:
  - Establishment of Bank Assets Management Company (BAMC) - March 2013
  - Adoption of principles, guidance to establish and follow best practices.
- Among the later, we can list the following documents adopted and issued by Bankers Association:
  - The Slovenian Principles for management of nonperforming debt of non-financial companies (based on London Approach) - 11 June 2014
  - Guidance for Management of non-performing exposures of SMEs - 9 December 2015
  - Guidance for responsible bank lending - first published November 2015 / last update (version 1.3) 2 October 2019
- All the above remains in place and are applied also in the recent period of favourable financial conditions in Slovenia.

Measures to stabilise the banking system in 2013

- The recapitalisation of NLB d.d., NKBM d.d., Abanka Vipa d.d. and two smaller banks, Factor banka d.d. and Probanka d.d.; which have been undergoing an orderly wind-down process since September,
- The recapitalisation via government securities obtained by the aforementioned banks in their portfolios, with the exception of Abanka (in 2014);
- The write-down of subordinated instruments (bail-in);
- The transfer of certain non-performing claims at NLB d.d. and NKBM d.d. to the BAMC.

Risk assess 2013 vs 2019

Bank of Slovenia's overview of risks to the Slovenian banking system

Systemic risk	Risk assess 2013	Risk assess Q2 2019	Trend in risk
Real estate market			↓
Macroeconomic risk			↑
Income risk			↑
Funding risk			→
Interest rate risk			→
Credit risk			→
Solvency risk			→
Contagion risk and large exposure			→

Colour code:

high elevated medium modest low

Source: Bank of Slovenia

Comparison of indicators 2013 vs 2019

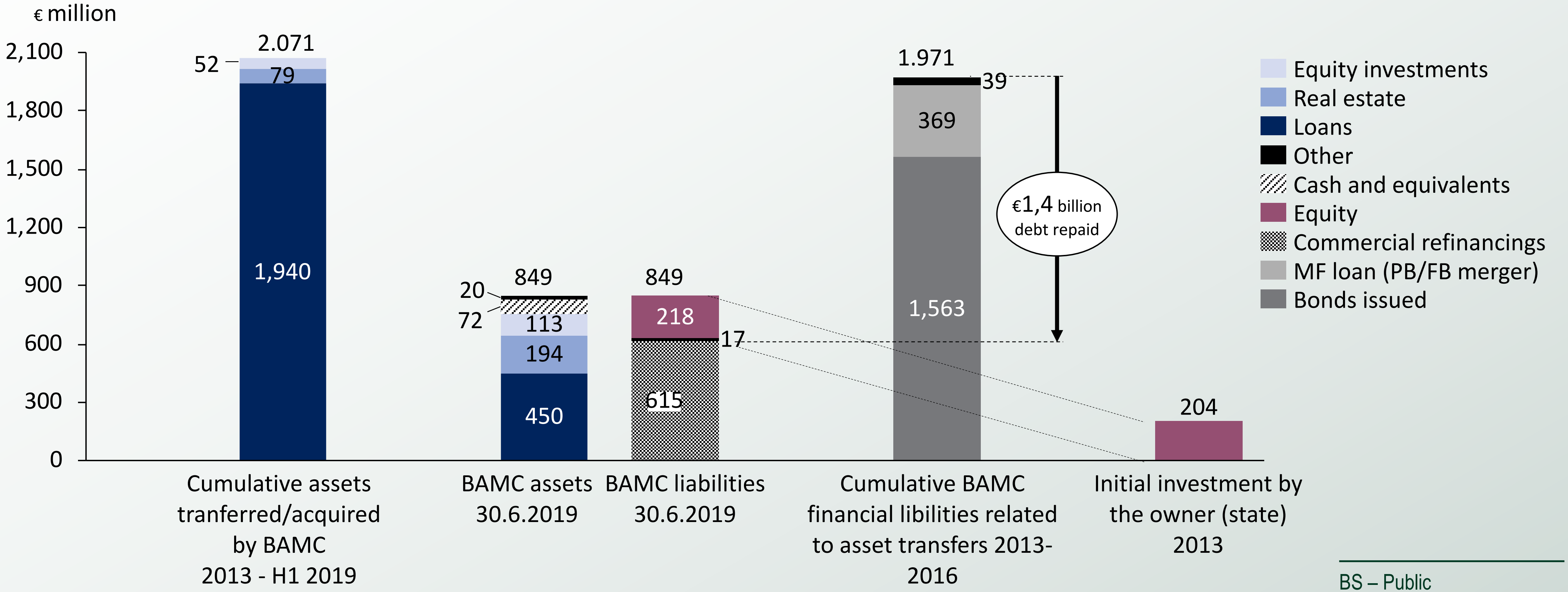
	Non-performing clains (more than 90 days in arrears)	Total capital ratio	Funding costs	Ratio of liquid assets to total assets	Yield for a 10 year Government Bond
2013	**17,8 %**	14,0 %	2,0 %	19,1 %	5,06 %
2019	1,5 %	19,8 %	0,3 %	31,3 %	0,12 %

Current ownership position of three major banks in Slovenia

- NKBM sold 100 % in 2016 to Apollo and EBRD
- Abanka sold 100 % in 2019 to Apollo
- NLB: privatization 75 %; 25 % + 1 share (Republic of Slovenia)

BAMC

- Successful and continuous reduction of (state-guaranteed) financial liabilities taken over with the transfer of non-performing assets → BAMC planned to be debt-free by the end of 2022
- After a decrease in the first years of operations, mid-2019 equity already above the initial investment by the owner (state)



Mid-term issues in banking sector in Slovenia

- The sustainability of business models (planning IT investment could decrease banks' profitability)
- Income risk (the key systemic risks over the medium term)
- Uncertainties in the international environment (Trade wars between US, China and other countries; Brexit without agreement; Geopolitical tensions, especially in the Near East; Lack of single anticyclical fiscal and monetary policy in EU or euro area, etc)
- Credit standards (the thread of banks to ease credit standards)
- IT risk including cybernetic risk (digitalisation leads banks to exposure to cybernetic risk)
- Regulatory environment and the problem of proportionality

Legal issues

- Draft law regulates judicial relief for the owners of subordinated debt that was written down during the restructuring of the banking system in 2013
- The main objective of the draft law is to remedy the unconstitutionality, as declared by the Constitutional Court of the Republic of Slovenia
- The draft law codifies ad hoc procedural rules of judicial redress for the former holders of qualified bank credit: court procedures, access to information, responsibility for damages, funds for compensation
- Bank of Slovenia will be the defendant, State can join on it side if so decides. Strict liability for damages is imposed on Bank of Slovenia and the reversal of the burden of proof.
- For individuals whose salary does not exceed average salary there is also lump sum compensation - max amount of compensation is 20.000 EUR
- Compensations shall be financed from the future profits and reserves of the Bank of Slovenia
- Due to the strict liability, draft law raises monetary financing concerns and due to use of central bank reserves it can violate financial independence of the central bank
- Several institutions (ECB, IMF, Bank of Slovenia, Legislative and Legal service of the National Assembly) expressed concerns about mentioned incompatibilities of the draft law.