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SLOVENIA – REVIEW OF PROGRESS ON POLICY MEASURES RELEVANT FOR THE CORRECTION OF MACROECONOMIC IMBALANCES

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List of Abbreviations

AMR	Alert Mechanism Report
AQR	Asset Quality Review
BAMC	Bank Asset Management Company
BoS	Bank of Slovenia
CPA	Competition Protection Agency
CSR	Country-specific Recommendations
DBP	Draft Budgetary Plan
EBA	European Banking Authority
EEP	Economic Partnership Programme
EDP	Excessive Deficit Procedure
EPC	Economic Policy Committee
EU	European Union
GDP	Gross Domestic Product
IDR	In-depth Review
IMF	International Monetary Fund
MIP	Macroeconomic Imbalances Procedure
NPL	Non-Performing Loans
NPR	National Reform Programme
SGP	Stability and Growth Pack
SIR	Slovenian Institute of Auditors
SOE	State Owned Entities
SSH	Slovenian Sovereign Holding
SSM	Single Supervisory Mechanism
ST	Stress Test
TSCG	Treaty on Stability, Coordination and Governance in EMU

Executive Summary

This report reviews the latest economic developments and the main policy measures taken by Slovenia that contribute to the rebalancing of the economy since the October 2013 progress report[1] under the macroeconomic imbalances procedure.

The main focus of the Slovenian authorities since summer 2013 has been the timely completion of a comprehensive Asset Quality Review (AQR) and Stress Test (ST) of the banking sector in order to assess its underlying health. An independent assessment of the health and resilience of the Slovenian banking sector was identified by the Council as an urgent priority in order for Slovenia to address its excessive macroeconomic imbalances. The exercise, which covered approximately 70% of the banking sector, was completed by external third parties. The results and the concrete plans for the banking sector reform were communicated by the Slovenian authorities on 12 December 2013. In line with this announcement, additional capital was provided to close the shortfall in the two largest state-owned banks followed up by the transfer of assets to the Bank Asset Management Company (BAMC), which was completed on 18 December 2013. Five other institutions, which were in compliance with capital requirements but where potential future capital shortfalls were identified, were instructed to increase their capital by June 2014 in line with the findings of the stress test. If this is unattainable, the government will provide the necessary capital backstops, in line with EU Competition rules.

The completion of the exercise is a key milestone in the necessary process of extensive restructuring and privatisation of the financial sector. The authorities have committed to fully dispose of their ownership of NKBM and Abanka in 2014 and to reduce their participating interest in NLB to no more than 25% plus one share in the medium term. Furthermore, in line with the state aid decision provided by the Commission in November 2013 both Factor banka and Probanka are in wind down which will be largely completed in 2014.

With the transfer of non-performing loans to the BAMC and the subsequent recapitalisation the banks' the authorities must now focus on enhancing corporate governance and stepping up supervisory actions to mitigate the risk of a repeat of the unsustainable lending practices, based on insufficient risk analysis, prevalent during the boom. The introduction of the corporate governance reforms identified in the state aid decisions, including policies to ensure the arms-length management of the banks, should minimise political interference. Banks submitted plans to the Bank of Slovenia (BoS) in January 2014 outlining the remedial actions planned in order to address the key issues identified by the AQR. Furthermore, the BoS has committed to informing the Commission of their supervisory strategy for the coming years which will build on the lessons learned from the AQR and ST.

Despite an (estimated) fall in Non-Performing Loans (NPL) by almost 10% (from 21% to approximately 12%) due to the transfers to the BAMC these levels remain elevated, especially in the corporate sector loan book and must be actively tackled by the banks. Continued progress at cleansing the banks' balance sheets coupled with supervisory and governance reforms would assist the swift privatisation of the banks.

The necessary tools are being put in place, albeit after some delay, to provide for the required privatisation and restructuring in both the financial and corporate sectors. The significant reforms to the corporate insolvency framework introduced in December 2013 should improve the efficiency of insolvency proceedings and provides for the preventive restructuring of viable businesses with unsustainable debt overhangs. The introduction of the reform is welcome, though its impact is yet to be assessed and close monitoring is required.

[1] Report is available here: http://ec.europa.eu/economy_finance/economic_governance/documents/si_imbalances_epc_report_en.pdf

A key issue is the level of state ownership and influence prevalent in Slovenia which creates significant risks to the public finances directly and by way of contingent liabilities from guarantees provided. It also reduces the overall efficiency of the economy through possible inefficient allocation of resources. A coherent strategy for the management of the state's investments coupled with improved corporate governance in state-owned enterprises would create a more favourable environment to attract Foreign Direct Investment. In that context the draft law amending the Slovenian Sovereign Holding (SSH), which is expected to be adopted in the first quarter of 2014, should provide a better platform for the management and privatisation of state owned entities. Decisive progress with regard to the privatisation of the 15 state owned entities identified for accelerated privatisation and the adoption of a comprehensive strategy for core and non-core state assets would provide a clear signal to the market regarding Slovenia's commitment to implementing the necessary reforms. Continued divestment of state ownership beyond the initial 15 companies identified is important in order to improve governance and efficiency and to ensure substantial withdrawal of the State from the economy.

While there has been welcome progress in addressing the financial sector issues several important fiscal and structural reform challenges remain, notably further reducing unit labour costs and enhancing the competitiveness of public and private sector businesses. Furthermore, pension and labour market reforms introduced in 2012 and 2013 are positive but given Slovenia's ageing population a fully-fledged pension reform and a reform of the long-term care system are required to ensure debt sustainability beyond 2020. Further reforms to the labour market would improve flexibility and assist in regaining previous losses in competiveness. In addition, the accelerated deregulation of regulated professions would assist in regaining competitiveness by realigning domestic costs to costs in other jurisdictions. These structural reforms should be seen as a part of a comprehensive strategy to restore growth of the Slovenian economy, which is expected to be presented in the National Reform Plan in April 2014.

The Government has committed to adopt the necessary fiscal adjustment in order to restore the sustainability of public finances. A comprehensive medium-term fiscal framework which provides clarity on future expenditure ceilings and is subject to scrutiny by an independent fiscal council would further assist in restoring confidence in the country's economic outlook. The constitutional amendments introduced last May pave the way for the introduction of the necessary implementing legislation which should be promptly adopted.

Overall, considerable progress has been made by Slovenia since the CSRs were adopted, particularly in the financial sector, but several challenges remain. Decisive action in respect to its banking sector has provided clarity regarding its underlying health and the Government's prompt recapitalisation and announced strategy for restructuring has been welcomed by the markets, as witnessed by the recent decline in yields. However, several of the structural reform measures identified and the privatisation process have lagged. The authorities need to take advantage of the current positive market sentiment, maintain and in some instances accelerate the pace of the implementation of its programme of structural reform and particularly the privatisation process to improve competiveness and to safeguard debt sustainability.

1. Introduction

In April 2013, the Commission concluded, in the framework of the Macroeconomic Imbalances Procedure (MIP), that macroeconomic imbalances in Slovenia were excessive. In July the Council addressed to Slovenia a set of country-specific recommendations (CSRs) mostly directed to support the correction of these imbalances, and it was agreed to monitor policy progress in October 2013 and in January 2014.

This report by the Commission services reviews the main measures taken by Slovenia since the previous report was presented to the Economic Policy Committee (EPC) on 22 October 2013. To underpin the analysis a fact-finding mission took place on 7-9 January 2014.

Background

On 28 November 2012, the European Commission presented its second Alert Mechanism Report (AMR) which concluded that a further in-depth analysis was required into whether imbalances existed or risks had emerged in Slovenia. The subsequent “in-depth review” (IDR), published on 10 April 2013, examined the nature, origin and severity of macroeconomic developments in Slovenia. On April 10 2013, the Commission concluded that "*Slovenia is experiencing excessive macroeconomic imbalances. Urgent policy action is needed to halt the rapid build-up of these imbalances and to manage their unwinding*".

On 30 April 2013, the Slovenian authorities submitted the Stability Programme and the National Reform Programme (NRP). Following the assessment of the two packages, the Commission proposed a set of policy recommendations to address macroeconomic imbalances which were reflected in the CSRs in the framework of the European Semester and eventually adopted by the Council on 9 July 2013[2] The scope of the MIP-relevant Recommendations aimed at addressing macroeconomic imbalances is wide-ranging and covers (i) fiscal sustainability; (ii) financial sector restructuring; (iii) privatisation and repair of private sector balance sheets; (iv) other policies supporting competitiveness and structural adjustment. An overview of the MIP-relevant recommendations, NRP commitments and related deadlines is provided in Annex 1. Moreover, in policy recommendation number 5 addressed to the euro area Member States, a specific call for an assessment of progress of MIP-relevant commitments and CSRs was made[3] and it was agreed to monitor policy progress in October 2013 and in January 2014. In this context, this report reviews the latest economic developments since the October report and the main relevant policy measures taken by Slovenia in recent months.

On 15 November 2013, the Commission published its assessment of effective action in the framework of the EDP, along with the assessment of Slovenia's Draft Budgetary Plan and Economic Partnership Programme. Though also MIP relevant, these issues will not be covered in this report, in order to avoid an overlap of surveillance processes.

[2] http://register.consilium.europa.eu/pdf/en/13/st10/st10655-re01.en13.pdf

[3] http://register.consilium.europa.eu/pdf/en/13/st11/st11216.en13.pdf: "Take the necessary steps for an effective implementation of the Macroeconomic Imbalances Procedure, in particular by assessing progress in reform commitments in Member States experiencing excessive imbalances and in reform implementation in Member States with imbalances requiring decisive action to limit negative spillovers to the rest of the euro area."

2. Recent macroeconomic developments

According to the European Commission Autumn forecast 2013, real gross domestic product (GDP) is expected to drop by 2.7% in 2013 and by a further 1% in 2014 on the back of steadily declining domestic demand. A tepid recovery of the economy is forecast to start only in the second half of 2014 and to continue in 2015, albeit at a very slow pace. The rebound would be driven by net exports, as global economic conditions improve, while the ongoing deleveraging is set to continue weighing on domestic demand.

More positive quarterly outturns in 2013 have eased the pace of real GDP contraction expected in 2013. More recent economic data is less negative than expected and points at a milder GDP decline up to Q2-2013 and GDP being stable at 0.0% quarter-on-quarter (q o q) in Q3-2013. This had a positive impact on the carry-over for the change in real GDP in 2013 as a whole. The external side continued to support GDP, with exports experiencing a large increase, while imports have increased only slightly in Q3-2013. At the same time, domestic demand and consumer confidence declined again in Q3-2013 with retail sales continuing to fall in October and November year-on-year. As to the supply side, the biggest contraction has been observed in the construction sector, while the decline was milder in the agriculture and manufacturing sector in Q3-2013. The value added of the private sector has continued to grow at a slow pace in the first three quarters of 2013.

On 15 October 2013 Slovenia submitted the Draft Budgetary Plan (DBP) for 2014[4]. On 15 November 2013, the Commission published[5] its assessment of effective action in the framework of the EDP, along with the assessment of the DBP and Economic Partnership Programme (EPP). Overall the Commission concluded that the DBP was in line with the rules of the Stability and Growth Pact (SGP), albeit with no margin.

Since the submission of the DBP fiscal discipline appears to have been broadly maintained and the 2013 structural budget deficit appears in line with targets. Nevertheless, further clarity has emerged on several policy issues and some downside risks to the headline deficit and debt forecasts, highlighted by the Commission in the DBP, have materialized which will have an impact on the 2013 outturn and the forecast for 2014.

Firstly, neither the DBP nor the Commission Autumn Forecast include any debt accumulation from the envisaged transfer of impaired banking assets to the Bank Asset Management Company (BAMC) and both project the bulk of bank recapitalisations to happen in 2014. In fact most of the capital was injected into the banks on 18 December 2013. The recapitalisation needs and costs of the transfer to BAMC were provided via a mix of funds available in governments' treasury accounts, including from the private placement of a EUR 1,500 million bond on 15 November 2013 and the tapping of existing bonds. The gross general government debt is now forecast to stand at approximately 72% of GDP at end 2013. Furthermore, contingent liabilities, mainly in the form of state-guarantees, remain high (at around 20% of GDP) and pose a risk to debt sustainability.

Secondly, following the Supreme Court Judgement repealing the postponement of the third instalment of the increase in public sector wages a law was adopted in November 2013 which provides for gross payment of approximately EUR 100 million (around 0.3% of GDP) in both 2014 and 2015. These payments were not included in the DBP or the Commission Autumn forecasts for 2013, 2014 and 2015. As these payments relate to arrears due for 2010-2012 they have a one-off impact on the 2013 headline deficit, without affecting the structural balance.

[4] http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/dbp/si_2013-09-30_dbp_en.pdf
[5] http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/dbp/si_2013-11-15_co_en.pdf

Finally, the Act Regulating Compensation for Damage to Persons Erased from the Permanent Population Register[6] entered into force on 18 December 2013 and will take effect from 18 June 2014. The authorities estimate the financial implications of the Act to be approximately EUR 130 million and this will arise over a number of years. The authorities indicated that the funds already earmarked in the budgets 2014 – 2015 should be sufficient but this depends on the timing of submissions for damages, which is likely to occur sooner rather than later.

Some potential upside to 2014 growth forecast arises from the upswing in market sentiment towards Slovenia, as evident from the recent fall in bond yields, as more clarity emerged regarding the fiscal liabilities from the banking stress test. Decisive follow up action and implementation of the planned restructuring of the banking system is necessary in order to sustain this positive sentiment and for this to translate into increased growth and domestic demand. Moreover there might be a one-off concession fee from the announced auction for the Fourth Generation of mobile network frequencies expected to be completed in March 2014.

The Commission is currently preparing its Winter 2014 forecast which will incorporate the various events outlined above.

[6] The Act regulates the restitution of damage to persons who were erased from the register of permanent population after Slovenia's independence. Further details here; http://www.mnz.gov.si/en/services/the_erased/

3. State of play with MIP-relevant reforms

3.1. Measures to support fiscal consolidation and enhance the quality of public finances

The authorities are currently preparing an overhaul of the legislation underpinning Slovenia's **fiscal framework**, in compliance with the Treaty on Stability, Coordination and Governance in EMU (TSCG) and the secondary European legislation on fiscal governance (in particular the directive on requirements for budgetary frameworks). On 24 May 2013 the constitution was amended to provide the basis for the general government budget balance/surplus rule. Despite the amendment stipulating that the implementing act would be adopted within six months (by end November 2013), the necessary legislation, namely the binding Fiscal Rules Act which will specify the relevant concepts and mechanisms[7], remains outstanding and the deadline in the CSR has been missed. The authorities indicated that a draft Bill has been prepared and the intention is for the political debate to commence in January. A detailed assessment by the Commission of compliance with the requirements of the TSCG is expected to be completed in due course. A Fiscal Council was established in 2009 but its effectiveness has been limited given its unclear mandate, the Act provides the opportunity to strengthen its role, enhance its visibility and resources so that it can provide, in addition to its existing tasks, a genuine multi-annual perspective to fiscal policy. To strengthen the monitoring of the fiscal rules the "comply or explain" principle should be fully enshrined in national legislation. The Council's independence should also be enhanced by providing for its members to be designated by a plurality of institutions. Clear procedural arrangements framing the contribution of the Fiscal Council to the annual budget cycle in line with recent developments in EU legislation (six and two-pack) and the TSCG should be established. Concepts from the Fiscal Rules Act will be further specified in the revised Public Finance Act, which the authorities expect will be submitted to Parliament before the summer.

As of end 2012, the Slovenian General Government sector consisted of 2,679 separate units/entities, with 53% of these units classified as indirect budget users[8]. The authorities have requested technical assistance from the IMF in designing and implementing controls over indirect budgetary users. The authorities intend to initiate an expenditure review for education and social care. While this is a welcome initiative the scope of the review is narrower than what was envisaged in the CSR. The exercise provides an opportunity to thoroughly assess all expenditure lines and provide credible estimates of the potential savings from various policy options over the medium term. Furthermore, it should identify options to enhance efficiency; cost effectiveness and exploit synergies e.g. reduce duplication through further amalgamation of functions via shared services initiatives. Given the structure of Slovenia's public service the review should cover the state, local level direct and indirect budget users as well as municipalities' owned providers of utilities and services.

Slovenia's demographics combined with its current social welfare system mean that it is forecast to experience one of the largest increases in ageing-related public spending in the EU by 2060[9]. The authorities have requested technical assistance from the World Bank in order to improve service delivery and efficiency in the health sector, and to strengthen its financial sustainability. It was envisaged that the exercise would be concluded in autumn 2014 but the status of the review is unclear as it has been suspended pending the appointment of a new Health Minister. Originally, it was envisaged that this technical assistance would be wider and also identify potential policy options for education and justice but it appears that the scope of the exercise has narrowed. Separately, in September 2013 the authorities established a working group with members from academia and

[7] The legislation is to provide the definitions of revenue and expenditure, general government, structural balance, as well as the format and mandate of the fiscal council. It also needs to provide details on the escape clause, a definition of significant deviations from the <MTO or the adjustment path towards it and the activation of the underlying correction mechanism. Furthermore, the necessary legislation has to be passed by a two thirds majority.

[8] Direct budgetary users are state or local authorities or organizations and the local administration. *Indirect budgetary users* are defined in Article 3 of the Act on Public Finances as public funds, public institutes and public agencies established by the state or municipality.

[9] Further details are available here: http://ec.europa.eu/economy_finance/publications/european_economy/2012/pdf/ee-2012-2_en.pdf

ministries to consider further pension reforms to preserve sustainability of the system beyond 2020 and to prepare a white paper on the issue. An analysis of the impact of the pension amendments introduced in 2013 is currently being prepared which will feed into the group's assessment. Separately, the blue print for the long-term care reform was published by the government at the end of 2013 and the reform is expected to be adopted at the end of 2014. Draft legislation under preparation will define new criteria for care receivers, new rights in long term care and the introduction of long term care insurance. In view of the demographic pressures a fully-fledged pension reform and a reform of the long-term care system are required to ensure debt sustainability beyond 2020.

3.2. Repair of bank and non-financial sector balance sheets

While the Slovenian banking sector is small relative to other euro area countries (approximately 130% of GDP vs. euro area average of 330%), the concentration of lending to highly leveraged corporates and the significant increase in non-performing loans resulted in uncertainty regarding the underlying health of the banking sector and the potential fiscal implications for the state. In light of this a robust **Asset Quality Review (AQR) and Stress Test (ST)** conducted by independent third parties was a priority for 2013 in order to regain market confidence and provide the necessary clarity regarding the outlook for the banking sector. The exercise incorporated an AQR and both bottom-up and top-down STs over the 3 year projected period 2013-2015. The exercise was based on the European Banking Authority (EBA) proposed harmonised definitions for forbearance and non performing exposures which will also be a key input for the upcoming SSM exercise. The macroeconomic scenarios used for the ST were prepared by the ECB in conjunction with the European Commission and was agreed by the Steering Committee supervising the exercise. The scope of the exercise was substantial; it covered approximately 70% of the Slovenian banking system and granular data was provided by the participating institutions for 2 million loan and 14,000 collateral assets. The AQR incorporated the results of 4,235 individual loan file reviews and the assessment of 15,358 real estate valuations conducted by independent third parties. The implementation of the exercise was coordinated and supervised by a Steering Committee comprising of representatives from the Bank of Slovenia (BoS), Ministry of Finance, and observers from the European Commission, the ECB and the EBA.

On 12 December 2013 the Slovenia authorities announced[10] elements of their strategy for the restructuring of the financial sector based on the outcome of the AQR and ST. The ST identified capital deficits of up to EUR 4,778 million under the adverse scenario. After full burden sharing by holders of subordinated debt instruments and taking to account the transfer of non-performing claims to the **BAMC** the remaining capital requirement of the three biggest banks to be provided by the State amounted to EUR 3,012 million[11]. The recapitalisation measures for the two largest state-owned banks (NLB, NKBM) were approved[12] by the European Commission on 18 December 2013. In parallel the Commission temporarily approved rescue aid for Abanka[13] and also adopted a decision allowing for new aid in the form of a State recapitalisation of up to EUR 236 million for Probanka and of up to EUR 285 million for Factor Banka. Once the decisions were adopted, recapitalisation to the five institutions totalling EUR 3,214 million was completed by Slovenia by way of cash and marketable sovereign securities [14](Table 1). In addition, EUR 200 million was provided to the BAMC by way of marketable sovereign securities to ensure its normal operations as a going concern.

[10] http://www.bsi.si/iskalniki/sporocila-za-javnost-en.asp?VsebinaId=16219&MapaId=202#16219

[11] Probanka and Factor banka were excluded from the ST as a result of the initiation of an orderly wind-down process in early September.

[12] Further details available here: http://europa.eu/rapid/press-release_IP-13-1276_en.htm

[13] The final state aid decision will be taken in the context of the assessment of Abanka's restructuring plan, which Slovenia committed to submit before the end of February 2014.

[14] Discussions between the Slovenian authorities and the ECB on the use of sovereign bonds for the recapitalisations of banks are ongoing.

Table 1: Overview of outcome of ST and the financial sources for recapitalisations and transfers to BAMC

Institution	**Total capital increase EUR million**		**Capital increase via cash EUR million**	**Capital increase via sovereign securities EUR million**	**Transfer value/gross value of assets transferred to BAMC EUR million**	
	2013	**2014**			**2013**	**2014**
NLB	1551		1141	410	622/2278	
NKBM	870		620	250	390/1023	
Abanka	348	243	348	243		543/1150[15]
Probanka	176		160	16		
Factor banka	269		160	109		
Total	**3214**	**243**	**2429**	**785**	**1012/3301**	**543/1150**

***Source**: Bank of Slovenia and BAMC*

Two privately owned domestic banks (Banka Celje and Gorenjska banka) and three foreign-owned subsidiaries (UniCredit Banka Slovenija, Hypo Alpe-Adria-Bank and Raiffeisen banka), which are currently in compliance with Bank of Slovenia capital requirements but for which the stress test identified a potential capital shortfall have until June 2014 to increase their capital in line with the findings of the stress test. If this is unattainable, the government will provide the necessary capital backstops, in line with EU Competition rules. The government announced their intention to fully dispose of their ownership of NKBM and Abanka in 2014 and to reduce their participating interest in NLB to no more than 25% plus one share in the medium term. Both Factor banka and Probanka are in wind down and will exit the market in 2014. The NKBM privatisation process has been restarted and an engagement letter with a new financial advisor has been signed.

A comprehensive strategy of arms-length management building on the basis of the corporate governance principles established in the state aid decisions will be developed promptly and result in relationship framework agreements governing the relationship between the Government and the banks' management with the objective to mitigate the risk of political interference in determining commercial policies and conducting its day-to-day operations. In parallel the framework for supervision and governance should be enhanced to prevent a repeated build up in NPLs as a result of unsustainable lending practices and poor oversight. The AQR and ST highlighted several vulnerabilities of the banks practices and procedures, including misclassification of the riskiness of loans, weak recovery processes, infrequent collateral valuations, unrealistic assumptions regarding the time to repossession and widespread evergreening of loans. The BoS has issued letters to all the banks drawing their attention to the key findings of the AQR and has instructed them and their auditors to take the findings into consideration when they are preparing their year-end financial statements. Furthermore, banks submitted plans to the BoS in January 2014 outlining the remedial actions planned in order to address the key issues identified. In parallel, the Slovenian Institute of Auditors (SIR) has sent the banks additional guidelines for the valuation of financial assets and real estate assets and for the treatment of restructured loans. These actions are welcome but should be closely monitored by the BoS and incorporated into its supervisory strategy. The BoS intends to carry out stress tests on all the banks in 2014 and NLB, NKBM and SID banka will be subject to the Single Supervisory Mechanism (SSM) comprehensive exercise in the autumn of 2014.

[15] Estimates – final figures to be determined in the context of State Aid decision.

As part of the financial sector restructuring loans with a gross value of EUR 3,449 million were earmarked for transfer to the **BAMC** from the two largest banks (NLB and NKBM) and on 20 December loans with a gross value EUR 3,301 million were transferred for a total consideration of EUR 1,012 million, representing an average discount of 69%. The transfer prices were determined in accordance with European Commission state aid rules and reflect the long term real economic value of the loans. The consideration for these loans was by way of two tranches of BAMC bonds with maturity of two and three years respectively, the bonds are market tradable and were listed on the Ljubljana Stock Exchange on the 27 December 2013. With regards to Abanka, the third largest bank, loans with a gross value of approximately EUR 1,150 million will be transferred once the restructuring plan is submitted to and approved by the European Commission. The authorities are intending to make several changes to the law governing the BAMC with regards to; (i) increasing the lifetime of the BAMC significantly above the 5 years that is currently provided for in the legislation (ii) removing the yearly 10% divestment obligation currently in place (iii) providing for the possibility for the participation of private investors. The intention of these amendments is to allow for an ownership structure of the BAMC similar to AMCs in other EU member states, to avoid fire sales and to maximise the return for the taxpayer. It is however crucial that these amendments do not postpone the disposal of assets which should take place at the earliest possible opportunity. The authorities estimate the transfers of NPLs to the BAMC will result in a reduction in the NPL ratio across the banks from almost 21% to approximately 12% once all transfers to the BAMC are completed. These levels remain elevated, especially in the corporate sector, and all efforts should be made by the banks to restructure their balance sheets and work out these loans.

While the legal titles to the relevant loans were transferred to the BAMC in December, the actual paperwork relating to the loans has yet to transfer, due to delays by the banks in preparing the required transfer documentation. An operational service agreement has been put in place, until 30th April 2014, whereby the banks will continue to manage the day to day servicing of the loans but all decision powers rest with the BAMC. The BAMC is increasing its operational capacity through the recruitment of both international and national restructuring and financial experts (at end January 2014 it had 38, the objective is to reach a complement of 70 staff). To enhance the transparency of the operation the BAMC management is accountable to the parliament. The entity will be subject to annual audits by the Slovenian Court of Auditors and will publish annual accounts. Furthermore, the BAMC may share with the ECB any relevant information on its operations that the ECB requires within its competences and the authorities have agreed that any information provided to the ECB would also be shared with the Commission. In order to facilitate the swift restructuring of corporate loans held by the BAMC special provisions have been included in the recently passed insolvency law which reduces the consenting creditor threshold from the standard 75% to 55% in the case of BAMC to proceed with a compulsory procedure. In this context, the BAMC has the possibility of purchasing assets from other banks at market price but this is not the preferred approach to restructuring. The BAMC has limited capacity to provide working capital which could prove problematic in the restructuring of loans as the necessary financing would have to be provided by the banks where credit channels have been constrained. The authorities consider the BAMC sufficiently capitalised and do not envisage additional capital needs arising in 2014. The adequacy of capital will however depend on the volume of restructurings and the approach still has to be finalised. Going forward the BAMC's strategy should be clearly defined; potential mergers which create synergies should be identified and promptly executed and cases where there is a viable underlying business swiftly restructured.

To facilitate the repair of private sector balance sheets a law amending **insolvency proceeding** and introducing preventive restructuring proceedings entered into force on 7 December 2013. The purpose of the amendments is to facilitate speedier restructuring of viable businesses with significant debt overhang and to restore insolvency as a credible threat for non-payment of loans, essential for a functioning financial system. The legislation however excludes micro and small companies[16] from the preventive restructuring procedure which could adversely impact the banks' ability to restructure loans relating to these companies and may lead to reduced recovery rates. The expedited compulsory settlement procedure will allow creditors to take a more proactive role in proceedings particularly where there is evidence of financial mismanagement. According to the authorities the relevant stakeholders, including members of the judiciary and court administrators, have been trained accordingly and the courts' IT infrastructure has been upgraded to support the new procedures. The new arrangements remain untested as the first applications under the revised framework are only beginning to be processed. As no economic assessment of the changes has been undertaken it is unclear whether the system is adequately resourced to deal with the potential demand or what will be the financial implications for the banks and the BAMC of the new arrangements. The authorities indicated that they will closely monitor the proceedings and if shortcomings emerge the new legislation will be revised accordingly.

With regards to the **functioning of the justice system,** preliminary data indicates that progress has been made with respect to enhancing the effectiveness of the courts and reducing the backlog of pending cases[17]. The improvements in disposition times vary with more significant improvements in civil and commercial cases and less notable improvements in enforcement cases. The Ministry of Justice in cooperation with the other relevant Ministries and the Judiciary should reflect on enhancing the communication efforts with respect to the improved functioning of the justice system. Continued improvements in the functioning of the system should improve the business environment in the medium to long term and potentially attract more investors.

3.3. Other policies supporting competitiveness and adjustment

The prompt publication of the future asset management strategy is essential and will provide clarity regarding the State's focus for the future and what it considers core and non-core assets. Furthermore, the transfer of shares of some of these companies to the BAMC provides the opportunity for the state to consolidate its shareholdings. As a first step in the privatisation process the authorities identified an initial 15 companies for accelerated privatisation in June 2013. Progress to date has been mixed. The sales agreement for Helios was signed in October 2013, for Fotona at end January 2014 and the disposal of Elan is expected to be completed in the first quarter of 2014. The sale of Telekom is expected to be completed in July 2014, though time lags experienced between the various stages of the privatisation process would have to be decreased in order to meet this deadline. Several of the other assets sales processes appear stalled with limited progress since the previous report, some of these delays are due to the intention to firstly undertake debt restructuring (Unior, Aero, Paloma) subsequently the relevant entities will be brought to the market. In a limited number of cases delays are due to difficulties in reaching shareholder agreement for the sale of the company. The Slovenian authorities have provided the anticipated dates for the completion of the disposals but, given the limited progress made to date, some of the timelines appear overly ambitious and there is a considerable implementation risk to these deadlines being met (Table 2).

The amendments to the legislation underpinning the **Slovenia Sovereign Holding (SSH)** reconstituting it as a vehicle for consolidating the management of direct and indirect ownership stakes of the Republic of Slovenia and facilitating privatisation of non-core assets have yet to be adopted. The political debate commenced in January with the intention that the amended legislation will be adopted in the first quarter of 2014. The classification of state-owned assets between core and non-core, envisaged by end September in the context of the CSRs has yet to be implemented. The

[16] The definitions of micro and small companies are set out in Article 55 of the Companies Act: http://www.mg.gov.si/fileadmin/mg.gov.si/pageuploads/predpisi/ZGD-1_prevod_AN.pdf

[17] Between 2011 -2012 the backlog of commercial cases reduced by approximately 7%. Preliminary data indicates that the backlog has fallen by an additional 12% from January - November 2013.

legislation provides that the strategy, which will identify the core and non-core assets for the SSH has to be published within three months of adoption. Given the significant lead times involved in the privatisation process and in light of the already significant delays experienced this strategy should be published as a matter of priority in parallel with the publication of the legislative amendments. To enhance the transparency of the SSH, it will be subject to annual audits by the Court of Auditors.

Table 2: Indicative timelines for the completion of the privatisation of the 15 companies identified for privatisation in June 2013

	Market value of company/ latest estimated value at end 2012 (EUR million)**	**% of assets identified for disposal**	**Anticipated signing of a sale of assets**
		Stated owned % / total percentage for disposal including shareholder agreement	
Adria Airways	11	72%/100%	Mar-15
Aerodrom Ljubjana***	125	65%/73%	Jul-14
Cinkarna Celje***	87	31%/73%	Sep-14
Elan	35	75%	Mar-14
Fotona	15	70%	Jan -14
Gospodarsko Razstavisce	22	31%	Oct-14
Helios***	139	18%/73%	Oct-13
Telekom Slovenije***	876	72%/73%	Jul-14
Terme Olimia Bazeni[N]	6	50%/100%	Dec-14
Terme Olimia[N]	25	25%/80%	Dec-14
Žito Group	28	27%/51%	Sep-14
Nova KBM****	150	100%	Aug-14
Adria Airways Tehnika	5	52%/100%	Oct-14
Aero*	5	33%	tbc
Paloma*	6	71%	tbc
Unior* /***	6	45%	tbc

Source: Slovenian Authorities, State owned refers to RS, SOD, KAD, PDP, MZ, DSU, figures have been rounded.
* Subject to restructuring before initiating the sales process
** For listed companies it is the market value on the 20th of January 2014, for non-listed it's a book value from the audited accounts as per December 31st 2012 or unaudited book value per 30th September 2013
*** Listed company
N Shareholders agreement has not yet been signed (the percentage is anticipated based on current negotiations)

With regards to the **labour market,** the authorities are currently monitoring the effects of the 2013 reform continues and it is too early to determine whether the reform will deliver in terms of reducing labour market segmentation, enhancing flexibility and supporting employment, especially of the low-skilled. The government has commissioned an independent impact assessment report due to be completed in March 2014. Furthermore, a draft law regarding student work was finalised in January 2014 and is expected to be adopted by the Parliament in March or April 2014. The law aims to preserve flexibility while introducing social security contributions and should assist in reducing labour market duality. Active labour market policies are expected to focus mainly on the young and long-term unemployed in the form of targeted actions and public works respectively and the youth guarantee implementation plan was approved by government on 30 January 2014..

The government initiated an inter-ministerial process in 2012 to streamline Slovenia's numerous **regulated professions** with a view to enhancing employment creation and competitiveness. However, limited progress has been made and significant reforms to the regulated professions are not expected to materialize before autumn of 2015. Furthermore, the impact assessment of the deregulation of the crafts sector has yet to be completed.

As wage rigidity at the bottom of the wage distribution reduces inflows to employment and impacts competitiveness the government has explored several options with the social partners with regards to the **minimum wage.** These possible options included freezing indexation for 2014 to linking minimum wage adjustments to economic indicators other than inflation or redefining the minimum wage base to which indexation applies. As no agreement has been reached the minimum wage will be adjusted by the 0.7% inflation of 2013, as per the legislation in force. Social partners will set up a working group to assess the applicable laws and possible amendments, thus negotiations with the social partners are expected to continue.

The **Competition Protection Agency (CPA)** work plan for 2014 is largely focused on the energy and telecom sector. They will also consider the health sector where there have been claims of bid rigging for public procurement contracts. Despite these important challenges, the Agency has seen a significant decrease in its 2014 budget allocation, as have all agencies. This is likely to adversely impact on the number of investigations the agency can initiate. The CPAs budget is subject to a high degree of scrutiny and two recently initiated administrative investigations are further impacting on the agency's limited resources and ability to proceed with the backlog of cases. Furthermore, leaks in the press on these investigations may affect the credibility of the CPA. Given the number of privatisations envisaged in the upcoming 18 months every effort should be made to strengthen the role of the CPA, particularly by ensuring it is adequately resourced and financially autonomous, in line with other state agencies.

Annex I – State of play of MIP relevant recommendations

Main components of CSR	Measures announced in NRP	Ddl NRP	Progress
I. Measures to improve fiscal outcomes and quality of public finances			
Safeguard growth-friendly spending, adopt measures to improve tax compliance and implement measures on the expenditure side underpinned by systematic reviews of public expenditure at all government levels.	- improved tax inspections and supervisions - control of transfers to tax havens - better supervision of high-risk activities - promotion of declaring business activities - strengthened tax enforcement procedures and sanctions	n/a	Throughout 2013: Adopted various measures to tackle the grey economy with the overarching aim to strengthen: - supervision and restrictions of cash operations - prevention of illegal work and employment - cooperation of inspection services - disincentives for illegal construction activities - supervision of specific risky sectors - awareness and sense of responsibility
To improve the credibility of consolidation, complete the adoption of a general government budget balance/surplus rule in structural terms, make the medium-term budgetary framework binding, encompassing and transparent, and strengthen the role of independent bodies monitoring fiscal policy by end 2013.	- Constitutional provision on general government budget balance/surplus rule in structural terms - New Fiscal Rule Act - Amended Public Finance Act - Amended Accounting Act	n/a	24/05/2013: The Constitution was amended and now provides a basis for establishing a general government budget balance/surplus rule in structural terms. The Fiscal Rule Act, implementing the constitutional provision, was due to be adopted by the end of 2013 but this deadline has been missed. The authorities have indicated that a draft bill has been prepared and the political debate commenced in January. The proposed amendment to the Public Finance Act is now not expected until mid- 2014.
Take measures to gradually reduce the contingent liabilities of the state.		n/a	21/06/2013: the government adopted a list of 15 companies earmarked for accelerated privatisation. Two companies have been sold to date; Helios, was sold on October 16 2013 and Fotona on 30 January 2014.

Main components of CSR	Measures announced in NRP	Ddl NRP	Progress
Strengthen the long-term sustainability of the pension system beyond 2020 by further adjusting all relevant parameters, including through linking the statutory retirement age to gains in life expectancy, while preserving the adequacy of pensions.	Discussion paper on the pension and disability insurance system after 2020	n/a	The government has established a reflection working group with members from academia and ministries on a further pension reform to preserve sustainability of the system beyond 2020. An analysis of the pension amendments introduced in 2013 is currently being prepared which will feed into the group's assessment of possible further required reforms which will be set out in a white paper.
Contain age-related expenditure on long-term care and improve access to services by refocusing care provision from institutional to home care, sharpening targeting of benefits, and reinforcing prevention to reduce disability/ dependency.	Act regulating the activity of long-term care and insurance for long-term care	n/a	The blue print for the long-term care reform was adopted by the government at the end of 2013 and the relevant legislation is expected to be adopted at the end of 2014.
II. Measures to repair bank and non-financial sector balance sheets			

Main components of CSR	Measures announced in NRP	Ddl NRP	Progress
Take the necessary steps, with input from European partners, to contract an independent external adviser in June 2013 to conduct a system-wide bank asset quality review.	Not in NRP, but in Minister Čufer's letter (23 May 2013)	n/a	Four independent firms were hired to conduct the AQR and ST.
Complete this exercise in 2013, with faster progress in the cases of the two banks already subject to the state aid procedure, to accelerate their balance sheet repair.	Not in NRP, but in Minister Čufer's letter (23 May 2013)	n/a	The authorities published the results of the exercise on a system wide basis on 12 December 2013.
Stand ready to provide additional capital should the asset transfer or asset quality review reveal additional shortfalls.	Not in NRP, but in Minister Čufer's letter (23 May 2013)	n/a	Based on the results of the exercise the State injected a total amount of EUR 3.214 billion into the banking system (EUR 2.429 billion via cash) on 18 December 2013
Develop by March 2014 and implement a comprehensive sector strategy to ensure arms-length management of reformed banks and to substantially improve governance, risk management and profitability in the sector, including through consolidation where appropriate.	None	n/a	BoS has already performed some analysis of the consolidation needed in the banking sector to achieve long-term sustainability and profitability. Orderly wind-down of two banks (Factor Banka and Probanka) is ongoing. Takeovers/mergers are to be expected. The restructuring plans set out several corporate governance actions to be implemented.
Swiftly proceed with preparations for the announced privatisation of NKBM and establish, by September 2013, an ambitious timetable for the divestment of direct and indirect state shareholdings of banks.	None	n/a	The September deadline has been missed; the intention is for the NKBM privatisation to be completed by August 2014.

Main components of CSR	Measures announced in NRP	Ddl NRP	Progress
Review the bank regulatory framework by end 2013	None	n/a	Amendments to the Banking Act adopted in 2013 allow for bail in of subordinated debtors in bank reorganisation processes.
(Based on this review) strengthen supervisory capacity, transparency and statistical disclosure.	None	n/a	The BoS has issued letters to all the banks drawing their attention to the key findings of the AQR and has instructed them and their auditors to take the findings into consideration when they are preparing their year-end financial statements. Furthermore, banks submitted plans to the BoS in January 2014 outlining the remedial actions planned in order to address the key issues identified. In parallel, the Slovenian Institute of Auditors (SIR) has sent the banks additional guidelines for the valuation of financial assets and real estate assets and for the treatment of restructured loans. The BoS intends to carry out stress tests on all the banks in 2014 and NLB, NKBM and SID banka will be subject to the Single Supervisory Mechanism (SSM) comprehensive exercise in the autumn of 2014.
III. Other measures supporting competitiveness and adjustment			
Ensure that wage developments, including the minimum wage, support competitiveness and job creation	Change in the minimum wage setting in consultation with social partners to support competitiveness and make it fairer.	n/a	Social partners will set up a working group to assess the applicable laws and possible amendments, thus negotiations with the social partners are expected to continue.
Monitor closely the effects of the recent labour market reform and if necessary identify the areas where further action is needed to foster job creation and tackle	Indicator based monitoring of the impact of the labour market reform in terms of increased flexibility and reduced segmentation.	n/a	A working group has been created and tasked with reporting on the implementation and impact of the March 2013 reform by March 2014. No preliminary evidence has been reported yet.

Main components of CSR	Measures announced in NRP	Ddl NRP	Progress
segmentation, including through the regulation for student work.	A survey among employers and employees whose contractual relations were discontinued. Monitoring of sectoral collective agreements. Overhaul of student work regulation.		Introduction of social security contributions for student work and new measures in the education sector to limit access to student status by March/April 2014.
Take further measures to increase employment of young tertiary graduates, older persons and the low-skilled by focusing resources on tailor-made active labour market policy measures while improving their effectiveness. Address the skills mismatch by improving the attractiveness of the relevant vocational education and training programmes and by further developing cooperation with the relevant stakeholders in assessing labour market needs.	Amendments to the Vocational Education Act, General High School Act, new Slovenian Qualifications Framework Act.	n/a	Some new tailor-made ALMP measures were prepared and implemented; however, it is not clear how their effectiveness is being monitored. Further measures are expected to focus on the young and long-term unemployed.
Accelerate the reform of regulated services, including a significant reduction of entry barriers.	De-regulation of regulated services/activities over 2013-2015	n/a	There has been no progress in recent months and no clear strategy has been set up yet. No results have been reported yet as to the deregulation of craft.
Improve the business environment, including through ensuring the independence of and providing sufficient and autonomous financing to the Competition Protection Agency.	Additional staff	n/a	The CPA's budget is subject to extensive oversight which is impacting on their ability to deal with the backlog of cases. Overall, it still appears it will take some more time before the agency's independence is fully in place.

Main components of CSR	**Measures announced in NRP**	**Ddl NRP**	**Progress**
Build on previous efforts to further reduce the length of judicial proceedings at first instance in litigious civil and commercial cases and the number of pending cases, in particular enforcement cases.	Organisational changes in the judiciary in the area of civil and commercial disputes: extending the Triaža project for commercial disputes with partial rollout to at least three additional district courts planned in 2013 before complete nationwide rollout in 2014. Increase in the number of resolved enforcement cases by 5% in 2013 and a further 5% in 2014 through a combination of organisational measures and amendments to the enforcement legislation (planned for 2014).	n/a	Recent amendments to the law are delivering positive results, as the disposition time and the case clearance rate have been further improved. However, no significant progress has been reported yet with respect to enforcement cases. The authorities are going to take further initiatives regarding the judicial functioning (such as further specialization of the Courts, expansion of the Triaža project) based on the results gradually achieved and the conclusions to be drawn.
As part of the planned strategy of the government, to be completed by September 2013, classify core and non-core state assets according to economic criteria, with a view to divesting non-core assets.	Announcement of the strategy and the classification of assets	2013 Q3	The government published a new SSH Act for public consultation in September. According to the draft law the Ministry of Finance should submit to the government a strategy which will identify objectives of individual assets and classify them in three groups (strategic, relevant and portfolio assets) within three months after the law enters into force. The authorities expect the law to adopted in the first quarter 2014
Make the Slovenia Sovereign Holding (SSH) fully operational in a timely manner, and transfer both ownership and management of all stakes to the SSH, potentially excluding those that are on the list for immediate full privatisation.	Announcement of amending the SSH Act, in line with the 13 March coalition agreement. The amendments would repeal the provisions on centralisation of ownership.	June 2013	According to the new draft law, the SSH will be set up immediately once the law enters into force. Management of all assets directly and indirectly owned by the state will be centralised, while ownership will remain partly decentralised. Although assets directly owned by the Republic of Slovenia will formally remain under state ownership, all voting rights and managerial functions will be transferred to the SSH. 21/06/2013: the government adopted a list of 15 companies earmarked for accelerated privatisation.

Main components of CSR	Measures announced in NRP	Ddl NRP	Progress
Ensure professional management of the SSH from the outset, potentially including international expertise, and a clearly defined arms' length relationship with the companies involved.	No measures announced	n/a	The appointment of management and supervisory board members has been brought closer to international best practices. The law strengthens arms' length relationship of the SSH with the State Owned Entities (SOEs) by introducing an integrity plan, the role of the compliance officer and legal obligation of the SSH board to disclose any illegal action. In addition, any guidelines from the SSH to companies in which the SSH has a capital investment should be in line with the Management Code.
For core stakes, develop sector-specific strategies to improve profitability and corporate governance.	The NPR refers only to the overall strategy	n/a	The strategy with possible additional sector-specific strategies for core stakes will be adopted within three months after the SSH law enters into force.
Introduce an obligatory and publicly available register of management and supervisory board appointments in state-owned enterprises with requirements for disclosure of interests.	No measures announced	n/a	The new draft law introduces public disclosure of both the register of board appointments in state-owned enterprises and conflicts of interest.
Ensure that the regulatory framework facilitates divestment of non-core state assets and that administrative hurdles are minimised.	No measures announced	n/a	The agreement with trade unions in the energy sector may pose a barrier to divestment of assets in this sector.
Identify and start to work on removing all existing legal and administrative impediments to sustainable restructuring of over-indebted/undercapitalised but viable companies through market-based solutions. In this context, take measures to ensure sufficient private burden sharing, to increase private investment, including foreign direct investment, and	No measures announced	n/a	

Main components of CSR	Measures announced in NRP	Ddl NRP	Progress
to achieve efficiency gains in troubled companies as part of the restructuring process.			Various amendments to the insolvency code (Financial Operations, Insolvency Proceedings and Compulsory Dissolution Act) were instituted in June 2013. A new Systemic Debt Deleveraging Act and further amendments to the insolvency code were adopted in December 2013.
Adopt the necessary legal framework for out-of-court restructuring by September 2013, ensuring that it is coherent with the existing provisions on insolvency and provides incentives for both creditors and shareholders to reach out-of-court restructuring agreements.	A new Systemic Debt Deleveraging Act to facilitate out-of-court restructuring was announced to be prepared by the MoF by May 2013.	September 2013	
Improve the enforcement of corporate insolvency procedures and in-court settlements, including swiftly resolving pending court cases related to bankruptcy procedures, in order to maximise recovery value and to facilitate the timely and efficient resolution of non-performing loans.	Measures to strengthen role of creditors in insolvency procedures; New fast track compulsory settlement procedures for micro companies; falling price ("Dutch") auctions; Regulation of mediation for settlement of disputes arising from insolvency; refined definition of insolvency	Adoption in the Parliament by June 2013.	