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INTRODUCTION

The euro area economy suffered a mild recession in 2012, as economic activity declined by 0.5%, while GDP was down 2.2% in Slovenia. That decline was the result of an accelerated contraction in domestic consumption, in particular on investment and inventories. The sharp fall in investment was due to government austerity measures, difficult access to financing and a high level of uncertainty in the economy. Total domestic consumption was down by nearly 6% in Slovenia and by just over 2% in the euro area. A more significant drop in GDP was prevented by the positive contribution of net exports, driven primarily by a sharp decrease in imports. The large current account surplus in the amount of 2.3% of GDP was largely a result of the narrowing of the merchandise trade deficit.

Average annual inflation in the euro area fell to 2.5% in 2012, mainly due to falling energy prices. In the second quarter, commodity prices were down on international markets amid renewed uncertainty regarding the resolution of the fiscal crisis in periphery euro area countries, particularly in Greece and Spain. Average prices of primary commodities were down 9.7% in 2012, food prices recording the smallest decline of 1.6%. A sharp rise in prices in July due to the severe drought in the US and Canada, and a heat wave in Europe contributed to persistently high food prices. Average annual inflation in Slovenia was above the euro area average, primarily due to more pronounced fiscal consolidation measures, which pushed inflation in Slovenia above the euro average.

The downturn in economic activity resulted in lower corporate and household demand for loans. The stock of loans to non-banking sectors was down 6.6% at the end of the year. The following factors contributed to diminished demand for loans: weak domestic and foreign consumption, the situation in the construction sector, the high level of corporate debt, payment indiscipline, the situation on the real estate and capital markets, and the tightening of the banks' loan collateral standards. The deepening of the crisis in Europe and Slovenia also resulted in an increase in funding costs, which the banks pass through into higher loan costs. Due to developments in the domestic banking sector, corporates sought financing in the rest of the world last year, primarily in the form of trade credits and loans.

The main factors affecting the balance of payments capital and financial account in 2012 were continuing debt repayments to the rest of the world and the replacement of these sources with funds via long-term ECB operations. The banks compensated for the loss of international sources of funding primarily by borrowing via the Eurosystem's 3-year long-term refinancing operations (LTROs), which was reflected in an increase in the proportion of funding accounted for by such liabilities. At the end of 2012, the proportion of funding accounted for by the aforementioned loans stood at 8.7%, or EUR 4 billion. At 51.7% of the banks' total assets, deposits by non-banking sectors still represent the most important source of funding.

A number of central banks adopted additional measures in 2012 to stimulate lending and economic activity. This had an indirect impact on exchange rates. The euro/US dollar exchange rate averaged 1.29 in 2012, compared with 1.39 the previous year. The euro was up against the US dollar in the first quarter due to improved confidence on the financial markets, to which the ECB's 3-year LTRO in February contributed significantly. The ECB cut its key interest rate by 0.25 percentage points in July to 0.75%, and in August announced new measures to improve the functioning of the monetary policy transmission mechanism.

The challenges now facing economic policymakers include stimulating the economy, strengthening the capital position of the real sector and banking sector, and improving the cost and innovative competitiveness of the Slovenian economy by creating a stimulating economic environment.

Ljubljana, April 2013

Marko Kranjec
Governor of the Bank of Slovenia

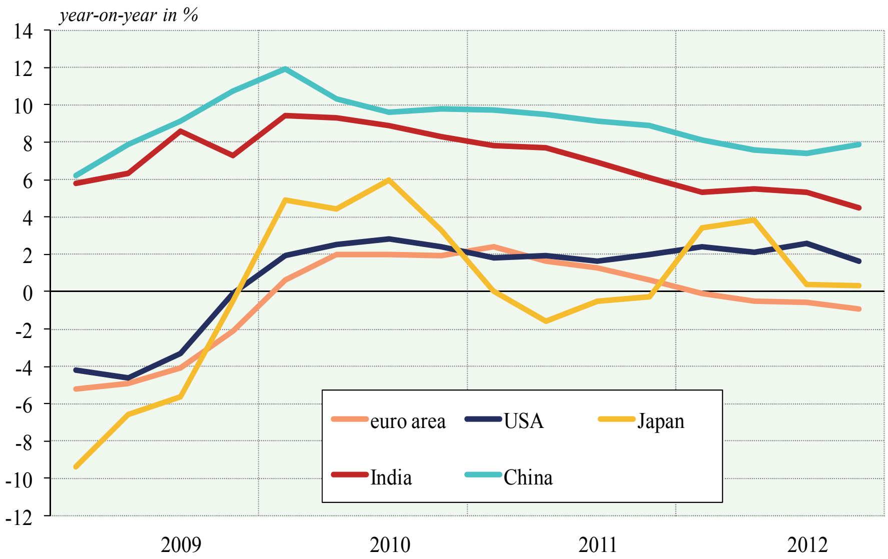
1 The economic environment and the banking system in 2012[1]

Economic environment

According to the preliminary estimates of the International Monetary Fund (IMF), global economic growth was 3.2% in 2012. Growth was once again fastest in emerging economies. Growth in global trade was just 2.8%, down more than 3 percentage points on 2011. There was also a significant difference in growth between the US and the euro area. The euro area economy was faced with a mild recession in 2012, as economic activity declined by 0.5%. Conditions deteriorated primarily during the second half of the year, when economic sentiment indicators and confidence on the financial markets deteriorated further. Economic growth stood at 2.2% in the US in the absence of fiscal consolidation measures and better conditions on the labour market. In the US, economic conditions also deteriorated slightly towards the end of the year due to concerns regarding the fiscal cliff. Growth also slowed in emerging countries. According to the IMF's preliminary estimates, in 2012 economic growth was 7.8% in China, 4.5% in India, 3.6% in Russia and just 1% in Brazil.

In 2012, the global economy was characterised by the continuing debt crisis in euro area periphery countries and the enhanced functioning of central banks.

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



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

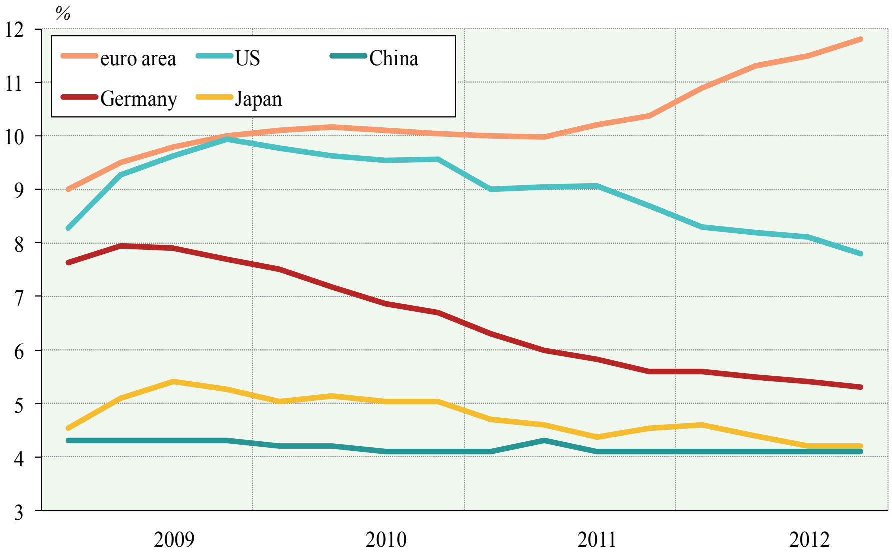
The situation on the labour market in the most advanced economies deteriorated slightly. The unemployment rate in the euro area was close to 12% at the end of the year. Alongside consolidation measures in periphery countries, high unemployment and a lack of consumer confidence contributed to the decline in household consumption. The situation on the labour market improved slightly in the US. The unemployment rate fell throughout the year to stand at 7.8% at the end of the year. This, in the context of higher household confidence, contributed to growth in consumption in 2012. US consumer confidence fell slightly at the end of the year due to uncertainty surrounding the resolution of public finance problems.

Unemployment remained high in the majority of the most developed economies.

Average annual inflation in the euro area was down 0.2 percentage points in 2012 to stand at 2.5%, primarily as a result of a diminishing contribution from energy

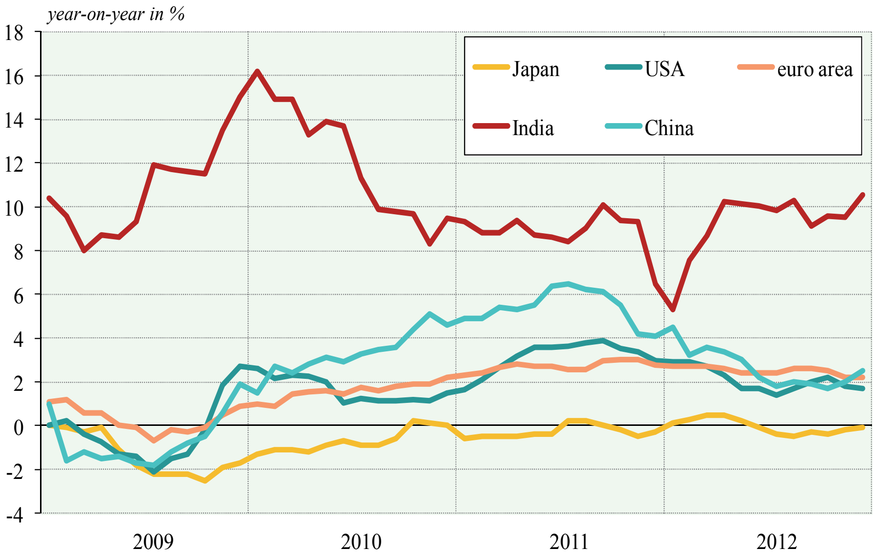
[1] A detailed illustration of macroeconomic trends and projections is given in the April 2013 publication Macroeconomic Developments and Projections (http://www.bsi.si/en/publications.asp?MapaId=70). A detailed analysis of the banking system is given in the May 2013 Financial Stability Review (http://www.bsi.si/en/publications.asp?MapaId=70).

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



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

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



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

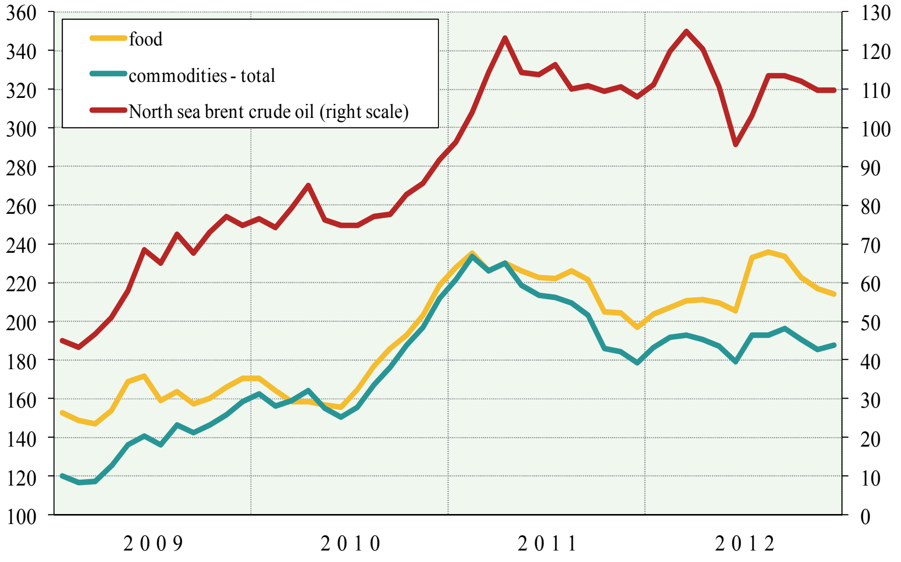
Core inflation indicators reflect weak household consumption in the euro area.

prices. Core inflation remained below 2%. This indicates weak domestic inflationary pressures and is in line with the unfavourable conditions on the labour market. Inflation in the US was down more sharply in 2012, by 1.1 percentage points to stand at 2.1%, as a result of the lower contribution made by energy prices. Growth in US dollar oil prices was significantly lower than the growth in euro oil prices, as the euro depreciated by 7.6% against the US dollar in 2012. Also contributing to the higher inflation in the euro area were rises in duties in the scope of consolidation measures that the US did not implement. Prices in Japan were unchanged in 2012, while prices in China and India were up 2.6% and 9.3% respectively.

Commodity prices were lower than the previous year in 2012, with the exception of oil prices.

Prices of oil and other commodities fluctuated sharply again in 2012. More favourable economic data in the first quarter and the dispute between the international community and Iran led to an increase in the prices of oil and other commodities. Prices fell in the second quarter amid renewed concerns regarding the resolution of

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



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

the fiscal crisis in periphery euro area countries, particularly in Greece and Spain. Confidence on the financial markets rose again slightly in the third quarter, while the price of oil was up in the context of the additional tightening of conditions in the Middle East, although quarter-on-quarter growth was weak. There was no significant change in commodity prices in the final quarter of 2012. The price of a barrel of Brent crude averaged USD 112 for the year, an increase of just 1% relative to 2011. Average prices of primary commodities were down 9.7% in 2012, food prices recording the smallest decline of 1.6%. A sharp rise in prices in July due to the severe drought in the US and Canada, and a heat wave in Europe contributed to persistently high food prices.

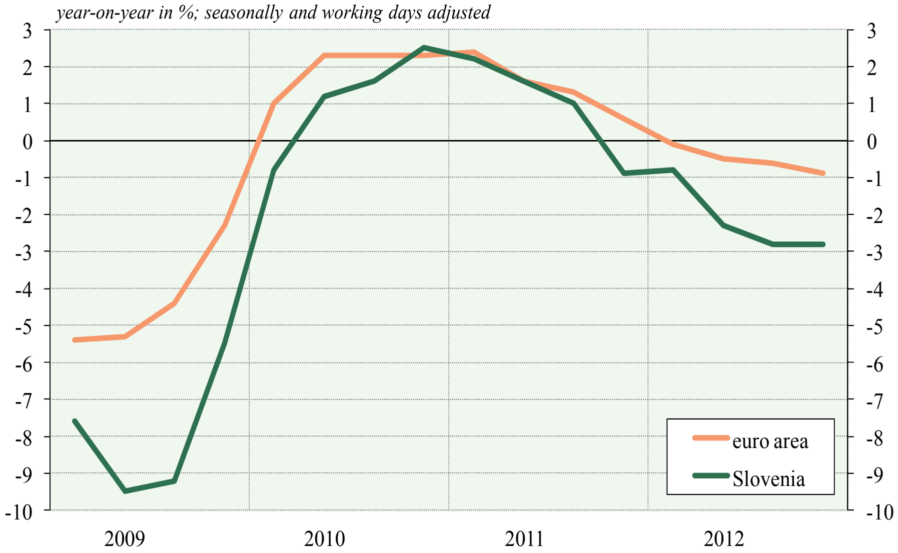
Central banks adopted a number of additional non-standard measures in 2012 to stimulate the economy.

A number of central banks adopted additional measures in 2012 to stimulate the economy, which also affected foreign exchange rates. The euro/US dollar exchange rate averaged 1.29 in 2012, compared with 1.39 the previous year. The exchange rate was highly unstable in 2012. The euro was up against the US dollar in the first quarter due to improved confidence on the financial markets, to which the ECB's 3

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

Sources: ECB, Federal Reserve.

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



Source: Eurostat.

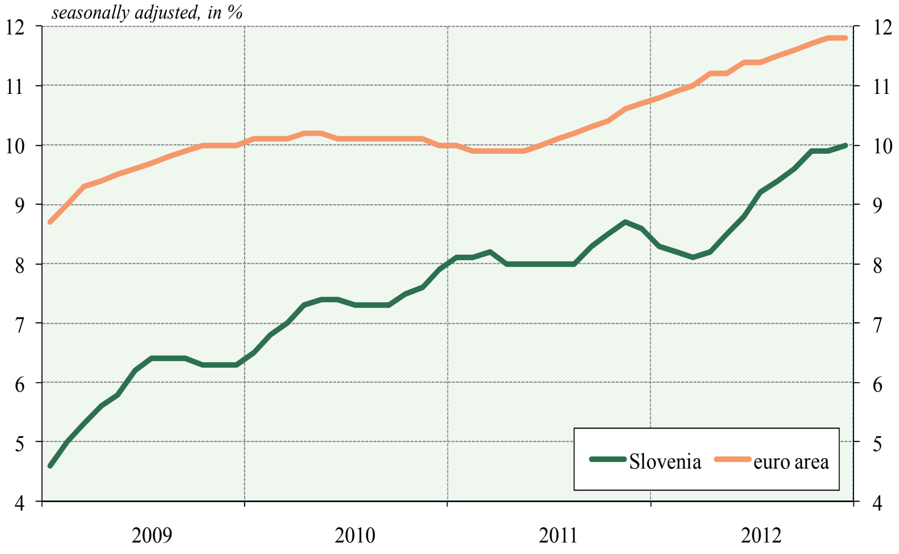
-year LTRO in February contributed significantly. The euro was down sharply from March to July, as uncertainty surrounding the development of the fiscal crisis in periphery countries rose sharply again. Concerns were particularly pronounced with regard to the request from Spain for international financial aid. The situation eased again from August on, as central banks announced new measures to stimulate the economy. The ECB thus cut its key interest rate by 0.25 percentage points in July to 0.75%, and in August announced new measures in the form of outright monetary transactions (OMTs). In September, the US Federal Reserve (the Fed) announced the additional easing of monetary policy and the maintaining of a low key interest rate until the middle of 2015. In December, the Fed announced another round of quantitative easing and the tying of its key interest rate to the unemployment rate. It is, however, expected to continue ensuring stable and low inflation. Additional measures to stimulate the economy were also adopted by other central banks, including the Bank of Japan and the Bank of England, and a number of central banks in emerging countries.

The deteriorating economic situation in Slovenia was primarily a result of the deepening of the domestic demand crisis due to cost adjustments in the private and government sectors.

According to figures adjusted for the season and the number of working days, Slovenian GDP was down 2.2% in 2012. The fall was 1.7 percentage points higher than the euro area average, thereby increasing the economic lag even further. The more significant fall was driven by a more rapid decline in domestic consumption, in particular investment spending. Taking into account inventories, the decline in investment was the second largest since the outbreak of the crisis. The sharp fall in investment was due to government austerity measures, difficult access to financing and a high level of uncertainty in the economy. Cost adjustments in the government and private sectors, which were particularly pronounced in the second half of the year, further impacted consumer purchasing power. This was seen in an accelerated decline in final consumption. Total domestic consumption was down by nearly 6% in Slovenia and by 3.7 percentage points less in the euro area. A more significant drop in GDP in 2012 was prevented by the high contribution of net exports, which was primarily the result of a sharp decrease in imports.

The crisis spread to all categories of economic activities in 2012. All categories of service activities in the private sector, where total value-added was down nearly 2%, were hit harder than in 2011 due to increasingly weak domestic consumption. The contraction in construction activity accelerated due to the continued sharp decline in investment in the aforementioned sector. There were no signs of an easing of the situation by the end of the year, as the quarterly decline in value-added in this sector rose to almost 5%. More pronounced consolidation measures resulted in a decrease in value-added in public services for the first time since the outbreak of

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



Source: Eurostat.

the crisis. Due to the deteriorating situation in the euro area, the contribution made to GDP growth by manufacturing, which was the basis for the weak economic recovery in 2010 and 2011, turned negative.

The deteriorating economic situation accelerated the decline in employment. The workforce in employment was down 3% in year-on-year terms at the end of 2012, bringing employment close to the level recorded in 2005. Employment was down sharply in the private sector, and also in public services in the final quarter of last year due to government austerity measures. The number of employees was down primarily in public administration, while growth in the number of employees in the health sector slowed and had come to a halt in the education sector by the end of the year. In addition to a direct impact on the public sector, austerity measures and uncertainty regarding future consolidation measures and regarding the situation in the rest of the world resulted in a sharp drop in the number of job vacancies. This led to a decrease in the number of new hires in the private sector.

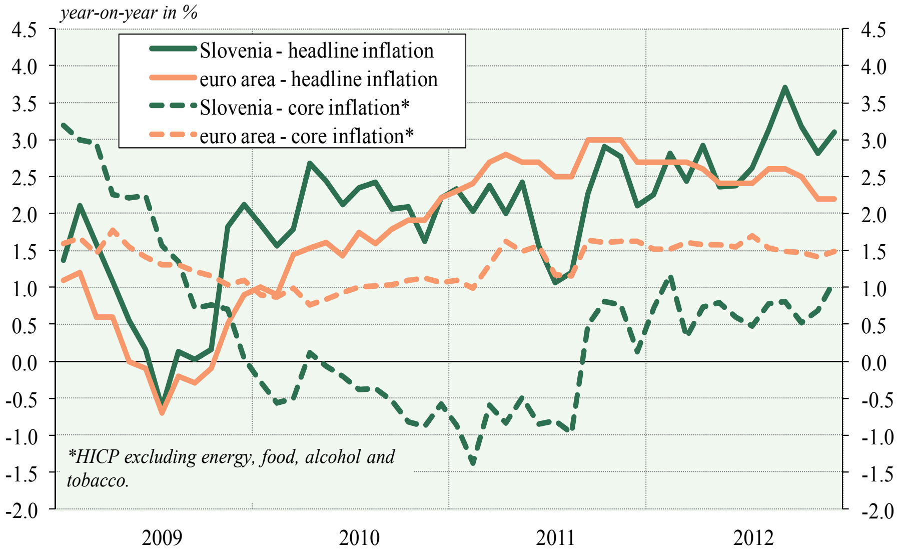
The surveyed unemployment rate remains lower than in the euro area.

By the end of 2012, the number of registered unemployed rose to nearly 120,000, bringing the unemployment rate to 13%, the highest since May 1999. The surveyed unemployment rate was also high at the end of the year, at 9.6%, but was still considerably below the euro area average. The proportion of long-term unemployed persons exceeds 50%, while the proportion of unemployed young persons and those with higher education qualifications is also rising. This indicates the widening of the imbalance between job vacancies and the structure of unemployed persons. In the context of adverse economic situation, the fall in public sector wages also had a signalling effect on private sector wages: growth came to a halt in the second half of the year and wages had already begun to decline towards the end of the year.

Inflation reached 2.8% in Slovenia in 2012, and was 0.3 percentage points higher than in the euro area, primarily as a result of more substantial consolidation measures.

As measured by the harmonised index of consumer prices, average inflation in Slovenia was up 0.7 percentage points in 2012 relative to 2011 to stand at 2.8%. The reason lies primarily in higher growth in services prices as a result of measures related to fiscal consolidation, and base effects. Nevertheless, the structure of inflation was mostly unchanged, as energy and food prices once again contributed most to overall inflation last year. The high contribution by these two categories was mostly the result of changes in commodity and oil prices on global markets, the depreciation of the euro and a rise in excise duties. Average annual inflation in Slovenia was somewhat above the euro area average of 2.5%.

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



Source: Eurostat.

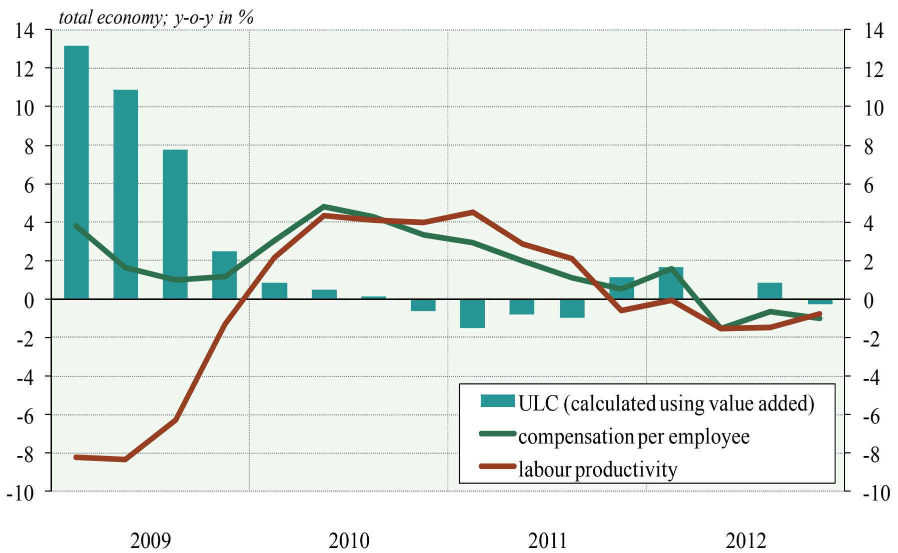
Core inflation in Slovenia remains below the euro area average due to the deteriorating economic situation.

Core inflation indicators remained low, in line with weak domestic demand and cost adjustments in the economy. As measured by the HICP excluding energy, food, alcohol and tobacco, core inflation was up 1.1 percentage points in 2012 to stand at 0.7%. The two other indicators of core inflation (excluding energy and excluding energy and unprocessed food) were up 0.8 percentage points in 2012. The rise was primarily due to growth in services prices, which were affected by fiscal consolidation measures. At the same time, the year-on-year decline in the prices of non-energy industrial goods slowed somewhat. Despite a rise on average in 2012, core inflation indicators remained below the euro area average, as economic conditions were worse in Slovenia.

In the context of low growth in ULC, the cost competitiveness of the Slovenian economy kept improving in 2012.

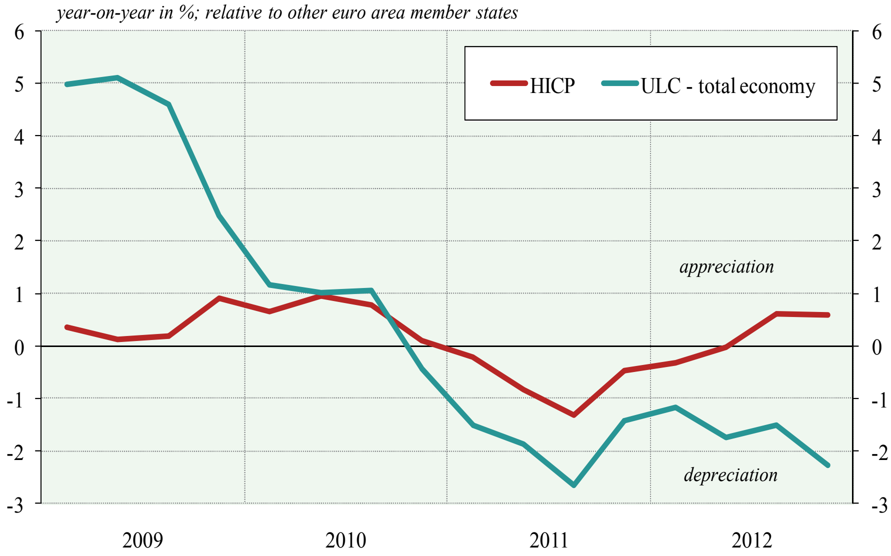
Nominal unit labour costs (ULC) were up by just 0.5% in 2012, as employment and wages adjusted faster to declining economic activity than during the first wave of the crisis at the end of 2008. The decline in employment was pronounced in the second half of the year following the adoption of more deep-rooted austerity measures and the deterioration of the situation in the international environment. The year-on-year drop in labour productivity, which reached 1.5% in the middle of

Figure 9: **Labour productivity, unit labour costs and compensation per employee in the Slovenian economy**



Sources: Eurostat, Bank of Slovenia calculations.

Figure 10: **Harmonised competitiveness indicator, deflated by HICP and ULC**



Source: ECB.

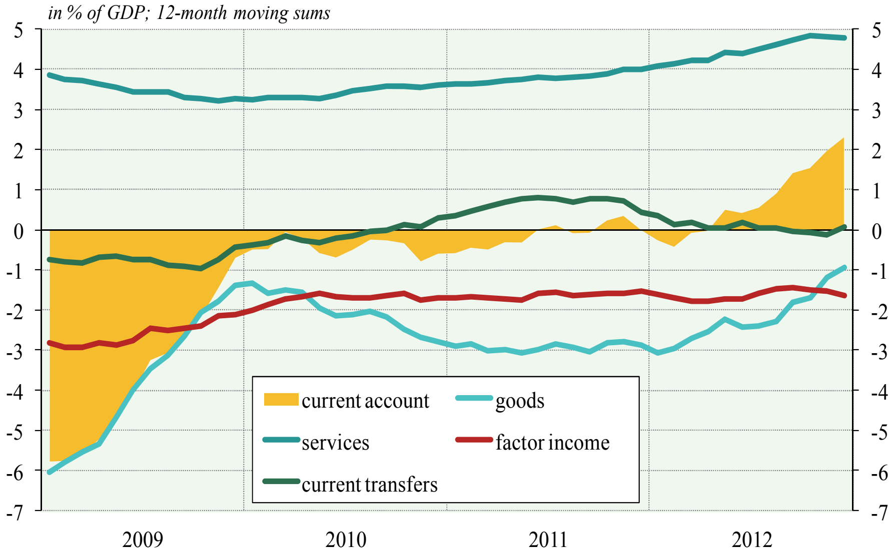
2012, was therefore less severe in the final quarter. Labour productivity was thus down 1% in 2012. The average nominal gross wage stagnated due to the decrease in wages in the public services and a significant slowdown in wage growth in the vast majority of private sector activities. The average nominal gross wage in public services fell by more than 2%, and was up by just 1% in the private sector. The real average gross wage, deflated by the HICP, was down nearly 3% in 2012.

Cost competitiveness improved relative to other euro area countries on average in 2012, while price competitiveness deteriorated. Growth in ULC in the economy as a whole was 1 percentage point lower than in the euro area. The gap by which Slovenia's cost competitiveness trails the euro area, which arose prior to the crisis due to the inflation cycle, private sector wage growth and wage reform in the public sector, continued to narrow. Manufacturing, where ULC has fluctuated at around the euro area level for some time, continues to stand out in terms of achieving cost competitiveness. Price competitiveness began to deteriorate in the second half of the year, primarily due to more pronounced fiscal consolidation measures, which pushed inflation in Slovenia above the euro average.

The sharp increase in the current account surplus was driven by a drop in domestic consumption.

A high current account surplus was achieved in 2012. The surplus amounted to EUR 818 million or 2.3% of GDP, largely due to the rapid narrowing of the merchandise trade deficit. The decline in domestic consumption picked up pace in the second quarter. This, together with declining growth in foreign demand and exports, accelerated the drop in imports. Merchandise exports were up by less than 1% in nominal terms in 2012, while imports were down by 2.3%. The merchandise trade deficit narrowed from 2.9% of GDP in 2011 to 0.9% of GDP. Despite weaker foreign demand, exports of services were up by more than 5% in nominal terms, while imports of services were down 0.1%. The surplus of trade in services thus widened from 4.0% of GDP to 4.7% of GDP, mainly as a result of an increased surplus in travel services. The deficit in factor income widened slightly to reach EUR 578 million or 1.7% of GDP. There was a sharp increase in the number of residents working abroad in 2012 due to the adverse situation on the domestic labour market. The surplus in labour income thus widened to EUR 338 million. The deficit in capital income widened by a similar amount, to 2.5% of GDP. The widening deficit in net direct investment, primarily due to the divestment activities of Slovenian corporates in the rest of the world, contributed more than two thirds to the deficit in factor income. The remainder of the deficit was the result of net interest payments on foreign loans and income from investments in securities. The surplus in current transfers narrowed from EUR 153 million in 2011 to EUR 29 million, primarily due to the higher deficit in the private transfers.

Figure 11: **Components of the current account**



Source: Bank of Slovenia.

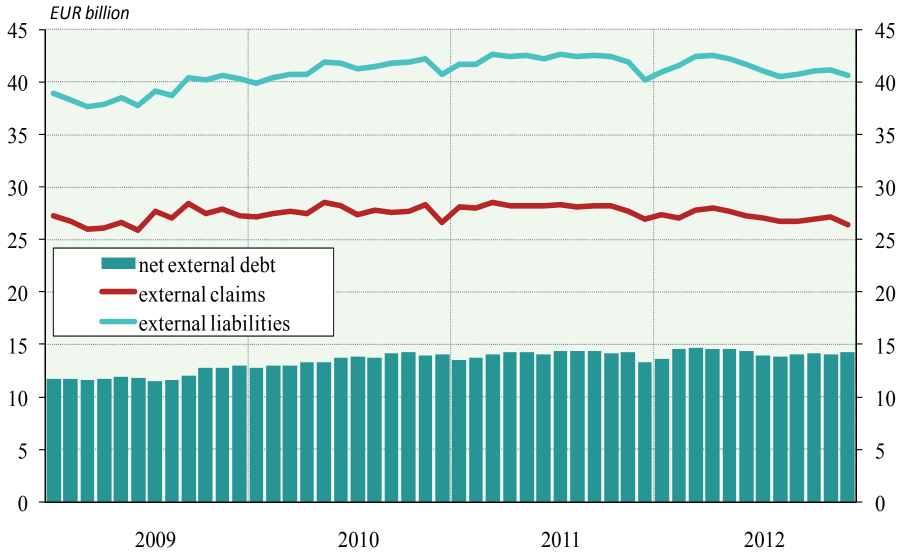
The main factors affecting the balance of payments capital and financial account in 2012 were the banks' continuing debt repayments to the rest of the world and the replacement of these sources with funds via the ECB's long-term operations. The private sector recorded a net outflow of funds to the rest of the world in the amount of EUR 3.5 billion, up one half on 2011. Private sector[2] investments in the rest of the world were up by EUR 865 million last year, primarily as a result of higher claims from currency and deposits, and capital transfers. The private sector reduced its investments in foreign securities again last year. Standing out in that regard are the banks, which reduced their investments in short- and long-term debt securities by almost EUR 600 million. The banks reduced their stock of loans to non-residents again last year, by EUR 200 million. The private sector's liabilities to the rest of the world declined by more than EUR 2.6 billion last year, primarily as a result of continuing debt repayments to the rest of the world and a decline in non-residents' portfolio investments in domestic securities. The banks reduced their liabilities from foreign (mostly long-term) loans again in 2012, by EUR 1.3 billion. The aforementioned sources were replaced in part by funds from the ECB's LTROs. The stock of non-residents' investments in private sector securities declined by EUR 1.25 billion in 2012. The main factor in this was the repayment of maturing bonds by the domestic banks. Due to developments in the domestic banking sector, corporates actively sought financing in the rest of the world last year in the form of trade credits and loans. The latter was particularly noteworthy at corporates linked to companies in the rest of the world (direct investment).

The significant increase in net external debt was due to additional borrowing by the government and by participation at the ECB's LTROs.

Net external debt rose by EUR 954 million in 2012 to stand at EUR 14.3 billion at the end of the year. The increase in net external debt was the result of an increase in the gross external debt and a decline in gross external claims. The gross external debt was up by EUR 390 million last year to stand at EUR 40.6 billion at the end of 2012. Gross external claims amounted to EUR 26.4 billion at the end of 2012, down EUR 564 million on the end of 2011. The main contributions to the increase in net external debt came from the government sector and the Bank of Slovenia, in the combined amount of more than EUR 3.2 billion, and in part from the private sector (excluding banks). The government issued USD 2.25 billion of government bonds last year, thereby increasing the government sector's net external debt by almost EUR 1.5 billion. Similar to last year, the banks reduced their net external debt by EUR 2.7 billion, primarily as a result of the previously mentioned reduction in debt to the rest of the world.

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

Figure 12: **Slovenia's external debt**

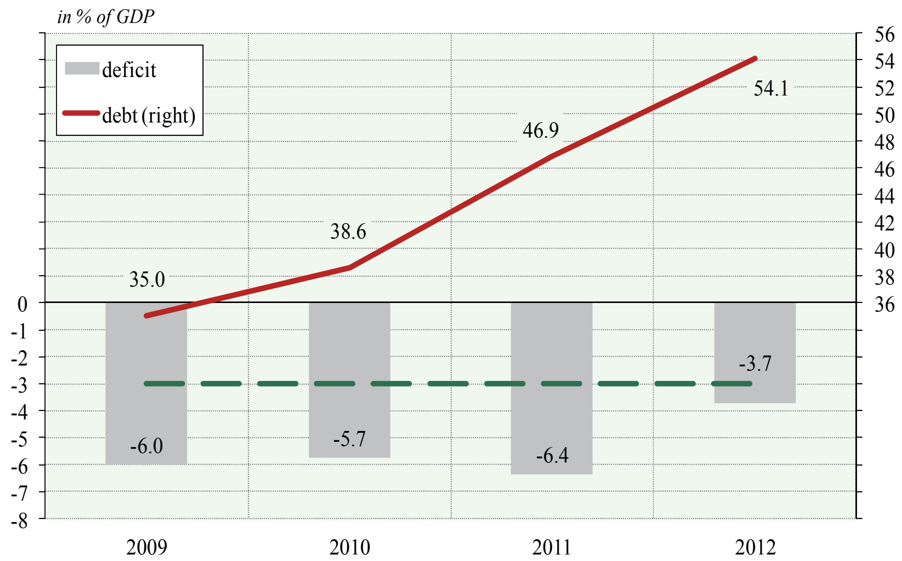


Source: Bank of Slovenia.

The general government deficit narrowed considerably in 2012; measures were primarily aimed at reducing expenditure.

According to ESA 95 methodology, the general government deficit narrowed by 2.7 GDP percentage points in 2012 to 3.7% of GDP. Contributing to the narrowing of the deficit were measures set out in the Fiscal Balance Act and the continued reduction in expenditure under discretionary government control, while transactions of a one-off nature were down in comparison to the previous year. General government revenues were down 0.4% in the context of the adverse economic conditions. Inflows from corporate income tax recorded the sharpest decline due to the lowering of the tax rate and an increase in tax relief amounts. Adverse developments on the labour market were seen in a year-on-year decline in revenues from social security contributions, while revenues from personal income tax were up slightly. Indirect tax payments were up 1.3% on the previous year, despite the fall in private consumption, as a result of the increase in excise duties on all types of products subject to such duties. General government expenditure was down in 2012 for the first time since the crisis period started, by 5.7%. All major categories of expenditure, with the exception of interest payments, were down. Government expenditure on investment was down for the fourth consecutive year. In contrast to previous years, social transfers were also down, as were compensation of employ-

Figure 13: **General government deficit and debt according to ESA95 methodology**



Source: SORS.

ees and intermediate consumption. The largest year-on-year decline was recorded by capital transfers, which were particularly high in 2011 due to transactions of a one-off nature (three major transactions of a one-off nature amounted to 1.1% of GDP), while only the recapitalisation of NLB d.d. in the amount of 0.2% of GDP was disclosed in 2012. In contrast, expenditure on interest increased again to reach 2.1% of GDP. Although the general government deficit narrowed significantly in 2012, it was 0.2 GDP percentage points higher than expected in the April 2012 update to the Stability Programme. According to the European Commission's estimates from February 2013, the structural deficit amounted to 3.1% of GDP, down 1.4 GDP percentage points on the previous year.

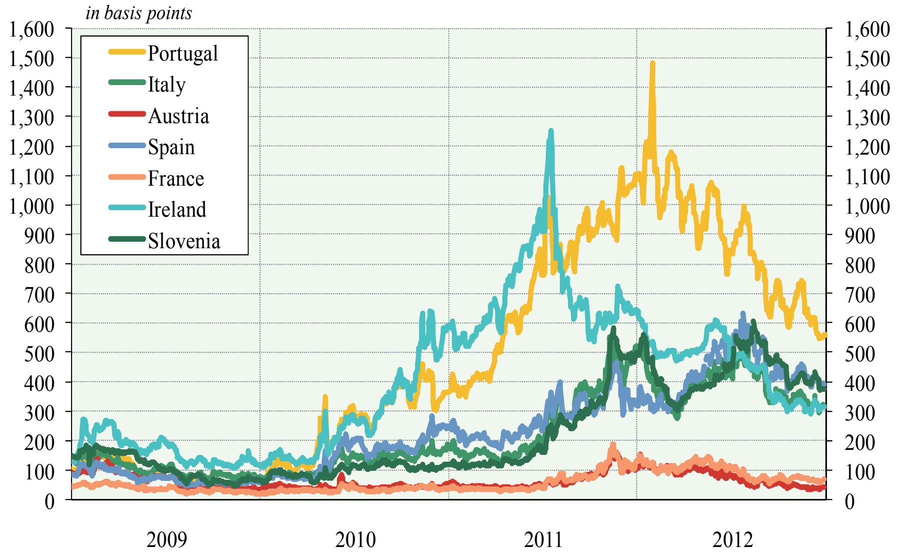
The general government debt is rising, but remains below the euro area average. The stock of Slovenian government guarantees was down.

At the end of 2012, the general government debt stood at EUR 19,189 million or 54.1% of GDP. The rise in the ratio of debt to GDP was driven by the financing of the deficit and in part due to advance borrowing for the repayment of debt principal maturing in 2013, and owing to participation in aid to euro area countries in financial distress. Borrowing was mostly undertaken in October via the issue of ten-year bonds on the US market in the amount of USD 2.25 billion, and via the issue of treasury bills and the raising of long-term loans. Slovenian government guarantees were down by nearly EUR 0.5 billion in 2012, to stand at EUR 6.5 billion or 18.3% of GDP at the end of the year. Of the aforementioned amount, EUR 2.8 billion relates to guarantees issued to DARS d.d. The decline in the stock of guarantees from the previous year was primarily a result of maturing bank bonds issued with government guarantees. In October 2012, Slovenia paid up capital in the amount of EUR 137 million to the newly established European Stability Mechanism, which will eventually replace the European Financial Stability Facility (EFSF). The aim of both mechanisms is to ensure the financial stability of the euro area. Slovenia participates in the ESM via paid-up capital and in the EFSF via guarantees issued for EFSF financial instruments. Slovenia government guarantees tied to the EFSF amounted to EUR 1.2 billion at the end of the year, and were intended as financial aid to Greece, Ireland and Portugal.

The spreads on Slovenian government bonds over German ten-year bonds were high.

The spreads on Slovenian long-term government bonds over the benchmark German bonds fell until the middle of March, as they did in other euro area periphery countries, primarily due to non-standard measures adopted by the ECB and the successful rescheduling of Greek debt. The spreads on Slovenian government bonds and the bonds of certain other periphery countries gradually increased after

Figure 14: **Spreads of 10-year government bonds over benchmark German bonds**



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

March, for the most part due to the deepening of the debt crisis in Italy and Spain. In the middle of the summer, when the spreads reached their peak of around 600 basis points and the required yield was close to 7.4%, the downgrading of Slovenia's long-term sovereign debt also had an impact on the high value of Slovenian spreads. Ratings agencies downgraded Slovenia twice during the year, during the first two months of the year and in August. The spreads on Slovenian long-term government bonds gradually fell from the middle of August on, primarily due to the announcement of a new non-standard measure by the ECB and the establishment of the ESM. From October on, when a Slovenian long-term bond was issued on the US market, the spreads reached a relatively stable level of close to 400 basis points, while required yields fluctuated at around 5.5%.

Pension reform was adopted, but additional measures are still necessary.

In December 2012 the National Assembly unanimously passed pension reform, which took effect on 1 January 2013. The conditions for retirement will gradually tighten, while the medium- and long-term sustainability of public finances will improve. The main solutions laid out in pension reform lead to an increase in the actual retirement age. The retirement age for both genders will increase to 65, while the right to an old-age pension may also be exercised at a lower age if a longer retirement period is achieved: retirement is possible at the age of 60 if a 40-year pension period without a buyout is achieved. The bonus-malus system encourages workers to stay active for a longer period. Under the new law, the most favourable consecutive 24 years of insurance are taken into account in the calculation of the pension base. Pensions are adjusted once a year, in February, whereby 60% of the growth in the average gross wage and 40% of the average growth in consumer prices, both in the previous year, are taken into account. The adjustment to pensions may not be less than one half of the growth in consumer prices. The implementation of structural reforms and the continuation of fiscal consolidation remain a priority for Slovenia in the future, in terms of requirements to further reduce the general government deficit, and in terms of accessibility to and the prices of financing on foreign markets and achieving long-term sustainable public finances. Nevertheless, measures must be planned to minimise the impact on already weak domestic demand.

Banking system[3]

There were no significant changes in the ownership structure of the banking system in 2012.

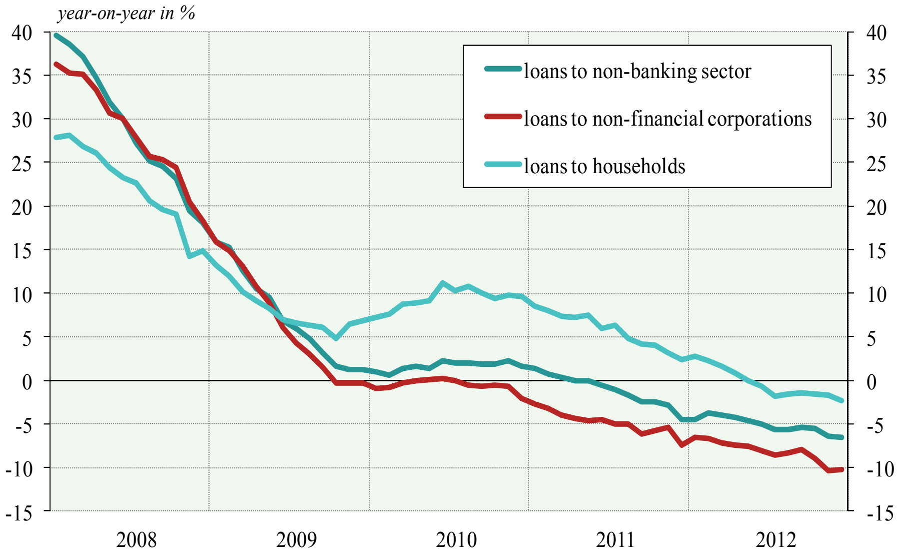
At the end of the year the Slovenian banking system comprised 17 banks (including seven subsidiary banks), three branches of foreign banks and three savings banks. The number of banks was down by two. One smaller bank under majority domestic ownership merged with another bank, while one bank under majority foreign ownership ceased to operate in Slovenia. The banks accounted for 98.8% of the total assets of the Slovenian banking system. In terms of ownership structure, the banking system comprises ten banks under majority domestic ownership and seven banks under majority foreign ownership. The proportion of the banks' equity held by non-residents increased by 3 percentage points in 2012 to 41%.

The banking system's total assets declined by EUR 3.1 billion in 2012 to EUR 46.1 billion.

The banking system's total assets amounted to EUR 46.1 billion at the end of 2012, having declined by EUR 3.1 billion or 6.3% during the year. The main factor in the decline in total assets was the banks' continuing repayment of debt on the wholesale markets. The banks made debt repayments to foreign banks and through the repayment of bonds in the amount of EUR 3.5 billion, compared with EUR 2.9 billion in 2011. Deposits by non-banking sectors, as the most important source of funding, were down by EUR 724 million last year, compared to an increase of EUR 703 million in 2011. Despite recapitalisations at seven banks in the total amount of EUR 576 million, the banking system's equity was down by EUR 212 million in 2012 due to losses generated during the year. The banks compensated for the decline in liabilities from issued securities and liabilities to the rest of the world in part in the form of loans and deposits by means of long-term funding obtained via the Eurosystem's 3-year LTROs.

3 Unaudited data available on 13 March 2013 were used in this section.

Figure 15: **Lending to non-banking sectors**



Source: Bank of Slovenia.

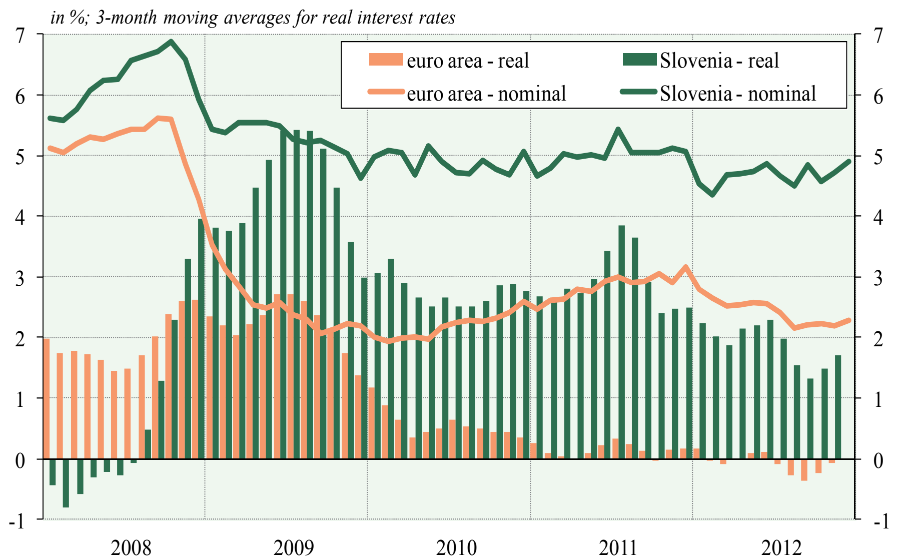
Among investments, which were down by EUR 3.3 billion relative to 2011, the banks primarily reduced loans to non-banking sectors, while investments in securities and claims against banks were down to a lesser degree. The largest decline was recorded by corporate loans. Loans to households were down for the first time last year owing to a decline in consumer loans.

Loans to non-banking sectors recorded the sharpest decline last year decline among the banks' investments.

Loans to non-banking sectors were down at both the domestic banks and the banks under majority foreign ownership in 2012. The stock of loans to non-banking sectors declined by EUR 2.2 billion or 6.6% relative to 2011, the large domestic banks recording the largest decline of 9.5%.

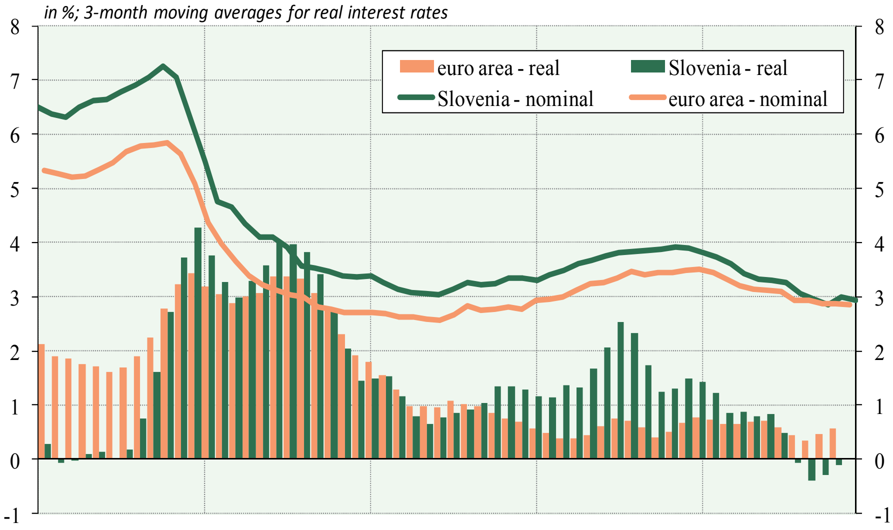
Loans were down last year as a result of lower demand and due to less affordable loans. The downturn in economic activity resulted in lower corporate and household demand for loans. At the same time, limited access to funding on the international financial markets forced banks to reduce their lending. The need to rationalise the use of their capital also forced the banks to restructure investments, as their capital adequacy is lower on average than the capital adequacy of EU banks.

Figure 16: **Interest rates on loans of more than EUR 1 million for non-financial corporations**



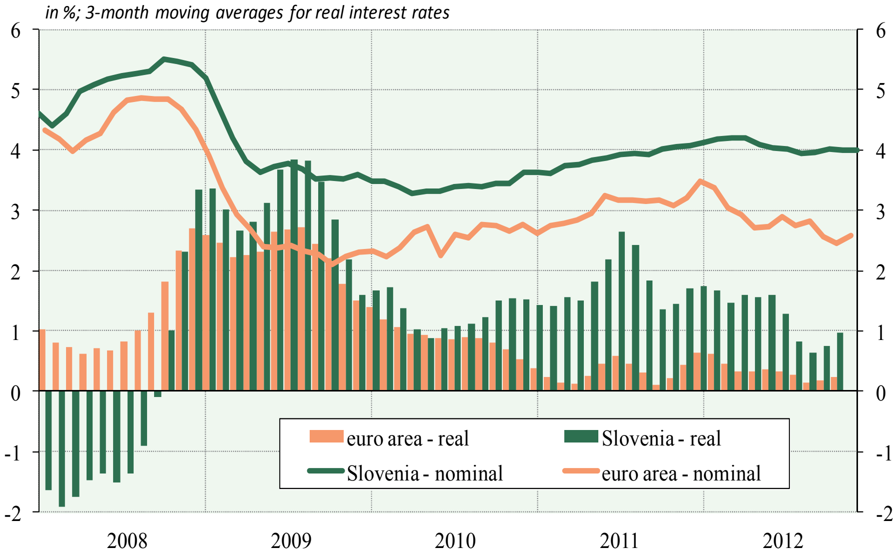
Sources: ECB, Bank of Slovenia.

Figure 17: **Interest rates on housing loans to households**



Source: ECB, Bank of Slovenia.

Figure 18: **Interest rates on household deposits of 1 to 2 years**



Source: ECB, Bank of Slovenia.

The following factors contributed to diminished demand for loans: weak domestic and foreign demand, the situation in the construction sector, the high level of corporate debt, payment indiscipline, the situation on the real estate and capital markets, and the tightening of the banks' loan collateral standards. The deepening of the crisis in Europe and Slovenia also resulted in an increase in funding costs, which was seen in higher interest rates on loans.

The adverse macroeconomic situation affected the labour market. The creditworthiness of households and thus their credit demand deteriorated due to unemployment and a fall in the real value of wages. Household consumption was affected by measures aimed at ensuring the sustainability of public finances.

High funding costs, the deterioration of the banking system's portfolio and the maturing debts of banks on the wholesale markets resulted in the reduced supply of loans. The proportion of total funding accounted for by wholesale sources has fallen sharply in recent years due to the limited access to foreign sources of funding. This was reflected last year at the banks under majority foreign ownership

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

	Amount (EUR million)				Growth rate (%)				Proportion of gross income (%)			
	2009	2010	2011	2012	2009	2010	2011	2012	2009	2010	2011	2012
Net interest	939.6	1,047.3	1,017.5	886.2	-1.3	11.5	-2.8	-12.9	65.2	70.2	70.3	56.6
Net non-interest income	500.5	443.7	429.3	679.7	18.5	-11.4	-3.3	58.3	34.8	29.8	29.7	43.4
Gross income	1,440.2	1,491.0	1,446.8	1,565.9	4.8	3.5	-3.0	8.2	100.0	100.0	100.0	100.0
Operating costs	777.0	778.7	776.6	742.7	-1.3	0.2	-0.3	-4.4	54.0	52.2	53.4	47.1
Labour costs	422.3	420.5	416.4	399.6	0.9	-0.4	-1.0	-4.0	29.3	28.2	28.8	25.5
Net income	663.2	712.4	670.2	823.2	12.9	7.4	-5.9	22.8	46.0	47.8	46.3	52.6
Net provisioning and inpairments	501.0	811.3	1,206.8	1,592.0	79.7	61.9	48.7	31.9	34.8	54.4	83.4	101.7
Pre-tax profit	162.1	-98.9	-536.5	-768.7	-47.4	-161.0	-442.4	-43.3	11.3	-6.6	-37.1	-49.1
Taxes	-39.1	2.6	94.5	22.1	-33.8	-106.7	3,510.7	-76.6	-2.7	0.2	6.5	1.4
Net profit	123.0	-96.3	-442.0	-746.6	-50.6	-178.3	-359.0	-68.9	8.5	-6.5	-30.5	-47.7

Source: Bank of Slovenia.

Table 2: **Bank performance indicators**

In %	2008	2009	2010	2011	2012
ROA	0.67	0.32	-0.19	-1.06	-1.59
ROE	8.15	3.87	-2.30	-12.54	-18.85
Interest margin on interest-bearing assets	2.21	1.98	2.14	2.13	1.93
Interest margin on total assets	2.08	1.88	2.02	2.02	1.83
Non-interest margin	0.93	1.00	0.86	0.85	1.4
Gross income on average assets	3.01	2.88	2.88	2.87	3.23

Source: Bank of Slovenia.

primarily in a reduction in liabilities to foreign banks, and also at the domestic banks as a reduction in the proportion of funding accounted for by securities. The deterioration in the banks' credit portfolio had a negative impact on the ability of the banks to ensure an appropriate level of capital adequacy, as the impairment of investments reduced the value of the capital.

The banks compensated for the decline in wholesale funding by means of long-term sources obtained from the ECB.

Refinancing risk remains high for Slovenian banks. The intense restructuring of the banks' funding continued in 2012. Banks reduced their dependence on wholesale funding due to the uncertain situation on the international financial markets, and owing to the downgrading of Slovenia and banks, which limited their access to funding on the aforementioned markets. The proportion of total funding accounted for by liabilities to foreign banks and liabilities from securities recorded the sharpest decline in 2012. The banks compensated for the loss of international sources of funding primarily by borrowing via the Eurosystem's 3-year LTROs. The proportion of total funding accounted for by LTROs was thus up by 5.1 percentage points to stand at 8.7% or EUR 4 billion at the end of 2012. At 51.7% of the banks' total liabilities, deposits by non-banking sectors still represent the banks' most important source of funding. The stock of deposits by non-banking sectors was down 2.9% in year-on-year terms in 2012. The stock of deposits was down in all non-banking sectors, mostly notably in the government and corporate sectors.

The banking system generated a loss for the third successive year due to high impairment and provisioning costs.

Slovenian banks were exposed to significant income risk again in 2012. Growth in net interest income was down in 2012 due to a more significant decline in interest income relative to interest expenses. The banking system's net interest income was thus down 12.9% last year. The deteriorating quality of the credit portfolio resulted in high impairment and provisioning costs, which were up 31.9% on 2011. Higher net non-interest income, which was mostly of a one-off nature, had a positive impact on the operating results of the entire system. The banking system recorded a loss after taxation of EUR 747 million, according to unaudited and unconsolidated figures.

Growth in credit risk slowed.

Credit risk continued to rise in 2012, but at a slower pace than in 2011. The further deterioration in the credit portfolio was evidenced by an increase in the proportion of non-performing claims, as measured by claims more than 90 days in arrears, by 3.2 percentage points to 14.4% of classified claims. The majority of non-

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

	31. Dec 2010			31. Dec 2011			31. Dec 2012		
	Classified assets	Impairments	Coverage of claims by impairments (%)	Classified assets	Impairments	Coverage of claims by impairments (%)	Classified assets	Impairments	Coverage of claims by impairments (%)
Total in EUR million	49,766	2,420	4.9	49,466	3,249	6.6	47,876	4,168	8.7
	Structure (%)			Structure (%)			Structure (%)		
A	70.6	5.7	0.4	66.0	3.3	0.3	57.4	2.0	0.3
B	21.4	19.8	4.5	22.7	14.6	4.2	28.1	12.4	3.8
C	4.4	22.4	25.0	5.1	20.9	26.8	5.6	17.2	26.9
D	2.9	35.8	60.0	5.5	50.6	60.4	8.2	60.0	63.6
E	0.8	16.3	100.0	0.7	10.6	100.0	0.7	8.5	99.4

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

performing claims are concentrated in the sector of non-financial corporations, where the proportion of corporates more than 90 days in arrears was up 1.3 percentage points to stand at 16%. The proportion of non-performing claims in this client group rose by 5.5 percentage points to 24%.

Liquidity risk, as measured by the first-bucket liquidity ratio, was moderate and lower relative to 2011. The restructuring of funding and the increase in the banks' net borrowing from the Eurosystem resulted in a decrease in the proportion accounted for by the pool of eligible collateral for Eurosystem transactions. However, that proportion remains at a satisfactory level for the banking system overall. An increased lack of confidence on the European interbank market affected liquidity risk in 2012, while the diminished participation of Slovenian banks on the euro area money market of unsecured loans and on the Slovenian interbank market had a negative impact on liquidity management. Interest rate risk as measured by the difference between the average repricing periods of asset and liability interest rates increased slightly in 2012.

Capital adequacy was at a satisfactory level. Solvency risk is nevertheless rising.

At 11.9% at the end of December 2012, capital adequacy on an unconsolidated basis was up 0.3 percentage points on the end of 2011. The Tier 1 capital ratio was up by 0.6 percentage points to stand at 10.2%. Nevertheless, the values of the two ratios on a consolidated basis are below the euro area average, which increases the lack of confidence of foreign investors.

2 BANK OF SLOVENIA ACTIVITIES

2.1 Tasks in the scope of the ESCB

2.1.1 Institutional framework

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

With the introduction of the euro in Slovenia on 1 January 2007, the Bank of Slovenia became a part of the Eurosystem, which comprises the European Central Bank (ECB) and the national central banks (NCBs) of the euro area countries. Since the introduction of the euro in Slovenia, as a member of the Governing Council of the ECB, the Governor of the Bank of Slovenia has attended meetings of the aforementioned body, which normally take place twice a month. The Governing Council of the ECB comprises the six members of the Executive Board and the governors of the NCBs of the euro area countries. The responsibilities of the Governing Council of the ECB include defining the monetary policy for the Eurosystem. In 2012 the Bank of Slovenia organised a meeting of the Governing Council of the ECB, which was held on 4 October 2012 in Brdo pri Kranju.

The Governor of the Bank of Slovenia is also a member of the General Council of the ECB, its third decision-making body, which meets four times a year. The General Council comprises the President and the Vice-President of the ECB and the governors of the NCBs of all EU Member States.

Bank of Slovenia representatives attended sessions of committees and their working groups in 2012, when meetings were conducted in the wider composition of the European System of Central Banks (ESCB), which comprises the ECB and the NCBs of all EU Member States, and in the narrower composition of the Eurosystem. The committees support the work of ECB decision-making bodies, which can request expert and technical advice from the committees.

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

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

The Bank of Slovenia's key for subscription to the ECB's capital is 0.3288%. The total amount of ECB capital paid up by the NCBs stood at EUR 7,650 million as at 27 December 2012.

2.1.2 Implementation of the Eurosystem's monetary policy

Three-year LTROs raised excess liquidity to record highs and contributed to the temporary improvement of financial markets conditions.

Due to the intensification of the euro area debt crisis in the second half of 2011, which spread to other financial markets as the inability of banks from a number of euro area countries to access funding and due to the geographical segmentation of trading, the Eurosystem had adopted additional non-standard monetary policy measures in December 2011 that also had a significant impact in 2012. Most notable among these were two 3-years LTROs which, in addition to continuing the provision of liquidity with full allotment,[4] expanding the list of assets eligible as collateral for Eurosystem credit operations and the January cut in the minimum reserve ratio from 2% to 1%, provided the banks sufficient liquidity with the aim of

[4] Full allotment means that all counterparties receive as much liquidity as they wish provided that they have sufficient eligible collateral.

maintaining their lending to non-banking sector and ensuring the smooth functioning of the monetary policy transmission mechanism throughout the euro area.

The aforementioned non-standard measures resulted in a significant increase in the excess liquidity of the European money market, which rose to over EUR 800 billion in March 2012 after the second 3-year LTRO, and triggered a fall in the unsecured and secured (repo) interbank money market interest rates. Excess liquidity, which was broadly unchanged during the first half of the year, declined during the second half of the year, primarily due to growth in autonomous items. Despite the decline by almost EUR 200 billion, excess liquidity was still high at EUR 620 billion at the end of the year, and maintained the unsecured and secured interbank money market interest rates low (see Figure 19).

The Governing Council of the ECB cut the key interest rate to 0.75% as of 11 July.

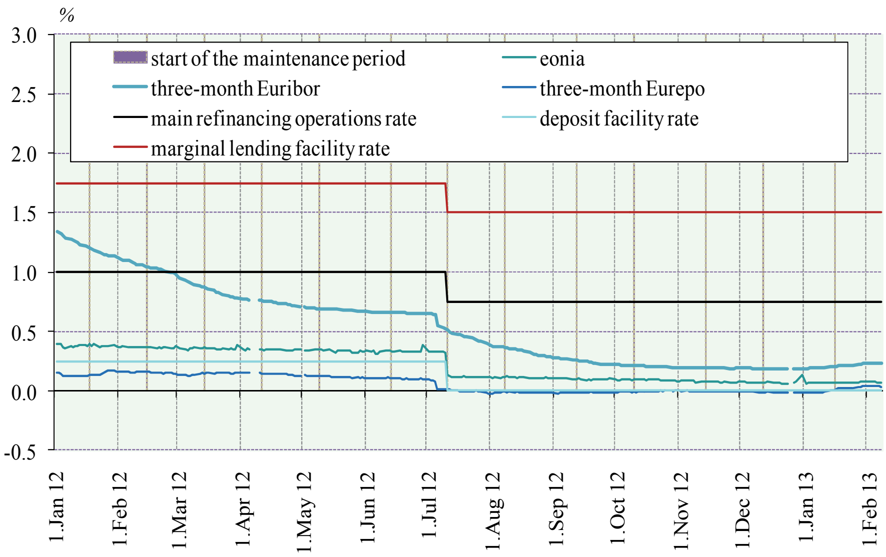
The debt crisis intensified in the middle of the year mainly due to weak macroeconomic indicators, and political and financial instability in the euro area, while the impact of non-standard monetary policy measures from the end of 2011 began to diminish. The inability to access market funding sources (short- and long-term and unsecured and secured), increased the demand for Eurosystem credit operations, which reached record highs in the third quarter. The higher level of credit operations and the downgrading countries' and banks' credit assessments resulted in a decline in assets eligible as collateral for the aforementioned credit operations in certain countries. In order to maintain the banks' access to monetary policy credit operations, the Governing Council of the ECB expanded the list of eligible assets (see the section on collateral below). As of 11 July the ECB's key interest rates were cut by 25 basis points to record lows: the rates on the main refinancing operations and the marginal lending facility were cut to 0.75% and 1.50% respectively, while the rate on the deposit facility was cut to zero.

The zero interest rate on the deposit facility equalised the yields on the deposit facility and excess reserves. Instead of transferring excess liquidity to the deposit facility as they did in the past, the banks began leaving their excess liquidity, to a greater extent, on accounts with central banks in the form of excess reserves. The cut in the ECB's interest rates also resulted in a fall in unsecured and secured interbank money market interest rates. Negative interest rates started to emerge on the secured interbank money market across all maturities after 11 July. Rates remained negative until the end of the year, except on maturities of up to one month.

The announcement of outright monetary transactions with government bonds improved the financial market conditions.

Conditions on the government debt market began to improve with announcement of the new non-standard measure of outright purchases of government bonds on the secondary market, known as *Outright Monetary Transactions* (OMT) in August. At

Figure 19: **ECB and interbank money market interest rates**



Sources: Bloomberg, ECB.

that time the Governing Council of the ECB ended the *Securities Markets Programme* (SMP), introduced in 2010. The assurance by the Governing Council of the ECB that the purchases will prevent a rise in the yields on government bonds above unacceptable levels, reduced the required yield on the bonds of countries with fiscal imbalances. Towards the end of the year, the banks also from the aforementioned countries started issuing covered and uncovered bonds, while the outstanding amount of Eurosystem credit operations fell back to the March level.

The use of monetary policy instruments is described in detail below, and their relative use in 2012 is quantified. These instruments include main refinancing operations, longer-term refinancing operations, fine-tuning operations, outright securities purchases, minimum reserves, standing facilities and US dollars lending. The use of collateral for monetary policy credit operations is also explained.

Open market operations: MROs, LTROs and FTOs

The Eurosystem has executed all liquidity providing open market operations as fixed rate tender procedures with full allotment since October 2008. In the context of full allotment, the counterparties themselves determine the level and maturity of allotted liquidity, which are adjusted to the desired liquidity and available collateral. The unwillingness of banks to lend to each other (one of the reasons for the introduction of full allotment) increased the intermediary role of the Eurosystem through lending to banks that did not obtain liquidity in the market and the absorption of liquidity from banks with excess liquidity. The former was accomplished via main refinancing operations and longer-term refinancing operations, the latter through the deposit facility and, since July, through excess reserves by leaving cash (unremunerated) on accounts with national central banks. Fine-tuning operations mostly played a special role, associated with outright securities purchases.

Main refinancing operations (*MROs*) are regular liquidity providing operations with a typical maturity of 1 week. They are tendered weekly according to a calendar announced in advance. The Eurosystem executed 52 tenders in 2012, all with full allotment at a predetermined fixed interest rate. The average volume of the MROs was EUR 98 billion (compared with EUR 160 billion in 2011). Slovenian banks and savings banks borrowed between EUR 19 million to EUR 131 million on a weekly basis via MROs, the average borrowed amount totalling EUR 58 million.

In normal circumstances *longer-term refinancing operations* (*LTROs*) are tendered on a monthly basis with a maturity of three months to provide banks with addi-

Table 4: **Open market operations in 2012**

Month	1	2	3	4	5	6	7	8	9	10	11	12	Total
Fixed-rate, full allotment liquidity providing tenders at:													
- main refinancing operations	5	4	4	5	4	4	5	4	4	5	4	4	**52**
- longer-term refinancing operations	2	3	2	2	2	2	2	2	2	2	2	2	**25**
special term operations with a maturity of one maintenance period	1	1	1	1	1	1	1	1	1	1	1	1	*12*
operations with a maturity of 3 months with a fixed rate at the average rate of the MROs	1	1	1	1	1	1	1	1	1	1	1	1	*12*
additional operation with a maturity of 3 years		1											*1*
Variable rate tenders at fine-tuning operations:													**53**
liquidity absorbing operations with a maturity of 1 day													*0*
liquidity providing operations with a maturity of 1 day		1											*1*
liquidity absorbing operations with a maturity of 7 days	5	4	4	5	4	4	5	4	4	5	4	4	*52*
US-dollar liquidity providing operations with a maturity of 7 days	4	5	4	4	5	4	4	5	4	5	4	3	**51**
US-dollar liquidity providing operations with a maturity of 84 days	1	2	1	1	1	1	1	1	1	1	1	1	**13**
Covered Bond Purchase Programme 2 (CBPP2)													
Securities Markets Programme (SMP)													
Outright Monetary Transactions (OMT)													

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

tional longer-term refinancing. The Eurosystem continued to execute regular monthly LTROs with a maturity of three months in 2012, with full allotment at a fixed rate, calculated as the average of the MRO bid rates during the period of the operation (so-called indexed rate). In addition, the Eurosystem also executed monthly tenders of LTROs with a maturity equal to the reserve maintenance period, with full allotment at an interest rate equal to the MRO bid rate, for the fourth consecutive year in 2012.

Additional 3-year LTROs in 2012.

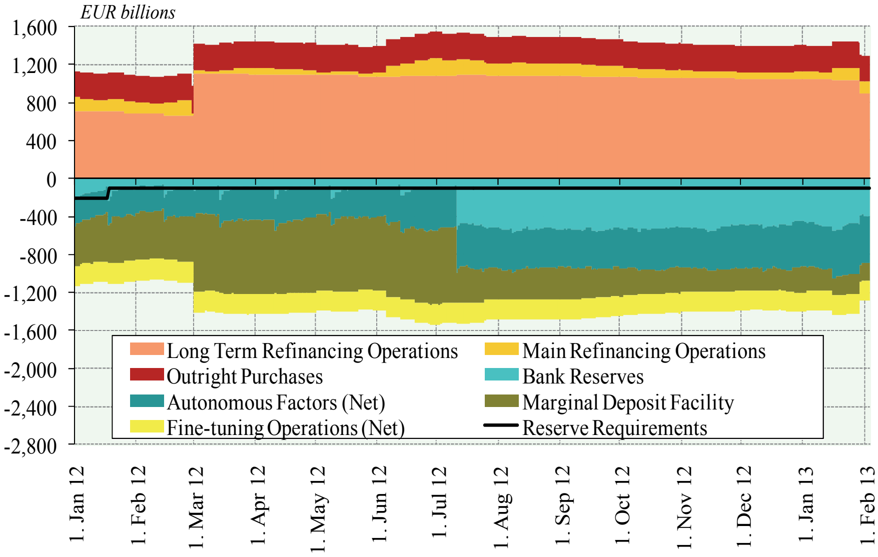
A record number of counterparties participated in both 3-year LTROs, the first in December 2011 and the second in February 2012. The amount of loans drawn was also a record.

A total of 800 counterparties were allotted EUR 530 billion in loans in the second 3 -year LTRO. Counterparties simultaneously reduced their funding in MROs and 3-month LTROs. An extraordinary 6-month LTRO executed in August 2011 matured on the same day. The overall effect was an increase in liquidity of EUR 314 billion on the settlement day of February's 3-year LTRO. The net increase in liquidity as the result of both 3-year LTROs was EUR 524 billion.[5]

The outstanding volume of the LTROs averaged EUR 1,006 billion in 2012, up sharply from EUR 354 billion in 2011 on account of both 3-year LTROs. The ratio between LTROs and MROs also changed significantly in 2012 in favour of LTROs: the proportion of liquidity allotted through LTROs rose from 69% in 2011 to 91% in 2012. A major increase in the outstanding amount of LTROs is also evident at Slovenian banks and savings banks, whose average amount stood at EUR 3,460 million in 2012, up from EUR 514 million in 2011. Slovenian banks financed an average of 6.7% of their total assets in this way in 2012. As a result of the 3-year LTRO in February 2012, the outstanding amount of LTROs as at the final day of 2012 was significantly higher than the outstanding amount as at the final day of 2011. The outstanding amount at the Eurosystem level increased from EUR 704 billion to EUR 1,036 billion at the end of the year, while the outstanding amount at Slovenian banks and savings banks increased from EUR 1,687 million to EUR 3,857 million.

Both 3-year LTROs offer the possibility of early repayment. Counterparties may repay a part or all allotted liquidity after one year. Early repayments are possible at the initiative of counterparties, from the end of January 2013 for the first LTRO and from the end of February 2013 for the second LTRO, each week until the maturity of both 3-year LTROs in the first quarter of 2015. A total of 278 counterpar-

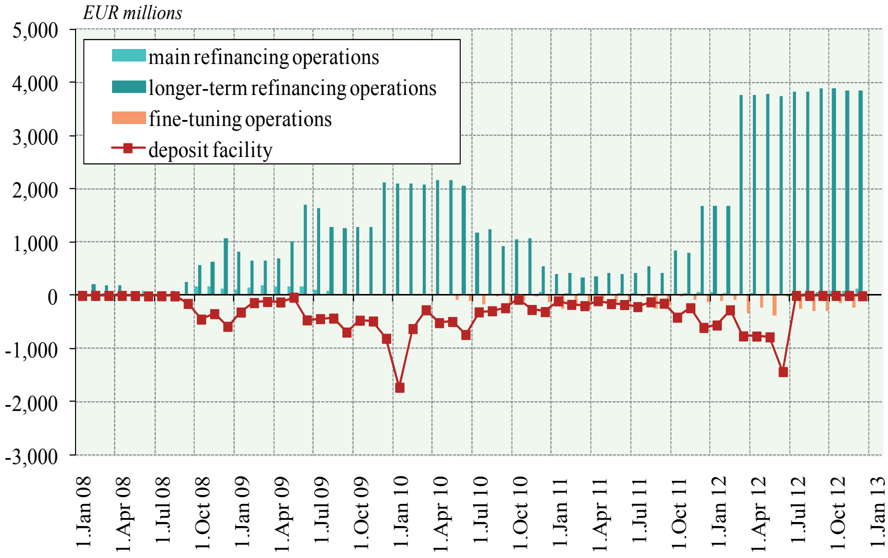
Figure 20: **Supply of (+) and demand for (–) Eurosystem liquidity**



Source: ECB.

[5] For additional information on the first 3-year LTRO, please see the 2011 Annual Report.

Figure 21: **Outstanding amounts of Eurosystem monetary policy instruments, 2008 to 2012: Slovenian banks and savings banks (at month-end)**



Source: Bank of Slovenia.

ties repaid EUR 137 billion during the first possible early repayment period for the first 3-year LTRO, or 28% of the associated operation.

Fine-tuning operations (FTOs) were used in two forms in 2012.

FTOs for the sterilisation of securities purchases and bridging of date mismatches in operations.

First, to offset the increased liquidity resulting from purchases of securities in the SMP, the Eurosystem collected 1-week fixed-term deposits via weekly tenders. Counterparties bid on the interest rate, while the bid (maximum) rate was equal to the ECB's key interest rate. The amount offered was equal to the cumulative amount of securities purchases settled by that time (securities that had not yet matured), and stood at EUR 211 billion at the beginning of the year and EUR 198 billion at the end of the year. Except for the last operation of the year, the banks' bids on fixed-term deposits exceeded the desired amount of liquidity to be absorbed at all tenders. The banks submitted counterbids that were on average 1.9 times higher than the amount offered by the Eurosystem. The marginal interest rate at tenders was merely two basis points higher on average than the deposit facility rate.[6] Slovenian banks and savings banks participated in 50 tenders at which they bid an average of EUR 386 million, while successfully depositing an average of EUR 199 million.

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

Fine-tuning through regular tenders of overnight deposits on the last day of the maintenance period, which the Eurosystem used in the past to counter liquidity imbalances that arose during the maintenance period, was abolished as of January 2012 until further notice, as it did not serve its purpose during the period of excess liquidity, i.e. it did not reduce the volatility of the Eonia on the last day of the maintenance period.

Other open market operations: outright securities purchases

Introduction of OMTs and the abolition of the SMP and CBPP2.

The Eurosystem implemented a second covered bond purchase programme (CBPP2) in 2012, which was introduced in November 2011 and ended on 31 October 2012. The aim of the programme was to ease the funding conditions of banks and corporates, and to encourage the banks to maintain and increase lending to

6 A basis point is one one-hundredth of a percent.

households and corporates. Covered bonds totalling EUR 16 billion of the originally planned EUR 40 billion were purchased during the aforementioned period. The Eurosystem reduced purchases of covered bonds in April, as the demand from other investors for such securities rose on the one hand, while supply fell on the other hand. The latter was primarily the result of both 3-year LTROs, which provided the banks (re)financing at a relatively favourable interest rate. The number of covered bond issues in 2012 was down one half relative to 2011 and 2010. The decrease in issues was most notable in countries with fiscal imbalances and in France.

The SMP was only active in purchases during the first quarter of 2012. Bonds totalling EUR 9 billion were purchased during this time. The Eurosystem did not purchase any more bonds in the scope of the SMP after February due to the improving confidence in the financial markets following the execution of the second 3-year LTRO. Because tensions rose again on sovereign debt market in the summer of 2012, the Eurosystem announced a new instrument in August 2012: OMTs, which replaced the SMP. OMTs are described in Box 1 on page 30.

Standing facilities and minimum reserves

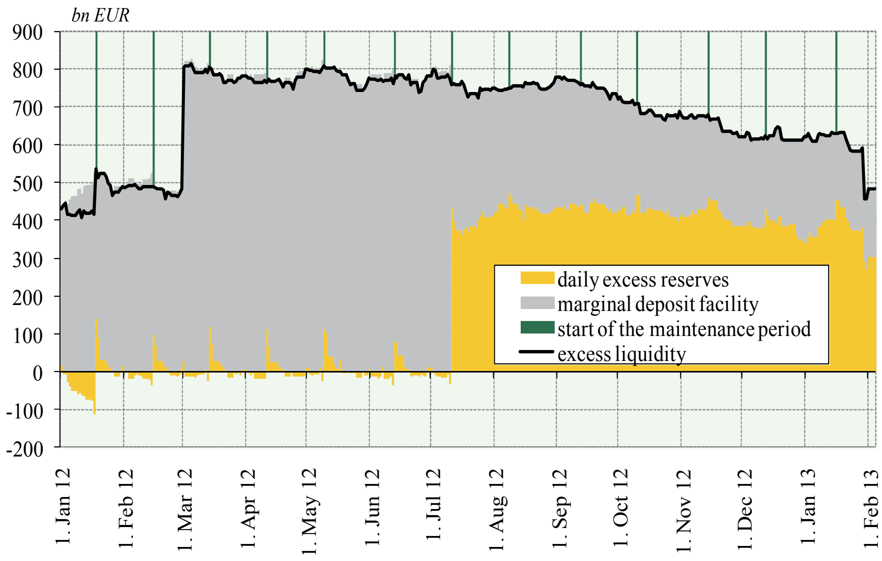
Average daily outstanding amount of the deposit facility at the Eurosystem increased for EUR 392 billion to EUR 494 billion in 2012 relative to 2011. An increase in excess liquidity was the reason for the higher outstanding amount of the deposit facility.

The high level of excess liquidity increased the use of the deposit facility, the ratio between the deposit facility and the balance on accounts with the national central banks changed with the cut of the deposit facility rate to zero.

Until 10 July the banks transferred their excess liquidity to the deposit facility, which was remunerated at 0.25 % up to that date; the deposit facility averaged EUR 682 billion (see Figure 22). As of 11 July, when the interest rate on the deposit facility fell by 25 basis points to zero and the yields on the deposit facility and excess reserves (which are not remunerated) were equalised, the ratio between the deposit facility and excess reserves changed in favour of the latter. From 11 July until the end of the year the banks' use of the deposit facility averaged "merely" EUR 277 billion, while average excess reserves leapt to EUR 412 billion compared to EUR 3 billion in 2011 (see Figure 22). Banks in some countries still use the deposit facility due to the different treatment of excess reserves and the deposit facility by regulatory bodies, and owing to automated processes to transfer excess reserves to the deposit facility.

The use of the deposit facility by Slovenian banks averaged EUR 434 million in 2012, an increase of EUR 273 relative to 2011. The deposit facility averaged EUR

Figure 22: **Excess liquidity in the euro area**



Source: ECB.

Box 1: **Outright monetary transactions (OMTs)**

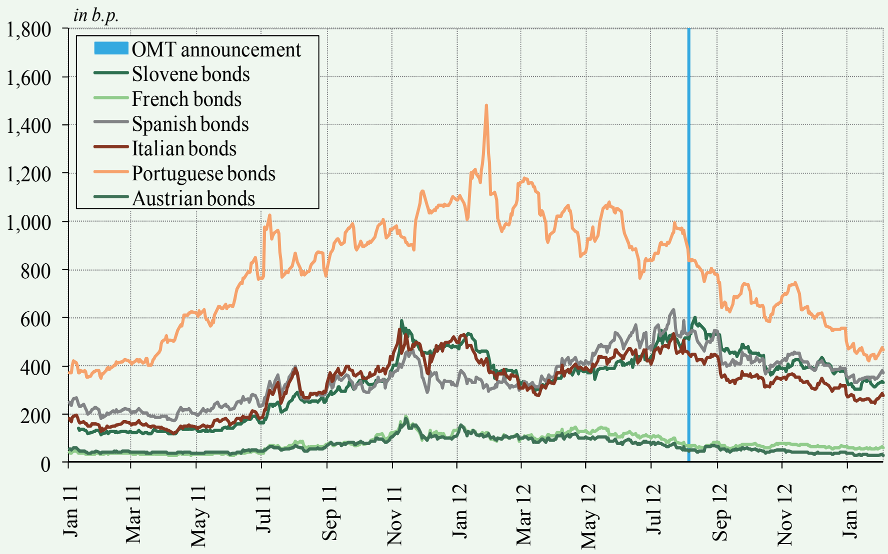
On 2 August 2012, with the aim of ensuring the normal transmission of monetary policy and maintaining the unity of the Eurosystem's monetary policy, the Governing Council of the ECB announced the possibility of using outright monetary transactions in the form of purchases of government securities on the secondary market.[1] The Eurosystem published the technical details of the aforementioned instrument on 6 September 2012. If and when the Governing Council of the ECB decides to start with the purchases, the Eurosystem will buy bonds with a shorter maturity (i.e. with a residual maturity of between one and three years). Purchases will not be limited in advance in terms of amount.

A country must be included in the EFSF/ESM aid programme or make a request for such aid, and must fulfil the conditions set out in the programme as a precondition for purchases in the scope of OMTs.

The Eurosystem will sterilise (i.e. withdraw) the liquidity that arises from such purchases. The total amount of purchases will be published weekly, while purchases by individual issuing country will be published monthly. As the investor in the securities purchased in the scope of OMTs, the Eurosystem assumes the status of creditor, which is equivalent (*pari passu*) to the status of private and other investors in the aforementioned securities.

The announcement of OMTs was one of the most important factors in restoring the confidence of market participants in the debt of countries with fiscal imbalances, and reduced the likelihood ascribed to the break-up of the euro area by market participants. As a result, the required yield and spreads of euro area countries with the fiscal imbalances declined (see Figure 1). The Eurosystem did not buy securities in the scope of OMTs in 2012.

Figure 1: **Spreads of 10-year government bonds for countries with fiscal imbalances over German government bonds**



Source: Bloomberg.

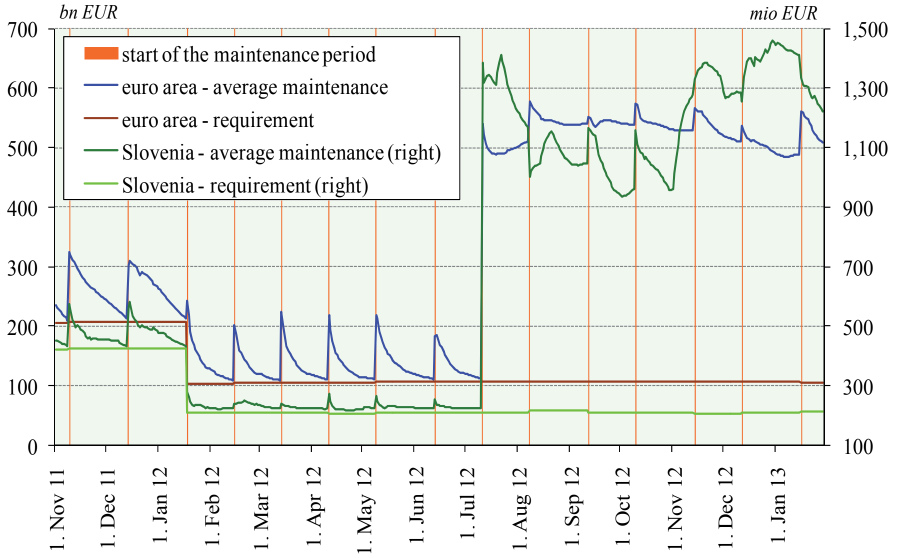
[1] Secondary market means buying and selling between the owners of previously issued securities. On the primary market, the issuer sells securities to the (first) owner.

826 million until 10 July. Except in very rare, occasional exceptions, the banks stopped using the deposit facility on 13 July. The average excess reserves of Slovenian banks therefore shot up from EUR 6 million in 2011 to EUR 468 million in 2012.

The average use of the marginal lending facility was unchanged in the euro area in 2012 relative to 2011, at EUR 2 billion, with a daily high of EUR 16 billion, a decrease of EUR 1 billion relative to 2011. Slovenian banks and savings banks did not draw on the marginal lending facility in 2012, expect in one case.

One of the non-standard monetary policy measures adopted in December 2011 was the cut of the minimum reserve ratio from 2% to 1%, effective from the January maintenance period, which began on 18 January 2012. The lower ratio reduced the average reserve requirement in the euro area in 2012 by EUR 98 billion to EUR

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



Sources: Bank of Slovenia, ECB.

111 billion relative to 2011, and in Slovenia by EUR 204 million to EUR 219 million EUR.

The minimum reserve ratio was cut in half, one of the non-standard monetary policy measures adopted in December 2011.

With the minimum reserve ratio cut in half, higher average excess reserves began to appear throughout the euro area, which in 2011 amounted to between 1% and 2% of reserve requirements. In the first half of 2012, average excess reserves were higher in Slovenia (between 6% and 7%) than in the euro area (between 4% and 5%). With the deposit facility bearing no interest, average excess reserves in the euro area climbed to around 500% of reserve requirements, and exceeded 700% in Slovenia (see Figure 23).

US dollar lending

US dollar lending rose at the beginning of 2012, but later declined.

The Eurosystem continued to lend US dollars to European banks in 2012. The Eurosystem executes US dollar refinancing operations on the basis of eligible collateral denominated in euros, at a pre-determined fixed interest rate with full allotment. There were 51 US dollar refinancing operations with a maturity of seven days in 2012, and 13 US dollar refinancing operations with a maturity of three months. The average balance of both US dollar operations in 2012 was USD 34 billion, which was mainly due to the tightening of the conditions on the markets at the end of 2011. Access by European banks to US dollar funding on the financial markets improved in 2012. Thus, participation in US dollar loans offered by the Eurosystem fell, both in terms of the amount and number of participating counterparties. The outstanding amount of operations of both maturities was USD 9 billion at the end of the year. Slovenian banks and savings banks have not participated in US dollar operations since the end of 2009.

In December 2012 the Eurosystem, together with the Bank of Canada, the Bank of England, the Bank of Japan and the Swiss national bank, extended the swap agreement with the Federal Reserve. The aforementioned agreement, which serves as the basis for US dollar refinancing operations, was extended until 1 February 2014. Loans in US dollars of both maturities will be available until further notice. Liquidity swap lines between central banks in other foreign currencies (e.g. euros, Japanese yen, pound sterling, Swiss francs and Canadian dollars), by which every central bank can offer its counterparties loans in the aforementioned currencies, were also available in 2012, but were not activated.

Collateral for monetary policy operations

Through its decisions regarding eligible collateral for Eurosystem monetary policy credit operations, the Governing Council of the ECB attempted in 2012 to balance the banks' need for a sufficient amount of eligible collateral for Eurosystem monetary policy credit operations with the required sufficient level of protection for the Eurosystem in the event credit operations are not repaid.

Additional eligible collateral in the form of additional credit claims, asset-backed securities and securities in foreign currencies.

Eligible collateral, the effective limit to bank borrowing from the Eurosystem in the fixed rate full allotment procedure, continued to be an important item in managing the banks' liquidity in 2012. Already in 2011 the alloted funds in 3-year LTROs increased the use of collateral for Eurosystem monetary policy credit operations. Together with measures to support bank lending to non-banking sector, the Governing Council of the ECB adopted a decision on 8 December 2011 regarding the possible use of additional credit claims. In 2012 it also expanded the list of eligible debt securities:

- on 1 January with bank bonds quoted on accepted non-regulated markets,
- temporarily on 29 June with some types of additional asset-backed securities with a credit rating of at least BBB-/Baa3,[7] and
- temporarily on 9 November with debt securities denominated in US dollars, pound sterling and Japanese yen (the measure was previously effective from 20 October 2008 to 31 December 2010).

The Eurosystem applies risk control measures to protect against the risk of financial losses. The value of an asset accepted as collateral for Eurosystem credit operations is reduced by a haircut, the amount of which depends on the credit rating, the type of asset (e.g. government, covered or other bonds, and bank loans), the type of interest rate (fixed or variable) and residual maturity of the asset in question. The Eurosystem may also use other measures to protect itself against losses.

Limits on own-used uncovered government -guaranteed bank bonds; occasional ineligibility of Greek government securities.

Moreover, the Governing Council of the ECB decided that banks' should not increase the amount of own-used uncovered government-guaranteed bank bonds more than already stocked as of 3 July 2012. It also adopted a decision regarding the eligibility of government and government-guaranteed assets that do not achieve the credit quality threshold of BBB-/ Baa3. It thus decided that as of 6 September, an asset issued or guaranteed by a sovereign state may remain eligible, notwithstanding the asset's credit rating, if the government securities of that state are eligible for outright monetary transactions (OMT; see description above) or if the government is included in an EU/IMF programme and fulfils the requirements thereof.

Greek government securities temporarily lost eligibility, from 28 February to 8 March, due to the downgrade of Greece to *selective default*, when such securities held by the private sector received the status of *default* in exchange for new securities. Due to the additional collateral provided by euro area governments, the aforementioned securities once again became eligible. They became ineligible again after 25 July, when the additional collateral expired. Greek securities were included again on the list of eligible collateral on 21 December due to the positive assessment of the EU/IMF's aid programme implementation for Greece. The government and government-guaranteed collateral of Cyprus became ineligible on 27 June when the country was downgraded below the credit quality threshold.

Owing to the need for greater transparency of asset-backed securities, in the future only those securities for which detailed information of the cash-flow generating assets that serve to repay the aforementioned securities are periodically publicly disclosed will be deemed eligible. Loan level data are published in electronic form in a data warehouse and are available to the public through various financial data

[7] For asset-backed securities a credit assessment from at least two rating agencies of AAA/Aaa at issuance and A-/A3 over the lifetime are requested.

providers. The requirement to disclose detailed information will be introduced gradually. The requirement for residential-mortgage backed securities and asset backed securities backed by loans to small and medium-sized enterprises came in force on 3 January 2013, later it will apply to commercial-mortgage backed securities and asset-backed securities where the cash flow generating assets comprise auto loans, consumer finance loans, or leasing receivables.

In September the Eurosystem implemented a uniform valuation of eligible securities and thus streamlined the valuation process. A uniform price is daily applied to more than 40,000 eligible securities, either in form of a price the asset achieves on the market or, if that is not available (illiquid securities), as a price derived via a theoretical model.

The value of eligible collateral posted to Eurosystem averaged EUR 2,448 billion in 2012, an increase of EUR 624 billion on the previous year. Non-marketable assets account for the highest proportion of assets (26%, primarily in the form of credit claims), followed by covered bank bonds (19%), asset-backed securities (16%) and government securities (15%).

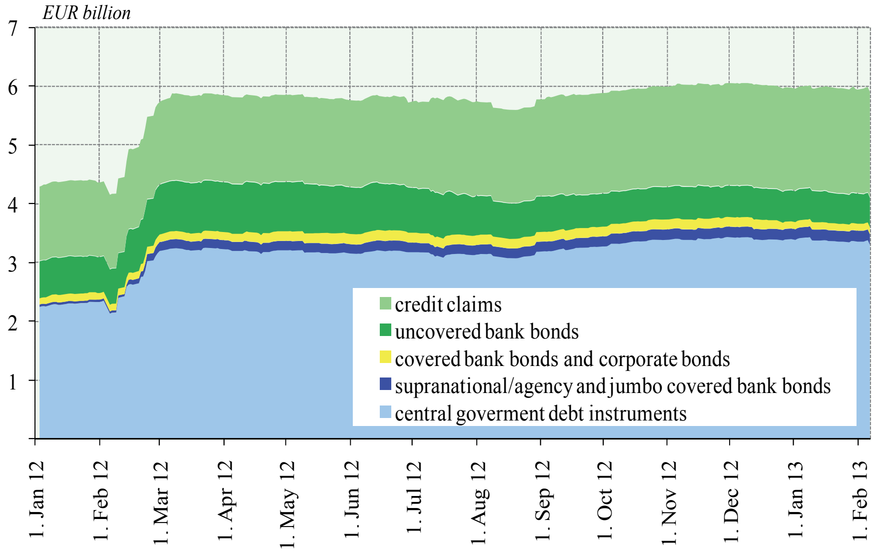
Collateral in Bank of Slovenia credit operations

The pool of collateral at the Bank of Slovenia rose considerably.

The aforementioned measures have not had a significant impact on the level of eligible collateral held by Slovenian banks. Nevertheless, in 2012 they increased – by using the already eligible collateral – assets posted as collateral for Bank of Slovenia's credit operations , via the pool of collateral at the Bank of Slovenia. The reason for increasing the pool of collateral was an increase in borrowing at the Bank of Slovenia via both 3-year LTROs. The banks' pool of collateral increased in 2012 from an average of EUR 3.7 billion to EUR 5.8 billion. The bank's collateral surplus in the pool over the Bank of Slovenia's credit operations (unused pool) was significantly lower than the previous year, but is still considerable, as it averaged 37% for the year (compared with 84% in 2011).

The banks increased the pool of collateral at the Bank of Slovenia primarily via government securities and credit claims (see Figure 24). The proportion of the pool of collateral accounted for by the securities of Slovenian issuers stood at 56% at the end of 2012, while the proportion accounted for by securities of foreign issuers was 15%. Credit claims to domestic debtors accounted for 29% of the collateral pool.

Figure 24: **Pool of collateral at the Bank of Slovenia**



Source: Bank of Slovenia.

Eligible securities traded on the regulated market in Slovenia (i.e. on the Ljubljana Stock Exchange) totalled 32 at the end of the year. These include Slovenian government bonds and treasury bills, two government-guaranteed bonds issued by DARS, three bonds issued by Nova Ljubljanska Banka and one bond issued by Slovenska odškodninska družba. Also included on the Eurosystem's single list of eligible securities were the following bonds of Slovenian issuers traded on foreign markets: two Slovenian government bonds, bonds issued by SID banka, and government-guaranteed bonds issued by Factor banka and Deželna banka Slovenije. A total of EUR 14 billion in assets (which of course were not owned solely by Slovenian banks) were included on the single list.[8]

The internal credit assessment system of the Bank of Slovenia started to operate.

Banks may use debt securities and bank loans that, in addition to other eligibility criteria, meet the credit quality threshold as collateral for Eurosystem credit operations. Because the majority of Slovenian debtors do not have a credit rating from a rating agency, eligible domestic financial assets held by Slovenian banks, in the past and again in 2012, consists primarily of Slovenian government debt, debt guaranteed by the Slovenian government or debt from the remainder of the public sector, whose credit rating derives from Slovenia's sovereign rating. In order to diversify eligible domestic collateral to include debtors from the sector of Slovenian non-financial corporations, the banks may use the internal credit assessment system of the Bank of Slovenia (ICAS BS) since 7 January 2013 to assess eligibility. The system is described in Box 2. The Bank of Slovenia has thus become the sixth national central bank in the euro area with such a rating system.[9]

Box 2: **Internal credit assessment system of the Bank of Slovenia**

The *Eurosystem Credit Assessment Framework* (ECAF) includes rules and procedures for determining whether a financial asset meets the credit quality threshold. The ECAF uses several eligible sources to assess financial assets. The *Internal Credit Assessment Systems* (ICAS) represent one of these sources.

The ICAS BS assesses non-financial corporations established in Slovenia that have submitted correct financial statements for at least the last two years in accordance with the Companies Act. It does not assess new companies or micro enterprises (the ICAS BS defines a micro enterprise on the basis of the following criteria: assets, revenues and number of employees). Assessment is limited to companies to which the Slovenian banking system's (including savings banks) exposure exceeds EUR 500 thousand. This excludes corporates in the construction sector.

The assessment of companies is carried out in two phases:

- The first phase is an assessment of the probability of default for the company in the coming year using a statistical model, which takes into account indicators of profitability, leverage, efficiency, net cash flow, liquidity, long-term solvency and growth. The assessment of probability of default in the first phase also takes into account (a) the classification of the company into categories A to E on the basis of an assessment and evaluation of the debtor's ability to settle its liabilities to the bank at maturity (categories A to E are set out in the Regulation on the assessment of credit risk losses of banks and savings banks; Official Gazette of the Republic of Slovenia, Nos. 28/07, 102/08, 3/09, 29/12 and 12/13), and (b) information regarding blockages of company's transaction accounts.
- The second phase is an assessment of qualitative factors, such as the sector and market position of a company, management, payment discipline and the impact of the group of related parties.

8 The complete single list of eligible securities, which included close to 40,000 securities at the end of 2012, is accessible at http://www.ecb.int/mopo/assets/assets/html/index.en.html.

9 The list of central banks can be found at http://www.ecb.int/mopo/assets/risk/ecaf/html/index.en.html.

2.1.3 Bank of Slovenia as a lender of last resort

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

2.1.4 Payment and settlement systems

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

TARGET2

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

Upgrade of the TARGET2 in November 2012.

The development of the functionality of the TARGET2 payment system continued in 2012 within the framework of Eurosystem activities. On the basis of a new and fully uniform TARGET2 statistical framework, the platform of the system's statistical module, which manages the database with information about payments processed in TARGET2, was upgraded. The aforementioned module provides a number of statistical reports regarding operations in the TARGET2 system to the national central banks included therein, and to the ECB, which conducts the oversight of the system. The upgrade only affected the central banks. Thus, other TARGET2 system participants were not included in the testing of new functionalities. In 2012 the Bank of Slovenia also participated in preparations for the next upgrade of the TARGET2 platform, which will be carried out in November 2013.

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

In December 2012 the Governing Council of the ECB adopted a new *Guideline on TARGET2*, which introduces a new price scheme for the TARGET2 payment system, as well as minor changes regarding access by participants to intraday credit. In line with changes to the aforementioned guideline, the Bank of Slovenia updated the *General conditions for participation in the TARGET2-Slovenija,* which entered into force 1 January 2013.

Updated proposal for upgrades to TARGET2 due to T2S.

Due to the planned establishment of the TARGET2-Securities (T2S) technical platform for securities settlement, the Eurosystem drafted a new proposal for the upgrading of the TARGET2 payment system platform in 2012. The upgrade will include adaptations to ensure the connectivity of TARGET2 and T2S. The proposal encompasses a range of core services that will be available to all TARGET2 participants, and optional services that will be available only to participants who opt to use them. Discussions regarding the proposal are proceeding in Slovenia in the TARGET2 National User Group, which functions under the aegis of the Bank of Slovenia. TARGET2-Slovenija participants were invited to submit (legally non-binding) letters of intent to use the aforementioned services. The Bank of Slovenia informed the ECB accordingly.

Single Euro Payments Area (SEPA)

The basic aim of the establishment of the Single Euro Payments Area (SEPA), as a necessary step to complete the introduction of the euro as the single currency for non-cash payments as well, is to introduce harmonised payment instruments (credit transfers, direct debits and payment cards), and to introduce common standards to enable payments to be made and received using a single payment account and a single set of basic payment instruments, under the same basic conditions, with the same rights and obligations within the entire SEPA region. When the single euro payments area is finally established, the distinction between payments within a country and cross-border payments will be abolished, effective competition will be established between payment service providers, resulting in the creation of the necessary conditions for the development of new products and services, and for payment innovations. The SEPA received its final framework with the adoption of the *Regulation of the European Parliament and of the Council on the introduction of technical requirements for credit transfers and direct debits in euros and amending Regulation (EC) No. 924/2009*, which sets 1 February 2014 as the mandatory date for the completion of the migration of credit transfers and direct debits in euros.

In Slovenia, the establishment of the SEPA, as a banking sector project, is managed by the Bank Association of Slovenia (BAS), which is also a member of the European Payments Council (EPC). The Bank of Slovenia, as part of the Eurosystem and in its role as a catalyst for the activities of market participants, monitors and supports the SEPA project at the national level. In this role it coordinates and guides the activities of the banking sector in the implementation of the SEPA, pursuing the objectives of security and efficiency in payments in so doing.

Publication of the document SEPA Project in Slovenia – Second Progress Report.

The key to performing this role is ensuring dialogue with other SEPA stakeholders. This dialogue also includes SEPA progress reports. A second progress report *(SEPA Project in Slovenia – Second Progress Report)* modelled on ECB reports was published in March. The Bank of Slovenia drafted the report to inform the professional and general public of its assessment of the progress and status of the project to establish the SEPA in Slovenia, and provided all key stakeholders recommendations for continued work.

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

The recommendations represent the starting point for the work of Bank of Slovenia representatives in the SEPA project's working bodies established under the aegis of the BAS, in which they again played an active role in 2012 as observers at meetings and in the formulation of positions, on the basis of which the Bank of Slovenia monitors and directs activities of the Slovenian banking community in accordance with the policy of the Eurosystem. Bank of Slovenia representatives participated in support and working groups, where solutions are formulated for the implementation of the SEPA in Slovenia. They also participated in the work of the National SEPA Implementation Committee, which represents a higher level of decision-making in the structure of the SEPA project in Slovenia. In particular in this committee, the Bank of Slovenia has the opportunity to present its views and to influence key decisions adopted in the introduction of the SEPA in the domestic environment.

The Bank of Slovenia also played an important role in 2012 in the successful migration of pension payments to SEPA credit transfers, namely in the planning phase of the migration. During that time an inter-institutional working group was established at the BAS specifically for that purpose. Pensions were processed for the first time via the SEPA ICP payment system in November. With the migration of the aforementioned segment of credit transfers, the migration of domestic credit transfers to SEPA credit transfers at the interbank level in Slovenia was virtually completed, one year before the legally prescribed deadline.

SEPA infrastructure management and the settlement function

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

The Bank of Slovenia provides a link between the systems operated by Bankart d.o.o. for the execution of SEPA credit transfers and SEPA direct debits and the pan -European payment systems for these payment instruments operated by EBA Clearing. As a direct participant in pan-European payment systems, in 2012 the Bank of Slovenia provided banks and savings banks (as indirect participants) with cross-border reachability for bank accounts in Slovenia for SEPA credit transfers and SEPA direct debits, thereby allowing banks and savings banks in Slovenia to exchange SEPA credit transfers with more than 4,500 payment service providers and to exchange SEPA direct debits with more than 3,800 payment service providers across Europe. Through this link, the Bank of Slovenia has also facilitated the use of the SEPA cross-border direct debit instrument for budget users since September 2012.

Provision of settlement in risk-free central bank money.

In 2012 the Bank of Slovenia also acted as a settlement agent for various Slovenian payment systems, namely the SEPA ICT, the SEPA IDD CORE, the SEPA IDD B2B, and ATM Settlement and Card Settlement systems (all operated by Bankart d.o.o.), the Activa Multilateral Clearing system operated by Banka Koper d.d. and the MasterCard Multilateral Clearing system operated by MasterCard International. This means that in the accounts of participants in these payment systems with the Bank of Slovenia it provides for the settlement of claims and liabilities arising from participation in the aforementioned payment systems in risk-free central bank money.

Introduction of an additional mechanism for ensuring liquidity.

In November 2012 the Bank of Slovenia, as a settlement agent, introduced an additional mechanism for ensuring the liquidity of participants in the aforementioned payment systems. Under this mechanism, the Bank of Slovenia may arbitrarily, i.e. without the specific request of a participant, grant an intraday credit to a participant facing liquidity problems in the settlement of liabilities arising from participation in the aforementioned payment systems. Intraday credit is collateralised by the collateral of participant placed at the Bank of Slovenia.

TARGET2-Securities

TARGET2-Securities (T2S) is a Eurosystem project with the aim of setting up a single technical platform for the settlement of securities transactions, to which central securities depositories will transfer securities accounts and central banks will transfer cash accounts. With T2S, the aim of the Eurosystem is to accelerate the integration of fragmented and locally focused securities settlement infrastructures in the EU and EEA, thereby increasing the efficiency and safety of cross-border securities settlement. The decision to build T2S was taken in July 2008, with the central banks of France, Italy, Germany and Spain responsible for its development and operation. The Bank of Slovenia (in the area of cash accounts) and the Central Securities Clearing Corporation - KDD (in the area of securities accounts) are responsible for Slovenia's inclusion in T2S, and are also represented in the governance structure of T2S.

Signing of the T2S Framework Agreement by the KDD.

One of a key project milestones was achieved in June 2012, when 22 central securities depositories (including KDD) signed the *T2S Framework Agreement* with the Eurosystem, thereby formalising the cooperation of both contracting parties. Of the central banks outside the euro area, only the Danish central bank signed the *T2S Currency Participation Agreement*, which will make the Danish krone as a T2S currency available in 2018.

Active dialogue maintained within the National T2S User Group.

In the national environment, the Bank of Slovenia continued to manage the National T2S User Group in 2012. The aforementioned group is a forum of relevant stakeholders from the Slovenian securities market regarding issues relating to T2S. The primary duties of the group are to discuss options for optimal inclusion of the Slovenian environment in T2S, to exchange information and views on the T2S project and to prepare comments and positions of Slovenian market in consultations with the ESCB. Key topic in 2012 was the discussion of adaptations of the KDD to T2S.

Bank of Slovenia's cooperation in harmonising the Slovenian securities market with international standards.

In addition to direct adaptations to existing securities settlement and payment systems, inclusion in T2S also requires indirect adaptations to national environments in terms of harmonising existing national market practices with internationally established practices and technical standards. In this context, the Bank of Slovenia was also active in 2012 within national Market Implementation Group, which deals with international harmonisation standards and initiatives with the goal to prepare proposals for adaptation of the Slovenian environment to the single financial market. Key topic in 2012 related to the preparation of the Slovenian model for the handling of corporate actions relating to securities in accordance with the relevant associated international standards.

Activities relating to the Bank of Slovenia's inclusion in T2S.

In 2012, the Bank of Slovenia continued activities linked to its inclusion in T2S with the goal to establish function of operator of T2S cash accounts, which will allow market participants' settlement of the cash leg of securities transactions through special cash accounts at the Bank of Slovenia. Key activities included the identification of the impact of T2S on the Bank of Slovenia's different business areas, the drafting of a feasibility study for the Bank of Slovenia's inclusion in T2S, the establishment of project management activities, the preparation of an estimate of required human and financial resources, the preliminary drafting of user requirements and the notification of Slovenian participants about planned changes in the area of cash accounts.

Payment and settlement systems oversight

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

Provision of payment systems oversight.

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

In 2012, in accordance with its powers and responsibilities, the Bank of Slovenia has overseen the functioning of payment systems through analysis of the regular and ad hoc reports that payment system operators are obliged to submit to the Bank of Slovenia. The operators' reports relate to the regular functioning of the payment systems and the operations of the payment system operators, to all planned or unplanned deviations from regular operations, and to changes in the functional concepts of payment systems.

Issuing of authorisations and on-site examinations.

In accordance with its legal powers, in 2012 the Bank of Slovenia issued authorisations to participants in two payment systems for the amendment of payment system rules. It also carried out two comprehensive regular on-site examinations of the functioning and operation of payment systems, and issued the appropriate recommendations for improvements.

Cooperation at the Eurosystem level.

The Bank of Slovenia also participated in the oversight of payment systems and other arrangements in this area (payment instruments/schemes, correspondent banking, external service providers) conducted at the Eurosystem level, and in the establishment and implementation of common standards regarding the security of retail payments. In the scope of the project of technical assistance for the central banks of South-Eastern Europe under the aegis of the ECB, the Bank of Slovenia was directly involved in the provision of advice to the National Bank of Serbia related to the establishment of a central bank payment system oversight function.

Another important function of central banks is oversight of the design and functioning of securities settlement systems with the aim of ensuring their safe, reliable and efficient (and in part internationally integrated) functioning. This function includes the monitoring of existing and planned securities settlement systems, assessing the aforementioned system compared with the objectives of the central bank and inducing changes. Thus, the Bank of Slovenia also contributes to ensuring general financial stability in Slovenia and to preventing the occurrence of systemic risk on the securities market. It is important to continuously conduct examinations in line with development in the scope of the Eurosystem and at the global level, and in cooperation with other relevant supervisory authorities.

Oversight of securities settlement systems.

The Bank of Slovenia is competent and responsible for oversight of the functioning of securities settlement systems on the basis of the *Bank of Slovenia Act*, while its responsibility is further complemented by the *Financial Instruments Market Act*, which empowers the Bank of Slovenia with the responsibility for conducting oversight of the central securities depository in respect of the systemic risk of the securities settlement system. Oversight activities are also conducted in cooperation with the Securities Market Agency (SMA). The Bank of Slovenia is accordingly active in identifying changes in the functioning of securities settlement systems and legislative changes, in determining the impact of these changes on the functioning of the settlement of securities transactions, and consequently on the occurrence of new risks (financial and operational) and related risk management procedures. The Bank of Slovenia monitored all significant changes in the functioning of the KDD in 2012 and issued six opinions in the scope of related consultations with the SMA.

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

This oversight function includes also the preparation of a Eurosystem user assessment regarding the compliance of the securities settlement system operated by the KDD for use in Eurosystem credit operations. To that end, the Bank of Slovenia prepared an assessment in 2012 of the cross-border links of the securities settlement system operated by the KDD with foreign securities settlement systems operated by the central securities depositories LuxCSD, Clearstream Banking Luxembourg and Clearstream Banking Frankfurt.

Supervision of payment institutions, electronic money institutions and exchange offices

Under the *Payment Services and Systems Act*, the Bank of Slovenia is the competent supervisory and misdemeanours authority in connection with the functioning of payment institutions as non-banking payment service providers. Under the same law the Bank of Slovenia is responsible for issuing authorisations to business entities to provide payment services.

Register of payment institutions and electronic money institutions.

In accordance with legal requirements, the Bank of Slovenia publishes and updates registers of payment institutions and electronic money institutions on its website. These registers are centralised databases of payment institutions and electronic money institutions to which the Bank of Slovenia has issued authorisation. The aforementioned databases are accessible to the public free of charge. On the website the Bank of Slovenia administers and updates lists of payment institutions and electronic money institutions in the countries of the European Economic Area that may provide payment services in Slovenia via a branch, via an agent or directly, on the basis of notification of the Bank of Slovenia by the competent supervisory authority of the home country (notification of payment institutions and electronic money institutions). There were 37 new notifications relating to payment institutions in 2012, and 12 notifications relating to electronic money institutions.

On-site examinations of payment institutions.

In 2012 the Bank of Slovenia conducted two on-site examinations of the operations of hybrid payment institutions to check whether the subject of supervision had been meeting the statutory and regulatory requirements throughout its operation. If the Bank of Slovenia identifies breaches of regulations during the course of supervision, it imposes the appropriate supervisory measures.

Under the *Payment Services and Systems Act*, the Bank of Slovenia is also competent and responsible for issuing authorisations to issue electronic money and for the oversight of electronic money institutions. Although it did not receive any requests in 2012 for the issue of authorisation to issue electronic money as an electronic money institution, the Bank of Slovenia carefully monitors developments in the market and business models that could entail the issuance of electronic money.

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

On-site examinations of the operations of currency exchange offices.

The Bank of Slovenia performed on-site examinations in 2012 of nearly all currency exchanges offices with Bank of Slovenia authorisation. It also issued authorisation to provide currency exchange services to three currency exchanges offices and revoked the authorisation of another in 2012.

List of currency exchange offices published on website.

The Bank of Slovenia also publishes on its website a list of currency exchange offices with Bank of Slovenia authorisation to provide currency exchange services, including the associated points of exchange. There were a total of 27 currency exchange offices with 35 points of exchange at the end of 2012.

Statistics for payment systems operated by the Bank of Slovenia

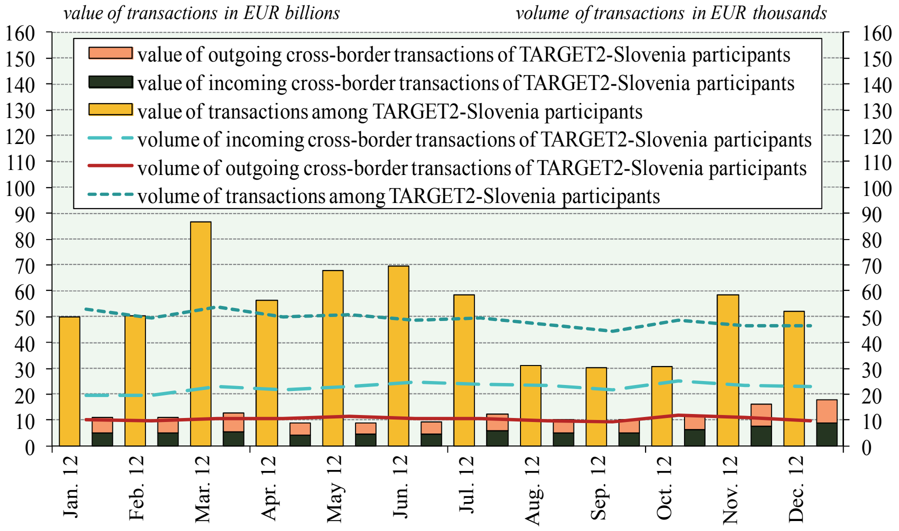
The Bank of Slovenia operates the TARGET2-Slovenija payment system for the settlement of high-value and urgent payments in euros.

The number of transactions between TARGET2-Slovenija participants decreased by 9.04% in volume terms, and increased by 28.21% in value terms. More incoming cross-border transactions and fewer outgoing cross-border transactions.

In 2012 there were 587,719 transactions settled between participants in the TARGET2-Slovenija payment system with a total value of EUR 642,288.66 million, a decline of 9.04% in the volume of transactions and an increase of 28.21% in the value of transactions compared to 2011. The increase in the value of transactions in 2012 was (indirectly) the result of the ECB's decision to offer 3-year LTROs on 29 February 2012. TARGET2-Slovenia participants obtained additional liquid assets via the aforementioned 3-year LTROs, which they did not (to a large extent) place in long-term investments, but rather daily in the deposit facility (primarily and for the most part until 11 July, when the ECB interest rate on the deposit facility decreased to 0.00%). Decrease in the number of transactions was primarily the result of the lower volume of payments made by payment service users via the TARGET2-Slovenia payment system.

A total of 271,480 incoming cross-border transactions with a total value of EUR 69,552.87 million were settled between participants in the TARGET2-Slovenija payment system and participants in other national components of the TARGET2

Figure 25: **Number and value of transactions via the TARGET2-Slovenija system by month in 2012**



Source: Bank of Slovenia.

payment system in 2012, an increase of 24.60% in the volume and a decline of 25.12% in value terms compared to 2011, while there were a total of 125,522 outgoing cross-border transactions with a total value of EUR 71,258.14 million, a decline of 6.90% in the volume and 23.81% in value terms compared to 2011. The major changes compared with 2011 were primarily linked to movement in the volume of (net) interbank payments.

2.1.5 Joint management of the ECB's foreign reserves

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

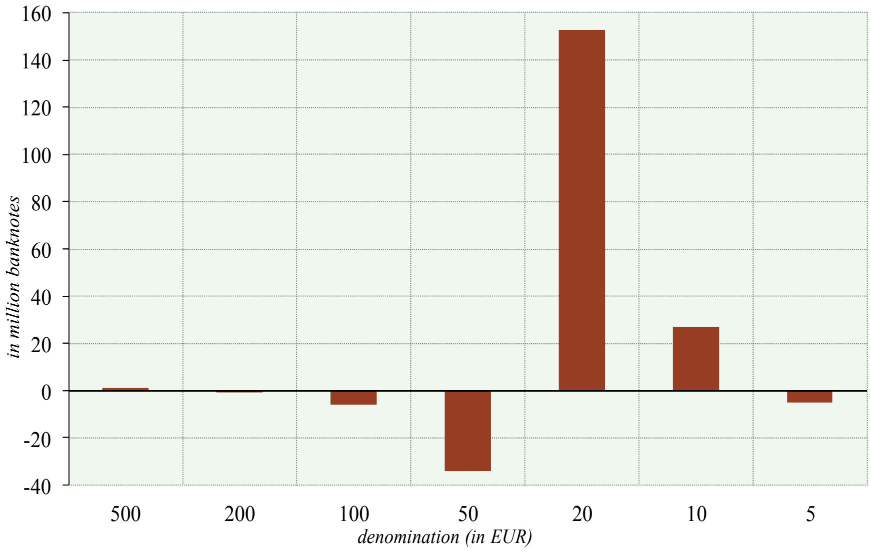
2.1.6 Cash operations

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

A net total of EUR 1.42 billion of cash had been released into circulation via the Bank of Slovenia by the end of 2012, of which banknotes accounted for EUR 1.37 billion (134.57 million banknotes) and coins for EUR 50.21 million (183.71 million coins).[10] In terms of quantity, the EUR 20 note was the most heavily issued (152.85 million banknotes), followed by the EUR 10 note (26.78 million banknotes) and the EUR 500 note (1.09 million banknotes). In the case of all other denominations (EUR 200, EUR 100, EUR 50 and EUR 5), there was a negative net issuance (i.e. the number of banknotes issued was lower than the number returned to the Bank of Slovenia). The coins that were issued most heavily in terms of net quantity were the 1-cent (48.91 million coins) and 2-cent (37.76 million coins),

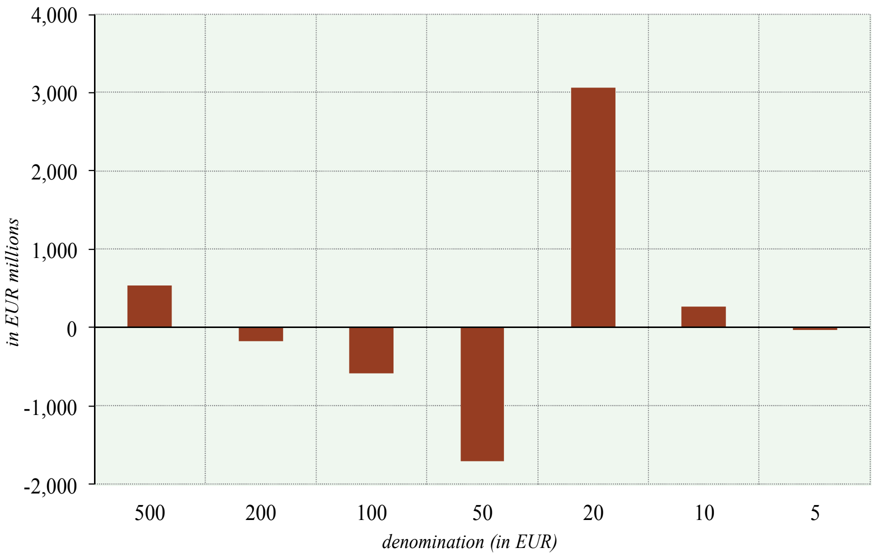
10 Figure 26 illustrates the breakdown of euro banknotes in circulation in terms of quantity, while Figure 27 illustrates the breakdown in terms of value.

Figure 26: **Quantitative breakdown of net issued euro banknotes**



Source: Bank of Slovenia.

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



Source: Bank of Slovenia.

while the lowest net quantity of issued coins was recorded by the 1-euro (6.58 million coins).

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

In January 2012 the Bank of Slovenia issued into circulation one million 2-euro commemorative coins to mark the 10th anniversary of euro cash. Collector coins issued by Slovenia were made available for sale and issued into circulation by the Bank of Slovenia to mark the European Capital of Culture – Maribor 2012 event (2,500 gold coins and 3,500 silver coins), and to mark the 100th anniversary of the first Olympic medal received by a Slovene as a member of the Austro-Hungarian team (2,500 gold coins, 3,500 silver coins and 300,000 bi-coloured 3-euro coins).

Commemorative coins issued in 2012.

For the collector market the Bank of Slovenia also issued a collection of euro coins minted in 2012, a card with a 2-euro commemorative coin and a card with a 3-euro collector coin.

As at 31 December 2012 there were still 46.74 million tolar banknotes in circulation (worth SIT 7.73 billion), 444.87 million tolar coins (worth SIT 2.16 billion) and 20.92 million payment notes (worth SIT 404.14 million). Compared with circulation at the end of 2005, 58.71% of the tolar banknotes have been returned from circulation (96.38% of the total value of the tolar banknotes), while 13.65% of the tolar coins have been returned (37.72% of the total value of the tolar coins).

The total value of the tolar banknotes, coins and payment notes still in circulation is EUR 42.97 million.

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

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

A total of 2,874 treasury receipts and outlays of euro cash (2011: 5,301) and 3,053 incoming and outgoing payments of cash for the needs of government bodies were made in 2011 (2011: 3,967), while there were 3,090 exchanges of tolar banknotes and coins (2011: 3,863).

The Bank of Slovenia cash processing unit sorted 38.51 million banknotes and coins (2011: 37.19 million), comprising 38.44 million banknotes and 75,850 coins (2011: 36.77 million banknotes and 0.42 million coins). A total of 17.29 million euro banknotes (compared with 11.09 million banknotes in 2011) were taken out of circulation and destroyed in order to maintain an appropriate quality for banknotes in circulation.

The money counting unit processed 38.51 million banknotes and coins.

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

Euro cash was supplied nationally via depots at banks.

The expert committee for testing, verifying and setting up machines for sorting euro banknotes and coins, which is composed of employees of the Bank of Slovenia and the Ministry of the Interior, conducted 46 monitoring tests in 2012 in line with their powers to verify that banknote-sorting machines at commercial banks were working accurately and properly. The Bank of Slovenia drew up a timetable for the testing on the basis of data (number and type of sorting systems) obtained from cash handlers. It was taken into account that in Slovenia the majority of activities in connection with the fitness and authenticity of euro banknotes are carried out at the five Bank of Slovenia banknote depots (NLB, NKBM, Banka Celje, Gorenjska banka and Banka Koper), where most testing was also conducted. All the tests were successful in 2012.

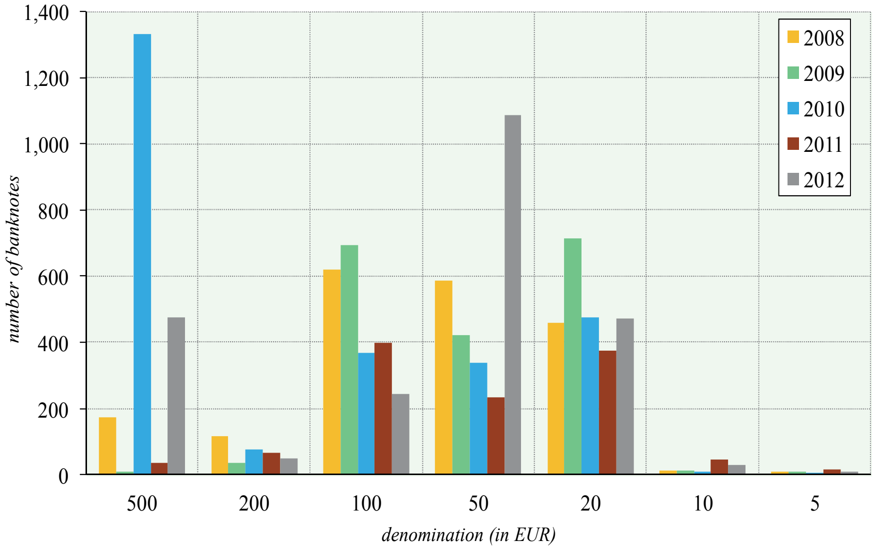
On the basis of Regulation 1210/2010/EU, the Bank of Slovenia issued the Regulation on the rules of reporting in accordance with Regulation 1210/2010/EU and on the fees for the procedure of returning and replacing euro coins unfit for circulation, thereby setting out detailed rules for reporting and the amount of the fee that the relevant parties are obliged to pay for services associated with the procedure of returning and replacing euro coins unfit for circulation. In conjunction with the government, the Bank of Slovenia also drafted a decree on the implementation of Regulation 1210/2010/EU defining the misdemeanours resulting from breaches of the aforementioned regulation and the competent authority for supervising the implementation of the regulation. In accordance with the aforementioned decree, an expert committee carried out monitoring tests of coin-sorting machines for the first time in 2012. Both machines were tested successfully.

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

According to figures of the National Analytical Centre (NAC) and the Coin National Analytical Centre (CNAC), 2,362 counterfeit euro banknotes and 1,956 euro coins were identified in 2012, compared with 1,174, euro banknotes and 1,459 EUR coins in 2011.[11] The numbers of counterfeit euro banknotes and euro coins identified in Slovenia thus increased, by 101.2% and 34.1% respectively in 2012. The value of the counterfeits identified in 2012 was EUR 338,236, compared with EUR 92,543 in 2011. EUR 50 notes accounted for the largest proportion of counterfeit banknotes in terms of quantity (45.9%), while 2-euro coins accounted for the largest proportion of counterfeit coins (55.9%). The number of euro counterfeits

[11] Figure 28 illustrates the breakdown of counterfeit euro banknotes in terms of quantity.

Figure 28: **Counterfeit euro banknotes discovered in Slovenia**



Source: Bank of Slovenia.

identified in Slovenia does not currently represent a problem. Eurosystem data in this area ranks Slovenia in the bottom half of countries in terms of the amount of counterfeit cash withdrawn from circulation per 1,000 inhabitants (1.15 counterfeits).

Foreign currency counterfeits were also discovered.

There were 321 foreign currency counterfeits identified in 2012 (US dollars, Swiss francs, pound sterling and Australian dollars), compared with 639 in 2011. The quality of foreign currency counterfeits has improved over time, making it more difficult for users to identify them, particularly US dollar counterfeits.

Control of the authenticity of euro cash has been organised.

Under Regulation (EC) No. 1338/2001, the NAC and CNAC are responsible for issuing expert opinions on the authenticity of euro banknotes and coins respectively. These agencies operate under the aegis of the Centre for Forensic Investigation (CFI) at the Ministry of the Interior. Supervision of the activities of the aforementioned centres, in connection with the work of the Counterfeit Monitoring System at the ECB, is carried out at the Bank of Slovenia by the National Counterfeit Centre (NCC). The NCC is actively involved in a system of data and information exchange on counterfeiting with the ECB's Counterfeit Analysis Centre (CAC), other national counterfeit centres and the European Technical and Scientific Centre for the analysis of euro banknotes.

2.1.7 Statistical system

Responsibility for monetary and financial statistics, external statistics and statistics of financial accounts.

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

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

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

Head of the Joint Expert Group on Reconciliation of credit institutions' statistical and supervisory reporting requirements.

The Bank of Slovenia is cooperating with international organisations and institutions, particularly the ECB, the IMF, Eurostat, the World Bank, the BIS and the OECD on the development of statistical requirements, methodologies and standards. Bank of Slovenia representatives participate in the ESCB's Statistics Committee and the working groups for external statistics, general economic statistics, general government statistics, monetary and financial statistics, euro area (national) accounts, statistics on securities and statistical information systems, and also on occasional task forces. In 2012 a Bank of Slovenia representative began a two year term as the head of the Joint Expert Group on Reconciliation (JEGR) under the auspices of the ECB and EBA (European Banking Authority). The organisation of the Financial Statistics Department is aligned with the need to cooperate within the ESCB.

Bank of Slovenia representatives also attend regular meetings of the relevant Eurostat working groups and regular plenary sessions of the Committee on Monetary, Financial and Balance of Payments Statistics (CMFB).

MoUs with the Ministry of Finance and the SORS are an important basis for the coordinated fulfilment of obligations in the area of macroeconomic and financial statistics, and an example of best practices.

The most notable form of cooperation with national statistical institutions is with the Ministry of Finance and the Statistical Office of the Republic of Slovenia (SORS), based on a Memorandum of Understanding in the area of macroeconomic and financial statistics, signed in 2004 and last updated in 2009. The MoU applies to the coordination of powers and responsibilities because of the increased burden of statistical requirements and interdependence of particular statistics, thereby easing compliance with international statistical requirements. At the international level, the MoU represents an example of best practices.

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

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

Quarterly reporting for financial accounts statistics collected by AJPES.

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

Aggregate quarterly financial accounts statistics were submitted to the ECB in 2012 in accordance with Guideline ECB/2005/13, while aggregates of quarterly financial accounts for the government sector were submitted to the ECB and Eurostat in accordance with Regulation (EC) No. 501/2004. Aggregates of annual financial accounts were submitted to Eurostat in accordance with Regulation (EC) No. 2223/96.

The publication Financial Accounts of Slovenia 2006–2011 was released in July 2012, and alongside tables of financial accounts and the compilation methodology it also contained analysis of financial accounts data in individual sectors and a comparison with the euro area. Annual and quarterly financial accounts data and quarterly information from the Financial Accounts of Slovenia were published on the Bank of Slovenia's website.

The introduction of an amended national accounting system (ESA 2010) also took place, concerning methodological changes and changes in institutional sectors and financial instruments.

The comprehensive production of monthly, quarterly and annual monetary and financial statistics continued in 2012 in accordance with the methodological requirements of the ECB, the OECD and the IMF, and the internal needs of the Bank of Slovenia. In addition to the balance sheet and interest rate statistics of monetary financial institutions (MFIs), the data pursuant to Regulations ECB/2001/18 and ECB/2008/32 and Guideline ECB/2007/9 also includes data on non-monetary financial intermediaries, securities and payment systems, and structural data from the banking system.

Introduction of multipurpose reporting by leasing companies.

New quarterly reporting by leasing companies was prepared in 2012 in cooperation with the Bank Association of Slovenia. Multipurpose reporting for the needs of financial stability, financial accounts statistics and the needs of the ECB began with figures for the final quarter of 2012.

In 2012 the Bank of Slovenia continued its activities to introduce multipurpose reporting of data in the subsector of insurance corporations and pension funds (S.125) in conjunction with the Insurance Supervision Agency (ISA), the Slovenian Insurance Association (SIA) and the ECB.

Comprehensive balance of payments and international investment position data, including external debt, FDI figures and international monetary reserves, was produced regularly in 2012.

Following the receipt of the final merchandise trade figures for 2011, figures from 2007, inclusive, were audited in the scope of a regular audit. The SORS audited merchandise trade figures for the period 2009-2011. The part of merchandise trade carried out by companies not registered in Slovenia was audited.

Revision of external statistics since 2007.

The Bank of Slovenia assessed household assets in the form of real estate held in the rest of the world during an audit of international investment position data. Data were audited for the period from 2007, inclusive. The basic source for estimating the number of real estate properties in the rest of the world owned by Slovenian residents is the Household Budget Survey conducted by the Statistical Office of the Republic of Slovenia. Figures are available for the period 2006-2010. According to the survey figures, residents of Slovenia owned 8,166 residential properties in the rest of the world in 2006, and 11,113 in 2010.

Other changes arising from the revision of external statistics relate to the system for assessing cash balances and household deposits, the valuation of government bonds and the inclusion of data on the purchase of fuel made by foreign carriers at service stations in Slovenia.

The liquidity of government bonds listed on the Ljubljana Stock Exchange is poor, thus bond prices are not updated or are non-existent. Because the market values of government bonds were down sharply in the final quarter of 2011 and this was not reflected in share prices on the Ljubljana Stock Exchange, share prices from the MTS, which facilitate the more realistic market valuation of bonds, have been used since the end of 2011 to value bonds registered with the KDD.

Since 2007 the balance of foreign currency held by domestic households is estimated to be at the level achieved prior to entry to the Economic and Monetary Union at the end of 2006 (EUR million 2,948.6), as in the monetary union it is no longer possible to trace the placement of mostly euro cash, which derives from current account transactions in the banking system or from the conversion to other forms of assets.

The publication Direct Investment 2011 was released in November 2012 with detailed data regarding the origin of foreign direct investment in Slovenia and its integration into the Slovenian economy. The publication also includes figures and a brief analysis of Slovenian outward direct investment, as well as figures for the operations of companies in the rest of the world in which Slovenian investors hold a direct or indirect controlling stake (Foreign Affiliates Statistics – FATS).

New survey on corporate access to financing conducted.

In the autumn of 2012 the Bank of Slovenia conducted its second survey of corporate access to financing, comparable to the survey conducted by the ECB on a sample of SMEs in larger euro area countries every half-year since 2009 (the data is available in the ECB's Statistical Data Warehouse [SDW]). The ECB and the European Commission conduct such surveys in all European countries every two years since 2009, although the number of respondents in Slovenia is small, at just 100.

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

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

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

Expert assistance in the area of statistics for the Albanian central bank.

In 2012 the Bank of Slovenia provided expert assistance in the area of statistics to the central bank of Albania. The professional delegation that visited the Bank of Slovenia received a presentation on the multipurpose reporting system of financial institutions.

2.1.8 Information system

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

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

ESCB information system infrastructure.

The Bank of Slovenia is technically linked to the information system of the ECB and ESCB via the ESCB physical network infrastructure system,[12] the ESCB application network infrastructure system,[13] the ESCB's system for the secure exchange

12 Core Network.
13 ESCB-Net.

of email[14] and via a teleconferencing system. Infrastructure equipment is situated at primary and backup locations at the Bank of Slovenia.

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

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

The aforementioned infrastructure equipment must be upgraded regularly with regard to technological advances, increases in the quantity of data and the increased requirements of commercial users. In 2012 we introduced TLS (*Transport Layer Security*) encryption on the external email server. The ESCB-Net system for the secure exchange of email between the ECB and the NCBs uses a CoreNet network, which itself ensures data encryption. TLS-encrypted email, which is transmitted over the internet, was established as a backup in the event of the complete inoperability of the CoreNet network. Service Pack 8 was installed in the EXDI production system, and additional security patches installed for the ESCB-Net system. All required patches to the ESCB-Net and EXDI systems were installed during the year. A TLS link was established with the Croatian National Bank in December.

ESCB information system applications.

A number of applications via which data is exchanged between the NCBs and the ECB and ESCB run on the aforementioned infrastructure. Activities continued in the ESCB system in 2012 to ensure the provision of application support for the implementation of crisis measures. The Bank of Slovenia was therefore obliged to modify and provide application support, most notably in support of the eligibility criteria of financial assets. It also provided application support during the establishment of a joint centre for the valuation of financial assets.

It upgraded the monthly and daily report for the needs of recording data regarding new, second series of euro banknotes. Preparations and adjustments were also required in the exchange of different statistical data, both in terms of content and technological solutions.

ESCB information system security.

The Bank of Slovenia participated in three major, associated projects in the area of information security. An infrastructure was established for the centralised management of user accounts and access rights in the scope of the IAM (Identity and Access Management) project. The ESCB-PKI project is being implemented in parallel to increase the level of confidence in electronic identities. A certification authority for digital certificates that will be recognised in the ESCB environment is being established in the scope of the aforementioned project. Digital certificates will be used by ESCB user accounts as an authentication mechanism when logging into ESCB applications. The aim of the third, *Secure ESCB Email* (*SEE*) project is to increase the security of content exchanged in the ESCB email system by using an encryption mechanism and electronic signature that is based on digital certificates recognised at the ESCB level.

[14] ESCBMail.

2.2 Other tasks

2.2.1 Systemic measures and activities relating to banking supervision and ensuring financial stability

The Bank of Slovenia continually and systematically warns the management boards of banks about the danger involved in the excessive assumption of risks to which the banks are exposed in their operations. As evident below, the adoption of systemic measures contributed to maintaining high lending growth prior to the outbreak of the crisis. At the same time, the Bank of Slovenia warned the banks in numerous letters, which took the form of mandatory instructions, that they must establish an appropriate risk management system and maintain the requisite amount of capital to cover all types of risks. Following the outbreak of the financial crisis, the Bank of Slovenia adopted measures that contributed to the easing of associated consequences. In addition to the measures and activities that the Bank of Slovenia adopted in 2012 to ensure stability and mitigate the effects of the crisis, the measures and activities adopted by the Bank of Slovenia since 2004 are presented in Box 3, listed by year.

The Bank of Slovenia continually and systematically warns the management boards of banks about the danger involved in the excessive assumption of risks. Following the outbreak of the financial crisis, the Bank of Slovenia adopted measures that contributed to the easing of associated consequences.

Measures and activities to maintain financial stability in 2012

In February the Bank of Slovenia adopted amendments to the internal capital adequacy assessment process (ICAAP) guidelines, such that increased profitability risk arising from liability interest rates will require additional capital in the scope of the ICAAP for a period of one year in advance. The measure reduces the banks' exposure to profitability risk by encouraging greater prudence in setting the level of liability interest rates, which also has a positive impact on the level of lending rates in the economy overall.

By amending the Regulation on the calculation of capital requirements for credit risk under the standardised approach and the Regulation on the calculation of capital requirements for credit risk under the internal ratings-based approach in March, the Bank of Slovenia amended the definitions of past due items and significant credit exposure in arrears in connection with the definition of default for the purpose of calculating capital requirements for credit risk. A loan obligation in arrears is significant at the latest when it exceeds 2% of the open exposure or EUR 50,000 for more than 90 days, but is at least EUR 200 (previously EUR 1,000 EUR for corporate clients and EUR 100 for retail clients). By amending the Guidelines for implementing the regulation on the assessment of credit risk, the same definition was introduced in April for the purpose of identifying clients in default in the scope of reporting banks' exposures to individual clients. Reporting by the banks was also supplemented to include reporting on the amount of an exposure where a client is more than 90 days in arrears. With the aforementioned amendments, the definition of clients in default is more comparable with the definition applied by other euro area countries.

By amending the Regulation on the minimum requirements for ensuring an adequate liquidity position at banks and savings banks in April, the Bank of Slovenia amended conditions regarding the inclusion of credit lines and the undrawn portion of loans, such that the aforementioned instruments are not included in the calculation of liquidity to their full amount, but gradually up to the amount of 50% of their value. The measure is aimed at reducing exposure to liquidity risk due to the persistent adverse situation on the financial markets, while bringing these sources of liquidity more in line with the requirements of the LCR liquidity standard.

With the aim of reducing the proportion of non-performing investments in the banks' balance sheets, which is rising due to protracted collection procedures, and with the aim of accelerating the process of redeeming real estate collateral, the Regulation on the assessment of credit risk losses of banks and savings banks was amended in April, such that the banks will be forced to write off financial assets measured at amortised cost which, during the collection process, they assess will not be recovered and which meet the conditions for derecognition from the financial statement according to the IFRS. The aforementioned financial assets must be accounted for off-balance-sheet until the legal basis is secured for the conclusion of collection proceedings. This measure will reduce the proportion of non-performing investments by slightly less than 1 percentage point.

In the context of a growing lack of liquidity, a decision was made to improve the internally developed system for determining corporate credit ratings in such a way that it will meet all requirements prescribed by the ECB for an internal model used to assess the credit quality of assets eligible as collateral in regular operations for obtaining liquidity via the ECB. The model was successfully updated and approved by the ECB in November 2012. Assuming no change in other conditions, the use of this model will increase the banks' potential to obtain liquidity via the ECB in 2013.

The Bank of Slovenia actively participates in activities aimed at providing prompter assistance to corporates in distress.

In addition to systemic measures relating to supervision and maintaining stability, the Bank of Slovenia and the Bank Association of Slovenia have been coordinating their activities since the middle of 2012 to improve operating conditions for the real sector, whose over indebtedness in the context of weak economic activities represents one of the major reasons for the deteriorating operations of the banks:

- an amendment was made to the Banking Act, which does not require banks to submit a takeover bid in the event of the acquisition of a capital investment in a corporate restructuring process for a period of two years after acquisition;

- proposals were drawn up in connection with the requisite changes in insolvency legislation; and

- solutions were formulated in connection with the conversion of banks' claims into corporate capital and in connection with the valuation and effective management of capital investments obtained as such (valuation at historical cost or fair value, as a rule using the valuation technique set out in the IFRS, and the transfer of investments to a special purpose vehicle (SPV), whereby the management of these investments is left to professionally qualified personnel).

Here, in conjunction with representatives of the Bank Association of Slovenia, creditor banks and the Chamber of Commerce and Industry, the Bank of Slovenia is also coordinating activities to reach agreement over acceptable terms for operational, financial and ownership restructuring to improve the financial position of corporates, to increase their ability to repay debts and to reduce the requirement for additional impairments and capital in the Slovenian banking system. This should stimulate a gradual economic recovery, thereby ending the feedback of negative economic growth into a contraction in lending activity and an increase in credit risk.

The above described review only includes key systemic supervisory measures and the measures for ensuring financial stability that applied to the entire banking system. There were also numerous supervisory measures that were aimed at eliminating deficiencies and breaches at specific banks and indirectly affected the stability of the banking system.

Box 3: **Chronology of the Bank of Slovenia's activities in the period 2004 to 2011**

- **2004**

Back in 2004 the Bank of Slovenia began to draw attention to the importance of the internal capital adequacy assessment process, and required the gradual establishment of the aforementioned practice until the transition to Basel II. The aim was to assess current and future capital requirements to ensure an appropriate level of capital adequacy, even in the unfavourable market conditions. The objective was to cover the risks assumed by a bank in its operations with sufficient capital, taking into account operations and risks in the future as well. It was emphasised that capital management has to take into account the risks and returns associated with instruments and banking activities, including in terms of strategic decisions regarding a bank's risk profile.

- **2005**

At the beginning of 2005 the Bank of Slovenia again called attention to the importance of managing capital, as in that way the management boards of banks increase public confidence in the security and stability of banks. It was expected that the banks would set appropriate capital requirement levels taking into account the risks that they assume, which could lead to a capital adequacy ratio well above the legally prescribed minimum. To that end, the banks were warned about the rapid growth in the scope of their operations, which occurred partly as the result of the approval of affordable loans. In addition to favourable interest rates and lower costs, the aforementioned loans were characterised by the speed and simplicity with which they were raised. The Bank of Slovenia demanded that the banks submit an appropriate assessment of the financial position of such new clients, primarily in terms of their ability to repay debt due to the expected further deterioration in general economic conditions.

- **2006**

In early 2006 the Bank of Slovenia introduced the prudential filter as a deduction item from original own funds to correspond with the introduction of the International Financial Reporting Standards (IFRS), which meant a significant reduction in the scope of required impairments. Thus, accumulated provisions and impairments at that time were not transferred to profit to be distributed to shareholders, but were transferred to capital. The introduction of this measure by the Bank of Slovenia had a significant impact on lending growth, as additional lending placed a significantly greater burden on the banks' capital due to the aforementioned deduction item. Despite numerous efforts by the banks and external auditors to abolish the prudential filter, the Bank of Slovenia maintained this form of reserves until October 2008, when the financial crisis intensified. By abolishing the prudential filter, the Bank of Slovenia acted anti-cyclically to mitigate the contraction in the banks' lending activities in the early period of the crisis's development. The abolishment of the prudential filter resulted in an increase in regulatory capital of EUR 308 million, which had the favourable effect of increasing the capital adequacy of the majority of banks.

Banks were warned in writing at the beginning of 2006 about the problem of falling interest rates and the search for more risky forms of alternative investments, such as complex derivatives and structured financial instruments. The Bank of Slovenia demanded that the banks' management boards unconditionally and fully understand every planned investment and every planned financial instrument that a bank intends to issue or obtain.

The Bank of Slovenia also warned the banks in writing to manage the risks arising from foreign currency loans, loans tied to foreign currencies and credit products that expose clients to market risk. It warned the banks that they must establish an appropriate and effective risk management system, and required the comprehensive notification of clients about the characteristics of products offered by the banks. It also required the banks to initially offer clients their products in euros at all times.

- **2007**

At the end of 2007 the Bank of Slovenia also required that the banks assess a client's creditworthiness if, despite being briefed on currency risk, the client still wishes to raise a loan in a foreign currency or tied to a foreign currency, by taking into account the raising of an equivalent loan in euros, and considering the amount determined as such as the maximum possible loan amount. The stock of new loans to non-banking sectors tied to the Swiss franc was thus down 38% in 2008 and 65% in 2009. The banks have not approved loans to households tied to the Swiss franc exchange rate since 2009.

At that time the Bank of Slovenia tightened the rules for calculating capital requirements for credit risk, as it expanded the definition of regulatory high-risk exposures, for which a weight of 150% is applied in the calculation of capital requirements (the normal weight for corporates without a credit assessment is 100%). Since the end of 2007, the banks were required to include in regulatory high-risk exposures, which otherwise comprise exposures to persons undergoing bankruptcy or composition proceedings and other exposures where objective conditions indicate that they are a very high risk, exposures from investments in the capital of private companies, exposures to venture capital firms and high-risk collective investment undertakings, and to unregulated entities with 50% of their assets invested in financial instruments. The category of regulatory very high-risk exposures included all companies that were established and operate primarily for the purpose of publishing takeover bids, or that operate in coordination with an acquiring entity.

The Bank of Slovenia has recommended every year since 2007 that the banks use a major portion of disclosed profit to create reserves and thus increase capital.

- **2008**

In the 2008 Financial Stability Review, the Bank of Slovenia warned the banks of the inappropriate structure and scope of capital taking into account high credit growth, and of the rising proportion of subordinated instruments in the structure of regulatory capital.

In addition to the abolishment of the prudential filter in October, which slowed the contraction in the banks' lending activities by improving their capital adequacy, the Bank of Slovenia also adjusted the calculation of liquidity ratios for the value of assets pledged as collateral at the central bank in the first bucket of the liquidity ladder. Thus, the regulatory barrier to drawing liquid funds at the ECB was eliminated.

In November the Bank of Slovenia called on banks to limit the level of interest rates on sight and short-term deposits, because the raising of interest rates in the context of a full government guarantee for bank deposits resulted in the transfer of deposits between banks and only increased the instability of deposits, instead of encouraging additional saving. The announced possible use of measures to punish banks that maintain inappropriate interest rate policies, by which the Bank of Slovenia was at liberty to change how the aforementioned deposits are taken into account in the calculation of the liquidity ratio, proved unnecessary. At the same time it called on banks to increase the creation of impairments and provisions, while banks would have to take into account the effects of the deterioration in the economic situation on the operations of corporates from specific sectors.

- **2009**

In the context of rising credit risk, the Bank of Slovenia called for the appropriate valuation of specific instruments and for an adequate level of impairments and provisions. It also warned that impairments and provisions may not reflect in full the deteriorating situation, which had become increasingly more evident. At the same time, it called on banks to coordinate their planned lending activities with available and stable sources of funding, and to allocate the majority of earnings generated in 2008 to reserves. The Regulation on the assessment of credit risk losses of banks and savings banks was amended to require monthly reporting (and disclosure in the income statement) of impairments and provisions, and classified claims. At the same time, a requirement for additional information regarding collateral on claims was introduced in the reporting system.

In June the Bank of Slovenia warned of the need for activities to improve risk management at the banks. A letter from the Bank of Slovenia included requirements regarding the repeated rolling over of short-term loans without cash flows arising from the repayment of loan principals. It determined that the banks may not include such loans in the calculation of liquidity ratios for first and second buckets of the liquidity ladder, and must create a sufficient level of impairments for the aforementioned loans. At the same time, a requirement was imposed that regulatory high-risk exposures should also include the financing of acquisition activities. In June the Bank of Slovenia adopted recommendations for coordinated action by creditor banks in the event of corporates in financial difficulties.

- **2010**

Despite a recovery in economic activity in 2010, uncertainty on the financial markets continued with the escalation of the debt crisis in certain euro area countries. For this reason, the Bank of Slovenia sent a letter to the banks calling on them to allocate the profit generated in 2009 to other profit reserves with the aim of strengthening their capital. At the same time, it warned the management boards of the banks that they should assess the need to increase capital in 2010, and to prepare for and carry out recapitalisations in a timely manner on the basis of the aforementioned assessment.

In July the Bank of Slovenia adopted a decision, by which the banks must, in the scope of the internal capital adequacy assessment process (ICAAP), cover 80% of internally assessed capital requirements with original own funds calculated in accordance with the regulation governing the calculation of capital. The measure was aimed at improving the structure of the quality of the banks' capital, as it became clear that the financial crisis was developing into a deep economic crisis. This was accompanied by expected pressure on the banks' deteriorating capital position due to increased credit risk linked to the weakening operations and financial position of non-financial corporations and to increased exposure owing to the rising number of arrears in the settlement of liabilities and bankruptcies.

In order to improve the system for managing problematic investments, in October the Bank of Slovenia amended the Regulation on risk management and assessment of internal capital adequacy for banks and savings banks by tightening requirements regarding the treatment and monitoring of problematic loans (e.g. systematic treatment, the establishment of IT-supported records for monitoring repayments and write-offs, timely restructuring, etc.).

- **2011**

In January the Bank of Slovenia once again called on the banks to assess their needs for capital in 2011, and to draw up procedures to strengthen capital accordingly. It called upon the management boards of the banks to adopt resolutions at general meetings on the allocation of profits to reserves with the aim of increasing the banks' capital.

The Regulation on the minimum requirements for ensuring an adequate liquidity position at banks and savings banks was amended in September, such that the weights applied to the sight deposits of households and non-financial corporations were reduced by 10 percentage points to 40% in the first bucket and to 35% in the second bucket of the liquidity ladder, thus bringing the treatment of such deposits in line with the treatment envisaged in the scope of the LCR liquidity standard. This reduced the banks' liabilities for investments in the first and second buckets by more than EUR 800 million, thus making it easier to manage the structure of investments. Exposure to rising refinancing risk was reduced as a result of a renewed, significant deterioration in the situation on the European financial market. This also alleviated the pressure on the reduced lending activity of the banks, which was the result of limited access to sources of funding.

Other changes in banking regulations in 2012

In addition to changes to implementing regulations linked to systemic measures and the activities for maintaining stability described in point 2.2.1, changes to Bank of Slovenia implementing regulations were also adopted in 2012 with the primary aim of upgrading the regulatory framework that serves as the basis for the supervision of the operations of banks and savings banks. These were the consequences of changes in legislation (e.g. domestic legislation, guidelines of the European Banking Authority, etc.) or the result of knowledge gained from supervisory practices. The common denominator of the aforementioned changes are the Bank of Slovenia's efforts to find appropriate solutions for the current and long-term management of risks and conditions in the Slovenian banking system, and to increase public confidence in the Slovenian banking system.

The Bank of Slovenia's efforts to find appropriate solutions to deal with the current situation in the Slovenian banking system and increase public confidence in the Slovenian banking system represent the common denominator of all changes to banking regulations.

In March the Bank of Slovenia adopted a package of implementing regulations on the basis of the Mortgage Bond and Municipal Bond Act (ZHKO-1) with the aim of defining in detail the requirements of the ZHKO-1. These included:

- the Regulation on the conditions for acquiring an authorisation to issue mortgage bonds and municipal bonds, which prescribes the documentation for determining the fulfilment of requirements to obtain authorisation to issue mortgage bonds and municipal bonds. The aforementioned documentation must be attached to a bank's request for the issue of authorisation;

- the Regulation on the documentation for demonstrating fulfilment of the conditions for appointment as a trustee of a cover register, which now defines the method for determining the conditions set out in the ZHKO-1 regarding the appointment of a trustee of a cover register that must be fulfilled by a bank that intends to issues mortgage bonds and municipal bonds;

- the Regulation on the coordination of the cover pool with issued mortgage bonds and municipal bonds, which now states that the calculation of the present value of collateral and mortgage bonds and their comparison, as well as stress testing, are carried out in at least one-month intervals. A bank must also now ensure that the current value of the cover pool exceeds the current value of mortgage bonds by at least 2%; and

- the Regulation on the conditions for including derivatives in the cover pool of mortgage bonds and municipal bonds, which defines the unchanged maximum amount of derivatives that are included in the cover pool at 12% (calculated as the ratio of claims arising from derivatives and total outstanding liabilities) and the conditions for their inclusion.

Also published in the same month were the new Regulation on the books of account and annual reports of banks and savings banks, the new Guidelines for compiling the statement of financial position, income statement and statement of comprehensive income, and calculating the performance indicators of banks and savings banks and a new Regulation on the reporting of individual facts and circumstances of banks and savings banks. The changes were a result of the abolition of the reporting of banks and savings banks according to the prescribed chart of accounts, and a result of the transition to the new matrix reporting system in accordance with the Guidelines for implementing the regulation on reporting by monetary financial institutions.

To ensure the readiness of the deposit guarantee system for the payment of guaranteed deposits by short deadlines as set out in the ZBan-1, the Regulation amending the regulation on the deposit guarantee system was amended in April. The amendments redefined in detail the tasks of the receiving bank in the process of paying guaranteed deposits in the event of the bankruptcy of a bank or savings bank. They also introduced the mandatory readiness potential of receiving banks, as defined by the Bank of Slovenia, so that those banks would be ready in advance for the obligations relating to assumed guaranteed deposits.

The new Regulation on the reporting of Member State bank branches was published in May due to the abolition of reporting according to the prescribed chart of accounts and reporting for the purpose of financial accounts statistics, due to new requirements regarding the reporting of financial assets for which clients are more than 90 days in arrears (according to the Guidelines for implementing the regulation on the assessment of credit risk losses of banks and savings banks from April 2012), and owing to the amendment to the content of the half-yearly report on guaranteed deposits.

In September the Bank of Slovenia adopted another new Regulation on the reporting of individual facts and circumstances of banks and savings banks, for the purpose of harmonisation with guidelines relating to the reporting of earnings, by which the EBA laid down precise rules regarding the collection of information and data on earnings, and standardised reporting forms used by Member States to submit the aforementioned information and data.

The Regulation on the deposit guarantee system was amended in October, with the updating of technical and substantive requirements for the uniform reporting of data by individual depositor for reporting by banks on guaranteed deposits and depositors, and for verifying the functioning of the system in the event of the bankruptcy of a bank or at the request of the Bank of Slovenia.

New Guidelines for compiling the statement of financial position, the income statement and the statement of comprehensive income, and for calculating performance indicators of banks and savings banks were published the same month as a result of the adaptation of the methodology to the new technical reporting standard as it relates to financial statements.

In December the Bank of Slovenia adopted amendments to the Regulation on the calculation of the own funds of banks and savings banks, the Regulation on the calculation of capital requirements for credit risk under the standardised approach for banks and savings banks, and the Regulation on credit protection. These are counter-cyclical regulatory incentives aimed at supporting the restructuring of the real sector in the scope of discretionary options, and comprise the following:

In the scope of discretionary options provided by the law, the Bank of Slovenia also supports the process of restructuring the real sector through changes to implementing regulations.

- an extension of the period during which banks are not required to deduct from own funds capital investments in other credit and financial institutions and management companies that they have acquired in a financial restructuring procedure. Currently this allowance is not used at banks;

- the introduction of a discretionary measure by which parent banks in a banking group are not required to include investments in institutions included in consolidation as deduction items in the calculation of own funds on a solo basis, but are allowed to include such investments in the calculation of risk-weighted assets. Calculations indicate that this amendment of the regulation will bring an improvement in the overall capital adequacy ratio on a solo basis for banks at the head of banking groups. The requirements to meet the overall capital adequacy ratio on a consolidated basis remain unchanged for the parent bank, which is the key to ensuring capital integrity in the banking group;

- the acceptance of provisional entries of a mortgage as evidence of legal certainty in the recognition of the effects of real estate collateral. The banks will include real estate as eligible collateral in the calculation of capital requirements for credit risk based on the entry itself, as the registration of a mortgage remains an overly protracted process;

- the use of the Surveying and Mapping Authority's generalised market value as the basis for the valuation of real estate in the calculation of capital requirements for credit risk. The option of using a generalised market value, which represents a simplification in the procedure for determining the value of real estate, is limited to residential real estate valued at up to EUR 500,000; and

- the abolition of the use of mortgage loan value in the determination of an exposure secured by commercial real estate in Slovenia. Mortgage loan value represents the estimated long-term market value of real estate, which is difficult to determine in an unstable economic situation and can consequently lead to errors in the valuation of real estate over time.

Licensing

In its role of supervisor of the banking system the Bank of Slovenia is competent and responsible for conducting comprehensive oversight at banks, part of which is the granting of authorisations for various banking operations. Oversight begins at each credit institution or bank with the issue of the requisite legally prescribed authorisations to pursue banking activities (financial services), to hold significant (qualifying) holdings and to hold office as a management board member.

In 2012 the Bank of Slovenia issued authorisations to acquire a qualifying holding in a bank, to provide ancillary financial services, to issue municipal bonds, to merge a bank, and to hold office as a member of a bank's management board.

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

The Bank of Slovenia issued a total of 21 authorisations in 2012, and suspended the authorisation procedure for five applications. Most authorisations (twelve) issued in 2012 were to hold office as a member of a bank's management board, three were to provide ancillary financial services, two were to merge one bank with another bank, and one was to acquire a qualifying holding in a bank. One authorisation was issued to issue municipal bonds, while two related authorisations were issued to provide cover pool trustee transactions. The number of authorisations issued in 2012 was up seven on the number issued in 2011, when nine of the 14 authorisations issued were to hold office as a member of a bank's management board. The Bank of Slovenia revoked two authorisations to acquire a qualifying holding in a bank in 2012, because the holders no longer satisfied the conditions defined by regulations that owners of a significant holding should permanently satisfy.

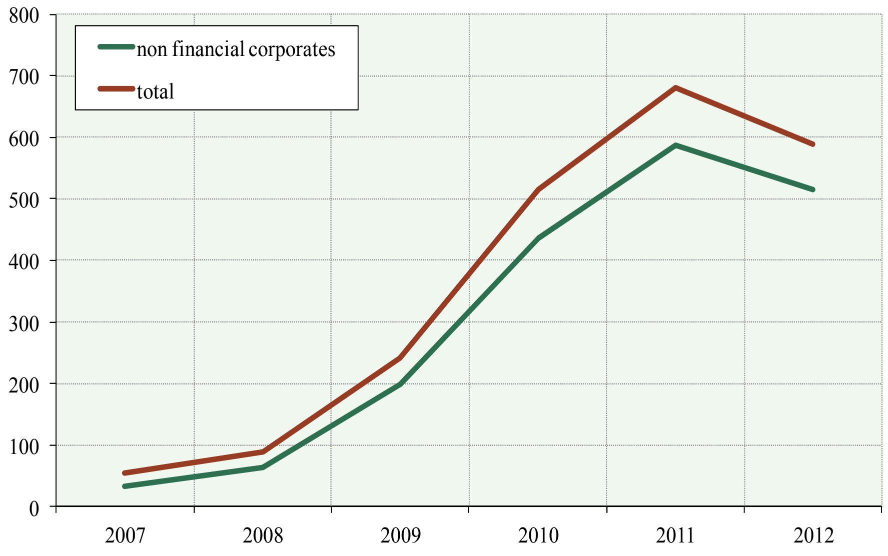
The Bank of Slovenia received 16 notifications in 2012 of the direct provision of services in Slovenia by banks of Member States.

Pursuant to Directive 2006/48/EC (previously: Directive 2000/12/EC) and Annex I (List of activities subject to mutual recognition), a Member State bank that is entitled to provide banking services and other (mutually recognised) financial services may also provide these services in Slovenia. It may provide them via a branch (*in the case of permanent pursuit of business activities*) or directly (*in the case of occasional provision of services without elements of permanent presence in Slovenia*) without an authorisation from the Bank of Slovenia, which must be provided with a written notification by the relevant supervisory authority in the home Member State. The Bank of Slovenia received 16 notifications of the direct provision of banking and other mutually recognised financial services in 2012 (compared with 22 the previous year). A list of banks of EU Member States that have carried out the notification procedure for the provision of banking services and other financial services in Slovenia via their home banking supervisors is available on the Bank of Slovenia's website. Different arrangements apply to banks of third countries. Banks from third countries may only provide banking and other (mutually recognised) financial services via a branch, where the authorisation of the Bank of Slovenia is required for the establishment of a branch. When granting such authorisation, the Bank of Slovenia may request that a bank of a third country deposit a specific sum of cash or other eligible collateral in Slovenia, or provide other appropriate collateral as a guarantee for the settlement of liabilities from transactions concluded in Slovenia.

Examinations of banks and savings banks

The consequences of several years of adverse economic conditions, which deteriorated even further in 2012, and the lack of confidence that still dominates the financial markets have an increasingly more significant impact on the banks' operations. The number of non-performing investments and arrears in the repayment of mature claims are rising due to the downgrading of corporates, a higher number of bankruptcies (see Figure 29) and growth in the number of unemployed. Costs to cover incurred and expected losses are therefore rising excessively. The banking system as a whole generated a loss for the third consecutive year, while the banks' capital is being absorbed by non-performing investments and operating results. All of this, together with the downgrading of Slovenia, has a significant impact on access to

Figure 29: **New bankruptcy procedures**



Source: Ajpes.

funding abroad and in Slovenia. Beside debt repayments to foreign banks over the last several years, government, corporate and household deposits were also reduced in 2012. The banks have compensated the reduced sources by borrowing at the ECB.

Given the situation in the banking system, the priorities of banking supervision in 2012 were the monitoring of increasing credit risk and the deteriorating liquidity at the banks, and achieving the required level of capital. Banking supervision is carried out continuously, primarily by analysing risks on the basis of periodic reports (daily, monthly, quarterly, half-yearly and yearly) submitted to the supervisor by the banks. Supervision is also carried out through on-site prudential and thematic examinations at the banks. Prudential examinations of banks usually focus on specific areas of operations. In accordance with the banking supervision methodology, the entire operations of an individual bank are examined over a three-year period, while areas of operations that supervisors assess as higher-risk are examined more frequently. The emphasis of thematic examinations of banks is on compliance with legislation or best banking practices, determined for individual products or even individual transactions at a specific bank or several banks. Changes to regulations, applicable to all banks, are frequently adopted on the basis of findings and conclusions from thematic examinations. The scope and content of examinations are determined primarily with regard to the material significance of specific risks at the bank, and the size and importance of the bank relative to the banking system as a whole. In procedures initiated in 2012 and procedures initiated prior to that, the Banking Supervision Department carried out:

- 13 prudential examinations which covered specific risk areas (e.g. credit, liquidity, market, operational, interest rate, capital and liquidity risks) and the control environment, and checks on compliance with legislation,
- 30 follow-up examinations to review the implementation of measures,
- 26 thematic examinations,
- two examinations in cooperation with other domestic supervisors (ISA and SMA), and
- two examinations of other non-banking entities due to suspicion of the performance of banking activity.

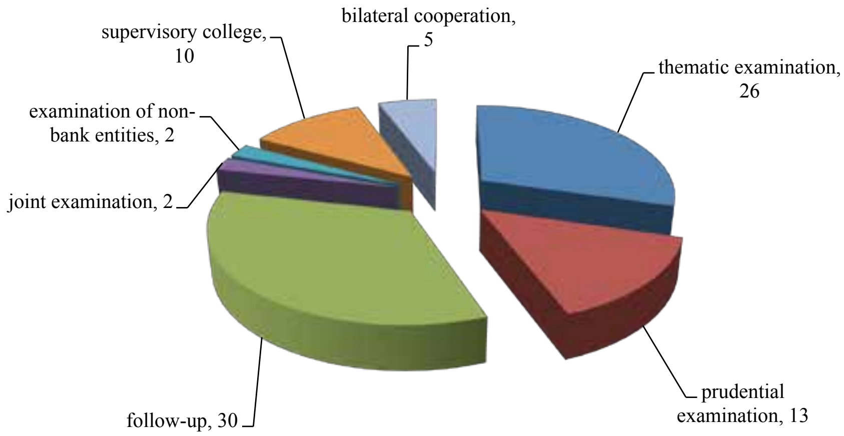
Supervision is also carried out by participating in supervisory colleges and in other forms of bilateral cooperation between supervisors (e.g. final meetings following examinations, cooperation in the implementation of the measures for banking groups or individual banks from a group for which supervisors are jointly responsible, etc.). Bank of Slovenia supervisors participated in 15 procedures with other supervisors in 2012, as follows:

- eight supervisory colleges of internationally active banking groups, whose subsidiary banks operate in Slovenia;
- two supervisory colleges for Slovenian banks with bank subsidiaries in other countries, where the Bank of Slovenia, as the home supervisor of the group in question, acted as the organiser of the colleges; and
- five other bilateral supervisory procedures.

The credit risk faced by banks is rising. The majority of open measures thus relate to this area.

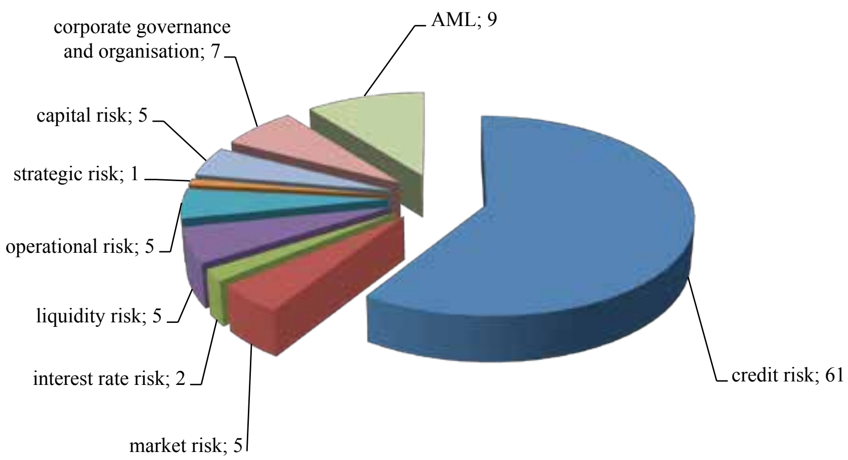
Based on the findings of examinations and reviews at banks and savings banks, the Bank of Slovenia may issue recommendations, admonishments or orders, or another measure in accordance with the Banking Act. There were 18 orders to eliminate violations issued in 2012, along with 56 admonishments and 64 additional reporting requirements and recommendations to improve operations, and conditions for the granting of authorisations. The majority of measures were issued in

Figure 30: **Supervisory procedures in 2012**



Source: Bank of Slovenia.

Figure 31: **Supervisory provisions in 2012**



Source: Bank of Slovenia.

the area of credit risk: of 103 points issued in orders and admonishments, 61 primarily relating to the creation of additional impairments and to improvements to the credit risk management system, in particular for the establishment of appropriate internal controls. Liquidity risk, operational risk, market risk and capital risk followed in terms of the measures imposed. Numerous measures were also issued because of breaches of legislation governing the prevention of money laundering and terrorist financing (11 measures). More attention in banking supervision was also given to the governance and management of banks in 2012, as the crisis causes inappropriate decisions and misconduct of banks, and thus requires truly experienced and professional personnel on the management boards and supervisory boards of banks. The Bank of Slovenia imposed measures on seven banks in 2012 relating to conduct and the fulfilment of the conditions to serve as a member of the management board or supervisory board of banks:

- demands for the dismissal of eight supervisory board members who did not possess the required expertise and necessary experience for the supervision of banks;

- admonishments of four management board members for inappropriate conduct in connection with the management of banks, and

- two decisions to dismiss two management board members for repeated violations.

Cooperation with other competent authorities in Slovenia

The Bank of Slovenia cooperates with other competent authorities in Slovenia when irregularities that surpass the competences of banking supervision are identified. In 2012 the Bank of Slovenia filed charges in three cases with the National Bureau of Investigation and charges in one case with the Ljubljana Police Department due to suspicion of criminal acts. At the invitation or request of other authorities, the Bank of Slovenia cooperated with the State Prosecutor General in two matters, the National Bureau of Investigation in seven matters, and in two matters with the Maribor Police Department and the Office for the Prevention of Money Laundering, and in one matter with the Commission for the Prevention of Corruption, by providing data and information relating to banking supervision.

Box 4: **Review of matters entrusted to the competent authorities, and the Bank of Slovenia's participation in the proceedings of other bodies**

- **2011**

The Bank of Slovenia filed charges in two cases with the State Prosecutor's Office in Ljubljana and charges in one case with the State Prosecutor's Office in Maribor, and sent a notice on the suspicion of corruption to the Commission for the Prevention of Corruption. It cooperated five times with the Office for the Prevention of Money Laundering, in relation to one procedure with the General Police Directorate, three times with National Bureau of Investigation, and once with each of the following agencies: the Ljubljana Police Department, the State Prosecutor's Office in Ljubljana, the District Court in Ljubljana, the State Prosecutor General of the Republic of Slovenia and the Ministry of the Economy.

- **2010**

The Bank of Slovenia Ljubljana filed charges in one case with the Ljubljana Police Department. It cooperated three times with the Office for the Prevention of Money Laundering, and once with each of the following agencies: the National Bureau of Investigation, the Tax Administration of the Republic of Slovenia and the State Prosecutor's Office in Celje.

- **2009**

The Bank of Slovenia filed charges in one case with the State Prosecutor General of the Republic of Slovenia, and cooperated once with the Murska Sobota Police Department and once with the Office for the Prevention of Money Laundering.

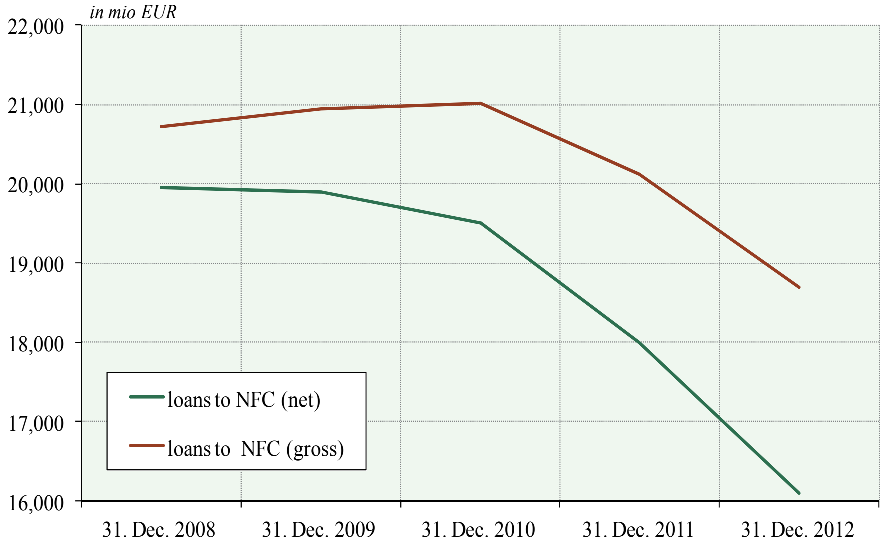
- **2008**

The Bank of Slovenia cooperated with the Commission for the Prevention of Corruption in one case.

Annual assessment of risks and capital

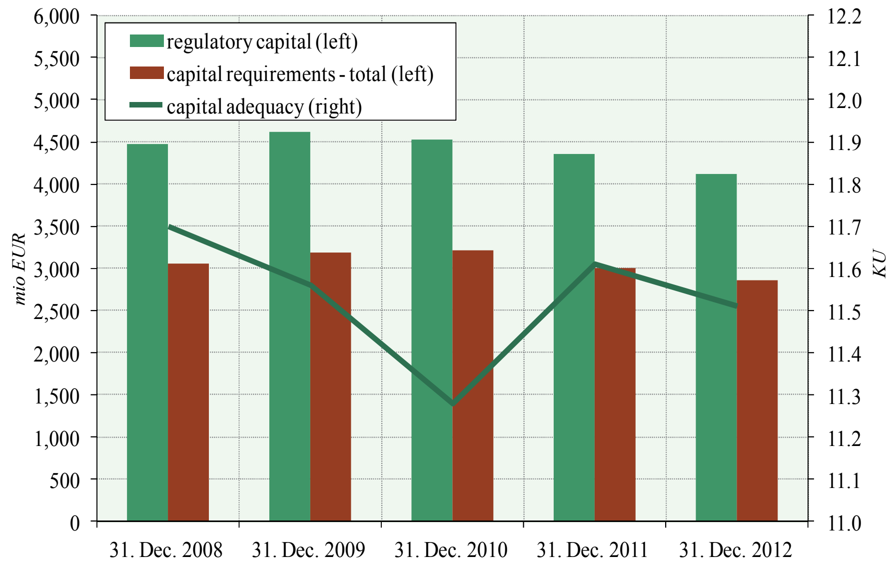
An important element of banking supervision is the regular annual review and assessment of risks and capital at all banks. The objective of this process, which takes the form of a dialogue between the bank and supervisor, is for the supervisor to determine a *minimum level of capital adequacy* for each bank with regard to the scope and level of risks that it is exposed to. The banks are bound to maintain this level of capital adequacy at all times in their operations. The results of this procedure, which was carried out in the middle of 2012, indicate that the overall risk

Figure 32: **Stock of loans to NFCs as at the final day of the year**



Source: Bank of Slovenia.

Figure 33: **Capital adequacy of banks and savings banks**



Source: Bank of Slovenia.

Banks are adjusting their strategies: they are mitigating operating risks by reducing lending to corporates and households, and are directing their investments to lower-risk transactions.

assessment deteriorated at all banks in 2012. Strategic risk was again assessed as the highest risk. Liquidity risk and capital risk increased due to the uncertainty on the financial markets and more difficult access to funding, while credit risk also increased owing to the deteriorating economic situation and the downgrading of corporates. Such conditions force the banks to adjust their business strategies: banks are shifting to safer/riskless investments, reducing the scope of operations, tightening loan approval criteria and withdrawing from non-strategic investments and markets. Similar to 2011, the most significant decrease in 2012 was recorded in the stock of loans to corporates (by EUR 1,891 million, of which EUR 465 million was due to the creation of additional impairments; see Figure 32). Growth in loans to household, which have continued to increase in recent years, also slowed considerably in 2012. The stock of household loans declined by 48 million in 2012 relative to the previous year. The results of these adjustments in the banks' operations were also seen in a decrease in assessed capital requirements by EUR 110 million (see Figure 33) in 2012. However, the internal assessment of capital was also down due to losses generated. It was thus determined during the review and assessment of risks and capital (for the situation on the cut-off date of 31 March

2012) that five banks did not meet the required capital adequacy ratio. These banks were instructed to draft a plan of activities to increase their capital or reduce the risks associated with operations, in order to meet the prescribed level of capital

adequacy. Supervisors regularly monitored the implementation of planned activities to meet capital adequacy requirements at the banks in question.

The Bank of Slovenia processed ten applications in 2012 for authorisations relating to the fulfilment of the required characteristics for the inclusion of financial instruments in the calculation of own funds, in particular the repayment of subordinated debt classified as additional own funds, the inclusion of subordinated debt in additional own funds, the redemption of a hybrid instrument, and the inclusion of a hybrid instrument in Tier 1 capital.

According to scenarios drawn up by the supervisor, all Slovenian banks calculate the effects of the deterioration in operating conditions, while the largest banks are also included in the stress tests of the European Banking Authority.

The assessment of the effect of a potential, sudden and extraordinary deterioration in the general situation or the impact of individual factors on banks' operations has become an element of the regular supervisory activities. When performing annual micro stress tests, the supervisor determines the deterioration in operating conditions, which the banks take into account in determining the impact on their operations. Stress tests are carried out so that sudden negative effects are taken into account when ensuring the necessary capital at banks, so that the banks have sufficient capital available to mitigate negative effects, so that the areas where major losses could occur at the banks are identified, and so that risks are mitigated through appropriate measures, thus limiting potential losses that could arise. The two most important Slovenian banks were also included in the stress test drafted by the European Banking Authority, which included 61 cross-border functioning and systemically important European banks. The European Banking Authority (EBA) also established the criterion by which the banks must maintain a Tier 1 capital adequacy ratio of at least 9%. Banks not meeting this criterion were obliged to draft a programme of activities to achieve the required criterion, and subsequently report on activities carried out to that end. According to the calculation of the effects of the EBA's scenario on capital, two Slovenian banks did not meet the required capital adequacy criterion. The Banking Supervision Department monitored all of the activities of banks aimed at fulfilling capital requirements. Both banks had enhanced their capital position by the end of the year by issuing contingent convertible (CoCo) bonds and reducing the scope of their operations. However, due to the further deterioration of the economic situation, both banks were forced to create additional impairments and provisions for non-performing investments in their 2012 financial statements, which increased the loss generated by both banks and lowered their capital below the legally prescribed limit. The capital adequacy threshold was thus reached, which requires the conversion of hybrid instruments (CoCo bonds) into capital.

The purpose of stress tests at the European level is also to identify links and potential cross-border effects in cases when difficulties in the operations of cross-border functioning banks could cause disruptions in the functioning of the financial systems in several Member States. In depth cooperation between the competent supervisors of Member States in crisis conditions is required to effectively resolve such situations. According to the European capital directive, it is the responsibility of the supervisor in the home country of a banking group to conclude a memorandum of understanding with the competent supervisors of other Member States in crisis conditions. At the initiative and under the organisation of Austrian supervisors, a memorandum of understanding in crisis conditions was signed in 2012 by all the institutions responsible for banking supervision from seven Member States. In the scope of the tasks set out in the aforementioned MoU, the first simulated crisis exercise, in which all the signatories of the MoU participated, was organised in the middle of 2012.

Cooperation with foreign supervisors

Cooperation between supervisors is carried out primarily via supervisory colleges of banking groups

For the banks under majority foreign ownership, frequent and ongoing cooperation with foreign supervisors is established within supervisory colleges which, in accordance with the provisions of the European capital directive, have recently assumed an increasingly important role in the exchange of information of relevance to supervisors of an individual banking group, in the coordination of supervisory activities, and approving the joint risk assessment decision of the banking group and the required capital and its allocation within the group. Managing supervisors and examiners responsible for individual banks regularly participate in supervisory colleges for individual international banking groups. The Bank of Slovenia participates in six supervisory colleges for the following banking groups: the Austrian banks Erste, Raiffeisen and Volksbank, the Italian banks UniCredit and Intesa Sanpaolo, and the French bank Societe General. For the operational functioning of these supervisory colleges the Bank of Slovenia has signed the relevant multilateral agreements with all other supervisors involved in supervision of the group. In the scope of supervisory colleges for all six foreign banking groups, which are managed by the supervisors of the banking group's parent bank and where the Bank of Slovenia participates as host supervisor responsible for a subsidiary bank, a joint decision on the capital adequacy of the banking group and of individual banks within the group was reached by all competent supervisors in 2012.

The Bank of Slovenia, as consolidated supervisor, is responsible for organising and chairing the supervisory colleges for the Slovenian banking groups of Nova Ljubljanska banka and Nova kreditna banka Maribor. The last two meetings of the supervisory colleges in October 2012 involved representatives of the supervisory institutions in the seven countries where the two banks have subsidiaries. At the supervisory colleges of both banking groups, the joint risk assessment and the joint decision on the capital adequacy of the banking group, taking into account the capital requirements of a specific bank, were adopted in cooperation with all supervisors from other countries.

In addition to cooperating with supervisors from other countries in the scope of supervisory colleges, the Banking Supervision Department also maintained bilateral contacts with certain supervisors on the basis of bilateral memorandums of understanding (the Bank of Slovenia has MoUs with the foreign supervisory institutions of the following 13 countries: Austria, Belgium, Bulgaria, Bosnia and Herzegovina, Montenegro, France, Italy, Macedonia, Germany, the Netherlands, Republika Srpska, Serbia and the United States) with the aim of directly exchanging information on individual subsidiaries and conducting joint examinations at banks. Bank of Slovenia supervisors cooperated with two foreign supervisors during three joint examinations in 2012.

Financial stability

The Bank of Slovenia continued its regular monitoring and analysis of the financial stability of the Slovenian financial system in 2012. Systemic supervisory measures and activities to maintain the stability of the financial system, as described in section 2.2.1, are adopted on the basis of analyses of financial stability and findings from banking supervision. A comprehensive analysis of the Slovenian financial system in terms of exposure to various risks was published in the spring Financial Stability Review. Macro stress tests were used in the autumn to determine the stability of the Slovenian banking system in the event of possible shocks. The publication Stability of the Slovenian Banking System, presenting the main risks to which the Slovenian banking system is exposed, was released at the end of 2012. In addition to the aforementioned analyses by the Financial Stability Department, the Bank of Slovenia continued with the regular monthly analysis of the performance of the banking system in 2012, and continued to act within the European Systemic Risk Board.

Financial Stability Review, May 2012: deteriorating quality of the credit portfolio, the over-indebtedness of companies, slow growth in deposits by non-banking sectors and high losses incurred by banks.

The Financial Stability Review analysed the changes and significant risks associated with the financial system in 2011 and early 2012. The deteriorating situation in the Slovenian economy was increasingly reflected in the activities of banks and the quality of the credit portfolio. Corporates were overly indebted and highly dependent on bank loans, while their leverage decreased slowly or remained almost unchanged. The poorly developed Slovenian capital market did not constitute an alternative for corporate financing. The deterioration in the quality of the credit portfolio, expressed as a proportion of total claims, is not merely the result of a rise in the proportion of claims against debtors in arrears, but also of a sustained decline in the banks' lending activity. It was determined that the banks should cooperate more actively with each other and with corporates in their commercial and financial restructuring efforts. Additional uncertainty is brought to the banking sector by slow growth in deposits by non-banking sectors and debt repayments to the rest of the world. The banking system's refinancing risk and liquidity risk were somewhat reduced by non-standard ECB operations. The banks' income risk remained high. The banks generated high aggregate losses in 2011 primarily as a result of the decline in net interest income and high impairment and provisioning costs, which reduced their ability to generate capital internally. The Financial Stability Review finds that, in order to successfully confront the crisis, changes are also required to the legal framework of the environment, in which businesses operate, as well as changes in corporate governance and the business models of corporates and banks, and in the legal relations between creditors and the owners of companies. The publication also analysed other financial corporations (insurance corporations, investment and pension funds, and leasing companies) and movements on the capital markets. The functioning of payment and settlement systems was also presented, from the point of view of risk management.

The publication *Macro Stress Tests for the Slovenian Banking System* presented forecasts for the banking system's balance sheet until the end of 2014. Shocks of a rise in interest rates, a decline in GDP growth, and a simultaneous rise in interest rates and lower economic growth were simulated. A piecewise approach was used to analyse refinancing risk, the market risk of a change in government securities prices, credit risk and the risk of infection.

Stability of the Slovenian banking system, December 2012: contraction in total assets, decline in lending, persistently high corporate leverage, repayments to foreign creditors, high income risk.

The Stability of the Slovenian Banking System analysed the risks associated with the banking system in the first three quarters of 2012. The risks faced by Slovenian banks during the observation period were affected by declining economic activity, a contraction in investment spending, a decline in household and government consumption, and by the slowing of economic growth in the EU and a lack of confidence on the part of the international financial markets in Slovenian long-term government debt. The Slovenian banking system's total assets were down EUR 2 billion in the nine months covered by the report. The decline in the volume of loans to non-financial corporations continued, while housing loans achieved low growth. The report finds that the banks could offer lower-risk clients with perspective projects relatively lower risk premiums, and thus lower interest rates. The over-indebtedness of corporates relative to equity remains high at 144%. The slow reduction in corporate leverage was a result of the decline in the value of capital and the negligible scope of recapitalisations. The banks made net debt repayments to foreign creditors and net repayments of securities, which diminished their lending potential. Repayments to foreign creditors were compensated in part by 3-year loans from the Eurosystem. Refinancing risk remained high due to limited access to the international financial markets and owing to the possible downgrading of Slovenia. Non-performing claims rose to more than 14% of total classified claims. The proportion of claims against corporates in bankruptcy rose with the increase in the number of bankruptcy proceedings initiated. The report finds that the negative impact of the spread of payment indiscipline among corporates could be mitigated through the more coordinated resolution of the financial difficulties of perspective corporates, supported by increased legal protection for creditors from irresponsible and financially strapped owners. Income risk was high due to the decline in lending and the deterioration in the quality of the portfolio. The Tier 1 capital adequacy ratio had risen to more than 10% by September 2012. The banks met capital requirements primarily by reducing the scope of operations and repurchasing subordinated debt. The report emphasises that the problem of accessing sources of funding and maintaining sufficient capital strength remain the focus of the banks' attention.

2.2.2 Payment services for Bank of Slovenia clients

The Bank of Slovenia administers accounts and provides payment services for clients.

The area of payments services is an integral part of the harmonisation of the European market, which also includes the establishment of the Single Euro Payments Area (SEPA). The payment instruments used within the SEPA have different standards and different rules than those applied to payment instruments within individual national banking systems. Slovenia ceased the processing of national payment instruments (e.g. direct debits and direct credits: pensions, wages of public employees, social transfers, etc.) in 2012, and replaced them with SEPA payment instruments (SEPA credit transfers and SEPA direct debits). This also applies to Bank of Slovenia clients, for which the migration to SEPA payment instruments was completed.

Administration of budget user accounts

The Bank of Slovenia administers the government's single treasury account and 195 standard municipal treasury accounts, open in a number of currencies. The accounts of direct and indirect spending units of the state budget and municipal budgets, the Health Insurance Institute and the Pension and Disability Insurance Institute (included in the single treasury account system as set out in the Public Finances Act) were opened as sub-accounts of the government or municipal treasury accounts. The sub-accounts are administered by the Public Payments Administration, to which direct and indirect spending units of the state budget and municipal budgets submit payment orders and from which they receive the full set of feedback about payments transacted.

In 2012 there were EUR 75.330 billion of inflows and EUR 75.332 billion of outflows processed through the government's single treasury account, and EUR 37.860 billion of inflows and EUR 37.853 billion of outflows processed through municipal treasury accounts.

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

Administration of accounts for the KDD and KDD members

The Bank of Slovenia administers a guarantee fund cash account and a fiduciary account for the custodian services of the Central Securities Clearing Corporation (KDD). In addition, the Bank of Slovenia also administers the accounts of KDD members via which cash settlements are made for securities transactions. At the end of 2012, there were 18 KDD members, namely 12 commercial banks and six investment firms, with open transaction accounts for customer funds and clearing accounts at the Bank of Slovenia.

EUR 2.511 billion of inflows and EUR 2.511 billion of outflows were processed through the accounts of the KDD and its members in 2012.

Administration of accounts for foreign financial institutions and EU institutions

The Bank of Slovenia also administers accounts for foreign financial institutions and EU institutions, via which inflows of EUR 941.4 million and outflows of EUR 950.6 million were processed in 2012.

2.2.3 Risk management at the Bank of Slovenia

Risk management is an administrative process that includes the planning, organisation, management and control of resources in a cost-efficient manner with the aim of maintaining risks within permitted limits and limits acceptable for the Bank of Slovenia. All Bank of Slovenia employees are included in the risk management process. Risk management at the Bank of Slovenia is in line with ECB/ESCB guidelines and methodologies, and also takes into account the principles and guidelines of ISO 31000 as appropriate.

The Bank of Slovenia's risk management system has a clear organisational structure, and predefined competences and powers. Control over the functioning of the system ensures that the key risks to which the Bank of Slovenia is exposed are identified in a timely manner, assessed and managed.

The risk management framework and policy are set by the Governing Board of the Bank of Slovenia, which is directly responsible for strategic risk and reputation risks. The Crisis Management Group and the Liquidity Committee function in the area of risks associated with financial stability, while the management of financial risks is carried out via the Investment Committee.

Operational risk management is guided and supervised by the Operational Risk Committee, which is responsible for managing risks associated with business continuity and operational risks, and for ensuring information and physical-technical security.

The Bank of Slovenia continued its planned implementation of an operational risk management policy. An assessment of the criticality of business processes was drafted and served as the basis for identifying and analysing operational risks, while specific plans were drawn up to manage identified risk. No incidents and related loss events were recorded. The operational risk management process includes supervision of the implementation of measures to mitigate risks. It also includes the maintenance of an operational risk register and register of incidents and related loss events, as one of the sources for the continuous improvement of the functioning of the operational risk management system at the Bank of Slovenia.

2.2.4 Management of the Bank of Slovenia's financial investments

The Bank of Slovenia's financial investments include all of its financial assets not related to the implementation of monetary policy. They comprise financial investments denominated in domestic and foreign currencies. The value of the Bank of Slovenia's financial investments as of 31 December 2012 stood at EUR 5,493.3 million, of which EUR 4,771.1 million were financial instruments, which are either claims against euro area residents or claims against non-euro residents denominated in euro. These include EUR 4,281.8 million of investments in capital market instruments, EUR 144.1 million in money-market instruments and EUR 345.2 million in cash and deposits. In addition, EUR 722.2 million was invested in financial instruments, which are claims against non-euro area residents denominated in noneuro and meet the criteria of international monetary reserves. The extent of financial investments also depends on the level of liabilities to the Eurosystem.

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

In EUR million	Financial investments of the Bank of Slovenia		
Balance as of:	Investments in euros and all investments in instruments of euro area issuers	International monetary reserves	Total
31. Dec 2009	4,118.7	749.1	4,867.7
31. Dec 2010	4,242.5	803.2	5,045.7
31. Dec 2011	4,824.7	766.8	5,591.5
31. Dec 2012	4,771.1	722.2	5,493.3

Source: Bank of Slovenia.

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

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

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

The currency exposure of the Bank of Slovenia's financial investments and the limits on permitted deviations are prescribed by the criterion for managing currency risk. The currency structure criterion lays down a target currency structure for Bank of Slovenia investments. In 2007 the foreign exchange swap was added to the list of eligible instruments, which allows for exposure to instruments denominated in foreign currencies, while hedging against changes in the exchange rate itself. In this manner, the Bank of Slovenia hedged its foreign currency exposure in January 2008, with the exception of the portion of investments representing the amount potentially activated into international monetary reserves by the ECB. The criterion for managing interest rate risk specifies the modified duration and lays down the maximum deviation from its target value. The criterion for managing liquidity risk specifies a minimum amount of liquid assets. The *Criteria for managing the Bank of Slovenia's financial investments* also set out the terms for securities lending and other activities. The Bank of Slovenia's investment policy must comply with the Article 123 of the Treaty on the Functioning of the European Union, which prohibits the monetary financing of EU public sector institutions. The prohibited forms of financing include investment deposits, reverse repos and purchases of primary-issue debt securities, commercial papers and certificates of deposit if the issuer is an EU public sector institution, while investments related to these institutions are permitted on the secondary market within a prescribed limit for each country. The management of the Bank of Slovenia's financial investments was carried out in line with both the *Guidelines for managing the Bank of Slovenia's financial investments* and the *Criteria for managing the Bank of Slovenia's financial investments* in 2012. More detailed information on the structure of the international monetary reserves as of 31 December 2012 is given in the section on the financial statements.

2.2.5 International cooperation

European Union

The Governor of the Bank of Slovenia participated in informal sessions of ECOFIN (meetings of finance ministers, with the governors of the central banks of EU Member States in attendance) in 2012, and in sessions of the General Board of the European Systemic Risk Board (ESRB), which takes decisions necessary for the performance of tasks entrusted to the ESRB. The ESRB is responsible for the macro-prudential supervision of the financial system of the EU as a whole, and for monitoring and assessing risks to its stability.

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

In addition to the ESRB, the new European structure for financial sector supervision in the EU also comprises the European Banking Authority (EBA), which is one of the three European supervisory authorities. On 1 January 2011 the EBA assumed all of the functions and responsibilities of the Committee of European Banking Supervisors (CEBS), and took on new competences and powers. The vice-governor responsible for banking supervision and financial stability attended sessions of the Committee of Supervisors, while employees from the Banking Supervision Department attended sessions of the EBA's committees and working groups.

In 2012 the employees of other Bank of Slovenia departments also attended sessions of committees, working groups and other bodies that are active within the institutions of the EU with a focus on financial and monetary matters: meetings of the Economic and Financial Committee (EFC) and its sub-committees, meetings of the Committee on Monetary, Financial and Balance of Payments Statistics and other working groups in the relevant areas that operate within the framework of the European Commission and the EU Council.

In 2012 representatives of the European Commission and ECB met with representatives of the Bank of Slovenia in the scope of the European Semester (annual cycle of economic policy coordination). The agenda included an in-depth review of the economic situation in Slovenia in accordance with the procedure for preventing and correcting macroeconomic imbalances.

International Monetary Fund

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

At a ceremony held in Vienna on 11 July 2012, Slovenia signed an agreement on establishing the IMF's new Central and Eastern European Constituency. In addition to Slovenia, the aforementioned agreement was signed by Austria, Belarus, the Czech Republic, Hungary, Kosovo, Slovakia and Turkey. The agreement states that Turkey, the Czech Republic and Hungary will rotate the executive director position after the interim two-year period from 2012 to 2014 in which Austria will hold the position of executive director. According to the agreement, Slovenia will rotate the position of the adviser to the executive director.

Slovenia's quota is SDR 275 million, or 0.14% of the voting power at the IMF.

Slovenia's quota remained unchanged at SDR 275 million, or 0.14% of the voting power at the IMF. In accordance with Resolution 66-2 on the reform of quotas and governance, which the Board of Governors approved in December 2010, quotas will be doubled from the current SDR 238.4 billion to SDR 476.8 billion in the scope of the 14th general review of quotas. The aforementioned increase was not made in 2012, as the adopted resolution requires an amendment to the IMF's Statute, which requires ratification by at least three fifths of members accounting for at least 85% of voting power.

Since 1998 Slovenia has contributed to the financing of IMF loans under the Financial Transaction Plan (FTP). Slovenia contributed funds for lending to Ireland, Greece and Portugal in the total amount of SDR 5.1 million as part of the FTP in 2012. Slovenia's reserve tranche position at the IMF increased relative to 2011 to stand at SDR 90.6 million at the end of December 2012.

SDR 4 million was drawn in 2012 under a bilateral loan agreement signed in September 2010 between the Bank of Slovenia and the IMF. Such agreements to increase the funding of the IMF had already been signed by most European countries in 2009. The amount of Slovenia's bilateral loan is EUR 280 million, with a disbursement period of no more than four years. In December 2011 EU finance ministers agreed to further strengthen the IMF's lending capacity by means of increased contributions from euro area countries in the form of bilateral loans. Coordination regarding the new bilateral loan between the Bank of Slovenia and the IMF began in 2012.

A Financial Sector Assessment program (FSAP) was carried out in Slovenia in April.

A *Financial Sector Assessment program (FSAP)* was carried out in Slovenia between 4 April and 16 April 2012. In contrast to consultations under Article IV of the IMF Statute, the FSAP is not conducted annually, but on the basis of an agreement between the IMF and member states. The FSAP mission assessed the soundness of the financial sector and its sensitivity to systemic risks. It also examined the supervisory framework and contingency procedures. The mission met with representatives from the Ministry of Finance, the Bank of Slovenia, the Insurance Supervision Agency and the Securities Market Agency, as well as representatives from financial institutions, professional bodies and various groups of experts.

IMF representatives held their annual consultations with Slovenia under Article IV of the IMF Statute from 20 September to 2 October 2012. The members of the mission met representatives of the Bank of Slovenia, the Slovenian government, the National Assembly, the banking sector and unions, who presented macroeconomic conditions and the Slovenian government's economic policy guidelines.

In accordance with the IMF's practice, the final report of the FSAP mission was discussed by the IMF's Executive Board on 21 November 2012, together with the final report from consultations under Article IV of the IMF's Statute.

Bank for International Settlements

The Governor of the Bank of Slovenia participated in meetings of central bank governors of BIS members, which are organised every two months. The meetings discussed developments in the global economy and on the financial markets. The governors' meetings are also an opportunity to exchange views on various central banking issues, most notably financial globalisation in 2012.

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

Organisation for Economic Cooperation and Development

Slovenia became a member of the OECD in July 2010. In 2012 a Bank of Slovenia representative participated in the interdepartmental working group, while Bank of Slovenia representatives also sat on other committees and working groups (the Economic Policy Committee, the Committee on Financial Markets and the Working Group on International Investment Statistics).

OECD representatives also met with Bank of Slovenia representatives in the scope of preparations for the Economic Review for Slovenia.

Technical assistance

In 2012 the Bank of Slovenia provided technical assistance to the central banks of Serbia, Montenegro, Albania and Macedonia.

In 2012 the Bank of Slovenia provided technical assistance to the central banks of Serbia, Montenegro, Albania and Macedonia (through the *Technical Assistance Information Exchange Instrument* for the latter). The central bank of Bosnia and Herzegovina and Kosovo did not request technical assistance in 2012. Eight study visits were carried out at the premises of the Bank of Slovenia relating to financial statistics, information technology, cash operations, protocol, security and safety in the workplace, organisation and personnel. Technical assistance relating to banking supervision was provided to the central bank of Macedonia in Skopje.

The Bank of Slovenia also participated in ESCB technical assistance programmes in 2012, namely the technical assistance programme for the central bank of Serbia (relating to payment transactions and payment systems) and the central bank of Macedonia (relating to accounting). The regional Eurosystem programme *Strengthening macro-and micro-prudential supervision in EU candidate countries and potential candidates*, in which the Bank of Slovenia participated, ended in January 2012.

In cooperation with the International Monetary Fund and the World Bank, the Bank of Slovenia organised a workshop in June 2012 on the topic of resolving non-performing loans. In addition to Bank of Slovenia representatives, the workshop was attended by representatives of commercial banks, the Bank Association of Slovenia and certain ministries. The emphasis was on non-performing loans in the countries of Central, Eastern and South-Eastern Europe, on the impediments that prevent the efficient resolution of non-performing loans, and a proactive, common solution to this issue.

3 ORGANISATIONAL STRUCTURE OF THE BANK OF SLOVENIA

Governing Board of the Bank of Slovenia

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

The Governing Board comprises five members: the Governor and four vice-governors. The Governor acts as the president of the Governing Board. The Governor may authorise one of the vice-governors to be his/her deputy. As at 31 December 2012, the make-up of the Governing Board was as follows:

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

Organisational structure of the Bank of Slovenia

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

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

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

Commissions, committees and working bodies of the Bank of Slovenia

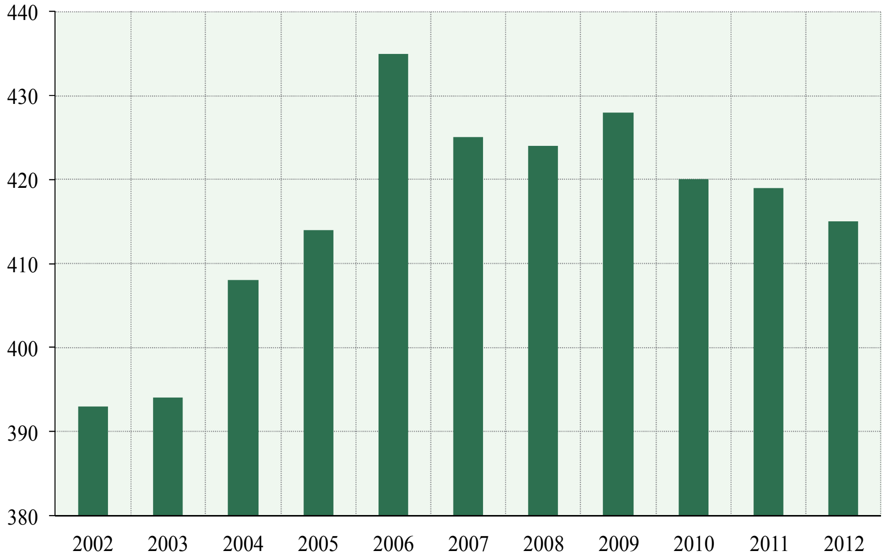
There are a total of 18 commissions, five committees and six working groups in various areas of operation functioning at the Bank of Slovenia. The most important working bodies are:

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

Employees

The Bank of Slovenia had 415 employees as at 31 December 2012.

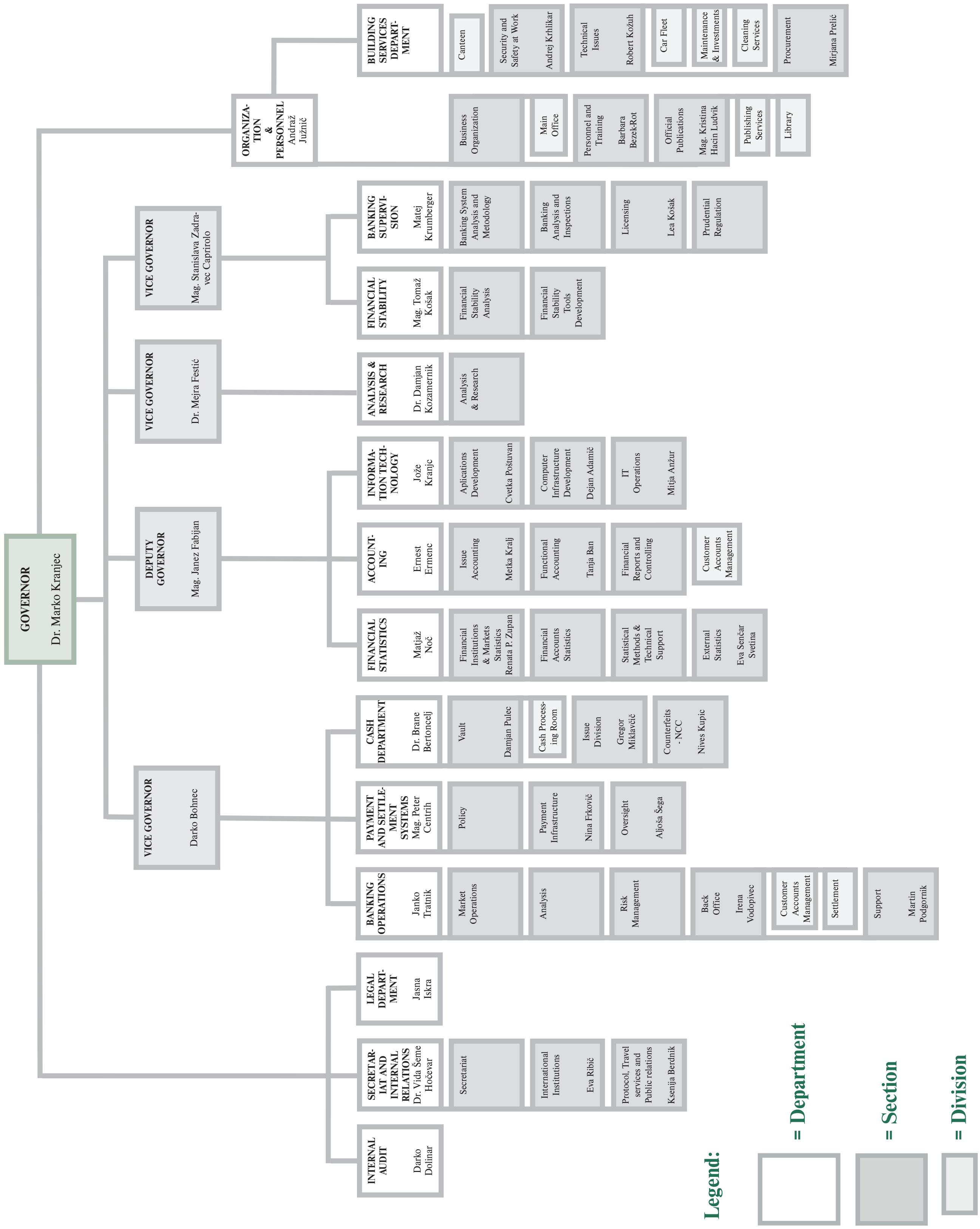
Figure 34: **Number of employees at the Bank of Slovenia as at the final day of the year**



Source: Bank of Slovenia.

BANKA SLOVENIJE
BANK OF SLOVENIA
EUROSYSTEM

Organisational structure of the Bank of Slovenia as at 31 December 2012



4 FINANCIAL STATEMENTS

Financial statements of the Bank of Slovenia for 2012

Statement of responsibilities of the Governing Board

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

. Select suitable accounting policies and then apply them consistently;

. Make judgements and estimates that are reasonable and prudent;

. State whether applicable accounting standards have been followed; and

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

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

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INDEPENDENT AUDITOR'S REPORT

To the Governing Board of the Bank of Slovenia

Report on the Financial Statements

We have audited the accompanying financial statements of Bank of Slovenia (the 'Bank'), which comprise the balance sheet as at 31 December 2012 and the income statement for the year then ended and a summary of significant accounting policies and other explanatory notes.

Responsibility for the Financial Statements

The Governing Board is responsible for the preparation and fair presentation of these financial statements in accordance with the Guideline of the European Central Bank of 11th November 2010 on the legal framework for accounting and financial reporting in the European System of Central Banks (ECB/2010/20) and articles of Law on Bank of Slovenia that are applicable for financial reporting. The Governing Board is also responsible for the level of internal control required in its opinion to prepare financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements of Bank of Slovenia as of 31 December 2012 are prepared, in all material respects, in accordance with the Guideline of the European Central Bank of 11th November 2010 on the Legal Framework for Accounting and Financial reporting in the European System of Central Banks (ECB/2010/20) and articles of Law on Bank of Slovenia, applicable for financial reporting.

DELOITTE REVIZIJA d.o.o.

Yuri Sidorovich
Certified Auditor
President of the board

Deloitte.
DELOITTE REVIZIJA D.O.O.
Ljubljana, Slovenija 3

Ljubljana, 12 March 2013

For signature please refer to the original Slovenian version.

FOR TRANSALTION ONLY – SLOVENE ORIGINAL PREVAILS

Constitution

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

Accounting policies

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

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

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

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

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

The following fundamental accounting principles have been applied:

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

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

[2] The term 'European System of Central Banks (ESCB)' refers to the twenty-seven National Central Banks (NCBs) of the member states of the European Union on 31 December 2012 plus the European Central Bank (ECB). The term 'Eurosystem' refers to the seventeen NCBs of the member states participating in the Monetary Union, plus the ECB on the same date.

[3] OJ L 35, 09.02.2011, p. 31-68. The Accounting guideline is amended by the Guideline of the European Central Bank of 21 December 2011 (ECB/2011/27), OJ L19, 24.01.2012, p. 37-50, and by the Guideline of the European Central Bank of 10 December 2012 (ECB/2012/29), OJ L356, 22.12.2012, p. 94-108.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Interim profit distribution

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

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

Provisions

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

In compliance with Article 49a of Bank of Slovenia Act, after introduction of the euro as the Republic of Slovenia’s currency, the Governing Board of the Bank may, with the intention of maintaining the real value of assets, take a decision to create general provisions for anticipated exchange rate, interest rate and price risks. Provisions may not be created if, together with the unrealised exchange rate differences, securities’ valuation effects and gold valuation effects, they exceed 20% of established net income. With the amendment of the Accounting Guideline, which entered into force as at the end

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

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

[10] Decision of the European Central Bank of 25 November 2010 on the interim distribution of the income of the European Central Bank on euro banknotes in circulation and arising from securities purchased under the securities markets programme (ECB/2010/24), OJ L 6, 11.01.2011, p. 35-36, amended by the Decision of the European Central Bank of 19 December 2012 (ECB/2012/33), OJ L 13, 17.01.2013, p.12.

of 2012, the legal background for the creation of provisions for credit risks is given. The relevant amount of provision for all such financial risks is determined annually on the basis of Value-at-Risk (VaR) method. VaR is defined as the maximum loss of portfolio with a given diversification of that portfolio at a certain level of probability (95%) and for a given holding period (one year). The provision will be used to fund future unrealised losses not covered by the revaluation accounts.

Intra-ESCB balances / Intra-Eurosystem balances
Intra-Eurosystem balances result from cross-border payments in the EU that are settled in central bank money in euro. They are primarily settled in TARGET2[11] and give rise to bilateral balances in the TARGET2 accounts of EU central banks. These bilateral balances are netted out and then assigned to the ECB on a daily basis, leaving each NCB with a single net bilateral position vis-a-vis the ECB only.

Intra-Eurosystem balances vis-a-vis the ECB arising from TARGET2, as well as other intra-Eurosystem balances denominated in euro (interim profit distribution to NCBs, monetary income results), are presented as a single net liability position and disclosed under ‘Other liabilities within the Eurosystem (net)’. Intra-ESCB balances versus non-euro area NCBs not arising from TARGET2 are disclosed either under ‘Claims on non-euro area residents denominated in euro’ or ‘Liabilities to non-euro area residents denominated in euro’.

Intra-Eurosystem claims arising from Bank’s participating interest in the ECB are reported under ‘Participating interest in ECB’.

Intra-Eurosystem balances arising from the transfer of foreign reserve assets to the ECB by the Bank at the time of joining the Eurosystem are denominated in euro and reported under ‘Claims equivalent to the transfer of foreign reserves’.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Auditing of financial statements
The financial statements were audited by Deloitte revizija d.o.o., Ljubljana, who was appointed as the external auditor of the Bank for the financial years 2012 to 2014.

Balance Sheet as at 31 December 2012

	ASSETS (thousands of euro)	31 December 2012	31 December 2011
1	**Gold and gold receivables**	**129,062**	**124,527**
2	**Claims on non-euro area residents denominated in foreign currency**	**591,634**	**641,012**
	2.1 Receivables from the IMF	387,621	388,161
	2.2 Balances with banks and security investments, external loans and other external assets	204,013	252,852
3	**Claims on euro area residents denominated in foreign currency**	**269,241**	**245,901**
4	**Claims on non-euro area residents denominated in euro**	**781,898**	**785,954**
	4.1 Balances with banks, security investments and loans	781,898	785,954
	4.2 Claims arising from the credit facility under ERM II	-	-
5	**Lending to euro area credit institutions related to monetary policy operations denominated in euro**	**3,982,160**	**1,740,000**
	5.1 Main refinancing operation	125,000	53,000
	5.2 Longer-term refinancing operations	3,857,160	1,687,000
	5.3 Fine-tuning reverse operations	-	-
	5.4 Structural reverse operations	-	-
	5.5 Marginal lending facility	-	-
	5.6 Credits related to margin calls	-	-
6	**Other claims on euro area credit institutions denominated in euro**	**49,094**	**289,450**
7	**Securities of euro area residents denominated in euro**	**3,774,162**	**3,444,066**
	7.1 Securities held for monetary policy purposes	1,097,801	1,165,377
	7.2 Other securities	2,676,361	2,278,689
8	**General government debt denominated in euro**	**-**	**-**
9	**Intra-Eurosystem claims**	**2,838,955**	**2,735,650**
	9.1 Participating interest in ECB	74,780	69,300
	9.2 Claims equivalent to the transfer of foreign reserves	189,410	189,410
	9.3 Claims related to promissory notes backing the issuance of ECB debt certificates*	-	-
	9.4 Net claims related to the allocation of euro banknotes within the Eurosystem	2,574,764	2,476,940
	9.5 Other claims within the Eurosystem (net)	-	-
10	**Items in course of settlement**	**-**	**-**
11	**Other assets**	**226,929**	**211,213**
	11.1 Coins of euro area	2,624	1,557
	11.2 Tangible and intangible fixed assets	22,610	22,285
	11.3 Other financial assets	50,376	50,921
	11.4 Off-balance sheet instruments revaluation differences	0	42
	11.5 Accruals and prepaid expenses	91,936	73,939
	11.6 Sundry	59,382	62,469
12	**Loss for the year**	**-**	**-**
	Total assets	**12,643,134**	**10,217,773**

* Only an ECB balance sheet item

LIABILITIES (thousands of euro)	**31 December 2012**	**31 December 2011**
1 Banknotes in circulation	**3,946,960**	**3,843,316**
2 Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	**1,320,335**	**1,125,711**
2.1 Current accounts (covering the minimum reserve system)	1,313,335	393,225
2.2 Deposit facility	7,000	602,486
2.3 Fixed-term deposits	-	130,000
2.4 Fine-tuning reverse operations	-	-
2.5 Deposits related to margin calls	-	-
3 Other liabilities to euro area credit institutions denominated in euro	**17,758**	**15,158**
4 Debt certificates issued	**-**	**-**
5 Liabilities to other euro area residents denominated in euro	**1,039,113**	**890,334**
5.1 General government	1,023,225	872,041
5.2 Other liabilities	15,888	18,293
6 Liabilities to non-euro area residents denominated in euro	**11,671**	**20,807**
7 Liabilities to euro area residents denominated in foreign currency	**74,883**	**71,410**
8 Liabilities to non-euro area residents denominated in foreign currency	**-**	**-**
8.1 Deposits, balances and other liabilities	-	-
8.2 Liabilities arising from the credit facility under ERM II	-	-
9 Counterpart of special drawing rights allocated by the IMF	**251,653**	**256,187**
10 Intra-Eurosystem liabilities	**4,409,285**	**2,727,622**
10.1 Liabilities equivalent to the transfer of foreign reserves*	-	-
10.2 Liabilities related to promissory notes backing the issuance of ECB debt certificates	-	-
10.3 Net liabilities related to the allocation of euro banknotes within the Eurosystem	-	-
10.4 Other liabilities within the Eurosystem (net)	4,409,285	2,727,622
11 Items in course of settlement	**-**	**-**
12 Other liabilities	**109,377**	**107,703**
12.1 Off-balance sheet instruments revaluation differences	10,641	17,754
12.2 Accruals and income collected in advance	17,721	8,176
12.3 Sundry	81,015	81,773
13 Provisions	**330,339**	**149,029**
14 Revaluation accounts	**156,343**	**162,727**
15 Capital and reserves	**843,507**	**830,665**
15.1 Capital	8,346	8,346
15.2 Reserves	835,161	822,319
16 Profit for the year	**131,910**	**17,105**
Total liabilities	**12,643,134**	**10,217,773**

* Only an ECB balance sheet item

Profit and Loss Account for the year ended 31 December 2012

thousands of euro	2012	2011
1.1 Interest income	300,671	153,464
1.2 Interest expense	-49,855	-41,243
1 Net interest income (expenditure)	**250,816**	**112,221**
2.1 Realised gains/losses arising from financial operations	50,324	51,225
2.2 Write-downs on financial assets and positions	-54	-131,463
2.3 Transfer to/from provisions for foreign exchange risks, price risks and other operational risks	-184,239	-10,928
2 Net result of financial operations, write-downs and risk provisions	**-133,968**	**-91,167**
3.1 Fee and commission income	6,110	8,039
3.2 Fee and commission expense	-2,152	-1,939
3 Net fee and commission income	**3,958**	**6,101**
4 Income from equity shares and participating interests	3,577	4,327
5 Net result arising from allocation of monetary income	29,705	8,572
6 Other operating income	4,207	4,202
Total net income	**158,294**	**44,256**
7.1 Staff costs	-18,170	-17,911
7.2 Administrative expenses	-5,546	-5,491
7.3 Depreciation of tangible and intangible fixed assets	-1,561	-1,736
7.4 Banknote production services	-391	-1,393
7.5 Other expenses	-716	-620
7 Total operating expenses	**-26,384**	**-27,151**
8 Profit (Loss) for the year	**131,910**	**17,105**

The notes on pages 14 to 34 form an integral part of the financial statements.

The unaudited financial statements were approved by the Governing Board on 19 February 2013 and these audited financial statements were approved by the Governing Board on 19 March 2013 and were signed on its behalf by:

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

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

Notes to the balance sheet

Assets

1. Gold and gold receivables

With the exception of gold stocks held in the Bank, the Bank's gold holdings consist of deposits with foreign banks. In the annual accounts gold has been valued on the basis of the euro price per fine ounce (ozf) derived from the quotation in USD established at the London fixing on 31 December 2012. This price, notified by the ECB, amounts to EUR 1,261.179 per ounce of fine gold compared with EUR 1,216.864 on 31 December 2011. Unrealised valuation gains of EUR 79.7 million (of which EUR 8.8 million from year 2007, EUR 5.5 million from year 2008, EUR 14.8 million from year 2009, EUR 29.6 million from year 2010, EUR 16.5 million from year 2011 and EUR 4.5 million from year 2012) were disclosed under the liability balance sheet item ‘Revaluation accounts’.

	000 EUR	Fine troy ounces
Balance as at 31 December 2011	124,527	102,334
Revaluation of gold stock as at end of 2012	4,535	-
Balance as at 31 December 2012	129,062	102,334

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

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

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

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

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

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

All claims are shown in the balance sheet on the basis of the market rate of SDR 1 = EUR 1.1657 (31 December 2011: SDR 1 = EUR 1.1867) calculated by the ECB at the end of the year for all central banks participating in the Eurosystem. At the balance sheet date, the market rate of SDR was above the average cost and valuation gains were therefore recognised in accordance with the accounting rules in the liability balance sheet item ‘Revaluation accounts’.

	31 December 2012		31 December 2011	
	000 SDR	000 EUR	000 SDR	000 EUR
Quota	275,000	320,568	275,000	326,343
Less IMF holdings of EUR	-184,350	-214,897	-189,450	-224,820
Reserve tranche in the IMF	90,650	105,671	85,550	101,522
Loan to the IMF	34,300	39,984	32,900	39,042
SDR Holdings	207,572	241,967	208,642	247,596
Total	332,522	387,621	327,092	388,161

The sub-item 2.2 'Balances with banks and security investments, external loans and other external assets' includes the foreign currency assets held with non-euro area residents (including international and supranational organisations). Foreign currency assets are shown under this sub-item at their euro equivalent as calculated on the basis of market exchange rates on 31 December 2012.

Breakdown of foreign currency assets by type of investment:

	31 December 2012	31 December 2011
	000 EUR	000 EUR
Current accounts	4,103	1,149
Time deposits	55,707	-
Securities	144,203	251,703
Total	204,013	252,852

Breakdown of foreign currency assets by currency:

	31.12.2012	31.12.2011
	000 EUR	000 EUR
USD	200,349	228,545
AUD	79	23,803
GBP	24	96
Other currencies	3,562	407
Total	204,013	252,852

Breakdown of securities according to their residual maturity:

	31 December 2012	31 December 2011
	000 EUR	000 EUR
≤ 1 year	52,976	116,806
>1 year and ≤5 years	87,477	130,919
> 5 years	3,750	3,978
Total	144,203	251,703

3. Claims on euro area residents denominated in foreign currency

The foreign currency assets held with euro area residents are invested in sight deposits, time deposits and securities in foreign currencies. Foreign currency assets are shown at their euro equivalent as calculated on basis of market exchange rates on 31 December 2012.

Breakdown of foreign currency assets by type of investment:

	31 December 2012	31 December 2011
	000 EUR	000 EUR
Current accounts	256	221
Time deposits	19,100	70,794
Securities	249,886	174,886
Total	269,241	245,901

Breakdown of foreign currency assets by currency:

	31.12.2012	31.12.2011
	000 EUR	000 EUR
USD	269,167	245,827
AUD	45	45
GBP	29	29
Total	269,241	245,901

Breakdown of securities according to their residual maturity:

	31 December 2012	31 December 2011
	000 EUR	000 EUR
≤ 1 year	53,686	92,288
>1 year and ≤ 5 years	196,199	82,598
Total	249,886	174,886

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

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

Breakdown of euro denominated assets by type of investment:

	31 December 2012	31 December 2011
	000 EUR	000 EUR
Current accounts	0	2,425
Time deposits	88,500	-
Securities	693,398	783,529
Total	781,898	785,954

Breakdown of securities according to their residual maturity:

	31 December 2012	31 December 2011
	000 EUR	000 EUR
≤ 1 year	363,237	111,156
>1 year and ≤ 5 years	330,161	646,156
> 5 years	-	26,217
Total	693,398	783,529

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

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

The total Eurosystem holding of monetary policy assets amounts to EUR 1,126,019 million, of which the Bank holds EUR 3,982 million. In accordance with Article 32.4 of the Statute, any risks from monetary policy operations, if they were to materialise, should eventually be shared in full by the Eurosystem NCBs, in proportion to the prevailing ECB capital key shares (see section on liability item L13 on provisions).

Losses can only materialise if both the counterparty fails and the recovery of funds received from the resolution of the collateral provided by the counterparty is not sufficient. For specific collateral which can be accepted by NCBs at their own discretion, risk sharing has been excluded by the Governing Council of the ECB.

Main refinancing operations are regular liquidity-providing operations which are conducted with a weekly frequency and a maturity of one week in the form of reverse transactions and executed through standard tenders. Since October 2008, the main refinancing operations were conducted as fixed rate tender procedures with full allotment. These operations play a key role in achieving the aims of steering interest rate, managing market liquidity and signalling the monetary policy stance.

Longer-term refinancing operations are regular liquidity-providing reverse transactions with a maturity of one, three, and occasionally operations with maturity of six or twelve months. In 2011 the three-year operation was conducted for the first time. In the year under review longer-term refinancing operations provided the bulk of refinancing to the banking sector. They were conducted as fixed rate tender procedures with full allotment. For some operations the rate was fixed at the average minimum bid rate of the MROs over the life of this operation. In the year 2012, regular one- and three-month operations existed, conducted with a monthly frequency. During the year also one three-year operation was conducted.

Fine-tuning reverse liquidity providing operations are not conducted regularly by the ECB. They were performed once in 2012 as the overnight operation with the aim to overcome the liquidity between the maturity of main refinancing operation and additional longer term refinancing operations with a maturity of three years. It was conducted as fixed rate tenders with full allotment.

	31 December 2012	**31 December 2011**
	000 EUR	**000 EUR**
Main refinancing operations	125,000	53,000
Longer term refinancing operations	3,857,160	1,687,000
Fine-tuning reverse operations	-	-
Total	3,982,160	1,740,000

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

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

	31 December 2012	31 December 2011
	000 EUR	000 EUR
Current accounts	1,335	1,412
Time deposits	47,759	288,038
Total	49,094	289,450

7. Securities of euro area residents denominated in euro

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

The sub-item 7.1 'Securities held for monetary policy purposes' contains securities acquired by the Bank within the scope of the purchase programme for covered bonds (CBPP)[12], and public debt securities acquired in the scope of the securities market programme (SMP)[13]. The securities are classified as held-to-maturity securities and are valued on an amortised cost basis subject to impairment (see 'Securities' in the notes on accounting policies). Annual impairment tests are conducted on the basis of the information available and estimated recoverable amounts as at the year-end.

Under the Securities Markets Programme, established in May 2010, the ECB and the NCBs were able to purchase euro area public and private debt securities in order to address the malfunctioning of certain segments of the euro area debt securities markets and restore the proper functioning of the monetary policy transmission mechanism.

The total Eurosystem NCB's holding of SMP securities amounts to EUR 208,733 million, of which the Bank holds EUR 975 million. In accordance with Article 32.4 of the Statute, any risks from holdings of SMP securities, if they were to materialise, should eventually be shared in full by the Eurosystem NCBs, in proportion to the prevailing ECB capital key shares.

Part of the Bank's holdings under the Securities Markets Programme comprises debt securities issued by the Hellenic Republic. In February 2012 the Eurosystem central banks exchanged their holdings of Greek government bonds purchased under the Securities Markets Programme for new securities issued by the Hellenic Republic. The newly acquired securities have the same characteristics as those purchased under the Securities Markets Programme in terms of their nominal values, coupon rates, interest payment dates and redemption dates, and were not included on the list of eligible securities that were subject to restructuring in the context of the private sector involvement (PSI) initiative.

In the context of the impairment test conducted as at the end of 2012 on securities purchased under the Securities Markets Programme, the Governing Council identified two impairment indicators in particular, relating to the holdings of Greek government bonds, which occurred in the course of 2012. The first was the restructuring in March 2012 of part of the debt issued by the Hellenic Republic in the context of the PSI initiative and the second was the debt buy-back operation carried out by the Greek government in December 2012. The Governing Council considered that the occurrence of these impairment indicators did not warrant an impairment of securities holdings purchased under the Securities Markets Programme, since on the basis of the information available as at 31 December 2012, there was no evidence of changes in the estimated future cash flows. As a result of an impairment test conducted as at 31 December 2012, the Governing Council decided that all future cash flows on these securities are expected to be received.

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

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

With regard to the impairment test conducted on securities purchased under the covered bond purchase programme, the Bank estimates that all future cash flows on these securities are expected to be received and therefore no impairment losses were recorded in respect of these holdings.

The Governing Council of the ECB assesses on a regular basis the financial risks associated with the securities held under the Securities Markets Programme and the covered bond purchase programme.

Breakdown of securities held for monetary policy purposes per portfolio:

	31 December 2012	**31 December 2011**
	000 EUR	**000 EUR**
CBPP securities	122,737	173,077
SMP securities	975,064	992,299
Total	1,097,801	1,165,377

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

	31 December 2012	**31 December 2011**
	000 EUR	**000 EUR**
≤ 1 year	327,520	100,020
>1 year and ≤ 5 years	585,463	827,657
> 5 years	184,818	237,699
Total	1,097,801	1,165,377

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

Breakdown of securities per portfolio:

	31 December 2012	**31 December 2011**
	000 EUR	**000 EUR**
Marketable securities other than those held to maturity	2,418,632	2,261,675
Held-to-maturity securities	257,729	17,014
Total	2,676,361	2,278,689

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

During 2012 the Bank has reclassified the part of its investment in securities, for which it decided that it intends to hold them until maturity, from market portfolio subject to regular valuation according to market prices, to the held to maturity portfolio. Reclassification was performed at the book value of individual securities at the end of previous year taking into account the premium/discount amortisation until the day of the reclassification, in the amount of EUR 177.2 million.

Breakdown of other securities according to their residual maturity:

	31 December 2012	31 December 2011
	000 EUR	000 EUR
≤ 1 year	1,219,259	846,546
>1 year and ≤ 5 years	1,330,003	1,215,883
> 5 years	127,099	216,259
Total	2,676,361	2,278,689

9. Intra-Eurosystem claims

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

In accordance with the legal acts adopted by the Governing Council on the increase of the subscribed capital of the ECB in December 2010 and the pay-up of the increase via three instalments[14], the Bank has paid up additional EUR 5,480,000 to the ECB at the end of 2012, representing the third instalment of its contribution to the increase in the ECB’s capital.

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

The subscribed and paid up capital of the 27 European central banks in the capital of the ECB on 31 December 2012 is as follows:

	Capital key per cent	EUR	Of which fully paid up	Eurosystem key
Nationale Bank van België/ Banque Nationale de Belgique	2.4256	261,010,385	261,010,385	3.4666
Deutsche Bundesbank	18.9373	2,037,777,027	2,037,777,027	27.0647
Eesti Pank	0.1790	19,261,568	19,261,568	0.2558
Central Bank and Financial Services Authority of Ireland	1.1107	119,518,566	119,518,566	1.5874
Bank of Greece	1.9649	211,436,059	211,436,059	2.8082
Banco de España	8.3040	893,564,576	893,564,576	11.8679
Banque de France	14.2212	1,530,293,899	1,530,293,899	20.3246
Banca d'Italia	12.4966	1,344,715,688	1,344,715,688	17.8598
Central Bank of Cyprus	0.1369	14,731,333	14,731,333	0.1956
Banque centrale du Luxembourg	0.1747	18,798,860	18,798,860	0.2497
Central Bank of Malta/Bank Ċentrali ta' Malta	0.0632	6,800,732	6,800,732	0.0903
De Nederlandsche Bank	3.9882	429,156,339	429,156,339	5.6998
Oesterreichische Nationalbank	1.9417	208,939,588	208,939,588	2.7750
Banco de Portugal	1.7504	188,354,460	188,354,460	2.5016
Banka Slovenije	**0.3288**	**35,381,025**	**35,381,025**	**0.4699**
Národná banka Slovenska	0.6934	74,614,364	74,614,364	0.9910
Suomen Pankki-Finlands Bank	1.2539	134,927,820	134,927,820	1.7920
Total euro-area NCBs	**69.9705**	**7,529,282,289**	**7,529,282,289**	**100.0000**
Bulgarian National Bank	0.8686	93,467,027	3,505,014	
Česká národní banka	1.4472	155,728,162	5,839,806	
Danmarks Nationalbank	1.4835	159,634,278	5,986,285	
Latvijas Banka	0.2837	30,527,971	1,144,799	
Lietuvos bankas	0.4256	45,797,337	1,717,400	
Magyar Nemzeti Bank	1.3856	149,099,600	5,591,235	
Narodowy Bank Polski	4.8954	526,776,978	19,754,137	
Banca Națională a României	2.4645	265,196,278	9,944,860	
Sveriges Riksbank	2.2582	242,997,053	9,112,389	
Bank of England	14.5172	1,562,145,431	58,580,454	
Total non-euro area NCBs	**30.0295**	**3,231,370,113**	**121,176,379**	
Total euro area and non-euro area NCBs	**100.0000**	**10,760,652,403**	**7,650,458,668**	

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

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

	31 December 2012
	000 EUR
Contribution to revaluation accounts	
- paid on 3 January 2007	7,647
- paid on 12 March 2007	18,105
Contribution to provisions	
- paid on 12 march 2007	10,947
Contribution paid on 9 March 2009	2,700
Total	39,399

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

Sub-item 9.4 'Net claims related to the allocation of euro banknotes within the Eurosystem' consists of the claims and liabilities of the Bank vis-à-vis the Eurosystem relating to the allocation of euro banknotes within the Eurosystem which arise from applying the euro banknote allocation key (see 'Banknotes in circulation' and 'Intra-ESCB balances/Intra-Eurosystem balances' in the notes on accounting policies)[15]. The increase of the net claim in comparison to 2011 (EUR 97.8 million) was mainly due to rise in banknotes in circulation in the Eurosystem as a whole (increase of 2.7% compared to 2011). The net position, taking into account the adjustment as a result of smoothing mechanism, which reduces the interest bearing claim for the compensatory amount of EUR 291.6 million (2011: EUR 584.9 million), is remunerated at the marginal interest rate applying to the main refinancing operations.

11. Other assets

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

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

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

	Land and buildings	Computers & equipment	Total
	000 EUR	000 EUR	000 EUR
Cost or valuation			
At 31 December 2011	**22,150**	**21,582**	**43,732**
Additions	291	1,603	1,895
Disposals	-	1,211	1,211
At 31 December 2012	**22,441**	**21,975**	**44,416**
Depreciation			
At 31 December 2011	**3,639**	**17,807**	**21,446**
Disposals	-	1,210	1,210
Charge for the year	185	1,384	1,569
At 31 December 2012	**3,824**	**17,981**	**21,805**
Net book value			
At 31 December 2011	**18,511**	**3,775**	**22,285**
At 31 December 2012	**18,617**	**3,993**	**22,610**

As at 31 December 2012 an amount of EUR 8.0 million relating to investment properties in Austria is included in land and buildings (2011: EUR 8.0 million).

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

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

Sub-item 11.5 'Accruals and prepaid expenses' contains the accrued income identified at 31 December 2012. This consists mainly of interest income which is due in the new financial year.

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

Liabilities

1. Banknotes in circulation

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

The total value of euro banknotes issued by the central banks in the Eurosystem is distributed among these banks on the last business day of each month in accordance with the key for allocating euro banknotes (see Accounting policies). In accordance with the banknote allocation key applying on 31 December 2012, the Bank has a 0.4325% (2011: 0.4325%) share of the value of all euro banknotes in circulation. During the year 2012 the total value of banknotes in circulation within the Eurosystem rose from EUR 888,628 million to EUR 912,592 million. In accordance with the allocation key, the Bank shows holdings of euro banknotes amounting to EUR 3,947.0 million at the end of the year 2012 (2011: EUR 3,843.3 million). The value of the euro banknotes actually issued by the Bank was EUR 1,372.2 million (2011: EUR 1,366.4 million). As this was less that the allocated amount, the difference of EUR 2,574.8 million (2011: EUR 2,476.9 million) is shown in asset sub-item 9.4 'Net claims related to the allocation of euro banknotes within the Eurosystem'.

	31 December 2012	31 December 2011
	000 EUR	000 EUR
EUR 5	-25,965	-14,793
EUR 10	267,822	212,946
EUR 20	3.057,064	2,802,208
EUR 50	-1,712,036	-1,529,938
EUR 100	-586,368	-360,635
EUR 200	-171,917	-134,061
EUR 500	543,597	390,650
Total euro banknotes actually put into circulation by the Bank	1,372,196	1,366,376
Redistribution of euro banknotes in circulation within the Eurosystem	2,917,835	2,811,002
Euro banknotes issued by the ECB (8%)	-343,071	-334,062
Total EUR banknotes according to the Bank's banknote allocation key	3.946,960	3,843,316

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

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

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

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

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

	31 December 2012	31 December 2011
	000 EUR	000 EUR
Current accounts (covering the minimum reserve system)	1,313,335	393,225
Deposit facility	7,000	602,486
Fixed term deposits	-	130,000
Total	1,320,335	1,125,711

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

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

5. Liabilities to other euro area residents denominated in euro

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

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

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

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

7. Liabilities to euro area residents denominated in foreign currency

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

9. Counterpart of special drawing rights allocated by the IMF

This item represents the liability of the Bank towards IMF which corresponds to the allocation of SDRs to the Republic of Slovenia as a result of its membership in the IMF. The liability is shown in the balance sheet at the end of 2012 on the basis of the market rate of SDR 1 = EUR 1.1657 (31 December 2011: SDR 1 = EUR 1.1867) calculated by the ECB at the end of the year for all central banks participating in the Eurosystem. The decrease in the amount of this liability in 2012 is solely due to valuation effects, i.e. the appreciation of the euro against the SDR.

10. Intra-Eurosystem liabilities

Sub-item 10.4 'Other liabilities within the Eurosystem (net)' includes net position of 'Other claims/liabilities within the Eurosystem (net). This item consists of a net TARGET2 balance, arising from cross-border transfers via TARGET2 with other NCBs in the ESCB and the ECB, the claim arising from the allocation of monetary income to the national central banks (see profit and loss item 5 'Net result arising from allocation of monetary income') and the claim arising from the distribution of ECB's income on euro banknotes in circulation (see profit and loss item 4 'Income from equity shares and participating interests').

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

12. Other liabilities

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

Sub-item 12.2 'Accruals and income collected in advance' contains the accrued expenses identified at 31 December 2012. This consists mainly of interest expenditure which is due in the new financial year but was incurred in the financial year just ended.

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

13. Provisions

	31 December 2012	31 December 2011
	000 EUR	000 EUR
Provisions for employees and for known risks	42,558	81,183
Provisions for general risks	286,360	63,497
Provision in respect of monetary policy operations	1,421	4,349
Total	330,339	149,029

Provisions for employees and for known risks

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

Provisions for known risks relate to potential liabilities of the Bank for the certain legal claims pending and to the potential liabilities streaming from off-balance sheet positions. Provisions for potential liabilities streaming from off-balance sheet positions were reduced on the basis of Value-at-Risk assessment as at 31 December 2012 in amount of EUR 39.2 million.

Provisions for general risks

Taking into account the Bank's exposure to interest rate, exchange rate, credit and price risks, general provisions for future unrealised interest rate, exchange rate and price change losses and credit events could be created. In 2011, the Bank created additional general provisions amounting to EUR 10.4 million and in 2012 in the amount of EUR 222.9 million. Significant change in general provisions was caused by the credit risks calculation of monetary policy operations and of own investment portfolio. Credit risk was assessed in 2012 for the first time based on the amended Accounting Guideline in 2012.

Provisions in respect of monetary policy operations

In accordance with Article 32.4 of the Statute, the provision against counterparty risks in monetary policy operations is allocated between the national central banks of participating Member States

(NCBs) in proportion to their subscribed capital key shares in the ECB prevailing in the year when the defaults have occurred. In accordance with the general accounting principle of prudence, the Governing Council has reviewed the appropriateness of the volume of this provision and decided to reduce the provision from a total amount of EUR 949 million as at 31 December 2011 to an amount of EUR 310 million as at 31 December 2012. The Bank's share in this provision amounts to EUR 1.4 million (2011: EUR 4.3 million). The respective adjustments are reflected in the NCB's Profit and loss account. In case of Bank of Slovenia the resulting income amounted to EUR 2.9 million in 2012 (see Profit and loss account item 5 'Net result of pooling of monetary income').

14. Revaluation accounts

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

In case of valuation of securities, gains of EUR 58.1 million arose from the valuation of EUR denominated portfolio (2011: EUR 57.1 million) and EUR 2.6 million from the valuation of USD denominated assets (2011: EUR 2.9 million). At the end of 2012, the Banks has no AUD denominated portfolio (2011: valuation gains amounting to EUR 2.2 million).

In case of foreign currency positions, gains of EUR 11.0 million arose from the valuation of USD position and EUR 5.0 million from the valuation of SDR position (2011: EUR 17.2 million from the valuation of USD position and EUR 8.1 million from the valuation of SDR position).

In case of gold the acquisition cost is EUR 482.688 per fine ounce of gold at the end of 2012 (2011: EUR 482.688), comparing with market price at the end of 2012, which was EUR 1,261.179 per fine ounce of gold (2011: EUR 1,216.864). Market value of gold position exceeded its acquisition price and resulted in a revaluation gain amounting to EUR 79.7 million (2011: EUR 75.1 million).

	31 December 2012	**31 December 2011**
	000 EUR	**000 EUR**
Price effect	60,678	62,255
- securities in foreign currencies (asset items 2 and 3)	2,606	5,148
- securities in euro (asset items 4 and 7)	58,072	57,108
Exchange rate effect	15,999	25,340
Gold value effect	79,666	75,131
Total	156,343	162,727

15. Capital and reserves

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

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

With regard to the assessment of risks and financial buffers to cover those risks, the Governing Board has taken a decision to reclassify a part of special reserves, created before entering into Eurosystem, to general reserves as at the end of 2012. This reclassification does not reduce the level of available financial buffers, but solely increase the possibility of using such reserves for covering different types of financial risks.

	Initial capital	General reserve	Special reserve	Revaluation reserve	Operating surplus/ deficit	Total
	000 EUR	000 EUR	000 EUR	000 EUR	000 EUR	000 EUR
Balance at 31.12.2011	**8,346**	**390,330**	**423,949**	**8,039**	**-**	**830,665**
Operating surplus for 2011	-	-	-		17,105	17,105
Transfer to general reserve	-	12,828	-		-12,828	-
Transfer to RS budget	-	-	-		-4,276	-4,276
Valuation of investments in equity	-	-	--	14	-	14
Transfer of special reserve for FX risks to general reserve	-	206,500	-206,500	-	-	-
Transfer of special reserve for gold price risks to general reserve	-	23,500	-23,500	-	-	-
Total increase/decrease	-	242,828	-230,000	14	-	12,842
Balance at 31.12.2012	**8,346**	**633,159**	**193,949**	**8,053**	**-**	**843,507**

Notes to the off-balance-sheet items

Foreign currency swaps

As at 31 December 2012, the forward foreign currency position arising from EUR/foreign currency swap transactions amounts to EUR 195.3 million (2011: EUR 223.2 million).

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

	31 December 2012		31 December 2011	
	000 Foreign currency	**000 EUR**	**000 Foreign currency**	**000 EUR**
Forward liabilities in AUD	-	-	30,100	23,658
Forward liabilities in USD	257,700	195,316	258,200	199,552
Total	**-**	**195,316**	**-**	**223,210**

Securities lending

As at 31 December 2012, securities with a market value of EUR 481 million (31 December 2011: EUR 371 million) were lent under automated security lending contracts with the agents, which were, in case of collateral, reinvested into reverse repo transactions, prime asset backed securities, bank bonds and certificates of deposits.

Other off-balance-sheet items

The following other financial liabilities of the Bank were stated off-balance-sheet as at 31 December 2012:

- obligation under the IMF's statutes to provide currency on demand in exchange for SDRs up to the point at which the Bank's SDR holdings are three times as high as the amount it has received gratuitously from the IMF, which was equivalent to EUR 513.0 million as at 31 December 2012 (31 December 2011: EUR 521.0 million);

- a contingent liability of EUR 164.4 million, equivalent to the Bank's share of the maximum of EUR 50 billion reserve assets that the ECB may require the euro area NCBs to transfer under Article 30.1 ESCB Statute (31 December 2011: EUR 164.4 million);

Notes to the profit and loss account

1. Net interest income (expenditure)

Interest income

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

	31 December 2012	31 December 2011
	000 EUR	000 EUR
Interest income		
Gold	**-**	**-**
Current accounts and deposits	**2,376**	**3,828**
- In foreign currency	589	421
- In euro	1,788	3,407
Securities	**244,771**	**115,382**
- In foreign currency	5,292	10,261
- In euro	239,479	105,121
IMF	**402**	**1,305**
Monetary policy operations	**31,076**	**6,726**
- Main refinancing operation	501	282
- Longer-term refinancing operations	30,574	6,442
- Other refinancing operations	1	1
Intra Eurosystem claims	**22,014**	**24,930**
- Claims arising from the transfer of foreign reserves to the ECB	1,442	2,039
- Net claims related to the allocation of banknotes within the Eurosystem	20,572	22,891
Foreign currency swaps	**-**	**1,259**
Other interest income	**32**	**34**
Total	**300,671**	**153,464**

An increase of interest income in comparison with 2011 mainly relates to the effect of reclassification of some securities to held to maturity portfolio (see section on asset item 7 ‘Securities of euro area residents denominated in euro’). Recognised income that arises from the discount amortisation after the reclassification date until 31 December 2012, amounts to EUR 139.7 million.

Interest expense

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

	31 December 2012	31 December 2011
	000 EUR	**000 EUR**
Interest expenditure		
Current accounts and deposits	**1,084**	**2,685**
- In foreign currency	233	54
- In euro	851	2,632
IMF	**239**	**851**
Monetary policy operations	**3,434**	**7,449**
- Minimum reserves	2,043	5,365
- Overnight deposits	1,102	810
- Fixed term deposits	289	1,274
Intra Eurosystem liabilities	**44,350**	**28,055**
- TARGET balances	44,350	28,055
Foreign currency swaps	**745**	**2,193**
Other interest expense	**2**	**10**
Total	**49,855**	**41,243**

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

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

Write-downs of financial assets and positions reflect the decline in market prices of balance sheet items as at 31 December 2012 below the average cost of the respective currencies or securities. The valuation losses in 2012 occurred mostly in EUR denominated securities (the same as in 2011).

According to the Governing Board decision, additional provisions have been made for the certain legal claims pending. Provisions for potential liabilities streaming from off-balance sheet positions were reduced on the basis of Value-at-Risk assessment.

Transfer to provisions for general risks represents the amount of provisions, created for potential losses from interest rate, price, exchange rate and credit risks (see section on liability item L13 on provisions).

	31 December 2012	31 December 2011
	000 EUR	**000 EUR**
Realised gains/losses		
Currency position	2,281	284
Securities	48,043	50,940
Total	**50,324**	**51,225**
Write-downs		
Currency position	-2	-304
Securities	-52	-131,159
Total	**-54**	**-131,463**
Transfer to/from provisions for foreign exchange risks, price risks, credit risks and other operational risks		
Provisions for specific risks	38,624	-568
Provisions for general risks	-222,863	-10,360
Total	**-184,239**	**-10,928**
Total	**-133,968**	**-91,167**

3. Net fee and commission income

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

4. Income from equity shares and participating interests

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

Also included under this caption is the distribution of the ECB's income on euro banknotes amounting to EUR 2.7 million (2011: EUR 3.1 million) (see 'Interim profit distribution' in the notes on accounting policies). In 2012 the ECB's income on euro banknotes in circulation was partially retained and on SMP securities was fully retained by the ECB in accordance with a decision of the Governing Council with respect to the establishment of a provision for foreign exchange rate, interest rate, credit and gold price risks. The retained amount not distributed to the Bank amounts to EUR 5.5 million (2011: EUR 5.7 million).

5. Net result of pooling of monetary income

The monetary income of the Eurosystem national central banks is allocated in accordance with the decision taken by the Governing Council of the ECB[16]. The amount of each Eurosystem NCB's monetary income is determined by measuring the actual annual income that derives from the earmarkable assets held against its liability base.

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

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

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

In the year 2012 the allocation of monetary income resulted in a net claim of EUR 26.8 million for the Bank (2011: EUR 2.8 million). This net claim consists of the claim for year 2012, which represents the difference between the EUR 83.6 million (2011: EUR 71.1 million) of monetary income paid by the Bank into the common pool and the Bank's claim of EUR 110.0 million (2011: EUR 73.7 million) on the common pool, corresponding to the Bank's share in the ECB's paid-up capital, and of claims resulting from subsequent adjustment for years 2008, 2009, 2010 and 2011.

This item also includes the net result of the provisioning against counterparty risks in monetary policy operations of the Eurosystem amounting to an income of EUR 2.9 million (2011: income of EUR 5,8 million) (see section on liability item L13 on provisions).

6. Other operating income

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

7. Operating expenses

Staff costs

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

The Bank employed 415 employees as at 31 December 2012 (31 December 2011: 419 employees).

In accordance with the contract between the Bank and the Trade union from March 2002 Bank employees have been included into Voluntary supplementary pension insurance, which is defined as a contribution plan. Staff costs include contribution of the Bank for Voluntary supplementary pension insurance of EUR 0.5 million (2011: EUR 0.5 million).

In 2012 the remuneration of the Governing board members of the Bank was of EUR 0.7 million (2011: EUR 0.7 million).

Other operating expenses

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

Depreciation of tangible and intangible fixed assets

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

Banknote production services

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

Other expenses

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

8. Profit for the year

According to the Accounting Guideline, to which the unrealised valuation losses shall be covered from the current financial result, whilst the unrealised valuation gains are transferred directly to revaluation accounts, the Bank shows the profit amounted to EUR 131.9 million (2011: EUR 17.1 million). Appropriation of the financial result will be performed in accordance with the Article 50 of the Law on the Bank of Slovenia.

5 APPENDICES

5.1 Publications and website

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

5.2 Secondary legislation affecting banking supervision

March 2012

- Regulation on the conditions for acquiring an authorisation to issue mortgage bonds and municipal bonds (Official Gazette of the Republic of Slovenia, No. 17/12 of 5 March 2012)
- Regulation on the documentation for demonstrating fulfilment of the conditions for appointment as a trustee of a cover register (Official Gazette of the Republic of Slovenia, No. 17/12 of 5 March 2012)
- Regulation on the coordination of the cover pool with issued mortgage bonds and municipal bonds (Official Gazette of the Republic of Slovenia, No. 17/12 of 5 March 2012)
- Regulation on the conditions for including derivatives in the cover pool of mortgage bonds and municipal bonds (Official Gazette of the Republic of Slovenia, No. 17/12 of 5.3.2012)
- Regulation on the books of account and annual reports of banks and savings banks (Official Gazette of the Republic of Slovenia, No. 17/12 of 3 March 2012)
- Guidelines for compiling the statement of financial position, income statement and statement of comprehensive income, and calculating the performance indicators of banks and savings banks of 5 March 2012 and valid from 6 March to 31 October 2012 (published on the Bank of Slovenia's website at http://www.bsi.si/zakoni-in-predpisi.asp?MapaId=503)
- Regulation amending the regulation on the reporting of individual facts and circumstances of banks and savings banks (Official Gazette of the Republic of Slovenia, No. 17/12 of 5 March 2012)
- Regulation amending the regulation on the calculation of capital requirements for credit risk under the standardised approach for banks and savings banks (Official Gazette of the Republic of Slovenia, No. 22/12 of 23 March 2012)
- Regulation amending the regulation on the calculation of capital requirements for credit risk under the internal ratings-based approach for banks and savings banks (Official Gazette of the Republic of Slovenia, No. 22/12 of 23 March 2012)

April 2012

- Regulation amending the regulation on the deposit guarantee system (Official Gazette of the Republic of Slovenia, No. 26/12 of 6 April 2012)
- Regulation amending the regulation on the minimum requirements for ensuring an adequate liquidity position of banks and savings banks (Official Gazette of the Republic of Slovenia, No. 26/12 of 6 April 2012)
- Guidelines for implementing the regulation on the assessment of credit risk losses of banks and savings banks (Official Gazette of the Republic of Slovenia, No. 28/12 of 16 April 2012)
- Regulation amending the regulation on the assessment of credit risk losses of banks and savings banks (Official Gazette of the Republic of Slovenia, No. 29/12 of 20 April 2012)

May 2012

- Regulation on the reporting of Member State bank branches (Official Gazette of the Republic of Slovenia, No. 32/12 of 4 May 2012)
- Guidelines amending the guidelines for implementing the regulation on the assessment of credit risk losses of banks and savings banks (Official Gazette of the Republic of Slovenia, No. 34/12 of 11 May 2012)

September 2012

- Regulation amending the regulation on the reporting of individual facts and circumstances of banks and savings banks (Official Gazette of the Republic of Slovenia, No. 71/12 of 21 September 2012)

October 2012

- Regulation amending the regulation on the deposit guarantee system (Official Gazette of the Republic of Slovenia, No. 75/12 of 5 October 2012)
- Guidelines for compiling the statement of financial position, income statement and statement of comprehensive income, and calculating the performance indicators of banks and savings banks of 8 October 2012 and valid as of 1 November 2012 (accessible on the Bank of Slovenia's website at http://www.bsi.si/zakoni-in-predpisi.asp?MapaId=503)

December 2012

- Regulation amending the regulation on credit protection (Official Gazette of the Republic of Slovenia, No. 100/12 of 20 December 2012)
- Regulation amending the regulation on the calculation of capital requirements for credit risk under the standardised approach for banks and savings banks (Official Gazette of the Republic of Slovenia, No. 100/12 of 20 December 2012)
- Regulation amending the regulation on the calculation of the own funds of banks and savings banks (Official Gazette of the Republic of Slovenia, No. 100/12 of 20 December 2012)

5.3 Glossary of selected terms

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

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

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

Eurepo -The reference interest rate for euro interbank loans, secured by selected government bonds.

Euro area – The area encompassing the EU Member States that have adopted the euro as their single currency in accordance with the Treaty on the functioning of the EU.

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

ECB key interest rate – The minimum bid rate on main refinancing operations. It is the interest rate used by the Eurosystem to signal the monetary policy stance. It also provides loans at this rate when conditions for full allotment are met.

Covered bond – A bond issued by a bank and secured by all its assets. In the event of the bank's bankruptcy the bond holder has the right of priority in repayment through the sale of specific assets of the issuer (e.g. mortgage loans) that were provided as collateral.

Own use of collateral for monetary policy loans – use of collateral by the counterparty who issued the collateral instrument (i.e. the debtor of the instrument), or by a closely related debtor, i.e. there is a direct or indirect capital link of more than 20% between the two parties. This is possible for covered bonds or uncovered government-guaranteed bank securities.

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

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

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

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

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

Open market operations – Operations implemented by a central bank at its own initiative to manage liquidity. The opposite are open tenders that are accessible at any time at the initiative of a counterparty. In the Eurosystem these are main refinancing operations (MROs), longer-term refinancing operations (LTROs), fine-tuning operations (FTOs) and structural operations such as outright purchases of securities.

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

Excess reserves – The balances of credit institutions on accounts with NCBs in excess of the reserve requirement.

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

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