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STAFF APPRAISAL REPORT

REPUBLIC OF SLOVENIA

INVESTMENT RECOVERY PROJECT

July 3, 1996

Country Operations Division
Central Europe Department
Europe and Central Asia Region

CURRENCY AND EQUIVALENT UNITS

Currency Unit = Slovene Tolar (SIT)

	1992	1993	1994	1995	April 1996
US$1.00 =	81.3	113.2	128.8	118.5	135.9

WEIGHTS AND MEASURES

Metric System

ABBREVIATIONS AND ACRONYMS

BoS	-	Bank of Slovenia
BRA	-	Bank Rehabilitation Agency
CAR	-	Capital Adequacy Ratio
CAS	-	Country Assistance Strategy
DM	-	Deutsche Mark
EBRD	-	European Bank for Reconstruction and Development
ECU	-	European Currency Unit
EFSAL	-	Enterprise and Financial Sector Adjustment Loan
EIA	-	Environmental Impact Assessment
EU	-	European Union
GDP	-	Gross Domestic Product
ICB	-	International Competitive Bidding
IMF	-	International Monetary Fund
IRP	-	Investment Recovery Project
LBdd	-	Ljubljanska Banka dd
LIB	-	Limited International Bidding
LIBOR	-	London Interbank Offered Rate
KBM	-	Kreditna Banka Maribor
KBNG	-	Kreditna Banka Nova Gorica
LBS	-	Ljubljanska Banka System
MoE	-	Ministry of Environment
MoF	-	Ministry of Finance
MoL	-	Ministry of Labor, Family and Social Affairs
NBY	-	National Bank of Yugoslavia
NKBMdd	-	Nova Kreditna Banka Maribor
NLBdd	-	Nova Ljubljanska Banka dd
SCL	-	Single Currency Loan
SDK	-	Social Accounting Service
SIT	-	Slovene Tolar
SOE	-	Statement of Expenditure
TA	-	Technical Assistance
USAID	-	United States Agency for International Development

SLOVENIA-FISCAL YEAR

January 1 - December 31

REPUBLIC OF SLOVENIA
INVESTMENT RECOVERY PROJECT

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This report was prepared on the basis of an appraisal mission to Slovenia in December 1993. The mission was led by Mr. Hormoz Aghdaey (EC2CO). Mission members were Messrs/Mmes: Hiran Herat, Ilham Zurayk (EC2CO); Joaquin Gutierrez (FSD); and Naushad Khan (EC2DR). The Peer Reviewer is Mr. Charles Woodruff (PSD). The Division Chief is Mr. Michel Noël (EC2CO) and the Department Director is Mr. Jean-Michel Severino (EC2DR).

SLOVENIA

INVESTMENT RECOVERY PROJECT

LOAN AND PROJECT SUMMARY

Borrowers	Nova Ljubljanska Banka dd SKB Banka dd Banka Celje dd
Guarantor	Republic of Slovenia
Beneficiaries	Private and newly privatized enterprises
Poverty	Not applicable
Amount	DM 35 million to NLBdd (US$ 23.0 million equivalent); DM 30 million to SKB Banka dd (US$19.7 million equivalent); and DM 10 million to Banka Celje dd (US$6.6 million equivalent); aggregating to about US$49.3 million equivalent.
Terms	LIBOR-based Single Currency loans in Deutsche Marks (DM) repayable over 15 years with 5 years grace period for level repayment of principal at the Bank's standard interest rate for LIBOR-based DM single currency loans.
Commitment Fee	0.75 percent on undisbursed loan balance, beginning 60 days after signing, less any waiver.
Relending Terms	The borrowers will on-lend loan proceeds to eligible private enterprises. Subloans to the final beneficiaries will be denominated in DM at market rates determined by the borrowers. Subloans will be made for periods no longer than 10 years with grace periods of up to 3 years. The final beneficiaries will assume the foreign exchange risk.
Financing Plan	IBRD DM 75 million equivalent
Net Present Value	Not applicable
Project Identification No	8855

The Republic of Slovenia
Investment Recovery Project

I. Economic Developments and Outlook

A. Economic Background and Recent Performance

1. Despite inherited structural problems and a difficult external environment (the disruptions in trade with the other former Yugoslav republics and the slackening of economic activity in Western Europe), Slovenia has made substantial progress in achieving macroeconomic stability since its independence in October 1991. A new currency--the Slovene Tolar (SIT)--introduced on October 8, 1991, allowed Slovenia to establish monetary control and implement a stabilization program aimed at reducing the high rates of inflation inherited from the former Yugoslav Federation, and increasing the critically low level of foreign exchange reserves. Inflation has fallen from close to 250 percent p.a. in 1991, to about 9 percent p.a. for 1995. Inflation for 1996 is expected to be slightly above the 1995 level. Reserve levels at end-1995 were about US$3.5 billion (about 4 months of imports).

Box 1: Slovenia - Main Indicators

Slovenia has a population of about 2 million, and an economy that has traditionally compared favorably with that of most other economies in Central and Eastern Europe. Slovenia's gross domestic product (GDP) per capita is estimated at about US$8,060 in 1995. The Slovene economy is very open by international standards and is heavily concentrated in industry and services (39 percent and 56 percent of the GDP respectively). In 1995, total external trade amounted to about US$19 billion, roughly about 114 percent of Slovenia's GDP, with exports accounting for about 57 percent and imports for about 56 percent of GDP. About 75 percent of external trade was with developed countries (EU 68 percent, EFTA 2 percent, and others 5 percent). Being a small and very open economy, Slovenia is very vulnerable to adverse external conditions. However, Slovenia's exports are quite diversified in terms of their product mix.

2. The stabilization program resulted in continuing contraction in economic activity in 1992. Real GDP declined by 5.5 percent during 1992, and industrial output in that year declined to 76 percent of the 1990 levels. Gross domestic investment declined to an all-time low of 15.2 percent of GDP in 1991. The contraction of activity was accompanied by a sharp increase in the rate of unemployment, from around 5 percent in 1990 to more than 14 percent in late 1993. In 1993, however, the economy began to show signs of recovery as GDP grew by about 1 percent. Since then, real GDP has recovered much faster than had been anticipated. It grew by 5.5 percent in 1994 and is estimated to have grown by 5 percent in 1995. The recovery of economic activity has been driven primarily by investment, which is estimated to have increased to 22 percent of GDP in 1995, and to a lesser extent by exports.[1]

3. Slovenia had enjoyed the highest standards of living among the former Yugoslav republics. Its economic performance, however, deteriorated dramatically with the rest of Yugoslavia during the 1980s, because of the structural weaknesses of the old Yugoslav system of enterprise self-management and of ownership links between banks and enterprises. The system of self-management[2] resulted in excessive

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[1] Mainly financed by retained earnings and short-term credits from the banks.

[2] Social ownership attributed ownership to society at large, but entrusted workers with the responsibility of utilizing enterprise assets. Absent was an owner interested in the long-run viability of the enterprise.

wage pressures, and large enterprise losses. Since the banks were owned by the enterprises, they financed these losses and could not rely entirely on commercial criteria in their assessments of investment proposals by the enterprises.

4. The 1992-1993 macroeconomic improvements, although impressive, were achieved on the same distorted microeconomic foundations that led to hyperinflation and economic stagnation in the 1980s. Enterprise accounting losses remained high--17 percent of GDP in 1992--and the continued poor performance of the enterprise sector led to major difficulties of near crisis proportions in the banking sector. Economic stability, therefore, could clearly not be sustained without a fundamental reform of the enterprise and banking sectors.

B. Enterprise and Banking Sector Program

5. Having established macro-stability, the authorities' focus shifted to addressing the inherited structural weaknesses of the previous system of self-management. In 1993, the Government of Slovenia, therefore, launched a comprehensive program to address these structural issues. This program has been supported by the Enterprise and Financial Sector Adjustment Loan (EFSAL, Loan 3636-SLO) which was approved by the World Bank's Board of Executive Directors on July 15, 1993.

6. The Slovene authorities have made significant progress in implementing these reforms including: (i) privatization of socially-owned enterprises; (ii) conversion of enterprises in public services into state-owned corporations; (iii) rehabilitation of insolvent banks representing a major share of the banking system; (iv) reduction of losses in the economy; and (v) establishment of the legal framework for private sector development, and the regulatory framework for a modern banking system. In view of the overall progress made in implementing the EFSAL program, the second tranche of this loan was released in December 1995. Chapters II and III of this report present in more detail the major elements and objectives of this program and summarize implementation results.

C. Medium-Term Outlook

7. Economic management in Slovenia has been very successful as evidenced by the high rate of growth and the low inflation achieved during the last two years. The likelihood that Slovenia will be able to sustain its recent recovery and a 5 percent p.a. long-run growth rate is high. Nevertheless, realization of such performance will continue to depend on continued progress in enterprise and bank privatization, and initiation of comprehensive social security reform. This should stimulate investments, improve efficiency, and pave the way for sustained long-run growth led by the private sector. As a result of expected efficiency gains and recovery in investment, Slovenia should be able to achieve sustainable growth rates of 5-6 percent in the long-run with an investment ratio of around 23-24 percent of GDP.

8. The majority of the investment should come from the private sector-- private, recently privatized, and newly established enterprises--as only a decentralized process can succeed in increasing the efficiency of the existing capital stock and choosing the appropriate new technologies and the pace of their incorporation. A well disciplined and regulated private banking system will be essential in intermediating and effectively allocating available resources to the private sector.

D. Bank Assistance Strategy

9. The Bank's program of assistance to Slovenia focusses on supporting the central elements of the Government's structural reform program, with reform of the enterprise and banking sectors at its core. The principal objective of this project is to provide financing for the investment needs of private enterprises during this transition period. It also aims to continue and reinforce the principals of the banking reforms initiated under the EFSAL, through the direct relationship to be established with banks accounting for more than 50 percent of Slovenia's banking assets. The project will be implemented following the reforms undertaken under the program supported by the EFSAL (paras 5-6), which have expanded the universe of private and creditworthy enterprises seeking credit, and substantially improved the efficiency of banking intermediation. In this way, the project will help meet the reform's ultimate objective of attaining sustainable long-term growth.

10. A limited Country Assistance Strategy was included in the EFSAL President's Report dated June 22, 1993. Because of its relatively high per capita income, and growing access to other sources of international finance, World Bank support to Slovenia is being targetted to a few key areas where the Slovenes consider our inputs to be particularly helpful.[3] Given the stable political and economic situation in the country risks to our operations and assistance strategy are minimal. At the request of the Slovene authorities, the Bank will start preparation of a CAS in September 1996, to define the nature of future collaboration during a phase of preparation for integration into the European Union.

11. IFC has provided assistance to Ljubljanska Banka dd (LBdd) in its restructuring efforts. It has also provided assistance in the preparation of securities legislation and revamping of the Stock Exchange. IFC has approved an equity investment in an international factoring company in Slovenia together with NLBdd. It has also set up a venture capital fund. IFC is currently considering a US$35 million subordinated loan to NLBdd (para 50).

Box 2: Slovenia - World Bank Loans

In FY96 there were two active Bank operations in Slovenia one of which (a US$32 million loan for the Slovene Coast Water Supply and Sewerage project) was approved when the Republic was still a member of the Yugoslav federation, and the US$80 million EFSAL which was the first loan granted to the Republic of Slovenia, following independence and membership in the Bank. Both loans are now closed. A loan of DM 34.6 million for an Environment Project was approved by the Board of Executive Directors on May 30, 1996. The Bank is involved in the phaseout of ozone depleting substances financed by the GEF. In addition, the Bank sponsored a seminar on Environmental Impact Assessment, which took place in April, 1994.

12. Slovenia became a member of the International Monetary Fund (IMF) in December 1992, and a member of the World Bank Group in February 1993, as a successor to membership of the former Yugoslavia. The last staff report on Article IV consultations was discussed at the IMF Board on September 1, 1995. Close cooperation has been maintained with IMF staff.

13. European agencies such as the European Bank for Reconstruction and Development (EBRD) and the European Investment Bank (EIB) are currently supporting the development and integration of Slovenia's infrastructure with that of Western Europe. EBRD's program in Slovenia, of about ECU 311

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[3] Standard and Poor's and Moody's of the US and the European agency IBCA have all placed Slovenia in the "A" category at the same level or slightly above the Czech Republic, previously the most highly rated of the transition economies.

million in total commitments, benefits both the public and the private sectors. This program includes an equity shareholding in and a line of credit to SKB Banka dd (para 51), a borrower under the proposed project, and technical assistance to NLBdd, another borrower under the proposed project. EU-Phare support has included inter alia support for enterprise restructuring and privatization, and financial sector reform. This support has been very closely coordinated with our efforts under the EFSAL and the proposed project. The British Know-How Fund and USAID have also been providing substantial technical assistance for the enterprise and financial sector reforms in close coordination with the Bank.

II. Private Sector Development

A. Background

14. Like most other reforming economies of Central and Eastern Europe, Slovenia has followed a two track path to private sector development: (i) creation of an increasingly favorable environment to encourage new entry into the private sector and expansion of existing private sector firms; and (ii) implementation of an extensive program for privatization of socially owned or State-owned enterprises. There has been remarkable growth in the private sector in the past few years. However, Slovenia has only recently begun to make progress in the sale of social property and establishment of joint ventures with majority private ownership.

15. On November 11, 1992, Parliament adopted of the "Law on Ownership Transformation," to govern the ownership transformation of about 1,700 medium and large Slovene enterprises. Privatization proceeded slowly in its initial phase but accelerated following termination of the period for voluntary submission of privatization applications on December 31, 1994. One of the most important aims of the Government is to finalize the privatization process by end-1996.

B. Transformation of the Enterprise Sector

Private Sector Development in 1992-1995

16. The share of the private sector in the formal enterprise sector revenues grew from 11.4 percent in 1992 to 28.5 percent in 1995, while employment in the formal private sector increased by almost 160 percent. Although the data on the informal sector is not reliable due to frequent cases of tax evasion, it is estimated that, in 1995, the formal and informal private sector accounted for about one third of GDP and about 25 percent of total non-farm employment. Most of this increase has been due to new entrants, mainly in trade and financial and business services.

17. The rapid increase in private sector activity is the result of the progress made in establishing an appropriate regulatory framework for a market economy.[4] This framework is becoming closely compatible with the legislation in EU countries.

Table 1: Formal Enterprise Sector by Type of Ownership

Ownership Type	# of Enterprises				# of Employees				percent of total output			
	1992	1993	1994	1995	1992	1993	1994	1995	1992	1993	1994	1995
Private Incorporated	16,404	23,907	26,245	28,878	28,457	45,730	73,740	97,859	11.4	18.3	24.4	n.a.
Cooperative	169	257	41	36	4,040	5,435	181	237	1.6	2.0	0.1	n.a.
Socially Owned	2,484	2,383	2,191	2,032	372,183	313,256	277,106	247,275	57.9	50.5	46.5	n.a.
Mixed	1,094	1,214	1,192	1,222	60,081	60,561	57,240	70,788	16.3	16.7	17.0	n.a.
State Owned	151	141	141	141	57,968	55,643	55,615	55,615	12.8	12.5	12.0	n.a.
Total Formal Sector	20,302	27,902	29,8 10	32,309	522,729	480,625	463,882	471,774	100.0	100.0	100.0	100.0

Source: Agency of the Republic of Slovenia for Payments, Supervision and Information
Note: The total number of socially owned enterprises in 1995 is over stated due to double counting of subsidiaries, and the backlog in courts for registering the privatized enterprises.

18. The most notable legislation adopted by Parliament includes: (i) a Company Law: "Law on Commercial Companies," based on the German model, adopted in May 1993; (ii) a Law on Bankruptcy and Liquidation, adopted in December 1993. The law most importantly introduces Chapter 11-style reorganization as an option in parallel with liquidation. The Government also intends to build up the capacity of the court system to deal with the bankruptcy and liquidation cases; (iii) the Law on Securities Market, adopted in February 1994; (iv) a Competition Law, adopted in April 1993, covering monopoly regulation and unfair competition, as well as anti-dumping. The law generally follows international norms and envisages the creation of the Agency for Protection of Competition for enforcement (anti-monopoly agency); (v) a Law on Mutual and Investment Funds, adopted in February 1994; (vi) a Patent Law, adopted in March 1992, which provides patent and trademark protection closely in line with modern international standards and conventions; the Law on Auditing, adopted in 1993, and Slovene Accounting Standards, according to "GAAP" of the European Union. The Yugoslav Copyright Law remains valid in Slovenia, and although the Slovene Government has announced its intention to adopt a new law, the need is not urgent; and (vii) the 1988 Yugoslav Foreign Investment Law (in force in Slovenia) which allows for 100 percent foreign ownership of enterprise assets. The law is very favorable to new investments (both foreign and local) and the company income tax rate of 30 percent is one of the lowest in Europe.

19. The Government is in the process of reviewing the current legal framework for secured transactions and plans to take steps to modernize the system of real estate and mortgage registration in

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[4] Slovenia has more than 55,000 enterprises, of which about 25,000 are small entrepreneurial firms, employing close to 55,000 workers, and the balance are classified as "formal" enterprises. The formal enterprise sector accounts for about two-thirds of both GDP and total employment. Employment in the formal enterprise sector dropped sharply in 1992-1993, and was the main cause of the rise in unemployment rates. Employment levels stabilized in 1994 (at a 14.4 percent unemployment rate) and began recovery in 1995 (a 13.5 percent unemployment rate).

order to provide the proper underpinnings for a secure and predictable system of collateral. The registration of security interests on movables is addressed by the Law on Notarial Services. The Securities and Exchange Commission has been established as an independent regulatory body, with considerably enhanced capacity to supervise the capital market, including the activities of the Stock Exchange.

Privatization Policy and Legislation

20. The 1992 privatization law relied initially on enterprises to initiate their transformation, under guidance and with monitoring by the Privatization Agency (the Agency). The law decreed that all enterprises covered must voluntarily have completed the initial transformation by end-1994--18 months after the date of effectiveness of the law--after which all transformation rights of the enterprise would be transferred to the Agency. Parliament held firm to this deadline and consequently the transformation rights of those enterprises which failed to meet the deadline are now held by the Agency. Following Parliamentary discussions on consolidating the acceleration in privatization, it has been decided to adopt amendments to the law, in the near future, to strengthen the enforcement powers of the Agency in implementing privatizations.

Box 3: Privatization under the Law on Ownership Transformation

Transformation under the law results first in the conversion of socially-owned enterprises into shareholding companies with a revalued capital base. Twenty percent of the shares of each enterprise are reserved for acquisition by employees using ownership certificates. A further 40 percent of the shares are allocated for sale through employee purchases, public tender, and public auction and sale. For these shares, employees are given the right of first refusal, with a 50 percent discount on the price of the shares. The remaining 40 percent are allocated as follows: 10 percent to the Compensation Fund, 10 percent to the Pension Fund, and 20 percent to the Development Fund (the Fund) which will distribute this share among Special Investment Funds. The law explicitly allows the sale of a company in its entirety, or the sale of the controlling interest in a company. The Compensation Fund, Pension Fund, and Special Investment Funds are compensated in cash from the proceeds of such sales. Ownership certificates (equivalent to 40 percent of the total social capital of enterprises) have been issued and freely distributed among all citizens of Slovenia. The non-transferable certificates have a nominal value ranging from SIT 100,000 to SIT 400,000 and have been distributed according to age, with those who were under 18 years of age receiving certificates valued at the bottom of the range and those who were 48 or older receiving certificates valued at the top of the range. Citizens can use their certificates to buy shares of Special Investment Funds, or the shares of companies offered through public sale. The employees of an enterprise have the additional option of using their certificates to purchase the shares reserved for them.

21. The Government has restricted State ownership of enterprises to those in electric power generation, transmission and distribution; gas distribution; the railroad subsector; road construction and maintenance; sea and air ports; telecommunications; postal services; and water distribution and other municipal public services. A Law on Commercial Public Services was adopted on June 2, 1993, and provided the legal underpinning for conversion of the concerned enterprises to State ownership, which has already been completed. A law on the Privatization of Legal Entities and Property Owned by the Republic of Slovenia is under consideration by Parliament. Independent regulatory systems for the designated subsectors are being established as a means for facilitating eventual private sector provision of commercial public services.[5]

[5] These regulatory systems will be established through specific laws for the energy, telecommunications and railway subsectors, which will, inter-alia, govern the organization and define the regulatory framework for these subsectors, and identify those activities which will be privatized in the medium term. The law for

Private Sector Institutions

22. The Privatization Agency, the principal institution in charge of implementing privatization, was established in December 1990, in accordance with a 1989 Yugoslav law. It has since been very competently managed and has gained valuable experience in privatization.

23. The Agency has been responsible for approval of the transformation programs submitted by enterprises and for valuation of the enterprises, where required, and has issued extensive guidelines to be followed by enterprises in preparing their privatization programs. The Agency is also responsible for privatizing the enterprises which did not submit programs by the end-1994 deadline. The Agency is receiving technical assistance from a number of sources including, the EU-Phare program, the British Know-How Fund and USAID.

24. The Development Fund is charged with the management and disposal of the shares it acquires during the process of transformation. It has been substantially self-supporting through revenues acquired from privatization proceeds. Its mandate also provides for it to support the development of small businesses. The Development Fund plays an interim role in holding and subsequently transferring 20 percent of the privatized capital of enterprises to the investment funds which were established during 1994. These investment funds are publicly held, and act either as passive or active investors.

25. The Small Business Development Fund, which has been in operation since 1991, provides credit subsidies and guarantees to small private businesses. The total annual size of these operations has not exceeded US$4 million.[6] The Ministry of Economic Activities (Industry) and the Slovene Chamber of Economy also have active programs for promotion of private sector activity. Slovenia has had a tradition of private small-scale economic activities, and the Government has introduced many measures to capitalize on this vibrant sector of the economy and to promote its further development. The Small Business Development Center has been established by the Ministry of Economic Relations and Development as a non-profit organization. The Center has some 500 regional and local branches and special networks, dealing with dissemination of information, consulting, training and promotional and public relations activities for small business. It is expected that the restructured banking sector will also play a major role in the development of the private sector through its new credit operations, as well as active participation in the debt work-out of privatizing enterprises. Finally, in addition to the many local business support organizations and consulting groups, many multinational auditing and management consulting companies have established offices in Ljubljana.

Privatization Progress

26. At the outset of the privatization program, the Government's goal was to privatize, under the new privatization legislation, some 1,700 medium-to-large enterprises (mainly in the industry/ manufacturing sector) in the course of three years. Privatization of 400 socially-owned enterprises, accounting for 20 percent of the value added contribution of all enterprises subject to the Law on Ownership

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the railways subsector was adopted by Parliament in December 1993; the law for telecommunications is under consideration by Parliament; and the law for the energy subsector will be submitted to Parliament shortly.

[6] The US$4 million program supports lending by the banks of about US$10-15 million.

Transformation, was a second tranche release condition of the EFSAL. The target was met and included enterprises for which preparations for privatization were initiated even prior to adoption of the new privatization law. The remaining socially owned enterprises are expected to be privatized by end-1996.

27. Privatization proceeded slowly in its initial phase, because of the voluntary character of the process, the delays in resolution of denationalization claims by the local authorities, and the mandated reviews of post-privatization transactions. This pace, however, changed markedly when the period for voluntary submission of privatization applications ended on December 31, 1994.

28. By end-May 1996 the Privatization Agency had received about 1,490 applications for privatization, and had approved the privatization of about 1150 enterprises.[7] This figure includes 600 enterprises which have finished their privatization procedures and are recorded, in the court register, as private companies, as well as 550 enterprises in the process of implementation of their approved (by the Privatization Agency) programs.

29. The Privatization Agency estimates that about 40 percent of the capital of privatized enterprises was privatized through internal buy-out and distributions, 22 percent was sold through public offerings, 18 percent was transferred to the Development Fund for future sale, and about 18 percent was transferred to the Pension and the Compensation funds.[8] By end-1995, almost 80 percent of the privatization certificates issued to Slovene citizens had been used either directly to purchase enterprise shares or placed with investment funds.[9] About twenty management companies (principally established by banks) had established 45 investment funds, which had collected more than SIT 240 billion equivalent of certificates. The investment funds had used about SIT 27 billion to purchase shares in about 146 companies which were offered in three auctions organized by the Development Fund. It is becoming evident that the supply of shares for privatization will need to be augmented, beyond the amount available in enterprises covered by the privatization law. This is likely to be accomplished by future offerings of shares in large public services enterprises and commercial banks.

C. Investment and Financing Requirements

30. During the initial phase of preparation of this project (in 1993-1994), a demand study was commissioned to assess the investment and financing needs of the private sector. The study was carried out through a survey of 20 banks covering more than 90 percent of bank lending in Slovenia, and their clients. The survey of the banks included questionnaires covering information on recent investment and lending activities and the banks' projections of future investment by their clients and demand for credit; direct contacts with general managers of profitable enterprises; and interviews with the Development Fund management.

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7 The first approval is the key decision taken in privatization of an enterprise. Second approval is awarded after contracts between the enterprise and buyers are finalized.

8 About 2 percent of the capital is being held in reserve for denationalization and other purposes.

9 As all certificates remaining with the citizens will loose their value by January 1, 1997, it is expected that the remaining 20 percent of certificates would be invested before end-1996.

31. Annex 8 summarizes, in table form, the findings of this initial study which indicated an average annual investment growth of about 18 percent during the 1994-1996. This figure was substantially in line with the macroeconomic projections at that time. Investment by private enterprises was expected to increase from US$273 million in 1994, to US$1,346 million in 1996. New equity financing and internal cash generation were expected to finance more than 70 percent of these investment needs. Demand for credit by private enterprises was expected to increase, on this basis, from about US$115 million in 1994 to about US$338 million in 1996. All banks interviewed showed marked interest in utilizing World Bank resources to meet their clients' needs for long-term credit.[10]

32. These projections were further substantiated in non-quantitative interviews with general managers of large profitable enterprises. Managers interviewed shared the opinion that, in Slovenia, there exists a high level of hidden demand for investment loans. Investment in enterprises was initially suppressed due to the delay in privatization, since investments would increase the value of enterprises and in turn would make internal privatization more costly. Enterprise managers were confident that new investments would pick up and grow with the pace of privatization.

33. This has in fact been the case, as indicated by the actual growth in investment in the last two years, following progress in the privatization process and in implementation of financial sector reforms. Gross fixed investment in 1995 is estimated to have amounted to about US$3,900 million or 22.4 percent of GDP. This is 36 percent higher than projected at the time the demand study was undertaken.

34. NLBdd, SKB Banka dd, and Banka Celje dd (the three borrowers under this project) have submitted information, to the Bank, on current outstanding applications by their clients for long-term loans. These requests amount to about DM 120 million for NLBdd, to about DM 40 million for SKB Banka dd, and to about DM 10 million for Banka Celje dd.

III. The Banking Sector

A. Banking Sector Restructuring Program

35. In parallel with its push for private sector development and enterprise sector reforms, the Government of Slovenia has implemented a comprehensive bank restructuring program, supported by the EFSAL.

36. Major elements of this program included: (i) reform of the legal and regulatory framework; and (ii) restructuring of individual banks and resolution of their problem portfolios. Now that the restructuring process is near completion, the Government is preparing the banks for privatization.

37. The bank restructuring program has had a major impact on the intermediation spreads of the banks, and consequently on the interest rates for working capital and long-term investment credits. By April 1996, average real interest rates on Tolar loans had declined to around 12 percent (from about 24-

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[10] To further examine the investment and credit demand projections of the commercial banks, the study undertook a review of the Small Business Development Fund operations and the business plans of 98 enterprises in the Development Fund portfolio. Commercial bank loans to small enterprises supported by the Small Development Fund program amounted to between US$10-15 million during 1992-1994.

27 percent in 1992). Currently, the larger banks are lending to their best clients at rates of about 9-11 percent in real terms. Given the improved credit standing of Slovenia and specifically of the larger commercial banks, these banks have been able to start raising funds on European markets on good terms. For example, recently syndicated loans have been secured by NLBdd and SKB for rates as low as about LIBOR plus 50 basis points for six year money. This has enabled the banks to provide, to their best clients, medium-term DM loans at about LIBOR plus 220-350 basis points. The rates, therefore, are now much closer to rates of return on capital which can be achieved on attractive projects.

Box 4: Slovenia - Financial sector

The Slovene financial system includes 33 banks: 12 previous LB System member banks; SKB Banka dd; Abanka; and a number of small new banks established following the removal of barriers to entry into the banking sector in 1990. Eight of these smaller banks have foreign partners, and one is 100 percent foreign owned. The former LB System member banks account for about 80 percent of total assets of the banking system, while Abanka and SKB Banka dd account for 5 percent and 12 percent of the total respectively. The small banks each represent less than 0.5 percent of the system's total assets. Commercial banks dominate the financial system and are the major source of credit to the Slovene economy. The financial system also includes about 110 saving and cooperative banks and several non-bank financial institutions. A Securities and Exchange Commission and a Stock Exchange were established in 1990.

38. At the same time, the bank restructuring program is having a major impact on resource allocation by the banks and private sector access to credit. The foundations for this change have already been established by the: (i) delinkage of bank owners and borrowers in the banks under rehabilitation; (ii) carving-out of seriously impaired loans; (iii) establishment of bank boards charged with the task of overseeing adoption of new credit policies and systems; and (iv) establishment of regulations to guide banking activities.

Legal and Regulatory Framework

39. As part of the initial reform of the legal framework, the Banking and Bank Rehabilitation laws were amended by Parliament in 1993. This was a first step which did not fully deal with all pending regulatory issues including those related to lending, bank governance, and the powers of the BoS as bank supervisor. During implementation of the EFSAL, a major effort was undertaken by the Government, in consultation with the Bank, to prepare comprehensive new banking legislation. The resulting proposed new banking law encompasses agreed improvements in the above crucial areas as well as in regulation of financial conglomerates, bank resolution, and prudential standards. The proposed new law is now under consideration by Parliament (para 56).

40. In mid-1993, the BoS adopted regulations on asset classification, provisioning and interest suspension, and capital adequacy. In addition, as part of its continuing program to improve banking regulations, the BoS has adopted a detailed plan for preparation and adoption of regulations which will govern application of the forthcoming banking law.

41. Moreover, under the program supported by the EFSAL, the BoS adopted a comprehensive plan to reinforce bank supervision including development of an off-site surveillance and credit risk system, on-site examination methodologies, and a training and staff development program. It reorganized the structure of the supervision department, which now includes: (i) a group responsible for designing and implementing an off-site surveillance system; (ii) a special unit in charge of quick assessments of potential problem banks; and (iii) two groups in charge of conducting normal inspection work. Because of the dearth of experienced supervisors in Slovenia, the BoS is utilizing EU-Phare funds to engage external

auditors to support its on-site examinations. During preparation of the IRP, the BoS developed, in consultation with the Bank, supervision programs tailored for the borrowers under the project.

Implementation of Bank Restructuring and Privatization

42. At the time of the initiation of the bank restructuring program, major banks in the system were suffering from high operational losses and were insolvent. Two critical financial problems were: (i) the banks' non-performing loan portfolios and doubtful guarantees; and (ii) the claims of the banks against NBY, which were largely related to the foreign currency deposits of households and were frozen following independence from Yugoslavia. Real lending rates had risen to levels much higher than normal rates of return on capital, substantially hampering investment and growth of viable enterprises. Real rates on working capital loans and long-term investment loans were about 25 percent and 28 percent respectively in June 1993. The losses were concentrated in three banks: LBdd, Kreditna Banka Maribor (KBM), and Kreditna Banka Nova Gorica (KBNG), which together accounted for 74 percent and 87

Table 2: Selected Banking Sector Reforms Supported by the EFSAL
Implementation of Bank Restructuring and Privatization and Debt Recovery

Status in July 1993	Current Status
Substantial progress in restructuring of LBdd and KBM.	Rehabilitation program of NLBdd and NKBM near completion.
	Preparation of a privatization law which defines the privatization process for NLBdd and NKBM and the desired ownership structure of the banks.
Carve-out of problem debts from the books of banks under rehabilitation.	Restructuring or other appropriate resolution for at least one third of the debtors and one third of the debts carved-out from the banks.

percent of banking system exposure to problem loans and doubtful guarantees, respectively. The three banks accounted for 53 percent of the total assets of the banking system.

43. At the time of the EFSAL Board presentation, some progress had already been made in restructuring LBdd and KBM, which were taken over by the Bank Rehabilitation Agency (BRA) in early-1993. The measures that had already been implemented included the: (i) write-off of losses against the banks' existing capital; (ii) BRA acquisition of the remaining net worth of the banks in exchange for conversion of previous bank owners' equity shares into a subordinated debt of the BRA; (iii) carve-out of potential losses from the banks in exchange for an equivalent amount of BRA bonds guaranteed by the State;[11] and (iv) adoption of restructuring programs aimed at enabling these banks to achieve a Capital Adequacy Ratio (CAR) of 4 percent and positive operating cash flows by mid-1994, and at strengthening the banks' governance and risk management policies and systems. All rights of previous owners of the banks, except the right to participate in possible revenues from the recovery of the impaired assets carved

[11] By end-December 1993, the BRA had completed carving-out DM 1.0 billion of LBdd's and DM 0.4 billion of KBM's problem assets identified at the time of their takeover.

out by the BRA, were eliminated. In a parallel action, the State had exchanged, for the banks in the system, the frozen claims against NBY with State bonds.

44. In July 1994, the Slovene Parliament adopted constitutional amendments which essentially effected a second stage restructuring of LBdd and KBM. Each of these banks was separated into a new bank and an old bank. All branches in other former Yugoslav republics and all assets and liabilities related to former Yugoslavia remained in the old banks, to be dealt with directly by the BRA and the Government. The new banks, Nova Ljubljanska Banka (NLBdd) and Nova Kreditna Banka Maribor (NKBM), were thus cleaned of the remaining major outstanding problem assets and liabilities in preparation for their future privatization. The authorities' initial efforts to sell KBNG to suitable investors were not successful and, in early 1994, the BRA took over the bank for rehabilitation. A diagnostic review indicated that this bank was too small to be an effective independent institution, and it was subsequently merged with NKBM as of January 1, 1995.

45. The end-1995 audits of NLBdd and NKBM indicate that (i) both banks have a CAR substantially exceeding the 4 percent target agreed under the EFSAL, and (ii) the major burden on operational cash flow of the banks, resulting from their holdings of DM denominated, 30 year BRA and Republic of Slovenia bonds, was substantially remedied by replacement of the BRA bonds in both banks with 3, 7, 10, and 15 year bonds denominated in SITs. Since their take-over and the appointment of new management, the two banks have been effectively managed. The supervisory boards of the banks have been dominated by the staff of the BRA. The Government, BoS, and the BRA are presently taking steps towards graduating the two banks from rehabilitation in advance of their privatization.

46. A privatization strategy is currently being formulated by the authorities with a view to privatizing the two banks by late-1996/early-1997. The legal framework for these privatizations will be established by the law on Privatization of Legal Entities and Property Owned by the Republic of Slovenia, currently under consideration by Parliament. As initially expected, the focus of the BRA, as the owner of the banks, is beginning to shift from rehabilitation to privatization. The BRA was directly in charge of the negotiations for divestiture of NLBdd's share in daughter banks, and by end-1994 it had sold the shares in the largest of NLBdd daughter banks (Koper and Novo Mesto, Celje, and Kranj). With the graduation of NLBdd and NKBM, the BRA will be wrapping up its banking rehabilitation operations.[12] The new banking law assigns the responsibility for future bank resolutions to the BoS.

B. Proposed Borrowers under the IRP

47. In preparation for IRP appraisal, all banks (over 30) were contacted and briefed, by the Ministry of Finance (MoF), about the objectives of the project as well as participation requirements. Seven banks *(NLBdd, KBM, SKB Banka dd, Banka Celje dd, SIBdd, Abanka, and LB Kranj)* applied to MoF to be considered as potential intermediaries for the line of credit.

48. During project preparation, the authorities agreed to a three step process leading to their endorsement of banks as borrowers under the project. These steps included: (i) thorough

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[12] The BRA's other major area of focus has been restructuring of the carved-out debt. Significant support from the British Know-How Fund, USAID, and EU-Phare has been utilized to further develop transaction experience, policies, procedures, and systems for asset management. The latest available (mid-1995) data showed that 36 percent of the debts of the enterprises originally transferred to the BRA had been resolved.

audits/diagnostics according to agreed terms of reference fully reflected in the auditors' engagement letters; (ii) conclusion of satisfactory supervisory agreements, as necessary, between the BoS and participating banks; and (iii) issuance to the Bank of a supervisory comfort letter by the BoS for each bank.

49. Following discussions and review of all applicant banks, it was decided to proceed with the extensive review of three banks, NLBdd, SKB Banka dd, and Banka Celje, which will be the borrowers under the project. The three banks have all had, in addition to their normal annual statutory audits by international auditors, an extended diagnostic audit performed on their accounts of 1993 or 1994. They together account for 46 percent of the banking assets in Slovenia and 53 percent of the banking sector's claims on the non-banking sectors. The detailed assessment of these banks are available on file, on a confidential basis, due to the propriety nature of the information.

50. *NLBdd* (Annex 5) is a particularly important participant in the IRP because of its skilled staff and record in investment financing as well as its size and reach in the country. The bank has been successfully undergoing rehabilitation since 1993 and is, at this time, fully Government owned. The bank is expected to be privatized by end-1997. The bank has benefitted from assistance from the Bank and IFC, since the 1980s, and has been the training ground for Slovene experts in the field of investment evaluation and financial analysis. Previous NLBdd staff are now occupying senior level positions in BoS, BRA, the Development Fund, the Privatization Agency, as well as in other banks and Government agencies. NLBdd is the borrower of the Energy Conservation and Substitution Project (Loan 2799-0) which disbursed US$24 million in FY94. The loan closed on June 30, 1994, and the final disbursement was made in July 1994. In addition to this proposed loan, NLBdd is in discussions with various financial institutions to secure subordinated debt for balance sheet strengthening, which will help in privatization of the bank. The bank has also successfully raised three syndicated loans of US$15 million, DM 120 million, and DM 75 million in Europe to reduce its Slovene interbank borrowings.

Table 4: Slovenia - Banking Sector (end-1995)

	total all banks						
	SIT[1/]	DM	US$	Percent	NLBd	SKBd	Celje
	(in billions)			GDP	as % of total banks		
Assets	1,552	17.7	12.3	76.3	31.9	11.5	4.4
Claims on non-banking sectors[2/]	906	10.3	7.2	44.7	35.1	12.5	5.4
Deposits	872	9.9	6.9	42.8	24.5	14.2	5.3

Notes:
1/ US$ 1 = 125.9 SIT; DM 1 = 87.89 SIT (end of month rates for 12/95)
2/ Includes loans, commercial papers and bonds, and shares and participations.
Source: Bank of Slovenia and Commercial Banks

51. *SKB Banka dd* (Annex 6) has actively sought dialogue with the Bank since the initial stages of EFSAL preparation. SKBdd is one of the youngest and most dynamic banks in Slovenia. Its management team is competent and reasonably experienced. SKBdd's risk management programs appear

better developed than those in other Slovene banks, but require further enhancement. Organizational changes are needed in order to integrate treasury functions and lending units (international and corporate). Management is aware of these limitations and is seeking to strengthen these key units. The bank is over 50 percent privately owned, including about 25 percent by foreign investors. EBRD, with a 15 percent shareholding, is the largest shareholder. The other major owners include, ASH dd Brokerage House (5.6 percent), the City of Ljubljana (5.1 percent), German Investment and Development Company (DEG -- 5 percent), and Merril Lynch International (4.3 percent). Management holds close to a 5 percent participation and also exercises control over 6 percent owned by SKBdd. The bank secured, in 1994, a line of credit of DM 50 million from EBRD for onlending to its clients (not limited to the private sector). The line is fully disbursed.[13] In addition, the bank has secured two syndicated loans from Barclay's Bank and Barclays de Zoete Wedd.

52. *Banka Celje dd* (Annex 7) is a well established bank that has its origins in the community savings bank of the Celje region of Slovenia. It was established in 1894. Since 1993, the bank's market share has steadily grown from about 4.0 percent to 4.4 percent of the total Slovene banking system. Management plans to increase this share to at least 8 percent, regarded as the minimum size needed to achieve medium-term viability. Senior management of the bank intends to achieve this major objective through mergers and acquisitions, as well as the establishment of new branches. The main focus of Banka Celje's business remains retail banking and support to the existing local corporate community. There is growing local competition, but the bank's regional market share has stabilized at around 75 percent of the retail accounts. The bank is over 60 percent privately owned. The ownership is well diversified with more than 1,000 shareholders, only one of which exceeds a significant level of participation (10 percent). The corporate governance structure in place is effective.

IV. The Project

A. Project Objectives and Description

53. The Investment Recovery Project (IRP) complements the Enterprise and Financial Sector Adjustment Loan (EFSAL) by helping to provide long-term finance for the new cycle of private investments resulting from Slovenia's program of enterprise and financial sector reforms. The project follows successful stabilization of the Slovene economy, and substantial progress in restructuring major banks. To this end, it will help maintain the momentum built under the EFSAL in reforming the banking system, by enforcing the principles of these reforms in three borrowing banks, accounting for about 50 percent of Slovenia banking assets. The project is timed to coincide with a period of intensive privatization of enterprises accounting for more than 75 percent of Slovenia's enterprise sector output.

54. It is proposed that a separate single currency loan (SCL) be made to each of the three borrowing banks with the Guarantee of the Republic of Slovenia. The loans will be to: (i) Nova Ljubljanska Banka dd (DM 35 million); SKB Banka dd (DM 30 million); and Banka Celje dd (DM 10 million). The single

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[13] The loan is for 8.5 years with 1.5 years of grace at LIBOR plus 125 basis points, and was disbursed in three tranches. The loan has already been fully utilized by SKB. This is an example of the demand for term finance in the country, and the dynamism with which Slovene banks intermediate such funds. It should be noted, however, that EBRD funds could be granted to enterprises prior to their privatization.

currency loans will be repayable over 15 years with 5 years of grace for level repayment of principal, at the Bank's standard interest rate for LIBOR-based DM single currency loans. During appraisal, Bank experts met Government officials and commercial bank managers to explain the terms and characteristics of the loans available under the Single Currency Loan Program (single currency and currency pool loans).

B. Actions Associated with the Project

55. The project encompasses three mutually reinforcing sets of actions designed to safeguard project objectives: first, submission to Parliament of a satisfactory new banking law, prior to IRP Board presentation; second, commitment by the Bank of Slovenia to supervise the borrowing banks according to criteria satisfactory to the Bank; and third, inclusion, in the project, of agreements with the banks, as appropriate, to ensure the application of prudent banking practices.

56. The proposed banking law, which was approved by Government on June 27, 1996, and has been submitted for Parliamentary approval, was prepared by the Ministry of Finance and the Bank of Slovenia in close collaboration with concerned parties including the Slovene Bankers Association. It also reflects close consultation with the Bank during implementation of the EFSAL and preparation of this project. The proposed law strengthens the authority of the Bank of Slovenia in bank regulation and supervision. The Bank of Slovenia will be vested with full powers for implementing the banking law and regulations. The law clearly delineates the enforcement process, as well as an effective mechanism for temporary intervention in problem banks, and defines the responsibility for managing bank resolutions.

57. As part of its collaboration in implementation of the project, the Bank of Slovenia has, inter alia, committed to perform an extensive on-site examination of SKBdd and Banka Celje in 1996, and of NLBdd in 1997. These on-site examinations will include a special portfolio review to be carried out by Bank of Slovenia supervisory staff with the assistance of external advisors, and special audits of the banks' organizations, procedures and processes to be carried out by international auditing firms financed by the EU-Phare. The Bank of Slovenia has committed to review with the Bank the results of these audits and the actions that they will request the banks to undertake to remedy shortcomings. This collaboration with the Bank of Slovenia on the three banks will be part of the ongoing enhancement of the supervisory function of the Bank of Slovenia, initiated under the EFSAL. As part of its commitment to this goal, the Bank of Slovenia has expressed its intent to review with the Bank during the implementation of the IRP the lessons learned from its supervision activities during 1996-1997, and accordingly modify its supervisory strategy and plan of activities for 1998-1999.

58. Moreover, the Bank of Slovenia intends to adopt, during the first year of implementation of the project, new regulations on risk concentration management standards and large exposure limits, liquidity risk management standards, and foreign exchange risk management.

59. The Bank of Slovenia has confirmed the good standing of the borrowers with respect to current Slovene regulations in letters of comfort sent to the Bank in March 1996. Given the strength of the Bank of Slovenia program and the positive future impact of the new banking law, specific conditions on the borrowers, in this project, has focussed on establishing risk management functions independent from the lending functions. To this end, specific agreements reached with the respective borrowing banks include: (i) assignment by Banka Celje, prior to effectiveness of the Bank loan, of a qualified consultant or staff of the bank, based on terms of reference acceptable to the Bank, to establish and expanded credit risk management function, independent from the lending function; and (ii) initiation by SKB and Banka Celje, by end-1996, of implementation of a plan, acceptable to the Bank, to introduce an improved risk

management function.[14] In addition, agreements have been reached with each of the borrowers to review with the Bank, by mid-November of each year during project implementation, the proforma letters of engagement of their respective statutory annual external audits with a view to modifying/expanding the scope of these audits as necessary.

C. Project Cost and Financing

60. The total cost of the line of credit is estimated at about DM 75 million equivalent.

D. Environmental Aspects

61. This project has been classified as a "B" project, in conformance with normal practice under O.D. 4.01 regarding intermediary lending. Since subprojects are yet to be determined, specific guidelines would be established for the environmental screening and analysis/assessment of subprojects, following subproject selection. Specific environmental requirements for subproject approval would be developed in cooperation with the Ministry of Environment (MoE) in Slovenia. The preparation of mitigation plans or environmental assessments as needed would be the responsibility of the MoE. The capacity of the selected intermediary banks to carry out environmental screening and of local firms to carry out environmental analyses and assessments was reviewed during appraisal, and were found to be satisfactory.

62. Specifically, during the appraisal mission, environmental impact assessment (EIA) procedures of LBdd and SKBdd, MoE, and participating organizations were reviewed. The knowledge of EIA procedures and the capabilities to undertake EIAs are generally very high in Slovenia, and the number of individuals and companies capable of doing them is growing. In June 1994, Parliament adopted a law which made EIAs obligatory on a broad scale.

63. As in the western countries, the banks themselves are not undertaking any major EIAs but delegate this task to specialized institutes. In Slovenia, there are currently a number of organizations with proven ability to undertake satisfactory western-style EIAs. The Bank, in collaboration with the authorities, made arrangements for a major training course, which took place in April 1994. The MoE and a number of the Slovene banks including the potential borrowers of IRP loans participated in this course. The cost for the training course was covered under the Bank's Mediterranean Environmental Technical Assistance Program (METAP).

E. Project On-Lending and Implementation Arrangements

64. The onlending and implementation arrangements were agreed during negotiations. They are summarized below and discussed in more detail in the Project Implementation Plan (Annex 2).

Onlending Arrangements

65. The bank subloans for investments will be made to eligible enterprises and would be for periods no longer than ten years with grace periods of up to three years. All subloans would be made in DM, at market rates, and the beneficiaries will assume the foreign exchange risk. Subloans will be made

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[14] NLBdd has already established separate and independent lending and risk management functions.

available on a first-come, first-served basis, without prior allocation to specific types of activity or categories of enterprises.

Project Implementation arrangements

66. A project implementation team has been appointed in each bank. The teams will be responsible for overall implementation of the project. The team will be headed by a team leader assisted by two other staff members, one for procurement and one for financial/disbursement matters. Team members will be trained in project implementation, including procurement and disbursement. Details of implementation arrangements, including inter alia Accounts and Audits, Training of Staff, Monitoring and Evaluation and Supervision are included in the Project Implementation Plan (Annex 2).

Eligible Enterprises and Subprojects

67. Any enterprise duly established under the laws of Slovenia, with at least 51 percent private shareholding (controlling share), will be eligible to seek financing under the loan. The borrowing banks will undertake normal financial investigations as part of their credit analysis of potential borrowers. Subloans over DM 4.5 million equivalent will require prior World Bank review. The first appraisal by each participating bank will be submitted for prior World Bank review, irrespective of subloan size.

68. The subloans may finance up to 80 percent of an expansion/modernization project in the case of an existing enterprise, or up to 50 percent of total investment in the case of a new enterprise.

69. For all subloans above DM 450,000 equivalent: (i) during the term of the subloan, the enterprise's debt:equity ratio should not exceed 60:40, and the debt-service coverage ratio should not fall below 1.5; and (ii) the proposed investment must have a financial rate of return of at least 12 percent. For subloans of less than DM 450,000 equivalent, the banks will utilize their own criteria to assess the viability and financial soundness of the investments and of the enterprise and its capacity to service the debt. Banks will be expected to include in their credit appraisal a demonstration that the currency and terms selected for the subloans are appropriate, given the projected foreign exchange revenues of the sub-borrowers.

70. The banks will ensure in their on-lending agreements that enterprises which benefit from the proceeds of the loan are currently in compliance with Slovene environmental regulations, and agree to build facilities and operate their plants according to these regulations.

Procurement and Disbursement

71. The loan will finance the procurement of goods and related services, including machinery, equipment, tools, materials, etc., needed by private enterprises for new plants, upgrading, debottlenecking and expansion, as well as, associated working capital. All procurement under the loan will be carried out in accordance with the Bank Procurement Guidelines. Given the nature of the project, involving support to subprojects which have not been preappraised, detailed estimates for the breakdown of the project expenditures by procurement method are not available. Accordingly, a procurement table is not included. Retroactive financing of about 9 percent of the aggregate amount of the three loans (DM 3.5 million and DM 3.0 million for NLBdd and SKB Banka dd, respectively) will be provided for payments for goods made after June 10, 1996. Details of the procurement and disbursement arrangements are included in the Project Implementation Plan (Annex 2).

F. Project Benefits and Risks

72. Investment growth is key to maintaining the impact of the structural reforms and speeding up the growth of the Slovene economy. Despite its small size, the Investment Recovery Project is expected to play an important role in supporting investment by the private sector. The funds to be provided are long-term resources whereas up to now enterprises have utilized revolving short-term credits to cover a major share of their credit needs. At this point, there is practically no local source of long-term finance in the country, although the major banks have recently been raising 3-5 year money on the European markets. The selection of DM for this project will benefit the beneficiaries by making available to them loans in the currency of their expected export revenues, thereby avoiding possible cross-currency risks. Furthermore, as the IRP funds will be exclusively targeted to private enterprises, it will help speed up private sector growth and the privatization process by promising to support the financing needs of the would-be owners at sustainable costs.

73. By following substantial progress in restructuring major banks, the project will help maintain the momentum built under the EFSAL in reforming the banking system. It will help consolidate the restructuring actions and institutional development in the three borrowing banks. Furthermore, the availability of Bank Group funds to these banks will help further sharpen their skills in assessing risks and extending long-term finance to private enterprises and help catalyze larger and more active banking sector participation in such financing. Because of understandings reached during the preparation of the project and implementation of the EFSAL, the project will also help engage BoS in in-depth supervision of these important banks.

74. The main risks affecting the successful implementation of the project arise from failure in maintaining macroeconomic stability, completing the banking reform program, and concluding privatization. However, the reform is proceeding steadfastly with the full backing of the population and political parties. Another risk arises from the possibility that the banks do not actively seek to lend. However, this has been minimized by working directly with the banks to determine the appropriate scale of lending to match their own business plans. In addition, by making the IRP funds directly available to the banks as borrowers, banks are responsible for the commitment fees. This creates an added incentive to lend the funds in a timely manner for attractive investments.

G. Agreements and Recommendations

75. The following agreements were reached during negotiations with individual Borrowers and the Guarantor:

General Agreements

(i) terms and conditions of the subloans (paras 65 and 68-70);

(ii) eligibility criteria for the final beneficiaries (para 67);

(iii) responsibilities of the implementation teams (para 66);

(iv) procurement arrangements and procedures (para 71);

(v) disbursement arrangements (para 71); and

(vi) auditing and reporting requirements (para 71).

Condition of Board Presentation

76. Submission to Parliament of a new banking law, satisfactory to the Bank, is a condition of Board presentation (para 56).

Borrower Specific Conditions of Effectiveness and Dated Covenants

77. During negotiations, with the respective borrowers, it was agreed that:

(i) prior to effectiveness of its loan, Banka Celje will employ a consultant, or assign a qualified staff, based on terms of reference satisfactory to the Bank, to establish an improved credit risk management function, independent from the bank's lending function (para 59);

(ii) SKB Banka and Banka Celje will each initiate by end-December 1996, implementation of a plan, acceptable to the Bank, to introduce an improved risk management function (para 59); and

(iii) each borrowing bank will, by November 15 each year during project implementation, submit to the Bank for its review, proforma engagement letters for its external audits of that year's accounts prior to entering into agreement with its external auditors (para 59).

SLOVENIA - Investment Recovery Project

List of Documents on File

A. Nova Ljubljanska Banka dd

A1. Slovenia - Investment Recovery Project, Appraisal of the Potential Participating Banks, Final Draft Report on Nova Ljubljanska Banka dd., AIB International Consultants, August 1995.

A2. Nova Ljubljanska Banka dd, Annual Report 1995.

A3. Nova Ljubljanska Banka dd, Annual Report 1994.

A4. Nova Ljubljanska Banka dd, Opening Balance Sheet & Note as at 28 July 1994.

A5. Ljubljanska Banka dd, EU Technical Assistance Project Phase 1 - Final Report Subsequent to Steering Committee Meeting of 11 July 1994, AIB International Consultants, July 1994.

A6. Ljubljanska Banka dd, Report and Financial Statements for the year ended 31 December 1993.

A7. Ljubljanska Banka dd, Diagnostic Review for the year ended 31 December 1993, Volumes I & II, Report and Appendices, Coopers & Lybrand.

B. Banka Celje dd

B1. Slovenia - Investment Recovery Project, Appraisal of the Potential Participating Banks, Final Draft Report on Banka Celje dd, AIB International Consultants, August 1995.

B2. Banka Celje dd, Report and Financial Statements for the year ended 31 December 1994, Coopers & Lybrand.

B3. Banka Celje, Annual Report, 1995.

B4. Banka Celje, Annual Report, 1994.

B5. Banka Celje, Brief Report, 30 June 1995

B6. BOS Supervisory Comfort Letter, 12 July 1994.

B7. LB Splosna Banka Celje dd, Credit Review, KPMG Peat-Marwick, 31 December 1993.

B8. LB Splosna Banka Celje dd, Financial & Diagnostic Review, KPMG-Peat Marwick, 31 March 1994.

C. SKB Banka dd

C1. SKB Banka dd, Draft Diagnostic Report, Touche Ross & Co, June 1995.

C2. Slovenia - Investment Recovery Project, Appraisal of the Potential Participating Banks, SKB Banka dd, Clydell McSpadden, Consultant, August 1995.

C3. SKB Banka dd, "Matters Arising from the Audit for the year ended 31 December 1994", Coopers & Lybrand.

C4. SKB Banka dd, Annual Report, 1995.

C5. SKB Banka dd, Annual Report, 1994.

C6. SKB Banka dd, Business Plan & Cash Flow Projections: 1994-1998, October 1994.

C7. Independent Auditors Report to the Shareholders of SKB Banka dd for the year ended 31 December 1993, Coopers & Lybrand London & Ljubljana, 20 April 1994.

C8. SKB Banka dd, Development Strategies of the Bank, September 1992.

C9. SKB Banka dd, Annual Report, 1991.

C10. SKB Banka dd, Report and Financial Statements for year ended 31 December 1991.

SLOVENIA - Investment Recovery Project

Project Implementation Plan

A. Project Objectives and Description

1. The Investment Recovery Project complements the Enterprise and Financial Sector Adjustment Loan (EFSAL) by helping to provide long-term finance for the new cycle of private investments resulting from Slovenia's program of enterprise and financial sector reforms. The project follows successful stabilization of the Slovene economy, and substantial progress in restructuring major banks. To this end, it will help maintain the momentum built under the EFSAL in reforming the banking system, by enforcing, during the course of the project, the principles of these reforms in three borrowing banks, accounting to about 50 percent of Slovenia banking assets. The project is timed to coincide with a period of intensive privatization of enterprises accounting for more than 75 percent of Slovenia's enterprise sector output.

2. It is proposed that a separate floating single currency loan (SCL) be made to each of the three borrowing banks with the Guarantee of the Republic of Slovenia. The loans would be made to: (i) Nova Ljubljanska Banka dd (DM 35 million); SKB Banka dd. (DM 30 million); and Banka Celje dd (DM 10 million). The Single Currency Loans will be LIBOR-based, and repayable over 15 years with 5 years grace, for level repayment of principal at the Bank's standard interest rate for LIBOR-based DM single currency loans.

B. Onlending and Implementation Arrangements

3. ***Onlending Arrangements***. The subloans for investments will be for periods no longer than ten years with grace periods of up to three years. All subloans will be made at market rates in DM and the beneficiaries will assume the foreign exchange risk. Subloans will be made available on a first-come, first-served basis, without prior allocation to specific types of activity or categories of enterprises.

4. The sub-loans will provide financing for investments and associated working capital for start up and expansion of private enterprises. This will inter alia include financing of licenses or other types of technology transfer when associated with an investment. The subloans may finance up to 80 percent of an expansion/modernization project in the case of an existing enterprise, or up to 50 percent of total investment in the case of a new enterprise.

5. ***Eligible Enterprises***. Any enterprise duly established under the laws of Slovenia, with a private share-holding (controlling share) of at least 51 percent, will be eligible to seek financing under the loan. The borrowing banks will undertake normal financial assessments as part of their credit analysis of potential borrowers. Subloans over DM 4.5 million equivalent will require prior World Bank review. The first appraisal by each participating bank will be submitted for prior Bank review, irrespective of subloan size.

6. For all subloans above DM 450,000 equivalent: (i) during the term of the subloan, the enterprise's debt:equity ratio should not exceed 60:40, and the debt-service coverage ratio should not fall below 1.5;

and (ii) the proposed investment should have a financial rate of return of at least 12 percent. For subloans of less than DM 450,000 equivalent, the bank will utilize its own criteria to assess the viability and financial soundness of the investments and of the enterprise and its capacity to service the debt. Banks will be expected to include in their credit appraisal a demonstration that the currency and terms selected for the subloans are appropriate, given the projected foreign exchange revenues of the sub-borrowers.

7. ***Organizations Responsible for Project Implementation***. The borrowing banks will be responsible for the overall implementation and administration of the project. The other entities involved in the implementation of the project will be private enterprises (sub-borrowers), the Bank of Slovenia, and the Bank. The following table summarizes respective responsibilities in implementation of the project.

	Primary Responsibility		
	Borrowers	Enterprises	BoS
-Overall project administration	x		
-Project supervision	x		
-Preparation of subprojects		x	
-Appraisal/assessment of subprojects	x		
-Subproject review and approval	x		
-Procurement	x	x	
-Disbursements	x		
-Submission of biannual progress reports	x	x	
-Audit of borrowing enterprise	x	x	
-Audit of Project accounts	x		
-Supervision of borrowers' commercial activities			x

8. ***Project Implementation Arrangements***. A project implementation team will be appointed in each bank, preferably within the credit department. The team will be responsible for overall implementation of the project. It will be headed by a project coordinator assisted by two other staff members, one for procurement and one for financial/disbursement matters. Several staff members from each bank have been trained in disbursement and procurement by Bank staff in July and September 1995.

9. Each project implementation team will be responsible for:

- Preparing and disseminating information about the credit line to eligible Slovene enterprises;

- Assisting beneficiaries in the application of agreed procurement procedures, including appropriate packaging of bid items; selection of the most appropriate methods of procurement for each individual subproject and their step-by-step implementation;

- Administering the use of World Bank resources and ensuring that procurement, disbursement and environmental procedures are followed, and making arrangements for the audit of accounts;

- Maintaining summary records of the flow of resources;

- Maintaining the special account, arranging payments, preparing withdrawal applications, maintaining project accounts; and

- Preparing and submitting periodic progress reports to the World Bank.

10. ***Project Implementation Team***. The functional responsibilities of each team member will be as follows:

(a) *Project Administration (Team Leader)*

- Overall responsibility for project implementation and supervision;

- Liaison with the World Bank staff and with private enterprise beneficiaries on project implementation issues;

- Preparation and dissemination of information about the credit line;

- Ensuring that loans are made to eligible beneficiaries in accordance with agreed criteria and that procurement and other requirements are adhered to by all concerned;

- Financial administration of the loan, i.e., management of the special account, timely payments to suppliers and withdrawal of funds from the loan account, maintenance of loan accounts and arrangements for audits in a timely manner; and

- Preparation and submission of semi-annual progress reports to the World Bank.

(b) Procurement

- Under the supervision of the team leader, advise enterprises on agreed procurement procedures; assist them as necessary in determining the most appropriate method of procurement within the framework of the Loan Agreement; and provide them with the necessary procurement documents, such as standard bidding documents;

- Advise and assist enterprises, as necessary, in the process of procurement, e.g., preparation and publication of advertisements, bidding documents, bid opening and evaluation of bids, award of contract;

- Review and approve procurement documentation (advertisement, bidding documents, evaluation report, and final contract) for bid packages subject to post review; and review and forward procurement documentation for bid packages subject to the World Bank's prior review;

- Provide training in procurement to the staff of enterprises, as necessary; and

- Collect procurement documents, maintain up to date procurement records in the team's offices, and compile procurement data for the bi-annual progress report to the World Bank.

(c) Disbursement

- Under the supervision of the team leader, manage the special account;
- Work closely to ensure that payments are made to suppliers in a timely manner in accordance with contract conditions;
- Prepare withdrawal applications for disbursements from the loan;
- Keep up-to-date project accounts and records and monitor disbursements under the loan and under different subloans; and
- Compile disbursements data for the bi-annual progress report to the World Bank.

11. The teams will be responsible for ensuring all required eligibility criteria are met before submission of the applications to the World Bank for review (where necessary), and ensure their compliance during the implementation of the project.

C. Procurement and Disbursements

12. The loan will finance the procurement of goods, including machinery, equipment, tools, materials, etc., needed by private enterprises for new plants, upgrading, de-bottlenecking and expansion, associated working capital, civil works and services. All procurement under the loan will be carried out in accordance with the Bank Procurement Guidelines. Given the nature of the project, involving support to subprojects which have not been preappraised, detailed estimates for the breakdown of the project expenditures by procurement method are not available. Accordingly, a procurement table is not included. A general procurement notice will be published in the Development Business of July 1996.

13. Each beneficiary would be required to group, to the extent practicable, machinery and equipment in sizable bid packages in order to enhance competition and gain from economies of scale in bid prices. International Competitive Bidding (ICB) would apply for all contracts with a value greater than DM 4.5 million equivalent. The manufacturing industry in Slovenia is already established and it is expected that bids would also consist of domestically manufactured goods and materials. Therefore, in the evaluation and comparison of bids for machinery and equipment to be procured through ICB, domestic manufacturers would be granted a margin of preference of 15 percent--or the relevant customs duty, whichever is lower--in accordance with Appendix 2, para 1 to 4 of the Bank Procurement Guidelines of January 1995. The borrowers will use the Bank's standard bidding documents wherever available; otherwise, suitable international bidding documents will be submitted to the Bank for prior review and approval.

14. For contracts for goods with an estimated value above DM 1.5 million equivalent and less than DM 4.5 million equivalent, beneficiaries may us international shopping, based on a comparison of price quotations obtained from at least three suppliers in two different countries.

15. For bid packages for goods with an estimated value of DM 1.5 million equivalent or less per account, beneficiaries would use their established Commercial Practices which have been found competitive and acceptable to the Bank. These involve competitive quotations obtained from other

countries. The use of the commercial practices is justifiable because the proceeds of the loan would be used only by privately owned enterprises (51 percent of ownership in private hands) who carry out their domestic and foreign purchases based on competitive prices. Certain equipment, components, parts and materials that beneficiaries would need are available locally on a competitive basis. Goods and technical licenses which the Bank agrees are of proprietary nature, or the quick purchase of which is critical for efficient project execution, or need to be compatible with other installed equipment, would be procured through Direct Contracting with Bank prior approval, in accordance with the Bank's Guidelines. For equipment and materials which the Bank agrees are supplied through a limited number of suppliers, procurement would be done following Limited International Bidding (LIB) procedures in accordance with the Bank's Guidelines.

16. ***Procurement Law and Country Procurement Assessment Report.*** A comprehensive procurement law is currently under preparation in Slovenia. However, since 1992, the MoF has been including in the yearly budget law some mandatory procurement provisions for the users of public funds. Since the loan for the Investment Recovery Project would be used by private enterprises, the procurement provisions of the budget law would not apply. A country procurement assessment for Slovenia is not planned.

17. ***Procurement Responsibility.*** The project implementation team in each bank will have the overall responsibility for ensuring that agreed procurement procedures are followed by the beneficiaries. More specifically, the team will be responsible for ensuring that beneficiaries are familiar with the Bank's Procurement Guidelines and procedures and have access to the Bank's standard bidding documents. The team will also provide the necessary general guidance on procurement to beneficiaries as well as information on procurement procedures and different procurement methods agreed with the Bank; will help beneficiaries determine which procurement method(s) will be applicable to their investment; will provide them with the necessary procurement documentation, such as standard bidding documents, etc., and will ensure that beneficiaries are adhering to agreed procurement procedures. Beneficiaries will be responsible for carrying out the procurement activities in accordance with the above procurement procedures, e.g., preparation of bidding documents, receiving, opening and evaluating bids, awarding contracts and supervising contract performance. A project start-up workshop in Slovenia is tentatively scheduled for September 1996.

18. ***Procurement Monitoring and Supervision.*** Each borrower would monitor the beneficiaries' procurement activities and would carry out regular supervision of the procurement process under each subproject to ensure that procurement actions are being undertaken in a timely manner and in accordance with agreed methods and procedures. Based on the information collected from the beneficiaries, the borrowers would prepare and submit to the Bank biannual progress reports in a format agreed with the Bank. These progress reports would be the basis of regular monitoring of project implementation progress by the Bank staff. The Bank staff would carry out physical supervision of the project twice a year during which an ex-post review of the documentation will be carried out. A mid-term review would also be held in late-1997.

19. ***Review of Procurement Actions.*** Procurement documentation for bid packages estimated to cost DM 4.5 million equivalent and above will be subject to the Bank's prior review. Procurement documentation for all bid packages to be procured through Limited International Bidding (LIB) and Direct Contracting will also be subject to the Bank's prior review. Selective post reviews will be carried out as a regular supervision activity.

20. The review limits are summarized in the following table:

	Teams	World Bank Review	
	Prior Review	Prior	Post
-ICB packages above DM 4.5 million	x	x	
-International Shopping between DM 1.5-4.5 million	x		x
-Commercial Practices up to DM 1.5 million per contract	x		x
-Direct Contracting	x	x	
-LIB	x	x	

* Documents to be retained by the teams be made available to Bank staff upon request for review.

21. In order to ensure enterprises' adherence to agreed procurement procedures, the implementation teams will carry out a review of procurement documentation for all methods of procurement listed above. They will verify all procurement documentation for ICB above DM 4.5 million per contract (draft advertisement, draft bidding documents, evaluation report, and final contract), direct contracting documents (proposal for direct contracting, justification, estimated amount of the contract, etc.), and LIB documents (list of suppliers to be invited to submit bids, draft bidding documents, evaluation report, final contract), before submission to the World Bank. The team will be responsible for keeping complete records of procurement documents (invitation to quote, including technical specifications, offers, evaluation of offers and contract) for International Shopping and Commercial Practices, and will make these records available to the Bank supervision missions for review and to auditors for audit.

D. Disbursements

22. Proceeds of the proposed Bank loan will finance 100 percent of subloans for goods and related services. Subloans in turn would finance up to 80 percent of expansion investments and 50 percent of start-up operations.

23. Disbursements for contracts valued at less than DM 4.5 million equivalent will be on the basis of statements of expenditure (SOEs). The documentation to support these expenditures will be retained by the team, audited by independent auditors acceptable to the Bank, and made available for review by Bank staff upon request. Applications for withdrawals against contracts valued at more than DM 4.5 million equivalent will be fully documented. The team will be working closely with beneficiaries to ensure timely payments to suppliers and timely preparation and submission of withdrawal applications to the Bank. A special account may be established by each bank in DM with a total authorized allocation of up to DM 4.0 million, for NLBdd, DM 3.5 million for SKB Banka dd, and DM 2 million for Banka Celje dd. The initial authorized allocation for the special account of NLBdd will be DM 1.4 million until the aggregate amount of withdrawals from this account exceeds DM 4.0 million. The initial authorized allocation for the special account of SKB Banka dd will be DM 1.2 million until the aggregate amount of withdrawals from this account exceeds DM 3.5 million. The initial authorized allocation for the special account of Banka Celje dd will be DM 1.0 million, until the aggregate amount of withdrawal from the special account is DM 2.0 million.

24. Retroactive financing of DM 3.5 million and DM 3.0 million will be provided for NLBdd and SKB Banka dd, respectively (about 9 percent of the aggregate amount of the loans) to finance payments for goods made after June 10, 1996.

25. Disbursements are expected to be slightly faster than the bank-wide profile since the loan represents only a small proportion of the expected credit allocated by the borrowing banks over the next two to three years. The Closing Date of the loan is expected to be June 30, 2000.

E. Accounts and Audits

26. The project account, Special Account and Statements of Expenditure will be maintained by each Borrower and will be audited at the end of each fiscal year in accordance with international standards and by independent auditors acceptable to the Bank. These audit reports and the financial statements of each bank will be sent to the Bank within six months of the end of each fiscal year. The financial statements of the beneficiaries will be audited in accordance with the Slovene accounting and auditing practices at the end of each fiscal year. The teams will forward copies of the audit reports to the Bank within six months of the end of the reporting period; audit reports from borrowing enterprises will be retained by the banks, and made available to the Bank on request.

F. Training of Staff

27. Representatives of the three borrowing banks, MoF and BoS (representing the guarantor) participated in a procurement and disbursement training workshops during 1995. It has been agreed with the borrowers that prior to the effectiveness, the Bank will organize a one-week procurement seminar in Slovenia for the staff of the banks, as well as, for potential beneficiaries to familiarize them with the World Bank procurement policies and procedures. This seminar is tentatively scheduled for September 1996, as part of the project startup workshop.

G. Monitoring and Evaluation

28. To enable the Bank to monitor the progress of project implementation, and to ensure conformity with project objectives, the implementation team in each bank will furnish the Bank with semi-annual progress reports. The team will prepare these reports based on its own information and the information supplied by beneficiaries. The frequency and format of these reports was agreed during negotiations. In addition, each borrower will prepare an Implementation Completion Report six months after the completion of disbursements, covering all related activities during project implementation and describing the project's costs and benefits.

H. Supervision

29. The performance of the borrowers will be supervised in close collaboration with the Bank of Slovenia as part of its normal supervisory activities and requirements. These requirements provide adequate basis for monitoring and assessing the performance of the borrowers under the project. The performance of the sub-borrowers will be monitored as part of the normal operating procedures of the borrowing banks, and will include, inter alia, compliance with the eligibility criteria for the sub-loans during the course of implementation of the project, as well as the sub-borrowers' record of servicing their debt.

30. The borrowers' staff are being trained on Bank procurement and disbursement procedures. Each team will monitor beneficiaries' project implementation activities in order to ensure timely and efficient implementation in keeping with agreed procedures. Two supervision missions per year are planned during the first two years following loan effectiveness. Agreed expanded scope of annual audits as well as BoS' extended supervision of the banks, based on terms of reference and frequency agreed with the Bank, will give the Bank the ability to monitor diligently the borrowers overall operations and compliance with the loan agreements. The task manager, a banking supervision specialist, and a procurement officer will participate in these missions. About twelve staffweeks per year, including about five weeks of FSD support are planned for supervision of the project.

SLOVENIA - Investment Recovery Project

Criteria Used in Selecting the Borrowing Banks

A. The bank would have deployed, or adopted a plan to deploy:

- A sound and balanced Credit Risk Management Program, including:
  - (i) credit risk identification and risk management policies;
  - (ii) credit extension, documentation and collection processes; and
  - (iii) credit portfolio monitoring and control procedures.

- Sound and balanced Management Programs for Liquidity and Foreign Exchange Risk, including:
  - (i) liquidity and funding policies;
  - (ii) foreign exchange policies, risk limits and risk taking authority; and
  - (iii) information systems & procedures to manage & control risks.

- Effective Internal Controls and an Independent Internal Audit service with sufficient resources and an adequate audit program;

B. The bank would have demonstrated and continue to maintain financial strength appropriate to the risk profile of its activities, as evidenced by:

- Return on assets >0 in real terms after adequate provisioning to maintain capital adequacy ratio (CAR) at acceptable level;

- Positive operating cash flow;

- Full coverage of potential losses in assets;

- General reserve for loan losses = > 1%;

- Tier I disbursed capital or retained earnings = > 4%;

- No single credit risk > 15% of net worth;

- No group of related borrowers > 25% of net worth;

- Sum of large exposures (over 10%) < 8 times net worth;

- Total exposure to bank's group of related parties < 50% of net worth;

- No single sector concentration > 15% of total credits + off balance sheet risks;

- Foreign exchange open position: overall + individual < 15% of net worth;

- Total positive liquidity gap at 8-15-30 days;
- Feasible liquidity contingency plan; and
- A capital adequacy ratio between 8 to 12% according to profile based on indicators above.

C. The bank would have a balanced business strategy supported by strengths, weaknesses, opportunities, threats (SWOT) analysis, linking the plan and the budget through quantifiable parameters for risk/reward, including identification of sources for additional capital support and supporting pro-forma financial statements.

D. Clean supervisory statement following diagnostic examinations commissioned by Bank of Slovenia or Bank Rehabilitation Agency (for banks under rehabilitation) following pre-agreed terms of reference indicating supervisory strategy and objectives for maintaining adequate supervision of each bank.

E. If necessary, an agreement between the borrowing bank and Bank of Slovenia specifying individual conditions and requirements for the bank to adapt to, or to maintain conformance with, Bank of Slovenia's standards and the eligibility criteria.

Annex 4

SLOVENIA - Investment Recovery Project

Schedule of Disbursements
(DM millions)

	Fiscal		Disbursements			Sector Disbursement Profile		Percentage Difference Project over Bankwide Profile
Project Year	Year	Semester	Periodic	Cumulative	Cumulative as % of Total	Regional	Bankwide	
Year 1	1997	1	4	4	5%	3%	3%	+2%
		2	9	13	17%	10%	10%	+7%
Year 2	1998	1	12	25	33%	18%	22%	+11%
		2	15	40	53%	30%	34%	+19%
Year 3	1999	1	14	54	72%	38%	50%	+22%
		2	10	64	85%	50%	66%	+19%
Year 4[1]	2000	1	9	73	97%	66%	78%	+19%
		2	2	75	100%	82%	90%	+10%
						90%	98%	
						94%	100%	
						98%		
						100%		

NOTE: There are no comparative disbursement profiles for Slovenia.

1/ Closing Date: June 30, 2000.

SLOVENIA - Investment Recovery Project

Nova Ljubljanska Banka dd

1. Nova Ljubljanska Banka d.d. (NLBdd) was created in July 1994 by a constitutional amendment transferring parts of the operations of the former Ljubljanska Banka dd (LBdd) to NLBdd. The founder and sole owner of NLBdd is the BRA. All branches in other former Yugoslav republics and all assets and liabilities related to former Yugoslavia remained in the old bank, to be dealt with directly by the BRA and the Government. NLBdd was thus cleaned of the remaining major outstanding problem assets and liabilities in preparation for its future privatization.

2. Although substantially downsized compared to its past level of operations, NLBdd (with total assets of SIT 460 billion) remains the largest universal bank in Slovenia with a staff of about 2500 (about 30 percent reduction since 1993) and a market share in primary banking activities of around 30 percent. The bank enjoys the major share (around 50 percent) of the international banking business in the country, and is well placed to serve its customers through its overseas network of subsidiaries, branches and representative offices, as well as through its extensive correspondent banking arrangements. Through its treasury department NLBdd is (de facto) the clearer of the Slovene foreign exchange market and a significant provider of foreign exchange services to its clients. The bank has, in the past, actively and quite successfully developed its investment banking, trade finance, and loan syndication activities in which it is still the leader in Slovenia. In addition to its international network, NLBdd holds 22 percent of shares in Adria Bank Vienna, 46.3 percent of shares in LBH International Handelsbank in Frankfurt, and is a major share holder (60 percent) in Proteus Finanz in Zurich. The bank is also the sole owner of LBS Bank in New York.

3. BRA supervises NLBdd through an appointed supervisory board, composed mainly of BRA staff. Day-to-day operations are under the control of the management board which include president (and CEO), and deputy president. The bank operates a divisionalized structure with each of its major three divisions managed by an experienced executive director. Internal audit, strategic development, and information technology are among the key areas reporting to the management board.

4. In parallel with extensive financial and internal control diagnostics carried out by Coopers & Lybrand during the last two years, the present president of the bank launched a comprehensive institutional development program (IDP), in the fall of 1993, to strengthen the most important risk management and operational areas of the bank. The bank has been very successful in mobilizing substantial external technical assistance, from the EU-Phare and other sources, to implement the IDP.[1] The first phase of the IDP focused on crucial risk management areas (credit, treasury, finance, and IT), and is expected to continue with other less priority areas such as branching and human resources in the future. Substantial overall progress has been achieved with the targets of the first phase. Specifically, the bank is now strong in credit management, both in policy and in lending practices, with a significant and evident improvement in the risk management area since the establishment of its independence from credit origination. In addition, a branching plan for NLBdd including the rationalization of its investments in subsidiaries has

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[1] AIB International Consultants.

been adopted by BRA. The above were discussed during negotiations and were found to be satisfactory to the Bank.

5. Historical financial performance of the bank has to be assessed keeping in mind the structural changes that took place in January1993 (initiation of rehabilitation of LBdd) and July 1994 (establishment of NLBdd). In the process of rehabilitating the bank, credit risk issues have been satisfactorily resolved and non-performing assets have been properly dealt with or provisioned. However, until recently, the structure and terms of the recapitalization bonds left important market risk exposures in NLBdd which were outside the control of the senior management of the bank. As a result, between 1993-1995, the performance of the bank was adversely affected by the impact of these bonds.

6. From July 28, 1994 to year-end 1994, NLBdd's net income was SIT 1.15 billion and at year-end 1994, the bank had a CAR of 10.2 percent. However, NLBdd suffered from a negative operating cash flow. Cash flow before changes in operating assets for the period from July 28, to year-end 1994 was a negative SIT 2.0 billion.

7. A major drag on operating cash flow was generated from the bank's SIT 115.7 billion[2] in holdings of BRA and Republic of Slovenia bonds at year-end 1994. The cash flow NLBdd received from these bonds was negative because the bonds generated cash only equal to their stated 8 percent interest rate (translated from DMs to SIT at the current exchange rate) while they were funded by liabilities which for the most part paid out cash for both a stated real interest rate and an inflation adjustment. Additionally, the bonds' DM-denomination caused fluctuations in earnings, cash flow, and asset values and their 30 year term significantly reduced the bank's liquidity. The bonds were not marketable and would not generate cash from principal repayments until 2023.

8. This unfavorable situation has now been substantially addressed. The Ministry of Finance carried out an evaluation of the impact of alternative structures for the new bonds on the financial results of NLBdd, taking into account such factors as benefits to the cash-flow resulting from the merger of the remaining small daughter banks (estimated by the BRA to have combined 8 percent of total deposits) with NLBdd, and further rationalization of NLBdd's international network. In late-1995, the Government replaced the old BRA bonds (representing 75 percent of the DM-denominated Government debt held by NLBdd) with new BRA bonds with substantially more attractive terms. The new bonds are denominated in SITs and have been issued in series of three, five, seven, ten, and fifteen year maturities. They carry a blended average interest rate of approximately 6 percent, and are freely tradeable.

9. The new bonds have eliminated the currency risk and would improve bank liquidity somewhat through principal repayments at earlier maturity dates than previous bonds. But they also lower cash interest payments. The Government has remedied this negative cash impact by buying back SIT 2.3 billion of these bonds in early-1996. There is some concern, however, that the new BRA bonds would be tradable only at a relatively large discount, and would consequently have a negative impact on the bank's capital. The Government is aware of this possibility and is keeping the situation under review. In this regard, the Ministry of Finance is committed to buying back more bonds, as necessary, in 1997.

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[2] BRA bonds totaled SIT 86.9 billion, Republic of Slovenia bonds totaled SIT 26.2 billion and Steel bonds were SIT 4.1 billion.

10. The bank appears to be fundamentally profitable. It has a good deposit base and all indications are that the loan portfolio is well provisioned. There are good flows of fee income and costs appear to be controlled. Furthermore, there are good budgetary systems, management information system structures are well designed, and the management has very clearly articulated plans for business growth over the next five years.

11. NLBdd's net income in 1995 was a healthy SIT 4.9 billion (or about twice that of annualized 1994). This was mainly due to a substantial increase in interest income. At end-December 1995, the bank had a CAR of 13.5 percent while cash flow before changes in operating assets was SIT 7.2 billion for the year. At year-end, 93.3 percent of the bank's total risk asset portfolio was categorized as A and B under the BoS guidelines.

12. The assessment of NLBdd included detailed analysis of the annual statutory audit of 1994, and the special diagnostic review of 1993, based on terms of reference prepared by the Bank. This assessment also included extensive discussions with senior management and review of key risk management issues and processes. Due to the confidentiality of facts and figures included in the report, these are kept out of, and are filed separately from, the SAR.[3]

13. The Bank of Slovenia has provided written confirmation that NLBdd adheres to prevailing prudential banking regulations in Slovenia and is in good standing with the supervisory authority. In addition, the Bank of Slovenia has agreed to undertake a full scope examination of NLBdd in 1997. The scope and coverage of these examinations have been agreed with the Bank.

14. During negotiations, NLBdd agreed to:

- Submit, by 15-November of each year, to the Bank and the BoS for their review, the proforma engagement letter for the external audits for that year's accounts, prior to entering into agreement with the external auditors. This review will focus on: (i) scope and coverage proposed for the annual review; (ii) extension to review quality of loan portfolio; (iii) concrete procedures and questionnaires to be used by auditors in evaluating risk management programs and internal controls; (iv) concrete program, procedures and tests to be followed to assess earnings and review the profit and loss account; and (v) special reporting topics/issues for the year. NLBdd has also agreed to authorize the Bank and BoS representatives to have access to the working papers of the auditors, and the management letter.

- Submit, by end-June of each-year, to the Bank for information, the auditors report and management letter for the previous year's activities.

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[3] Consultants' report containing the relevant financial analysis and institutional assessment as well as their summary of recommended key development actions are in the Project File (See Annex 1).

Nova Ljubljanska Banka

Balance Sheet as of 31 December

in millions of tolars

	1995	1994	1994 Jul
Assets			
Cash in hand and balances with central bank	12,392	9,720	6,552
Placements with, and loans to other banks	81,401	78,783	77,412
Loans to other customers	156,715	113,703	108,865
Investment securities	154,479	139,738	127,688
Securities held for dealing purposes	9,365	2,550	2,386
Investments in non-associated companies	-	0	0
Investments in associated companies	6,151	5,905	5,732
Fixed Assets	19,710	18,961	17,173
Own share	-	0	0
Other assets	13,679	8,028	9903
Accrued income not yet due	5,723	2,624	2,059
Total assets	**459,615**	**380,012**	**357,770**
Liabilities and funds employed			
Deposits from banks	30,052	37,248	27,973
Borrowings from banks	143,537	117,799	113,772
Deposits from other customers	199,924	164,459	154,302
Amounts owed to other depositors	6,737	6,567	3,312
Liabilities evidenced by paper	14,665	3,504	4,998
Other liabilities	10,677	4,819	10,325
Accruals and deferred income	9,691	10,990	10,846
Provisions for liabilities and charges	17,818	15,881	18,423
Total liabilities	**433,101**	**361,267**	**343,951**
Subscribed capital	15,159	12,840	11,938
Reserves	11,355	5,905	1,881
Long term reservations	-	0	0
Capital revaluation reserve	-	0	0
Unappropriated profit from current year	-	0	0
Totals funds employed	**26,514**	**18,745**	**13,819**
Total liabilities and funds employed	**459,615**	**380,012**	**357,770**

Profit and Loss Account for the year ending 31 December

	1995	28 Jul to end-1994	
Interest income	40,445	16,656	(1)
Interest expenses	(27,440)	(15,626)	
Net interest income	**13,005**	**1,030**	
Fees and commission income	7,493	3,074	
Fees and commission expenses	(847)	(473)	
Net fees and commission income	**6,646**	**2,601**	
Other operating income	186	(2,377)	
Extraordinary income	3,140	1,458	
Total income	**22,977**	**2,712**	
Change for bad and doubtful debts & investments	(74)	146	
Operating expenses	(13,411)	(5,862)	
Extraordinary Profit (loss)	(4,121)	4,199	
Profit before taxation	**5,371**	**1,195**	
Tax	(459)	(45)	
Net Profit for the Period	**4,912**	**1,150**	
Minority Interest	(172)	(13)	
Unappropriated net profit	**4,740**	**1,137**	

Note (1): Due to the formation of Nove LBdd on July 1994, the Account for 1993 is not comparable

SLOVENIA - Investment Recovery Project

SKB Banka dd

1. SKB Banka dd (SKB) was originally established 30 years ago as a specialized mortgage institution that reached a 60 percent market share in Slovenia. In 1989, SKB became a joint stock holding company and dramatically changed its strategy in order to become a full service bank, moving away from its specialized mortgage lending. The development attained since then by the SKB group has been impressive. The bank is now the second most important bank in Slovenia both by asset size (about 10 percent of Slovenia's total banking assets) and the branch network (43 offices in Slovenia and a representative office in London), with a total staff of about 900. It has an expanded range of services and products and is very active in commercial, international, investment and retail banking operations. The bank has a direct ownership interest in eight subsidiaries focusing mainly on real estate, investment, and leasing activities. A distinguishing feature of SKB is the fact that it received no type of support from the Government as part of the bank rehabilitation program, since its assets were not affected by the general factors which impacted other banks in the system.

2. SKB's shares are the most actively traded stock on the Slovene stock exchange. Its 20 largest shareholders hold 56.5 percent of the capital of the bank. Of them, only EBRD, with a 15 percent shareholding, has a significant participation in the bank. The other major owners include, ASH dd Brokerage House (5.6 percent) the City of Ljubljana (5.1 percent), German Investment and Development Company (DEG -- 5 percent), and Merril Lynch International (4.3 percent). The entry of EBRD as a major shareholder is expected to substantially improve the governance, especially in regards to strengthening the supervisory board. To this end, EBRD has nominated a reputable banker to oversee its interests, and reinforce the self-assessment of the bank's strategy, risk management and operations.

3. Since 1991, SKB has been following a growth strategy with a view to attaining a 20 percent share of the Slovene market by end-1996. As a result, between 1992 and end-1994, SKB pursued an aggressive commercial expansion, opening new branches and acquiring branches from a failing bank, resulting in tripling the size of its activities during that period. According to SKB's business plan, its total assets are expected to double by end-1998, among other means by acquisitions, since the bank's branch network is already well established and developed. The bank, however, is currently preparing a new three-year business strategy, which could inter alia moderate its growth strategy.

4. Much of the success of SKB in achieving its strategy is directly attributable to the powerful leadership of its CEO who has surrounded himself with a dynamic and cohesive team of 8 senior deputy directors (serving on the bank's executive board), while retaining much of the decision-making authority. All the deputy directors have extensive banking experience in other Slovene banks. The senior management of the bank, however, has recently concluded that the current managerial organizational structure and centralized decision making would prove inadequate to cope with the growing complexity and volume of activities of the SKB group. It has, therefore, begun an extensive self-driven restructuring of the responsibilities, reporting, and decision-making functions within the organization.

5. In recent years, apart from the standard recommendations by its external auditors (Coopers and Lybrand), as part of the bank's annual audits, SKB's senior management has benefited from several

additional reviews. A full diagnostic review was performed by Deloitte & Touche in 1995.[1] These reviews identified the need to strengthen the controls and risk management processes of the bank. These steps are necessary in order to ensure the continued health of the bank following its rapid growth in the last few years. In recognition of this need, the bank has undertaken steps to improve its risk management function and will initiate implementation of a plan, by end-1996, to further strengthen this function.

6. As mentioned earlier, SKB's business strategy has been driven by the expansion of its activities. This expansion, however, has been accompanied by a general decline in profitability margins and ratios, in part induced by external factors such as dis-inflation and liquidity tensions originated by monetary policy decisions. The bank's return on assets (ROA) dropped by more than 50 percent during 1992-94, to 0.7 percent in 1994. This was due not only to the accelerated expansion of the business volume, but also to narrowing margins and the pressure of operating costs associated with it. In parallel, while the capital adequacy ratio (CAR) was a healthy 15 percent at end-1994, following a capital increase due to EBRD's participation, the level of CAR could have been lower after considering several adjustments proposed in the 1995 diagnostic review.

7. This was remedied in 1995, when SKB increase the level of its loan specific provisions by about SIT 1.4 billion. In spite of this high level of provisioning during the year, the bank recorded a slight increase in before tax profits to SIT 1.5 billion. This was mainly due to an increase of more than 50 percent in net interest income. The bank reported a CAR of 14.4 percent at end-1995.

8. The assessment of SKB included detailed analysis of the annual statutory audit of 1994, and the special diagnostic review of 1994. This assessment also included extensive discussions with senior management and review of key risk management issues and processes. Due to the confidentiality of facts and figures included in the report these are kept out of, and are filed separately from, the SAR (Annex-1, SKB Executive Summary; Highlights; and Facts and Notes).[2]

9. The Bank of Slovenia has provided written confirmation that SKB Banka dd adheres to prevailing prudential banking regulations in Slovenia and is in good standing with the supervisory authority. In addition, the Bank of Slovenia has agreed to undertake a full scope examination of SKB in 1996. The scope and coverage of these examinations have been agreed with the Bank.

10. During negotiations, SKB Banka dd agreed to:

- Initiate, by end-December 1996, implementation of a plan, acceptable to the Bank, to introduce an improved risk management function;

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[1] This diagnostic audit was commissioned by the BoS, as part of its supervisory operations. The terms of reference for the audit were agreed with the Bank as part of the strengthening of the supervision function supported under the EFSAL. The audit was financed by the EU-Phare.

[2] The report containing the relevant financial analysis and institutional assessment as well as summary of recommended key development actions is in the Project File (See Annex 1).

- Submit to the Bank for review, by November 15 of each year, the proforma engagement letter for the external audits for that year's accounts, prior to entering into agreement with the external auditors. This review will focus on: (i) scope and coverage proposed for the annual review; (ii) extension to review quality of loan portfolio; (iii) concrete procedures and questionnaires to be used by auditors in evaluating risk management programs and internal controls; (iv) concrete program, procedures and tests to be followed to assess earnings and review the profit and loss account; and (v) special reporting topics/issues for the year. SKB has also agreed to authorize the Bank to have access to the working papers of the auditors, and the management letter;

- Submit, by end-June of each-year, to the Bank for information, the auditors report and management letter for the previous year's activities.

SKB

Balance Sheet as of 31 December

in millions of tolars

	1995	1994	1993	1992
Assets				
Cash in hand and balances with central bank	7,325	4,933	853	1,985
Placements with, and loans to other banks	34,031	33,422	18,128	8,198
Loans to other customers	94,520	66,532	43,797	22,396
Investment securities	12,933	2,778	707	297
Securities held for dealing purposes	7,172	8,028	2,971	3,170
Investments in non-associated companies	-	0	0	0
Investments in associated companies	-	0	0	0
Fixed Assets	12,236	10,766	7,412	7,053
Own share	-	0	0	0
Other assets	10,408	7,580	5,238	92
Accrued income not yet due	-	0	0	979
Total assets	**178,625**	**134,039**	**79,106**	**44,170**
Liabilities and funds employed				
Deposits from banks	26,639	14,173	2,389	1,679
Borrowings from banks	-	0	0	0
Deposits from other customers	117,020	90,571	55,338	31,225
Amounts owed to other depositors	-	0	0	0
Liabilities evidenced by paper	7,154	7,557	5,316	0
Other liabilities	3,674	2,574	1,718	0
Accruals and deferred income	2,727	3,576	1,870	1,595
Provisions for liabilities and charges	-	0	0	87
Total liabilities	**157,214**	**118,451**	**66,631**	**34,586**
Subscribed capital	13,360	8,269	1,508	1,508
Reserves	429	393	160	0
Long term reservations		0	0	0
Capital revaluation reserve	3,514	2,938	5,733	8,879
Unappropriated profit from current year	4,110	3,989	5,074	(803)
Totals funds employed	**21,413**	**15,589**	**12,475**	**9,584**
Total liabilities and funds employed	**178,627**	**134,040**	**79,106**	**44,170**

Profit and Loss Account for the year ending 31 December

in millions of tolars

	1995	1994	1993	1992
Interest income	18,898	16,211	12,536	12,527
Interest expenses	(12,663)	(12,777)	(9,468)	(10,317)
Net interest income	**6,235**	**3,434**	**3,068**	**2,210**
Fees and commission income	1,718	1,252	1,176	233
Foreign Exchange (loss)/profit (net)	(456)	(103)	630	1,411
Net fees and commission income	**1,262**	**1,149**	**1,806**	**1,644**
Other operating income	1,725	2,695	871	617
Extraordinary income	-	0	0	0
Total income	**9,222**	**7,278**	**5,745**	**4,471**
Change for bad and doubtful debts & investments	(2,001)	(734)	(905)	(876)
Operating expenses	(6,276)	(5,767)	(3,582)	(2,236)
Extraordinary Profit (loss)	-	0	(50)	0
Profit before taxation	**945**	**777**	**1,208**	**1,359**
Tax	(230)	(14)	0	0
Profit After Taxation	**715**	**763**	**1,208**	**1,359**
Transfer to other Fund/Reserves	-	233	160	1,666
Dividends	421	265	112	91
Retained Profit for the Year	**294**	**265**	**936**	**(398)**

SLOVENIA - Investment Recovery Project

Banka Celje dd

1. Banka Celje d.d. is a well established bank that has its origins in the community savings bank of the Celje region of Slovenia, which was created in 1894. After several changes over its 100 years of existence, the bank was reorganized into a joint stock company in 1990, as a member bank of the LB System. In December 1994 the bank bought back its preferred shares owned by Nova Ljubljanska Banka (accounting for 50 percent of the bank's total capital). These shares were reissued to current and new shareholders. The ownership of the bank is now well diversified with more than 1,000 shareholders, only one of which has a significant level of participation (10 percent). The bank is over 60 percent privately owned. In addition to its head office in Celje, the bank's network comprises 31 branches and agencies and 19 ATMs. It employs 550 people.

2. Since 1993 the bank's market share has steadily grown from about 4.0 percent to 4.6 percent of the total Slovene banking system. Management plans to increase this share to at least 8 percent, regarded as the minimum size needed to achieve medium-term viability. Senior management of the bank intends to achieve this major objective through mergers and acquisitions, as well as the establishment of new branches. The main focus of the Banka Celje's business remains retail banking and support to the existing local corporate community. There is growing local competition, but the bank's regional market share has stabilized at around 75 percent of the retail accounts.

3. The corporate governance structure in place is effective. In practice, the supervisory board approves the recommendations of the CEO. The CEO heads the executive management committee comprised of three executive managers and ten sector managers. The committee meets formally once a week (and informally on a daily basis) and is supported by two subcommittees for credit and liquidity.

4. The CEO is a strong leader and is fully conversant with all business and other aspects of the bank. He has led the bank through a period of significant change and appears to enjoy the full support and trust of his management team. He is particularly conscious of the need to control and monitor the bank during its course of future expansion; as well as of the need to continuously improve the quality of the staff and the management information systems to meet future demands. Given the plans to expand the branch network and increase market share through mergers and acquisitions, it is important that the bank consider establishing an independent risk management function reporting directly to the CEO.

5. Banka Celje has comprehensive information on its assets and liabilities, margins and other details of its income, costs, advances and loan portfolio quality. Good information is also available on bank customers, and loan administration is adequate for the level and complexity of its lending activities. The bank follows a very conservative lending practice and 90 percent of all branch credits are insured. Of the remaining 10 percent of branch lending, 67 percent is secured by collateral mortgages and 33 percent by State securities.

6. Trends in key financial performance indicators reflect the steady growth in business and profitability of the bank with the return on assets (ROA) improving from 0.74 percent in 1992 to 1.28 percent in 1994 (measured in real terms before extraordinary items). After extraordinary charges reflecting

the cost of buying back the preferred shares held by NLBdd, the audited ROA for 1994 was 0.47 percent. The bank's capital adequacy ratio at end-1994 was an impressive 21 percent of weighted risk assets. As is the case with other banks in Slovenia, a major factor affecting the bank's financial strength and performance could be the valuation of the existing long-term Government bonds (SIT 13 billion or 25 percent of the bank's assets) which were issued against the frozen foreign currency deposits in the National Bank of Yugoslavia. However, the bank's very high net worth provides for an acceptable buffer to absorb a potential mark down of these bonds.

7. The 1995 results of the bank show a continued improvement in the bank's financial position, with a reported after tax profit of about SIT 800 million, a CAR in excess of 20 percent, and a well provisioned portfolio. The bank continues to enjoy a very healthy deposit base of SIT 52 billion (about 75% of its total assets).

8. The assessment of Banka Celje dd included detailed analysis of the annual statutory audit of 1994, and the special diagnostic review of March 1994, based on terms of reference prepared by the Bank[1] This assessment also included extensive discussions with senior management and review of key risk management issues and processes. Due to the confidentiality of facts and figures included in the report, these are kept out of, and are filed separately from, the SAR.[2]

9. The Bank of Slovenia has provided written confirmation that Banka Celje dd adheres to prevailing prudential banking regulations in Slovenia and is in good standing with the supervisory authority. In addition, the Bank of Slovenia has agreed to undertake a full scope examination of Banka Celje dd in 1996. The scope and coverage of these examinations have been agreed with the Bank.

10. During negotiations, Banka Celje dd agreed to:

- Assign, prior to effectiveness of this loan, a consultant (or a qualified staff of the bank), based on terms of reference acceptable to the Bank, to establish an expanded credit risk management function, independent from the lending function;

- Initiate, by end-December 1996, implementation of a plan, acceptable to the Bank, to strengthen its risk management function;

- Submit to the Bank and the BoS for their review, by November 15 of each year, the proforma engagement letter for the external audits for that year's accounts, prior to entering into agreement with the external auditors. This review will focus on: (i) scope and coverage proposed for the annual review; (ii) extension to review quality of loan portfolio; (iii) concrete procedures and questionnaires to be used by auditors in evaluating risk management programs

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[1] This diagnostic audit was commissioned by the BoS, as part of its supervisory operations. The terms of reference for the audit were agreed with the Bank as part of the strengthening of the supervision function supported under the EFSAL. The audit was financed by the EU-Phare.

[2] Consultants' report containing the relevant financial analysis and institutional assessment as well as their summary of recommended key development actions are in the Project File (Annex 1).

and internal controls; (iv) concrete program, procedures and tests to be followed to assess earnings and review the profit and loss account; and (v) special reporting topics/issues for the year. Banka Celje has also agreed to authorize the Bank and BoS representatives to have access to the working papers of the auditors, and the management letter;

- Submit, by end-June of each-year, to the Bank for information, the auditors report and management letter for the previous year's activities.

Banka Celje

Balance Sheet as of 31 December

in millions of tolars

	1995	1994	1993	1992
Assets				
Cash in hand and balances with central bank	1,830	1,498	973	327
Placements with, and loans to other banks	12,163	11,880	7,832	7623
Loans to other customers	29,630	18,270	13,409	7917
Investment securities	19,546	13,891	12,073	6552
Securities held for dealing purposes	404	70	284	0
Investments in non-associated companies	-	179	30	11
Investments in associated companies	39	35	88	3
Fixed Assets	2,510	2,078	1,633	1233
Own share	15	1,615	7	1
Other assets	3,262	1927	893	500
Accrued income not yet due	-	271	263	276
Total assets	**69,399**	**51,714**	**37,485**	**24,443**
Liabilities and funds employed				
Deposits from banks	8,588	3,104	2,887	2566
Amounts owed to other depositors	43,101	34,679	23,637	14242
Liabilities evidenced by paper	2,516	1,112	1,338	1095
Other liabilities	729	541	707	839
Accruals and deferred income	2,976	2,257	980	742
Provisions for liabilities and charges	452	213	225	67
Total liabilities	**58,362**	**41,906**	**29,774**	**19551**
Subscribed capital	3,377	3,377	422	422
Reserves	4,485	4,411	6,407	4470
Long term reservations	308	308	308	0
Capital revaluation reserve	2,070	1,247	0	0
Unappropriated profit from current year	799	465	574	0
Totals funds employed	**11,039**	**9,808**	**7,711**	**4892**
Total liabilities and funds employed	**69,401**	**51,714**	**37,485**	**24,443**

Profit and Loss Account for the year ended 31 December

Interest income	4,446	3,674	7,905	7,209
Interest expenses	(2,187)	(1,633)	(3,720)	(3,730)
Net interest income	**2,259**	**2,041**	**4,185**	**3,479**
Fees and commission income	1,406	1,056	1,501	2,262
Fees and commission expenses	(233)	(174)	(669)	(579)
Net fees and commission income	**1,173**	**882**	**832**	**1,683**
Other operating income	561	365	223	108
Extraordinary income	2,757	819	0	0
Total income	**6,750**	**4,107**	**5,240**	**5,270**
Change for bad and doubtful debts	(2,671)	(860)	(2,109)	(1,802)
Operating expenses	(3,278)	(2,758)	(1,861)	(1,216)
Extraordinary Profit (loss)	-	(22)	0	0
Profit before taxation	**801**	**467**	**1,270**	**2,252**
Tax	(2)	(2)	(35)	(33)
Unappropriated net profit	**799**	**465**	**1,235**	**2,219**

Annex 8

SLOVENIA - Investment Recovery Project

Summary of the Demand Study

Table: Investment and Demand for Commercial Bank Credit in US$ Million, 1993-1996

	Actual		Projected					
	1993		1994		1995		1996	
	Invest	Credit	Invest	Credit	Invest	Credit	Invest	Credit
Private Unincorporated	120	33	123	35	128	36	134	38
Current Private Incorporated	73	65	150	80	300	93	470	100
Current Mixed & Socially Owned	746	161	836	206	891	238	949	251
of which privatized	-	-	-	-	*445*	*119*	*760*	*200*
Total	939	260	1109	321	1319	367	1553	388
of which private	*193*	*98*	*273*	*115*	*873*	*248*	*1364*	*338*
Comm. Bank Credit as % of Total Investment		28%		29%		28%		25%
Comm. Bank Credit as % of Private Investment		51%		42%		28%		25%

Private Sector

Total Investment 95-96 (US$ millions)	2237
Total Commercial Bank Credit 95-96 (US$ millions)	586
Total Commercial Bank Credit as % of Total Investment 95-96	26%

Note: Investment and credit figures are based on survey of commercial banks and macroeconomic projections.

IMAGING

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