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*Chapter 2*

# Corporate Governance Review

## 1. Slovenia's corporate governance framework

From its independence in 1991, Slovenia has quickly sought to develop its capital markets and the legal, regulatory and institutional structures that underpin these markets. This process commenced in 1992 with a mass-privatisation programme that established private ownership of capital and was reinforced with the passage of the first framework Companies Act in 1993. Post-independence, Slovenia has rapidly pursued political and economic integration with Europe, joining the EU in May 2004, and the European Monetary Union in January 2007. Since joining the EU, the government has also pursued a comprehensive strategy to amend its capital markets and corporations' law architecture to ensure consistency with EU directives. Notwithstanding this, capital markets in Slovenia are not well developed by OECD standards, are extremely limited in both depth and liquidity, and have a narrow (and domestically focused) investor base.

The current state of development of Slovenia's capital markets, and corporate governance framework, must be seen through the prism of its historical development. In particular, there has been less than twenty years for the country to develop both the legal/regulatory architecture of governance and the cultural norms of operating private capital markets. On gaining independence from the former Yugoslavia in 1991, Slovenia quickly established a process to transform a large number of commercial enterprises from "social"[1] to private ownership. The 1992 Law on Ownership Transformation included components of both voucher and cash privatisation. The Law provided that 20% of the capital of the subject companies would be allocated to managers and employees; 20% would be allocated equally to two state funds (a pension fund and a restitution[2] fund); and up to 20% would be allocated to Privatisation Investment Funds (PIFs), or voucher funds, that would obtain shares in return for privatisation vouchers collected from the public. The remaining 40% was available for discretionary distribution by workers' councils to be sold either to employees/managers or to outside parties in exchange for ownership certificates (or vouchers). In most cases, the employees/managers chose to distribute these shares to company insiders, but not necessarily extensively to management.

Immediately after the mass-privatisation process, there were over 200 companies listed on the Ljubljana Stock Exchange. However, their number has steadily diminished over time, partly as the result of leveraged management buyouts, some of which have been highly contentious in the manner in which they were executed to circumvent the takeover law. As a result, there has been a substantial delisting of smaller companies, such that there are now only 84 issuers in the listed equity market. The Stock Exchange, which has itself been recently taken over by the Vienna Stock Exchange, is relatively small with total equity market capitalisation of EUR 8.5 billion (as at 31 December 2008), which represented 25.2% of GDP.[3]

Since privatisation, the state has continued to be a significant shareholder in both listed and non-listed companies. The government has significant direct and indirect control over a large number of sizeable companies in the domestic market. Its direct

holdings are concentrated in infrastructure sectors, banking and insurance, where it holds a dominant position. Its indirect holdings are owned principally through the two state controlled funds that were established as part of the privatisation process, the pension fund ("KAD") and the restitution fund ("SOD"). These funds' investments are dispersed across a large number of listed and unlisted companies. The two funds have provided the government with a strong mechanism to influence the boards and management of privatised firms and, ultimately, to play an active role in determining ownership changes. In part, this appears (at least initially) to have been motivated by a desire to manage the extent to which foreign firms gained control over important domestic firms and industries.[4] The extent of direct and indirect ownership has allowed past governments to exercise a very significant, and sometimes opaque, role in influencing the operation of large sectors of Slovenia's commercial enterprises and in the market for corporate control. This has created controversies in the past, including allegations that board member appointments have been based on political allegiance rather than qualifications or skill, and that transactions in state shareholdings have been undertaken at prices or for reasons that have not been wholly commercially driven.

There are, however, indications that things are changing. In November 2008, a new coalition government came to power in Slovenia which has identified corporate governance generally, and state owned enterprises more specifically, as an area where it intends to pursue reform. As a first step the government announced a plan to reform the manner in which state representatives to supervisory boards are appointed, with the establishment of an external commission to identify qualified candidates according to pre-specified criteria and to make non-binding recommendations to government (and Ministries) for board nominations. While this shows a welcome commitment to reform, Slovenia has recognised that the reform process for board appointments (and for SOEs more generally) will require a comprehensive approach that accommodates the unique nature of its ownership structure.

More recently, the Government has announced a comprehensive reform framework for the corporate governance of SOEs, the centrepiece of which is the establishment of an independent and separate central ownership agency. This entity will: control all the direct holdings of Government; exercise all of the ownership rights pertaining thereto, including board nominations; be responsible for gathering centralised information on government holdings; measuring and reporting performance; and developing and enforcing a code of corporate governance that will apply to the state owned companies. Legislation to establish the ownership was passed in April 2010.

The Government has also drafted legislation to better define the relationship between the Government and the two state-controlled funds, KAD and SOD. This legislation will see the transformation of the funds into investment companies with defined investment policies and, in the case of KAD, the removal of certain non-portfolio (strategic) assets out of the fund and into central ownership. This legislation has been subject to public consultation and was expected to be adopted by the Government in April 2010 and submitted to parliament shortly afterwards for expected adoption in mid 2010.

### *1.1. The structure of ownership and control*

#### *1.1.1. Ownership*

In the immediate aftermath of the mass privatisation programme, the ownership structure largely reflected the objectives of the Law on Ownership Transformation. In most privatisation cases, the workers' committees directed the sale of much of the discretionary 40% holdings to insiders (managers and other employees) as possible, limited only by the financial capacity of insiders to buy the shares. As such, most firms ended up with substantial inside ownership, reflecting previous traditions with "labour managed enterprises". Inside owners ended up holding approximately 44% of shares in privatised firms, 20% went to the Privatisation Investment Funds (PIFs), 22% to the state owned pension and restitution funds, 7% was held directly by the state, while the remaining 7% was publicly sold (Simonetti and Gregoric, 2004). The end result was that there was highly dispersed inside ownership with the state pension and restitution funds and the PIFs emerging as outside block-holders. While the state funds were expected to slowly divest their concentrated holdings, the legislative framework encouraged the establishment of the PIFs to balance the position of insiders and act as effective monitors of company management. In the case of both the state funds and the PIFs, the reality has been somewhat different from that envisaged: the state funds have rationalised their holdings but have retained (or even increased) their ownership control over companies considered to be strategic. The PIFs have, on the other hand, not emerged as a counterpoint to the inside owners or the state and have been largely ineffective as active monitors of company performance (refer further below).

While inside ownership of privatised firms was high, the privatisation process nevertheless resulted in a highly dispersed ownership structure when compared to other transition economies. Managers obtained only minor stakes, holding 3.85% on average and even less (1.40%) in listed companies at the point of initial privatisation (Table 2.1). Aside from the block-holding stakes, the remaining shares were widely distributed. At the peak of the process, there were 1.6 million registered shareholders out of a total population of two million. Reflecting this starting point, the post-privatisation phase has been characterised by a widespread process of ownership consolidation; for instance, between 1999 and 2004 the average size of the largest block-holder in registered companies increased 14 percentage points to approximately 37% (Cankar, Deakin and Simonetti, 2008) and the total number of shareholders decreased from the high water mark of 1.6 million to approximately 600 000.

The subsequent consolidation of ownership has largely been effected through the emergence of non-financial groups. In the decade ending in 2007 private non-financial firms' share of ownership has increased from 9% to 29%, which is by far the largest movement of any ownership group over the period (Federation of European Stock Exchanges, 2008). These non-financial firms have often gained controlling interests through highly leveraged buyouts including by inside managers, and the level of management ownership has been steadily increasing, while the level of employee ownership is steadily decreasing. The rise in the non-financial firms' share of ownership might be indicative of a growing prevalence of cross-shareholdings or pyramid structures. However, according to the World Bank's most recent corporate governance ROSC (in 2004), such structures were not particularly prevalent in Slovenia then and there is little evidence that the situation has changed greatly in the period since.

Table 2.1. **Ownership structure at the time of privatisation**
(%)

| Group of owners | All companies | Listed |
|---|---|---|
| The State – | | |
| *Directly* | 7.75 | 6.78 |
| *Restitution and pension funds* | 21.60 | 20.49 |
| PIFs (privatisation funds) | 19.38 | 17.65 |
| **ALL Funds** | **40.98** | **38.14** |
| Inside owners – managers | 3.86 | 1.40 |
| Inside owners – current employees | 29.23 | 21.88 |
| Inside owners – former employees | 11.05 | 7.48 |
| **ALL Inside** | **44.14** | **30.77** |
| Financial investors – domestic | 4.80 | 22.37 |
| Financial investors – foreign | 0.03 | 0.08 |
| **ALL Financial** | **4.83** | **22.45** |
| Strategic investors – domestic | 2.00 | 1.86 |
| Strategic investors – foreign | 0.30 | 0.00 |
| **ALL Strategic** | **2.30** | **1.86** |
| **TOTAL (all groups)** | **100.00** | **100.00** |

*Source:* Simonetti and Gregoric, 2004.

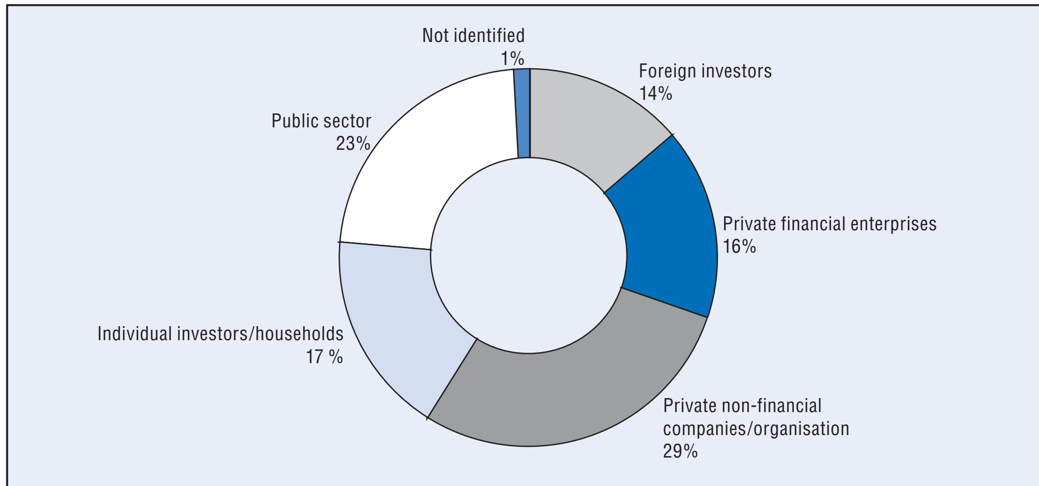
There are a number of reasons why this may be the case: there are strict limits on cross-representation on supervisory boards[5] reducing the capacity to exercise effective control; the mandatory bid threshold in the takeover law is the lowest in the EU, and at 25% prevents the establishment of a blocking minority position under Slovenian Law[6]; and the Companies Act mandates the principle of "one share one vote", limiting the ability of block-holders to use differential voting rights to control cross-holding structures. Perhaps less positively, a capacity to rely on "parked shares" to control a company (discussed below) is also likely to have made the use of complicated cross-holding structures comparatively less attractive.

The last ten years have also seen the relative emergence of foreign shareholders as an investor group, although still at a comparatively low level. In the ten years to 2007, foreign firms' share of ownership has increased from 5.2% to 14% (Figure 2.1). By comparison, the weighted average of foreign ownership is 37% in EU countries (Federation of European Stock Exchanges, 2008). Market participants suggested that foreign portfolio investors have to date shown a very low level of interest in the Slovenian market, with most of the actual investments aimed at establishing a controlling position.

The listed equity market is segregated into three tiers: a prime market (7 issuers), a standard market (17 issuers) and an entry market with 60 issuers. All three tiers of the market are "regulated markets" within the meaning of the European directives. Classification among the tiers is subject to valuation and turnover criteria, with the higher tier markets also subject to greater transparency and disclosure requirements under the listing rules. For instance, issuers on the standard and prime markets are required to issue quarterly financial reports and to issue annual statements on compliance with the corporate governance code, whereas entry market issuers are not. Prime market participants are further required to comply with IFRS and to provide all market releases in both English and Slovene.

All segments of the market are highly illiquid, with low turnover that is itself concentrated in a small number of stocks. Total annual on-market turnover for 2008 was

Figure 2.1. **Share ownership structure, listed companies, Slovenia 2007**




*Source:* Federation of European Stock Exchanges, Share Ownership Structure in Europe, December 2008.

EUR 0.95 billion (being 11% of year end market capitalisation[7]). More than 40% of that turnover accounted for by one stock (KRKA[8]). It follows that average daily turnover for 2008 was only a fraction of a per cent of total market capitalisation. Again, the nature of the privatisation process provides the antecedents for understanding this low liquidity. There are, on the one hand, a very large number of small public shareholders who infrequently trade their shares on the market and, on the other, a small number of concentrated block-holdings that arose out of the allocation policies of the mass-privatisation process. In addition to the low turnover, historically a large number of trades are off-market transactions. In 2008, off-market transactions totalled EUR 2.6 billion compared to the above-mentioned on-market turnover of EUR 0.95 billion (Ljubljana Stock Exchange Annual Statistical Reports, 2008). Gregoric and Vespro, (2009) estimated that there were substantial control premiums associated with block trades in Slovenia. Based on a sample of 31 block trades in the 2000/2001 period, the study found a median post trade premium of 21%.

### *1.1.2. Privatisation Investment Funds (PIFs) and other private institutional investors*

The role of institutional investors in Slovenia is not strong, with the value of funds under management small and the management of those funds highly concentrated in the hands of a few dominant players. The key institutional investors are *i)* the mutual investment funds, some of which have grown out of the Privatisation Investment Funds (PIFs), and *ii)* the invested reserves of domestic insurance and pension funds. While these funds have grown substantially over the last five years, this has been from a very small base. The growth in the value of all institutional funds to 2007 is set out in Table 2.2 below.

As noted above, the majority of the domestic investment funds have their antecedents in the Privatisation Investment Funds, or PIFs, that were established at the start of the privatisation process. The first of these funds was launched in early 1992 and, in 1993, a comprehensive investment funds law was established to provide a more certain legal framework for the operation of the funds. At their inception, the PIFs were closed-end funds that accumulated privatisation certificates of Slovenian citizens and exchanged them for shares in privatised companies. The funds grew quickly in number such that

Table 2.2. **Growth in institutional funds**

| Investor Class | 2003 EUR M | 2004 EUR M | 2005 EUR M | 2006 EUR M | 2007 EUR M |
|---|---|---|---|---|---|
| Insurance Corporations | 2 036 | 2 345 | 2 707 | 3 293 | 4 332 |
| Mutual Investment Funds | 1 294 | 1 986 | 2 220 | 2 943 | 4 140 |
| Private Pension funds | 348 | 535 | 728 | 961 | 1 087 |
| **Total** | **3 678** | **4 866** | **5 655** | **7 197** | **9 559** |

*Source:* SMA.

by 1997 there were fifty separate PIFs operating in the market. Despite the proliferation of the funds, their role as active investors did not materialise to the extent originally envisaged. One study (Gregoric and Vespro, 2009) has advanced a number of possible reasons for this: the PIFs lacked the capital and expertise to undertake the necessary restructuring; in a transitional environment the incentives for proper monitoring of management could at times be outweighed by stronger incentives for expropriation of firm value; and the widely dispersed ownership and the lack of proper regulation of the investment funds themselves did not engender strong incentives to play a role as active investors.

A series of changes to the law on investment funds (in 1999 and 2002) has required the PIFs to transform themselves into either joint stock companies or into open end mutual funds. While the process of transformation has been slow it has seen a rise in the value of funds under the management of more traditional institutional investors. By the end of 2007, there was over EUR 4 billion invested in investment funds, compared to less than EUR 2 billion in 2004. Despite the recent growth, the funds management industry is still very small by OECD standards.

Given their history as PIFs, most of the managed funds are heavily focused toward listed securities and to the domestic market. However this has not necessarily translated to greater depth in the capital markets: while there are now a reasonable number of managed funds, there are only a limited number of management companies (14) responsible for managing these funds, and the funds are further concentrated in the hands of the three largest managers. Of these three largest managers, two (NLB and Triglav) have substantial government ownership. While the vast majority of the PIFs chose to become open ended management funds, a small number remained as closed end investment funds[9] (Table 2.3).

Table 2.3. **Selected data on managed funds as at 31 December 2007**

| Investment fund characteristics | Open end funds | Closed end funds |
|---|---|---|
| Number of entities | 110 | 7 |
| Number of unit holders | 321 628 | 226 845 |
| **Total assets (million EUR)** | **2 924** | **1 235** |

*Source:* SMA.

There has also been strong growth in pension and insurance assets; however as an institutional investor class these are of less importance than the mutual funds in terms of investment in equity capital markets. The regulatory investment rules or guidelines for both the investment of insurance reserves and pension funds are conservative, and both types of funds hold less than 30% of their investment assets in equities (Insurance

Supervisory Agency, 2008). Furthermore, Slovenia's accession to the European Monetary Union has made such funds more open to investments in other European markets. In comparison, the proportion of mutual fund assets held in shares traded on regulated securities markets was 76% in 2007, with most of this domestically focused (Securities Market Agency, 2008).

#### *1.1.3. State funds*

The government owned pension and restitution funds continue to play a significant role in the ownership of large sectors of the productive economy. As noted above, both funds were allocated shares in all privatised firms as part of the mass privatisation process. While both funds have specific mandates, their establishment was in part also seen as a means of providing some stability in ownership and ensuring a role for the state in the ownership of companies as a transitional measure to a private ownership model.

The restitution fund, SOD, issues bonds in satisfaction for restitution claims and the assets (and associated income) acquired as part of the mass privatisation program are used to pay the interest and principal on the bonds. In terms of its original mandate, the fund is meant to be wound up by 2016 when the final outstanding bonds will mature. The fund itself is not listed on the LJSE, but bonds issued by the fund are listed and traded. While SOD obtained shareholdings in a large number of firms, it has gradually rationalised its holdings, both to improve the manageability of the portfolio and also to satisfy maturing claims. The requirement to liquidate the fund by 2016 is likely to further drive the rationalisation of their holdings. The fund currently has ownership interests in 54 companies, of which it holds a significant stake in 28 companies. By the fund's own estimation only 20 of these holdings are meaningful. (By way of comparison, in 2004 SOD had holdings in 179 companies, reflecting the extent to which it has sought to rationalise its holdings in recent times). Despite this process of rationalisation, SOD has kept (and in some cases increased) its holdings in enterprises that are considered to be more strategic to government.

The pension fund, KAD, is responsible for the management of Slovenian civil servant pension schemes and, more latterly, has established business operations offering both compulsory and supplementary pension schemes for the private sector. It is one of the largest supplementary pension fund managers in Slovenia. Its initial capital was also established via its guaranteed shareholdings granted as part of the mass privatisation process. However, unlike SOD, KAD has an active and growing business with its ongoing participation in the compulsory and supplementary pensions market. In common with SOD, KAD has actively managed its investments. From an initial portfolio of over 1200 companies, KAD now has investments in 83 domestic companies, both listed and unlisted. Again, this process of concentration has seen the fund focus its holdings on larger and more strategic enterprises.

The two funds are organised as unlisted limited liability companies, 100% owned by the Slovenian government. Both have a two tier board structure, with the members of the supervisory boards appointed by government. In each case, the lead Ministry in charge of oversight is the Ministry of Finance. In a *de jure* sense, the operation and management of the companies is independent of government and of each other, being controlled by the supervisory board appointed by government. However, there is a widespread perception that the actions of the companies are closely co-ordinated and the nature of their holdings would suggest that governments have in the past viewed the funds' holdings as part of an

overall government portfolio. By way of example, KAD holds ownership interests of between 5-25% in four of the seven companies listed on the prime market of the LJSE and held exactly 25% in a fifth company. SOD also owns between 5-25% in the same four companies, such that between them the two funds own a blocking minority (greater than 25%) in five of the seven largest listed companies. The government itself is a majority owner in another of these seven listed firms, meaning that the state, via direct and indirect holdings has at least a blocking minority in six of the seven largest listed firms in Slovenia.

Companies in which the government and the two funds hold controlling positions themselves also directly invest in other listed and non-listed companies, often alongside the government. As a result it is very difficult to get an accurate picture of the extent of government ownership and control from public sources. For instance, the government collectively has beneficial ownership of 48% of the largest commercial bank in the country, NLB. Its direct ownership stake is only 35.41%, and KAD and SOD each own just over 5%. The remainder is held through indirect subsidiary holdings which are not readily observable. While the Public Finance Act provides (Public Finance Act, 1999)[10] that the Ministry of Finance is responsible for keeping a record of the government's equity holdings, the Ministry does not yet collect comprehensive data on the extent of its beneficial ownership via its funds and subsidiaries.[11] The ownership data cited above in relation to NLB was collated by the Central Bank as part of its supervisory responsibilities and was not collected as part of a regular process by government to document the extent of its holdings. The collection of data is also complicated by the fact that the government controlled banks and insurance companies also hold substantial positions in the domestic asset management industries and, as such, hold legal (although not beneficial) ownership over substantial shareholdings held within their funds.

Because of their dominant position and the less than transparent nature of their existing degree of cooperation and co-ordination, clarifying and formalising the relationships among Government, KAD and SOD is recognised as a key priority in advancing the corporate governance framework in Slovenia. The Policy on the Corporate Governance of SOEs makes this point clearly: "A complete separation of entities such as KAD and SOD is not realistic in the current circumstances. Due to the shareholder structure of Slovene companies and established processes of the funds' operations it is urgent that the State continues to pursue its interest as an indirect shareholder of companies in KAD and SOD's portfolio and, above all, that it also formally accepts responsibility for governing these companies and ensures higher transparency and accountability in this field." The Government has drafted legislation that seeks to give effect to this policy. Under the framework, "strategic" holdings of the funds will be transferred to central ownership, and the funds will structure their investments as portfolio holdings better matched to the profile of their liabilities and with limits on their exposures to individual companies. KAD will be separated into two funds: one managing the pension fund and the other assuming the insurance functions.

### *1.1.4. The banking system*

Given the relatively early stage of development of the listed capital markets, it is not surprising that market-based financing for companies is very limited. Apart from the companies that were listed as part of the mass-privatisation process, there have been limited examples of companies entering the listed market or using it to raise additional funds. The only substantial Initial Public Offering that has occurred was the recent

privatisation by the state of a minority stake in NKBM. Instead, bank financing is still the norm for most enterprises in Slovenia, and the banking system has tended to focus on providing credit to existing clients, rather than to new enterprises.

The banking sector in Slovenia is marked by a high degree of concentration and of state ownership. The three largest banks account for half of total banking assets and the top five hold nearly 60% of the market (Bank of Slovenia, 2008). The state is the majority owner in the two largest banks and holds ownership positions in a number of other smaller or subsidiary banks.

Over recent years, a number of Slovene banks have been partially or fully taken over by foreign banks. In 2001, France's Société Générale took over Slovenia's largest privately owned bank, SKB Banka. In October 2001, Italian banking group San Paolo IMI purchased 82% of Bank of Koper, the fifth largest bank. In spring 2002, the government sold 34% of the largest bank, Nova Ljubljanska Banka (NLB), to the Belgian KBC Group. In late 2007, the previous government sold a minority interest Nova Kreditna Banka Maribor (NKBM) by way of IPO. It was also expected that NLB would be a target for further privatisation. It is not clear whether the current government proposes to continue the process of bank privatisation.

#### *1.1.5. Boards*

From its inception in 1993, Slovenian company law adopted a two tier board structure, comprising a supervisory board and a management board. The legislation provides that the term of appointment for members should be set in the articles of association but should not exceed six years. In practice, supervisory boards are generally appointed for a collective four year mandate with all members appointed at the same time. Under the current Companies Act, adopted in 2006, companies can also choose a single tier board structure. While some larger listed companies have examined the option of moving to a single tier structure, to date the two tier model prevails amongst larger, listed companies with single tier boards being adopted for smaller, closer-held companies. Regardless of the structure adopted, the law provides for worker participation: the articles of association must specify the extent of worker representation, with between one third and one half of all supervisory board members (two tier system) and up to one third of directors (one tier system) appointed as workers' representatives[12].

The power of the supervisory board is effectively executed through its capacity to appoint and recall members of the management board. As noted above, the supervisory board members are themselves appointed by the general meeting for a four year term and may only be recalled early by the general meeting where more than 75% of voting shareholders approve such a move. In a structure where there are often significant block-holders who have a high degree of control at the general meeting, the combined effect of this framework is that these block-holders are often able to exert a high degree of control over appointments to both the supervisory board and management. The qualifying provisions for appointment to supervisory boards or single tier boards are quite restrictive and are designed, in part, to reduce the capacity of managers to control appointments to supervisory boards. First, direct swapping of board memberships amongst managers is not allowed; if a manager of one company is on the supervisory board of another company, then the reverse situation is not allowed. Second, an individual is not able to sit on more than three boards in total, be they supervisory boards, management boards or single tier boards. This is a hardening of earlier provisions which limited board memberships to five.

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One consequence of the legislation is that it places a significant limitation on the capacity of individuals to operate as professional board members and, anecdotally, it appears that there are very few people who drew the majority of their income from acting as a supervisory board member.

Reflecting its controlling interest in a large number of companies, it has been widely acknowledged that the government has, in the past, used its position to influence board appointments to companies in which they have a dominant or even an important stake. In some instances, the criteria by which appointees were chosen were considered to be based on affiliation to ruling parties. As part of a new policy framework on the corporate governance of SOEs, the government has developed a process for selecting nominees for directors to company boards. The amended process, involves an independent expert group (Staff Accreditation Council) developing a list of "approved" directors from which government nominees would be drawn and, for larger companies, specific non-binding recommendations to be submitted to the relevant Minister responsible for choosing government nominees to the particular company. The draft Law on the Corporate Governance of State Capital Investments, expected to be adopted on 20 April 2010, foresees that the Council will be transferred to become a subsidiary body of the new central ownership agency.

### *1.2. The corporate governance framework*

#### *1.2.1. The legal framework*

As noted above, the first Companies Act was enacted in 1993 and was inspired predominantly by the German/Austrian corporate law model, but also drew from other continental corporate law frameworks that operated in a similar tradition. The Companies Act was modernised with a substantial redraft in 2006 and has been subject to significant revision both before and after the introduction of the redraft to align Slovenian law with the EU acquis. Accession to the EU has also resulted in a complete overhaul of the suite of legislation governing the Slovene capital markets. To date, legislation has been passed to fully implement the EU's Market in Financial Instruments Directive; Transparency Directive; Prospectus Directive; and the Takeovers Directive. Aside from the framework Companies Act, these directives are transposed into Slovene law under a new Market in Financial Instruments Act, which came into operation in 2007 and a new Takeovers Act (enacted in 2006). In June 2009 the government passed legislation to give effect to the EU Shareholder Rights Directive.

The Slovene company law model is strongly grounded in the principle of one-share, one vote, and places a great emphasis on the role of the general meeting as a tool to enforce the rights of shareholders. That is, for certain shareholder actions the law focuses the rights of shareholders as a collective group, rather than on the rights of individual shareholders. However, there are also a large number of procedural rights that are enforceable by individual shareholders.[13] The general meeting is required to consider and adopt the annual report and undertake a formal process of "discharging" each of the members of the supervisory board and management board. By issuing a discharge, the general meeting confirms and approves the work of the management or supervisory body in the previous financial year. These powers are exercised by simple majority of the votes cast.

The focus on the role of shareholders as a collective body, impacts on the means by which minority shareholders are able to enforce their rights. There is no form of class action under Slovenian Law, and minority shareholders seeking to rely on their collective rights are required to use the general meeting to pursue such action. For example, the general meeting has the power to take action in the name of the company[14] where management or supervisory board members have violated their obligations and the general meeting may also appoint a special auditor to examine particular transactions or company affairs. Shareholders must meet the relevant thresholds to institute such proceedings: in order to call a general meeting, shareholders must represent at least 5% of the capital. In the case that the general meeting does not approve the legal action or the auditor being appointed, minority holders can seek a court appointed special auditor, but only if they represent at least 10% of the common stock of the company. The costs of such legal action or the appointment of the special auditor are required to be met by the company.

Other minority protection is focused on the requirement to achieve super-majorities for significant corporate actions, including those that affect the company's capital structure, consent to certain mergers, acquisitions, divisions, dissolutions etc, and votes to remove members of the supervisory board. For these transactions, the Companies Act requires three-quarters of the votes at the general meeting be cast in favour of the resolution for it to proceed. As such, holders of a 25% plus one share stake have an effective blocking minority over most strategic corporate transactions.

According to some interlocutors, the thresholds required for certain minority rights have limited the effectiveness of the legislation to protect the interests of the small shareholders who acquired their shareholdings through privatisation. The dispersed nature of these shareholdings has meant that their level of participation at annual general meetings is low. Because of this, block-holders, even if they are minorities, are able to exert substantial control over company affairs and company management.

Recently, Slovenia has re-examined the issue of minority shareholder rights as part of the Action Plan they have developed for corporate governance reform in Slovenia. With the passage of the legislation giving effect to the Shareholder Rights Directive, the Government "believes that issues concerning the protection of minority shareholders have been solved to a great extent". Under the new legal regime, proposals and counter-proposals must be received in advance of the General Meeting and the appointment of proxies has been streamlined. The Government also notes that the development of a Code of Corporate Governance for SOEs will "deal with the issues of unequal treatment of non-state shareholders in state-owned enterprises and the protection of minority shareholders". Nonetheless, the Government proposes "as an additional measure, a survey will also be carried out, aimed at improving the implementation of the provisions of the Companies Act, more precisely the provisions relating to the protection of minority shareholders, also in connection with thresholds for pressing claims". The survey has been approved by the Government and is currently being tendered. After its completion, scheduled for 2012, appropriate measures are expected to be taken depending on the survey's conclusions and recommendations.

### *1.2.2. Regulatory and institutional framework*

The regulatory and enforcement powers covering the operation of capital markets are largely concentrated in the hands of the Securities Markets Agency (SMA). The Ljubljana

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Stock Exchange has no regulatory functions with respect to the capital markets and its listing rules are subject to the approval of the SMA. In banking matters, prudential supervision is the responsibility of the Bank of Slovenia; and in insurance there is also a separately constituted regulator, the Insurance Supervision Agency. In their self-assessment, Slovenia expresses the view that the division of responsibility among the regulators is established clearly in the legislative framework and is facilitated by bilateral cooperation agreements between each of the agencies that provide for an effective exchange of information. The Slovenian authorities did consider whether the three regulators should be amalgamated into a single "super-regulator" but subsequently decided to postpone the amalgamation of the regulatory bodies noting that "in the short term, there are higher priorities and the costs and risks of an immediate move to integration are too high".

The Securities Market Agency is governed by a Council comprising five members, one of whom is appointed as the President of the Council. The President also acts as Director of the Agency. The SMA supervisory role encompasses: issuing authorisations and approvals for public offers, takeovers and other financial market activities; supervising the operations of financial institutions (with respect to their financial market operations), brokers, the stock exchange, and the central clearing house; and promulgating secondary legislation for the operation of the financial markets. In 2009 the SMA signed the IOSCO Multilateral Memorandum of Understanding.[15]

As part of the package of reforms that resulted in the adoption of the Market in Financial Instruments Act, the enforcement powers of the SMA have been increased. The SMA has (since 2005) been afforded powers to operate as a "minor offences body", providing a fast-track process for imposing fines for minor breaches of the legislation and regulations within the scope of its operations. This includes powers to issue fines for breaches of the financial markets legislation, takeover legislation, and laws relating to investment funds, insurance and private pensions. The size of the fines that the SMA can issue varies depending upon the legislation, however, by way of example, fines of up to EUR 125 000 for companies and EUR 4 100 for individuals under the Market in Financial Instruments Act. In 2008, the SMA issued a total of 20 fines which had an average size of EUR 36 000. The vast majority of the SMA's minor offences decisions in 2008 relate to breaches of reporting of transactions where shareholdings exceed the thresholds of 5%, 10%, 15%, 20%, 25%.

The SMA has wide ranging supervisory and enforcement powers which co-exist with their powers to levy fines. The nature of the enforcement powers vary according to the legislation concerned and the nature of the breach. For the regulation of financial markets, the powers include suspension or prohibition of trading; the lifting of authorisations to individuals or institutions; and issuing orders to rectify breaches. In relation to the takeover legislation, enforcement powers are grounded in the right to suspend voting rights for parties that breach the provisions of the act and the SMA has been reasonably active since the passage of the new legislation in pursuing this remedy (refer further below).

Instead of amalgamating supervisory bodies, the Government is drafting legislative amendments which would improve the independence of the SMA. The proposed amendments would increase the financial autonomy of the Authority via an improved capacity to charge levies; introduce fixed term independent appointments for supervisory

board members of the SMA on a similar basis to the Central Bank; and remove SMA employees from the public employment regulations, to enable the Authority to offer market based salaries. It is expected that the legislation will be finalised during 2010 and will be considered by the Government in the first half of 2011 before being submitted to parliament.

An important issue for the review is the extent to which the SMA is adequately resourced and empowered to exercise its supervisory and enforcement functions effectively, especially in an environment of block holders and a substantial number of minority shareholders. The Agency is funded by supervision charges that they determine internally, but is subject to approval by the Government. The Agency feels that they are adequately resourced and are functioning with sufficient powers. Market participants are less convinced of the capacity of the SMA to adequately supervise market activity. At a practical level, it is worth noting that the authority has a total of 46 employees spread over eight separate divisions, which would suggest that the depth of their capacity to oversee the market is somewhat limited.

Concerns over the capacity and willingness to pursue enforcement action, in particular, arose in relation to a number of leveraged buyouts that were undertaken in the period up until 2007. The level of takeover activity is, by number, relatively small, with the SMA approving 35 takeovers in 2007 and 20 takeovers in 2008. However, as noted above, there has been a number of high profile takeovers in the recent past that have seen apparent circumvention of the mandatory bid provisions of the takeover law.[16] Amongst the management buyouts that have occurred, many participants felt that "share parking" in advance of takeovers had become widespread and the supervising agencies had exhibited little real power to ensure effective disclosure.[17]

The new takeover law (introduced in 2006) contains quite extensive provisions governing "acting in concert", including some strong enforcement powers. The regulators feel that the new legislative regime, and the information disclosure requirements, provide an adequate framework for preventing future episodes of share parking. All substantial changes in ownership are required to be notified to regulators within three days of occurring, which limits the capacity to park shares. When a takeover application occurs, the SMA "demands from potential offerors all documentation related to acquisition of target shares in order to determine whether shareholdings of the target company are in line with the takeover legislation".

One particular challenge for the regulator is the scope of companies that fall within the operation of the takeover framework. Unlike many OECD countries, there are a large number of unlisted companies in Slovenia that have very wide share ownership. Because of this there has been a policy emphasis placed on extending takeover protection to unlisted companies with a large shareholder base, such that the legislation provides that any company with either a minimum of 250 employees or total capital of EUR 4 million is subject to the takeover rules. This creates a number of problems for the regulator: the exact scope of its regulatory activities is subject to yearly review and some uncertainty, and the population of companies to be regulated is comparatively large given the size of the office.[18] Against this, the efficacy of the protection that can be afforded to minority shareholders in unlisted companies (particularly in relation to minimum price guarantees) is particularly constrained by the lack of a transparent and liquid market.

A related issue is whether the judicial system is sufficiently robust to provide an adequate forum for redress in circumstances where concerned parties or regulators seek relief against corporate abuse. Where particular enforcement actions relate to matters beyond their judicial competence, the SMA has powers to seek enforcement action through formal court proceedings. In addition, the decisions of the SMA, both in its role as a body deciding on minor offences and its supervisory/enforcement role are subject to judicial review.[19] Because of the short history of corporate law in the country, the court system has less experience in dealing with commercial disputes and little in the way of jurisprudence to guide its decision making. There have been limited moves to establish more specialised courts for commercial cases, although this has principally been in the field of insolvency law. A recent interim decision of the courts on the restriction of voting rights in the attempted takeover of the Ljubljana Stock Exchange by the Vienna Stock Exchange has highlighted the difficulties of using the court processes in Slovenia to resolve such cases.[20] A shared view of Slovenian corporate practitioners and foreign observers is that the process for enforcing contracts and seeking redress through the court system is long-winded, taking up to five years, is costly, and lacking in certainty as to the application of the law. According to the Pan-Slovenian Shareholders Association, cases that are pursued tend to be undertaken by larger stakeholders who have both the means and the incentive to pursue court action.[21] However, cases tend to be settled out of court providing no redress to shareholders that were not part of the action.

Slovenia has recognised the need to address the efficiency of the judicial system as part of improving its systems of corporate governance, and highlighted this issue as an element of its recently adopted Action Plan for Corporate Governance Reform in Slovenia. The Action Plan states "[t]he Government of the Republic of Slovenia is also aware of the importance of ensuring efficient and competent courts to enable the entire field of corporate governance to run smoothly. Therefore several actions have already been taken to reduce court backlogs and to improve their efficiency. The current legal system already enables specialisation of judges as well as specialised court units for corporate affairs. Such units are in place in all district courts (with the exception of one). Besides, permanent specialisation and training of judges is provided."

Slovenia has a single, centralised clearing house and securities register, KDD. KDD was established in 1995 and is a privately owned institution, with its shareholders being the major market participants, namely banks, stock-broking firms, fund management companies, and issuers. The process for dematerialising shares for all Slovenian companies commenced in 1999 and was required to be completed by the beginning of 2009; all shares are now held in KDD's central register. KDD records the legal owner of the shares and this is largely relied upon as the basis on which company law enforcement and compliance is assessed; where the legal owner holds the shares as a formal nominee for an underlying beneficial owner, the regulators have the power to obtain information on underlying beneficial ownership. The problems with "share parking" highlighted above have not arisen because of the failures in the registry system but rather via market participants using informal or undisclosed agreements on share ownership to frustrate the regulators.

For larger listed companies, a self-regulatory Code of Corporate Governance was developed jointly by the Ljubljana Stock Exchange, the Association of Supervisory Board Members of Slovenia and the Managers' Association in 2004. The Code has been reviewed and amended three times, in 2005, 2007 and 2009 (in force from January 2010). In its

present form, the Code's provisions provide guidance on; the relationship between shareholders and management, in particular, to protect shareholder rights; the roles, duties and obligations of the management and supervisory boards and their members and the relationship between the two boards; separate provisions for board members in unitary structures and in company groups; and audit and disclosure requirements. The Code forms part of the listing requirements for companies listed on the prime and secondary markets of the Ljubljana Stock Exchange, but may also be adopted by non-listed companies on a voluntary basis. Companies that adopt the Code do so on a "comply or explain" basis. At its inception, the proponents of the Code invited all capital market participants, regulators, professional associations, investors and other players on the Slovene capital markets to sign a statement of support of the provisions of the Code. As a result of that process, the Code has been widely endorsed by most relevant bodies including the Bank of Slovenia; the Slovenian Institute of Auditors; the Stock Exchange Members' Association; the Slovenian Employers' Association; the Pan-Slovenian Shareholders Association; and the Chamber of Commerce and Industry of Slovenia.

The impact of the introduction of the Code on Corporate Governance on company behaviour has been mixed. A 2008 study (Cankar, Deakin and Simonetti, 2008) found that when the Code was introduced in 2004, formal non-compliance by listed firms with eleven separate provisions exceeded 40% (and ranged up to 77%). By 2006, the level of non-compliance with these same provisions was never greater than 35%. However, the quality of the declarations is low, with validly explained derogations the exception rather than the rule. According to the study, in most cases companies do not seek to explain derogations at all or, if they do, copy-paste them from other companies disclosures. Nonetheless, the introduction and evolution of the Code has seemingly had a positive impact on the development of corporate law in Slovenia, with many of the "soft law" provisions of the Code now incorporated as legal or regulatory provisions of the new financial markets legislative framework. As an example, Code recommendations regarding the structure of board committees and disclosure of board member remuneration have largely been adopted by Slovenian law.

The Code has not been formally endorsed by either KAD or SOD (and is not adopted by them for their own operations), or by the government in its role as a shareholder. However, Slovenia has made it a requirement of the draft Law on the Corporate Governance of State Capital Investments that the new ownership agency must develop a new Corporate Governance Code for SOEs which will also apply to KAD and SOD.

### *1.3. The legal and regulatory framework for SOEs*

SOEs in Slovenia can be classified according to whether they are: owned directly by the state; indirectly through one or both of the restitution /or pension funds; or a combination of the state, the funds and other SOEs. In total, the government has substantial (greater than 10%) direct ownership in 65 enterprises. Of these, 26 are 100% owned, and a further 16 are majority owned. According to the government's questionnaire response, 23 of these SOEs would be classified as large in terms of the specified criteria[22]. These large SOEs cover a variety of industries including infrastructure (electricity generation, transmission and distribution; ports; telecoms, railways) banking (including majority ownership of the two largest domestic banks) and insurance. KAD and SOD are also considered to be large SOEs in their own right.

The exercise of ownership control over SOEs is dependent upon the form of ownership adopted. For SOEs held directly by government, ownership authority is vested in the line Ministry with portfolio responsibility for the industry in which the SOE operates. For instance, the Ministry of Transport has competence over the ownership of transport infrastructure assets such as the railways and airports; the Ministry of Finance is responsible for state ownership of banks; and the Directorate for Energy within the Ministry of Economy is responsible for government electricity companies. Directly government owned companies can be further classified by their legal forms, either as 100% owned entities established as Public Enterprises under the Public Utilities Act or, more usually, as limited liability companies under the Companies Act, in which case the government may be an absolute, majority, or minority shareholder.

Public Enterprises are established where the government's intention is that their operations include the performance of public services to a large extent, or where they have monopoly elements, but are still considered as profit making enterprises. In such a case, the role and powers of the overseeing Ministry are broad, as set out in both the Public Utilities Act and the Public Finance Act. These powers include the determination of prices and tariffs, the approval of the business reports and accounts of the company, and the determination of any special obligations placed on the enterprise. To the extent that it is consistent with the Public Utilities Act, the operations of Public Enterprises are governed by the Companies Act.

The more usual form of ownership that is adopted is for SOEs to be established as limited liability companies under the Companies Act. In such a case, the role of the competent Ministry is set out in the Public Finance Act. The powers are again broad and include; to supervise their operations; to supervise their financing; and to exercise their rights as a shareholder. In practice, proposals regarding important shareholder matters such as voting at general meetings are developed in consultation with other relevant government Ministries including, in particular, the Ministry of Finance. The Public Finance Act requires[23] that where the state holds a greater than 15% shareholding in an enterprise all material for the general meeting must be sent to both the competent Ministry and the Ministry of Finance. Final decisions on important shareholder matters are then made by government.

The Public Finance Act also provides[24] that SOEs over which the government has a "decisive influence" on management may only borrow funds (or issue guarantees) according to a defined process which includes the requirement to obtain consent of the Minister for Finance. The Ministry of Finance is responsible for coordinating such requests and, in so doing, acts as a point of central coordination for the government's ownership interests. The government does not directly lend to SOEs, with financing instead sought on commercial terms. The Slovenian questionnaire response highlights that state guarantees of SOEs have occurred only in a couple of exceptional cases.[25] Despite the coordinating role of the Ministry of Finance with regard to SOE borrowing and the maintenance of an ownership register, ownership responsibilities within government are still largely dispersed. There are individual units housed within each of the competent Ministries that deal with the ownership issues for the specific SOEs within their control.

As noted above, Slovenia has subsequently adopted a government endorsed Policy on the Corporate Governance of State Owned Enterprises, which seeks to define the medium term policy framework for the management and ownership of SOEs. The centrepiece of the

framework is the proposed establishment of a central ownership unit that would be an independent body of government to be established by legislation. It would be responsible for ownership functions for all directly held SOEs that are incorporated under the Corporations Law and for establishing the framework for coordination between Government, KAD and SOD for indirectly held SOEs. The legislation to give effect to these policies was adopted by Parliament in April 2010.

### *1.3.1. Conclusions on the corporate governance framework*

The existence of large block-holders, including the government, and the otherwise highly dispersed nature of shareholdings, has delivered a high level of control to these large shareholders. The protection for minorities in the law is focussed on the role of shareholders as a group, which creates challenges for smaller shareholders seeking to balance the power of larger, controlling shareholders. This suggests that the *Principles* and the *Guidelines* that are relevant to the first of the five core review features (and, in particular, the components of Principle III.A and Guideline III.A) are highly relevant to Slovenia's situation.

The capacity of the market regulators and the legal system to appropriately monitor and control the operations of the market and its participants is a key focus of the review. Past buyout/takeover transactions suggest that there have been difficulties in appropriately regulating the market for corporate control, with acquirers allegedly utilising questionable techniques to acquire control over companies. There have been recent improvements in the enforcement remedies available to the regulator and some signs that these new measures may have lead to an overall improvement in the quality of enforcement. Principle II.D is particularly relevant to the review in this regard.

The governance of State Owned Enterprises is a significant issue in Slovenia. The government has considerable involvement in a large number of influential sectors of the economy, both directly and through its satellite funds. Despite the extent of its control, to date there appears to have been a low degree of coordination across government in terms of establishing an overarching policy framework for its continued ownership, negotiating transparent corporate objectives with individual companies/boards, or monitoring the performance of portfolio companies *ex-post*. The government appears committed to developing a more coordinated policy framework for SOEs and has commenced this process by proposing a more transparent one for identifying and nominating appropriately qualified and independent directors to SOE boards. The third and fourth core review features provide a strong framework to assess Slovenia's position in this area.

## 2. Ensuring a consistent regulatory framework

**The first core corporate governance feature for the review calls for Slovenia to ensure a consistent regulatory framework that provides for the existence and effective enforcement of shareholder rights and the equitable treatment of shareholders, including minority and foreign shareholders.**

### *2.1. The regulatory framework for corporations*

Analysing the implementation of this core feature relies on assessing implementation of Chapters II and III of the *OECD Principles of Corporate Governance*, and Chapter III of the SOE Guidelines. For listed corporations, particular emphasis is placed on the extent to

which Slovenia has implemented Principles II.E, F and G and III.A, B and C. For SOEs the key guideline is Guideline III.A.

In its self-review, Slovenia assessed that it had fully implemented all of the Chapter II principles, except for Principle II.F.1 (regarding institutional investor's disclosure of corporate governance and voting policies) which was assessed as "broadly implemented". Its self-review of compliance with the Chapter III principles also rated its level of implementation as broadly or fully implemented for all of the principles. The World Bank's 2004 ROSC, performed relative to the 1999 Principles, reported that the disclosure of related party transactions (as per the current Principle III.C) was only partially observed, but all other similar principles to the current Chapters II and III were "largely observed".

**Principle II.D** states that "Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed."

The corporate law framework is largely founded on the principle of "one share, one vote"; while the Companies Act explicitly provides that companies can issue different classes of shares, it further provides that it is specifically forbidden to issue shares which confer a different voting power for the same proportion of subscribed capital. There is no provision in the law for any form of "golden share" arrangement and these have never been used by government. The only exception to the general rule is with respect to preference shares, which can be issued without voting rights.[26]

While share classes cannot have differential voting rights it is possible for a company's articles of association to provide for restrictions or caps on the extent to which individual shareholders can exercise their voting rights, so that it may not exceed a certain number or a certain percentage. Such restrictions must themselves apply generally and not to specific individuals. In terms of reporting ownership structures, Slovenia has directly transposed the disclosure requirements of the EU Takeover Directive into the Companies Act. This means that as part of their annual business report, companies must disclose "the structure of the company's subscribed capital, including the rights and obligations arising from the shares or the shares of individual classes; the share of subscribed capital in each share class; any restrictions related to the transfer of shares, and the nature and ownership of any securities that carry special control rights."

Despite the fact that the legal framework provides for equal treatment of shareholders, the prevalence of block-holders as significant equity owners raises the prospect that these owners could use ownership structures to exercise disproportionate control. There is limited evidence of the use of complicated ownership structures[27], and the benefit of cross-shareholdings is at least partially limited by the fact that the mandatory bid threshold (at 25%) precludes cross-shareholdings that would establish a blocking minority. However, the use of "share parking", involving shareholders utilising formal or informal control agreements over shares, has been a significant means by which block shareholders have sought to obtain a disproportionate degree of control.

**Principle II. E** states that "Markets for corporate control should be allowed to function in an efficient and transparent manner: 1) The rules and procedures governing the acquisitions of corporate control in the capital markets, and extraordinary transactions such as mergers and sales of substantial portions of corporate assets, should be clearly articulated and disclosed so that investors understand their rights and recourse. Transactions should occur at transparent prices and under fair conditions that protect the

rights of all shareholders according to their class. 2) Anti-takeover devices should not be used to shield management from accountability."

A new Takeovers Act was introduced in 2006 that transposed the requirements of the EU Takeovers Directive. The new Act enhanced the procedural provisions of the previous legislation with a more structured bid process and improved safeguards. As with the previous legislation, the key thresholds of the takeover requirements are that a mandatory offer must be made to all other shareholders once a shareholder (or entities acting in concert) has acquired a 25% holding. In addition, after a takeover offer has been completed, a shareholder must make an additional takeover each time they acquire an additional 10% shareholding in a company. Once a 75% shareholding is reached, a shareholder can acquire additional shares without having to make additional takeover bids, and once 90% shareholding is reached, squeeze out provisions allow the bidder to take full control. At this point a company may also be delisted, since delisting can occur if approved by more than 90% of shareholders. Information about changes in shareholding levels is facilitated by the disclosure provisions of the Market in Financial Instruments Act, which requires shareholders to disclose ownership changes when their voting rights exceed 5, 10, 15, 20, 25%, ?, 50 or 75% of total voting rights in a public company.

Takeover bids must follow a highly structured process set down in the legislation that imposes "fair price" limits[28], requirements to notify a company and its shareholders of an intention to make a bid, and a requirement to seek the approval of the SMA prior to making a bid. The legislation also facilitates a transparent process to enable shareholders to make informed decisions. All takeovers involve a requirement to publish a comprehensive prospectus in relation to the bid, setting out: the full details of the bid; the minimum acceptance conditions and any conditions allowing withdrawal of the bid; relevant timeframes, payment and financing terms; and the bidders' intentions for the target company, including any changes to employment levels or conditions.

In comparison to the previous Act, the new Takeovers Act implemented the following key substantive changes: a widened scope of application, with the Act applying also to unlisted companies, with greater than 250 employees or EUR 4 million in total capital; significantly strengthened "acting in concert" provisions; an introduction of squeeze out and sell out rights; and broader enforcement powers for the SMA. The widened scope of operation reflects the fact that there are still a large number of unlisted companies that have highly dispersed ownership because of the privatisation process. The second change not only implements the requirements of the EU directives but is a legislative response to the widespread use of "share parking". According to the Pan-Slovenian Shareholders Association, the main use of share parking has been to frustrate the fair price provisions of the takeover legislation. Under such schemes, shares were purchased and then "parked" for at least a year, after which a formal takeover bid would be made at a very low price. This low price would be accepted for the parked shares and could also then be used as the squeeze out price for the remaining shareholders.

The new provisions relating to "acting in concert", which again reflect the requirements of the EU's Takeover Directive, seek to address the problem of share parking by casting a wide definition of people acting in concert and creating presumptions that certain classes of people are acting in concert. The definition includes persons that act in concert on the basis of an explicit or implicit oral or written agreement and whose aim is either to acquire/consolidate their control of the target company or to prevent a bidder

from making a successful bid. Enforcement of the legislation is the responsibility of the SMA, that now has the power to both issue fines and to suspend the voting rights of shareholders who they consider have breached the mandatory bid thresholds. The SMA used the power to block voting rights in three cases in 2008 to seek to prevent alleged breaches of the mandatory bid provisions, including a high profile case involving the takeover of the Ljubljana Stock Exchange.

Past takeover activity has also given rise to concerns regarding the extent to which acquirers were financing their takeovers by leveraging their purchase against the assets of the target company. In response to this concern, the government introduced a range of measures in so-called "anti-tycoon" legislation that seeks to limit the extent to which target company assets can be used to finance takeovers. The package of measures included: amendments to the Takeovers Act preventing acquirers from pledging the shares (either directly or indirectly) of target companies as a means of securing financing; amendments to the Banking Act specifying that shares pledged in such a way are not eligible collateral; and amendments to the Companies' Law limiting the capacity of companies to provide financial assistance for the purchase of shares which they have issued and requiring employee and individual creditor approval of post-acquisition mergers.

The governments' view is that compliance problems under the takeover legislation have diminished significantly, and its recently adopted Action Plan indicates that there are no plans at this stage to make any further changes to the law or enforcement arrangements. The improvements are ascribed to a more pro-active and intensive role of the SMA, together with more dissuasive sanctions associated with the introduction of the new legislative framework. Certainly, the discovery powers of the SMA have been used recently to uncover undisclosed related party arrangements that have subsequently led to strong enforcement action.[29] Regulatory enforcement has also been facilitated by establishing rebuttable and non-rebuttable presumptions that certain classes of persons are acting in concert. For instance, there is a rebuttable presumption that persons linked merely by circumstances associated with the acquisition of securities, (for example, the time period in which the securities were acquired) are acting in concert. Similarly, there is a non-rebuttable presumption that a management company and investment funds managed by that company are acting in concert. The view that the level of undisclosed ownership has diminished was backed up by market participants.

In terms of anti-takeover defences, the Slovenian legislation prevents, without the prior consent of the general meeting, the management or supervisory boards of target companies to use certain prescribed takeover defences. Such actions are defined broadly to include: issuing additional securities; entering into transactions outside the ordinary operations of the company; taking up actions or enter into transactions that could seriously jeopardize future operations of the company; acquiring own shares or securities giving entitlement to them; or carrying out other actions that might impede the bid.[30]. In contrast, where the articles of association of a company contain pre-existing takeover defences then such provisions will remain in place during a takeover, unless withdrawn by shareholders by special resolution.

**Principle II.F** states that "The exercise of ownership rights by all shareholders, including institutional investors, should be facilitated: 1) Institutional investors acting in a fiduciary capacity should disclose their overall corporate governance and voting policies

 

with respect to their investments, including the procedures that they have in place for deciding on the use of their voting rights. 2) Institutional investors acting in a fiduciary capacity should disclose how they manage material conflicts of interest that may affect the exercise of key ownership rights regarding their investments."

There are no specific provisions in the law requiring institutional investors to disclose their voting policies, or procedures for deciding on the use of voting rights. Investment fund managers (including the investment funds that have arisen from the PIFs) have the power to vote shares according to their own proposals. There are no formal requirements for such voting policies to be disclosed and, as far as could be ascertained, it did not appear to be common practice for the local investment funds to disclose voting intentions or policies. As noted in the 2004 corporate governance ROSC, the role of custodians is limited in Slovenia, and almost all shareholders hold their shares in their own name. Custodians and brokers generally provide administrative services only. Custodian shareholders can exercise voting rights, but this is subject to being authorised to do so. If they are so authorised, a shareholder can give the custodian instructions as to the exercise of the voting right or, if granted a general authorisation, the financial organisation can exercise that right in accordance with its own proposals. However, where it does so, it must notify the underlying shareholder of its voting intentions.

The provisions relating to custodians do not apply to KAD and SOD, two of the largest institutional investors act in a fiduciary capacity in relation to their beneficiaries. Until recently, neither of the state funds had a policy on disclosing voting intentions. However, the Supervisory Board of KAD recently approved an internal code of corporate governance that is designed to clearly and publicly identify the "principles, procedures and criteria" which will be applied with respect to the exercise of its ownership rights in its investment holdings. The document mandates the public disclosure of voting policies as well as the procedures for deciding on how to develop specific voting decisions. SOD has informally advised that it wishes to follow a similar practice, although less formally than via a code such as KAD has developed. The code has only just been approved and it is too early to assess whether it has impacted on the behaviour of the fund. However, implementation of such a measure would greatly improve the transparency of their ownership objectives.

Conflicts of interest are regulated by the requirements of the Markets in Financial Instruments Act and the Investment Funds and Management Companies Act, which variously require institutional investors acting on behalf of clients to establish and implement appropriate measures for identifying, preventing and managing conflicts of interest, both between clients and the investment manager and among clients. In addition, the recent amendments to the Companies Act to give effect to the EU Shareholder Rights Directive include a regime for managing and disclosing conflicts of interest by proxy holders. The SMA monitors the enforcement of these provisions and has the power to withdraw operating licenses and/or to issue fines for breaches of the legislation.

**Principle II.G** states that "Shareholders, including institutional shareholders, should be allowed to consult with each other on issues concerning their basic shareholder rights as defined in the Principles, subject to exceptions to prevent abuse."

Aside from the provisions of the Takeovers Act in relation to "acting in concert", the company law framework does not provide specific restrictions on the capacity of investors to consult one another regarding the exercise of their rights. The Takeovers' Act specifically provides that the exercise of the voting rights on the basis of organized collecting of proxies

shall not be considered as concerted action, unless it is only used to conceal an arrangement of which the object is to gain control over the offeree company. Shareholder agreements are generally accepted and do not have to be disclosed by shareholders, except in circumstances where their construction results in the parties acting in concert under the terms of the Takeovers Act. Companies, on the other hand, are obliged to disclose in their annual business report "all agreements among shareholders known to the company that could result in the restriction of the transfer of securities or voting rights".

**Principle III.A (1)** states that "All shareholders of the same class should be treated equally. 1) Within any series of class, all shares should carry the same rights. All investors should be able to obtain information about the rights attached to all series and classes of shares before they purchase. Any changes in voting rights should be subject to approval by those classes of shares which are negatively affected."

The principle of "one share one vote" is enshrined in Slovenia's corporate governance legislation and framework. The Code of Corporate Governance expands the legal position, setting out explicitly that "companies shall treat equally all shareholders who hold shares of the same class, internal and external, minority and substantial shareholders, the state as a shareholder, and domestic and foreign shareholders". Information about the rights that accrue to the different classes of shares is contained in companies' articles of association and is required to be disclosed in company annual reports. The Code stipulates that companies' management should publicly disclose, both on the company's official website and in hard copy at the company address, the total number of shares and voting rights, along with the number of shares and voting rights for a particular class of shares.

Changes to voting rights or classes require an amendment to the articles of association. All changes to the articles requires a vote at the general meeting supported by a three quarters majority of the subscribed capital, unless the articles stipulate a different majority, (but, in any case it must not be less than a simple majority and at least half the subscribed capital must vote). In addition, where the rights of the classes of shares are changed to the detriment of one class of shares, the consent of the shareholders of that class is required. The shareholders affected must adopt an extraordinary resolution giving their consent, again by a three-quarters majority of shareholders within their class.

**Principle III.A (2)** states that "Minority shareholders should be protected from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and should have effective means of redress."

Slovenia has established a number of *ex-ante* measures to protect the interests of minority shareholders. Apart from the "super-majority" provisions related to change in the articles of association impacting on shareholder rights, the Companies Act also provides[31] for strong rights to existing shareholders in relation to capital raising: any increases in share capital must be approved by a three-quarters majority of represented shares and, where there is more than one class of shares, by a three-quarters majority of each class of shares. Furthermore, existing shareholders have a right of pre-emption to the issue of any new shares, unless they waive this right (again by a vote at the general meeting supported by at least a three-quarters majority of represented shares).

Minority shareholders also have significant rights which they can exercise through the general meeting, and shareholders who together hold at least 5% of the voting capital in a company have the right to request an extraordinary general meeting and make resolutions to that meeting.[32] The general meeting can require the company to take legal action for

damages in its own name (and at the company's cost) where management or supervisory board members have violated their obligations. The general meeting also has rights to appoint, with simple majority of votes, a *special auditor* who can be asked to verify individual operations of a company, including increases and decreases in the subscribed capital, or an *extraordinary auditor* who can examine the reported financial statements.[33] If the general meeting (by simple majority) rejects the commencement of legal action or the appointment of a special/extraordinary auditor, shareholders representing at least 10% can apply to court to have such an auditor appointed. The court's decision depends on there being reason to believe that a serious violation (for example of the articles of association) has occurred in the conduct of business. In this regard, the Pan-Slovenian Shareholders Association expressed concerns that shareholders had limited rights of access to company information and that this limited their capacity to pursue the relevant actions. In practice, these remedies are more commonly pursued by larger shareholders who have the capacity and incentives to take such actions.

The World Bank's Corporate Governance ROSC identified that while the legal rights were strong, the enforcement abilities of shareholders for breaches of the rights was weak. The ROSC identified a number of specific weaknesses in the enforcement framework. Firstly, the SMA did not at that stage have the power to impose administrative sanctions without first going through a judicial process. In the new legislation, this has been formally addressed with the SMA having new powers to issue fines as a quasi-judicial body under Slovenia's Minor Offences Act. Given that the misdemeanour powers afforded to the SMA will not provide a corrective remedy when shareholder rights have been breached, the enforcement actions of the SMA and the enforcement rights of shareholders through the courts is of more significance. The timeliness and effectiveness of the court system that was assessed as weak under the ROSC remains as a major issue for enforcing shareholder protection. The Pan-Slovenian Shareholders Association brought this to the attention of the OECD in their formal submission, noting that it generally takes three to five years to bring an action to conclusion and that procedural hurdles make it difficult for small shareholders to commence actions.

As noted above, the Slovene authorities consider that with the passage of the legislation giving effect to the Shareholder Rights Directive, that the protection of minority shareholders has largely been addressed. They note that additional safeguards for non-government shareholders in SOEs are likely to accrue from the development of a specific code of corporate governance to apply to SOEs. They have also proposed that a survey be completed, focussing on the enforcement of the minority protection provisions in the Companies Act, specifically as they relate to thresholds for bringing actions. The survey would report in 2012.

**Principle III.A (3)** states that "Votes should be cast by custodians or nominees in a manner agreed upon with the beneficial owner of the shares."

Article 309 of the Companies Act provides a comprehensive framework for ensuring that custodians may only exercise voting rights for registered shares if it has written authorization to do so. A voting authorization can be given to a custodian for a period of up to 15 months, but may be revoked at any time. For the authorization to be valid, it has to be submitted to, and retained by, the company in which the shares are held.

**Principle III.A (4)** states that "*Impediments to cross border voting should be eliminated.*"

There are no *de jure* impediments to cross-border voting in listed Slovenian companies. The Market in Financial Instruments Act imposes a requirement on companies to ensure access to all relevant information needed for exercising shareholder rights, specifies the minimum information that must be disclosed and facilitates the electronic dissemination of such information. The passage of the amendments to the Companies Act to give effect to the Shareholder Rights Directive has included specific provisions to facilitate voting in absentia and by electronic means. The legislation also allows for adding new items on the agenda and counter resolutions to the AGM, and for the appointment of proxies via electronic means,

**Principle III.A (5)** states that "Processes and procedures for general shareholders meetings should allow for equitable treatment of all shareholders. Company procedures should not make it unduly difficult or expensive to cast votes."

The voting procedures are generally straightforward. Voting at shareholder meetings is conducted by poll as standard practice. With fully dematerialised shares, ownership is determined according to holdings as recorded in the register. Recent amendments to the Companies Act to give effect to the Shareholder Rights Directive have mandated that the registration date for determining ownership be set at the end of the 4th day prior to the general meeting. The legislative changes have also reinforced the disclosure of information regarding the general meeting. This includes providing a clear and explicit list of all information to be provided to all shareholders in a timely and accessible form (including via the web) to enable informed decision making at the general meeting, and providing explicit disclosure of the results of the general meeting.

Discussions with some participants suggested that the procedures for running general meetings have in the past been abused to favour the interests of larger shareholders. Where financial institutions are custodians, the law provides that they can be authorised to exercise the voting rights of the shares by the beneficial owner for a period up to 15 months. They and other shareholders are also allowed to undertake a formal process for the collection of proxies. However, where parties are engaged in proxy solicitation such proxies are, by law, only valid for the meeting for which they are collected. The Pan-Slovenian Shareholders Association argued that this has made the organized collection of proxies impractical: they highlighted cases where they had gone to the expense of collecting proxies, but their efforts were thwarted by larger shareholders who had cancelled meetings or submitted counter-proposals in ways that ensured the collected proxies would no longer be valid. The changes to the Companies Act implemented to give effect to the Shareholder Rights Directive have substantially resolved these concerns. Under the new regime, proposals and counter-proposals must be received in advance of the General Meeting and the appointment of proxies has been streamlined. The Government also notes that the limits on the validity of proxy solicitation apply equally to all parties. Further, the Takeovers Act provides that proxy collection does not amount to "acting in concert" and a more open ended approach to proxy collection could provide a means of circumventing the safeguards in the takeovers legislation.

Discussions with market participants noted that the level of participation at company general meetings is usually very low. This seems likely to be a function of the dispersed nature of the small shareholdings combined with the impediments, both legal and practical, to the collection of proxies.

**Principle III.B,** states that "*insider trading and abusive self-dealing should be prohibited.*"

Chapter 10 of the Market in Financial Instruments Act provides a framework for prohibiting "market abuse", which is defined to encompass both trading on the basis of inside information[34] and market manipulation[35]. The Penal Code of the Republic of Slovenia imposes a punishment up to five years of imprisonment for the abuse of insider information.

The enforcement of the insider trading and market manipulation provisions has not been particularly strong, apparently hampered by limited powers of discovery. Since its inception, the SMA has brought only one (unsuccessful) enforcement action for insider trading, involving trades in the shares of Lek d.d. prior to its takeover in 2002 by Novartis. The investigation included obtaining data and documentation from the company, employees, supervisory board members, workers' council, union, the LJSE, legal and other consultancy firms, large shareholders, investment firms, and the acquiring company. Ultimately, the Prosecutor's Office was unable to proceed with the cases because of lack of evidence. The Prosecutors sought court approval for the discovery of further essential documents related to the investigation, but the requests were declined by the court on the basis that they would represent a breach of privacy. Nevertheless, there are two other cases of market manipulation (shares of Pivovarna Laško and Istrabenz). A bank and an investment firm were subject of Agency's enforcement actions. The Agency decided to take measures against brokers, management board members and against investment firm itself. Both cases are still pending before the Supreme Court. Additionally, the Agency has two final decisions as regards its minor offences in the field of insider trading (cases from 2005 and 2008).

The Pan-Slovenian Shareholders Association argues that the effectiveness of the market abuse prohibitions has also been impaired because of a lack of disclosure by the SMA of its enforcement actions: while shareholders may "have incurred losses from such illegal actions, [they] have no access to information that was gathered by the SMA and no legal way to obtain it." They consider that the SMA should provide more details in relation to procedures that are initiated (rather than just concluded), the reasons for initiating them and the documented results from each case. However, the SMA seems generally predisposed to ensuring a high degree of transparency of their enforcement procedures but note that they are subject to confidentiality requirements under their legislation that prevent them from disclosing information related to investigations beyond the level of disclosure that is currently provided.

Aside from the legal protection for companies subject to the Code, there is also an explicit responsibility for protecting insider information. Companies are required to prevent trading in their securities on the basis of inside information and cannot disseminate price sensitive information before it is made public, (except to the Securities Market Agency on the basis of their jurisdiction). Companies are required to set up procedures to document and monitor access to inside information and to ensure that members of companies' bodies, related persons and employees who have access to inside information do not misuse it.

**Principle III.C** states that "Members of the board and managers should be required to disclose any material interests in transactions or matters affecting the corporation."

The legal framework for reporting related party transactions in Slovenia was recently amended to align them to the requirements of the EU Fourth Directive. The Companies Act now requires that transactions entered into with related parties must be disclosed in a

note to the annual accounts, and the disclosure must include information on the amount of the transaction, the nature of the relationship and other information about the transaction necessary for an understanding of whether the transaction is material and has been concluded under market terms. The definition of a related party is the definition set out in IAS 24.

Those firms that are required to, or choose to, comply with IFRS are also covered by the disclosure provisions of IAS 24. The 2004 ROSC assessed Slovenia's implementation of the equivalent 1999 principle as only partially observed. In their policy recommendations, the World Bank proposed that the SMA should begin a process of reviewing the content of companies' periodic disclosure and, in doing so, should place a high priority on the level and quality of disclosure of related party transactions. However, in discussions with the SMA, they have advised that the extent of their role with respect to periodic disclosure is to monitor the technical compliance with the law (for instance, that reporting deadlines are met), and they do not analyse the substance of disclosures. Instead, they consider this issue to be primarily an audit issue[36].

For listed companies that are covered by its operations, the Code of Corporate Governance also provides a process to ensure that potential conflicts of interest at the management board and supervisory board levels, are transparently reported. These provisions go beyond reporting and seek to elaborate a framework for companies to deal with potential conflicts, which is consistent with the legal duties of directors and supervisory board members.[37] The Code provides that companies should establish and publicly disclose detailed criteria for assessing the existence of conflicts of interest and measures to be taken to avoid them; board members who have conflicts of interest should disclose these and abstain from voting; and where a board member has abstained from voting due to a conflict of interest, this should be recorded in the minutes of the meeting.

### *2.2. Equitable treatment for shareholders of state-owned enterprises*

While all elements of Chapter III of the SOE Guidelines on equitable treatment of shareholders are relevant, Annex A suggests a particular relevance for **Guideline III.A:** "*The co-ordinating or ownership entity and SOEs should ensure that all shareholders are treated equitably.*"

The treatment of non-government shareholders in SOEs is a highly relevant issue for Slovenia. As noted elsewhere, the government and its satellite funds hold significant ownership positions in a large number of dominant companies in the Slovenian economy. The widely dispersed ownership of the remaining shares in many of these companies, combined with the low level of shareholder participation, means that the state often has a controlling influence on the general meeting and the appointment of members to the supervisory board. This is so even in cases where their holdings are little more than a blocking minority. The apparent coordination of voting intentions between the government and KAD and SOD intensifies this degree of control. In such circumstances, there is an onus on government to ensure an equitable treatment of non-government shareholders.

The past practice of the government in this regard has been less than ideal, particularly as it relates to the selection and appointment of supervisory board members. While the appointment of board members is dealt with in detail later in this review, one example serves to highlight how government practice has impacted on the rights of

minority shareholders. In late 2007, the second largest bank, NKBM, was partially privatised by way of an IPO. The government maintained a direct interest of just over 42% and each of the funds, KAD and SOD retained a 4% stake. At the annual general meeting in the months after the privatization, the company proposed to retain the supervisory board that had been appointed by the government prior to the privatisation. The restitution fund, SOD, made a counter-proposal at the meeting to remove certain members of the supervisory board and replace them with a list of candidates produced at the meeting. Because the counter-proposal was made at the meeting, no details of the candidates apart from their names needed to be provided. The Government, KAD and SOD all voted for the counter-proposal, so replacing their own nominees to the supervisory board without any consultation with other shareholders.

The annotations to the Guidelines propose that governments develop a set of transparent guidelines to facilitate the equitable treatment of minority shareholders. In Slovenia, the Government has started on this path by reviewing the manner in which its board nominees are chosen, with the intention that non-binding nominees be identified by an independent commission based on transparent criteria. The two funds, KAD and SOD, have also highlighted their intention to reform their nomination processes independently of government[38], with KAD having gone further in developing an internal corporate governance code that seeks to comprehensively guide its actions as a shareholder.

The recently endorsed Policy on the Corporate Governance of SOEs would move Slovenia a substantial way toward implementing the relevant Guidelines. From the perspective of ensuring equitable treatment of non-government shareholders, the new ownership unit will be responsible for: "transparently exercising the State's ownership functions"; "participating in defining the important goals of the SOEs"; "establishing the State's positions for general meetings of companies"; "exercising ownership rights at the general meetings of the companies"; "developing and upgrading the nomination mechanisms for the selection of nominees to SOEs' management and supervisory bodies and their remuneration"; "supervising consistent implementation of responsibilities of the appointed members of SOEs' management and supervisory bodies"; "o-operating and reporting on relationships with stakeholders"; "preparing annual reports on exercising the ownership function, to be reported to the National Assembly"; and "determining measurable objectives of corporate governance which will increase the efficiency of governance". The legislation establishing the agency was adopted by Parliament in April 2010. In addition, Slovenia has drafted legislation to reform the structure of KAD and SOD, and to transfer their strategic holdings to central ownership has been drafted. This legislation is expected to be adopted by the Government in April 2010 and by parliament in mid 2010.

### *2.3. Conclusions regarding the rights and equitable treatment of shareholders*

The legal framework in Slovenia provides a relatively high degree of protection for shareholders, in particular minority shareholders. There is limited capacity for large shareholders to use capital structures to obtain disproportionate control and qualifying majorities are required to effect substantial changes to the constitution of the company or the capital structure. Minority shareholders powers of redress are predominantly exercised through the general meeting, and include rights to seek the appointment of independent auditors to verify a number of matters, including the financial accounts, alleged breaches of the articles of association or specific transactions.

 

While the legal rights are strong, the capacity of shareholders to enforce their rights is partly constrained. At a practical level, minority shareholders are widely dispersed with limited economic interests in the companies in which they are shareholders. To exercise their rights via the general meeting requires a threshold level of voting interest (either 5 or 10% depending on the circumstances), meaning that only the larger shareholders often have the practical means to seek some forms of redress, and purely to their own advantage. The court system has in the past been slow and is having to adjust to a dynamic legal and commercial environment, limiting its effectiveness as a forum for settling corporate actions. The passage of the legislation giving effect to the Shareholders Rights Directive will significantly address these concerns. Furthermore, the government is undertaking a study focussed on further improving the enforcement of provisions of the Companies Act dealing with minority shareholders rights. The study is due to be completed in 2012. Slovenia has also recognised the importance of efficient and competent courts, as evidenced by actions taken in order to enable specialisation, reduce court backlogs and improve their efficiency.

Concerning Principle II.E, the legislators and regulators have taken significant steps to seek to address the significant concerns regarding the conduct of takeovers, and in particular the use of “share parking”. An expanded definition of “acting in concert” has been established in the new legislation and the regulator has been afforded powers to withhold voting rights as a remedy for breaches of the mandatory bid provisions of the Act. The revised regime has apparently been matched with an increased level of enforcement. However, continued regulatory vigilance is required to ensure that share parking practices have indeed been curtailed. The extension of the takeovers legislation to non-listed companies has significantly increased the burden on the regulators, with some doubt as to the capacity of the legislation to adequately deal with non-listed companies.

Concerning Principle II.F and Guideline III.A, improvements in the way in which the state and its satellite funds operate as shareholders could significantly enhance the treatment of minority shareholders in the substantial number of listed companies in which they are invested. In the past, the state has at best been opaque in the way it has exercised its ownership interests, and in some cases has acted with little regard for the interests of other shareholders. The legislation to establish the central ownership agency, and to invest it with the powers and functions as described, provides a sound basis for establishing a policy framework consistent with the OECD’s SOE Guidelines. Further improvements will be made by the adoption of draft legislation to defining the relationship between the ownership actions of Government and the two state-controlled funds, KAD and SOD (while respecting their specific mandates).

## 3. Disclosure of corporate information

**The second core corporate governance feature for the review calls for requiring timely and reliable disclosure of corporate information in accordance with internationally recognised standards of accounting, auditing and non-financial reporting.**

### *3.1. The regulatory framework covering disclosure*

This Roadmap core principle refers generally to Chapters 5 of the *Principles* and SOE Guidelines on transparency and disclosure. The Methodology described in Annex A suggests focusing particularly on Principles V.B and V.C and Guidelines V.C and V.D related to auditing and accounting practices and standards, as well as some aspects of Principles

V.A, V.E and Guideline V.E, dealing with other disclosure requirements of particular importance.

In their self-review, Slovenian authorities rated themselves as having fully implemented all the Chapter V principles. The World Bank Accounting and Auditing ROSC of 2004 highlighted that the main challenge for the authorities was to ensure "effective enforcement of accounting, auditing and ethical standards". Since that time, Slovenia has progressed further with the adoption of more rigorous reporting standards for listed companies, through the transposition of the EU Transparency Directive into the local securities law and a revised and strengthened enforcement framework for the auditing profession, with the passage in 2008 of a new Audit Act.

**Principle V.B** calls for information to "be prepared and disclosed in accordance with high quality standards of accounting and financial and non-financial disclosure."

Slovenia has moved gradually toward the adoption of IFRS reporting standards for larger public companies. Since 2005, (consistent with the requirements of EU regulation 1606/2002/EC) IFRS is mandatory for all listed companies that prepare their accounts on a consolidated basis. In addition, the new Companies' Law required that banks adopt IFRS from 1 January 2006 and that insurance companies comply with this requirement from 1 January 2007. Companies not covered by these specific requirements are free to continue utilising existing Slovenian Accounting Standards or may voluntarily adopt IFRS. However, the Companies' Law mandates that a decision to move to IFRS accounts, once made, must continue to be used for a period of at least five years.

The listing rules of the LJSE also mandate certain accounting disclosure requirements. Under new rules approved by the SMA in 2008, the use of IFRS accounts is a mandatory condition for listed companies in the primary market. Companies in this prime market are also required to release their accounts in both Slovene and English. Listed companies in the standard market are not compelled to adopt IFRS accounts, but are nevertheless subject to the Corporate Governance Code, and Chapter 8 of the Code itself proposes the use of IFRS accounts. As such, it follows that companies listed on this market have to "comply or explain" with this requirement. In practice, the companies on the standard market that adopt IFRS are those which are required to under law (that is, because of the need to prepare consolidated accounts, or because they are a regulated bank or insurance company).

Pursuant to the terms of the Companies Act, Slovenian Accounting Standards are developed and issued by the Institute of Auditors. The Institute's view was that these standards were a simpler set of standards that in the vast majority of cases met the needs of the small and medium size companies that principally utilised them, and that the standards would in most cases yield similar reporting results to IFRS. It was only in situations where complicated issues were involved (such as accounting for financial instruments under IAS 32) that the standards did not adequately address companies' reporting requirements and, in such cases, the Institute's view was that such companies should move to IFRS. The World Bank's Accounting and Auditing ROSC highlighted that a revision to the domestic accounting standards in 2002 could "generally be considered to have been a massive step toward harmonisation with IFRS". While it did highlight certain divergences between the standards and IFRS, these predominantly related to specific issues for banks and insurance companies – companies that, in any case, are now required

to report according to IFRS. Since that time, there has been a further revision to the standards (in 2006) that has brought them closer into alignment to IFRS standards.

Public disclosure of annual reports is established both in the securities market law and the listing requirements of the LJSE. The law requires that annual reports must be published within four months of the end of the financial year and must be publicly available for at least five years. The report must include the audited financial statements; a management report, and a management statement that the accounts provide a "true and fair" presentation of the company's financial position and the management report gives a fair presentation of the company's operations, financial position and key risks. Public companies are also required by law to prepare a semi-annual report, with summary financial statements, an interim management report and a management statement (to the same effect as above). The listing requirements for the prime market further require the preparation and release of quarterly reports that need not include full financial statements but should include key operational data such as revenues for the period.

For listed companies, the LJSE maintains a centralised, web-based database for company announcements and, at a minimum, the disclosure of financial and non-financial information is performed electronically via this data-base. The LJSE has also established comprehensive best practice guidelines for the reporting of financial and non-financial information to the market, which it expects Prime and Standard market issuers to follow. In addition, all large companies[39], whether listed or unlisted, are required to register their annual statements with the Agency of the Republic of Slovenia for Public Evidences and Services (APJES). This is a public register and compliance with the registration requirements is enforced by APJES, although it's role is limited to ensuring that statements are filed rather than having any role in monitoring or regulating their content.

**Principle V.C** focuses on the need for an annual audit to "be conducted by an independent, competent and qualified auditor in order to provide an external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects."

The Companies Act establishes extensive requirements for the auditing of annual reports: all large and medium-sized companies (as defined in the legislation[40]), whether listed or unlisted and all listed small companies must have their annual report audited by a registered auditor. The auditor must also examine the business report to an extent sufficient to verify whether its content is in conformity with the other elements of the annual report. The auditor's report must contain the following information: an introduction providing the audited accounting report as well as the extent of the audit and the accounting and auditing standards utilised; and an audit opinion which must clearly indicate whether the accounting report reveals a true and fair view of the financial position. Publication of an audit report is required simultaneously with release of the annual report according to the requirements set out above.

Auditors are formally appointed by the general meeting, upon the recommendation of the supervisory board. Supervisory boards have, under the Companies Act, the power to establish an audit committee, but are not obliged to do so. (For companies with a one tier structure, audit committees are compulsory where they are listed or have workers participation in management). The Code recommends the establishment of an audit committee as standard practice. The Code also sets out the main responsibilities that the audit committee should perform including monitoring the company relationship with the

external auditor. These responsibilities include: cooperating in the selection of the auditor and preparing the agreement between the auditor and the company; calling the external auditors' attention to important or problematic areas; and monitoring the independence, impartiality and effectiveness of the auditor. While the adoption of the Code by listed companies has increased the use of audit committees, outside of the listed sector the use of audit committees is not widespread.

Until recently, the certification and regulation of the audit profession was the sole province of the Institute of Auditors. This self-regulatory structure, when combined with their role as the accounting standard setters, was described in the World Bank ROSC as anachronistic. The adoption of a new Audit Act in 2008 has now removed responsibility for regulating the profession to an independent Agency for the Public Oversight of Auditing. The Agency is a legally separate entity with a Director and a professional council of nine members. The members are drawn from other regulatory agencies (the SMA and the Bank of Slovenia), relevant Ministries, the LJSE, academia and the profession. The Institute of Auditors has retained their role as accounting standard setters and will also pursue a systematic process of monitoring, which will be authorised and supervised by the Agency[41]. The Agency is now responsible for all disciplinary proceedings and sanctions for breach of auditing standards, or professional requirements, which resolves the tension inherent in the previous structure.[42]

As is common in a country the size of Slovenia, the audit profession is small; it comprises only 50 firms utilising 130 individual auditors. This creates particular difficulties in ensuring adequate auditor independence. In this regard, the new Act contains significantly enhanced protection to ensure the independence of the auditor from their client companies. For instance, the Act disqualifies auditors from undertaking ancillary services, such as tax, valuation, or business consulting advice. Furthermore, the Act has rotation requirements for auditors and bans auditors from working as an employee at an audited firm (in defined roles) for a period of two years after completing their role as an auditor.

A criticism of the current legislation voiced by some market participants was the strict limitations imposed on the liability of auditors: for small companies, the limit of their liability is EUR 150 000, for medium companies it is EUR 500 000 and for large companies it is EUR 1 000 000.[43] These limitations can perhaps be explained by the small size of the auditing firms that operate in Slovenia. Nonetheless, the limitations on liability, and the lack of any cases enforcing auditor liability, was put to the OECD (particularly by the Pan Slovenian Shareholders' Association, VZMD) as a limitation on the extent to which auditors were compelled to meet their legal obligations.

### *3.2. Non-financial disclosure*

Annex A identifies a number of principles and guidelines as critical to ensuring effective non-financial disclosure. These include disclosure of *i)* the ownership and voting structure of the company (in accordance with Guideline V.E.2, Principle II.D and Principle V.A.3); *ii)* related party transactions (in accordance with Guideline V.E.5, Principle V.A.5); and *iii)* corporate governance structures and policies (in accordance with Principle V.A.8).

With respect to ownership and voting structures, as noted above, complicated control structures are not a common feature of the Slovenian commercial landscape and are not generally accommodated by the legislative framework. For larger and listed companies, the

Companies Act requires that the business report of the management board must contain (as at the last business day) details of:

- the structure of the company's subscribed capital including the rights and obligations arising from the shares or the shares of individual classes, and (if there are several classes of shares), the share of subscribed capital in each class;
- any restrictions related to the transfer of shares, such as the need to obtain authorisation of the company or any other holders of securities for the transfer of shares;
- significant direct and indirect holdings of the company's securities;
- any restrictions related to voting rights; and
- all agreements among shareholders known to the company that could result in the restriction of the transfer of securities or voting rights.

Disclosure of legal ownership is further facilitated by the central register of security holdings, KDD, which provides an accessible database. As noted earlier, the register can provide details of beneficial ownership where nominee owners are used. The reporting requirements above proceed on the basis that beneficial ownership is a relevant criterion: for the purpose of reporting significant ownership stakes a person is deemed an indirect holder of securities if "these are held on their behalf by another person, or if they can assure that the rights arising from them are exercised in accordance with their will"[44].

### *3.3. SOE disclosure and transparency*

**Guideline V.D** proposes that SOEs should be subject to the same high quality accounting and auditing standards as listed companies. Clearly for those SOEs in Slovenia that are listed, this is the case, with prime listed SOEs required to adopt IFRS and standard market SOEs required to comply with IFRS or explain their decision not to. Similarly, direct and indirect government owned banking and insurance companies are also subject to the same IFRS reporting standards that apply to all licensed banks and insurers. For other non-listed SOEs, the accounting and disclosure provisions of the Companies Act apply as they do to private companies. In practice, this means that most of these SOEs utilise the Slovenian Accounting Standards as the basis for preparing their financial reports.

**Guideline V.C**, recommends that SOEs, especially large ones, should be "subject to an annual independent audit based on international standards." In the case of Slovenia the requirements laid down in the Companies Act that apply to private sector companies also apply to SOEs. That is, external audit by an independent auditor is required for all medium and large companies. In practice, this size requirement means that the requirement for an audit applies to all SOEs in which the government has an ownership interest. In addition to external financial audits, SOEs can also be subject to state performance audits conducted under the auspices of the Court of Audit (the state audit institution), which executes supervision over public spending.[45] These audits do not obviate the need for an SOE to have an external financial audit.

In terms of other reporting, **Guideline V.E.5** highlights that transactions between SOEs and related entities might be a source of potential abuse and should be disclosed. The disclosure of related party transactions is discussed in relation to Principle III.C above, and the legal and accounting requirements highlighted there, apply equally to SOEs.

The Guidelines also propose that the ownership and voting structure of SOEs should be transparent (**Guideline V.E.2**). While ownership is registered in a transparent manner, the nature of the Slovenian government and related funds' extensive holdings has made it difficult to easily capture an understanding of the government's true beneficial ownership of important SOEs. An example quoted above was of the largest bank in the country, NLB, in which the government has a beneficial ownership of 48%. This ownership is held through direct and indirect means; aside from direct ownership, the indirect interests are held via twenty different entities. This data was collected by the Bank of Slovenia; consistent and comprehensive ownership data (that is, including the holdings of KAD and SOD) on ownership are not collected or reported in a systematic manner. The Ministry of Finance collects and reports accurate data collated from all government ministries, but this excludes indirect holdings and so does not provide a true picture of the extent of government's ownership.[46] Under the Policy on the Corporate Governance of SOEs, and the newly passed legislation, there are a number of measures which will improve the transparency of government's ownership and voting practices. The central ownership unit will keep a record of all direct and indirect holdings. For direct holdings, the ownership unit will exercise the voting rights and report on its voting policies and procedures. For indirect holdings, the policy makes clear that all shareholders "affiliated to the State should disclose their general governance and voting policy including the procedures established for decision-making on exercising voting rights".

### *3.4. Conclusions regarding transparency and disclosure*

In general, the legal, regulatory and institutional structures that govern the transparency and disclosure regimes for listed companies appear strong. Concerning Principle V.B, the Slovenian accounting standards are substantially simplified compared to IFRS, but are designed (according to the standard setters) to yield similar reporting results to IFRS in most cases. The larger listed companies are, in any case, required to comply with IFRS.

With respect to Principle V.C, there are some concerns that the monetary limitations on auditor liability diminishes the extent to which auditors could be held to their legal obligations. However, balanced against this, the recent introduction of a new Audit Act has substantially improved the governance architecture for the profession and there is a systematic process for supervising and reviewing the performance of individual auditors and firms.

Concerning Guideline V.E.2, there is a lack of comprehensive data on government's direct and indirect shareholdings, which limits the transparency of the government's ownership and voting powers. The proposals contained in the Policy on the Corporate Governance of SOEs, and related legislation, will correct this problem.

## 4. Separation of ownership and regulation

**The third core corporate governance feature to be reviewed concerns establishing effective separation of the government's role as an owner of state-owned companies and the government's role as regulator, particularly with regard to market regulation.**

### *4.1. Exercising ownership rights over SOE*

Chapter I of the SOE Guidelines (Guidelines I.A through I.D and I.F) are of particular relevance to assessing Slovenia's implementation of this core corporate governance feature.

**Guideline I.A** calls for "a clear separation between the state's ownership function and other state functions that may influence the conditions for state-owned enterprises, particularly with regard to market regulation."

As noted elsewhere in this review, the Slovenian government has not adopted until now a highly centralised or coordinated approach to managing its ownership function. However, Slovenia has now passed legislation such that, a new central ownership agency will be established that will be responsible for ownership functions, and will be separate from the state's other functions. At present, for direct holdings, ownership responsibility is devolved to the Ministry with competence with respect to the particular industry sector in which the SOE operates. The Ministry of Finance does have a coordinating role, derived from its responsibilities under the Public Finance Act, focused around gathering materials for general meetings and control of the borrowing of SOEs. The devolution of ownership responsibility amongst several ministries creates particular challenges for ensuring an effective separation of ownership and other state functions. The current arrangements (that is, prior to the establishment of the new agency) exhibit an apparent lack of coherence across government as to the overarching policy objectives of state ownership and no processes established at the government-wide level to facilitate the development of such objectives.

In its questionnaire response, Slovenia states that it has no unified document which it considers to be an ownership policy. Again, the creation of the new centralised agency should resolve this concern, since the legislation will require the creation of a capital investment strategy that would define the objectives of government as a shareholder and define the types of capital investments as strategic or portfolio investments. At the company level, corporate level objectives are not presently communicated in a consistent or transparent manner and there seems to be limited *ex-post* assessment of whether SOEs achieve such objectives that have been set. There is also no clear process established for assessing or documenting the performance of the ownership units themselves.

The establishment of individual ownership groups within each ministry risks multiple approaches to the ownership function and creates an incentive for ministries to use SOEs within their control to pursue the other industrial functions for which they are responsible. In Slovenia's case, this appears to have had an impact both on the effective separation of market regulation from ownership and, perhaps more extensively, on the separation of the government's ownership function from its pursuit of industry wide policy objectives. The establishment of the central ownership agency will provide a policy framework for addressing these concerns.

In relation to market regulation, Slovenia has gone a considerable way (although not completely) toward establishing regulatory bodies with both substantive and legal independence from government. The principle competition regulator, the Competition Protection Office enforces the provisions of Restriction of Competition Act. A new act came into force in 2008 which the regulators argue provides a clearer enunciation of their competency to pursue anti-competitive behaviour. SOEs are subject to the provisions of the competition legislation and the Office has apparent independence to pursue actions against SOEs. Notwithstanding the apparent independence of the Office, it is not established as a separate legal entity, is still located within the Ministry of Economy and officers remain subject to public employment conditions.

Despite the lack of complete separation of the Office from government, the view of market participants was that this has not prevented a rigorous regulation of markets in which SOEs operate. This view has been reinforced recently by high profile cases brought by the Competition Protection Office involving a large number of SOEs. In 2007, the Office pursued action against five state owned electricity distribution companies that announced almost identical price increases to take effect on the same day. The Office found the increases were the result of illegal collusive behaviour among the distributors and issued fines against all of the companies. Also in 2007, four large Slovenian banks (including state controlled banks) were found to have illegally colluded on the introduction of a cash withdrawal fee.

Aside from the general competition regulator, there are specific industry regulators for the energy sector and post and telecommunications, where in all cases the government owns the dominant incumbent operators. Unlike the Competition Protection Office, these regulators have been established as independent legal bodies and they appear to operate on an arms' length basis from general government. The regulators are generally responsible for implementing price/access regimes according to regulatory frameworks established by legislation and consistent with EU norms. The government also has significant or dominant ownership position in the banking, insurance and pensions industries. All three reported that they felt free to exercise their regulatory authority in relation to state companies.[47] The Bank of Slovenia, the Insurance Supervision Agency and the SMA all have regulatory responsibilities in relation to SOEs. Again, these agencies have been established separate to government and appear to have the capacity and authority to pursue enforcement action against SOEs. This view is reinforced by comments from the Pan-Slovenian Shareholders Association, VZMD, which stated that "the supervisory authorities have recently been given some more resources to enhance their performance and allowed to operate more independently from daily politics. That goes especially for the SMA and the Competition Protection Office."

While market regulation appears to have been at least functionally separated from ownership control, the situation is more complex when it comes to the state co-mingling industrial policy with ownership. The co-location of the ownership functions with industry ministries appears to have created examples of SOEs being used to pursue industry development functions. As an example of this, the commercial port Luka Koper (51% owned by the government) is, according to Slovenia's SOE Questionnaire "used as the maritime and port industry leader". In practice, the leadership function has involved leading "all governmental (top-down) initiatives when sectoral activities had to be undertaken (*i.e.* Transport-logistic cluster; Slovenian waterborne technological platform)."

**Guideline I.B** calls for governments to "strive to simplify and streamline the operational practices and the legal form under which SOEs operate. Their legal form should allow creditors to press their claims and to initiate insolvency procedures."

There are a number of variations in the legal form for SOEs (listed company / unlisted limited liability company / public enterprise) and some specific examples, such as KAD and SOD whose ownership takes an individual form of limited liability company. However, with the exception of public enterprises, the corporate governance of all SOEs is regulated by the Companies Act. For public enterprises, the Companies Act applies to the extent it is not inconsistent with the Public Utilities Act.

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SOEs are not generally excluded from the insolvency legislation, and at present a number of SOEs are in either bankruptcy or liquidation proceedings.[48] There are a couple of very minor exceptions to this rule[49] but in general the legal framework provides an adequate basis for creditors to enforce their claims. A number of SOEs are also subject to government guarantees (refer further below).

**Guideline I.C** states that "Any obligations and responsibilities that an SOE is required to undertake in terms of public services beyond the generally accepted norm should be clearly mandated by laws and regulations . . . and … should also be disclosed to the general public and related costs should be covered in a transparent manner."

There is no unifying framework for the identification, costing and funding of non-commercial obligations, and what processes are in place have developed in a piecemeal fashion. According to the Slovenian questionnaire response, SOEs that are required to perform public services generally do so under explicit obligations that are set out in a range of ways, such as through legislated requirements, negotiated contracts or incorporated into the terms of their operating licenses. Funding is a mixture of direct budget funding (for example the costs of railway concessions), or no funding at all (such as in the case of the export development bank, SID). The questionnaire highlights that the cost of any non-commercial obligations can be found in SOE annual reports, but there is no centralised collection or dissemination of the range or cost of non-commercial obligations.

**Guideline I.D** states that "SOEs should not be exempt from the application of general laws and regulations. Stakeholders, including competitors, should have access to efficient redress and an even-handed ruling when they consider that their rights have been violated."

Apart from the minor exceptions to the bankruptcy laws, SOEs in Slovenia are subject to private law. In their questionnaire response, Slovenia highlights that anyone can seek redress for a violation of their rights by an SOE and that the legal mechanisms for claiming compensation are no different for SOEs when compared to private enterprises. There is also no special procedure of arbitration for disputed between SOEs. In discussions with market participants, there were no allegations that SOEs were beyond the operation of the legal system.

**Guideline I.F** stipulates that "*SOEs should face competitive conditions regarding access to finance*" with relations to state-owned financial institutions and other SOEs based on purely commercial grounds.

SOE access to finance is a relevant issue for the review, given that the main source of debt finance for SOEs is the domestic banking market, which is itself dominated by government ownership. According to Slovenia's Questionnaire response, SOEs do not have any easier access to financing sources than private companies, and where they access their finance from state controlled banks they do so on commercial terms. There is little reason or evidence to doubt such a proposition and the Bank of Slovenia concurred with such a view. With some limited exceptions, Slovenia does not explicitly guarantee the liabilities of SOEs. Limited guarantees have been provided in favour of a small number of infrastructure related SOEs (such as the railway, roads authority and an electricity generator). Where the guarantees are in place, they are pre-approval processes required for new lending and the approvals are subject to parliamentary scrutiny.

### *4.2. Conclusions regarding separation of ownership and regulation*

There are many positive aspects to the Slovenian SOE arrangements. SOEs are with very limited exceptions subject to the same legal framework as private companies; they are generally organised as corporations under the Companies Act; they are subject to appropriately separated market regulation; they are in most cases subject to bankruptcy legislation; and the accounting and reporting arrangements are similar to private sector companies. All of these factors contribute positively to the view that there is a high degree of competitive neutrality between private companies and SOEs.

With respect to Guideline I.A, the ownership function for SOEs in Slovenia is widely dispersed, and the lack of central coordination creates difficulties for the effective management of the government's ownership interests or ensuring a consistent approach. By allocating the SOE ownership function to the line Ministry with responsibility for the industry in which the SOE operates, in some cases it appears that Ministries have sought to use their ownership function to pursue wider industrial objectives. The establishment of the central ownership agency through the adoption of the Law on the Corporate Governance of State Capital Investments will clearly separate ownership functions from other industrial and regulatory functions of government.

## 5. Ensuring a level playing field

**The fourth core corporate governance feature concerns ensuring a level playing field in markets where state-owned enterprises and private sector companies compete in order to avoid market distortions.**

### 5.1. *The institutional arrangements role in promoting a level playing field*

The dominance of the state as a direct and indirect owner of commercial enterprises requires a particular emphasis on how they manage their ownership function to promote a level playing field. In circumstances where state ownership is so extensive, it is as important to focus on how state ownership is implemented in a *de facto* sense as it is to focus on the legal framework within which SOEs operate. For this reason, this section focuses more fully on the requirements of Chapter II of the Guidelines.

**Guideline II.A** states that "the government should develop and issue an ownership policy that defines the overall objectives of state ownership, the state's role in the corporate governance of SOEs, and how it will implement its ownership policy."

In Slovenia, there is currently no overarching ownership policy that guides the government's strategic ownership decisions, and a lack of consensus regarding the over-riding rationale for continued state ownership. There do not appear to be whole of government objectives established for the portfolio of SOEs. In interviews with Ministry officials, it appeared that there was also no formal process for developing objectives for individual SOEs, that there were no *ex-ante* financial or non-financial targets established in any systematic manner, and there was no process for *ex-post* evaluation or consolidated reporting of SOE performance. If objectives are set for individual SOEs, these do not appear to be transparent, are not communicated in a consistent way and do not appear to be subject to any form of public accountability. The Law on the Corporate Governance of State Capital Investments will address this concern by requiring the establishment of an overarching Capital Investment Strategy. The strategy will establish the over-riding objectives for government ownership and will separately identify those state

shareholdings that are considered to be strategic. The ownership agency will be responsible for developing the strategy, but it will be endorsed by parliament. The strategy will be a medium term document (covering three years) with an annual management plan (approved by government) developed to specify the short term implementation of the plan.

Prior to the passage of the new Act, Slovenia had already made the first steps to developing consistent corporate governance practices for its SOEs. An independent commission was established to accredit potential board candidates and provide non-binding recommendations to government on appointments to SOE supervisory boards. This is designed to improve the capacity of SOEs boards to exercise objective and independent judgement. The recently adopted Law on the Corporate Governance of State Capital Investments adopts a more comprehensive approach: establishing clear and transparent objectives for the companies concerned, and holding the boards accountable to these objectives, will significantly increase the prospects of the reformed board structure being effective.

The establishment of a comprehensive ownership framework, with appropriate transparency and accountability mechanisms, should curb the tendency and capacity for SOEs or governments to act in a manner which distorts the markets in which they operate is greatly increased. As a member of the European Union, there are significant features in Slovenia (both in the regulation of state aid, and the competition policy requirements in some sectors) that limit these risks. Nonetheless the risks of increased SOE inefficiency and a lack of market dynamism is greatly increased under the current arrangements.

**Guideline II.D** states that "The exercise of ownership rights should be clearly identified within the state administration. This may be facilitated by setting up a co-ordinating entity or, more appropriately, by the centralisation of the ownership function."

As highlighted earlier, there are examples[50] where particular Slovenian ministries have sought to utilise SOEs to pursue industry policy objectives in a manner that is not conducive to ensuring an appropriate separation of the ownership function. This lack of separation, while no means ubiquitous, highlights a more structural concern regarding the organisation of the ownership function. According to Slovenia's Questionnaire response there is no coordinated or centralised ownership function. This limits the capacity to establish a coordinated process for developing government ownership policies of the kind described above, As there has to date been limited coordination of the ownership function, there is also no capacity to assess how the government, as an owner, has performed. As noted previously, the new legislation's approach of centralising direct ownership holdings in a distinct unit with a separate legal entity will be consistent with the recommendations of the Guidelines in this area. The agency will operate independently of existing Ministries, and will have Supervisory and Management boards whose appointments would be confirmed by a qualified majority of Parliament on the recommendation of the Government. Appointments will be for five years with appointments to the management board capable of renewal only once. The legislation provides that the agency must be set up within three months of the adoption of the legislation.

In Slovenia, this situation has been made even more complicated by the interaction between the state and the two funds, each of which may have different objectives and governance structures for exercising their ownership responsibilities. In this respect, Slovenia's new policy framework noted that it will be necessary to clarify the relationship between Government, KAD and SOD. Draft legislation has been prepared for public

consultation which would transform the two state-run funds into portfolio investors, with both ultimately being limited to stakes of 5% (voting or share capital) in companies. Because of the 5% ownership limit, both KAD and SOD will have to sell stakes in a number of listed Slovenian companies (within a three year period) and abide by rules that apply to fund managers. Since this involves some large stock holdings, the transformation will be undertaken gradually. In the interim, the new ownership agency will assume responsibility for exercising the corporate governance rights and responsibilities attaching to KAD and SOD shareholdings (such as exercising voting rights), with the funds retaining the underlying economic interests. As part of the transformation, a pension insurance company will be created by spinning off the insurance part of KAD. The new pension insurance company will operate all the pension and disability funds currently managed by KAD, and will be subject to the supervision of the pension regulatory agency. The draft legislation is scheduled to be adopted by the Government in April 2010 and by parliament in mid 2010.

### 5.2. Conclusions regarding a level playing field

Concerning Guideline II.A, the government has recently established an overall ownership policy for SOEs that includes the establishment of a legally separate central ownership agency. The legislation for the establishment of the agency has recently been passed. The development of the detailed elements of the ownership policy will be the responsibility of the ownership unit once it is established. Based on the framework contained in the policy, the proposal would enable Slovenia to clarify and prioritise its objectives for state ownership, promote a higher degree of consistency and transparency in its ownership decisions, which will provide a greater degree of predictability to market participants, including SOE competitors.

Concerning Guideline II.D, the current institutional arrangements for the ownership of SOEs is highly dispersed with limited central coordination. The creation of the central agency will increase the capacity of the government to define and monitor the objectives that it has from the ownership of SOEs, in a transparent manner. In developing the coordinated ownership arrangements, Slovenia has also drafted legislation that will transform KAD and SOD into portfolio investors, with strategic stakes they hold sold back into central government ownership. The adoption of this legislation will be a significant step.

## 6. Stakeholder rights and boards of directors

**The fifth core corporate governance feature to be reviewed calls for recognising stakeholder rights as established by law or through mutual agreements, and the duties, rights and responsibilities of corporate boards of directors.**

This core feature relates mainly to Chapters IV and VI of the *Principles* and Chapters IV and VI of the *Guidelines* on stakeholders and boards. Annex A notes that a full assessment of these chapters could potentially call for quite detailed information about actual board practices (including in relation to stakeholders) that may be difficult in some cases to obtain. It therefore recommended focusing on some of the key framework conditions, such as the legal framework defining the duties of board members, and the enforcement mechanisms and the legal rights of stakeholders. It suggested focusing particularly on Principles IV.A, B and E and Principle VI.A; and Guidelines IV.A and C, and Guideline II.B

 

recommending that the state not be involved in day-to-day management of SOEs to allow them full operational autonomy to achieve their defined objectives.

### *6.1. Stakeholder rights*

In their self-review, the Slovenian authorities identify themselves as having fully implemented all of the Chapter IV principles, with the exception of Principle IV.E (ability to freely communicate concerns about illegal or unethical practices), which they assess as broadly implemented. The 2004 ROSC assessed Slovenia's compliance with the stakeholder chapter of the 1999 Principles as largely observed, (although it should be noted that the *OECD Methodology* now places a greater emphasis on enforcement and actual practices, which may impact on that assessment). The self-assessment focuses particular attention on the relationship between companies and their employees, which follows a German co-determination model.

The Worker Participation in Management Act sets out the core principles of Slovenia's co-determination model including, in particular, the methods of and conditions for worker participation in the management of commercial companies. The workers' representatives are nominated by the companies' workers' council independently of shareholders and are not subject to a shareholder vote. Instead, the workers' representatives are appointed and/or recalled according to the rules of procedure of the workers' council, with the general meeting of shareholders merely informed of the workers' candidates. The worker nominated supervisory board members need not be (and in some cases are not) employees of the company concerned, with some members in practice being sourced from union bodies or confederations. Notwithstanding the different appointment process, worker representatives on the supervisory board have the same powers and are subject to the same duties under the Companies Act as shareholder-appointed members.

Other institutional arrangements have also been established to ensure management proactively engages with employees. Companies with over 20 workers must set up a Worker's Council, and when a company has greater than 500 employees the Workers' Council also has the right to nominate a representative to the management board. This representative is a full member of the management board and formally appointed by the supervisory board. Unlike supervisory board members, in this instance the workers' councils merely nominate a candidate who is appointed formally by the supervisory board.[51] The workers' director is meant to act on behalf of, and represents the interests of, workers regarding personnel issues. However, this is meant to be within the framework of the general rights and duties pertaining to all directors. There is a clear capacity for tension in reconciling the role of the worker directors with their duties under the Companies Act, but in practice the OECD could find little example of this being a material issue and there is no case law to provide guidance on how such tensions might be resolved or managed.

The existence of the Workers' Council as employee representative is in addition to, rather than instead of trade union representation. These two forms of representation co-exist and are institutionally and functionally separate: trade unions operate in a more adversarial role (dealing with collective bargaining, infringement of rights etc), whereas the Workers Councils are designed to be more consensual, consistent with the objectives of co-determination. Discussions with the Managers Association suggested that the model was effective as means of balance the interests of workers in the Slovenian context and that workers' representatives on Management and Supervisory boards had a positive influence on the operations and performance of companies.

Creditor rights have been reinforced in Slovenia with the passage of a new Insolvency Act in 2008. The Act transposes the relevant provisions of the EU acquis and so provides for cross-border insolvency protection within the EU according to the model provisions. For other cross-border cases, the legislation is modelled on UNCITRAL model laws on cross-border insolvency. Insolvency proceedings are overseen by the courts, which appoint and supervise trustees to liquidate assets and distribute the proceeds according to the contractual priorities or legislated outcomes. As an example of the latter, the courts can void related party transactions that occurred in the year prior to the insolvency. Individual creditors can petition the court to declare insolvency, but the actual decision is judicial and based on objective criteria. According to the Department of Justice, the number of insolvency cases has been quite limited (750 in total) and in the past the court process has been slow. Currently, cases take approximately two years on average to complete. A dedicated insolvency court has now been established which is anticipated will improve the speed and quality of creditor enforcement protections.

Aside from employees and creditors, the rights of other stakeholders are not as specifically dealt with in the in relation to companies. The Corporate Governance Code, however, provides a general framework to guide companies in their dealings with stakeholders. It provides that relationships with stakeholders (including customers, suppliers, the natural and business environment and the state) a company should *i)* exercise its rights responsibly and fulfil undertaken obligations in the manner that is compatible with the company's goals and that serves its long-term interests *ii)* communicate to its shareholders and to affected stakeholders any decisions having a direct impact on a given stakeholder group, and *iii)* when deciding on a matter, consider the legitimate interests of all stakeholders. However, the OECD is not aware that individual companies have adopted specific corporate social responsibility codes or explicit policies related to stakeholders.

### *6.2. The rights, duties and responsibilities of boards of directors*

**Principle VI.A:** states that "Board members should act on a fully informed basis, in good faith, with due diligence and care and in the best interests of the company and its shareholders".

The Companies Act contains a number of common provisions regarding the roles and responsibilities of members of the supervisory board and the management board. The law sets out that the primary duty of members is to "act with the diligence of a conscientious and fair manager and protect the business secrets of the company."[52] While the duty is not expressed as a fiduciary duty in favour of either the company or the shareholders individually, the operation of the Companies Act is such that the duty principally operates in favour of the company[53]: it is the company that has the capacity to bring actions and shareholders who seek to take action against a director or the board would need to do so through the general meeting for damage to the company. Members of both boards are jointly and severally liable for damages, unless they can show they acted within their duty (that is, acted fairly and conscientiously) or that the act was based on a lawful resolution of a company general meeting. There have been limited examples of cases involving a breach of directors' duties; in the last three years there have only been six cases in the Court of Appeal (High Court) and five of them were rejected. Market participants advised that board members' use of directors' and officers' liability insurance was the exception rather than the rule, which may suggest that office holders do not take the threat of legal liability seriously.

Aside from the legal framework, there are a number of voluntary or non-binding codes that can guide board members in the exercise of their functions. The Code of Corporate Governance which applies to listed companies contains extensive provisions on the rights and duties of both management board members and supervisory board members. These provisions take the legal basis as their starting point and seek to expand them to more prescriptive guidelines governing the conduct of members and the execution of their functions. In addition, the Association of Supervisory Board Members has established a Code of Conduct for Supervisory Board Members and has published a set of Recommendations for the Appointment, Discharge and Remuneration of Management Board Members.

Where a two tier structure is adopted, the division of responsibility between the supervisory board and the management board is enunciated in only very broad terms in the Companies Act. A more detailed description of the respective powers and functions is set out in the Code of Corporate Governance. The law anticipates that management boards should have a high degree of autonomy in pursuing the conduct of the company's business, and expressly prohibits the supervisory board becoming engaged in business conduct. The articles of association may specify that certain types of operations can only be carried out with the supervisory board's consent, but even in these cases the management board has the right to take a matter to the general meeting in circumstances where the supervisory board withholds its consent. Interviews with managers and supervisory board members confirmed that in listed companies where ownership is dispersed, managers did in fact operate with a high degree of autonomy. For instance, mergers and acquisitions, if pursued within the agreed company strategy, were undertaken by the management and then put to the supervisory board for approval only when key terms had been agreed.

To balance the autonomy of the management board, the law grants the supervisory board wide powers to appoint and dismiss its members. Apart from matters such as breach of duty, the law provides that supervisory board can recall management "for other economic and business reasons (significant changes in the shareholder structure, reorganisation, etc)". In practice, management is required to provide at least quarterly operational reports to the supervisory board and, in listed companies at least, usually attend board meetings on an as required basis. Boards are not required to establish committees (with the exception of an audit committee, which is a requirement for listed companies) but may do so and include members from outside the ranks of the board itself. Responses from market participants suggested that the use of committees was not yet a widespread practice in listed companies.

There is also a strong debate in Slovenia regarding the remuneration of supervisory board members which is driven both by some high profile cases of excess but also, it seems, a rather widespread view in the public that board positions involve little or no real work. The average remuneration for a supervisory board member (including Chairmen) in private sector companies in 2006 was less than EUR 6 300 per annum and in listed companies it was less than EUR 12 600 per annum. For companies in the prime market, annual compensation averaged EUR 15 300. This reaction against supervisory board member fees has been particularly focussed on SOE boards, which may be a reflection on the process of past appointments and the quality of the nominees. In response to this public debate, the government has recently put before Parliament legislation that would prevent supervisory board members from receiving performance related remuneration. This legislation will apply to both SOEs and fully private companies.

### *6.3. SOE boards*

The appointment processes, composition and authority of supervisory boards in Slovenian SOEs are important issues for the review. The Guidelines (in Chapters II and VI) provide a range of recommendations for how to ensure that SOE boards have the necessary authority, competence and objectivity to carry out their functions. These include, allowing them to exercise their responsibilities and respecting their independence (Guideline II.B); assigning them a clear mandate with responsibility for performance (Guideline VI.A), and ensuring their composition allows objective and independent judgement (Guideline VI.C).

The nomination process for SOE boards in Slovenia does not appear in the past to have been structured to always ensure that Boards have appropriate authority and independence. In a formal sense, government nominations to SOE boards (both direct and indirect) are subject to the provisions of the Companies Act and the government is in no better position to nominate representatives than other shareholders. However, in a practical sense, government's high level of ownership gives it a strong role in the nomination and appointment of supervisory board members to a large number of companies. It was widely acknowledged by market participants that the selection process for nominees to SOE boards in the past had in many cases been driven by criteria that were not related to competency, but rather to factors such as political affiliation. Board mandates in Slovenia generally run for a four year period, which ties into the electoral cycle. In past elections, a change of government has also heralded extensive changes to the membership of SOE boards. Since the supervisory boards appoint the management board members, and they also operate on a four year mandate, the replacement of the supervisory board members tends also to have preceded a later change in the composition of the management board. [54]

The government has recently established a process for modifying the nomination of SOE board members. As a first step they have established an expert commission (the Staff Accreditation Council, or "SAC") that will perform two separate functions. Firstly, it will establish a register of suitable candidates that could be considered for nomination to an SOE board. Candidates for the register will be sought through an open process and subject to pre-determined vetting criteria. The register, once established, will be available to government ministries as the relevant pool from which they can select nominees for particular posts. In certain cases (namely particularly large SOEs) the SAC will also have a role in making non-binding recommendations to government on candidates for board positions in particular companies. The legislation establishing the centralised ownership unit provides that the Council will come under the auspices of the Agency that will then take primary responsibility for coordinating board appointments:

One challenge for the proposed arrangements is to ensure an appropriate degree of coordination between the government, KAD and SOD, where they are co-investors. Both of the funds have an independent supervisory board responsible for voting decisions on board representatives in their portfolio companies. Without some degree of coordination between the different government shareholders, the capacity to implement consistent policies to improve board quality would be difficult to achieve. However, the legislation to transform KAD and SOD into portfolio investors will largely address this concern. Once it is passed, the legislation will transfer the nomination and voting rights of the funds to the new ownership agency. The funds will ultimately be limited to holdings of less than 5% and strategic holdings will be transferred to the central ownership agency.

### *6.4. Conclusions regarding stakeholders and boards*

There appears to be a robust framework in place for dealing with key stakeholder rights. The co-determination model for employee participation in the management of corporations provides a strong framework for ensuring that the rights and interests of employees are adequately addressed by companies. Creditor rights have also been significantly strengthened as a result of the introduction of the new Insolvency Act and the establishment of specific courts to deal with insolvency cases.

The rights and duties of directors are quite clearly established in the Companies Act and further elaborated through the Code of Corporate Governance. However, the extent to which these duties can be enforced appears constrained by the procedural limitations on shareholders bringing actions for the breach of duties and the operation of the court system. This is reflected in the very low number of cases that have been heard for breach of directors' duties; the low rates of success of such cases; and the anecdotal evidence that the use of Directors liability insurance is not prevalent.

There is a widespread view that the operation and composition of SOE boards has in the past been weak. Appointments have allegedly been made for reasons other than merit and using processes that have been less than transparent. The government has commenced a process of reform of board appointments that will seek to introduce both greater transparency and a greater focus on ensuring appropriately qualified candidates capable of exercising independent judgement.

## 7. Conclusions

This report has reviewed Slovenia's corporate governance framework and formulated conclusions regarding each of five core corporate governance features. While reaching positive conclusions in relation to many aspects of these core features and of the recommendations in both the *Principles* and the *Guidelines,* the report also identified a number of weaknesses in the Slovenian's corporate governance framework:

- **Slovenia's corporate governance framework:** In a period of less than 20 years since its independence, Slovenia has developed a comprehensive private sector corporate governance framework. In the last three years, new legislation in the form of a modernised Companies Act, Takeovers Act and Market in Financial Instruments Act has been developed which provide a solid legal foundation for the operation of Slovene capital markets. In September 2009, the Government formally adopted an Action Plan for Corporate Governance Reform in Slovenia. This Action Plan commits the Government to a range of actions identified by the Committee that would improve corporate governance practices in Slovenia, including a review of the legislative provisions protecting minority shareholder rights; an increase in the capacity of the judicial and regulatory authorities to monitor and enforce compliance with corporate laws, and improvements in the way in which state owned enterprises are governed. A continuing issue for policy makers is to ensure the legal and regulatory framework is appropriately matched to Slovenia's share ownership structure, which is characterised by significant block-holders (including the state), but otherwise widely dispersed ownership. The development of Slovenian company law over the past decade has seen a substantial increase in the rights afforded to shareholders, and in particular minority shareholders. However, many of these rights are focused on the role of shareholders as a group, and are rights more

readily exercisable by block-holders. In such circumstances, strong regulatory enforcement is a critical tool for ensuring equitable treatment of smaller shareholders.

- **Effective enforcement of shareholder rights:** The effective enforcement of shareholder rights has in the past been seen to be lacking, with insufficient capacity on the part of SMA to adequately regulate takeovers, in particular. This has resulted in significant cases of minority expropriation where takeovers have occurred in apparent breach of the relevant law. The new legal framework provides better tools for the SMA to conduct its oversight functions and this appears to be having a positive effect. However, the SMA has a wide mandate and better resourcing would enable this be more effectively implemented. The court system has struggled to adjust to a dynamic legal and commercial environment, and this continues to limit its effectiveness as a forum for settling corporate disputes. As some of the leveraged MBOs of recent years come under stress, the authorities will need to exercise vigilance so that minority shareholders are not expropriated.
- **Requiring timely and reliable disclosure in accordance with internationally recognised standards:** The legal, regulatory and institutional structures that govern the transparency and disclosure regimes for listed companies are generally consistent with the relevant chapters of the *Principles* and the *Guidelines*. Not all listed companies are required to report according to IFRS, with smaller listed companies relying on Slovene accounting standards. While these are less comprehensive than IFRS, they are designed (according to the standard setters) to yield similar reporting results to IFRS in most cases. There are some concerns that the monetary limitations on auditor liability diminish the extent to which auditors could be held to their legal obligations. However, the recent introduction of a new Audit Act has substantially improved the governance architecture for the profession and there is a systematic and independent process for supervising and reviewing the performance of individual auditors and firms.
- **Separation of ownership and regulatory functions and ensuring a level playing field:** In 2009, the Government endorsed a Policy on Corporate Governance of State-Owned Enterprises, the centrepiece of which has been the passage of the Law on the Corporate Governance of State Capital Investments. The Policy also proposes legislation to better define the relationship between the Government, KAD and SOD, and to structure these separate funds as portfolio investors at arms' length from the Government. While not passed during the review, legislation giving effect to this reform was adopted by the National Assembly on 28 September 2010. Prior to the establishment of the new centralised ownership agency, the management of the ownership of state owned enterprises was widely dispersed in the Slovenian government, with a lack of central coordination and no overall ownership policy or objectives for SOEs. SOE boards are a particular area of concern, with evidence that government appointments have become politicized and the level of board independence compromised. The current government has commenced a process of reform of board appointments that will seek to introduce both greater transparency and a greater focus on ensuring appropriately qualified candidates capable of exercising independent judgement. The new ownership agency is also tasked with developing a comprehensive ownership policy. This should clarify and prioritise the overall objectives for state ownership as well as provide a basis for setting SOE specific objectives against which boards can be held accountable. Such a policy should also seek to promote a higher degree of consistency and transparency in ownership decisions, particularly in relation to listed SOEs, where in the past state

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bodies have acted opaquely, not necessarily in the best interests of the state, and in some cases with little regard for the interests of other shareholders.

- **Recognising stakeholder rights and the duties, rights and responsibilities of boards:** The legal framework recognizes stakeholder rights in a manner which is broadly consistent with the stakeholder chapter of the *Principles*. The rights and duties of directors are quite clearly established in the Companies Act and further elaborated through the Code of Corporate Governance. However, there is little evidence of directors being held accountable to their duties, with only one successful private action and a low take-up of directors and officers liability insurance. The latter indicates that the threat has little deterrent power.

### *Notes*

1. Yugoslavia was unique among the socialist economies in having “labour managed” enterprises.
2. The restitution fund was established in 1993 with a legislated mandate to provide limited compensation to defined groups of people whose assets were nationalised, but for whom restitution of assets during the “de-nationalisation” process was not possible.
3. This was a substantial reduction from 2007 when market capitalisation was EUR 19.7 billion or 64.5% of GDP.
4. Slovenia was exceptional amongst the republics of the former Yugoslavia and other socialist states in having a sophisticated industrial base oriented to exports. Strong interest on the part of foreign investors could therefore have been expected.
5. Refer further Section 1.1.5.
6. While the current Takeover Law was only enacted in 2006, the 25% threshold is unchanged from the previous Takeover Law which dates from 1997.
7. In comparison, turnover velocity for the main OECD stock exchanges averaged over 125%, according to data from the World Federation of Exchanges. The proportion of off-market transactions is significantly larger than in earlier years, when on market turnover was higher. In 2007, on-market turnover on the Ljubljana Stock Exchange (LJSE) was EUR 2 177.3 million, while off-market block trades had a total value of EUR 1 201.6 million (Ljubljana Stock Exchange Annual Statistical Reports, 2008).
8. KRKA is a generic pharmaceutical company. It is 25.2% owned by the Slovenian Government, via the pension fund, KAD (10.2%) and the restitution fund, SOD (15%).
9. During 2008 a further three closed end funds became open ended mutual funds, such that there are now only four closed end funds with less than EUR 400 million in assets.
10. Refer Article 71(3) of the Public Finance Act 1999.
11. According to the Ministry of Finance, legislative amendments in July 2008 will enable the supervision of indirect state investments as well as investments by local councils. They forecast that the collection of such data will commence within the next two years.
12. Small companies are exempt from these requirements.
13. Such individual rights include contesting the validity of general meetings or of particular resolutions and the enforcement of fundamental shareholder rights, such as to be informed of and to participate at the general meeting.
14. *Actio pro socio*.
15. The Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information.
16. As noted above, the mandatory bid provisions of the Takeover Law have an initial threshold of 25%. The current law (introduced in 2006) did not amend this threshold which dates to the previous legislation enacted in 1997.
17. The difficulties in ascertaining beneficial ownership and the view that its practice was widespread is the subject of significant public debate. Slovenian financial magazine Manager each year

compiles a list of the wealthiest 100 Slovenian's based on information in the central share register, KDD. The Slovenia Times reported that the most recent list included at 4th place a publicly unknown stock broker employed by Probanka who was alleged to be a temporary owner (acting on behalf of someone else) of a chain of companies, that ultimately owns the Laško Brewery company. Laško is itself a significant minority shareholder in Probanka.

18. More than 500 companies are subject to the takeover regulation, and the SMA expends considerable effort merely to update and maintain the scope of companies subject to the takeover law.
19. With respect to minor offences, in 2008 the courts decided on six such appeals first filed in 2006 and three filed in 2007. The courts rejected six of these appeals, two appeals have been accepted while one was stopped.
20. In the recent takeover of the Ljubljana Stock Exchange, the SMA removed the voting rights of the acquirer, the Vienna Stock Exchange, on the basis of its view that the VSE had breached the takeover legislation. In a Supreme Court decsision, the court confirmed the Agency's decision as regards voting rights of the Vienna stock exchange. However the same case is still pending in the Slovene Constitutional Court. A final resolution of the case could potentially take some years to resolve.
21. Although, as noted above, minority shareholders have certain rights to take action in the name of the company and, in such cases, the costs are borne by the company.
22. The parameters set out in the Questionnaire defined a large SOE as one having either USD 100 million in revenue, USD 100 million in assets or 500 employees.
23. Public Finance Act, Article 72.
24. Public Finance Act, Article 87 and the related Decree on the terms and conditions and methods of borrowing by legal entities.
25. The questionnaire response also sets out the government's position that lending by state owned or state controlled banks to other SOEs is conducted purely on commercial terms.
26. In addition, preference shares may not comprise more than half of a company's subscribed capital.
27. Amongst the listed companies, the only significant cross-shareholding was that between Istrabenz and Petrol that was the result of a takeover contest between the two companies. Istrabenz has sold out the majority of its stake in Petrol and so the cross-shareholding no longer exists.
28. The price offered must be at least equal to the highest price paid by the acquirer for shares in the target company in the 12 months preceding the bid.
29. In the Istrabenz case, the SMA used its powers of inspection to force disclosure of written agreements that allegedly fell within the scope of the "Acting in Concert" provisions of the legislation.
30. This is consistent with the optional requirement of Article 9 of the Takeover Directive.
31. Article 333.
32. Apart from their collective rights, shareholders also have certain individual rights which they can exercise independently, such as seeking declaration of resolution as invalid.
33. The person who audited the company's annual report in the last five years cannot be appointed a special or extraordinary auditor.
34. For information to be "inside information it must be *i)* precise, *ii)* unpublished, *iii)* related to financial instruments (or their issuers) and *iv)* if it were made public, it would probably have a significant impact on the prices of such financial instruments".
35. Widely defined to include transactions, orders or the supply of information which *i)* could give a misleading picture regarding the supply, demand or price of a financial instrument *ii)* ensures the price of a financial instruments trades at artificial levels, or *iii)* employs some form of deception or contrivance.
36. The accuracy of the reporting and disclosure regime and is dealt with in Section 3 below.
37. Directors' duties are dealt with in detail in Section 6.2.
38. While there is coordination between Government, KAD and SOD as to the reforms to the nomination processes relating to their respective shareholdings in companies in which they are

co-owners, the reforms are still separate exercises. This would seem appropriate given the funds have specific mandates and potentially differing interests from the Government in its ownership.

39. Defined as companies having either 250 employees or USD 4 million in capital.
40. A medium size company is one that has at least two of the three following characteristics: its average number of employees in a financial year is greater than 50, its net sales income is in excess of 7 300 000 euros, and/or the value of its assets is in excess of 3 650 000 euros.
41. The Agency is also empowered under the Act to perform its own supervisory activities should it see fit.
42. Under the old framework, in the five year period from 2003-2008, the Institute issued 24 public warnings, 27 remedial actions and withdrew one license for various breaches of required auditing procedures. Most complaints arose as a result of a rolling process of review of all Slovenian audit firms.
43. It should also be noted that these limits on liability do not apply if the damage was caused intentionally or through gross negligence.
44. Article 70 of the Companies Act.
45. Based on the provisions of the Public Finance Act, the Minister of Finance can request an operational audit of an SOE, in which the State has at least 15% share.
46. As noted earlier, the Ministry of Finance advises that recent legislative changes will allow more comprehensive data to be collected and this is planned to occur in the next two years.
47. There are examples of these regulators taking enforcement action against SOEs – in 2004, for instance, the ISA removed its license for a government nominated supervisory board member at Triglav, the insurance company, resulting in the member being replaced.
48. Bonisima, Deloza and Hidro Koper are currently in bankruptcy proceedings; EGS-RI and RSCM are in liquidation proceedings.
49. A bankruptcy procedure cannot be introduced against the railway company, SŽ, if insolvency is a consequence of performing compulsory public services; and the public enterprise, Uradni list, cannot cease to exist. If Uradni list is insolvent, the government of the Republic of Slovenia would appoint an interim manager to effect a financial reorganisation.
50. The Luka Koper example, highlighted in section 4.1 above.
51. There are formal procedures for breaking a deadlock in the event that the supervisory board does not accept the nomination.
52. Article 263 of ZGD-1, the Slovenian Companies Act
53. In a recent case, the court refused to hear an action for breach of duty brought by shareholders on the basis that only the Company could bring the action, and not shareholders themselves.
54. For instance, in 2005 the supervisory board of the state insurance company Triglav was replaced when its mandate expired (after the election in 2004). At the first meeting of the supervisory board, the head of the Management Board was replaced.

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