VZMD
Vseslovensko združenje malih delničarjev
PanSlovenian Shareholders' Association

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Civil initiative »Erased small shareholders of Nova KBM bank« and

NKBM Section at the Pan-Slovenian Shareholders' Association

European Commission
President José Manuel Barroso
Rue de la Loi / Wetstraat 170
B-1049 Bruxelles/Brussels
Belgique/Belgium

Ruše, Ljubljana, 18th March, 2014

Dear Mr José Manuel Barroso, President of the European Commission,

We are writing to you on behalf of the small (uninformed) investors of the Nova Kreditna Banka Maribor bank (hereinafter referred to as NKBM), which was until 17th December, 2013, the company with the most shareholders in Slovenia. On 17 December, 2013, the Bank of Slovenia adopted a *Decision about Emergency Measures* with which, among other things, all »bank qualified obligations were terminated,« among them also shares and subordinated bonds. In the three banks with majority state ownership, a hundred thousand owners of bank shares were expropriated; the same thing also happened to 2.000 owners of subordinated bonds and, through them, to half a million inhabitants (a quarter of the population), who have been saving in pension companies, asset management companies, and insurance companies, which amounts to more than 500 million euros in total (hereinafter referred to as M€). Many companies and municipalities have also suffered losses. The following was written in Večer newspaper on 20th December, 2013: »One of the conditions for state aid was to wholly erase the property of shareholders and owners of subordinated bonds. « The state transferred all bank property, including our own capital, to itself.

In 2007 the State of the Republic of Slovenia (hereinafter referred to as the state) sold, in the first mass public sale of shares of any state owned company, 5.6 million shares to 109,627 citizens at a price of 27 € (euros). The number of shares for each individual shareholder was limited in such a way that one could pay 7.000 € at the most. The average investment was 1.380 €. Many savers have transformed their (time) deposits into shares at the same bank, and some of them have also borrowed money to buy shares. The Finance Minister of the then conservative government, Dr Andrej Bajuk, claimed that the price was fair, internationally checked, that the investment would be profitable in the long term, and that it was safe. Before the sale NKBM published a *Summary of the prospectus about the shares offer to the public,*[1] which was confirmed by the Slovenian government and the Securities Market Agency; the prospectus is, therefore, an official contract in which all the rights of the owners of the shares are written. There was also a symbolic incentive in the prospectus (2 shares worth 54 €) for long-term ownership – more than 90% of small (uninformed) investors who bought the shares indeed remained faithful to the bank, until the cancellation of bonds, until trust in domestic banks, the state and the European Commission was lost. Small investors were therefore not speculators, which could be inferred from the words of the president of the

[1] Summary of the prospectus about shares offer to the public, NKBM, 2007.

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European Parliament, Mr Martin Schultz: » Only a handful of people are gaining huge profits and they do not even pay taxes for them, but when banks' losses need to be covered, the taxpayers are the ones who need to pay them.«[3] In developed countries, bank owners might indeed be millionaires who became rich because of the crisis – in our country almost a quarter of bank shares was owned by small shareholders whose salaries and pensions were decreasing, if they got them at all.

European Commission demands for assessing the quality of means and stress tests

On a demand from the European Commission, an assessment of the quality of means was carried out in NKBM last year, and stress tests were done as well, according to the state, on **31 December**, **2012**. NKBM had at that time 327 M€ of basic capital of the utmost quality (Core Tier 1, CT1) – capital adequacy was 9.17 %. Apart from that the bank also had 70 M€ of profit before weakened conditions and reservations which up to then cumulatively totalled 675 M€. The main test was carried out by the Oliver Wyman Company, which was selected by the European Central Bank. [2] It was found out that in the case of an unfavourable scenario with a 1% possibility of realisation, an alleged loss of 1,947 M€ could arise in the period between 2013 and 2015. The NKBM absorption capacity was estimated to be 892 M€, therefore at the end of 2015 the potential uncovered net loss was supposed to be 1,055 M€[3].

The National Assembly of the Republic of Slovenia, on the demand of the European Commission and in accordance with its *Message*[4]*,* on 14 November, 2013, adopted the *Law about Changes and Amendments of the Banking Act*[6]. After the European Commission approved the measures of financial support, the Bank of Slovenia issued the above mentioned *Decision about Emergency Measures*.

A month after the *Decision* about shares and bonds cancellation had been issued, it turned out that the assumptions about stress tests were wrong, therefore the estimations about the potential uncovered loss in the amount of 1,055 M€ were also unreal; e.g. a decrease in GDP was in the unfavourable scenario for the year 2013 estimated to –3.1 %, when in fact it was –1.1 %. This year the decrease is supposed to be –1.0 %, but the Institute of Macroeconomic Analysis and Development is predicting a +0.5 % increase! NKBM operated with a loss of 62 M€ in 2013, and in 2014 it is supposed to have positive results, even after the weakened conditions and reservations. The Austrian Raiffeisen Bank, which »very conservatively« estimated capital deficit in the same stress test, recapitalised its branch in Slovenia with only 40 M€. They did not expropriate their shareholders, because this would not change the amount of capital, and an aggressive change of ownership could have fatal consequences for the bank and the state. The basis of a market economy is collecting and investing capital, and »credit capitalism« can quickly decay, which has been proved by recent Slovenian experiences.

In the last balance sheet published before cancellation on **30 September, 2013**, the total capital of NKBM Group was 278 M€, cumulative weakened conditions and reservations were 847.8 M€, 110 % of those from 2012[5]. Profits from regular business operations in the period from 1 January 2013 to 9 September 2013 were 25.8 M€; net reservations and weakened conditions were 95.7 M€, therefore the net loss was 66.9 M€. The NKBM capital adequacy was 8.39 %, a little bit under the required boundary of 9.0 %. NKBM

[2] Benoît Cœuré, Delo, 15. 2. 2013.
[3] http://www.nkbm.si/rezultati-skrbnega-pregleda.
[4] European Commission, Rules regarding bank state aid, 2013/C 216/01 (Ur. l. EU, 30. 7. 2013).
[5] The results of Nova KBM Group indicate favourable trends, 29 November, 2013, NKBM website (access 8 January, 2014)

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balance sheets on the day of the shares and bonds cancellation were not done and published, which therefore allowed for manipulations related to business success and shareholders' property.

State manipulations revealed

On **17 December 2013,** NKBM capital was, according to the Bank of Slovenia data, 143.2 M€, which means that remissions and reservations reached 982.6 M€. NKBM got bonds in the amount of 390 M€ for the »bad debts« from the Bank Asset Management Company (BAMC). If we take into account the 61 M€ profit of the current year, the means of owners on that day came to at least 594 M€. On the basis of this it is obvious that the capital was positive, and that the bank was solvent. The cancellation of small shareholders was not legitimate – the capital was positive, the recapitalisation in the approximate amount of 30 M€ would suffice to reach the 9.0 % capital adequacy. The management board wanted to get 300 M€ in order to have more capital reserve. On 18 December 2013, the state recapitalised the bank with 620 M€ , and with bonds in the amount of 250 M€, as well as with the »purchase price« of 390 M€ through BAMC, 1,260 M€ in total, so after the first estimation it had 16.8 % capital adequacy, and after the closing balance in 2013 the capital adequacy was even 19.1 %! NKBM's president stated on 28 December 2013: «NKBM reorganisation would have been successful even with less capital. ... It seems that the insurances of our loans have been evaluated much more strictly than market estimates. «

Out of 1,260 M€, 640 M€ were given in bonds, i.e. as a promised payment in two or three years. Out of 620 M€ in cash, the state changed 361 M€ of its deposits and 56 M€ of its bonds into equity capital. NKBM was therefore supposed to get only 223 M€ of the means, 80 M€ less than it expected from recapitalization. With a transfer to BAMC, the state dispossessed the bank of claims in the amount of 1,022.7 M€, and almost twice as many warranties for them. The key factors were the transfers of good companies (benefits C and B) including warranties (real estate), and not the transfers of bad debts; the currently transferred companies mostly regularly repay their obligations to the bank, and they only want to re-programme their obligations. Among them are the following companies: Pivovarna Laško (Brewery), which also owns a quarter of Mercator, Pivovarna Union, Radenska, newspaper companies Delo and Večer, etc. The second example is Gradis Celje Company, which had 100% warranty of the state, and an additional warranty in real estate. They transferred it to BAMC with 7% value – the state thus relieved itself, but caused an additional loss to NKBM. Obviously it was about selling good companies on the demand of the European Commission. BAMC has to sell these companies – for this reason state banks were not allowed to transfer »bad debts« of the companies from ex-Yugoslavia. At the same time the state had to, on the demand of the European Commission, expropriate the owners of shares and subordinated bonds.

While transferring »bad debts« to BAMC they were artificially lowered in such a way that the inter-ministerial commission of the Slovenian Finance Ministry and the Bank of Slovenia, after the suggestion and approval of the European Commission, artificially lowered them to about a third, and for every euro of repayment of claims it got additional 5 € warranties; BAMC thus took over from NKBM 1.022,7 M€ of claims, and close to 2.000 M€ of warranties; it promised 390 M€ of repayment in bonds and thus caused NKBM a loss in the amount of 632.7 M€. In the case of NKBM, the loss for 2013 thus, in spite of the sale of Maribor Insurance Company, amounted to 673, 4 M€[6]! Losses that used to be hardly possible in this way became real, and they were published as already realised losses. In order to legalise the decisions of the inter-ministerial commission, they obviously »found out« additional losses[8] in the period from January to

[6] Večer, March 3, 2014 in Seonet.

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March 2014, although the audit companies Deloitte and Ernst & Young were carrying out the assessment of the quality of means parallel to stress tests. Along with the above mentioned, 594 M€ of means, owned by the shares and bonds owners, were nullified. They remained in NKBM, but the state became the owner (597, 8 M€). The numbers are the same as in the estimated losses in 2013–2015, therefore it has been confirmed that additional weakened conditions were carried out after the cancellation of shares and bonds with the purpose of nullifying positive capital and with this especially the means of shares and bonds owners[9]. Concurrently with the bank, the state also seized the Postal Bank of Slovenia, half of Adria Bank AG, KBM Bank AD and 9 sister companies, and it also got rid of all the obligations related to state-guaranteed company loans. In other words – **the state has, on demand and in cooperation with the European Commission, robbed the bank and its owners!**

Let us add that the European Commission demanded »an independent assessment of the quality of means« in 2012 (it was carried out for 2, 5 M€ by Ovington, the sister company of European Resolution Capital Partners, ERC). In 2013 assessors from four international real-estate companies and two audit companies from the City of London came over and they were paid 22, 1 M€ for their work - 4 M€ were paid for NKBM, much more than they paid in Spain or Austria. In 2014 there will be new assessments and tests which will again be paid by the banks affected by the crisis. The European Commission dictated the criteria for the last year's assessment of bad debts and conditions for the transfer to »bad banks« which have not been accepted yet, because the European Central Bank has just asked the European Banking Authority (EBA). There is a difference between valid international accounting standards and forced, illegal criteria, and because of this difference shareholders and the owners of subordinated bonds were expropriated – **the procedure was not in accordance with the principle of the rule of law.**

The blow in Slovenia was much greater in numbers and more fatal than in Cyprus, where 47,5 % of the value related to bank deposits in the amount of over 100,000 euros, mostly owned by foreign investors, were transformed into shares and with them they recapitalised the Cyprus Bank. None of the »crisis« countries (Greece, Ireland, Italy, Portugal, Spain) have so far invalidated the property of small investors. NKBM shareholders have been erased contrary to Article 33 of the Constitution of the Republic of Slovenia, and contrary to the 1st Article of the Protocol to the Convention on Human Rights and Fundamental Freedoms. The State of the Republic of Slovenia has expropriated them in two phases: first it oppressively devaluated their deposits (5.6 million shares, each worth 27 €, 151 M€ in total); it forbade them bank recapitalisation, while at the same time it transformed coco-bonds and 10% fixed interest on them into shares: 100 million shares each worth 1 €, and 185 million shares each worth 1, 3 cents, in total 285 million shares for 102, 4 M€! The book value of a share has thus dropped from 5, 37 € to 0, 76 €, and the market value has dropped to only 0, 10 €. The small investors have thus practically been pushed out of ownership, and a 92% bank ownership has been established which then, **with a special law which so far none of the EU countries has adopted, erased their shares!**

As a ridicule to this unethical act, the state and the Bank of Slovenia in Article 347/4 of ZBan-1L in the *Summary of the Decision about Emergency Measures*, wrote that the shareholders whose common shares have reached at least one tenth of the basic capital of the bank can – because of the enforcement of judicial protection against the decision of the Bank of Slovenia about the extraordinary measure - demand a call of a General Meeting of shareholders and appoint a person who represents the bank in the procedures of judicial protection against the Bank of Slovenia – only the state has so far had such a share.

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The European Commission is to be blamed

The representative of small shareholders demanded balance sheets from the NKBM Management Board, the Government of the Republic of Slovenia and the Bank of Slovenia on 17 December, 2013, but they either did not have them or they did not want to give them to us, which is an illegal act. NKBM did not even give the share owners the decisions about the cancellation of shares, or legal counsel about the possibility of complaint, which was against the rule of law and which was even provided to those whose property was nationalised after the 2nd World War by the communist government. The Government of the Republic of Slovenia and the Bank of Slovenia used the European Commission and its *Message*[3] as an excuse at the National Assembly and in public when they were adopting and enforcing extraordinary measures. The Slovenian Ministry of Finance has recently sent us a letter in which it is written: « Without establishing a legal framework for implementing the new rules[3] related to state aid for supporting measures in favour of banks, it will not be possible to continue the rehabilitation of those banks which were not able to fulfil the demands of the Bank of Slovenia regarding capital adequacy. The new rules of the European Commission unambiguously specify that state aid is not to be granted to a bank until the equity, hybrid capital and subordinate debt instruments do not contribute to the overall offset (balance) of the potential bank losses.« Let's wait and see if the same rule holds true for the Austrian bank Hypo Alpe-Adria?

The Slovenian Prime Minister stated in an interview[7]: «Due to European rules, the owners and the owners of subordinated bonds are the first to pay for the bank rehabilitation from August 1st. If they did not do it, European permission for bank recapitalisation would not be granted. ... A loan and insurance go on BAMC. End. « On 27 January she said again in the National Assembly of the Republic of Slovenia: »We practically did not have any other choice. The use of this extraordinary measure was in accordance with European rules. We would not get a consensus from Brussels for bank reorganisation if losses were not also covered by the owners of shares and bonds. « The Bank of Slovenia also stated in its press release (20 January 2014): The admissibility of each individual case of state aid is being scrutinised by the European Commission. The preliminary consensus of the European Commission is a prerequisite for granting state aid to an individual bank.« The Government of the Republic of Slovenia as well as the Bank of Slovenia therefore claim that the European Commission is to be blamed for a unique expropriation of shareholders in the EU.

We suggested to the Prime Minister that, on the basis of the above mentioned findings, subordinate bonds and shares owned by small shareholders be reinstituted in an out-of-court settlement in the amount of the actual payment, with deducted dividends and with accumulated interest for time deposits. A similar agreement was reached after independence with the Bank of Slovenia regarding foreign currency deposits, resulting in general satisfaction of savers, banks and the state. The Cabinet of the Prime Minister of the Republic of Slovenia then replied to our proposal that they cannot discuss the out-of-court settlement since it »would lead to the incompatibility of the measures related to the rehabilitation of the bank system with European rules related to state aid for supporting measures in favour of banks in the framework of the financial crisis. «

The State of the Republic of Slovenia therefore is using the European Commission as an excuse. But in the *Message* of the European Commission, it is not written that shareholders need to be expropriated. Even the states which accepted a bailout (Greece, Portugal, Ireland, Spain) did not cancel shares and subordinate

[7] Do I completely trust bankers?, Delo, 28 December, 2013.

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bank bonds. Germany, Belgium, Austria and other member states have even recapitalised private banks themselves, without expropriating the existing shareholders, and the European Commission did not consider it an aid. Spain and the Netherlands had to invalidate the decisions about the nullification of the share property. It is more than obvious that Slovenia was treated unequally.

Why was it necessary to destroy market capital in Slovenia?

The Government of the Republic of Slovenia as well as the Bank of Slovenia are making excuses that »in the period of the economic recession, the risks related to share ownership and other financial instruments, which at higher risk also indicate bigger capital revenue for the owners, become fundamentally higher in comparison with the risks and expectations which existed in the conditions of the economic growth and positive state of banks. « NKBM shareholders on average got an annual dividend in the amount of 0.2 % of an investment, which does not even cover inflation, let alone a long-term bank deposit; the value of a share was decreased before the state manipulations from the book value 14.44 € when buying it, to the book value 5.37 €, and the market value was decreased from 27€ to 1,3 €. At the European and world stock exchanges, last year's values of shares were at record heights after the crisis, and in our country they are at a record low due to the above described functioning of the state and the European Commission (hereinafter referred to as EC). Apparently this was not enough – the shares and bonds of small investors have even been confiscated or annulled and erased from the register.

NKBM gave an initiative to the state to carry out measures in June 2013, hence even before the EC *Message* was published. In Article 90 of the *Message*, it is written that the declarations which were recorded before 1 August, 2013, will be assessed according to the measures that were used at the time of declaration. NKBM is not a private bank, the state is a majority owner and the present Prime Minister, Ms Alenka Bratušek, was a member of the NKBM supervisory board between 2009 – 2011. The *Message* of the EC in the Articles 28-31 explicitly allows recapitalisation. Why should the recapitalisation of banks be forbidden to shareholders only in Slovenia? On the contrary, the state as a majority shareholder should, together with other shareholders, decisively stand up for itself.

The State of the Republic of Slovenia appointed the Management Board and all the members of the NKBM Supervisory Board – small shareholders, in spite of their 24% capital share, were not adequately represented in the supervisory board, and many of their suggestions and initiatives about appointing members of the supervisory board, recapitalisation and redemption of bad debts have never been taken into account. The state has, because of the crisis and company bankruptcies, demanded that the state banks give credits to the affected companies by breaching the rules about risk management processes, and by internal rules for granting loans. It invested more than 3 billion euros of deposits into banks for these purposes, and it borrowed the financial means for them from the world financial markets. The state was recruiting top management in the banks politically; the parliamentary investigation, which is currently taking place, showed that the politicians were also putting pressure on the bank management with their demands for granting loans, which later turned out to be bad. As the number of bad debts is up to 15% in the biggest state bank, there is a suspicion of fraud and criminal acts,[8] which the media is revealing daily. »None of the small shareholders has created a bad loan or a bank hole, « their representatives rightly claim. [10]

[8] Trio about the reasons for billion losses of banks, Delo, 24 January, 2014.

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Under the orders of the European Central Bank in July 2010 the Bank of Slovenia demanded a rapid increase of the capital adequacy of banks – the deadline was much shorter than the one that was demanded for the German banks by their regulator. Business banks adapted to this demand by decreasing the scope of loans, which triggered a great deal of »bad debts.«[9] Why should small shareholders be punished because of the state, which has not even taken into account any of their suggestions – meanwhile, German and French banks which were, carelessly and contrary to good practice, lending financial means for »bad« loans are wholly protected?

To forbid recapitalisation and then destroy the property of a hundred thousand small shareholders is a breach of contract[1] and a violation of the right to enjoy property, guaranteed by the Constitution of the Republic of Slovenia and by the Convention on Human Rights. Shares cannot be confiscated, especially not on the basis of the supposed future scenarios with a 1% probability, and even less so with manipulations, such as the flood of shares or the unreal depreciation of "bad debts" and the confiscation of guarantees for them. Shareholders and subordinated creditors were not informed in the official prospectus that the state could confiscate their investments after they had bought shares or bonds. The effect of the law for previous times was an intervention into acquired rights, which is in contradiction with the Constitution of the Republic of Slovenia. The change of official criteria for bank assessment and the manipulation of balance sheets for the past is a criminal act of forging documents.

The European Commission and the state have, by erasing small shareholders and the owners of subordinate bonds, definitely destroyed the Slovenian capital market of shares and bonds – both business and state-owned. Mutual and pension funds are located almost entirely in foreign markets, where they create jobs, whereas in Slovenia they are being closed down. When the President of the EU Council, Mr Herman van Rompuy, visited Slovenia at the beginning of February 2014, he congratulated the Slovenian Government for such measures?! By confiscating the shares which concurrently traded at the Ljubljana and Warsaw Stock Exchanges and whose owners were also foreign investors, the government and the European Commission destroyed the trust of international markets in Slovenian shares and bonds. Some people claim that this was the final aim of the European Commission or lobbies which are active in Brussels, and which have a crucial influence on EU administration. Why was it necessary to delay the rehabilitation for 8 months and thus slow down the recuperation of the economy and drastically increase public debt? The assessments could have been carried out after minimal recapitalisation (300 M€ in NKBM case) had been done, without harming the state, economy and tax payers.

While foreign stock exchanges reach record index values, the index of the Ljubljana Stock Exchange is reaching only one quarter of its previous value. The aggregate turnover on the Slovene capital markets in the year 2007 was 3.800 M€, and in 2012 it was only 360 M€, less than a tenth of the turnover in 2007. Greece, Spain, Ireland and Portugal were getting billions of euros of deposits through the stock exchange market when they were experiencing the economic crisis, and it worked as an injection into the economic circulation, whereas in Slovenia even foreigners have lost their trust in the Slovenian financial market. This is the reason why the Slovenian crisis is so persistent.

The European Bank for Reconstruction and Development (EBRD) is opening its office in Slovenia again, before the sale of Slovenian property. The other »vultures« are gathering as well - Ovington (ERC) Company, which carried out the bank stress tests in Slovenia in 2013, »established a fund which is planning

[9] France Križanič, Delo SP, 22 February, 2014.

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to buy worthless, bad investments«[10] - after these companies have assessed the state of the companies in the Republic of Slovenia, they will now be able to use their »knowledge of weak points« for (cheaply) buying Slovenian banks and companies. Apparently this was the purpose of the invisible lobbies hidden behind the decisions in Brussels?!

The EC *Message* in Article 45 specifically warns that the exclusion of the demands of Articles 43 and 44 is possible when the implementation of such measures would endanger the financial stability or cause disproportionate measures. The crash of the Slovenian capital market will surely be »fatal« for the financial stability of Slovenia. NKBM lost 178 M€ of deposits in 2013, and it will lose even more of them in 2014. If the deprived investors continue to withdraw deposits and transfer them to non-state banks, the financial stability of the nationalised banks will be endangered too, and therefore most of the banking system will be endangered – so the measures were foolish and **disproportionate**. Besides, the Constitution of the Republic of Slovenian will also be violated because of the expropriations and retroactivity.

Suggestion for solutions

We suggest that you support our endeavours for the out-of-court settlement, in accordance with Article 45 of the EC *Message*, excluding the demands of Articles 43 and 44. The expropriation of small investors is a **disproportionate measure**, the implementation of the decision of the Bank of Slovenia **endangers the financial stability of the capital market, bank system, and economy, and with it the entire state of Slovenia**. This caused that, before the elections into the European Parliament, euro-sceptical parties started to gain influence (the Slovenian Labour Party: «Exit from the EC as it is today is essential«), as well as parties which demand substantive amendments in the EC (the United Left, Solidarity), because of the destruction of the social-market economy and the double-crossing of small investors by the financial industry, big capital and their lobbies.

For the Civil Initiative »Erased small shareholders of Nova KBM«

Prof Dr Peter Glavič

For the NKBM Section at VZMD

Kristjan Verbič, MSc
VZMD President

[10] The Doctrine of Shock, Mladina magazine, 13 December, 2013.