Foreword

This Review of Corporate Governance in Slovenia is part of a series of reviews of national policies undertaken for the OECD Corporate Governance Committee. It was prepared as part of the process of Slovenia’s accession to OECD membership.

The OECD Council decided to open accession discussions with Slovenia on 16 May 2007 and an Accession Roadmap, setting out the terms, conditions and process for accession, was adopted on 30 November 2007. In the Roadmap, the Council requested a number of OECD Committees to provide it with a formal opinion. In light of the formal opinions received from OECD Committees and other relevant information, the OECD Council decided to invite Slovenia to become a Member of the Organisation on 10 May 2010. After completion of its internal procedures, Slovenia became an OECD Member on 21 July 2010.

The Corporate Governance Committee (the “Committee”) was requested to examine Slovenia’s position with respect to core corporate governance features and to provide Council with a formal opinion on Slovenia’s willingness and ability to implement the recommendations laid down in the OECD Principles of Corporate Governance (the “Principles” and the OECD Guidelines on Corporate Governance of State-Owned Enterprises (the “SOE Guidelines”). The assessment was based on, inter alia, the Methodology for Assessing the Implementation of the OECD Principles of Corporate Governance.

This report, prepared as part of the Committee’s accession review, highlights some of the key corporate governance challenges facing Slovenia. A major feature of Slovenia’s corporate governance framework is the importance of managing State Owned Enterprises (SOEs) to ensure that there is a consistent and transparent ownership policy; that the state acts as an informed and responsible shareholder; and that SOE boards are appropriately composed to ensure that they have the skills and authority to exercise their functions. SOEs are a significant component of both the listed and non-listed sectors and the Government has significant direct or indirect control over a large number of sizeable companies in the domestic market. Direct holdings are concentrated in infrastructure sectors (banking and insurance) where SOEs hold a dominant position. Indirect holdings are managed 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”).

Slovenia has taken significant steps to improve the governance of its SOEs. In 2009, the Government endorsed a Policy on Corporate Governance of State-Owned Enterprises, the centrepiece of which was a commitment to pass legislation to establish a separate central ownership agency to coordinate all government ownership actions. The legislation establishing the central ownership agency (the Law on the Corporate Governance of State Capital Investments) was adopted by the National Assembly on 20 April 2010. The Policy also proposed legislation to better define the relationship between the Government, KAD and SOD. Reforming the relationship between Government and the satellite funds, KAD and SOD, to facilitate implementation of a coordinated
ownership policy and transparent approach to their shareholder responsibilities, remains a key measure to be addressed in the short term.*

The Committee review also identified a number of challenges in the listed company sector in Slovenia, including the need for more effective protection of minority shareholder interests and consistent enforcement of takeover provisions. In 2009, the Government adopted an Action Plan for Corporate Governance Reform in Slovenia, including a plan to review the legislative provisions protecting minority shareholder rights and increase the capacity of the judicial and regulatory authorities to monitor and enforce compliance with corporate laws. Slovenia recently passed legislation to give effect to the European Union’s Shareholder Rights Directive. Enhancing the effectiveness of these measures should remain a focus of Slovenia’s reform efforts.

This review of corporate governance in Slovenia was conducted on the basis of a comprehensive self-assessment by the Slovenian authorities and Slovenia’s answers to a detailed questionnaire on state-owned enterprises, supplemented by information gathered from OECD fact-finding missions, interviews with public officials, market participants, academics and relevant literature. Successive drafts of the report were discussed with Slovenian representatives at joint meetings of the Corporate Governance Committee and its Working Party on State Ownership and Privatisation Practices in April and November 2009, and again in April 2010. This final version of the report reflects the situation as of April 2010. It is released on the responsibility of the Secretary General of the OECD.

The review was prepared by Jim Colvin under the overall supervision of Mats Isaksson, Grant Kirkpatrick and Robert Ley of the Directorate for Financial and Enterprise Affairs. The analytical framework is explained in Annex A.

* Legislation to give effect to these reforms was adopted by the National Assembly on 28 September 2010
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Chapter 1

Assessment and Recommendations
1. Corporate governance framework

Slovenia has made a rapid progression from a state controlled economy. After independence in 1991, Slovenia quickly sought to develop its capital markets and the legal, regulatory and institutional structures that underpin these markets.

On gaining independence from the former Yugoslavia in 1991, a mass-privatisation programme began in 1992 that established the private ownership of capital. This was reinforced with the passage of the first framework Companies Act in 1993. Slovenia rapidly pursued political and economic integration with Europe, joining the European Union (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 in order to ensure consistency with EU directives. While implementation of EU standards has provided Slovenia with a solid legal framework in the field of corporate governance, the accession review has focused on the implementation of the OECD Principles through the practices of the regulatory authorities and the dynamic capacity of the system to change in response to evolving market practice.

Capital markets in Slovenia are 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. 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 which represented 25.2% of GDP (as at 31 December 2008).

However, while the rate of progress has been impressive, two key corporate governance challenges remain. First, Slovenia has retained significant ownership of commercial enterprises. As shown by the experience of OECD Members, this can be a problematic area. When companies are owned by governments, they can be inefficient, uncompetitive, a drain on public finances and used to pursue political objectives. The OECD Guidelines on Corporate Governance of State-Owned Enterprises stress that effective ownership by government requires coherent and transparent policy and the capacity to make objective and commercial decisions as a shareholder. The Slovenian Government recognises this challenge and introduced significant reforms in early 2010.

Second, after less than twenty years, Slovenia's legal and regulatory architecture of governance and the cultural norms of operating private capital markets are not yet well developed. A key focus of the Committee in carrying out its review was on ensuring that not only were the legal and regulatory frameworks in place for effective corporate governance, but that regulators and policy makers are adequately resourced, and have the appropriate political support to ensure that the systems could promote and enforce appropriate market behaviour.

As noted above, 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 and in banking and insurance where it holds a dominant position.
Its indirect holdings are managed 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”). The investments of these two funds 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. 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.

In the course of the review, the Government commenced comprehensive reform to its corporate governance framework. In mid-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 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. To give effect to the Action Plan, the Government endorsed a Policy on Corporate Governance of State-Owned Enterprises, the centrepiece of which was a commitment to pass legislation to establish a separate central ownership agency to coordinate all government ownership actions. The Policy also proposed 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.

The legislation establishing the central ownership agency (the Law on the Corporate Governance of State Capital Investments) was adopted by the National Assembly on 20 April 2010. Under the new law, the agency will control all the direct holdings of Government in companies established under the Corporations Law; exercise all of the ownership rights pertaining to all shareholdings (both direct and indirect) including board nominations; gather centralised information on government holdings; measure and report performance; and develop and enforce a code of corporate governance that will apply to SOEs. The agency will operate independently of existing ministries, and will have a Council and a management board whose members will be appointed by a qualified majority of Parliament on the recommendation of the Government. The law provides that the agency must be set up within three months of the adoption of the legislation. Once established, the agency has another three months within which to adopt a code of corporate governance for SOEs. It will also, as part of its mandate and within three months of its establishment, define and allocate financial assets by their groupings (marketable, non-marketable, strategic, public interest, etc.) and define the State’s objectives for these asset groups.

Under the draft legislation to define the relationship between the Government and the two state-controlled funds (KAD and SOD), KAD will be separated into two funds: one being a pension fund manager, and the other an insurance company. The central ownership agency will assume responsibility for exercising the shareholding rights (such as voting) attaching to the KAD and SOD shareholdings. Following public consultation, the legislation for the reform of KAD and SOD has been adopted by the Government and was planned to be submitted to parliament in the middle of 2010.
2. Assessment

The following section assesses Slovenia’s corporate governance in terms of five core corporate governance features:

- Ensuring 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.
- Requiring timely and reliable disclosure of corporate information in accordance with internationally recognised standards of accounting, auditing and non-financial reporting.
- 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.
- Ensuring a level playing field in markets where state-owned enterprises and private sector companies compete in order to avoid market distortions.
- Recognising stakeholder rights as established by law or through mutual agreements, and the duties, rights and responsibilities of corporate boards of directors.

**Ensuring the enforcement of shareholder rights and equitable treatment.** 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, shareholders must have a threshold level of voting interest (either 5 or 10% depending on the circumstances), meaning that often only the larger shareholders have the practical means to seek some form of redress. The court system has in the past been slow and is having to adjust to a dynamic legal and commercial environment, which limits its effectiveness as a forum for settling corporate actions. Legislation passed in 2009 giving effect to the EU’s Shareholders Rights Directive will make significant steps towards addressing these concerns. Furthermore, the Government is undertaking a study focused on further improving the enforcement of the 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.

Past buyout/takeover transactions suggest that there have also 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 led to an overall improvement in the quality of
enforcement. Nevertheless, it is important to ensure the Securities Market Agency has the financial and operational independence to adequately exercise its function and Slovenia could take further action, both with regard to the manner in which the Board of the Authority is appointed and with regard to the security of the Agency's funding.

Legislators and regulators have taken significant steps to address the concerns regarding the conduct of takeovers, and in particular the use of “share parking” (holding shares in another name). 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 legislation. 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 and there remain some doubts as to the capacity of the legislation to adequately deal with non-listed companies.

Improvements in the way in which the state and its satellite funds (KAD and SOD) operate as shareholders will 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 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 establishment of the central ownership unit 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 the draft legislation defining the relationship between the ownership actions of Government and the two state-controlled funds, KAD and SOD.

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 strong. Slovenian accounting standards are substantially simplified compared to International Financial Reporting Standards (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.

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, 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.

Until now, there has been 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 ownership agency will, as part of its mandate, be required to collect such data.

Effective separation of the government's role as owner and its regulatory role, and ensuring a level playing field. There are many positive aspects to the Slovenian SOE arrangements. With few exceptions, SOEs are 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.

However, the ownership function for SOEs in Slovenia has to date been widely dispersed, and the lack of central coordination has created difficulties for the effective management of the Government's ownership interests. 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 objectives. The new Law on the Corporate Governance of State Capital Investments, which establishes a central ownership agency, should facilitate a comprehensive overall policy for the Corporate Governance of SOEs.

The new Agency will be tasked with developing a detailed strategy for the management of state capital investments that will be subject to parliamentary approval and reporting. This strategy will identify strategic government holdings and clarify and prioritise government objectives for state ownership. This will in turn 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.

The Government has also drafted legislation that will transform the pension fund, KAD, and the restitution fund, SOD, into portfolio investors. Any strategic stakes they hold will be sold to the new central government agency. The adoption of this legislation will be a further major step in improving the transparency and consistency of the government's role as an owner of state enterprises.

Recognising stakeholder rights and the duties, rights and responsibilities of boards. There appears to be a robust framework in place for dealing with key stakeholder rights. The co-determination model for employee participation on the supervisory board 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. The extent to which these duties can be enforced appears to be constrained by procedural limitations on shareholders bringing actions for breach of duties. 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. The Government has introduced administrative reforms to board appointments that will introduce both greater transparency and a greater focus on ensuring appropriately qualified candidates capable of exercising independent judgement.

3. Recommendations

While Slovenia has made significant progress in its implementation of the Principles and the Guidelines the Committee identified a number of areas where further improvements are recommended:

- The legislation for the transformation of the pension fund, KAD and the restitution fund, SOD, is a complementary reform to the establishment of the new central ownership agency and should be passed as a matter of priority.
● Once established, the new central ownership agency should quickly develop the policy instruments that will enable it to successfully execute its function. These include: a robust code of corporate governance that is applicable to its own functions and to the state owned enterprises themselves; a detailed capital investment strategy setting out the Government’s ownership objectives; as well as the classification of assets into strategic and portfolio investments and the definition of the Government’s objectives for these asset groups.

● Slovenia should conduct a formal review of the provisions of the Companies Act within the anticipated time frame dealing with the treatment of minority shareholders to ensure that they provide adequate protection of shareholder rights in practice and give due consideration to any recommendations from that review.

● Slovenia should consider further measures to support the financial and operational independence of the Securities Market Agency, including ensuring that the Agency has sufficient and independent financial capacity for its mission and its activities; ensuring that the Supervisory Board and management are appointed according to arrangements that ensure their independence; and consider the exemption of employees of the Agency from public sector employment arrangements.

● Regulators and policy makers should remain vigilant in monitoring the potential for “share parking” activities, particularly in relation to takeovers, to ensure that current legislative and enforcement arrangements are adequate to prevent such practices.