



LESSONS LEARNED FROM WORK OF DUTB

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1. ECONOMIC CONTEXT OF DUTB:

SLOVENIAN ROLLER COASTER

2004 – 2008: Slovenian economy after EU accession

- Fast GDP growth and low unemployment rate
- Joining the Eurozone (2007)
- Excessive credit growth and corporate indebtedness

2009 – 2013: Slovenian economy after outbreak of global financial crisis

- Delayed reaction to global effects and „home-grown“ imbalances
- Sharp drop in GDP and employment
- Hike in budget deficit, public debt and financing risks/costs
- Sharp increase in corporate insolvency, banking sector losses and capital short fall, corporate NPL ratio peaking at 28%

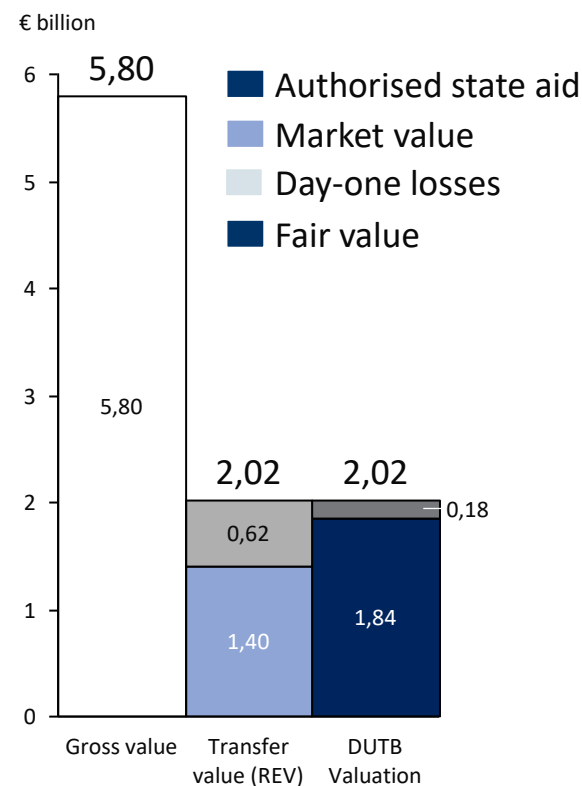
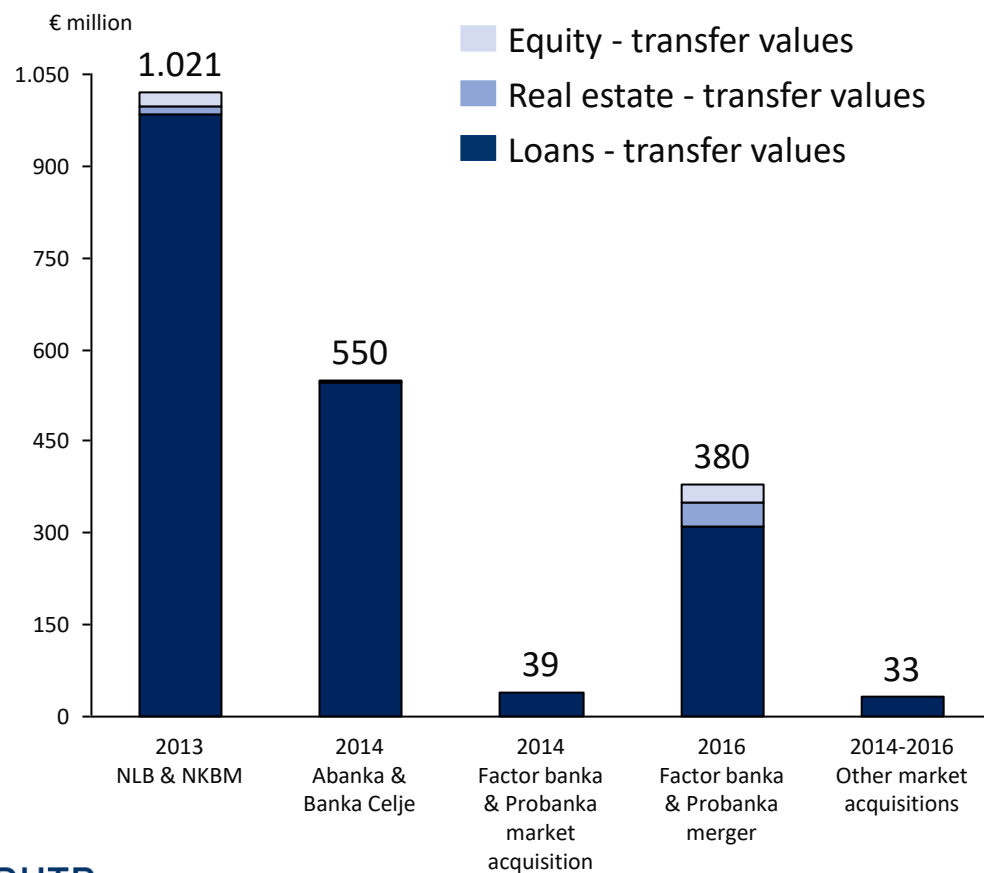
2013 – 2014: Establishment of DUTB and bank rehabilitation

2014 – 2017: Slovenian economy bouncing back

- Recovery of growth, reduction in unemployment and financing cost (CDS spread)
- Return to pre-crisis profitability levels
- Gradual reduction in corporate NPL ratio and leverage, largely creditless recovery until recently

BANK REHABILITATION IN FIGURES

DUTB'S ROLE



- **€5,8 billion** contractual (gross) value of transferred / merged assets
- **€2,0 billion** assets transfer value (REV-based)
- **€623 million** above market value (documented in EC state aid decisions)
- **€179 million** above fair value (DUTB valuation)

ECONOMIC SIGNIFICANCE OF DUTB

TRANSFERRED CORPORATE EXPOSURES

- **25% of gross loans** to domestic corporates and sole proprietors (in November 2013, right before the first tranche of transfer)
- **60% of NPLs** of domestic corporates as of November 2013
- **16% of Slovenian GDP** in 2013
- **Liabilities of corporates with min. 10-15% share of GDP** and employment (conservative, rough expert estimate)

ECONOMIC SIGNIFICANCE OF DUTB

CONTRIBUTION TO THE SLOVENIAN ECONOMIC RECOVERY

- **Unlocked more than €1.3 billion worth of frozen or misused assets** and recycled them for the more efficient use in the economy.
- **Cashed more than 60% of its assets** and repaid more than €1.1 billion debt.
- **Partially relieved recapitalized banks** from the burden of NPLs and took leadership role in a number of high impact restructurings.
- **Slovenia advanced farthest** in implementation of country-specific recommendations by EC especially in NPL reduction and implementation of DUTB's strategy.
- **Established credibility** with investors regarding efficiency and reliability of sales/investment processes.
- **Reduced the guarantee exposure of the Republic of Slovenia** from initial €2.6 billion (including Factor banka and Probanka to current €0.9 billion).
- **Provided 25% average annual return on equity** via profit stream plus paid €91 million in guarantee fees and interest surplus to the budget and public sector entities.

STRATEGIC TASKS

KEY ACTIVITIES:

- **Active asset management** and key role position in corporate restructuring.
- **Monetizing** the asset portfolio taken over from Slovenian banks as effectively as possible.
- **Repaying** raised debt and reducing exposure of the Republic Slovenia as guarantor.
- **Adding value** through performance and corporate governance improvements in debtor companies.

STRATEGIC KPIs

Min. 8% ROE p.a. → min. 8% average EROE p.a. on cumulative basis

Cash generation p.a. min 10% of weighted transferred assets

2. DUTB CORPORATE GOVERNANCE AND OPERATIONS

MAIN CHALLENGES

- Corporate governance described as **system in evolution**, responding to changing circumstances rather than a snapshot.
- Due to **100% state ownership** and DUTB's economic significance very complex stakeholder structure to manage.
- Sustain autonomous, fast, professional **decision making**.
- Develop and maintain **business-oriented** and **result-maximising** corporate culture against public sector bureaucratic and error minimising requirements.
- Maintain **integrity** of organization under enormous stress and temptations.
- Develop into **self-improving** organization despite limited lifetime.

LEGAL AND CORPORATE GOVERNANCE FRAMEWORK

- „**Lex specialis**“(ZUKSB) providing special conditions for DUTB’s establishment and operations.
 - All corporate, civil, insolvency, labor, criminal etc. **laws applicable** unless regulated in ZUKSB otherwise.
 - **On-going control** by Ministry of Finance (but no interference with business decisions), oversight by Court of Audit, Parliamentary committees, special watchdogs (e. g. Securities Market Commission).
- **Shareholders rights** exercised by the Government as general meeting.
 - **One-tier board** with separated duties to ensure political non-interference:
 - 4 non-executive directors, appointed by the government, with powers of Supervisory board,
 - 3 executive directors running daily operations, selected and dismissed by the non-executives.

INTERNAL STRUCTURES AND PROCEDURES

- **Organization:** segregation of duties and responsibilities of units, built-in process controls, four-eye principle.
- **Defence line** functions (internal audit, compliance, AML, corporate security) reporting directly to Board of Directors, anti-corruption integrity plan, whistle blowing system.
- All decisions taken in committees, ensuring **transparency and traceability**, efficient decision-making and impact control (20/80 rule).
- **Sales controlling system:** aspirational target setting, continuous deal flow management, incentives linked to sales performance.
- **Performance management:** targets and action plans derived from strategy in balance-scorecard format, bonus rewards linked to overwhelmingly measurable KPIs for all units.
- **Cohesive team spirit** and HR management: education, best-practice sharing, self-improving organization.

DUTB COMMERCIAL SUCCESS FACTORS

Key channel for investments in Slovenia – Commercial imperative

- Attractive mix of different types of assets.
- Equal treatment of every investor in competitive tenders – no favoritism.
- Transparent, ethical and efficient sales processes.
- Supported by deal flow management, marketing and investor relations management.

The highest level of business integrity – No reputational risk



Ethic Intelligence Certificate 2015. Awarded with the highest level in 2017.

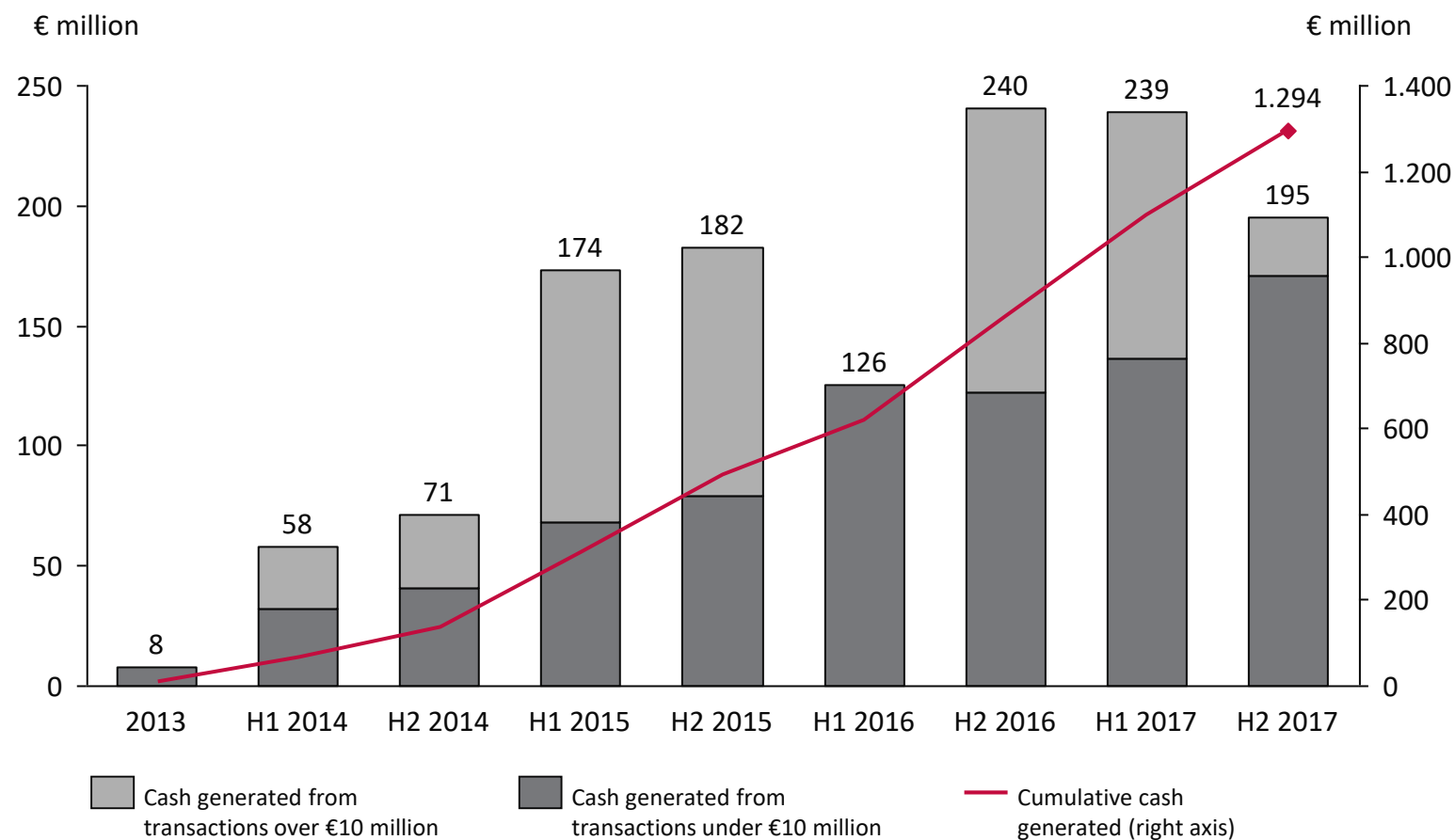
- All employees of DUTB are committed to highly professional code of conduct as a standard on all levels of the company.
- Robust KYC, AML checks.
- Standard in contracts: anti-corruption clause, no primary or secondary resale to debtor-related investors.

Efficient and flexible business partner – No risk of failure for non-commercial reasons

- Fast and commercially driven decision making.
- Knowledgeable and independent approach.
- Maintain sense of urgency for buyers.
- Practically all transactions completed in envisaged timeframe.
- Credible track record in sales.

3. TRENDS AND BASIC FIGURES

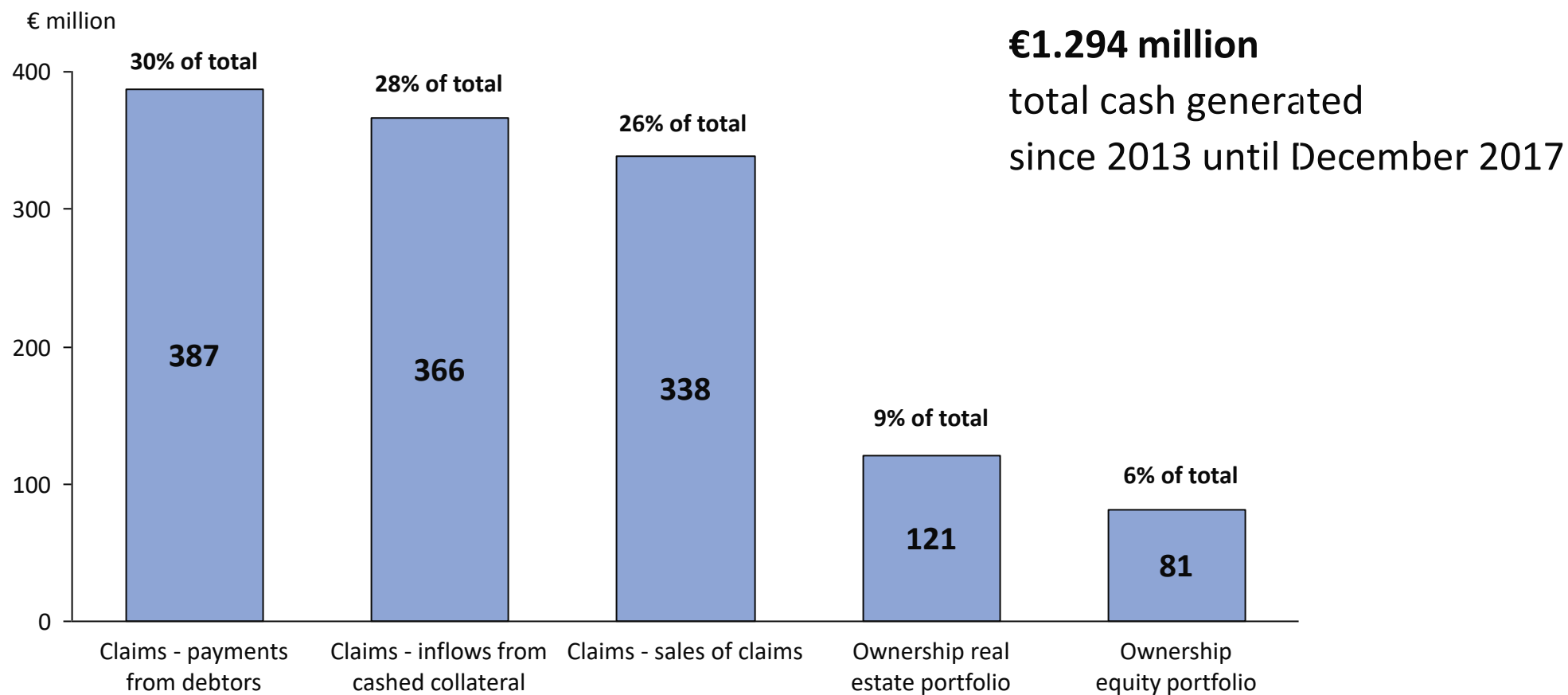
CASH GENERATION



**€1,3 billion
cash generated**

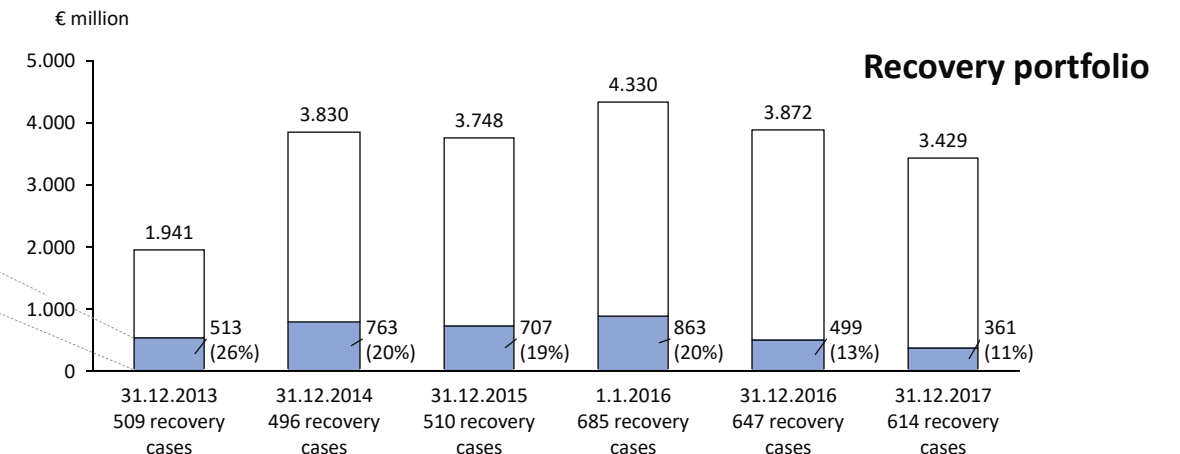
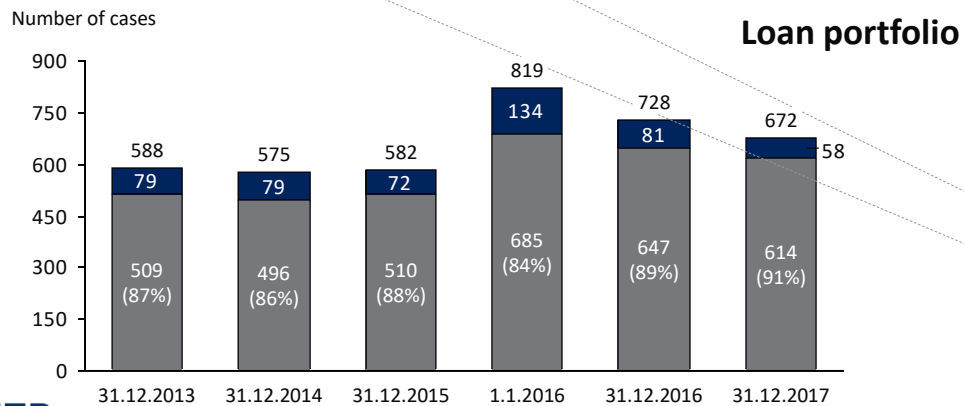
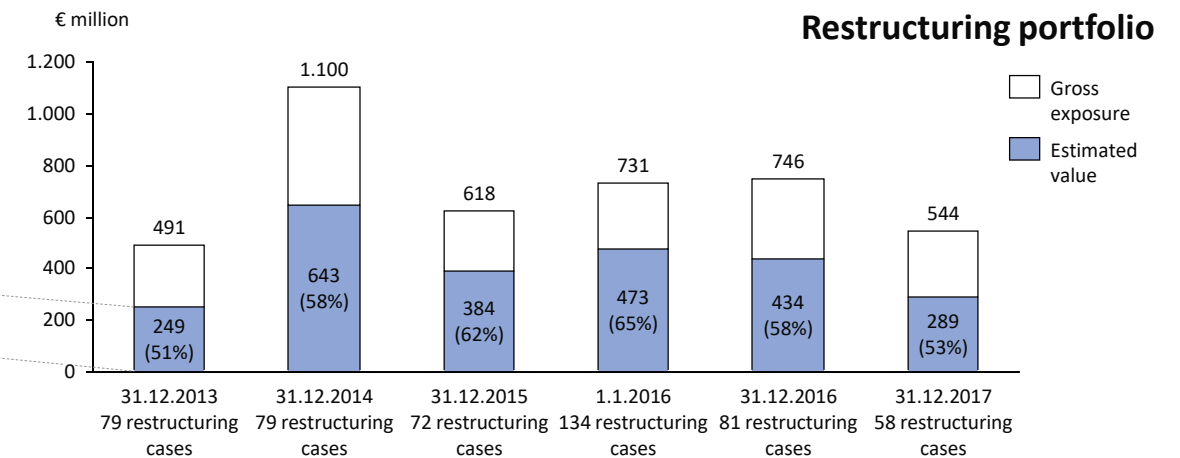
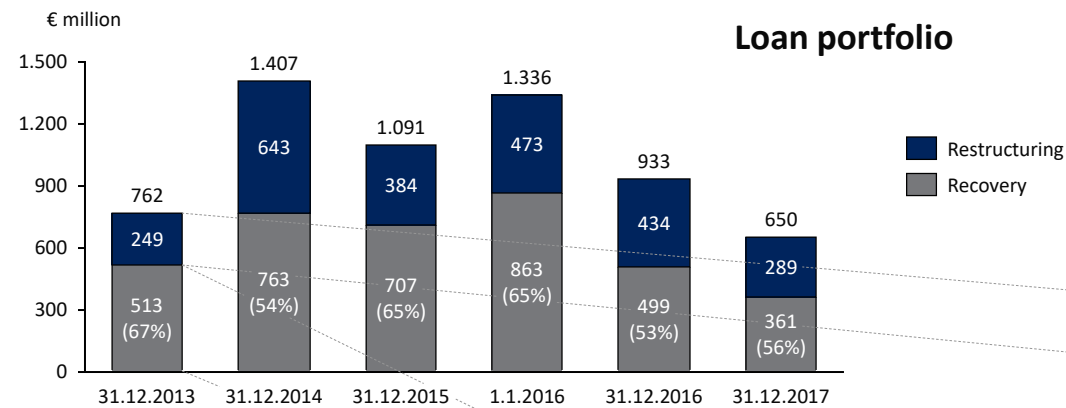
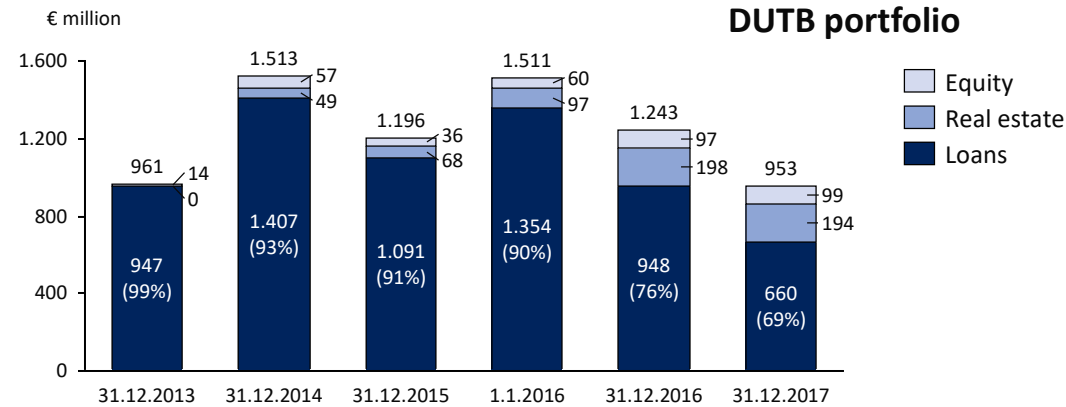
- >60% of asset transfer value liquidated in 4 years
- through both larger and smaller transactions
- Steady growth in volume of granular transactions
→ stable monthly cash flow

BREAKDOWN OF CASH INFLOWS



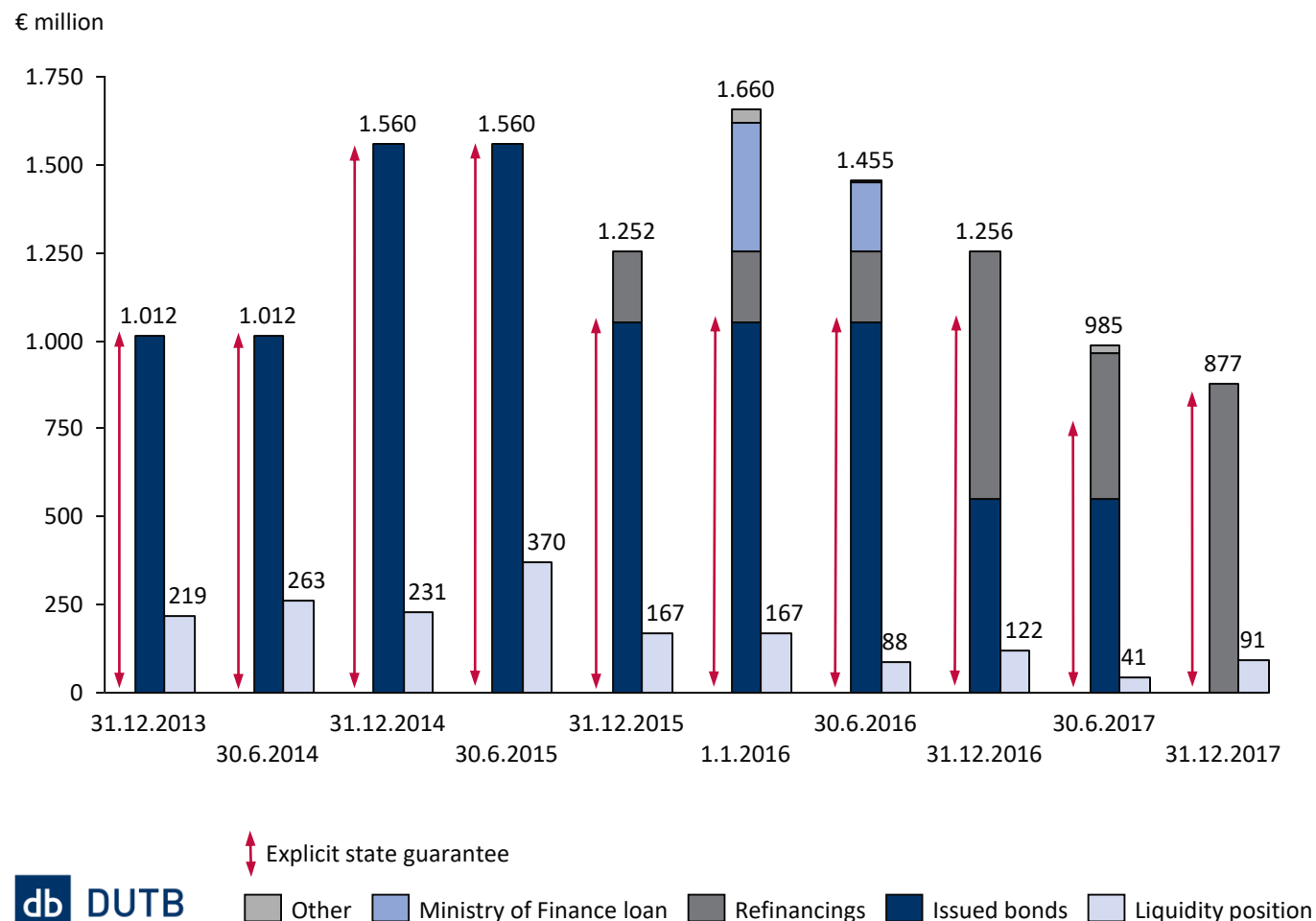
PORTFOLIO DEVELOPMENT

NOTE: DUTB acquired (2014) and merged (2016) additional assets during its lifetime. Due to the timing of transfers, not all cases were individually valued at the end of 2013, hence the difference between loan portfolio values. The difference between the total loan portfolio value and restructuring/recovery portfolio sum since 2016 are minor, non-individually valued claims.

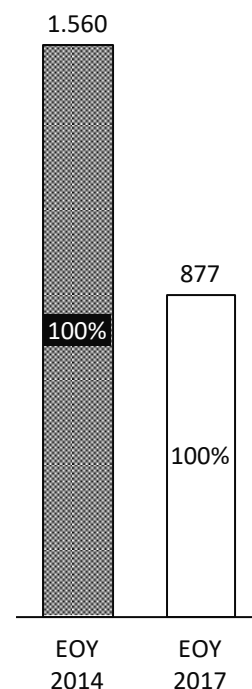


DEBT STRUCTURE AND MANAGEMENT

Debt outstanding



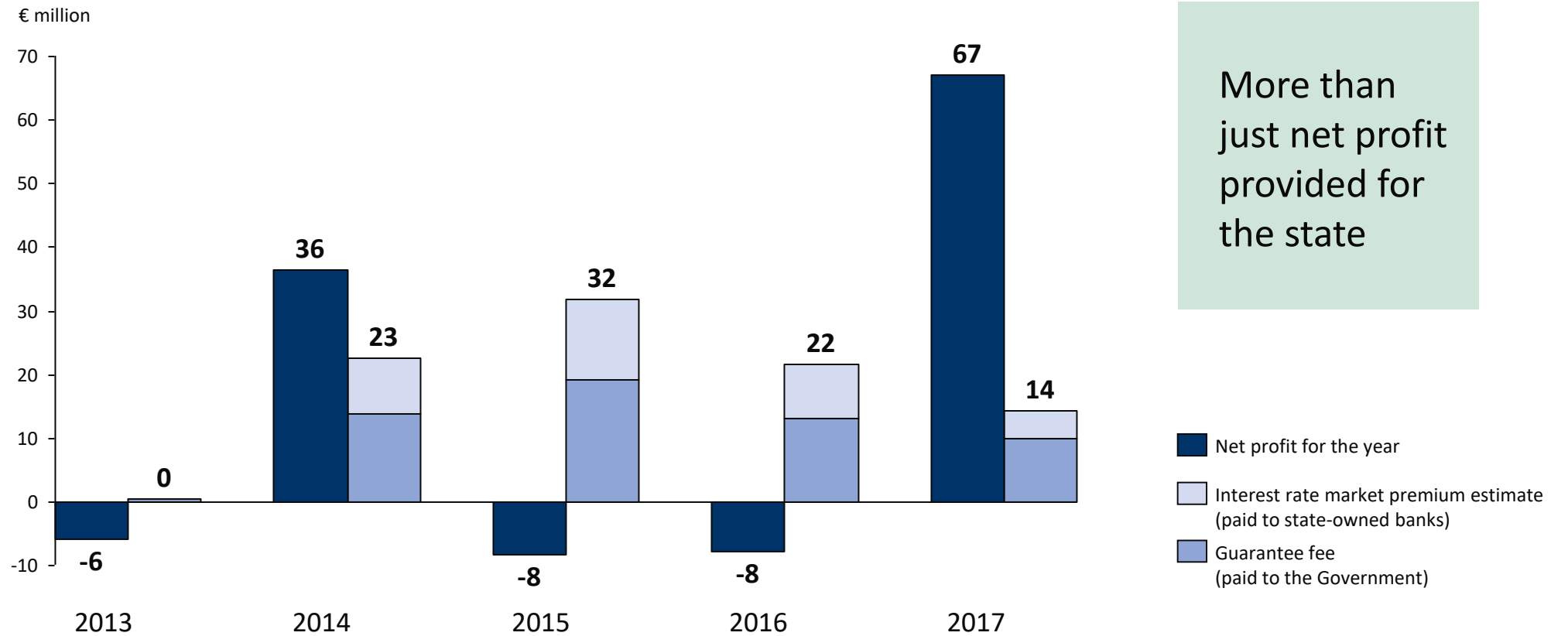
Debt structure



Debt outstanding reducing and changing in structure

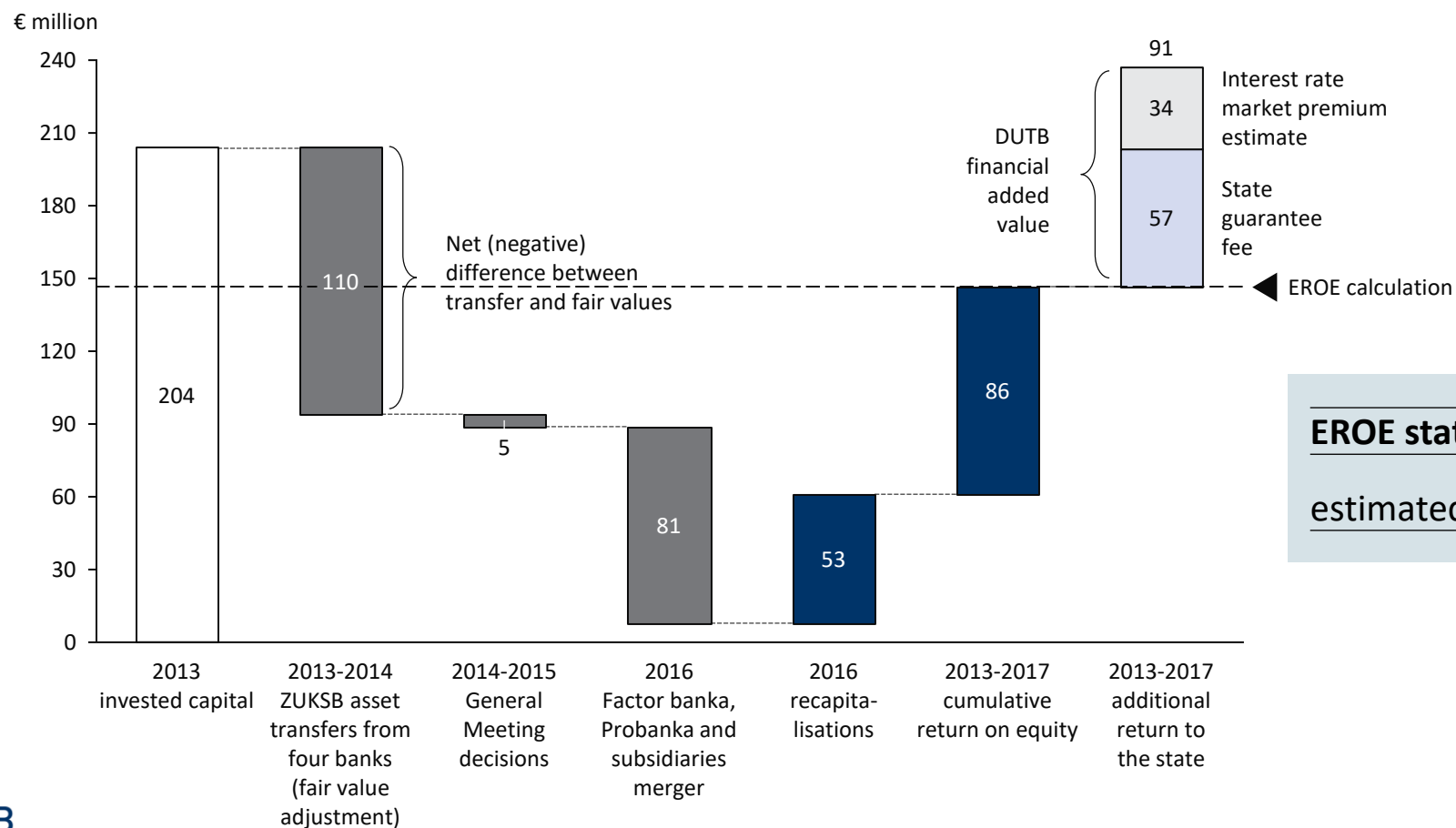
- 2013-2015**
 High-cost fixed-term debt, accumulating intra-year liquidity
- 2016-2017**
 Mixture of fixed maturity and amortizing/repayable debt, tighter liquidity management
- 2018-2022**
 Exclusively amortizing low-cost debt with end-balloon, no new borrowing → higher liquidity buffer

RETURN



EQUITY MOVEMENT & RETURN TO TAXPAYERS

Equity movements through owner's decisions and company operations

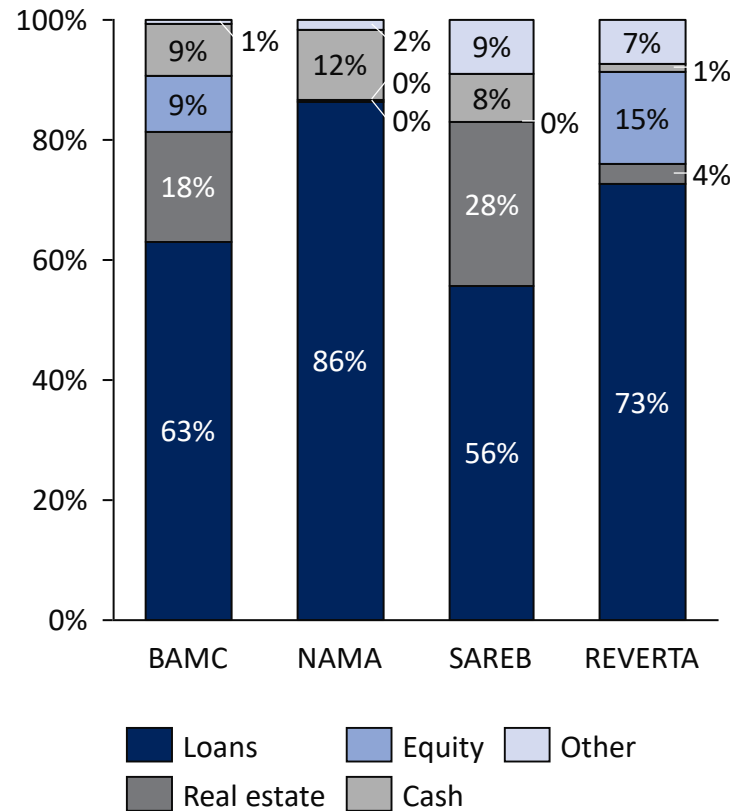


EROE statutory requirement 8,0%

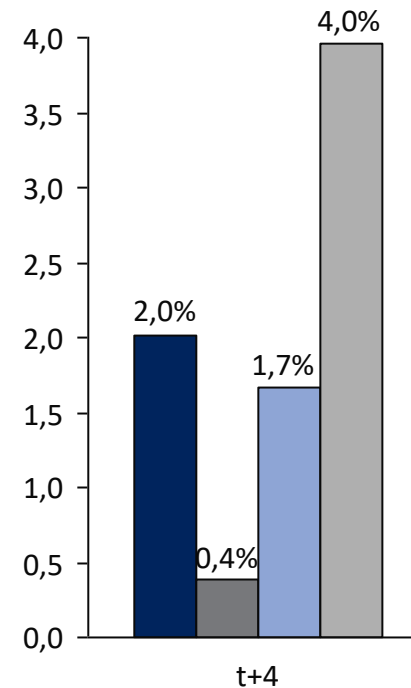
estimated EROE including 2017 24,7%

BENCHMARKING WITH SIMILAR COMPANIES

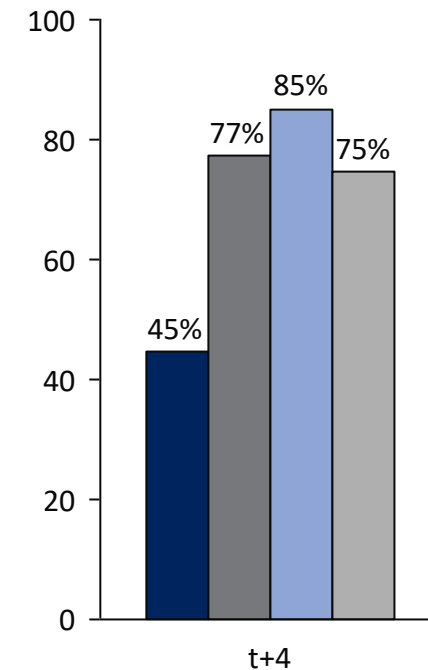
End-of-year t+4
asset structure



Yearly costs as
% of average assets



Debt outstanding



4. KEY LESSONS LEARNED

CONCLUSIONS AND TAKEAWAYS*

- DUTB is a **unique** profile AMC by design.
- Efficiency of initial operations could have been largely enhanced by **careful preparation**.
- DUTB's excellent track record is as much attributable to **constant adjustment to evolving circumstances** as to initial design.
- **Suitable framework and excellence in management** systems and practice are equally indispensable factors of success and fulfilment of the mission of an AMC.

** Conclusions especially but not exclusively relevant for centralized, partially or fully publicly supported AMC. References to AMC Blueprint by EC:*

- ✓ Conclusion in line with recommendations
- ☑ Conclusion in line with Blueprint with some additional details
- + Addition to Blueprint proposals

CONCLUSIONS AND TAKEAWAYS

OWNERSHIP & LEGAL FRAMEWORK

- ✓ Independent legal entity on private investor operations principle (even when publically supported)
- ✓ Majority private ownership can help avoid/reduce state aid issues and state budget impacts.
- ✓ Only non-voting shares in AMC to transferor banks, if any.
- ☑ Special rights for AMC in in-court and out-of-court procedures to counter-balance limitations in armory.
- ✓ Ensure balance of creditors vs. debtor legal protection and judicial practice.
- + Ensure effective bail-in rules vis-a-vis shareholders and junior creditors of distressed debtors.

SUPERVISION

(of publically supported AMC)

- ✓ Sufficient public control over usage of funds and overall operational KPIs
- ☑ Prohibit interference into individual business decisions
- + Prudential supervision of operations and especially if new lending significant
- ☑ Allow business/bank secret disclosures in due diligence and marketing/sales processes

OPERATIONS SET-UP

- + Minimise initial cash-burn period.
- + Adopt key manuals, procedures, internal regulations before start of handover.
- ☑ Single IT system, data model and back-office from day 1 after transfers.
- ☑ Enter/migrate all case relevant information into IT from day 1 to ensure traceability.
- ☑ Enter all decisions / transactions, according to pre-classified criteria into systems to ensure traceability and central KPIs from day 1.

CONCLUSIONS AND TAKEAWAYS

FUNDING & CAPITAL

- ✓ Flexible funding which can be adjusted to actual cash-inflows and minimalized open interest rate risk position.
- ✓ Provide capital buffer to state guaranteed capital back-up for entire lifetime, if equity is equity is secured by the state.
- ✓ Design waterfall mechanism for senior / mezzanine / non-voting shares repayment / buy-back (transferor banks share upside or realize losses spreading over time – alternative to full upfront haircuts).
- + Provide fresh cash for (majority privately owned) AMC to bridge the period between debtor rehabilitation (restart of business expansion) and reaching bankability level.
- + Provide capital cover or pre-defined wind-up mechanism for loss making tail period of AMC but avoid pressure for pre-mature/fire sale.

TRANSFER PROCESS & DOCUMENTATION

- ✓ Transfer only high impact, high volume, relatively homogenous asset classes (CRE, project finance, large corporations, fragmented SMEs).
- ✓ Mandatory transfer of all exposures towards debtor groups from all participating banks.
- ✓ Design the transfers - provide (super) majority among creditors for AMC for the bulk of the exposures to individual debtors/groups.
- ✓ Effective case handover from transferor banks before legal / physical transfer.
- ✓ Take over full operational and decision-making responsibility from transferor banks from day 1 after legal and physical transfer.
- ✓ Set-up documentation management system → enter all received documents before or at date of transfer.

ASSET PRICING

- ✓ Mark-to-market on a non-fire sale level (between actual market value EMV and REV)
- ✓ Avoid low marketability of transferred assets due to overpricing (containing vast state aid buffer).
- ✓ Define clearly in advance cumulative management costs and financial discount factor/IRR for expected holding period.
- ✓ Cover the difference in bank book values and transfer prices by mix of mezzanine debt and non-voting shares of AMC (alternative to full upfront haircuts).

CONCLUSIONS AND TAKEAWAYS

ACCOUNTING & REPORTING

- + If apply fair value accounting, make fair value of assets the center of reporting, decision-making, incentive system.
- + Preferably design business model to be defined as „other business model“ to avoid asset tests under IFRS9 (to apply FVTPL).
- ✓ Design specific features that way to avoid unnecessary consolidation of transferred assets, both under national legislation and IFRS.
- + Define single asset data model, revenue origination and cost allocation system from day 1 to trace return on assets for individual debtors/assets.
- + Apply proportional write-off policy in legislation & internal rules to trace net/gross values trends.

CORPORATE GOVERNANCE

- ✓ Pre-defined professional criteria and selection / dismissal mechanisms for executive and non-executive BoD / Supervisory Board members.
- + Licensing of by monetary supervisor may be desirable as defence against political interference.
- ✓ Exclude influence of transferor banks on post-transfer decision making.
- ✓ Pre-define contractual arrangements and competitive remuneration packages.
- ✓ Provide immunity for non-criminal decision/actions.

HUMAN RESOURCES & INTEGRITY

- ✓ Define job requirements, documented selection and competitive remuneration system.
- ✓ Define measurable KPIs for all departments / individuals in line with norms / operative plan.
- ✓ Link performance assessment to bonus and promotion system.
- + Build success culture and cultivate tolerance.
- ✓ Establish clear outplacement system for employees for period after the operation.
- ✓ KYC, AML, anti-corruption, personal integrity, whistle-blowing mechanism from day 1 of operations.

CONCLUSIONS AND TAKEAWAYS

BUSINESS CONDUCT & MANAGEMENT

- ☑ Establish competitive and transparent sales process with equal treatment for investors.
- + Define in advance preference between recovery maximisation and asset buy-back possibility.
- + Define burden-sharing rules, super seniority and waterfalls / upside-sharing structures for restructuring of viable debtors.
- + Build into restructuring agreements covenants for cash sweep/conditions adjustment options and above market terms to minimise holding period for viable debtors.
- + Establish internal sales management & controlling system, CRM and marketing to trigger and maintain sales momentum

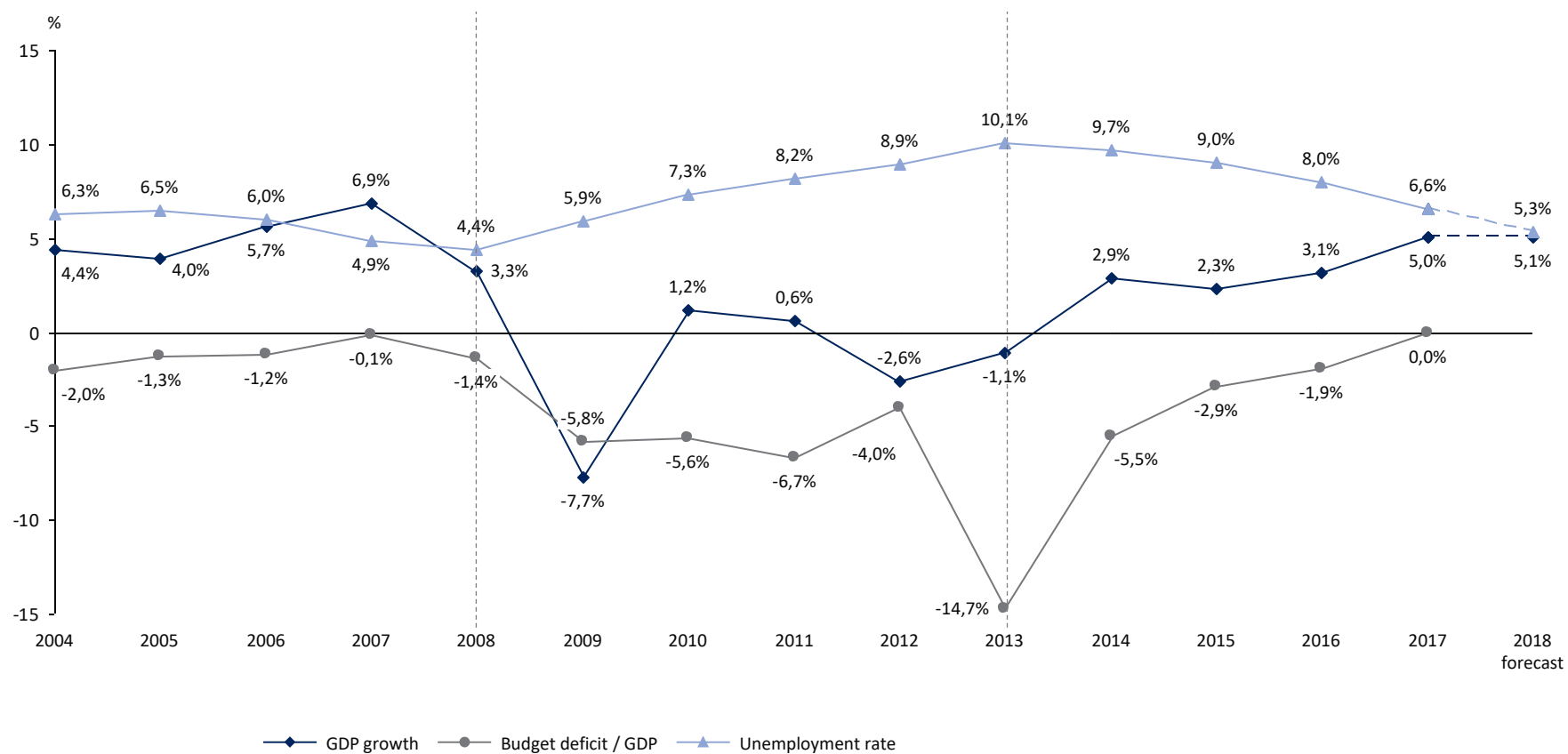
PUBLIC IMAGE & TRANSPARENCY

- ☑ Avoid excessive or highly visible expenses and initial cash burn.
- + Go for quick wins to establish public acceptance.
- ✓ Transparency on asset transfers, expenses, contracts, overall results.
- + Prohibit disclosure of on-going transactions (to media, politics, supervisors).
- + Strictly regulate ex-post transaction disclosures.
- + Never call it a „bad bank“!

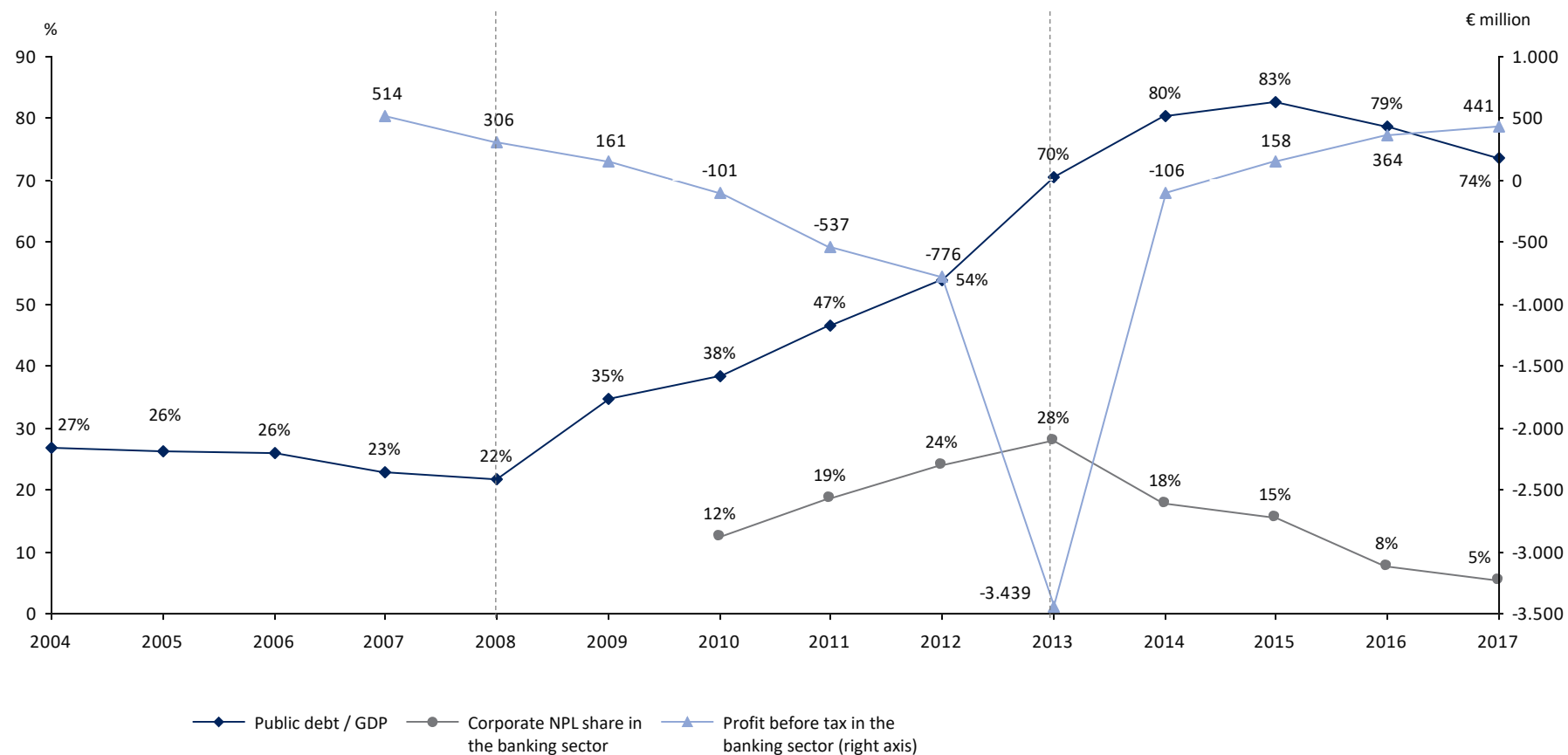


ANNEX

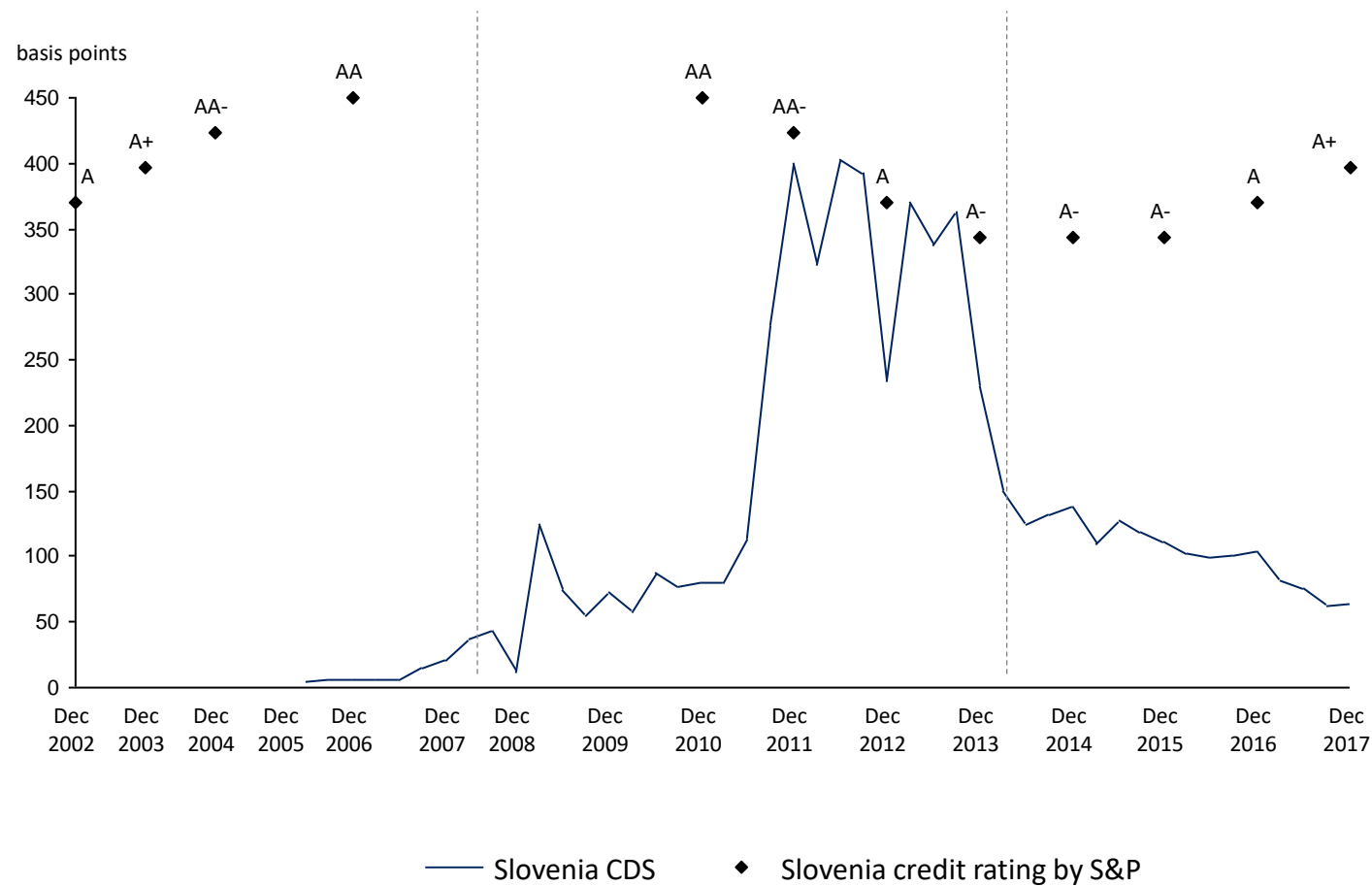
ECONOMIC CONTEXT OF DUTB: SLOVENIAN ROLLER COASTER



ECONOMIC CONTEXT OF DUTB: SLOVENIAN ROLLER COASTER



SLOVENIA CDS & CREDIT RATING



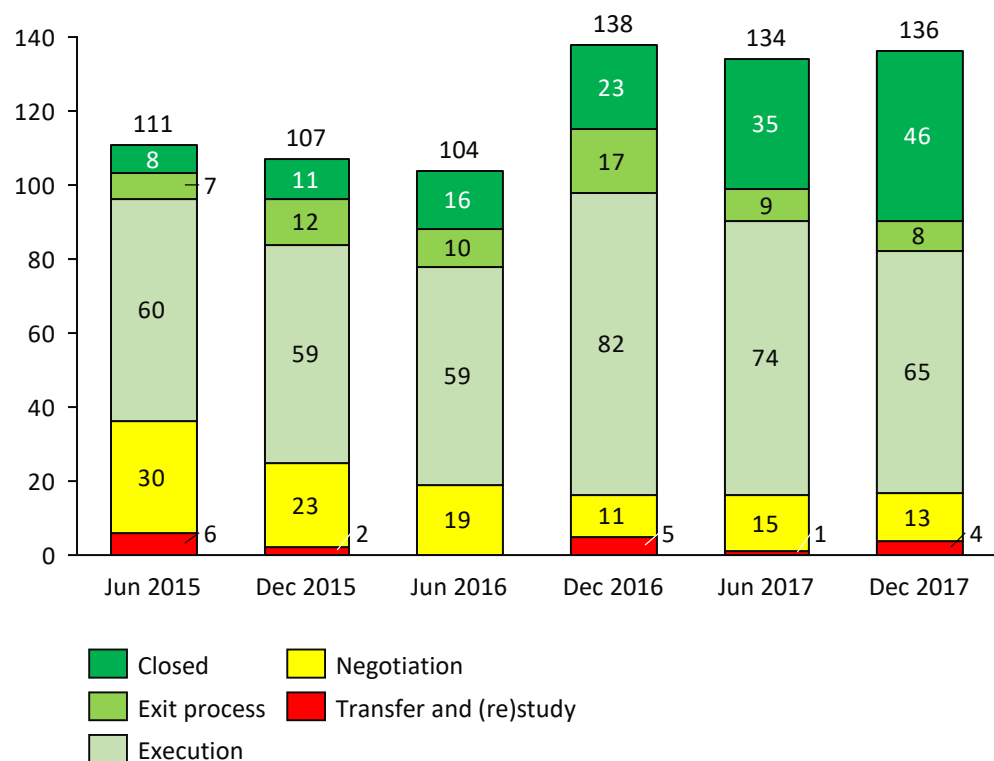
BANK REHABILITATION IN FIGURES

Ownership composition and NPL structure in the banking system

Banking sector claims (in €m) towards	2012		2013		2014		2017	
	total claims (gross)	NPL %	total claims (gross)	NPL %	total claims (gross)	NPL %	total claims (gross)	NPL %
Corporate (domestic)	17.460	22,8%	17.010	28,0%	14.650	17,7%	13.202	6,2%
Private persons	7.081	3,8%	7.306	4,1%	8.617	4,4%	10.035	2,8%
Foreign	4.046	15,8%	4.421	18,7%	5.508	20,6%	3.316	12,1%
Total claims	47.876	14,4%	44.879	17,3%	37.467	11,9%	34.565	4,6%

PROGRESS IN PORTFOLIO STRUCTURE

RESTRUCTURING CASE:



SALES AND REFINANCING:

2013 - H1 2017	Number of sales comple ted	Of these foreign buyers	Average number of interested buyers per case	Average number of due diligences performed	Total contract ual value (in € million)
Loans	57	18	2,5	2,3	301
Equity & bonds	33	9	4,8	3,8	72
Total	90	27	3,1	2,5	374

Fully refinanced exposures towards 6 debtors with the total (transferred) gross exposure of **€116 million**.

CORPORATE GOVERNANCE FRAMEWORK

GOVERNMENT AS 100% SHAREHOLDER

- Tasks and responsibilities of the DUTB AGM exercised by the Government as the sole shareholder
- The Ministry of Finance:
 - monitors the work of DUTB (the compliance of DUTB operations with ZUKSB)
 - can not be actively involved in DUTB individual business decisions

ONE-TIER BOARD

- Board of Directors as strategic decision-making body
- Separated tasks of Executive and Non-Executive Directors
- Defend the professional autonomy of executive management from external / political interference

BOARD OF DIRECTORS

- Sub-committees reporting to BoD: Audit, Remuneration and Accreditation Committee
- Recommendations implemented via BoD decisions

EXECUTIVE DIRECTORS

- Sub-committees reporting to EDs: Risk Management & Compliance and Corporate Security Committee
- Recommendations implemented via ED decisions

CREDIT AND INVESTMENT COMMITTEES

- Effective and fast decision making structure
- Layered 3-level system with segregated responsibilities
- Empowerment of lower lever for large number of smaller tickets / simplified decisions
- Strong controls for executive level over high impact larger tickets (80+% of volumes)

CORPORATE GOVERNANCE FRAMEWORK

ETHICAL MODUS OPERANDI THROUGHOUT THE ENTIRE ORGANIZATION

INTERNAL CONTROLS THROUGHOUT EVERY PROCESS AND ENTIRE COMPANY

Defense lines with responsibility / reporting line to the Board of Directors:

- Internal audit
- Compliance and AML department
- Corporate security

CLEAR SEGREGATION OF ROLES COMBINED WITH TEAM STRUCTURE

- Strictly segregated roles of units in organizational structure
- Bank-like horizontal process controls and full 4-eye principle
- Balanced with teamwork to foster flexible operations and proactive approach
- Clear responsibilities on all decision-making levels
- Management of assets in largely homogenous asset classes (efficiency requirement)

HIGHEST ETHICAL AND QUALITY STANDARDS

- Ethic Intelligence Certificate: Anti corruption compliance certificate since 2015, awarded with the highest level of certificate in 2017 making DUTB the only company with such certificate in Slovenia
- Personal integrity plan for employees
- „Whistleblowing“ system



CORPORATE GOVERNANCE FRAMEWORK

KNOWLEDGE CENTER AND SALES VEHICLE FOR NPLs

WELL DEFINED SALES RULES

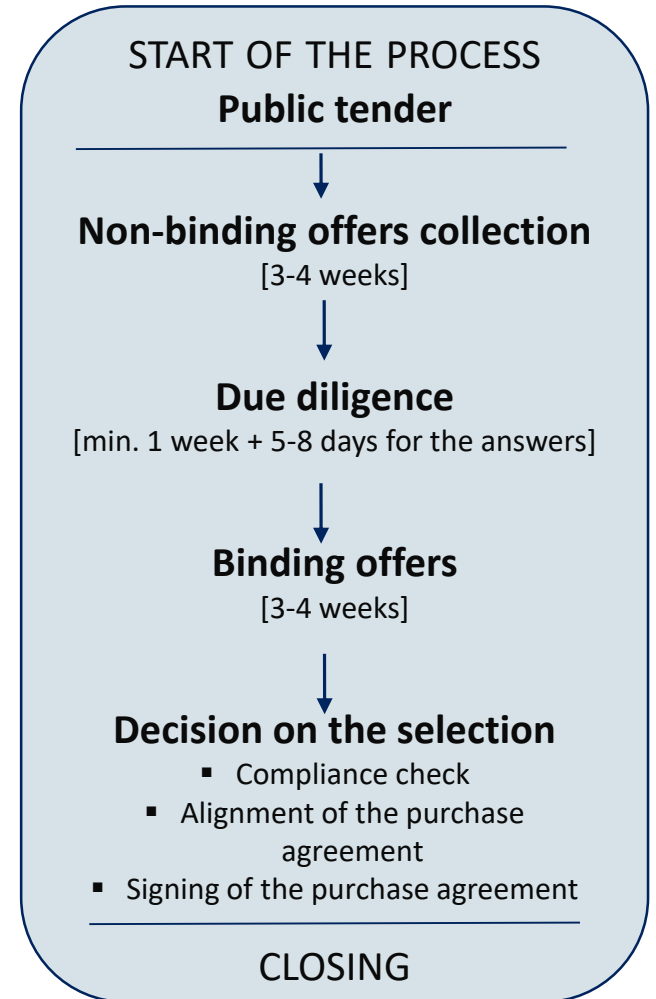
- Transparent standardized sales process
- KYC and The Law on Prevention of Money Laundering and Financing of Terrorism: prevention of primary and secondary sale to former owners/executives of distressed debtors or to „blacklisted“ investors

EFFICIENT SALES PROCESS

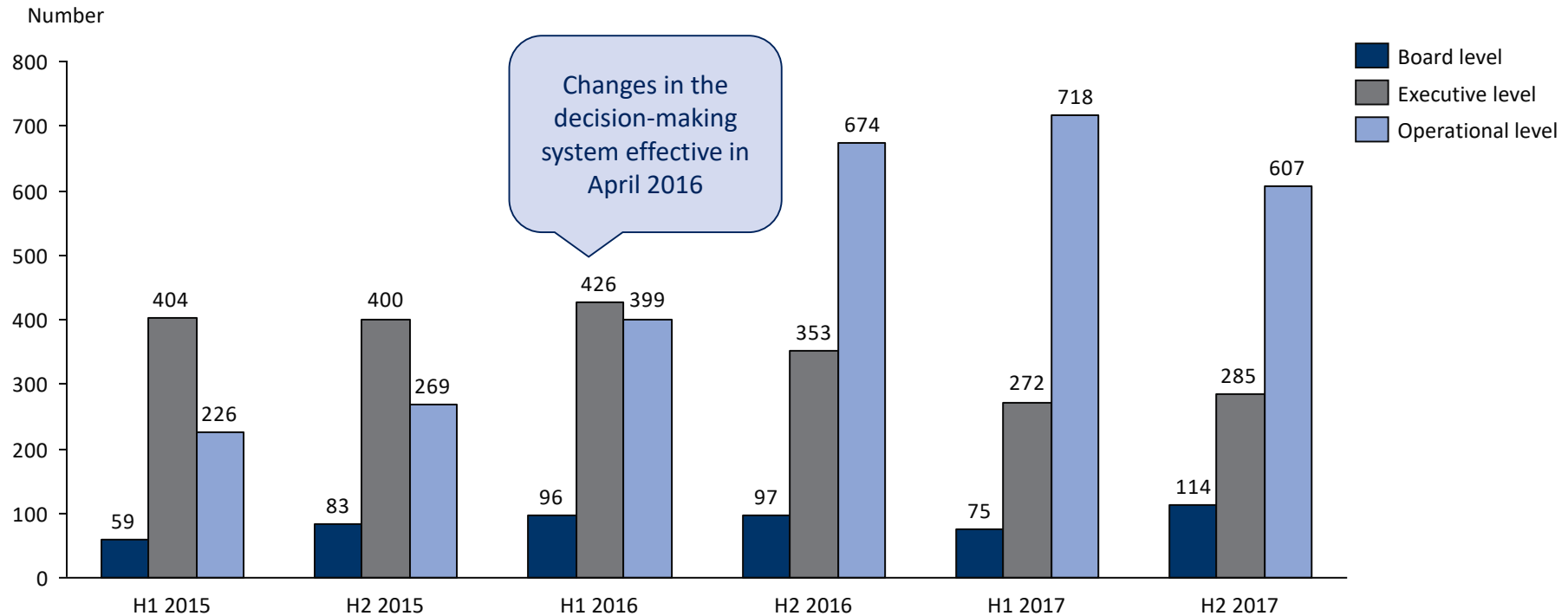
- Fast decision making, flexibility and independence
- Equal treatment of every investor in tenders (competitive bidding process, sufficient time for each phase, equal information)
- Supported by deal flow management, marketing and investor relations management

RENOWNED KNOWLEDGE CENTER

- Expert for NPL management and corporate restructuring
- High demand from the market for DUTB employees
- Internal and external best practice sharing
- Performance and development oriented human resources management



COMMITTEE DECISIONS



Merger of 2 banks (February 2016):

- High number of added cases
- Mainly smaller tickets



Change was a must

MANAGING HR CHALLENGES

- **Project type** organization with limited life span → keep fluctuation of quality staff at acceptable level
 - **Tensions** between internal perception of mission and external image („bad bank“)
 - **Shock of 3-way merger:** mix of corporate cultures, extra operational burden, fundamental organizational and process changes, portfolio reallocation, internal competition for jobs → redundancy 20+%, mid-management replacement / renewal in competitive selection process
 - Develop and run a measurable performance oriented **evaluation system**
 - Preserve accumulated **knowledge** base
 - Maintain **cooperative spirit** under circumstances of constant downsizing
- **Norms based staffing model is key for managing labour efficiency**, dilemma for the future:
 - a) Maintain current (stock-type) norms based staffing model (more even pace of redundancies, slow-down of sales in favor of managing assets) *OR*
 - b) Switch to flow-based norms (maintain strong momentum, but higher upfront FTEs and costs with faster decline later, shorten organizational lifetime)
 - **Providing hope and perspective**
 - 1. for the organization: expansion into new fields
 - 2. for the individuals:
 - improved future employment opportunities
 - education to strengthen competitiveness in job market
 - outplacement with a human face, support in job search

PERFORMANCE DRIVEN REWARDS

PERFORMANCE - BASED REMUNERATION SYSTEM

BASIC SALARY – MARKET BASED

- Internal and market check and potential „outliers“ salaries adjustment once a year.
- „Outlier“ is salary which is less than 80% of the median of the salaries for the comparable positions.

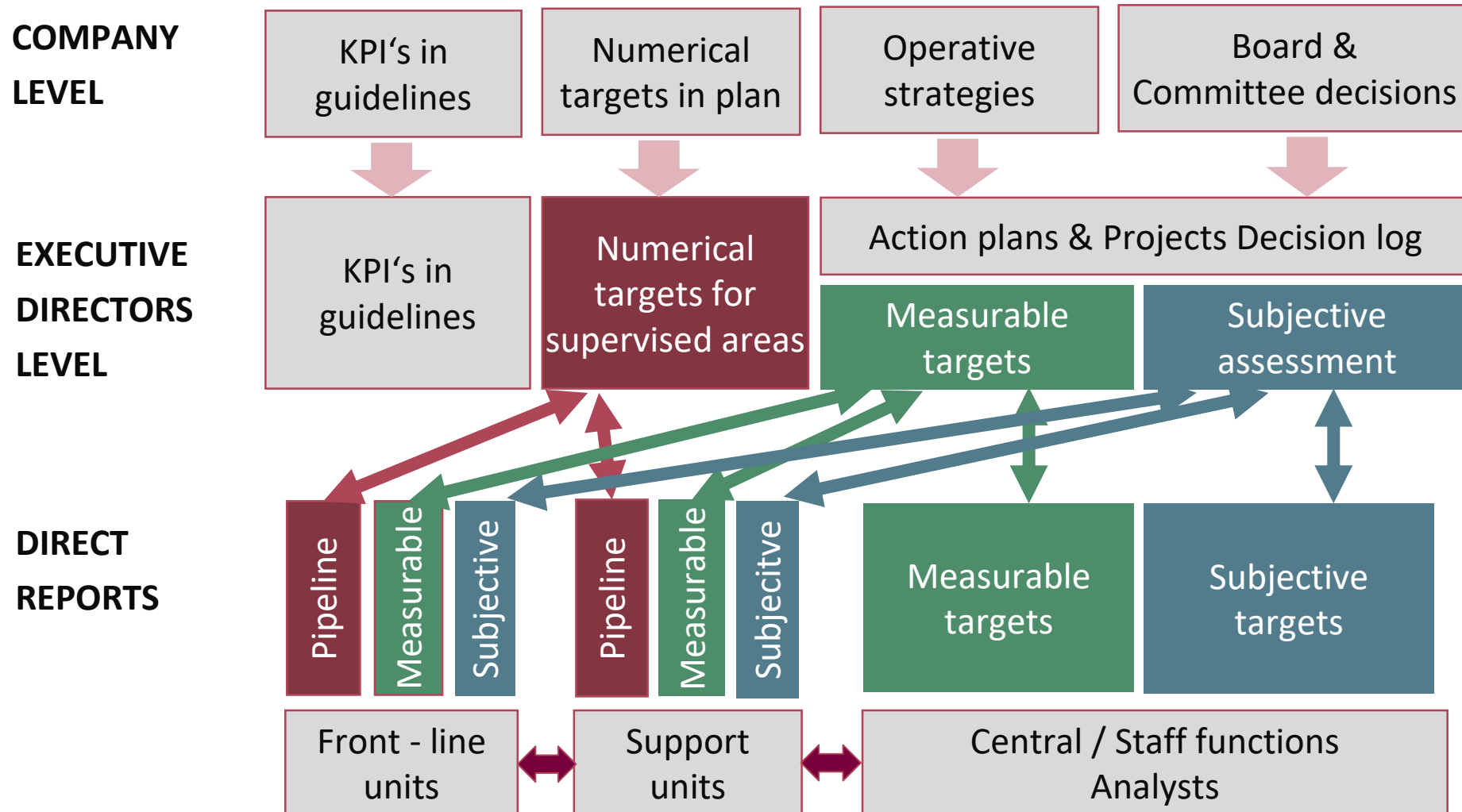
BONUS SYSTEM

- Performance bonus up to 2 month salaries annually – comprehensive annual target setting and assessment
- Stay bonus up to 2 month salaries annually – to key personnel in high demand / at risk
- Extraordinary bonus (project based) up to 0.5 month salary annually

PROMOTION REFLECTED IN THE SALARY

- Horizontal promotion within the position up to 15% of the salary annually – based on performance grades for previous year
- Vertical promotion to more demanding and responsible positions
- Deputy head (managerial reserve) allowance up to 20 % of the salary

PERFORMANCE DRIVEN REWARDS



PERFORMANCE DRIVEN REWARDS

PRINCIPLES OF TARGET SETTING AND PERFORMANCE ASSESSMENT

- **Targets derived from:**
 - KPI's in Operating Guidelines (Government)
 - Numerical targets in annual plan
 - Operative strategies in Strategic plan
 - Board and Committees decisions
- Maximize proportion of **quantifiable / measurable targets**
- **Personal targets:** breakdown of company level targets to areas of specific own responsibilities
- **Balanced scorecard type alignment of targets and implementation**
 - Action plans and projects allocated to address implementation and achievement of all targets
 - Executive Directors' targets built up from and aligned with direct report targets

RETAINING THE STAFF

NON-FINANCIAL ASPECTS OF RETAINING THE STAFF

VISION, MISSION AND GOAL COMMUNICATION

- Regular staff meetings (each 3 months, all employees)
- Success celebrations (every 1-2 months, top 3 business success deals: case team in front of all employees)

PEOPLE DEVELOPMENT

- Trainings and exams
- Internal conferences: hot educational topics and best practice sharing
- Annual interviews (performance assessment and target setting)
- Caring outplacement

SOCIAL CLIMATE SURVEY

- Strengths: Alignment with mission, respect for professionalism, highly valued cooperation and team spirit > Cultivate further
- Weaknesses: Objectivity of performance assessment, linkage to bonus and promotion > Develop new system

SOCIAL EVENTS

- Internal newsletter (electronic version)
- Sports activities (each week)
- Picnic twice per year
- Presents for children for New Year
- Internal charity auctions

SALES MANAGEMENT

„Easy-to-sell“ assets running out, tail risk grows over time → Crucial to maintain cash-flow generation momentum to slim / shorten tail

METHOD

- **New initiatives in 2017:**
 - package sales
 - refinancing drive for restructured / bankable companies
 - accelerated reposessions of real-estate suitable for fit-for-sale minor investments or
 - for joint-venture developments
- Development of **Investor Database** (CRM)
- **Marketing-supported**, focused investor targeted sales initiatives to create sense of urgency
- **Linking cash-flow generation** performance measurement with **bonus system** plus pipeline management: internal pull/push for sales drive

SALES MANAGEMENT

PIPELINE METHOD

- **Quarterly review of target fulfilment** in pipeline management concept (usual lead time for initiation to closing 6 – 9 months).
- **Constant feeding of deal flow** into pipeline requires:
 - Preparatory initiative 6 – 9 months before targeted cash-flow realization
 - Replacement of fall-out cases with at least 2 times bigger volume new initiatives

