1. **Basic Information**

1.1 Number: SK0003.02  
1.2 Title: Bad Debt Recovery  
1.3 Sector: Economic criteria  
1.4 Location: Slovak Republic

2. **Objectives**

2.1 *Wider Objective:* Substantial level of bad debts decreased and economic recovery facilitated  
2.2 *Immediate Purpose:* Improved institutional capacity of Slovak economy to handle large scale restructuring  
2.3 *Accession Partnership and NPAA priority:*  

Accession Partnership - Short term priority – Economic criteria:  
“promote competitiveness through market-driven enterprise restructuring, particularly in energy intensive heavy industries, supported by transparent financial sector reform, including privatisation of three major banks and one insurance company, and bad debt recovery mechanisms”

2000 NPAA  
Chapter 3.3. –Economic and Fiscal Affairs

3. **Description**

3.1 *Background and Justification:*  

- Bank restructuring programme in Slovakia

The Slovak economy suffers from extremely high internal indebtedness. Enterprises have an unsustainable level of debts and the major banks hold a huge portfolio of classified loans on their books (25% of GDP).

In order to cope with this impediment to economic growth in Slovakia, the Government, with support from the World Bank, designed a comprehensive Programme of restructuring for banks and enterprises. The approval of the Programme by the Slovak Cabinet in August 1999 paved the way for completion of the design of a work-out scheme and elaboration of several pieces of legislation, including bankruptcy law, and necessary amendments in other relevant legislation.

The institutional infrastructure for privatisation and restructuring of banks has been set-up and a Steering Committee has been established in order to take decisions on the implementation of the Programme. Consequently, a Co-ordination Unit for restructuring and
privatisation (BPU) has been established with the specific task to implement the decisions of the Steering Committee and ensure the daily management of activities.

The Government programme for the restructuring of the three largest state-owned banks and the enterprise sector focuses on three basic issues: reform of the bankruptcy system, the design of a work-out scheme and the financial restructuring of enterprises.

The adopted scheme for bank restructuring is based on a bad-assets swap in which the doubtful and loss categories in the loan portfolio of the three troubled banks are carved out and transferred into a special loan rehabilitation agency.

An important step in the implementation of the programme was completed in December 1999 when a substantial portion of classified assets from the portfolio of the three major state-owned banks was carved out. 45 billion SKK from General Credit Bank (hereinafter VUB), 22.8 billion SKK from Slovak Savings Bank (hereinafter SLSP), 6.4 billion SKK from Investment and Development Bank (hereinafter IRB) and transferred to the recently established Slovak Consolidation Agency (67 billion SKK) and to the state-owned Consolidation Bank Bratislava (8 billion SKK).

The Ministry of Finance used funds from the National Bank of Slovakia (as a result of the issuance of a state guarantee which released reserves held by NBS) and re-capitalised the two banks and injected in 10.1 billion SKK into the equity of VUB and 4.9 billion SKK to SLSP. The objective of this first phase of bank restructuring was the proper clean up of the banks’ balance sheets in order to increase their capital adequacy ratio to the minimum standard level (8%) and to improve their profitability and value prior to privatisation.

A second carve out of around 31 billion SKK has been carried out during the first half of 2000. The loans carved out within this second wave should be of “better” quality, being rated as watch and doubtful loans. This will complete the clean-up of the banks prior to privatisation, so they may be privatised as quickly and for as much value as possible.

About 15-20% of classified but still recoverable loans which remain in the banks’ portfolios will be worked out by the banks themselves. Investors should provide further skills and training to improve restructuring capacity within the banks.

- **Slovak Consolidation Agency (SCA – Slovak Consolidation, j.s.c.)**

The Slovak Consolidation j.s.c. (hereafter the SCA) was legally established on 25 October 1999. The initial shareholder structure includes: Ministry of Finance (24%), Consolidation Bank Bratislava (19%), VUB (19 %), SLSP (19%), (IRB) 19%. During the year 2000 the shareholders’ shares will be transferred to the government through the provision of coverage for the bad loans by the issuance of government bonds. The Agency will then be a fully state-owned company.

At the Ministry of Finance experts are working on the institutional design of the Agency and elaborating the sales & outsourcing scheme. This scheme is to establish an orderly, transparent and fair system of efficient dealing with cases being processed through the Slovak Consolidation Agency. On 25th February 2000 the Government approved this scheme. The Agency’s top management will be selected through a tendering process to ensure a
transparent selection of the most qualified candidates. The SCA should have a limited life-span whereas the sunset is foreseen within 3 – 5 years.

The Slovak Consolidation Agency will be responsible for the work-out of the majority of the recently carved out non-performing loans. These loans are of poor quality – in about 90% of cases bankruptcy has already been declared. A further carve-out of classified loans has been carried out during the first semester of 2000. Then the Slovak Consolidation Agency will manage a loan portfolio of around 100 billion SKK. Recoveries are estimated at around 10% and will be used to offset both the costs of the Slovak Consolidation Agency and the costs of servicing government bonds issued to finance the carve-outs from the banks. The majority of claims will have to be covered by budgetary provisions. Government bonds will be issued in exchange for these claims.

The Slovak Consolidation Agency will analyse and structure the portfolio of classified loans, auction selected bundles or pools of loans and will oversee the process of restructuring within the portfolio. The crucial issue is the availability of technical expertise though the provision of external work-out specialists as well as through building the Agency's own restructuring capacity.

The SCA will focus on the pooling and packaging of loans and assets either for immediate sale to investors or, where an immediate sale is not possible, the pools of loans will be restructured and managed by private sector asset management firms. The SCA will not itself attempt to restructure loans or the underlying borrowers, and the SCA will not act as a source of finance for restructuring.

The SCA will initiate a pilot programme directed at assets already in bankruptcy proceedings from the first carve out. This programme, which will essentially consist of competitive tendering for law firms to carry out bankruptcy proceedings, should be underway by mid 2000. They will provide valuable experience in developing asset management contracts, contract administration, and tender administration procedures. However, in the second round of carve outs the transferred assets will be sold or managed and will therefore require extensive work to prepare due diligence and information packages and to develop the sophisticated marketing and auction techniques.

- Legislative framework of the restructuring process

The most important assumption for ensuring sustainable economic growth and cleaning-up the economy is to create an appropriate legislative environment. Several pieces of legislation are to be adopted and a number of provisions are being amended in order to make bank restructuring feasible.


This comprehensive amendment of the Bankruptcy Code introduces new features; strengthens creditors’ rights and facilitates fast track bankruptcy and debt-equity swap. Several provisions relating to working with claims institute the possibility of forgiving claims and related tax
treatment, write-off claims and related tax treatment, receivable assignment with/without discount and collateral and security. The tax and other related legislation is also to be amended.

3.2. Linked activities:

US AID experts assisted the Slovak government on the Agency institutional design. They focuses in particular on the development of the work-out scheme and made recommendations on organisation and staffing of the Agency. The proposed World Bank Enterprise and Financial Sector Adjustment Loan (EFSAL) will in part indirectly support the activities of the Agency and the restructuring measures, which will in turn assist the whole economy.

In 1999 MEUR a total of 2.88 was reallocated to support the bank privatisation under the 1997 Phare National Programme. This package covers 6 comprehensive projects: diagnostic audits of VUB and SLSP, long term advisor for the Bank Privatisation Unit (BPU), financial and legal advisors to privatised banks and short-term experts for the privatisation and restructuring of banks, and the enterprise sector. The bank privatisation programme is also supported by the World Bank, US AID and the British Know-How Fund. The Japanese government made also available a grant in support of preparation for the World Bank EFSAL facility.

3.3. Results:

The Phare assistance will aim at enhancing operational and working capacity of the Slovak Consolidation Agency and substantially increasing the rate of resolved classified loans.

At the end of the project this financial institution should be able to resolve efficiently the caseload of carve-out loans transferred from troubled large banks. The executives officers supported by EU experts shall be able to manage the sale efficiently and the staff will be adequately skilled to handle the cases professionally.

The SCA will either transfer the ownership a large part of the enterprise sector to private investors, or to asset managers who will then sell these assets to private sector. This should accelerate the transformation of the enterprise sector and provide a mechanism for the entry of capital to support economic development and modernisation.

The technical assistance will support the privatisation of the banks through mechanisms designed to quickly resolve the enterprise sector’s problems and clear the “bottleneck” of insolvency which is the impediment to restructuring process and the entry of much-needed capital and skills. A subsidiary benefit of this process will be enhanced recoveries to offset the massive costs of the bank privatisation programme.

3.4 Activities:

The required Phare technical assistance will be structured into three activities, directed at the SCA. The overall approach of the TA will be “hands on”, with Phare-supported EU experts providing extensive support and focusing on tasks which the institutions themselves cannot perform effectively. TA to the SCA will have a low training component because the SCA will be a short-life institution and not functioning as an active asset manager.
The following TA activities are envisaged:

**Activity 1:**

**Pool Packaging and Auctions, Due Diligence and Restructuring by SCA**

Experts would select assets for inclusion in auction packages. This selection would be based upon the experts’ knowledge of the market and discussions with potential bidders for asset packages. The experts would develop specifications for the due diligence and asset data packs for use by the due diligence experts. The experts would then be responsible for conducting a marketing process followed by conducting the auction of asset packages in an open and transparent fashion according to international market norms.

Experts will be required to prepare individual credit files and data packs for pools of assets selected for auction (initially for sale and, if this is not possible, for asset management contract tenders). The experts will also prepare detailed offering memoranda in co-operation with the auction experts to international market standards. This project is expected to be very extensive due to the large number of assets expected to be transferred.

These activities will be performed by 2 EU LTE and STE specialised in auctioning and pooling of assets and by 10 EU and 10 local STE sector specialists working on the information packages.

**Activity 2:**

**Legal Assistance to SCA**

3 EU and 6 local ST legal experts would provide assistance to the SCA. There activities will include the preparation of contracts covering two main items: (1) closing documents for sales of asset packages; and, (2) development of a standard asset management contract for use by the SCA in contracting out the management of asset packages which cannot be sold through the auction process.

**Activity 3:**

**Member of the Investment Council of SCA**

An EU ST Expert flying in for 2-3 days a month during the period of 2 years would be provided to serve as a member of the five person investment council of the SCA. The council will be responsible for: (1) preparing the policy of the SCA with respect to sales and management of assets; and, (2) day-to-day decision making regarding individual transactions and management contracts. The governance structure proposed for the SCA gives only the supervisory board of the institution the right to overrule the proposals of the investment council. The Council is therefore expected to function as the primary expert decision making body of the institution. The expert selected for this position shall have an extensive experience in SCA-type operations and shall operate in full independence.
The proposed TA activities 1 and 2 are related to tasks which should be entrusted to a single consortium whereas the due diligence part will be presumably covered by an auditing company. This would have the added effect of improving co-ordination between the experts and reducing project overheads and management costs.

Activity 3 requires an expert who will be independent from the contractors selected for activities 1 and 2. This expert will be required to evaluate and make recommendations as concerns the work performed by the consortium carrying out activities 1 and 2.

4. Institutional Framework

The Ministry of Finance is in charge of the design of the detailed work-out scheme as well as the division of responsibilities for the management of carved-out debts between Slovak Consolidation Agency and the Consolidation Bank Bratislava. The scheme was approved by the Slovak Government on 25th February 2000.

The Steering Committee for the restructuring and privatisation of banks and the enterprise sector was established in the second half of 1999 and acts as an experts' cross-sector decision-making body.

5. Detailed Budget

<table>
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<tr>
<th>Phare Support</th>
<th>Investment Support</th>
<th>Institution Building</th>
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<th>National Co-financing (EUR)</th>
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(*) The Slovak Government will ensure adequate office facilities and human resources

6. Implementation Arrangements

6.1 Implementing Agency: CFCU
Milan Michalicka

Mlynské Nivy 52
813 25 Bratislava
Phone: +421-7-5341.8093,
Fax: +421-7-5341.8095

Beneficiary institution:
Ministry of Finance: Mr. Juraj Rencko
The Slovak Consolidation j.s.c.: Jaroslav Galajda

6.2 Contract 1: MEUR 2.4
Contract 2: MEUR 0.1

7. Implementation Schedule

7.1 Start of tendering: 1st quarter 2001
7.2 Start of project activity: 2nd quarter 2001
7.3 Project Completion: 2\textsuperscript{nd} quarter 2003

8. Equal Opportunity
Equal opportunity principles and practices in ensuring equitable gender participation in the project will be guaranteed

9. Conditionality and sequencing

- Legal framework effective

ANNEXES TO PROJECT FICHE

1. Logical framework matrix in standard format
2. Detailed implementation chart
3. Cumulative contracting and disbursement schedule by quarter for full duration of programme (including disbursement period)
7. Government Decree on the Slovak Consolidation j.s.c.
**Logical Framework Planning Matrix for:**

<table>
<thead>
<tr>
<th>Programme name:</th>
<th>Bad Debt Recovery</th>
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<tr>
<td>Programme no.:</td>
<td>SK0003.02</td>
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<tr>
<td>Country:</td>
<td>Slovakia</td>
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<tr>
<td>Date of drafting:</td>
<td>April 2000</td>
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<td>Contracting period expires:</td>
<td>31.12.2002</td>
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<td>Total budget (MEUR):</td>
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<td>PHARE contribution (MEUR):</td>
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| Sheet no. | 2.5 |

### Intervention logic

<table>
<thead>
<tr>
<th>Objectively verifiable indicators</th>
<th>Sources of verification</th>
<th>Assumptions</th>
</tr>
</thead>
</table>

#### Overall objectives:

- Substantial level of bad debts decreased and economic recovery facilitated
  - Financial flows in the economy set free
  - Increased volume of credits to viable enterprises by 10 bill. SKK
  - Share of private investment on GDP increased by 5% by the end of the project
  - Statistical office data
  - NBS data on credits
  - Indicators of Slovak economy performance
  - Continuity in functioning of market economy
  - Political stability of the country
  - Continuation of the Government commitment to restructuring programme
  - Compliance with the World Bank EFSAL loan

#### Project purpose:

- Improved institutional capacity of Slovak economy to handle large scale restructuring
  - Recovery rate of 10% of the bad loans book value by the end of the project
  - Slovak Consolidation Agency and Consolidation Bank books and accounts statements
  - Business plans of the Slovak Consolidation Agency
  - Entry of strong strategic investors into the process of privatisation of banks

#### Results:

1. Improved operational capacity and enhanced working capability of the Slovak Consolidation Agency
   - Feasible and detailed work-out, sale & outsourcing scheme designed within 6 month time
   - Business plans of the Slovak Consolidation Agency
   - Entry of strong strategic investors into the process of privatisation of banks

2. Rate of resolved classified loans increased
   - Ratio of income versus volume of bad debts has risen steadily by 2% a year till 2003
   - Total amount of bad debt resolved as a percentage of the total amount treated (shall reach 75% in 2003)
   - Annual financial accounts of the Slovak Consolidation Agency
   - Legal framework for bankruptcy system improved
   - Creditors’ rights improved due to new bankruptcy legislation
   - Government commitment to the project
   - Sufficient budgetary provision
**Programme name:** Bad Debt Recovery  
**Date of drafting:** April 2000  
**Total budget (MEUR):** 2.5  
**Programme no.:** SK0003.02  
**Contracting period expires:** 31.12.2002  
**Country:** Slovakia  
**Disbursement period expires:** 31.12.2003  
**PHARE contribution (MEUR):** 2.5

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<th>Objectively verifiable indicators</th>
<th>Sources of verification</th>
<th>Assumptions</th>
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<td>1.1 To prepare due diligence information packages on individual cases</td>
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<td>2.1 To provide legal advise in process of outsourcing and restructuring</td>
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**Project Preconditions:**  
- Legal framework effective
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<th>Sub-Projects</th>
<th>Time Implementation Chart (in quarters)</th>
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## CUMULATIVE CONTRACTING AND DISBURSEMENT SCHEDULE

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I. Introduction

Based on the Resolution of the Government of the Slovak Republic No. 908, dated October 21 1999, decision was made to establish an agency for management of claims transferred from banks under restructuring - Slovenská konsolidacná, a.s. This Company was registered on October 26 1999 with share capital of SKK 1,000,000, and the following temporary structure of shareholders, composition of Supervisory Board and Board of Directors:

Structure of Shareholders
- Ministry of Finance: 24%
- VÚB, a.s.: 19%
- SLSP, a.s.: 19%
- IRB, a.s.: 19%
- Konsolidacná banka, š.p.ú.: 19%

Composition of Supervisory Board
- Ministry of Finance
- Ministry of Economy
- Ministry of Agriculture
- Office of the Government
- Konsolidacná banka, š.p.ú.

Composition of Board of Directors – representatives of the claims transferring banks
- VÚB, a.s.
- SLSP, a.s.
- IRB, a.s.

In December of last year, within the first phase of pre-privatisation restructuring of selected banks, the Agency was transferred classified claims from loans from VÚB, a.s., SLSP, a.s. and IRB, a.s. in the total amount of SKK 62,7 billion. Based on mandate contracts, these claims are currently worked out by the banks. Pursuant to mandate contracts, banks’ staff is authorised to perform all actions related to management of claims, except of transferring the claims, remission of claims and entering into an onerous court reconciliation. The Agency now has offices and some administrative staff, who does not have the competence to work with claims.

Based on the Agenda of the Government of the Slovak Republic in 2000, approved by the Resolution of the Government No. 47, dated January 26 2000, the Ministry of Finance was obliged to present the Project of the Agency for Workout of Transferred Claims - Slovenská konsolidacná, a.s., to meeting of the Government by the end of February. The Agency Project provides the main principles of Agency’s functioning, structure and competence of Agency’s bodies, base characteristics of the Agency’s portfolio after the first phase of pre-privatisation restructuring of selected banks, main techniques and methods of work with claims and a schedule of developing the Agency as an institution independent from the founding banks.
Main Objective
The Agency has in its portfolio classified claims transferred from portfolios of the banks under restructuring. The main objective of the Agency will be to quickly settle these claims:
by speeding-up the liquidation of unviable companies, whereby the revenue from recovery of claims shall be used to reduce fiscal expenditures of bank and enterprise restructuring. Due to the quality of the Agency’s portfolio, the rate of recovery of claims over approx. 10 percent cannot be expected;
by supporting the restructuring of viable companies. The objective of restructuring is to allow continuation of those production / business operations of companies, which are economically justified;
in order to maximise productive utilisation of assets from Agency’s portfolio. The Agency’s objective, however, will not be to restructure debtor’s debt and to keep the claim in its portfolio subsequently nor to execute owner’s rights towards business entities. Debtor, whose financial problems can be handled simply by debt restructuring, is potentially a standard client of a bank and there is no reason to transfer a claim to such debtor to the Agency. Agency shall have in its portfolio claims to debtors that are in very complicated financial situation. Therefore, the result of restructuring will usually be a change in the debtor’s ownership structure, or sale of debtor’s assets to third party. Revenues from such operations shall also be used for reducing fiscal expenditures of bank and enterprise restructuring.

Methods of Work
The Agency has been established as a non-banking entity, which allows to set up such organisation structure, work procedures and auditing mechanisms that secure flexibility in working with claims. In order to achieve its objective, the Agency will be applying the existing legislation (the Act on Bankruptcy and Composition, tax legislation and other pieces of legislation, especially those that will increase the flexibility of working out the claims) and internal procedures to be prepared by the Agency. Slovenská konsolidacná, a.s. should be a relatively small organisation aimed rather on quick settlement of claims and not on long-term management of claims, restructuring of claims to debtors by in house capacities, in order to increase the value of such claims in the future. Slovenská konsolidacná, a.s. should be a managing unit, which coordinates quick sale of assets and claim management contracts and contracts on management and handling of claims, which fully uses the services of well-known specialised agencies. Use of services from private sector should be based on the principle of success fee, or other incentive for quick and efficient settlement of claims. Sale of assets shall be carried out and claim management contracts shall be signed based on auction or another form of public bidding.

Agency’s Ownership Structure
The present ownership structure of the Agency is not appropriate from several reasons:
If the above banks keep their ownership share in the Agency, this might be a fact complicating privatisation of these banks. Potential risk following from non-transparent liabilities, related to ownership share in the Agency, could reduce ha value of the banks perceived by the investor. Therefore, the Agency shall, as soon as possible, become a fully functioning institution independent from the founding banks, with its own staff, work procedures and methods and with developed auditing and decision-making mechanisms;
Due to high fiscal expenditures of restructuring and the need for unambiguous and transparent rules of Agency’s operation and funding, keeping the banks within the structure of owners would not be justified;
Heterogeneous structure of owners with differentiated motivation of owners may become an impediment to development of the Agency in the form that would assure achievement of the main objective at lowest costs; 
In fulfilling its main objective, the Agency shall cooperate with state institutions, public funds and the National Property Fund of the Slovak Republic that have claims to debtors involved; For its functioning and achievement of its main objective, the agency will need some exceptions from the rules applicable to standard business entities (especially in the tax area – the obligation of provisioning for overdue bills receivable, and in the Act on Bankruptcy and Composition).
From the above reasons, it is necessary that the Agency - Slovenská konsolidacná, a.s. should be completely owned by the state. Potential risk of moral hazard and corruption needs to be eliminated by internal and external decision-making and auditing mechanisms. The conversion from an agency to and entity completely owned by the state must be carried out as soon as possible, not later than by the full start-up of Agency’s operation in mid 2000 (proposed schedule of development of Slovenská konsolidacná, a.s. is provided in Section VI. of this document).

Duration of Operation
With respect to the main objective, methods applied, the need of exceptions from general regulations, Slovenská konsolidacná, a.s., owned by the state, must be regarded as an entity with limited duration of existence. With regard to the structure of portfolio and the legal status of receivables, the agency should not exist longer than 3 to 5 years. During this period, it should settle the portfolio transferred within pre-privatisation restructuring of selected banks. In the last one or two years of operation, the Agency shall keep in its portfolio only legally complicated cases awaiting court resolution. After this period, the Agency shall be liquidated. With regard to the fact that after fulfilling its main role, the Agency will be a functioning entity with specific know – how, qualified staff, base of information and contacts, privatisation of the Agency may be an alternative to liquidation.
Another option is to privatise the Agency as soon as possible. However, experience from other countries indicates that similar organisations are always as state-owned. Private firms – investment companies are used either for management and settlement of individual claims, or for management of selected part of folio, based on success fee. Due to low and unpredictable yield from Agency’s assets and due to the legal status of those assets, even if buyer is found, who is interested to buy the entire assets, which is unlikely, the revenue for the state would be lower than in the case of applying various strategies of asset settlement following thorough analysis of Agency’s portfolio. A standard approach of potential investor would be to calculate the non-quantifiable risk in the price and terms of payment.
A more feasible strategy than immediate sale of entire assets of the Agency would be splitting the portfolio by quality, sector, or other criteria, and involving private firms for settlement of those assets, either based on success fee, or selling a part of assets to an investor.

Agency’s Funding
Financial Coverage of Claims Transfer from Banks
The transfer of loss-making claims in the first phase of pre-privatisation restructuring of selected banks (carried out in December 1999 based on Resolutions of the Government No. 908, dated October 21 1999 and No. 1133, dated December 22 1999) was financially covered by loans provided to the Agency by founding banks, to which the state provided special guarantee. This guarantee assures that the loans provided to the Agency are regarded in the banks’ portfolios as sound assets to without the need of provisions or reserves. The claims
were transferred at face value; the provisions made before in the banks were “dissolved”, and from the resources gained, additional provisions were made for the rest of classified loan portfolio in the banks.

The second phase of pre-privatisation bank restructuring, to be carried out in April – May 2000, will follow from the results of diagnostic audits of bank portfolios and from the recommendations of privatisation adviser. The scheme of financial coverage of claims transfer in the second phase will be the same as in the first phase, except that the claims will not be transferred at face value, but at a net value that takes into account provisions and reserves. This means that the payment for transferred claims (fiscal expenditure) and the face value of transferred claims will not be identical; fiscal expenditure (amount of special guarantee) will represent approx. one third of the face value of transferred claims. Thus, after completion of the second phase of pre-privatisation restructuring, the transferred claims in the balance sheet of Slovenská konsolidacná, a.s. will be covered by loans provided by the founding banks, with special guarantee of the Government. This type of loan is not a standard financial asset and could cause complications in privatisation of the banks. Therefore, it will be necessary to replace it with Treasury Bonds issued into share capital of Slovenská konsolidacná, a.s., by which the Agency will repay the loans from the founding banks.

After this transaction, the state will be the sole owner of the Agency - Slovenská konsolidacná, a.s. and the claims transferred will be covered by share capital of the Agency. This transaction must be carried out as soon as possible, based on the approach in privatisation of selected banks, however, not later than by March 2001, when the exception from effectiveness of Article 66g of the drafted amendment of the Bankruptcy and Composition Act expires.

Any other activities (e.g. management of third party claims to debtors common with the Agency) will be performed by the Agency on commercial basis, without additional fiscal expenditures.

Financing of Operation and Activities of the Agency - Slovenská konsolidacná, a.s.
Primary source of funding of operational costs and activities of the Agency will be the revenues from sale of claims. Therefore, such revenues will not be spent on repayment of principal and interest from loans provided by the banks (until the issue of Treasury Bonds). Slovenská konsolidacná, a.s. will operate on the basis of annual business plan and liquidity plan, which will be approved by the Supervisory Board. Liquidity Plan will also include a proposal to transfer excessive liquidity to the state budget, as non-budgeted revenue, by reducing share capital of the Agency. If in any year, in an exceptional case, the Liquidity Plan (as approved by the Supervisory Board) assumes that operational costs of the Agency exceed the revenues from sale of claims, additional liquidity shall be obtained by increasing the share capital of the Agency, which, however, must be incorporated in draft bill on the State Budget for the relevant year.

1 This transaction will not represent additional fiscal expenditure to the existing liability of the state following from the special guarantees. The original debt arose in the assets of state owned banks during the transformation period. This debt was a consequence of unsuccessful involvement of the state, which owned the banks, prepared legislation and regulations, prepared the concept and implemented privatisation, which was a complete failure with regard to expected benefits in expected behaviour of microeconomic sector. The existence of this debt crippled the banking sector and hindered the fulfilment of its functions in relation to real economy. Provision of special guarantee for loans from funding banks meant an implicit recognition of this debt; replacement of the special guarantees by Treasury Bonds will represent an explicit quantification of the debt in the form of internationally acceptable financial instrument.
Final clearance, quantification of total fiscal expenditures and settlement with the state budget will be done after termination of operation of Slovenská konsolidacná, a.s. - being a state owned entity.

III. Structure of Portfolio and Methods and Procedures of Handling Agency’s Assets

Methods and procedures of handling Agency’s assets will ultimately depend on: detailed analysis of Agency’s portfolio with regard to legal status, time since declaration of bankruptcy or time since filing bankruptcy motion, amount of claim, size of debtor, distribution of debtors by regions and branches, type of security related to the claim, time from last repayment of principal and interest, etc.; existing legal framework.

Detailed data analysis of Agency’s portfolio will be one of the first most urgent actions of Agency’s management after approval of the Project, which will be followed by proposal of techniques and methods of handling Agency’s assets, presented by the Investment Committee to the Supervisory Board.

After the first stage of pre-privatisation restructuring of selected banks, Slovenská konsolidacná, a.s. has in its portfolio claims to 1287 debtors, in total amount of SKK 62.708 million. Total claims to debtors in bankruptcy (789 debtors) are SKK 43.340 million, which represents 69,1% share in total amount of claims. Assets of 231 debtors that have been transferred to Agency’s portfolio, are subject to bankruptcy motion. The total amount of these claims is SKK 6.875 million (11,0 %). The smallest group of claims are claims to debtors in liquidation. An important share (19,0 % from total amount of claims) belongs to other claims (not subject to bankruptcy and liquidation), in total amount of SKK 11.940 million, to 248 debtors. Claims in Agency’s portfolio, broken down by legal status, are presented in Table 1.

| Tab. 1 Classification of Claims in Agency’s Portfolio by Legal Status (in SKK million) |
|---------------------------------|----------|------|-----|
| - liquidation                   | 0,9      | 19   | 1,5 |
| - bankruptcy motion             | 11,0     | 231  | 17,9|
| - bankruptcy declared           | 69,1     | 789  | 61,3|
| - other                         | 19,0     | 248  | 19,3|
| Total claims                    | 100      | 1287 | 100 |

With regard to amount of claims, the major share (39,9 %) represents claims from SKK 100 to 500 million, in the total amount of SKK 24.991 million. With regard to number of debtors, the broadest scope of claims is in the category of SKK 5 to 25 million, i.e. to 534 debtors (41,5 %). Classification of claims by amount is provided in Table 2.

| Tab. 2 Classification of Claims in Agency’s Portfolio by Amount - (in SKK million) |
|---------------------------------|----------|------|-----|
| less than SKK 5 million         | 1,2      | 280  | 21,8|
| SKK 5 to 25 million             | 10,9     | 534  | 41,5|
| SKK 25 to 50 million            | 12,0     | 208  | 16,2|
| SKK 50 to 25 million            | 14,1     | 128  | 9,9 |
| SKK 100 to 500 million          | 39,9     | 121  | 9,4 |
| SKK 500 million to 1 billion    | 12,6     | 12   | 0,9 |
| over SKK 1 billion              | 9,3      | 4    | 0,3 |
| Total                           | 100      | 1287 | 100 |
With regard to classification of claims by line, the biggest share of claims are claims to
trade and tourism businesses, i.e. 27.7\%, followed by engineering industry - 13 \%, food
industry - 12.5 \% and wood industry with 7.2\% share. Classification of claims by line is
provided in Table 3.

<table>
<thead>
<tr>
<th></th>
<th>Amount</th>
<th>Share in %</th>
<th>No. of debtors</th>
<th>Share in %</th>
</tr>
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<tbody>
<tr>
<td>Agriculture</td>
<td>410</td>
<td>0.65</td>
<td>22</td>
<td>1.71</td>
</tr>
<tr>
<td>Forestry, logging</td>
<td>9</td>
<td>0.01</td>
<td>2</td>
<td>0.16</td>
</tr>
<tr>
<td>Mineral mining</td>
<td>835</td>
<td>1.33</td>
<td>7</td>
<td>0.54</td>
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<tr>
<td>Food industry</td>
<td>7817</td>
<td>12.47</td>
<td>159</td>
<td>12.35</td>
</tr>
<tr>
<td>Textile, clothing and tanning</td>
<td>3449</td>
<td>5.50</td>
<td>45</td>
<td>3.50</td>
</tr>
<tr>
<td>Wood industry</td>
<td>4491</td>
<td>7.16</td>
<td>63</td>
<td>4.89</td>
</tr>
<tr>
<td>Paper and printing industry</td>
<td>1604</td>
<td>2.56</td>
<td>36</td>
<td>2.80</td>
</tr>
<tr>
<td>Chemical industry</td>
<td>1635</td>
<td>2.61</td>
<td>44</td>
<td>3.42</td>
</tr>
<tr>
<td>Metallurgy</td>
<td>1356</td>
<td>2.16</td>
<td>15</td>
<td>1.17</td>
</tr>
<tr>
<td>Engineering</td>
<td>8172</td>
<td>13.03</td>
<td>112</td>
<td>8.70</td>
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<tr>
<td>Electrical industry</td>
<td>3529</td>
<td>5.63</td>
<td>23</td>
<td>1.79</td>
</tr>
<tr>
<td>Construction</td>
<td>3383</td>
<td>5.40</td>
<td>85</td>
<td>6.60</td>
</tr>
<tr>
<td>Generation of power, gas and water</td>
<td>0</td>
<td>0.00</td>
<td>0</td>
<td>0.00</td>
</tr>
<tr>
<td>Trade and tourism</td>
<td>17348</td>
<td>27.66</td>
<td>458</td>
<td>35.59</td>
</tr>
<tr>
<td>Transport and communications</td>
<td>1289</td>
<td>2.06</td>
<td>52</td>
<td>4.04</td>
</tr>
<tr>
<td>Other operations</td>
<td>7381</td>
<td>11.77</td>
<td>164</td>
<td>12.74</td>
</tr>
<tr>
<td>Total</td>
<td>62708</td>
<td>100</td>
<td>1287</td>
<td>100</td>
</tr>
</tbody>
</table>

Despite the fact that the final structure of portfolio will be known only after the second
phase of pre-privatisation restructuring of selected banks, it is already obvious that the
portfolio will include major share of claims to debtors in bankruptcy and low concentration
of claims by amount. The share of Agency’s claims to debtors in bankruptcy and debtors, for
which bankruptcy motion was filed, is 80 percent. Concentration by amount of total claim to
one debtor is provided in the chart on Fig. 1. As indicated in the chart, claim to 30 percent is
up to SKK 10 million, claim to 50 percent of debtors is up to SKK 20 million and claim up to
80 percent of debtors is up to SKK 60 million.
Fig. 1
One can assume that Agency’s portfolio quality will slightly improve after the second phase of pre-privatisation restructuring, because the Agency will be transferred not only claims classified by the NBS methodology as loss claims, like in the first phase of pre-privatisation restructuring, but also claims classified as non-standard and doubtful and disputed (proposal of the second phase of pre-privatisation restructuring of selected banks shall be presented by the end of March 2000 to meeting of the Government, pursuant to Resolution No. 730, dated August 25 1999). Following from the existing structure of portfolio and the assumed scope and nature of the second phase, techniques and methods of handling Agency’s claims, we can preliminarily assume that they will be based on the following principles.
In case of already declared bankruptcies, the Agency will only play a passive role awaiting the result of distribution, or supervising the bankruptcy in the extent allowed by the effective legislation. For supervision of bankruptcy proceeding, Agency will be able to use contracted lawyers, motivating them to speed up the bankruptcy proceeding.
In cases when bankruptcy has not been declared and the debtor is still functioning as a business entity, it is possible to seek agreement with the debtor. With regard to the nature of transferred claims, it is more likely that bankruptcy motion will be filed by the agency pursuant to the amended bankruptcy legislation and sale of debtor’s assets to third party (as entire functioning business, functioning parts of the business, tangible and intangible assets) under supervision of the Agency, being the creditor. Preparation of strategy in such cases should be outsourced to private firms specialised in enterprise restructuring and seeking investors.
In cases of bigger and potentially viable debtors, strong position of creditor in bankruptcy proceeding poses pressure on debtor to admit out of court settlement, including capitalisation of claims and subsequent sale of capital share to an investor (third party). Like in the previous case, these activities will not be done by Agency’s own staff, but specialised contracted firms will be used, including foreign firms, operating on a success fee basis or other form of motivation.
In case of claims to debtors, who are not in bankruptcy, auctions of claims can also be assumed, which shall be organised on a regional basis for small claims and nation-wide auctions in case of large claims. It will be important that the Agency establishes mechanisms that will minimise the risk of buying claims by debtors themselves or by buyers acting in...
accordance with debtors. Therefore, claims have to be sold in public auctions, with clear rules of notification about the time and place of auction with long enough notice, with obligation of participants in the auction to register in advance and provide clearly defined scope of information, etc. These rules must be included in internal regulations of the agency. For quick and efficient settlement of claims, it will be important for the Agency to cooperate with tax offices, public funds (Social Insurance Company, National Labour Office, health insurance companies), National Property Fund, Konsolidacná banka, š.p.ú. and with banks that transferred claims to the Agency, all being creditors to same debtors. The relevant document, which will identify the needs of institutional and legislative changes that will create such possibility on the side of the above institutions, shall be presented to meeting of the Government, in accordance with the Agenda of the Government in 2000, by the end of this March.

**IV. Bodies of the Agency - Slovenská konsolidacná, a.s. and their Competences**

Slovenská konsolidacná, a.s. will be an agency, which will manage large volume of claims financially covered by public funds and which may significantly affect the functioning of the enterprise sector. This is inevitable in order to secure highest possible transparency of Agency’s operations, in order to separate controlling and decision-making competences and in order to secure professional decision-making about handling Agency’s assets in accordance with the main objective of the agency. Even though Slovenská konsolidacná, a.s. is established as a joint-stock company pursuant to Commercial Code, the above requirements for functioning of the agency shall be secured by the composition of company bodies, their competences and, ultimately, by existence of an additional body, which is the Investment Committee.

**Supervisory Board**

Representatives of both state institutions and private sector shall be represented in the Supervisory Board of Slovenská konsolidacná, a.s. (SK) as follows:

- Ministry of Finance (two members),
- Ministry of Economy (two members),
- Ministry of Agriculture,
- Ministry of Administration and Privatisation of National Property,
- Office of the Government,
- National Property Fund,
- Ministry of Justice,

whereby the required quorum shall be six voting members. The representatives of the following entities shall participate in Supervisory Board meetings:

- Slovak Chamber of Commerce and Industry,
- Employers’ Association,
- Confederation of Trade Unions,
- Parliamentary Committee for Budget, Finance and Monetary Issues,
- Parliamentary Committee for Economy.

Supervisory Board shall approve annual business plan prepared by the Board of Directors, which provides in details especially the following:

- annual objective of sale of assets and revenues from various sources,
- methods and techniques of handling assets, including expected revenues from various strategies of handling assets,
- plan of using private sector for management and handling of assets.

The function of the Supervisory Board will be exclusively auditing. The role of the Supervisory Board will be to approve general guidelines on handling assets; neither the
Supervisory Board as the entire body, nor its individual members, shall be involved in any specific transactions of SK.

Other obligations of the Supervisory Board will include the obligation:
- to review all auditor reports containing information on abuse of confidential information, corruption or other undue activities related to SK,
- to have prepared and review other reports, which the Supervisory Board will regard as necessary for efficient performance of supervision over SK operations,
- to approve decisions on bringing issues related to SK activities possibly to criminal prosecution, review all reports concerning abuse of confidential information by internal staff, corruption or other issues concerning accusation of illegal or incorrect decisions concerning activities of SK,
- to review eventual rejections of Investment Committee proposals on handling of assets by Board of Directors of the Agency,
- to review SK periodic budgetary reports on expenditures as of specific date in a year and to compare them with approved budget,
- to approve organisation structure, including the number of managing positions and wage tariffs for various managing positions,
- to assure granting of authorities to SK’s Board of Directors in order to secure effective and efficient operation of SK,
- to approve annual budget of SK and Liquidity Plan,
- to approve salary terms for SK’s Board of Directors.

With regard to establishment of the Agency, the Supervisory Board’s competences are to:
- approve the budget for establishment of SK,
- approve the method of remuneration of Investment Committee members,
- approve Professional Ethics Code of SK employees.

Supervisory Boards should approve business plan and budget for the first year of Agency’s existence, including the budget for its establishment, within 120 days after approval of the Agency Project by the Government and, later on, every December in the following year. Exact definition of competences and obligations of the Supervisory Board shall be provided in Articles of Association of Slovenská konsolidacná, a.s..

Investment Committee

The role of the Investment Committee, being an advisory body, is to propose to the Supervisory Board preparation of data and legislation analyses, to propose techniques and methods of working with Agency’s assets, guide the Board of Directors in preparing proposals for handling individual claims or claims to individual debtors.

In this context, the competences of the Investment Committee shall especially include the following:
- to recommend annual business plan to the Supervisory Committee,
- to provide the Supervisory Board with opinions on proposed techniques and methods of handling Agency’s assets, including revenues expected from various handling strategies,
- to provide opinions on proposed plans of using private sector for management and handling of assets,
- to present the Board of Directors with proposals of handling Agency’s assets.

The Investment Committee should be composed of five renowned experts with outstanding reputation and international experience in banking, especially investment banking, and various private business sectors and with knowledge of commercial principles in competitive market environment. Members of the Investment Committee do not represent any institutions. Members of the Investment Committee are appointed by the Supervisory Board.

Board of Directors
Board of Directors will be responsible for everyday operation of the Agency and for implementation of strategy approved by the Supervisory Board. Board of Directors should every month present to the Supervisory Board and to the Investment Committee report on the progress of main initiatives of handling assets and on important programs to be implemented in the course of the next months. Members of the Board of Directors are appointed by the Supervisory Board.
Composition of the Board of Directors shall be as follows (see the structure provided in attachment):
General Director and Chairman of the Board of Directors,
Deputy general Director,
Director of Legal Division,
Director of Financial Division,
Director of Claims Management Division.
Board of Directors makes decisions, as a collective body, on the most important issues entrusted in its competence:
it approves documents presented to the Supervisory Board and to the Investment Committee,
it prepares details for the Investment Committee for preparing proposals of methods of handling individual claims, joining claims into blocks, assignment of claim management contracts or other decisions concerning high-value contracts.

V. Organisation Structure and Scope of Work

The enclosed Attachment provides proposed initial organisation structure of SK, which, in the initial stage of Agency’s operation assumes approx. 35 employees. We can assume that the required number of employees will gradually increase, however maximally to 50.
Proposed initial positions, presented in the organisation structure, shall provide basic managing structure of SK, which shall help to start up the organisation. After start-up and stabilisation, the Agency shall revise its needs and, if necessary, additional employees will be recruited.

Scope of Work of Some Position in the Organisation Structure

Contract Revision Specialist
One can assume that during several years, SK will award many contracts to private sector contractors. Therefore, this position is especially aimed at reviewing contracting process, to determine whether it has been abused or whether all approved contracting procedures have been complied with. This position is different from the position of Director of Internal Supervision Unit, because it deals exclusively with contract, as contract will probably be one of the highest operational costs of SK. In addition to other duties, this person shall investigate complaints of suspicious actions taken by SK or contractor’s staff during contracting and prepare reports thereon for the Supervisory Board (only in serious issues), Board of Directors, General Director and his/her deputy. Contract Revision Specialist reports to the Supervisory Board.

Director of Internal Supervision Unit
Director of Internal Supervision Unit presents reports to the Board of Directors. His competences shall be to prepare and follow-up the functioning of a controlling system, which supervises proper operations in various areas of the approved competences, policies and procedures in individual activities of the Agency.
Director of Internal Supervision Unit shall receive instructions from the Board of Directors and from the General Director of SK concerning the areas to be audited and scope of such audits to be carried out every year. Director of Internal Supervision Unit shall present written
reports on all findings to Board of Directors, General Director and Supervisory Board. Director of Internal Supervision Unit shall report to the Supervisory Board.

Professional Ethics Compliance Specialist
Professional Ethics Compliance Specialist should be responsible especially for interpretation of legal advice, if required, about SK, its internal procedures and instructions concerning compliance with ethical standards by employees and managing staff of the Agency and violation of such rules incorporated to contracts by investors and contractors. Ethics Specialist shall be the key person, who would recommend to General Director and to Board of Directors layoffs and withdrawals from contracts with contractors and investors due to breach of its internal procedures and instructions. This person shall also draw final resolutions whether SK regulations have been breached and whether such action needs to be notified to Board of Directors, General Director, Investment Committee or the Supervisory Board. This person reports to the Supervisory Board.

Special Assistant of General Director
Person in this position shall be the main advisor to the General Director. He/she should have good general knowledge in banking and finance. Special Assistant would be General Director’s advisor in all areas concerning SK and should have general knowledge in law, finance, management information systems, budgeting, financial administration, contracting, ethics, sale of claims, management of claims and other areas, in which the Agency will operate.

Success of the Agency - Slovenská konsolidacná, a.s. will be, in a major extent, determined by decisions of the Supervisory Board, Investment Committee, quality of top management and selection of qualified employees in specialised positions in the Agency. SK employees shall be selected exclusively through selection procedures, in which candidates with required qualified knowledge for a specific post shall be selected. It is important that SK employees have high qualification for fulfilment of their task. Therefore, SK employees should be given salaries comparable to salaries in commercial banking sector. This difference from the normal standard in the public sector follows from the limited lifetime of the Agency and the significant financial effect in Slovakia. The Agency will be subject to severe criticism and negative publicity, which applies to all such operations managing claims in state ownership all over the world. This intensifies the need for qualified employees, who will represent this Company. SK employees shall be obliged by the above code of professional ethics and, in addition to that, qualified employees of the Agency will be obliged to file annual income and property statement.

Controlling mechanisms for protection of SK against corruption or illicit activities of managing personnel or employees
composition and competences of bodies of the Company, clear separation of controlling, decision-making and executive functions between the Supervisory Board, Investment Committee and Board of Directors, Investment Committee composed of individuals from the private sector, who have considerable experience in banking and business, including foreign experts in this field, application of independent assessment of possible yield from assets by private assessors, requested annual or, if required, periodic audits by independent external auditor, existence and compliance of the professional ethics code by Agency staff, annual income and property statements required from staff in managing positions and qualified personnel of SK, existence of the Contract Review Specialist subordinated, to the Supervisory Board,
existence of the Internal Supervision Unit, subordinated to the Supervisory Board, existence of the position of specialist supervising the compliance with the professional ethics code, subordinated to the Supervisory Board.

**Principles of the Processional Ethics Code**
Employees of the Agency, top representatives of political parties, Members of Parliament and public officials or their immediate family members shall not be entitled to acquire assets from SK portfolio. This restriction shall also apply to members of the Supervisory Board and Investment Committee and to their business interests. None of the above shall be entitled to acquire assets or any privilege from contractual operations of SK. Employees shall be prohibited to enter into employment relationship or business relations with potential investors or contractors. SK employees shall be required to keep written records of all telephone, mail or other contacts with political officials concerning any activity related to debtors, investors, contractors, etc. All such records shall be stored in central archive of SK and shall be available to media anytime. All employees, members of the Supervisory Board, Investment Committee or Board of Directors shall be prohibited to take any steps on behalf of SK based on political intervention.

SK shall operate in transparent way. Regular reports on SK operations status shall be presented to the press. Information about decisions on asset handling and awarding of contracts shall be presented to the press releases and available to the public within 30 days after performance of contract. Methods and work procedures of the Agency shall be accessible to public auditing. Information on offered assets from Agency’s portfolio, on claim management contracts awarded, on methods and work procedures of the Agency and other information required to assure transparency and competition in handling Agency’s assets shall also be published on the INTERNET.

**VI. Schedule of Slovenská konsolidacná, a.s. Start-up**

For efficient sale of claims in Agency’s portfolio it is necessary to start up its operation as soon as possible and to undertake management of claims from founding banks as quickly as possible. The presented proposal assumes complete start-up of Agency on June 1 2000; actual start-up date should in no case exceed mid 2000.

<table>
<thead>
<tr>
<th>Event Description</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Publishing of advertisement for selection of SK staff</td>
<td>01/03/2000</td>
</tr>
<tr>
<td>Start of works on data analysis of Agency’s portfolio, preparation of annual budget and budget for establishment of the Agency</td>
<td>01/03/2000</td>
</tr>
<tr>
<td>Approval of Agency Project by the Government</td>
<td>15/03/2000</td>
</tr>
<tr>
<td>Appointment of the Supervisory Board</td>
<td>20/03/2000</td>
</tr>
<tr>
<td>Completion of the selection procedure for the position of General Director and his/her deputy</td>
<td>20/03/2000</td>
</tr>
<tr>
<td>Selection of SK employees pursuant to the proposed preliminary organisation structure, needs and budget of SK, complement of the Board of Directors</td>
<td>30/03/2000</td>
</tr>
<tr>
<td>Appointment of Investment Committee</td>
<td>15/04/2000</td>
</tr>
<tr>
<td>Completion of data analysis and preparation of budgets</td>
<td>30/04/2000</td>
</tr>
<tr>
<td>Introduction of General Ledger</td>
<td>15/05/2000</td>
</tr>
<tr>
<td>Implementation of temporary management information system (completion of physical transfer of claims documentation, dossiers and records)</td>
<td>15/06/2000</td>
</tr>
<tr>
<td>Approval of key internal instructions and procedures, code of ethics and other regulations necessary for transparent and efficient functioning of the Agency</td>
<td>15/06/2000</td>
</tr>
<tr>
<td>Purchase of shares from VUB, SLSP, IRB and KBB by the Ministry of Finance</td>
<td>July 2000</td>
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