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Down the banking hole: Investigating the case of Slovenian banks

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Abstract

The aim of this paper is to analyse who was responsible for the deterioration of the Slovenian banking sector to such an extent that it was almost destroyed by the 2008 financial crisis, necessitating the consideration of an international bailout. A literature review focused specifically on reports from law enforcement agencies and commissions that investigated banking practices, complemented by a qualitative empirical study. In order to gain insight into the reasons why this situation unfolded, ten structured interviews were conducted. The interviewees included experts with experience in the fields of prevention, detection, investigation and prosecution of economic crime, bad credit management, central banking, parliamentary committee management, forensic investigations, investigative journalism, and experts with academic knowledge in law and economics. Five different investigations explored the behaviour of banking sector actors before, during, and after the 2008 financial crisis. These investigations revealed behaviours ranging from negligence to criminal acts. The interviews indicated that the perpetrators were individuals of high social status with significant influence, explaining why people are often not willing to testify against them. On the detection and prosecution front, the main challenges were fears among criminal investigators, prosecutors, judges, and others of retaliation from superiors, job loss, and being publicly lambasted in the media.

Keywords: financial crime; banking sector; investigation; white-collar crime

1 Introduction

In the wake of the recent collapses of one Swiss and two U. S. banks (Hooker, 2023), which underscore the credo that history repeats itself, it is wise to look for lessons that have been learned from the aftermath of the 2008 financial crisis. We concur with (Ruggiero, 2019) that situations similar to the one in 2008 are likely to reoccur. While some scholars argue that the 2008 financial crisis was a result of financial crimes deeply embedded within the global financial and especially the banking sectors, others view it as an unavoidable accident, akin to natural disasters, or merely a systemic slip (Hetzer, 2012; Pontell et al., 2014;

Sturc, 2023; United States Senate, Permanent Subcommittee on Investigations, 2011). This perspective is echoed in contemporary analyses of ongoing banking issues (see Pazzanese, 2023). Ironically, the economic crises typically reveal financial malpractices through post-event audits or when funding shortages expose fraudulent activities, such as the case of Bernard Madoff's Ponzi scheme, which only came to light due to the liquidity crisis. Similarly, financial misdeeds by Wall Street figures during the 2008 crisis might have been driven by funds originally intended for investment in Madoff's ventures.

Freeman (2010) highlights how the Great Depression uncovered the insider dealings and fraudulent activities of Wall Street's top financiers, while the 1980s Savings and Loan crisis was marked by extensive criminal looting, which consequently led to the imprisonment of as many as 3,500 bankers. The indicator of potential financial crimes, the instrument of suspicious activity reports gathered by the U.S. Department of the Treasury's Financial Crimes Enforcement Network from banks and other financial service businesses, has shown, similarly to the 1980s, that the number of mortgage frauds increased sharply from 2003, reaching almost ten-fold by 2009. According to Freeman, before the late 2000s financial crisis, in addition to mortgage frauds, in Ponzi schemes were proliferating.

The global economic crisis that erupted in the US In 2008, hit Slovenia's overheated economy hard. The Slovenian banking sector was particularly affected, as banks suddenly had very limited access to funds on international financial markets and had to repay the funds they had borrowed. They, therefore, wanted to get these funds back from companies, many of which did not have them, and at the same time, their revenues fell sharply as a result of the global financial crisis (Tajnikar, 2019). The ongoing developments resulted in sum, resulting in a serious capital shortfall in the banks. To prevent the collapse of the Slovenian financial system, Slovenian banks had to be recapitalized, but there was no interest from owners and foreign investors. The only solution to the situation was for Slovenia to recapitalize its banks with taxpayers' money. Kordež (2019) estimates that the rescue of the state-owned banks, together with the deficit coverage for the orderly liquidation of Factor banka and Probanka, cost around €4.5 billion. The public nicknamed the capital shortfall in the banks the 'banking hole' *(bančna luknja)*. Soon the question arose if the poor conditions in which Slovenian banks have found themselves were also a by-product of financial crime. This paper addresses this line of thought and researches whether there was a link between the Slovenian banking hole and financial crime. It is structured in five parts. Following (1) the introduction, there is (2) a short description of the official causes of the poor state in which Slovenian banks found themselves after the 2008 financial crisis; followed by (3) descriptions of the investigations into the banking hole and (4) our research undertaking, carried out to deepen the understanding of the official causes of the banking hole and results of the investigations into the banking hole. The last (5) section summarises and combines the crucial information from all the sections and provides some suggestions for the prevention of such behaviour in the future.

2 The Slovenian banking hole

The post-EU accession economic boom and subserviating banks' willingness to extensively credit businesses, including managerial takeovers can be recognized as connected to the issues of post 2008 Slovenian banking crisis (Damijan, 2013; 2018; Guardiancich, 2016;

Tajnikar, 2019). More precisely and according to Tajnikar (2019), the roots of the Slovenian banking hole can be traced back to 2004–2008. He divides the roots into three categories: (i) the rapid growth of the Slovenian economy based on borrowing by companies and the state, (i) the large public financial expenditures financed by economic growth and the state's borrowing abroad – the state's guaranteed debt to foreign countries rose from €2.9 billion in 2000 to €10.2 billion in 2008, and (iii) the managerial takeovers, which were based on the managers' borrowing from Slovene banks and were secured by the assets of the companies they were taking over. In 2008, the Slovenian economy was heavily indebted, especially abroad, with companies as the most indebted, followed by the state. The Bank of Slovenia total gross external debt rose from €9.5 billion in 2000 to €40.3 billion in 2008. Bank of Slovenia in its report about the capital deficit of banks, also lists three key segments that contributed to the development of the banking crisis in Slovenia (Banka Slovenije, 2015): (i) Rapid and unbalanced economic growth before the crisis; (ii) The over-indebtedness of non-financial firms and the ownership transformation model financed by borrowing and by burdening the future cash flows of the bought-out firms with debt repayments to carry out the ownership transformation; (iii) The factors behind the accumulation of non-performing loans in the crisis.

In contrast, Damijan (2013) provides five reasons for the rapid credit growth in Slovenia between 2005 and 2008: (i) Slovenia joined the EU in May 2004, which reduced the political risk premium to the Italian level. This made the sources of foreign funds for Slovenian entities much cheaper, Slovenian banks were able to borrow cheaply abroad and lend them at a premium; (ii) The Slovenian real estate market grew rapidly, and new projects were financed by bank borrowing; (iii) High global economic boom stimulated demand for Slovenian exports, Slovenian companies' profits grew rapidly and investment in new capacity was needed, for which companies also borrowed bank loans; (iv) As a result of the high conjuncture and profits, managers started to take out bank loans to acquire their own companies and thus consolidate their ownership; (v) About one-fifth of the credit boom was generated by households buying property and cars due to low interest rates.

Using (the Slovenian) bank(s) stability report, Damijan (2013), writes that the size of Slovenian banks' balance sheets more than doubled between 2004 and 2008, increasing by €23.8 billion. Of this, €20.5 billion was due to an increase in lending to the non-bank sector, of which almost €12 billion was to businesses and €4.2 billion to households. Over the period, the balance sheet total of banks increased by 43 per cent more than the GDP, whereas in the years before 2004, the balance sheet total of the entire banking system was only 85–87.5 per cent of GDP. It should be stressed that Slovenian banks were mainly financed by loans taken out from other banks. Thus, they took out around €15 billion in loans from other banks, of which around €12 billion from banks abroad, while deposits from the non-banking sector represented around €6 billion of additional resources for Slovenian banks (Damijan, 2013).

Due to liquidity problems in global financial markets, foreign banks and investors had demanded Slovenian banks to repay the money they borrowed which they did not have. As Slovenian banks were also the largest lenders to companies, they demanded repayment of loans, while hardly any new loans were granted. As a result, private sector indebtedness was reduced by €3.8 billion in 2009. However, more and more Slovenian companies had problems repaying their loans, as the global economy reduced demand for their goods from their trading partners by €4.4 billion in 2009 alone. The limited amount of funds also forced Slovenian companies to cut investments by almost €4 billion in 2009. Slovenian exports have already rebounded in 2010 and 2011, and Slovenian GDP growth was positive in these years. However, this has not contributed to the positive economic climate and political optimism in Slovenia. The prevailing opinion in Slovenian society is that Slovenia is on the verge of bankruptcy. The unfavourable sentiment and tight liquidity in global financial markets influenced the deleveraging of the Slovenian corporate sector from 2009 until 2014. During this period, Slovenian banks significantly reduced corporate borrowing and avoided reprogramming existing loans. Commercial banks are co-responsible for the creation of the Slovenian banking hole, as they significantly reduced corporate borrowing while being unwilling to reschedule existing loans (Tajnikar, 2019).

So, because Slovenian banks had to repay the loans, they had taken out abroad, they demanded repayment from companies, and foreign consultancy firms started to value the assets of these companies at liquidation value, which made many companies capital-inefficient, and consequently insolvent and eligible for bankruptcy. Also, as a result of the new accounting standards, many operating companies no longer had access to financial resources and Slovenian banks suffered a significant deterioration in their position as a result. In their balance sheets, they recorded investments in these companies at liquidation value, which meant that they no longer had access to foreign investors or lenders. Slovenian banks themselves had become insolvent and faced bankruptcy. And as mentioned to prevent the collapse of the Slovenian financial system, Slovenian banks had to be recapitalized, but there was no interest from owners and foreign investors. The only solution to the situation was for Slovenia to recapitalize its banks with taxpayers' money. To make matters even worse, the establishment of the bad bank, which would take on the bad loans and other illiquid holdings was accompanied by a new set of problems, questionable acts and as managers of it, involved some of the same actors that were recognized elsewhere as those that caused some of the banking hole problems in the first place (Š., L., STA, 2019).

Guardiancich (2016) sees the reason why 2004-2009 crediting was done that such poor due diligence often includes almost no risk assessment and unsuitable collaterals in the fact that post-socialist transition was never completed fully. Returning to the debate of gradualism vs. shock therapy. While on the one hand, it is true, that privatization was done poorly (Stojan, 2014) as it, most often just rebranded the elites of the old regime. In the transition, the most powerful state-owned firms were 'bought' by those that were already in some sort of power or have been economically powerful. If they were not bought, then they were managed by the state or politically connected personas. And since this created strong (in)formal networks consisting of actors that managed state own banks, state own businesses as well as managers of private businesses (Dobovšek, 2008) the latter were given credits due to these informal connections. As Damijan (2013) puts it, the credits were given regardless of the political colour or political orientation, but if the project was risky, political connections helped. And all was done just that the economic growth hype would continue. Undoubtedly such usage of informal connections among Slovenia's political and economic elite worsens the banking crisis. On the other hand, the absence of due diligence, negligence, poor risk assessment and overall, extremely high-risk behaviours were present in financial sectors and banking all over the world. Even in those that did not have socialistic history. This returns us to the debate of slipped capitalism or criminal behaviour as the reason for the crisis.

3 Is the Slovenian banking hole also the result of financial crime?

As banks were seen as crucial contributors to the extreme post-2008 crisis worsening of the financial situation in Slovenia, several inquiries were deemed necessary. Besides journalistic exposé (MMC RTV Slovenija, 2018), undergraduate thesis (e. g. Pirnat, 2016) five insights are worth mentioning. Listed in chronological order – according to the year when inquiries started: (i) The comprehensive review of the Slovenian banking sector undertaken by the Bank of Slovenia in cooperation with the Slovenian Ministry of Finance over the period June to December 2013; (ii) Commission for the Prevention of Corruption, examinations of the operations of the two biggest banking groups, the NLB Group and the Nova KBM Group, in which the State of Slovenia had a majority shareholding or dominant influence; (iii) Investigation into the causes of the Slovenian banking hole by the Specialised State Prosecutor's Office of the Republic of Slovenia; (iv) Commission of Inquiry to determine the abuses in the Slovenian banking system and to determine the causes and responsibilities for the already second rehabilitation of the banking system in independent Slovenia. The Commission works within the National Assembly; (v) The Court of Audit of the Republic of Slovenia issued an audit on the Bank of Slovenia's supervisory functions.

(i) Review of the Slovenian banking sector by the Bank of Slovenia in cooperation with the Slovenian Ministry of Finance. The review was done over the period from June to December 2013. It consisted of the Asset Quality Review and Stress Test which were closely monitored by international organizations: the European Commission, the European Central Bank, and the European Banking Authority. This Asset Quality Review and Stress Test's specific goals were to determine whether the Slovenian banking system could withstand a three-year stress scenario of deteriorating macroeconomic and market conditions and to calculate the amount of capital that each participating institution would need in that scenario. The Bank of Slovenija chose eight banks, representing approximately 70 per cent of the total Slovenian banking sector in terms of end-of-year 2012 assets (NLB, NKBM, Abanka, UniCredit Banka, Banka Celje, Hypo Alpe Adria Bank, Gorenjska Banka and Raiffeisen Banka). Thus, after reviewing assets and performing stress tests in eight banks in Slovenia, the capital requirement was estimated at € 4.778 billion. Bad assets were transferred to the Bank Assets Management Company, while the recapitalization of banks was carried out from the budget of the Republic of Slovenia (Banka Slovenije, n.d.).

(ii) In 2011 and 2012, the Commission for the Prevention of Corruption examined the operations of the two biggest banking groups, the NLB Group and the Nova KBM Group, in which the State of Slovenia had a majority shareholding or dominant influence. The Commission for the Prevention of Corruption (2023) states that it 'is not a detection and prosecution body in pre-trial or trial criminal proceedings, but it does possess certain executive, supervisory, and investigative (administrative) powers.' The Commission frequently investigates behaviours in cases reported to it and sometimes self-initiates inquiries into specific high-corruption-risk fields (e. g. public procurements, elements of the healthcare system, etc.). Based on the inquiry specifics and inquiry outcomes, the Commission publishes various types of reports. In cases where it finds that an act under its investigation has signs of criminality, criminal charges are filed (Komisija za preprečevanje korupcije, 2020).

According to the Integrity and Prevention of Corruption Act (2011), which governs the work of the Commission, it can fine legal entities for violations of the Act or inadequate cooperation with the Commission.

As part of its systemic control, the Commission examined more than 40 transactions concluded by companies from the two banking groups in Slovenia, Croatia, and Bosnia and Herzegovina, covering the period from 2005 to 2011. In this context, the Commission examined loans granted, receivables, repurchases of receivables, project transactions, leases, and the purchase and sale of shares. Through a systemic analysis, the Commission detected and identified suspicious criminal transactions and corruption risks in the Slovenian banking system, classifying them into four areas (Komisija za preprečevanje korupcije, 2013). (a) The area of bank investment treatment and approval procedures: informal delegation of business, non-transparent implementation of investment approval procedures, exposure of bank managers and executives to investment approval risk based on personal, business, and political connections, a non-transparent system of keeping minutes of credit committees and bank boards, the existence of informal power centres within sectors and directorates within the bank, and powerful individuals outside the bank. (b) The area of conduct of members of banks' boards of directors and supervisory boards: members knowingly violated applicable laws and adopted codes of ethics, failed to address irregularities identified in audit reports, failed to take appropriate measures to establish liability for damages and criminal liability, and failed to recall or remove members of the board of directors. Additionally, members of management and supervisory boards are exposed to conflicts of interest. (c) The area of staffing of the banks' boards of directors, supervisory boards, and senior management levels within the banking group: high exposure to the risk of appointing persons with a history of controversial, unscrupulous, and unethical behaviour; exposure to appointing persons who lack professionalism and experience in banking; non-transparent selection and appointment procedures for senior management in banking groups; and political recruitment and clientelism. (d) The scope of the Bank of Slovenia's competencies: failure to implement legal options and measures to manage risks and non-performing investments of banks, inadequate responsiveness to irregularities identified in investment approval procedures, uncritical assessment of the professionalism of persons and disregard for past controversial behaviour in authorizing bank board members, conflicts of interest and bias in bank supervision, and ineffective supervision of bank operations.

The Commission's 2011 report describes the above-mentioned behaviours that show clear signs of corruption, noting that some actors did not cooperate with the Commission. However, the report does not mention whether any fines were issued (Komisija za preprečevanje korupcije, 2013).

(iii) Investigation into the causes of the Slovenian banking hole by the Specialised State Prosecutor's Office of the Republic of Slovenia. To establish the link between the Slovenian banking hole and banking crime, it is necessary to define banking crime. The Specialised State Prosecutor's Office of the Republic of Slovenia (Vrhovno državno tožilstvo Republike Slovenije, 2020) defines banking crime as offences against banks, where the perpetrator has a managerial or supervisory function and where significant damage has been caused or significant financial illegal gain has been obtained. The Specialised State Prosecutor's Office of the Republic of Slovenia states that the key dilemma concerning bank credit transactions under examination is the distinction between a wrongful and harmful business decision. This means on the one hand, a business decision for which responsible bank staff cannot be held liable, either in damages or in criminal law, due to the circumstances in which it was made, and on the other hand, a decision that constitutes a serious and manifest breach of the standard of care of a conscientious and honest businessman, potentially leading to legal, civil, or criminal liability.

To investigate banking crime more effectively, a specialised investigation group was set up in 2012, including representatives from criminal investigators, the Commission for the Prevention of Corruption, the Office for Money Laundering Prevention, and representatives from the Bank of Slovenia, under the leadership of the Specialised State Prosecutor's Office of the Republic of Slovenia (Vrhovno državno tožilstvo Republike Slovenije, 2020).

To assist the police and prosecutors in identifying and investigating banking crime or irregularities in banking practices, the Bank of Slovenia established a special inspection group in April 2014. This group assisted in interpreting the content, identifying facts and circumstances, and recognizing forms of suspicion of criminal offences in banking, including violations of the Banking Act (ZBan-1, 2006), the decision on risk management, and other legal principles. Inspectors with expertise in credit risks and equity instruments were engaged, and a forensic scientist licensed as a bankruptcy trustee and company valuation appraiser was included. In 2016, the Bank of Slovenia changed the status of the special inspection group, integrating it into the banking supervision department (Banka Slovenije, 2016).

The special inspection group's work revealed 18 *modus operandi* or forms of bad banking practice, which could be defined as negligence or abuse of position, including: (a) takeover loans channelled through friendly companies or even suppliers, violating the Banking Act's maximum allowed exposure; (b) exceeding the permissible exposure of related companies; (c) increased lending activity to extended or close family members of those in management or supervisory boards; (d) repo or option contracts allowing banks to avoid acquiring a qualifying holding; (e) banks acting as share parking lots for acquiring companies, enabling them to avoid submitting a takeover bid; (f) loans to seemingly unrelated companies, with an option agreement to assume credit obligations of the target company; (g) inappropriate recapitalization forms through clauses for repurchasing subordinated instruments or equity securities, misleading the supervisor; (h) failure to exercise due diligence in lending processes; (i) manipulations of insurance valuations; (j) manipulations in real estate transactions, granting loans for overvalued properties or land without clear spatial plans, potentially causing damage if the land doesn't become building land; (k) misuse of credits; (l) bank management decisions beyond professional services, credit committees, and risk management committees; (m) abuse of the institute of personal bankruptcy; (n) moral hazard in connection with purchasing bad debt receivables sold by the Bank Assets Management Company, risking former owners buying their debts at a discount; (o) abuse of compulsory settlement, where debtors propose settlement while draining the company; (p) issues with commercial banks showing the will of the injured party; (q) allegations identifying related transactions, exemplifying bad banking practices.

The special inspection group stressed that criminal denunciations must contain all the necessary elements crucial for identifying criminal offences, as it makes no sense to burden the Specialised State Prosecutor's Office with criminal charges that do not meet this criterion.

The quality, not the quantity, is what matters (Preiskovalna komisija, 2018). Not every act of bad banking practice is a criminal offence, as all the elements of a specific offence must be fulfilled. In the Republic of Slovenia, the economic crimes with the highest material damage are abuse of position or trust in economic activity, economic fraud, abuse of official position or rights, detriment to creditors, fraud, tax evasion, detriment to creditors and causing bankruptcy by fraud or dishonesty (Policija, 2023).

The Specialised State Prosecutor's Office of the Republic of Slovenia identified controversial lending practices by commercial banks, characterized as follows (Vrhovno državno tožilstvo Republike Slovenije, 2019): (a) The granting of credit contrary to the standards and principles of acceptable bank lending practices. (b) The granting of multimillion or tens of millions of euros of credit to ad hoc companies set up by managers as acquirers, registered solely for carrying out management takeovers with minimal start-up capital, even though they knew these borrowers would never repay the large loans. (c) An incomprehensible policy of securing loans contrary to the principle of mandatory provision of two exits, where some loans were secured only by pledging non-marketable securities or not secured at all. (d) Several loans for management takeovers granted solely based on a promise to secure the loan with shares of the target company A and to merge it with company B, which would then repay the loans, exposing banks to a scissors effect, diminishing company cash flows and collateral values, while misleadingly claiming project financing. (e) Lending to managers for large private projects without collateral or personal guarantees. (f) The rescheduling of credit transactions on increasingly unfavourable terms to the bank, particularly in financial holding companies for corporate takeovers. (g) Management ignoring qualitative assessments of bank analysts regarding clients' solvency and creditworthiness, adjusting credit ratings for loans that otherwise would not have been granted. (h) Granting credit to favoured representatives of political, corporate, and banking elites, supposedly to preserve national ownership or interest. (i) Disregarding professional judgments on assets pledged as collateral for credit exposure, uncritically accepting valuations made in the client's interest.

From 2013 to the end of 2018, 97.8 per cent of banking crime offences were investigated (Policija, 2019). In 2020, the National Bureau of Investigation completed the investigation into the last so-called banking crime reported between 2013 and 2019 (Policija, 2021). The Joint Annual Report on the work of the Public Prosecutors' Offices states that 'By the end of 2020, 16 judgments had been handed down in banking cases, 14 of them convictions, against 23 people, 18 of them bankers. 9 convictions for 12 persons have become final' (Vrhovno državno tožilstvo Republike Slovenije, 2021). 'The total damage or benefit value in court cases amounts to around €367 million' (Vrhovno državno tožilstvo Republike Slovenije, 2022).

In 2016, the former director of the Slovenian Criminal Police's specialised department for detecting and investigating the most complex forms of financial crime stated that 230 suspected bank fraud crimes had been detected, mostly involving state-owned banks, with an estimated damage of around €783 million (Ba. Pa., STA, 2016). However, not all suspected crimes have been confirmed. The Specialised Public Prosecutor's Office reported that by 2020, damage caused or proceeds obtained in court cases amounted to €305 million, with 16 judgments, 14 convictions, against 23 people, 18 of them bankers (Vrhovno državno tožilstvo Republike Slovenije, 2021). According to official figures, approximately 5 per cent of the Slovenian banking hole is due to banking crime, but as said, we may never know the true proportion.

(iv) Parliamentary commission within the National Assembly of the Republic of Slovenia inquired into abuses in the Slovenian banking system and the causes and responsibilities for the second rehabilitation of the banking system in independent Slovenia.

A working body, the Commission of Inquiry to determine the abuses in the Slovenian banking system and to determine the causes and responsibilities for the already second rehabilitation of the banking system in independent Slovenia, was established within the National Assembly of the Republic of Slovenia in 2015. It concluded its work in 2018 when it issued its final report. The main findings are as follows (Preiskovalna komisija, 2018): (a) The Bank of Slovenia had neglected the credit risks accepted by banks into their portfolios during the period of expansionary credit growth. (b) NLB's management and credit committees bear objective and subjective responsibility for taking too slow and inadequate action in the management of bad investments. (c) NKBM's management and credit committees bear criminal and tort liability for bad banking practices, criminal offences, inadequate supervision of banking operations, non-compliance with professional warnings, and inadequate supervision of subsidiary operations. (d) The supervisory boards of NLB and NKBM did not perform supervision in accordance with the due diligence of the Banking Act. Several conflicts of interest and excessive cohesion between bank management boards and supervisory bodies were found, leading to inadequate supervision of bank management operations, and increasing the cost of rehabilitating the banking system for taxpayers. (e) Successive governments of Slovenia have shown a lack of political will to find those responsible for the first banking hole, which contributed to the second banking hole, as bad banking practices and those responsible went unsanctioned. Consequently, abuse thrived in the post-rehabilitation period. This blame lies with the governments from 1997 to 2002, while the government also failed to complete the privatization of NLB between 2004 and 2008, allowing structures to continue bad banking practices and relocate to branches and subsidiaries outside Slovenia, where another banking hole emerged.

(v) The Court of Audit of the Republic of Slovenia issued an audit on the Bank of Slovenia's supervisory function on December 9 2020 (Računsko sodišče, 2020). It audited the effectiveness of the Bank of Slovenia's supervisory practices that led to Slovenia's budget expenditures from the beginning of 2008 to November 4, 2014. The audit has two main parts.

In the first part, auditors examined whether the Bank of Slovenia had a control system in place between 2008 and 2013 to ensure the effective supervision of banks' operations, particularly capital adequacy and credit risk management. The objective was to assess the adequacy of the supervision's planning, implementation, measures imposed, and monitoring. The Court of Audit considers that the Bank of Slovenia was partially successful in this component.

In the second strand, auditors examined whether the Bank of Slovenia based the imposition of extraordinary measures for bank recovery in 2013 and 2014 on adequate grounds. The objective was to determine whether due diligence, the Asset Quality Review (AQR), stress tests, and asset valuations for banks assuming a going concern provided an adequate basis for imposing extraordinary measures. In the Court of Audit's opinion, the Bank of Slovenia did not perform well in this strand.

Regarding the second strand, the Court of Audit considered that: (a) The methodology for the AQR had not yet been agreed upon at the time the AQR contract was concluded. (b) The Bank of Slovenia was unsuccessful in ensuring that the methodologies between the AQR contractors were harmonized, as there were significant methodological differences in the implementation of the AQR. (c) The collection of information on properties placed as collateral using drive-by and desktop approaches did not allow for achieving the required International Financial Reporting Standards' criteria. (d) The Bank of Slovenia did not obtain from the AQR providers all the materials and calculations that would have enabled it to carry out checks on the implementation of the additional impairments required, the purpose of the AQR being, inter alia, to provide input data for the stress tests. (e) Even after completing the bottom-up stress tests, the Bank of Slovenia did not have a comprehensive document describing the entire bottom-up stress test methodology. (f) The total expected capital shortfall of the banks in the adverse scenario amounted to €4.779 billion and was calculated as the difference between the expected loss of €10.364 billion and the absorption capacity of €5.586 billion. (g) In December 2013, the Bank of Slovenia imposed on NLB, NKBM and Abanka an extraordinary measure to terminate all the banks' qualifying liabilities and an extraordinary measure to increase the share capital. (h) The Bank of Slovenia justified the failure to provide the minimum capital on the basis of the banks' statements of financial position assessments through the identification of negative (accounting) capital, while the Court of Audit could neither confirm nor deny that the banks' statements of financial position assessments were prepared in accordance with the Decision on loss assessment (including compliance with the International Financial Reporting Standards).

From all five inquiries, it is clear that not only bad business practices but also behaviour with heavy signs of criminality were present for an extensive period. The report from the Commission for the Prevention of Corruption also shows that even though a person exhibited unethical and unsuitable behaviours, they were still permitted to be part of decision-making bodies (Komisija za preprečevanje korupcije, 2013). While law enforcement reports (Policija, 2019; 2021; Vrhovno državno tožilstvo Republike Slovenije, 2020; 2021; 2022) show that some actors were convicted in criminal trials, it is unclear how many received prison sentences and are in prison and more importantly, how many were top management and not middle or lower management scapegoats. This is a question asked in other countries when prosecuting crimes in banks (Pontell et al., 2014; Sturc, 2023). Research into the Slovenian banking hole was conducted to gain needed insight.

4 Research and methodological framework

A pilot study comprising 10 structured interviews with ten experts experienced in exposing, investigating, researching, and preventing economic crimes was conducted between 28th September and 7th November 2018. The characteristics of the interviewees are presented in Table 1.

Table 1 Characteristics of the interviewees and information about the interviews*

Interview Serial No.	Position/job/area of activity	Duration of the interview
1	a member of the National Assembly and president of its working body the Commission of Inquiry to determine the abuses in the Slovenian banking system and to determine the causes and responsibilities for the already second rehabilitation of the banking system in independent Slovenia	41:41
2	The Commission for the Prevention of Corruption	26:17
3	an advisor to the President of the Republic of Slovenia/The first Governor of the Bank of Slovenia/former CEO of a commercial bank	43:17
4	a bad-debt manager	34:17
5	The National Bureau of Investigation	47:00
6	a full Professor of International Economics and Business	29:54
7	a full Professor of Economics	46:07
8	a journalist, an editor of the Delo newspaper	36:21
9	The Specialised State Prosecutor's Office of the Republic of Slovenia	25:29
10	a forensic investigator	44:37
AVERAGE INTERVIEW TIME		00:37:30
TOTAL DURATION OF INTERVIEWS		6:15:00

* All interviews were done in person. To safeguard the anonymity of some of the interviewees, the precise date of the specific interview is omitted from the table, but the data is available with the first author of the paper.

The aim of the research was to find out (i) the reasons for the emergence of the banking hole in Slovenia, (ii) how effective the investigation of the banking hole was, (iii) where the biggest problems were, and (iv) what needs to be done to make the detection and investigation of financial crime more effective in the future.

We wanted to gather all interviewees' views on the material under discussion, despite their diverse backgrounds. We aimed to understand how economists and financiers view financial crime, how criminal investigators perceive the financial and economic situation, and how journalists view the investigation of financial crime. Through the responses of all interviewees, we sought to bring together views of experts from different institutions and go beyond institutional constraints.

To analyse the interview transcripts, we used MAXQDA Analytics Pro 2022, a software tool for analysing interviews with capabilities for coding, commenting, and color-coding based on previously defined concepts and codes prepared from a literature review. All interviewees were asked the same five questions: (i) The introductory question asked for their opinion on Slovenia's current economic and financial situation compared to Europe and worldwide. (ii) The second question focused on the reasons for the emergence of the banking hole in Slovenia and how relevant institutions dealt with it. (iii) The third question asked about the effectiveness of detecting and investigating crimes linked to the banking hole. (iv) The fourth question asked for their personal experience regarding the banking hole, including opinions on shortcomings and problems during criminal investigations. (v) The fifth question sought to understand what commercial banks, the Bank of Slovenia, the police, the prosecutor's office, courts and other state bodies need to do to prevent a repeat of the banking hole and make detection and investigation more effective.

The analysis results are presented in five sets, according to the questions asked. For reporting purposes, where several interviewees had the same or similar answer, their responses are grouped together, while individual responses are included only when they differ from the rest.

From the answers to the first question, we conclude that the financial and economic situation in Slovenia in the last quarter of 2018, when the interviews were conducted, was favourable and comparable to countries in the Western world. However, in such favourable economic conditions, banks usually relax their lending criteria, which leads to an increase in borrowing and a rise in the prices of real estate and financial products. This behaviour, without adequate internal supervision by commercial banks and regulatory supervision by the banking market regulator, risks a resurgence of bad loans and a crisis in the financial markets. Thus, it is important to consider how much commercial banks and the banking market regulator have upgraded their systems for supervising and preventing abuses and irregularities in credit granting. The economy was already overheated by the end of the year, increasing the risk of a new financial and economic crisis in the years to come. Somewhat more than a year later, the global Covid-19 pandemic occurred, which affected not only the economic and financial markets but also transformed global society.

From the answers to the second question, we see that the interviewees consider the reasons for the Slovenian banking hole to be: (i) External or International: High liquidity on international financial markets in the years before the global financial crisis. (ii) Internal or State-Level: Granting credit without adequate collateral and not meeting minimum approval conditions, and personal acquaintances between entrepreneurs and bank managers. (iii) Combination of International and Internal: Slovenia joined the EU, and commercial banks operating in Slovenia paid lower interest rates for credit, resulting in higher profits for them when granting credit to forward companies, thus relaxing their credit-granting criteria.

Abuses and financial crime also occurred. The banks' internal controls failed or were inadequate and insufficient, which allowed this to happen. The state's and banking regulator's responses to the financial crisis were inadequate and untimely. This led the public to place its hopes in the criminal police, expecting them to investigate all suspected crimes as soon as possible. When this did not happen, it was all the more disappointing.

For the third question, interviewees stress that detecting and investigating financial crime requires specialized knowledge in banking, finance, and forensic investigation. Experience and practical knowledge of banking transactions, a passion for investigative work, and a desire to establish the reality of the situation are also crucial for complex forms of financial crime. The criminal police quickly started investigating the financial crime after receiving initial information and reports and cooperated with other institutions that could provide useful information and assistance. To this end, a specialised investigation team was set up to investigate banking crime. However, questions remain about the capacity of competent authorities to investigate complex forms of derivative financial transactions, carry out sophisticated forensic investigations, and deal with interconnected banking transactions. The investigation of crimes related to the Slovenian banking hole showed that investigation and prosecution practices in banking crime are modest, with no clear lines drawn between bad banking practice and criminal offence. A major obstacle in investigating financial crime is the collection of evidence, as the perpetrators are usually intelligent people with influence in their business environment who leave no trace. Additionally, the delayed nature of financial crime consequences poses difficulties for investigations. The more distant the time, the harder it is to obtain evidence, as documentation is destroyed or lost, and people with relevant information may forget it or be unwilling to recall past practices, leading to delayed investigations or unconfirmed suspicions.

In answering the fourth question, interviewees had varied levels of experience with financial crime. Criminal investigator and prosecutor had the most practical experience, explaining how their work involved investigating and prosecuting financial crime. The journalist encountered it while monitoring managerial takeovers and analysing links individuals on boards of companies and banks, noting the problem of the same individuals moving between positions in different companies and banks, carrying bad business practices with them. A forensic investigator with practical experience in investigating financial crime has also detected suspected financial crime through her work.

From the answers to the fifth question, we conclude that a specialised court with judges trained in the most serious forms of financial and economic crime is needed to combat financial crime more effectively. Criminologists, prosecutors, and judges should receive regular additional training in banking, finance, and economics. In cases of complex financial crime, external experts with specific skills and experience should be engaged more frequently. Prevention is also crucial, and both commercial banks and the banking market regulator need to be more aware of their responsibilities in preventing abuse. Preventing and containing financial crime also mitigates the direct and indirect damage it causes. Criminal investigators detect and investigate financial crime that has already occurred, but proving suspicions of crime is time-consuming and difficult.

5 Discussion and conclusion

The Slovenian banking hole refers to the capital shortfall in the Slovenian banking system due to bad loans, which amounted to more than €7.1 billion at the end of 2012. The bulk of the bad loans, around €6 billion, originated in banks directly owned by the state. This was the amount of taxpayers' money used to recapitalize the banks.

We note several reasons for the Slovenian banking hole, which are interlinked. During the global financial and economic crisis, liquidity in global markets was reduced, and Slovenian banks found it much more difficult to borrow on international markets and had to repay the loans. Lacking the financial means to repay, the banks did not extend credit to clients but demanded repayment of funds lent. Some companies faced financial difficulties due to the global economic crisis, which sharply reduced demand for their products and services, making them unable to repay their loans to the banks. Many companies that had taken out short-term loans for a long-term purposes extended these loans as they matured during favourable economic and financial conditions. They were caught by surprise by the financial crisis and did not have the financial means to repay their loans, which were insufficiently secured or not secured at all. The bulk of the loans used to finance management takeovers were also inadequately secured.

Responsibility for this lies with the internal control departments, credit committees, and the banks' managements, which allowed bad business practices to occur. Part of the responsibility also lies with the central bank, which, despite rapid balance sheet growth, did not react quickly and decisively enough to supervise credit collateralization adequately. The state, as an owner, also bears responsibility for failing to prevent such behaviour.

The study's findings echo those of others (Damijan, 2013; Komisija za preprečevanje korupcije, 2013). In most cases, this was bad business practice linked to banks' desire to attract new customers and maximize profits. Banks proved to be economic actors prone to high-risk behaviours, losing sight of the damage this can cause. Yet, the unanswered question is whether banks, especially state-owned ones, should be bound to a model of corporate social responsibility. Calls for such managerial models typically arise after crises caused by big businesses, though scholastic works on the issue seem unpopular (de Bakker et al., 2020). As Sturc (2023) notes for the United States and Slovenia, no law prohibits bad business practices. This reinforces the idea that the main purpose of business is business, not solving social issues. This returns to Adam Smith's (1776) idea of the invisible hand of the market, successfully advocated by Friedman (2002), suggesting that in pursuing self-interest, society benefits. However, Smith's idea includes integrity and ethics, which are absent from present-day and 1980s neoliberal discussions. If some pre- and post-2008 banking problems were the result of crimes, they cannot also be ethical. The Slovenian and global bad loans significantly result from financial crime, as these loans would not have been granted otherwise. In the Slovenian case, only after all judgments on banking crime that predate the financial crisis become final, we will have an indication of how much of the banking hole is due to banking crime. However, the true proportion may never be known.

Indeed, criminal investigators face difficulties in detecting and investigating financial crime, especially its complex forms. Perpetrators are influential, intelligent people with good connections, who ensure no trace is left, and people hesitate to testify against them due to fear of reprisals, including loss of employment, business opportunities, and damage to their reputation and loved ones. This makes it difficult for criminal investigators to gather initial information and documents related to transactions suspected of banking crime. Additionally, it often takes a long time to uncover the first clues, complicating proving suspicions. An active role from regulators is crucial. Pontell et al. (2014) note that when regulators alert institutions about problematic behaviour in economic sectors, perpetrators are caught and brought to trial. This did not happen in Slovenia or elsewhere regarding the latest economic crisis.

Criminal investigators must be guaranteed to work independently, regardless of political developments in the country, and must receive continuous training in financial instruments, IT systems, and cybercrime. Prosecutors and judges also need additional skills in these areas. The courts' work should be reorganized so that specific judges handle only the more serious forms of economic and financial crime, instead of all judges addressing all types of crime. This would make it easier for them to receive professional training and to upgrade their knowledge in these areas.

On the other hand, preventive measures must be put in place. Stronger regulation and oversight are crucial, something learned after every economic or financial crisis and even implemented. Yet, as soon as things improve, state financial regulators seem to loosen regulations (Pazzanese, 2023). For Slovenia, due to strong informal networks and revolving door phenomena, business transparency must be increased, accompanied by further development of ethical codes (Komisija za preprečevanje korupcije, 2013). The revolving door phenomenon, or the fact that those most responsible for the banking problems of 2008 remain in power, is not limited to Slovenia. Larry Summers, a former Treasury secretary, led the charge to deregulate the derivatives market and played a known role in the processes leading to the 2008 financial crisis (Hirsh, 2013). Even more interesting is the story of Barney Frank, one of the authors of the Dodd-Frank Act, created after the 2008 financial crisis to restore regulation and consumer safeguards omitted in the 1980s deregulation. Frank, after leaving Congress, joined the Signature Bank board and endorsed changes to the act, raising the $50 billion threshold for intense bank oversight to $250 billion. This reduced the number of banks subjected to scrutiny from a few dozen to just one dozen (Enrich, 2023). While the Signature Bank collapse cannot be solely attributed to this, it still 'helped'. Although Frank did not change his mind about the Dodd-Frank Act, the threshold change he supported aided the act's opponents. Even though no evidence links Frank's board position to this change, it led to a conflict of interest due to the revolving door phenomenon.

Crime in the financial sector will not disappear, as this sector is a natural breeding ground for criminal behaviours, offering high reward and low personal risk (Pontell et al., 2014; Ruggiero, 2019). Since many banking actors 'are too big to fail', this aligns with what Sturc (2023) noticed – that investigations into banks could damage their reputation, trigger bank runs, and financial problems to solve, thereby protecting their behaviour from prosecution. The financial sector's uncertainty (Ruggiero, 2019) almost mimicking the idea of the fog of war (Clausewitz, 2022) or as Kiesling (2001) notes, uncertainty in war and combat. Sturc (2023) also observed such narratives, and this uncertainty makes it hard to blame someone for a lack of due diligence. All is fair in love and war, and seemingly, in big business too.

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