

Part Four

STRUCTURING AND CONDUCT OF BANK SUPERVISION IN BULGARIA

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General Structure and Characteristic of the Trends of Development of the Bulgarian Banking System

Studying the structure and general condition of the banking system requires commercial banks to be divided in similar groups and by this means the indexes for their financial status will become comparable. The basic criteria for the Directorate would be the size of the respective bank, determined by the relative share of the balance sheet assets of the bank in the balance sheet assets of the whole banking system. Banks are divided into four groups:

- **Group I** - including the major banks. The group consists of seven state owned banks and makes up 71.8% of the banking system as per balance number as of the end of June 1997. The biggest banks in the group are Bulbank and the State Savings Bank (SSB).

- **Group II** - including small and middle size banks with primarily privately owned share capital (only one with primary state owned and one municipally owned share capital). The group consists of 16 (sixteen) banks and makes up 9.4% of the banking system.

- **Group III** - including all banks with foreign share capital and banking branches. The group consists of four banks and five banking branches and makes up 4.2% of the banking system.

- **Group IV**- including all banks, declared bankrupt by the court up to the end of 1997. The group consists of 16 (sixteen) banks, making up 14.5% of the banking system up to the end of the half of the year. They were not taken into consideration while characterizing in general the financial situation of the banking system because their licenses were deprived and essentially they are no more part of the banking system.¹

¹ *Group I* includes: United Bulgarian Bank (UBB), Commercial Bank "Expressbank", Bulbank, State Savings Bank, Commercial Bank "Biochim", Commercial bank "Hebros", Bulgarian Post bank.

Group II includes: Bulgarian Commercial and Industrial Bank, International Ortodoxal Bank "St. Nikola", Capital Municipality Bank, First Investment Bank, Unionbank, Corporation Bank, Commercial Bank "Creditexpress", Trakiabank, First East International Bank, "Teximbank", Commercial Bank "Bulgaria - Invest", Balkan Universsal Bank, Credit Bank, Central Coperative Bank, Bulgarian Russian Investment Bank, International Bank for Investment and Development.

Group III consists of: Bairish Bulgarishe Handelsbank, ING Bank Sofia branch, raifeizenbank, Eurobank, Commercial Bank "Xious" Sofia branch, National Bank of Greece, BNP Dresdner Bank, Bulgarian Investment Bank, Yonion Bank Sofia branch.

Group IV consists of: Bissnes Bank, Commercial bank "Elit", Dobrudja Commercial Bank, Commercial bank "Kapitalbank", Agricultural Credit Bnak, International bank for Investment and Development, Commercial Bank "Balkanbank", Private Agricultural Bank "Agrobusinessbank", Economic Bank, First Private Bank, Commercial bank "Krisstalbank", Commeccial Bank "Slaviani", Commercial and Saving Bank, "Mineralbank", Agricultural and Industrial Bank, Private Agricultural and Ivestment Bank.

The general situation of the banks may be characterized by the following – they are in a long-lasting stagnation, which will last comparatively long time. Most of the operating banks managed to improve their capital adequacy by provisioning most of their bad debts. We should stress on the fact that commercial banks managed to increase the volume of their provisions for classified credits due to the high net incomes accumulated as a result from exchange rate divergences, incurred by the devaluation of the leva. Increase of legal provisions is to a great extent resulting from the revaluation of the current exchange bad debts and other current exchange assets. Credit granting limitations

(imposed by the economic crisis and the activities undertaken by the executive power and the Bulgarian National Bank), combined with the real devaluation of bank liabilities resulting from the last year and the begging of this year hyperinflation are the determinant factors for the improvement of liquidity in the middle of the current year. High liquidity combined with low credit demand and low budgetary demand for inside credit granting is the main reason for the record breaking low interest rates for the last months.

In the system of a Currency Board no possibility exist for losses to be liquidated by the means of exchange rate divergences and the accumulated bad debts of banks in poor financial situation continue to influence negatively. This is of a great importance mostly for banks, which according to the new accounting standards are obliged to provision in whole their bad debts and are respectively reporting losses. The economy in general is in stagnation and going out of it may be expected only if the privatization process speeds up and foreign investments are attracted. These are not single and quick processes and even if they succeed their positive influence will be felt after certain period of time. Simultaneously the currency board system led to harsh decrease of interest rates and the currency exchange rate was fixed. This created favorable conditions for activating the long term investment credit granting.

Now the banking sector is static and this is imposed by the stagnation in the real economy, which followed the hard recession. Clients' thrust in the banking system is low and the result is that banks continue to be very liquid without being able to operate normally due to the narrowed banking services market. Bank services profitability is low due to the little credit demand and offering, the fixed currency rate gives no opportunity inflation incomes to be accumulated through the exchange rate divergences mechanism. These process influences differently on different banks and the process of market selection for the participant in the banking market continues. The general system risk in the banking system is most substantially influenced by the financial situation of the seven major banks. The banks form group I are with

the lowest value of capital adequacy and at the same time are most dangerous for the stability of the banking system. The correlation between net capital/balance sheet assets for group I is 3.6%, whereas for the banks from group II and III – 15.4% and 7% respectively. Liquidity of banks from group I although high is lower than that of banks from group II and III. The correlation amounts accumulated from financial institutions/total amounts accumulated is 38% for group I and 23% and 17% for groups II and III respectively, which shows that some of the major banks are not able to overcome their dependence upon the accumulation of interbank deposits. The correlation monetary funds/amounts accumulated from non—financial institutions and monetary funds/total amounts accumulated indicates the higher liquidity of small, middle size and foreign banks. for group I they are 27.5% and 17% respectively, for group II – 49.3% and 38.2%, for group III – 30% and 24.6%.

In worst situation out of the seven major banks are those with big credit portfolio and great comparative share of bad debts respectively, and at the same time too widened branches network. That is the reason those banks to be most severely influenced by the stagnation, low profits accumulated from bank operations and the prolonged crisis. Here should be added that low interest rates and respectively narrowing of interest rate margins influences negatively on commercial banks profitability. And again this process affects to a great extent upon major banks, which have high operational expenses for personnel and branches network.

In principle till now in the Bulgarian banking system was applied the principle the greater the volume of granted credits and the wider the branches network are (both conditions given together) the more are stability and survival of the bank in danger. The reason is that due to the great credit expansion comparatively fast losses from bad debts were accumulated and this was combined with the high operational expenses for maintenance of wide network of branches and equity. Combination of those factors led to worsening the financial situation of those banks.

Should be taken into consideration that for the comparatively small Bulgarian economy most rational would be the oligopolistic structure of the banking system, according to which 70% of the system's assets are controlled by 3 to 5 banks. Observing the hitherto prevailing processes in the banking system leads to the conclusion that even 7 major banks are too much for the narrowed banking market. When depositors start to recover their thrust in the banking system, which will be a slow and step by step process, the accumulated amounts will be directed mainly to major banks which are in comparatively good financial situation because of the higher stability they may offer (these banks are the most stable against financial crisis). big

industrial companies to be served by big banks with enough credit resource is an inevitable market requirement (banks, which do not have to accumulate/accumulated funds from the international market). Only comparatively big banks can provide necessary financing and other services for bigger industrial companies and at the same time control their solvency. By these means the continuing process of concentration in the banking sector may be explained. The concentration index (Herfindal-Hishmann index), calculated on the grounds of the total assets of the banking system increased at the end of July up to 0.25 (0.30 without any banks closed), compared to the end of the last year (0.17 and 0.27 respectively). The same results are obtained when the index is calculated for the total amount of claims from non-banking institutions – it increased from 0.19 (0.41 without any banks closed) at the end of 1996 to 0.45 and 0.56 respectively in July. Due to these processes it is to a great extent possible to presume that some of the major banks in not so good financial situation will vegetate long if they do not manage to adapt to the new conditions and will be pushed out to the periphery of the financial markets and through the time their importance for the banking sector will decrease and their comparative share into the total assets will become smaller considerably. The same process takes effect for banks in poor financial situation from the group of small and middle size banks and problems should be expected with banks with the biggest credit portfolio from this group (the biggest banks from the group).

A process of gradual and moderate development in bank operations, especially in the credit granting is observed in big banks in comparatively good financial situation. This process is limited. In the first place due to the big shock from the previous year financial crisis (according to the data from the end of 1996, 24% of the assets of the system are in 14 banks that were closed and this determines the prevalence of pessimistic expectations of the economic agents) banks are striving to restrict to the maximum the credit granting. Due to the same reason the credit demand of the real economy will remain low at least for a short period. In the second place still budget restrictions and moral gambling in the economy prevails, very important especially for commercial banks are the still insufficient legal protection of the creditors' interests, the lack of thrust in the relations creditor- borrower and the resulting from the undeveloped market limitations for realization of guarantees and this makes the banks to be extremely cautious while granting credits. In the third place recapturing depositors' thrust in the banking system is difficult and long process and this will limit the increase of accumulated amounts and the credit resource. In the fourth place in the system of a currency board the possibilities for the BNB to support commercial banks in liquid crisis by the means of

refinancing are extremely limited and this constrains banks to limit credit granting and to maintain high liquidity levels. Commercial banks already know that they are not insured against license deprivation and bankruptcy declaring in case they suffer financial difficulties the rules of the game are completely different compared to those of 1991-1995. In the fifth place the requirements of the new Law on Banks and the new Regulations about capital adequacy, evaluation of risk exposures of banks and formation of provisions for covering the loss risk, bank liquidity, big and internal credits of banks and others are considerably stricter, in compliance with the accepted international rules. This is another motive for limitation of credit activity – especially for granting of big credits.

In principle small and medium banks have better opportunities to develop their financial operations, because in the private sector they are connected with recovers quicker for the recession. The banks from Group II could participate in the privatization process and establishment of capital market by applying different investment banking methods, as well as by offering specific financial services to their clients. The specific close relations between banks and their shareholding companies and other economically related persons still exist. This is no longer dangerous for the banking sector as a whole because the mass depositors do not trust in private banks due to the obstacle that most of the bankrupt in the banking crisis period banks were private, and among them were the biggest private banks. Due to this it is not expected in the near future banks from group II to accumulate big amounts. In this respect the new eventual cataclysms in banks from this group will affect a narrow range of depositors and will not lead to a substantial increase of system risk and new trust crisis.

Foreign branches and subsidiary banks will keep enlarging their operations on the Bulgarian market, especially credit granting and will achieve greater comparative share in it. The reasons for this process may be found in the weakness of local banks after the hard bank crisis, as well as in the foreign investment process in the country. Traditionally foreign investors prefer to be served by banks from the mother country or allied countries. Privatization of state owned banks additionally speeds up this process.

In the group of banks declared bankrupt or banks in bankruptcy procedure a slim chance exists for credits granted by those banks to be collected even partially. Payment of deposits to the depositors in those banks is undertaken by the budget pursuant to the Law on Protection of Deposits. The word is for comparatively sizable amounts, around 36 milliard leva and 200 USD (currency deposit will be paid on parts within 2 years period). Obviously the budget will

be overloaded. The backdated amendment of the law aimed to limit these payments will influence negatively on the trust of the public in the banking system.

The above analysis premises the conclusion that no danger exists for a new credit expansion that may influence negatively on the stability of the banking system. On the other hand the limits for credit granting will prolong the stagnation period in the economy.

The main issue faced by the banking system and essentially by the group of the major banks remain the high percentage of inherited bad debts (doubtful loans - Group B and uncollectable loans) from the previous year. The correlation (doubtful loans - Group B+ uncollectable loans) /total credits is 24% for the group I banks which is a great value compared to those for groups II and III – 13.5% and 11.3% respectively. Solving this problem which will be for instance solving the problem with recapitalization and recovering of Bulgarian Banking System should be the main aim of the structural reform in the banking sector.

Notwithstanding these problems the hereinabove described process of concentration distinctly shows the trend to recovering of the banking sector. Another distinct indicator for this trend is the sudden downfall of interest rate differential for the interest on credits and deposit – from 30-40 points at the beginning of this year to 5-6 points in July and August. The conclusion is that after the catastrophic banking crisis in the previous year the Bulgarian Banking System confidently and irreversibly starts to recover and stabilize.

Policy of the BNB in management of the Banking System in the Conditions of a Currency Board – New Legal Framework for Conducting Bank Supervision

In the middle of the current year the bank legislation was basically amended in compliance with the introduction of the Currency Board system. New Law on the Bulgarian National Bank and Law on Banks were adopted and they abrogated respectively the Law on the Bulgarian National Bank as of 1991 and the Law on Banks and Credit Activity as of 1992.

The new Law on the BNB governs the legal status and functions of the central bank in the conditions of a Currency Board.

Structure and management of the Bulgarian National Bank were changed. Three basic Departments were differentiated – “Issue Department”, “Banking Department” and “Bank Supervision Department”, headed respectively by a Deputy Governor, elected by the National Assembly.

Main function of Issue Department is to maintain complete currency coverage of the total liabilities of the BNB. The national monetary unit – Lev – was stucked to the German Mark, and the law fixed the official currency exchange rate of the lev to 1000 Leva per 1 DM. The Law on the BNB requires the monetary debts of the BNB to be completely covered by its gross currency reserve. Issue department is obliged to manage effectively the international currency assets of the BNB, as well as to sell and buy (exchange) without limitations throughout the country DM for Leva on the grounds of the fixed rate and with diversion of not more than 0.5%.

Banking Department functions as a lender of last resort under conditions, specified by the law and the adopted by the Managing Board of the BNB legislative acts. The BNB is prohibited to grant credits to banks except in case the liquidity risk affects the whole banking system and only to the amount of not more than the surplus leva equivalent of the gross international currency reserve over the monetary debts of the BNB. No matter its form granting credits to the state and to state institutions is prohibited.

The Deputy Governor in charge of Bank Supervision Department should conduct supervision over the banking system and perform his supervisory powers through applying independently the sanctions and measures provided for by the law.

In the conditions of a Currency Board and consolidated independence of the Deputy Governors in charge of the BNB main Departments, powers of the Managing Board and the Governor are considerably changed. They are the bodies that have the power to perform general organizational and functional management of the central bank. The most important power of the Managing Board is to adopt acts of regulatory type on the application of the Law on BNB and Law on Banks, including the Regulations on the conduct of bank supervision. The Governor should have the power to organize, manage and control the activities of the bank, excluding those of the exclusive competency of the Deputy Governors. Issuance and deprivation of licenses for conducting bank operations should be done with an act of the Governor upon Deputy Governor's proposal.

Law on Banks follows closely some of the prescriptions of the abrogated Law on Banks and Credit Activity and at the same time amended and improved the legal framework for bank activity.

The new law provides for regulation of the main financial institutions – the universal commercial banks. It does not govern the activities of other financial institutions, except in case

they participate in a bank group or financial holding and the central bank is obliged to supervise them on a consolidated basis.

Compared to the abolished Law on Banks and Credit Activity the Law on Banks defines more precisely the content and scope of bank activities through providing legal definitions of the terms “bank deposit”, “public drawing of bank deposits” and “bank”.

More strict requirements are introduced for the managers of a bank. They should hold high education in economics or law, qualification and professional experience, and should as well not been members of the managing bodies of a bank or company declared bankrupt. The above listed facts should be certified with a certificate, issued by the Deputy Governor in charge of Bank Supervision Department. The provisions for bank licensing are more precise. Stricter requirements are introduced for bank shareholders and administrators.

Considerably new are the provisions on deprivation of a license for conducting bank operations. The law provides for obligatory deprivation regime in case the bank becomes insolvent. In such cases a bankruptcy proceeding should be initiated. The license may be deprived if any of the provisions of the law are infringed but in such cases the consequence will be compulsory liquidation of the bank. The decision for deprivation of the bank license can not be appealed before the court and should be executed immediately.

The special provisions chapter provides for confidentiality and disclosure of conflict of interest requirements. According to it each bank administrator should declare in writing every substantial business interest that he or a member of his family have in entering into commercial transaction with the bank. Interest is presumed to exist when a party to the agreement with the bank is the administrator or a member of his family or person, economically related with the administrator or with a member of his family (holds a share capital in a company or is partner, member of the managing bodies of the company. administrators are prohibited to participate in negotiations and conclusion of commercial transactions if conflict of interests exists. Breach of the above listed requirements should result in declaring transaction null and void., and the management of BNB should oblige the management of the bank to terminate for a specified period of time the powers of the administrator or to dismiss him. Banks are obliged to adopt Rules on the Procedure for Disclosure (reveal) of Conflict of Interests and for Ensuring Confidentiality for the purpose no damage of the interests of the bank or its clients to be caused by a bank administrator or employee or by other clients of the bank.

For the first time the internal bank control was introduced. Strict requirements are provided for the audit control aimed to clarifying the real situation of the bank. The law

provides for a requirement the audit to be conducted by specialized audit companies, enlisted by the central bank.

BNB has the right to impose a large number of supervising measures that can not be appealed before the court. More substantial are the following:

1. To convene the General Meeting of the Shareholders, or to call a session of the Managing or Supervisory Boards for making decisions on certain measures that should be undertaken.
2. To issue written orders to cease and eliminate infractions and remedial measures to be undertaken.
3. To impose on the bank stringent supervisory requirements than the ones imposed on it in normal operation, including to order to the bank to limit its operations or to undertake actions in respect to changing the bank operation status, including credit granting, drawing of bank deposits and off-balance sheet commitments.
4. To impose administrative penalties and property sanctions to those administrators and other employees of the bank and to other persons, who infringed the Law and the Orders of the bank supervision.
5. To oblige the bank by a written notification to increase its capital.
6. To prohibit dividend payments.
7. To appoint bank consultant.
8. To appoint in-house auditor of the bank, who should conduct the audit in compliance with the requirements specified by the BNB. The expenses should be for the account of the audited bank.
9. To dismiss managers of the bank, empowered to manage and represent it.
10. To order to a shareholder of the bank to transfer shares held by him within 30 (thirty) days term.
11. To appoint two or more conservators of the bank for a specified period of time.
12. Other measures specified by the law.

Acts on application of those measures should be issued by the Deputy-Governor in charge of Bank Supervision Department. Acts on issuance, issuance refusals and deprivation of licenses for conducting bank operations should be issued by the Governor of BNB upon the proposal of the Deputy Governor in charge of Bank Supervision Department.

The law pays special attention to the conservator and governs his appointment and powers.

Precise and well developed are the provisions concerning bank insolvency, declared by the court, but decisive is the deprivation of the license for conducting bank operations by the central bank. Detailed are the requirements for a bank to be liquidated compulsory.

New Supervisory Regulations on Cautious Conduct of Bank Operation by the Commercial Banks

Adoption of new fundamental (structural) laws on the activity of the BNB and the commercial banks is aimed to establish a new legal framework for bank activities, as well as to a new legal framework for conduct of bank supervision by the BNB. This requires new regulations on all aspects of the activities of the commercial banks to be adopted (new regulations on conduct of bank supervision). In the Currency Board conditions the considerably limited are the possibilities to support banks in critical financial situation throughout refinancing by the BNB. This necessities regulations on bank supervision to provide for stricter requirements for proper bank activities as well as bank supervision to severe the penalties for violencing the banking regulation by the commercial banks. The main characteristic of the policy of the BNB for management of the banking system in the Currency Board conditions is harsh increase of restrictions for conduct of bank supervision in the new regulations. This should be aimed to achieve stable financial situation of separate commercial banks and the banking system as a whole, without putting reliance on out of the banking system factors – for example refinancing by the BNB, budgetary financial aid and others. In such environment the efficiency of bank supervision should be increased especially towards early recognition and keeping under control crisis situations.

New Regulation 8 on Capital Adequacy of Banks provides for more requirements that commercial banks should meet. For example the minimum equity required should be at the amount of 10 (ten) milliard leva. This amount in general is in compliance with the requirements of the White Book of the European Union (5 million EQU) – see Direction 89/299/EEC on Equity Capital of Credit Institutions. This amount should be the basis (as a minimum) for the deposition of the subscribed capital of the bank at the moment of the issuance of the license, and after this the bank should dispose at any time with equity (capital basis) not less than the above mentioned amount.

The requirements on the capital adequacy of banks are more strict than those provided by the abolished Regulation. The general capital adequacy (capital basis / general risk

component) should not be less than 12%, compared to the requirement provided by the abolished Regulation – 8%. Adequacy of the initial capital (initial capital / general risk component) should not be less than 6% - compared to the requirement provided by the abolished Regulation – 4%. Degree of asset coverage (capital basis / total assets) should not be less than 6%. These requirements are in compliance with the standards, adopted by the Bezel Committee for Bank Supervision, as well as with Direction 89/647/EEC of the European Commission for the Solvency Coefficient for the Credit Institutions. The banks should meet those requirements as follows:

1. by the end of 1997 – at least 8% general capital adequacy and at least 4% adequacy of the initial capital;
2. by the end of 1998 – at least 10% general capital adequacy and at least 5% adequacy of the initial capital;
3. by the end of 1999 - at least 12% general capital adequacy and at least 6% adequacy of the initial capital

New Regulation on Evaluation of Risk Exposures of Banks and Allocation of Provisions to Cover the Risk Related Thereto abolished the Regulation on Classification of Credits and Allocation of Special Obligatory Reserves (Provisions) of Banks. The Regulation is based on completely new principles which limit considerably the active operations of banks.

In the first place classified and provisioned should be not only credits, but any other claims of the bank (including funds in other bank's accounts, share participations, stakes, bonds and others), as well as conditional off-balance liabilities of the bank (guarantees, stand-by letters of credit, accepts, avails and promissory note endorsements and others), realization of which leads to arising of unconditional claims to the benefit of the bank. Pursuant to the Regulation all these positions are risk exposures and should be evaluated and classified in five (5) classification groups (the abolished Regulation provided for four groups) according to the period of delay of the amounts due, assessment of the financial position of the debtor and the main sources for payment of debtor's obligations. The expired interest on risk exposures should be provisioned in whole no matter in which group the respective exposure was classified. The Regulation consecutively provides for a principle of cautiousness according to which when doubting in the criteria for classification the exposure should be classified in the group with higher risk.

Another substantial change is the requirement provisions at the specified by the Regulation amount to be allocated by the banks, no matter whether the profit before taxation

covers or not these expenses. In case incomes can not cover the expenditures for provisions banks are obliged to make these financial expenses should report loss for a operational result. In compliance with these requirements the accountancy methodology for accounting of provisions was changed. Provisions should be treated as a corrective which decreases the respective reported amount of risk exposures.

Risk exposures should be classified in the following groups – standard exposures, watch exposures, substandard exposures, doubtful exposures, loss. Banks are obliged to allocate provisions which compared to the capital for the risk exposures should be as follows – for 3% to 5% for standard, 25% for watch exposures, 50% for substandard exposures, 75% for doubtful exposition and 100% for the loss.

Criteria for classification of risk exposition should be the following:

1. Overdue exponent of the payments for the capital and the interest according to the agreement – regular or delayed up to 30 days, delayed 31 up to 60 days, delayed 61 up to 90 days, delayed 91 up to 180 days, delayed more than 180 days for the respective five groups risk exposures.

2. Overdue exponent of the submitted by the debtor and required by the bank financial statements and other data, necessary for the evaluation of the loan position.

3. Purposeful usage of the loan by the debtor specified in the agreement.

4. Temporal or permanent monetary shortage of the debtor

5. Insolvency or liquidation risk.

These criteria are more detailed, clear and strict than those provided by the abolished Regulation. In case one of the criteria provides for the exposition to be classified in a higher risk group, differing from the status under another criteria, the bank should classify the exposition in the higher risk group pursuant to the principle for cautiousness.

In contradiction to the abolished Regulation the new one provides for banks to be prohibited to accrue interests upon interest (capitalization of interest). Exemptions should be made only under extraordinary circumstances and capitalization of overdue interest should not be allowed. (see article 17). Banks should stop the balance sheet accruing of interests upon risk exposures with 90 days overdue payments. These interests should be accrued off-balance.

New Regulation on Management and Supervision over the Liquidity of Banks provides for completely new principles and method for management and evaluation of the short-term liquidity of banks. The new provisions are more concrete, adequate and simple than those

of the abolished Regulation. According to the new Regulation the informational system for monitoring the bank liquidity should be based on:

1. Working out and maintenance of a maturity date table;
2. Evaluation and management of the cash flow according to these maturity date tables;

and

3. Maintenance of adequate amount liquid assets.

The maturity date table should be worked out by classification of the chosen assets, liabilities and off-balance positions of the bank according to of the expiration term till the maturity date for each of them. The periods for classification according to the expiration term till the maturity date should be:

1. seven days till the reporting date
2. One month till the reporting date;
3. three months till the reporting date;
4. six months till the reporting date;

The divergence between the so grouped assets and liabilities should be respectively net incoming (in case assets are more than liabilities) and outgoing cash flow for the respective period of the maturity date table. Banks are obliged to prepare separate maturity date tables under two scripts – “operating enterprise” script and “in liquidity crisis” script. “Operating enterprise” script should be the case in which the bank operates without difficulties, the banking system is stable and enough profit is incurred.

“In Liquid crisis” script should be the case in which the bank can not manage to pay all or part of its liabilities at the maturity dates and a distrust in its capability may occur and/or insolvency.

According to the Regulation letters of credit should be deemed to be:

1. Banknotes and coins in cash;
2. Amounts in BNB accounts minus the obligatory reserves’
3. Amount in operating accounts in other banks;
4. Governmental bonds issued by the government of the Republic of Bulgaria;
5. Other assets, specified by the BNB as liquid;

Adequacy of liquid assets should be observed by taking into consideration the following coefficients:

1. Corrected coefficients of the liquid assets – the cumulative net incoming or outgoing cash flow for the four periods of the maturity date table, shown as a percentage of the liquid assets.

2. Liquid assets coefficient – liquid assets as a percentage of the accumulated by the bank amounts (deposits)

3 Corrected coefficient of the liquid assets against the deposits – the liquid assets minus the cumulative net outgoing cash flow for each of the four chosen periods, shown as a percentage of the deposits.

If necessary the BNB may determine minimal amounts for the hereinabove listed coefficients for each bank.

Banks that are operating normally are obliged to submit monthly to the BNB reports on the cash flow of the bank, prepared in compliance with of the “operating enterprise” script. If substantial liquid problems occur the Deputy Governor in charge of Bank Supervision Department should oblige the bank to prepare and submit weekly or daily reports on the cash flow in compliance with the “liquid crisis” script.

New Regulation on Currency Positions of Banks introduced more unburden regime on regulation of currency positions of banks because in the Currency Board system the currency risk is limited due to the fixed currency exchange rate.

Own funds of a foreign bank branch should be deemed to be deposits and other subsidies provided by the central of the bank. As the new Law on Banks does not provide for a different regime for banks, licensed to conduct operations in the country and abroad and banks, licensed to conduct operations only in the country the new Regulation does not provide for separate restrictions upon the open positions of banks licensed to conduct activity in the country and abroad and those licensed to conduct activity just in the country, as was provided by the abolished Regulation.

Banks are obliged to maintain the maximum allowed limits as follow:

1. Up to 25% between the open position in every foreign currency and the amount of the equity (10% in the abolished Regulation), except for the DM;

2. Up to 60% between the net open position and the amount of the equity (30% in the abolished Regulation), except for the DM;

As the DM is the reserve currency and in the currency Board system should not bear currency risk, its exclusion from the regulation of the currency positions is reasonable.

The new Regulation does not provide for an obligation for the banks to maintain minimal obligatory reserves to the amount of 20% of the net open currency positions as was provided by the abolished one. Banks that are going beyond these maximum allowed limits specified by the Regulation should reach these correlation by the 31 December 1998 through increasing every month the exceeded limits.

The requirements of the new Regulation are in compliance with the standards adopted by the countries of the European Union - see Directive 93/6/EEC on Capital Adequacy of Investment Companies and Credit Institutions.

The Draft for a new Regulation 7 on Big Credits of Banks provides for more strict requirements on criteria and methods for distribution of Credit risk resulting from the granted by the banks big credits. A credit granted to a client should be deemed to be big if its volume is to the amount of more than 10% of the capital of the bank – 15% in the old Regulation. In this case credit should be the general exposure of the bank to a single client, including the amount of all credits and other commitments made equal to balance sheet assets under the order provided by the Regulation on Capital Adequacy. The provisions about the big credits should be applied as well to big credits granted by a banking group to a single client.

The draft Regulation provides for restrictions for granting big credits. The total exposure of banks to a single client should not exceed the amount of 25% of the capital of the bank. Total amount of granted big credits to all single clients should not exceed more than eight times the equity of the bank. In contradiction to the requirements of the old, still in force Regulation no exemptions should be made for granting secured with a mortgage or pledge over movables or securities credits. Banks should observe whether their borrowers are economically related persons or not. The Regulation provides for a legal definition of the term economically related persons.

Big credit exposures should not be deemed to be those, granted to;

1. The government or guaranteed by the government;
2. BNB
3. Governments or central banks, enlisted by the BNB;
4. International institutions, enlisted by the BNB;
5. Exposures in securities of the hereinabove listed entities or guaranteed by

them. The amount of the guarantee should be at least to the amount of 10% over the amount of the credit.

6. Exposures guaranteed with leva or currency deposits. The amount of the guarantee should be at least to the amount of 25% over the amount of the credit.

The provisions of the draft regulation are in compliance with the requirements of Direction 92/121/EEC on Monitoring and Control over Big Exposures of Credit Institutions.

The draft regulation does not provide for regulation on internal credits, granted by the banks. Another regulation should be adopted to govern those relations.

Bank Supervision Department is now drafting new bank regulations. Bank Supervision as an institution is in the structure of the central bank. In the near future a new Regulation 2 on Licenses, Issued by the BNB will be drafted and adopted. The provisions of the old Regulation are in compliance with the abrogated Law on banks and Credit Activity and therefor they should be amended in compliance with the new Law on Banks. No distinction between banks licensed to conduct bank operation in the country and abroad and banks, licenses to conduct operations just in the country will be made. The requirement non-banking financial institutions to be licensed by the BNB will be abrogated. A new Regulation 10 on Internal Banking Control will be drafted and adopted. The provisions of the old Regulation which is still in force are putting the stress on the procedure and methods for conducting the internal control but the draft will put the stress on the aims and assignments of the internal control in evaluating the banking risks.

Organizational Structure of Bank Supervision and Characteristic of the Functions of Its Particular Directorates

As an institution Bank supervision in Bulgaria is within the structure of the central bank.

This is the way for Bulgaria to join the group of countries whose central banks are in charge of regulation, issuance of licenses and conduct of supervision and control over the banking activity. This structure is typical for smaller countries in the European Union, as well as for almost all of the ex – socialist countries. According to the Law on BNB and Law on Banks the BNB should regulate and control the activities of other banks in Bulgaria in view to maintain the of banking system stable and to protect depositors' interests. Pursuant to the law execution of this function of the central bank is assigned to the Bank Supervision Department, which should supervise the activities of the commercial banks in compliance with the order provided for by the Law on BNB and Law on Banks. While executing its supervision powers

the Bank Supervision Department should impose independently the measures and penalties provided by the law.

Similar to most other countries, the supervision in Bulgaria covers the following:

1. Regulates the banking system structure through:
 - Issuing and depriving of licenses for conducting bank operations;
 - permitting acquisitions of more than 5% of the voting shares in a bank, opening branches abroad, mergers, acquisitions and Directorate, reduction of capital, increase of capital by the means of non – cash contributions, acquiring share participation in a company, which is not a bank.
 - Supervising on a consolidated basis over banking groups and financial holdings
 - Issuing certificates to the members of the Managing Board and the Board of Directors certifying that they hold professional experience and qualification and meet the requirements of the Law on Banks.
2. regulating the bank supervision – preparing and correcting all Regulations and Ordinances
3. Distant current (prudential) supervision
4. Conducting on site inspections
5. Utilizing a wide range of procedures and supervising measures according to the Law on Banks aimed to correct the operation of a bank when the law is infringed or the financial stability of the bank is in danger

In all circumstances Bank supervision should be mainly aimed to defend the debtors' interests (not shareholders' interest). Famous to the economic theory is the fact that depositors in banks can not be kept well informed about the in good faith and successful management of their savings by the owners of the bank. This issue in the microeconomics is studied in details by the theory on asymmetry of information and is known as the issue "agent-principle". For right of private ownership of depositors to be guaranteed, as well as for effective functioning of the banking system, which is of key importance for the successful development of the economy, it is necessary the state through the bank supervising institutions to defend the depositors' interests and to monitor for the conduct of correct banking practice by the commercial banks.

Bank Supervision Department is lineally structured. Four directorates plus one legal and administrative Directorate are directly subordinated to the Deputy Governor in charge of the Bank Supervision Department. Restructuring of the managing structure was completed and the

staff was increased from 65 to 90 persons. This was aimed to stimulate the functions and responsibilities of the Bank Supervision. At present the Bank Supervision Department in the BNB consists of the following units:

1. **Supervision Policy Directorate** – its main function is to issue licenses and other permissions, summarized analysis on the banking system as a whole, to draft bank regulations and methodological instructions, to develop international relations and relations with other institutions.

2. **Distance (Current) Supervision and Analysis Directorate** – its main function is to summarize the information reported by the banks and to keep in touch with the auditors of the commercial banks and to analyze their reports.

3. **Inspections Directorate** – its main function is to conduct bank supervision on side (Supervising inspections).

4. **Special Supervision Directorate** – its main function is to supervise the significant bank shareholders, transactions with shares, property and financial investments of banks, to supervise the non - banking financial institutions, to impose measures against money – laundering

5. **Legal and Administrative Directorate** – directly subordinated to the Deputy Governor and in charge of the implementation of supervising measures, control over the conservators and trustees.

Detailed functional characteristic of the Directorates and sections in the Bank Supervision Department is following.

1. Distant Supervision and Analysis Directorate

Distant Supervision is one of the two main techniques used for conducting bank supervision. The activities of the distant supervising are aimed mainly to identify in an early stage problematic banks and respectively to conduct supervising intervention before problems become critical and danger of insolvency occur. For the purpose the Directorate regularly collects, summarizes and reviews the statistic information submitted by the banks and according to it regularly develops financial analysis on the financial position of each commercial bank. The bank statistical information should be received weekly, monthly and every three months and the Directorate should draft forms and instructions on preparation of these reports by the commercial banks. Bank statistical sources should be the balance sheet of the bank, the profit and loss statement, the turnover register, reports in compliance with the provisions of all Regulations. For the purposes of the distance supervision other sources may be used – the

money circulation statistic, other statistics, obtained by the BNB, reports of the inspectors for the status of the inspected banks and others. If a commercial bank does not conform the requirements on preparation of the reports for the bank statistics the Directorate may recommend a penalty to be imposed to the bank.

The distant (prudential) supervision is mainly characterized by the means of the quantity analysis – determining of the financial position of each bank according to the financial analysis prepared by the Directorate. Of extreme importance is to monitor permanently over the system of indexes for periodical evaluation of the situation of different banks and groups of banks and their risk reiting.

After the necessary information is collected and reviewed the Directorate should work out week, month and three months reports and submit written financial analysis about the current and future results for the operational activity of the banks. The Directorate should work out week, month and three months analytic reports on the operational results and trends for the development of the risk exposures of particular banks, groups of banks with similar results and the banking system as a whole. For distant supervision purposes a system was developed for early notification of the negative trends in separate banks, groups of banks and the bank system in whole. The Directorate may work out special reports and financial comparative analysis for the International Currency Fund and other official bodies. Upon the consent of the Supervision Policy Directorate the Directorate may evaluate the business plan of the applicants for bank license.

2. Inspection Directorate

The on side inspections are one of the major instruments used by the Bank Supervision for performing its functions. Inspections on side are the most efficient method for fair and independent evaluation of the actual situation of banks and non – banking financial institutions. The main characteristic of the on side inspections is the quality analysis – analysis of the reasons that caused problems to the financial situation of a certain commercial bank. Here the stress should be putted on the position of the bank management, functioning of the bank administration, as well as on adequacy of conducted operational and strategic policy. These usually are the main reasons for the poor or good financial situation of a certain commercial bank.

The distant control (prudential supervision) contents one immanent limitation – it depends entirely on the reliability of the reports, submitted by the bank institutions. The on side

inspections are completing the current control, conducted by the means of analysis and monitoring over certain prudential standards (Rules, Indexes and Standards).

The on side inspections, similarly to the well developed countries strive for few basic tasks: to check the correctness and thoroughness of the reports, submitted by the banks; to check the compliance of the reports with the provisions of the law, indexes and rules as well as to review the activity not too familiar to the bank supervision. The logistic result from the inspections on side is the evaluation of all aspects of the bank activity – subject to the activities of the supervising bodies. In this respect partial and in whole inspections may be conducted and this depends mainly on thoroughness of the constellations, obtained in the process of prudential control.

Bank legislation in Bulgaria provides for inspections to be conducted at any time and any place, where bank operations are performed and at the same time some of the provisions require on side inspections to be conducted regularly in certain period of time. The Directorate works out yearly schedule for the regular and topical inspections on according to the risk reiting of particular banks. On side inspections are conducted by a group of inspectors, formed by three to five persons.

Similarly to the world supervising practice on side inspections in Bulgaria pass through different stages. The procedure usually starts with a preliminary analysis of the information accessible as a result from the distant control and determination of problematic areas in the activity of the respective institution. The first on practice step towards realization of an on side inspection is to prepare the analysis for the reliability of accountancy and to draft afterwards the report for the technical analysis. The technical analysis presumes review of the basic criteria influencing the general financial stability of the inspected object.

The scope of the technical analysis depends directly on the negative points specified by the prudential supervision. In this respect, the attention is in most cases to the credit portfolio and liquidity.

Usually problematic banks are subject to more frequent on side inspections. The financial status of those banks may be described by the means of:

- insufficient capital adequacy;
- poor management;
- low quality of the assets;
- insufficient liquidity;
- low or negative profitableness

Reasons for this may most often be discovered in the wrong functioning of the inside control system, as well as in the management, performed by the bodies of the bank.

When issues are found in the course of the inspection the bank supervision should assess:

First: how serious they are;

Second: whether a direct risk for the depositors exists or not;

Third: Is the bank solvent and will it be declared bankrupt and if yes how its bankruptcy will influence on the banking system.

After the assessment the Directorate should draft a report on the inspection results, and submit it to the management of the BNB and the supreme management body of the respective bank and if necessary to suggest penalties and to conduct the supervising interventions arising out of them. The Directorate should determine the risk reiting of particular banks according to the information collected by the bank supervision. The Directorate should work out a plan for topical inspections in particular banks for checking separate risk exposures, inside control, ets. The Directorate should introduce procedures for monitoring and control over “problematic” banks for observing with the inflicted supervising measure and the legal provisions.

1. Supervisory Policy Directorate

The Directorate should draft new regulations and revise the international requirements and ordinances of the European Union enforced in compliance with the new legal framework. For this purpose it should coordinate its activities with the other managing Directorates, the Commercial Banks Association, other official bodies and should conduct adequate supervisory policy. The Directorate issues a collection with rules to ensure that principles of supervisory policy would be applied impartially and consecutively for all institutions under the supervision of the BNB. The Directorate regularly consults with the Commercial Banks Association and the Auditors’ Association in drafting new accounting standards, in compliance with the international accounting standards.

The Directorate should evaluate the quality of the annual statements of the banks and the in-house audit. The Directorate is obliged to prepare and maintain a list of auditors, approved by the BNB pursuant to article 61, para 2 of the Law on Banks.

The Directorate is obliged to file the applications for issuance of a license for conducting bank operations, to coordinate and to prepare a recommendation for issuing of a license or to refuse to.

The Directorate is obliged to conduct public relations of the bank management with international and local organizations. The Directorate should work out research reports and financial statements for the annual statement of the BNB, draft articles on banking issues that may be published in out of the bank professional editions. The Directorate should inspect the stability of foreign banks applying for issuance of a license to conduct operates in Bulgaria.

4. Special Supervision Directorate

The Directorate should control the relations between the significant shareholders and the management of the bank. It is obliged to monitor over the conduct of the “at one hand distance” policy in respect to the transactions with shares and property. The Directorate should control investments in other financial institutions and loans for them.

This Directorate is obliged to conduct inspections/supervision over non-banking financial institutions and to maintain a register for them. The Directorate may impose penalties for infringements of the law by non-banking financial institutions.

The Directorate should inspect activities, potentially connected with money laundering. It should inspect individuals suspected in performing illegal activity.

The Directorate is obliged to inspect banks and non-banking financial institutions when there is a complaint not ethical and not loyal and/or illegal activity.

5. Legal and Administrative Division

Should report directly to the Deputy Governor and should provide legal services to all managing Directorates when they need legal advise. The division is obliged to control the activities of the conservators and trustees and maintain a register for conservators and trustees. It should coordinate the program for professional training of the employees of the managing staff.

Strategy for Structuring of the Banking System and Conducting the Reform in the Banking Sector

Few reasons are premising the demand for a concept for quick and radical structural reform in the banking sector to be constructed. In the first place, the prevalence of state ownership in the banking system (most of the major banks are still owned by the state) continues to influence negatively on the operation of the banking sector. The big state banks are suffering from the “surplus bureaucracy decease” and poor organization, often the personnel is not well qualified, the quality of bank services is low, the management is not enough motivated to increase the efficiency and profitableness of the bank. State banks are often subject to political pressure for granting credits to certain enterprises or branches.

In the second place the banking sector reform should lead to a recovering and recapitalisation of the banking sector, and solving all the problems with the high percentage of bad debts in the accumulated in the commercial banks portfolios and the insufficient capital basis of comparatively many banks, most of which are among the major banks (banks from group I)

In the third place, the bank reform should assist for the improvement of the commercial banks management, especially the management of the credit risk, liquidity, profitableness and increase the quality of bank services. The most important issue is the management of credit risk, because till now the banks were managing it according to the “pendulum” principle – credit expansion. It is extremely important to create conditions for protecting bank from excessive binding with their borrowers, which is the main reason for deterioration of banks credit portfolios.

In the forth place the structural reform in the banking sector should stimulate closer relations between Bulgarian banks and the International Banking Community. This will result in import of modern banking technologies and know-how, increase of the quality of banking services, introduction of new rules for behavior in the modern economic environment.

The reform of the Bulgarian Banking System should follow the market trends in the banking sector. According to the authors unquestionable is the main trend of structural development of the banking system. In three to five years period most of the assets of the system will be concentrated in privatized with a sizable participation of foreign investors state banks, and foreign banks and subsidiary banks. The large scaled crisis in the last two years (the largest in Europe after the Second World War) proved that neither the state, nor the Bulgarian private sector could undertake the responsibility for development of banking in Bulgaria. Prevalence of foreign banks in Bulgaria is in compliance with the principles for operation of the Currency Board. Foreign banks are prevailing on the banking market in compliance with the governing principles of the Currency Board. Foreign banks through their headquarters may act as lenders of last resort due to the obstacle that in this respect the capacity of the BNB is limited.

There are several possible ways for accomplishing structural reform, which might be used separately or in combination:

- 1) Privatization of the state banks with attracting foreign investors for that purpose (as it is envisaged in the program for bank privatization included in the Agreement with IMF). Bank privatization with the decisive participation of foreign strategic investors is the most appropriate solution of the above listed tasks of the bank sector reform. Under Currency Board

regime major commercial banks may be protected from system risks and at the same time may perform lucrative activities when they have strong relations with stable international banks. Entering of the international capital in BBS will lead to correspondent rapid and thorough entering of foreign investors in the real economy and fast economic development. But one must keep in mind that it would be difficult for foreign investors to be found for some of the banks because of their poor financial situation, unstable and lack of information about situation in Bulgaria. A possible solution for those banks is the concluding of management contract with a big foreign bank. In this respect, we must point out that attracting foreign consultants and managers in the management of the state banks is not well implemented in practice. As a matter of principle, management of the state banks by international experts and institutions is an efficient way for their stabilization and preparation for privatization.

In the process of privatization of the state banks main criteria for performing the deal should be the existence of strategic investors and the rapidity of the sale. As the purpose of the privatization is the achievement of stability in the bank system and economy and not accruing revenues for the state budget, the selling price of a bank should be of minor importance. Main problem in this respect is the establishment of a criterion for exact determination, which are the strategic investors. Obviously, banks situated in the neighboring countries and far-eastern concerns could hardly be considered as strategic investors. According to the authors, as a strategic investor should be considered an international bank with high reputation determined in compliance with the classifications accepted in banking.

Yet another problem occurs - the offering of Bulgarian banks is still higher than the demand. A possible explanation of that circumstance could be the fact that foreign investment climate in Bulgaria is hostile because of corruption, criminalization, lack of efficient legal system and the small inner market. We should also mention that in principle Bulgaria is not well known and it is not considered to be an attractive country on the international markets. Moreover, BCC has an extremely bureaucratic and slow procedure for accomplishing of the privatization process. With the purpose of overcoming that obstacle, bank privatization should start with the most attractive for the foreign investors banks. Presently, it means the acceleration of privatization procedure for those banks as for that purpose a strategic investor - a big bank with high reputation, preferably from a member-country of the European Union - is sought. That process could be also combined with public offering of shares from those banks or with other forms of privatization. The successful completion of this transaction would considerably increase the interest in the Bulgarian bank privatization on the part of the foreign investors.

Respectively an acceleration of the privatization process may be expected, which at present is definitely halted. Moreover such type of privatization is in compliance with the strategy of Bulgaria for becoming member of the EU and of the Euro- Atlantic organizations.

Due to the forestalled reasons the slowing down of the process of bank privatization is inevitable and the five state owned banks would hardly be privatized until the end of the year, which was the initial intent of the government and of the international financial institutions. Notwithstanding this fact, the process of bank privatization has to continue and deviation from the announced strategic objectives - privatization of the state owned banks with prevailing participation of the strategic foreign investors should not be allowed. The achievement of this objective is a decisive condition for the final stabilization of the bank system and for the transformation of the main Bulgarian banks into efficient and reliable credit institutions. The experience until the present moment has shown that the bank privatization is successful where the management of the particular state owned bank actively participates in the privatization process and strives to cooperate for finding of strategic investors (we should mention UBB). Consequently the government, BCC, and BNB should look for different incentives to engage actively the managing staff of the state owned banks in the privatization process.

The only bank, which has to remain state owned in the near future, is to State Savings Bank. This is necessary because the trust of the small depositors in this institution is still considerable due to the special governmental guarantees and the existing trend of trust in this institution. In the future the government may use the State Savings Bank to conduct its economic policy.

2) The consolidation of and/or establishment of a consortium between the banks, servicing particular branches, and the big state owned credit banks. The privatization of OBB is an example for combination between this method (consortium with Bulbank) and the aforementioned method. This is a possible solution for the problematic main banks - provided that the consolidating "resource" bank is enough stable to take the burden of their bad credits portfolio.

The consolidation would be a solution for the small and middle sized private banks, which are not in a condition to respond to the new requirements for capital adequacy. Until the present moment the private banks avoided this solution because of the low trust among the owners of the different banks. However it is obvious that the new conditions for conducting bank activities require new solutions.

3) Recapitalization of the main banks by funds originating from the state budget. The experience in this aspect is not the similar for all banks. All budget subsidies to the state owned banks until the present moment (ZUNK (bed debt bonds), the rehabilitation of Business bank and Mineralbank, the BULBANK scheme, and others) only gave to the banks the reason to think that their losses will be borne by the budget in the future. The only effect of such recapitalization would be a temporal solution of the issue. Moreover under the Currency Board regime it is doubtful whether the state budget may afford such considerable expenses.

4) Recapitalization of the main banks by using funds originating from official creditors - the loan FESAL of the World Bank and others. This is similar to the foregoing decision, but compared to it, here the official creditors will control the use of the extended funds and will set conditions for amendments of the legal framework and of the micro economic environment, which on its turn will cause a change to the factors determining the behavior of the commercial banks and of the other economic agents. For example such are the terms and conditions of the loans FESAL 1 and FESAL 2. In this relation we may think about the creation of a special institution (special Fund, Hospital - Bank, Agency for Collection of Credits, ext.) which will buy the bed credits from the state owned banks and will collect them. The accumulated foreign funds may be used for this purpose as well as foreign consultants.

5) It is very important to work out and implement in short terms the large scaled program for amendments to the legal framework, whose purpose has to be the protection of the creditor's interests. The Association of Commercial Banks have interested projects in this respect. Without a legal regime, defining and protecting clearly property rights the development of the bank system is impossible neither the establishment of market economy. Obviously this issue is part of the great issue for establishment of a legal order in economy as well as in other spheres of social relations.

6) The establishment of a Credit Register by BNB together with the commercial banks, where detailed information about all borrowers should be collected and further should be subject to free circulation among the banks. The establishment of such system would ease very much the management of the credit risk. According to the authors the establishment of a Credit Register was slowed unreasonably during the past years.

7) It is very important to follow strictly the principle "banks shall keep the client at one hand distance" when the new bank supervision regulations are worked out by BNB. In fact this means that the regulations should protect the banks from establishment of long term relations and extending of large credits to companies, owned by the shareholders of the banks, or to other state

owned and private companies. In the projects for new regulations this policy is strictly followed.

8) The process of free licensing of foreign banks from EC member states should continue. This process should be considered a part of the efforts of Bulgaria for integration in the EC and is in compliance with the obligations, which Bulgaria has assumed as an associated member, as well as with the EC policy of free access to financial services. As far as licensing of the foreign banks from other countries is concerned, art. 12, par. 4 of the Banks Act should be complied with - the licensed bank should have good reputation on the world financial market, which fact should be acknowledged by the recognized banking ratings.

9) Here we have to mention that the on-going process of privatization, isolation and liquidation of state owned companies, which report great losses, as well as the establishment of efficient capital market would strong and positively influence the bank system. These processes would be completed successfully should they go together with increase of the foreign investments and/or inflow of short term foreign capitals, which under the current situation is necessary and sufficient condition for going out of the economic stagnation and economic growth commencing. The inflow of capital would increase the credit resources of the banks, and would create conditions for the increase of credit demand on the part of reliable clients in result of the recovery, which has started. The growth and the increasing profitability of the bank operations on its turn would bring about resuming of the trust in the bank system and inflow of accumulated funds.

The privatization of the larger companies in the real economy with prevailing participation of foreign investors on its turn would attract the interest of the international banks for development of bank activities in the country, because the number of their potential clients would increase substantially. This circumstance would bring about acceleration of the bank privatization, as well as of the process of opening branches and affiliates of foreign banks in Bulgaria.

Obviously more of the above listed measures are within the competence of the parliament, the government, and BCC. BNB may be the initiator of similar proposals to the respective state and international institutions. The opinion of the authors is that the existing tendency of lack of initiative on the part of the institutions on important issues concerning the financial stability of the bank system should be overcome.