

BANKS' STRATEGIES TOWARDS NON-PERFORMING LOANS IN BULGARIA: PROBLEMS, CHALLENGES OF THE REGULATION AND POLICIES ALTERNATIVES

Tatiana HOUBENOVA-DELISIVKOVA⁷⁹

Abstract

The paper analyses the main features of non-performing loans (NPLs) in Bulgaria and qualitative assessment of the varieties of the banks' strategies for their management with regard to the related risk and the consequences for the banks. On one hand, the emergence of NPLs is discussed from point of view of the common behaviour of banks as credit risk arbitrageurs as well as a result of crisis consequences. On the other hand, the 'post ante' issues of the NPLs and especially the banks' resolution policies when NPLs are not repaid any more, require high levels of provisioning and write-downs.

The liquidity crisis of two Bulgarian banks that resulted in their closure in mid summer of 2014 is discussed. The issues of the non-performing banks' liabilities to depositors are discussed and the risk of contagion for the banking and nonbanking intermediaries is revealed. A risk assessment of the interdependence between the banks's insolvency on deposits and the losses sustained by other financial institutions underlines the need of making use of more strict banking regulation. The adoption of more strict regulation concerning the NPLs is revealed with regard to the implementation of good practices of NPLs management and corporate governance of banks.

Keywords: indebtedness, nonperforming bank assets, assets quality management, liquidity, capital adequacy, solvency, contagion.

JEL classification: G21,G28,G32,G33.

Introduction

The typology of the various types of banks' strategies for the treatment of the NPLs may be characterised by several main criteria that should be applied in credit management in order to consider how the monitoring and supervision of the banks may ensure financial stability. On one side, the classification of the non-performing loans has been considered an important approach for the new EU member states to deal uniformly with the bad loans according to accepted international standards (2012, p.32). Besides for the bank management the non-performing loans are to be treated inseparably with regard to the performing and restructured or cured loans. In the interests of a bank with regard to the losses caused by the non-performing is to increase its capacity of self control and to undertake the forbearance of the repayment of all loans with special care. The synonyms of forbearance are self-control and self-restraint in the management of the financial stability and solvency of a bank.

The bank management is to be involved in principle by the proper matching of liabilities and assets as qualitative and quantitative characteristics. At the same time any disproportions in the liabilities-assets management may result in inadequate management of bank's liabilities with threat for the bank's insolvency. Thus non-performing loans are becoming only one aspect of non-performing bank or bank's running into insolvency. The lack of adequate credit policy and specific risk assessment approaches prove to cause difficulties to the bank management of its liquidity and solvency. The issues of unmanageable mismatch between the liabilities and the assets of a bank seem considerably underestimated at present in the Bulgarian case not only by the bank's management staff but also by the Banking supervision. The case of a recent massive bank run and closure of two Bulgarian banks is to be properly analyzed as a necessity to focus on better banking regulation for crisis prevention.

Main features of the NPLs in the banking sector in Bulgaria

The Bulgarian banking system has been characterized by rise of the gross total value of non-performing loans since 2008. On one hand, this increase is a result of the deepening of the crisis and the slowdown of economic growth in Bulgaria in 2009-mid2014 which caused more

⁷⁹ Economic Research Institute at the Bulgarian Academy of Sciences, Sofia, Bulgaria

bankruptcies among the banks' clients (small and medium size companies, non-financial entities and households). On the other hand, due to the slowdown of economic growth and the business uncertainty there has been a credit crunch which did not allow the rise of the total sum of all loans. This is another reason for keeping the share of the non-performing loans high as percentage from the total debt instruments and advances (See Figure 1.)

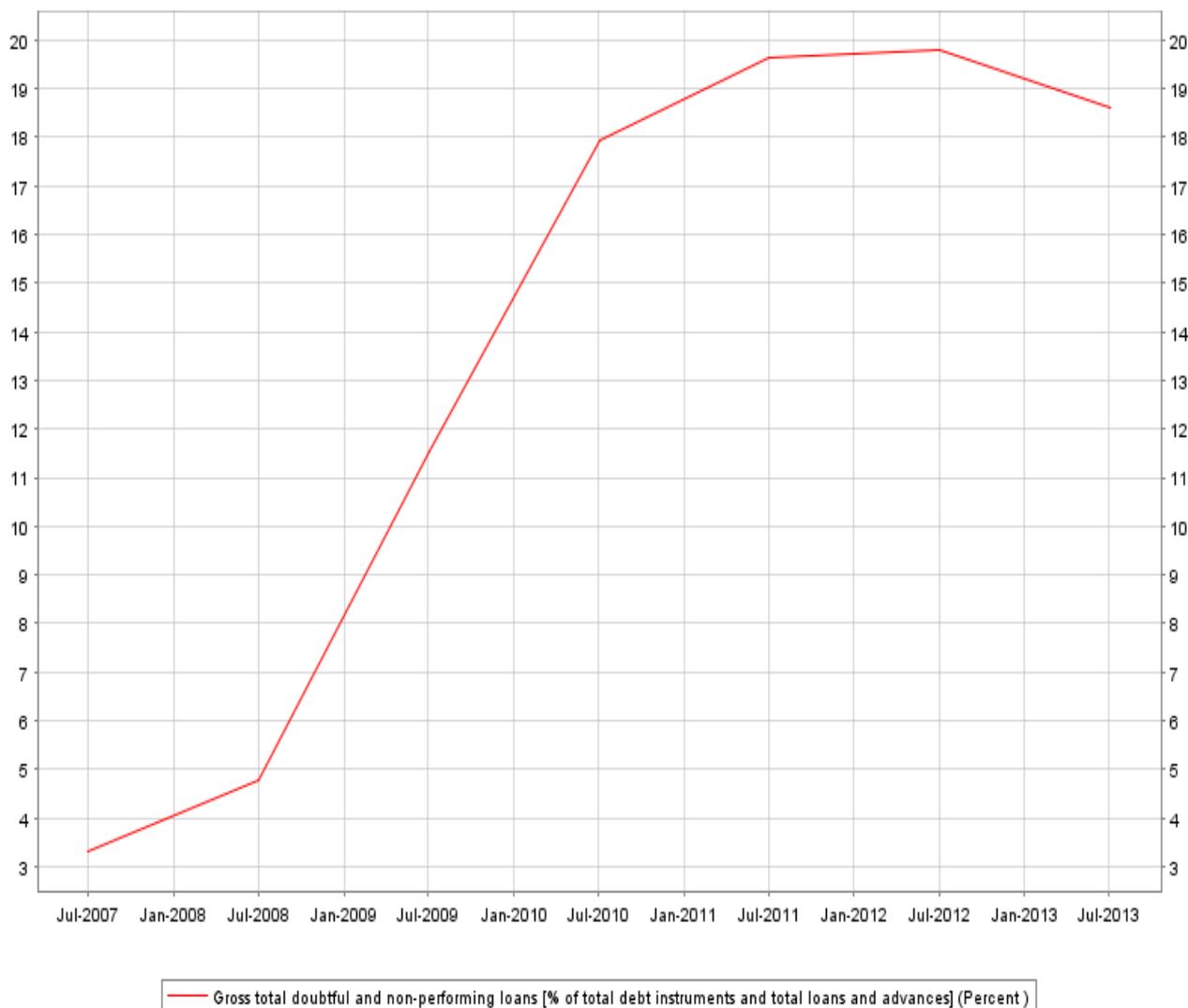


Figure 1. Gross total doubtful and non-performing loans in the banking sector of Bulgaria (2007-2013) (As % of total debt instruments and advances) (In %)

Source: ECB Statistics database, <http://sdw.ecb.europa.eu>

Under the conditions of economic stagnation it has become necessary to improve the discipline of the banks in applying the regulation for the provision of non-performing loans and their explicit management. The outcome of the more strict discipline of the banks' management of non-performing loans has been the relative reduction of the rate of annual growth of non-performing loans (year to year change in percent) compared to their percentage growth as a share of total debt instruments and loans in the banking sector (See Figure 2.).

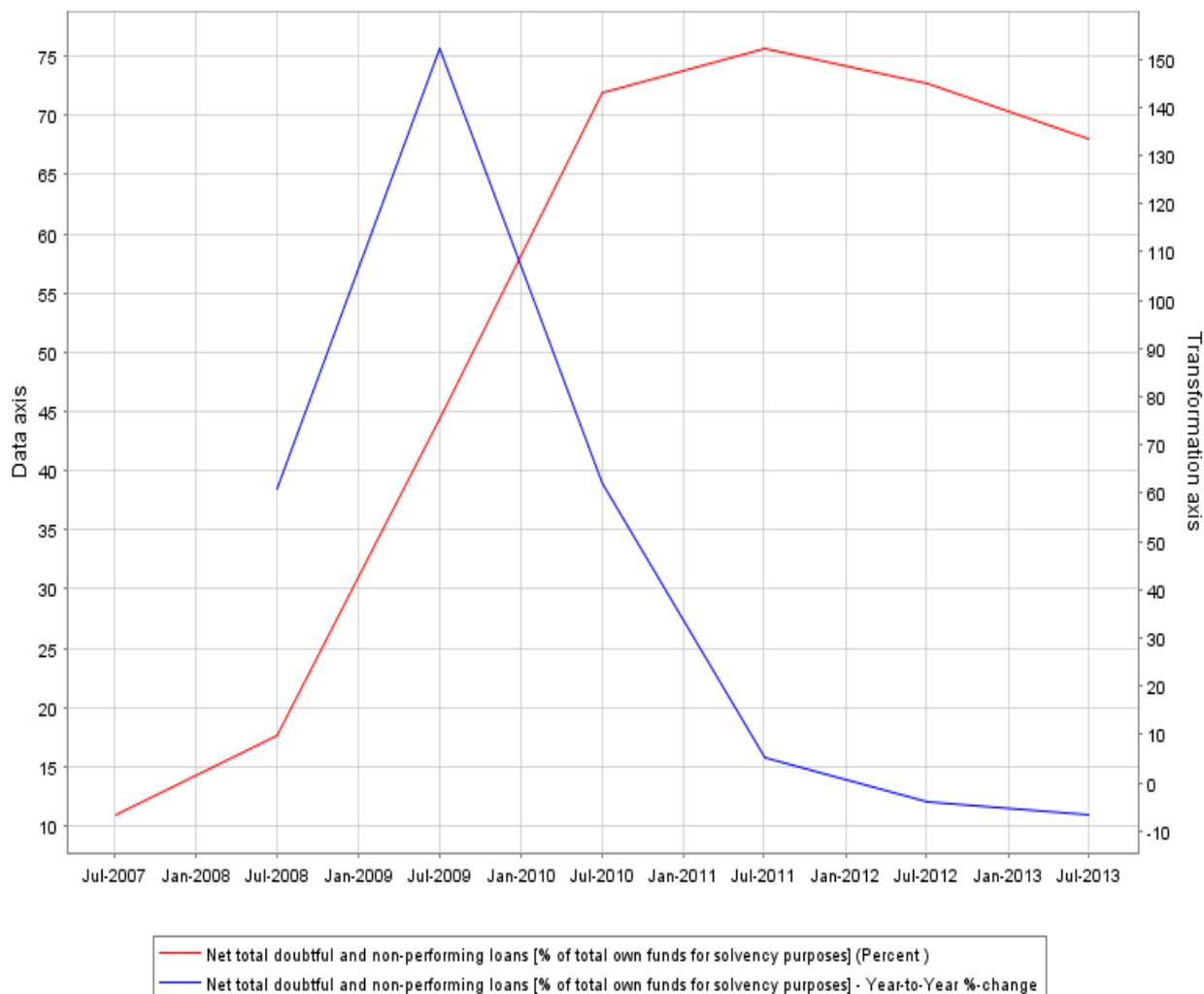


Figure 2. Net total doubtful and non-performing loans in the banking sector of Bulgaria (as % of total own funds for solvency purposes (2007-2013) in % and year to year % change

Source: ECB Statistics database, <http://sdw.ecb.europa.eu>

The cost of the management of doubtful and non-performing loans has been increased as well. As shown in Figure 3. The total sum of provisions of doubtful and non-performing loans has been on a rise in parallel with the annual growth of the gross total non-performing loans as a share of all debt instruments and loans in the banking sector.

At the same as pointed out the category of “doubtful” loans has also been given due consideration. For some of these loans the need of debt restructuring has become a relevant factor in the context of the bank lending strategies. It gives rise to some actual increase in demand for loans following the decision of corporations with outstanding debt obligations to alter the terms and conditions of these loans. Generally, companies use the debt restructuring due to the banks to avoid defaulting on existing debt or to take advantage of lower interest rates or lower interest rate expectations.

In the context of the Bulgarian case the debt restructuring should not be interpreted as the switching between different types of debt to the banks (such as MFI loans and debt securities) but as redesigning the terms of repayment of the restructured bank loan with regard to the debt capacity of the relevant indebted entity.

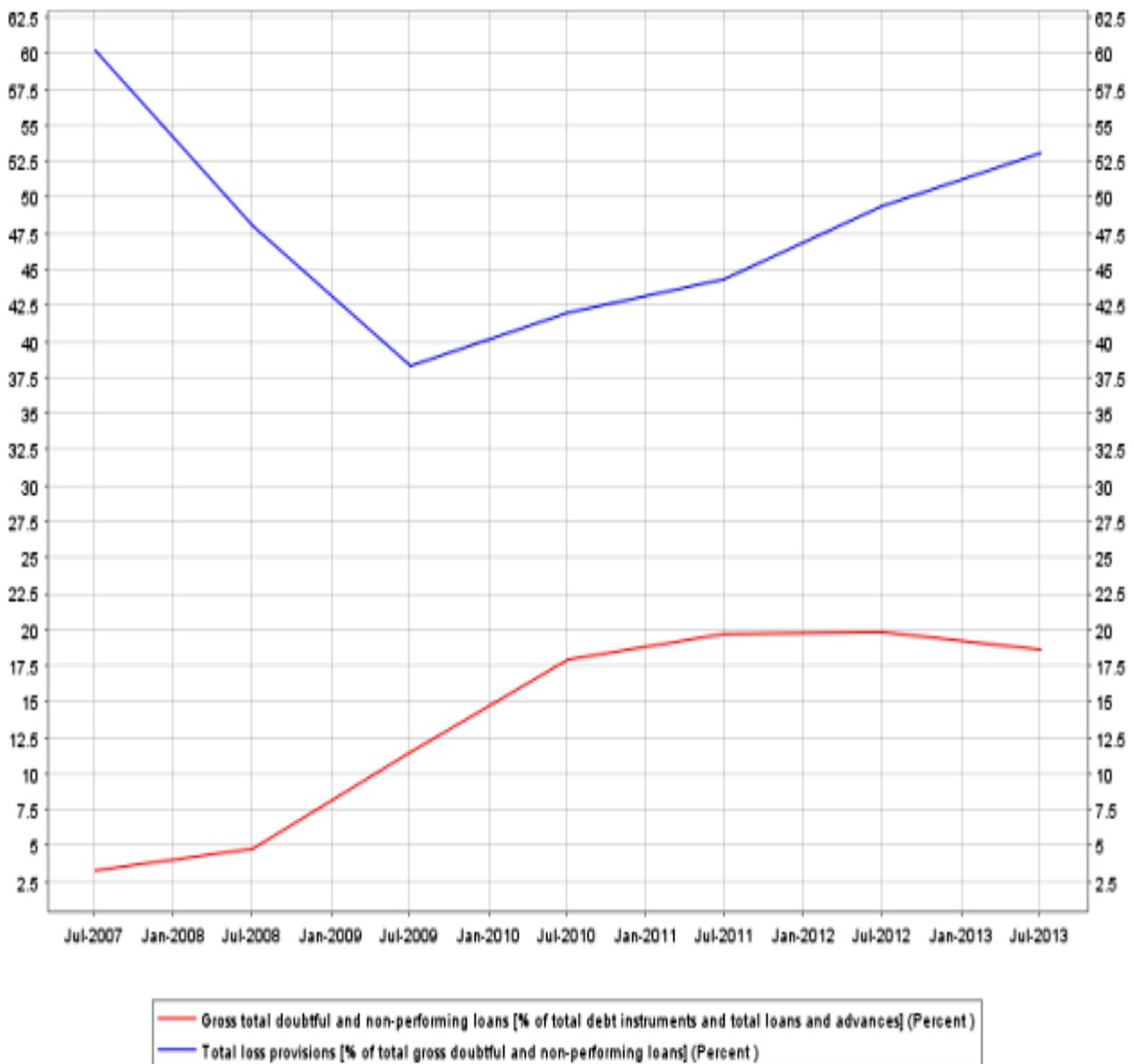


Figure 3. Gross total doubtful and non-performing loans (% of total debt instruments and total provisions (as % of total gross doubtful and non-performing loans) (percent)

In times of lowering the rates of economic growth and stagnating credit the management of banks' liabilities has become an issue of concern. The banks' competition for attracting new deposits has been growing in Bulgaria since 2008 onwards. Gradually the size of NPLs has been reduced and this has made the NPLs manageable and consistent with the other major macroeconomic systems (government finance, money and capital markets). At the same time the imbalances of the *growth of deposits* in the main banks in Bulgaria has been growing especially due to the deposits made by other clients (enterprises and households) than from credit institutions. (See Figure 4).

The competition among banks has been for attracting new deposits. Besides the deposits from institutions other than credit institutions have increased at a higher rate and thus the financial flows to the banking system has allowed a greater area of freedom for the banks to rely on the increased liquidity in the banking system.

However this issue of the disposable liquidity of the banks which most aggressively have increased the deposits has been underestimated as risk for the adequate bank performance (Raiffeisen (2011)). The overview of the banks deposit growth that has been observed in the Bulgarian banking sector in the period (2007- first quarter of 2014) confirms that the most striking example of such rapid growth of attracted deposits is the Corporate Commercial bank which has run into insolvency crisis in June 2014. Its deposits have grown without being paid the due concern by the banking supervision on the grounds of the "too- big-to fail-syndrome".



- Total deposits other than from credit institutions in domestic banking groups and stand alone banks, foreign (EU and non-EU) controlled subsidiaries and foreign (EU and non-EU) controlled branches reporting sector, [% of total assets], Percentage

-Total deposits other than from credit institutions in domestic banking groups and stand alone banks, foreign (EU and non-EU) controlled subsidiaries and foreign (EU and non-EU) controlled branches reporting sector, [% of total assets], year to year %change

Figure 4. Total deposits other than from credit institutions [% of total assets] in the banking sector in Bulgaria

Source: ECB Statistics on Consolidated Banking Data (2007-2013)

The crisis of the Corporate commercial bank in Bulgaria presents a case of moral hazard of too-big-to-fail bank which has become risk taker due to its specific credit policy and the neglected issues of proper evaluation of the risks of non performing loans (Louzis et al, 2011). A policy concern is that as a too-big-to-fail bank this bank has resorted to excessive risk taking by much higher interest rate on deposits. Since market discipline has not been imposed neither by its shareholders and management nor by the Banking Supervision has the bank's credit portfolio undergone excessive growth in recent years. The expected protection of deposits by the Deposit Guarantee fund and by the Government in case of a bank's insolvency has also encouraged the risk of too-big to-fail bank. Consequently, as a large bank the Corporate bank has increased its leverage too much and has acted as usually in such cases banks do by extending loans to companies related to the main shareholder and to lower quality borrowers (Louzis et al, 2011,p.34).

Banks' strategies to NPLs

Given the negative trend of the sharp rise of NPLs in 2008-2012 the NPL resolution has become a major issue of concern in the banking sector. The NPLs resolution has been proceeding at a steady

but low speed due to the fact that the economic recovery in Bulgaria has been weak and the debt market has not been properly developed to help the banks sell their toxic assets.

The strategies of banks towards NPLs have diversified considerably but there are several main trends of their evolution.

First, the NPLs have increased the necessity of reappraisal of the credit discipline as bank's financial health is largely dependent upon the extent and size of performing assets. Credit losses are equivalent to capital losses. Based on data published by the BNB the exposures past due over 90 and over 180 days rose BGN 234 million (2.4 per cent) in 2013. The share of both categories in gross loans (excluding ones to credit institutions) rose

to 17.1 by 30 June from 16.6 per cent at the end of 2012 the net non-performing loans past due over 90 days 52 to net loans ratio also rose to 10.7 per cent, while remaining lower than the gross ratio. The larger share of net nonperforming loans reflected mainly BGN 146 million corporate exposure growth. Non-performing mortgages and consumer loans increased BGN 59 million and BGN 18 million.(2013). Banks responded to sharpened credit risk by raising provisions. An increase in non-performing loan (NPL) has prolonged adverse impacts on bank's balance sheet having consequential effect of erosion of capital impairing earning streams, profitability, liquidity and solvency.

Due to the economic recession the banks still are not acting fully on the basis of the understanding that any compromise with the quality of assets will be a contributing factor towards enhancement of NPLs. The bank management has no choice but to stay focused on the issue of keeping the growth of credit portfolio performing to the maximum extent though the risks may increase due to the worse business environment (Hennie, 2003). The banks' care taking of the borrowers still needs to be upgraded as methods of monitoring the credit discipline (BNB, 2013). As preventive measures against NPLs the maintaining of methodologically consistent framework of analysis, monitoring and control of the borrower's execution of the credit terms is a substantial part of improving the bank's credit policy. The experience of many countries also confirms the importance of making the right choice of the strategic priorities for NPLs management (Masoom, 2013). The forecasting methods of credit risk analysis also have to play a role in the preventive strategies as regards the NPLs by making use of internationally acknowledged good practices (Maggi, Guida, 2009).

Second, a number of bank strategic options are implemented on the basis of wider understanding of forbearance.

As a special agreement between the bank and the borrower the forbearance is meant to delay foreclosure. The bank as a lender delays its right to exercise foreclosure if the borrower can catch up to his payment schedule in a certain time. This period and the repayment plan depend on the details of the agreement that are accepted by both parties. The restructuring of NPLs in this way gains importance and calls for innovative approaches to the specific clients.

The implications of implementation of a wide range of options for foreclosure are positive for the banks. In cases when they do not sell NPLs to specific debt collectors' companies (or transfer the bad loans collection to companies owned by them), the banks apply themselves some of the following options: (1) A reduced loan rate %; (2) A reduced repayment (above Interest only, i.e. positive amortising); (3) A reduced repayment (below interest only, i.e. negative amortising) ;(4) Interest only ;(5) A full moratorium on payments for some period of time; (6) Split Mortgage.

The importance of keeping the proper distinction between the forbearance exposures and the non-performing exposures will be part of enacting the EU in Bulgaria. As seen in Table 1 the forbore loans and debt securities can be performing, cured loans and non-performing loans.

There are definitions proposed by the European Banking Authority (EBA) for forbearance exposures and non-performing exposures and templates in application of Article 99(4) of Regulation EU No 575/2013 (Capital Requirements Regulation (CRR)). Once adopted by the European Commission, they will form an addendum to the FINREP (financial reporting) framework as defined by the implementing technical standards (ITS) on supervisory reporting approved by the European Commission and published on 28 June 2014. In the current context of uncertainties surrounding asset quality for European banks, the EBA has provided supervisors with additional tools to assess on a comparable basis across the European Union the level of banks' forbearance activities and non-performing exposures. Thus the implementation of these strategic options to manage the NPLs in the future may become a new important area of banking activities to be

reported in compliance with the EU law. In cases of write-offs of non-performing loans the enforcement of collateral tends to depend heavily on non-market intervention and cumbersome judicial processes. Introducing regulation with an emphasis on realistic collateral valuation and asset classification may improve the bank resolution. Due to the crisis impact the provisioning of restructured loans to avoid ever-greening and ensure resolution to all truly nonperforming assets has received due attention.

Table 1

Forbearance and its relevance to the banking strategies to NPLs

Performing past due below 90 days	Cured	Non-performing Generic criteria: (past due more than 90 days or unlikely to pay)
<p><u>Fully performing</u> <i>Loans and securities that are not past due and without risk of non-repayment and performing off-balance sheets items</i></p> <p><u>Performing assets past due below 90 days</u> <i>Loans and securities between 1-30 days past due</i> <i>Loans and securities between 31-60 days past due</i> <i>Loans and securities between 61-90 days past due</i></p>	<ul style="list-style-type: none"> • Modification of terms and conditions • Refinancing • Other forbearances 	<p><u>Defaulted banking book (loans and securities)</u> <i>Fair value option</i> <u>Impaired: fair value through other comprehensive income</u> <u>Amortized cost</u></p> <p><u>Off-balance sheet items:</u> <i>Loan commitment's</i> <i>Financial guarantees(except derivatives)</i> <i>Other commitment's</i></p>

Source: EBA (2014) EBA FINAL draft Implementing Technical Standards on Supervisory reporting on forbearance and non-performing exposures under article 99(4) of Regulation (EU) No 575/2013, p.6, EBA/ITS/2013/03/rev1, p.6.

The write-off of fully provisioned NPLs in some cases is a preferable solution. Such a proactive strategic approach is gaining importance when lengthy liquidations through legal procedures may cause rising expenditures of the bank that has become an owner of the debtor's assets as collateral. Though the sale of collaterals may end with low recoveries on bad loans, the cleaning of bad loans could be a better solution for the bank than the decapitalisation of the collateral.

The market revaluation of collaterals of NPLs tends to reduce the price of assets and the banks encounter great difficulties in execution of NPLs from the ongoing slowdown of the Bulgarian economy. Banks are flexible in adjusting the payment terms of cooperative distressed borrowers, but generally avoid interest capitalization or refinancing.

Third, the sale of problem bank loan portfolios and outsourcing of their collection to separate companies registered under the Trade law in Bulgaria presents an important instrument of encouraged out-of-court restructurings. This strategy to NPLs is to make them a performing debt with a loan modification as agreed with the collectors' company. The investor who purchased the NPL has to make the debt on credit performing and the borrowers will be making their payments to the investor as long as they repay their debt. Once the debt becomes performing it also becomes much more valuable and could be sold on the market to another investor who is looking for a

performing investment. This approach to NPL resolution through an effective risk asset management strategy, has given good results where NPLs are identified, organized and then resolved. This usually involves the establishment of an asset management company (AMC) by the bank itself or by resorting to an independent collectors' company.

Forth, legislative changes in favour of making better the legal terms and providing availability of choices to the borrower to repay his debt have been introduced since 2012. These changes may encourage application of such measures of direct intervention in dealing with the NPL problem, as for instance setting some barriers to the interest rate burden on consumer credits offered by nonbanking institutions. Some recently introduced legal treatments as regards banking credits are also a novelty (notably the possibility of early repayment schemes without banks' imposing a tax) but yet have not been taken into a wider application by the banks.

The case of Non-performing banks: new agenda for the bank regulation of non-performing assets and Banking supervision

The bank crisis in Bulgaria of two interrelated private banks (Corporate commercial bank and Victoria bank) has demonstrated the weaknesses in the bank management with regard to asset quality and prudential supervision of bank's management of assets and liabilities. The massive bank run of 20 of June 2014 resulted in suspending the payments to customers of the Corporate Commercial Bank AD ('KTB') and the Bulgarian National Bank ('BNB') Governing Council decided to place it under conservatorship due to a risk of insolvency, for a period of three months.

As a consequence, the fulfilment of all of KTB's obligations have been suspended (including giving depositors access to their funds – both depositors whose deposits benefit from the cover provided by Directive 94/19/EC ('protected deposits' and 'protected depositors') and depositors whose deposits do not benefit from that cover().

Further deepening of the bank crisis has been the suspension of the payments to customers by Victoria Commercial Bank EAD ('VCB') (whose capital is 100 percent held by KTB) on 22 June 2014, as the BNB Governing Council decided to place it under special supervision due to a risk of insolvency, for a period of three months. Thus the fulfilment of all of VCB's obligations has been suspended (including giving depositors access to their funds – both protected depositors and non-protected depositors).

Since the start of the crisis the issue of the deposit guarantees at the banks has become extremely controversial case of *bank liabilities management*. At the same time while the two banks have been placed under conservatorship the issues of the bad management of *banks' assets* have become also a concern due to the fact that the preliminary information brought to the public has focused on the difficulties to evaluate the state of the assets. Thus on 25 June 2014, following BNB's instructions, a review of the KTB bank group's assets and liabilities by independent external auditors was ordered by the conservators and on 11 July 2014, the BNB publicly announced the results of these audits.

However, due to a *lack of important information on the financial position and/or the proper utilization of loans in the loan files regarding a specific category of borrowers*, the auditors were requested to make a full evaluation of all KTB assets, which is due by 20 October 2014, at the latest. The political situation in Bulgaria worsened with the fall of the former Coalition government and the Parliament has suspended its sessions. This has made impossible to adopt a draft special law as conceived the BNB and the Ministry of Finance in order to enact certain measures, such as the acquisition of VCB by the Bulgarian state, the transfer of certain assets and liabilities of the KTB to the then state owned VCB and the revocation of KTB's bank license and to declare the KTB bankrupt. This law could not be agreed on, and is therefore not yet adopted.

The banking crisis has raised several *issues for the state of the banking and financial system*.

On one hand, the problems of the two banks have become indicative for the need to focus on the evaluation of the risks related to the banks' assets management. The European Banking Authority underlined the need of risk assessment of banks' assets in its recommendations for the banking sector in EU in 2013. Bulgaria has not applied for accession to the EBA but at present there is a pending need of more strict regulation and assets management in compliance with the EU law (EBA, 2014).

On the other hand, according to the EU law *the deposit protection* is an essential element in the completion of the EU internal market, and it is as essential as the prudential rules for the completion of the single banking market. This is also an indispensable supplement to the system of supervision of credit institutions on account of the solidarity it creates amongst all the institutions in a given financial market in the event of the failure of any of them. The bank crisis has a negative impact on the financial sector as a whole and the difficulties encountered are indicative for the necessity of reforms for further integration to the EU. Even in the area of the regulation of the guaranteed deposits which has been comparatively easily harmonized with the EU since 2008 there seem to be a great need of better compliance with the EU regulation. i

Under Article 1(3)(i) of Directive 94/19/EC a deposit is considered 'unavailable' if the "deposit is due and payable but has not been paid by a credit institution under the legal contractual conditions applicable thereto, where the relevant competent authorities have determined that in their view the credit institution concerned appears to be unable for the time being, for reasons which are directly related to its financial circumstances, to repay the deposit and to have no current prospect of being able to do so. The competent authorities shall make that determination as soon as possible and in any event no later than five working days after first becoming satisfied that a credit institution has failed to repay deposits which are due and payable"(EC,2009).

Article 10(1) of Directive 94/19/EC states that "deposit guarantee schemes shall be in a position to pay duly verified claims by depositors in respect of unavailable deposits within 20 working days of the date on which the competent authorities make a determination as referred to in Article 1(3)(i) or a judicial authority makes a ruling as referred to in Article 1(3)(ii)." Besides the Recital 12 to Directive 2009/14/EC2 explains that "Deposits may be considered unavailable once early intervention or reorganisation measures have been unsuccessful. This should not prevent competent authorities from making further restructuring efforts during the payout delay (EC,2009)."

The reference to early intervention measures demonstrates that deposits may be considered unavailable without a credit institution being subject to insolvency proceedings, while it is also clear that the process for payment of protected deposits should not be delayed once initial reorganisation measures have failed.

The situation of the bank crisis management in Bulgaria has become incompatible with the with the Directive 94/19/EC. Since 31 July 2014 the EBA made a preliminary enquiry requesting information from the BNB, particularly, on the ability of depositors to access their deposits and, in case of unavailability of deposits, the availability of recourse to the Bulgarian Deposit Insurance Fund ('BDIF'), after receiving information on the inability of depositors to access their deposits in KTB, and in accordance with Article 17 of the Regulation.

The BNB's position has been argument by several main points according to the Bulgarian national legislation:

First, according to the present Bulgarian legislation, the repayment of guaranteed deposits is possible when a bank's licence is withdrawn by the BNB. Within the timeframes provided for in Directive 94/19/EC it is foreseen to repay guaranteed deposits within 20 working days of the date on which the competent authorities make a determination regarding the unavailability of the credit institution's deposits or a judicial authority makes a ruling which has the effect of suspending depositor's ability to make claims against it) (BNB, BFGD, 2014).

Second, the decision for withdrawal of bank's license is required to be taken by the BNB within five business days of establishing the insolvency of the credit institution. However, for the purpose of resolving a credit institution at risk of insolvency, the BNB may place such a credit institution under conservatorship. While under conservatorship, the bank may be subject to different measures, including suspension of payment of obligations. On 16 September 2014 the BNB Governing Council extended the conservatorship of KTB and VCB to 20 and 22 November 2014 respectively. A final decision with regard to KTB's future is expected to be made between 1 and 20 November 2014.

Third, the BNB argues that in case the BDIF repays the guaranteed amount of the deposits placed with a bank under conservatorship while its financial situation is being reviewed, and with no decision reached for its insolvency yet, the bank may lose the larger part of its depositors, which would make its resolution pointless or impossible.

Fourth, BNB also argues that where the European Commission decides that the national provisions do not comply in full with Directive 94/19/EC, measures should be taken to amend them within a short timeframe but this cannot be done before an amendment of the of the Bulgarian legislation adopted by the Bulgarian Parliament. Following dissolution of the parliament in August a new parliament has not been established yet after the elections held on 4 October. Thus thee option of a possible interim partial access to deposits is not covered by the currently effective legislation either, and cannot be realized without the relevant legal amendments.

Fifth, finally, the BNB states that consideration should be given to the fact that the

guaranteed amount of deposits placed with KTB and its subsidiary VCB is higher than the funds contributions accumulated at the BDIF. The BDIF has not made any payment to depositors so far. The BDIF has informed the EBA that it received a number of claims for payments from depositors, and has received over 500 inquiries regarding the status of KTB and VCB. The BDIF has also stated that Bulgarian law provides for payment of verified protected deposits without individual claims being necessary, but there is no legal procedural provision with respect to payment of individual claims. It considers that under the Bulgarian implementation of Directive 94/19/EC any full or partial payment by the BDIF would require an explicit act by the BNB or a judicial authority.

In June 2014 the banking system in Bulgaria was under pressure as a result of

active withdrawal of funds attracted by both credit institutions - banking group KTB were placed under special supervision. Problems in the banking system proved inevitably negative impact on the Bulgarian capital market , which is characterized by relatively downstream development. All BSE indices (SOFIX, BGBX40, BGTR30 and BGREIT) noted seriously decrease on a monthly basis respectively -8.9% , -9.9% , -7.3% and -3.7% . The problems of " Corporate Commercial Bank" (KTB) have negative impact on the bank's shares traded on the BSE in the period 16 to 20 June the price of CCB shares fell by -9.8% and 86.501 lev / share (opening price on Monday) is dropped to 78.05 lev / share (closing price on Friday) when he was stopped trading with them. Placed under special supervision and suspension of activities of banking CCB group at the end of . June 2014 led to a number of problems in the non-banking financial sector:

- An inability both companies and investment firms to fulfill their obligations under the Markets in Financial Instruments (FIMA), which leads to serious risks to the rights and interests of bank customers in their capacity investment firms due to the inability of its customers to dispose of own funds ;
- other investment firms as own funds and their customers remain blocked in the banking group KTB
- management companies have invested funds managed by them collective investment schemes in securities issued by the CCB or in deposits in both credit institutions , leading to a violation of the requirement assets in which they invest are fast liquid;
- After cessation of the activities the two banks can not perform obligations in their capacity as trustee for the holders of bonds , which creates risks to the rights and interests of the holders of such emissions concern for the rights and interests of investors receiving services by the two banks, in their capacity as investment intermediaries and rights shareholders of CCB as a public company and the holders of bonds CCB in its capacity as issuer;

The possibility of contagion in other credit institutions and in the non-bankingl sector has worsened. Based on the available information collected and blocked funds in the banking group KTB under the form of deposits and current accounts investment firms , management companies and mutual funds amounted to 42.9 million. In the development of the adverse scenario as the bankruptcy of Corporate Commercial Banking Group, the direct losses from blocked funds in them in the form of deposits and current accounts, estimated at 41.1 mln for the insurance segment, not considering the loss of accrued interest on these deposits (CFS,2014).The direct losses from holdings of shares and bonds of the CCB are assessed to amount to a larger sum of losses together with the indirect losses that would be suffered as a result of the investments in collective investment schemes which have been blocked as funds in the banking group KTB .

The estimated total losses only on the side of the insurance market amounted to almost 19 million, and all the data show clearly that exposure of pension funds to the CCB are relatively small in adverse scenarios and other things being equal, the impact will be only in the direction of reducing the realized yield. These estimates should be regarded as a lower limit of possible losses of the

non-banking financial sector, as due to the interconnectedness of participants financial system. However any disturbance on the participants in non-banking financial sector as a result of the bankruptcy of CCB can become possible. Contagion in both banking institutions and other credit non-banking institutions and among those in the non-banking financial sector increase the amount of losses and significantly raise the price of the overcoming the crisis with public money.

In the present case, by suspending all obligations of KTB and VCB for more than three months the BNB made deposits unavailable within the meaning of Article 1(3)(i) of Directive 94/19/EC. Under conservatorship state it is questionable what initial reorganisation measures are undertaken and if not why they have not been undertaken.

The suspension of the access to deposits has been imposed for reasons which are directly related to the financial circumstances of KTB and VCB. This derives from the fact that the decision was based on Article 115(1) and (2) point 2 and 3 of the Bulgarian Law of Credit Institutions which requires that “the bank’s liquid assets in BNB’s opinion will be insufficient to enable the bank to fulfil its obligations on the day they become due, or the bank has not met in time one or more of its obligations to its creditors when they have become due”.

The first condition seems therefore to have been met on 20 and 22 June 2014 respectively for the two banks, and continues to be met. From that point, KTB and VCB were unable to repay deposits which are due and payable. Such inability resulted from the depletion of the liquidity of KTB and VCB and was perpetuated by the moratorium.

The second condition also appears to be met. There is “no current prospect” of deposits being repaid if the credit institution cannot be expected to regain its ability to repay deposits in the short term. The deposit-guarantee scheme required under Directive 94/19/EC serves to insure not only the nominal value of covered deposits but also provides, at least to some extent, a substitute for the otherwise availability of such deposits in accordance with their terms. The determination that deposits are unavailable can therefore only be avoided if access to deposits is expected to be resumed within a very short time period.

The recommendation of the European Banking Authority has underlined the fact that any margin available to the Bulgarian national bank has been overstepped in this particular case, with deposits still unavailable more than three months after their initial unavailability and, as conservatorship having been extended to 20/22 November 2014, no immediate prospects of those deposits becoming available by that time.

The analysis of the Bulgarian case shows a number of arguments for the need to refer to the EU Directive for early intervention measures because deposits at the two banks under under conservatorship may be considered unavailable without a credit institution being subject to insolvency proceedings, while it is also clear that the process for payment of protected deposits should not be delayed once initial reorganisation measures have failed (Directive 94/19/EC, 2009, p. 3). Besides the delay in the crisis management worsens the uncertainties of the conflicts and problems that have arisen.

Conclusion

The crisis of trust in the Bulgarian banking system has become a result not so much because of mismanagement of NPLs but a result of neglected internal banking control on the mismatch of assets-liabilities bank management and lack of strict and responsible. Banking Supervision on a bank which has grown to be “too-big-to-fail”. Thus at present the setting of adequate priorities in the policy agenda of the banks themselves has to ensure that their risk asset portfolio is performing to the maximum extent by exercising professional due diligence from the beginning process of the borrower selection all along to the ultimate end of repayment of credits..The improvement of the implementation of the EU law as regards the supervision and the good corporate governance in the banking sector is considered to be the necessary condition for the banks and non-banking financial institutions to provide credits in favour of stimulating growth. Improved governance and future steps of Bulgaria for accession to the EBA and to prepare for entry in the European Monetary Union are to limit unmanageable risks that could be cleared only at the cost of public money and with the funds of the Deposit guarantee scheme.

Bibliography

1. BNB (2014) Letter of 19 August 2014 of the BNB's Deputy Governor and Vice-Chairman of the BDIF Management Fund to the EBA, 19 of August, 2014.
2. Bulgarian National Bank (2013) Bulgarian National Bank EPORT • January – June 2013, pp. 49-50.
3. Commission for Financial Supervision in Bulgaria (2014) Review of the nonbanking financial sector in Bulgaria, 2/2014, <http://www.fsc.bg/Analizi-na-KFN-bg-29>.
4. Directive 2009/14/EC of the European Parliament and of the Council of 11 March 2009 amending Directive 94/19/EC on deposit-guarantee schemes as regards the coverage level and the payout delay, 2009, (OJ L 68, 13. p. 3).
5. EBA (2014) Recommendation to the Bulgarian National Bank and the Bulgarian Deposit Insurance on action necessary to comply with Directive 94/19/EC, www.eba.europa.eu/documents/10180/856039/EBA+REC+2014+02+%28Recommendation+to+the+BNB+and+BDIF%29.pdf, 22.11.2014
6. EBA (2013) Recommendations On Asset Quality Reviews Report, www.eba.europa.eu/documents/10180/449802/EBA-Rec-2013-04+Recommendations+on+asset+quality+reviews.pdf, 07.11.2013.
7. European Banking Coordination "Vienna" Initiative (2012) *Working Group on NPLs in Central, Eastern and Southeastern Europe*, March 2012.
8. Espinoza, R. and Ananthakrishnan P. (2010) *Nonperforming Loans in the GCC Banking System and their Macroeconomic Effects*," IMF Working Paper 10/244, (Washington, October), 2010.
9. Maggi, B. and Guida, M. (2009) *Modeling non performing loans probability in the commercial banking system: efficiency and effectiveness related to credit risk in Italy*, Working Papers, No. 1 ,May 10, 2009 , Sapienza University of Rome, Faculty of Statistics,
10. Masoom, M. (2013) *Strategies for recovery of non-performing loans*, FEATURE & ANALYSES, 16 February 2013.
11. Nkusu, M. (2011) *Nonperforming Loans and Macroeconomic Vulnerabilities in Advanced Economies*, IMF Working Paper 11/161, (Washington, July), 2011.
12. Hennie V. G (2003) *Analyzing and Managing Banking Risk: A Framework for Assessing Corporate Governance and Financial Risk*, 2nd Edition, Washington DC: World Bank Publications.
13. Raiffeisen (2011) *CEE Banking, Special Report: Banking Sector Convergence 2.0*, (Vienna, October), www.rbinternational.com/ceebankingreport, 2011.