

Bulgarian National Bank

Mr. Andrea Enria
Chairperson
European Banking Authority
Tower 42 (Level 18)
25 Old Broad Street
London EC2N 1HQ
United Kingdom

21 October 2014

Re.:EBA/REC/2014/02

Recommendation to the Bulgarian National Bank and Bulgarian Deposit Insurance Fund on action necessary to comply with Directive 94/19/EC

Dear Mr. Enria,

With reference to your letter as of 17.10.2014 and the enclosed Recommendation to the Bulgarian National Bank (“BNB”) and the Bulgarian Deposit Insurance Fund (“BDIF” or “the Fund”) on action necessary to comply with Directive 94/19/EC (“Recommendation”), we hereby inform you about the steps we have taken or intend to take to ensure compliance with Union law. Please note that if there is any additional relevant information that we find important and necessary to provide within the 10-working day term, set under the Recommendation, we shall update you in a swift manner.

1. Recommendations and Legal Analysis

Recommendations 1 and 2

Under paragraph 1 of the Recommendation, BNB and BDIF are requested to ensure that, in accordance with their duty under Article 4(3) of the Treaty on European Union, they take all appropriate measures to ensure they fulfil their obligations under Article 1(3)(i) and Article

10 of Directive 94/19/EC, as set out in paragraphs 2 and 3 of this Article, including by interpreting national law, so far as possible, in line with those Union law obligations.

Moreover, under paragraph 2 the BNB is recommended to ensure that depositors have access to deposits covered by the protections given under Directive 94/19/EC ('protected deposits'), whether by removing or limiting the restriction on access to deposits resulting from its supervisory actions in placing KTB and VBC in conservatorship, or by making the determination referred to in Article 1(3)(i) of Directive 94/19/EC immediately and communicating it to the BDIF. The BNB is recommended to take one or other of these actions by 21 October 2014.

As we have already stated in our previous communication, the definition of the "unavailable deposit" under Art. 1(3)(i) of Directive 94/19/EC, may not be directly applied, insofar as it is not unconditional, sufficiently clear and precise to confer directly rights and obligations on the authorities in each Member State. The definition entrusts no direct competences to a specific competent authority in each Member State. In compliance with the definition, the national legislation shall specify the relevant competent authority and set forth its competences, including national measures to determine that the deposits are "unavailable". In addition, we have made it clear that the Directive 94/19/EC sets out minimum harmonization and therefore, transposition measures are required so as to achieve the result of the Directive, while also ensuring full compliance with the national legal order and the legal system particularities.

The determination of "unavailable deposit" under Art. 1(3)(i) of Directive 94/19/EC is to be made by the „relevant competent authorities“. The competent authorities, however, are designated under the national law and are vested with competences exhaustively listed in the national legislation. In this respect, the only competence entrusted to the BNB under the relevant national provisions implementing Article 1(3)(i) of Directive 94/19/EC, is to revoke a bank's license provided that the conditions laid down in Article 36 of the Law on Credit Institutions ("LCI") are met. Revocation of the banking license is subject to appeal before the Bulgarian Supreme Administrative Court. In this respect, any other decision made by the BNB outside its scope of competences, set out in the national legislation, would be null and void. The BNB is not competent under the applicable national legislation to determine that deposits in a credit institution are unavailable in any other manner but by revoking the banking license.

Likewise, the BDIF is obliged to repay the guaranteed deposits under Article 23 of the Law on the Guaranteed Deposits in Banks ("LGDB") only in cases where the BNB has revoked the banking license of the relevant bank. No other preconditions for the repayment of the deposits are envisaged under the effective legislation. Moreover, such a decision implies for distribution of assets of the Fund for billions of levs and cannot be approved without clear and sound legal basis in the national legislation.

Any administrative authority can make its decisions and adopt administrative acts within the scope of its competences which are determined by the national law. Provided the national law implementing the respective EU legislative act narrows its sense and fails to provide the designated competent authority with the full range of competences as required by that EU act, the national law should be amended.

The provisions of Article 1(3)(i) of Directive 94/19/EC, which is in fact only a definition, requires national implementation measures in compliance with the national legal order and particularities. Such measures as stipulated under the Bulgarian legislation provide for revocation of the banking license as a precondition for any repayment of deposits from the BDGF. No other national measures are available in the legislation transposing the provision of Article 1(3)(i).

Furthermore, the placement of a bank under conservatorship, including the suspension of execution of its duties, is a national supervisory measure available under Chapter VIII of the LCI. This measure is implemented with respective administrative acts which the BNB adopted in June 2014 in compliance with the conditions set forth under the law. The said acts were not appealed before the court and entered into legal force. Under Article 115, para 3 of the LCI, this measure can be imposed for a maximum term of six months. Provided that this term is too long compared to the term for repayment of guaranteed deposits under Directive 94/19/EC the national legislation needs to be respectively amended.

In light of the aforesaid, we shall note that although the alleged non-compliance with the EU law is attributable to the BNB and the BDIF, neither of the two institutions is responsible for the revision of the national legislative acts ensuring the correction of the non-compliance. Therefore, the issue related to the potential inconsistency between Bulgarian legislation and the Directive 94/19/EC can be addressed only with an amendment of the Bulgarian legislation adopted by the Bulgarian Parliament. In this regard the measures, on which the Bulgarian authorities are already elaborating, are outlined below.

Recommendation 4

Paragraph 4 of the Recommendation suggests that if the BNB considers that providing full availability of deposits directly from the deposit-holder could create adverse effects for the financial sector in Bulgaria, as an initial step towards ensuring full compliance with its Union law obligations, it should ensure that partial access to those deposits is provided immediately, with full access made available as soon as possible.

BNB remains consistent in its efforts to ensure full availability of the deposits on sound legal grounds. In this respect, we shall note that there are no legal rules and procedures that enable the BNB to allow partial access to deposits. As specified above, except for the provision of Article 23 of the LGDB, no other preconditions for the repayment of the deposits are set forth under the effective Bulgarian legislation. There are no legal provisions on the basis of which a

partial repayment could be implemented in case of substantially insufficient liquid assets. No rules governing the distribution of the liquid assets in such a case are available. Therefore, the Bulgarian legislature has not entrusted the BNB with the competence to allow or deny partial access to deposits. In this regard any decision made by the BNB would be arbitrary, thus not legally sound.

Recommendation 5

Under paragraph 5 of the Recommendation the BNB is recommended to accelerate the ongoing audits of the KTB and VCB and the process for taking decisions on the future of the credit institutions, in order to provide certainty for all depositors and other creditors as quickly as possible.

In this respect, please note that the results from the asset quality assessment of KTB and the relevant measures to be taken so as to ensure both compliance with the relevant legislation and certainty for the concerned depositors are outlined below.

2. Measures Undertaken by the National Authorities

On 29 September 2014 the Bulgarian authorities received a letter for formal notice from the European Commission regarding an alleged failure for compliance the Directive 94/19/EC. On 15 October 2014 the Council of Minister of Bulgaria submitted the observations of the country on the problem identified by the Commission regarding the application of the Union law.

With regard to the observation of the Commission for incorrect transposition of Article 1(3) and Article 10(1)(1) of the Directive 94/19/EC, Bulgaria has stated that while transposing the Directive 94/19/EC, it aimed at achieving the result set by the European legislative act, giving due regard to the specific provisions as well as to the spirit of the act as whole. Nevertheless, the Bulgarian authorities have observed that there might be a non-compliance regarding the prompt access of the depositors to their deposits. The Bulgarian state informed the Commission that in order to deal with the suggested non-compliance, it has initiated an accelerated drafting of a new Law on the DGS. A respective time schedule for its elaboration has been enclosed. In addition, the Bulgarian government announced that there was no existing legal framework in Bulgaria for the restructuring of the credit institutions. In this context Bulgaria expressed its readiness to transpose the Directive 2014/59/EC Establishing a Framework for Recovery and Resolution of Credit Institutions and Investment Firms and respective introduction of the restructuring tools envisaged therein by the end of 2014 (January 2015 at the latest), introducing a gradual change in the current legislation, including amending the relevant conservatorship provisions and the term of this supervisory measure.

The new legislation that is being drafted shall, *inter alia*, give due regard to the concerns expressed both by the EBA and the European Commission. BNB is and will continue to provide its expertise on the matter to assist the competent authorities in Bulgaria in the process of the legislative changes so as ensure full compliance with the Union law.

Today, 21 October 2014, the Governing Council of the BNB adopted a decision that took consideration of the information on the analysis and valuation of the assets of the KTB, as submitted by the auditors “Deloitte Audit” OOD, “Ernst and Young Audit” OOD and “AFA” OOD. The findings of the analysis and the assessment made by the three audit firms of the assets of KTB show that additional impairments in the amount of billions of levs shall be set aside which once accounted for will create a huge loss in the P/L account, respectively will show a negative capital. These losses have resulted from very uncommon for the banking system vicious lending practices, which have been obviously concealed by misleading and untrustworthy financial and supervisory reports submitted to the BNB for long by the management of this bank. The conclusions indicate a case that is completely isolated and not typical for other Bulgarian credit institutions. The Governing Council of the BNB has requested that the conservators book the results from the analysis and assessment of KTB’s assets in full compliance with the International Financial Reporting Standards and ensure that until 31 October 2014 they will be ready to provide to the BNB the necessary supervisory reports, on the basis of which the decisions, stipulated under the LCI, shall be made.

Yours sincerely,



Nelly Kordovska
Acting Deputy Governor
Banking Supervision Department
Bulgarian National Bank