

# Bulgaria: Two bank runs and a bankruptcy

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***Bulgaria experienced a run on two of its biggest banks in late June, leading the central bank to close the fourth-largest bank in early July and start criminal investigations against several people. Moreover, the bank runs may have been the final push for the government to call early elections and have pushed the country into talks with the ECB to take over supervision of its banks and with the EBA to review the central bank's banking supervision. Banking sector risks are obviously elevated!***

## Two bank runs and a bankruptcy

It is not entirely clear what triggered the run on the fourth-biggest bank, Corporate Commercial Bank (CCP or Corpbank or KTB), in the days ahead of 20 June, when the Bulgarian National Bank (BNB) placed it under conservatorship. Negative media reports about CCP's main shareholder on 17 June forced the BNB to issue a statement that it was watching the banks closely. However, on 18 June when local media found out that the BNB's deputy governor and head of banking supervision had to take a leave of absence due to criminal investigations, and linked that to the CCP, people apparently started queuing to get their savings out. On 20 June the CCP was out of cash and had to ask the BNB to place it under conservatorship. Two days later, Crédit Agricole Bulgaria – a subsidiary of the CCP acquired from French Crédit Agricole in May – was put under three-month special supervision.

A total of BGN 1bn was withdrawn from the CCP before it had to close. After an external audit concluded on 9 July, the BNB learned that one person had taken out a fifth of the total deposit withdrawals during the run, or BGN 206m, the day before the bank had to close. The receipt of the withdrawal had been delivered to the bank's main shareholder. Moreover, the BNB learned from the audit [nexus.nordea.com/research](http://nexus.nordea.com/research)

that documentation for two-thirds of the BGN 5.4bn loan portfolio was missing and that a considerable part of that loan portfolio was related to the bank's main shareholder. The BNB decided that good assets will be transferred to Crédit Agricole Bulgaria, which will open under a new name on 21 July, and to close the CCP. Parliament is still discussing how to treat bondholders and whether to cover deposits up to the EUR 100k deposit insurance guarantee or in full. The government budget deficit target for this year has been doubled to 3% of GDP to cover the potential capital shortfall at the CCP.

Bulgarians queued one more time in late June. This time First Investment Bank, Bulgaria's third-biggest bank, was the target of what the BNB called an organised criminal attack. A total of BGN 800m was withdrawn from the bank, but apart from an early-Friday close for logistical reasons, the bank stayed open and liquid. According to The Wall Street Journal, the run on First Investment Bank was triggered by text messages and e-mails urging the bank's clients to get their money out. During the last weekend of June, the European Commission approved a BGN 3.3bn credit line from Bulgaria to its banks to prevent additional speculative attacks, which has so far put an end to the bank runs.

## **Banks look healthy in general**

The Bulgarian banking sector seems to be fairly sound. The three main rating agencies – S&P, Moody's and Fitch – as well as the IMF have all said that Bulgarian banks are liquid and well-capitalised despite high non-performing loan ratios. The two bank runs and a bankruptcy are thus isolated events probably related to criminal activities, corruption and fraud – criminal investigations will show. S&P downgraded Bulgaria to BBB- with a stable outlook in June, but cited a weak political environment unlikely to foster reforms and growth rather than banking sector woes.

A large share of foreign banks is generally thought to reduce the risk of bank runs as foreign banks may find it easier to provide the necessary liquidity to their local subsidiaries in case of a run than a local bank. Two-thirds of the Bulgarian banking sector is owned by foreign banks, but a large part of that is Greek banks, which increases the risk of spill-over from renewed financial instability in Greece to Bulgaria.

Moreover, the tendency for foreign banks has generally been to take capital out of Bulgaria rather than to send more money. The big question is therefore if foreign banks believe risks have increased in Bulgaria.

This week's news is that the BNB has started talking with the ECB about joining the Single Supervisory Mechanism (SSM), that is, it wants the ECB to take over the supervision of Bulgarian banks. Bulgaria would be the first non-Euro-area country to join, but the SSM is in principle open for all EU countries. Letting the ECB take over the supervision seems to be a smart move to increase confidence in the banking system, especially because it most likely requires an Asset Quality Review (AQR) just like the big Euro-area banks are going through at the moment. If there are more skeletons in the closet, it should become visible during the AQR and hence before the ECB takes over supervision. Another news headline said that the BNB has asked the European Banking Authority (EBA) to review its own banking supervision, which should also help restore confidence. In the near term, however, risks are that more wrongdoing will come to the fore.

## **Limited risks for the broader economy and the BGN**

Barring new evidence of wrongdoing at other banks, the implications for the broader economy seem limited. The bill for bailing out bondholders and depositors of CCP could increase the budget deficit this year, but parliament has already agreed to increase the budget deficit this year to 3% of GDP. Public finances are not the main concern, though. Government debt is below 20% of GDP – one of the lowest in the EU – and past years have seen fairly responsible fiscal policy. However, the government also risks unexpected bills from the disagreement between the energy regulator and foreign energy distribution companies, and from the international pressure to intervene in the South Stream project as part of the sanctions against Russia. Additional increases in the budget deficit could trigger rating downgrades.

The economy is also in much better balance now than prior to the global financial crisis. The massive current account deficit from 2007 had been turned into a small surplus

by 2013. External debt has also been reduced, though it remains high. We see limited risks to the EUR/BGN peg that has been in place for more than a decade.

## **Politics and lack of growth are the real problems**

The real problem, however, is the lack of growth. GDP remains below pre-crisis levels, investment remains 30% below pre-crisis levels and there are half a million fewer jobs now than before the crisis. There are a few positive signs from the domestic economy so far this year supported by reduced energy prices, while exports have disappointed a bit. Growth is likely to stay modest.

Closing the current account deficit, tightening the fiscal stance, suffering from the peg to a strong EUR and lack of capital inflows are key reasons why the recovery has still not really taken off. However, other countries, such as the Baltics, have been in a similar situation and have managed to grow somewhat faster. Thus, we believe that a significant part of the “lack of growth” problem is structural.

Two “real” governments and an interim government have governed just since 2013. The current government has said it will resign on 6 August and let an interim government take over until the 5 October parliamentary elections result in a new government. No wonder that no real structural reforms have been implemented. A disastrous European Parliamentary election result for the ruling socialist party (BSP) and the two June bank runs may have been the final push for the government to call early elections.

The next government needs to deal with corruption, attract foreign interest in investing in the country and not least to persuade foreign banks to keep capital in Bulgaria. A particular risk relates to the period ahead of the 5 October elections. Will an interim government be able to handle another bank run? International pressures on the South Stream project? Discussions with the ECB and the EBA?

## **Conclusion**

The banking sector is generally seen as sound, and the two bank runs and a bankruptcy are seen as isolated criminal events. However, these events have attracted attention to a

weak political environment and a weak economy that may find it difficult to absorb too many additional isolated events. Looking further ahead, the involvement of the ECB and the EBA should strengthen confidence in the banking system and could – with the help of a new, stronger government, structural reforms and a bit of growth – help increase foreign interest in investing in Bulgaria.

## Timeline of events

**13 June** S&P downgrades Bulgaria to BBB- with a stable outlook, citing weak reform environment.

**17 June** BNB says it is closely monitoring the banks and especially Corporate Commercial Bank (CCP) after media speculation about its main shareholder.

**18 June** BNB's deputy governor and head of banking supervision takes leave of absence due to criminal investigations.

**20 June** Corporate Commercial Bank (CCB) is placed under conservatorship at the request of the bank itself. CCP is the fourth-largest bank in Bulgaria. Nearly BGN 1bn deposits were withdrawn from the bank before it had to close. It later becomes known that a fifth of the total amount of deposits, BGN 206m, was withdrawn by one person on 19 June, and the receipt was delivered to the bank's main shareholder.

**22 June** Crédit Agricole Bulgaria – a subsidiary of CCB – is placed under special supervision for three months. CCB had acquired Crédit Agricole Bulgaria from French Crédit Agricole on 7 May 2014.

**25 June** An independent audit of the entire CCB group's assets and liabilities starts. It concludes on 9 July.

**27 June** The Bulgarian National Bank (BNB) states that First Investment Bank is under *organised attack*, "*launched by an outbreak of rumours and malicious public statements*". The BNB will use all means to guarantee people's savings, it says. First Investment Bank closes early for logistical reasons after people have queued all day to take out deposits, but reopens on Monday. It continues to pay out

deposits during the run. First Investment Bank is the third-largest bank in Bulgaria.

**29 June** The [European Commission](#) authorises the provision of a credit line of BGN 3.3bn to be provided by the BNB to the banking system to prevent speculative attacks.

**29 June** President Plevneliev announces that parliament will be dissolved on 6 August to pave the way for early elections on 5 October.

**30 June** The BNB announces that the bank runs have ceased.

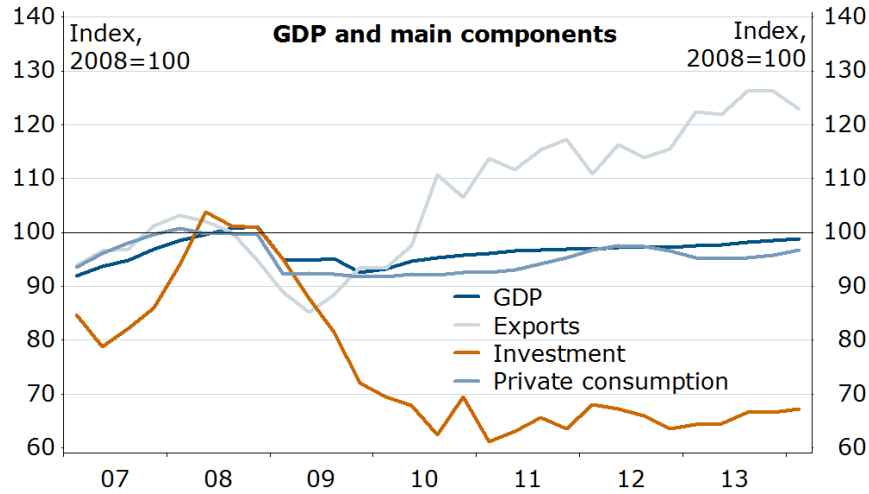
**11 July** The [BNB releases](#) the results of the independent audit. The BNB states that Crédit Agricole Bulgaria was well-managed with good loan quality and adequate buffers, while the CCB audit “... *show actions which are inconsistent with the law and good banking practices, to put it mildly. Significant parts of credit files for a loan portfolio of BGN 3.5 billion, out of the total BGN 5.4 billion loan portfolio, are missing, most probably destroyed during the days before the conservatorship was placed. A considerable part of that credit portfolio suggests a very large connectedness between debtors and the majority shareholder of the bank, Mr Tsvetan Vassilev.*” The BNB hands over the case to the General Prosecutor.

**11 July** Crédit Agricole Bulgaria is nationalised and the good assets of CCP are transferred to Crédit Agricole Bulgaria. Crédit Agricole Bulgaria is expected to reopen on 21 July under a new name. CCP’s banking licence is revoked and bankruptcy proceedings commenced.

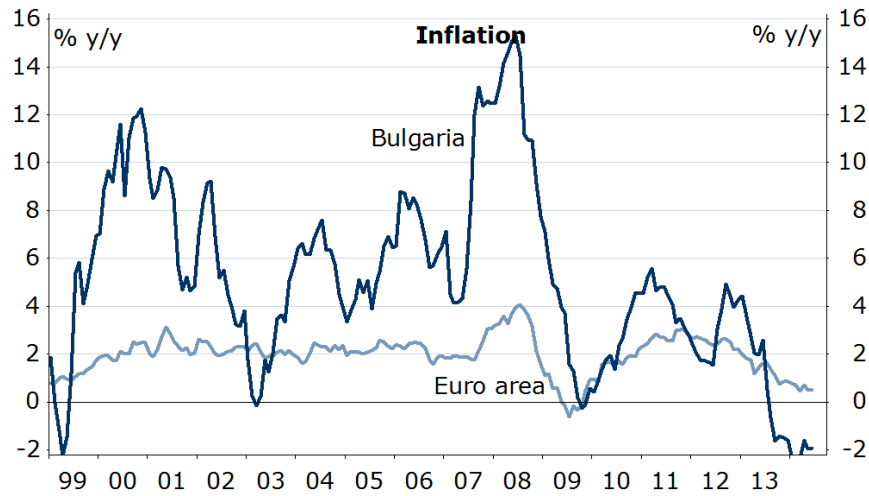
**14 July** The president says parliament has agreed to double the budget deficit to 3% of GDP to cover losses related to the banking crisis, not least covering deposit guarantees up to EUR 100k.

**15 July** Bulgaria says it is in talks with the ECB as the first step towards formal application for membership of the EU’s Single Supervisory Mechanism (SSM). Bulgaria would be the first non-Euro-area member to join, but it is in principle open for all EU countries. Moreover, the BNB has asked the European Banking Authority (EBA) to review its banking supervision.

**A few charts**



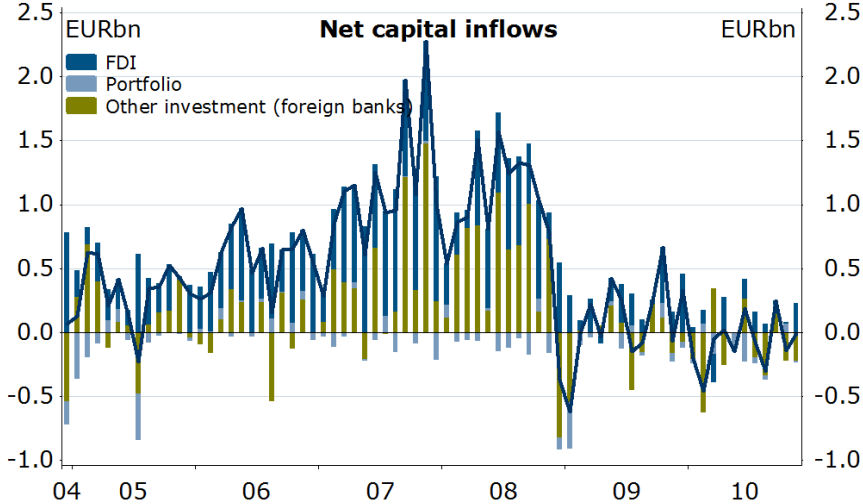
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