

BANKING SYSTEM IN BULGARIA CHARACTERISTICS AND INDICATORS

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Abstract. *The current article presents a model of creditworthiness analysis of bank loan applicants. The author emphasizes the possibility of using accounting information when analyzing the creditworthiness of loan applicants. The essence, prerequisites and the factors that influence creditworthiness are defined. The creditworthiness analysis is based on preliminary research into the factors and the prerequisites that can influence the repayment of the credit in due course. The credit analysis is defined as a process of establishing the current creditworthiness of loan applicants and forecasting the trends in its development. Top priority goals and stages in the bank credit analysis are determined.*

Key Words: *Assets, liabilities, capital, loan, liquidity, bank.*

The beginning of banking in Bulgaria is associated with the establishment of Bulgarian National Bank /BNB/ in the beginning of 1879. The bank was established on the ground of statute approved by prince Alexander Dondukov-Korsakov, who at the time in his quality of Russian imperial commissar led the Temporal Russian government in Bulgaria. In the beginning of 1885, the Law for establishment of BNB was passed, according to which it was a governmental bank with fixed capital 10 000 000 golden levs, deposited by the state and given to ownership of the bank. The law envisaged operations traditional for the central bank, such as: emission of coins and bank–notes, crediting of the state, preserving of money resources, and cash servicing of the governmental budget. The law also permitted BNB to realize banking – deposit and credit deals typical for a commercial bank. In 1881, the first Bulgarian coins were cut and in 1885, the first Bulgarian bank–notes were put into currency.

With the last two laws for BNB in 1906 and 1926, the independence of the bank was increased significantly and it became a real central bank of the banks with issuing and regulatory functions. Simultaneously with the establishment and development of BNB as

a central bank, commercial banks with participation of Bulgarian and foreign capitals arose and started to function in the country. So towards 1945, the banking system in Bulgaria already consisted of: BNB – 107 branch offices, Bulgarian agricultural and cooperative bank -119 branch offices, Bank Bulgarian credit – 32 branch offices, foreign banks – 33 branch offices, General union of popular banks – with 250 popular banks.

In 1947, the Law for banks was passed, which put the beginning of new banking legislation in the conditions of centralized planned economy. The commercial banking was liquidated and the construction of new banking system on the ground of introduced governmental monopoly in the banking sphere begun. According to this law, the banking and the conclusion of all banking deals and operations: deposit, credit, commission and commercial, are exceptional monopoly right of the state. This monopoly right is realized by BNB and in the sphere of long-term crediting by Bulgarian Investment Bank /BIB/. BNB can delegate the right of realization of banking deals and operations to Post saving bank, popular banks, universal agricultural co-operations, departmental cash-desks and others. In 1951, with the Decree of Presidium of National assembly, Governmental saving bank (GSB – DSK) was created with the status of deposit-taking institute with full governmental guarantee of bank deposits. From 1964/5 it started offering financial services in the sphere of non-cash payments and crediting of population for consumer credit type, and from 1967 its activity is regulated with the Law for DSK.

Two years after the political changes that took place in Bulgaria in 1989, the new Law for BNB /1991/ was passed, with which the bank received the status of central bank with significant autonomy, and in 1992 the Law for banks and crediting entered in power. With these two laws, the full-value and vigorous existence and functioning of commercial and central banking as differentiated sector in the national economy was restored. An important role for restructuring of banking system was played by Bank Consolidation Company / BCC/ and via it, in a short period of time, the former branch offices of BNB and some other governmental banks have been transformed in new bank institutions, which have gradually introduced market mechanisms in their activity and take leading place in bank sector of the country. Simultaneously with this, on the market appear new-licensed banks and also foreign banks, which completely change the appearance of bank system in Bulgaria. Under the influence of internal and external political and economical factors and reasons, in the end of 1996 and the beginning of 1997, a serious economical crisis sets in the country, and it has most seriously influenced the bank system. The expression of this is the announcement of insolvency of more than 15 commercial banks and their deprivation of license for bank activity. With the changes in bank legislation in 1997, the so-called currency board has been practically introduced in Bulgaria, and after that, as a result of concrete measures and decisive actions taken by the Government and the Central bank, the crisis has been gradually overcome and conditions and prerequisites for stabilization and development of bank system were created via the introduction and implementation of strict rules, restrictions, and norms for bank activity. The money system of the country has been stabilized via the introduction of fixed exchange rate of lev, first connected with the German mark and consequently with the Euro.

Towards the end of 2008, the bank system in the Republic of Bulgaria includes 24 commercial banks, 6 branch offices of foreign banks and Central bank /BNB/. The bank legislation in the country is expressed by: Law for BNB, Law for credit institutions, Law for bank insolvency, Law for guaranteeing of bank deposits, Law for money transfers,

electronic payment instruments and payment systems, Law for consumer credit. Of some importance are also other laws, which regulate separate aspects of bank activity or treat deals that banks can include in their license as: Monetary law, Law for measures against money laundering, Law for public offer of securities, Law for markets of financial instruments, Law for governmental debt and others. An important part of regulations for bank activity is the Orders of BNB, which determine basic requirements and conditions for issuing of license and functioning of commercial banks, as well as most important regulators, norms and indicators for bank activity such as capital adequacy, liquidity, solvency, credit risk and other.

With the admission of Bulgaria to EU, reciprocal acknowledgment and admission of activity of the banks from member states of the union has been settled in a legal way. A bank, licensed in a member state can realize, via a branch office on the territory of Republic of Bulgaria, the activities envisaged in Law for credit institutions, if they are included in its license, after BNB has been informed by the competent organ who has issued the license. Meanwhile, it is allowed for a bank licensed in the Republic of Bulgaria to realize its activities on the territories of other member states via a branch office, if they are included in its license for banking activity

According to current Bulgarian legislation, the commercial banks in the Republic of Bulgaria are created and work as joint-stock companies. The own capital of the banks is formed and maintained as share capital. In special Law for credit institutions some specific requirements for capital of the banks are settled, and, according to them, the minimum deposited capital in establishment of a bank can not be less than 10 million leva, and the payments against the recorded stock must be money and made with own resources. The bank issues only unavailable stocks as each stock gives the right of one vote. Without the written permission of the central bank no bank can increase its capital with non-money payments, to buy back stocks emitted by it and to decrease its capital.

Each bank is obliged to own its own capital at all times corresponding to general risk profile. In connection with this, the banks set up a relation of general capital adequacy as a percentage ratio between the own capital and risk-assessed assets. According to regulation of BNB this ratio can not be less than 12 %. The ratio of capital from first row / initial capital/ towards risk-assessed assets must not be less than 6 %.

The banks compose and present in the Central bank a Report for capital adequacy every three months on the basis of data from the accountancy balance. A bank whose capital adequacy falls under the percentage determined by norm is obligated to work out and implement a sanitary program with the aim of setting the capital adequacy in correspondence with legal requirements. In the period of program's realization the bank can not allocate dividends. In case of non-execution of the accepted program, the Central bank applies measures and sanctions determined by it, including taking off the license for banking activity.

There are particular requirements for solvency and liquidity of the banks. The solvency is the ability of the bank to cover its obligations in long-term period. When the total value of obligations exceeds the total value of bank assets, the Central bank compulsory withdraws its issued license because of insolvency.

The liquidity is the ability of the bank to pay its current /demandable/ obligations and is expressed in the availability of money resources or other current assets, which in short period can be transformed into money. The requirement for liquidity imposes mainte-

nance of particular assets' structure, depending on their type, parameters and characteristics, and at the same time, the adequacy of assets and liabilities towards settled indicators, such as amount, maturity and other must be ensured.

The banks manage their liquidity in a way that guarantees them that they can realize their daily obligations regularly and with no delay, both in normal bank environment and also in conditions of crisis. The system for management of liquidity in a bank includes:

1. rules and procedures for management of liquidity
2. organs for management of liquidity
3. management of information systems

The liquid assets of the bank in the sense of Regulation issued by BNB are: money resources in Central bank, resources on current accounts and deposits with period to 7 days in other commercial banks, government treasury bills and bonds of Bulgarian government, tradable debt securities, in requirements and conditions, settled by Regulation of BNB, gold in form of bars and ingots with weights accepted on markets of gold.

The liquidity of the bank is observed on the ground of two coefficients:

1. Coefficient of liquid assets – ration between sum of liquid assets at disposal and sum of deposits and other bank's liabilities.
2. Coefficient of liquidity on dates of payments and other intervals – ratio between sum of assets /incoming money flood/ for corresponding ending interval plus the remainder of net money flood for the previous interval towards deposits and other bank's liabilities.

The liquidity of the bank is considered acceptable, if the coefficients for liquidity of ending intervals are not less than 1, at least for the two ending periods. BNB observes the amount and content of liquid assets of the bank and, if necessary, determines minimum coefficients of liquidity for each separate bank.

The banks periodically assess their risky expositions and form provisions for losses of devaluation on criteria determined with the regulation of the Central bank. Risk expositions are all credits and other claims of a bank regardless of their origin and the used financial instrument for which there is a risk of loss and is accounted on amortization value. The criteria on which they are evaluated are classified as follows: period of delay of demandable sums on them, assessment of debtor's financial status and sources for payment of his liabilities, and additional criteria determined by the Central bank.

On this basis of the risk involved, the expositions are classified in four groups: regular, under observation, irregular, and non-served expositions.

Regular exposition is a risk exposition which is served as the data for debtor's financial status does not give any reason for doubt that he will pay his liabilities completely. They are classified as such in the simultaneous presence of the following conditions: the principal and interest are paid regularly, in correspondence with the contract's conditions, or with a delay up to 30 days, but when the delay is casual and the debtor uses the loan for purposes envisaged in the contract, the bank has enough actual information about debtor's financial condition and sources of payment of his obligations and also other documents connected with his activity.

Expositions under observation are risk expositions in which there are insignificant breaches in their serving or there is possibility for aggravation of debtor's financial condition, which can put the full payment of the liability under doubt. Exposition under ob-

servation arises in the presence of the following conditions: collected overdue payments on the principal or interest with period of delay from 31 to 60 days, debtor uses the loan for purposes different from those envisaged in the contract, the end term of contract with lump-sum payment is re-negotiated, given to newly-established company or to a company with bad credit history.

In irregular expositions there are breaches in their serving or there are data that debtor's financial status is not stable, its current and expected receipts are not sufficient for full payment of his liabilities towards the bank and his other creditors, and when there are found weaknesses with clearly expressed possibility for the bank to undertake losses. The risk exposition is classified as irregular when one of the following circumstances is present: collected overdue payments on the principal or interest with period of delay from 61 to 90 days; there is significant aggravation in debtor's financial condition which can impede liquidation of liabilities.

Non –served are those risk expositions in which there are significant breaches in their serving due to aggravation of debtor's financial status, for his liabilities it is accepted that they can not be collected, although there is partial restoration value, which can be realized in the future. The risk exposition is classified as non – served in one of the following conditions: collected overdue payments on the principal or interest with period of delay longer than 90 days; the debtor has permanent money insufficiency; the debtor is in insolvency or is in process of liquidation and there is risk to leave the creditors unsatisfied; the claim registered as balance position is subject of legal procedure or is adjudged by court to the bank, but it is not collected; there are other circumstances which give reason to consider that there is danger for the risk investment not to be paid.

Against concrete risk expositions classified as under observation, irregular or non – served, the banks calculate specific provisions for losses of their devaluation. The specific provisions represent increase of balance value calculated according to applicable accountancy standards, over the risk value of the exposition. The risk value of the exposition is determined as follows:

1. the negotiated money positions are deducted with percentage for risk of losses depending on exposition's classification group.
 - a) for the exposition under observation not less than 10 %
 - b) for irregular expositions – not less than 50 %
 - c) for non – served expositions – 100 %
2. fixed money floods are discounted via the application of the method of effective interest percentage and are summed.

The specific reserves for risk expositions form reserve against losses of future events that participates in the calculation of capital adequacy. They are deducted from the own capital /capital base/,

The expositions of a bank towards one person or economically connected persons as set of balance assets off –balance positions, if they are in great amounts, lead to concentration of risk and because of that, they are liable to normative regulation. The exposition is considered big when it is equal or exceeds 10 % from bank's own capital, and it cannot exceed 25 %. The total amount of all big expositions cannot exceed 8 times its own capital.

Bank legislation in Bulgaria does not allow a bank to be partner with unlimited responsibility in a trade company. The size of direct and indirect share participation of the

bank in a company that is not a bank, investment broker, or insurer cannot exceed 10 % of its own capital. The total amount of share participations in companies that are not banks, investment brokers, or insurers cannot exceed 50 % of its own capital.

Towards the end of September 2008, the assets of bank system in Bulgaria were 69 349 million leva /35 454 million Euro/. Over half of the bank market is taken by five big banks, which for statistical purposes, on the basis of their assets sum are determined as first group commercial banks. Towards the end of September 2008, their market share is 57.8 % / the total sum of their assets is 40 089 million leva which is distributed in the following way: Unicredit Bulbank – 15,43%, DSK bank – 12.64, United Bulgarian bank – 11,41%, Raiffeisen bank Bulgaria – 10,33%, Eurobank EFG – 7,99%. The second group which includes other commercial banks is with market share of – 37,1%, and the third group – branch offices of foreign banks – 5,1%.

In last several years there is a tendency towards decrease in market share of banks with national capital /local banks/. Towards 30th September 2008, it was 15,7%. The biggest share was of the banks which are daughter companies to banks from EU – 77%. Following it were: branch offices of banks from European Union 4,6%, commercial banks outside the EU 4,6%, and branch offices of banks outside EU – 0,6%.

Bulgarian Bank for Development (BBD) is created and works completely with national / governmental/ capital. It was created with special law of Bulgarian parliament and although in its form it is a commercial bank, it is actually a specialized governmental credit institution with a mission to support the development of Bulgarian economy, encouraging export and supporting the realization of governmental policy relating to micro, small and medium-sized enterprises.

According to the Law for BNB, under the conditions of currency board in Bulgaria, the Central bank can not give credits to commercial banks, but only as an exception, in cases determined by law. Until the current moment such exceptions have not been made. Practically commercial banks can refinance themselves from BBD on the basis of the package of measures for minimizing the negative effects of world financial crisis over the Bulgarian economy, accepted in the end of 2008. According to the accepted measures, BBD will allocate credit lines to the amount of 10 million Euro to commercial banks in the country, which on their side from these credit lines will allocate loans to small and medium-sized enterprises to the amount of 1 million Euro, in conditions and requirements, which are standard for the bank system in the country.

In the sum of bank system's assets on balance value, the biggest is the share of claims on credits and advanced payments, including financial leasing which are 54 750 million leva /78,95%. According to currency types the credits are distributed in the following way: in Euro – 53%, in leva – 42,9%, in other currencies – 4,1%. The credits allocated to corporative clients represent 56,23 % from the total gross amount of the credits. From them, 67,3% are in Euro, and from credits allocated to physical persons 72,4% are in leva.

In the balance of bank system in Bulgaria towards 30th September 2008, liabilities were 61 791 million leva /89,10%/ and own capital was 7 558 million leva /10,90%. In attracted banking resources, the biggest is the percentage of deposits of households and citizens. /36,36%. Following are: attracted resources from non-credit institutions /33,16%, from credit institutions /27,47%/ and those in regime of subordinated debt and hybrid instruments/3,01%. In capital's total volume the biggest is the share of reserves on account for deductions from profit including undistributed profit /47,01%/ Following it is

the part of inscribed and deposited capital. /32,67%/, the profit /income/ from the current year /14,55%/, and total sum of bonus and revalued reserves loans 5,77%.

Indicators for quality of assets, capital adequacy of liquidity of banks in Bulgaria towards end of September 2008 are high and confirm conclusions and assessment for the stability of bank system in the country during the examined period. The share of regular exposition is 95,72%, and non – served expositions take 2,03%. The degree of assets' preservation is 1,76%, and the coefficient for covering of non – served expositions is 124,93%.

Generally, the good capital base /own capital/ and high capital adequacy of banks in Bulgaria is seen in the following table:

In thousand levs

| № | Indicators | Total for the bank system | Commercial banks – first group | Commercial banks – second group |
|----|--|---------------------------|--------------------------------|---------------------------------|
| 1 | 2 | 3 | 4 | 5 |
| 1. | Capital base | 7 586 162 | 4 827 467 | 2 758 695 |
| 2. | Capital from first row | 6 006 483 | 3 667 441 | 2 339 042 |
| 3. | Capital from second row | 1 873 275 | 1 323 342 | 549 933 |
| 4. | Total capital adequacy | 14,35% | 14,59% | 13,95% |
| 5. | Capital adequacy of capital from first row | 11,04% | 10,84% | 11,37% |

The good quality of the assets is confirmed by the data in the following table, which show high liquidity of the banks in the end of ninth month of 2008.

| № | Banks | Coefficient of liquidity in % | Coefficient of liquidity for interval during the year in % | | | | | |
|----|------------------------------------|-------------------------------|--|-------------------------|--------------------|---------------------------|----------------------------|-------------|
| | | | In observation – up to 7 days | From 8 days to 1 month. | Over 1 to 3 months | Over 3 months to 6 months | Over 6 months to 12 months | Over 1 year |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
| 1. | Total for the bank system | 22,94 | 76,78 | 19,02 | 17,59 | 18,08 | 36,59 | 98,74 |
| 2. | Commercial banks from first group | 19,75 | 71,40 | 19,26, | 16,71 | 18,31 | 45,38 | 111,14 |
| 3. | Commercial banks from second group | 26,06 | 93,65 | 27,02 | 22,96 | 22,12 | 30,72 | 96,84 |
| 4. | Commercial banks from third group | 24,05 | 55,46 | 4,20 | 9,28 | 6,18 | 13,71 | 42,35 |

The accountancy of the banks is organized and realized in correspondence with Accountancy act, International accountancy standards and bank chart of accounts. More special significance is given to ISFR (International standards for financial reporting) 7 "Financial instruments – announcing". It regulates reporting of the risks specific for the bank, which come from all financial instruments that do not exist in other enterprises and are not treated in the remaining International accountancy standards. BNB issues methodological and supervising instructions for organization of accountancy in the banks, reporting of bank deals, giving and announcing of information in financial reports.

Financial reports of the banks are prepared according to the regulations of Accountancy act, Law for credit institutions, International standards for financial reporting /International accountancy standards/ and instructions of BNB /Supervising instructions and reports/. The annual financial report is prepared towards 31st December in thousands levs and must correctly and honestly present the property and financial condition of the enterprise, the registered financial result, changes in money floods and own capital. It includes the following components: accountancy balance; report for incomes and expenses; report for money floods; report for own capital and application. Their content and form are determined according to applicable International accountancy standards and International standards for financial reporting.

The application contains information about applied accountancy policy, condition and changes in assets, own capital, income, expenses and money floods, about off-balance engagements, and other announcements according to the requirements of International accountancy standards. The structure and content of applications for supervising purposes is determined by BNB, which gives it to commercial banks mainly in the form of tables /verifications/. Such tables /verifications/ are for example the ones for derivatives, kept for trading, for financial assets at disposal for sale, for credit claims and investments, kept to date of payment, for devaluation of overdue assets, for investment properties, for financial assets, for provisions and other.

In accordance with principles determined in national normative acts on accountancy and the requirements of International accountancy standards and observing ordinary international practice, each separate bank develops its own accountancy policy, which represents a combination of specific principles, bases, conventions, rules, and practices. The central place in accountancy policy is taken by approaches / methods and principles that a bank must observe and apply in realization of its accountancy and in composition of financial reports. It comes from basic accountancy principles for current calculation, acting enterprise, cautiousness, matching between incomes and expenses, advantage of content over form, keeping if it is possible of accountancy policy for the previous period of review and independence of separate periods of review and value connection between initial and final balance.

From 1st January 2007, division "Bank supervision" in BNB introduced new Frame for consolidated financial reporting for market purposes (Frame for consolidated financial reporting – FCFR) applicable for credit institutions in Europe. The new frame substituted the requirements existing until 31st November 2006 and it was based on IAS / ISFR, accepted by the European union. The introduction of uniform frame gives the opportunity for harmonization of accountancy of credit institutions in Bulgaria. They will use identical and standardized forms and definitions of the data both for supervision and public aims. The frame consists of basic and additional (non-basic) financial information, which is

divided into 39 forms of review. Towards each form of review there are references concerning the corresponding IAS / ISFR, ordinary bank practice and documents of European central bank (ECB). The frame for consolidated financial reporting takes under consideration ISFR 7 and IAS 32 in their part for presentation.

Basic financial information is presented in the frame via consolidated balance and consolidated report of incomes /the previous report for incomes and expenses/. BNB initially introduced only the basic information via two mentioned forms of review. The forms of review containing additional /non-basic/ financial information will be introduced in stages until the end of 2008.

The banks compose annual report for management /annual report for the activity/ which contains least demandable information according to Accountancy act and other information on instructions of the Central bank or estimation of the leadership.

Annual financial report is given and published in correspondence with common rules and requirements of accountancy, bank and commercial legislation and according to instructions of BNB for preparation and giving of annual financial report.

The banks prepare annual financial report until 31st March and consolidated financial report until 30th June of the following year. The financial reports are checked and certified by specialized auditing enterprise with seat in the country, which is a registered auditor according to the Law for independent financial audit. For the check –up's results of annual financial report, the auditor prepares a report in which he gives a conclusion about circumstances concerning reliable presentation of property and financial condition of the bank and the received financial result. The auditor makes check – up and expresses his auditor's opinion also about:

1. reliability of system for internal control
2. correspondence of supervisory reports prepared by the bank with bank legislation

The auditor of the bank also prepares a separate report for supervisory purposes on a form, determined by the Central bank. It is presented to managing organs and to the leadership of specialized service for internal control of the commercial bank and also to division "Bank supervision" of BNB.

Commercial banks also present to BNB some additional reports / intermediate and annual/ determined in separate regulations of the central bank. Such are for example: report for capital adequacy; report for classified risk expositions and fixed specific provisions for credit risk; report for liquidity; report for determination of deposits' amount and its relation towards bank's own capital; report for big expositions and other. The reports on regulations in the end of the year are considered as an inseparable part of bank's annual report.

Annual financial report for the activity of branch office of a bank with a seat in a third country is checked and certified by specialized auditing enterprise, which is registered according to Law for independent financial audit and is published in accordance with Accountancy act. This does not concern branch offices of banks that are licensed in member – states of EU.

The certified annual financial report of the bank is published together with auditing report and annual report for activity until 30th June of the following year, via declaration and an announcement in Trade register.

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BANKARSKI SISTEM U BUGARSKOJ KARAKTERISTIKE I INDIKATORI

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U članku se istražuju počeci i razvoj bankarskog sistema u Bugarskoj i načinjena je analiza i procena osnovnih karakteristika i indikatora bankarske aktivnosti. Veća pažnja je posvećena značaju indikatora za adekvatnost kapitala, likvidnost i kreditni rizik i činjenični datumi se analiziraju za njih, generalno za bankarski sistem na grupama komercijalnih banaka ka 30.IX 2008. Donešen je zaključak da je prema kraju trećeg kvartala, finansijsko stanje bugarskih banaka stabilno i kvalitet njihovih aktiva dobar. Pojašnjen je značaj i sadržaj finansijskih izveštaja banaka i praćen način njihovog sređivanja, revizije i izdavanja. Istaknut je značaj novog okvira koji je predstavljen od strane BNB za konsolidovanje finansijskog izveštavanja, za harmonizaciju računovodstva bugarskih kreditnih institucija sa onima Evropske Unije putem primene standardizovanih formi i definisanja finansijskih informacija i za svrhe kontrole i javnu namene.

Ključne reči: novčana sredstva, obaveze, kapital, zajam, likvidnost, banka