

Ivan Iskrov: Association of Banks in Bulgaria – 20 years

Congratulatory address by Mr Ivan Iskrov, Governor of the Bulgarian National Bank, to the Association of Banks in Bulgaria on the occasion of the 20th Anniversary of the Association's Foundation, Sofia, 3 April 2012.

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Mr. President,

Ladies and gentlemen,

Dear colleagues and friends,

It is a great honour and a pleasure for me to be here today commemorating with you the 20th Anniversary of the guild of the banking profession – the Association of Banks in Bulgaria. This is a perfect opportunity to congratulate the Association for the long way it successfully traversed, and along which it established itself as one of the most reputed trade associations in the Republic of Bulgaria. All these years the Association consistently assisted its members in pursuing their banking business and protecting their interests, all the while standing as a stable and constructive partner of the central bank, as the banking regulatory authority, of other government authorities, and of the representatives of the business.

Therefore, we the members of the BNB Governing Council are all pleased to attend this occasion as a proof of the respect cherished by the central bank's management for your work and professional achievements!

Behind the ABB's history stands the individual road of achievements, but also of challenges, of each one of the Association's members. As an anniversary usually brings up both a tally of what was done in the past, and wishes for the future, I will try to have some measure of both in my congratulatory address to you.

Practicing our profession involves our capability to serve society and help the Bulgarian economy. Because, as we are all very well aware, banks have high responsibilities in a market economy – the ongoing technological innovation, developing and offering new products and services, as well as the predictability and stability of banks are a mandatory prerequisite for economic prosperity. From my first day as a BNB Governor to this very day, I have never stopped reiterating and instilling the idea that this responsibility requires the individual efforts of each one of us to be governed by a long-term goal – let's call it a sense of mission – which goes beyond the specific financial or market considerations of the current day. It is exactly a jubilee like today's that reminds us of the historic horizons behind the daily statistics, balance sheets or income statements, which ultimately mark the road of new and democratic Bulgaria.

Speaking of history, exactly the current crisis stirs the need to examine the past. It is often said about this crisis that it has been the biggest one globally in the recent decades. Although we are in the fourth year after the collapse of Lehman Brothers, which triggered the turmoil on the global financial markets, the ripples of which we still evidence, the Bulgarian banking sector continues to stand out with its stability and predictability.

Irrespective of the unfavourable general economic situation, the banks in this country demonstrated flexibility and operational efficiency, enabling them to preserve significant capital and liquidity buffers. Although loan portfolio quality deteriorated (as of end-2011 the share of bad loans was 14.93%), the banking sector continues to have at its disposal adequate degree of provisioning and capital protection. The sum of loan impairment according to the International Financial Reporting Standards, specific provisions for credit risk and capital surplus (i.e. the capital in the system in excess of the required regulatory minimum) amounts to 103% of the gross amount of bad loans. Notwithstanding the considerable increase of provisioning costs in the recent three years, the banking system has

never stopped generating positive financial results which increase the capital buffer. And in the cases of shortage or lack of profit in an institution, the BNB exercised supervisory pressure on shareholders to invest additional capital. Today our banking sector enjoys extremely high indicators (including compared to international practices) of liquidity (25.87% as of February this year) and capital adequacy (17.53% as of December last year, including 15.74% Tier 1 capital adequacy), without counting a single lev of public funds in calculating these ratios, at that.

Bulgaria remained one of the few EU member states, where not a single credit institution needed to be rescued with taxpayers' money. Banks in this country not only could never be blamed for the economic downturn and have not been a source of systemic risks but just the opposite – they continue to be one of the main pillars of the macroeconomic and financial stability in the country.

As a logical outcome, the stability of the banks in Bulgaria has won the confidence of domestic depositors – by the end of February the deposits of households increased year on year by 13.2%. Owing to this, an important structural trend is noticeably confirmed – gradually and with no significant upward pressure on the interest rates on deposits, the dependence on attracted resources from external sources has been reduced to an acceptable minimum. For example, at the end of February around 12% of total attracted resources were from foreign parent banks, compared to almost one fourth at the end of 2008).

When we look back we realise that the current state of the banking system in Bulgaria is largely due to what was done over the years immediately preceding the global crisis. Instilling a prudent behaviour in the banks in that period through BNB's conservative and anti-cyclical supervisory policies, regardless of the pursuit of market shares and profits, equipped the banks for the ensuing crisis with solid liquid and capital buffers.

This prudent behaviour of the banks and the BNB during the economic boom, however, also had its origins further back in history. It followed the well-learned lessons from a still earlier period – the great financial and banking crisis in the mid-1990s.

We will leave it to researchers into Bulgaria's modern economic history to mark out the different stages – such as for instance the initial point at the onset of transition characterized by a huge state ownership in the banks and the hectic emergence of a great number of private banks amidst a just-forming banking supervision and regulations; the state's interference in the credit processes and banks' decapitalisation in the mid-1990s; the sector gradually freeing itself from political dependence; the privatisation and foreign capital inflow (mainly from EU countries); the development of modern regulations and the building up of supervisory experience. However, even now we could sum up, and it would not at all be far-fetched, that the history of modern banking is the best part of Bulgaria's history of socio-economic transition after the changes that took place in 1989.

Today Bulgaria has a modern and sound banking system.

Still, a responsible behaviour implies the need of not only recognising what has been achieved, but preserving it too. Because the banking sector in Bulgaria has played a major role for the overall economic growth after the stabilisation and the introduction of the currency board regime in 1997. The average annual real rate of GDP growth in Bulgaria in the period 1998–2011 stood at 4% and the real cumulative growth in the same period was 63.5%. At the same time, the added value posted by the sector, classified by the national statistics as “finance and insurance”, boasted an average annual real growth of 13.3%, and cumulatively for the same period – a notable 384.9%. All that time, around 1/6 of the country's GDP growth was contributed by this sector, which is largely dominated and represented by the banks.

Besides being a factor of economic growth, the banking system has played a significant role for attracting foreign direct investments to Bulgaria. A total of BGN 76.6 billion in foreign

direct investments inflow was registered over the period from 1998 to 2011, of which over 1/6 (BGN 11.9 billion) were direct investments in the banking sector in particular.

Not lastly, the banking sector accounts for a large part of the “brightest” share in Bulgaria’s economy. The role of banks in Bulgaria should not be considered in isolation from the fact that they are among the biggest and most immaculate employers. In 2011 the number of full-time employees in the banking system reached 33 677 at year-end. With the BGN 77.6 million in tax costs and BGN 722.8 million in personnel costs paid in 2011 only, for example, the banking sector ranks among the largest taxpayers and contributors to the social security system in Bulgaria. Please note that these numbers do not even take into account the contribution by the central bank.

Therefore, all that is good for the banking system and allows it to perform its traditional functions, is also good for the Bulgarian economy. Our country can ill afford to do without the banks’ considerable positive contribution to economic growth – which will be the effect, unfortunately, if the policymakers succumbed to certain populist sentiments that have been promoted recently by some figures who would use every occasion to come onto the media stage. There is no reason for the banks in Bulgaria to be additionally burdened by ill-considered administrative regulations and the related costs. Quite the contrary, the weight of such additional burden would turn back as a boomerang against the interests of our society and the Bulgarian economy in general.

The nihilistic attitudes to our own achievements in the past hold back enterprise and the ability to plan for the future. That slows down the economy. Simply not knowing one’s own economic history, however, could lead to making decisions with very adverse implications. Therefore, the best we could wish ourselves for the future with regard to the sector and the economy as a whole is that in the future the public interference in the banking area in Bulgaria continues mainly within the confines of prudential and conservative regulations and supervisory practices.

Undermining the good name of the sector is a no-win strategy as this would limit and make the services offered by banks costlier, which would eventually harm customers and thwart economic growth. In this context, please allow me to also quote the call of the Head of State who, following his meeting with the BNB Governing Council in February, summed up the situation in a fine and very pragmatic way: “The State should continue to work for the good reputation of our banking system, which is a precondition for more favourable lending and is of benefit to people”.

Looking ahead now, we need to stress that coping well in these times of crisis so far does not mean that we can afford to be less watchful or less precise in our next steps. This year, too, will be rich in new challenges. Based on the current projections for a recession in the euro area, we expect that the growth rate of the Bulgarian economy would slow down to about 0.7% in 2012, and this would have a direct impact on the potential of banks in Bulgaria to generate incomes from sources of their own. The weak demand for new loans is facing banks with a double challenge. On the one hand, it will be difficult for them to accumulate new buffers from profits; and on the other hand, the existing classified assets will go on putting pressure on the available reserves. While seeking new business opportunities, you should very carefully approach the question of capital planning. Because you are well aware that the BNB makes no compromises with safety.

The President of the Republic of Bulgaria is present today, so I am tempted to take advantage and draw the attention of the responsible State institutions to some significant gaps in the commercial legislation. Legal and subjective obstacles get in the way of reducing the share of non-performing loans. Bulgaria is no exception among the countries of Central and Eastern Europe where the winding-up and insolvency proceedings, as well as the sale of the collateral, are relatively more sluggish. Regretfully, in Bulgaria the cases of unethical debtors taking advantage of some weaknesses of the existing insolvency proceedings, which allow them to manipulate the initial date of insolvency and nullify the pieces of collateral

pledged after that date, are becoming more and more frequent. The problems with the insolvency and winding-up court proceedings in the corporate sector inhibit the rehabilitation of banks' books (i.e. that part of banks' balance sheet assets which has been hit the hardest during the crisis). This prolongs the procedures and increases the costs for managing the so-called "bad loans", which negatively affects banks' capacity to take new credit risk at an acceptable cost. Hampering the lending processes in turn impedes the economic growth in the country, and hence – employment and people's living standards.

Since one of the banks' major tasks still is to strengthen their loan portfolios, the slower growth rate of the economy and the slower improvement in the economic profile of some categories of clients would force banks to look for new niches for business. This may lead to greater specialisation in certain types of services and to more intense competition for every new client. I would like to point out that the increased competition does not exclude the need for you to keep up a high level of correctness in your relations with one another and with your clients.

While the bank services market is getting saturated, consumers' awareness is being raised. The stronger competition in the banking sector also promotes new approaches in the dealings with clients¹. One possible room for competition between credit institutions is, for instance, the transparency and predictability of structuring, and especially of pricing, their products and services. One should work more for the benefit of clients, adopting a more individual approach to those facing difficulties, summing up and analysing the experience gained and drawing conclusions that could be put to good use in new and better banking practices. The happy client is the cheapest advertising for the bank.

The work done in each of the above problematic areas allows for a more active presence – at an expert level and in the public area – both of the individual banks' representatives and of the ABB as their legitimate and highly reputable association. With its twenty years of experience the ABB is now mature enough to stop looking on itself only as an intra-branch organisation and to "open up" so as to actively and publicly uphold the views of the Association members and their loyal clients.

I will finish by assuring you that we at the BNB will also continue to work invariably for the financial stability of Bulgaria and to enable the banking system to support the growth of the Bulgarian economy. You know that a considerable part of our activity is done in a way that is invisible to the public, including outside the country where the BNB participates in numerous bodies and working initiatives of the EU and the ECB. An example of this is the issue of financial transaction tax – an ill-advised concept which has turned out to suit politicians with populist leanings in Europe. For over two years the BNB has been defending with firmness and argumentation the position that this tax would be detrimental to both the EU economy and the Bulgarian economy. Luckily, just a few days ago (at the informal ECOFIN meeting in Copenhagen on 30 and 31 March) some of the biggest EU countries, like Germany, which had most ardently insisted on introducing a financial transaction tax, practically gave up on that idea because reaching an agreement in the entire EU proved impossible. This is an example of how Bulgaria can and should stand up for its own national economic interests, opposing (and even forming situational "coalitions"), if necessary, the large countries in the EU which as a rule pass their own interests as interests of the entire EU. The BNB is also a constructive opponent of the Bulgarian institutions when it sees that rash proposals are being put forward that may have an adverse effect on the stability and economic growth in the country.

¹ I dislike the phrase "financial services consumer" because it brings to my mind associations with expending, eating or consuming (in the negative sense) without any efforts made and one-off, and this phrase does not consider the interest of the counterparty who is implicitly unethical. Whereas "client" implies reciprocity, discretion and a long-term relationship.

Thus, what has been achieved so far gives us confidence in ourselves and optimism about the future of the banking sector in Bulgaria. Despite all the difficulties, the banks in Bulgaria bear responsibility not only for going forward as sustainable and successful business enterprises, but also for taking their clients and the whole economy through the times of crises. We do hope that in the coming years the banking community's voice of common sense will be heard by the State institutions, businesses and society at large. Because we have learnt from experience that a well-functioning banking system is a necessary pre-condition for the economic prosperity of our home country.

Dear colleagues, happy anniversary!