



**BRITISH  
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COMMERCE

**The British Bulgarian Chamber of Commerce (BBCC) was pleased to host an Evening with the Governor of the Bulgarian National Bank, featuring Distinguished Guest and Principal Speaker Mr Ivan Iskrov and Co-hosted by His Excellency Jonathan Allen, Ambassador of Great Britain**

Date: Wednesday, 21st November, 2012

*Governor Ivan Iskrov has worked, in tandem with the government and other stakeholders, to maintain a well-regulated, conservatively capitalised, highly liquid and efficiently working banking sector, against the backdrop of the recent years of turbulence in the global economy and the financial markets. Fiscally, the country is a role-model for compliance with the Maastricht criteria, enabling it to speak with authority on key European policy topics like the governance reforms in the Euro zone, the European banking union, etc.*

*The Ambassador welcomed the speaker. He noted that he had often found himself in agreement with the opinions of Governor Iskrov and impressed by both the independence of his thinking and his commitment to do what is right for Bulgaria. Governor Iskrov was re-elected to the position of Governor of the Bulgarian Central Bank in 2009, meaning that he will hold the position until at least 2015. He has broad experience in the commercial banking sector, as an elected member of the senate (in 2001) and in EU regulatory bodies.*

*Bill Drysdale endorsed the Ambassador's remarks. He noted that the BBCC is focused on promoting British companies to do business in Bulgaria and particularly to compete for high value procurement opportunities. He also noted that Bulgaria now has excellent conditions for FDI to which Governor Iskrov has made a significant contribution.*

**Governor Iskrov gave a presentation on "The Bulgarian Economy and the Banking System and Economic Policy Issues in the EU".**

The Governor expressed his pleasure at speaking before the chamber on such interesting topics and thanked the BBCC and the Ambassador for their hospitality.

He noted that he was once proud to be the youngest Governor of a Central Bank in the EU, but, the status of youngest Governor in the EU is now held by the Governor of the German Central Bank recently appointed, for whom he has great respect.

He also took a moment to attribute the success of the Bulgarian banking sector to the staff at the Central Bank and also to the colleagues in the commercial banking sector, not only to his own leadership and shared with the forum his pride in promoting the behaviour and achievements of the Bulgarian banking system.

His reappointment in 2009 coincided with the onset of the impact of the global Financial Crisis in Bulgaria. At that time, he felt that many observers and analysts, particularly from abroad, were very anxious about the robustness of the system, and in particular the stability of the currency board, despite the good

fundamentals which he was proud to publish widely. He is certain that even the most pessimistic observers of those times must now be convinced of the resilience of the Bulgarian banking system and the soundness of government fiscal policies and regulation, given the strong performance of the sector during the last few years.

He decided not to go into all the details of how and why the system did in fact survive the crisis. These are statistics which are well known, but he gave us some highlights.

During the crisis, the Currency Board coverage ratio actually improved and it remains strong, above the established targets, with the coverage in high quality international reserves, which speaks much about the stability of the Board.

The competitiveness of the Bulgarian economy has also improved. The complaints from time to time that the fixed rate is a disadvantage to exporters are simply not born out by the statistics, as compared to similar countries with floating rates. Other strong performers such as Lithuania also operate a currency board with a fixed exchange rate.

The Bulgarian economy is very small but also very open, with a 2011 trade openness indicator of 132% compared to the UK of 66% (reliance on internal market).

Governor Iskrov acknowledged that some macro-economic indicators were modest over the last several years, but it is important to put these in context. As compared to the EU-27 and EuroZone, the performance is not so bad. Growth expectations for Bulgaria for 2012 and 2013 are low, but positive.

Governor Iskrov described how Bulgaria experienced a giant transformation over the last twenty years. The economy started with a huge dependence on Comecom countries (particularly Russia and Czechoslovakia). But, the last 10 years have seen a huge migration of trade toward the EU. In H1 2012, 60% of trade was with the EU, with Germany the biggest trade partner. In imports, Russia still features very strongly because almost all of energy imports still come from Russia, but in other sectors, EU countries are again the major partners.

However, Governor Iskrov noted that the UK has only 1.5 – 2% share in Bulgarian foreign trade, with which he is not satisfied, far behind Belgium, for example. Greece was the second biggest trade partner perhaps 3 years ago, but now they are the 5<sup>th</sup> export partner, with Turkey a more important new player which represents a very promising current and future destination for Bulgarian business abroad.

The UK is better represented when we discuss FDI, mainly due to pre-crisis investment in real estate (6.5% of FDI stock from 1999 – June 2012). Netherlands represent 21.5% over the same period, due to the favourable tax and business treatment there, although the underlying investors are often from other EU countries. Austria is the next largest at 16%.

Governor Iskrov gave a brief summary of the Bulgarian banking system, for which the Bulgarian National Bank is fully responsible. The Financial Supervision Commission is responsible for the regulation of the non-banking financial industry.

There are 31 licensed banking institutions (24 banks and 7 bank branches). This distinguishes Bulgaria from its neighbours which typically have a much more concentrated banking sector. This promotes competition. In Bulgaria, foreign banks control almost 74% of banking assets. Governor Iskrov is very proud of the strength of local banking groups and the strength of foreign subsidiaries here. His policy has been to restrict the number of licences in order to stimulate consolidation and capital adequacy of the market participants. Only reputable territories and businesses are permitted to operate here.

Despite the recent difficult period, the banking system has exceeded the 12% capital adequacy requirements set by the Bulgarian National Bank (and actually rose to over 17% during the crisis). The minimum capital adequacy requirement is 50% more conservative than in the rest of the EU. This was achieved by the National Bank strongly recommending, among other measures, against dividend payments during the crisis years. Tier 1 capital adequacy is also very healthy at over 15% in September 2012.

Governor Iskrov stressed the importance of comparing like things, not just to look at ratios or statistics that seem to be the same but are in fact calculated differently. Bulgaria has very transparent reporting, based upon IFRS and mandated methodologies which are conservative by international standards. This makes Bulgarian statistics very robust and forced the banks to focus on capital and this has been one of the sources of the observed stability. The excess of capital above the minimum capital adequacy requirements in the Bulgarian banking system is now around 3 billion BGN.

Governor Iskrov is proud to note that Bulgaria has spent zero public or central bank money on interventions in the financial sector during the last 4 years, compared to high value “bail outs” in most Western European countries.

The Eurozone and the UK have both experienced negative growth of credit to the private sector during 2011/12. By contrast, the Bulgarian banking system has grown credit to the private sector by on average 3 - 4% YoY. This is despite the huge interventions made elsewhere by government and regulators. Governor Iskrov noted that he was criticised by some colleagues for the countercyclical measures he introduced before 2008/9, but he believes that the results are clear to see as Bulgarian banks are now stable, well-capitalised and liquid. Other regulators and policymakers have sent mixed instructions – pressing banks to raise capital and at the same time increase lending to support the real economy, after years of permitting real capital decline.

There is no deleveraging at present in the banking system of Bulgaria. Besides, Bulgaria has strengthened the funding structure of its banking sector, due to growth in core domestic deposits. Bulgarian banks do not have a deep reliance on foreign capital. Bulgarian branches of foreign banks have been able to substitute foreign parent capital with local deposits, which are historically very stable. The Bulgarian banking system does not have any reliance on the international wholesale banking system. From time to time, the Bulgarian way may be more expensive, but the wholesale market is a highly sensitive and therefore very risky source of funds.

The overnight interest rates represent a useful “Thermometer” for the banking system. The Bulgarian “temperature” is calm, with steady rates over the last few years. The UK also has a “cool” temperature, while the European Central Bank’s overnight rate has been very “feverish”.

Governor Iskrov stated several times his position that the job of Central bankers is to make the business climate predictable and favourable for business.

Bulgaria is a fully-fledged member of the EU and is a very active member of the regulatory bodies there. Bulgarian and UK representatives have often worked on common initiatives to support Eurozone stability.

Bulgaria is among the strongest supporters in the EU of fiscal consolidation and itself a paragon of budgetary discipline, which both the Finance Ministry and the National Bank consider to be an essential competitive tool. Both the Finance Ministry and the National Bank are opposed to any tax harmonisation initiatives by the EU.

Bulgaria is strongly against the proposed EU financial transaction tax. Governor Iskrov believes that it would simply redirect financial operations to other regions or markets and is against Bulgaria’s long term national interest. This proposal was also blocked by UK on the basis that it is against the interests of Europe as a whole. However, 11 countries, including most of the Eurozone (excluding Netherlands and Luxembourg)

have proposed to adopt it as an “enhanced cooperation” measure. Time will tell how it will work for them. However, Bulgaria feels strongly that any implementation by those countries should be permitted only if there is an impact assessment to confirm safeguards to non-participating members (such as Bulgaria and UK) and if the proposed allocation and use of proceeds, if there were to be any substantial proceeds at all, is made clear in advance.

The Banking Union initiative for a single supervisory mechanism for the EU financial sector was initially proposed in order to establish preconditions for direct recapitalisation of weaker banks from the European Stability Mechanism. It was anticipated that the Single Supervisory Mechanism would be within the European Central Bank, whose independence and credibility are widely accepted. Moreover, it was clear that this process should go hand in hand with the process of establishing a common bank resolution framework and a common deposit guarantee scheme.

However, Eurozone members have not yet found agreement among themselves on even the fundamental principles for such regulations. Non-Eurozone members also express their concerns, which are shared by Bulgaria, Chief among these concerns are three things: Under the current proposals, non-participating members will have no vote on the ECB’s governing council, nor will their institutions have access to liquidity support from the ECB or recapitalisation from the ESM if it is needed. Also, as a result of the proposed voting rules in the European Banking Authority, the ECB/euro area will always dominate. And it is important for Member States to preserve their national macro-prudential tools, including the Pillar 2 national supervisory competences.

Bulgaria actively participates in the working groups to try to support a measured and balanced solution. In particular, Bulgaria wishes very much to see higher capital environments across Europe to better cover risks.

## **Questions**

*Question:* David Jones of EVS Translations asked about the attractiveness of Bulgaria to China as an investment destination.

*Answer:* Bulgaria’s Minister for Enterprise made a strong case for Chinese investment in Bulgaria yesterday in Shanghai. Governor Iskrov confirms that Chinese investment will be an important part of future FDI to Bulgaria. He sees that demands for protectionism will rise in Europe. Bulgaria represents a liberal and low tax environment for Chinese investments to address growing nationalist concerns in the continent and reach consumers from the base of a full-EU-member state. China is not the only giant – South Africa and South America also offer great challenges and opportunities in terms of competition and investment potential. The solution is not protectionism but openness.

*Question:* Vesey Crichton asked Governor Iskrov what he would do if he were the President of the ECB.

*Answer:* Governor Iskrov noted that he has a strong voice in the ECB decision making process, because he is a full member of the General Council of the ECB. But, these are issues to be discussed behind closed doors between the participants. The ECB is one of the key institutions for European unity. It is not right for it to stand aside and focus only on price stability. Many other factors are important, and social and economic policy also have important parts to play in ensuring a favourable business climate.

*Question:* George Ganchev (who was involved in 1997 in the Parliamentary approval of the legislation introducing the currency board) asked whether Governor Iskrov receives support from the Government for his positions and how he manages his response to some proposals that he cannot support.

*Answer:* Governor Iskrov noted that all Central bankers prefer to do their work behind the scenes. He paraphrased the Governor of the Bank of England in saying that the more boring the Central Banker is, the better it is for the Economy.

Behind the scenes there is much working together with other departments, particularly with the Ministry of Finance. This involves both partnership and challenge. Governor Iskrov has made the reluctant decision to go public on issues which he believes are against the National Interest from time to time in the past, but he tries to exert his influence internally, to be a good partner to his governmental colleagues and to provide constructive challenge to government policies and initiatives where these impact the Banking sector. Governor Iskrov reminded the forum that on his reappointment, he stated that he intended to be thoroughly independent and a strong opponent to government if necessary. However, fortunately, there is much common ground on which to build a consensus.

*Question:* Bill Drysdale added that he hoped to have a British bank attracted and licensed in Bulgaria, because he believed that it would support FDI from Britain.

*Answer:* Governor Iskrov noted that if a reputed player wished to enter the market with the support of the Home Supervisor, then consideration would be given to the application. However, he noted that no licence had been granted in the last couple of years. The first interest of the Bulgarian National Bank is what is good for Bulgaria and only a highly reputable bank would be considered, from any country.

*Question:* Vladimir Mihailovski asked how will the Banking system look in 5 – 7 years' time.

*Answer:* Governor Iskrov did not want to comment on the future because he is not a fortune teller. However, he believes that strong regulations will continue to ensure that the banking system in Bulgaria will remain stable. Consolidation is a market driven process. For example, in Greece, the National Bank of Greece and EuroBank are now merging in response to market conditions, not regulatory action. In the Governor's opinion what is important is not to count the number of the banks but to have stable, predictable institutions. Accordingly, the regulator would most likely impose preconditions on any significant consolidations to ensure that merged entities would be active and support the economy. What is important is that there are "enough" banks and that there is real competition between them.

*Question:* Wayne Diamond from the British Embassy asked about how Bulgaria could improve the business environment for foreign companies and any specific tips for British companies.

*Answer:* Governor Iskrov said that this was a question for the Minister for the Economy. He is responsible for the banking sector only and has tried to do his best to create the best business climate for them. The main role of regulation should be to allow business to feel comfortable to focus on their core activities and in some sense to ignore the political environment. Governor Iskrov noted that many changes were possible, but that this was the work and responsibility of others in government and the question should be addressed to them. However, he stresses the importance of predictability in any changes and mentioned the harm arising from uncertainty, for example, where there is a fear of retro-active implementation of new measures.

***Ambassador Allen thanked the Governor for his presentation and reiterated the common agreement between the UK and Bulgaria on many issues surrounding the governance of the banking system in the European Union. The Ambassador stressed that he too was dissatisfied by the relatively low level of UK trade with, and investment into, the Bulgarian economy and assured all present of the commitment of the British Embassy and the BBCC to improve this situation.***