

MAIN PRINCIPLES OF THE BNB LICENSING POLICY

(Approved by the BNB Governing Council on 19 July 2007)

The Law on the BNB assigns to the central bank high responsibilities with regard to the regulation and implementation of supervision over the banking system in the country, maintaining its stability and protecting investors' interests. The BNB's licensing policy is among the main instruments for achieving these tasks. Its prime goal is to allow in the banking market only new participants with quality, experience, competitiveness and contribution to the development of banking intermediation beyond any doubt. Therefore, having regard to the following:

1. Since the end of the 1996-1997 Crisis, the BNB made great efforts to stabilize the banking system and to implement the best standards and practices in credit institutions' activities. The cautious and conservative licensing policy was and still is among the key factors for achieving financial stability and gaining back the confidence in the banking sector.

2. With Bulgaria's full-fledged membership in the European Union from the beginning of 2007 the challenges to the banking sector will continuously grow. There are no legal or administrative barriers to the extremely strong banking and financial groups from the EU member states to start shortly providing banking services in Bulgaria. The number of notifications received from competent authorities in the member states that credit institutions licensed by them intend to provide directly banking services in Bulgaria is continuously increasing. Intentions are also stated by such institutions of opening branches in Bulgaria.

3. In addition to the persistently growing competition among banks domestically, the banking sector should expect to face the increasing competition of non-bank financial intermediaries. There are no reasons to believe that this global trend will not affect Bulgaria. The administrative restrictions imposed by the BNB on bank credit growth had their positive impact on the development of the non-banking financial sector.

4. Bulgaria's membership in the European Union presupposes that Bulgaria will follow the same rules and principles in admitting new banking market participants, as applied in the other member states. Statistics indicate that in the recent years the absolute number of credit institutions operating in the European Union follows a clear-cut downward trend, and the number of market exitors sustainably exceeds the number of newly licensed institutions.

5. In its capacity of a supreme supervision authority empowered to make decisions on granting banking licenses, the BNB Governing Council should meet the requirements of transparency and public awareness, provided for in Directive 2006/48/EC, and Chapter Eleven, Section V of the Law on Credit Institutions.

The BNB Governing Council proclaims that it will pursue a licensing policy based on the following principles:

The Bulgarian National Bank will follow, as in the recent 10 years, a cautious and conservative licensing policy aimed at preserving and improving the quality of banking intermediation and the stability of intermediaries, enhancing the benefits and minimizing the risks of increasing competition in the banking market, encouraging the consolidation that is underway in the banking sector and optimizing its structure while preserving the high requirements to banking sector entrants. Only market participants that can contribute to the improvement of banking intermediation and add new value to the market by offering innovative products and services will be allowed into the market.

A prudent and conservative approach will be applied both to the establishment of a domestic bank and in the consideration of applications by third country banks (non-member state banks) willing to pursue banking activities in this country. With a view to the considerably higher risks entailed in the admittance of *third-country banks to the Bulgarian market*, exceptionally high attention will be paid to the requirement of *applicant's high*

reputation at the international financial markets, reliability and stable financial condition, also in line with the provisions of the Law on Credit Institutions. The good quality of foreign banks admitted to participation in bank intermediation in Bulgaria will also be guaranteed by the requirement of **having an investment rating**. In such cases, the existence of any legal barriers, which could cause difficulties to normal supervisory cooperation with the competent third country supervisor, the level and conditions of deposit insurance, the lack of preferences providing for more favourable terms and conditions for the receivables of residents of a bank's home country compared to creditors of its overseas branches, will be thoroughly examined.

In case of willingness to establish a domestic bank, the practice of conducting preliminary consultations with representatives of the applicant and its main shareholders will be maintained and further developed. At such consultations, applicants will be acquainted with the structure and specifics of the Bulgarian banking market, the highly competitive environment, and the existence of specific risks in pursuing banking activities in Bulgaria. They will be required to have a clear strategy for the successful operation of the prospective bank, a vision of the potential market niches, and a convincing presentation of the advantages of their application. Positive treatment will be granted only to applicants with experience in the financial area and proven reputation, capable of innovative development, offering new banking products adequate to the conditions in Bulgaria.

Particular attention will be paid to the **share structure of any prospective bank**. The absence of a clear-cut core of qualified shareholders based on serious equity commitment and stable prospects for their own business, also demonstrated by easy access to bank lending, will be treated as a potential shareholding problem of the prospective bank. The willingness of individual successful business groups to establish their own banks, not backed up by proven capabilities to manage financial assets and to successfully service their liabilities, will not be treated without reserves. Such applicants will be encouraged to acquire a share corresponding to their business potential in domestic banks, where with their influence on the management and activities of the respective bank they will prove their reliability and responsibility in managing finances of others. Share structures of prospective banks will be considered as holding much promise, if large and stable international financial groups with investment rating have committed significant share in their equity, that ensures offering modern and attractive banking products, corporate management meeting the proven high standards and best practices, and also, if needed, immediate capital support against the assumed risk for the successful business development.

The enforcement of high criteria will continue in the future with regard to any **applicant's share capital**. Meeting only the minimum statutory requirements, recognizing the inevitable losses incurred at the beginning of any business activity, will be considered as a potential risk. In addition to launching the business in physical terms, the capital of any prospective banking institution should correspond to its risk profile, figured on the basis of the product structure of banking services offered, and should provide the necessary reserves capable to ensure the medium-term capital coverage of planned asset growth. The strict examination of the **sources of funds for capital subscription** by the shareholders will continue, while extending and deepening the analyses of financial and business potential of main shareholders, the consistency between the scale and results of their previous activities, and their expected impact on the operation and management of the prospective bank. The founders' willingness to register a bank as a public company and to ensure compliance with the high standards for raising capital through public offering of securities at stock exchanges will be considered an advantage.

The Bulgarian National Bank will continue improving the requirements to the **corporate structure and corporate management** of banking companies. No banking business can be pursued without adequate corporate structure that guarantees reliable functional relation and

effective internal control mechanisms. In spite of the still underdeveloped system of bodies to protect the rights of banking services consumers in the country, banking management should be able to overcome the limited corporate interests and to prepare and implement such a strategy of client relations, as would not be just consistent with the rapidly increasing EU requirements in this regard, but would also be able to eliminate or at least minimize potential reputation risk resulting from the relations with consumers with ever growing requirements as to the quality of services rendered. In the formation of the senior management of future credit institutions, the Bulgarian National Bank will continue its efforts at finding the successful combination of domestic experts conversant with the specifics of the Bulgarian market and reputed foreign professionals with established banking experience gained in leading world credit institutions, capable of importing and implementing a know how.

In a broader aspect bearing directly upon the potential banking market participants, the Bulgarian National Bank will continue to ***definitely resist all attempts at developing a legal framework that may allow other deposit institutions to enter the market at lower requirements compared to the ones governing the activities of credit institutions in the EU.*** Any potential consequences of the emergence of noncompetitive institutions would entail unpredictable risks, would bring our financial system back to the situation of uncertainty, and would put to serious trial the high credibility of the banking market participants. With the continually expanding range of financial services rendered by non-banking financial intermediaries, an activity the pursuit of which is subject to the most liberal legislations in EU – the Bulgarian – the establishment of low-quality quasi-banks would be an adventure with extremely serious consequences which the Bulgarian National Bank, as an institution responsible for the financial stability in the country, would not support in the future.