



Bulgarian National Bank

**TO
EXECUTIVE DIRECTORS
OF BANKS
TO
MANAGERS OF FOREIGN
BANKS' BRANCHES**

Dear Chief Executives and Managers,

The financial crisis that began in the summer of 2007 in the U.S. spreading over to Western Europe deepened its negative impact on the European financial system particularly after mid-September 2008 and exerted considerable strain in EU. Since October 2008, we have been witnessing the real effects of the global financial crisis on the Bulgarian economy.

Currently, the Bulgarian banking system is not affected by losses as the assets of Bulgarian banks are mainly loans to the real Bulgarian companies and households and the banks do not have any significant direct exposures in the form of the so-called "toxic securities". The banking system in Bulgaria is characterized by a good level of capital adequacy, quality of loan portfolios and liquidity. Meanwhile, amid the growing distrust among participants in the international financial markets, over the last three months we have seen record high appreciation of the price of funding and very difficult access of banks to funding from global money markets.

Additionally, over the past two months there has been a sharp drop in the economic activity in all European economies, with official forecasts signaling that they will enter into recession in 2009. These processes are the result of deepening international financial crisis and they are affecting all European banking systems, and will inevitably have a negative impact on the balance sheets and income of the Bulgarian credit institutions, especially in terms of profit growth and liquidity positions in the next financial year.

Therefore, regardless of the sound financial condition of the Bulgarian banking system at present, BNB Banking Supervision Department is of the opinion that in 2009 the Bulgarian credit institutions will face the following serious challenges:

- 1) Continuing failure of the international financial markets (despite all measures announced by most euro zone governments) and related difficulties and high costs of attracting resources from both residents and non-residents;
- 2) Expected decline in consumer credit products demand by firms and households as a result of slowing economic activity globally and in Bulgaria;
- 3) Deteriorating forecasts for the main macroeconomic indicators in 2009 in Europe and in Bulgaria.

The above challenges call for urgent adaptation of Bulgarian credit institutions to an adversely changing environment.

In accordance with the continuously conducted prudent supervisory policy of the BNB and the principles enshrined in the EU's plan to limit the negative effects of the crisis, as well as taking into account the specifics of the national banking system, the Bulgarian National Bank is convinced of the need for preventive intervention in support of maintaining bank stability and reasonable rates of economic growth. In this regard, BNB Banking Supervision Department recommends that all credit institutions should maintain the following minimum indicators of capital adequacy and liquidity:

Capital Adequacy

1. Keeping the core capital of at least 10 percent by credit institutions and where this indicator is currently below this value, they should reach this ratio until **30-06-2009**.

In this connection, the general meeting of shareholders of all credit institutions must adopt decisions that the accumulated profit for 2008 and 2009 should not be distributed in the form of dividends and other payments, but attributed to primary capital.

Liquidity

2. Maintain at all times a ratio of liquid assets, as stipulated by BNB Ordinance 11, to attracted funds from institutions other than credit institutions, individuals and households of 15 per cent.

In addition to the above recommendations, BNB Banking Supervision Department believes that the adaptation of the business of credit institutions to the current environment should be accompanied by stringent cost management in order to minimize the negative impact of the worsening economic conditions on the growth of earnings and their financial position as a whole.

RESPECTFULLY YOURS,

**BNB Deputy Governor
Banking Supervision Department**