



BULGARIAN NATIONAL BANK

Plan on Reforms and Development of Banking Supervision Exercised by the Bulgarian National Bank

Banking supervision reform and development is a key priority in the section dealing with the immediate measures slated in the BNB governance programme. This is prompted both by the need of adequate response to the KTB crisis, which demonstrated serious weaknesses in the BNB banking supervision function, and by the goal of making our supervisory practices as compliant as possible with the current international standard, the 2012 *Basel Core Principles for Effective Banking Supervision*.

The plan is the result of an almost one year long process including mainly the two phases: internal analysis and assessment of the procedures and practices of the Banking Supervision Department and an independent external assessment of the effectiveness of the banking supervision in Bulgaria by a joint IMF – World Bank team¹. Important findings and recommendations on banking supervision activities were also made by the National Audit Office in relation to the banking supervision effectiveness and efficiency audit it conducted, the initial report of which was submitted as of end-September and will be finalised by end-October 2015.

The analysis and assessments indicate the degree of conformity of our supervisory practices with the Basel principles is unsatisfactory. Out of a total of 29 principles, 9 principles have been identified as compliant, 12 as largely compliant, and 8 as materially non-compliant.

Six problem areas were outlined: (1) inadequate governance model of exercising the BNB's supervision functions; (2) weaknesses in the internal organisation of the Banking Supervision Department; (3) incompleteness in the regulatory acts, internal rules and guidelines regulating banking supervision; (4) absence of an institutional framework for crisis management and bank resolution; (5) deficient IT and communication support for the supervisory function; and (6) insufficient coordination and information exchange with other institutions relevant to the supervisory function.

The banking supervision reform and development plan includes specific measures till the end of 2016 for resolving the problems in these areas, as follows:

¹ The full original text of the IMF and World Bank report can be found [*here*](#).

1. Governance Model

The existing *governance model* concentrates an extremely broad range of powers and responsibilities in the hands of the Deputy Governor in charge of the banking supervision, without providing for reliable information channels and control mechanisms by the other members of the BNB Governing Council. This encapsulates the supervisory decision-making process and makes supervision highly vulnerable to external pressure and influence. To resolve these issues, the plan envisages the following measures:

- 1.1. Adoption of a decision by the BNB Governing Council that it will approve the internal rules and guidelines regulating supervision activities.
- 1.2. Conducting annually an internal audit of the compliance with the supervision rules and procedures and reporting audit results to the BNB Governing Council.
- 1.3. Submission to the BNB Governing Council of a quarterly report on the current supervisory monitoring of banks (off-site monitoring and on-site inspections), supervisory problems identified, supervisory measures taken, and their enforcement, as well as on changes in the shareholding structure of banks.

2. Internal Organisation of the Banking Supervision Department

The existing *internal organisation of the Banking Supervision Department* fails to ensure the necessary coordination and quality assurance of controlling activities, nor effective internal communication. To overcome these weaknesses, the plan envisages the following organisation measures:

- 2.1. To establish a new Off-site Supervision Directorate within the Banking Supervision Department, by which this important phase of supervisory activities will be separated from the on-site inspections, which will continue to be conducted by the Credit Institutions Supervision Directorate. This is aimed at achieving: (1) better mutual internal control of quality; (2) reduction of the time needed for supervisory inspections; (3) higher frequency of inspections corresponding to the risk assessment of the institutions; and (4) more frequent rotation of teams inspecting individual banks.
- 2.2. To establish an internal advisory council to the Deputy Governor in charge of the Banking Supervision Department to work for setting-up and implementation of supervisory measures, in which the key management staff of the department will participate. Thus, conditions will be provided for better interaction and utilisation of the capacity of individual units within the department, and higher predictability, transparency and sustainability of the supervisory policies impact.
- 2.3. To increase the number of inspection teams to six, thus improving both the frequency of supervisory inspections, and the possibilities for team rotation.
- 2.4. To establish an Analysis of Market Behaviour-related Risks Division within the Special Supervision Directorate, which will assume all tasks not directly related to the BNB supervisory function but carrying legal and reputational risks. This division will engage in monitoring and analysis of business practices in areas such as consumer and mortgage lending, offering of deposit and other banking products, analysis of customer complaints, keeping of a register of bank accounts (after adoption of the legislative decisions to that effect).

3. Regulatory Framework

Organisational measures will be supported by improvement of the *regulatory framework* for implementation of risk-based supervisory activities with a view to expanding the powers of banking supervision and defining clear requirements and good supervisory practices in the areas of corporate management of banks, concentration risk management, compliance with the restrictions as regards large exposures and transactions with related parties, for which incomplete compliance with the principles of effective supervision was established. For these purposes, the plan envisages the following measures:

- 3.1. Drafting legislative amendments with the purpose of expanding the powers for imposing supervisory measures, such as dismissal of not only members of management and supervisory bodies but also of senior management; enforcing a requirement for rotation of bank auditors and access to more extensive information of their work.
- 3.2. Conducting a full review of ordinances, internal rules and guidelines regulating supervisory activities, and bringing them into compliance with the Basel principles.

4. Institutional Framework for Crisis Management (preventive supervisory measures and bank resolution)

The KTB crisis clearly demonstrated the lack of an *institutional framework for crisis management*, both in terms of a strengthened preventive role of banking supervision, and for regulating the bank resolution processes. With entry into force of the Law on Recovery and Resolution of Credit Institutions and Investment Firms on 14 August 2015, a regulatory framework governing such processes was established. The relevant organisational structures should be established for the resolution activities and drawing up of operational procedures for interaction with the Banking Supervision Department. For this purpose the plan envisages:

- 4.1. Establishing a new Bank Resolution Directorate outside the Banking Supervision Department.
- 4.2. Specifying the requirements and processes for preparation and approval of recovery plans.
- 4.3. Setting up rules and procedures for early intervention.

5. IT and Communication Support

The analyses and assessments underline the need for significant improvement of the *IT and communication support* for supervisory activities and of ensuring similar support for the bank resolution activities. For this purpose, the following should be made: an independent assessment if the existing IT and communication (*ITC*) solutions meet the needs of banking supervision and bank resolution activities, as well as the effectiveness requirements; preparation of a specification of a comprehensive *ITC* project; stage-by-stage implementation of the project. In this regard, the plan envisages two main steps to be undertaken as early as 2016:

- 5.1. Selection of an independent consultant to assess the adequacy of the *ITC* solutions.
- 5.2. Preparation of an independent assessment of the adequacy of the *ITC* solutions to the banking supervision needs and to the requirements for effectiveness, flexibility, consumer orientation, and other applicable criteria.

6. Coordination and Information Exchange with Other Institutions

The KTB crisis also indicated the need of considerably improving the *coordination and information exchange* in relation to supervisory activities with other institutions, including the Bulgarian Deposit Insurance Fund, the State Agency for National Security, the Ministry of Finance, the Financial Supervision Commission and the Commission for Public Oversight of Statutory Auditors. The plan envisages that the initial steps made in this direction be further developed and find their specific implementation in:

- 6.1. Signing of memorandums with the relevant institutions, which will clearly define the coordination and information exchange procedures in relation to the implementation of BNB's supervisory function.

The table attached summarises the key measures in the plan by the end of 2016 and the indicative time frame for their implementation. The implementation of the measures will be managed and coordinated by the Deputy Governor in charge of the Banking Supervision Department, who will periodically inform the BNB Governing Council of the progress of implementation and, depending on the development of implementation and an on-going review of the supervisory practice, will propose additional measures for the period after end-2016.

Key Measures for Reforms and Development of the Banking Supervision

Measures	Indicative timeframes
1. Governance model	
1.1. Adopt a decision that the BNB Governing Council will approve the internal rules and guidelines regulating the supervisory activities	October 2015
1.2. Perform annually an internal audit of the compliance with the supervision rules and procedures and reporting the audit results to the BNB Governing Council	Annually
1.3. Submit to the BNB Governing Council a quarterly report on the current supervisory monitoring of banks (off-site monitoring and on-site inspections), supervisory problems identified, supervisory measures pursued, and their enforcement, as well on changes in the shareholding structure of banks	On an on-going basis
2. Internal organisation of the Banking Supervision Department	
2.1. Establish an Off-site Supervision Directorate	October 2015
2.2. Establish an internal advisory council for setting-up and implementation of supervisory measures	October 2015
2.3. Increase the number of inspection teams	December 2015
2.4. Establish an Analysis of Market Behaviour-related Risks Division within the Special Supervision Directorate	December 2015
3. Regulatory framework	
3.1. Draft legislative amendments with the purpose of expanding the powers for imposing supervisory measures	March 2016
3.2. Conduct a full review of ordinances, internal rules and guidelines regulating supervision activities to bring them into compliance with the Basel principles	September 2016
3.3. Adopt a supervisory review and assessment manual in line with the decisions of the European Banking Authority on common procedures and methodologies	September 2016
4. Preventive supervisory measures and bank resolution	
4.1. Establish a new Bank Resolution Directorate outside the Banking Supervision Department	October 2015
4.2. Specify the requirements and processes of preparation and approval of recovery plans	December 2015
4.3. Setting-up rules and procedures for early intervention	March 2016
5. IT and communication support	
5.1. Select an independent consultant	June 2016
5.2. Prepare an external assessment of the adequacy of existing ITC solutions to the banking supervision needs and to the bank resolution activities	September 2016
6. Coordination and information exchange	
6.1. Sign of coordination and information exchange memorandums with the relevant institutions	December 2015