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17 October 2014

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# Recommendation to the Bulgarian National Bank and Bulgarian Deposit Insurance Fund on action necessary to comply with Directive 94/19/EC

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## The Board of Supervisors of the European Banking Authority

**Having regard to** Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC<sup>1</sup> (the 'Regulation' and 'the EBA'), in particular Article 17(3) thereof,

**Having regard to** Decision EBA/2014/100 of 14 July 2014 of the European Banking Authority adopting Rules of Procedure for Investigation of Breach of Union Law,

## Whereas

### Relevant factual background

- (1) On 20 June 2014, as the payments to customers had been suspended because of a massive bank run, the Bulgarian National Bank ('BNB') Governing Council decided to place Corporate Commercial Bank AD ('KTB') under conservatorship due to a risk of insolvency, for a period of three months; as a consequence, the fulfilment of all of KTB's obligations have been suspended (including giving depositors access to their funds – both depositors whose deposits benefit from the cover provided by Directive 94/19/EC ('protected deposits' and 'protected depositors') and depositors whose deposits do not benefit from that cover.
- (2) On 22 June 2014, as the payments to customers had been suspended because of a massive bank run, the BNB Governing Council decided to place Victoria Commercial Bank EAD ('VCB') (whose capital is 100 percent held by KTB) under special supervision due to a risk of insolvency, for a period of three months; as a consequence, the fulfilment of all of VCB's

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<sup>1</sup> OJ L 331, 15.12.2010, p. 1.

obligations have been suspended (including giving depositors access to their funds – both protected depositors and non-protected depositors).

- (3) On 25 June 2014, following BNB's instructions, a review of the KTB bank group's assets and liabilities by independent external auditors was ordered by the conservators.
- (4) On 11 July 2014, the BNB publicly announced the results of these audits. However, due to a lack of important information on the financial position and/or the proper utilization of loans in the loan files regarding a specific category of borrowers, the auditors were requested to make a full evaluation of all KTB assets, which is due by 20 October 2014, at the latest.
- (5) In view of the initial conclusions of the auditors' report the BNB and the Ministry of Finance conceived a draft special law in order to enact certain measures, such as the acquisition of VCB by the Bulgarian state, the transfer of certain assets and liabilities of the KTB to the then state owned VCB and the revocation of KTB's bank license and to declare the KTB bankrupt. This law could not be agreed on, and is therefore not yet adopted.
- (6) By letter of 31 July 2014, after receiving information on the inability of depositors to access their deposits in KTB, and in accordance with Article 17 of the Regulation, the EBA made a preliminary enquiry requesting information from the BNB, particularly, on the ability of depositors to access their deposits and, in case of unavailability of deposits, the availability of recourse to the Bulgarian Deposit Insurance Fund ('BDIF'), or failing both, the compatibility of this situation with Directive 94/19/EC.
- (7) By letter of 19 August 2014, the BNB's Deputy Governor and Vice-Chairman of the BDIF Management Fund replied to the EBA. The BNB's position is that, according to the Bulgarian national legislation, the repayment of guaranteed deposits is possible within the timeframes provided for in Directive 94/19/EC (20 working days of the date on which the competent authorities make a determination regarding the unavailability of the credit institution's deposits or a judicial authority makes a ruling which has the effect of suspending depositor's ability to make claims against it) when a bank's licence is withdrawn by the BNB. That decision is required to be taken by the BNB within five business days of establishing the insolvency of the credit institution. However, for the purpose of resolving a credit institution at risk of insolvency, the BNB may place such a credit institution under conservatorship. While under conservatorship, the bank may be subject to different measures, including suspension of payment of obligations.
- (8) The BNB argues that in case the BDIF repays the guaranteed amount of the deposits placed with a bank under conservatorship while its financial situation is being reviewed, and with no decision reached for its insolvency yet, the bank may lose the larger part of its depositors, which would make its resolution pointless or impossible.
- (9) It also argues that where the European Commission decides that the national provisions do not comply in full with Directive 94/19/EC, measures should be taken to amend them within a short timeframe but this cannot be done before an amendment of the of the Bulgarian

legislation adopted by the Bulgarian Parliament. Following dissolution of the parliament in August a new parliament will be established after the elections held on 4 October. The option of a possible interim partial access to deposits is not covered by the currently effective legislation either, and cannot be realized without the relevant legal amendments.

- (10) Finally, the BNB states that consideration should be given to the fact that the guaranteed amount of deposits placed with KTB and its subsidiary VCB is higher than the funds contributions accumulated at the BDIF.
- (11) On 16 September 2014 the BNB Governing Council extended the conservatorship of KTB and VCB to 20 and 22 November 2014 respectively. A final decision with regard to KTB's future is expected to be made between 1 and 20 November 2014.
- (12) The BDIF has not made any payment to depositors so far. The BDIF has informed the EBA that it received a number of claims for payments from depositors, and has received over 500 inquiries regarding the status of KTB and VCB. The BDIF has also stated that Bulgarian law provides for payment of verified protected deposits without individual claims being necessary, but there is no legal procedural provision with respect to payment of individual claims. It considers that under the Bulgarian implementation of Directive 94/19/EC any full or partial payment by the BDIF would require an explicit act by the BNB or a judicial authority.

### EBA Findings

- (13) Deposit protection is an essential element in the completion of the internal market, as essential as the prudential rules for the completion of the single banking market, and an indispensable supplement to the system of supervision of credit institutions on account of the solidarity it creates amongst all the institutions in a given financial market in the event of the failure of any of them.
- (14) Article 10(1) of Directive 94/19/EC states that *“deposit guarantee schemes shall be in a position to pay duly verified claims by depositors in respect of unavailable deposits within 20 working days of the date on which the competent authorities make a determination as referred to in Article 1(3)(i) or a judicial authority makes a ruling as referred to in Article 1(3)(ii).”*
- (15) Under Article 1(3)(i) of Directive 94/19/EC a deposit is considered ‘unavailable’ if the *“deposit is due and payable but has not been paid by a credit institution under the legal contractual conditions applicable thereto, where (...) the relevant competent authorities have determined that in their view the credit institution concerned appears to be unable for the time being, for reasons which are directly related to its financial circumstances, to repay the deposit and to have no current prospect of being able to do so. The competent authorities shall make that determination as soon as possible and in any event no later than five working days after first becoming satisfied that a credit institution has failed to repay deposits which are due and payable.”*

(16) Recital 12 to Directive 2009/14/EC<sup>2</sup> explains that *“Deposits may be considered unavailable once early intervention or reorganisation measures have been unsuccessful. This should not prevent competent authorities from making further restructuring efforts during the payout delay.”* The reference to early intervention measures demonstrates that deposits may be considered unavailable without a credit institution being subject to insolvency proceedings, while it is also clear that the process for payment of protected deposits should not be delayed once initial reorganisation measures have failed.

(17) In the present case, by suspending all obligations of KTB and VCB for three months the BNB made deposits unavailable within the meaning of Article 1(3)(i) of Directive 94/19/EC. The suspension of the access to deposits has been imposed for reasons which are directly related to the financial circumstances of KTB and VCB. This derives from the fact that the decision was based on Article 115(1) and (2) point 2 and 3 of the Bulgarian Law of Credit Institutions which requires that *“the bank’s liquid assets in BNB’s opinion will be insufficient to enable the bank to fulfil its obligations on the day they become due, or the bank has not met in time one or more of its obligations to its creditors when they have become due”*. The first condition seems therefore to have been met on 20 and 22 June 2014 respectively for the two banks, and continues to be met. From that point, KTB and VCB were unable to repay deposits which are due and payable. Such inability resulted from the depletion of the liquidity of KTB and VCB and was perpetuated by the moratorium. The second condition also appears to be met. There is *“no current prospect”* of deposits being repaid if the credit institution cannot be expected to regain its ability to repay deposits in the short term. The deposit-guarantee scheme required under Directive 94/19/EC serves to insure not only the nominal value of covered deposits but also provides, at least to some extent, a substitute for the otherwise availability of such deposits in accordance with their terms. The determination that deposits are unavailable can therefore only be avoided if access to deposits is expected to be resumed within a very short time period.

(18) While these conditions are to be assessed by the competent authorities, the margin of appreciation for BNB in reaching its assessment is limited by the timescales and objectives of the Directive, in particular the requirement to make a determination within five working days of a deposit not being paid. Any margin available has been overstepped in this particular case, with deposits still unavailable nearly three months after their initial unavailability and, conservatorship having been extended to 20/22 November 2014, no immediate prospects of those deposits becoming available.

(19) Despite the conditions of Article 1(3)(i) of Directive 94/19/EC being met, the BNB has failed to make an express determination that deposits are unavailable since it states that Bulgarian law does not provide for such a determination but only provides for the BNB to revoke KTB and

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<sup>2</sup> Directive 2009/14/EC of the European Parliament and of the Council of 11 March 2009 amending Directive 94/19/EC on deposit-guarantee schemes as regards the coverage level and the payout delay (OJ L 68, 13.3.2009, p. 3).

VCB's licences within five working days of BNB establishing that KTB and VCB are insolvent<sup>3</sup>. The BNB has indicated that it will not take this step pending the results of the ongoing audit.

- (20) The understanding of the BNB and BDIF is that the BDIF cannot pay claims from depositors since Bulgarian law provides that the BDIF pays liabilities to depositors where the BNB has withdrawn the banking licence of the bank concerned, and within 20 business days of BNB's resolution to withdraw the licence<sup>4</sup>.
- (21) However, Member States are under an obligation to achieve the result envisaged by a directive. The obligations quoted above on the BNB under Directive 94/19/EC impose clear and unconditional obligations on the Bulgarian authorities which are responsible for implementing and enforcing Union law.
- (22) In addition, national authorities are under a duty under Article 4(3) of the Treaty on European Union to take all appropriate measures to ensure the fulfilment of that obligation. National authorities are required, in applying national law, to interpret it, so far as possible, in the light of the wording and purpose of the directive in order to achieve the result pursued by the directive.<sup>5</sup>
- (23) The fact that Bulgarian national law requires the institution to be insolvent and its licence to be withdrawn before a pay-out by the BDIF can be initiated, does not exonerate the BNB from its duty to act within no later than five working days after first becoming satisfied that a credit institution has failed to repay depositors which are due and payable.
- (24) The obligation to act within the given time limits is not limited by the possibility that the orderly resolution of the concerned institution would be endangered. Furthermore, one of the guiding principles enshrined in the newly enacted Directive 2014/59/EU<sup>6</sup> of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms, whose transposition is due by 31 December 2014, is that any resolution action should ensure that depositors continue to have access to their deposits. The European Court of Justice, in its *Inter-environment Wallonic* judgement<sup>7</sup> held that "*although the Member States are not obliged to adopt measures of transposition prior to the expiry of the time limit for transposition, it results from the combined application of articles 5, 2nd paragraph, and 189*

<sup>3</sup> Paragraphs 2 and 3 of Article 36 of the Law on Credit Institutions: '2. The Bulgarian National Bank shall withdraw the license granted to a bank due to insolvency, where: (1) a bank fails to pay its obligation due for more than 7 business days if it is directly related to a bank's financial status and, at BNB discretion, no repayment on obligation due may be expected in a reasonable period of time; or (2) the amount of a bank's own funds is negative. 3. The decision under paragraph 2 shall be taken by the BNB within five business days from establishing the insolvency.'

<sup>4</sup> Article 23 of the Law on Bank Deposit Guarantee: '1. The Fund shall pay the liabilities of a particular bank to its depositors up to the amount guaranteed, in the cases where the Bulgarian National Bank has withdrawn the banking license granted to the commercial bank. ... 5. Payments from the Fund shall begin no later than 20 business days from the date of the resolution of the Bulgarian National Bank under paragraph 1.'

<sup>5</sup> Case C-106/89 *Marleasing SA v La Comercial Internacional de Alimentación SA* [1990] ECR I-4135.

<sup>6</sup> Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (recast) (OJ L 173, 12.6.2014, p. 149).

<sup>7</sup> CJEU of 18th December 1997, C 129/96.

*third paragraph of the Treaty that, during such time period, they may not take any provisions of a nature to seriously compromise the result prescribed by the directive”.*

## Conclusions

- (25)The BNB has breached Union law by failing to make the necessary determination of the unavailability of assets in accordance with the requirements of Article 1(3)(i) of Directive 94/19/EC. The BNB has also taken a discretionary decision to suspend all obligations, a decision which breaches Union law by removing access by protected depositors to their protected deposits, access which is protected by Directive 94/19/EC by ensuring availability of protected deposits through the relevant deposit guarantee scheme where direct access through the deposit-holder is not available.
- (26)The fact that the BDIF has insufficient accumulated contributions in order to pay in full the guaranteed amounts does not remove the BNB’s obligation to make the determination on the ‘unavailability of deposits’ as referred to in Article 1(3)(i) of Directive 94/19/EC: the payment of protected deposits is a matter for the BDIF which may be subject to an action by protected depositors for any shortfall in accordance with Article 7(6) of Directive 94/19/EC.
- (27)The BDIF is required to pay out on duly verified claims that it has received following a determination by the competent or judicial authorities. While there has been no express determination by BNB, the decision of BNB to impose conservatorship and suspend obligations inheres in the determination by BNB that deposits are unavailable. BDIF is aware of the imposition of conservatorship and the suspension of obligations which have been publicly announced by BNB and published in the Bulgarian Commercial Register in addition to being communicated to the BDIF by telephone call shortly before publication in a BNB press release on 22 June 2014.
- (28)Although the BDIF only received claims from protected depositors on 23 and 24 September 2014, it has informed the EBA that neither full nor partial payment of protected deposits can be made without an explicit act of the BNB or a judicial authority. The BDIF is therefore in breach of Union law due to it not being in a position to pay duly verified claims by depositors in respect of unavailable deposits within 20 working days of the determination referred to in Article 1(3)(i) of Directive 94/19/EC which became known to the BDIF on 22 June 2014.
- (29)Recommendations issued by the EBA pursuant to Article 17(3) of Regulation (EU) No 1093/2010 are intended to set out the action necessary to comply with Union law. Competent authorities need to undertake every effort to fulfil their obligations under Union law, and are required to inform the EBA of the steps they have taken or intend to take to ensure compliance with Union law. Should full compliance with Union law not be feasible immediately, competent authorities should nevertheless take such initial steps as they can without delay, with full compliance achieved as soon as possible. In the present case, if it is not considered feasible for depositors to have full access to their protected deposits, ensuring that depositors have partial access to their deposits would be an important step towards full compliance with Union law obligations.

## Has adopted this recommendation:

### I – Recommendations

1. BNB and BDIF are recommended to ensure that, in accordance with their duty under Article 4(3) of the Treaty on European Union, they take all appropriate measures to ensure they fulfil their obligations under Article 1(3)(i) and Article 10 of Directive 94/19/EC, as set out in paragraphs 2 and 3 of this Article, including by interpreting national law, so far as possible, in line with those Union law obligations.
2. The BNB is recommended to ensure that depositors have access to deposits covered by the protections given under Directive 94/19/EC ('protected deposits'), whether by removing or limiting the restriction on access to deposits resulting from its supervisory actions in placing KTB and VBC in conservatorship, or by making the determination referred to in Article 1(3)(i) of Directive 94/19/EC immediately and communicating it to the BDIF. The BNB is recommended to take one or other of these actions by 21 October 2014.
3. Should the BNB not have taken one of the actions described under point 2 by 21 October 2014, the BDIF is recommended to invite claims from protected depositors, and to verify and pay out on those claims in accordance with Article 10 of Directive 94/19/EC on the basis that the conservatorship measures adopted by the BNB on 20 June 2014 in respect of KTB and 22 June 2014 in respect of VCB are a determination made by the BNB that deposits are unavailable, as referred to in Article 1(3)(i) of that Directive 94/19/EC.
4. The BNB should make all necessary efforts to provide full access to protected deposits in accordance with paragraph 2. If the BNB considers that providing full availability of deposits directly from the deposit-holder could create adverse effects for the financial sector in Bulgaria, as an initial step towards ensuring full compliance with its Union law obligations, it should ensure that partial access to those deposits is provided immediately, with full access made available as soon as possible.
5. In order to support the achievement of the other recommendations set out in this Article, the BNB is recommended to accelerate the ongoing audits of the KTB and VCB and the process for taking decisions on the future of the credit institutions, in order to provide certainty for all depositors and other creditors as quickly as possible.

### II – Implementation and monitoring

1. The BNB and BDIF shall, in accordance with the second paragraph of Article 17(3) of Regulation (EU) No 1093/2010, inform the EBA within 10 working days of receipt of this recommendation of the steps they have taken or intend to take to ensure compliance with Union law.
2. If the European Commission issues a formal opinion referred to in Article 17(4) of Regulation (EU) No 1093/2010 to the BNB or the BDIF, the addressees of that formal opinion shall, in

accordance with Article 17(5) of that Regulation, inform the EBA, within 10 working days of receipt of the formal opinion, of the steps they have taken or intend to take to comply with that formal opinion.

3. The information referred to paragraphs 1 and 2 should be set out in a report explaining the measures taken or to be taken and clearly setting out when the addressees expect to comply with Union law, together with evidence of the actions taken and planned.

Done at London, 17 October 2014