



The Bulgarian Banking Disaster

By Frances Coppola
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Two months after it was taken into conservatorship by the Bulgarian National Bank (BNB) after a catastrophic bank run, Bulgaria's CorpBank is still closed.

Well, nearly closed. It is now open for loan repayments. Depositors can't get their money out of CorpBank, but borrowers can pay their debts.

There are good reasons for this. Closing a bank's operations completely leaves it unable to service its obligations, not just to depositors but to bondholders too. CorpBank recently defaulted on a bond payment because of its lack of cash flow. Personally I am at a loss to understand how a bank in central bank conservatorship can be allowed to default on a bond payment: until the bank is either recapitalized or wound up, it is the central bank's job to ensure that it has the liquidity to meet obligations. Claims that CorpBank doesn't have sufficient assets to support provision of central bank liquidity are frankly unbelievable. Allowing CorpBank to default on a bond payment is central bank negligence, pure and simple.

Not that this is the first example of BNB incompetence. One of the interesting features of the Bulgarian bank runs story is the difference between the treatment of CorpBank and First Investment Bank. Both banks were subject to runs driven by media reports and social media messages. The BNB allowed the run on CorpBank to continue until it had torn a huge hole in its balance sheet, then closed it down. In contrast, First Investment Bank was provided with emergency liquidity by both the BNB and eventually the EU: the President issued reassuring messages about the safety of deposits, and the BNB called for prosecution of people guilty of "spreading rumors" about bank instability. Why were the two banks treated so differently?

Not only that, but the BNB's treatment of CorpBank prior to its collapse does not give the impression of a regulator that knows what it is doing. CorpBank was paying very high interest rates to attract deposits – in my view always an indication of liquidity problems: it had an unusual concentration of state assets and breached regulatory limits on lending to limited companies. But the BNB lauded CorpBank to the skies, naming it in "Bank of the Year" awards and turning a blind eye to its growing risks.

The BNB also ignored evidence of corruption. We now know that CorpBank is embedded in a complex and opaque edifice of financial and non-financial companies owned by Tsvetan Vassilev, who is now in hiding. As I've observed before, complex and opaque structures exist for one purpose only – to conceal what is really going on. Bulgarian oligarchs understandably like to conceal their business interests from predators, so a complex and opaque structure in a Bulgarian enterprise is not necessarily an indicator of fraud. But the Bulgarian Chief Prosecutor says that there was fraud in this case. In addition to the earlier claim that large amounts of cash were withdrawn from the bank on Vassilev's orders immediately prior to its failure, allegations have now been made that Vassilev systematically drained the bank to support his other business interests over the course of about 4 years. Investigators into CorpBank's failure claim to have found documents that were deliberately concealed from auditors and evidence that documents were shredded on the order of senior bank executives immediately prior to CorpBank's closure. Along with the bank's Chief Cashier, Vassilev stands accused of embezzlement, and an international arrest warrant for him has now been issued. Interpol were looking for him in Vienna, apparently, but he had long gone.



Tsvetan Vassilev. Photo credit: Novinite

But corruption in Bulgarian banks is endemic. CorpBank is no more corrupt than FI Bank: both banks were named by Wikileaks as being among several “bad apples” in the Bulgarian banking system. Why was CorpBank closed but FI Bank kept open? Indeed, why is there no investigation into the other banks named by Wikileaks?

Nikolay Staykov of the Bulgarian Protest Network says that the BNB had completely different objectives with regard to the two banks. CorpBank was to be brought down in order to remove the current majority owner, Tsvetan Vassilev. But FI bank – the bank to which Delyan Peevski moved his money, sparking the CorpBank run – was to be protected. Ostensibly this was to keep the banking system stable: but as this whole affair is really a fight to the death between Vassilev and Peevski, it is hard not to conclude that Bulgarian institutions are partisan. The judiciary is known to be corrupt and the Chief

Prosecutor's office seems to be politically captive: it is hardly surprising therefore that the Protest Network's call for the entire banking sector to be investigated for corruption appears to have fallen on deaf ears. One "bad apple" has been removed, but the rest have been protected for unknown reasons. As ever in Bulgaria, it is all as clear as mud – except for one thing. The removal of Vassilev from the scene leaves Peevski in effective control not only of Bulgarian media and secret services, but of its banking sector too. Such concentration of power is a cause for concern in a supposedly democratic country.



Delyan Peevski. Photo credit: Novinite

And as always in Bulgaria, when big fish fight, little fish get hurt. According to Zheni Stefanova from KTB ALive, a Facebook group of CorpBank depositors which is organizing street protests against its continuing closure (the next one is today, Monday August 18th):

We can't use our savings and money at all. The employees of the bank are not sure about their jobs in the future . As an addition, the companies can't use their frozen accounts,

which creates so much difficulties for them with their cash flows, their financial planing, investments and blocked wages for their employees. There are many health institutions that can't function normally because of that problem. There were 6000 retired people with blocked accounts that can't use their money and they really need it because of their health problems as old people.

Admittedly, since no-one in Bulgaria trusts banks, most of them have other resources. But the longer CorpBank remains closed, the more likely it becomes that there will be tales of real hardship. Indeed according to Stefanova there are already a few:

There is a man who needs a cancer treatment and his life depends on a quick solution, there is a little boy who had the misfortune to use an account at Corpbank for charitable needs , another man who's wife is dying , she needs an urgent treatment and now he needs his money as soon as possible.

But at present there seem to be no plans to re-open CorpBank before the elections in October, or indeed before the completion of the audit into its books, currently scheduled for October 20th. By that time depositors will have been denied access to their money for four months.

Stefanova says that depositors have tried to persuade the Bulgarian authorities to re-open – or resolve – CorpBank, to no avail:

So far nothing has been undertaken by neither the Government, nor the Central Bank. We send letters to the Central bank with a hope of a support. They just answer that the law doesn't allow them to help us and release our own money. They just suggest that we should find different ways to solve our problems. Here arises the question what kind of law is that? Nobody is doing anything about this problem.

And she also criticizes the EU authorities:

Listening to the news I hear different opinions about the problem and everybody says that the bank should open soon, however nothing is happening. We are not less Europeans than the other European countries. We have waited two months for this problem to be solved and we can't wait anymore.

She is right. The inaction of Bulgarian and EU authorities over the plight of CorpBank's depositors is disgraceful. No other bank in the EU has been allowed to remain in limbo for two months with no decision regarding its future and no payout to depositors. Even in Cyprus, bank closure was only for two weeks: admittedly, large deposits remained frozen after that, but at least insured deposits were covered.

But the problem is that insured deposits are NOT covered. As Shaun Richards explains, Bulgaria's deposit insurance fund is insufficient to meet claims from insured depositors. No wonder the Bulgarian authorities are keeping the bank closed. If they re-open it, there will immediately be a massive bank run, which will force it into bankruptcy and could break the Bulgarian currency board due to the need for leva and possibly Euro

liquidity to support such a massive run: while if they wind it up, they will have to pay insured depositors within 20 days under EU rules, which they don't have the money to do.

This of course explains why the bank has been opened for repayments, and why the BNB has been holding talks with representatives of Oman's sovereign wealth fund – an existing shareholder of CorpBank – about recapitalizing the bank. And it also explains a report that the Bulgarian authorities are considering a Brady-style refinancing deal for the bank devised by a special consultative committee organised by corporate depositors, trades unions and people from the finance industry. It all smacks of desperation to me. Somehow, they have to get more money into CorpBank, and it isn't going to come from the Bulgarian government.

But there is a wider issue here. Allowing CorpBank to default on a bond payment raises questions about the trustworthiness of the Bulgarian authorities. Shabby treatment of depositors raises questions about the commitment of the Bulgarian authorities to the responsibilities of EU membership. And growing evidence that the BNB is both incompetent and politically captive casts doubt on the stability of the Bulgarian financial system. My source close to Vassilev warned that the ultimate objective of those behind the failure of CorpBank was to destabilize the Bulgarian banking system, break the currency board and cause a repeat of the 1996 financial collapse and hyperinflation. Professor Steve Hanke of the Cato Institute, who designed Bulgaria's currency board system, also expressed concern that the currency board might be at risk unless CorpBank is resolved quickly, ideally through bankruptcy and losses for bondholders and large depositors. A financial collapse in Bulgaria would be disastrous for the entire Balkan region. Despite Steve Hanke's reservations, in my view the EU authorities must now intervene.