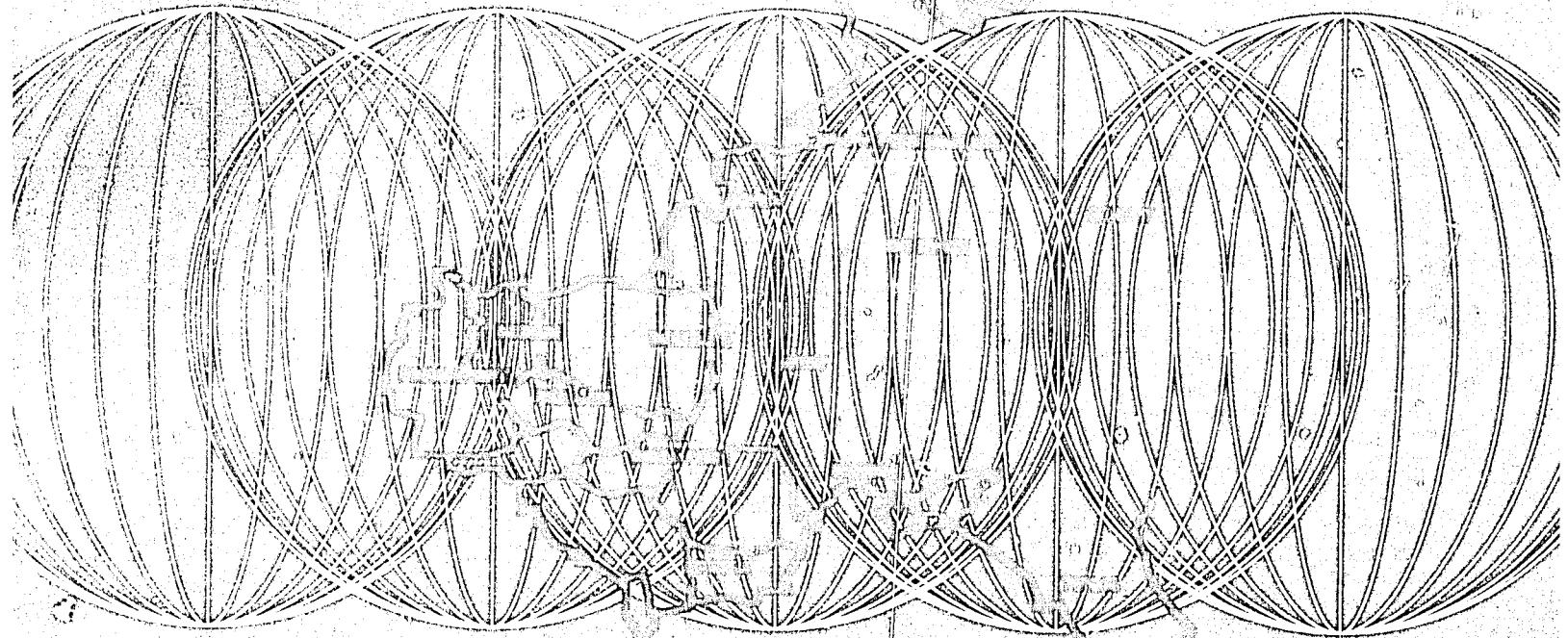
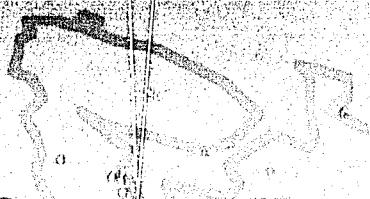
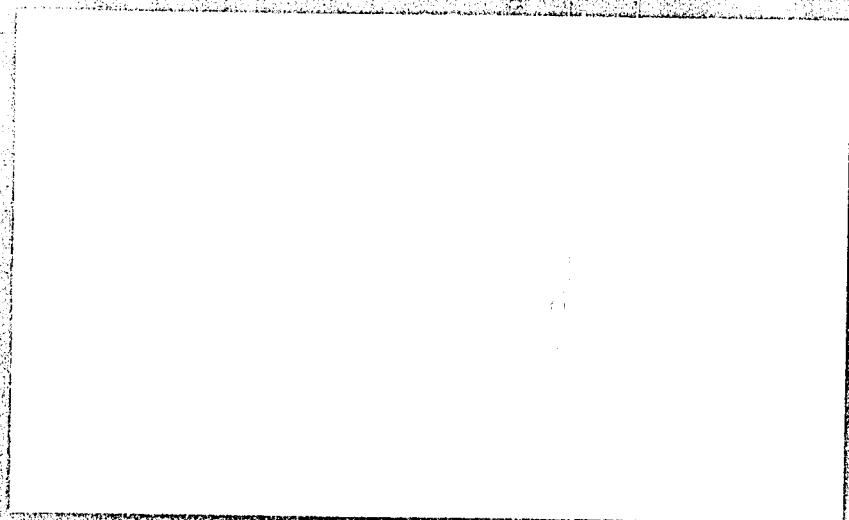


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AN INTERNATIONAL ACTIVITIES PROJECT

FROM PLANNING TO MARKETS  
HOUSING IN EASTERN EUROPE



THE URBAN INSTITUTE  
Prepared for the Office of Housing and Urban Programs (USAID)

**MEMORANDUM  
ON  
BULGARIA MEETINGS**

Prepared by

H. Beth Marcus  
FannieMae

Under Subcontract to

The Urban Institute  
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**MEMORANDUM**

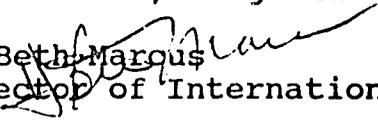
**FANNIE MAE  
WASHINGTON, D.C.**

**Date** : July 29, 1992

**To** : Sonia Hammam  
Housing and Urban Development Officer  
AID - Warsaw, Poland

Sarah Wines  
Housing Officer for Eastern Europe  
AID - Washington, D.C.

Michael Hoffman  
Research Associate  
AID - Sofia, Bulgaria

**From** : H. Beth Marcus   
Director of International Finance

**Subject** : Memorandum Summarizing Meetings on  
Bulgarian Housing Finance

Pursuant to US AID's Request for Services, "Developing a Housing Finance Strategy and Stimulating Competition in the Bulgaria Housing Finance Industry", I conducted a series of meetings and interviews in Sofia, Bulgaria from July 5 through July 17, 1992. These meetings were with representatives from the Government of Bulgaria (GOB), financial institutions, and other organizations related to the specifics of the RFS and the objective of designing a market-oriented housing finance strategy.

Because key subjects were covered from different approaches in a variety of meetings, I have summarized these meetings by the subject matter included in the RFS list of tasks, rather than by meeting. These summaries, which are attached to this memorandum, are organized under the following headings:

- o Proposed Bank Merger Program and the Future of the SSB
- o Training Programs
- o Construction and Home Improvement Loan Programs
- o Policy Incentives
- o Competition in Housing Finance
- o Consideration of the PLAM in Bulgaria
- o Presentation to Bulgarian Housing Finance and Government Officials

Also attached is a list of recommended tasks, consolidating all the tasks that appear throughout the above summaries in one document. The sources for the information contained in these summaries are provided in the attached Trip Report which lists the names and organizations for those interviewed and the subject matter covered in each meeting.

Attachments

## **ABSTRACT**

The US Agency for International Development (AID) requested that this consultant conduct a series of meetings and interviews in Bulgaria from July 5 through July 17, 1992. These meetings were with representatives from the Government of Bulgaria, financial institutions, and other related organizations. Key subjects were to be covered in these meetings: proposed bank merger program and the future of the SSB; training programs; construction and home improvement loan programs; policy incentives; competition in housing finance; consideration of the PLAM in Bulgaria; and presentation to Bulgarian officials. The results of these meetings are summarized by subject.

## **EXECUTIVE SUMMARY**

The US Agency for International Development (AID) requested that this consultant conduct a series of meetings and interviews in Bulgaria from July 5 through July 17, 1992. These meetings were with representatives from the Government of Bulgaria (GOB), financial institutions, and other related organizations. AID identified key subjects to be covered in these meetings: executive summaries of these meetings by subject are presented below.

### Proposed Bank Merger Program and the Future of the SSB

With assistance from the World Bank, a Bank Consolidation Company (BCC) was formed to help the GOB merge the 80 plus commercial banks to create five to eight banks. This consultant was asked to review an interim report just produced by DFC, a British consultant firm, on this effort and to determine the current status of the merger plan, especially as it pertains to the State Savings Bank (SSB).

The consultant discovered that there is disagreement with the conclusions of the DFC report, and one of the areas of discord appears to relate to the SSB. The report recommends that the SSB become a foundation bank in the merger plan and separate completely from the GOB. All those interviewed, including World Bank officials, did not expect this to occur. It is expected that the SSB will basically retain its current status, at least during the first stage of the merger plan, which is expected to take five years.

At the end of the consultant's last week in Bulgaria, a new SSB president and vice president were announced. These executives were not available to meet before the consultant's departure. Instead, the resident AID housing representatives agreed to meet with these new executives to learn their plans for the SSB's future, including pending legislation, and report back to appropriate AID staff.

### Training Programs

There are several training mechanisms that AID may wish to consider as it offers housing training programs. They include the International Banking Institute (IBI), the SSB training department, the Union for Private Economic Enterprise (UPEE) training facilities, the KPMG bank training program, and packaged training materials.

IBI is the training facility created by the Bulgarian National Bank (BNB) and the Bulgarian Foreign Trade Bank, with other banks continually joining the partnership. IBI focuses primarily on training for management and executive levels, has a very extensive catalogue, and is establishing permanent training facilities. IBI is clearly the training institute backed by the banks and government; it is recommended that IBI be an integral part of any AID-assisted training plans.

The SSB training department is better prepared to train non-management staff. They also have off-sight facilities and trainers. They are interested in working with IBI in setting up training programs. AID-assisted training plans that pertain to lower level employees may benefit from SSB support.

The other programs each bring potentially a different benefit to AID-assisted programs. If assistance in setting up a conference is required, UPEE may be useful. The KPMG courses may offer an opportunity to include housing finance in banking training already funded by AID. Lastly, the packaged materials offer an inexpensive way to get training to a larger audience.

### Construction and Home Improvement Lending

The SSB is the only lender offering construction loans and, with a few exceptions, the only lender offering consumer loans (an option for home improvement lending needs). The other lenders offer instead business loans which could be used by builders to help finance some construction costs.

The SSB program finances loans to an individual building a home, loans to individuals who are giving funds to a cooperative building homes for its members, and loans to municipalities and state-owned companies. The business loan programs for commercial banks provide working capital for operational purposes; they are underwritten based upon the potential profitability of the business. Often, personal home real estate is used as collateral for these business loans, making them effectively mortgages.

The general consensus is that the construction needs are primarily for rehabilitation, completion of existing buildings, and new homes for the new upper middle class. Demand is very limited due to the high interest rates and cost of supplies.

Bulgarian lenders, including the SSB, do not appear to have experience in market-oriented construction lending practices. It is recommended that training and technical assistance be a primary focus of any AID assistance in construction lending. Also, there is no experience in home improvement lending; training and technical assistance in this area would be beneficial too.

### Policy Incentives

Government policies can be impediments or aids to housing finance. For this reason, this consultant reviewed current and proposed tax and capital reserve policies as they relate to housing finance. The overall conclusion based upon interviews with Bulgarian officials responsible for these activities is that those concerned with housing finance should play an active role in defining these policies to ensure housing finance receives appropriate treatment.

The new BNB Governor is very supportive of housing finance. There may be additional ways for BNB policies to help "jump-start" these programs, such as requiring some of the BNB loans to lenders be used to finance housing and using housing bonds as collateral for BNB loans.

### Competition in Housing Finance

AID identified a critical issue in housing finance in Bulgaria as the lack of competition. Until recently, only the SSB was permitted to originate housing loans. Although all lenders are now able to enter this business, none have chosen to do so.

As long as the SSB remains the only housing lender, the Bulgarian system will not benefit from the stimulus of competition. For this reason, it is important to understand why lenders do not enter this business so that their concerns can be addressed.

Based on over 30 interviews, the following issues were identified as impediments to lender participation in housing finance:

- o Demands on funds for more profitable purposes
- o Difficulty in matching funds used for long-term housing loans with short-term funding tools
- o Credit risk concerns and lack of market demand, particularly as they relate to affordability and unemployment problems
- o Lack of staff expertise and the cost of setting up a mortgage operation

### Consideration of the Plam in Bulgaria

After researching the experience of the PLAM in countries with similar high inflation, volatile interest rates, and increasing unemployment, certain features of the PLAM were noted as likely to create the greatest problems for Bulgaria:

- o validity of the index
- o varied relationship between wages and inflation
- o volatility of inflation
- o difficulty in handling administrative matters
- o wage fluctuations based upon economic conditions

Based upon this information and an updated economic forecast in Bulgaria indicating expected inflation at 80% for 1992, this consultant recommends reevaluating the PLAM as it was originally intended. It is not recommended to discard the PLAM but rather to attempt to refine it in response to these concerns. AID may also wish to consider two other mortgages - the "inflation proof mortgage" (a variation of the PLAM) and the "low start mortgage".

#### Presentation to Bulgarian Officials

This consultant was asked to present a speech to about 50 Bulgarian housing finance and government officials. The audience was extremely interested in issues pertaining to the mobilization of funds. The speech outline is included as part of this memorandum.

#### List of Tasks

Follow-up tasks are included in each subject summary. To assist AID in their consideration of these activities, a separate list of tasks by subject category is included as part of this memorandum.

#### Trip Report

The trip report lists all those interviewed, their organization, and the subject matter of the meeting. Thirty five meetings were held during the field assignment.

## **PROPOSED BANK MERGER PROGRAM AND THE FUTURE OF THE SSB**

### **Background**

There are approximately 80 banks in Bulgaria today. Most of these banks were created from former branches of the Bulgarian National Bank (BNB). Previously, the BNB acted both as a central bank and a commercial bank and the only other banks in Bulgaria were specialized institutions, such as the State Savings Bank (SSB) which specializes in housing finance.

The Bulgarians recognize that 80 distinct banks is too large a number for a population of approximately 9 million people. With assistance from the World Bank, a Bank Consolidation Company (BCC) was formed. In support of this effort, the US Department of Treasury and AID have provided an advisor to the BCC.

The purpose of the BCC is to develop the procedures for merging the 80 banks into 5 to 10 banks and then to assist these banks in the merger process. A consulting firm based in London, DFC Limited, was hired to assist the BNB and BCC in designing a plan for this process.

AID assigned this consultant the task of researching the bank merger program to determine its current status, especially as it pertains to the SSB. In particular, this consultant was asked to obtain and review an interim report produced by the DFC and to interview those involved with the report who were in Sofia at the time of the consultant's field work. This paper is based on a review of the DFC report and on meetings with Hans Mortiz, World Bank Mission leader and Senior Financial Specialist, Roy Karagolan, World Bank mission member and International Finance Corporation Commercial Banking Advisor, Robert Weeks, World Bank mission member, Robert Perry, US Treasury Advisor to the BCC, and Sally Warren, consultant to the European Bank for Reconstruction and Development.

### **Evaluation of the DFC Interim Report**

The DFC Interim Report has not been accepted well by the World Bank mission and thus had to be obtained from other sources. It is difficult to determine with certainty the World Bank's concerns about the report. Although this consultant uncovered some factual inaccuracies, the World Bank's objections may relate more to DFC's conclusions. This may be particularly true regarding the DFC recommendations on the SSB.

The DFC report recommends that the SSB be included in the merger program as one of

**the 5 to 8 "foundation banks" into which all other banks would merge. The other foundation banks proposed in the report are: the Bulgarian Foreign Trade Bank, the Bulgarian Post Bank, the Transport Bank, and the Agricultural Bank jointly with the Commercial Bank of Plovdiv.**

**DFC recommends that the SSB become a universal bank and not a specialized housing finance lender. It also recommends that the SSB be placed on an equal basis with other banks. This would include elimination of its unique government guarantee on deposits as well as reducing its tax rate, which is approximately 30% higher than the rate imposed on other banks. This would also require a major change in the SSB's structure since, unlike the other banks, the SSB was created under a special act of parliament, and is not a joint stock company as are the commercial banks.**

**If the DFC recommendation is followed, then its affect upon the SSB will obviously be tremendous. However, none of those interviewed about the report and BCC plans for the SSB believe that the DFC proposal regarding the SSB is likely to be implemented.**

**Hans Moritz, the leader of the World Bank mission, indicated that he did not think it was politically likely that the BNB would require that the SSB merge with other banks and lose its special status. Perhaps the most important political reason for not changing the SSB is that it is the primary lender to the BNB. The BNB requires that the SSB give it loans at a "market" rate that it establishes. In this way, the SSB's deposits are passed on to the BNB which then makes loans to other banks.**

**Although Mr. Moritz advocated greater parity with other lenders - particularly in regard to deposit insurance - the greatest structural change he suggested was possibly giving a few SSB branches to other banks included in the merger process. Mr. Moritz also stated that if the SSB were to be "privatized" and merged into other banks, this would probably not take place until after the other banks completely the merger process, which is expected to take at least 5 years.**

### **Additional Analysis and Conclusion**

**All those interviewed on the bank merger subject advocated parity for all lenders on the deposit insurance issue. However, in this consultant's discussions with other lenders, although the other lenders wanted their deposits insured, these lenders pointed out that they are beginning to compete with the SSB through pricing and service. The public, therefore, may not be placing as great a weight on the SSB's deposit guarantee advantage as previously believed.**

**There is a proposed draft law that would change the SSB into a joint stock company, which would be a first step toward "equalization" with other banks. This action, however, would be conditioned, among other items, on the SSB's sale of its bad loans. The consensus on**

**this law is that it is unlikely to be enacted as currently written.**

**Near the end of the period in which this consultant was in Bulgaria, the Government announced the appointment of a new SSB President and Vice President - Messrs. Dromev and Karagyaourov, respectively. Both this consultant and the AID RHUDO staff in Bulgaria tried to schedule a meeting with these new SSB executives prior to the consultant's departure to learn about their response to this draft law and their future plans for the SSB. Although a meeting could not be scheduled during this limited time period, the resident staff will follow-up with a meeting and provide the update on SSB plans that AID needs to evaluate its assistance to the SSB.**

**A meeting was held, however, with the new Governor of the BNB - Mileti Mladenov. Mr. Mladenov's comments suggest the BNB is very supportive of the SSB's role in housing finance.**

**AID or its consultants should review the final DFC report. Based upon the comments made by Hans Moritz, the support given to the SSB by the BNB, and the influence of new SSB leadership, the final report's conclusions regarding the SSB may be very different from those in the interim report.**

## TRAINING PROGRAMS

### The International Banking Institute

The International Banking Institute (IBI) is the training facility that was created by the Bulgarian National Bank (BNB) and the Bulgarian Foreign Trade Bank with an initial capitalization of 2 million levs. IBI was originally created in May, 1991, as a department within BNB. In April, 1992, it was separated from BNB and became a limited liability company with stock held principally by the BNB. Five commercial banks will be joining as partners in IBI in August, 1992 and the SSB has indicated its interest in becoming an owner in the future.

The Director of IBI is Maria Georgieva. She is a former professor from a university specializing in economics. She currently has a full time staff of five: one international relations liaison; three bank liaisons; a driver; and an administrative assistant. Bulgarian lecturers are hired on a part time basis and come from academia and the banking system. Foreign lecturers are usually funded by international donor organizations.

Currently, IBI resides in the BNB where it rents office space. Training classes are conducted in the Palace of Culture, if they are only one or two days in duration, or in hotels located in "resort" towns outside Sofia, if they are longer. IBI plans to create a permanent facility in one of these towns - Bankya. The selected building, which IBI would rent from the BNB, was used previously for training purposes so it will not require significant renovation. It has five classrooms: four holding 15 to 20 people and one large enough for 50 students. However, although BNB has put in a request for the building, it is still owned by the government which has not yet decided to sell it.

The facilities used now by the IBI appear to be adequate. They all have available classroom-type facilities. IBI owns or rents equipment enabling simultaneous translation, use of slides, transparencies, and video.

IBI's Articles of Association state its activities to: train bank staff from the BNB, commercial banks and other Bulgarian financial institutions; conduct banking research; be a conduit for banking information; and publish relevant materials. Thus far it is focused on its primary responsibility - training.

As the attached catalogue of 1992 courses and seminars indicate, the course selection focuses on a broad variety of banking subjects such as accounting, credit analysis and bank operations. Housing finance is not included in this list; this is certainly understandable considering it is currently only relevant to the SSB. Most of these courses are for 3 to 5-days. Three courses on investment and financial analysis are for 4 weeks. Students receive a certificate upon course completion. Student fees cover course and administrative costs.

The courses are targeted to management level staff. When queried regarding IBI's ability to provide training for lower staff levels, the response was positive. However, IBI does not have computers which are likely needed for such training so this capability may currently be limited.

IBI chose to include the word "international" in its name because it plans to train in accordance with international standards, has international lecturers, and hopes in the future that it will offer courses that attract students from other countries. As examples of these international lecturers are: the KPMG banking trainers (Gwen Chandler and Clifford Lewis); William Hunter from the Atlanta Federal Home Loan Bank; and Maxwell Stamp, an English company funded by the Know-How Fund. IBI also works with the University of Delaware on its Bulgarian activities.

IBI has been approached by CIFPB, a French banking institute to become partners. CIFPB appears to be the same French institute that helped set up the banking school in Poland that was reviewed positively by an AID consulting team in May, 1991, as well as one in Hungary. No decision has been made on this offer, and it does not appear to be imminent.

### SSB Training Programs

SSB also has in-house training capability. The director of training coincidentally has the same name as the IBI director - Maria Georgieva. Like IBI, SSB has training directed towards the management group with "resort town" facilities available for these training efforts. In addition, SSB began this year a one-year sabbatical program in two locations where 56 select individuals - mostly branch directors - are being taught business English and how to do banking in a market environment.

The SSB is very interested in working with IBI in the courses designed for the management group. The SSB sees itself using its own facilities and organizing the administrative part of the program. IBI would provide course recommendations and instructors. It appeared that the SSB intends these combined programs to be available to SSB staff, although opening up enrollment to other lenders could be discussed.

The SSB facilities do not sound as if they are as professional as those of IBI; this conclusion is based only on information obtained in the interviews and not on first-hand observation. The two facilities - one in the mountains and one on the seaside - consist of a classroom over an SSB branch. If computers are needed, they are borrowed from the respective branch. Other equipment is also brought in as needed.

Perhaps the most important contribution SSB training programs make is for the lower level staff - the people who will be doing the first cut at underwriting borrowers and who will be responsible for the hands-on servicing tasks. Of the 8,000 SSB staff, over 7,000 fall into the category of lower level, non-managerial staff. Training for these staff members is generally conducted by the individual branches on the local level. Thus far, it sounds like this training is primarily an introduction to the SSB. Recently, the SSB has begun training staff at all levels

on using computers. The computer room where this training takes place, however, consists only of about a half a dozen computers - obviously not enough to make any real impact on the broad staff base.

### Other Training Opportunities

The Union for Private Economic Enterprise (UPEE) is a non-governmental association of private companies offering a variety of services. Among its services are organizing seminars. In addition to handling administrative and marketing tasks, some of the UPEE staff or membership also present the courses in subjects such as legal topics, strategic planning, marketing, and financial analysis. UPEE plans to expand this service in 1993. It is negotiating on purchasing a building to use as its training center.

Because the DFC World Bank draft report speaks highly of a Training Center at the Bulgarian Post Bank, the Bulgarian Post Bank training was also researched. It appears that the DFC report is a bit overstated; the Post Bank has staff responsible for in-house training but there is no center nor are there plans to create one. Any training conducted by this in-house staff is intended only for Post Bank employees and there is no interest in expanding this program for fee income to other banks.

Two other US training efforts also appear to be in effect. The US Treasury Department has awarded KPMG a contract to conduct bank training in the region and, as noted above, they are working with IBI to put on a program. The University of Delaware was also mentioned as an institution assisting in training in Bulgaria.

Lastly, the SSB director mentioned several companies in Sofia that are selling training modules or videos that are bank related. One she mentioned dealt with taking an application from a prospective borrower. These resources may be a very cost-effective way to provide needed training to lower level staff.

### Training Evaluation

Based upon discussions with these potential training offices, it would appear that IBI offers the most viable assistance to AID for its training activities, especially for the management level. IBI specializes in related topics and has a track record for putting on these classes, not only with Bulgarian sponsors but also international organizations. The facilities sound adequate (they were not visited) and future plans appear reasonable and supportive of a good training environment. Another reason to support IBI is that in doing so, AID would be supporting the institute owned by the bankers being assisted and by the BNB, an important supporter of AID's programs, and by the SSB.

Before using IBI, AID may wish to contact "references". It is suggested that KPMG and the

University of Delaware be contacted for this purpose. When doing this contacting, it would be useful to also find out what training these institutions are offering; there may be a way to utilize their efforts in the housing finance area.

Although IBI appears to be the best institute to use for AID training, there may be occasion when AID only needs conference support. In such cases, UPEE may be of assistance.

Lastly, in regard to lower level training, it may be more cost effective for SSB to conduct in-house training for lower level staff than to use IBI or for SSB to use pre-recorded videos or existing training modules geared to this student group. Perhaps IBI can assist the SSB in initially setting up these efforts or perhaps AID can fund some short term technical assistance to assist the SSB.

I N T E R N A T I O N A L                      B A N K  
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I N S T I T U T E  
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1992      CATALOGUE      OF      COURSES      AND      SEMINARS

## INTRODUCING BANKING

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BANKS AND FINANCIAL INSTITUTES - CENTRAL BANK AND COMMERCIAL BANKS; DEFINING FUNCTIONS AND FEATURES OF BANKING ENTERPRISES. RELATIONS BETWEEN THE CENTRAL BANK AND THE COMMERCIAL BANKS; BETWEEN THE CENTRAL BANK AND GOVERNMENT; BETWEEN THE CENTRAL BANK AND FOREIGN CONTRACTORS. NONBANKING FINANCIAL INSTITUTES. SPECIALIZED FINANCIAL BROCKERS. BANKING SYSTEMS OF INDUSTRIALIZED COUNTRIES - SPECIFICATIONS, DIFFERENCES, DEVELOPMENT.

## INTRODUCING BANK TRANSACTIONS

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BASIC BANK TRANSACTIONS (OPERATIONS). TYPES OF BANK TRANSACTIONS AND BANK SERVICES. CONNECTIONS BETWEEN THE SEPARATE BANK TRANSACTIONS IN THEIR DEVELOPMENT. SPECIFYING BANK SERVICES - CIVIL PRINCIPLES OF OF BANK TRANSACTIONS (OPERATIONS). MODERN INFORMATIONAL BANK TECHNOLOGIES. SOLVENCY, MONEY IN CASH (READY MONEY) AND SECURITY OF BANKS. SHORT-TERM AND LONG-TERM STRATEGIES OF BANKS.

## THE BANK AS AN ENTERPRISE

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UNIVERSAL AND SPECIALIZED BANKS. CIVIL FORMS OF BANKING ENTERPRISE. BANKING LICENCES. BANKING BRANCHES AND FOREIGN REPRESENTATIONS, CORRESPONDING BANKS. BANK STRUCTURE - DEPOSIT AND SAVING DEPARTMENTS; ECONOMIC ANALYSIS DEPARTMENT; ACCOUNTANCY; CREDIT DEPARTMENT; CORRESPONDING RELATIONS AND PAYMENTS; SECURITY DEPARTMENT OPERATIONS. OTHER SPECIALIZED DEPARTMENTS AND OFFICES.

## COMMERCIAL BANK BALANCE

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BASIC ELEMENTS OF COMMERCIAL BANK BALANCE. OWNED CAPITAL AND MONEY IN CASH. MANAGING OF THE BANK'S LIABILITIES. DISTRIBUTION OF ASSETS. BANKING PROFITABLENESS. FORMATION AND DISTRIBUTION OF BANK INCOME.

## MANAGEMENT OF MONEY IN CASH (READY MONEY)

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DEFINITION FOR MONEY IN CASH. RISK CONNECTED TO THE AVAILABILITY OF ASSETS AND LIABILITIES WITH DIFFERENT DATE OF PAYMENT. INFORMATIONAL INSURANCE ON MANAGEMENT OF ASSETS AND LIABILITIES. TECHNIQUES AND INDEXES IN VALUATION OF MONEY IN CASH. FLOWING MONEY IN CASH AND FORECASTS.

### CORRELATED MANAGEMENT OF BANK ASSETS AND LIABILITIES

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BANK FINANCIAL BALANCE. METHODS OF CORRELATED MANAGEMENT. APPLICATION OF LINEAR PROGRAMMES IN MANAGEMENT OF BANK ASSETS AND LIABILITIES. MATHEMATICAL METHODS OF MUTUAL TIME PLANNING (POSITIONING) OF ASSETS AND LIABILITIES OF THE BANK.

### BANK MARKETING

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DEFINITION. ORIENTATION OF BANK ACTIVITIES TOWARDS CLIENTS AND MARKET RESEARCH. BUILDING UP OF MARKETING STRATEGY, SEGMENTATION OF MARKETS. BANK SERVICES AND PRODUCTS AND THEIR MANAGEMENT. ANALYSIS OF MARKETS. PLANNING OF DEVELOPMENT OF BANK TURNOVER. ADVERTISEMENT AND ACCUMULATING CLIENTS. PUBLIC RELATIONS.

### BUILDING UP INFORMATIONAL MANAGING SYSTEMS

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DEFINITION AND NECESSITY. BUILDING UP OF CONCEPT FOR MANAGING AND INFORMATIONAL SYSTEM. INNER INFORMATION SYSTEM. FORMATION OF DATA BASE STRUCTURE AND USAGE OF ACCUMULATED AND PROCESSED INFORMATION IN DEFINING READY MONEY, PROFITABLENESS, CREDIT, DEPOSIT AND BANK RATE POLICY. BANKING DATA PRODUCTS USAGE.

### MANAGEMENT OF BANK BRANCH

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TYPES OF BANK BRANCHES. STRUCTURE AND ORGANIZATION OF ACTIVITIES. SYSTEM OF COMMUNICATION IN THE BRANCH AND CONNECTION WITH OTHER BANK BRANCHES. MARKETING FUNCTIONS. TIME AND STRATEGIC MANAGEMENT. DELEGATION OF RIGHTS AND MANAGEMENT ACCORDING TO MAIN AIMS.

### BANK MANAGEMENT

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ORGANIZATION AND MANAGEMENT OF BANKS. FUNCTIONS OF MANAGEMENT. MANAGEMENT METHODS. TIME MANAGEMENT. STRATEGIC PLANNING AND MANAGEMENT. ANALYSIS OF COMPETITIVENESS. HARMONIZING OF STRATEGY AND ORGANIZATION OF THE BANK; MARKETING, FORMATION OF MANAGEMENT SKILLS, MANAGING OF PERSONNEL, FORMATION OF WORKING GROUPS, QUALIFICATION OF PERSONNEL. CENTRAL BANK REGULATION MECHANISM ON BANKING SYSTEMS. DISCOUNT OPERATIONS OF CENTRAL BANK. CONDITIONS FOR NEGOTIATING. DISCOUNT OPERATIONS AND MOVEMENT OF RATE OF INTEREST IN THE COUNTRY AND CREDIT CAPITALIZATION. OPEN MARKET OPERATIONS. TYPES AND MECHANISMS OF REFINANCING. MINIMAL OBLIGATORY RESERVES OF COMMERCIAL BANKS IN THE CENTRAL BANK. MECHANISM OF MANAGEMENT OF RESERVE ACCOUNTS. ADMINISTRATIVE METHODS OF REGULATION - CREDIT LIMITATIONS AND LIMITS.

P A Y M E N T            S Y S T E M

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FORMS OF PAYMENT

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CASH AND NON-CASH PAYMENTS. BASIC PAYMENT FORMS IN THE COUNTRY. CIVIL NORMS OF PAYMENT THROUGH THE BANK. AGREEMENTS ON OPENING BANK ACCOUNTS. TYPES OF BANK ACCOUNTS. BANK TRANSFERS. DEBITING OF BANK ACCOUNTS. AUTOMATIZATION OF PAYMENT PROCESSES.

CASH PAYMENT

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LEGAL BASES FOR EXECUTION OF CASH PAYMENTS. TECHNIQUE AND ACCOUNTANCY OF CASH OPERATIONS. MEANS OF PAYMENT PROTECTION AGAINST FORGERY AND FALSIFICATION. TECHNIQUE FOR IDENTIFICATION OF FORGED BANK-NOTES AND CHEQUES. CONTACT WITH CLIENTS. USAGE OF MODERN EQUIPMENT AND METHODS IN CASH PAYMENTS.

N O N - C A S H            P A Y M E N T S

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PAYMENT BY LETTER OF CREDIT

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DEFINITION AND SCHEDULE OF PAYMENTS BY LETTER OF CREDIT. DOCUMENTATION IDENTICITY RULES FOR LETTERS OF CREDIT OF INTERNATIONAL CHAMBER OF COMMERCE- I C C . OPENING OF LETTERS OF CREDIT. REMITTED AND REIMBURSED LETTERS OF CREDIT. LETTERS OF CREDIT STAND-BY AND BACK-TO-BACK. FEATURES IN PAYMENTS BY LETTER OF CREDIT. PAYMENT BY SPECIAL ACCOUNT.

ENCASHMENT PAYMENT

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BASES OF ENCASHMENT OPERATIONS. WAY OF PAYMENT. RISK AND PRICE OF ENCASHMENT. EQUAL RULES FOR ENCASHMENT OF INTERNATIONAL CHAMBER OF COMMERCE - I C C .

COMPANY FORM OF PAYMENT (DIRECT TRANSFER)

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CONDITIONS FOR PAYMENT AND ESSENCE OF DIRECT TRANSFERS. WAY OF PAYMENT NATIONAL SYSTEM OF NON - CASH PAYMENTS.

## CHEQUE PAYMENTS

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DEFINITION OF CHEQUE AND LEGAL ASPECTS. TYPES OF CHEQUES AND CHEQUE BOOKS. ISSUING OF CHEQUES, ENDORSMENT AND ENCASH. OVERDRAFT. CREDIT CARDS AND ELECTRONIC PAYMENTS.

## BILLS

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DEFINITION OF BILLS, TYPES OF BILLS. LEGAL DEMANDS FOR VALIDATION OF BILLS. FORM AND CONTENT OF BILLS - OBLIGATORY PROPERTIES. WAY OF MANAGING OF BILLS. DUPLICATES AND COPIES. RISKS IN PAYMENTS, BANK GUARANTEES. DATE OF PAYMENT. PRESENTING, ACCEPTING AND PAYING OF BILLS. DENYING PAYMENT. DISCOUNTING BILLS - CONDITIONS AND TECHNIQUE. LEGAL REGIME OF BILL EXCHANGE.

## PAYMENTS IN INTERNATIONAL COMMERCIAL TURNOVER

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INTRODUCING THE SYSTEM OF INTERNATIONAL STOCK AND FINANCIAL TRANSFERS. THE RISK IN INTERNATIONAL EXCHANGE AND THE ROLE OF THE BANK. COMMERCIAL CONTRACTS AND SPECIFIC DOCUMENTS. BILLS - SPECIFICATIONS IN USING OF INTERNATIONAL EXCHANGE, UNIFIED RULES, NEGOTIATION. DOCUMENTARY LETTER OF CREDIT IN EXPORT AND IMPORT OF GOODS - DEFINITION, SPECIFIC FEATURES, RESPONSIBILITIES, IDENTIFIED RULES. DOCUMENTARY CREDIT - DEFINITION, PAYMENT, DOCUMENTS, ACCEPTANCE, NEGOTIATION, DISCOUNT. BILLS IN DOCUMENTARY CREDIT. SPECIFIC DOCUMENTARY CREDITS - RED CLAUSE, BACK TO BACK, STAND -BY, REVOLVING ETC. TYPES OF RISKS, BANK GUARANTEES. PRINCIPLES IN INTERNATIONAL PAYMENT - SPOT RATES, FORWARD RATES, HEDGING.

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### INTRODUCING CREDITING

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GENERAL CONDITIONS OF CREDITING. TYPES OF CREDITS AND CREDIT OPERATIONS. ORDER OF CREDITING , COMMERCIAL, INDUSTRIAL AND MORTGAGE CREDITS. CREDITING OF AGRICULTURAL PRODUCTION. SPECIAL FORMS OF CREDITING. BASIC ACCOUNTING PROBLEMS OF SOLVENCY AND CREDIT SECURITY. PARTICULARS IN MAKING CREDIT AGREEMENTS.

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## FINANCIAL ANALYSIS OF BANK CREDITS

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ANALYSIS AND VALUATION OF FINANCE FLOWS. DISCOUNT OF FINANCIAL FLOW - METHODS, ANALYSIS OF RESULTS. VALUATION OF CONTRACT DEBTS AND CREDITABILITY OF CREDIT PURCHASERS. VALUATION OF PRESENT AND FUTURE CONDITIONS OF INCOMES AND PROPERTY OF DEBTORS. CREDIT AGREEMENTS - TYPES AND PECULIARITIES. BANK SECRET. BANK INFORMATION FOR CLIENTS. CREDIT OPERATIONS OF BANKS AND READY MONEY.

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DEFINING OF RISK AND TYPES OF RISKS. TECHNIQUE OF DEFINING OF RISKS AND POSSIBILITIES FOR THEIR MINIMALUIZING. INSOLVENCY OF DEBTORS. WAYS OF FORECASTING CLIENTS INSOLVENCY. PRELIMINARY SIGNALS FOR INSOLVENCY. UNREGULARITY OF ACCOUNTS AND MANIPULATIONS IN CLIENTS, BALANCE . WAY OF BEHAVIOUR OF THE BANK BEFORE, DURING AND AFTER UNCOVERING OF INSOLVENCY.

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## CURRENCY MANAGEMENT

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## CURRENCY RISK

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DEFINITION OF CURRENCY RISK. ORIGIN AND LIMITS OF CURRENCY RISK. CURRENCY MARKET. POSITIONS ON CURRENCY MARKET. RISKS IN LONG, SHORT AND BALANCED POSITIONS. OPENING, CHANGE AND CLOSING OF CURRENCY POSITION. HEDGING AND PRICES OF HEDGING. FORWARD CONTRACT. OUTRIGHT DEALS AND USAGE OF CURRENCY OPTIONS. MANAGEMENT OF CURRENCY RISK.

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## INTERNATIONAL BANK OPERATIONS

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CURRENCY OPERATIONS AS FORM OF BANK SERVICE. CASH DEALS. SWAP DEALS. OPTIONS. RATE OF INTEREST IN FIXED DATE DEALS. CLASSIC INSTRUMENTS IN CURRENCY DEALS.

## INTERNATIONAL BANK OPERATIONS

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## VALUATION OF SECURITIES

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## FIXED DEALS

BASES OF FIXED DEALS ON DEVELOPED AND NON-DEVELOPED MONEY AND CAPITAL MARKETS. INDEXES. FIXED DEALS IN CURRENCY AND SECURITIES. STRATEGY OF FIXED DEALS. EVALUATION CRITERIA AND ANALYSIS. USING OF FIXED DEALS IN EVERYDAY BANK OPERATIONS.

## BANK ACCOUNTANCY

PRINCIPLES OF ACCOUNTANCY. ACCOUNTS - TYPES AND PECULIARITIES. NATIONAL ACCOUNTANCY PLAN, PECULIARITIES. INTRODUCTION OF THE NEW SYSTEM OF ACCOUNTANCY. BANK BALANCE - DEFINITION, PECULIARITIES, MAKING OF THE BALANCE. FINANCIAL ANALYSIS OF THE BALANCE.

## BANK TAXATION

TAXATION SYSTEM - COMPOSITION AND STRUCTURE. TAX POLICY. TURNOVER TA ( TAX ON GOODS AND SERVICES), EXCISE, DUTY, FISCAL MONOPOL. TAXATION ON PROPERTY. INCOME TAXATION - PROFIT TAX AND OTHER INCOME TAXES. TECHNICS OF TAXATION OF TURNOVER, INCOMES AND PROPERTY. TAX CONTROL.

## BANK LAW

LEGAL CONDITION OF BULGARIAN NATIONAL BANK AND ITS ORGANS. REGULATIV AND CONTROL RIGHTS OF BULGARIAN NATIONAL BANK. LEGAL CONDITION OF COMMERCIAL BANKS AND OTHER FINANCIAL INSTITUTES. NORMATIVE REQUIREMENTS CONNECTED WITH RISK AND READY MONEY OF BANK. ACTIVITY. LEGAL ASPECTS OF BANK DEALS.

## CURRENCY LAW

CHARACTERISTICS OF CURRENCY REGIME. BASIC REGULATION CONCEPT. CURRENCY VALUABLES. PROPERTIES UNDER CURRENCY CONTROL. LOCAL AND FOREIGN PERSONS. RIGHTS AND OBLIGATIONS ON DEALS AND ACTIONS WITH CURRENCY VALUABLES AND PROPERTIES UNDER CURRENCY CONTROL. LIMITATIONS AND BANS. CURRENCY CONTROL. LEGAL RIGHTS OF BANKS.

TAX LAW

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DEFINITION OF TAXES AND TYPES OF TAXATION. TAXES CONNECTED WITH ECONOMIC ACTIVITIES. CATEGORIES OF PAYERS. SUBJECTS AND LIMITS OF TAXATION. TERMS FOR CHARGING AND PAYMENT OF TAXES. TAX CONTROL. REVISION AND APPEALS AGAINST TAXES. PECULIARITIES IN TAXATION OF BANKS.

COMMERCIAL LAW

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DEFINITION. MERCHANTS AND COMMERCIAL ENTERPRISE. COMMERCIAL REPRESENTATION. TYPES OF MERCHANTS - INDIVIDUAL MERCHANT, MERCHANT PUBLIC ENTERPRISE, COMMERCIAL SOCIETIES. TRANSFORMATIONS AND UNITING OF COMMERCIAL ASSOCIATIONS. COOPERATIONS. COMMERCIAL INSOLVENCY.

## **CONSTRUCTION AND HOME IMPROVEMENT LOAN PROGRAMS**

### **Overview**

Bulgarian lenders other than the State Savings Bank (SSB) do not offer housing construction and home improvement loans to either builders, developers, or homeowners. With the exception of the SSB and a few loans made by the Bulgarian Post Bank, these lenders also do not offer consumer loans that could potentially be used for rehabilitation purposes.

These lenders do offer business loans which could be used by builders to help finance some construction costs. These loans, and the SSB construction loan program, are described below.

Bulgarian lenders do not appear to know much about what is meant by construction lending as it is practiced in a market-oriented environment. In order to attract lenders to construction lending, it is recommended that AID sponsor an introductory seminar on construction lending and project development, followed by more comprehensive training and technical assistance when lenders appear closer to starting this product line.

### **The SSB Construction Lending Program**

The SSB offers three types of construction loan programs:

- o a loan to an individual to build one home. This loan becomes a long-term mortgage loan when construction is completed. The loan has the same terms as any other SSB mortgage loan (generally 20-year fully amortizing loans with adjustable rates), except that interest is capitalized during the construction period.
- o loans to cooperative members to build homes. In this program, individuals group together and form a cooperative. The loan is given to each individual who then turns the funds over the cooperative for housing construction. The loans also become permanent mortgages with typical SSB terms.
- o loans to municipalities and state-owned companies. These loans are typically offered for a two and a half year term at market rates, with interest only paid during the first two years and principal paid during the last six months.

(For further detail on the specific SSB construction loan programs, see the AID-funded paper, "The Bulgarian Banking System and the Housing Finance Market" by R. Marisol Ravicz).

Most lenders who were interviewed felt that the state construction industry has been one of the hardest hit industries in Bulgaria in the last year. The high cost of materials and high interest rates have made housing construction too expensive. This observation is reinforced by the decline in the SSB's construction lending programs.

## Business Loans

As noted, only the SSB has a construction loan program. One bank -the Stroybank - was created in 1987 to specialize in construction lending. However, Stroybank has never provided project construction loans; their construction program has been limited to fund start-up costs of construction industry companies. In the future, Stroybank plans to merge with other commercial banks and become a more universal bank.

Almost all commercial banks have short-term loan programs that are available to all business enterprises, including those companies involved in the construction industry. These commercial lending programs provide working capital for operational purposes, such as materials and salaries.

The loans are underwritten based upon the potential profitability of the business. Loans to the construction industry are underwritten the same as any other industry. The loans are not linked to specific projects and, thus, there is no project-based underwriting.

The maximum terms are short - generally no more than one year. Rates adjust and are usually five to ten percent over the base rate (the borrowing rate charged by the Bulgarian National Bank to its lenders). Repayment of principal during the loan term is negotiable; most loans appear, however, to provide for some principal repayment prior to maturity.

Collateral for the loan tends to be the materials being purchased. However, lenders consistently stated that they often use an individual's home as collateral for a commercial loan - especially for the increasing number of loans being provided to fund working capital for small businesses cropping up as a result of the restitution process.

The use of an individual's home as collateral for a commercial loan has several implications for housing finance. Lender confidence in this type of collateral suggests that they believe foreclosure will work as a deterrent to delinquencies. The use of homes as collateral for non-housing loans reinforces the need for an efficient and accessible loan recordation program to ensure that a lender has appropriate lien priority and sufficient collateral for the loan.

Home values used for these loans tend to be very conservative. This suggests that the commercial loans may have relatively low loan-to-value ratios. A home could have sufficient value to support more than one loan. Thus, there may be sufficient value remaining in the homes to be used as collateral for second mortgages financing home improvements. It should be noted, however, that this places the home loan in a second and riskier position.

## Construction Lending Needs

As noted by other consultants, there are no reliable statistics on what the housing need is in Bulgaria. The AID office in Bulgaria is currently undertaking a survey to obtain better

information on housing needs. Additional work under the "Private Development of Housing" contract should also add to an evaluation of housing needs.

Although actual need projections are not available, this consultant did solicit opinions on construction needs in Bulgaria. Responses indicated that there is no unit shortage, although there may be significant overcrowding in cities such as Sofia coupled with under-utilization of housing in rural areas. All those interviewed on this subject recommended focusing on the following areas:

- o rehabilitation of existing structures;
- o completion of partially completed buildings; and
- o new construction for the new upper middle class.

In evaluating construction lending needs, any proposed program must also take into consideration demand. In Bulgaria, due to the high cost of construction materials and high interest rates, the low affordability of housing construction will greatly impact whether the "needs" are the same as "demand". Thus, in developing any construction lending program, emphasis should be placed on those "needs" that are either the least costly and that address real demand.

#### Future Technical Assistance Recommendations

Future technical assistance recommendations fall into four areas:

- o additional fact finding;
- o home improvement lending program design;
- o introduction of market development and lending practices; and
- o development and implementation of programs

#### **Fact Finding**

In regard to fact finding, as noted above, there is limited factual information on actual housing needs and demand in Bulgaria. Although it appears unnecessary, for the purpose of developing a construction lending program, to obtain exact statistics in this area, it would be helpful to test the impressions of those interviewed on this subject before designing programs targeted exclusively to these opinions. For this reason, those efforts to obtain better information planned by the AID office in Sofia and other consultants should continue to receive support and evaluation.

Another component of information gathering that should be considered relates to the legal area. Critical legal issues should be identified, researched and, if necessary, solutions proposed. As examples of such issues:

- o Is there a legal entity eligible to act as a borrower to finance rehabilitation in a multifamily projects where the units are individually owned?
- o Are there mechanisms to enforce construction liens?

### **Home Improvement Lending Program Design**

Currently, lenders in Bulgaria are not offering any home improvement lending programs, even though those interviewed recognized the need for housing rehabilitation. Assuming that these impressions are supported by additional fact finding, special emphasis on designing affordable and practical home improvement lending programs will be required. The development of such programs should be tied closely to an evaluation of the type and feasibility of rehabilitation needs and the legal analysis of multifamily structures recommended above.

There are already significant rehabilitation efforts underway in Bulgaria for small commercial structures. It is possible that this activity could be tapped for housing rehabilitation, either as a demonstration of "sweat equity" by owners or of a growing small builder/contractor industry. Development of home improvement lending programs should include an analysis of these efforts.

### **Introduction of Market Practices**

The interviews highlighted that Bulgarian lenders do not have knowledge or experience in construction lending and home improvement lending as they are practiced in market-oriented environments. Without this familiarity, it is very difficult for them to evaluate whether they should participate in such programs.

In order to market a construction lending program to lenders to get them interested in offering such programs, lenders, as well as builders, will need to be introduced to these concepts. For this reason, a basic seminar on construction development and lending should be offered as an introduction of these concepts.

### **Development and Implementation of Programs**

The introductory seminar should be followed by more technical training and hands-on assistance for those lenders and builders willing to put into practice construction programs. The type of emphasis already identified by AID as important to mortgage lending - development and implementation of program requirements and procedures - also should be applied to construction and home improvement lending. In addition, builder education and assistance should be viewed as a component of developing a market construction lending program since builder/developer competence is tied to construction lending credit risk.

## **CONSIDERATION OF THE PLAM IN BULGARIA**

### **Background**

On behalf of AID, the Urban Institute (UI) worked extensively with the State Savings Bank (SSB) to develop a mortgage instrument for the SSB's market housing finance program. UI analyzed several alternative mortgage instruments in the context of Bulgaria's economy as part of this effort. Based upon this work, the SSB selected a modified Price Level Adjusted Mortgage (PLAM).

A PLAM is a mortgage with a fixed, real interest rate, that is applied annually to a changing outstanding unpaid principal balance (UPB). The UPB adjustments are based upon a pre-selected index, usually one relating to inflation. New monthly payments are determined based on reamortization calculations using the original real interest rate, the new UPB, and the remaining term.

The major benefit of the PLAM is that it adjusts for the payment tilt problem found in fixed-rate mortgages (FRMs) by allowing nominal payments to change over time as the economic conditions change. Thus, with the PLAM, the borrower does not end up paying a higher amount in nominal terms at the beginning and then a lower amount in nominal terms later on when borrower wages, and thus relative affordability, have increased.

Although the PLAM enables the borrower to have a relatively lower rate upfront than with FRMs, unlike the Dual Indexed Mortgage (DIM), PLAM payments are not capped. This means that if the index applied to the principal rises faster than wages, the borrower may have a serious affordability problem.

The UI/SSB model is a modification of the standard PLAM described above. Instead of using an inflation index, the UPB would be adjusted based upon a spread over the base rate, the rate charged by the Bulgarian National Bank (BNB) to its lenders for borrowings. The model also addressed the affordability issue by adding a "workout" provision, under which a borrower could get some payment relief by capitalizing interest if their monthly payment was more than 50% of their monthly wage.

### **Lessons from Other Countries**

In conducting its research on mortgage products, UI considered Bulgaria's economic situation. The UI staff also took into account their work in other countries as part of this evaluation.

To assist UI in their work, this consultant was asked by AID to review the use of the PLAM in Bulgaria. UI's work was used in this analysis. In addition, this consultant conducted further research to determine what made the PLAM successful in some countries and a failure in others.

A list of contacts and publications used in this research is attached.

As a result of this research, this consultant found a consistent pattern regarding the factors impacting the success of the PLAM. The countries where the PLAM has been successful, such as Columbia, have had relatively stable inflation and employment. Those countries where the PLAM has not been as successful, such as Israel in the 1970's and Chile, had extremely high and volatile inflation cycles.

We also looked into the features of the PLAM that are most vulnerable under these negative conditions. These factors are:

- o Validity of the index. Is it current? Does it lag inflation? Is it accurate? Does the market perceive it to be accurate?
- o Relationship between wages and inflation. Are wages changing proportionately to inflation? To price changes?
- o Inflation: How volatile is it? Is it over 50%? (All those interviewed stated that the PLAM is difficult to control if inflation is over 50%).
- o Difficulty of handling administrative matters. If the inflation is volatile, does the index lag far behind economic changes? Is the index independent or is it prone to political intervention? Are there mechanisms "encouraging" that borrowers remain current, such as enforcement of foreclosure laws, or is it easy for the borrower to remain in their home or to find subsidized housing?
- o Wage fluctuations based upon economic conditions. Do wages change based upon free market changes or are they basically controlled by the government?

### Current Economic Situation in Bulgaria

Unfortunately, Bulgaria suffers from the similar economic problems experienced by those in countries that had problems with the PLAM. In regard to Bulgaria's current economic condition, Rumen Avramov, Vice President of the Agency for Economic Coordination and Development (AECD), predicted inflation this year to be 80%. In May, the official government figures showed inflation to be 12% - much higher than the monthly figure needed to keep inflation within the 80% range. June figures were down to about 6%. These figures suggest inflation remains both extremely high and volatile. In addition, although Dr. Avramov would not provide a 1993 inflation estimate, he did indicate his expectation that a similar pattern would continue next year.

Other government statistics provide further evidence of a stagnant economy with particular impact on wage and employment issues. In May, the government estimated the decline in

production to be 20% and unemployment to be a little under 500,000. Unemployment figures are expected to continue to increase with a projected 750,000 Bulgarians seeking work by the end of the year.

Others believe these figures to be even worse. In the June 29 to July 5, 1992 issue of the newsletter "168 Hours", the trade unions suggested inflation in May was closer to 40%. These same unions charged that production declined much more than the 20% that the government reported. Unemployment is also allegedly much higher: unions estimated the figure to be closer to 650,000 than under 500,000.

The volatility of the economy also impacts the credibility of the indices that might be used in the PLAM. The proposed BNB base rate is relevant as long as no other investment instruments compete with mortgages. This is because the BNB rate does not mirror changes in inflation. Other possible indices have their own problems - particularly the question of accuracy. At the time the UI conducted its research, no other indices were available that had any market credibility. The AECD, however, does believe there has been some improvement in the way two inflation-related indices - the Producer Price Index and the Retail Price Index - are calculated.

### Recommendations

In a country with high and volatile inflation, relatively low wages and employment instability, it is not possible to design a mortgage that is both affordable to most borrowers and provides the "investor" (the lender) with a fair and competitive return. Expectations regarding the extent to which housing finance can be offered within this environment need to be realistic. However, within these limitations, the best effort should be made to fine-tune a mortgage product to make it as affordable as possible for the borrower while remaining attractive to an investor.

The PLAM should be reevaluated to determine whether it can be refined to overcome some of the features cited as causing problems in other countries. The SSB may also wish to consider two other mortgages being proposed for use in countries with high inflation - the "inflation proof mortgage" , a version of the PLAM, and the "low start mortgage" , a mortgage being proposed for Hungary.

Another possible consideration is whether there is a funding mechanism that would allow for a delay of return on the part of the investor. Private investors typically attracted to this type of instrument, such as insurance companies and pension funds, do not have sufficient funds to support such an instrument at this time. Within a few years, they may be in a position, however, to offer a "home" for instruments funding such mortgages. Currently, however, this type of mortgage product would require some government intervention - such as a tax or capital reserve benefit that would offset the negatives of a delay in cash flow. AID may want to investigate this possibility in order to help design a mortgage product that is affordable to more Bulgarians.

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## **POLICY INCENTIVES**

**The design of a market-oriented housing finance strategy should take into account any potential incentives to attract the three critical players in housing finance: the borrower, the lender, and the investor. Tax policies and capital reserve requirements are among these potential incentives. For this reason, this consultant met with a Bulgarian expert in each area to learn more about current policy and any plans that could impact housing finance. This paper summarizes these meetings as well as offers some additional ways government policy could be used to provide incentives for housing finance.**

### **Tax Policies**

**Bulgaria is undergoing a major review of all tax policies. An explanation of the key features of these policies as they relate to housing finance is included below. However, perhaps the most important conclusion that should be drawn from this information is that the tax law is in a state of change and it is very important that these proposals be monitored to ensure that they encourage, not discourage, housing construction and finance.**

**The lead on this reevaluation is within the Ministry of Finance. The chairman of the working group, Iliya Martsolov, explained that this work is very comprehensive and welcomed assistance from the US. If appropriate, one of the advisors funded by AID under the auspices of the US Department of Treasury could assist in this activity.**

**We discussed relevant taxes as follows:**

- o Property taxes. There appears to be a great deal of disagreement on whether local jurisdictions should be delegated the authority to determine local tax rates. There is also a dispute over how to calculate such taxes if this power is retained within the central government. The MOF recommends using a method that undervalues the property but is administratively easier; this approach would be based upon a formula per square meter that results in a lower value.**
- o Recordation and transfer taxes. The MOF recommends using a different property appraisal to determine transfer and recordation taxes. These taxes would be based on actual market value.**
- o Income taxes on rental incomes. Income from rental property is subject to a tax.**

- o Income tax deductions on interest and/or principal payments. Principal and interest on mortgages appear to be deductible if the homeowner ties the home to some business purpose, thus making the interest and principal payments part of operating expenses. It is not clear whether a homeowner can deduct either interest or principal payments if the home is use strictly for residential purposes.**
- o Taxes on bonds used to fund housing. At one time, there were bonds similar to US savings bonds that were tax exempt. Treasury bonds sold to commercial banks are tax free. In both cases, the bonds are not restricted for housing. However, these bonds may have established a precedent that could be used to justify the creation of a tax exempt housing finance bond.**

**Mr. Martsolov explained that the MOF is considering a proposal to exempt income if it is used for working capital for a manufacturing industry to create jobs. We discussed the importance of including housing construction industries in this proposal.**

#### **Capital Reserve Policies**

**The International Basle Accords provide an incentive for lenders to hold mortgages in their portfolio. The risk weighting given to home loans is 50% of the capital requirement for commercial loans. The reason to meet with Kamen Toshkov, the Head of the Bank Supervision Department in the Bulgarian National Bank (BNB) was to find out how the BNB plans to treat mortgages.**

**Mr. Toshkov explained that the BNB plans to follow the Basle Accords and the European Community Solvency Directive regarding all capital reserve requirements. However, the BNB has not yet implemented these rules. This should be monitored because, even though the risk weighting is beneficial to mortgages under these rules, the rules allow a country to be more conservative as long as it applies the rules equally to domestic and foreign owned banks. Therefore, the BNB could elect to implement rules that are stricter than Basle and thus not favorable to housing loans.**

#### **Other Policy Incentives**

**The new Governor of the BNB, Mileti Mladenov, stated that the BNB will do what it can to support housing finance. Mr. Mladenov has been an important supporter of housing finance in the past, and his position should be helpful when the BNB decides to implement the international rules described above.**

**There may be other ways that the BNB could facilitate housing finance. For example:**

- o The BNB provides loans to commercial banks and requires these banks to put up collateral behind these loans. If a special housing bond program is created, the BNB could support this bond program by allowing these bonds to be used as collateral for BNB loans.**
- o The BNB requires overcollateralization for the loans described above. If housing bonds are created and become eligible collateral for such loans, the BNB could consider giving such bonds favorable treatment by limiting the required overcollateralization.**
- o The BNB obtains loans from the SSB to help fund its loans to other banks. The BNB could restrict the use of some of its loans to banks when these loans are indirectly funded with SSB monies, for housing purposes.**
- o The BNB could allow banks to hold an unlimited amount of housing bonds or other mortgage related securities to help this market develop.**

# COMPETITION IN HOUSING FINANCE

## Introduction

The US Agency for International Development (AID) has identified a critical issue in housing finance in Bulgaria as the lack of competition. Until recently, only one bank - the State Savings Bank (SSB) - was permitted to originate mortgages used for the construction, rehabilitation, and purchase of housing. However, even though commercial banks are no longer legally prevented from entering this business, the SSB remains the only bank with housing and construction loan programs.

As long as the SSB remains the only housing lender, the Bulgarian system will not benefit from the stimulus of competition. For this reason, AID asked this consultant to assess issues relating to competition in housing finance in Bulgaria.

This paper identifies reasons why commercial banks are reluctant to enter the housing finance market. It also attempts to analyze these obstacles in ways that may present opportunities for housing finance in short-, mid-, and long-terms. These opportunities are incorporated into the proposals contained in a separate Working Paper on a Housing Finance Strategy that was prepared by this consultant at AID's request.

## Overview

To some extent, the subject of competition was raised in almost all of the more than 30 meetings held during the consultant's 10 day field trip to Sofia, Bulgaria. Based upon these discussions, the following issues have been identified:

- o Demands on funds for more profitable purposes
- o Difficulty in matching funds used for long-term housing loans with short-term funding tools
- o Risk concerns and lack of market demand, particularly as they relate to affordability and unemployment problems
- o Lack of staff expertise and the cost of setting up a mortgage operation

## Other Demands for Funds

With the exception of the SSB and interbank loans, all lending taking place in Bulgaria appears

to be for commercial loans. The banks are attracted to this type of lending for several reasons:

- o This is the type of lending they know and are set up to do.
- o They are more confident in underwriting these loans because they can evaluate potential operating income to determine the feasibility of the proposal.
- o In addition to underwriting these loans based upon expected earnings, they are able to get a variety of collateral, including materials being purchased, any physical improvements owned by the business, and a mortgage on the owner's home.
- o These loans are adjustable rate loans with terms that are rarely more than one year. It is assumed that the borrower's income will also adjust based upon the increasing rise in the price of products and services provided by the borrower's business.
- o The terms of these loans are more able to match the terms of the timed deposits and interbank loans obtained by the banks to fund the loans.

Although the reasons why Bulgarian lenders only lend to businesses are logical, these reasons also could be applied to construction lending, especially if there is a way to fund the long-term loans. Thus, there may be a way to use the profitability rationale to support an increase in loans to construction industries and builders.

There may be other motivations for lenders to become more universal in their lending practices. The bank merger program is designed to create 5 to 10 commercial banks that are diversified in their activities. Another incentive may arise from enforcement of international risk-based capital rules which should require higher reserves for commercial loans than for home mortgages. This will increase the profitability for housing loans as compared to commercial lending.

### Match Funding

For housing loans to be affordable, they need to be amortized over a long time period. Generally, this means that the terms must be no shorter than 20 years. Thus, to fund the loans with a proper duration match, lenders need long-term instruments.

## **Household and Business Deposits**

Household and business deposits are short-term. However, the term of these deposits as well as the placement of these deposits have changed in recent months and these changes may have important implications for the future.

Most of those interviewed believe that deposits are moving away from the SSB to other lenders. The SSB lagged behind the commercial banks in raising its deposit rates. The commercial banks were successful in competing with the SSB on price and service in spite of the SSB's advantage of being the only lender with government guaranteed deposits. The lender thought to have taken away the most from the SSB is the Bulgarian Post Bank.

The aggregate volume of deposits increased in both the SSB and the commercial banks. Unfortunately, information on the number of accounts was unavailable so it is not possible to verify that the total number of household accounts in the SSB have decreased.

The published percentage of total household deposits attributed to the SSB ranges from 80 to 90 percent. However, the deposits from companies have significantly increased, and since these deposits are placed in commercial banks rather than the SSB, the estimated SSB share of all deposits is closer to 60 to 65 percent.

Perhaps the more interesting change demonstrating a move toward longer termed investments is the growth of savings accounts and timed accounts (6 months to one year) over demand accounts. In 1990, 59 commercial banks had about 9 billion levs in demand accounts and none in timed/savings accounts. By the end of 1991 there were 15 billion levs in demand accounts and 5 billion in timed/savings accounts; by May 1992, demand accounts were down to 12 billion but timed/savings account were up to 8 billion levs.

The figures for the SSB are also interesting. By the end of 1990 and 1991 and in May 1992, the SSB had 2 billion levs in demand accounts. In comparison, their timed/savings accounts had deposits as follows: 20 billion levs in 1991; 30 billion levs by the end of 1992; and 35 billion levs in May 1992.

Because the duration of the timed and savings accounts is still short, the banks still do not have funds that can be used to match the long terms of mortgage loans. However, the trend toward less liquidity by depositors is interesting and may suggest an opportunity for longer term investments.

## **Compensation Fund**

The parliament recently passed a law providing for compensation to some of those depositors who had funds tied up in contract savings where these funds, due to inflation, have lost their relative value. The plan is to provide a one-time additional deposit to these accounts to be used

for housing purposes. Although this Fund is temporary, and there is much disagreement over how the government will pay for these additional deposits, if there is money added to the Fund, then perhaps it can be tied to a market demonstration project.

### **Interbank Deposits and Loans**

Another important source of funding are deposits and loans between banks. The SSB is the largest lender for these activities. The BNB has a relationship with the SSB that requires the SSB to lend to the BNB at a BNB "market" rate. The BNB uses these funds to lend to commercial banks. In this way, the SSB is indirectly funding the commercial banks. The World Bank mission leader, Hans Moritz, explained that the SSB's role in funding the BNB is the reason why the government will not likely change the SSB's charter to make it a commercial bank that is part of the bank merger program.

The SSB is also the biggest depositor for interbank deposits. Interbank deposits occur when a bank with cash excess offers its funds to a bank with a cash deficit and receives in return, in the case of Bulgaria, typically 3.5 to 4 percent over the base rate. Most of these accounts are timed deposits of 1, 3, or 6 months, (1 month is most common) with a right of renewal upon agreement of both parties. The interbank deposit program is another example of how the SSB funds are already being used to fund other lenders.

### **Long-Term Bonds**

Only one investment instrument appears to have a term that matches the duration of housing loans: the 20-year Treasury bond being swapped by the government for the non-performing loans to failed government industries. These bonds were issued once - at the end of 1991. The bonds pay interest only in the first five years and then amortize the principal payments over 15 years. The rate floats at a 1% spread over the BNB base rate (the rate at which the Bulgarian National Bank (BNB) lends to commercial banks). Mr. Ljubomir Velkov, head of the MOF Department of the State Treasury and Sovereign Debt, indicated that the government may issue another 5 billion leva in these bonds in 1992 to swap for bad debt on companies already in bankruptcy proceedings or where liquidations resulted in losses.

The banks are understandably willing to take such long-term bonds because they are better assets than the failed loans. The banks also prefer these assets over new loans, which has a negative impact since it discourages new lending. In addition, these bonds provide stable income, are tax exempt, and can be used for collateral for BNB loans.

## **Other Securities**

Interest in more liquid and tradable securities may suggest that in the next few years there will be more opportunities for raising funds on a longer-term basis. These indications center around the growth both of instruments with increasingly longer terms and of the industries typically investing in long-term instruments.

A market in treasury securities, in addition to the 20-year bonds described above, is beginning. The BNB, acting as the fiscal agent for the government and at the request of the Ministry of Finance (MOF), now auctions treasury bills twice a month. Thus far, they have held 14 auctions. Although only the last auction was for 6-month bills (the rest for one-month issues), the bids were for over three times the amount authorized by the MOF. Also, there have been one or two attempts by the First Bulgarian Stock Exchange to create a secondary market in these securities.

Mr. Velkov stated that the MOF intends to issue one year bonds this year. He stated that as the base rate stabilizes, the MOF intends to gradually increase the term of treasury securities.

Banks are attracted to the treasury securities for several reasons. Like the 20-year bonds, these securities are tax exempt and are acceptable collateral for BNB loans. The securities also, obviously, are considered to have a low credit risk. For a security funding housing loan to compete with these securities, some comparable benefits will probably be necessary.

Another reason for the popularity of these securities is that there are very few alternative instruments that have the potential of being liquid. This suggests that the treasury securities may help create a securities market, providing an opportunity potentially for housing loan securities.

The marketplace should become even more liquid in the next few years if the growth of long-term investors continues. These investors are typically insurance companies, pension funds, and mutual funds. Several private insurance companies have already started and a new law is pending that should help define and assist this industry. This law will most likely also include reserve requirements; if special bonds are created for housing finance, it would be beneficial if these bonds were included as eligible reserve instruments.

Private pension funds have not yet started up in Bulgaria. There is, however, a legislative proposal being drafted and those interviewed projected passage in early 1993.

## **Credit Risk and Lacking Market Demand**

Although only one lender - Stroybank - mentioned credit risk as a deterrent to being a mortgage lender, Bulgaria's unstable economy, high inflation, and rising unemployment justify this concern. In addition, although interest rates are significantly under the inflation rate, these rates are extremely high, making housing loans very expensive.

According to Rumen Avramov, Vice President of the Agency for Economic Coordination and Development (AECD), inflation in 1992 will be approximately 80%. Government unemployment estimates suggest that there will be 42 people looking for every job at the end of 1992, compared to 13 in 1991. Those outside the government believe the inflation and unemployment figures will even be worse.

New employment opportunities appear to be in the growth of small businesses. In a more stable economy, small businesses are very risky enterprises. They are probably also equally if not more risky in Bulgaria.

The same concerns that discourage lenders from making mortgage loans in this environment also affect market demand for these loans. Until there is greater employment stability, Bulgarians will be more likely to invest in businesses than in their housing. Also, the high interest rates of over 50% for loans make long-term borrowings extremely difficult.

### Set-up Costs

The cost of establishing a mortgage operation is another deterrent to the creation of a competitive housing finance market. Except for the SSB, commercial banks do not have the knowledge or staff expertise in this field. Also, these banks lack the operational structure for these loans, although they should be able to adapt some of their existing origination and servicing functions for housing finance.

The lack of a potential market due to the issue of affordability discourages lenders from entering this business. To make a program profitable, there needs to be sufficient business to justify the set-up costs and create operational efficiencies.

There is also a belief among Bulgarian lenders that in order to offer a housing finance program, the banks need large retail outlets. This may be based on economic reasons, although the concern that was expressed was that a limited branch system offering housing loans would give the appearance that the bank favored certain regions.

AID assistance can be most helpful in overcoming some of these concerns. Training and hands-on technical assistance may help overcome some of the obstacles associated with lack of experience and costs of establishing a business.

At least two lenders interviewed indicated interest in creating a mortgage operation. The most likely to participate is the Bulgarian Post Bank which was described in very positive terms in the DFC interim report as well as by staff from the World Bank, International Finance Corporation, European Bank for Reconstruction and Development, and the Bank Consolidation Company (the holding company responsible for bank mergers). The Bulgarian Post Bank discussed starting a contract savings program; however they appeared to be very interested in learning more about other housing finance programs.

The other expression of interest came from Oleg Nedyalkov, Chairman of CB Doverie Inc. (Doverie). Mr. Nedyalkov has taken the lead in working with other banks, including Stroybank which was originally created to lend for construction purposes, to merge institutions even before the Bank Consolidation Company takes action. Doverie's actions are viewed very favorably. However, even though Mr. Nedyalkov will likely have an important role in the new bank, which will be called the Bulgarian Credit Bank, he will not be in charge. The Stroybank will most likely be the "foundation bank" in this merger, and Stroybank staff were the lenders most concerned about credit risk for housing loans.

In order for there to be competition, there needs to be at least two lenders. The SSB is clearly going to be involved in a market housing finance program. If, at the beginning, at least one or two other lenders can be brought into this business, and especially if they are successful, this should stimulate other competition when the economic environment is more encouraging.

## PRESENTATION TO BULGARIAN HOUSING FINANCE AND GOVERNMENT OFFICIALS

### OVERVIEW

AID Activities To Date: Presentation by Michael Hoffman

Market-Housing Finance in the US: Presentation by Beth Marcus

Impression of Challenges and Opportunities in Bulgaria: Presentation by Beth Marcus

Group Discussion

### AID ACTIVITIES TO DATE

#### MARKET-HOUSING FINANCE IN THE US

- o Lessons from the US Experience
  - high level of ownership
  - system response to important challenges such as depression (1930's), housing boom (1950's), and inflation (1970's)
  - efficient fund intermediation
  - government leveraging/ diminished government involvement
  - evolutionary
  - standardization, efficiency and innovations
- o Mortgage Products: key features that can vary
  - term
  - interest rate: fixed or adjustable, ceiling and floors, index and margin
  - payment: frequency, amortization, and ceiling (capitalization)
- o Underwriting

- ability of borrower to repay loan
- creditworthiness of borrower
- property value
- o **Servicing**
  - payment collection
  - delinquencies
  - foreclosure
  - property management
  - if servicing for others, reporting, property inspection, maintenance and sales, in addition to the above tasks
  - value in servicing: flow of income and liquid asset
- o **Fund Mobilization/Matching**
  - from depositors
  - from other lenders or financial institutions
  - from traditional long-term investors such as insurance companies and pension funds
  - US: primary market and secondary market (options - FHLB loans, loan sales, loan securitization, collateralized bonds)
  - evolutionary development: all of the above used today
  - US benefits of secondary market: more capital in housing, greater liquidity of loans, standardization of lending requirements, and greater market efficiency
- o **Construction Lending**
  - relationship to mortgage finance: need borrower loans to repay construction lender
  - covers one or all of following: acquisition, development, an construction (ADC)
  - loan terms: tend to be short, adjustable with interest repaid during construction or

capitalized and paid at end, principal repayments made as houses sold, construction draws made as pre-determined construction schedule is met

-underwriting: market feasibilities, borrower financial and construction capabilities, project feasibilities

-loan management: (loan servicing) - draws, inspections, payment collection, delinquencies, foreclosure, project completion

-funds: usually from deposit base

### IMPRESSION OF CHALLENGES AND OPPORTUNITIES IN BULGARIA

#### o Challenges

-Economic volatility

-Employment instability

-High inflation

-Subsidization of housing

-High cost of housing but housing needs (rehabilitation and completion of projects)

-Inexperience with market housing finance systems

-Lack of builder track record

#### o Opportunities

-Large deposit base and tradition of savings

-Housing shortage not in crisis stage; allows for controllable development of system

-Base deposit rate just reduced

-Lender interest in housing finance programs

-Desire of new higher income for better quality housing

- Agreement of government to meet IMF and World Bank goals
- Technical assistance opportunities from international organizations
- Growth of institutions supporting training and set-up activities
- Development of investor market through creation of government securities, insurance companies growth, pension fund expectations, and stock exchanges
- Bank changes: consolidation of banks along with increase in branches
- Entrepreneurial spirit of Bulgarians

### GROUP DISCUSSION

## **TRIP REPORT FOR BULGARIA**

**July 5 thru 17, 1992**

### Meeting Schedule: Contacts and Subject

- July 5: Michael Hoffman: AID/UI  
Introductory Meeting
- July 6: Michael Hoffman, Maya Koleva, Mois Bello: AID/UI  
Overview of current status of housing efforts Preparation of plan of action for in-field activities
- Sally Warren: Consultant for the European Bank for Reconstruction and Development (EBRD)  
Overview of current banking system with emphasis on the bank merger effort
- July 7: Robert Perry: Advisor for Bank Consolidation Corporation (BCC)  
Discussion on the BCC, the bank merger effort, and the DFC report on this subject, with emphasis on the SSB and the potential for other lenders in housing finance
- George Petkov: International Bank for Investments and Development (aka Bulgarian-American Bank)  
Discussion on current status and methodology for housing finance with emphasis on construction lending  
Evaluation of potential of this Bank as a mortgage or construction lender  
Identification of potential institutions, individuals, and associations in the housing finance field  
Discussion on consultants proposal for housing finance system
- Victor Papazov: First Bulgarian Stock Exchange  
Discussion on the potential and requirements of investors for housing finance related investment instruments
- July 8: I. Dragnevski and Vladimir Christov: OREL, Insurance and Reinsurance Company  
Discussion on the projected growth of insurance companies, the availability of funds for longer term investment vehicles, the interest of these companies in such investments, and the specific investment needs for these companies

**Kamen Toshov: Bulgarian National Bank (BNB), Bank Supervision Division**  
Discussion on current and projected bank supervision and capital requirement rules as they relate to mortgages, bonds, mortgage-backed securities, and government bonds

**Nicolina Mitcheva: BNB, Government Securities Division**  
Discussion on the newly created government securities, including terms, volume, investor interest, market acceptance, liquidity, and any special benefits or attributes

**July 9: Oleg Nedyalkov: CB Doverie Inc.**  
Discussion on housing finance in Bulgaria, Doverie Inc.'s past lending experience and its proposed activities as part of a merger of banks, and on ways to facilitate housing finance in the future

**Irena Komitova: Union for Private Economic Enterprising (UPE)**  
Discussion on UPE, its purpose, the organizations set up by it - particularly the Bulgarian Investment Fund, the Private Bank, and the upcoming Training Center - and their perception of how technical assistance can be useful to facilitate private housing.

**Dimitar Dimitrov and Vladimir Georgiev: Stroybank Ltd.**  
Discussion on the Stroybank (construction bank), its lending programs, future planned merger with other banks, including CB Doverie Inc., its perception of the current housing finance situation, and on ways to facilitate housing finance.

**July 10: Sally Warren: Consultant to the EBRD**  
Discussion on housing finance and the potential of the EBRD to participate in facilitating market-oriented housing finance

**Maria Georgieva: International Banking Institute**  
Meeting to learn about the capabilities of this Institute in order to evaluate whether it can assist AID in putting on training seminars

**Nikola Karadimov and Adriana Damianova: Ministry of Regional Development, Housing Policy and Construction (MOC)**  
Meeting to share with Minister Karadimov the purpose of my assignment

**July 11: Sarah Wines and Sonia Hammam: AID**  
Discussion on strategy paper

**July 12: Hans Moritz: World Bank mission leader**  
Discussion on the Bulgarian bank merger effort and the World Bank consultant's report

- Roy Karagolan: IFC and member of World Bank mission team  
Meeting on bank restructuring with emphasis on deposit base for all banks.  
Discussion on concept proposal
- July 13: Robert Doughty Weeks and Hans Moritz: World Bank mission  
Discussion on private banks and fund used by Bulgarians to receive international donor contributions and Bulgarian-matched contributions
- Miltcho Giurov: Bulgarian Post Bank  
Meeting on Post Bank activities, lending, training, plans for future. Discussion on concept proposal
- Gerogy Tomov: State Savings Bank (SSB)  
Meeting on deposits, lending strategy, proposed new law on SSB, proposed construction lending fund, changes to existing fund, and training. Discussion on concept
- July 14: Maria Georgieva SSB  
Meeting on SSB training programs
- Roman Totev, Emil Froloshki, and Adriana Hadjieve: Ministry of Finance  
Discussion on AID program in Bulgaria
- Stoyan Mishev and Christian Petrov: Bulgarian Investment Fund  
Discussion on the Fund's activities and possible relationship to housing finance as investor or construction funder
- Nikola Karadimov, Adriana Damianova, and Belin Mollov: MOC  
At request of the Minister, follow-up meeting to continue discussion on housing finance
- July 15: Ljubomir Velkow: Ministry of Finance  
Meeting to learn more about MOF position on treasury securities, particularly 20-year bonds used to replace bad debt
- Iliya Martsolov: Ministry of Finance  
Meeting to discuss taxation policies
- July 16: Ventzeslav Boitchev: Bank for Agricultural Credit Ltd.  
Discussion on the bank's programs and the potential for its involvement in construction lending and housing finance
- Frank Bauer: Bulgarian American Enterprise Fund  
Discussion on the Fund and its activities

**July 17:** Stefan Hubanov, Galina Gyurova, and other staff from the MOC, the National Center for Regional Development and Housing Policy, other GOB offices, and from banks  
Presentation by consultant on housing finance and discussion with participants on Bulgarian situation

Roumen Avramov: Agency for Economic Coordination and Development  
Discussion on the Agency's economic projections and potential indices for mortgage products

Mileti Mladenov and Dimitar Mikov: BNB  
Briefing to the new Governor of the BNB on housing finance efforts

Emilian Dimitroff: First Private Bank  
Meeting to learn about the bank's programs, in general and potential as a housing finance lender

Michael Hoffman and Maya Koleva: AID  
Briefing on the in-field work and discussion on future activities

Liam Howard and Peter Keane: FISERV  
Discussion on the computer systems being placed in the Bulgarian Post Bank and the FISERV programs for loan origination and servicing

## **LIST OF TASKS FOR AID CONSIDERATION**

### **Bank Merger Program**

- o Review the final DFC report.
- o Meet with new SSB president and vice president to learn about their plans for the SSB.
- o Track the proposed law on the SSB.

### **Training Programs**

- o Contact references for IBI such as KPMG and the University of Delaware.
- o Get more details on the KPMG bank training program and the University of Delaware program to determine if housing finance could be added to their seminars.
- o Identify possible training tools such as pre-taped videos that could help train non-managerial staff.
- o Provide technical assistance to IBI and SSB in their development of housing finance training programs.

### **Construction and Home Improvement Loan Programs**

- o Verify what is thought to be Bulgaria's housing needs/demand (i.e. rehabilitation, completion of structures, and upscale projects).
- o Conduct legal research on construction issues.
- o Design proposals for home improvement loan programs.
- o Conduct an introductory seminar on construction lending and project development.
- o Develop and implement a construction lending program.

### **Policy Incentives**

- o Research the possibility of having a US Treasury advisor assist the MOF in their tax law drafting activities.

- o Monitor tax changes and capital reserve rules to ensure that housing finance is treating advantageously.
- o Work with the BNB to ensure housing finance receives special treatment.

### Competition

- o Present the separate Working Paper to the Working Group proposed by Michael Hoffman to stimulate discussion and actions to facilitate competition in housing finance.
- o Identify one or two lenders in addition to SSB and work with them to develop pilot housing finance programs.
- o Monitor the different funding opportunities to ensure that housing finance takes advantage of market opportunities and is treated advantageously.

### PLAM

- o Evaluate the "inflation proof mortgage" and the "low start mortgage" to see if they offer any advantages for Bulgaria.
- o Refine the PLAM taking into consideration the factors affecting success in other countries.
- o Consider a funding mechanism that can help mortgage affordability by delaying cash flow, test this on potential lenders or investors, and if feasible, use modify the mortgage product to include this feature.
- o Evaluate the use of other indices such as treasury bills, the retail price index, and the producer price index.

### General

- o Follow-up on AID request for analysis by macroeconomist.
- o Conduct legal research on a variety of housing finance issues in addition to those relating to construction, such as ease of lien recordation, ease of foreclosure enforcement, ability of condominium associations to borrow, condemnation issues, land ownership due to restitution, and lien perfection.