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Project Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 07-Nov-2019 | Report No: PIDA27448

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Bulgaria	P168133	Bulgaria - Deposit Insurance Contingency Financing Project	
Region	**Estimated Appraisal Date**	**Estimated Board Date**	**Practice Area (Lead)**
EUROPE AND CENTRAL ASIA	14-Nov-2019	20-Feb-2020	Finance, Competitiveness and Innovation
Financing Instrument	**Borrower(s)**	**Implementing Agency**	
Investment Project Financing	Bulgarian Deposit Insurance Fund	Bulgarian Deposit Insurance Fund	

Proposed Development Objective(s)

The Project Development Objective is to strengthen the financial sector safety net to meet potential deposit insurance and bank resolution obligations.

Components

Provision of contingent financing upon the occurrence of pre-defined trigger events related to deposit insurance and resolution obligations of the BDIF

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Project Cost	384.00
Total Financing	384.00
of which IBRD/IDA	384.00
Financing Gap	0.00

DETAILS

World Bank Group Financing

International Bank for Reconstruction and Development (IBRD)	384.00

Environmental and Social Risk Classification

Low

Decision

The review did authorize the team to appraise and negotiate

Other Decision (as needed)

B. Introduction and Context

Country Context

1. **Following a contraction in 2009 and slow recovery thereafter, the Bulgarian economy has embarked on more robust growth since 2015, reaching an average of 3.6 percent for the 2015-2018 period.** Bulgaria's progress to catch-up with average EU levels of income has continued, as GDP per capita in purchasing power standards (PPS) terms reached 50 percent of the EU average in 2018. From a supply-side perspective, economic growth in recent years has been driven primarily by export-oriented industries such as production of auto parts, pharmaceuticals, machinery and equipment, computer and communications hardware, etc., as well as the rapid expansion of several services sectors such as IT and the outsourcing of business services. The expansion of these economic activities took advantage of improving external conditions and significant private investment, attracted by a relatively low flat income and profit tax of 10 percent, as well as comparatively low cost of labor and other inputs.

2. **Robust economic growth has fed into a strong fiscal position**. The general government budget ran surpluses in the 2016-18 period as a result of improved revenue collection, prudent expenditure and lower-than-planned capital spending, not least due to slower implementation of EU funded public investment. This contributed to further reduction in public debt to 22.6 percent of GDP as of end-2018 – the third lowest debt level in the EU. In December 2017, both S&P and Fitch upgraded Bulgaria's long-term credit rating, to BBB- and BBB+, respectively. Moreover, S&P improved the outlook on Bulgaria's rating to positive in mid-2018, while Fitch and Moody's followed in its steps in 2019. The main factor for the outlook upgrade has been Bulgaria's recent policy course towards eurozone entry, following a June 2018 joint letter from the Minister of Finance and the Governor of the Bulgarian National Bank (BNB) to the Presidents of the Eurogroup[1] and the Economic and Financial Affairs Council (ECOFIN), where they stated they firm intention to apply to the EU's Exchange Rate Mechanism II (ERMII), and ultimately the euro[2].

3. **Growth is expected to remain above the EU average in the medium run but risks to the outlook have recently tilted to the downside.** Overall, real GDP growth is expected to reach 3.2 percent in 2019 but slow down to 3.0 percent in 2020, due to expected deterioration in the external environment, including the ongoing global trade tensions and their spillover effects on Bulgaria's main export markets. Against the backdrop of worsening external environment, domestic consumption and public investment (including EU-funded projects) are expected to drive economic expansion in the medium run.

Sectoral and Institutional Context

[1] The Eurogroup is an informal body where the ministers of the euro area member states discuss matters relating to their shared responsibilities related to the euro.
[2] The joint letter also contained a commitment to undertake an action plan on several policy areas. More details in section B.b.

(a) Banking Sector Structure and Performance

4. **The banking system is primarily foreign owned, although with a sizeable domestically owned segment.** There are 25 banks operating in the country, 18 of which are majority foreign-owned (13 are subsidiaries of foreign banks, and 5 are branches of foreign banks), all of them representing 78.5 percent of total bank assets as of June 2019. There is one state-owned bank, the Bulgarian Development Bank, representing 2.6 percent of total assets. The top five banks in Bulgaria have a market share of 59.9 percent of total bank assets, with the largest two owned by Italian and Hungarian parents, with 18 percent and 14.2 percent market shares, respectively. There are 6 domestically owned private banks with a combined asset share of 18.9 percent (compared to 27 percent in 2013), including the fourth largest bank (First Investment Bank).

5. **There have been material changes in the structure of the Bulgarian banking sector over the past 4 years, most notably, the exit of Greek-owned banks.** As of end-2014, Greek-owned banks represented the largest share of the banking sector, with almost a quarter of total bank assets. Since then, and as a result of mergers, the asset share of Greek banks has reduced to 2.5 percent, and when the merger between Piraeus Bank and Eurobank is completed[3], there will not be any majority Greek-owned banks in Bulgaria. Belgian-owned CIBANK merged with Greek-owned United Bulgarian Bank (UBB) in 2018, with the new UBB becoming the third largest bank in the country. French-owned Société Générale Expressbank was acquired by Hungarian-owned DSK Bank, and after the merger is completed, DSK Bank will likely become the largest bank in the country (see Figures 1 and 2).

Figure 1. Asset share of banks, June 2019

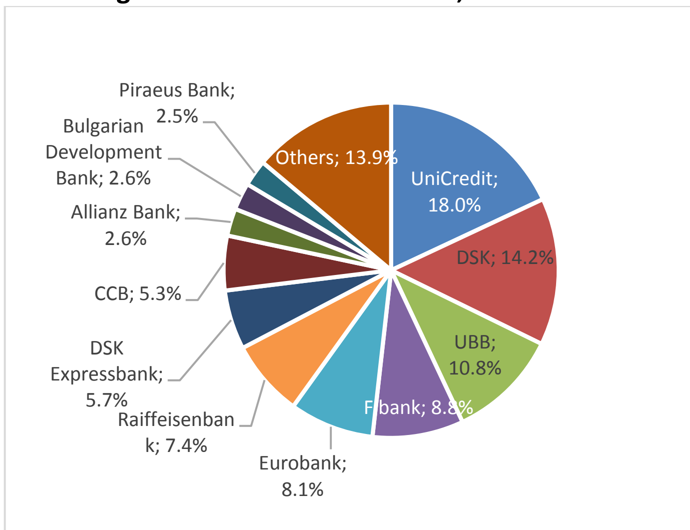
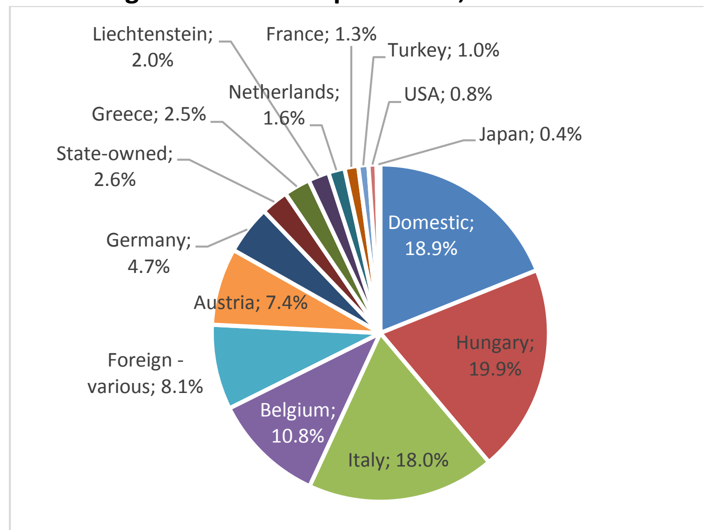


Figure 2. Ownership of banks, June 2019



Source: BNB, WB staff calculations

6. **While 2018 was characterized by a sizeable credit growth, the first 6 months of 2019 have shown a slight deceleration, explained by the clean-up of NPL portfolios.** The total outstanding amount of loans to the private sector

[3] In November 2018, foreign-owned Eurobank (which itself used to be a Greek-owned bank) announced that it had agreed to buy Piraeus Bank, a deal that was approved by the BNB in 2019. Eurobank also absorbed Greek-owned Alpha Bank in 2016.

(non-financial corporations and households) rose from BGN 53.3 billion in June 2018 to BGN 56.6 billion in June 2019, driven by the improved economic environment and increases in household income. In June 2019, year-on-year (y-o-y) credit growth was 6.1 percent, down from 7.7 percent in 2018 (see Figure 3), which was the fastest growth since 2008. Growth in loans to households decelerated from 11.2 percent in 2018 to 8.1 percent in June (y-o-y), mostly explained by slower growth in consumer loans (10.6 percent versus 17.7 percent in 2018), while mortgage loans grew steadily at 11.8 percent (compared to 11.4 percent in 2018). Growth in corporate loans decelerated from 5.4 percent in 2018 to 4.6 percent in June (y-o-y). The deceleration in credit growth is mostly explained by the clean-up of NPLs, as, for example, credit to corporates grew from 7.5 percent in 2018 to 9.5 percent in June (y-o-y), when NPL write-offs are excluded. Almost 65 percent of loans are denominated in local currency, while another 33.4 percent are denominated in euro, to which the local currency is pegged to.

7. **Strong deposit growth continues to drive lending.** Funding continues to be relatively comfortable, driven mostly by a significant increase in deposits, which encourages stronger lending. As of June 2019, the total amount of outstanding deposits in the banking system reached BGN 76.3 billion (see Figure 4), representing a y-o-y growth of 6.5 percent despite record-low interest rate levels, and compared to 6.9 percent in 2018. The share of deposits to GDP was 69.1 percent in June, compared to 72 percent in 2018. More than 64 percent of deposits were denominated in local currency, while 28.2 percent were denominated in euro. Two thirds of the total amount of deposits came from the household sector.

Figure 3. Credit to the private sector (y-o-y % change)

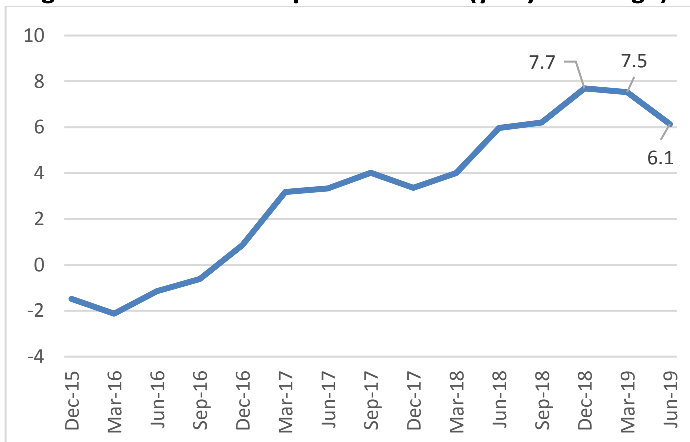
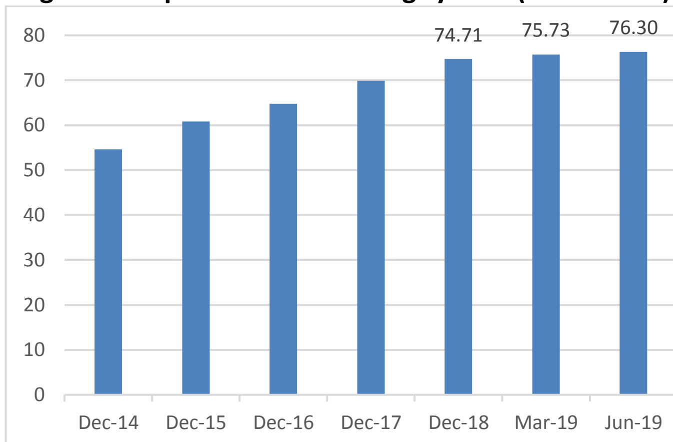


Figure 4. Deposits in the banking system (BGN billion)



Source: BNB

8. **Despite improvements, the ratio of NPLs of non-financial corporations remains above EU average.** As of June 2019, the NPL ratio of the banking system continued to decline to 7.2 percent from 7.6 percent at the end of 2018 (see Figure 5), the lowest ratio since 2009 and significantly below the peak of almost 19 percent in late 2014. NPLs of non-financial corporations declined to 7.9 percent in June, compared to 8.7 percent in 2018, while those of housing and consumer loans stood at 6.6 and 5.1 percent respectively (compared to 6.6 and 5.7 percent in 2018). While this represents a significant downward trend, NPLs levels are still above the EU average of 3.6 percent. However, the coverage of NPLs in terms of loan loss provisions (60.8 percent) remains significantly higher than the EU average of 44.7 percent (see Figure 6).

9. **Banking sector capital adequacy and profitability are generally strong.** The capital position of the banking

sector is well above regulatory requirements[4]. After showing a decline in March 2019, the total capital adequacy ratio (CAR) in June 2019 increased to 20.5 percent from 20.4 percent in 2018, while the Tier 1 capital ratio increased to 19.7 percent from 19.4 percent in 2018, and the Core Equity Tier (CET) 1 ratio increased to 19.4 percent from 19 percent in 2018 (see Figure 7). According to the BNB, the temporary decrease in capital ratios in the first quarter of 2019 was due to regulatory changes, including the implementation of the International Financial Reporting Standard 9 (IFRS 9) as of January 2019, accounting changes, changes in the total amount of risk exposures as well as in total equity. The capital adequacy indicators are above the average level reported for European banks, where CAR, Tier 1 and CET1 ratios in June 2019 stood at 18, 15.6 and 14.3 percent, respectively. The 0.5 percent countercyclical capital buffer that starts applying in October 2019 and which will increase to 1 percent in April 2020, will have an impact on the capital adequacy indicators of the banking system. In terms of profitability, ROA and ROE of the banking sector in June stood at 1.7 and 13 percent respectively, compared to 1.6 and 12.1 percent in 2018. Net interest income and revenue from fees increased, and impairment costs and administrative costs declined.

Figure 5. Non-performing loans (NPLs)

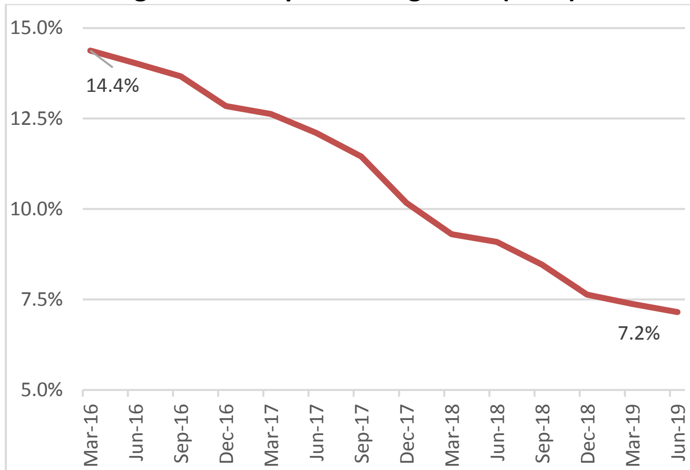
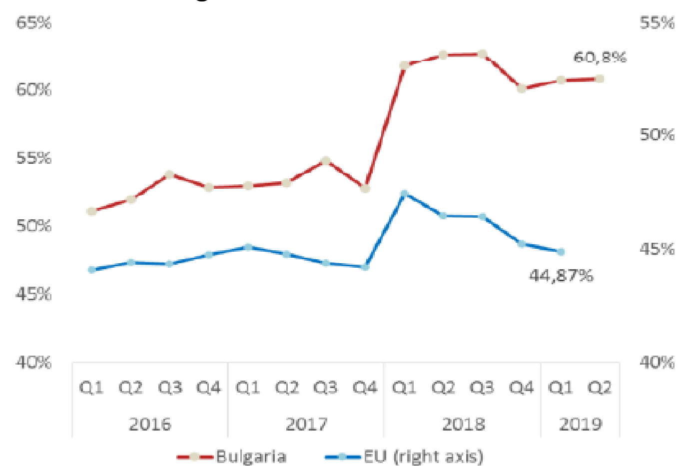


Figure 6. Provisions to NPLs



Source: BNB, Association of Banks in Bulgaria

10. **The liquidity coverage ratio of the banking system in Bulgaria stands above the EU average.** In June 2019, the liquidity buffer and the net liquidity outflows were BGN 27.8 billion and BGN 10.7 billion respectively. The liquidity coverage ratio (LCR) was 260.6 percent compared to 294.1 percent in 2018. The LCR for the banks in the Single Supervisory Mechanism (SSM) was 149.7 percent in March 2019 (see Figure 8).

[4] The minimum total CAR is set at 8%, while the minimum Tier 1 capital ratio is 6%, and the minimum Core Equity Tier 1 capital ratio is set at 4.5%. In addition to these, the BNB has set up other capital buffers: i) a capital conservation buffer of 2.5%, ii) a systemic risk buffer of 3%, iii) a countercyclical capital buffer (for credit risk exposures) of 0.5% from October 2019 and 1% from April 2020, and iv) a buffer for other systemically important institutions (applicable to ten banks identified as such by the BNB) of 0.25% to 0.75% for 2019, and of 0.5% to 1% for 2020.

Figure 7. Capital ratios

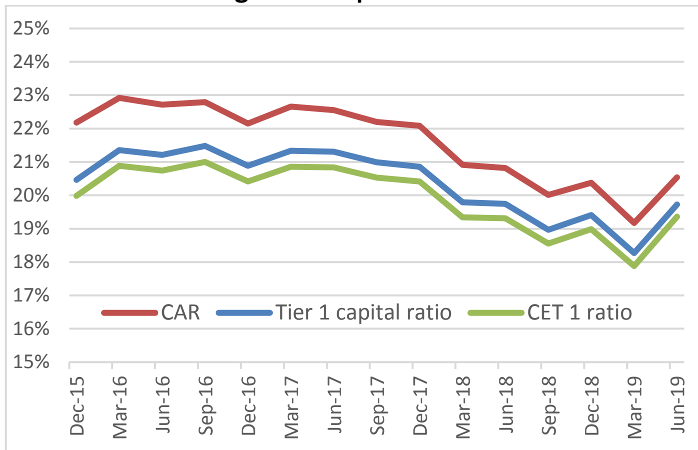
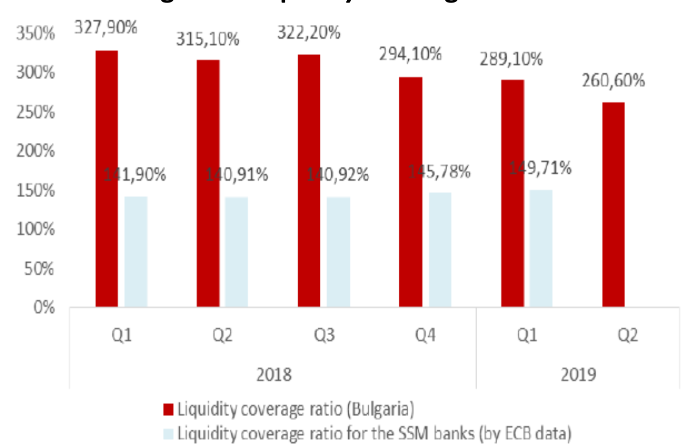


Figure 8. Liquidity coverage ratio



Source: BNB, Association of Banks in Bulgaria

(b) Government Measures to Preserve Banking Sector Stability

11. **In June 2014, Corporate Commercial Bank (KTB) – the 4th largest bank at the time – was put under a lengthy conservatorship after a large deposit run, a period during which KTB depositors did not have access to their savings.** According to the existing legislation at the time, the Bulgarian Deposit Insurance Fund (BDIF) could only start reimbursing depositors once the banking license of a failed institution was withdrawn. This clause and the five months conservatorship before license revocation led to a situation where depositors did not have access to their deposits for the period of conservatorship. The BNB finally revoked KTB's license in November 2014 on the basis of its insolvency, thus triggering the payment of KTB's BGN 3.8 billion (€1.9 billion) of insured deposits (for up to BGN 196,000, or €100,000 per deposit account) by the BDIF, and KTB entered into bankruptcy procedures under the BDIF's oversight.

12. **The repayment of KTB's insured deposits put a severe strain on BDIF's financial capacity.** Prior to KTB's failure, the BDIF had accumulated total reserves of BGN 2.1 billion (€1.07 billion). In order to bridge the funding gap, in December 2014 the Government provided the BDIF with a loan of BGN 1.675 billion (€837.5 million), with a maturity of 5.5 years, at a fixed interest rate of 2.95%. At the same time, since the BDIF reserves were fully depleted after the payment to insured depositors, the BDIF, with support from the Government, negotiated loans from the World Bank (and the EBRD) to rebuild the BDIF reserves. Box 1 provides more details on the World Bank response to this request.

13. **The failure of KTB highlighted corporate governance problems in the banking sector, and exposed weaknesses in bank supervision and resolution regime.** The crisis revealed a number of institutional weaknesses in the BNB's supervisory framework as it failed to take action prior to the collapse of KTB. Finally, the crisis exposed a number of deficiencies in the legal and institutional framework for bank resolution and deposit insurance and depleted the reserves of the deposit guarantee scheme.

14. **Authorities have pursued a wide-ranging strategy to address weaknesses in regulatory and supervisory framework exposed by the 2014 banking crisis.** A new legal framework for bank resolution and deposit insurance, consistent with the EU Deposit Guarantee Schemes Directive (DGSD) and the EU Bank Recovery and Resolution Directive (BRRD), was enacted in 2015 and is being operationalized. Governance and independence of the BNB has been strengthened. Based on the recommendations from the BCP Assessment conducted by the IMF and the WB (advanced module of the FSAP), the BNB adopted and largely implemented an action plan to strengthen its bank

supervision functions. The early intervention framework has been strengthened through the introduction of a broad and increasingly intrusive set of powers as different thresholds are crossed.

Box 1. The World Bank's Deposit Insurance Strengthening Project (P154219)

Following the failure of KTB in 2014, the BDIF, with support from the Government, negotiated a loan from the World Bank to mitigate its consequences. The World Bank was able to offer a customized solution to the country needs by offering, in a timely manner, the combination of a loan to the BDIF and a FSAP Update (performed jointly with the IMF). The loan was instrumental in rebuilding the reserves of the BDIF (together with a parallel loan from the EBRD, see below), while the FSAP assessed and helped improve the authorities' crisis response, including the role of the deposit insurance scheme from the perspective of international and EU good practice.

A pivotal part of this support was the Deposit Insurance Strengthening Project, the first lending operation in Bulgaria in seven years. This project contributed to financing the BDIF following a results-based approach with financing made available to the BDIF in several tranches based on the achievement of 10 Disbursement Linked Indicators (DLIs) that measure progress towards the project development objective. The €300 million loan was approved by the Board in March 2016 and declared effective in June 2016. To date, the entire amount has been disbursed, based on the achievement of all the DLIs, and the Project is expected to close on December 31, 2019.

The project development objective is to strengthen the financial and institutional capacity of the BDIF so as to enable to meet its deposit insurance and bank resolution obligations. The project has helped restoring the public confidence in the banking system by promptly replenishing reserves of the deposit insurance fund. In addition, the World Bank intervention has helped strengthening the BDIF's institutional capacity based on the lessons from the 2014 banking crisis, the findings of the World Bank 2015 assessment against the IADI's Core Principles for Effective Deposit Insurance Systems (an advanced module of the FSAP), and in line with the EU DGSD and BRRD.

This project was the World Bank's first ever operation with a deposit insurance fund acting as the Borrower. The World Bank's innovative approach combined funding on attractive terms with knowledge transfer in a critical area to ensure financial stability and contribute to the effective functioning of the financial sector going forward.

15. **In mid-2018 the Government adopted a comprehensive action plan that included measures to further strengthen financial sector stability and governance of institutions.** The implementation of this action plan is seen as the essential pre-condition for Bulgaria's joining the ERMII, and eventually, the euro area. As part of this plan, the Bulgarian authorities committed to: (i) entering into close cooperation with the ECB (i.e. joining the banking union as a non-euro area country), (ii) providing the legislative basis for borrower-based macroprudential measures, (iii) enhancing the supervision of the non-banking financial sector, (iv) identifying gaps in the insolvency framework and preparing a roadmap to address them, (v) strengthening the anti-money laundering (AML) framework by addressing any issues identified in the transposition into national legislation of the fourth EU AML directive and transposing the fifth AML directive into national legislation, and (vi) improving the governance of state-owned enterprises (SOEs) by aligning legislation with the OECD Guidelines on Corporate Governance of SOEs. By July 2019, almost all the commitments have been reported as completed by the Government, with the secondary legislation on banking supervision (i.e. adoption of EBA Guidelines by the BNB) and assessment of bank supervision and secondary legislation under implementation.

16. **As part of the process to enter the banking union, the ECB performed a comprehensive assessment of six Bulgarian banks.** The process of engaging into close cooperation with the ECB involves a comprehensive asset quality review (AQR) and stress test of selected banks operating in Bulgaria.[5] The assessment covered six banks: the three largest (and foreign-owned) banks (UniCredit Bulbank, DSK Bank and United Bulgarian Bank), and three domestically owned banks (First Investment Bank, Central Cooperative Bank, and Investbank). The AQR was conducted by the ECB based on its updated AQR methodology (from June 2018)[6] using financial information of the selected banks as of end-2018. The stress tests looked at the evolution of the capital positions of the selected banks under hypothetical baseline and adverse scenarios over 2019-2021. The CET1 ratio was the key measure used for the assessment, with the relevant thresholds being 8 percent for the AQR and the stress test's baseline scenario, and 5.5 percent for the stress test's adverse scenario.

17. **While four banks did not show capital shortfalls after the AQR and stress tests, two domestically-owned banks fell below the relevant CET1 ratio thresholds.** First Investment Bank had a CET1 ratio of 4.5 percent after AQR adjustments and of 4.1 percent when the baseline scenario of the stress test was applied, and of -2 percent when the adverse scenario of the stress test was applied, with a total €263 million capital shortfall. Investbank had a CET1 ratio of 5.7 percent when the baseline scenario of the stress test was applied, and of -3.1 percent when the adverse scenario of the stress test was applied, with a total €52 million capital shortfall (see Table 1). Most of the capital shortfall in both cases resulted from adjustment to provisions for corporate exposures (based on sample portfolios of different asset classes)[7].

18. **The BNB endorsed the results of the comprehensive assessment and will undertake further measures to improve the capital positions of the banks.** According to the BNB, the results are consistent with those of the 2016 AQR and stress tests, taking into consideration the time lag and the changes in the AQR methodology to incorporate the effect of the accounting standard IFRS 9. While it did not specify follow-up actions on those banks that showed capital shortfalls, the BNB announced that they will be conducted in strict compliance with its mandate and the relevant regulatory framework. Finally, and on the basis of the AQR results and post reference date developments, the BNB undertook an estimate of the minimum capital requirements applicable in Bulgaria[8], confirming that each of the six banks met such requirements as of June 2019.

19. **Both First Investment Bank and Investbank issued press releases indicating how they have covered or are planning to cover the capital shortfall.** First Investment Bank announced that – as of June 2019 – it has already covered half of the €263 million shortfall through: (i) pre-provisioning profit in the amount of €65 million, (ii) loan provisions in the amount of €37 million as a result of the adoption of IFRS 9, recognized in the financial statements for 2018, and (iii) loan payments and additional collateral provided for exposures with AQR adjustments, in the amount of €28 million. It also announced that the remaining shortfall will be bridged with its operating profit, de-risking of its

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[5] An AQR and stress tests of the entire Bulgarian banking system was performed by the BNB in 2016, following the ECB methodology and using financial information as of end-2015. The results were published in August 2016, showing that the capital adequacy of all banks remained above the required regulatory minimum after AQR adjustments. Two domestically-owned banks (First Investment Bank and Investbank) were required to restore the coverage of their capital buffers, after taking into account the AQR adjustments. The banks achieved this goal organically, through a combination of retention of profits, de-risking of exposures, sale of assets, and shareholders' support through capital increases (in the case of Investbank).

[6] More details available at https://www.bankingsupervision.europa.eu/press/pr/date/2018/html/ssm.pr180620.en.html

[7] More details available at https://www.bankingsupervision.europa.eu/press/pr/date/2019/html/index.en.html?skey=ECB%20concludes%20comprehensive%20assessment%20of%20six%20Bulgarian%20banks

[8] As per Art. 92 of the EU Capital Requirements Regulation (CRR).

corporate portfolio, and any other eligible measures. Investbank informed that its stress test results were impacted by the acquisition of bank Victoria (subsidiary of the failed KTB bank) in 2018, as 95 percent of the acquired loan portfolio was impaired. In addition, it informed that the bank has indefinite hybrid instruments amounting to €20 million (which are not included in the calculation of the CET1 ratio in the AQR and stress tests), which, if converted, it would fully cover the capital shortfall in the baseline scenario of the stress test. The capital shortfall under the adverse scenario would be covered with profits and asset restructuring.

Table 1. ECB Comprehensive Assessment, Summary of Results

Bank name	Initial CET1 ratio (1)	CET1 ratio post-AQR (1)	CET1 ratio in baseline scenario (2)	CET1 ratio in adverse scenario (2)	CET1 shortfall (3)
	(%)	*(%)*	*(%)*	*(%)*	*(EUR millions)*
UniCredit Bulbank AD	24.7%	23.1%	19.2%	14.3%	0
DSK Bank EAD	19.0%	18.6%	19.1%	12.3%	0
United Bulgarian Bank AD	21.5%	21.1%	20.2%	11.8%	0
First Investment Bank AD	15.7%	4.5%	4.1%	-2.0%	262.9
Central Cooperative Bank AD	16.4%	16.2%	15.7%	8.0%	0
Investbank AD	15.2%	10.0%	5.7%	-3.1%	51.8

Source: ECB
(1) CET1 ratio as of December 31, 2018.
(2) Lowest CET1 ratio over the stress test's three-year horizon.
(3) Bank's capital needs on the basis of the maximum shortfalls in the various components of the exercise.

(c) BDIF's financial capacity

20. **Following the KTB case, the BDIF has been able to rebuild its reserves, which are mostly invested in liquid assets.** After the KTB failure, the BDIF has continued collecting annual premiums from banks, receiving a cumulative amount of BGN 884.46 million between 2015 and 2019. By the end of 2017, the BDIF reserves had reached the target level of 1 percent of covered deposits set by the LBDG, 7 years before the 2024 deadline. In May 2019, the BDIF received BGN 418 million allocated to it in the first partial account for distribution of the available cash among KTB creditors. As a result, the BDIF's net investment portfolio amounted to BGN 1,225.25 million as of August 2019, or 2.16 percent of covered deposits. Most of these reserves are invested in deposits with the BNB, with a minor portion (less than 1 percent) invested in bonds issued by the Bulgarian government.

21. **Going forward, based on current projections, the BDIF expects to maintain the deposit insurance fund's minimum target level of 1 percent, after repayment of its obligations.** By April 2020, the BDIF has to fully repay the loan with the Government (the outstanding amount of the loan as of August 2019 was BGN 505.5 million), and from 2022, it will start making amortizations to its obligations with the WB and the EBRD, until it fully repays them by 2026. The lump sum of the banks' annual premium contributions will continue to be set at an amount that ensures a minimum reserve ratio of 1 percent as of July 3, 2024, after repayment of obligations. In addition, the BDIF expects to receive by the end of 2021 additional significant recoveries from the KTB estate.

22. **The LBDG allows for the collection of extraordinary premiums in case of funding deficits.** According to Article 18 of the LBDG, the BDIF shall request extraordinary premiums in a given year of up to 0.5 percent of covered deposits or higher, in extraordinary circumstances with explicit consent from the BNB, when funds available with the BDIF are not sufficient to cover its obligations in the case of a payout event. Higher extraordinary premiums can also be requested under extraordinary circumstances, with explicit consent from the BNB. To date, this provision has not been used, as there have been no bank failures since the LBDG was enacted.

C. Proposed Development Objective(s)

Development Objective(s) (From PAD)

The Project Development Objective is to strengthen the financial sector safety net to meet potential deposit insurance and bank resolution obligations.

Key Results

23. **The proposed Project addresses a remaining institutional weakness of many deposit insurance schemes around the world, related to prompt access to emergency funding.** As outlined in section II.F below, pre-funding all the expected contingent obligations of a deposit insurance scheme is costly. Therefore, since payout of large amounts of insured deposits would normally exhaust the resources of most deposit insurance schemes, best international practice recommends the establishment of emergency funding arrangements for these unlikely, but possible events. In the absence of a European Deposit Insurance Scheme (EDIS),[9] the only practical option for the BDIF to access emergency funding is to request a loan from the Government, as it was the case in 2014 after the failure of KTB. Given the changes in the legal framework that reduced the timeframe to start payout of insured depositors from 20 to 7 business days, a loan from the Government may not be promptly available, putting at risk the ability of the BDIF to fulfill its legal mandate.[10] Moreover, a loan from the Government involves the use of taxpayers' money, which is not considered best international practice. A contingent facility where funds are made available within 7 business days – upon occurrence of pre-defined trigger events – addresses this institutional weakness.

[9] In November 2015 the EC proposed the establishment of a European Deposit Insurance Scheme (EDIS) for the euro area countries as the third pillar of the European Banking Union. Under the EC proposal, the EDIS shall be implemented in several stages. At its final stage of execution the payout of insured deposits shall be fully funded by the EDIS with the assistance of and the close cooperation with national deposit guarantee schemes. Negotiations on the EC proposal in the European Council and the European Parliament continue to take place, thus the final features and timeline for the implementation of EDIS are still unclear.

[10] According to Article 24 of the LBDG, the BDIF can also request a loan from deposit guarantee schemes of other EU Member States to bridge a funding gap, but only up to 0.5 percent of covered deposits of the borrowing scheme, and fulfillment of other conditions. Whether any deposit guarantee scheme in the EU is able and willing to provide such loan to the BDIF – and within 7 business days – is not clear.

D. Project Description

24. **The Project Development Objective will be accomplished through:**

(a) Offering a contingent financing facility to the BDIF during the course of the Project;

(b) Building the long-term financial sustainability of the BDIF; and

(c) Maintaining the BDIF's institutional capacity to fulfill its mandate.

25. **The Project will have a single component, with the World Bank contingent financing to be used solely upon the occurrence of pre-defined trigger events.** Pursuant to the Bank Policy and Bank Directive: Investment Project Financing (formerly OP/BP 10), such expenditure meets the productive use requirements as financing of the obligations of a deposit insurance scheme helps increase confidence in the financial system. This, in turn, is likely to lead to increased deposits in the banking sector, which can be utilized for financing investment lending and other forms of productive economic activity. The Bank has financed Deposit Insurance Schemes through IPF instruments in the past and the eligibility under the Bank Policy and Bank Directive: Investment Project Financing has already been established.

26. **The first trigger for the partial or full drawdown of World Bank loan proceeds is the occurrence of events that require a payout of insured depositors from the deposit insurance fund.** The natural trigger event for the drawdown of funds would be a bank failure or several bank failures, for which the BDIF foresees the need of additional funding to reimburse insured depositors. As Article 20(5) of the Law stipulates that the BDIF has 7 business days to start the payout, if the BDIF foresees the need to access WB loan proceeds before that deadline, prompt access should be granted, and certainly, before the BDIF exhausts its own resources.

Trigger 1: A decision by the competent authority[11] or judicial authority which require a payout of covered deposits, following Article 20(1) of the LBDG, including its amendments, if any.

27. **A second trigger for the drawdown of funds relates to bank resolution actions that require the financing from the deposit insurance fund.** In case of resolution of a bank, the BDIF can be requested by the competent Resolution Authority[12] to participate in financing the resolution with cash contribution with the aim to cover losses, provided that depositors continue to have access to their deposits. Such contribution could be as much as 1 percent of covered deposits[13], which is the minimum funding ratio prescribed by the LBDG. In such cases, the deposit insurance fund may be left with little or no resources for its other obligations under the LBDG, which may have a negative impact on depositor confidence.

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[11] Currently, the competent authority as per the relevant legal framework is the BNB. In the event Bulgaria joins the European Banking Union during the project implementation period, the competent authorities will be the ECB (for "significant" banks) and the BNB (for "less significant" banks). Banks falling under each category will be decided upon entry to the European Banking Union.

[12] Currently, the competent Resolution Authority as per the relevant legal framework is the BNB. In the event Bulgaria joins the European Banking Union during the project implementation period, the competent resolution authorities will be the Single Resolution Board – SRB (for banks under direct supervision by the ECB and cross-border groups) and the BNB (for other banks). Banks falling under each category will be decided upon entry to the European Banking Union.

[13] Regardless of whether the BDIF has sufficient ex-ante funds to cover the requested amount.

Trigger 2: The competent Resolution Authority takes resolution action on a bank(s) under its remit and notifies the BDIF that it will need to contribute to the financing of resolution for a certain amount and by a certain deadline, following Article 144 of the LRRCIIF, including its amendments, if any.

28. **The occurrence of any of the trigger events would give the BDIF the right to request withdrawal(s) of World Bank loan proceeds, for a pre-specified length of time following the occurrence of the event.** The BDIF may request one or more withdrawals of WB loan proceeds upon the occurrence of any of the pre-defined trigger events, up to 12 months following the date of the trigger event, and up to the following cumulative amounts[14]:

(a) In case Trigger 1 occurs, the total amount of covered deposits of the bank(s) under liquidation;

(b) In case Trigger 2 occurs, the total cash contribution for the financing of resolution;

29. **Relevant documentation shall be furnished by the BDIF to the World Bank for ex-post verification, by pre-specified deadlines after the occurrence of the trigger event, and after the BDIF requests disbursement of World Bank loan proceeds – if it decides to do so.**

Legal Operational Policies

	Triggered?
Projects on International Waterways OP 7.50	No
Projects in Disputed Areas OP 7.60	No

Summary of Assessment of Environmental and Social Risks and Impacts

30. The project will provide contingent financing to BDIF so that it can meet its obligations as bank deposit insurer. The project is expected to have positive impacts on domestic and commercial savings by protecting them from losses in the event of bank failure. Protection of deposits is particularly significant for households with low liquid assets, thus having an even higher impact on poor households. Project will not fund civil works, not procure goods and no impacts on private land and assets are anticipated. No direct nor indirect employment for the purpose of performing project activities is expected. Given the low risk nature of the intervention, the absence of major social and environmental risks and impacts, the project's environmental and social risk is considered to be low.

31. The Strategy of BDIF for Promotion of Public Awareness of the Deposit Guarantee System, approved by its Management Board in 2018, provides details on how BDIF will maintain public awareness of the deposit insurance system. The Project will monitor the implementation of the strategy through a specific indicator in the results framework and stakeholder measures defined in the Borrower Environmental and Social Commitment Plan. In case of a payout event, the conservator, the temporary administrator or special manager, the liquidator, the interim trustee or the trustee of the bank will manage any potential grievances by claiming depositors which are submitted within 3 months of the initial day of payout (Article 21 of the LBDG). All claims must be addressed within 7 days of receipt. In

[14] In case the original amounts under each trigger are subsequently increased following the availability of new information, the revised amount will be the total limit for withdrawal in each case.

case of claim dismissal, the claimant can seek his/her rights in court under the Civil Procedure Code. The Grievance Mechanism procedures are available on the website of the BDIF and in the Questions and Answers about Deposit Guarantee brochure, which is disseminated via the branch network of banks.

E. Implementation

Institutional and Implementation Arrangements

32. **The BDIF will serve as the Borrower and implementing agency, while the MoF will serve as a representative of the Republic of Bulgaria, which will provide a sovereign guarantee for the WB loan.** The implementation arrangements are expected to be fairly straightforward as the WB funds will not be used for procurement of goods or services, and disbursements will only take place upon the occurrence of pre-defined trigger events. The BDIF has prior experience in implementing WB projects, and will designate a small team of relevant staff, led by a Project Coordinator, to ensure the Project is properly implemented. The principal activities of the implementing agency will comprise: (i) gathering required documentation for ex-post verification of trigger events – in case they occur – and use of funds – in case withdrawal(s) are requested – in accordance with protocols agreed with the Bank; (ii) reporting on the Bank transfers – if any – that result in the financing of the deposit insurance and resolution obligations of the BDIF; and (iii) liaising with and reporting to the Bulgarian authorities and the World Bank on project progress.

33. **The Borrower will be asked to ensure that throughout the project implementation period it maintains adequate governance and financial management arrangements** to reflect the operations, resources and expenditures of the implementing agency, which are acceptable to the World Bank.

34. **The BNB and the MoF will be important stakeholders.** Both of these entities, in addition to the BDIF, play a critical role in the financial safety net, and BNB and the Government of Bulgaria are represented on the BDIF's Management Board. Therefore, the project design and implementation will require buy-in and close cooperation from both parties in order to ensure that the Project Development Objective is achieved.

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