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FINANCIAL SECTOR ASSESSMENT BULGARIA

DECEMBER 2002

EUROPE & CENTRAL ASIA REGION VICE PRESIDENCY
FINANCIAL SECTOR VICE PRESIDENCY

BASED ON THE JOINT IMF-WORLD BANK FINANCIAL SECTOR ASSESSMENT PROGRAM

A. INTRODUCTION

1. **This Financial Sector Assessment (FSA) summarizes the FSAP findings for Bulgaria, and reports on the actions of the Government and the Bulgarian National Bank (BNB) to date in response to the FSAP recommendations**.[1] The FSAP mission visited Sofia during the period October 29 to November 14, 2001.[2]

2. **The Bulgaria FSAP took place after five years of aggressive financial reforms in response to the deep economic and financial crisis of 1996-97**. After the collapse of the banking system and establishment of the Currency Board Arrangement (CBA) in July 1997, the Government and the BNB pursued structural and institutional reforms in both the enterprise and banking sectors, including the privatization of about 85 percent of the banking system assets, mainly to foreign financial institutions, and the upgrading of banking supervision capabilities at the BNB. The FSAP mission occurred at a time when the banking system had stabilized, but financial intermediation remained low compared to the more advanced transition economies. In addition to the assessments[3] of compliance

[1] There was a follow-up mission to strengthen the payments component of the FSAP report.

[2] The assessment team was led by Mr. Albert Martinez (World Bank, Head) and Mr. Jan Willem van der Vossen (IMF, Deputy Head) and included Mr. Mark De Broeck, Mr. Boyko Dimitrachkov, Ms. Yuri Kawakami, Ms. Jia Liu (Research Assistant), Mr. Hemant Shah (all IMF), Mr. Paul O'Brien (Central Bank of Ireland), Mr. Arpad Kiraly (Hungarian State Financial Supervision), Mr. Aditya Narain (Reserve Bank of India), Mr. Euan Abernethy, (formerly New Zealand Securities Commission), Mr. Luc Cardinal, Mr. Simeon Djankov, Mr. Luc Laeven, Ms. Esperanza Lasagabaster, Mr. Kenneth Mwenda, and Ms. Susan Rutledge (all World Bank). Ms. Stella Ilieva and Ms. Maria Kalimerova of the Bank Country Office in Sofia provided support to the team.

[3] The Bulgaria FSAP mission completed the Assessment of Compliance with Basel Core Principles for Effective Banking Supervision, Assessment of Observance of the IOSCO Objectives and Principles of Securities Regulation, Assessment of Observance of IAIS Insurance Core Principles, Assessment of Observance of the CPSS Core Principles for Systemically Important Payments Systems, Assessment of Observance of the OECD Principles for Corporate Governance, and Assessment of the IMF Code of Good Practices on Transparency in Monetary and Financial Policies.

with standards and codes, the Bulgaria mission focused on addressing the constraints to lending and advising the BNB on how to ensure that an expansion of bank lending does not jeopardize the gains in financial stabilization. The FSAP findings were major inputs to the medium term program to be supported by the Programmatic Adjustment Loans (PALs).

B. The Macroeconomic Environment

3. **Bulgaria started its transition to a market economy late, but has come a long way in five years due to sound macroeconomic policies and deep structural reforms**. During the early years of transition, progress in economic reforms was slow and macroeconomic policies erratic, leading to a severe financial crisis in 1996–97. Since then, Bulgaria has witnessed significant structural changes in its economy, as most of the non-infrastructure state enterprises and banks have been privatized or liquidated, trade and prices liberalized, and pension and health care reforms initiated. Macroeconomic stability was achieved and maintained through tight fiscal and incomes policies in the context of the CBA. As a result of these policies, output growth has picked up from negative levels, led by investment and exports, inflation has declined to single digits from hyperinflationary episodes in early 1997, and the external debt-to-GDP ratio, which was 100 percent in 1997, has come down rapidly. The EC recognized these achievements in its 2001 and 2002 Regular Reports, noting that Bulgaria has established a satisfactory track record of macroeconomic performance. The EC has recently assessed Bulgaria as a functioning market economy and Bulgaria has closed 22 of 30 chapters of the *acquis communautaire*.

4. **The external position has remained under pressure, although the external current account deficit is improving in 2002 compared to 2001.** In 2001, the external current account deficit accounted for 6.1 percent of GDP driven by strong domestic demand for imports, lower international prices, and global slowdown, including in the EU and Turkey, Bulgaria's main trade partners. FDI inflows of about 5.1 percent of GDP, together with the debut Eurobond issue in late 2001, provided for the bulk of the financing of the external current account deficit. Thus, foreign exchange reserves have remained at a comfortable level, covering five months of imports of goods and services. The external current account deficit is expected to decline from 6.1 percent in 2001 to about 4 percent in 2002. External debt to GDP has declined by more than 30 percentage points since 1997, to 69 percent at end-September 2002.

5. **Significant but manageable external risks exist.** Bulgaria faces several significant external risks. A failure to carry out the envisaged privatization program or attract sufficient greenfield FDI would put the projected external financing at risk, requiring additional adjustment to ensure that debt levels continue to decline. Moreover, Bulgaria's external accounts are sensitive to two key parameters: an increase in oil prices and a worse than anticipated slowdown in EU economies which are the destination of over fifty percent of Bulgarian exports and the origin of more than half the FDI inflows. However, the achievements to date, the better than expected performance in the last several months of 2002, and the implementation of prudent fiscal policy substantially

mitigate these risks. In addition, the Government has identified and agreed with the Fund under the Stand By Arrangement (SBA) to contingency measures – totaling about ¾ percent of GDP – in the event that, in the short run, the external account deficit worsens or international reserves decline significantly.

C. THE BANKING SYSTEM

Structure and Performance

6. **The financial sector of Bulgaria is small relative to the size of its economy and is dominated by the banking system**. The information base on bank ownership is weak and this can pose medium-term vulnerabilities from an anti-money laundering/counter terrorism finance (AML/CTF) as well as a prudential point of view, as consolidated supervision is not possible without good information on group (beneficial) ownership and financial structures. *Based on FSAP recommendations, the Government submitted, and the Parliament passed, amendments to the Banking Law providing greater authority to the BNB to identify and investigate direct and indirect ownership of banks.*

7. **Bulgaria has made significant progress in privatizing state-owned banks attracting some strong foreign banks as strategic investors.** As of mid-2002, the state-owned banks had a market share of only about 15 percent of assets and 20 percent of deposits. Foreign branches and subsidiaries hold about 75 percent of assets and deposits. The three largest banks accounted for almost half bank assets, deposits, and capital and reserves. Further consolidation among the smaller banks is likely as competition increases. *The Government privatized in October 2002 another state owned bank – Biochim Bank – and has engaged J.P. Morgan as privatization adviser for the privatization of the State Savings Bank (DSK), scheduled to be sold by mid-2003. With the sale of DSK, the banking system will be 98 percent private sector owned in terms of banking assets.* [4]

8. **Bank intermediation remains low, reflecting risk averse behavior after the 1996-97 crisis, although BNB data indicate an increase in lending to the private sector during the 12 month period ending June 2002.** At mid-2001, almost 40 percent of banking system assets were in the form of foreign exchange deposits in reputable banks abroad, far exceeding the share of loans to the private sector. Low bank intermediation is broadly accounted for by supply and demand factors, legal issues, unreliable corporate financial accounts, and weak corporate governance. SMEs in Bulgaria rely primarily on cash and informal credit sources. In general, much liquidity, in leva as well as in dollars, is still retained outside the banking system. Only a third of the population has a bank account. *Between 2001 and mid-2002, there has been an increase in lending to mid-size domestic companies, with the deposits in foreign banks as a share*

[4] With the planned privatization of the DSK, only two non-private banks will be left. One is the Municipality Bank owned by the City of Sofia. The other is the state owned Business Promotion Bank, which is not allowed to take deposits from the population and was established to channel KfW funds to SMEs.

of banking assets declining to about 25 percent[5] *and the share of loans to the private sector increasing to 37 percent. This shift is explained by the high level of liquidity, lower interest rates abroad, and more intensive competition in the banking system.*

9. **However, vulnerabilities could arise as a result of higher competition, shrinking margins, continued high overheads and the increase in credit risk from increased lending.** Therefore, commercial banks as well as the Banking Supervision Department of BNB will need to closely monitor asset quality and banks' risk management capability during the coming period. In addition, while more than half of bank loans are in foreign currency, BNB and the banks have to monitor more closely the foreign exchange exposure of borrowers whose main sources of revenues are in domestic currency. Banks' risk management systems are still relatively basic: up to end-2001, commercial banks have managed credit risk by limiting lending volume and imposing high collateral requirements, high lending rates and short-term variable-rate lending.

10. **The banking system is highly capitalized.** The average capital adequacy ratio (CAR) for the banking system, although gradually declining from 43 percent at end–1998 to 29 percent in June 2002, suggests that banks can still expand their lending considerably. Subsidiaries of foreign banks' capital adequacy ratios have declined since 2000 to about 32 percent in mid-2002, while the CAR of domestic banks hovered at around 23–25 percent during 2000–2002. For long-term profitability, these ratios are too high, but justified for the immediate term to take into account risks in a post crisis situation where enterprises and banks are restructuring. The capital position of the banking system would also provide a strong buffer as banks expand their lending.

11. **The ratio of classified loans to total loans was about 6 percent in June 2002, and bank profitability has been generally high compared to banks in Central and Eastern European countries.** Over the period 1998–2001, the return on average equity (ROAE) increased from six percent to over 20 percent, while the return on average assets (ROAA) almost tripled from one percent to three percent. In June 2002, capital including reserves was 14 percent of total assets. Deposits in the banking system represent almost 80 percent of total assets.

Liquidity Arrangements

12. **The BNB has placed a high priority on monitoring commercial banks' liquidity management.** A minimum reserve requirement of 11 percent was reduced to eight percent (compared to two to three percent in EU countries) in July 2000 to stimulate lending to the private sector. Banks prefer to keep low stocks of leva liquidity, depositing most of the surplus liquidity in foreign currencies in foreign banks. Liquidity ratios of banks are generally high, with a stable primary liquidity ratio at around 10 percent. Since the third quarter of 2001, the BNB has started compiling a "marketable assets ratio," to

[5] In addition, about 15 percent of banking assets are investments in government and other high grade securities, of which about 45 percent are denominated in foreign exchange.

monitor banks' liquidity. The ratio of marketable assets[6] to total assets was as high at 48 percent in March 2002.

13. **Bunching of large payments of corporate and personal income taxes and social security payments around mid-month has resulted in short term liquidity shortages, and associated interest rate spikes.** The BNB cannot provide liquidity support under the currency board rules, but since November 1, 2001 it has been providing same day leva against euro to ease these pressures. This bunching of liquidity needs has been exacerbated by the centralization of government accounts in a single treasury account, and the fact that the current payment system infrastructure does not provide the banks information on true real time and complete intra-day balances in reserve accounts at the BNB. The latter issue will be resolved when the Real Time Gross Settlement (RTGS) payment system becomes operational in the first quarter of 2003.

Deposit Insurance

14. **The Deposit Insurance Fund (DIF) currently guarantees, in full, household and corporate, resident and non-resident, foreign exchange as well as domestic currency account holders, to a maximum of BGN 10,000 per depositor per bank**.[7] Average household deposits in Bulgaria were BGN 535, and average corporate deposits BGN 6,534 as of end-2001. The high level of cover is required as an interim step to meet the requirements of the EU rules on deposit insurance. Banks are obliged to participate in the deposit insurance system, with the exception of foreign branches covered by the schemes applicable to their head offices. Annual premiums are 0.5 percent of the average deposit base over the previous year, which is high by international standards. The mission raised this issue and the commercial banks have complained about this high level. However, in view of the need to bring cover up to the very high level required by the EU, lower contributions are not considered feasible by the authorities. In general, in light of the sharply increased ceilings of insurance cover, and the expected increase of the use of the banking system as confidence returns, funding of the DIF will need to reconsidered.[8]

Regulation, Supervision, and Vulnerabilities

15. **Banking supervision is exercised by the BNB**. The *Law on Banks* lays down prudential regulations in the areas of capital, liquidity, loan classification and

[6] To take account of Bulgarian banks' significant holding of deposits in foreign banks which can be liquidated without much difficulty, a new category called marketable assets has been developed which includes cash, non-interest-bearing deposits, interest-bearing deposits with banks, Bulgarian treasury bills and bonds, minus all interest-bearing deposits with banks classified as watch or worse and all assets pledged to third parties.

[7] Amendments to the *Law on Bank Deposit Guarantee* were passed by Parliament in December 2001, and entered into force on December 22, 2001.

[8] The DIF is authorized to borrow from the government to meet liquidity needs, but requires Parliamentary approval to do so. As of December 2001, the DIF was authorized to borrow from banks.

provisioning, credit concentration, risk exposures, connected lending and investments, and also empowers the BNB to issue further regulations. The system of bank supervision effectively monitors compliance with prudential regulations and takes enforcement action based on a regular schedule of on-site supervision and off-site surveillance. With approximately 75 staff, the Supervision Department of the BNB is sufficiently staffed. The banking supervisory system is found to be fully compliant or largely compliant with the near totality of the 25 Basel Core Principles. However, more work can be done on the regulation and supervision of country, market, and operational risk, formalizing information sharing arrangements, and strengthening corporate governance in banks. The BNB largely observes good practices with regard to transparency in banking supervision.

16. **Although overall the system is robust, as indicated by the results of the stress tests, the banking system is subject to a number of vulnerabilities**. These include: (i) weak company law, non-transparent corporate ownership, poor corporate financial disclosure, and weak accounting and auditing rules and practices, all of which undermine the safety and transparency of the credit allocation process; (ii) weak loan enforcement and collateral foreclosure rules, and inefficient judicial procedures, all of which hinder effective loan collection practices; (iii) risk management systems which are in a developmental stage and need to be further upgraded to handle increased lending; and (iv) relatively high cost levels, which makes banks' current profitability more vulnerable to stronger competition, for instance when Bulgaria joins the single EU banking market. Weak loan enforcement by the courts can create a ripple effect of defaults, as company managers see that other companies successfully delay paying off their debt. *Most of these deficiencies are being addressed as part of the medium term program supported by the PALs. The accounting and auditing laws have been passed imposing International Accounting Standards (IAS) and International Standards of Auditing (ISA), amendments to the Law on Registered Pledges and the Civil Procedure Code have been enacted since the mission, and a judicial reform program is underway.*

17. **The bank resolution system has proven effective in the closing of insolvent banks and the protection of small depositors, but not in the dissolution of closed banks.** Seventeen banks went into insolvency in 1996-97 and the process of the liquidating these banks has been slow, with five banks still to be liquidated. Court appointed trustees oversee the process in the context of the general insolvency legislation. *The Parliament recently passed a Bank Bankruptcy Law which provides for a more expedient process, with more effective oversight to be exercised by the DIF.*

D. Capital Market and Non-Bank Financial Institutions

Capital Market

18. **The role of the capital market in intermediating savings and productive investment is extremely limited.** The Bulgarian capital market is in an early stage of development with one of the lower ratios of stock market capitalization to GDP and stock market turnover to GDP among CEE countries. Its institutions, specifically the Bulgarian National Securities Commission (BNSC) and the Bulgarian Stock Exchange (BSE), are

new, and are building experience. The BSE rules are extensive and in general reflect good stock exchange practice. However, there is little incentive for companies to remain subject to the more stringent requirements imposed by the *Law on the Public Offering of Securities* (LPOS) and the BSE compared with the requirements of the *Commercial Code*, which governs other companies. At the present time, the stock market is highly illiquid. However, with the introduction of the multi-pillar pension reform and the development of the insurance industry, there is potential for greater activity in capital markets over time.

19. **Although the legal and regulatory framework is largely harmonized with EU and IOSCO standards, the *Commercial Code* and the *Law on the Public Offering of Securities* (LPOS) still require amendments to enhance investor confidence.** The amendments should address the deficiencies in minority shareholder protection and provide for clear duties of directors to all shareholders, including minority shareholders. Other useful amendments would be to authorize the BNSC to take court action on behalf of disadvantaged shareholders in civil actions, to give more power to general shareholder meetings over certain corporate decisions, and to provide new rules for taking companies out of the register of publicly traded companies. *The Government has submitted to Parliament draft amendments to the Commercial Code to strengthen provisions relating to minority shareholder rights and corporate governance. In addition, Parliament recently passed several amendments to the LPOS to address the deficiencies identified during the FSAP*.

20. **The BSE provides a good trading system, which is designed to cope with trading volumes many times greater than are experienced at present.** The system is fully electronic and automatic, provides maximum transparency, and enables good information disclosure. However, company information is not supplied to the BSE in a timely way despite the fact that the rules provide that information that may affect the value of the shares need to be sent within seven days. The system for clearing and settlement of transactions is reliable and efficient. Since all public company shares are dematerialized, settlement and delivery are done through the Central Depository. The settlement period is T+3 and the BSE has a guarantee fund against broker default. *The recently enacted amendments to the LPOS tighten the requirements for provision of material information by listed companies.*

Insurance Sector

21. **The insurance industry is small and fragmented**. At mid-2002, there were 32 licensed insurance companies operating in Bulgaria – 12 life insurance companies and 20 non-life insurance companies. Foreign insurance companies accounted for 15 percent of the assets of all the life insurance companies, and 56 percent of the assets of all the non-life companies. Insurance penetration is increasing with premiums to GDP increasing from 1.1 percent in 1998 to 1.6 percent in 2001, although there is still much scope for growth. Gross rates of return on investments for life insurance in 2000 and 2001 were only just sufficient to compensate for inflation, leaving a real rate of return of around

zero. For non-life, the rate of return was clearly insufficient to compensate for inflation and implies a loss. Solvency requirements are currently met by all companies, although in 1999 and 2000 one company was not in compliance. About 95 percent of all reinsurance is placed outside Bulgaria. *The state owned insurance company DZI, which accounted for 18 percent of the non-life market (premium income) and 32 percent of the life market in 2001, was recently privatized making the sector 100 percent private.*

22. **The supervision of insurance companies has been undergoing significant upgrading in 2002.** The FSAP mission assessed that the Insurance Supervision Agency needed to be reorganized and supported by better information systems. It also found that most of the supervision staff was inexperienced as most of their experienced colleagues went back to the industry for better remuneration. The ISA was not independent with its spending limited to 43 percent of the fees collected from insurers, reinsurers and brokers, the remainder being allocated to the government budget. Furthermore, the position of director of the agency would need to be for a specific term and dismissal should be based on professional reasons. *The Parliament recently passed amendments to the Law on Insurance which strengthened the role and powers of ISA and harmonized the insurance legislation with EU directives. A new head of the ISA has been appointed, who has reorganized the agency along the lines recommended by the FSAP and begun implementing an institutional development plan. The staffing has also been strengthened with the entry of 13 professionals, of which six came from the industry.*

Pension Funds

23. **The governance structure of pension insurance companies and pension funds requires upgrading.** Current legislation does not establish an adequate fit and proper test for shareholders, members of the board of directors or investment managers. Nor does it require members of the board of directors and investment managers to exert due care in the management of the pension fund, a fundamental principle that should apply to any investment intermediary. In the case of insolvency of a pension fund, the legislation does not hold the board and fund managers accountable in case of improper management, nor is the pension insurance company liable. The financial and operational capacity across funds differs widely, and the State Insurance Supervision Agency (SISA) should prepare for a restructuring and further strengthening of the market. *Draft amendments to pension legislation are being prepared to address issues relating to pension insurance companies and pension funds.*

24. **The institutional capacity of the State Insurance Supervision Agency (SISA) requires strengthening.** SISA is relatively new and will take time to gain skills and experience. Regulation of private pension funds should be more rigorous, in particular with regard to accounting practices, asset valuation, crediting of accounts and disclosure, in order to foster transparency and comparability of performance of pension funds. *The Council of Ministers is currently reviewing draft amendments to legislation to be submitted to Parliament that would strengthen SISA. Bank staff are assisting SISA in developing an institutional development plan. Several new regulations have been issued to address the deficiencies in the regulatory framework identified during the FSAP mission.*

Leasing and Agricultural Credit

25. **The financial leasing market is small but growing**. As of mid-2001, there were three equipment-leasing companies with assets of around US$60 million, and around 10 car/truck leasing companies with assets of around US$90 million. At US$150 million, total assets of the leasing industry amount to only 3 percent of total banking system assets.[9] Accounting standards are not in conformity with IAS, in particular with regard to income recognition. *The Parliament recently passed amendments to the Law on Registered Pledges aimed at improving enforcement of secured claims.*

26. **Agricultural credit is provided by the banks and agricultural credit unions.** As of end-2001, these credit unions totaled 33 with total assets of about BGN 25 million. These credit unions extend loans only to their members on the account of contributions made by them and cooperative funds. Credit unions fall under the Cooperative Law and are not supervised by the BNB.

Unification of Supervision of Financial Services

27. **In Bulgaria, the introduction of a unified agency for the regulation and supervision of all financial services, which had been discussed within the Government, seems premature.** While there are arguments for combining non-bank financial supervision agencies, setting up a joint agency at this time would risk disrupting the development and emerging stature of these agencies. As an interim step, the recent creation by the authorities of a coordination committee of all financial sector supervisory agencies has merit and can start a process of better cooperation, coordination and exchange of information. This forum should be used to develop a system-wide perspective of risks and vulnerabilities, to share experiences, and develop common approaches. In any case, there are compelling reasons for maintaining the responsibility for banking supervision with BNB. *The Financial Supervision Coordination Council, composed of the heads of all financial supervisory bodies, has been formed to improve coordination and information sharing. In addition, Parliament is considering a bill, expected to be passed by end-2002, integrating the supervision of non-bank financial institutions. The implementation of this law would require technical assistance to ensure successful implementation.*

E. Payments, Clearing and Settlement

28. **The key institutional constraint on the daily settlement of the payment systems, and in particular of the large-value payment streams, is that the BNB operates a Currency Board Arrangement**, under which it is currently unable to provide liquidity to the commercial banks, either intra-day or overnight or longer, to ensure the

[9] As of end-2000, the assets of the equipment leasing industry in the Czech Republic totaled US$2.2 billion, US$1.6 billion in Poland, US$1.1 billion in Hungary, and US$0.6 billion in Slovakia. Source: Leaseurope.

full settlement of all payments due each day.[10] Banks are permitted to draw down their minimum reserve balances, which are maintained on a monthly average, to finance their payment flows, but there is a penalty, in the form of a penal interest rate, if the reserve balance is drawn to below 50 percent of the required average, even for one day. There is an inter-bank market in leva, which operates in reasonable depth from same-day to 7-day deposits, but the availability of funds in that market is variable, with several days each month of potentially quite severe shortages (caused by tax payments). Moreover the access of the smaller banks to funds in the market is limited, even against collateral (the bulk of inter-bank deposits are un-collateralized). The only source of additional intra-day liquidity for the banking sector, to assist in the timely settlement of large-value same-day payments, comes from the legal obligation of the BNB to sell to the banks for same-day value leva against euro, where a bank has a sufficient euro balance on its account with the BNB.

29. **The BNB and the banks are in the process of implementing an RTGS system, which was originally planned to go live on September 16, 2002.** The mission emphasized that the implementation schedule for the RTGS system is extremely ambitious, and that in some key respects it is vulnerable to disruption. No rigorous steps appeared to have been taken to ensure that by September 16, 2002 all commercial banks would be ready, with the required software installed and fully tested, and tested across the entire membership, and with operational staff trained. More importantly, as noted in the previous paragraph, there are concerns about intra-day liquidity, and there is no certainty that the banks' treasurers are properly prepared for the task of managing the flows of their payments and receipts across their accounts with the BNB in real time throughout each day. Thus, the mission recommended that the BNB suspend its chosen implementation date, and to set a new date only when it could be certain that all the banks are in every key respect ready for the new system. *The BNB has delayed the start-up date of the RTGS to late first quarter 2003 and has taken into account the FSAP recommendations*.

F. Legal Framework and Infrastructure

Creditor Rights

30. **Bulgarian law does not provide creditors, secured and unsecured ones alike, with an effective mechanism for the enforcement of their claims.** The 1996 *Law on Secured Pledges* establishes a modern system for pledges on movables, receivables, and going concerns. However, the *Civil Procedure Code* foreclosure provisions can delay the enforcement of a valid claim. Particular attention should be given to replacing the foreclosure section of the *Civil Procedure Code* with a set of rules, which allow creditors, once a writ of execution has been obtained, to enforce their claims without delay. *While Parliament has recently passed amendments to the Civil Procedure Code to improve*

[10] The BNB is permitted by law to lend to a bank (against collateral, for up to 3 months) if, and only if, the value of its unsettled payments is such as to threaten major systemic problems. This is defined as a situation where a bank with more than 10 percent of the daily payment traffic is unable to settle its position, or where payments that have been queued unsettled for 3 days amount to 10 percent of the daily traffic.

certain provisions relating to enforcement, the Ministry of Justice (MoJ) is planning an overhaul of the 1952 Code. In addition, the MoJ is developing a proposal to establish specialized commercial courts. This would complement the overall program for judicial reform.

Insolvency

31. **Bulgaria's corporate insolvency law (Part IV of the *Commercial Code*) has not provided an efficient mechanism for the resolution of companies' financial difficulties in a way that does not unduly prejudice creditor rights**. Courts are not sufficiently predictable and expeditious, mostly at the expense of creditors. Causes for the courts' lack of efficacy include: deficient financial and human resources; lack of adequate professional training and specialization; and outdated systems of case and document management. Trustees' lack of experience, inadequate incentives, and poor monitoring have resulted in performance that is generally perceived as incompetent, corrupt, and unaccountable. *The CoM has recently approved draft amendments to Part IV of the Commercial Code for submission to Parliament. A program for improving selection and oversight of bankruptcy trustees has also been prepared. There is a two year program financed by Phare to improve the insolvency regime in Bulgaria.*

Corporate Governance

32. **From a corporate governance perspective, the *Commercial Code* has a number of important weaknesses that would enable asset stripping and share dilution.** The *Commercial Code* provides insufficient protection for minority shareholders, and includes provisions that have been abused in other transition countries: (i) shares may have disproportionate voting rights, rather than one-share one-vote; (ii) shareholders' meetings may be held with a quorum of as few as five percent of the capital; (iii) assets may be sold or transferred without approval of either the (supervisory) board or the shareholders' meeting; (iv) new capital can ignore pre-emption rights of existing shareholders; and (v) capital may be increased through in-kind contributions of uncertain value. The above provisions are prohibited under the LPOS, but the majority of the medium and large companies, including most banks and all insurance companies and pension insurance corporations, are not publicly traded and thus do not fall under the securities legislation. Furthermore, neither the *Commercial Law* nor the LPOS has a well-defined fiduciary responsibility for members of (supervisory) boards. *The CoM has submitted draft amendments to the Commercial Code to strengthen minority shareholder rights and corporate governance provisions.*

Anti-Money Laundering

33. **The authorities are taking action to further improve the implementation of effective AML/CTF policies and practices.** The Financial Investigations Bureau (FIB) has been placed under new management and is being reorganized to enhance its

effectiveness. Six additional analysts have been appointed, although five vacancies are still to be filled. Computer systems and databases to assist in tracing financial transactions are being upgraded. EU, UK and USAID funded technical assistance has been obtained for institution building and to further develop the FIB’s analytical tools. A steering committee has been created to improve coordination between the Bulgarian agencies involved in the AML/CTF area. *The CoM has submitted to Parliament a draft Law on Measures Against Terrorist Financing and draft amendments to the Law on Measures Against Money Laundering in line with international standards and good practices.*