BULGARIA

Report on the Observance of Standards and Codes (ROSC)

Prepared by:

Staff of The International Monetary Fund

ABBREVIATIONS AND ACRONYMS

ALII	-	Association of Licensed Investment Intermediaries
BGN	-	Bulgarian leva (new). On July 5, 1999 the lev was redenominated by removing three zeroes. As a result, one lev now equals one deutsche mark.
BNB	-	Bulgarian National Bank
BSD	-	Banking Supervision Department
BSE	-	Bulgarian Stock Exchange – Sofia Ltd.
COM	-	Council of Ministers
CP	-	Core Principle
DIF	-	Deposit Insurance Fund
ESA	-	European System of Accounts
GDDS	-	General Data Dissemination System
GFS	-	Government Finance Statistics
IAIS	-	International Association of Insurance Supervisors
IBA	-	Insurance Business Act
IFS	-	International Finance Statistics
IMF	-	International Monetary Fund
IOSCO	-	International Organization of Securities Commission
ISD	-	Insurance Surveillance Directorate
LBDG	-	Law on Bank Deposit Guarantee
LMAML	-	Law on Measures against Money Laundering
LMB	-	Law on Municipal Budgets
LoB	-	Law on Banks
LoBNB	-	Law on the Bulgarian National Bank
LoFX	-	Law on Transactions in Foreign Exchange Valuables and Foreign Exchange Control
MOF	-	Ministry of Finance
NAO	-	National Audit Office
NCI	-	National Insurance Council
NSI	-	National Statistical Institute
OTC	-	Over-the-Counter
SDDS	-	Special Data Dissemination Standard
SNA	-	System of National Accounts
SSEC	-	Securities and Stock Exchange Commission
SSEICA	-	Law on Securities, Stock Exchanges and Investment Companies

Overview

Bulgaria

Prepared by a staff team from the
International Monetary Fund
on the basis of information provided by the
Bulgarian authorities.

The International Monetary Fund
Prepared in August 1999 and reissued in March 2000

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Director
European I Department
700 19th Street, NW
Washington, DC 20431
202-623-7000
http://www.imf.org
email: scu-comment@imf.org

OVERVIEW

1. Since mid-1997, Bulgaria has implemented wide-ranging reforms under a comprehensive economic adjustment program. In July 1997, a currency board arrangement was adopted to anchor the stabilization strategy. Structural reforms have been initiated in all key areas, and they have resulted in accelerated enterprise privatization and restructuring, strengthened prudential regulations and banking supervision, improved public expenditure management and tax administration, and further price and trade liberalization.[1]

2. Within the context of the adjustment program, Bulgaria has made considerable efforts to improve the process of formulating economic policies and disseminating information on these policies and their outcomes to the public. The Bulgarian authorities have aimed at increased transparency in economic and social statistics, in fiscal, monetary, and financial policies, and in banking supervision. In addition, they have striven to adhere to international standards, often going beyond the disclosure elements, including in the area of financial policies. To these ends, laws and regulations have been revamped in the areas of statistics, banking supervision, deposit insurance, insurance supervision, securities market, and accounting, and further amendments are in the pipeline. Moreover, the 1999 budget included several expenditure and revenue-related reforms toward more transparent government operations.

3. This report considers Bulgaria's practices against a set of internationally accepted standards and codes. The coverage includes the core areas of IMF surveillance: data dissemination (considered against the *General Data Dissemination System*, GDDS); fiscal policy (considered against the *Code of Good Practices on Fiscal Transparency*); monetary and financial policies (considered against the *Code of Good Practices on Transparency in Monetary and Financial Policies*); and banking supervision (considered against the Basel Committee's *Core Principles for Effective Banking Supervision*). In addition, the report reviews transparency practices in deposit insurance, securities and insurance supervision.

4. On the basis of the review, it is evident that Bulgaria has made significant progress toward meeting internationally recognized standards in most areas. The country now disseminates generally good quality statistics in a timely manner, with comprehensive coverage in most sectors. Bulgaria's decision to participate in the GDDS is a significant step in improving data compilation and dissemination. In the fiscal policy area, a solid institutional and legal framework is in place, and the Ministry of Finance (MOF) has made significant efforts to improve the transparency of fiscal operations. With Bulgaria's currency board arrangement set out clearly in the legislation, monetary policy design and implementation are transparent, and the Bulgarian National Bank (BNB) provides high-

[1] For a full discussion of the adjustment strategy and its results, see the IMF Staff Country Report No. 99/26 ("Bulgaria: Recent Economic Developments and Statistical Annex," April 1999).

quality, timely, and comprehensive information about its operations. The country has a competent, professional staff in banking supervision, and a satisfactory legal and regulatory framework within which to supervise banks. Indeed, Bulgaria is fully or largely compliant with most of the 25 Basle *Core Principles for Effective Banking Supervision*. The deposit insurance system is transparent and in many respects conforms with best practices. The regulatory framework of the securities market is also transparent, and is being updated to better correspond to the International Organization of Securities Commissions (IOSCO) and European Union standards. Similar efforts are ongoing in insurance supervision where the framework is being revised to conform to that of the International Association of Insurance Supervisors (IAIS).

5. Nevertheless, further progress can be made. The key areas where improvements in transparency and observance of international standards could be made include the following:

- In data dissemination, while current data compilation and dissemination practices meet or exceed most GDDS recommendations, it would be desirable to address the remaining weaknesses in trade data, the measurement of output and inflation, details of fiscal data, and the dissemination of external debt data.

- In fiscal transparency, the government could explain more clearly the objectives and benefits of reforms in public finance. Building on significant progress already made, further steps should be taken toward a well-functioning Treasury system, and more progress is needed in ensuring uniform interpretation and enforcement of tax laws.

- In monetary policy, the autonomy of the BNB could be solidified by sharpening the criteria for removing the Governor and other members of the Managing Board. Moreover, the internal audit and control functions within the BNB should be developed, and a comprehensive code of conduct for BNB staff could be introduced.

- In banking supervision, further attention should be given to improving the banks' risk management, implementing consolidated supervision, and tightening the rules on collateral. Also, the procedures for examinations should be documented and made publicly available.

- In nonbank financial areas, efforts to move toward international standards, including through new legislation and regulations, should continue. The Deposit Insurance Fund's relationship with the BNB could be clarified. The Securities and Stock Exchange Commission (SSEC) could establish information sharing protocols with the relevant national and international agencies. It would also be important to pass the draft *Law on Public Offerings of Securities* which is broadly in line with international standards. An amendment to the *Insurance Act* to improve its consistency with international standards should be passed.

The IMF staff welcomes the initiatives that are in many cases already underway to achieve the intended improvements.

Data Dissemination

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DATA DISSEMINATION[1]

1. The principal standard against which the transparency of Bulgaria's macroeconomic data is assessed is the IMF's General Data Dissemination System (GDDS).[2] The GDDS focuses on (i) improving data quality through providing a framework for evaluating the need for data improvements and prioritizing such improvements, and (ii) providing guidance on data dissemination. The focus on data quality recognizes the fact that for many countries improvements in data quality are a necessary precursor to enhanced dissemination of data to the public. The features of the GDDS take account of the fact that substantial improvements in data compilation and dissemination practices take considerable time.

2. The GDDS places emphasis on sound practices in four dimensions: data coverage, periodicity, and timeliness; the quality of the disseminated data; the integrity of the disseminated data; and access by the public. The GDDS covers data in five sectors: real, fiscal, financial, external, and socio-demographic. The GDDS emphasizes the development of core statistical frameworks and indicators supplemented by encouraged data systems and indicators. Participation in the GDDS is voluntary; it requires a commitment to use the GDDS as a framework for statistical development, designation of a country coordinator, and preparation of metadata for posting on the Internet on the IMF's Data Standards Bulletin Board.[3] The structure of the GDDS provides a development path to subscription to the more demanding SDDS.

3. Bulgaria has committed to participate in the GDDS, has named a coordinator, and substantial progress has been made on the development of metadata.

A. Institutional Framework

4. Three agencies are primarily responsible for the production and dissemination of data covered by the GDDS—The National Statistical Institute (NSI), the Bulgarian National Bank, and the Ministry of Finance.

[1] Prepared by Mr. O'Connor and Mr. Sisson (both Statistics Department), in consultation with the Bulgarian authorities and European I Department. In preparing this chapter IMF staff held discussions with officials of the Bulgarian National Bank, the National Statistical Institute, and the Ministry of Finance.

[2] Information on the IMF's General Data Dissemination System and the related Special Data Dissemination Standard (SDDS) can be found on the IMF's Dissemination Standards Bulletin Board on the Internet at dsbb.imf.org.

[3] Metadata refers to information about the data, such as how data are compiled and disseminated, data coverage, periodicity, and timeliness, etc.

5. The NSI is the official statistical agency of Bulgaria and is responsible for production and dissemination of real sector and part of the socio-demographic data. The *Statistics Act* of June 25, 1999 governs the activities of the NSI as well as other statistical bodies. The Act does not specify the statistical areas covered by the NSI, but it does establish a National Statistical Council whose functions include coordination of statistical responsibility among agencies and the development of a long-term strategy for statistical development. The NSI disseminates data under the provisions of the *Statistics Law*, and the confidentiality of reporting is guaranteed. The dissemination policies and practices of the NSI closely follow the recommendations of the GDDS with respect to data integrity and access by the public. Data are released to the public and government officials simultaneously and advance release calendars are in an advanced planning stage. The NSI disseminates data primarily through press releases and hardcopy publications, but a new Internet web site is expected to be launched in late summer 1999, which will substantially expand the availability and transparency of data and explanatory materials.

6. The BNB compiles and disseminates data on the financial sector (broad money survey, central bank aggregates, and interest rates), and the external sector (balance of payments, total external debt, merchandise trade, international reserves, and exchange rates). Data on merchandise trade are also compiled by the NSI (based on the same input data), which disseminates them with more detailed classifications but lower periodicity. By law, the BNB has the right to require banks and others to report information, has the obligation to compile the balance of payments for Bulgaria, and must maintain the confidentiality of the individual reported information. BNB practices with regard to access and integrity are close to GDDS recommendations, and improvements are planned in the area of advance release calendars, which are not presently disseminated, and the dissemination of more detailed methodological notes. The BNB disseminates, as a public service, statistical data that it compiles on the financial and external sectors, along with selected summary statistical data compiled by the Ministry of Finance and the NSI in press releases, and/or publications, as well as on its web site (www.bnb.bg).

7. The Ministry of Finance operates under the provisions of the *Organic Budget Law* and is responsible for compiling and disseminating data for central government operations and, in conjunction with the BNB, central government debt. Data on bilateral government debt are not disseminated, since these data are considered state secrets. As a public service, through its publications the MOF compiles and disseminates on a monthly basis data on revenue and expenditure summaries, the overall budgetary position, and domestic and external financing, and in conjunction with the BNB, monthly data on domestic and external debt. It also provides summary updates of central government operations on a biweekly basis through press releases and a press conference by the Minister of Finance. To provide wider dissemination, the Ministry of Finance plans to post these data on a web site to be inaugurated in Fall 1999. While annual fiscal data are disseminated in Bulgaria for the main aggregates, detailed annual data which can be used for fiscal analysis are not.

B. Description of Practice

8. The production and dissemination practices for macroeconomic data in Bulgaria are summarized and compared with the recommendations of the GDDS in Table 1.

9. Real sector data for national accounts, producer and consumer prices, and production generally conform to the GDDS recommendations for coverage, periodicity, and timeliness. Annual and quarterly national accounts are produced according to the recommendations of the 1993 System of National Accounts (1993 SNA) and the 1995 European System of Accounts (1995 ESA), but only the annual data are widely disseminated. There are problems related to the coverage of economic activity in the national accounts measures, particularly relating to the non-observed economy, but these problems are acknowledged and measures are being taken to address them by improving response rates to surveys and improving indirect measures of underground activities. The producer price index and index of industrial production are compiled monthly and disseminated on a timely basis. A number of shortcomings in these indices including sampling response rates are currently being addressed, and revisions of the indices will be introduced in the coming year. The consumer price index is produced monthly following international guidelines, and on a timely basis. Timely monthly data are also produced for employment, unemployment, and wages. An NSI self assessment indicates that the compilation of the wage data is affected by methodological problems.

10. Financial sector data are produced and disseminated according to the coverage, periodicity, and timeliness recommendations of the GDDS. Data for the banking system meet the coverage recommendations for the broad money survey, and detailed data are disseminated for the accounts of the BNB and the commercial banks. Separate information is provided in the monetary survey for positions of banks in liquidation. This substantially increases the transparency of the monetary data, as credit and deposits of operating banks can be isolated from banks that have been closed. A wide range of interest rate data are also disseminated.

11. The external sector data meet the GDDS data dissemination recommendations for coverage, periodicity, and timeliness. Improvements are planned in compilation procedures of selected current (transportation and travel) and financial (private sector data) transactions. The MOF and the BNB compile and disseminate monthly data on external debt, and will begin compiling International Investment Position data before the end of 1999.

12. Fiscal sector data are produced monthly according to the recommendations of the GDDS for coverage, periodicity, and timeliness. The use of biweekly press releases and related press conferences by the Minister of Finance provides wide dissemination of budgetary operations on a timely basis, which is expected to improve further with development of a Ministry of Finance web site in Fall 1999. However, detailed annual data for the fiscal sector are not disseminated in Bulgaria. Comprehensive, detailed annual data are compiled and sent to the IMF for publication in the GFS Yearbook, but such data are not currently disseminated locally.

C. IMF Staff Commentary

13. Bulgaria has made good progress in improving the transparency of its statistical system. In the recent past, the statistical system was oriented to support government policies, and the steps being taken to move toward an independent data dissemination system which could be used to identify government priorities represent a major departure from past practices. In recent years the authorities have moved to improve the scope, timeliness, and public access to economic data; more importantly, the production and dissemination process has improved data integrity. Advance access by government officials to unreleased data has been limited, and the use of advance release calendars to promote good data dissemination practices is being developed. The authorities have started to utilize press releases and the Internet to expand the scope and timeliness for public dissemination of official data, and see this expanding in the near future.

14. Bulgaria's decision to participate in the GDDS is a significant step in improving the compilation and dissemination of data. While current data compilation and dissemination practices meet most GDDS recommendations, and in many cases go beyond them, other areas still need attention. In particular, trade data, usually among the most reliable balance of payments components, have been subject to prolonged and large adjustments, which create significant balance of payments revisions and complicate external sector analysis. In regard to the national accounts, despite the development of a sound methodological foundation for data collection, including recent improvements in developing a true industrial production index, Bulgaria still shares many of the survey reporting problems in measuring output and inflation common to transition economies, impairing the monitoring of real sector developments. In the fiscal sector, the current data reporting system does not provide an adequate basis for the analysis of structural issues, and the authorities should persevere in their plans to move from a system which focuses on financial management to a well-functioning Treasury system. Finally, the transparency of external debt data could be improved by disseminating a broader range of information on external debt, including bilateral debt.

Table 1. Bulgaria: Data Categories and Indicators

Data Categories	Indicators	Periodicity (GDDS recommendations)	Timeliness (GDDS recommendations)
Real sector			
National accounts aggregates	GDP (nominal and real) Gross national income Gross national saving	Annal and Quarterly (annual)	110 days (6–9 months) 3 months
Production index/indices	Manufacturing or industrial	Monthly (monthly)	One month (6 weeks–3 months)
Price indices	Consumer price index Producer price index	Monthly (monthly) Monthly (monthly)	10 days (1–2 months) 1 month (1–2 months)
Labor market indicators	Employment index Unemployment Wages	Monthly Monthly Monthly (annual for all)	6–7 weeks 2 weeks 6–7 weeks (6–9 months for all)
Fiscal sector			
Central government budgetary aggregates	Revenue, expenditure, deficit, financing	Monthly (quarterly)	1 month (1 quarter)
Central government debt	Domestic and foreign debt	Monthly (annual)	1 month (1–2 quarters)
Financial sector			
Broad money and credit aggregates	Net external position, domestic credit, broad or narrow money	Monthly-summary weekly (monthly)	1 month (1–3 months)
Central bank aggregates	Reserve money	Weekly (monthly)	5 days (1–2 months)
Interest rates	Short and long-term government securities rates Policy variable rate (not in use) Lending and deposit rates	Monthly-base rate weekly (monthly)	Disseminated in monthly bulletin
Stock market	Not significant at this time	n.a.	n.a.
External sector			
Balance of payments aggregates	Imports and exports of goods and services, income, current transfers, current account balance, reserves, overall balance	Monthly (annual-quarterly strongly encouraged)	8 weeks (6 months)
International reserves	Gross official reserves denominated in BGN Gross official reserves denominated in (US$) (Euros)	Weekly (monthly)	1 day (1–4 weeks)
External debt	Total external debt	Monthly (no specification)	5 weeks (no specification)
Merchandise trade	Total exports and total imports	Monthly (monthly)	8 weeks (8 weeks–3 months)
Exchange rates	Spot rates	Daily (daily)	Same day

Fiscal Transparency

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FISCAL TRANSPARENCY[1]

1. This chapter provides an assessment of fiscal management practices in Bulgaria against the requirements of the IMF's *Code of Good Practices on Fiscal Transparency—Declaration on Principles* (available on the IMF web site at http://www.imf.org/external/np/fad/trans/code.htm). The Code identifies desirable transparency practices for governments in their conduct of fiscal policy. Following the Code, this chapter focuses on: clarity of roles and responsibilities; availability of information on fiscal activities; openness in budget preparation, execution, and reporting; and integrity of fiscal information.

2. In making public the objectives of fiscal policy, the government enhances the public's understanding of what it is seeking to achieve, and provides a context for articulating its own policy choices, thereby contributing to the effectiveness of fiscal policy. Further, by providing the private sector with a clear description of the considerations guiding fiscal policy decisions, transparency about the policy process makes the fiscal policy transmission mechanism generally more effective, in part by ensuring that market expectations can be formed more efficiently. By providing the public with adequate information about its activities, the government can establish a mechanism for strengthening its credibility by matching its actions to its public statements.

A. Description of Practice

Clarity of roles and responsibilities

3. The role of the government is defined in the Constitution, the laws on state and municipal property, and in the government's medium-term program (*Agenda 2001*). The 1991 Constitution delineates the distribution of powers between the National Assembly and the Council of Ministers (COM). The Constitution also contains rules concerning the National Audit Office, control of the execution of the State Budget, and the budgetary autonomy of the municipalities. The distribution of powers between the National Assembly and the COM is further specified in the 1996 *Law on the Structure of the State Budget* (*Organic Budget Law*). This law defines the scope and the structure of the state budget, including its subdivision into several sub-budgets. Other laws, including the *National Audit Office Act* and the *State Financial Control Act,* further define the legislative framework of

[1] Prepared by Mr. Kähkönen and Mr. Horváth (both European I Department) and Mr. Cangiano, Mr. Allan and Mr. Tandberg (all Fiscal Affairs Department), in consultation with the Bulgarian authorities. In preparing this chapter, IMF staff held discussions with officials of the Ministry of Finance, and reviewed the relevant legislation and regulations (including the *Organic Budget Law*, the annual *Budget Laws* for 1998 and 1999, and the draft *Tax Procedure Code*) and the Government's medium term program *Agenda 2001*. The report also draws heavily on the answers to a questionnaire on transparency practices prepared by the staff of the Ministry of Finance.

the budget. The National Assembly approves the state budget and the budgets of the National Social Security Institute and the National Health Insurance Fund. The other extrabudgetary funds, as well as the budgets of the municipalities, are controlled indirectly through the parliamentary approval of subsidies and legislation governing their tax powers and other sources of revenue. Most central spending units and municipalities have extrabudgetary accounts for donations; while at present there is little central control over these accounts, the establishment of a new Treasury system is expected to enhance this control significantly from the beginning of 2000. The currency board arrangement places strict limits on the government's options for financing the budget. This arrangement is clearly defined in the *Law on the BNB* (see Chapter IV). A recent COM decree has established the main criteria for granting state guarantees, as well as a mechanism for identifying priorities in assuming these guarantees. Finally, the regulation of the non-bank private sector is covered in functional and sectoral legislation.

4. Taxation is based on the *Tax Procedure Code*, laws on specific taxes (the *Corporate Income Tax Law*, the *Personal Income Tax Law*, the *VAT Law*, the *Excise Duty Law*, and the *Law on Local taxes and Fees*), the *Budget Laws*, the *Civil Procedures Code*, the *Trade Act*, and the *Contracts and Obligations Law*, and laws on specific taxes. Tax administration is being reformed in accordance with the Tax Procedure Code which will enter into force on January 1, 2000. This reform is aimed at strengthening the interpretation and enforcement of tax laws and at streamlining procedures for taxpayers.

5. Fiscal relations between the central government and the municipalities are covered in the *Organic Budget Law* and the *Law on Municipal Budgets* (LMB). The LMB broadly defines municipal budget jurisdiction, and clearly identifies municipal revenue sources and financial resources that municipalities receive from the republican budget. Specific and general subsidies are set annually based on a specified methodology. The LMB gives municipalities protection from changes in central government policy and allows for compensation if changes made to the budget law affect municipal expenditures. Despite the enhanced status of municipalities in the budget process, the central government retains control. The LMB remains vague on the allocation process for state transfers and the role of sectoral ministries in defining expenditure priorities. It mentions that the draft budget should incorporate "suggestions put forward by the ministries concerning structural changes in their systems in keeping with the independence of the municipal budget," but does not specify the level of autonomy municipalities have in determining the allocation of funds across facilities and expenditure types.

6. Fiscal control and transparency of extrabudgetary funds and accounts have improved in 1999 as the number of such accounts was reduced significantly and the central spending units began making their payments through a single treasury account. The Ministry of Finance has carried out a survey of all government bank accounts to ensure that budgetary funds are transferred to the single account as required and not redirected to special-purpose accounts held by the spending units. Additional improvements are planned for 2000, including further consolidation of extrabudgetary funds and accounts into the budget on a gross basis.

7. The delineation between government and the rest of the economy is changing with ongoing privatization. The government's privatization strategy is set out in the annual program approved by the COM and implemented by the Privatization Agency and the line ministries. The privatization strategy is available on the agency's web site in English. The rules for privatizing firms under this strategy are generally clear. For enterprises that are not included in the current program (those that handle infrastructure and military-related businesses) alternative plans, typically involving restructuring, are being developed and implemented.

Public availability of information

8. Fiscal information is made publicly available in biweekly, monthly, quarterly, and annual publications prepared by the Ministry of Finance and the Bulgarian National Bank, as well as in the IMF's Government Finance Statistics and International Finance Statistics pages. A highly aggregated report of the consolidated budget, based on cash flows from the central budget, is included in Ministry of Finance's monthly publication. Detailed information on the previous year's outturn is given to the National Assembly together with the draft budget. This information is published with a reasonable lag in *The Budget* (a monthly publication of the MOF) and in the press. In 1999, the COM distributed an informative pamphlet about the budget to all households in Bulgaria. Data on contingent liabilities, tax expenditures, and quasi-fiscal activities are not published, but are available to the National Assembly. The MOF, jointly with the BNB, publishes a detailed monthly survey of domestic and external debt. A soon-to-be-launched MOF web site is expected to become an important information channel.

Open budget preparation, execution, and reporting

9. The fiscal policy objectives and the macroeconomic framework that underlie the budget are defined in the MOF's internal budget preparation documents. The objectives and the framework are to some extent also reflected in the budget report submitted to the Economic Commission and Budget Commission in the National Assembly, although they are not published in detail. The budget report includes estimates for the current year and forecasts for the core macroeconomic indicators and the budget for the next three years. There are no long-term economic projections in the budget documents, the macroeconomic framework does not include indicators related to tax expenditures and quasi-fiscal operations, and there is no comprehensive analysis of overall fiscal risks.

10. Arrears to the budget are now made transparent. While some municipalities and state-owned enterprises continue to have overdue obligations, these are gradually being cleared. The government's strategy toward reducing arrears focuses on the restructuring of state-owned monopolies which have accumulated the largest arrears.

11. Budgetary execution is defined in the *State Finance Control Act*, the *Organic Budget Law*, annual budget laws, annually adopted COM decrees on budget implementation, and in various regulations on the implementation of the budget issued by the MOF and usually valid

for the current budget year. The funds of first-level spending units are managed through the Single Account System established in January 1999. The MOF issues monthly spending limits to the FLSUs which in turn are responsible for the control of the spending of subordinate units.

12. The National Audit Office, created in 1995, participates in the discussions and adoption of the annual state budget acts in the National Assembly, monitors compliance by all spending units with budget laws and regulations, and is responsible for assessing the reliability of the reports of all spending units. The reports of the state budget, the National Social Security Institute, and (from 2000) the Health Insurance Fund are approved by the National Assembly. The National Accounting Office audits these reports and presents the results to the National Assembly. The accounting reports focus on the financial position of these entities. There is little or no emphasis on measuring results achieved against objectives. Budget accounting is currently on a cash basis. In the central government and some other institutions there are additional systems for monitoring certain items, such as tax arrears, on an accrual basis.

Independent assurances of integrity

13. Mechanisms to ensure the integrity of data and budget processes have been established. The National Audit Office is independent from the executive branch of government; in particular, the National Assembly elects its chairman and members. The NSI is assured of technical independence under the *Law on Statistics*. The Agency for Economic Analysis and Forecasting, a semi-independent institution, carries out much of the macroeconomic analysis and forecasting. Its projections are open for external review, but there are no formalized arrangements to carry out such reviews.

B. IMF Staff Commentary

14. Over the past few years, the Bulgarian authorities have taken significant steps to improve fiscal transparency. Many reforms are already firmly established within the fiscal management framework. A number of additional measures are under implementation or being planned.

15. Discussions with the authorities have revealed some areas where Bulgaria could build on this progress to achieve additional improvements in fiscal transparency:

- The government should strengthen ongoing efforts to explain the objectives and benefits of the reforms in public finance. These reforms have broad implications across the public sector and the whole economy, but there is currently limited knowledge and understanding of the reforms among many who will be influenced by them. The reforms could be presented in the context of a comprehensive strategic vision, outlining the long-term results of the reforms and their impact on the government, the private sector, and the public.

- The relative roles of the government and the private sector in the longer term could be elaborated and clarified, especially the government's strategy toward state-owned enterprises in the energy and other infrastructure areas.

- The establishment of a modern internal audit function in the context of the new Treasury system would make financial management more efficient and transparent. Setting up mechanisms for evaluating and monitoring budget expenditure, including detailed in-year reporting, could help to improve the quality of these expenditures. Strengthening procurement processes would improve transparency, reduce the risk of corruption, and enhance the quality of public expenditures.

- Also in the context of the new Treasury system, the government should develop a new and comprehensive accounting framework that provides for both cash- and accrual-based accounting reports. Budget classification should be brought into line with ESA 95. The program to establish a comprehensive computerized accounting system, with a view to generating timely and reliable data on all stages of the payments and receipts process, should be implemented.

- The budget report to the National Assembly would be improved further by the inclusion of a more complete description of the macroeconomic framework, assumptions and risks related to revenue and expenditure assessments, and the government's expenditure programs, priorities, and objectives. It should also give a more complete picture of the consolidated government, in particular the municipalities and the remaining extrabudgetary funds and accounts.

- Transparency can be enhanced by assessing and publicizing long-term fiscal sustainability, all contingent liabilities, as well as tax expenditures and quasi-fiscal arrangements. These assessments should include close monitoring and scrutiny of state guarantees and interactions with state-owned enterprises.

- Current macroeconomic models that underlie the budget preparations should be documented in more detail and be made more open for external scrutiny.

- Further progress is needed in ensuring uniform interpretation and enforcement of tax laws.

- The budget report should be published and distributed more broadly. It could be made available to subscribers and be posted on the Ministry of Finance web site. A shorter, summary version could be distributed very widely, as is the practice in many countries.

- As the present monthly publication by the Ministry of Finance is primarily directed at financial management personnel in the spending units, the scope of this publication should be expanded. Alternatively, it could be supplemented by another publication with a broader focus.

- A formal public commitment should be made to promote transparency and provide financial information, and to establish and announce a detailed schedule for publishing key economic data. The Ministry of Finance web site could be used for this purpose.

Transparency of Monetary Policy

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TRANSPARENCY OF MONETARY POLICY[1]

1. The following considers the transparency practices of Bulgaria in the area of monetary policy as they relate to the broad principles underlying the IMF's *Code of Good Practices on Transparency in Monetary and Financial Policies* (available on the IMF web site at http://www.imf.org/external/np/mae/mft/code/index.htm). The Code identifies desirable transparency practices for central banks in their conduct of monetary policy. Following the Code, this chapter focuses on: the clarity of roles, responsibilities, and objectives of the central bank; the processes for formulating and reporting of monetary policy decisions by the central bank; public availability of information on monetary policies; and accountability and assurances of integrity by the central bank.

2. In making the objectives of monetary policy public, the central bank enhances the public's understanding of what it is seeking to achieve, and provides a context for articulating its own policy choices, thereby contributing to the effectiveness of monetary policy. Further, by providing the private sector with a clear description of the considerations guiding monetary policy decisions, transparency about the policy process makes the monetary policy transmission mechanism generally more effective, in part by ensuring that market expectations can be formed more efficiently. By providing the public with adequate information about its activities, the central bank can establish a mechanism for strengthening its credibility by matching its actions to its public statements.

A. Description of Practice

Clarity of roles, responsibilities, and objectives

3. The objectives and institutional framework of monetary policy are defined in laws and regulations. With effect from July 1, 1997, Bulgaria adopted currency board rules embodied in a new *Law on the Bulgarian National Bank* (LoBNB). The exchange rate is fixed to the euro, and can only be changed by an act of the National Assembly to change the law. The BNB's purpose is to "contribute to the maintenance of the stability of the national currency," and the currency board provisions of the Law explicitly ensure the achievement of

[1] Prepared by Mr. Kähkönen and Mr. Feyzioðlu (both European I Department) and a team from the Monetary and Exchange Affairs Department of the IMF led by Mr. Coats, in consultation with the Bulgarian authorities. In preparing this chapter, IMF staff held discussions with officials of the Bulgarian National Bank, the Public Debt Department of the Ministry of Finance, the Bankers' Association, and representatives of five banks, and reviewed the *Law on the Bulgarian National Bank*, *Law on Banks*, *Law on Bank Deposit Guaranty* and other laws and regulations published in *Banking Laws and Regulations*, Bulgarian National Bank, July 1999 (available in English and Bulgarian). The report also drew heavily on the answers to a questionnaire on transparency practices prepared by the staff of the BNB.

that objective. The autonomy of the BNB in conducting monetary policy is further protected by the provisions of the LoBNB for appointing and removing the Governor and the Managing Board. The Governor is elected by the National Assembly as are the three Deputy Governors from the recommendations of the Governor. The other three non-executive members of the Managing Board are appointed by the President of the Republic. All seven members service for (staggered) six-year terms and can only be removed for good cause as defined in the LoBNB. The central bank and persons authorized by it may not be held liable for damages caused while exercising their supervisory powers unless they acted with intent.

4. In addition to its monetary policy function, the BNB also is empowered by the LoBNB to assist in the establishment and functioning of efficient payment mechanisms, to regulate and supervise banks, and has the exclusive right to issue banknotes and coins in Bulgaria.

5. The institutional relationship between the BNB and the government is defined in explicit agreements between them and in the laws. As stipulated in the LoBNB, the BNB may extend credit to the government only against purchases of SDRs from the IMF as part of a stabilization program supported by the IMF. Otherwise, the BNB is not permitted to buy or sell government securities or any other securities issued by residents. The distribution of the BNB's net income to the government is also provided for in the LoBNB, and the actual distribution of net income is reported in the BNB's Annual Report. The BNB operates the primary sales and registers the secondary sales of government securities as agent of the MOF in accordance with agreements between the two. In addition, the BNB registers, monitors, and services foreign and domestic public debt as agent of the government. The market is given all relevant information on a timely basis about government borrowing plans and auction outcomes (in the Ministry of Finance and BNB Monthly Bulletin on Government Debt Management, and the BNB monthly bulletin on Secondary Market of Government Securities). Finally, the BNB is the government's official depository and provides payment services for the government, but is explicitly prohibited from charging for them, except for payments related to public debt. Accordingly, the MOF pays fees to the BNB for maintaining the debt registry and for making debt service payments. The BNB, jointly with the Ministry of Finance, has selected banks from the list of primary dealers to act as (subcontracted) depositors and to provide payment services for the government.

Open process for formulating and reporting policy decisions

6. Within the currency board arrangement, where the BNB must fully back all of its monetary liabilities with euros, the BNB has one policy instrument (reserve requirement) and a limited lender of last resort facility. The level of the reserve requirement, which is defined in *BNB Regulation No. 21*, can be changed, but this instrument is not expected to be used actively, except in the event of a liquidity crisis. The lender of last resort facility is established in *BNB Regulation No. 6,* which includes explicit conditions of lending to banks. Since the adoption of currency board rules, the reserve requirement ratio has not been changed, and the lender of the last resort facility has not been utilized. The distribution of the government's deposits between the BNB and banks is determined by the MOF.

Public availability of information

7. Extensive publications on the activities of the BNB are available to confirm the fulfillment of the BNB's obligations under the currency board arrangement. The BNB publishes the balance sheet of its monetary operations for each week on Tuesday of the following week. Detailed balance sheets for the BNB are published monthly generally by the following month, but without an explicit time table. A semi-annual summary balance sheet for the first half of the year is published in September. Summary audited balance sheets are published in the BNB's Annual Report to the National Assembly in April. Detailed information on the foreign exchange operations and position of the BNB, and the totality of its monetary operations, are reported weekly, monthly, quarterly, semi annually and annually. These and other data can be found on the BNB's web page (www.bnb.bg). The same web page also contains the laws and regulations relevant to its operations.

8. The BNB also publishes occasional analytical papers, press releases, information brochures, and other educational material (many of them in English), and its officials make frequent appearances on TV and in other public forums.

Accountability and assurances of integrity for monetary policy

9. The LoBNB includes articles to assure public accountability for activities related to monetary policy. Officials of the BNB are required to report to the National Assembly on the activities of the BNB and to share information with the Council of Ministers. In addition, the BNB's internal procedures and controls, while still requiring further development, have now been documented in Mission Statements, and functions for each unit. The statements are available to the public. Finally, information on the expenses and revenues in operating the BNB are submitted to the National Assembly, examined by the National Audit Office, and published in the official gazette.

10. The LoBNB stipulates that members of the Managing Board must report their, and their families', property status and other interests. The declarations shall be kept in a special register at the BNB. Although the rules for the register are public, the information in the register is not. There is no corresponding register for other BNB staff, and no formalized "Code of Conduct," though the LoBNB binds all employees of the BNB to sign declarations that they will observe the law, properly perform their functions, and keep bank and trade secrecy.

B. IMF Staff Commentary

11. The currency board arrangement is clearly and explicitly set out in the LoBNB. As a result, monetary policy design and implementation are transparent. The BNB provides the public with all important monetary policy information on a timely basis and it is of good quality. The financial results of the BNB's operations are published regularly in accordance

with international accounting standards and its officials report regularly to the National Assembly and to the public. The BNB's internal standards of conduct for members of the Managing Board are fully established and are available to the public. The monetary policy activities of the BNB meet high standards of transparency.

12. Nevertheless, there is room for improvement in the following areas:

- While the Managing Board's role and composition are clearly laid out in the LoBNB, the autonomy of the BNB can be solidified by sharpening the criteria for removing the Governor and other members of the Managing Board to prevent potential abuse. Best practices would also recommend that the BNB budget be approved by its Board rather than the National Assembly. In either case the budget should be published and its implementation audited.

- The costs and benefits of holding funds on behalf of the MOF and providing payment services could be made more transparent. Currently, the BNB is explicitly prohibited to charge for the services rendered as the government's official depository and for providing payment services, except for those related to public debt. In return, the BNB pays the MOF less than market rates on its deposits. This cross subsidy distorts incentives.

- The selection criteria for determining which banks are allowed to act as depositories and provide payment services for the government should be publicly available.

- While the reports on the BNB's activities are comprehensive and the information is timely, the BNB should establish exact deadlines for the publications of each report, and should hold its staff accountable for meeting the deadlines.

- With regard to internal procedures, the impressive progress made over the past year should continue so that earlier traditions of secrecy and arbitrary use of management authority can be fully overcome. There is an urgent need for further development of internal controls and audit within the BNB, including a modern system for budget preparation and monitoring.

- A comprehensive BNB Code of Conduct for its staff should be introduced, to establish explicit and transparent standards.

Banking Supervision

Bulgaria

Prepared by a staff team from the International Monetary Fund on the basis of information provided by the Bulgarian authorities.

The International Monetary Fund
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Queries/Comments should be directed to:
Director
European I Department
700 19th Street, NW
Washington, DC 20431
202-623-7000
http://www.imf.org
email: scu-comment@imf.org

BANKING SUPERVISION[1]

1. The following reviews banking supervision practices in Bulgaria. The first two sections consider the financial policy transparency practices of Bulgaria in the area of banking supervision as they relate to the broad principles underlying the IMF's *Code of Good Practices on Transparency in Monetary and Financial Policies* (available on the IMF web site under http://www.imf.org/external/np/mae/mft/code/index.htm). The Code identifies desirable transparency practices for central banks (or other regulatory bodies) in their supervision of banks. Following the Code, these sections focus on: clarity of roles, responsibilities and objectives of the BNB in the area of banking supervision; the processes for formulating and reporting supervisory decisions by the central bank; public availability of information on supervision policies; and accountability and assurances of integrity by the central bank. The last section provides a summary of the IMF staff's views on the extent to which domestic practices are consistent with the *Basle Core Principles of Effective Banking Supervision*.

2. Transparency by bank supervisors, particularly in clarifying their objectives, should contribute to policy effectiveness by enabling financial market participants to assess better the context of bank supervision, thereby reducing uncertainty in the decision making of market participants. Moreover, by enabling market participants and the general public to understand and evaluate bank supervision policies, transparency is likely to be conducive to good policymaking. This can help to promote financial as well as systemic stability. Transparent descriptions of the policy formulation process provide the public with an understanding of the rules of the game. The release of adequate information to the public on the activities of bank supervisors provides an additional mechanism for enhancing the credibility of their actions. There may also be circumstances when public accountability of decisions by bank supervisors can reduce the potential for moral hazard.

3. The Basle Core Principles represent the basic elements of an effective supervisory system. They are comprehensive in their coverage, addressing the preconditions for effective banking supervision, licensing and structure, prudential regulations and requirements, methods

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[1] Prepared by Mr. Kähkönen and Mr. Feyzioðlu (both European I Department) and a team from the Monetary and Exchange Affairs Department of the IMF led by Mr. Coats, in consultation with the Bulgarian authorities. In preparing this chapter, IMF staff held discussions with officials of the BNB, the Securities and Stock Exchange Commission, the Deposit Insurance Fund, the Ministry of Finance, and the Bankers' Association, and with bankers and representatives of the accountancy and auditing firms. The staff reviewed the *Law on the Bulgarian National Bank*, the *Law on Banks*, the *Law on Bank Deposit Guaranty* (LBDG), the *Law on Measures against Money Laundering* (LMAML), and other laws and regulations published in *Banking Laws and Regulations*, Bulgarian National Bank, July 1999. This chapter also draws on the BNB's answers to a questionnaire on *Good Transparency Practices for Financial Policies by Financial Agencies* and on an IMF assessment of the BNB's observance of the *Basle Core Principles for Effective Banking Supervision*.

of ongoing banking supervision, information requirements, formal powers of supervisors and cross-border banking.

A. Description of Practice

Clarity of roles, responsibilities, and objectives

4. BNB is the sole supervisor of banks. Its role as supervisor is clearly stated in the LoBNB: "The Bulgarian National Bank shall regulate and supervise other banks' activities in this country for the purpose of ensuring the stability of the banking system and protecting depositors' interests." The role, responsibilities, and powers of the BNB in performing its supervisory role are mainly provided for in the LoBNB, the LoB, and the regulations governing its implementation. Also the *Law on Securities, Stock Exchanges and Investment Companies*, the *Bank Deposit Insurance Law*, the *Law on Measures against Money Laundering* and the *Law on Transactions in Foreign Exchange Valuables and Foreign Exchange Control* (LoFX) are applicable to some extent. These laws and regulations are reproduced, in Bulgarian and English in *Banking Laws and Regulations*, Bulgarian National Bank, July 1999, and they are available on line. The BNB also monitors the transactions in foreign instruments of payment of finance houses and exchange bureaus.

5. As the LoBNB and the LoB make clear, the banking supervision function is performed by the Banking Supervision Department (BSD) which is a part of the BNB, an autonomous central bank. Hence, the basic provisions of autonomy and accountability of the BNB (discussed in Chapter IV) cover those of the BSD as well. Moreover, the BSD has a degree of autonomy within the BNB. The LoBNB states that the Deputy Governor responsible for banking supervision, in exercising his supervisory powers, "shall apply, separately and at his own discretion, the remedial actions and penalties as provided for by law. Granting and revoking a bank permit (license) shall require a decision by the Governor, taken on a motion by the said Deputy Governor."

6. The relationships between the BNB and the following agencies on supervising financial institutions are regulated by law: The Committee on Securities and Stock Exchanges, the Bank Deposit Insurance Fund, and the Ministry of Finance. There is no explicit provision in the LoBNB regarding relations with the Insurance Supervision Directorate. However, the LoBNB includes a general provision about cooperation between government authorities, which is interpreted by the BNB to apply, e.g., to cooperation with the insurance supervisor. Moreover, the *Regulation on the Structure and Operations of the Insurance Supervision Directorate* covers such cooperation. The legislation on relationships between various supervisors and other agencies, inter alia, defines to what extent secret information may be exchanged between these agencies.

Open process for formulating and reporting policy decisions

7. The regulatory framework for banking supervision is spelled out in detail in the LoB and in the LoBNB. The BNB has issued a number of regulations, guidelines and instructions in

order to transform the general framework into operative policies and procedures. The BNB also issues instructions to banks and nonbank financial institutions on BNB requirements, providing unified enforcement practices and interpreting disputable regulatory provisions. The BNB maintains an Internet web site, where information on all its normative acts is presented (www.bnb.bg).

8. The reporting requirements by banks for banking supervision purposes are based on the LoB. The rules and procedures for reporting are established by the BNB and presented in the general instruction circulars that are sent to the banks for preparing specific reports. Sample forms and guidelines are attached to the circulars. Banks must also comply with the *Accountancy Law* and with National Accounting Standards, for which the BNB issues interpretations. The BNB's regulations for prudential reporting are publicized, including, e.g., the format for the reporting forms. Highly technical documents such as detailed instructions for filling in the reporting forms are not actively published, but are available upon request.

9. The BNB conducts on-site examinations and assigns CAMELS[2] ratings to banks as an integral part of its supervision. For these purposes it has developed (and continues to refine) an examination manual. Neither the manual nor the results of on- and off-site examinations are publicly available.

10. The LoB states that the BNB may require banks to pay charges for administrative supervisory services. The charges are to be decided by the BNB´s Management Board. So far, the BNB only levies charges for granting banking permits and for issuing certificates ascertaining qualification and professional experience in banking. The exact amount of such charges is stated in the BNB regulations.

11. There are legal provisions for information sharing between domestic authorities. However, there are no formal arrangements, such as MoUs, governing these arrangements. The *Law on Bank Deposit Guarantee* provides a mechanism for the exchange of information between the BNB and the Deposit Insurance Fund and for performing inspections in relation to the deposit insurance law. The LoB and other laws set forth procedures for performing joint examinations such as are presently conducted between the BNB and the Securities and Stock Exchanges Commission (SSEC), exchange of information and consultations between the BNB and the MOF, and through the Financial Intelligence Office. The BNB and the MOF also have legal powers to jointly oversee compliance of the foreign exchange regime. The BNB, MOF and the Securities Commission work jointly on a committee that decides on the approval of primary dealers for government securities. The LoB provides the mandate for the BNB, in exercising its supervisory powers, to conclude agreements with other central banks or foreign supervisory bodies for the mutual exchange of information. So far, no such agreements have been concluded. Cooperation is reported, by the BNB, to function well on an informal basis.

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[2] "S" in the Bulgarian framework stands for "systemic," i.e., evaluating the impact of macroeconomic developments on banks.

12. The BNB informs the banks and the Bankers' Association about proposed changes in prudential and other regulations, and the Bankers' Association is invited to comment, through a consultative procedure, on such proposals. When relevant, discussions are also held with representatives of other financial agencies.

Public availability of information on supervision policies

13. The BNB publishes a number of reports on the condition of the banking sector. The LoBNB obliges the BNB to present to the National Assembly twice a year a detailed report on its activities as well as an Annual Report. Both reports are comprehensive and contain both statistical and qualitative information on the financial system and measures taken by the BNB. The reports are published. These reports contain a large number of data and indicators on financial market factors, and aggregate data for banks grouped into categories, such as on distribution of assets and liabilities, capital ratios, and on risk exposure ratios. The BNB also publishes a monthly Information Bulletin on the development of the financial system and of financial policy decisions taken by the BNB. Individual bank financial statements, together with information on management and shareholders, will be published in the Bulletin starting in the Fall of 1999. Data are published in the Bulletin with a time-lag of about 1 ½months from the reporting date.

14. As banking supervision is conducted by the central bank, the provisions for publishing the BNB's financial statements are discussed in the chapter on monetary policy.

15. All laws and regulations regarding banking are published in the State Gazette, annual reports, and on the BNB´s Internet web site. In the event of major changes, these are explained in press conferences held by BNB management. The BNB issues and regularly updates a compendium on all banking laws and regulations.

16. The BNB has no formal responsibility for consumer protection issues. However, the central bank receives and reacts to complaints from bank clients. There is no public announcement about the BNB´s procedures as to consumer complaints, or of the BNB´s actions based upon complaints. The LoB sets out rules on banks' relations with their customers, such as that banks must publicize their conditions for receiving deposits and making loans.

Accountability and assurances of integrity by the BNB

17. When the National Assembly discusses issues related to the BNB´s competencies, the Governor and the relevant Deputy Governor take part in the discussion. Sessions of the National Assembly, and some meetings of its sub-committees are open to the public and reported in the media.

18. In addition to the accountability clauses applicable to the BNB in general (see the corresponding section in the monetary policy chapter), it follows indirectly from the LoB and the LoBNB that BNB staff may not have financial interests in the banks they supervise. Supervisory staff must report to the appropriate body in the BNB about their interests, such as equity holdings, in financial institutions. The LoBNB binds all employees of the BNB to sign

declarations that they will observe the law, properly perform their functions, and keep bank and trade secrecy. The LoB imposes restrictions on loans granted by banks to persons who supervise the banking system.

B. IMF Staff Commentary

19. Bulgaria's transparency practices in the area of banking supervision is overall quite good and, with a few exceptions, in line with international best practices. Of the still remaining weaknesses which have been identified by IMF staff, the following are the most important ones:

- The procedures for on-and off-site examinations should be documented in a manual which should be publicly disclosed. To this end, current efforts to develop a manual for onsite examinations, which would allow the banks to see the rules of the game, should continue.

- The quality of the considerable data reported by the BNB has improved substantially in the last year, but the reports and analysis of the data should be further improved. Specifically, the quarterly compliance report could be made shorter and more pointed, and a new report could be produced on the condition of the banking sector and the factors affecting and likely to affect it.

- The relationships between the BNB and other financial agencies should be defined in a clearer way, and formal arrangements for their cooperation should be concluded. These arrangements should explicitly state what kind of information may be exchanged between these financial agents. At the same time, protection against releasing information beyond accepted purposes should be established.

- The BNB should strengthen consultation with banks/the Bankers Association on Regulations and on Statistical/Prudential Reports. In addition to giving valuable input to the process, consultations will also provide banks with an opportunity to learn of coming changes and to adapt their own systems accordingly.

- Especially in view of the considerable powers available to the Banking Supervision Department of the BNB, the development of effective internal controls and audit should be given high priority.

- The BNB should conclude and publish agreements on consultations and exchange of information with foreign supervisory authorities.

C. Summary Assessment of Compliance with Basle Core Principles

20. Traditionally the Basle Core Principles are grouped into seven major categories: (i) objectives, autonomy, powers, and resources; (ii) licensing and structure; (iii) prudential regulations and requirements; (iv) methods on ongoing supervision; (v) information requirements; (vi) formal powers of supervisors; and (vii) cross-border banking. The results of

the IMF staff assessment are grouped according to these categories (with a summary provided in Table 2), preceded by a review of preconditions for effective banking supervision in Bulgaria.

21. **Preconditions for effective banking supervision.** The general legal and accounting framework in which banking and banking supervision takes place is quite good. Contracts may be expected to be honored and collateral can be claimed, though sometimes rather slowly. Financial statements provide meaningful information and are in most material aspects in line with international accounting standards. The rule of law prevails. BNB regulations and guidelines are generally very comprehensive and detailed, and are supervised on a detailed level. The market environment in which the banks operate and which disciplines bank behavior is reasonably transparent and competitive. With the exception of the tax treatment of provisions for doubtful loans, there are no major distortionary factors, such as direct or indirect subsidies from the state. The earlier overall deposit guarantee has since January 1, 1999 been transformed into a limited deposit guarantee that is generally in line with guidelines developed in an IMF Working Paper regarding the configuration of a system of deposit insurance (see Chapter VI). The 16 illiquid and bankrupt banks which still have not been fully wound up (although their licenses have been revoked) do not act or interfere in the banking markets.

22. **Objectives, autonomy, powers, and resources, Core Principle (CP) 1.** The BNB is the sole supervisor of banks. There are laws and regulations setting forth the autonomous status of the BNB and of its supervisory functions. The BNB has the powers to issue normative acts in all areas of bank regulation and supervision. The BNB has created a Banking Supervision Department which is organized to conduct effective supervision. Through an explicit provision in the LoB, BNB management and staff are protected from liability when conducting their supervisory tasks, if in good faith. All sub-divisions of CP 1 are complied with, although some minor amendments of laws and regulations are recommended, e.g. to reduce the risk of having to resort to interpretations of the exact meaning of the rules.

23. **Licensing and structure, CPs 2–5.** These Principles focus on the definition of banking activities and the proper use of the name “bank” as well as supervisory means to protecting sound ownership and structure of banks. Bulgaria complies with these Principles, with minor exceptions. The required skills and expertise of bank managers are explicitly defined, and evaluated in the laws and regulations. However, it is recommended that in applying the laws and regulations the supervisor should focus more on assessing the appropriateness of a manager’s background in enabling the manager to control the bank and its business activities. Further, the BNB should have the powers, and use them, to prevent banks from starting certain activities if the managers and management bodies do not have the relevant expertise to manage and monitor these.

24. **Prudential regulations and requirements, CPs 6–15**. Bulgarian banks have to maintain a minimum capital, a (non-risk-weighted) leverage ratio, and a capital adequacy (risk-weighted) ratio (CP 6). The risk-weighted ratio is based on the model of the Basle Capital Accord, although it is less demanding in some aspects. It does not include market risks, with the exception of open positions in foreign currency and some off-balance sheet risks. The risk-

weights for commercial real estate and maritime mortgages are only 50 percent, as opposed to the Basle rule of 100 percent. Finally, the capital ratios are not calculated on a consolidated basis, although this is still a minor problem in practice because it would only apply to very few banks. On the positive side, it should be noted that the BNB applies a 10 percent capital adequacy ratio requirement, to be raised to 12 percent by end-1999. There are comprehensive rules for granting credit and for the evaluation of loans and of loan-loss provisions (CPs 7 and 8). Moreover, a central credit registry will be made operational starting October 1, 1999, giving all banks and the BNB access to standard information on all bank credits with cumulative exposure exceeding 10,000 leva. However, in the present BNB regulations, some types of illiquid collateral, such as commercial property and movable properties, are treated too generously as a basis for calculating the need for provisioning. There is also a need for requiring banks' higher management bodies to take decisions not only on loans for large amounts, but also on loans that are risky or uncommon to the bank.

25. On large exposures (CP 9), consolidated reporting should be implemented, and allowances for some types of illiquid collateral should be less generous. To facilitate its monitoring of connected lending (CP 10), the BNB should create a comprehensive database. The broad definition of connected parties, which by itself is commendable, makes such a systematized register important. The Principle on country risk (CP 11) is not met. The BNB should set out rules for country risk, including a requirement for banks to create and maintain adequate policies and procedures. The BNB should also formulate internal guidelines for the supervision of such risks. For market risks (CP 12), compliance is mixed. There are detailed regulations for foreign exchange risk, including a capital requirement and limits for open foreign currency positions. There also exist implicit rules for bank managers, within their overall management, to manage other market risks and adherence is verified during on-site and off-site supervision. However, there are no explicit rules—and no capital requirements—for important market risks such as interest rate risk in the trading book, and equity risk. Nor are there any rules or guidelines for an integrated management of market risks. It is recommended that the BNB address these deficiencies. A similar situation applies to "other risks" (CP 13). The BNB should adopt regulations and guidelines for banks to establish integrated policies and procedures, and for bank management/Board oversight over compliance.

26. On internal control systems (CP 14), the guidelines on corporate governance should be made more explicit, defining the roles and responsibilities of the different managerial bodies. The conduct of internal controls and the supervisory verification should gradually put more emphasis on strategic, structural, and organizational issues in addition to the validation of banks' transactions and activities. As noted above, the fit and proper tests of management and Board members should focus more on the actual understanding of a bank's activities, in addition to the formal criteria. Rules for the creation of audit committees in banks should be introduced. To make prevention of money laundering and fraud (CP 15) more effective, lowering the present threshold for reporting a large cash transaction—about US$15,000—could be considered. Banks should introduce policies that include the prevention of fraud (i.e., not only money laundering). Banks should adopt more stringent ethical and professional standards for their management and staff.

27. **Methods of ongoing supervision, CPs 16–20.** This group of principles relates to the supervisory methods that should be applied, both on-site and off-site, and the necessity to evaluate these methods qualitatively and on an ongoing basis. The group includes the necessity of supervising banks on a consolidated basis. CP 16 (the framework for on-site and off-site supervision) is complied with. On CP 17 (bank management contact), it is recommended that the list of events that the bank, immediately, has to notify the supervisor about be expanded to include breaches of prudential requirements other than those defined in present regulations, as well as major losses to the bank. On off-site supervision (CP 18), Bulgaria must implement consolidated reporting in order to comply. On validation of information (CP 19), the BNB is encouraged to start systematized “horizontal” examinations of various bank functions, e.g., to ensure equal interpretation of regulatory rules and prudential requirements. Bulgaria is materially non-compliant with the Principle on consolidated supervision (CP 20); such supervision should be implemented. Most of the legal basis is already in place, and the BNB has recently started to require banks to present their annual financial statements on a consolidated level.

28. **Information requirements, CP 21.** The existing legal requirement that banks’ external auditors must report to the BNB all major events that may be detrimental to the financial situation of the bank (this is internationally known as the “BCCI-requirement”), should be enforced in practice.

29. **Remedial measures and exit, CP 22.** The BNB complies with this Principle.

30. **Cross-border banking, CP 23–25.** These principles are all related to cross-border banking, such as cooperation between home and host country supervisors and exchange of information, consolidated supervision on a global basis, and equal treatment of foreign establishments. First, it should be noted that at present only one Bulgarian bank maintains (two) branches abroad. However, there is a significant number (at present 11) of foreign bank establishments in Bulgaria. So far, the BNB seems to have had no problems in conducting effective supervision on the branches abroad, and has had good and open relations both with host and home country supervisors. This has been achieved on informal grounds, without any written arrangements. A recent amendment to the *Law on Banks* provides the explicit legal basis for the exchange of supervisory information with supervisory authorities in other countries. It is recommended that the BNB enter into formal arrangements with other countries’ supervisors to facilitate future supervision. The BNB should also prepare for consolidated supervision on a global basis, although this is not needed at present (since the only case involves branches, which anyway are consolidated into the bank). For better control over overseas operations, the BNB should be provided with the explicit legal powers to refuse, or close, banking activities abroad if proper supervision, commensurate with the risk the establishment poses to the parent bank, cannot be granted.

31. If measured against the Essential Criteria only, Bulgaria is fully compliant with 15, largely compliant with 8, materially non-compliant with 1, and non-compliant with 1 of the 25 core principles. If measured against the Essential and Additional Criteria in combination,

Bulgaria is fully compliant with 9, largely compliant with 14, materially non-compliant with 1, and non-compliant with 1.

32. Initiatives underway in the BNB, such as the introduction of consolidated reporting of certain prudential ratios, stricter rules for the valuation of some types of collateral applied when calculating prudential requirements, introduction of rules and capital charges for market risks, concluding agreements with foreign supervisors, and introduction of policies for country risk, should markedly improve compliance on several Principles, such as CPs 6, 8, 9, 11, 12, 18, 20, 23, and 25. A remaining group of "related" improvements refers to requiring banks to introduce and maintain comprehensive and integrated policies and practices for, e.g., corporate governance, overall risk management (including comprehensive internal controls, audit committees, and management information systems), loan granting and evaluation policies, market risk management, and management of "other risks." After all these measures have been taken, only a number of relatively minor measures, not requiring changes in laws or regulations but rather simple changes in practices, remain before achieving full compliance with the Core Principles.

Table 2: Bulgaria: Compliance with the Basle Core Principles on Effective Banking Supervision

Core Principle	Gradings								Recommendations for Full Compliance
	Essential Criteria 1/				Additional Criteria				
	1	2	3	4	1	2	3	4	
1. Objectives, autonomy, powers, and resources	X				X				Fully compliant.
2. Permissible activities	X				X				Fully compliant.
3. Licensing criteria	X					X			Focus more on actual skills of managers, structure of the bank, corporate governance, and the way the bank will be run.
4. Ownership transfer	X				X				Fully compliant.
5. Investment criteria	X				X				Fully compliant.
6. Capital adequacy		X				X			Apply capital adequacy requirement on a consolidated basis, charge capital for interest rate and equity risks, conform risk weights for mortgages to international standards.
7. Credit policies	X					X			Combine the definition of risk categories and criteria to classify loans in these categories. Require high management decisions on risky or unusual loans.
8. Loan evaluation	X					X			Ensure that banks have adequate systems for collecting past due loans. Clarify guidelines for write-offs. Tighten rules for valuation of collateral.
9. Large exposures		X				X			Implement consolidated supervision. Tighten acceptance rules of collateral for large exposures.
10. Connected lending	X				X				Fully compliant.
11. Country risk				X				X	Require banks to create policies and procedures for actively analyzing country and transfer risks. Verify adherence to these policies and procedures, and create a system for setting provisions for these risks.
12. Market risks		X				X			Implement regulations and capital charges on a consolidated bases for interest rate and equity risks. Require banks to have policies for measuring, controlling and managing such risks, and to perform stress tests, scenario analyses, and contingency planning.
13. Other risks		X				X			Implement regulations and policies for interest rate risks in the banking book, operational risk, and legal risk.
14. Internal control	X					X			Implement more explicit rules on the roles and responsibilities of the different management bodies. Establish rules for Audit Committees.
15. Money laundering	X				X				Fully compliant.
16. On-site and off-site supervision	X				X				Fully compliant.
17. Bank management		X				X			Focus on strategic and other general issues in discussions with banks. Broaden the list of events about which the banks must immediately notify the supervisor, including major losses.
18. Off-site supervision		X				X			Implement consolidated reporting on all quantitative prudential requirements.
19. Validation of info	X					X			Start programs for systematic, horizontal evaluation of the implementation of prudential requirements.
20. Consolidated sup.			X				X		Implement consolidated supervision.
21. Accounting	X					X			Enforce reporting by auditors of any significant event that is potentially damaging to a bank.
22. Remedial measures	X				X				Fully compliant.
23. Global consolidation		X				X			Introduce rules for consolidated global supervision. Acquire legal powers to refuse licensing of, or close banks' foreign establishment.
24. Host country sup.	X				X				Fully compliant.
25. Sup./foreign establishments		X				X			Conclude arrangements with foreign supervisory authorities.

1/ The columns marked 1-2-3-4 indicate the degree of compliance. 1= full compliance; 2= largely compliant; 3=materially non-compliant; 4=non-compliant. The first set of columns refer to the Essential Criteria, the next set to the Essential + Additional Criteria combined, that is an overall assessment of each Core Principle.

System of Deposit Insurance

Bulgaria

Prepared by a staff team from the International Monetary Fund on the basis of information provided by the Bulgarian authorities.

The International Monetary Fund
Prepared in August 1999 and reissued in March 2000

Queries/Comments should be directed to:
Director
European I Department
700 19th Street, NW
Washington, DC 20431
202-623-7000
http://www.imf.org
email: scu-comment@imf.org

SYSTEM OF DEPOSIT INSURANCE[1]

1. The following considers the financial policy transparency practices of Bulgaria in the area of deposit insurance policy. The first two sections cover the broad principles underlying the IMF *Code of Good Practices on Transparency in Monetary and Financial Policies* (available on the IMF web site at http://www.imf.org/external/np/mae/mft/code/index.htm). The Code identifies desirable transparency practices for financial agents in their conduct of financial policy. In this instance, transparency practices in the Code focus on: clarity of the roles, responsibilities, and objectives of the Deposit Insurance Fund (DIF) implementing the deposit guaranty; the processes for formulating and reporting policies for the guaranty; public availability of information on such policies; and the accountability and assurances of integrity by the DIF. The last section ventures beyond transparency and provides a summary assessment of the extent to which Bulgaria's deposit insurance system is consistent with guidelines developed in an IMF working paper.[2]

2. Transparency by DIF, particularly in clarifying its objectives, should contribute to policy effectiveness by enabling financial market participants to assess better the context of deposit insurance, thereby reducing uncertainty in the decision making of market participants. Moreover, by enabling market participants and the general public to understand and evaluate DIF policies, transparency is likely to be conducive to good policymaking. This can help to promote financial as well as systemic stability. Transparent descriptions of the policy formulation process provide the public with an understanding of the rules of the game. The release of adequate information to the public on the activities of DIF provides an additional mechanism for enhancing the credibility of its actions. There may also be circumstances when public accountability of decisions by DIF can reduce the potential for moral hazard.

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[1] Prepared by Mr. Kähkönen and Mr. Feyzioðlu (both European I Department) and a team from the Monetary and Exchange Affairs Department of the IMF led by Mr. Coats, in consultation with the Bulgarian authorities.In preparing this chapter, IMF staff held discussions with management and the staff of the Deposit Insurance Fund, representatives of five banks and of the Bankers' Association, experts in two international accounting firms operating in Bulgaria, the Bulgarian National Bank, and the National Accountancy Department of the Ministry of Finance. The staff also consulted the *Law on the Bulgarian National Bank*, the *Law on Banks,* the *Law on Bank Deposit Guaranty*, and Regulation No. 23 on the *Terms and Procedure for Payment of Insured Amounts of Deposits with Banks with Revoked Licenses*. The chapter draws heavily on answers to a questionnaire on *Good Transparency Practices for Financial Policies by Financial Agencies* prepared by the Deposit Insurance Fund.

[2] See Gillian Garcia, "Deposit Insurance: Actual and Best Practices," IMF Working Paper No. 99/54, April 1999. It should be noted that these guidelines have not been considered by the IMF Executive Board and that there are no internationally agreed standards in this area.

A. Description of Practice

Clarity of roles, responsibilities, and objectives

3. The system of deposit protection is provided by the Deposit Insurance Fund, an independent financial agency created under the *Law on Bank Deposit Guarantee*, which was adopted in April 1998. This Act, together with Regulation 23 on the *Terms and Procedures for Payment of Amounts on Deposits with Banks with Revoked Licenses up to the Insured Amount*, which was adopted in February 1999, and the DIF Management Board's *Rules of Procedure*, define the legal framework of the agency.

4. The DIF's broad objectives—to promote financial stability, protect depositors' interests, and enhance public confidence and trust in the banking system—are not directly defined in the LBDG or in Regulation 23. The Chairperson of DIF considers that they have been disclosed in written reports submitted to the Legislature, in official government publications (such as the State Gazette), and by press releases to the media. The objectives have not been prioritized.

5. The procedures for appointment, term of office, and any general criteria for removing the heads and members of the governing body of the DIF have been publicly disclosed. As specified in the LBDG, the Board comprises a Chairperson, appointed by the Council of Ministers, Deputy Chairperson, appointed by the BNB, and three other members (one appointed by commercial banks and the other two by the Chairperson and Deputy Chairperson). The Chairperson is not permitted to accept employment elsewhere (except in research or teaching). Board members are appointed for a four-year term, but may be re-appointed. They may be removed from office for serious conflicts of interest, serious misconduct, prolonged incapacity, impairing the DIF's interests, or absence from three consecutive meetings of the DIF Board. In addition, since they are not regarded as civil servants, management and staff are not legally protected in exercising their duties under the LBDG. The terms of appointment and dismissal have been publicly disclosed in the LBDG, official government publications (such as the State Gazette), and through the media. It is not clear who holds the responsibility for initiating removal.

6. The DIF's relationships with the other financial agencies (the BNB, MOF, COM, and National Audit Chamber) have been publicly disclosed in the LBDG, and by publication in official organs. For example, the LBDG specifies that the "National Audit Chamber shall exercise control over the Fund's activities." In addition, it requires the BNB to provide data (although not sufficient data) to the DIF; the DIF to present its Annual Report to the COM, BNB, and National Audit Chamber; and the DIF to obtain approval from the BNB for its budget, proposed legislative amendments and new regulations.

Open process for formulating and reporting policy decisions

7. The regulatory framework of the DIF and its operating procedures are defined in legislation and regulations. Information is released on: annual premium contributions, the deposit base, and the size of insured amounts. Regulation 23 sets the terms and procedures for reimbursement of guaranteed deposits. In case the DIF resources are insufficient,

additional funding from banks, the markets, and the government is allowed. The DIF is allowed to exercise certain control over the collection activities of a trustee. However, its role in controlling the effectiveness of the assignees is not clear. The DIF charges premiums to banks. The premium structure has been disclosed in the LBDG.

8. The DIF is dependent on the BNB for information essential to fulfilling its role and responsibilities. The agency has formal procedures for sharing information with other domestic financial agencies, especially the BNB. These have been established in the LBDG and Regulation 23, and have been disclosed in written reports to the legislature and the State Gazette, and to the media.

9. The LBDG permits the DIF to invest in short-term deposits with commercial banks that are authorized dealers of government securities. While the current Chairperson does not intend to use this provision to provide support to illiquid banks, it could be so used in principle.

Information on policies

10. The agency publicizes its objectives and operational performance through publications and public meetings. Its audited financial statements are to be published in the Annual Report. In addition, the texts of regulations and other generally applicable directives and guidelines are readily available to the public through the Gazette and the Annual Report when it is published. Written information is also available on the nature and form of the deposit protection, the operating procedures of the scheme, the financing of the guarantee, and the performance of the protection arrangement, but not internal governance procedures. To enhance transparency further, senior officials stand ready to explain the DIF's objectives and performance to the public in speeches made at public and private meetings, and media interviews. The timing of statements by senior DIF officials depends on the frequency of changes and developments in the deposit guaranty environment. Thus statements are made on an irregular basis but at least once a month.

Accountability

11. The modalities of the DIF's accountability have been publicly defined in the LBDG, in DIF regulations, and the internal legal framework as defined in the Management Board's Rules of Procedure. The DIF management is not required by law to appear before any designated public authority. However, under Article 76 of the 1991 Constitution of Bulgaria, officials of every state body, official or public organization and citizens are required to submit data and documents relating to their work to Parliamentary committees. Moreover, the LBDG requires the DIF to submit its independently audited annual report, which includes its financial statements, to the BNB, the Council of Ministers, and National Audit Chamber for approval.

12. The DIF's internal governance procedures for ensuring the integrity of its operations, including internal audit procedures, are not publicly disclosed.

B. IMF Staff Commentary

13. The DIF has been designed with regard to considerations that favor transparency. While it is too early to know whether the agency will take advantage of its good design to make its actions transparent, it did successfully handle the failure of a commercial bank and payment of its insured depositors soon after it went into operation. Public confidence was rapidly restored, whereas it could have deteriorated seriously.

14. The DIF can nevertheless further improve the transparency of its objectives and performance in the following ways:

- The DIF's relationship with the BNB needs to be more clearly articulated, with more responsibility being placed on the BNB to supply data (for example, on the condition of banks, and the distribution of deposits by size) that are essential for the DIF's successful operation.

- It would be important for the newly created DIF to publicly disclose its investments in the annual statement because Article 22 of the LBDG permits investing DIF funds in commercial banks, exposing DIF funds to losses.

- To provide better information to domestic depositors, foreign investors, and market analysts, the DIF should write and publish a mission statement, issue a brochure describing its role and operations, and introduce a web site. It needs to use these media to clarify coverage under the law, which is complex and obscure. In addition, DIF officials could consider making personal appearances before the legislature to enhance public understanding and confidence in the safety of deposit protection.

- In connection with the DIF's accountability and integrity, the requirement to obtain an independent auditor for financial statements should be clarified. As the agency develops, it should disclose additional information on internal governance procedures. In addition, the law should clarify who holds the responsibility for dismissing members of the DIF Board.

C. Conformance with a Set of Guidelines[3]

15. The DIF in Bulgaria has a design that conforms in many respects to guidelines developed in an IMF working paper (Table 3). It has many provisions designed to help avoid the pitfalls of perverse incentives (moral hazard, adverse selection, and agency problems) that a poorly designed system could convey to the financial system.

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[3]This section compares actual practices with guidelines developed in Gillian Garcia, "Deposit Insurance: Actual and Best Practices," IMF Working Paper No. 99/54, April 1999. These guidelines have not been considered by the IMF Executive Board, nor are there internationally agreed standards in this area.

16. The Bulgarian deposit insurance system is explicitly defined in law and regulation; is compulsory; provides low coverage; and should provide adequate funding from private sources in time after the fund has grown to approximate its target level of 5 percent of insured deposits. The granting to the DIF of priority over the assets of a failed bank as compared to uninsured depositors and other creditors will help the insurance fund to limit its losses should additional banks fail. However, the current legal provisions lead to severe delays in the liquidation of failed banks, and need to be amended if the DIF is to protect its financial viability. While premiums are not currently risk-adjusted, a flat premium structure is appropriate for a newly formulated system during its testing period.

17. The DIF is independent of political interference, but needs BNB’s approval for legislative amendments, new regulations, and its budget. It is largely, but not fully, accountable for its activities. The banking legislation gives supervisors an adequate system of sanctions to remedy weak institutions, and close failed ones. However, the requirement that failed institutions be dealt with quickly is not met. This deficiency may damage confidence in the DIF and the banking system, and can be costly for the DIF because it will diminish the amount recovered from failed banks’ assets. Ways to remedy this deficiency are currently under discussion.

18. The BNB is required under the LBDG to provide information at the DIF’s request on banks’ deposits to enable the DIF to calculate premiums. The BNB is also required to provide information at the DIF’s request on the financial status of banks so that the DIF can assess its exposure to risk. It would be preferable if the BNB were given the responsibility to provide this information to the DIF on a regular basis and to regularly inform, and consult with, the DIF of the condition of banks in the system. This information would allow the DIF to prepare for impending failures and not be taken by surprise when a bank’s license is revoked. The BNB should also have the responsibility to inform the DIF immediately when the condition of any bank deteriorates to a point that it imposes a risk to the DIF.

19. The BNB should also be responsible for informing the public of the condition of all individual banks. This would exert market discipline which would help protect the financial integrity of the DIF. The DIF itself is required to inform the public of its financial condition; however, the basis for the practice of obtaining an independent audit of financial statements should be clarified.

Table 3: Conformance of Bulgaria's Deposit Insurance System with a Set of Guidelines [4]

Best Practice	Practices in Bulgaria	Comments
1. Avoid incentive problems.	Legislation addresses moral hazard, adverse selection and agency problems.	The design is modern.
2. Define the system explicitly in law and regulation.	Met.	However, some amendments are recommended.
3. Give the supervisor a system of prompt remedial actions.	Met.	A wide range of prudential sanctions exist, but they should be graduated.
4. Resolve failed depository institutions promptly.	Failed institutions are closed promptly, but are resolved only very slowly.	Improvements in resolution procedures are under discussion.
5. Provide low coverage.	Met (coinsurance 95% to BGN 2,000, 0.8 times per capita GDP, and 80% up to BGN 6,250, with a maximum paid amount of BGN 6,900).	Would be better to insure smallest deposits in full.
6. Make membership compulsory.	Met.	
7. Pay (transfer) deposits quickly.	Article 23 of the LBDG provides that depositors be compensated within 45 days of revoking the bank's license.	Faster payment would be preferable and could be achieved by permitting deposit transfer.
8. Ensure adequate sources of funding to avoid insolvency.	(1) Initial contribution is 1% of minimum capital; (2) annual premiums of 0.5% of deposits can be raised to 1.5%; (3) target of 5% of total deposits; can borrow in markets (without a government guarantee) or from government.	Fund currently stands at 30 million BGN, and will take 10 years to reach its target. Parliament is judged unlikely to provide aid. No provision for aid from BNB.
9. Risk-adjust premiums.	Not in operation.	System has only just started; risk adjusting needs more experience.
10. Invest DIF resources wisely.	Article 22 of the LBDG permits investments in government or government-guaranteed securities, and short-term deposits with primary dealer banks or the BNB.	Restricting investments to Bulgarian securities exposes the DIF to foreign exchange risk.
11. Organize good information.	Under Article 21 of the LBDG, the DIF is dependent on the BNB supervisor for data, without placing the onus on the BNB to keep the DIF informed.	Data availability is insufficient. Data are needed on the amount of insured deposits, and the distribution of deposits by size.
12. Make appropriate disclosure.	Annual report, data to legislature and press.	Web site might be useful.
13. Create an independent, but accountable DIF.	Politically independent, but is subordinated to the BNB under Article 12 of the LBDG.	Good, but not quite perfect provisions.
14. Have bankers on an advisory, not the main, board.	Met: no currently employed bankers allowed on the DIF's Board.	Relations with bankers remain to be developed.
15. Ensure close relations with the lender of last resort and the supervisor.	The legislative arrangements in Article 21 are inadequate.	To be seen if arrangements will work in practice.
16. Start the system when the banking system is sound.	Not perfectly satisfied: one of 35 banks failed quickly.	Additional failures could strain the DIF.

[4] Adapted from Table 1 of Gillian Garcia, "Deposit Insurance: Actual and Best Practices," IMF Working Paper No. 99/54, April 1999. It should be noted that these guidelines have not been considered by the IMF Executive Board and that there are no internationally agreed standards in this area.

Insurance Supervision

Bulgaria

Prepared by a staff team from the International Monetary Fund on the basis of information provided by the Bulgarian authorities.

The International Monetary Fund
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202-623-7000
http://www.imf.org
email: scu-comment@imf.org

INSURANCE SUPERVISION[1]

1. The description that follows examines financial policy transparency in the area of insurance supervision in Bulgaria. The first section covers the broad principles underlying the IMF's *Code of Good Practices on Transparency in Monetary and Financial Policies* (available on the IMF web site at http://www.imf.org/external/np/mae/mft/code/index.htm). The Code identifies desirable transparency practices for insurance supervisors in their conduct of insurance supervision. Following the Code, this chapter reviews: clarity of the roles, responsibilities, and objectives of the agencies implementing regulation and supervision of the insurance industry; the processes for formulating and reporting policies for them; public availability of information on such policies; and the accountability and assurances of integrity by the insurance regulators. The second section provides a summary of the authorities' views on the extent to which domestic practices are consistent with existing international standards.

2. Transparency by the National Insurance Council (NIC) and the Insurance Surveillance Directorate (ISD), particularly in clarifying their objectives, should contribute to policy effectiveness by enabling financial market participants to assess better the context of insurance supervision, thereby reducing uncertainty in the decision making of market participants. Moreover, by enabling market participants and the general public to understand and evaluate insurance supervision policies, transparency is likely to be conducive to good policymaking. This can help to promote financial as well as systemic stability. Transparent descriptions of the policy formulation process provide the public with an understanding of the rules of the game. The release of adequate information to the public on the activities of insurance supervisors provides an additional mechanism for enhancing the credibility of their actions. There may also be circumstances when public accountability of decisions by supervisors can reduce the potential for moral hazard.

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[1] Prepared by Mr. Kähkönen and Mr. Feyzioðlu (both European I Department) and a team from the Monetary and Exchange Affairs Department of the IMF led by Mr. Coats, in consultation with the Bulgarian authorities. In preparing this chapter, IMF staff held discussions with officials of the Insurance Supervision Directorate (who completed a transparency questionnaire), the State Insurance Institute, the National Accountancy Department of the Ministry of Finance, and representatives of accounting firms. IMF staff also consulted the *Law on the Bulgarian National Bank*; the *Law on Banks*; the *Insurance Business Act*, the *Ordinance for the Establishment and Organization of the Insurance Supervision Directorate*, the *Ordinance for the Establishment of the National Insurance Council*, the *Regulation on the Allocation of Insurance Reserve*, Decree No. 19 on the *Enactment of an Ordinance Regulating the Procedures and Methods of Setting up an Insurance Reserve*, and the *Regulation for Determining the Own Resources, Solvency Margin, and Its Calculation by Insurers*.

A. Description of Practice

Clarity of roles, responsibilities, and objectives

3. The institutional framework is defined in the *Insurance Business Act* (IBA) and in the implementing regulations. The objectives of the NIC and ISD, as defined in the IBA and the implementing regulations, are to promote "financial stability, market and systemic stability, competitive and fair markets, client asset protection, and enforcement of laws and regulations." Moreover, the "ISD supervises the activities of insurers in conformance with the law and advises the NIC on granting and terminating licenses, merging, consolidating, dividing, or transferring portfolios of insurance companies; initiates insolvency procedures; takes prudential measures against undercapitalized and illiquid insurers; appoints conservators and keeps a register of licenses granted; and approves or disapproves rehabilitation plans." These objectives have been revealed in the legislation, written reports to the legislature and other public bodies, public appearances before the legislature, the Annual reports, press releases to the media, and publication in the Official Gazette.

4. The ISD's and NIC's relationships with the MOF and COM are specified in the Act. The NIC comprises the Minister of Finance, who acts as Chairperson; three other ministers; the Director of the ISD; a representative of the Insurers' Association; and an academic expert in insurance. The NIC, which is not a politically independent body, has the power to grant and revoke licenses to conduct insurance business in Bulgaria and to authorize merger or to initiate insolvency proceedings. The relationship between the NIC and the ISD is not clearly specified in the law. The ISD is a juristic person within the MOF, and its Director is appointed and dismissed by the Prime Minister (PM) on the recommendation of the NIC, and its budget is controlled by the MOF. Procedures for appointment to the ISD and the terms of the office are defined in the IBA and the ordinance. Only one ground for removal is laid out in the IBA (releasing confidential data), while other grounds (premeditated crime or prolonged incapacity) are specified in the *Regulation on the Structure and Operation of the Insurance Supervision Directorate*. There are no legal protections for officials and staff in the conduct of their official duties.

5. The relationships of these institutions with BNB, the MOF, and the Ministry of Justice and Legal Euro Integration are specified in regulation and have been publicly disclosed in the State Gazette. The ISD maintains a department for international cooperation and officials have stated that they maintain close cooperation with the MOF and the BNB, and particularly its banking supervision department. Such cooperation is essential as insurance companies are permitted under Bulgarian law to own up to 99 percent of the shares of commercial banks and, while banks cannot own insurance companies outright, they can own shares in insurance companies. In addition, the agency officials report that they maintain close contact with international supervisory bodies.

Open process for formulating and reporting policies

6. The ISD's operating procedures are specified in law and regulation and have been reported in public appearances before the legislature, the State Gazette, and press releases. The regulations for financial reporting by financial institutions to the ISD have been publicly disclosed in the IBA, where insurers are required to report annual balance sheets to the ISD within four months of the end of the reporting period. Insurers also are required to release their annual reports in at least two national newspapers. The Act requires insurers to obtain audits of their accounts by at least 2 certified public accountants and mandates that these independent auditors report material breaches of regulations to the ISD. The Act also specifies the documents that must be submitted in order to obtain a license. The ISD in turn is required to disclose the terms of fees that it charges to financial institutions and the public. The IBA specifies the types of fees that the ISD may charge, and regulations provide greater detail. The schedule of charges has been approved by the COM and published in the State Gazette.

7. While not specified in the IBA law or the regulations reviewed by the staff, ISD officials report that they utilize written reports to and public appearances before Parliament, the Annual Report, State Gazette and press releases to disclose information on changes in regulations immediately after a decision is made.[2]

Public availability of information on policies

8. Under the IBA, the ISD reports only to the NIC and MOF. However, Directorate officials state that they will soon issue the first annual report that will describe its activities and the condition of the insurance markets. In addition, the monthly newspaper, *The Insurer*, carries such information. Moreover, ISD officials make written reports to, and public appearances before, the legislature, and provide press releases. To conduct its publication program, the ISD maintains a Publications Department. The publications are provided free of charge. The ISD submits its budget to the MOF monthly and to the legislature in writing.

9. The ISD has an obligation to provide aggregate data that relate to its jurisdictional responsibilities. It fulfils this obligation monthly in the *Insurer* newspaper and annually in its Annual Report. It also reports in writing to, and via public appearance before, the legislature, in the State Gazette, and through press releases. The ISD maintains a register of licensed insurers. This register contains very detailed information and, consequently, is not published. However, a list of licensed insurers is kept and is available to anyone who requests it at the ISD's office in Sofia, or will be sent in response to a request received by phone or fax. In

[2] While the ISD does not have a web site, insurance legislation is made available on the government's web site.

addition, a list of licensed insurers has been published in local newspapers and in one German paper. In addition, this list will be published in the forthcoming Annual Report.

10. The texts of legislation and regulations are readily available to the public through the State Gazette and Annual Report. Applicable directives are published in the State Gazette. In addition, all guidelines are sent directly to licensed insurance companies. They are not published, but agency officials stated that they would be published in newspapers if the public showed an interest in them. Minutes of NIC meetings are maintained and relevant sections are sent to the insurers who are affected by the decisions that have been taken. In addition, summaries of the minutes are released to the media.

11. Guarantees and consumer protection arrangements are publicly available. A system of guarantees for holders of accident policies was promised in the IBA, and a Guarantee Fund was founded and made operational in 1997. In particular, the IBA states that “a Guarantee Fund shall be set up to pay third party accident insurance where the perpetrator cannot be found or is uninsured.” In addition, the ISD has, and has publicly disclosed, its consumer protection arrangements. Beyond the guarantee noted above, consumer protection arrangements are not provided. There are, however, provisions for insurers to appeal adverse decisions under the Administrative Procedures Act. In addition, agency officials stated that there are provisions for disagreements between policyholders and their insurer to be submitted to the ISD for adjudication.

12. The ISD sends its financial statements to the MOF and has not yet published them itself. However, the agency’s financial statements can be found in the section on the MOF in the Government’s financial statements. The ISD sends its financial statements to the National Audit Office and does not utilize the services of independent auditors. Accounting policies and qualifications to the accounts are disclosed.

Accountability and assurances of integrity

13. The modalities of the two agencies’ accountability have been publicly defined in legislation, which allows appeal under the *Administrative Procedures Act* against the NIC’s decisions, and requires the ISD to report to the MOF. The officials are not required to appear before a designated public authority. The insurance supervisor is responsible to the MOF, who would presumably take this responsibility. However, the Director of the ISD is available to appear before the legislature to explain the ISD’s objectives and performance and to exchange views on the condition of the financial system.

14. The ISD does not have the internal governance procedures and internal audit arrangements that are necessary to ensure the integrity of its operations. Moreover, there is no code of good conduct. However, the IBA forbids disclosing confidential information except in approved circumstances. Breaching this requirement could presumably be grounds for dismissal.

B. IMF Staff Commentary

15. The ISD is making determined progress toward achieving transparency in insurance regulation in Bulgaria. Nevertheless, further improvements would be welcome:

- It would be important to strengthen the *Insurance Business Act* to increase the ISD's autonomy and to clarify its roles and relationships with the NIC, MOF, and COM.

- Greater transparency is needed in the regulations and practices regarding cross holdings between banks and insurance companies.

C. Observance of International Principles and Standards[3]

16. ISD has been a member of the International Association of Insurance Supervisors (IAIS) since October 1998. Officials state that they have no fundamental disagreements with international best practices, and the NCI and ISD are becoming actively acquainted with the recommendations for best practices specified by the IAIS as well as by the OECD. Despite its relatively recent membership, experts from ISD are already participating in three subcommittees of the IAIS, on accounting standards and the insurance laws and by-law legislation within the Technical Committee of the IAIS.

17. Bulgaria is in the process of adopting IAIS standards, including through various amendments to the *Insurance Act* currently under consideration by the parliament. Existing laws are also being updated to comply with the European Union standards in this area, which are similar to the IAIS recommendations. These amendments will bring Bulgaria into almost complete compliance with the IAIS standards for insurance markets. In particular, the frequency and standards of supervision of the insurance industry, as well as the penalties and sanctions for non-compliance with supervision standards, will comply with the standards established by the IAIS in these areas. The only IAIS standard that is not included in the present revisions is the *Supervisory Standard on Derivatives*. This was judged unnecessary as Bulgaria does not yet have an active market on derivatives. The adoption of the IAIS model *Memorandum of Understanding on Exchange of Information with Other Countries* is part of the proposed new law on amending and supplementing the *Insurance Act*. Bulgaria has not conducted a self-assessment of its observance of the IAIS *Insurance Supervisory Principles*, mainly because it has no legal basis for doing so. Officials expect that these few differences between Bulgarian standards for insurance markets and international standards would remain as they reflect specific characteristics of the Bulgarian markets.

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[3] This section represents a summary of the authorities' description of practices in this area. No attempt has been made to provide an independent assessment of observance of standards in this area.

Enforcement of standards

18. In enforcing the *Insurance Act*, the ISD applies IAIS standards with regard to the frequency of supervision as well as penalties and sanctions. The ISD has the right to (i) impose measures to improve the financial status of inadequately capitalized insurers; (ii) oblige an insurer to increase his capital; (iii) recommend to insurers measures to redress violations of legal acts and by-laws in the insurance sector; and (iv) take decisions on other issues related to the supervision of the insurance industry.

Securities Market Supervision

Bulgaria

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Queries/Comments should be directed to:
Director
European I Department
700 19th Street, NW
Washington, DC 20431
202-623-7000
http://www.imf.org
email: scu-comment@imf.org

SECURITIES MARKET SUPERVISION[1]

1. The following considers the financial policy transparency practices of Bulgaria in securities market supervision. The first two sections cover the broad principles underlying the IMF *Code of Good Practices on Transparency in Monetary and Financial Policies* (available on the IMF web site at http://www.imf.org/external/np/mae/mft/code/index.htm). The Code identifies desirable transparency practices for securities market regulators. Following the Code, this chapter reviews and comments on: clarity of roles, responsibilities and objectives of the Securities and Stock Exchanges Commission; the processes for formulating and reporting supervisory decisions by the SSEC; public availability of information on supervision policies; and accountability and assurances of integrity by the SSEC. The last section provides a summary of the authorities' views on the extent to which domestic practices are consistent with existing international standards.

2. Transparency by the SSEC, particularly in clarifying its objectives, should contribute to policy effectiveness by enabling financial market participants to assess better the context of supervisory policies, thereby reducing uncertainty in the decision making of market participants. Moreover, by enabling market participants and the general public to understand and evaluate financial policies, transparency is likely to be conducive to good policymaking. This can help to promote financial as well as systemic stability. Transparent descriptions of the policy formulation process provide the public with an understanding of the rules of the game. The release of adequate information to the public on the supervisory activities of the SSEC provides an additional mechanism for enhancing the credibility of their actions. There may also be circumstances when public accountability of decisions by the SSEC can reduce the potential for moral hazard.

A. Description of Practice

Clarity of roles, responsibilities, and objectives

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[1] Prepared by Mr. Kähkönen and Mr. Feyzioðlu (both European I Department) and a team from the Monetary and Exchange Affairs Department of the IMF led by Mr. Coats, in consultation with the Bulgarian authorities. This report is primarily based on a self-assessment in the form a questionnaire on *Good Transparency Practices for Financial Policies by Financial Agencies* completed by the Securities and Stock Exchanges Commission, and a separate short descriptive self-assessment by the Bulgarian authorities. In preparing the report IMF staff also held discussions with SSEC management, a primary broker and trader in the securities markets, and experts in two international accounting firms operating in Bulgaria. The staff also consulted the *Law on Banks, Law on Securities, Stock Exchanges, and Investment Companies* and the *Regulation on the Structure and Activities of the Securities and Stock Exchanges Commission.*

3. The securities markets are regulated by the SSEC, which was created under the *Law on Securities, Stock Exchanges, and Investment Companies* (SSEICA) of 1995, which was last amended in 1999. This Act, together with the 1997 *Regulation on the Structure and Activities of the Securities and Stock Exchanges Commission,* defines the framework of the agency. According to this framework, the SSEC has the following responsibilities: it (i) issues and revokes the licenses of stock exchanges and over-the-counter securities markets (currently the Bulgarian Stock Exchange-Sofia Ltd. (BSE)) and the OTC market) and of investment companies and intermediaries; (ii) supervises securities market activities with a view to ensuring strict compliance with statutory requirements; (iii) approves prospectuses for public offerings of securities; (iv) approves tender offers for the purchase or exchange of shares accounting for more than 25 percent of voting power; (v) registers public companies; (vi) keeps public registries of stock exchanges, investment intermediaries, investment companies, public companies, and other issuers of securities; and (vii) determines requirements for securities brokers, formulates procedures for their licensing, and keeps a registry of licensed brokers.

4. To achieve transparency, the SSEC publicly releases information about its roles, responsibilities, and objectives. The SSEC's broad objectives to promote market and systemic stability; competitive and fair markets; client protection; and enforcement of laws and regulations—are defined in the SSEICA. They have been disclosed in public statements by officials before the Legislature; in official government publications (the State Gazette) and the official monthly bulletin and the Commission's Annual Reports; by press releases; and through the Commission's recently developed web site. While not prioritized in the legislation, the SSEICA states that the Commission's primary roles are "ensuring the protection of investors and encouraging the development of the securities markets."

5. The autonomy of the SSEC is defined in the procedures for appointment, term of office, and any general criteria for removal of the heads and members of the SSEC in the SSEICA. The Commission comprises a Chairman, Vice-Chairman, and five members who are appointed for a five-year term by the Council of Ministers on the recommendation of the Ministry of Finance. Commission members can be dismissed by the COM on the recommendation of the Ministry of Finance only under conditions that are clearly defined in the law. That is, a commissioner shall be removed if he/she commits a flagrant violation of the SSEICA, or is convicted by a court of a deliberate crime, or becomes incapacitated for more than six months. In such cases, or where a commissioner resigns or dies, he/she shall be replaced by a person appointed by the COM for the remaining period of the term. The terms of appointment and dismissal have been publicly disclosed in official government publications and reports, through the media and the web site. There have been no changes in these procedures since the SSEC was established in 1995. Officials and staff are legally protected in the exercise of their duties. These protections are publicly disclosed in the Official Bulletin, through the media and a special order issued by the Chairman of the SSEC. The names of involved SSEC staff are written in the order from the Chairman to perform inspections so that the recipients are aware of the purpose of the inspection, the names of those who will perform it, and the authorization to perform it.

6. The Commission's relationship with the other financial agencies has been publicly disclosed in legislation; publication in official organs; the media; the web site; and, in particular, in the SSEICA and the *Regulation on the Structure and Activities of the SSEC*. The Commission prepares and presents to the COM an annual report on its activities. In addition, it conducts joint inspections with the BNB of banks that are licensed to act as investment intermediaries. Any state official is obliged under the SSEICA to assist the Commission in the exercise of its supervisory functions.

7. Currently, draft legislation to improve the whole legislative framework for the capital market in Bulgaria is under active discussion between the SSEC and a broad spectrum of interested parties, including the Association of Licensed Investment Intermediaries (ALII), the BSE, the Association of Commercial Banks, the Privatization Agency, the Central Depositary, ministries, and other government institutions. Advice is also being provided by the European Commission and the Securities and Exchange Commission in the United States.

Open process for formulating and reporting policy decisions

8. To promote transparency, the SSEC's policy rules and regulations are in the public domain. The regulatory framework and its operating procedures and regulations have been publicly disclosed in legislation, official documents, public appearances before the legislature, and through the media, the web site, and the BSE's Rule-Book. The BSE's Rule-Book provides for: the types of trading floors, the terms and procedures for dealing on them; the terms and procedures for admitting members and their temporary or permanent removal from the floor; the terms and procedures for admitting stock exchange brokers and for supervising their activities; the terms and procedures for admitting securities for trading and for temporarily or permanently suspending them from trading; the type of trades and manner of conducting trading; the kinds of services offered and their prices; the terms and conditions for imposing sanctions on members of the exchange and on stock exchange brokers. The SSEICA was substantially amended in 1998 when the definition of a public company and its registration with the SSEC was introduced and the OTC market established by law. The Commission publishes its resolutions in the official bulletin of the Commission, via the Internet page, and in the Commission's Public Register. In addition, the SSEC's regulations for financial reporting by financial institutions have been publicly disclosed in legislation (the SSEICA), in the State Gazette, and in the Official Bulletin. Finally, the SSEC discloses the structure of its fees through the *Tariff for Fees Collected by the SSEC for Activities Carried out and Documents Issued.*

9. Information on the SSEC's progress toward achieving its objectives and any significant changes in its policies are disseminated widely. The SSEC issues periodic reports of its activities, and also uses the Official Bulletin, the media, and the web site to disclose information on its achievements. The periodic reports are published within seven days after their filing with the Commission, as stipulated in the SSEICA. In addition, significant changes in financial policies are publicly disclosed and explained immediately after the decision is taken through official publications (such as the State Gazette, the Official

Bulletin, and the Commission's Annual Report), the media, and the web site. Consequently, the announcements appear as needed and are not made according to a set schedule.

10. There is no presumption in favor of public consultation for proposed substantive technical changes to the structure of financial regulations. Nevertheless, changes in legislation, such as those currently under consideration, are the subject of broad public discussion. That discussion is not, however, conducted within a set time.

11. The SSEC does not have formal procedures for sharing information with other domestic or foreign financial agencies. Instead, official letters from the Commission are commonly used for this purpose.

Public availability of information on policies

12. The Commission provides information consistent with its jurisdictional responsibilities on a monthly and annual basis, makes available the texts of regulations and other generally applicable directives and guidelines, and disseminates data and research by its staff. In particular, the SSEC, as required under the SSEICA, issues periodic reports (the Monthly Bulletin that contains information on decisions taken, licenses granted/rejected, administrative measures imposed, data on market developments and market participants, analyses and articles) that appear within one month of the end of the reporting period and are provided free or at a nominal charge. To this end, the SSEC maintains a public information service, including a web site (http://www.sec.bg).

13. The Commission does not release its balance sheet on a pre-announced schedule. Data on market transactions are provided by the BSE. As the SSEC, like other financial agencies in Bulgaria, is not permitted to provide financial support, it does not release information about such support.

14. Senior officials are ready to explain the SSEC's objectives and performance to the public, and there is a presumption in favor of releasing the text of public statements in the Bulletin and other publications, the media, and the web site, and through participation in seminars, discussions, and conferences. The frequency of appearances by senior SSEC officials depends on the frequency of changes and developments in the securities markets' legal framework.

Accountability and assurances of integrity

15. Under the 1991 Constitution, officials of every state body and official or public organization, and citizens are required to submit data and documents that relate to their work to parliamentary committees. Senior SSEC officials are currently participating in sessions of the Parliamentary Economic Standing Committee in connection with the discussions that relate to changing the securities legislation. They also appear before Parliament to explain policy objectives and describe the SSEC's progress toward achieving them. Officials appear before the Parliament, not according to a set schedule but as needed.

16. The *Rules on the Structure and the Activities of the Commission* (adopted by the COM and published in the State Gazette) define the structure of the Commission's administrative department and provide guidelines for the Commission's activities. However, the SSEC currently has no formal internal governance and internal audit procedures. The Chairman agrees that these responsibilities will need to be formalized and disclosed as the SSEC increases in size.

17. Financial data submitted by the SSEC to the MOF are reported to the National Audit Office (NAO) which by law is required to audit these data. The availability of these data in the NAO is considered to constitute publication. Thus, information on the expenses and operating revenues of the SSEC are not made directly available to the public. The SSEC is currently consulting the Institute of Certified Public Accountants and private firms prior to adopting the practice of releasing audited financial statements, which will be required under the draft securities law.

18. There are standards to govern the conduct of the SSEC's public officials and staff that are designed to establish fiduciary obligations and to prevent the exploitation of conflicts of interest. These standards are publicly disclosed in the State Gazette, the Official Bulletin, through the media and the web site. These standards require that the Chairman, Vice Chairman, and members of the Commission may not hold any other paid position during the term of their office, nor receive remuneration under contract, except in the case of research or lecturing. Members of the Commission are also obliged to keep confidential any trade secrets they have learned of in fulfilling their functions. Senior officials of the SSEC cannot be members of the Board of Directors of privatization funds.

B. IMF Staff Commentary

19. Securities legislation, ordinances, and regulations have been drafted with care to ensure transparency, which is essential to facilitating the market discipline that is a fundamental regulator of the securities markets. While the formal achievements in these markets and their regulatory apparatus are impressive, the Chairman of the SSEC points out that it is difficult to achieve transparency in practice. The problem arises, he believes, because the management of companies in Bulgaria needs greater training and experience. In addition, some issuers and public companies do not provide data as required. This omission makes it difficult for the Commission to report accurate data on market valuation and transactions on a timely basis.

20. The IMF staff identified a number of areas for improvement:

- With regard to articulating the roles, responsibilities, and objectives of the SSEC, the agency should create a mission statement, and make formal provision to consult and exchange information, on a reciprocal basis, with the BNB, the Insurance Surveillance Directorate, and other relevant national and international financial agencies. The mission statement and the information sharing protocols should be publicly disclosed.

- To ensure public availability of information on financial policies, the Commission should release its financial statements directly to the public (for example, in its annual report) in addition to providing them to the National Audit Office. In fact, it is planning to do so under the new securities law that is currently under consideration in the National Assembly. In addition, as many people in Bulgaria do not have ready access to the internet, on which the Bulgarian Stock Exchange relies to communicate aggregate market data, the SSEC itself needs to find some alternative means to communicate these data.

- With regard to accountability and assurances of its integrity, the SSEC needs to develop and publicly release procedures for its internal governance.

C. Approach to International Standards and Cooperation[2]

21. Bulgaria has been a member of the International Organization of Securities Commissions[3] since 1997, and has adopted practically all of its *Objectives and Principles of Securities Regulation*. Bulgaria's existing and proposed legislation in the area of securities market regulations follows IOSCO's general principles and disclosure standards.

22. Bulgaria is currently updating its regulatory framework to make it correspond even better to IOSCO and European Union standards. The new draft *Law on Public Offerings of Securities*, prepared by the SSEC, reflects to a large extent the principal requirements of the European legislation (Acquis Communitaire) on the regulation of capital markets, which in turn is based on the IOSCO standards. This new law would substantially revise and tighten existing legislation and extend it to new areas, such as OTC markets and portfolio management. It would also, for the first time, regulate public offerings of securities issued by nonresidents and residents, with a view to harmonizing Bulgarian legislation with international principles and treating residents and nonresidents equally. The new draft law is in line with the European legislation especially with regard to the scope of the rights and activities of the SSEC, the secondary securities markets, the activities of the investment intermediaries, information disclosure and collective investment schemes. This law is expected to be approved by Parliament by end-1999. Once this law is passed Bulgaria's law will be consistent with 29 of IOSCO's 30 principles (only Principle 6 on self regulation will be different in that Bulgaria's law envisages dual regulation by the self-regulating body and the overseeing body—in certain areas).

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[2] This represents a summary of the authorities' description of practices in this area. No attempt has been made to provide an independent assessment of observance of standards in this area.

[3] For more information on these standards see the IOSCO's web site at http://www2.iosco.org/.

23. The SSEC has not yet entered into any agreements on collaboration with foreign regulators. It nevertheless cooperates with them on a voluntary basis to develop adequate legislation in the sphere of capital markets by providing information (which is publicly available) if requested by foreign regulators. Formal collaboration agreements with other countries may be undertaken in the future. The SSEC also actively participates in various international fora with a view to improving cooperation with foreign regulators. In a July 1999 Southeastern Europe regulatory commission conference Bulgaria signed a memorandum of understanding on setting up a framework for sharing information.

24. On pending changes in the area of securities markets, the SSEC is currently drafting the secondary legislation in anticipation of the eventual passage of the *Securities Law*. A draft law on mortgage backed securities is also under preparation. Moreover, the Stock Exchange and the Association of Licensed Intermediaries are working on setting up an electronic OTC market, and they also intend to make the official market electronic.