Bulgaria's Capital Markets in the Context of EU Accession: A Status Report

Stefan Petranov

Member of the Board of Directors, „Zlaten Lev" Investment Company; Faculty of Economics,
Sofia University „St. Kliment Ohridski"

Professor Jeffrey Miller

Department of Economics, University of Delaware

CENTER FOR THE STUDY OF DEMOCRACY
1999

Published with the support of the Delegation of the European Commission in Bulgaria.

CSD REPORTS/АНАЛИЗИ:

1. Bulgaria's Participation in EU Structural Funds. Sofia, 1999.
   ISBN 954-477-051-8

2. Social Policy Aspects of Bulgaria's EU Accession. Sofia, 1999.
   ISBN 954-477-053-4

3. Preparing for EU Accession Negotiations. Sofia, 1999.
   ISBN 954-477-057-7

4. The Role of Political Parties in Accession to the EU. Sofia, 1999.
   ISBN 954-477-055-0

5. **Bulgaria's Capital Markets in the Context of EU Accession: A Status Report. Sofia, 1999.**
   ISBN 954-477-059-3

Bulgaria's Capital Markets in the Context of EU Accession: A Status Report

ISBN 954-477-059-3

Center for the Study of Democracy
1 Lazar Stanev Str., 1113 Sofia
phone: (+359 2) 971 3000, fax: (+359 2) 971 2233
www.csd.bg, csd@online.bg

Bulgaria's Capital Markets in the Context of EU Accession

Българският капиталов пазар в контекста на присъединяването на България към Европейския съюз

ACKNOWLEDGEMENTS

The Center for the Study of Democracy would like to thank the following persons for their valuable comments and suggestions:

Bistra Boeva, Member, State Securities Commission

James D. Stewart, Jr. Resident Advisor, Ministry of Finance; US Department of Treasury, Office of Technical Assistance

Kamen Koltchev, Chief Executive Officer, Elana Inc.

Luybomir Philipov, former Governor, Bulgarian National Bank

Manyu Moravenov, Director, Department "Listing, Membership & Surveillance", Bulgarian Stock Exchange–Sofia

Vessela Stancheva, Attorney at Law, Djingov, Gouginski, Kyutchukov & Velichkov

CONTENTS

CURRENCY AND EQUIVALENT UNITS

Currency Unit = Bulgarian Lev (BGL)

From July 1999 DEM 1 = BGL 1 (Fixed Exchange Rate Under Currency Board Arrangement)

Until July 1999 DEM 1 = old-BGL 1000 (Fixed Exchange Rate Under Currency Board Arrangement)

According to the statistical and accounting practices and publications in the country all nominal values in this report are expressed in old-BGL because the period before the denomination of the BGL has been reviewed.

ACRONYMS AND ABBREVIATIONS

BNB	Bulgarian National Bank
BSE-Sofia	Bulgarian Stock Exchange-Sofia
CD	Central Depository
CMEA	Council for Mutual Economic Assistance
CMP	Center of Mass Privatization
EEC	European Economic Community
EU	European Union
GDP	Gross Domestic Product
LPOS	Law on Public Offering of Securities
LSPI	Law on Supplementary Voluntary Pension Insurance
LSSEIC	Law on Securities, Stock Exchanges and Investment Companies
MECs	Manager-Employee Companies
MF	Ministry of Finance
OECD	Organization for Economic Co-operation and Development
OTC	Over – the counter
OTE	Off – the – exchange
SAIS	State Agency of Insurance Supervision
SSC	State Securities Commission
UCITS	Undertaking for Collective Investment in Transferable Securities
ZUNK	Law on Settlement of Unperforming Credits

LIST OF TABLES

LIST OF FIGURES

EXECUTIVE SUMMARY

The objective of this report is to contribute to the discussion of capital market reform in Bulgaria in preparation for eventual integration into the European Union. The report views the accession question on two levels. The first is whether the necessary capital market institutions and legislation are in place. The second is whether capital markets are functioning in a manner that supports economic growth and development.

The impetus for the development of the capital market in Bulgaria was the first wave of the mass privatization program. This program was similar to the program implemented earlier in the Czech Republic. At the same time the Czech Republic is among the first countries in transition that has been invited to negotiate accession with the European Union. For these reasons it is useful to compare the process of capital market developments in the two countries. However, it should be taken into account that because of the problems that have surfaced recently in the Czech capital markets, the Czech example does not necessarily furnish solutions to the problems that are likely to arise.

MACROECONOMIC PERFORMANCE OF THE BULGARIAN ECONOMY[1]

While the period of transition has been difficult for the countries in Central and Eastern Europe, the macroeconomic performance of the Bulgarian economy has been among the weakest. After a sharp decline in output at the beginning of the transition and a shallow recovery, there was a severe financial crisis in 1996 and 1997. The financial crisis created hyperinflationary levels of inflation in early 1997. In July 1997 a currency board was established as a result of which in 1998 inflation was only 1% and for 1999 the inflation remained at very low levels – 6.2%.

Foreign investment in Bulgaria during the first years of transition has been very low. Total foreign investment for the period 1992 – 1998 was barely about $225 per person. An important contributing factor for this unsatisfactory result was a debt moratorium declared in 1991 and lifted in 1994.

Structural change has proceeded very slowly. This has been particularly true of large-scale privatization. It is estimated that only between 5 and 7% of state enterprise assets were privatized cash between 1992 and 1997. An additional 12-14% of state enterprise assets were included in the first wave of mass privatization that was completed in the summer of 1997. There has been very little investment in or restructuring of state enterprises during the whole period. In addition to that the managerial turnover in those enterprises has been high. Unclear perspective and short horizons in front of the managers of state enterprises had often reflected in "tunneling" and decapitalization of those enterprises. For the last year and a half the Government has made a more concerted effort to privatize the remaining large state enterprises through cash sales.

ORIGINS OF THE CAPITAL MARKET

The basic structure of the first wave of mass privatization was very similar to the Czech program. Voucher books were sold to citizens for a small participation fee. The vouchers could then be used to purchase shares directly in offered enterprises or the books could be transferred to privatization funds. The first wave was completed in June 1997.

Shares in 1050 (out of a 3701) state-owned companies were offered in the auction and the percentages of shares in these companies that were offered varied considerably. For many large companies only 25% of the total capital was offered. For smaller companies as much as 90% might be offered. The program was much smaller than the Czech program. As a result it should be underlined

[1] Further information could be obtained from Bulgaria Online (www.online.bg)

that the market capitalization of the Bulgarian market ($900-950 million) is much smaller than the Czech ($14 billion).

The second wave of mass privatization was organized very differently. The second wave is still proceeding, but presently it has insignificant influence on the capital markets.

OVERVIEW OF THE CAPITAL MARKETS

Unlike the Czechs, who purposely attempted to minimize supervision of the capital markets, Bulgaria established an extensive regulatory framework. This included the Bulgarian Stock Exchange –Sofia (BSE-Sofia), a Central Depository (CD) and a State Securities Commission (SSC), the name of the State Securities Commission according to the repealed Law on Securities, Stock Exchanges and Investment Companies was Securities and Stock Exchange Commission (SSEC).

To create price integrity and transparency, the law encourages trading with shares of public companies on the BSE-Sofia. Block trades can be negotiated off the exchange, but they have to be registered on the exchange. The only transactions that can take place off the exchange are swaps or transactions that take place between physical persons.

In spite of legal rules limiting off-the-exchange trading (OTE), there has been substantial OTE trading as the number of OTE transactions have far exceeded the number of BSE –Sofia transactions. Between January 1998 and June 1999 period, the number of shares traded OTE exceeded BSE–Sofia trading by 33.9%. (In the first quarter of 1998 approximately 48% of the share turnover in the Czech Republic was OTE.)

The size and volume of OTE trading raises serious questions about price integrity in the market. Prices of OTE transactions are not registered so there is no way to know how prices in the two markets compare. At this point one can only speculate as to why so much trading is occurring OTE, but making OTE trading more transparent may encourage more trading to move to the BSE-Sofia.

SIZE OF THE MARKET

There are a large number of companies listed on the BSE-Sofia, but in practice many small companies have not been traded at all. While the unadjusted market capitalization figure is about $950 million, this includes all investment funds and holding companies and all shares in partially privatized companies that are still owned by the State. The actual figure for shares not held by the Government and available for trading on the BSE-Sofia is probably closer to $425 million. This works out to $121 per participant in the mass privatization program or a little more than one month's wage.

The market also has very low levels of turnover. Turnover figures at the individual company level are available only for trades on the BSE-Sofia. Most company shares have been traded very few times since the stock market opened. Only eight companies have traded shares in more than half the sessions for which they were registered.

CONCENTRATION OF OWNERSHIP

There is increasing concentration of ownership in Bulgarian companies. Records obtained from the CD show that 614 (of 1142) companies have a major shareholder with more than 50% ownership. Holding companies and investment companies which succeeded former privatization funds have restructured their portfolios typically aiming at more concentration. Holding companies are now the biggest shareholder in 393 companies, and investment companies are the largest shareholder in 9 companies. This kind of concentration is not possible in the Czech Republic where investment funds have been limited to a 20% interest in any one company.

PRIVATIZATION FUNDS HOLDING COMPANIES AND INVESTMENT COMPANIES

Privatization funds played an important role in the mass privatization programs in both the Czech Republic and Bulgaria. Czech funds have not played the anticipated role in corporate governance and it is widely known that fund managers have "tunneled" money out of the funds for their own private use.

The greater ownership concentration in fund portfolios makes the Bulgarian funds more like traditional holding companies. Bulgarian regulations also encouraged privatization funds to convert to holding companies and 76 out of total 81 former privatization funds are now holding companies. The rest converted to investment companies. The analysis shows that Bulgarian privatization funds (now holding companies) appear to be more active in the governance of the companies in their portfolios than their Czech counterparts.

CAPITAL MARKET INSTITUTIONS

The three main institutions which support the capital market are the Bulgarian Stock Exchange – Sofia, the Central Depository and the State Securities Commission. The legislation that was passed to support these institutions provides a good foundation. The most serious difficulties facing these institutions comes from forces that are creating pressures that are slowing the development of open and transparent markets.

For example, at the BSE-Sofia there has been a tension between trying to serve the widest possible clientele and creating a transparent market. Many companies that were privatized through mass privatization have not provided the necessary information required for public companies under Bulgarian law and have not taken necessary steps to register on the stock exchange. For this reason, the BSE-Sofia created two types of markets: an official market and a free market. Unfortunately, some of the larger more liquid companies have decided to remain on the free market.

Government securities, municipal bonds and corporate bonds are supposed to be listed on the bond market of the BSE-Sofia. Presently, there is no trading with government bonds on stock exchange. The obstacles are mainly technical. But developing a secondary market in government securities is a real possibility. This would expand the scope of trading on the BSE-Sofia and provide a structure of interest rate levels that would become a basis for evaluation of riskier securities.

The first corporate bond was issued in August 1999. Sofia municipality has successfully issued bonds in Luxembourg where the market is deeper. Two other cities have applied to issue bonds and Svishtov's request was recently approved by the SSC.

The BSE-Sofia uses a continuous order-driven trading system. Since order flow is so small, continuous trading can cause large swings in prices. This fluctuation has been controlled by putting constraints on price movements for securities traded on BSE-Sofia. Given the illiquidity in the market there may be advantages in splitting the market and creating call auctions for the shares in all but a few companies that do not trade frequently.

CENTRAL DEPOSITORY (CD)

All public companies have dematerialized shares, and the shareholder registration books for these companies are kept by the CD. Transactions are also settled through the CD. The establishment of the CD has facilitated transactions in securities, and eliminated many problems that have arisen in other transition economies.

Membership in the CD is important since only members can interact directly with the CD to register transactions and anyone registering a transaction must

be represented by a member of the CD. Only members and duly authorized persons have access to the CD's data and then only with respect to transactions to which they are a party. This is unnecessarily restrictive and makes it difficult to obtain important information.

SECURITIES LAWS AND THE STATE SECURITIES COMMISSION (SSC)

The repealed Law On Securities, Stock Exchanges and Investment Companies (LSSEIC) from 1995 established the Securities and Stock Exchanges Commission (SSEC) to ensure the protection of the interests of investors and to stimulate the development of the securities market. Although most provisions of the LSSEIC were broadly in harmony with relevant EU Directives, several provisions of the LSSEIC needed modification if the law is to be consistent with EU standards. The National Assembly enacted at the end of 1999 the new Law on Public Offering of Securities (LPOS). This new law makes Bulgarian securities law nearly compatible with the standards and requirements of the most important EU directives and contributes to the institutional strengthening of the regulating and controlling body, renamed into the State Securities Commission.

At this stage enforcement is a bigger challenge than the passage of good law. Many provisions of the repealed LSSEIC had not been implemented in practice. For example, information disclosure has been a serious problem. The LPOS as well as preceding LSSEIC lays down formal requirements for the disclosure of information to the SSC and to the BSE-Sofia, but many companies do not comply. Many companies lack the motivation to disclose information since the potential advantages and benefits provided by the chance to raise funds in the capital market remain distant.

Accounting procedures and standards are another area where problems exist. Important differences still persist between national and international accounting standards and shareholders cannot be confident that auditors in all cases have fulfilled their obligations in good faith.

CORPORATE GOVERNANCE

Corporate governance is another area that needs improvement. There are important weaknesses in the Commercial Code that could be corrected and that would improve the position of shareholders. Improvements could be made if the Commercial Code was brought into more conformity with a recent OECD (Avilov, et. al., 1999) report on corporate governance for transition economies. Such changes would include changes like the following: (a) making it easier for shareholders to obtain information on other shareholders so that shareholders could organize opposition to management initiatives; (b) lowering the voting requirements from 10 to 5 percent of the capital to call a general meeting; (c) change of the voting rules to cumulative voting rules; (d) spelling out the duties of members of the board of directors to specify codes of conduct and rules on conflict of interest; (e) establish provisions for buying out "stranded" minority shareholders.[2]

Whatever the legal provisions a serious enforcement problem will remain. The courts need to acquire a better understanding of company law and apply it appropriately. The Ministry of Justice should provide special training for judges in matters pertaining to corporate governance and control.

[2] The Corporate Governance Initiative (www.csd.bg/cgi), a coalition of Bulgarian non-governmental organizations, established in the beginning of 1999 by the Association of Voluntary Pension Funds, the Center for Economic Development, the Center for the Study of Democracy, the Investor's Union and the Security Holders Association, has developed a Policy Recommentation Paper. Its aim is to facilitate the adoption of relevant corporate governance standards and procedures.

CONCLUSIONS

In preparation for integration into the EU, Bulgaria has established institutions and laws that are largely in conformity with EU provisions. A much bigger challenge is bringing about better functionality.

In spite of efforts to improve the regulation of the capital market, serious problems remain. It is possible to create institutions that look like capital market institutions in the West but do not function effectively. Some key areas which need attention are:

- Regulation of holding companies: The Czech experience demonstrates that investment funds need to be closely monitored. The transformation of privatization funds into holding companies may be an appropriate change given the situation in Bulgaria, but there are dangers as well. Holding companies should be treated as financial institutions. They should be audited as financial institution.
- Strengthening the BSE-Sofia: The BSE–Sofia definitely suffers from very low trading levels. In connection to this questions have been raised as to whether it is a viable institution. Furthermore, low liquidity has made it difficult to establish price integrity. (a) The Government could help the BSE-Sofia by making more information about OTE trading available. Presently these transactions are totally not transparent. If the CD releases trade information on a timely basis, this would lower the incentive to trade OTE. (b) Trading volume would also be higher if traders were convinced that they can get best execution by trading on the exchange. Moving to call auctions for illiquid shares may help. (c) Establishing a secondary market in government securities would also increase activity on the exchange.
- Improving corporate governance and control: Good corporate governance is key if the privatization process is going to be successful. Company law in transition economies needs to be more restrictive and regulated environment than exists in Western countries. The recent OECD report provides good guidelines for further review of existing laws. Because there is so little experience with capital markets, training programs for regulators and judges are extremely important. Reorganization of the court system so there are specialized courts would help. This would enable judges to gain needed experience and make the training process easier.

All these changes need to be directed towards creating markets where companies can raise capital. The present situation is not adequate. Unless companies see the capital markets as a place where they can raise new financial resources, companies will not have the right incentives to provide information and participate actively in the market. A market in new issues needs to be actively promoted. While many important capital market institutions have been put into place in Bulgaria, the market has serious weaknesses. Before integration into the EU, the capital market needs to be strengthened and become a source of investment capital.

I. INTRODUCTION

During the early stages of the transition period in Bulgaria (1992-1996), economic policy was focused mainly on issues of macroeconomic stability and restructuring. While considerable attention was directed at restructuring the banking system, other financial markets played no significant role. This changed with the completion of the first wave of mass privatization in 1997. Under this program, significant state owned entities were transferred to citizens either directly or indirectly through privatization funds. The mass privatization program created pressure to create capital markets to trade the shares in the former state companies. The shift in ownership also changed the economic climate. With these new ownership patterns, successful economic performance now depends on the development of a new legal and regulatory system that encourages the new owners to restructure the former state enterprises and supports the development of capital markets that can become a source of financing for future growth.

1. MACROECONOMIC PERFORMANCE OF THE BULGARIAN ECONOMY

While the period of transition has been difficult for the countries in Eastern Europe, the macroeconomic performance of the Bulgarian economy has been among the weakest. (See Table 1.) After a sharp decline in output at the beginning of the transition, the economy began to grow slowly in 1994. But in 1996 and 1997 Bulgaria experienced a severe financial crisis and output fell again. In July 1997 a currency board was established and the economy began to slowly grow again. Initial evaluations for 1999 were for continued growth of over 2.5%.

TABLE 1. Basic Economic Indicators

	1992	1993	1994	1995	1996	1997	1998
GDP growth %	-7.3	-1.5	1.8	2.1	-10.9	-6.9	3.5
Inflation (CPI) %	79.2	63.9	121.9	32.9	310.8	578	1
Unemployment Rate	15.6	16.4	12.8	10.5	12.5	13.69	12.17
Basic Interest Rate (end period)	49	63	94	38.6	342	6.8	5.3
Government balance (cash) % GDP	-13	-10.9	-5.8	-5.7	-8	-3.1	-1.1
Trade Balance (millions US dollars)	-212	-885	-17	132	-35	381	-329

Sources: Economics of Transition, Volume 5 (1), 1997 p.257 and Volume 6 (2) 1998

Until recently inflation has also been a serious problem. Prices were released in February 1991. Prices jumped sharply and inflation for the year was 334% . Inflation came down but remained at high levels. In the spring of 1994 the nominal value of the lev fell significantly and inflation surged again. Inflation declined to 62% in 1995, but the onset of the financial crisis in 1996 caused inflation to rise dramatically, reaching 240% per month in February 1997. With the introduction of the currency board in mid 1997 the inflation was put under control. Under the currency board inflation in 1998 was 1% per annum and in 1999 the inflation continued to be very low – around 6 %.

Bulgaria is a small country. Total GDP in 1998 was DM 21.6 billion ($ 12.3 billion). The foreign trade sector is important for the country. In 1998 exports were $4.2 billion or approximately 35% of GDP. Before the transition began, Bulgaria was heavily dependent on trade with the CMEA countries, especially the Soviet Union. Over time trade with the former Soviet Union has declined

and trade with the European Union has increased. In 1998 half of Bulgaria's exports went to the European Union, less than 5% to the former Soviet Union.

Foreign investment in Bulgaria are still very low. Total foreign investment for the period 1992 – 1998 is only $1.8 billion or about $225 per person.[3] There were several contributing factors. Bulgaria borrowed large sums in international markets during the 1980s. Unable to meet debt service requirements, Bulgaria declared a moratorium on debt repayments in 1991. The moratorium was lifted in 1994 when negotiations with the London Club were concluded. Other factors that discouraged foreign investors were the high levels of political and economic instability. Since 1991, there have been five governments (and two provisional governments). Along with these political changes there have been many changes in the laws governing business activity.

Since the currency board has been established, the internal economic and political climate has improved, but the international climate has deteriorated. The financial crisis in Russia has reduced international investor interest in the region. The events in Kosovo have reinforced the perception that the Balkans is a high risk unstable region. As a result foreign investment at this stage remained at low levels.

2. STRUCTURAL CHANGE IN THE BULGARIAN ECONOMY

Structural change has proceeded very slowly. Early privatization was focused on the return of agricultural land and the restitution of urban buildings to former owners. The restitution of agricultural land was much more problematic than originally anticipated. Small plots of land proved inefficient. Animal herds declined when farmers received animals before they obtained the land to support them. Restitution of urban property proved more successful and provided an avenue for the expansion of small retail and wholesale businesses.

Privatization of large scale enterprises proved to be a much more politically sensitive issue. It is estimated that only between 5 and 7% of state enterprise assets were privatized between 1992 and 1997.[4] An additional 12-14% of state enterprise assets were included in the first wave of mass privatization which was completed in the summer of 1997. This brought total privatization to about 20% at the end of 1997. In 1998 and 1999, the pace of cash privatization accelerated somewhat. By June 1999 about a third of state assets had been privatized.[5] If the contribution of the new private firms and agricultural production by cooperatives is accounted for, the contribution of the private sector is close to two-thirds of GDP.

There has been little restructuring of state enterprises. Managerial turnover has been high. Managerial positions were part of the political spoils system and Governments changed several times during the nineties. Short tenures have encouraged asset stripping. Only in 1998 and 1999 the Government has made a more concerted effort to privatize the remaining large state enterprises through cash sales, but because there has been so little investment or no investment at all in these enterprises over the past ten years, the prices offered for these companies have been very low.

---

[3] Total foreign investment for 1999 is expected to be $ 600-700 million or about $ 72-84 per person. Total foreign investment includes privatization, green field and reinvestment, capital market. Sourcre:Agency for Foreign Investment.

[4] Many different numbers have been used to describe the percentage of privatization. An important distorting factor is that many firms have been partially privatized with the State retaining a significant share of ownership. The figures used here include as private only those percentages of an enterprise that have been privatized. So if 25% of a company has been privatized, then only 25% of its assets are included in the overall calculation of the privatized sector.

[5] This percentage is based on total state assets. According to the current privatization law, some assets are not eligible for privatization e.g. railroads, electric power companies, gas pipes, and the nuclear power station. By May 1999, almost 50% of assets eligible for privatization had been privatized.

While Bulgaria quickly organized a two-tier banking system, the banking system functioned very poorly. From the outset the banks were burdened by bad loans which were carried over from the pre-transition period. There were several failed attempts to recapitalize the banks. In the largest program in 1994 the government replaced bad loans to enterprises with government (so called ZUNK) bonds. However, banks made additional highly risky loans and therefore their balance sheets did not improve.

Very weak commercial bank balance sheets and large deficits of the budget helped bring on the Bulgarian financial crisis in 1996-7. The full extent of the banking problems were not known until reporting requirements were tightened and enforced in 1995. Along with inadequate regulation during the period leading up to the crisis, the BNB also provided liberal refinancing of the commercial banks. The banks then loaned this money to enterprises or financed private firms under vague conditions. In many cases these loans were a form of implicit subsidy since there was little chance they would be repaid. In other cases financing of private firms turned to be a form of bank resources tunneling. "Until 1996, credit was expanded to the non-financial sector in Bulgaria to a degree that was unprecedented relative to any other European transition economy." (OECD, 1999, p. 32)

During the financial crisis, several banks were closed, and proposals were put forward to establish a currency board. The currency board has restored confidence and signalled a change in regime where there is much greater economic discipline. The situation in the banking sector has also improved dramatically. The banks have reduced their exposure to the non-financial sector and the capitalization of the banks rose to 36.7% in 1998 (against the minimum requirement of 10%) (OECD, 1999) When the currency board was established, the banks initially did little additional lending to the non-enterprise sector and expanded their holdings of cash and government securities. More recently banks have taken a less conservative positions and have expanded their lending to the non-financial sector and reduced their cash holdings.

The establishment of the currency board, and the stabilization that came with it, coincided with the end of the first wave of mass privatization, While the mass privatization program had many distinct features, this first wave was modeled after the Czech program. Citizens paid a small fee for vouchers which could be used to bid for shares in state-owned enterprises in national auctions. As in the Czech program, Bulgarian citizens could choose to transfer their vouchers to privatization funds if they did not want to bid directly in the auctions.

Once the mass privatization auctions were concluded, there was increased need to develop new capital markets. "Block trading" of shares began in October 1997 and was substantial for several months, but more general trading on the new stock exchange did not really begin until March 1998. Some delays were due to technical problems in organizing of the exchange. Other problems also made the start of the exchange market difficult. New regulations had to be passed in many of the company charters, where clauses for pre-emptive rights of shares existed. Furthermore, the information that had been made available for the auctions fell well short of the information needed to create a prospectus under Bulgarian law for publicly traded companies.

At first, trading volume on the stock market was high as a number of transactions were concluded as a result of the tendency for restructuring and shares consolidation. But in 1999 the volume of the average non-block trading has been averaging about DM 220,000 per day (January through May) or about the one-third the average trading level in 1998. The low volume of trading raises questions about the viability of the Bulgarian Stock Exchange (BSE-Sofia), whether the securities traded on the BSE-Sofia can be expanded or what its future role might be in the capital market.

3. OUTLINE OF THE REPORT

The objective of this report is to contribute to the discussion of reform of the capital markets in Bulgaria and prepare for accession into the European Union. The process of mass privatization in Bulgaria was similar to the program implemented earlier in the Czech Republic. As in Bulgaria the impetus for the development in the Czech Republic came from the mass privatization program. For these reasons it is useful to compare the process of capital market developments in the two countries. About the time that Bulgaria was completing the auctions in the first wave of mass privatization, difficulties began to surface in the Czech capital markets. This report includes recommendations for improvements in the Bulgarian markets in hopes of avoiding problems that have arisen in the Czech Republic.

The report is organized as follows. Section II presents the development of the Bulgarian capital markets. It includes an analysis of the impact of the mass privatization process as an impetus to the development of the stock exchange and describes some of the implications this has for the present performance of the market. Section III provides an overview of the capital market. Indicators of size and liquidity for the Bulgarian market are compared with indicators for other transitional economies. The section points out the process of ownership concentration and examines its implications for the capital market. Section IV describes capital market institutions created to support and regulate the market.

Section V studies the legal basis regulating the capital market. This section includes an extensive appendix where a detailed comparison of the Bulgarian legislation, EU and Czech laws is provided. Section VI analyzes the laws pertaining to corporate governance and makes recommendations for possible improvements. Section VII provides a brief overview of developments in insurance and pension funds which at this stage play relatively small role for the capital market compared to the former privatization funds. Section VIII summarizes the most important findings and provides policy recommendations. Section IX concludes.

II. DEVELOPMENT OF THE CAPITAL MARKET IN BULGARIA

1. THE FIRST WAVE OF MASS PRIVATIZATION

During the early years of transition Bulgaria attempted to privatize its state enterprise sector through cash sales and various forms of manager-employee buy-outs. Many political conflicts arose over the proper course of action and the process was very slow and cumbersome. Under Socialist leadership Parliament passed a Program for mass privatization in Bulgaria at the end of 1995. Ideologically it was introduced as a means of "restitution of labor" as a counterpoint of the earlier governments' policy of "restitution of property".

Compared to some other mass privatization programs (i.e. Poland), the Bulgarian program was relatively liberal, restricting the role of the State and the state bureaucracy. The first wave allowed the formation of privatization investment funds which have become an important ownership group. The program was designed to be carried out in two separate "waves". The Government had to design specific programs for each wave and these programs had to be separately approved by Parliament. The "first wave" was carried out in 1996-1997 by specially organized Center of Mass Privatization (CMP). The Government declared that it was trying to achieve the following main goals:[6]

- acceleration of the privatization process;
- creation of a modern capital market and its infrastructure;
- involvement of a large segment of the population in the ownership, control and the management of privatized companies;
- redirect economic policy to focus on long-run structural problems; recovery of the state budget; improvement of the management of the state-owned sector; and determining priorities for state directed investments.

Under the mass privatization program all adult Bulgarian citizens had the right to purchase, for a small participation fee, a certificate (voucher book) with 25,000 "investment bonds." The "investment bonds" could only be used to purchase shares in the companies included in the program. These bonds were not tradable and could only be transferred to close relatives. These restrictions discouraged the establishment of a secondary market in "investment bonds". On the other hand, the restrictions made it more important to establish a secondary market in shares.

The owners of certificates (voucher books) had two options. They could take part in the centralized auctions and use their investment bonds to bid directly for shares in one or more companies. Alternatively investment bonds could be exchanged for shares in a privatization fund(s). With the received bonds the privatization fund then participated in the centralized auctions and acquired shares.

The total number of shares offered for mass privatization was 90.4 million from 1050 companies out of a total of 3701 state-owned companies. The program included enterprises from all sectors of the economy except for infrastructure, utilities, military and banking.

Companies participated in the program with different amounts of capital. Basically, there were three classes of companies:

1. companies where 25% of the capital was offered for mass privatization. Typically, these were large-scale enterprises with an important place in the na-

[6] Privatization program through investment vouchers", adopted by Parliament on December 19, 1995.

tional economy. The State retained the remaining 75% to maintain control and look for prospective strategic investors;

2. companies where 67% of the capital was offered. These were primarily medium-sized enterprises although some large enterprises were also included here. In those enterprises the State remained a majority shareholder (privatization funds were allowed to hold up to 34%), and thus the State retained veto power over important decisions in these firms.[7]

3. companies for which 70 – 90% of the capital was offered. These were medium and small enterprises.

The distribution of companies included in the program is presented on Table.2.

TABLE 2. Distribution of Companies by Share of Capital Offered for Mass Privatization

Share of capital offered for MP	Number of companies	Total number of shares	Number of shares offered for MP
up to 1/2	230	127,802,109	33,141,005
from 1/2 to 2/3	8	845,494	483,695
over 2/3	812	81,575,645	56,758,437
Total	1,050	210,223,248	90,383,137

Source: CMP

At the conclusion of the auctions, 69.1 million shares of 1040 enterprises, or 76.4% of the total number of shares offered, were transferred to privatization funds and individuals. By way of comparison, 93% of the shares offered in the Czech program were transferred. The difference was due to different auction procedures employed in the two auctions.

The auctions succeeded in transferring between 12 and 14% of state assets to the private sector. It is estimated that only 5-7% of state property was transferred by other schemes (mainly cash privatization) during the period from 1992 till end-1997. Thus the mass privatization scheme represented an important step forward in the privatization process. Still the mass privatization scheme was small when compared with the Czech program. In the Czech Republic estimates vary, but somewhere between 65 % and 90% of the Czech economy was privatized by the end of the second wave of mass privatization. (Coffee, p. 71)

The difference here is important, because the Czech mass privatization was viewed as far more important by Czech citizens. At one point the Czech capital market had a capitalization of $14 billion while the Bulgarian market has a capitalization of only $900-950 million.

In the end, nearly 3.5 million Bulgarian citizens became shareholders. Of these about 3 million individuals became shareholders in the 81 privatization funds established during the process. The remaining 0.5 million acquired shares in the enterprises included in the program.

While these participation rates are very high, they are far below the levels recorded in the Czech Republic. As Table 3. shows, close to four-fifths of eligible Czech citizens participated in their voucher privatization program. On the other hand, privatization funds are more important in the Bulgarian program.

[7] Initially, 65% of the capital in these enterprises was to be included in the mass privatization program. Under the Commercial Law, one-third was enough to give the State veto power over all key decisions. After the World Bank made a statement that a company is considered privatized when its private owners hold control over all decisions, the participation of these companies was increased to 67% (more than two-thirds) of their capital. Formally, this would have given private owners full control of these companies. However, on the eve of the first centralized auction, the State changed the articles of association of many of these companies so that it still retained veto power over key decisions even though it had only 33% of the shares.

This lead to more concentration of shareholdings in the Bulgaria market from the opening of the market. Furthermore, once the voucher privatization auctions were concluded, investment funds in Bulgaria were no longer bound by the 34% limit on the percentage of shares they could hold in any one company. When block trading began in October 1997, many funds quickly acquired additional shares in companies where they had a strong interest.[8] Czech funds were formally limited to 20% ownership, although fund groups could acquire as much as 40%. (Coffee, p. 121-22)

TABLE 3. Participation of the Population in Mass Privatization

	Bulgaria	Czech Republic*	
		I-wave	II-wave
Eligible Population (millions)	6.5	7.6	7.6
Participants (millions)	3.5	5.9	6.2
Relative Share of Participants (%)	53.8	77.6	81.6
No. of Voucher Books Transferred to Funds (millions)	2.4	4.3	3.9
Rel. Share of Voucher Books Transferred to Funds (%)	80.5	72.8	62.9

** Data is only for the Czech Republic. First wave was carried out within Czechoslovakia.*

Data Sources: CMP; Mass Privatization in Central and Eastern Europe and the Former Soviet Union, The World Bank, 1995.

TABLE 4. Size of Privatization Funds by Type of Founders (mil. inv. bonds)

Main founders	Number of funds	Average Capitalization	Largest	Smallest
Private banks and financial institutions	11	736	2,765	104
State banks and financial institutions	8	1,477	6,565	84
State organizations and enterprises not in mass privatization	2	749	1,014	485
State enterprises in mass privatization	9	1,467	5,693	66
Labor unions	1	2,239	2,239	2,239
Cooperatives	2	2,075	2,645	1,505
Other	48	454	2,833	55
Total	81	775	6,565	55

Source: Center for Mass Privatization

One difference between the Czech and Bulgarian auctions is that Bulgaria did not privatize banks in the mass privatization program while in the Czech case, many question on issues of cross-ownership arose. Banks established privatization funds and these funds, in turn, purchased shares in the founding bank. (Coffee, 1998) Banks were founders of several large funds in Bulgaria, but this kind of cross-ownership could not occur.

[8] Many of these block trades had been negotiated much earlier. Before the voucher auctions began investment funds signed futures agreements where they agreed to purchase shares in the auctions for one another or for other strategic buyers.

By way of contrast, in Russia the managers gained control of the firms. The Bulgarian results in that respect are much more mixed. Table 4. identifies six categories of founders of privatization funds. Nineteen funds were founded by banks or financial institutions. Two bank-founded funds are among the biggest with more than a billion investment bonds.[9] Three other large funds (over one billion investment bonds) were founded by enterprises involved in the auction. As a whole we were able to identify a total of only nine funds clearly associated with an enterprise in the auction. So out of 1040 firms and 81 privatization funds only nine enterprises in the auction had managers directly controling also privatization funds.[10]

The mass privatization program created pressure to open the Bulgarian Stock Exchange. Trading in shares of companies privatized through the mass privatization program gradually began to develop. The inevitable consequence was the emergence of the capital market, and the related necessity in creating its appropriate institutions and regulations.

2. THE SECOND WAVE OF MASS PRIVATIZATION

The stock market opened after the first wave, but there was always the intention to have a second wave of mass privatization. The design of the first wave, both before and after its implementation, had been controversial. The new UDF government, which came to power in the spring of 1997, clearly did not like the design of the first wave and even before it was completed, the Government announced that there would be significant changes in the program.

The new Government raised a number of objections to the first wave, that can be summarized to three arguments. On one hand there was concern that the program created widely-dispersed ownership, that impedes the management. Besides, the privatization funds were perceived to be unappropriate owners since they brought no new capital to help restructure enterprises. Third, there was arisk that funds would not be good proprietors of enterprises since they lacked appropriate experience and expertise.

The second-wave program, which is currently ongoing, is built around new principles. First, investment bonds can be used in a variety of ways. The bonds can be used to make payment in different kinds of transactions. These include manager-employee buy-outs, centralized auctions of state-owned enterprises or as installment payments to pension funds (which would then use the bonds to purchase shares). Second, bonds can be purchased over an extended period of time, above 2 years the possibilities for participation in the program are more extended in time. Third, collective forms of investment are ruled out. Citizens can participate individually or through pension funds or manager-employee companies (MECs), but they cannot transfer the bonds to specialized privatization funds.

The short history of the program has revealed until now several shortcomings. The program was designed to increase the funds available for management-employee buyouts, but strategic investors have shown little or no interest in most of the enterprises. For these companies, privatisation by MEC is perhaps the only chance to preserve them as economic entities and avoid liquidation. Furthermore, under present conditions in Bulgaria, there are many potential problems since the manager-employee companies are the prevailing form of

9 Unlike the Czech situation these two funds did not pursue strategies that were closely related to their bank sponsors. In fact not before very long neither fund was controlled by its initial sponsor.

10 Complete information about fund sponsorship, especially with regard to smaller funds is difficult to obtain, but Table 4 should be reasonably representative. The categories are by necessity somewhat arbitrary. Not accounted for here is that some funds were run by people who had previously been managers of state enterprises. In additions some funds had CEOs from several enterprises on the board and bought shares in these enterprises. (See Miller and Petranov (2000) and Tchipev (1998))

ownership The capacity to restructure those companies is circumscribed, and access to credit resources is limited. There has been a tendency to bid unrealistically high offer prices for these firms that shifts the real buyers, and this has made it difficult to pay off shares later. Management–employee buyouts have also been a preferred method of acquiring firms by back-stage players.

The use of investment bonds as payments to pension funds is also problematic. If the pension funds use these bonds to buy shares, then the greater part of pension assets will be in risky securities offered by the state in the second wave. What companies these will be is still unknown. At the same time, funds will owe regular pension payments to subscribers. These problems will be further exacerbated if people nearing pension age invest their bonds in pension funds during the period when liquidity of Bulgarian capital market remains low.

The second wave of mass privatisation started in July 1998. After one year (30 June 1999), 976,000 people have registered. This is 15.2% of the eligible population and 27.9% of the participants in the first wave. BGL 244 billion in investment bonds have been acquired.

Thus far the auctions have mostly been for stock in enterprises which were included in the first wave of mass privatisation. Some of this stock was not offered in the first wave; other stock was not purchased in the first wave. These have generally been small and medium enterprises which have attracted little interest. Until now none of the large companies that are actively traded on the BSE-Sofia have been offered in the second wave. Also absent from the second wave is stock in enterprises which were not included in the first wave, but would certainly attract the interest of capital market investors, e.g. the Bulgarian Telecommunication Company.

Until mid-1999 three centralized public auctions have been held by the Center of Mass Privatization where state-owned stock can be purchased using investment bonds or cash. The results are presented on Table 5. and Table 6.

TABLE 5. Results of Centralized Public Auctions, minority stock

		Number of enterprises		Number of shares		Amounts paid (thous)		
Auction	Average share of capital offered	Offered	Bought	Offered	Bought	Invest. bonds (%)	BGL (%)	Total
1st	8.77%	31	28	164, 246	69 ,711	97.5	2.5	661, 643
2nd	14.53%	47	46	544, 843	244 ,696	96.6	3.4	3,161,925
3rd	16.06%	36	36	522, 443	229, 903	97.1	2.9	2,649,503
Total		114	110	1, 231, 532	544, 310	96.9	3.1	6, 473, 071

Source: CMP

TABLE 6. Results of Centralized Public Auctions, majority stock

		Number of enterprises		Number of shares		Amounts paid (thous)		
Auction	Average share of capital offered	Offered	Bought	Offered	Bought	Invest. bonds (%)	BGL (%)	Total
1st	-	-	-	-	-	-	-	-
2nd	50.49%	1	1	362,599	356,561	97.5	2.5	3,911,474
3rd	79.20%	1	1	18,249	11,771	99.8	0.2	393,069
Total		2	2	380,848	368,332	97.6	2.4	4,304,543

Source: CMP

A total of 1,612,380 shares were offered. 56.6% of them were purchased. For minority stock only 44.2% were purchased. In all, 10,5 billion investment bonds were used in the auctions. This is only 4.3% of the investment bonds issued before the auctions. Another 11,3 billion (4.6%) of investment bonds were used for payments in management-buyouts. Cash payments for shares acquired at the auctions account were only 2.8% of the total. Cash was used only when participants in the auctions did not have enough investment bonds.[11]

The most likely buyers of these shares, offered on centralized auctions are holding companies (former privatisation funds) which already have shares in the companies as employees working in the companies. Thus far neither group has been very active in the second wave. Holding companies have not been allowed to collect investment bonds as they did in the first wave and cash payments do not make sense since 1 lev has greater value than 1 investment bond.[12] Furthermore, holding companies that have already acquired control of a company do not need to purchase additional shares. Emplyees in the companies have better alternatives as well. If they form a MEC, they could take advantage of special preferences which are more advantageous than participation in the auctions.

Unless there are changes in the second wave, it will not contribute to the development of capital market in Bulgaria. Shares acquired are illiquid. Most investment bonds will be used in management-employee buyouts or invested in pension funds. It is very likely that a high percentage of bonds will not be used at all. If the program is to be have more impact on the capital market, more shares in attractive companies need to be auctioned.

3. SOME IMPLICATIONS OF STARTING WITH MASS PRIVATIZATION FOR THE FUNCTIONING OF THE CAPITAL MARKET

The origins of the capital market in Bulgaria have important implication for the way that the capital market is functioning. Under normal circumstances companies begin their lives as private companies and become publicly traded companies when they need additional capital or they want to create a liquid market for trading in their ownership rights. The impetus for becoming a publicly traded company comes from the company itself and there are different costs to that. The company must provide extensive information about its operations. The original owners lose some degree of control since the new shareholders also have voting rights. Sometimes firms revert to private ownership to avoid the responsibilities of a publicly traded company.

Given the desire to raise additional capital and/or create a liquid market in equity shares, the penalties for failure to comply with disclosure regulations can be severe. The market will punish fraudulent or inadequate financial disclosure by reducing the price of shares on the secondary market making it more difficult for the firm to raise additional capital and reducing the value of the ownership shares of the founding members of the company.

The situation in Bulgaria is very different. The impetus for opening the stock market came from the mass privatization program. Public trading of firm shares began after the voucher auctions were completed. The stock market was established to provide a location where shares could be traded. The management of the enterprises did not initiate the changes. The firms did *not* become publicly traded because they wanted to raise additional capital. Managers did not

[11] The system of auctions envisages a uniform price for all participants, which is formed as a weighted average of all orders. Investors with offer prices lower than the price formed at the auction should pay more.

[12] Cash has greater value because it can be used in more than just privatization transactions. Furthermore, Bulgarian Brady bonds can be used in payment for purchasing state enterprises. These bonds sell at a discount and can be used in payment for state enterprises at their full nominal value. Since Brady bonds can be substituted for investment bonds the value of investment bonds cannot exceed the price of Bradys.

have an ownership stake in the firm before the voucher auctions (although they may have acquired a stake later).

While the management of Bulgarian companies may have perceived few benefits of being publicly traded, there were significant costs. The new owners were often perceived to be a threat by the existing management who were now thrown into a new environment. Furthermore, public disclosure of the firms' operations was costly. Not only is preparing the materials expensive, full disclosure makes it more difficult for the manager to manage the firm in ways that can be personally beneficial.

Even if the manager is not trying to exploit the situation for personal monetary gain, the manager may perceive the enhancement of share value as secondary. It is also possible that persons related in some ways to the company are trying to exercise pressure on the manager. At the end the manager may be more responsive to the demands of these stakeholders than the demands of shareholders as a whole.

Even if managers acquire shares in the company, they may not be interested in the company. The market of shares is so thin for most companies that attempts to sell significant blocks will depress the price. Realistically the market for large blocks works more like the sale of significant interests in a privately held company. To sell a significant interest requires identification of a potential buyer who is interested in acquiring a large interest in the firm. These transfers will not occur in open trading on a stock exchange.

The same situation exists for other large shareholders in Bulgarian companies. These shareholders may have positions on the supervisory or management board of the company. They are well-informed investors because of their position on the board. They have little interest in public disclosure because these large stakes cannot be effectively sold on an illiquid stock market. If they identify a potential buyer this buyer can become more informed without public dissemination of information. Thus the governing body is not a constituent for public dissemination of information either, and the incentives are such that even publicly traded companies have the incentive to act more like private companies.

The danger is that minority shareholders will be left out because there is no place for them to sell their shares (which was the reason for the establishment of the stock market in the first place.)

III. OVERVIEW OF THE EQUITY MARKET

Unlike the Czechs authorities, who purposely attempted to minimize supervision of the equity markets, the Bulgarian authorities established three important institutions to regulate the market. The Bulgarian Stock Exchange –Sofia (BSE-Sofia) was organized as a semi-private institution to facilitate trading in shares, mostly from the mass privatization program. The BSE-Sofia was the only registered and licensed exchange. A Central Depository (CD) was also established to register transfers and shareholding in the dematerialized shares in companies. But the most important institution is the State Securities Commission (SSC) created under the Law on Securities, Stock Exchanges and Investment Companies (LSSEIC) as Securities and Stock Exchanges Commission (SSEC) and regulated in the Law on Public Offering of Securities as the regulatory body to oversee the operations of the securities markets.[13]

1. GENERAL OVERVIEW

As a result of the mass privatization program block trading began in October 1997 and significant non-block trading on the BSE-Sofia began in March, 1998.

TABLE 7. Trading on the BSE – Sofia

1998-1999	Transactions	Total Shares	Turnover (mil. BGL)
January`98	251	2,300,402	41,212
February`98	335	4,871,483	20,252
March`98	202	1,329,932	14,035
April`98	551	1,887,861	12,992
May`98	1907	3,624,446	28,594
June`98	2728	2,649,519	15,669
July`98	3111	2,207,045	21,050
August`98	2343	1,783,314	10,198
September`98	2191	1,157,816	11,418
October`98	2166	1,178,211	8,890
November`98	1812	1,309,128	8,165
December`98	1933	1,873,688	21,007
January`99	1621	977,505	5,081
February`99	1685	3,181,158	26,611
March`99	2774	2,005,470	19,234
April`99	1657	908,000	9,193
May`99	1481	935,469	11,069
June'98	1422	1,212,573	8,246

Source: BSE-Sofia

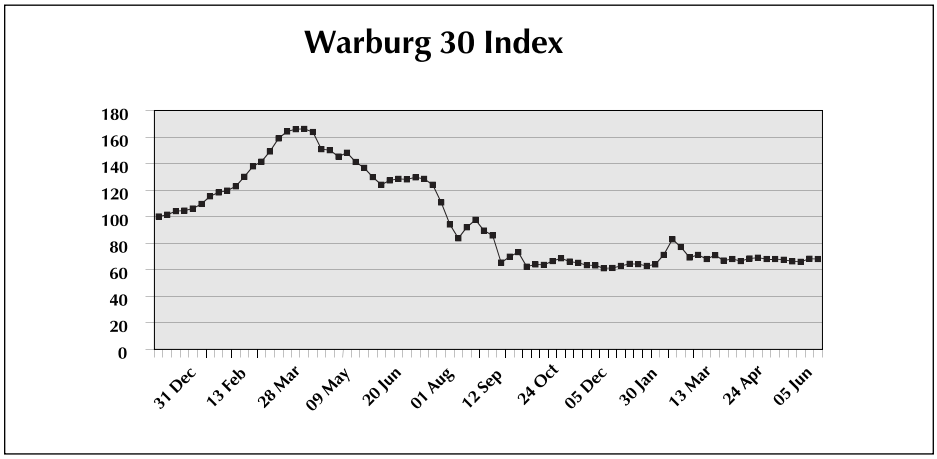
A decision was made that all trading in companies that had participated in the mass privatization program should take place on the BSE-Sofia. It was hoped

[13] The Czechs did not create a regulatory body like the SSEC until 1998, four years after the market opened.

that this would create price integrity and transparency. Block trades can be negotiated off the exchange, but they have to be registered on the exchange. The only transactions that can take place off the exchange are swaps or transactions that take place between physical persons.

As will be outlined in more detail below (See IV.1.) , the BSE-Sofia set up both an official market and free market segment within the exchange. Table 7. shows the level of trading on the BSE-Sofia from the beginning of 1998 to June 1999 (See Table B1.-B2. in Appendix B for more detailed trading data). The small number of transactions in the early part of 1998 reflects the fact that most trading during this period was block trades. The turnover, however, during the first five months of 1998 was 60% higher than the comparable period in 1999, that rises some concerns about the development of exchange trading.

FIGURE 1.



Stocks, as measured by the Warburg 30 Index of the largest market capitalization stocks, also performed well during the early period, but have fallen considerably below the highs they reached in May 1998 (See Table B3. for the companies included in the index). In June-July 1998 the market was falling already, the decline accelerated after the Russian crisis in August and September the same year. After the index was set at 100 in December 1997, it reached a high of 165 in May 1998 and was at 67 in July 1999.[14]

In spite of the legal rules that might be expected to limit off-the-exchange trading (OTE), there has been substantial OTE trading.[15] The law is designed to provide extra flexibility for trading to those individuals in rural areas who might have difficulty trading on the BSE- Sofia. During the period before extensive general trading began on the BSE-Sofia, this might not have been too surprising, but significant trading outside of the BSE-Sofia has continued. Table 8. compares monthly trading levels on and off the BSE-Sofia. It is not possible to compare the monetary value of exchange trading and OTE because the prices of shares traded off the exchange are never registered. The number of OTE transactions have exceeded the number of BSE –Sofia transactions in every month. At its peak in March 1998, the number of OTE trades were nearly seventy-eight times the number of BSE-Sofia trades. At this point few companies had been approved for trading on the BSE-Sofia what explains this unexpected ratio. But even later this ratio varies between 3 to 5 for the whole period. The last column shows the ratio of number of shares traded. Here there is much

[14] It should be noted that the index is weighted by market capitalization. Two stocks, Bulgartabac Holding, the large tobacco holding company, and Neftochim, a large chemical company, together represent more than half the index. These together with the next five companies make up three-quarters of the index.

[15] We have chosen the term 'off-the-exchange' trading rather than 'over-the-counter' trading to emphasize the point that there is no formal trading mechanism like the NASDAQ system for trading shares in the U.S.

greater balance since the transactions on the BSE-Sofia tend to be larger than OTC transactions. Still the number of shares traded OTC during the January 1998 – June 1999 period was 33.9% higher than the number of shares traded on the BSE. In addition, another 16 million shares were traded OTE during 1997.

Many of the transactions in the Czech market also occur OTE. The relative volume of this trading has varied over the years as regulations have changed. In the first quarter of 1998 approximately 48% of the share turnover was OTE.

TABLE 8. Comparison of BSE-Sofia and Off-the-Exchange Trading

	Number of Transactions (OTE)	Number of Shares (OTE)	Average Size of Transaction (OTE)	Number of Transactions (BSE)	Number of Shares (BSE)	Average Size of Transaction (BSE)	Ratio of Transactions (OTE/BSE)	Ratio of Shares (OTE/BSE)
Jan-98	8578	3893416	454	251	2300402	9165	34.18	1.69
Feb-98	10851	8309726	766	335	4871483	14542	32.39	1.71
Mar-98	15754	4038281	256	202	1329932	6584	77.99	3.04
Apr-98	10745	2730298	254	551	1887861	3426	19.50	1.45
May-98	8958	510986	57	1907	3624446	1901	4.70	0.14
Jun-98	8875	1205379	136	2728	2649519	971	3.25	0.45
Jul-98	9345	1521093	163	3111	2207045	709	3.00	0.69
Aug-98	9054	1026847	113	2343	1783314	761	3.86	0.58
Sep-98	8255	1067295	129	2191	1157816	528	3.77	0.92
Oct-98	7744	1173517	152	2166	1178211	544	3.58	1.00
Nov-98	7657	1612861	211	1812	1309128	722	4.23	1.23
Dec-98	5850	4635013	792	1924	1916688	996	3.04	2.42
Jan-99	5495	1869267	340	1621	977505	603	3.39	1.91
Feb-99	8472	1604314	189	1 685	3181158	1888	5.03	0.50
Mar-99	6 20	1658311	247	2 774	2005470	723	2.42	0.83
Apr-99	7793	1968762	253	1657	908000	548	4.70	2.17
May-99	4775	437261	92	1481	935469	632	3.22	0.47
Jun-98	6126	8199304	1338	1422	1212573	853	4.31	6.76

Source: BSE-Sofia, CD

The size and volume of OTE trading raises serious questions about price integrity in the market. Prices of OTE transactions are not recorded so there is no way to know how prices in the two markets compare.[16] The amount of OTE trading strongly suggests that there is a strategy on the part of some traders to avoid the BSE-Sofia. Fees for trading on the BSE-Sofia are reasonable so traders appear to be gaining some other kind of advantage by trading off the exchange.

One reason some traders may choose to trade OTE is that they are gaining a price advantage. In a market where many participants have little understanding of how these markets function, some purchasers may be able to convince sellers to sell to them OTE at prices below the price on the BSE-Sofia.[17]

Another possibility is that agents may wish to conceal their attempts to acquire large holdings of particular companies. If they trade OTE, these activities will

[16] One close observer of the market stated that the price difference in the two markets was 20%. Without price data we were not able to confirm this.

[17] In some instances investment funds have paid dividends. People living in rural areas have complained that agents, not associated with the investment fund, asked them to sign documents to receive their dividends. The documents turned out to be transfer documents.

not become public knowledge until after the firm is required to report major shareholdings to the SSC.

Later in the report we will provide more detail on the availability of information. While a great deal of information is collected by the BSE-Sofia, the Central Depository and the SSC , important information is not easily available to the public. If the lack of transparency is an important motivation for trading OTE, then improving the transparency of OTE transactions is one way of encouraging more trading on the BSE-Sofia.

General Market Indicators

Table 9. provides a general picture of the capital markets in Bulgaria when they are compared with other capital markets – mainly in Central and Eastern Europe and on the Balkans.

TABLE 9. Equity Market Indicators, 1998.

Country	Number of Listed Companies	Market Capitalization (% of GDP)	Turnover (% of GDP)*	Turnover/ Capitalization* (%)	Average P/E**
Bulgaria	998	8	2	20	13.2
					(median 3.2)
Czech Rep.	261	23	9	39	-11.3
Hungary	55	31	35	115	17.0
Poland	198	53	6	12	10.7
Russia	237	5	2	33	3.7
Romania	5753	3	2	59	-19.4
Slovenia	28	13	4	28	205.3
Croatia	50	17	50	3	11.1
Estonia	26	9	17	180	25.9
Portugal	135	62	46	75	22.8
Greece	244	65	38	59	33.6
Turkey	277	17	36	204	7.8
Germany	700	28.3	33	118	20.7

Sources: Data for countries other than Bulgaria is from IFC, Emerging Stock Markets Factbook, 1999. Bulgarian data is from BSE-Sofia.

** Turnover figures for Bulgaria assume that average prices of off the exchange trading are the same as prices on the Bulgarian Stock Exchange.*

*** P/E ratio for Bulgaria is for a small sample of companies with positive profits listed on the Official Exchange and a few large companies traded on the free market. (See Table B4 and B5 for P/E ratios and other indicators for individual companies)*

As the table illustrates the number of companies on the capital market is relatively large but this is a function of the mass privatization. Many of these companies are very small. Many have not traded at all.

The large number of companies on the Romanian exchange is also an outcome of the voucher privatization program in Romania. The number of companies listed in the Czech Republic in 1998 is relatively small. It should be taken into account that in 1995 there were more than 1600 companies in the Czech Republic with listed shares.

The market capitalization evaluation is based on an unadjusted market capitalization figure of $950 million. (Czech Republic, $14.1 billion) This includes all investment companies and holding companies and all shares in partially privatized companies that are still owned by the State. (See Table B6.1-B6.2 for the market capitalization of different segments) Because it is difficult to get accurate figures on the net asset value of all holding companies, we can only approximate the value of these holdings. Table 10. shows how would look an adjustment of market capitalization estimating holdings and investment companies having double counting as well as the fact that the state participation is in practice out of the capital market. With this adjustment the size of the market would be lower than either Hungary or Poland. Given that 3.5 million people participated in the mass privatization process a capitalization of this level would be $121 (= 425/3.5) per person or a little more than one month's wage. This is a small amount even by Bulgarian standards. For this reason the financial impact of the program has not been very significant for most citizens and they don't have special interest in the development of the capital market.

TABLE10. Recalculation of Market Capitalization

Total Market Capitalization	**$920 million**
- State holdings (approx.)	-$435 million
- Double counting for holding companies and investment funds	- $60 million
Recalculated Market Capitalization	**$425 million**

The turnover ratios for both "turnover to GDP" and "turnover to market capitalization" are also very low, although the turnover to capitalization ratio would be more than twice as large if the adjusted market capitalization figures were used. Because no data exist on the market prices of shares that are traded OTE, these figures are necessarily approximations. If the average price of shares traded OTE are much lower than BSE-Sofia prices, this would reduce these ratios.

These low turnover ratios are indicative of the low level of liquidity in the market. The conclusion can be drawn also from the trading analysis of separate positions. Data on the turnover of individual companies shares are available only for shares traded on the BSE-Sofia. Table 11. describes the trading levels for companies on the BSE- Sofia. (A more detailed description of the different segments of the BSE –Sofia is given in Sec. IV.1.) It can be seen that most companies have been traded very few times. Nearly 84% of companies (734 out of 876), registered on the BSE-Sofia were traded less than 15 times for the whole estimated period from the start of the exchange trading. Twenty companies have been traded more frequently and twelve of these are on the free market.

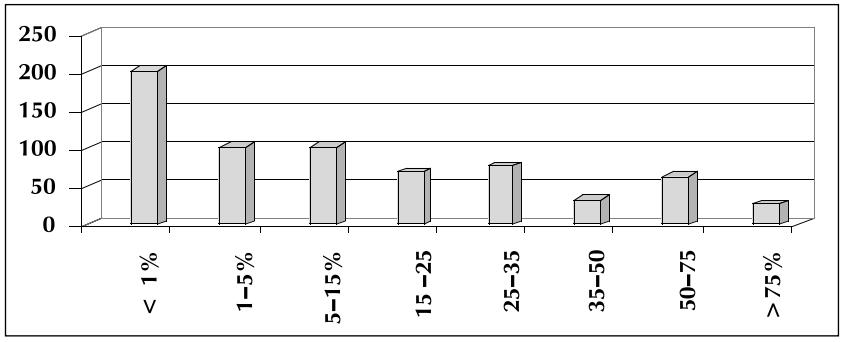
TABLE 11. Number of Transactions per Company on BSE-Sofia for the Period 21.10.1997-15.6.1999

	Number of Transactions					Total
Market	< 15	16 – 30	31 – 60	61 – 120	> 120	
Official A				1	2	3
Official B		1		3	1	5
Official C	6	4	2	6	5	23
Free	728	49	34	22	12	845
Total	734	54	36	32	20	876

Source: BSE – Sofia

The low level of liquidity for most companies is also evident from looking at the percentage of company shares that have been traded since the opening of the BSE-Sofia.

FIGURE 2. Percentage of Shares Traded on the BSE (No. of Companies in Each Category: Total 671)



Source: BSE – Sofia

As Figure 2. illustrates, for almost 45% of companies the number of shares that are traded for the whole period since the opening of the exchange is less than 5% of the whole number of their shares.[18] Only 26 companies have traded more than 75% of their shares and these are almost all very small companies. The notion that liquidity is low is reinforced by the fact that only 8 companies have traded in more than half the sessions and only 18 have traded more than 40% of the time.

2. CONCENTRATION OF OWNERSHIP

The low level of trading and liquidity on the BSE has occurred along with a growing concentration of ownership in Bulgarian companies. Table 12. describes the present level of ownership concentration. The total number of companies in this table is 1142 and includes not only the companies that participated in the mass privatization program but also the new holding companies and investment companies. In the first wave of the mass privatization program, the State retained more than 66.7% of the shares in 174 companies. Furthermore, only three quarters of the total shares in the auctions were purchased. Thus many of the companies in the first category in the table are companies where the State is the major shareholder. Indeed the State is still the major shareholder in 234 companies.

[18] The data includes trading on all 682 companies that have traded on the BSE-Sofia. We were not able to obtain share data on 11 companies.

Still the concentration levels have increased since the mass privatization program was completed. As indicated in the table more than half the companies have a major shareholder who owns more than half the company. Even ownership of holding companies is becoming more concentrated. There were 81 privatization funds participating in the mass privatization auctions, yet after an year and a half there are only 51 of those companies that do not have a major shareholder with more than 10% of the shares.[19]

TABLE 12. Concentration of Ownership in Public Companies

Characteristics	No. of Companies
The major shareholder owns more than 66.7% of the capital	257
The major shareholder owns between 50% and 66.7% of the capital	357
The major shareholder owns between 33.3% and 50% of the capital	298
The major shareholder owns less than 33.3% of the capital	230
Including companies where the major shareholder owns less than 10% of the capital	51

Source: CD

The share holdings of the former privatization funds have also become more concentrated. These funds have been presented with a choice to become a holding company or become an investment company. Important characteristic of the holding companies is that they can make loans to companies in which they hold 25% or more of the shares.[20] For investment companies an intention to have more diversified portfolios is expected. According to statistics compiled by the Central Depository, holding companies are now the biggest shareholder in 393 companies and investment companies are the largest shareholder in 9 companies.

Table 13. shows the dynamics of investment portfolio characteristics of the largest former privatization funds. These funds collected 60% of the investment bonds in the first wave of the mass privatization. All of the funds in this group with the exception of "Zlaten Lev" have chosen to become holding companies. "Zlaten Lev" is actually splitting their portfolio into two parts: one part holding company and one part investment company. As can be seen in the table, these former privatization funds have restructured their portfolios in a way that they sharply reduced the number of companies they hold and have almost uniformly increased the average share holdings in the companies in their portfolios. Most of these changes occurred before mid- 1998.

This kind of concentration is not possible in the Czech Republic. Their funds have been limited to a 20% interest in any one company. This limitation has been criticized by commentators like Coffee (p. 122) who argue that this kind of dispersed ownership makes good corporate governance more difficult.

[19] We would have liked to break down these numbers so that we could see more clearly the relationship between ownership types and concentration of ownership. Unfortunately, the Central Depository was only able to provide us with aggregates. Under present law, there are severe restrictions on what the depository can make available.

[20] In the present environment where the banks are providing little credit and interest rates on loans are high, these loans can benefit both the holding companies and the companies in their portfolios. The loans provide liquidity to the companies, and the holding companies which often have representatives on the board can evaluate the risk.

TABLE 13. Portfolios of the Largest Funds

	No. of Companies			Average Size of Holding		
	After the Auctions	Mid 1998	End of 1998	After the Auctions	Mid 1998	End of 1998
AKB Fores	80	36	38	20.9%	32.0%	30.8%
Akzioner Favorit	97	67	60	9.6%	12.4%	14.2%
Albena Invest	84	N/A	29	17.4%	N/A	36.4%
Bulgaria	88	50	19	17.0%	16.7%	45.8%
Bulgaro-Holandski	112	95	91	16.5%	18.7%	20.5%
Doverie	175	115	82	22.1%	27.3%	25%
Industrialen Capital	21	10	9	17.1%	24.3%	23.6%
Melinvest	73	56	N/A	22.5%	24.6%	25.0%
Multigroup (MG) Elit	36	27	N/A	18.8%	21.8%	N/A
Neftochim Invest	34	22	N/A	20.1%	22.2%	N/A
Orel Invest	38	24	24	14.6%	16.7%	15.0%
Petrol	66	33	N/A	21.2%	26.5%	27.0%
Severcoop Gumza	68	51	N/A	19.3%	24.1%	N/A
Sveta Sofia	55	46	48	17.5%	17.4%	19.5%
Trud I Capital	91	61	54	20.1%	25.6%	27.8%
Youg	53	37	24	17.8%	17.4%	21.4%
Zentralen	49	21	21	14.3%	16.3%	20.5%
Zlaten Lev	67	45	36	17.2%	16.2%	15.4%

Source: SSC, Relevant companies

This rapid move to greater concentration of ownership on the part of the former privatization funds supports the general perception among participants in the capital market that much of the early trading reflected the activity of potential strategic owners as they purchased shares in companies they wanted to control. Having established control, trading volumes have fallen.

The low intensity of trading for many companies on BSE-Sofia it seems improbable that high concentrations of ownership could evolve out of this trading. But without more detailed data it is not possible to determine to what role OTE trading has played in the consolidation of ownership.

3. PRIVATIZATION FUNDS HOLDING COMPANIES AND INVESTMENT COMPANIES

Privatization funds played an important role in the mass privatization programs in both the Czech Republic and Bulgaria. The Czechs have been disappointed with the performance of these funds. They have not played the anticipated role in corporate governance, and they have exploited the unregulated situation in the Czech capital markets to take advantage of their shareholders.

In many of the cases managers of funds have “tunneled” money out of the funds for their own private use. As a result of this and as closed-end funds,

Czech funds sold for deep discounts of the value to net asset value. Recent changes in the Czech legislation is forcing these funds to 'open' gradually. This opening process will occur over time and allows funds to charge a redemption fee of 20% in the first year and 10% in the second year. (World Bank (1999), p. 35)

Not all Czech funds will open, however. As the Czechs have increased the level of supervision, many Czech funds have chosen to become holding companies. By 1998 there were 131 conversions to holding companies, 338 investment companies remained. (World Bank (1999), pp. 30, 31) As holding companies, they are not required to open and have none of the special reporting requirements expected from financial institutions.

The situation in Bulgaria is somewhat different. The greater concentration of ownership of companies in fund portfolios makes the Bulgarian funds more like traditional holding companies. Bulgarian regulations also encouraged privatization funds to convert to holding companies and 76 out of 81 funds are now holding companies.[21] Although direct comparisons are difficult, Bulgarian holding companies appear to be more active in the governance of the companies in their portfolios. This may be a function of the larger stake that they have in their companies. The large holding companies have significant holdings in several companies and are often represented on the boards. Smaller funds are concentrated in one or two companies and are very active in the governance of these companies.

A direct comparison of price-to-NAV ratios in the Czech and Bulgarian markets is difficult because so few shares of Bulgarian funds (now holding and investment companies) trade very much. The fifteen former privatization funds that trade on the BSE-Sofia official market have an average price-to-NAV ratio of 0.51. The range for different funds varies from 1.0 to 0.23. These are steep discounts but are somewhat better than the discounts on comparable Czech funds.[22] In 1996 the price-to – NAV ratio for large funds in the Czech Republic was 0.37. This improved to 0.47 in 1997 after the announcement that they would be required to open.

What is more disturbing than the significant discounts for the funds trading on the BSE-Sofia is the low level of liquidity and the lack of information about the large number of former privatization funds that do not trade on the BSE-Sofia. It is difficult for shareholders in these funds to determine what the value of their stake in these funds might be and to trade this value.

Since so few Bulgarian funds converted into investment companies, it would not be very useful for Bulgaria to follow the Czechs and force funds to open. Since almost all the funds are now holding companies, it would be much more helpful to pass legislation which requires the holding companies to file reports with the SSC that give a more complete picture of their financial holdings than is presently required of other corporations. Then they can continue to be monitored as financial institutions.

[21] Zlaten Lev and Nadejda are the only two investment companies traded on the BSE-Sofia. The others are small and are not traded on the exchange.

[22] Discounts on closed-end funds are common. In the U.S. discounts have averaged about 10%.

IV. CAPITAL MARKET INSTITUTIONS

In this section we provide a more detailed analysis of the three main institutions which support the capital market: the Bulgarian Stock Exchange –Sofia, the Central Depository and the State Securities Commission. The legislation that was passed to support these institutions provides a good foundation. The most serious difficulties facing these institutions come from forces that are creating pressures that are slowing the development of open and transparent markets.

1. BULGARIAN STOCK EXCHANGE – SOFIA

The Bulgarian Stock Exchange-Sofia was established on 28 January 1991 under the name First Bulgarian Stock Exchange. Trading in securities began in 1992. By 1995 there were twelve stock exchanges registered, but the volumes were very low and only 15 –20 companies, mostly banks, were traded on the exchanges.

In June 1995 the Law on Securities, Exchange and Investment Company (LSSEIC) was passed and actions were undertaken to create a regulatory structure and reorganize the capital market. In January 1996, the Securities and Exchange Commission (SSEC) was established and the Central Depository opened in August the same year. In 1995 several exchanges merged and the Bulgarian Stock Exchange was founded. During the financial crisis, which began in 1996, confidence in the market eroded and trading ceased in late 1996. In July 1997, following the last auctions in the first wave of mass privatization, the Sofia Stock Exchange and the Bulgarian Stock Exchange merged forming the Bulgaria Stock Exchange-Sofia (BSE- Sofia). The BSE-Sofia is now the only securities market in the country licensed under the repealed LSSEIC and opened for trading on 21 October 1997.

Normative regulations envisage that all securities transactions in shares of companies participating in the mass privatization program must be executed on the BSE-Sofia. The only two exceptions are transactions between two physical people or swaps. Swaps can be exchanges of shares in publicly traded companies or can be the exchange of shares for government securities. When large blocks are traded, negotiations between the two parties usually take place off the exchange floor, but the transaction takes place on the exchange and the price is registered by the exchange. When off-the-exchange (OTE) transactions take place, the transfer is registered at the Central Depository, but the price is not recorded. In spite of these restrictions, there are almost five times as many OTE transactions as BSE-Sofia transactions (See Table 7). On the other hand, the number of shares transferred in these OTE transactions tend to be smaller than BSE-Sofia transactions.

CAPITAL STRUCTURE AND MANAGING BOARDS OF BSE-SOFIA

BSE-Sofia is a joint-stock company. The State holds the largest stake (37.6%). More than two-thirds of the remaining shares are held by financial institutions, i.e. banks, investment intermediaries, financial brockerage firms, and insurance companies. Pursuant to the legislation, non-State shareholders cannot directly or through related persons hold more than 5% of shares in BSE-Sofia.

BSE-Sofia has a one-tier system of management represented by a Board of Directors. The Board of Directors is responsible for the current operation of the exchange. All decisions concerning membership, securities trading, and sanctions on members of the exchange are coordinated with a special committee in accordance with the legislation. The committee is a five-member body, including representatives of shareholders in the exchange, members of the exchange, stock brokers and issuers of securities.

MEMBERSHIP AND ARBITRATION OF DISPUTES

The BSE-Sofia operates under a system of regulations and requirements that aim to guarantee transparency of transactions, equality among participants, and strict performance of obligations.

Under the rules of the exchange members must:

- be investment intermediaries licensed to execute transactions in securities, in accordance with the provisions of the law, and banks licensed for such activity, in accordance with the provisions of the Law on Banks, and listed in the registrar of SSC;
- not be members of any other stock exchange in the Republic of Bulgaria;
- be members of the Central Depository, or have contract with a member of the Central Depository;
- hold not less than 1000 shares of the capital of the Exchange;
- have full-time or part-time labor contracts with a minimum of two stock brokers.

Presently 78 Bulgarian institutions have been approved as members – 56 investment intermediaries and 22 banks. Among them 12 (5 investment intermediaries and 7 banks) are owned by foreign institutions.

The BSE-Sofia has established an arbitration court to hear claims against members of the exchange regarding the settlement and execution of transactions. The arbitration court decides disputes on the basis of law, stock exchange rules and common stock trading practice. The chairman of the arbitration court is elected by the general meeting of the exchange and serves for three years.

MARKET SEGMENTS

In establishing the BSE-Sofia there has been a contradiction between trying to serve the widest possible clientele and creating a transparent market, because the big amount of companies that were privatized through the mass privatization program presented the BSE-Sofia with a problem. While these firms had been required to provide financial information before the mass privatization auctions began, this information was inadequate for tradable securities under Bulgarian law. The law requires publicly tradable companies to produce a well prescribed prospectus. If trading in shares were to begin quickly following the mass privatization auctions, it would not have been possible for most companies to produce an adequate prospectus. To manage this problem, the BSE-Sofia decided to create two types of markets: an official market and a free market. These designations are designed to signal what kind of information is being made available by the company.

The Official Market for Shares

The official market for shares has been broken down into segments that are largely based on the number of years of audited financial statements. The standards for listing in each segment are described in Table 14. At the end of June 1999, 3 companies are traded on segment „A", 5 companies on segment „B", and 23 companies on segment „C".

TABLE14. Standards for Listing on the Official Market of BSE-Sofia

	Official market		
	Segment "A"	**Segment "B" (Parallel)**	**Segment "C" (Provisional)**
Completed fiscal years with audited financial statements	minimum 5	minimum 3	minimum 1
Market capitalization	minimum BGL 2 billion	minimum BGL 1 billion	Minimum BGL 500 million
Publicly offered issue, %	minimum 25%	minimum 10%	minimum 10%
Number of shareholders	minimum 500	minimum 250	minimum 250
Positive financial results	for the last 3 years	for the last fiscal year	-
Dividend	At least once in the last 3 years	-	-

Source: Rules of operation of BSE-Sofia

The three companies on segment "A" are all industrial companies. "Polimeri" and "Olovno Zinkov Kompleks" are large companies privatized through the mass privatization. "Elkabel", producer of industrial cables, was one of the few companies privatized through sales of shares on the stock exchange. Segment B has four pharmaceutical companies (minority stakes in the mass privatization) and a private bank – "CCB". Listed on the C segment are fifteen former privatization funds, one private bank ("BRIB"), and "Elektroimpex" another firm privatized through selling its shares on the stock exchange. The only important of the industrial company on the C segment is "Varnenska Korabostroitelniza", the Varna shipyard.[23]

The most important condition which differentiates the companies on different segments of the official market is the number of years of audited financial statements. This applies directly to privatization funds which have been converted to investment or holding companies. Since they have existed for less than three years, they do not qualify for the "A" or "B" segments of the market.

The other requirements have not created serious barriers to potential listings. Neither the market capitalization requirement nor the constraint on the percentage of publicly traded shares is particularly limiting. The market capitalization requirement for "C" segment trading is reasonably low ($280,000). Nearly all firms in the mass privatization program had at least 25% of their shares offered in the auctions so this is not a major constraint.

Most firms that are traded on the exchange have participated in the mass privatization and almost all of them have many shareholders. Delisting has occurred, however. When the State's stake in "MDK", a large metalurgy company producing copper, was sold to the Belgian company, "Union Minierre", "Union Minierre" bought out the remaining shareholders.

The last two conditions, positive financial results and payments of dividends, have not prevented any firms from being listed, but they could in the future. On one hand the requirement that firms have positive financial results has not been enforced. On the other since state enterprises with positive profits were required to pay 50% of their profits in dividends to the Government, these firms

[23] Recently "Varnenska Korabosrtoitelniza" has been moved to the "free market" because the company was announced insolvent.

automatically satisfy this requirement. It remains to be seen whether this requirement will become a problem in the future or indeed be enforced.

The barriers to listing on the official market are very low, yet there are very few firms on the official market. The problem lies in the origin of the market. Almost all the firms have been privatized through the mass privatization process and they do not see possibility of raising additional capital on the stock exchange. As described in Section II.3., the firms do not have the incentive to participate in the capital market. Participation is costly and the firms see few benefits.

A similar pattern has developed on the Prague Stock Exchange. Between 1991-1998, no private Czech company has carried out an initial public offering. As Johnson and Shleifer (1999) point out, this contrasts sharply with the Warsaw exchange where 136 non-privatizing companies have made public offering over the same period and more than US $1 billion in new shares funds were raised in 1998 alone.[24]

The Official Market for Bonds

There is also a fourth segment of the official market: the bond segment. The BSE-Sofia is obliged to list on the official market all securities that are issued or guaranteed by the State or the Bulgarian National Bank (BNB).[25] In addition it must list all securities issued by international institutions in which the Republic of Bulgaria is a member.

While government securities, municipal bonds and corporate bonds are supposed to be listed on the bond segment, presently, there are no trading with government bonds. The obstacles to trading government securities are mainly technical, because while the BSE-Sofia works with the Central Depository, the registration and settlement of government securities are administered by the BNB.New issues of government securities are handled by primary dealers that have been selected by the Ministry of Finance. At present, these are mainly large commercial banks. Secondary trade in government securities, however, is not well-developed. Most secondary trades are executions of repurchase agreements. A secondary market in government securities is a real possibility. This would expand the scope of trading on the BSE-Sofia and increase the volume on the exchange. Since they are generally considered the asset carrying the lowest risk, government securities are an important asset in most diversified portfolios. At the same time the interest rate on government securities provides an important basis against which riskier securities can be measured.

The market in government securities in Bulgaria is small at present. The government has initial surplus in the budget so the bonds that the government is issuing are for refinancing paper which is coming due. It should be noted that because of the importance of the government securities markets, several Asian governments have issued government securities even though they did not need the money to finance government expenditures.[26]

There are certain requirements as regards corporate bonds. To issue bonds on the market corporations must meet the following conditions: (1) the issuer should have completed no less than three fiscal years since the date of initial

[24] Johnson and Shleifer argue that failure of firms to raise additional capital on the Czech markets is strong indicator of the problems that exist in the Czech markets. In explaining the contrasting behavior in Poland and the Czech Republic, they focus on differences in the regulatory environment, not the methods of privatization. While the Bulgarian regulatory framework is far from perfect, it is substantially stronger than the Czech framework was during this period.

[25] The internal rules of operation of BSE-Sofia in principle allow for trading securities issued or guaranteed by BNB on the official market for bonds. At the same time, because of the regulations related to the role of BNB as a Currency Board it can't issue or guarantee securities at this stage.

[26] It should be noted that the entire first section of the recent OECD (1998) report on capital markets in transition economies is devoted to government securities markets. In Russia government securities were a major attraction for foreign investors.

registration; (2) the nominal size of the issue should be no less than BGL 100 million; (3) a minimum of 25% of the issue should be publicly offered.

Many market participants expressed the view that the opportunities for issuing new bonds appear better than the opportunities for issuing new shares. Banks are presently charging between 14-16% on new loans for working capital and even higher for investment loans while deposit rates are 3-4%. Issuing bonds would be a way of exploiting this big spread. Thus far there is only one issuer. "Prosoft", a computer company, issued the first bond on the stock exchange in August 1999. There is no collateral for the bond, but the issue is insured by one of the largest insurance companies, and the company showed excellent financial results for 1998. As of November 1999, the success in selling the issue is still limited.

It is important that the Commercial Code regulates that bonds may be issued from the joint-stock companies if minimum two years after their listing in the trade register are completed and if there are two annual fiscal reports accepted by the general meeting.Another possibility is the issuance of municipal bonds. Sofia municipality successfully issued a bond in Luxembourg where the market is deeper. Two other municipalities have applied to issue bonds and the Svishtov's request was recently approved by the SSC after completion of a long procedure. The difficulty for municipalities issuing bonds is that their revenue base is dependent on the central government so lenders have to take these additional risks into consideration.[27] Sofia was a special case since the municipality managers in the capital exert so much influence on the central government.

Free Market

The free market is a single undifferentiated market. Companies listed on the free market fall into three categories: a) companies that have not applied for listing and registration on the official market, b) companies that have applied to be listed and registered on the official market, but have been refused and c) companies from the mass privatization, that do not meet the standards of the official market are also listed.

Privatization Segment

Recently a privatization segment has been opened on BSE-Sofia. Until July 1999 the Government has used the free market of BSE-Sofia in order to offer state owned shares for privatization. Primarily shares of companies which were included in the "first wave" of mass privatization were offered. (See Table B7. In Appendix B) With the opening of a special segment where trading rules will differ from other segments the Government intends to use BSE-Sofia for privatization more intensively.

Trading system

Trading sessions on the BSE-Sofia are held each working day. The BSE-Sofia uses a continuous order-driven system. Buy and sell orders are entered into an electronic trading system that handles orders automatically. Standard types of orders can be executed including limit, all or nothing, market, day, good till cancelled.

There are advantages and disadvantages to using a continuous order-driven system when markets are so illiquid.[28] Since order flow is so small, continuous

[27] Svishtov attempted, unsuccesfully, to obtain bank guarantees or insurance for the loan. If problems arise, investors will have to go to court and sue the municipality which is cumbersome process. The maturity of the bond is seven years and the bond will pay a variable interest rate of base rate plus 3%. The investment intermediary that is organizing the subscription has announced that it intends to sell the bonds on the stock exchange.

[28] See Pohl, Jedrzejczak and Anderson, "Creating Capital Markets in Central and Eastern Europe, World Bank Technical Paper No. 295," 1995, for discussion of the advantages and disadvantages of various options.

trading can cause large swings in prices. Because they can be manipulated, continuous markets have to be carefully monitored.

BSE-Sofia has been concerned with problems that have arisen on the trading system. Cross-dealing, where the same broker is on both sides of the trade, has been a problem. The electronic system was modified so that the trades did not execute immediately. This made it possible for another broker to step into the trade before both sides could be executed. Later this rule has been abandoned.

Another problem have been all or nothing type or orders, because execution priorities (price and time) are difficult to be followed in the presence of such orders. To deal with this, the system is trying to execute all or nothing kind of orders by accumulating counter-orders until the requested number of shares is reached.

Price volatility has been reduced by putting constraints on price movements for securities traded on both the official and the free market. For the official market prices were initially limited to a range within +/- 5% of the average-weighted price of all transactions executed during the session when an issue was last traded. Subsequently, this range was widened up to +/-15%. Price limitations on orders executed on the free market were initially +/- 25%. They were widened up to +/-30% as well. The trading system allows entering orders that are outside these limits only in special cases arising from specific new public information or from relatively long periods with no trading.

Transactions involving large blocks of securities can be negotiated between members off the floor. These "block" trades must still be executed on the floor of the BSE- Sofia. Securities must be approved for block trading. The Board of Directors meets regularly, but not less than once a quarter, to review the list. The list is published in the official bulletin of the Exchange. For each issue on the block-trading list, the Board of Directors determines also the minimum number of shares which form a package for block trading.

The price of block transactions cannot differ significantly from the price of floor transactions. Price limitations relative to floor transactions for each issue on the block-trading list are determined also by the Board of Directors. The price range depends on market conditions and liquidity of the issue. Recent price limitations are +/- 30% on the official market, and +/- 100% on the free market.[29]

Fees collected by the exchange include membership fees, initial registration fees, registration maintenance fees, and transaction fees. The transaction fees are 0.2% of the value of share transaction, and 0.01% and 0.002% of the value of corporate bond and government security transactions, respectively. Initial registration and registration maintenance fees depend on the value of the issue.

Given the very low levels of liquidity for the shares of all but a few companies, BSE-Sofia should consider the possibility of following the lead of several other stock exchanges in Europe and create two separate trading systems. Shares in companies that trade frequently should continue to use the continuous order-driven system that is presently in place. Shares in companies that trade infrequently could use a call auction system where orders might trade once a day. This may improve the liquidity of the shares in companies that do not trade often.[30]

---

[29] Many of these trades violate provisions in the LSSEIC which require a public auction when acquiring a major interest in a company. There has been no enforcement of this provision of the law.

[30] The Riga Stock Exchange went from a call auction system to a continuous order driven system in 1997. This is one of the few examples we have where trading systems were changed. Kairys, et. al., (1999) find that this change greatly increased overall trading on the Riga Stock Exchange, but the volume of trading in low liquidity shares fell significantly.

Clearing, Settlement and Guaranty Fund

The process of clearing and settlement starts from day T when the transaction is executed. After the trading sessions the BSE-Sofia makes a gross-basis report for the shares traded and for the related money transfers. It sends the report to the Central Depository. The Central Depository checks the sellers' security balances and sends orders for executing money transfers to the banks where investment intermediaries keep their accounts. On day T + 2, the Central Depository receives confirmation from banks that transfers have been done and executes settlement. On day T + 3, the BSE-Sofia receives confirmation from the Central Depository that the security transfers have been registered.

The adopted procedure practically executes each transaction without doing clearing in advance due to the impossibility of clearing within the banking payment system. Such procedure requires relatively more money from the investment intermediaries to be involved in the process than actually needed and makes their trading activity less flexible.

A Guaranty Fund has also been established by the BSE-Sofia to secure settlement of floor transactions. All members of the BSE-Sofia must participate in the Guaranty Fund. Members contribute 5% of the their average value daily volume during the last reporting period. However, block transactions are not guaranteed by the Guaranty Fund. If the seller is short of securities or the buyer's account in the bank has insufficient funds, no settlement of the transaction takes place.

Disclosure Rules

According to LPOS issuers whose stock is listed on the BSE-Sofia are obliged to provide extensive information to the market. These requirements are similar to the reporting requirements of the SSC. (See discussion of general disclosure rules in Section V.2.) The managing boards and the executive members of issuers whose stock is listed on the exchange are responsible for complete and timely disclosure of information which might influence the market price of the stock.

In reality few companies comply with this requirement. Those which are listed on the official market have contracts with BSE-Sofia and provide information. But only small fraction of the companies listed on the free market provide information to BSE-Sofia. Actually less than 70 companies out of about 850 listed on the free market supply information on regular basis. It should be noted that there are many companies which supply information to the SSC but don't supply information to the BSE-Sofia which calls for better coordination between these important institutions.

At this stage BSE-Sofia has no legal mechanism to enforce compliance on issuers. The only measure it could take is to stop the their stock from trading which in practice will hurt shareholders interest.

At the same time BSE-Sofia has surveillance and enforcement responsibilities with respect to investment intermediaries. It has the responsibility to control trade, to watch for manipulative trades and to inspect investment intermediaries but the practical procedures are still not well established. BSE-Sofia can impose fine on investment intermediaries or it can remove them temporarily from trade.

2. INVESTMENT INTERMEDIARIES

The LPOS specifies that all transactions in securities must be executed by licensed investment intermediaries. Licenses for investment intermediaries are obtained from the SSC with one exception – commercial banks. They obtain licenses for banking activity from the BNB. Once they have such banking license

they don't need to apply for investment intermediary license. They have only to register with the SSC that they carry out such activity.

The SSC is responsible for regulation of investment intermediaries. It is also responsible for regulation commercial banks with respect to their activities as investment intermediaries on the capital market. These regulations include capital adequacy and liquidity requirements, competency standards for managers, and certified brokers on staff.

The SSC issues two types of licenses. A more limited license allows investment intermediaries to perform brokerage services. A broader license allows intermediaries to broker, deal on their own account and underwrite new issues.

According to the repealed LSSEIC investment intermediaries in Bulgaria were permitted to combine trading activities with securities and portfolio management activities for institutional investors. The potential conflict of interest was widely discussed in professional circles. As a result of this the new LPOS includes requirements for the separatation of trading with securities from portfolio management and assignes portfolio management to specialized 'managing companies' whose activities would also be regulated by the SSC.

In June 1999, there were 105 investment intermediaries, including commercial banks registered (but not licensed) as investment intermediaries by SSC. Of these only 73 are members of the BSE-Sofia and have trading posts on the exchange. To be a member the investment intermediary must be a shareholder in the BSE-Sofia. To have a trading post the intermediary must also have two licensed brokers working on the exchange. To obtain a license brokers must pass SSC exams.

Trading is dominated by a few large investment intermediaries. Seven or eight major investment intermediaries control 55-65% of the transaction turnover on the BSE-Sofia. The most active 20 intermediaries cover nearly 80% of BSE turnover. With the low turnover on the BSE-Sofia, it is difficult to see how the remaining intermediaries will remain in business.

3. CENTRAL DEPOSITORY

The Central Depository (CD) was established as a joint-stock company in August 1996. Under the LPOS and also under the repealed LSSEIC, all public companies have dematerialized shares, and the shareholder registration books of these companies are kept by the CD. Furthermore, since transactions are cleared through the CD, it also acts as a transfer agent. The establishment of the CD has facilitated transactions in securities, and eliminated many problems that have arisen in other transition economies where the registration books have been kept by companies.

Shareholders in the CD are the big commercial banks, the Bulgarian National Bank (BNB), and the Ministry of Finance (MF). The CD has a five-member Board of Directors. The BNB and MF have one representative each. The BNB and MF have the power to veto decisions of the general meeting of shareholders.

Membership in the CD is important since only members can interact directly with the CD to register transactions. Anyone else wishing to register their transactions must be represented by a member of the CD. Members of the CD include investment intermediaries, investment companies, the stock exchange, and foreign depository and clearing institutions. Members must meet specific financial, technical and operational requirements. The financial requirements include the maintenance of bank balances needed for settlement operations and contributions to the Guarantee Fund.

The CD keeps the official shareholders registration books. All transactions, whether they occur on the BSE-Sofia or off- the –exchange, must be recorded at the CD. Since only members can interact with the CD, all transactions take place through investment intermediaries. When transaction occur off the ex-

change the investment intermediaries just present the documents demonstrating that a transaction has occurred between two individuals. The CD just registers it. Clearing the transaction is the responsibility of the two individuals. When transactions occur on the BSE-Sofia, clearing and settlement occurs within three days. The CD administers a Guarantee Fund that is used for preventive measures and compensation of damages emerging out of the depository's activities.

Each investor have a right to access the Central Depository registers through the members of the CD only with respect to the owned by him shares, to the securities transactions if he/she is a party, as well as with respect to all the data from the Book of the shareholders or bond-owners in which he/she is a shareholder or bond-owner (Art. 133 (1), LPOS). While it is really important to protect transactions data, it is difficult under these circumstances to receive information on the changing structure of ownership in the economy. In this respect it is more difficult to argue that aggregate data describing the structure of ownership in the economy should be so protected.

Presently the CD has performed well. There have been few disputes arising from improper registration of shareholders, and there is growing confidence that transactions will be settled expeditiously.

4. THE STATE SECURITIES COMMISSION (SSC)

Legal Status and Functions of the SSC

The SSC was created to ensure the protection of the interests of investors and to stimulate the development of the securities market. The SSC has regulatory authority and control over: the issuance and transactions in securities; the establishment and the activity of stock exchanges; the establishment and activities of investment intermediaries and investment companies.

The SSC is a seven person commission. The chairman and the members of the SSC are appointed by the Council of Ministers on the recommendation of the Minister of Finance for a period of five (5) years. Members can only be removed after conducting an intentional crime prosecuted by the state with an effective verdict on the infringement of the LPOS provisions or in case of inability to exercise duties for more than 6 months. The individual administrative acts issued by the SSC can only be challenged before the Supreme Administrative Court.

Control Exercised by the SSC

The regulatory function of the SSC relates primarily to the drafting and enactment of regulations under the powers prescribed in the law. Drafts of regulations are then submitted to the Council of Ministers for final adoption. In most cases the Council of Ministers has adopted, without major objections, the drafts prepared by the SSC.

In April 1998 the SSC was instrumental for the changes and amendments of LSSEIC, which was in force at that time, in some important aspects which had serious positive impact on the organization of the capital market. These included the definition of public company, public companies' obligation to have only dematerialized registered shares, public companies' obligation to keep their shareholders' books only with the Central Depository. Also, the SSC played a significant role in the drafting and enactment by the Parliament of the new LPOS, that pursues as one of its aims to bring the legislation closer to the EC directives. It organized several public discussions of LPOS in the professional circles, as well.

The most important activity of the SSC is licensing and supervision of agents that come under its jurisdiction. Agents are required to file reports with the SSC on a periodic basis and are obligated to notify the SSC when important changes

occur. The SSC can also has the power to request information and/or make on site inspections.

If the SSC finds violations of the law or the need to protect investors, the SSC has the power to impose administrative sanctions including the suspension of trading, the convening of meetings of corporate boards, and the withdrawal of a license. The chairman of the SSC is empowered to impose administrative penalties, in the form of fines in cases where infractions of the applicable rules and regulations have been established.

V. SECURITIES LAWS

1. MAIN NORMATIVE ACTS REGULATING THE BULGARIAN CAPITAL MARKET

The main normative acts regulating the capital market in Bulgaria are: The Law On Public Offering of Securities (LPOS) (published in the State Gazette, number 114 of 1999); The Ordinance On The Prospectuses In The Case Of Public Offering Of Securities (published in the State Gazette number 23 of 1996); The Ordinance On The Licenses For The Carrying Out Of The Activity Of A Stock Exchange, An Investment Intermediary And An Investment Company (published in the State Gazette, number 23 of 1996); The Ordinance On The Activity Of Investment Intermediaries (published in the State Gazette number 95 of 1997); The Ordinance On The Capital Adequacy Of Investment Intermediaries (published in the State Gazette, number 95 of 1997); The Ordinance On The Minimal Content Of Proxies Regarding General Shareholders' Meetings Of Public Companies (published in the State Gazette, number 124 of 1997); The Ordinance on the Requirements in Respect of the Physical Persons which Directly Conclude and Perform Transactions in Securities and on the Order to Aquire the Right to Carry Out Such Activity (published in the State Gazette, 8 of 1998).

The repealed LSSEIC, adopted in 1995, was the first Bulgarian legislation designed to regulate the securities market. The LSSEIC regulated the issuance of securities, trading in securities, the establishment and activity of stock exchanges, investment intermediaries and investment companies. The LSSEIC established requirements for disclosure of information by issuers of publicly traded securities, proxy solicitation and special rules for investor protection like disclosure of major shareholdings in companies whose shares have been subject to a public offering.

The LSSEIC also provided for the legal basis for the creation of the Securities and Stock Exchanges Commission (SSEC), renamed in the new LPOS to the State Securities Commission (SSC). The SSC is the designated authority with the responsibility to ensure the practical functioning of the regulations under the law.

The LSSEIC and the Law on Privatization Funds provided a legal framework for the mass privatization process. These laws enabled the mass privatization process to proceed in a relatively well-regulated environment. The Law on Privatization Funds introduced licensing requirements for the privatization funds and rules for continuous monitoring of the funds by the SSEC at that time. These regulations included compliance with provisions regarding the diversification of fund portfolios and other restrictions and prohibitions designed to protect the interests of investors.

During the past four years the experience with the LSSEIC has revealed a number of shortcomings. Although most provisions of the LSSEIC were broadly in harmony with relevant EU Directives, several provisions of the LSSEIC needed to be modified if the law is to be consistent with EU standards. In connection to this the Parliament has enacted the new Law on Public Offering of Securities. This new law makes Bulgarian securities law nearly compatible with the standards and requirements of the most important EU directives. The new law increases the investigation capabilities and strengthen enforcement mechanisms available to the SSC. The new law also grants the SSC wider powers with respect to the activities of the stock exchange and the Central Depository. In addition, the SSC is granted broader possibilities to introduce ordinances; thus providing more flexibility to respond quickly to changes that are occurring in the market. Overall, the new law marks a serious step in the direction of improvement in the legal structure of the securities market and brings Bulgarian law closer to respective EU requirements and practices. A more detailed com-

parison of the currently in force LPOS, repealed LSSEIC, EU and Czech laws is provided in Appendix A.

At this stage enforcement is a bigger challenge than the passage of good law. While the laws are similar to laws in European countries, many provisions of the LSSEIC were more appropriate for a developed market and had proven to be inadequate or unsuitable for the reality of an emerging securities market. Many provisions had not been implemented in practice. For example, while rules exist for auction offers for the acquisition and exchange of shares, these provisions had never been enforced. Although the SSC is vested with substantial powers to license and control the activities of market participants, it has not yet been able to establish effective procedures for identification of violations. As a result the SSC has not yet been able to demand strict adherence to established requirements and rules, nor has it adequately penalized infractions. More flexibility is necessary to accommodate the EU standards and the needs of the emerging Bulgarian market. It should be noted that recently SSC has taken serious measures to penalize investment intermediaries involved in illegal transactions in order to keep confidence in the market and to protect investors.

2. DISCLOSURE OF INFORMATION AND ACCOUNTING STANDARDS

The LPOS lays down formal requirements for the disclosure of information to the SSC and to the BSE-Sofia. The rules require that annual and six-month reports be submitted and that additional reports be submitted at shorter intervals when requested by the SSC.

Issuers are required to submit an annual report within 90 days of the end of the financial year. The annual report must contain data about the issuer and its business, the members of its governing and supervisory boards, the persons holding or controlling more than 10 per cent of the votes in the general meeting, as well as any other information that may be required by the commission. The six-month report must be submitted within 60 days following the mid-point of the fiscal year and must contain a financial statement for the previous six months and any other information requested by the commission. In both cases the issuer must also publish a notice within seven days of submission of the report. The notice, which must appear in two national daily newspapers and in the official bulletin of the SSC, should describe the place, the time and a way to obtain the report so that it can be inspected.

The issuer is also obliged to provide information on a timely basis to the SSC whenever: (a) there is any amendment to the Articles of Association; (b) there are any alterations in the governing boards; (c) any contentious issues arising in court proceedings; (d) execution of collateral proceedings have been instituted; (e) insolvency proceedings have begun; (f) any resolution is put forth to transform the company; and (g) any changes occur in the business which may directly or indirectly influence the price or quotation of the securities.

In spite of the legal requirements to file reports with the SSC, many companies do not. According to information provided by the SSC only 860 out of 1142 public companies and investment intermediaries have submitted reports for 1999 in a timely manner. As this suggests, ensuring compliance with the statutory requirements is a serious problem. Many companies lack the motivation to disclose information, because the potential advantages and benefits provided by the chance to raise funds in the capital market remain distant and, hence, are not appreciated by the companies' managers.

Issuers are obliged to disclose information also to the BSE-Sofia when their securities are trading there. But even less companies supply information to the Exchange – only about 10% of the listed companies. This makes impossible to obtain information from the BSE-Sofia on many companies, including some of the largest and most liquid.

The existing legislation is not sufficiently clear and unequivocal regarding the scope of information to be reported. The legislation does not spell out the lia-

bility of members of the governing boards when reports contain false, incomplete or misleading information that damages shareholders. To ensure compliance with the statutory requirements for disclosure of information, the SSC needs to adopt ordinances that lay out the required contents of the regular reports submitted by public companies and then impose administrative sanctions.

According to the law, the SSC must make this information available to the public, thereby ensuring investors' access. In practice, however, access often has been limited or provided in a form which makes it difficult to use. These problems exist at both the SSC and BSE-Sofia. Reports are not sufficiently uniform and part of the information provided is not up-to-date. This makes comparisons between companies difficult. In some cases access is further limited by cumbersome procedures which discourage all but the most aggressive clients. While these problems make it more difficult for professional institutional investors, the effects are particularly damaging for the individual, non-professional, investors.

Recent efforts have been made particularly by the SSC to improve significantly the process of providing investors with information. It opened for the public an Information Center. It is expected that access to information will continue to improve with the future development of the Center and with the improvement of the technical specifications of the register itself.

Another important area is accounting procedures and standards. Present law requires each joint-stock company to close the financial year after an audit by a chartered accountant appointed by the general meeting of shareholders. This requirement applies to all public and private joint-stock companies. Two important issues must be faced. First, important differences still persist between national and international accounting standards. This makes it very difficult and expensive for foreign investors to interpret Bulgarian financial statements. This leads to the perception by foreign investors that Bulgarian companies are high risk, effectively increasing the cost of financing for Bulgarian companies. Second, liability of auditors *vis-a-vis* shareholders is not well established. Shareholders cannot be confident that all auditors have always fulfilled their obligations in good faith. This weakens the position of shareholders in their position as monitors and controllers of the company's activities. From this perspective, a legislation that gives shareholders the right to sue auditors would create pressure for better financial statements and would improve the position of shareholders.

VI. CORPORATE GOVERNANCE

Good corporate governance arrangements need to be supported by good laws and a high-quality judicial system. But this is not enough. It is equally important that a tradition develops that supports moral and ethical conduct in business affairs. Only then will there be a general climate which promotes good corporate governance.

Both the legal environment and the social environment are presently underdeveloped in Bulgaria. The courts have no previous experience with issues related to corporate governance in a market environment. The lack of tradition increases the importance of more stringent and detailed regulation of governance relations through company law.

Under the present Commercial Code, joint-stock companies (which include all public companies traded in the capital market) are governed by a) a general meeting of shareholders and b) board of directors (one-tier management system) or supervisory board and managing board (two-tier management system).

The Commercial Code specifies that the general meeting of shareholders includes all shareholders with voting rights. Shareholders can attend the meeting either in person or by proxy. The general meeting has the powers to:

- amend the Articles of Association;
- increase and reduce capital;
- transform and wind-up the company;
- appoint and remove the members of the board of directors (one-tier system) and supervisory board (two-tier system);
- determine the compensation of the members of the board of directors or the supervisory board
- appoint and remove chartered accountants (auditors);
- approve the issue of debentures;
- appoint liquidators in the event of winding up, except for the case of insolvent liquidation;
- exempt from liability the members of the supervisory board or the managing board (two-tier system), and members of the board of directors (one-tier system);
- determine all other issues falling within its competence by virtue of the law or of the Articles of Association.

As a general rule, the resolutions of the general meeting are passed by a simple majority of the shares represented. The law specifies only three exceptions. A two-thirds majority of the shares represented at a general meeting is required for resolutions: (1) to amend the Articles of Association, (2) to transform the purpose of the company or (3) to wind-up the company.

The Articles of Association may provide for larger majorities for certain resolutions, and this practice is common. Unfortunately such provisions can make it more difficult to conduct business. When there are several large shareholders, the specification of a supermajority in the Articles of Association to pass certain resolutions can give a large minority shareholder the power to reject many resolutions. In some cases such supermajority provisions become in practice tantamount to a unanimity rule .

The Commercial Code also defines special voting rules for some resolutions of the managing board or the board of directors. Unanimity is required by the board of directors (or preliminary consent of the supervisory board under the two-tier system) when significant changes occur such as closing down or trans-

ferring substantial parts of the enterprise, making substantial changes in the company's business, reorganising the company or opening a new branch.

There were important weaknesses in the Commercial Code and the repealed LSSEIC which were corrected with the new LPOS. The most important are the following:

1. CONSTRAINTS ON SHAREHOLDER POWER

One area where the repealed LSSEIC made it difficult for shareholders to exercise their rights as owners were the rules regarding attendance at the general meeting. The old rules did not explicitly regulate the place and the terms for holding a general meeting. Governing boards have convened general meetings at unreasonably long intervals or have chosen a location that is difficult to reach (e.g. locations that cannot be reached by public transportation). The LPOS has introduced the requirements for the general meeting of the public company to be held in the principal place of business of the company. The regular general meeting should be held by the end of the first half-year after the end of the fiscal year.

Another problem which had existed is that it was difficult for shareholders to organise in opposition to management. While the Central Depository is the central registry also when the repealed LSSEIC was in force, shareholders couldn't obtain information on other shareholders from the Central Depository. The SSEC only provided information on shareholders who own more than 10% of the shares in the company**.** At the same time, no rules required the management of a public company to provide information from their list of shareholders. For these reasons, one or more shareholders of a given public company who would wish to discuss the company's business with other shareholders, address proposals to them, or organise a meeting with other shareholders were virtually unable to do so. The new LPOS introduced the requirement for the Central Depository to provide data to the investors with respect to the owned by them securities and transactions to which they are party as well as all the relevant information from the Book of shareholders or the Book of the bond-owners of the company in which they are respectively shareholders or bond-owners.

Shareholders should also have the right to convene a general meeting and set its agenda. A general meeting of a joint-stock company may currently be convened by shareholders holding at least 10 per cent of the capital. This rule is the same for all joint stock companies, whether public or not. In public companies, especially, this rule makes it difficult for minority shareholders to protect their own rights. Such difficulties are encountered not only by individual shareholders but also by institutional shareholders such as investment companies, pension funds and insurance companies have relatively small shareholdings. If the requirement was lowered to 5% as in Germany and Austria, this would strengthen the rights of minority shareholders.

It should be underlined that the Law on Public Offering of Securities enables shareholders holding in group or separately 5 % of the public company's shares to sue the governing body of a public company for its inability to act threatening the interests of the company to file an action against third parties. These shareholders can bring an action in front of the regional court where the registration of the company took place for intentional crime or gross negligence resulting from action or inaction of the company's governing body.

Presently, minority shareholders have limited possibilities for nominating their representatives to the governing boards of public companies. The existing legislative rules make it possible for a member holding 50 (or less) per cent of the company's capital to virtually dominate the election of governing boards. One way of alleviating this problem would be to establish a rule that „cumulative" voting be used in the election of governing boards of public companies. If this rule were adopted in conjunction with a rule which specified a minimum num-

ber of board members, then minority shareholders should be able to obtain representation on the governing boards. To further protect shareholder interests, the governing body should all stand for election at the same time so that it is easier to remove a governing body which is not performing well. (*Avilov, et. al.*, 1999, Art. 117)

2. RESPONSIBILITIES OF THE GOVERNING BOARDS

Governing boards play a crucial role in the supervision of the operative management. Due to this it is of central importance that the members of governing boards conduct business in the best interest of the company and the shareholders as a whole. In Bulgaria managers often behave as if they were sole proprietors or consider only the interests of a subset of all the shareholders.

The Commercial Code and LPOS does not spell out the responsibilities of the governing boards and fails in this respect to draw a distinction between public and private joint-stock companies. Presently liability of members of governing boards is limited to three months wages. Sanctions are limited to cases of failure to comply with reporting requirements pertaining to the commercial register and regulatory requirements of the SSC.

The duties of the board of directors should be spelled out more clearly in the Commercial Code taking into account the directors' needs to have sufficient discretion to manage the company. The Commercial Code should describe the basic responsibilities of the board. A recent study by *Avilov, et. al.* (1999) suggests that company law in transition economies should specify codes of conduct "anchored on the concepts of good faith and interest of the company."[31] (Art. 121). Furthermore, these rules "should be applied together with more specific rules on conflicts of interest." (Art. 121)

Presently, some Bulgarian companies suffer because controlling shareholders siphon off funds to companies that are owned by controlling shareholders. For example, the public company might sign a "sweetheart" contract with a company wholly-owned by controlling shareholders. Under present law this is not illegal *per se*. If the Commercial Code were amended, then this would violate both the code of conduct and conflict of interest provisions.

A problem of corporate governance in Bulgaria is the participation of the government as major shareholder in a large number of commercial companies. This participation often results in unnecessary politicising of purely economic decisions. At present, there is no uniform governmental policy with respect to its role as shareholder. The existing legislation is obsolete and fails to take into account recent changes in the ownership structure of enterprises. . There is no consistency in the way various ministries approach their role as representatives of the State. The result of all this is lower efficiency. A solution is completion of the privatisation process, but until this is accomplished, the government will remain a peculiar factor in terms of corporate governance.

3. ADDITIONAL PROTECTIONS FOR MINORITY SHAREHOLDERS

Protection of minority rights is particularly difficult in Bulgaria, because the mass privatization program created very diffuse ownership patterns. Given the lack of adequate traditions in protecting shareholders' rights and the fact that the owners and managers of companies still have very short-term horizons, it is particularly important to legally protect the position of minority shareholders. The LPOS envisaged new provisions in that respect. One of the most sensitive areas where minority shareholders' protection is important is the possibility that majority shareholders will try to dilute the value of minority holdings. Therefore, the LPOS envisaged that in case of the increase of the capital each shareholder has the right to obtain shares corresponding to his/her sharehold-

[31] The OECD report provides some examples. In Germany, for example, the law provides that governing boards are liable if they do not act with "the care of a diligent and conscientious manager."

ings in the capital before it has been increased. This right cannot be revoked with the resolution of the general meeting. In case of the increase of the capital of the public company there is a possibility for a general meeting to take a decision to issue rights, and each shareholder can obtain rights corresponding to his/her shareholdings before the increase of the capital. LPOS does not allow for the capital to be increased with non-monetary contributions or under the condition that a person buyes the emission. Furthermore, a person making a take-over bit resulting from the acquisition of a more than 50 per cent of the voting rights in the general meeting, has a right to register a take-over bit to buy shares of the other shareholders, if subsequently this person acquires directly or via related persons more than 90 per cent of the voting rights in the general meeting. This person is also obliged upon request to buy the shares of each of the other shareholders. The provisions allows minority shareholders to liquidate their investment under the fair market conditions in case they are not interested in keeping the shares of the company.

4. ENFORCEMENT

A serious problem for Bulgaria is the lack of an adequate judicial infrastructure for settling complex business disputes. This also fully applies to issues of corporate governance. The entries in the court registers, the protection of shareholders' rights, the liability of the management are only some of the issues giving rise to contradictory case-law. The Ministry of Justice should provide special training for judges in matters pertaining to corporate governance and control.

Any single law itself is not sufficient. For example, conflict of interest laws can be passed which prevent members of governing boards from voting on agreements which involve other companies in which they have an interest. Unless other members of the governing body object, it is unlikely that these conflicts of interest will be brought to light. If other members of the governing body are also liable or if other shareholders have access to information about these actions, then they are less likely to occur. Still the laws will not be effective unless the courts enforce them. This requires that the judiciary have sufficient training to discern what the fundamental issues are.

However, improvement in legal framework and the involvement of governmental agencies alone will not be enough to solve the problems of corporate governance. There are many aspects of corporate governance where legal restrictions are not appropriate, but codes of conduct could provide guidence in a situation where there is so little previous experience and practice. The active commitment of non-governmental organisations and professional associations should be promoted. These organizations can lay the foundation of positive norms of behaviour.[32]

For example, at present there are no rules or criteria concerning who should serve on corporate boards, nor is there any attempt to regulate what the balance should be between internal and outside directors. There is also a lack of understanding of how boards should be structured *e.g.* committees for compensation, appointments, internal audit. Seldom is there any link between the direct results of a company's business and the compensation of the members of its governing boards.

It would be inappropriate to legislate such matters, but it would be extremely helpful if shareholders and other participants in the governance process had additional guidelines to assistant them in organizing effective structures to enhance the value of firms. Non-governmental institutions can play an important role in this area.

[32] As Stiglitz (1999) states: "The social and organizational capital needed for the transition cannot be legislated, decreed, or in some other way imposed from above. People need to take an active and constructive role in their self –trasnaformtion; to a large extend, they need to be in the driver's seat." (p. 9)

VII. OTHER INSTITUTIONAL INVESTORS

Insurance companies and pension funds are relatively small, at present, and they are not an important participants on the capital market, but there is no doubt they will become increasingly important in the future.

1. INSURANCE COMPANIES

In 1998, the insurance sector underwent fundamental restructuring. The Insurance Supervision Directorate undertook licensing of insurance companies in accordance with new amendments to the Law on Insurance. A number of insurance companies could not meet the new capitalisation requirements, and the new requirements regarding the origin of capital, and legitimacy of activity of major shareholders. As a result, the sector has significantly restructured.[33]

At present, 16 general insurance companies and 6 life insurance companies are in operation. The sector is highly concentrated. The three largest general insurance companies (including two state-owned) hold 61.3% of the market; the five largest, 75.2%. Life insurance is even more concentrated. The biggest company, the State Insurance Institute, controls 76.6% of the market.

Revenues from premiums in the general insurance sector were BGL 198 billion in 1997 and BLG 226 billion in 1998. Life insurance premiums were BGL 20 billion in 1997 and BGL 27 billion in 1998. Notwithstanding the 14.1% increase in general insurance premiums and 35% increase in life insurance premiums, financial resources controlled by insurance companies are still relatively small. Total revenues from insurance premiums were 1.27% of GDP in 1997 and 1.18% of GDP in 1998. This compares with 2.9% of GDP (1995) in the Czech Republic, and 1.6% in Greece, which has the smallest insurance sector in the EU.

Pursuant to the Law on Insurance, insurance companies must obey certain restrictions in their investment policy. These restrictions apply to both general and life insurance. Insurers are allowed to invest only on the territory of Bulgaria in the following instruments: securities issued or guaranteed by the state; real estate; bonds issued or guaranteed by municipalities; securities listed on the stock exchange; bank deposits and loans extended against life insurances. The maximum volume of investments is 5% in bonds, and 10% in listed securities (but not more than 5% of the company's capital). Under Bulgarian law, there are two additional restrictions: (1) Investment in securities in one company which exceed 10% of capital must receive approval from the Insurance Supervision Directorate. (2) Foreign investments must receive explicit permission from the Minister of Finance.

At present, insurance companies participate in the capital market in a very limited way. Few financial instruments meet the investment needs of insurers. Low liquidity and the low activity level of the stock exchange also discourage participation. The insurance companies also lack the expertise, information and knowledge necessary to invest in risky capital market assets. Because special permits are required, insurance companies do not invest at present abroad as well. The result is that insurance companies are mainly invested in medium-term and long-term government securities. Government securities account for 50-55% of the consolidated investment portfolio of insurance companies. Another 40-43% of their assets are in bank deposits and barely 1% in shares.

2. PENSION FUNDS

After the start of economic reforms in 1991, voluntary pension funds emerged first in early 1994. These funds began operations without any specific regulation or legal basis. At the beginning of 1999, there were 30 (all private) registered

[33] An important motivation for the new law was a desire to put pressure on mafia groups that were masquerading as insurance companies.

pension funds in Bulgaria, but only 12 are actually in operation. It is estimated that pension funds have attracted about 200,000-250,000 people, or nearly 6-8% of the total number of employed people.

In July 1999, the Law on Supplementary Pension Insurance (LSPI) was passed. Pursuant to the law pension funds must now be licensed by a State Agency of Insurance Supervision (SAIS) – a new body established by LSPI. The Agency is created to be the regulating body for the pension funds focusing entirely on this new field. It will supervise the activity of pension funds and pension companies. The Agency is not yet in existence – the appointment of members to the SAIS, the creation of an operating framework and the development of licensing procedures will take time. Pursuant to the provisions of LSPI, pension funds will have to meet specific requirements and obey certain restrictions in their investment policy. Investment instruments will be limited to: securities issued or guaranteed by the state; stock or corporate bonds traded on the official capital market; municipal bonds; real estate; foreign government securities or corporate stock and bonds; and other instruments as decided by the management. Pension funds must invest at least 50% of their assets in government securities or bank deposits. Investment in corporate securities, stock and bonds, cannot exceed 10%. The same restriction of 10% applies to investment in municipal bonds and real estate. At most 10% of their assets can be invested in foreign securities. Investments in other instruments shall not exceed 5% of fund's total assets. These restriction will force pension funds, like insurance companies, to orient their portfolios entirely toward domestic markets.

Pension funds are estimated to have about BLG 20-25 billion (0.11% of GDP) in assets. The sector is highly concentrated. The largest fund holds about 45% of the market; the five largest almost 65%. These funds are almost entirely invested in government securities (84.8%) and bank deposits 6.2% (1998 figures). Although the stock exchange has been operating for only a short time, pension funds have already invested 8.6% of their assets in securities, which is close to the maximum permitted under the newly adopted law.

Overview

Insurance companies and pension funds have conservative investment policies dictated by strong restrictions which limit the scope of their investments. The capital market is still not capable of providing the financial products necessary for these institutions to build proper investment portfolios. There are only a couple of municipal and corporate bonds available, and list of appropriate securities is very short because of low liquidity and high risk.

At the present stage of development of financial system in Bulgaria, insurance companies and pension funds are not important players on the capital market. This notwithstanding, they can be expected to expand their markets gradually.[34] The groundwork for an adequate legal framework has been established. Their need for investment instruments will inevitably stimulate the development of the capital market. This is likely to occur even faster if the arrangements for using investment bonds to provide supplementary pension insurance in the 'second wave' of mass privatisation is widely applied. (See Section II.2.).

[34] Vitas (1998, p.18) argues that given political commitment institutional investors can provide a strong stimulus to the development of securities market.

VIII. POLICY RECOMMENDATIONS

1. CHANGES TO THE LEGAL STRUCTURE

Further Strengthening of the SSC: Banks were automatically given licenses to function as intermediaries. To act as a reasonable enforcement agency, it must be clear that the SSEC has the right to revoke these licenses even if they did not initially grant them.

Improve Ownership Disclosure Practices: Presently firms are required to report ownership if the ownership exceeds 10%. In Poland for example firms must report if the ownership levels exceed 10, 20, 33, 50, 66 and 75. More detailed knowledge of ownership levels would assist the courts and the SSEC in enforcing the securities laws.

Regulation of Holding Companies: Problems in the Czech Republic have demonstrated that holding companies need to be carefully monitored. At present there are no special provisions for holding companies. Holding companies should be treated like financial companies. Laws should be passed which give special regulatory authority to either an existing regulatory body or a newly created regulatory body to supervise the activities of holding companies and develop reporting requirements similar to the requirements for other financial institutions.

Functioning of the judiciary: New laws must be supported by a well-trained and experienced judiciary. There are numerous examples where the laws are well constructed, but their enforcement is a problem. More resources need to be directed at training the judiciary. This training cannot fully substitute for experience, however. The establishment of special courts to deal with issues of bankruptcy and company law would help promote better capital markets.

Neutral tax laws: Income from government securities and bank deposits is not taxed, but income from dividends and capital gains are taxed. Tax neutrality would create a more level playing field and make it easier for the capital market to compete with other financial institutions.

Abandoning preferences for individual investors: Currently, the Ministry of Finance is offering government securities with preferential (higher) interest rates to individuals. Institutional investors cannot purchase these securities. These preferences distort the market competition, distord the financial markets and discourage intermediation.

Normative Regulations on Municipal Bonds: There is already need to provide funding to municipalities through the bond market. This can be an important area for capital market expansion. These can be important assets in pension fund and insurance portfolios. Three cities have already issued or have requested to issue bonds. There are serious problems since municipal budgets are not fully independent from the national budget and municipalities do not have clear legal control over the funds raised through these offerings. New laws that clarify borrowers' obligations would make it easier for this market to expand. The LSSEIC and the new LPOS are directed at regulation of primarily corporate bonds, and these regulations do not address the special issues related to municipal bonds**.**

2. MARKET TRANSPARENCY

Release of more ownership information by Central Depository: The Central Depository has extensive information on the ownership concentration levels. This is valuable information for researchers and for participants in the capital market. Present laws restrict the availability of this information. These laws should be reviewed and altered in order to encourage greater dissemination of information.

Accounting Standards: Shareholders and potential investors need information to accurately access the financial condition of publicly-traded companies. It is especially difficult for foreign investors to determine the financial condition of Bulgarian firms when the accounting conventions differ from international accounting standards. Efforts should be made to bring Bulgarian accounting standards into conformity with international practice.

3. EXPANDED TRADING ON THE BULGARIAN STOCK EXCHANGE-SOFIA

Release of information on share transactions by Central Depository: Presently OTE trades are hidden from public view. If the Central Depository made *timely* reports on the volume of shares traded, the lack of transparency would be reduced and this would encourage more trading on the BSE-Sofia.

Movement away from continuous order trading for all shares: The BSE-Sofia uses a continuous order trading system. Most of the companies traded on the BSE-Sofia have very illiquid markets for their shares. If the BSE-Sofia adopted a call auction system for all but a few companies, market participants might feel more confident they are receiving best execution and the liquidity of the market may improve.

Trading in government securities: At present Bulgaria does not have an active secondary market in government securities. At the same time interest rates on government securities should provide a benchmark interest rate for the rest of the market. Now that clearing arrangements for securities trading have been established for other types of bonds, it should be possible for trading in Government securities, including ZUNK bonds, to begin on the BSE-Sofia. This will benefit the further development of Government securities' market, this will also benefit the exchange since there will be more instruments traded on the exchange. The Government should take the necessary measures to make at least selected categories of Government securities available for trading on the BSE-Sofia.

4. CORPORATE GOVERNANCE

Company law: Earlier in the report we describe a number of areas where company law can be improved. The recent OECD report (Avilov*, et.al.* ,1999) argues that company law in transition economies needs to be more restrictive than company law in the EU. It is particularly important that minority shareholder rights be protected. The OECD report should be used as a basis for further evaluation of company law in Bulgaria to bring company law in Bulgaria into greater conformity with the basic guidelines outlined in the report.

Improve the accounting/auditing systems: Accurate information on company performance is important to both shareholders and potential investors. The Institute of Certified Expert Accountants presently has a monopolistic position for the certification of accountants. The SSC might encourage the establishment of another certification agency so that shareholders have more choices in finding reputable accountants. Furthermore if auditors were held legally liable for the reports they submit, this would put more pressure on the auditors to improve the accuracy of the reporting.

Company law (special conditions): Because of the high concentration levels of ownership in Bulgarian firms and the large number of small firms that are publicly traded, special emphasis should be given to legal provisions which would encourage companies to become private. These changes would help protect 'stranded' minority shareholders by requiring owners with large stakes to buy-out minority shareholders. The possibility of creating a new legal status for private companies with a small number of shareholders should also be investigated.[35]

[35] This would be similar to a partnership arrangement but the law would specify voting rules, etc in recognition of the fact that the these companies were not originally created as partnership among friends.

Completion of privatization: The State still has large ownership positions in many important companies. In many instances representatives of government agencies which hold positions on corporate boards are active in decision making. At the same time the government has provided no clear guidelines for how these representatives should vote. This problem can be eliminated if the Government proceeds more quickly with further privatization.

5. FURTHER PRIVATIZATION

Supply policy of the mass privatization. The "second wave" of mass privatization has proceeded very slowly and has had little effect on the capital market. Participation has been low because interest in the program has largely been limited to insiders of the companies that are being privatized.

Several important changes could make generate more participation from a wider segment of the population and lead to further development of the capital market**.** In the first wave well-regulated privatization funds played an important role in increasing interest in the program. If the second wave allowed similar institutions to participate (as pension funds are presently allowed to do), the program could move forward more quickly. It is difficult for most citizens to participate effectively in the privatization process except through intermediaries. If additional intermediary possibilities are not permitted, semi-official schemes for collective investment could emerge or many people will be disappointed and will not participate in the program.

The second wave has also offered, to this point, only a small number of shares in remaining state companies. The Government has now had an opportunity to access the prospects for further cash privatization. It should be prepared to expand the sale of additional shares in important companies. By offering more of the remaining shares from cash privatization or other shares on the stock exchange, the Government can encourage the development of the capital market.

Introducing ADRs (GDRs): The Bulgarian capital market is not deep enough to offer large companies for sale. The Government should consider introducing large and attractive companies that are still state-owned (Bulgartabac, Bulgargas etc.) into international markets through ADRs (GDRs). This will increase investors' interest in Bulgarian companies and the Bulgarian market**.**

IX. CONCLUSION

The impetus for the development of the capital market in Bulgaria was the first wave of mass privatization. Unlike the Czech Republic, Bulgaria planned for a more regulated market. From the beginning there was a Securities, Stock and Exchange Commission, a Central Depository and stock exchange. The Bulgarian Stock Exchange – Sofia was established as the only registered stock exchange. To create price integrity, regulations required that all but a few special types of share transactions be posted on the stock exchange.

Efforts to improve the regulation of the capital market are continuing. A new Law on Public Offering of Securities enacted by the Parliament approximate the Bulgarian securities law to securities law in the field of securities market of the European Union.

In spite of these efforts serious problems remain. It is possible to create institutions that look like capital market institutions in the West but do not function effectively. A similar problem arose earlier in the transition. The two-tier banking system in Bulgaria had the same institutional form as banking systems in the West, but underlying problems contributed to the financial crisis in 1996-97. As the recent events in the Czech Republic demonstrate, problems in capital markets can also contribute to poor economic performance.

Because most companies traded on the capital markets in Bulgaria were privatized through the mass privatization program, building open transparent capital markets is a particularly challenging task. Without the incentive to raise additional capital through the markets, companies do not have the same incentives to provide information to the market that would be present in a normal capital market. Still there are significant steps that can be taken to improve the performance and openness of the markets.

The Czech experience demonstrates that investment funds need to be closely monitored. The transformation of privatization funds into holding companies may be an appropriate change given the situation in Bulgaria, but there are dangers as well. It is particularly difficult for diffuse stockholders to monitor the activities of holding companies, and the holding company structure creates opportunities for abuses. Regulators need to be aware of these problems so that the tunneling observed in the Czech Republic is constrained. (Because present information is so limited it is difficult to know how much tunneling has already taken place in Bulgaria.) Holding companies should be treated as financial institutions. They should be audited and required to provide reports appropriate for a financial institution.

The Bulgarian Stock Exchange – Sofia suffers from very low trading levels. Questions have been raised as to whether it is a viable institution. Because of these economic pressures the exchange has made compromises that have led to the creation of a confusing array of alternative markets. In spite of these compromises and laws designed to support trading on the exchange, substantial trading is occurring off-the-exchange. Low liquidity of most companies has made it difficult to establish price integrity. Block trades, while registered on the exchange, often have posted prices that bear little relation to the actual prices in the transaction. Off-the-exchange transactions are not recorded at all. In this way there is little price integrity in the market. Potential investors have to be discouraged in such an environment.

To be successful the BSE-Sofia has to increase the volume of trading. To increase trading in shares, it needs to convince traders that they can get best execution by trading on the exchange. If the exchange is able to attract more of the OTE trading, volume on the exchange could in practice double.

Because of these pressures the BSE-Sofia is not in a strong position to carry out its responsibilities as a private institution that regulates the security markets. A greater burden must be placed on the SSC to monitor the activities of the mar-

kets and insist on full disclosure under its mandates. Fortunately, the SSC has been given important administrative powers which can be used to promote fair and transparent markets. These powers are considerably strengthened in the new Law on Public Offerings of Securities. It is important that the SSC use these powers.

Unless companies see the capital markets as a place where they can raise new capital, companies will not have the right incentives to provide information and participate actively in the market. The present situation is exactly like this. Without sufficient liquidity, issuers of new securities will not want to come to the market. For example, Sofia municipality sold its new bonds in Luxembourg. Without better information investors will turn elsewhere.

A market in new issues needs to be more actively promoted. The SSC has taken a careful and deliberate stance in approving new issues. This is a wise course in the beginning, but it is also important that new proposals be processed expeditiously so that potential issuers are not discouraged by bureaucratic red tape. The financial services organizations – banks and investment intermediaries should be encouraged to broaden their professional competence and activity in showing businesses in need of low-cost, long-term capital how they can obtain it through a properly managed public offering of either debt or equity.

Good corporate governance is key if the privatization process is going to be successful. Corporate governance is an area where there is serious disagreement about the best institutional arrangements. This limited report does not attempt to analyze these issues in depth. More needs to be understood first about developing ownership patterns in Bulgaria. The information presented in this report suggests that a highly concentrated ownership pattern is evolving where a few shareholders are gaining control of many companies. Once these patterns are better understood consideration should be given to changes in the commercial code which will encourage better governance structures within firms and better protection of minority shareholders.

New institutions and new laws alone do not make a well-functioning capital market. Laws and regulations must be enforced. There is a disturbing trend to enforce only certain laws and procedures. For instance, the requirements for public offerings are universally ignored. Selective enforcement is extremely dangerous. If laws are not applicable, they should be changed. The regulatory authorities and the courts have an important role here. Because there is so little experience with capital markets, training programs for regulators and judges are extremely important. Given the complexity of these laws, creating courts that specialize in these disputes could be an effective way of training judges in these areas.

This report only attempts to provide an overview. While many important capital market institutions have been put into place in Bulgaria, the market has serious weaknesses. The market needs to be strengthened if it is to become a source of investment capital, and the privatization program is to succeed. Bulgaria has established the required institutions, but integration into the EU requires better functionality as well.[36]

[36] For a more detailed analysis refer to Bulgaria and the European Union: Towards an Institutional Infrastructure, CSD, 1998 (www.csd.bg/publications.htm).

BIBLIOGRAPHY

Avilov, Gainan, Bernard Black, Dominique Carreau, Oksana Kozyr, Stilpon Nestor and Sarah Reynolds, *General Principles of Company Law for Transition Economies* [prepared under the auspices of the OECD], 1999

Bulgarian Stock Exchange – Sofia, *Annual Report, 1998*

Coffee, John C., "Inventing a Corporate Monitor for Transition Economies: The Uncertain Lessons from the Czech and Polish Experiences, " in K. Hopt, H. Kanda, M. Roe, E. Wydermeersch, and S. Prigge (eds) *Comparative Corporate Governance: The State of the Art and Emerging Research* (Oxford: Claredon Press, 1998), pp. 67-138.

Johnson, Simon and Andrei Shleifer, "Coase and the Coasians: The Regulation and Development of Capital Markets in Poland and the Czech Republic, draft, MIT and Harvard Universities, 1999.

Kairys, Joseph P. Jr; Raimonds Kruza, and Ritvars Kumpins, "Winners and Losers from the Introduction of Continuous Variable Price Trading: Evidence from the Riga Stock Exchange, 1999 (forthcoming in *Journal of Banking and Finance*)

Miller, Jeffrey B. and Stefan Petranov, "The First Wave of Mass Privatization in Bulgaria and Its Immediate Aftermath," *Economics of Transition* (forthcoming, 2000)

Organization for Economic Cooperation and Development, *Capital Market Development in Transition Economies: Country Experiences and Policies for the Future*, (Paris: OECD, 1998)

Organization for Economic Cooperation and Development, *Economic Survey of Bulgaria, 1999,* (Paris: OECD, 1999.

Pohl, Gerald, Gregory T. Jedrzejczak and Robert E. Anderson, "Creating Capital Markets in Central and Eastern Europe, World Bank Technical Paper Number 295, 1995.

Stiglitz, Joseph E. "Whither Reform?: Ten Years of Transformation," Keynote Address, Annual Bank Conference on Development Economics, World Bank, April , 1999.

Tchipev, Plamen, „Bulgarian Mass Privatization Scheme: Implications on Corporate Governance" in Plamen D. Tchipev, Jurgen G. Backhaus and Frank H. Stephan (eds) *Mass Privatization Schemes in Central and East European Countries: Implications on Corporate Governance* (Sofia: Gorex Press, 1998)

Vitas, Dimitri, „Institutional Investors and Securities Markets: Which Comes First?", Development Research Group, The World Bank, Paper Presented at the ABCD LAC Conference, 1998.

World Bank, *Czech Republic: Capital Market Review,* (Washington: World Bank 1999)

APPENDIX A

Legal Framework of the Bulgarian Capital Market in the Light of the European Union and Czech Experience

LIST OF TABLES

APPENDIX A. LEGAL FRAMEWORK OF THE BULGARIAN CAPITAL MARKET IN THE LIGHT OF THE EUROPEAN UNION AND CZECH EXPERIENCE

This appendix provides a more detailed comparison of European Union (EU), Czech, and Bulgarian law. Also included is an analysis of the relationship between the European and Check Laws on one hand and the repealed Law on Securities, Stock Exchanges and Investment Companies (LSSEIC) and the new Law on Public Offering of Securities (LPOS) on the other (the latter published in the State Gazette, № 114, 1999). After four years of functioning of the repealed LSSEIC and the experience collected, this analysis is based primarily on the status of the law provisions and on the shaped during the enforcement process guidelines for their further approximation with the requirements envisaged in the EU directives, as well on the level reached in accomplishing this aim with the new LPOS.

1. DISCLOSURE OF INFORMATION

The EU regime

The European Union regime for regulation of disclosure of information in case of listings and public issues consists of the following Directives: Directive 79/279 Co-ordinating The Conditions For The Admission Of Securities To Official Stock Exchange Listing, which stipulates the minimum standards for listing of corporate issues on recognised stock exchanges; Directive 80/390 Co-ordinating The Requirements For The Drawing Up, Scrutiny And Distribution Of Listing Particulars, which sets out the requirements regarding the information necessary for securities to be admitted to official listing; Mutual Recognition Directive 87/345 which sets out the conditions for securities to be admitted simultaneously, or within a short interval to an official listing on stock exchanges in two or more member states; Directive 89/298 Co-ordinating The Conditions For The Drawing Up, Scrutiny And Distribution Of Prospectuses When Transferable Securities Are Offered To The Public, which sets out the regime for disclosure of information for initial public offering of securities; Directive 82/121/EEC On Information To Be Published On A Regular Basis By Companies The Shares Of Which Have Been Admitted To Official Stock Exchange Listing.

The Bulgarian and the Czech Law

Both the Bulgarian law and the Czech law require that a prospectus be published when securities are admitted for official listing on the stock exchange. The repealed LSSEIC, unlike the Directives, did not differentiate between the obligation to publish a prospectus in the case of admission of securities to official listing on the stock exchange and cases of "ordinary" initial public offering of securities off the exchange (i.e. on the primary market). If securities have been sold through public offering, the company cn could have applied for an official listing on the basis of the same prospectus, duly updated for occurred changes in the data. However, if the initial public offering has not been made, for the admission of securities for trading on the stock exchange the issuing of the prospectus was required as it is in the initial offering. Both the repealed LSSEIC and the Czech legislation are restrictive compared to the Directives regarding exemptions from the prospectus requirement. For example, the repealed LSSEIC and Czech legislation do not provide for exemptions from the prospectus requirement regarding issues that are of small overall market price on all traded securities or of high value on individual participation of the investors in the subscription. Regarding authorisation of omission of certain data from the prospectus the repealed Bulgarian law appeared close to the Directives, although it was still more restrictive with regard to the discretionary

powers of the competent authority than the EU regime. Concerning the content of the prospectus and the procedure of its confirmation by the controlling body, the repealed Bulgarian law was close to, although not fully, compatible with Directive 89/298/EEC. However, the LSSEIC in effect did not comply with the EU requirements concerning the manner in which a prospectus should be brought to the attention of the public.

The repealed Bulgarian law was more restrictive than Czech law regarding the definition of a public offer. However, LSSEIC did not follow the Directive 89/298/EEC in full. The Directive, in contrast to the repealed Bulgarian Law, provides for an exemption from the public offer requirements in cases where offers are made to persons in the context of their trades, professions or occupations, or where offers are made to a restricted number of persons.

The repealed LSSEIC appeared to be much closer to EU requirements for disclosure of periodic issuer information since it obligated issuers of publicly traded securities to submit annual and half yearly reports, as well as to announce the submission thereof in an appropriate manner.

Guidelines for making the repealed Bulgarian Law consistent with EU law and level of approximation reached in the new LPOS:

a) The LSSEIC did not differentiate between the requirements regarding disclosure of information for admission of securities to official listing and primary public offerings of securities. Possible explanation for this approach is that the repealed LSSEIC did not regulate the differentiation between the primary and the secondary public offering of securities.

On the contrary, the LPOS brings in the difference between the definition of "primary public offerings" on one hand and "trade with securities" on the other. The "primary public offering" is an offering corresponding to the requirements of public offerings of:

1. securities subject to listing from their issuer or authorized by him/her investment intermediary (subscription), or

2. securities for primary trading from the investment intermediary according to the concluded with their issuer underwriting contract;

3. share of an open-ended investment company for primary selling from their managing company or from the authorized investment intermediary.

On the other hand trading with securities is:

1. public offering of an issued securities not including the case of primary selling from an investment intermediary according to the concluded with the issuer underwriting contract (secondary public offering);

2. transaction with securities resulting from a secondary public offerings.

3. conclusion of transactions or offers to conclude transactions for purchase and/or

selling of securities not under the conditions of the public offering, when:

i) securities have been issued by the public companies or other issuers, and

ii) person making the offer or being a party to the transaction is a legal person or a sole proprietor;

1. public offering for acquisition by consideration or an invitation to offer proposition for transfer by consideration of securities under the conditions of public offerings.

The LPOS keeps the introduced with the repealed LSSEIC definition of a "public offerings of securities" as an "offer for transfer by consideration or an invitation to offer acquisition by consideration of securities for:

1. at least 50 persons, or

2. non-defined number of persons, including through the mass media."

According to the law there is a public offering also when the person that is not an investment intermediary or an owner of securities takes part in the offering of public securities.

According to the LPOS the primary public offerings is allowed if the issuer or its investment intermediary publish a prospectus and a notice according to the requirements of the law. As regards the trading with securities, the LPOS envisages that the securities for which the prospectus for primary public offerings have not been issued are accepted for trading on the official market if the short prospectus is offered.

b) In the repealed LSSEIC prospectuses were also required for small placements of securities as well as for high value of individual participation of certain investor in the subscription. In this respect the LPOS do not include any exemptions from the obligation to offer prospectus. In view of the forthcoming amendments of the law, possible exemptions according to the Directive 89/298/EEC can be discussed.

c) The LSSEIC did not provide for sufficient exemptions from the prospectus requirement, i.e. when the offer is made to a restricted number of persons, or when persons are engaged in a particular trade. The LPOS allows for more cases when the prospectus might not be offered, for example in case of securities that are offered only to institutional investors, for shares of a public company that are offered for listing only to its shareholders and/or persons working on a labor contract. In this respect the new Bulgarian legislation marks a substantial step ahead in view of its approximation with the requirements of the EU Directives. Furthermore, in the law it is explicitly said that there is no public offering when:

1. the securities are offered in case of liquidation, executive proceedings or bankruptcy proceedings in a way, regulated in another law.

2. shares are offered for listing only to the shareholders in the company and/or employees working on the labor contracts, if they are less than 300 persons.

d) The LPOS envisages wider possibility for so called "closure" of the public company. Thus, a company cease to be public with the decision of the SSC to remove it from the registry of the commission, if: 1. If the general meeting of the company takes the decision to remove it from the registry under the condition that 14 days before that:

i) the number of shareholders is under 50 persons, or

ii) the capital is less than 200 000 BGL;

2. The company is terminated or a bankruptcy proceedings have begun.

1. A take-over bid has been made under the Article 146 (6) of the law.

After the decision of the SSC on the removing from the registry, the shares of the company can not be traded on the regulated market of securities.

It can be expected that the new regime of "closure" of a public companies will bring the practice of establishing and functioning of the public companies in Bulgaria closer to the respective practices in other European countries.

e) The LPOS did not give broader powers to the SSC to exempt certain data from inclusion in the prospectus on grounds of public interest or of issuers' interests. In fact, the scope of powers of the SSC in that respect remained as it used to be in the repealed LSSEIC – if the SSC considers that the information might cause damage to the issuer and this does not mislead the investors as regards the circumstances that are important for reaching the aim of an improved informing of investors. In view of a possible future amendments in the legislation an improved harmonization with the European standards can be reached.

g) The LSSEIC did not regulate adequately the manner in which the prospectus is brought to the attention of the public. In contrast, the LPOS includes the detailed requirements in that respect. The issuer is obliged to offer prospectus to

the public by its publishing in the press in a form of a brochure or in an other appropriate form. The requirements for an offering of a prospectus to the public, deadlines, methods and places of dissemination of the prospectus, an obligatory publishing of the resume of the prospectus in the press or delivery of an information included in the prospectus with the information agency can be determined in an Ordinance. In that respect, it can be considered that the European requirements on this issue are met.

See Table A1 for a detailed comparison of disclosure requirements between the EU, Czech regime, the repealed LSSEIC and the new LPOS.

2. UNDERTAKINGS FOR COLLECTIVE INVESTMENT IN TRANSFERABLE SECURITIES (UCITS)

The EU Regime and the Bulgarian regime according to the repealed LSSEIC and the new LPOS

The EU legislation Directive 85/611/EEC On The Co-ordination Of Laws, Regulations And Administrative Provisions Relating To Undertakings For Collective Investment In Transferable Securities (the UCITS Directive) requires the Member States to adapt their national legislation to facilitate the circulation of UCITS throughout Europe, subject to comparable minimum guarantees. This Directive does not only deal with the harmonisation of organisational rules applicable to UCITS, but also streamlines the administrative control on UCITS. This was one of the first areas in which the "home country control rule" was put into force: the authorisation of a UCITS in one member state is valid for the entire Community. The UCITS will not be subject to control in other member states once it has been authorised by the competent authorities of the member state in which its primary palace of business is situated. The state of authorisation is bound to the minimum level of regulation, contained by the Directive.

Guidelines for making the repealed Bulgarian law consistent with EU law and the level reached by the LPOS to meet this aim:

a) In the LSSEIC the capital of the open-ended investment companies was not adequately regulated as variable capital. Therefore, it was practically impossible to operate an open-ended investment company. The LPOS regulates that the capital of an open-ended investment company can be increased or decreased following the changes in the net value of its assets, also including as a result of a sold shares or redemption of own shares. Thus, regulation of an open-ended investment companies was made consistent with the European model of functioning of this type of institutions.

b) The functions of the bank-depository according to the repealed LSSEIC were not consistent with the requirements of Directive 85/611/EEC. The LPOS makes a substantial progress in that respect by following closely the European model, that includes substantial responsibilities for maintaining and managing the activities of the investment company on behalf of the bank-depository as well as increased controlling function of the bank-depository in the management of the company.

c) The repealed LSSEIC followed in an insufficient way the European regulations on the types of securities in which the assets of the investment company can be invested and on its portfolio diversification and risk spreading. The LPOS almost fully incorporates the requirements of the Directive 85/611/EEC in that respect.

d) The repealed LSSEIC did not regulate adequately the requirements for the composition of a prospectus in case of public offering of shares in an open-ended investment company. In the LPOS additional requirements were supplemented in order to meet the requirements of the Directive 85/611/EEC. They were mainly as regards the content of the prospectus and on its updating after every change in the included data;

e) Rules of the repealed LSSEIC regarding publication of the issuance, selling and price in case of redemption of own shares of an open-ended investment company were to be made more precise. The LPOS reached this goal both on one hand by introducing clear rules on calculation of the values and on the other, by requiring their publication in a daily newspaper indicated in the prospectus at least two times per month.

f) The rules of the repealed LSSEIC on management of an open-ended investment company were to be streamlined as far as they regulated the possibility to chose between the management by the governing body of the company according to the Commercial code and management by the investment intermediary according to the concluded management contract. The LPOS envisages more detailed regulation that is in conformity with the Directive 85/611/EEC and requires the activities of an open-ended investment company to be governed only by a managing company according to concluded contract, and for the „closed-end" investment company – by a managing company or by the governing body of the investment company.

g) Rules on suspension of redemption according to the repealed LSSEIC were not stringent enough to meet the requirements of the Directive 85/611/EEC. The LPOS fully meets the requirements of the Directive in that respect.

See Table A2 for a detailed comparison between the requirements of the Directive 85/611/EEC, the repealed LSSEIC and the new LPOS.

3. INVESTMENT SERVICES

EU Directive 93/22/EEC On The Investment Services In The Securities Field (ISD) is the foundation of the EU single market in securities market activities. Directive 93/22/EEC establishes a single passport regime under which investment firms authorised in one Member State can conduct securities business in any other Member State, whether as a branch or by way of provision of services. An investment firm must be authorised. To be eligible, investment firms must meet the minimum standards set by the Directive and enforced by the competent authorities in the Member States. An investment firm is defined as a physical or legal person engaged in one or several of the transactions defined in the annex to Directive 93/22/EEC.

Furthermore, the license implies that Member States must open up the access to their stock exchanges or other organised markets to all investment firms in the EU that engage in trading with securities. Securities market organisers may not discriminate against firms of other member states, provided that these firms are effectively established, whether as a branch or as a subsidiary.

Each Member State must indicate which authorities will be competent to supervise compliance of investment firms. These authorities must be public entities or entities appointed by public authorities.

For purposes of comparison we distinguish three main areas: (i) functions of investment firms and the securities with which they operate; (ii) licensing (authorisation and revocation) requirements; and (iii) requirements for a regulated market. The detailed comparisons between the European Laws, Check Law, repealed LSSEIC and LPOS are also laid out in Tables A3i, A3ii and A3iii.

(i) Functions of investment firms and types of securities – subject of transactions

Guidelines for making the repealed Bulgarian law consistent with EU law and level of approximation reached in the new LPOS:

a) The repealed LSSEIC did not differentiate between core and non-core activities of an investment firms (investment intermediaries, according to the established Bulgarian legal definition), as it is required in the Directive 93/22/EEC. LPOS lays down this differentiation, regulating on the one hand the main transactions forming the core activities of the investment firms and on the other – listing the activities that an investment firm can pursue in addition to its main

business. In that respect it can be concluded that the European requirements are met.

b) The repealed LSSEIC did not regulate explicitly the rights to acquire shares or bonds by subscription or exchange as securities. Regardless of this, their qualification as securities was taken out from the category of "other documents and rights related to shares and bonds" as part of the definition "securities" according to the law. The LPOS introduces clear definitions by explicitly defining in the supplementing rules the category of "other rights related to shares and bonds or other debt securities" as "rights, warrants, options, futures, contracts for difference and others". The rights are defined as "securities, giving right to list a number of shares in connection with a decision to increase the capital of the public company". In this respect there are no doubts that the LPOS as it is formulated and following the European model treats the rights to acquire shares by subscription as securities.

c) According to the repealed LSSEIC the money market instruments were not classified as securities. The LPOS follows the same pattern and does not regulate the legal status of those instruments in view of the special legislation regulating securities. Due to this, doubts remain on how far the money market instruments fall within the rules of the LPOS. Thus, it can be concluded that there is a certain disparity between the European Laws on securities and the model accepted in the Bulgarian Law.The repealed LSSEIC did not include definition of derivatives. The LPOS following the old laws on securities keeps the same approach and introduces in the supplementary rules the definitions of "warrant", "option", "futures", "contracts for differences" and "term transactions".

(ii) Licensing requirements (for authorization and revocation) for an investment firm

Guidelines for making the repealed Bulgarian law consistent with EU law and level of approximation reached in the new LPOS:

a) The repealed LSSEIC did not regulate questions related to the need for an independent professional audit. The LPOS did not regulate the aspect of functioning of the investment firms either (investment intermediaries).

b) The repealed LSSEIC did not include adequate requirements and procedures for approval of certain changes in the status of an investment firms (investment intermediaries) by the SSEC, that would assure the competent authority that licensed investment firms (investment intermediaries) are in compliance with the law and regulations at all times. Following the European rules the LPOS makes progress in that respect as far as it introduces the requirement for prior approval from the SSC as a condition for changes in the company's structure, for acquisition by one person of more than 10 per cent of the shareholdings participation or shares of an investment intermediary or acquired participation, that would allow this person to control it, and also subsequent acquisition of a shareholdings participation by the same person and changes in the general conditions applicable to contracts with clients.

c) The repealed LSSEIC did not have adequate provisions for refusal to grant a license for an investment firm (investment intermediary) or for the revocation of an issued license. The LPOS broadens these provisions making them consistent with the established model in the Directive 93/22/EEC.

(iii) Regulated markets

The UCITS Directive 85/611/EEC mentions regulated markets as markets which operate regularly, are recognised and are accessible to the public. Directive 93/22/EEC explicitly indicates the essential elements of a regulated market – openness and access, as well as regular functioning. The market should operate on the basis of predetermined rules, which must be prescribed or approved by the competent regulatory and controlling body. A regulated market must comply with specialised requirements for transparency and disclosure of information. Investors should be provided with price data at the start of each day

based on the previous day's trading, including high/lows and weighted average prices. Additionally, for continuous markets, the market should ensure regular price and volume reports during the day. Each Member State is required to draw up a list of regulated markets for which it is the home Member State and which comply with its regulations.

The LSSEIC did not introduce the notion of a regulated market, however, it referred to the notion of a stock exchange and the notion of an "organised OTC market". A stock exchange was defined as an organised market for securities which ensures its members and their clients equal access to market information and equal conditions for participation in trading. An organised OTC market was defined as a securities market which:

1. functions on the basis of established rules for access, for admission of securities, for carrying out of trading, and disclosure of information;

2. ensures to its members equal access to market information and equal conditions for participation in trading;

3. provides a unified system for distance trading.

Both the stock exchange and an organised OTC market were subject to licensing by the SSEC.

The LPOS defines a "regulated markets" as an official market of a stock exchange and also an unofficial market of securities. An unofficial market can be organised by the stock exchange itself or by a joint stock company the shareholders of which are investment intermediaries. An unofficial market and stock exchange under the LPOS should comply with the requirements in relation to a regulated market according to the Directive 93/22/EEC, the most important being the regular formation of contracts for purchase and selling of securities, regular announcement of information on the concluded transactions, equal access to the market information and equal conditions for the trading to all the investment intermediaries, functioning on the basis of the approved by the SSC rules. It can be concluded that with the coming into force of the new LPOS a full approximation of rules on regulated markets of securities with the EU requirements was reached.

4. DISCLOSURE OF MAJOR SHAREHOLDINGS

EU legislation on disclosure of major shareholdings in a listed company which shares are traded on the stock exchange is contained in Directive 88/627/EEC On The Information To be Published When A Major Shareholding In A Listed Company Is Acquired Or Disposed Of.. Both the repealed LSSEIC and the Czech Commercial Code are nearly compatible with Directive 88/627/EEC. The new Bulgarian Law is more compatible with the EU Directive with the adoption of a threshold setting up an obligation for disclosure of shareholdings in cases when the company's shares are accepted for trading on the regulated market of the stock exchange at 5 per cent or number multiple to 5 per cent from the number of voting rights in the general meeting of the company. See Table A4 for a comparison.

5. INSIDER DEALING

The repealed LSSEIC followed Directive 89/592/EEC very closely regarding the rules on trading with inside information in connection with definitions of "inside information" "insiders", and "insider dealing offences". It even adopted a more stringent approach by defining members in the management of an issuer as insiders *per se,* regardless of whether they effectively possess inside information or not. On the contrary, Czech law defines insiders slightly more narrowly and restricts the definition of an insider to persons who are "authorised" to possess inside information, whereas the Directive 89/592/EEC does not require such a relationship. The repealed Bulgarian law was more stringent than the Directive in that it defined "secondary" insiders as persons who have acquired

information directly or indirectly from a "primary insider", without the requirement that they have done this knowingly. The LSSEIC basically followed Directive 89/592/EEC regarding the nature of the offence of insider dealing (the prohibitions with respect to the insiders). In that respect the Bulgarian legislation is much clearer than the Czech law, which simply defines insider dealing as trading in the securities or making use of unpublished confidential information for personal benefit.

The new LPOS follows the same approach as the repealed LSSEIC in the definitions of "inside information", "insiders" and makes the definition of "secondary insiders" compatible with the Directive 89/592/EEC. Due to its compatibility with the European standards the prohibitions on the insiders according to the LPOS are analogous with the one existing in the repealed LSSEIC. The LPOS extends protection against insider dealing to any regulated market (i.e. including any unofficial market), not just on a stock exchange.

Enforcement is a problem. The authorities need the capability to monitor and control trading or create better conditions for practical implementation of the regulations on inside information. The new LPOS has expanded considerably the powers of the SSC by providing for a possibility to request data and trading information also on concluded transactions with securities from the stock exchange and from the Central Securities Depository. Furthermore, according to the LPOS each person that concludes transactions with securities that are traded on the regulatory markets is obliged to declare before the investment intermediaries whether he/she possesses inside information. The LPOS regulates the increased capacity to investigate and identify insider trading related offences by setting up that the Council of Ministers must adopt an Ordinance on measures for prevention and revealing of transactions and activities infringing the relevant legal requirements.

Table A5 compares the various regimes in more detail**.**

5. CAPITAL ADEQUACY

The Capital Adequacy Directive 93/6/EEC sets the minimum initial capital for investment firms. The capital requirement for firms not dealing on their own account and not holding client assets is XEU 50 000; for firms which do hold client assets and undertake singly or in combination, mandate in order routing, order execution and/or portfolio management, XEU 125 000; and for all other firms, XEU 730 000.

The Bulgarian Ordinance On The Capital Adequacy Of Investment Intermediaries sets the minimum initial capital for investment firms, dealing for their own account at BGL 250 Thousand, and for firms acting only on behalf of clients at BGL 90 Thousand. The Ordinance takes into account all the requirements of the Directive, relating to position risk, settlement/counterparty risk, settlement/delivery risk, foreign exchange risk, own funds and large exposures. However, due to the very low liquidity of the market, it is doubtful whether capital adequacy of licensed investment intermediaries is maintained at all times and whether regular and timely reports are made to the SSC.

6. MONEY LAUNDERING

The Money Laundering Directive 91/308/EEC provides for the establishment of adequate rules against money laundering in order to avoid the financial sector being used for disguising proceeds from criminal activities in general and drug offences in particular.

The Bulgarian Law On Measures Against Money Laundering (published in the State Gazette, number 85 of 1998) defines "money laundering" as the preparation, carrying out and receiving of the result of acts through which money or other properties, as well as the proceeds thereof, which are in the possession of a person through or in relation to a crime, are entered in the economic circulation and the result of their use is accounted for and taxed. The Law speci-

fies four concrete types of "money laundering". The Law creates a regime for monitoring of transactions, which may involve "money laundering". Financial institutions are required to identify the principals in transactions exceeding a specified threshold and to report unusual transactions to the Financial Investigation Office at the Ministry of Finance. Addressees of the measures, provided for in the Law are banks and non-banking financial institutions, insurance companies, investment companies and investment intermediaries, privatisation organs and privatisation funds, persons who conduct auctions and leasing activity, operators of gambling clubs, political parties, non-profit organisations and others. These institutions are required to adopt internal rules designed to provide for effective implementation on the internal level of the adopted legislation.

The Bulgarian law, like the case with Czech Money Laundering Act 61/1996, follows much of what is provided in the Directive 91/308/EEC. However, the practical implementation of the adopted provisions remains very unsatisfactory.

7. THE EU AND THE BULGARIAN RULES ON INVESTOR COMPENSATION

The Investor Compensation Directive 97/9 requires each member state to ensure that one or more compensation funds are in operation, and that all investment firms and credit institutions must belong to a fund. The funds must cover claims arising from the liability of an investment firm to repay money owed or belonging to investors, or to return securities to their owners. The funds do not have to cover professional and institutional investors, state bodies and supranational institutions.

Like the case with Czech law, the Directive 97/9 is not yet implemented in Bulgarian law. The Law On Guaranteeing Deposits In Banks provides for a deposit guarantee fund, but that relates to another EU directive (the Directive on Deposit Guarantee Funds of May 1994).

TABLE A1. Disclosure of Information

The EU regime	The Czech laws	The repealed Law on Securities, Stock Exchanges and Investment Companies (LSSEIC)	The new Law On Public Offering Of Securities now in effect (LPOS)
1. Information Released Upon Listing Of Securities On The Stock Exchange, as well as in case of initial public offering of securities	*1. Information Released Upon Listing Of Securities On The Stock Exchange*	*1. Information Released Upon Listing Of Securities On The Stock Exchange*	*1. Information Released Upon Listing Of Securities On The Stock Exchange*
1.1. Admission of securities to official listing on a stock exchange requires a listing or admission prospectus which must be approved by the competent authority and must contain "the information which ... is necessary to enable investors and their investment advisers to make an informed assessment of the assets and liabilities, financial position, profits and losses, and prospects of the issuer and of the rights attaching to such securities; The objective would as a rule be met by disclosing the information that has been stipulated in the annexes to the Directive. Initial public offering of securities requires the publication of a prospectus, for which the characteristics mentioned in regard to the listing particulars apply.	1.1. Only "publicly tradable" securities can be traded on public markets, which requires a license from State Supervision; An application for a public trading license requires a prospectus.	1.1. Only securities for which a prospectus, duly confirmed by the SSEC, has been published under the conditions and procedures laid down in the Law can be admitted to stock exchange trading; The prospectus should contain information, which should enable investors to make a sound assessment of the economic and financial situation of the issuer and the rights attached to the securities; The scope of the information to be included in the prospectus is regulated in detail in the Ordinance On The Prospectuses In Case Of Public Offerings Of Securities. The repealed LSSEIC did not differentiate between a prospectus for initial public offering of securities, and the prospectus or listing particulars in the case of admission of securities to official listing on the stock exchange in respect to the content and scope thereof.	1.1. Securities for which a prospectus for a primary public offering, confirmed by the State Securities Commission (SSC), has been published pursuant to the conditions and procedures laid down in the Law can be admitted to stock exchange trading. If no prospectus for a primary public offering has been published, securities can be admitted to stock exchange trading provided a condensed prospectus is published. The Law introduces the concept of a primary public offering of securities, which necessitates a prospectus, to be confirmed by the SSC and published in accordance with the conditions and procedures laid down in the Law.
1.2. Exemptions from the requirement to prepare listing particulars:	*1.2. Exemptions from prospectus requirement:*	*1.2. Exemptions from prospectus requirement:*	*1.2. Exemptions from prospectus requirement:*

Member States may allow the authorities responsible for checking the listing particulars to provide partial or complete exemption from the obligation to publish listing particulars in the following cases:	Czech law does not provide for any exemptions from the prospectus requirement.	Under the repealed LSSEIC no prospectus is to be provided:	The new LPOS now in effect provides that a prospectus may not be prepared and submitted:
1. where securities for which admission to official listing is applied for are: (a) securities which have been the subject of a public issue; (b) securities issued in connection with a takeover offer; (c) securities issued in connection with a merger, acquisition, division, the transfer of all or part of an undertaking's assets and liabilities or as consideration for the transfer of assets other than cash; and where not more than 12 months before the admission of the securities to official listing, a document regarded by the competent authorities as containing information equivalent to that of listing particulars provided for by the Directive, has been published in the same Member State; 2. where the securities for which admission to official listing is applied for are: (a) shares allotted free of charge to holders of shares already listed on the same stock exchange; or (b) shares resulting from the conversion of convertible debt securities or shares created after an exchange for exchangeable debt securities, if shares of the company whose shares are offered by way of conversion or exchange are already listed on the same stock exchange; or (c) shares resulting from the exercise of the rights conferred by warrants, if shares of the company whose shares are offered by way of conversion or exchange are already listed on the same stock exchange; or (d) shares issued in substitution for shares already listed on the same stock exchange if the issuing of such new shares does not involve any increase in the company's issued share capital and where appropriate, the information provided for in Chapter 2 of Schedule A is published in accordance with Articles 20 (1) and 21 (1). 3. where the securities for which admission to official listing is		1. for securities issued or guaranteed by the state or by the Bulgarian National Bank; 2. for securities, issued by international organizations of which the Republic of Bulgaria is a member; 3. for shares, which are distributed between shareholders in case of transformation of part of the profit in share capital without payment of their value; 4. in case of conversion of bonds in shares, if a prospectus has been published for the bonds. This applies both to the prospectus in the case of initial public offering off the exchange, as well as to the case of a prospectus for admission of securities to official listing on the stock exchange. Moreover, if one class of shares has been admitted to trading on the stock exchange the SSEC may authorize partial or complete exemption from the obligation to publish a prospectus for public offering provided: 1. the number of the offered new shares is less than 10% of the number of shares of the same class already admitted to	1. in respect of securities, issued or guaranteed by the state or the Bulgarian National Bank; 2. in respect of securities, issued by international organizations of which the Republic of Bulgaria is a member; 3. in respect of shares which are distributed between the shareholders in case of transformation of part of the profit in share capital without payment of their value; 4. in case of conversion of bonds in shares, in case for the bonds a prospectus has been published; 5. in case of issuance of rights. 6. in respect of securities which are offered only to institutional investors; 7in respect of futures and options subject to a public offering on the stock exchange; 8. in respect of shares of a public company which are offered for subscription only to its shareholders and/or persons under labor contract; 9. in respect of shares offered as a result of a merger, acquisition or tender offer. The SSC may authorize the partial or full exemption from the obligation to publish a prospectus for a primary public offering when: 1. the number of the offered new securities is less than 10% of the number of securities of the same class which have already been admitted to trading; and

applied for are: (a) shares of which either the number or the estimated market value or the nominal value or, in the absence of a nominal value, the accounting par value, amounts to less than 10% of the number or of the corresponding value of the shares of the same class already listed on the same stock exchange; or (b) debt securities issued by companies and other legal persons which are nationals of a Member State and which: - in carrying on their business, benefit from State monopolies, and - are set up or governed by a special law or pursuant to such a law or whose borrowings are unconditionally and irrevocably guaranteed by a Member State or one of a Member State's federated States; or (c) debt securities issued by legal persons, other than companies, which are nationals of a Member State, and - were set up by a special law, and - whose activities are governed by that law and consist solely in: (i) raising funds under state control through issue of debt securities, and (ii) financing production by means of the resources which they have raised and resources provided by a Member State, and - the debt securities of which are, for the purposes of admission to official listing, considered by national law as debt securities issued or guaranteed by the State; or (d) shares allotted to employees, if shares of the same class have already been admitted to official listing on the same stock exchange; shares which differ from each other solely as to the date of first entitlement to dividends shall not be considered as being of different classes; or		trading; and 2. the investors already dispose of the information, which corresponds to the requirements relating to disclosure of information in case of public offering of securities.	2. the investors already dispose of the information , which corresponds to the requirements regarding disclosure of information in case of public offering of securities; 3. for the same class of shares a prospectus has been confirmed not more than one year ago; 4. in other cases, provided for by way of an ordinance, provided that the investors already dispose of the information, corresponding to the requirements regarding disclosure of information in case of public offering of securities or such information is not necessary for the assessment of the economic and financial position of the issuer and the rights attaching to the securities.

1.3. Authorization of omissions of certain information from the listing requirements:	*1.3. Authorization of omissions of certain information from the prospectus:*	*1.3. Authorization of omissions of certain information from the prospectus:*	*1.3. Authorization of omissions of certain information from the prospectus:*
The competent authority may authorize omission from the listing particulars of certain information if it considers that: (a) such information is of minor importance only and not such as will influence assessment of assets and liabilities, financial position, profits and losses and prospects of the issuer; or (b) disclosure of such information would be contrary to the public interest or seriously detrimental to the issuer, provided that, in the latter case, such omission would not be likely to mislead the public with regard to facts and circumstances, knowledge of which is essential for the assessment of the securities in question.	The State Supervision can permit the contents of a prospectus to be condensed if it does not impair the interests of shareholders.	The SSEC may grant an exemption regarding some of the data which must be disclosed in a prospectus if it deems that the disclosure of such data can be detrimental to the interests of the issuer provided that this would not be likely to mislead the investors in relation to price sensitive issues.	The SSC may authorize omission from the prospectus of certain data if it considers that such information can be detrimental to the interests of the issuer, provided that this would not be likely to mislead the investors in relation to circumstances which are of relevance to the assessment of the economic and financial position of the issuer and of the rights attaching to the securities.
1.4. Manner in which the listing particulars should be brought to the attention of the public:	*1.4. Manner in which the prospectus should be brought to the attention of the public:*	*1.4. Manner in which the prospectus should be brought to the attention of the public:*	*1.4. Manner in which the prospectus should be brought to the attention of the public:*
Listing particulars must be published either: - by insertion in one or more newspapers circulated throughout the Member State in which the admission to official listing of securities is sought, or widely circulated therein, or - in the form of a brochure to be made available, free of charge, to the public at the offices of the stock exchange or stock exchanges on which the securities are being admitted to official listing, at the registered office of the issuer and at the offices of the financial organizations retained to act as the latter's paying agents in the Member State in which the admission of securities to official listing is sought.	No information available	The LSSEIC did not regulate adequately the manner in which the prospectus should be brought to the attention of the public. The Law simply stated that the issuer should publish a notice about the public offering, the beginning and the end of the subscription, the registration number of the confirmation issued by the SSEC, the place, time and manner of getting acquainted with the prospectus.	The issuer is required to arrange for access of the public to the prospectus by way of publishing it in the press, by way of a brochure or in another appropriate manner. The advertising materials and publications in relation to the public offering of securities should indicate the place where the prospectus is available to the public. Such materials may not contain false or misleading information, as well as information which contradicts the information contained in the prospectus. The Law provides for the possibility for the issuance of a regulation to introduce additional requirements concerning the availability of the prospectus to the public, inclusive methods, deadlines and places for distribution of the prospectus, printing of a minimum number of copies of the prospectus, obligatory publication of a summary of the prospectus in the press etc.
1.5. Updating of information in the listing particulars	*1.5. Updating of information in the prospectus*	*1.5. Updating of information in the prospectus*	*1.5. Updating of information in the prospectus*

Every significant new factor capable of affecting assessment of the securities which arises between the time when the listing particulars are adopted and the time when stock exchange dealings begin shall be covered by a supplement to the listing particulars, scrutinized in the same way as the latter and published in accordance with procedures to be laid down by the competent authorities.	No information available	The issuer is required to inform the SSEC about all changes occurred in the period from the submission of the application for the approval of the prospectus by the SSEC until the taking of the decision by the SSEC, if such changes necessitate amendments to the prospectus before the issuance of the confirmation of the prospectus. The issuer is required to introduce the necessary changes in the prospectus if in the period between the issuance of the confirmation and the time when stock exchange dealings begin he learns about changes which necessitate such amendments. The issuer is obligated to update the data in the prospectus every six months and at each change of the data, which may influence the price of the securities.	The issuer is required to inform the SSC about all changes occurred in the period from the submission of the application for the approval of the prospectus by the SSC until the taking of the decision by the SSC, if such changes necessitate amendments to the prospectus before the issuance of the confirmation of the prospectus. The issuer is required to introduce the necessary amendments in the prospectus if in the period between the issuance of the confirmation and the deadline of the subscription or sale the issuers becomes aware about changes that necessitate such amendments. The SSC and the regulated market on which the securities of the issuer are being traded should be informed about the amendments. The issuer is required to introduce amendments in the prospectus if until the deadline of the validity of the prospectus the issuer learns about changes that necessitate such amendments.
2. Periodic disclosure of information	*2. Periodic disclosure of information*	*2. Periodic disclosure of information*	*2. Periodic disclosure of information*
2.1. Annual information:	*2.1. Annual information:*	*2.1. Annual information:*	*2.1. Annual information:*
EU regime requires disclosure of annual information by way of an annual report on financial statements, including the consolidated financial statements;	Czech law does not specify how issuer information other than annual reports is to be made public, leaving it to State Supervision.	The issuer is obligated to submit to the SSEC an annual report in a period of 90 days from the end of the financial year. The annual report should contain data about the issuer and its activity, the members of its managing and controlling bodies, the persons that own or control more than 10% of the votes in the general shareholders' meeting, an audited	The issuer is required to submit to the SSC an annual report in 90 days from the end of the financial year. The annual report should contain data about the issuer and its activity, the members of its management and controlling bodies, the persons which own or control more than 10% of the votes in the general shareholders' meeting, an audited annual financial statement, as well as other information determined by way of an ordinance;

		annual financial statement as well as other information determined by the SSEC; The SSEC has not yet issued a special ordinance to specify the additional information required to be included in the annual report.	

TABLE A2. Undertakings for Collective Investment in Transferable Securities

The EU regime	The repealed LSSEIC	The Law On Public Offering Of Securities now in effect (LPOS)
Definition of UCITS	*Definition of UCITS*	*Definition of UCITS*
The Directive defines a UCITS as an undertaking: – the sole object of which is the collective investment in transferable securities of capital raised from the public and which operate on the principle of risk-spreading, and – the units of which are, at the request of holders, re-purchased or redeemed, directly or indirectly, out of the undertakings' assets.	The repealed LSSEIC defined the investment companies as joint stock companies licensed under the conditions and the order of the law, with a subject matter of activity the investing in securities, except for securities of its founders.	The LPOS defined the investment company as a joint stock company, licensed under the conditions and the procedures of the law, with a subject matter of activity investing in securities on the basis of risk spreading, through money collected by way of a public offering of securities.
Form of UCITS	*Form of UCITS*	*Form of UCITS*
Form of UCITS – either under the law of contract (as common funds managed by management companies) or trust law (as unit trusts) or under statute (as investment companies)	Under the repealed LSSEIC investment companies could only be organized in the form of joint stock companies.	The Law provides that the investment company may be organized only in the form of a joint stock company.
Management of UCITS	*Management of UCITS*	*Management of UCITS*
Management of UCITS – either by a management company or, if the UCITS has been organised in the form of a company, by its board of directors	Management – investment companies are managed either by their board of directors or by an investment intermediary pursuant to a management contract.	The Law provides that the investment company of an open-ended type is to be managed only by a management company pursuant to a management contract. Investment companies of a closed-ended type could be managed either by their management body (management board or board of directors) or by a management company pursuant to a management contract.
Functions of the depository	*Functions of the depository*	*Functions of the depository*
The Directive provides for a clear differentiation between management and depository functions. A unit trust's assets must be entrusted to a depository for safe keeping. A depository must, moreover: (i) ensure that the sale, issue, repurchase, redemption and cancellation of units effected on behalf of a unit trust or by a management company are carried out in accordance with	The repealed LSSEIC provided that the securities acquired by an investment company and the cash should be held in the Central Securities Depository or in a bank-depository. The bank-depository cannot be a creditor or a guarantor of the investment company. The bank-depository should segregate the securities and cash of the investment company, held by it from its own assets and should maintain a	The Law now in effect provides that the uncertificated securities owned by the investment company should be recorded in the register of the Central Securities Depository, and the cash and the other securities should be held in a bank-depository. The bank-depository is obligated to maintain a separate accounting for the cash and the other assets of the investment company. It should segregate the

the law and the fund rules; (ii) ensure that the value of units is calculated in accordance with the law and the fund rules; (iii) carry out the instructions of the management company, unless they conflict with the law or the fund rules; (iv) ensure that in transactions involving a unit trust's assets any consideration is remitted to it within the usual time limits; (v) ensure that a unit trust's income is applied in accordance with the law and the fund rules. An investment company's assets must be entrusted to a depository for safe-keeping. A depository must, moreover: (i) ensure that the sale, issue, repurchase, redemption and cancellation of units effected by or on behalf of a company are carried out in accordance with the law and with the company's instruments of incorporation; (ii) ensure that in transactions involving a company's assets any consideration is remitted to it within the usual time limits; (iii) ensure that a company's income is applied in accordance with the law and its instruments of incorporation.	separate accounting therefor	assets of the investment company from its own assets. The bank-depository is obligated: – to ensure that the sale, issue, repurchase, redemption and cancellation of the shares of the management company are carried out in accordance with the law and the investment company rules; – to ensure that in transactions involving a company's assets any consideration is remitted to it within the legally determined time limits, unless the counterparty is in default or there are sufficient grounds to consider that the counterparty is in default; – to ensure that a company's income is collected and applied in accordance with the law and its instruments of incorporation. – to dispose of the assets of the investment company only on the basis of instructions of the authorized persons, unless such instructions contradict the law, the by-laws of the company or contract for depository services; – to report regularly to the investment company in respect of the entrusted assets and the operations carried out.
Assets of a UCITS	**Assets of a UCITS**	**Assets of a UCITS**
Securities eligible for investment purposes – only transferable securities which are traded on stock exchanges or negotiated in a recognised, regulated and open markets may be used for investment purposes, without distinction as to nationality. However, for non-EEC securities, the stock exchange or market has to be approved by the competent authority of the member state or has to be laid down in the rules of the fund.	The repealed LSSEIC provided that the property of the investment company of an open ended type should consist of: (i) securities admitted to stock exchange trading; (ii) government securities; (iii) shares of other investment companies; (iv) movable and immovable property, insofar as it is necessary for the direct carrying out of the activity of the company; (v) cash.	The assets of an investment company of an open ended type should consist of: (i) securities, admitted to trading on a regulated market; (ii) government securities; (iii) securities which are not traded on a regulated market; (iv) shares of other investment companies; (v) movable property, insofar as it is necessary for the direct carrying out of the activity of the company;

		company; (vi) cash.
Diversification of portfolio	*Diversification of portfolio*	*Diversification of portfolio*
Management of UCITS – in a spirit of risk spreading (i) a UCITS may invest no more than 10% of its assets in transferable securities other than those referred to in the foregoing table row; (ii) a Member State may provide that a UCITS may invest no more than 10% of its assets in debt instruments which, for the purposes of the Directive, shall be treated, because of their characteristics, as equivalent to transferable securities; (iii) an investment company may acquire movable and immovable property which is essential for the direct pursuit of its business; (iv) a UCITS may not acquire either precious metals or certificates representing them.	The LSSEIC provided that investments in securities, which have not been admitted to stock exchange trading may not exceed 10% of the capital of the investment company; - investments in shares of other investment companies and in movable and immovable property may not exceed 5% of the capital and jointly 10% of the capital of the investment company; The investment company may not invest more than 5% of its capital in securities issued by one and the same issuer, except for investments in government securities; The SSEC may permit to an investment company to invest up to 10% of its capital in securities, issued by one and the same issuer, if the aggregate value of those investments does not exceed 20% of the capital of the investment company.	Investments in securities which are not traded on a regulated market may not exceed 10% of the assets of the investment company of an open ended type; Investments in shares of other investment companies and in movable property may not exceed 5% , and jointly 10% of the assets of the investment company; The investment company of an open-ended type may not invest more than 5% of its assets in securities issued by a public company or another issuer, the securities of which have been admitted to trading on a regulated market; The investment company of an open-ended type may not invest more than 20% of its assets in one issue of government securities;
Shareholding in one single issuer	*Shareholding in one single issuer*	*Shareholding in one single issuer*
Shareholdings in one single issuer – an investment company may not acquire any shares carrying voting rights which would enable it to exercise a significant influence over the management of any issuing body	An investment company of an open ended type may not acquire more than 10% of the votes in one and the same company	An investment company both of an open ended and a closed ended type may not acquire a shareholding in the voting shares of one issuer which can allow the investment company or the members of its managing or controlling organs, inclusive the management company or the members of its managing or controlling organs, to exercise control over it.
Suspension of redemption	***Suspension of redemption***	***Suspension of redemption***
Suspension of redemption – only in exceptional cases where circumstances so require, and having regard to the interests of unit holders	The repealed LSSEIC provided that an investment company may temporarily suspend the redemption of its shares under the conditions and the procedure, laid down in its founding documents. In such case it should	The investment company of an open ended type may temporarily suspend the redemption of its shares under the conditions and the procedure, laid down in its by-laws, but only in exceptional cases, if the circumstances so

	inform the SSEC about its decisions in three days.	require and the suspension is justified in view of the interests of the shareholders.
Rules on valuation	***Rules on valuation***	***Rules on valuation***
The rules on the valuation of assets and the rules for calculating the sale or issue price and the repurchase or redemption price of the units of a UCITS must be laid down in the law, in the fund rules or in the investment company's instruments of incorporation.	The repealed LSSEIC provided that the by-laws of the investment company should contain rules on the conditions and order for calculating the value of the shares in case of redemption; However, the LSSEIC did not contain any provisions regarding valuation of assets and rules on calculating the sale or issue price of the shares.	The LPOS provides that the by-laws of the investment company should contain the conditions and order for calculation of the net asset value, the issue value and the value of the shares in case of redemption, as well as of the dividend in case distribution of dividends is provided for. Both the issue value and the redemption value are based on the net asset value and should be determined at least twice in the week at equal time intervals.
Disclosure requirements	***Disclosure requirements***	***Disclosure requirements***
The directive provides for disclosure requirements in the form of a prospectus in the case of initial public offering of shares, as well as periodic disclosure in the form of annual reports and half-yearly reports.	The repealed LSSEIC required investment companies to disclose information in the form of a prospectus in the case of public offering of its shares, and periodic information in the form of an annual and half – yearly report.	The LPOS requires investment companies to disclose information in the form of a prospectus in the case of public offering of shares, and periodic information in the form of annual reports, half yearly reports, monthly balance sheets and quarterly balance sheets.
Publishing of prices	***Publishing of prices***	***Publishing of prices***
The Directive requires publishing of prices at least twice monthly, particularly the issuance price, the sale price, the redemption and/or repurchase price of the units or certificates.	The investment company should announce in the SSEC and in the media the issue price of its shares, and in case it is of an open ended type – the redemption price of its shares. Such announcements should be made at each issue, sale and redemption, but not less than twice in the month.	The investment company of an open ended type is obligated to announce in the SSC at least twice in the week at equal time intervals the issue and the redemption price of its shares as well as to publish them in one central newspaper, as indicated in the prospectus, at least twice in the month. .
Prohibitions	***Prohibitions***	***Prohibitions***
Neither an investment company, nor a management company or depository acting on behalf of a unit trust may grant loans or act as guarantor on behalf of third parties, or carry out uncovered sales of transferable securities. However, this shall not prevent such undertakings from acquiring transferable securities which are not fully paid up.	The repealed LSSEIC prohibited the investment companies to take or grant loans, to engage in short sales. An investment company may not acquire transferable securities, which have not been fully paid up.	The Law now in effect prohibits the investment company to grant loans or to be a guarantor of third parties obligations. The investment company may not: – acquire securities which have not been fully paid up; – sell securities which it does not own; – invest in securities issued by its founders or persons related with them and/or persons that control the investment company or persons related with them..

TABLE A3i. Comparison of the Function of Investment Firms and the Classification of Securities

The Investment Services Directive	The repealed LSSEIC	The Czech laws	The Law On Public Offering Of Securities (LPOS)
Investment firms activities	*Investment intermediary activities*	*Securities dealer activities*	*Investment intermediary activities*
Core services Underwrite issues; Act as broker; Deal for own account; Portfolio management; *Non-core services* Safe-keeping and administration; Provision of finance to investors; Corporate finance advice; Services related to underwriting; Investment advice; Foreign exchange service related to investment.	Act as dealer – execute transactions for its own account; Act as broker – execute transactions for the account of clients; Underwrite issues of securities for its own account or for the account of the issuer;	Act as dealer; Arrange issues of securities; Act as broker (agent) for a customer; Act as custodian; Portfolio management; Act as depository; Deal in derivatives; Corporate finance advice.	Act as dealer; Act as broker – execute transactions for the account of clients; Underwrite issues of securities for its own account; Individual portfolio management; Holding of securities and money of clients in a depository institution (custodian activity); Intermediation in respect of conclusion of securities transactions; The investment intermediaries licensed to carry out the transactions listed hereinabove are also entitled to carry out the following transactions and services: – Provision of investment advice in relation to securities; – Consultation and analysis of companies in relation to the financing of their activity, capital structure, industrial strategy and related issues, as well as consultations and services in relation to transformation of companies and transactions in respect of acquisition of enterprises; – Preparation of prospectusses for public offering of securities; - Representation of owners of securities before the issuer of the securities and at general meetings of the owners of such securities; – Provision of non-bank loans for the purchase of securities and for securities lending under conditions and order determined by an ordinance.
Definition of securities	*Definition of securities*	*Definition of securities*	*Definition of securities*
1 (a) Transferable securities; (b) Units in UCITS; 2. Money market instruments; 3. Financial futures contracts (including cash settled transactions); 4. Forward interest rate	Transferable documents and rights, which can be a subject of public offering, like: (a) Shares;	1 (a) Shares; (b) Interim certificates; (c) Participation certification (fund units); (d) Bonds; (e) Investment coupons (privatization);	Transferable rights registered in accounts with the Central Securities Depository (uncertificated securities), or documents incorporating transferable rights (certificated or materialized securities) which due to their nature can be offered publicly, like: (a) shares; (b) bonds and other debt securities;

agreements; 5. Interest rate, currency and equity swaps; 6. Options to acquire or dispose any of the above and includes currency and interest rate options.	(b) Bonds; (c) Other documents and/or rights, related to shares and bonds.	(f) Coupons from bearer securities; (g-k) Bills of exchange, cheques, travellers' cheques, waybills; (l) Other instruments recognized as securities. Derivatives [Transferable rights and obligations derived from securities or relating to exchange traded commodities, and from currency, interest rate and exchange rate indices and related contracts]	(c) other rights related to shares, bonds or other debt securities. Definition of "other documents and rights, related to shares, bonds or other debt securities": warrants, options, rights, forwards, futures, contracts for difference etc; Definition of debt securities:- transferable claims for predetermined or subject to determination income against the issuer of the securities, occurred as a result of money or other property rights lent to it. Debt securities may express other rights too, insofar as this does not contradict the law. Definition of futures:- standardized security, traded on regulated securities markets and expressing the right and the obligation for purchase or sale of a specified number securities on a fixed price at a fixed date; Definition of option: – security incorporating the right for the purchase or sale of a specified number of securities at a fixed price until the expiration of a specified term or on a specified date. The Law now in effect defines as securities also the investment contracts, in respect of which investors provide money or other property rights to another person without direct participation in their management, with the aim to realize profit.

TABLE A3ii. Comparison of Licensing, Grounds for Refusal and Grounds for Revocation of License Requirements

The EU regime	The Czech Laws	The repealed LSSEIC	The Law On Public Offering Of Securities (LPOS)
Investment firms principal authorization requirements	*Czech principal licensing requirements*	*Principal licensing requirements*	*Principal licensing requirements now in effect*
1. Provision for segregation of customer assets;	1 Segregation required under amended law;	1. Segregation required under LSSEIC	1. Segregation of customer assets
2. Independent professional audit;	2. Not specified in the Act;	2. Not specified in the LSSEIC	2. Not specified in the Law;
3. Reputable and competent management;	3. All employees to be suitable and qualified;	3. Reputable and competent management	3. Reputable and competent management;
4. Provision of business plan;	4. Provision of business plan;	4. Provision of business plan	4. Provision of business plan;
5. Approved controllers and >10% shareholders;	5. Not required except for foreign interest;	5. Approved controllers and >10% shareholders	5. Approved controllers and >10% shareholders
6. Adequate capital in accord with Directive 93/6;	6. Basic capital specified: regulations in preparation;	6. Basic capital specified: capital adequacy regulations in place, compatible with Directive 93/6	6. Basic capital specified: capital adequacy regulations in place, compatible with EU Directive 93/6;
7. Observance of official prudential rules;	7. General rules of conduct in amended law, further regulations to follow;	7. Observance of official prudential rules;	7. Observance of officical prudential rules;
8. Observance of official rules of conduct.	8. Arrangement to prevent abuse of conflict of interest.	8. Observance of promulgated official rules on conduct; arrangement to prevent abuse of conflict of interests;	8. Observance of promulgated official rules on conduct; arrangement to prevent abuse of conflict of interest;
		9. General terms for client contracts safeguarding the interests of investors	9. General terms for client contracts safeguarding the interests of investors;
			10. Shareholders with more than 10% of the capital have not used borrowed funds in relation to their contribution in the capital.

Grounds for refusal of authorization	*Grounds for refusal of license*	*Grounds for refusal of license*	*Grounds for refusal of license*
1. Insufficient capital; 2. The management is not of adequate repute or experience; 3. Other conditions specified in national law.	1. The material, personnel and organizational prerequisites for conducting activities as a dealer in relation to the business plan and the activities for which a license is applied are not ensured.	1.Insufficient capital; 2. The management is not of adequate repute or experience; 3. Controllers and/or persons owning more than 10% of the votes in the company potentially can influence negatively the security of the company or its operations; 4. The general conditions for customer contracts do not safeguard sufficiently the interests of the investors.	1. Insufficient capital; 2. The management is not of adequate repute or experience; 3. Controllers and/or persons owning more than 10% of the votes in the company potentially can influence negatively the security of the company or its operations; 4. The general conditions for customer contracts do not safeguard the interests of the investors; 5. Persons owning more than 10% of the votes in the general shareholders' meeting of the applicant have made their contributions with borrowed funds; 6. The applicant does not comply with other requirements, laid down in the law and the acts on its implementation; 7. The applicant has presented false data or documents with false content.

TABLE A3iii. Comparison of Regulated Markets

The EU regime	Bulgarian Law and Practice	Czech Practice
1. Regulation – i.e. under the EU regime a regulated market is subject to regulations, issued or approved by the competent authority on the operation of the market, access to the market, listing and admission to dealing.	1. The LPOS defines regulated markets for securities as the official stock exchange market and the unofficial securities market, on which or through which: – transactions for the purchase and sale of securities are concluded and proposals and invitations for conclusion of such transactions are made regularly, by way of attendance or through a uniform system without attendance; and – information about the concluded transactions and the proposals for conclusion of such transactions is being regularly announced. The LPOS provides that a regulated market, be it the official stock exchange market or an unofficial securities market should function on the basis of rules approved by the SSC. At present the only regulated market in the country is the Bulgarian Stock Exchange – Sofia. The Bulgarian Stock Exchange – Sofia has the authority, among other things, to regulate its members and requirements for official listing of securities.	1. The Prague Stock Exchange has the authority to regulate its members and listing. The RM-system does not have members and is not in a regulatory relationship with its customers.
2. Price integrity – i.e. no fragmentation.	2. Prices are uniform since there is no other regulated market apart from the Bulgarian Stock Exchange, i.e. organized off-exchange market.	2. Different prices can occur on different markets, though there is increasing convergence.
3. Regular opening, associated with regularity of disclosure by issuers.	3. The Bulgarian Stock Exchange operates regularly, and its Rules require regular disclosure of information by the issuers the securities of which are admitted to trading. The LPOS provides that the stock exchange can require that the public companies and the other issuers the securities of which are admitted to the official market, to provide information which the stock	3. The RM System and the Prague Stock Exchange operate regularly

	exchange deems necessary for the carrying out of the stock exchange trading or the protection of the investors.	
4. Open to the public – i.e. available for the execution of orders on behalf of the public and without discrimination between investors.	4. The Bulgarian Stock Exchange is available for the execution of public orders, and without any discrimination between the investors.	4. Both organized markets are available for the execution of public orders and the RM system permits the public direct access
5. Transparent and liquid – i.e. in accord with the Investment Services Directive.	5. In accordance with the Investment Services Directive, the LPOS requires that the stock exchange should distribute in the beginning of the working day in an appropriate manner information about the traded volumes, the minimum and maximum price, the average weighted price, as well as the price as of the closing of the preceding working day. The Law provides that the stock exchange can apply special rules for disclosure of information in case of securities transactions of a big volume, in case of transactions with unliquid securities and in the case of debt securities. The Bulgarian Stock Exchange reports on-market transactions promptly	5. Both markets report on-market transactions promptly but official reporting of “direct trades” is not reliable intra-day
6. Recognized.	6. Recognition, for EU purposes is for the European Commission to decide.	6. Recognition, for EU purposes is for the Commission to decide

TABLE A4. Disclosure of Major Holdings in a Listed Company

EU Regime	Czech Regime	The repealed LSSEIC	The Law on Public Offering of Securities (LPOS)
Requires any person who directly or indirectly acquires or disposes major shareholdings in a listed company to inform the company and the competent authority. The Directive also sets up the disclosure threshold.	Commercial Code requires disclosure of ownership changes which cross the thresholds of 10, 20, 30, 50, 65 percent. Securities Law requires the issuer to disclose in prospectuses stakes of 10 percent or more, which are known to the issuer.	Requires disclosure of ownership changes (direct or indirect) in a publicly traded company, when they cross the thresholds of 10 or a multiple thereof. Requires prospectuses to disclose ownership stakes of 10% or more which are known to the issuer.	The public company, the SSC as well as the respective regulated market on which the company's shares are admitted to trading, should be notified about every person whose voting right reaches, crosses or falls below: 1. 5% or a multiple thereof of the number of the votes in the general shareholders' meeting of a company the shares of which have been admitted to trading on the official stock exchange market; 2. 10%, 1/4, 1/3, 1/2 or 3/4 of the number of the votes in the general shareholders' meeting of a company, the shares of which have been admitted to trading on an unofficial securities market. For the purpose of the notification the voted attached to the following shares should be added to the votes attached to the shares directly owned by the person referred to hereinabove: 1. shares owned by the spouse and the minors of the person referred to hereinabove; 2. shares owned by a company, in respect of which the person referred to hereinabove exercises control; 3. shares owned by other persons in their own name, but for the account of the person referred to hereinabove;

			4. shares owned by a person with which the person referred to hereinabove has concluded a written agreement to follow a common policy in respect of the management of the respective company by way of joint exercising of the voting rights owned by them; 5. shares provided by a person with which the person referred to hereinabove or a person controlled by it has concluded a written agreement, providing for the temporary transfer of the voting rights attached to such shares; 6. shares provided by the person referred to hereinabove as security, except for the cases when the secured creditor exercises the voting rights; 7. shares deposited with the person referred to hereinabove with transfer of the voting rights without special instructions by the shareholders. The LPOS contains specific provisions as to the person subject to the notification obligation for each particular scenario.

TABLE A5. Insider Dealing

EU Regime	Czech Regime	The repealed LSSEIC	The LPOS now in effect
Definition of inside information	*Definition of inside information*	*Definition of inside information*	*Definition of inside information*
Defines inside information as: information, not known to the public, that relates to precise information, and relates to one or more issuers of securities, or to one or more securities, and which if disclosed, would have a significant influence on the price of that or those securities.	Defines inside information as: unpublished, price sensitive information.	Defined inside information as all kind of data, for which there exists no obligation to be publicly disclosed or which have still not yet been publicly disclosed, and which relate to one or more issuers or their securities, or to other such data, if their public announcement is likely to influence significantly the price of securities, admitted to trading.	Defines inside information as all kind of data, for which there exists no obligation for their public announcement or which have not yet been publicly announced, which relate to a public company or to an issuer of securities traded on a regulated market, or to the securities themselves, if their public announcement is likely to influence significantly the price of securities traded on a regulated market.
Definition of insiders	*Definition of insiders*	*Definition of insiders*	*Definition of insiders*
Defines insiders as: persons who possess inside information by virtue of membership in the management of an issuer, or by virtue of an investment in the issuer, or by virtue of employment, profession or duties.	Defines insiders as: persons who due to their employment, profession, job or function are authorized to acquire confidential information about the economic and financial position of a certain issuer, or other facts significant for financial market development.	Defined insiders as: 1. each member of a managing or controlling body of the issuer of securities traded on the stock exchange; 2. each member of a managing or controlling body or general partner in a company, which is a related person with the issuer of securities traded on the stock exchange; An insider is also a person owning directly or through related persons more than 10% of the votes in the general shareholders' meeting of the issuer, if it has access or disposes of inside information, as well as any other person which due to its profession, activity, obligations or relatedness with the issuer or with the insiders referred to here in above has access or disposes of inside information.	Defines insiders as: 1. each member of a managing or controlling body of a public company or an issuer of securities traded on a regulated market; 2. each member of a managing or controlling body or general partner in a company, which is a related person with the respective public company or the issuer of securities traded on a regulated market; An insider is also a person owning directly or through related persons more than 10% of the votes in the general shareholders' meeting of the public company or the issuer of securities traded on a regulated market, if it has access or disposes of inside information, as well as any other person which due to its profession, activity, obligations or relatedness with the public company or the issuer of securities traded on a regulated market or with the insiders referred to hereinabove has access or disposes of inside information.

Definition of secondary insider	*Definition of secondary insider*	*Definition of secondary insider*	*Definition of secondary insider*
Defines secondary insiders as: persons who have knowingly acquired inside information from primary insiders.	Same as EU regime	A secondary insider is defined as a person, which, without being an insider owns inside information, the direct or indirect source of which is an insider.	A secondary insider is defined as a person which, without being an insider, knowingly owns (disposes of) inside information, the direct or indirect source of which is an insider as referred to hereinabove**.**
Prohibited activities	*Prohibited activities*	*Prohibited activities*	*Prohibited activities*
Prohibited activities: 1. use of inside information for one's own behalf; 2. transmission of inside information except for the normal business purpose of the receiver; 3. recommendation to trade, without giving the information, but with the use, by the advisor, of the inside information.	Prohibited activities: - trading in the securities or making use of unpublished confidential information for personal benefit.	Prohibited activities: 1. to trade on the stock exchange or off the exchange for its own account or for the account of another person in the securities to which the inside information owned by it relates; 2. to disclose the inside information owned by it to another person, which is not an insider, without the permission of the general shareholders' meeting of the issuer, to which such inside information relates; 3. to recommend to another person on the basis of the inside information owned by it, to trade on the stock exchange on its own account or for the account of another person, in the securities to which the inside information owned by it relates. Regarding secondary insiders only the prohibition to trade on the stock exchange or off the exchange in securities to which the owned inside information relates, apply.	Prohibited activities: 1. to acquire or to transfer for its own account or for the account of another person securities, in respect of which disposes of inside information; 2. to disclose the inside information owned by it to another person, which is not an insider, without the permission of the general shareholders' meeting of the company, to which the inside information relates; 3. to recommend to another person on the basis of the inside information owned by it, to acquire or to transfer for its own account or for the account of another person the securities, to which the inside information owned by the insider relates. Regarding secondary insiders, only the prohibition to acquire or to transfer for its own account or for the account of another person the securities, to which the inside information disposed of relates, applies. Each person, which concludes a transaction in securities that are traded on regulated securities markets, is obligated to declare before the investment intermediary whether it disposes of inside information or not.
Scope of protection	*Scope of protection*	*Scope of protection*	*Scope of protection*
Protection against insider trading only as far as securities admitted to trading on a regulated market are concerned.	Not clear, since the nature of the offence of insider dealing should be clarified itself.	Protection against insider trading only on stock exchanges.	Protection against insider trading on any regulated market.

APPENDIX B

Statistical Annex

LIST OF STATISTICAL TABLES

TABLE B1. Indicators of Trade on BSE – Sofia

1998-1999	Official Market					Free Market					Block Trading		
	No. Listed Companies	No. Transactions	No. Shares Traded	Turnover (mil. BGL)	Market Capitalization (mil. BGL)	No. Listed Companies	No. Transactions	No. Shares Traded	Turnover (mil. BGL)	Market Capitalization (mil. BGL)	No. Transactions	No. Shares Traded	Turnover (mil. BGL)
Jan.98	1	92	96 964	2 123,3	19 147,8	195	44	21 394	376,3	665 285,9	115	2 182 044	38712,1
Feb.98	1	57	49 017	1 023,0	18 973,7	294	103	900 516	5 633,2	1 541 946,3	175	3 921 950	13595,4
Mar.98	1	44	100 957	2 095,5	17 494,1	322	130	703 632	10 509,2	1 823 671,3	28	525 343	1430,8
Apr.98	1	31	93 890	1 930,4	17 311,4	384	488	1 264 566	9 071,1	2 507 881,1	32	529 405	1990,8
May.98	1	25	281 740	5 280,3	17 581,2	1040	1 797	1 930 156	20 072,9	3 115 501,3	85	1 412 550	3240,9
Jun.98	4	110	67 884	1 484,1	48 102,9	983	2 618	2 581 635	14 185,3	3 094 227,7	0	0	0,0
Jul.98	6	403	206 283	619,0	102 857,0	983	2 708	2 000 762	20 430,7	2 644 287,4	0	0	0,0
Aug.98	8	401	530 334	2 250,7	121 337,6	983	1 942	1 252 980	7 947,1	1 869 589,9	0	0	0,0
Sep.98	10	465	175 142	537,0	182 417,1	983	1 726	982 674	10 881,3	1 654 719,7	0	0	0,0
Oct.98	11	705	373 230	690,1	304 243,5	982	1 461	804 981	8 199,8	1 223 562,7	0	0	0,0
Nov.98	16	618	530 775	625,3	321 843,8	983	1 194	778 353	7 539,8	1 215 334,0	0	0	0,0
Dec.98	19	430	460 889	1 399,4	243 401,2	979	1 486	1 120 233	17 884,2	1 092 452,6	8	335 566	1836,6
Jan.99	19	656	152 143	513,7	236 122,4	980	956	378 950	335,7	1 411 344,8	9	446 412	4231,4
Feb.99	22	638	213 061	500,4	238 522,3	869	1 032	392 673	6 844,8	1 435 658,4	15	2 575 424	19265,8
Mar.99	25	753	180 772	426,8	268 532,1	844	1 994	515 179	4 155,2	1 451 865,5	27	1 309 519	14651,9
Apr.99	29	689	302 946	6 735,3	267 334,8	844	962	172 088	1 035,1	1 383 886,8	6	432 966	1422,6
May.99	30	574	168 773	382,4	302 369,0	847	889	286 044	1 287,2	1 346 819,3	18	480 652	9399,5

Source: BSE-Sofia

TABLES B2. Indicators of Trade on BSE – Sofia, perentage distribution

TABLE B2.1: Listed Companies (% of total)

1998-1999	Official Market	Free Market	Total
Jan.98	0,51	99,49	100
Feb.98	0,34	99,66	100
Mar.98	0,31	99,69	100
Apr.98	0,26	99,74	100
May.98	0,10	99,90	100
Jun.98	0,41	99,59	100
Jul.98	0,61	99,39	100
Aug.98	0,81	99,19	100
Sep.98	1,01	98,99	100
Oct.98	1,11	98,89	100
Nov.98	1,60	98,40	100
Dec.98	1,90	98,10	100
Jan.99	1,90	98,10	100
Feb.99	2,47	97,53	100
Mar.99	2,88	97,12	100
Apr.99	3,32	96,68	100
May.99	3,42	96,58	100

Source: BSE-Sofia

TABLE B2.2: Number of Transactions (% of total)

1998-1999	Official Market	Free Market	Block Trading	Total
Jan.98	36,65	17,53	45,82	100
Feb.98	17,01	30,75	52,24	100
Mar.98	21,78	64,36	13,86	100
Apr.98	5,63	88,57	5,81	100
May.98	1,31	94,23	4,46	100
Jun.98	4,03	95,97	0	100
Jul.98	12,95	87,05	0	100
Aug.98	17,11	82,89	0	100
Sep.98	21,22	78,78	0	100
Oct.98	32,55	67,45	0	100
Nov.98	34,11	65,89	0	100
Dec.98	22,35	77,23	0,42	100
Jan.99	40,47	58,98	0,56	100
Feb.99	37,86	61,25	0,89	100
Mar.99	27,14	71,88	0,97	100
Apr.99	41,58	58,06	0,36	100
May.99	38,76	60,03	1,22	100

Source: BSE-Sofia

TABLE B2.3: Number of Shares (% of total)

1998–1999	Official Market	Free Market	Block Trading	Total
Jan.98	4,22	0,93	94,85	100
Feb.98	1,01	18,49	80,51	100
Mar.98	7,59	52,91	39,50	100
Apr.98	4,97	66,98	28,04	100
May.98	7,77	53,25	38,97	100
Jun.98	2,56	97,44	0,00	100
Jul.98	9,35	90,65	0,00	100
Aug.98	29,74	70,26	0,00	100
Sep.98	15,13	84,87	0,00	100
Oct.98	31,68	68,32	0,00	100
Nov.98	40,54	59,46	0,00	100
Dec.98	24,05	58,45	17,51	100
Jan.99	15,56	38,77	45,67	100
Feb.99	6,70	12,34	80,96	100
Mar.99	9,01	25,69	65,30	100
Apr.99	33,36	18,95	47,68	100
May.99	18,04	30,58	51,38	100

Source: BSE-Sofia

TABLE B2.4: Turnover (% of total)

1998-1999	Official Market	Free Market	Block Trading	Total
Jan.98	5,15	0,91	93,93	100
Feb.98	5,05	27,82	67,13	100
Mar.98	14,93	74,88	10,19	100
Apr.98	14,86	69,82	15,32	100
May.98	18,47	70,20	11,33	100
Jun.98	9,47	91	0	100
Jul.98	2,94	97	0	100
Aug.98	22,07	78	0	100
Sep.98	4,70	95	0	100
Oct.98	7,76	92	0	100
Nov.98	7,66	92	0	100
Dec.98	6,63	84,68	8,70	100
Jan.99	10,11	6,61	83,28	100
Feb.99	1,88	25,72	72,40	100
Mar.99	2,22	21,60	76,18	100
Apr.99	73,27	11,26	15,48	100
May.99	3,45	11,63	84,92	100

Source: BSE-Sofia

TABLE B2.5: Market Capitalization (% of total)

1998-1999	Official Market	Free Market	Total
Jan.98	2,80	97,20	100
Feb.98	1,22	98,78	100
Mar.98	0,95	99,05	100
Apr.98	0,69	99,31	100
May.98	0,56	99,44	100
Jun.98	1,53	98,47	100
Jul.98	3,74	96,26	100
Aug.98	6,09	93,91	100
Sep.98	9,93	90,07	100
Oct.98	19,91	80,09	100
Nov.98	20,94	79,06	100
Dec.98	18,22	81,78	100
Jan.99	14,33	85,67	100
Feb.99	14,25	85,75	100
Mar.99	15,61	84,39	100
Apr.99	16,19	83,81	100
May.99	18,33	81,67	100

Source: BSE-Sofia

TABLE B3. Companies Included in the Warburg – 30 Index (end of June)

Ranking	Stock Name	Sector	MC US$ mln.	Weight
1	Bulgartabac Holding	Tobacco	134,5	26,13%
2	Neftochim	Chemicals	128,6	24,98%
3	Solvay-Sodi	Chemicals	45,9	8,91%
4	Blagoevgrad BT	Tobacco	35,6	6,91%
5	Sopharma	Pharmaceuticals	26,9	5,22%
6	Petrol	Chemicals	16,7	3,24%
7	Kremikovtsi	Steel	16,4	3,19%
8	Albena	Resorts	15,2	2,96%
9	Pharmacia	Pharmaceuticals	11,4	2,22%
10	Zlatni Piassatsi	Resorts	10,6	2,05%
11	Chimco	Fertilisers	7,8	1,52%
12	Polimeri	Chemicals	7,6	1,48%
13	Biovet	Pharmaceuticals	7,6	1,47%
14	Neochim	Fertilisers	6,6	1,29%
15	Antibiotic	Pharmaceuticals	6,5	1,26%
16	Alen Mak	Pharmaceuticals	6,0	1,17%
17	Troyapharm	Pharmaceuticals	5,8	1,12%
18	Stomana	Steel	3,3	0,65%
19	Tezhko Mashinostroene	Engineering	3,2	0,62%
20	Elkabel	Engineering	3,1	0,60%
21	Slanchev Briag	Resorts	2,5	0,48%
22	Alumina	Metals	2,3	0,45%
23	Agropolychim	Fertilisers	2,1	0,42%
24	OCK	Metals	1,8	0,36%
25	Yambolen	Chemicals	1,7	0,32%
26	Varna Shipyard	Engineering	1,4	0,28%
27	Plovdiv BT	Tobacco	1,3	0,25%
28	Sviloza	Chemicals	0,9	0,17%
29	Agrobiochim	Fertilisers	0,8	0,17%
30	Balkancar Record	Engineering	0,6	0,11%
	TOTAL		**514,9**	**100,0%**

Source: BSE-Sofia

TABLE B4. Characteristics of Companies Traded on the Official Market of the BSE – Sofia

	Company	Date of Listing	Total No. of Shares	Book Value (thous.BGL)	Revenues (thous. BGL)	Net Income (Earnings) (thous.BGL)	Aver. Price per Share (BGL), Jun.99	Price-Earnings Ratio	Price-Revenue Ratio	Price-BV Ratio
Official	Elkabel	01.12.1998	870 355	21 131 234	75 837 153	4 402 504	9 000	1,78	0,10	0,37
Market	Polimeri	14.9.1998	5 772 611	130936129	57 322 511	614 969	4 278	40,16	0,43	0,19
A	Olovno Tsinkov Kompleks	04.5.1998	210 334	43 258 676	98 746 739	72 735	13 200	38,17	0,03	0,06
Official	Antibiotik	17.12.1998	1 906 198	50 806 393	55 311 702	-827 898	6 400	neg*	0,22	0,24
Market	Elma	11.9.1998	835 475	11 328 859	25 206 252	642 132	2 486	3,23	0,08	0,18
B	Troyafarm	17.12.1998	391 045	21 895 029	37 198 533	3 681 577	41 000	4,35	0,43	0,73
	Central Cooperative Bank	01.3.1999	15000000	na	na	na	1 000	na	na	na
	Farmatsia	04.6.1999	663 531	37 874 990	83 557 291	10 081 372	34 650	2,28	0,28	0,61
	Sofarma	05.10.1999	942 717	52 861 628	78 679 201	23 492 742	56 221	2,26	0,67	1,00
Official	Albena Invest Holding	11.9.1998	5 500 000	16 611 833	8 322 281	3 305 770	1 331	2,21	0,88	0,44
Market	BRIB	22.6.1998	1 000 000	na	na	na	17 442	na	na	na
C	Dobrudzha Holding	17.7.1998	2 962 181	696 070	448 804	235 588	230	2,89	1,52	0,98
	Doverie Holding	07.6.1998	6 574 924	20 847 658	25 627 237	9 241 374	1 597	1,14	0,41	0,50
	Himmash	08.10.1998	665 674	3 570 570	3 128 763	-208 444	3 300	neg	0,70	0,62
	"Zlaten Lev" Investment Company	14.12.1998	6 481 959	24 290 746	7 140 482	5 574 766	1 573	1,83	1,43	0,42
	Melinvest Holding	29.6.1998	3 641 000	10 807 944	993 900	656 433	1 911	10,60	7,00	0,64

** neg - negative profits*
Source: BSE-Sofia

	M G Elit Holding	14.9.1998	22 912 977	10 828 669	7 068 520	788 114	120	3,49	0,39	0,25
	Neftochim Invest Holding	11.9.1998	2 289 147	13 476 400	5 739 793	2 347 423	2 180	2,13	0,87	0,37
	Petrol Holding Group	22.6.1998	6 002 756	34 840 345	8 879 117	5 130 802	2 175	2,54	1,47	0,37
	Razvitie Industria Holding	23.11.1998	980 925	1 429 130	748 544	89 742	782	8,55	1,02	0,54
	Kostenets	02.1.1999	236 277	6 191 359	9 987 061	305 245	3 144	2,43	0,07	0,12
	"Nadezhda" Investment Company	02.1.1999	551 836	1 976 069	1 889 213	1 432 371	1 200	0,46	0,35	0,34
	Elektroimpex	03.2.1999	3 500	25 435 973	30 255 761	1 245 059	2 810 143	7,90	0,33	0,39
	Stara Planina Holding	03.4.1999	1 750 000	9 334 559	4 340 526	831 185	1 850	3,90	0,75	0,35
	Severokoop Gamza Holding	03.1.1999	2 673 899	11 480 049	4 677 448	2 793 762	2 059	1,97	1,18	0,48
	Bimas	15.2.1999	187 385	2 203 493	8 935 423	-1 161 730	8 000	neg	0,17	0,68
	AKB Corporation Holding	11.9.1998	2 843 483	4 008 368	9 151 268	1 275 613	1 000	2,23	0,31	0,71
	Aktsioner Favorit	04.6.1999	2 211 000	15 591 038	3 511 454	2 891 180	1 600	1,22	1,01	0,23
	Varnenska Korabostroitelnitsa	30.11.1998	2 302 553	13 322 434	196221357	3 351 058	1 367	0,94	0,02	0,24
	Industrial Holding "Bulgaria"	17.8.1998	17 500 000	21 106 377	5 110 300	614 575	1 205	34,31	4,13	1,00

** neg - negative profits*

Source: BSE-Sofia

TABLE B5. Characteristics of Most Traded Companies on the Free Market of the BSE – Sofia

	Company	Date of Listing	Total No. of Shares	Book Value (thous. BGL)	Revenues (thous. BGL)	Net Income (Earnings) (thous.BGL)	Aver. Price per Share (BGL), Jun.99	Price-Earnings Ratio	Price-Revenue Ratio	Price-BV Ratio
Free	Solvei Sodi	15.12.1997	5 236 089	160 167 960	171530423	2 865 008	14 228	26,00	0,43	0,47
Market	Himko	02.4.1998	13628275	18 058 894	79 129 150	-46157769	1 195	neg*	0,21	0,90
	Neftochim	15.12.1997	13545743	21 108 232	1623400519	89 306 485	17 005	2,58	0,14	10,91
	Albena	20.5.1998	4 273 126	66 330 561	55 407 323	7 535 652	6 078	3,45	0,47	0,39
	Bulgartabak Holding	19.5.1998	7 367 222	25 962 065	27 125 934	3 440 842	33 270	71,23	9,04	9,44
	Blagoevgrad BT	na	1351313	81 317 319	212273445	25 558 034	41 674	2,20	0,27	0,69
	Sofia BT	na	608 435	24 432 914	62 567 473	5 391 213	17 833	2,01	0,17	0,44

Source: BSE-Sofia

TABLE B6.1: Market Capitalization (mil. BGL)

Month	Market Segment				Total
	A	B	C	Free	
Jan.98	19 147,8	0,0	0,0	665 285,9	684 433,8
Feb.98	18 016,9	0,0	0,0	1 541 946,3	1 559 963,3
Mar.98	17 505,2	0,0	0,0	1 823 671,3	1 841 176,4
Apr.98	17 311,4	0,0	0,0	2 507 881,1	2 525 192,4
May.98	14 905,9	0,0	10 484,4	3 115 501,3	3 140 891,5
Jun.98	19 111,1	0,0	36 393,9	3 094 227,7	3 149 732,6
Jul.98	20 018,2	0,0	88 967,7	2 644 287,4	2 753 273,2
Aug.98	18 573,4	0,0	103 879,3	1 869 589,9	1 992 042,6
Sep.98	66 242,3	0,0	119 930,3	1 654 719,7	1 840 892,3
Oct.98	196 529,9	0,0	107 666,4	1 223 562,7	1 527 758,9
Nov.98	153 492,2	6 725,4	114 413,3	1 215 334,0	1 489 964,8
Dec.98	50 030,5	12 962,9	169 360,9	1 092 452,6	1 324 806,8
Jan.99	51 198,9	34 773,4	150 240,1	1 411 344,8	1 647 557,2
Feb.99	46 354,1	30 644,9	161 523,3	1 435 658,4	1 674 180,7
Mar.99	48 340,2	57 653,2	162 538,8	1 451 865,5	1 720 397,6
Apr.99	44 120,7	67 940,5	155 237,6	1 383 886,8	1 651 185,5
May.99	36 223,5	122 202,5	143 943,0	1 346 819,3	1 649 188,2

Source: BSE-Sofia

TABLE B6.2: Market Capitalization, distribution

Month	Market Segment				Total
	A	B	C	Free	
Jan.98	2,80 %	0,00 %	0,00 %	97,20 %	100,00 %
Feb.98	1,15 %	0,00 %	0,00 %	98,85 %	100,00 %
Mar.98	0,95 %	0,00 %	0,00 %	99,05 %	100,00 %
Apr.98	0,69 %	0,00 %	0,00 %	99,31 %	100,00 %
May.98	0,47 %	0,00 %	0,33 %	99,19 %	100,00 %
Jun.98	0,61 %	0,00 %	1,16 %	98,24 %	100,00 %
Jul.98	0,73 %	0,00 %	3,23 %	96,04 %	100,00 %
Aug.98	0,93 %	0,00 %	5,21 %	93,85 %	100,00 %
Sep.98	3,60 %	0,00 %	6,51 %	89,89 %	100,00 %
Oct.98	12,86 %	0,00 %	7,05 %	80,09 %	100,00 %
Nov.98	10,30 %	0,45 %	7,68 %	81,57 %	100,00 %
Dec.98	3,78 %	0,98 %	12,78 %	82,46 %	100,00 %
Jan.99	3,11 %	2,11 %	9,12 %	85,66 %	100,00 %
Feb.99	2,77 %	1,83 %	9,65 %	85,75 %	100,00 %
Mar.99	2,81 %	3,35 %	9,45 %	84,39 %	100,00 %
Apr.99	2,67 %	4,11 %	9,40 %	83,81 %	100,00 %
May.99	2,20 %	7,41 %	8,73 %	81,67 %	100,00 %

Source: BSE-Sofia

TABLE B7. Companies Privatised by the State through the Bulgarian Stock Exchange 1998 – Jun. 1999

Company	Percentage of Capital Offered	No. of Shares Offered through BSE - Sofia	Average Price per Share (BGL)	Total Value (BGL)
Majority Interest				
Elkabel	60	522 214	19 584	10 227 038 976
Himmash	67,5	449 343	3 034	1 363 306 662
Elektroimpex	64	2 236	2 810 143	6 283 479 748
Minority Interest				
Kramex - Sofia	26.4	62 705	3 200	200 656 000
Terma - Tutrakan	26.4	23 474	2 500	58 685 000
Panayot Volov - Shoumen	26.4	43 117	2 000	86 234 000
Vereya - Stara Zagora	8	1 241	2 200	2 730 200
Niva - Kostinbrod	24	52 613	4 010	210 978 130
Dobrudzhanska Mebel - Dobrich	24.4	25 095	2 500	62 737 500
Bimas - Rouse	16.4	30 732	14 320	440 082 240
Orfei - Batak	11	2 915	4 100	11 951 500
ZMM - Sliven	29,76	84 092	2 400	201 820 800
Katrik 61 - Kavarna	6	942	8 611	8 111 562
ZMM Metalik - Pazardzhik	23	23 000	12 100	278 300 000
Mayak - Dobrich	26	44 100	2 880	127 008 000
Mikrodvigateli - Etropole	22	7 555	4 500	33 997 500
ZIIU Standard - Blagoevgrad	21.4	4 000	4 300	17 200 000
Mlechna Promishlenost - Vratsa	19	10 891	2 500	27 227 500
Tekstilni Vlakna - Gorna Oryahovitsa	26.4	2 392	20 000	47 840 000
Frigo Plod - Vresovo	19	16 459	8 470	139 407 730
Primorets Tourist - Bourgas	26.12	14 687	11 840	173 894 080
Triko - Omortag	26,3	12 356	7 340	90 693 040
Bertex - Berkovitsa	26,4	5 198	4 347	22 595 706
Agrokomb - Doulovo	33.16	30 460	1 300	39 598 000
Ardino - Ardino	25,5	10 389	1 470	15 271 830
Ralin Tex - Dolni Rakovets	26	13 655	1 280	17 478 400
Elektrometal - Pazardzhik	25	8 077	1 150	9 288 550
Lesko - Sliven	8	3 024	2 000	6 048 000
Venets - Oreshets	25,1	9 048	3 000	27 144 000
Amatitsa		1 088	3 500	3 808 000
Total		**1 517 098**		**20234612654**

Source: BSE-Sofia