

Strategy for Development of the Bulgarian Capital Market

In the recent years, mainly due to the effect of the global crisis, we witness a decrease of investments in Bulgaria, in both the private and the public sectors.

Despite their very high liquidity, banks refrain from lending due to the high risk resulting from the low level of capital and assets of the Bulgarian companies.

Theoretically, there are three possibilities for funding:

- own reserves and capital accumulation of the companies,
- attracting of investors (foreign and domestic) and
- European Union (EU) programmes.

In the last 10 years, mainly the EU programmes have been relied on for investments both in the public and the private sectors.

At the same time, enormous investment resources are available globally, which regretfully bypass Bulgaria, in spite of the favourable taxation conditions. For the recent two years or so, very strong interest has been observed in investing in emerging and developing markets, with Central and Eastern Europe among the main destinations, but not in Bulgaria.

Large (long-term) investment resources are available in Bulgaria, accumulated by pension funds – more than BGN 10 billion; by insurance companies and mutual funds. Unfortunately, due to the low liquidity and regulatory restrictions, a considerable portion of these resources are invested outside Bulgaria.

The reasons for the weak capital market from the beginning of the transition lie in the absence of a government policy for development of the capital market and of the stock exchange as means of attracting investments.

It is important for the future of the country's economy that the development of the capital market and attraction of investments through the stock exchange becomes a leading priority for Bulgaria.

According to World Bank data of 2013, each 10 percent increase of the market capitalization compared to GDP results in growth of approximately USD 2,500 GDP per capita. At present, the capitalization of the Bulgarian Stock Exchange – Sofia AD (BSE) is less than 12% of GDP, while in the developed European countries it is 60 - 100% of GDP, and in the USA and U.K. – 120% of GDP.

The analysis has identified the following main problems of the Bulgarian capital market:

1. Insufficient liquidity;
2. Lack of sufficiently suitable instruments and companies for investment;
3. Lack of instruments with a sufficiently large volume for attracting large institutional investors;
4. Exit of foreign investors after 2008;
5. Insufficient financial literacy.

To address the above-mentioned issues it is necessary to take actions in the following main directions:

1. Increase the variety of financial instruments (FI) that are traded on BSE in terms of:
 - a. Quality – enhance the quality of the existing instruments by helping companies enhance their

- corporate governance, information disclosure, etc. Improve the regulatory framework governing debt instruments;
- b. Variety – diversify the FI currently offered by launching markets for trading in government securities, structured instruments (certificates), creating a derivatives market, etc.;
 - c. Volume – encourage issuers and majority shareholders to increase the volume of free float, capitalize large state-owned companies through the capital market, etc.;
 - d. Keep the existing and create new incentives in the regulatory framework for companies to go public;
2. Attract foreign and domestic investors by:
- a. Improving and harmonizing the regulatory framework with the EU legal framework;
 - b. Providing new services, and ensuring that core services are provided in compliance with the international best practices;
 - c. Modernizing and continuous development of the market infrastructure, including the trading platform, the clearing and settlement system, the registration system, the corporate action processing system and other changes in the market infrastructure that aim at high efficiency and transparency;
 - d. Active advertising of the capital market outside the country by the government, InvestBulgaria Agency, trade representative offices abroad, etc.;
 - e. Active advertising by organising roadshows for presentation of the capital market and the Bulgarian companies, etc.
 - f. Reducing the administrative burden, shortening some administrative timeframes, e.g. for registration of a subscribed issue of FI after a public offering, etc.
3. Educate Bulgarian investors and enhance financial literacy by:
- a. Introducing additional specialised courses in the educational institutions;
 - b. Organizing seminars and financial forums;
 - c. Training courses by mass media;
 - d. Encourage the organisation of specialised courses and introduce minimum quotas for lecturers with business background in the universities;
 - e. Encourage publishing of stock exchange information in the mass media, etc.

Specific measures for development of the market:

1. Amendments to laws regulating financial markets to remove regulatory and administrative burdens.

Some of these amendments include:

- a. Amendments to ease the administrative procedures related to corporate actions, inheritance, etc.;
- b. Amendments to the regulatory framework related to the regime of changing bond issue parameters;
- c. Amendment to the Law on Public Offering of Securities (LPOS) in relation to regulation of rights to participate in general meetings of shareholders and shareholder registers.
- d. Amendment to the LPOS in relation to Regulation (EU) No. 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012;
- e. Shortening the terms for registration of securities resultant from capital increases once the subscription has been completed;
- f. Establishing procedures for delisting of companies which have no interest in staying public or do not

- conform with the good corporate practices of public companies;
- g. Law on Clearing and Settlement of Financial Instruments;
- h. Other amendments.

The implementation of these amendments in the legislation will result in:

- establishing of a sound regulatory framework for development of the capital market;
- optimising and reducing the administrative burden for public companies and other market participants;
- resolving existing regulatory inconsistencies.

Implementation deadline: September 2017.

2. Facilitate financing of public offerings of financial instruments through operational programmes and EU funding.

The project involves creating opportunities for IPO and SPO to be funded from EU funds through Operational Programme 'Innovations and Competitiveness' 2014-2020.

Deadline for applying (launching the programme): November 2016.

Deadline for implementation of IPO/SPO: 18 months after approval of the project.

3. Development of a single entry point for disclosure and distribution of information by market participants ('single entry point').

The concept of the project is to establish a single portal for provision of integrated services to capital market institutions.

Project term: 12 months after provision of funding.

4. Incentives to small and medium size businesses to raise capital through the capital market. Increase 'soft' thresholds for prospectuses. Encourage the establishment of specialised platforms (segments) for trade in startups, innovative, small and medium companies without prospectuses.

The project is related to creating preferential conditions for small and medium businesses to access financing through the capital markets.

Implementation deadline: 15 months (by December 2017).

5. Establish opportunities for Bulgarian investors and issuers to access, via the BSE, foreign markets, including listing on such foreign markets.

The project is related to ensuring direct access of resident BSE members to a number of highly liquid instruments in Europe and the rest of the world.

Implementation deadline: 8 months.

6. Re-activate dormant accounts holding shares acquired from the mass privatization

6.1. Information campaign for re-activation of dormant, inactive accounts holding shares acquired as a result of the mass privatisation.

The project 'Information campaign for re-activation of dormant accounts holding shares acquired as a result of the mass privatisation' aims to inform holders of such instruments of the available opportunities for disposal.

Implementation deadline: 12 months after amendments to LPOS

6.2. Measures for re-activation of dormant, inactive accounts holding shares acquired as a result of the mass privatisation.

Measures to relieve the procedures for disposal of assets acquired from the mass privatisation (sale, inheritance, etc.) in a manner that is economically effective for their owners.

Implementation deadline: 12 months after amendments to LPOS

7. Launch of a secondary market of government securities on the BSE.

Implementation deadline: June 2017.

8. Organise and conduct an awareness campaign at various levels to explain the mechanisms of operation of the financial market.

The project is related to organising an awareness campaign to increase the financial literacy regarding the Bulgarian capital market, its operation, essence, services and access to them in the Bulgarian capital market. This also includes access to the capital market, services of investment intermediaries, pension system – opportunities and manner of access, insurance services – manner of access.

Implementation deadline: a period of 12 months after provision of funding.

Provision of funding: within 6 months

9. Organising of and access to services for clearing of mutual obligations at a central counterparty (CCP).

The project is related to exploring the possibilities for providing access to CCP clearing service under a contract for provision of such service by an existing EU clearing institution.

Implementation deadline: 12 months.

10. Development of an infrastructure for trading in financial derivatives.

Implementation deadline: for a period of 12 months after provision of funding

11. Establishment of a single system for lending of financial instruments (lending pool).

The project is related to the establishment of a single system for lending of financial instruments, which will facilitate the settlement of short positions and will guarantee settlement when financial instruments are lacking.

Implementation deadline: 2017.

12. Capitalisation of large state-owned companies via BSE.

The proposal is to capitalise large state-owned companies through sale of existing shares or capital increase capital by issuance of new shares on the stock exchange, whereas the State retains its strategic control over each of the companies.

Implementation deadline: gradual implementation by 2018.

Start of the project: the second half of 2017.

13. Exploring, organising and facilitating of the possibility for funding of infrastructure projects through the capital market.

Implementation deadline: 2019.

14. Exploring the possibility and developing a roadmap for accession to the European securities settlement engine, TARGET2-Securities.

This is a project related to the development of a single European system for clearing and settlement of transactions in financial instruments.

Implementation deadline: 2017.

The positive effects of all proposed measures can be as follows:

- The liquidity and debt issues of state-owned companies will be resolved – by their capitalisation on the stock exchange;
- Transparency of management will be enhanced, and hence also the efficiency of the listed state-owned companies will improve – a trend proven for all known cases;
- Economic growth will accelerate in the medium term. Attracting of investments inevitably leads to higher GDP and an improved economic situation;
- Additional revenue will be provided for the State budget: one-off significant amount from the sale of minority shares in state-owned companies, and in the long term – from dividends from state-owned companies and from taxes as a result of their better corporate governance;
- Large long-term resources will be attracted from foreign investors;
- Important infrastructure projects, for which the funds from EU programmes will be otherwise insufficient or unavailable, will be financed by issues of shares and long-term bonds;
- Long-term resources accumulated in the pension system will be utilised – pension funds are long-term investors and would invest in long-term debt, and also in shares if liquidity is improved;
- The capital market liquidity will increase, which is presently the main barrier to investors – this will additionally speed up the inflow of investment in publicly-owned companies;
- The availability of fresh capital will facilitate significantly bank lending – as per the established practice for each lev attracted as capital, the banks extend additional funding up to 2-3 times of the attracted capital;
- A new practice will be established for attracting domestic and foreign private resources to fund state projects in the territory of Bulgaria;
- The country's image as an investment destination will be improved, which will contribute to enhancing the credit rating up to investment levels, and this, on its part, will reduce the cost of government debt;
- And last but not least, Bulgaria will again position itself on the 'investment map', which will also open the door to private investors. In the medium term perspective, the inflow of investments via the capital market can become commensurate to the money obtained from EU funds.

The Strategy for Development of the Bulgarian Capital Market was adopted at the meeting of the Capital Market Development Council held on 17 November 2016.

Members of the Capital Market Development Council:

Association of Banks in Bulgaria (ABB) represented by Petar Andronov, Chairman;

Association of Bulgarian Insurers (ABI) represented by Svetla Nestorova, Chairperson;

Association of Bulgarian Investor Relations Directors (ABIRD) represented by Daniela Peeva, Chairperson;

Special Investment Purpose Companies Association (SIPCA) represented by Manyu Moravenov, Chairman;

Bulgarian Industrial Capital Association (BICA) represented by Vassil Velez, Chairman;

Bulgarian Association of Supplementary Pension Security Companies (BASPSC), represented by Nikola Abadjiev, Chairman;

Bulgarian Association of Licensed Investment Intermediaries (BALII), represented by Lyubomir Boyadjiev, Chairman;

Bulgarian Association of Asset Management Companies (BAAMC) represented by Petko Krastev, Chairman;

Bulgarian Industrial Chamber (BIC) represented by Bozhidar Danev, Executive Chairman;

Bulgarian Stock Exchange - Sofia AD (BSE) represented by Ivan Takev, Executive Chairman;

Confederation of Employer and Industrialists in Bulgaria (KRIB) represented by Kiril Domuschiev, Chairman;

Financial Supervision Commission (FSC) represented by Karina Karaivanova - Ganozova, Chairperson;

National Corporate Governance Committee (NCGC) represented by Ivan Takev, Chairman;

Central Depository AD (CDAD) represented by Vassil Golemansky, Executive Director;

and its associated members

American Chamber of Commerce in Bulgaria represented by Dr. Krassimira Chemishanska, MD, MBA, President;