



**Valdis DOMBROVSKIS**  
Executive Vice-President

**Paolo GENTILONI**  
Commissioner for the Economy

**Mr Mário Centeno**  
President of the Eurogroup

Brussels, 8 July 2020

Ares(2020)s4125443

Dear President,

The Republic of Bulgaria expressed its firm intention to enter the Exchange Rate Mechanism II (ERM II) in a letter of intent dated 29 June 2018. In this letter, the Bulgarian authorities committed to implement measures in six policy areas that are of high relevance for a smooth transition to, and participation in, the ERM II.

In their statement of 12 July 2018, ERM II parties welcomed Bulgaria's intention to simultaneously join the ERM II and the Banking Union, and asked the European Central Bank (ECB) and the Commission to monitor the effective implementation of the prior commitments acting within their respective areas of competence as provided for by the Treaties and secondary legislation.

On 19 June 2020, the Bulgarian authorities informed ERM II parties of the full implementation of the prior commitments, which do not relate to establishing close cooperation with the ECB, and asked ERM II parties to invite the Commission and the ECB to assess their effective implementation.

On 22 June 2020, the President of the Eurogroup Working Group invited, on behalf of the ERM II parties, the Commission and the ECB to assess the implementation of the five prior commitments, in accordance with the division of competence between both institutions provided for in the statement of 12 July 2018.

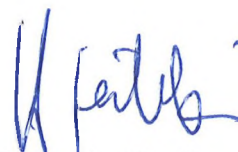
Regular technical exchanges with the Bulgarian authorities have allowed our services to monitor continuously the progress made as regards the four prior commitments falling within the Commission's area of competence. These relate to the following policy areas: i) the supervision of the non-banking financial sector, ii) the insolvency framework, iii) the anti-money laundering framework, and iv) the governance of state-owned enterprises.

We hereby confirm that, in view of the detailed evidence provided by the Bulgarian authorities, the Commission's assessment is that these four prior commitments have been fulfilled. We welcome the efforts that Bulgarian authorities have put into fulfilling their commitments to better prepare Bulgaria's economy for a smooth participation in ERM II. An accompanying technical report provides the details of the Commission services' assessment of the implementation of the prior commitments.

Yours sincerely,



Valdis Dombrovskis



Paolo Gentiloni

*Cc: Finance Ministers of the euro area Member States, President of the European Central Bank, Finance Minister and Central Bank Governor of Denmark, President of the Economic and Financial Committee and Eurogroup Working Group, Members of the Eurogroup Working Group, Members of the Economic and Financial Committee of Denmark*

## Commission Staff Working Document

### Technical assessment of the implementation of the prior-commitments 3 to 6 taken by the Republic of Bulgaria in view of its participation in ERM II

In July 2018, Bulgaria announced its intention to put in place the necessary elements for a successful entry into ERM II. For that purpose, it committed to implement before joining ERM II policy measures in the following six areas: i) banking supervision (close cooperation with the European Central Bank (ECB)), ii) the macro-prudential framework, iii) non-banking financial sector supervision, iv) the insolvency framework, v) the anti-money laundering framework, and vi) the governance of state-owned enterprises.

The ERM II parties have asked the ECB and the Commission to monitor the implementation of the Bulgaria's commitments in their respective areas of competence, i.e. banking supervision and the macro-prudential framework for the ECB and the other four commitments for the Commission.

Regular technical exchanges with the Bulgarian authorities have allowed Commission services and the ECB to monitor continuously the progress made with the implementation of the measures and to inform regularly ERM II parties on the state of play.

On 19 June 2020, the Bulgarian authorities notified ERM II parties of the fulfilment of their prior commitments and invited them to ask the ECB and the Commission to prepare their assessment. On 22 June 2020 the President of the EWG asked the two institutions to prepare the assessment of the effective implementation of Bulgaria's prior-commitments in their respective areas of competence.

This report presents the assessment of the Commission services on the fulfilment of the prior commitments 3 to 6 against the provisions of the common understanding of the commitments taken by Bulgaria, accompanying the ERM II parties' statement of Bulgaria of 12 July 2018<sup>1</sup>. The first section of the assessment describes the "overall objective and rationale" of each prior-commitment based on the common understanding. The "implementation" section details the actions taken by the Bulgarian authorities in relation with each prior-commitment. The assessment of the Commission at staff-level is presented in the third section for each prior-commitment.

### Prior commitment 3: Non-banking financial sector

*Enhance the supervision of the non-banking financial sector by i) implementing and reporting on the action plan for supervision of the non-banking financial sector (pension funds and insurance companies) adopted by the regulator in September 2017; ii) preparing and adopting guidelines for the*

---

<sup>1</sup> Letter of the President of the members of the Eurogroup and representatives from Denmark and Bulgaria, 24 July 2018: <https://www.consilium.europa.eu/media/36257/summing-up-letter-ad-hoc-meeting-erm-ii-12-july-2018.pdf>

*valuation of assets and liabilities in the non-banking financial sector; and iii) designing and implementing a risk based supervisory system under Solvency II.*

## **1. Overall objective and rationale**

A reinforcement of the non-bank supervision is needed side by side with that of banking supervision. The whole financial sector needs to be subject to the highest regulatory and supervisory quality to ensure adequate allocation of capital inflows, which are likely to markedly increase upon entry into ERM II.

*(i) Implement and report on the action plan for supervision of the non-banking financial sector (pension funds and insurance companies) adopted by the regulator in September 2017*

The authorities committed to continue the efforts towards a sustainable correction of financial sector imbalances. In the non-banking sector, those efforts included completing follow-up measures resulting from the independent asset quality reviews and stress tests concluded in February 2017 and implementing the supervisor's action plan in order to improve its functioning and continue to improve the health and soundness of the non-banking financial sector.

*(ii) Prepare and adopt guidelines for the valuation of assets and liabilities in the non-banking financial sector*

Within the non-bank financial sector, improved practices for the valuation of assets and liabilities were needed, especially in the case of illiquid assets and liabilities. Inappropriate valuations have in the past exaggerated the solvency position of insurance firms and pensions funds, as concluded in the 2017 Balance Sheet Review. Guidelines from the FSC would be very beneficial in this respect.

*(iii) Design and implement a risk based supervisory system under Solvency II*

The Solvency II directive is in application since 2016. Measures, which had to be taken on the basis of the Solvency II Directive and to be fully implemented for the purpose of this process included supervisory action, such as challenging some valuations (e.g. on property investments), as well as the amendment of secondary legislation, in particular concerning models for quantitative measurement of different types of risk and the risk premium calculation where the discount cash flow is used.

## **2. Deliverables and Implementation by the authorities**

On Part i), in line with the action plan adopted in September 2017, changes in primary and secondary legislation to increase the independence of the Financial Supervision Commission (FSC), and to enhance its decision-making process and effectiveness have been introduced as of 1 January 2018. Additional actions to ensure an adequate level of human resources through new hires and training took place throughout 2019. Furthermore, FSC took supervisory measures, including on-site inspections, to follow up on the independent asset insurance balance sheet review and pension funds' asset review concluded in February 2017 that had found weaknesses in valuation, governance and prudent management.

In relation to part ii), the FSC adopted important amendments to two regulations in the field of insurance and pension insurance. Amendments to Ordinance No 9 of 19 November 2003, laying

down detailed rules for valuation of the assets and liabilities of the supplementary pension insurance funds and the pension insurance companies, came into force as of 19 November 2018. An ordinance amending and supplementing Ordinance No 53 of 23 December 2016 on the requirements for accountability, valuation of assets and liabilities and formation of technical reserves of insurers, reinsurers and the Guarantee Fund was promulgated in the State Gazette on 4 January 2019.

Concerning part iii), Risk Assessment Frameworks (RAFs) in the insurance and pension insurance sectors, designed by the FSC, were introduced on 1 January 2019. The adopted supervision manuals allow for proper application of risk based supervision and support supervisory capacity. Review of the RAFs and possible improvements to the new system through updates in the supervisory plan are expected as experience and new data are gathered.

Further supervisory actions by the FSC, in compliance with the updated FSC supervisory plan, are envisaged in agreement with EIOPA to tackle outstanding challenges in the sector. These supervisory actions are aiming to address remaining weaknesses in some areas, such as the adequacy of technical provisions, application of the prudent person principle, including appropriateness of the valuation for all assets and liabilities, and the effectiveness of governance practices.

### **3. Commission services' assessment**

The Commission services' assessment is that the prior commitment 3 has been fulfilled. The Commission assessment takes into account the opinion of EIOPA on the completion of steps undertaken to fulfil the commitment in the non-banking financial sector. The positive assessment by the Commission is based on the progress with implementing the FSC action plan adopted in September 2017, the improved valuation guidelines and the introduction of risk-based supervision. It also takes into account the planned additional supervisory actions resulting from the supervisory action plan agreed between EIOPA and FSC.

## **Prior commitment 4: Insolvency framework**

*Identify, in cooperation with the SRSS, the existing gaps in the insolvency framework and prepare a Roadmap listing the steps that need to be taken to address those, with a focus on i) introducing a system of reliable data collection on insolvency and restructuring proceedings, and (ii) introducing measures to reinforce the judicial infrastructure.*

### **1. Overall objective and rationale**

The economic role of insolvency frameworks is particularly relevant in situations of high outstanding debt. In such conditions, debt overhang reduces the incentives to invest, while high NPL stocks impair the supply and allocation of credit. Efficient insolvency frameworks align incentives in such a way that viable debt is repaid, while unviable debt is resolved. By enabling a faster and less costly resolution of debt distress, efficient frameworks can have a positive effect on bank balance sheets. Increasing the effectiveness of the current insolvency framework in Bulgaria would help to reduce non-financial corporate indebtedness and non-performing loans (NPLs). It would also help to reduce the length of the insolvency proceedings and to increase the recovery rates.

Bulgaria committed to identify the existing gaps in the insolvency framework, in cooperation with the European Commission's DG REFORM.<sup>2</sup> Particular focus was to be placed on the following areas:

*(i) introduce a system of reliable data collection on insolvency and restructuring proceedings*

Bulgaria should work on introducing a reliable system of data collection on restructuring and insolvency that would operate in an electronic way and contain, inter alia, annual data on the number of different types of insolvency and restructuring proceedings started and terminated in the given year, costs of proceedings, and recovery rates.

*(ii) introduce measures to reinforce the judicial infrastructure*

To reduce the length of insolvency proceedings and improve the low recovery rates, Bulgaria should look into strengthening the judicial infrastructure, namely by a) organising trainings leading to enhanced proficiency of judges in the insolvency area, and b) introducing more electronic means into the operation of insolvency procedures.

## **2. Deliverables and Implementation by the authorities**

In 2018, Bulgaria requested technical support under the Structural Reform Support Programme (SRSP) to advance the insolvency framework reform. The main elements of that project were the following:

- Review of legislation and identification of shortcomings within the current insolvency and restructuring framework and preparation of specific recommendations for addressing the detected gaps
- Development of a roadmap with detailed action steps for the implementation of the specific recommendations on the current insolvency and restructuring framework
- Review of the current data collection process for insolvency and restructuring proceedings in view of making such data publicly available
- Provision of recommendations for the set-up of a reliable and efficient data collection and publication process; and design of a new process for collecting data on insolvency and restructuring proceedings
- Development of training for trainers and delivery of pilot trainings for insolvency practitioners

The roadmap listing the steps that need to be taken to address the identified gaps in the system was adopted by the government on 19 June 2019 and is published on the web site of the Bulgarian Ministry of Finance<sup>3</sup>. The main milestones for the implementation of the roadmap are the following (all taking into consideration the timely transposition of Directive 2019/1023 on Restructuring and Discharge of Debt):

- Amendments of all the primary and secondary legislation by Q4 2021
- Organisational changes in order to improve the supervision of insolvency practitioners by Q4 2021
- Launch of the Training Program for judges and for insolvency practitioners by Q4 2021

---

<sup>2</sup> On 1 January 2020, SRSS became the Directorate-General for Structural Reform Support (DG REFORM).

<sup>3</sup> <https://www.minfin.bg/en/1291>

- Development of Procedural Manuals and standardised templates to be used by parties in insolvency by Q2 2022
- Introduction of Specialised Electronic Tools within insolvency and restructuring and of Statistical Data Collection and Publicity system in the course of 2022, depending on the implementation of the broader judicial digitalisation reform

The SRSP project was successfully completed. The authorities are preparing follow up steps, including legislative changes that are crucial to the success of the reform. A dedicated steering body (the 'Coordinating Council') was established, which will be in charge of the overall management and coordination of the roadmap's implementation. The roadmap will also facilitate the transposition of Directive 2019/1023 on Restructuring and Discharge of Debt, for which the transposition period of 2 years started to run on 16 July 2019.

A new technical assistance project to be provided via the SRSP is starting in July 2020. This concerns several aspects connected to the successful transposition of Directive 2019/1023 on Restructuring and Discharge of Debt.

### **3. Commission services' assessment**

The Commission services' assessment is that the prior commitment 4 has been fulfilled. The authorities identified the existing gaps in the insolvency framework and prepared a Roadmap to address them. Moreover, the authorities are taking active steps to implement the Roadmap, such as setting up of the above-mentioned Coordinating Council.

## **Prior commitment 5: Anti-money laundering framework**

*Strengthen the anti-money laundering framework by addressing any issue potentially identified by the Commission in its assessment of the transposition into national legislation of the fourth anti-money laundering directive (AML4-Directive) and adopting a draft law transposing the fifth anti-money laundering directive (AML5-Directive) at the government level.*

### **1. Overall objective and rationale**

An effective anti-money laundering framework is key to mitigate potential financial abuses but also to reinforce the effectiveness of measures aimed at ensuring financial stability (e.g. macro-prudential measures). As a complement to such measures it therefore has an important role to play in supporting financial sector stability and the overall resilience of the economy.

The fourth anti-money laundering directive (AML4-Directive) strengthens the existing AML rules with the aim of making the fight against money laundering and terrorism financing more effective and of improving transparency. Bulgaria communicated the measures adopted to transpose the directive in April 2018. Bulgaria was expected to address speedily any issue potentially identified by the Commission in its assessment and amend its national law(s) as appropriate.

The fifth anti-money laundering directive (AML5-Directive) substantially amends the fourth anti-money laundering directive to better equip the EU to prevent the financial system from being used for money laundering and for funding terrorist activities. The AML5-Directive: (i) enhances

transparency on the real owners of companies, trusts and other legal arrangements; (ii) enhances the powers of EU Financial Intelligence Units, and provides them with access to broad information for the carrying out of their tasks; (iii) limits the anonymity related to virtual currencies and wallet providers, but also for pre-paid cards; (iv) broadens the criteria for the assessment of high-risk third countries and improve the safeguards for financial transactions to and from such countries; (v) sets up central bank account registries or retrieval systems in all Member States; (vi) improves the cooperation and enhances the information flows between anti-money laundering supervisors, between them and prudential supervisors and the European Central Bank.

The fifth anti-money laundering directive (AML5-Directive) was published in the Official Journal of the European Union on 19 June 2018. Member States had 18 months to transpose these new rules into their national order; the exact transposition deadline was on 10 January 2020.

## **2. Deliverables and Implementation by the authorities**

The deadline for the transposition of Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (AMLD4) was 26 June 2017. Due to delays in the transposition of the AMLD4 the Commission opened an infringement procedure for Bulgaria on 8 December 2017. Bulgaria notified transposition measures of AMLD4 in April and December 2018, which according to the Commission's assessment were not yet complete.

The adoption of the necessary amendments for the transposition of the AMLD4 was completed with the adoption of the Law on Amendments to the Law on Measures against Money Laundering of 28 May 2019, which Bulgaria notified to the Commission on 29 May 2019 and the Law on Measures against Money Laundering of the 29 November 2019, notified the 19 December 2019. Based on the notified laws, the Commission concluded that the current national legal framework ensures a complete and conform transposition of the AMLD4. The Commission services have therefore proposed closure of the infringements procedure for completeness and do not intend to open a new one for conformity.

On 3 July 2019, the government adopted the draft law transposing the AMLD5 (Directive EU/2018/843), in line with the requirements of the commitment. The transposing legislative acts (Law on Measures against the Financing of Terrorism and Law on measures against money laundering) were subsequently adopted by the Parliament on 29 November 2019, respecting the transposition deadline. The authorities officially notified the legal documents to the European Commission on 17 December 2019. The Commission has performed the assessment of the completeness of the transposition of AMLD5. Some pending issues are being followed up through technical dialogue with the Bulgarian authorities.

## **3. Commission services' assessment**

The Commission services' assessment is that the prior commitment 5 has been fulfilled. Without prejudice to the Commission's powers under Article 258 TFEU, all issues identified by the Commission in its assessment of the transposition into national legislation of the AMLD4 have been addressed. A draft law transposing the AMLD5 has been adopted by the government. In addition to the fulfilment of the prior commitment, the transposing legislative acts were adopted by parliament on 29 November 2019, respecting the transposition deadlines.



## **Prior commitment 6: State-owned enterprises**

*Improve, with the assistance of the SRSS, the governance of state-owned enterprises (SOEs) by revising and aligning legislation with the OECD Guidelines on Corporate Governance of SOEs.*

### **1. Overall objective and rationale**

The economic performance of SOEs is relatively weak compared with countries in the region and the private sector. In most sectors of the economy, SOEs are less profitable and less efficient in their use of capital and labour than both private companies and SOEs in peer countries. This lacklustre performance distorts competition and is a source of uncertainty and risk for public finances. The size of liabilities of public enterprises inside and outside the general government is large and a source of risk for the public finances.

The corporate governance framework of SOEs deviated substantially from international good practices. This is of particular concern given the role and the level of state control over strategic decisions. A more robust SOEs corporate governance aligned with international good practice could improve the financial performance of the companies, and capital allocation and competition in key sectors of the economy.

With the goal to improve the governance and performance of its SOEs, Bulgaria committed, with the assistance of DG REFORM<sup>4</sup> and in cooperation with international experts, to assess the existing fragmented framework and prepare and adopt a new legislative framework for the corporate governance of SOEs in line with international good practices, as defined by the OECD Guidelines.

### **2. Deliverables and Implementation by the authorities**

The Bulgarian authorities received technical support by DG REFORM and the OECD under a Structural Reform Support Programme (SRSP). The project provided two reports (“SOE Landscape Report” providing an overview of the Bulgarian SOE sector and “Assessment Report” benchmarking existing Bulgarian SOEs practices against the OECD Guidelines), an integrated “SOEs Review” identifying priority areas and drawing recommendations for reform and technical advice on draft legislation in order to align the Bulgarian legal framework to international good practices, as defined by the OECD Guidelines. The project covered areas such as: clarifying the rationale for state ownership of enterprises; developing a high-quality ownership policy supported by corporate objectives for individual SOEs; professionalising the state ownership function and ensuring that ownership rights are exercised on a whole-of-government basis; ensuring a level playing field between SOEs and private companies; implementing high standards of transparency and information disclosure; and professionalising boards of directors and empowering them to play a key role in strategy and corporate oversight.

Assisted by DG REFORM and the OECD, the Bulgarian authorities prepared a draft legislation and the National Assembly of Bulgaria adopted the new Law on Public Enterprises on 26 September 2019 (promulgated by Decree No. 79 on 8 October 2019).

The Law addresses the main vulnerabilities in state ownership practices and establishes a legislative foundation to implement the most urgent policy and institutional priorities, as identified in the SOE Review. The Law applies to all fully and majority-owned SOEs, including subsidiaries, at the central

---

<sup>4</sup> On 1 January 2020, SRSS became the Directorate-General for Structural Reform Support (DG REFORM).

level of government, with the exception of the Bulgarian Development Bank. As a credit institution, the Bulgarian Development Bank will continue to be under the supervision of the Bulgarian National Bank, complying with the applicable national and European banking legislation, including for disclosure of information, accounting, auditing, selection of board members, etc., and at the same time fulfilling its goals and principles as a development bank (art.2 of the Bulgarian Development Bank Act).

The Law includes the following aspects:

- Establishment of an ownership coordination unit to mitigate shortcomings associated with Bulgaria's decentralised ownership arrangements;
- Elaboration of an ownership policy and SOE objectives-setting mechanism;
- Development of aggregate reporting to address gaps in accountability for SOEs' performance, corporate governance and disclosure practices;
- Introduction of a harmonised SOE board nomination process;
- Corporatisation of commercially-oriented statutory SOEs to private companies' level playing field.

The Law renamed the former Agency for Privatisation and Post-Privatisation Control into Agency of Public Enterprises and Control (PECA) and entrusted it with new rights and responsibilities. PECA was placed under the Council of Ministers of Bulgaria with a mandate to design, coordinate and monitor the implementation of the government policy for public enterprises.

The timeline for the implementation of the main provisions of the Law is:

- Within 3 months, the Council of Ministers shall adopt the Rules of Procedure of the PECA. § 3. (1)
- Within 6 months, the Council of Ministers shall adopt the Implementing rules of the Law. § 3. (2)
- Within 6 months, the Council of Ministers shall bring the regulatory framework into compliance with this Law. § 3. (3)
- Within 12 months, the composition of the management and control bodies of public enterprises shall be brought in compliance with the provisions of the Law. § 3. (4)
- Within 12 months, the PECA should submit an analysis on the nature of the activities carried out by SOEs created by special laws (e.g. predominantly public functions or predominantly commercial activities that could be carried out by a private operator for profit). § 2. (2)
- Within 3 years: the Council of Ministers shall adopt a programme for transformation of the SOEs created by special laws. § 2. (2)

The Law also stipulates in Art. 10 that the Council of Ministers shall adopt the state ownership policy. Although no deadline is given, the Bulgarian authorities intend to do this within one year of the entry in force of the Law and they have included it in the new technical assistance project with the SRSP, which is expected to start soon. The policy should be updated at least every four years. According to Art. 31. (1) of the Law, PECA shall submit an annual report (Aggregate Report for the year) to the Council of Ministers for approval by 31 October of the following year.

As a result of this legislative reform, on 17 October 2019, the OECD Working Party on State Ownership and Privatisation Practices issued a positive assessment on Bulgaria's adherence to the OECD Guidelines. On 19 November 2020, the Corporate Governance Committee and the OECD Council endorsed this assessment.

With the support of DG REFORM and OECD, the Bulgarian authorities drafted the Implementing Rules of the new law and the Rules of Procedure of the Public Enterprises and Control Agency (PECA). The Council of Ministers approved the two sets of rules on 15 April 2020 and 21 April 2020 respectively, fulfilling the first three points in the timeline of the Law.

The SRSP project was successfully completed in April 2020 and the Bulgarian authorities have already requested technical assistance from the SRSP and the OECD to put into effect the implementing actions for the new legislation and to improve the capacity of the responsible authorities to execute their role.

### **3. Commission services' assessment**

The Commission services' assessment is that prior commitment 6 has been fulfilled. The legislative framework has been aligned with the OECD Guidelines on Corporate Governance of SOEs and the authorities have already planned the next steps.