

REPORT ON

THE PROGRESS OF IMPLEMENTING IN BULGARIA
THE WHITE PAPER ON CORPORATE GOVERNANCE
IN SOUTH EAST EUROPE

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ACRONYMS AND ABBREVIATIONS

AL	Accountancy Law
BSE-Sofia	Bulgarian Stock Exchange-Sofia
FSC	Financial Supervision Commission
IAS	International Accounting Standards
ICPAB	Institute of Certified Public Accountants of Bulgaria
IFAC	International Federation of Accountants
IFAL	Independent Financial Audit Law
ISA	International Standards on Auditing
LPOS	Law on Public Offering of Securities
LSSEIC	Law on Securities, Stock Exchanges and Investment Companies
NAS	National Accounting Standards

I. EXECUTIVE SUMMARY AND MAIN CONCLUSIONS

1. The majority of the recommendations made in the White Paper on Corporate Governance in South East Europe (the White Paper) have been implemented in Bulgaria's legal and institutional framework in one form or another. The legal framework in place follows closely international standards and practices and has been largely brought into line with the relevant EU acquis. The institutions required have been in place for some time now and are effectively functioning. The only exception in this regard is the supervisory body recommended in the White Paper to monitor the accounting and auditing profession. Furthermore, capital market infrastructure can be said to be effectively performing given the size and stage of development of the local market. Registration of ownership and transactions with public companies' securities are fast and reliable. Free transferability of shares is required by law for all public companies. There is a wide network of brokerage services including Internet based online trading for final customers.

2. In 2000 the law has enhanced and broadened the powers of the securities regulator. In addition to licensing and monitoring, now the Financial Supervision Commission (FSC) is authorized with a large number of powers as follows: instituting administrative compulsory measures, imposing fines on individuals and legal entities, requiring information, and carrying out investigation on its own. Most of the measures initiated by the Commission may be appealed in court. However, with respect to law enforcement and implementation, it is much relied on the market regulator rather than on courts. At this stage a great number of evaluations still view the judiciary as a major weakness and flaw of the country's law enforcement system.

3. Currently, the private sector remains somewhat uncommitted to the corporate governance reform effort. The bulk of companies have gone public in an administrative manner as the logical outcome of the privatisation programme. Despite the very few exceptions, most companies, in particular their major shareholders and Board members, regard the public status as a burden rather than as a possibility to eased access to market funding. Furthermore, most of these companies are viewed as not having the appropriate public company profile due to their economic characteristics and high concentration of ownership. At the same time, companies having an essentially public profile have not gone public or are well on their way to abandon the public company status. Since 2003 the FSC has been requiring all public companies to draw up corporate governance programmes brought into line with the OECD Principles and to report annually on their implementation. This is an important step forward to instituting the best international practices of corporate governance in the private sector. However, it is still too early to rush to any conclusions as to the quality of these programmes and to their real effect.

4. As far as training goes, a great deal of work is yet to be done. Over the past few years many international donors, including among others USAID, the British Know-How Fund

and the German Society for the Development of the Capital Markets in Central and East Europe, have greatly assisted the securities regulator's staff training under different programmes and projects. Furthermore, there have been training programmes for accountants and auditors alike, but the focus was mainly on the introduction of the international accounting standards rather than on the best international practices in the corporate governance field. Training of board members and judges needs to be further enhanced. Corporate governance training (theory and practice) has been mainly carried out on an *ad hoc* basis usually by non-government organizations and under international projects. Corporate governance curricula are usually not available at universities.

5. The principle of minority rights protection and equitable treatment of all shareholders is provided thoroughly in the Securities Law from its initial adoption. Insider trading is forbidden in Bulgaria since 1995 and market manipulation – since 2000. However, since June 2002 there is an overall improvement of the securities regulation with respect to the protection of minority shareholders. New detailed provisions in the Law on Public Offering of Securities were adopted, requiring shareholders' approval of major transactions and related party transactions over certain threshold. Public companies' shareholders were entitled with redemption rights if they vote against company's reorganization. The right of the shareholders to question the Board at the general meeting, even out of the agenda, was expressly stated in the Law. Each public company was required to appoint an investor relations officer. The tender offers regulation was significantly developed and it expressly provided for paying the fair shares price in case of mandatory offers and going-private tender offers. With respect to new issues shareholders were entitled to tradable pre-emptive rights; in case the shareholders do not exercise or sell these rights in a pre-determined period the company *ex officio* offers them for sale and if successful, it transfers the proceeds to the shareholders. Clear rules in the law were adopted regarding who is entitled to dividends and the company is required to be ready to pay dividends to all shareholders within three months period. Elaborated legal rules regarding boards' duties of care and loyalty toward all shareholders were adopted in 2002 in the Securities Law and one year later in the Commercial Law. One third of the members of a public company board are required to be independent directors and the criteria for independence were set forth in the Securities Law in conformity with the international practice.

6. New Accountancy Law (AL) and new Independent Financial Audit Law (IFAL) came into effect in 2002 both aiming to reach compliance with the relevant international standards. The Accountancy Law requires from all public companies and financial institutions to apply the International Accounting Standards (IAS) from the beginning of 2003 and from the rest of the companies not later than 2005. The Independent Financial Audit Law is in compliance with the EU Eighth Directive and the International Standards of Auditing (ISA). As a result financial reporting and auditing procedures are currently in a period of transition from compliance with National Standards to compliance with International Standards and EU Directives and Regulations. The transition to full International Accounting Standards requires new educational curricula and extensive training for practicing accountants, auditors, tax authorities and market regulators. Although there have been organized efforts by the Ministry of Finance and the Institute

of Certified Public Accountants of Bulgaria (ICPAB), there is a wide spread opinion that the current level of training and experience is far from enough.

7. In the end of 2003 a notable far-reaching upgrade in the disclosure legal framework was enacted. The prospectuses' and periodic disclosure reports' content and publication rules have been harmonized with the best international standards and practices. With respect to disclosure requirements of significant events Bulgaria has improved the modified general obligation approach: a broad definition of price-sensitive information was adopted plus a non-exclusive list of events, which are typically considered material.

8. Bulgarian legal framework recognizes the rights of various groups of stakeholders and is gradually improving in this respect. Bulgarian Labour Law and Social Insurance Law are traditionally well developed in protecting rights and of employees. The 2003 amendments to the Commercial Law provided that if the number of employees in a joint-stock company is over fifty, they have a representative at the general meeting who has the same access to information as any shareholder. During the last few years the insolvency legal framework has been revised several times and amendments to other enforcements laws, including the Civil Procedure Code and the Registered Pledges Law, have been enhanced in order to increase the effectiveness of procedures for exercising creditors claims.

9. Despite the progress made over the last few years, the corporate governance reform effort is not yet completed. Certain aspects of the reform agenda are in an advanced phase, whereas others are still at a too early stage of development. Some of the significant changes in the legislation (with respect to the on-going disclosure of information, corporate governance programmes, transition to the international accounting standards, improved protection of minority shareholders) have been adopted very recently – in 2002 and 2003. Therefore the implementation practices are, at present, incipient and still somewhat underdeveloped. The effectiveness of enforcing the novel legal rules remains a major challenge. More time and educational efforts are needed for the boards of directors to realize better their strategic role, the essence of their duties, the concept of independence and loyalty toward all shareholders. At the same time, there are in place some signs that the capital market has responded to the development of the corporate governance reform rather positively, improving its performance over the last two years. And yet, the above trend is still too fragile, and hence it is too early to rush to any conclusions whether or not it will persist over time.

10. The objective of this report is to examine the correspondence between corporate governance legislation and practices in Bulgaria on one side and White Paper recommendations on the other side. The report is organized as follows. Part II presents the dynamic development of the corporate governance framework. It gives a clear idea of the efforts and the continuous strive of the legislators in Bulgaria to adopt the leading international ideas and practices. Part III provides an overview of the capital market with the purpose to trace the effect of institutional changes on the development of the market. Part IV focuses on transparency and disclosure and Part V focuses on implementation

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and enforcement, the areas that will be the focus of the 5th meeting of the SEE
Roundtable.

II. OVERVIEW OF THE CORPORATE GOVERNANCE LEGAL FRAMEWORK (1991-2004)

11. In 1989 the socialist system in Bulgaria collapsed and the process of building democratic society and market economy commenced. The Commercial Law was passed in 1991 and it established the basis of the corporate governance legal rules. However, the insufficient joint-stock companies legal regulation, in particular regarding the funds raising process from the public, made possible the blatant financial pyramids in the next few years where many people lost part of their savings.

12. The state response to the above fraudulent schemes was the adoption of the Law on Securities, Stock Exchanges and Investment Companies (LSSEIC) in 1995. It provided for licensing investment intermediaries (brokers/dealers), stock exchanges and investment companies, as well as for prospectus and ongoing disclosure of listed companies, major ownership disclosure and tender offer regulation. A Securities Commission as a specialized administrative regulator of the capital market was established in 1996. The law established a very broad definition of security and required a Commission's permission for each public offering of securities. Insider trading was prohibited.

13. In 1996, simultaneously with the privatization of major stakes of state-owned companies for cash, commenced the first wave of the mass-privatization process. Bulgarian citizens over the age of eighteen received vouchers from the state and invested them in companies under privatization and/or in privatization funds. The mass-privatization created dispersed ownership in the privatized companies. The numerous shareholders, possessing usually only few shares, lacked basic investment culture. Typically they were not interested in their ownership and had no idea of the value of their shares. For mass-privatized companies the Securities Law disclosure requirements didn't apply, since the voucher privatization was not legally considered as a public offering. At the same time most of the companies had major shareholders, either privatization funds or "cash privatization" shareholders. Although there were positive exceptions, it was usual practice major shareholders not to respect the rights of the minority ("voucher") shareholders. During this period many voucher shareholders sold their shares, probably below their value, to "gray" (not licensed) brokers, often acting in favor of the major shareholders.

14. The obvious shortfalls of the legal framework fostered the first major Securities Law amendment in 1998. It introduced the concept of "public company" with the main purpose to encompass the privatization funds and the widely held mass-privatized companies and subject them to the Securities Law disclosure provisions.¹ In an attempt to

¹ The public company definition envisages 3 groups of public companies: (i) companies, which have issued shares by means of public subscription; (ii) companies with shares admitted for trading at a stock-exchange; (iii) companies, which have at least 50 shareholders owning not less than 10 percent of the capital due to *factual* public offering of shares, i.e. also including the mass-privatization of shares for the

neutralize the buy-up practices of shares at the detriment for the interest of the small shareholders, the law provided that transactions with shares of public companies may be executed only at the stock exchange, except for transactions between natural persons. It was also an attempt to concentrate the demand and supply at the stock exchange thus providing for representative market prices of shares.²

15. Meanwhile, with the transition to a market economy many deficiencies of the Securities Law and the Commercial Law, which turned to be common for Bulgaria and other transition countries, gradually became evident. But it is a Bulgarian specificity that the securities regulator took the lead for improving the corporate governance legal rules. The Securities Commission drafted and justified before the Parliament the second significant amendments of the Securities Law, which passed in December 1999 (technically, it was a new statute named Law on Public Offering of Securities (LPOS), which repealed the 1995 Securities Law³).

16. The new Securities Law came into effect in the end of January 2000. It provided for improvement in all areas of securities and public companies regulation. However, the most significant corporate governance provisions were related to strengthening minority rights and the powers of the Securities Commission. The preemptive rights of the shareholders of a public company were reinforced by the legal prohibition of the increase of capital with in-kind contributions and in other cases where designated persons subscribe the new shares. Important disclosure and other requirements were introduced regarding the general meeting of shareholders. The new law provided for procedure and deadline for paying out dividends, as well as for the competence of the general meeting of shareholders to permit major transactions. Five percent shareholders were empowered to file at the court derivative suit against the board for damages suffered by the company. Rules for transformation of public companies were adopted in accordance with the Third and Sixth EU Directives. It was provided also that the securities regulator should supervise the transformation process.⁴ Another very important new Securities Law provision dictated, in case of control change in a public company the new controlling shareholder to make a tender offer to the rest of the shareholders to purchase all of their shares. Significant elaboration of the rules for registration of securities and securities

exchange of vouchers. The first and the third item captured the privatization funds and around a thousand privatized companies, which were forced to register at the Securities Commission. As a result many companies got the status of a public company in an “administrative way” i.e. regardless of the will of the shareholders and often against the will of the major shareholders.

² However, the natural persons exception was a serious loophole in the regulation, but it was the unavoidable compromise for adoption of the “stock exchange concentration of trade” provision.

³ The new Securities Law has the same and even broader scope as the repealed one: it also regulates investment intermediaries, stock exchanges and investment companies.

⁴ All of these corporate governance rules were considered traditionally and systematically a domain of the Commercial Law or, more precisely, of the Company Law (the latter is part of the Bulgarian Commercial Law). However, the activism of the Securities regulator brought about a special set of “Company Law” provisions, located technically in the Securities Law, which were applicable for public companies only. Later (in August 2000 and mainly in August 2003), the same or similar rules were incorporated in the Commercial Law, so they bound the non-public joint-stock companies as well.

transactions in the Central Depository were adopted as well. Market manipulation was defined and explicitly prohibited. Last, but not least, the powers of the Securities Commission were considerably strengthened and broadened and the level of the administrative fines it imposes was 3-4 times increased.

17. The next major Securities Law amendments took place in June 2002. Again, like in 2000, they brought further overall improvement of the securities regulation, including notable far-reaching upgrade of the corporate governance provisions: in the ongoing disclosure process of listed companies, in the provisions related to shareholders approval of major transactions and others. For the first time the law provided for shareholders approval also of related party transactions over certain threshold (the rest of the related party transactions have to be approved by the board without the votes of persons with conflicts of interests).⁵ The law defined the board members duty of care and loyalty toward the company and all shareholders. The right of the shareholders to question the board at the general meeting about the business and financial conditions of the company, even out of the agenda, was explicitly stated in the law. Each public company was required to appoint an investor relations officer. The law provided for derivative suit also against the controlling shareholder, who has inclined the board for action or omission to act in a way detrimental for the interests of the company. Public companies' shareholders were entitled with redemption rights if they vote against a company's reorganization. The tender offers regulation was significantly developed and it expressly provided for paying shares' fair price in case of mandatory offers and going-private tender offers. With respect to new issues shareholders were entitled to tradable pre-emptive rights; in case the shareholders do not exercise or sell these rights in a pre-determined period the company *ex officio* offers them for sale and if successful, it transfers the proceeds to the shareholders. Clear rules in the law were adopted regarding who is entitled to dividends and the company is required to be ready to pay dividends to all shareholders within three months period. Elaborated legal rules regarding boards' duties of care and loyalty toward all shareholders were adopted in 2002 in the Securities Law and one year later in the Commercial Law. One third of the members of a public company board are required to be independent directors and the criteria for independence were set forth in the Securities Law in conformity with the international practice. The penalty provisions of the Securities Law were additionally revised and the sanctions increased for the most serious violations of the law.

18. In August 2003 were adopted the most important corporate governance amendments in the Commercial Law, which introduced provisions similar to many of the Securities Law corporate governance rules and thus the distance between the public and non-public companies regulation was considerably decreased. In addition, these Commercial Law amendments provided for a new right of the five percent shareholders to add items in the agenda for the shareholders meeting. This right benefits also the five percent shareholders in a public company.

⁵ In this regard, as well as with the respect to the major transactions rules, the Bulgarian legislator was heavily influenced by the analogous provisions of the amended Russian Joint-Stock Companies Law and, more generally, by the Black/Kraakman's "self-enforcing model of corporate law".

19. Finally, the last up to now significant amendments in the corporate governance legal framework came into effect in December 2003. They are related to prospectuses and ongoing disclosure requirements of listed companies (see item 57).⁶ One of the most important new rules was the requirement for detailed non-financial disclosure (prospectus and annual reports) from all listed companies, including the companies, traded at the lower tier of the Bulgarian Stock Exchange, the so called Unofficial market.⁷

⁶ Technically, these amendments took place by a piece of secondary legislation: the new Ordinance on Prospectuses and Ongoing Disclosure, adopted by the securities regulator.

⁷In practice most of the listed companies, including the Bulgarian “blue-chips”, are traded at the Unofficial Market, where disclosure requirements have been much less demanding. Nevertheless that the Official Market, (i.e. the higher segment of the Bulgarian Stock Exchange), should have been viewed as more prestigious, all the companies which had the option to chose a market tier for listing their shares, had decided to register at the lower market segment with much relaxed disclosure requirements.

III. OVERVIEW OF THE CAPITAL MARKET DEVELOPMENT

20. The country's economic and institutional environment as well as the market infrastructure have influenced the development of the local capital market tremendously.

21. The organized capital market in Bulgaria emerged as late as 1998 mainly as a result of the mass privatization program. However, well until 2001 its performance was rather poor, if not altogether unsatisfactory, and the trends then underway gave rise to a number of adverse developments, e.g. low demand and low liquidity, decreasing prices and hence low market capitalization.

22. Table 1 shows data on trading in shares. The number of companies listed on the Bulgarian Stock Exchange-Sofia (BSE-Sofia) had decreased from 861 in end-1999 to some 369 in end-2001. Turnover volumes ran rather low at only BGN 42-50 million, or a bare 0.15% of the country's nominal GDP, as did the turnover/market capitalization ratio (2.5%-3.8%). Furthermore, the bulk of the turnover volumes reported was mainly due to block trading, which at that time is not exchange trading in essence.⁸ Block trading relative share in total trading increases from 62.1% in 1999 to 73.1% in 2001.

Table 1. Trading on the BSE – Sofia (shares)

	1999	2000	2001	2002	2003
<i>Official Market</i>					
Nbr of Listed Issues	33	30	30	31	35
Turnover (mil. BGN)	12.3	8.6	4.4	14.4	60.9
Market Capitalization (mil. BGN)	219.1	283.5	195.0	252.9	986.7
<i>Unofficial Market</i>					
Nbr of Listed Issues	828	478	369	325	303
Turnover (mil. BGN)	38.1	23.6	37.8	69.6	120.0
Market Capitalization (mil. BGN)	1154.0	1003.0	909.0	1122.3	1742.0
<i>Total</i>					
Nbr of Listed Issues	861	508	399	356	338
Turnover/Capitalization (%)	3.7	2.5	3.8	6.1	6.6
Capitalization/GDP (%)*	6.9	5.7	3.7	4.3	7.9
Block Trading (mil. BGN)	82.6	91.1	114.9	244.7	151.2
Market Index (SOFIX)	na	106.7	118.6	183.1	454.3

*Data for nominal GDP is preliminary

Data Source: BSE-Sofia

⁸ In fact these were off-exchange negotiated transactions, most of them between privatization funds and other big players during the mass-privatization process. Their execution was "legalized" at the stock exchange as block trades.

23. Trading in bonds revealed a similar picture (see Table 2). The number of listed issues was rather small resulting in insignificant turnover. In addition, municipal bonds⁹ were not traded at all.

Table 2. Trading on the BSE – Sofia (bonds)

	1999	2000	2001	2002	2003
<i>Corporate Bonds - Official Market</i>					
Nbr of Listed Issues	1	3	3	3	7
Nominal Value (mil. BGN)	0.3	4.1	4.1	13.7	44.7
Turnover (mil. BGN)	0.0	3.3	0.8	2.5	41.5
<i>Corporate Bonds - Unofficial Market</i>					
Nbr of Listed Issues	0	0	4	6	10
Nominal Value (mil. BGN)	0.0	0.0	10.6	28.1	61.1
Turnover (mil. BGN)	0.0	0.0	0.3	17.1	26.0
<i>Municipal Bonds</i>					
Nbr of Listed Issues	0	0	0	1	2
Nominal Value (mil. BGN)	0.0	0.0	0.0	3.0	4.0
Turnover (mil. BGN)	0.0	0.0	0.0	0.0	0.0

Data Source: BSE-Sofia

24. Year 2002 saw the enforcement of the amended Securities Law, which was largely brought into line with the practices and regulations governing EU capital markets. It provided a solid basis for further improvement of the country's capital market legislation and led to the development of market infrastructure. Nevertheless, a great deal of work was yet to be done as it failed to give a strong push up of the market and did not reverse the negative market trends.

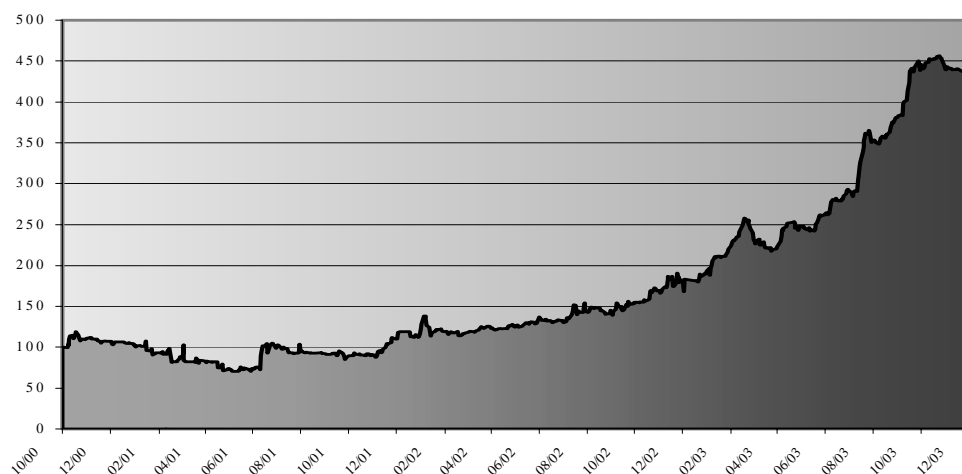
25. Over the same period, the capital market was not yet a source of financing for companies in the Bulgarian economy – by the end of 2000 there had been not a single significant public offering of shares, and traded on the exchange were only three issues of bonds. In addition, the reform in the pension, health and insurance industry failed to foster the capital market. In 2001 the financial institutions from these sectors have already mobilized savings, which could be considered as significant for the local market scale. Nevertheless, they aimed their investment policies mainly at government securities due to the high market risk and poor choice of financial instruments that suited their investment profile.

26. Year 2002 witnessed a certain improvement in capital market performance, as did 2003 when practically all indicators went on the rise. Turnover volumes of trading in 2003 (shares and bonds) on the BSE-Sofia stepped up by 474% relative to 2001. The number of transactions increased while block trading share in total trading decreased to 45% in 2003, resulting in higher liquidity. At the same time the stock exchange index, SOFIX, was steadily rising to close at 454.3 points in end-December'03, posting a vigorous 2-year increase of 283% (see Fig.1). As a result, market capitalization in end-

⁹ The only two issues of municipal securities placed on the market at that time (of Sofia and Svishtov Municipalities) were not listed on the Sofia Stock Exchange.

2003 stepped up by 147% relative to end-2001, given the ever-declining number of companies listed. At the end of 2003 the market capitalization reached 7.9% of GDP.

Fig.1. SOFIX Index 2000-2003



Data Source: BSE-Sofia

27. The role of the Bulgarian Stock Exchange gained in importance for the privatization process in 2002 and 2003. Basically, the development of the capital market in Bulgaria has always been closely related to the privatization process underway. But during the same period, the above relation was further reinforced as privatization through the stock exchange was used in a much larger extent compared to the preceding years.

28. Year 2003 witnessed the first signs that the capital market could be a possible source of company financing, as new issues of shares and bonds the volumes of which ran well above volumes in the preceding four years were listed on the exchange. Furthermore, local institutional investors – mostly pension funds, became market players, and while in end-2001 their investment portfolios were entirely based on government securities, in 2002 and 2003 they started holding both corporate bonds and shares. Their investments in corporate securities are still small relative to their total assets, but the change in their investment policy might be indicative.

29. A number of factors at work boosted the capital market over the 2002-2003 period as followed: real growth in the economy, macroeconomic stability, the progress on EU and NATO accession negotiations, larger foreign direct investments inflows into the country, government policies as to the capital market, and the development of the market infrastructure. But at the same time, part of the improved market performance was undoubtedly due to the improved institutional basis of corporate governance, in particular the essential legislation changes with respect to disclosure of information, protection of minority shareholders and tender offers procedures and practices made in 2000, 2002 and 2003.

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30. The positive trends discerned in 2002 and 2003 in particular are quite encouraging, but still rather fragile. Therefore, it is too early to rush to conclusions whether and if they will persist over time.

IV. TRANSPARENCY AND DISCLOSURE

The text below represents the Bulgarian experience in implementation of the principle of Disclosure and Transparency, following the respective recommendations of Chapter 3 in the White Paper.

31. The adoption of full International Financial Reporting Standards (IFRS) should be pursued and fully implemented for listed companies. Special attention should be given to consolidation requirements and related party rules (Recommendations 157-160).

32. Like most other transition countries Bulgaria has approached the implementation of the IFRS gradually and at stages. During the last five years Bulgarian National Accounting Standards (NAS) have been revised several times, each time getting closer to the International Accounting Standards (IAS). However, because of the later partial and sometimes incorrect adaptation important discrepancies between the local accountancy framework and the IAS still remained. The EU accession process and the strong political will for increasing foreign investments justified more radical steps in accelerating the accounting reform. The new Accountancy Law in 2001 provides for full IAS application since the beginning of January 1, 2003 for all listed companies on official and non-official securities markets, as well as for some other companies.¹⁰ The rest of the companies shall be required to follow the IAS as of January 1, 2005. By that time they apply the NAS, though these companies are permitted to choose the IAS instead. The second group of companies is highly heterogeneous: it consists of sole merchants and companies with few partners or shareholders, but also of widely held joint-stock companies with many “mass privatization” shareholders, which went private and were delisted.

33. It should be noted that two critical areas of financial reporting with respect to listed companies are regulated by the securities legislation as well. First, listed companies are required to file at the FSC annual consolidated financial report not later than 180 days after the end of the financial year and quarterly consolidated financial report not later than 60 days after the end of the respective quarter. Very important, the FSC has the power to compel the companies to eliminate omissions and correct other deficiencies in the financial reports and has used this power many times. The expertise of the FSC’s accountants that check the reports, on the one hand, and the regulator’s powers, including

¹⁰ These other companies are mainly financial institutions like banks, pension funds, investment and insurance companies, which are established and operate on the basis of special legislation, not solely on the Commercial Law. Most of these financial institutions are not listed companies and have limited number of shareholders, although they reach the broad public in other capacity: depositors, insured persons, etc.

the power to impose high penalties, on the other hand, seems to be a reliable instrument against at least the most blatant violations of the consolidation rules. In contrast, there is no such device to ensure basic compliance of the non-listed companies with the national accountancy standard on consolidation (based on the respective IAS).

34. The second critical issue is related parties transactions. Bulgarian Securities Law regulates in detail these transactions for the public companies (i.e. companies, which shares are listed), including their approval by the general meeting of shareholders or the board and the disclosure of these transactions before the approving body. Similar, but more relaxed rules apply for non-public companies on the grounds of the Commercial Law.

35. Information concerning major ownership and control structure of listed and widely held companies should be accessible to all shareholders and publicly available (Recommendations 161-168).

36. The basic legal framework for disclosure of major ownership and control structure of public companies was introduced by the first Bulgarian Securities Law as of 1995. Gradually, the regulation of this matter became more detailed with respect to the terms and procedures of such disclosure, without altering the basic principles of its regulation.¹¹ However, with respect to the private widely held companies, as a rule, information about their major ownership and control structure is not publicly available.¹²

37. The control structure of a listed company, as well as the whole major ownership structure (the latter consists of the shareholders with 5 and more percents of the voting capital) is disclosed initially in the prospectus of the company's initial public offering of securities. Afterwards, any changes in these structures are subject to ongoing disclosure in short period of time after the change (see item 38). The company is obliged also to disclose in the annual report its actual (updated) major ownership and control structure.

¹¹ Initially, in 1995 the threshold for disclosure major ownership was set to 10 percent and multiple of 10 percent of the company's voting shares. However, in 1999 the new Securities Law, reflecting the current realities and trends in regulation of major ownership disclosure, provided for a threshold of 5 percent of the voting shares of a company, which shares are admitted for trading at a regulated *official* securities market, while relaxing the threshold for public companies traded at a *unofficial* regulated securities market (10%, ¼, 1/3, 2/3 and ¾ of the votes). Finally, the 2002 amendments of the Securities Law equalized the thresholds for disclosure of major ownership at 5 percent for all (official and unofficial) regulated securities market. In the period of 1997-2000 the securities regulator has issued guidelines for implementation the provisions of the law, which were incorporated and developed in an ordinance on disclosure of major ownership in 2000.

¹² Bulgarian Commercial Law does not provide for entry into the commercial court register information about shareholders' ownership.

38. Currently, the Securities Law provides that the public company, the FSC and the stock exchange must be notified by the person, which direct or indirect voting right¹³ reaches, exceeds or drops under 5 percent or a figure multiple by 5 percent of the number of the votes of the general meeting of the company. In addition, the Central Depository, which is the national registrar of book-entry (dematerialised and immobilized) securities, is obliged by law to double this notification with respect to the direct voting right, i.e. the change of voting shares ownership. The notification shall be made within 7 days from the respective ownership change. However, if the change is price-sensitive information, e.g. change of control, it must be disclosed not later than the next business day after the change. In order to facilitate the shareholders and to ensure better compliance with the rules the FSC has prepared detailed notification form.

39. The *ratio legis* of the above rules is not only that the FSC shall supervise in real time the disclosure process; also, shareholders and investors shall have an alternative to the public company trustworthy source of the major ownership information: the public register kept by the FSC and the stock exchange bulletin. Investors really benefit from the FSC public register, which is free and is available also online. Also, the 2002 Securities Law amendments further demand that each public company shall maintain the position of an investor relations officer, who is obliged to provide shareholders and investors with the information they are entitled to, including major ownership data. Before these amendments it had been a usual situation that nobody from a public company will answer to shareholders requests, claiming that there is no such obligation.

40. In addition, under the Securities Law as of 2000 every shareholder has the right of access to the entire information from the book of shareholders kept by the Central Depository. The law prohibits the Central Depository to refuse such a request, in case the shareholder declares legitimate purpose for using the information.

41. However, the implementation of the above “investor-friendly” legal rules about disclosure of shareholders ownership information is not without any impediments. The online version of the FSC register is still under development and is not complete; there are more data in the paper register available at the FSC public reference room. The BSE-Sofia bulletin and the access to the complete shareholders book from the Central Depository are paid services and many shareholders and investors could not afford their current fees.¹⁴ Finally, the position of an investor relations officer in a public company

¹³ Indirect voting right of a person that has to be disclosed includes voting shares, which are: (i) held by the spouse and the underage descendants of this person; (ii) held by a company controlled by this person; (iii) held by other persons on their behalf but for the account of this person; (iv) held by a other person with whom the person that must disclose major ownership has concluded written agreement for following a common policy for the management of the respective company through a joint exercising of the rights of vote they have; (v) conceded by other person with whom the person that must disclose major ownership or a person controlled by him has concluded written agreement stipulating temporary transfer of the rights of voting related to the securities; (vi) submitted by the person as a collateral unless the secured creditor exercises a right of voting; (vii) deposited to the person with a transfer of the rights of voting without special orders of the stock holders.

¹⁴ The fee of the stock exchange for online access of the daily bulletin euro 350-700 per year and the Central Depository fee for providing to a shareholder the information of the shareholders’ book amounts to

could not change automatically the prevailing attitude of major shareholders, board members and managers against more transparency of company's affairs.

42. As noted above, from its initial adoption in 1995 the Securities Law requires disclosure of indirect ownership in public companies, including the case when connected shareholders act in concert. However, the rules were not very clear and this impedes their implementation and enforcement. Therefore, the 2002 Securities Law amendments *expressly* provide for disclosure of the ultimate (beneficial) ownership. In case a legal entity acquires or disposes of the specified 5 percent or multiple of 5 percent ownership, its notification to the company, the FSC and the stock exchange must also point out the persons, who control it directly or indirectly and the manner they exercise control.¹⁵ In this regard Bulgaria relies primary on the up-front disclosure system because of the high proportion of shell companies, lack of considerable investigative experience in the regulator and of sufficient support from the judicial system (Option 1 of the OECD template "Options for Obtaining Beneficial Ownership and Control Information"). It should be also pointed out that in Bulgaria as nominees may serve only foreign broker/dealers when purchasing securities for the account of their clients non-residents; however, these nominees are obliged to disclose to the FSC at its request the identity of the beneficial owners. In all other cases the law provides that the names of the ultimate (beneficial) security holders shall be entered in the Central Depository registers.¹⁶

43. The new securities legislation in effect as of December 2003 provides that each manager and board member shall disclose in the annual report of the public company information about the type and number of shares he/she owns in the company and the percentage these shares represent of the respective class of shares, as well as the options owned for acquisition of securities issued by the company. The annual report is disseminated to the public in the same way as the major ownership information.

44. The Securities Law as of 2000 provides for serious administrative sanctions for breaching the above legal obligations, several times higher than before. If major shareholders natural persons fail to disclose their directly or indirectly owned shares, the FSC should impose pecuniary fine between euro 1000-2500 and for the same violation

euro 180-250 (for comparison the average monthly salary in Bulgaria is about euro 130). However, a shareholder or an investor still has the free option to get from the FSC's register or directly from the company information about shareholders with 5% (or more) votes in the general meeting, which is actually most important for taking informed investment or voting decision.

¹⁵ Pursuant to the Securities Law definition a person exercises "control" when he/she: (i) holds, including through a daughter company or by virtue of an agreement with another person over 50 percent of the number of votes in the general meeting of a legal entity; (ii) can determine directly or indirectly more than half of the members of the managing body of a legal entity; (iii) can, in another way, exercise a decisive influence on taking decisions in connection with the activity of a corporate body.

¹⁶ Of course, "hidden" nominees cannot be avoided, i.e. somebody to agree to hold securities at its name, but for the account of other person. In this case, as already pointed out in item 38 of the report the law requires the *real* owner to disclose his/her ownership if it is over the 5 percent threshold.

again during the year - between euro 2500-5000.¹⁷ In case of a major shareholder legal entity, apart from the fine imposed to the guilty natural person (usually its CEO) the FSC may impose sanction to the legal entity as well in the range between euro 2500-5000 for first time violation and euro 5000-10000 for same violation again during the year. For incomplete or misleading data in a public company's annual report, including for disclosure of its major ownership and control structure, the law provides for the same structure, but double amounts of administrative pecuniary fine in relation to the fines for non-disclosure of major ownership.

45. No criminal sanctions are provided for the above legal violations. The reason is that at this stage a specialized administrative body as the FSC shall enforce the Securities Law much more effectively than the judicial system.¹⁸ Monitoring and enforcing the legal provisions related to disclosure, including the major ownership and control disclosure, is a main area of the activity of the securities regulator.¹⁹ However, the difficulties of checking and proving undisclosed indirect ownership and control are straightforward. The lack of sufficient investigative powers and experience, as well as not effective support from the other investigative and enforcement institutions in the country are among the factors, which result in modest success of the FSC's enforcement of major ownership and control disclosure legal requirements.²⁰

46. Ongoing disclosure of significant events should be considerably improved (Recommendations 169-175).

47. The Securities Law provides for 3-staged ongoing disclosure of significant events, which are considered to be price-sensitive information. First, and most importantly, as of 2000 listed companies are required to disclose such events on an immediate basis, which means by the end of the business day following the day the event occurs or the company become aware of it.²¹ It is well understood by the Bulgarian regulator and the stock

¹⁷ As already noted, the average monthly salary in Bulgaria is about euro 130. When impose a concrete fine in the above range the FSC must take into account the type of guilt and other mitigating and aggravating facts in the specific case, as well as the incomes of the perpetrator.

¹⁸ This issue is discussed in more details in Part V of the report "Implementation and Enforcement" (see Footnote 67).

¹⁹ The BSE-Sofia so far is not involved in this process at all.

²⁰ Two years ago there was a case when it was obvious that the new foreign major owners of a big Bulgarian public company did not disclosed that they act in concert, in order to circumvent the mandatory tender offer requirement. In the investigative process the securities regulator, asked for assistance the home securities regulator of the foreign shareholders regarding data of the latter's connection as stipulated in the signed Memorandum of Understanding between the regulators. Eventually, the result of the investigation gave no ground for imposing sanctions. There is no doubt that this is not the only case of concealed major ownership and control.

²¹ In the 1995-2000 period the law provided for "immediate" disclosure of major events. However, in practice it proved to be very difficult for the securities regulator to enforce successfully such a broad term. Therefore, in 2000 it was specified in the Securities Law what exactly should mean "immediate". In this regard Bulgaria follows the timeliness standard of "2 business days" in the 2002 IOSCO Technical

exchange that immediate disclosure of material events from listed companies is critical for successfully combating insider dealings and market manipulation and fostering public confidence in the securities market.

48. The second requirement in the 3-staged ongoing disclosure framework (in effect as of December 2003) is that the quarterly reports of listed companies filed at the FSC and the stock exchange include all price-sensitive information events that have occurred in the preceding quarter. Third, the annual report updates of the information related to the listed company and contained in its prospectus or previous annual report. These requirements are aimed to provide the public on an ongoing basis with systematical material information about the listed company: after reading the annual report or the prospectus plus the last quarterly report the investor should be able to get an updated picture of the company that will let him make informed investment decision.

49. With respect to disclosure requirements of significant events in December 2003 Bulgaria has improved the modified general obligation approach: a broad definition of price-sensitive information was adopted²² plus a non-exclusive list of events, which are typically considered material.²³ In this way it is expected that two objectives shall be successfully pursued: first, the non-exclusive list of events shall prescribe to the companies the most usual material event and at the same time navigating them about similar events, which could be regarded material; second, the broad definition of price-sensitive information serves as general guideline and assures no material event to be left outside the disclosure requirements. A FSC's recent guideline has clarified that disclosure of significant events is required even there are uncertainties remained, but the later need to be expressly spelled out.

The law provides that the company shall disclose price-sensitive information simultaneously to the FSC and the stock exchange.²⁴ As already stated in this report, the FSC not only supervises in real time the disclosure process, by means of entering the

Committee Report "Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities".

²² Before December 2003 basically the same legal approach was used; however, there was no precise definition of price-sensitive information and the list of major events was much shorter. Price-sensitive information, as currently defined in the Bulgarian securities legislation is any information, which may arise in issuer's area of activity and which is not publicly known, if such information is likely to influence materially the exchange price of the admitted securities, due to its effect on the assets and liabilities, financial position or general business operations of the issuer. Before December 2003 the concept of price-sensitive information was the same, but broadly determined in the law.

²³ In order to facilitate compliance and enforcement the December 2003 legal provision attempts for the first time to give at least a guideline to the content of "materiality", stating that a fact (event, information, change, etc.) shall be considered "material" when: (i) it results in or is reasonably likely to have, now or in the future, a favorable or unfavorable effect amounting to 5 or more percents (or other expressly provided in the law minimum percentage threshold) of revenues, net income or other financial indicator of the listed company or the market price or value of its securities; and/or (ii) if there is a substantial likelihood that investors would consider it important in taking investment or voting decision.

²⁴ The law provides also that if the securities are admitted to trading on a regulated market abroad, the information shall be released on an identical basis and simultaneously in all jurisdictions.

disclosed information in its public register investors have a reliable source of the current status and the current material events regarding listed companies. However, it is important that the 2002 amendments of the Securities Law clarify that there is one primary source of price-sensitive information for investors: the stock exchange bulletin. The information may not be publicly announced by the FSC by means of its register and even by the listed company, before being publishing in the bulletin of the regulated market of securities. The idea was to be designated a centralized and close to the market participants “official” source of investment price-sensitive information (analogous to the State Gazette regarding legislative information). In case investors watch closely the stock exchange bulletin they could by sure they will miss no price-sensitive information and they will be among the first who learn it.

51. The 2002 Securities Law amendments also specify the procedure the stock exchange shall follow in disseminating the price-sensitive information. It is required that the stock exchange disseminates in an accessible for the investors way its daily bulletin with the price-sensitive information at latest one hour before the start of securities trading. Also, the stock exchange shall disseminate immediately in special issues of the daily bulletin this information, received after publishing the bulletin’s regular issue till the end of the trade with securities for the day.

52. It is worth noting that since 2002 the law expressly states that the price-sensitive information represents an inside information until it is publicly announced by the daily stock exchange bulletin. Therefore, it is clear that trading in securities by persons, who possess price-sensitive information for securities are prohibited to trade in these securities before this information is published. Heavy sanctions are provided for in the law for breaching this prohibition.²⁵

53. In contrast to the case with prospectus disclosure rules, the regulation on ongoing disclosure in Bulgaria does not exempt listed companies from immediate disclosure of material information, if such disclosure would be seriously detrimental to companies’ legitimate interests. However, analogous situations should be regulated under the same legal principles and the FSC has the power to interpret broadly the prospectus exemption rule as applicable accordingly to the ongoing disclosure process as well.²⁶

²⁵ The law goes further in regulating the disclosure process stating that the information to be disclosed in compliance with the ongoing disclosure obligation shall not be disclosed to selected investors or other interested parties before it is released to the public by the stock exchange in its daily bulletin. However, the information shall not be considered disclosed to selected investors or other interested parties, if it is communicated with advisers and rating agencies or, in the ordinary course of business, communications with persons with whom the issuer is negotiating, or intends to negotiate, a commercial, financial or investment transaction or representatives of its employees or trade unions acting on their behalf. In all these cases, the recipients of the information are obliged to keep the information confidential.

²⁶ Under the prospectus exemption rule the FSC may permit the exclusion from the prospectus of some material information, if its disclosure may cause damages to the listed company and this will not cause misleading of the investors in order making informed investment decision.

54. The 2002 Securities Law amendments expressly clarified that listed companies shall disclose timely material information, which shall be complete, true and non-misleading. Further, the December 2003 provisions more precisely than before stated that this information is required to be presented in an easily analysable and comprehensible form. The corporate governance programs, which are mandatory for all listed companies are intended to go beyond the corporate governance legal rules both in substance and procedures, and in particular, to contain procedures tailored for each company that should assure compliance with the disclosure requirements.²⁷

55. As discussed above the law designates a central role of the stock exchange in the ongoing disclosure process. BSE-Sofia promptly disseminates the information on material events provided by the companies. However, the extract of information, which is disseminated free of charge on the stock exchange website, is not always complete and meaningful enough. With respect to monitoring and enforcing public companies' disclosure failures, the Stock Exchange rules provide only for suspension of trading. It is relied again, as with the case of monitoring disclosure of major ownership, to the government regulator to enforce and penalize the violations of disclosure obligations. In fact, BSE-Sofia has fewer resources compared with the FSC to exercise monitoring and enforcement, but more importantly, it has no serious incentives to suspend trading, since no fees will be generated. Suspension of trading has also an undesired consequence; though it preserves investors from taking wrong uninformed decision to buy or sell shares, at the same time it unduly deprives shareholders of the possibility to cash their investments. Nevertheless, in principle the stock exchange could also play an important role in ensuring fair and orderly securities market, so BSE-Sofia might introduce in its rules other sanctions for companies that does not comply with disclosure rules, e.g. public exposure of their failure to report, as recommended in the White Paper.

56. Companies should disclose all relevant information material to an informed understanding and assessment of the company's business, activities and situation (Recommendations 176-180).

57. In December 2003 the FSC has taken pro-active policy regarding non-financial disclosure by adoption new prospectus legislation that provides for new format, structure

²⁷ According to the 2002 Securities Law amendments listed companies must introduce and implement programs for application of the internationally recognized standards for good corporate governance. The FSC has stated that these standards are the OECD Principles of Corporate Governance. The law requires the board to adopt such a program and to account for its implementation before the general meeting of shareholders. It is worth noting the program is an internal act of the company and its non-implementation is not backed with administrative penalties. However, an administrative violation is the non-disclosure before the general meeting the degree of implementation of the programme, or when there is no such program – the reasons why the program has not been prepared, or the reasons why the board has not been in compliance with the program and the measures, which the board shall undertake to comply in future with the programme, as well as a re-assessment of the programme and proposals for its change for improvement of the application of the standards for good corporate governance. The important inference is that for improvement of corporate governance practices it is relied not only to legal sanctions, but also to the effect of the pure disclosure.

and content of the prospectus, based on the new EU Prospectus Directive.²⁸ The later, on its side, has incorporated much from the IOSCO International Disclosure Standards.²⁹ Therefore, companies may tap the public capital market for equity financing only after disclosing non-financial information according to the recent EU standards and the best international practices. Information is disclosed initially in a prospectus, which is afterwards updated on an ongoing basis.

58. The upgrade of the Bulgarian legal framework on prospectuses is a radical step toward greater market transparency and unification with the rest of the world. At the same time, it is a kind of a challenge for the public companies to comply with the new disclosure requirements, which are more detailed and more demanding than the old ones.³⁰ The effort required from the vast majority of the public companies, which shares are traded at the unofficial stock exchange market, is significant, since so far they were not required by law to prepare prospectus and disclose annually detailed non-financial information.

59. Among other data, current non-financial disclosure requirements include the following: (i) names and addresses of the auditors for the preceding three years, as well as details if auditors have resigned, been removed or not been re-appointed; (ii) risk factors specific to the company or the industry where it transacts business; (iii) investments overview;³¹ (iv) business overview;³² (v) identification of the most significant trends in production, sales and inventory;³³ (vi) information of the issuer's prospects for at least the current financial year,³⁴ (vii) information about members of the

²⁸ Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC. Regarding the detailed content of the prospectus the FSC has considered the CESR's (Committee of European Securities Regulator's) documents Advice on Level 2 Implementing Measures for the Proposed Prospectus Directive and the Annexes of Technical Advice of April 2003.

²⁹ International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers, IOSCO, September 1998.

³⁰ An important part of the annual report of the listed companies is the update of the information in their prospectuses or previous annual reports, including the non-financial information. Listed companies have to prepare their annual reports for 2003 considering the new disclosure rules in effect as of 1 December 2003. The FSC has recently issued a guideline to facilitate companies to comply with the requirements.

³¹ The investment overview includes description of the company's principal capital expenditures and interests in other companies and information concerning the principal capital expenditures currently in progress and the method of financing.

³² The business overview includes description of the nature of the company's operations and its principal activities, the main categories of products sold and/or services performed for each of the last three financial years, indication of any significant new products and/or services that have been offered on the market, to the extent the development of new products or services has been publicly disclosed, the principal markets in which the company operates, including a breakdown of total revenues by category of activity and geographic market for each of the last three financial years.

³³ Here are discussed any known trends, uncertainties, demands, commitments or events in the current year that are reasonably likely to have a material effect on the company's net sales, income from continuing operations, profitability, liquidity or capital resources.

³⁴ Here should be included the principal assumptions upon which the company has based its forecast, estimate and prospect, the principal assumptions for each factor which could have a material effect on the

management and supervisory boards and senior management and employees upon whose work the company is dependent;³⁵ (viii) major shareholders;³⁶ (ix) related party transactions.³⁷

The respective responsibilities of the different company organs and the external auditors regarding disclosure should be clarified (Recommendations 181-190).

61. Although not expressly specified in the law it is in the competence of the board to set up internal systems for collection, elaboration and disclosure of information to shareholders, regulators and to the public as a whole. Depending on the dimensions of the listed company and its organization, its managers in different extent and according to their job descriptions and contract obligations toward the company control and/or participate in the process of collection, verification and disclosure of company's internal information. In practice, it is the company's chief accountant or financial director (when there is such a position) who are most actively involved in that process.

62. However, as in most other countries in transition, in practice the role and the functions of the board are not often well distinguished from these of the management,

achievement of the forecast. The assumptions should be: /a/ segregated between assumptions about factors which the management body could influence and assumptions about factors which are exclusively outside their influence; /b/ be presented plainly to investors; /c/ be specific and precise. There should be also a statement that said forecast has been properly prepared on the basis of the above assumptions and that the accounting practices are consistent with the accounting policies of the company.

³⁵ Here are presented the names, date of birth and duties of the board members, their principal business activities performed outside the issuing company, their relevant business experience, as well as any arrangement or understanding with major shareholders, customers, suppliers or others, pursuant to which they have been elected, respectively appointed. It shall be disclosed also the compensation for the last financial year paid to board members, including amounts paid and benefits in kind granted, and contingent or deferred compensation accrued for the year, even if the compensation is payable at a later date.

³⁶ Names of the shareholders holding 5 percent or more of each class of the company's voting shares, and the number of shares and the percentage of the total number of shares of the class; if there are no major shareholders, this fact shall be stated expressly; significant change in the number of shares held by each major shareholder during the past three years. Name of the person(s), who controls the company directly or indirectly, to the extent the company has information about such persons; brief description of the nature of such control, including the amount of voting shares held and the ratio of such shares to all voting shares.

³⁷ Information regarding transactions concluded between the company and the related parties for the period since the beginning of the first of the preceding three financial years up to the date, including the nature and extent of any transactions or currently proposed transactions which are material to the company or the related party, or any transactions that are unusual in their nature and/or conditions, to which the company or any of its subsidiaries are a party, as well as the amount of outstanding loans (including guarantees of any kind) made by the company or any of its parent or subsidiaries to or for the benefit of any of the related parties. Related parties are: /a/ persons that directly or indirectly through one or more companies, control or are controlled by, or are under common control with, the company; /b/ unconsolidated enterprises in which the company has a significant influence or which has significant influence over the company (associates); /c/ persons beneficially owning, directly or indirectly 5% interest or more in the voting power of the company; /d/ members of the management and supervisory boards and senior management, as well as close members of such individuals' families; /e/ enterprises, which are controlled by any person described in /c/ or /d/ or over which such a person is able to exercise significant influence.

especially with respect to Securities Law requirements. In order to assist companies in implementing the law and developing sound and corporate governance practices, the securities regulator has adopted in October 2002 (3 months after the major amendment of the Securities law) a Corporate Governance Manual, which clarifies the differences between the board of directors and the company's management.³⁸

63. Usually managers and other senior staff are employees on the grounds of labor contract with the company. For material omissions or misstatements regarding the disclosed information they may be held liable before the company according to the rules of the Labor Code.

64. Board members are responsible for the reliability of the information in external relationships before shareholders, institutions and other third parties. As of 2002, board members are jointly and severally liable for damages, caused by untrue, misleading or incomplete data in the periodic reports and major events notifications (before that this liability was provided for only with respect to prospectus disclosure).³⁹ Also, board members are jointly responsible with the chief accountant for damages, caused by untrue, misleading or incomplete data in the financial statements of the company, as well as with the auditor regarding damages, caused by the audited financial statements. In addition, the law provides for administrative liability of the board members for disclosure of untrue, misleading or incomplete information.⁴⁰

65. The above-discussed division of the type of legal liability for violation of the disclosure provisions of the law, i.e. labor liability for employees, on the one side, and civil and administrative liability for board members, on the other side, is well illustrated by the following example. According to the Securities Law the investor relations officer, who is an employee, is not subject to administrative liability for breaching his duties to file timely and complete reports and other disclosure documents with the FSC and the stock exchange. Instead, the Securities Law provides that in such case the board members shall be fined for violating their duty to supervise the investor relations officer.

66. The IFAL provides that the external auditors express independent opinion on the authenticity of the financial statements in all their essential aspects. The formation and presentation of the independent audit opinion shall be made in accordance with the International Audit Standards. The Audit Law requires full independence of the auditor from the company's board, management and controlling shareholders.⁴¹ Also, it is

³⁸ This Corporate Governance Manual has been prepared with the technical assistance of USAID.

³⁹ Although the companies' executive directors sign the disclosure documents and declare that the information is true, complete and non-misleading the joint and several liability of the board members implies that these documents should be approved at a board meeting.

⁴⁰ The Criminal Code provides for criminal liability in case of use of untrue information in a prospectus or similar disclosure document in relation with public offering of securities. However, this provision has not been applied in practice so far.

⁴¹ In particular, the Audit Law provides for the principles that bind auditors, which include: (i) independence – non-alignment of auditors, also through their partners and personnel, with the company

expressly prohibited for an auditor to perform an audit to a company in the following cases: (i) if s/he has signed labor contract with the company; (ii) if s/he is related person to the company; (iii) if s/he is directly or indirectly bound with or participate in dealings with the company and these dealings violate his/her independence as auditor or cause conflict of interests; (iv) if s/he is engaged with accounting services on the current financial statements of the company or participates in taking managing decisions on the financial statements, or provides services related to the evaluation of assets for the purposes of the financial statements of the company.

67. Bulgarian Commercial Law provides that company's board shall approve, together with the annual financial statements, a report (MD&A) which briefly describes the company's activity in the last year and explains its financial statements. The 2003 amendments of the Commercial Law envisage that boards shall provide in the MD&A also additional non-financial information about the following: (i) total remuneration of board members received during the last year; (ii) acquired, possessed and transferred stocks and bonds of the company by the board members during the year; (iii) stock options owned by board members; (iv) board members participation in other companies as general partners, board members or senior managers or possession of more than 25 percent of the capital of another company; (v) related party transactions with participation of board member concluded during the year; (vi) brief indication of planned economic policy for the next year⁴².

68. The new Commercial Law requirements about the content of the annual report makes it partially resemble a disclosure document under the Securities Law; though, the latter's non-financial disclosure requirements are much more detailed and specific. Securities Law remains more specific also in regulating the core part of the MD&A, i.e. the requirements for explanation of the annual financial statements (in fact the Commercial Law, as well as the Accountancy Law, do not regulate this matter at all). As of December 2003 the securities legislation requires that the MD&A shall give a narrative understandable explanation, in reasonable details, of the financial statements and to contain, in particular: (i) a truthful presentation about the development of the activity and the status of the enterprise, as well as about its future development, including information about the liquidity,⁴³ capital resources⁴⁴ and results of operation⁴⁵; (ii) major events

subject to audit, its managers or related persons in material, personal or any other aspect; (ii) objectivity, impartiality and absence of bias, conflict of interest or other influence, which may compromise the real judgement of the auditor.

⁴² It shall include information about the expected investments and development of the personnel, the expected revenue from investments and development of the company, as well as the forthcoming transactions of substantial importance for the activity of the company.

⁴³ In particular, there should be an identification of any trends, events or uncertainties that will result in or that are reasonably likely to result in the company's liquidity increasing or decreasing in any material way. If a material deficiency is identified, there should be an indication of the course of action that the company has taken or proposes to take to remedy the deficiency. Also, an identification and separate description of the internal and external sources of liquidity and a brief discussion of any material unused sources of liquid assets.

occurring after the balance sheet data; (iii) material research and the scientific development activities; (iv) changes in the price of company's shares; (v) any other information as decided by the company itself.

69. Board members of the audited company are required by the Audit Law to provide full cooperation and any information requested from the auditor. The auditor has also the right to supervise the process of stocktaking of assets and liabilities of the audited company. Board members, who provide false or misleading information to an auditor, commit criminal offence only if they do this knowingly, with the purpose of frustrating the establishment of tax liabilities amounting to over 3000 leva (equal approximately to euro 1500).⁴⁶ It is also a criminal offence when an auditor knowingly endorses untrue annual financial statements.⁴⁷ Auditors bear financial liability for the damages incurred to their clients (audited companies), whenever these damages arise directly or indirectly from auditors' willful acts or omissions.

70. Securities regulators and stock exchanges should strengthen their monitoring of companies' compliance with disclosure requirements. Securities regulators should have the capacity to prescribe and enforce these requirements (Recommendations 190-195).

⁴⁴ With respect to capital resources the MD&A is required to contain: (a) a description of the company's material commitments for capital expenditures as of the end of the latest fiscal period; (b) an indication of the general purpose of such commitments and the anticipated source of funds needed to fulfill the commitments; (c) description of any material trends, favorable or unfavorable in the company's capital resources; (d) an indication of any expected material changes in the mix and relative cost of such resources; (e) consideration of any changes between equity, debt and any off-balance sheet financing arrangements.

⁴⁵ More specifically, the following information should be provided for in the MD&A regarding the company's results of operations: (a) a description of any unusual or infrequent events or transactions or any significant economic changes that materially affected the amount of reported income from continuing operations; (b) an indication in each case of the extent to which the income was so affected; (c) a description of any other significant components of revenues or expenses that in the management's judgment should be described in order to understand the company's results of operations; (d) a description of any trends or uncertainties that have had or that the management reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations; (e) disclosure of the change in the relationship between the costs and revenues (such as future increases in costs of labor or materials or price increases or inventory adjustments), if the management knows of events that will cause changes in the relationship; (f) disclosure of increases in net sales or revenues and discussion of the extent to which such increases are attributable to increases in prices or to increases in volume or amounts of goods or services being sold or to the introduction of new products or services; (g) discussion of the material impact of inflation and changing prices on the company's net sales and revenues and on income from continuing operations for the most recent fiscal years.

⁴⁶ The punishment provided for in the Criminal Code is imprisonment of one to five years and a fine of one thousand to five thousand levs. However, only an isolated case is criminalized. Therefore, the current Bulgarian Criminal Code meets only partially (and quite insufficiently) the recommendation of the White Paper that board members should be deemed to have committed a criminal offence in all cases they provide false or misleading information to the auditor, even when they do this recklessly.

⁴⁷ The punishment provided for in the Criminal Code is imprisonment of up to one year and a fine of up to five hundred levs, as well as revocation of right to carry out audits. It could be recommended that the auditor should be criminally liable for endorsement of untrue financial statements in all cases, including interim financial statements, when the latter is ordered by the company or is required specifically by law.

71. Ensuring market transparency is a main function and goal of the FSC as well as a prime objective of the Securities Law.⁴⁸ Most of the FSC's powers could be used as instruments for increasing market transparency. First, the FSC has adopted an ordinance for implementation and elaboration of the disclosure principles set forth in the law. As noted above, the current disclosure requirements in the Securities Law and the FSC's ordinance are in full compliance with the best international disclosure practices. Also, the FSC has already issued guidelines on the proper implementation of that ordinance. Second, although the primary source of disclosed information is the stock exchange, the FSC's public register serves as an additional medium for public dissemination of the information received from companies and major shareholders. Third, the FSC monitors the information disclosed from companies and other obliged persons and has broad enforcement powers to require complete and accurate disclosure when necessary.⁴⁹ Finally, as pointed out above the FSC has the power to impose heavy fines for violation of the disclosure obligations.

72. There is a notable trend of increasing the monitoring and enforcement activity of the securities regulator regarding disclosure in the last few years: while the number of public companies is gradually decreasing due to going private actions, the number of compulsory measures and penalties imposed increases. The latter fact definitely does not mean that currently companies breach the law more often than before. The most often disclosure violations are not meeting the deadline for filing annual and interim companies' reports, as well as the minutes from the general meeting of shareholders at the securities regulator and/or at the stock exchange, as well as incompleteness in the financial and non-financial part of the companies' reports.⁵⁰ The FSC penalizes the companies that violate

⁴⁸ The Law on the Financial Supervision Commission states that in pursuing its functions and powers the FSC shall be governed by the goals to protect the interests of the investors and assure stability, *transparency* and public confidence in the financial markets. In addition, the Securities Law states that its own goals are: (i) to ensure that the interests of the *investors* in securities are protected, including by creation of *conditions for increase of their information about the securities market*; (ii) to create conditions for development of a fair, *transparent* and effective securities market; and (iii) to maintain the stability and of the public confidence in the securities market.

⁴⁹ In case of a legal violation or when otherwise the interests of investors are jeopardized the FSC may issue a compulsory order to companies and their major shareholders obligating them to undertake measures in a specified period, which the regulator considers necessary for prevention and removal of the violation incurred or the harmful consequences from the violation, or of the threat to the interests of the investors. A usual practice is the FSC to issue such a compulsory order requiring companies to eliminate omissions and correct deficiencies in the disclosed information, or to file at the FSC the due periodic reports. The regulator may also use other type of compulsory measures in case of non-disclosure or poor disclosure, if considered appropriate, e.g. to inform the public about the company's activity, which threatens the interests of the investors (i.e. the lack of sufficient disclosure); to suspend for a period of up to 6 months or stop completely the trading of a securities issue; to refuse the issuance of confirmation of prospectus for a new issue of securities.

⁵⁰ As laid down in the former Securities Commission annual report for 2002 and in the first FSC's annual report for 2003. In 2002 the FSC has required 93 companies to file (after breaching the deadline) or to remove incompleteness in their annual disclosure reports, and in 2003 the number of companies with deficiencies were 254. However, with respect to the interim report there is no such increase: the FSC issued compulsory measures or send letters for filing or completing their interim reports to 74 companies in 2002

the law; however, these sanctions are not final, since they are appealable before the court.

73. So far the big number of the above rude and easy for establishment violations occupy to great degree the FSC staff's attention; therefore, less time and efforts remain for dealing with sophisticated violations like misleading or untrue information in the reports. In the same line of thoughts, in 2002 the FSC found 13 persons failing to disclose their major ownership, since it was reported by the Central Depository. However, nobody could tell the number of non-disclosed indirect (beneficial) major ownership cases, but market participants estimate it as considerable. However, it could be expected that the currently prevailing rude offences will decrease in the coming years, as more companies go private and the remaining public companies become more diligent in fulfilling their legal obligations, backed with high penalties. Hence, the challenge before the FSC will shift toward ensuring improvement of the quality and reliability of the disclosed information. The later should be pursued not only by means of more active and profound investigative and enforcement work of the FSC, but also by continuously educating the companies, e.g. issuance of guidelines, organizing seminars, publication of FSC interpretations and decisions.⁵¹

74. The stock exchange is required by law to be the primary source for public dissemination of the information disclosed by listed companies (see item 50). However, BSE-Sofia still does not play an important role in monitoring this information. Its rules generally require listed companies to disclose the same informations as provided for in the law and the stock exchange mostly relies on the FSC to monitor the compliance with the disclosure obligations. The only enforcement measures the stock exchange may currently take against companies that fail to disclose the required information is temporary and permanent delisting. The later, as already noted, could penalize more innocent minority shareholders than the offenders. In fine, it is a policy issue for the FSC to initiate more active role of the stock exchange in monitoring the disclosure process. Thus, the FSC could be partly unburdened and the combined efforts of the capital market institutions should be a prerequisite for better monitoring and enforcement of the disclosure requirements.

75. Shareholders' access to information needs to be enhanced, through the use of efficient and modern communication by companies as well as authorities (Recommendations 196-200).

76. The Securities Law provides for timely, easy and cheap investors' access to disclosed information, although the way they are implemented should be improved. The legal idea that investors will get an easy and cheap access to information by means of the daily stock exchange bulletin and from the FSC's register is not completely achieved for the moment. The centralized channel of disclosed information through the stock exchange is an effective measure for assuring simultaneous access to all shareholders and investors to

and nearly the same figure in 2003. Also, in 2003 the FSC found 15 offences of delayed disclosure notifications for major events.

⁵¹ A good example is the seminar for public companies and market participants explaining the new disclosure obligations recently organized by the FSC.

the same public information. However, currently investors have free online access only to the news section at the BSE-Sofia website, which contains only an abstract from the disclosed information by listed companies. The daily bulletin with the full information is a paid service which costs more than what a typical small investor and the general public could afford.⁵² Whether the disclosed information is publicly disseminated through the daily bulletin or through the news section of the stock exchange is a technical device issue; however, what really matters is that all investors should have free online access to the full disclosed information by the listed companies.

77. The information in the public register kept by the FSC is free. Important part of the publicly disclosed information, e.g. companies' financial statements, prospectuses, board members, major shareholders (owning 5% and more of the voting shares) is also available online, which highly facilitates investors. However, not all of the non-financial part of the annual reports and of the notifications for major events could be reached online. Efforts should be made so that all hard copy information contained in the register to be available online, as in this way truly wide and easy public dissemination of information will be achieved.

78. In order to avoid duplication and to achieve optimal utilization of capital market institutions' scarce resources, the new disclosure securities legislation as of December 2003 provides for unified disclosure electronic system, established and maintained by the FSC, the stock exchange and the Central Depository. This unified system is intended to contain all the information required by the Securities law to be disclosed, including the major shareholdings.⁵³ Such a system will be a major step toward upgrading market transparency, since it will provide investors and the public at large with centralized channel of all the information disclosed by the listed companies in an easy, free and timely manner. In addition, the integrated system will also facilitate to a large extent listed companies to file electronically at one place the information required to be disclosed.⁵⁴ The integrated disclosure electronic system is currently under construction and is expected to be finalized in the mid of this year.

79. Finally, shareholders and investors could receive the information disclosed by public companies through the investor relations officer. Communication is usually realized by phone, letters or in person at the company's headquarters; sometimes by email. With very limited exceptions listed companies do not maintain websites with the disclosed information. The latter should be encouraged, since it will provide investors and the public with another reliable and easy access of information, thus improving the overall level of market transparency in the country.

⁵² See Footnote 15.

⁵³ It is not currently planned the unified system to be linked to the commercial court register. But practically it will contain the information entered into the court register, since the Securities Law disclosure requirements provide for this information to be entered into the public register kept by the FSC.

⁵⁴ Currently, listed companies are required to file hard copies of the disclosed information at the FSC and the stock exchange separately.

80. The regulation of the accounting and audit function should be strengthened (Recommendations 201-206).

81. According to the Independent Financial Audit Law⁵⁵ (Audit Law) the auditing profession is independent and self-regulated by the Institute of Certified Public Accountants of Bulgaria (ICPAB). The Audit Law requires that the ICPAB regulates the performance of the profession in the interest of the whole society. Liability of registered auditors is unlimited, but until now there have been no legal cases against auditors. Auditors are required by law to take out professional indemnity insurance and the ICPAB is required to determine the minimum amount of such insurance.⁵⁶ ICPAB is authorized to impose sanctions for auditor's misconduct and violations. These sanctions can be pecuniary (varying from 300 to 3,000 BGN⁵⁷) or administrative (individuals can be barred from auditing for a period up to three years).

82. There have been attempts to establish a governmental regulatory body for auditor oversight. These attempts have been unsuccessful due to the widespread understanding within the profession that it should be independent, including independent from government supervision. So far, no major scandal resulting from financial reporting failure has occurred in Bulgaria to bring argument for establishment of auditor oversight body independent from the audit profession, as is highly recommended by the IOSCO "Principles for Auditor Oversight" (2002). However, it will be prudent for the government to take into account the weaknesses of the pure self-regulation discovered in other countries and to initiate public discussion about the optimal for the country system of auditor oversight.

83. There is no particular regulatory body for the accounting profession as well. The requirements for practicing the profession are set up in the Accountancy Law⁵⁸. Sanctions are imposed by the tax authorities.

84. The quality and strength of professional organizations of accountants and auditors should be significantly reinforced (Recommendations 207-211).

85. The Law requires from ICPAB to perform a wide variety of activities including specific regulatory functions since it is recognized as a self-regulatory body for the auditing profession. More specific the ICPAB should: organize and conduct professional examinations; register auditors, maintain and publish special registers of auditors (individual persons and specialized audit firms); organize training for auditors; approve internal control systems of members' activity and compliance with professional ethical

⁵⁵ Enacted since the beginning of 2002.

⁵⁶ For the moment 10,000 BGN (around EU5,000).

⁵⁷ Around EU150-1500.

⁵⁸ The first Accountancy Law was adopted in 1991. A new Accountancy Law was enacted in 2002.

standards; develop a professional code of ethics for its members; develop, if necessary, professional audit rules and techniques; control the quality of audit activity and professional conduct of its members.

86. The IFAL requires that the ICPAB professional code of ethics should be based on the International Federation of Accountants (IFAC) Code of Ethics. The Law also requires that the following ethical principles should guide the auditor: independence, objectivity, professional competence (including knowledge of IAS and ISA), confidentiality, professional conduct, integrity, responsibility, and knowledge and implementation of the professional standards. The ICPAB has approved Rules for Quality Assurance of the Auditors' Work and adopted an external quality control review program whereby all members of the ICPAB will be inspected every three years.

87. The IFAL complies with the EU Eighth Directive by requiring that an auditor should have:

- higher education;
- four to ten years practical experience of accounting, internal and external financial audit, and tax administration (including at least three years as an assistant auditor);
- passed the ICPAB examination on accounting, commercial law, independent financial audit, taxation, and social security.

88. ICPAB requires that its members should participate in a minimum of 40 hours per year of continuing professional education (CPE). The ICPAB has established CPE programs that it also operates. The ICPAB indicated that it would impose sanctions on members who fail to comply. Facing the introduction of the IAS and ISA the ICPAB has organized training programs and examinations in this regard.

89. Despite of the high standards required actual education of auditors and accountants is not free of deficiencies at this stage. Universities have just started adapting their curriculum to the requirements of the new laws. There is a lack of IAS training materials in Bulgarian language. Training courses for ISA and IAS for auditors have been relatively short – only 60 hours, which is not sufficient to guarantee that auditors are fully proficient in IAS and capable of carrying out an audit in accordance with ISA.

90. While ICPAB is a self-regulatory body for the auditing profession, professional organizations of accountants have very limited scope of activity. Currently they are involved mostly in short educational IAS courses. The Institute of Professional Accountants has started in 2003 to certify internal auditors.

91. The independence of auditors should be reinforced by adequate regulatory provisions and effective monitoring (Recommendations 212-217).

92. According to the Accountancy Law the financial statements of a large group of enterprises should pass an independent audit by a certified public accountant (registered

auditor).⁵⁹ This group includes: issuers of securities to the public, joint stock companies (i.e., unlisted), partnerships limited by shares, banking and non banking financial institutions (i.e., unlisted), large enterprises that prepare consolidated financial statements (i.e., unlisted), large enterprises (i.e., unlisted).⁶⁰

93. Auditors are obliged to comply with the ISA, with the Professional Code of ICPAB and to give an account of their activity to ICPAB. In particular, they have to be independent from the audited company although the legal concept of independence is relatively narrow. First, the Audit Law broadly defines the principle of independence: non-alignment of the auditor, including through its partners and personnel, with the audited company, its managers or related persons related to them in material, personal or *any other aspect* (see also item 66). On the other hand, the Law explicitly specifies when an auditor can not be considered as being independent. These are the situations when the auditor has financial interest in the company (defined as possession of securities or participation in its operations), when the auditor participates in the governing bodies of the company, when the auditor has relatives among the members of the governing bodies or when there is a court case between the auditor and the company. In fine, the Audit Law's attempt to establish general all-catching definition of auditor's independence is precluded by the limitative enumeration of few situations where the Law finds to exist lack of independence.

94. Some of the independence safeguards recommended by the White Paper are in place like the separation of auditing from other advisory services. Others are not explicitly stated in the Audit Law and typically are not a common practice. These include mandatory rotation of auditors, restrictions on the employment of auditors by their former clients, publicly disclosure of auditors' fees.

95. An effort should be made to develop the training of accountants and auditors, as well as officials concerned in the regulatory bodies and the government. This should constitute a priority for international technical assistance (Recommendations 218-221).

96. A special committee under the Ministry of Finance, which includes representatives of international accounting firms and Academia, has been established to translate IAS. The ISA have also been translated in Bulgarian.

97. It was clearly understood by the state authorities and the Institute of Certified Public Accountants that introducing the full IAS application as of 2003 for listed companies and financial institutions will be a great challenge, especially for small companies, which became public because of the mass privatization. Therefore, in 2001 started various training programmes on IAS organized by the ICPAB with the technical assistance and

⁵⁹ All auditors are certified and registered by ICPAB.

⁶⁰ A large enterprise is defined as an enterprise, which exceeds at least two of the following three limits: assets of 500 thousand BGN, net revenue of 1 mln. BGN or 30 employees. (1EU=1.95583 BGN).

sponsorship of USAID and the Fulbright Foundation. Till the end of 2002 all auditors have attended the IAS training; moreover, 570 auditors have passed exams and received certificate to be trainers in IAS. The Ministry of Finance together with the ICPAB has organized courses for the Tax Administration.

98. In 2003 the training programs of the Institute of Certified Public Accountants extended their scope and were addressed to a broader audience: companies' accountants, managers and other interested persons. Because of the large demand based on the legal requirements⁶¹ courses for accountants were organized by other licenced institutions as well (usually auditing companies). Since the law doesn't specify any requirements for the organization of such courses a significant variation in their quality was observed.

99. Another priority of the USAID technical assistance was training in IAS for securities regulator's staff, as well as for listed companies' and financial institutions' accountants. However, still much efforts are needed for improvement of the overall IAS understanding and their accurate application, so training shall be an ongoing process.

100. More generally, it is also well recognized that the insufficient knowledge in best disclosure practices both of the regulator's staff and the companies is a serious obstacle for considerable improvement of market transparency. Again, USAID provided valuable assistance in drafting disclosure regulations and organizing seminars for listed companies and market participants. In the same line, during the last few years the securities regulator has also much benefited from disclosure training programs supported by other donors like the British Know-How Fund and the German Society for the development of the Capital markets in Central and East Europe.

101. The role of the media in the dissemination of company information and in promoting global transparency in business practices needs to be strengthened and supported (Recommendations 222-225).

102. Currently there is a well-established pool of media, which are capable of reflecting the business news at company level with enough broad view and competency. These are mostly specialized newspapers and shows on the electronic media, which are business oriented. There are also rather active web sites. To a much lesser extent deep analysis and good understanding is available in the media with general orientation although they enjoy much wider audience.

103. At this stage in general there is no active and systematic cooperation between public companies and media. Dissemination of information by companies through media varies a lot as a practice and usually is ad hoc. The quality of company analyses in general media varies a lot as well. The independence of the analyses from certain business

⁶¹ The Accountancy Law requires all accountants should possess a certificate for training in IAS.

interests is not always available. There haven't been significant cases when journalists have been sanctioned for false business information⁶².

104. Journalists' qualifications are usually a personal question and a matter for the relevant media. There have been training seminars for journalists organized with the support of international donors⁶³ but this is not a wide spread form of education and a lot more could be done in this area.

⁶² Although there have been cases of sanctioned journalists for their publications in the field of politics and in the field of legislative system.

⁶³ For example one of the most influential non-government organizations in the country – the Center for the Study of Democracy, has organized training seminars for journalists for the principles and practices in the field of corporate governance.

5. IMPLEMENTATION AND ENFORCEMENT

The below discussion of how the Bulgarian corporate governance legal framework is implemented and enforced follows the respective recommendations of Chapter 5 in the White Paper.

105. The capacity of the judicial system to effectively deal with commercial disputes should be strengthened (Recommendations 289-292).

106. There is a widespread opinion in Bulgaria, as well as between various EU officials, politicians and commentators that the Bulgarian court system, like in most other SEE countries, as a whole does not work effectively.⁶⁴ The prevailing attitude is that courts are slow, uncertain and costly to use.

107. The grounds for the above situation are not unique for Bulgaria; rather, they are common for all the countries in transition and for some more developed countries as well. A fundamental reason among these grounds is the shortage of court system's resources, which leads simultaneously to overworking and insufficient compensation for judges and other court personal. Also, in the process of harmonization with the EU legal framework and with the establishment of new market economy relationships many new laws are transplanted from more developed economies, e.g. securities legislation. However, this new legislation is not easy to implement, especially in the first years after its adoption, since it is rather complex, often sound alien and ambiguous.

108. The major economic impact of the way corporate and securities law work in practice is well realized in Bulgaria. More specifically, it is obvious at this point that further improvement of corporate governance framework functioning will come predominantly not from introducing new laws or refining the existing ones, but rather from their proper implementation and enforcement. In the same vein, since these are ultimately court functions and responsibilities, it is recognized in all state levels that the reform of the judiciary is inevitable.

109. Actually, the judiciary reform has already commenced and its implementation is a current national priority.⁶⁵ Most of the measures recommended by the White Paper are more or less pursued. The idea of establishing specialized commercial courts is currently

⁶⁴ This assessment does not apply personally to any of the judges, prosecutors and other jurists or court personal with high professionalism and morale; it simply reflects the fact that the individual is just a link in the complex judicial mechanism and the later does not work smoothly and sometimes does not work at all.

⁶⁵ In 2001 the Government, after consulting the Supreme Court Council, adopted a National Strategy for the reform of the Bulgarian court system. The Strategy was updated in 2003. Based on profound analysis of the situation, it provides for concrete measures to face the problems, e.g. determination of time limits for finalizing court cases, mandatory trainings for young judges, in case of promotion of judges in higher court and for court personal, etc.

under analysis. Various training programs for magistrates on different aspects of the Bulgarian company law and EU law are organized repeatedly. Many court decisions are made public in legal magazines and codes, specialized web sites and, importantly, on the web sites of some courts.

110. However, the judicial reform is a long-term process and considerable results could not be expected soon. Adequate implementation of new, complex and not always clear market economy laws requires time and efforts for training, upgrading of qualification and accumulation of the necessary experience. The issue with insufficient resources for the judiciary and its critical reflections on the capacities and motivation of the magistrates could hardly be solved in a short-term period.⁶⁶ Although the Constitution proclaims the principle of full independence of the court system from the Parliament and from the government, most difficult seems to be the establishment of effective guarantees for such independence in practice, as well as of effective mechanisms to counter corruption.

111. Securities regulators in SEE countries should have the independence, resources, remedies and accountability necessary to oversee financial markets and self-regulatory organizations effectively (Recommendations 293-298).

112. The White Paper's observation that the national securities regulator is the first, and in many cases, last line of defense for shareholders' rights is completely true for Bulgaria. The FSC has a clear mandate in the law that its primary objectives are to protect the interests of investors and to preserve the public confidence in the securities market. Being far from perfect in carrying out its activity and having much room for improvement, still the FSC is perceived both by market participants and investors as considerably more effective in "policing" the capital market and enforcing the securities law than the courts.⁶⁷

113. The Securities Law arms the FSC as a securities regulator with considerable powers. Apart from licensing and monitoring at an ongoing basis the professional capital market participants,⁶⁸ the FSC have at its disposal effective enforcement powers like issuance of

⁶⁶ In this regard it should be noted the valuable technical and financial support for the judiciary provided from USAID and other donors.

⁶⁷ When providing the securities regulator with powers to impose heavy penalties, to issue stop orders and other compulsory measures the Bulgarian Parliament has realized that initially investor protection will depend primary on the capacities of the administrative agency rather than on the court. The securities regulator has a clear advantage to be more competent of capital market issues than judges, more motivated to enforce the law and more operative in doing so. For the same reasons, it was considered that at the initial stage of establishment of the corporate governance legal framework its more effective enforcement will be guaranteed by means of severe administrative liability and compulsory measures imposed by the securities regulator rather than by criminalizing the securities and corporate law wrongdoings and leaving the enforcement exclusively in the hands of the public prosecutors and the penal court.

⁶⁸ With the 2002 amendments of the Securities Law related to establishment of the unified non-banking regulator, the FSC, as a reaction to some inadequate court decisions, it was provided that the regulator's judgment to reject granting a license or to revoke a license granted shall not be subject to court appeal.

binding preventive or restoring compulsory orders and other compulsory administrative measures.⁶⁹ These measures are imposed for breaching the law by supervised persons, but also in case the interests of investors are jeopardized or the supervisory functions of the regulator are hindered. The compulsory orders are subject to immediate execution regardless of whether they have been appealed before the court; however, the court could suspend execution except in the case of revocation of license.

114. In the last 3 years the securities regulator had imposed on listed companies' CEOs and boards a great number of compulsory orders. Most commonly listed companies were required: (i) to file periodic disclosure report at the FSC and/or at the BSE or to remove deficiencies in such report; (ii) to convene the annual general meeting of shareholders; (iii) to propose to the general meeting of shareholders not to vote for an illegal and/or detrimental for minority shareholders item in the agenda; (iv) not to accomplish an illegal decision of the general meeting of shareholders; (v) to recruit or substitute a person at the position of an Investor relations director; (vi) to list new shares issue at the BSE-Sofia⁷⁰; (vii) not to transfer assets; (viii) to pay due dividend to shareholders. The compulsory orders have proved to be so far exclusively effective as an enforcement tool: according to information from the FSC all compulsory orders imposed on listed companies have been complied with.

115. The FSC has been empowered also with significant investigative powers. With respect to supervised persons, as well as to other (non-supervised) persons, for which there are data that they have violated the Securities Law, the regulator's staff may require written explanations, documents, including official copies of documents, electronic data, etc. The regulator has free access to the office premises of these persons and may inspect their documents and books, establish their cash, valuables and other assets. The FSC may also conduct cross-references and require from third parties information, documents and other data necessary for the conduct of cross-references.⁷¹ Banks are obliged to provide information to the FSC about inspected entities' existing and closed bank accounts along with the date of the last transaction on these accounts.

116. Finally, the FSC is authorized by law to impose administrative fines, which are for the most offences in the range of 100-5000 euro. However, for some more severe

⁶⁹ Some specific compulsory measures provided for in the Securities Law are: (i) to determine the agenda and convene general meeting and/or to set a meeting of the Boards of supervised persons for taking necessary decisions; (ii) to inform the public about activity, threatening the interests of the investors; (iii) to suspend for a period of up to 6 months or stop completely the sale or the transactions with particular securities; (iv) to require a supervised person other than a listed company to dismiss one or more of its Board members and CEOs and revoke their managing and representing rights until being released; (v) to appoint an auditor to accomplish financial or other inspection to a supervised person at the expense of the later, according to requirements determined by the FSC.

⁷⁰ The Securities Law requires each new shares issue of a public company to be listed at the stock exchange.

⁷¹ The law also obliges the police, the prosecutor's office and other government bodies and officials to provide, within their powers, cooperation to the FSC in carrying out its supervisory functions.

violations of the law, e.g. of the legal requirement related to major transactions and related party transactions, as well as of the prohibition of insider dealing and market manipulation, the penalty is between 1000-25000 euro. In case of non-compliance with imposed compulsory order the fine is from 2500 to 10000 euro. In addition, the Securities Law provides for the possibility of imposing pecuniary sanction to legal entities for violations of its rules, separately from the fines of the concrete offenders natural persons. Generally, the amounts of the sanctions to the legal entities are double compared to the natural persons fines. When the FSC establishes offences, it regularly sanctions the guilty natural persons and often the legal entities as well. The statistics shows that the bulk of the securities regulator's fines and pecuniary sanctions have been challenged before the court and the later has confirmed, speaking in broad terms, around half of them.

117. However, it is well realized that without appropriate checks and balances a powerful securities regulator could become source of abuses with the potential to erode public confidence in the capital market and in state institutions as a whole. The Securities Law addresses these issues by containing provisions aimed at ensuring transparency and accountability of the regulator, as well as reducing conflicts of interests. First, the FSC is required to announce publicly its supervisory policy and its practice in implementing and enforcing the securities legislation, as well as the reasons for their change. In fact, the FCS announces publicly broader scope of its decisions than required: not only its practice (legal interpretations), guidelines on policy issues and draft regulations for public comment, but decisions on individual cases as well.

118. Second, on taking office the members of the FSC and its staff shall file a declaration about the property they own, including securities possessed by them or by their spouses and non-mature children. Afterwards, each securities transaction should be reported promptly and once per year the Commissioners and the staff should file updated property declarations.

119. Third, in order to limit the potential conflicts of interests, the Commissioners are restricted from any other paid-for activities, except research and teaching, or as members of international organizations in relation to the FSC's activities. Staff members are prohibited to work for a supervised entity. However, in case a conflict of interest arises, the Commissioners are required to disclose it without delay and are prohibited to participate in proceedings of discussion, voting or decision-making, when they hold interest in the outcome or have relations with interested supervised entities. The same rules apply to FSC staff members, which may not take part in an inspection of a supervised entity, if a conflict of interest exists.

120. One of the most important reasons for creation of unified regulator was to enhance regulator's independence. While the former securities, insurance and pensions regulators were elected and accountable before the government, the FSC has higher status – Commissioners are elected by the Parliament. Commissioners have 6 years staggered mandates and may not be removed pre-term except for few strictly defined

circumstances.⁷² Another implication of greater independence of the FSC relates to its budget, which is approved by the Parliament.⁷³ The FSC shall present to the Parliament an annual report for its activity, including annual financial statements and a statement for the budget implementation. In addition, the FSC is required, upon request, to present to the Parliament at any time information and documents related to its activities.

121. However, what hinders most the effective work of the FSC is, like in the case with the court system, the shortage of resources for the regulator. It is the opinion of the FSC's staff that the human and financial resources are insufficient for qualitative supervision.⁷⁴ In the last 5-6 years USAID and other international donors have organized and sponsored a great number of various training programs for the securities regulator.⁷⁵ However, though the salaries of the regulator's staff have always been relatively high for a state budgetary institution, most of the qualified and trained employees have joined the private sector tempted by higher income opportunities.

122. Shareholders should have access to effective redress mechanisms, including professional arbitration and low cost collective efforts (Recommendations 212-217).

123. In Bulgaria both individual and derivative lawsuits are possible. While the legal basis for individual court actions is in the general law on obligations (tort law), derivative lawsuits need special regulation. As of year 2000 the Securities Law entitles public company's shareholders owning separately or collectively 5 percent of the capital of the company with two types of shareholders derivative lawsuits. First, in case of inactivity of its managing bodies, which threatens the interests of the company, the shareholders may bring the court actions of the company against third persons. Second, the 5 percent shareholders may bring court action for indemnification of damages, caused to the company by actions or lack of action of the board members, as well as of the procurators of a public company.⁷⁶ Moreover, the 2002 amendments of the Securities law, following

⁷² These circumstances are: (i) if the Commissioner has been unable to perform its duties for more than 6 months; (ii) if he/she no longer meets the requirements for being elected at this positions; (iii) if he/she carries out the prohibited other paid-for activities; (iv) if they failed to participate in three of more subsequent meetings of the FSC without having a meritorious cause for that.

⁷³ The Council of Ministers may not change the draft budget of the FSC; it may only express its opinion on it before the Parliament.

⁷⁴ Often one staff member has to deal simultaneously with 4-5 cases. Shortage of financial resources dictates that on-site inspections, especially out of Sofia, to be accomplished not as often as necessary.

⁷⁵ Under the auspices of USAID in the last few years many Commissioners and employees of the securities regulator participated in different training programs (from 1 week to 1 year) in US: at the SEC, at several universities and other institutions. The British Know-How Fund and the German Society for the development of the Capital markets in Central and East Europe have organized seminars and other training programs for securities regulator's staff, both in Bulgaria and abroad (in London, at Frankfurt Stock Exchange and other).

⁷⁶ With respect to private joint-stock companies the Commercial Law provides also for the second type of derivative lawsuit against the board members, but entitles with it shareholders owning collectively or separately 10 percent of the capital of the company.

the German joint-stock company law, provided that controlling shareholders and any other persons, who with their influence on the public company has persuaded a board member or its procurator to act or to restrain from action not in the interest of the company, shall be jointly responsible for the damages, caused to the company.

124. As it was already commented, lawsuits involve much time, costs and efforts. Very important, the results from the lawsuits are unpredictable, moreover when there is no court practice at all. Having in mind the anticipated narrow view of court regarding what constitutes harm to minority shareholders, often it will be very difficult to prove damages, especially in individual lawsuits. Even if the shareholders win the court case against board members, then most probably there will be no way to collect the awarded damages. Therefore, not surprisingly, shareholders lawsuits are not popular in Bulgaria. There have been not more than 3-4 derivative suits initiated in the last few years. None of them has been announced to reach the phase of court ruling.

125. At present shareholders do not have alternative to courts dispute resolution mechanism. There is no professional arbitration in Bulgaria to settle disputes between companies and shareholders.⁷⁷ The main reason is not in the existence of legal obstacles for establishment of private binding arbitration, but rather in the fact that so far no real necessity for such arbitration has appeared. However, the idea of expanding the competence of the BSE-Sofia arbitration to cover disputes between listed companies and shareholders has its merits and deserves attention from capital market institutions and shareholders associations.

126. What could be at present an effective tool for minority shareholders protection is the power of the securities regulator, established with the 2002 Securities Law amendments, to file lawsuits on behalf of shareholders in case of some rude legal violations. More specifically, the regulator may bring claims for proclamation of the invalidity of transactions, related to the activity of the supervised entities, as well as for cancellation of a decision of the general meeting of a public company's shareholders, when it contradicts imperative provisions of the Securities Law or the company's Articles of Incorporation. Also, the securities regulator may appeal invalid entries in the commercial court register, e.g. related to public companies' capital, board members, transformation, etc. For the moment the FSC seems to prefer to "hold the gun loaded" and to use its claim-filing power as a last resort.

127. Active regional cooperation should be developed further between all the main actors in the corporate governance institutional framework. This regional

⁷⁷ The BSE-Sofia arbitration court has the authority over disputes arisen in connection with stock exchange transactions as well as other disputes regarding relationships regulated by the stock exchange rules. It is noteworthy that for more than 8 years after being established no claim has been filed at this arbitration court.

cooperation should be initiated regionally and supported by international organisations (Recommendations 304-307).

128. International cooperation is considered as one of the important areas for activity by all of the institutions related to the development of the capital market. In the context of the EU integration the FSC is putting efforts in active contacts and participation in international initiatives with the purpose to study the experience of countries with developed financial markets and to harmonize the legislative framework with the EU acquis. The FSC is a member of the International Organization of the Securities Commissions (IOSCO), The International Association of the Insurance Supervisors (IAIS) and of the International Network of the Pension Regulators and Supervisors (INPRS). The BSE-Sofia is member (or corresponding member) of the Federation of the Euro-Asian Stock Exchanges (FEAS), World Federation of Exchanges (WFE), Federation of the European Stock Exchanges (FESE).

129. Regional cooperation is in process of development as well. In 2000 the Bulgarian securities regulator has initiated the First Meeting of Capital Markets Regulators of SEE countries, which was held in Bulgaria. Later the Bulgarian regulator took the lead in signing a Memorandum of understanding and exchange of information with supervisory bodies from the region. The BSE-Sofia has intensive contacts with the stock exchanges in Croatia, Macedonia, Romania and the Thessalonica Stock Exchange in Greece. However, for the moment the regional cooperation is still at initial stage. Exchange of information, seminars and other initiatives have taken place but the cooperation hasn't reached yet the level of common training institutions, standards, licensing. Primarily regulative bodies are involved in the process and less is done by the professional associations.

130. The Roundtable should continue its work and review and support progress in the area of corporate governance and other related corporate sector issues (Recommendations 308-311).

131. The Roundtable has had significant impact on the ongoing process of corporate governance reform in Bulgaria. Regulatory changes, corporate governance code, training courses for directors and investors relations officers, seminars for journalists and other interested parties, manual for corporate governance have been influenced by the Roundtable process. A Corporate Governance Institute has been established. An annual award for best corporate governance has been established as well. The development and the implementation of a program for corporate governance complying with the OECD principles are legally required from all public companies. It is expected that the possible continuation of the Roundtable work could contribute even more, since important aspects of the corporate governance reform are still not completed.