20 YEARS

BULGARIAN BOOK-ENTRY GOVERNMENT SECURITIES

MINISTRY OF FINANCE

BULGARIAN NATIONAL BANK

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Ladies and Gentlemen,

The 3 of February 2012 marks the 20th anniversary of the first book-entry government securities auction conducted in the Republic of Bulgaria. On this occasion the Ministry of Finance and the Bulgarian National Bank present to the public a brief history of Ministry of Finance's issuing policy as an element of Bulgarian government's fiscal policy implemented over the past two decades.

The market of government debt instruments is the most significant market within the single securities market. Government securities are a key instrument and preferred investment alternative both for institutional and individual investors in all advanced market economies.

In Bulgaria government securities trade started in the early 1990s in the context of conducted social and economic reforms and in support of the Bulgarian government's intents to resolve the problems with the deficit and to smooth financial imbalances using internal resources.

In its 20-year history the market of book-entry government securities passed a long way and various stages of development. The circulation of first short-term book-entry government securities as a source to regularly raise funds required for financing the government budget deficits during the transition to a market economy was followed by a gradual diversification of the type, maturity and financial characteristics of debt instruments. In parallel, the legal framework has been continuously improved aimed at establishing a smoothly operating integrated financial market.

The issuing policy is now identified as a result of an overall fiscal policy aimed mainly at maintaining macroeconomic stability in Bulgaria and retaining the positive trends in Bulgaria's credit rating.

Simeon Djankov
Deputy Prime-Minister
and Minister of Finance

Ivan Iskrov
Governor
of the Bulgarian National Bank

CONTENTS

Abbreviations

BIR	Base Interest Rate
BGL	Bulgarian currency before the adoption of the Law on Redenomination of the Bulgarian Lev on 19 February 1999
BGN	Bulgarian currency after the adoption of the Law on Redenomination of the Bulgarian Lev on 19 February 1999
BNB	Bulgarian National Bank
CM	Council of Ministers
ECB	European Central Bank
ESROT	Electronic System for Registration and Trade in Government Securities
GSAS	Government Securities Auctions System
GSSS	Government Securities Settlement System
ISIN	International Securities Identification Number
LIBOR	London Interbank Offered Rate
MF	Ministry of Finance
SII	State Insurance Institute
SSB	State Savings Bank
ZUNK	The Bulgarian abbreviation of the Law on Settlement of Non-performing Credits Negotiated Prior to 31 December 1990

Section One
NATURE AND MAJOR CHARACTERISTICS OF GOVERNMENT SECURITIES: RISK-FREE, PROFITABLE AND LIQUID INVESTMENT

Modern investors in securities more often put the question how to invest their money in the safest and most profitable way under the conditions of financial instability. The experience suggests that the government, the largest securities issuer, is traditionally the best payer of amounts due on securities. Government securities are the major source of attracting borrowed funds required for covering the budget deficit. They are extensively used in market economies and are part of the domestic government debt.

Government securities are a specific form of lending, with the state being a credit borrower and the government an issuer. The group of creditors is practically unlimited and include commercial banks, insurance corporations, pension and investment funds, companies from various business sectors and natural persons investing temporarily their free funds in government securities.

Government securities are debt financial instruments, issued by the government for covering the borrowing requirements, and materialise the loans drawn and used by the central government sector for a particular period. Existence and circulation of government securities are mainly driven by the need to finance the budget deficit. In addition to covering the current budget deficit, government securities are also issued to repay the loans drawn, to guarantee the cash execution of the budget or to offset uneven tax revenue inflow.

Government securities are a direct obligation of the government and a major instrument for domestic government debt management. Government securities are a dominating financial market instrument due to their high liquidity and guaranteed payment by the government.

Being an immediate subject of trade in the financial market, government securities are quite diversified and could be hardly encompassed in full. However, all government securities have one major common feature: to generate income for their holders.

Section Two

TRANSITION TIMES

1. The Launch of Economic Reform in Bulgaria

The deep economic depression accompanying the transition from a centrally planned to a market economy under the conditions of slow macroeconomic structural changes, prevailingly unfavourable and continuously complicating external environment and limited foreign financing made the post-1989 fiscal policy in Bulgaria a major instrument for achieving financial stability. The problems associated with overcoming the financial imbalances in the complex macroeconomic environment, unstable external political conditions and Bulgaria's volatile social and economic development in the post-1989 period entailed resilient fiscal policy and predetermined its restrictive nature. The sizeable external debt, accumulated until 1991, delayed structural reform, and existing ineffective economic structures resulted primarily in shortfalls of expected revenue and higher budget deficit.

2. Major Sources of Budget Deficit Financing

2.1. Direct Budget Financing by the BNB

The dramatic external debt increase due to excessive attraction of foreign loans (primarily from the London Club and the Paris Club), intended to neutralise the factors seriously impeding national economy growth, brought forward the need of settling deficit problems by employing an economically grounded methods for using domestic resources in deficit financing.

The successful settlement of these issues required close coordination between the monetary policy pursued by the Bulgarian National Bank (BNB) and the government's fiscal policy, particularly in forecasts of the budget deficit amount and the forms of deficit financing which were basically split into two major groups:

- external financing including international operations;
- domestic financing in the form of loans from the BNB and government securities operations.

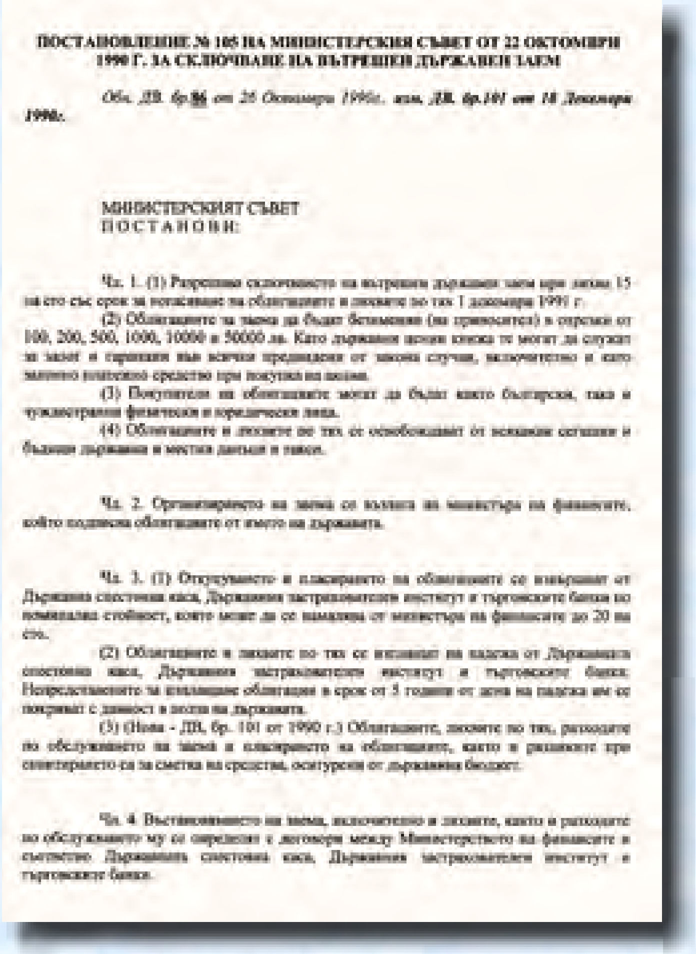
Dramatically increased budget deficit financing costs under the deteriorating financial markets tempted the government to monetise the larger share of the deficit exerting pressure on the BNB at that time to directly or indirectly finance the government deficit in the form of long-term and short-term loans up to the amounts provided for by the Republic of Bulgaria's State Budget Law for the respective year. Long-term loans were extended by the BNB by a decision of the Parliament or the Council of Ministers and short-term loans were disbursed to the government under Article 46 of the former Law on the BNB[1]. These loans were aimed at covering the temporary deficit of funds for the current implementation of the state budget and the term of repayment was up to 3 months but not later than the end of the current calendar year. By virtue of Article 48 of the same Law, the BNB may purchase and sell securities issued or guaranteed by the government which are part of a public issue.

2.2. Issue of Government Securities for Budget Deficit Financing – Conclusion of Domestic Government Loans and Issue of Physical Government Securities

Financing through government securities issues is most commonly used by the government to raise funds by using free resources in the financial system. This type of financing is preferred because this way the debt is distributed not only for a longer period but also on a broader base of investors that have different preferences as to the maturity and liquidity of the issues. Circulation of government debt instruments allows to accumulate cash and to manage liquidity and credit resources, and help establish a government debt secondary market which is a prerequisite for stronger demand and more effective debt management.

The sale of government securities in Bulgaria was launched with a 12-month bond loan concluded by the Ministry of Finance in 1990. The government bonds were issued as physical bonds. The CM Decree No. 105 of 22 December 1990 announced the conclusion of a domestic government loan in the form of bearer bonds with a term of securities redemption and interest payment on 1 December 1991. The bonds were purchased and sold by the State Savings Bank (SSB), the State Insurance Institute (SII) and commercial banks. Securities were sold both to residents and non-residents (natural persons and legal entities). Payment of bonds, including interest and service costs, was set by agreements concluded between the Ministry of Finance, on the one part, and the State Savings Bank, the State Insurance Institute and commercial banks, on the other part. Initially bonds were sold at a 20-per cent discount of the nominal value. To attract more investors a week after the Decree had been adopted, it was amended. The amendments provided for a one-off interest payment in the amount of 15 per cent of the nominal value upon maturity. Thus, the yield of the issue reached 43.75 per cent.

1 Published in Darjaven Vestnik, issue 50 of 25 June 1991; amended, issue 32 of 16 April 1996; repealed, issue 46 of 10 June 1997.



ПОСТАНОВЛЕНИЕ № 105 НА МИНИСТЕРСКИЯ СЪВЕТ ОТ 22 ОКТОМВРИ 1990 Г. ЗА СКЛЮЧВАНЕ НА ВЪТРЕШЕН ДЪРЖАВЕН ЗАЕМ

Обн. ДВ. бр.86 от 26 Октомври 1990г., изм. ДВ. бр.101 от 18 Декември 1990г.

МИНИСТЕРСКИЯТ СЪВЕТ
ПОСТАНОВИ:

Чл. 1. (1) [illegible]

(2) [illegible] 100, 200, 500, 1000, 10000 и 50000 лв. [illegible]

(3) [illegible]

(4) [illegible]

Чл. 2. [illegible]

Чл. 3. (1) [illegible]

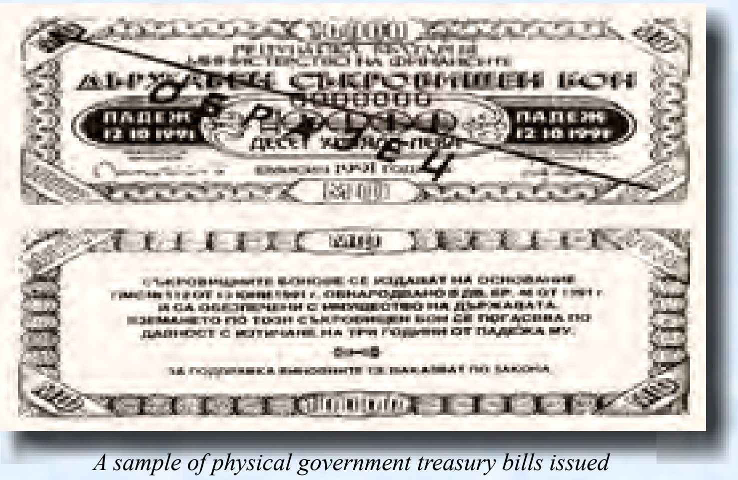
(2) [illegible]

(3) (Нова - ДВ, бр. 101 от 1990 г.) [illegible]

Чл. 4. [illegible]

Decree No. 105 of 22 October 1990 of the Council of Ministers on concluding a domestic government loan for sale of physical government bonds. The Decree established the procedure, manner and terms of distribution, sale and redemption of the bonds.

The agent in primary sale of government securities and their payment upon maturity was the SSB. The bulk of the securities was purchased by individuals. The securities of this issue were not subject to secondary market trade.



A sample of physical government treasury bills issued on the ground of Decree No. 112 of 13 June 1991 of the Council of Ministers on concluding short-term 91-day domestic government loans for budget deficit financing.

The 1991 State Budget Law for the first time provided for covering Bulgaria's budget deficit by direct loans from the BNB and by issues of government securities in a 50:50 proportion. Given the high inflationary expectations for 1991 and general market uncertainty, the Ministry of Finance issued mostly three-month government securities. To improve the current domestic debt management and to cover temporary gaps between state budget revenue and expenditure, as of early July the Ministry of Finance started issuing short-term government securities: treasury bills. CM Decree No. 112 of 13 June 1991 announced the conclusion of short-term 91-day domestic government loans for budget deficit financing. The Minister of Finance was assigned to organise the conclusion of loan agreements. The distribution, sale and redemption of securities was based on agreements concluded between the Minister of Finance or a person authorised by him, on the one part, and the Bulgarian National Bank, the State Savings Bank, the State Insurance Institute, commercial banks and Communications and Informatics Committee, on the other part. According to the agreements, bearer treasury bills were to be sold by purchase or on a commission basis: securities to be provided to selling financial institutions at the original price set through a discount from the nominal value, while their subsequent sale to other natural persons and legal entities was to be effected at a market price. The issue of bearer treasury bills was aimed at state budget deficit financing and encouraging the development of primary and secondary securities markets for servicing government debt. In 1991, 41.5 per cent of the budget deficit was financed by the net issue of treasury bills and 49.8 per cent by loans from the BNB.

A sample of nine-month physical government treasury bills issued on the ground of Decree No. 215 of 4 November 1991 of the Council of Ministers on concluding domestic government loans for budget deficit financing with a term of over three months.

With the adoption of CM Decree No. 215 of 4 November 1991, the Council of Ministers authorised the Minister of Finance to conclude domestic loans with a term of over three months. As of November 1991 the agreements on domestic government loans which were bearer securities (bills, bonds and treasury notes) issued by the Ministry of Finance were to be concluded with a term of three to ten years. In fact, the Decree did not change the organisation for concluding government loans and the terms and conditions of distribution, sale and redemption of securities. The Ministry of Finance, the BNB, the SSB, the SII and commercial banks remained the main market participants. Under the same Decree, in early 1992 the Ministry of Finance sold two three-month treasury bills issues with a total nominal value of BGL 1406 million at 13 per cent discount and in October and November the Ministry of Finance concluded agreements with the SSB for purchase and sale of one nine-month physical treasury bills issue and one three-year physical treasury bonds issue. The yield of these securities was in the form of a floating interest rate: the first two issues accrued interest equal to the base interest rate minus 1 percentage point and the second two issues accrued interest equal to the base interest rate plus 1 percentage point.

A sample of 3-month government treasury bills issued on the ground of Decree No. 215 of 4 November 1991 of the Council of Ministers on concluding domestic government loans for budget deficit financing with a term of over three months.

Physical issues were circulated until 1993. They were earmarked for individuals and sold through the branches of the SSB and commercial banks. By nature they were a document of materialised rights issued by the government and had all the features of a security. The securities were issued in a physical form and using a special technology the relevant requisites were printed on paper protected against counterfeiting. However, this type of government securities was poorer protected against counterfeiting and printing required huge costs provided by the government.

3. The First Issue of Book-entry Government Securities

3.1. The First Auction for Sale of Book-entry Government Securities

The practice in government securities trade showed the inconvenience of using the physical form of issuing government securities which made this activity much more expensive and hampered to some extent the active secondary market trade. This entailed to seek for and establish on the market a new form: book-entry government securities which exist as accounting and/or electronic records in programme systems certifying the ownership on them. They are characterised by low issuing costs, more convenient storage and higher security against counterfeiting.

In Bulgaria the issue and sale of securities of this type are a source of raising a significant amount of funds necessary to balance the government budget in the period of transition from centrally planned economy to freely regulated market economy.

The issue of book-entry government securities started in 1992 and the terms and conditions and procedure for issuing government securities were established by Ordinance No. 5 on the Issuance of Book-entry Government Securities and the Procedure for Acquisition and Redemption Thereof adopted by the Ministry of Finance and the BNB. This Ordinance established the procedure for concluding domestic government loans through issues of book-entry government securities with a term of up to one year. In accordance with the agreements between the Ministry of Finance and the BNB of February 1992, the BNB launched sales of book-entry government securities on behalf and for the account of the Ministry of Finance. Pursuant to this Ordinance, government securities sale was based on an auction principle. The Ordinance also provided for conducting two auctions monthly: on each first and third Monday of the month. Only short-term government securities with a term of three to nine months were offered. The yield was in the form of a discount and the Ministry of Finance announced a minimum acceptable selling price of securities.

The first auction of book-entry treasury bills was held on 3 February 1992. The securities available for sale were with a term of three months. The volume determined preliminary for sale by the Ministry of Finance amounted to BGL 500 million nominal value at minimum participation cost of BGL 87.00

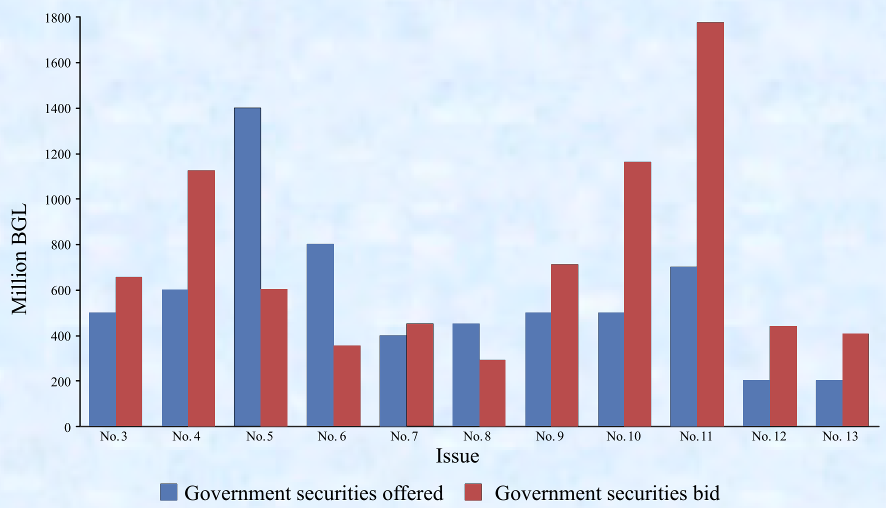
per BGL 100 nominal value. Twenty bids from 11 financial institutions totalling nominally BGL 655 million were received. Bids worth BGL 155 million remained unapproved with the average selling price of approved bids being BGL 87.48 per BGL 100 nominal value.

3.2. Introduction of Regular Issues of Book-entry Government Securities

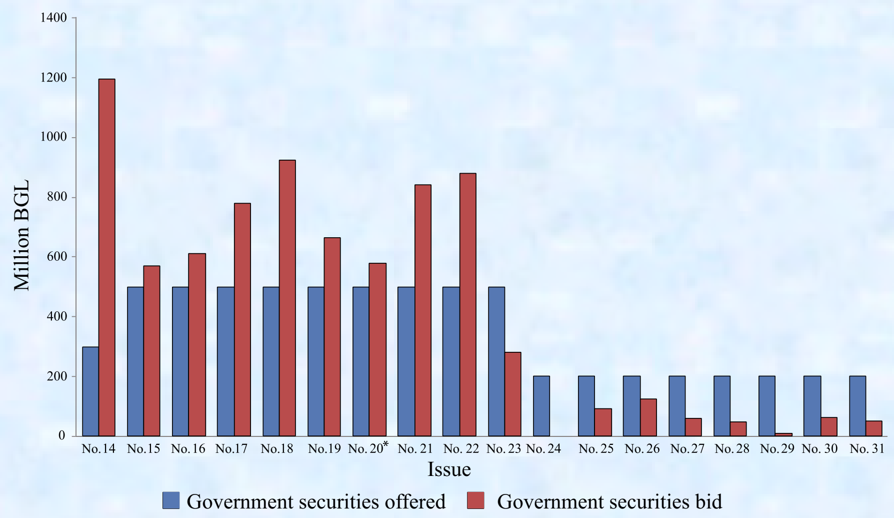
To reschedule government obligations for a longer period, as of July 1992 the Ministry of Finance started issuing six-month book-entry government treasury bills, and as of September the first issue of nine-month treasury bills was offered for sale. Over 1992, 29 issues of book-entry government securities were sold, including 11 issues of three-month treasury bills, 17 issues of six-month treasury bills and one issue of nine-month treasury bills totalling BGL 9879 million nominal value. Thirty financial institutions participated in the auctions conducted by the BNB.

The issues of short-term book-entry government securities sold throughout the year showed inconsistency and instability in the development of this market of debt instruments. The lack of an annual calendar of issues consistent with the current budget requirements, high selling prices offered by the Ministry of Finance, frequency of conducted auctions, saturation of government securities market in the absence of a secondary market for purchase and sale of government securities predetermined the low demand for government securities by financial institutions. They showed stronger interest in three-month treasury bills. As a result of the higher price and longer term to maturity, the demand for six-month bills was lower.

Three-month Treasury Bills Offered and Bid in 1992



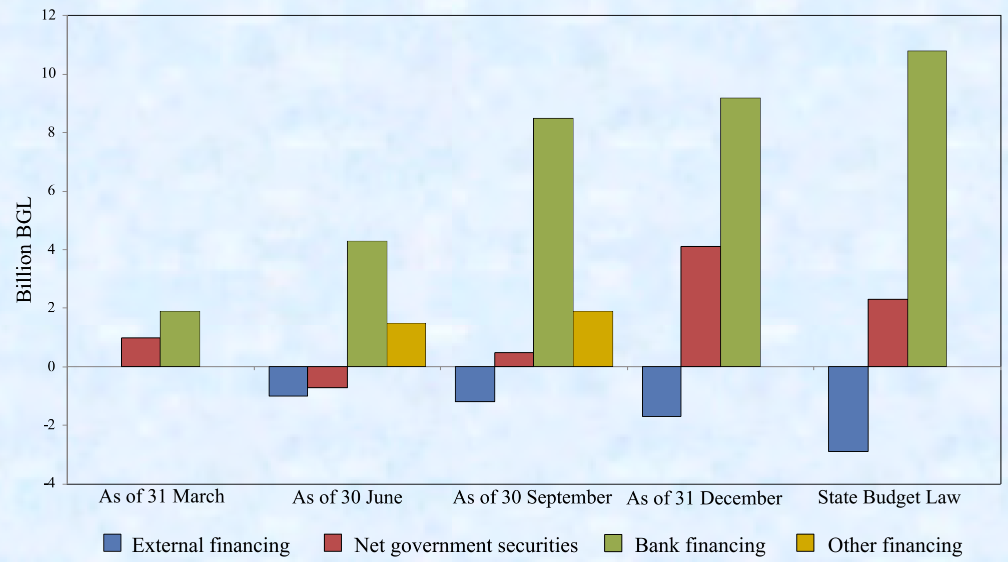
Six-month and Nine-month Treasury Bills Offered and Bid in 1992



** Issue of nine-month book-entry treasury bills.*

On a quarterly basis, the structure of net financing of the 1992 budget deficit changed.

Net Financing of the Budget Deficit in 1992



4. Transition Issues

Since its emergence in 1990, the government securities market in Bulgaria experienced significant changes and its development was accompanied with the government's initiation of a number of transactions driven by the need to rapidly accumulate sizeable financial resources for covering general borrowing requirements for financing public expenditure. Dramatically increasing government borrowing requirements and assumption of sizeable deficits of the real and banking sectors by the government during the first years of transition to a market economy prompted the employment of a great variety of debt instruments the issue of which satisfied to the maximum extent the government borrowing requirements and the needs and requirements of individual investor groups, participants in the government securities market.

Under the conditions of deepening financial imbalances and the need of timely provision of resources to finance sizeable expenditure unevenly distributed in time, the Ministry of Finance issuing policy focused on the use of the following major types of debt instruments:

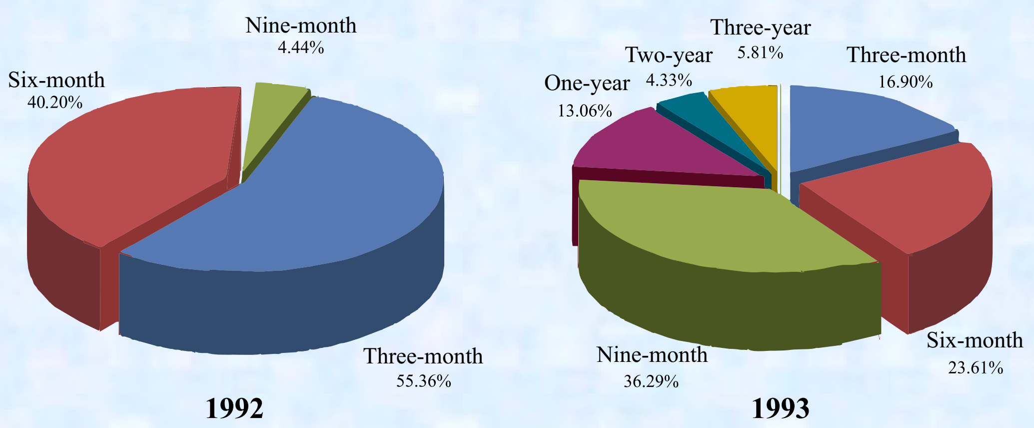
- government securities for budget deficit financing;
- government securities targeted at individual investors (called target government securities);
- government securities issued for structural reform to ease the banking system from the non-performing loans of state enterprises;
- guarantee government securities issued to address the consequences of the insolvency of 15 commercial banks.

4.1. Government Securities for Budget Deficit Financing

Since 1990 government securities have been regularly used for financing of Bulgaria's state budget financing. The volume of issues is determined annually by the State Budget Law of the Republic of Bulgaria as part of the domestic financing of the budget, and the types of instruments to be used are determined by the policy of the Ministry of Finance. Since its establishment, the government securities market has progressively strengthening its role as an instrument for budget deficit financing. In 1992 just 30 per cent of the deficit was funded by government securities issues, while in 1993 this share increased to 72 per cent and in 1995 the deficit was entirely funded by government securities issues. In 1996 the trend reversed when at the close of the year the revised budget deficit was partly financed by a direct loan from the BNB. With the launch of the currency board arrangements, government securities retained their role of a dominating instrument in financial markets and a main source for budget deficit financing.

The first book-entry government securities issued by the Ministry of Finance in 1992 were with a term of three to nine months. The yield of these securities was in the form of discount. Enhanced demand for government securities and the need of rescheduling government obligations for longer periods of time entailed a timely improvement of the legal framework establishing the issue and conduct of government securities transactions compliant with the government intents for a change in the implemented issuing policy. With the amendment to Ordinance No. 5 in 1993, regular issues of medium-term securities were launched and securities with a term of one year were added to the issued short-term securities. The securities with a term of over one year were interest-bearing and were sold at a price equal to or over the nominal value.

Maturity Structure of Issued Government Securities



Limits for maximum quantity of government securities which a participant may acquire with competitive bids were set:

- for short-term government securities – 15 per cent of the quantity earmarked for sale through competitive bids;
- for medium-term government securities – 35 per cent of the quantity earmarked for sale through competitive bids;
- for long-term government securities – 50 per cent of the quantity earmarked for sale through competitive bids.

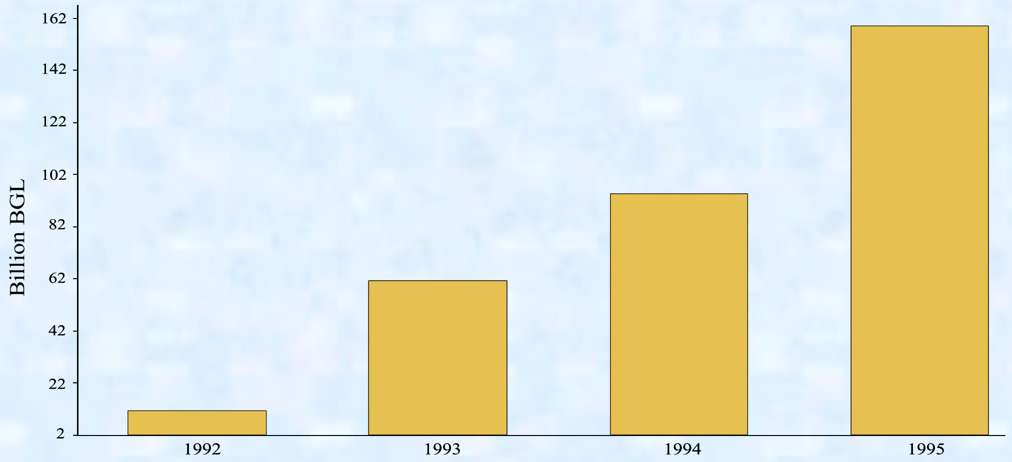
In 1994 the extensive development of the Bulgarian government securities market continued. Eighty per cent of the budget deficit was funded by government securities and about 20 per cent by a direct bank loan. Consistent with the market conditions, by the end of the year the principle of pricing at primary auctions was changed. The Ministry of Finance did not announce in advance a minimum price and financial institutions were allowed to offer a minimum price in their bids.

The rate of growth in the number and total nominal value of issued government securities was sustained in 1995 as well. The average selling prices of issues sold ensured yield higher than the base interest rate for the respective period.

The overview of book-entry government securities market between 1992 and 1995 outlined the following major trends in market development:

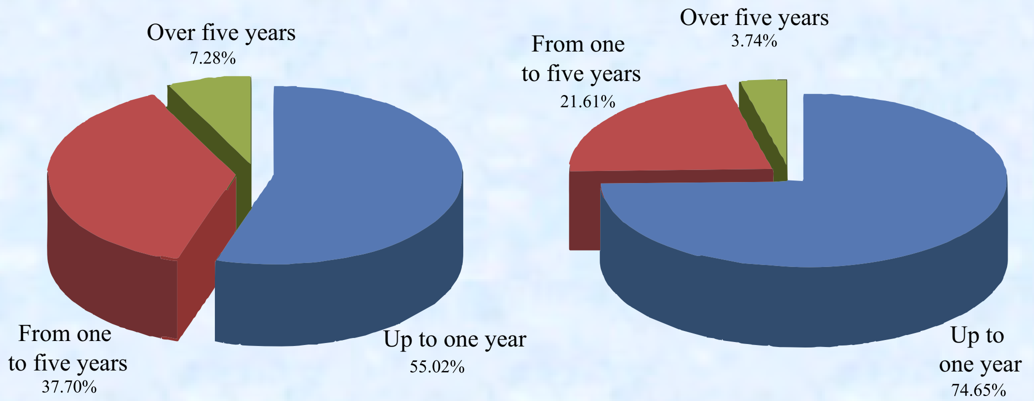
1. investor interest in government securities enhanced strongly, particularly in short-term government securities;
2. the frequency of government securities issues increased and the primary market of government securities extended as a result of enhanced demand;
3. secondary market also developed and the number of transactions for purchase and sale of government securities significantly increased;
4. the bulk of government securities issues ensured an average yield equal to or higher than the effective base interest rate for a particular period.

Volume of Government Securities Issued between 1992 and 1995



The complex macroeconomic environment in 1996, dynamic changes in the base interest rate, devaluation of the national currency, the budget deficit and total borrowing requirements of the government were among major factors influencing the maturity and amount of issued government securities. The financial crisis limited the primary market capacity to sell the issued government securities. This also entailed the use of a direct bank loan (short- or long-term) both for covering the temporary cash disruptions and for financing the cash deficit irrespective of the pro-inflationary effect. The trend towards issuing mostly short-term government securities for budget deficit financing (due to the volatile market of debt instruments and investor interest primarily in this type of securities) was sustained in 1996 as well. The SSB remained the main investor in treasury bonds issues. This predetermined the maturity structure of outstanding government securities issued under Ordinance No. 5. Government securities with a term of up to one year accounted for 74.7 per cent, up to five years – 21.6 per cent, and those with a term of up to nine years (securitised direct debt)[2] – 3.7 per cent of the total amount of outstanding government securities.

Maturity Structure of Outstanding Government Securities

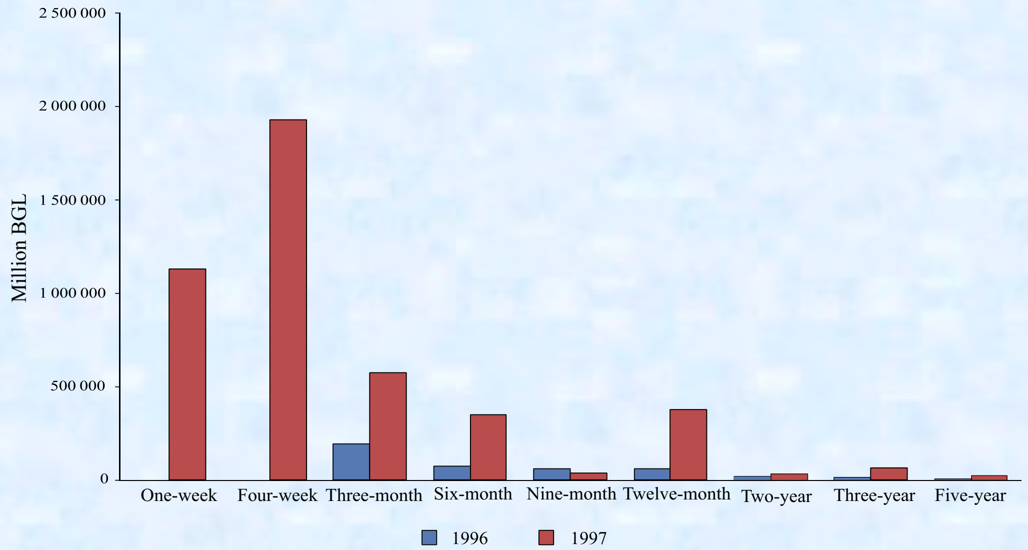


31 December 1995 **31 December 1996**

2 The Ministry of Finance issued eight- and nine-year government securities to cover part of direct loans extended to the government by the BNB under Article 46 of the Law on the BNB of 1991.

By the end of 1996 the first signs of hyperinflation and destabilisation of the Bulgarian lev occurred which significantly eroded the confidence in investments in national currency resulting in shortening the maturity of investments. Concurrently, the banking system was characterised by ample liquidity and rapidly increasing budget requirements. Government securities market showed no interest in traditional instruments. As a result, it became extremely difficult to provide funds for the budget. Rumours of government's inability to cover its obligations added to the destabilisation effect. One of the best resolutions in this situation was a full change of the used instruments. Economic instability in early 1997, the dramatic increase in the exchange rate and strong inflationary expectations forced the Ministry of Finance to change its issuing policy and to launch daily issuance of discount ultra short-term treasury bills (seven and 28-day treasury bills). These securities provided several advantages for market participants: a daily opportunity for investment; daily earnings from maturing government securities and a short term of the investment. This practice caused a number of inconveniences to the budget: first of all, uncertainty of the cash flows and inability to plan cash flows even for a three-month period. On the other hand, this practice helped provide the necessary funds for covering due payments, thus avoiding the announcement of a second moratorium on debt payments. Concurrently, free cash resources were directed to the government debt and not to the most probable alternative source: foreign currencies. As a result, the rate of the national currency devaluation and inflation growth were curbed. In fact, government securities were used for attracting ultra short-term liquidity by commercial banks. Over this period three-, six-, nine- and 12-month treasury bills were also issued where necessary.

Government Securities Issued between 1996 and 1997



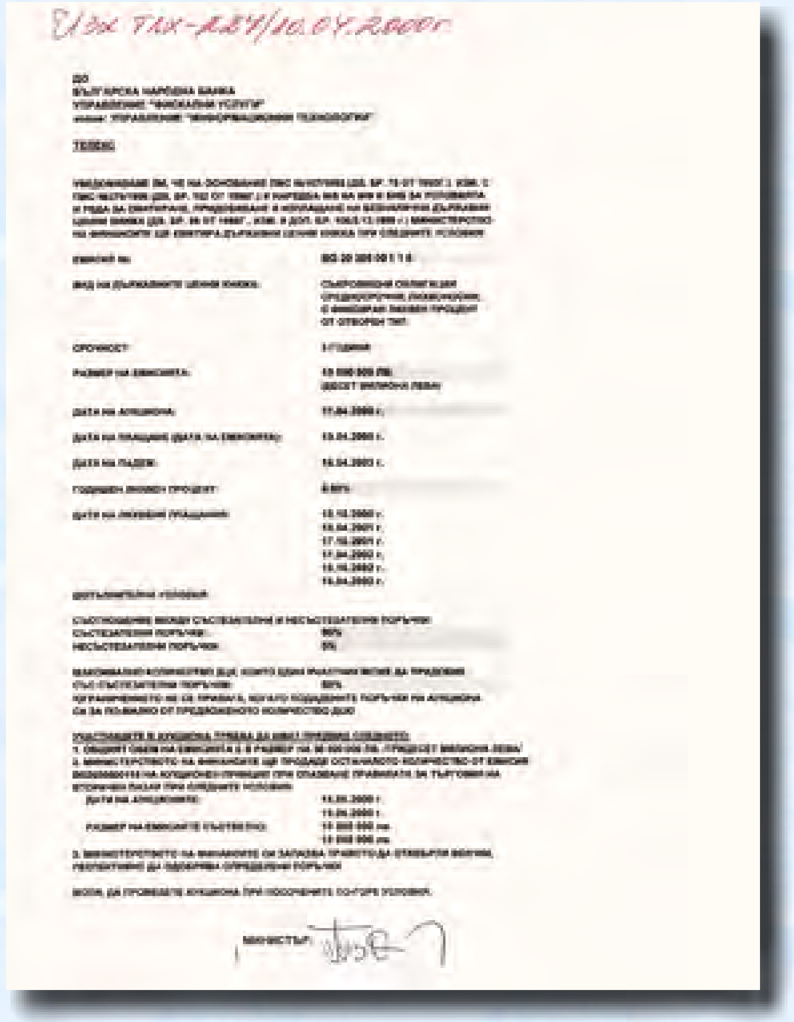
The objectives set forth with the introduction of the currency board arrangements were implemented in the period of high inflation and serious turmoil in the banking and budget sectors which also impacted the government securities market. The BNB started operating under the currency board rules experiencing one of the deepest institutional changes since its establishment in 1879. With the introduction of the currency board, the practice of extending direct loans to the government by the BNB, used for financing the deficit the share of which dramatically rose in 1996, was discontinued. Pursuant to the Law on the BNB[3] the central bank may extend loans to the government only against purchases of Special Drawing Rights from the International Monetary Fund under strict constraints. Concurrently, the budget appeared to be in trouble due to huge interest expenditure on domestic loans, particularly in the period of high base interest rate, and to budget spending caused by inflation. Before the inflation was curbed, interest lowered, tax collectability improved, government securities transactions had been the major source for budget deficit financing. Immediately after the introduction of the currency board, financial institutions were in a similar situation as the budget and the market experienced a shortage of liquid funds. Banks' free resources were directed to the government securities market which ensured the safest alternative and comparatively high yield in such a situation. This required a change in the Ministry of Finance issuing policy mostly as to the amount, type and maturity of the new government securities issues.

As a result of the started financial stabilisation, the practice of holding auctions for sale of government securities each Monday (for treasury bills) and each second and fourth Friday of the month (for treasury bonds) was restored. Later, auctions were conducted only on Mondays. The maturity of government securities issued gradually increased, while the volumes offered declined. Curbed inflation and the pegged exchange rate allowed for better evaluation of the future interest rate levels which contributed to the compliance of yield levels offered by the budget with investor expectations.

The macroeconomic stabilisation as a result of the currency board introduction was the major feature of Bulgaria's economy in 1998. The consistent policy of strengthening the attained stability and the transition to sustainable growth reflected in the three-year agreement signed with the IMF. The strict adherence to the currency board rules steadily depressed inflation. The implementation of a balanced budget policy in 1998 helped maintain a cash surplus over the whole year. The higher responsibility in spending budget funds and tighter discipline and control in collecting revenue reduced the need of budget financing through debt issue. The general economic stability resulted in an improved maturity structure of government securities issued,

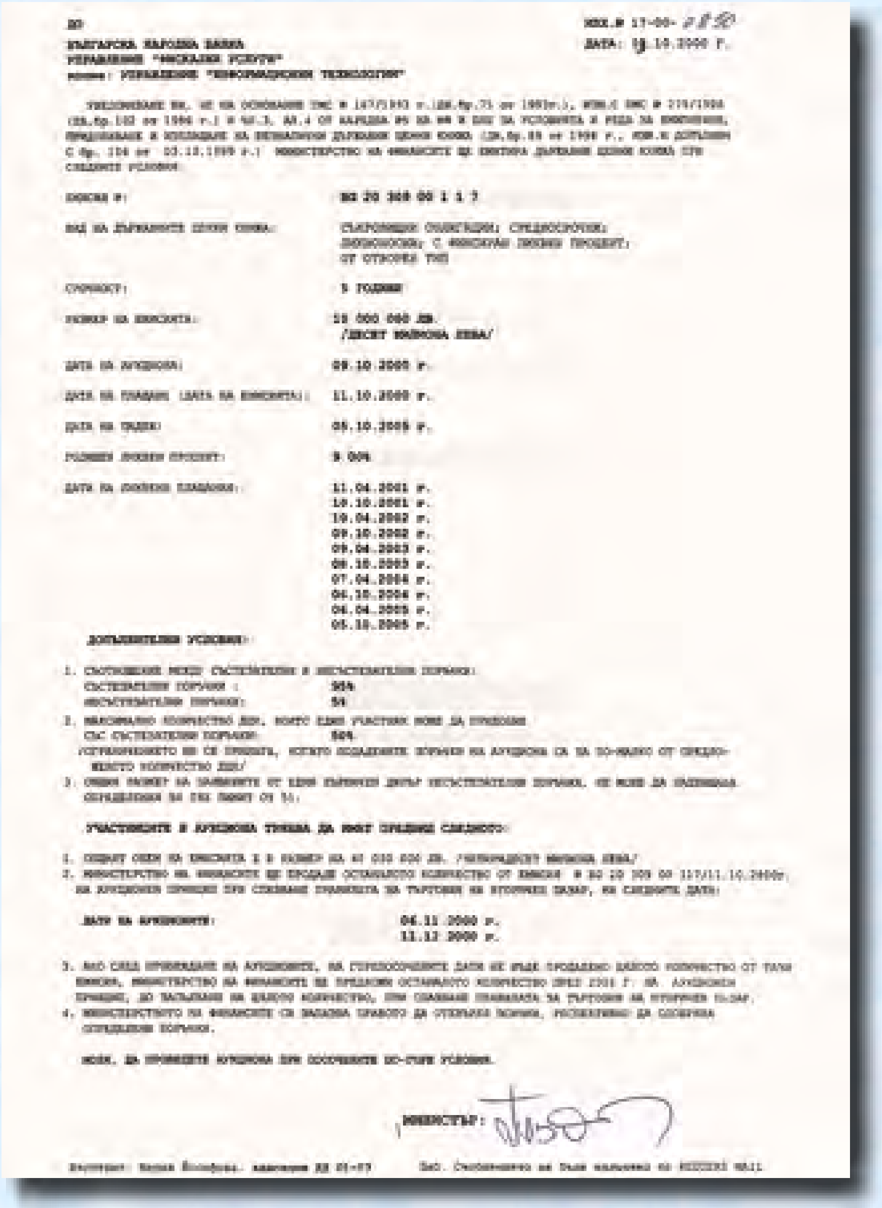
3 Published in Darjaven Vestnik, issue 46 of 10 June 1997; amended, issue 49 of 29 April 1998; amended, issue 153 of 23 December 1998; amended, issue 20 of 5 March 1999; amended, issue 54 of 15 June 1999; amended, issue 109 of 18 December 2001; amended, issue 45 of 30 April 2002; amended, issue 10 of 28 January 2005; amended, issue 39 of 10 May 2005; amended, issue 37 of 5 May 2006; amended, issue 59 of 21 July 2006; amended, issue 108 of 29 December 2006; amended, issue 52 of 29 June 2007; amended, issue 59 of 20 July 2007; amended, issue 24 of 31 March 2009; amended, issue 42 of 5 June 2009; amended, issue 44 of 12 June 2009; amended, issue 97 of 10 December 2010; amended, issue 101 of 28 December 2010.

with the share of medium-term securities posting a significant increase. The issues of government securities under Ordinance No. 5 of the Ministry of Finance and the BNB followed an issuing calendar announced in advance, which allowed the participants in the primary market of government securities to estimate optimally their portfolio investments and the volumes to be sold in the secondary market.



A letter of the Ministry of Finance announcing the pending auction and the terms and conditions of the first three-year tap issue of book-entry governments securities. For further details, see Annual Review of Government Debt, 2000.

In early 2000 the Ministry of Finance circulated the first three-year tap issue. Along with the ambition to increase the share of medium-term issues with a fixed interest rate coupon, the Ministry of Finance required changes in the implemented issuing policy. The number of medium-term government securities rose at the expense of short-term securities and alternating two- and three-year tap issues were projected in the calendar of issues. In the last quarter of 2000 the first five-year tap issue occurred. As a result, the investor interest shifted toward government securities with longer maturity. This reflected the higher yield of these securities and the lack of alternative investment decisions in terms of risk and maturity.



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06.11.2000 г.
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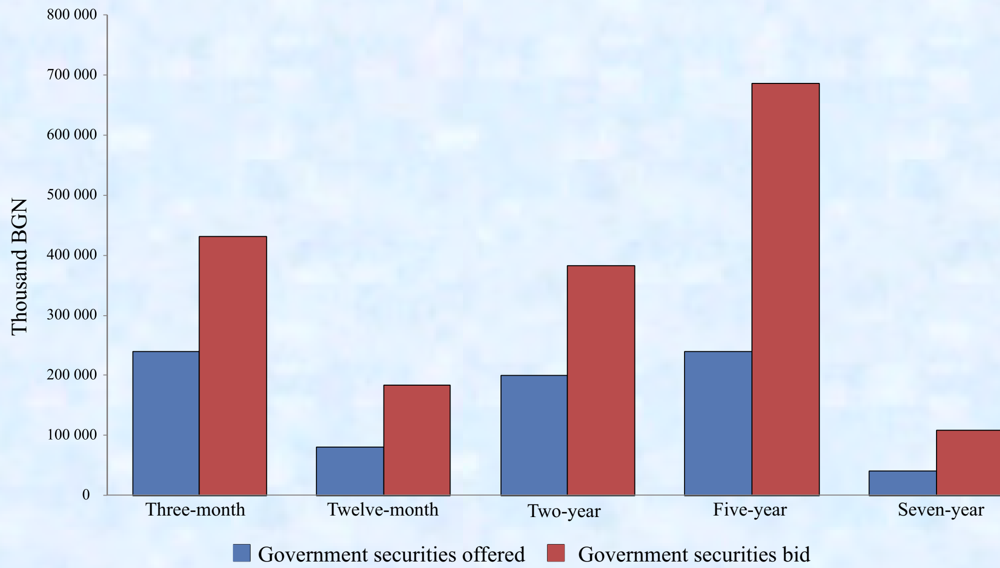
МИНИСТЪР:

A letter of the Ministry of Finance announcing the pending auction and the terms and conditions of the first five-year tap issue of book-entry governments securities. For further details, see Annual Review of Government Debt, 2000.

To implement a balanced issuing policy and to serve the needs of the market, in 2001 the Ministry of Finance changed the volume and frequency of three-month government securities issues: from weekly issues, worth BGN 5 million, to issues of BGN 10 million traded twice a month. The 2001 issue calendar included also one-year government securities traded on a quarterly basis. The upward trend in the relative share of medium-term government bonds was sustained, with two- and five-year tap issues scheduled on a quarterly basis. The review period was characterised by optimized conditions of bond issuance, adherence to the MF pre-scheduled issue calendar and retained investor interest in longer-term bonds. Several new factors began to affect this sector's liquidity. They included both new market entrants and increased significance of institutional investors as the Health Insurance Fund, pension funds and insurance corporations. At the end of 2001, the MF put in circulation the first seven-year treasury bonds tap issue to explore the bonds market sentiment on these long-term instruments. This issue attracted extremely high interest which led to some changes in the scheduled 2002 issuing policy. The total volume of projected short-term issues was reduced at the expense of increased volumes of medium- and long-term bonds.

Government Securities Offered and Bid in 2001



The upward trend in demand for longer-term bonds was particularly pronounced in 2002 as well. In response to the increased interest in these bonds, the MF issued a new seven-year-and-three-month issue. In addition, ten-year treasury bonds were issued for the first time.

In 2003 the issuing policy was directed at longer-term securities: three-, five-, seven-, ten- and 15-year treasury bonds. The first euro-denominated seven- and 15-year issues appeared in the market. In addition, the first auction for sale of domestic euro-denominated government securities was held in February 2003. Their maturity was seven years and three months, and the annual interest coupon 5.75 per cent. Later, in November, the MF offered euro-denominated bonds with a maturity of 14 years and 11 months and annual interest coupon of 6 per cent. The resulting overall economic stability led to improvements in the maturity structure, boosting significantly the share of long-term government bonds. This trend persisted in subsequent years.

In recent years the MF issuing policy has been complied both with economic and fiscal stability measures set in the State Budget Law for the relevant year and the strategic government debt management goal of providing required sources of state budget financing and outstanding debt refinancing at the lowest possible cost and optimal risk degree. This policy has been consistent with the goals set in the Government Debt Management Strategy[4]. Major indicators whose underlying developments predetermine the issuing policy stance include: the budget balance, private and public gross external debt, balance of payments current account, the fiscal reserve level, banking system liquidity, major investor preferences, main assumptions about the tax and income policy, public expenditure, *etc*. Taking into account these policies, restrictions and assumptions, over the recent years the MF has pursued an active issuing policy in the domestic market by offering a wide maturity spectrum of highly liquid issues consistent with the dynamic trends in the domestic and external debt markets. By issuing lev- and euro-denominated government securities with a fixed interest coupon, the MF aims to minimize the risks associated with external debt servicing. This approach has limited the influence of interest and exchange rate fluctuations in the world markets on the nominal value and service costs of domestic government debt. Issuer's efforts have focused on the use of the whole range of instruments to promote domestic government bond market developments and to strengthen the role of domestic government securities as a key investment alternative offering an attractive risk to return ratio. This has been accompanied by attempts to fully adjust the fluctuations in liquidity-absorbing and liquidity-providing operations through government bond maturities and issues to avoid a possible market volatility and fragmentation.

The issuing policy is one of the major instruments for government debt management and prudent fiscal policy. The Ministry of Finance makes efforts to implement a balanced issuing policy and to serve the needs of the state budget and financial system liquidity with the aim of ensuring access to market financing and increasing the overall confidence of capital markets in Bulgaria.

4.1.1. Government Securities Targeted at Individual Investors

Government securities targeted at individuals are part of book-entry government securities which are issued, acquired and repaid under MF and BNB Ordinance No. 5. They may be acquired solely by resident and non-resident natural persons.

To create conditions for enhancing non-bank funding sources of the state budget and to ensure direct access of individual investors to government debt instruments, in May 1994 the MF launched government securities

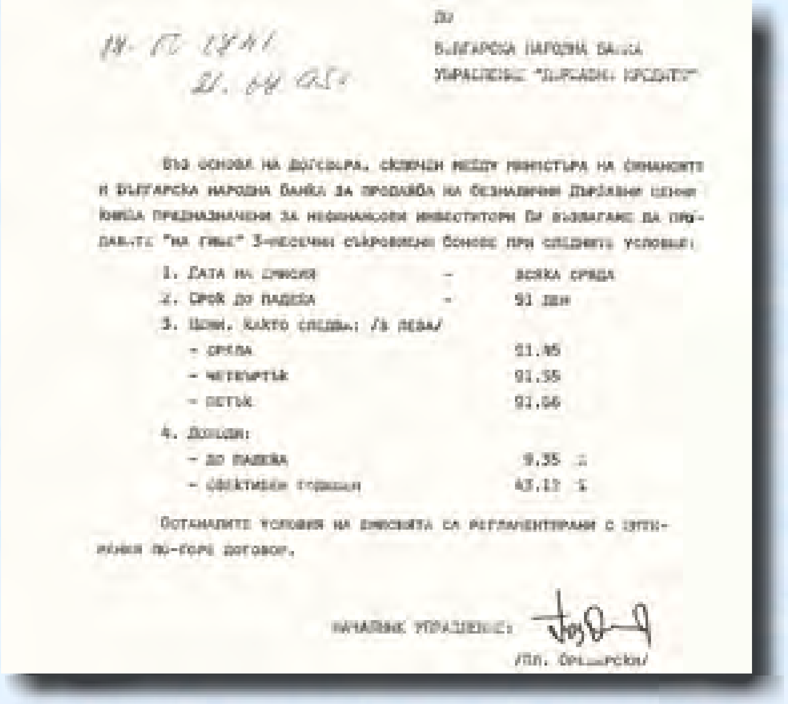
4 Pursuant to Article 16 of the Law on the Government Debt (published in Darjaven Vestnik, issue 93 of 1 October 2002; amended, issue 34 of 19 April 2005, effective as of 1 June 2005; amended, issue 52 of 29 June 2007, effective as of 1 November 2007, issue 23 of 27 March 2009, effective as of 1 November 2009, issue 101 of 28 December 2010, effective as of 30 June 2011), the Minister of Finance developed a three-year Government Debt Management strategy, which was approved by the Council of Ministers. The strategy under paragraph 1 was updated on an annual basis and submitted together with the three-year budget projections for approval by the Council of Ministers.

earmarked for direct sale to individuals and corporations through preliminary selected financial institutions. Initially, they were sold mainly at the central BNB office. Later, in 1995, the SSB, commercial banks and financial houses started selling these securities. Thus, intermediaries numbered more than twenty. Overall, the significant number of financial institutions offering these securities made easier individuals' access providing more options to choose from. However, this form of non-bank budget financing has slowly gained importance among the public since these securities are a comparatively new form whose advantages of risk-free and high-yielding investment have not yet become popular among investors.

Individual issues of target government securities have been put in circulation. Individuals and corporations wishing to invest in them may purchase three-month (discount), six-month (interest-bearing), one-year (interest-bearing) treasury bills and two-, three- and five-year (interest-bearing) treasury bonds. Each issue features specific terms:

- number of issue;
- date of issue;
- sales term: the period in which a government securities issue is sold;
- issue term: the period in which government securities are in circulation;
- issue maturity: the date of nominal value repayment;
- dates of interest payments;
- the total volume of sales: unlimited except for the cases under preliminary notification by the issuer upon setting and announcing issue terms and conditions;
- the minimum amount of sale: the minimum amount of each purchase;
- selling prices: set on a daily basis by the issuer for the sales term of each issue;
- interest rate (on interest-bearing issues): the rate at which the nominal value is remunerated to calculate the amount of interest received by the issue holder. This rate may vary across interest periods to maturity;
- possible repurchases prior to maturity: defined by the issuer and announced together with the terms of the issue by indicating the periods/dates in/from which this issue may be repurchased. The MF announces daily price quotations of all repurchased issues.

In sales of target government securities, a registered certificate is issued to the acquirers.



ДО

БЪЛГАРСКА НАРОДНА БАНКА
УПРАВЛЕНИЕ "ДЪРЖАВЕН КРЕДИТ"

Въз основа на договора, сключен между Министъра на финансите и Българска народна банка за продажба на безналични държавни ценни книжа предназначени за нефинансови инвеститори Ви възлагаме да продавате "на гише" 3-месечни съкровищни бонове при следните условия:

1. ДАТА НА ЕМИСИЯ – ВСЯКА СРЯДА
2. СРОК ДО ПАДЕЖА – 91 ДНИ
3. ЦЕНИ, КАКТО СЛЕДВА: /В ЛЕВА/
   - СРЯДА 91.45
   - ЧЕТВЪРТЪК 91.55
   - ПЕТЪК 91.66
4. ДОХОДИ:
   - ДО ПАДЕЖА 9.35 %
   - ЕФЕКТИВЕН ГОДИШЕН 43.12 %

Останалите условия на емисията са регламентирани с цитирания по-горе договор.

НАЧАЛНИК УПРАВЛЕНИЕ:
/ПЛ. ОРЕШАРСКИ/

A letter of notification, thereby the Ministry of Finance assigned to the BNB the sale of target book-entry government securities (earmarked to financial institutions) based on an agreement concluded between the Minister of Finance and the BNB.
The letter contained information on the general terms and conditions of the issue sale.

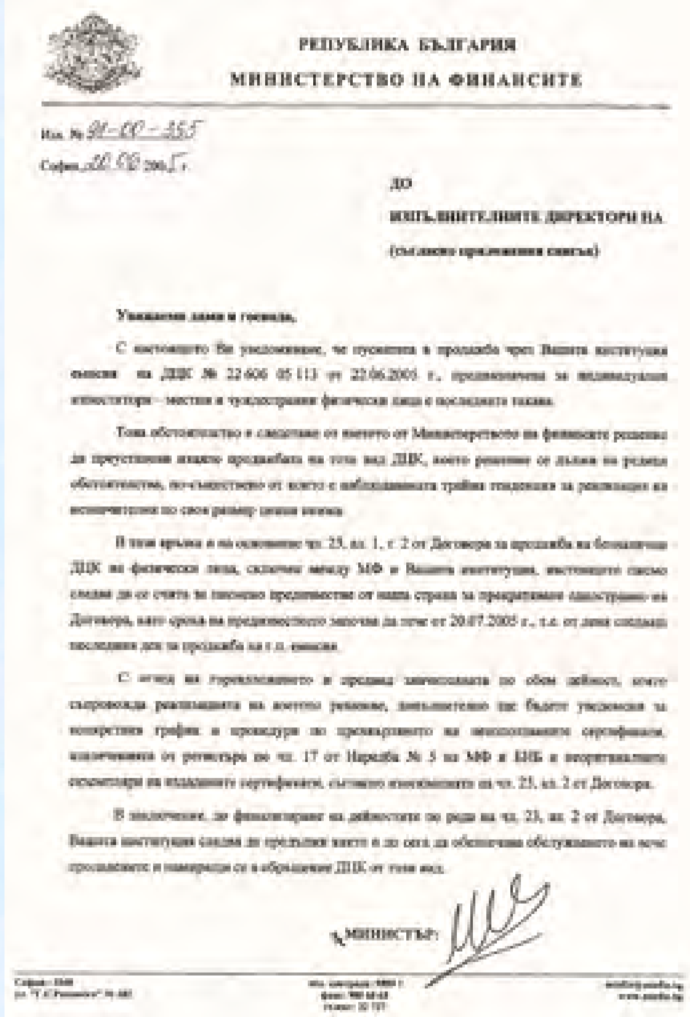
Inflation-indexed government securities issued by the MF are earmarked for natural persons. These are no fixed income securities with variable interest rates depending on the movements of an index. These debt instruments provide a hedge against inflation erosion. High inflation in Bulgaria entailed the need for inflation-indexed bonds to be issued from November 1996 to the introduction of the currency board in 1997. Their yield was based on the inflation index of the National Statistical Institute. They were six-month securities with a variable interest rate set by the MF as an inflation risk premium based on the six-month consumer price index. Six-month interest accrual started from the month following that on which the issue had been launched. The inflation premium was calculated on an accrual basis: the interest for each month was accrued on the initial amount and previous months' interest thereon. In addition, bond holders were protected by a two point margin over the six-month yield.

Government securities targeted at individuals have been issued by the Ministry for ten years. Their yield is fixed and increases progressively in the form of interest accrued on a semi-annual basis. Lev- and euro-denominated government securities are offered to investors *via* financial institutions selected by the MF on the basis of contracts for sale of this financial instrument. They are not auctioned and traded in the secondary market. The issue terms provide for the manner of interest and principal payments along with the possibility of repurchase prior to maturity.

The practice in this area has replicated that in advanced market economies with a well-functioning market of savings government bonds. In Bulgaria, this market has only been developed since the second half of the 1990s. Annually, the State Budget Law provides for government securities earmarked for investors, natural persons, setting limits on their volume and maximum yield. The annual volume of target issues comprises 10 or 20 per cent of the total volume of all issues for the relevant budget year and their maximum yield is up to 2 percentage points higher than the yield achieved at the regular auctions. An exception was the 2002 State Budget Law providing for a 1 point yield.

The specific nature of this bond market is due both to its participants and the type of securities issued by the MF to increase the share of issues targeted at retail investors by diversifying the instruments offered in terms of maturity, denomination and current income.

Despite the special efforts in this area, trade in these debt instruments has been characterised by a limited potential for growth and a sustainable downward trend in sold volumes. In the first half of 2005 sales remained insignificant which predetermined the MF decision to stop issuing, after a period of almost ten years, savings bonds earmarked for individual investors, local and foreign natural persons.



РЕПУБЛИКА БЪЛГАРИЯ
МИНИСТЕРСТВО НА ФИНАНСИТЕ

ДО
ИЗПЪЛНИТЕЛНИТЕ ДИРЕКТОРИ НА
(съгласно приложения списък)

Уважаеми дами и господа,

МИНИСТЪР:

A letter of the Ministry of Finance on the unilateral termination of the agreements concluded between the Minister of Finance and commercial banks for sale of target book-entry government securities. With this letter the Ministry of Finance also announced its decision to discontinue the sale of this type of government securities.

4.2. Government Securities Issued for Structural Reform to Ease the Banking System from Non-performing Loans to State-owned Enterprises

Government securities issued for settlement of non-performing loans to state-owned enterprises were the result of a planned operation on transformation of existing bad loans generated by state-owned enterprises before the economic reforms. Between 1991 and 1994 four lev-denominated bonds issues under CM Decree No. 244 of 1991, CM Decree No. 186 of 1993, Article 4 of the Law on Settlement of Non-performing Credits Negotiated Prior to 31 December 1990 (ZUNK) and CM Decree No. 3 of 1994 and one USD-denominated bonds issue under Article 5 of ZUNK were put in circulation.

The statutory principle provided for transforming real sector's debt into government debt by issuing treasury bonds, with the budget covering servicing costs. Enterprises whose loans were to be transformed remain debtors to the government under new repayment schedules and easier interest rate conditions. This operation has been made to clear bad loans from commercial bank portfolios and to create conditions for real sector development.

The first loan transformation operation was performed in 1992. As a result, non-performing assets were cleared off the bank portfolios and balance sheets. Simultaneously, debt burden was redistributed among the budget, financial system and enterprises. This process continued in the following two years by adopting CM Decree No. 186, CM Decree No. 3 and ZUNK.

Treasury bonds are issued in a book-entry form allowing the costs and procedures on their initial distribution to be reduced and secondary trading to be facilitated. The bond register is kept by the BNB and trading is effected under Ordinance No. 5 of the MF and BNB.

Bond maturity is 25 years except for those issued under CM Decree No. 244 (19 years) and CM Decree No. 186 (24 years). The grace period is five years and bond depreciation is made in equal annual instalments.

Until the seventh year, interest coupons on lev-denominated bonds are calculated using the base interest rate (BIR) in an ascending principle (in the first and second years: one-third of BIR; in the third and fourth years: one-half of BIR; in the fifth and sixth years: two-thirds of BIR and from the seventh year to maturity: BIR). The only exception are lev-denominated bonds issued under CM Decree No. 244 with an interest coupon of BIR plus one point. The coupon of USD-denominated securities is based on the six-month US dollar LIBOR[5] effective in the previous interest rate period.

5 LIBOR (London Interbank Offered Rate) is the average interest rate on non-guaranteed loans offered by banks in the London interbank market. It is used as a reference rate for interest rates in bank operations.

Interest rates on all treasury bonds are paid twice a year excluding those on lev bonds issued under CM Decree No. 3 of 1994 which are paid once a year.

Interest and principal payments on USD-denominated bonds issued under Article 5 of ZUNK are based on the BNB exchange rate on the day of payment.

Government securities issued for structural reform are long-term low interest bonds which makes them less attractive assets in bank portfolios. This was the reason along with the need to stimulate privatisation through expanding its instruments to introduce a mechanism for substitution of debt against ownership. The substitution was regulated by CM Decree No. 221 of 1995 providing for possible use of these treasury bonds as legal tender in privatisation deals.

By CM Decree No. 22 of 1995, companies in debt under ZUNK were given the opportunity to use government bonds issued under Articles 4 and 5 of the Decree to repay their obligations. USD-denominated bonds used in such repayments were accepted at nominal value and lev-denominated bonds 80 per cent of their nominal value.

The option for substitution of debt against ownership and repayment of obligations under ZUNK supported the secondary market, creating conditions for alternative investment solutions.

As part of the measures to reduce the share of the US dollar component in the structure of government securities and the debt as a whole, on 10 June 1999 the Ministry of Finance started regular subscriptions for replacement of USD-denominated government bonds issued under Article 5 of ZUNK by EUR-denominated long-term bonds. Initially, they were held once a year and from 2002 quarterly. Lack of interest by financial institutions in subscriptions organized in 2005 led to their suspension.

ZUNK bonds are of two types:

Lev ZUNK bonds (issue No. 98 of 1993):

loan amount: BGL 32,000,000,000;

form: book-entry bonds;

denomination: BGL 1000 nominal value;

issue date: 1 October 1993;

maturity: 25 years, five-year grace period;

yield – until the seventh year: one-third, one-half and two-thirds of BIR; after the seventh year: BIR.

Приложение:

Подписки за замяна на държавни дългосрочни облигации, деноминирани в щатски долари от емисия BG 20 097 94 228, с държавни дългосрочни облигации, деноминирани в евро от емисия BG 20 400 99 223 за периода 1999 г. - 2005г.			
Дата на подписката за замяна	Намаляване на общата номинална стойност на емисия BG 20 097 94 228 /в щ. долари/	Увеличаване на общата номинална стойност на емисия BG 20 400 99 223 /е евро/	Брой на участниците в подписката за замяна
01.12.2005 г.	0	0	0
15.09.2005 г.	0	0	0
15.06.2005 г.	0	0	0
08.03.2005 г.	15 000.00	11 315.00	1
13.12.2004 г.	0	0	0
28.09.2004 г.	701 000.00	571 035.00	1
14.06.2004 г.	0	0	0
11.03.2004 г.	0	0	0
22.12.2003 г.	2 732 000.00	2 214 124.00	3
20.08.2003 г.	10 000 000.00	9 037 500.00	1
06.06.2003 г.	0	0	0
24.01.2003 г.	4 441 000.00	4 168 767.00	3
02.12.2002 г.	150 000.00	149 833.00	2
19.09.2002 г.	123 000.00	125 021.00	2
18.06.2002 г.	19 850 000.00	21 093 603.00	7
01.03.2002 г.	42 017 000.00	48 204 102.00	16
02.07.2001 г.	31 898 000.00	37 478 515.00	27
03.07.2000 г.	0	0	0
01.07.1999 г.	26 666 000.00	25 729 448.00	9
Всичко	138 593 000.00	148 783 263.00	

A list of replacement subscription of USD-denominated long-term government bonds issued under Article 5 of ZUNK of 1993 by EUR-denominated long-term government bonds conducted by the Ministry of Finance between 1999 and 2005.

The list included the following information:
***Column 1** – Dates of replacement subscriptions conducted by the Ministry of Finance;*
***Column 2** – The amount of the decrease (in US dollars) in the nominal value of USD-denominated long-term government bonds after the respective replacement subscription;*
***Column 3** – The amount of the increase (in euro) in the nominal value of EUR-denominated long-term government bonds after the respective replacement subscription;*
***Column 4** – Number of participants in the replacement subscription.*

Foreign currency ZUNK bonds (USD-denominated issue No. 97 of 1994):

loan amount: USD 1,808,000,000;

form: book-entry bonds;

denomination: USD 100 nominal value;

issue date: 1 October 1994;

maturity: 25 years, five-year grace period;

yield: interest income of the six-month US dollar LIBOR for the respective period;

exchange rate of the payment: the BNB US dollar central exchange rate on the date of the purchase.

Other Government Securities Issues on Transformation of Bad Loans:

Issue No. 95 of 1992 (CM Decree No. 244 of 1991);

Issue No. 99 of 1993 (CM Decree No. 186 of 1992);

Issue No. 96 of 1994 (CM Decree No. 3 of 1994).

4.3. Guarantee Government Securities Issued to Address the Consequences of Insolvency of Fifteen Banks in 1996

The terms and procedure for issuing and servicing guarantee government bonds were laid down in the Law on State Protection of Deposits and Accounts with Commercial Banks, in Respect Whereof the BNB Has Petitioned the Institution of Bankruptcy Proceedings.[6] This Law was adopted by the National Assembly on 23 May 1996: few days after the amendments to the Law on Banks and Credit Activity[7] allowing the BNB to withdraw licenses of insolvent commercial banks and to petition the court to open bankruptcy proceedings against them.

This Law regulated the terms and procedure for providing government protection of natural persons and legal entities' deposits and accounts with banks in respect of which the BNB has initiated bankruptcy proceedings. Under the Law, the government entered into the rights of account titleholders (natural persons and legal entities) as of the effective date of the ruling on insolvency up to the amount of the limits set forth in the Law.

This Law was not applied to financial institutions, senior managers and bank shareholders, as well as to a range of their relatives. The Law provided for 100 per cent deposit-guarantee protection for individuals and 50 per cent for legal entities irrespective of the type of currency in which deposits were denominated. The service of net lev deposits of natural persons and net lev and foreign currency deposits of corporations was entrusted to the SSB. Post Bank AD was a servicing bank for net foreign currency deposits of individuals.

Under the provisions of this Law, a Guarantee Fund managed by the Minister of Finance was established. Its funds were generated through long-term guarantee bond issues, privatisation revenue and sold property of the banks declared in bankruptcy. The Law set a maximum amount of the issue at BGL 80 billion and USD 100 million until the end of 1996. In the following

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6 Published in Darjaven Vestnik, issue 46 of 29 May 1996; amended, issue 90 of 24 October 1996; repealed; issue 49 of 29 April 1998.

7 Published in Darjaven Vestnik, issue 25 of 27 March 1992; Resolution No. 8 of 27 July 1992 of the Constitutional Court, issue 62 of 31 July 1992; amended, issue 59 of 9 July 1993; amended, issue 109 of 28 December 1993, issue 63 of 5 August 1994, issue 63 of 14 July 1995; amended, issue 12 of 9 February 1996; amended, issue 42 of 15 May 1996, effective as of 15 May 1996; amended, issue 90 of 24 October 1996, effective as of 24 October 1996; amended, issue 100 of 22 November 1996, effective as of 1 April 1997; repealed, issue 52 of 1 July 1997, effective as of 1 July 1997.

years limits on government bond issues were specified in the State Budget Law for the relevant year. Guarantee government securities placed at the Fund's disposal along with all receipts were used to collateralise depositors' accounts in the SSB and Post Bank, with the amount and terms of the collateral and the date of issue agreed between the Minister of Finance, the SSB and Post Bank.

Lev-denominated guarantee government bonds with a seven-year maturity are redeemed at equal annual instalments, earning interest equal to BIR and payable semi-annually.

Foreign currency guarantee government bonds are denominated and payable in US dollars with a maturity of three years and interest equal to the average six-month LIBOR effective for the preceding interest period plus two percentage points. Interest coupons are six-month and principal repayment is one-off at maturity.

Foreign currency guarantee bonds may be transferred only between commercial banks with registered office in Bulgaria. An option exists for separating interest coupons from principal and free transferability of this new instrument in the secondary market. To this end, a preliminary programme prepared by a bank is required along with a registration of the new instruments in the BNB Government Securities Depository.

In 1996 lev-denominated securities issued under the above Law amounted to BGL 13.1 billion and foreign currency securities USD 79.1 million. In 1997 an additional amount of BGL 67.4 billion and USD 90.5 million was issued. Due to the collapse of the financial system and bankruptcy declared by fifteen banks in the 1996 to 1998 period, the government issued lev guarantee securities to the amount of BGL 87.3 billion and foreign currency bonds of USD 174.3 million, redirecting the funds due at maturity date to stable financial institutions for effecting payments thereafter.

Government Securities Issued for Structural Reform

Guarantee Government Securities

Lev Guarantee Government Securities

Issue No.	BG 2040296225	BG 2040396223	BG 2040596228	BG 2044397227	BG 2047397224	BG 2047597229	BG 2047497222
Issue date	05.06.1996	12.06.1996	27.06.1996	18.08.1997	22.10.1997	22.10.1997	27.10.1997
Maturity date	28.05.2003	04.06.2003	19.06.2003	09.08.2004	13.10.2004	13.10.2004	18.10.2004
Principal (million BGL)	4285.71	4527.65	566.48	25355.82	2796.63	9111.74	8078.71
Interest rate	BIR	BIR	BIR	BIR	BIR	BIR	BIR
Interest payments	semiannual	semiannual	semiannual	semiannual	semiannual	semiannual	semiannual
Repayments	equal annual	equal annual	equal annual	equal annual	equal annual	equal annual	equal annual
Maturity (in years)	7	7	7	7	7	7	7

Issue No.	BG 2047697227	BG 2040098225	BG 2040298221	BG 2040398229
Issue date	05.11.1997	29.01.1998	12.02.1998	10.03.1998
Maturity date	27.10.2004	20.01.2005	03.02.2005	01.03.2005
Principal (million BGL)	12419.73	2936.32	3197.97	135.4
Interest rate	BIR	BIR	BIR	BIR
Interest payments	semiannual	semiannual	semiannual	semiannual
Repayments	equal annual	equal annual	equal annual	equal annual
Maturity (in years)	7	7	7	7

Foreign Currency Guarantee Government Securities

Issue No.	BG 2031496115	BG 2031596112	BG 2032996113	BG 2040097110	BG 2040198116	BG 2040297116	BG 2040397114	BG 2045697112
Issue date	19.06.1996	26.06.1996	26.06.1996	02.05.1997	29.01.1998	21.10.1997	21.10.1997	15.08.1997
Maturity date	16.06.1999	23.06.1999	23.06.1999	28.04.2000	25.01.2001	17.10.2000	17.10.2000	11.08.2000
Principal (million USD)	50.00	28.15	0.95	8.86	0.51	1.44	0.66	2.04
Interest rate	LIBOR + 2	LIBOR + 2	LIBOR + 2	LIBOR + 2	LIBOR + 2	LIBOR + 2	LIBOR + 2	LIBOR + 2
Interest payments	semiannual	semiannual	semiannual	semiannual	semiannual	semiannual	semiannual	semiannual
Repayments	one-off at maturity	one-off at maturity	one-off at maturity	one-off at maturity	one-off at maturity	one-off at maturity	one-off at maturity	one-off at maturity
Maturity (in years)	3	3	3	3	3	3	3	3

Issue No.	BG 2047297119	BG 2047797118	BG 2047897116	BG 2040498110	BG 2040598117	BG 2040698115
Issue date	18.08.1997	24.10.1997	05.11.1997	13.02.1998	13.03.1998	11.05.1998
Maturity date	14.08.2000	20.10.2000	01.11.2000	09.02.2001	06.03.2001	07.05.2001
Principal (million USD)	49.57	23.33	5.34	3.13	0.05	1.01
Interest rate	LIBOR + 2	LIBOR + 2	LIBOR + 2	LIBOR + 2	LIBOR + 2	LIBOR + 2
Interest payments	semiannual	semiannual	semiannual	semiannual	semiannual	semiannual
Repayments	one-off at maturity	one-off at maturity	one-off at maturity	one-off at maturity	one-off at maturity	one-off at maturity
Maturity (in years)	3	3	3	3	3	3

LIBOR – average six-month LIBOR (London Interbank Offered Rate) quoted by the Reuters for the preceding interest period.
STRIPS – Separate Trading of Registered Interest and Principal of Securities.

In compliance with Article 8 and Article 9, para. 1, items 1 and 2 of the ZUNK, the Ministry of Finance issues lev and foreign currency guarantee government securities. These are issued under the following conditions:

(a) in levs – 7-year redemption term; interest – BIR for the respective period, payable semiannually; redemption schedule – equal annual installments.

(b) in US dollars – 3-year redemption term; interest – six-month LIBOR plus 2 percent, payable semiannually; redemption schedule – one-off at end-period; transferable only between commercial banks based in this country. Interest coupons are separated from the principal and are freely transferable, provided that the MF and the BNB approve a STRIPS programme for the banks applying to trade in interest coupon derivative financial instruments, to be registered in BNB Government Securities Depository.

The Law on Bank Deposit Guarantee (published in the Darjaven Vestnik, issue 29 of 1998) repeals the Law on State Protection of Deposits and Accounts with Commercial Banks in Respect Whereof the BNB Has Petitioned the Institution of Bankruptcy Proceedings. The repealed law is applicable to deposits and accounts with banks which had been declared insolvent before the enforcement of the Law on Bank Deposit Guarantee, as well as to the special fund for state protection of deposits and accounts and guarantee government securities service.

Section Three
INSTITUTIONAL STRUCTURE OF THE GOVERNMENT SECURITIES MARKET

1. The Ministry of Finance as an Issuer of Government Securities

The Central Government sector is the issuer of government securities through the Ministry of Finance. In line with Bulgaria's financial legislation and fiscal policy purposes, the Ministry of Finance issues regular and extraordinary government securities on behalf and for the account of the government.

The 2002 Law on the Government Debt introduced comprehensive definitions of the types of debt, outlining the powers of individual institutions which take part in the overall process of sovereign debt issuance.

The Ministry of Finance is the body which assumes the debt on behalf of the government and issues government guarantees in line with the Constitution of Bulgaria. The Ministry works on implementation of the government budget, specifying its funding sources on an annual basis.

The Ministry has an overall organisation role in concluding loans on behalf of the government and setting the terms and conditions of their issuance, placement, service and repayment. The Minister of Finance is delegated the right to issue government securities, to negotiate and sign contracts on government loans and agreements on government guarantees within the framework set in the State Budget Law.

The MF jointly with the BNB defines the procedure and terms under which securities are issued in the domestic market. They are issued in the following cases:

- to finance budget deficit;
- to finance investment projects and specific programmes;
- to refinance the government debt outstanding on the maturity date or prior to this date;
- to meet payments under government guarantees that have become due;
- to support Bulgaria's balance of payments.

As a bond issuer, the Ministry supports the overall formation and implementation of the government debt management policy by pursuing government's issuing policy, organising the domestic bond market and servicing domestic debt. The Ministry of Finance performs these functions by:

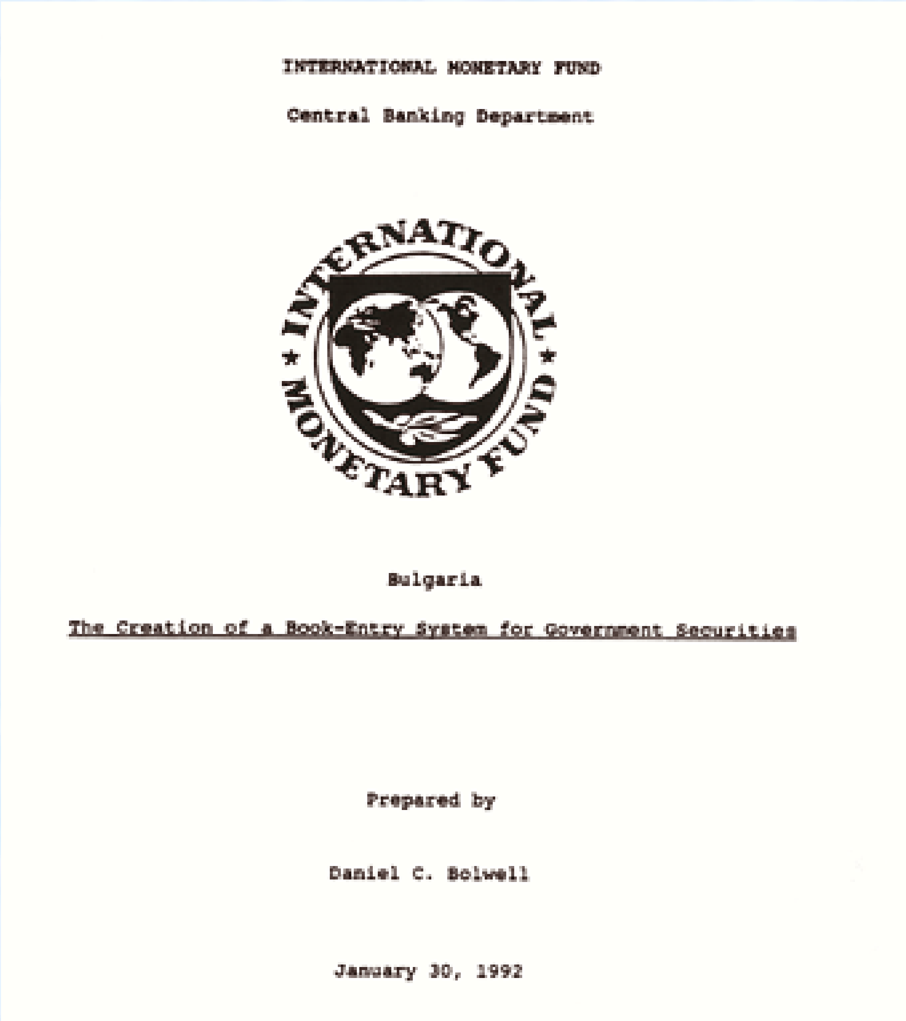
- monitoring and analysing the state and developments in financial markets and government debt markets in Bulgaria and abroad;
- specifying government's issuing policy for the relevant year, developing and announcing issue calendars on conducting auctions for sale of government securities;
- preparing and announcing the terms and conditions of pending auctions in line with the provisions of MF and BNB Ordinance No. 5;
- approving and announcing results of the auctions held;
- offering and organising operations on managing and restructuring domestic government debt: repurchases, replacements, subscriptions;
- developing criteria on selection of primary dealers and monitoring their fulfilment;
- participating jointly with the BNB in the procedure on assessment and selection of government securities primary dealers;
- developing the legal framework in the area of government bond issuance and supervising the proper functioning of government bond primary and secondary markets;
- developing and maintaining adequate mechanism for coordinating and exchanging information with the BNB acting in its capacity as an agent on government and government guaranteed debts;
- maintaining an active dialogue with the government debt market participants;
- exploring European requirements, standards and rules on government bond market functioning and supporting the process of their adaptation to domestic use.

2. The BNB as a Fiscal Agent of the Government

2.1. Development of BNB Agent Functions

Every stage of the economic development in Bulgaria has immediate implications on the relations between the Bulgarian National Bank and the government. Before the economic reform launched in the early 1990s, the central bank used to extend direct loans to the government at administratively set interest rates, regular subsidies from the budget and default on the part of the government to report the real demand for and supply of financial resources. An important prerequisite for the success of this reform and for the real transition from centralised to market economy was the setting up of a stable and competitive financial sector. To this end, the reconstruction of the banking sector through the establishment of a two-tier banking system and the creation of conditions for the establishment of a market-oriented interest rate were of paramount importance. The legal basis of the system was laid down by the Law on the BNB of 1991 and by the Law on Banks and Credit Activity of 1992.

The Law on the Bulgarian National Bank granted the central bank the statute of an independent government institution which reported its activities to the National Assembly twice a year. Under Article 46 of this Law, the Bank could extend to the government only interim credits (advances) with up to three months of maturity, but repayable no later than the end of the calendar year. The maximum amount of outstanding loans could not be more than 5 per cent of the annual budget revenue and the sum of the paid-in capital and the funds in the Reserve Fund. In practice, this provision was invalidated by the Law on the State Budget for the current year adopted by the National Assembly between 1991 and 1997, which provided for part of the budget deficit to be used to finance longer-term direct loans (with a maturity of ten and more than ten years) extended by the central bank. Against this background, the BNB played a crucial role for the launch and the initial development of the government securities market and in the very beginning it functioned both as an intermediary and a financial advisor of the government on issues related to domestic government debt management with a view to achieving better coordination between the monetary and fiscal policies.



INTERNATIONAL MONETARY FUND

Central Banking Department

Bulgaria

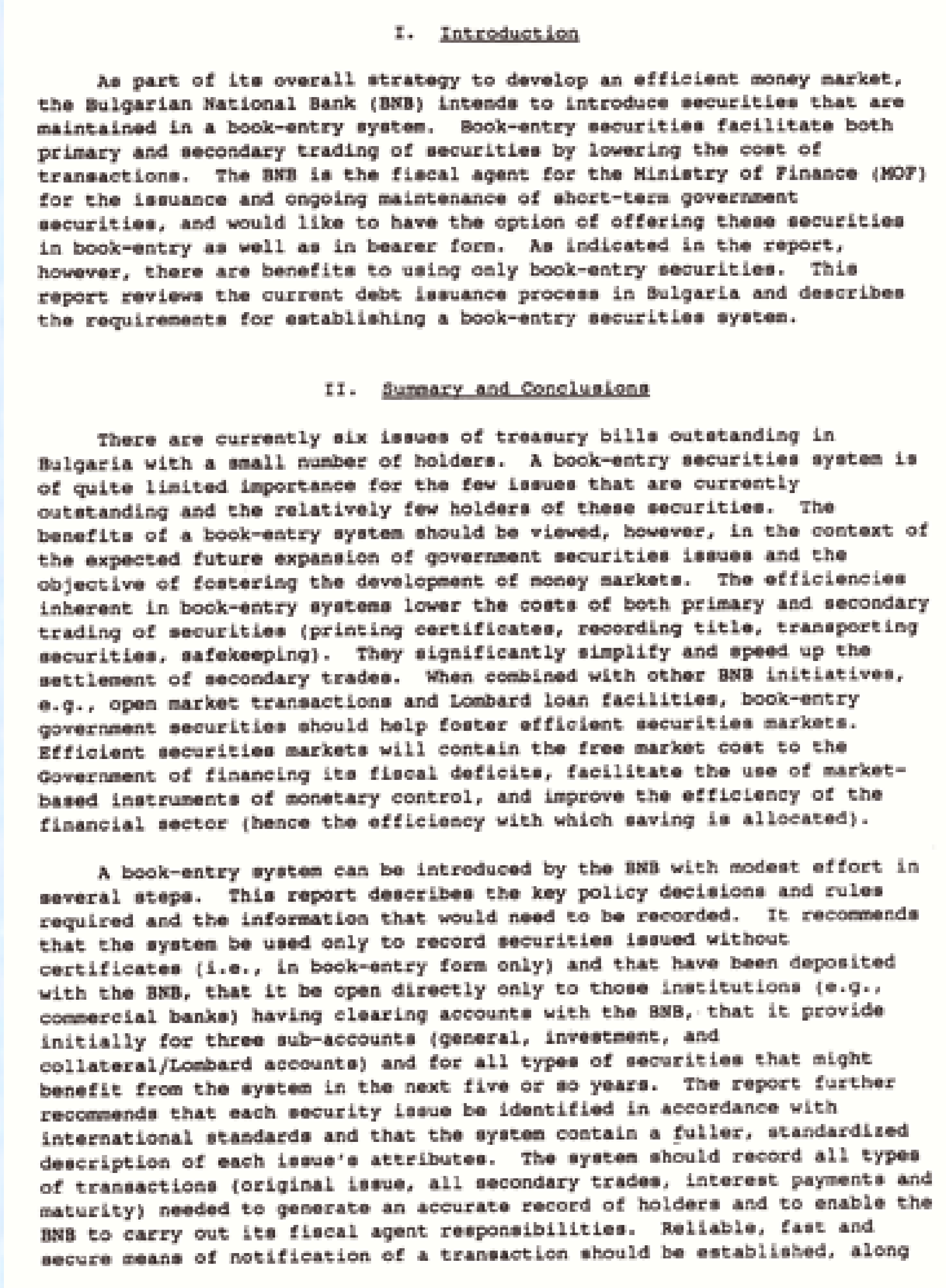
The Creation of a Book-Entry System for Government Securities

Prepared by

Daniel C. Bolwell

January 30, 1992

IMF Report of January 1992 for the technical assistance on the establishment of a system of book-entry government securities in Bulgaria (see also p. 37).



I. Introduction

As part of its overall strategy to develop an efficient money market, the Bulgarian National Bank (BNB) intends to introduce securities that are maintained in a book-entry system. Book-entry securities facilitate both primary and secondary trading of securities by lowering the cost of transactions. The BNB is the fiscal agent for the Ministry of Finance (MOF) for the issuance and ongoing maintenance of short-term government securities, and would like to have the option of offering these securities in book-entry as well as in bearer form. As indicated in the report, however, there are benefits to using only book-entry securities. This report reviews the current debt issuance process in Bulgaria and describes the requirements for establishing a book-entry securities system.

II. Summary and Conclusions

There are currently six issues of treasury bills outstanding in Bulgaria with a small number of holders. A book-entry securities system is of quite limited importance for the few issues that are currently outstanding and the relatively few holders of these securities. The benefits of a book-entry system should be viewed, however, in the context of the expected future expansion of government securities issues and the objective of fostering the development of money markets. The efficiencies inherent in book-entry systems lower the costs of both primary and secondary trading of securities (printing certificates, recording title, transporting securities, safekeeping). They significantly simplify and speed up the settlement of secondary trades. When combined with other BNB initiatives, e.g., open market transactions and Lombard loan facilities, book-entry government securities should help foster efficient securities markets. Efficient securities markets will contain the free market cost to the Government of financing its fiscal deficits, facilitate the use of market-based instruments of monetary control, and improve the efficiency of the financial sector (hence the efficiency with which saving is allocated).

A book-entry system can be introduced by the BNB with modest effort in several steps. This report describes the key policy decisions and rules required and the information that would need to be recorded. It recommends that the system be used only to record securities issued without certificates (i.e., in book-entry form only) and that have been deposited with the BNB, that it be open directly only to those institutions (e.g., commercial banks) having clearing accounts with the BNB, that it provide initially for three sub-accounts (general, investment, and collateral/Lombard accounts) and for all types of securities that might benefit from the system in the next five or so years. The report further recommends that each security issue be identified in accordance with international standards and that the system contain a fuller, standardized description of each issue's attributes. The system should record all types of transactions (original issue, all secondary trades, interest payments and maturity) needed to generate an accurate record of holders and to enable the BNB to carry out its fiscal agent responsibilities. Reliable, fast and secure means of notification of a transaction should be established, along

Under Article 45 of the Law on the Bulgarian National Bank of 1991 which laid down that the central bank was the official depository of the state monetary funds and under terms agreed upon with the Minister of Finance, the Bank was allowed to issue and manage securities of the state or securities guaranteed by the state which were public issues, the BNB and the Ministry of Finance concluded the first agency contract in early 1992. The agreement set out the agent's functions of the central bank related to the organization and conduct of short-term government securities auctions in the primary market and the repayment of these government securities upon maturity on behalf and for the account of the Ministry of Finance. The agreement had a clause regulating the monthly fee that the Ministry of Finance was to pay to the BNB for the performed agent functions.

Meanwhile, the first Ordinance No. 5 of the Ministry of Finance and the BNB on the Issuance, Sale and Repurchase of Short-term Book-entry Government Securities was adopted. It regulated the procedure and the frequency of the government securities auctions, the terms and procedure for the submission of bids for the auctions; the terms for settlement operations between the Ministry of Finance and the participants in the auction whose bids had been approved; the registration of the government securities in the register kept by the BNB; the procedures for concluding government securities transactions in the secondary market; the repayment of the amounts due to the issuer upon maturity of the issues, *etc*.

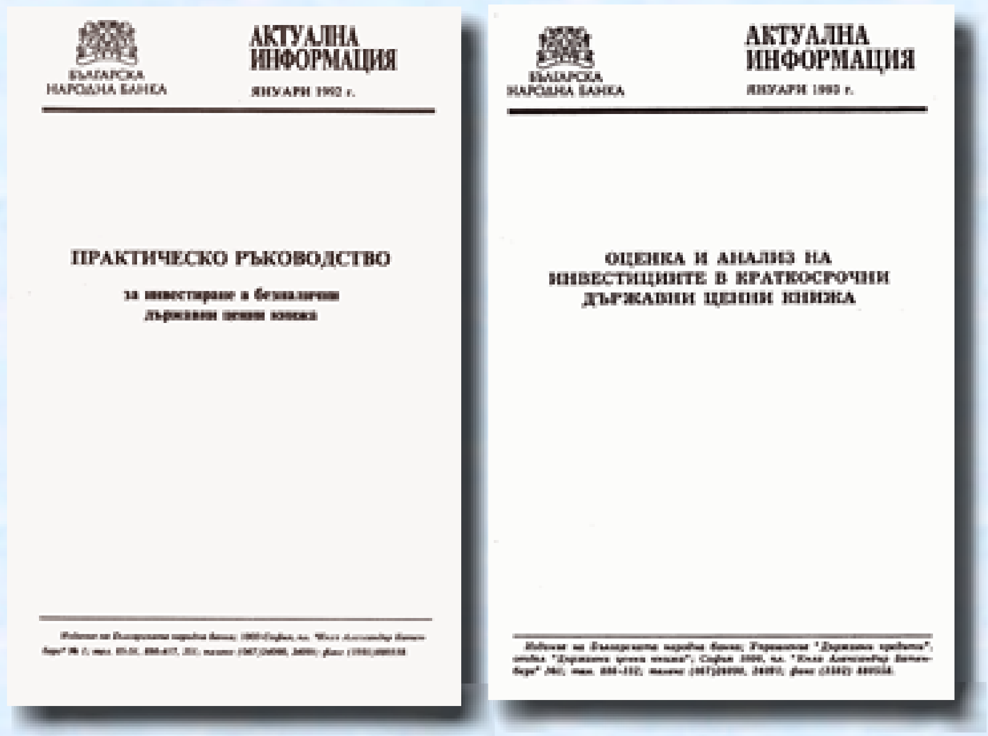
Immediately after the elaboration of the regulatory framework and settlement of the relations between the Ministry of Finance in its capacity as an issuer and the BNB in its capacity as a fiscal agent of the government, the first auction for book-entry government securities was conducted successfully on 3 February 1992. It offered a three-month issue which enjoyed a great interest on behalf of the financial institutions, which according to the regulations in force at that time, had the right to participate in the auctions.

At the early stage of the establishment and development of an effective government securities market, the central bank played a key role supported by the IMF, the US Treasury and the Federal Reserve Bank of New York.

The BNB was active in training the participants in the government securities market. To this end, the Bank organised and hosted seminars to explain the specifics of using government securities as an instrument for market financing of budget deficit and for regulating liquidity in the banking system by conducting open market operations. The Bank also published various leaflets.

With the development of the government securities market, the Bank's fiscal agent functions have been gradually expanding. In this context, the obligations of the central bank set out in the then concluded agent agreement between the Ministry of Finance and the BNB were continually being complemented by new functions. The Bank was to:

- organise and conduct diverse operations related to government debt management in line with the issuing policy of the Ministry of Finance: short- and long-term government securities sale auctions (1993); repurchase auctions (1994); replacement subscriptions (1999); auctions for sale of tap government securities issues (2000); auctions for government securities denominated in euro (2003); switch auctions for sale/buy-back of government securities and their replacement with government securities from other issue(s) (2004);
- support the establishment and development of an effective secondary market of government securities;
- register and service government securities issued under ZUNK (1993);
- register and service the securitised direct debt to the BNB (1994);


БЪЛГАРСКА НАРОДНА БАНКА
АКТУАЛНА ИНФОРМАЦИЯ
ЯНУАРИ 1992 г.
ПРАКТИЧЕСКО РЪКОВОДСТВО
за инвестиране в безналични държавни ценни книжа

БЪЛГАРСКА НАРОДНА БАНКА
АКТУАЛНА ИНФОРМАЦИЯ
ЯНУАРИ 1993 г.
ОЦЕНКА И АНАЛИЗ НА ИНВЕСТИЦИИТЕ В КРАТКОСРОЧНИ ДЪРЖАВНИ ЦЕННИ КНИЖА

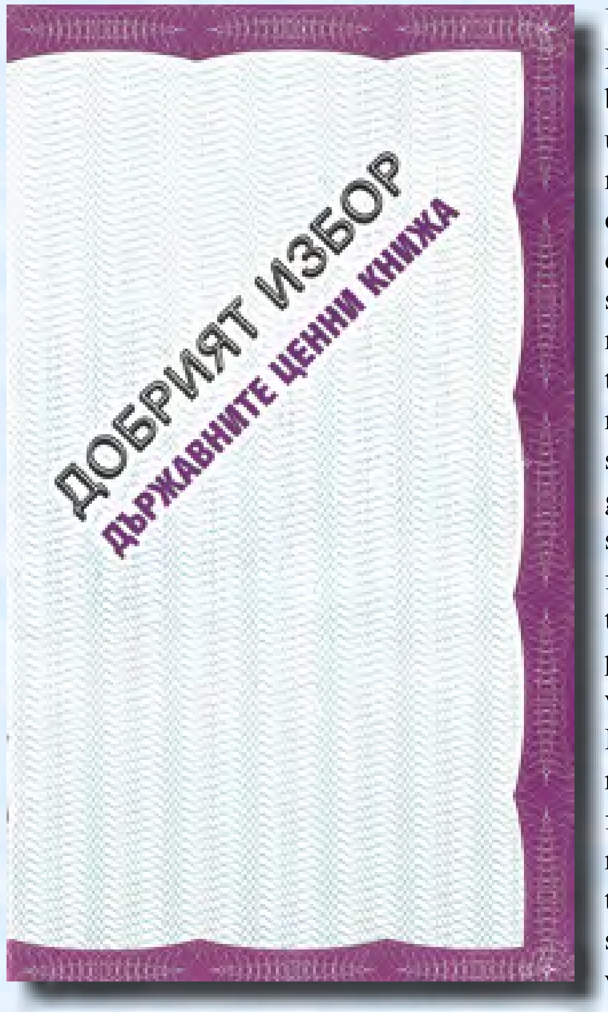
Manual of investment in book-entry government securities (1992) and Assessment and analysis of investment in short-term government securities (1993). The leaflets were published by the BNB to promote government securities and to provide useful information on the manners of participating in the primary and secondary market of government securities.

- sell desk book-entry government securities from target issues to corporations and individuals, register the transactions concluded by other dealers of this type of government securities and the repayment thereof (1994). The Bank continued to develop its functions in cooperation with the *Bank of England* and *National Savings*[8]. Under an agreement with the Ministry of Finance, the BNB undertook to organise a widespread advertising campaign (radio and television commercials, publication of leaflets, articles, and other advertising materials related to the sale of government securities including of target issues) on the sale of government securities from target issues in order to restore public confidence in this type of investment;

8 Post Office Savings Bank, set up in 1861 by the Palmerstone Government. In 1961 the Post Office Savings Bank became a separate government department accountable to Exchequer and was renamed National Savings. In 1996 the National Savings became an Executive Agency of the Chancellor of the Exchequer whose main activity was to enhance investment by selling savings bonds only to the public. From 2002 National Savings and Investments (NS&I) was the new name for National Savings and it was one of the biggest savings companies in Great Britain. As it used a government guarantee provided by the Exchequer, all products of the company had a 100 per cent coverage.

- actively participate in the selection of primary dealers of government securities (1996) and for this purpose support the Ministry of Finance in setting up the criteria for the selection of primary dealers; the Bank has representatives in the commission responsible for the selection of primary dealers and monitors the fulfilment of the set criteria; provide the information required by the issuer on the fulfilment of the key criteria by the primary dealers; communicate with the participants in the government securities market; perform examinations in the different institutions with a view to their technical preparedness to work on the government securities market, *etc*. In line with the agreement between the Ministry of Finance and the BNB on the redistribution of the functions of these two institutions of end-2007, the selection of primary dealers now is within the sole purview of the Ministry of Finance, while the Bank continues to provide the issuer with the necessary information contained in the systems that it operates;
- offer services to citizens and sell indexed treasury bills issued by the government in response to the growing needs of the government securities market for more stable financial instruments in the context of the financial crises in Bulgaria at the end of 1996 and in early 1997;
- register and service guarantee government securities used by the government to cover the obligations of the banks announced insolvent in the period 1996–1998 to the depositors therein;
- help increase the transparency in the government securities market by issuing information bulletins (monthly and quarterly) with aggregate data on the government securities auctions, transactions in government securities in the secondary market, government securities holders, debt government securities, issued on the domestic and external market, *etc*.;
- support the participants in the government securities market by providing up-to-date information on the changes in the regulatory framework and in the requirements on the completion of electronic communications used by the systems operated by the BNB.

After the adoption of the new Law on the Bulgarian National Bank and the introduction in Bulgaria of the currency board as of 1 July 1997, the possibility the central bank to credit the budget in whatever form was no longer available. Moreover, the securities issued or guaranteed by the Bulgarian government no longer were to be regarded as reserves. The Bank no longer provided advice with a view to government debt management. However, it retained its intermediary functions in its capacity as a government debt agent as provided for in the first Law on the Government Debt adopted in 2002. As a result, the Ministry of Finance and the BNB concluded a new Government Debt Agency Agreement to elaborate on the rights and obligations of the parties thereof.



Government Securities: the Good Choice (1994).
The leaflet was issued by
the BNB to promote government securities
earmarked for individuals and companies.

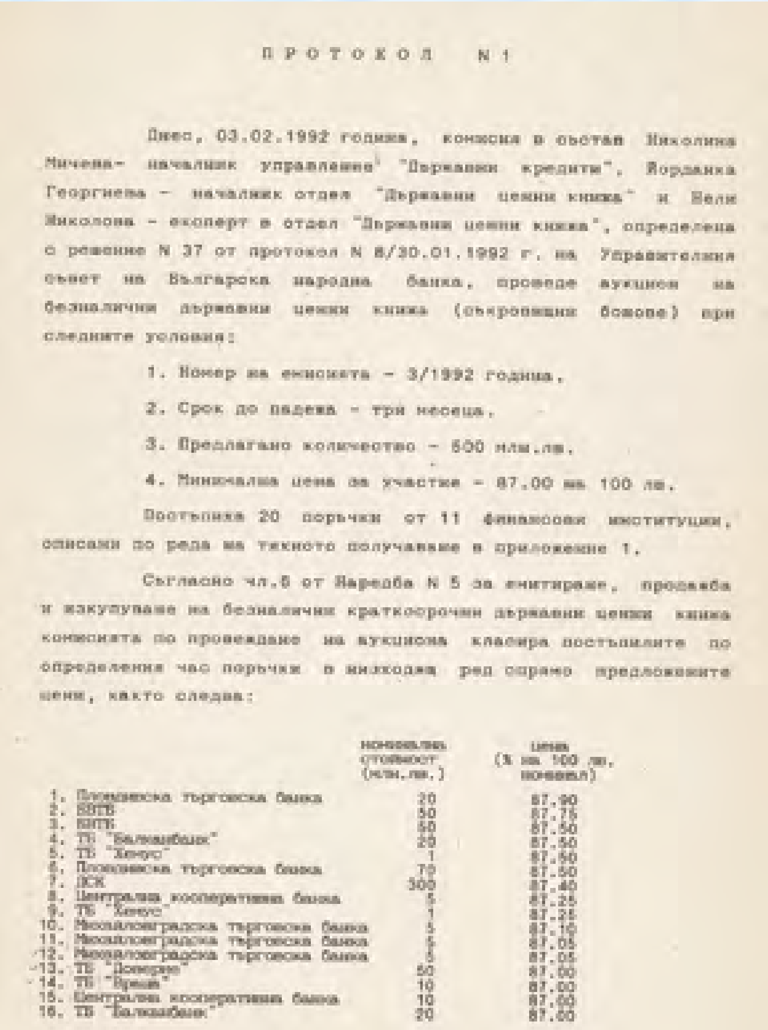
Under Article 43 of the current Law on the BNB, the central bank performs its activities under market conditions and at market prices. In line with the commitments assumed, the Bank develops and improves its systems continually: the government securities auction system; the electronic system for registering and servicing government securities trading, and the government securities settlement system. The Bank is responsible for the hardware, software and the maintenance thereof. In parallel, under the agreement with the Ministry of Finance, the Bank takes part in the development of the regulatory framework for the government securities market; issues an ordinance on the settlement of government securities; issues guidance for work with the systems used for government debt servicing. Regardless of the numerous amendments regarding the agent functions performed by the BNB, the organisation and conduct of government securities auctions *via* specially established automated systems remains an integral part of the Bank’s obligations.

2.2. Technical Support of Debt Management Operations

2.2.1. A Brief History

The Government Securities Auction System was initially developed in 1991 as part of the Electronic System for Registration and Trade in Government Securities (ESROT) by BNB experts with the technical assistance of the IMF and the Federal Reserve Bank of New York. The BNB conducted the first auction for sale of treasury bills using the system.

With the development of the government securities market, the system is continuously being modernised and improved in line with the demands of this market and the changes in the issuing policy of the Ministry of Finance, with the required technical support for the agent functions of the Bank being ensured. The system proved to function successfully also in the context of a financial crisis (1996–1997)[9], when the need for additional funds for budget deficit financing and debt servicing required the conduct of two or sometimes three auctions a day. This functionality contributed to the successful restructuring in the first half of 1997 of the domestic government debt issued in the form of government securities and the smooth introduction of the currency board as of 1 July 1997. With a view to the implementation of the Law on Redenomination of the Bulgarian Lev, the system was used for the successful denomination of the nominal value of the outstanding government securities issues as of 1 July 1999.



П Р О Т О К О Л   N 1

Днес, 03.02.1992 година, комисия в състав Николина Мичева- началник управление "Държавни кредити", Йорданка Георгиева - началник отдел "Държавни ценни книжа" и Нели Николова - експерт в отдел "Държавни ценни книжа", определена с решение N 37 от протокол N 8/30.01.1992 г. на Управителния съвет на Българска народна банка, проведе аукцион на безналични държавни ценни книжа (съкровищни бонове) при следните условия:

1. Номер на емисията - 3/1992 година.

2. Срок до падежа - три месеца.

3. Предлагано количество - 500 млн.лв.

4. Минимална цена за участие - 87.00 на 100 лв.

Постъпиха 20 поръчки от 11 финансови институции, описани по реда на тяхното получаване в приложение 1.

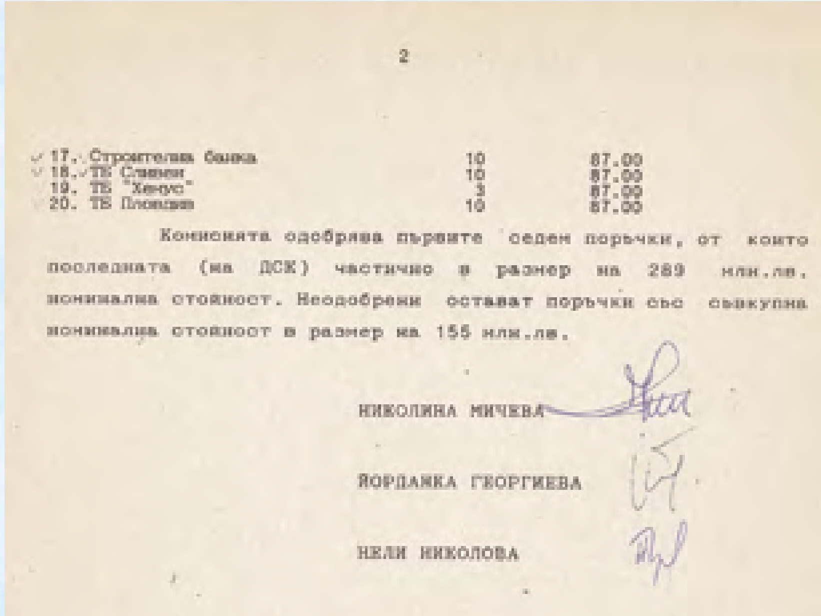
Съгласно чл.6 от Наредба N 5 за емитиране, продажба и изкупуване на безналични краткосрочни държавни ценни книжа комисията по провеждане на аукциона класира постъпилите по определения час поръчки в низходящ ред спрямо предложените цени, както следва:

	номинална стойност (млн.лв.)	цена (% на 100 лв. номинал)
1. Плевенска търговска банка	20	87.90
2. БНТБ	50	87.75
3. БНТБ	50	87.50
4. ТБ "Балканбанк"	20	87.50
5. ТБ "Хемус"	1	87.50
6. Плевенска търговска банка	70	87.50
7. ДСК	300	87.40
8. Централна кооперативна банка	5	87.25
9. ТБ "Хемус"	1	87.25
10. Михайловградска търговска банка	5	87.10
11. Михайловградска търговска банка	5	87.05
12. Михайловградска търговска банка	5	87.05
13. ТБ "Доверие"	50	87.00
14. ТБ "[illegible]"	10	87.00
15. Централна кооперативна банка	10	87.00
16. ТБ "Балканбанк"	20	87.00

Protocol No. 1 of 3 February 1992 on the results of the first auction for sale of book-entry government securities (see also p. 43).

9 The relative share of the total amount of domestic and external government debt by-end 1996 was 289.2 per cent of GDP, of which only 60.7 per cent domestic government debt. By end-1997 these shares accounted for 107.3 per cent and 25.6 per cent respectively.

In line with the Strategy for Bulgarian National Bank Development for the period 2004–2009 adopted by the BNB Governing Council and upon exploring the experience of other EU Member States, the Bank launched a new automated Government Securities Auction System (GSAS) in November 2004 and a new Electronic System for Registration and Servicing of Trade in Government Securities (ESROT) in May 2006.



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17. Строителна банка	10	87.00
18. ТБ Славяни	10	87.00
19. ТБ "Хемус"	3	87.00
20. ТБ Пловдив	10	87.00

Комисията одобрява първите седем поръчки, от които последната (на ДСК) частично в размер на 289 млн.лв. номинална стойност. Неодобрени остават поръчки със съвкупна номинална стойност в размер на 155 млн.лв.

НИКОЛИНА МИЧЕВА

ЙОРДАНКА ГЕОРГИЕВА

НЕЛИ НИКОЛОВА

2.2.2. Functionality of the GSAS

The government securities auction system is structured as an independent system that allows for fully automated processing of the auction bids from entry to exit under the provisions of Ordinance No. 5 of the Ministry of Finance and the BNB on the Terms and Procedure for Acquisition, Registration, Redemption and Trade in Government Securities. The system was developed by BNB experts in line with the business requirements agreed with the Ministry of Finance. GSAS functionality meets the issuer requirements for technical support of the list of debt management operations including government securities auctions; repurchase of government securities auctions with or without a definite term; and government securities replacement subscriptions. The system's major assets are:

- better communication with the government securities auction participants due to the application of interchangeable technical facilities (SWIFT and WEB-based interface in applying universal electronic signature) and international procedures and standards;
- providing automated processing of auction bids from entry to exit and submitting the aggregated information required for the registration and settlement of approved bids to the ESROT system;
- minimising risks of errors of manual document handling, which allows for a serious reduction of the time necessary for the auction and for

sending the results thereof to the Ministry of Finance within 30 minutes after the submission deadline;

- providing an opportunity for the preparation of different types of statements related to government securities auctions held.

The GSAS meets the up-to-date technological and software solutions and allows several auctions of different types to be conducted simultaneously. This is an open-end system and can be upgraded and supplemented in line with the development in the government securities market and the changes in the regulatory base. The interest rate conventions set up into the system are harmonised with those of the EU Member States.

Under Ordinance No. 5 of the Ministry of Finance and the BNB, the participants in the GSAS may be government securities primary dealers selected by the MF having the technical communication facilities needed to send bids for participation in auctions and to receive notifications by the BNB.

In order to entitle primary dealers to participate in the GSAS, each primary dealer should successfully pass tests to prove its technical preparedness to send bids in line with the publicly announced system rules. The participation in the GSAS is terminated unilaterally by the BNB when: the participant in the GSAS has been excluded from the list of primary dealers by a decision of the Minister of Finance; its participation in the ESROT has been terminated; the tests of the system have not been performed successfully.

For the participation in the GSAS and handling of the bids for each auction, the central bank ex-officio collects fees and commissions from the system participants under the Tariff of Fees and Commissions Charged on Processing Government Securities Transactions adopted by the BNB Governing Council in consultation with the Ministry of Finance.

One of the key requirements in the development of the GSAS was to ensure the confidentiality of information related with the conduct of government securities auctions. Access to the bids for the respective auction may be acquired only after expiry of the deadline for their receipt (10:00 am). Immediately after that, the information is processed and presented to the Ministry of Finance within a short period of time in order to approve the ranking made pursuant to the auction conditions initially announced by the issuer. The functionality of the GSAS gives the Ministry of Finance opportunity to announce the results in a period of 30 minutes to two hours after the auction as is the practice in the other EU Member States. Where the terms are amended by the Minister of Finance, the changes are reflected in the GSAS and a second ranking is made in line with the additional requirements set by the issuer. Where the Ministry of Finance sends the approved results to the BNB after 4:00 pm on the day of the auction, the central bank notifies all participants thereto on the following business day.

2.2.3. Functionality of the ESROT System

Since the very beginning, the ESROT functions in line with the relevant standards and recommendations in place for such systems adopted by G30. The delivery-versus-payment on a gross basis principle has been adopted for settlement of securities (Model 1)[10], which is applied and now is considered the lowest-risk system with a view to systemic risk; the T + 0 settlement cycle has been adopted and the current accounts of the participants in the central bank are used to settle transactions. Since its introduction, the system is being constantly developed and improved in line with issuer's requirements and the needs of conducting debt management policy.

After launching RINGS, a real-time gross settlement system, in 2003 the accounts, on which the government securities acquired by each participant and its customers are recorded, are transferred by the internal accounting system of the BNB in a separate Government Securities Settlement System.

The current ESROT version was developed in 2006 as an open-end system. The up-to-date technological and software solutions allow to extend and synchronise the working time with that of RINGS. The overall efficiency, reliability, transparency and accessibility of the system are increased together with the ability for its continuous improvement and development in line with the guidelines for the development of the European securities market and the requirement of the market participants and the issuer. From a functional point of view the ESROT and GSSS report to the international and European financial institutions as a unified system for registration and settlement of government securities – *BNBGSSS* (*BNB's Government Securities Settlement System*)[11].

The functionality of the system allows:

- straight-through processing (STP);
- real time transaction by transaction processing (*DvP*, Model 1) and *T + 0* settlement cycle in the secondary market;
- application of the bilateral notice principle, one request/notification of a transaction by each party thereto;
- to use two uniform communication channels: SWIFT per *ISO 15022* and a VPN web-based[12] interface using universal electronic signatures;
- using the International Securities Identification Number (*ISIN* code);

10 The so called delivery-versus-payment models of the Bank for International Settlements and the Committee on Payment and Settlement Systems were as follows: model 1 – gross and simultaneous settlement of securities and funds transfers; model 2 – gross settlement of securities transfers, followed by net settlement of funds transfers; model 3 – simultaneous net settlement of securities and funds transfers.

11 See *http://www.bnb.bg/FiscalAgent/FAServiceSystemDCK/FABNBGSSS/FAESROTINTRO/index.htm*

12 VPN (virtual private network).

- real time monitoring on behalf of the participants of the status of their requests for/notifications of registering government securities transactions at every stage of their processing;
- automatic generation of a general or detailed report about the government securities market for its participants, the issuer, ECB statistics, *etc*. through a statistical module in the system;
- automatic calculation of principals and interest on government securities issues payable by the issuer, in aggregate and by individual participant, based on the database and the interest rate conventions set up into the system according to the parameters of relevant issues.

The ESROT electronic system for registration and servicing of trade in government securities. The leaflet issued by the BNB contains information on the functionality of the system.

Under the Directive on Settlement Finality in Payment and Securities Settlement Systems (Directive 98/26/EO), the *BNBGSSS*, operated by the BNB, was notified in the European Economic Area as a government securities settlement system, functioning on the territory of the Republic of Bulgaria.

The BNB in its capacity as a fiscal agent and depository of the state has always supported the issuer's efforts to develop government securities market using the rich experience and modern systems acquired over time.

3. Primary Dealers of Government Securities

Trade in government securities is carried out by primary dealers – banks and investment intermediaries which have the right to acquire government securities directly at the auctions organised by the BNB. Only primary dealers who have obtained investment intermediary licences have the right to participate in these auctions.

From a historical perspective, the primary dealers' system in Bulgaria underwent diverse alterations. The currency board regime and Bulgaria's accession to the European Union resulted in new requirements for the institutional organisation and the domestic market infrastructure which meant that the latter should constantly improve in line with the guidelines on the development of the European securities market. Long after the launch of the first book-entry securities, the main or rather the only purchasers thereof were commercial banks. The terms under which the respective financial institutions may participate in the auctions are laid down in Ordinance No. 5 of the Ministry of Finance and the BNB on the Issuance, Sale and Purchase of Short-term Book-entry Government Securities effective as of February 1992.

The gradual development of the government securities market required the terms and procedure for participation in the auctions to be complemented. Since September 1993 government securities sales were effected in line with the amendments to Ordinance No. 5 on the Issuance of Book-entry Government Securities and the Procedure for their Acquisition and Redemption. The Ordinance provided for new requirements and broadened the range of participants in the government securities market. Only commercial banks, the SSB, the SII, and insurance corporations with no less than BGL 200 million registered capital, as well as financial houses and brokers, may participate in the auctions upon submitting an unlimited, unconditional and irrevocable bank guarantee to cover the obligations arising under the government securities transactions carried out by them.

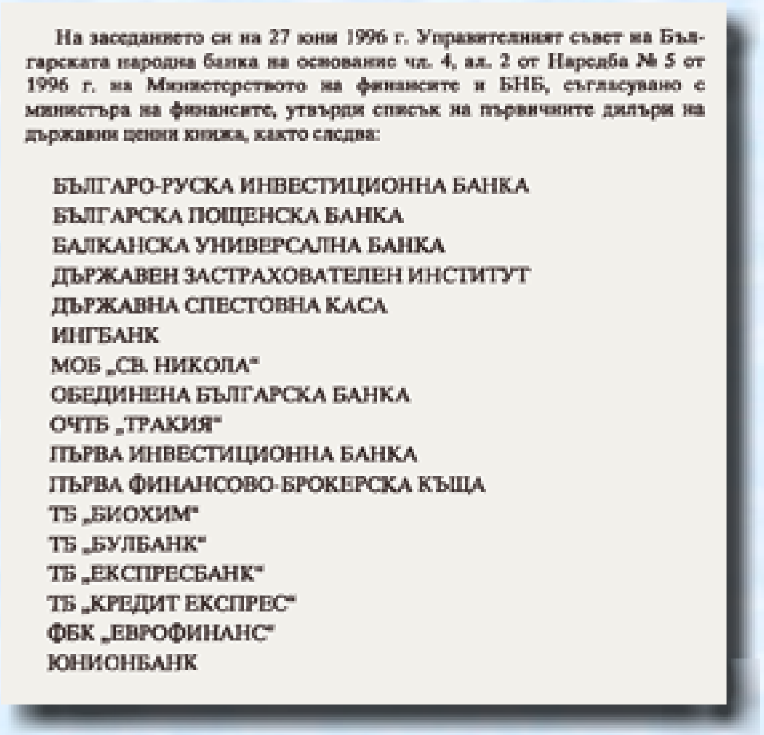
In compliance with the practice in most countries with developed financial markets, the primary dealership system was launched in 1996. Banks and investment intermediaries within the meaning of the Law on the Government Securities, Stock Exchanges and Investment Companies may participate in the auctions. The primary dealers are approved by a Commission whose members are appointed by the Minister of Finance and the BNB Governing Council. Primary dealers are designated twice a year according to the criteria set out by the Ministry of Finance and the BNB. The latter fall into several major groups:

- financial stability criteria based on the set indicators of liquidity, own funds, capital adequacy, and risk exposures;
- active participation in the primary and secondary markets of government securities over the period preceding the selection, participation in auctions, tariff for fees and commissions on processing government securities transactions offered;

- technical capabilities to manage the systems for registration of transactions in government securities: availability of an automated registers of the government securities held by them and their customers.

The evaluation of the applicants for primary dealers is carried out in line with the fulfilment of the set criteria and after on-site examinations made by representatives of the BNB and the Ministry of Finance. The Commission draws up minutes on the evaluation of the applicants for primary dealers. The list of primary dealers is approved by the Governing Council of the BNB and the Minister of Finance.

The introduction of the primary dealership system contributes to the development and improvement of the government securities market by expanding the range of participants in primary auctions to include licensed and approved non-bank financial institutions, as well as due to the decentralisation of the registers of government securities holders by making clearing, settlement and registration procedures easier and quicker. The BNB keeps registers of the government securities held by primary dealers. Each primary dealer keeps a register of the government securities held by its customers.


На заседанието си на 27 юни 1996 г. Управителният съвет на Българската народна банка на основание чл. 4, ал. 2 от Наредба № 5 от 1996 г. на Министерството на финансите и БНБ, съгласувано с министъра на финансите, утвърди списък на първичните дилъри на държавни ценни книжа, както следва:

БЪЛГАРО-РУСКА ИНВЕСТИЦИОННА БАНКА
БЪЛГАРСКА ПОЩЕНСКА БАНКА
БАЛКАНСКА УНИВЕРСАЛНА БАНКА
ДЪРЖАВЕН ЗАСТРАХОВАТЕЛЕН ИНСТИТУТ
ДЪРЖАВНА СПЕСТОВНА КАСА
ИНГБАНК
МОБ „СВ. НИКОЛА"
ОБЕДИНЕНА БЪЛГАРСКА БАНКА
ОЧТБ „ТРАКИЯ"
ПЪРВА ИНВЕСТИЦИОННА БАНКА
ПЪРВА ФИНАНСОВО-БРОКЕРСКА КЪЩА
ТБ „БИОХИМ"
ТБ „БУЛБАНК"
ТБ „ЕКСПРЕСБАНК"
ТБ „КРЕДИТ ЕКСПРЕС"
ФБК „ЕВРОФИНАНС"
ЮНИОНБАНК

List of financial institutions approved as government securities primary dealers after the introduction of the primary dealership system in Bulgaria and the first procedure for selection of government securities primary dealers in 1996.

The Law on the Government Debt adopted in 2002 clearly defines the powers, responsibilities and procedures related to the process of government debt issuance, which requires the conduct of a single policy by the individual institutions participating in the process. This called for a number of bylaws to complement the regulation of the overall process of government securities issuance with the primary objective to optimise the functions of the individual institutions related to the initial issuance of government securities on the domestic market and to the procedures for the subsequent trade in government securities on the secondary market. Pursuant to the provisions of the Law on the Government Debt, Ordinance No. 5

of 2002 on the Terms and Procedures for the Acquisition, Redemption and Trade in Government Securities, Ordinance No. 15 of 2002 on the Control over Transactions in Book-entry Government Securities and Ordinance No. 31 of 2003 on the Settlement of Government Securities were adopted by the Minister of Finance and the Governor of the Bulgarian National Bank.

Ordinance No. 5 of 2002 sets out the rights and obligations of the key participants in the government securities market: the issuer, the fiscal agent, the primary dealers and other government securities holders in the different types of operations and transactions carried out with government securities in the primary and secondary markets. The Ordinance lays down that the BNB should set up and maintain an Electronic System for Registration and Trade in Government Securities (ESROT).

Ordinance No. 15 of 2005 introduces a separate legislative act which regulates the rules and procedure for control over government securities transactions with the primary objective to ensure a fair, transparent and efficient government securities market, to protect investor interests and to minimise risks in government securities registration systems in line with the recommendations developed and adopted by the International Organization of Securities Commissions (IOSCO). The Ordinance also regulates the organisation of the control activities whose scope covers the main requirements for the selection of primary dealers of government securities, the adherence on behalf of primary dealers to the set criteria, as well as the control over the system for registration of transactions in government securities with the BNB and with the primary dealers.

Ordinance No. 31 of 2003 issued in line with the Law on the BNB regulates the settlement of government securities transactions carried out in the primary and secondary markets under Ordinance No. 5, as well as the requirement for the setting up and maintenance of an electronic system for settlement of government securities in the BNB.

In 2007 the regulatory framework of the government securities market in Bulgaria was changed. The amendments were driven by the Law on the Markets in Financial Instruments adopted by the National Assembly to transpose the up-to-date European requirements for investment intermediaries and trade in financial instruments, including government securities into Bulgarian legislation. The Law on the Government Debt was amended accordingly. In line with these amendments and in its capacity as a government debt agent, the BNB has established and operates the GSAS, ESROT and GSSS. The old ordinances were repealed and new were adopted – Ordinance No. 5 on the Terms and Procedure for Acquisition, Registration, Redemption and Trade in Government Securities, Ordinance No. 15 on the Control over Transactions in Government Securities, and Ordinance No. 31 on Government Securities Settlement. A new Tariff of Fees and Commissions Charged on Processing Government Securities

Transactions was developed and adopted. New criteria for the selection of primary dealers of government securities were approved, which, apart from the requirements for participation in the primary market, provided for criteria related to the support of a liquid and transparent market by a fixed lower threshold for the market share of dealers, participation thereof in consultations with the issuer, provision of accessible government securities services to investors, *etc*.

These changes and the development of the primary dealership system after 2007 are aimed at enhanced competition in the primary and secondary market of government debt between individual primary dealers through the implementation of a wide range of requirements for market behaviour with a relevant access to certain operations related to the initial issuance and domestic government debt management. The terms and procedure for the acquisition of government securities providing that only primary dealers may participate in the auctions were retained. A requirement to prove their technical preparedness to work with the government securities auction system and replacement subscriptions was introduced. The primary dealers have the right to submit bids on their own behalf and for their own account at auctions, as well as on behalf of and for the account of their customers. Primary dealers are selected once a year by a commission appointed by the Minister of Finance on the basis of the criteria approved by him.

The amendments introduce the concept of a single passport in the area of investment services and in the government securities market in particular, broadening of the range of persons authorised to participate in the government securities depository in the BNB. These may be both local and foreign banks and investment intermediaries which have been granted a license to conduct investment services and activities. The participants in the Government Securities Depository may be central depositories of government securities from EU Member States which provides a legal basis for the possibility to establish relations with foreign government securities depositories. A new special category of market participants was introduced: government securities subdepositories. These may be only banks whose licenses include the activities under Article 2, paragraph 2, item 4 of the Law on Credit Institutions. On a contractual basis, they keep registers of government securities, arranged by names of owners and by their customers and by customers of the participants in ESROT that are not subdepositories of government securities. The changes provide for enhanced control over the provision of depository and custodian services for customers portfolios in government securities to guarantee the stability and protection of customers' assets.

In line with the best practices, the Ministry of Finance continues elevating both the primary dealership system and the applicable regulations and methodology for regulating government securities markets which guarantees a safe, well-functioning, transparent and liquid market, as well as the timely integration of the domestic government securities market into the single European market. The smooth functioning of the domestic debt market is an important pillar of both the Bulgarian capital market development and state budget financing. As a bond issuer, the Ministry of Finance maintains an active dialogue with all market participants to meet investor preferences in terms of major bond characteristics and the future bond market development. Under the effective regulation, in December 2011 the Ministry initiated a transparent pre-announced procedure on selection of government securities primary dealers. The MF efforts to promote partnership with all market agents and to pursue a predictable issuing policy contribute to boosting the interest in primary dealership. At the end of 2011, 13 banks submitted applications for primary dealers for 2012, with all 12 primary dealers wishing to preserve their dealership status. The Ministry of Finance and the Bulgarian National Bank have highly appreciated the efforts of the financial community and especially of the banks, primary dealers, in developing Bulgaria's financial market.

Conclusion

Recent years' trends in the Bulgarian government debt management policy have contributed to enhancing the significance of domestic government securities, outlining them as a major instrument in the government debt structure and a key investment alternative offering an attractive risk to return ratio. Taking into account their role as a measure of a riskless rate of return and the related importance for the overall financial market development in Bulgaria, in recent years the Ministry of Finance has implemented a flexible, predictable issuing policy consistent with the domestic debt market environment. Over the past twenty years of transition to a market economy, administrative, technical, and last but not least, expert capacities have been established both within the Ministry of Finance as a government debt issuer and within the BNB as a government fiscal agent. Building the legal framework and technological infrastructure of the government securities market has allowed a shift from past loans from official creditors to market-oriented budget financing.

Offering benchmark issues in the whole securities spectrum and diversifying their maturity and currency structure by issues denominated and payable in euro have attracted more investors in the Bulgarian government debt market. Applying innovative instruments in the domestic financial market, including repurchase and replacement auctions as part of the active government debt management policy, has further improved the liquidity and government debt structure.

Amid the strong volatility in the global financial market and ongoing debt crisis in some euro area countries, Bulgaria has sustained its fiscal consolidation. Government bond demand has remained stable, with a pronounced downward trend in yields on all maturity segments observed over the recent years. This has been confirmed by the European Central Bank data on the harmonised long-term interest rate for assessing the degree of convergence (Maastricht criteria) which suggests that Bulgaria is among the fewer EU countries reporting decreasing values of this indicator in the last three years. Maintaining low-cost budget financing has allowed the tax burden in Bulgaria to remain small and service costs of government debt to be reduced over the medium to longer term.