REPUBLIC OF BULGARIA
MINISTRY OF FINANCE
99-00-196/09.07.2020г.

Bulgarian National Bank
БНБ - 60226/09-07-2020

MR MÁRIO CENTENO

PRESIDENT OF THE EUROGROUP

9 July 2020

Dear Mr Centeno,

Following up on our letter dated 29 June 2018, whereby the Government of the Republic of Bulgaria and the Bulgarian National Bank expressed firm intention to join the Exchange Rate Mechanism II (ERM II) and ultimately introduce the euro, and having regard to the statement by the Eurogroup of 12 July 2018, welcoming the intention of the Bulgarian authorities to put in place the necessary elements for the successful participation in ERM II, we hereby request to initiate the ERM II Procedure with the intention to join ERM II.

Please allow us to reiterate the achievements of the Republic of Bulgaria in preparing its economy for successful participation in ERM II:

(1) The Republic of Bulgaria has been successful in maintaining price and financial sector stability for more than 23 years now, by pursuing a monetary policy based on the fixed exchange rate of the Bulgarian lev against the Deutsche Mark since 1 July 1997, against the euro since 1 January 1999, within the currency board framework. Macroeconomic and financial stability has been supported by sound economic policies, in particular fiscal policy and macro-prudential policy. Such a policy mix is conducive to export competitiveness, growth and sustained real convergence.

(2) Since the introduction of the currency board, the Republic of Bulgaria maintained sound management of its public finances. General government debt declined significantly from 96.2% of GDP in 1997 to 20.4% in 2019. The general government fiscal position was balanced or in surplus between 1997 and 2008 and in deficit from -4.0% of GDP in 2009 to -0.4% of GDP in 2013. The deficit rose to -5.4% of GDP in 2014 due to one-off factors. Fiscal consolidation resumed since 2015 resulting in budget surpluses for four consecutive years, reaching 2.1% of GDP in 2019. Thus the Republic of Bulgaria faced the COVID-19 pandemic with favourable initial position of its public finances. The European Commission's Spring 2020 Economic Forecast projects the general government balance to deteriorate to -2.8% of GDP in 2020 and -1.8% of GDP in 2021. The debt ratio is set to go up in 2020 to 25.5% of GDP. According to the forecast, the debt ratio should remain at 25.4% of GDP in 2021.

(3) The Republic of Bulgaria also achieved a substantial reduction of external imbalances. The current account balance improved from excessive pre-crisis deficit levels to surpluses since 2013, largely due to strong export growth. Against this background, the net international investment position improved considerably, by 60.8 percentage points of GDP between 2010 and 2019, when it stood at -31.6% of GDP. The current account surplus is expected to exceed 4.0% of GDP in 2020. In the labour market, a shrinking labour force has been underpinning wage increase and thus income convergence. The unemployment rate fell to a historically low level of 4.2% in 2019. The adverse impact of the COVID-19 crisis on the labour market will be partly mitigated by Government's wage support measures. With the expected economic rebound in 2021, the current account surplus should further increase and unemployment should improve to around 6.0%.

(4) The Bulgarian banking system is highly liquid, profitable and well capitalized, with the total capital ratio standing at 20.45% in March 2020. Non-performing loans have been reduced significantly between 2015 and the first quarter of 2020 and are adequately covered by loan loss provisions. The Bulgarian National Bank maintains a vigilant and persistently conservative supervisory approach. It has been actively implementing guidelines and recommendations by the European Banking Authority and the European Central Bank in the field of prudential regulations, solvency and risk management practices.

(5) In the context of the European Semester, the Commission and the Council monitor, assess and issue recommendations to the Republic of Bulgaria, taking into account the progress made towards overcoming structural weaknesses and avoiding macroeconomic imbalances. In the 2020 Country Report, the Commission concludes that Bulgaria does not experience macroeconomic imbalances.

(6) The Republic of Bulgaria also carried out an extensive reform of its judicial and anti-corruption legal frameworks. In light of their importance for the stability and integrity of the financial system, Bulgaria will continue working consistently to implement those reforms and address any remaining challenges. The monitoring of the implementation of these reforms will be ensured by the national post-monitoring council and, in dialogue with the Commission, in the appropriate EU framework.

(7) Following our firm intention to join ERM II, the Republic of Bulgaria fully implemented the set of prior commitments in six policy areas – as put forward in the Action Plan for joining ERM II and the Banking Union in our letter of 29 June 2018.

- In its letter of 19 June 2020, the Republic of Bulgaria notified the ERM II parties of the progress made, i.e. the full implementation of the prior commitments under titles 2-6, and requested a formal assessment of the implementation of these policy commitments. Subsequently, the European Commission and the European Central Bank confirmed, each within its own area of competence, that these prior commitments had been fully implemented.

- As regards the implementation of the prior commitment under Title 1 - to further strengthen banking supervision by entering into close cooperation with the European Central Bank, the European Central Bank assessed the relevant Bulgarian legislation in the field of banking activities and prudential regulation, ensuring presence of the

necessary legal grounds for the Bulgarian National Bank to follow ECB instructions and to adopt all measures requested by the ECB in relation to Bulgarian credit institutions. The ECB also conducted in 2019 a comprehensive assessment of six Bulgarian banks. The comprehensive assessment identified needs for further strengthening of capital position of two banks, which submitted capital plans and undertook actions for covering the identified shortfalls, based on the guidance and terms for implementation as applied by the ECB. Both banks have already implemented their capital plans thus building-up additional capital buffers. On this basis, the European Central Bank adopted a decision to enter into close cooperation with the Bulgarian National Bank.

(8) In the past few months, constructive discussions were held with the European Central Bank, the Commission, the euro area Member States and Denmark on the necessary elements for joining ERM II.

In light of all of the above considerations, we hereby submit our application to join ERM II, i.e. to include the Bulgarian lev in ERM II, and restate our firm intention to introduce the euro once the convergence criteria in accordance with Article 140 of the Treaty on the Functioning of the European Union will have been fulfilled. To this purpose, we confirm our readiness to establish close cooperation with the European Central Bank and firmly commit to implement a number of policy measures in reform areas of high relevance for achieving a high degree of sustainable economic convergence and successful participation in the third stage of the Economic and Monetary Union, in particular:

1) to ensure the sustainability of the Bulgarian non-banking financial sector;

2) to ensure the timely and effective implementation of the Law on Public Enterprises of 8 October 2019 and enable the Agency for Public Enterprises and Control to assume the powers and competences set out in this Law;

3) to implement the roadmap on the insolvency framework adopted on 19 June 2019 to ensure the full transposition of Directive 2019/1023 in accordance with the applicable transposition deadlines;

4) to strengthen Bulgaria's anti-money laundering framework following the transposition of the 5th Anti-Money Laundering Directive (AML5 Directive).

The Republic of Bulgaria also remains dedicated to pursuing sustainable economic and structural policies that further enhance the competitiveness and resilience of the Bulgarian economy, including its financial system, as well as to maintaining an environment that is conducive to sustainable economic convergence.

We propose to include the Bulgarian lev in ERM II with a central rate equal to the current exchange rate of BGN 1.95583 to EUR 1 and we unilaterally commit to the existing currency board with no additional obligations on the ECB and other ERM II parties. The Bulgarian lev will be subject to the standard ERM II fluctuation margins set out in the Resolution of the European Council on the establishment of an exchange-rate mechanism in the third stage of economic and monetary union, Amsterdam, 16 June 1997 (97/C 236/03).

We stand ready to discuss further on this basis with the Eurogroup, Denmark, the European Central Bank and the European Commission, including on the main features of the arrangement with regard to the participation of the Bulgarian lev in ERM II.

For the Republic of Bulgaria

Vladislav Goranov
Minister of Finance

For the Bulgarian National Bank

Dimitar Radev
Governor

cc: Mr Tuomas Saarenheimo

President of the EWG and EFC

Ms Christine Lagarde

President of the European Central Bank

Mr Valdis Dombrovskis

Executive Vice President

Attachment

The Republic of Bulgaria's post-entry commitments for participation in Exchange Rate Mechanism II (ERM II)

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Bulgaria ERM II post commitments

1. ***Non-banking financial sector***

Ensure the sustainability of the Bulgarian non-banking financial sector. In particular, address the identified challenges in the non-banking sector with regard to the (i) adequacy of the level of technical provisions, (ii) compliance with the applicable requirements for assets and liabilities valuation, (iii) effectiveness of the system of governance and the (iv) application of the prudent person principle. (v) Ensure proper claims' handling and settlement process by undertakings, as required by the European Law in order to resolve the problems the Green Card system is facing that led to the imposition of monitoring by the international Council of Bureaux. (vi) Strengthen the capacity of insurance and social insurance supervision with provision of trainings. (vii) Ensure the efficient governance of the supervisory authority, including by timely filling open positions in their governing boards with persons of relevant skill and expertise and who meet all other necessary requirements.

Explanatory text

The financial sector needs a strong, high quality and well-enforced regulatory environment to ensure adequate allocation of capital inflows, which are likely to increase markedly upon entry into ERM II and euro adoption. The commitment addresses remaining weaknesses identified in the context of EIOPA's and Commission's assessment of the completion of the commitment on non-banking sector prior to the ERMII entry and more recent developments related to the functioning of the Bulgarian Green Card bureau, as well as the need to fill the vacant positions at the Financial Supervision Commission board. Commitments i)-v) were already covered in the FSC's supervisory plan from August 2019, agreed between FSC and EIOPA. The supervisory plan lists specific and measurable objectives. It includes deliverables that require supported supervisory conclusions and consequent timely corrective supervisory measures to ensure the undertakings' compliance with the applicable prudential requirements, as well as reporting on the monitoring measures that will guarantee the sustainability of the corrections. The supervisory plan contains information of confidential nature, accessible only to supervisors, which precludes sharing of its full content. All parts of this commitment will be monitored by EIOPA, whose opinion will inform the assessment by the Commission.

(i) adequacy of the level of technical provisions

The verification of the adequacy of the technical provisions is one of the ongoing supervisory activities of FSC that is required to ensure compliance with all the quantitative and qualitative requirements of Solvency II. The assessment of the adequacy of technical provisions includes the establishment of sufficient technical provisions with respect to the obligations related with the Green Card system. The FSC will carry out checks to reach a supervisory conclusion over the adequacy of technical provisions taking where needed the appropriate supervisory measures to ensure compliance with the Solvency II requirements.

(ii) compliance with the applicable requirements for assets and liabilities valuation

As agreed in the supervisory plan, FSC will reach a supervisory conclusion over the solvency position of undertakings considering the appropriateness of the valuation of the assets and liabilities. The actions to effectively enforce this commitment include the verification of the compliance with the valuation requirements, taking where needed the appropriate supervisory measures to ensure compliance with the Solvency II requirements.

(iii) effectiveness of the system of governance and the (iv) application of the prudent person principle

Following the agreed supervisory plan, FSC will reach a supervisory conclusion over the undertakings' appropriateness of the system of governance, including of the risk management system, taking where

needed the appropriate supervisory measures to ensure compliance with the Solvency II requirements. Likewise, the FSC will reach a supervisory conclusion, and take the appropriate supervisory measures, in regards the undertakings' compliance with the Prudent Person Principle (PPP) including in respect to how the undertakings' investment policies are aligned with the objectives in terms of risk and return and how it relates to the liabilities and solvency needs. The actions to effectively enforce this commitment include verification through thematic inspections and taking where needed the appropriate supervisory measures to ensure compliance with the Solvency II requirements.

(v) Ensure proper claims' handling and settlement process by undertakings, as required by the European Law in order to resolve the problems the Green Card system is facing that led to the imposition of monitoring by the international Council of Bureaux.

This element of the commitment addresses the concerns related to the Bulgarian Green Card system. The financial stability of the Bulgarian Green Card bureau is under pressure mainly due to the inadequacy of the claims handling process with respect to the applicable requirements by one undertaking. In December 2018, the international Council of Bureaux increased the bank guarantee required from the Bulgarian Green Card Bureau, put it under monitoring and requested sectoral reinsurance cover.

The FSC will reach a supervisory conclusion over the undertaking's adequacy of the claims handling process ensuring compliance with applicable requirements, due reimbursements and practices. FSC shall also play a coordinating role in fulfilling the requirements of the Council of Bureaux regarding the monitoring imposed on the National Bureau of the Bulgarian Motor Insurers. Furthermore, the FSC will monitor the financial stability of the National Bureau of the Bulgarian Motor Insurers and will receive periodic reports on its financial status, further ensuring that undertakings practices diverging from the applicable requirements in terms of claims handling are timely identified and subject to appropriate supervisory measures.

(vi) Strengthen the capacity of insurance and social insurance supervision with provision of trainings

The action includes the active participation of the supervisors in relevant trainings. This may include the strengthening of the FSC annual training plans and participation in the Training Pilot Project provided by EIOPA with the support of the EC Structural Reform Support Programme (SRSP) in the area of Solvency II regime.

(vii) Ensure the efficient governance of the supervisory authority, including by timely filling open positions in their governing boards with persons of relevant skill and expertise and who meet all other necessary requirements

It will be ensured that the non-banking supervisor is provided on an ongoing basis with the appropriate staffing and expertise at the level of the Board. The FSC should be able to demonstrate compliance of the Board appointment process with the national legislation and that the vacant positions at the Board are filled by persons with the relevant skills and knowledge of the sector for which they are responsible.

2. State-owned enterprises (SOE)

*Ensure the timely and effective implementation of the **Law on Public Enterprises** of 8 October 2019 and enable the Agency for Public Enterprises and Control to assume the powers and competences set out in this Law. The Bulgarian authorities also commit to (i) develop a state ownership policy; (ii) bring the composition of the boards of public enterprises in compliance with the selection procedures set out in the Law; (iii) undertake an analysis of the activities of state enterprises established by special laws and submit it to the Council of Ministers; and (iv) prepare and approve annual aggregate reporting on the performance of state public enterprises.*

Explanatory text

As part of the action plan to join the ERMII, Bulgaria started a reform of the framework of state-owned enterprises (SOE) corporate governance, in line with good international practices. Under the Structural Reform Support Programme (SRSP), Bulgaria received technical support from the OECD and adopted a Law on Public Enterprises (No. 79/08.10.2019), which sets the legislative foundation for the reform in the SOE sector.

The aim of this commitment is to ensure full compliance with the law and to enable the Agency for Public Enterprises and Control (Agency) to assume its role. This will require to implement without deviation and exceptions the provisions of the law respecting its timetable.

The Law sets out a series of transition provisions and subsequent deadlines. In particular:

- Within 3 months of the entry into force of this Law, the Council of Ministers shall adopt the Rules of Procedure of the Agency for Public Enterprises and Control.
- Within six months, the Council of Ministers should adopt its Implementing rules.
- Within six months, the Council of Ministers shall bring the regulatory framework into compliance with this Law.[1]
- Within 12 months, the composition of the boards of the public enterprises shall be brought in compliance with the selection procedures and the law (part (ii) of this commitment).
- Within 12 months, the agency has to prepare an analysis of the state enterprises to clarify the nature of the activities carried out by them – predominantly commercial or public functions and policies and submit it to the Council of Ministers (part (iii) of this commitment).
- Within 3 years, the Council of Ministers shall adopt a programme for transformation of state enterprises with predominantly commercial functions into joint stock companies.

In addition, the Law requires the development of a state ownership policy (part (i)) and annual aggregate reporting on the performance of state public enterprises (part (iv)).

The progress with the implementation of the Law largely relies on the continuous and effective collaboration of relevant line ministries. In this respect, it is important that the Ministries of Finance and Economy remain actively engaged in the steering of the follow up project, and other relevant stakeholders are involved. Enabling the Agency to perform its role will also require keeping its independence and ensuring appropriate resources, including through optimisation of the existing ones.

A SRSP follow-up project is planned to start in 2020, with a duration of around 18 months. The Agency for Public Enterprises and Control will benefit from OECD's assistance to develop: a policy document establishing the state's ownership policy for the next four years; a methodology for aggregate annual reporting, documenting the financial and non-financial performance of the SOE portfolio; a monitoring mechanism for board nominations; and guidelines for the analysis of the activities of state enterprises, with a view to assist their transformation into joint stock companies or agencies.

3. Insolvency framework

*Implement the roadmap on the **insolvency framework** adopted on 19 June 2019. This includes the implementation of (i) legislative amendments, (ii) organisational change, (iii) training programs for insolvency practitioners and judges, (iv) specialised electronic tools within insolvency and restructuring; (v) development and introduction of manuals, codes, templates and guidelines, (vi) statistical data*

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

collection and publicity, and (vii) any other amendments or actions necessary to ensure the full transposition of Directive 2019/1023 in accordance with the applicable transposition deadlines.

Explanatory text

The roadmap on the insolvency framework (hereinafter the roadmap) was produced with the support of the European Commission's Structural Reform Support Service and adopted on 19 June 2019 by the Council of Ministers. In order to continue the efforts to improve the insolvency and restructuring framework, Bulgaria should fully implement the adopted roadmap. The commitment text refers to the six components of the Roadmap that entail the below described actions:

(i) Legislative amendments. Adopting primary and secondary legislative amendments to:

a. Increase the efficiency of insolvency and restructuring procedures. This includes, amongst others, measures to: introduce early warning tools; introduce a procedure leading to a discharge of debt; facilitate the opening of insolvency proceedings; introduce a comprehensive framework for the duties of directors where there is a likelihood of insolvency, enable fast-track insolvency proceedings for SMEs; shorten procedural deadlines within restructuring and insolvency procedures; reform the regime of claw-back actions; introduce a new framework for the rehabilitation procedure; ensure protection of new financing, interim financing and other restructuring related transactions; introduce rules on cross-class cram-down; reform the rules on liquidation to shorten the procedure and make it less costly; introduce additional safeguards preventing fraudulent actions within procedures concerning restructuring; insolvency and discharge of debt.

b. Reform the organisation of the courts handling procedures concerning restructuring, insolvency and discharge of debt (i.e. judicial infrastructure).

c. Strengthen the regulation of the profession of insolvency practitioners

d. Introduce reforms to allow the use of electronic means throughout procedures concerning restructuring, insolvency and discharge of debt.

(ii) Organisational change. Adoption of the amended rules of procedure of the Ministry of Justice (i.e. complete the change of the organisational structure of the Ministry). This reform will operationalise the new regime for the profession of insolvency practitioners.

(iii) Training programs for insolvency practitioners and judges. For judges, a training methodology and specialised trainings will be developed and launched. For insolvency practitioners, the actions to be implemented are a continuation of efforts and will include the development of a methodology for assessment of training needs followed by the launch of the Continuous Professional Development framework.

(iv) Specialised electronic tools within insolvency and restructuring. Gradual implementation of the electronic tools and platforms to ensure electronic means of communication can be used by parties throughout insolvency and restructuring proceedings.

(v) Development and introduction of manuals, codes, templates and guidelines to ensure an efficient and effective use of procedures concerning restructuring, insolvency and discharge of debt.

(vi) Statistical data collection and publicity. Gradual enhancement of the process and the quality of the statistical data collection and processing to ensure an efficient monitoring of procedures concerning restructuring, insolvency and discharge of debt in line with the Restructuring Directive.

Whilst implementing the actions from the Roadmap, the Bulgarian authorities shall also ensure the full transposition of the Directive 2019/1023 on preventive restructuring frameworks on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt (the "Restructuring Directive"), in accordance with the

obliged entities and limited usefulness of the financial intelligence produced by the FIU for law enforcement authorities. As part of this commitment, the Financial Intelligence Unit will increase its resources in order to perform its role. This includes hiring more and specialised staff, as well as developing or acquiring IT tools to process and analyse the suspicious transactions reports it receives.

(iii) to draw up an action plan to follow up on the risks identified in its national risk assessment

The recently completed national risk assessment will be followed up by an action plan that will help the country to define an effective strategy to mitigate money laundering risks. A project with the Commission's DG REFORM under the Structural Reform Support Programme (SRSP) is planned to start in 2020 with the aim to support the design of such follow up actions and their implementation. The project will also complement the existing risk assessment by looking at risks in the non-profit sector and possible other areas not covered by the previous assessment (these may also include point (iv) below).

(iv) to complement its national risk assessment with an analysis of risks linked to virtual assets and general risks emanating from citizenship schemes

Bulgaria's exposure to emerging risk will be thoroughly analysed by producing sector-specific risk analyses. These include: (a) risks linked to virtual assets, in light of recent money laundering scandals in Europe involving virtual assets services providers; and (b) risks related to the possible misuse of citizen schemes for money-laundering purposes, in line with concerns raised by the Bulgarian parliament and the proposed amendments (adopted by government 2 October 2019).