

3.6 BULGARIA

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I. FRAMEWORK

The legal basis for the issue of covered bonds in Bulgaria is the new Covered Bonds Act (CBA), published in the State Gazette (*Darzhaven vestnik*) issue 25 of 29 March 2022, which entered into force on 8 July 2022. The CBA repealed the previous Mortgage-Backed Bonds Law adopted in 2000. Under delegation of the CBA, the Bulgarian National Bank (BNB) issued Ordinance No 42 dated 21 June 2022 on the Procedures and Conditions for the Issue of Covered Bonds (Ordinance No. 42). The CBA designates the BNB as the national competent authority for public supervision of covered bonds.

Pursuant to the CBA, covered bonds are debt securities, investors in, and other creditors in respect of, which, are secured by eligible assets serving. Covered bonds may be issued in accordance with the CBA or the national laws of a state part of the European Economic Area, which transposes Directive (EU) 2019/2162 of the European Parliament and of the Council of 27 November 2019 on the Issue of Covered Bonds and Covered Bond Public Supervision and amending Directives 2009/65/EC and 2014/59/EU (Covered Bonds Directive or CBD).

Covered bonds may be issued by a bank, licensed under the Bulgarian Credit Institutions Act, only after obtaining an explicit permission by the BNB.

II. STRUCTURE OF THE ISSUER

The CBA follows the so-called on-balance-sheet approach of issuing covered bonds. Covered bonds may be issued by banks that have been granted a banking license under the Bulgarian Credit Institutions Act and have received a prior permission by the BNB. The procedure and the necessary documents for obtaining permission to issue covered bonds, either as part of a programme or on a standalone basis, are set out in the CBA and build up on the minimum requirements of the CBA.

III. COVER ASSETS

The covered bonds' cover pool may consist of the following eligible assets of the issuing bank:

- > **Primary assets** under Art.129, (1), letters (a), (b), (d) to (g) of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and amending Regulation (EU) No 648/2012 (Regulation (EU) No 575/2013 or the Capital Requirement Regulation, CRR).
- > **Substitution assets** under Art. 129, (1), letter (c) of Regulation (EU) No 575/2013;

Primary assets shall form at least 85% of the outstanding covered bond principal, and shall generally be of the same type, whereas the assets referred to in each of letters (a) to (g) of Art.129, (1) of Regulation (EC) No 575/2013 form **a separate asset type**.

Upon approval by the BNB the issuing bank may also issue mixed asset covered bonds, which include another type of primary assets which have similar features, maturity structure and risk profile with the other type of primary assets.

To fulfil the coverage requirement of the Covered Bonds Act the issuing bank may include in the cover pool substitution assets, as well as any other type of primary assets, up to an amount not exceeding 15% of the outstanding covered bond principal.

The cover assets shall meet the requirements of Art. 129, (1a) – (3) of Regulation (EC) No 575/2013.

The tangible assets securing the primary assets (e.g. residential property) shall have received permission for use and any other applicable authorizations for proper operation. In addition, there must be in place

generally accepted valuation methods for estimating their value and the acts or documents for transfer of ownership over such assets shall be entered in the Property Registry (for immovable property), respectively in the Unified Ships Register (for ships), or the respective public register of the country where the respective asset is situated or registered.

Banks may also issue covered bonds using **intragroup pooled covered bond structures**, whereby the covered bonds issued by a bank from a particular group ("**internally issued covered bonds**") are included in the cover pool of covered bonds issued by another bank that belongs to the same group ("**externally issued covered bonds**") subject to certain requirements under Section III of Chapter II of CBA, such as:

- > the bank issuing externally issued covered bonds has acquired the internally issued covered bonds and has recorded them on its balance sheet prior to or simultaneously with their inclusion in the cover pool of the externally issued covered bonds;
- > the cover pool of the externally issued covered bonds includes only internally issued covered bonds of one bank from within the group;
- > the externally issued covered bonds are designated for placing to external investors not part of the issuer's group;
- > the externally and internally issued covered bonds shall meet, at the time of issuance, the requirements for credit quality step 1 as per part three, title II, chapter 2 of Regulation (EU) No 575/2013, or in case of subsequent change in the credit quality – credit quality step 2, as per the requirements of part three, title II, chapter 2 of Regulation (EU) No 575/2013, provided the BNB grants permission on the basis of a determination that such quality change is not the result from a breach of the requirements of CBA for issue of covered bonds.

Intragroup pooled covered bond structures can also be used in a cross-border context, whether the Bulgarian bank acts as issuer of the internally or the externally issued covered bonds.

Derivative contracts can be included in the cover pool where each of the following conditions is cumulatively met:

1. the derivative contracts are concluded under the terms of a derivative transactions master agreement, which is separate from any other master agreements of the issuing bank
2. the derivative contracts cannot be terminated upon the insolvency or resolution of the bank issuing covered bonds and are not part of a netting set which includes any derivative contracts concluded outside the master agreement under item 1
3. the derivative contracts are entered into exclusively for the purposes of hedging interest rate and currency risks associated with the cover assets and contain provisions ensuring that in the case of a reduction in the hedged risk the exposures under the contracts are adjusted in accordance with the reduction, as well as that the hedge is closed out when the hedged risk ceases to exist, and
4. the derivative contracts are enforceable in accordance with their terms.

The eligible counterparties to cover pool derivatives contracts include EU/OECD central banks and certain multilateral development banks, as well as credit institutions which qualify for credit quality step 1 or 2 under the CRR. With the BNB's prior approval, an issuer may transact with a credit institution of lesser credit quality or another type of counterparty.

Requirements for coverage, overcollateralization and liquidity

All present and future covered bond liabilities must be covered by claims for payment attached to eligible cover assets. The said **liabilities** comprise of obligations for:

1. payment of the principal amount of the covered bonds;

2. payment of interest and other monetary liabilities attached to the covered bonds;
3. payment attached to derivative contracts included in the cover pool; and
4. covering the costs related to maintenance and administration of covered bonds and cover assets in the event of placing the covered bonds under separate administration in accordance with Chapter Eight of the Covered Bonds Act.

The **eligible cover assets to cover these liabilities** are:

1. primary assets;
2. substitution assets;
3. assets included in the liquidity buffer; and
4. receivables of the issuer under derivative contracts included in the cover pool.

The cover assets may not include any assets in respect of which a default is considered to have occurred within the meaning given by Art. 178 of Regulation (EU) No. 575/2013.

The issuing bank shall ensure that the aggregate principal amount of all cover assets recorded in the cover register is at any time at least equal to the aggregate principal amount of outstanding covered bonds (“nominal principle”) and shall furthermore maintain at any time a minimum level of 5% of statutory overcollateralisation calculated under the nominal principle. The BNB may set a higher minimum level of mandatory overcollateralisation and may further revoke or amend this decision setting a different level of mandatory overcollateralisation. The covered bonds terms and conditions may provide for a level of voluntary overcollateralisation that is higher than the mandatory levels set at 5% or such higher level determined by the BNB.

IV. VALUATION AND LTV CRITERIA

Valuation

The valuation of the cover assets shall be carried out in accordance with the applicable accounting standards, Art. 6 of the CBA, and – in respect of cover pool derivatives – Art. 4 of Ordinance No. 42.

The value of primary assets included in the cover pool shall follow their outstanding principal amount, but shall not exceed the values, which are determined in Art. 129, (1) of the CRR for the different asset types, typically, by reference to the value of the tangible asset securing the primary asset. For valuation of the tangible assets securing primary assets, the issuing bank shall use an up-to-date valuation performed by an independent appraiser and shall not exceed the tangible asset’s market value or mortgage lending value, as the case may be. For valuation of a tangible asset, which is real estate, the comparable approach, income approach and cost approach shall apply, as well as the generally accepted methods related to these approaches.

LTV criteria

The LTV criteria for the assets in the pool are generally defined in the banks’ own lending policies depending on their risk appetite and their internal rules. No specific legal requirements are imposed by local banking law.

Nonetheless, primary assets can contribute towards the fulfilment of the coverage requirement of the CBA only up to the amounts specified in Art. 129, (1) of the CRR, which – most notably – provide for an LTV ratio of 80% for primary assets that are residential mortgage loans, 60% for loans secured by commercial real estate, or 60% in the case of loans secured by maritime mortgages on ships.

V. ASSET – LIABILITY MANAGEMENT

The covered bond issuer shall adopt separate rules and procedures for management of the risk associated with the issue of covered bonds, including for the performance of periodic stress tests of the cover pool and liquidity management. The stress tests of the cover pool shall be performed at least once every quarter in order to

assess whether the value of the cover pool will continue to meet the requirements for coverage and applicable level of overcollateralisation in the event of a sharp deterioration of market conditions, as well as ad hoc stress tests depending on the prevailing market conditions. In case if during a stress test the value of the cover pool falls below the required coverage amount, the cover pool shall be replenished with cover assets at the amount at least equalling the shortage identified during the stress test, within one month.

The issuing bank shall lay down rules and procedures ensuring that cover assets are properly segregated from the remaining assets of the issuer and shall be so booked and recorded on its balance sheet of the issuer. These rules and procedures shall also ensure the proper administration of cover assets in case said assets are placed under separate administration as a result of initiation of winding-up proceedings or imposition of reorganisation measures over the issuing bank.

In particular, the issuing bank shall record all cover assets that form part of the cover pool in the cover register maintained for the covered bonds. An asset shall be deemed included in the cover pool and thus separately booked and recorded on banks' balance sheet from the time of recording of the said asset in the cover register.

The removal of an asset from the cover register, including the replacement of an asset with another asset, shall be effected according to a procedure which approved in advance by the cover pool monitor or, respectively, by the BNB, where a cover pool monitor has not been appointed. Any deregistration effected in conflict with such procedures shall be ineffective.

Covered bond liabilities shall be collateralised by a first-ranking registered pledge over the pool of assets recorded in the cover register. The pledge must be recorded in Bulgaria's Central Register of Special Pledges (CRSP), except in the cases of a pledge on dematerialised internally issued covered bonds which shall be recorded in the Central Register of Securities kept by Central Depository, or in other relevant central securities depository where the internally issued covered bonds are registered. A security agent, as designated in the covered bonds' terms and conditions, shall be named as pledgee.

The pledge shall be perfected with regard to every cover asset included in the cover pool upon recording of the pledge in the CRSP, upon the initial creation of the cover pool, or, respectively, upon a subsequent inclusion of an asset in the cover register. The issuing bank shall record the original cover pool in the relevant cover register on the day of issue of the covered bonds and on the same day shall provide the BNB and the cover pool monitor, where such has been appointed, with the necessary data regarding the cover pool and proof that the recording has been effected. No subsequent recordations in the CRSP are required where changes of cover assets are taking place during the life of covered bonds – such changes are subject to recordation only in the cover register.

VI. TRANSPARENCY

The issuing bank shall publish, on a quarterly basis, detailed information on each covered bond programme or, respectively, standalone covered bond issue, to allow investors to assess the characteristics of the covered bond issue or programme and the risks associated therewith and to carry out their due diligence.

In the case of externally issued covered bonds, the issued bank shall provide investors with the information with regard to the internally issued covered bonds included in the cover pool of the externally issued covered bonds, on at least an aggregated basis or via a link to a relevant internet site on which such information is available.

The information shall be current as of the end of each calendar quarter and shall be published within 30 days after the end of the quarter.

The issuing bank shall publish the information in a separate section on its website and keep it for a period of at least five years after the date of payment of all obligations attached to the covered bonds.

VII. COVER POOL MONITOR AND BANKING SUPERVISION

Under the CBA, issuers may but are not required to appoint cover pool monitors. A cover pool monitor may be a bank authorised in the Republic of Bulgaria or in another Member State, including where such a bank was appointed as a security agent, or it may be an audit firm according to the Independent Financial Audit Act. An audit firm may not be a cover pool monitor for covered bonds issued by a bank of which the said company has been an auditor before the lapse of two years after the completion of the audit engagement under Art. 76 of the Credit Institutions Act. The choice of a cover pool monitor shall be coordinated with the BNB in the covered bonds permission procedure.

VIII. SEGREGATION OF COVER ASSETS AND BANKRUPTCY REMOTENESS OF COVERED BONDS

The issuing bank shall account for the assets recorded in a cover register separately on its balance sheet, in a manner that makes them identifiable at all times. The cover assets shall not be affected by the opening or continuation of winding-up proceedings or reorganisation measures with regard to the issuing bank and shall not fall within the scope of any such proceedings or measures. In case bankruptcy proceedings are opened against the issuing bank, assets recorded in the cover register as at the date of the decision to initiate bankruptcy proceedings as well as the proceeds from any payments on or in connection with such assets effected after the date of the decision to initiate bankruptcy proceedings shall not form part of the bankruptcy estate.

Any obligations for payment attached to the covered bonds shall not be subject to automatic acceleration and shall not be otherwise affected by the opening or continuing of winding-up proceedings or reorganisation measures with regard to the issuing bank, shall not fall within the scope of any such proceedings or measures, and shall continue to originate, to be serviced and enforced in accordance with their terms and conditions.

Any actions connected with the issuing of covered bonds, the recording and removing of assets in and from the cover register, as well as the discharging of covered bond liabilities, taken before or on the date of commencement of winding-up proceedings or the imposition of a reorganisation measure, shall not be null and void, unenforceable or voidable and may not be reversed by a competent authority or party in the winding-up proceedings or the reorganisation measure concerning the issuing bank.

Pursuant to Art. 51 of the CBA the BNB shall place covered bonds under separate administration from the rest of the estate of the issuing bank and appoint a special administrator of the covered bonds upon withdrawal of the banking license of the issuer or after the issuer has obtained permission for voluntary liquidation in accordance with the Bulgarian Credit Institutions Act.

When the BNB determines that this is necessary in order to ensure the due discharge of the covered bond liabilities, the BNB has the right, but not the obligation, to place covered bonds under separate administration and appoint a special administrator in the following cases:

1. a decision has been taken determining that the deposits in the issuing bank are unavailable;
2. early intervention measures or resolution actions have been taken in respect of the issuing bank in accordance with the Recovery and Resolution of Credit Institutions and Investment Firms Act;
3. the issuing bank has defaulted on a due obligation for payment of interest or principal under the covered bonds or on a due payment under a cover pool derivative contract; or
4. there are other circumstances that give rise to well-founded concerns about the continuous and sound administration of the covered bonds by the issuing bank.

As special administrator may serve one or two natural persons who meet the requirements for a bankruptcy trustee under the Bulgarian Bank Bankruptcy Act. Upon appointment of the special administrator, all powers of the management and supervisory bodies of the issuing bank related to the administration of the covered bonds and the cover pool shall be suspended and shall be exercised by the special administrator, unless the decision

on the appointment thereof provides for any restrictions. In particular, the special administrator has the right to enter into transactions, to dispose of individual cover assets or the cover pool, as a whole, and to take all other actions covered by the issuing bank's banking license as may be necessary for the proper administration of the covered bonds, the management of the risks associated with the cover assets, and for providing liquid assets for the discharge of the liabilities attached to the covered bonds.

When covered bonds are placed under separate administration, claims attached to cover bonds shall be satisfied as preferred claims from the proceeds from cover assets, including from the proceeds upon the realisation of the collateral. Cover assets and the funds left, if any, after the claims attached to cover bonds have been satisfied in full shall be restored to the estate of the issuing bank. Any covered bond liabilities that are not satisfied in full after the maturity date of the cover bonds, or otherwise after the liquidation of the cover pool, shall take part in any winding-up proceedings in respect of the issuing bank as common unsecured claims.

IX. RISK-WEIGHTING & COMPLIANCE WITH EUROPEAN LEGISLATION

Risk weighting

Criteria for exposures secured by mortgages on immovable property are laid down in Ordinance No. 7 of 24 April 2014 on Organisation and Risk Management of Banks, adopted by the Bulgarian National Bank (Ordinance 7); Art. 27(1) of this Ordinance states, as regards the application of Art. 124, (2) of Regulation (EU) No 575/2013:

1. The part of the exposure secured by mortgages on residential property that receives a risk weight of 35% shall not exceed 70% of the lower of the market and mortgage lending value of the property in question;
2. Part of the exposure secured by mortgages on commercial immovable property that receives a risk weight of 50% shall not exceed 50% of the lower of the market and mortgage lending value of the property in question.

For the purpose of updating the ratios mentioned in paragraph 1, banks shall submit data required under Art. 101 of Regulation (EC) No 575/2013 and in Annex VI and Annex VII of the Implementing technical standard for supervisory reporting, taking into account the percentages under items 1 and 2 above.

According to Art. 29. (1) of Ordinance No 7 referring to Art. 400, (2) of Regulation (EU) No 575/2013, in calculation of large exposures under Art. 395, banks shall exempt legally required guarantees used when a mortgage loan financed by issuing covered bonds is paid to the mortgage borrower before the final registration of the mortgage in the land register, provided the guarantee is not used as reducing the risk in calculating the risk-weighted exposure amounts. According to Art. 29, (2), item 3., in calculation of the large exposures under Art. 395, banks shall include 20% of the following exposures: covered bonds falling within the terms of Art. 129, (1), (3) and (5) of Regulation (EU) No 575/2013. According to Art. 29, (5) in applying the exemptions, banks shall monitor compliance with the requirements of this article and Art. 400, (3) of Regulation (EU) No 575/2013. The BNB may at any time carry out a check on compliance with this requirement and to require information evidencing the compliance.

Compliance with European Legislation

The CBA transposes the Covered Bond Directive into Bulgarian law. The legislation when taken together with the practices, processes and procedures across the industry will fall within the criteria for preferable capital treatment of Art. 129 of the Regulation (EU) No 575/2013.

X. ADDITIONAL INFORMATION

The BNB, as the authority exercising covered bond public supervision, shall cooperate, inter alia by exchanging information, with the Bulgarian Financial Supervision Commission (FSC), with the respective competent authorities of the other Member States performing covered bond public supervision, with the EBA and, where appropriate, with the European Securities and Markets Authority.

The provisions of the Public Offering of Securities Act (POSA), the statutory instruments for the application thereof, Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are **offered to the public or admitted to trading on a regulated market**, and repealing Directive 2003/71/EC (OJ L 168/12 of 30 June 2017) (Regulation (EU) 2017/1129) and the other applicable acts of European Union law shall apply when covered bonds are offered to the public, as well as where public bonds are admitted to trading on a regulated market, which requires publishing a prospectus subject to approval by the FSC.

The issuing bank shall submit an application and necessary documents and information for obtaining permission to the BNB, unless the said bank has already obtained such permission, not later than 60 days before the submission of an application for approval of a prospectus by the FSC. In such cases, the issuer shall provide the prospectus, as drawn up, to the BNB simultaneously with the submission of the application for approval of the prospectus by the FSC.

Where covered bonds are **offered without a requirement to publish a prospectus**, an offering circular shall be drawn up for subscription for covered bonds according to the procedure established by the Commercial Act or, respectively, an offer document according to the procedure established by Art. 89 (c) or 89 (d) of the POSA.

The prospectus or, respectively, the offering circular for subscription of covered bonds, shall contain the following **additional information**:

1. Information on the rules and measures taken by the issuing bank for recording and keeping information in the cover register and for access to the cover register;
2. Information on the cover pool, including
 - (a) data on the value of the cover pool;
 - (b) the geographical distribution and type of cover assets;
 - (c) the maturity structure of cover assets;
 - (d) the minimum level of required coverage and the minimum level of required overcollateralisation;
 - (e) information on the outstanding principal amount of each cover asset at the time of origination of the said asset and by the end of the last full calendar quarter;
 - (f) total valuation of the assets securing cover assets and ratio of the outstanding principal amount and the valuation at the time of origination of the cover assets and by the end of the last full calendar quarter, as well as the valuation method used to carry out the valuation;
 - (g) characteristics of cover assets, including applicable interest rates, fees and commissions;
 - (h) the risks associated with cover assets by the end of each calendar year, from the time of the origination of the said assets and by the end of the last full calendar quarter.

Bulgarian covered bond market information

Since 2000 until 2014, 29 mortgage bonds of 11 issuing banks were issued in Bulgaria. The total principal amount of the bonds issued was about EUR 275 million. As of May 2023, no Bulgarian mortgage or other covered bonds had been outstanding.

For the most up-to-date information, please consult the new ECBC Covered Bond Comparative Database webpage on the Covered Bond Label website www.coveredbondlabel.com or via the following QR code:

