

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 Law, adopted by the 47th National Assembly on 16 March 2022 and published in the State Gazette (*Darzhaven vestnik*) issue 25 of 29 March 2022, entering into force on 8 July 2022, with which the previously existing Mortgage-backed Bonds Law adopted in 2000 was repealed.

The covered bonds are debt securities, which are secured by assets serving for satisfying receivables of investors in their capacity of preferred creditors, issued in accordance with the Covered Bonds Law or the legislation of national legislation of a Member Country of European Union for transposition of 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 (OB, L 328 of 18 December 2019).

Issue of a Covered Bond Program or issue of a single Covered Bond Issue is only allowed after an explicit permission is received by the Bulgarian National Bank (BNB). The application shall include legally required information and confirmation of meeting certain criteria.

II. STRUCTURE OF THE ISSUER

The Covered Bonds may be issued by banks that have been granted a banking license under the Credit Institutions Law. The public supervision of the Covered Bonds is of the responsibility of the Bulgarian National Bank under the Covered Bonds Law and the Ordinance No42 adopted by BNB on 21 June 2022, in force since 8 July 2022.

III. COVER ASSETS

The Covered Bonds are secured by assets of the issuing bank, which are acceptable assets that are:

- > **Principal cover:** primary assets under art.129, paragraph 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"), which shall form at least 85% of the outstanding covered bond principal. The cover pool of primary assets shall be of the same type.

The tangible assets securing the assets in the principal cover shall have received permission for use and other authorizations for proper utilization and for them to be available generally accepted evaluation methods for estimating their value and the acts or certificates arranging the property transfer rights shall be entered in the Property Registry, respectively for ships – shall be entered in Unified Ships Register

Upon approval by BNB under Chapter VI of the Covered Bond Law the issuing bank may include other primary assets in the cover pool up to 15% of the outstanding principal of the covered bonds. These shall have similar features, maturity structure and risk profile with the initially included primary assets.

- > **Substitution cover** under art. 129, paragraph 1, letter (c) of Regulation (EU) No 575/2013;

The assets included in each of letters from (a) to (g) in art.129, paragraph 1 of Regulation (EC) No 575/2013 form **a separate coverage asset type**.

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

Banks may issue covered bonds as a result of using **intragroup pooled covered bond structures**. 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 the certain requirements under Section III of Chapter II of Covered Bonds Act.

The covered assets may be **intragroup issued covered bonds** provided the following conditions were met:

- issuer bank has acquired the intragroup issued covered bonds and has include them in its balance sheet prior to or simultaneously with their inclusion in the cover pool; and
- the cover pool of the externally issued covered bonds (issued outside issuer's group) includes only intragroup issued covered bonds issued by only one bank from this group
- the externally issued bonds are designated for placing to external investors not part of the issuer group
- the externally and intragroup issued cover bonds shall meet the quality requirements for first quality rank at the time of issue as per the requirements of part III, section II, chapter II of Regulation (EU) No 575/2013 or in case of change in the credit quality – to second quality rank, as per the requirements of part III, section II, chapter II of Regulation (EU) No 575/2013, provided BNB grants permission on the basis of such quality change is not a result from breach of the requirements of Covered Bond Law for issue of covered bonds.

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

1. the derivative contracts concluded under the terms of a derivative transactions framework agreement other than the rest of the framework agreements of the issuing bank and segregated for each covered bond programme of the said bank or particular issues under the said programme or, respectively, for each covered bond issue that is not part of a programme
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 framework agreement under item 1
3. the derivative contracts are exclusively for purposes of hedging interest rate and currency risks associated with 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 called or otherwise closed out when the hedged risk cases to exist, and
4. the derivative contracts are performable in accordance with the terms and conditions thereof.

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** represent obligations for 1. payment of the principal amount of covered bonds; 2. payment of interest and other monetary liabilities attached to covered bonds; 3. payment attached to derivative contracts included in the cover pool; 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 **permitted assets to cover these liabilities** are primary assets; substitution assets; assets included in the liquidity buffer and claims for payment attached to 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 Article 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 overcollateralisation calculated under the nominal principle. BNB may set a higher minimum level of

overcollateralisation and may further revoke or amend this decision setting a different level of overcollateralisation. The conditions containing the rights and obligations attached to covered bonds may provide for a minimum level of overcollateralisation that is higher than the levels set at 5% or such higher level determined by BNB.

IV. VALUATION AND LTV CRITERIA

Valuation

The valuation of the cover assets, which value serve for calculation of the coverage percent, overcollateralisation and liquidity of a cover bond issue shall be carried out according to applicable accounting standards and art. 6 of the Covered Bonds Act, as well as art. 4 of Covered Bonds Act in respect to evaluation of the derivatives contracts. For valuation of the cover assets generally accepted methods shall be used by the appointed independent appraisers. For evaluation of a tangible asset – real estate shall be applied the comparable approach, income approach and cost approach, as well as the generally used 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 the local banking law.

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 minimum level of overcollateralisation and in the conditions of the covered bond issue, in the event of a sharp deterioration of market conditions, as well as ad hoc stress tests depending on the prevailing at that time market conditions. In case the amount of the cover pool is below the required coverage amount, it shall be replaced by cover assets at the amount at least equaling to discovered during the stress test shortage amount within 1 (one) month.

The issuing bank shall lay down rules and procedures ensuring that cover assets are properly segregated from the rest of the assets of the issuer and will be shown on its balance sheet separately from the rest of the property thereof, as well as to ensure the proper administration of cover assets in case the said assets are placed under separate administration according to the winding-up proceedings and reorganisation measures.

Covered bond liabilities shall be collateralised by a first-rank registered pledge on the set of cover assets recorded in the cover register. The pledge shall be subject to recording in the 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 Securities Depository ("CD"), or in other relevant central securities depository where the internally issued covered bonds are registered. The collateral agent, as designated in the conditions containing the rights and obligations attached to covered bonds, shall be named as pledgee.

A pledge on the separate cover assets in the cover pool shall not be subject to recording in the CRRP. The pledge shall be considered to be created and enforceable with regard to any cover asset upon the recording of the pledge in the CRRP 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 monitor, where such has been appointed, with the necessary data regarding the cover pool and proof that the recording has been effected.

The issuing bank shall record all new assets that are included in the cover pool in the relevant cover register. A legally valid and enforceable inclusion of an asset in the cover pool, which is enforceable against the issuer

and against all third parties, shall be considered to exist as from the time of recording of the said asset in the cover pool. As from the time of recording in the cover register of each subsequently included asset, the said asset shall be included in the pledge created to secure covered bond liability claims without the need of an additional recording.

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

VI. TRANSPARENCY

Upon the exercise of the powers thereof regarding public supervision under this Act, the BNB, as an authority performing 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 issuing bank shall publish, on a quarterly basis, detailed information on each covered bond programme or, respectively, 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 be obliged to provide investors with the information with regard to the internally issued covered bonds which are 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 the said 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 concerned.

The issuing bank shall publish the information in a separate section on the Internet site thereof for a period expiring not earlier than five years after the date of payment of all obligations attached to the covered bond issue or programme.

VII. COVER POOL MONITOR AND BANKING SUPERVISION

A cover monitor may be a bank authorised in the Republic of Bulgaria or in another Member State, including where such a bank has appointed a collateral agent, or an audit company according to the Independent Financial Audit Act. An audit company may not be a cover 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 Article 76 of the Credit Institutions Act.

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

The issuing bank shall show and record assets recorded in a cover register separately on the balance sheet thereof in a manner that the said assets are identifiable at all times. These 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 a cover register by 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 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 the conditions applicable under Covered Bond Act notwithstanding any such proceedings or measures.

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

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. The proceeds shall be recorded in the cover register, with a separate sub-register being kept for the said proceeds. Cover assets and the funds left after the claims attached to cover bonds have been satisfied shall be restored to the rest of the property of the issuing bank.

IX. RISK-WEIGHTING & COMPLIANCE WITH EUROPEAN LEGISLATION

Risk weighting

Criteria for exposures secured by mortgages on immovable property are treated in Ordinance No. 7 of 24 April 2014 on Organisation and Risk Management of Banks, adopted by the Bulgarian National Bank ("Ordinance 7")¹, in which article 27(1) states as regards the application of Article 124, paragraph 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 Article 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 Article 29. (1) of Ordinance No 7 referring to Article 400, paragraph 2 of Regulation (EU) No 575/2013 in calculation of large exposures under Article 395, banks shall exempt legally required guarantees used when a mortgage loan financed by issuing mortgage 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 article 29 (2), item 3., in calculation of the large exposures under Article 395, banks shall include 20% of the following exposures: covered bonds falling within the terms of Article 129, paragraphs 1, 3 and 5 of Regulation (EU) No 575/2013. According to article 29 paragraph 5 in applying the exemptions, banks shall monitor compliance with the requirements of this Article and Article 400, paragraph 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 Covered Bonds Act is transposing 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 (OJ L 328/29 of 18 December 2019) that are secured by assets which serve to satisfy covered bond investors as preferred creditors.

¹ Published in the State Gazette (Darzhaven Vestnik), Issue 40 of 13 May 2014, last amended by issue 40 of 14 May 2021. http://www.bnb.bg/bnbweb/groups/public/documents/bnb_law/regulations_risk_management_en.pdf.

The Covered Bonds Law is compliant with the requirements of Article 52(4) of Directive 2009/65/ EC (the "UCITS Directive"). The legislation when taken together with the practices, processes and procedures across the industry should fall within the criteria of Article 129 of the Regulation (EU) No 575/2013.

A collective investment scheme may invest up to 25% of the assets thereof in covered bonds. The total value of the investments above the limit for exposures to a single issuer may not exceed 80% of the assets of the collective investment scheme.

X. ADDITIONAL INFORMATION

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 be obliged to submit an application and necessary documents and information for obtaining permission to 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 be obliged to 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**, a proposal shall be drawn up for subscription for covered bonds according to the procedure established by the Commerce Act or, respectively, an offer document according to the procedure established by Article 89c or 89d of the POSA.

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

1. rules and measures taken by the issuing bank for storing information in the cover register and for access to the said register;
2. 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 by 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 ration of the outstanding principal amount and the valuation by 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 in Bulgaria had been issued 29 mortgage bonds by 11 issuing banks and totalled EUR 273.3 mn. As of 31 March 2022 there were no mortgage or other covered bonds 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.

In the context of the transposition of the Covered Bond Directive (the final deadline for which was 8 July 2022), the ECBC has undertaken a full review and update of the Covered Bond Comparative Database to take account of the latest regulatory developments. This unique reference tool can be accessed via the link hosted on the Covered Bond Label website (www.coveredbondlabel.com/legislation/comparative_database).

For further national information on the Bulgarian market, please see compare.coveredbondlabel.com/frameworks. To access the "Country Comparison" feature of the database, please see compare.coveredbondlabel.com/compare/select/frameworks.