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# NAVIGATING BULGARIA'S PATH TO THE EUROZONE ACCESSION



## Introduction

Bulgaria's journey towards Eurozone accession has been marked by strategic milestones and ongoing preparations. Since signing the Treaty of Accession to the European Union, the country has set its sights on adopting the euro, anticipating significant benefits for its economy. However, the path to euro adoption entails meeting stringent economic and legal criteria outlined in the 1992 Maastricht Treaty. These criteria encompass factors such as price stability, sustainable public finances, exchange rate stability, and long-term interest rates.

In addition to the currency peg to the euro set at 1.95583 leva for 1 euro, the country's participation in the Exchange Rate Mechanism II (ERM II) underscores its commitment to the euro transition, setting the stage for the Eurozone accession tentatively scheduled for January 1, 2025. While Bulgaria has made notable progress, challenges remain, particularly in achieving and maintaining price stability. Bulgaria's inflation rates have exceeded the thresholds set by the European Union, necessitating efforts to address underlying economic imbalances and structural inefficiencies. Another factor that could potentially delay Bulgaria's accession to the Eurozone in early 2025 is the ongoing political instability. With a caretaker government currently in power and expected another round of early parliamentary elections in June 2024, it is debatable whether the country will be able to meet the necessary criteria within the anticipated timeframe.

Other than the economic convergence criteria and the clear and stable political course, transitioning to the euro requires comprehensive adjustments in the Bulgarian legislation, to ensure that the national legislation is tailored to meet the Eurozone accession.

## Bulgaria's General Legislative Approach

Bulgaria has adopted a multilayered approach to the Eurozone accession, underpinned by strategic planning and legislative initiatives. Central to this approach is the development of the National Euro Changeover Plan (the "**Plan**"), a comprehensive roadmap outlining Bulgaria's transition to the euro. Additionally, on 25 March 2024, a draft of the Law on the introduction of the euro (the "**Euro Act**") has been submitted for public discussion. Once enacted, the contemplated Euro Act will be the key pillar in the legal framework for Bulgaria's integration into the Eurozone.

To facilitate Bulgaria's Eurozone accession process, a specialized governmental council has been established. The Coordinating Council for the Preparation of Bulgaria for Eurozone Membership is tasked with analyzing the technical, economic, and legal dimensions of the accession process. Through collaborative efforts and expert analysis, the Council aims to ensure a smooth and seamless transition to the euro, minimizing disruptions and maximizing benefits for all stakeholders.

Alongside with legislative preparations, Bulgaria has now adopted the new Bulgarian National Bank (BNB) Act. This legislation, set to take effect upon Eurozone accession, regulates various aspects of the euro transition, including the status of the euro as a monetary unit, currency design, and the issuance of euro banknotes and coins. The BNB Act underscores Bulgaria's commitment to ensuring a robust and well-regulated financial system in preparation for Eurozone membership.

## **The Euro Act Draft Legislation**

According to the Plan and the draft Euro Act Bulgaria's euro adoption will take place under the so-called Big Bang scenario, where the euro will become the official means of payment from the date of the Eurozone accession. In this scenario, levs will be automatically converted into euros on that day (this to include prepaid payment instruments such as mobile phone cards, public transport cards and vouchers, issued before the introduction of the euro), the conversion set to take place at the fixed rate of 1.95583, with rounding rules being introduced in the draft Euro Act. However, it is contemplated that within the first month following the euro adoption, both the lev and the euro will be legal tender, and thereafter, the euro will remain Bulgaria's single official currency.

The forthcoming Euro Act will play a pivotal role in Bulgaria's Eurozone accession process, providing a legal framework for the transition. This legislation will address critical aspects such as currency conversion mechanisms, contract continuity, and regulatory alignment. For businesses, the Euro Act will introduce new requirements and challenges, including adjustments to capital and equity denominations (alongside the respective constitutional document amendments), accounting practices, pricing strategies, information systems, handling of refunds, and others alike.

In parallel, consumer protection measures are expected to emphasize accurate price conversion and dual price display during the transition period. Businesses will have to ensure transparency and consistency in pricing, with oversight from regulatory authorities to mitigate potential price discrepancies.

The above considered, as Bulgaria advances towards Eurozone accession, proactive engagement with the Euro Act will be essential for ensuring compliance and minimizing disruptions.

## **Specific Implications – Financial Institutions**

On the day of euro adoption, all lev-denominated bank and other payment service provider accounts will be converted into euros and all loans originally granted in levs will be considered as loans in euro. In this regard, if the contracted interest rate for the deposit or loan is fixed, banks will be required to continue to apply a fixed interest rate, ensuring that customers receive terms that are no less favorable. However, if the interest rate is variable, the adjustments will need to be made in a way that is not less favorable to the client than the state of events prior to the conversion.

As a matter of market practice, the majority of lev-denominated loans are priced with a floating interest rate, which is linked to composite reference rate indexes, quoted internally by each bank. While the Euro Act sets the general rule that the conversion should not be prejudicial to borrowers, it remains an open point whether banks will continue to be in the position to quote these composite indexes, or whether the loans will be linked to a benchmark such as the EURIBOR.

As an additional point to consider from a lender's perspective, adjustments in the nominal value of collateral pledged or mortgaged in favor of banks and financial institutions will likely be automatically converted through the competent registries for the specific types of collateral. However, the current draft of the Euro Act omits this matter, and it is likely to be settled with secondary legislation.

Another point to be addressed by secondary legislation is the banks' specific participation in the exchange of levs against the euro. While the Euro Act will oblige the banks to conduct the lev to euro cash conversion free

of charge for an initial period of six months, the specific procedure and framework will be outlined by the Bulgarian National Bank.

While the key banking considerations will be addressed on a legislative level, financial institutions, as the economic lifeblood, are expected to play a key role in the euro transition. In that regard, the transition to the euro will require revisions to the lenders' internal systems to accommodate the adjustments in financial instruments, contracts, accounting practices, and collateral handling. In particular, three months prior to the euro adoption date, banks will be obliged to update their information systems to accommodate the euro and meet other similar criteria.

Furthermore, amendments to existing laws and regulations, including the Payment Services and Payment Systems Act, the Currency Act, and the Credit Institutions Act, may be necessary to ensure full compatibility with the euro. Given the significant involvement of the Bulgarian fintech sector in payment-related activities, such changes are expected to impact both conventional financial institutions and fintech players alike.

## **Conclusion**

It's essential to acknowledge the fluidity of Bulgaria's Eurozone accession process. While progress is evident, uncertainties persist, particularly regarding Bulgaria's ability to meet Maastricht Criteria and finalize legislative frameworks. The Euro Act, pivotal to the transition, remains in conceptual stages, subject to refinement and adoption. However, as Bulgaria advances towards Eurozone accession, proactive preparation and adaptability are paramount for businesses and policymakers alike. While the process will likely be associated with certain challenges and uncertainties, diligent planning and adherence to evolving regulatory requirements will facilitate a smooth transition.

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