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Legal framework of the securities market in Bulgaria

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The article deals with the evolution of the Bulgarian legislation in the field of the securities market since 1990, in the course of which the transition to market economy took place. In particular, it focuses on the sequence of developments, both on the legislative and on the institutional level, as well as on the scope and quality of the legal framework from the point of view of the interests it aims to protect. An attempt is also made to provide for a short assessment regarding the compatibility of the newly adopted regulation with the international and European standards in effect.

The modern Bulgarian securities legislation has evolved gradually since 1995. As a first step in this respect the Law on Securities, Stock Exchanges and Investment Companies¹ (LSSEIC) was adopted in 1995. It came as a measure to meet the concerns caused by the so called mass privatisation process, launched in 1996. In this process packages of shares of the capital of ex state-owned enterprises were offered at centralised auctions for acquisition against vouchers. Participants were either the citizens directly or especially created vehicles – privatisation funds. This development led to the emergence of a broad circle of minority shareholders, which deserved to be afforded a special protection for their specific rights.

The LSSEIC laid down the framework of the new phenomena, in particular by way of providing for the legal regime of the functioning of investment intermediaries, public issuers of securities, the stock exchange, as well as investment companies. Most importantly, all ex state-owned enterprises that were privatised in the mass privatisation process were transformed automatically, by way of legal provision, into public joint stock companies the shares of which were traded on the stock exchange. Subsequently, a large part thereof were de-listed and closed. As for the privatisation funds, in the following years most of them transformed themselves into holding companies, involved in active management of the acquired enterprises, whereas only a few became investment companies.

However, the LSSEIC, being the first legislation in the field of securities, revealed a number of lacunae and drawbacks. Therefore, in the year 1999 a new Law on Public Offering of Securities² (LPOS) was adopted. The LPOS provides for a more detailed, consistent and contemporary regime of the public offering and the trade in securities, the activity and functioning of the regulated securities markets, of the Central Securities Depository, of investment intermediaries,

investment and management companies, as well as the physical persons who directly carry out investment consultations and transactions in securities.

The LPOS introduces some concepts, which predefine its scope as well as the nature of the legal regulation in question. A public offering of securities shall be deemed to be one or more than one offers (or solicitation of offers) in respect of a transfer of securities of one and the same class to (1) 50 and more persons during the course of one calendar year, or (2) an undefined circle of persons, including through the mass media. A public offering of securities shall be allowed provided that information by way of a duly approved prospectus and periodic reports is continuously disclosed in order to allow investors to make an informed judgment about the investment offered.

According to the law secondary trading in securities issued by public companies and other issuers should take place on the regulated market for securities only. Moreover, in order to avoid abuses, it is mandatory that any execution or offer for execution of transactions in securities even if not in the framework of a public offering, but by way of private negotiations, shall take place on the regulated securities market, provided that (1) the securities are issued by a public company or another public issuer of securities, and (2) a legal person is either the offeror or a party to the transaction.

The only regulated securities market in Bulgaria as of now is the market, both official and unofficial, organised by the 'Bulgarian Stock Exchange – Sofia' AD, which was licensed by the regulatory and controlling institution for the securities market - the Commission on Financial Supervision (CFS) in the year 1997.

A public company is defined by the law as a joint stock company which has issued new shares by way of a public offering, or the shares of which have been

admitted for trading on the regulated securities market, i.e. the stock exchange. The LPOS provides for a detailed legal regime of public companies, the goal of which is to achieve a better and efficient protection of the rights of minority shareholders. The special protective measures, as opposed to the general regime of the so called closed joint stock companies under the Law on Commerce³, refer for example to the issuance of rights in the framework of the increase of the capital of a public company, to certain restrictions regarding the types of shares that could be issued by a public company, to specific internal corporate resolutions that are necessary for the authorisation of certain transactions when entered into by the legal representatives of a public company, to the prevention of conflicts of interests between the public company and its managers and directors, to the process of proxies' solicitation, to certain fiduciary duties of the managers and directors, etc.

Investment intermediaries are defined as either banks, duly licensed by the Bulgarian National Bank under the Law on Banks⁴, or joint stock companies or limited liability companies, duly licensed by the CFS under the LPOS, for the carrying out in particular of

(1) transactions in securities for their own or for the account of a third party, (2) underwriting of issues of securities, (3) management of individual portfolios of securities, (4) custodian activity. Hence, Bulgaria's legal system is in accordance with the continental tradition where banks obtain the so called universal licence which grants them the capacity to perform the whole range of banking transactions, including on the securities and investment market, without having to set up any specialised subsidiary. Investment intermediaries are subject to strict prudential requirements as well as conduct of business rules, which are comparable with the respective standards in the developed securities markets in Europe.

The LPOS lays the foundations for the investment business also by way of introducing the concept of investment companies as entities, which invest in securities publicly attracted funds, and which act on the basis of risk distribution. Investment companies may be either of an open end type or of a closed end type. The investment activity of an open end investment company shall be managed by a management company, on the basis of a duly executed management contract. The law provides for

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a detailed regulation of the public offering of shares by an investment company, as well as of the structure of the capital and the investment portfolio of investment companies.

As mentioned above, the regulation and control in respect of the participants in the securities market, the activity and functioning of such participants, and the transactions in securities, is carried out by the CFS as collegiate body, and in particular by the Vice-chairman heading the department on 'Supervision of the Investment Activity'. The CFS was created in the year 2003 pursuant to the Law on the Commission on Financial Supervision⁵. Apart from the securities market, the CFS is responsible for the activity of insurance companies, insurance agent and insurance brokers under the Law on Insurance⁶ and the health assurance companies under the Law on Health Assurance⁷, as well as for the activity of the companies for additional social assurance and the funds managed by them under the Code on Social Assurance⁸. In this way, for purposes of a better efficiency the CFS concentrates in one single body the functions of the specialised state institutions existing prior to the adoption of the Law on the Commission on Financial Supervision – namely the State Securities Commission, the State Agency on Insurance Supervision and the State Agency on Pension Assurance Supervision.

The CFS is composed of seven members – chairman, three vice-chairmen each one responsible for one of the three segments of the financial markets referred above, and three other members, all of them elected by the National Parliament for a mandate of six years. An important feature of the status of the CFS is its independence from the executive and the fact that it reports on its activity only to the National Parliament. It goes without saying that the personality of the Vice-chairman heading the department on 'Supervision of the Investment Activity' plays an extremely important role in the field of the securities market, for reasons that a number of important decisions and acts on the application of the LPOS are taken by her directly in person, whereas the remaining issues, although considered by the CFS in a plenary session are submitted by her together with a proposal for a decision.

The powers of the CFS in the field of the securities market are very broad and strong. Apart from the issuance and withdrawal of various licences and permissions, the CFS as regulatory and controlling institution is entitled to issue regulations on the implementation of the LPOS⁹, to impose various compulsory measures and administrative sanctions in all cases of infringements of the legislation in effect. It should be underlined that the underlying goal of all acts, decisions and interventions of the CFS shall refer

to the protection of the interests of investors, the creation of conditions for the development of a fair, open and efficient securities market, and the maintenance of the stability of public trust in the securities market.

In conclusion, the following should be underlined by way of summarising the features of the newly evolved legislation. Bulgaria already disposes of a detailed set of laws and regulations, encompassing almost all potential participants, structures and constellations for the carrying out of activity on the securities market. Such laws and regulations are to a very high extent, if not even fully, harmonised with the European requirements and standards, which are embodied in the respective European Union Directives. Mention should be made of the EU Prospectus Directive of 1989¹⁰, the EU Listing Particulars Directive of 1980¹¹, the EU Periodic Information Directive of 1982¹², the EU Disclosure of Major Holdings' Directive of 1988¹³, EU Insider Dealing Directive of 1989¹⁴, EU UCITS Directive of 1985¹⁵, EU Investment Services Directive of 1993¹⁶. Moreover, different elements of regulation have been adopted from various models on the level of national legal orders in Europe and the US, as well as on the level of IOSCO.

The new Bulgarian legislation takes care of all significant interests in the field of the securities market that deserve protection by way of special legal provision, as well as of all modern forms and structures for the carrying out of activity as participant in such market. It may be argued that the new legislation, being so detailed and sometimes overly complicated, is well in advance of the real development of the Bulgarian securities market, which is still evolving, and therefore may sometimes even play an inhibiting role. However, the counter argument should be supported, namely that in a transition economy it is the legal framework that naturally precedes the real development of the social relations. This is positive to the extent that it channels the emergence of the market in the right direction, thus modernising the society and creating the necessary preconditions for investments and for a smooth accession to the larger European internal market.

Notes:

¹ Promulgated in the State Gazette, issue 63 of July 14, 1995, supplemented issue 68 of August 9, 1996, amended issue 85 of October 8, 1996, amended issue 52 of July 1, 1997, supplemented issue 94 of October 17, 1997, amended and supplemented issue 42 of April 14, 1998, amended issue 52 of May 8, 1998, amended issue 127 of October 31, 1998,

amended issue 29 of March 30, 1999, revoked issue 114 of December 30, 1999.

² Promulgated in the State Gazette, issue 114 of December 30, 1999, amended issue 63 of August 1, 2000, amended issue 92 of November 10, 2000, amended issue 28 of March 19, 2002, amended and supplemented issue 61 of June 21, 2002, amended issue 93 of October 1, 2002, amended issue 101 of October 29, 2002, amended issue 8 of January 28, 2003, amended issue 31 of April 4, 2003, amended issue 67 of July 29, 2003, supplemented issue 31 of April 4, 2003, amended issue 67 of July 29, 2003, supplemented issue 71 of August 12, 2003, amended issue 37 of May 4, 2004.

³ Promulgated in the State Gazette, issue 48 of June 18, 1991, as subsequently amended and supplemented.

⁴ Promulgated in the State Gazette, issue 52 of July 1, 1997, supplemented issue 15 of February 6, 1998, amended issue 89 of August 3, 1998, amended issue 21 of February 20, 1998, supplemented issue 52 of May 8, 1998, amended issue 70 of June 19, 1998, amended and supplemented issue 54 of June 15, 1999, amended issue 103 of November 30, 1999, amended and supplemented issue 114 of December 30, 1999, amended issue 1 of January 4, 2000, supplemented issue 24 of March 24, 2000, amended issue 63 of August 1, 2000, amended and supplemented issue 84 of October 13, 2000, amended issue 92 of November 10, 2000, amended issue 1 of January 2, 2001, supplemented issue 45 of April 30, 2002, amended and supplemented issue 91 of 25 September 2002, amended issue 92 of September 27, 2002, amended issue 31 of April 4, 2003.

⁵ Promulgated in the State Gazette, issue 8 of January 28, 2003, amended issue 31 of April 4, 2003, amended and supplemented issue 67 of July 29, 2003, amended issue 112 of December 23, 2003, amended and supplemented issue 85 of September 28, 2004.

⁶ Promulgated in the State Gazette, issue 86 of October 11, 1996, as subsequently amended and supplemented.

⁷ Promulgated in the State Gazette, issue 70 of June 19, 1998, as subsequently amended and supplemented.

⁸ Promulgated in the State Gazette, issue 110 of December 17, 1999, as subsequently amended and supplemented.

⁹ Regulations on the implementation of the LPOS, issued by the CFS, include inter alia: Regulation N 1

of September 15, 2003 on the Requirements to the Activity of Investment Intermediaries (promulgated in the State Gazette, issue 90 of October 10, 2003, amended and supplemented issue 61 of July 13, 2004, amended issue 65 of July 27, 2004); Regulation N 2 of September 17, 2003 on the Prospectuses upon Public Offering of Securities and on Disclosure of Information by Public Companies and Other Issuers of Securities (promulgated in the State Gazette, issue 90 of October 10, 2003, effective as of December 1, 2003); Regulation N 7 of November 5, 2003 on the Requirements that Should be met by Natural Persons who Carry out under Agreement Transactions with Securities and Investment Consultations Regarding Securities, and on the Procedure for Granting and Withholding the Right to Carry out such Activity (promulgated in the State Gazette, issue 101 of November 18, 2003); Regulation N 11 of December 3, 2003 on the Permits for Carrying out Activity as Stock Exchange, Establisher of Unofficial Securities Market, Investment Intermediary, Investment Company, Managing Company and Special Investment Purpose Company (promulgated in the State Gazette, issue 109 of December 16, 2003); Regulation N 13 of December 22, 2003 on the Takeover Offers in Relation to the Purchase and Exchange of Shares (promulgated in the State Gazette, issue 4 of January 16, 2004, amended and supplemented issue 109 of December 14, 2004), etc.

¹⁰ Published in OJ,EC, L124/8-15 of May 5, 1989.

¹¹ Published in OJ,EC, L100/1-26 of April 17, 1980.

¹² Published in OJ,EC, L48/26-29 of February 20, 1982.

¹³ Published in OJ,EC, L348/62-65 of December 17, 1988.

¹⁴ Published in OJ,EC, L334/30-32 of November 18, 1989.

¹⁵ Published in OJ,EC, L375/3-18 of December 31, 1985.

¹⁶ Published in OJ,EC, L141 of June 11, 1993.

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