



FINANCIAL SUPERVISION COMMISSION

**ANNUAL REPORT
ON THE ACTIVITIES
DURING YEAR 2004**

Contents

- I. Chairman’s Address..... 3
- II. FSC’s Objectives and Functions..... 4
- III. Review of FSC’s Activities in 2004..... 5
 - 1. Regulatory Activity**..... 5
 - 1.1. Legislative Amendments..... 5
 - 1.2. Amendments to the Subdelegated Legislation..... 9
 - In the Field of Investment-Related Activity..... 9
 - In the Field of Insurance and Voluntary Health Insurance..... 10
 - In the Field of Supplementary Pension Insurance..... 11
 - Other Legislative Amendments..... 13
 - 2. Licensing Activity and Authorisations Regimes**..... 14
 - In the Field of Investment-Related Activity..... 14
 - Investment Intermediaries..... 14
 - Investment and Management Companies..... 16
 - Public Companies and Issuers of Securities..... 17
 - In the Field of Insurance and Voluntary Health Insurance..... 18
 - In the Field of Supplementary Pension Insurance..... 19
 - 3. Control Activity**..... 20
 - 3.1. Off-site Supervision..... 20
 - In the Field of Investment-Related Activity..... 21
 - In the Field of Insurance and Voluntary Health Insurance..... 21
 - In the Field of Supplementary Pension Insurance..... 22
 - 3.2. On-Site Inspections..... 23
 - In the Field of Investment-Related Activity..... 23
 - In the Field of Insurance and Voluntary Health Insurance..... 23
 - In the Field of Supplementary Pension Insurance..... 24
 - 3.3. Complaints and Claims..... 24
 - 4. Coercive Administrative Measures and Administrative Sanctions**..... 26
 - In the Field of Investment-Related Activity..... 26
 - In the Field of Insurance and Voluntary Health Insurance..... 27
 - In the Field of Supplementary Pension Insurance..... 28
 - 5. Co-operation and Membership in International Organisations**..... 29
 - 5.1. Internal Co-operation..... 29
 - 5.2. International Co-operation..... 30
 - 6. Information and Educational Policies**..... 31
 - 7. Human Resources Policies and Staff Training**..... 33
 - 8. Information Technologies**..... 36
 - 9. Development Strategy**..... 37
 - 9.1. Plan for Legislative Amendments..... 37
 - In the Field of Investment-Related Activity..... 37

In the Field of Insurance and Voluntary Health Insurance.....	38
In the Field of Supplementary Pension Insurance.....	38
Other Legislative Amendments.....	39
9.2. New Approaches to Supervisory Methodology.....	40
10. Financial Statements.....	43
IV. The Bulgarian Economy in Year 2004.....	44
V. Review of the Non-Banking Financial Sector in Year 2004.....	45
11. Investment Activity.....	46
11.1. Capital Market Development.....	46
11.2. Market Structure and Analysis of the Participants.....	50
Public Companies and Other Issuers.....	50
Investment and Management Companies.....	52
Investment Intermediaries.....	55
12. Insurance Market.....	57
12.1. Development of the Insurance Market and of the Health Insurance Services Market.....	57
12.2. Markets Structure and Analysis of the Participants.....	58
Non-life Insurance Companies.....	58
Life Insurance Companies.....	60
Health Insurance Companies.....	61
Reinsurance.....	62
Insurance Brokers.....	64
Guarantee Fund.....	64
13. Supplementary Pension Insurance.....	65
13.1. Development of the Supplementary Pension Insurance Market.....	65
13.2. Markets Structure and Analysis of the Participants.....	66
Pension Insurance Companies.....	66
Supplementary Pension Insurance Funds.....	68

I. Chairman's Address

Ladies and Gentlemen,

It is a pleasure to present to you the Annual Report on the Activities of the Financial Supervision Commission (FSC) for year 2004.

Having responsibilities that combine protection of the consumers and preventive regulation over a vast array of financial services within the sphere of investment, insurance and supplementary pension insurance, the Financial Supervision Commission has one of the broadest scopes of operation among the financial regulators around the world. Thus, the present Report covers a rather wide range of activities. At the same time, the FSC, being a unitary authority, upholds the principles of equal treatment and common policy with respect to all types of financial services, which it regulates and supervises.

In the present Report, special attention has been paid to our strategy and the policy we intend to pursue. It is our hope that thus we, on the one hand, shall contribute towards the predictability of the financial market's evolution and our actions in the capacity of a regulator, and, on the other hand, shall give rise to an extensive public debate on the forthcoming innovations.

In the Report, we present the activities of the Financial Supervision Commission for year 2004, as well as the trends in the development of the capital, insurance, and pension insurance services markets.

The first section of the Report pinpoints the licensing, regulatory and control activities performed by the Commission in 2004, as well as the coercive administrative measures and the administrative sanctions that have been imposed as a result of the supervision exercised. Information is provided on the FSC's internal and international co-operation with other institutions and organizations, whose activity directly or indirectly affects the functions performed by the Commission. The main aspects of the information and educational policies implemented by the FSC, as well as the policy regarding human resources and information technologies are duly described. The FSC's development strategy and its main priorities are presented in detail.

Following a brief review of the Bulgarian economy in 2004, the FSC presents the second section of its Report. In the said section, information is provided on the evolution of, the main trends in and the participants in the capital, insurance, and pension insurance services markets.

I do believe that readers shall find the present Annual Report on the Activities of the Financial Supervision Commission for year 2004 to be interesting and useful.

Apostol Apostolov

II. FSC's Objectives and Functions

The Financial Supervision Commission regulates the capital, the insurance, the voluntary health insurance, and the supplementary pension insurance markets. The objectives of the activities performed by the Commission are to ensure stability and transparency on, and trust in the financial markets, as well as to protect the interests of the investors, the insured and the assured persons.

The FSC achieves the above objectives through the functions it performs:

- refinement of the legal framework, regulating the activities of the non-banking financial market participants, and the supervision exercised over these
- licensing of the participants
- exercise of constant control over their activities and condition
- imposition of sanctions where offences have been established
- disclosure of information on the functioning and status of the non-banking financial market participants to the general public.

The FSC enforces financial discipline on the capital, insurance and pension insurance markets. Thus, the Commission limits the potential for committing financial crimes and for failures in the financial market, while at the same time it promotes the increase in public awareness in the sphere of the non-banking financial sector.

The achievement of FSC's principle objectives contributes to the recognition of the proper conduct in the financial markets, to the establishment of organized administration and efficient market and to the presence of sound institutions, which are fundamental prerequisites for the development of the market.

III. Review of FSC's Activities in 2004

The Financial Supervision Commission, in its capacity of an independent authority for regulation and supervision over non-banking financial institutions, aims when performing its functions and exercising its powers to clearly formulate its priorities and guidelines for development in compliance with the internationally recognized regulation and supervision principles and standards.

When performing its regulatory activities, the FSC strenuously works on the refinement of the normative legislation, regulating the non-banking financial sector. The amendments introduced into the legal framework have been prompted by the dynamic development of the financial system, by the flaws established in the operative normative legislation, as well as by the necessity to harmonise the national legal framework with that of the European Union (EU).

The observance of the prescribed normative requirements is ensured through the exercise of the FSC's supervisory powers, which may be classified as follows: grant of licences, entry into the Public Registry, issuance of permits and approval of particular transactions or activities; performance of examination of documentation and on-site inspections of supervised entities; enforcement of coercive administrative measures and imposition of administrative sanctions.

1. Regulatory Activity

The FSC's regulatory activity is directed towards the establishment of efficient system of rules, which is to adequately protect the interests of the investors, of the insured and assured persons, without creating normative restrictions, hampering initiative and bureaucratising the processes.

The past year 2004 was notable for the Commission's intensive regulatory activity not only at the legislative, but also at the sublegislative level.

1.1. Legislative Amendments

With the Bulgaria's accession date to the EU drawing near, it becomes necessary to consolidate the activities within the process of **harmonization of the Bulgarian legislation** with the EU *acquis communautaire*. With regard to aforesaid, in 2004 the FSC drew up two bills – Insurance Code and Amendment to the Law on Public Offering of Securities Act. The requirements of the EU directives in the sphere of securities and insurance have been taken cognizance of in the texts of the two bills. In connection with the commitments undertaken on the negotiation positions, these directives are to be transposed into the Bulgarian legislation by the end of year 2005. Along these lines, an Ordinance on the Compulsory Insurance was adopted and the Ordinance on the Capital Adequacy and Liquidity of the Investment Intermediaries was amended.

The adoption of the two draft acts is also necessitated in order to perfect the legislation in the field of securities and insurance through creation of a legal framework, adequate for the dynamics of the regulated public relations. The said draft acts have been adopted by a

Resolution of the Council of Ministers and it is expected to be put to the vote in the National Assembly by the end of year 2005¹.

The Draft Act on Amendments to the Public Offering of Securities Act (POSA) proposes amendments, concerning those provisions that regulate the activities of the **investment intermediaries**, the **management companies** and the **undertakings for collective investment in transferable securities**, as well as overcoming some imperfections and omissions under the POSA, and alignment of the legal norms in accordance with the amendments introduced to other laws that have bearing on the subject matter regulated by the POSA.

In connection with the activities of the **investment intermediaries**, an amendment was introduced to the investment services regulation in compliance with the requirements set out under *Directive 93/22/EEC on investment services in the securities field*. The division into principal and ancillary activities that may constitute a part of the investment intermediary's subject of activity has been retained, where the investment intermediaries have been regulated in a greater detail and it has been provided for these to be licensed not only for their principal investment services and activities, but also for each ancillary activity they intend to perform.

The regulations providing for the capital requirements to the investment intermediaries have been aligned in conformity with the requirements set out under *Directive 93/6/EEC on the capital adequacy of investments firms and credit institutions*. It has been provided for, in the cases where the investment intermediary holds money and/or securities of customers, its capital to be not less than BGN 250,000. Following January 1, 2006, the initial capital's minimum amount of those investment intermediaries who effect transactions in securities for their own account and/or underwriting issues of securities, is to reach BGN 1,500,000. Until then, its staged increase shall be regulated under FSC's *Ordinance No. 6 on the capital adequacy and liquidity of the investment intermediaries*. Other than the cases described above, the investment intermediary's capital shall be not less than BGN 100,000.

The establishment of an *Investors in Securities Compensation Fund* in compliance with the requirements set out under *Directive 97/9/EC on investor-compensation schemes* is provided for under the Act. The Fund's activities are to be mainly funded by the participants in the investor-compensation system. These are the persons who have been granted permission in conformity with the valid legislation to perform activities as an investment intermediary. The Fund's resources shall be raised through an entrance fee and annual installments, as well as from the revenues, received as a result of investing the accrued funds. The accumulated resource shall secure compensation to the investment intermediary's non-professional customers in the cases where bankruptcy proceedings has been instituted against the intermediary, or the FSC has established that in view of the investment intermediary's financial standing, it may not fulfill its obligations towards its customers.

With respect to the **management companies**, the main amendments provided for under the Act are broadening their subject of activity through the establishment of a possibility to provide accessorial services, and namely: individual portfolio management, encompassing securities and/or money at the management company's own discretion without particular orders on the customer's part, and provision of investment advice with regard to securities, as well as increase in the capital requirements in conformity with the provisions set out under *Directive 85/611/EEC*.

A new type of collective investment in transferable securities scheme, and namely: the **contractual fund** is also introduced under the Act. It is separate property, the purpose of which is collective investment in securities of funds, raised through public offering of units. The contractual fund's main specificity is that it is not a legal entity; therefore it does not have

¹ The Act on Amendments to the Public Offering of Securities Act was adopted by a Resolution of the National Assembly (Promulgated, SG, Issue 39 of May 10, 2005).

its own management bodies, and is organised and run by an investment management company. The contractual fund is a separate property apportioned into units, which units may have varying nominal value for the purpose of collective investment in securities of funds raised through public offering of the units.

The net value of the fund's assets shall not be less than BGN 500,000, and it shall be attained within the framework of one year following the issuance of a permit to the management company to manage the fund. The contractual fund may only be of the open-end type, where, similar to the investment companies of the said type, the fund's units are constantly offered to the investors for acquisition or reverse takeover at a price based on the assets' net value.

The so-called "single passport", pursuant to which a possibility is established for the Bulgarian licensed investment intermediaries to perform activities within the territory of an EU Member State, or a different country, belonging to the European Economic Area, without being necessary to obtain a licence issued by the respective competent authorities in the country where they are to perform their activities, and reciprocally – investment intermediaries, having their seat in an EU Member State, or a country, belonging to the European Economic Area, to perform activities in the territory of the Republic of Bulgaria, without being secondarily licensed by the FSC is introduced under the Act on Amendments to the Public Offering of Securities Act.

Similarly to the investment intermediaries, the "single passport" is also introduced for the management companies when performing activities within the European Union and the European Economic Area, as well as for the collective investment schemes where their shares, units respectively, are offered.

It is prescribed under the Law on Normative Acts that public relations belonging to one and the same sphere are to be governed by a single normative enactment, and not by several such enactments of the same degree. In relation to the above, the FSC drew up and adopted a Draft Insurance Code, which consolidates the four acts in the sphere of insurance Bulgaria has undertaken to adopt in connection with its accession to the EU – *The Insurance Undertakings Act*, *The Insurance Contract Act*, *The Insurance Supervision Act*, and *The Mandatory Insurance Act*. At the same time, 22 directives in the field of insurance in the EU are transposed into the Bulgarian legislation under the *Draft Insurance Code*.

The regulations under the *Draft Insurance Code* address the four Acts listed above:

1. An insurance undertaking. The Draft Code prescribes a number of requirements towards the activities of the insurers and the reinsurers, the purpose of which requirements is to ensure their financial stability and good corporate governance, as well as protection of the insured persons' interests. Firstly, these are the requirements towards the insurers' financial standing that include the solvency margin and the guarantee capitals with their corresponding own funds, as well as the technical reserves. The requirements towards the insurers' internal organization and accountability have also been established with a view to avoidance of conflicts of interests, including establishment of a specialized internal control office, maintenance of an information system and disclosure of timely, accurate and complete information on their financial standing and activities.

The insurance portfolio transfer, transformation, liquidity and bankruptcy of the insurers, where the functions and the powers of the supervisory bodies are regulated, the requirements towards the liquidators and the assignee in bankruptcy, their rights and obligations are settled in greater detail. Mechanisms for protection of the consumers of insurance services are also provided for.

2. Insurance Contract. The Draft Code makes provision for the insurance contract, which currently is a subject to regulation under the Commerce Act. The form and contents of the insurance contract, the pre-contractual information the insurer is to provide to the

consumers of insurance services prior to contract's conclusion, the contract's entry into force and termination, the rights and liabilities of the parties under it, the main types of insurance contracts, as well as the principles of the co-insurance and re-insurance contracts are regulated.

3. Compulsory Insurance. The Insurance Code defines the circle of compulsory insurances; the subjects of the obligation to conclude a compulsory insurance contract; the amounts of the minimum liability limits under the insurances; imperative rules that guarantee conclusion of the insurances by the obligated persons, as well as the interests of the legally empowered persons to receive indemnity.

Under the Draft Code, a National Guarantee Bureau is established, following reorganization through merger of the National Bureau of Bulgarian Motor Insurers and the Guarantee Fund. The National Guarantee Bureau is a non-profit association for performance of socially useful activities, members of which are those insurers who possess a licence for the compulsory *Third-Party Motor Liability* insurance of the motorists, or the compulsory *Accident* insurance of the passengers in the public transport. In the cases, defined under the Draft Code, the Bureau shall pay indemnities to the injured persons out of the Guarantee Fund's financial resources, which Fund the Bureau manages.

4. State supervision over the insurance business. The Code regulates the specific powers of the supervisory bodies, the procedures, the timeframes, the statements and the procedure for protection against illegal acts. In connection with Bulgaria's accession to the EU, a "single passport" is introduced for carrying out insurance and reinsurance activities, and insurance and reinsurance brokerage activities, where a possibility is provided for the implementation of supervision over contingent overseas operations of the insurer, of the reinsurer respectively. The underlying principles and indices of the early warning system for potential financial problems of insurers, as well as the recovery measures which the supervisory authority may impose are also included. The coercive administrative measures system and the procedure for its implementation are also refined. The principles of interaction of the FSC and its line deputy-chairperson in their capacity of state supervisory authorities with other such supervisory institutions in the Republic of Bulgaria and abroad are also introduced.

Following the accession of the Republic of Bulgaria to the European Union, the licensed Bulgarian insurers and reinsurers shall be also allowed to carry out insurance, reinsurance respectively, activities in the EU member - countries, as well as in the other states constituting the European Economic Area under the terms and conditions of the right of establishment and the freedom to provide services.

The Draft Insurance Code regulates the activities of the insurance and reinsurance intermediaries, where the most material new situation in principle is the replacement of the insurance brokers' licensing regime with a registration one, and the introduction of registration for the insurance agents. Similarly to insurers, the insurance and reinsurance intermediaries registered shall also be able to make use of the "single passport".

The legal regime of the insurance agents is settled in considerably greater details. The requirements these have to meet are identified. The insurer shall verify whether the said requirements have been satisfied and shall bear responsibility for non-observance thereof.

In relation to the insurance brokers, with a view to guaranteeing their financial stability, an obligation to maintain their own funds within a specified minimum amount is provided for. The insurance brokers and the insurance agents are to conclude a compulsory *Professional Liability* insurance, which covers any liability for the damages caused by these and their employees where carrying out insurance and reinsurance brokerage activities.

1.2. Amendments to the Subdelegated Legislation

- **In the Field of Investment-Related Activity**

In the month of July, the FSC adopted ORDINANCE No. 16 of July 7, 2004 on the conditions and procedure for execution of margin purchases, short sales and lending of securities. Pursuant to the above Ordinance, taking into consideration the high degree of risk posed by short sales, these may only be effected by investment intermediaries, institutional and professional investors. Lending of securities is solely permitted with regard to the execution of short sales, where lenders may only be investment intermediaries and institutional investors. With the purpose of safeguarding the capital market's stability, the margin purchases and short sales' subject is limited to the most liquid securities, and the provision of adequate security as a condition for their execution is stipulated. Upon the entry into force of this Ordinance, the commencement of the process of building up a market for derivative securities is initiated, which process shall provide new possibilities for investment and risk limitation.

In connection with the necessity of protecting the investors to the maximum degree against possible fraud and abuses in the trading of the securities owned by them, the Commission adopted Ordinance on amendment to Ordinance No. 1 on the requirements to the investment intermediaries' activities². Under the aforesaid Ordinance, a compulsory requirement is introduced to open subsidiary accounts with an investment intermediary in the case of increase in the capital of a public company through an issue of new shares. Thus, implementation of the custodian system is introduced for these, and the replenishment of Registry "A", kept by the Central Depository, is restricted.

Amendments to Ordinance No. 1 are also introduced under Ordinance No. 16 on the conditions and procedure for execution of margin purchases, short sales and lending of securities³. These stipulate that the investment intermediary is to render an account at regular intervals to its client not only in the cases where a concluded contract for management of an individual securities portfolio and/or money at its sole discretion without customer instructions is present, but also in the case of concluding a contract for execution of margin purchases or a contract for execution of short sales.

Upon a proposal submitted by the Central Depository, and with a view to the necessity to provide for under an enactment the possibility to utilize the *Real Time Gross Settlement System* at the Bulgarian National Bank when effecting payments on behalf of the Central Depository, an Ordinance on amendment to Ordinance No. 8 on the Central Depository of Securities⁴ was also adopted. The amendments are mainly concentrated on the regulation of the procedure, the method and the terms of and conditions for payment of dividends, interest, principals and other payments effected on the part of the Central Depository.

With a view to attaining compliance of the Bulgarian legislation with that of the European Union with respect to the requirements for forming own funds of the investment intermediaries, an Ordinance on amendment to Ordinance No. 6 was adopted. Under the amendments introduced in the Ordinance, a requirements is brought in stating that the investment intermediaries are to allocate own funds in order to cover the risk associated with the settlement and with the inaccurate execution of the counterparty where performing transactions in derivatives based on an underlying asset as follows: interest rate, currency or an

² The Ordinance on amendment to Ordinance No. 1 was adopted by resolution of the FSC dated June 23, 2004 (Promulgated, SG, Issue 61 of 2004)

³ Ordinance No. 16 was adopted by resolution of the FSC of July 7, 2004 (Promulgated, SG, Issue 65 of 2004).

⁴ The Ordinance on amendment to Ordinance No. 8 was adopted by resolution of the FSC dated September 8, 2004 (Promulgated, SG, Issue 85 of 2004).

index, and the procedure and method for calculation of the own funds, necessary to cover the risk are provided for.

In December, the FSC adopted Ordinance on amendment to Ordinance No. 13 on tender offer to purchase and exchange shares, under which exceptions to the obligation to table a tender offer where passing the threshold of 2/3 of the votes in the general meeting of a public company and certain clarifications were introduced under some of the provisions of the Ordinance are provided for.

- **In the Field of Insurance and Voluntary Health Insurance**

The FSC adopted Ordinance on amendment to Ordinance No. 4 on the compulsory insurance. The amendments provide for a prohibition imposed on the insurers, the insurance brokers and the insurance agents in the case of or in connection with the conclusion of an insurance contract to provide or offer benefits under any form whatsoever that have not been explicitly provided for under the general terms and conditions, tariffs and insurance and technical plans on the insurances approved. The procedure for settlement of the injured persons' claims, resulting from damages caused through the fault of a driver of motor vehicle, having foreign registration, is also regulated under the Amendment Ordinance.

With a view to the necessity of staged harmonization of the operative Bulgarian insurance legislation in the field of motor insurance with the EU Law, Ordinance No. 18 on the compulsory insurance under Art. 77, Para. 1, Items 1 & 2 of the Insurance Act was adopted. The new Ordinance provides for the common terms and conditions, the minimum insurance amount, the minimum compulsory risk premium, the procedure and timeframe for undertaking the compulsory insurance under the *Third-Party Motor Liability* and *Accident* insurances. Under the said Ordinance, uniform numbering of the policies under the two insurances was introduced, as well as a prohibition for the insurers, the insurance brokers and agents to render benefits under any form whatsoever in the case of or in connection with taking out compulsory insurances. Under the Ordinance, a new approach was adopted where the obligation of the regulatory agency to fix the gross premiums under the *Third-Party Motor Liability* insurance, i.e. the final premiums, was repealed. When setting the final premium, the insurers shall be granted the possibility to take into account the individual risk profile of the drivers, as well as other factors.

In the month of November, the Commission adopted at first reading Ordinance on the licences, permits and current control under the Insurance Act and the Health Insurance Act. The said Ordinance regulates in detail the procedure for and the terms and conditions of issuance of acts under the preliminary supervision and the activities under the current supervision, carried out by the FSC and by the Deputy-Chairperson in charge of the *Insurance Supervision* Division under the Insurance Act and the Health Insurance Act.

During the above month, *Ordinance on the form and content of the annual financial report of insurance undertakings and health insurance undertakings* was also adopted at first reading. The Draft Ordinance aims at achieving a higher degree of comparability amongst the financial statements of the individual insurers and health insurance undertakings. The adoption of the Ordinance at second reading is forthcoming in 2005⁵.

In order to attain complete compliance with the provisions of the EU legislation, Ordinance on the own funds and the solvency margin of insurers and health insurance undertakings was adopted at first reading. Under the above Ordinance, provisions have been included that regulate the methods for performing supervision over the solvency of insurers

⁵ The Ordinance on the form and content of the annual financial report of insurance undertakings and health insurance undertakings was adopted by Resolution of the FSC dated February 2, 2005.

on consolidated basis for the first time. The Ordinance defines the elements that are covered when calculating the own funds' amount, the solvency margin of insurers and health insurance undertakings and the methods used where it is being calculated, as well as the methods of exercising extra supervision over insurers' solvency. The aforesaid Ordinance is to be adopted at second reading in 2005.⁶

At the end of 2004, new Regulation of the structure and the activity of the Guarantee Fund was also adopted at first reading. It is provided for the Guarantee Fund to be managed by a managing board comprising: a chairperson and four members, elected by the Management Board of the Association of Bulgarian Insurers amongst representatives of the insurers who undertake activities related to taking out the compulsory *Third-Party Motor Liability* and *Accident* insurances. The Regulation makes provision for the Guarantee Fund's resources, reduced by the reserve for forthcoming payments, to be not less than BGN 3 million, and in the case where the Fund's resources drop under the said minimum amount for a period exceeding one month, the deficit is to be covered by funds of the insurers who conduct the compulsory insurances. Another novelty is that the period for delivery a judgment on a claim may not exceed 30 days, and in the cases where the said period has been exceeded, default interest shall be due to the damaged person following the date, on which date the period for delivery a judgment on the claim has expired. It is expected that the Regulation shall be adopted at second reading in the following year 2005.⁷

- **In the Field of Supplementary Pension Insurance**

The *Financial Supervision Commission* adopted Ordinance No. 14 on the terms and the conditions for granting licenses to actuaries of pension insurance companies and of supplementary pension funds, managed by them. Under the above Ordinance, the licensing regime provided for under the Social Insurance Code is further developed with regard to the persons who are to conduct actuarial servicing. The requirements which are to be met by a person in order to be an actuary are regulated in detail, as well as the terms and conditions and the procedure for issuance, denial to issue and withdrawal of a licence to an actuary.

In July 2004, Ordinance No. 17 on the documentation necessary for the issuance of an authorisation to transform a pension insurance company and a supplementary pension insurance fund and on the requirements toward the plans under Art. 327, Para. 1, Item 3 and Art. 336, Para. 1 of the Social Insurance Code was passed. Under the said Ordinance, the requirements toward the contents of the liquidation plan of a pension insurance company and the assignee in bankruptcy's plan in the case of insolvency of a pension insurance company have been settled.

The Commission also adopted Ordinance No. 19 on the terms of establishing pension reserves in pension insurance companies managing a universal pension fund and/or a supplementary voluntary pension insurance fund. Under the said Ordinance, the establishment of a pension reserve to meet payments of lifelong pensions to these pensioners who have lived longer than the preliminary actuarial accounts is provided for. The hitherto prevailing regulation on the procedure for the establishment of a pension reserve by the pension insurance companies, managing a universal pension fund has been taken cognizance of, and an attempt has been made to overcome problems established into practice. The matter related to the procedure for the establishment of a pension reserve by the pension insurance companies,

⁶ The Ordinance on the own funds and the solvency margin of insurers and the health insurance undertakings was adopted by a Resolution of the *FSC* dated March 16, 2005.

⁷ Regulation for the structure and the activity of the Guarantee Fund was adopted by a Resolution of the *FSC* dated February 15, 2005.

managing a supplementary voluntary pension insurance fund, paying lifelong pensions, for which matter there was no legal regulation until now is completely provided for.

On a proposal submitted by the *FSC* and jointly with the Ministry of Labour and Social Policy, a Draft Ordinance on the custodian and advisory boards of the supplementary pension insurance funds has been drawn up and adopted at first reading at a session of the Commission. The procedure for and method of establishment of the boards, their composition, their activities and functions, as well as the co-operation the pension insurance companies, managing the respective funds, are obligated to provide to the above boards where these perform the said functions have been regulated. Clauses have also been provided for in the cases where conflict of interest may arise, and the prohibitions related to that possibility concerning the members of the boards.

With a view to compliance of the active legislation with the amendments to the Social Insurance Code, Ordinance on amendment to Ordinance No. 3 on the terms and procedures for switching participation and transferring the amounts accrued in an insured person's individual account from one supplementary pension fund to another fund of the same type, managed by another pension insurance company was passed. Under the said amendments, the right to appeal before the *FSC* the denial for switching the participation on the part of the insured person, and respectively the obligation related to it for the pension insurance company to enter in its registries circumstances regarding the appeal is abolished. A new *Administrative and Penal Liability* Section is also created.

With a view to the cases of detected legal offences where the participation of the insured persons in the supplementary pension insurance funds is changed, Ordinance No. 3 was once again amended. Under the amendments, efficient methods for avoiding abusive acts with the applications of the insured persons for switching participation in the supplementary pension insurance funds and where transferring the amounts accrued in these are established.

During the year, for the purpose of achieving compliance with the amendments introduced in the Social Insurance Code, amendments having legal and technical nature were introduced under Ordinance No. 12 on the terms of and the procedure for determining the minimum rate of return resulting from the management of supplementary mandatory pension fund assets, on covering the difference up to the minimum rate of return, as well as on the establishment and utilization of the reserves for guaranteeing the minimum rate of return; Ordinance No. 10 on the requirements to the composition and structure of the own funds (capital base) of the pension insurance company and to the minimum liquid funds of the company and the supplementary pension funds under its administration, and Ordinance No. 9 on the terms and procedures for valuation of assets and liabilities of supplementary pension funds and pension insurance companies, the value of the fund's net assets, on calculation and announcement of the value of a unit, as well as on the requirements for maintaining individual accounts.

The Commission also adopted Instruction No. 1 on the procedure for and method of official distribution of the persons who have not selected a supplementary mandatory pension insurance fund, which was subsequently approved by the Governor of the National Social Security Institute. Under the Instructions, the initially adopted method of proportional distribution was substituted by a market approach, based on three criteria – annual profitability attained by the pension fund, amount of charges accrued by the pension insurance companies, and number of received individual statements for participation in a universal or professional pension fund for the quarter, preceding the official distribution.

- **Other Legislative Amendments**

In connection with the need for the adoption of a single subdelegated enactment that shall regulate the circumstances about all supervised entities which are to be entered into the registries of the *FSC*, the Commission adopted Ordinance No. 15 for keeping and storing of the registers by the Financial Supervision Commission and the circumstances, subject to entry.

2. Licensing Activity and Authorisations Regimes

The aim of the licensing activity is to admit to the financial market only participants who are able to demonstrate financial stability, professionalism and potential for development. At the same time, the *FSC* is the barrier against the market penetration of unfit, ill-intended or financially unstable players, who might pose threat not only to its customers and partners, but also to the stability of the whole financial system. Where performing its licensing activity, the *FSC* is guided by the principle of objectivity and implementation of a single approach and criteria towards all applicants.

The main challenge facing the licensing and authorisation activity of the *FSC* is finding an appropriate balance between the aspiration for maximum protection of the market participants, which often leads to a long and complicated licensing procedure, and the desire to stimulate the market development, and a maximum number of participants to be admitted to it.

Processing the statements received implies documentary inspection undertaken by the experts of the separate directorates of the specialised supervision and drawing up opinions on these, including, if need be, demand for additional information or rectification of established incompleteness and discrepancies in the normative requirements.

Apart from the licences and resolutions issued by the Commission, the Deputy Chairpersons in charge of the three divisions of the *FSC* also have powers to autonomously resolve on issues related to the regulation of the activities of the non-banking financial market participants. Where exercising the said powers, the Deputy Chairpersons issue **individual administrative acts**, which may be sanctions, coercive administrative measures, etc.

- **In the Field of Investment-Related Activity**

Investment Intermediaries

In 2004 four companies were granted a licence to conduct investment intermediary-related activities: *Capital Finance LLC*, *Pozitiva JSC*, *BenchMark Finance JSC* and *STS Finance SC*. Seven other companies were divested of their licences to conduct investment intermediary-related activities: *MILLIARD INVEST LTD.*, *Ulpia Securities JSC*, *NEWTON FINANCE BULGARIA JSC*, *Trezor AD*, *FISC PLUS FINANCIAL HOUSE JSC*, *VI-VESTA FINANCIAL BROKERAGE HOUSE JSC*, *ABAGAR FINANCE JSC*.

Throughout the past year, the *FSC* denied to issue a licence to conduct investment intermediary-related activities to two companies, and authorised the renaming of four investment intermediaries, and namely:

- 1) *Financial Company Iztok AD* was renamed *Abagar Finance JSC*
- 2) *Elana JSC* was renamed *Elana Trading JSC*
- 3) *Odessos AD* was renamed *Balkan Investment Company JSC*
- 4) *Giorgo, Nikolas & Jonathan Capital JSC* was renamed *CEE Securities Plc*

Throughout the past year, under the amendments to Ordinance No. 6 on the capital adequacy and liquidity of the investment intermediaries, in compliance with the requirements for staged increase in capital introduced and coming into force after June 30, 2004, the investment intermediaries may be divided into three categories:

First type: Investment intermediaries that perform transactions in securities for someone else's account and custodian activity are to hold capital that is not less than BGN 200,000.

Second type: Investment intermediaries that (apart from the above listed) also perform fiduciary management of individual securities portfolios and/or money, with the exception of portfolios of investment companies and pension funds, are to hold capital that is not less than BGN 250,000.

Third type: Investment intermediaries, whose purposes also include transactions in securities for their own account and/or underwriting issues of securities, are to hold capital that is not less than BGN 500,000. The type of investment intermediaries under question is to hold capital of BGN 1,500,000 until January 1, 2006.

In pursuance of the above requirements, a number of investment intermediaries are broadening or narrowing their purposes, in order to bring these into line with their capital. The said process, together with the licensing activities undertaken by the Commission, introduces amendments into the correlation amongst the three groups of investment intermediaries, as classified in relation to their activities.

The number of investment intermediaries of the third type sharply decreases due to the high amount of the callable capital, which many of these may not attain. This necessitates shrinking the subject of activity and is the main reason for withdrawal of the licence for performing transactions in securities for their own account and/or underwriting issues of securities of eleven companies, ten out of which were transferred into the second group of investment intermediaries, and only one into the first.

The reverse process is observed in the case of the investment intermediaries of the first type - part of these broadens their activities due to the availability of the necessary higher capital level. Along these lines, the *FSC* issued a licence, supplementing the subject of activity of three companies with the following: 'management of individual securities portfolios and/or money, with the exception of portfolios of investment companies and pension funds'.

As a result of these two processes, the investment intermediaries of the second type have increased twofold – from 13, they have become 26.

Where taking cognizance of the licences issued and withdrawn during the year, the total number of the investment intermediaries of the first type decreased from 11 to 9, and the number of these of the third type – from 42 to 28.

In 2004, the *FSC* held two examinations to gain the right to perform activities as a securities broker and an investment consultant – in May and October. As a result, thirty-two candidates to become brokers and thirty-six of those applying to become investment consultants have received certificates.

Throughout the year, the *FSC* divested five persons of the right to perform broker-related activities, and recognized the qualifications of five brokers and investment consultants, certified under a document issued by a competent foreign agency.

The Deputy Chairperson in charge of the *Investment Supervision Division* issued 26 individual administrative decisions, where 18 were authorizations for the acquisition of more than 10 per cent of the shares/stakes of the investment intermediary's capital by one person, 7 resolutions on denial of approval, and one denial to approve an amendment in the general terms and conditions applicable to the contracts with customers of an investment intermediary.

During the period under review, orders for entering 1,192 circumstances, where 1,015 were entered into the investment intermediaries' registry, and 177 were entered into the brokers and investment consultants' registry have also been drawn up.

Investment and Management Companies

In 2004, a licence to perform activities as a management company was granted to three companies: *UBB Asset Management AD*, *First Financial Brokerage House Asset Management* and *DSK Asset Management*, where the issuance of a licence procedure for two of these had commenced as early as year 2003. By licensing the new companies, the total number of the management companies for year 2004 increased to nine.

For the period January 1, 2004 – December 31, 2004, licences to perform activities as an open-type investment company were issued to four companies: *Advance Invest*, *Capman Capital*, *KD Pelikan*, *UBB Balanced Fund*, where the licensing procedure for two of these had commenced in the preceding period. Proceedings on the licensing of a company – *Elana High Yield Fund* have commenced, which are expected to be concluded at the beginning of the following year⁸.

With the four licences issued, the number of open-type investment companies has increased two times. It is expected that the reported increased interest in the incorporation of the said type of companies shall be retained as a result of the enhanced investment culture of the population, the growth in incomes and savings, the search for higher yield schemes than the bank deposit, etc.

During the period under review, the prospectuses for public offering of shares of the four new investment companies of the open type, as well as the prospectuses for public offering of units of six mutual funds managed by Management Company *Capital Invest*, Austria, were approved.

In 2004, the first representatives of a specific type of investment companies – the special purpose vehicles appeared in the market of non-banking financial services in Bulgaria. Their status and activity are regulated under the Special Purpose Vehicles Act, which became effective on January 1, 2004. The licensing of the first five special purpose vehicles during the year testifies to the deep interest in this type of investment scheme. Four of the companies direct their activities towards real estates securitisation - *TBI – BAC Real Estate Investment Trust*, *Colos - 1*, *BenchMark Fund Real Estate* and *ERG Capital - 1*, and only one – towards receivables securitisation: *Capital Direct - 1*. Along with the issuance of the licence for performing activities, the respective prospectuses of the companies for public offering of their shares were also approved.

It may be expected that the reported activity related to the incorporation of special purpose vehicles shall be also maintained throughout the following years. The expectations are based, on the one hand, on the fact that the sector is only in its initial development phase, and on the other hand, on the well-developed real estates market, on which are based the activities of these companies.

This type of companies obtains a licence to perform the activities declared upon their incorporation with a respective minimum amount of the capital that is normatively specified, and with the participation of an institutional investor.

Under individual administrative decisions issued by the Deputy Chairperson in charge of the Investment Supervision Division, the asset valuation rules for four investment companies have been approved, and amendments to the asset valuation rules for another three companies have been approved. During the period under review, approvals for amendments to the by-laws of four investment companies, a temporary prohibition for publication of advertisements to two companies have been issued, as well as a request for granting a permit to invest more than 10% of the assets of one investment company into shares of one issuer has

⁸ *Elana High Yield Fund* obtained a licence by Resolution of the FSC dated February 21, 2005.

been considered. Amendments to the by-laws and a change of the service company of special purpose vehicles have also been approved under individual administrative decisions.

In connection with the keeping and the preservation of the *FSC*'s Public Registry of Supervised Entities, 294 orders for entries of circumstances related to the accounts of the investment and the management companies, as well as to the special purpose vehicles have been drawn up. As a result of the above, 2,862 pieces of circumstances have been entered.

Public Companies and Issuers of Securities

During the period under review, the *FSC* approved the prospectuses of four public companies for initial public offering of their shares, and approved the prospectuses for secondary public offering of shares of another six. The *FSC* issued three rejections to approve a prospectus for secondary public offering, and relieved one company of its obligation to publish a prospectus for initial public offering of shares.

During the year, the share issues of three companies were entered into the Public Companies and Other Issuers of Securities Registry upon approval of their IPO prospectuses. 21 share issues, 9 of which were subsequent share issues, and the remaining 12 were registered share issues for the purpose of trading these on a regulated securities market, were also entered. One rejection to register a subsequent share issue was issued to a company.

In 2004, one prospectus for public offering of bonds was approved – of convertible bonds. 12 prospectuses for secondary public offering of bonds were approved: four (4) of mortgage bonds, seven (7) of corporate bonds and one (1) of municipal bonds. Upon approval of the prospectuses, the respective issues were entered into the Public Companies and the Other Issuers of Securities Registry; in addition to these, one issue of corporate bonds of an issuer released from the obligation to publish a prospectus was also entered. Two companies have been denied entering of respectively a mortgage issue and a corporate bonds issue. Within the period being reported upon, two issues of mortgage bonds and one issue of corporate bonds were written off from the Registry. As of December 31, 2004, one statement on writing off an issue of corporate bonds and six statements on approving a prospectus for secondary public offering of bonds are undergoing a review process. As of the above date, the proceedings under these have not been concluded and the Deputy Chairperson in charge of the Investment Supervision Division has not delivered a judgment.

In 2004, five public companies were written off from the Public Companies and the Other Issuers of Securities Registry under a statement on writing off, and twelve public companies – following the implementation of a tender offering. Five companies have been denied writing off, and five other statements are undergoing a review process as of December 31, 2004. Twelve public companies and twelve in their capacity of other issuers of securities were entered into the *FSC*'s Registry. Three companies received a refusal to be entered as public companies, along with a refusal to approve a prospectus for secondary public offering of shares, and one received a refusal to be entered as an issuer together with the denial to approve a prospectus for secondary public offering of corporate bonds. In addition to the above, the *FSC* annulled five of its Resolutions, under which the companies are entered as public ones under the special procedure of the Privatisation and Post-privatisation Control Act.

In 2004, a considerable increase in the number of entries of circumstances related to the issuers in the Public Registry was observed compared to year 2003. This is mainly due to the entry into force of Ordinance No. 2 on the prospectuses in the case of public offering of securities and on the disclosure of information by the public companies and other issuers of securities after December 1, 2003, and more precisely on a regulation, providing legal definition of the important information, influencing the price of the securities, and the Annex

to the Ordinance, under which the circumstances are listed, which circumstances are considered to be such information. The review of the contents of these notifications enforces the conclusion that the persons obligated approach the issue with the necessary seriousness and show greater and greater depth and initiative when disclosing the above information.

The entries into the Registry regarding circumstances and amendments to these with regard to the issuers of securities during the year number 2,325.

In 2004, the Deputy Chairperson in charge of the Investment Supervision Division issued thirty-two (32) individual administrative measures regarding the activities and the status of the public companies and other issuers of securities. Sixteen statements for temporary prohibition to publish tender offers for purchase of shares addressing shareholders having voting right were issued. Upon elimination of the inadequacies and the discrepancies, permission for publication was granted to nine of these, and final prohibition for publication of a tender offer was issued to three other companies. Resolutions not to issue a prohibition for publication of offers to purchase shares addressing shareholders having voting right were adopted with regard to four companies.

- **In the Field of Insurance and Voluntary Health Insurance**

In 2004, the *FSC* rendered opinion on seven applications for issuance of permits and licences, related to the insurance and health insurance sector. During the period, newly-licensed health insurance companies are *BULGARIA ZDRAVE JSC Health Insurance Company*, *ZDRAVE JSC Voluntary Insurance Network*, *NADEZHDA JSC Health Insurance Company*, *Planeta JSC Health Insurance Company* and *St. Nicola JSC Health Security Company*. The issuance of a licence was denied to one of these, but upon elimination of the grounds for the initial refusal and submission of a new application, the company was granted a licence to perform activities on voluntary health insurance.

A licence to conduct life insurance activities on particular types of insurances was issued to *DSK-Garancia* Life Insurance Company. The company has foreign participation.

Where exercising their powers to make independent decisions under the Insurance Act and the Health Insurance Act, the Deputy Chairperson in charge of **Insurance Supervision** Division issued a total of 275 individual administrative measures. The greater part of these were decisions on approval of submitted amendments and methods for forming insurance and health insurance reserves, on approval of persons to become members of management bodies of insurance and health insurance companies, on approval of submitted reinsurance programmes, resolutions on performance and termination of activities as an insurance broker, resolutions on broadening the scope of activity with new types of insurances and health insurance packets, and permits to invest own funds and insurance reserves abroad.

- **In the Field of Supplementary Pension Insurance**

During the period under review, in the sphere of supplementary pension insurance new licences to pension insurance companies were not issued. In 2004, the *FSC* issued licences to two applicants for actuaries of pension insurance companies and of the funds for supplementary pension insurance managed by these.

Throughout the year, the documentation submitted by the Bulgarian National Bank (BNB) was duly examined and opinions were drawn up on co-ordination on the part of the Commission with regard to proposals submitted by the BNB to include 13 banks in the list of custodian banks under the Social Insurance Code, and subsequently, on expanding the above

list with yet one more bank. The *FSC* agreed without demur on the proposals submitted by the BNB and, respectively, these banks were included on the list.

In 2004, the Deputy Chairperson of the *FSC* in charge of the *Social Insurance Supervision* Division issued 71 administrative measures related to licensing and permission regimes. Most of these are resolutions on approval of amendments to the regulations on the supplementary pension funds' organization and activities, and eight were resolutions on approval of assets and liabilities valuation rules of the pension insurance companies and supplementary pension insurance funds managed by these.

3. Control Activity

The Commission's control activity is implemented into two directions: constant remote surveillance and on-site inspections. The purpose of the said activity is to ascertain the observance of the statutory regulations on the capital adequacy and market conduct in order to prevent or reveal violations of the law. The *FSC* exercises control with regard to the observance of the FSC Act, the Public Offering of Securities Act, the Insurance Act, the Health Insurance Act, the Social Insurance Code and the valid enactments of the secondary legislation in the sphere of investment, insurance and pension insurance services.

3.1. Off-site supervision

The remote surveillance exercised by the *FSC* on the activities of the supervised entities finds expression in examination of the annual and periodic (quarterly and half-year) financial statements submitted, as well as of other normatively exigible documentation specific to the various supervised entities. In case of establishment of inadequacies and discrepancies with reference to the normative requirements, the *FSC* forwards letters to the supervised entities demanding rectification of the inaccuracies under the documentation submitted.

- **In the Field of Investment-Related Activity**

Investment Intermediaries. Securities Markets Directorate conducts inspection and analysis of the capital adequacy and liquidity reports, of the balance sheets and income statements of the **investment intermediaries**, submitted monthly to the Commission. This allows for current monitoring of their financial status. In case of establishment of violations of the normative requirements on the capital adequacy and liquidity, additional examination is carried out. Where the violations are confirmed, written statements ascertaining administrative violations are drawn or undertaking specific measures is recommended. It is possible to conduct on-site inspections or to impose coercive administrative measures (CAM).

At the same time, throughout the year, concurrent documentary examination of notifications submitted by the investment intermediaries on their activities, as well as by the brokers and the investment advisors with regard to amendments to the circumstances, entered into the *FSC*'s Registries was conducted.

The documentary examination of the periodic reports submitted by the investment and management companies is carried out by the *Investment and Management Companies Directorate*. For violations established in the information disclosed, nine (9) proceedings on implementation of CAM were instituted, which were subsequently terminated due to dropping out of the grounds: the companies have eliminated the inadequacies and discrepancies established in the periodic statements. Warning letters were also forwarded to three (3) management companies, and in case of non-observance of the recommendations stated under these, it is usually proceeded to institution of proceedings on implementation of CAM. No CAM was imposed on the three management companies due to elimination of the discrepancies.

Inspection was also carried out of the normatively exigible materials on general meetings of shareholders held as submitted by six investment companies. A letter was forwarded to one company containing recommendations on amendments to the company's by-laws where incorrectness was established regarding the evaluation of debt securities and the issuance and repurchase costs.

Where inspecting the documentation submitted to the *FSC*, untimely disclosure of information with regard to entry into the Trade Registry and non-submittal within the normatively defined timeframe of materials concerning a general meeting of an investment company was established.

The experts with the *Issuers of Securities Directorate* exercise control over the activities of **the public companies and the other issuers of securities**, where they see to the observance of the rules regarding the initial and subsequent (periodic and current) disclosure of public information. The control over the information initially disclosed is exercised through approval of the prospectuses of the public offering companies. In connection with the above, throughout the year, the *FSC* considered 25 applications for approvals of public offering prospectuses.

The control over the periodic information disclosed subsequently is exercised through inspection of the public companies and other issuers of securities' financial statements submitted to the Commission. During the past year, the percentage of companies that have failed to observe the deadline for submission of the annual financial statements decreased, reaching 6 per cent. With regard to the quarter statements, the said rate was even lower – approximately 3 per cent. Pursuant to the legal requirements, the Directorate also exercises control over the quality of the information submitted under the statements. Inadequacies and discrepancies were established in the case of 42% of the public companies and other issuers of securities' financial statements.

Over the current information disclosed subsequently, control is exercised in two directions. The first covers the disclosure of the important information, influencing the securities' price through current supervision. The aforesaid process includes daily monitoring of the information submitted by and concerning the public companies and other issuers of securities published in the means of mass communication, the electronic media also inclusive. The Directorate also exercises documentary examination on the basis of the documentation available at the *FSC*, regarding the disclosure of the already disclosed information in compliance with the requirements set under the POSA and Ordinance No. 2.

The second direction, into which control is exercised over the information currently disclosed, is with regard to the circumstances and the amendments to these as entered into the *FSC*'s Registry. Within the entry procedure, inspection of the contents of the information disclosed is exercised with regard to breach or the existence of prerequisites for breach of the legal requirements. Current surveillance is also exercised with reference to the forwarding of invitation for holding general meetings of the shareholders to the *FSC*. In connection with the above, 296 examinations of documents were conducted. Letters of reminder about items included on the agenda of the general meeting of the shareholders, inconsistent with the legal requirements: capital increase, unavailability of a reasoned report, release of management bodies' members of responsibility, adoption of annual report, etc., were forwarded to 24 companies. Letters to 52 of the supervised entities were forwarded regarding violations of the requirements under disposal transactions in companies' assets.

- **In the Field of Insurance and Voluntary Health Insurance**

The experts with the *Inspections and Financial Supervision Directorate* analyze a system of indices that, along with the reference information submitted, annual and quarterly reports provide a notion on the current financial status of each insurance company within the given period, as well as the activity development trends. Thus, violations of the Insurance Act and the Health Insurance Act are established.

In 2004, the annual financial statements, reports and reference information as of 2003 of 163 supervised entities as submitted to the *FSC* were examined and analyzed at the

Inspections and Financial Supervision Directorate with the *Insurance Supervision* Division: 31 insurers, 126 insurance brokers and 6 health insurance companies. Within the said period, 236 periodic reports were also examined, where 94 were periodic reports of insurers, 114 – of insurance brokers, and 28 – of health insurance companies. The Directorate also conducted inspection of the reports submitted by the Guarantee Fund and of the insurers undergoing liquidation and insolvency proceedings.

- **In the Field of Supplementary Pension Insurance**

In 2004, the monthly and annual financial statements of the eight pension insurance companies and the twenty-four supplementary pension insurance funds managed by these, as well as the annual reports on the activities of the pension insurance companies in 2003, were examined and analyzed as submitted to the *FSC*.

Under the analyses drawn up, the levels of all indices normatively set (i.e.: capital adequacy, liquidity, ratio of the investments in the separate types of financial instruments in relation to the pension funds' assets, etc.) are defined. Apart from the indices having normatively regulated levels, other indices related to the capital, pension insurance companies' income and expenditure, as well as to the investment of the pension funds' assets are also analyzed. Through these indices, separate aspects of the activity and its efficiency are evaluated on the basis of comparative analysis not only for each company in dynamics, but also amongst the separate companies within a specified period.

Through the analysis of the reference information and financial statements periodically drawn up, as well as on the basis of the information additionally submitted by the PAC, control over the process of bringing the activities of the companies and the pension funds managed by these into line with the regulations of the SIC and the subdelegated enactments, adopted in connection with the Code's entry into force is realized. Generalized analytical reports are drawn up on the basis of the monthly and annual analyses.

Since July 1, 2004, daily examination of the results ensuing from the activities of the twenty-four pension funds has also been performed on the basis of the information being submitted electronically to the *FSC* by the pension insurance companies and by the custodian banks. For the above purpose, the experts with the *Control Activity* Directorate participated in the designing, development and introduction of a special data receipt and processing information system.

Within the daily control exercised, the transactions concluded in the pension funds' assets, the ratio of the investments in different types of financial instruments in relation to the pension funds' assets, the method of evaluating the assets and their correct registration in the pension insurance company and under the custodian banks' registries is kept track of. The observation of the normatively set deadline for investing the funds received; the amendments to the net assets' value; the correct deduction of the investment fee and the correct allocation of the number of units, corresponding to the sums received and withdrawn, is controlled. By introducing the new control system, the accounting units' values calculated daily are announced and data on the pension funds' profitability on a yearly basis are made public.

In 2004, the Deputy Chairperson of the *FSC* in charge of *Social Insurance Supervision* Division issued a total of 24 individual administrative measures – resolutions and orders, related to the control activity. Seven resolutions were issued with reference to the disclosure of the minimum profitability resulting from the asset management of the compulsory supplementary pension insurance funds. Excerpt samples of the insured persons' individual accounts were approved under resolutions of the Deputy Chairperson.

3.2. On-Site Inspections

The control exercised over the activities of the supervised entities is also realized through on-site inspections, which are planned and thematic. The *FSC* also performs inspections following warnings and claims submitted by injured persons in connection with the activities of the supervised entities.

A plan, a list of the source documentation necessary and a written statement of ascertainment are drawn up for the implementation of each inspection. In case of the establishment of problems and violations, a report is also drawn up, containing proposals for supervisory measures to be undertaken, and the said report is submitted to the respective Deputy Chairperson.

- **In the Field of Investment-Related Activity**

In 2004, the *Investment Intermediaries. Securities Markets* Directorate conducted a total of 87 planned and ad hoc inspections of the investment intermediaries' activities. 31 of these followed warnings submitted, 30 were planned, 21 were related to monitoring of the trade and publications in the media, 3 concerned a voluntary surrender of a licence by an investment intermediary, and 2 were internal inspections initiated the *FSC*. Two inspections were carried out in co-operation with the *National Police Office* Directorate. 13 joint inspections of the *Investment Intermediaries. Securities Markets* and the *Issuers of Securities* Directorates were also undertaken during the said period, where 7 of these were related to disclosure of information.

Throughout the year, apart from the joint inspections, 39 inspections of companies and natural persons were opened by the *Issuers of Securities* Directorate. In total, 36 inspections were concluded, where a part of these were initiated in the preceding reporting period. 10 inspections of companies are still continuing after December 31, 2004. The objective of the inspections' main part is to establish violations regarding the current and subsequent disclosure of information, disposal of the public companies and the issuers of securities' assets.

Within the sphere of activity of the investment and management companies, during the period under review, planned on-site inspections of two investment and one management companies were carried out. As a result, non-observance of the assets' valuation rules, as well as deviations from the normatively defined investment restrictions were established. Throughout the year, inspections of two investment and two management companies commenced, which were not completed as of the year's end.

- **In the Field of Insurance and Voluntary Health Insurance**

In 2004, 66 on-site inspections of supervised entities, as well as of other persons, for whom information was received regarding violations of the Insurance Act and the Health Insurance Act, were performed. In 24 insurance companies, a total of 38 inspections were carried out. 30 of these were thematic, and the rest were planned. The thematic inspections were realized in connection with taking out the *Compulsory Third Party Liability Insurance* and due to deterioration of the indices system established ('early warning system'), as well as in connection with warnings and claims submitted to the *FSC*. In response to the substantial increase in the violations established, the Commission enhanced the control through thematic inspections, and their number increased dramatically.

With regard to the activity of the insurance brokers, 20 inspections were carried out. 7 inspections of persons who are not supervised by the *FSC*, but for whom information was received that these violated the Health Insurance Act – non-hospital aid medical centres – were also performed. In addition to the above, one joint inspection of a bank was also carried out.

- **In the Field of Supplementary Pension Insurance**

During the year, 29 on-site inspections of the licensed pension insurance companies and the supplementary pension insurance funds managed by these were carried out. Four of these were full inspections, covering the complete activities of the companies and the pension funds managed by these. The other 25 were thematic. By the number of inspections, which has trebled compared to 2003, it may be judged for the enhanced control on the part of the *FSC*. The main reason for the aforesaid is the necessity to exercise control in connection with the adoption of Ordinance No. 3 of the *FSC*, regulating the switch of participation and the transfer of the amounts of the insured persons. 15 inspections were carried out with regard to the observance of the regulations imposed under the said Ordinance.

Another 7 inspections were conducted in all pension insurance companies that realized activities throughout the whole 2003 in connection with allocation of the insured persons' individual accounts' profitability. Three inspections following warnings and claims were also performed within the said period.

3.3. Complaints and Claims

The Commission maintains an open public dialogue with persons, whose rights have been infringed by the non-banking financial sector institutions. The *FSC* accepts claims and warnings not only for violations perpetrated by the supervised entities when performing their activities, but also in relation to resolutions issued by the Deputy Chairpersons in charge of the Commission's Divisions.

In 2004, four claims against Commission's rulings and 15 against resolutions of the Deputy Chairpersons of the specialized supervision Divisions were received.

Within the year, nine reports were drawn up on claims received at the *FSC* against resolutions issued by the Deputy Chairperson of the *FSC*, in charge of the *Investment Supervision* Division, under which draft rulings of the *FSC* were prepared. Against these, another two claims were filed regarding refusal to grant approvals for acquisition of more than 10 per cent of the capital stock of an investment intermediary and for amendment to the general terms and conditions, applicable to the contracts concluded with customers of an investment intermediary. Both claims were rejected as being groundless.

In 2004, three individual administrative acts issued by the Deputy Chairperson in charge of the *Insurance Supervision* Division were appealed against. Upon consideration, these were rejected by rulings of the *FSC*.

Throughout the year, 3 claims against individual administrative acts issued by the Deputy Chairperson in charge of the *Social Insurance Supervision* Division were lodged. Under the above acts, coercive administrative measures were imposed and binding directions were issued. The Commission rejected as being groundless the claims received. Against one of the Commission's rulings ordained, under which a claim was repudiated against an individual administrative act issued by the Deputy Chairperson in charge of the *Social Insurance Supervision* Division, an appeal was lodged with the Supreme Administrative Court. The Court did not consider the appeal and discontinued the proceedings initiated due to non-removal of irregularities under the said appeal.

The *FSC* also considers the claims which are received against the supervised entities.

The biggest part of the claims lodged against **investment intermediaries** concerned wrongful disposal of investment vouchers and shares of natural persons, as well as infringements arising where settling the relations between clients and investment intermediaries that have been divested of the licence to perform activities. In the case of doubts about frauds and criminal offences, the competent authorities of the Prosecutor's Office, the Financial Investigation Agency and the *National Police Office* Directorate were approached.

The most common reasons for lodging appeals against **the public companies and the other issuers of securities** were problems with obtaining information on the rights of their shareholders.

The claims lodged with the *FSC* with regard to violations in the sphere of the activities of **the investment companies** were mainly caused by wrongful disposal of the shares of the ex-privatization funds belonging to the citizens.

In 2004, a total of 1,106 claims against **insurers** were lodged with the Commission. 58% of these were directed toward one insurance company. Most of the claims lodged were considered during the same year; however, there are also claims that are to be considered in 2005.

In the field of **supplementary pension insurance**, the Commission received 575 claims and warnings by insured persons and pension insurance companies. Complaints mainly regarding actions or lack of actions of pension insurance companies on consideration and satisfaction of applications for transfer of funds of insured persons from one to another fund were elaborated under the claims received. All claims and warnings were considered and replies were forwarded within the statutory timeframe. Due to the existence of a reasonable suspicion for criminal offence perpetrated, 29 warnings were forwarded to the authorities of the Prosecutor's Office and the *National Police Office* Directorate.

4. Coercive Administrative Measures and Administrative Sanctions

A main authority of the Commission and of the Deputy Chairpersons within the supervisory activities is the right to impose coercive administrative measures and administrative sanctions in case of establishment of breach of the legislation regulating the non-banking sphere. Three are the main principles of the *FSC* where implementing the said policy: equal treatment of all market participants, transparency of its actions and proportionality of the sanctions to the degree of risk, which the breach that has given rise to is to the whole system.

- **In the Field of Investment-Related Activity**

The most common breach established on the basis of the remote surveillance exercised and the on-site inspections carried out is conclusion of a contract between **an investment intermediary** and a customer where not all necessary documentation was signed, as well as the presence of inadequacies or discrepancies in the documentation submitted. Lack of a concluded contract between an investment intermediary and a customer is often established, as well as a declaration on customer's identity check, authentication of the contract and the declaration by a person with the internal control department.

Based on the breaches of investment intermediaries established throughout the year, a total of 168 written statements ascertaining administrative violations were drawn up. Out of the proceedings on the implementation of coercive administrative measures opened toward three legal entities, two were closed by the end of the reporting period herein.

In the sphere of activity of the management companies, the most common offences established under the control activities exercised are non-observance of the assets valuation rules and deviations allowed from the normatively defined investment restrictions. With regard to **the investment and the management companies**, offences in connection with the activities undertaken on investment counseling, as well as with untimely disclosure of information regarding entries in the Trade Registry and non-submittal within the normatively defined timeframe of materials concerning the general meeting of the shareholders of an investment company are also to be found. Not only with the investment intermediaries, but also with these companies, had the *FSC* established inadequacies and discrepancies in the documentation submitted by the supervised entities.

As a result of the establishment of the aforementioned, as well as of other violations, 10 proceedings on the implementation of coercive administrative measures were initiated throughout the year, subsequently terminated due to removal of the grounds. 21 statements of established violations were issued to management companies, one to an investment company, as well as four statements ascertaining administrative violations.

The offences established under the current control and the on-site inspections exercised with regard to **the public companies and the other issuers of securities** include non-submittal of the reports and of various notifications within the timeframe statutory set, as well as allowance of inadequacies and discrepancies in these. In relation to 42% of the companies submitted an annual report for the year 2003, proceedings on implementation of CAM in order to remove inadequacies and discrepancies established were opened. Under the reports for the first and second quarters of 2004, the above percentage is respectively 52.2, and for the third quarter of 2004 – 34.2.

The Commission also established a number of violations in the organization and holding of the general meetings of the shareholders, and namely: the regular meetings were not convened within the statutory timeframe, an item on the agenda was not voted on, the record of proceedings was not forwarded to the *FSC* within the statutory timeframe. Many companies failed to deposit their annual fee for the year 2003 within the specified deadline.

During the year, the following measures were undertaken with regard to the violations established: 590 proceedings on implementation of coercive administrative measures were opened, where 123 of these were closed with the implementation of the measures, and 348 proceedings were terminated. In comparison with the preceding year, the measures imposed have decreased by half. The reason for the aforesaid fact is the enhanced discipline amongst the public companies and the other issuers of securities with regard to the requirements set by the *FSC*.

In addition to the above, proceedings were opened against 178 companies regarding issuance of an individual administrative act on establishment of public government collections; and as a result of the above, 58 rulings were issued. Throughout the year, a total of 267 measures and 183 written statements of ascertainment were drawn up to public companies and other issuers of securities.

- **In the Field of Insurance and Voluntary Health Insurance**

The breaches established under the current financial control and under the on-site inspections of the insurers, the insurance brokers and the health insurance companies may be systematized within several directions.

On account of accumulated losses from activity, in the case of some supervised entities the own funds, decreased by the intangible assets, did not cover the minimum guarantee capital. The requirements regarding the assets structure were also violated: the amount of the tangible fixed assets and the intangible assets exceeded the statutory limit. In the case of certain supervised entities, deficiency of assets to cover the insurance and the health insurance reserves was established.

A part of the newly-licensed health insurance companies does not invest the health insurance reserves set aside in the statutory assets. Violations of the requirement stating that the companies licensed with a minimum capital of BGN 500 thousand are to invest own funds amounting to a one third of the solvency margin under the terms and conditions and under the procedure for investing the health insurance reserves were established.

A common infringement was non-compliance with the requirements for diversification where investing the insurance and the health insurance reserves, such as for instance the limits on investing in unencumbered under charges real estates, bank deposits and mortgage bonds.

A discrepancy was established between the property's net worth and the subscribed capital, which has led to infringement of Trade Act regulations in the case of certain supervised entities.

In the case of some supervised entities, it was established that the annual and periodic reports submitted were drawn up incorrectly, which gave rise to doubts regarding the truthful and honest presentation of their financial status.

Under the inspections of the medical centres, it was established that some of these perform activities on voluntary health insurance under subscription contracts for provision of medical services without being licensed for such activities.

The main breach established in the case of the insurance brokers, was non-fulfillment of their obligations to submit the periodic reports.

In 2004, 3 coercive administrative measures were imposed: two rulings issued by the *FSC* on assignment of a quaestor with insurers, and one resolution by the Deputy Chairperson

of the *FSC* in charge of the *Insurance Supervision* Division, regarding an order on elimination of an infringement by an insurer.

With regard to the violations of the Insurance Act and the Health Insurance Act established and as a result of the current financial control exercised, throughout the year, 117 written statements ascertaining administrative violations and 68 penal decisions were issued and served. Out of these, 62 written statements ascertaining administrative violations and 44 penal decisions were served to insurers; to health insurance companies: 4 written statements ascertaining administrative violations; to persons, representing medical centres: 28 written statements ascertaining administrative violations and 24 penal decisions; and to other persons that are not supervised entities: 4 written statements ascertaining administrative violations.

- **In the Field of Supplementary Pension Insurance**

As a result of the remote surveillance exercised, it was established at certain supplementary pension insurance funds that the subsequent valuation of securities accepted for trade on regulated markets had not been undertaken pursuant to the normative requirements, as well as violations of the legal restrictions imposed on investing the pension funds' pecuniary means in bank deposits and shares. With regard to the annual accountability of the pension insurance companies for the year 2003, non-submittal within the prescribed timeframe of the annual reports on the activities of three companies and the monthly reports of a supplementary pension insurance fund were established. An excess of the investment fee's amount withheld at a voluntary pension fund exceeding the normatively set amount was also established.

Under the four full inspections undertaken, violations were established of the regulations set under Ordinance No. 9 of the *FSC* on the terms and procedures for valuation of assets and liabilities of supplementary pension funds and pension insurance companies, as well as of Ordinance No. 3 of the *FSC* on the terms and procedures for switching participation and transferring the amounts accrued in an insured person's individual account from one supplementary pension fund to another fund of the same type, managed by another pension insurance company. Offences were also established where defining the reserve's amount, calculated as a percentage of the net assets' value of the respective fund, etc.

As a result of the thematic inspections undertaken, non-observance of the timeframe for conclusion of insurance contracts with insured persons was established, without the availability of a rejection to switch participation, as well as non-observance of the timeframe for notification of the National Social Security Institute on the insurance contracts concluded and the timeframe for transfer of the amounts accrued in the insured persons' individual accounts. Unjustified denials to switch participation of an insured person, failure to notify the *FSC* on the violations under Ordinance No. 3 of the *FSC* as established by the company's internal control department, as well as offences under the procedure for submitting applications for transfer or switch of participation were established.

In order to eliminate the violations established, in 2004, 14 coercive administrative measures were imposed, under which 21 binding orders were issued to the management of four pension insurance companies. 108 measures were also drawn up, under which 456 administrative violations were established. 82 penal decisions were issued, under which fines amounting to BGN 61,500, and a property sanction amounting to BGN 10,000 were imposed.

5. Co-operation and Membership in International Organisations

The *FSC* has always endeavoured to co-ordinate its activities with a number of local and foreign institutions that have direct or indirect influence over the functioning of the financial markets. The Commission directs its efforts toward co-operation with these in order to achieve common goals, as well as in order to realize an exchange of useful information and experience.

5.1. Internal Co-operation

With a view to the powers of the *FSC* to exercise control only over the non-banking financial sector, in order to broaden and improve the efficiency of the control over the financial market in 2003, a Memorandum on Co-operation and Interaction with the Bulgarian National Bank was concluded. This is the authority, exercising regulation over the banking sector. The objective of the agreement is enhancement of the co-ordination between the two institutions on issues of mutual interest in the field of the financial services. The efforts are directed at perfection of the practice on laws implementation; rendering co-operation necessary to enhance the legislation, regulating the activities of their supervised entities and support where exercising their supervisory functions.

In order to guarantee the security and the stability of the financial markets in Bulgaria and the possibility for adequate strategic planning of the industry's development, Consultative Council on Financial Stability was established. The Chairman of the *FSC*, the Deputy Governor of the BNB and the Minister of Finance participate in the said Council.

In 2003, the *FSC* also concluded an agreement on co-operation and exchange of information with the Protection of Competition Commission. Support of the co-operation between the two parties is aimed in compliance with the sphere of their activities through exchange of information, establishment of interdepartmental task forces, joint organization of seminars, workshops and other events.

The Memorandum signed during the same year with the Financial Investigation Agency at the Ministry of Finance and the instruction to it provide for the contracting parties to render co-operation where collecting, preserving, examining and disclosing the information they have at their disposal with regard to financial transactions, for which there exist doubts that these are related to money laundering or criminal activities.

Stemming from the necessity to co-ordinate the activities of the *FSC* and the Ministry of Interior on issues of mutual interest, related to the financial supervision and the counteraction to the organized crime within the spheres of economic and financial system, on September 14, 2004 the two institutions signed Agreement on Co-operation and Interaction. Under the above Agreement, the exchange of information and the processes, calling for the implementation of joint actions are facilitated.

A very important detail in the agreements concluded by the *FSC* is the possibility provided for to carry out joint inspections. Task forces were formed comprising experts representing the different organizations, interested in certain results. Three task forces were set up throughout the year, two of which had already commenced their activities as of December.

5.2. International Co-operation

The *FSC* places accent on the activities it undertakes in the direction of broadening the international co-operation. The accelerated rates of development of the capital markets and the appearance of financial groups on a world scale make the necessity for co-operation with foreign institutions more and more evident. The study of the international practices in the field of the financial supervision has a particular importance in supporting the process of perfecting the Commission's activities in compliance with the constantly altering terms and conditions and needs falling within the financial sphere's scope.

The conclusion of international agreements allows for the implementation of a more efficient control exercised over the financial companies having international activity, prevention of market manipulations and financial abusive acts, unscrupulous trade, money laundering, as well as facilitation of the process of introduction of a single European passport to the companies, providing financial services in connection with the forthcoming date of Bulgaria's accession to the EU.

Apart from the concluded in 2003 Memorandum on Co-operation with the Hungarian Financial Supervision and Memorandum with the Republic of Albania in the field of the securities, in 2004 the *FSC* concluded five memorandums on co-operation: with the Macedonian Securities and Stock Exchanges Commission, with the Macedonian Capital Coverage Pension Insurance Supervisory Agency, with the Romanian Insurance Supervision Commission, with the Romanian National Securities Commission and a memorandum with the Turkish Capital Markets Board. Throughout the year, negotiations in order to conclude an agreement were also held with the Hellenic Capital Markets Commission, with the Austrian Financial Markets Supervision and with the Polish Insurance and Pension Supervision.

In its capacity of a member of the International Organization of the Securities Commissions (IOSCO), the *FSC* has undertaken steps to become a party under the IOSCO's Multilateral Memorandum of Understanding. The said Memorandum has already been signed by 24 countries, most of which have well-developed financial markets.

In addition to IOSCO, the *FSC* is an active member of the International Association of the Insurance Supervisions (IAIS) and a founding member of the International Organization of the Pension Supervisions (IOPS).

An important forum for the Commission during the year was the three meetings of the consultative group on the capital market's regulation and supervision. The Consultative Group on the Capital Market's Regulation and Supervision, established in May 2001, aims at facilitation of the exchange of information and experience of the candidate countries to become EU members, as well as to provide for a possibility for co-operation amongst these in the harmonization process with the EU regulation and standards. Bulgaria is one of the founding members of the said group in the person of the then State Securities Commission.

In 2004, the *FSC* participated in the regular annual conferences of the organizations, associations and committees it is a member of. In connection with the pre-accession process of Bulgaria, the *FSC* continuously participates at the meetings with experts of the European Commission and the EU member states on the issues in the securities and insurance fields, as well as at sessions of task forces, committees and other forums on the issues related to the country's accession.

6. Information and Educational Policies

The *FSC*'s **information policy** is based on the principles of publicity, transparency and accessibility. All activities in the said direction are governed by one of the Commission's objectives: provision of information on the financial market in order to enhance its efficiency and to reduce the possibilities for abuses.

The practice of public announcement of all rulings of the *FSC* and of the Deputy Chairpersons in charge of the Commission's Divisions, the information on the supervised entities, as well as the Institution's initiatives is adopted.

The *FSC* maintains a **website** that is daily updated, on which detailed information about the Commission, the supervised entities and the legislation is provided. The said website is intended for use not only by the general public, but also by the institutions themselves, which institutions provide financial services. Since 2004, the above information is also accessible in the English language. For the supervised entities' sake of convenience, samples of all documents these are to submit to the *FSC* have been published. In addition to the above, the users of financial information and the financial analyzers may find useful and updated statistics and analyses on the non-banking financial sector on the Commission's website.

Pursuant to the normative requirements, the *FSC* keeps an **Electronic Registry & Card-index (ER&C)**. Access to the said Registry is provided via the Commission's webpage. The above Registry contains detailed and up-to-date information on the supervised entities and their activities. The Registry's data is maintained by a specially developed information system, which provides for the possibility to generate various types of reference information. The system is easy to utilize, functional and flexible. The provision of access to the public information is of considerable importance for making adequate financial decisions. In 2004, ER&C was expanded with electronic registries of the insurance and health insurance companies, the insurance brokers, pension insurance companies and funds. Additional information on the supervised entities was also included in the Electronic Registry and possibility was provided for drawing up new reference information.

Of considerable importance in order the information provided by the *FSC* to reach the general public are the good working relations established with the media through drawing up and circulation of daily press releases, which are also published on the *FSC*'s website. **Briefings** for the journalists are regularly held, and for the year 2004 they numbered 29. Press conferences on the occasion of special events are also organized. Throughout the past 2004, representatives of the *FSC* gave 42 interviews on themes of interest to the general public.

The great influence of the information broadcast by the media on the public opinions necessitates its truthful and impartial presentation. In connection with the above, in June 2004, jointly with the Media Development Centre, a seminar was organized at which **journalists** from the Balkan countries were acquainted with the Commission's activity, the principles for disclosure of information, the prevention and avoidance of market manipulations.

On September 15, 2004, a **telephone information centre** commenced work at the *FSC*, whose main purpose is the realization of a more direct connection between the Commission and the general public. The officers at the information centre may be contacted on telephone 0900 32 300 with regard to incoming enquiries falling within the competencies of the Commission. For the sake of the citizens, two impulses are registered for a minute conversation from any point within the country. The most common enquiries are related to the securities trade mechanisms and the non-pecuniary payment means, information about the former privatization funds, on the Compulsory Third Party Liability Insurance and the principles of supplementary pension insurance. By submission of specialized information

through the Information Centre, the *FSC* aims at providing better servicing and protection of the non-banking financial services users' interests. At the information centre, statistical data is accumulated on the most common enquiries by age groups and towns and villages. An analysis of the data allows for the definition of the most interesting and unclear subjects for the society. The latter are subsequently explained through information brochures and publications in the mass media in order to enhance the investment culture of the financial services' users.

The *FSC*'s official printed matter is the **monthly bulletin**, where rulings and resolutions, ordinances, instructions, reports, as well as commentaries on the most important events and issues in the field of the non-banking financial sector are published.

The *FSC*'s **educational policy** is directed at enhancing the society's awareness of the non-banking financial sector, and in particular of the activity of the Commission itself. Throughout the year, a number of initiatives were undertaken, aiming at attainment of a better knowledge of the terms and conditions for functioning and the development perspectives of the non-banking financial sphere.

The *FSC*'s members and officers were invited as lecturers at a number of public events in the country and abroad, amongst which The Second International Financial Exhibition *Banks, Investments & Money*, The Economic Forum for South Eastern Europe, The Bulgarian Economic Forum, The Regional Conference on Co-operation amongst the Regulatory Agencies of the Capital markets in the Countries of South Eastern Europe, etc.

At the European Regional Committee's meeting of the International Organization of the Securities Commissions (IOSCO) held in November in Lisbon, particular attention was paid to the *FSC*'s information policy, as well as to the Institution's educational programmes, aimed at enhancing the investment culture of the financial services' users.

Throughout the year, the Commission held a number of educational initiatives, directed toward various social groups. For the students studying economics at the schools throughout the whole country, the *FSC* organized an educational programme entitled *The Non-banking Financial Sector in Bulgaria*. It turned out to be exceptionally successful and useful. The programme was held twice in 2004, where its main objectives were to enrich the knowledge of the young people about the financial sector, to acquaint these with the non-banking financial sector's structure and the Commission's role in its capacity of a regulatory institution. Similar educational event was also organized in the month of October 2004 for head-teachers of economic schools, the purpose of which was to present the participants with the trends in the non-banking financial sector's development in Bulgaria.

An objective of the *FSC* is to constantly enhance the investment competencies of the supervised entities by creating all necessary prerequisites for their swifter adaptation to the new legal requirements. Following the entry into force of Ordinance No. 2 on the prospectuses in case of public offering of securities and disclosure of information by the public companies and other issuers of securities and the implementation of the International Financial Reports Standards, in 2004 for the first time the public companies and issuers of securities implemented a number of new rules where drawing up the annual reports for 2003. On account of the above reason, an educational initiative was undertaken and an elucidation campaign was realized in connection with the practical implementation of the normative requirements. The *FSC* organized a seminar on the following subject: *Disclosure of Information by the Public Companies and Securities Issuers Pursuant to POSA*.

7. Human Resources Policies and Staff Training

The experts with the *Human Resources* Directorate are responsible for the implementation of the Organization's policies on management and development of the human capital, where a constant reference point in the Directorate's activity is to render support for the strengthening and development of the FSC in order to attain its objectives. The main activities, toward which the efforts of the Directorate's team are directed, are three.

Recruitment, Selection and Appointment of New Employees

The purpose is to secure the Commission's activities with valuable specialists who are able to adequately meet the high requirements for professionalism, team work, personal and organizational development.

Throughout the past year 2004, a considerable part of the labour relations arose following selection procedures held (mainly through interviews and written working out of cases). Clear and transparent rules were applied where appointing the applicants. A staff selection procedure is being developed and approved.

The allocation of the specialists in terms of educational level and type of education corresponds to the objectives and tasks solved by the Commission. The qualitative composition of the Commission's employees conforms to the work requirements. 89% of the staff holds a higher educational degree; 11% – a secondary educational degree.

Nearly 10% of the specialists holding a higher educational degree also have higher qualifications: a scholarly degree/academic rank, a second higher educational degree, etc. Amongst the specialists holding a higher educational degree, 31% have juridical education, 46% – economic, 19% – another type of higher education.

There is a satisfactory balance of the staff in terms of age. The average age at the *FSC* is around 38. The highest percentage of employees is from the age of 30 to 50 (59%). The fewest number of employees are at an age exceeding 50 years (17%). The employees at an age of up to 30 are 24%.

The improvement of the qualitative composition of the employees finds expression in the establishment of an internal organizational system for proactive behaviour in relation to the dynamics of the requirements set towards the staff. The specialists' general and specific competencies are enhanced. The creation of a personnel reserve is important, as well as maintaining and improving the balances related to education, age, sex.

During the past year, a successful start was given to the trainee programme at the *FSC*, through which not only chance is given to the graduating students to acquire valuable experience, but it is also a possibility for the Commission itself to recruit candidatures of students having high potential.

Setting up a Work Evaluation System and Stimulation of the Labour Participation

An efficient means for evaluation of the Commission's employees' professionalism and competencies is the appraisal system through the implementation of the Ordinance on the terms and conditions and the procedure for attestation of the state administration employees. At the same time, at the *FSC* there is a well-developed and operative (quarterly) extra incentive bonus system. Through the said system, the employees receive complementary remuneration depending on their work results throughout the elapsed period.

The results from the attestation procedure held are grounds for differentiation of the employees' remuneration, for better substantiation of the personal and team plans for labour participation and development, for designation and realization of work enhancements.

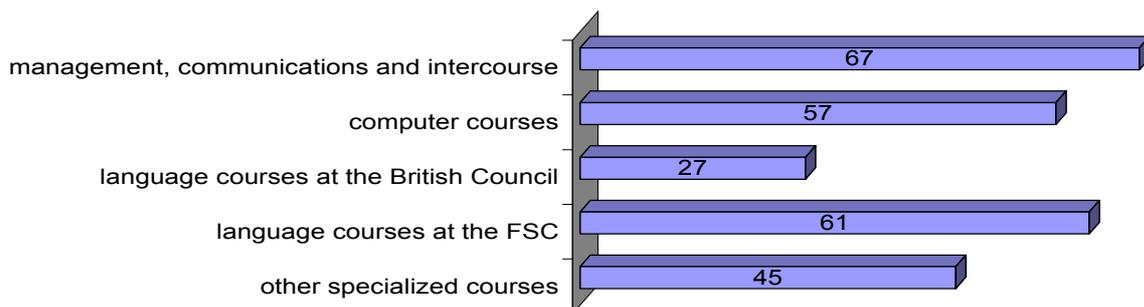
A main guideline for enhancement of the work evaluation and stimulation of the labour participation activity is the incorporation of the possibilities provided for under the Ordinance on the terms and conditions and the procedure for attestation of the state administration employees into an integral, continuously operative system. Within the said system, we are to also utilize more fully the resources of the internal quarterly attestations. It is also important to find suitable ways for further rationalization and mastery of the system on the part of the employees/managers in order to utilize more fully its various potentialities.

Training and Qualifications Enhancement

The Training and Qualifications Enhancement System contributes to the improvement of the labour performance's quality. Through the said System, the needs of the Organization and the personal development and promotional plans are better bound. The employees' participation in the planning of the individual labour career is furthered. Thus, a rise is given to a stronger responsibility toward work. It is a means to stimulate the individual and team development, to form and perfect a working organizational culture.

In 2004, 162 employees of the Commission participated in various forms of training and qualifications enhancement.

Number of employees, undergone trainings in 2004



Through increase in the Employees' Training and Qualifications Enhancement System's efficiency, the Commission strives to secure durability of planning, as well as closer and well-grounded binding of the Training and Qualifications Enhancement System with enhancing the personnel and labour performance's quality. To this end, the elaboration of a network of flexible contemporary forms of training with a staged introduction of WEB-based education and rationalization of the concept of the learning organization would also help, as well as setting up mechanisms for continuous organizational studying.

In 2004, our efforts were directed toward enhancement of the communications within the Organization, the main purpose being creation of stimulating organizational climate. The monthly publication of a newspaper entitled "KaΦeHe" ('Café', after the abbreviation of the FSC in Bulgarian) commenced, which reflects the Commission's internal life and the Institution's major issues. A number of trainings were organized and held, which also continue throughout the present year. The objective of the said trainings is perfection of the management skills and the team climate, as well as enhancement of the communication at the place of work.

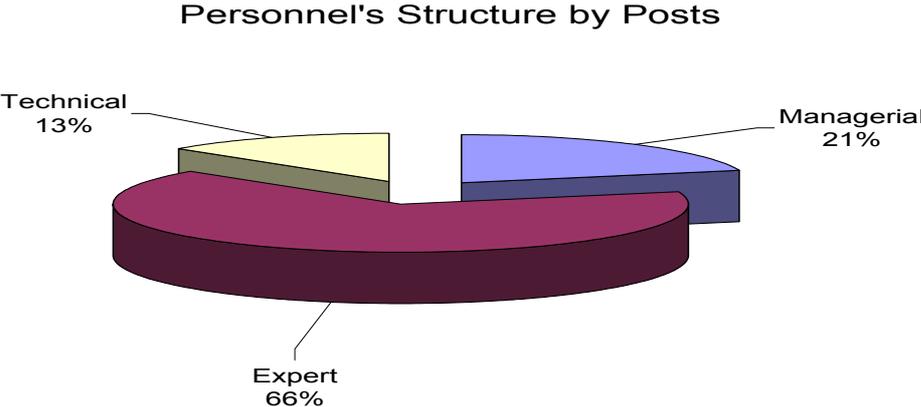
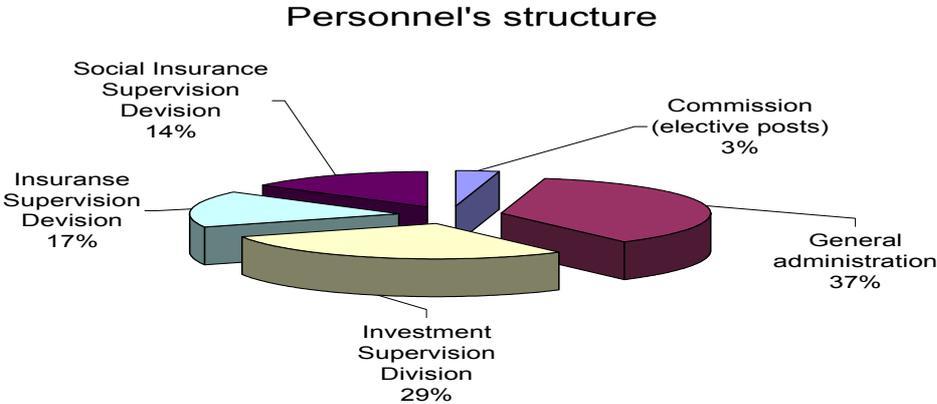
In addition to the attainment of these three main objectives in the activity of the *Human Resources* Directorate, the team directs its efforts toward all activities related to the

personnel administration at the *FSC*. To this end, a complete set of documents is being prepared that shall secure the correct implementation of the valid enactments, projects for guaranteeing the health and safe work and enhancing the labour conditions are being elaborated, the activities under national and international programmes in the field of the human resources are co-ordinated.

Number of Staff

In 2004, the *FSC* strengthened its position as a responsible regulatory agency, securing regulations that stimulated the market’s development. This preconditioned the necessity to increase and stabilize the *FSC*’s personnel’s number of staff. Since March 2004, the number of staff is 215 (an increase of 13 compared to 2003), where the number of staff at the *FSC* is considerably better utilized in comparison to 2003.

The present structure of the personnel is in conformity with the Commission’s organizational regulations and meets the *FSC*’s organizational structure. During the elapsed two years, no necessity has arisen for an amendment to the personnel’s structural organization in principle.



For the period January 1, 2004 – December 31, 2004, 51 new employees have joined the Commission, and 32 employees have left. Upon holding conversation with the employees leaving the Commission, the conclusion was reached that the main reasons to resign were the considerably higher remuneration in the private sector, as well as the limited possibility for career development. In order to strengthen the *FSC*’s potential and in order to attract and keep highly qualified persons, the Human Resources Directorate has directed its efforts toward undertaking activities, related to enhancing the *FSC*’s personnel’s motivation, as well as toward the establishment and elaboration of a promotional system of the *FSC*’s staff.

8. Information Technologies

Following the contemporary trends for setting up information networks, and namely giving priority to their orientation toward providing services, the requirements set toward the security of the said systems also considerably change. The FSC already has at its disposal certificates for enhanced electronic signature – of the *Server* Type and of the Programme Code Type.

Jointly with experts under the *Labour Market* Project, the USAID set up an e-FSC System. Via the above System, in 2004, the *FSC* processed over 12,000 pieces of financial reference information signed electronically.

In 2004, the personal computers were renewed and it was proceeded to utilization of a single platform as operational environment of the work stations. Switching to a newer version of the operational system used allowed for the improvement in the work stations' maintenance, as well as for enhancement of the possibilities of the information environment. The parameters of the *FSC*'s local network were improved.

The Emerging Markets Group, an authorized independent analyst, conducted a detailed analysis of the *FSC*'s information technologies. Under the said analysis, an assessment of the IT environment at the Commission, findings and recommendations along these lines were provided. On the basis of the said recommendations, an Integrated Information System Strategy was drawn up.

9. Development Strategy

The present Section aims at marking the main policies the FSC is to follow in future not only in the regulatory field, but also where pursuing its supervisory activity.

The financial system plays a key role for the economy of each country. The reliable functioning of the financial markets, the stability of the financial institutions and the protection of the financial products and services' users are a precondition for economic growth. The importance of the financial system for the whole economy predetermines its more intensive regulation and supervision compared to the other sectors. The aforesaid defines the FSC's considerable importance in the field of the non-banking financial services.

The perfection of the Commission's activity and functioning is a constant process, whose parameters are defined by the dynamic development of the financial environment. The FSC strives to meet the ever changing needs falling within the sphere of regulation and supervision of the non-banking financial sector.

9.1. Plan for Legislative Amendments

- **In the Field of Investment-Related Activity**

It is provided for the adoption of:

Ordinance on the terms and conditions and the procedure for entering and writing off public companies, other issuers of securities and issues of securities into the Financial Supervision Commission's Registry. The above Ordinance is adopted with a view to attaining conformity with the amendments introduced into the POSA and Ordinance No. 2 on the prospectuses in the case of public offering of securities and on the disclosure of information by the public companies and other issuers of securities.

Ordinance on the procedure for and method of payment of compensation on customers' assets. The said Ordinance is to be adopted in connection with regulating the payments of amounts by the Investors in Securities Indemnification Fund provided for under the Draft POSA. By a legal delegation, under the Draft it is also provided for the adoption of Regulation on the organizational structure and activity of the Investors in Securities Indemnification Fund.

With regard to the harmonization of the Bulgarian legislation in the field of the securities with the achievements of the EU law, by the end of 2005 it is provided for the adoption of Ordinance on the inside information and the inside persons, on the mala fide trade and manipulation of the securities' market. Under the aforementioned Ordinance, the requirements set under the directives with regard to inside information trading and market manipulation shall be introduced, along with unification of their definitions, as well as the terms and conditions for fair presentation of investment recommendations and disclosure of conflicts of interest.

The ordinances on the requirements towards the activity of the investment and management companies are to be amended in order to attain complete conformity with the directives in the field of the collective investment schemes. The requirements regarding the annual and consolidated reports, the publication of prospectuses and the financial instruments market are also to be harmonized by the end of 2006.

- **In the Field of Insurance and Voluntary Health Insurance**

In 2005, it is provided for the drawing up and the adoption of:

Ordinance on liquidation of damages under a *Third Party Liability* Insurance of the owners, users, holders and drivers of motor vehicles. The objective of the above Ordinance is the establishment of a uniform methodology for determining the actual values of the vehicles and the amount of the insurance indemnities for property damages inflicted on motor vehicles with a view to securing equality of the insured persons taking cognizance of the variances established in the practice of the insurers in the case of liquidation of damages under a *Third Party Liability Insurance*.

Commitments have been undertaken in the field of insurance to transpose directives regarding the insurance intermediation and the remote sales of financial services by the end of 2006.

- **In the Field of Supplementary Pension Insurance**

In 2004, the *FSC* introduced amendments to the operative ordinances. However, for the purpose of establishing a full and efficient regulation of the relations in that field, it is necessary to also refine these throughout the following year. The said refinement shall be implemented through the adoption of:

Ordinance on the amendments to Ordinance No. 12 dated December 10, 2003 on the terms of and the procedure for determining the minimum rate of return resulting from the management of supplementary mandatory pension fund assets, on covering the difference up to the minimum rate of return, as well as on the establishment and utilization of the reserves for guaranteeing the minimum rate of return. The objective of the above Ordinance on the amendments to Ordinance No. 12 is to specify the determination of the reserves' amount in order to guarantee the minimum rate of return under Art. 193, Para. 8 of the SIC with funds of the company by non-inclusion into it of the pension fund's reserve funds since it has the same purpose.

Ordinance on the amendments to Ordinance No. 3 on the terms and procedures for switching participation and transferring the amounts accrued in an insured person's individual account from one supplementary pension fund to another fund of the same type, managed by another pension insurance company. The amendments are connected with the establishment of a mechanism, which, on the one part, is to guarantee the submission of the application to switch a participation and to transfer funds from one pension fund to another in person, and, on the other hand, not to lead to decrease in the amounts accrued in the insured person's individual account, where it is provided for the introduction of a notary public certification of the insured person's signature on the application's first copy. It is provided for in the case of a change or discrepancy in the personal data, which the insured person has submitted in order to be registered with the pension fund s/he wishes to switch their participation in, to request in advance from the respective pension insurance company to update or correct the data.

Ordinance on the amendments to Ordinance No. 9 dated November 19, 2003 on the terms and procedures for valuation of assets and liabilities of supplementary pension funds and pension insurance companies, the value of the fund's net assets, on calculation and announcement of the value of a unit, as well as on the requirements for maintaining individual accounts. The objective of the amendments is refinement of several texts, regulating the utilization in the case of valuation of a supplementary pension fund's assets of a 'buy' price on a regulated securities market, where the possibilities to utilize 'buy' orders that have been submitted at the end of the trade session and have been cancelled at the beginning of the next session, obviously in order to be used for the valuation of the pension funds' assets, and not

for concluding transactions are limited; the regulation of a subsequent valuation of participation rights in a public company's capital increase and introduction of a requirement for a more frequent valuation of the investment properties, owned by the supplementary pension insurance fund.

With respect to the supervision exercised over the supplementary pension insurance funds, there is a commitment undertaken by the end of 2005 under negotiation Chapter 11 'Economic and Monetary Union' to amend the Social Insurance Code. The said amendment is related to the removal of the restriction imposed on the pension funds to invest over a specified percentage of their assets into securities issued or guaranteed by the state. Its objective is to secure conformity with the requirements of the European law for prohibition of an established under a law privileged access of the government to the funds of private financial institutions.

- **Other Legislative Amendments**

In connection with transposing the EU Directive regarding the additional supervision exercised over the credit institutions, the insurance undertakings and the investment firms included into financial conglomerates into the Bulgarian legislation, a task force was set up and is currently at work. Experts with the *FSC*, the BNB and the Ministry of Finance participate in the proceedings of the said task force. The task force's objective is transposing the regulations within this sphere until the date of Bulgaria's accession to the EU.

At the same time, it is provided for the transposition of Directive 2003/51, amending the directives regarding the annual and consolidated reports of a specific type of companies, banks and other financial institutions and insurance companies into the Bulgarian legislation again by the accession date.

For the purposes of setting up a stable and efficient legal framework for the functioning of the non-banking financial sector meeting the EU standards and requirements, in 2004 the *FSC* applied for funding and was awarded a grant under the PHARE Programme 'Strengthening the *FSC*'s Administrative Capacity in Order to Implement the Achievements of the European Law'. The Project, the implementation of which is to commence in the autumn of 2005, shall be realized in the form of the so-called „twinning“⁹. The *FSC* has selected its twinning partners – the Polish Insurance and Pension Insurance Supervision Commission in co-operation with the Polish Securities and Stock Exchanges Commission and the Spanish Insurance and Pension Insurance Commission.

The Project's main objective is, over the two years remaining to the accession, to facilitate the transposition of the EU legislation in the field of the financial markets within Bulgaria's legal framework and to create conditions for the implementation of the said legislation: training of the *FSC*'s staff and of the supervised entities with regard to the new principles and standards, as well as holding public training campaigns and forums.

⁹ 'Twinning' is an instrument for purposeful administrative co-operation within the process of rendering support to the EU membership candidate countries for the purpose of strengthening their administrative and juridical capacity in order to implement the Community's legislation as future EU member countries.

9.2. New Approaches to Supervisory Methodology

By the act of its establishment, the *FSC* has laid the foundation of the unified supervision of the institutions offering services in the non-banking financial sector. Based on the experience gained by the government institutions, existing prior to the establishment of the *Financial Supervision Commission*, the Commission gradually builds up a unified policy. The main priorities under the said policy are attainment of **neutrality** of the regulation with regard to the various types of financial institutions, strengthening the control exercised over **financial groups**, consolidation of **co-ordination** and reinforcing the **efficiency** of the resources utilized in order to enhance the supervisory capacity, conformity of the supervisor's intensity to the degree of market **risk**.

The integrated regulation calls for **unification** to the maximum degree of the requirements set toward the various supervised entities and the indices, which are subject to monitoring and control. The above finds expression in the implementation of unified principles and processes in the case of similar risks, and determination of compatible accounting, reporting and licensing standards.

Globalization, the horizontal integration within the sector, as well as the consolidation and the merging processes that have been gaining speed during the last few years, create the necessity for the supervision to develop in conformity with the evolution in the financial sphere. Setting up an integrated management information system, based on unified requirements imposed on the supervised entities, shall enhance the **co-ordination** within the *FSC* where implementing regulation and supervision over the financial groups and conglomerates. Co-operation and co-ordination of the Commission's activities with the other institutions, exercising control within the financial sphere are also of considerable importance due to the necessity to exercise joint supervision. This is the direction taken by the Commission's activity under the initiative of the *Financial Sector Integrity Project*, which is implemented with funding by the US Agency for International Development (USAID). Beneficiaries under the said Project are also the BNB and the Bank Deposits Guarantee Fund. It is an established practice now representatives of the *FSC* to participate in the proceedings of task forces together with experts with other institutions, whose activity is bound to the Commission's objectives.

Under its policy, the *FSC* is guided by the pursuit of enhancing the **efficiency** of the activities performed by it by directing its efforts toward a better utilization of the resource potential in order to attain a more complete and timely control.

The use in its full volume of the possibilities of the unified financial supervision, the attainment of optimal utilization of the resources and enhancing the efficiency calls for the switch from the traditional approach, based on control exercised over the implementation of the legal requirements, to the **risk-based approach** of regulation and supervision of the non-banking financial institutions.

A traditional approach toward regulation and supervision in the case of existence of separate government agencies, each one realizing their powers autonomously, is: direct establishment of the conformity between the legislative and subdelegated legislative requirements for performing the respective activity and the behaviour of the financial institution in its entirety, as well as the separate transactions and activities, carried out by it. The above approach was also adopted and is still being implemented by the *Financial Supervision Commission* in its capacity of a unified supervisor over the non-banking financial institutions, where based on the foundation of the experience accumulated from its initial functioning, a single policy gradually started to emerge, which aims at unification to a maximum degree of the requirements imposed on the various supervised entities and the indices that are subject to monitoring and control.

The main principle, upon which the risk-based supervision is being set up, is implementation of monitoring and control over a specified system of indices that account for the common and specific risks, intrinsic to the respective category of non-banking financial institutions, their comparison to a universally-adopted standard model and analysis of the results obtained. Under the risk-based supervision, the accent shifts toward early warning and prevention of possible shocks in the stability of a given financial institution and the market as a whole, compared to the traditional approach, which rather finds expression in elimination of already allowed violations of the statutory legislative and subdelegated legislative requirements for performance of the respective activity.

The implementation of the risk-based approach in the implementation of the supervision shall allow for focusing the inspections of the supervised entities on the problematic sections in the activities of the persons, where critical values of deviation in the indices monitored have been observed; hence, the costs of performing supervision shall decrease, and at the same time its efficiency shall increase.

The risk-based supervisory model attaches a particular importance to the adequacy of the rules and procedures, related to the internal risk management of each separate institution. The establishment and development of a specific policy, internal rules and internal risk management organization, as well as the active participation in the above processes of the institution's management bodies and the persons comprising the administrative management are some of the indices, in relation to which the stability of a given financial institution is assessed. Where carrying out the inspections, not only the rules and procedures established for risk management themselves shall be evaluated, but also their relevance to the circumstances characteristic of the separate institution. The risk-based inspections evaluate not only the adequacy of the above policy and of the procedures, but also their efficient and consistent practical implementation.

In the cases where circumstances are established that lead to inadequacy, instability or inconsistency where implementing the rules, internal organization and procedures established for risk management, a subsequent detailed inspection is carried out in regard to the separate elements of the supervised entity's activity and the observation of the statutory normative requirements.

The introduction of the risk-based supervision and its efficient implementation is a serious challenge facing the *Financial Supervision Commission*, which calls for enhancement of the professional knowledge and skills of the employees in the administration, drawing up of a methodology for its implementation, as well as of the information systems necessary for the gathering, processing and analyzing the information. The objective is to fully utilize the advantages of the unified supervision over the non-banking financial institutions, enhancement of the efficiency of the regulatory and supervision processes and a more efficient utilization of the resources. The main stages to attain the above objective are as follows: definition of the common and specific risks, which are intrinsic to the various categories of supervised entities and evaluation of the already existing rules and procedures for risk management, formulation of risk-based supervisory standards and techniques, including indices, databases and comparative models and the respective obligations for periodic and current accountability of the supervised entities.

The initiative for the implementation of the risk-based approach is supported by the Project funded under the 'First Initiative' Programme of the World Bank, the International Monetary Fund and a number of donor governments, and is realized by the 'Emerging Markets Group'.

The integration of the information system, through which risk-based computerized supervision shall be implemented, is provided for to be funded to a great degree under the PHARE Programme.

The *Financial Supervision Commission* pays particular attention to the **exchange of information**, received at its three specialized Divisions: *Investment Supervision*, *Insurance Supervision* and *Social Insurance Supervision*. The objective is to introduce unified internal standards, defining common rules and procedures with regard to the gathering, processing and analyzing the information disclosed periodically and currently by the supervised entities. The above contributes to enhancing the **co-ordination** where regulating and exercising supervision over group and holding companies.

Therefore, a main priority in the *FSC*'s development strategy is enhancing the **information technologies**, and more specifically, setting up an integrated Management Information System (MIS), which shall benefit the Organization's human capital, shall increase the efficiency where processing the information, shall strengthen the information exchange platform and the management control exercised over the supervisory operations and shall reduce the costs and the burden over the regulatory firms where rendering account before the *FSC*.

The system provides for the supervised entities to submit electronically their reports in a standard data format. The presentation of the whole information in a unified way shall allow for easy data transfer and conversion, so that these may be utilized within a broad spectrum of applications. Documentation on the various groups of supervised entities that are specific and may not be unified also exists. With regard to it, the attainment of at least a more consistent style and format shall be sought.

The integrated MIS provides for receipt of the data at a single place, as well as for centralised preservation of the information. The aforesaid means establishment of unified databases, containing updated and archive information reported by the companies, having a common format and under a unified procedure.

The standard and specialized appendices, which are to facilitate the work of the higher management and of the employees at the supervised entities, constitute an inseparable part of the System.

10. Financial Statement

The Financial Supervision Commission is a legal entity supported by the state budget. The Commission is a first level budget spending unit, with an independent budget, which is a part of the republican budget of the Republic of Bulgaria.

The FSC's budget is formed by own revenues and a subsidy from the central budget. In the past 2004 the Commission realized 110% of the planned own revenues. This also influenced the ratio between the own revenues and budget subsidy – the expenditure part was covered by 63% own revenues and 37% budget subsidy, instead of the expected proportion respectively 53% and 47%.

Revenues and Expenditures of the FSC in 2004

FSC's revenues (in BGN)		FSC's expenditures (in BGN)	
Own revenues	2 466 971	Salaries, other remunerations and payments for the personnel and social insurance contributions	2 739 478
Fees collected from the supervised entities	2 190 962	Current costs	921 796
Fines, penalty sanctions and interests	237 752	Acquirement of tangible and intangible assets	244 284
Other revenues	38 257	Major repair	11 800
Subsidy from the central budget	1 450 387		
TOTAL INCOMES	3 917 358	TOTAL EXPENSES	3 917 358

The item **other revenues** covers own revenues, among which revenues and incomes from property (sale of the FSC's periodical publication „Bulletin“), sale of assets, sale of competition and tender documentation.

The capital expenditures made in the FSC during 2004 were intended mainly for support of the administrative activity and improvement of the property base in the institution. Part of them were directed to the buying of computer and hardware equipment and a program product for internal control, whereby the security of the available servers was improved and a centralized management and monitoring of the resources in the FSC's computer network was achieved.

The expenses for a major repair were directed to the construction of a premise – secret section in fulfillment of the Classified Data Protection Act.

The 2004 financial statement of the Financial Supervision Commission was certified without any reservations by the National Audit Office on the grounds of Art. 44, para 1 of the National Audit Office Act. The position of the audit team was that the report on the budget implementation, the balance sheet as of 31 Dec., 2004 and the appendixes to them did not contain any substantial errors and irregularities and gave a correct and fair idea of the trustworthiness, lawfulness and the regularity of the information included in them, as well as of the property and financial situation of the Financial Supervision Commission.

IV. Bulgaria's Economy in Year 2004

The economy of Bulgaria continued to develop positively in 2004, as well. The macroeconomic stability was retained on the basis of the principles of the currency board, strict fiscal discipline and comparatively low inflation rates. The achieved high levels of direct foreign investments, as well as the improvement in the business climate testify to the increased attractiveness and potential of the Bulgarian economy.

2004 Macroeconomic indicators for Bulgaria

	Amount in 2004 (in million BGN)	Growth on a yearly basis
GDP	38 038,4	5,6 %
Balance of Payments	2 737,4	122,0 %
Current account, incl.	-2 830,3	11,2 %
trade balance	-5 315,9	-23,6 %
services, net	1 415,0	38,3 %
Financial account, incl.	5 295,5	16,5 %
Direct foreign investments	4 135,1	14,3 %
Internal government debt	2 680,6	19,6 %
	Amount in 2004	Growth on a yearly basis
Inflation at the end of the period	4,0 %	-1,6 percentage points
Unemployment	11,8 %	-0,9 percentage points

In 2004 all world rating agencies increased Bulgaria's **credit rating**, our country being awarded for the first time an investment rating for the long-term debt in foreign currency: BBB- by „Fitch“ and “Standard & Poors“.

At the end of December, 2004 the size of the **gross internal debt** of the government amounted at 5824,7 million euro. Decrease on a yearly basis was noted, as in the end of December, 2003 the gross internal debt of the government was 6624,1 million euro.

At the end of December, 2004 the nominal value of the **internal debt** amounted to BGN 2 680,6 million, whereby it marked a growth of 19,6% on a yearly basis. The government securities, issued during the year amounted at BGN 693, 7 million, from which securities for BGN 22,6 million were sold directly to physical persons.

At the same time the **earnings from government securities** fell during the year, the effective interest rates of the bonds in leva dropped from 4,87% at the end of 2003 to 4,08% at the end of 2004. In the year a decline was also noted in the rate of the nominal base interest rate and the interests on term deposits.

The total income per capita of the population rose during the year, reaching BGN 2466, against BGN 2244 for the preceding year.

V. Review of the Non-banking Financial Sector

In the conditions of macroeconomic stability, intensified competition among the non-banking financial institutions, increase in incomes and investor confidence enhancement, the non-banking financial sector was developing dynamically in 2004. This was evidenced by the stable growth in the values of indicators, describing the depth of the financial intermediation.

Depth of the financial intermediation, per cent of the GDP

	2001	2002	2003	2004
Banks assets	41,13 %	45,04 %	50,34 %	65,51 %
Assets in pension funds	0,63 %	1,03 %	1,48 %	2,07 %
Insurance premiums	1,61 %	1,91 %	1,94 %	2,19 %
Total market capitalization of the BSE – Sofia	3,72 %	4,25 %	7,91 %	10,6 %

A favorable tendency has been outlined in recent years towards enhancement of the activity of the non-bank financial intermediaries. Nevertheless, the bank system retains its dominant role in this field.

With the forthcoming Bulgaria's accession to the EU and the impending direct competitive pressure over the Bulgarian economy, the role of the non-banking financial intermediation will be key for increasing the national economy efficiency. This sector already raises considerable financial resource and the well operating market would ensure its optimal distribution, to contribute to a maximum economic growth.

11. Investment Activity

11.1.Capital Market Development

The capital market was developing dynamically during 2004, which was evidenced by the values of the indicators, characterizing its state.

As a result of rise in the prices of most of the actively traded issues, the overall **market capitalization** of BSE-Sofia increased by 48% compared to the end of year 2003. Its value reached BGN 4 033 million, which represented 10,60% of the 2004 GDP. Unfortunately, the free volume of this capitalization was still comparatively low.

Result from the trade on Bulgarian Stock Exchange – Sofia in 2004

Market	Volume (lots)		Turnover (BGN)		Trades	
	2004	Annual growth	2004	Annual growth	2004	Annual growth
Official market, segment A	920 515	1367%	6 550 438	1132%	52	-78%
Official market, segment B	12 714 043	132%	40 808 478	163%	3 811	4%
Official market, segment C	133 096 484	1309%	428 572 249	856%	32 028	128 %
Official market, corporate bonds	39 160	0%	42 329 495	2%	355	35%
Unofficial equities market	29 725 989	22%	184 815 870	54%	32 862	46 %
Unofficial bonds market	46 173	226%	83 320 756	221%	365	97%
Unofficial market of compensatory instruments	637 834 428	89%	233 221 148	199%	49 862	153%
Block and other agreed trades	558 368 705	83%	435 421 351	188%	273	-11%
Privatization trades in BGN	2 355 613	568%	14 682 784	-11%	676	336%
Privatization trades in compensatory instruments	980 869	-78%	14 978 798	-95%	371	-82%
Unofficial market of other securities	19 658 946	2330%	2 584 352	530%	197	89%
Total:	1 408 891 327	105%	1 596 257 221	101%	124 805	97%

Nearly twofold was the growth in the turnover, volume of trading and concluded transactions on BSE in year 2004. Influence for the capital market's dynamics during the year was exercised by the equities market, and more particularly the official equities market, which was attested by over 1000% growth of the volumes and turnovers of market segments „A“ and „C“.

The trade with compensatory instruments and investment vouchers was with the most substantial contribution for the realized volumes and turnovers on the stock exchange during the year. The volume of this trade jumped considerably, but the main reason for the turnover growth was the dynamics in the compensatory instruments and investment vouchers' prices. During the reviewed period it was in strong dependence on the stock exchange privatization. In connection with the offering of packages from attractive state-owned enterprises for privatization against compensatory instruments, their prices increased considerably. At the

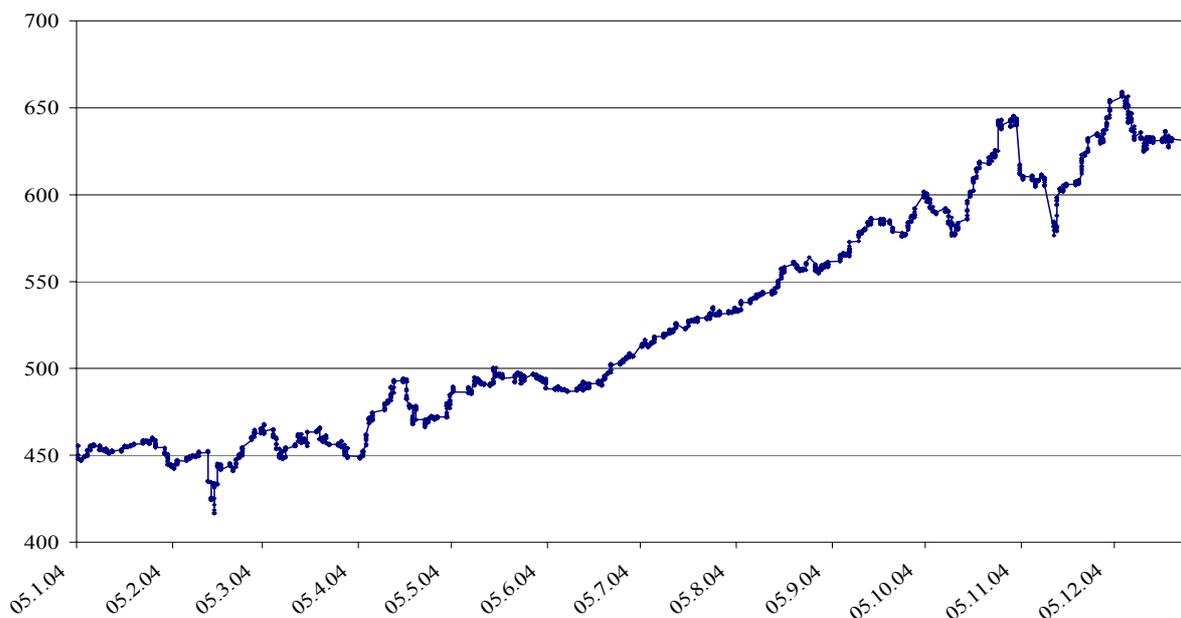
end of 2004 they were traded at 90% of the nominal, as a result of the decision the whole residual government stake of 35% from the Bulgarian Telecommunications Company (BTC) to be offered for privatization against compensatory instruments. Investment vouchers also realized strong rise, being traded at the year's end at 42% of the nominal. Due to the more limited utilization of investment vouchers in the privatization process, their price rose more weakly than that of the compensatory instruments.

A serious impact over the turnover and the traded lots was also exercised by the block and other agreed transactions, which marked a growth during the year. They, however, did not give a realistic idea for the stock exchange trade, as prices with block and some agreed transactions are not determined by market mechanisms.

The investment interest to the bond market enhanced in 2004, but the turnovers and volumes were still at very low levels. Both the volume of trade in bonds on the unofficial market, and their turnover marked a growth of over 220%, and the number of transactions climbed almost twice. On the official corporate bonds market the number of trades edged up by 35%, while the volume and turnover retained their levels from the previous year.

The value of the official exchange index SOFIX marked a high growth during the year, starting from 454,34 points early in 2004, it reached a level of 625,31 points at the end of the reported period.

SOFIX



The indicators, characterizing the shares of the public companies, covered by the SOFIX index were calculated on the basis of the current financial results, the capital and net asset value, of these companies.

Financial indicators for the public companies, included in
the calculation of the SOFIX index

Name of company	Financial performance (in BGN thousand)	Price/earnings per share	Net asset value per share (in BGN)
Albena AD – r.c. Albena	16 223	10	51,51
Biovet AD - Peshtera	515	53	8,04
Blagoevgrad-BT AD - Blagoevgrad	15 928	17	65,10
Bulgartabac-Holding AD - Sofia	8 016	35	7,56
DZI AD - Sofia	4 212	21	21,38
Zlatni Piasatsi AD - Varna	1 609	28	16,64
Lukoil Neftochim Burgas AD-Burgas	17 432	12	16,33
Neochim AD - Dimitrovgrad	3 300	7	23,50
Orgachim AD- Russe	4 542	3	23,43
Petrol AD- Sofia	14 478	25	1,77
Slanchev Briag AD – r. c. Slanchev Briag	10 661	3	44,43
Sopharma AD - Sofia	20 058	13	2,43
CB Central Cooperative Bank AD-Sofia	5 643	17	1,81

At the end of 2004 a new index BG-40 has been presented, for whose calculation are used only the prices of the shares covered by it, and not the number of shares from each issue. The only criterion of a company to fall within the index is its liquidity. BG-40 covers the shares of the 40 companies with biggest number of trades in the preceding 6 months. The number of companies will not be changed. If the liquidity of any of the companies decreases, it will drop off the index and will be replaced by another.

Many and of various types were the factors, underlying the rapid growth of the stock exchange during the year. The favorable economic situation, continuous enhancement of the confidence in the financial system's integrity, the clearly expressed support by the government for the capital market, the forthcoming membership in the EU undoubtedly led to reducing in the assessment of risk by investors. Thus it is not accidental that prices of financial assets were increased, trade energized. On the other side, however, it must be taken into account that the increase of the savings and most of all of the institutional investors' assets resulted in increase of the demand on the capital market, without the offering to have grown substantially during the period.

The main source of new offering on the capital market in 2004, too, was privatization. The focusing of privatization, trade with compensatory instruments and investment vouchers on the stock exchange floor improved the efficiency and organization of the privatization process. It, in turn, was an important factor for increase in the liquidity and volume of trade on the exchange. The drawing of the mass investor attention by the privatization to the

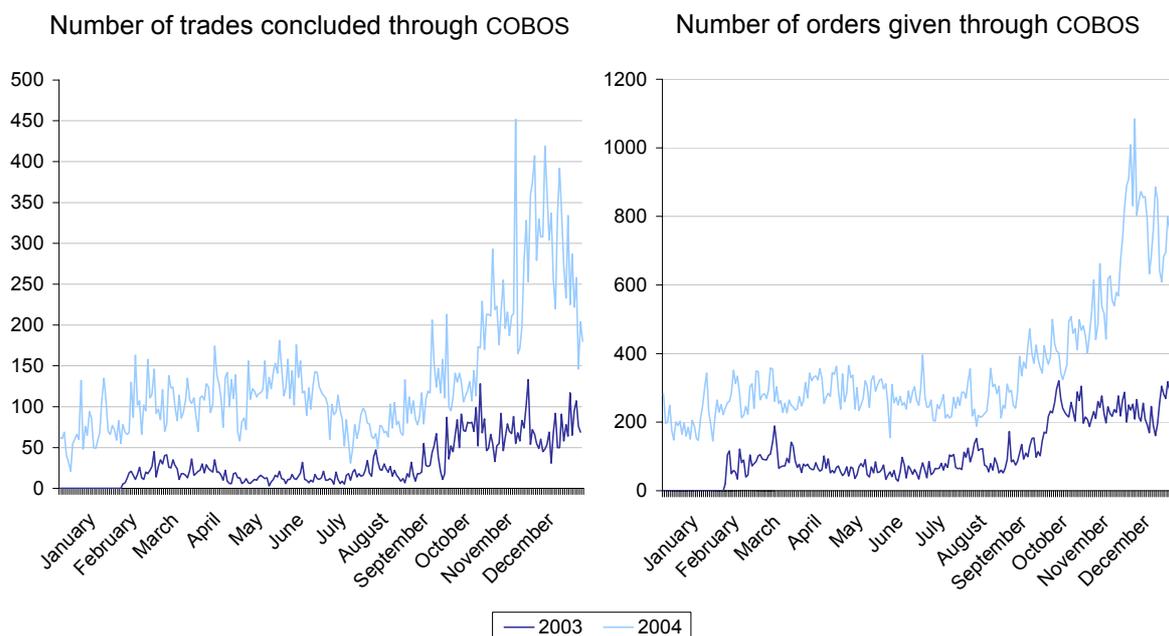
processes on the exchange, being characterized with transparency and publicity, contributed to a large extent to enhancement of the trust and interest in the capital market.

Unlike the preceding year, most of the privatization transactions in 2004 were executed in leva. The decrease of privatization transactions in compensatory instruments was due mainly to their high volume for the previous year, determined by the privatization of minority packages from Bulgartabac Holding AD. Besides, the commented in year 2004 privatization of BTC and other significant privatization transactions against compensatory instruments were left for year 2005.

In 2004 the privatization began to be carried out also through centralized and remote auctions. At the eight conducted centralized auctions 11 446 246 shares were sold, contributing to the exchange turnover with BGN 58, 7 million. At the organized during the year 7 remote auctions 247 commercial companies were divested. The turnover with them reached BGN 43, 6 million.

Since March, 2003 an internet system for stock exchange trading – COBOS, has been in operation. Through it electronic orders are given by clients through internet to BSE members. Growing interest is noted and increasingly wide application of the trading through COBOS. As of the end of 2004, by means of the system were given 40,58% of the orders on the stock exchange.

Dynamics of the given orders and concluded trades through COBOS from the setting up of the system till the end of 2004



It has been envisaged at a later stage an Electronic Disclosure System to be put into operation. Presently FSC, BSE and the Central Depository are working on the realization of a joint project for the system's implementation.

11.2. Market Structure and Analysis of the Participants

Public Companies and Issuers

Of vital importance for the capital market development are the number of listed issues and companies, volume of freely traded shares of companies, presented on the stock exchange, as well as the percentage of the companies, whose shares are traded actively on the stock exchange and attracting the mass investor interest.

In 2004 on BSE-Sofia were listed to be traded 50 new companies and 56 issues of securities, including rights to increase in capital. Simultaneously during the year 26 companies dropped off, and 39 issues were suspended from trading.

During the year an issue of convertible bonds was listed for the first time. The interest for the issue of mortgage bonds by banks was retained as a result of the mortgage credits' expansion in the bank system. With regard to corporate bonds, in relation to the higher risk of unsuccessful placement in case of direct public offering, the private placement and subsequent secondary trading of bonds remained a preferred way of raising bonds loans.

The number of companies, filed in the FSC's register of public companies and other securities issuers as a whole increased during the year. In relation to the growing interest for registration of bonds issues, 12 new issuers were entered in the FSC's public register in 2004. Exceeding was still observed of the number of deleted public companies over that of the entered, their total number being reduced by 5 companies in 2004.

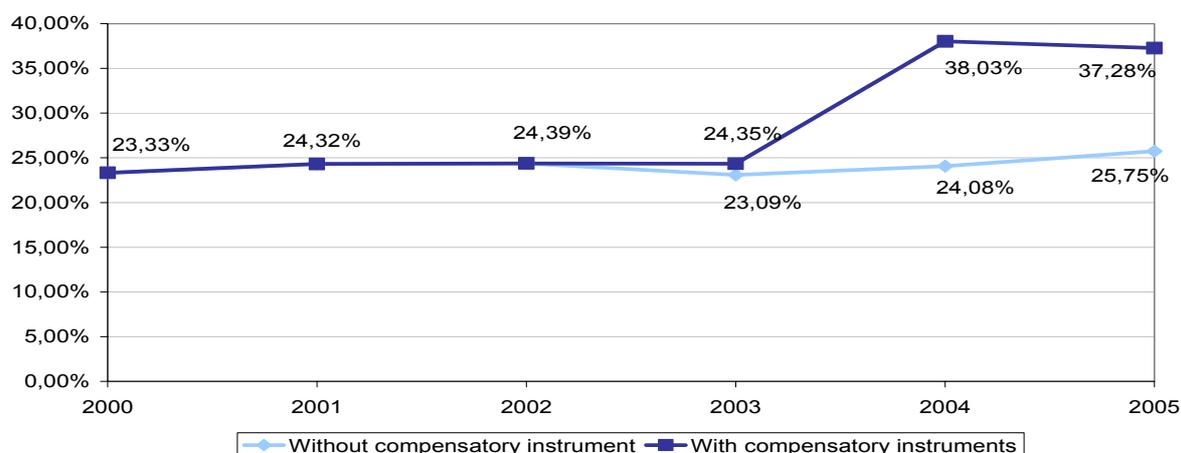
From the public companies, that filed in due time their annual reports in the FSC, 194 realized a positive current financial performance from their 2004 operations. On the basis of 123 companies, which closed 2004 with a negative current financial performance and the five, which had a zero financial result, it may be concluded that there is still more to be wished for in respect to the companies' attractiveness.

In the course of the year FSC received notifications by 31 public companies which took decisions at the conducted by them general meetings to distribute a part of their 2003 profit as dividends.

The market capitalization of the public companies picked up by 48%, and the free volume in this capitalization retained its slower, but stable ascending trend.

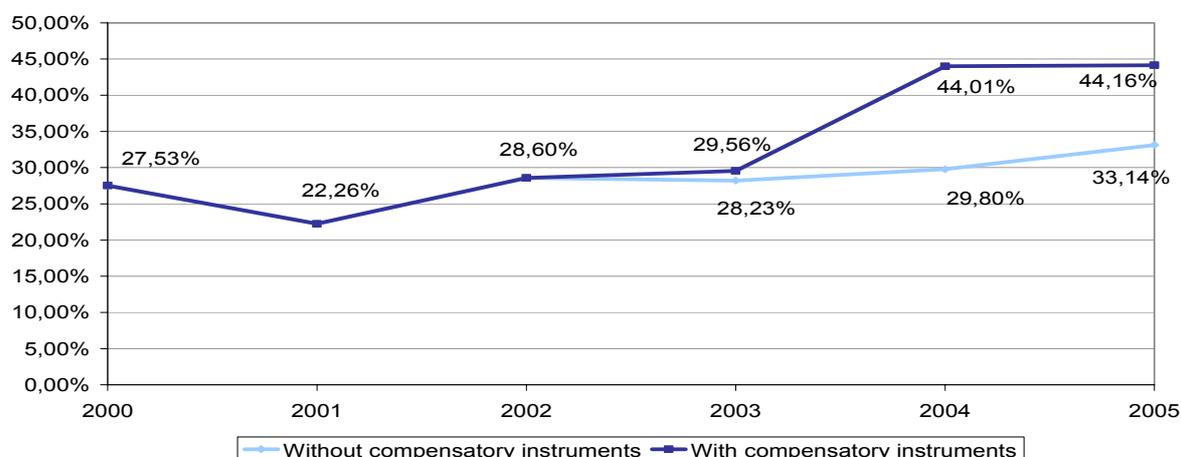
If we accept as freely tradable any shareholding below 5% of the capital of a given company, then the percent of the freely traded securities in year 2004 rose, and taking into account the influence of compensatory instruments, then this percent was considerably higher. The strong influence by the compensatory instruments is explained with the fact that by their nature they are freely traded securities. But thus calculated, the indicator's value declined during the year.

Percent of freely tradable shareholdings (below 5%) from the public companies capital



If we accept as freely tradable any shareholding below 10% of the capital, then an increase was also observed in regard to the percent of freely traded securities. When accounting for the compensatory instruments influence, the registered growth was more insignificant.

Percent of freely tradable shareholdings (below 10%) from the public companies capital



In 2004 the first initial public offering (IPO) was carried out, whereby the internet company Investor BG realized increase in capital. Subsequently, an initial public offering of shares was also made by the company for investment in real estate Interlogic – Property and the leasing company Interlogic-Leasing. The performed initial public offerings of shares were estimated as exceptionally successful. The initial public offering is used usually for attracting additional capital with the purpose of developing the main business or new for the company businesses, implementation of new technologies, etc.

In recent years efforts have been made for the improvement of public companies corporate governance. Since 2002 a requirement has been introduced same to present a program for the applying of the internationally recognized standards for good corporate governance (program), based on the Principles for Corporate Governance of the Organization for Economic Cooperation and Development (OECD). Corporate governance is a new matter

for the participants on the capital market and the preparation of such programs for year 2003 proved to be a serious challenge for the public companies.

Since 2004 companies also submit information about the program's fulfillment, reasons for any deviation from it, as well as a reassessment and proposals for changes in the program. In view of the comparatively short period, in which the programs were applied, the companies had not taken actions for amendment to the drawn by them programs. In the 2004 annual reports submitted till now, i. e. after a two-years applying of the programs, some of the companies made a reappraisal and indicated the problem points in their programs, but in general they were only a few.

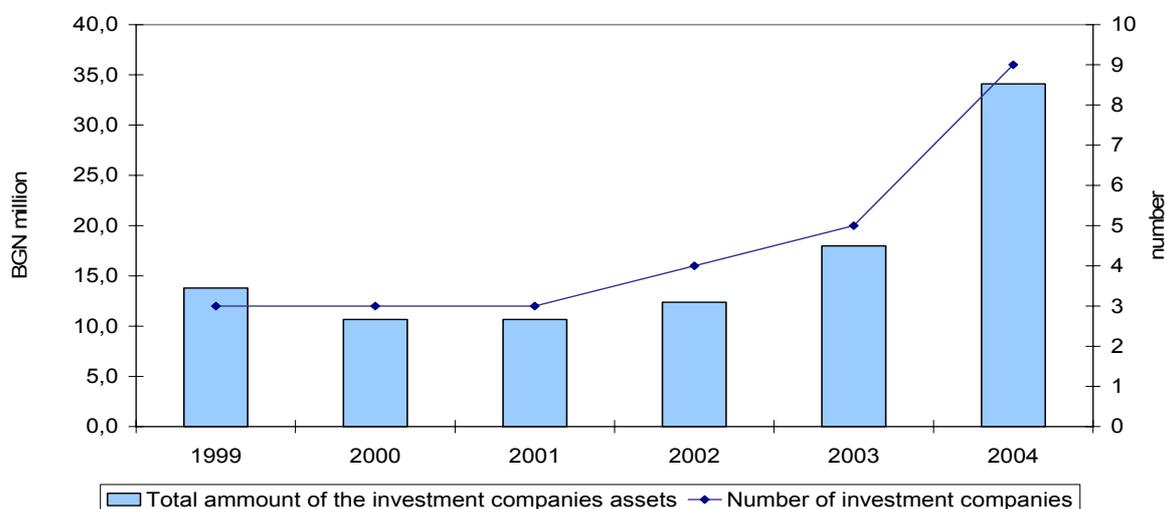
It is important the programs for good corporate governance to be efficient and appropriate, and not only to be delivered as fulfillment of stipulated by law obligation. They are a key factor for improvement of the quality of the public companies and other issuers of securities and respectively for attracting investor interest. This, in turn, is underlying for the capital market development.

Investment and Management Companies

With the development of the capital market in Bulgaria and the accumulation of experience by its participants, a growing interest to the investment companies shares has been noticed, as a successful instrument for raising of pecuniary means by investors and their investment in the country's economy. The first investment companies were transformed privatization funds, that had restructured their portfolios in such a way, as to meet the new legal requirements. The new participants on that market increasingly bear resemblance to the western analogues of investment companies. This type of collective investment schemes attracts the interest not only of the mass investor, but also of companies and institutional investors.

The advantages, which investment companies provide, such as comparatively low amount of operational costs, high liquidity of their shares, especially those of open-end type, determine the tendency of growth in the size of funds, oriented to them. During the last 4 years the total amount of their assets increased considerably, for year 2004 only marking a rise of 89,65%. At the year's end their value amounted at BGN 34,11 million. For the same period the net asset value climbed almost twice (97,8%), reaching respectively BGN 33,25 million.

Increase of the total amount of assets and the number of investment companies



The growth of the value of the investment companies' assets was due both to increase in the number of the newly licensed companies, and the increase in their amount as a result of the revaluations done according the approved by the FSC rules for portfolio valuation. The four new companies licensed during the reported period, at their formation contributed to the increase of the total amount of investment companies assets with BGN 4,15 million.

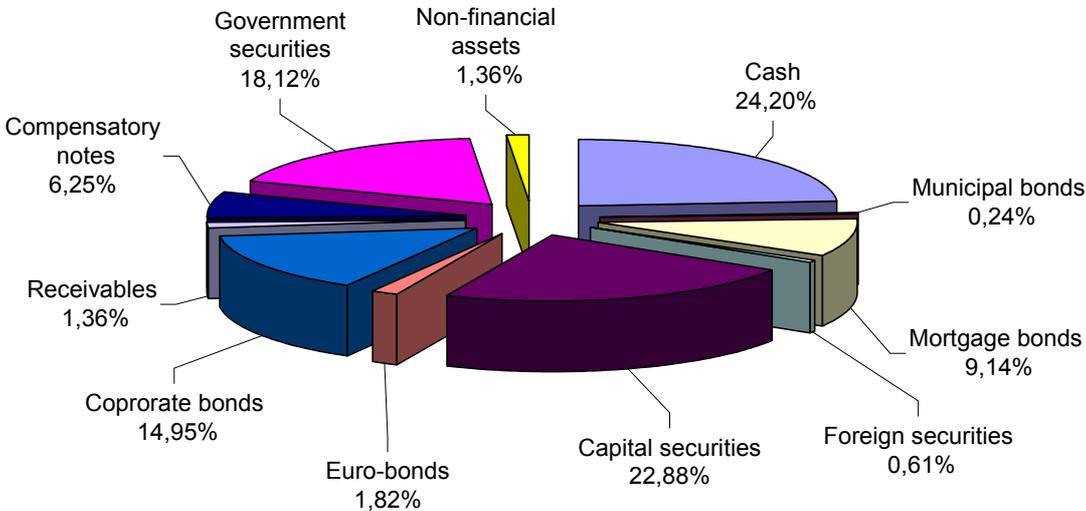
The open-end investment companies were with a predominant market share according the amount of their assets, respectively according their net value, coming to 85,88% of the net assets of all investment companies. This circumstance was determined by the existing possibility such companies to issue shares continuously, which led to increase of their assets. On the other side, the right given to the shareholder to demand for redemption of his/her shares, ensuring high extent of liquidity of the investment made, is a stimulus for investment mainly in investment companies of open-end type.

The still small number of investment companies, operating on the market, resulted in its high concentration. Two investment companies held over 50% of the total amount of the assets of open-end companies and slightly below 50% of the total amount of assets of all investment companies.

The two investment companies of closed-end type also had a place on the capital market, even though with smaller market share (14,12%). Analyzing the data about their shareholders membership, the conclusion could be drawn that a more limited number of investors oriented to them, often legal persons, with elements of relatedness among themselves, who combined their efforts with a view to professional management of the portfolio and use of the tax regime, provided for in the Corporate Income Taxation Act.

With regard to the structure of the investment companies assets, there is a statutorily stipulated requirement to the companies of open-end type to invest not less than 10 per cent of their assets in highly liquid instruments – cash in safe, bank deposits with residual period till maturity of 90 days, as well as government securities with a residual period till maturity of up to 3 months. The regulation is connected with the obligation of such type of companies to redeem their shares on request at price, based on the net asset value. What is noticed, however, is that most of the companies maintained twice higher per cent of liquid funds, predominantly in bank deposits.

Structure of investment companies' assets



Upon analysis of the assets structure, three groups of investment companies can be outlined, depending on that in what financial instruments they invested and to what target group they had oriented. Investment companies, defined as highly profitable, invest the larger part of their funds in shares, which is also related to a higher degree of risk. Only one of the nine companies had chosen this investment strategy. Other two investment companies were conservative and invested their funds predominantly in government securities and bonds. This type of investment bears lower risk and respectively smaller return. The remaining six companies took a balanced approach to the investment of their funds. It is characterized with moderate values of risk and return.

The earnings per share for year 2004 can be calculated only for companies, which carried out activity throughout the whole year. It is defined as an annual rate of change in the investment company's net asset value. For the same reason the earning per share of the newly licensed companies was incomparable with that of the investment companies which operated during the whole year. Thus, the earning per share of the five companies, which operated during the whole 2004, varied from 7,09% to 52,23%. For the same these companies the ratio price/earning per share moved between 0,81 and 17,77.

By 31 December, 2004 activities were carried out by 9 management companies, one of them still not having a concluded contract for management. The managed by them assets amounted to BGN 32 959 472.

By the amendments to the LPOS, introducing mutual funds of contractual type, a possibility for choice has been given in determining the company's legal form. The new collective investment schemes are characterized with more relieved legal regime, stipulating the dropping out of the need of management bodies, internal organization and listing on the stock exchange, lessening the accountability to the depository bank and a number of expenses. At the same time with the amendments the amount of the minimal required capital upon establishment of a management company has been increased twice, which is related to the extension of their subject of activity.

Stimulus have been created for the formation of another type of structures – to each management company a family of funds to be set up, which are to satisfy the various needs of investors from a viewpoint of combining profitability and risk. This type of organization is characterized with higher efficiency and lower costs. Thus the normal process of the market development for such types of financial services, characteristic for many other states, has been followed.

At the beginning of 2004 one contractual fund operated in Bulgaria. This was the foreign fund Pioneer Funds, representing a family of funds with nine sub-funds. The management company is Pioneer Asset Management Luxembourg. During the reviewed period the offering started of units from 6 mutual funds of a new contractual fund Capital Invest funds. They are non-personified entities and do not have an independent legal statute. The management company is Capital Invest, Austria.

With the licensing of the first five Special Purpose Vehicles in 2004 for the first time a possibility has been allowed to the mass investor to participate in the process of securitization of real estate and receivables. Due to it, this market was still characterized with rather high concentration and comparatively small amount of the accumulated assets. Only one of the licensed special purpose vehicles carried out securitization of receivables. At the same time, one of the four companies that have targeted their activity at securitization of real estate, owned a market share of the total amount of the assets of such type of companies, exceeding 66%.

At the end of the reviewed period, the value of assets of the special purpose vehicles was BGN 22 006 740. Investments in real estate amounted to BGN 16 307 194, and the receivables under commercial loans amounted to BGN 5 699 546.

Three of the companies, operating on this market, closed the year with profit. The other two invested their funds in property, whose construction had not finished by the end of 2004, due to which they had a negative financial result from their operation.

The developed market of real estate in Bulgaria determine the favorable conditions in which the special purpose vehicles operate. This is the reason why such types of companies develop comparatively quicker than the investment companies, bound with the still developing capital market.

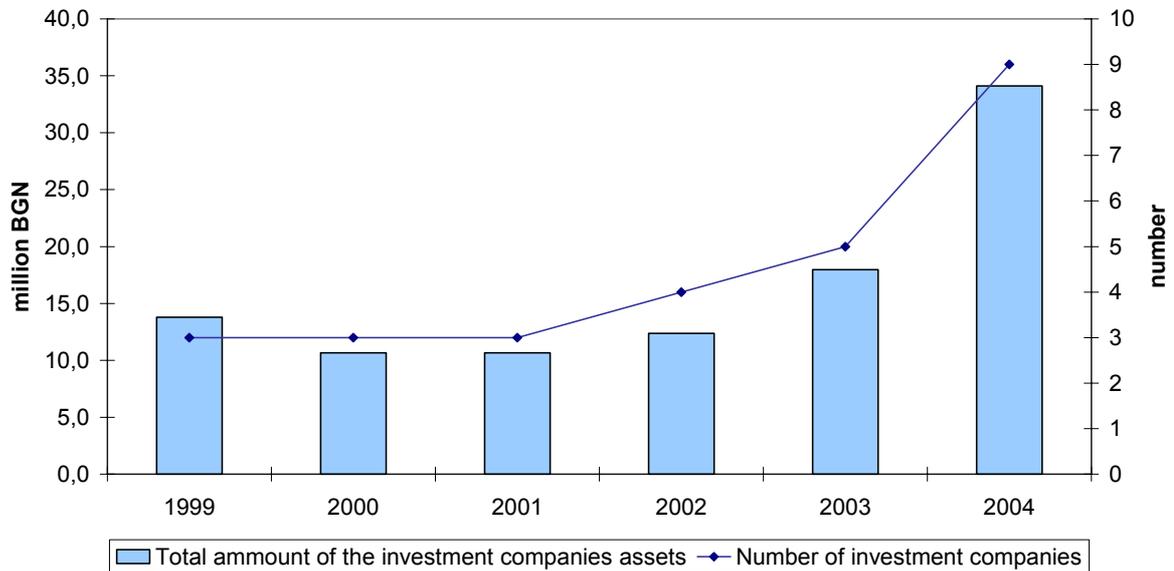
With the forthcoming adoption of the Law on Promotion of Investments in Small and Medium-size Enterprises, the entry of new participants on the markets is expected – joint-stock companies for risk investment. This will be realized in the form of shareholding, long-term loans or convertible bonds. The new instruments will be an alternative source for financing of the small business, a risk capital promotion scheme being envisaged, directed to small and medium-size enterprises, which are around 230 000. From them about 10% are limited liability companies and joint-stock companies, to which the risk investments may be directed, of which they will have the possibility to avail themselves. The aim and expectations from the introduction of this new legal entity is to extend the possibilities for financing of the small business and to stimulate the economic development of the country in medium and long-term aspect.

Investment Intermediaries

On 31 December, 2004 in the register of investment intermediaries, kept by the Commission there were entered 93 companies, 31 of them being banks. From 62 companies, which have been granted license by FSC to pursue activity of investment intermediary, 26 were issued licenses to execute transactions abroad. With the stage by stage increase since 2004, a large part from the intermediaries changed their subject of activity, bringing it in compliance with the capital owned by them. The envisaged towards the end of 2005 increase in the capital of investment intermediaries, executing transactions with securities for their own account, to BGN 1 500 000, is a comparatively high threshold for most of the intermediaries. The richer range of services, offered by the intermediaries, which will be successful in increasing their capital, will attract most of the customers.

In spite of the large number of investment intermediaries, high concentration was observed on the market of services, offered by them. Almost 50% of the turnover realized during the year was concentrated within the activity of one investment intermediary. Other two investment intermediaries executed transactions with almost half of the traded during 2004 shares. Furthermore, only three investment intermediaries concluded over 50% of the overall number of trades on the stock exchange during the year.

Increase of the total amount of assets and the number of investment companies



At the end of 2004, the overall size of the assets of investment intermediaries – non-banking institutions, amounted to nearly BGN 820 million. This amount marked a considerable growth of 154% on a yearly basis, whereby the positive tendency for increase in the assets concentrated in investment intermediaries continued. The growth for the preceding year was 72,7%. As a cause of this increase can be indicated the capital market’s favorable development and the enhancement of the trade’s intensity on it. Influence was also exercised by the transfer which many investment intermediaries made from their off-balance sheet assets to the main part of their balance sheet, as well as the increase in capital during the year in compliance with the legal requirements.

12. Insurance and Voluntary Health Insurance

12.1. Development of the Insurance Market and the Market of Health Insurance Services

The achieved lasting macroeconomic stability, strict fiscal discipline and maintenance of comparatively low inflation rates were conducive to the state and development of the insurance market during the year. From an insurance-technical viewpoint, favorable influence was exercised by the gradual enhancement of the population's insurance culture, lessening of unemployment, stabilization of the households' purchasing power and strengthened the financial situation of the enterprises from the real sector.

Indicators about the place of insurance and the voluntary health insurance in the Bulgarian economy

Indicators	2002	2003	2004
1. Gross domestic products (thousand BGN)	32 335 083	34 410 200	38 008 406
2. Gross premium income from insurance (thousand BGN)	618 156	666 346	834 296
3. Gross premium income from voluntary health insurance (thousand BGN)	3 315	6 405	11 612
4. Insurance penetration (%)	1,91	1,94	2,19
5. Penetration of voluntary health insurance (%)	0,01	0,02	0,03
6. Population at the year's end (number)	7 845 841	7 801 300	7 761 049
7. Insurance density (BGN)	78,79	85,41	107,50
8. Health insurance density (BGN)	0,42	0,82	1,49
9. Deposits of the population (thousand BGN)	5 795 500	6 852 600	8 752 700
10. Mathematical reserve (thousand BGN)	67 563	62 300	85 600

In the period 1999-2004 the growth rate of the **gross premium income** compared with a preceding year moved in levels over 23%, except for the realized growth of 7,8% in 2003.

The forestalling dynamics of the insurance market is illustrated by the lasting retaining of a level above one of the indicator **coefficient of elasticity of the premium income**, calculated as a ratio between the growth rates of the gross domestic product at current prices for the respective year. For 2003-2004 this indicator was 2,41 with 1,21 for 2002-2003 and 3,19 respectively for 2001-2002. The tendency proves the considerable potential of the Bulgarian insurance market, a large part from which is still uncovered.

In recent years the tendency of lasting increase of the insurance industry significance for the national economy has been strengthened. The two major indicator – **insurance penetration** (gross premium income, to the gross domestic product in %) and **insurance density** (gross premium income per capita), determining the place of insurance in the economy of the country, retained the tendency of growth during the last years, but were still far away from the levels, characteristic of the developed countries. The main factor, which exert influence is the level of labor payment, and hence the solvency of the population.

The health insurance penetration reached 0,03% in 2004, with density of BGN 1,60 on that newly emerging for Bulgaria market. As a withholding factor for the health insurance

market must be noted the existence of certain overlapping of the health packages, offered by health insurance companies with those of the public health insurance system along the lines of the National Health Insurance Fund (NHIF).

During the reviewed period **the foreign investor interest** to insurance was retained. As reasons for it may be indicated the stable economic environment in the country, the clear and transparent regulation of the insurance activity and the oversight over it, as well as the existing high potential for growth of the Bulgarian insurance market. From the 29 joint-stock companies, pursuing insurance activity in this country, 19 are with shareholding participation of foreign investors.

12.2. Structure of the Insurance and Health Insurance Markets and Analysis of Their Participants

In 2004 on the **insurance market** the predominant share of the non-life insurance compared with the life insurance, according the gross premium income, was retained. Nevertheless, the percent of the life insurance in the gross premium income picked up from 11,2% in 2003 to 12,1% in 2004. As a reason for the low share of life insurance in the overall volume of the premium income in Bulgaria remained the insufficient solvency of the predominant part of the population. One must not ignore also factors, such as the comparatively low insurance culture and established habits of the population for priority of motor insurance over their own life and the family life.

31 insurers were operating on the insurance market at the end of 2004. From them 20 were non-life insurance companies, 9 – life-insurance companies and 2 – mutual insurance co-operative societies, whose activity was in the field of life insurance. For the same period 11 joint-stock companies participated on the market of voluntary health insurance, from which 5 were licensed in year 2004. The licensed brokers at the year's end were 158.

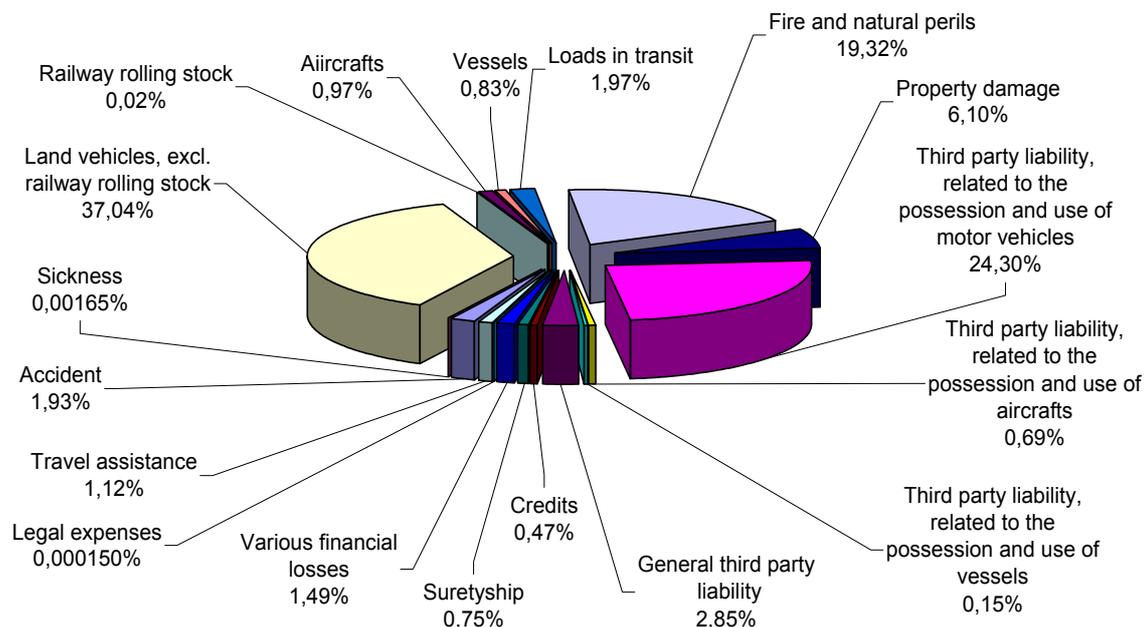
Insurance Companies Pursuing Non-life Insurance Activity

During the year a tendency of de-concentration of the market of non-life insurance services was observed as a result of the intensified competition among insurers. In 2004 the aggregate shares of the three companies with highest premium income in non-life insurance came to 46,6%, against 49,53% in 2003.

The realized during the year **gross premium income** by the insurance companies, carrying out activity of non-life insurance edged up by 23,9%, reaching an amount of BGN 733 214 thousand. This confirmed the tendency of stable dynamic development of this market and illustrated the increased significance of non-life insurance for the country's economy.

Some unsatisfactory tendencies with respect to the **portfolio structure** of insurance companies carrying out non-life insurance activity continued to strengthen. The percentage of insurances of motor vehicles was retained in the premium income of non-life insurance.

Premium income of non-life insurance companies by types of insurances



In 2004 insurance companies, carrying out non-life insurance activity paid up indemnities at the amount of BGN 235 837 thousand, which was by 21% more in comparison with those, paid in the preceding year. With highest percent in the paid indemnities were the insurance of Land Motor Vehicles, Excluding Railway Rolling stock („Autocasco“) and insurance Third Party Liability of the owners, holders, users and drivers of motor vehicles – 81,56%.

The amount of the insurance reserves of non-life insurance increased with a higher rate than the rate of increase of the total assets amount. As a result, the ratio of the insurance reserves to the assets rose by 1,56 percentage points.

Assets and reserves of the insurance companies, pursuing activity of non-life insurance

	2003 (thousand BGN)	2004 (thousand BGN)	Growth
Total amount of assets	567 382	674 905	18,95 %
Insurance reserves	326 033	398 308	22,17 %
Outstanding claims reserve	154 937	198 550	28,15 %
Unearned premium reserve	168 965	197 348	16,80 %
Contingency fund	2 597	2 410	-7,20 %
Other reserves, approved by the FSC	534	0	
Insurance reserves to assets	57,46%	59,02%	

In the fiscal year 2004, the insurers reported a profit at the amount of BGN 70 306 thousand, 83% of it (BGN 58 753) being formed from the result of the non-life insurers. The major part from the profit of non-life insurance (over 60%) was a consequence of positive results of two from the insurance companies, registering totally a profit over BGN 38 million.

The reported financial results of the non-life insurers varied in a wide range, 3 from 20 companies closing the year with a loss.

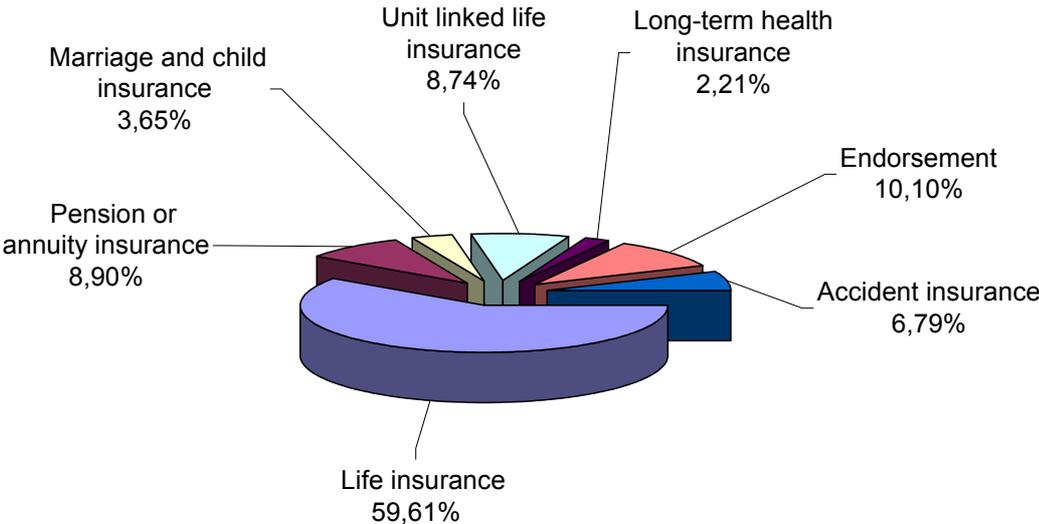
Insurance Companies, Pursuing Life-insurance Activity

In life-insurance **the market concentration** in year 2004, on the basis of the three companies with highest premium income was 66,8%, against 66,2% in 2003 and 63,0% in 2002.

During the reviewed period the realized **gross premium income** in life insurance amounted at BGN 101 082 thousand, the rate of its growth in comparison with the preceding year being 35,1%. For 2003 a drop was reported of 98,97% compared to 2002, as a result of the limited tax relieves, related to certain types of life insurances. Despite the high growth in 2004, the 2002 level of premium income in life insurance could not yet be achieved.

In the **portfolio structure** of the insurance companies, carrying out life insurance activity, Life and Annuity Insurance continued to have a largest share in the obtained premium income – 68,51%.

Premium income of life-insurance companies by types of insurances



The paid up indemnities and amounts by insurance companies, carrying out life insurance activity came totally to BGN 43 631 thousand, which was a decline by 9,15% in comparison with the preceding year. Similar to the gross premium income structure, Life and Annuity Insurance was with the biggest share in the paid indemnities and amounts - 70,33%.

The amount of the insurance reserves in life insurance rose by higher rate compared to the rate of increase of the total amount of assets. As a result the ratio of the insurance reserves to assets grew by 5,07 percentage point.

Assets and reserves of the insurance companies, pursuing life insurance activity

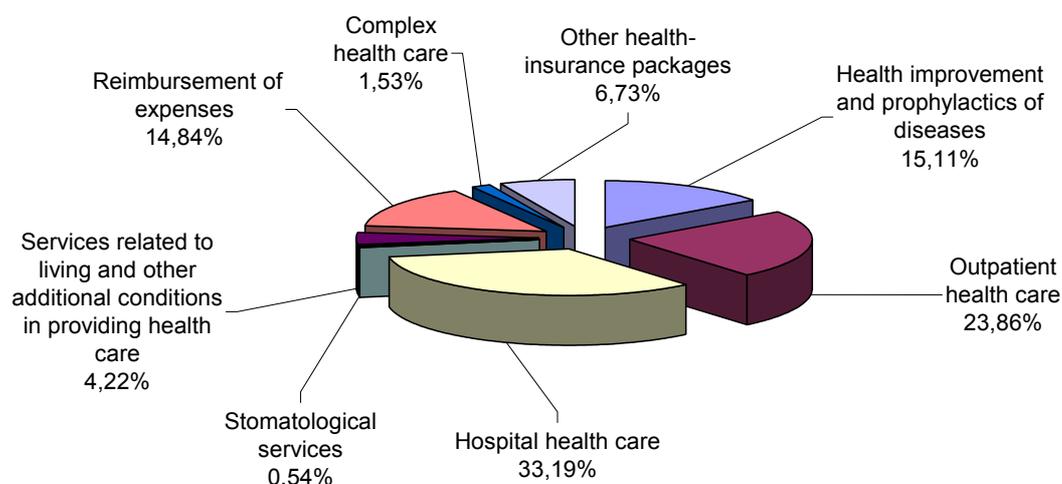
INDICATORS	2003 (thousand BGN)	2004 (thousand BGN)	Growth
Total amount of assets	233 480	272 000	16,50 %
Insurance reserves	106 094	137 374	29,48 %
Outstanding claims reserve	9 095	10 906	19,91 %
Unearned premium reserve	12 497	9 496	-24,01 %
Mathematical reserve	62 300	85 088	36,58 %
Capitalized value of pension	6 760	11 241	66,29 %
Contingency fund	3 325	2 169	-34,77 %
Other reserves, approved by FSC	2 277	2 399	5,36 %
Unit-linked life insurance reserves	9 840	16 075	63,36 %
Insurance reserves to assets	45,44 %	50,51 %	

The reported profit for the year by life insurers was at the amount of BGN 11 555 thousand, the main share in it (over 78%) was due again to the operation of two insurance companies, accounting for an aggregate profit of over BGN 9 million, and one from 11 insurers closed the year with a loss.

Health Insurance Companies

On the market of voluntary health insurance enhancing competition was observed as a consequence of the appearance of new participants. The increase of the gross premium income from **voluntary health insurance** for 2004 was 81,7% and reached an amount of BGN 11 638 thousand. The reason for the high annual growth realization is the initial stage of development of this sector.

Premium income of health insurance companies by types of health insurance packages



The claims paid by health insurance companies in 2004 amounted to BGN 2572 thousand. Their amount marked a 119% growth compared with the preceding year. Two insurance packages covered a more considerable share in the paid claims, exceeding 30% - the outpatient health care and hospital healthcare.

Assets and reserves of the health insurance companies

	2003 (thousand BGN)	2004 (thousand BGN)	Growth
Total amount of assets	11 383	15 113	32,77 %
Health insurance reserves	1 530	2 700	76,47 %
Unearned premium reserve	360	318	-11,67 %
Outstanding claims reserve	1 048	2 146	104,77 %
Contingency fund	122	236	93,44 %
Health insurance reserves to assets	13,44%	17,87%	

During fiscal year 2004 the **voluntary health insurance** companies reported a total profit at the amount of BGN 53 thousand. It must be noted that a half of the participants on the market for voluntary health insurance were licensed in 2004 and did not account for real activity during the year.

Reinsurance

Outward Reinsurance

In 2004 the outward reinsurance of the risks, subject of **non-life insurance**, recorded on the Bulgarian insurance market was realized by proportionate and disproportionate contracts. Big international reinsurers with a high credit rating were main partners to the Bulgarian companies in reinsurance. An increase was observed in the number of insurance companies, which secured reinsurance cover (CAT XL) for the insured by them objects with the occurrence of events of catastrophic nature.

The premiums ceded in non-life insurance in 2004 amounted at BGN 317 571 thousand, which represented 43,31% of the premium income of the non-life insurance companies. In the structure of the premiums ceded to reinsurers by types of insurances with highest share (between 50% and 100% from the gross premium income of the relevant insurances) were Aircraft Insurance, Third Party Liability Insurance, related to the possession and use of aircraft, Ship Insurance, Third Party Liability, related with the possession and use of ships, Suretyship Insurance, General Third Party Liability and Property Damage. A tendency was noticed of providing additional protection by the insurance companies against unfavorable development of the risks, connected to Land Vehicles excluding Railway Rolling Stock, where the ceded premium were over 30% of the total amount of the gross premium income from this insurance and Third Party Liability, related to the possession and use of motor vehicles, including Green Card, with which the ceded premiums came to 54% of the overall premium income for the relevant insurance market.

The indemnities reimbursed as a result of reinsurance contracts amounted at BGN 109 390 thousand, which was 46,38% of the paid indemnities in non-life insurance. General Third Party Liability Insurance, Goods in Transit Insurance, Suretyship Insurance, Ship Insurance and Aircraft Insurance were with a predominant share in respect to the indemnities recovered by reinsurers, compared to the total amount of indemnities paid for the relevant insurances. The sums received from reinsurers in relation to paid indemnities for Land

Vehicles, Excluding Railway Rolling Stock Insurance, represented 41% of the total amount of payments made for damages, related to this insurance. With insurance Third Party Liability, related to the possession and use of motor vehicles, including Green Card, the reinsurers shares in the settled claims on the insurance amounted to nearly 60%.

In 2004 the outward reinsurance of the risks, related to **life insurance**, recorded on the Bulgarian insurance market, was realized mainly through proportionate contracts. By disproportionate contracts was provided reinsurance cover against catastrophic risks. As with the non-life insurance, reinsurers of the Bulgarian life insurance companies were leading international reinsurance companies.

The life insurance companies ceded premiums at the amount of BGN 13 835 thousand - 13,69% of the total gross premium income in the sector. During the year BGN 2250 thousand were reimbursed, which represented only 5,67% from the paid indemnities. Unlike the non-life insurance, with the life insurance the share of reinsurance is comparatively small.

Inward Reinsurance

In year 2004 the insurance undertakings, pursuing inward insurance activity, were overall five – four in the field of non-life insurance and one – in life insurance. The total amount of the received premiums by ceding insurers amounted at BGN 9733 thousand, from which BGN 1082 - by ceding life insurers. The non-life reinsurers accepted risks from ceding insurers with a legal seat outside of the territory of the Republic of Bulgaria against a total amount of the premium of BGN 802 thousand. The commissions paid to ceding insurers in non-life insurance were at the amount of BGN 1804 thousand, and to life insurers – BGN 108 thousand. The paid indemnities to ceding insurers of non-life insurance amounted to an aggregate sum of BGN 2398 thousand, from which BGN 1307 thousand related to risks, accepted outside of Bulgaria. The indemnities, paid to ceding life-insurers amounted to BGN 102 thousand.

In 2004 retrocession of recorded risks was done by only one of the reinsurers in the field of non-life insurance. The amount of the retroceded to foreign insurers premium came to BGN 1613 thousand, the received commissions and sums for participation in the result with the retrocessions done amounted totally to BGN 479 thousand. The sums received from reinsurers of paid indemnities, connected with retroceded risks amounted to BGN 57 thousand.

A major share in the inward insurance activity on the Bulgarian market in 2004 belonged to the risks, related to Fire and Natural Perils Insurance. The premiums received by ceding insurers on this insurance represented 69% of the total amount of the received premiums on inward reinsurance. Next followed Third Party Liability, related to the possession and use of motor vehicles and Insurance of Land Vehicles, excluding Railway Rolling Stock with an aggregate share of 18% of the received premiums from these insurances compared to the total premium income of inward reinsurance. The inward insurance activity also covered the risks of insurances Goods in Transit, Property Damage, Aircraft Insurance, Accident and Travel Assistance. Inconsiderable was the amount of premiums, received in reinsurance of risks, related to insurances Miscellaneous Financial Losses, Credit Insurance and Suretyship Insurance.

With respect to the indemnities paid to ceding insurers, the biggest share is that of Land Vehicles, excluding Railway Rolling Stock Insurance – 35% from the total amount of the indemnities paid under contracts, subject of inward insurance. Next followed Ships Insurance – 20%, General Third Party Liability – 18% and Third Party Liability, related to the possession and use of motor vehicles -12%.

In the field of life insurance, the inward insurance activity was restricted to accepting risks, related to Accident Insurance.

Insurance Brokers

The realized premium income by insurance brokers amounted at BGN 126 639 thousand, the received commissions being at the amount of BGN 29 188 thousand.

Largest share in the premium income, realized by the insurance brokers in carrying out intermediation in non-life insurance was reported in insurances Autocasco and Third Part Liability of the owners, holders, users and drivers of motor vehicles – total at the rate of 66,14%.

In carrying out insurance intermediation in life insurance, the premium income was mainly of Life and Annuity Insurance – 93,53%.

Guarantee Fund

The incomes and expenses for the Guarantee Fund operation in 2004

№	Description	Amount (thousand BGN)		Increase/decrease compared to the previous period (in %)
		2003	2004	
I.	INCOMES			
1	Incomes from insurers	1 755	1 902	8,38 %
2	Incomes from regress claims	177	143	-19,21 %
3	Other incomes	280	212	-24,29 %
II.	EXPENSES			
1	Expenses for indemnity	924	1 044	12,98 %
2	Expenses for liquidation	6	7	16,67 %
3	Expenses for the personnel	363	363	0,00 %
4	Expenses for court proceedings	43	46	6,98 %
5	Administrative expenses	220	221	0,45 %
6	Result from the fund's operation	656	576	-12,20 %
7	Financial income/expenses	115	229	99,13 %
III.	OPERATING RESULTS			
1	Net result of the fund	771	805	4,41 %

13. Supplementary Pension Insurance

13.1. Development of the Market for Supplementary Pension Insurance

The role of the pension insurance sector in the field of financial intermediation has increased in recent years. This is evidenced by the growing amount of assets, concentrated in the funds for supplementary pension insurance. On 31 December, 2004 their balance sheet value amounted at BGN 794,309 million, which represented 2,07% of the GDP for the year. For the last four years this share increased almost three-fold

A number of **socio-economic indicators** had a favorable influence over the dynamics in the supplementary pension insurance during the year. According data of the National Statistical Institute, the unemployment for 2004 declined from 13,52% to 12,16%. A growth of the total income per person was also noted, reaching BGN 2466, against BGN 2244 for the previous year. Simultaneously, according 2004 data of the National Social Insurance Institute, the average annual insured income picked up from BGN 286,76 to BGN 308,80.

In 2004 services in the field of supplementary pension insurance were offered by eight licensed pension insurance companies, each of them managing two funds for supplementary mandatory pension insurance and one for supplementary voluntary pension insurance.

The market of supplementary pension insurance services was characterized by high **concentration**. On 31 December, 2004 two pension insurance companies held over 50% of the net assets (68,69%) and had attracted over 50% of the socially insured persons (64,7%) in the field of supplementary pension insurance. Compared with the preceding year, their total market share dropped by 1,56% on net assets basis and by 4,17% according the number of pension insured persons. At the same time the proportion between the shares of the two companies became more balanced.

A determining factor for strengthening the de-concentration was the adopted in June Instruction on the way and procedure of official distribution of persons, who have not chosen a supplementary mandatory pension insurance fund. More apparent was its impact on the number of insured persons in the separate pension insurance companies. Nevertheless, the effect from it was still weak, because of the little time during which it had been in force, but it is expected the new criteria for official distribution of the persons to result in more uniform proportion in market shares.

Change in the distribution of the insured persons is also initiated with the effectuated as of 1 January, 2004 Ordinance № 3 on the way and procedure for switching of participation and for transfer of the accumulated funds by the insured person from one supplementary pension insurance fund to another relevant fund, managed by another pension insurance company. Most dynamic is the process with the occupational funds, where the accumulations on the individual accounts of the insured persons are biggest.

Number of persons, who have switched their participation in supplementary pension insurance funds and amount of the transferred funds

	UPF	OPF	VPF	Total
Average number of insured persons for the period	1 809 326	170 559	525 782	2 505 667
Total number of persons, who switched their participation	75 190	14 217	7 668	97 075
Percent of persons, who switched their participation (%)	4,16	8,34	1,46	3,87
Average amount of the net assets for the period (thousand BGN)	187 592	172 325	289 063	648 980
Total amount of the transferred amounts (thousand BGN)	10 366	21 987	7 085	39 438
Percent of the transferred funds (%)	5,53	12,76	2,45	6,08

Throughout the year 134 032 applications in total were filed for switching of participation, the largest share of which was that of the applications filed by socially insured persons in universal pension funds. The pension insurance companies pronounced with a denial for 15,39% of the overall number of filed applications. The voluntary funds were with biggest percent in the received refusals. With them a refusal was given to 23,38% of the filed applications for transfer. As a result, smallest number of contracts and agreements were concluded in this type of funds.

It is noted that the refusals for review of applications predominated over the refusals for change of participation, although the denials to review an application became possible with the amendments to Ordinance № 3, effectuated as of 1 October, 2004.

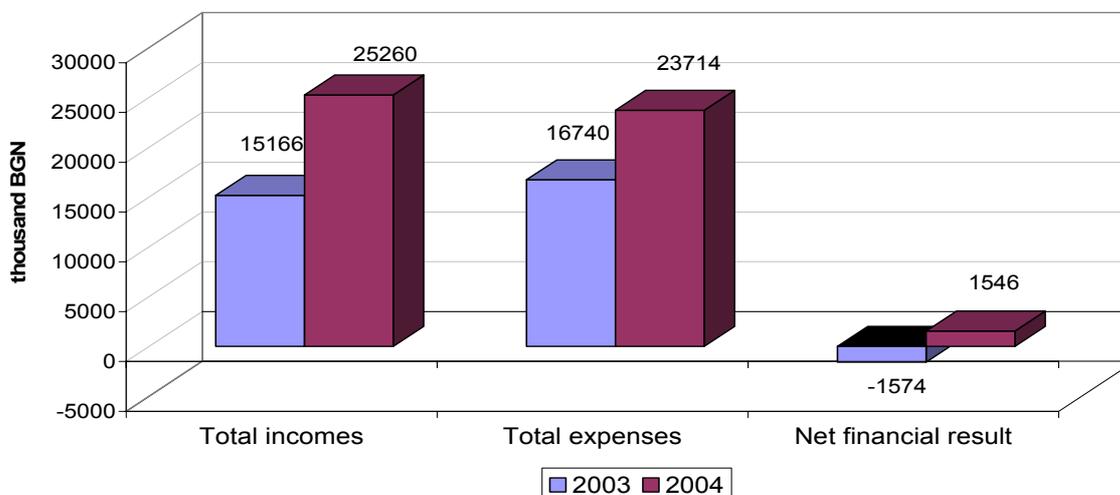
13.2. Market Structure and Analysis of the Participants

Pension Insurance Companies

On 31 December, 2004 the total amount of the paid in **capital** of the pension insurance companies amounted at BGN 59,104 million. The increase of BGN 9,10 million for the year was due to amendments to the legislative framework, with which a higher amount of the minimum required capital had been introduced. In this relation, four companies realized an increase in the base capital and as a result a rise was observed in the average values of the indicators for paid in capital per one participants in the managed pension funds and per BGN 100 of the managed assets – respectively by 1,5% and by 2%.

Pension insurance companies maintained a high rate of **capital adequacy** in 2004, too, in spite that the value of this indicator declined in the course of the year. The average rate of the capital adequacy on 31 December, 2004 was 86% with statutorily set rate of not less than 50% of the minimal capital. With the different companies this indicator varied between 57% and 174%.

Financial indicators for pension insurance companies for year 2003 and 2004



The total revenues of the pension insurance companies marked an annual growth of 66% in 2004. The major factor for increase in the operating revenues was the growth in the receipts from insurance contributions as a result of the increased number of insured persons in the supplementary pension insurance funds and the higher amount of insurance contributions for the universal pension funds. Also contributing for the growth in revenues was the high return from the funds assets management. In spite that the revenues from fees and deductions retained their predominant share in the overall incomes of the pension insurance companies in the year, their ratio to the revenues from the own funds management became more balanced – from 6:1 in 2003, it changed to 4:1 at the end of 2004.

Due to the quicker rate of increase of the operating incomes compared to the rate of increase in the number of persons, insured in the supplementary pension insurance funds, the values of the indicator incomes from fees and deductions per one insured person was improved with all companies.

The companies' expenses increased at slower rates than the incomes – 42% on a yearly basis. Nevertheless, the incomes from fees and deductions could not yet cover the costs, incurred by pension insurance companies in carrying out activity in relation to supplementary pension insurance. This is shown by the average value of the indicator incomes from fees and deductions per operating costs BGN 100, amounting to BGN 81,70.

Certain surge in the expenses for investments were observed during the year as a result of the inclusion of new investment instruments in the investment portfolios of the supplementary pension insurance funds.

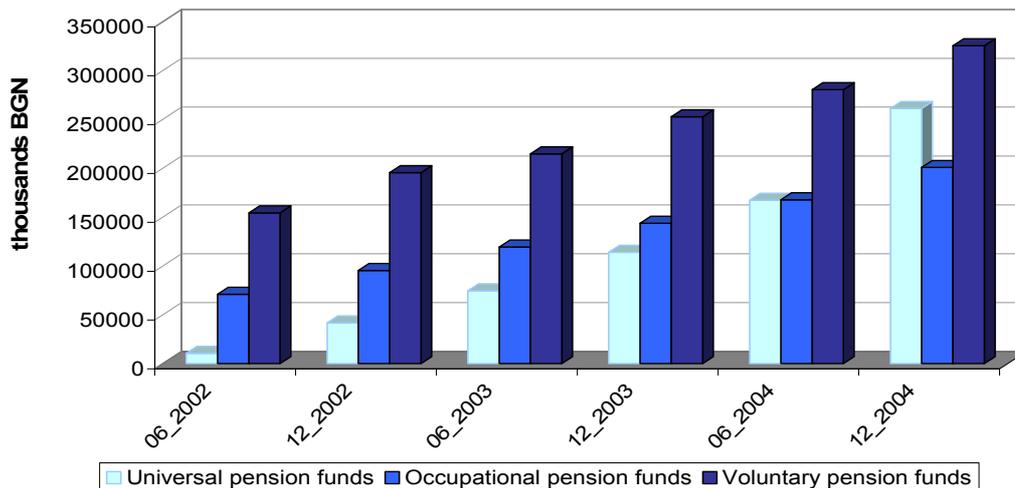
In 2004 the total **net financial result** for the eight licensed pension insurance companies became positive, reaching BGN 1,55 million. Unlike the previous year, when only one company formed a positive operating financial result, in year 2004 already four pension insurance companies reported a profit. As a result of it, a positive change in the rate of return in the sector was observed, the average value of which in year 2003 was negative. In 2004 the values of the indicators for the capital rate of return for the separate companies were between -41% and 36,17%, and for the assets rate of return – between -36% and 24%.

The factors, that contributed to improvement of the financial result were increased incomes from fees and deductions, from management of the company's own funds, as well as good administration of the expenses related to the pension funds management.

Supplementary Pension Insurance Funds

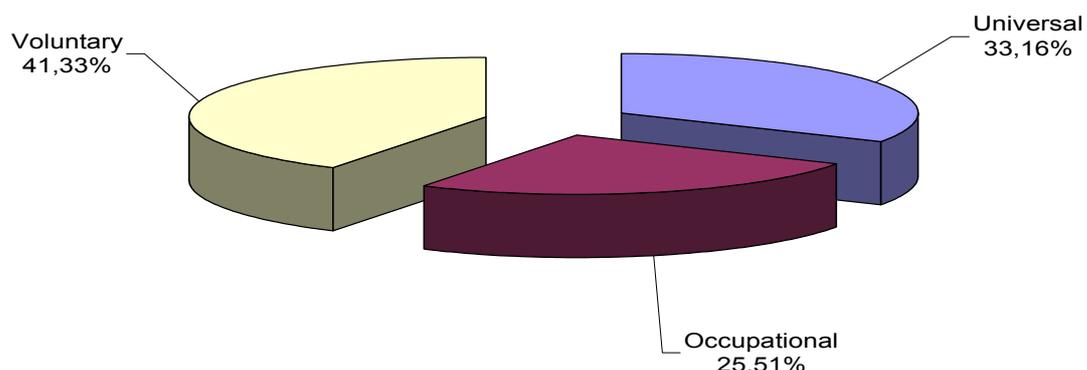
On 31 December, 2004 the pension insurance companies managed net assets at the amount of BGN 787 412 thousand. **The net asset value** of the pension funds marked a considerable growth on a yearly basis, amounting to 54%.

Dynamics of net assets distribution by funds



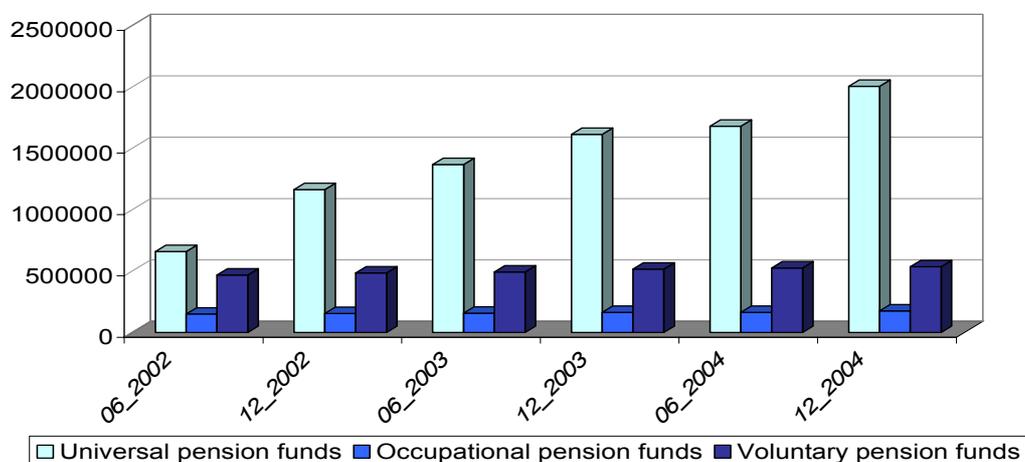
Largest part of the total net assets was concentrated in the voluntary pension funds. The reason for that was the longer period of time during which these funds functioned. On 31 December, 2004 the net asset value in the voluntary pension funds amounted to BGN 325 457 thousand, whereby a growth of 29% was realized on a yearly basis. The net assets of the universal pension funds on the same date were BGN 261 125 thousand. With these funds most considerable growth in the net asset value of 128% was observed on a yearly basis. Main reason for it was the increase since early 2004 in the amount of the mandatory contribution for these funds from 2% to 3%, as well as the big number of insured persons in this type of funds. On 31 December, 2004 the occupational pension funds owned net assets at the amount of BGN 200 830 thousand. Their size edged up by 39% on a yearly basis.

Net assets distribution among supplementary pension insurance funds



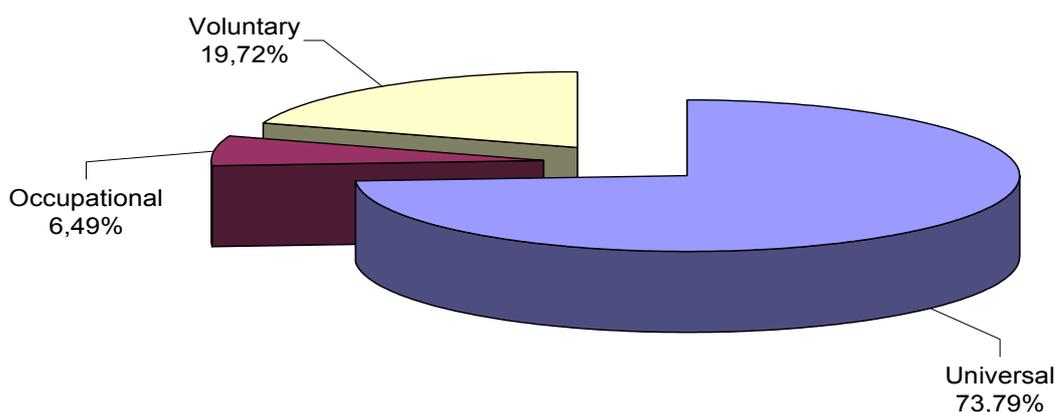
In 2004 the number of persons, insured in the supplementary pension insurance funds was increased by 18%, reaching 2 716 367 persons.

Dynamics of insured persons distribution by funds



The biggest part of them were concentrated in the universal pension funds, where 2 004 776 persons were insured. During the last years this share rose considerably, a reason for which was the growing number of persons, born after 31 December, 1959 who were obliged to insure themselves in a universal pension fund. 176 175 persons were insured in the occupational pension funds on 31 December, 2004, and in the voluntary pension funds - 535 416 .

Distribution of the insured persons among the supplementary pension insurance funds



The average rate of accumulated amounts per one insured person in the supplementary pension insurance funds rose in 2004. Most considerable was this growth in the universal funds (84,3%), where at 31 Dec., 2004 the average rate of the accumulated amounts per one insured person was BGN 130,25. Due to the comparatively small number of persons, insured in occupational pension funds and the highest amount of the contribution to them, the average rate of accumulated amounts per one insured person in these funds was considerably higher. On 31 December, 2004 it amounted to BGN 1139,96. For the year this

amount rose by 30,74%. The average rate of accumulated amounts per one insured person in voluntary pension funds on 31 Dec., 2004 was BGN 607,86. This value marked a 24,17% growth on a yearly basis.

For the reported period **the proceeds from insurance contributions** also increased considerably, being BGN 254,82 million at the year's end. The universal pension funds, which realized a big growth because of the increased amount of the contribution paid in them, were the major factor for that. On 31 Dec., 2004 the total amount of proceeds from insurance contributions in these funds came to BGN 133,76 million, whereby a 87,85% annual growth was marked. This rise formed 90,95% from the increase in the net asset value in these funds in the year under review. At the year's end the proceeds from insurance contributions in the occupational funds amounted at BGN 47,59 million. Their annual growth of 7,38% outstripped the annual rate of increase in insured persons, which was reflected in rise of the average rate of proceeds from insurance contributions per one insured person in the occupational funds.

The insurance contributions, received in the voluntary pension funds in 2004 came to a total amount of BGN 73,472 million. Nearly a 4% growth was observed compared with the preceding year. The monthly proceeds in this type of funds were with strongly expressed seasonal nature. A certain drop is noticed during the summer months and a considerable growth in the month of December. Such dynamics could be explained with the typical for the summer months vacations and holidays, when the share of the personal contributions in the total amount of proceeds considerably decreases, and the reason for the almost two-fold increase at the year's end were the paid in December bonuses and additional labor remunerations to the insured persons.

The structure of the proceeds from social insurance contributions in the voluntary pension funds was characterized with a predominant share of employer's contributions. For 2004 they reached 53,73% from the total amount of the incomes. Personal contributions formed 37,21%, and the contributions from another insurer represented 9,06 % from the incomes from pension insurance contributions.

The professional management of the pension funds resources allowed the achieved by all supplementary pension insurance funds **rate of return** on a yearly basis for the last 24-month period to be higher than many of the economic indicators in the country in 2004. It exceeded to a large extent the base interest rate and the inflation levels for 2004, ensuring real growth of the pension savings of the insured persons. During the year all supplementary mandatory pension insurance funds achieved a rate of return on a yearly basis, exceeding the set level of minimal rate of return of 6,73%.

The achieved rate of return on a yearly basis for the last 24-months period for the universal pension funds was 11,38%, varying among the eight universal funds from 9,35% to 12,02%. The average weighted rate of return of the occupational funds for the period 1 January, 2003 - 31 December, 2004 was 11,40% on a yearly basis, and that of the voluntary funds was 10,45%.

On 31 Dec., 2004 the overall amount of the invested pecuniary means of the pension funds was BGN 785 781 thousand. The observed growth of almost 60% on a yearly basis was due to a considerable increase in the accumulated by the pension funds resources. In 2004 the invested moneys of the supplementary pension insurance funds formed 98,9% from the total amount of the balance sheet assets.

Largest share (41%) of the total investments of the supplementary pension insurance funds belonged to the voluntary funds. The invested resources of the universal pension funds represented 33% of the overall amount of the investments by the three types of funds, and those of the professional funds – 26%.

Allocation of the supplementary pension insurance funds' assets at the end of 2004

Investment instruments	UPF		OPF		VPF	
	Amount (thousand BGN)	Share (%)	Amount (thousand BGN)	Share (%)	Amount (thousand BGN)	Share (%)
Securities, issued or guaranteed by the state	148 957	57,17	116 820	57,35	172 374	53,60
Securities, admitted to be traded on the regulated securities markets	29 005	11,13	19 966	9,80	33 522	10,42
<i>Equities</i>	10 708	4,11	5 103	2,51	10 016	3,11
<i>Corporate bonds</i>	18 297	7,02	14 863	7,30	23 507	7,31
Municipal bonds	2 314	0,89	2 114	1,04	1 217	0,38
Bank deposits	49 004	18,81	38 315	18,81	65 490	20,37
Mortgage bonds	28 586	10,97	22 894	11,24	38 319	11,92
Investment property	1 141	0,44	3 083	1,51	9 017	2,80
Securities derivatives	0	0,00	0	0,00	0	0,00
Investments abroad	1 531	0,59	489	0,24	1 624	0,51
Investments total	260 538	100,00%	203 679	100,00%	321 564	100,00%

The pension funds moneys were invested almost wholly in the country, the share of the investments abroad being below 1%. Main reason for that was the higher rate of return, which the pension funds realized on the local market in connection with the low interest rates levels on the international financial markets.

In 2004 securities, issued or guaranteed by the state continued to predominate in the structure of the investment portfolios of the supplementary pension insurance funds. Their per cent shrank during the year, the reduction with the universal pension funds being the biggest – 14,51 percentage points. The government securities' share was smallest in the structure of investments of the voluntary pension funds resources. Nevertheless, it still considerably exceeded the set under the Social Insurance Code minimum of 30%.

It has been envisaged in the following years the minimal threshold of the size of amounts invested in government securities to be reduced or even removed. With the availability of sufficiently attractive alternative instruments, a larger part of the pension funds portfolio could be directed to investments on the stock exchange.

Bank deposits were in second place in the structure of the general investment portfolio of supplementary pension funds. The major factors, which promote the growth of funds, invested in bank deposits, were the high interest rates levels in the country compared to the same in the EU, which also presupposes a higher rate of return of the deposited funds. The stable bank system in the country was also a factor, reducing the risk, customary for investments in such type of instruments.

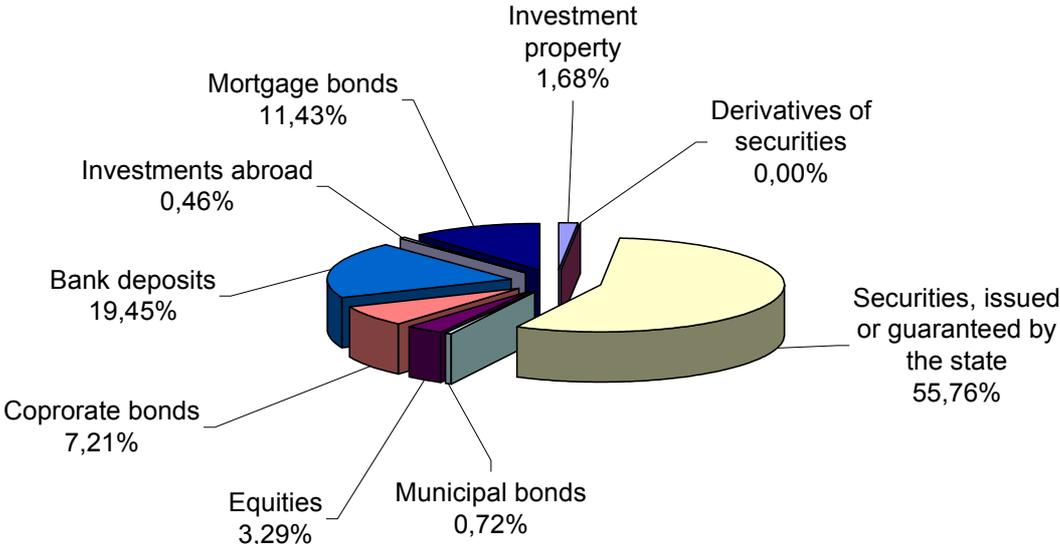
With the coming into effect of the Social Insurance Code in August, 2003, the mortgage bonds fell within the instruments, in which the resources of both universal and occupational pension funds could be invested. As early as in 2003 an interest to this investment possibility was noted, which was retained during the reported period, as well. On 31 Dec., 2004 the mortgage bonds' share in the aggregate portfolio of the supplementary

pension insurance funds was about 11%, this investment instrument being most widely included in the voluntary funds portfolio. As a reason for the high interest to the mortgage debt instruments may be pointed out the higher rate of return, which they offer in comparison with the two instruments above considered – government securities and bank deposits and at the same time the comparatively low risk. The mortgage crediting development in 2004 was also conducive to the rise of the mortgage bonds percentage in the pension funds portfolio.

On 31 Dec., 2004 none of the companies had invested assets of managed by it supplementary pension fund in derivatives (put options on indexes and bonds), traded on regulated securities markets and used for reduction of investment risks. One of the reasons for that was the lack of trade with such type of investment instruments on a local regulated securities market and low interest on the side of supplementary pension insurance funds to investment in derivatives of securities, traded on foreign regulated securities markets.

The funds, invested in shares, corporate and municipal bonds, investment property retained their percentage to a large extent unchanged during the reported period, regardless of their absolute growth.

Structure of the aggregate investment portfolio of supplementary pension insurance funds



The expected liberalization of the statutory requirements to the structure of the pension funds investment portfolio, as well as the creation of new investment possibilities will allow the pension insurance companies to form portfolios with various investment risk, which are to be chosen by the insured persons, depending on their preferences concerning the rate of return and the remaining for them time till retirement.