

### **3.6 BULGARIA**

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#### **I. FRAMEWORK**

In Bulgaria, the legal basis for the issue of covered bonds is the Mortgage-backed Bonds Law issued by 38<sup>th</sup> National Assembly on 27 September 2000, published in the State Gazette (Darzhaven vestnik) issue 83 of 10 October 2000<sup>1</sup>.

#### **II. STRUCTURE OF THE ISSUER**

Pursuant to the Mortgage-backed Bonds Law, the mortgage-backed bonds shall be securities issued by banks on the basis of their loan portfolio and secured by one or more first in rank mortgages on real estate in favour of banks (mortgage loans). Only banks may issue bonds called mortgage-backed bonds.

The real estate under the previous paragraph shall be insured against destruction and shall be of the following type:

- > Housing units, including leased out;
- > Villas, seasonal and holiday housing;
- > Commercial and administrative office spaces, hotels, restaurants and other similar real estate; and
- > Industrial and warehousing premises.

The issuing bank shall adopt internal rules on conducting and documenting mortgage appraisals of real estate which shall comply with the requirements of Article 73, paragraph 4 of the Bulgarian Law on Credit Institutions.

Securities issued under procedures other than the one laid down by the Mortgage-backed Bonds Law may not be referred to with, or include in their appellation, the extension "mortgage-backed bond", or any combination of these words.

#### **III. COVER ASSETS**

The outstanding mortgage-backed bonds shall be covered by mortgage loans of the issuing bank (principal cover). To substitute loans from the principal cover that have been repaid in full or in part, the issuing bank may include the following of its assets in the cover of mortgage-backed bonds (substitution cover):

- > Cash or funds on account with the Bulgarian National Bank (BNB) and/or commercial banks;
- > Claims on the Government of the Republic of Bulgaria or the Bulgarian National Bank, and claims fully secured by them;
- > Claims on governments or central banks of states as determined by the Bulgarian National Bank;
- > Claims on international institutions as determined by the Bulgarian National Bank;
- > Claims fully backed by government securities issued by the Government of the Republic of Bulgaria, the Bulgarian National Bank, the Governments, Central Banks or international institutions;
- > Claims secured by gold; and
- > Claims fully backed by bank deposits denominated in Bulgarian levs or in a foreign currency for which the BNB quotes daily a central exchange rate.

<sup>1</sup> Amended; issue 59 of 2006; in force on the date of entry into force of the Treaty of Accession of the Republic of Bulgaria to the European Union; amended; issues 52 and 59 of 2007; amended; issue 24 of 2009; effective as of 31 March 2009.

The substitution cover of mortgage-backed securities shall not exceed 30% of the total amount of liabilities of the issuing bank under that issue. Mortgage-backed Bonds cover from any issue (the sum total of the principal cover and the substitution cover) may not be less than the total amount of liabilities towards the principals of mortgage-backed bonds from that issue which are outstanding and in circulation outside the issuing bank.

The claims of the bondholders under mortgage-backed bonds from each issue shall be secured by a first pledge on the assets of the issuing bank included in the cover of that issue. The pledge is a subject of entrance in the Central Registers of Special Pledges, with the respective issue of mortgage-backed bonds being indicated as a pledge creditor.

The issuing bank shall request an entry and submit to the Central Register of Special Pledges all data required for the entry of the pledge within one month after executing a mortgage-backed bonds issue and shall update that data at least once every six months thereafter. The pledge shall remain in force until the full redemption of the liabilities of the issuing bank under the respective issue of mortgage-backed bonds without the need for any renewal. Deletion of the pledge entry shall be made upon the full redemption of the issuing bank's liabilities under the respective issue of mortgage-backed bonds on the basis of a document issued by the bank's auditors.

#### **IV. VALUATION AND LTV CRITERIA**

##### **Valuation**

Mortgage appraisals of property shall be performed by officers of the issuing bank or by physical persons designated by it having the relevant qualifications and experience.

For appraisals of the property the comparative method, the revenue method and the cost-to-make method shall be used for the purposes of the law.

The mortgage appraisal shall explicitly specify the method or combination of the above methods used with the relative weight of each method in the appraisal, as well as the sources of data used in the analysis and calculations.

Subsequent mortgage appraisals of property used as collateral on the loans recorded in the register of mortgage-backed bonds cover shall be made at least once every twelve months for loans which:

- > Have outstanding liabilities exceeding 1% of the issuing bank's own funds; or
- > Have not been consistently classified as standard risk exposures throughout that period.

##### **LTV criteria**

The LTV criteria (for the mortgage loans) are generally defined in the banks own lending policies depending on their risk appetite and other internal rules. No specific legal requirements are imposed by the local banking law, except for the Article 6 of the Law on Mortgage-backed Bonds (see below).

Article 6 of the Law on Mortgage-backed Bonds stipulates that mortgage loans shall be included into the calculation of the principal cover at the value of their outstanding principal but at no more than 80% of the mortgage appraisal value of the real estate as housing units, including leased ones, and at no more than 60% of the mortgage appraisal value of the real estate as villas, seasonal and holiday housing units used as collateral on mortgage loans.

Mortgage-backed bonds cover from any issue (the sum total of the principal cover and the substitution cover) may not be less than the total amount of liabilities towards the principals of mortgage-backed bonds from that issue which are outstanding and in circulation outside the issuing bank.

#### **V. ASSET – LIABILITY MANAGEMENT**

Substitution cover of mortgage-backed bonds from any issue may not exceed 30% of the total amount of liabilities of the issuing bank under that issue.

In making calculations under the previous paragraph for mortgage-backed bonds and assets constituting their cover denominated in different currencies, the official foreign exchange rate for the Bulgarian lev to the respective currency quoted by the Bulgarian National Bank of the day of the calculation shall apply.

A loan recorded in the register of the cover of mortgage-backed bonds from a particular issue may be repaid at any time by bonds of the same issue at their face value.

#### **VI. TRANSPARENCY**

Banks (the only eligible issuers of mortgage bonds) produce regular reporting to Banking Supervision authority – Bulgarian National Bank (BNB), and provide and publish financial information on a monthly basis. The public banks are reporting issuers and submit all required information to the regulated market – Bulgarian Stock Exchange – Sofia (BSE), as well as to the Bulgarian Financial Supervision Commission (FSC). No additional specific measures in respect to the mortgage bonds are currently announced.

#### **VII. COVER POOL MONITOR AND BANKING SUPERVISION**

The cover pool is managed by the issuing bank which should have adopted the internal rules for maintaining it, the rules for access to the cover pool data base and the regularity of the update of the cover.

Bulgarian National Bank carries out general assessment of the banks, including issued mortgage bonds, as part of general banking supervision.

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

After the record of the assets in the register as a cover of mortgage-backed bonds of a particular issue, those specific assets may be used as collateral solely for the liabilities of the issuing bank on that issue. The issuing bank may not allow any encumbrances on its assets constituting the cover of outstanding mortgage-backed bonds. The issuing bank accounts assets recorded in the register of mortgage-backed bonds cover separately from the rest of its assets.

The issuing bank shall keep a public register of the cover of mortgage-backed bonds issued by it. A register is kept separately for each mortgage-backed bond issue.

In case bankruptcy of the issuing bank, the assets recorded in the register of mortgage-backed bonds covers as of the date of declaring the bank bankrupt shall not be included in the bankruptcy estate. Proceeds from the liquidation of assets recorded in the register as a cover on a particular issue of mortgage-backed bonds are distributed among the bondholders from that issue in proportion to the rights under their bond holdings. Any funds remaining after settling the claims under mortgage-backed bonds from a particular issue is included in the bankruptcy estate.

The asset pools under the above mentioned paragraphs are managed by a holders' trustee of mortgage-backed bonds which is appointed by the bankruptcy court when it has been established that the bank has outstanding liabilities under mortgage-backed bonds. The trustee is managing the assets by individual mortgage-backed bonds issue.

The Trustee shall have the powers of an assignee in bankruptcy in respect of the asset pool described above, as well as in respect of any outstanding liabilities of the issuing bank under mortgage-backed bonds.

The Trustee shall manage the above mentioned assets separately for any mortgage-backed bond issue. The Trustee shall sell the above described assets under the procedure set forth in Articles 486-501 of the Civil Procedure Code and shall account any proceeds to an escrow account opened for each issue with commercial banks as determined by the Bulgarian National Bank. The Trustee shall publish in the State Gazette (*Darzhaven vestnik*) and in at least two national daily newspapers the place and time for the tender for the sale of assets under the procedures of previous sentence no later than one month prior to the date of the tender.

The bondholders of any issue of mortgage-backed bonds of a bank which has been declared bankrupt shall have the right to obligate the Trustee to sell loans included in the issue cover to a buyer specified by them and the Trustee shall follow precisely the decision of the Bondholders' General Meeting under the previous sentence.

The liabilities of the issuing bank under a mortgage-backed bonds issue shall be deemed repaid when the amount of outstanding principals of the sold loans becomes equal to the total amount of liabilities on principals and interest accrued on the bonds prior to the sales.

Under Article 66 paragraph 2 of the Law on the Recovery and Resolution of Credit Institutions and Investment Firms<sup>2</sup> it is foreseen that the resolution authority (the Bulgarian National Bank) shall not exercise its powers for a write-down or conversion in relation to the secured liabilities. These liabilities include mortgage-backed bonds within the meaning of the Law on Mortgage-Backed Bonds, covered bonds and liabilities in the form of financial instruments used for hedging purposes, which form an integral part of the coverage pool and which according to the applicable law are secured in a way similar to covered bonds, whether the liabilities are governed by the legislation of the Republic of Bulgaria, by the law of another Member State or by the law of a third country.

## **IX. RISK-WEIGHTING & COMPLIANCE WITH EUROPEAN LEGISLATION**

### **Risk weighting**

Criteria for exposures secured by mortgages on immovable property are treated in Article 27 of Ordinance No. 7 of 24 April 2014 on organisation and risk management of banks<sup>3</sup>, adopted by the Bulgarian National Bank ("Ordinance 7"). This Ordinance shall put into force the provisions of Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

The Ordinance contains provisions related to the exercise of national discretions by the Republic of Bulgaria under Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms ("Regulation (EU) No 575/2013")<sup>4</sup>. Article 27(1) of Ordinance 7 states as regards the application of Article 124, paragraph 2 of Regulation (EU) No 575/2013:

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

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

According to Article 29. (1) of Ordinance 7 which refers to Article 400, paragraph 2 of Regulation (EU) No 575/2013 in calculation of large exposures under Article 395 of Regulation (EU) No 575/2013, banks shall exempt the exposures in covered bonds falling within the scope of Article 129, paragraphs 1, 3 and 5 of Regulation (EU) No 575/2013.

2 Adopted by the 43<sup>rd</sup> National Assembly on 30 July 2015; published in the Darjaven Vestnik, issue 62 of 14 August 2015, amended, issue 59 of 29 July 2016. The Law on the Recovery and Resolution of Credit Institutions and Investment Firms transposes Directive 2014/59/EC of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council.

3 Published in the Darjaven Vestnik (State Gazette), Issue 40 of 13 May 2014; [http://www.bnb.bg/bnbweb/groups/public/documents/bnb\\_law/regulations\\_risk\\_management\\_en.pdf](http://www.bnb.bg/bnbweb/groups/public/documents/bnb_law/regulations_risk_management_en.pdf).

4 Amending Regulation (EU) No 648/2012 (OJ, L 176/1 of 27 June 2013), including the transitional provisions under Part Ten, Title I of Regulation (EU) No 575/2013 and supplemented by Commission Delegated Regulation (EU) No 523/2014 of 12 March 2014.

## **Compliance with European Legislation**

The Mortgage-backed Bonds Law is compliant with the requirements of Article 52(4) of Directive 2009/65/EC (the UCITS Directive). The legislation when taken together with the practices, processes and procedures across the industry should fall within the criteria of Article 129 of the Capital Requirements Regulation (CRR).<sup>5</sup>

## **X. ADDITIONAL INFORMATION**

### **Minimum information requirements for issuance prospectuses**

The draft prospectus for an issue of mortgage-backed bonds must contain data valid at the time of their preparation, such as:

- > The Rules of the issuing bank concerning the contents, the entry and deletion procedures as well as the terms and procedures authorizing access to the register and its internal rules of conducting and documenting mortgage appraisals;
- > Data on mortgage loans held in the issuing bank's portfolio on the basis of which an issue is being made, including for each loan:
  - a) The size of the outstanding principal at the time of extending the loan and by the end of the most recent full quarter;
  - b) Loan life at the time of extending the loan and the remaining term to maturity;
  - c) Interest rates, fees and commissions on the loan;
  - d) Risk classification of the loan by the end of each calendar year from the time it was extended and by the end of the most recent full quarter;
  - e) Type of real estate mortgaged as collateral, their mortgage appraisal value and the ratio between the outstanding principal and the mortgage appraisal value at the time of extending the loan and by the end of the most recent full quarter;
- > Characteristics of the mortgage loan portfolio on the basis of which the issue is made, including a distribution of loans by:
  - a) The size of the outstanding principal;
  - b) The residual term to the final repayment of the loan;
  - c) Interest rate level;
  - d) Their risk classification by the end of the most recent full quarter; and
  - e) The ratio between the outstanding principal and the most recent mortgage appraisal value of the real estate pledged as collateral.

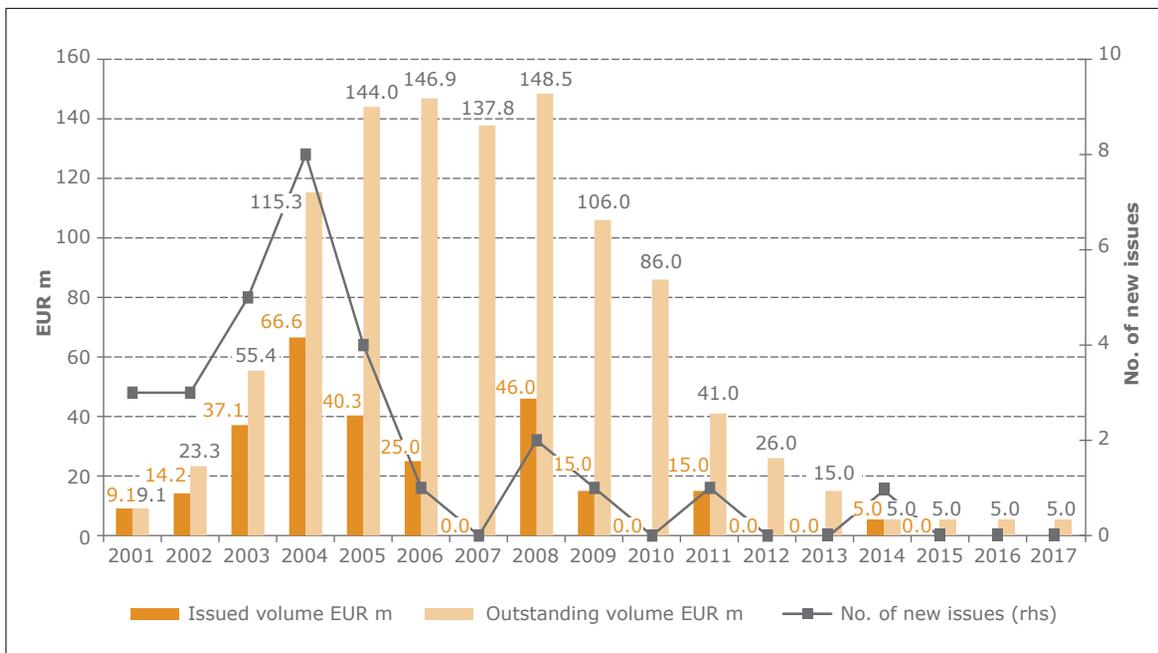
In public offerings of mortgage-backed bonds the provisions of the Public Offering of Securities Act (POSA) and the Ordinances on its enactment shall apply. In non-public offerings of mortgage-backed bonds the provisions of Commerce Law shall apply.

### **Bulgarian mortgage bond market information**

Since the adoption of the Bulgarian Law on Mortgage-backed Bonds in 2000 there were in total 29 mortgage bond issues in Bulgaria. The last mortgage bond issued was in 2014. The volume of issued mortgage-backed bonds totals EUR 273.3 m originated by 11 issuing banks (currently 9 banks after the merger of MKB Unionbank with First Investment Bank and the merger of United Bulgarian Bank with Economic & Investment Bank). As of 31 December 2017, the outstanding mortgage bonds amounted to EUR 5.0 m.

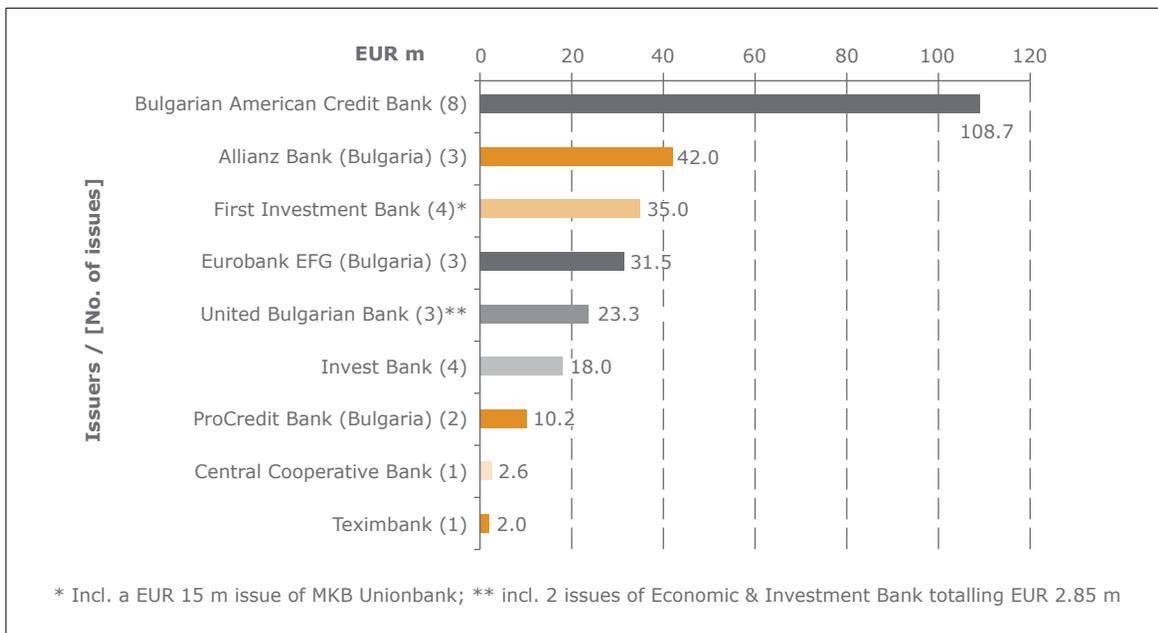
<sup>5</sup> Please click on the following link for further information on the UCITS Directive and the Capital Requirements Regulation (CRR): <https://hypos.org/ecbc/covered-bonds/>.

> FIGURE 1: MORTGAGE BOND ISSUES IN BULGARIA, 2001-2017



Source: Bulgarian Central Depository

> FIGURE 2: MORTGAGE BOND ISSUERS IN BULGARIA, 2001-2017



Source: Bulgarian Central Depository

ECBC Covered Bond Comparative Database: <http://ecbc.eu/framework/72/Bulgaria>.