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BULGARIA — REVIEW OF PROGRESS ON POLICY MEASURES RELEVANT FOR THE CORRECTION OF MACROECONOMIC IMBALANCES

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Executive summary

The 2018 Specific Monitoring Report for Bulgaria reviews policy initiatives taken since November 2017 that are relevant for the correction of macroeconomic imbalances. In 2018, Bulgaria was found to be experiencing imbalances related to vulnerabilities in the financial sector coupled with high indebtedness and non-performing loans in the corporate sector, in a context of incomplete labour market adjustment. This report reviews the latest developments and policy initiatives undertaken by the authorities relevant for the correction of the imbalances identified in the 2018 country report and targeted by the second and third 2018 country-specific recommendation for Bulgaria. The cut-off date of this report is 22 November 2018.

Macroeconomic imbalances have been further reduced in 2018, in an environment of strong GDP growth and employment creation. The Bulgarian economy continued to grow robustly by 3.8 % in 2017 and is set to grow by an estimated 3.5 % in 2018. Domestic demand is the main growth driver, while the contribution of net exports has diminished. The unemployment rate has been approaching its pre-crisis low and is expected to continue to decline. Building on past progress, the authorities have made further efforts to tackle the identified macroeconomic imbalances, including strengthening the financial sector and enhancing employability.

Important steps have been made towards ensuring the continued stability of the banking sector, while a number of actions are yet to be finalised or implemented. Banks have addressed the capital buffer recommendations after the 2016 asset quality review. In addition to stronger capital buffers, efforts to improve banks' robustness have included enhancing provisioning policies and credit-granting practices, as well as reducing the non-performing portfolios and de-risking balance sheets, e.g. by selling and writing off repossessed collateral. Several important regulatory initiatives have been introduced and while are being to put in use, the implementation is ongoing, e.g. regarding related-party exposures. There has also been progress in improving bank supervision. Key outstanding measures include finalising the revision of the supervisory review and assessment manual and strengthening the resolution framework. In July 2018, Bulgaria requested to enter into close cooperation with the ECB. To address the level of non-performing loans, the central bank intends to implement the European Banking Authority (EBA) guidance. However, no specific actions to tackle valuation issues and to support the development of a secondary market for non-performing loans are envisaged.

The reform of non-bank supervision has continued and initial follow-up measures to the reviews in the insurance and pension funds sectors are being implemented. The key remaining challenges include the implementation of an action plan to establish a proper risk-based forward-looking supervisory process and the follow-up to all the issues highlighted by the non-bank financial sector reviews. While relevant legal and regulatory provisions have been introduced by authorities, the concrete implementation will be crucial, especially concerning the supervisory practices over valuation methods for both the insurance and pension funds' sectors, related-parties transactions for the pension funds' sector and group-level supervision for the insurance sector. Also, financial stability of the Green Card system would benefit from ensuring insurers' compliant solvency and sufficient liquidity.

M**easures to increase employability have been further developed, despite remaining challenges.** Active labour market policies (ALMP) have improved through new services to job seekers and stronger support for vulnerable groups, though the level of participation is still low and the effectiveness of some measures is limited. Disparities among regions and between urban and rural areas remain high and a transparent mechanism to determine the minimum wage is still lacking.

The insolvency framework has been improved with the introduction of a restructuring procedure, but the impact of the procedure is not yet apparent and other important elements of the framework are still missing. In July 2018, Bulgaria asked for assistance under the Structural Reform Support Service (SRSS) programme to continue the reform of the insolvency framework. The project aims to identify existing gaps. A roadmap to address the gaps has been prepared. If properly implemented, this Roadmap would help to address the pressing issues with the framework.

In sum, policy advances have been made to reduce the identified imbalances but some structural weaknesses remain to be addressed. Measures taken to reform banking and non-banking are going in the right direction. They need to be implemented decisively. Implementation of the insolvency framework needs to be stepped up, which would improve investors' confidence and could help to further reduce NPLs. Activation policies have improved but further efforts are needed to reduce labour market segmentation, especially in light of labour shortages.

Table 1: Key findings on implementation of reforms[1]

On track	Wait-and-see	Action wanted
• Legislation for supervising related-party exposures in the banks has been adopted • Revision of the supervisory review and assessment manual • Implementation of banks' internal rules and procedures for related-party exposures and assessment of the effectiveness of the new legal provisions • The recommendations of the 2017 insurance balance sheet review have been completed • Balance sheet de-risking has improved • The FSC Act has been amended and new Internal Rules have been adopted • The Social Insurance Code (including a broader definition	• Finalising the implementation of the plan to reform banking supervision • Improving banks' corporate governance and risk management • Implementation of EBA guidelines for credit institutions on how to effectively manage non-performing exposures and forborne exposures • Nomination of the FSC's Head of Insurance Supervision • Follow-up supervisory actions to the independent reviews of the insurance and pension sectors, such as treatment of reinsurance contracts and of insurance receivables for the insurance sector and	• Strengthen the implementation of insolvency framework reforms

[1] The table classifies reforms under review on the basis of their respective adoption and implementation process, uncertainty and their level of detail. "On track" are measures for which the legislative or implementation process has been completed or is progressing well according to the foreseen timeline, and which are expected to be sufficiently effective. "Wait and see" are measures for which the legislative process is on-going, but is still in a relatively early phase, or measures for which there is still uncertainty on the complete implementation and effectiveness. "Action wanted" are measures for which limited or no action has been taken, or measures that have been announced but which are not sufficiently detailed yet to be assessed.

of related parties) has been amended • A restructuring procedure has been introduced in the insolvency framework • Secondary legislation amendments in preparation to address valuation issues in the non-bank financial sector • New services offered to job seekers and network of employment centres expanded	supervisory review over the new legal and regulatory provisions applicable to valuation and related-parties transactions in regards to the pension's sector • Full implementation of the 2017 Action Plan for reforming non-bank financial supervision, including enhancing supervisory practices fully supported by a proper risk assessment framework and a forward-looking resource plan. • Addressing recent liquidity concerns faced by the Green Card Bureau	

1 Introduction

On 22 November 2017, the European Commission presented, in the context of the Macroeconomic Imbalance Procedure (MIP), its seventh Alert Mechanism Report, which identified Bulgaria as requiring an in-depth investigation into the evolution of its macroeconomic imbalances. The in-depth review, published on 7 March 2018 as part of the 2018 Country Report[2], examined the nature, origin and severity of macroeconomic imbalances and risks in Bulgaria. In its Communication published the same day[3], the Commission concluded that Bulgaria is experiencing macroeconomic imbalances. In particular, the Commission emphasised vulnerabilities linked to the financial sector coupled with high indebtedness and non-performing loans in the corporate sector, in a context of incomplete labour market adjustment. On 19 April 2018, Bulgaria submitted its Convergence Programme[4] and National Reform Programme (NRP)[5], respectively outlining the fiscal strategy and policy measures undertaken or planned to improve its economic performance and to unwind imbalances. Based on an assessment of these programmes, the Commission proposed three country-specific recommendations (CSRs)[6], which were subsequently adopted by the Council on 13 July 2018[7]. The CSRs addressed to Bulgaria concern: (1) tax collection and efficiency of public spending, (2) strengthening supervision and stability of the financial sector, complete the reform of the insolvency framework, and (3) labour market and social policy issues. CSR 2 and 3 were considered MIP-relevant.

The Commission conducted a specific monitoring mission within the framework of the MIP to Bulgaria on 9-11 October 2018. Also based on the findings of the mission, the present report assesses the latest key policy initiatives[8] undertaken by Bulgaria[9].

2 Outlook and recent developments on imbalances

Recent economic developments and outlook

Economic growth remains robust and unemployment continues to decline. In 2017, the Bulgarian economy expanded by 3.8 %. Real GDP is expected to grow 3.5 % in 2018. Domestic demand was the main growth driver and is set to remain so until 2020. The ongoing expansion is being driven by strong domestic demand. Wage increases continued to boost private consumption, while a recovery in the use of EU funding is fuelling the growth of investment. The labour market has recovered, with the unemployment rate close to its pre-crisis low in 2017 and expected to decrease to below 6 % by 2020. Labour shortages and planned government wage increases are expected to drive wage growth above productivity growth until 2020. The government reached a budget surplus of 1.1 % in 2017 due to improved tax collection and higher-than-projected nominal growth. The supportive

[2] https://ec.europa.eu/info/sites/info/files/2018-european-semester-country-report-bulgaria-en.pdf
[3] https://ec.europa.eu/info/sites/info/files/2018-european-semester-country-reports-comm-en.pdf
[4] https://ec.europa.eu/info/sites/info/files/2018-european-semester-convergence-programme-bulgaria-en.pdf
[5] https://ec.europa.eu/info/sites/info/files/2018-european-semester-national-reform-programme-bulgaria-en.pdf
[6] https://ec.europa.eu/info/sites/info/files/2018-european-semester-country-specific-recommendation-commission-recommendation-bulgaria-en.pdf
[7] http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018H0809(02)&from=EN
[8] Details on the policy measures can be found in the overview table in the Annex.
[9] For previous MIP Specific Monitoring Reports, see: https://ec.europa.eu/info/business-economy-euro/economic-performance-and-forecasts/economic-performance-country/bulgaria/macroeconomic-surveillance-bulgaria_en

macroeconomic environment and an overall prudent approach to fiscal policy are forecast to lead to sustained budget surpluses until 2020.

Developments as regards imbalances

Financial sector

The banking sector has experienced continued balance sheet expansion, improved quality of assets and stable capital levels. Commercial banks' total assets grew by 8.5 % in September 2018, year-on-year (y-o-y). Banks' funding has been driven mostly by a significant increase in deposits. Household deposits grew by 7.8 %, while the growth rate of non-financial corporate deposits was 11.8 %.[10] In particular, households and non-financial corporations continued to place deposits mainly in the domestic currency, thereby signalling an ongoing positive confidence effect. As a result of the positive liquidity developments, the customer loan-to-deposit ratio declined further, from 74.8 % in September 2017 to 72.8 % in September 2018. Profitability remained relatively high in first half of 2018. The share of non-performing loans (NPLs) decreased to 8.5 % in September 2018, from 11.4 % a year before, supported by increased lending activity and a more active secondary market. Mortgage loans grew by 9.9 % y-o-y in September, driven by the improving economic environment and higher income. The banking system's capital and reserves remained broadly unchanged at slightly above EUR 6.3 billion.

Domestic credit growth continued to expand at an elevated pace. Broad money grew by 9.2 % y-o-y in September 2018, while the growth rate in M1, i.e. currency in circulation and overnight deposits, was somewhat higher at 13.5 %. Banks continued to increase substantially their claims on the non-government sector and, to a lower extent, their foreign assets. The growth of claims to the private sector increased to 7.9 % y-o-y in September 2018, entirely driven by the increase in claims denominated in domestic currency.

Asset prices show a somewhat mixed picture with growing house prices and declining stock prices which are remaining at a high level. House prices grew by 7.5 % y-o-y in Q2 2018, with substantial regional differences. The largest rises have been in Plovdiv (14.5%), while in Sofia prices increased by 8.3 %. Following the rapid growth in the domestic stock exchange in 2017, SOFIX, the main index, underwent a downward correction in the first nine months of 2018, but remains at a historically elevated level. The market's recovery appears to be supported by the favourable economic activity, such as the decline in unemployment and the increase in real disposable income, as well as low bank interest rates. However, the pace of the asset prices increase suggests that monetary factors may be at play too.

Corporate debt and deleveraging

The economic environment has supported continuous deleveraging. The consolidated private sector debt decreased from 104.8 % of GDP in 2016 to 100.1 % in 2017, in part due to robust nominal GDP growth. The majority of debt continues to be on the books of non-financial corporations. Households' indebtedness is still among the lowest in the EU. In 2017, corporate debt has, nonetheless, decreased to 79.6 % of GDP, 4.3 pps less than in 2016 and

[10] According to Financial Supervision Reports Data, http://www.bnb.bg/BankSupervision/BSCreditInstitution/BSCIFinansReports/BSCIFRBankingSystem/BS_201709_EN.

29.5 pps less compared to the peak registered in 2013. The trend is expected to continue in 2018 but to slowly reverse in 2019 and 2020 as investment accelerates.

Labour market

The labour market continued improving despite persisting labour shortages. and inequality of opportunities. The employment rate reached a higher level than before the crisis (72.6 % in Q2-2018 vs. 70.7 % in 2008 for the age group 20-64), while unemployment decreased for the fifth consecutive year and is now below the EU average (5.3 % vs. 6.8 % in Q3-2018). Long-term unemployment also decreased, to reach 3.4 % in 2017, although it still represents a high share of total unemployment (55 %). Youth unemployment dropped from 28.4 % in 2013 to 12.9 % in 2017, below the EU average of 16.8 %. Despite these positive developments, Bulgaria's growth potential could be hampered by negative demographic trends and increasing scarcity of skilled workforce. At the same time, people living in rural areas, low skilled and Roma have comparatively more difficulties to integrate the labour market.

3 Policy implementation and assessment

3.1 Banking sector

Banks have addressed the recommendations after the 2016 asset quality review but some actions are still ongoing. Following the 2016 asset quality review (AQR) conducted by the BNB all banks replenished their capital buffers. In addition to stronger capital buffers, efforts to improve the banks' robustness have included measures to enhance provisioning policies and credit-granting practices, to reduce the non-performing portfolios, and to de-risk balance sheets, e.g. by selling off repossessed collateral. Despite recommended action formally agreed with the BNB, First Investment Bank did not yet successfully obtain fresh capital from external sources[11]. Attracting new *bona fide* investors could further enhance credibility and improve governance, as also identified by the IMF[12]. Monitoring and limiting the risk associated with large exposures remains key for strengthening the balance sheets and enhancing the resilience of banks. Sustained supervisory efforts to limit loan-granting activities to bank-related parties and penalise infringements of collateral provisions are also crucial to support sound business practices in the sector.

The new International Financial Reporting Standard (IFRS 9) was phased in by around half of the banks as of the beginning of 2018. Following the 2016 AQR, banks were required to present plans to implement IFRS 9. The trigger points for detecting credit deterioration under the new ECB AQR Methodology are linked to the IFRS9 triggers for SICR and credit impairment. The supervisor expects this to result in increased loan-loss provisions in some banks, which could be verified once the IFRS 9 phasing-in proceeds. At the same time, the IFRS 9 implementation coincides with a cyclical upturn. As such, banks face the challenge to avoid underestimating the risk from new unfavourable economic developments, namely from reduced borrowers' capacity to service their debt.

[11] http://www.bnb.bg/bnbweb/groups/public/documents/bnb_download/bs_aqr_results_a2_bg.pdf
[12] https://www.imf.org/en/Publications/CR/Issues/2017/07/11/Bulgaria-Financial-Sector-Assessment-Program-Technical-Note-Stocktaking-of-Progress-Achieved-45057

Several important regulatory initiatives have been introduced, with implementation still ongoing in several areas. The Law on the Bulgarian National Bank (BNB) was amended. The transfer to the BNB Governing Council banking and payment supervision competencies, previously held by the Deputy Governors in charge, should enhance the institutional decision-making process. The amendments to the Law on Credit Institutions adopted in December 2017 strengthened the definition of bank related-party exposures (Article 45). The changes were followed by the adoption in July 2018 of BNB Ordinance 37 which sets out the scope of banks' internal rules and procedures, rules for calculation of exposures, and reporting requirements to the supervisor. As banks are requested to implement their internal rules and procedures within a six-month period, implementation and the assessment of the effectiveness of the measures are still forthcoming. Regarding large exposures and identification of connected clients, the BNB adopted a decision in April 2018 to implement the EBA guidelines[13] as of the beginning of 2019 and introduced a reporting template. Once banks have adjusted their internal rules of interconnectedness, the supervisor's careful evaluation of implementation is expected to follow.

There have been improvements to bank supervision, with some important measures delayed but scheduled for implementation in the coming months. The BNB adopted in 2015 a detailed plan to improve banking supervision. Important progress has been made in many areas, although some of the original deadlines have been missed. Key outstanding measures include strengthening the resolution framework. In addition, the process of upgrading the ICT tools available for the banking supervision department has taken longer than expected. It has, however, delivered key elements, such as upgraded data warehouse for banking supervision, automated update of key risk indicators and a regularly updated data point model to verify the quality of data reported by banks.

Non-performing loans (NPLs) are decreasing and the secondary market has become more dynamic. The NPL ratio has been on a downward trend across individual banks and segments, declining to 8.5 % at the end of September 2018 (from 11.4 % a year earlier). The current stock represents mainly the legacy of the credit boom prior to the 2009 recession[14]. Increased lending activity and reduced stock contributed to this decline. At the same time, the secondary market for NPLs has become more dynamic, also in the corporate segment. Ample liquidity is generating demand for NPL portfolios and collateral sales. On the supply side, banks are more active in selling large NPL portfolios. The market continues to be driven by subsidiaries of euro-area banks.

To further reduce the level of non-performing loans, the BNB will align its prudential guidance with the forthcoming implementation of the EBA guidelines[15]. The BNB planned to adopt a strategy to reduce the level of NPLs by the end of 2017, based on guidance adopted by the ECB in March 2017[16]. The BNB circulated for industry comments draft prudential guidance on NPLs incorporating supervisory metrics for loan-loss provisioning, NPL accounting write-offs and collateral valuation. These draft guidelines were used for simulation purposes and as a basis to justify higher provisions, but have not been

[13] EBA Guidelines on Connected Clients under Article 4(1)(39) of Regulation (EU) No 575/2013.
[14] The share of gross non-performing loans in total gross loans is calculated using the EBA methodology.
[15] EBA Guidelines for credit institutions on how to effectively manage non-performing exposures (NPEs) and forborne exposures (FBEs), expected to enter into force at the beginning of 2019.
[16] https://www.bankingsupervision.europa.eu/ecb/pub/pdf/guidance_on_npl.en.pdf

formally adopted. Instead, the BNB plans to adopt in 2019 guidelines issued by the European Banking Authority (EBA), but no specific timeline has yet been announced.

The implementation of a counter-cyclical capital buffer (CCyB) and the ongoing work on new borrower-based macro-prudential tools are new, welcome initiatives. In September 2018, the BNB decided to set the CCyB at 0.5 % as of October 2019. The value of the reference indicator (deviation of the credit-to-GDP ratio from the long-term trend) would correspond to maintaining the buffer at zero but the decision to introduce positive value of CCyB constitutes an important signalling tool. Furthermore, on the back of buoyant economic activity, growth in bank credit to the private sector recently accelerated, in particular in the household loans segment. In order to limit the accumulation of risks, in addition to the introduction of the CCyB by the BNB, the authorities envisage amendments to the Law on Credit Institutions, introducing macroprudential tools for borrower-based measures, in addition to existing capital-based measures.

Bulgaria also requested to enter into close cooperation with the ECB. In July 2018, Bulgaria announced its intention to apply for ERMII membership in 2019. At the same time, Bulgaria announced a set of commitments to improve the economy's resilience in areas of high relevance for a smooth transition for ERM II participation[17]. In this context, Bulgaria formally notified its intention to establish close cooperation with the Single Supervisory Mechanism on 18 July 2018.

Overall, further steps have been made to strengthen the resilience of the banking system, including initiatives such as a counter-cyclical capital buffer and macroprudential tools for borrower-based measures. To further decrease the level of non-performing loans, the central bank supervision intends to implement the EBA guidelines for credit institutions, but the timeline has not been set. Still some follow-up actions to the 2016 AQR are expected together with implementing regulation and improving banking supervision.

3.2 Non-banking financial sector

The non-bank supervisor is reforming non-bank financial supervision in close cooperation with EIOPA but faced some new challenges in 2018. As a consequence of the failure of Olympic Insurance, a non-life insurer based in Cyprus but whose Bulgarian branch represented a relatively important share of the Bulgarian Motor Third-Party Liability (MTPL) market, the head of Insurance Supervision resigned in August 2018. The Financial Supervision Commission (FSC) expects a successor to be designated by the end of 2018. Given the current situation and the ambitious scope of the planned reforms, it is crucial to ensure the timely appointment of a professional who duly fulfils fit-and-proper requirements. The FSC, in cooperation with the European Insurance and Occupational Pensions Authority (EIOPA), is following-up on the reviews in the insurance and pension fund sectors, and working on the implementation of the Action Plan for reforming non-bank financial supervision adopted by the FSC in September 2017. The plan considers the findings of the independent pension funds' asset quality review (PFAR) and insurance balance sheet review (IBSR) as well as those of the Financial Sector Assessment (FSAP) performed by the IMF

[17] See https://www.minfin.bg/upload/37885/letter-by-bulgaria-on-erm-ii-participation.pdf

(banking) and the World Bank (non-banking), published in 2017. The full and timely implementation of this Action Plan, which includes the implementation of risk-based supervision fully supported by an improved supervisory approach in cooperation with EIOPA, will be an important step towards ensuring adequate supervision.

Legislative changes aimed at improving non-bank financial supervision have been adopted and their implementation is still under way. Changes to the Social Insurance Code, including a broader definition of related parties in line with international standards, were adopted by the national parliament in November 2017. They are still to be duly enforced as they entered in force in November 2018. Results need to be monitored to assess their effectiveness. Amendments have also been adopted for the Law on the FSC. These include measures to enhance the decision-making process, executory powers and legal protection as well as steps to ensure its financial independence from the state budget through direct collection of levies from the industry. The FSC now benefits from sufficient funding to strengthen and expand its supervisory practices, by helping in particular to attract experienced professionals to the FSC. The currently-remaining vacancies are expected to be fulfilled by end of 2018 and an updated assessment of the FSC's forward-looking resource plan is expected in the beginning of 2019. However, non-banking financial companies still systematically appeal the decisions of the FSC and have regularly succeeded in having them overturned. The unpredictability of the courts' decisions may suggest the need to expand technical expertise among judges and other judicial practitioners.

Solvency has improved, at least nominally, since the completion of the reviews in the insurance and pension funds' sectors in February 2017. According to the FSC, all recommendations of the IBSR had been fully implemented by April 2017. At the end of 2017, all but one insurer satisfied their Solvency Capital Requirement (SCR), without the application of Long-Term Guarantee and transitional measures. However, some insurers' business sustainability with potential impact over their future solvency and liquidity raises concerns and requires close monitoring. In 2017 the FSC withdrew the licences of two insurers for a number of reasons, including failures to comply with the capital requirements. Both companies have appealed this sanction; the decision is still pending before the administrative higher court.

Some issues related to valuation require further monitoring. The treatment applicable from a supervisory perspective to the valuation of recoverable amounts under specific reinsurance contracts was clarified by EIOPA through a Q&A published on its website. According to the FSC, auditors have not identified any particular problem with these contracts; however, concerns regarding the supervisory treatment of those remain to be addressed. The on-going on-site inspections are expected to allow further assessment by the FSC. The issue of hard-to-value assets, including both traded securities with low liquidity and low free float as well as non-traded assets,[18] has been identified in the reviews of both banking and non-bank financial sectors and has not yet been fully addressed. Amendments to secondary legislation to address this issue are under public consultation and could be followed by changes to the rules governing the work of valuation practitioners to improve the application of valuation rules.

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[18] Hard-to-value assets may include majority and minority stakes in subsidiaries, insurance receivables, land plots, industrial plans and other types of commercial real estate.

Group-level supervision remains a crucial challenge to ensure adequate risk-based insurance supervision. The group-level assessment of two insurance groups was not completed, neither under the original nor during the second round reviews. While in one case following a restructuring group supervision is no longer applicable, in the other case, the Supreme Administrative Court revoked the decision of the authority for identification of the group. The authority's approach following the court's decision will have to be monitored considering that the requirements established under the transposed Solvency II Directive impose group level supervision to be applied at the ultimate parent level.

Insurers have significantly increased the premiums of their motor third-party liability policies, but a recent ruling of the Supreme Court might threaten the sustainability of this line of business. Following a period of low premiums and in some cases negative margins, insurers have increased their MTPL premiums in 2018. However, a recent Supreme Court ruling has expanded the scope of eligible persons entitled to moral (non-material) damages in case of accidents. The ruling concerns new claims as well as those incurred over the last 5 years. The possible impact on the insurance sector is yet unknown. It could have a massive impact on technical provisions and future premiums, albeit the FSC believes that the recently increased premium levels may be enough to absorb the losses. In order to mitigate the risks, the National Assembly adopted on 22 November 2018 an amendment to the Insurance Code imposing ceilings for the amounts of compensation to be awarded to the persons entitled to compensation according to the recent ruling of Supreme Court of Cassation.

A methodology for claims and improved pricing methods would contribute to the stability of the sector. Well-specified rules on compensation would facilitate a more harmonised approach by judges when deciding on individual cases. In the longer-term, such a methodology for the awarding of compensation would contribute to reduce cost, volatility and the underwriting risk in the MTPL line. The sustainability of MTPL would also benefit from improving pricing, which is still largely rudimentary. Unlike in most developed markets, MTPL pricing in Bulgaria does not take into account the clients' driving history, the best predictor of future claims. The FSC has put forward a proposal of a bonus-malus system, which is under a broad public debate and which, if effectively designed and timely implemented, would also significantly improve the pricing of MTPL policies and could positively influence the driving behaviour of policyholders.

The FSC is seeking to address the liquidity concerns faced by the National Bureau of Bulgarian Motor Insurers (NBBMI) or "Green Card Bureau", Some Bulgarian insurers are not paying the correspondents / claims handling entities on time for cross-border MTPL claims, potentially creating pressure over the financial stability of the Green Card system. The FSC took measures in the past to ensure the proper compensation of victims of car accidents regarding cancelled insurance contracts and that all Bulgarian insurers had a network of claims representatives in all EU Member States under the Motor Insurance Directive. Furthermore, to avoid previous fraud situations the Bulgarian authorities started since November 2017 to automatically match the databases on car registration and MTPL insurance contracts. The FSC is starting to address the current liquidity concerns with measures which include on-going on-site inspections. However it is important to ensure that measures are timely and fully implemented, while also tackling the potential remaining governance issues, in order to ensure trust and participation of member insurers.

Overall, non-bank financial supervision is in the process of being reformed, while initial follow-up measures to the reviews in the insurance and pension fund sectors are being implemented. The implementation of an action plan to improve and strengthen the supervisory body, involving a risk-based supervision, has also started. The timely and adequate follow-up to all issues highlighted by the non-bank financial sector reviews remains a key priority, including valuation methods, sufficient liquidity and compliant solvency of insurers.

3.3 Insolvency framework

Although some reforms have been undertaken in previous years and some are in the pipeline, important elements of a fully functioning insolvency framework are still missing. In 2016, a new stabilisation proceeding was introduced in the Bulgarian Commercial Act to help financially distressed businesses restructure and potentially avoid opening an insolvency procedure. This pre-insolvency restructuring procedure entered into force on 1 July 2017, but has so far been rarely tested by market participants. The new framework could benefit from a further streamlining and less complexity. This could include encouraging out-of-court settlements and lower thresholds when voting on the adoption of restructuring plans. Moreover, Bulgaria still lacks functioning rules for granting a second chance to consumers and entrepreneurs within a reasonable timeframe following a bankruptcy.

Measures are needed to improve the efficiency and effectiveness of the insolvency framework. This would help the reduction in private sector indebtedness and the work-out of NPLs, which are declining but are still high in comparison to the EU averages. Lengthy (3.3 years compared to the EU average of 2) and costly insolvency proceedings usually result in very low recovery rates for creditors (35 % compared to the EU average of 65 %[19]). In the period of 2010-2017, 1,200 insolvency cases were lodged with the district courts per year on average[20]. At the same time, about 900 cases per year remained unresolved. In the same period, 49 % of insolvency cases were settled within 3 months, while 51 % of cases took longer. There were also large regional differences in terms of courts' workloads. For the period of 2010-2017, the District Court in Vratsa had an annual average of 88 bankruptcy decisions per 10,000 companies, which is almost three times the national average and well above the District Court in Montana that came in second.

Enhancing the effectiveness of the regulatory and institutional framework would help to address the unsatisfactory performance of the insolvency proceedings[21]. The number of successful reorganisation plans is very low and the constant reopening of insolvency proceedings presents a serious problem. Cumbersome requirements for commencing insolvency, inefficient rules and processes for the recognition of creditors' claims, as well as weak adherence by market participants and courts to the prescribed deadlines are some of the major impediments to a cost-effective and timely access to insolvency proceedings. There is also a lack of adequate rules on the protection of post-petition financing that would enable debtors to meet their ongoing business needs by facilitating access to commercially sound

[19] World Bank report, Doing Business 2017: Equal Opportunity for All.
[20] Institute for Market Economics, 2018: A Brief Overview of the development of institutions in Bulgaria: Project "Reforms for Enhancing Economic Freedom and Entrepreneurship in Bulgaria"
[21] See also: World Bank's 'Report on the observance of standards and codes Insolvency and creditor/debtor regimes', 2016.

forms of financing upon commencement of the insolvency procedure. Rules on the stay of enforcement actions also need an overhaul. Moreover, a diverse interpretation of rules on avoidance actions causes legal uncertainty and prevents an orderly distribution of funds to creditors. Insufficient training in the field of insolvency and restructuring for both trustees and judges further exacerbates these problems.

Most insolvency cases end up as piecemeal asset liquidations, often resulting in a deterioration of firm's asset value and consequently lower creditors' recovery rates. The lack of electronic access to insolvency files and insufficient transparency of cashing out processes carried out by trustees, combined with the lack of effective control of assets' appraisals, has led to sales of assets within the insolvency estate at exceptionally low prices or in ways that are considerably disadvantageous to a large part of creditors. This adds to the wide-spread perception of insolvency, not as an effective collection mechanism, but as a vehicle used by debtors to evade obligations, and in many cases fraudulently.

Lack of adequate monitoring tools makes it difficult to assess both existing and new procedures. The existing data collection system in Bulgaria does not allow for a comprehensive analysis of the efficiency of insolvency and restructuring proceedings, as well as intercompany debt and enforcement in general. The data collected within the judicial system include quantitative data about pending and completed cases, the average length of proceedings and the terms for issuance of court acts. However, this is used mainly to report on the workload of courts. In addition, the Supreme Judicial Council and the National Statistical Institute gather data on insolvency and restructuring proceedings, but this information is not used for analytical purposes.

In 2018, Bulgaria asked for assistance under the Structural Reform Support Service (SRSS) programme to progress on the reform of the insolvency framework. This project should start early October 2018 and end in June 2019 and it will have the following components:

a) Review and recommendations on the insolvency and stabilization framework
b) Model development of an efficient system to collect and publish data and acts on insolvency and stabilization proceedings
c) Roadmap for the implementation of Recommendations on the insolvency framework and the model for data collection and publication
d) Training of insolvency resolution professionals and training for trainers

Overall, the insolvency framework reform has started and this project should help to move it along but many issues remain to be addressed both on the legislative and implementation fronts.

3.4 Labour market

Targeting of active labour market policies (ALMP) has improved. New services are offered to job seekers and specific measures are being implemented to support people with disabilities, the long-term unemployed and the low skilled. The network of integrated centres for employment and social assistance has been expanded from 65 to 73 centres. Although increasing compared to previous year, only 5.4 % of those unemployed and wanting to work participated in labour market policies in 2016. The structure of ALMP shows that training and adult learning might be underdeveloped, especially in view of the shortages of skills in the labour market.

Disparities among regions and between cities and rural areas remain strong, despite economic progress of recent years. The levels of employment (20-64) are comparatively higher in the most populated South-West region (76.7 %), followed by the South-Central one (71.3 %), which is also among the most densely populated. Although the regional dispersion of wage levels has been decreasing since 2013, for some regions (Vidin and Blagoevgrad) wages are still less than half the levels in Sofia and the catching-up process is weak. Similarly, disaggregated data shows a large gap between the employment rate of people living in cities and those living in rural areas (over 14 % pps difference, among the highest in the EU). Such disparity is also evident for the younger population, with a much lower level of not in employment education or training (NEET) in the cities (7.8 %) than in the rural areas (27.2 %).

The minimum wage is still being adopted without an objective and transparent mechanism. In the absence of agreement between employers and trade unions, the minimum wage is still set by medium-term budgetary projections of the government. It was increased to BGN 510 (EUR 260.8) in 2018, which represents an increase of over 10 % from 2017 and over 100 % since 2011. Meanwhile, the minimum social security contributions for agriculture workers were also considerably increased to equal the minimum wage by 2019, year in which also the maximum insurable income is expected to increase from BGN 2600 to 3000.

Overall, better-targeted ALMP, along with economic growth, are having a positive impact on the labour market. Disparities among regions and between urban and rural areas remain high, while a transparent and objective mechanism to determine the minimum wage is still lacking.

4 Annex 1: Overview table of MIP-relevant reforms

Stabilise the banking and non-banking financial sector			
Financial sector			
Financial services			
Announced measures	*Adopted measures*	*Implemented measures*	*Sources of commitment*
Expected in 2018: Validation of a risk-based supervisory manual for the non-banking financial sector – to be implemented as of 2019 **Expected in 2018**: Practical testing of a re-designed system of criteria for the categorization of insurance companies (degree of risk – systemic significance) – system established by Order 343 (Oct. 2017) – to be implemented as of 2019 **Expected in 2018**: Outcome of the internal audit: first summary annual report on compliance with supervisory rules and procedures and quarterly reports on ongoing supervisory activities **Expected in 2018**: FSC vacancies to be fulfilled, including nomination of a new FSC's Head of Insurance Supervision **Expected in 2018**: Addressing the valuation of assets: Ordinances 53. **Expected in 2019:** A multi-year forward-looking resource plan for the FSC that takes account of risk assessment, emerging risks, lessons	**July 2018:** Adoption of BNB Ordinance 37 on related-party exposures. Banks are requested to implement their internal rules and procedures within a six-month period **April 2018**: BNB decision to implement the EBA guidelines on connected clients as of the beginning of 2019 **November 2018**: Entry into force of the amendments to the Social Insurance Code including a new related-parties definition (adopted by parliament in Nov. 2017) **February 2018**: New FSC Procedural Rules for Organisation and Operation – being implemented (see measures in first column, such as annual and quarterly reports) **November 2018**: Entry into force of amendments to Ordinance 9 of the FSC, concerning the valuation of the assets and liabilities of the pension funds.	**December 2017**: the amendments to the Law on credit Institutions strengthened the definition on the related-party exposures (Article 45) **December 2017:** Law on FSC (LFSC) adopted by the Council of Ministers and submitted to Parliament **December 2017**: The recommendations of the 2017 insurance balance sheet review IBSR has been completed **September/October 2018**: Progress with key ICT tools elements **January 2018**: the amendments to the FSC Act are effective **July 2018**: FSC study on premiums level in the insurance sector **December 2017:** Law on FSC (LFSC) adopted by the Council of Ministers and submitted to parliament	CSR (2) – 2018 "Take follow-up measures resulting from the financial sector reviews and implement the supervisory action plans in order to strengthen the oversight and stability of the sector. Ensure adequate valuation of assets, including bank collateral, by enhancing the appraisal and audit processes."

learned and existing and new priorities. **Expected in 2019**: Implementation of the EBA guidelines for credit institutions on how to effectively manage non-performing exposures and forborne exposures.			
Competitiveness, business environment and institutional capacity			
Labour market policies			
Wages and wage setting			
Announced measures	*Adopted measures*	*Implemented measures*	*Sources of commitment*
Expected in 2018: Minimum wage setting mechanism proposed by the government, but not yet agreed on by the social partners.			CSR 3 – 2018 "Introduce a regular and transparent revision scheme for the minimum income and improve its coverage and adequacy."
Active labour market policies (ALMP)			
Announced measures	*Adopted measures*	*Implemented measures*	*Sources of commitment*
Expected in 2018: Implementation of individual profiling and agreement for employment integration. **Expected in 2018:** New service for long-term unemployed – consulting and mentoring after start of work. **Expected in 2018:** Introduction of		**October 2017:** Schemes for training and employment of young people and long-term unemployed are being implemented, benefitting from EU funding. **2017:** Creation of additional centres for employment and social affairs.	CSR 3 – 2018 "Increase the employability of disadvantaged groups by upskilling and strengthening activation measures."

family labour consultant for vulnerable groups.			
Public administration and business environment			
Insolvency framework			
Announced measures	*Adopted measures*	*Implemented measures*	*Sources of commitment*
October 2018-June 2019: Project with SRSS. Concept Note and Terms of Reference for contractor for the implementation of the project have been approved. Contract with provider was signed in October and the kick off meeting was held on 7 November. The activities, part of the project, have been launched according to a Detailed Working Plan. • Review and recommendations on the insolvency and restructuring frameworks. • Development of an efficient process to collect and publish data and acts on insolvency and restructuring proceedings. • Roadmap for the implementation of recommendations on the insolvency and restructuring frameworks and the process for data collection and publication. • Training of IPs and training for trainers.		**February, April and May 2017:** Three trainings of judges on the new stabilisation procedure were organised. One training was organised in September 2018. A total of 189 judges have been trained on the stabilisation procedures	CSR 2 – 2018 "[…] Complete the reform of the insolvency framework […]"