EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 13 April 2012

on the State fund for guaranteeing the stability of the state pension system

(CON/2012/29)

Introduction and legal basis

On 12 March 2012, the European Central Bank (ECB) received a request from the Bulgarian Minister for Finance for an opinion on a draft law amending and supplementing the Law on the State fund for guaranteeing the stability of the state pension system (hereinafter the 'draft law').

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union (hereinafter the 'Treaty') and the third and sixth indents of Article 2(1) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions[1], as the draft law relates to Българска народна банка (Bulgarian National Bank) and rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

1. Purpose of the draft law

The draft law provides for a more flexible choice of financial instruments for investing the assets of the State fund for guaranteeing the stability of the state pension system (hereinafter the 'Fund'), including investments in domestic assets[2]. It is also aimed at improving the regulation of the investments and at introducing wider possibilities to diversify the Fund's investment portfolio.

2. General observations

2.1 The Law on the State fund for guaranteeing the stability of the state pension system[3] (hereinafter the 'Law') regulates the Fund's status and activities. The Fund's main objective is to ensure the sustainability of the state pension system through accumulation, investment and transfer of additional financial resources to the Pensions fund held within the state social security budget[4]. The Fund's resources are a separate part of the central budget and are managed and structured within

1 OJ L 189, 3.7.1998, p. 42.

2 See the explanatory memorandum to the draft law.

3 Published in *Darjaven vestnik,* issue 98 of 14.11.2008.

4 See Article 1(2) of the Law.

investment portfolios in accordance with the Law[5]. The Fund is managed by a management board consisting of various government ministers and other members representing relevant institutions or organisations. The Law also provides for the instruments in which the Fund's resources may be invested[6] and prohibits investment in a number of instruments including Bulgarian government securities, shares of Bulgarian companies and other assets[7]. In addition, according to the Law, the transfer of the Fund's resources to the state social security budget may not take place before 2018 and will be in an amount specified in the Law on the state budget of the Republic of Bulgaria for the respective year[8]. The ECB understands that most of the Fund's resources are deposited in Българска народна банка (Bulgarian National Bank).

2.2 Pursuant to the draft law, the prohibition of investments of the Fund's resources into securities issued or guaranteed by the Republic of Bulgaria or issued by Bulgarian municipalities and certain other Bulgarian issuers will be removed. In addition, up to 70% of the Fund's assets may be invested in securities issued or guaranteed by the Republic of Bulgaria; these liabilities comprise government or government guaranteed debt[9]. The ECB notes that the draft law does not require an investment grade credit rating to apply to securities issued by the Bulgarian government, whereas the other debt securities do require such a rating.[10] This leads to unequal treatment of the different investment instruments, which could create competition and market distortions. It puts the government in a privileged position compared to other issuers. Furthermore, under the draft law, securities issued by the Bulgarian government can only be acquired in the primary market[11]. To the extent that the draft law provides that the Fund may acquire debt securities issued by other Member States and third countries only if they have an investment grade credit rating awarded by a credit rating agency registered or certified in accordance with Regulation (EC) No 1060/2009[12], while investments in debt securities issued by Bulgaria are not subjected to such requirement, an issue of indirect discrimination arises that may lead to unjustified restrictions on the free movement of capital contrary to Article 63 of the Treaty.

The ECB notes that the market for Bulgarian government securities is limited in size and liquidity. Furthermore, no other similarly large Bulgarian public fund or body participates on that market. The investment of significant Fund resources in the market for Bulgarian government securities could have some implications for the volume and the yields of the Bulgarian government securities. Therefore, the proposed investment regime may distort domestic securities markets, including

5 See Article 1(3) of the Law.

6 See Article 13(1) to (7) of the Law.

7 See Article 13(8) of the Law, government securities issued by the Bulgarian government, municipal securities issued by Bulgarian municipalities, shares of companies registered in the territory of the Republic of Bulgaria and any derivative financial instruments related thereto, shares or units in collective investment scheme or contractual funds, immovable property and precious metals.

8 See paragraph 3 of the Transitional and final provisions of the Law.

9 See Article 13(1)(3) of the draft law.

10 See Article 13(1) of the draft law.

11 See Article 14(12) of the draft law.

12 Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies (OJ L 302, 17.11.2009, p. 1)

primary and secondary markets for Bulgarian government securities. One implication is that channelling the Fund's resources into the primary government securities market may skew the yields there, so that those will not be purely market-driven. This would also affect secondary market yields for Bulgarian government securities. Thus, if the Fund purchases the envisaged amounts, exclusively in the primary market or in the secondary market, the prices and yields of Bulgarian government securities will not reflect the true state of the Bulgarian economy and the position of the country's public finances. In addition, some investors might stop participating in a debt securities market dominated by a public sector fund, which is under the control of the issuer. This would reduce the depth and liquidity of this market.

2.3. In accordance with Article 5 of the Act concerning the conditions of accession of the Republic of Bulgaria and Romania and the adjustments to the treaties on which the European Union is founded[13], Bulgaria shall participate in Economic and Monetary Union from the date of accession as a Member State with a derogation within the meaning of Article 122 of the EC Treaty. Before a Member State may adopt the euro it must achieve a high degree of sustainable convergence assessed on the basis of the criteria provided in the Treaty[14] and detailed in Protocol No 13 on the convergence criteria annexed to the Treaty. The ECB notes that the assessment on Bulgaria's progress in fulfilling the criterion related to long-term interest-rate levels provided for in the fourth indent of Article 140(1) of the Treaty could be influenced by the operations of the Fund in the Bulgarian market for government securities. The potential distortion of this market, as a result of the predominant participation of the Fund acquiring high volume of government securities on a small market with low liquidity could undermine the credibility and accuracy of the fulfilment of the long-term interest rates criterion. The ECB will closely monitor Bulgaria's progress in fulfilling the convergence criteria and will report as provided in Article 140(1) of the Treaty.

3. Specific observation

The draft law provides that the Fund's management board determines the types, structure, investment horizon and parameters for measuring, evaluating and controlling yield and risk related to the Fund's investments in deposits and other accounts at Българска народна банка (Bulgarian National Bank)[15]. The ECB understands that this provision aims to empower the Fund's management board to take decisions on all important aspects of the Fund's investment portfolio and to standardise the approach used in Article 5(3) of the Law. For reasons of legal certainty and to avoid any ambiguities that could undermine the independence of the Българска народна банка (Bulgarian National Bank), Article 5(9) of the draft law should be amended.

This opinion will be published on the ECB's website.

13 OJ L 157, 21.6.2005, p. 203.

14 See Article 140(1) of the Treaty.

15 See the Article 5(9) of the draft law.

Done at Frankfurt am Main, 13 April 2012.

[signed]

The President of the ECB

Mario DRAGHI