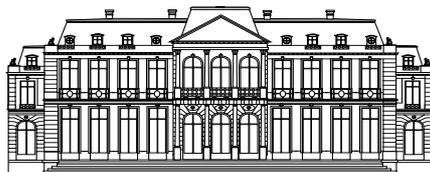


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**A REVIEW OF BULGARIAN
PRIVATISATION**

**Mr. Peter JOTEV
Executive Director
Bank Consolidation Company
(Bulgaria)**

***The consolidation, rehabilitation and privatisation process
of Bulgarian banks***

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THE CONSOLIDATION, REHABILITATION AND PRIVATIZATION PROCESS OF BULGARIAN BANKS

*Peter Jotev - Executive Director
Bank Consolidation Company*

BULGARIA

Bulgaria met 1992 in the conditions of irregular processes in the economic and banking activity which coincided with the transition of the country to the market economy. The negative trends in the financial and credit system kept worsening. The losses in the banking sector kept accumulating and more and more banks were included in the group of the unprofitable banks. All these factors created the necessity to consolidate the financial and credit institutions, as a part of an overall strategy for stabilization of the banking system in the country. The initial plans foresaw the banking consolidation process to be carried out by the banks themselves, on the basis of their voluntary mutual agreement and in compliance with the applicable market mechanisms. Unfortunately, these expectations were not justified, partially, because of the lack of an adequate legislation. All these factors predetermined the establishment of the Bank Consolidation Company (BCC) as an institution, aiming at speeding up the consolidation process, managing the State interest in the commercial banks and creating and effective performing banking system in the country.

I. Initiating a consolidation and rehabilitation process of the banking system in Bulgaria

BCC was established in 1992 and its initial shareholders were the Bulgarian National Bank (BNB) - the Central Bank of the country, Bulbank and several branch ministries. Later on Bulbank transferred its shares to the State, and the branch ministries - to the Ministry of Finance. In this way, as of October 1998, the main shareholders of BCC are: BNB (47.45%) and the Ministry of Finance (45.32%). A small amount of the capital is comprised by the Sofia Municipality, municipal and private companies.

At the beginning, BCC was organized in a two-tier management system, consisting of Supervisory Board and Managing Board. At the end of 1992 a more effective management system was implemented in the company, in which the BNB and the Ministry of Finance appointed most of the members of the Board of Directors. At the present moment, the Board of Directors is composed of five members. The Minister of Finance is a chairman and one of the deputy governors of BNB is a deputy chairperson of the Board. The Board of Directors also include two representatives of the government (the deputy Prime Minister, responsible for the conducting of the structural reform and the privatization in the country, the first deputy Minister of Finance) and the executive director of BCC.

In the initial period of its establishment, BCC determined as its priority to reduce the total number of the state-owned banks (which at the beginning of 1992 were over 70) and through their consolidation to create a few larger banks, some of which shall also be restructured. After completing this consolidation and rehabilitation process, BCC shall initiate the privatization of all state-owned banks.

The consolidation process started in September 1992 with the merger of 22 commercial banks and the establishment of Bulgarian United Bank (UBB). The process continued during the next several years and at the end of 1996 in Bulgaria remained only six state-owned banks - UBB, Bulgarian Post Bank (Post Bank), Bulbank, Expressbank, Hebrosbank and Biochimbank (Biochim). The positive effect of the

consolidation process resulted in a reduction of the financial intermediaries on the market, consolidation of the cash-flows, implementation of a branch network in the country, creation of conditions allowing to develop the competition in the banking sector.

Despite that, the consolidation process did not pass off smoothly. During the second half of 1994, Bulgaria was torn by a deep political crisis, reflected in the worsening of the economic situation in the country and mostly of the banking sector because of its key role in the economy. This necessitated to undertake immediate measures for the rehabilitation of some banks, stabilization measures for other banks, in parallel with their consolidation.

In order to stabilize the banking system, BCC undertook measures to recapitalize most of the state-owned banks, increasing their capital through cash resources or capital infusion. In March 1996 the so-called "Bulbank scheme" came into effect with the goal of assisting the rehabilitation process of the problem banking institutions. In compliance with this scheme, Bulbank sold to the State Fund for Reconstruction and Development ZUNK obligations, denominated in U.S.Dollars and amounting to 400 Million U.S.Dollars, with a 50 % discount of their face value, which equaled 200 Million U.S.Dollars. Subsequently, these ZUNK obligations were infused in the capital of banks like Expressbank, Post Bank, Biochim, Hebrosbank. The amount obtained from Bulbank was deposited with the BNB for the term of five years and with the aim to be utilized by the Central bank for the coming payments on the external debt. The use of the " Bulbank scheme " was a successful method to solve some of the current problems in the banking sector, especially when the implementation of this scheme was regulated with a ministerial ruling.

The entire consolidation and rehabilitation process of the banking system in Bulgaria was marked with difficulties that came both from economic and political factors.

First, these were problems, originated with the implementation of a set of principles and criteria, related to the consolidation of banks. The lack of a unified position in applying the voluntary consolidation and the wilful actions of the managers of some commercial banks, led to the delay of the consolidation process. Subsequently, this delay became fatal, because the worsening of the conditions in the real sector went deeper and the inefficient management of some banks led to their bankruptcy. The incapacity to guarantee an efficient management of the credit portfolio of banks also provoked serious collapse in the entire Bulgarian economy. The granting of non-collateralized or insufficiently collateralized loans additionally impeded the efforts to recapitalize the banks. The market recapitalization mechanisms didn't bring the desired results because of the lack of collectability of the loans already granted. On the other hand, BCC couldn't infinitely rely on funds from the state budget to increase the shareholders' equity of banks. This became a reason for the banks to limit at maximum the volume of the credits they grant and to invest their available resources mainly in long-term government bonds. This policy of "non-crediting", led by the banking institutions, was another cause for the recession in the producing sector, it cut the basis of any possible economic growth and impeded the functioning of the BCC in its efforts to restructure the Bulgarian banks.

Second, in the course of the consolidation and rehabilitation of the banking sector, BCC faced many legal problems, coming from the lack of adequate legal basis which should have regulated the functioning of the whole system. A serious problem was caused by the fact that the creditors were not well protected against the borrowers, because of the heavy legal procedures when repossessing a collateral, when declaring a debtor in bankruptcy, when replacing a debt against property. The cause for the small amount of investments in the country was the lack of appropriate legislation regarding the foreign investments and tax requirements. The difference between the national accountancy and the international accounting

standards created a duality when reporting the financial results and valuing the overall status of banking institutions.

The problems in the banking sector went deeper also because of the worsening macro-economic indicators. The high exchange rate in 1996, the high interest rate on all leva operations and the high inflation increased the amount of the non-performing loans, the expenses of banks on their operations on the liability side of the balance sheet, and reduced the income coming from the main operations on the asset side of the balance sheet. All these factors resulted in an increase of the negative operating result of banks. Because of the large fluctuations in the exchange rate during the year, the citizens and the companies treated the foreign currency more like an investment, instead of savings, and this caused many withdrawals of deposits in leva and foreign currency, a factor which stimulated the depreciation of the Bulgarian lev. These actions of the citizens and the companies reflected the erosion and the loss of confidence in the banking system and were followed by many bankruptcies of state-owned and private banking institutions. Moreover, the impossibility to make a prognosis even for a very short period of time repelled the foreign investors. Bulgaria became for them one of the countries with the highest investment risk.

All these factors imposed the necessity to take urgent measures for the stabilization of the banking sector and the economy as a whole. The realization of this goal should have been combined with an internal political stability, able to guarantee the consistent implementation of all aims and purposes. In February 1997, the Bulgarian socialist party that have governed the country for the period 1995-1996, lost the power and the Bulgarian people, on a democratic way, chose a new reform-minded government, which undertook the obligation to create a clear conception for the future development of Bulgaria as politically and economically stable state, and to implement all necessary reforms. In order to achieve this goal, the country should establish an economic mechanism, able to guarantee a severe financial discipline when implementing the structural economic reforms and stabilizing the banking sector. For such a well-regulated mechanism was selected the Currency Board, established on July 1, 1997. Its implementation showed the readiness of Bulgaria to cooperate with the international financial institutions on its way to achieve a permanent economic stabilization

From this moment on, the role of BCC in the economic life of the country became much more important, because of the key role that the company should play in the restructuring process of the banking system, which logical end would be the privatization of the state-owned banks.

II. Initial privatization efforts

In connection with the goals of BCC to privatize the Bulgarian state-owned banks, since in 1993 the company prepared a program, according to which the privatization process in the country shall be carried out through two main methods: sale and reduction of the equity of BCC by non-use of its right to acquire new shares in case of a capital increase. The program outlined two privatization stages - initial sales of minority stake of BCC and after that, sales of majority package of shares. In 1994 BCC sold its minority stake in Agrobusinessbank, Turistsportbank, Businessbank, First East International Bank and several other banks through bids and through the stock exchange. BCC didn't utilize its right to participate in the capital increase of Post Bank and sold its entire right to participate in the capital increase of Hebrosbank, preserving however the number of its shares in the bank within the blocking quota.

In result of its privatization activity in 1994 and the beginning of 1995, BCC sold its entire interest in six banks and reduced the number of its shares in two other banks. During that period no majority stake of BCC in the state-owned banks was sold.

In 1995 BCC didn't privatize any banks. The crisis in the economic sector, which went deeper in 1996, made impossible the conducting of privatization deals.

For this reason, until 1997 no majority stake of BCC in the commercial banks was sold. At the beginning of 1997, the BCC held majority control of six state-owned banks: Bulbank, UBB, Expressbank, Post Bank, Hebrosbank and Biochim. During the same year BCC gradually modified its priorities and concentrated its efforts in the privatization of these state-owned banks and the performance of a permanent control on their financial status, as a part of their preparation for privatization.

Almost immediately after the completion of the UBB consolidation, the European Bank for Reconstruction and Development (EBRD) expressed its wish to participate in the capital increase of the bank in the course of its privatization. After several years of negotiations, at the end of July 1997, BCC finalized its first privatization deal and successfully sold its entire interest in UBB to a consortium, comprised of EBRD, U.S. Oppenheimer&Company, and Bulbank. After the sale, the EBRD acquired 35% of the shares, U.S. Oppenheimer&Company - 29.63% and Bulbank - 35%. The new majority shareholders increased considerably the capital of the bank (about 30 Million U.S.Dollars) immediately after the acquisition and undertook the commitment to make other investments under the form of a capital, other capital form or a long-term credit, in compliance with the financial status of the institution and the necessity for its future development.

While, as of December 31, 1996, 82.2% of the assets of all banks in Bulgaria were concentrated in the state-owned banks, at the end of 1997 this percentage was reduced to 67.1% due to the sale of UBB. The privatization of UBB was of material importance for the start of the sale of the majority stake of BCC in other commercial banks.

III. Adoption of a privatization strategy by BCC

In the middle of February 1998, the BCC adopted a privatization strategy for each of the state-owned banks in which the company is a majority shareholder: Bulbank, Expressbank, Post Bank, Hebrosbank and Biochim. This strategy was developed with the clear intention to reflect the changing interest of the foreign investors and the emerging crisis in Asia. The privatization strategy was also prepared in compliance with the recommendations of international financial institutions like the International Monetary Fund (IMF), the World Bank, Bulgarian and foreign experts, and was finally approved by the Board of Directors of BCC. The privatization strategy includes several key elements which are common for all future privatization deals, and at the same time, each forthcoming privatization deal should be examined as an integral part of the overall privatization strategy for Bulgarian banks. The main aspects of the privatization strategy include the following elements:

1. Each privatization deal shall be preceded by an independent valuation of the bank, conducted by a company of good standing. The independent valuation and the results of the internal and international audit form the basis on which an Information Memorandum shall be developed (necessary to carry out a competitive bid and/or direct negotiations with potential acquirers) and a prospectus (necessary to register the shares of the bank at the Bulgarian Stock Exchange). The price resulting from such a valuation shall be set as an initial indicative price under which the Board of Directors, at its discretion, may "fall" when

reviewing bids and in the course of direct negotiations. The independent valuation shall be utilized as a basis of establishing the issuing value of the BCC's shares in case of public offering as well as of new issue of shares. The issuing value may be adjusted upward or downward, in compliance with one specific factor or a group of factors: market response to the offering or changes, occurred in the financial status of the bank. BCC shall consider the purchase price for Post Bank, Expressbank and Bulbank for its priority when assessing and classifying the bids, under the condition that the remaining goals of the privatization strategy are met or included as a commitment in the business-plan of the future purchasers of these banks; for Hebrosbank the BCC shall put the stress on the choice of a strategic investor instead of the purchase price.

2. The BCC shall undertake aggressive marketing and investment promotion in the course of each privatization deal. It shall also do its best to generate maximum investors' interest abroad and in Bulgaria. In order to achieve this goal, BCC, at the discretion of its Board of Directors, shall appoint an investment advisor on the privatization of some of the banks included in the privatization strategy.

3. Depending on the interest of the potential acquirers, the Board of Directors of BCC shall approve the privatization techniques that shall be applied in the bank privatization process - tender procedures, direct negotiations, public offering of shares or a combination of two or more privatization techniques. The privatization techniques shall be combined in a way that reflects the unique characteristics of each bank. However, in general, a strategic investor shall be appointed to purchase the majority stake; and after that or at the same time, a portion of the shares shall be floated on the Bulgarian Stock Exchange or a foreign stock exchange, and a portion shall be offered, under preferential terms, to the managers and employees of the banks.

4. Depending on the financial condition and the prospects for future development of the banks, BCC seeks to achieve a balance of the following priorities - selling the bank to investors with outstanding reputation, obtaining reasonable market price; and assuring the future development of the privatized bank by requiring from the new owners a sound business plan and commitment for capital infusion.

IV. Implementation of BCC's Privatization Strategy

IV.1. Privatization procedures for Bulgarian Post Bank

The preparation of the Post Bank privatization began in 1997. An information package was developed and was presented to the attention of investors that had expressed interest in the bank acquisition and had previously executed a Confidentiality Agreement. The Information Package contained detailed information for the financial status, the branch network, the information technologies, the staff and management of Post Bank, as well as general information for the role of BCC in the bank privatization process, the legislation etc.

In September 1997, BCC with assistance from Barents Group, advisors to the BCC under a contract funded by USAID, began an intensive marketing program for Post Bank. The marketing campaign included advertisements in several leading foreign newspapers, letters to over 100 potential investors from all over the world and a number of meetings with potential acquirers.

These intensive marketing efforts resulted in 20 letters from potential investors, in which they expressed their interest in the Post Bank privatization. Later on, several potential investors expressed a request to

carry out a due diligence review in the bank. The financial and management reviews were accomplished after the execution of a Confidentiality Agreement between BCC, Post Bank and the potential acquirers.

BCC developed instructions to the potential acquirers, containing the terms to participate in the competitive bid. A draft stock purchase agreement was enclosed with these instructions.

At the end of 1997 BCC obtained four bids for the privatization of Post Bank from the National Bank of Greece, Nomura International, Evrobank and the American Life Insurance Company (ALICO). The Board of Directors of BCC discussed the bids and appointed Nomura International as "preferred purchaser" of the bank. The bids of the National Bank of Greece and ALICO were classified respectively as the second and third best bids.

The Board of Directors of BCC appointed a team to conduct the negotiations and after obtaining a mandate from the Council of Ministers in March 1998, BCC started the negotiating process with Nomura International.

The candidates from Nomura were informed that both sides dispose of three months to finalize the Post Bank privatization deal. Despite the fact that in the course of the negotiations certain number of the differences between Nomura and BCC were overcome, the parties couldn't reach an agreement on some of the key elements of the deal. One of the problems consisted of the fact that, while during the negotiations with Nomura between March-May 1998, Nomura had indicated it would be able to finalize a new contract with Bulgarian Posts (related to the banking activity and the performance of banking services in the buildings of Bulgarian Posts) before signing the stock purchase agreement with BCC, in late June the candidates totally changed their position. It became obvious that Nomura wished to renegotiate the terms of the agreement between Post Bank and Bulgarian Posts only after it executed the stock purchase agreement. At this moment BCC understood that the achievement of an agreement acceptable to Nomura was highly questionable. This would mean that the BCC could have kept negotiating with Nomura, but the whole process could have been postponed several months before reaching an agreement; still, the possibility existed that an agreement could have never been reached. Despite all that, the Board of Directors of BCC gave one more chance for the successful completion of the deal, taking the decision to extend the term of the negotiations with 10 days. Because of the possibility Nomura to disagree with the terms of the revised contract between Bulgarian Posts and Post Bank, the Board of Directors of BCC considered that to continue its negotiations only with Nomura would threaten its intentions to complete the deal in time and took the decision to revoke the status of Nomura as a "preferred purchaser" of Post Bank. At the same time BCC decided to start parallel negotiations with the National Bank of Greece, Nomura International and ALICO. The company provided each of the three potential purchasers with a standard set of acquisition documents, containing: draft stock purchase agreement, amount of the capital increase that the potential buyers are willing to make, the current agreement between Bulgarian Posts and Post Bank, and revised financial statements of the bank (as of June 30, 1998). The BCC also asked each of the candidates to offer a draft agreement between Bulgarian Posts and Post Bank, containing the terms acceptable for the buyer.

After the expiration of the 10 days term, the National Bank of Greece submitted to BCC a revised bid, while ALICO and Consolidated Eurofinance Holding (CEH) submitted a jointly bid for the acquisition of the Post Bank equity. At this stage of the privatization process Nomura decided to drop out. As neither the bid of the National Bank of Greece, nor the bid of ALICO and CEH required a revision of the contract, BCC managed to privatize the bank earlier. The Board of Directors of BCC considered and evaluated the offers of the two bidders, according to criteria, including: the stock option agreement; the period of time during which the future owners of the bank intend to keep their shares of the bank; the amount of the

capital increase the buyers commit to make; the amount of the deposit as well as the representations and warranties which should be made by BCC. When all these elements were examined as a whole, it became obvious that the general financial terms in the jointly bid of ALICO and CEH were most appropriate for the future development of Post Bank.

In August 1998, BCC, ALICO and CEH executed the stock purchase agreement for the sale of BCC's shares in Post Bank, amounting to 78.23% of the total equity of the bank. The purchase price amounted to 38 Million U.S.Dollars and 10% deposit was paid on the signing of the stock purchase agreement. The successful aspect of this bank privatization may be assessed due to several parameters of the deal: in compliance with the stock purchase agreement, the buyers undertook the commitment to increase the capital of the bank with 20 Million U.S.Dollars within 12 months after the closing; apart that, the purchasers took the obligation to preserve their stake in the bank for the term of minimum 7 years, as well as to pay to the Bulgarian State 10% of their after tax profit within the next 5 years.

IV.2. Preparation, current status and privatization prospects for Expressbank

Since in 1995 the Italian bank "Agricola Mantovana" expressed its interest in the privatization of Expressbank, but its offer referred to the purchase of only 5% of the bank's shares.

In September 1996, Reiffeisenbank - Bulgaria sent to BCC an official request to make a valuation of the bank and to conduct preliminary negotiations for the purchase of the majority stake of Expressbank. Unfortunately, the collapse of the political and financial basis of the country interrupted temporarily these contacts.

In March 1997 a potential interest in the privatization of Expressbank was expressed by Daewoo Securities. Reiffeisenbank also renewed its interest for the sale of the majority stake of the bank. The two potential buyers carried out a due diligence review of Expressbank during June-August 1997.

In September 1997 only Daewoo Securities submitted a bid for the purchase of the BCC's interest in the bank, but BCC was not satisfied with this bid and required additional information, related to the terms and conditions of the stock purchase agreement. In October 1997 BCC prepared a standard set of acquisition documents, including: a draft stock purchase agreement, escrow agreement, option agreement and a standardized bid form. BCC gave the possibility to the candidates to propose a percentage of the purchase price that, according to them, shall be maintained in the Escrow account. Although the BCC's primary consideration in evaluating the final offers was the purchase price, a consideration was also given to the amount of funds required to be held in the Escrow account. Apart that, BCC allowed Daewoo Securities and Reiffeisenbank to conduct an additional due diligence review in November 1997. At the beginning of December same year Daewoo submitted its bid to BCC, but the Board of Directors of the company considered the bid unsatisfactory, because of the lack of commitments regarding the conducting of the deal and the purchase price, far below the valuation of BCC. Reiffeisenbank didn't submit any offer, but proposed to take the management of Expressbank and eventually, in future, to submit a bid for the purchase of the bank.

As a part of the whole privatization strategy for Bulgarian banks, made in February 1998, BCC prepared a new privatization program for Expressbank which is already in process of implementation. This program includes the appointment of investment advisor on the privatization of Expressbank, which shall be performed with the financial assistance of the PHARE program of the European Union (EU). The terms of reference for the investment advisor were developed in advance; they highlight the key requirements for the advisor when performing the privatization deal - performance of independent valuation of the bank;

preparation of Information Memorandum and a prospectus; conducting an extensive marketing strategy in order to attract the most suitable investors for the bank.

At the beginning of August 1998, a consortium comprised of HSBC Investment Bank and Deloitte&Touche - Bulgaria were appointed as investment advisors for disposition of BCC's 98% equity in Expressbank. The advisor already started its work and it is expected to submit a short-list of strategic investors of the bank to BCC. According to the privatization strategy for Expressbank, a majority stake of the banking institution (about 80%) shall be sold to a strategic investor through an open bid procedure; there is also an option to sell the controlling interest of the bank to two strategic investors in proportion 40:40% or 50-30% of the stock.

It is possible to sell 5-8% of Expressbank's shares to a third investor which maintains good relations with the bank. This part of the privatization strategy shall be realized after the completion of the majority stake deal and after the consent of the strategic investor.

In compliance with the privatization strategy, after the preparation of a prospectus, certain percentage of the shares shall be offered at the Bulgarian Stock Exchange. At the discretion of BCC's Board of Directors, the managers and employees of Expressbank will be given the possibility to purchase, under preferential terms, the remaining small amount of the bank's shares.

IV.3. Preparation, current status and privatization prospects for Bulbank

The privatization of Bulbank will be the most important of all privatization deals in Bulgaria. The size of the bank which manages 70% of the total assets of all state-owned banks and its importance for the Bulgarian economy will attract the attention of investors around the world. This privatization deal will raise interest not only among the potential acquirers, specialized in investments in financial institutions, but will also generate a wider interest, because of the fact that the Bulbank activity is perceived as a mirror-image of the status of the whole Bulgarian economy.

In compliance with the privatization strategy for Bulbank, the appointment of an investment advisor and the financial assistance of its work, shall be accomplished with the help of the PHARE program of the EU. At the end of August 1997, the EU approved as investment advisor for Bulbank a consortium, comprised of Creditanstalt Investmentbank (CAIB Investmentbank), Credit Suisse First Boston and Arthur Andersen. The obligations of the investment advisor include the conducting of an independent valuation of the bank, the preparation of Information Memorandum (including a due diligence review) and the establishment of prospectus, necessary for the future floating of the shares on the stock exchange. After completing the due diligence review and the independent valuation of the bank, the investment advisor shall start conducting an aggressive marketing campaign and investment promotion. Despite the fact that the privatization techniques and the main parameters of the deal depend on the investment advisor, the privatization strategy for Bulbank outlines the directions that shall be followed when conducting the privatization deal. The first two parameters of the transaction include the sale of the majority stake of the bank to one or more strategic investors and the registration of a certain amount of Bulbank's shares to an international stock exchange or the Bulgarian Stock Exchange.

About 5% of the capital of Bulbank may be offered for sale, under preferential terms, to the managers and employees of the bank. This option shall be carried out only after the sale of bank's shares to a strategic investor have been completed and Bulbank's shares have been registered on the Bulgarian Stock Exchange. This initiative would be a well-deserved remuneration for the efforts, exerted by the employees

and managers of the bank and an additional incentive for their future work which should guarantee the stability and prosperity of Bulbank in the new economic reality.

IV.4. Preparation, current status and privatization prospects for Hebrosbank

The Hebrosbank privatization was started with the conducting of a financial and management review of the bank by a team, composed of experts from the Banking Supervision Department of the BNB and Barents Group consultants. The review was completed in July 1998 and led to the preparation of an Information Memorandum, containing all necessary financial and legal information, related to the bank.

On the basis of the results of the financial and management review, in August 1998 BCC adopted a revised privatization strategy for Hebrosbank which included two possible directions for the privatization of the bank:

1. The first direction of this strategy is already in process of implementation. BCC presented the Information Memorandum to potential investors from the Balkans, which have expressed interest in the privatization of the bank and executed a Confidentiality Agreement with BCC. In the near future they are expected to ask to perform a due diligence review in Hebrosbank. In case this review results in the submission of at least 3 or 4 letters of intent of serious strategic investors, regarding the purchase of the majority stake of the bank, BCC is ready to initiate privatization procedure for Hebrosbank.

2. The second direction of the privatization strategy will enter into effect only if the above actions of BCC don't result in the sale of the bank. In this event BCC will appoint an investment advisor, which activity will be financed by the PHARE program of the EU (through the SARA program) and by proceeds, resulting from the Hebrosbank privatization. The investment advisor will be appointed on an international tender basis by a Commission that includes representatives of BCC, Hebrosbank, the SARA program and the EU. The work of the investment consultant will be based on preliminary developed Terms of Reference, which will include the conducting of an independent valuation of the bank, initiation of a marketing campaign on the privatization of the bank and the offering of a short-list of potential buyers of Hebrosbank.

Notwithstanding which of the two directions will result in the sale of the bank, the main parameters of the deal shall include:

- sale of a package of shares of Hebrosbank (about 60-70%) to a strategic investor. At the insistence of the strategic investor, BCC is ready to offer to it all its shares in the bank, and in this case the company will renounce to sell a part of its shares through the Bulgarian Stock Exchange and won't sell another part of its shares to the managers and employees of the bank.
- offer of about 30% of the bank's stock at the Bulgarian Stock Exchange. The preparation for the public offering and the registration of the shares at the stock exchange shall be performed by the investment consultant.
- upon a decision of the BCC's Board of Directors and after consultations held with the investment advisor, about 2-5% of the shares will be offered for sale under preferential terms to the managers and the employees of the bank. The value of the preference will be additionally determined by the BCC's Board, depending on the financial results of the bank and the input of the managers and employees of Hebrosbank in the privatization process.

This part of the privatization strategy will be applied after the sale of the controlling stake to a strategic investor and after the registration of bank's shares at the stock exchange.

IV.5. Preparation, current status and privatization prospects for Biochim

At the end of 1996 and the beginning of 1997, Biochim was the only state-owned bank which suffered from liquidity shortage. A considerable part of its depositors (citizens and companies) withdrew their deposits from the banking institution.

In order to overcome this problem, the State, represented by BCC, carefully analyzed the situation and decided to provide financial assistance to the bank. The state "injected" in the bank about 20 Million U.S.Dollars under the form of government securities and at the same time undertook energetic measures to improve Biochim's management. Moreover, in June 1998 was developed and adopted a program for the financial stabilization of the bank. BCC imposed a number of restrictions in the credit activity of the banking institution. Biochim was obliged to grant credits only to good and reliable borrowers, disposing of good business plan. For a certain period of time the bank was forbidden to exceed a determined credit limit within its credit exposure, as of the end of March 1998.

Due to the coordinated actions of BCC and Biochim's management, the liquidity problems of the bank were overcome and the banking institution was quickly stabilized. Several months later, in August 1998, Biochim began to generate profit. The whole activity of the bank was considerably improved and gradually it restored the confidence of its customers.

At the end of 1997 Biochim reported 990 Million Leva profit and its general capital adequacy reached 11.2% (with 8% capital adequacy requirements by the BNB regulations).

The successful development of Biochim continued in 1998. For June 1998, the bank reported 10.5 Billion Leva after tax profit.

Despite the good financial status of Biochim, the BCC's Board of Directors considered the bank is not still ready for privatization and needs to be partially restructured. For this reason, according to the privatization strategy for Bulgarian banks, BCC shall first conclude a management agreement with a foreign managing team for the term of two years, and within this period of time the bank shall be prepared for privatization. At the beginning of September 1998, BCC appointed a team of four experienced foreign bankers, that shall take leading key management positions in Biochim's Managing Board. The first foreign banker will be appointed as a chief executive director and two other bankers - as members of the Managing Board, responsible respectively for the credit activity and the accountancy and information technologies. The fourth foreign manager will be responsible for the internal control, and without being member of the Managing Board, will report directly to the Supervisory Board of the bank.

In order to overcome this period of transition, related to the appointment of new foreign managers, a part of the actual bank's managers will keep their positions as members of the Managing Board or as consultants to the team of foreign managers. Apart that, BCC will directly appoint one representative of BCC in the Managing Board of Biochim. At the end of the two-year period after the conclusion of the management agreement, BCC expects the bank to improve even more its financial results, to reduce its administrative costs, to close some losing branches and to be privatized.

Conclusion

The banking sector is a complex mechanism which should be examined in the context of a number of factors, both internal political and economic, and also in the light of the world economic processes. In this sense, year 1998 for Bulgaria represents a new stage of the country's political maturity and economic renaissance. The economy celebrated its first anniversary in the conditions of a Currency Board - a guarantor for the presence of financial discipline and stability. In the banking sector this change was expressed in the improvement of the financial indicators of banks, the reduction of all ineffective costs and optimization of the overall activity of the banking institutions. All these factors led to the stabilization and restoration of the society's confidence in the banking sector.

At the same time, the financial world witnessed the deepening of a financial crisis of worldwide importance, which was provoked by the markets in south-eastern Asia and Russia. As the future development of Bulgaria can't be examined separately from the trends of development in the world economy, this financial collapse will undoubtedly have an impact on the Bulgarian economy. For the moment it's impossible to foresee this effect as a whole, but two events give us a direction for the possible future development of the process. The first event is the meeting of the World Bank in Washington in October 1998. On this economic forum Bulgaria was presented as a country which has at its disposal a set of mechanisms to resist against the world crisis - stable macro-economic factors, considerable inflation drop, interest rate reduction and increase of the BNB reserve. The progress Bulgaria made in the bank privatization was also assessed. As a kind of positive estimation may be considered the interest of the International Financial Corporation and EBRD to participate as portfolio investors in the privatization of the Bulgarian state-owned banks in a moment when the entire financial world is concerned about the crisis and seeks how to escape from it. The second event, which already became traditional for Bulgaria, is the Bulgarian Investment Forum, held in Sofia, for the period 12-14 October 1998. On this forum Bulgaria confirmed its image in the world as a country, ready to defend the positions gained in the conditions of the world financial crisis and to generate interest even among the most prudent investors. In conclusion, I would like to emphasize that the credit of confidence Bulgaria obtained one year ago from the international financial institutions, was justified with dignity by the country and for this reason, in the conditions of financial crisis an insecurity, Bulgaria remains attractive for the foreign investors with its stability and prospects for future economic growth.

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Sofia