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KEY CHARACTERISTICS AND SCOPE OF THE BULGARIAN CORPORATE BOND MARKET

The aim of this paper is to investigate the main Bulgarian corporate bond attributes, such as: size of issue, industry, currency, maturity and floating rate occurrence, from 2004 to 2014. In addition, important parameters such as the object of allocations of funds, collateral and the ownership concentration of issuers are exposed. Examples of prospectus clauses undermining corporate bond safety and soundness are also detailed and evaluated.

Bulgaria's corporate bond legislation is analysed in relation to the potential of loopholes allowing for issuers' actions being taken against the interest of bondholders. The possibility of the former stems from loose norms of a regulation permitting an ease alteration of base loan parameters. Finally, the sample corporate bond performance is analysed in terms of defaulted and restructured bond issues from 2016 perspective.

JEL: G10; G23; G28; G30

Introduction

The existence of a well-functioning corporate bond market is crucial for the efficiency of financial markets and real economy funding. Corporate bonds provide advantages to corporations, investors and the economy as a whole. Through corporate bonds, corporations are able to raise steady amounts of financing at a lower cost and reduced dependency on loans from the banks. An additional cost advantage is provided by means of a reduction of disintermediation fees.

Because of the services associated with the corporate bond market, investors are able to gather information, and thus, to value corporate entities more precisely and diversify their portfolios with yet another class of assets. Corporate bonds reduce the burden on other sources of financing of business, promote investors' vigilance and reduce the vulnerability of the economy at times of cyclical downturn.

The Bulgarian corporate bond market emerged a decade after the democratic changes of 1989. This was not just a "new era" or "re-emergence" of the country's domestic corporate

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bond market, but essentially its birth as it was almost non-existent prior to 1989 during the communist regime.[2]

The corporate bond issuance in recent Bulgarian history commenced in 2000. The face value of non-financial corporate bonds amounts to 1.3% of the country's GDP for this year. The outstanding principal of corporate bonds grew and peaked at 4% of Bulgarian GDP in 2006 (Eurostat, 2018). Such an extent of corporate bond financing is obviously insufficient for a growing economy to reach a momentum.

Bulgaria's late arrival in the corporate bond market was far from unique in European terms. In fact, the lack of developed and well-functioning corporate debt markets was the norm throughout continental Europe up until the mid-1990s despite the dominance of different forms of the market economy. The latter is mostly a consequence of bank lending being a dominant form of debt intermediation (Schinasi and Smith, 1998). Here contemporary Europe differs from the United States where financing through corporate bonds has been much more prevalent. Europe's relative 'gap' with the US is attributable to a range of factors, notably historically evolved cultural and legal practices and the dominance of bank lending over that from the corporate bond market. This situation, however, is changing. The 2009 post-crisis trend shows a growth in corporate bond financing across Europe, while bank lending remains rather stagnant (Kaya and Meyer, 2013). Thus, the importance of corporate bond financing will increase as long as bank lending continues to lessen in the future (ICMA, 2013).

The second important factor driving these changes is the EU effort to develop an integrated capital market. Compared to the US approach to corporate bond market, EU law – in an attempt to boost the market – seems to favour bond issuers over bondholders. The differences are mostly evident in the mandatory information disclosure regime, published in the prospectus. EU corporate bond prospectuses do not contain information about the remuneration and benefits paid to corporations' administrative, management, or supervisory bodies. The EU Prospectus Directive[3] has a more loose structure that shields issuers from the massive shareholder class actions so widespread in the United States. However, "when issuers are not haunted by the spectre of potential litigation by investors for disclosures they make in a prospectus, the disclosure framework can provide issuers with more leeway to determine what information is material to investors and must be disclosed (Kung, 2005)." These concessions may motivate borrowers to resort more often to the bond market, but on the other hand, assuming some degree of opportunism, may erode the lenders' base.

Turning back to Bulgaria and having in mind the substantial stock of bank deposits at virtually zero interest rates and Bulgarian entrepreneurs' inclination toward debt financing, this study addresses the problematic areas of the Bulgarian corporate bond market. An ideal

[2] „Although incomplete, data for firm bonds are gathered from the State Gazette balances. The interest rate is averaged of the interest rates of the two bond issues known prior to 1945 – Electric Power Sofia and Electric Power Bulgaria, i.e. 4.25%." (Ivanov, 2004).

[3] Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC.

type corporate bond market would suggest more efficient allocation and enhancement of the lending base, as well as barring access to the market of deceptive issuers. The first part of the article summarises the key characteristics of Bulgarian corporate bonds, i.e. – the newly issued debt and its interest rate, the nominal value, maturity, fixed or floating interest rate and covenants. The second part analyses the issuers' profile features, drawn from bond prospectuses, such as the purpose of the loan, collateral and issuer ownership concentration. The final part investigates the legislative basis for the renegotiation of debt, and subsequently bondholders wealth expropriation

Key characteristics of corporate bonds

There are two main methods for issuing corporate bonds – public offer and private placing. The public offer requires a mandatory information disclosure, reckoning with certain regulatory provisions and publishing a prospectus *inter alia*. The private placement does not call for publishing a prospectus, when securities are offered to a limited number of investors or to professional investors.

The prevailing number of corporate bond issues in Bulgaria have been carried out through private placing. For the period 2004-2014 the sample consists of 138 issues in total with 135 of them privately executed. However, within a year of inception, these 135 issues gained a public status through a procedure known as an "admission to public listing". The latter is legislated through an EU directive (***Directive 2003/71/EC***) and transposed into the Bulgarian law, aiming at "boosting the market liquidity". That change led to unprecedented growth of the Bulgarian corporate bond market, taking into consideration the embryonic stage of development, lack of previous experience and a stagnant, virtually fibrillating stock market.

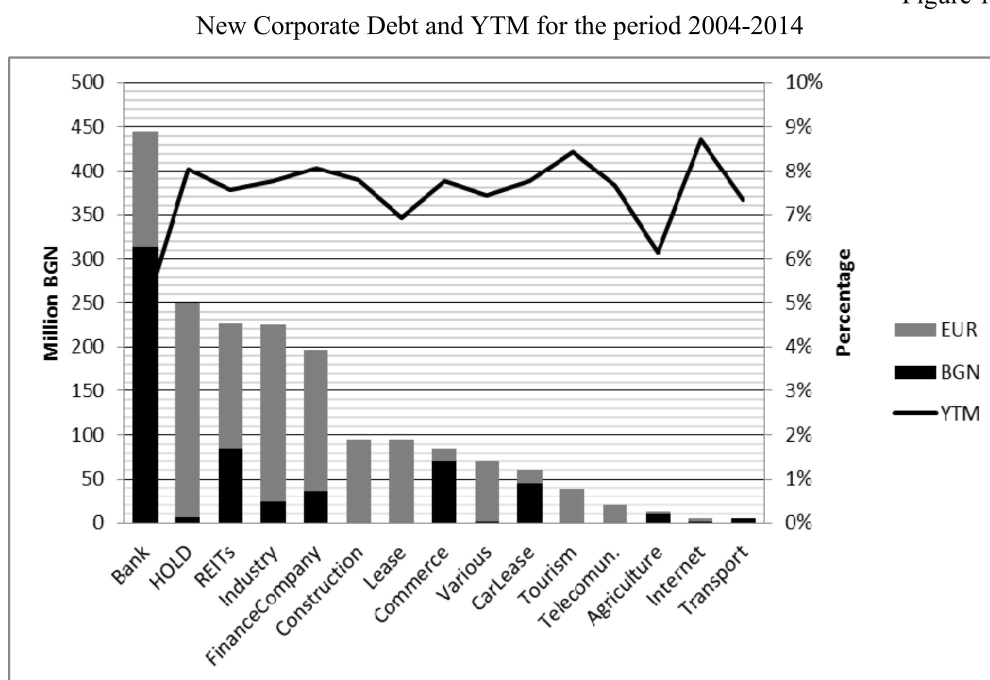
Fig. 1 attempts to answer the question: "Who does issue corporate bonds in Bulgaria?" Most issues are Euro denominated and other – in the local currency, the Bulgarian lev (BGN)[4]. The face value of the newly issued debt is expressed in Bulgarian lev. The right-hand axis depicts the average yield to maturity (YTM) of issuers, at the moment of issue.

It emerges that the banks are leaders in issuing corporate bonds, followed by Real Estate Investment Trusts (REITs) and Holding companies for the period 2004-2014. They also appear to have a competitive cost advantage, borrowing at lowest interest rate (less than 5% pa), in contrast to the rest of the issuers. Note the large volume of issues is accomplished by financial intermediaries. Besides banks, the latter include REITs, financial companies and lease companies. This trend of corporate bond issuance does not correspond to the worldwide pattern of dominance by non-financial corporations.

[4] The exchange rate of the Bulgarian lev (BGN) is fixed to 1, 95577139 BGN per 1 Euro, since the adoption of a currency board in 1999.

Figure 1

New Corporate Debt and YTM for the period 2004-2014



Source: Bond issue prospectuses, Author's calculation.

The YTM has 2 fractions – coupon yield and capital gain or loss. For the purpose of this study, the yield to maturity is derived from the bond prospectuses at the moment of the sale to qualified (professional) investors, by a private placement. At this moment, the corporate bond yields consist only of a coupon yield, as they are sold at par, so that the capital gain is zero. The market interest rate fluctuates, which causes fluctuations in the bond prices, after corporate bonds are admitted to the secondary market trading. The coupon rate, as a fraction of YTM, should be constant until maturity as a general rule. However, as regulatory norms allow alterations in the parameters of corporate bonds, including the coupon rate, the YTM for the issuers (alternatively, cost of capital) may not be the same as that originally laid out in the prospectuses. Thus, the issuers who have succeeded in reducing the original coupon rate, have enjoyed a lower cost of borrowing. On the other hand, investors in corporate bonds with a reduced coupon, will not be able to achieve the envisaged YTM, even if they hold these bonds until maturity. Table 1 presents the corporate bonds, whose coupon rate underwent a fall.

Inasmuch as some corporate bonds have experienced a coupon rate reduction, the original YTM presented in Figure 2 will be further lowered.

Table 1

Corporate Bonds with reduced coupon rates

Year	ISSUER	Currency	Principal (million BGN)	Original Coupon rate	Date of issue	Original maturity date	Altered Coupon rate
2006	East Gas Company	EUR	2.94	0.082	26.6.2006	26.6.2011	0.05
2007	Intercapital REITs	EUR	9.79	0.09	14.8.2007	14.8.2010	0.06
2009	Auto Union Group	EUR	14.69	0.095	14.4.2009	14.4.2014	0.0625
2009	Assen's Fortress	EUR	11.75	0.11	30.1.2009	30.1.2015	0.072
2010	Specialised Logistic Systems	EUR	3.92	0.075	4.5.2010	4.5.2015	0.06
2011	Azzalya	EUR	11.75	0.08	15.12.2011	15.12.2019	0.045
2011	Astera	EUR	9.79	0.08	14.3.2011	14.3.2018	0.045
2011	JPS Control	EUR	7.84	0.07	10.1.2011	10.1.2016	0.05
2011	VEI Project	EUR	1.96	0.085	2.12.2011	2.12.2016	0.055
2012	Gipsum	EUR	9.79	0.08	5.4.2012	5.4.2019	0.03
2012	Auto Union	BGN	6.8	0.0675	10.12.2012	10.12.2017	0.0625

Source: Bond issue prospectuses, Bulgarian Stock Exchange News Platform, Author's calculation.

Tendulkar and Hancock (2014: 24) provide evidence of the global trend of corporate bond issuance by financial and non-financial corporations. In 2000 the value of issued corporate bonds by financial and non-financial corporations was more or less equal. Financial corporations formed a larger share of corporate bond issuance (59%) by 2007, but with the evolution of the financial crisis, their percentage dwindled. During the period 2007-2013 financial corporations reduced the volume of newly issued debt from $1.2 trillion in 2007 down to $1.1 trillion in 2013, despite the record-high $1.4 trillion in 2009. Over the same period of time non-financial corporations nearly doubled the value of bonds they issued, reaching $2.1 trillion, or 66 percent of the total issuance in 2013.

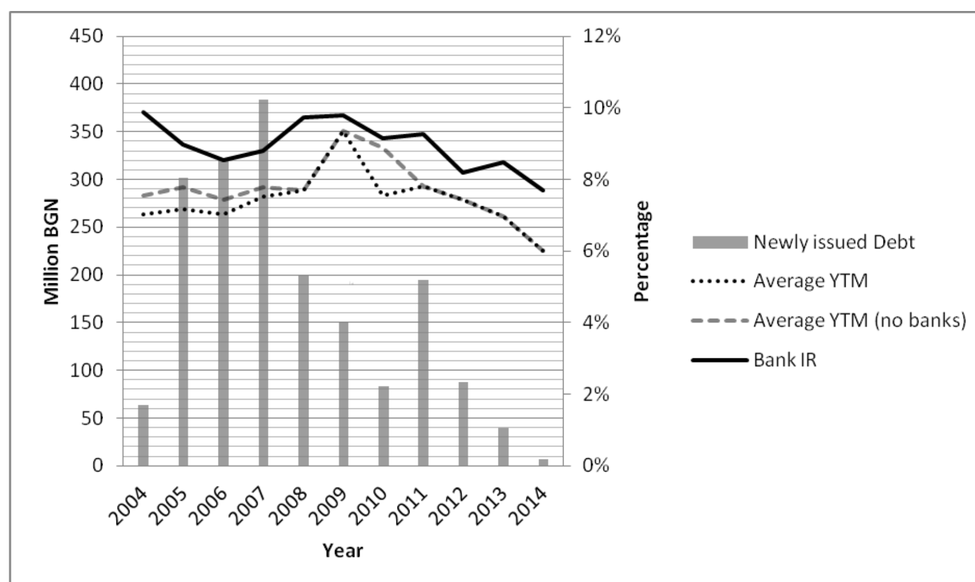
On that account, it seems compelling to trace the issuance activity, as well as the average yield year-by-year. Figure 2 provides these details.

The largest volume of newly-issued corporate debt was issued in 2007. This was the year when Bulgaria finally acceded to the European Union, and that naturally led to a standard of living and GDP growth higher expectations. In the run-up to EU accession, everything grew – FDI, real estate prices, deposits and bank loans, GDP and last but not least – interest rates. The global financial crisis hit Bulgaria with a lag in 2008, but the corporate bond market did not experience a severe drop, rather a gradual contraction. That might be due to several reasons. One is the momentum – issues which gained access to the public trading in 2008 had been privately placed and negotiated a year earlier. The other reason is the competitive cost of servicing the debt, compared to the cost of bank lending. Thirdly, the

globally ongoing phenomenon of disintermediation along with the deleveraging of banks also mattered to some degree.

Figure 2

Newly Issued Corporate Debt, Average YTM and Bank Interest rate by Year[5]



Source: Bond issue prospectuses, Bulgarian National Bank Interest Rate Statistics, Author's calculation.

In order to compare the cost advantage of corporate bonds to commercial bank loans an equally weighted average yield and interest rate at the moment of issuing are calculated.[6] The data of fixed coupon (or spread over benchmark) rates and interest rates on commercial bank loans to non-financial corporations is obtained from prospectuses and Bulgarian central bank statistics.[7]

There is a considerable cost of debt divergence in favour of corporate bonds from 2004 to 2009. Subsequently, the variation narrows, due to diminishing demand for bank loans while the saving base widens just as the Global financial crisis takes hold. Note that the cost advantage of corporate bonds over bank loans abates somewhat, when bank issues are excluded from the sample. As a whole, the volume of issued corporate bonds subsides after

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[5] 2014 is not representative, due to delayed publication of bond floatation.

[6] The commercial bank lending rates are referred at the moment of allowing credit, for terms from 1 to 5 years. The yield to maturity of corporate bonds are taken from their prospectuses. Note that corporate bond yield may vary after IPOs, due to fluctuation in benchmark reference rate or amendments in coupon rate.

[7] Interest rate statistics, Bulgarian National Bank.

2011, though 2014 data is not representative, as some issues may be omitted, due to time lags in publication.

However, such a deduction can be deceptive due to several factors. First of all, it does not take into account the transaction costs. Such costs apply to corporate bonds and bank loans. While the transaction costs of bond issues can be derived from prospectuses, the transaction costs of bank loans are not revealed by banks. Second, the average numbers conceal the difference in terms of size, duration and currency denomination of corporate bonds and bank loans. However, something can be done with respect to the currency denomination. The Euro Denominated Average Bank interest rate is exhibited in the last row of Table 2. The first row of the same table shows the YTM on Euro denominated corporate bond issues.

Table 2

Average YTM on Euro and Lev Denominated Corporate Bonds and Average Interest Rate on Euro Denominated Bank Loans (2004-2014)

Year / YTM/ Interest rate	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Euro denominated corporate bonds (%)	7.00	7.75	7.44	7.76	7.13	8.96	8.98	7.69	8.15	7.22	
Lev denominated corporate bonds (%)	7.37	7.93	7.69	7.33	8.09			7.07	6.43	6.69	6.00
Number of Euro to Lev issues	1:4	12:3	19:3	21:1	10:6	10:0	4:0	11:04	5:4	5:2	0:2
Euro Denominated Average Bank interest rate (%)	8.81	7.91	7.89	8.17	8.84	8.99	8.26	8.91	7.78	7.53	7.38

Source: Bond issue prospectuses, Bulgarian National Bank Interest Rate Statistics, Author's calculation.

It is evident that a cost advantage on Euro-denominated corporate bonds compared to Euro-denominated bank loans prevailed until 2009. However, the difference is mitigated or reversed in the period after the financial crisis.

Choosing the face value of corporate bonds implies two considerations. Larger denominations hamper small investors in buying corporate bonds. Note that the average salary in Bulgaria is approximately 500 Euro per month, and nominals over 100 Euro or 200 BGN may be an obstacle for small investors.

Smaller denominations, on the other hand, will increase the issuing cost (Central Depositary services) as well as secondary trade costs. In our sample, most issues are denominated in Euro, and over 98% of the bond value outstanding have a face value €1000. Issues denominated in BGN constitute nearly a third of the total bonds outstanding. The preferred face value is 1000 BGN. Two extreme issues are 1 BGN and €50000 face value.

Table 3

Nominal (Face) Value and Currency Denomination of Corporate Bonds

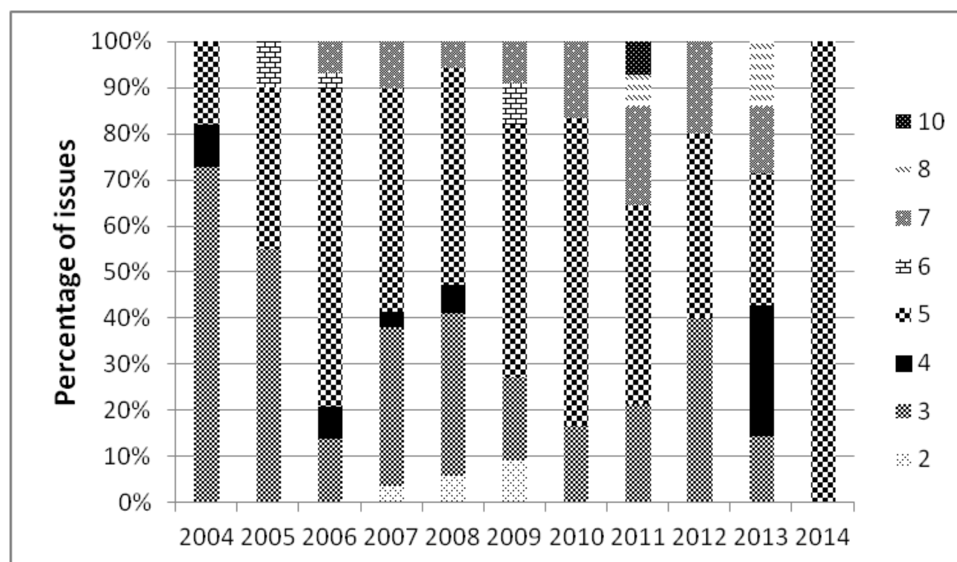
Issues Denominated in BGN				Issues Denominated in EUR		
Face Value (BGN)	Number of issues	Total principal in millions of BGN		Face Value (EUR)	Number of issues	Total principal in millions of BGN
1	1	5.25				
10	1	3		100	1	19.59
100	2	43.6		1000	103	1304.79
1000	29	452.05		50000	1	1.96
Total	33	503.9		Total	105	1326.34

Source: Bond issue prospectuses, Author's calculation.

Figure 3 represents the maturity structure of newly issued corporate bonds each year from 2004 to 2014. Longer maturity implies that bondholders are confident that the issuer is safe and sound. Unsurprisingly, at the early stage of bond market activity in Bulgaria (2004, 2005) issues with short maturity prevailed, namely 3 years. As the market evolved, 5 years and longer maturities become dominant. The latter include 6, 7 and 8-year terms. 2011 saw even a 10 years maturity issue.

Figure 3

Maturity Structure by Year



Source: Bond issue prospectuses, Author's calculation.

The practices within the Bulgarian corporate bond market do not preclude the application of floating interest rates. In this instance, the coupon rate floats depending on some index value. So far, the indices used are 3 and 6 months Euribor to Euro-denominated issues and 3 and 6 months Sofibor – to BGN denominated issues. Floating rate bonds reduce the price risk for both borrowers and investors. The coupon fluctuates, so it is less likely to differ substantially from the current market yield-to-maturity. In addition, the coupons may have a “collar” – the rate cannot go above a specified “ceiling” or below a specified “floor”.

Table 4

Floating rate corporate bond in Bulgaria by Issuer and Year

Issuer	Year										
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Bank	2	1	2	2							
HOLD	0	1		1							
REITs	0		1	1						1	
Industry	0	2	3	1	1						
FinanceCompany	0	4	1	1	1						
Construction	0	1	1								
Lease	0		3	2	1					1	
Commerce	0		1	1							
Various	0				1			1			
Car Lease	0		1	3							
Tourism	0		1								
Telecom	0										
Agriculture	0		1								
Internet	0		1								
Transport	0										
Total Floating	2	9	16	12	4	0	0	1	0	2	0
Percentage of Total	25	50	64	50	24	0	0	7	0	29	0

Source: Bond issue prospectuses, Author’s calculation.

It is remarkable that floating rate bonds (FRB) were fashionable from 2004 to 2008, and virtually disappeared afterward. The reason for the evaporation of new issue Floating Rate Bonds after 2008 may relate to the stark fall in Interbank Rates, amid the Financial Crisis. Out of 46 FRB, 12 are issued with floors – Euri/Sofi-Bor, but not less than the specified fixed rate.

A bond indenture is likely to contain a number of *protective covenants*, especially when a bond has no collateral. *Protective Covenants* are restrictions designed to protect bondholders, and in general appear in a form of a negative and positive covenant. A *negative covenant (“thou shalt not”) for example* is when the firm cannot pay dividends to stockholders in excess of what is allowed by a formula based on the firm’s earnings. A *positive covenant (“thou shalt”) example* is when proceeds from the sale of assets must be used either to acquire other assets of equal value or to redeem outstanding bonds.

Table 5

Financial Covenants of Bulgarian Corporate Bonds from 2004 to 2014

		Smaller or greater than:							
Covenants	Number of issues	<1	<0.95	<0.9	<0.85	<0.8	<0.75	<0.7	<0.65
Ratio L/Assets	50	4	17	14	2	3	6	1	3
			<1.1	<0.4					
Ratio L/Equity	2		1	1					
			>0.2						
Ratio Equity/Assets	1		1						
			<0.02						
Arrears/Lease portf.	1		1						
		>4	>3	>2	>1.5	>1	>0.2		
Interest Coverage	44	1	1	4	5	30	3		
New Debt	Most Issues								
Dividend Restrictions	3								
Retention ratio	1								

Source: Bond issue prospectuses, Author's calculation.

Positive covenants specify things that a borrower must do. Some of the most common positive covenants commit the borrower to maintain a minimum level of net working capital. Inadequate liquidity is a common precursor to default. The borrower is often considered to be in default on all debts if it is in a default on any debt to any lender (cross-default covenant).

Negative covenants specify what a borrower must not do. Common negative covenants often set restrictions on the fixed assets of the firm with respect to liquidation and acquisition. Many debt agreements prohibit borrowing additional long-term debt or require additional borrowing to be subordinated to the original claim. Most Bulgarian corporate indentures include cross-default covenant and prohibit borrowing additional long-term debt or require additional borrowing to be subordinated to the original claim.

Table 5 shows a detailed outline of the financial covenants of the sample corporate bonds, issued from 2004 to 2014. It is interesting to note that covenants are applied not only to debentures (unsecured loans), but in some cases – to secured loans too. Out of 55 bond issues with covenants, 50 include restrictions on the ratio Liabilities/Assets. In 35 cases that ratio must be less than 0.9, implying that the equity capital ratio may not be less than 11% of the liabilities, corresponding to a leverage ratio up to 9!

There are 4 bond issues that dare even to impose "restriction" of less than 1, which means that *the borrower has no requirement to maintain any equity*. It seems, the threshold of these restrictions are somehow "arbitrary", chiefly set because "there must have" such covenants because of regulations. The preposterous values of Liabilities/Assets covenants instigate at least some important questions. Are investors, (most of which are institutional – for example, pension and insurance funds) unable to spot a palpable ploy? Does the regulator's (Financial Supervision Commission) prospectus overhaul care only for the formal presence of the mandatory information?

The other popular financial covenant restriction is interest coverage, or the ratio Earnings Before Interest and Taxes (EBIT)/Interest. The true level of the minimum acceptable interest coverage ratio varies across sources. According to the Corporate Finance Institute (CFI, 2019), as a general benchmark, an interest coverage ratio (ICR) of 1.5 is considered the minimum acceptable ratio. An ICR below 1.5 may signal default risk and the refusal of lenders to lend more money to the company. Another scientific source (Ross, 2006:120) states that a ratio of 2.5 times or so is generally the minimum acceptable level. A more sophisticated approach is applied by Bhattacharya (Bhattacharya: 181), who distinguishes between developed and developing markets. He states: "In developed countries, it is widely held that the (coverage) ratio should be between 5 and 7. Such a high coverage is possible there because of a low debt-equity ratio. In developing economies like India, where the debt-equity ratio is generally high, a lower coverage is nothing but expected. Generally, for a manufacturing firm in India, a coverage of 3 is a reasonable standard." A short screening survey[8] on the interest coverage ratio of the public stocks listed at the Bulgarian Stock Exchange – Sofia, has shown that 71 stocks have a ratio above 3. Between 2 and 3 are 18 stocks, between 1 and 2 – 34 stocks, and finally – 77 stocks have an interest coverage ratio below 1.

In our sample, only 6 out of 44 issuers declare a ratio above 2. At the extreme, 33 issues impose a ratio above 1, which means an EBIT of just enough to pay the interest! An interesting point is that 44 issues with covenants are also collateralized.

Corporate bond funds allocation, collateral and issuer ownership concentration

As mentioned earlier in the text – there are two routes through which a prospective corporate bond issuer may gain a public status. These are through a public offer and a private placing. No matter which path is chosen, an issuer must meet first the statutory requirements set in the Bulgarian Commercial Law. According to the above (Commerce Act of Bulgaria) Debentures[9] may only be issued by a joint-stock company. The issuance of debentures by public offering may be done at least two years after the company's recordation in the commercial register at the earliest, and provided it has two annual financial statements that have been approved by the general meeting.

Note that the issuer is not necessarily a publicly traded company, nor a company that operates on profit two years prior of the corporate bond issue. In addition, a confusion erupts from the peculiar legislation and misleading interpretation of the form of business organisation, i.e. 'joint-stock company'. The English-speaking world will probably regard it more as a "Private Limited Liability Company"[10]. An important feature of the 'joint-stock

[8] Survey has been performed on 9/03/19 with the aid of Infostock.bg screening services.

[9]Debentures is incorrect translation. The original in Bulgarian language refers to 'Bonds'.

[10] The Bulgarian Commercial Low recognises two major form of non-publicly traded limited liability business organisations. These are 'Art. 113. A ***limited liability company*** may be formed by one or more persons who shall be liable for the company's obligations to the extent of their share contributions to the company's capital.' and 'Art. 158. (1) A ***joint-stock company*** is a company the capital of which is divided into stocks. The company shall be liable before its creditors with its assets.' There are several substantive differences between them:

company' that possibly can affect the rights of bondholders is that a joint-stock company *may be founded by one or more natural or legal persons. That will potentially secure an influential standing of the borrower, in case of loan renegotiation.*

Accessing public trading, no matter whether directly by IPO or in a roundabout way *of private placement followed by admission to public trade, is channelled according the requirements of the European* (***Directive 2003/71/EC***) and national (Financial Supervision Commission, FSC, 2003) legislation.

Almost all issuers resort to the second option – private placement targeting institutional and professional investors, followed by an application to FSC and Bulgarian Stock Exchange (BSE) for public listing. Only at this stage must the issuer conform to the public trading requirements and minimum information disclosure set by Prospectus Directive.

Obviously, accessing corporate bond public trading after private placing is a way for an easier entry – and possibly a way to circumvent the law. The latter is acknowledged by the regulatory body, the Financial Supervision Commission (FSC) and will be further expounded.

Having in mind the above-underlined peculiarities of the Bulgarian corporate bond market, the present paper attempts further to analyse some important parameters, concerning the public interest, such as the aim of the issue (purposed allocation of the raised capital), corporate governance of the issuer and type of collateral. The information is derived from the prospectuses of issuers in Bulgaria from 2004 to 2014.

The object of the issue delineates the allocation of the funds raised by the corporate bond subscription, implying the risk and expected return from the undertaking. Out of the total 138 issues, 30 have a clearly defined object, 72 – ambiguous and 36 either lack any or are so obscure that it makes setting the allocation of funds difficult. For instance, the last group includes objects stated as: “funding the accomplishment of the signed contracts' or 'funding the basic activity of the firm”. The issues with a lacking object were reduced down to 16, after associating the basic activity of the issuers, as described in their financial reports, Summarisation of the allocation of funds as declared in prospectuses is exhibited in Table 6.

- A ***limited liability company*** requires a minimum initial capital paid by owners of 1 Euro. For the ***joint stock company*** this amount is much larger – about 25000 Euro. However, in order to start its operation, the ***joint stock company's*** stockholders are solicit to pay only 25% of the statutory minimum capital in;
- A ***limited liability company*** owners are involved in everyday running of the firm, while the ***joint stock company*** owners – not.
- A ***limited liability company*** owner needs a consent of the rest of owners in order to sell/transfer its ownership, while the ***joint stock company*** owners – not.

Table 6

Bond Issue Object as declared in Prospectuses

Object of the Issue	Number of issues	Percentage of total
Repaying loan outstanding	37	26.81
Finance Company Credit/Financing	23	16.67
Land/Construction/Machinery/General Repair	22	15.94
Asset (land) Securitization	9	6.52
Lease (Cars and Consumer Appliances)	6	4.35
Purchasing accounts receivable	7	5.07
Leveraged Buyouts (LBOs)/asset restructuring	7	5.07
Financing Working capital and Long Term Assets	7	5.07
Others	4	2.90
No Object	16	11.59
Total	138	100.00

Source: Bond issue prospectuses, Author's calculation.

Table 6 shows that the prevailing number of issues allocate funds towards some form of "restructuring" (repaying debts outstanding, Leveraged Buyouts and asset restructuring), financial intermediation (bank loans, consumer financing, purchasing accounts receivable, consumer leasing and factoring) or asset securitization – land and tangible property. Particular attention has to be paid to consumer financing and purchasing accounts receivable, due to the excessive risk-taking of the issuers' nature of business. In addition, the collateral for these corporate bonds is the first order special pledge of present and future cash receivables, exposing bondholders to a risk, incommensurate to the promised yield. Furthermore, extending consumer credit with the proceeds from corporate bonds, may be viewed as a circumvention of bank legislation by non-bank financial intermediaries, besides the moral matter of an excessive interest charge.

Guy Standing (2016:151) refers to the proponents of so-called 'payday loans' as a lever for boosting economic growth: "This revival of Faustian bargain has stimulated growth, but it is unsustainable. It is scarcely the model of the prudent housewife, on which the Thatcherite economics was based. It has increased the fragility of the economy and the probability of another financial crash." And even after imposing a legislative APR cap of no more than 5 times the legitimate overdue interest on the payday loans in Bulgaria (State Gazette №35, 2014), the restriction is circumvented by applying various hoaxes, such as "guarantor's" fee (Toshev, 2016).

Yet for a true liberal economist, justifying the demand side of payday loans as a "personal choice", there is great difficulty accepting the fact that part of our prospective pensions will derive from corporate bonds issued by financial companies that thrive on preying on (often poor) individuals and communities.

Only 22 out of 122 issues report investments in land, buildings, machinery and general repair. This corporate bonds' objective entails investments in projects that will provide goods and services, generate income and – eventually – reduce unemployment.

Nonetheless, even issues with genuine “productive” allocation of resources show some clashes with the interest of bondholders. For instance, "Florina – Bulgaria' issued corporate bonds with a face value of 8 million euro in 2007. The object of the issue, disclosed in the prospectus resume, is the purchase of property and equipment, currently leased from Piraeus Leasing Bulgaria. There would have been nothing irregular with this transaction, if, the trustee – Bank Piraeus Bulgaria was not a parent company of the lessor – Piraeus Leasing Bulgaria! Bank Piraeus Bulgaria is also a merchant bank of the issuer – Florina – Bulgaria. As such, the trustee-bank may have had a direct interest to clinch the issue, especially, if solvency problems cropped up, jeopardizing the lease payment to its subsidiary. The subsequent events validated the above hypothesis. From 2010, when the debtor should have started redeeming the principal, the problems arose. There were restructurings and delays of the debt payments, followed by the default of the issuer Florina – Bulgaria in 2013.

So far there is no conclusive empirical evidence of how the *shareholder ownership concentration* affects the interests of bondholders. On the one hand, the greater concentration of ownership may reduce the costs of monitoring and control of the management, alongside the improved loan collateral evaluation. This curbs the probability of default and buttresses the value of corporate bonds. Shareholders can exercise their rights in order to restrict the management perks, malingering and management empire-building trough precarious investments. (Jensen and Meckling, 1976).

On the other hand, according to the *Bondholders' Wealth Expropriation Hypothesis*, concentrated shareholding can be a premise for an expropriation of bondholders' wealth. The wealth transfer from bondholders to shareholders can be completed by three major approaches (Renneboog, 2012: 93): 1. An unexpected increase in investment projects' risk. 2. A hefty dividend payout. 3. An unexpected new debt issue, with higher/equal seniority, or shorter maturity.

This hypothesis presents a major puzzle regarding the Bulgarian Bond market. There is a strong argument to suggest that Jensen and Mecklings' hypothesis is more applicable to capital markets with more disperse stock ownership, strong protection of minority shareholders interest and bondholders' rights and last but not least – efficient and enforceable law to underpin market exchange[11].

Further, Jensen and Mecklings may subconsciously assume the markets to be exclusively of the Anglo-Saxon type of stock markets, which differ to a great extent to those in developing countries and continental Europe.[12] The Bulgarian Stock Market features characteristics of

[11] In spite of the harmonization of Bulgarian law with the EU directives, the lender protection is still deficient of speed and efficiency. “In general, the regulatory environment in Bulgaria is characterized by a complex regulations, lack of transparency, and arbitrary or a weak enforcement. These factors create incentives for public corruption and, as a result, foreign investors may experience a cumbersome investment climate.” (International Business Publications 2016, p.73)

[12] A study of the publicly held corporations around the world finds that rights of minority shareholders are better protected in Common Law countries, where shareholder concentration is more disperse. (La Porta, Lopez-de-Silanes and Shleifer 1999).

developing markets adopting the German/French style of regulation with a typical high ownership concentration where opaque outside and offshore firms create (or potentially can create) a (largely invisible) controlling chain. Thus, the prevailing high ownership concentration in the Bulgarian Stock Market, coupled with the legal possibility of bond indenture amendments render favour of the *Bondholders' Wealth Expropriation Hypothesis.*

To address the foregoing conjectures, it is worth examining the ownership structure of the bond issuers. The sample consists of 137 bond issues, admitted to public trade for the period from 2004 to 2014.

Table 7

Ownership concentration of corporate bond issuers[13]

	Outside firm owner	
	Yes	NO
	105	32
Majority stake (over 50%)	85	16
including Offshore registered	24	0
Board member with ownership stake over 10%	21	19

Source: Bond issue prospectuses, Author's calculation.

As shown in Table 7, 105 out of 137 corporate bonds have been issued by companies whose larger (dominant) shareholder is an outside public or (in most cases) private firm or a holding company. In eighty-five out of these 105 companies, the majority shareholder have a stake above 50%, which implies an outright control of the whole business. Thirty-five corporate bond issues are done by companies in whose ownership structures outside firms are not majority shareholders. But again – half of the issuers (16) are owned by a large shareholder, with a stake above 50%. Thus, it can be deduced that the prevailing number of issuers have a high ownership concentration, which is, in turn, a premise for colluding against the interest of bondholders. A further impetus for such a scenario is facilitated by the legislative amendments (see below) allowing for *inter alia* coupon rate alteration, after the public floatation of bonds. The latter may further be exacerbated by the lack of transparency of those bondholders who are shareholders of the bond issuer simultaneously.

The collateral of corporate bonds is essential, especially when the issue is not rated. All issues in our sample have no credit ratings. This fact contradicts the stipulation made by Miller (2008: 336), i.e.: "Virtually all leveraged loans and some of the more risky investment-grade credits are backed by pledges of collateral".

Another publication further specifies: "The results of the analysis of creditor rights show a pattern similar to that for shareholder rights. Common law offers the best protection, and French civil law the worst." (La Porta, Lopez-de-Silanes, Shleifer and Vishny 1997).

[13] The sample consists of 137 firms, as one firm, Enemona JSC, does not reveal its ownership structure.

Despite the high leverage in a number of corporate bond issues, Table 8 emphasises the detailed stratification of the collateral. Out of the 138 corporate issues, 68.12% (94) are backed with a collateral, while the remaining 31.88% (44) are debentures.

Table 8

Corporate Bonds Collateral

Type of Collateral	Number of issues	Percentage
Real estate (property lien)	38	27.54%
First order special pledge of present and future cash receivables	18	13.04%
Real estate and machinery	5	3.62%
Machinery and Equipment	2	1.45%
Leased Vehicles (Cars, Vans, Trucks)	7	5.07%
First order special pledge on leased movables	7	5.07%
Issuer's shares	1	0.72%
Loan Insurance	16	11.59%
Debentures	44	31.88%
Total:	138	100.00%

Source: Bond issue prospectuses, Author's calculation.

Most of the collateralized issues are backed with real estate mortgages (38), followed by a first pledge on receivables[14] (18) and loan insurance (16).

There are some cases which cast a shadow on the prospective bondholders' confidence. A bond issue of 'Finance Consulting' Ltd. with a face value of 10 million euro is backed with a pledge on the company's receivables. The alarming detail, however, is that these receivables are overdue over 120 days! (Finance Consulting Ltd 2009: 21).

Another puzzling case is Álen Mack Ltd corporate bonds, with a face value of 592, 000 euro, where for collateral "shares of the issuer and objects of industrial and intellectual property, i.e. patents" are used (Alen Mack Ltd., 2009: 60, 61). It is somehow absurd to use borrower's shares as a pledge of collateral. Shares are actually a title of ownership of the physical assets of the company. As the latter are a general collateral of the loan, it is immaterial to use their financial title as a pledge. Of course, shares and other securities may serve as a pledge of collateral, providing that they belong to a company other than the issuer. An example of such a good practice is the bond issue of Spectar Net Ltd. of 2009, with a face value of 4.25 million euro, where the shares of the acquired company Orbytel Ltd are lodged as collateral.

The legislative loophole premises to bondholders' wealth expropriation

Current legislation norms and regulations allow for Indenture amendments. According to the Good Practices of the Bulgarian FSC, (Protocol № 11, 2011) amendments to the bond

[14] Most of the companies whose business is a quick credits (no credit check loans) disbursement, use debtors' liabilities as collateral. This practice exposes bondholders to a greater risks, as debtors default risk is transferred to the former.

contract characteristics can be made by exception, after fulfilling the necessary requirements and in respect to the following parameters:

The maturity date can be extended, but for no more than 10 years from the settlement date. During the extension period, it is possible to defer or reschedule repayments of the principal. It is permissible to alter the interest rate (coupon rate), frequency and other provisions referring to interest payments, as well as terms and conditions for exercising call options by the Issuer.

It is also permissible to alter the corporate bond covenants and the collateral. Last, but not least, the regulator permits amendments to the collateral or a pledge of additional collateral for the loan outstanding.

These lax regulations are in breach of best practice in relation to developed financial markets. Although the possibilities for corporate bond characteristic alterations are not the exception in developed markets, the Bulgarian regulations are alarming. The change in bond indenture parameters can be granted by the General Meeting of Bondholders (GMB). The GMB can be called by the bondholder trustee or by 10% of the bondholders (Commerce Act, Art. 214, para 1 and 2 and Public Offering of Securities Act, Art. 100a, para 7). The third party that can call the GMB is the General Meeting of Shareholders (GMS) under article 214, paragraph 3 of the Commerce Act.

GMB can legitimately alter indenture parameters if there is 1/2 representation (quorum) of the outstanding debt.[15] Then, in order for changes to take an effect, the vote must be 2/3 or over of the bonds presented at GMB (Commerce Act, Art. 214, para 5). The GMB date must be announced at least 10 days prior to the date of the convention.

What are the implications concerning bondholder rights and subsequently – the operational efficiency of the corporate bond market?

Firstly, the date of the GMB is at least 10 days after its announcement. Surely, if the meeting is even 15 days after the announcement date, the turnout would hardly be 100%. If the GMB attendance is 100, then a 67% vote would be enough to change such important parameters of the indenture such as the interest rate and maturity. If 50% attend, then only 34% of the outstanding debt issue would be enough for imposing changes in the indenture.

But that’s not the end. Secondly, if there is no quorum, “In the absence of such quorum in the cases referred to in paragraphs (1) and (2) a new meeting date may be set which shall not be sooner than in 14 days, and the general meeting at such latter date shall be valid regardless of the equity represented. The date of such second meeting may be stated in the original notice as well.” (Commerce Act, Art. 227, para 3).

As a consequence of the above legislative settings, as well as the deviating examples mentioned above, it is possible to state a hypothesis on the *ex-post* status of corporate bonds’ servicing. In a nutshell, the current practice of issuing and supervision of corporate bonds in Bulgaria provides legal and economic premises, which may lead to *mal*-practices, such as suspensions in loan servicing, alteration of the bond interest rate, maturity and other

[15] Note, representation is not 1/2 of the bondholders, rather 1/2 of the outstanding bonds.

parameters, last but not least – loan default. And this is in spite of the now more than decade-long harmonization of the Bulgarian law, relating to bond issuance, with EU legislation.

There are several grounds on which the already stated conjecture may come about. Firstly, the proposition of Article 204 1) of Commerce Act (amend. SG 114/99; amend. SG 58/03): "Debentures may only be issued by a joint-stock company. The issuance of debentures by public offering may be done at least two years after the company's recordation in the commercial register at the earliest, and provided it has two annual financial statements that have been approved by the general meeting"

This legal stipulation of the first statement is practically in vain, as Article 159 of the same Act allows a joint stock company to be established by one person. (Article 159 (amend. SG 84/00) 1) "A joint stock company can be found by one or more individuals or corporate bodies.") In addition to two annual accounts approved by the general meeting, there is no prerequisite of profit records for these 2 mandatory years.[16] Further, as Table 7 shows, most companies are dominantly held by one person or one outside company. In many cases, one person is not just a majority holder, but 100% owned by proxy companies. Table 7 also shows, that issuers with more than 50% stake are 85 held by individuals and 16 by an outside company, totally 101. Out of these 101, 23 issuers are owned by an absolute majority of 100%. The high concentration of the issuer ownership provides opportunities for strong bargaining power and eventually – adverse action against the interest of disperse bondholders.

Secondly, the possibility of major loan characteristics changes, like interest rate and maturity. In an attempt to deal with this contentious point the state regulator, the Financial Supervision Commission (FSC) issued a good practice guidance (Protocol № 11, 2011) on the contents of bond prospectuses for admission to public trading. It states a further requirement of declaring the possibility of bond characteristic alteration at the earliest possible stage of a security offering, i.e. a private placement offer. It also recognizes that the Commercial Law does not explicitly state the possibility of loan characteristics alteration, notably lacking case law. Together with the fact that the bondholder configuration at the private offering is not known, and after secondary admission to public trading is a secret kept by Central Depository that exposes the unwary bondholder to an extreme risk.

The above-stated obstacles to the Bulgarian corporate bond market have not passed unnoticed by some investment intermediaries, such as Mr. Kamen Kolchev, CEO of Elana Financial Holding: We have legislative loopholes, which must be closed, for instance, the general legislation of the bond market. Such legislation provides issuers with opportunistic incentives, not to proceed ethically with their investors. We had several cases in Bulgaria, publicly flagged in the media. In the last one, with Bross Holding, the loopholes in the legislation were used, so that [corporate bond] money was not redeemed. (Investbook Programme, 2015).

[16] In fact, a number of issuers reveal in their prospectus either losses or losses and negligible profit for the last 3 years prior going public.

Our preliminary review of the corporate bond sample confirms Mr Kolchev's supposition. At January 31-st, 2016, the entire sample of 138 bond issues falls into 5 categories:

1. Repaid corporate bond issues. These are issues with regular servicing and which has been fully repaid at its original maturity date. This group is denoted as ***fully paid-up.***
2. Repaid and restructured corporate bond issues. These are issues whose parameters, i.e., loan amortization schedule, maturity, coupon rate, have been altered, but repaid by January 2016. This group is denoted as ***paid-up restructured***.
3. Certain issues that either have "Call option" to indenture or obtained the bondholders' consent have been repaid earlier than the maturity date. This group is denoted as ***early repayment***.
4. Restructured issues. These are bond issues whose maturity must have occurred by January 2016, but due to loan parameters alteration, the maturity date was shifted forward. In this group are included also issues with original maturity after January 2016, whose maturity was extended. This group is denoted as ***restructured***.
5. Defaulted issues. When issuer ceases to pay the principal and/or interests on a loan within the original or extended maturity. Formally followed by BGM resolution to file a court case. This group is denoted as ***defaulted***.
6. Last, but not least are regularly serviced issues, within its original maturity. These issues did not bear any restructurings, and are denoted ***no change***.

Table 9 delineates the distribution of the above defined four categories corporate bonds.

Table 9

Ex-post status of corporate bond issues 2004-2014 at January 2016

Fully paid-up	Paid-up restructured	Early repayment	Restructured	Defaulted	No change	Total
62	11	13	26	8	18	138
44.93%	7.97%	9.42%	18.84%	5.80%	13.04%	100.00%

Source: Bond issue prospectuses, Bulgarian Stock Exchange News Platform, Author's calculation.

At first glance defaulted corporate bonds are 5.8% of the sample, but assuming the subsample of matured issues (94), then the actual defaulted rate rises to 8.51%. However, in terms of value the default rate of Bulgarian corporate bonds is 3.76%. The defaulted corporate loans rate for the whole Bulgarian bank system is 11.52%[17] of the outstanding principal at the end of 2016, a rate three times higher than that of the corporate bonds. However, a closer look at the corporate bond issues where default occurred reveals a pattern. For the entire sample of corporate bonds, 37 out of 138 issues have as their object "Repaying loan outstanding". For the defaulted issues however the figure is 7 out of 8. Are some of these corporate bonds a "last resort" for restructured bad bank loans? That question opens an opportunity for much needed further research in this area.

[17] Bulgarian National bank, Reference on nonperforming loans and advances and the accumulated impairment.

It seems though that restructured issues pose a greater threat compared to defaulted ones. Firstly, their weight is comparatively higher, 18.84%. Secondly, bondholders can pledge their cash flow from the collateral of defaulted issues, despite often lengthy and protracted court procedures. With the restructured issues they can only wait, in many cases being compensated with a reduced coupon rate.

The prevailing number of corporate bond issues in Bulgaria have been carried out through private placing. For the period 2004-2014 the sample consists of 138 issues in total with 135 of them privately executed.

It emerges from this research that the banks are leaders in issuing corporate bonds, followed by Real Estate Investment Trusts (REITs) and Holding companies for the period 2004-2014. However, that trend was evident prior to 2009, but abated somewhat afterwards. Inasmuch as some corporate bonds have experienced a coupon rate reduction, the original YTM presented in Figure 2 will be further lowered.

The preferred currency of Bulgarian corporate bonds is Euro, constituting more than 2/3 of total principal value outstanding. In the earlier period under review issues with 3 years maturity were prevalent, while in the second half of the period 5 years or longer maturity became a norm. Floating rate bonds (FRB) were fashionable from 2004 to 2008, and almost disappeared afterward. Out of 138 issues consisting of the total sample of corporate bonds, 55 bond issues have covenants. In many instances, issues with covenants attached are also collateralized. However, the prevailing number of covenants are set at inadequately low levels, typical for distressed firms.

The predominant volume of issues allocate funds towards some form of "restructuring" (repaying debts outstanding, Leveraged Buyouts and asset restructuring), financial intermediation (bank loans, consumer financing, purchasing accounts receivable, consumer leasing and factoring) or asset securitization – land and tangible property. The object of funds allocation turned out to be an important indicator discriminating defaulted issues – 7 out of 8 defaulted issues, raised bond money to repay former (mostly bank) loans.

Most of the collateralized issues are backed with real estate mortgages (38), followed by the first pledge on receivables (18) and loan insurance (16). Generally, the pledge on receivables may pose some risks. Companies whose businesses involve consumer and goods credit, or debt collecting, declare their (present and future) receivables as a collateral. In fact, these are the bondholders' money, but in a much riskier position. There are also problems with real estate mortgages.

It is also worth noting the thin trading[18] of the corporate bonds on the secondary market. The idea of opting for private placing across institutional investors first, and then gaining access to the secondary market to create liquidity of corporate bonds does not seem to work. The trade activity and the wide involvement of small investors in the secondary corporate bond market is hampered by lax legislative settings, allowing for bondholders'

[18] As of October 2018, the total value outstanding of corporate bonds was 739 million BGN, as Euro denominated ones accounted for over 80%. For 2018 the average trade of corporate bonds varies between 2.1 and 2.4 million BGN a month. (Infostock, 2018).

wealth expropriation. The latter does not take place without the complaisant assistance[19] of the major bondholders – fiduciary institutions such as pension and mutual funds.

These facts unequivocally call for legislative amendments to corporate bond regulation, most important *inter alia*, stipulating that alteration of the major parameters of corporate bond indenture, such as interest rate, maturity and collateral require 100% votes of bondholders. This is supported by Wilson and Fabozzi (1995: 31): “changes of a substantive or essential nature require a 100% vote. The latter category includes changes in the maturity, interest rate, redemption premium, place of payment, currency in which the debt is payable, or any provisions which would impair the right to start a legal suit for the enforcement of any defaulted payment.” It is undoubtedly strange that norms accepted as “industry standard” can be circumvented. Another measure may be to cease the practice of private placement first and then access to public trading.

Both proposals aim to protect bondholders. Such measures, however, could actually provide a higher degree of protection for bondholders, but, on the other hand, higher protection may bring about lack of flexibility and other problems for the bondholders. That is why more appropriate actions can be directed towards setting higher standards for collateral and covenants in prospectuses as well as higher scrutiny, when the regulatory body (FSC) approves prospectuses. In addition to measures aiming at reducing the possibility of conflict of interest from fiduciary institutions – pension funds, mutual funds and insurance companies, it would be prudent to insist that stakes in bond issues over 10% be publicly announced before admission to public trading, in a manner similar to shares of stock.

[19] The conflict of interest problem, where pension fund(s) belonging to a financial group buys corporate bonds of an issuer located within the same group is not unfamiliar to Bulgarian lawmakers. The latter became a public fact, owing to the “Trud” (Labour) newspaper inquiring in the Bulgarian Parliament Budget and Finance Commission and FSC. The Trud newspaper question (one of 15 questions) was “What is the information available to the FSC in respect to the funding of Mr. Ivo Prokopievs’ businesses by corporate bonds and stocks held by pension funds?” From the FSC’s (Republic of Bulgaria Parliament, 2015) answer became clear: 24% of issue BG2100007033, Kaolin JSC, 40% of issue BG 2100010094, Alpha Finance Holding, 27.54% of issue BG2100021091, Alpha Energy Holding JSC are bought by Doverie pension fund.
However, the newspaper Capital (close to Mr. Prokopiev) replies in turn (Capital, 22.01.16): “What the [pension] funds of Himimport and Eurohold undertook, was to exchange stacks of shares and bonds of their companies. For instance, Suglasie (pension fund) and CKB – Sila (pension fund) became investors in companies tied to Eurohold, including its majority owner – Starkom Holding. In return, Budeshte [pension fund] invested in Velgraf Asset Management and Web Finance Holding (the biggest shareholder in Suglasie [pension fund]. This is not an entirely new strategy. Prior to 2015 such cross-deals were carried out by Budeshte [pension fund] and Toplina [pension fund]. Now simply the scale is up.”

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