

BSE-Sofia

2010

**Development Strategy of BSE-Sofia by
the end of 2012**

TABLE OF CONTENTS

List of acronyms.....	3
Introduction	4
1. New instruments, order types and trading opportunities.....	5
Spot-trading with warrants and certificates.....	5
Margin purchases and short sales	5
Exchange-traded funds	6
Futures and options.....	6
2. Improvements of the capital market infrastructure in cooperation with other institutions.....	6
National-level clearing	6
Settlement guarantee and guarantee fund	7
Cross-border clearing and settlement	7
Establishment of a back-up center.....	7
3. Improvement in the trading conditions	7
Extending the duration of the trading session	7
Differentiation of the trading fees and the fees for maintenance of listing	8
Arbitration court.....	8
New types of orders.....	8
4. Attraction of new issuers and investors.....	8
5. Regulatory amendments	9
6. Corporate governance of public companies	9
7. Improvements in the corporate structure of the company.....	10

LIST OF ACRONYMS

BSE-Sofia – Bulgarian Stock Exchange–Sofia AD
FSC – Financial Supervision Commission
BNB –Bulgarian National Bank
CD – Central Depository AD
GDP – Gross Domestic Product
EU – European Union
REIT – Real Estate Investment Trust
CIS – Collective Investment Schemes
SEC – Securities
POSA – Public Offering of Securities Act
MFIA – Markets in Financial Instruments Act
MiFID - Markets in Financial Instruments Directive

INTRODUCTION

The purpose of this document is to systematize the strategic aspects of BSE-Sofia's development in a midterm perspective (2010-2012).

The historical period under consideration is based on the previous two Development Strategies – adopted in January 2005 and March 2008 respectively. The deepening of the global economic crisis during the second half of 2008 required a revision of some of the BSE-Sofia's priorities with a view to the uncertain situation at the international capital markets and the serious impact of the crisis on the real economy in Bulgaria.

The present Strategy reflects the vision of BSE's senior management on the main challenges as well as the actions to be taken for achieving the envisaged objectives in the context of the recovery of the interest in the local capital market by local and foreign investors and overcome the effects of global financial and economic crisis.

BSE-Sofia's mission is to facilitate the establishment and development of an organized capital market which would guarantee the members of the Exchange and their clients an equal access to market information and equal conditions for participation in securities trading.

BSE-Sofia's main strategic goal is to maintain an efficient capital market in Bulgaria within 2 years and to strengthen its public acknowledgment as a source of funding for the local business and an essential tool in the Bulgarian economy. In this respect, BSE-Sofia's main priorities include:

- Introduction of new instruments, order types and trading opportunities;
- Improvement of the market infrastructure in cooperation with the other capital market institutions;
- Improvement of the trading conditions;
- Attraction of new investors and issuers;
- Changes in the legal framework;
- Improvement in Corporate Governance in Bulgaria;
- Improvement of the corporate structure of the Exchange.

Although the Exchange plays an important role with regards to the development of the capital market, the key to the achievement of the objectives is the effective communication and interaction between all market participants - the State (Ministry of Finance; Ministry of Economy, Energy and Tourism), the Financial Supervision Commission, Central Depository, investment intermediaries, issuers and investors.

1. NEW INSTRUMENTS, ORDER TYPES AND TRADING OPPORTUNITIES

SPOT-TRADING WITH WARRANTS AND CERTIFICATES

Among the short-term objectives of BSE-Sofia is the establishment of a structured products market, at which certificates, warrants and other products based on indices and stocks can be traded. In this regard in the beginning of November 2009 BSE-Sofia adopted amendments to its Rules related to the regulation of the new market, which are in effect as from 08 March 2010. As regards to the development of this segment, however, an interest on behalf of the financial institutions to issue such instruments and the investors to trade with them is essential.

With regard to the other opportunities for spot-trading with financial instruments BSE-Sofia will review and update its Rules in case there is an interest from the market participants to start trading in new types of instruments.

MARGIN PURCHASES AND SHORT SALES

One of the main priorities in the short term that is related both to the introduction of new instruments at BSE-Sofia and to the improvement of the conditions for exchange trading is the elimination of the technical difficulties in concluding margin purchases and short sales. Currently margin purchases and short sales are allowed for a certain number of financial instruments that meet defined criteria for liquidity, as the instruments themselves are announced on a daily basis by the Exchange.

It is a fact however that there are no real transactions as a result of margin purchases and short sales and many Exchange members do not offer such services to their clients, because the completion of these transactions is greatly hampered. In order to solve this problem BSE-Sofia could contribute expertise in the future expansion of the clearing functions of the CD, which will enable centralized management of collaterals and reduce the counterparty risk. In addition, the introduction of short selling of stocks included in the main BSE-Sofia indices, would allow at a later stage derivatives (e.g. futures) on the respective index to be offered.

The current regulation creates significant obstacles on several levels, which can generally be summarized as follows:

- Lack of effective system for securities lending and centralized management of collaterals. As is known, the above is the main problem in relation to the real implementation of margin purchases and short sales, since it is very difficult to find free securities to lend in connection to a short sale, respectively – to monitor their market value and its collateral. In practice, as a result of the above-mentioned the investment intermediaries become quasi-clearing institutions with respect to their clients and the lack of a centralized clearing institution is an obstacle when it comes to relations between two investment intermediaries.
- Very strict regulation of margin purchases. The same regulation is applicable to both margin purchases and short sales.

Generally with margin purchases the loans provided are in the form of money and their return does not so directly depend on the liquidity of the instruments compared to short sales. The loan with a short sale is in the form of securities and the liquidity is the main factor when closing the respective position. In this regard, BSE-Sofia considers that it is not well-founded the same liquidity criteria to apply to both types of transactions. That corresponds with the international practice where the requirements are only applicable to short sales but not to margin purchases

- Practical problems in relation to the market-makers activity. Since it is possible within its activity, a market-maker to be on a short position accidentally without having such an intention, it is necessary for him to have the opportunity in these cases to borrow the appropriate amount to cover short position. However, Ordinance № 16 creates practical obstacles in this regard, because of the requirement securities to be lent only in connection to short sales.

In pursuance of the above, BSE-Sofia will develop specific proposals for changes in Ordinance № 16 in order to facilitate the execution of such transactions. Since the conditions for their conclusion, however, depends on the existence of an efficient clearing, which falls outside the scope of the regulated market functions, it can be expected that such transactions would be made possible by the end of 2010

Deadline: end of 2010

Partners: FSC, MF, CD

EXCHANGE-TRADED FUNDS

In a midterm perspective BSE-Sofia plans to start a market segment for trading of exchange-traded funds (ETFs). The Exchange, together with the other participants from the working group for structured products established in 2009, will contribute to this project. The Bulgarian Association of Asset Management Companies has already defined specific proposals for legislative changes. However, the realization of this goal does not depend entirely on the stock exchange and a specific time frame for the completion of the legislative changes cannot be defined. Till the actual changes in legislation are fact, BSE-Sofia will take the appropriate actions in order to coordinate the trading method for these instruments, as long as the trading platform gives an opportunity for more effective and specially developed for these instruments method.

Date: first quarter of 2011

Partners: FSC BAAMC, MF

FUTURES AND OPTIONS

In the long term, an important strategic objective is the establishment of a derivative market and the start of trading in futures and options, while the realization of this project depends entirely on the existence of an effective clearing. Another problem is related to the liquidity of the underlying assets on which the respective derivatives are structured, having in mind that lower liquidity creates conditions for both easier manipulation of their prices and carries high risk of sharp movements in the derivative instruments prices. The realization of this goal depends also on other factors such as an efficient clearing system and a higher liquidity and therefore it represents a longer goal.

In addition, the Exchange will explore the possibility of providing the market with the necessary data for trading in government securities, which in turn will make it possible the start trading in interest rate futures. For this purpose, coordination with the Bulgarian National Bank and the Ministry of Finance is needed.

Duration: The first quarter of 2011

Partners: FSC, MF, BNB, CD, BALIP, ABB, BAAMC

2. IMPROVEMENTS OF THE CAPITAL MARKET INFRASTRUCTURE IN COOPERATION WITH OTHER INSTITUTIONS

The task is mainly associated with joint actions with the CD and other market institutions for the establishment / improvement of the following services:

NATIONAL-LEVEL CLEARING

The Exchange will support the work of the CD in relation to the improvement of the clearing activities at a national level, as this is crucial both for margin trades and short sales and for the introduction of new financial instruments at the Bulgarian capital market. Also, in case there is a technological opportunity, BSE-Sofia considers as a high priority the establishment of a regulatory framework for the so-called non-clearing membership that would enable the

members to settle their trades through another (clearing) member of the CD. This is also the preferred way for foreign investment intermediaries to access a certain capital market. In this regard BSE-Sofia will continuously support the CD for the accomplishment of the objective without defining its own current deadlines.

SETTLEMENT GUARANTEE AND GUARANTEE FUND

Since the CD is the institution which carries out the clearing and settlement of the transactions in financial instruments conducted at the Exchange and in relation to the possible extension of the clearing functions of the institution, BSE-Sofia will initiate consultations among the local capital market participants on the idea to establish, at a later stage, the Guarantee Fund within the structure of the clearing institution. Possible deadlines on that objective cannot be stated firmly, as far as it is related to changes in the Law on Public Offering of Securities with regard to the CD's guarantee fund.

Also a detailed analysis has to be conducted on the necessity of a CCP that guarantees the settlement of the Exchange transactions as well as its effect on the price of the service.

CROSS-BORDER CLEARING AND SETTLEMENT

In a long term perspective, the Exchange will assist the CD to complete the relevant changes at clearing and settlement level, in order to establish links with other depository institutions. The Exchange considers it appropriate to allow local participants to settle in the CD transactions with instruments executed at other markets and vice versa - trades executed at BSE-Sofia to be able to be settled in other depositories. That process is a European practice and its realization is possible only if it is associated with lower costs for the investors. Regarding this specific task deadlines cannot be defined as it requires constant proceedings in accordance with the continuously changing conditions on pan-European level in the field of clearing and settlement.

ESTABLISHMENT OF A BACK-UP CENTER

In order to ensure continuity of the processes, BSE will launch a project to build a separate backup center to minimize the risk of technical accidents affecting the proper conduct of the trading sessions.

Deadline: the fourth quarter of 2010

3. IMPROVEMENT IN THE TRADING CONDITIONS

EXTENDING THE DURATION OF THE TRADING SESSION

In the short term BSE-Sofia will consult with the capital market participants on the possibility of extending the duration of the trading session. On the one hand such a decision would have a positive impact on the image of the Exchange, as currently the duration of the trading session on the Bulgarian market is one of the shortest within the EU. On the other hand the extension of the trading session is logical in the light of the increasing correlation between the local market and the markets in Western Europe and the USA. Thus, by the end of the second quarter of 2010 the Exchange will submit for discussion the need of extending the trading session and its synchronization with the other European markets. By the end of April, if there is agreement among the market participants, the implementation of this initiative can be completed

Deadline: second quarter of 2010

Partners: FSC, CD, ABB BALIP, BAAMC

DIFFERENTIATION OF THE TRADING FEES AND THE FEES FOR MAINTENANCE OF LISTING

In the short term BSE-Sofia will analyze the opportunities for introducing differentiated fees for the exchange members according to the realized turnover for a specified period of time. Such an approach, depending on the size of the issue, can be applied to the financial instruments admitted to trading if there is feasibility and consensus among the market participants.

Deadline: Second quarter

Partners: All interested associations

ARBITRATION COURT

In the short term BSE-Sofia will analyze and, if necessary - will review the procedures under which operates the arbitration court in order to make it a practically functioning opportunity to resolve disputes between market participants. As a specific deadline for the realization of this goal can be set for the third quarter of 2010, as it directly depends on the election of a President and Vice-Chairman of the court on the regular annual general meeting of the shareholders.

Deadline: Third quarter

Partners: All interested associations

NEW TYPES OF ORDERS

In accordance with the functionality of the trading system, BSE-Sofia in the short term will align with market participants whether there is a necessity of introducing new types of orders that are available in Xetra, including those provided in the subsequent versions of the system. By the end of the second quarter of 2010, the Exchange intends to explore the opinion of the market participants, whether the supported by the trading platform order types should be introduced in the local market, including those available in the planned for introduction Xetra Release 28/06/2010 11.

Deadline: Second quarter of 2010

Partners: All interested associations

4. ATTRACTION OF NEW ISSUERS AND INVESTORS

The attraction of new issuers will remain among the main priorities of BSE-Sofia, since offering quality issues of financial instruments is the key to solving the low liquidity problem of the Bulgarian capital market. An important additional prerequisite is the provision of sufficient free float on the positions of the new issuers, which would increase the interest of local and foreign institutional investors.

With a view to the realisation of this priority, BSE-Sofia will:

- Prepare a Marketing Strategy for the Attraction of New Issuers by the end of the second quarter of 2010.
- Initiate an awareness campaign to ensure sufficient free-float and create interest in the public companies including proposing legislative changes by the end of the first half of 2010.
- Analyse and discuss with the market participants the possibility of launching a separate market segment or a multilateral trading system for low liquidity companies, solving in this way the largely discussed issue during 2009 about the delisting of these companies. Target deadline for offering a solution in this direction will be the end of the first half of 2010.

- Revise the conditions for listing on the Exchange towards facilitation by the end of the first half of 2010 as at the same time provide and discuss a mechanism for non-admission of issuers, clearly seen as low liquid.
 - Initiate meetings with the Ministry of Finance and other representatives of the government by the end of the second quarter of 2010, in order to enable the listing on the BSE-Sofia of packages of attractive state-owned companies especially those of the structure of the Bulgarian Energy Holding (NEK, Bulgartransgaz and others).
 - Develop a strategy for a regional cooperation aimed at the good positioning of the Exchange in the region by the end of the third quarter of the year. Concrete opportunities for cooperation and joint operation of markets in the region will be considered, which in the long run would attract investors and new companies on the floor of BSE-Sofia.
- There are some obstacles with regard to the attraction of foreign members, which would otherwise positively influence the number of foreign investors in the market. Provided that it is technically possible on the part of the Central Depository, the Exchange will seek ways to ease the membership procedures in both institutions including for foreign investment intermediaries and to enable them to work as non-clearing members according to the international practice.

5. REGULATORY AMMENDMENTS

The Exchange will take an active part in all discussions on the necessary legislative changes in the field of trade in financial instruments and will initiate such discussions as the need arises.

The Exchange is in particular of the opinion that the regulatory amendments listed below are necessary and is ready to actively contribute expertise to this end:

- Comprehensive review of Ordinance No 16 of the FSC on the conditions and procedure for execution of margin purchases, short sales and lending of financial instruments
- Amendments to Part III, Chapter 9 of the POSA concerning the activity of the Central Depository and to Ordinance No 8 of the FSC, regulating in details the clearing functions of the Central Depository
- Amendments to the State Fund for Guaranteeing the Stability of the State Pension System Act (Art. 13 (8)), enabling the investment of fund's means in local financial instruments
- Amendments to Part IV of the POSA concerning the activity of the collective investment schemes and to the respective subordinate legislation, which would allow structuring of funds outside the limits, set by the UCITS directives. This amendment would enable the organisation of ETFs based on local and foreign indices under more liberal limits with respect to the mandatory diversification of the respective fund.

Deadline: The second quarter of 2010

Partners: The Financial Supervision Commission (FSC), the Ministry of Finance and all supporting organisations

6. CORPORATE GOVERNANCE OF PUBLIC COMPANIES

The improvement in the corporate governance quality of the public companies is one of the main priorities of BSE-Sofia. In the recent years, the Exchange has taken a series of actions aimed at promoting the principles and good practices of corporate governance. BSE-Sofia has developed and adopted its own Corporate Governance Code and has actively contributed to the development of the National Corporate Governance Code to be applied on the territory of the country. The Exchange is also a co-founder of the Bulgarian National Corporate Governance Committee and has put into practice the principles and recommendations of the National Corporate Governance Code.

The Exchange will further:

- Continue initiating and participating in programs and events connected to the corporate

governance of Bulgarian public companies and will encourage the issuers to actually apply the principles laid down in the National Corporate Governance Code.

- BSE-Sofia will actively take part in the work of the Bulgarian National Corporate Governance Committee, which is in charge of making revisions of the National Code and evaluating the state of the corporate governance in the country on an annual basis.
- The Exchange will continue the initiated at the end of 2009 discussion with the National Corporate Governance Committee regarding the establishment of an Exchange index comprising the companies with a good corporate governance by extending the number of participants involved in the discussion and summarising the standpoints. The period set for accomplishment of this target is the end of the first half of 2010.
- The Exchange will create a concept for establishment of awards for best corporate governance and for market performance and active trading until the end of the third quarter of 2010.

7. IMPROVEMENTS IN THE CORPORATE STRUCTURE OF THE COMPANY

With a view to a new image and improvement of the BSE-Sofia communication with the rest of the institutions and market participants, the Exchange will take the following steps:

- By the end of the first half of 2010, BSE-Sofia will establish a practice for carrying out monthly panels involving the community of intermediaries and representatives of the capital market associations.
- BSE-Sofia will strengthen its existing international relations and will establish new ones at European and regional level in order to ensure the proper positioning of the local market among the other regulated markets and alliances.
- The Exchange will reconsider, update and put up for discussion the fees and commissions payable by issuers and members, as mentioned above in this Strategy.
- BSE-Sofia will take steps towards transformation of the Exchange into a public company, in case this coincides with the privatisation strategy for the state-owned stake in the capital of BSE-Sofia and with the opinions of the potential strategic investors.
- Until the end of 2010, the Exchange will modernize the system for collection and submission of information to the Exchange members with regard to their day-to-day operations with a view to change over to a wholly electronic service.
- BSE-Sofia will analyse and discuss the necessity of a new Statute by the end of the second quarter of the year. The Statute will be then proposed for approval to the Annual General Meeting of the Exchange.