

TOKUDA BANK AD

ANNUAL MANAGEMENT ACTIVITY REPORT,
CORPORATE GOVERNANCE STATEMENT,
INDEPENDENT AUDITOR'S REPORT AND
ANNUAL FINANCIAL STATEMENTS

For year 2018



**MANAGEMENT
ACTIVITY REPORT
2018**



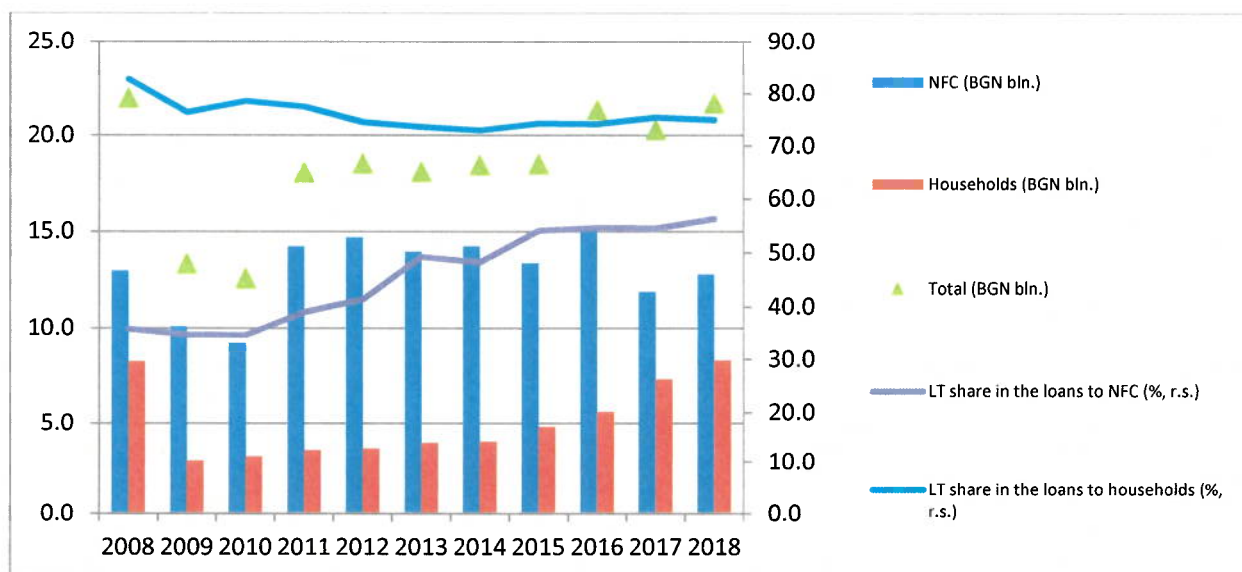
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I. Environment in which Tokuda Bank AD operated in 2018

In the past year 2018, the banking sector continued to develop in the direction already established over prior years. Profit in the system has been increasing, concentration has been growing, and lending activity has remained at pre-crisis levels despite the continuing decrease in interests and the recovery of economic activity. In fact, the monetary statistics data (Figure 1) show some increase in the nominal volume by new business for non-financial corporations (NFC) (from BGN 20.3 billion in 2017 to BGN 21.7 billion in 2018). This volume, however, is lower than the one stated in 2008 (BGN 21.9 billion), and the relative dynamics assessment shows that in fact, activity has weakened (from 24.45% of the gross amount of loans and advances at the end of 2017 to 24.35% of the gross amount stated at the end of 2018). A longer-period comparison does not result in more favourable findings either, since despite the 7.5% increase of loans granted to NFC, their total amount is only BGN 12.8 billion, which is about 1/10 lower compared to pre-2017 levels (BGN 14.2 billion per year on average over the 2011-2016 period). It can be noticed that the relatively weak activity in the corporate segment is accompanied by a slight increase in the share of long-term loans, which could be explained with the increased demand for investment-purpose loans, as well as with the weaker activity of re-negotiation and re-financing of existing receivables.

Figure 1 Volumes by new business



Source: BNB, own calculations

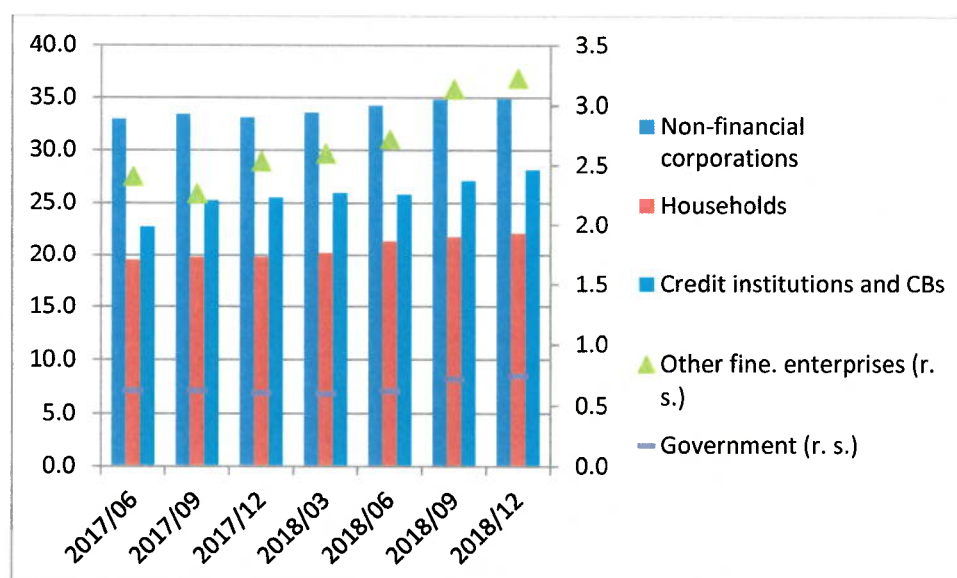
Nearly BGN 7.2 billion of the volumes of new business in the corporate segment have an agreed maturity of over 5 years, with the share of long-term loans thus reaching 56.3%, or 1.7 percentage points more than in 2017. This volume however cannot yet reach the levels stated in 2015 and 2016, which shows that despite some acceleration of investment activities in companies, as a whole, in 2018 they retained their short- and mid-term pessimistic prospect.

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This is a translation from Bulgarian of the Management Activity Report of Tokuda Bank AD for year 2018.

On the background of conservative business attitudes, the main contribution to the increase in loan activity in the corporate segment was that of preserving commercial banks' lending policy. The summarised results of the lending activity survey of BNB show that with the exception of the first quarter of 2018, most respondents have kept the standards for loan disbursement to corporations unchanged for the second consecutive year, mainly due in the past year to the risk assessment (non-weighted average of the assessment of the macroeconomic environment). In the meantime, financial institutions aim to stimulate lending activity by continuing to relieve conditions on the loans offered thereby – throughout 2018, the balance of opinions on interest on loans to NFC remains negative, and in the first and fourth quarter, almost 1/3 of the respondents state there was a decrease in newly granted loans in the segment. Evidently, this manages to incentivise some of the potential corporate customers, since in 2018 the number of respondents reporting increased demand for corporate loans (between 7 and 9 in the different product categories) remains higher than the number of respondents reporting a decrease in demand.

Figure 2 Gross loans before impairment at the end of the period [BGN billion]



Source: BNB, own calculations

It can be noticed that the increase in the nominal amount of gross loans (by BGN 1.7 billion over the past year) is slightly higher than the increase in volumes by new business in the segment (BGN 897 million) despite the pressure against the increase of the gross amount of the portfolio, which is exercised in relation to the intense activity of forced debt collection and write-off of non-performing loans. Indicative of this is the data released in April 2019 by the Association of Collection Agencies in Bulgaria (ACAB), according to which the volume of debt bought by collection companies has significantly increased – from BGN 772 million in the prior year to BGN 1.905 million in 2018, as a result of the conclusion of record deals for corporate loans. Banking products are growing in share, reaching 51% of the total volume in the non-serviced debt portfolio in the ACAB sample. Based on this, it could be assumed that the faster rate of

growth of gross loans to NFC is mainly due to the relief for amortisation of the portfolio in this segment, which is a natural consequence of the continuous increase of the share of long-term loans (from 34.7% in 2010 to 54-56% in the period after 2014).

In retail banking, the trends are much more favourable (Figure 1). The segment demonstrates higher activity and the total volume by new business increased for the ninth consecutive year, reaching BGN 8.265 billion in 2018, which is BGN 975 million, or 13.4% more than in 2017. It needs to be pointed out that this trend is characterized by high sustainability over time – in fact, volumes by new business in this segment have been continuously rising since 2010. Also very sustainable is the trend in the share of long-term loans to households. While immediately before the financial crisis this share amounted to 81-82% of the total volume by new business in household loans, over the next six years, the share of long-term loans decreased to 72.9%. Since 2015, the percentage has varied within a narrow range and as a whole, has remained high – between 74 and 76% (which is mainly due to the intensive activity in the mortgage segment). There was a slight decrease in 2018 (by 49 b.p., to 74.9%), which could be explained with shortening the terms for some of the newly concluded contracts with individuals and households, and is a natural result of the intensive increase in nominal income over the last three years.

The increased activity in retail lending impacts the dynamics of the absolute volume of gross loans. Following the continued retention of negative growth rates in the loans to individuals and households (in the years after 2010), in the summer of 2016 the segment's rates reached positive values (0.17% on an annual basis as at the end of August), and since October 2017 the growth rate has been sustained over 6% on an annual basis. The acceleration of the dynamics indicators also continued in 2018, and in the second half of the year, they reached two-digit values; as at the end of December, the annual growth rate of household loans reached 11.56%.

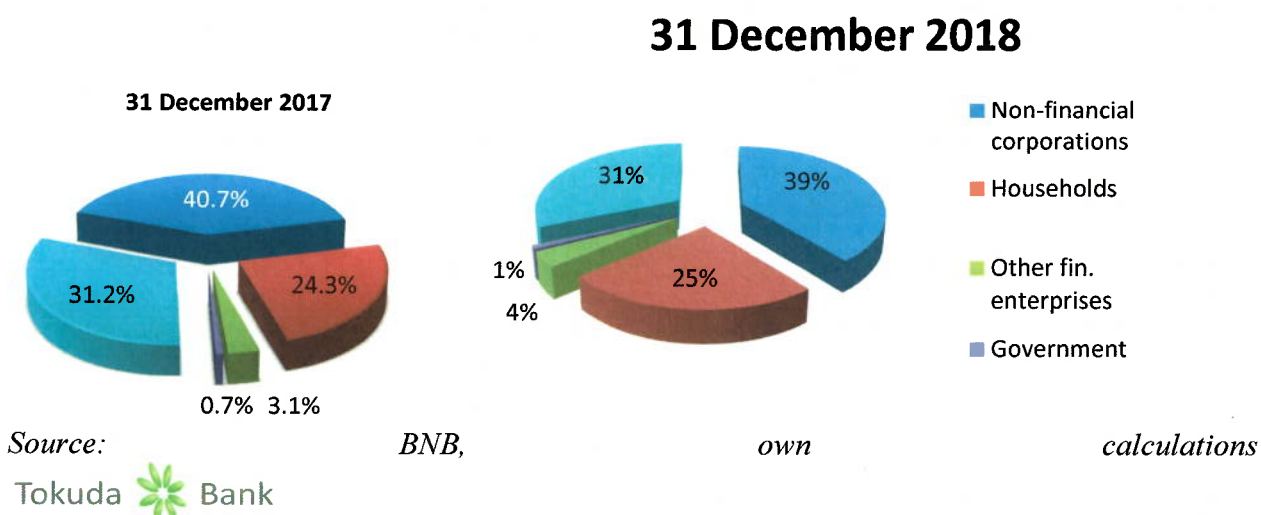
The main contributor to the maintenance of high rates in this segment is the intensive increase in new business, which in the past year reached double the volume of the 2013-2015 period (about BGN 4 billion per year). The faster increase in gross loans to households (by BGN 2.201 billion compared to a two times lower growth in volumes by new business) could be explained on the one hand with the longer original maturity of loans granted after 2014, and on the other hand – with the lower share of refinancing of existing loans, which can be seen in the change in dynamics in overdrafts to individuals. It is known that over the period of intense re-financing (until the end of 2017) the annual growth rate in the segment remained negative, and some of the individuals and households switched to new products with fixed repayment schedules. This trend was discontinued in 2018 and overdrafts began growing, and the change rate in December reached 2.95% on an annual basis.

As a whole, the intensification of activity among individuals and households can be explained most of all by retention of relatively stable indicators of population's income, as far as over the whole period since the beginning of 2018 employee benefit expenses have been growing (6-9%), unemployment dropped for the seventh consecutive year (to 6.2% according to the Employment Agency data for the last year), and actual GDP growth has remained above 3% for the fourth consecutive year.

The data from the periodic BNB survey shows that demand for consumer loans over the past year has remained stable, and the interest in home purchase loans has continued to rise. According to the non-weighted results for the last quarter of 2018, the number of banks that registered an increase in demand for consumer loans and those that stated a decrease is comparable (3 versus 2). In home loans, the balance has been shifted towards increased demand (reported by 4 banks against just one bank which stated a decrease). It should be pointed out that unlike the corporate segment, here the contribution of the commercial banks' policy to enhance demand in the segment is much smaller, as far as in the first half of the year most financial intermediaries practically discontinued the relief of lending conditions. The results of the regular BNB survey show that in the third quarter, the balance of opinions on the changes made in consumer loan interests is -5, and in the fourth quarter it changed to -4 (compared to -18 for the same period of the past year). The balance of opinions on mortgage loans for 2018Q4 is -9, while for the same period of 2017 it was -32 (in the first half of 2017 half of the respondents surveyed decreased interests on newly granted consumer loans, and the share is even higher in home and mortgage loans – 13 out of 19 respondent banks).

The overall impression from the observation of lending activity in 2018 is that despite of its partial recovery it is below the target values of most banks in the country, since the growth rate in gross loans (excluding loans to banking institutions) has remained lower than the overall rate of loans, which grew over the past year by 8.61% on an annual basis, while the total volume of loans and advances granted increased by 8.89%, reaching BGN 89.029 billion at the end of December. The approximation of the two dynamics indicators (in 2017 the difference between the rates was several times bigger) results in retaining the structure of the loan portfolio, which until last year was changing in favour of low-interest and non-interest segments (loans to financial institutions, credit institutions and central banks). Over the past 12 months, this share has grown comparatively weakly (by 0.36 percentage points), completely at the expense of shrinkage of the share of NFC (Figure 3). In comparison, in the prior year, the increase in exposures to the low-interest and non-interest segment was several times higher (1.98 percentage points).

Figure 3 Structure of the loans and advances



The retention of lending standards against the still unsatisfactory volumes by new business (especially in the corporate sector) show that, just like in the prior year, banks in the country are more likely to retain the excess of attracted funds, accepting to pay the respective price for this in the form of a negative interest rate on excess reserves, than to lower their standards and decrease the share of rejected loan requests (this increasing the realization rates of available resources), but in the meantime risking a loss from potential future aggravation of the portfolio quality.

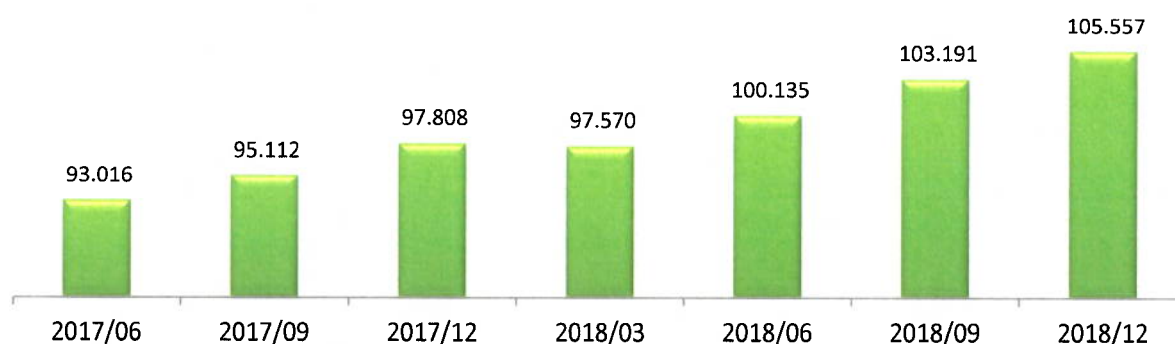
Financial intermediaries are also adverse to another alternative use of the resource, namely the purchase of securities. The balance sheets of commercial banks show that, with the exception of the first quarter, over the past year, the volume of debt securities in their portfolios have remained relatively constant (BGN 13.2-13.3 billion), which could be explained with the contradictory signals for forthcoming changes in interest rates. This is the reason why the excess in attracted funds is directed to exposures in central or commercial banks (in 2018, the total increase in these categories reached BGN 2.652 billion).

It is not surprising that local banks continue to compensate for their insufficient activity by increasing funding to non-bank financial institutions. Over the past year, the portfolio in this segment increased by 27.3% (BGN 690 million), which is more intensive compared to the prior year (24.9%). Thus they to some extent manage to compensate for the insufficient volume of gross loans, but not for the poorer profitability of their interest-bearing assets, since loans to BNFI by rule have low profitability.

The moderate intensification of lending activity and the retention of the high-liquidity (and low-profitability) assets structure are inevitable against the background of the established set of factors for the activity of financial intermediaries. The uncertainty remains high, and the criteria for impact of the asset quality on banks' profit are growing increasingly stricter, which on its part requires the adoption of a stricter approach to granting loans. In the meantime, deposits in the banking system continue to increase faster than expected, which results in an increase in the balance amount of banks to BGN 105.557 billion in 2018 (Figure 4); however, the placement of the accumulated resource remains focused on low-profitability categories (excess reserved and interbank deposits) rather than being redirected to business and household spending.

In an attempt to reverse this unfavourable trend, throughout 2018, the Bulgarian National Bank (BNB) retained the negative interest rate on excess reserves, by the transfer of the monetary impact on the actual economy remains unconvincing. As it was noted above, despite the negative interest rate on excess reserves, the share of the "cash and balances with central banks" item in the structure of bank assets over the past years decreased very slightly (from 19.9% at the end of 2017 to 19.3% at the end of 2018), and this decrease was fully offset by an increase in the share of another class of liquid assets (receivable from credit institutions), whose profitability is also low to negative.

Figure 4 Assets of commercial banks [BGN billion]



Source: BNB

The effect of the latest increase in the negative interest rate on excess reserves (to -0.6% as from 4 October 2017) has continued to be mainly manifest in the form of income redistribution between the financial institutions and to some extent to support the price of securities, rather in the form of an actual incentive to lending. It can be said that this is only logical due to the still weak trust of business in the development of the local economy, an indication whereof is the high rate of increase of funds attracted by NFCs.

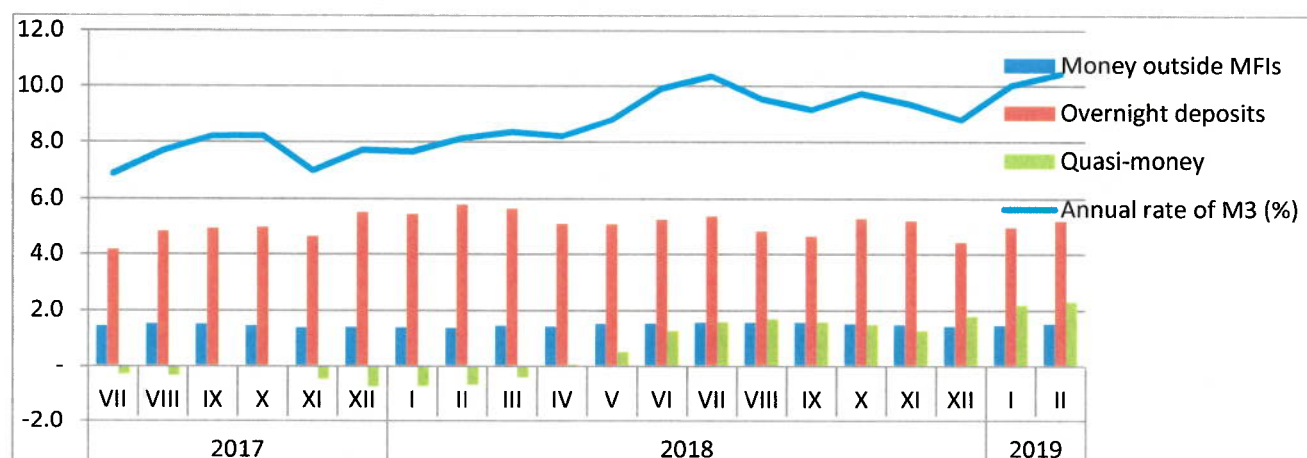
It is a fact that despite of the sustained stable macroeconomic indicators, many Bulgarian enterprises still refrain from commencing new projects and continue providing their available cash to local banks for safekeeping. In fact, at the end of 2018 there was a slowdown in the growth rate in the deposits segment (from 11-13% annual increase over the last five quarters to 4.5% in the final quarter of 2018), but this slowdown is probably due to factors of temporary nature (such as changes in the rates of certain banks), since in the very beginning of the following years, the indicator again increased (to 7.3% in February 2019).

The interesting thing is that the reinforced sanction failed to have a significant effect despite of households' increased aptitude to saving, which should have stimulated banks to be more active in lending. The Banking Supervision data shows that despite the growing expectations for forthcoming increase of interest rates on attracted funds, in 2018 the deposits from individuals reversed the prior year's trend. While throughout 2017 they followed a trend of slowdown of the dynamics indicators (from 6.2% on an annual basis in the first quarter of 2017 to 4.8% in the last), in 2018 the trend was exactly the opposite, and the annual rate of household deposits increased from 5.1% in the first quarter to 7.9% in 2018Q4. To some extent, this could be considered to be a natural result of the continuing increase of income and the uncertain recovery of the aptitude to spending. Last but not least, however, this is indicative of the individuals' weakening preferences for alternative forms of preserving value over time (mainly real estate), as well as growing negative expectations in the mid-term.

A clear indication of the weight of the last factor determining the behaviour of Bulgarian households is the dynamics of money aggregates. Following a certain period (the second quarter of 2017 and the first quarter of 2018, when the economic growth remained close to the post-crisis record of 2016Q4, and the growth rate of salaries reached two-digit values), quasi-money

(deposits with agreed maturity, or deposits agreed for use after a notice of up to 3 months) maintained a zero and even negative contribution to the change in cash, a point was reached when the trend was reversed. After the end of the first year-half, households became less prone to holding cash in a form allowing fast transfer to a more profitable alternative (a higher-interest product, or an alternative saving option), and more and more often prefer fixed-maturity products. Over the last months this trend has increased, and the growth in quasi-money has increased from 1.6% in the summer of 2018 to 2.3% in the beginning of 2019. The graph (Figure 5) shows that despite the retention of the profitability curve, households renew an increasing portion of matured fixed term deposits, which means that their expectations for future normalization of interest rates are weakening.

Figure 5 Money aggregates (annual growth, BGN billion)



Source: BNB, own calculations

An interesting finding may be made based on the comparison between the income statements for 2017 and 2018. The data shows that in the past year, banks in the country had total operating income at the amount of BGN 4.222 billion, which is BGN 336 million more than in 2017. This difference could to some extent be explained by some one-off effects, such as: including a new reporting item in the past year – foreign bank branch, which until the end of the first year-half was reported as non-bank financial institution, and whose net profit for 2018 amounts to BGN 45 million; receiving dividends on interest in other companies (BGN 150 million); recognition of revenue from sales on non-interest-bearing assets (BGN 82 million), etc. In the prior year, an effect of similar nature was stated (in the form of extraordinary income for banks, amounting to BGN 186 million, as a result of the deal between Visa Europe and Visa Inc. in June 2016), but now the contribution to increase in operating income from this category of effects is higher. The second reason is the increase in income from fees and commissions, amounting to BGN 103 million (8.9%), which is due on the one hand to the continuing loan refinancing, and on the other – to the imposing of fees on corporations' current accounts. The next reason is the decrease in interest costs on financial liabilities stated at amortised cost (mostly customer deposits) by BGN 83.9 million (28.9%). In the meantime, income for regular activities is growing at a slower rate (for instance, gross interest income on loans and receivables increased by only 1.57%). In short –

the allocation of contribution of the above mentioned factors is indicative of exhausting the potential for improving the profitability of banking institutions, and most probably – also of a forthcoming deterioration of indicators in the system.

The main risk for banks' profits in the short term is the forthcoming extension of the scope of Regulation (EC) No 924/2009, which will result in unification on outgoing EUR-denominated transfers in all EU states (until now, the Regulation only applied to Euro zone countries). The planned amendments will be effective as from 15 December 2019 and this will result in a significant decrease in the income from outgoing transfer fees, especially in Bulgaria, where these fees are the highest. Of course, this certainly does not exhaust the risks of aggravation of banking institutions' performance. A much more serious threat to the condition of financial intermediaries is the possible economic stagnation and the resulting risk of increase in provision costs.

As a whole, the observations made over the past period since the beginning of the year confirm our expectations – for moderate growth in lending, continuing recovery of the quality of loan portfolios, which remains probably the most significant trend, maintaining an asset structure of high liquidity and low profitability, continuing increase of attracted funds at relatively constant prices, and the retention of high liquidity ratios. The consolidation pressure will remain high, as a result of intensification of competition (including on the part of e-money companies and paying institutions), due to which new mergers may be expected in the bank sector.

II. Review of the activity of Tokuda Bank in 2018

As at 31 December 2018, the assets of Tokuda Bank AD amount to BGN 402.494 million, which (according to data of the Banking supervision) is 0.38% of the total amount of assets in the Bulgarian banking system. When compared to the assets of Group Two banks, to which Tokuda Bank AD belongs, this share is 1.01%. The average monthly value of assets is relatively constant; in the past year, the indicator reached BGN 398.4 million, and in 2017 – BGN 380.6 million.

In 2018, the Bank realised a net loss of BGN 267 thousand, with the potential income per share reaching a negative value. The reported result was weaker than in the preceding year – 2017, when the Bank stated a profit of BGN 1.001 million.

Over the past year, the Bank met all regulatory requirements and successfully adopted IFRS 9 and GDPR. The lending portfolio dynamics maintained its volatile nature due to intense competition for high-quality projects with acceptable return period and investors with proven creditworthiness. At the end of the period, gross loans to customers before impairment decreased to BGN 195.984 million. The portfolio quality improved significantly, and at the end of 2018, the share of the gross amount of serviced loans increased by 1.32 percentage points, reaching 83.56% (compared to 82.24% in 2017).

In 2018, the liquidation proceedings of the subsidiary Tokuda Sigurnost EOOD was completed; the subsidiary's financial and operating policy during its existence was sent by the Bank. The company was established in 2013 with registered capital of BGN 25 thousand (100% owned by Tokuda Bank AD) and over the period of its operation, its financial indicators were included in the consolidated financial statements of the Group. On 21 December 2017, by a decision of the sole owner of the capital, Tokuda Sigurnost EOOD discontinued its activity, and as at the point of preparation of this Report, the company has been liquidated.

1. Operating income and expenses

In 2018, the Bank generated operating income before impairment and loss provisions at the amount of BGN 13.289 million (Table 1), which is BGN 3.972 million (23.01%) less than in the preceding year. Its dynamics over the past year was still influenced most of all by the effect of the decrease in interest rates in the country, which resulted in an overtaking decrease in gross interest income, by BGN 1.736 million (14.11%). The rate of decrease of interests costs slows down due to approaching the psychological limit for deposit interests, and over the past period, this expense category shrank by BGN 474 thousand.

In 2018, the Bank continued to adhere to the adopted conservative policy regarding administrative expenses. As part of this policy, the management exercises systematic control over expenditure, in the meantime maintaining some of the measures on the Bank's rebranding on incentivizing staff efficiency. Conducting the above mentioned measures resulted in an increase in some items of the administrative and operating expenses, as a result of which their total amount increased in 2018 by BGN 243 thousand (to BGN 13.455 million).

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The ratio of the total volume of administrative and operating expenses to the total operating income before impairment and loss provisions for the past year increased by 24.70 percentage points (to 101.24%), which is due both to the above mentioned increase in expenses by BGN 243 thousand, and to the decrease in overall operating income before impairment and loss provisions by BGN 3.972 million (from BGN 17.261 million in 2017 to BGN 13.289 million).

The continuing decrease in interest levels and the preservation of the not particularly favourable market situation over the past year resulted in noticeable changes in the income structure (Table 1). In 2018, the share of net interest income increased by 7.20 percentage points and reached 63.06% of the total amount of net income, while non-interest income increased its share, reaching 36.94% (in the same period of 2017, these values were respectively 55.86% and 44.14%). The changes in the structure could be explained with the overtaking decrease in income from the second category, which dropped by 35.58% on an annual basis (due to the recognition of gains on revaluation upon the sale of a real estate owned by the Bank in the prior year and the lack of an analogous source in 2018) as compared to the net interest income, which decreased by 13.09% (BGN 1.262 million) in the past year.

Table 1. Operating income

	2018	2017
Interest income	10 569	12 305
Interest costs	(2 190)	(2 663)
Net interest income	8 380	9 642
Income from fees and commissions	4 023	3 837
Expenses for fees and commissions	(283)	(297)
Net income from fees and commissions	3 741	3 540
Net profit from financial assets held for trading	273	283
Other operating income (expenses)	895	3 796
Total operating income	13 288	17 261

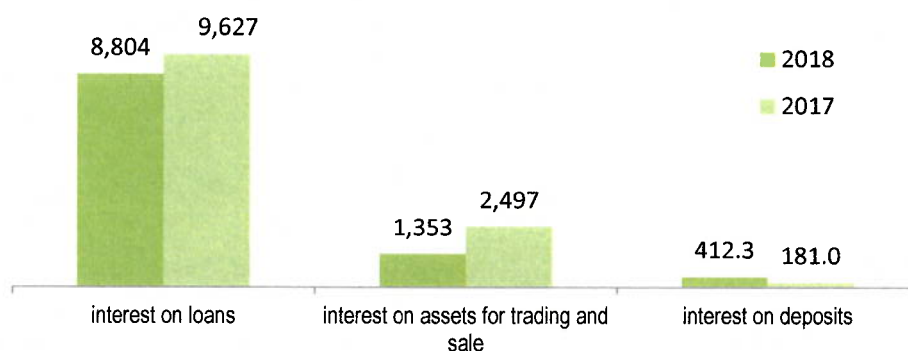
The grow income from interest on loans and other receivables decreased by BGN 823 thousand to BGN 8.804 million and continued to have the biggest relative share as compared to the total amount of interest income. The main factor for the decrease in grow income from the loan portfolio of Tokuda Bank AD is the overall market trend of decrease in interest rates, which is partially offset by an improving quality of the portfolio (over the past year, the share of classified loans before impairment decreased by 2.92 percentage points (to 24.16%), and the share of loans classified as “loss” – by 3.36 percentage points – to 11.65%). Irrespective of the decrease stated in this category of income (by 8.55%), on the background of the overtaking rate of decrease of interest income on securities (45.82%), in 2018 the share of interest income on loans increased by 5.06 percentage points compared to the previous year, reaching 83.30% at the end of the period.

Interest income from the debt instruments portfolio (Figure 6) decreased by BGN 1.144 million (or by almost a half of the figure stated in 2017), to BGN 1.353 million for the past year, on the one hand due to portfolio amortisation (resulting in the replacement of maturing issues with new ones, whose profitability is lower), but also due to the limited purchases of securities in 2018,

which resulted to a decrease in the portfolio's volume. The quicker rate of shrinkage of income from this source (compared to the change in interest income on loans) results in a noticeable decrease in the share of the first category in the total amount of interest income in 2018 – from 20.29% to 12.80%. Irrespective of the decrease in interests on interbank deposits (resulting from a higher sanction on excess reserves to -0.6% as from 4 October 2017), the interest income on loans and receivables from banks increased by BGN 231 thousand (compared to 2017), reaching BGN 412 thousand. The two-time increase of income from this item is entirely due to an increase in the average annual amount of this group of assets over the reporting period (BGN 41.388 million compared to BGN 22.702 million for the prior year).

The price of attracted funds remained above the average level for the country's banking system (as individual and household deposits maintained their predominant share in the Bank's deposit base), continuing to follow the overall downward trend. In 2018, interest costs decreased by 17.78% compared to 2017 (when they amounted to BGN 2.663 million) and reached 2.190 million as a result of the implemented effective policy of liability management.

Figure 6. Interest income by sources

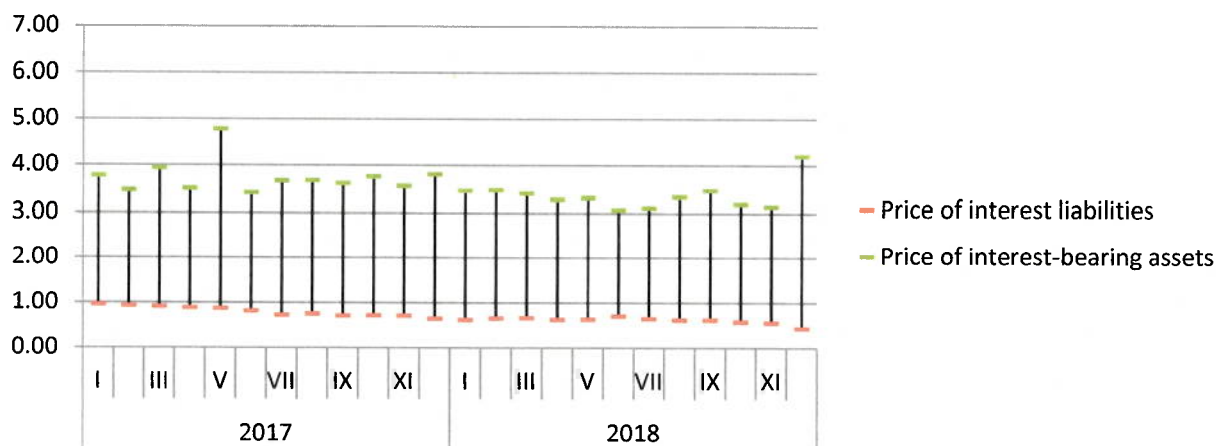


In 2018, the interest spread maintained its prior-year level (Figure 7), and until the end of November the indicator varied within a relatively narrow range (2.4-2.9), while in December it increased to 3.77. The comparison of the profitability of interest-bearing assets shows that over the past year, the average weighted profitability ratio increased by 0.37 percentage points (from 3.74% for 2017 to 3.37% for 2018), despite the decrease in the share of classified loans with delays on principal and interest payments by more than 180 days. This is a logical result from the decrease of interests in newly granted loans in view of consideration of the market dynamics, but was to a large extent compensated for by the decrease in expenses on attracted funds, which on an average annual basis decreased by 0.18 percentage points – from 0.61% in 2017 to 0.43% in 2018 (as a result of interest decreases and maturity occurrence of a significant part of the relatively expensive longer term deposits at the Bank).

The attraction of customers from the household segment has a favourable impact on the maturity structure of the resource, and in the past year resulted in an increase in the share of fixed term deposits by 5.12 percentage points (to 60.46%). The offsetting decreased in expenses for attracted resource, as well as the realization of additional income over the past year (as a result of

the realization of additional income from collected awarded receivables) resulted in maintaining profitability from interest-bearing assets upon reporting on accumulated basis in 2018 relatively close to the one reported in 2017.

Figure 7. Interest spread components



Non-interest income

In 2018, non-interest income decreased by BGN 2.711 million (35.58%) compared to the prior year and reached BGN 4.909 million, which is mainly due to the net impact of the decrease of gains on remeasurement of debt instruments measured at fair value through other comprehensive income (by BGN 1.480 million – to BGN 639 thousand), the decrease in dividend income (by BGN 66 thousand – to BGN 2 thousand), the decrease in gains on disposal of property and equipment, by BGN 2.061 million, the increase in the net income from fees and commissions by BGN 201 thousand, and the increase of rental income by BGN 194 thousand.

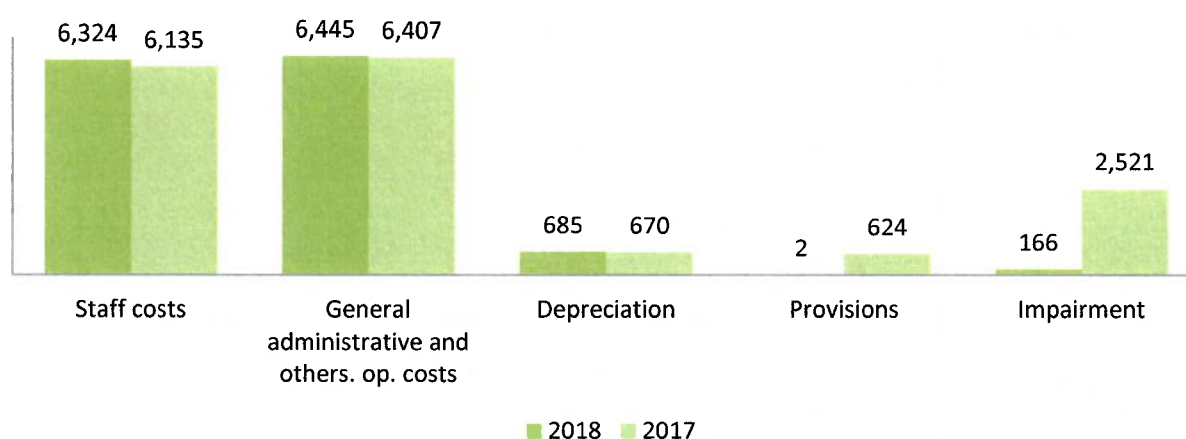
The largest share in this group of income remained that of net income from fees and commissions, which marked a moderate increase over the past year (by BGN 201 thousand or 5.67% on an annual basis) to BGN 3.741 million as a result of the increase income from loans granted, servicing of accounts, and guarantees issued. These increases were partly compensated for by the lower income from other sources, for instance, card services, outgoing transfers, and other fees, which decreased over the past year. As a whole, the structure of receipts from fees and commissions over the past year did not undergo significant changes, and the biggest increase was that of loan fees (5.91 percentage points, up to 21.65% of gross fees income), and the biggest shrinkage was that of outgoing transfer fees (2.47 percentage points, down to 38.58% of gross fees income).

The poorly expressed dynamics in prices and the known expectations for increase in basic interest indexes, which within the year moved further away in time, was expressed in less trading in securities, as a result of which the net income from trading operations remained relatively low, and reached BGN 273 thousand in the past year.

Non-interest expenses

The Bank's non-interest expenses in 2018 amount to BGN 13.622 million (Figure 8), which is BGN 2.637 million or 16.22% less than the preceding year. This is due to the decrease in impairment expenses (by BGN 2.257 million – to BGN 166 million) and provision expenses (by BGN 622 thousand – to BGN 2 thousand). Personnel expenses grew moderately, by BGN 189 thousand (to BGN 6.324 million), which is due to slight changes in the administrative structure and maintaining the average number of employees at a relatively permanent level (reaching 249 individuals at the end of 2018 as compared to 257 individuals at the end of 2017). Amortisation and depreciation costs increased by BGN 15 thousand (to BGN 685 thousand) as a result of the Bank's measures for renovation of the technological equipment. Rental expenses increased by BGN 47 thousand to BGN 1.143 million in relation to the measures undertaken to close down branches, while the other administrative and operational expenses remained almost unchanged (BGN 5.988 million in 2018).

Figure 8. Non-interest expenses



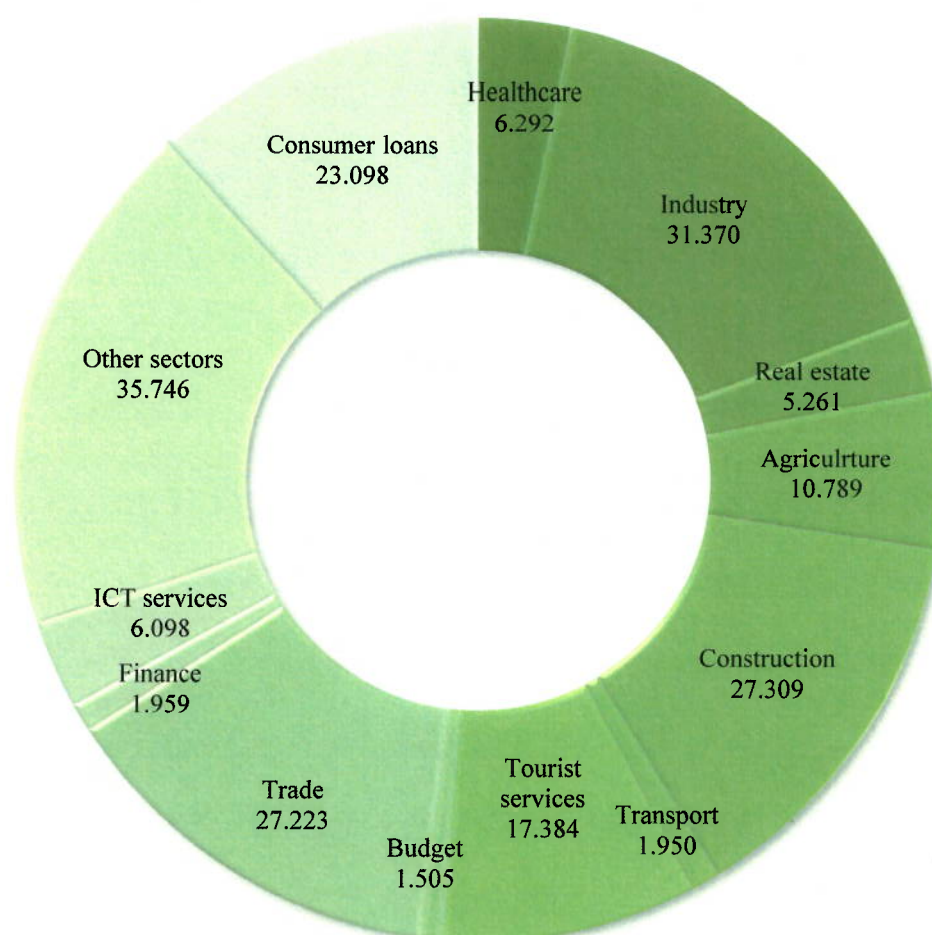
The clearly expressed dynamics of a portion of expenses in this group results in a change in its structure. For instance, the share of personnel expenses (including the labour remunerations and social security contributions) in the overall structure of non-interest expenses increased by 8.69 percentage points (from 37.73% to 46.43% over the past year), the share of total administrative and other operating expenses increased to 47.31%, and amortisation and depreciation costs in 2018 were 0.91 percentage points lower compared to the preceding year. The share of provisions decreased by 3.83 percentage points, and that of impairment expenses – by 13.68 percentage points (to 1.22% in the past year).

2. Loan portfolio

At the end of 2018, the gross carrying amount of the Bank's loan portfolio (Figure 9) was BGN 195.984 million. After allocation of provisions for loss from impairment at the amount of BGN 12.368 million, the net amount of the portfolio is BGN 183.616 million. The small increase

is due to intense competition on the loan market and the continuing relatively high risk of the environment, but also to the intensified activity of collection of receivables classified in the “loss” group. This on its part results in some decrease in the share of the loan portfolio following impairment in the overall assets structure, to 45.62% of the total asset amount at the end of 2018 (compared to 46.77% in the prior year).

Figure 9. Loan portfolio allocation [BGN million]



The loans to corporate customers decreased by BGN 6.262 million (to BGN 147.532 million before impairment), and their share in the gross amount of the credit portfolio shrank by 1.64 percentage points compared to the prior year (to 75.28%), which is due to the increased activity of forced collection and write-off against provisions accrued for non-performing loans in this segment.

The changes in the “*individuals and households*” segment were due to the Bank’s activities in this segment. The share of this category increased from 22.33% of the total amount of gross loans in 2017 to 23.95% in 2018. In absolute value terms, the segment increased by BGN 2.295 million, which is an increase of 5.14% compared to the prior year.

In 2018 the Bank continued its traditional business with entities from the industry, trade, energy, agriculture, healthcare, and other sectors. The biggest relative share this year was again that of loans to the industry sector, which in 2018 decreased by 3.82 percentage points and at the end of the year loans to the sector amounted to 16.01% of gross loans. Next by share are the construction sector (whose share increased by 2.06 percentage points to 13.93%), trade (whose share shrank from 15.25% to 13.89%), and tourism, whose share remained unchanged compared to the prior year (8.87%).

In the past year, the Bank has continued to maintain its moderately conservative lending policy, and new loans are approved if the individuals meet high reliability and creditworthiness criteria. An indicator of the effectiveness of these criteria is the regular servicing of loans by new customers.

The balance achieved in the lending activity has gradually been changing in favour of new loans to individuals and households, which during the year increased to 25.21% of the amount of newly granted loans, and the share of new loans to companies and budget entities decreased slightly, to 74.79% (in the previous year, these shares were respectively 24.88% and 75.12%).

The changes in the portfolio's currency structure are moderate. The share of BGN-denominated loans has increased by 8.27 percentage points (to 67.61% of the carrying amount of the loan portfolio following impairment) at the expense of a decrease in loans denominated in the single European currency (by 8.21 percentage point), and the share of loans in USD (by 0.07 percentage points – to 0.00%). At the end of 2018, 67.61% of the loan portfolio following impairment is denominated in BGN, and the remaining 32.39% - in EUR.

Table 2. Loan portfolio allocation by classification groups

	2018			2017		
	gross amount	provisions according to IAS	carrying amount	gross amount	provisions according to IAS	carrying amount
Served	163 200	312	162 888	164 435	616	163 819
Unserved	32 784	12 056	20 728	35 512	17 947	17 565
Total	195 984	12 368	183 616	199 947	18 563	181 384

Despite the preservation of a moderate economic growth rate, the increasing instability (in domestic and external political perspective), as well as the concern about forthcoming stagnation in foreign trade, continue to determine the behaviour of economic agents in the country. The slowdown of the rate of actual income, and the retaining uncertainty of the environment influence consumption patterns, which on its part makes it impossible to compensate for aggravated portfolio quality by means of a more intensive volume increase. Therefore, despite the success of the measures taken to decrease the share of non-performing loans over the last year, their share in the gross amount of loans and receivables from customers remained relatively high (16.73%), which could be explained by the insufficient intensification of lending activity.

In order to cover the risk of losses from loan impairment and in accordance with the requirements of the new IFRS 9, as at 31 December 2018 the Bank charged an allowance for

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expected credit losses at the amount of BGN 12.368 million, and the coverage coefficient has decreased from 9.28% to 6.31%. With regards to performing loans, the coverage of impairment provisions has decreased by 0.18 percentage points, reaching 0.19%. Nearly the entire impairment (97.48%) has been allocated to non-performing receivables (Table 2).

3. Securities

The securities portfolio has decreased at the end of 2018 by BGN 30.399 million, to BGN 44.528 million. Thus, its share in the total assets amount has shrunk by 8.26 percentage points compared to the previous year, reaching 11.06%. The rate of change was intensive (-40.57%), despite the fact that in view of the poor restoration of lending activities there were insufficient possibilities for relocation of the free resource towards lending. The restriction on this asset category is to some extent due to the policy adopted by the Bank, aimed at gradual restructuring of its assets by reducing low-profitability assets, and is also due to the growing expectations for a forthcoming change in the situation on the securities market.

The predominant portion of securities are available for sale, and they total amount over the last year has decreased by over one fourth (to BGN 44.354 million). The volume of the trading portfolio has also decreased, from BGN 14.126 million at the end of the previous year to BGN 174 thousand as at 31 December 2018.

Table 3. Securities portfolio

	31.12.2018	31.12.2017
Stocks and shares of local enterprises	467	551
Bulgarian state securities (including Eurobonds)	27 523	50 341
State securities of foreign governments (including Eurobonds)	14 807	22 222
Corporate bonds of local and foreign issuers	1 877	1 890
Impairment accrued for the year and allowance for credit losses	(146)	(77)
TOTAL	44 528	74 927

Over the last year, there has been a decrease in investments in local government securities (Bulgarian state securities and Eurobonds) in the Bank's balance sheet. In 2018, issues in this category decreased by BGN 22.818 million to BGN 27.523 million. Thus their share in the overall portfolio structure has shrunk by 5.38 percentage points to 61.81%. Foreign government securities have also decreased (by BGN 7.415 million to BGN 14.807 million), but their share in the total securities portfolio has increase by 3.60 percentage points (to 33.25%) due to the faster rate of Bulgarian sovereign securities. There has also been a decrease over the last year in the category of shares and interests in local entities, which have decreased by BGN 84 thousand, to BGN 467 thousand, and the slowest change rate is that of corporate bonds by local and foreign issuers, which in 2018 decreased by 0.69% (to BGN 1.877 million).

4. Attracted funds

In 2018, the volume of attracted funds from customers increased by 5.39% and in the end of the year reached BGN 359.330 million. The sources of most of the attracted resources were individuals and households (Table 4). Over the past year, the share of funds from this source increase by 0.60 percentage points (from 73.61% to 74.21% in the overall structure). This change is almost entirely at the expense of the resource of budget allocation entities, whose proportion decreased from 2.94% to 2.42%, or by 0.52 percentage points. The deposits of non-financial enterprises remained at second place when ranked by the share of attracted funds and were unchanged in the past year (23.30%). The continuing decrease in the attracted resource from non-bank financial institutions is completely explicable in view of the increasing liquidity indicators in the banking system. Over the last year, deposits from this source decreased by 52.72% to BGN 252 thousand, thus decreasing their share in the structure of attracted resources from 0.16% to 0.07%.

Tokuda Bank is no exception from the banking system and keeps maintaining high liquidity, this preserving a relatively weak interest in attracting any resource from banks. The total amount of deposits from credit institutions at the end of 2018 continues to occupy a negligible share of the Bank's liabilities (0.07%), increasing from BGN 191 thousand to BGN 268 thousand.

Table 4. Structure of attracted resources

	2018			2017		
	On-demand and savings deposits	Fixed term deposits	Total	On-demand and savings deposits	Fixed term deposits	Total
Accounts of local individuals	85 880	180 766	266 646	80 547	170 411	250 958
Budget accounts	8 711	0	8 711	9 015	1 008	10 023
Company accounts	47 253	36 468	83 721	62 201	17 229	79 430
NBFIs accounts	252	0	252	533	0	533
TOTAL	142 096	217 234	359 330	152 296	188 648	340 944

In 2018, several interest rate decreases were undertaken on the Bank's deposit products in view of optimisation of the funding price, as well as imposing fees on current account balances in order to improve the maturity structure of liabilities. As a result of achieving a good balance in targeting the effects sought, the average contract price of the resource has decreased, and its structure has changed in favour of fixed-term deposits, whose share increased by 5.12 percentage points to 60.46% (respectively, the share of current accounts decreased to 39.54%).

The changes in the currency structure of the attracted funds are insignificant and in favour of the USD, whose share over the last year increased from 7.62% to 9.16% at the expense of deposits denominated in BGN and EUR, whose shares decreased respectively by 0.58 percentage points (to 50.71%) and by 0.95 percentage points (to 38.81%). The shares of deposits denominated in JPY and other currencies remain unchanged – respectively 1.12% and 0.21% of the overall structure.

5. Risk exposure

The Bank has established a risk management system for the risk related to financial instruments, which for the purpose of its monitoring and management is defined as the likelihood of discrepancy between expected proceeds (from the financial instruments held) and actual ones. The system has been established so as to allow the timely identification and management of the different types of risk related to financial instruments. Particularly important to this system are the management procedures, the mechanisms for maintaining reasonable risk levels, ensuring optimal liquidity, and portfolio diversification.

A key element of the management system is the possibility to present and analyse the types of risks that the Bank is exposed to, in an exhaustive and certain manner, but also make a clear distinction between the types of risk that the Bank is exposed to, namely: credit risk, liquidity risk and market risk, which includes interest, currency, and price risk.

Credit risk, within the system used, is addressed by setting limits on the maximum credit risk exposure to a debtor, to a group of related parties, by relevant business sectors. In order to reduce credit risk, according to the internal credit rules, adequate collaterals and guarantees are required.

Cash and cash balances with the Central Bank amount to BGN 101,508 thousand as at 31 December 2018 (respectively BGN 70,362 thousand as at 31 December 2017) and do not bear a credit risk to the Bank due to their nature and the fact that they are at the Bank's disposal.

Loans and receivables from credit institutions as at 31 December 2018 amount to BGN 33,376 thousand (respectively BGN 25,114 thousand as at 31 December 2017) and represent mostly deposits in first-class international and Bulgarian financial institutions with maturity of up to 7 days. The Bank manages the credit risk associated with loans and receivables from credit institutions, by setting exposure limits at counterpart level.

Loans and advances to customers, with a carrying amount of BGN 183,616 thousand as at 31 December 2018 (respectively BGN 181,384 thousand as at 31 December 2017), expose the Bank to credit risk. In order to classify it, the Bank assesses the individual risk of each exposure by applying the criteria for risk assessment and classification according to the Policy for impairment of financial assets and contingent liabilities.

In order to calculate risk exposures to credit risk, the Bank applies the standard approach pursuant to Regulation (EC) No 575/2013. Due to the relatively small volume of financial instruments in the trading portfolio, capital requirements are calculated in accordance with the requirements of Regulation (EC) No 575/2013, applicable for the banking portfolio.

As at 31 December 2018, in order to calculate risk exposures to credit risk, Tokuda Bank AD applies the standard approach pursuant to Regulation (EC) No 575/2013. Due to the relatively small volume of financial instruments in the trading portfolio, capital requirements are calculated in accordance with the requirements of Regulation (EC) No 575/2013, applicable for the banking portfolio. To calculate the amount of capital necessary to cover operating risk losses, the basic indicator approach is applied.

Regarding **liquidity risk** (arising from the maturity gap of the assets and liabilities and the probable lack of sufficient funds of the Bank to meet its obligations on its current financial liabilities), it should be pointed out that Tokuda Bank maintains a high amount of liquid assets in the form of cash in hand and cash balances with the Central Bank, which guarantee the Bank's ability to meet its liquidity requirements/ As at 31 December 2018, the Bank's cash and cash balances with the Central Bank represent 25% of the Bank's total assets (respectively 18% as at the end of 2017).

As an additional instrument to ensure liquidity, the Bank uses loans granted to banks. These comprise mostly deposits in first-class international and Bulgarian banks, with maturity of up to 7 days. As at 31 December 2018, loans and receivables from banks constitute 8% of the Bank's total assets (respectively 6% as at the end of 2017).

Government securities owned by the Bank and not pledged as collateral as at 31 December 2018 represent 8% of the Bank's total assets (respectively 16% as at the end of 2017). By maintaining above 40% of its assets in highly liquid assets, the Bank ensures its ability to meet all its payment needs on matured financial liabilities.

Market risk arises on opened exposures in interest, currency and equity instruments, which are sensitive to general and specific market movements and affect the Bank's profitability. Market exposure is managed in accordance with the risk limits set by the management. The Bank manages the financial instruments held thereby, considering the changing market conditions. Market risk exposure is managed in accordance with the risk limits set by the management, by means of the purchase and sale of financial instruments or by opening an offsetting position to hedge the risk.

In order to measure and assess the **interest rate risk**, the Bank uses the GAP analysis method (misbalance method), allocating interest-bearing assets and liabilities in time ranges depending on the period left until their remeasurement (for instruments with floating interest rate) and maturity (for instruments with fixed interest rate). Thus it identifies the sensitivity of the expected revenue and expenses to changes in interest rates. The GAP analysis method aims to determine the exposure of the Bank, as a total amount and by separate types of financial assets and liabilities, in relation to expected interest rate fluctuations and their impact on net interest income. Its results support the management of assets and liabilities, and ensure sufficient and stable net interest income. Upon interest rate risk management, the Bank applies a policy and procedures according to the nature and complexity of its operations. By managing interest rate risk, the Bank aims at a stable spread between the interest income and expense to provide an adequate profitability and maximum value at an acceptable risk value, and in view of the business volumes and structure, the Bank's exposure to interest rate risk and its sensitivity to this risk may be determined as moderate.

Foreign currency risk is the possibility to realise losses as a result of changes in foreign currency exchange rates. Most of the Bank's assets and liabilities are denominated in EUR and BGN; therefore, an adverse change in interest rates is insignificant, in as far as the exchange rate of the BGN is fixed to the EUR (under the Bulgarian National Bank Act, adopted by XXXVIII

National Assembly on 5 June 1997, promulgated in the State Gazette, issue 47 dated 10 June 1997). Therefore, the Bank's open positions in EUR bear no currency risk for the Bank; such risk is posed by open positions in currencies other than EUR.

Price risk is related to the fluctuations in market prices of financial assets and liabilities which can cause losses for the Bank. The main risk for the Bank is the decrease in the market prices of the financial instruments held thereby for trading, which can lead to a decrease in net profit. As described in item 3 of this Section, most of the Bank's investments are in Bulgarian sovereign securities, which do not pose a significant price risk.

In 2018, Tokuda Bank AD kept adhering to a conservative approach in risk management and assessment, including with respect to credit risk, forming 88% of all risk exposures as at 31 December 2018. The Bank takes actions to decrease the risk on all credit exposures (mostly at the expense of the portfolio of non-performing loans), as a result of which the share of risk-weighted assets for credit risks has increased very slightly (by 1 percentage point). Overall risk exposure has increased by BGN 21.982 million compared to 31 December 2017.

Table 5 Risk-weighted assets

	31.12.2018		31.12.2017		change	
	BGN million	share	BGN million	share	BGN million	rate
For credit risk	193.251	88%	172.306	87%	20.945	12%
For market risk	0.35	0%	1.913	1%	-1.563	-82%
For operating risk	26.4	12%	23.8	12%	2.6	11%
Total	220.001	100%	198.019	100%	21.982	11%

Besides for the purposes of supervision, Tokuda Bank AD also calculates the Bank's economic capital, which would secure its solvency under unfavourable market conditions. For this purpose, an Internal Capital Adequacy Analysis (ICAA) is prepared.

6. Capital and reserves

As at 31 December 2018, the Bank's equity amounted to BGN 41.937 million, and the basic capital according to the capital adequacy requirements for credit institutions is BGN 42.125 million.

The Bank's capital indicators are above the regulatory limits. Its capital position ensures an adequate coverage of risk exposures. The adequacy of the core Tier 1 capital has decreased by 2.24 percentage points, reaching 19.15%, which exceeds the required regulatory limits.

As at 31 December 2018, the share capital amounts to BGN 68,000,000 /sixty-eight million/. The capital is allocated in 6,800,000 /six million and eight hundred thousand/ registered, non-materialised shares entitled to vote, with a nominal value of BGN 10 /ten/ each, and with an emission value equal to the nominal value.

According to the Book of Shareholders kept at the Central Depository, the Bank shareholders as at 31 December 2018 have remained, as follows:

- Tokushukai Incorporated, Japan (holding 99.94% of the capital);
- Gama Holding Group AD, Bulgaria (0.06%).

7. Branch network

Over the past year, the Bank has refrained from expanding its branch network. It closed down the Smolyan branch and the IRM Sheynovo branch in Varna, as part of the consistent efforts to optimize the regional structure, centralize and automate it, as well as relocate points of presence to better locations.

The structure of the branch network is as follows:

- Headquarters
- Offices – 22 nos.
- Remote workplaces – 4 nos.

The Bank's regional offices provide professional and high-quality services to their customers, as well as timely support in solving various issues and possibilities for utilization of new products and services.

8. Relations with correspondents

The Bank corresponds to all Bulgarian banks, as well as to leading banks abroad, following a policy for continuous optimization and expanding its relations with correspondents.

9. Human resources

The human resource is one of the key factors for achievement of the strategic objectives of Tokuda Bank AD. The Bank's management has been developing a human resource management system through continuous optimization of the staff administration processes (planning, recruitment, appointment, monitoring, assessment, promotion and dismissal). At the end of 2018, the total number of employees working at the bank is 249 (respectively 257 in 2017).

A determining factor for fulfilling the Bank's mission and strategy is the quality of its employees – their qualification, professional skills, and loyalty. The Bank's employees take part in a number of trainings and communications related to the functions performed thereby, since improving qualifications is one of the main and proven means to improve the working environment, service quality, and Bank's performance.

For the purpose of effective management of human resources, the internal information system (portal) is subject to continuous updates; in it, employees have access to internal documents and news related to the Bank's activity.

10. Information technologies

Over the past years, the process of decision making and the models related to the implementation of IFRS 9 have been successfully implemented in the Bank's main system. Moreover, a process commenced of selection and transfer to a software platform servicing the debit and credit cards issued by the Bank. The initiative aims to improve the quality of customer service and provide reliable information for the purpose of adequate management of card operations. One of the challenges in this area in 2019 will be the implementation and promotion of the new system in a way to support the better realization of Tokuda Bank's card products.

III. Development prospects in 2019

Upon determining development perspectives for 2019, some major assumptions have been made with respect to the environment in which the Bank will operate, in particular for certain slow-down in the growth rate of the Bulgarian economy, sustain of the conservative investment attitudes in the country, and additional weakening in consumption over the last quarter. In view of this situation, the Bank's management intends to maintain a moderately conservative policy upon performing its main operations, in view of stabilizing its profitability indicators, and conduct active marketing campaigns in order to increase market share. The main objective for 2019 is intensification of lending activity and improvement of the portfolio quality. The preliminary estimates in the financial plan show that the planned growth in activity may be achieved, as far as the Bank has a relatively small market share and has the potential to achieve lending rates that are above the average ones for the system.

A leading principle in determining development prospects is maintaining reasonable risk levels; therefore, the main priority in this year will again be the precise selection of appropriate customers and the reasonable assessment and management of credit risk.

In short, the main priorities for the Bank's development in 2019 have been retained in the way they were set upon determining its mid-term strategy, and may be summarised as follows:

- Improving the loan portfolio quality and optimising the asset structure in accordance with the policy on admissible credit risk and its capital coverage;
- Improving the Bank's efficiency; decrease of operating risks and building a solid base for long-term sustainable growth;
- Full use of modern information technologies to reach a wide range of customers, which would allow improving the quality and expanding the range of services offered;
- Increased activity in the field of retail lending in order to achieve better risk diversification and improve profitability indicators;
- Expansion of the market presence of the Bank by undertaking active measures aimed to increase the popularity of the "Tokuda Bank" brand and achieve better recognition thereof among potential customers;
- Establishing stable income from main operations to ensure higher return of share capital.

IV. Information about changes in the share capital, dividend policy and management

1. Changes in the share capital

In 2018 there were no changes in the volume and structure of the Bank's share capital. The majority shareholder, holding 99.94% of the capital, is Tokushukai Incorporated, Japan. As at 31 December 2018, Tokuda Bank AD does not possess any own shares.

2. Management

In 2018, the Bank preserved its two-layer management system. The members of the management bodies of the joint-stock company in 2018 were as follows:

Bank's Supervisory Board

Arthur Sterne – Chairperson of the Supervisory Board;

Dimitar Vouchev – Member of the Supervisory Board;

Thomas Michael Higgins – Member of the Supervisory Board.

Bank's Management Board

Maria Sheytanova – Member of the Management Board and Executive Director;

Anna Tsankova – Boneva – Member of the Management Board and Executive Director;

Todorina Doktorova – Member of the Management Board, Head of Corporate Banking.

The total amount of remunerations received over the reporting year by members of the Supervisory Board is BGN 42 thousand (respectively BGN 43 thousand in the prior year). The total amount of remunerations received over the reporting year by members of the Management Board is BGN 419 thousand (respectively BGN 454 thousand in the prior year).

The members of the Management Board and of the Supervisory Board have no rights granted for acquisition of Bank shares and bonds, as they or their related individuals have not concluded with the Bank any contracts beyond the usual activity or significantly deviating from the market conditions.

3. Dividend policy

The Bank has not paid any dividends. The 2018 result has been allocated for coverage of past-year losses.

4. Events after the date of the statement of financial position

On 12 April 2019, Kris Matlan joined the Supervisory Board. On 8 May 2019, Dimitar Vouchev joined the Management Board as a Board Member and Executive Director. No significant events

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This is a translation from Bulgarian of the Management Activity Report of Tokuda Bank AD for year 2018.

have occurred since the date of preparation of the statement of financial position that would result in adjustments or additional disclosures in the separate or consolidated financial statements.

5. Participation of Board Members in other companies

Supervisory Board:

- Arthur Sterne – Chairperson of the Supervisory Board: Shareholder and General Manager of Global Prime OOD, UIC 203874715;
- Dimitar Vouchev – Member: Member of the Board of Directors of Adamant Capital Partners AD, UIC 200413613; Owner and General Manager of Delta Capital EOOD, UIC 175278566; Member of the Board of Directors of the America for Bulgaria Foundation (NPO); Member of the Board of Directors of Partners Bulgaria Foundation (NPO);
- Thomas Michael Higgins – Member: Shareholder (58% of the capital) in EASTISOFT Inc.; Shareholder (38.3% of the capital) in YATOTO Inc. /USA/; Member of the Board of Directors and Shareholder (22.5% of the capital) in EMP Invest Bulgaria AD with UIC 203120042; General Manager of YATOTO EOOD with UIC 203831062

Management Board:

- Maria Sheytanova – Executive Director: Shareholder and General Manager of CTM Bulgaria OOD, UIC 201987988; Chairperson of the Board of Directors of TMA Bulgaria Association (NPO), UIC 176928159;
- Anna Tsankova-Boneva – Executive Director: Shareholder (70% of the capital) in Fine Line OOD, UIC 201758352;

V. Responsibility of the management

The prepared annual financial statements are in compliance with the statutory requirements and the International Financial Reporting Standards (IFRS) adopted by the European Union and applicable in the Republic of Bulgaria. They reflect in a reliable manner the property and financial condition of the Bank.

Upon preparing the annual financial statements (AFS), the management acknowledges that:

- the statements have been developed in compliance with the International Financial Reporting Standards;
- the statements have been prepared in accordance with the going concern principle and provide a truthful representation;
- the accounting policy applied is appropriate and has been consistently applied;
- the necessary judgements and assumptions made are in accordance with the prudence concept;
- all measures necessary for protection of the Bank's assets and prevention of fraud have been taken.

VI. Activities in the field of research and development

Due to the specifics of its operations, in 2018 the Bank did not perform any activities in the field of research and development.

VII. Activity as investment intermediary

Tokuda Bank AD performs services in its capacity as investment intermediary. The Bank intermediates the purchase and sale of financial instruments traded on a regulated market (Bulgarian Stock Exchange AD) and outside the regulated market. The Bank is a member of BSE and of Central Depository AD, and offers services as a Registration Agent. In its capacity as investment intermediary, the Bank meets certain requirements for the protection of customer's interests, in accordance with the provisions of the Markets in Financial Instruments Act (MFIA), Ordinance 38 on the requirements to operation of investment intermediaries, and Ordinance 58 on the requirements on protection of customers' financial instruments and cash, on product management and provision or receipt of consideration, commissions, other cash or non-cash rewards, issued by the Financial Supervision Commission (FSC). The Bank has established and applies an organisation for concluding and fulfilling contracts with customers, for compliance with the requirement for customers' data, accountability and storage of customers' assets in compliance with the statutory requirements, and in particular the provisions of Ordinance 38,

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Art. 28-31, and Ordinance 58, Para 3. Tokuda Bank has established and applies internal rules and procedures to ensure compliance with the legislation applicable to its operation as an investment intermediary.

The prepared Annual Management Activity Report and the Corporate Management Declaration are in compliance with the requirements of Chapter Seven of the Accountancy Act and Art. 1000 n, Para 8 of the Public Offering of Securities Act (POSA).

In 2018 and up to the date of this Report, there have been no tax consultations or any other forbidden services performed by either of the two audit firms – AFA OOD and ABVP-AUDIT STANDARD OOD, which carried out a joint independent financial audit of the Bank’s annual financial statements for 2018. Over this period, the audit firms and their network companies have carried out the following permitted services:

- Agreed-upon procedures for the application at the Bank of Ordinance 10 of the Bulgarian National Bank (BNB) for the period 1 January 2017 – 31 December 2018 in compliance with the requirements of the International Standard on Related Services (ISRS) 4400 “Engagements to perform agreed-upon procedures regarding financial information” – the engagement was undertaken and performed jointly by the two audit firms, AFA OOD and ABVP-AUDIT STANDARD OOD;
- Agreed-upon procedures for the application at the Bank of Ordinance 10 of the Bulgarian National Bank (BNB) for the period 1 January 2017 – 31 December 2017, in compliance with the requirements of the International Standard on Related Services (ISRS) 4400 “Engagements to perform agreed-upon procedures regarding financial information” – the engagement was performed by ABVP-AUDIT STANDARD OOD, jointly with the audit firm Deloitte Audit OOD, which performed the independent financial audit of the Bank’s separate and consolidated financial statements for 2017.
- Standard training, through online registration, on IFRS 15 and IFRS 16, to two Bank employees, provided by AFA Consultants OOD (a company which is a related party to AFA OOD).

By virtue of a Resolution of the Management Board of Tokuda Bank AD:

Maria Sheytanova

Member of the Management Board and
Executive Director



Anna Boneva

Member of the Management Board and
Executive Director

Sofia, 15 May 2019

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**CORPORATE GOVERNANCE STATEMENT OF
TOKUDA BANK AD**

(pursuant to Article 40 of the Accountancy Act and Art. 100m, Para 8 of the Public Offering of Securities Act (POSA))

1. Information on compliance with the Corporate Governance Code (Art. 100m, Para 8, p. 1, letter “a“ of POSA)

In 2018, TOKUDA BANK AD (the Bank) continued to comply, where appropriate, the National Corporate Governance Code (NCGC, the Code), published on the web page of the Bulgarian Stock Exchange AD (BSE), approved by means of decision No 461-KKY dated 30.06.2016 of the member of the Financial Supervision Commission (FSC) acting as Deputy Chair of the FSC responsible for the Supervision of Investment Activities Directorate, as corporate governance code pursuant to Art. 100m, Para 8, p.1, letter “a” from POSA.

The text of the National Corporate Governance Code is published on the website of the Financial Supervision Commission (www.fsc.bg).

2. Information on application of additional corporate governance practices (Art. 100m, Para 8, p. 1, letter “c“ of POSA)

TOKUDA BANK AD considers that the terms of the National Corporate Governance Code are sufficient to cover the requirements of good corporate governance. Considering this, the Bank does not apply additional corporate governance practices other than those included in the Code.

3. Description of the main characteristics of the internal control and risk management systems in relation to financial reporting (Art. 100m, Para 8, p.3 of POSA)

3.1. The Bank has established an adequate system for identification, management and control of its risk profile, including:

- organizational structure for assessment and management of risk sensitivity;
- rules and methods for risk assessment and control;
- parameters and limits for transactions and operations related to credit, liquidity and market risks;
- a reliable system for accounting and management information, which allows identification and control of different types of risks.

The system for risk management performs preventive functions regarding potential losses and control over the amount of incurred losses.

The Bank’s risk management and control organisation corresponds to the nature and volume of operations, the inherent risks and the degree and scope of the control over operations exercised by the management. The activities it includes may be summarised as follows:

- management control and control environment;
- risk control;
- control activities and allocation of duties;
- information and communication;
- monitoring and correction of deviations.

The Bank's development strategy is determined by the Supervisory Board. Based on the strategy, the Bank's risk appetite and risk profile are determined, which define its business model. The business model is subject to the risk appetite within the limits and thresholds established by the Management Board with respect to the significant risks which the Bank faces. Based on the strategy, risk appetite and profile of the Bank, the Management Board approves a plan and budget to accomplish the strategy, which includes targets, deadlines and measures to achieve the targets.

The competent bodies whose decisions on management lead to the formation of the Bank's risk profile:

- 1) Supervisory Board – performs overall supervision over risk management; approves the Bank's development strategy, on which the institution's risk profile and risk appetite depends; approved a plan, budget and measures for the realization of the strategy and monitors their implementation. It appoints the head of the Risk Monitoring and Management Division and receives periodic and regular reports from the management, including capital management and capital plan; approves and confirms the capital plan prepared by the Risk Monitoring and Management Division and approved by the Management Board.
- 2) Management Board – responsible for overall approach to risk management and for the approval of the plan, budget, principles and specific methods, techniques and procedures for risk management, as well as for approving the capital plan.
- 3) Risk Monitoring and Management Division – a specialised Bank unit for risk analysis, management and monitoring. The Division's functions are independent from the business units and from the units performing compliance and internal audit functions. The Division reports directly to the Bank's Supervisory Board.

The Risk Monitoring and Management Division performs activities in the following areas: maintenance of database of information needed for risk assessment; monitoring and control of risks; regular control over compliance with limits; methodological support for other Bank's units related to application of internal rules and procedures for regular assessment and control of risks; compliance with internal rules and procedures for risk management; update of procedures for risk management and tools for controls of the risks in the Bank.

- 3.2. The main principles and actions, aims, rights and responsibilities, reporting lines and types of audits performed by the Internal Audit are regulated in the Rules for organisation and activities of the Internal Audit specialised service at Tokuda Bank AD. The rules are compliance with the applicable regulations of: the Bulgarian National Bank Act, the Credit Institutions Act, Ordinance 10 of BNB regarding the internal control in Banks, the Financial Supervision Commissions Act, the Public Offering of Securities Act, the Special Purpose Investment Companies Act, the Measures Against Market Misappropriation with Financial Instruments Act, the Markets for Financial Instruments Act.

The Internal Audit supports the Management and Supervisory Boards in the performance of their function by providing objective, independent and reasonable assurance that the Bank is in condition to achieve internal control environment relevant to its goals. The Internal Audit performs assessment and recommends improvements to the efficiency of the corporate governance system, risk management and control processes by:

- a) performing assurance engagements and providing an independent and objectively documented opinion regarding:
 - the reliability, accuracy, completeness and timeliness of financial reporting and management information;
 - the effectiveness and efficiency of operations and of achieving operational and financial objectives and safeguarding of assets;
 - legal compliance with the applicable statutory and regulatory provisions.
- b) making suggestions for remediation of identified deficiencies and weaknesses in the control environment;

- c) performing advisory engagement by providing recommendations for improvement of existing practices and procedures and for development of effective control activities in the process of development of new procedures.
- d) performing extraordinary audit engagements and audits for fraud prevention.

The Internal Audit reports administratively to the Management Board and functionally to the Supervisory Board of TOKUDA BANK AD, which allows attaining the necessary degree of independence and effective performance of its responsibilities. The Head of the Internal Audit has direct and unrestricted access to the Management Board and Supervisory Board.

3.3. As part of the Bank's operational activities, internal financial control is established and carried out – preliminary, current, and subsequent control. There are established systems for internal control over financial reporting.

Preliminary control is carried out over all types of accounting transactions and precedes their performance with the aim to ensure their lawful implementation.

Current control for operations with high level of operating risk is performed in the process of execution of banking transactions and aims to exclude deviations from established rules and procedures for performance of accounting operations, their compliance with legal requirements and timely correction of any errors, etc.

Subsequent control comprises all actions and measures with the aim of timely detection of unlawful activities and transactions, omissions and errors, fraud, waste of assets and other irregularities which were committed despite the measures included in the preliminary and current control.

The internal control environment established at the Bank ensures the reliability of the financial reporting information. The functions of control over financial reporting include: organizational and operating independence of the unit responsible for financial reporting from the business units; alignment between the organization structure and the process for control and management of the related risks by strict definition of responsibilities; integrated information systems, which provide detailed breakdowns and report; developed framework of procedures and rules related to financial reporting and information security; definition and monitoring of approval limits and system for internal control processes; independent assessment for compliance performed by Internal Audit.

3.4. The risk assessment and monitoring function is performed by the Risk Monitoring and Management Division. The Division receives and analyses information about the assessment, control and monitoring of the Bank's inherent risks, including:

- Credit risk;
- Market and liquidity risk;
- Operational risk.

Sources of information for the Division for analysis and assessment of risks:

- IT systems and software used by the Bank – general banking and accounting system;
- The business units related to new loans proposals and data for performing loan portfolio monitoring;
- The Liquidity and Money Markets Division about information concerning the banking and commercial securities portfolio;
- The Legal Division (including Legal Compliance and Anti-money Laundering) with respect to legal risks, incl. litigation risks and risk of non-compliance of the internal regulations, banking products, etc. with the legislation and regulatory framework;
- The Banking Security Department with respect to operational risks, including risk of fraud and other potential risks related to the Bank's security;

- Chief Economist – summarised information on a daily basis about the development of the deposit base and attracted funds;
- All employees of the Bank, clients and other external parties with respect to information for operational events and submitted complaints.

The Risk Monitoring and Management Division received requests for analysis and opinion with respect to transactions that lead to additional credit or market risk through:

- provision of new loan exposures;
- approval of new or change/discontinuing of existing loan or deposit products;
- executing new deals and purchases of financial instruments;
- establishing correspondence relations and opening new Bank exposures with other banks;
- other proposals for taking/terminating or change in the effect of risks to which the Bank is exposed.

Based on the received proposals, the Division prepares opinions addressed to the respective committees and the Management Board, which perform review and take decision on the proposals in compliance with the Bank's internal policies and procedures, the rules for activities of the committees and the approved limits for risk taking by different bodies.

It also prepares periodic and current reports to the Supervisory Board regarding the Bank's capital adequacy, based on quarterly reports.

Regarding the operational risk, the Division collects information from all employees and external clients regarding operational events that have occurred and maintains a database of registered operational events and claims. The information is reviewed regularly by the Risk Committee and the Risk Monitoring and Management Division periodically informs the Management Board of any significant operational events and identified deficiencies in the activities which expose the Bank to operational risk.

Units which perform risk-taking functions:

- Supervisory Board and Management Board approve measures and tools for implementation of the Bank's strategy in compliance with its risk profile and appetite and provide final approval/rejection of the proposals for new loans resulting in significant exposure (at an amount equal to or exceeding BGN 500,000), changes in terms of existing loans, measures for exiting of problem exposures, new investments in securities and other assets, etc.;
- The Business units, including the branch network and the departments which provide lending services, perform the following:
 - Decisions of the Credit Council and the Management Board for approval of new loans, changes in terms of existing exposures, actions for decreasing non-performing exposures, etc., made based on risk opinions provided by the RMMD;
 - Decisions of the Credit Council and the Management Board for introduction of new loan or deposit products, discontinuance or changes to existing loan and deposit products;
- The Liquidity and Money Markets Division implements decisions of the Assets and Liabilities Committee (ALCO) taken based on the opinions provided by the Risk Monitoring and Management Division with respect to purchases of securities for the portfolios of the Bank and establishment of correspondence relationships or deposit of funds with other banks.

4. Information per Art. 10, Paragraph 1, letters "c", "d", "f", "h" and "i" of Directive 2004/25/EC of the European Parliament and of the EU Council of April 21, 2004 related to takeover bids (pursuant to Art. 100m, Para 8, p. 4 of POSA)

4.1. Significant direct or indirect shareholdings (including indirect shareholdings through pyramid structures and cross-shareholdings) within the meaning of Art. 85 (repealed) of Directive 2001/34/EC.

As at 31 December 2018, TOKUDA BANK AD has no direct or indirect shareholdings within the meaning of Art. 85 of Directive 2001/34/EC.

As at 31 December 2018, the shareholder structure of TOKUDA BANK AD is as follows:

Shareholder	Number of shares	Share in capita (%)
Tokushukai Incorporated	6,796,250	99.94
Gama Holding Group AD	3,750	00.06
Total	6,800,000	100.00

Dr. Torao Tokuda is the owner of Tokushukai Incorporated, Tokyo, Japan, and he is the individual who controls the direct shareholder Tokushukai Incorporated because he: 1) owns over 50 percent of the voting rights in the General Meeting of Shareholders and 2) can nominate more than half of the members of the Management Board. Therefore, Dr. Torao Tokuda has significant indirect interest in the Bank's capital.

4.2. TOKUDA BANK AD has not issued shares with special rights of controls and has no shareholders, which own shares with special control rights;

4.3. The Statute of TOKUDA BANK AD does not specify restrictions over voting rights of shareholders.

4.4. The rules that establish the appointment or change of the Management and Supervisory Board and changes in the Statute:

- Statute of TOKUDA BANK AD;
- Rules for reporting of conflict of interest and ensuring confidentiality in the transactions and operations of TOKUDA BANK AD;
- Guidelines for the competencies of the members of the Management Board and key employees of TOKUDA BANK AD;
- Rules for selection of members of relevant management unit of TOKUDA BANK AD;
- Rules for activities of the Supervisory Board of TOKUDA BANK AD;
- Rules for activities of the Management Board of TOKUDA BANK AD.

4.5. The powers of the members of the Supervisory Board and Management Board of TOKUDA BANK AD are established in:

- Statute of TOKUDA BANK AD;
- Rules for establishment of the responsibilities of the Management Board of TOKUDA BANK AD;
- Rules for activities of the Management Board of TOKUDA BANK AD;
- Rules for activities of the Supervisory Board of TOKUDA BANK AD.

4.6. The share capital of TOKUDA BANK AD may be increased by means of a decision of the General Meeting of Shareholders, or by a decision of the Management Board, approved by the Supervisory Board, according to the Statute's provisions. The share capital of TOKUDA BANK AD may be decreased by means of a decision of the General Meeting of Shareholders, made by a qualified majority of 2/3 (two thirds) of the shares represented. The share capital of the Bank may be decreased upon the preliminary written approval of BNB, following the statutory procedure: 1) through decrease of the nominal value of the shares; 2) through redemption of shares.

5. Information regarding composition and functions of administrative, management and supervisory units and their committees (pursuant to Art. 100m, Para 8, p. 5 of POSA)

TOKUDA BANK AD has a two-tier management system, which includes a Supervisory Board and a Management Board with the following responsibilities, power and composition:

The Supervisory Board (SB) currently consists of three members, elected by the General Meeting of Shareholders for a five-year term. According to the Bank's Statute, members of the Supervisory Board may be re-elected without restrictions. A member of the Supervisory Board may be a physically able natural person, and a legal entity, which meet the requirements of the law and bylaws of the Bulgarian National Bank and have been approved thereby. SB performs its powers and responsibilities in compliance with the applicable legal requirements, the Bank's Statute, decision of the Shareholders and the Rules for its activities. The SB appoints and releases the members of the Management Board and approves the Executive Directors.

The members of the Supervisory Board as at 31 December 2018 are:

- Arthur Stern – Chairperson of the Supervisory Board;
- Thomas Michael Higgins – Member of the Supervisory Board;
- Dimitar Voutchev – Member of the Supervisory Board.

The Management Board (MB) consists of 3 to 5 members, and their number is determined by the Supervisory Board. Members of the Management Board may only be individuals who meet the requirements of the law and bylaws of the Bulgarian National Bank and have been approved thereby. Members of the Management Board are elected by the Supervisory Board for a 5-year term and may be re-elected without restrictions, and may be dismissed and replaced before their term expires at any time by means of a decision of the Supervisory Board. The MB operates according to the Statute of the Bank and the Rules for its activities and performs tasks and activities required by law, by decision of the Shareholders and the Supervisory Board. The MB is a permanently-functioning collective body for management and representation of the Bank, which operates under the supervision of the Supervisory Board and in compliance with the established vision, goals and strategy of the Bank.

In 2018 and as at the present moment, the members of the Management Board are:

- Maria Sheytanova – Member of the Management Board and Executive Director;
- Anna Tsankova-Boneva – Member of the Management Board and Executive Director;
- Todorina Doktorova – Member of the Management Board.

By means of a decision of the Supervisory Board dated 12 April 2019, Mr. Dimitar Vouchev was elected member of the Bank's Management Board. By means of a decision of the Management Board dated 12 April 2019 and with the approval of the Supervisory Board, Mr. Dimitar Vouchev was elected Executive Director. Within the statutory term, BNB was informed of these decisions. Registration in the Commercial Register of Mr. Dimitar Vouchev as member of the Management Board and Executive Director of the Bank is pending..

The members of the Management Board and Supervisory Board have no rights for acquisition of shares or bonds of the Bank, as well as they and their related parties have no concluded contracts with the Bank outside of the ordinary activities or under terms outside the market terms.

The activity of the Management Board and the Supervisory Board is supported by permanent committees established at the Bank (listed herein below) – consultants for assessment and decision making on lending activity, liquidity and securities portfolios, asset profitability, risks, and other aspects of the Bank's operations.

In 2018 and at present, the following committees are active within the Bank's structure:

The Credit Council (CC) in its capacity as a collective body to the Management Board, in accordance with the approved rules on its work, the Bank's lending policy and the applicable legislative provisions:

- reviews and takes decisions for approval of new loan exposures, changes in existing exposures (renegotiated and restructured), taking measures for exit the existing exposures, enforcement of problem exposures of clients or group of related clients with exposures up to 10% of the Bank's capital base;
- proposes for review and approval by the Management Board loan proposals for exposures exceeding 10% of the capital base;
- reviews and submits to the Management Board proposals for collateral acquisitions by the Bank under bad debts, cession of loans and write off of loans under existing exposures.

The Credit Council is structured in three levels and the power of each level is determined in the "Rules for Activities of the Credit Council of Tokuda Bank AD" and in the "Policy, Rules and Procedures for Credit Activity of Tokuda Bank AD". In its operations, the Credit Council is governed by the requirements of the Law on Credit institutions and other legislation, which regulates the credit activities, as well as the internal policies and procedures of the Bank.

Currently, the members of the Credit Council are as follows:

First level:

- Veneta yancheva – Head of Credit Risk – Small and medium Clients, in Risk Monitoring and Management Division, Chairperson.
- Regional Manager or Retail Banking team manager.

In 2018, the following changes occurred in the Credit Council composition – first level: in the beginning of 2018, Svetozara Stoyanova-Tavityan – Head of Legal Division, left.

Second level:

- Todorina Doktorova – Head of Corporate Banking Division, Member of the Management Board, Chairperson;
- Sabin Simeonov – Head of Risk Monitoring and Management Division;
- Emil Krastev – Chief Legal Advisor in Legal Division.

Third level:

- Maria Sheytanova – Executive Director; Chairperson;
- Todorina Doktorova – Head of Corporate Banking Division, Member of the Management Board;
- Sabin Simeonov – Head of Risk Monitoring and Management Division;
- Svetozara Stoyanova-Tavityan – Head of Legal Division.

The Committee for Analysis, Classification and Impairment (CACI) is the Bank's competent body on monitoring, measurement and classification of financial assets and contingent liabilities, and on determining impairment losses and provisions, which makes the decisions on classification and determining impairment losses on financial assets and determined provisions under contingent liabilities. CACI analyses the ground for reclassification of credit exposures and controls compliance with BNB's requirements and the internal rules in this area.

The current members of the Committee are as follows:

- Anna Boneva – Member of the Management Board and Executive Director – Chairperson;
- Svetlin Todorov – Head of Finance and Accounting Division – Member;
- Miglena Ivanova – Head of Loan Administration Division – Member;
- Reny Paneva – Head of Receivables Department– Member;
- Delyan Pehlivanov – Chief expert in Credit Risk – corporate clients in Risk Monitoring Division – Member;
- Marina Borisova – Legal advisor in Receivables Department – Member. She is currently being substituted at this role by Hristina Stefanova – Legal Advisor in theReceivables Department .

The Assets and Liabilities Committee (ALCO) is the main body for management of the liquidity of TOKUDA BANK AD. It bears direct responsibility for the liquidity state and daily liquidity management based on decisions of the Management Board, as well as for the current management of the assets and liabilities. ALCO performs a monthly analysis of the existing interest and liquidity risk and presents it to the Management Board. In compliance with the Rules on the organisation and activity of the Assets and Liabilities Committee of Tokuda Bank AD, ALCO consists of seven members, as follows:

- Executive Director –Chairperson;
- Executive Director – Deputy Chairperson;
- Head of Risk Monitoring Division;
- Head of Corporate Banking Division;
- Head of Retail Banking Division;
- Head of Liquidity and Money Markets Division;
- Chief economist of the Bank.

The current ALCO members are as follows:

- Anna Boneva – Member of MB and Executive Director –Chairperson;
- Vanya Vassileva – Chairperson of MB and Executive Director –Deputy Chairperson;
- Sabin Simeonov – Head of Risk Monitoring Division – Member;
- Todorina Doktorova – Member of MB, Head of Corporate Banking Division – Member;
- Teodora Stoyanova – Head of Retail Banking Division – Member;
- Dessislava Nikova – Head of Liquidity and Money Markets Division;
- Grigor Sariiski – Chief economist – Member.

There were no changes to the members of the Assets and Liabilities Committee in 2018 and no changes are presently planned.

The Risk Committee is a specialized internal body of the management of TOKUDA BANK in the area of management and control of the exposure of the Bank to credit, market (including interest, liquidity, currency), operational and other risks. The activities of the Risk Committee serve to fulfill the Bank’s goals and tasks, by supporting the Management Board and Executive Directors with suggestions and decisions, for the purpose of effective risk management. The Risk Committee is currently comprised of:

- Sabin Simeonov – Head of Monitoring and Risk Management Division –Chairperson;
- Svetlin Todorov – Head of Finance and Accounting – Member;
- Grigor Sariiski – Chief economist – Member;
- Miglena Ivanova – Head of Loan Administration Division – Member;
- Emil Krastev – Chief Legal Advisor in Legal Division – Member.

There were no changes to the members of the Risk Committee in 2018 and no changes are presently planned.

The Audit Committee, established pursuant to the requirements of the Independent Financial Audit Act, is a permanent specialised independent advisory body at the Bank, whose aim is to

monitor the effectiveness and adequacy of the financial reporting processes, risk management and control, including internal audit, in accordance with the applicable legislation and best practices. The Audit Committee is appointed by the General Meeting of Shareholders of Tokuda Bank AD, which also determines its term and number of members.

The Audit Committee performs its activities in accordance with the Rules on its activity approved by the Bank's Supervisory Board, and reports its activity to the General Meeting of Shareholders once a year, together with the approval of the annual financial statements. The Audit Committee monitors the financial reporting and the independent audit of the Bank, the effectiveness of the internal control systems and risk management, recommends the selection of a registered external auditor and monitors his independence.

In 2018 and at present, the members of the Audit Committee are:

- Veneta Ilieva –Chairperson;
- Rumyana Asenova – Member;
- Violeta Milusheva – Member.

6. Description of the diversity policy applied with respect to administrative, management and supervisory bodies (pursuant to Art. 100m, Para 8, p. 6 of POSA)

TOKUDA BANK AD in its capacity as a credit institution under the CIA is subject to special statutory criteria in the selection and approval of applicants for Board Members of the Bank, including, but not limited to, education, qualification and professional experience, reliability and suitability, etc.

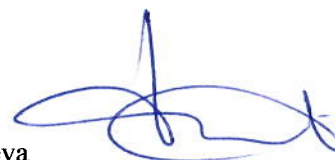
TOKUDA BANK AD ensures diversity by means of:

- balanced age and gender structure at management and control levels;
- level of education and diverse areas of knowledge (finance, law, information technologies) corresponding to the national regulatory requirements and aimed to include a wide range of skills and competences;
- professional experience adequate to the respective positions, in compliance with the regulatory requirements, in the meantime aiming to maintain a balance between experience, professionalism, familiarity with the activity, as well as independence and objectivity in sharing opinions and decision making.

In addition, the diversity at TOKUDA BANK AD is also related to continuity of historical traditions and fast adaptation to the latest technologies in the field of financial services.



Maria Sheytanova
Member of the Management Board and
Executive Director



Anna Boneva
Member of the Management Board and
Executive Director



INDEPENDENT AUDITORS' REPORT

To the shareholders of Tokuda Bank AD

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

Opinion

We have audited the financial statements of Tokuda Bank AD (“the Bank”), which comprise the statement of financial position as at 31 December 2018 and the statement of profit or loss and other comprehensive income, the statement of changes in equity and the statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2018, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union (EU).

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditors' Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants (IESBA Code)* together with the ethical requirements of the Independent Financial Audit Act (IFAA) that are relevant to our audit of the financial statements in Bulgaria, and we have fulfilled our other ethical responsibilities in accordance with the requirements of the IFAA and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.



Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key Audit matter	How this key audit matter was addressed in our audit
<p data-bbox="172 562 778 640"><i>Impairment of credit losses on loans granted to and receivables from customers and the related impact of the initial adoption of IFRS 9 Financial Instruments (IFRS 9)</i></p> <p data-bbox="172 663 778 819">The Bank's disclosures regarding the impairment of credit losses on loans granted to and receivables from customers are included in <i>Note 3.2.1.4. Impairment of financial assets, Note 3.1.2. Determining expected credit losses on loans to and receivables from customers, Note 30.2. Credit risk and Note 8 Loans granted to and receivables from customers</i> to the financial statements.</p> <p data-bbox="172 853 778 1279">Loans granted to and receivables from customers represent a substantial proportion (46%) of the Bank's total assets as at 31 December 2018. The gross carrying amount of these loans as at 31 December 2018 is BGN 195,984 thousand, and the respective allowance for accumulated credit losses therefrom is BGN 12,368 thousand. As disclosed in <i>Notes 30.2 and 8</i>, the impairment of credit losses on loans to and receivables from customers is determined on an individual and portfolio basis.</p> <p data-bbox="172 1301 778 1682">The Bank has adopted IFRS 9 <i>Financial Instruments</i>, effective as from 1 January 2018. The most significant impact of initial adoption on the Bank is related to the fact that determining impairment is based on expected credit losses, rather than on incurred losses. The effect stated in the opening balances of equity in relation to the impairment of credit losses on loans granted to and receivables from customers amounts to BGN 618 thousand.</p> <p data-bbox="172 1715 778 1921">The application of the new model to determine the impairment of credit losses on loans granted and receivables to customers results in a significant increase in the complexity and the need of judgements and key assumptions on the part of the</p>	<p data-bbox="778 562 1455 819">In this area, our audit procedures included, among others:</p> <ul data-bbox="778 842 1455 1921" style="list-style-type: none"><li data-bbox="778 842 1455 1379">• Obtaining understanding of the process of adoption of IFRS 9, with a focus on the implementation of a new methodology in the Bank's model to determine credit losses, including the use of key assumptions and estimates, and on the impact on the date of initial adoption of the standard, 1 January 2018. Additionally, an assessment was made of the management of the process of developing impairment models, as well as of their documentation, justification, frequency of updates to the models and the main data used therein;<li data-bbox="778 1402 1455 1592">• Inquiries, walk-throughs and obtaining an understanding of the Bank's process and controls of monitoring and determining impairment of credit losses on loans granted to and receivables from customers in the Bank.<li data-bbox="778 1615 1455 1921">• Obtaining understanding of the procedures and calculations of the impact of initial adoption of IFRS 9. Analysis and assessment of the established amounts of the effects as at 1 January 2018, including whether they have been stated in accordance with the standard's transition requirements.

Bank's management – both regarding the identification of loans and receivables with credit losses, and regarding the process of determining the amount of credit losses.

In order to determine the amount of impairment of expected credit losses, the Bank applies a model based on key inputs, originating from internal and external sources and parameters which suggest significant judgements and assumptions in:

- Interpretation of the requirements to determine impairment pursuant to IFRS 9, on which the Bank's model is based to determine and calculate expected credit losses;
- The assumptions inherent in the model of expected credit losses aimed to identify a significant deterioration of the credit quality of exposures, the presence of low and/or significantly increased credit risk, respectively exposures with objective evidence of impairment;
- Calculations and interpretations of the key indicators "probability of default", "loss given default" and "exposure at default". There is a higher degree of approximation and judgements by management in the calculations of expected credit losses of the portfolio basis in Stages 1 and 2;
- Judgements related to the scope and completion of the inputs and calculation logic;
- Assumptions and estimates in a number of scenarios for expected future cash flows, based on past events, current conditions and future economic forecasts;
- Assumptions applied by management in the review of significant credit-impaired exposures in Stage 3, related to recent losses, set of probability scenarios for future cash flows and results therefrom, and for future collection, including from realised collaterals.

- Inspection and review of the internal policies and procedures related to the process of determining the impairment of credit losses, as well as the process of monitoring and management of loans granted to customers. Inquiries to Bank experts responsible for the modelling and management of credit risk.
- Assessment and testing of the design and operating effectiveness of key controls in the process of monitoring and determining the amount of impairment of credit losses. Use of our IT experts to perform, assess, and test general IT controls.
- Review and assessment of the relevance of the methodology applied by the Bank for the purpose of identification of credit losses and calculation of impairment according to the concepts and requirements of the new IFRS 9. Analysis and assessment of the models applied to calculate impairment at the date of initial adoption and at the date of the financial statements, in compliance with the guidance of IFRS 9, the specifics of the Bank's credit portfolios and the available internal historical data and macro forecast information. In relation to this, analysis and assessment were carried out of:
 - relevance of the criteria to identify a significant increase in credit risk;
 - appropriateness of the allocation made of exposures into stages according to the classification criteria determined by the Bank;
 - the justification and relevance of the calculations of the indicators "probability of default" and "loss given default" by checking the assumptions and outputs used;
 - mathematical accuracy of the calculations by types of indicators;
 - the approach of including forecast information in the models.
- Performing detailed tests, based on a risk-based sample of loans at all stages, for the purpose of assessing the relevance of the impairment charged of credit losses. For the respective exposures in the sample, the following audit procedures were performed:

Due to the significance of the above described circumstances that: a/ the materiality of loans granted to and receivables from customers as a reporting item for the Bank's financial statements, and b/ the inherent uncertainty of using numerous judgements and assumptions by management in the specific calculations of the amount of credit losses related to loans granted to and receivables from customers on an individual and on a portfolio basis according to the new model, as a result of the adoption of IFRS 9, we have considered this matter as a key audit matter.

- analysis of the financial position and results of borrowers, and inspection of information and documents related to loan servicing;
 - review of collateral valuation reports of the respective exposures; for some collaterals, we used our expert appraisers regarding the assumptions and methods applied in the valuations of collateral realisable value;
 - analysis and assessment of the key assumptions and judgments in determining the amounts of future cash flows, including from realisation of collaterals, made by the Bank's management upon calculation of specific provisions for credit losses on individual exposures at Stage 3;
 - testing and recalculation of the mathematical accuracy of the established amounts of expected credit losses on individual exposures.
- Review, analysis and evaluation of the model used for the calculation of collective impairment of credit losses on portfolio basis, including of the inputs, sequence of assumptions and analysis of the development of the parameters applied. Review of the update of data used and the monitoring of the logical justification of the calculated indicators. Sample-based testing of the mathematical accuracy of the calculations.
 - Performing analytical procedures to assess the logical sequence and interrelation of trends in the costs stated for impairment losses versus the development trends in the Bank's loan portfolio.
 - Assessment of the relevance, completeness and adequacy of the Bank's disclosures in relation to its exposure to credit risk and to impairment of credit losses on loans granted to and receivables from customers, including the impact of adoption of IFRS 9.

Estimates of the fair value of non-financial assets used for the purpose of determining the fair value of review for impairment of these assets

Information about the fair value estimates of financial assets used for the purpose of fair value measurement of review for impairment is disclosed in *Note 9 Non-current assets held for sale, Note 11 Investment property, Note 13 Other assets, and Note 30.5 Fair value* to the financial statements.

The Bank states non-current assets held for sale, at the amount of BGN 4,984 thousand, investment property at the amount of BGN 12,590 thousand, and other assets acquired under non-serviced loans, at the amount of BGN 18,773 thousand, consisting mainly of real estate acquired in exchange for debt from collaterals.

The Bank's accounting policy for the subsequent measurement of investment property following their recognition is based on a fair value model in accordance with IAS 40. In view of the sensitivity and specifics of the real estate market, on an annual basis the Bank has a policy of performing annual reviews and fair value measurement of non-current assets held for sale, and of the other assets acquired from non-serviced loans, for the purpose of their impairment test (based on their fair value less costs for disposal), and of the fair value of investment property – for the purpose of their subsequent measurement.

Fair value measurement is based on valuations prepared by appraisers appointed by the Bank and/or independent real estate valuers assigned thereby. In the calculation of these measurements, multiple inputs, assumptions and models are used, and the fair value determined on this base is classified within Level 3 of the fair value hierarchy according to IFRS 13.

Due to the fact that the fair value estimates of non-financial assets (investment property, non-current assets held for sale and other assets) of the Bank is characterized by higher uncertainty related to the inputs used and the assumptions for the purposes of fair value measurement and/or review for impairment, which may have a significant effect on both the carrying amount of non-financial assets, and the calculation of the Bank's capital adequacy as at 31 December 2018, we have determined this to be a key audit matter.

In this area, our audit procedures included, among others:

- Assessing the objectivity, independence and competence of the external appraisers assigned by the Bank.
- For a sample of non-financial assets which are subject to impairment review and test or subsequent measurement at fair value, performing analysis and assessing the inputs applied regarding real estate, by also involving our internal valuation experts in the review and analysis of the valuation methods used, the information and key assumptions used in the valuation.
- For a sample of real estate, performing analysis by our internal valuation experts on whether the fair value measured is consistent with intervals of comparable market prices of similar assets.
- Assessment of the relevance and appropriateness of the Bank's disclosures of fair value estimates of non-financial assets (investment property, non-current assets held for sale and other assets) used for the purpose of fair value measurement or review for impairment.

Information Other than the Financial Statements and Auditor's Report Thereon

The Management Board of the Bank (“Management”) is responsible for the other information. The other information comprises the management report and the corporate governance statement, prepared by management in accordance with Chapter Seven of the Accountancy Act, but does not include the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon, unless and to the extent explicitly specified in our report.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRSs as applicable in the EU and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank or to cease its operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank's financial reporting process.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with International Standards on Auditing (ISAs) will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters.

We describe these matters in our auditors' report unless law or regulation precludes public disclosure of information about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

We are jointly responsible for the performance of our audit and the audit opinion expressed by us, in accordance with the requirements of the IFAA applicable in Bulgaria. In accepting and performing the joint audit engagement, in respect to which we are reporting, we have considered the Guidelines for Performing Joint Audits, issued on 13 June 2017 by the Institute of Certified Public Accountants in Bulgaria and the Commission for Public Oversight of the Registered Auditors in Bulgaria.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Additional Matters to be Reported under the Accountancy Act

In addition to our responsibilities and reporting in accordance with ISAs, described above in the *Information Other than the Financial Statements and Auditors' Report Thereon* section, in relation to the management report and the corporate governance statement, we have also performed the procedures added to those required under ISAs in accordance with the "*Guidelines Regarding New Extended Reports and Communication by the Auditor*" of the professional organisation of Registered Auditors in Bulgaria, i.e. the Institute of Certified Public Accountants (ICPA). These procedures refer to testing the existence, form and content of this other information to assist us in forming an opinion about whether the other information includes the disclosures and reporting provided for in Chapter Seven of the Accountancy Act applicable in Bulgaria and Art. 100(m), paragraph 8, where applicable, of the Public Offering of Securities Act.

Opinion in connection with Art. 37, paragraph 6 of the Accountancy Act

Based on the procedures performed, our opinion is that:

- The information included in the management report referring to the financial year for which the financial statements have been prepared is consistent with those financial statements.
- The management report has been prepared in accordance with the requirements of Chapter Seven of the Accountancy Act.
- The corporate governance statement referring to the financial year for which the financial statements have been prepared presents the information required under Chapter Seven of the Accountancy Act and Art. 100(m), paragraph 8 of the Public Offering of Securities Act.

Additional reporting in accordance with Ordinance No 38/2007 and No 58/2018 of the Financial Supervision Commission

Statement in relation to Art. 33 of Ordinance No 38/2007 of the Financial Supervision Commission (FSC) on the requirements to the activity of investment intermediaries and Art. 11 of Ordinance No 58/2018 of FSC on the requirements for protection of clients' financial instruments and cash, for product management and for granting and receiving consideration, commissions, other cash and non-cash benefits

Based on the audit procedures performed and the obtained knowledge and understanding of the Bank's operation and the context of our audit of the financial statements as a whole, the organisation established and applied in relation to the safeguarding of clients' assets complies with the requirements of Art. 28-31 of Ordinance No 38 and Art. 3-10 of Ordinance No 58 of the FSC regarding the Bank's activities in its capacity as an investment intermediary.

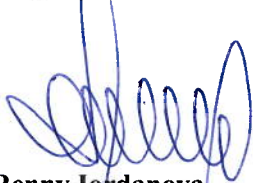
Reporting in accordance with Art. 10 of Regulation (EU) No 537/2014 in connection with the requirements of Art. 59 of the Independent Financial Audit Act

In accordance with the requirements of the Independent Financial Audit Act in connection with Art. 10 of Regulation (EU) No 537/2014, we hereby additionally report the information stated below.

- AFA OOD and ABVP-AUDIT STANDARD OOD were appointed as statutory auditors of the financial statements of the Bank for the year ended 31 December 2018 by the General Meeting of Shareholders held on 6 November 2018, for a period of one year.
- The audit of the financial statements of the Bank for the year ended 31 December 2018 represents a first consecutive statutory audit engagement carried out by AFA OOD and a second total statutory audit engagement carried out by ABVP-AUDIT STANDARD OOD.
- We hereby confirm that the audit opinion expressed by us is consistent with the additional report dated 15 May 2019, provided to the Bank's Audit Committee, in compliance with the requirements of Art. 60 of the Independent Financial Audit Act.

- We hereby confirm that no prohibited non-audit services, referred to in Art. 64 of the Independent Financial Audit Act, were provided.
- We hereby confirm that in conducting the audit we have remained independent of the Bank.
- Over the period to which the statutory audit performed by us applies, other than the audit, we have not provided other services to the Bank, which are not stated in the management report or the Bank's financial statements.

Audit firm
AFA OOD:



Renny Iordanova
*General Manager,
Legal representative*

Audit firm
ABVP-AUDIT STANDARD OOD:



Sevdalina Paskaleva
*General Manager,
Legal representative
Registered Auditor in Charge of the Audit*



Valia Iordanova
Registered Auditor in Charge of the Audit

**38, Oborishte Street
1504-Sofia, Bulgaria**

**40B, Simeon Radev Street
Sofia, Bulgaria**

15 May 2019

TOKUDA BANK AD
STATEMENT OF FINANCIAL POSITION
As at 31 December 2018

(all amounts are in BGN'000)

	Notes	2018	2017
ASSETS			
Cash and cash balances with the Central Bank	4	101,508	70,362
Loans and receivables from banks	5	33,376	25,114
Financial assets at FVPL	6	174	14,126
Debt instruments at FVOCI	7	44,061	-
Equity instruments at FVOCI	7	293	-
Available-for-sale financial assets	7	-	60,801
Loans to and receivables from customers	8	183,616	181,384
Non-current assets held for sale	9	4,984	6,734
Investments in subsidiaries	12	-	25
Investment property	11	12,590	9,853
Property, plant and equipment	10	1,795	2,022
Intangible assets	10	587	713
Other assets	13	19,510	16,702
Total assets		402,494	387,836
LIABILITIES			
Deposits from banks	14	268	191
Deposits from clients	15	359,330	340,944
Deferred tax liabilities	16	27	95
Other liabilities	17	932	1,923
Total liabilities		360,557	343,153
EQUITY			
Share capital	18	68,000	68,000
Reserves	18	3,127	3,789
Accumulated loss		(29,190)	(27,106)
Total equity		41,937	44,683
Total liabilities and equity		402,494	387,836

The accompanying notes 1 to 33 form an integral part of the annual financial statements.

The annual financial statements on pages 1 to 64 was approved for issue by the Management Board of Tokuda Bank AD and was signed on 15 May 2019 by:

		
Anna Tsankova-Boneva	Maria Sheytanova	Svetlin Todorov
Member of the Management Board	Member of the Management Board	Finance Director
Executive Director	Executive Director	

Financial statements on which our auditors' report was issued dated 15th of May 2019

“AFA” OOD

“ABVP – AUDIT STRANDART” OOD



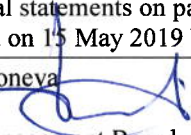


TOKUDA BANK AD
STATEMENT OF COMPREHENSIVE INCOME
For the year ended 31 December 2018
(all amounts are in BGN'000)

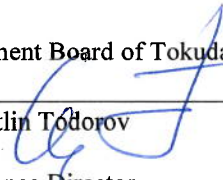
	Notes	2018	2017
Interest income		10,569	12,305
Interest costs		(2,189)	(2,663)
Net interest income	19	8,380	9,642
Fees and commissions income		4,023	3,837
Fees and commissions costs		(282)	(297)
Net fees and commissions income	20	3,741	3,540
Net trading income	21	273	283
Other operating income	22	895	3,796
Operating income before loss on impairment and provisions		13,289	17,261
Loss on impairment and provisions	23	(168)	(3,047)
Employee benefit expenses	24	(6,324)	(6,135)
Rental expenses		(1,143)	(1,096)
Depreciation and amortisation	10	(685)	(670)
Other expenses	25	(5,303)	(5,311)
Administrative and operating expenses		(13,455)	(13,212)
(Loss)/Profit before tax		(334)	1,002
Tax savings/(expense)	26	67	(1)
(Loss)/Profit for the year		(267)	1,001
Other comprehensive income			
Items that may be reclassified to profit or loss			
Net loss from remeasurement of debt instruments at FVOCI		(1,145)	-
Reclassification of remeasurement of debt instruments at FVOCI disposed of in the year		(686)	-
Net gain on remeasurement of available-for-sale financial assets		-	1,013
Reclassification of remeasurement of available-for-sale financial assets disposed of in the year		-	(1,982)
Items that will not be reclassified to profit or loss			
Remeasurement of retirement obligations		(2)	(1)
Total other comprehensive income		(1,833)	(970)
Total comprehensive income for the year		(2,100)	31

The accompanying notes 1 to 33 form an integral part of the annual financial statements.

The annual financial statements on pages 1 to 64 was approved for issue by the Management Board of Tokuda Bank AD and was signed on 15 May 2019 by:

Anna Tsankova-Boneva

Member of the Management Board
Executive Director


Maria Shevtanova
Member of the Management Board
Executive Director

Svetlin Todorov

Finance Director

Financial statements on which our auditors' report was issued dated 15th of May 2019

"AFA" OOD

"ABVP – AUDIT STRANDART" OOD

TOKUDA BANK AD
STATEMENT OF CHANGES IN EQUITY
For the year ended 31 December 2018

(all amounts are in BGN'000)

	Share capital	Reserves	Financial assets at FVOCI reserve	Accumulated loss	(Loss)/ Profit for the year	Total
Balance at 1 January 2017	68,000	808	3,951	(26,368)	(1,739)	44,652
Transfer to accumulated loss	-	-	-	(1,739)	1,739	-
Profit for the year	-	-	-	-	1,001	1,001
<i>Other comprehensive income for the year</i>	-	(1)	(969)	-	-	(970)
Remeasurement of retirement obligations	-	(1)	-	-	-	(1)
Net change in the fair value of available-for-sale financial assets	-	-	(969)	-	-	(969)
Total comprehensive income for the year	-	(1)	(969)	-	1,001	31
Balance at 31 December 2017	68,000	807	2,982	(28,107)	1,001	44,683
Balance at 1 January 2018	68,000	807	2,982	(28,107)	1,001	44,683
Impact of the initial adoption of IFRS 9	-	-	170	(816)	-	(646)
Balance at 1 January 2018 (restated)	68,000	807	3,152	(28,923)	1,001	44,037
Profit allocation to reserves	-	1,001	-	-	(1,001)	-
Net loss for the year	-	-	-	-	(267)	(267)
<i>Other comprehensive income for the year</i>	-	(2)	(1,831)	-	-	(1,833)
Remeasurement of retirement obligations	-	(2)	-	-	-	(2)
Net change in the fair value of debt instruments at FVOCI	-	-	(1,831)	-	-	(1,831)
Total comprehensive income for the year	-	(2)	(1,831)	-	(267)	(2,100)
Balance at 31 December 2018	68,000	1,806	1,321	(28,923)	(267)	41,937

The accompanying notes 1 to 33 form an integral part of the annual financial statements.

The annual financial statements of pages 1 to 64 was approved for issue by the Management Board of Tokuda Bank AD and was signed on 15 May 2019 by:

Anna Tsankova-Boheva

Member of the Management Board
Executive Director

Member of the Management Board
Executive Director

Svetlin Todorov
Finance Director

Financial statements on which our auditors' report was issued dated 15th of May 2019
"AFA" OOD

"ABVP – AUDIT STRANDART" OOD

TOKUDA BANK AD
STATEMENT OF CASH FLOWS
For the year ended 31 December 2018

(all amounts are in BGN'000)

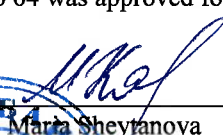
	Notes	2018	2017
Cash flows from operations			
(Loss)/Profit before tax		(334)	1,002
<i>Adjustments from non-cash operations</i>			
Depreciation and amortisation		685	670
Impairment and loss provisions		168	3,047
Net interest income		(8,380)	(9,642)
Dividend income		(2)	(68)
Loss/(Gain) on disposal of property, plant and equipment		17	(2,067)
Other accruals		(45)	539
Gain on disposal of a subsidiary		24	-
		<u>(7,867)</u>	<u>(6,519)</u>
Interest income received		10,842	13,500
Interest costs paid		(1,964)	(4,610)
Dividend income received		2	68
		<u>1,013</u>	<u>2,439</u>
<i>Cash flows from operations before changes in operating assets and liabilities</i>			
Decrease in financial assets at FVPL		3	10,461
Decreased in available-for-sale financial assets		-	25,938
Decrease in financial assets at FVOCI		27,158	-
Increase in loans to and receivables from customers		(4,582)	(9,509)
Decrease in non-current assets held for sale		1,623	537
Increase in other assets		(2,720)	(7,605)
Increase in deposits from banks		77	104
Increase in deposits from customers		18,179	1,654
Decrease in other liabilities		(995)	(290)
		<u>38,743</u>	<u>21,290</u>
Cash flows from investing activities			
Payments for acquisition of property, plant and equipment		(236)	(497)
Proceeds from sale of property, plant and equipment		9	2,746
Payments for acquisition of intangible assets		(122)	(333)
Proceeds from subsidiary liquidation		1	-
		<u>(348)</u>	<u>1,916</u>
Net cash flows (used in)/from investing activities			
Net increase in cash and cash equivalents		39,408	25,645
Cash and cash equivalents at the beginning of the year		95,476	69,831
Cash and cash equivalents at the end of the year	28	<u>134,884</u>	<u>95,476</u>

The accompanying notes 1 to 33 form an integral part of the annual financial statements.

The annual financial statements on pages 1 to 64 was approved for issue by the Management Board of Tokuda Bank AD and was signed on 15 May 2019 by:


 Anna Tsankova-Boneva

Member of the Management Board
 Executive Director


 Maria Sheytanova
 Member of the Management Board
 Executive Director




 Svetlin Todorov

Finance Director

Financial statements on which our auditors' report was issued dated 15th of May 2019

"AFA" OOD

"ABVP – AUDIT STRANDART" OOD

TOKUDA BANK AD
NOTES TO THE ANNUAL FINANCIAL STATEMENTS
FOR YEAR 2018

All amounts are in BGN '000, unless explicitly stated otherwise

1. CORPORATE INFORMATION ON THE BANK

1.1. Incorporation

Tokuda Bank AD (The Bank), UIC 813155318, was incorporated on 27 December 1994 as a joint-stock company. The Bank's management address is: 21, George Washington Street, Sofia.

1.2. Ownership

As at 31 December 2018, the issued share capital of the Bank amounts to BGN 68,000,000 (sixty eight million levs), comprising 6,800,000 (six million and eight hundred thousands) registered voting shares with a nominal value of BGN 10 (ten) per share.

As at 31 December 2018, the major shareholder of the Bank is Tokushukai Incorporated, holding 99.94% of the Bank's capital.

1.3. Main activities

The Bank holds a banking license issued by the Bulgarian National Bank (BNB, Central Bank) to perform all banking activities allowed by the Bulgarian legislation.

In 2018 and 2017, the Bank's activity is mostly related to rendering banking services related to granting loans to private companies, attracting deposits from customers, servicing of client payments both locally and internationally, performing transactions with securities and other financial services in Bulgaria.

1.4. Structure and management

The Bank has a two-tier management system, consisting of Management Board and Supervisory Board.

As at 31 December 2018, the Bank's management, represented by the Management Board (MB), consists of three members, namely: Maria Sheytanova – Member of the Management Board and Executive Director, Anna Tsankova-Boneva – Member of the Management Board and Executive Director, and Todorina Doktorova – Member of the Management Board. As from 8 May 2019, the Management Board consists of four members, and the new MB member, respectively Executive Director, is Dimitar Vouchev.

As at 31 December 2018, the Bank's charged with governance, represented by the Supervisory Board (SB), are: Arthur Stern – Chairperson of the SB, Thomas Michael Higgins – Member of the SB, and Dimitar Vouchev – Member of the SB (until 12 April 2019). As from 12 April 2019, Chris Matlan was elected Member of the SB.

According to the requirements of the Credit Institutions Act, the provisions of the Statute and court registration of the Bank, it is represented by the two Executive Directors.

An Audit Committee operates at the Bank, which monitors the work of its external auditors, the activities of the internal audit, risk management and accounting and financial reporting. The Audit Committee consists of the following members: Veneta Ilieva – Chairperson, Romyana Asenova – Member, Violeta Milusheva – Member.

In 2018, the Bank operates through its Head Office and 26 offices and remote working places (2017: 27). As at 31 December 2018, 249 employees work at the Bank (2017: 257).

1.5. Legal environment

The Bank's activities are regulated by the Credit Institutions Act and the bylaws related thereto, and BNB exercises supervision and controls compliance with banking legislation.

TOKUDA BANK AD
NOTES TO THE ANNUAL FINANCIAL STATEMENTS
FOR YEAR 2018

All amounts are in BGN '000, unless explicitly stated otherwise

2. BASIS FOR PREPARATION OF THE FINANCIAL STATEMENTS

2.1. General

These financial statements have been prepared for general purposes for the year ended 31 December 2018. The financial statements are presented in thousand Bulgarian Levs (BGN'000).

2.2. Accounting convention

The annual financial statements of Tokuda Bank AD have been prepared in accordance with all International Financial Reporting Standards (IFRS), which comprise Financial Reporting Standards and the International Financial Reporting Interpretations Committee (IFRIC) interpretations, approved by the International Accounting Standards Board (IASB), as well as the International Accounting Standards (IAS) and the Standing Interpretations Committee (SIC) interpretations, approved by the International Accounting Standards Committee (IASC), which have been effective since January 1, 2018 and have been accepted by the Commission of the European Union. IFRS, endorsed by EU, is the generally accepted name of the general purpose framework – the basis of accounting equivalent to the framework introduced with the definition in § 1, p. 8 of the Additional Provisions of the Accountancy Act under the name of “International Accounting Standards” (IASs).

For the current financial year the Bank has adopted all new and/or revised standards and interpretations, issued by the International Accounting Standards Board (IASB) and respectively, by the International Financial Reporting Interpretations Committee (IFRIC), which have been relevant to its activities.

The adoption of these standards and/or interpretations, *applicable to entities in Bulgaria for annual reporting periods beginning on 1 January 2018 at the earliest*, has caused changes in Bank's accounting policies with regard to the principles, rules and criteria on the accounting for the following reporting items as well as the presentation and disclosure of financial information thereon: cash and cash equivalents (Note 4), loans and receivables from banks (Note 5), loans and receivables from customers (Note 8), debt and equity instruments at fair value through other comprehensive income (FVOCI) (Note 7), bank guarantees and irrevocable commitments related to the undrawn amount of permitted loans (Note 29), interest income (Note 19).

The changes are resultant from the application of the following standards and interpretations:

IFRS 9 “Financial Instruments” (in force for annual periods beginning on or after 1 January 2018 – endorsed by EC). This is a new standard for financial instruments. It is ultimately intended to replace IAS 39 in its entirety. This standard sets out new principles, rules and criteria for classification, and an approach to measurement, incl. for hybrid contracts, by preserving almost entirely the rules of IAS 39 on the recognition and derecognition of financial assets and liabilities. 1. IFRS 9 introduces a requirement that financial assets are to be classified based on entity's business model for their management and on the contractual cash flow characteristics of the respective assets. Based on that, two primary categories are established for subsequent measurement: at amortised cost and at fair value. The new rules lead to changes mainly in the accounting for financial assets of the type of debt instruments and financial liabilities designated at fair value through profit or loss (for credit risk). A specific feature of the classification and the measurement model for financial assets at fair value is the category “subsequent measurement at fair value through other comprehensive income”, in which debt and capital instruments can be classified if certain conditions are met. 2. Hedge accounting – the standard includes a new chapter, introducing a new, more flexible, approach, and respectively model for hedge accounting, which permits consistent and complete reflection of all financial and non-financial risk exposures, subject to economic hedge transactions, and also, better presentation of risk management activities in the financial statements and specifically, their relation to hedge transactions, and the scope and type of documentation to be used. In addition, the requirements to the structure, contents and presentation approach for hedge disclosures have been improved. Furthermore, an option is introduced that fair value changes of financial liabilities measured at fair value through profit or loss due to changes in the entity's own credit quality (own credit risk), to be recognized in other comprehensive income rather than in profit or loss. 3. Impairment methodology – the amendment is fundamental and introduces the application of the 'expected loss' concept and approach. According to this approach, all expected credit losses of a financial asset at amortised cost shall be recognised earlier, and the three-stage model is usually applied, depending on its credit quality change, and not only if a triggering default event has occurred as per the current model under IAS 39. The three stages are: a. upon the initial recognition of the financial asset – impairment for the 12-month period, b. in case of increased credit risk – for the full lifetime of the asset; and respectively, c. upon default - of the actual impairment. This model also determines the rules to measure impairment losses and respectively the application of the effective interest rate upon

TOKUDA BANK AD
NOTES TO THE ANNUAL FINANCIAL STATEMENTS
FOR YEAR 2018

All amounts are in BGN '000, unless explicitly stated otherwise

recognition of interest income. The impairment of debt instruments measured at fair value through the other comprehensive income is also determined and measured by applying the methodology which is used for financial assets at amortised cost. With regards to trade receivables, lease receivables and assets under contracts with customers, the standard permits the use of a simplified model to measure impairment, which however also retains the “expected losses” concept. The management has done research and has concluded that the changes made through the new standard have an impact on the accounting policies, and on the value and classification of Bank’s assets, liabilities, transactions and performance, with regard to: receivables from banks, loans and receivables from customers, debt and equity instruments at fair value through other comprehensive income, bank guarantees and irrevocable commitments related to undrawn amounts of permitted loans, and interest income. The effects of the restatements and reclassifications made thereby are disclosed in Note 2.3.1;

IFRS 7 (amended) “Financial Instruments: Disclosures” – regarding the relief from the requirement to restate comparatives and the related thereto disclosures when applying IFRS 9 (in force for annual periods beginning on or after 1 January 2018 – endorsed by EC). The amendment is related to a relief from the requirement to restate the comparative financial statements and the option to present modified disclosures on the transition from IAS 39 to IFRS 9 as at the date of the standard application by the Bank and whether it chooses the option to restate prior periods. The management has chosen modified retrospective application of IFRS 9 upon its initial application and will not restate comparative information. (Note 2.3.1)

IFRS 15 “Revenue from Contracts with Customers” (in force for annual periods beginning on or after 1 January 2018 – endorsed by EC). This is an entirely new standard on the recognition and measurement of the revenue of entities from all economic sectors. It introduces a new concept, and based on it – a complete set of new principles, rules and approaches for recognition, accounting for and disclosure of information about the nature, amount, timing and uncertainties related to revenue and cash flows arising from contracts with customers. The standard fully supersedes all current standards related to revenue recognition, mainly IAS 18 and IAS 11 and the interpretations thereto. The main concept of the new standard is to provide a five step model whereby the revenue amount and timing reflect the fulfilment of obligation characteristics and performance of each of the parties to the transaction. The key components include: (a) contracts with customers that are commercial in their substance and assessment of the probability for collecting contractual amounts by the entity in line with the terms and conditions of the particular contract; (b) identification of the separate performance obligations under the contract for providing of a good or service – their distinction from the other assumed contractual commitments/promises, from which the customer would obtain benefits; (c) determination of the transaction price – the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer – special attention is paid to the types of variable components of the price, incl. the financing component, as well as the non-cash consideration; (d) allocation of the transaction price to separate performance obligations under the contract – usually on a stand-alone sale price of each component (good/service); and (e) the point of time or the period of revenue recognition – when an entity satisfies a performance obligation by transferring control of a promised good or service to the customer, which could occur at a point in time or over time. Rules and criteria are introduced regarding: (a) identification of the performance obligations based on specific promises for the delivery of goods or services; (b) determining whether an entity acts as principal or agent in the provision of goods or services, and (c) license transfers. The application of this standard usually leads to more material changes: (a) in complex contracts with bundled sales of goods and services a clear distinction will be required between the goods and services of each component and provision of the contract; (b) probability for a change in the time of sale recognition; (c) expanding of disclosures; and (d) introduction of additional rules for recognising the revenue from a particular type of contracts – licences; consignment; one-time collection of preliminary fees; guarantees and other similar. The standard allows a full retrospective approach or a modified retrospective approach from the beginning of the current reporting period (2018) with particular disclosures for prior periods. The management has done research and has concluded that the changes made through the new standard have an impact on the accounting policies, but no significant impacts and impact on the classification of the Bank’s assets, liabilities, transactions and performance. The management has chosen modified retrospective application of IFRS 15 on its initial application and will not restate comparative information.

IAS 40 (amended) “Investment Property” – regarding transfers of investment property (in force for annual periods beginning on or after 1 January 2018 – endorsed by EC). The amendment refers to an additional clarification regarding the terms and criteria that allow transfers of property, incl. property under construction and/or undergoing reconstruction and alteration to, or from, the category 'investment property'. Such transfers are only eligible when the property meets, or respectively, ceases to meet, the criteria and definition of investment property – when evidence exists for a change in its use. A change in the intents and plans of the management are not regarded as evidence for a change in use. The amendment may be applied prospectively or retrospectively, subject to compliance with the rules set thereby.

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Regarding the other standards and interpretations stated herein below, the management has analyzed their possible impact and has determined they would not impact the Bank's accounting policy, respectively its assets, liabilities, transactions and results, as far as it does not possess/operate such items and/or does not perform such deals and transactions.

IFRS 2 (amended) "Share-based Payment" – Classification and measurement of share-based payment transactions (in force for annual periods beginning on or after 1 January 2018 – not endorsed by EC). These amendments clarify three major issues: (a) the treatment of the conditions and effects related to obtaining vested rights in the measurement and accounting for cash-settled share-based payment transactions; (b) approach for the classification of share-based payment transactions with net settlement features for the purposes of withholding personal tax for entity's employees (in the form of equity instruments) – by introducing an exception from the common rule in order to achieve a facilitation in the practice, these transactions shall be classified in a way as if in the absence of the net share settlement feature; and (c) a new rule of accounting whereby a modification to the terms and conditions of a share-based payment transaction changes its classification from cash settled to equity settled.

IFRS 4 (amended) "Insurance Contracts" in force for annual periods beginning on or after 1 January 2018 – endorsed by EC). This amendment is related to the need to synchronise the reporting of entities that issue insurance contracts and which fall within the scope of IFRS 9, but prior to the adoption of the future IFRS 17. It defines two approaches – the overlay approach and the temporary deferral approach (subject to certain conditions) under IFRS 9. Both approaches are valid until the entry into force of the new IFRS 17. It is not applicable to the Bank's operation.

Annual Improvements to IFRSs 2014-2016 Cycle (December 2016) – improvements to IFRS 1 and IAS 28 (in force for annual periods beginning on or after 1 January 2018 – endorsed by EC). These improvements introduce partial amendments to and editions of the respective standards primarily with a view to remove the existing inconsistency or ambiguities in the application of the rules and requirements of individual standards as well as to set out more precise terminology. These amendments are basically focused on the following items or transactions: (a) removal of certain exemptions in the application of IFRS 1 with regards to IFRS 7, IAS 19 and IFRS 10; and (b) the choice of venture capital funds or other similar entities to measure their investments in associates or joint ventures at fair value through profit or loss should be made for each individual investment in associates or joint ventures upon initial recognition (IAS 28).

IFRIC 22 "Foreign Currency Transactions and Advance Consideration" (in force for annual periods beginning on or after 1 January 2018 – endorsed by EC). This Interpretation applies to the accounting for foreign currency transactions or part of them upon the receipt of advance consideration before the entity recognises the related asset, expense or income. In these cases the entities shall recognise first a non-monetary asset for the advance consideration (advance consideration paid on supply of assets or services) or a non-monetary liability for deferred income (advance consideration received from clients on sales). Upon receipt of such advance consideration in a foreign currency, the transaction date shall be used to determine the exchange rate while in case of multiple payments the entity shall determine a date of the transaction for each individual payment. Following this, the interpretation clarifies that upon the initial recognition of the respective asset, expense or income, as a result of the payment or receipt of advance consideration or a series of payments or receipts in a foreign currency, the transaction date is the date of initial recognition of the non-monetary asset or liability (in case of one-off payment/receipt) or the date of each separate payment/receipt. This Interpretation may be applied on a fully retrospective basis or prospectively, either: (a) from the beginning of the reporting period in which it is first applied; or (b) from the beginning of the period preceding the period in which the entity first applies the interpretation.

At the date when these financial statements have been approved for issue, there are several new standards and interpretations as well as amended standards and interpretations, issued but not yet in force for annual periods beginning on or after 1 January 2018, which have not been adopted by the Bank for early application. The management has decided that out of them the following are likely to have a potential impact in the future for changes in the accounting policies, and in the classification and value of reporting items in Bank's financial statements for subsequent periods, namely:

IFRS 16 "Leases" (in force for annual periods beginning on or after 1 January 2019 – endorsed by EC). This standard has an entirely new concept. It establishes new principles for the recognition, measurement and presentation of a lease by introducing a new model with the objective to ensure a more faithful and adequate representation of such transactions primarily for the lessee. The standard will supersede the effective so far standard related to leases – IAS 17. (a) The main principle of the new standard for lessees is the introduction of a single lessee accounting model in the statement of financial position – an asset will be recognised for all contracts with

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duration of more than 12 months in the form of a 'right-of-use', which will be subsequently depreciated over the duration of the contract, and respectively, a financial liability will be stated for the lease liability under these contracts. This is the significant change in the current accounting practice. The standard allows an exception and retaining the current practice for leases of low-value assets and short-term leases. (b) There would not be any significant changes for lessors and they would continue to account for leases as per the old standard IAS 17 – as operating and finance lease. As far as the new standard introduces a more comprehensive concept, a more detailed analysis of contractual terms should be carried out on their part as well and it is possible that grounds for reclassification of particular lease transactions may occur for them (lessors), too. The new standard requires more extensive disclosures. The management has done research and has concluded that the changes made through the new standard have an impact on the accounting policies, and on the value and classification of Bank's assets, liabilities, transactions and performance, with regard to the Bank's operating leases in its capacity as lessee. The effects of the analyses, the preliminary restatements and reclassifications performed thereby are disclosed in Note 2.4. The management has chosen modified retrospective application of IFRS 16 on its initial application and will not restate comparative information.

IFRS 9 (amended) "Financial Instruments" – regarding prepayment features with negative compensation in case of early repayment and modifications of financial liabilities (in force for annual periods beginning on or after 1 January 2019 – endorsed by EC). This change covers two aspects: (a) it amends the existing requirements in IFRS 9 by enabling entities to measure at amortised cost some financial assets and their passing of the SPPI test, despite the availability of "prepayment features with negative compensation". Negative compensation exists when the terms of the contract allow the debtor to make an early repayment of the instrument prior to its maturity, and the amount repaid may differ from the outstanding principal and interest, but this negative compensation should be reasonable and relevant to the early termination of the contract. Prepayment itself is not a sufficient assessment indicator, i.e. depending on the interest rate prevailing at the time of termination a payment may also be made in favour of the contracting party initiating the early repayment. The calculation approach of this compensation payment must be the same for both type of payments - the case of an early repayment penalty and the case of an early repayment gain. Moreover, the respective asset should belong to the category of assets "held to collect contractual cash flows" according to the entity's business model; (b) it confirms that when a financial liability measured at amortised cost is modified but not derecognised, the effect of the modification should be recognised in the profit or loss. The effect is measured as the difference between the original negotiated cash flows and the ones, following the modification, discounted at the original effective interest rate.

Amendments to IAS 1 "Presentation of Financial Statements" and IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors" (in force for annual periods beginning on or after 1 January 2020 – not endorsed by EC). These changes relate to providing a more precise definition of 'material' as stated in the two standards. According to them, the new definition of 'material' is: "Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity". There are three new aspects of the definition which should be noted: (a) "Obscuring". The existing definition only focused on omitting or misstating information, however, the IASB concluded that obscuring material information with information that can be omitted can have a similar effect. (b) "Could reasonably be expected to influence decisions of the primary users". The existing definition referred to 'could influence' which the IASB felt might be understood as requiring too much information as almost anything 'could' influence the decisions of some users even if the possibility is remote; and (c) Primary users. The existing definition referred only to 'users' which again the IASB feared might be understood too broadly as requiring to consider all possible users of financial statements when deciding what information to disclose. Moreover, the amendments stress especially five ways material information can be obscured: (a) if the language regarding a material item, transaction or other event is vague or unclear; (b) if information regarding a material item, transaction or other event is scattered in different places in the financial statements; (c) if dissimilar items, transactions or other events are inappropriately aggregated; (d) if similar items, transactions or other events are inappropriately disaggregated; and (e) if material information is hidden by immaterial information to the extent that it becomes unclear what information is material.

IAS 19 (amended) "Employee Benefits" (in force for annual periods beginning on or after 1 January 2019 – not endorsed by EC). This amendment clarifies that in case of changes to defined benefit plan amendments, curtailments and settlements, upon determining the current service cost and interest costs for the period following the restatement, the entity is obliged to use the assumptions made therein. Additionally, changes are envisaged to the disclosure of impact for changes to defined benefit plan amendments, curtailments and settlements in relation to the plan asset ceiling.

IFRIC 23 (amended) "Uncertainty over Income Tax Treatments" (in force for annual periods beginning on or after 2019).
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1 January 2019 – endorsed by EC). This Interpretation provides guidance on the accounting treatment and accounting for income tax when tax treatments involve uncertainty that affects the application of IAS 12. It does not apply to taxes or other state levies outside the scope of IAS 12, nor does it specifically include requirements relating to interest and penalties associated with uncertain tax treatments. The Interpretation addresses the following matters: (a) whether an entity considers uncertain tax treatments separately; (b) the assumptions an entity makes about the examination and assessment of tax treatments by taxation authorities; (c) how an entity determines taxable profit (tax loss), tax bases, unused tax losses, tax rates and unused tax credits; (d) how an entity considers and treats changes in facts and circumstances; and (e) the entity's approach whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments.

Amendments to the Conceptual Framework for Financial Reporting (in force for annual periods beginning on or after 1 January 2020, not endorsed by EC). These amendments include revised definitions of “asset” and “liability”, as well as new guidance for their measurement, derecognition, presentation, and disclosure. The amendments to the Conceptual Framework are accompanied by amendments to some references thereto in the International Financial Reporting Standards, including IFRS 2, IFRS 3, IFRS 6, IFRS 14, IAS 1, IAS 8, IAS 34, IAS 37, IAS 38, IFRIC 12, IFRIC 19, IFRIC 20, IFRIC 22 and SIC 32. Some of the references state which version of the Conceptual Framework statements in the respective standards should refer to (the IASC framework adopted by IASB in 2001, the IASB framework of 2010, or the new revised framework dated 2018), while others specifically state that the standard's definitions have not been updated in accordance with the framework's latest amendments.

The management is in the process of examination, analysis and assessment of the effects of the changes to the Conceptual Framework and the above listed standards (with the exception of IFRS 16) which will impact the Bank's accounting policies and the value and classification of its assets, liabilities, transactions and performance in subsequent reporting periods.

Additionally, with regard to the stated below new standards, amended/revised standards and new interpretations that have been issued but not yet in force for annual periods beginning on 1 January 2018, the management has judged that they are unlikely to have a potential impact resulting in changes in the accounting policies and the financial statements of the Bank:

IFRS 17 “Insurance Contracts” (in force for annual periods beginning on or after 1 January 2021 – not endorsed by EC). This is an entirely new accounting standard on all types of insurance contracts, including some guarantees and financial instruments, and includes rules on recognition and measurement, presentation and disclosure. The standard will supersede the effective so far standard related to insurance contracts – IFRS 4. It establishes an entirely new overall model for insurance contracts' accounting, covering all relevant accounting aspects. It is not applicable to the Bank's operations.

IAS 28 (amended) “Investments in Associates and Joint Ventures” – regarding long term interests in associates and joint ventures (in force for annual periods beginning on or after 1 January 2019 –endorsed by EC). The amendment clarifies that an entity should apply IFRS 9 including its impairment requirements regarding long term interests in associate or joint venture that form part of the net investment in the associate or joint venture but to which the equity method is not applied. A change in the intents and plans of the management are not regarded as evidence for a change in use.

IFRS 10 (amended) “Consolidated Financial Statements” and IAS 28 (amended) “Investments in Associates and Joint Ventures” – regarding the sale or contribution of assets between an investor and its associates or joint ventures (postponed effective date, to be determined by the IASB). These amendments address the accounting treatment of the sale or contribution of assets between an investor and its associates or joint ventures. They confirm that the accounting treatment depends on whether the assets sold or contributed constitute in substance a business as defined in IFRS 3. If these assets as an aggregate do not meet the definition of a business, then the investor shall recognise gain or loss only to the extent of other unrelated investor's interests in the associate or joint venture. In cases of sale or contribution of assets, which as an aggregate constitute a business, the investor shall recognise the full gain or loss on the transaction. The amendments will be applied on a prospective basis. IASB postponed the initial date of application of these amendments for an indefinite period.

Annual improvements to IFRSs 2015-2017 Cycle (December 2017) – improvements to IAS 23, IAS 12 and IFRS 3 in relation to IFRS 11 (in force for annual periods beginning on or after 1 January 2019 –endorsed by EC). These improvements introduce partial amendments to and editions of the respective standards primarily with a view to remove the existing inconsistency or ambiguities in the application of the rules and requirements of individual standards as well as to set out more precise terminology. These amendments are basically focused on the following

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items and transactions: (a) they clarify that when an entity acquires control over a business which constitutes a joint venture, it should restate its previous holding in the business under IFRS 3. It is further clarified that when an entity acquires a joint control over a business which constitutes a joint venture, it should not restate its previous holding in the business under IFRS 11; (b) they clarify that all tax consequences on dividend income (i.e. upon profit distribution) should be stated within profit or loss irrespective of how they occurred – upon the application of IFRS 12; and (c) they clarify if under special-purpose loans concluded to finance a specific asset remain outstanding after the asset is ready for its intended use or disposal, these loans become part of general-purpose financing, and capitalisation rate is calculated under IAS 23.

IFRS 3 (amended) “Business Combinations” (in force for annual periods beginning on or after 1 January 2020, not endorsed by EC). This change concerns the definition of “business” provided in the appendices to the standard and is related to the difficulties that acquiring entities experience when determining whether they have acquired a business or a group of assets. The amendment aims: (a) to clarify that to be considered a business, an acquired set of activities and assets must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create outputs; (b) to narrow the definitions of a “business” and of “outputs” by focusing on goods and services provided to customers and by removing the reference to an ability to reduce costs; (c) to add guidance and illustrative examples to help entities assess whether a substantive process has been acquired; (d) to remove the assessment of whether market participants are capable of replacing any missing inputs or processes and continuing to produce outputs; and (e) to add an optional concentration test that permits a simplified assessment of whether an acquired set of activities and assets is business or not.

2.3. Impact of the initial adoption of IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*

2.3.1. IFRS 9 *Financial Instruments*

On 1 January 2018 the Bank’s management assessed the business models of the separate financial assets and liabilities held by the Bank, and reclassified its financial instruments into the respective categories under IFRS 9.

Upon managing its financial assets, the Bank applies the business models described in detail in Note 3.2.

Regarding impairment depending on the presence of a significantly increased credit risk following initial recognition and credit impairment following initial recognition, credit exposures are stated in stages, in accordance with the requirements of IFRS 9. Detailed description of the Bank’s policy is presented in Notes 3.2 and 30.2.

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The impact of reclassifications as at 1 January 2018 compared to the IAS 39 categories, and the value impact of initial adoption of IFRS 9 as at 1 January 2018 are as follows:

	IAS 39 category	Impact of IFRS 9 adoption		IFRS 9 Category
		Amount	Restatement effect	
Financial assets				
Cash and balances with the Central Bank	loans and receivables	70,362	(13)	70,349 financial assets at amortised cost
Loans and receivables from banks	loans and receivables	25,114	(7)	25,107 financial assets at amortised cost
Debt securities	held for trading	13,949	(13,949)	- financial assets at fair value through profit or loss
Equity securities	held for trading	177	4	2 financial assets at fair value through profit or loss
Debt securities	available for sale	60,504	13,949	- 74,453 financial assets at FVOCI
Equity securities	available for sale	297	(4)	- 293 financial assets at FVOCI
Loans and receivables from customers	loans and receivables	181,384	(618)	180,766 financial assets at amortised cost
Total financial assets		351,787	(636)	351,151
Financial liabilities				
Deposits from banks	amortised cost	191	-	191 financial liabilities at amortised cost
Provisions for expected losses under financial guarantee contracts and loan commitments	N/A	-	(10)	(10) N/A
Deposits from customers	amortised cost	340,944	-	340,944 financial liabilities at amortised cost
Total financial liabilities		341,135	(10)	341,125

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The link between the impairment provisions stated under IAS 39 as at 31 December 2017 and the opening balance of expected credit losses in accordance with IFRS 9 as at 1 January 2018 is as follows:

	Impairment under IAS 39 /Provisions under IAS 37	Restatement	Impairment under IFRS 9
Measurement category			-
Cash and balances with the Central Bank	-	13	13
Loans and receivables from banks	-	7	7
Debt securities at FVOCI	-	170	170
Loans and receivables from customers	18,563	618	19,181
Commitments under loans and financial guarantee contracts	-	10	10
Total	18,563	818	19,381

The impact on the Bank's accumulated loss on 1 January 2018 from the adoption of IFRS 9 is as follows:

Closing balance as at 31 December 2017 (originally stated according to the accounting policy for 2017)	(28,107)
Accrual of a provision for impairment of expected credit losses on:	
cash and cash equivalents	(13)
loans and receivables from banks	(7)
loans and receivables from customers	(618)
debt securities at FVOCI	(170)
commitments under loans and financial guarantee contracts	(10)
Transfer of revaluation reserve of reclassified equity securities	2
Opening balance on 1 January 2018 following restatement from the application of IFRS 9	(28,923)

2.3.2. IFRS 15 Revenue from Contracts with Customers

The standard's adoption has no material value or classification impact on the financial statements, respectively on the Bank's assets and liabilities and equity as at 1 January 2018.

2.4. Potential impact of the adoption of the new IFRS 16 Leases

IFRS 16 is mandatory for financial years commencing on or after 1 January 2019. The Bank has decided not to adopt the standard before its effective date. It has elected modified retrospective adoption of the standard's rules, as of 1 January 2019. Comparative amounts for the year prior to first adoption (2018) will not be restated.

The Bank has reviewed and analysed all lease agreements according to the guidance of the new IFRS 16. The standard will affect primarily the operating leases in which the Bank is a lessee.

According to the estimate as at 31 December 2018, the Bank has non-cancellable commitments under 25 operating lease agreements, for which it will recognise right-of-use assets. All other contracts are related to low-value lease payments, which will continue to be recognised on a straight-line basis as current expenses in profit or loss.

The potential effects of the change in the accounting policy resulting from the adoption of IFRS 16 are set out below:

- The Bank expects to recognise right-of-use assets of approximately BGN 3,695 thousand on 1 January 2019, respectively lease liabilities of the same amount. The Bank will measure the right-of-use assets under all lease agreements at an amount equal to the lease liabilities, adjusted with the amount of all lease payments paid or accrued in advance and recognised immediately prior to adoption (31 December 2018);
- The change in the accounting policy resulting from the adoption of IFRS 16 on 1 January 2019 will not impact the Bank's net assets;

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- The Bank expects that the net profit for 2019 will decrease by BGN 10 thousand as a result of adopting the new standard;
- Net operating cash flows will increase and net financing cash flows will decrease by approximately BGN 1,068 thousand as repayment of the principal portion of the lease liabilities will be classified as cash flows from financing activities.

2.5. Basis of measurement

The Bank's annual financial statements have been prepared on a historical cost basis, with the exception of financial assets held for trading, financial assets measured at fair value through other comprehensive income (available-for-sale financial instruments under IAS 39 as at 31 December 2017), and investment property, which have been measured at fair value.

2.6. Going concern

The Bank's financial statements have been prepared under the going concern assumption. As a result of the operations executed by the Bank in prior reporting periods, losses have been accumulated that may cast doubt about the Bank's ability to continue as a going concern. Despite the accumulated losses, the Management has analysed the ability of the Bank to continue its operations and has undertaken actions to strengthen its positions through optimization of the banking products and services, improvements of the assets structure and expenses which will create conditions for generating future income. The aims on which the Bank's strategic development plans are based are:

- improving the structure of assets and liabilities by means of:
 - sustainable annual growth on the loan portfolio;
 - decreasing the portion of non-serviced loans to levels average or lower than the average in the banking system;
 - decreasing the portion of acquired assets;
 - controlled amount of customers' deposits in order to reduce resource expenditure while retaining stable funding;
- gradual increase of the average profitability of the performing portfolio;
- limiting impairment costs of loans and receivables from customers by improving the quality of newly granted loans;
- growth in fees and commissions income;
- strict control of operating expenses;
- optimization of the branch network;
- active marketing of the Bank's products;
- improving the quality and efficiency of service through enhancing staff's qualification.

As at 31 December 2018, there is no significant doubt on the ability of the Bank to continue as a going concern. In addition, the Bank is subject on current monitoring and regulation by BNB with respect to all of its licensed activities, financial status and stability.

3. SUMMARY OF THE SIGNIFICANT ACCOUNTING POLICIES

3.1. Accounting estimates

The presentation of financial statements requires management to apply certain accounting estimates and reasonable assumptions that affect the reported carrying amount of assets and liabilities as of the date of the financial statements, as well as the amount of revenues and expenses during the reporting period and to disclose contingent assets and liabilities. These estimates and assumption are based on the information available at the date of the preparation of the financial statements and the actual results may differ from these estimates.

The main assumptions and estimates applied in these financial statements are as follows:

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3.1.1. Determining expected credit losses from financial assets with low credit risk

Instruments with low credit risk are considered to be the instruments for which the risk of default is low, the counterpart's ability to fulfil contractual conditions is stable, and long-term adverse changes in economic conditions are unlikely to change the ability to repay debts. For short-term receivables from banks and debt instruments measured at FVOCI, the Bank assumes that the probability of default is unlikely, and therefore determines 12-month credit losses for these instruments. If in subsequent reporting periods the criteria for low credit risk are no longer met, the Bank analyses the change in the credit risk compared to initial recognition in order to determine the need of lifetime credit losses. Designating instruments as low credit risk ones requires judgement. Upon making this judgement, the Bank uses all the reasonable, grounded and relevant information accessible without making unnecessary costs or efforts (Note 30.2).

3.1.2. Determining expected credit losses from loans and receivables from customers

Upon determining expected credit losses from loans and receivables from customers, the Bank applies the general approach of IFRS 9 based on internal policies, rules, models and calculation techniques. The Bank classifies its financial assets in three risk stages depending on changes in the credit risk following the initial recognition of the asset, respectively determines 12-month credit losses if there is no change in the credit quality (Stage 1) and lifetime credit losses (Stages 2 and 3) if there is a significant increase in the credit risk. Upon determining how significantly the credit risk has increased compared to the initial recognition of the asset, the Bank uses all the reasonable and grounded information accessible without making unnecessary costs or efforts.

The loss given default is an estimate of the damages the Bank would suffer upon default and is based on the difference between the contractual cash flows and the cash flows it actually expects to receive, including from collaterals and other loan facilities. Significant judgement is needed upon determining the timeframe and amount of expected cash flows, including upon determining the amount of collateral. The management forms its judgements based on historical experience of losses from assets with inherent credit risk and objective evidence of impairment. This process requires assumptions related to expected future cash flows, amount of collaterals, expected period of realization of collaterals, expected change in real estate prices over the sales period, discounts depending on the type of property.

Upon determining the amount of expected credit losses, the Bank uses forecast information about expected future changes in certain macroeconomic conditions and indicators, and assumptions for correlations of how changes in these indicators would impact the probability of default. The Bank has developed internal models to determine the probability of default by loans, mostly based on historical information for periods when such information is available. The assessment of the correlation between the historical default rates and the forecast economic indicators is a significant estimate. Note 30.2 describes the process applied by the Bank to manage credit risk and determine expected credit losses from loans and receivables from customers.

3.1.3. Determining the fair value of financial instruments

When the fair value of financial assets and financial liabilities carried in the statement of financial positions cannot be obtained based on quoted prices on active markets, their fair value is determined by using other valuation techniques, involving the use of mathematical models. The input used in these models is obtained from observable financial markets, where possible, but when this cannot be done, significant judgement is applied to determine fair values (Note 30.5);

3.1.4. Recognition of tax assets

On recognising deferred tax assets, the probability for a reversal of the individual differences and the abilities of the Bank to generate sufficient taxable profit in the future is taken into account by the management of the Bank. As a result of this analysis, the management has decided to not recognise deferred tax assets in the annual financial statements (Note 16).

3.1.5. Classification and measurement of assets acquired from collaterals

Acquired assets, which prior to their acquisition were held as collateral of loans granted, are classified by the bank

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as assets held for sale, investment property and other assets acquired from collaterals. Upon the initial acquisition of these assets, the Bank's management makes judgements regarding their classification, based on its intentions and possibilities for future use and/or disposal. The management performs an annual review, as at the date of preparing the financial statements, of its assumptions and judgements based on the existing circumstances, and if necessary, the assets are reclassified. According to the Bank's accounting policy, assets classified as held for sale or as other assets acquired from collaterals, are subsequently measured at the lower of the their carrying amount and the fair value less costs for disposal. In order to determine the fair value of assets held for sale and other assets acquired from collaterals, the Bank uses independent external valuers. Acquired assets classified as investment property are subsequently measured at fair value, whose amount is determined by independent external valuers appointed by the Bank, holding suitable professional qualification and valuation experience with respect to analogous assets. The application of the valuation approaches and techniques, and of the inputs used for each case of fair value measurement, is subject to mandatory discussion and coordination between the external expert valuers and the Bank's valuation specialists, as well as the approval of the valuation reports issued – especially with respect to significant assumptions and final conclusions (Note 30.5).

3.2. Financial instruments

3.2.1. Financial assets

3.2.1.1. Recognition of financial assets

The Bank usually recognises in the statement of financial position financial assets on the “trade date”, being the date on which it has committed to purchase the respective financial assets. This includes transactions performed under a regulated framework – purchases and sales of financial assets that presume a settlement and assets transfer to be performed in a generally accepted manner established by law or relevant market convention. Loans and receivables from customers are recognised when the funds are transferred to the customer's account. Respectively, the Bank recognises amounts due to customers when funds are received at the Bank.

3.2.1.2. Initial measurement of financial assets

All financial assets are initially measured at their fair value plus the directly attributable transaction costs, except for the financial assets at fair value through profit or loss. Trade and other receivables are measured at invoice amount (transaction price).

When the fair value of financial assets upon initial measurement deviates from the transaction price, the Bank recognises the difference within current profit or loss under the following conditions:

- a) if the fair value has been determined by means of a valuation technique based on observable inputs about the market participants, the difference is recognised as early as the first date within current profit or loss; and
- b) if the fair value has been determined by means of a valuation technique based on unobservable inputs, the difference is not recognised within current profit or loss until the data is observable and the financial instrument is written-off.

3.2.1.3. Classification and subsequent measurement of financial assets

Accounting policy applied as from 1 January 2018

Depending on their subsequent measurement, the Bank classifies its financial assets in one of the following categories:

- financial assets at amortised cost;
- financial assets at fair value through profit or loss;
- financial assets at fair value through other comprehensive income with or without reclassification to profit or loss.

The classification of financial assets is determined based on the following two conditions:

- the Bank's business model for management of financial assets;
- the characteristics of the financial asset's contractual cash flows.

Upon managing its financial assets, the Bank applies the following business models:

- **Business model to collect contractual cash flows** – within this business model, the Bank holds the

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respective financial instruments to maturity in order to collect the cash flows agreed with the issuer of the financial instrument /the debtor/. The financial assets held within this business model are not subject to sale, except for individual cases with an explicit decision of the Bank's management. The business model does not change upon executing sales of financial assets or expectations for future sales;

- **Business model to collecting cash flows and sell financial assets** – within this business model, the Bank holds the respective financial instruments in order to collect the contractual cash flows, but also for the purpose of sale of financial assets. As compared to the business model whose purpose is the hold financial assets to collect cash flows, in this business model there is greater frequency and value of sales. Sales of financial assets are not sporadic; rather, they constitute a major factor for achieving the purpose of the business model, but in the meantime have no frequency and value threshold.
- **Business model to sell assets** – within this business model, the Bank holds the respective financial instruments for the purpose of trading, even though for the period of holding them the Bank may receive contractual payments of various nature for the respective financial instruments, the ultimate objective is to achieve a positive financial result from differences in the prices of the financial assets.

Establishing (testing) the characteristics and conditions of contractual cash flows (SPPI) is the second factor in determining the classification of each financial instrument. This process constitutes a check of a set of selected characteristics of expected contractual cash flows from the transactions which are of key importance for the financial instrument. The aim is to identify assets for which cash flows are solely payments of principal and interest (SPPI test).

For the purpose of this test, principal is defined as being the fair value of the financial asset at initial recognition, which may change over the instrument's life term. Moreover, the most significant element of the interest which is measured during the test is the compensation for the time value of money and credit risk. Upon assessing SPPI, the Bank makes a number of assumptions and judgements and considers a number of factors, in particular the fluctuation of cash flows and risks inherent in the respective exposure.

The process of establishing characteristics of contractual cash flows includes:

- identification and grouping the financial assets applicable for the respective business model;
- identification of sub-portfolios of instruments covered by standardised products for which the available information and/or examination of product documentations equivocally demonstrate compliance with the SPPI test;
- regarding homogeneous portfolios, the SPPI test is based on review of the applicable conditions based on internal rules, general rules and contracts and/or expert examination;
- in the remaining cases, the SPPI test is performed by means of individual examination of characteristics at the level of individual contracts.

The Bank has established the following frequency in identifying and testing the characteristics of contractual cash flows:

- one-off test, on 1 January 2018, upon enforcement of IFRS 9 – for financial assets existing at this date;
- upon introducing new standardised banking products at product documentation level;
- upon occurrence of a new instrument and/or product in the case of specific rules or rules that deviate from the standard ones set in internal rules, price list, general terms and conditions and contracts.

Financial assets at amortised cost

Financial assets are measured at amortised cost if both of the following conditions are met:

- the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows;
- according to the instrument's contractual conditions, on certain dates cash flows originate which are solely payment of principal and interest on the principal outstanding.

Within this category, the Bank states cash and balances with the Central Bank, loans and receivables from banks and customers, and other operating receivables. Amortised cost is the instrument's initial value adjusted for principal repayments and the amortisation accumulated on the difference between the initial value and maturity value using the effective interest rate method reduced with the accounted expected credit loss allowance. Interest income is measured and recognised based on the effective interest method and is presented in the statement of comprehensive income (within profit or loss for the year), within Interest income. Upon determining expected future cash flows, the Banks takes into consideration all contractual conditions of the transaction, including premiums, fees and other consideration payable by the counterpart, which impact the transaction's profitability and constitute an integral part

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of the effective interest rate.

Financial assets at fair value through other comprehensive income (FVOCI)

The Bank classifies in this category debt and equity securities.

The Bank classifies and subsequently measures a debt financial asset within *financial assets at fair value through other comprehensive income*, when both of the following conditions have been satisfied:

- the assets are managed in a business model for the purpose of collecting contractual cash flows and sale of the financial assets;
- according to the instrument's contractual conditions, on certain dates cash flows originate which are solely payment of principal and interest on the principal outstanding.

Regarding debt securities at fair value through other comprehensive income, the interest income, foreign exchange gains, and impairment losses or reversal are recognised in the statement of comprehensive income (within profit or loss for the year) and are calculated in the same manner as those for financial assets measured at amortised cost. Unrealised gains and losses from changes in the fair value are recognised directly within a separate component of equity in the statement of changes in equity (reserve for financial assets at fair value through other comprehensive income) through other comprehensive income. Upon derecognition, the cumulative change in the fair value, recognised in prior period within equity, is reclassified to profit or loss for the year.

The Bank may make an irrevocable choice to classify certain equity instruments as equity instruments at fair value through other comprehensive income at initial recognition, when they are not held for trading. The classification is determined at the level of individual instruments. Gains and losses on these financial assets are never reclassified to profit or loss. Dividends are recognised as other income in the statement of comprehensive income when the right on payment is established. Equity instruments at fair value through other comprehensive income are not subject to impairment tests.

The Bank has elected to classify into this category its investments in equity instruments which it intends to hold in the long term.

Financial assets at fair value through profit or loss (financial assets held for trading)

Financial assets at fair value through profit or loss include financial assets held for trading, as well as financial assets initially measured at fair value through profit or loss, or financial assets for which there is obligatory measurement at fair value. Financial assets are classified as held for trading, if they have been acquired for the purpose sale or of short-term repeated acquisition. Derivatives are also classified as held for trading, unless they have been designated as effective hedging instruments. Financial assets whose cash flows do not constitute solely payments of principal and interest are classified and measured at fair value through profit or loss, irrespective of the business model.

Irrespective of the criteria for debt instruments which should be classified at amortised cost or at fair value through other comprehensive income as described herein above, debt instruments may be measured at fair value through profit or loss upon their initial recognition, if this would eliminate or significantly decrease the accounting discrepancy. Financial assets at fair value through profit or loss are stated in the statement of financial position at fair value, and net changes in fair value are recognised in the statement of comprehensive income (within profit or loss for the year).

Accounting policy applied until 31 December 2017

Financial assets and liabilities held for trading

These are financial assets and liabilities, as well as all derivatives (excluding those, presented as hedging instruments), which were either acquired for the purpose of generating profit from short-term fluctuations in price or dealer's margin, or for the purpose of generating short-term profit from sales. These financial instruments are initially recognized and subsequently measured at fair value. Subsequent revaluations are based on market quotations. All realized gains on transactions with such financial instruments, as well as gains or losses on subsequent revaluations are included in the statement of comprehensive income. As at 31 December 2017 financial assets held for trading consist mainly of Bulgarian government securities. Purchase and sale of financial assets held for trading are recognized at transaction date.

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The Bank uses derivative financial instruments both to meet the financial needs of its customers, acting as an agent, and in its own transactions. These instruments include open market foreign currency transactions, open market security purchase and sale transactions, open market forward exchange rate agreements and currency swaps. Subsequent to initial recognition and measurement, financial instruments are remeasured at each reporting date and reported at their fair value. Changes in fair value of derivatives held for trading are included in the statement of comprehensive income.

As at 31 December 2017 there were no transactions with derivative financial instruments that qualify for hedge accounting under the specific rules of IAS 39.

Investments held to maturity

Investments held to maturity are investments with fixed or determinable payments and fixed maturity, which the Bank has the positive intention and ability to hold until maturity. These securities are initially recognized at cost, including any transaction costs. Investments held to maturity are subsequently measured at amortized cost using the effective interest rate method.

Acquisitions and derecognition of financial assets classified as investment held to maturity are recognized on transaction date.

Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are not classified as loans and receivables, investments held to maturity or financial assets, measured at fair value through profit or loss.

These assets are measured at fair value, based on quoted market prices in an active market. Equity securities for which there is no market price information are presented at acquisition cost and are reviewed for impairment, which is recognized in statement of comprehensive income.

Dividends from equity investments are recognized as income at the time when the Bank has the right to receive them.

Sales and acquisitions of financial assets available for sale are recognized on transaction date.

Loans and receivables

Loans and derivatives are non-derivative financial assets with fixed and determinable payments which are not quoted on an active market and are classified in the other groups. These financial assets are carried at amortised cost by applying the effective interest rate method, less impairment for losses and uncollectability.

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents include cash in hand, balances with the Central Bank, loans and receivables from banks – on sight or with original maturity up to 3 months.

3.2.1.4. Impairment of financial assets

Accounting policy applied as from 1 January 2018

The Bank recognises an allowance for losses on impairment of financial assets by applying the so-called “expected credit losses approach” (ECL), i.e. it recognises a loss allowance irrespective of whether a specific loss event occurred. The model is applied upon the initial recognition of all debt instruments which are not measured at fair value through profit or loss, including receivables under lease agreements, loan commitments and financial guarantees.

ECL are based on the difference between the contractual cash flows due according to the contract’s conditions, and all cash flows which the Bank expects to receive, discounted with the initial effective interest rate. Expected cash

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flows include cash flows from the sale of collaterals held or other loan facilities which constitute an integral part of the contractual conditions.

When following the asset's initial recognition no significant increase in the credit risk has occurred, the allowance for impairment is based on the expected credit loss occurring as a result of default events probable over the next 12 months (12-month ECL). For exposures that have a significant increase in credit risk compared to initial recognition, the impairment provision is recognised for the credit loss expected over the remaining lifetime of the exposure, irrespective of the point of default (lifetime ECL).

The change in the loss allowance is stated as result from impairment in profit or loss for the period. When in subsequent period the credit quality of the financial asset improves so that there is no longer a significant increase in credit risk compared to the asset's initial recognition, the allowance is again measured based on 12-month expected credit losses.

Additional information about the assumptions used in determining ECL is presented in Notes 30.2 and 3.1.

Accounting policy applied until 31 December 2017

Impairment of financial assets

As of the end of each reporting period, the Bank reviews whether there are any indications for impairment of individual financial asset or a group of financial assets. A financial asset or a group of financial assets are impaired only when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the asset/group of assets and the estimated future cash flows have been affected.

The objective evidence for impairment includes:

- Significant financial difficulties suffered by the issuer /borrower;
- Non-performance of an agreement, including default payment or delay payment of principal or interest;
- Debt restructuring due to economic or legal reasons resulting from financial difficulties of the issuer/debtor;
- Probability of bankruptcy or other financial reorganization of the issuer/debtor;
- Disappearance of an active financial market of the financial asset due to finance difficulties of the issuer/debtor.

The disappearance of an active market for certain securities, i.e. the securities are no longer traded, is not in itself evidence for impairment. The decrease of the credit rating of a certain issuer, as well as the decrease in fair value of a financial asset below its acquisition cost are not in themselves evidence for impairment without the existence of other indicators.

Loans and receivables

The allowance for impairment and uncollectability is measured considering the specific risk of the asset. In determining the level of the impairment required, management considers a number of factors including domestic economic conditions, the composition of the loan portfolio and prior irregular and non-performing debt experience, quality and liquidity of collateral.

The allowance for impairment and uncollectability is determined as the difference between the carrying amount of a financial asset and its estimated recoverable amount. For portfolios of exposures with similar credit risk characteristics and no objective evidence of impairment, the Bank estimates portfolio impairment (incurred but not reported loss).

Any difference between the carrying amount and recoverable amount of the financial asset (loss on impairment and uncollectability) is carried to the statement of comprehensive income for the period when it occurs. A reversal of any loss on impairment and uncollectability is stated as income for the respective period. The recovery of amounts previously written off is treated as income when received.

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3.2.1.5. Reclassification of financial assets

Accounting policy applied as from 1 January 2018

Under certain circumstances it is possible for non-derivative financial assets at fair value to be reclassified to amortised cost and vice versa. Such reclassification is only permitted upon change in the business model within which the respective assets are managed. The change in the business model is determined by the Bank's management as a result of external or internal changes of material nature to the Bank's operations. A change may also occur upon reorganization of operations resulting from change in the business model's objectives. Changes to the initial classification of financial assets are expected to occur in relatively rare and limited cases.

The new treatment is applied for future periods, following the date of reclassification when the business model was changed, without restatement of prior periods. The date of reclassification is taken to be the first day of the first reporting period following the change in business model, as a result of which the reclassification occurred.

Accounting policy applied until 31 December 2017

Upon reclassification of a financial asset from the "held for trading" category into "held to maturity" category, the fair value of the respective asset at reclassification date is taken to constitute its amortised cost. Consequently, the asset, as well as each profit or loss stated until the date of reclassification to other comprehensive income, are amortised based on the effective interest method.

Reclassification of financial assets from the "held for trading" category into "held to maturity" category is only done when there is a change in the Bank's intention and ability to hold this asset to maturity.

The Bank may not reclassify a financial asset as "held to maturity" if during the current financial year or in the past two years it sold or reclassified more than an insignificant portion of the portfolio held to maturity, prior to maturity.

3.2.1.6. Derecognition of financial assets

Financial assets are derecognised from the Bank's statement of financial position when: a) the rights to cash flows from the asset have expired, or b) the contractual rights have been transferred by the Bank or it holds them, but has undertaken an obligation to transfer the cash flows received thereby to a third party without undue delay (so-called pass-through agreement). A transfer leads to derecognition when: a) the Bank has transferred substantially all risks and rewards from ownership of the asset to the recipient; or b) the Bank has neither transferred nor retained substantially all risks and rewards from ownership of the asset, but has transferred control thereon. It is assumed that the Bank has transferred control only when the recipient has the practical possibility to freely and unrestrictedly dispose of or sell the assets to third unrelated parties.

If the Bank continues to hold substantially all risks and rewards from ownership of a transferred financial asset, or has retained control thereon, it continues to recognise the asset transferred to the extent of its continuing interest therein, but also recognises the associated liability for the consideration received. Both the asset and liability are measured so as to most adequately assess the continuing rights and obligations of the Bank. If the continuing involvement is in the form of a guarantee on the transferred asset, it is measured according to the policy on financial guarantees, and if it is in the form of put or call options – at the fair value.

3.2.1.7. Modification due to material change in terms and conditions

The Bank modifies the financial asset when the terms and conditions are renegotiated to a degree that may be considered to constitute a new asset, and the difference is recognised as gain or loss on derecognition, as far as the impairment loss has not yet been recognised. The newly created assets are classified in Stage 1 for the purpose of calculation of expected credit losses (ECL). When the modification of a financial asset results in derecognition of the existing financial asset and the subsequent recognition of the modified financial asset, the modified asset is considered to be a new one.

Upon assessment whether an asset should be derecognised, the Bank also considers the following additional factors: change in the loan's currency, change in counterpart, whether the change results in the instrument no longer meeting the SPPI test criterion (solely payment of principal and interest).

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3.2.2. Financial liabilities and equity instruments

The Bank's financial liabilities include: payables to banks and customers under attracted deposits, and other current liabilities.

The Bank classifies its liabilities, debt and equity instruments as either financial liabilities or as equity in accordance with the substance of the contractual arrangements with the respective counterparty regarding these instruments. The Bank determines the classification of its financial liabilities at the time of their origination. All financial liabilities held by the Bank are classified as financial liabilities and are subsequently measured at amortised cost.

The accounting treatment of financial liabilities remains to a large extent unchanged compared to the guidance of IAS 39, with the exception of the treatment of differences resulting from changes in own credit risk for financial instruments measured at fair value through profit or loss. According to IFRS 9, these differences are carried to a reserve for financial assets at fair value through other comprehensive income, without subsequent reclassification in the statement of profit and loss and other comprehensive income.

They are initially recognised in the statement of financial position at fair value, net of the directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest method.

Interest costs are carried currently to the statement of profit or loss and other comprehensive income (within profit or loss for the year) systematically over the life of the instrument.

Financial liabilities are derecognised when the obligation thereunder is discharged, or cancelled, or the counterparty loses its entitlement.

3.2.3. Netting of financial assets and financial liabilities

Financial assets and financial liabilities are netted, and the net amount is carried to the Bank's statement of financial position only if a legally enforceable right exists to offset the recognised amounts and if there is an intention to settle on a net basis or realise the asset and settle the liability simultaneously.

3.2.4. Financial guarantees and undrawn commitments

Contingencies are liabilities arising as a result of past events whose existence can only be confirmed by the occurrence or non-occurrence of one or more uncertain future events which cannot be fully controlled by the Bank or it is not probable that a resource outflow would arise to repay the liability. In its usual course of business, the Bank grants bank guarantees having the nature of loan substitutes, good performance guarantees, tender guarantees, customs' guarantees and letters of credit to its clients. It treats these as conditional commitments until an event resulting in the occurrence of an actual obligation for it to make a payment to a client's counterpart in whose favour the respective guarantee has been issued. Such an event is a claim to the Bank for payment of the respective commitment undertaken.

Financial guarantees are initially recognised at fair value, which is the amount of the fee (premium) received. The Bank's liability under each financial guarantee is subsequently measured at the higher of the following: a) the amount initially recognised less the amortised portion thereof recognised in profit or loss, and b) the impairment of expected credit losses (under IFRS 9) or the best estimate of the costs the Bank may expect to incur to settle each financial liability arising from a financial guarantee (under IAS 39).

The net effect of the change in the estimate of expected credit losses from financial guarantees granted, letters of credit and undrawn commitments is presented in the statement of profit and loss and other comprehensive income (within profit or loss for the year). The fee collected for bank guarantees issued is amortised on a straight-line basis over the period of the guarantees and is presented in the statement of profit or loss and other comprehensive income within "revenue from fees and commissions".

The undrawn loan facilities and letters of credit are commitments for which over a certain time period the Bank commits to grant to its client a loan under conditions agreed in advance. Like for financial guarantees, provisioning is done when there is an irrevocable loan agreement (under IAS 39) and at the amount of the impairment of expected credit losses (under IFRS 9).

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The nominal amount of financial guarantees, undrawn loan facilities (where the loan is agreed at market conditions) and letters of credit is not recognised and carried to the statement of financial position. This amount, together with the recognised losses, is disclosed in the notes to the financial statements (Note 30.2).

3.2.5. Receivables and payables under repurchase agreements (repo deals)

The Bank enters into agreements for temporary sale of securities with repurchase clause on a future date at a fixed price.

Receivables and liabilities under repurchase agreements are recognized at cost, which represents the funds placed/obtained by the Bank, secured by the value of the securities, together with the accrued to the moment interest receivable/payable.

Securities sold with repurchase clause are not derecognized from the statement of financial position and are stated as financial assets held for trading. The difference between the sale price and repurchase price is considered as interest and is accrued proportionally for the term of the agreement.

3.3. Investment property

The Bank states as investment property real estate owned thereby from which it intends to realise rental income or capital gains, or both.

Investment property is recognised as an asset only when it is probable that the Bank will obtain the future economic benefits related to the property, and when the acquisition price can be reliably measured. Recognition is usually performed when all risks and rewards related to the asset are transferred to the Bank.

Investment property is initially measured at acquisition cost, including transaction costs. Current costs related to servicing the asset are not included in the carrying amount, but are stated as expense for the period. Enhancements made after the date of initial recognition are included in the value of the investment property, in as far as they meet the criteria for asset recognition.

The Bank uses the fair value model for presentation of investment property.

Gains or losses on changes in the fair value of investment property are carried to the statement of comprehensive income (within profit or loss for the year).

Investment property is derecognised from the statement of financial position when it is permanently decommissioned and no future economic rewards are expected therefrom or upon sale. Gains and losses on sale of individual assets from the "investment property" group are determined by comparing the consideration the Bank expects to be entitled to (the sales revenue) and the carrying amount of the asset at the date on which the recipient obtains control thereon.

3.4. Leases

The determination of whether an arrangement is or contains a lease is based on the substance of the arrangement. It requires an assessment of whether: (a) fulfilment of the arrangement is dependent on the use of a specific asset or assets (the asset); and (b) the arrangement conveys a right to use the asset.

Operating lease

Leases where a significant portion of the risks and rewards of ownership of the asset are retained by the lessor are classified as operating leases. The payments made under operating leases are carried to the statement of comprehensive income on a straight-line basis over the period of the lease and are presented as rent expenses. When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognized as an expense in the period in which termination takes place. Assets leased out by the Bank under operating leases are recognised in the statement of financial position based on their nature. Rental income under lease contracts is recognized on a straight-line basis over the lease term and is presented as "other operating income/expenses" in the statement of comprehensive income.

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Finance lease

Leases where the lessee has substantially all the risks and rewards of ownership of the asset are classified as finance leases. When assets are leased out under a finance lease, the present value of the minimum lease payments is recognized as a receivable. Lease income is recognized over the term of the lease using the net investment method (before tax), which reflects a constant periodic rate of return. Finance lease receivables from funded participation in finance lease contracts are included within "Loans and receivables from customers" in the statement of financial position.

3.5. Property, plant and equipment and intangible assets

Property (land and buildings) is carried to the statement of financial position at acquisition cost less accumulated depreciation and impairment loss, if any.

The acquisition cost includes the purchase price and all direct costs for acquisition.

Intangible assets are carried at acquisition cost less accumulated amortization and impairment loss, if any.

The Bank has set a value threshold of BGN 150, below which the acquired assets, regardless of having the features of fixed assets, are treated as current expense at the time of their acquisition.

Depreciation of property and equipment is accrued according to the straight-line method and over the expected useful life of the respective assets at the following annual rates:

Buildings, investment properties	2%
Machinery and equipment	20%
Computers	20%
Vehicles – automobiles	15%
Fixtures and fittings	15%
Software	15%
Leasehold enhancements	According to the term of the agreement but not higher than 33.3%

The useful life set is reviewed at the end of each year and in case of any material deviation from the future expectations on the period of assets' use, the latter is adjusted prospectively.

Property, plant and equipment and intangible assets are subject to periodic review for impairment upon existence of impairment indicators. In the cases when the asset's carrying amount is higher than its expected recoverable amount, the asset is impaired and the Bank states impairment loss.

Property and equipment are derecognised from the statement of financial position when they are permanently withdrawn from use and no future economic benefits are expected therefrom or on disposal, upon transfer of control to the asset's recipient.

Gains and losses arising from the disposal of assets are determined as the difference between the disposal proceeds determined pursuant to IFRS 15, and the carrying amount of the asset in the statement of financial position at the disposal date. Gains and losses on disposal are recognised in the statement of profit or loss and other comprehensive income (within profit or loss for the year).

3.6. Interest income and costs

Interest income and expense are recognised in the statement of comprehensive income (within profit or loss for the year) on accrual basis for all interest-bearing financial instruments.

Interest income comprises: interest income from debt securities measured at fair value through other comprehensive income in 2018 (interest income from available-for-sale debt securities in 2017), interest income from deposits with other banks, interest income from financial assets held for trading, interest on loans and receivables from customers, including fees and charges on loans and receivables from customers, which form a constituent part of the effective income of the financial instrument.

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Interest costs comprise: interest on deposits from customers, as well as interest on financial assets (current accounts at other banks) with negative profitability.

Pursuant to IFRS 9 and IAS 39, upon recognition of interest income and costs, the effective interest method is applied for all financial instruments at amortised cost and at fair value.

The effective interest method is a method to determine the amortised cost of a financial instrument and to allocate the income/cost therefrom/therefor over a period of time. The effective interest rate is the interest rate that discounts the future inflows and outflows (including all fees and other add-ons or discounts) that are expected to be generated during the life of a financial instrument or a shorter period of time, as appropriate, to its carrying amount.

The recognition of interest income from financial assets at fair value through other comprehensive income pursuant to IFRS 9 is analogous to the recognition of interest income from available-for-sale financial assets and held-to-maturity financial assets pursuant to IAS 39.

Accounting policy applied as from 1 January 2018

The interest income from financial assets at amortised cost is calculated by applying the effective interest rate on the gross amount of the financial assets, with the exception of assets classified in Stage 3, for which the effective interest rate is applied on the amortised cost (net carrying amount) of the financial asset.

Accounting policy applied until 31 December 2017

Interest income and costs are recognised on a proportional time base by using the effective interest method, amortising the difference between the initially recognised asset or liability and the amount at maturity.

3.7. Fees and commissions

Bank service fee and commission income and non-bank service income (mostly under current transactions in BGN or foreign currencies and for opening letters of credit or issuing bank guarantees) are recognised over time or upon performance as per the conditions for transfer of control over the service.

Fees and commissions on bank guarantees are recognised on a systematic basis over the period of the exposure so as to match the cost of providing the service.

Fee and commission expenses related to the servicing of nostro accounts and other bank accounts are usually recognised at the time of performing/consuming the service they refer to, unless they are consumed over a period of time – in this case, they are recognised on a systematic basis over the period.

3.8. Foreign currency transactions

Transactions denominated in foreign currencies are translated into BGN at the rates of BNB at the date of transaction. Receivables and payables in foreign currencies are revaluated on a daily basis. At the end of the year, they are revalued into the BGN equivalent at closing exchange rates of BNB, which are as follows for the more important currencies as at the dates of the statement of financial position:

Currency	31.12.2018	31.12.2017
USD	1.70815	1.63081
EUR	1.95583	1.95583

Effective from 1999 the exchange rate of the Bulgarian Lev is fixed to the Euro, official currency of the European Union, at a rate of EUR 1 = BGN 1.95583.

Net foreign exchange gains and losses arising from revaluation of cash and cash equivalents, loans and receivables, investments in securities, payables under deposits and other liabilities and from foreign currency transactions are recognized in the statement of comprehensive income (within profit or loss for the year) when occurred.

3.9. Employee benefits

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Employee benefits are all forms of consideration given by the Bank in exchange for service rendered by the employees.

Short-term employee benefits include:

- basic remuneration for service;
- remuneration above the basic one according to the applied plans for service payment;
- additional remuneration for prolonged service, overtime and internal replacement;
- other specific additional remuneration according to individual labour contract;
- social security contributions and other benefits, including for paid sick leave, maternity leave and others;
- annual paid leave and other compensated leaves.

According to the requirements of the Labour Code upon termination of labour contract entities in the country are obliged to pay compensation at the amount of 2 to 6 salaries depending on the employee's length of service in the Bank.

In accordance with IAS 19 Employee Benefits the Bank recognizes liabilities for retirement benefits, which are calculated by a licensed actuary using the projected unit credit method (Note 17). The amount reported in the statement of financial position represents the present value of the long-term liabilities of the Bank for retirement benefits.

3.10. Income taxes

The current income taxes of the Bank are determined in accordance with the requirements of the Bulgarian tax legislation. Income tax is calculated based on the taxable profit for the period, determined in accordance with the provisions of the Corporate Income Taxation Act (CITA). The nominal income tax rate in Bulgaria for 2018 is 10% (2017: 10%).

Deferred income taxes are determined using the liability method for all temporary differences of the Bank as at the date of preparation of the financial statements between the carrying amounts of the assets and liabilities and their tax bases.

Deferred tax liabilities are recognised for all taxable temporary differences, with the exception of those originating from recognition of an asset or liability, which has not affected the accounting and the taxable profit/(loss) at the transaction date.

Deferred tax assets are recognised for all deductible temporary differences and the carry-forward of unused tax losses, to the extent that it is probable they will reverse and a taxable profit will be available or taxable temporary differences might occur, against which these deductible temporary differences can be utilised. This does not apply to differences arising from the recognition of an asset or liability, which has affected neither the accounting nor taxable profit/(loss) at the transaction date.

The carrying amount of all deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is probable that they will reverse and sufficient taxable profit will be available or taxable temporary differences will occur in the same period, to allow the deferred tax asset to be deducted or offset.

Deferred taxes are recognised as savings or expenses and are included in the statement of comprehensive income (within profit or loss for the year), except for the cases when these taxes originate from a transaction or event stated in the same or other period directly within equity. Deferred taxes are directly accrued or deducted within equity when they refer to items accrued or deducted in the same or other period within equity.

Deferred tax assets and liabilities are measured at the tax rates and on the bases that are expected to apply to the period and type of operations when the asset is realised or the liability – settled (repaid) on the basis of the tax laws that have been enacted or substantively enacted, and at tax rates of the country (Bulgaria) under the jurisdiction of which the respective deferred asset or liability is expected to be recovered or settled.

As at 31 December 2018 the deferred income taxes of the Bank are computed at a tax rate of 10%, which is also valid for 2019 (31 December 2017: 10%).

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3.11. Fair value of financial assets and liabilities

Some of the Bank's assets and liabilities are measured and presented at fair value on recurring basis and / or fair values are only disclosed for financial reporting purposes. These include:

- for the purpose of measurement and presentation at fair value in the financial statements: financial assets – securities at fair value through other comprehensive income, pursuant to IFRS 9 (2018); financial assets – available-for-sale securities, pursuant to IAS 39 (until 2018); financial assets held for trading; non-financial assets – investment property;
- for the purpose of fair value disclosures in the financial statements: financial assets and liabilities – measured at amortised cost, pursuant to IFRS 9 (2018): receivables from banks, loans and receivables from customers, deposits from banks and deposits from customers; financial assets and liabilities – receivables from banks, pursuant to IAS 39 (until 2018); non-financial assets – assets held for sale.

Moreover, the Bank also determines the fair value of the collaterals obtained thereby.

Fair value is the price that would be received to sell an asset or transfer a liability in an orderly transaction at a major (or most favourable) market at currently applicable market conditions. Fair value according to IFRS 13 is an exit price, irrespective of whether it is immediately available or estimated by means of another measurement technique.

Fair value is measured from the perspective of using the assumptions and judgments that potential market participants would use when pricing the respective asset or liability assuming that market participants act in their economic best interest. In measuring the fair value of non-financial assets the starting point is always the assumption what would be the highest and best use of the particular asset for the market participants.

The Bank has developed internal rules and procedures for measuring the fair value of various types of assets and liabilities.

The Bank applies various valuation techniques that would be relevant to the specific features of the respective conditions and for which it has sufficient available inputs while trying to use at a maximum the publicly observable information, and respectively, to minimize the use of unobservable information. It uses all three acceptable approaches – *the market approach, the income approach and the cost approach* – whereas the most frequently applied valuation techniques include direct and/or adjusted quoted market prices, market comparables (analogues) and discounted cash flows.

If an active market exists the Bank uses direct quoted (unadjusted) prices to determine the fair value of the respective financial instrument.

If the market for the respective financial instrument is not active the Bank establishes its fair value using a particular valuation technique. Valuation techniques include using recent arm's length transactions between knowledgeable, willing parties (if available), reference to the current fair value of other instruments that are substantially the same, discounted cash flows analyses and option pricing models. The valuation technique chosen makes maximum use of market inputs, relies as little as possible on estimates specific to the Bank, incorporates all factors that market participants would consider in setting a price, and is consistent with the accepted economic methodologies for pricing of financial instruments. Inputs to the valuation techniques reasonably represent market expectations and measures for risk-return factors inherent in the financial instrument. The Bank calibrates the valuation techniques and tests their validity using prices from observable current market transactions in the same instrument or based on other available observable market data. Fair values reflect the credit risk of the instrument and include adjustments to account for the credit risk of the Bank and the counterparty, where appropriate. Fair value estimates obtained from models are adjusted for any other factors, such as liquidity risk or model uncertainties, to the extent that the Bank believes a third-party market participant would take them into account in pricing a transaction.

The determination of the fair value of non-financial assets is carried out periodically (annually). The Bank uses the expertise of external independent licensed valuers in determining the fair value of its investment properties for the purpose of disclosures in the financial statements. The selection of valuers is made on the basis of the following criteria: applied professional standards, professional experience and knowledge, reputation and market status. The application of the valuation approaches and techniques as well as the inputs used in all cases of fair value measurements are subject to mandatory discussion and agreement between the external expert valuers and the respective officers in charge within the Bank. The final fair value measurements are subject to approval by the Bank's management.

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The Bank uses the following hierarchy to measure and disclose the fair value of financial instruments through valuation technique:

- Level 1: quoted (unadjusted) prices of active markets for identical assets or liabilities;
- Level 2: other techniques based on inputs, which has significant effect on the reported fair value and are observable either directly or indirectly;
- Level 3: techniques which have significant effect on the reported fair value and use inputs that are not based on observable market data.

The fair value hierarchy does not grant priority to the valuation techniques used, but is based on the nature of the input used in applying these techniques. The selection of a valuation technique to be applied takes into consideration the selling prices on the market (i.e. the major (or most favourable) market) for the asset or liability and the valuation inputs corresponding to the nature of the valued item.

Note 30.5 and Note 11 provide information on the fair values of financial assets and liabilities, investment property, and assets held for sale.

3.12. Provisions and conditional commitments

Provisions are recognised when the Bank has a present obligation, constructive or legal, as a result of a past event and it is probable that an outflow of resources will be required to settle the obligation. The measurement of provisions is based on the best estimate made by the management at the date of preparation of the statement of financial position concerning the expenses required for the settlement of the particular obligation. The estimate is discounted if the obligation is long-term.

3.13. Assets acquired from collaterals

Assets acquired from collaterals which the Bank does not intend to use in the course of its business, and which are not investment properties, and are not held for sale are presented as "Other assets". These assets are collaterals which the Bank has acquired from borrowers who became insolvent. The Bank's policy is to sell the acquired collaterals when the Bank finds a profitable enough market for them.

Assets acquired from collaterals are initially measured at acquisition cost, including transaction costs. They are subsequently measured at the higher of their carrying amount and their net selling price.

Assets acquired from collaterals that meet the conditions of IFRS 5 and IAS 40 are presented as non-current assets held for sale (Note 3.14) and investment property (Note 3.3).

3.14. Non-current assets held for sale

Non-current assets held for sale are property and other non-current assets, which the Bank intends to realize through a sale transaction, rather than through continuing use. Assets are classified in this category if they meet the following criteria:

- The asset is available for immediate sale
- The sale is highly probable, including:
 - Management is committed to a plan to sell the asset;
 - Active action has been undertaken to identify a buyer and carry out the sales plan;
 - The asset is actively marketed for sale at a price close to its current market value;
 - Sale is expected to take place within one year after the asset's classification as held for sale.

Certain circumstances may extend the period to complete the sale beyond one year, if the delay is caused by events and circumstances beyond the Bank's control and there is sufficient evidence that the Bank remains committed to its plan to sell the asset and undertakes actions to respond to the circumstances which caused the delay.

The Bank classifies as non-current assets held for sale assets acquired as collateral under non-performing loans. Initially, the assets are recognized at acquisition cost including direct transaction costs. After their initial recognition assets are recognized at the lower of their carrying amount or fair value, less costs to sell. These assets are not depreciated.

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3.15. Share capital and reserves

The Bank is a joint-stock company and it is obliged to register in the Commercial Register a certain amount of share capital, which should serve as a security for the receivables of the Bank's creditors. Shareholders are liable for the obligations of the Bank up to the amount of the capital share held by each of them and may claim refunding of this interest only in liquidation or bankruptcy proceedings.

The share capital represents the non-distributable capital of the Bank and is presented at the nominal value of the issued shares.

The Bank is obliged to set aside a Reserve Fund (statutory reserve) in accordance with the requirements of the Commercial Act on distribution of the profit (Note 18.2).

The financial assets at FVOCI reserve (2017: available-for-sale financial instruments revaluation reserve) is being set aside from the difference between the carrying amount of financial assets at fair value through other comprehensive income (2017: the available-for-sale financial assets) and their fair values at the revaluation date.

The financial assets at FVOCI reserve is transferred to the current profit and loss in the statement of profit or loss and other comprehensive income, when the financial assets are sold or in case of lasting and prolonged impairment. As from 1 January 2018, the revaluation reserve of equity instruments upon their derecognition is not recycled in the current profit and loss in the statement of comprehensive income.

3.16. Cash and cash equivalents

Cash and cash equivalents for the purpose of the statement of cash flows comprise cash in hand, cash in current accounts with other banks, deposits placed with other banks – payable upon demand and/or with original maturity of up to 3 months, as well as balances with the Central Banks, free of restrictions.

3.17. Comparative information

In these financial statements, the Bank provides comparative information for one prior year. Where necessary, comparative data is reclassified (and restated) in order to achieve comparability in view of the current year presentation changes. In 2018, an improvement was made to the format of the statement of cash flows, for the purpose of more precise presentation of the Bank's cash transactions. The respective reclassifications have been made to the comparative information for year 2017.

An exception to this rule is the presentation of the impact of the first-time adoption of IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*. Upon adopting IFRS 9 *Financial Instruments*, the Company has applied the exceptions (practical expedients) for its initial application. The Bank has elected modified retrospective initial adoption of IFRS 15 *Revenue from Contracts with Customers*.

All adjustments arising from the initial application of both new standards are reflected in equity (retained earnings/ accumulated loss and the financial assets at FVOCI reserve) as of January 1, 2018. Comparative information for 2017 has not been restated. It has been presented and disclosed as per the requirements of IAS 39 *Financial Instruments: Recognition and Measurement* (repealed), IFRS 7 *Financial Instruments: Disclosure*, IAS 18 *Revenue* (repealed) and the interpretations related thereto.

The impact of the initial application of the new IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers* are presented in Note 2.3

4. CASH AND BALANCES WITH THE CENTRAL BANK

	31.12.2018	31.12.2017
Cash in hand	7,976	8,100
Due from the Central Bank	93,552	62,262
	<hr/>	<hr/>
	101,528	70,362

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Allowance for credit losses	(20)	-
Total	101,508	70,362

As at 21 December 2018 and 2017 cash with the Central Bank includes minimum reserves at the amount of BGN 55,028 thousand and BGN 43,419 thousand respectively, reserve guarantee fund for securing the payments through the system for gross settlement in real time – RINGS in accordance with the requirements of the Central Bank amounting to BGN 444 thousand and BGN 377 thousand, respectively. There are no limitations imposed by the Central Bank for using the minimum reserves. The amount of the reserves depends on the amount of deposits attracted by the Bank.

The movement in the allowance for credit losses of balances with the Central Bank is as follows:

	2018
Balance on 1 January	13
Increase in the impairment for expected credit losses	7
Decrease (reversal) of the impairment for expected credit losses	-
Balance on 31 December	20

5. LOANS AND RECEIVABLES FROM BANKS

Loans and receivables from banks are as follows:

	31.12.2018	31.12.2017
Current accounts at local banks	618	907
Current accounts at foreign banks	5,122	4,751
Deposits placed with local banks	21,147	14,563
Deposits placed with foreign banks	6,496	4,893
	<u>33,383</u>	<u>25,114</u>
Allowance for credit losses	(7)	-
Total	33,376	25,114

Deposits placed with banks as at 31 December 2018 and 2017 have maturity of up to three months.

As at 1 January 2018 and as at 31 December 2018, loans and receivables from banks are classified in Stage 1. Expected credit losses are calculated on an individual basis.

The movement in the allowance for loans and receivables from banks is as follows:

	2018
Balance on 1 January	7
Increase in the impairment for expected credit losses	6
Decrease (reversal) of the impairment for expected credit losses	(6)
Balance on 31 December	7

6. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT AND LOSS

	31.12.2018	31.12.2017
Bulgarian government securities	-	12,183
Foreign government securities	-	1,766
Shares and interest in local entities	174	177
Total	174	14,126

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Financial assets at FVPL are portfolios of securities held for trading.

7. DEBT AND EQUITY INSTRUMENTS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

	31.12.2018	31.12.2017
<i>Available-for-sale financial assets</i>		
Shares and interest in local entities	-	374
Impairment charged at year's end	-	(77)
Bulgarian government securities	-	38,158
Foreign government securities	-	20,456
Corporate bonds of foreign issuers	-	1,890
	<u>-</u>	<u>60,801</u>
<i>Debt instruments at fair value through other comprehensive income</i>		
Bulgarian government securities	27,458	-
Foreign government securities	14,726	-
Corporate bonds of foreign issuers	1,877	-
	<u>44,061</u>	<u>-</u>
<i>Equity instruments at fair value through other comprehensive income</i>		
Shares and interest in local entities	293	-
	<u>293</u>	<u>-</u>
Total	<u>44,354</u>	<u>60,801</u>

The movement in the fair value of securities at fair value through other comprehensive income is as follows:

	2018	2017
Balance at 1 January	60,801	89,085
Impact of the initial adoption of IFRS 9 – reclassifications	13,945	-
Balance at 1 January (restated)	74,746	89,085
Increase (purchases)	4,870	2,211
Decrease (sales and/or maturity)	(33,292)	(30,389)
Net effect of restatement to fair value	(975)	1,013
Change in interest charged	(995)	(1,119)
Balance at 31 December	44,354	60,801

As at 1 January 2018 and as at 31 December 2018 debt securities at fair value through other comprehensive income are classified in Stage 1. Expected credit losses are determined on an individual basis (Note 30.2).

The movement in the allowance for credit losses on debt securities at fair value through other comprehensive income is as follows:

	2018	2017
Balance on 1 January	170	-

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Increase in the impairment on credit losses on debt securities recognised in other comprehensive income	57	-
Decrease (reversal) in the impairment on credit losses on debt securities recognised in other comprehensive income	(81)	-
Balance on 31 December	146	-

As at 31 December 2018, government securities with carrying amount of BGN 9,512 thousand are pledged as collateral with BNB to secure attracted funds from the State Budget (31 December 2017: BGN 10,716 thousand).

8. LOANS AND RECEIVABLES FROM CUSTOMERS

8.1. Analysis by type of customers

	31.12.2018	31.12.2017
Private entities	139,060	143,307
Households and individuals	46,947	44,652
State budget	1,505	1,501
Financial entities	1,959	1,959
Finance lease corporate clients	6,513	8,528
	<u>195,984</u>	<u>199,947</u>
Allowance for credit losses	(12,368)	(18,563)
Total	183,616	181,384

8.2. Analysis by sectors

Information for allocation of loans and receivables from customers in accordance with the internal classification of the Bank is, as follows:

	31.12.2018	31.12.2017
Industry	31,370	39,643
Trade	27,223	30,494
Consumer loans	23,098	23,743
Construction	27,309	23,739
Tourist services	17,384	17,734
Agriculture	10,789	11,615
Health care	6,292	6,192
Information and communication services	6,098	5,792
Real estate transactions	5,261	5,695
Transport	1,950	2,017
Finance	1,959	1,959
State budget	1,505	1,501
Other sectors	35,746	29,823
	<u>195,984</u>	<u>199,947</u>
Allowance for credit losses	(12,368)	(18,563)
Total	183,616	181,384

8.3. Movement of the allowance for credit losses and allocation by portfolios and stages

	2018	2017
	Loans and receivables	Loans and receivables
Balance at 31 December	18,563	20,783
Impact of the initial adoption of IFRS 9	618	-

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Balance at 1 January	19,181	20,783
Accrued impairment	2,020	4,535
Increase in the allowance for impairment of unrecognized interest on loans in Stage 3	89	-
Reversed impairment	(2,082)	(2,788)
Impairment written of	(6,840)	(3,967)
Balance at 31 December	12,368	18,563

The allocation of loans and receivables from customers based on type and stage of impairment is as follows:

	31.12.2018	1.01.2018
<i>Individually impaired</i>		
Gross amount	22,592	25,886
Allowance for credit losses	(8,051)	(14,252)
Stage 3	14,541	11,634
Individually impaired	14,541	11,634
<i>Collectively impaired</i>		
Gross amount	142,168	145,800
Allowance for credit losses	(54)	(73)
Stage 1	142,114	145,727
Gross amount	21,118	18,635
Allowance for credit losses	(258)	(646)
Stage 2	20,860	17,989
Gross amount	10,106	9,626
Allowance for credit losses	(4,005)	(4,210)
Stage 3	6,101	5,416
Collectively impaired	169,075	169,132
Total	183,616	180,766

8.4. Analysis of lease receivables of corporate clients

Finance lease receivables are as follows:

	31.12.2018	31.12.2017
Up to 1 year	520	772
1 to 5 years	3,409	4,961
Over 5 years	5,473	5,986
Gross investments in finance leases, receivables	9,402	11,719
Less: unearned finance income	(2,889)	(3,191)
Net investments in finance leases	6,513	8,528

The net investments in finance leases are as follows:

	31.12.2018	31.12.2017
Up to 1 year	224	470
1 to 5 years	1,905	3,373
Over 5 years	4,384	4,685
	6,513	8,528
Allowance for credit losses	-	(37)

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9. NON-CURRENT ASSETS HELD FOR SALE

	2018	2017
Balance at the beginning of the year	6,734	7,271
Additions during the year	124	2,092
Disposals during the year	(1,747)	(1,997)
Transferred to assets acquired from non-performing loans	(117)	(632)
Impairment	(10)	-
Balance at 31 December	4,984	6,734

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10. PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLE ASSETS

	Land and buildings	Office equipment	Transport vehicles	Furniture and fixtures	Other assets	Intangible assets	Total
Book value							
1 January 2017	1,978	2,685	898	540	528	1,219	7,848
Additions		351		69	77	333	830
Disposals	(961)	(231)	-	(21)	(35)	(60)	(1,308)
Sold	-	(13)	(58)	(3)	-	-	(74)
31 December 2017	1,017	2,792	840	585	570	1,492	7,296
Additions	-	74	-	67	95	122	358
Disposals		(157)	-	(65)	(35)	-	(257)
Sold	-	(67)	(62)	(3)	-	-	(132)
31 December 2018	1,017	2,642	778	584	630	1,614	7,265
Accumulated depreciation and amortisation							
1 January 2017	(542)	(1,836)	(831)	(429)	(335)	(616)	(4,589)
Charged during the year	(39)	(271)	(41)	(36)	(60)	(223)	(670)
Written-off	286	241	57	24	30	60	698
31 December 2017	(295)	(1,866)	(815)	(441)	(365)	(779)	(4,561)
Charged during the year	(20)	(290)	(20)	(37)	(70)	(248)	(685)
Written-off	-	208	63	66	26	-	363
31 December 2018	(315)	(1,948)	(772)	(412)	(409)	(1,027)	(4,883)
Net carrying amount							
31 December 2017	722	926	25	144	205	713	2,735
31 December 2018	702	694	6	172	221	587	2,382

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As at 31 December 2018, non-current assets include non-current tangible and intangible assets with book value of BGN 2,505 thousand and BGN 167 thousand respectively (31 December 2017: BGN 2,288 thousand and BGN 128 thousand respectively), which are fully depreciated/amortised, but are still used in the Bank's operations.

11. INVESTMENT PROPERTY

	2018	2017
Balance at the beginning of the year	9,853	1,274
Additions during the year	-	2,532
Reclassified from assets acquired from non-performing loans	-	6,145
Property acquired from finance lease	2,737	-
Change in fair value	-	(98)
Balance at 31 December	12,590	9,853

The fair value of investment property has been categorised as Level 3 fair values based on the input used in the valuation technique. The fair values have been determined using the methods determined by the International Valuation Standards and references of market evidence on transactions or bid prices of similar property (Note 30.5).

The Bank's investment property as at 31 December 2018 comprises a hotel complex, regulated landed property, and retail properties. A significant portion of the investment property is leased for a period of one year with an extension option and one-month termination notice. The rental income from investment property for the year ended 31 December 2018 amounts to BGN 255 thousand (31 December 2017: BGN 70 thousand).

12. INVESTMENTS IN SUBSIDIARIES

The financial statements as at 31 December 2017 include an investment in the subsidiary Tokuda Sigurnost EOO, of which the Bank owned 100% of the capital, amounting to BGN 25 thousand. In 2017, liquidation proceedings initiated at the subsidiary, which were successfully completed in September 2018.

13. OTHER ASSETS

	31.12.2018	31.12.2017
<i>Assets acquired from non-performing loans</i>	22,182	19,795
<i>Impairment of assets acquired from non-performing loans</i>	(3,409)	(3,609)
	18,773	16,186
VAT refundable	30	-
Deferred expenses	208	196
Guarantee deposits	73	66
Advance payments	143	118
Other assets	283	137
Impairment of other assets	-	(1)
Total	19,510	16,702

The movement in the impairment of other assets and assets acquired from non-performing loans is presented in the tables below:

Movement in the impairment of other assets

	2018	2017
Balance at 1 January	1	1,185
Impairment accrued	7	37
Impairment reversed	-	(2)
Impairment written-off	(8)	(1,219)
Balance at 31 December	-	1

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Movement of the impairment of assets acquired from non-performing loans

	2018	2017
Balance at 1 January	3,609	3,300
Impairment accrued	28	641
Impairment reversed	(228)	(332)
Balance at 31 December	<u>3,409</u>	<u>3,609</u>

14. DEPOSITS FROM BANKS

The term deposits from banks amount to BGN 268 thousand (31 December 2017: BGN 191 thousand) and have maturity of up to three months.

15. DEPOSITS FROM CUSTOMERS

	31.12.2018	31.12.2017
Individuals' accounts		
- Deposits on demand and savings accounts	85,880	80,547
- Term deposits	180,766	170,411
State Budget accounts		
- On demand deposits	8,711	9,015
- Term deposits	-	1,008
Corporate accounts		
- On demand deposits	47,253	62,201
- Term deposits	36,468	17,229
Accounts of other non-bank financial institutions		
- On demand deposits	252	533
	<u>359,330</u>	<u>340,944</u>

As at 31 December 2018, 5.84% (31 December 2017: 6.29%) of customers' deposits are funds of the main shareholders and related parties thereto.

Customer deposits includes customers' cash blocked by the Bank: for collateral of loans and bank guarantees at the amount of BGN 1,159 thousand (31 December 2017: BGN 1,233 thousand), as well as accounts under special conditions: accumulation accounts at the amount of BGN 3,998 thousand (31 December 2017: BGN 1,845 thousand).

16. DEFERRED TAX ASSETS AND LIABILITIES

Deferred income tax assets as at 31 December are related to the following items:

	31.12.2018	31.12.2017
Deferred tax assets:		
Unused paid leaves	8	10
Long-term employee benefits	27	26
Total deferred tax assets	<u>35</u>	<u>36</u>

Deferred tax liabilities:

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Differences between accounting and tax depreciation/amortisation	(62)	(131)
Total deferred tax liabilities	(62)	(131)
Deferred tax liabilities, net	(27)	(95)

Deferred tax assets and liabilities as at 31 December 2018 and 2017 have been calculated by applying a tax rate of 10%, determined in accordance with the Corporate Income Taxation Act and applicable for periods of temporary differences.

On recognising deferred tax assets, the probability for a reversal of the individual differences and the abilities of the Bank to generate sufficient taxable profit in the future, have been taken into account.

As at 31 December, the Bank does not recognise deferred tax assets at the amount of BGN 1,293 thousand (31 December 2017: BGN 1,098 thousand) on accumulated tax loss of BGN 12,934 thousand (31 December 2017: BGN 10,977 thousand) and other temporary differences at the amount of BGN 5,532 thousand (31 December 2017: BGN 8,124 thousand), in as far as there is uncertainty regarding the future taxable profit against which they can be deducted.

17. OTHER LIABILITIES

	31.12.2018	31.12.2017
Ongoing bank transfers	142	198
Accruals for unused paid leave	64	81
Long-term retirement benefit obligation	267	264
Litigation provisions	-	625
Remeasurement of financial guarantees and loan commitments	12	-
Other liabilities	447	755
	932	1,923

Ongoing bank transfers represent liabilities on money transfers ordered by customers in the last day of 2018 and 2017 respectively, with value date within two days. The transfers are processed up to the second working day of 2019 and 2018, respectively.

According to the provisions of the Labour Code, upon termination of employment relations, if the worker or employer is entitled to pension for length of service and age, the Bank is obliged to pay a compensation amounting to double the gross monthly remuneration. If the worker or employee has worked at the Bank over the last 10 years, the amount of the compensation equals 6 gross monthly salaries. As at 31 December 2018 and 31 December 2017, the Bank accrued BGN 267 thousand and BGN 264 thousand respectively for retirement benefit obligations, and the provision amount has been determined by a licensed actuary.

The main assumptions used by the licensed actuary upon determining the present value of the obligations are as follows:

- Mortality rate and average longevity of population in Bulgaria by the National Statistical Institute over 2015-2017;
- Disability probability;
- Turnover rate – 0.1886;
- Financial assumptions, 2% salary growth as compared to the previous year;
- Discount rate – due to the long-term nature of the payable, annual discount rate of 2.91% has been applied.

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18. EQUITY AND RESERVES

18.1. Share capital

As at 31 December 2018 and 2017, the Bank's share capital is fully paid and is distributed in registered voting shares, as follows:

	31.12.2018	31.12.2017
Number of shares	6,800,000	6,800,000
Share nominal in BGN	10	10
Share capital (BGN'000)	68,000	68,000

As at 31 December 2018 and 2017, the Bank's shareholder structure is as follows:

	31.12.2018	%	31.12.2017	%
Tokushukai Incorporated	6,796,250	99.94	6,796,250	99.94
Gamma Holding Group AD	3,750	0.06	3,750	0.06
Total shares	6,800,000	100	6,800,000	100

18.2. Reserves

A summary of the Bank's reserves is presented in the table below:

	31.12.2018	31.12.2017
Statutory reserves (Reserve Fund)	1,815	813
Reserve of financial assets at fair value through other comprehensive income (31 December 2017: reserve of available-for-sale financial assets)	1,321	2,982
Actuarial losses on revaluation of defined income retirement plans	(9)	(6)
	3,127	3,789

Statutory reserves (Reserve Fund)

According to the Bulgarian legislation, the Bank is obliged to allocate a portion of its profit to the Reserve Fund until the amount thereof reaches at least 1/10 of the capital envisaged by the Statute.

The funds in the Reserve Fund may only be used to cover present- or past-year losses, and when they exceed 1/10 of the capital envisaged by the Statute, the excess may also be used to increase capital. In addition, under the Credit Institutions Act banks are not allowed to pay dividends before reaching the minimum reserves required by law or by the Articles of Association, or in case the distribution of dividends will result in violation of the regulatory capital adequacy ratios.

Reserve of financial assets at fair value through other comprehensive income

The reserve of financial assets at fair value through other comprehensive income is formed from the effects of remeasurement of securities measured at fair value through other comprehensive income. Upon derecognition of debt securities, the reserve is recycled through the statement of profit and loss and other comprehensive income (through profit or loss for the period). Upon derecognition of equity securities, the reserve is not recycled through the statement of profit and loss and other comprehensive income (through profit or loss for the period). Prior to the adoption of IFRS 9, the name of this reserve was Available-for-sale financial assets reserve and upon derecognition of the investment, it was subject to statement (reclassification) through the statement of comprehensive income (within profit or loss for the period).

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19. INTEREST INCOME AND COSTS

	2018	2017
Interest income		
Interest on loans and receivables from banks	412	181
Interest on loans and receivables from customers	8,804	9,627
Interest on financial assets at fair value through other comprehensive income	1,353	-
Interest on available-for-sale financial assets	-	2,082
Interest on financial assets held for trading	-	415
	10,569	12,305
Interest costs		
Interest on deposits, including:	1,836	2,602
Individuals	1,743	2,394
Corporate clients	76	172
State budget	17	36
Interest on current accounts at other banks	353	61
	2,189	2,663
Net interest income	8,380	9,642

In 2018 the Bank charged interest income on loans and receivables from customers classified at Stage 3, at the amount of BGN 1,051 thousand.

20. FEES AND COMMISSIONS INCOME/COSTS

	2018	2017
Fees and commissions income		
Fees and commissions on money transfers	1,552	1,575
Fees and commissions on account servicing	759	721
Fees and commissions on loans granted	871	604
Fees on card servicing	378	438
Commissions on cash balance transactions	324	324
Fees on guarantee servicing	113	83
Other	26	92
	4,023	3,837
Fees and commissions costs		
Fees on card servicing	200	209
Fees and commissions on money transfers	5	5
Fees and commissions on insurance	8	11
Fees on account opening and servicing	31	29
Other	38	43
	282	297
Net fees and commissions income	3,741	3,540

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21. NET INCOME ON TRADE TRANSACTIONS

	2018	2017
Loss on revaluation of securities held for trading	(8)	(79)
Foreign exchange gains	281	328
Gain on sale of securities held for trading	-	34
	273	283

22. OTHER OPERATING INCOME

	2018	2017
Net gain on sale of debt instruments at fair value through other comprehensive income	639	-
Rent income	312	118
Net foreign exchange gains	8	8
Gain on sales of property, plant and equipment	6	2,067
Dividends	2	68
Net gain on sale of available-for-sale securities	-	2,119
Revaluation of investment property	-	(98)
Net loss on assets written-off, other than assets held for sale	(23)	(9)
Loss on non-current assets held for sale	(99)	(567)
Other operating income (net)	50	90
	895	3,796

23. LOSSES ON IMPAIRMENT AND PROVISIONS

	2018	2017
Impairment charged on receivables from the Central Bank	7	-
Reversed impairment of debt instruments at fair value through other comprehensive income	(24)	-
Reversed impairment of loans and receivables from customers	(62)	1,747
Impact of modifications of loans and receivables from customers	199	-
Impairment charged on other financial assets	7	34
	2	-
Remeasurement of financial guarantee contracts and loan commitments	39	641
Impairment of non-financial assets	-	625
Litigation provisions	-	625
	168	3,047

24. EMPLOYEE BENEFIT EXPENSES

	2018	2017
Salary expenses	5,319	5,220
Social security contributions	662	595
Health insurance contributions	224	212
Expenses for additional mandatory pension insurance	119	108
	6,324	6,135

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25. OTHER ADMINISTRATIVE AND OPERATING EXPENSES

	2018	2017
Hired services	1,459	1,424
Contributions to the Deposit Insurance Fund	824	888
Unrecognised VAT expenses	687	648
IT licenses and support	479	420
Utility costs	308	261
Contributions to the Banks Restructuring Fund	298	359
Litigations	203	67
Office supplies	122	117
Other expenses	923	1,127
	5,303	5,311

The expenses for statutory joint audit of the annual financial statements for year 2018 amount to BGN 54 thousand (2017: BGN 149 thousand). The expenses for other services granted by the registered auditors in 2018 amount to BGN 9 thousand (2017: BGN 19 thousand).

26. INCOME TAX EXPENSES

The main components of the tax expenses for the periods ended on 31 December are:

	2018	2017
Current tax expense	-	-
Deferred tax savings/(expense)	67	(1)
Total savings from/(expense for) income tax carried to the statement of comprehensive income (within profit or loss for the year)	67	(1)

Reconciliation between (loss)/profit before tax and the tax savings/expense:

(Loss)/Profit before income tax	(334)	1,002
Tax at 10% applicable tax rate for 2018 (2017: 10%)	33	(100)
Effect of unrecognized amounts in the tax return related to:		
increases	(7)	(342)
decreases	347	330
Tax loss (available for deduction)/deducted	(306)	111
Total savings from/(expense for) income tax carried to the statement of comprehensive income (within profit or loss for the year)	67	(1)

27. RELATED PARTY TRANSACTIONS

The Bank's related parties and the types of relation are as follows:

Related parties	Type of relation	Period of relation
TOKUSHUKAI INCORPORATED	Main shareholder	2017 and 2018
GLOBAL-PRIME OOD	Companies under common control	2017 and 2018.
TOKUDA SIGURNOST EOOD – deleted entity	Subsidiary	2017 and until September 2018

The key management personnel is disclosed in Note 1.

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As at 31 December 2018 and 31 December 2017, the Bank has receivables from and payables to related parties, as follows:

	31.12.2018	31.12.2017
Related parties and balances		
Main shareholders		
Deposits received	19,276	19,562
Companies under common control		
Deposits received	1,706	1,879
Key management personnel		
Loans granted	15	15
Deposits received	28	29
Subsidiaries		
Deposits received	-	2

The income and expenses of the Bank in 2018 and 2017 from related party transactions are as follows:

	2018	2017
Related parties and types of transactions		
Main shareholder		
Fees and commissions income	2	2
Interest costs	2	2
Companies under common control		
Fees and commissions income	1	17
Interest costs	3	5
Subsidiaries		
Service revenue	-	1
Service costs	-	34

The transactions' conditions do not deviate from market conditions for such transactions.

The remuneration to the Supervisory Board members accrued and paid in 2018, amount to a total of BGN 42 thousand (2017: BGN 43 thousand). The remuneration to the Management Board members paid in 2018, amount to a total of BGN 419 thousand (2017: BGN 454 thousand).

28. CASH AND CASH EQUIVALENTS IN THE STATEMENT OF CASH FLOWS

Cash and cash equivalents for the purpose of the statement of cash flows include:

	31.12.2018	31.12.2017
Cash in hand (Note 4)	7,976	8,100
Cash with the Central Bank (Note 4)	93,532	62,262
Current accounts with local banks (Note 5)	618	907
Current accounts with foreign banks (Note 5)	5,121	4,751
Deposits to banks with original maturity of up to three months (Note 5)	27,637	19,456
Total cash and cash equivalents in the statement of cash flows	134,884	95,476

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29. CONDITIONAL COMMITMENTS AND CONTINGENCIES

The Bank's conditional commitments and contingencies include guarantees issued and undrawn loan commitments.

	31.12.2018	31.12.2017
Guarantees	4,822	7,971
Undrawn loan commitments	17,864	19,366
	<u>22,686</u>	<u>27,337</u>

As at 31 December, the Bank has charged provisions for credit losses on financial guarantee contracts and loan commitments at the amount of BGN 12 thousand, including on 1 January 2018 – BGN 10 thousand.

30. MANAGEMENT OF THE RISK RELATED TO FINANCIAL INSTRUMENTS

The risk for the Bank related to financial instruments is the possibility that the actual proceeds from financial instruments could differ from the expected proceeds. The specifics of banking operations requires the Bank to apply adequate systems for timely identification and management of different types of risk, with special focus on risk management procedures, mechanisms for maintaining risks within reasonable limits, optimal liquidity, portfolio diversification. The main risk management objective is presentation and analysis of the types of risk exposures of the Bank in a comprehensive and conclusive manner.

The risk management system has preventive functions with regard to loss prevention and control of the amount of incurred losses and includes:

- risk management policy;
- rules, methods and procedures for risk assessment and risk management;
- risk management organizational structure;
- parameters and limits for transactions and operations;
- procedures for reporting, assessment, notification and subsequent control of risks.

The organizational structure for risk management is centralized and is structured based on competence levels, as follows:

- Management Board – determines the acceptable risk levels of the Bank within the adopted business strategy;
- Specialized collective committees – approve the framework and parameters of the Bank's operations with respect to risk management;
- Executive Directors – control the process of approval and implementation of adequate policies and procedures within risk management strategy adopted by the Bank;
- Heads of structural units within the Bank – implement the adopted risk management policy within the operations of the respective organizational units.

The main types of financial risks the Bank is exposed to are credit risk, liquidity risk and market risk, which includes interest, currency and price risk.

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30.1. Financial assets and liabilities

The tables below present the carrying amounts and fair values of financial assets and liabilities:

31 December 2018	Carrying amount	Fair value
Financial assets		
Cash and balances with the Central Bank	101,508	101,508
Loans and receivables from banks	33,376	33,376
Loans and receivables from customers	183,616	185,909
Financial assets held for trading	174	174
Debt instruments at fair value through other comprehensive income	44,061	44,061
Equity instruments at fair value through other comprehensive income	293	293
Total assets	363,028	365,321
Financial liabilities		
Deposits from banks	268	268
Deposits from customers	359,330	360,227
Other financial liabilities	142	142
Total liabilities	359,740	360,637

31 December 2017	Carrying amount	Fair value
Financial assets		
Cash and balances with the Central Bank	70,362	70,362
Loans and receivables from banks	25,114	25,114
Loans and receivables from customers	181,384	184,467
Financial assets held for trading	14,126	14,126
Available-for-sale financial assets	60,801	60,801
Total assets	351,787	354,870
Financial liabilities		
Deposits from banks	191	191
Deposits from customers	340,944	341,442
Other financial liabilities	198	198
Total liabilities	341,333	341,831

30.2. Credit risk

Credit risk is the risk of loss due to the probability that counterparty will be unable to settle its obligations when they are due. The Bank structures the credit risk by setting limits on the maximum credit risk exposure to a debtor, to a group of related parties, by relevant business sectors. Adequate collateral and guarantees are required in order to reduce the credit risk, according to the adopted internal credit rules.

Cash and cash balances with the Central bank at the amount of BGN 101,508 thousand and BGN 70,362 thousand, respectively as at 31 December 2018 and 31 December 2017 do not bear credit risk to the Bank due to their nature and the fact that they are at the Bank's disposal.

Loans and receivables from banks at the amount of BGN 33,376 thousand and BGN 25,114 thousand respectively as at 31 December 2018 and 31 December 2017 consist mostly of deposits with first-class international and Bulgarian banks with maturity of up to seven days. The Bank manages the credit risk related to loans and receivables from banks, by setting exposure limits at counterparty level.

Counterparty risk is considered at the following levels:

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- sovereign risk - impossibility or unwillingness of a country's government to repay its obligations;
- state-related risk – the risk of adverse changes in the social and political and/or economic situation in a country, as a result of which the Bank would take additional political and cross-border risks, such as moratorium on payments or impossibility of currency conversion;
- banking risk – the risk of deterioration of the financial condition of a bank or non-bank financial institution or counterparty, including insolvency, as a result of which the Bank would take additional risks and would incur losses;
- pre-settlement risk – the risk of deterioration of the financial condition of a certain bank-counterpart, including insolvency, as a result of which it is unable to meet its contractual obligations before the settlement date. This risk exists in trade in securities, debt instruments, FX and derivatives;
- settlement risk – the risk that occurs on the date of settlement and consists of impossibility to meet contractual obligations.

The counterpart risk level is determined based on the following ratings:

- official rating – short-term rating in accordance with the long-term rating of a country or bank, prepared by the following rating agencies – Moody's, Thompson Bank Watch, Standard & Poors, Fitch;
- working rating – the rating of the respective bank as prepared by Tokuda Bank AD in case of lack of rating prepared by one of the agencies listed above;
- internal rating – the rating of a bank as determined by Tokuda Bank AD in accordance with the "Internal Rating Scale for Bank Counterparts". The internal rating is based on the official or working rating and directly corresponds to a certain "global banking limit". The internal rating of a non-bank financial institution is only determined in case of availability of official ratings by at least one of the rating agencies listed above.

Based on the internal rating, a global banking limit is determined, which is the lower of the permissible percentage of the Bank's capital and the permissible percentage of the counterpart's capital, and the percentages are determined based on a rating scale.

Financial assets held for trading, at the amount of BGN 174 thousand and BGN 14,126 thousand, respectively as at 31 December 2018 and 31 December 2017, pose mainly a market risk to the Bank (Note 30.4). The maximum exposure to credit risk for these instruments is their carrying amount.

Debt instruments at fair value through other comprehensive income (2017 – available-for-sale financial assets) amount to BGN 44,061 thousand as at 31 December 2018 and BGN 60,801 thousand as at 31 December 2017. The maximum exposure to credit risk for these instruments is their carrying amount.

The conditional commitments undertaken by the Bank consist of guarantees issued and undrawn loan amounts, whose amount of BGN 22,686 as at 31 December 2018 and BGN 27,337 thousand as at 31 December 2017 (Note 29) is the Bank's maximum credit exposure.

Loans and advances to customers with carrying amount of BGN 183,616 thousand and BGN 181,384 thousand, respectively, as at 31 December 2018 and 31 December 2017, bear credit risk to the Bank. The exposure of the Bank to that risk is determined on the basis of individual assessment of each loan, as the Bank applies the criteria for assessment and classification of risk exposures according to the Policy for impairment of financial assets and contingent liabilities.

The competent body for monitoring, assessment and classification of financial assets and contingent liabilities and determination of impairment losses and provisions is the Committee for analysis, classification and provisioning (CACP), which performs its activities according to rules set by the Management Board.

Credit risk assessment and management is essential for the bank. Traditionally, the loan portfolio holds the largest share of the Bank's total assets.

The bodies responsible for managing the Bank's credit risk are the Management Board, the Credit Council and the Committee for analysis, classification and provisioning. The structure and activities of these bodies are regulated in their rules of operation. The operational duties of the Bank's units and officials on credit risk management are regulated in the internal documents.

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The Bank's Management Board determines the parameters and limits of performing transactions related to credit risk. Reports and analyses to the MB are prepared by the Risk Monitoring and Management Division at the end of each quarter.

Credit risk monitoring and control are carried out at the level of:

- loan transaction:
 - upon forming the credit exposure.
 - after forming the credit exposure.
- loan portfolio.

Credit risk monitoring and control have a continuous nature and are manifest through a system of procedures and measures, including allocation of responsibilities between the Head Office structural units and the Bank's branches.

Control over the credit process at loan transaction level includes:

- assessment (rating) of the customer's creditworthiness, including with respect to financial condition, business risk, and collateral;
- assessment of the banking credit risk, including share of the proposed exposure in the total loan portfolio and capital base, etc.

Control over the credit process at loan portfolio level includes:

- assessment of the quality of the loan portfolio based on coefficients reflecting:
 - the share of loans stated in groups other than "performing", to the total amount of the loan portfolio;
 - provisioning ratio;
 - share of impairment on exposures to the total impairment on the loan portfolio.
- proposal on limits reflecting the credit policy applied:
 - limits by sectors;
 - maximum exposure to the borrower and a group of related parties.

Internal structure and units involved in credit risk management

The Corporate Banking Division and Retail Banking Division at the Bank's Head Office, as well as the loan specialists at the Bank's branches where such a position exists:

- collect the necessary information and prepare a company, market and financial analysis and loan proposals to the Credit Council;
- administer, monitor and manage the loan portfolio, including collection.

The credit risk management departments at the Bank's Head Office are responsible for preventive control over structured transactions, degree of collateral, meeting the applicable limits, and analyse and provide a written opinion on the credit risk taken and the permissibility of the loan request by loan proposals, in accordance with procedures regulated in the Policy, rules and procedures for the lending activity at Tokuda Bank AD.

The Loan Administration (LA) Division at the Bank's Head Office:

- monitors and controls compliance with the conditions envisaged in the loan agreements and annexes thereto;
- controls the process of updates of collateral valuation, as collaterals' validity;
- controls the process of updates (renewal) of collaterals' insurance.

The Court Receivables Department at the Bank's Head Office monitors and controls, together with other units, loans past due by over 90 days or upon the occurrence of other events necessitating early repayment, and carries out the process of all due receivables on forced execution loans.

The Legal Division at the Bank's Head Office analyses and provides opinions on the legal risks to the loan transaction, as well as on the collateral offered.

The Credit Council is a collective body to the MB, whose main task is to manage the lending process. Its activities are subordinated to the provisions of the Credit Institutions Act and the other legal acts on lending relations, the Bank's lending policy, internal regulations and rules on the organisation of its activities. The Credit Council

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examines and makes decisions on proposals for granting new exposures and changes on existing exposures (including renegotiation, restructuring, early repayment, forced execution, etc.) at an amount of up to 10% of the Bank's capital base, and proposes for review loan proposals for exposures exceeding 10% of the capital base.

The Committee for analysis, classification and provisioning (CACP) in its capacity as the Bank's competent body on monitoring, measurement and classification of financial assets and contingencies and on determining impairment losses and provisions, makes decisions on the classification and determining of impairment losses on financial assets and on determining provisions for contingencies. The activities of CACP are subordinated to the provisions of the Credit Institutions Act, the effective legislation in the country, and the Bank's internal regulations.

The methodology on determining impairment provisions applies the classification according to the rules set out in Regulations 2014/680 и 2015/1278. The management considers expositions as non-performing and performing.

Non-performing exposure is one that has significant breaches in its servicing or there is evidence that the financial position of the debtor is deteriorated to the extent that current and anticipated proceeds are insufficient to pay all its debts to the Bank and other creditors and when the Bank expects to incur losses. Non-performing is also exposure for which the debtor is assessed as unlikely to pay its credit obligations in full without realisation of collateral regardless of the existence of any past due amount or of the number of days past due, with the exception of exposures where the realization of collateral is set in the initial loan agreement repayment schedule. Additionally, an exposure is classified as non-performing when it satisfies any of the following criteria:

- it has accumulated arrears on principal or interest more than 90 days;
- the exposure is individually impaired;
- the financial position of the debtor has substantially deteriorated, which may jeopardize repayment;
- debtor has been declared bankrupt or is in liquidation procedure and there is risk of leaving unsatisfied creditors;
- the balance sheet receivable is subject to legal proceedings or is granted to the Bank by the court but is not collected.

Performing exposure is exposure that cannot be classified as non-performing.

Restructured exposure is exposure in respect of which restructuring measures have been applied. The restructuring measures consist of concessions towards a debtor that is experiencing difficulties in meeting its financial commitments. An exposure is not regarded to be restructured when there are no indications that the debtor experience difficulties in meeting its financial commitments. The Modifications in the terms of the contract which applies concessions towards debtor that is experiencing difficulties in meeting its financial commitments may include, but are not necessarily limited to a reduction in the interest rate, principal, accrued interest or rescheduling of principal and/or interest repayment dates.

Policy and process of impairment of loans and receivables from customers, applied as from 1 January 2018

Significant increase in credit risk following initial recognition

At each reporting date the Bank assesses whether the credit risk of a financial instrument has significantly increased following the instrument's initial recognition. In this assessment, the Bank considers the change in risk of default over the expected life term of the financial instrument, by comparing the risk of default of the financial instrument at the reporting date with the same risk at the date of initial recognition and considers the reasonable and grounded information accessible without incurring unnecessary costs or efforts which confirms a significant increase in credit risk following the initial recognition.

Objective evidence of a significant increase in the credit risk of the financial instrument following initial recognition:

- quantitative criteria: delay in loan payments by over 30 days, a significant increase in the probability of default over the next 12 months – as at the reporting date;
- qualitative criteria: change in the risk group of exposure to the customer from "Performing" to "Under-Performing", "Non-Performing", or "Loss", which is not due to reclassification of exposures of the customer's related parties to the Bank; data from a filled-in questionnaire on assessment of the loan quality (the questionnaires examine the presence of increased credit risk or credit impairment since the date of loan disbursement, and the assessment is done based on a set of questions regarding the financial position,

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liquidity, legal status, etc., each of which has a certain weight in the final rating; other reasonable and grounded information.

Credit impairment following initial recognition:

The financial asset is credit-impaired following the initial recognition upon occurrence of a combination of events, which may include significant financial difficulties of the debtor, resulting in impossibility to repay the debt in full.

Objective evidence of credit impairment of the financial assets includes:

- quantitative criteria: delay in loan payments by over 90 days.
- qualitative criteria: change in the risk group of exposure to the customer to “Non-Performing” or “Loss” which is not due to reclassification of exposures of the customer’s related parties to the Bank or classification as “Court” or “Awarded” status; reasonable and grounded information, data from a filled-in questionnaire on assessment of the loan quality.

Financial assets purchased or initially created with a big discount which reflects credit losses incurred are classified as “POCI” - Purchased or originated credit impaired and are classified within credit-impaired financial assets.

Stages of classification of credit exposures

Depending on the presence of significantly increased credit risk following initial recognition and of credit impairment following initial recognition, credit exposures are classified in the following stages:

- Stage 1 – there no significantly increased credit risk of the exposure following its initial recognition;
- Stage 2 – there is a significant increase in the credit risk following initial recognition;
- Stage 3 – there is credit impairment.

The classification stage of loan exposures is determined at each reporting date based on the assessment of presence of a significant increase in the credit risk following initial recognition and of credit impairment.

Determining expected credit losses on loan exposures

Individual and collective impairment assessment of loan exposures

Loan exposures individually assessed for impairment are all significant exposures at Stage 3 and other exposures based on the Bank’s judgement. Loan exposures collectively assessed for impairment are all loan exposures which are not individually assessed for impairment. Upon determining the expected credit losses on loan exposures, the Bank uses different approaches, depending on whether the loan exposures is assessed for impairment individually or collectively.

Determining expected credit losses for loan exposures collectively assessed for impairment

The approaches used to determine expected credit losses take into consideration the historic behaviour of loan exposures and the expected future development of certain macro-economic, market, statutory, etc. Factors that impact the borrower’s ability to service their payables under loan exposures. Expected credit losses are determined at loan level and are calculated using the formula $ECL = EAD \times PD \times LGD$, where:

- EAD (exposure at default) = current balance sheet item + CCF x unused part of the available limit, where CCF – credit conversion factor; EAD for off-balance sheet commitments = CCF x off-balance sheet commitment;
- PD (probability of default) – the probability of occurrence of default applicable for the loan, calculated based on the model of calculation of possibilities of default. For loans at Stage 1, probability of default over the next 12 months is used. For loans at Stage 2 and Stage 3, probability of default over the financial instrument’s life term is used;
- LGD (loss given default) – loss upon occurrence of default – it is the difference between the loan exposure and the total amount of NRV (as defined below) of the available loan collaterals (if $NRV > 0$) and the amount of the loan exposure; if NRV of the collaterals exceed the credit exposure, $LGD = 0$;

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- NRV (Net Realizable Value) – net realizable value of the collateral at the respective reporting date; determined as the sum of market values of the loan’s collaterals calculated by using standard assumptions for (i) expected changes in value over time, (ii) expected realisation timeframe and (iii) expected realisation costs.

The parameter values, assumptions and rules for calculation are defined in detail in the Policy on classification, provisioning and impairment of financial assets and contingent liabilities.

Determining expected credit losses for loan exposures individually assessed for impairment

Expected credit losses are determined on a loan level. The loan exposure is assessed for impairment by comparing the gross amount of the exposure with the net present value of expected cash flows from operations, sale of collateral, or other sources. Expected cash flows have a forecast nature and at least two main scenarios are taken into consideration in the analysis: (i) a scenario in which the exposure is regularly serviced in accordance with the effective repayment schedule and (ii) a scenario in which the exposure is repaid by realisation of the collateral. The expected cash flows from realisation of the collateral are determined individually for the respective exposure. The net present value of the cash flows in the different scenarios is allocated different weight to reach a total result, which is compared with the loan’s gross amount. The expected credit losses are the difference between the loan’s gross amount and the weighted net present value of the expected cash flows in the different scenarios.

In order to minimise the credit risk in the lending process, detailed procedures are applied for the analysis of the economic viability of each project, the types of collateral acceptable for the Bank, control over the use of the loans granted and the administration related to this activity. The Bank has adopted and monitors limits of credit exposure by sectors. These limits aim to restrict concentration of the loan portfolio which would result in increased credit risk.

Quality of balances with the Central Bank

The tables below provide information on the credit quality and maximum exposure to credit risk of exposures to the Central Bank as at 31 December 2018 according to the Bank’s internal risk classification. The amounts presented reflect the amortised cost of exposures before the allowance for credit losses in the reporting period.

<u><i>Change in the gross amortised cost</i></u>	Stage 1	Stage 2	Stage 3	2018
Amount on 1 January 2018	62,262	-	-	62,262
Newly arising exposures	166,520	-	-	166,520
Paid exposures	(135,230)	-	-	(135,230)
Transfer between stages	-	-	-	-
Amount on 31 December 2018	93,552	-	-	93,552
<u><i>Change in the impairment allowance</i></u>	Stage 1	Stage 2	Stage 3	2018
Amount on 1 January 2018	13	-	-	13
Newly arising exposures	7	-	-	7
Paid exposures	-	-	-	-
Transfer between stages	-	-	-	-
Amount on 31 December 2018	20	-	-	20

Quality of loans and receivables from banks

The tables below provide information on the credit quality and maximum exposure to credit risk of exposures to banks as at 31 December 2018 according to the Bank’s internal risk classification. The amounts presented reflect the amortised cost of exposures before the allowance for credit losses in the reporting period.

<u><i>Change in the gross amortised cost</i></u>	Stage 1	Stage 2	Stage 3	2018
Amount on 1 January 2018	25,114	-	-	25,114
Newly arising exposures	53,875	-	-	53,875
Paid exposures	(45,606)	-	-	(45,606)
Transfer between stages	-	-	-	-
Amount on 31 December 2018	33,383	-	-	33,383

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<u>Change in the impairment allowance</u>	Stage 1	Stage 2	Stage 3	2018
Amount on 1 January 2018	7	-	-	7
Newly arising exposures	6	-	-	6
Paid exposures	(6)	-	-	(6)
Transfer between stages	-	-	-	-
Amount on 31 December 2018	7	-	-	7

Quality of debt and equity instruments at fair value through other comprehensive income

The tables below provide information on the credit quality and maximum exposure to credit risk of exposures to debt and equity instruments at fair value through other comprehensive income as at 31 December 2018 according to the Bank's internal risk classification. The amounts presented reflect the amortised cost of exposures before the allowance for credit losses in the reporting period.

<u>Change in the gross amortised cost</u>	Stage 1	Stage 2	Stage 3	2018
Amount on 1 January 2018	74,746	-	-	74,746
Newly arising exposures	5,025	-	-	5,025
Paid exposures	(35,271)	-	-	(35,271)
Transfer between stages	-	-	-	-
Amount on 31 December 2018	44,500	-	-	44,500

<u>Change in the impairment allowance</u>	Stage 1	Stage 2	Stage 3	2018
Amount on 1 January 2018	170	-	-	170
Newly arising exposures	57	-	-	57
Paid exposures	(81)	-	-	(81)
Transfer between stages	-	-	-	-
Amount on 31 December 2018	146	-	-	146

Quality of loans and receivables from customers

The tables below provide information on the credit quality and maximum exposure to credit risk of exposures to customers at 31 December 2018 according to the Bank's internal risk classification. The amounts presented reflect the amortised cost of exposures before the allowance for credit losses in the reporting period.

<u>Change in the gross amortised cost</u>	Stage 1	Stage 2	Stage 3	2018
Amount on 1 January 2018	145,800	18,635	35,512	199,947
Newly arising exposures	37,912	1,873	88	39,873
Paid exposures	(29,187)	(4,027)	(3,782)	(36,996)
Transfer to Stage 1	1,382	(1,345)	(37)	-
Transfer to Stage 2	(13,057)	13,195	(138)	-
Transfer to Stage 3	(682)	(7,213)	7,895	-
Amounts written-off	-	-	(6,840)	(6,840)
Amount on 31 December 2018	142,168	21,118	32,698	195,984

<u>Change in the impairment allowance</u>	Stage 1	Stage 2	Stage 3	2018
Amount on 1 January 2018	73	646	18,462	19,181
Newly arising exposures	186	248	1	435
Paid exposures	(16)	(264)	(128)	(408)
Transfer to Stage 1	2	(2)	-	-
Transfer to Stage 2	(57)	58	(1)	-
Transfer to Stage 3	(134)	(428)	562	-
Amounts written-off	-	-	(6,840)	(6,840)
Amount on 31 December 2018	54	258	12,056	12,368

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The information on loans and receivables from customers by classification groups is as follows:

31 December 2018	On granted loans			Undrawn commitment	On granted guarantees		
	Group	Amount	Share in %	Impairment	Amount	Amount	Share in %
Performing	163,200	83.27	312	17,838	4,822	100.00	12
Non-performing	32,784	16.73	12,056	26	-	-	-
Total	195,984	100.00	12,368	17,864	4,822	100.00	12

31 December 2017	On granted loans			Undrawn commitment	On granted guarantees		
	Group	Amount	Share in %	Impairment	Amount	Amount	Share in %
Performing	164,435	82.24	616	19,347	7,971	100.00	-
Non-performing	35,512	17.76	17,947	19	-	-	-
Total	199,947	100.00	18,563	19,366	7,971	100.00	-

	31.12.2018		31.12.2017	
	Past due but unimpaired	Impaired	Past due but unimpaired	Impaired
Not overdue	-	52,406	-	22,481
up to 30 days past due	13,005	2,992	20,321	2,577
31 to 60 days past due	2,949	882	1,501	79
61 to 90 days past due	1,492	4,513	818	469
91 to 180 days past due	1,165	183	631	545
over 180 days past due	2,408	20,315	3,384	26,520
Book value	21,019	81,291	26,655	52,671
Allowance for impairment losses	-	(12,368)	-	(18,563)
Carrying amount	21,019	68,923	26,655	34,108

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The impaired exposures include those on which the Bank stated impairment.

The following table presents the Bank's portfolio based on recognised types of collaterals:

	2018	2017
Secured by cash and government securities	1,001	715
Secured by mortgage	155,956	150,288
Pledge on machines and equipment	8,790	7,078
Pledge on receivables	17,267	18,812
Other collaterals	8,554	19,937
Unsecured	4,416	3,117
Impairment	(12,368)	(18,563)
Total	183,616	181,384

The table below provides information on the credit ratings upon determining the credit quality of the Bank's financial assets. The Bank uses as a main source of information on credit ratings data from Fitch credit agency; and when such data is not available, it has used the rating of another rating agency (S&P).

	31.12.2018	31.12.2017
Balances with the Central Bank:		
rating BBB-	93,532	62,262
Total balances with the Central Bank	93,532	62,262
Loans and receivables from banks		
rating A+	5,670	-
rating A	-	3,745
rating A-	10,429	9,998
rating BBB+	5,121	-
rating BBB-	5,578	6,183
rating BB	75	283
rating BB-	-	12
no rating	6,503	4,893
Total loans and receivables from banks	33,376	25,114
Financial assets held for trading:		
rating BBB-	-	12,183
rating BB	-	1,766
no rating	174	177
Total financial assets held for trading	174	14,126
Available-for-sale financial assets:		
rating A	-	1,890
rating BB	-	5,966
rating BBB-	-	52,648
no rating	-	297
Total available-for-sale financial assets	-	60,801
Debt instruments at fair value through other comprehensive income		
rating A+	1,877	-
rating BB+	5,417	-
rating BBB	27,458	-
rating BBB-	9,309	-
Total debt instruments at fair value through other comprehensive income	44,061	-
Equity instruments at fair value through other comprehensive income		
no rating	293	-
Total equity instruments at fair value through other comprehensive income	293	-

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Loans and receivables from banks with no rating are those of local banks which have no credit rating from rating agency and for which an equivalent credit rating has been used for the purpose of impairment.

Financial assets held for trading with no rating are mainly corporate bonds and shares of domestic issuers for which there are no credit ratings from rating agencies.

Concentration of credit risk

A significant percentage of the loan portfolio of the Bank is concentrated in a limited number of borrowers. Despite the regulatory restrictions on large exposures, there is a risk that the Bank's activities, its financial position and the result of its operations are negatively affected if some of the largest borrowers do not settle their obligations. Information on large exposures of the Bank other than exposures to credit institutions (exposures which represent 10% or more of the Bank's capital base) at their carrying amount as of December 31, 2018 and 2017 is presented in the table below:

	2018		2017	
	BGN'000	% of the capital base	BGN'000	% of the capital base
Largest total exposure to a customer group	9,151	21.72%	8,660	20.45%
Total amount of the five largest exposures	34,392	81.64%	31,421	74.20%
Total amount of all exposures – over 10% of the capital	72,054	171.05%	68,500	161.77%

Concentration of credit risk by economic sectors is disclosed in Note 8.

30.3. Liquidity risk

Liquidity risk arises from the maturity gap of the assets and liabilities and the probable lack of sufficient funds of the Bank to meet its obligations on its current financial liabilities, as well as to provide funding to increase the financial assets and the potential claims on off-balance sheet commitments.

The Bank's operations require stable cash flows to replace the existing deposits when they expired (at maturity) and to satisfy customer demand for additional loans.

In liquidity management, the Bank also considers commitments related to the not-utilized portion of loans granted and the level of all contingent liabilities.

To ensure the liquidity policy compliance, the Bank takes the following measures:

- develops rules and procedures for liquidity management;
- defines adequate liquid assets;
- develops an information system for monitoring the liquidity, based on the maturity table;
- forms liquidity measurement indicators;
- appoints a liquidity regulation body and defines its responsibilities and tasks;
- establishes a system for management and control of liquidity risk;
- develops scenarios for the Bank's action in normal circumstances - "going concern" and in a period of "liquidity crisis";
- regulates the mandatory information for the current management needs, as well as for the reporting to the BNB.

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The main parameters of the Bank's liquidity policy are determined by the Management Board, and the overall organization of its implementation is assigned to the Assets and Liabilities Management Committee, which is the main body responsible for the Bank's liquidity management. It is directly responsible for the liquidity status and its ongoing management, based on the decisions of the Management Board, as well as for the ongoing management of assets and liabilities. The Committee meets at least once a month, and if necessary (at the risk of a liquidity crisis) it meets daily, in order to overcome any liquidity difficulties.

The control and regulation of the liquidity for the Bank as a whole and by bank offices is carried out centralized by "Liquidity and Markets" Department.

The level of liquid funds and the level of liquid funds for maintenance are monitored. On that basis the Bank monitors its ratio of available liquid funds to loans and other receivables.

The Bank maintains high amount of liquid assets in the form of cash in hand and cash balances with the Central bank, which guarantee Bank's ability to meet its liquidity requirements. As at 31 December 2018 and 2017, cash and cash balances with the Central Bank represent respectively 25% and 18% of the Bank's total assets.

As an additional instrument to provide high liquidity, the Bank uses loans granted to banks. These comprise mostly of deposits in first-class international and Bulgarian banks with maturity up to 7 days. As at 31 December 2018 and 2017, loans and receivables from banks represent respectively 8% and 6% of the Bank's total assets.

Government securities owned by the Bank and not pledged as collateral as at 31 December 2018 and 2017 represent respectively 8% and 16% of the Bank's total assets. By maintaining above 40% (2017: 40%) of its assets in highly liquid assets, the Banks ensures the ability to meet its all payment needs on matured financial liabilities.

The gross cash outflow of financial liabilities of the Bank is as follows:

	up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Total
31 December 2018						
Deposits from banks	268	-	-	-	-	268
Deposits from customers	202,369	24,626	69,083	62,564	2,450	361,092
Other financial liabilities	142					142
Total financial liabilities	202,779	24,626	69,083	62,564	2,450	361,502
31 December 2017						
Deposits from banks	191	-	-	-	-	191
Deposits from customers	176,762	22,706	88,426	52,308	3,087	343,289
Other financial liabilities	198					198
Total financial liabilities	177,151	22,706	88,426	52,308	3,087	343,678

The financial liabilities of the Bank are mainly formed by attracted funds on deposits – retail and corporate. Large portion of them as at 31 December 2018 – 56% (2017: 52) are with residual term within one month. Customers often prefer to sign a deposit agreement with one month term and to renegotiate it regularly for a longer period. As a result, one-month deposits are practically a long-term and relatively permanent resource of the Bank.

30.4. Market risk

Market risk is the risk that changes in the market prices of financial assets, interest or currency rates may have an adverse effect on the Bank's financial results. Market risk arises on opened exposures in interest, currency and equity instruments, which are sensitive to general and specific market movements and affect the profitability of the Bank. Market exposure is managed by the Bank, in accordance with risk limits, adopted by the management.

The Bank manages its financial instruments, considering the changing market conditions. Exposure to market risk is managed in accordance with risk limits, set by the Bank's management by transactions with financial instruments or by opening a compensating position to hedge the risk.

To minimize the sources of market risk, the Bank has adopted limits for investments in financial instruments as follows:

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- Foreign government securities – may be purchased only if they have a credit rating not lower than BBB/positive perspective on Standard & Poor's or an equivalent assessment of creditworthiness, and the maximum level of exposure is limited;
- Corporate bonds issued by banks – at issuer's credit rating not lower than BBB/positive perspective on Standard & Poor's or an equivalent assessment of creditworthiness, and the maximum level of exposure is limited;
- Corporate shares – limited total exposure;
- Corporate bonds – may only be purchased if they have a credit rating not lower than BBB/ positive perspective on Standard & Poor's or an equivalent assessment of creditworthiness. Otherwise, a precise analysis of quantitative and qualitative factors is performed to support the decision for their acquisition. The maximum level of exposure is limited.

Market risk management includes:

- Determination of securities and money market placements ratio. This ratio is a dynamic variable and as the ratio of investment/trading portfolio, it is determined, according to the maturity structure of the Bank's attracted funds, cash inflows and outflows, liquidity needs, income level and objectives of the Bank.
- Risk/return ratio analysis.

In accordance with principles and objectives adopted, the Bank applies approaches to market risk management as follows:

- VaR analysis, Duration of financial instruments and standardized interest rate shocks analysis to identify and analyse the effect of various risk factors on the value and profitability of the portfolio, in order to determine the optimal risk/return ratio;
- The Bank analyses the risk/return ratio, and at given level of risk the instrument with higher return is selected; at given level of return, the instrument with lower risk is selected.

The Assets and Liabilities Management Committee develops alternative action plans in circumstances of increased market risk, due to sudden changes in market conditions within the limits, provided for different types of operations. The Committee monitors and suggests actions to divert from the usual limits in order to overcome such situations.

To assess the interest rate sensitivity of the commercial portfolio, the Bank uses the modified duration of the portfolio, calculated on a daily basis.

To assess the potential impact of possible extreme fluctuations in interest rates on the value of trading portfolio, the Bank analyses the effect of certain standardized interest rate shocks. The price change in parallel shift of the yield curve by 100 basis points should not exceed 5% of the capital base, calculated in the last quarter.

Pursuant to Ordinance 7 of BNB, the Bank analyses the impact of change in interest rates by 200 b.p. as an expected effect on capital. The effect should not exceed 20% of the capital base.

30.4.1. Interest rate risk

Interest rate risk is the probability of possible changes in the net interest income or net interest margin, due to fluctuations in the general market interest rate levels. The interest rate risk management of the Bank aims to minimize the risk of decrease in the net interest income as a result of changes in interest rate levels.

The Bank uses the GAP analysis method (gap analysis, imbalance method) to measure and assess the interest rate risk, allocating the interest-bearing assets and liabilities in time ranges, depending on the moments of their revaluation (for instruments with floating interest rate) and maturity (for instruments with fixed interest rate). Using this method the management of the Bank identifies the sensitivity of the expected income and expenses to changes in interest rates. The Gap analysis method aims to determine the exposure of the Bank, as a total amount and by

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separate types of financial assets and liabilities, in relation to expected interest rate fluctuations and their effect on the net interest income. It assists the management of assets and liabilities and is also an instrument for securing sufficient and stable net interest profitability. The management assesses the exposure of the Bank's portfolio to interest rate risk and its sensitivity to this type of risk as moderate in view of the volumes and structure of the operations.

In interest rate risk management, the Bank applies policy and procedures according to the nature and complexity of its operations. By managing the interest rate risk, the Bank aims at stable spread between the interest income and expense to provide an adequate profitability and maximum value at acceptable level of risk.

The interest rate risk management of the Bank is based on the assessment of the amount and sensitivity of the exposure to fluctuations in the market interest rates and the probability for occurrence of such fluctuations. The Bank has established a system for measurement of interest rate risk, which covers all sources of interest rate risk and assesses the effect of the fluctuations in interest rates.

Interest rates for assets and liabilities denominated in BGN are usually determined on the basis of the movement of the basic interest rate determined by the Central Bank (BNB). Interest rates for assets and liabilities denominated in EUR are based on the quoted prices of the European Central Bank.

In cases of assets and liabilities with floating interest rates, the Bank is exposed to risk of fluctuations in the reference rates, which are used to estimate the interest rates.

Depending on the specific conditions, the Bank uses the following approaches to interest rate risk management, applying the imbalance method:

- Balance – providing parity between the sensitivity of the interest-bearing assets and liabilities.
- Restructuring of the portfolios of assets and liabilities when cyclical fluctuations in interest rates occur.
- Determining the amount of the interest rates, and their type (fixed or floating) on the assets and liabilities of the Bank depending on the trends for development on the domestic and international financial markets.

In its operations, the Bank aims to achieve a positive imbalance in relation to the maturity of the assets and liabilities and a balanced position regarding the sensitivity of the interest-bearing assets and liabilities.

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The interest-bearing assets and liabilities of the Bank, categorized by date of agreed change of interest rates by periods of interest rate change are as follows:

31 December 2018	up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Total
<i>Interest-bearing assets</i>						
Loans and receivables from banks	33,376	-	-	-	-	33,376
Loans and receivables from customers	145,264	6,046	3,541	3,809	24,956	183,616
Debt instruments at FVOCI	947	2,741	1,769	38,604	-	44,061
Total interest-bearing assets	179,587	8,787	5,310	42,413	24,956	261,053
<i>Interest-bearing liabilities</i>						
Deposits from banks	268	-	-	-	-	268
Deposits from customers	202,365	24,599	68,779	61,366	2,221	359,330
Total interest-bearing liabilities	202,633	24,599	68,779	61,366	2,221	359,598
Imbalance between interest-bearing assets and liabilities, net	(23,046)	(15,812)	(63,469)	(18,953)	22,735	
31 December 2017	up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Total
<i>Interest-bearing assets</i>						
Loans and receivables from banks	25,114	-	-	-	-	25,114
Financial assets held for trading	7,638	-	-	6,488	-	14,126
Loans and receivables from customers	141,311	268	3,653	10,213	25,939	181,384
Available-for-sale financial assets	6,106	1,890	15,044	28,820	8,941	60,801
Total interest-bearing assets	180,169	2,158	18,697	45,521	34,880	281,425
<i>Interest-bearing liabilities</i>						
Deposits from banks	191	-	-	-	-	191
Deposits from customers	176,757	22,679	87,933	50,770	2,805	340,944
Total interest-bearing liabilities	176,948	22,679	87,933	50,770	2,805	341,135
Imbalance between interest-bearing assets and liabilities, net	3,221	(20,521)	(69,236)	(5,249)	32,075	

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The average effective interest rates on the Bank's interest-bearing financial instruments are as follows:

	31.12.2018	31.12.2017
<i>Interest-bearing assets</i>		
Loans and receivables from banks	0.96	0.80
Financial assets held for trading	-	2.21
Loans and receivables from customers	4.53	5.09
Debt instruments at FVOCI	2.78	-
Available-for-sale investments	-	2.51
<i>Interest-bearing liabilities</i>		
Deposits from banks	-	-
Deposits from customers	0.52	0.78

30.4.2. Currency risk

Currency risk is the possibility to realize losses for the Bank due to changes in foreign currency exchange rates.

In the Republic of Bulgaria the exchange rate of the BGN is fixed to the EUR by the Currency Board Act. The open positions of the Bank in EUR bear no currency risk for the Bank.

The currency risk is the risk of negative effect of the fluctuations of prevailing exchange rates on the financial position and the cash flows of the Bank. The main part of the assets and liabilities of the Bank are denominated in EUR and BGN. The Bank aims to not hold open positions in currencies other than EUR.

The foreign currency structure of financial assets and liabilities by carrying amount is as follows:

31 December 2018	BGN	EUR	USD	JPY	Other	Total
Assets						
Cash and balances with the Central Bank	43,943	56,561	727	139	138	101,508
Loans and receivables from Banks	5,295	6,208	17,369	3,898	606	33,376
Financial assets held for trading	174					174
Debt instruments at FVOCI	15,844	13,383	14,834	-	-	44,061
Equity instruments at FVOCI	293	-	-	-	-	293
Loans and receivables from customers	124,143	59,473	-	-	-	183,616
Total assets	189,692	135,625	32,930	4,037	744	363,028
Liabilities						
Deposits from banks	-	172	96	-	-	268
Deposits from customers	182,209	139,439	32,928	4,009	745	359,330
Other financial liabilities	1	80	59	2	-	142
Total liabilities	182,210	139,691	33,083	4,011	745	359,740
Net position	7,482	(4,066)	(153)	26	(1)	3,288

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31 December 2017	BGN	EUR	USD	JPY	Other	Total
Assets						
Cash and balances with the Central Bank	21,898	47,687	588	72	117	70,362
Loans and receivables from Banks	498	756	19,516	3,745	599	25,114
Financial assets held for trading	11,057	1,098	1,971	-	-	14,126
Available-for-sale financial assets	18,255	38,807	3,739	-	-	60,801
Loans and receivables from customers	107,625	73,640	119	-	-	181,384
Total assets	159,333	161,988	25,933	3,817	716	351,787
Liabilities						
Deposits from banks	-	159	32	-	-	191
Deposits from customers	174,879	135,560	25,989	3,817	699	340,944
Other financial liabilities	1	177	20	-	-	198
Total liabilities	174,880	135,896	26,041	3,817	699	341,333
Net position	(15,547)	26,092	(108)	-	17	10,454

30.4.3. Price risk

Price risk is related to the fluctuations in market prices of financial assets and liabilities, which can cause losses for the Bank. The main risk for the Bank is the decrease of market prices of the financial instruments held for trading owned by the Bank, which can lead to decrease of the profit for the period. As described in note 6 and 7, the main part of the investments of the Bank is in Bulgarian government securities, which do not bear significant price risk.

30.4.4. Sensitivity to market risk

In accordance with the adopted objectives and principals, the Bank applies: VaR (Value-at-risk) analysis, Duration analysis and Standardized interest rate shocks for identify and analyse the effect of different risk factors on the value and the profitability of the portfolio, and thus aims to find the optimal ratio risk to income.

As at 31 December 2018, the Bank performed an interest rate sensitivity analysis based on the assumption of parallel increase in the interest curve applied on the interest imbalance. The expected effect is 200 b.p., i.e. +/- BGN 175 thousand.

To assess the effect of potentially possible extreme fluctuations of interest rates, the Bank analyses the effect of several Standardized interest rate shocks. The price fluctuation in the parallel shift of the yield curve by 100 basis points should not exceed 5% of the capital base calculated in the last quarter. As at 31 December 2018, due to the lack of such instruments, the Bank did not calculate this ratio.

30.5. Fair value

Fair value of financial instruments

The Bank determines the fair value of its financial instruments based on the available market information or by using appropriate valuation techniques when no such information is available. Information about the carrying amounts and fair values of financial assets and liabilities is presented in Note 30.1.

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The tables below summarise information about the financial assets carried at fair value to the statement of financial position:

31 December 2018	Carrying amount	Level 1 – quoted market price	Level 2 – valuation technique – observable market data	Level 3 – valuation technique - unobservable market data	Fair value unavailable
Assets measured at fair value					
Financial assets held for trading	174	174	-	-	-
Debt instruments at FVOCI	44,061	-	44,061	-	-
Equity instruments at FVOCI	293	-	-	293	-
Total	44,528	174	44,061	293	-
31 December 2017	Carrying amount	Level 1 – quoted market price	Level 2 – valuation technique – observable market data	Level 3 – valuation technique - unobservable market data	Fair value unavailable
Assets measured at fair value					
Financial assets held for trading	14,126	177	13,949	-	-
Available-for-sale financial assets	60,801	-	60,504	297	-
Total	74,927	177	74,453	297	-

The tables below contain information on determining the fair value of financial assets and liabilities which are not carried at fair value to the statement of financial position:

31 December 2018	Level 1	Level 2	Level 3	Total
<i>Financial assets</i>				
Cash and balances with the Central Bank	7,976	93,532	-	101,508
Loans and receivables from banks	-	33,376	-	33,376
Loans and receivables from customers	-	-	185,909	185,909
Total	7,976	126,908	185,909	320,793
<i>Financial liabilities</i>				
Deposits from banks	-	268	-	268
Deposits from customers	-	360,227	-	360,227
Other financial liabilities	-	-	142	142
Total	-	360,495	142	360,637
31 December 2017	Level 1	Level 2	Level 3	Total
<i>Financial assets</i>				
Cash and balances with the Central Bank	8,100	62,262	-	70,362
Loans and receivables from banks	-	25,114	-	25,114
Loans and receivables from customers	-	-	184,467	184,467
Total	8,100	87,376	184,467	279,943

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Financial liabilities

Deposits from banks	-	191	-	191
Deposits from customers	-	341,442	-	341,442
Other financial liabilities	-	-	198	198
Total	-	341,633	198	341,831

The fair value of loans to customers with a floating interest rate is close to their carrying amount. The fair value of loans with fixed interest rate is determined based on the Bank's current interest rates.

Fair value of non-financial assets

The tables below provide information on the main valuation methods and inputs used in determining the fair value of investment property and non-current assets held for sale.

31 December 2018		Market comparables method – bid prices for sale used (EUR/square meter)	Income method – bid prices for rental used (EUR/square meter)
<i>Type of investment property</i>			
holiday	6,145	446-509	-
retail	6,287	288-2476	2.50-12.85
regulated landed property	158	25-30	-
Total	12,590		
<i>Non-current assets held for sale</i>			
holiday	4,904	150-813	4.23-5.88
residential	80	250-345	1.82-2.19
Total	4,984		
31 December 2017		Market comparables method – bid prices for sale used (EUR/square meter)	Income method – bid prices for rental used (EUR/square meter)
<i>Type of investment property</i>			
holiday	6,145	-	-
retail	3,550	361-1,078	2.33-6.56
regulated landed property	158	-	-
Total	9,853		
<i>Non-current assets held for sale</i>			
holiday	4,835	200-888	-
retail	1,701	341-708	-
residential	198	203-251	1.01-1.58
Total	6,734		

31. OTHER REGULATORY DISCLOSURES

According to the requirements of Art. 70, paragraph 6 of the Credit Institutions Act, banks are obliged to disclose certain quantitative and qualitative data related to key financial and other parameters separately for the Republic of Bulgaria to other countries - EU Member States and third countries in which the Bank has subsidiaries or has established branches.

As disclosed in Note 1, Tokuda Bank operates under a banking license granted by BNB, under which it may accept deposits in local and foreign currency, to extend loans in local and foreign currency, open and maintain nostro accounts in foreign currency, abroad to conduct transactions with securities, foreign currency, and to perform other banking operations and transactions authorized by the Credit Institutions Act.

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The Bank has no subsidiaries and branches registered outside the Republic of Bulgaria.

The summarised quantitative indicators related to mandatory disclosures required by the Credit Institutions Act are as follows:

	2018	2017
Total operating income	13,289	17,261
Operating profit/(loss) before tax	(334)	1,002
Tax expense	67	(1)
Return on assets (%)	-0.07%	0.26%
Equivalent number of full-time employees as at 31 December	249	257
State subsidies received	-	-

Return on assets is calculated based on the average monthly values of the assets.

The Bank provides services as an investment intermediary under the provisions of the Public Offering of Securities Act. As investment intermediary the Bank must meet certain requirements to protect the interests of customers under the Markets in Financial Instruments Directive and Ordinance 38 issued by the Financial Supervision Commission. The Bank has established and applies an organization rules and internal control procedures related to the execution and performance of contracts by customers with information requests from clients, record keeping and preservation of clients' assets in accordance with Regulation 38, Art. 28-31.

32. CAPITAL MANAGEMENT

The Bank is subject to regulations in relation to meeting the requirements for capital adequacy in accordance with Directive 2013/36/EU on access to the activity of credit institutions, Regulation (EU) 575/2013 n prudential requirements for credit institutions and investment firms (package CRD IV) and the Bulgarian legislation. In Bulgaria the authorized share capital of a bank shall not be less than BGN 10 million and there is an additional requirement that at any time the equity (the capital base) of the Bank should not fall below the required minimum.

The minimum levels of capital adequacy for banks in Bulgaria that institutions need to comply with are, as follows: common equity Tier 1 capital ratio 4.5%, Tier 1 capital ratio 6%, and total capital adequacy ratio 8%.

The Bulgarian National Bank sets in Ordinance 8 additional capital buffers that Banks should maintain, above the minimum capital requirements. As at 31 December 2018, these are:

- protective capital buffer, equal to 2.5% of the Bank's total risk exposure;
- counter-cyclical capital buffer – 0% of the Bank's total risk exposure;
- systematic risk buffer – 3% of the Bank's total risk exposure.

The Bank monitors and analyses on monthly basis its capital position and prepares quarterly reports for supervisory purposes, which are presented to the BNB in compliance with legal requirements. Capital management policy aims to provide an adequate coverage of risks arising in the normal course of banking activities, as well as risks of unforeseen circumstances. The main priority in the management of capital is compliance with the regulatory requirements for capital adequacy and maintenance of sufficient capital, which covers risks assumed and provides sufficient capital buffer for unforeseen events.

The Bank maintains capital adequacy above the minimum regulatory ratios. The total capital ratio as at 31 December 2018 is 19.15% (31 December 2017: 21.38%).

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Additional information is presented in the table below:

	31.12.2018	31.12.2017
Equity	42,125	42,345
Common equity Tier 1 capital	42,125	42,345
Capital requirements		
Total risk-weighted assets for credit risk, credit risk from the counterpart and risk of dilution and free supplies	193,251	172,306
Total exposures to position, currency and commodity risk	350	1,913
Total risk exposures to operational risk	26,400	23,800
Total risk exposures	220,001	198,019
Capital ratios		
Common equity Tier 1 capital ratio	19.15%	21.38%
Excess (+)/Shortage (-) of common equity Tier 1 capital	32,225	33,434
Tier 1 capital ratio	19.15%	21.38%
Excess (+)/Shortage (-) of Tier 1 capital	28,925	30,464
Total capital ratio	19.15%	21.38%
Excess (+)/Shortage (-) of total capital	24,525	26,503

33. EVENTS AFTER THE DATE OF THE STATEMENT OF FINANCIAL POSITION

No events occurred after the statement's date that would require either adjustments or additional disclosures in the financial statements, other than the changes to the Bank's Management and Supervisory Board (disclosed in Note 1.4).