**TOKUDA BANK AD**

ANNUAL SEPARATE REPORT
ON THE ACTIVITIES,
INDEPENDENT AUDITOR'S REPORT
AND SEPARATE
FINANCIAL STATEMENTS

December 31, 2015

*Unofficial translation of the original in Bulgarian*

# ANNUAL SEPARATE REPORT ON THE ACTIVITIES

# FOR 2015

# TOKUDA BANK AD

ANNUAL REPORT ON THE ACTIVITY

2015

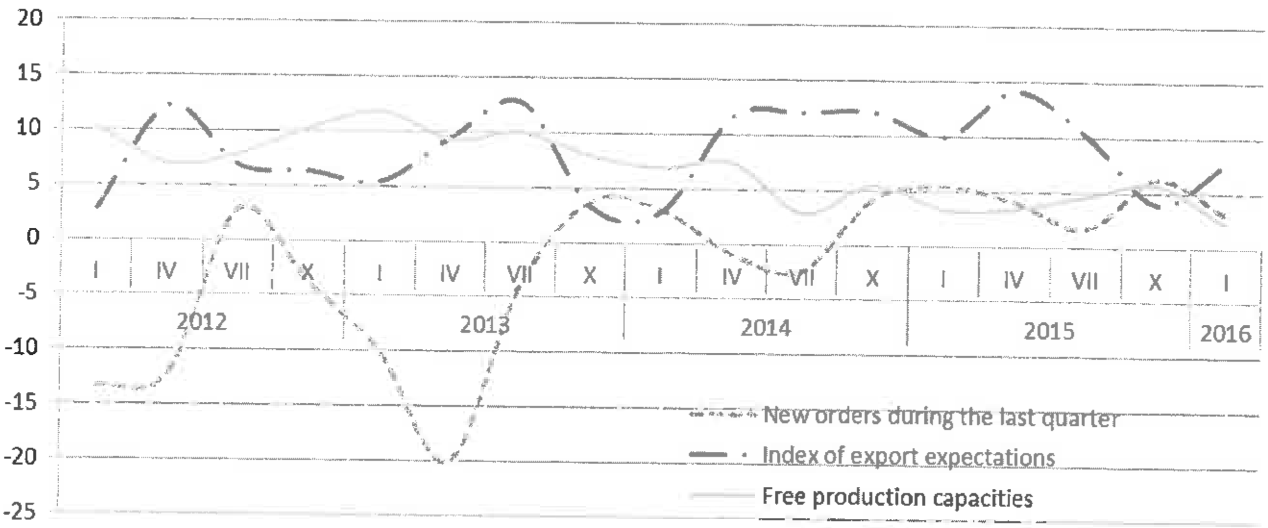
## CONTENTS:

## I. Environment in which Tokuda Bank AD operates in 2015

During the past 2015 the rate of economic growth in the country was unsatisfactory (3% on yearly basis according to preliminary data by the National Statistical Institute) ), the local market indicators remained unstable (figure 1) and the environment conditions did not contribute in any manner to the recovery of the real economy. In fact, observations indicate that some grounds for positive expectations exist since in the first three quarters of the past 2015 the index of industry export expectations kept levels above 10, the index for new orders followed higher (although varying) trends, and the share of idle production capacity remained without any significant changes. So far, however, the recovery of economy growth runs slowly under the leading role of domestic demand, and, in particular, collective consumption. This, on the other hand, had an unfavorable impact on the banking sector as an unstable production cannot be a source of profit for the credit institutions. Adverse business environment in Bulgaria was stated in many eminent reports (including the reports of the European Commission), which had an immediate negative impact on the behavior of local and foreign investors.

In the last review of the EC on the microeconomic gaps (published in February, 2016) was stated that despite significant improvements following the liquidity crisis in the middle of 2014, the banking sector continues to be potential source of microeconomic risks. Indeed, it seems that the public trust in the banking system gradually recovers and the liquidity and profitability of banks improve. In the sector, however, still there are too many issues related to asset quality and in particular, no appropriate diversification, lending to related parties, etc.

**Figure 1 Business environment indicators**




Further, we should note that along with adverse conditions of the economic environment the existing conservatism in investment attitude (both of financial intermediaries and their clients) also put pressure on the lending rates, which during 2015 kept low - about 1-2% on an annual base. Lending activity in the country remained low - the amount granted new loans to non-financial companies in 2015 was lower compared to the previous year (although it remained at levels above BGN 1 billion). This trend resulted from continuing weak demand for loans due to the reluctance of firms and households to accumulate new debts or commit to new investments in the existing uncertain economic environment. At the same time, banks continued to hold relatively prudent lending policy. At the end of 2015, the amount of non-government sector fell by 1.6% compared to the end of 2014. In addition, a decrease in receivables yoy both from non-financial corporations (1.6%) and households (1.3%) was observed. Net sales of loans by commercial banks also had an impact on the dynamics of lending to the non-governmental sector in 2015.

The dynamics of loans to households almost throughout the year was characterized by a tendency to delay the reported growth. In late December, the annual rate reached minus 1.3 percent. The main contribution to negative growth in loans to households caused the category "housing loans". A decline was also observed in the categories of overdraft and "other loans", while the consumer segment during most part of the year marked a slight positive growth.

Most likely, the leading factor in reviving consumer lending this year remains the emergence of urgent expenses such as health care, repayment of debts to the budget or to utility companies, etc.. Overall the population and businesses as well, still have weak motivation to borrow even though interest rates continued to decline, albeit at a slower rates.

Regarding liabilities it could be concluded that two of the trends which have been formed in the beginning of the financial crisis stayed the same, namely: weakening of local resources and increase in the population's savings. The continued growth of funds from residents, as well as the interest conditions in interbank money markets in the country and in the Eurozone continued to act as an incentive for commercial banks to further lower interest rates on deposits during the past year. As of November 2015, the weighted average interest rate on new term deposits of non-financial enterprises" and "households" sectors' reached in total 1.1% (whereas a year earlier the index kept at levels above 2.1%). Decrease in interest rates is reported both on new deposits of households and of non-financial enterprises, with higher downturn in households. In both sectors registered pace of decline was more significant in the first half.

With regard to the 2014 trend of substitution of resources provided by foreign parent banks to their subsidiary banks in the country with a local resource, it should be noted that during the year it was discontinued and at the end of 2015 net foreign assets of banks dropped down to BGN 2.6 billion (compared to BGN 4.2 billion in 2014).

The continued growth of savings (albeit moderating) in lowering interest rates is symptomatic for the adverse business environment. Maintaining high tendency towards savings, despite the continuing reduction in the yield achieved is indicative of the lack of adequate investment alternatives. The reason for this is both a relatively low rate of income under those alternatives and the high degree of risk arising from the uncertainty in the country. The latter creates problems both for economic agents and for banks, which in terms of limited lending have no opportunity to realize the accumulated free resource.

## II. Overview of the activity of Tokuda Bank AD in 2015

According to the Bulgarian National Bank, at the end of 2015 Tokuda Bank AD ranked 24th in terms of total assets with a share of assets in the banking system reaching 0.49%. Compared to the assets of the banks in the second group which the Bank belongs to, this share is 1.31%.

The Bank's assets as at December 31, 2015 amount to BGN 427.284 mln. The average amount of the assets remains relatively constant, and for the past period they amount to BGN 434.2 mln., while for the previous two years they are of BGN 427.7 million. and BGN 424.4 mln., respectively.

For 2015 the Bank realized a net loss of BGN 6.845 mln., due to which the potential earnings per share is a negative amount. The reported loss is by 23.37% less than the year before - in 2014 it reached BGN 8.932 mln.

During the past year, the dynamics of the loan portfolio is slow due to the continuing economic stagnation in the country resulting in proper financing projects and investors with good credit standing. At the end of the period, gross loans before impairment decreased to BGN 203.341 mln. The share of loans outside the 'loss' group remains near the recorded one in the previous year and as of December 31 reached 70.57% (74.14% in 2014).

In 2013, Tokuda Bank established a subsidiary "Tokuda Security" EOOD, with registered share capital at the amount of BGN 25 thousand, which is 100% owned by the Bank. The Bank defines the financial and operating policies of the subsidiary. The results of the subsidiary are recognized in the consolidated financial statements.

## *1. Operating income and expenses*

In 2015, the Bank generated income from core business at the amount of BGN 13.529 mln. (table 1), which is by BGN 1.640 mln. (13.79%) less than the prior year. The measures to reduce and control administrative costs still have an effect on their dynamics during the past period. During the past year the Bank continued to follow its policy of administrative cost restriction. In accordance with this policy management exercised regular cost control and undertook active measures to limit these expenses. As a result of these measures, the ratio between administrative expenses, including depreciation/amortization charges, and net operating income (91.07%) remained relatively close to the prior year level (99.75), although the decrease in some main groups of income. For example, the gross interest income decreased by BGN 1.558 mln., income from fees and commissions - by BGN 121 thousand and trading income dropped down by BGN 11 thousand. The above ratio is supported also by restricting the administrative costs close to the prior year level, as well as decreasing interest expense by BGN 3.411 mln. (from BGN 11.113 mln. to BGN 7.702 mln.)

Administrative expenses increased by BGN 466 thousand (4.10%) compared to those reported in 2014 (BGN 11,366 mln.) and at the end of 2015 reached BGN 11.832 mln. The reported increase is mainly due to the occurrence of extraordinary expenses relating to the procedure for assessing the quality of assets and the contribution of the newly established fund for bank restructuring. Other items of administrative costs remained close to the levels of 2014, since no major reorganizations in the administrative and regional structure of the Bank have been made during the past year.

Changes in the structure of the Bank's total operating income are moderate (see table 1). Net interest income increased by BGN 1.853 mln. due to the decrease in price of attracted funds. In 2015, these income comprise 64.93% of total net income and non-interest income decreased their share to 35.07%. These values for the prior year are 58.30% and 41.70%, respectively.

**Table 1. Operating income**

| | 2015 | 2014 |
|---|---|---|
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Interest income on granted loans and other receivables decreased by BGN 564 thousand and amounted to BGN 13.438 mln. and continued to hold the largest share of its total interest income (81.51%). Despite the decrease in revenue in absolute value, for the past year, their share increased by 3.91 percentage points compared to the one recorded in 2014 (77.60%) as a result of the accelerated decrease in interest income from securities.

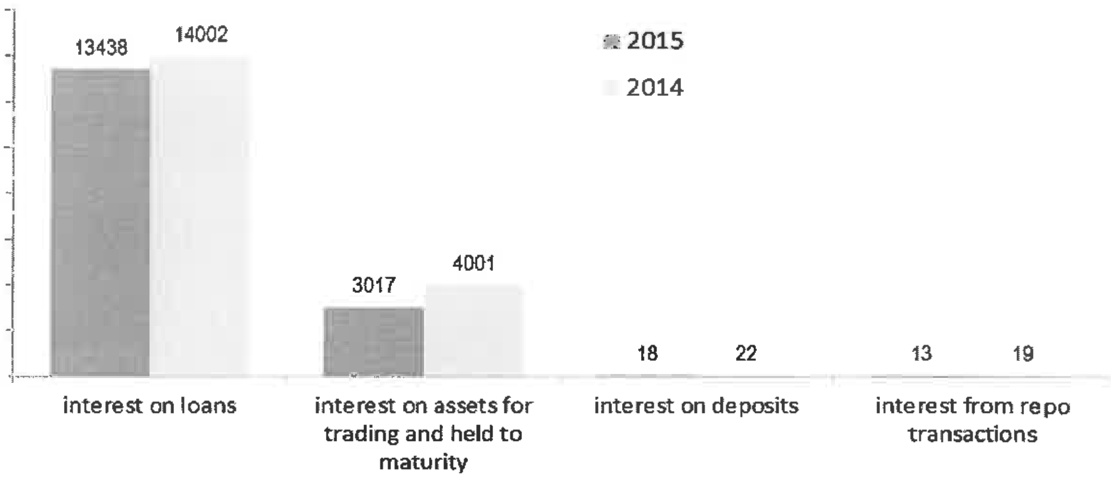
A major factor for the reported shrinkage in the share of income on this indicator by 4.03%, compared to last year is the increase in the high share of classified loans in "loss" group (from 25.86% in 2014 to 29.43% at the end of 2015), which is a serious obstacle to the realization of stable interest income for the Bank.

Interest income from management of debt instruments portfolio (figure 2) indicate noticeable decline (by 24.59% compared to 2014) due to the amortization of the portfolio, leading to the replacement of old (more profitable) issues by new ones with lower yield. The share of this income in total interest income during the year decreased from 22.17% to 18.30%.

Interest income on placed deposits amounts to BGN 17.7 thousand, which is by 19.07% (BGN 4.2 thousand) less than the reported figures for 2014, mainly due to the shrinkage of this group of assets and compared to the average amount of BGN 24.970 mln. For 2014 their volume dropped down to BGN 17.125 mln. for 2015. The effect on revenue is quite weak and commensurate with indicators of changes in volume, since the changes to this group of assets have slow dynamics.

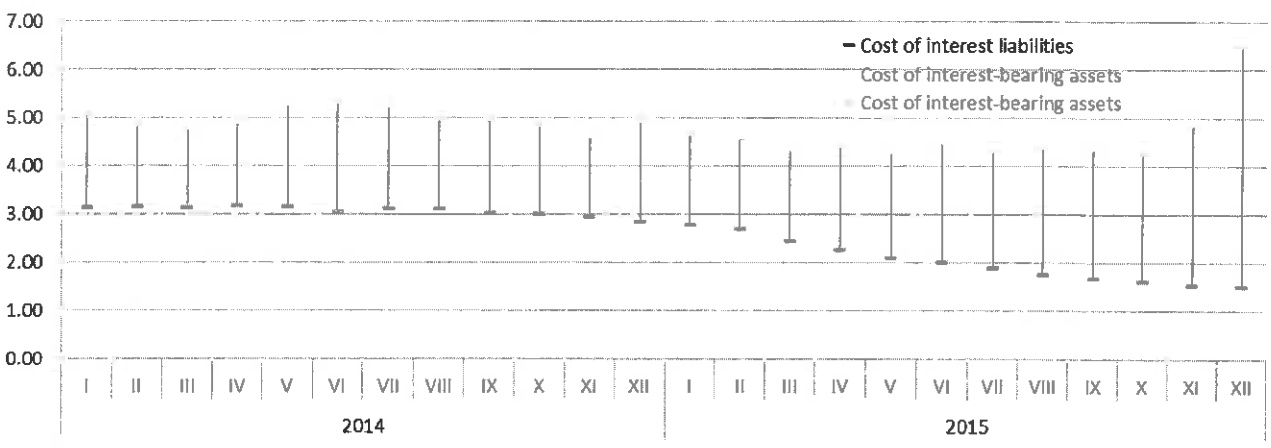
Interest expense in 2015 represent significant portion of the Bank's operating expenses, as the deposit base is formed mainly by individuals and households and as of December 31, 2015 these expenses reached BGN 7.702 mln., indicating a decrease of 30.69% compared to 2014 (when they amounted to BGN 11 113 mln.), as a result of the ongoing effective policy of liabilities and interest expenses management.

Figure 2. Interest from assets held for trading, assets available for sale and assets held to maturity




During the past reporting period there is an increase in the interest spread (figure 3), despite the decrease in income from interest-bearing assets for the period until October. Compared to the weighted average rate of income of 4.96% for 2014 the latter indicator decreased to 4.61% in 2015, due to the bigger share of classified loans with overdue above 180 days on principal and interest and the decrease in interest rates on newly granted loans in order to comply with market conditions and competitive environment. However, this is compensated by the reduced cost of attracted funds, which decreased from 3.07% in 2014 to 2.02% in 2015 as a result of decreased interest rates on attracted funds and maturity of major part of relatively expensive deposits of Bank's customers. Winning new customers from the corporate sector and the public sector had further favorable effect on the price of attracted funds, leading to an increase in the share of current accounts by 5.6 percentage points during the year. The accelerated dynamics of the cost of attracted funds, and the realization of additional income in the last two months of the year (due to the generation of additional income from collected writs) caused an increase in interest spread up to 2.56% cumulatively in 2015., which is 0.67 percentage points higher than the previous year (1.89%).

Figure 3. interest spread components



***Non-interest income***

Net non-interest income remained close to the levels reported in the prior year, marking a slow decline of BGN 213 thousand (4.30%) and at the end of 2015 reached BGN 4.745 mln.. The largest share in this group still has the net income from fees and commissions (BGN 3.552 thousand) which during the past year decreased by BGN 130 thousand (3.53%) due to the decrease (by BGN 58 thousand) in income from issued guarantees and loan charges. .

In the past year, an increase in income from fees on transfers in BGN and in foreign currency by BGN 120 thousand, amounting in total up to BGN 1.721 mln., was observed. This led to a growth of their share in the total structure of gross income from fees and commissions by 1.98 percentage points

Adverse conditions on the securities market had a negative impact on net income from sales and revaluation of trading portfolio and as a result, they decreased by BGN 124 thousand 13.6%) - from BGN 908 thousand in 2014 to BGN 784 thousand for the past reporting period. The result from foreign currency transactions and revaluation of foreign currency assets and liabilities dropped down by BGN 5 thousand and reached BGN 333 thousand in 2015.

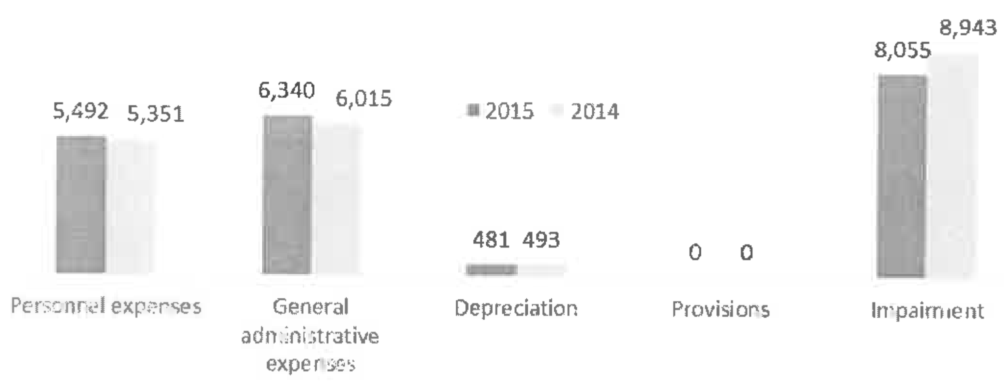
***Non-interest expenses***

Non-interest expenses of the Bank for 2015 (figure 5) amount to BGN 20, 368 mln., which represents an decrease of BGN 434 thousand or by 2.09% compared to prior year

This group marked an increase in general administrative expenses (including those for services, rent, materials, contributions to the Bulgarian Deposit Insurance Fund and newly established fund for bank restructuring, telecommunications and information technology, security, etc.), which grew by BGN 325 thousand (up to BGN 6.340 mln.).

Depreciation/amortization expenses (BGN 481 thousand) virtually remained unchanged compared to 2014 (as a result of low rate of upgrading technology park) and personnel costs increased by BGN 141 thousand (up to BGN 5.492 mln.), although the administrative structure and office network of the Bank marked no significant changes, and the average number of staff remained relatively constant level (255 persons for the past 2015).

**Figure 4. Non-interest expenses**

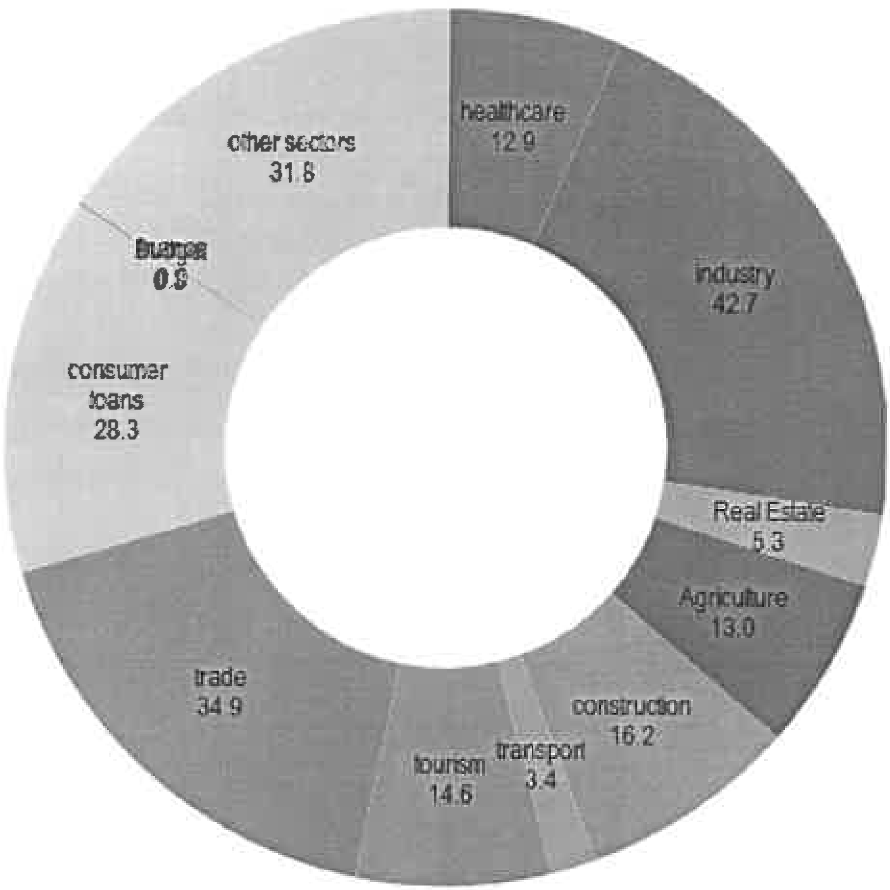


The slow dynamics of the expense in this group caused relatively small changes to its structure. For example, the share of staff costs (including salaries and social security and health insurance contributions) in the total structure of non-interest expenses decreased by 1.24 pp (from 25.72% to 26.96% at the end of last year). The change in the share of general administrative expenses (2.21 pp) is also comparable. The share of depreciation/amortization charges remained unchanged (2.36%), and the provision expense kept zero level of the prior year.

## 2. *Loan portfolio*

At the end of 2015 the gross loan portfolio of the Bank (figure 5) amounts to BGN 203.341 mln.. After providing allowances for impairment losses at the amount of BGN 23.089 mln., the net value of the portfolio is BGN 180.252 mln. The weak portfolio growth is due to the unfavorable conditions and the continuing relatively high credit risk of the business environment. In 2015 the carrying amount of the loan portfolio after impairment decreased its share in the total assets' structure to 42.19% (47.15% for the prior year).

**Figure 5. Loan portfolio distribution [in BGN million]**




Corporate loans decreased to BGN 164.224 mln. and their share in the gross loan portfolio (80.76%) changed slightly compared to the prior year (78.25%), which is a natural result of the maintained balance of the lending activity.

Changes in the consumer loans segment are also moderate. Their share increased from 16.57% of the gross loans in 2014 to 19.05% in 2015. In absolute value the segment reported growth at the amount of BGN 21.437 mln., which represents an increase by 3.85% compared to the prior year values.

In 2015 the Bank continued to work with companies from the sectors of industry, trade, energy, agriculture, healthcare, etc. The largest relative share took loans to the Industry sector, which unlike last year, now increased its share (by 2.02 percentage points to 20.99% of the portfolio), followed by the trade sector (whose share decreased from 17.30% to 17.15%), construction sector (whose share decreased by 0.21 percentage points to 7.97%), and healthcare whose relative share increased to 6.35%.

There are no significant changes in the currency structure of loan portfolio after impairment. The share of loans in the European single currency (EUR) decreased by 4.93 percentage points against the increase of loans in USD (by 0.12 percentage points) and in BGN (by 4.81 percentage points). At the end of 2015 the loan portfolio after impairment is as follows: 53.55% in local currency, 45.43% in EUR and 1.02% in USD.

Despite some positive signs of economic recovery, the consequences of the crisis continued to shape the attitudes of the private sector and households. The deterioration of their economic status and the difficulties in settlement of their obligations, as well as the absence of investment interest, affect negatively the rate of lending and thus preventing the compensation of poor portfolio quality through increasing its volume. During the past year, the Bank followed its policy for granting loans only to individuals meeting high standards for reliability and credit standing, as indicative in this respect is the regular servicing of such loans. However, during the past year a slight increase in classified loans (up to 48.89%) was observed, which is mostly result of the stagnation in lending.

In order to cover the risk of impairment losses on loan receivables at present the Bank has allocated allowances at the amount of BGN 23.089 mln., which lead to the increase of portfolio coverage ratio with accounting provisions from 7.77% to 11.35%. The coverage with allowances for impairment for loans classified in groups other than 'regular' is 22.94%. Almost all impairment (87.69%) is charged on receivables classified as "loss" (table 2).

**Table 2. Allocation of loan portfolio to classification groups**

| | 2015 | | | 2014 | | |
|---|---|---|---|---|---|---|
| | Gross amount | Allowances under IAS | Carrying amount | Gross amount | Allowances under IAS | Carrying amount |
| **Regular** | 103 919 | 285 | 103 634 | 135 383 | 0 | 135 383 |
| **Watch** | 16 866 | 306 | 16 560 | 16 293 | 139 | 16 154 |
| **Non-performing** | 22 717 | 2 252 | 20 465 | 15 197 | 113 | 15 084 |
| **Loss** | 59 839 | 20 246 | 39 593 | 58 207 | 17 229 | 40 978 |
| **Total** | 203 341 | 23 089 | 180 252 | 225 080 | 17 481 | 207 599 |
| **Classified** | 99 422 | 22 804 | 76 618 | 89 697 | 17 481 | 72 216 |

### 3. Securities

The securities portfolio as at the end of 2015 increased by BGN 6.182 mln. to BGN 121.386 thousand, and thus its share in the total structure of assets grew to 28.41% of the total assets, which is by 2.24 percentage points more than the prior year. Compared to the prior year such change is relatively moderate (5.37%). Keeping relatively high share of this asset category can be explained by the general stagnation in lending in the country, still motivating local banks to direct their available resources to securities market. The main part of this category of assets (BGN 93.445 mln.) is classified as available for sale. During the past year the volume of trading portfolio decreased by BGN 2.486 mln. (down to BGN 27.941 mln.) and investment held to maturity were totally reclassified as available for sale.

**Table 3. Securities portfolio**

| | 2015 | 2014 |
|---|---|---|
| Shares and participation in local companies | 86 | 165 |
| Bulgarian government securities | 63 880 | 77 618 |
| Eurobonds of local governments | 28 352 | - |
| Government securities of foreign governments | 17 511 | 19 549 |
| Eurobonds of foreign governments | 3 824 | - |
| Corporate bonds of local and foreign issuers | 7 622 | 17 796 |
| Shares of local companies | 111 | 153 |
| Impairment accrued for the year | - | (77) |
| TOTAL | 121 386 | 115 204 |

Securities of local government (Bulgarian government securities and Eurobonds of the local government) increased by BGN 14.614 mln., up to BGN 92.232 mln., and their share in the total structure of the portfolio grew to 75.98%. Securities of foreign governments increased by BGN 1.786 mln. (up to BGN 21.335 mln.), Shares of local companies decreased to BGN 111 thousand.

## 4. *Attracted funds*

The volume of attracted funds in 2015 (table 4) decreased by 1.94% and at the end of the year reached BGN 379.872 mln., where the source of these funds are individuals and households. In 2015, the share of funds from this source declined by 3.15 percentage points (from 68.14% to 64.98% in the total structure). Also the resource from organizations operating with State budget funds decreased and at the end of 2015 their share comprised 3.68% of the Bank's attracted funds (at 5.08% in 2014).

Similarly is the movement of attracted funds from non-banking financial institutions, which in the past year decreased by 27.80% and their share of borrowed funds declined from 4.77% to 3.51%. Deposits of non-financial companies retained second place, according to their share in attracted funds. Last year the segment increased by 5.81 pp (from 22.02% to 27.82%).

The Bank continues to maintain high liquidity and therefore interest in attracting deposits from banks remains relatively weak, so their volume at the end of the year reached BGN 563 thousand (compared to BGN 149 thousand in 2014).

During the past year repeated adjustments of interest rates on the Bank's deposit products were made in order to optimize interest expenses, which resulted in changes to the structure of attracted funds (as in the previous year) in favor of current accounts and the share of term deposits decreased by 7.09 pp to 54.40%.

Changes in the currency structure of attracted funds are relatively weak and in favor of the US dollar, whose share over the past year increased from 3.61% to 4.78% against deposits in local currency, whose share decreased from 53.33% to 52.01%. Changes in the shares of other currencies are relatively weak and at the year-end deposits in Euro occupied 42.31%, while deposits in Japanese yen and other currencies - 0.83% and 0.08%, respectively, of the total structure.

**Table 4. Structure of attracted funds**

| | 2015 | | | 2014 | | |
|---|---|---|---|---|---|---|
| | Sight deposits and saving deposits | Term deposits | Total | Sight deposits and saving deposits | Term deposits | Total |
| **Accounts of individuals** | 71 882 | 174 974 | 246 856 | 63 439 | 200 513 | 263 952 |
| **Budget accounts** | 13 995 | 0 | 13 995 | 19 682 | 0 | 19 682 |
| **Corporate accounts** | 86 920 | 18 769 | 105 689 | 65 577 | 19 714 | 85 291 |
| **Accounts of other non-banking financial institutions** | 420 | 12 912 | 13 332 | 474 | 17 991 | 18 465 |
| **TOTAL** | 173 217 | 206 655 | 379 872 | 149 172 | 238 218 | 387 390 |

## 5. *Equity and reserves*

As of December 31, 2015 the share capital of the Bank amounts to BGN 45.264 mln.

As of December 31, 2015 the share capital amounts to BGN 68 000 000 /sixty eight million/. It is distributed in 6 800 000 / six million and eight hundred thousand/ registered dematerialized voting shares with face value of BGN 10 / ten / each and issue value equal to nominal.

According to the register of shareholders with the Central Depository, as of December 31, 2015 the shareholders of the Bank are:

- Tokushukai Incorporated, Japan (holder of 99.53% of the share capital)
- "Garant Co Ko 97" AD, Bulgaria (0.22%)
- AUC Establishment, Lichtenstein (0.20%)
- Gama Holding Group AD, Varna (0.05%)

## 6. *Office network*

Due to the unfavorable economic environment and by following its conservative budgeting policy, during the past year the Bank refrained from expanding its regional network.

In 2015 an office in Kardzhali was closed; a new office in Kazanlak was opened; Doyran Office was included in the Sofia structure as a remote workplace.

The structure of the office network is as follows:

- Head Office
- Offices – 23
- Remote workplaces – 10

The regional divisions of the Bank provide its customers with professional and quality services, timely assistance for solving various issues and possibilities to benefit of new products and services.

### 7. *Correspondent banking relationships*

Correspondents of the Bank are all Bulgarian banks and a number of leading foreign banks abroad - BNP-Paribas SA, Paris; Commerzbank AG, Franufurt/Main; Dresdner Bank AG, Frankfurt/ Main; Bank of China, Beijing; Landesbank Hessen-Thueringen Girozentrale, F/M; Bank of Tokyo-Mitsubishi UFJ, LTD, Tokyo; Sumitomo Mitsui Banking Corporation, Tokyo; Banque Generale du Luxembourg S.A., Luxemburg; Banca Popolare di Milano S.C.A.R.L., Milano; Uniastrum Bank, Moscow; International Bank for Economic Cooperation, Moscow; Unistream Commercial Bank, Moscow; Banco Cooperativo Espanol S.A., Madrid; Credit Suisse, Zurich; Hyposwiss Privatbank AG, Zurich; Wachovia Bank, NA, London; Bank of New York, New York; CITIBANK N.A., New York and other.

### 8. *Human resources*

The human resource is a key factor for realizing the strategic goals of the management. The Bank's management develops a system for managing human resources and administration of personnel - planning, selection, recruitment, movement and discharge. In 2015 the average number of employees of the Bank is 255 (compared to 260 in 2014).

A crucial factor in achieving the mission and strategy of the Bank is the quality of personnel - qualifications, professional skills and loyalty. Bank's employees also attend various forms of training and qualification related to their main functions, since the improvement is one of the main tools, which has proven its reliability.

For the purposes of effective human resources management, the internal information system (internal site) is continuously updated, where access is granted to internal company documents and news concerning the Bank.

### 9. *Information technologies*

During the past year continued the process for optimization of the implemented in 2012 new software platform, which processes the main data flows of the Bank. The implementation of a new platform contributed to the development of the Bank's technological processes and their control, improvement of the quality of customer services and provision of reliable information to answer of their needs.

## III. Development trends in 2016

In determining the prospects for development in the next reporting period, some basic assumptions about the environment in which the Bank will carry out its activity (relatively slow pace of development of the Bulgarian economy and holding the unfavorable investment climate in the country) are set out. Amid such emerging economic environment, the Bank intends to maintain a moderately conservative policy in performing its activities with a view to stabilize profitability indicators and create conditions for increasing its market share. The main objective set for 2016 is to increase the loan portfolio and improve its quality. For this purpose, a strong increase in lending activity is foreseen, and despite the expectations for slow stabilization of economic growth and investment climate in the country, the pace of dynamics can be achieved, as the Bank has a relatively small market share and has the potential to maintain above average rate of lending by using purely market mechanisms.

A guiding principle in determining the prospects for development is keeping risk at a reasonable level, so that the main priority of activity this year will remain the precise selection of suitable clients and the reasonable assessment and management of credit risk.

In short, the main priorities for the Bank's development for 2016 are summarized in the following areas:

- Keeping the high liquidity of the Bank;
- Improving quality of loan portfolio;
- Promoting sales of new products and services;
- Expanding the market share of the Bank;
- Optimization of the asset structure and following the policy of acceptable credit risk and its coverage with the necessary capital.
- Improving rate of return on assets;
- Ensuring stable operating income to guarantee the achievement of a higher return on share capital;
- Limitation of expenses by their optimization.

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

### 1. *Changes in share capital*

In 2015 Tokushukai Incorporated, Japan acquired the ownership on International Hospital Services Co Ltd., Japan (holder of 99.53% of the Bank's share capital) and as of December 31, 2015 the majority shareholder, owner of 99.53% of the Bank's share capital is Tokushukai Incorporated, Japan.

### 2. *Management*

In 2015 the Bank preserved its two-tier management system. The bodies of the joint-stock company in 2015 have the following members:

***Supervisory Board of the Bank***

Arthur Stern – Chairperson of Supervisory Board.

Tokushukai Incorporated, Japan, represented by Eiji Yoshida – Deputy Chairperson of the Supervisory Board.

Dimitar Vuchev - member of Supervisory Board.

***Management Board of the Bank***

Vanya Vasileva – Chairperson of the Management Board and Executive Director;

Kiril Pendev – member of the Management Board and Executive Director until December 1, 2015;

Boyan Ikonomov – member of the Management Board and Executive Director;

Dimitar Slavchev – member of the Management;

The total remuneration received by the members of the Management and the Supervisory Boards during the reporting period amounts to BGN 350 thousand (three hundred fifty thousand) (respectively, BGN 328 thousand in 2014).

The members of the Management and the Supervisory Boards do not have rights to acquire shares and bonds of the Bank. Also neither they, nor related to them persons have signed with the Bank contracts, which are beyond the regular activity or significantly deviate from the market conditions.

### 3. Dividend distribution policy

The Bank paid no dividends. The net profit for the year is allocated to cover losses from prior years.

## V. Responsibility of the Management

The annual financial statements have been prepared in compliance with the statutory requirements and the International Financial Reporting Standards (IFRS), as adopted by the European Union and applicable in the Republic of Bulgaria. They give a true and fair view of the financial position of the Bank.

Upon preparation of the annual financial statements, the management confirms that:

- They have been prepared in compliance with the International Financial Reporting Standards;
- The annual financial statements have been prepared under going concern assumption and are fairly presented;
- The adopted accounting policies are adequate and have been consistently applied;
- The required estimates and assumptions have been made on the basis of the prudence concept;
- The management has undertaken all necessary measures to protect the assets of the Bank and to prevent fraud.

**By virtue of decision of the Management Board of Tokuda Bank AD:**

**Vanya Vassileva**
Chairperson of Management Board and
Executive Director

**Boyan Ikonomov**
Member of Management Board and
Executive Director

**Sofia, April 5, 2016**

# INDEPENDENT AUDITOR'S REPORT AND
# ANNUAL SEPARATE FINANCIAL STATEMENTS
# DECEMBER 31, 2015

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*This document is a translation of the original Bulgarian text, in case of divergence the Bulgarian text shall prevail.*

# INDEPENDENT AUDITOR'S REPORT

**To the Shareholders of**
**Tokuda Bank AD**

## Report on the separate financial statements

We have audited the accompanying separate financial statements of Tokuda Bank AD ("the Bank"), which comprise the separate statement of financial position as of December 31, 2015, and the separate statement of comprehensive income, separate statement of changes in equity and separate statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

*Management's responsibility for the separate financial statements*

Management is responsible for the preparation and fair presentation of these separate financial statements in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union 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.

*Auditor's responsibility*

Our responsibility is to express an opinion on these separate financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the separate financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the separate financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the separate financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Bank's preparation and fair presentation of the separate financial statements 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. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the separate financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

*Opinion*

In our opinion, the separate financial statements present fairly, in all material respects, the financial position of Bank as of December 31, 2015, and its financial performance and its cash flows for the year then ended in accordance with IFRS, as adopted by the European Union.

**Other reports on legal and regulatory requirements - Annual separate report on the activities of the Bank according to the Accountancy Act**

Pursuant to the requirements of the Bulgarian Accountancy Act, we have read the accompanying Annual separate report on the activities of the Bank, prepared by the Bank's management. The Annual separate report on the activities of the Bank is not a part of the financial statements. The historical financial information presented in the Annual separate report on the activities of the Bank prepared by the management is consistent, in all material aspects with the financial information disclosed in the separate financial statements of the Bank as of December 31, 2015, prepared in accordance with IFRS, as adopted by the European Union. Management is responsible for the preparation of the Annual separate report on the activities of the Bank dated April 6, 2016.

Deloitte Audit

Deloitte Audit OOD

Sylvia Peneva
Statutory Manager
Registered Auditor

Sofia
April 6, 2016

TOKUDA BANK AD

SEPARATE STATEMENT OF FINANCIAL POSITION
as of December 31, 2015
All amounts are in thousand BGN, unless otherwise stated

| | Note | As at 31 December 2015 | 2014 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and cash balances with central banks | 4 | 88,384 | 89,985 |
| Loans and advances to credit institutions | 5 | 16,625 | 11,077 |
| Financial assets held for trading | 6 | 27,941 | 30,427 |
| Financial assets available for sale | 7 | 93,445 | 88 |
| Loans and advances to customers | 8 | 180,252 | 207,599 |
| Investments held to maturity | 9 | - | 84,689 |
| Non-current assets held for sale | 13 | 7,135 | 3,752 |
| Property, plant and equipment | 10 | 2,880 | 3,161 |
| Intangible assets | 10 | 651 | 544 |
| Investments in subsidiaries | 11 | 25 | 25 |
| Other assets | 12 | 9,946 | 8,963 |
| **Total assets** | | **427,284** | **440,310** |
| **LIABILITIES** | | | |
| Deposits from credit institutions | 14 | 563 | 149 |
| Deposits from clients other than credit institutions | 15 | 379,872 | 387,390 |
| Tax liabilities | 16 | 89 | 83 |
| Other liabilities | 17 | 1,496 | 3,398 |
| **Total liabilities** | | **382,020** | **391,020** |
| **EQUITY** | | | |
| Share capital | 18 | 68,000 | 68,000 |
| Reserves | 18 | 3,632 | 813 |
| Accumulated loss | | (19,523) | (10,591) |
| Loss for the year | | (6,845) | (8,932) |
| **Total equity** | | **45,264** | **49,290** |
| **Total liabilities and equity** | | **427,284** | **440,310** |

These separate financial statements have been approved by the Management Board of Tokuda Bank AD on 06 April 2016.

Vanya Vassileva
Chairperson of Management Board
and Executive Director

Boian Ikonomov
Member of Management Board
and Executive Director

Svetlin Todorov
Finance Director

ТОКУДА БАНК АД
СОФИЯ

The accompanying notes are an integral part of these separate financial statements.

СПЕЦИАЛИЗИРАНО ОДИТОРСКО ПРЕДПРИЯТИЕ
София
Рег. №033
"Делойт Одит" ООД

06/04/2016

This document is a translation of the original Bulgarian text, in case of divergence the Bulgarian text shall prevail.

TOKUDA BANK AD

SEPARATE STATEMENT OF COMPREHENSIVE INCOME
for the year ended December 31, 2015
All amounts are in thousand BGN, unless otherwise stated

| | Note | Year ended 31 December 2015 | 2014 |
|---|---|---|---|
| Interest income | 19 | 16,486 | 18,044 |
| Interest expense | 19 | (7,702) | (11,113) |
| Net interest income | | 8,784 | 6,931 |
| Fee and commission income | 20 | 3,900 | 4,021 |
| Fee and commission expense | 20 | (348) | (339) |
| Net fee and commission income | | 3,552 | 3,682 |
| Net trading income | 21 | 305 | 700 |
| Other operating income | 22 | 888 | 576 |
| **Operating income** | | 13,529 | 11,889 |
| **Impairments and provisions for losses** | 24 | (8,055) | (8,943) |
| Personnel costs | | (5,492) | (5,351) |
| Operating lease rentals | | (936) | (1,040) |
| Other expenses | | (5,885) | (5,468) |
| Operating expenses | 23 | **(12,313)** | **(11,859)** |
| Loss before income tax | | **(6,839)** | **(8,913)** |
| Tax expense | 25 | (6) | (19) |
| Loss for the year | | **(6,845)** | **(8,932)** |
| **Other comprehensive income** | | | |
| Items that may be reclassified to profit or loss | | | |
| Net change in fair value of available for sale financial assets | | 2,820 | - |
| Items that will never be reclassified to profit or loss | | | |
| Remeasurements of defined benefit liability | | (1) | - |
| **Total other comprehensive income** | | 2,819 | - |
| **Total comprehensive income for the year** | | **(4,026)** | **(8,932)** |

These separate financial statements have been approved by the Management Board of Tokuda Bank AD on 06 April 2016.

| | | |
|---|---|---|
| Vanya Vassileva<br>Chairperson of Management Board<br>and Executive Director | Boian Ikonomov<br>Member of Management Board<br>and Executive Director | Svetlin Todorov<br>Finance Director |

ТОКУДА БАНК АД София

The accompanying notes are an integral part of these separate financial statements.

ОДИТОРСКО ПРЕДПРИЯТИЕ София Рег. №033 "...Одит" ООД

This document is a translation of the original Bulgarian text, in case of divergence the Bulgarian text shall prevail.

С ...
06/04/2016

SEPARATE STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
AS OF DECEMBER 31, 2015
All amounts are in thousand BGN, unless otherwise stated

| | Share capital | Revaluation reserve of financial assets available for sale | Reserves | Accumulated loss | Total |
|---|---|---|---|---|---|
| **Balance at 1 January 2014** | **68,000** | - | **813** | **(10,591)** | **58,222** |
| Loss for the year | - | - | - | (8,932) | (8,932) |
| Other comprehensive income for the year | - | - | - | - | - |
| Total comprehensive income for the year | - | - | - | (8,932) | (8,932) |
| **Balance at 31 December 2014** | **68,000** | **-** | **813** | **(19,523)** | **49,290** |
| Loss for the year | - | - | - | (6,845) | (6,845) |
| Other comprehensive income for the year | - | 2,820 | (1) | - | 2,819 |
| Remeasurements of defined benefit liability | - | - | (1) | - | (1) |
| Net revaluation reserve of financial assets available for sale | - | 2,820 | - | - | 2,820 |
| Total comprehensive income for the year | - | 2,820 | (1) | (6,845) | (4,026) |
| **Balance at 31 December 2015** | **68,000** | **2,820** | **812** | **(26,368)** | **45,264** |

These separate financial statements have been approved by the Management Board of Tokuda Bank AD on 06 April 2016.

Vanya Vassileva
Chairperson of Management Board and Executive Director

Boian Ikonomov
Member of Management Board and Executive Director

Svetlin Todorov
Finance Director

ТОКУДА БАНК АД СОФИЯ

The accompanying notes are an integral part of these separate financial statements.

СПЕЦИАЛИЗИРАНО ОДИТОРСКО ПРЕДПРИЯТИЕ София Рег. №033 "Делойт Одит" ООД

06/04/2016

TOKUDA BANK AD

## SEPARATE STATEMENT OF CASH FLOWS
For the year ended December 31, 2015
All amounts are in thousand BGN, unless otherwise stated

| | Note | Year ended 31 December 2015 | Year ended 31 December 2014 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Net loss for the year | | (6,845) | (8,932) |
| Income tax expense | | 6 | 19 |
| Amortization | | 481 | 493 |
| Net impairments and provisions for losses | | 8,055 | 8,943 |
| Net interest income | | (8,784) | (6,931) |
| Dividend income | | (19) | (31) |
| (Gain)/Loss on disposal of property, plant and equipment | | (21) | 38 |
| Provisions | | 22 | 138 |
| Interest income received | | 16,112 | 19,922 |
| Interest expense paid | | (7,923) | (11,560) |
| Dividend income received | | 19 | 31 |
| Currency revaluation of investments held to maturity | | (284) | (587) |
| **Cash flows from operating profit before changes in the operating assets and liabilities** | | **819** | **1,543** |
| Decrease in Trading securities | | 2,592 | 7,776 |
| Decrease in Financial assets available for sale | | 2 | - |
| Decrease/(Increase) in loans and receivables from customers | | 15,889 | (5,555) |
| (Increase)/Decrease of non-current assets held for sale | | 165 | (1,291) |
| Increase of other assets | | (79) | (1,358) |
| Decrease of receivables under repurchase agreements | | - | (1,456) |
| Decrease of financial liabilities held for trading | | - | (1,370) |
| Increase/(Decrease) of deposits from credit institutions | | 413 | (782) |
| Increase/(Decrease) of deposits from clients other than credit institutions | | (7,326) | 34,330 |
| Increase/(Decrease) of other liabilities | | (1,895) | 1,338 |
| **Net cash flow (used in)/generated by operating activities** | | **9,761** | **31,632** |
| **Cash flows from investing activities** | | | |
| Payments for acquisition of investment held to maturity | | (30,734) | (26,462) |
| Proceeds from investments held to maturity | | 13,290 | 17,922 |
| Proceeds from financial assets available for sale | | 11,097 | 8,066 |
| Payments for acquisition of property, plant and equipment | | (153) | (285) |
| Proceeds from sale of property, plant and equipment | | 104 | 3 |
| Payments for acquisition of intangible assets | | (237) | (45) |
| **Net cash flow used in investing activities** | | **(6,633)** | **(801)** |
| **Cash flows from financing activities** | | | |
| Repayments of borrowings | | - | (38) |
| **Net cash flow used in financing activities** | | - | **(38)** |
| **Net increase of cash and cash equivalents** | | **3,947** | **32,336** |
| **Cash and cash equivalents at the beginning of the year** | | **101,062** | **68,726** |
| **Cash and cash equivalents at the end of the year** | 27 | **105,009** | **101,062** |

These separate financial statements have been approved by the Management Board of Tokuda Bank AD on 06 April 2016.

Vanya Vassileva
Chairperson of Management Board and Executive Director

Boian Ikonomov
Member of Management Board and Executive Director

Svetlin Todorov
Finance Director

The accompanying notes are an integral part of these separate financial statements.

This document is a translation of the original Bulgarian text, in case of divergence the Bulgarian text shall prevail.

## 1. ORGANIZATION AND OPERATIONS

Tokuda Bank AD (the Bank) is a joint stock company registered in the Republic of Bulgaria on December 27, 1994. The Bank's registered address is 3, Graf Ignatiev Street, Sofia.

As of December 31, 2015 the issued share capital amounts to BGN 68,000,000 (sixty eight million levs), comprising 6,800,000 (six million and eight hundred thousands) registered voting shares with face value of BGN 10 (ten) per share.

As of December 31, 2015 the major shareholder of the Bank is Tokushukai Incorporated, holding 99.72%.

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

The 2015 and 2014 activity of the Bank mainly consists of rendering of banking services related to granting loans to private companies, attracting deposits from customers, servicing of client payments both locally and internationally, performing transactions with government securities and securities under repurchase agreements, as well as other financial services in Bulgaria.

The Bank has a two-tier management system, consisting of Management Board and Supervisory Board. Two of the members of the Management Board are Executive Directors of the Bank.

In 2015 the Bank operates through its Head Office and 29 offices, points of services and representative offices (2014: 29). As of December 31, 2015 the Bank has 255 employees (2014: 260).

## 2. BASIS FOR PREPARATION OF THE SEPARATE FINANCIAL STATEMENTS

### 2.1 General

These separate financial statements have been prepared for general purposes for the year ended December 31, 2015. The separate financial statements are presented in thousand Bulgarian Levs (BGN'000).

These separate financial statements have been prepared in accordance with the Bulgarian national legislation. The Bank's operations are regulated by the Law on Credit Institutions, BNB Ordinances, applicable regulations of the European Union. BNB supervises and monitors the compliance with the banking legislation.

The Bank owns 100% the subsidiary Tokuda Security EOOD, Sofia, Republic of Bulgaria. According to the requirements of IAS 27 Consolidated and Separate Financial Statements, the Bank prepares consolidated financial statements which is approved by the Board on April 6, 2016.

### 2.2 Accounting convention

These financial statements have been prepared on the historical cost convention, except for the securities held for trading, investments available for sale and derivatives, which are presented at fair value (see note 3.2). Loans, receivables and financial assets held to maturity are presented at amortized cost.

These separate financial statements are prepared in all material aspects in accordance with International Financial Reporting Standards (IFRS), issued by the International Accounting Standards Board (IASB) and the interpretations, issued by the International Financial Reporting Interpretations Committee (IFRIC), as adopted by the European Union (EU) and applicable in the Republic of Bulgaria.

## 2. BASIS FOR PREPARATION OF THE SEPARATE FINANCIAL STATEMENTS (CONTINUED)

### 2.3 Changes in IFRS

*Initial application of new amendments to the existing Standards and Interpretations effective for the current financial period*

The following new amendments to the existing standards and new interpretation issued by the International Accounting Standards Board (IASB) and adopted by the EU are effective for the current financial period:

- Amendments to various standards "Improvements to IFRSs (cycle 2011-2013)" resulting from the annual improvement project of IFRS (IFRS 3, IFRS 13 and IAS 40) primarily with a view to removing inconsistencies and clarifying wording - adopted by the EU on December 18, 2014 (amendments are to be applied for annual periods beginning on or after January 1, 2015),
- IFRIC 21 "Levies" adopted by the EU on June 13, 2014 (effective for annual periods beginning on or after June 17, 2014).

The adoption of these amendments to the existing standards and interpretation has not led to any changes in the Bank's accounting policy.

*Amendments to the existing Standards issued by IASB and adopted by the EU but not yet effective*

**At the date of authorisation of these financial statements the following amendments to the existing standards issued by IASB and adopted by the EU were in issue but not yet effective:**

- Amendments to various standards "Improvements to IFRSs (cycle 2010-2012)" resulting from the annual improvement project of IFRS (IFRS 2, IFRS 3, IFRS 8, IFRS 13, IAS 16, IAS 24 and IAS 38) primarily with a view to removing inconsistencies and clarifying wording - adopted by the EU on December 17, 2014 (amendments are to be applied for annual periods beginning on or after February 1, 2015),
- Amendments to IAS 16 "Property, Plant and Equipment" and IAS 41 "Agriculture" - Agriculture: Bearer Plants - adopted by the EU on November 23, 2015 (effective for annual periods beginning on or after January 1, 2016),
- Amendments to IAS 16 "Property, Plant and Equipment" and IAS 38 "Intangible Assets" - Clarification of Acceptable Methods of Depreciation and Amortisation - adopted by the EU on December 2, 2015 (effective for annual periods beginning on or after January 1, 2016),
- Amendments to IAS 19 "Employee Benefits" - Defined Benefit Plans: Employee Contributions - adopted by the EU on December 17, 2014 (effective for annual periods beginning on or after February 1, 2015),
- Amendments to IFRS 11 "Joint Arrangements" – Accounting for Acquisitions of Interests in Joint Operations adopted by the EU on November 24, 2015 (effective for annual periods beginning on or after January 1, 2016).
- Amendments to IAS 1 "Presentation of Financial Statements" - Disclosure Initiative – adopted by the EU on December 18, 2015 (effective for annual periods beginning on or after January 1, 2016),
- Amendments to IAS 27 "Separate Financial Statements" - Equity Method in Separate Financial Statements - adopted by the EU on December 18, 2015 (effective for annual periods beginning on or after January 1, 2016),
- Amendments to various standards "Improvements to IFRSs (cycle 2012-2014)" resulting from the annual improvement project of IFRS (IFRS 5, IFRS 7, IAS 19 and IAS 34) primarily with a view to removing inconsistencies and clarifying wording - adopted by the EU on December 15, 2015 (amendments are to be applied for annual periods beginning on or after January 1, 2016).

*New Standards and amendments to the existing Standards issued by IASB but not yet adopted by the EU*

At present, IFRS as adopted by the EU do not significantly differ from regulations adopted by the IASB except from the following new standards and amendments to the existing standards, which were not endorsed for use in EU as at the date of publication of financial statements:

## 2. BASIS FOR PREPARATION OF THE SEPARATE FINANCIAL STATEMENTS (CONTINUED)

### 2.3. Changes in IFRS (continued)

- IFRS 9 Financial Instruments (effective for annual periods beginning on or after January 1, 2018);
- IFRS 14 "Regulatory Deferral Accounts" (effective for annual periods beginning on or after January 1, 2016) - the European Commission has decided not to launch the endorsement process of this interim standard and to wait for the final standard,
- IFRS 15 "Revenue from Contracts with Customers" and further amendments (effective for annual periods beginning on or after January 1, 2018),
- IFRS 16 "Leases" (effective for annual periods beginning on or after 1 January 2019),
- Amendments to IFRS 10 "Consolidated Financial Statements" and IAS 28 "Investments in Associates and Joint Ventures" - Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (effective for annual periods beginning on or after January 1, 2016),
- Amendments to IFRS 10 "Consolidated Financial Statements", IFRS 12 "Disclosure of Interests in Other Entities" and IAS 28 "Investments in Associates and Joint Ventures" - Investment Entities: Applying the Consolidation Exception (effective for annual periods beginning on or after January 1, 2016),

The Bank anticipates that the adoption of these standards and amendments to the existing standards will have no material impact on the financial statements of the Bank in the period of initial application, except:

- IFRS 9 Financial Instruments uses a single approach to determine whether a financial asset is measured at amortised cost or fair value, replacing the many different rules in IAS 39. The approach in IFRS 9 is based on how the Bank manages its financial instruments (its business model) and the contractual cash flow characteristics of the financial assets. The new standard also requires a single impairment method to be used, replacing the many different impairment methods in IAS 39.

At the same time, hedge accounting regarding the portfolio of financial assets and liabilities, whose principles have not been adopted by the EU, is still unregulated.

According to the Bank's estimates, application of hedge accounting for the portfolio of financial assets or liabilities pursuant to IAS 39: Financial Instruments: Recognition and Measurement, would not significantly impact the financial statements, if applied as at the reporting date.

### 2.4 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 and increase of share capital, which will create conditions for generating future income.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### 3.1 Accounting estimates and accounting assumptions

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 separate financial statements and the actual results may differ from these estimates.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 3.1. Accounting estimates and accounting assumptions (continued)

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

- Allowance for impairment of loans and receivables from customers – to determine the amount of allowance for impairment of loans and receivables from customers the Bank measures the recoverable amount of the assets. This process requires assumptions related to expected future cash flows, collateral values, and anticipated time of collateral realization. Note 29.2 describes the process applied by the Bank to manage the credit risk and to determine the allowance for impairment of loans and receivables.
- Measurement of fair value of financial assets and financial liabilities carried at fair value – note 29.5 discloses detailed information for the main methods and assumptions for measurement and disclose of fair value;
- Useful lives of property, plant and equipment and intangible assets – the Bank reviews the useful lives of these assets at the end of each reporting period and changes their useful lives, if needed. In 2015 there were no changes in the useful lives of these assets.

The entire 2015 passed in the conditions of the continuing economic crisis which determines that the Bank continues its operations in uncertain market environment. As a result, the amount of impairment losses on loans and advances, financial assets available for sale, other financial instruments, as well as the values of other accounting estimates in subsequent reporting periods may differ substantially from those measured and reported in these separate financial statements. The recoverability of the loans and the adequacy of the recognized impairment losses, as well as the maintaining of the Bank's liquidity ratios depend on the financial position of the borrowers and their ability to settle their obligations at contracted maturity in subsequent reporting periods. The Bank's management applies the necessary procedures to manage these risks, as disclosed in note 29.

### 3.2. Financial assets

<u>Financial assets at fair value through profit or loss</u>

Financial assets at fair value through profit or loss are securities, which upon initial recognition are designated as measured at fair value through profit or loss. This group includes financial assets with quoted prices in an active market. Securities measured at fair value through profit or loss are subsequently revalued at fair value.

Differences between the carrying amounts of securities sold and their selling price is recorded in the statement of comprehensive income as net gain or loss on dealings with financial assets at fair value through profit or loss. Any changes in the securities' fair value are reported in statement of comprehensive income as profit or loss. Interest earned, whilst holding the securities, is reported as gain on dealings in financial assets at fair value through profit or loss.

As of December 31, 2015 and 2014 the Bank has no such assets.

<u>Financial assets and liabilities held for trading</u>

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 of December 31, 2015 financial assets held for trading consist of Bulgarian government securities . As of December 31, 2014 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, i.e. the date on which the Bank engages to purchase or sale the asset.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 3.2. Financial assets (continued)

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 of December 31, 2015 and 2014 there are 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, i.e. when the Bank commits to buy the asset or the asset matures.

Financial assets available for sale

Financial assets available for sale 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 valued 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, i.e. when the Bank commits to buy or sale the asset.

Loans and receivables

The accounting policy with regards to loans and receivables is described in note 3.3.

Cash and cash equivalents

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

Derecognition and netting of financial assets

A financial asset is derecognized on the value date when the Bank no longer has control over the contractual rights and transfers substantially all risks of ownership of the asset such as: the Bank realizes the rights, the rights expire, or when the rights are bought out. A financial liability is derecognized when it is paid off.

Financial assets and financial liabilities are netted and the net carrying amount is reported in the statement of financial position when the Bank is legally entitled to offset the recognized amounts and the transactions are to be settled on a net basis.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 3.2 Financial assets (continued)

Off-balance financial instruments

In its operations the Bank has off-balance sheet financial instruments comprising mainly financial guarantees and letters of credit. Such financial instruments are reported in the statement of financial position upon utilization of the funds.

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, 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 is not in themselves evidence for impairment without the existence of other indicators.

### 3.3 Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments, which are not quoted in an active market and are not classified in the other groups. These financial assets are carried at amortized cost, by using the effective interest rate method, less allowance for impairment and uncollectability.

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 expositions with similar credit risk characteristics and no objective evidence of impairment, the Bank estimates portfolio impairments (incurred but not reported loss).

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

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 3.4 Receivables and payables under repurchase agreements (repo deals)

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

### 3.5. Property, plant and equipment and intangible assets

Property (land and buildings) is reported in the statement of financial position at acquisition cost less accumulated depreciation/amortization and impairment loss, if any. Upon first-time adoption of IFRS the Bank has determined the fair value of property held as of that date and treated this fair value as deemed cost of the property as of the date of transition to IFRS. Deemed cost is considered acquisition cost of these properties as of this date.

Equipment and fixtures and fittings are reported at acquisition cost less accumulated depreciation and impairment loss, if any. Acquisition cost includes purchase price and all direct costs for acquisition.

Intangible assets are reported at acquisition cost less accumulated amortization and impairment loss, if any.
Leasehold improvements for rented offices are amortized in accordance with the rent agreement term.

Property, plant, equipment and intangible assets are periodically reviewed for impairment when indicators for impairment exist. When the carrying amount of the asset is higher than its expected recoverable amount, the asset is impaired and the Banks recognizes impairment loss. When the fixed assets are sold the difference between the carrying amount and the sale price is reported as profit or loss in the current period.

Depreciation of property and equipment is accrued according to the straight-line method and during 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 improvements | According to the term of the agreement but not higher than 33.3% |

### 3.6. Interest income and expense

Interest income and expense is recognized on a time proportion basis, using the effective interest rate method by amortization of any difference between the amount at initial recognition of the respective asset or liability and the amount at maturity.

The effective interest rate method is a method for determining the amortized cost of a financial instrument and for allocation of its income/expense for a certain period of time. The effective interest rate is the interest which exactly discounts the expected future cash inflows or outflows (including all fees received and other margins or rebates) for the expected life of the financial instrument or, when appropriate for a shorter period, to its carrying amount.

Interest income from possession of financial assets, reported at fair value, is reported as interest income from financial assets at fair value.

All amounts are in thousand BGN, unless otherwise stated

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 3.7. Fees and commissions

Fees and commissions consist mainly of fees for payment transactions in Bulgarian Levs and foreign currency, fees for servicing deposit accounts, fees for opening of letters of credit and issuing of bank guarantees. The fees and commissions for granting and handling of short and long-term loans, which represent an integral part of the effective income, are recognized as a correction of the interest income. The fees and commissions received under long-term loans are deferred for the period of the loans.

### 3.8. Foreign currency transactions

Transactions, denominated in foreign currencies, have been translated into BGN at the rates of BNB on the date of transaction. Receivables and payables in foreign currencies are revaluated on a daily basis. Receivables and payables denominated in foreign currencies are translated into BGN at reporting date using closing exchange rates of BNB on that date.

| **Currency** | **31.12.2015** | **31.12.2014** |
|---|---|---|
| US Dollars | 1.79007 | 1.60841 |
| Euro | 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 gains or losses resulting from change in exchange rates, arisen from revaluation of receivables, liabilities and from settlement of foreign currency transactions are recognized in the statement of comprehensive income in the period they occurred.

### 3.9. Employee benefits

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

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 Labor 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 licensed actuary using the Projected Unit Credit Method (see 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. Taxation

The Bank accrues taxes in accordance with the Bulgarian legislation. Income tax is computed on the basis of taxable profit for the period, calculated in compliance with the requirements of the tax legislation, related to tax payment/refunding.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 3.10. Taxation (continued)

Tax effect, related to transactions or other events, which are reported in the statement of comprehensive income, is also reported in the statement of comprehensive income, and the tax effect related to transactions or other events, which are reported directly to equity, is also reported directly to equity.

A deferred tax liability is recognized for all taxable temporary differences unless it arises from the initial recognition of an asset or liability in a transaction, which at the time of the transaction affects neither accounting profit nor taxable profit (tax loss).

Deferred tax assets are recognized for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilized. This does not apply to cases where the deferred tax asset arises from the initial recognition of an asset or liability in a transaction, which at the time of the transaction affects neither accounting profit nor taxable profit (tax loss).

Deferred taxes are recognized as income or expense and are included in the net profit for the period except to the extent that the tax arises from a transaction or event which is recognized in the same or different period, directly in equity. Deferred taxes are charged or credited directly to equity when the tax relates to items that are credited or charged in the same or a different period, directly to equity.

### 3.11. Fair value of financial assets and liabilities

Fair values represents the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal market at the measurement date under current market condition. Fair value under IFRS 13 is an exit price regardless of whether the price is directly observable or estimated using another valuation technique.

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.

Note 29.5 presents information about fair value of financial assets and liabilities.

### 3.12. Provisions and contingent liabilities

The amount of provisions for guarantees, credit agreements, pending legal proceedings and other off-balance sheet commitments is recognized as an expense and a liability when the Bank has present legal or constructive obligations, which have arisen as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle that obligation and a reasonable estimate of the amount of the resulting liability can be made. Any loss resulting from recognition of provision for liabilities is recognized in the statement of comprehensive income for the period.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 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 are presented as "Other assets" in accordance with IAS 2 "Inventories" (see also Note 12). These assets are collaterals which the Bank acquired from borrowers who became insolvent. The Bank's policy is to sell the acquired collaterals when the Bank finds profitable enough market for them.

### 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 plan to sell the asset;
  - Active program to locate a buyer and complete the plan is initiated;
  - 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 asset 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.

### 3.15. Comparative information

The presentation and classification of items in the separate financial statements is retained in different reporting periods to ensure comparability of information. The comparative information in the separate financial statements is changed if any of the following factors apply:

- As a result of a significant change in the Bank's operations or after reviewing the financial statements management has determined that other presentation or classification will be more appropriate;
- Certain IFRS requires change in presentation;
- Correction of error from prior reporting period;
- Change in accounting policy.

If any of these factors apply, the comparative information for each reporting period is changed to achieve comparability of information.

## 4. CASH AND CASH BALANCES WITH CENTRAL BANKS

| in BGN thousand | 2015 | 2014 |
|---|---|---|
| Cash in hand | 8,295 | 8,188 |
| Cash with the Central bank | 80,089 | 81,797 |
| **Total** | 88,384 | 89,985 |

Cash with the Central bank as of December 31, 2015 and 2014 include minimum non-interest bearing reserves at the amount of BGN 39,117 thousand and BGN 39,117 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 141 thousand and BGN 157 thousand, respectively. There are no limitations imposed by the Central bank for using the minimum reserves. The amount of the reserves depends on the deposits attracted by the Bank.

## 5. LOANS AND RECEIVABLES FROM CREDIT INSTITUTIONS

Loans and receivables from credit institutions by types of counterparty are as follows:

| in BGN thousand | 2015 | 2014 |
|---|---|---|
| Nostro accounts with domestic credit institutions | 281 | 204 |
| Deposits with domestic credit institutions | 8,552 | 49 |
| Nostro accounts with foreign credit institutions | 7,792 | 10,824 |
| **Total** | 16,625 | 11,077 |

Deposits to credit institutions as of December 31, 2015 and 2014 have maturity within 3 months.

## 6. FINANCIAL ASSETS HELD FOR TRADING

| in BGN thousand | 2015 | 2014 |
|---|---|---|
| Bulgarian government bonds | 19,746 | 28,240 |
| Eurobonds of local governments | 8,084 | - |
| Corporate bonds of domestic and foreign issuers | - | 2,034 |
| Shares and participations of domestic enterprises | 111 | 153 |
| **Total** | 27,941 | 30,427 |

## 7. FINANCIAL ASSETS AVAILABLE FOR SALE

| in BGN thousand | 2015 | 2014 |
|---|---|---|
| Shares and participations of domestic enterprises | 163 | 165 |
| Allowance for impairment | (77) | (77) |
| Bulgarian government bonds | 44,134 | - |
| Eurobonds of local governments | 20,268 | - |
| Foreign government securities | 17,511 | - |
| Eurobonds of foreign governments | 3,824 | - |
| Corporate bonds of domestic and foreign issuers | 7,622 | - |
| | 93,445 | 88 |

On December 31, 2015 all held to maturity investments were reclassified (note 9). As of December 31, 2015 securities with carrying amount of BGN 20,702 thousand are pledged as collateral with BNB to secure attracted funds from the State budget

## 8. LOANS AND RECEIVABLES FROM CUSTOMERS

### 8.1. Analysis by type of customers

| in BGN thousand | 2015 | 2014 |
|---|---|---|
| Private entities | 164,224 | 176,127 |
| Households and individuals | 38,731 | 37,294 |
| State budget | 250 | 278 |
| Financial entities | 14 | 5,263 |
| Finance lease | 122 | 6,118 |
| | 203,341 | 225,080 |
| Allowance for uncollectibility | (23,089) | (17,481) |
| **Total** | **180,252** | **207,599** |

### 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:

| in BGN thousand | 2015 | 2014 |
|---|---|---|
| Consumer loans | 28,324 | 29,186 |
| Manufacturing | 42,675 | 42,688 |
| Construction | 16,211 | 18,412 |
| Trade | 34,864 | 38,945 |
| Agriculture | 12,985 | 12,504 |
| Health sector | 12,916 | 13,421 |
| Tourism | 14,602 | 18,795 |
| Transportation | 3,397 | 3,642 |
| Operations with real estate | 5,322 | 3,596 |
| Finance | 14 | 5,263 |
| State budget | 250 | 278 |
| Other sectors | 31,781 | 38,350 |
| | 203,341 | 225,080 |
| Allowance for uncollectibility | (23,089) | (17,481) |
| **Total** | **180,252** | **207,599** |

In 2015 and 2014 receivables on loans written-off against allowances for impairment and uncollectibility are at the amount of BGN 341 thousand and BGN 1,907 thousand.

Movement of impairment losses is as follows:

| in BGN thousand | 2015<br>Loans and receivables | 2014<br>Loans and receivables |
|---|---|---|
| **Balance as at January 1** | **17,481** | **12,400** |
| Additional allowances for impairment losses | 9,217 | 12,373 |
| Reversals | (3,268) | (5,385) |
| Written off receivables | (341) | (1,907) |
| **Balance as at December 31** | **23,089** | **17,481** |

## 9. INVESTMENTS HELD TO MATURITY

| in BGN thousand | **2015** | **2014** |
|---|---|---|
| Bulgarian government bonds | - | 49,378 |
| Foreign government securities | - | 19,549 |
| Corporate bonds of domestic and foreign issuers | - | 15,762 |
| **Total** | - | **84,689** |

As of December 31, 2014 securities with carrying amount of BGN 22,907 thousand respectively, are pledged as collateral with BNB to secure attracted funds from the State budget.

On December 31, 2015 pursuant to the decision of the Management board all held to maturity investments were reclassified as financial assets available for sale. The difference between the carrying amount and the fair value (BGN 3,017 thousand positive and BGN 197 thousand negative revaluation) of the reclassified debt instruments as of December 31, 2015 is accounted for as revaluation reserve. The net positive revaluation reserve as of December 31, 2015 is at the amount of BGN 2,820 thousand.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
For the year ended December 31, 2015
All amounts are in thousand BGN, unless otherwise stated

## 10. PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLE ASSETS

| in BGN thousand | Land and buildings | Office equipment | Vehicles | Fixture and fittings | Other assets | Intangible assets | Assets under construction | Total |
|---|---|---|---|---|---|---|---|---|
| **Cost** | | | | | | | | |
| 01 January 2014 | 2,746 | 2,650 | 973 | 568 | 593 | 843 | 79 | 8,452 |
| Additions | - | 170 | - | 40 | 75 | 47 | - | 332 |
| Disposals | - | (427) | - | (49) | (213) | (24) | - | (713) |
| Sold | - | (2) | - | (1) | - | - | - | (3) |
| Transfers | - | (2) | - | 2 | - | - | - | - |
| 31 December 2014 | 2,746 | 2,389 | 973 | 560 | 455 | 866 | 79 | 8,068 |
| Additions | - | 114 | - | 3 | 36 | 237 | - | 390 |
| Disposals | - | (146) | - | (19) | (15) | - | (79) | (259) |
| Sold | - | (22) | (75) | (7) | - | - | - | (104) |
| Transfers | - | - | - | - | - | - | - | - |
| 31 December 2015 | 2,746 | 2,335 | 898 | 537 | 476 | 1,103 | - | 8,095 |
| **Accumulated depreciation/amortization** | | | | | | | | |
| 01 January 2014 | (507) | (2,216) | (783) | (457) | (366) | (214) | - | (4,543) |
| Charged during the year | (60) | (158) | (41) | (48) | (56) | (130) | - | (493) |
| Written off | - | 427 | - | 48 | 176 | 22 | - | 673 |
| 31 December 2014 | (567) | (1,947) | (824) | (457) | (246) | (322) | - | (4,363) |
| | - | - | - | - | - | - | - | - |
| Charged during the year | (60) | (159) | (41) | (34) | (57) | (130) | - | (481) |
| Written off | - | 166 | 75 | 24 | 15 | - | - | 280 |
| 31 December 2015 | (627) | (1,940) | (790) | (467) | (288) | (452) | - | (4,564) |
| Net book value | | | | | | | | |
| 31 December 2014 | 2,179 | 442 | 149 | 103 | 209 | 544 | 79 | 3,705 |
| 31 December 2015 | 2,119 | 395 | 108 | 70 | 188 | 651 | - | 3,531 |

## 11. INVESTMENTS IN SUBSIDIARIES

Investments in subsidiaries as of December 31, 2015 and 2014 are as follows:

| in BGN thousand | Share | | Carrying amount | |
|---|---|---|---|---|
| Company | 2015 | 2014 | 2015 | 2014 |
| „Tokuda Security" EOOD | 100% | 100% | 25 | 25 |
| **Total** | | | 25 | 25 |

Investments in subsidiaries are presented at carrying amount (cost) in these separate financial statements. The subsidiary is established in 2013.

The summarized financial information of the subsidiary as of December 31, 2015 and 2014 is, as follows:

| **„Tokuda Security" EOOD** | **2015** | **2014** |
|---|---|---|
| Total assets | 17 | 19 |
| Total liabilities | (3) | (3) |
| Net assets | 14 | 16 |
| Bank's share in the net assets of the subsidiary | 100% | 100% |

## 12. OTHER ASSETS

| in BGN thousand | 2015 | 2014 |
|---|---|---|
| Assets acquired from non-performing loans | 10,840 | 8,867 |
| Allowance for impairment of assets acquired by the non-performing loans | (1,744) | (660) |
| Other assets | 1,581 | 1,683 |
| Impairment of other assets | (1,393) | (1,409) |
| Vat recoverable | - | 234 |
| Deferred expenses | 196 | 122 |
| Guarantee deposits | 68 | 67 |
| Advance payments | 398 | 59 |
| **Total** | 9,946 | 8,963 |

Movement of impairment of assets and other assets acquired by non-performing loans is presented in the tables below:

| **Movement of impairment of other assets** | **2015** | **2014** |
|---|---|---|
| **Balance as of 1 January** | 1,409 | - |
| Additional allowances for impairment losses | 21 | 1,409 |
| Reversals | (37) | - |
| Written off receivables | - | - |
| **Balance as of 31 December** | 1,393 | 1,409 |

| **Movement of impairment of assets acquired from non-performing loans** | **2015** | **2014** |
|---|---|---|
| **Balance as of 1 January** | 660 | 94 |
| Impairment losses related to assets reclassified from held for sale | - | 98 |
| Additional allowances for impairment losses | 1,084 | 468 |
| **Balance as of 31 December** | 1,744 | 660 |

## 13. NON-CURRENT ASSETS HELD FOR SALE

| in BGN thousand | 2015 | 2014 |
|---|---|---|
| Balance at the beginning of the year | 3,752 | 7,455 |
| Acquisitions during the year | 6,558 | 1,291 |
| Disposals during the year | (165) | - |
| Transferred assets, acquired from ordinary activities (non-performing loans) | (1,973) | (4,993) |
| Allowance for impairment | (1,037) | (1) |
| **Balance at the end of the year** | 7,135 | 3,752 |

In 2015 the Bank terminated defaulted finance lease contract and acquired back assets at the amount of BGN 5,987 thousand. In 2014 the Bank acquired assets worth BGN 1,200 thousand of a contract for transfer of ownership rather than performance.

## 14. DEPOSITS FROM CREDIT INSTITUTIONS

| in BGN thousand | 2015 | 2014 |
|---|---|---|
| Deposits from credit institutions | 563 | 149 |
| | 563 | 149 |

Term deposits from credit institutions received as of December 31, 2015 and 2014 have maturity within 3 months.

## 15. DEPOSITS FROM CLIENTS OTHER THAN CREDIT INSTITUTIONS

| in BGN thousand | 2015 | 2014 |
|---|---|---|
| Individuals deposits | | |
| - Demand and savings deposits | 71,882 | 63,439 |
| - Term deposits | 174,974 | 200,513 |
| State budget funds | | |
| - Demand deposits | 13,995 | 19,682 |
| Corporate deposits | | |
| - Demand deposits | 86,920 | 65,577 |
| - Term deposits | 18,769 | 19,714 |
| Other non-bank financial institutions deposits | | |
| - Demand deposits | 420 | 474 |
| - Term deposits | 12,912 | 17,991 |
| | 379,872 | 387,390 |

## 16. TAX ASSETS AND LIABILITIES

### 16.1. Tax assets

As of December 31, 2015 and 2014 the Bank does not recognize deferred tax assets on accumulated tax loss of BGN 12,805 thousand and BGN 11,048 thousand respectively, due to the fact that there is uncertainty regarding future taxable profits against which it can be utilized.

31 December 2015 unrecognized deferred tax assets are as follows:

| Tax loss occurred in | Amount | Unrecognized tax asset | Expiring in |
|---|---|---|---|
| 2012 | 1,208 | 121 | 2017 |
| 2013 | 1,725 | 173 | 2018 |
| 2014 | 8,115 | 811 | 2019 |
| 2015 | 1,757 | 176 | 2020 |
| **Total** | **12,805** | **1,281** | |

| Other temporary differences | Amount | Unrecognized tax asset |
|---|---|---|
| Financial assets available for sale | 2,819 | 282 |
| Impairment on assets | 2,781 | 278 |
| | 5,600 | 560 |

### 16.2. Tax liabilities

As of December 31, 2015 and 2014 tax liabilities consist of deferred tax liabilities, arisen from the following temporary tax differences:

| in BGN thousand | 2015 | 2014 |
|---|---|---|
| Deferred tax assets: | | |
| Unused paid leave | 14 | 14 |
| Long-term employee benefits | 25 | 26 |
| **Total deferred tax assets** | **39** | **40** |
| Deferred tax liabilities: | | |
| Differences between accounting and tax amortization and depreciation | (128) | (123) |
| **Total deferred tax liabilities** | **(128)** | **(123)** |
| **Deferred tax liabilities, net** | **(89)** | **(83)** |

Deferred tax assets and liabilities as of December 31, 2015 and 2014 are calculated using tax rate of 10 % according to the Corporate Income Tax Act and applicable for the periods when the temporary differences are expected to be realized.

## 17. OTHER LIABILITIES

| in BGN thousand | 2015 | 2014 |
|---|---|---|
| Ongoing bank transfers | 436 | 715 |
| Unused paid leave | 116 | 120 |
| Impairment for long-term employee benefits | 251 | 258 |
| Liabilities to Commercial bank Victoria AD | - | 1,847 |
| Other liabilities | 693 | 458 |
| | 1,496 | 3,398 |

Ongoing bank transfers represent liabilities on money transfers ordered by customers in the last day of 2015 and 2014 respectively, with value date within two days. The transfers are processed up to the second working day of 2016 and 2015, respectively.

As of December 31, 2014 liabilities to Commercial bank Victoria AD represent amounts due under two contracts for the assignment of loans.

According to the provisions of the Labor Code, the Bank is obliged to compensate employees upon retirement with two gross salaries. If the employee has worked for the Bank in the last ten years the compensation amounts to six gross salaries. As of December 31, 2015 and 2014 the Bank has accrued long-term employee benefits at the amount of BGN 251 thousand and BGN 258 thousand, respectively. The provision amount has been determined by a licensed actuary.

Underlying assumptions used by the licensed actuary at determining the present value of the liability are as follows:

- Demographic assumptions;
- Mortality table and disability probability;
- Turnover rate – 0.21;
- Financial assumptions, salary growth;
- Discount rate – due to the long-term nature of the payable, annual discount rate of 2.91 % has been applied.

## 18. EQUITY AND RESERVES

### 18.1. Share capital

As of December 31, 2015 and 2014 the Bank's share capital is fully paid in and is distributed in registered, voting shares, as follows:

| in BGN thousand | 2015 | 2014 |
|---|---|---|
| Number of shares | 6,800 | 6,800 |
| Share nominal in BGN | 10 | 10 |
| **Share capital** | 68,000 | 68,000 |

In 2015 International Hospital Services merged into Tokushukai Incorporated.

As of December 31, 2015 and 2014 the Bank's shareholder structure is as follows:

| | 2015 | % | 2014 | % |
|---|---|---|---|---|
| International Hospital Services | - | 0.00 | 6,767,950 | 99.53 |
| Tokushukai Incorporated | 6,767,950 | 99.53 | - | 0.00 |
| Garant and Co 97 AD | 15,000 | 0.22 | 15,000 | 0.22 |
| A U C Establishment | 13,300 | 0.20 | 13,300 | 0.20 |
| MM Holding AD | 3,750 | 0.06 | 3,750 | 0.06 |
| **Total shares** | 6,800,000 | 100 | 6,800,000 | 100 |

## 18. EQUITY AND RESERVES (CONTINUED)

### 18.2. Reserves

According to the Bulgarian legislation the Bank is required to establish Reserve Fund by distribution of part of its profit until the amount of the reserve becomes 1/10 or higher of the share capital, as determined by the Bank's Statute.

The Reserve Fund is used only for covering losses for the current or previous years. When the amount of the reserves is higher than 1/10 (or the higher proportion determined by the Bank's statute) of the share capital, the excess can be used for share capital increase.

As of December 31, 2015 and 2014 reserves include Reserve Fund at the amount of BGN 812 thousand and BGN 813 thousand, respectively. The revaluation reserve of financial assets available for sale is at the amount of BGN 2,820 thousand (2014: nil)

## 19. INTEREST INCOME/EXPENSE

| in BGN thousand | 2015 | 2014 |
|---|---|---|
| **A. Interest income** | | |
| Interest from financial assets held for trading | 818 | 1,029 |
| Interest from loans and advances to credit institutions | 18 | 21 |
| Interest from repo deals | 13 | 19 |
| Interest from loans and advances to customers | 13,438 | 14,003 |
| Interest from investments held to maturity | 2,199 | 2,972 |
| | 16,486 | 18,044 |

| in BGN thousand | 2015 | 2014 |
|---|---|---|
| **B. Interest expenses** | | |
| Interest on deposits from credit institutions | 1 | 1 |
| Interest on deposits from clients other than credit institutions | 7,701 | 11,110 |
| Interest on loans received | - | 2 |
| | 7,702 | 11,113 |

## 20. FEE AND COMMISSION INCOME/EXPENSE

| in BGN thousand | 2015 | 2014 |
|---|---|---|
| **Fee and commission income** | | |
| Fees and commission income under money transfers | 1,612 | 1,552 |
| Fees receipts under accounts opening and closing | 500 | 481 |
| Fees and commission income under loan transactions | 270 | 456 |
| Fees income under servicing cards | 375 | 331 |
| Commission income under cash balances | 347 | 276 |
| Service guarantees | 139 | 197 |
| Other | 657 | 728 |
| | 3,900 | 4,021 |

## 20. FEE AND COMMISSION INCOME/EXPENSE (CONTINUED)

| Fee and commission expense | 2015 | 2014 |
|---|---|---|
| Fees for service of cards | 227 | 205 |
| Fees for money transfers | 28 | 28 |
| Insurances fees | 22 | 26 |
| Fees for opening and servicing of accounts | 29 | 24 |
| Fees to register securities | 18 | 14 |
| Other | 24 | 42 |
| | 348 | 339 |
| | | |
| **Net fee and commission income** | 3,552 | 3,682 |

## 21. NET PROFIT/ (LOSSES) ON FINANCIAL ASSETS AND LIABILITIES HELD FOR TRADING

| in thousand BGN | 2015 | 2014 |
|---|---|---|
| Loss from sale of securities held for trading | - | (16) |
| Loss from revaluation of securities held for trading | (82) | (61) |
| Gain from foreign exchange differences | 387 | 777 |
| | 305 | 700 |

## 22. OTHER OPERATING INCOME / (EXPENSE)

| in thousand BGN | 2015 | 2014 |
|---|---|---|
| Net losses from foreign currency revaluation | (54) | (438) |
| Profit from sale of investment securities available for sale | 865 | 809 |
| Dividends | 19 | 31 |
| Net loss from disposed assets other than held for sale | (5) | (4) |
| Gain from non-current assets held for sale | 8 | - |
| Other operating income | 55 | 178 |
| | 888 | 576 |

## 23. OPERATING EXPENSES

| in thousand BGN | 2015 | 2014 |
|---|---|---|
| Personnel costs | 5,492 | 5,351 |
| Depreciation and amortisation | 481 | 493 |
| Operating lease rentals | 936 | 1,040 |
| Payments to Deposit Insurance Fund | 1,661 | 1,685 |
| Payments to Bank Restructuring Fund | 343 | - |
| Other expenses | 3,400 | 3,290 |
| | 12,313 | 11,859 |

## 24. IMPAIRMENT AND PROVISIONS FOR LOSSES

Net expenses of depreciation in 2015 and 2014 are presented in the table below:

| in BGN thousand | 2015 | 2014 |
|---|---|---|
| Impairment loss on | | |
| Loans and advances to customers | 5,949 | 6,988 |
| Other assets available for resale | - | 77 |
| Non-current assets held for sale | 1,037 | 1 |
| Other assets | 1,069 | 1,877 |
| **Net Impairments and provisions for losses** | **8,055** | **8,943** |

## 25. INCOME TAX EXPENSE

Current tax expense represents taxes due under the Bulgarian legislation according to the applicable tax rate of 10 % for 2015 and 2014. Deferred tax income/expense arises as a result of a change in the carrying amount of deferred tax assets and liabilities.

Reconciliation between tax expense and the accounting profit is as follows:

| in BGN thousand | 2015 | 2014 |
|---|---|---|
| Current tax expense | - | - |
| Deferred tax expense | (6) | (19) |
| **Total tax expenses** | **(6)** | **(19)** |
| **Reconciliation between loss before tax and tax expense:** | | |
| Loss before income tax | (6,839) | (8,913) |
| Income tax at applicable tax rate of 10 % for 2015 (10% for 2014) | 684 | 891 |
| Tax effect of non-deductible expenses | (20) | (52) |
| Effect of unrecognized deferred tax asset on tax losses available for carry forward | (176) | (811) |
| Tax effect of revaluation of financial assets available for sale | (282) | - |
| Effect of other temporary differences, for which no deferred tax asset is recognized | (212) | (47) |
| **Tax expenses** | **(6)** | **(19)** |

## 26. RELATED PARTIES

As of December 31, 2015 and 2014 the Bank has receivables from, payables to and contingent commitments to related parties, as follows:

| Related parties and balances (in BGN thousand) | 2015 | 2014 |
|---|---|---|
| Majority shareholder | | |
| Deposits received | 27,118 | 656 |
| Companies under common control | | |
| Deposits received | 27,486 | 41,589 |
| Key management personnel | | |
| Loans granted | 30 | 20 |
| Deposits received | 30 | 88 |
| Subsidiaries | | |
| Deposits received | 3 | 2 |
| Other receivables | 3 | 3 |

Income from and expenses for related party transactions, generated by the Bank in 2015 and 2014 are as follows:

| Related parties and type of transactions (in BGN thousand) | 2015 | 2014 |
|---|---|---|
| Majority shareholder | | |
| Income from foreign exchange differences | 6 | - |
| Interest expense | 11 | 47 |
| Companies under common control | | |
| Income from fees and commissions | 233 | 190 |
| Income from foreign exchange differences | 20 | 29 |
| Income from services | 3 | 6 |
| Interest expense | 239 | 536 |
| Expenses for fees and commissions | 2 | 1 |
| Key management personnel | | |
| Interest income | - | 1 |
| Interest expense | - | 1 |
| Other expenses | 1 | 1 |
| Subsidiaries | | |
| Income from services | 1 | 2 |
| Expenses for services | 41 | 42 |

The remuneration to Supervisory Board members in 2015 are at the total amount of BGN 36 thousand (2014: BGN 41 thousand). The remuneration to the Management Board members in 2015 are at total amount of BGN 314 thousand (2014: BGN 287 thousand).

## 27. CASH AND CASH EQUIVALENTS IN THE STATEMENT OF CASH FLOWS

Cash and cash equivalents for the purposes of the statement of cash flows consist of the following balances:

| in BGN thousand | 2015 | 2014 |
|---|---|---|
| Cash in hand (note 4) | 8,295 | 8,188 |
| Cash with the Central bank (note 4) | 80,089 | 81,797 |
| Nostro accounts with domestic credit institutions (note 5) | 281 | 204 |
| Nostro accounts with foreign credit institutions (note 5) | 7,792 | 10,824 |
| Loans and deposits to credit institutions with original maturity up to three months (note 5) | 8,552 | 49 |
| **Total cash and cash equivalents in the statement of cash flows** | **105,009** | **101,062** |

## 28. COMMITMENTS AND CONTINGENCIES

Bank's commitments and contingencies consist of guarantees issued, unutilized loan commitments.

| in BGN thousand | 2015 | 2014 |
|---|---|---|
| Guarantees | 5,017 | 7,952 |
| Undrawn credit commitments | 16,347 | 12,382 |
| | **21,364** | **20,334** |

## 29. FINANCIAL RISK MANAGEMENT

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 main underlying principles in the Bank's risk management policy are:

- segregation of responsibilities between those taking the risk and those managing it;
- the principle of "prudence", which assumes the reporting of the simultaneous occurrence of the worst case for each of the risk-weighted assets;
- the principle of risk management at source.

The risk management organizational structure is centralized and structured in terms of competency 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.

## 29. FINANCIAL RISK MANAGEMENT (CONTINUED)

### 29.1. Financial assets and liabilities

The tables below sets out the carrying amounts and fair values of the Bank's financial assets and financial liabilities:

in BGN thousand

| As of 31 December 2015 | Trading | Loans and receivables | Financial assets available for sale | Other amortised cost | Total carrying amount | Fair value |
|---|---|---|---|---|---|---|
| **Financial assets** | | | | | | |
| Cash and balances with Central Bank | - | 88,384 | - | - | 88,384 | 88,384 |
| Loans and advances to banks | - | 16,625 | - | - | 16,625 | 16,625 |
| Loans and advances to customers | - | 180,252 | - | - | 180,252 | 181,716 |
| Financial assets held for trading | 27,941 | - | - | - | 27,941 | 27,941 |
| Financial assets available for sale | - | - | 93,445 | - | 93,445 | 93,445 |
| **Total assets** | 27,941 | 285,261 | 93,445 | - | 406,647 | 408,111 |
| **Financial liabilities** | | | | | | |
| Deposits from credit institutions | - | - | - | 563 | 563 | 563 |
| Deposits from clients other than credit institutions | - | - | - | 379,872 | 379,872 | 383,806 |
| Other financial liabilities | - | - | - | 436 | 436 | 436 |
| **Total liabilities** | - | - | - | 380,871 | 380,871 | 384,805 |

in BGN thousand

| As of 31 December 2014 | Trading | Loans and receivables | Financial assets available for sale | Held to maturity | Other amortised cost | Total carrying amount | Fair value |
|---|---|---|---|---|---|---|---|
| **Financial assets** | | | | | | | |
| Cash and balances with Central Bank | - | 89,985 | - | - | - | 89,985 | 89,985 |
| Loans and advances to banks | - | 11,077 | - | - | - | 11,077 | 11,077 |
| Loans and advances to customers | - | 207,599 | - | - | - | 207,599 | 211,101 |
| Financial assets held for trading | 30,427 | - | - | - | - | 30,427 | 30,427 |
| Financial assets available for sale | - | - | 88 | - | - | 88 | 88 |
| Investments held to maturity | - | - | - | 84,689 | - | 84,689 | 86,237 |
| **Total assets** | 30,427 | 308,661 | 88 | 84,689 | - | 423,865 | 428,915 |
| **Financial liabilities** | | | | | | | |
| Deposits from credit institutions | - | - | - | - | 149 | 149 | 149 |
| Deposits from clients other than credit institutions | - | - | - | - | 387,390 | 387,390 | 390,364 |
| Other financial liabilities | - | - | - | - | 2,562 | 2,562 | 2,562 |
| **Total liabilities** | - | - | - | - | 390,101 | 390,101 | 393,075 |

## 29. FINANCIAL RISK MANAGEMENT (CONTINUED)

### 29.2 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 manages 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 88,384 thousand and BGN 89,985 thousand, respectively as of December 31, 2015 and 2014 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 credit institutions at the amount of BGN 16,625 thousand and BGN 11,077 thousand, respectively as of December 31, 2015 and 2014 represent mostly deposits in first-class international and Bulgarian financial institutions with maturity up to 7 days. The Bank manages the credit risk associated with advances to banks as sets limits on exposure to counterparty.

Financial assets held for trading at the amount of BGN 27,941 thousand and BGN 30,427 thousand as of December 31, 2015 and 2014, respectively, bear mainly market risk to the Bank, which is described in note 29.4. The maximum exposure to credit risk on these instruments is their carrying amount.

Financial assets available for sale are at the amount of BGN 93,445 thousand and 88 thousand as of December 31, 2015 and 2014. The maximum exposure to credit risk on these instruments is their carrying amount.

As of December 31, 2015 the Bank has no debt securities held to maturity and issued by the Republic of Bulgaria (2014: BGN 49,378 thousand). The maximum exposure to credit risk on these instruments is their carrying amount.

As of December 31, 2015 the Bank has no debt securities held to maturity and issued by foreign governments (2014: BGN 19,549 thousand). The maximum exposure to credit risk on these instruments is their carrying amount.

As of December 31, 2015 the Bank has no debt securities held to maturity and issued by domestic and foreign commercial companies (2014: BGN 15,762 thousand). These securities expose the Bank to credit risk to the carrying amount of the investment, which is managed by periodically monitoring of the financial position of issuers.

The Bank's contingent and non-cancellable arrangements comprise issued guarantees and unutilized funds under loans agreed which amount, as disclosed in note 28, represents the maximum credit exposure of the Bank.

Loans and advances to customers with carrying amount of BGN 180,252 thousand and BGN 207,599 thousand, respectively as of December 31, 2015 and 2014 expose the Bank to credit risk. 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.

In 2015 the Bank introduced improvements in the methodology for allowances for impairment estimation as the classification according to the rules set out in the regulations 2014/680 and 2015/1278 was implemented. The management considers the expositions as non-performing and performing.

**29. FINANCIAL RISK MANAGEMENT (CONTINUED)**

**29.2. Credit risk (continued)**

*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:

- 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.

For portfolios of expositions with similar credit risk characteristics and no objective evidence of impairment, the Bank calculates portfolio impairments (incurred but not reported loss). The impairment amount is calculated taking into account the probability of default, the amortized amount (before impairment) of the exposure, the expected cash inflow from eligible collateral realisation (discounted at the effective interest rate) and the loss identification period.

The impairment amount of significant exposures (whose BGN equivalent of the amortized amount before impairment and unutilized amount exceeds BGN 500 000) with objective evidence of impairment is determined individually on the basis of the expected cash flows from the exposure, as the impairment loss is the difference between the carrying amount of the exposure and its recoverable (present) value (present value of expected cash flows).

The impairment amount of insignificant (whose currency equivalent of amortized cost before impairment and undigested portion does not exceed BGN 500 000) performing exposures with no objective evidence of impairment is determined individually or on a portfolio basis.

To minimize the credit risk in the lending process the Bank applies detailed procedures with respect to the analysis of the economic ground of each project, types of accepted collaterals for the Bank, control over disbursed funds and the related administration. The Bank has adopted and monitors the compliance with the limits for credit exposure by sectors. The objective of these limits is to minimize the loan portfolio concentration, which would lead to increased credit risk.

## 29. FINANCIAL RISK MANAGEMENT (CONTINUED)

### 29.2. Credit risk (continued)

Information on exposure classification groups as of December 31, 2015 is as follows:

| **2015** | Loan granted | | | Unutilized commitment | Issued letters of guarantee | | |
|---|---|---|---|---|---|---|---|
| Group | Amount | % Share | Allowance | Amount | Amount | % Share | Allowance |
| Performing | 120,785 | 59.40 | 591 | 16,347 | 5,017 | 100.00 | - |
| Non-performing | 82,556 | 40.60 | 22,498 | - | - | - | - |
| **Total** | **203,341** | **100.00** | **23,089** | **16,347** | **5,017** | **100.00** | - |

The loans granted by the Bank and receivables from customers can be summarized in the following table:

| in BGN thousand | **Loans and advances to customers** |
|---|---|
| | **2015** |
| **Assets at amortised cost** | |
| **Individually impaired** | |
| Non-performing | 54,319 |
| Carrying amount before impairment | 54,319 |
| Impairment loss | (14,957) |
| **Carrying amount** | **39,362** |
| **Collectively impaired** | |
| Regular | 27,073 |
| Non-performing | 14,928 |
| Carrying amount before impairment | 42,001 |
| Impairment loss | (8,132) |
| **Carrying amount** | **33,869** |
| **Past due but not impaired** | |
| Regular | 17,871 |
| Non-performing | 3,566 |
| Carrying amount before impairment | 21,437 |
| **Carrying amount** | **21,437** |
| **Neither past due nor impaired** | |
| Regular | 75,841 |
| Non-performing | 9,743 |
| Carrying amount before impairment | 85,584 |
| **Carrying amount** | **85,584** |
| **Total carrying amount** | **180,252** |

## 29. FINANCIAL RISK MANAGEMENT (CONTINUED)

### 29.2. Credit risk (continued)

As of December 31, 2014 the Bank classified loans and advances to customers in one of the following categories:

| Group | Category | Main criteria | % risk |
|---|---|---|---|
| I | Regular | Exposures, served on regular basis or with accidental arrears up to 30 days and no other impairment indications. | - |
| II | Watch | Exposures with insignificant breaches in their servicing (arrears from 31 to 90 days) or other indications of deterioration of ability to fully settle the obligation. | up to 10% |
| III | Non-performing | Exposures with significant breaches in the service (arrears from 91 to 180 days) or significant deterioration of ability to settle the obligation. | up to 50% |
| IV | Loss | Exposures, which are expected to become uncollectible, including arrears over 180 days, permanent shortage of cash by the debtor, debtor's bankruptcy or liquidation, litigation and others. | up to 100% |

The allowance for impairment and uncollectability of loans and receivables as of December 31,2014 was determined on the basis of the risk classification of the exposure, according to the criteria described above and the estimated cash flows from realization of collaterals on exposures.

As of December 31, 2014 the Bank's loans and receivables from customers can be summarized in the following table:

| in BGN thousand | Loans and advances to customers 2014 |
|---|---|
| Assets at amortised cost | |
| **Individually impaired** | |
| Watch | 315 |
| Non-performing | 2,570 |
| Loss | 42,187 |
| Carrying amount before impairment | 45,072 |
| Impairment loss | (17,481) |
| **Carrying amount** | **27,591** |
| | |
| **Past due but not impaired** | |
| Regular | 10,799 |
| Watch | 14,785 |
| Non-performing | 6,845 |
| Loss | 10,964 |
| Carrying amount before impairment | 43,393 |
| **Carrying amount** | **43,393** |
| | |
| **Neither past due nor impaired** | |
| Regular | 124,582 |
| Watch | 1,194 |
| Non-performing | 5,782 |
| Loss | 5,057 |
| Carrying amount before impairment | 136,615 |
| **Carrying amount** | **136,615** |
| | |
| **Total carrying amount** | **207,599** |

## 29. FINANCIAL RISK MANAGEMENT (CONTINUED)

### 29.2. Credit risk (continued)

An analysis of past due and individually impaired loans and advances to customers is given in the table below:

| in BGN thousand | 2015 | | 2014 | |
|---|---|---|---|---|
| | **Past due but not impaired** | **Impaired** | **Past due but not impaired** | **Impaired** |
| Without arrears | - | 51,714 | - | 14,606 |
| Arrears up to 30 days | 16,080 | 5,822 | 15,726 | 617 |
| Arrears from 31 to 60 days | 1,123 | 7,364 | 5,248 | 8 |
| Arrears from 61 to 90 days | 757 | 262 | 4,981 | 324 |
| Arrears from 91 to 180 days | 992 | 1,013 | 6,569 | 3,413 |
| Arrears over 180 days | 2,485 | 30,145 | 10,869 | 26,104 |
| Carrying amount | 21,437 | 96,320 | 43,393 | 45,072 |
| Impairment loss | - | (23,089) | - | (17,481) |
| **Carrying amount** | 21,437 | 73,231 | 43,393 | 27,591 |

The following table presents the Bank's portfolio by type of collateral:

| in BGN thousand | **2015** | **2014** |
|---|---|---|
| Secured by cash and government securities | 5,569 | 1,803 |
| Secured by mortgage | 143,525 | 163,310 |
| Pledge of machinery and equipment | 8,650 | 16,871 |
| Pledge of receivables | 15,523 | 15,101 |
| Other collaterals | 26,563 | 24,682 |
| No collateral | 3,511 | 3,313 |
| Impairment loss | (23,089) | (17,481) |
| **Total** | 180,252 | 207,599 |

## 29. FINANCIAL RISK MANAGEMENT (CONTINUED)

### 29.2. Credit risk (continued)

The table below provides information on the credit quality of other financial assets. To determine the quality of these assets are used Fitch's ratings, where this is not available is represented equivalent rating of another rating agency (S & P).

| | 2015 | 2014 |
|---|---|---|
| Cash and cash balances with central banks: | | |
| rating BBB- | 88,384 | 89,985 |
| **Total cash and cash balances with central banks** | **88,384** | **89,985** |
| Loans and receivables from credit institutions | | |
| rating A+ | - | 1,700 |
| rating A | 7,468 | - |
| rating BBB+ | 4,654 | - |
| rating BBB | 324 | - |
| rating BBB- | - | 9,124 |
| rating BB+ | 180 | 90 |
| rating BB | 3,850 | - |
| rating B | 148 | - |
| no rating | 1 | 163 |
| **Total loans and receivables from credit institutions** | **16,625** | **11,077** |
| Financial assets held for trading: | | |
| rating BBB- | 27,830 | 30,274 |
| no rating | 111 | 153 |
| **Total financial assets held for trading** | **27,941** | **30,427** |
| Investments held to maturity | | |
| rating BB | - | 8,057 |
| rating BB+ | - | 4,537 |
| rating BBB- | - | 61,683 |
| rating BBB+ | - | 4,058 |
| no rating | - | 6,354 |
| **Total investments held to maturity** | **-** | **84,689** |
| Financial assets available for sale | | |
| rating BB | 10,085 | - |
| rating BB+ | 6,341 | - |
| rating BBB- | 76,933 | - |
| no rating | 86 | 88 |
| **Total financial assets available for sale** | **93,445** | **88** |

Loans and receivables from credit institutions with no rating are those of local banks, which have no official credit rating.

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

Financial assets held to maturity, for which there are no specified credit rating, are mainly corporate bonds of local issuers, secured by property.

## 29. FINANCIAL RISK MANAGEMENT (CONTINUED)

### 29.2. Credit risk (continued)

***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, 2015 and 2014 is presented in the table below:

| | 2015 BGN'000 | 2015 % of the capital base | 2014 BGN'000 | 2014 % of the capital base |
|---|---|---|---|---|
| The largest total exposure to customer group | 8,377 | 19.58% | 9,197 | 18.89% |
| Total amount of the five largest exposures | 33,652 | 78.67% | 36,262 | 74.47% |
| Total amount of all exposures - over 10% of the capital | 47,311 | 110.60% | 52,924 | 108.69% |

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

### 29.3. Liquidity risk

Liquidity risk arises from the maturity gap of the assets and liabilities and the 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.

Liquidity risk is the risk of inability of the Bank to meet its current and potential liabilities, associated with payments when they fall due, without incurring unacceptable losses.

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, 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, regulated by Ordinance № 11 of the BNB;
- 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.

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.

The main body for liquidity management of the Bank is the Assets and Liabilities Management Committee. 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.

## 29. FINANCIAL RISK MANAGEMENT (CONTINUED)

### 29.3. Liquidity risk (continued)

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 meets its liquidity requirements. As of December 31, 2015 and 2014 cash and cash balances with Central Bank represent 21% and 20%, respectively of total assets of the Bank.

As an additional instrument to provide high liquidity, the Bank uses loans granted and advances to credit institutions. These comprise mostly of deposits in first-class international and Bulgarian credit institutions with maturity up to 7 days. As of December 31, 2015 and 2014 loans and receivables from credit institutions represent 4% and 3%, respectively of total assets of the Bank.

Government securities, issued by the Republic of Bulgaria, owned by the Bank and not pledged as collateral as of December 31, 2015 and 2014 represent 10.0% and 12.4%, respectively of total assets. By maintaining above 31% (2014: 35%) of its assets in highly liquid assets, the Bank ensures the ability to meet its all payment needs on matured financial liabilities.

The gross cash outflow of financial liabilities as of December 31, 2015 is as follows:

| 31.12.2015<br>in BGN thousand | Up to 1 month | From 1 to 3 moths | From 3 months to 1 year | From 1 to 5 years | Over 5 years | Total |
|---|---|---|---|---|---|---|
| Deposits from credit institutions | 563 | - | - | - | - | 563 |
| Deposits from clients other than credit institutions | 200,300 | 39,553 | 106,414 | 37,138 | - | 383,405 |
| Other financial liabilities | 436 | - | - | - | - | 436 |
| **Total financial liabilities** | **201,299** | **39,553** | **106,414** | **37,138** | **-** | **384,404** |

The gross cash outflow of financial liabilities as of December 31, 2014 is as follows:

| 31.12.2014<br>in BGN thousand | Up to 1 month | From 1 to 3 moths | From 3 months to 1 year | From 1 to 5 years | Over 5 years | Total |
|---|---|---|---|---|---|---|
| Deposits from credit institutions | 149 | - | - | - | - | 149 |
| Deposits from clients other than credit institutions | 188,394 | 41,540 | 124,019 | 40,338 | - | 394,291 |
| Other financial liabilities | 2,562 | - | - | - | - | 2,562 |
| **Total financial liabilities** | **191,105** | **41,540** | **124,019** | **40,338** | **-** | **397,002** |

The financial liabilities of the Bank are mainly formed by attracted funds on deposits – retail and corporate. Large portion of them as of December 31, 2015 –53% (2014: 45%) are with residual term within one month. Traditionally, in the Republic of Bulgaria the customers prefer to sign a deposit agreement with one month term and to renegotiate it regularly for longer period. As a result, one month deposits are practically a long-term and relatively permanent resource of the Bank.

## 29. FINANCIAL RISK MANAGEMENT (CONTINUED)

### 29.4. 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, as all of them 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:

- 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. Maximum level of exposure - 10%;
- 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 total exposure - 20%;
- Corporate shares - the total exposure cannot exceed 1% of the total portfolio of securities;
- Corporate bonds - can 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. Maximum level of exposure - 20%.

Market risk management includes:

- Determination of securities and money market placements ratio. This ratio is 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 200 basis points should not exceed 5% of the capital base, calculated in the last quarter.

## 29. FINANCIAL RISK MANAGEMENT (CONTINUED)

### 29.4. Market risk (continued)

#### 29.4.1. 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, misbalance 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 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, and which are determined based on floating interest rate indices, such as the basic interest rate or six-month LIBOR.

The Bank uses the approaches to interest rate risk management, depending on the circumstances by applying the misbalance method, as follows:

- 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.

Performing its activities, The Bank aims to achieve a positive misbalance in relation to the maturity of the assets and liabilities and a balanced position regarding the sensitivity of the interest-bearing assets and liabilities.

## 29. FINANCIAL RISK MANAGEMENT (CONTINUED)

### 29.4. Market risk (continued)

#### 29.4.1. Interest rate risk (continued)

The interest-bearing assets and liabilities of the Bank as of December 31, 2015 are, as follows:

| 31.12.2015<br>in BGN thousand | Up to 1 month | From 1 to 3 moths | From 3 months to 1 year | From 1 to 5 years | Over 5 years | Total |
|---|---|---|---|---|---|---|
| *Interest-bearing assets* | | | | | | |
| Loans and advances to credit institutions | 16,625 | - | - | - | - | 16,625 |
| Financial assets held for trading | 2,188 | 7,980 | - | 9,455 | 8,318 | 27,941 |
| Loans and advances to customers | 169,600 | 144 | 2,639 | 995 | 6,874 | 180,252 |
| Financial assets available for sale | - | 16,834 | 2,050 | 46,051 | 28,510 | 93,445 |
| **Total interest-bearing assets** | 188,413 | 24,958 | 4,689 | 56,501 | 43,702 | 318,263 |
| | - | - | - | - | - | |
| *Interest-bearing liabilities* | - | - | - | - | - | |
| Deposits from credit institutions | 563 | - | - | - | - | 563 |
| Deposits from clients other than credit institutions | 200,283 | 39,455 | 105,199 | 34,935 | - | 379,872 |
| **Total interest-bearing liabilities** | 200,846 | 39,455 | 105,199 | 34,935 | - | 380,435 |
| **Mismatch between interest-bearing assets and liabilities, net** | **(12,433)** | **(14,497)** | **(100,510)** | **21,566** | **43,702** | |

The interest-bearing assets and liabilities of the Bank as of December 31, 2014 are, as follows:

| 31.12.2014<br>in BGN thousand | Up to 1 month | From 1 to 3 moths | From 3 months to 1 year | From 1 to 5 years | Over 5 years | Total |
|---|---|---|---|---|---|---|
| *Interest-bearing assets* | | | | | | |
| Loans and advances to credit institutions | 11,077 | - | - | - | - | 11,077 |
| Financial assets held for trading | 2,681 | - | 9,828 | 17,695 | 223 | 30,427 |
| Loans and advances to customers | 196,261 | - | 1,004 | 871 | 9,463 | 207,599 |
| Investments held to maturity | 5,024 | 9,408 | 2,003 | 49,730 | 18,524 | 84,689 |
| **Total interest-bearing assets** | 215,043 | 9,408 | 12,835 | 68,296 | 28,210 | 333,792 |
| | - | - | - | - | - | |
| *Interest-bearing liabilities* | - | - | - | - | - | |
| Deposits from credit institutions | 149 | - | - | - | - | 149 |
| Deposits from clients other than credit institutions | 188,355 | 41,298 | 121,325 | 36,412 | - | 387,390 |
| **Total interest-bearing liabilities** | 188,504 | 41,298 | 121,325 | 36,412 | - | 387,539 |
| **Mismatch between interest-bearing assets and liabilities, net** | **26,539** | **(31,890)** | **(108,490)** | **31,884** | **28,210** | |

## 29. FINANCIAL RISK MANAGEMENT (CONTINUED)

### 29.4. Market risk (continued)

### 29.4.1. Interest rate risk (continued)

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

| in thausand BGN | Year ended 31.12.2015 | Year ended 31.12.2014 |
|---|---|---|
| *Interest-bearing assets* | | |
| Loans and advances to credit institutions | 0.11 | 0.08 |
| Financial assets held for trading | 2.44 | 3.27 |
| Loans and advances to customers | 6.49 | 6.51 |
| Investments held to maturity | 2.66 | 3.69 |
| | | |
| *Interest-bearing liabilities* | | |
| Liabilities under repurchase agreements | - | 0.37 |
| Deposits from credit institutions | 0.48 | 0.12 |
| Deposits from clients other than credit institutions | 2.02 | 3.06 |

### 29.4.2. 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 has significant foreign currency transactions in Japanese yen (JPY), since part of the deposit base of the Bank is in this currency. The Bank does not hold open positions in currencies other than EUR.

## 29. FINANCIAL RISK MANAGEMENT (CONTINUED)

### 29.4. Market risk (continued)

### 29.4.2. Currency risk

The foreign currency structure of financial assets and liabilities by carrying amount as of December 31, 2015 is as follows:

| 31.12.2015 in BGN thousand | BGN | EUR | USD | JPY | Other | Total |
|---|---|---|---|---|---|---|
| Assets | | | | | | |
| Cash and cash balances with Central banks | 45,636 | 41,420 | 951 | 148 | 229 | 88,384 |
| Loans and advances to credit institutions | 181 | 4,555 | 8,817 | 2,987 | 85 | 16,625 |
| Financial assets held for trading | 9,456 | 18,037 | 448 | - | - | 27,941 |
| Financial assets available-for-sale | 22,902 | 64,741 | 5,802 | - | - | 93,445 |
| Loans and advances to customers | 96,516 | 81,893 | 1,832 | 11 | - | 180,252 |
| **Total assets** | 174,691 | 210,646 | 17,850 | 3,146 | 314 | 406,647 |
| Liabilities | | | | | | |
| Deposits from credit institutions | - | 469 | 94 | - | - | 563 |
| Deposits from clients other than credit institutions | 197,556 | 160,711 | 18,146 | 3,146 | 313 | 379,872 |
| Other financial liabilities | 1 | 379 | 55 | 1 | - | 436 |
| **Total liabilities** | 197,557 | 161,559 | 18,295 | 3,147 | 313 | 380,871 |
| **Net exposure** | (22,866) | 49,087 | (445) | (1) | 1 | 25,776 |

The foreign currency structure of financial assets and liabilities by carrying amount as of December 31, 2014 is as follows:

| 31.12.2014 in BGN thousand | BGN | EUR | USD | JPY | Other | Total |
|---|---|---|---|---|---|---|
| Assets | | | | | | |
| Cash and cash balances with Central banks | 46,909 | 41,545 | 1,204 | 177 | 150 | 89,985 |
| Loans and advances to credit institutions | 159 | 3,756 | 5,400 | 1,700 | 62 | 11,077 |
| Financial assets held for trading | 9,492 | 20,432 | 503 | - | - | 30,427 |
| Financial assets available-for-sale | 86 | 2 | - | - | - | 88 |
| Loans and advances to customers | 101,197 | 104,558 | 1,844 | - | - | 207,599 |
| Investments held to maturity | 29,838 | 49,827 | 5,024 | - | - | 84,689 |
| **Total assets** | 187,681 | 220,120 | 13,975 | 1,877 | 212 | 423,865 |
| Liabilities | | | | | | |
| Deposits from credit institutions | - | 47 | 102 | - | - | 149 |
| Deposits from clients other than credit institutions | 206,606 | 164,729 | 13,978 | 1,883 | 194 | 387,390 |
| Other financial liabilities | 1,847 | 586 | 129 | - | - | 2,562 |
| **Total liabilities** | 208,453 | 165,362 | 14,209 | 1,883 | 194 | 390,101 |
| **Net exposure** | (20,772) | 54,758 | (234) | (6) | 18 | 33,764 |

## 29. FINANCIAL RISK MANAGEMENT (CONTINUED)

### 29.4. Market risk (continued)

#### 29.4.3. 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, the main part of the investments of the Bank is in Bulgarian government securities, which do not bear significant price risk.

#### 29.4.4. 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 manages to find the optimal ratio risk to income.

As of December 31, 2015 the Bank performed analysis of its interest rate sensitivity on the basis of the assumption of increase by 200 basis points of the interest rate, applied to the interest rate misbalance. In addition, the Bank has performed sensitivity analysis to decrease of the interest rate margin in view of the recent negative trend with respect to this indicator. The analysis shows that further decrease of the interest rate margin by 0.20% would result in an additional loss at the amount of BGN 764 thousand (2014: BGN 781 thousand).

To evaluate 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 200 basis points should not exceed 5% of the capital base calculated in the last quarter.

## 29. FINANCIAL RISK MANAGEMENT (CONTINUED)

### 29.5. Fair value

IFRS 7 Financial instruments: Disclosure requires information for the measurement of fair value of financial assets and liabilities that are not reported at fair value in the statement of financial position.

The following table summarizes the information for the assets measured at fair value in the statement of financial position as of December 31, 2015:

| 2015<br>(all amounts are in BGN thousand) | Carrying amount | Level 1 – quoted market price | Level 2 – technique for evaluation – observable market data | Level 3 - technique for evaluation – not observable market data | Fair value not available |
|---|---|---|---|---|---|
| **Assets measured at fair value** | | | | | |
| Financial assets held for trading | 27,941 | 1,11 | 27,830 | - | - |
| Financial assets available for sale | 93,445 | - | 93,359 | - | 86 |
| **Total** | 121,386 | 111 | 121,189 | - | 86 |

The following table summarizes the information for the assets measured at fair value in the statement of financial position as of December 31, 2014:

| 2014<br>(all amounts are in BGN thousand) | Carrying amount | Level 1 – quoted market price | Level 2 – technique for evaluation – observable market data | Level 3 - technique for evaluation – not observable market data | Fair value not available |
|---|---|---|---|---|---|
| **Assets measured at fair value** | | | | | |
| Financial assets held for trading | 30,427 | 153 | 30,274 | - | - |
| Financial assets available for sale | 88 | - | - | - | 88 |
| **Total** | 30,515 | 153 | 30,274 | - | 88 |

## 29. FINANCIAL RISK MANAGEMENT (CONTINUED)

### 29.5. Fair value (continued)

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

| 2015<br>in BGN thousand | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| *Financial assets* | | | | |
| Cash and cash balances with central banks | 88,384 | - | - | 88,384 |
| Loans and advances to credit institutions | 16,625 | - | - | 16,625 |
| Loans and advances to customers | - | - | 181,716 | 181,716 |
| **Total** | **105,009** | **-** | **181,716** | **286,725** |
| *Financial liabilities* | | | | |
| Deposits from credit institutions | 563 | - | - | 563 |
| Deposits from clients | - | 383,806 | - | 383,806 |
| Other financial liabilities | | | 436 | 436 |
| **Total** | **563** | **383,806** | **436** | **384,805** |

| 2014<br>in BGN thousand | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| *Financial assets* | | | | |
| Cash and cash balances with central banks | 89,985 | - | - | 89,985 |
| Loans and advances to credit institutions | 11,077 | - | - | 11,077 |
| Loans and advances to customers | - | - | 211,101 | 211,101 |
| Investments held to maturity | - | 79,883 | 6,354 | 86,237 |
| **Total** | **101,062** | **79,883** | **217,455** | **398,400** |
| *Financial liabilities* | | | | |
| Deposits from credit institutions | 149 | - | - | 149 |
| Deposits from clients | - | 390,364 | - | 390,364 |
| Other financial liabilities | | | 2,562 | 2,562 |
| **Total** | **149** | **390,364** | **2,562** | **393,075** |

## 30. OTHER REGULATORY DISCLOSURES

According to the requirements of Art. 70, paragraph 6 of the Law on Credit Institutions, 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 AD 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 Law on Credit Institutions.

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

Summary quantitative indicators on an individual basis, related to statutory disclosures required by the Law on Credit Institutions, are as follows:

| | 2015 | 2014 |
|---|---|---|
| Operating income | 13,529 | 11,889 |
| Loss before income tax | (6,839) | (8,913) |
| Tax expense | (6) | (19) |
| Return on assets (%) | -1.57% | -2.11% |
| Equivalent number of employees full-time at 31 December | 260 | 261 |
| Received state subsidies | - | - |

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.

## 31. CAPITAL MANAGEMENT

The Bank is subject to regulations in relation to meeting the requirements for capital adequacy in accordance with 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 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.

As of December 31, 2015 the capital adequacy ratios of the Bank exceeded the minimum regulatory ratios.

## 32. EVENTS AFTER THE REPORTING DATE

There are no events after the reporting date that would require either adjustments or additional disclosures in the financial statements