TOKUDA BANK AD
ANNUAL REPORT ON THE ACTIVITIES,
INDEPENDENT AUDITOR'S
REPORT AND ANNUAL
FINANCIAL STATEMENTS

December 31, 2011

Unofficial translation of the original in Bulgarian

ANNUAL REPORT
ON THE ACTIVITIES FOR 2011

CONTENTS:

I. Information about the Bank

Activity description

Tokuda Bank AD is a universal commercial bank holding a license from Bulgarian National Bank to render a full range of banking services in Republic of Bulgaria and abroad.

The key priorities of the Bank during the past financial year were stabilization of main business indicators (including the quality of loan portfolio), increase the efficiency, optimization of management costs and decrease the operational risk through a new software platform. During the reporting year the Bank managed to ensure presence in most segments of banking products and services, including full-range service to corporate clients, companies operating in the healthcare, agriculture and energy sectors in the country, and a good presence on the money and capital markets, etc.

Membership

Tokuda Bank AD is a member of the economic group of International Hospital Service Co., Japan, the owner of the largest hospital chain in Japan - Tokushukai Medical Corporation, comprising more than 280 medical institutions.

Incorporation

Tokuda Bank AD was incorporated on 27 December 1994 as a joint-stock company under the Law on Banks and the Commercial Act in force as at that date.

Banking license

The Bank holds a license from Bulgarian National Bank to execute all banking transactions on the territory of the Republic of Bulgaria and abroad. The Bank performs its activity in compliance with the legal framework requirements and the license received.

Share capital

The share capital of the Bank is divided into registered dematerialized shares, each giving the right to one vote in the General Meeting of Shareholders. The total issued capital as at 31 December 2011 amounts to BGN 53 000 000 (fifty-three million Bulgarian leva), divided into 5 300 000 (five million and three hundred thousand) registered voting shares, each having nominal value of BGN 10 (ten Bulgarian leva).

Based on the Register of Shareholders kept by the Central Depository, shareholders of the Bank are:

- International Hospital Service Co., Ltd., Japan (holding 99.03% of the share capital);
- ET ARMADA – Radoslava Dimitrova, town of Smolyan (0.37%);
- Garant & Co. AD, city of Sofia (0.28%);
- AUK Establishment, Lichtenstein (0.25%);
- MM Holding AD, city of Varna (0.07%).

Majority owner

Majority owner of the Bank is International Hospital Service Co., Ltd., Japan, holding 99.03% of its capital.

Management

The Bank has a two-tier management system. The General Meeting of Shareholders elects the Supervisory Board, which elects the members of the Management Board, appoints the executive directors and determines their remuneration. Three of Management Board members are executive directors of the Bank.

Supervisory Board of the Bank as at 31 December 2011

Arthur Stern – Chairperson of Supervisory Board.

International Hospital Service Co., Ltd., Japan, represented by Eiji Yoshida – Deputy Chairperson of Supervisory Board.

Katsuyuki Noso – member of Supervisory Board.

Management Board of the Bank as at 31 December 2011

Vanya Vasileva – Chairperson of Management Board and Executive Director.

Kiril Pendev – member of Management Board and Executive Director.

Lyubomir Manolov – member of Management Board and Executive Director.

Nikolay Dimitrov – member of Management Board and Head of Office "Sofia"

Yonka Kinova – member of Management Board.

Changes in the management of the Bank in 2011

In the Supervisory Board: By decision of extraordinary General Meeting of Shareholders held on 20 October 2011, two members of the Supervisory Board were discharged – Tokushukai Sofia EOOD, represented by Mr. Rumen Serbezov and MBAL Tokuda Hospital Sofia AD, represented by Mr. Yordan Kostadinov and two new members were elected on their place, namely Mr. Arthur Stern and Mr. Katsuyuki Noso. International Hospital Service Co., Ltd., Japan, represented by Mr. Eiji Yoshida remained as third member of the Supervisory Board.

In 2011 there were no changes in the Management Board**.**

Address

The Bank's seat and address of management is at 3 Graf Ignatiev Street, 1000 Sofia. In the past year, the Head Office of the Bank was moved at 21 Georg Washington Street, 1000 Sofia, which is also the address for correspondence.

Office network

As at 31 December 2011 the Bank has 21 offices and 12 remote workplaces in the country. The Bank operates in the following cities: Sofia, Plovdiv, Varna, Burgas, Ruse, Stara Zagora, Pleven, Vratsa, Vidin, Blagoevgrad, Kyustendil, Dobrich, Razgrad, Dupnitsa, Gotse Delchev, Haskovo, Kardzhali, Smolyan, General Toshevo, Sliven, Shumen and Ihtiman.

Correspondent relations

Correspondents of the Bank are all Bulgarian banks and a number of leading foreign banks – Standard Chartered Bank Ltd, New York; Citibank N. A., New York; Bank of New York, New York; Commerzbank, Frankfurt/Main; Dresdner Bank AG, Frankfurt/Main; Standard Chartered Bank (Germany) GMBH, Frankfurt/Main; BNP - Parisbas SA, Paris; Piraeus Bank S. A., Athens; Bank of Tokyo - Mitsubishi UFJ Ltd, Tokyo; Intesa SanPaolo SPA, Milano; Finibanco S. A., Lisbon; Credit Suisse, Zurich; Fortis Bank, Brussels; Danske Bank A/S, Copenhagen; ABC International Bank PLS, London, etc.

Mission of the Bank

To offer the full range of banking products and services based on efficient use of new information technologies and high-quality and timely customer service. To ensure confidentiality and protection of the interests of the Bank's clients as well as the interest of its shareholders.

II. Condition of banking system

In 2011, the banks in Bulgaria continued to operate in a situation of uncertainty from the deflation registered in the country in 2010. The increased risk in Europe, the Greek crisis, and the lack of growth made a strong adverse impact on the banking system. After the strong periods of credit expansion the banks continued to restrict their active lending activities due to the reduced demand for loans and the lack of attractive events for crediting.

The weak economic growth and the decrease of employment rates contributed to continuing increase of overdue loans and problem loans. At the end of 2011 the regular loans are only 80.75% of the gross loans. And the share of loans overdue by over 90 days increased from 11.9% at the end of 2010 to 13.53% at the end of 2011. This continuing pressure from problem loans, for the first time since the beginning of 2009, leads to decrease of the capital of the banking system during the year from 10.15 billion at the end of March to 10 billion at the end of June 2011. At the end of 2011, the carrying amount of capital of the banking system increased by 2.4% compared to the previous year and reached BGN 10.4 billion mainly due to the income from the current year, the issued capital and the premium reserve. The inability of the banking system to compensate the increase of problem loans by other sources of income is an extremely worrying signal, especially in the conditions of continued economic growth at levels below full potential.

The European debt crisis and the debt problems in Greece also have a negative impact on the development of the banking system. The share of Greek banks in the Bulgarian banking system remains high, despite the decrease registered at the end of 2011 compared to the beginning of the year.

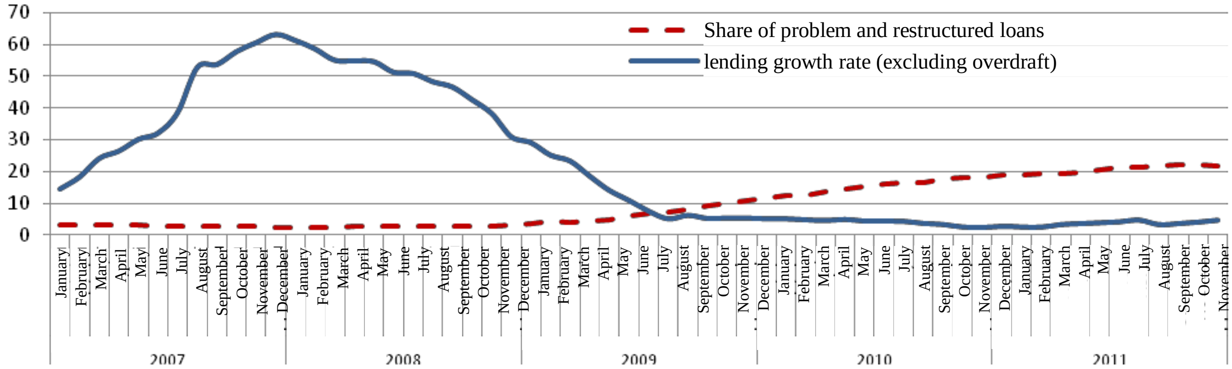
The continuing slowdown in property prices is a factor contributing to the reluctance of banks to develop mortgage lending.

All these factors will also influence the Bulgarian banking system in 2012. The situation in Europe will hardly face any significant change over the next year and the expectations are for a year that will be difficult for banks in Europe and respectively in Bulgaria.

As it is likely that the increase of restructured loans and the losses from problem loans will increase faster than the ability of the banking system to cover these losses with current profits, the banks will be forced to increase their capital. In the absence of adequate measures to quickly overcome the debt crisis in the EU, in 2012 it is possible our banking system to become a factor limiting the growth of the economy through the need for growth of deposits of citizens, weak ledning and high interest rates.

Currently, Bulgaria has one of the lowest rates of lending growth in the Southeastern Europe. For 2010 and 2011 it reached the average of 2.1% annually, while in Romania it is 3%, in Croatia - 5% and in Serbia it reached significantly higher rates. During the past year we have witnessed a situation completely opposite to that before the advent of the global crisis, and one of the reasons for this contrast is that during the period 2006 - 2008 the growth of local financial sector (achieving an absolute record for the CEE region) significantly surpassed the development of real sector and that deprived it from solid basis for sustainable development.

Figure 1



Source: BNB

The amount and quality of the capital position of the banking system in 2011 remained at levels that provide stability and opportunity for expansion of banking business. The average values of capital indicators remained significantly more favorable than those for the European banking system.

The overall capital adequacy in the banking sector is 17.53% at the end of December 2011. This is more favorable compared to the figure reported a year ago (17.48%).

The leverage ratio (equity / gross assets) increased at the end of 2011 and reached the level achieved at the end of the previous year. As of December 2011 leverage is 13.60% (ratio 1/7.4 against 1/20 for the European banking system).

The liquidity position continues to be supported by growth in funds from local depositors. At the end of 2011 no significant changes occurred in the structure of assets and liabilities of the banking sector, which can affect significantly its liquidity position and it remains stable. The limited growth in lending is also among the factors for maintaining good liquidity for most of the credit institutions.

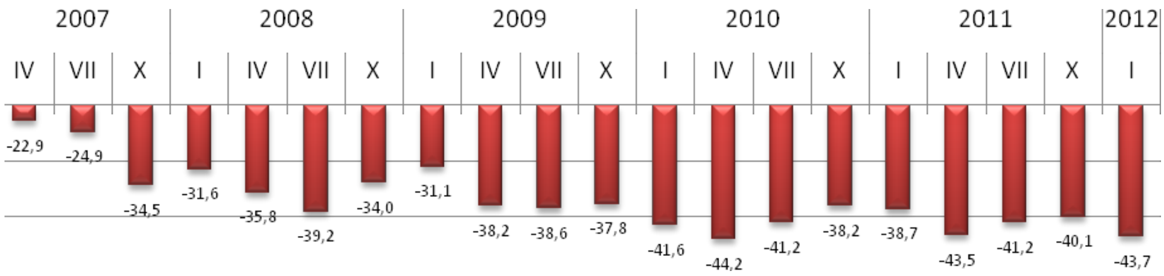
Most factors hindering the stabilization of the real sector are well known, such as strong dependence of local economy on the export; inefficient investment policy that led to accumulation of unproductive assets (primarily in real estate) at the expense of alternative investments in production "on green"; decreasing competitiveness on international markets, driven by low innovation activity, decreasing qualification of working population and wage growth, including in the so-called Schumpeterian industries, which reduces the attractiveness of the country as a destination for labor-intensive stages of production; lack of monetary and fiscal protective mechanisms, including mechanisms for market regulation of the exchange rate of national currency and deliberate creating tariff barriers; high energy intensity of production, etc. The latter is particularly true in general for the CEE region and this creates conditions for the slow recovery from the crisis as the rising in fuel prices (which will inevitably accompany the process of recovery) will further weaken the competitive positions of the countries in the region.

The adverse conditions also create a problem with finding a balance between assets and liabilities in the portfolios of financial institutions.

Deposits of individuals and households marked an average increase by 14% annually during the period 2008 - 2011. In line with the abrupt slowdown in lending activities after 2009, the rate of lending (and consequently the profitability of main activity) over the past two years has deteriorated significantly. For the period January 2009 - November 2011 the proportion loans/deposits in the country decreased to 1.25, which although higher than the average for Central and Eastern Europe (1.12) has a significant negative effect on the financial performance of commercial banks in the country and thus forcing many of them to seek funds to establish a new balance by reducing the interest rates on deposit products. The result of these actions can be easily monitored through the dynamics of the proportion between interest costs versus borrowed funds. At the end of the period of credit expansion (2008 and 2009) this ratio increased from 2.4% to 3.8%, and then, in the conditions of more limited possibilities to cover interest costs with operating income, it decreased to 3.3%. Over the past two years, we are witnessing a trend completely opposite to that by the mid 2009.

During the credit expansion interest rates on deposits with agreed maturity in Bulgarian leva of households sector reached more than 8%. After this period, when the impact of global crisis on local economy (and on the performance of commercial banks) materialized, financial intermediaries have taken actions focused to decrease the cost of borrowed funds, which led to a decline of more than two percentage points within two years.

Figure 2. Assessment of financial position of households over the past 12 months



Source: NSI

However, at the same time, the supply of deposits remained constantly high and this (on the background of low lending activities) has led to increased liquidity in the banking system. Free funds were directed to purchase of securities whose shares (in the asset portfolio of banks) increased by 21% in 2010 and by 8.4% in 2011. This had a positive impact on the market of government securities but placed the financial institutions in difficult position as significantly decreased the rate of return on interest bearing assets. Compared with the peak 2008 and 2009 when it reached 8.6%, at the end of 2011 a decrease was recorded of almost one percentage point, complemented by insignificant portfolio growth and growing deposit base.

In practice, during the last two years the financial system has accumulated significant resources (amounting to BGN 65.6 billion), which could not be realized in the form of loans due to:

- The unfavorable business environment leading to diminishing the load of production capacity and thus resulting in lack of motivation to launch investment projects (which in turn would require bank financing).
- Substantially increase risk of falling into a state of inability to service loans, both for individuals (risk of unemployment), and legal entities (risk of bankruptcy). Intercompany indebtedness has a significant adverse impact in this respect.

In this situation the local banks focused their efforts on compensating the reduced profitability of business through a fully standard approach - by reducing the administrative costs. The data from financial statements show that during credit expansion administrative costs increased at a rapid pace, as the distribution of financial services in Bulgaria is dependent on physical presence. During this period, both the office rents and personnel salaries increased. In 2008 the rate of increase in administrative costs reached 27%, while in 2009-2011 it varied between 0.5 and 2.5 per cent.

Notebly, the salary costs are more flexible than the general administrative expenses. Immediately before the crisis, in 2008, they increased by 31% while the rate of general administrative costs was 24.5%. With the staff downsizing in 2009, their rates are 1% and 3.4%, respectively, and in 2011, when some signs of economic recovery are witnessed, salaries rose faster.

The pursuit for increasing efficiency is completely logical response to the financial crisis. Many banks have taken steps to optimize their office network and downsize staff, which resulted in reduction of administrative costs/assets ratio from 2.91 in 2008 to 2.69 in 2011. Banks with predominantly Greek participation were more active in shrinking their main activities, while at the same time withdrawing part of their capital. As a reasonable consequence of this process in the allocation of local market occurred certain changes – the assets of Greek banks in 2011 decreased by 10.8% on annual base and their market share shrunk by four percent - to 23.7%. As a result of these changes at the end of 2011 in the so called first group (including the five largest banks in the country based on their total assets) for the first time ranked a bank with predominant participation of domestic capital.

We have every reason to expect that the redistribution of banking sector will continue in the same direction - the growing need of finding resources for recapitalization of the parent banks (for which also significantly contributed the writing-off of the external debt of Greece) against the rising price of financing, especially for banks from the periphery of the Euro zone, will probably determine the continuing withdrawal of foreign capital from Bulgaria in the next 12-18 months. Such a process would not destabilize the system as a whole, given its high capital adequacy ratio (reaching 17.53% at the end of December 2011), but for sure will affect negatively the financial performance as the compensation of cheap resources from parent banks will be difficult. This will encourage financial institutions to be more active in their attempts to realize the free cash resources, which in turn could lead to a decline of interest rates on new loans and thus would lead to decrease in profitability indicators.

III. Activity overview

According to data from Bulgarian National Bank in the past year Tokuda Bank AD managed to keep its 26th place in terms of total assets – holding 0.54% share of assets in the banking system. Total amount of assets of the Bank as at 31 December 2011 is BGN 413,468 million, which is BGN 1,2 million more than the previous year. The monthly average amount of assets for 2011 is BGN 433 259 thousand, which is BGN 58 542 thousand or 15.62% more than in 2010.

In 2011 the Bank realized net profit amounting to BGN 22 thousand or potential earnings per share of BGN 0.004. In comparison with the previous 2010 the profit is reduced by BGN 266 thousand, and the potential earnings per share – by BGN 0.06. The higher profit at the end of 2010 is due to the problem loans amounting to nearly BGN 10 million assigned to a third party at the end of the year.

The decrease of profit in 2011 compared to 2010 had a negative influence on the indicators for return on equity and return on assets. The return on equity in 2011 is 0.05% compared to 0.75% in 2010, and return on assets is 0.01% compared to 0.07 % during the previous year. These values are quite low in comparison with the other banks on the local market.

During the reporting year the loan portfolio was strongly influenced by the supply and demand for good businesses and projects for funding. At the end of the year, its volume increased to BGN 219 770 thousand compared to BGN 202 298 thousand in 2010. As a result of loan exposures generated in previous years with relatively low quality and as a result of their inefficient management in 2011, significant portion of these loans have turned into problem loans, which together with the unfavorable macroeconomic conditions in the country led to the deterioration of the portfolio quality to 60.74%.

Operating income and expenses

In 2011, the Bank realized operating income amounting to BGN 12,415 million, which is BGN 1,944 million (13.6%) less than the previous year. This is due to the lower weighted-average loan portfolio in 2011 compared to 2010 with BGN 5 million, to the higher weighted-average volume of borrowed funds from non-financial institutions and households with BGN 60 million and also to the growth of loans overdue by more than 180 days compared to previous years, resulting in missed interest income in 2011 in the amount of BGN 1.28 million. Although in the past year numerous measures have been taken to lower the administrative costs and systematic and strict control has been exercised on them, the ratio of administrative costs plus depreciation against the operating income increased from 76% in 2010 to 96% in 2011. Key factors for this increase are both the slowdown of the total income and the increased costs due to maintaining the expanded at the end of 2010 administrative structure to the end of the first half of 2011, and also to the increased deposit base, resulting in higher Deposit Guarantee Fund contribution due under the law. The positive economic effects from the cuts in order to optimize the organizational and management structure of the Bank in the office network and the Head Office during the third quarter of 2011 could not be reported until the end of past year, as the big and inefficient administrative structure from the previous years generates significant volume of expenses in the first half, which can not be compensated by the end of 2011 due to the incurred additional payments arising from the cuts (benefits, notices, etc.).

Changes occurred in the structure of total operating income (see the table). The net interest income constitutes 64.32% of the total net income and the noninterest income - 35.68%. In 2010, these values are 69.61% and 30.39%, respectively. The main reason for these changes is the poor quality of the loan portfolio from loans granted in previous years, leading to increase in missed interest income.

The income from interests on loans and receivables is amounting to BGN 19,317 million and continues to take the largest share of the total interest income (81.95%), although in the past year, this share decreased by 5.27 pp. The main factor for the reported decrease of BGN 2.324 million for this item compared to 2010 is the increase in overdue credit exposures over 180 days from previous years, which is a serious obstacle for realization of stable interest income.

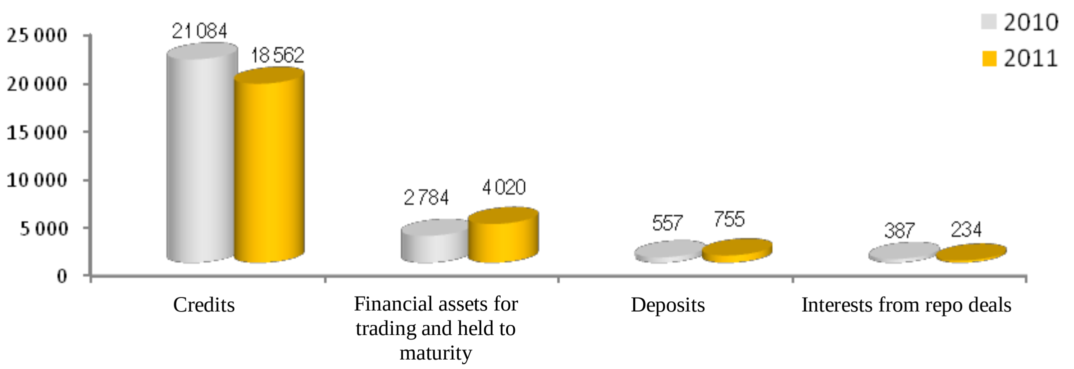
Table 1

Operating income	**2011**	**2010**
Interest income	23 571	24 812
Interest expenses	15 586	14 817
Net interest income	**7 985**	**9 995**
Income from charges and commissions	4 354	3 852
Costs for charges and commissions	796	535
Net income from charges and commissions	**3 558**	**3 317**
Net income from commercial transactions	964	810
Other operating income	-92	236
Total operating income	**12 415**	**14 358**

Interest income from managing the debt instrument portfolio marked growth of 44.4% compared to 2010. The share of these revenues in total interest income amounted to 17.05%. The increase in interest income is primarily related to the increase in debt securities portfolio by 49.58%.

Interest income on deposits increased by 35% compared to the previous year due to the maintenance of relatively large amounts of funds over the large part of the year due to lack of suitable investment alternatives, leading to weaker realization of financial resource.

Figure 3. Interest income by sources

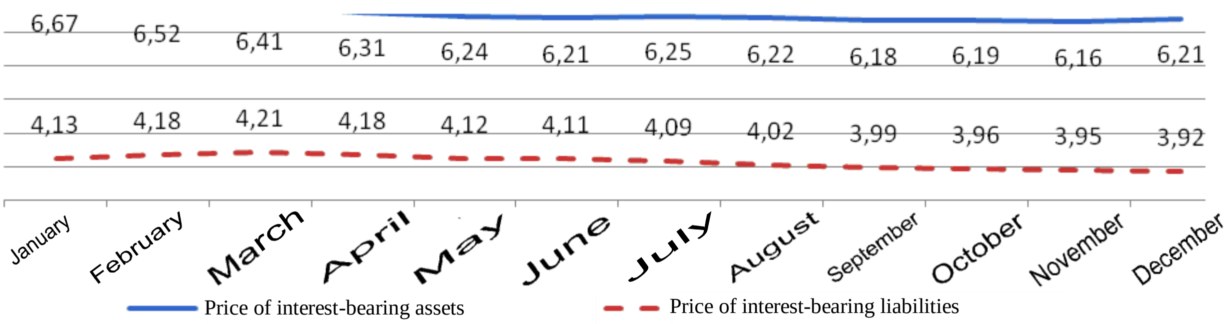


Interest expenses in 2011 represent a significant item in the operating activities of the Bank and as of 31 December 2001 they reached BGN 15 586 million, marking an increase of 5.2% compared to 2010 mainly due to the increase in deposits from local individuals and legal entities by 4.8%.

Expenses on term deposits from individuals and households traditionally represent the largest part of total interest expense, amounting to BGN 12,588 million (80.76%). This is due to the relatively high share of term deposits and the attractive interest rates, which are maintained until the beginning of the IV quarter of 2011. The share of interest expenses on borrowed funds from companies and the state budget is 16.3%.

The misbalance between the growth in interest income and expenses had a negative impact both on the financial performance and the interest spread. For the past reporting period, the interest spread declined by 0.46% as the price of interest-bearing assets from 6.67% at the beginning of the year fell to 6.21 percent, i.e. by 0.46%, and the cost of interest-bearing liabilities decreased from 4.14% to 3.92% due to the decrease in interest rates on deposits and termination of contracts for relatively expensive resource.

Figure 4. Components of interest spread during 2011



Net non-interest income

Net non-interest income in 2011 increased by BGN 67 thousand compared to 2010, reaching BGN 4.43 million. The net income from fees and commissions continues to be with the highest weight in the non-interest income (BGN 3,558 million). During the past year this item marked an increase by BGN 241 thousand, which in relative terms is 7.36% and falls behind the growth of gross income from fees and commissions (12.97%) due to the relatively faster growth of expenses on fees and commissions.

During the past year the Bank reported 49% growth of income from fees and commissions in Bulgarian leva and foreign currency transactions reaching BGN 1,827 million and representing 42% from the gross income from fees and commissions.

The net income from sales and securities revaluation in trading portfolio increased by 56.38% compared to 2010 and reached BGN 466 thousand, where the income from revaluation of debt instruments is BGN 490 thousand and the income from sales marked a net negative result amounting to BGN 24 thousand.

The result from foreign exchange transactions and revaluation of foreign currency assets and liabilities in 2011 remained at the level from the previous year and reached BGN 498 thousand.

Other non-interest operating income (including dividends) amount to minus BGN 92 thousand, and the major factor for the negative result achieved is the written-off capitalized expenses (BGN 138 thousand) of leasehold improvements of vacated office premises in the course of optimization of the regional structure of the Bank from unprofitable divisions, and also the loss from sale of asset (non-current asset classified as held for sale) overstated upon its acquisition amounting to BGN 56 thousand.

Non-interest expenses

Non-interest expenses of the Bank for 2011 amount to BGN 12,341 million, which is less than previous year by BGN 1,657 million or 11.8%.

Expenses for services, rents, materials, for Deposit Guarantee Fund, for telecommunications and IT services, for security and other administrative costs amount to BGN 5,782 million, which is higher than the previous year by 20%. With regard to the variations in rental prices on the property market many of the lease agreements for premises were revised, which along with the cut of some unprofitable offices contributed to realization of savings, which however will be reported in 2012 because of the compensations and penalties related to such actions.

Depreciation expenses during the past year decreased by BGN 199 thousand and reached BGN 773 thousand, representing 6.3% share in the non-interest expenses.

The total impairment loss on assets is BGN 3,525 million, while the income from reintegrated provisions is BGN 3,110 million or the net impairment costs are amounting to BGN 415 thousand. This amount is 7,5 times less than the last year's impairment and takes only 3.4% of the non-interest expenses.

Loan portfolio

At the end of 2011 the gross carrying amount of the loan portfolio is BGN 219 770 million. After provisions for impairment loss amounting to BGN 6,060 million, the net portfolio is BGN 213 710 thousand. The portfolio increase by BGN 17,5 million is achieved despite the adverse market conditions, due to the active actions of Corporate Banking and Retail Banking Directorate in the Head Office and the Bank's management.

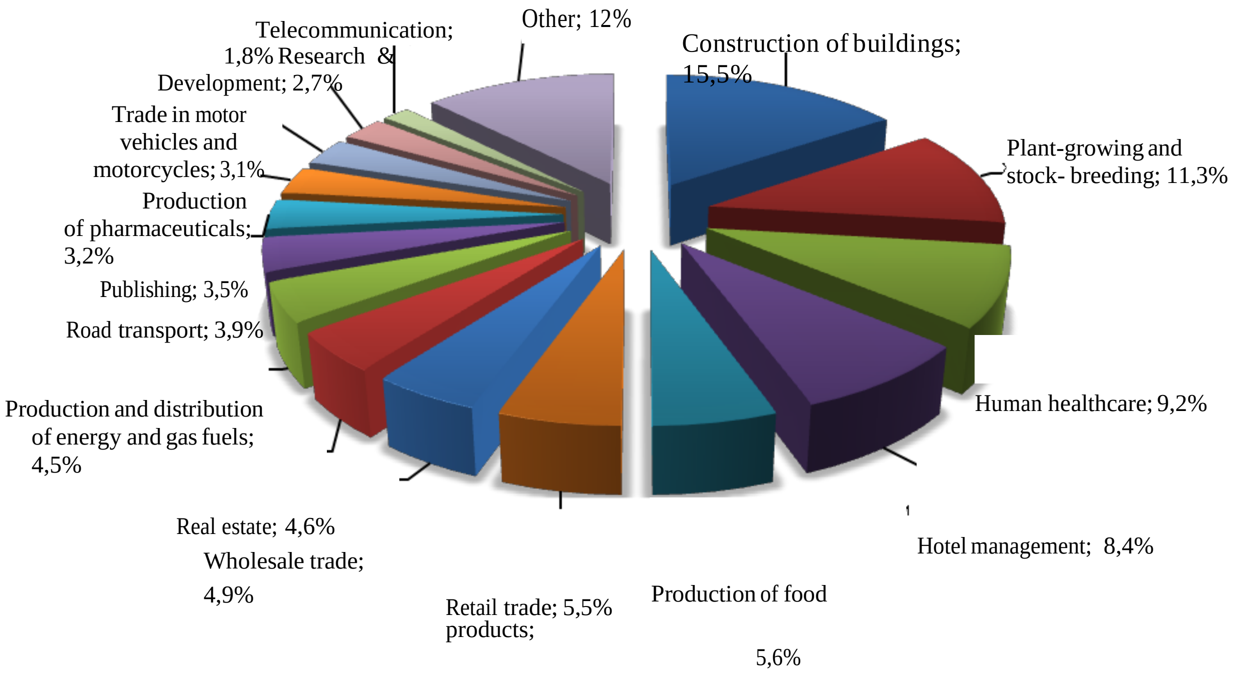
The share of the loan portfolio (after impairment) in the total assets in 2011 increased by 3.9 p.p. and reached 51.69% (compared to 47.7% in the previous year).

The loans granted to corporate clients are BGN 178,870 million and represent 81.4% of the gross amount of the loan portfolio (compared to 79.6% in the previous year). The increase of this share by 1.8 points over the past year was expected given the relatively higher rates of lending to the corporate segment in the country.

Unlike the increase in corporate lending, retail banking experienced the opposite development. The loans to individuals and households over the past year decreased by BGN 2,127 million and reached the amount of BGN 38,244 million (17.4% of the volume of gross loans). Major part (BGN 31,283 million) represents consumer loans and the remaining part (BGN 6,961 million or 1/5 of total retail loans) are granted in the form of residential mortgage loans. The changes in the relative shares of these segments are relatively small - about 1,2 percentage points, and in absolute terms – BGN 2,3 and BGN 0,2 million.

In 2011 the Bank continued to work with companies from the sectors of energy, construction, agriculture, healthcare, etc. (See Figure 5).

Figure 5. Distribution of corporate credits by economic sectors



The largest relative share is still occupied by loans to construction companies - 15.5%, followed by Agriculture - 11.3%, Healthcare - 9.2% and Hotel management - 8.4%. Significant change was reported in the segment of Production and distribution of electricity and heat energy and gas fuels which by the end of 2010 had practically no presence in the Bank's portfolio, but since during the last year 6 new deals were signed with companies in that sector, the share of loans to the sector reached 4.5% of the total volume (BGN 7,9 million). The increase in Agriculture was also significant (BGN 4,9 million or by 1.6 p.p.). However, the exposure to certain sectors has decreased, particularly in the sectors of Real estate (0,9 p.p.), Hotel management (1,2 p.p.) and Telecommunications (1,3 p.p.).

In the currency structure of loan portfolio there are limited changes. In general, the trend from the recent years for increasing the share of loans in euro continues, as these loans increased by 6,8 p.p. in 2011

(BGN 22,786 million) and at the end of the reporting period they formed 51.2% (BGN 112,602 million) of the gross loans. Loans in local currency decreased by BGN 4,667 million and at the end of the year reached BGN 101,149 million (or 46% of the portfolio).

The share of loans in Japanese yen decreased to less than one percent and at the end of the year they reached BGN 1,640 million, and the value of dollar loans remained practically unchanged (BGN 4,379 million, which represents 2% of the portfolio).

Table 2. Portfolio maturity structure

	By original term				By remaining term			
	2010	2011	share 2011	Change in p.p.	2010	2011	share 2011	Change in p.p.
Until 1 year	14 274	12 034	5,48	*-1,58*	51 011	66 523	30,27	*5,05*
1-3 years	28 404	39 067	17.78	*3.73*	29 479	17 318	7.88	*-6.69*
3-5 years	27 114	33 300	15,16	*1,76*	31 446	44 599	20,30	*4,76*
5-10 years	72 198	74 091	33.71	*-1.98*	44 828	47 516	21.62	*-0.54*
10-15 years	29 068	29 117	13,25	*-1,12*	28 165	19 990	9,10	*-4,83*
15-20 years	19 187	12 402	5,64	*-3,84*	10 567	16 817	7,65	*2,43*
Over 20 years	12 054	19 759	8,99	*3,03*	6 804	7 007	3,19	*-0,17*
Total	**202 298**	**219 770**	100,00	**-**	**202 298**	**219 770**	100,00	-

The data show that changes in the maturity structure compared to 2010 are relatively limited. As a whole, in 2011 the loans with shorter residual maturities increased (up to 1 year and between 3 and 5 years). An increase was also observed in exposures with residual maturity of 15 to 20 years, but their share is still relatively small (7.65%).

Despite some positive signs of economic recovery, the crisis continues to shape the attitudes of the private sector and households. The deterioration of their economic status and the difficulties they are facing in repayment of their obligations affects negatively the rate of lending and thus preventing the compensation of poor portfolio quality through increasing its volume. During the past year loans have been granted only to individuals meeting the high standards for reliability, as indicative in this respect is the almost regular servicing of such loans. However, this year, the indicator of portfolio quality also marked a decrease and this is quite understandable due to the inert nature of the process of changing the portfolio quality. During the past year loans for BGN 57,3 million were reclassified to a higher group, and almost all of them were negotiated during the period 2006-2010.

For covering the risk from impairment loss on loans and receivables the Bank has set provisions under IAS amounting to BGN 6,060 million.

Securities

The security portfolio at the end of 2011 is amounting to BGN 118,126 million and comprises 28.57% of total assets, which is by 9.37 percentage points more than the previous year. In absolute terms, the investment in securities in 2011 increased by BGN 38,957 million (49.2%), which is not an exception in the banking system and can be explained by the general stagnation in lending, motivating local banks to direct their available resources to government securities market. The majority of this category of assets (69.5% or BGN 82,074 million) represents investments held to maturity. Securities available for sale during the past year decreased by BGN 72 thousand and reached BGN 165 thousand, and the volume of trading portfolio increased by BGN 12,135 million and reached the amount of BGN 35,887 million.

Significant share of the portfolio (82.1%) consist of Bulgarian government securities amounting to BGN 96,996 million. The corporate bonds (from local and foreign issuers) during the past year increased by BGN 1,137 million to BGN 5,454 million and comprise 4.62% of the portfolio. Compared to 2010, they increased by 26.34%. Equity instruments amount to BGN 288 thousand and comprise insignificant share of the portfolio (0.23%).

The majority of the securities (52.8%) are denominated in local currency. The share of securities denominated in euro (42.2%) is similar, and the share of dollar assets in this group is only 5%.

Attracted funds

The volume of attracted funds in 2011 decreased by 1.74% and reached BGN 364,145 million. Two thirds of borrowed funds come from Bulgarian citizens and households. Non-residents rank second in share of borrowed funds (with 20.76%). The resource from local legal entities and organizations operating with government budget occupies the smallest share (16.27%). The Bank's management has taken active measures to increase that share in the total structure. Throughout the year, the Bank maintained overliquidity and therefore the interest in attracting deposits from banks was weak, so their volume at the end of the year was only BGN 901 thousand.

During the reporting year the trend for increasing the share of more stable resources of term deposits continued. Over three quarters of the attracted funds from customers of the Bank come from term deposits. Deposits and current accounts of individuals and households amount to BGN 227,377 million. Borrowed funds from Agriculture Fund and SAPARD decreased to BGN 1,052 million.

Table 3. Structure of attracted funds

	2011			2010		
	BGN	**Original Currency**	**Total**	**BGN**	**Original Currency**	**Total**
RESIDENTS	**102 008**	**184 605**	**286 613**	**84 135**	**189 888**	**274 023**
Households and individuals	55 793	171 584	227 377	45 874	175 311	221 185
State budget	3 517	-	3 517	3 674	-	3 674
Services	20 611	5 102	25 713	10 794	4 179	14 973
Industry	4 568	333	4 901	5 624	1 622	7 246
Trade	5 523	2 395	7 918	6 000	2 133	8 133
Transport	380	265	645	765	299	1 064
Construction	3 888	2 079	5 967	4 561	2 573	7 134
Financial institutions	2 033	443	2 476	1 850	423	2 273
Agriculture	5 695	2 404	8 099	4 993	3 348	8 341
NON-RESIDENTS	**821**	**74 758**	**75 579**	**372**	**71 148**	**71 520**
Total	**102 829**	**259 363**	**362 192**	**84 507**	**261 036**	**345 543**

The changes in the currency structure of attracted funds in each of currency groups (BGN, EUR, other currencies) compared to the previous year are less than 1 percentage. With largest relative share remain the funds in Euros - 51.17% (compared to 51.96% in 2010). The relative share of BGN funds decreased from 28.56% to 28.49% and the share of other currencies increased slightly - to 20.34%.

Capital and reserves

As of 31 December 2011 the Bank's capital is amounting to BGN 53 million and is higher than the previous year by 19.86%. This increase is a result of capital increase by BGN 8 million and the profit amounting to BGN 22 thousand realized in the current year.

The Bank still can not cover the loss accumulated from previous years amounting to BGN 5,774 million. The reserves are amounting to BGN 1,159 million (including revaluation of tangible fixed assets of BGN 347 thousand).

For the purposes of Ordinance 8 of BNB, the Bank applies the standardized approach for credit risk for the calculation of the capital requirements for credit and market risk and the approach of the base indicator of the operating risk.

In 2011 the capital adequacy ratios of Tokuda Bank AD are above the required levels. The bank's capital position provides adequate cover of its risk exposures. As at 31 December 2011 the ratio of capital adequacy and capital adequacy of tier one capital are 14.98% (15.84% at the end of 2010), which exceeds the legal requirement of 12%.

Office network

In 2011, Tokuda Bank AD closed 11 branches and transformed four of them into a lower category. Four new remote work places were opened - one in Maritza municipality, city of Plovdiv, one in Kula municipality, Vidin region and two in the Registry Agency in the cities Sofia and Varna.

The structure of the office network is as follows:

- Head Office;
- Offices – 21;
- Remote work places – 12.

Human resources

In 2011 the employees working in the Bank are 274 persons, and the average listed personnel for actual working time is 261 employees.

The human resource is the vehicle for reaching the strategic purposes of the management. The Bank's management develops a system for managing of human resources and administration of the personnel - planning, selection, appointment, movement and discharge.

A crucial factor in achieving the mission and strategy of the Bank is the quality of personnel - qualifications, skills and loyalty of employees. Involving a substantial number of staff in various forms of training and qualification improvement is one of the main tools, which has proven its reliability.

During the past year the education in English language under Human Resources Development program financed by the European Union was completed. Bank employees are also involved in various forms of training related to their functions.

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. Migration to a new, more reliable software serving the main data flows in Tokuda Bank AD is forthcoming.

Development trends

The main priorities of the Bank for its development in 2012 are in the following areas:

- Improving the efficiency in Bank's operations;
- Expansion of the Bank's market share;
- Improving the quality of the loan portfolio;
- Activation the sales of debit and credit cards;
- Optimization of the asset structure and following the policy of acceptable credit risk and its coverage with the necessary capital. Improvement of the ratio of return on assets;
- Ensuring stable operating income to guarantee the achievement of a higher return on share capital.

Responsibility of the Management

The anuual financial statements have been prepared in compliance with the requirements of the Legislation and the International Financial Reporting Standards. They give a true and fair view of the financial position of Tokuda Bank AD.

As to the preparation of the annual Financial statements, the management confirms that:

- They have been prepared in compliance with the International Financial Reporting Standards (IFRS), including the Standards and Interpretations adopted by the International Accounting Standards Board;
- The annual Financial statements have been prepared on the basis of going concern concept;
- The applied 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 possible measures to protect the assets of the Bank and to prevent frauds.

By virtue of decision of the Management Board of Tokuda Bank AD dated 05 April 2012:

Vanya Vasileva	Lyubomir Manolov
Chairperson of Management Board and	Member of Management Board and
Executive Director	Executive Director

INDEPENDENT AUDITOR'S REPORT AND FINANCIAL STATEMENTS DECEMBER 31, 2011

Deloitte.

Deloitte Audit OOD
UIC 121145199
103, Al. Stambolijski Blvd.
1303 Sofia
Bulgaria

Tel: +359 (2) 80 23 300
Fax: +359 (2) 80 23 350
www.deloitte.bg

Делойт Одит ООД
ЕИК 121145199
бул. „Ал. Стамболийски" 103
София 1303
България

Тел: +359 (2) 80 23 300
Факс: +359 (2) 80 23 350

This document is a translation of the original in 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 statement of financial position as of December 31, 2011, and the statement of comprehensive income, statement of changes in equity and 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 financial statements

Management is responsible for the preparation and fair presentation of these 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 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 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 financial statements present fairly, in all material respects, the financial position of Bank as of December 31, 2011, and its financial performance and its cash flows for the year then ended in accordance with IFRS, as adopted by the European Union.

Other matter

The financial statements of the Bank for the year ended December 31, 2010 were audited by another auditor who expressed an unmodified opinion on those statements on April 5, 2011.

Other reports on legal and regulatory requirements - Annual report on the activities of the Bank according to article 33 of the Accountancy Act

Pursuant to the requirements of the Bulgarian Accountancy Act, article 38, paragraph 4 we have read the accompanying Annual report on the activities of the Bank, prepared by the Bank's management. The Annual report on the activities of the Bank is not a part of the financial statements. The historical financial information presented in the Annual report on the activities of the Bank prepared by the management is consistent, in all material aspects with the financial information disclosed in the financial statements of the Bank as of December 31, 2011, prepared in accordance with IFRS, as adopted by the European Union. Management is responsible for the preparation of the Annual report on the activities of the Bank dated April 5, 2012.

Deloitte Audit

Deloitte Audit OOD

Sylvia Peneva
Managing Director
Registered Auditor

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

Sofia
April 5, 2012

TOKUDA BANK AD

STATEMENT OF FINANCIAL POSITION
as of December 31, 2011
All amounts are in thousand BGN, unless otherwise stated

	Note	As of 31.12.2011	As of 31.12.2010
ASSETS			
Cash and cash balances with central banks	4	35,746	34,767
Loans and receivables from credit institutions	5	18,759	76,709
Financial assets held for trading	6	41,324	28,434
Financial assets available for sale	7	165	237
Receivables under repurchase agreements (repo-deals)	8	2,190	-
Loans and receivables from customers	9	213,710	196,566
Investments held to maturity	10	82,074	55,180
Property, plant and equipment	11	4,141	4,213
Intangible assets	11	218	230
Investments in subsidiaries and associates	12	-	1,037
Tax assets	19.1	115	152
Other assets	13	1,014	1,914
Non-current assets held for sale	14	14,012	12,829
TOTAL ASSETS		**413,468**	**412,268**
LIABILITIES			
Deposits from credit institutions	15	901	6,366
Deposits from clients other than credit institutions	16	362,192	345,543
Borrowings	17	1,052	18,682
Provisions	18	237	240
Tax liabilities	19.2	96	84
Other liabilities	20	583	968
TOTAL LIABILITIES		**365,061**	**371,883**
EQUITY			
Share capital	21	53,000	45,000
Reserves	21	1,159	1,159
Accumulated loss		(5,774)	(6,062)
Profit for the year		22	288
TOTAL EQUITY		**48,407**	**40,385**
TOTAL LIABILITIES AND EQUITY		**413,468**	**412,268**

These financial statements have been approved by the Management Board of Tokuda Bank AD on April 5, 2012.

Vanya Vassileva Executive Director	Lyubomir Manolov Executive Director	Desislava Beluhova Chief Accountant

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

The original financial statements have been signed by Sylvia Peneva, Managing Director and Registered Auditor at Deloitte Audit OOD on April 5, 2012.

STATEMENT OF COMPREHENSIVE INCOME
for the year ended December 31, 2011
All amounts are in thousand BGN, unless otherwise stated

	Note	Year ended 31.12.2011	Year ended 31.12.2010
Interest income	22	23,571	24,812
Interest expenses	22	(15,586)	(14,817)
Net interest income		**7,985**	**9,995**
Dividend income		22	70
Fee and commission income	23	4,354	3,852
Fee and commission expenses	23	(796)	(535)
Fee and commission income, net		**3,558**	**3,317**
Net gains on financial assets and liabilities held for trading	24	5,021	8,713
Net losses on foreign currency revaluation	25	(4,057)	(7,903)
Other operating income /(expenses)	26	(114)	166
Administrative expenses	27	(11,153)	(9,910)
Depreciation/amortization	11	(773)	(972)
Net expenses for impairment and uncollectability	28	(415)	(3,116)
PROFIT BEFORE TAXATION		**74**	**360**
Taxation	29	(52)	(72)
PROFIT FOR THE YEAR		**22**	**288**
Other comprehensive income		-	-
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		**22**	**288**

These financial statements have been approved by the Management Board of Tokuda Bank AD on April 5, 2012.

Vanya Vassileva	Lyubomir Manolov	Desislava Beluhova
Executive Director	Executive Director	Chief Accountant

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

The original financial statements have been signed by Sylvia Peneva, Managing Director and Registered Auditor at Deloitte Audit OOD on April 5, 2012.

TOKUDA BANK AD

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
AS OF DECEMBER 31, 2011
All amounts are in thousand BGN, unless otherwise stated

	Share capital	Reserves	Retained earnings	Total
BALANCE AS OF JANUARY 1, 2010	**45,000**	**1,159**	**(6,062)**	**40,097**
Profit for the year	-	-	288	288
Other comprehensive income for the year	-	-	-	-
Total comprehensive income for the year	-	-	288	288
BALANCE AS OF DECEMBER 31, 2010	**45,000**	**1,159**	**(5,774)**	**40,385**
Increase of share capital	8,000	-	-	8,000
Profit for the year	-	-	22	22
Other comprehensive income for the year	-	-	-	-
Total comprehensive income for the year	-	-	22	22
BALANCE AS OF DECEMBER 31, 2011	**53,000**	**1,159**	**(5,752)**	**48,407**

These financial statements have been approved by the Management Board of Tokuda Bank AD on April 5, 2012.

Vanya Vassileva	Lyubomir Manolov	Desislava Beluhova
Executive Director	Executive Director	Chief Accountant

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

The original financial statements have been signed by Sylvia Peneva, Managing Director and Registered Auditor at Deloitte Audit OOD on April 5, 2012.

The original financial statements have been signed by Sylvia Peneva, Managing Director and Registered Auditor at Deloitte Audit OOD on April 5, 2012.

STATEMENT OF CASH FLOWS
For the year ended December 31, 2011
All amounts are in thousand BGN, unless otherwise stated

	Note	Year ended 31.12.2011	Year ended 31.12.2010 (restated)
OPERATING ACTIVITIES			
Net profit for the year		22	288
Adjustments for reconciliation of net profit with net cash flows from operating activities:			
Tax expense		52	72
Depreciation/amortization		773	972
Net expenses for impairment and uncollectability		415	3,116
Interest income		(23,571)	(24,812)
Interest expense		15,586	14,817
Dividend income		(22)	(70)
Loss on disposal of property, plant and equipment		187	-
Provisions		(3)	-
Interest income received		22,974	24,019
Interest expense paid		(16,386)	(16,275)
Dividend income received		22	-
Taxes paid		(19)	(47)
Cash flows from operating profit before changes in the operating assets and liabilities		**30**	**2,080**
(Increase)/ decrease in loans and receivables from credit institutions with maturity over 3 months		8,008	(8,008)
(Increase) of financial assets and liabilities held for trading		(12,743)	(23,197)
(Increase)/decrease of financial assets available for sale		72	(70)
(Increase)/decrease of receivables under repurchase agreements		(2,190)	6,072
(Increase)/ decrease in loans and receivables from customers		(15,846)	6,501
(Increase)/ decrease of non-current assets held for sale		(1,183)	(9,745)
(Increase)/ decrease of other assets		900	(827)
Increase /(decrease) of deposits from credit institutions		(5,465)	(3,566)
Increase /(decrease) of deposits from clients other than credit institutions		16,072	85,931
Increase /(decrease) of other liabilities		(385)	253
Net cash flow (used in)/generated by operating activities		**(12,730)**	**55,424**

STATEMENT OF CASH FLOWS (CONTINUED)
For the year ended December 31, 2011
All amounts are in thousand BGN, unless otherwise stated

	Note	Year ended 31.12.2011	Year ended 31.12.2010 (restated)
INVESTING ACTIVITIES			
Payments for acquisition of investment held to maturity		(37,443)	(21,955)
Proceeds from investments held to maturity		10,500	12,272
Payments for acquisition of property, plant and equipment		(1,046)	(380)
Proceeds from sale of property, plant and equipment		241	-
Payments for acquisition of intangible assets		(55)	(125)
Payments for acquisition of investments in subsidiaries and associates		-	(992)
Proceeds from sale of investments in subsidiaries and associates		1,037	-
Net cash flow used in investing activities		**(26,766)**	**(11,180)**
FINANCING ACTIVITIES			
Repayments of borrowings		(17,577)	(3,352)
Increase of share capital		8,000	-
Net cash flow used in financing activities		**(9,577)**	**(3,352)**
Effect of exchange rate changes on the balance of cash held in foreign currencies		110	275
Net increase/(decrease) of cash and cash equivalents		**(48,963)**	**41,167**
Cash and cash equivalents at the beginning of the year		**103,468**	**62,301**
Cash and cash equivalents at the end of the year	31	**54,505**	**103,468**

These financial statements have been approved by the Management Board of Tokuda Bank AD on April 5, 2012.

Vanya Vassileva Executive Director	Lyubomir Manolov Executive Director	Desislava Beluhova Chief Accountant

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

The original financial statements have been signed by Sylvia Peneva, Managing Director and Registered Auditor at Deloitte Audit OOD on April 5, 2012.

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, 2011 the issued share capital amounts to BGN 53,000,000 (fifty three million levs), comprising 5,300,000 (five million and three hundred thousands) registered voting shares with face value of BGN 10 (ten) per share. In 2011 the Bank increased its share capital by BGN 8,000,000 (eight million) by issuing 800,000 (eight thousand) registered dematerialized voting shares with face value of BGN 10 (ten) per share.

As of December 31, 2011 the major shareholder of the Bank is International Hospital Service Co, Ltd., Japan, holding 99.03%.

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

The 2011 and 2010 activity of the Bank mainly consist 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. Three of the members of the Management Board are Executive Directors of the Bank.

In 2011 the Bank operates through its Head Office and 33 offices, points of services and representative offices (2010: 45). As of December 31, 2011 the Bank has 274 employees (2010: 323).

2. BASIS FOR PREPARATION OF THE FINANCIAL STATEMENTS

2.1 General

These financial statements have been prepared for general purposes for the year ended December 31, 2011. The financial statements are presented in thousand Bulgarian Levs (BGN‘000).

These financial statements have been prepared in accordance with the Bulgarian national legislation. The Bank‘s operations are regulated by the Law on Credit Institutions and BNB Ordinances and BNB supervise and monitors the compliance with the banking legislation.

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.

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

2.2 Accounting convention (continued)

These financial statements are prepared in all material respects in accordance with International Financial Reporting Standards (IFRS) 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.

2.3 Changes in IFRS

Standards and Interpretations effective in the current period

The following amendments to the existing standards issued by the IASB and adopted by the EU are effective for the current period:

- Amendments to IAS 24 Related Party Disclosures **-** Simplifying the disclosure requirements for government-related entities and clarifying the definition of a related party, adopted by the EU on July 19, 2010 (effective for annual periods beginning on or after January 1, 2011),
- Amendments to IAS 32 Financial Instruments: Presentation – Accounting for rights issues, adopted by the EU on December 23, 2009 (effective for annual periods beginning on or after February 1, 2010),
- Amendments to IFRS 1 First-time Adoption of IFRS - Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters, adopted by the EU on June 30, 2010 (effective for annual periods beginning on or after July 1, 2010),
- Amendments to various standards and interpretations Improvements to IFRSs (2010) resulting from the annual improvement project of IFRS published on May 6, 2010 (IFRS 1, IFRS 3, IFRS 7, IAS 1, IAS 27, IAS 34, IFRIC 13) primarily with a view to removing inconsistencies and clarifying wording, adopted by the EU on February 18, 2011 (amendments are to be applied for annual periods beginning on or after July 1, 2010 or January 1, 2011 depending on standard/interpretation),
- Amendments to IFRIC 14 IAS 19 — The Limit on a defined benefit Asset, Minimum Funding Requirements and their Interaction **-** Prepayments of a Minimum Funding Requirement, adopted by the EU on July 19, 2010 (effective for annual periods beginning on or after January 1, 2011),
- IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments, adopted by the EU on July 23, 2010 (effective for annual periods beginning on or after July 1, 2010).

The adoption of these amendments to the existing standards has not led to any changes in the Bank‘s accounting policies.

Standards and Interpretations issued by IASB and adopted by the EU but not yet effective

At the date of authorisation of these financial statements the following standards, revisions and interpretations were in issue but not yet effective:

- Amendments to IFRS 7 Financial Instruments: Disclosures **-** Transfers of Financial Assets, adopted by the EU on November 22, 2011 (effective for annual periods beginning on or after July 1, 2011).

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

2.3 Changes in IFRS (continued)

The Bank has elected not to adopt these standards, revisions and interpretations in advance of their effective dates.

The Bank anticipates that the adoption of these standards, revisions and interpretations will have no material impact on the financial statements of the Bank in the period of initial application.

Standards and Interpretations 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 for the following standards, amendments to the existing standards and interpretations, which were not endorsed for use as at the date of publication of financial statements:

- IFRS 9 Financial Instruments (effective for annual periods beginning on or after January 1, 2015),
- IFRS 10 Consolidated Financial Statements (effective for annual periods beginning on or after January 1, 2013),
- IFRS 11 Joint Arrangements (effective for annual periods beginning on or after January 1, 2013),
- IFRS 12 Disclosures of Involvement with Other Entities (effective for annual periods beginning on or after January 1, 2013),
- IFRS 13 Fair Value Measurement (effective for annual periods beginning on or after January 1, 2013),
- IAS 27 (revised in 2011) Separate Financial Statements (effective for annual periods beginning on or after January 1, 2013),
- IAS 28 (revised in 2011) Investments in Associates and Joint Ventures (effective for annual periods beginning on or after January 1, 2013),
- Amendments to IFRS 1 First-time Adoption of IFRS - Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters (effective for annual periods beginning on or after July 1, 2011),
- Amendments to IFRS 7 Financial Instruments: Disclosures - Offsetting Financial Assets and Financial Liabilities (effective for annual periods beginning on or after January 1, 2013),
- Amendments to IFRS 9 Financial Instruments‖ and IFRS 7 Financial Instruments: Disclosures – Mandatory Effective Date and Transition Disclosures,
- Amendments to IAS 1 Presentation of financial statements -Presentation of Items of Other Comprehensive Income (effective for annual periods beginning on or after July 1, 2012),
- Amendments to IAS 12 Income Taxes - Deferred Tax: Recovery of Underlying Assets (effective for annual periods beginning on or after January 1, 2012),
- Amendments to IAS 19 Employee Benefits - Improvements to the Accounting for Post-employment Benefits (effective for annual periods beginning on or after January 1, 2013),
- Amendments to IAS 32 Financial instruments: presentation - Offsetting Financial Assets and Financial Liabilities (effective for annual periods beginning on or after January 1, 2014),
- IFRIC 20 Stripping Costs in the Production Phase of a Surface Mine (effective for annual periods beginning on or after January 1, 2013).

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

2.3 Changes in IFRS (continued)

The Bank anticipates that the adoption of these standards, amendments to the existing standards and interpretations will have no material impact on the financial statements of the Bank in the period of initial application, except for the following standards that may have significant effect on the financial statements

- IFRS 9 Financial Instruments, which 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 an entity 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.

- IFRS 13 Fair Value Measurement, which provides definition for fair value, guidance on fair value measurement and requires disclosures related to fair value measurement.

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 analyzed 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 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 33.1 describes the process applied by the Bank to manage the credit risk and to determine the allowance of loans and receivables.

- Measurement of fair value of financial assets and financial liabilities carried at fair value – note 3.11 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 2011 there were no changes in the useful lives of these assets.

The entire 2011 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 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 33.

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, 2011 and 2010 the Bank has no such assets.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.2 Financial assets (continued)

Financial assets and liabilities held for trading

These are financial assets and liabilities, as well as all derivatives (excluding those, presented as hedging instruments), which were either acquired for the purpose of generating profit from short-term fluctuations in price or dealer's margin, or for the purpose of generating short-term profit from sales. These financial instruments are initially recognized and subsequently measured at fair value. Subsequent revaluations are based on market quotations. All realized gains on transactions with such financial instruments, as well as gains or losses on subsequent revaluations are included in the statement of comprehensive income. As of December 31, 2011 and financial assets held for trading consist mainly of Bulgarian government securities and derivatives.

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.

The Bank uses derivative financial instruments both to meet the financial needs of its customers, acting as an agent, and in its proprietary 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 derivatives held for trading are included in the statement of comprehensive income.

As of December 31, 2011 and 2010 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.

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. Debt bonds that have no liquid market are measured at amortized cost. 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.

Loans and receivables

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.2 Financial assets (continued)

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. This occurs when the Bank realizes the rights, the rights expire, or when the Bank surrenders those rights. 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.

Off-balance financial instruments

In its operations the Bank has off-balance sheet financial instruments comprising 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 include:

- 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;
- Lack of an active financial market due to finance difficulties of the issuer/debtor.

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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. The risk relates to those loans and receivables that have been specifically identified as watch, non-performing or loss exposures. 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.

The Bank classifies loans in several groups. Outside the regular loans group the Bank uses risk percentages, which are applied to the contractual cash flows to determine the expected cash flows, which are then discounted using the effective interest rate. Cash flows, related to short-term loans are not discounted.

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.

3.4 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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.3 Property, plant and equipment and intangible assets (continued)

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 as 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.

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 discounted by the effective interest rate method for the period to maturity using the contracted interest rate.

All amounts are in thousand BGN, unless otherwise stated

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 revalued 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	December 31, 2011	December 31, 2010
US Dollars	1.51158	1.47276
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 occured.

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 labor 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 a labor contract entities in the country are obliged to pay a compensation at the amount of 2 to 6 salaries depending on the employee's length of service in the entity.

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 18). 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 currently due 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 value is defined as the amount for which an asset can be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction. The Bank discloses the fair value of those assets and liabilities, for which published market information is readily available and whose fair value is materially different from their reported carrying amounts.

Currently, there is not enough market experience, stability and liquidity for purchases and sales of loans and advances to customers, other assets, and also all liabilities of the Bank, for which published market information is not readily available. Accordingly, their fair values cannot be reliably determined. According to the management, the reported recoverable amounts of such assets and the amounts required for settlement of such liabilities at the reporting date, are the most valid and useful amounts under these circumstances.

<u>Fair value hierarchy</u>

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 are observable either directly or indirectly;
- Level 3: techniques which use inputs that are not based on observable market data.

All amounts are in thousand BGN, unless otherwise stated

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.11 Fair value of financial assets and liabilities (continued)

The following table summarize the information for the assets measured at fair value in the statement of financial position as of December 31, 2011:

2011	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	41,324	35,887	5,437	-	-
Financial assets available for sale	165	-	-	-	165
TOTAL	41,489	35,887	5,437	-	165

The following table summarize the information for the assets measured at fair value in the statement of financial position as of December 31, 2010:

2010	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	28,434	23,752	4,682	-	-
Financial assets available for sale	237	-	-	-	237
TOTAL	28,671	23,752	4,682	-	237

Disclosure of 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 table below presents information about the carrying amount and fair value of financial assets and liabilities which are not stated at fair value in the statement of financial position:

	Carrying amount		Fair value	
	2011	2010	2011	2010
Financial assets				
Cash at central banks	35,746	34,767	35,746	34,767
Loans and advances to credit institutions	18,759	76,709	18,759	76,709
Loans and advances to customers	213,710	196,566	215,867	200,133
Receivables under repurchase agreements	2,190	-	2,190	-
Investments held to maturity	82,074	55,180	83,440	56,076
Deposits of credit institutions	901	6,366	901	6,366
Deposits of customers	362,192	345,543	383,444	362,117
Loans received	1,052	18,682	1,052	18,682

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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

3.13 Non-current assets held for sale

Non-current assets held for sale are property and other non-current assets, which the Banks 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.

3.14 Comparative information

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

- As a result of a significant change in the Bank's operations 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.

All amounts are in thousand BGN, unless otherwise stated

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.14 Comparative information (continued)

In 2011 the management has made the following restatements and changes in comparative information:

(a) In 2011 the Bank has identified an error in the description of the accounting policy for reporting of property, which is corrected in the present financial statements. The error is in relation to the applied accounting policy for reporting of property, plant and equipment, as in prior financial statements the Bank has disclosed that property (land and buildings) are reported at revalued amount less accumulated depreciation and impairment loss. The Bank has not applied the fair value method for subsequent measurement for property, plant and equipment according to IAS 16 Property, plant and equipment and the reported revaluation reserve as of December 31, 2011 and 2010 is related to the revaluation of these assets upon initial application of IFRS and determination of deemed cost of assets in accordance with IFRS 1 First-time Adoption of IFRS. In the present financial statements the Bank has amended the disclosed accounting policy in accordance with the applied policy. This adjustment has no effect on the presented financial information for the current or prior periods as the Bank's policy is applied consistently during the years (see also note 3.5).

(b) The Bank has identified errors and reclassifications in the presentation of cash flows in the statement of cash flows for the year ended December 31, 2010, which are adjusted in these financial statements. The main changes are as follows:

- Increase in balances of cash and cash equivalents at the beginning and end of the year by adding loans and receivables from credit institutions with original maturity within 3 months according to the Bank's policy as disclosed in note 3.2. The effect of this adjustment is increase in cash and cash equivalents as of December 31, 2010 and 2009 with BGN 66,740 thousand and BGN 33,593 thousand, respectively, and the related effect on net increase of cash and cash equivalents for the year.

- Reclassification of cash flows to correspond more accurately to the operating activities of the Bank.

The reclassifications described above have no effect on the statement of financial position and the statement of comprehensive income of the Bank for prior years and therefore the Bank has not presented a statement of financial position as of January 1, 2010.

The effect of the changes on the statement of cash flows for the year ended December 31, 2010 is as follows:

	Year ended 31.12.2010 (before restatement)	Effect from restatement	Year ended 31.12.2010 (after restatement)
Net cash flows from operating activity	18,810	36,614	55,424
Net cash flows from investing activity	(10,790)	(390)	(11,180)
Net cash flows from financing activity	-	(3,352)	(3,352)
Effect of exchange rate changes on the balance of cash held in foreign currency	-	275	275
Net increase in cash and cash equivalents	8,020	33,147	41,167
Cash and cash equivalents at the beginning of the year	28,708	33,593	62,301
Cash and cash equivalents at the end of the year	36,728	66,740	103,468

All amounts are in thousand BGN, unless otherwise stated

4. CASH AND CASH BALANCES WITH CENTRAL BANKS

	As of 31.12.2011	As of 31.12.2010
Cash on hand	8,263	8,323
Cash with Central bank	27,483	26,444
TOTAL	35,746	34,767

Cash with Central bank as of December 31, 2011 and 2010 include minimum non-interest bearing reserves at the amount of BGN 27,645 thousand and BGN 26,085 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 142 thousand and BGN 75 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

	As of 31.12.2011	As of 31.12.2010
Current accounts with credit institutions	1,021	1,961
Amounts and deposits with credit institutions	17,738	74,748
TOTAL	18,759	76,709

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

	As of 31.12.2011	As of 31.12.2010
In BGN		
Nostro accounts with local credit institutions	23	7
	23	7
In foreign currency		
Deposits with foreign credit institutions	4,249	4,349
Deposits with local credit institutions	13,489	70,399
Nostro accounts with foreign credit institutions	571	1,937
Nostro accounts with local credit institutions	427	17
	18,736	76,702
TOTAL	18,759	76,709

The average contracted interest rates on funds with credit institutions are as follows:

	As of 31.12.2011	As of 31.12.2010
BGN	0.2%	0.7%
Euro	0.8%	0.6%
US Dollars	0.2%	0.4%

Deposits to banks as of December 31, 2011 and 2010 have maturity within 3 months, except for a deposit with a local bank as of December 31, 2010 at the amount of BGN 8,008 thousand.

All amounts are in thousand BGN, unless otherwise stated

6. FINANCIAL ASSETS HELD FOR TRADING

	As of 31.12.2011	As of 31.12.2010
Bulgarian government bonds	30,310	19,409
Corporate bonds of domestic and foreign issuers	5,454	4,317
Shares and participations in domestic enterprises	123	26
Derivative instruments	5,437	4,682
TOTAL	41,324	28,434

7. FINANCIAL ASSETS AVAILABLE FOR SALE

	As of 31.12.2011	As of 31.12.2010
Shares and participations in local enterprises	165	237
TOTAL	165	237

8. RECEIVABLES UNDER REPURCHASE AGREEMENTS (REPO-DEALS)

	As of 31.12.2011	As of 31.12.2010
Repo-deals with private non-financial entities	1,518	-
Repo-deals with individuals	672	-
TOTAL	2,190	-

As of December 31, 2011 the residual maturity of all receivables under repurchase agreements is within 4 months. Receivables under repurchase agreements are secured with shares of a local company.

9. LOANS AND RECEIVABLES FROM CUSTOMERS

(a) Analysis by type of customers

	As of 31.12.2011	As of 31.12.2010
Private entities	178,870	161,026
Households and individuals	38,244	40,371
State budget	731	901
Financial entities	1,925	-
	219,770	202,298
Allowance for impairment	(6,060)	(5,732)
TOTAL	213,710	196,566

All amounts are in thousand BGN, unless otherwise stated

9. LOANS AND RECEIVABLES FROM CUSTOMERS (CONTINUED)

(b) Analysis by sectors

	As of 31.12.2011	As of 31.12.2010
Consumer loans	31,283	33,570
Manufacturing	30,827	21,357
Construction	28,362	26,131
Trade	24,130	21,488
Agriculture	20,527	15,233
Health sector	16,368	13,141
Tourism	15,024	16,272
Transportation	9,061	7,946
Operations with real estate	8,109	9,184
Finance	1,925	-
State budget	731	901
Other sectors	33,423	37,075
	219,770	202,298
Allowance for impairment	(6,060)	(5,732)
TOTAL	213,710	196,566

In 2011 and 2010 loans and receivables from customers to the amount of BGN 87 thousand and BGN 712 thousand respectively were written-off against allowance for impairment (see also note 28).

Loans granted bear mainly floating interest. The weighted average effective interest rates on loans are as follows:

	As of 31.12.2011	As of 31.12.2010
Loans and receivables in BGN	9.0%	9.4%
Loans and receivables in EUR	8.7%	9.3%
Loans and receivables in USD	10.0%	10.4%

10. INVESTMENTS HELD TO MATURITY

	As of 31.12.2011	As of 31.12.2010
Bulgarian government bonds		
In BGN	37,131	29,291
In foreign currency	29,556	18,573
Corporate bonds of local and foreign issuers		
In BGN	13,609	7,316
In foreign currency	1,778	-
TOTAL	82,074	55,180

As of December 31, 2011 and 2010 securities with carrying amount of BGN 7,930 thousand and BGN 15,773 thousand respectively, are pledged as collateral with BNB to secure attracted funds from the State budget and long-term borrowings granted by the Bulgarian Development Bank (see note 17).

As of December 31, 2011 and 2010 the Bank has no exposures to the sovereign debt of foreign governments.

All amounts are in thousand BGN, unless otherwise stated

11. PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLE ASSETS

	Land and buildings	Office equipment	Vehicles	Fixture and fittings	Other assets	Intangible assets	Total
Cost							
January 1, 2010	2,814	2,403	775	1,723	1,200	653	9,568
Additions	11	98	-	9	270	125	513
Disposals	-	(60)	-	(2)	-	(26)	(88)
Transfers	(84)	-	-	-	84	-	-
December 31, 2010	2,741	2,441	775	1,730	1,554	752	9,993
Additions	-	303	202	77	464	55	1,101
Disposals	-	(16)	(49)	(1)	(943)	-	(1,009)
December 31, 2011	2,741	2,728	928	1,806	1,075	807	10,085
Accumulated depreciation/amortization							
January 1, 2010	(267)	(1,425)	(597)	(1,408)	(478)	(479)	(4,654)
Charged during the year	(60)	(372)	(124)	(94)	(260)	(62)	(972)
Written off	-	56	-	1	-	19	76
December 31, 2010	(327)	(1,741)	(721)	(1,501)	(738)	(522)	(5,550)
Charged during the year	(60)	(351)	(55)	(74)	(166)	(67)	(773)
Written off		15	49	1	532		597
December 31, 2011	(387)	(2,077)	(727)	(1,574)	(372)	(589)	(5,726)
Net book value							
As of December 31, 2010	2,414	700	54	229	816	230	4,443
As of December 31, 2011	2,354	651	201	232	703	218	4,359

12. INVESTMENT IN SUBSIDIARIES AND ASSOCIATES

Investments in subsidiaries and associates as of December 31, 2011 and 2010 are as follows:

	SHARE		COST	
COMPANY	As of 31.12.2011	As of 31.12.2010	As of 31.12.2011	As of 31.12.2010
Tokuda Health Insurance Fund	-	51.85	-	1,037
TOTAL			-	1,037

The investment in subsidiaries and associates are reported in these financial statements at cost (acquisition cost). In 2011 the Bank sold its share in Tokuda Health Insurance Fund and as of December 31, 2011 the Bank has no investments in subsidiaries and associates.

The summarized financial information of subsidiaries and associates as of December 31, 2010 is as follows:

Tokuda Health Insurance Fund	As of 31.12.2010
Total assets	3,033
Total liabilities	731
Net assets	2,302
Bank‘s share in the net assets of the company	1,194

All amounts are in thousand BGN, unless otherwise stated

12. INVESTMENT IN SUBSIDIARIES AND ASSOCIATES (CONTINUED)

Tokuda Health Insurance Fund	Year ended 31.12.2010
Total income	1,178
Total profit for the year	35
Bank‘s share in the company‘s profit	18

13. OTHER ASSETS

	As of 31.12.2011	As of 31.12.2010
Deferred expenses	279	183
Guarantee deposits	59	65
Advance payments	103	68
VAT recoverable	-	1,305
Other receivables	573	293
TOTAL	1,014	1,914

14. NON-CURRENT ASSETS HELD FOR SALE

	As of 31.12.2011	As of 31.12.2010
Balance at the beginning of the year	12,829	3,084
Acquisitions during the year	1,564	9,786
Disposals during the year	(381)	(41)
Balance at the end of the year	14,012	12,829

15. DEPOSITS FROM CREDIT INSTITUTIONS

	As of 31.12.2011	As of 31.12.2010
In BGN	-	6,000
In foreign currency	901	366
TOTAL	901	6,366

Term deposits from credit institutions received as of December 31, 2011 and 2010 have maturity within 3 months.

The contracted interest rates on deposits from credit institutions are as follows:

	As of 31.12.2011	As of 31.12.2010
Deposits in BGN	0.2%	0.2%
Deposits in EUR	0.4%	-

All amounts are in thousand BGN, unless otherwise stated

16. DEPOSITS FROM CLIENTS OTHER THAN CREDIT INSTITUTIONS

	December 31, 2011			December 31, 2010		
	In BGN	In foreign currency	Total	In BGN	In foreign currency	Total
RESIDENTS	102,008	184,605	286,613	84,135	189,888	274,023
Households and individuals	55,793	171,584	227,377	45,874	175,311	221,185
State budget	3,517	-	3,517	3,674	-	3,674
Service	20,611	5,102	25,713	10,794	4,179	14,973
Manufacture	4,568	333	4,901	5,624	1,622	7,246
Trade	5,523	2,395	7,918	6,000	2,133	8,133
Transport	380	265	645	765	299	1,064
Construction	3,888	2,079	5,967	4,561	2,573	7,134
Financial institutions	2,033	443	2,476	1,850	423	2,273
Agriculture	5,695	2,404	8,099	4,993	3,348	8,341
NON-RESIDENTS	821	74,758	75,579	372	71,148	71,520
	102,829	259,363	362,192	84,507	261,036	345,543

The average contracted interest rates on deposits as of December 31, 2011 and 2010 are as follows:

2011	BGN	USD	EUR
Demand deposits	1.54	0.82	1.31
Term deposits	5.72	3.50	5.97

2010	BGN	USD	EUR
Demand deposits	2.22	0.93	2.04
Term deposits	6.10	4.30	6.28

17. BORROWINGS

As of December 31, 2011 and 2010 the Bank has received long-term and short-term financing under contracts, in order to use these funds for lending to customers of the Bank, as follows:

	As of 31.12.2011	As of 31.12.2010
Long-term financing from:		
- Bulgarian Development Bank	-	13,000
- State Fund "Agriculture"	517	1,052
	517	14,052
Short-term financing from:		
- Bulgarian Development Bank	-	3,376
- State Fund "Agriculture"	535	1,254
	535	4,630
TOTAL BORROWINGS	1,052	18,682

17. BORROWINGS (CONTINUED)

Borrowings from Bulgarian Development Bank

The Bank has received loans from the Bulgarian Development Bank under programs for lending to micro, small and medium-sized enterprises, as well as for funding of agricultural producers. As of December 31, 2010 liabilities on these loans are at the amount of BGN 16,376 thousand. In 2011 the loan is fully repaid.

Borrowings from State Fund „Agriculture"

On April 19, 2002 the Bank has entered into a long-term contract with the State Fund "Agriculture" for refinancing by the Fund of granted loans to agricultural producers. The interest rate on the refinanced funds is 2% on an annual basis. The Bank provides loans under investment projects of agricultural producers at 9% annual interest rate. Funds are repaid to the Fund on the basis of agreed loan repayment schedules with the borrowers. As of December 31, 2011 and 2010, the balance under this contract is at the amount of BGN 952 thousand and BGN 1,770 thousand.

On April 29, 2003 the Bank has signed a contract for refinancing by the State Fund "Agriculture" of loans for implementation of approved projects under SAPARD program. Interest payable by the Bank on the borrowings from the Fund is 2% on an annual basis. The Bank grants loans to agricultural producers under the SAPARD program at 9% annual interest rate. The funds are repaid to the Fund on the basis of agreed loan repayment schedules with the borrowers. As of December 31, 2011 and 2010, the balance under this contract is at the amount of BGN 100 thousand and BGN 536 thousand.

18. PROVISIONS

As of December 31, 2011 and 2010 the provisions represent long-term employee benefits.

According to the provisions of the Labour 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, 2011 and 2010 the Bank accrued BGN 237 thousand and BGN 240 thousand, respectively, for long-term employee benefits. The amount of the provision has been determined by a licensed actuary.

Main assumptions used by the licensed actuary upon determining the present value of the payables are as follows:

- Demographic assumptions;
- Mortality table and disability probability;
- Turnover rate – 0.25;
- Financial assumptions, salary growth;
- Discount rate – due to the long-term nature of the payable, annual discount rate of 6.54 % has been applied.

All amounts are in thousand BGN, unless otherwise stated

19. TAX ASSETS AND LIABILITIES

19.1 Tax assets

	As of 31.12.2011	As of 31.12.2010
Receivables on tax audit acts	63	63
Overpaid income tax advances	52	89
Total	115	152

19.2 Tax liabilities

As of December 31, 2011 and 2010 tax liabilities consist of deferred tax liabilities, arisen from the following temporary tax differences:

	As of 31.12.2011	As of 31.12.2010
Deferred tax assets:		
Unused paid leave	12	26
Long-term employee benefits	24	24
TOTAL DEFERRED TAX ASSETS	36	50
Deferred tax liabilities:		
Property revaluation upon transition to IFRS	(38)	(38)
Differences between accounting and tax amortization and depreciation	(94)	(96)
TOTAL DEFERRED TAX LIABILITIES	(132)	(134)
DEFERRED TAX LIABILITIES, NET	(96)	(84)

Deferred tax assets and liabilities as of December 31, 2011 and 2010 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.

Deferred taxes related to property revaluation upon transition to IFRS at the amount of BGN 38 thousand are recorded in equity.

20. OTHER LIABILITIES

	As of 31.12.2011	As of 31.12.2010
Ongoing bank transfers	162	293
Unused paid leave and other liabilities to personnel	131	263
Deferred income	21	31
Other liabilities	269	381
TOTAL	583	968

Ongoing bank transfers represent liabilities on money transfers ordered by customers in the last day of 2011 and 2010 respectively, with value date within two days. The transfers are processed on the first working day of 2012 and 2011, respectively.

All amounts are in thousand BGN, unless otherwise stated

21. EQUITY AND RESERVES

Share capital

As of December 31, 2011 and 2010 the Bank's share capital is fully paid in and is distributed in registered, voting shares as follows:

	As of 31.12.2011	As of 31.12.2010
Number of shares	5,300	4,500
Share nominal in BGN	10	10
SHARE CAPITAL	53,000	45,000

As of December 31, 2011 and 2010 the Bank's shareholder structure is as follows:

	As of 31.12.2011	%	As of 31.12.2010	%
International Hospital Services	5,248,560	99.03	4,312,060	95.82
ET „Armada-Radoslava Dimitrova‖	19,390	0.37	-	-
Legis Consult	-	-	19,390	0.43
„Garant and Co 97‖ AD	15,000	0.28	15,000	0.33
A U C Establishment	13,300	0.25	13,300	0.31
MM Holding AD	3,750	0.07	3,750	0.08
„Tokushukai Sofia‖ EOOD	-	-	136,500	3.03
TOTAL SHARES	5,300,000	100	4,500,000	100

Reserves

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

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 increase of the share capital.

As of December 31, 2011 and 2010 reserves include Reserve Fund at the amount of BGN 813 thousand and reserves from revaluation of property to deemed cost upon adoption of IFRS at the amount of BGN 384 thousand presented net of deferred tax at the amount of BGN 38 thousand.

All amounts are in thousand BGN, unless otherwise stated

22. INTEREST INCOME/EXPENSE

	Year ended 31.12.2011	Year ended 31.12.2010
A. Interest income		
Operations in BGN		
Interest from financial assets held for trading	248	39
Interest from repo deals	234	387
Interest from loans and receivables	8,890	11,292
Interest from investments held to maturity	2,185	1,593
	11,557	13,311
Operations in foreign currency		
Interest from financial assets held for trading	648	341
Interest from loans and receivables	10,428	10,349
Interest from investments held to maturity	938	811
	12,014	11,501
TOTAL	23,571	24,812

	Year ended 31.12.2011	Year ended 31.12.2010
B. Interest expenses		
Operations in BGN		
Interest on deposits from credit institutions	24	4
Interest on other deposits	3,883	3,119
Interest on loans received	393	709
	4,300	3,832
Operations in foreign currency		
Interest on deposits from credit institutions	-	4
Interest on other deposits	11,257	10,917
Interest on loans received	29	64
	11,286	10,985
TOTAL	15,586	14,817

23. FEE AND COMMISSION INCOME/EXPENSE

	Year ended 31.12.2011	Year ended 31.12.2010
Fee and commission income		
In BGN	3,052	2,514
In foreign currency	1,302	1,338
	4,354	3,852
Fee and commission expenses		
In BGN	247	275
In foreign currency	549	260
	796	535
FEE AND COMMISSION INCOME, NET	3,558	3,317

All amounts are in thousand BGN, unless otherwise stated

24. NET GAINS ON FINANCIAL ASSETS AND LIABILITIES HELD FOR TRADING

	Year ended 31.12.2011	Year ended 31.12.2010
Gain/(loss) from sale of securities held for trading	(24)	163
Gain from revaluation of securities held for trading	490	135
Gain from foreign currency exchange rate differences	4,555	8,415
	5,021	8,713

As disclosed in note 33.3 the Bank uses derivative instruments to manage its exposure to currency risk including by currency forward contracts. Gain from foreign currency exchange rate differences for 2011 and 2010 consists mainly of gain from transactions and revaluation of these derivative instruments.

25. NET LOSSES FROM FOREIGN CURRENCY REVALUATION

Net losses from foreign currency revaluation results from daily revaluation of the currency exposure of the Bank. As disclosed in note 33.3 the Bank has material net exposure to Japanese Yen.

26. OTHER OPERATING INCOME /(EXPENSES)

	Year ended 31.12.2011	Year ended 31.12.2010
Net profit from financial assets and liabilities not at fair value	36	56
Profit / (loss) from non-current assets held for sale	(56)	72
Other operating income / (expense)	(94)	38
TOTAL	(114)	166

27. ADMINISTRATIVE EXPENSES

	Year ended 31.12.2011	Year ended 31.12.2010
Personnel costs	5,371	5,095
Materials, rents, consulting and other hired services	3,503	2,914
Taxes, fees, business trips, trainings, etc.	2,279	1,901
TOTAL	11,153	9,910

All amounts are in thousand BGN, unless otherwise stated

28. NET EXPENSES FOR IMPAIRMENT AND UNCOLLECTABILITY

In 2011 and 2010 the Bank reports net expenses for impairment and uncollectability on loans granted and receivables from customers at the amount of BGN 415 thousand and BGN 3,116 thousand, respectively.

The movement in the allowance for impairment is as follows:

	Loans and receivables from customers
BALANCE AS OF JANUARY 1, 2010	3,328
Impairment charged for the period	4,698
Reintegrated impairment for the period	(1,582)
Written-off during the period	(712)
BALANCE AS OF DECEMBER 31, 2010	5,732
Impairment charged for the period	3,525
Reintegrated impairment for the period	(3,110)
Written-off during the period	(87)
BALANCE AS OF DECEMBER 31, 2011	6,060

29. TAX EXPENSES

Current tax expense represents taxes due under the Bulgarian legislation according to the applicable tax rate of 10 % for 2011 and 2010. Deferred tax income/expense arises as a result of a change in the carrying amount of deferred tax assets and liabilities.

The reconciliation between tax expense and the accounting profit is as follows:

	Year ended **31.12.2011**	Year ended **31.12.2010**

All amounts are in thousand BGN, unless otherwise stated

30. RELATED PARTIES

As of December 31, 2011 and 2010 the Bank has receivables from, payables to and contingent commitments to related parties as follows:

Related parties and balances	As of 31.12.2011	As of 31.12.2010
Companies under common control		
Loans granted	-	724
Other receivables	781	419
Deposits received	4,663	3,509
Subsidiaries and associates		
Deposits received	-	1,730
Key management personnel		
Loans granted	244	399
Deposits received	5,899	3,537

Income and expenses realized by the Bank in 2011 and 2010 from transactions with related parties are as follows:

Related parties and type of transactions	Year ended 31.12.2011	Year ended 31.12.2010
Companies under common control		
Interest income	47	27
Income from fees and commissions	46	57
Income from foreign currency exchange differences	-	22
Income from services	-	40
Interest expense	189	64
Expenses for fees and commissions	18	16
Loss from sale of investments	45	-
Subsidiaries and associates		
Interest expense	-	86
Key management personnel		
Interest income	17	142
Income from fees and commissions	149	91
Income from foreign currency exchange differences	-	65
Income from services	10	16
Interest expense	132	119
Expenses for fees and commissions	32	14
Other expenses	27	-

In 2011 the Bank sold its shares in Tokuda Health Insurance Fund (note 12) to a related party. As a result of the transaction no gain or loss was realized.

The remuneration to the members of Supervisory Board in 2011 amounts to BGN 58 thousand (2010: BGN 72 thousand). The remuneration to the members of Management Board in 2011 amounts to BGN 442 thousand (2010: BGN 343 thousand).

All amounts are in thousand BGN, unless otherwise stated

31. 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:

	As of 31.12.2011	As of 31.12.2010
Cash on hand	8,263	8,323
Cash with the Central bank	27,483	26,444
Nostro accounts with local credit institutions	450	24
Nostro accounts with foreign credit institutions	571	1,937
Loans and deposits to credit institutions with original maturity up to three months	17,738	66,740
TOTAL CASH AND CASH EQUIVALENTS IN THE STATEMENT OF CASH FLOWS	54,505	103,468

32. COMMITMENTS AND CONTINGENCIES

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

As of December 31, 2011 and 2010 the Bank has issued bank guarantees in favour of third parties at the amount of BGN 10,000 thousand and BGN 9,991 thousand, respectively, out of which BGN 9,142 thousand and BGN 9,318 thousand, respectively, are performance guarantees secured with restricted cash at the Bank or with other customers’ assets.

As of December 31, 2011 and 2010 unutilized loan and overdraft commitments amount to BGN 19,802 thousand and BGN 15,470 thousand, respectively.

33. 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.

33. FINANCIAL RISK MANAGEMENT (CONTINUED)

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.

In 2011 and 2010 the Bank has not used derivative instruments to hedge risks. The Bank uses derivative instruments in the form of forward currency contracts and currency swap transactions to manage its currency risk.

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.

33.1 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 geographic area and relevant business sectors. Adequate collateral and guarantees are required in order to reduce the credit risk, according to the adopted Internal credit rules.

The maximum exposure to credit risk of the Bank is the carrying amount of the financial assets.

Cash and cash balances with the Central bank at the amount of BGN 35,746 thousand and BGN 34,767 thousand, respectively as of December 31, 2011 and 2010 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 18,759 thousand and BGN 76,709 thousand, respectively as of December 31, 2011 and 2010 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.

All amounts are in thousand BGN, unless otherwise stated

33. FINANCIAL RISK MANAGEMENT (CONTINUED)

33.1 Credit risk (continued)

Receivables under repurchase agreements of securities at the amount of BGN 2,190 thousand as of December 31, 2011 are secured with publicly traded shares of a local company.

Financial assets held for trading at the amount of BGN 41,324 thousand and BGN 28,434 thousand as of December 31, 2011 and 2010, respectively, bear mainly market risk to the Bank, which is described in note 33.3.

Financial assets available for sale at the amount of BGN 165 thousand and BGN 237 thousand, respectively as of December 31, 2011 and 2010 represent shares in financial and non-financial enterprises, which bear exposure to credit risk up to the carrying amount of the investment.

Debt securities held to maturity and issued by the Republic of Bulgaria at the amount of BGN 66,687 thousand and BGN 47,864 thousand, respectively as of December 31, 2011 and 2010 do not bear credit risk to the Bank as they are guaranteed by the Bulgarian State.

Debt securities held to maturity and issued by domestic and foreign commercial companies at the amount of BGN 15,387 thousand and BGN 7,316 thousand, respectively as of December 31, 2011 and 2010 expose the Bank to credit risk to the amount of the investment, which is managed by periodically monitoring of the financial position of issuers.

Loans and advances to customers with carrying amount of BGN 213,710 thousand and BGN 196,566 thousand, respectively as of December 31, 2011 and 2010 expose the Bank to credit risk. The exposure of the Bank to this risk is determined based on individual assessment of each loan, as the Bank applies the criteria for assessment and classification of risk exposures required by the banking legislation in the Republic of Bulgaria.

The Bank classifies 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	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	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.	100%

The allowance for impairment and uncollectability of loans and receivables is 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.

All amounts are in thousand BGN, unless otherwise stated

33. FINANCIAL RISK MANAGEMENT (CONTINUED)

33.1 Credit risk (continued)

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, control over disbursed funds and the related administration. The Bank has adopted and monitors the compliance with the limits for credit exposure by regions and sectors. The objective of these limits is to minimize the loan portfolio concentration in specific regions or sectors, which would lead to increased credit risk.

Quality of the loan portfolio

Classification groups as of December 31, 2011:

	Granted loans			Unutilized commitment	Issued letters of guarantee		
Group	Amount	*Share in %*	Allowance	Amount	Amount	*Share in %*	Allowance
Regular	133,490	60.74	-	19,767	10,000	100.00	-
Watch	38,168	17.37	62	2	-	-	-
Non-performing	16,516	7.52	129	33	-	-	-
Loss	31,596	14.37	5,869	-	-	-	-
Total	219,770	100.00	6,060	19,802	10,000	100.00	-

Classification groups as of December 31, 2010:

	Granted loans			Unutilized commitment	Issued letters of guarantee		
Group	Amount	*Share in %*	Allowance	Amount	Amount	*Share in %*	Allowance
Regular	137,014	67.73	450	13,446	9,991	100.00	-
Watch	43,314	21.41	1,233	2,005	-	-	-
Non-performing	8,301	4.10	492	-	-	-	-
Loss	13,669	6.76	3,557	-	-	-	-
Total	202,298	100.00	5,732	15,471	9,991	100.00	-

The loans granted by the Bank can be summarized in the following table:

Groups	As of 31.12.2011		As of 31.12.2010	
	Loans, granted to companies	Loans, granted to individuals	Loans, granted to companies	Loans, granted to individuals
Neither past due nor impaired	105,998	18,839	101,735	23,218
Past due but not impaired	6,531	2,122	9,843	2,218
Impaired on individual basis	68,997	17,283	50,349	14,935
Total	181,526	38,244	161,927	40,371
Allowance for impairment	4,171	1,889	4,548	1,184
Net loans	177,355	36,355	157,379	39,187

All amounts are in thousand BGN, unless otherwise stated

33. FINANCIAL RISK MANAGEMENT (CONTINUED)

33.1 Credit risk (continued)

Quality of the credit portfolio (continued)

The category of neither past due nor impaired loans includes exposures that at the end of the reporting period have no arrears to the agreed repayment schedules and no other impairment indication.

Loans and advances to customers that are neither past due nor impaired are presented in the following table:

	As of 31.12.2011	As of 31.12.2010
Consumer loans	14,993	19,644
Mortgage loans	3,846	3,574
Corporate clients	105,998	101,735
Total	124,837	124,953

The category of past due but not impaired include exposures that are overdue by up to 30 days and no other impairment indication. The Bank considers that these overdues are accidental and do not represent an indication of impairment.

The carrying amount of loans, which are overdue, but not impaired, is as follows:

	As of 31.12.2011	As of 31.12.2010
Consumer loans	1,729	1,744
Mortgage loans	393	474
Corporate clients	6,531	9,843
Total	8,653	12,061

Information on the carrying amount of loans and receivables from customers classified as other than Regular is as follows:

2011	Carrying amount before impairment	Carrying amount before impairment	Carrying amount before impairment	Total highly liquid collateral
	Group II	Group III	Group IV	
Consumer loans	4,717	2,693	7,153	12,808
Mortgage loans	488	586	1,646	2,786
Corporate clients	32,963	13,237	22,797	43,921
Total	38,168	16,516	31,596	59,515

2010	Carrying amount before impairment	Carrying amount before impairment	Carrying amount before impairment	Total highly liquid collateral
	Group II	Group III	Group IV	
Consumer loans	5,771	1,919	4,492	10,840
Mortgage loans	1,737	667	349	2,390
Corporate clients	35,806	5,715	8,828	35,831
Total	43,314	8,301	13,669	49,061

All amounts are in thousand BGN, unless otherwise stated

33. FINANCIAL RISK MANAGEMENT (CONTINUED)

33.1 Credit risk (continued)

Quality of the credit portfolio (continued)

The following table presents the Bank_s portfolio by type of collateral:

	As of 31.12.2011	As of 31.12.2010
Secured by cash and government securities	4,529	1,186
Secured by mortgage	113,621	125,773
Other collaterals	101,020	75,144
No collateral	600	195
Allowances for impairment	(6,060)	(5,732)
Total	213,710	196,566

Business sector, classification group and overdues as of December 31, 2011:

Sector	Amount Group	Number of transactions	Debt	Including overdue on: Principal	interest	Court receivables	Allowances	Unutilized commitments
Retail	Regular	1,113	20,961	9	14	-	-	817
	Watch	99	5,205	26	49	-	16	1
	non-performing	59	3,279	60	59	-	66	-
	Loss	144	8,799	403	131	4,270	1,807	-
Total		1,415	38,244	498	253	4,270	1,889	818
Corporate	Regular	522	111,798	48	35	-	-	18,950
	Watch	57	32,963	231	250	-	46	1
	non-performing	20	13,237	58	135	-	63	33
	Loss	71	22,797	4,442	992	6,938	4,062	-
Total		670	180,795	4,779	1,412	6,938	4,171	18,984
State budget	Regular	1	731	-	-	-	-	-
	Watch	-	-	-	-	-	-	-
	non-performing	-	-	-	-	-	-	-
	Loss	-	-	-	-	-	-	-
Total		1	731	-	-	-	-	-
	Total portfolio	2,086	219,770	5,277	1,665	11,208	6,060	19,802

Business sector, classification group and overdues as of December 31, 2010:

Sector	Amount Group	Number of transactions	Debt	Including overdue on Principal	interest	Court receivables	Allowances	Unutilized commitments
Retail	regular	1,256	25,436	15	13	-	24	1,175
	watch	117	7,508	50	75	-	92	2
	non-performing	33	2,586	74	63	-	62	-
	loss	93	4,841	90	137	2,738	1,006	-
Total		1,499	40,371	229	288	2,738	1,184	1,177
Corporate	regular	411	110,677	688	44	-	417	12,291
	watch	55	35,806	158	326	-	1,141	2,002
	non-performing	21	5,715	555	154	-	430	-
	loss	48	8,828	3,099	458	3,189	2,551	-
Total		535	161,026	4,500	982	3,189	4,539	14,293
State budget	regular	1	901	-	-	-	9	-
	watch	-	-	-	-	-	-	-
	non-performing	-	-	-	-	-	-	-
	loss	-	-	-	-	-	-	-
Total		1	901	-	-	-	9	-
	Total portfolio	2,035	202,298	4,729	1,270	5,927	5,732	15,470

33. FINANCIAL RISK MANAGEMENT (CONTINUED)

33.1 Credit risk (continued)

Credit risk concentration

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 activities of the Bank, its financial condition 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 carrying amount as of December 31, 2011 and 2010 is presented in the table below:

	As of December 31, 2011		As of December 31, 2010	
	BGN'000	*% of the capital base*	*BGN'000*	*% of the capital base*
The largest total exposure to customer group	9,600	24.5 %	9,663	24.9%
Total amount of the five largest exposures	41,017	104.7%	40,025	103.1%
Total amount of all exposures - over 10% of the capital	88,255	225.3%	73,472	189.2%

Credit risk concentration by economic sectors is disclosed in note 9.

33.2 Liquidity risk

Liquidity risk arises from the gap between the maturity 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 for the increase in 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.

33. FINANCIAL RISK MANAGEMENT (CONTINUED)

33.2 Liquidity risk (continued)

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.

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 Bank prepares daily reports on liquidity status. Attracted funds are reviewed as "hot money", "unstable money" and "stable money". The average value of minimum deposit balance and dynamic components are monitored. Key parameters such as coverage ratios and coefficients of maintenance are determined. 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 ratio of the portion of the Bank's assets that will be invested in liquid assets /securities and money market placements/ and the portion that will be provided as loans to non-financial companies and/or individuals is determined by the Assets and Liabilities Management Committee and is approved by the Management Board of the Bank. At present, the ratio is 25:75 in favour of loans to non-financial companies and/or individuals.

Quantitative measure of the liquidity risk is the liquid assets coefficient, which represents the ratio between the liquid assets (cash in hand and at accounts with the Central bank, Bulgarian government securities not pledged as collateral, placements with financial institutions with maturity up to 7 days) to the attracted funds of the Bank. As of December 31, 2011 and 2010 the liquid assets ratio is 39.81% and 45.37%, respectively. The Bank maintains high amount of liquid assets in the form of cash in hand and cash balances with the Central bank, which guarantees that the Bank can meets its liquidity requirements. As of December 31, 2011 and 2010 cash and cash balances with Central Bank represent 8.6% and 8.4%, respectively of total assets of the Bank.

As an additional instrument to provide high liquidity, the Bank uses loans and receivables from 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, 2011 and 2010 loans and receivables from credit institutions represent 4.5% and 18.6%, 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, 2011 and 2010 represent 21% and 16%, respectively of total assets. By maintaining above 34% (2010: 27%) of its assets in highly liquid assets, the Bank is able to meet all payment needs on matured financial liabilities.

All amounts are in thousand BGN, unless otherwise stated

33. FINANCIAL RISK MANAGEMENT (CONTINUED)

33.2 Liquidity risk (continued)

The allocation of the Bank's financial liabilities as of December 31, 2011 according to their residual term is, as follows:

	Up to 1 month	From 1 to 3 moths	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Total
FINANCIAL LIABILITIES						
Deposits from credit institutions	901	-	-	-	-	901
Deposits from customers other than credit institutions	129,450	104,873	100,755	27,114	-	362,192
Borrowings	178	113	226	535	-	1,052
TOTAL FINANCIAL LIABILITIES	130,529	104,986	100,981	27,649	-	364,145

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, 2011 – 36% (2010: 22%) 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 for the Bank.

The allocation of the Bank's financial liabilities as of December 31, 2010 according to their residual term is, as follows:

	Up to 1 month	From 1 to 3 moths	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Total
FINANCIAL LIABILITIES						
Deposits from credit institutions	6,366	-	-	-	-	6,366
Deposits from customers other than credit institutions	137,195	95,022	94,327	18,999	-	345,543
Borrowings	357	210	4,063	4,052	10,000	18,682
TOTAL FINANCIAL LIABILITIES	143,918	95,232	98,390	23,051	10,000	370,591

33. 3 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.

33. FINANCIAL RISK MANAGEMENT (CONTINUED)

33. 3 Market risk (continued)

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

- ✓ Bulgarian government bonds - the share of bonds issued by the Bulgarian government on domestic or foreign debt should not exceed 50% of the total securities portfolio of the Bank;
- ✓ Foreign government securities - may be purchased only if they have a credit rating not lower than BBB/positive perspective on Standard & Poors 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 & Poors 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 & Poors 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 the ratio of Bank's assets invested in liquid assets /securities and money market placements/ to the amount that will be provided as loans to non-financial companies and/or individuals. The ratio is determined by the Assets and Liabilities Management Committee and is approved by the Management Board of the Bank. At present, the ratio is 25:75 in favour of loans to non-financial companies and/or individuals.
- ✓ 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 adopted principles and objectives, 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 analyze 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 suggest actions to divert from the usual limits in order to overcome such situations.

33. FINANCIAL RISK MANAGEMENT (CONTINUED)

33. 3 Market risk (continued)

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.

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.

When managing the interest rate risk 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 interest expense to provide 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.

All amounts are in thousand BGN, unless otherwise stated

33. FINANCIAL RISK MANAGEMENT (CONTINUED)

33. 3 Market risk (continued)

Interest rate risk (continued)

Applying the misbalance method the Bank uses the following approaches to the interest rate risk management, depending on the circumstances:

1. Balance – providing parity between the sensitivity of the interest-bearing assets and liabilities.
2. Restructuring of the portfolios of assets and liabilities when cyclical fluctuations in interest rates occur.
3. 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.

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

The interest-bearing assets and liabilities of the Bank as of December 31, 2011 are as follows:

	Up to 1 month	Between 1 and 3 months	Between 3 months and 1 year	Between 1 and 5 years	Over 5 years	Total
INTEREST-BEARING ASSETS						
Loans and receivables from credit institutions	18,759	-	-	-	-	18,759
Financial assets held for trading	-	1,967	6,888	20,751	6,158	35,764
Receivables under repurchase agreements	1,518	-	672	-	-	2,190
Loans and receivables from customers	195,658	787	9,560	3,800	3,905	213,710
Investments held to maturity	3,765	-	2,062	47,118	29,129	82,074
TOTAL INTEREST-BEARING ASSETS	219,700	2,754	19,182	71,669	39,192	352,497
INTEREST-BEARING LIABILITIES						
Deposits from credit institutions	901	-	-	-	-	901
Deposits from client other than credit institutions	129,450	104,873	100,755	27,114	-	362,192
Borrowings	178	113	226	535	-	1,052
TOTAL INTEREST-BEARING LIABILITIES	130,529	104,986	100,981	27,649	-	364,145
MISBALANCE BETWEEN INTEREST-BEARING ASSETS AND LIABILITIES, NET	89,171	(102,232)	(81,799)	44,020	39,192	(11,648)

All amounts are in thousand BGN, unless otherwise stated

33. FINANCIAL RISK MANAGEMENT (CONTINUED)

33. 3 Market risk (continued)

Interest rate risk (continued)

The interest-bearing assets and liabilities of the Bank as of December 31, 2010 are as follows:

	Up to 1 month	Between 1 and 3 months	Between 3 months and 1 year	Between 1 and 5 years	Over 5 years	Total
INTEREST-BEARING ASSETS						
Loans and receivables from credit institutions	64,353	4,349	8,007			76,709
Financial assets held for trading			10,395	11,113	2,218	23,726
Loans and receivables from customers	181,228	561	7,425	2,639	4,713	196,566
Investments held to maturity	1,518	5,229	2,086	22,477	23,870	55,180
TOTAL INTEREST-BEARING ASSETS	247,099	10,139	27,913	36,229	30,801	352,181
INTEREST-BEARING LIABILITIES						
Deposits from credit institutions	6,366	-	-	-	-	6,366
Deposits from client other than credit institutions	137,195	95,022	94,327	18,999	-	345,543
Borrowings	357	210	4,063	4,052	10,000	18,682
TOTAL INTEREST-BEARING LIABILITIES	143,918	95,232	98,390	23,051	10,000	370,591
MISBALANCE BETWEEN INTEREST-BEARING ASSETS AND LIABILITIES, NET	103,181	(85,093)	(70,477)	13,178	20,801	(18,410)

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

	Year ended 31.12.2011	Year ended 31.12.2010
Interest-bearing assets		
Loans and receivables from credit institutions	0.71	0.54
Financial assets held for trading	4.29	4.35
Receivables under repurchase agreements	7.63	-
Loans and receivables from customers	9.05	10.15
Investments held to maturity	4.71	5.01
Interest-bearing liabilities		
Deposits from credit institutions	0.20	0.21
Deposits from clients other than credit institutions	4.04	4.36
Borrowings	2.39	2.35

All amounts are in thousand BGN, unless otherwise stated

33. FINANCIAL RISK MANAGEMENT (CONTINUED)

33. 3 Market risk (continued)

Currency risk

Currency risk is the possibility of realizing losses for the Bank as a result of 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.

The foreign currency structure of the carrying amount of financial assets and liabilities as of December 31, 2011 is as follows:

	BGN	EUR	USD	JPY	Other	Total
ASSETS						
Cash and cash balances at central banks	12,232	22,211	766	212	325	35,746
Loans and receivables from credit institutions	22	10,825	5,964	1,303	645	18,759
Financial assets held for trading	11,473	29,114	737	-	-	41,324
Financial assets available-for-sale	164	1	-	-	-	165
Receivables under repurchase agreements	2,190	-	-	-	-	2,190
Loans and receivables from customers	96,969	110,730	4,371	1,640	-	213,710
Investments held to maturity	50,740	26,142	5,192	-	-	82,074
TOTAL ASSETS	173,790	199,023	17,030	3,155	970	393,968
LIABILITIES						
Deposits from credit institutions	-	733	168	-	-	901
Deposits from client other than credit institutions	102,687	185,597	19,883	53,065	960	362,192
TOTAL LIABILITIES	102,687	186,330	20,051	53,065	960	363,093
NET EXPOSURE	71,103	12,693	(3,021)	(49,910)	10	

33. FINANCIAL RISK MANAGEMENT (CONTINUED)

All amounts are in thousand BGN, unless otherwise stated

33. 3 Market risk (continued)

Foreign currency risk (continued)

The foreign currency structure of the carrying amount of financial assets and liabilities as of December 31, 2010 is as follows:

	BGN	EUR	USD	JPY	Other	Total
ASSETS						
Cash and cash balances at central banks	10,537	23,260	686	103	181	34,767
Loans and receivables from banks	7	57,458	13,034	5,909	301	76,709
Financial assets held for trading	12,064	16,370	-	-	-	28,434
Financial assets available-for-sale	236	1	-	-	-	237
Loans and receivables from customers	102,194	88,103	3,926	2,343	-	196,566
Investments held to maturity	36,607	16,007	2,566	-	-	55,180
TOTAL ASSETS	161,645	201,199	20,212	8,355	482	391,893
LIABILITIES						
Deposits from credit institutions	6,000	276	90	-	-	6,366
Deposits from clients other than credit institutions	84,509	188,952	20,367	51,141	574	345,543
Borrowings	15,345	3,337	-	-	-	18,682
TOTAL LIABILITIES	105,854	192,565	20,457	51,141	574	370,591
NET EXPOSURE	55,791	8,634	(245)	(42,786)	(92)	

As of December 31, 2011 and 2010 the Bank has significant net liabilities in JPY, due to the fact that part of the deposit base of the Bank is denominated in that currency. The exchange rate of the Japanese yen is characterized by high volatility, which the Bank manages using derivative instruments, including currency forward contracts and swap transactions. The derivative instruments are reported as financial assets held for trading and are reported at their fair value.

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.

Sensitivity to market risk

The risk exposure of the trading portfolio of the Bank is assessed on daily basis using VaR (Value-at-risk), whose value is compared to the limit determined by the Asset Liability Management Committee of the Bank. The daily VaR of the trading portfolio is calculated using Monte Carlo Simulation, confidence level of 99% and standard deviation of 2.33%. In 2011 the limit of the value of VaR is 0.20%.

33. FINANCIAL RISK MANAGEMENT (CONTINUED)

33. 3 Market risk (continued)

Sensitivity to market risk (continued)

As of December 31, 2011 the Bank performed analysis of its the 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. Due to the open net exposure of the Bank, this scenario could lead to increase of the financial result for the year by BGN 193 thousand or 0.16%. 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 of 0.25% would lead to loss of BGN 914 thousand.

As of December 31, 2011 the Bank applies the Value-at-Risk analysis (VaR) using Monte Carlo Simulation and assumption of changes in foreign currency exchange rates by 10% to determine the currency risk sensitivity. At these parameters the Value-at-risk as of December 31, 2011 is determined to be BGN 18 thousand.

In 2011 in relation to changes in banking regulations, the Bank has changed the way in which it determines its sensitivity to market risk. As of December 31, 2010, the Bank uses the following scenario to determine the sensitivity of the Bank to market risk: foreign exchange rate depreciation of 10%, loss from stock market price downturn – 15%, increase of interest rate curve, used to discount the cash flows, by 200 basis points. These parameters are applied for the portfolios of securities of the Bank. On the basis of this scenario, VAR as of December 31, 2010 amounts to BGN 2,604 thousand.

In accordance with the BNB regulations the market risk sensitivity indicators determined by the Bank are included when determining the required capital of the Bank as of December 31, 2011.

34. 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 may 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 this set minimum.

Ordinance № 8 of the BNB regarding the capital adequacy requires that the Bank maintains a ratio of capital adequacy of at least 12% and ratio of tier I capital adequacy of at least 6%. The capital requirements of the Bank depend on many factors, including the growth of the credit portfolio and income, regulatory capital requirements and potential acquisitions of assets. Every change that limits the ability of the Bank to manage actively its assets and capital resources, for example, deterioration of the quality of the loan portfolio, decrease in profit as a result of written-off loans, increase of risk-weighted assets, delay in realization of assets, may lead to a necessity for additional capital requirements.

The Bank monitors and analyzes on monthly basis its capital position and prepares quarterly reports for supervisory purposes, which are presented to the BNB in compliance with the legal requirements. The policy for capital management aims to provide an adequate coverage of risks arising in the normal course of banking activities, as well as risks resulting from unforeseen circumstances.

34. CAPITAL MANAGEMENT (CONTINUED)

All amounts are in thousand BGN, unless otherwise stated

The table below presents information regarding the capital adequacy as of December 31, 2011 and 2010. The Bank uses the standardized approach for calculation of capital requirements for credit risk and the approach of the basic indicator for measurement of operational risk.

Capital base	As of 31.12.2011	As of 31.12.2010
Tier I capital		
Share capital	53,000	45,000
Reserves	(4,962)	(5,249)
Less: Intangible assets	218	230
Less: Investments in shares of other companies	-	1,037
Less: Specific provisions for credit risk	8,995	-
Total Tier I capital	***38,825***	***38,484***
Tier II capital	***347***	***347***
Total capital base	**39,172**	**38,831**
Capital requirements		
Capital requirements for credit risk	17,942	17,227
Capital requirements for exposure risk, foreign currency and commodity risk	1,029	638
Capital requirements for operational risk	1,952	1,741
Additional capital requirement - 4%	10,461	9,803
Total capital requirements – Standard approach	**31,384**	**29,409**
Ratios		
Total capital adequacy (%)	**14.98**	**15.84**
Tier I capital adequacy (%)	**14.98**	**15.84**

One of the requirements of the BNB is that the specific provisions for credit risk should be deducted from the amount of the capital base. The specific provisions for credit risk represent the excess of the carrying amount of the loans, determined in accordance with the applicable accounting standards and reflected in these financial statements, over the risk value of the exposure, calculated in accordance with the requirements of Ordinance № 9 of the BNB. For the purposes of determining the specific provisions, for loans classified as loss for a period greater than 365 days, the amount of the collateral is assumed to be nil. As of December 31, 2011 the Bank has set specific provisions for credit risk at the amount of BGN 8,995 thousand.