TOKUDA BANK AD

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

for year 2019

This is a translation of the Annual Financial Statements of Tokuda Bank AD for the year ended 31 December 2019.

Токуда Банк

MANAGEMENT ACTIVITY REPORT 2019

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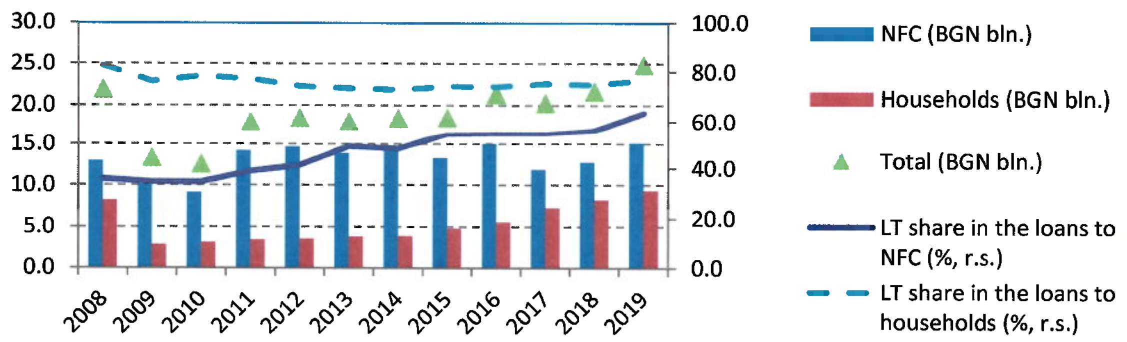
I. Environment in which Tokuda Bank AD operated in 2019

In the past year 2019, the banking sector continued to develop at a sustainable pace, irrespective of the signs of slowdown of the economy, which appeared as early as the beginning of the second half. Profit in the system almost reached last-year's volume, concentration has been increasing, as far as the market share of the five biggest banks increased from 59.4% to 62.1%, and the share of second-group banks decreased by almost 1/10, to 34.7%. To a large extent, these changes may be explained by the transfer of a Group II bank into the structure of a Group I bank, accomplished in November 2019.

Lending activity exceeded the pre-crisis levels for the first time since 2008. The monetary statistics data (Figure 1) show that in the past 2019 the total amount of loans disbursed and re-negotiated increased by 12.8% - from BGN 21.7 billion in 2018 to BGN 24.9 billion in 2019, which is BGN 3 billion more than the pre-crisis peak (BGN 21.8 billion in 2008). The growth rate achieved is a bit slower in new business for households (11.6% compared to 15.7% in company loans), but nevertheless, the activity in both segments (BGN 15.16 billion for NFC and BGN 9.35 billion for individuals and households) has a higher nominal value than the level achieved in 2008 (respectively BGN 12.95 billion and BGN 8.22 billion). It has to be considered that in real terms (i.e. if new-business volumes are compared to the gross amount of the loan portfolio for the respective periods), the activity indicators are still significantly weaker than the pre-crisis levels.

It can be noticed that the increasing lending in the corporate segment is accompanied by a sharp increase in the share of long-term loans. The share of exposures with original maturity over 5 years has increased from 56.3% to 63.6% of the total volume of new business for NFC, which against the background of the negative rates of gross share capital formation stated by the NSI (reaching -6.4% in 2019Q4) could not be explained to such extent with an increased demand for investment financing, but rather with the evident wish to limit the burden of servicing debts of non-financial corporations, which on its part shows that despite some increase in the investment activities of economic agents, they have generally retained a conservative attitude.

Figure 1 Volumes of new business

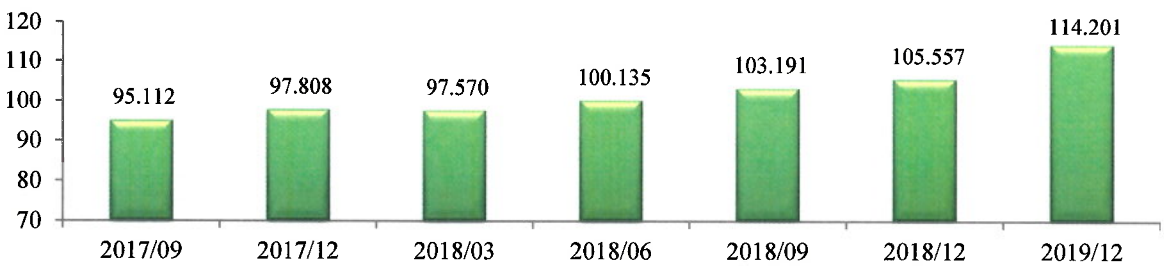


Source: BNB, own calculations

Aiming to reverse this trend, the Bulgarian National Bank (BNB) retained the negative interest rate on excess reserves and despite the difficult transfer of the monetary effect thereof on the real economy (which is to a large extent prevented by the possibilities to export resources, including through the parent banks to their ECB accounts, where the sanction on excess reserves is lower), the assets of financial intermediaries increased by the record BGN 8.6 billion (**Error! Reference source not found.**). In addition, unlike in 2018, the growth in 2019 is entirely at the expense of exposure to the non-financial sector. On-demand deposits during the past year decreased by 18%, and cash balances with the Central Bank – by over 12%, thus shrinking their share in the assets structure from 14.5% to 11.8%. On the other hand, loans and advances in the past year increased by 12.4%, and their share in the overall assets structure increased from 63.3% to 65.7%.

The transfer of effects of the Central Bank's policy onto financial intermediaries' behaviour in the country is clearly seen. Given the conservative approach of the business, lending facilities are a key contributor to the increase of activity in this sector. The summarised results of BNB's lending survey show that financial intermediaries continue to relieve conditions of the loans offered thereby. For instance, throughout the entire 2019, the balance of opinions regarding the interest on loans to NFC is negative, and the number of banks surveyed that decreased interest on new loans in this segment ranges from 5 to 7 against one that increased interest rates. This seems to lead to the result sought among potential business customers, since in 2019 the number of banks reporting increased demand for corporate loans (between 3 and 8 in the different product categories and reporting sub-periods) is definitely higher than the number of banks reporting decreased demand (between 0 and 3).

Figure 2 Commercial banks' assets [BGN billion]



Source: BNB

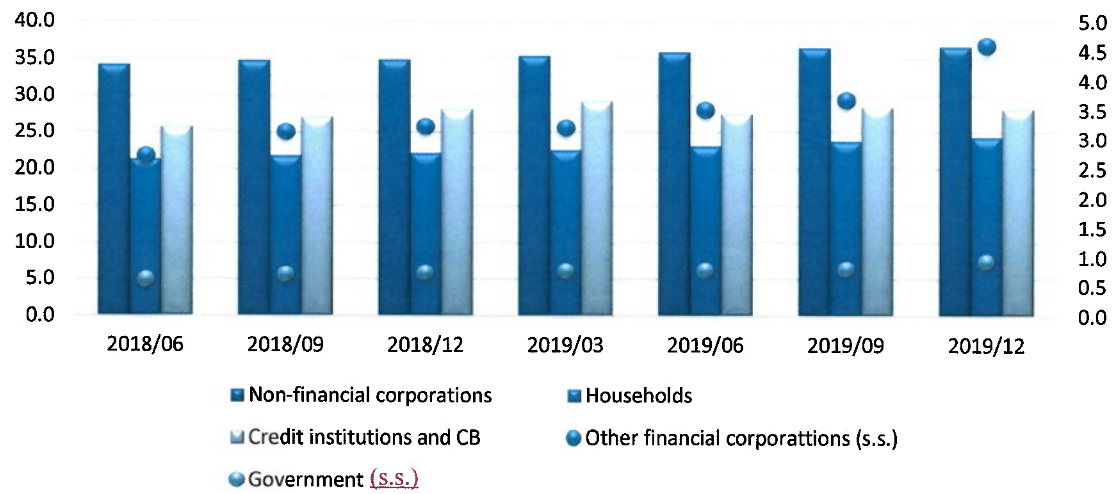
An additional incentive to lending is the retention of NFC lending standards without change for a third consecutive year at almost all respondent banks. There are individual exceptions, for instance, in the fourth quarter of 2019 a bank reported tightening of standards, versus one – relieving standards, and 20 that kept them unchanged.

Favourable tendencies are also evident in the retail lending. The segment demonstrates stable growth and the overall new business volume continued to increase (Figure 1), reaching BGN 9.351 billion in 2019, which is by BGN 1.086 billion or 11.6% higher than in 2018. It can be seen that this trend is characterized by high sustainability over time – in fact the new business volumes in this segment have been continuously increasing since 2010.

A shift occurred during 2019 in the trend of change in the share of long-term household loans. After the two stages that can be identified on the basis of monitoring this indicator (namely the six years until 2014, when the share of long-term household loans was constantly decreasing – to 72.9%, and the subsequent four years, during which there was slight fluctuation), in the past 2019 monetary statistics show a considerable increase in this sector – by 1.8 percentage points, to 76.7%. The change can be explained with the extension of the periods of some of the new loans to individuals and households, which on its part is due to the faster rate in mortgage loans, resulting in the attraction of individuals with lower income (respectively needed a relatively longer repayment period).

The higher activity in retail banking impacts the dynamic of the absolute volume of gross loans (Figure 3), but there is certain change in the trend also, that originated in the summer of 2016, when the rates in this segment reached a positive value for the first time since the crisis started. The good dynamic indicators were upheld in 2019, and at the end of December the annual rate of household loans reached 9.6%, which is comparable, yet lower than the prior-year level (11.6%).

Figure 3 Gross loans before impairment at the end of the period [BGN'000]



Source: BNB, own calculations

The main contribution for maintaining high rates in this segment, like in prior years, belongs to the intensive growth of new business volumes, which in the past year reached an absolute record of BGN 9.4 billion. The faster increase in gross household loans by BGN 2.118 billion compared to the twice smaller absolute growth in new business volumes (BGN 1.086 billion) can mainly be explained with the longer original maturity of the loans originated after 2014, characterized by the above-mentioned increase in loans negotiated for a period over 5 years. In 2019, this segment reached a 7-year maximum, approximating the pre-crisis level (respectively 76.7% against 82.6% in 2008).

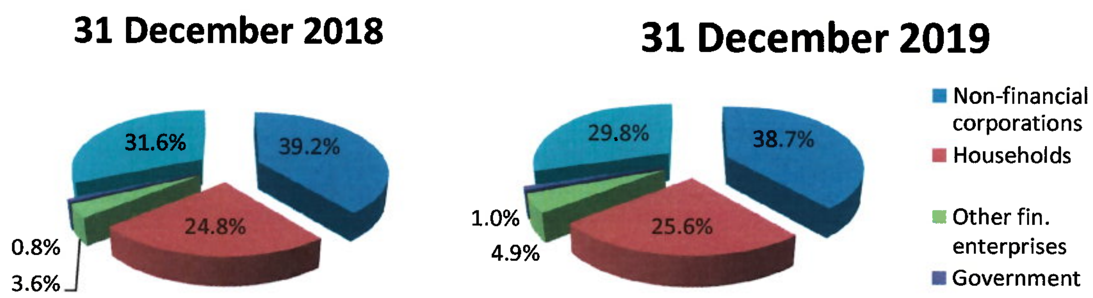
The data from the regular BNB survey shows that demand for consumer loans over the past year has remained stable, and the interest towards the home purchase loans has continued to rise. According to the non-weighted results for 2019, the banks that reported an increased demand in consumer loans exceeds those that reported a decrease (respectively 3 to 6 against 0 to 1 in the separate sub-periods).

The increased interest may be explained most of all with the faster growth of population income, as far as over the whole period from the beginning of 2019 the labour costs have been intensively growing (by 10-13% on a working-day adjusted base), unemployment has been steadily decreasing for the eight consecutive year (to 5.9% for 2019 according to the Employment Agency), and the real GDP growth has remained over 3% for the fifth consecutive year.

This naturally results in increased demand for loans by the individuals and households, and it has to be pointed out that like in the corporate segment, the increased demand among households is also due to the favourable terms offered by commercial banks. The results from the regular BNB survey show that in the third quarter of 2019 the balance of opinions on the changes in consumer loans' interest rates in the beginning of this year reached -38, and the number of banks reporting a decrease in interest rates over the entire period is between 5 and 6. The balance of opinions regarding mortgage loans for Q1 and Q3 of 2019 is -39, and in the entire period about over ¼ of the respondents reported a decrease in interests on newly originated home and mortgage loans (between 5 and 7).

The general impression based on observation of the lending activity in 2019 is that as a result of its continuing recovery, it is already close to the target levels of the most banks in the country, as far as the growth rate of gross loans (excluding those to banking institutions) since the beginning of the year has overcome the overall lending rate, and at the end of the period the overtaking reached 275 b.p. (with 8.84% in gross loans versus 6.09% for the overall portfolio volume). This, on its part, results in certain changes in the structure of the loan portfolio (Figure 4), which until the last year altered mainly in favour of low-interest and non-interest segments (loans to financial entities, credit institutions, and central banks).

Figure 4 Structure of the loans and advances



Source: BNB, own calculations

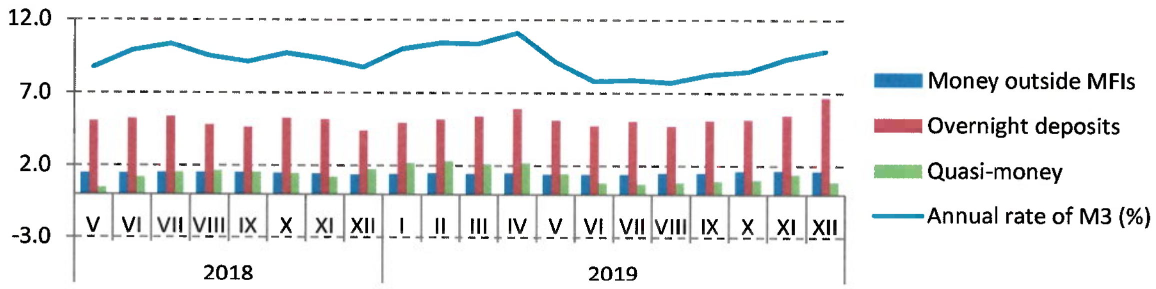
Over the past 12 months, the share of exposure to the financial sector has considerably shrunk (by 1.77 percentage points – to 29.81%), at the expense of an increase in household loans (from 24.80% to 25.61%), loans to other financial entities (from 3.62% to 4.86%) and state government, which increased its share by 15 b.p.

During the past year, the indicators of dynamics in the non-banking financial institutions sector accelerated twofold and the exposure to this sector grew by 42.3% (BGN 1.374 billion), compared to 27.3%, (respectively, BGN 690 million) for the previous year. The reported acceleration is not surprising, insofar as through funding the NBFCs, commercial banks in the country obtained access to some customers with lower creditworthiness without formally experiencing the impact thereof on their business model and capital indicators.

Against the set of factors characterizing the activity of financial intermediaries, it cannot be expected that the changes in the assets structure observed in 2019 will turn into a long-term trend. The degree of uncertainty has been considerably growing as a result of the weakening of economic activity related to the anti-epidemic measures against the COVID-19 pandemic and irrespective of the temporary relief of capital adequacy criteria, the complicated situation requires adoption of more conservative lending approach.

Along with the probability of a significant increase of the share of non-performing loans and the decrease in lending as a logical consequence of the sudden slowdown in the real economy as a result of the anti-epidemic measures, one of the serious risks for the banking system in 2020 is the continuing increase in the disbalance in the maturity structure of interest assets and liabilities. Compared to the already mentioned increase in the share of long-term loans, which showed signs of acceleration in the past year, the structure of liabilities gives signs of beginning a reverse trend (Figure 5).

Figure 4 Money aggregates (annual growth, BGN billion)



Source: BNB, own calculations

The graph shows that in the past 2019 the growth rate of quasi money has considerably slowed (from 2.2-2.3% in the first quarter to 0.7-1.4% in the remaining part of the year). In the meantime, overnight deposits were increasing by accelerating paces (from 4.8% in April to 6.7% in December). This shows that companies and households renew fewer and fewer of the maturing fixed-term deposits, that the share of long-term funds with banks is decreasing, and that the improvement of the maturity structure of liabilities (along with maintaining lending activity and the quality of loans) will be one of the main challenges in 2020.

II. Review of the activity of Tokuda Bank in 2019

As at 31 December 2019, the assets of Tokuda Bank AD amount to BGN 392.943 million, which (according to BNB data) is 0.34% of the total amount of assets in the Bulgarian banking system. When compared to the assets of the Group II banks, to which Tokuda Bank AD belongs, this share is 0.99%. The average monthly value of balance amount is relatively constant; in the past year, the indicator reached BGN 399.9 million, and in 2018 – respectively BGN 398.4 million.

In the past year, the Bank has successfully meets the challenges of the environment and continues to increase its potential to generate sustainable growth by strictly following the main priorities in its strategy. For instance, in relation to the priority for improving the structure of assets and liabilities, the following results may be indicated: gross loans increased to BGN 218.404 million, with moderate change in impairment, and as a result, the share of loan portfolio after impairment in the overall assets structure has increased by 7.32 percentage points – to 52.94% of the total assets at the end of 2019 (compared to 45.62% in the previous year), and along with that, the quality thereof improved – in the past year, the Bank managed to shrink the share of non-performing loans by 2.32 percentage points, to 14.41% of the gross amount of loans to and receivables from customers.

This was one of the key challenges for the past year, against the moderate dynamic of the loan portfolio, which is a logical result of the increased competition for good projects with an acceptable return period and investors with proven creditworthiness. The increase in the share of performing loans and of the loan portfolio as a whole into the balance sheet structure was achieved at the expense of categories generating relatively low (including zero) income for the Bank.

The latter corresponds to one of the Bank's other business objectives, namely, improving its profitability indicators. The fulfilment of this objective may be tracked through the dynamic of the ratio between total operating expenses to the total operating income, which over the past year decreased by 4.53 percentage points (to 96.72%) as a result of the increase in the total operating income, before allowance for credit losses, by 3.58% (from BGN 13.288 million in 2018 to BGN 13.764 million for 2019), but also as a result of the limiting of operating expenses by BGN 142 thousand (to BGN 13.312 million for 2019).

The latter fact is a natural result of fulfilling another key objective, namely, improving the effectiveness of the Bank's market presence through optimisation of the office network. Pursuant to this objective, the following offices were closed down in 2019: – IRM Sheinovo – II RM in Varna, Kyustendil office, Shumen office and IRM Cadastre – II RM in Shumen, and in the beginning of 2020, the Sofia Business Park office was closed; the optimisation process was carried out without a significant client outflow. Thus, the Bank managed to optimise its expenses and thus free resources to be relocated to the points that have the potential to generate higher added value.

There has also been successful fulfilment of another priority in the strategy and business plan, namely the effective management and control of the amount of customer deposits aimed at reduction of the resource costs while maintaining stable financing. In 2019 the Bank managed to limit the volume of attracted funds by 3.63% (to BGN 346.276 million), while the share of more expensive financing, whose source are individuals and households, decreased by 0.90 percentage points (from 74.21% to 73.31% of the overall structure at the end of the past year). Thus the price of attracted funds continues its downward trend and in 2019 interest costs decreased by 28.34%, reaching BGN 1.569 million (compared to BGN 2.189 million in 2018).

In accordance with the strategy and objectives in its business plans, in 2019 the Bank managed to significantly improve its financial result, realizing a net profit of BGN 1.153 million. The result is significantly higher than in the previous year – 2018, when the Bank stated a net loss of BGN 267 thousand.

1. __Operating income and expenses__

In 2019, the Bank generated operating income before impairment and allowance for credit losses at the amount of BGN 13.764 million (Table 1), which is BGN 476 thousand (3.58%) more than in 2018. Its dynamics over the past year was still influenced most of all by the effect of the decreasing interest rates in the country, resulting in a limited increase in gross interest income on loans, which while the volume of the performing portfolio increased by 13.09% grew two times slower (4.99% or BGN 439 thousand). The decrease in interest expenses accelerated to 28.34%, and their amount decreased by BGN 621 thousand compared to the previous year, mainly due to the planned limitation of fixed-term deposits (whose volume decreased by 9.18%, and their share in the overall structure of attracted funds – by 3.48 percentage points).

In 2019, the Bank continued to adhere to the adopted conservative policy regarding administrative expenses. As part of this policy, the management exercises systematic control over expenditure, and in 2019 some of the expenses related to the Bank's rebranding were ceased. This resulted in a decrease of some items within the administrative and operating expenses, as a result of which their total amount decreased in 2019 by BGN 142 thousand (to BGN 13.312 million).

The ratio of the total operating expenses to the total operating income for the past year decreased by 4.53 percentage points (to 96.72%), which is due both to the above mentioned reduction of the operating expenses by BGN 142 thousand, as well as to the increase in overall operating income before allowance for credit losses by 3.58%, or BGN 476 thousand (from BGN 13.288 million in 2018 to BGN 13.764 million in 2019).

The continuing decrease in interest levels and the preservation of the not particularly favourable market situation over the past year resulted in some changes of the income structure (Table 1). In 2019, the share of net interest income increased moderately – by 2.70 percentage points and reached 65.76% of the total amount of net income, while non-interest income decreased its share, reaching 34.24% (in the same period of 2018, these values were respectively 63.06% and 36.94%). The changes in the structure could be explained with the overcoming rate of income from the first category, which increased by 8.01% on an annual basis (as a result of improving the quality and increasing the volume of gross loans) compared to non-interest income, which in the past year decreased by BGN 671 thousand.

Table 1. Operating income

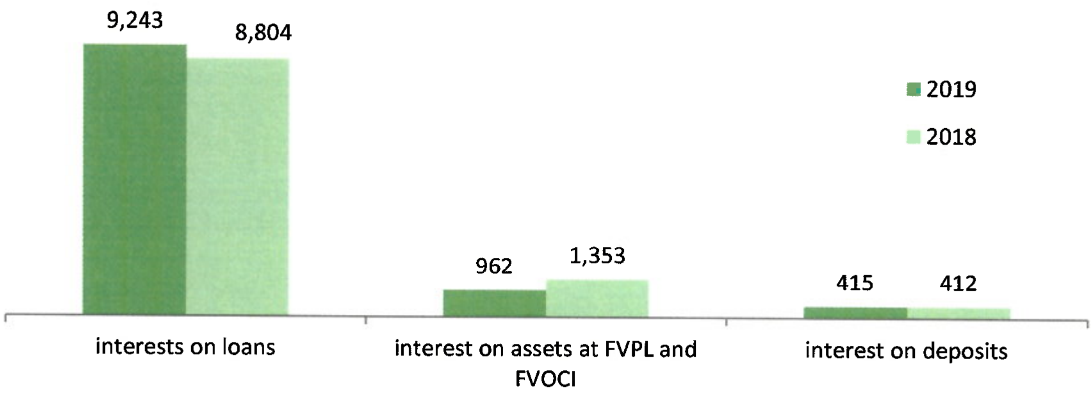
	2019	*2018*
Interest income	10,620	10,569
Interest expense	(1,569)	(2,189)
Net interest income	**9,051**	**8,380**
Fee and commission income	3,974	4,023
Fee and commission expense	(259)	(282)
Net fee and commission income	**3,715**	**3,741**
Net profit from financial assets held for trading	**286**	**273**
Other operating income	**712**	**895**
Total operating income	**13,764**	**13,288**

The gross income from interest on loans and other receivables increased by BGN 439 thousand to BGN 9.243 million and continued to have the biggest relative share as compared to the total amount of interest income, and retaining it is a huge challenge against the general market trend of decrease in interest rates. The main factor contributing to the growth in gross income from the loan portfolio of Tokuda Bank AD is the higher activity, as well as the continuing improvement of the portfolio quality (although during the past year the share of the classified loans before impairment increased by 1.72 percentage points – to 25.88%, the Bank has managed to limit the share of non-performing exposures, which has decreased by 2.32 percentage points – to 14.41%). The growth rate of the interest income on loans achieved in 2019 (4.99%) to a great extent offsets the decrease in this category last year (by 8.55%); compared to the decrease in interest income on securities in 2019, the share of interest income on loans increased by 3.73 percentage points compared to last year, reaching 87.03% at the end of the period.

Interest income from the debt instruments portfolio (Figure 6) decreased by BGN 391 thousand (or by 28.89% compared to the figure stated in 2018), to BGN 962 thousand for the past year due, on the one hand to portfolio amortisation and the sales made at the amount of BGN 17,663 million, accompanied by intensive purchases, resulting in replacing the issues recognized in the Bank's 2018 balance sheet with new ones whose profitability is lower. The accelerated rate of shrinkage of income from this source results in a noticeable decrease in the share of the first category in the total amount of interest income in 2019 – from 12.80% to 9.06%. Irrespective of the decrease in interests on interbank deposits (resulting from effective transfer of the effects of the Eurozone's quantitative easing policy), the growth rate of interest income on receivables from banks is close to zero (0.65%), as its volume thereof reaches BGN 414.9 thousand. The retention of this income item in the situation of continuing decrease in interest rates is due to the increase of the average annual amount of this group of assets in the past period (BGN 48.670 million against BGN 41.388 million for the previous year).

The price of attracted funds remained above the average level for the local banking system (as individual and household deposits maintained their predominant share in the Bank's deposit base), continuing to follow the overall downward trend. In 2019, interest costs decreased by 28.34%, reaching BGN 1.569 million (against BGN 2.189 million in 2018) as a result of the implemented effective policy of liability management.

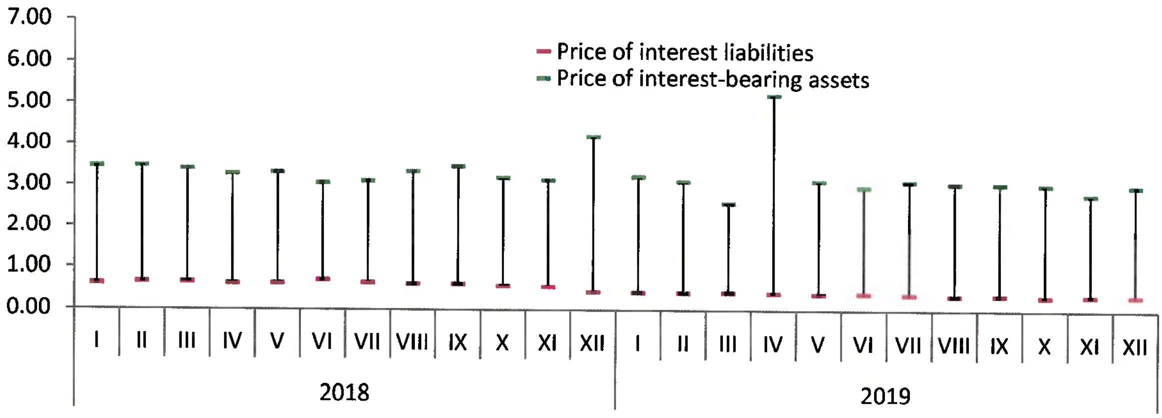
Figure 5. Interest income by sources



In 2019, the interest spread maintained its prior-year level (Figure 7), and during most of the reporting period the indicator varied within a relatively narrow range (2.44-2.81). The only exception is the month of April, when the spread increased to 4.80 as a result of the recognition of court and court-awarded interest on one of the biggest non-performing exposures of the Bank. The comparison of the profitability of interest-bearing assets shows that over the past year, the average weighted profitability ratio decreased by 18 b.p. (from 3.37% for 2018 to 3.19% for 2019), despite the decrease in the share of classified loans with delays on principal and interest payments by more than 180 days. This is a logical result from the decrease of interests in newly originated loans in view of consideration of the market dynamics, but was to a large extent compensated by the decrease in expenses on attracted funds, which on an average annual basis decreased by 15 b.p.– from 0.53% in 2018 to 0.38% in 2019 (as a result of interest decreases and maturity occurrence of a significant part of the relatively expensive longer term deposits at the Bank).

The more moderate actions related to applying fees on higher current account balances and retaining more favourable (compared to the widespread) interest on fixed-term deposits in 2019 resulted in slight changes in the maturity structure of attracted funds, and in the past year the share of current accounts increased by 3.48 percentage points (to 43.03%). The resulting decrease in expenses on attracted funds, along with the realization of additional proceeds (from collected court receivables) in the past year led to maintaining the interest spread on accumulated basis in 2019 close to the one stated for 2018 (respectively 2.81% against 2.85%).

Figure 6. Interest spread components



Non-interest income

In 2019, the non-interest income decreased by BGN 196 thousand (4.00%) compared to the prior year and reached BGN 4.712 million, which is mainly due to the net impact of the decrease of gains on remeasurement revaluation of debt instruments measured at fair value through other comprehensive income by BGN 515 thousand (from BGN 639 thousand in 2018 to BGN 124 thousand in 2019), partly offset by an increase in revenue by some of the other items in this category.

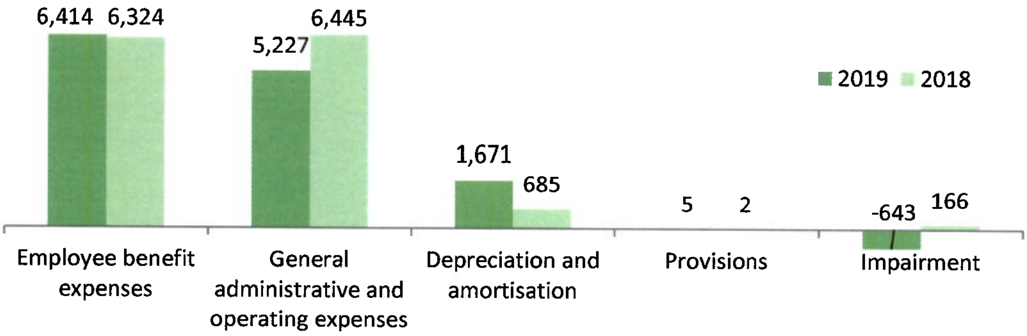
The largest share in this group of income remained that of net income from fees and commissions, decreasing insignificantly over the past year (by BGN 26 thousand or 0.68% on an annual basis) to BGN 3.715 million as a result of the decreased income from loans granted, servicing of cards, and guarantees issued. These decreases were partly compensated by the higher income from account servicing and fees on cash availabilities, which in the past year increased by a total of BGN 175 thousand. As a whole, the structure of incomes from fees and commissions over the past year did not undergo significant changes, and the biggest increase was that of cash services (2.79 percentage points, up to 10.85% of the gross fees income), and the biggest shrinkage was the one of the loan fees (3.13 percentage points, down to 18.52% of the gross fees income).

The poorly expressed dynamics in prices and the known expectations for increase of the basic interest indexes, which within the past year went further away in time, was expressed in smaller volume of trading in securities, as a result of which the net income from trading operations remained relatively low, and reached BGN 286 thousand in the past year.

Non-interest expenses

The Bank's non-interest expenses in 2019 amount to BGN 12.674 million (Figure 8), which is by BGN 948 million or 6.96% less than the preceding year. This is due to the decrease in total administrative expenses by BGN 1.218 million (to BGN 5.227 million), as well as the impairment expenses - by BGN 809 thousand. Personnel expenses grew insignificantly by BGN 90 thousand (to BGN 6.414 million), which is due to relatively slight changes in the administrative structure and maintaining the average number of employees at a relatively permanent level (223individuals at the end of 2019 as compared to 249 individuals at the end of 2018). Amortisation and depreciation expenses increased by BGN 986 thousand (to BGN 1.617 million) as a results of the Bank's continuing measures for renovation of the technological equipment, and due to the change in the accounting of leased premises, resulting in a corresponding decrease in rental expenses (by BGN 1.110 million – to BGN 33 thousand). The other administrative and operating expenses decreased by BGN 109 thousand (from BGN 5,303 million in 2018 to BGN 5,194 million in 2019).

Figure 7. Non-interest expenses

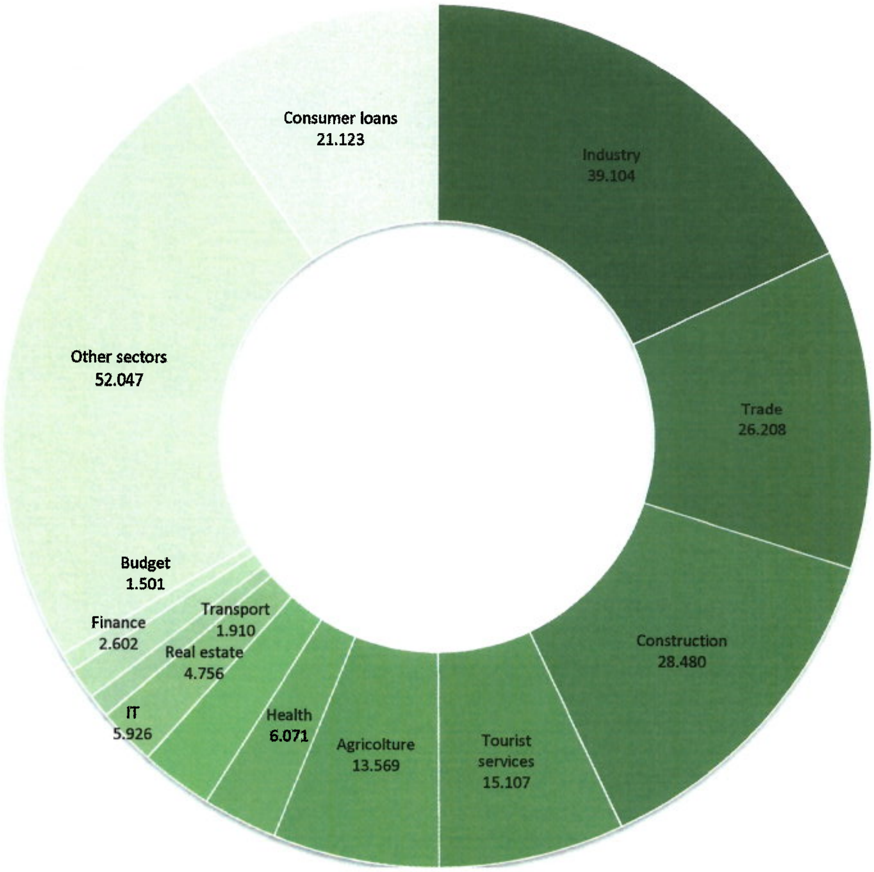


The clearly expressed dynamics of a portion of expenses in this group led to a change in its structure. For instance, the share of personnel expenses (including the labour remunerations and social security contributions) in the overall structure of non-interest expenses increased by 4.18 percentage points (from 46.43% to 50.61% over the past year), the share of total administrative and other operating expenses decreased by 6.07 p.p. to 41.24%, and amortisation and depreciation costs in 2019 were 8.15 percentage points higher compared to the preceding year. The share of provisions increased by 0.03 percentage points, and the one of impairment expenses reached a negative value.

2. *Loan portfolio*

At the end of 2019, the gross carrying amount of the Bank's loan portfolio (Figure 9) was BGN 218.404 million. After allocation of allowance for credit losses at the amount of BGN 10.375 million, the net amount of the portfolio is BGN 208.029 million. The moderate increase is due to the intense competition on the loan market and the continuing relatively high risk of the environment, but also due to the intensified activity of collection of receivables classified as "loss". As a whole, the rate achieved is sufficient to contribute to a considerable increase in the share of the loan portfolio after impairment in the overall assets structure (which is one of the Bank's strategic objectives, in view of increasing profitability ratios) by 7.32 percentage points – to 52.94% of the total assets at the end of 2019, against 45.62% in the previous year.

Figure 8. Loan portfolio allocation [BGN million]



The loans to corporate customers increased by BGN 20.502 million (to BGN 168.034 million before impairment), and their share in the gross amount of the credit portfolio increased by 1.66 percentage points compared to the prior year (to 76.94%), which is due to the elevated activity of the Corporate Banking Division at the head office.

The changes in the "*individuals and households*" segment were caused by the moderate activity in this category of borrowers. This segment's share decreased from 23.95% in the structure of gross loans in 2018 to 22.38% in 2019. In absolute terms, the segment demonstrated an increase close to last-year's growth, amounting to BGN 1.922 million, which is a growth of 4.09% compared to the previous year, when its share in the overall portfolio structure decreased by 1.55 percentage points due to the faster growth of the exposures to corporate clients.

In 2019 the Bank continued its traditional business with entities from the industry, trade, construction, energy, agriculture, healthcare, and other sectors. The biggest relative share this year was dedicated again to loans to the industry sector, which in 2019 increased by 1.90 percentage points and at the end of the year loans to the sector amounted to 17.90% of gross loans. Next by share are the trade sector (whose share shrank from 13.98% to 12.00%), construction (whose share decreased by 0.89 percentage points to 13.04%), and tourism, whose share decreased by 1.95% percentage points (to 6.92%).

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

The changes in the portfolio's currency structure are relatively slight. The share of BGN-denominated loans has increased by 3.28 percentage points (to 69.25% of the carrying amount of the loan portfolio following impairment) at the expense of a decrease in loans denominated in the single European currency (by 3.28 percentage point). At the end of 2019, 69.25% of the loan portfolio after impairment is denominated in BGN, and the remaining 30.75% - in EUR.

Table 2.Loan portfolio allocation by classification groups

	2019			2018		
	gross amount	provisions according to IAS	carrying amount	gross amount	provisions according to IAS	carrying amount
Serviced	186,932	124	186,808	163,200	312	162,888
Unserviced	31,472	10,251	21,221	32,784	12,056	20,728
Total	218,404	10,375	208,029	195,984	12,368	183,616

Pursuant to one of its strategic objectives, during the past year the Bank managed to shrink the share of non-performing loans by 2.32 percentage points, to 14.41% of the gross amount of loans to and receivables from customers. Continuing this trend is becoming an even greater challenge given the expected consequences of the COVID-19 pandemic, namely a slowdown in income growth, surge in unemployment, as well as growing uncertainly of the environment, which will increase pressure on household consumption patterns, hence – on lending rates, which can prevent the process of improving the portfolio quality through more intensive increase of its volume.

In order to cover the risk of losses from loan impairment and in accordance with the requirements of the new IFRS 9, as at 31 December 2019 the Bank charged an allowance for expected credit losses at the amount of BGN 10.375 million, and the coverage coefficient has decreased from 6.31% to 4.75%. With regards to performing loans, the coverage of impairment provisions has decreased by 0.12 percentage points, reaching 0.07%. Nearly the entire impairment (98.80%) has been allocated to unserviced (non-performing) receivables (Table 2).

3. ***Securities***

The securities portfolio has increased at the end of 2019 by BGN 20.140 million, to BGN 64.668 million. Thus, its share in the total assets amount has increased by 5.39 percentage points compared to the previous year, reaching 16.46%. The rate of change was intensive (45.23%), as far as in view of the moderate restoration of lending activities there were insufficient possibilities for relocation of the free resource towards lending. The restriction on this asset category is to some extent due to the policy adopted by the Bank, aimed at gradual restructuring of its assets by reducing low-profitability assets, and is also due to the growing expectations for a forthcoming change in the situation on the securities market.

Unlike in the previous year, in 2019 most of the securities are classified at fair value through profit or loss, and the total volume of this category in the past year increased from BGN 174 thousand to BGN 37,434 million. The share of securities classified at fair value through other comprehensive income has decreased, from BGN 44.354 million at the end of last year to BGN 27.234 million as at 31 December 2019.

Table 3. Securities portfolio (carrying amount, following impairment and credit loss allowance)

	31.12.2019	31.12.2018
Stocks and shares in local enterprises	454	467
Bulgarian government securities (including Eurobonds)	25,026	27,458
Foreign government securities (including Eurobonds)	37,273	14,726
Corporate bonds of local and foreign issuers	1,915	1,877
TOTAL	64,668	44,528

Over the past year, there has been a decrease in investments in local government securities (Bulgarian state securities and Eurobonds). In 2019, the carrying amount of assets in this category decreased by BGN 2.432 million to BGN 25.026 million, and their share in the overall portfolio structure has shrunk by 22.97 percentage points to 38.70%. Foreign government securities have increased by BGN 22.547 million (to BGN 33.273 million), and their share in the total securities portfolio has increased by 24.57 percentage points (to 57.64%).

Apart from investments in local government securities, there was also a decrease during the past year in the category of stocks and shares of local enterprises, which decreased by BGN 13 thousand (2.78%) to BGN 454 thousand, while the slowest change (2.02%) is that in corporate bonds of local and foreign issuers, which in 2019 increased by BGN 38 thousand – to BGN 1.915 million. Some of these effects are also due to currency revaluations of USD-denominated securities. The total impairment charges and credit loss allowance increased by BGN 28 thousand in 2019, reaching BGN 109 thousand at the end of the year.

4. *Attracted funds*

In 2019, the volume of attracted funds from customers decreased by 3.63% and in the end of the year reached BGN 346.276 million. The sources of most of the attracted resources were individuals and households (Table 4). Over the past year, the share of funds from this source decrease by 0.90 percentage points (from 74.21% to 73.31% in the overall structure). This change is both at the expense of budget entities (whose share increased by 0.38 percentage points – from 2.42% to 2.80%), and at the expense of resources from companies and NBFI, whose shares increased by respectively 0.37 and 0.15%. This has not resulted in any changes in the categories stated and at the end of 2019 the deposits of non-financial corporations retained second place based on share of attracted funds (23.67%), while the attracted resource from non-banking institutions has a negligible share, which can be explained by the high liquidity indicators. Over the past year, deposits from this source have increased insignificantly – by BGN 505 thousand, to BGN 757 thousand, and thus, their share in the overall structure of attracted funds reached 0.22%.

Tokuda Bank is no exception from the banking system and keeps maintaining high liquidity, this preserving a relatively weak interest in attracting any resource from banks. The total amount of deposits from credit institutions in the past 2019 decreased by BGN 268 thousand to BGN 113 thousand and in the end of 2019 took a negligible share of the Bank's liabilities (0.03%).

Table 4. Structure of attracted resources

	2019			2018		
	On-demand and savings deposits	Fixed term deposits	Total	On-demand and savings deposits	Fixed term deposits	Total
Accounts of local individuals	85,081	168,768	253,849	85,880	180,766	266,646
Budget accounts	9,696	0	9,696	8,711	0	8,711
Company accounts	53,456	28,518	81,974	47,253	36,468	83,721
NBFIs accounts	757	0	757	252	0	252
TOTAL	148,990	197,286	346,276	142,096	217,234	359,330

In 2019, additional steps were undertaken in view of optimisation of the funding price and maturity structure, including the retention of fees on current account balances. As a result of achieving a good balance in the effects sought, the average contract price of the resource has decreased, and its structure has been retained, and the share of fixed-term deposits shrank by 3.48 percentage points to 56.97%, while the share of on-demand deposits increased to 43.03%.

The changes in the currency structure of the attracted funds are insignificant and in favour of the USD, whose share over the last year increased from 9.16% to 10.03% at the expense of deposits denominated in BGN and EUR, whose shares decreased respectively by 0.31 percentage points (to 50.40%) and by 0.54 percentage points (to 38.26%). The shares of deposits denominated in JPY and other currencies remain almost unchanged, and at the end of the period reached respectively 1.05% and 0.26% of the overall structure.

5. ***Risk exposure***

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

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

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

Cash and cash balances with the Central Bank amount to BGN 53,193 thousand as at 31 December 2019 (respectively BGN 101,508 thousand as at 31 December 2018) and do not bear a credit risk to the Bank due to their nature and the fact that they are at the Bank's disposal.

Loans and receivables from credit institutions as at 31 December 2019 amount to BGN 26,163 thousand (respectively BGN 33,376 thousand as at 31 December 2018) and represent mostly deposits in first-class international and Bulgarian financial institutions with maturity of up to 7 days. The Bank manages the credit risk associated with loans and receivables from credit institutions, by setting exposure limits at counterpart level.

Loans to and advances to customers, with a carrying amount of BGN 208,029 thousand as at 31 December 2019 (respectively BGN 183,616 thousand as at 31 December 2018), expose the Bank to credit risk. In order to assess it, the Bank analyses the individual risk of each exposure by applying the criteria for risk assessment and classification according to the Policy for impairment of financial assets and contingent liabilities.

As at 31 December 2019, in order to calculate exposures to credit risk, Tokuda Bank AD applies the standard approach pursuant to Regulation (EC) No 575/2013. Due to the relatively small volume of financial instruments in the trading portfolio, capital requirements are calculated in accordance with the requirements of Regulation (EC) No 575/2013, applicable for the banking portfolio. To calculate the amount of capital necessary to cover operating risk losses, the basic indicator approach is applied.

Regarding **liquidity risk** (arising from the maturity gap of the assets and liabilities and the probable lack of sufficient funds of the Bank to meet its obligations on its current financial liabilities), it should be pointed out that Tokuda Bank maintains a high amount of liquid assets in the form of cash in hand and cash balances with the Central Bank, which guarantee the Bank's ability to meet its liquidity requirements. As at 31 December 2019, the Bank's cash and cash balances with the Central Bank represent 13.54% of the Bank's total assets (respectively 25.22% as at the end of 2018).

As an additional instrument to ensure liquidity, the Bank uses loans granted to banks. These comprise mostly deposits in first-class international and Bulgarian banks, with maturity of up to 7 days. As at 31 December 2019, loans and receivables from banks constitute 6.67% of the Bank's total assets (respectively 8.29% as at the end of 2018).

High-liquidity bonds owned by the Bank and not pledged as collateral as at 31 December 2019 amount to BGN 52.144 million (12.96% of the Bank's total assets). By maintaining above 40% of its assets in highly liquid assets, the Bank ensures its ability to meet all its payment needs on matured financial liabilities.

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

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

Foreign currency risk is the possibility to realise losses as a result of changes in foreign currency exchange rates. Most of the Bank's assets and liabilities are denominated in EUR and BGN; therefore, an adverse change in interest rates is insignificant, in as far as the exchange rate of the BGN is fixed to the EUR (under the Bulgarian National Bank Act, adopted by XXXVIII National Assembly on 5 June 1997, promulgated in the State Gazette, issue 46 dated 10 June 1997). Therefore, the Bank's open positions in EUR bear no currency risk for the Bank; such risk is posed by open positions in currencies other than EUR.

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

In 2019, Tokuda Bank AD continued adhering to a conservative approach in risk management and assessment, including with respect to credit risk, forming 87% of all risk exposures as at 31 December 2019. The Bank takes actions to decrease the risk on all credit exposures (mostly at the expense of the portfolio of non-performing loans), as a result of which the share of risk-weighted assets for credit risks has decreased by 1 percentage point. Overall risk exposure has increased by BGN 4.674 million compared to 31 December 2018.

Table 5 Risk-weighted assets

	12/31/2019		12/31/2019		change	
	BGN million	*share*	*BGN million*	*share*	*BGN million*	*rate*
For credit risk	195.55	87%	193.251	88%	2.299	1%
For market risk	2.725	1%	0.35	0%	2.375	679%
For operating risk	26.4	12%	26.4	12%	0	0%
Total	**224.675**	**100%**	**220.001**	**100%**	**4.674**	**2%**

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

6. ***Capital and reserves***

As at 31 December 2019, the Bank's equity amounted to BGN 42.717 million, and the basic capital according to the capital adequacy requirements for credit institutions is BGN 41.562 million.

The Bank's capital indicators are above the regulatory limits. Its capital position ensures an adequate coverage of risk exposures. The adequacy of the core Tier 1 capital has decreased insignificantly compared to the previous year (by 0.65 percentage points), reaching 18.50%, which exceeds the required regulatory limits.

As at 31 December 2019, the share capital amounts to BGN 68,000,000 /sixty-eight million/. The capital is allocated in 6,800,000 /six million and eight hundred thousand/ registered, dematerialised (non-cash) shares entitled to vote, with a nominal value of BGN 10 /ten/ each, and with an emission value equal to the nominal value.

According to the Book of Shareholders kept at the Central Depository, the Bank shareholders as at 31 December 2019 have remained, as follows:

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

7. ***Branch network***

The Bank has a total of 24 offices and remote workplaces (RWP) in the country. The Bank has no branches and offices in other countries. Pursuant to the planned optimisation of the office network, in 2019, the following offices were closed down – IRM Sheinovo – II RM in Varna, Kyustendil office, Shumen office and IRM Cadastre – II RM in Shumen, and in the beginning of 2020, the Sofia Business Park office was closed; the optimisation process was carried out without a significant client outflow.

The structure of the branch network as at 31 December 2019 is as follows:

- Headquarters
- Offices – 21 nos.
- Remote workplaces – 3 nos.

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

8. *Relations with correspondents*

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

9. *Human resources*

The human resource is one of the key factors for achievement of the strategic objectives of Tokuda Bank AD. The Bank's management has been developing a human resource management system through continuous optimization of the staff administration processes (planning, recruitment, appointment, monitoring, assessment, promotion and dismissal). In 2019 the number of employees decreased from 249 to 223 as at 31 December 2019. This change is due to the closed divisions in the regional structure, the dismissal of security employees, due to the expiry of the Bank's security license, as well as the recruitment of new employees in the office network and the head office. The total number of newly appointed employees at the head office and the office network is 32, and half of the eight new employees at the head office are engaged in lending.

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

The 'open door', communication and collaboration between divisions policy is ongoing. The Bank continues to make effort to retain and motivate valuable staff, by means of trainings, reporting, periodic control and changes, where necessary.

10. *Information technologies*

Over the past year, the process of selection and transfer to a software platform servicing the debit and credit cards issued by the Bank was completed. The initiative aims to improve the quality of customer service and provide reliable information for the purpose of adequate management of card operations. One of the challenges in this area in 2020 will be to use the functionalities of the new system in a way to support the better realization of Tokuda Bank's card products.

In 2019, the internal information system (portal) where employees have access to internal documents and news related to the Company's operations was fully renewed and updated.

III. Development prospects in 2020

As a whole, the operating plan for 2020 envisages continuing the actions taken to optimise business processes and complete projects initiated in 2019, as well as taking targeted measures for organizational and technological improvements aiming to help the Bank meet the latest regulatory requirements, customer needs and business expectations. In view of the fact that the planning process was held and completed before the period of increasing uncertainty and aggravation of the indicators of the local and global economy as a result of the COVID-19 spread, the Bank plans to update its forecast and business objectives after the period of extraordinary measures ends, due to the still insufficient clarity regarding the economic impact of the pandemic.

Currently, the Bank's management intends to maintain a moderately conservative policy upon performing its main operations, in view of stabilizing its profitability indicators, and conduct active marketing campaigns in order to increase market share. The main objective for 2020 is intensification of lending activity and improvement of the portfolio quality. The preliminary estimates in the financial plan show that the planned growth in activity may be achieved, as far as the Bank has a relatively small market share and has the potential to achieve lending rates that are above the average ones for the system.

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

In short, the main priorities for the Bank's development in 2020 have been retained in the way they were set upon determining its mid-term strategy, and may be summarised as follows:

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

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

1. *Changes in the share capital*

In 2019 there were no changes in the volume and structure of the Bank's share capital. The majority shareholder, holding 99.94% of the capital, is Tokushukai Incorporated, Japan. As at 31 December 2019, Tokuda Bank AD does not possess any own shares.

2. *Management*

In 2019, the Bank preserved its two-layer management system. The members of the management bodies of the joint-stock company in 2019 were as follows:

Bank's Supervisory Board

Arthur Sterne – Chairperson of the Supervisory Board;

Thomas Michael Higgins – Member of the Supervisory Board;

Chris Matlon – Member of the Supervisory Board, as from 12 April 2019. He took the place of Mr. Dimitar Vouchev, who as from 8 May 2019 holds the position of Chairperson of the Management Board and Executive Director.

Bank's Management Board

Dimitar Vouchev – Chairperson of the Management Board and Executive Director

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

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

Todorina Doktorova – Member of the Management Board.

The total amount of remunerations received over the reporting year by members of the Supervisory Board is BGN 61 thousand (respectively BGN 42 thousand in the prior year). The total amount of remunerations received over the reporting year by members of the Management Board is BGN 428 thousand (respectively BGN 419 thousand in the prior year).

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

3. *Dividend policy*

The Bank has not paid any dividends. The 2019 result has been allocated for coverage of past-year losses.

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

In order to limit the spread of the COVID-19 pandemic, on 13 March 2020, a state of emergency was declared in Bulgaria, which blocked activities in a number of economic sectors and disrupted the normal economic operations of almost all economic subjects in Bulgaria. Due to the unpredictable dynamic of COVID-19, the assessment of the scope and impact of the measures introduced for the Bank's business, respectively, its future operations, assets, and liabilities, is practically impossible. The general expectation is that the pandemic will have a negative impact on credit activities, the quality of already disbursed loans, and the revaluation of most assets. It is the management's initial assessment that at this stage it is not possible to identify circumstances and factors questioning the applicability of the going concern principle for the Bank.

In accordance with the measures taken by the state's government and the Management Board of the Bulgarian National Bank, the Bank's management has taken timely measures aimed to preserve the health and life of its employees and clients, as well as measures to support the business positions thereof, related to maintaining the quality of the loan portfolio. Tokuda Bank supports its customers who were affected by the COVID-19 crisis, by offering them means and mechanisms to relieve loan repayments, following BNB's "Procedure for deferral and settling payables to banks and their subsidiaries – financial institutions, in relation to the state of emergency declared by Parliament in relation to the COVID-19 pandemic".

No significant events have occurred since the date of preparation of the statement of financial position that would result in adjustments or additional disclosures in the separate or consolidated financial statements.

5. ***Participation of Board Members in other companies***

Supervisory Board:

- Arthur Sterne – Chairperson of the Supervisory Board: shareholder and General Manager of Global Prime OOD, UIC 203874715;
- Thomas Michael Higgins – Member: shareholder (58% of the capital) in EASTISOFT Inc.; shareholder (38.3% of the capital) in YATOTO Inc. /USA/; Member of the Board of Directors and shareholder (22.5% of the capital) in EMP Invest Bulgaria AD with UIC 203120042; General Manager of YATOTO EOOD with UIC 203831062;
- Chris Matlon – Member of the Board of Directors of America for Bulgaria Foundation (non-profit).

Management Board:

- Dimitar Vouchev – Chairperson: owner and General Manager of Delta Capital EOOD, UIC 175278566; Member of the Board of Directors of the America for Bulgaria Foundation (NPO); Member of the Board of Directors of Partners Bulgaria Foundation (NPO);
- Maria Sheytanova – Executive Director: shareholder and General Manager of CTM Bulgaria OOD, UIC 201987988; Chairperson of the Board of Directors of TMA Bulgaria Association (NPO), UIC 176928159;
- Anna Tsankova-Boneva – Executive Director: shareholder (70% of the capital) in Fine Line OOD, UIC 201758352;

V. Responsibility of the management

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

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

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

VI. Activities in the field of research and development

Due to the specifics of its operations, in 2019 the Bank did not perform any activities in the field of research and development.

VII. Activity as investment intermediary

Tokuda Bank AD performs services in its capacity as investment intermediary. The Bank intermediates the purchase and sale of financial instruments traded on a regulated market (Bulgarian Stock Exchange AD) and outside the regulated market. The Bank is a member if BSE and of Central Depository AD, and offers services as a Registration Agent. In its capacity as investment intermediary, the Bank meets certain requirements for the protection of customer's interests, in accordance with the provisions of the Markets in Financial Instruments Act (MFIA), Ordinance 38 on the requirements to operation of investment intermediaries, and Ordinance 58 on the requirements on protection of customers' financial instruments and cash, on product management and provision or receipt of consideration, commissions, other cash or non-cash rewards, issued by the Financial Supervision Commission (FSC). The Bank has established and applies an organisation for concluding and fulfilling contracts with customers, for compliance with the requirement for customers' data, accountability and storage of customers' assets in compliance with the statutory requirements, and in particular the provisions of Ordinance 38, Art. 28-31, and Ordinance 58, Para 3. Tokuda Bank has established and applies internal rules and procedures to ensure compliance with the legislation applicable to its operation as an investment intermediary.

The prepared Annual Management Activity Report and the Corporate Management Declaration are in compliance with the requirements of Chapter Seven of the Accountancy Act and Art. 100n, Para 8 of the Public Offering of Securities Act (POSA).

In 2019 and up to the date of this Report, there have been no tax consultations or any other forbidden services performed by either of the two audit firms – AFA OOD and ABVP-AUDIT STANDARD OOD, which carried out a joint independent financial audit of the Bank's annual financial statements for 2019. Over this period, the audit firms and their network companies have carried out the following permitted services:

- Agreed-upon procedures for the application at the Bank of Ordinance 10 of the Bulgarian National Bank (BNB) for the period 1 January 2019 – 31 December 2019 in compliance with the requirements of the International Standard on Related Services (ISRS) 4400 "Engagements to perform agreed-upon procedures regarding financial information" – the engagement was undertaken and performed jointly by the two audit firms, AFA OOD and ABVP-AUDIT STANDARD OOD;

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

Maria Sheytanova
Member of the Management Board and
Executive Director

Anna Boneva
Member of the Management Board and
Executive Director

ТОКУДА БАНК АД
СОФИЯ

Sofia, 30 April 2020

Токуда Банк

CORPORATE GOVERNANCE STATEMENT OF

TOKUDA BANK AD

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

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

In 2019, Tokuda Bank AD (the Bank) continued to comply, where appropriate, the National Corporate Governance Code (NCGC, the Code), published on the web page of the Bulgarian Stock Exchange AD (BSE), approved by means of decision No 461-KKY dated 30.06.2016 of the member of the Financial Supervision Commission (FSC) acting as Deputy Chair of the FSC responsible for the Supervision of Investment Activities Directorate, as corporate governance code pursuant to Art. 100m, Para 8, p.1, letter "a" from POSA.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

- performing assurance engagements and providing an independent and objectively documented opinion regarding:
  - the reliability, accuracy, completeness and timeliness of financial reporting and management information;
  - the effectiveness and efficiency of operations and of achieving operational and financial objectives and safeguarding of assets;
  - legal compliance with the applicable statutory and regulatory provisions.
- making suggestions for remediation of identified deficiencies and weaknesses in the control environment;
- performing advisory engagement by providing recommendations for improvement of existing practices and procedures and for development of effective control activities in the process of development of new procedures.
- performing extraordinary audit engagements and audits for fraud prevention.

The Internal Audit reports administratively to the MB and functionally to the SB of the Bank, which allows attaining the necessary degree of independence and effective performance of its responsibilities. The Head of the Internal Audit has direct and unrestricted access to the MB and SB.

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

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

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

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

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

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

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

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

- IT systems and software used by the Bank – general banking and accounting system;
- The business units related to new loans proposals and data for performing loan portfolio monitoring;
- The Liquidity and Money Markets Division about information concerning the banking and commercial securities portfolio;
- The Legal Division (including Prevention of Money Laundering Department) with respect to legal risks, incl. litigation risks and risk of non-compliance of the internal regulations, banking products, etc. with the legislation and regulatory framework;
- The Banking Security Department with respect to operational risks, including risk of fraud and other potential risks related to the Bank's security;
- Chief Economist – summarised information on a daily basis about the development of the deposit base and attracted funds;
- All employees of the Bank, clients and other external parties with respect to information for operational events and submitted complaints.

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

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

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

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

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

Units which perform risk-taking functions:

- MB and SB approve measures and tools for implementation of the Bank's strategy in compliance with its risk profile and appetite and provide final approval/rejection of the proposals for new loans resulting in significant exposure (at an amount equal to or exceeding BGN 500,000), changes in terms of existing loans, measures for exiting of problem exposures, new investments in securities and other assets, etc.;

- The Business units, including the branch network and the departments which provide lending services, perform the following:
  - Decisions of the Credit Council and the MB for approval of new loans, changes in terms of existing exposures, actions for decreasing non-performing exposures, etc., made based on risk opinions provided by the RMMD;
  - Decisions of the Credit Council and the MB for introduction of new loan or deposit products, discontinuance or changes to existing loan and deposit products;
- The Liquidity and Money Markets Division implements decisions of the Assets and Liabilities Committee (ALCO) taken based on the opinions provided by the Risk Monitoring and Management Division with respect to purchases of securities for the portfolios of the Bank and establishment of relations with counterparts or deposit of funds with other banks, and if necessary provides support in establishing correspondent relations.

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

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

As at 31 December 2019, the Bank has no direct or indirect shareholdings within the meaning Art. 85 of Directive 2001/34/EC.

As at 31 December 2019, the shareholder structure of the Bank is as follows:

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

Dr. Torao Tokuda is the majority owner of Tokushukai Incorporated, Tokyo, Japan. Therefore, Dr. Torao Tokuda is considered to the beneficial owner – natural person of the Bank's capital (a person who directly or indirectly holds a sufficient percentage of shares or voting rights, including through bearer's shares, pursuant to §2, Para 1, item 1 of the Supplementary Provisions to the Measures Against Money Laundering Act), which has been duly announced in the Commercial Registry.

4.2. The Bank has not issued shares with special rights of controls and has no shareholders, which own shares with special control rights;
4.3. The Statute of the Bank does not specify restrictions over voting rights of shareholders.
4.4. The rules that establish the appointment or change of the MB and SB and changes in the Statute:
- Statute of Tokuda Bank AD;
- Policy of Tokuda Bank AD on identification, management and prevention of conflicts of interests;
- Policy on selection and assessment of the fitness of the members of the Management Board and key employees of Tokuda Bank AD;
- Rules for activities of the Supervisory Board of Tokuda Bank AD;
- Rules for activities of the Management Board of Tokuda Bank AD.

4.5. The powers of the members of the Supervisory Board and Management Board of the Bank are established in:
- Statute of Tokuda Bank AD;
- Rules for establishment of the responsibilities of the Management Board of Tokuda Bank AD;
- Rules for activities of the Management Board of TOKUDA BANK AD;
- Rules for activities of the Supervisory Board of TOKUDA BANK AD.

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

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

The Bank has a two-tier management system, which includes a SB and a MB with the following responsibilities, power and composition:

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

The members of the SB as at 31 December 2019 are:

- Arthur Stern – Chairperson of the SB;
- Thomas Michael Higgins – Member of the SB;
- Chris John Matlon – Member of the SB.

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

As at 31 December 2019, the members of the MB are:

- Maria Sheytanova – Member of the MB and Executive Director;
- Anna Tsankova-Boneva – Member of the MB and Executive Director;
- Todorina Doktorova – Member of the MB.
- Dimitar Vuchev – Member of the MB and Executive Director as from 12 April 2019 (the change in circumstances was registered with the Commercial registry on 8 May 2019).

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

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

In 2019 and at present, the following committees are active within the Bank's structure:

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

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

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

The first level of the Credit Council consists of: Retail Banking Team Manager/ Retail Banking Regional Manager/ Corporate Banking Regional Manager, who is proposing the respective loan transaction, and the Head of the Credit Risk Department – Small and Medium-Sized Customers in the Risk Monitoring and Management Division or Loans to Individuals Team Manager/ Retail Banking Division Head, in accordance with the "Rules for granting loans to individuals".

The second level of the Credit Council consists of: Executive Director in charge of the Corporate Banking Division, Corporate Banking Division Head – votes on loans to legal entities, Loans to Individuals Team Manager in the Retail Banking Division – votes on loans to individuals, Head of the Risk Monitoring and Management Division, Chief Legal Advisor in the Legal Division.

The third level of the Credit Council consists of: Executive Director in charge of the Corporate Banking Division, Executive Director, Corporate Banking Division Head, Head of the Risk Monitoring and Management Division, Head of the Legal Division.

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

The current members of the Committee are as follows:

- Executive Director – Chairperson;
- Head of Finance and Accounting Division – Member;
- Head of Loan Administration Division – Member;
- Head of Receivables Department – Member;
- Chief expert in Credit Risk – Member;
- Legal advisor in Receivables Department – Member

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

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

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

- Head of Monitoring and Risk Management Division – Chairperson;
- Head of Finance and Accounting – Member;
- Chief economist – Member;
- Head of Loan Administration Division – Member;
- Chief Legal Advisor in Legal Division – Member.

The Audit Committee, established pursuant to the requirements of the Independent Financial Audit Act, is a permanent specialised independent advisory body at the Bank, whose aim is to monitor the effectiveness and adequacy of the financial reporting processes, risk management and control, including internal audit, in accordance with the applicable legislation and best practices. The Audit Committee is appointed by the General Meeting of Shareholders of the Bank, which also determines its term and number of members.

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

As at 31 December 2019, the members of the Audit Committee are:

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

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

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

The Bank ensures diversity by means of:

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

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

Maria Sheytanova
Member of the Management Board and
Executive Director

Anna Boneva
Member of the Management Board and
Executive Director

This is a translation of the Corporate Governance Statement of Tokuda Bank AD for year 2019.

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INDEPENDENT AUDITORS' REPORT

To the shareholders of Tokuda Bank AD

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

Opinion

We have audited the financial statements of Tokuda Bank AD ("the Bank"), which comprise the statement of financial position as at 31 December 2019 and the statement of comprehensive income, the statement of changes in equity and the statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2019, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union (EU).

Basis for Opinion

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

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter included in the table below, the description of how this matter was addressed in our audit was made in this context.

Key Audit matter	How this key audit matter was addressed in our audit
Impairment of credit losses on loans and advances to customers according to the requirements of IFRS 9 Financial Instruments (IFRS 9) The Bank's disclosures regarding the impairment of credit losses on loans and advances to customers are included in *Note 3.2.1.4.* ***Impairment of financial assets****, Note 3.1.2.* ***Determining expected credit losses on loans and advances to customers****, Note 29.2.* ***Credit risk*** *and Note 8* ***Loans and advances to customers*** to the financial statements.	
Loans and advances to customers represent a substantial proportion (53%) of the Bank's total assets as at 31 December 2019. The gross carrying amount of these loans to and receivables from customers as at 31 December 2019 is BGN 218,404 thousand, and the respective allowance for accumulated credit losses therefrom is BGN 10,375 thousand. The Bank applies an impairment model for credit losses on loans to and receivables from customers on an individual and portfolio basis, in accordance with IFRS 9. The application of such a model to determine the impairment of credit losses on loans granted and receivables to customers results in an increased complexity in the calculations and assumptions, as well as the involvement of significant judgements on the part of the Bank's management in determining the amount of expected credit losses. In order to determine the amount of impairment of expected credit losses, the Bank applies a model based on key inputs, originating from internal and	In this area, our audit procedures included, among others: • Inquiries, walk-throughs and obtaining an updated understanding of the Bank's process of monitoring and impairment of credit losses on loans and advances to customers in the Bank. We focused on the methodology applied by the Bank, on the internal policy and impairment model used, as well as on changes related thereto made during the current year. Inquiries to Bank experts responsible for the modelling and management of credit risk. • Assessment of internal procedures and key controls at organisation level regarding the impairment policy and model, including documentation supporting the model, as well as monitoring and update frequency and justification of the parameters applied. • Obtaining an updated understanding, assessing the design and application, and testing the operational effectiveness of certain key controls appropriate for the audit, over the process of monitoring, staging, and determining the amount of impairment of credit losses on loans to and receivables from customers.

external sources and parameters which suggest significant judgements and assumptions in: • Interpretation of the requirements to determine impairment pursuant to IFRS 9, on which the Bank's model is based to determine and calculate expected credit losses; • The assumptions inherent in the model of expected credit losses aimed to identify a significant deterioration of the credit quality of exposures, the presence of low and/or significantly increased credit risk, respectively exposures with objective evidence of impairment; • Calculations and interpretations of the key indicators "probability of default" (PD), "loss given default" (LGD) and "exposure at default" (EAD). There is a higher degree of approximation and judgements by management in the calculations of expected credit losses of the portfolio basis in Stages 1 and 2; • Judgements related to the scope and completion of the inputs and calculation logic; • Assumptions and estimates in a number of scenarios for expected future cash flows, based on past events, current conditions and future economic forecasts; • Assumptions applied by management in the review of significant credit-impaired exposures in Stage 3, related to recent losses, in the set of probability scenarios for future cash flows and results therefrom, and upon assessment of future collection, including from collaterals realisation.	We involved our IT experts in the testing and assessment of general IT controls in the Bank's internal information system, used in the process of monitoring loans to and receivables from customers and determining expected credit losses. • Assessing the consistency of application and continuing relevance of the methodology, the specific models to identify credit losses and calculate impairment, as well as the key assumptions and judgements used therein, in accordance with the requirements of IFRS 9 and in the context of the specifics of the Bank's loan portfolio and the availability of internal historical information, as well as data about the parameters' future development. Moreover, reasonableness analysis and assessment were carried out of: - the relevance of the criteria to identify a significant increase in credit risk; - the appropriateness of the staging of exposures, in accordance with the classification criteria set by the Bank; - the calculations of the indicators "probability of default" (PD), "loss given default" (LGD) through checking the assumptions and outputs used; - the approach to using forecast data in the models. • Analysis of the appropriateness of the results obtained as changes to the impairments stated in the context of our understanding of the development of the Bank's loan portfolios and the quality of the available, data. We also tested the mathematical accuracy of certain formulas used to calculate impairment in the models. • Analysis of the Bank's loan portfolio and other analytical procedures regarding its structure, composition and development trends, incl. the interrelation of trends in the expenses stated for impairment losses versus trends in loan portfolio development.

<table>
<tr>
<td>Due to the significance of the above described circumstances that: a/ the materiality of loans granted to and receivables from customers as a reporting item for the Bank's financial statements, and b/ the complexity, significant multiple judgements and assumptions, and the high inherent uncertainty of estimates of expected credit losses laid down in the impairment model for loans to and receivables from customers on an individual and portfolio basis, according to the requirements of IFRS 9, we have considered this matter as a key audit matter.</td>
<td>

Performing detailed tests and analysis, based on a risk-based sample of loans at all stages, for the purpose of assessing the relevance of the impairment charged of credit losses. For the respective exposures in the sample, the following audit procedures were performed:

analysis of the financial position and results of borrowers, and inspection of information and documents related to loan servicing;
review of collateral valuation reports of the respective exposures; for some collaterals, we used our expert appraisers regarding the assumptions and methods applied in the valuations of collateral realisable value;
analysis and assessment of the key assumptions and judgments made by the Bank's management upon calculation of specific provisions for credit losses on individual exposures at Stage 3;
testing and recalculation of the mathematical accuracy of the established amounts of expected credit losses on individual items, incl. versus certain changes in given parameters.

Assessment of the relevance, completeness and adequacy of the Bank's disclosures in relation to the impairment of credit losses on loans and advances to customers.

</td>
</tr>
<tr>
<td colspan="2">Estimates of the fair value of non-financial assets used for the purpose of determining the fair value of review for impairment of these assets

Information about the fair value estimates of financial assets used for the purpose of fair value measurement of review for impairment is disclosed in Note 9 Non-current assets held for sale, Note 12 Investment property, Note 13 Other assets, and Note 29.5 Fair value to the financial statements.</td>
</tr>
<tr>
<td>As at 31 December 2019, the Bank states non-current assets held for sale, at the amount of BGN 2,674 thousand, investment property at the amount of BGN 12,751 thousand, and other assets acquired</td>
<td>In this area, our audit procedures included, among others:

Assessing the objectivity, independence and competence of the external appraisers assigned by the Bank.

</td>
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</table>

under non-serviced loans, at the amount of BGN 19,531 thousand, consisting mainly of real estate acquired in exchange for debt from collaterals.

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

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

Due to the fact that the fair value estimates of non-financial assets (investment property, non-current assets held for sale and other assets) of the Bank is characterized by higher uncertainty related to the inputs used and the assumptions for the purposes of fair value measurement and/or review for impairment, which may have a significant effect on both the carrying amount of non-financial assets, and the calculation of the Bank's capital adequacy as at 31 December 2019, we have determined this to be a key audit matter.

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

Emphasis of Matter

We draw attention to *Note 32* to the annual financial statements, disclosing a material non-adjusting event after the reporting date, related to the spread of the coronavirus (COVID-19) pandemic, its impact on the economic environment in Bulgaria and the uncertainties related thereto, as well as the management's position on the potential effects thereof on the Bank's operations, financial position and results. Our opinion is not modified in respect of this matter.

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

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

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

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

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

We have nothing to report in this regard.

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

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

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

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

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with International Standards on Auditing (ISAs) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

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

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors' report unless law or regulation precludes public disclosure of information about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

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

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Additional Matters to be Reported under the Accountancy Act

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

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

Based on the procedures performed, our opinion is that:

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

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

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

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

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

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

- AFA OOD and ABVP-AUDIT STANDARD OOD were appointed as statutory auditors of the financial statements of the Bank for the year ended 31 December 2010 by the General Meeting of Shareholders held on 27 September 2019, for a period of one year.
- The audit of the financial statements of the Bank for the year ended 31 December 2019 represents a second consecutive statutory audit engagement carried out by AFA OOD and a third total statutory audit engagement carried out by ABVP-AUDIT STANDARD OOD.

- We hereby confirm that the audit opinion expressed by us is consistent with the additional report dated 30 April 2020, provided to the Bank's Audit Committee, in compliance with the requirements of Art. 60 of the Independent Financial Audit Act.
- We hereby confirm that no prohibited non-audit services, referred to in Art. 64 of the Independent Financial Audit Act, were provided.
- We hereby confirm that in conducting the audit we have remained independent of the Bank.

Audit firm	***Audit firm***
AFA OOD:	**ABVP-AUDIT STANDARD OOD:**
Valia Iordanova	**Seydalina Paskaleva**
General Manager,	***General Manager,***
Legal representative	***Legal representative***
Registered Auditor in Charge of the Audit	***Registered Auditor in Charge of the Audit***
38, Oborishte Street	**Nadezhda I Residential Area,**
1504-Sofia, Bulgaria	**block 173, entr. B**
	1202- Sofia, Bulgaria

30 April 2020

TOKUDA BANK AD
STATEMENT OF FINANCIAL POSITION
As at 31 December 2019

(all amounts are in BGN'000)

	Notes	2019	2018
ASSETS			
Cash and balances with the Central Bank	4	53,193	101,508
Loans and advances to banks	5	26,163	33,376
Financial assets at FVPL	6	37,434	174
Debt instruments at FVOCI	7	26,941	44,061
Equity instruments at FVOCI	7	293	293
Loans to and advances to customers	8	208,029	183,616
Non-current assets held for sale	9	2,674	4,984
Investment property	11	12,751	12,590
Property, equipment and right-of-use assets	10	4,380	1,795
Intangible assets	10	695	587
Deferred tax assets	15	36	-
Other assets	12	20,354	19,510
Total assets		**392,943**	**402,494**
LIABILITIES			
Deposits from banks	13	113	268
Deposits from customers	14	346,276	359,330
Deferred tax liabilities	15	-	27
Other liabilities	16	3,837	932
Total liabilities		**350,226**	**360,557**
EQUITY			
Share capital	17	68,000	68,000
Reserves	17	2,754	3,127
Accumulated loss		(28,037)	(29,190)
Total equity		**42,717**	**41,937**
Total liabilities and equity		**392,943**	**402,494**

The accompanying notes from 1 to 32 form an integral part of the annual financial statements.

The annual financial statements on pages from 1 to 67 were approved for issue by the Management Board of Tokuda Bank AD and were signed on 30 April 2020 by:

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

ТОКУДА БАНКА АД СОФИЯ

Financial statements on wich our auditors' report was issued dated 30 April 2020

AFA OOD

ABVP - AUDIT STANDART OOD

This is a translation from Bulgarian of the Annual Financial Statements of Tokuda Bank AD for the year ended 31 December 2019.

TOKUDA BANK AD
STATEMENT OF COMPREHENSIVE INCOME
For the year ended 31 December 2019

(all amounts are in BGN'000)	Notes	2019	2018
Interest income		10,620	10,569
Interest expense		(1,569)	(2,189)
Net interest income	18	**9,051**	**8,380**
Fee and commission income		3,974	4,023
Fee and commission expense		(259)	(282)
Net fee and commission income	19	**3,715**	**3,741**
Net trading income	20	286	273
Other operating income	21	712	895
Operating income before loss on impairment and provisions		**13,764**	**13,289**
Gains/(Loss) on impairment and provisions	22	**637**	**(168)**
Personnel expenses	23	(6,414)	(6,324)
Rental expenses		(33)	(1,143)
Depreciation and amortisation	10	(1,671)	(685)
Other expenses	24	(5,194)	(5,303)
Administrative and operating expenses		**(13,312)**	**(13,455)**
Profit/(loss) before tax		**1,089**	**(334)**
Income tax benefit	25	64	67
Profit/(loss) for the year		**1,153**	**(267)**
Other comprehensive income			
Items that may be reclassified to profit or loss			
Net loss from remeasurement of debt instruments at FVOCI		(190)	(1,145)
Reclassification of remeasurement of debt instruments at FVOCI disposed of in the year		(182)	(686)
Items that will not be reclassified to profit or loss			
Remeasurement of retirement obligations		(1)	(2)
Total other comprehensive income		**(373)**	**(1,833)**
Total comprehensive income for the year		**780**	**(2,100)**

The accompanying notes from 1 to 32 form an integral part of the annual financial statements.

The annual financial statements on pages from 1 to 67 were approved for issue by the Management Board of Tokuda Bank AD and were signed on 30 April 2020 by:

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Member of the Management Board
Executive Director

Maria Sheytanova
Member of the Management Board
Executive Director

Svetlin Todorov
Finance Director

Financial statements on wich our auditors' report was issued dated 30 April 2020

AFA OOD

ABVP - AUDIT STANDART OOD

This is a translation from Bulgarian of the Annual Financial Statements of Tokuda Bank AD for the year ended 31 December 2019.

TOKUDA BANK AD
STATEMENT OF CHANGES IN EQUITY
For the year ended 31 December 2019

(all amounts are in BGN'000)	Share capital	Reserves	Financial assets at FVOCI reserve	Accumulated loss	Total
Balance at 1 January 2018	**68,000**	**807**	**3,152**	**(27,922)**	**44,037**
Profit distibution for reserves	-	1,001	-	(1,001)	-
Net loss for the year	-	-	-	(267)	(267)
Other comprehensive income for the year	-	(2)	(1,831)	-	(1,833)
Total comprehensive income for the year	-	(2)	(1,831)	(267)	(2,100)
Balance at 31 December 2018	**68,000**	**1,806**	**1,321**	**(29,190)**	**41,937**
Balance at 1 January 2019	**68,000**	**1,806**	**1,321**	**(29,190)**	**41,937**
Net profit for the year	-	-	-	1,153	1,153
Other comprehensive income for the year	-	(1)	(372)	-	(373)
Total comprehensive income for the year	-	(1)	(372)	1,153	780
Balance at 31 December 2019	**68,000**	**1,805**	**949**	**(28,037)**	**42,717**

The accompanying notes from 1 to 32 form an integral part of the annual financial statements.

The annual financial statements on pages from 1 to 67 were approved for issue by the Management Board of Tokuda Bank AD and were signed on 30 April 2020 by:

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Member of the Management Board
Executive Director

Maria Sheytanova
Member of the Management Board
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Finance Director

ТОКУДА БАНК АД СОФИЯ

Financial statements on wich our auditors' report was issued dated 30 April 2020

AFA OOD

ABVP - AUDIT STANDART OOD

This is a translation from Bulgarian of the Annual Financial Statements of Tokuda Bank AD for the year ended 31 December 2019.

TOKUDA BANK AD
STATEMENT OF CASH FLOWS
For the year ended 31 December 2019
(all amounts are in BGN'000)

	Notes	2019	2018
Cash flows from operations			
Profit/(loss) before tax		1,089	(334)
Adjustments from non-cash operations			
Depreciation and amortisation		1,671	685
Impairment and loss provisions		(637)	168
Net interest income		(9,051)	(8,380)
Dividend income		(2)	(2)
Loss on disposal of property and equipment		20	17
Other accruals		(30)	(45)
Loss on disposal of a subsidiary		-	24
		(6,940)	*(7,867)*
Interest received		9,444	10,842
Interest paid		(1,627)	(1,964)
Dividends		2	2
Cash flows from operations before changes in operating assets and liabilities		*879*	*1,013*
(Increase)/Decrease in financial assets at FVPL		(37,581)	3
Decrease in financial assets at FVOCI		16,234	27,158
Increase in loans to and advances to customers		(21,704)	(4,582)
Decrease in non-current assets held for sale		2,310	1,623
Increase in other assets		(902)	(2,720)
(Decrease)/Increase in deposits to banks		(155)	77
(Decrease)/Increase in deposits from customers		(12,992)	18,179
Decrease in other liabilities		(99)	(995)
Net cash flows (used in)/from operations		**(54,889)**	**38,743**
Cash flows used in investing activities			
Acquisition of property and equipment		(175)	(236)
Proceeds from sale of property and equipment		10	9
Acquisition of intangible assets		(282)	(122)
Proceeds from subsidiary liquidation		-	1
Net cash flows used in investing activities		**(447)**	**(348)**
Cash flows from financing activities			
Lease payments		(1,071)	-
Net cash flows used in financing activities		**(1,071)**	**-**
Net (decrease)/increase in cash and cash equivalents		**(55,528)**	**39,408**
Cash and cash equivalents at the beginning of the year		134,884	95,476
Cash and cash equivalents at the end of the year	27	**79,356**	**134,884**

The accompanying notes from 1 to 32 form an integral part of the annual financial statements.

The annual financial statements on pages from 1 to 67 were approved for issue by the Management Board of Tokuda Bank AD and were signed on 30 April 2020 by:

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

Financial statements on wich our auditors' report was issued dated 30 April 2020

AFA OOD ABVP - AUDIT STANDART OOD

This is a translation from Bulgarian of the Annual Financial Statements of Tokuda Bank AD for the year ended 31 December 2019.

1. CORPORATE INFORMATION ON THE BANK

1.1. Incorporation

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

1.2. Ownership

As at 31 December 2019, the issued share capital of the Bank amounts to BGN 68,000,000 (sixty eight million levs), comprising 6,800,000 (six million and eight hundred thousands) registered voting shares with a nominal value of BGN 10 (ten) per share.

As at 31 December 2019, the major shareholder of the Bank is Tokushukai Incorporated, holding 99.94% of the Bank's capital.

1.3. Main activities

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

In 2019 and 2018, the Bank's activity was mostly related to rendering banking services related to granting loans to private companies, attracting deposits from customers, servicing of client payments both locally and internationally, performing transactions with securities and other financial services in Bulgaria.

1.4. Structure and management

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

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

As at 31 December 2019, those charged with governance of the Bank are represented by the Supervisory Board (SB): Arthur Stern – Chairperson of the SB, Thomas Michael Higgins – Member of the SB, and Chris Matlan – Member of the SB.

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

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

In 2019, the Bank operates through its Head Office and 24 offices and remote working places (2018: 26). As at 31 December 2019, 223 employees work at the Bank (2018: 249).

1.5. Legal environment

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

2. BASIS FOR PREPARATION OF THE FINANCIAL STATEMENTS

2.1. General

These financial statements have been prepared for general purposes for the year ended 31 December 2019.

The functional and reporting presentation currency in the Bank's financial statements is the Bulgarian lev (BGN).

The financial statements are presented in thousand Bulgarian Levs (BGN'000), unless when explicitly stated otherwise.

2.2. Accounting convention

The annual financial statements of Tokuda Bank AD have been prepared in accordance with all International Financial Reporting Standards (IFRS), which comprise Financial Reporting Standards and the International Financial Reporting Interpretations Committee (IFRIC) interpretations, approved by the International Accounting Standards Board (IASB), as well as the International Accounting Standards (IAS) and the Standing Interpretations Committee (SIC) interpretations, approved by the International Accounting Standards Committee (IASC), which have been effective since January 1, 2019 and have been accepted by the Commission of the European Union. IFRS, endorsed by EU, is the generally accepted name of the general purpose framework – the basis of accounting equivalent to the framework introduced with the definition in § 1, p. 8 of the Additional Provisions of the Accountancy Act under the name of "International Accounting Standards" (IASs).

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

The adoption of these standards and/or interpretations, applicable to entities in Bulgaria for annual reporting periods beginning on 1 January 2019 at the earliest, has not caused changes in Bank's accounting policies, apart from some new and expanding already existing disclosures, without resulting in other changes in the classification and measurement of individual reporting items and transactions, with the exception of the new IFRS 16.

- *IFRS 16 "Leases" (in force for annual periods beginning on or after 1 January 2019 – endorsed by EC).* This standard has an entirely new concept. It establishes new principles for the recognition, measurement, presentation and disclosure of a lease by introducing a new model with the objective to ensure a more faithful and adequate representation of such transactions primarily for the lessee. The standard supersedes the effective so far standard related to leases – IAS 17, and the interpretations thereto. (a) The main principle of the new standard for lessees is the introduction of a single lessee accounting model in the statement of financial position – an asset will be recognised for all contracts with duration of more than 12 months in the form of a 'right-of-use', which will be subsequently depreciated over the duration of the contract, and respectively, a financial liability will be stated for the lease liability under these contracts. This is the significant change in the accounting practice until 2018. The standard allows an exception and retaining the current practice for leases of low-value assets and short-term leases. The standard will impact the financial result for the period, since during the first years expenses related to leases are higher; moreover, operating costs will be replaced by depreciation and interest costs, which will result in a certain change in key metrics such as EBITDA; operating cash flows will increase, since principals and interest will be classified as cash from financing activities; (b) There would not be any significant changes for lessors and they will continue to account for leases as per the old standard IAS 17 – as operating and finance lease. As far as the new standard introduces a more comprehensive concept, a more detailed analysis of contractual terms should be carried out on their part as well and it is possible that grounds for reclassification of particular lease transactions may occur for them (lessors), too. The new standard requires more extensive disclosures, as presented in Note 2.3. The initial adoption of the standard has resulted in a change in the principles, rules and criteria for accounting for the following reporting items, as well as the presentation and disclosure of financial information thereon: property, equipment and right-of-use assets (Note 10), and other liabilities (Note 16). The impact of the initial adoption of IFRS 16 is presented in Note 2.3.
- *IFRIC 23 (amended) "Uncertainty over Income Tax Treatments" (in force for annual periods beginning on or after 1 January 2019 – endorsed by EC).* This Interpretation provides guidance on the accounting treatment and accounting for income tax in the scope of IAS 12 when tax treatments involve uncertainty. It does not apply to taxes or other state levies outside the scope of IAS 12, nor does it specifically include requirements relating to interest and penalties associated with uncertain tax treatments. The Interpretation

addresses the following matters: (a) the entity's approach whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments depending on which approach better resolves the respective uncertainty; (b) the assumptions an entity makes to determine how the taxation authorities would examine and check a given uncertainty of tax treatment assuming that tax authorities have all available information; (c) how an entity determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates when there are given uncertainties; (d) the requirement to assess the impact of uncertainties on the income tax stated, given that the tax authorities are unlikely to accept the Bank's tax treatment; (e) measuring the impact may be done in the more appropriate of the two methods – "most likely amount" and "expected value"; and (f) how an entity considers and treats changes in facts and circumstance;

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

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

- *IAS 28 (amended) "Investments in Associates and Joint Ventures" – regarding long term interests in associates and joint ventures (in force for annual periods beginning on or after 1 January 2019 – endorsed by EC).* The amendment clarifies that an entity should apply IFRS 9 including its impairment requirements regarding forms of long term interests in associate or joint venture that are part of the net investment in the associate or joint venture but to which the equity method is not applied. The accounting for the impact under IFRS 9 for these forms of interests shall be done before accounting for the distribution of losses and impairment under IAS 28. A change in the intents and plans of the management are not regarded as evidence for a change in use.
- *Annual Improvements to IFRS Standards 2015-2017 Cycle (December 2017) – improvements to IAS 23, IAS 12 and IFRS 3 in relation to IFRS 11 (in force for annual periods beginning on or after 1 January 2019 – endorsed by EC).* These improvements introduce partial amendments to and editions of the respective standards primarily with a view to remove the existing inconsistency or ambiguities in the application of the rules and requirements of individual standards as well as to set out more precise terminology. These amendments are basically focused on the following items and transactions: (a) they clarify that when an entity acquires control over a business which constitutes a joint operation, it should remeasure its previous held interest in the business under IFRS 3 as a business combination achieved in stages; (b) when an entity acquires a joint control over a business which constitutes a joint operation, it should not remeasure its previous held interest in the joint operation under IFRS 11; (c) they clarify that all tax consequences on dividend income should be stated within profit or loss or other comprehensive income or directly within equity – depending on where the respective transactions and/events generating the respective distributable profits have been stated, as far as these consequences are related thereto; and (d) they clarify if under special-purpose loans concluded to finance a qualifying asset remain outstanding after the asset is ready for its intended use or disposal, these loans shall be treated as part of general-purpose financing for the purpose of calculating the capitalisation rate and amounts under IAS 23.
- *IAS 19 (amended) "Employee Benefits" (in force for annual periods beginning on or after 1 January 2019 – endorsed by EC).* This amendment clarifies that in case of changes to defined benefit plan amendments,

curtailments or settlements, upon determining the current service cost and net interest for the period following the change, the entity is obliged to use the assumptions made therein. Additionally, changes are envisaged to the presentation and disclosure of impact for changes to defined benefit plan amendments, calculation of past service, effects of changes in plans, curtailments or settlements in relation to the plan asset ceiling.

At the date when these financial statements have been approved for issue, there are several new standards and interpretations as well as amended standards and interpretations, issued but not yet in force for annual periods beginning on or after 1 January 2019, which have not been adopted by the Bank for early application. The management has decided that out of them the following are likely to have a potential impact in the future for changes in the accounting policies, and in the classification and value of reporting items in Bank's financial statements for subsequent periods, namely:

- *Amendments to the Conceptual Framework for Financial Reporting and the respective references thereto in various IFRS (in force for annual periods beginning on or after 1 January 2020, endorsed by EC).* These amendments to the Framework include revised definitions of "asset" and "liability", as well as new guidance and concepts for their measurement, derecognition, presentation, and disclosure. The amendments to the Conceptual Framework are accompanied by amendments to some references thereto in the International Financial Reporting Standards, including IFRS 2, IFRS 3, IFRS 6, IFRS 14, IAS 1, IAS 8, IAS 34, IAS 37, IAS 38, IFRIC 12, IFRIC 19, IFRIC 20, IFRIC 22 and SIC 32. Some of the references state which version of the Conceptual Framework statements in the respective standards should refer to (the IASC framework adopted by IASB in 2001, the IASB framework of 2010, or the new revised framework dated 2018), while others specifically state that the standard's definitions have not been updated in accordance with the framework's latest amendments.
- *Amendments to IAS 1 "Presentation of Financial Statements" and IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors" (in force for annual periods beginning on or after 1 January 2020 – not endorsed by EC).* These changes relate to providing a more precise definition of 'material' as stated in the two standards. According to them, the new definition of 'material' is: "Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity". There are three new aspects of the definition which should be noted: (a) "Obscuring". The existing definition only focused on omitting or misstating information, however, the Board concluded that obscuring material information with information that can be omitted can have a similar effect. (b) "Could reasonably be expected to influence". The existing definition referred to 'could influence' which the Board felt might be understood as requiring too much information as almost anything 'could' influence the decisions of some users even if the possibility is remote; and (c) Primary users (existing or potential investors, lenders and other creditors) -the existing definition referred to 'users' which again the Board feared might be understood too broadly as requiring to consider all possible users of financial statements when deciding what information to disclose. Moreover, the amendments stress especially five ways material information can be obscured: (a) if the language regarding a material item, transaction or other event is vague or unclear; (b) if information regarding a material item, transaction or other event is scattered in different places in the financial statements; (c) if dissimilar items, transactions or other events are inappropriately aggregated; (d) if similar items, transactions or other events are inappropriately disaggregated; and (e) if material information is hidden by immaterial information to the extent that it becomes unclear what information is material. Moreover, the amendments clarify that referring to unclear information shall have the same effect as to omitted or missing information, and that materiality shall be assessed by the entity in the context of the financial statements taken as a whole.
- *Amendments to IFRS 9 "Financial Instruments", IAS 39 "Financial Instruments: Recognition and Measurement" and IFRS 7 "Financial Instruments: Disclosures" (in force for annual periods beginning on or after 1 January 2020 – endorsed by EC).* These amendments are related to the uncertainty ensuing from the interest rates benchmark reform undertaken by the Financial Stability Board of G20. This reform is aimed at replacing the existing interbank interest rates used as benchmarks in transactions with financial instruments (for instance: Libor, Euribor, Tibor) with alternative benchmarks based on interbank offered rates, and at developing alternative interest rates benchmark that are almost risk-free. The aims is to overcome consequences on the financial reporting resulting from the reform in interest rates benchmark in the period before the replacement of an existing interest rate benchmark with an alternative interest rate benchmark. The amendments envisage temporary and limited relief to the hedge accounting requirements in IFRS 9 and IAS 39 allowing entities to continue observing the two standards while ignoring the reform's effect.

The management is still in the process of survey, analysis and assessment of the impact of the changes that would affect the Bank's accounting policy and the classification of its assets and liabilities, as a result of the above standards.

Additionally, with regard to the stated below new standards, amended/revised standards and new interpretations that have been issued but not yet in force for annual periods beginning on 1 January 2019, the management has judged that they are unlikely to have a potential impact resulting in changes in the accounting policies and the financial statements of the Bank:

- *IFRS 17 "Insurance Contracts" (in force for annual periods beginning on or after 1 January 2021 (with an option for deferral to 2022), not endorsed by EC).* This is an entirely new accounting standard on all types of insurance contracts, including some guarantees and financial instruments, and includes rules on recognition and measurement, presentation and disclosure. The standard will supersede the effective so far standard related to insurance contracts – IFRS 4. It establishes an entirely new overall model for insurance contracts' accounting, covering all relevant accounting aspects. It is not applicable to the Bank's operations.
- *IFRS 10 (amended) "Consolidated Financial Statements" and IAS 28 (amended) "Investments in Associates and Joint Ventures" – regarding the sale or contribution of assets between an investor and its associates or joint ventures (postponed effective date, to be determined by the IASB).* These amendments address the accounting treatment of the sale or contribution of assets between an investor and its associates or joint ventures. They confirm that the accounting treatment depends on whether the assets sold or contributed constitute in substance a business as defined in IFRS 3. If these assets as an aggregate do not meet the definition of a business, then the investor shall recognise gain or loss only to the extent of other unrelated investor's interests in the associate or joint venture. In cases of sale or contribution of assets, which as an aggregate constitute a business, the investor shall recognise the full gain or loss on the transaction. The amendments will be applied on a prospective basis. IABS postponed the initial date of application of these amendments for an indefinite period.
- *IFRS 3 (amended) "Business Combinations" (in force for annual periods beginning on or after 1 January 2020, not endorsed by EC).* This change concerns the definition of "business" provided in the appendices to the standard and is related to the difficulties that acquiring entities experience when determining whether they have acquired a business or a group of assets. The amendment aims: (a) to clarify that to be considered a business, an acquired set of activities and assets must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create outputs; (b) to narrow the definitions of a business and of outputs by focusing on goods and services provided to customers and by removing the reference to an ability to reduce costs; (c) to add guidance and illustrative examples to help entities assess whether a substantive process has been acquired; (d) to remove the assessment of whether market participants are capable of replacing any missing inputs or processes and continuing to produce outputs; and (e) to add an optional concentration test that permits a simplified assessment of whether an acquired set of activities and assets is not a business.
- *Amendments to IAS 1 "Presentation of Financial Statements" (in force for annual periods beginning on or after 1 January 2022 – not endorsed by EC) – regarding the classification of liabilities as current or non-current.*

2.3. Impact of the initial adoption of IFRS 16 Leases

IFRS 16 is mandatory for the annual period beginning on 1 January 2019. The Bank has chosen to apply the standard on the modified retrospective approach as from 1 January 2019. Comparative data for 2018 is not recalculated.

The Bank has reviewed and analysed all leases, in accordance with the requirements of IFRS 16. As a result, with respect to the contracts classified as operating leases (which constitute 25 leases of office premises) as at 1 January 2019:

- The Bank has recognized right-of-use assets at the amount of BGN 3,695 thousand at 1 January 2019, presented in the statement of financial position within "Property, equipment". The assets are recognized at an amount equal to the amount of liabilities at the date of initial application;
- The Bank has recognized lease liabilities at the amount of BGN 3,695 thousand, included within "Other liabilities" in the statement of financial position. Lease liabilities have been measured at the present value of the outstanding lease payments, discounted with an incremental discount rate of 0.52%;
- The Bank has not identified amounts that should be accounted for in retained earnings;
- As a result of the application of IFRS 16, in the statement of comprehensive income (within profit or loss for the year) for year 2019, additional depreciation expenses have been recognized at the amount of BGN 1,078

thousand, and interest expenses related to leases, at the amount of BGN 17 thousand.

Upon application of IFRS 16, the Bank has used a uniform discount rate for all operating leases, due to the similar contractual characteristics thereof. The Bank applies the exemption for the recognition of lease contracts for short-term lease contacts (where the lease term is up to 12 months) and for lease contracts for "low-value" assets. The Bank's policy regarding the accounting for lease transactions is presented in Note 3.4.

2.4. Basis of measurement

The Bank's annual financial statements have been prepared on a historical cost basis, with the exception of financial assets held for trading, financial assets measured at fair value through other comprehensive income and investment property, which have been measured at fair value.

2.5. Going concern

The Bank's financial statements have been prepared under the going concern assumption. As a result of its operations, the Bank has accumulated losses that may raise doubt about the Bank's ability to continue as a going concern, respectively to what extent it could realise its assets at least to their carrying amount and to settle in full its liabilities at their carrying amount. Irrespective of this fact, the management, like each year, has analysed the development, respectively, the Bank's possibilities and ability to continue to function in its usual volumes and structure in the future. Therefore, it has undertaken actions to strengthen its positions through optimization of the banking products and services, improvements of the assets structure and expenses which will create conditions for generating future income, stabilising profitability and offsetting accumulated losses. The aims on which the Bank's strategic development plans are based are:

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

In 2019 the Bank complied with its development strategy and to a significant extent managed to achieve the main objectives set in its strategy. In relation to the priority for improving the structure of assets and liabilities, the following results may be indicated: the share of the net loan portfolio in the overall assets structure has increased by 7.32 percentage points – to 52.94% of the total assets at the end of 2019 (compared to 45.62% in the previous year), and along with that, the quality thereof improved – in the past year, the Bank managed to shrink the share of non-performing loans by 2.32 percentage points, to 14.41% of the gross amount of loans to and advances to customers. The increase in the share of performing loans and of the loan portfolio as a whole in the balance sheet was achieved at the expense of the categories that generate relatively low (including zero) income for the Bank.

The latter corresponds to one of the Bank's other business objectives, namely, improving its profitability indicators. The fulfilment of this objective may be tracked through the dynamic of the ratio between total operating expenses to the total operating income, which over the past year decreased by 4.53 percentage points compared to 2018 as a result of the increase in the total operating income, before loss on impairment and provisions by 3.58%, but also as a result of the limiting the Bank's operating expenses.

This fact is the logical result of fulfilling another key objective, namely, improving the effectiveness of the Bank's market presence through optimisation of the office network. Pursuant to this objective, in 2019 one remote working place and two offices were closed down, and in the beginning of 2020 another office was closed down; the optimisation process was carried out without a significant client outflow. Thus the Bank managed to optimise its expenses and thus free resources to be relocated to the points that have the potential to generate higher added value.

There has also been successful fulfilment of another priority in the strategy and business plan, namely the effective management and control of the amount of customer deposits in order to reduce the resource costs while maintaining stable financing. In 2019 the Bank managed to limit the volume of attracted funds by 3.63% at the end of the past year, while the share of more expensive financing, whose source are individuals and households, decreased by 0.90 percentage points in the overall structure of attracted funds. Thus the price of attracted funds continues its downward trend and in 2019 interest costs decreased by 28.34% compared to 2018.

Based on the above, the management has determined that as at 31 December 2019, the Bank has the potential and conditions to continue as a going concern. In addition, the Bank is also subject to current monitoring and regulation by BNB with respect to all of its licensed activities, financial status and stability.

3. SUMMARY OF THE SIGNIFICANT ACCOUNTING POLICIES

3.1. Accounting estimates

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

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

3.1.1. *Determination of expected credit losses on financial assets with low credit risk*

Instruments with low credit risk are considered to be the instruments for which the risk of default is low, the counterpart's ability to fulfil contractual conditions is stable, and long-term adverse changes in economic conditions and unlikely to change the ability to repay debts. For short-term receivables from banks and debt instruments measured at FVOCI (these are mainly government securities), the Bank assumes that the probability of default is unlikely, and therefore determines 12-month credit losses for these instruments. If in subsequent reporting periods the criteria for low credit risk are no longer met, the Bank analyses the change in the credit risk compared to initial recognition in order to determine the need of lifetime credit losses. Designating instruments as low credit risk ones requires judgement. Upon making this judgement, the Bank uses all the reasonable, grounded and relevant information accessible without making unnecessary costs or efforts (Note 29.2)

3.1.2. *Determination of expected credit losses on loans and advances to customers*

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

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

Upon determining the amount of expected credit losses, the Bank uses forecast information about expected future changes in certain macroeconomic conditions and indicators, and assumptions for correlations of how changes in these indicators would impact the probability of default. The Bank has developed internal models to determine the probability of default by loans, mostly based on historical information for periods when such information is available. The assessment of the correlation between the historical default rates and the forecast economic indicators is a significant estimate. Note 29.2 describes the process applied by the Bank to manage credit risk and determine expected credit losses on loans and advances to customers.

3.1.3. *Determinattion of the fair value of financial instruments*

When the fair value of financial assets and financial liabilities carried in the statement of financial positions cannot be obtained based on quoted prices on active markets, their fair value is determined by using other valuation techniques, involving the use of mathematical models. The input used in these models is obtained from observable market data, where possible and if not possible, significant judgement is applied to determine fair values (Note 29.5);

3.1.4. *Recognition of tax assets*

On recognision of deferred tax assets, the Management of the Bank takes into account the probability for reversal of the separate differences and the ability of the Bank to generate sufficient taxable profit in the future against which the difference con be utilised. As a result of this analysis, the management has decided to not recognise deferred tax assets in the annual financial statements, with the exception of the tax assets described in Note 15.

3.1.5. *Classification and measurement of assets acquired from collaterals*

Acquired assets, which prior to their acquisition were held as collateral of loans granted, are classified by the Bank as non-current assets held for sale, investment property and other assets acquired from collaterals. Upon the initial acquisition of these assets, the Bank's management makes judgements regarding their classification, based on its intentions and possibilities for future use and/or disposal. The management performs an annual review, as at the date of the financial statements, of its assumptions and judgements based on the existing circumstances, and if necessary, the assets are reclassified. According to the Bank's accounting policy, assets classified as non-current assets held for sale or as other assets acquired from collaterals are subsequently measured at the lower of the their carrying amount and the fair value less costs for disposal. In order to determine the fair value of non-current assets held for sale and other assets acquired from collaterals, the Bank uses independent external valuators. Acquired assets classified as investment property are subsequently measured at fair value, whose amount is determined by independent external valuators appointed by the Bank, holding suitable professional qualification and valuation experience with respect to analogous assets. The application of the valuation approaches and techniques, and of the inputs used for each case of fair value measurement, is subject to mandatory discussion and coordination between the external expert valuators and the Bank's valuation specialists, as well as the approval of the valuation reports issued – especially with respect to significant assumptions and final conclusions (Note 29.5).

3.1.6. *Leases*

Dertermination whether a contract contains a lease or lease components
Upon identification and classification of a lease or a lease component of a contract, the Bank determines whether the contract contains an identifiable asset and whether it transfers the right of control over this asset for the contract term. The Bank has identified that office rental contracts contain lease components. The Bank obtains all economic benefits from the use of premises and determines the manner, time and the extent of the office ussage.

Determination of the lease term of lease contracts with renewal and termination options – as lessee
The Bank determines the lease term as the non-cancellable period of the lease, together with both: a) periods covered by an option to extend the lease contract, if the Bank is reasonably certain that it will exercise that option; and b) periods covered by an option to terminate the lease contract, if the Bank is reasonably certain that it will not

exercise that option.

When determining the term of leases, the Bank's management considers all relevant facts and circumstances that create an economic incentive for the lessee to exercise the option to extend the lease, or not to exercise the option to terminate the lease, such as significant improvement to the underlying asset, significant adaptation and customisation of the underlying asset, costs related to termination of the lease and costs for the lease, relocation and identification of another asset, the importance of the underlying asset for the Bank's operations. Extension options (or periods following the termination option) are only included within the lease term when it is reasonably certain that the lease will be extended (or not terminated). The options are reassessed if a significant event or a significant change in circumstances occurs that is in the Bank's discretion and also impacts assessment.

After the commencement date, the Bank reassesses the lease term upon the occurrence of a significant event or a significant change in circumstances that is within its control and affects whether the Bank is reasonably certain to exercise an option not previously included in its determination of the lease term, or not to exercise an option previously included in its determination of the lease term.

Termination options for leases are included within the lease term when the Bank is reasonably certain that it will not exercise these options.

Determination the incremental interest rate of leases in which the Bank is a lessee
In the cases when the Bank is a lessee and cannot readily determine the interest rate to discount lease liabilities, it uses the incremental borrowing rate it would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of- use asset in a similar economic environment.

Review of indicators for impairment of right-of-use assets
As at the date of the financial statements, the Bank's management performs an impairment review of right-of-use assets. If indicators exist that the approximate recoverable amount is lower than their carrying amount, the latter is impaired to the recoverable amount of assets.

The Bank has performed a review and has determined that no indicators for impairment exist as at 31 December 2019.

3.2. Financial instruments

3.2.1. Financial assets

3.2.1.1. Recognition of financial assets

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

3.2.1.2. Initial measurement of financial assets

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

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

- if the fair value has been determined by means of a valuation technique based on observable inputs about the market participants, the difference is recognised as early as the first date within current profit or loss; and

- if the fair value has been determined by means of a valuation technique based on unobservable inputs, the difference is not recognised within current profit or loss until the data is observable or the financial instrument is written-off.

3.2.1.3. Classification and subsequent measurement of financial assets

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

- financial assets at amortised cost;
- financial assets at fair value through profit or loss (FVPL/PL);
- financial assets at fair value through other comprehensive income (FVOCI/OCI) with or without reclassification to profit or loss.

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

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

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

- **Business model to collect contractual cash flows** – within this business model, the Bank holds the respective financial instruments to maturity in order to collect the cash flows agreed with the issuer of the financial instrument /the debtor/. The financial assets held within this business model are not subject to sale, except for individual cases with an explicit decision of the Bank's management. The business model does not change upon executing sales of financial assets or expectations for future sales;
- **Business model to collect cash flows and sell financial assets** – within this business model, the Bank holds the respective financial instruments in order to collect the contractual cash flows, but also for the purpose of sale of financial assets. As compared to the business model whose purpose is the hold financial assets to collect cash flows, in this business model there is greater frequency and value of sales. Sales of financial assets are not sporadic; rather, they constitute a major factor for achieving the purpose of the business model, but in the meantime have no frequency and value threshold.
- **Business model to sell assets** – within this business model, the Bank holds the respective financial instruments for the purpose of trading, even though for the period of holding them the Bank may receive contractual payments of various nature for the respective financial instruments, the ultimate objective is to achieve a positive financial result from differences in the prices of the financial assets.

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

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

The process of establishing characteristics of contractual cash flows includes:

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

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

- upon introducing new standardised banking products at product documentation level;
- upon occurrence of a new instrument and/or product in the case of specific rules or rules that deviate from the standard ones set in internal rules, price list, general terms and conditions and contracts.

Financial assets at amortised cost

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

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

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

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

The Bank classifies in this category debt and equity securities.

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

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

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

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

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

Financial assets at fair value through profit or loss (FVPL)

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

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

3.2.1.4. Impairment of financial assets

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

ECL are based on the difference between the contractual cash flows due according to the contract's conditions, and all cash flows which the Bank expects to receive, discounted with the initial effective interest rate. Expected cash flows include cash flows from the sale of collaterals held or other loan facilities which constitute an integral part of the contractual conditions.

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

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

Additional information about the assumptions used in determining ECL is presented in Notes 29.2 and 3.1.

3.2.1.5. Reclassification of financial assets

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

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

3.2.1.6. Derecognition of financial assets

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

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

3.2.1.7. Modification due to material change in terms and conditions

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

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

3.2.2. Financial liabilities and equity instruments

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

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

The differences resulting from changes in own credit risk for financial instruments measured at fair value through profit or loss are carried to a reserve for financial assets at fair value through other comprehensive income, without subsequent reclassification in the statement of profit and loss and other comprehensive income.

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

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

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

3.2.3. Netting of financial assets and financial liabilities

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

3.2.4. Financial guarantees and undrawn commitments

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

Financial guarantees are initially recognised at fair value, which is the amount of the fee (premium) received. The Bank's liability under each financial guarantee is subsequently measured at the higher of the following: a) the amount initially recognised less the amortised portion thereof recognised in profit or loss, and b) the impairment of expected credit losses.

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

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

The nominal amount of financial guarantees, undrawn loan facilities (where the loan is agreed at market conditions) and letters of credit is not recognised and carried to the statement of financial position. This amount, together with the recognised losses, is disclosed in the notes to the financial statements (Note 29.2).

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

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

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

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

3.3. Investment property

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

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

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

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

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

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

3.4. Leases

As disclosed in Note 2.2 the Bank applies IFRS 16 *Leases*, as from 1 January 2019. The effects of transition to IFRS 16 Leases are described in Note 2.3.

Accounting policy applied as from 1 January 2019
At the lease inception, which is the earlier of the date of a lease agreement and the date of commitment by the parties to the principal terms and conditions of the lease, the Bank performs analysis and assesses whether the contract is, or contains, a lease. A contract is, or contains, a lease, if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

Transfer of control over the use of an asset exists when the Bank in its capacity as customer receives simultaneously:

- the right to dispose of an asset – to determine how and for what purpose it will use the asset over its term of use;
- the right to obtain essentially directly or indirectly all economic benefits from the asset's use over its term of use – through use, holding, or sub-leasing the underlying lease asset.

The Bank's accounting policy as *lessee* has undergone significant changes, as disclosed in Note 2.3.

At the lease inception, the Bank recognizes a right-of-use asset and lease liability. The right-of-use asset is initially measured at acquisition cost. The acquisition cost includes:

- the amount of the initial measurement of the lease liability;
- any lease payments made at or before the commencement date, less any lease incentives received;
- any initial direct costs; and
- costs for dismantling and removing the underlying asset, restoring the site.

Following the lease inception, the Bank applies remeasurement by applying the acquisition cost model, measuring the right-of-use asset at acquisition cost less all depreciation and impairment losses accumulated and adjusted in accordance with each remeasurement of the lease liability as a result of subsequent modifications.

The Bank depreciates the right-of-use asset to the earlier of the end of the useful life of the right-of-use asset or the end of the lease term. If ownership of the asset is transferred under the lease by the end of the lease term, the Bank shall depreciate it to the end of the useful life.

Right-of-use assets are tested for impairment in accordance with IAS 36 *Impairment of Assets*, by applying an impairment determination and reporting policy analogous to the one for property and equipment. The recoverable amount of right-of-use assets is the higher of the fair value less disposal costs, or value in use. To determine assets' value in use, future cash flows are discounted to their present amount, by applying a pre-tax discount rate reflecting the market conditions and time value of money and the risks inherent to the respective asset. Impairment losses are determined as the difference between the recoverable and carrying amount (when the recoverable account is lower than the carrying amount).

Right-of-use assets are presented within property and equipment and right-of-use assets in the statement of financial position, and the depreciation and impairment losses thereof – in the statement of comprehensive income (within profit or loss for the year) as depreciation and amortization expense.

The Bank recognises lease liabilities at the commencement date, measured at the present value of the lease payments that are not paid at this date. Lease payments are discounted using the interest rate implicit in the lease. If this percentage could not be reliably determined, the Bank uses the incremental borrowing rate. As incremental borrowing rate, the Bank uses the effective interest rate on interest-bearing attracted funds. For year 2019, the incremental interest rate is 0.52%. Lease liabilities are subsequently measured using the effective interest method, the carrying amount of the liability is remeasured so as to reflect any change in the lease or fixed payments.

The Bank determines the lease term as the non-cancellable period of the lease, together with both: periods covered by an option to extend the lease if the Bank is reasonably certain to exercise that option; and periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option. The basis for determining the lease term is the term stipulated in the agreement and the strategies, plans and intentions adopted with respect to each particular asset. The Bank adjusts a lease term (irrespective of whether it contains a renewal option) if there are sufficiently certain circumstances and expectations justifying a change in the term envisaged in the lease. The Bank analyses all factors that confirm the possibility to renew or terminate the lease. The lease term is reviewed at the end of each calendar year for all leases or upon change in the non-cancellable period of the lease.

The Bank has elected to apply the exemption allowing it to not recognize right-of-use assets and lease liabilities for leases whose underlying asset amounts to less than USD 5,000. The Bank recognizes the lease payments related thereto as an expense on a straight-line basis for the lease term or on another systematic basis. Assets for which the above exemption has been applied, whose term is up to 12 months and/or amounting to less that USD 5,000 comprise office equipment, rental of parking places, rental of ATM locations, etc.

The application of IFRS 16 as from 1 January 2019 has not resulted in changes in the Bank's policy as *lessor*.

The Bank as lessor classifies its leases as operating or finance leases.

<u>Operating lease</u>
A lease in which the lessor continues to hold a significant portion of all risks and economic benefits from ownership over the asset is classifies as an operating lease. Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease. The underlying asset which is subject to the lease shall remain and be stated within the Bank's statement of financial position.

<u>Finance lease</u>
Upon leasing assets under finance leases, the Bank recognises and presents the assets held under finance leases in its statement of financial position as lease receivables whose amount is equal to present value of minimum lease payments. The Bank recognises finance income, using the net investments method (before taxes), with reflects a constant periodic rate of return on investment. Receivables under funding agreements in finance leases are stated within "Loans and advances to customers" in the statement of financial position.

Accounting policy applied until 31 December 2018

<u>Operating lease</u>

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

<u>Finance lease</u>

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

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

3.5. Property and equipment and right-of-use assets and intangible assets

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

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

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

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

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

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

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

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

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

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

Right-of-use assets are stated within property and equipment in the statement of comprehensive income, and the policy applies is disclosed in Note 3.4.

The Bank depreciates right-of-use assets on a straight-line basis over the lease term. The depreciation rate applied is 10%-60%.

3.6. Interest income and expense

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

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

Interest income comprises: interest income from debt securities measured at fair value through other comprehensive income, interest income from deposits with other banks, interest income from financial assets held for trading, interest on loans and advances to customers, including fees and charges on loans and advances to customers (including paid to intermediaries in relation to the loan disbursement), which are integral part of the effective income of the financial instrument.

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

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

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

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

3.7. Fee and commission

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

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

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

3.8. Foreign currency transactions

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

Currency	31.12.2019	31.12.2018
USD	1.74099	1.70815
EUR	1.95583	1.95583

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

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

3.9. Employee benefits

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

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

At the date of each financial statements, the Bank measures the expected expense on accumulated unused paid leaves which is expected to be paid as a result of the unused entitlement to paid leave. The measurement includes the estimate of remuneration and social security and health insurance contributions due by the employer thereon.

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

In accordance with IAS 19 Employee Benefits the Bank recognizes liabilities for retirement benefits, which are calculated by a licensed actuary using the projected unit credit method (Note 16). The amount reported in the statement of financial position represents the present value of the long-term liabilities of the Bank for retirement benefits.

3.10. Income taxes

The current income taxes of the Bank are determined in accordance with the requirements of the Bulgarian tax legislation. Income tax is calculated based on the taxable profit for the period, determined in accordance with the provisions of the Corporate Income Taxation Act (CITA). The nominal income tax rate in Bulgaria for 2019 is 10% (2018: 10%).

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

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

Deferred tax assets are recognised for all deductible temporary differences to the extent sufficient taxable profit is available from which the deferred tax asset could be set off. This does not apply to differences arising from the recognition of an asset or liability, which has affected neither the accounting nor taxable profit/(loss) at the transaction date.

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

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

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

As at 31 December 2019 the deferred income taxes of the Bank are computed at a tax rate of 10%, which is also valid for 2020 (31 December 2018: 10%).

3.11. Fair value of financial assets and liabilities

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

- for the purpose of measurement and presentation at fair value in the financial statements: financial assets – securities at fair value through other comprehensive income, financial assets at fair value through profit or loss, non-financial assets – investment property;
- for the purpose of fair value disclosures in the financial statements: financial assets and liabilities – measured at amortised cost: loans and advances to banks, loans and advances to customers, deposits from to banks, deposits from customers; non-financial assets – assets held for sale.

The Bank also determines the fair value of the collaterals obtained thereby.

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

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

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

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

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

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

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

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

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

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

Note 29.5 and Note 11 provide information on the fair values of financial assets and liabilities, investment property, and assets held for sale.

3.12. Provisions and contingent liabilities

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

3.13. Assets acquired from collaterals

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

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

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

3.14. Non-current assets held for sale

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

- The asset is available for immediate sale
- The sale is highly probable, including:
  - Management is committed to a plan to sell the asset;

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

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

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

3.15. Share capital and reserves

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

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

The Bank is obliged to set aside a Reserve Fund (statutory reserve) in accordance with the requirements of the Commercial Act on distribution of the profit (Note 17.2).

The financial assets at FVOCI reserve is being set aside from the difference between the carrying amount of financial assets at fair value through other comprehensive income and their fair values at the revaluation date.

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

3.16. Cash and cash equivalents

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

3.17. Comparative information

In these financial statements, the Bank provides comparative information for one prior year. Where necessary, comparative data is reclassified (and restated) in order to achieve comparability in view of the current year presentation changes.

An exception from this rule is the presentation of the impact of the initial adoption of IFRS 16; the Bank has elected modified retrospective application of the standard and will not restate comparative data.

The impact of initial adoption of the new IFRS 16 Leases is presented in Note 2.3.

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

4. CASH AND BALANCES WITH THE CENTRAL BANK

	31.12.2019	31.12.2018
Cash in hand	9,570	7,976
Cash with the Central Bank	43,632	93,552
	53,202	*101,528*
Allowance for credit losses	*(9)*	*(20)*
Total	**53,193**	**101,508**

As at 31 December 2019 and 2018 cash with the Central Bank includes mandatory minimum reserves at the amount of BGN 27,428 thousand and BGN 29,622 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 267 thousand and BGN 444 thousand, respectively. There are no limitations imposed by the Central Bank for using the minimum reserves. The amount of the reserves depends on the amount of deposits attracted by the Bank.

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

	2019	2018
Balance on 1 January	**20**	**13**
Increase in the impairment for expected credit losses	-	7
Decrease (reversal) of the impairment for expected credit losses	(11)	-
Balance on 31 December	**9**	**20**

5. LOANS AND ADVANCES TO BANKS

Loans and advances to banks are as follows:

	31.12.2019	31.12.2018
Current accounts at local banks	1,292	618
Current accounts at foreign banks	4,791	5,122
Deposits at local banks	20,083	21,147
Deposits at foreign banks	-	6,496
	26,166	33,383
Allowance for credit losses	(3)	(7)
Total	**26,163**	**33,376**

Deposits placed with banks as at 31 December 2019 and 2018 have maturity of up to three months.

As at 31 December 2019 and 2018, loans and advances to banks are classified in Stage 1. Expected credit losses are calculated on an individual basis.

The movement in the allowance for expected credit losses on loans and advances to banks is as follows:

	2019	2018
Balance on 1 January	**7**	**7**
Increase in the impairment for expected credit losses	-	6
Reversal of the impairment for expected credit losses	(4)	(6)
Balance on 31 December	**3**	**7**

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

6. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT AND LOSS

	31.12.2019	31.12.2018
Debt instruments at FVPL		
Foreign government securities	37,273	-
	37,273	**-**
Equity instruments at FVLP		
Stocks and shares in local entities	161	174
	161	**174**
Total	**37,434**	**174**

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

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

	31.12.2019	31.12.2018
Debt instruments at fair value through other comprehensive income		
Bulgarian government securities	25,026	27,458
Foreign government securities	-	14,726
Corporate bonds of foreign issuers	1,915	1,877
	26,941	44,061
Equity instruments at fair value through other comprehensive income		
Shares and interest in local entities	293	293
	293	**293**
Total	**27,234**	**44,354**

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

	2019	2018
Balance at 1 January	**44,354**	**74,746**
Increase (purchases)	-	4,870
Decrease (sales and/or maturity)	(17,663)	(33,292)
Net effect of restatement to fair value	(189)	(975)
Change in accrued interest	732	(995)
Balance at 31 December	**27,234**	**44,354**

As at 31 December 2019 and 2018 debt securities at fair value through other comprehensive income are classified in Stage 1. Expected credit losses are determined on an individual basis (Note 29.2).

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

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

	2019	2018
Balance on 1 January	**146**	**170**
Increase in the impairment credit losses on debt securities recognised in other comprehensive income	-	57
Decrease (reversal) in the impairment credit losses on debt securities recognised in other comprehensive income	(109)	(81)
Balance on 31 December	**37**	**146**

As at 31 December 2019, government securities with carrying amount of BGN 20,362 thousand are pledged as collateral with BNB to secure attracted funds from the State Budget (31 December 2018: BGN 9,512 thousand).

8. LOANS AND ADVANCES TO CUSTOMERS

8.1. Analysis by type of customers

	31.12.2019	31.12.2018
Private entities	159,080	139,060
Households and individuals	48,869	46,947
State budget	1,501	1,505
Financial entities	2,603	1,959
Finance lease corporate clients	6,351	6,513
	218,404	195,984
Allowance for credit losses	(10,375)	(12,368)
Total	**208,029**	**183,616**

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

8.2. Analysis by sectors

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

	31.12.2019	**31.12.2018**
Industry	39,104	31,370
Trade	26,208	27,223
Consumer loans	21,123	23,098
Construction	28,480	27,309
Tourist services	15,107	17,384
Agriculture	13,569	10,789
Health care	6,071	6,292
Information and communication services	5,926	6,098
Real estate transactions	4,756	5,261
Transport	1,910	1,950
Finance	2,602	1,959
State budget	1,501	1,505
Other sectors	52,047	35,746
	218,404	195,984
Allowance for credit losses	(10,375)	(12,368)
Total	**208,029**	**183,616**

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

	2019	**2018**
	Loans and receivables	**Loans and receivables**
Balance at 31 December	**12,368**	**18,563**
Impact of the initial adoption of IFRS 9		618
Balance at 1 January	**12,368**	**19,181**
Accrued impairment	1,589	2,020
Increase in the allowance for impairment of unrecognized interest on loans in Stage 3	108	89
Reversed impairment	(2,203)	(2,082)
Impairment written of	(1,487)	(6,840)
Balance at 31 December	**10,375**	**12,368**

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

The allocation of loans and advances to customers based on type and stage of impairment is as follows:

	31.12.2019	31.12.2018
Individually impaired		
Gross amount	22,976	22,592
Allowance for credit losses	(6,698)	(8,051)
Stage 3	16,278	14,541
Individually impaired	**16,278**	**14,541**
Collectively impaired		
Gross amount	161,377	142,168
Allowance for credit losses	(44)	(54)
Stage 1	161,333	142,114
Gross amount	25,576	21,118
Allowance for credit losses	(80)	(258)
Stage 2	25,496	20,860
Gross amount	8,475	10,106
Allowance for credit losses	(3,553)	(4,005)
Stage 3	4,922	6,101
Collectively impaired	**191,751**	**169,075**
Total	**208,029**	**183,616**

8.4. Analysis of finance lease receivables from corporate clients

Finance lease receivables are as follows:

	31.12.2019	31.12.2018
Up to 1 year	504	520
1 to 5 years	2,817	3,409
Over 5 years	5,623	5,473
Gross investments in finance leases, receivables	8,944	9,402
Less: unearned finance income	(2,593)	(2,889)
Net investments in finance leases	**6,351**	**6,513**

The net investments in finance leases are as follows:

	31.12.2019	31.12.2018
Up to 1 year	215	224
1 to 5 years	1,584	1,905
Over 5 years	4,552	4,384
	6,351	**6,513**
Allowance for credit losses	-	-

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

9. NON-CURRENT ASSETS HELD FOR SALE

	2019	**2018**
Balance at the beginning of the year	4,984	6,734
Additions during the year	48	124
Disposals during the year	(162)	(1,747)
Transferred to assets acquired from non-performing loans	(2,196)	(117)
Impairment	-	(10)
Balance at 31 December	**2,674**	**4,984**

The fair values of non-current assets held for sale are categorized as Level 3 fair values based on the inputs used in the valuation approach. The valuations have been done in compliance with the methods set in the International Valuation Standards and the reference for market evidence based on transactions or bids for similar properties. Additional information about the inputs used in determining their fair value and the types of non-current assets held for sale is provided in Note 29.5.

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

10. PROPERTY, EQUIPMENT, RIGHT-OF-USE ASSETS AND INTANGIBLE ASSETS

Property, equipment and right-of-use assets

	Land and buildings	Right-of-use assets (buildings)	Office equipment	Motor vehicles	Furniture and fixtures	Other assets	Total property, equipment and right-of-use assets
Book value							
1 January 2018	1,017	-	2,792	840	585	570	5,804
Additions	-	-	74	-	67	95	236
Disposals	-	-	(157)	-	(65)	(35)	(257)
Sold	-	-	(67)	(62)	(3)	-	(132)
31 December 2018	1,017	-	2,642	778	584	630	5,651
Impact of the adoption of IFRS 16	-	3,695	-	-	-	-	3,695
Additions	-	522	159	-	16	-	697
Disposals	(266)	(119)	(98)	-	(22)	(73)	(578)
Sold	-	-	(11)	(45)	(7)	-	(63)
31 December 2019	751	4,098	2,692	733	571	557	9,402
Accumulated depreciation							
1 January 2018	(295)	-	(1,866)	(815)	(441)	(365)	(3,782)
Depreciation charge for the year	(20)	-	(290)	(20)	(37)	(70)	(437)
Depreciation written off	-	-	208	63	66	26	363
31 December 2018	(315)	-	(1,948)	(772)	(412)	(409)	(3,856)
Depreciation charge for the year	(18)	(1,078)	(289)	(6)	(38)	(75)	(1,504)
Depreciation written off	105	-	107	45	27	54	338
31 December 2019	(228)	(1,078)	(2,130)	(733)	(423)	(430)	(5,022)
Net carrying amount							
31 December 2018	702	-	694	6	172	221	1,795
31 December 2019	523	3,020	562	-	148	127	4,380

As at 31 December 2019, tangible fixed assets include assets with a book value of BGN 2,545 thousand (31 December 2018: BGN 2,505 thousand), which have been fully depreciated, but continue to be used in the Bank's operations.

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

As at 31 December 2019, right-of-use assets are related to leases of office premises.

The buildings disposed include an asset with carrying amount BGN 161 thousand, which has been reclassified to "investment property".

Intangible assets

	Licenses	Software	Total intangible assets
Book value			
1 January 2018	560	932	1,492
Additions	47	75	122
31 December 2018	607	1,007	1,614
Additions	-	282	282
Disposals	(19)	(51)	(70)
31 December 2019	588	1,238	1,826
Accumulated depreciation			
1 January 2018	(193)	(586)	(779)
Depreciation charge for the year	(80)	(168)	(248)
31 December 2018	(273)	(754)	(1,027)
Depreciation charge for the year	(78)	(89)	(167)
Depreciation written-off	18	45	63
31 December 2019	(333)	(798)	(1,131)
Net carrying amount			
31 December 2018	334	253	587
31 December 2019	255	440	695

As at 31 December, intangible assets include assets of book value BGN 181 thousand (31 December 2018: BGN 167 thousand), which have been fully depreciated, but continue to be used in the Bank's operations.

11. INVESTMENT PROPERTY

	2019	2018
Balance at the beginning of the year	**12,590**	**9,853**
Reclassified from property, equipment and right-of-use assets	161	-
Property acquired from finance lease	-	2,737
Balance at 31 December	**12,751**	**12,590**

The fair value of investment property has been categorised as Level 3 fair values based on the input used in the valuation technique. The fair values have been determined using the methods determined by the International Valuation Standards and references of market evidence on transactions or bid prices of similar property (Note 29.5).

The Bank's investment property as at 31 December 2019 comprises a hotel complex, regulated landed property, and retail properties. A significant part of the investment property is leased for a period of one year with an extension option and one-month termination notice. The rental income from investment property for the year ended 31

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

December 2019 amounts to BGN 331 thousand (31 December 2018: BGN 255 thousand).

12. OTHER ASSETS

	31.12.2019	31.12.2018
Assets acquired from non-performing loans	19,531	18,773
VAT receivable	1	30
Deferred expenses	217	208
Guarantee deposits	69	73
Advance payments	171	143
Other assets	365	283
Total	**20,354**	**19,510**

Movement in the impairment of other assets

	2019	2018
Balance at 1 January	-	1
Impairment accrued	-	7
Impairment reversed	-	-
Impairment written-off	-	(8)
Balance at 31 December	-	-

Assets acquired under non-performing loans
The fair values of assets acquired under non-performing loans are categorized as Level 3 fair values based on the inputs used in the valuation approach. The valuations have been done in compliance with the methods set in the International Valuation Standards and the reference for market evidence based on transactions or bids for similar properties. Additional information about the inputs used in determining their fair value and the types of assets acquired under non-performing loans is provided in Note 29.5.

13. DEPOSITS FROM BANKS

The term deposits from banks amount to BGN 113 thousand (31 December 2018: BGN 268 thousand) and have maturity of up to three months.

14. DEPOSITS FROM CUSTOMERS

	31.12.2019	31.12.2018
Individuals' accounts		
- Deposits on demand and savings accounts	85,081	85,880
- Term deposits	168,768	180,766
State Budget accounts		
- On demand deposits	9,696	8,711
Corporate accounts		
- On demand deposits	53,456	47,253
- Term deposits	28,518	36,468
Accounts of other non-bank financial institutions		
- On demand deposits	757	252
	346,276	**359,330**

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

As at 31 December 2019, 6.07% (31 December 2018: 5.84%) of customers' deposits are funds of the main shareholder and related parties thereto.

Customer deposits includes customers' cash blocked by the Bank: for collateral of loans and bank guarantees at the amount of BGN 1,182 thousand (31 December 2018: BGN 1,159 thousand), as well as accounts under special conditions: accumulation accounts at the amount of BGN 4,333 thousand (31 December 2018: BGN 3,998 thousand).

15. DEFERRED TAX ASSETS AND LIABILITIES

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

	31.12.2019	31.12.2018
Deferred tax assets:		
Long-term employee benefits	28	27
Unused paid leaves	8	8
Total deferred tax assets	**36**	**35**

Deferred tax liabilities:		
Differences between accounting and tax depreciation/amortisation	-	(62)
Total deferred tax liabilities	**-**	**(62)**
Deferred tax assets/(liabilities), net	**36**	**(27)**

Deferred tax assets and liabilities as at 31 December 2019 and 2018 have been calculated by applying a tax rate of 10%, determined in accordance with the Corporate Income Taxation Act and applicable for periods of temporary differences.

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

As at 31 December, the Bank does not recognise deferred tax assets at the amount of BGN 482 thousand (31 December 2018: BGN 1,293 thousand) on accumulated tax loss of BGN 4,819 thousand (31 December 2018: BGN 12,934 thousand) and at the amount of BGN 503 thousand (31 December 2018: BGN 553 thousand) for other temporary differences at the amount of BGN 5,031 thousand (31 December 2018: BGN 5,532 thousand), in so far as there is uncertainty regarding the future taxable profit against which they can be deducted.

16. OTHER LIABILITIES

	31.12.2019	31.12.2018
Ongoing bank transfers	219	142
Lease liabilities	3,027	-
Accruals for unused paid leave	71	64
Long-term retirement benefit obligation	279	267
Remeasurement of financial guarantees and loan commitments	16	12
Other liabilities	225	447
	3,837	**932**

Bank transfers
Ongoing bank transfers represent liabilities on money transfers ordered by customers in the last day of 2019 and 2018 respectively, with value date within two days. The transfers are processed up to the second working day of 2020 and 2019, respectively.

Payables to personnel

According to the provisions of the Labour Code, upon termination of employment relations, if the worker or employer is entitled to pension for length of service and age, the Bank is obliged to pay a compensation amounting to double the gross monthly remuneration. If the worker or employee has worked at the Bank over the last 10 years, the amount of the compensation equals 6 gross monthly salaries. As at 31 December 2019 and 31 December 2018, the Bank accrued BGN 279 thousand and BGN 267 thousand respectively for retirement benefit obligations, and the provision amount has been determined by a licensed actuary.

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

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

Lease liabilities
The change in the lease liabilities is presented in the table below:

	2019
Balance at 1 January	3,695
Accumulated interest	16
Payments	(1,087)
Extended	522
Terminated	(119)
Balance at 31 December	**3,027**

The maturity analysis of lease liabilities is presented in Note 29.3

17. EQUITY AND RESERVES

17.1. Share capital

As at 31 December 2019 and 2018, the Bank's share capital is fully paid and is distributed in registered voting shares, as follows:

	31.12.2019	**31.12.2018**
Number of shares	6,800,000	6,800,000
Share nominal in BGN	10	10
Share capital (BGN'000)	**68,000**	**68,000**

As at 31 December 2019 and 2018, the Bank's shareholder structure is as follows:

	31.12.2019	**%**	**31.12.2018**	**%**
Tokushukai Incorporated	6,796,250	99.94	6,796,250	99.94
Gamma Holding Group AD	3,750	0.06	3,750	0.06
Total shares	**6,800,000**	**100**	**6,800,000**	**100**

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

17.2. Reserves

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

	31.12.2019	31.12.2018
Statutory reserves (Reserve Fund)	1,815	1,815
Reserve of financial assets at fair value though other comprehensive income	949	1,321
Actuarial losses on revaluation of defined income retirement plans	(10)	(9)
	2,754	**3,127**

Statutory reserves (Reserve Fund)

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

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

Reserve of financial assets at fair value through other comprehensive income

The reserve of financial assets at fair value through other comprehensive income is formed from the effects of remeasurement of securities measured at fair value through other comprehensive income. Upon derecognition of debt securities, the reserve is recycled through the statement of profit and loss and other comprehensive income (through profit or loss for the period). Upon derecognition of equity securities, the reserve is not recycles through the statement of profit and loss and other comprehensive income (through profit or loss for the period).

18. NET INTEREST INCOME

	2019	2018
Interest income		
Loans and advances to banks	415	412
Loans and advances to customers	9,243	8,804
Financial assets at FVOCI	717	1,353
Financial assets at FVPL	245	-
	10,620	**10,569**
Interest expenses		
Deposits, including:	1,277	1,836
Individuals	1,245	1,743
Corporate clients	27	76
State budget	5	17
Current accounts at other banks	276	353
Lease liabilities	16	-
	1,569	**2,189**
Net interest income	**9,051**	**8,380**

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

In 2019 the Bank accrued interest income on loans and advances to customers classified at Stage 3, at the amount of BGN 1,301 thousand (31 December 2018: BGN 1,051 thousand).

19. NET FEE AND COMMISSION INCOME

	2019	2018
Fee and commission income		
Money transfers	1,503	1,552
Account servicing	827	759
Loans granted	736	871
Card servicing	367	378
Cash transactions	431	324
Guarantee servicing	99	113
Other	11	26
	3,974	**4,023**

Fees and commissions expenses	**2019**	**2018**
Card servicing	181	200
Money transfers	6	5
Insurance	7	8
Account opening and servicing	31	31
Other	34	38
	259	**282**
Net fee and commission income	**3,715**	**3,741**

20. NET TRADING INCOME

	2019	2018
Loss on revaluation of financial assets at FVPL	(5)	(8)
Foreign exchange gains	291	281
	286	**273**

21. OTHER OPERATING INCOME

	2019	2018
Net gain on sale of debt instruments at FVOCI	124	639
Rental income	442	312
Net foreign exchange revaluation gain	8	8
Gain on sales of property and equipment	8	6
Dividends	2	2
Net loss on assets written-off, other than assets held for sale	(28)	(23)
Loss on non-current assets held for sale	(14)	(99)
Other operating income (net)	170	50
	712	**895**

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

22. GAIN AND LOSS ON IMPAIRMENT AND PROVISIONS

	2019	2018
Impairment (reversed)/charged on receivables from the Central Bank	(11)	7
Reversed impairment of debt instruments at FVOCI	(109)	(24)
Reversed impairment of loans and advances to banks	(4)	-
Reversed impairment of loans and advances to customers	(614)	(62)
Impact of modification of loans and advances to customers	39	199
Impairment charged on other financial assets	-	7
Remeasurement of financial guarantee contracts and loan commitments	4	2
Impairment of non-financial assets	58	39
	(637)	**168**

23. PERSONNEL EXPENSES

	2019	2018
Salary expenses	5,404	5,319
Social security contributions	657	662
Health insurance contributions	230	224
Expenses for additional mandatory pension insurance	123	119
	6,414	**6,324**

24. OTHER EXPENSES

	2019	2018
Hired services	1,415	1,459
Contributions to the Deposit Insurance Fund	965	824
Unrecognised VAT expenses	661	687
IT licenses and support	546	479
Utility costs	304	308
Contributions to the Banks Restructuring Fund	280	298
Litigations	46	203
Office supplies	118	122
Other expenses	859	923
	5,194	**5,303**

The expenses for statutory joint audit of the annual financial statements for year 2019 amount to BGN 63 thousand (2018: BGN 54 thousand). The expenses for other services granted by the registered auditors in 2019 amount to BGN 8 thousand (2018: BGN 9 thousand).

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

25. INCOME TAX BENEFIT

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

	2019	**2018**
Deferred tax	64	67
Total benefit from income tax carried to the statement of comprehensive income (within profit or loss for the year)	**64**	**67**

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

Profit/(Loss) before income tax	1,089	(334)
Tax at 10% applicable tax rate for 2019 (2018: 10%)	(109)	33
Effect of unrecognized amounts in the tax return related to:		
increases	(156)	(7)
decreases	201	347
Tax loss (available for deduction)/deducted	128	(306)
Total benefit from income tax carried to the statement of comprehensive income (within profit or loss for the year)	**64**	**67**

26. RELATED PARTY TRANSACTIONS

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

Related parties	Type of relation	Period of relation
TOKUSHUKAI INCORPORATED	Main shareholder	2018 and 2019
GLOBAL-PRIME OOD	Companies under common control	2018 and 2019

The key management personnel is disclosed in Note 1.

As at 31 December 2019 and 31 December 2018, the Bank has receivables from and payables to related parties, as follows:

Related parties and balances	**31.12.2019**	**31.12.2018**
Main shareholders		
Deposits received	17,933	19,276
Companies under common control		
Deposits received	3,072	1,706
Key management personnel		
Loans granted	56	15
Deposits received	61	28

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

The income and expenses of the Bank in 2019 and 2018 from related party transactions are as follows:

Related parties and types of transactions	2019	2018
Main shareholder		
Fees and commissions income	2	2
Interest expense	3	2
Companies under common control		
Fees and commissions income	2	1
Interest expense	4	3

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

The remuneration to the Supervisory Board members accrued and paid in 2019 amount to a total of BGN 61 thousand (2018: BGN 42 thousand). The remuneration to the Management Board members paid in 2019 amount to a total of BGN 428 thousand (2018: BGN 419 thousand).

27. CASH AND CASH EQUIVALENTS

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

	31.12.2019	31.12.2018
Cash in hand (Note 4)	9,570	7,976
Cash with the Central Bank (Note 4)	43,623	93,532
Current accounts with local banks (Note 5)	1,291	618
Current accounts with foreign banks (Note 5)	4,791	5,121
Deposits to banks with original maturity of up to three months (Note 5)	20,081	27,637
Total cash and cash equivalents	**79,356**	**134,884**

28. COMMITMENTS AND CONTINGENCIES

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

	31.12.2019	31.12.2018
Guarantees	4,713	4,822
Undrawn loan commitments	25,030	17,864
	29,743	**22,686**

As at 31 December 2019, the Bank has charged provisions for credit losses on financial guarantee contracts and loan commitments at the amount of BGN 16 thousand (31 December 2018: BGN 11 thousand). The provisions accrued for credit losses in the statement of comprehensive income for years 2019 and 2018 are disclosed in Note 22).

29. MANAGEMENT OF THE RISK RELATED TO FINANCIAL INSTRUMENTS

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

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

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

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

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

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

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

29.1. Financial assets and liabilities

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

31 December 2019	**Carrying amount**	**Fair value**
Financial assets		
Cash and balances with the Central Bank	53,193	53,193
Loans and advances to banks	26,163	26,163
Loans and advances to customers	208,029	211,226
Financial assets at FVPL	37,434	37,434
Debt instruments at FVOCI	26,941	26,941
Equity instruments at FVOCI	293	293
Total assets	**352,053**	**355,250**
Financial liabilities		
Deposits from banks	113	113
Deposits from customers	346,276	346,618
Other financial liabilities	3,027	3,027
Total liabilities	**349,416**	**349,758**

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

31 December 2018	**Carrying amount**	**Fair value**
Financial assets		
Cash and balances with the Central Bank	101,508	101,508
Loans and advances to banks	33,376	33,376
Loans and advances to customers	183,616	185,909
Financial assets at FVPL	174	174
Debt instruments at FVOCI	44,061	44,061
Equity instruments at FVOCI	293	293
Total assets	**363,028**	**365,321**
Financial liabilities		
Deposits from banks	268	268
Deposits from customers	359,330	360,227
Other financial liabilities	142	142
Total liabilities	**359,740**	**360,637**

29.2. Credit risk

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

Cash and cash balances with the Central Bank, at the amount of BGN 53,193 thousand and BGN 101,508 thousand, respectively as at 31 December 2019 and 31 December 2018, 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 advances to banks at the amount of BGN 26,163 thousand and BGN 33,376 thousand respectively as at 31 December 2019 and 31 December 2018 consist mostly of deposits with first-class international and Bulgarian banks with maturity of up to seven days. The Bank manages the credit risk related to loans and advances to banks, by setting exposure limits at counterpart level.

Counterpart risk is considered at the following levels:

- sovereign risk – impossibility or unwillingness of a country's government to repay its obligations;
- state-related risk – the risk of adverse changes in the social and political and/or economic situation in a country, as a result of which the Bank would take additional political and cross-border risks, such as moratorium on payments or impossibility of currency conversion;
- banking risk – the risk of deterioration of the financial condition of a bank or non-bank financial institution 0 counterparty, including insolvency, as a result of which the Bank would take additional risks and would incur losses;
- pre-settlement risk – the risk of deterioration of the financial condition of a certain bank-counterpart, including insolvency, as a result of which it is unable to meet its contractual obligations before the settlement date. This risks exists in trade in securities, debt instruments, FX and derivatives;
- settlement risk – the risk that occurs on the date of settlement and consists of impossibility to meet contractual obligations.

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

- official rating – short-term rating in accordance with the long-term rating of a country or bank, prepared by the following rating agencies – Moody's, Tompson Bank Watch, Standard & Poors, Fitch;
- working rating – the rating of the respective bank as prepared by Tokuda Bank AD in case of lack of rating prepared by one of the agencies listed above;

- internal rating – the rating of a bank as determined by Tokuda Bank AD in accordance with the "Internal Rating Scale for Bank Counterparts". The internal rating is based on the official or working rating and directly corresponds to a certain "global banking limit". The internal rating of a non-bank financial institution is only determined in case of availability of official ratings by at least one of the rating agencies listed above.

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

Financial assets held for trading, at the amount of BGN 37,434 thousand BGN 174 thousand, respectively as at 31 December 2019 and 31 December 2018, pose mainly a market risk to the Bank (Note 29.4). The maximum exposure to credit risk for these instruments is their carrying amount.

Debt instruments at FVOCI amount to BGN 26,941 thousand and BGN 44,061 thousand as at 31 December 2019 and as at 31 December 2018. The maximum exposure to credit risk for these instruments is their carrying amount.

The contingent liabilities of the Bank consist of guarantees issued and undrawn loan amounts, whose amount of BGN 29,743 as at 31 December 2019 and BGN 22,686 thousand as at 31 December 2018 (Note 28) is the Bank's maximum credit exposure.

Loans and advances to customers with carrying amount of BGN 208,029 thousand and BGN 183,616 thousand, respectively, as at 31 December 2019 and 31 December 2018, bear credit risk to the Bank. The exposure of the Bank to that risk is determined on the basis of individual assessment of each loan, as the Bank applies the criteria for assessment and classification of risk exposures according to the Policy for impairment of financial assets and contingent liabilities.

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

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

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

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

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

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

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

Control over the credit process at loan transaction level includes:

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

Control over the credit process at loan portfolio level includes:

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

<u>Internal structure and units involved in credit risk management</u>

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

- identify, coordinate and are responsible for the Bank's customer relations on loan transactions, as well as for attracting new customers;
- collect the necessary information and prepare a company, market and financial analysis and loan proposals to the Credit Committee;
- administer, monitor and manage the loan portfolio, including collection;
- apply, coordinate and are responsible for and report on the results from the Bank's lending activity in accordance with the approved lending policy.

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

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

- reviews, approves and controls the loan documentation and its compliance with the competent bodies on the loan transactions;
- keeps a register of collaterals and of related parties;
- monitors and controls compliance with the conditions envisaged in the loan agreements and annexes thereto;
- controls the process of updates of collateral valuation, as well as collaterals' validity;
- controls the process of updates (renewal) of collaterals' insurance.

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

The Legal Division at the Bank's Head Office analyses and provides opinions on the legal risks to the loan transaction, as well as on the collateral offered and participate in the approval and preparation of loan agreement and in the process of collateral incorporation.

The Credit Committee is a collective body to the MB, whose main task is to manage the lending process. Its activities are subordinated to the provisions of the Credit Institutions Act and the other legal acts on lending relations, the Bank's lending policy, internal regulations and rules on the organisation of its activities. The Credit Committee examines and takes decisions on proposals for granting new exposures and changes on existing exposures (including renegotiation, restructuring, early repayment, forced execution, etc.) at an amount of up to 10% of the Bank's capital base, and proposes for review loan proposals for exposures exceeding 10% of the capital base.

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

The methodology on determining impairment provisions applies the classification according to the rules set out in

Regulations 2014/680 и 2015/1278. The management considers expositions as non-performing and performing.

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

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

A performing exposure is an exposure that cannot be classified as non-performing.

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

Policy and process of impairment of loans and advances to customers

Significant increase in credit risk following initial recognition

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

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

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

Credit impairment following initial recognition:

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

Objective evidence of credit impairment of the financial assets includes:

- quantitative criteria: delay in loan payments by over 90 days.

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

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

Stages of classification of credit exposures

Depending on the presence of significantly increased credit risk following initial recognition and of credit impairment following initial recognition, credit exposures are classified in the following stages:
- Stage 1 – there is no significantly increased credit risk of the exposure following its initial recognition;
- Stage 2 – there is a significant increase in the credit risk following initial recognition;
- Stage 3 – there is credit impairment.

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

Determining expected credit losses on loan exposures

Individual and collective impairment assessment of loan exposures

Loan exposures individually assessed for impairment are all significant exposures (exposures exceeding BGN 500 thousand) at Stage 3 and other exposures based on the Bank's judgement. Loan exposures collectively assessed for impairment are all loan exposures which are not individually assessed for impairment. Upon determining the expected credit losses on loan exposures, the Bank uses different approaches, depending on whether the loan exposures is assessed for impairment individually or collectively.

Determining expected credit losses for loan exposures collectively assessed for impairment

The approaches used to determine expected credit losses take into consideration the historic behaviour of loan exposures and the expected future development of certain macro-economic, market, statutory and other factors that impact the borrowers' ability to service their payables under loan exposures. Expected credit losses are determined at loan level and are calculated using the formula ECL = EAD x PD x LGD, where:
- EAD (exposure at default) = current balance sheet exposure + CCF x unused part of the available limit, where CCF – credit conversion factor; EAD for off-balance sheet commitments = CCF x off-balance sheet commitment;
- PD (probability of default) – the probability of occurrence of default applicable for the loan, calculated based on the model of calculation of possibilities of default. For loans at Stage 1, probability of default over the next 12 months is used. For loans at Stage 2 and Stage 3, probability of default over the financial instrument's life term is used;
- LGD (loss given default) – loss upon occurrence of default – it is the difference between the loan exposure and the total amount of NRV (as defined below) of the available loan collaterals (if NRV>0) and the amount of the loan exposure; if NRV of the collaterals exceed the credit exposure, LGD = 0;
- NRV (Net Realizable Value) – net realizable value of the collateral at the respective reporting date; determined as the sum of market values of the loan's collaterals calculated by using standard assumptions for (i) expected changes in value over time, (ii) expected realisation timeframe and (iii) expected realisation costs.

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

Determining expected credit losses for loan exposures individually assessed for impairment

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

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

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

Quality of balances with the Central Bank

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

Change in the gross amortised cost	**Stage 1**	**Stage 2**	**Stage 3**	**2019**
Amount on 1 January 2019	93,552	-	-	93,552
New exposures	1,160,626	-	-	1,160,626
Paid exposures	(1,210,545)	-	-	(1,210,545)
Transfer between stages	-	-	-	-
Amount on 31 December 2019	**43,633**	-	-	**43,633**

Change in the impairment allowance	**Stage 1**	**Stage 2**	**Stage 3**	**2019**
Amount on 1 January 2018	20	-	-	20
New exposures	-	-	-	-
Paid exposures	(11)	-	-	(11)
Transfer between stages	-	-	-	-
Amount on 31 December 2019	**9**	-	-	**9**

Change in the gross amortised cost	**Stage 1**	**Stage 2**	**Stage 3**	**2018**
Amount on 1 January 2018	62,262	-	-	62,262
New exposures	166,520	-	-	166,520
Paid exposures	(135,230)	-	-	(135,230)
Transfer between stages	-	-	-	-
Amount on 31 December 2018	**93,552**	-	-	**93,552**

Change in the impairment allowance	**Stage 1**	**Stage 2**	**Stage 3**	**2018**
Amount on 1 January 2018	13	-	-	13
New exposures	7	-	-	7
Paid exposures	-	-	-	-
Transfer between stages	-	-	-	-
Amount on 31 December 2018	**20**	-	-	**20**

Quality of loans and advances to banks

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

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

Change in the gross amortised cost	**Stage 1**	**Stage 2**	**Stage 3**	**2019**
Amount on 1 January 2019	33,383	-	-	33,383
New exposures	373,761	-	-	373,761
Paid exposures	(380,978)	-	-	(380,978)
Transfer between stages	-	-	-	-
Amount on 31 December 2019	**26,166**	-	-	**26,166**

Change in the impairment allowance	**Stage 1**	**Stage 2**	**Stage 3**	**2019**
Amount on 1 January 2019	7	-	-	7
New exposures	-	-	-	-
Paid exposures	(4)	-	-	(4)
Transfer between stages	-	-	-	-
Amount on 31 December 2019	**3**	-	-	**3**

Change in the gross amortised cost	**Stage 1**	**Stage 2**	**Stage 3**	**2018**
Amount on 1 January 2018	25,114	-	-	25,114
New exposures	53,875	-	-	53,875
Paid exposures	(45,606)	-	-	(45,606)
Transfer between stages	-	-	-	-
Amount on 31 December 2018	**33,383**	-	-	**33,383**

Change in the impairment allowance	**Stage 1**	**Stage 2**	**Stage 3**	**2018**
Amount on 1 January 2018	7	-	-	7
New exposures	6	-	-	6
Paid exposures	(6)	-	-	(6)
Transfer between stages	-	-	-	-
Amount on 31 December 2018	**7**	-	-	**7**

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

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

Change in the gross amortised cost	**Stage 1**	**Stage 2**	**Stage 3**	**2019**
Amount on 1 January 2019	44,500	-	-	44,500
New exposures	-	-	-	-
Paid exposures	(17,229)	-	-	(17,229)
Transfer between stages	-	-	-	-
Amount on 31 December 2019	**27,271**	-	-	**27,271**

Change in the impairment allowance	**Stage 1**	**Stage 2**	**Stage 3**	**2019**
Amount on 1 January 2019	146	-	-	146
New exposures	-	-	-	-
Paid exposures	(109)	-	-	(109)
Transfer between stages	-	-	-	-
Amount on 31 December 2019	**37**	-	-	**37**

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

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

Change in the impairment allowance	**Stage 1**	**Stage 2**	**Stage 3**	**2018**
Amount on 1 January 2018	170	-	-	170
New exposures	57	-	-	57
Paid exposures	(81)	-	-	(81)
Transfer between stages	-	-	-	-
Amount on 31 December 2018	**146**	**-**	**-**	**146**

Quality of loans and advances to customers

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

Change in the gross amortised cost	**Stage 1**	**Stage 2**	**Stage 3**	**2019**
Amount on 1 January 2019	**142,168**	**21,118**	**32,698**	**195,984**
New exposures	49,983	1,433	21	51,437
Paid exposures	(24,184)	(2,273)	(1,073)	(27,530)
Transfer to Stage 1	208	(208)	-	-
Transfer to Stage 2	(6,612)	7,049	(437)	-
Transfer to Stage 3	(186)	(1,543)	1,729	-
Amounts written-off	-	-	(1,487)	(1,487)
Amount on 31 December 2019	**161,377**	**25,576**	**31,451**	**218,404**

Change in the impairment allowance	**Stage 1**	**Stage 2**	**Stage 3**	**2019**
Amount on 1 January 2019	54	258	12,056	12,368
New exposures	18	15	102	135
Paid exposures	(31)	(71)	(647)	(749)
Increase in the impairment allowance for unrecognised interest on loans in Stage 3	-	-	108	108
Transfer to Stage 1	5	(5)	-	-
Transfer to Stage 2	-	13	(13)	-
Transfer to Stage 3	(2)	(130)	132	-
Amounts written-off	(2)	(130)	132	-
Amount on 31 December 2019	**44**	**80**	**10,251**	**10,375**

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

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

Change in the impairment allowance	**Stage 1**	**Stage 2**	**Stage 3**	**2018**
Amount on 1 January 2018	73	646	18,462	19,181
New exposures	186	248	1	435
Paid exposures	(16)	(264)	(217)	(497)
Increase in the impairment allowance from unrecognised interest on loans in Stage 3	-	-	89	89
Transfer to Stage 1	2	(2)	-	-
Transfer to Stage 2	(57)	58	(1)	-
Transfer to Stage 3	(134)	(428)	562	-
Amounts written-off	-	-	(6,840)	(6,840)
Amount on 31 December 2018	**54**	**258**	**12,056**	**12,368**

The change in the amount of the commitments undertaken and financial guarantee contracts and the change in the revaluation provisions is presented in the tables below:

Change in the amount of the commitments undertaken and financial guarantee contracts	**Stage 1**	**Stage 2**	**Stage 3**	**2019**
Amount at 1 January 2019	**22,374**	**306**	**6**	**22,686**
New exposures	19,361	1,136	10	20,507
Paid exposures	(12,440)	(1,007)	(3)	(13,450)
Transfer to Stage 1	7	(4)	(3)	-
Transfer to Stage 2	(2,392)	2,392	-	-
Transfer to Stage 3	-	-	-	-
Amounts written-off	-	-	-	-
Amount at 31 December 2019	**26,910**	**2,823**	**10**	**29,743**

Change in the revaluation provision	**Stage 1**	**Stage 2**	**Stage 3**	**Stage 1**
Amount at 1 January 2019	7	5	-	12
New exposures	2	3	6	11
Paid exposures	(2)	(5)	-	(7)
Transfer to Stage 1	(1)	1	-	-
Transfer to Stage 2	-	-	-	-
Transfer to Stage 3	-	-	-	-
Amounts written-off	-	-	-	-
Amount at 31 December 2019	**6**	**4**	**6**	**16**

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

Change in the amount of the commitments undertaken and financial guarantee contracts	**Stage 1**	**Stage 2**	**Stage 3**	**2018**
Amount at 1 January 2018	**27,337**	**-**	**-**	**27,337**
New exposures	10,214	261	6	10,481
Paid exposures	(15,132)	-	-	(15,132)
Transfer to Stage 1	-	-	-	-
Transfer to Stage 2	(45)	45	-	-
Transfer to Stage 3	-	-	-	-
Amounts written-off	-	-	-	-
Amount at 31 December 2018	**22,374**	**306**	**6**	**22,686**

Change in the revaluation provision	**Stage 1**	**Stage 2**	**Stage 3**	**2018**
Amount at 1 January 2018	10	-	-	10
New exposures	1	5	-	6
Paid exposures	(4)	-	-	(4)
Transfer to Stage 1	-	-	-	-
Transfer to Stage 2	-	-	-	-
Transfer to Stage 3	-	-	-	-
Amounts written-off	-	-	-	-
Amount at 31 December 2018	**7**	**5**	**-**	**12**

The information on loans and advances to customers by classification groups is as follows:

31 December 2019	Loans and advances to customers			Undrawn commitment	Guarantees		
Group	Amount	Share in %	Impairment	Amount	Amount	Share in %	Provision for credit losses
Performing	186,932	85.59	124	25,030	4,713	100.00	17
Non-performing	31,472	14.41	10,251	-	-	-	-
Total	**218,404**	**100.00**	**10,375**	**25,030**	**4,713**	**100.00**	**17**

31 December 2018	Loans and advances to customers			Undrawn commitment	Guarantees		
Group	Amount	Share in %	Impairment	Amount	Amount	Share in %	Provision for credit losses
Performing	163,200	74.72	312	17,838	4,822	102.31	12
Non-performing	32,784	15.01	12,056	26	-	-	-
Total	**195,984**	**100.00**	**12,368**	**17,864**	**4,822**	**100.00**	**12**

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

	31.12.2019		**31.12.2018**	
	Past due but unimpaired	**Impaired**	**Past due but unimpaired**	**Impaired**
Not overdue	-	66,409	-	52,406
up to 30 days past due	16,257	846	13,005	2,992
31 to 60 days past due	660	59	2,949	882
61 to 90 days past due	342	392	1,492	4,513
91 to 180 days past due	959	125	1,165	183
over 180 days past due	4,076	23,805	2,408	20,315
Book value	22,294	91,636	21,019	81,291
Allowance for impairment losses	-	(10,374)	-	(12,368)
Carrying amount	**22,294**	**81,262**	**21,019**	**68,923**

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

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

	2019	**2018**
Secured by cash and government securities	420	1,001
Secured by mortgage	177,297	155,956
Pledge on machines and equipment	8,248	8,790
Pledge on receivables	21,261	17,267
Other collaterals	9,147	8,554
Unsecured	2,031	4,416
Impairment	(10,375)	(12,368)
Total	**208,029**	**183,616**

The Bank accepts real estate as collateral of the *mortgage loans* it grants to its customers. The Bank monitors the collateralization of mortgage at Retail Banking, using the loan to value (LTV) ratio, which is calculated as the ratio between the gross loan amount to the collateral's market value. The collateral valuation is based on (1) external valuation by licensed appraisers from an approved list, which according to the Bank's internal rules is subject to annual review, and (2) additional review and adjustment of the value according to a technical opinion prepared by the Bank's experts. The amount of the collateral for home mortgage loans is usually based on the initial value of the collateral, updated based on changes in the home price index and respectively subject to periodic revaluation of collaterals according to the effective internal rules on lending activities. In addition, the Bank requires update of the collaterals' values upon each renegotiation, restructuring or upon commencing forced execution of individual exposures.

The table below shows mortgage loan exposures (those for the purpose of home purchase and those whose collateral is a residential property) based on LTV range. The collateral value used in LTV calculation is the lower of their market and insurance value.

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

	31.12.2019		**31.12.2018**	
	Gross amortised cost	**Allowance for impairment loss**	**Gross amortised cost**	**Allowance for impairment loss**
LTV ratio/loan-value ratio				
Below 50%	4,397	-	3,559	-
51-70%	6,451	-	4,708	-
71-90%	8,889	(18)	6,782	(1)
91-100%	1,372	(1)	1,484	(25)
Over 100%	1,881	(197)	1,747	(148)
Total	**22,990**	**(216)**	**18,280**	**(174)**

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

	31.12.2019	**31.12.2018**
Balances with the Central Bank:		
rating BBB	43,623	-
rating BBB-	-	93,532
Total balances with the Central Bank	**43,623**	**93,532**
Loans and advances to banks		
rating A+	-	5,670
rating A-	-	10,429
rating AA-	9,775	-
rating BBB+	4,790	5,121
rating BBB-	11,561	5,578
rating BB	36	75
no rating	1	6,503
Total loans and advances to banks	**26,163**	**33,376**
Financial assets at FVPL:		
rating AAA	31,273	-
rating BBB-	6,000	-
no rating	161	174
Total financial assets at FVPL	**37,434**	**174**
Debt instruments at fair value through other comprehensive income		
rating A+	-	1,877
rating A	1,915	-
rating BB+	-	5,417
rating BBB	-	27,458
rating BBB-	25,027	9,309
Total debt instruments at fair value through other comprehensive income	**26,942**	**44,061**
Equity instruments at fair value through other comprehensive income		
no rating	293	293
Total equity instruments at fair value through other comprehensive income	**293**	**293**

Loans and advances to banks with no rating as at 31 December 2018 include a foreign bank which has no credit rating from rating agency and for which an equivalent credit rating has been used for the purpose of impairment.

Financial assets held for trading with no rating are mainly corporate bonds and shares of domestic issuers for which there are no credit ratings from rating agencies. Investments in securities whose rating is lower than BBB+ are subject to the explicit approval of the Assets and Liabilities Management Committee.

Concentration of credit risk

A significant percentage of the loan portfolio of the Bank is concentrated in a limited number of borrowers. Despite the regulatory restrictions on large exposures, there is a risk that the Bank's activities, its financial position and the result of its operations are negatively affected if some of the largest borrowers do not settle their obligations. Information on large exposures of the Bank other than exposures to credit institutions (exposures which represent 10% or more of the Bank's capital base) at their carrying amount as of 31 December 2019 and 2018 is presented in the table below:

	2019		**2018**	
	BGN'000	% of the capital base	BGN'000	% of the capital base
Largest total exposure to a customer group	7,980	19.20%	9,151	21.72%
Total amount of the five largest exposures	33,309	80.14%	34,392	81.64%
Total amount of all exposures – over 10% of the capital	78,627	189.18%	72,054	171.05%

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

29.3. Liquidity risk

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

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

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

To ensure the liquidity policy compliance, the Bank takes the following measures:
- develops rules and procedures for liquidity management;
- defines adequate liquid assets;
- establishes an information system to monitor liquidity based on a maturity table;
- sets 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";
- sets the mandatory information for the current management needs, as well as for the reporting to the BNB.

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

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

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" division.

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

The Bank maintains a large value of highly liquid assets as cash in hand and cash balances with the Central Bank, which guarantee Bank's ability to meet its liquidity requirements. As at 31 December 2019 and 2018, cash and cash balances with the Central Bank represent respectively 14% and 25% of the Bank's total assets.

As an additional instrument to provide high liquidity, the Bank uses loans granted to banks. These comprise mostly of deposits in first-class international and Bulgarian banks with maturity up to 7 days. As at 31 December 2019 and 2018, loans and advances to banks represent respectively 7% and 8% of the Bank's total assets.

Government securities owned by the Bank and not pledged as collateral as at 31 December 2019 and 2018 represent respectively 11% and 8% of the Bank's total assets. By maintaining 32% (2018: 41%) of its assets in highly liquid assets, the Banks ensures the ability to settle all maturities of financial liabilities.

The gross (undiscounted) nominal cash outflow of financial liabilities of the Bank is as follows:

31 December 2019	up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Total
Deposits from banks	113	-	-	-	-	113
Deposits from customers	202,954	18,526	77,681	46,239	1,988	347,388
Lease liabilities	91	181	805	1,645	338	3,060
Other financial liabilities	219	-	-	-	-	219
Total financial liabilities	**203,377**	**18,707**	**78,486**	**47,884**	**2,326**	**350,780**

31 December 2018	up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Total
Deposits from banks	268	-	-	-	-	268
Deposits from customers	202,369	24,626	69,083	62,564	2,450	361,092
Other financial liabilities	142	-	-	-	-	142
Total financial liabilities	**202,779**	**24,626**	**69,083**	**62,564**	**2,450**	**361,502**

The financial liabilities of the Bank are mainly from attracted funds on deposits – retail and corporate. Large portion of them as at 31 December 2019 – 58% (2018: 56%) are with residual term within one month. Customers often prefer to sign a deposit agreement with one month term and to renegotiate it regularly for a longer period. As a result, one-month deposits are practically a long-term and relatively permanent resource of the Bank.

29.4. Market risk

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

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

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

- Foreign government securities – could be purchased only if they have a credit rating not lower than

BBB/positive perspective on Standard & Poor's or an equivalent assessment of creditworthiness, and the maximum level of exposure is limited;

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

Deviations from the limits set are only allowed with the explicit permission of the Assets and Liabilities Management Committee.

Market risk management includes:

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

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

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

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

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

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

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

29.4.1. Interest rate risk

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

The Bank uses the GAP analysis method (gap analysis) 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.

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

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

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

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

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

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

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

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

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

31 December 2019	**up to 1 month**	**1 to 3 months**	**3 months to 1 year**	**1 to 5 years**	**over 5 years**	**Total**
Interest-bearing assets						
Loans and advances to banks	26,163	-	-	-	-	26,163
Loans and advances to customers	173,553	119	2,450	9,050	22,857	208,029
Debt instruments at FVOCI	8,439	5,047	-	13,455	-	26,941
Total interest-bearing assets	**208,155**	**5,166**	**2,450**	**22,505**	**22,857**	**261,133**
Interest-bearing liabilities						
Deposits from banks	113	-	-	-	-	113
Deposits from customers	202,950	18,508	77,314	45,655	1,849	346,276
Total interest-bearing liabilities	**203,063**	**18,508**	**77,314**	**45,655**	**1,849**	**346,389**
Gap between interest-bearing assets and liabilities, net	**5,092**	**(13,342)**	**(74,864)**	**(23,150)**	**21,008**	**(85,256)**

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

31 December 2018	up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Total
Interest-bearing assets						
Loans and advances to banks	33,376	-	-	-	-	33,376
Loans and advances to customers	145,264	6,046	3,541	3,809	24,956	183,616
Debt instruments at FVOCI	947	2,741	1,769	38,604	-	44,061
Total interest-bearing assets	**179,587**	**8,787**	**5,310**	**42,413**	**24,956**	**261,053**
Interest-bearing liabilities						
Deposits from banks	268	-	-	-	-	268
Deposits from customers	202,365	24,599	68,779	61,366	2,221	359,330
Total interest-bearing liabilities	**202,633**	**24,599**	**68,779**	**61,366**	**2,221**	**359,598**
Gap between interest-bearing assets and liabilities, net	**(23,046)**	**(15,812)**	**(63,469)**	**(18,953)**	**22,735**	**(98,545)**

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

	31.12.2019	31.12.2018
Interest-bearing assets		
Loans and advances to banks	0.52	0.77
Financial assets at FVPL	1.73	-
Loans and advances to customers	4.55	4.53
Debt instruments at FVOCI	2.16	2.78
Interest-bearing liabilities		
Deposits from banks	-	-
Deposits from customers	0.38	0.52

29.4.2. Currency risk

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

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

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

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

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

31 December 2019	BGN	EUR	USD	JPY	Other	Total
Assets						
Cash and balances with the Central Bank	50,129	1,927	719	230	188	53,193
Loans and advances to banks	389	18,925	2,723	3,403	723	26,163
Financial assets at FVPL	161	6,000	31,273	-	-	37,434
Debt instruments at FVOCI	14,288	12,653	-	-	-	26,941
Equity instruments at FVOCI	293	-	-	-	-	293
Loans and advances to customers	146,921	61,108	-	-	-	208,029
Total assets	**212,181**	**100,613**	**34,715**	**3,633**	**911**	**352,053**
Liabilities						
Deposits from banks	-	67	46	-	-	113
Deposits from customers	174,630	132,425	34,679	3,632	910	346,276
Other financial liabilities	-	218	1	-	-	219
Total liabilities	**174,630**	**132,710**	**34,726**	**3,632**	**910**	**346,608**
Net position	**37,551**	**(32,097)**	**(11)**	**1**	**1**	**5,445**

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

29.4.3. Price risk

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

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

29.4.4. Sensitivity to market risk

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

As at 31 December 2019, the Bank performed an interest rate sensitivity analysis based on the assumption of parallel shift in the interest curve applied on the interest gap. The expected effect on 200 b.p. shift is +/- BGN 903 thousand (2018: +/- BGN 175 thousand).

To assess the effect of potentially possible extreme fluctuations of interest rates, the Bank analyses the effect of several standardized interest rate shocks on trading portfolio. The price fluctuation in the parallel shift of the yield curve by 100 basis points should not exceed 5% of the capital base calculated in the last quarter. As at 31 December 2019, the ratio amounts to 0.32% of the capital base (2018: due to the lack of such instruments, the Bank did not calculate this ratio).

29.5. Fair value

Fair value of financial instruments

The Bank determines the fair value of its financial instruments based on the available market information or by using appropriate valuation techniques when no such information is available. Information about the carrying amounts and fair values of financial assets and liabilities is presented in Note 29.1.

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

31 December 2019	Carrying amount	Level 1 – quoted market price	Level 2 – valuation technique – observable market data	Level 3 – valuation technique 0 unobservable market data	Fair value unavailable
Assets measured at fair value					
Financial assets at FVPL	37,434	161	37,273	-	-
Debt instruments at FVOCI	26,941	-	26,941	-	-
Equity instruments at FVOCI	293	-	-	293	-
Total	**64,668**	**161**	**64,214**	**293**	**-**

31 December 2018	Carrying amount	Level 1 – quoted market price	Level 2 – valuation technique – observable market data	Level 3 – valuation technique 0 unobservable market data	Fair value unavailable
Assets measured at fair value					
Financial assets at FVPL	174	174	-	-	-
Debt instruments at FVOCI	44,061	-	44,061	-	-
Equity instruments at FVOCI	293	-	-	293	-
Total	**44,528**	**174**	**44,061**	**293**	**-**

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

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

31 December 2019	Level 1	Level 2	Level 3	Total
Financial assets				
Cash and balances with the Central Bank	9,570	43,623	-	53,193
Loans and advances to banks	-	26,163	-	26,163
Loans and advances to customers	-	-	211,226	211,226
Total	**9,570**	**69,786**	**211,226**	**290,582**
Financial liabilities				
Deposits from banks	-	113	-	113
Deposits from customers	-	346,618	-	346,618
Other financial liabilities	-	-	219	219
Total	-	**346,731**	**219**	**346,950**

31 December 2018	Level 1	Level 2	Level 3	Total
Financial assets				
Cash and balances with the Central Bank	7,976	93,532	-	101,508
Loans and advances to banks	-	33,376	-	33,376
Loans and advances to customers	-	-	185,909	185,909
Total	**7,976**	**126,908**	**185,909**	**320,793**
Financial liabilities				
Deposits from banks	-	268	-	268
Deposits from customers	-	360,227	-	360,227
Other financial liabilities	-	-	142	142
Total	-	**360,495**	**142**	**360,637**

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

Fair value of non-financial assets

The tables below provide information on the main valuation methods and inputs used in determining the fair value of investment property (Note 11), assets acquired from non-performing loans (Note 12) and non-current assets held for sale (Note 9).

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

31 December 2019		Market comparables method – bid prices for sale used (EUR/square meter)	Income method – bid prices for rental used (EUR/square meter)
Type of investment property			-
holiday	6,145	358-489	
retail	6,448	257-3343	4-13
regulated landed property	158	25-30	-
Total	**12,751**		
Non-current assets held for sale			
holiday	2,674	150-370	-
Total	**2,674**		
Assets acquired from unserviced loans			
holiday	2,354	189-620	-
retail	1,065	318-732	-
regulated landed property/landed property	828	5-68	-
industrial	13,931	75-900	-
residential	1,353	62-1409	-
	19,531		

31 December 2018		Market comparables method – bid prices for sale used (EUR/square meter)	Income method – bid prices for rental used (EUR/square meter)
Type of investment property			
holiday	6,145	446-509	-
retail	6,287	288-2476	2.50-12.85
regulated landed property	158	25-30	-
Total	**12,590**		
Non-current assets held for sale			
holiday	4,904	150-813	4.23-5.88
residential	80	250-345	1.82-2.19
Total	**4,984**		
Assets acquired from unserviced loans			
holiday	239	127-165	-
retail	1,276	318-816	-
regulated landed property/landed property	1,023	1-72	-
industrial	14,928	100-1026	2-6
residential	1,307	62-1408	-
	18,773		

30. OTHER REGULATORY DISCLOSURES

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

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

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

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

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

	2019	**2018**
Total operating income	13,764	13,289
Operating profit/(loss) before tax	1,089	(334)
Tax expense	64	67
Return on assets (%)	0.29%	-0.07%
Equivalent number of full-time employees as at 31 December	223	249
State subsidies received	-	-

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

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

31. CAPITAL MANAGEMENT

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

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

The Bulgarian National Bank sets in Ordinance 8 additional capital buffers that banks should maintain, above the minimum capital requirements. As at 31 December 2019, these are:

- protective capital buffer, equal to 2.5% of the Bank's total risk exposure;
- anti-cyclical capital buffer – 0.5% of the Bank's total risk exposure;
- systematic risk buffer – 3% of the Bank's total risk exposure.

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

The Bank maintains capital adequacy above the required regulatory ratios. The total capital ratio as at 31 December 2019 is 18.5% (31 December 2018: 19.15%).

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

Additional information is presented in the table below:

	31.12.2019	**31.12.2018**
Equity	41,562	42,125
Common equity Tier 1 capital	41,562	42,125
Capital requirements		
Total risk-weighted assets for credit risk, credit risk from the counterpart and risk of dilution and free supplies	195,553	193,251
Total exposures to position, currency and commodity risk	2,725	350
Total risk exposures to operational risk	26,400	26,400
Total risk exposures	**224,678**	**220,001**
Capital ratios		
Common equity Tier 1 capital ratio	18.50%	19.15%
Excess (+)/Shortage (-) of common equity Tier 1 capital	31,451	32,225
Tier 1 capital ratio	18.50%	19.15%
Excess (+)/Shortage (-) of Tier 1 capital	28,081	28,925
Total capital ratio	18.50%	19.15%
Excess (+)/Shortage (-) of total capital	23,588	24,525

32. EVENTS AFTER THE REPORTING PERIOD

The global spread of the COVID-19 pandemic has impacted a number of economic sector, insofar as global industrial regions and entire countries are being placed under quarantine. On 13 March 2020 a state of emergency was declared in Bulgaria. Strict anti-epidemic measures were imposed in the country, as well as limitations, aiming to restrict social contacts and the virus spread. This has resulted in a disruption of the usual business operations of all economic subjects in Bulgaria.

As at the date of issue of the financial statements, there is still a material uncertainty regarding the development and duration of the pandemic, as well as the level of recovery and the consequences for the country's economy in the whole of 2020. Therefore, the scope and impact on the Bank's business, respectively on its future operations, assets and liabilities, are hard and practically impossible to accurately measure at this stage, but the expectation is that the pandemic might have a negative impact on lending activities, the quality of loans already granted, and on the valuation of certain securities and properties. Based on the management's initial assessment, no circumstances and facts have been identified questioning the validity of the going concern assumption for the Bank.

In accordance with the measures taken by the Government and the Management Board of the Bulgarian National Bank, the Bank's management has taken timely measures aimed to preserve the health and life of its employees and clients, as well as measures to support the business positions thereof, related to maintaining the quality of the loan portfolio. On 10 April 2020, Tokuda Bank has joined and supports its customers who were affected by the COVID-19 crisis, by offering them means and mechanisms to relieve loan repayments, following BNB's "Procedure for deferral and settling payables to banks and their subsidiaries – financial institutions, in relation to the state of emergency declared on 13 March 2020 by the Parliament in relation to the COVID-19 pandemic". In relation thereto, the Bank assesses the potential possibility to recognize loss on modifications, but at these stage there are not yet conditions for the reliable measurement of the amount thereof, due to the influence of multiple and various, currently unforeseeable, factors. Additionally, the estimates of potential negative effects are based on the expectation for future downturns in property market volumes.

The actions taken so far to limit the negative impacts on the Bank's operations are:

- identifying critical process and immediately determining steps for security thereof;
- monitoring of the loan portfolio and proactive communication with borrowers for the purpose of timely indication of problems and urgent development of actions and risk management;
- developing and applying instructions for lending and re-negotiation of exposures;

- facilitating the process of re-negotiating customers' credit exposures;
- daily monitoring of security markets and forecasts thereon in order to take specific measures, if necessary;
- ongoing monitoring of property markets and forecasts thereon;
- conducting multiple information and awareness campaigns regarding protection from COVID-19;
- provision of personal protective equipment and disinfection products, to both employees and customers visiting the Bank's offices;
- establishing organization for work based on a schedule, at the Bank and from home.

For the purposes of the financial statements, the management has classified the COVID-19 pandemic as non-adjusting event pursuant to IFRS 10 Events after the reporting period.

No other events have occurred after the date of the financial statements that would result in adjustments or additional disclosures therein.