TOKUDA BANK AD

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

December 31, 2013

Unofficial translation of the original in Bulgarian

TOKUDA BANK AD

ANNUAL REPORT ON THE ACTIVITY

2013

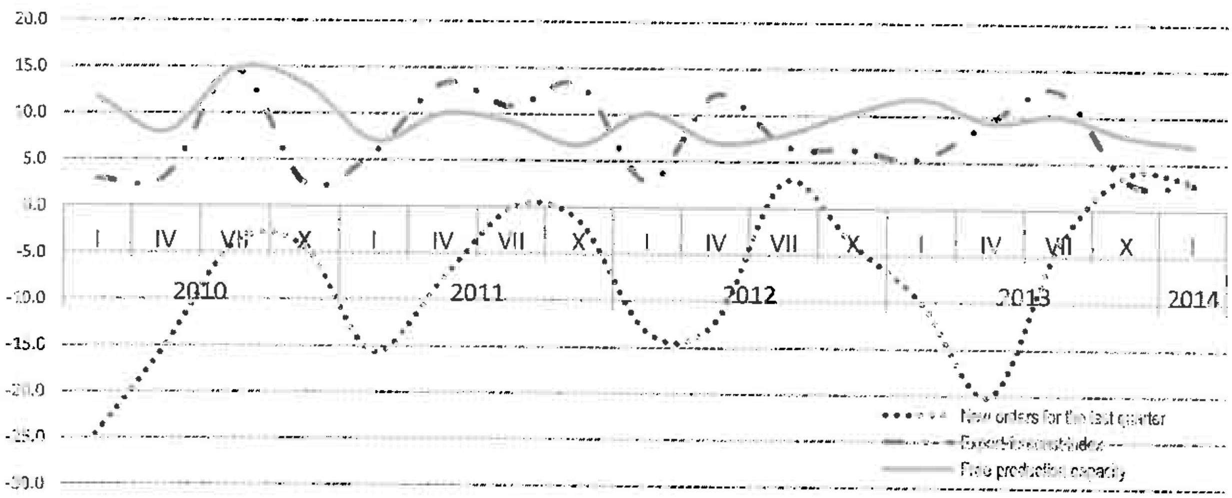
CONTENTS:

I. Environment in which Tokuda Bank AD operates in 2013

The unfavorable general economic and market conditions predetermined the outcome for the past financial year 2013. The rate of economic growth in the country approximates zero level, the business indicators during the second half of the year aggravated (figure 1) and the environment conditions did not contribute in any manner to the recovery of the economy. This, on the other hand, had an adverse impact on the banking system as an unsteady functioning business cannot gain profits for its creditors. Worsening conditions for the business in Bulgaria were also stated in many competent reports including the World Bank Report, which affected negatively the investment decisions of local and foreign investors.

The activities of the commercial banks during the past year depended on the state of and the dynamics of the processes in the real economy. The difficult recovery of the economic growth in the country, prevented the improvement of the quality of the banks' assets, repressed the profitability of the banks and decreased the opportunities for generating revenue from one of their core activities – lending to the business and households. Along with the adverse environment the retained conservative approach in the disposition of the financial intermediaries as well as in their clients also exerts pressure on the credit trends due to which in 2013 they remained low.

Figure 1 business environment indicators



The dynamics of receivables in the bank system during the past financial year accelerated but a large part of the increase of loans and advance payments falls into the loans to credit institutions' category which in 2013 has increased by BGN 2.740 billion and has reached BGN 9.625 billion, or nearly 1/6 of the total loans amount. The gross loans increased only with BGN 647 mln., which is the lowest increase since the beginning of the financial crisis.

This could be explained with the passive disposition of the economic subjects which indicates the structure of the increase in gross loans. The half of the reported increase (BGN 300.5 mln) came from the increase of loans in the budget sector, which at the end of 2013 reached BGN 566.3 mln., whereas the increase in the loans to corporate clients is considerably lower. During the past year they increased just with BGN 139 mln., and at the end of the year they stayed almost at the same level as in 2012, reaching BGN 8.3 billion.

To a certain extent a positive ascertainment could be made regarding the retail exposures, for which also is reported a low trend in the dynamics (0.5%). In spite of this, it should be mentioned that for the first time since 4 years during 2013 the indicator had positive value (during the period 2010 – 2012 the trends in this segment were negative – in 2010 the individuals and households debts has decreased with BGN 85.5 mln., in 2011 – with BGN 65.5 mln., and during 2012 – with BGN 98 mln.). The reported increased in 2013 (BGN 88.7 mln.) was due to retail credits which increase with BGN 141.8 mln., whereas the mortgage loans decrease with BGN 53 mln. This, however, is hardly in a result of the positive expectations of the population since the observations show that in 2013 the customers' confidence stayed on the same level as in 2012 and the unemployment has increased (even though with 0.4 percentage points).

The recovery of the retail credits in all probability was in a result of the rise of urgent expenditures such as health expenses, paying off budget or public services expenses, etc. As a whole neither the population nor the business had motivation to borrow in spite of the interest rate levels' decreased (the proportion of income over gross credits during the past year decreases from 7.6% to 7.2%). The decrease is uniformly in all segments: for corporate loans the decreased is from 6.7% to 6.4%; for retail loans with 0.5 percentage points to 9%; and for mortgage loans the decreased is from 7.7% to 7.2%. Despite all the volume indicators for mortgage loans have reported a slight decrease in 2013, whereas the growth trends of the corporate and retail loans are very low (respectively 0.4% in the corporate loans and 0.5% of the retail loans).

Regarding the liabilities it could be concluded that the trends which have been formed in the beginning of the financial crisis stayed the same, in particular three of these trends could be differentiated: local resources become cheaper; increase in the population's savings; replacement of the resources granted from foreign banks (mothers) to daughter banks in the country with local resources.

The increase in savings while the interest levels decrease indicates not good conditions of the economic environment. The tendency toward savings despite the decrease of achieved profitability could be explained with the lack of viable investment alternatives, i.e. the population and the enterprises have no other alternatives for realization of their free resources during the past financial year. The reason for this is both – the relatively low profitability under these alternatives and the high level of risk incorporated due to the uncertainty in the country and abroad. This originated problems for the economic agents as well as for the banks which under these circumstances of low levels of lending had low opportunities for realization of their free resources, and therefore despite preservation of the interest rate spread, their net interest income decreased on the account of increase in the deposit base and the worsening in the level of lending.

Last but not least, it should be noted that the very duration of the financial crisis has put the available capital reserves of the banks under intense pressure, and required constant optimization of their business strategies.

II. Review on the activity of Tokuda Bank AD in 2013

In accordance with data of the Bulgarian National Bank /BNB/ during the past year Tokuda Bank /the Bank/ stays on the same place as in 2012 - the 25th place considering total amount of assets which represented 0.49% share of the total assets of the banking system (1.10% of the assets of second group in which Tokuda Bank AD is classified). As of December 31, 2013 the Bank's assets amount to BGN 417.510 mln., which is a decrease by BGN 39.947 mln., compared to the prior year (BGN 457.457 mln.). The average monthly amount of the assets for 2013 (BGN 424.344 mln.) approximates 2012 levels (BGN 430.275 mln.).

In 2013 the Bank realized a net loss of BGN 2.887 mln., due to which the potential earnings per share is a negative amount (BGN -0.42). The loss for prior 2012 is of BGN 2,336 thousand.

During the year the loan portfolio slightly increased in spite of the continuing economic stagnancy in the country determining the lack of suitable financing projects and investors with good credit standing. At the year-end the volume of the loan portfolio reached BGN 222.092 mln. before impairment (2012: BGN 219.408 mln.), and its quality increased with 2.7 percentage points compared to the prior year and at the end of 2013 the share of loans classified as regular reached 63.33%.

During 2013 Tokuda Bank AD set up a daughter company "Tokuda Sigurnost" EOOD, which capital is 100% owned by the Bank. The Bank defines the financial and operating policy of this company. The result of the acquired in 2013 company are reported in the consolidation report which the Bank issued for 2013, on the date on which the acquisition has been realised. The company has registered capital of BGN 25 thousand and realised a loss of BGN 8 thousand in 2013.

1. Operating income and expenses

In 2013 the Bank generated operating income at the amount of BGN 12.944 mln., which represented a decrease of BGN 1.428 mln. (9.94%) compared to prior year. During the past year the effect of undertaken various measures for cost restrictions of the administrative expenses of the Bank continued. As a result of these measures and due to the regular and strict control exercised by the Bank's management, the ratio between administrative expenses plus depreciation/amortization charges and operating income (83.18%) remained close to the level in 2012 (81.53%) in spite of the recorded decrease in the income. Factors for the retention of this ratio comprised both the realised economies in the administrative expenses (BGN 260 thousand) and in the interest expenses (BGN 1.369 mln.), the increase of net income from fees and commissions (with BGN 547 ths.), as well as the increase in net income from trading operations (BGN 319 ths.). An important role for preservation of the coverage ratio has the realised decrease of the administrative expenses - from BGN 11.158 mln., in 2012 to BGN 10.898 mln., for 2013. The recorded decrease of BGN 260 ths., is a result of the continuing process of optimisation of the office network (started in 2011), which positive impact is realized at later stage as some of the divisions of the Bank generated sizable expenditures which could not be compensated in short terms because of the arising additional payments, resulted from their restructuring.

Changes in the structure of the Bank's total operating income are insignificant (see table 1). Net interest income decreases with 4.4 percentage points due to retention of relatively big part of classified loans with overdue of more than 180 days and in 2013 they represent 60.8% of the total net income, non-interest income increase its share as a result of the increase of fees and commission income on granted guarantees and their share is 39.2%. For 2012 these figures are respectively 65.2% and 34.8%.

Interest income on granted loans and other receivables amount to BGN 14.954 mln., and still have the largest relative share compared to the total interest income (76,72%), although during the past year this share decreased by 1.74 percentage points. Main factor of the reported decrease by BGN 2.593 mln. compared to 2012, is the growth of loans classified in the "loss" group or loans with overdue payments of principle and interest above 180 days (from 21.35% in 2012 up to 23.70% in 2013), which is a serious impendent for realization of constant interest income for the Bank.

Table 1. Operating income (in BGN '000)

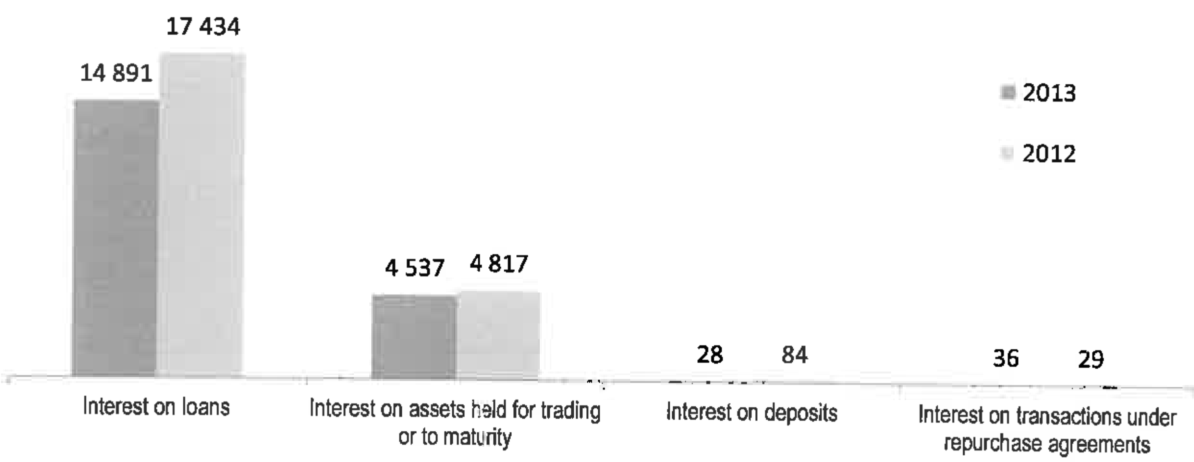
	2013	2012
Interest income	19 491	22 364
Interest income expense	(11 625)	(12 994)
Net interest income	**7 866**	**9 370**
Fee and commission income	4 288	3 956
Fee and commission expenses	(337)	(552)
Net fee and commissions income	**3 951**	**3 404**
Net income from commercial operations	**1 796**	**1 477**
Other operating income /(expense)	**(669)**	**121**
Total operating income	**12 944**	**14 372**

Interest income from management of debt instruments portfolio (figure 2) indicates certain decrease of 5.81% compared to 2012 as a consequence of the sale of a part of the securities with high yield in the beginning of the third quarter. The share of this income in the total interest income increased with 1.74%, reaching 23.28% as the rate of decrease of credits' interest income was higher (14.59%).

Interest income on placed deposits decreased compared to prior year in spite of the increase of this group of assets and its detention on average monthly level over BGN 57.5 mln., until the end of the third quarter. During the prior year this amount was significantly lower (BGN 36.7 mln.). In the last quarter of 2013 the amount of these assets decreased with 1/3 (to BGN 39.1 mln.)

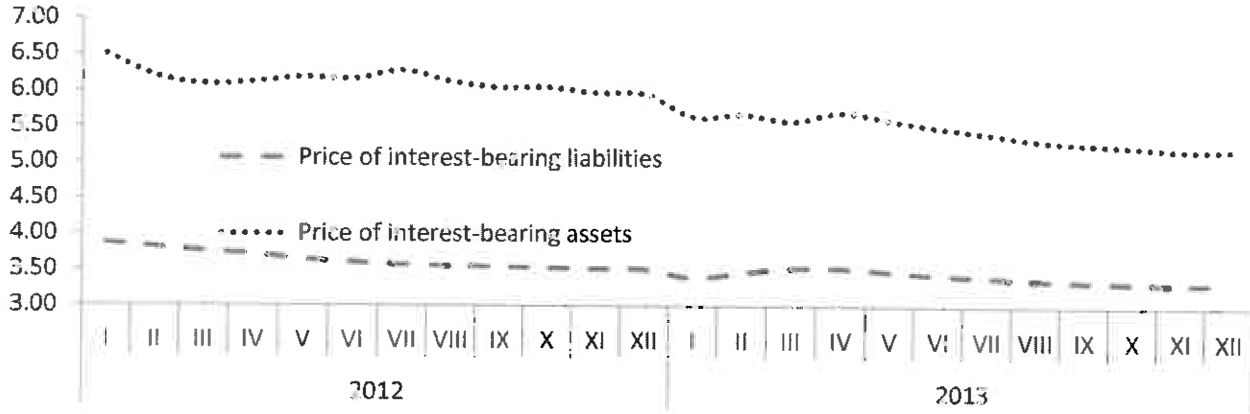
Interest expenses for 2013 represent significant share in the expenses related to the Bank's operating activity, as the deposit base is formed mainly by individuals and households and as of December 31, 2013 they reached the amount of BGN 11.625 mln., indicating a decrease by 10.54% compared to 2012 (when their volume was BGN 12.994 mln.), as a result of the effective policy for liabilities and interest expenses management followed by the Bank's management.

Figure 2. Interest income by sources (in BGN '000)



During the reporting period interest spread (figure 3) marked certain decrease due to decrease in the levels of income from interest-bearing assets resulted from the retained high share of classified loans with overdue principals and interest payments above 180 days, as well as the decrease of interest levels on newly granted loans following the market trends and competitive environment. Interest spread decreased to 1.87 percentage points at the end of 2013, as the price of the interest-bearing assets dropped down by 0.76% (from 5.96% on accumulation basis at the end of 2012 to 5.20% at the year-end of 2013), and the price of interest-bearing liabilities decreased by 0.18% (from 3.51% to 3.33%) because of the decrease in deposit interest levels and maturity of relatively expensive deposits of Bank's customers. Favourable effect on the price of attracted funds influenced the attraction of clients from the corporate segment and budget sector, which lead to increase in the share of the payment accounts with 1.4 percentage points.

Figure 3.Interest spread components for 2013



Non-interest income

Net non-interest income stayed close to the level reported in the prior year, they increased by BGN 76 thousand (1.52%) and in the end of 2013 reached BGN 5.078 mln. The largest share in this group still has the net income from fees and commissions (BGN 3.951 mln.) which during the past year increased with BGN 547 ths. (16.07%) as a consequence mainly due to the increase in the commission income from granted guarantees.

During the last year a decrease by 8.6% of income from fees on transfers in BGN and foreign currency was observed and they decreased to BGN 1.582 mln., which is a decrease by 4.09% of their share in the total structure of gross income from fees and commissions.

Net income from sales and revaluation of securities in trading portfolio increased with 40% during the past year. From BGN 1 mln. in 2012 they went up to BGN 1.4 mln. during the reporting period.

Results from currency transactions and revaluation of currency assets and liabilities in 2013 decreased with BGN 82 thousand and reached BGN 394 thousand.

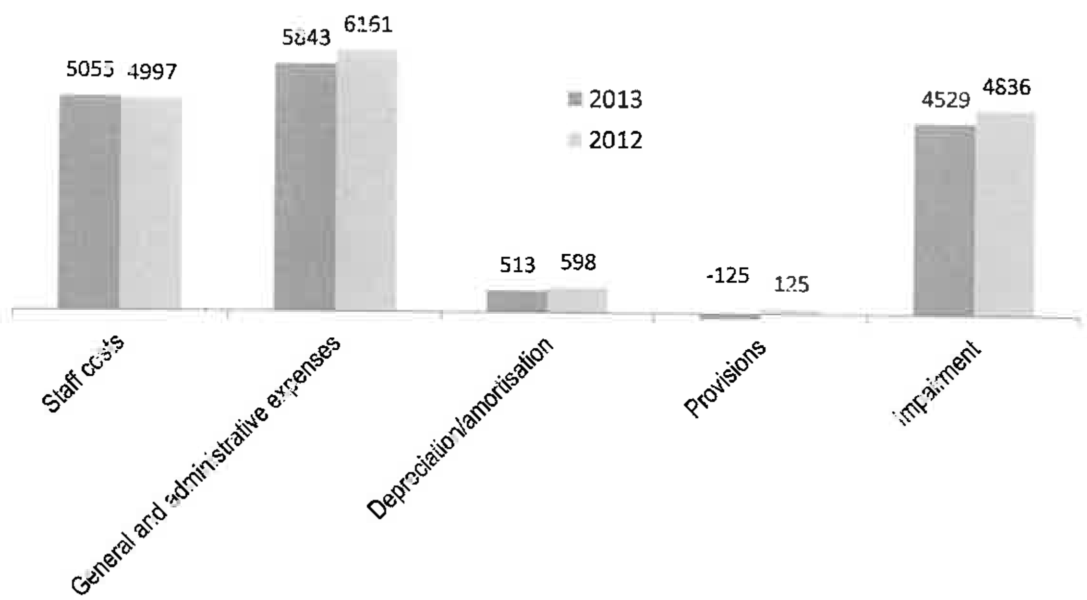
The net amount of the other items related to the activity is negative - BGN 669 thousand mainly due to realised losses from sale and impairment of non-current assets and groups of assets for disposal classified as held for sale (at the amount of BGN 775 thousand).

Non-interest expenses

The Bank's non-interest expenses for 2013 (figure 4) are at the amount of BGN 15.815 mln., which is a decrease with BGN 902 thousand or 5.40% compared to prior year. The reason for the decrease of this group of costs is both the lower general administrative expenses (with BGN 318 ths. less compared to the prior year) as well as the lower impairment expenses (with BGN 307 ths. less than in 2012), which amount to BGN 4.529 mln. or with 6.35% less than during the prior year. Retention of low rates of changes lead to preservation of the structure of the expenses in this group. For example, the share of personnel costs (including salaries, social securities and health insurance expenses) in the structure of the non-interest expenses increases with 2.07 percentage points from 29.89% to 31.96% during the past year. In absolute terms the decrease in this indicator is BGN 58 thousand or 1.16% on yearly basis resulting in decline of staff costs to BGN 5.055 mln., in 2013. The retention of the administrative expenses at that level is logical result from the retention of the administrative structure and the office network of the Bank, as a result of which the average number of employees stays at a relatively constant level (284 employees at the end of 2013).

The share of general administrative expenses (including those for hired services, rents, materials, contributions to the Bulgarian Deposit Insurance Fund /BDIF/, telecommunication and information technologies, security, etc.) is 36.95% which is close to the levels from 2012. In absolute terms showed decrease of BGN 318 thousand or 5.16% on yearly basis, resulting in total amount of BGN 5.843 mln. The decrease of this group of expenses is mainly because of the strict following of the policy on restriction and control over the administrative expenses. As a result of the slowed rate of renewal of the technology park and the optimization of Bank's divisions, the depreciation/amortization expenses continued to reduce and during the past year reached by BGN 513 thousand (2012: BGN 598 ths.) while their share in the total structure decreased to 3.24%.

Figure 4. Non-interest expenses (in BGN '000)



During the past year the loan portfolio quality indicator as well as the share of loans in the "loss" group remains on relatively constant levels. Generally, processes of deterioration of loan portfolio quality got under control already in 2011, evidence of which is the regular service of loans granted at the end of 2010, but it would take time to reduce the provision expenses as to the inert nature of the process.

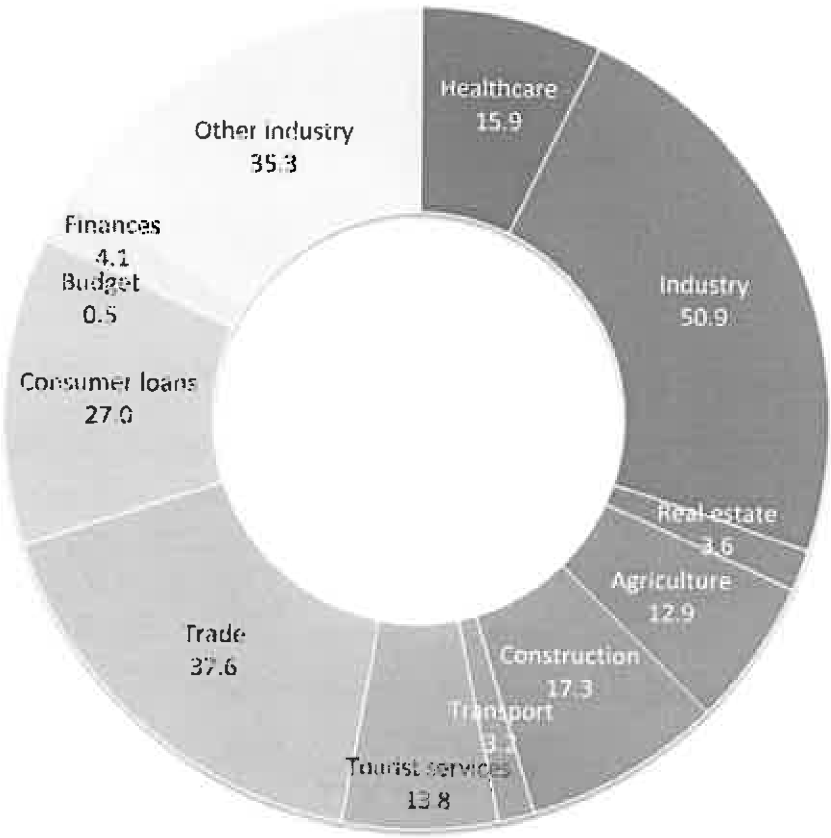
2. Loan portfolio

At the end of 2013 the gross loan portfolio of the Bank (figure 5) is BGN 222.092 mln. After allocation of allowances for impairment losses in the amount of BGN 12.400 mln., the net value of the portfolio is BGN 209.692 mln. The lack of portfolio growth is due to unfavourable conditions for economic growth and the remaining relatively high credit risk of the business environment. In 2013 the net book value of the loan portfolio after impairment increased its share in the total assets' structure to 50.22% (45.96% for the prior year).

Loans of corporate clients amount to BGN 184.821 mln., and their share in the gross loan portfolio (83.2%) changed slightly compared to the prior year levels (81.96%), which was expected due to the decrease in the retail financing during the past year.

Changes in the consumer loans segment are also relatively immaterial. Their share decreased from 16.15% of the gross loans in 2012 to 14.72% in 2013. In absolute value the segment bears negative growth at the amount of BGN 2,752 mln., which represents a decrease by 7.76% compared to the prior year values. The structure of retail banking remains unchanged – consumer loans decrease by BGN 2.561 mln. to the amount of BGN 27 mln., at the end of 2013 where their share in this segment decreased from 83.4% to 82.58%. The share of mortgage loans (BGN 5.694 mln.) remains below 1/5 of the total volume retail loans.

Figure 5. Loan portfolio distribution [Gross amount in BGN'000 000]



In 2013 the Bank continued to work with companies from the sectors of industry, trade, energy, agriculture, healthcare, etc. The largest relative share is held by loans to the Industry sector, which during the year increased its share by 4.34 percentage points to 22.91% of the portfolio, followed by the trade sector whose share decreased from 17.94% to 16.95%, construction whose share decreased by 3.95 percentage points to 7.78%, and healthcare whose relative share decreased to 7.15%.

There are no significant changes in the currency structure of loan portfolio. The share of loans in BGN increased with 2.66 percentage points, while the loans in EUR decreased with 2.50 percentage points and USD decreased by 0.17 percentage points. At the end of 2013 the shares are as follows: 48.9% in local currency, 49.66% in EUR and 1.44% in USD.

Despite some positive signs of economic recovery, the crisis continued to shape the attitudes of the private sector and households. The deterioration of their economic status, the high intercompany indebtedness and the difficulties they are facing in repayment of their obligations affects negatively the rate of lending and thus preventing the compensation of poor portfolio quality through increasing its volume. During the past year loans were granted only to individuals meeting high standards for reliability, as indicative in this respect is the regular servicing of such loans. However, this year, the indicator of portfolio quality marked a slight increase (the share of the loans classified as "regular" reached 63.33%) which is quite understandable due to the inert nature of the process.

Table 2. Allocation of loan portfolio to classification groups (in BGN' 000)

	2013				2012			
	Gross amount	Provisions under	Specific provisions	Total provisions	Gross amount	Provisions under	Specific provisions	Total provisions
Regular	140 659	0	0	0	132 898	0	428	428
Watch	25 250	9	373	382	27 204	84	53	137
Non-performing	3 555	3	149	152	12 453	730	743	1 474
Loss	52 628	12 388	24 579	36 967	46 853	8 355	25 653	34 007
Total	222 092	12 400	25 101	37 501	219 408	9 169	26 877	36 046

For covering the risk from impairment losses on loans the Bank has allocated allowances amounting to BGN 12.400 mln., by which the coefficient of coverage of the portfolio with accounting provisions increased from 4.18% to 5.58%. Loans classified outside the "regular" group are provided with allowances for impairment of 15.23%. The main portion of impairment (99.9%) is accrued for receivables, classified in the "loss" group (table 2). The specific provisions decreased to BGN 25.101 mln.

3. Securities

The securities portfolio as at the end of 2013 increased by BGN 13.764 mln., to BGN 123.214 mln., and thus its share in the total structure of assets slightly increased to 29,51% of the total assets, which is with 5.59 percentage points more than the prior year. Compared to the prior year such change is relatively moderate (12.58%). The uphold of relatively high share of this asset category can be explained by the general stagnation in lending, motivating local banks to direct their available resources to government securities market. The majority of this category of assets (BGN 84.568 mln.) are classified as investments held to maturity. Securities available for sale remain unchanged (BGN 165 thousand) and the volume of trading portfolio increased by BGN 6.038 mln., and reached the amount of BGN 38.481 mln.

The share of Bulgarian securities decreased by 17 percentage points to 66.52% of the portfolio, decreasing with 10.33% up to BGN 81.967 mln., as a consequence of sale of a highly profitable emission of Bulgarian Government Bonds. This change was on compensated by the five times increase of securities issued from foreign issuers which reached BGN 28.953 mln., while their share in the total structure of the securities portfolio increased with 18.5 percentage points up to 23.5%. Capital instruments also increased (with BGN 36 ths.) as their value at the end of 2013 reached BGN 322 ths.

4. ***Attracted funds***

The volume of attracted funds in 2013 (table 3) from clients different from credit institutions decreased by 8.5% and reached BGN 353.484 mln. Source of 59.8% from the attracted funds are Bulgarian individuals and households. On second place by attracted funds, with 13.5% are non-residences. The resources from local entities and organizations operating with State budget funds stayed close to the prior year levels and at the end of 2013 is 26.7% from the total attracted funds (2012: 26.9%), which is an expected result due to the continuation of the active policy in this direction. The Bank continued maintaining high liquidity and therefore the interest in attracting deposits from banks remained weak, so their volume at the end of the year decreased three times and reached BGN 2.387 mln., (2012: BGN 7.161 mln.). The long term contract with State Fund "Zemedelie" for refinancing of loans granted by the Bank to agriculture producers terminates in 2014 and at the end of 2013 the resources arising from this line amounted BGN 38 ths. (2012: BGN 400 ths.)

During the reporting year several adjustments of interest rates on deposit products were made for optimization of interest expenses, and as a result the structure of borrowed funds changed in favour of current accounts (BGN 125.9 mln.). Their share during the year increased from 29.2% to 30.6% from the total amount.

Changes in the currency structure of attracted funds are in favour of local currency, during the reporting period its share increased from 43.0% to 48.9% while the share of foreign currency deposits has decreased by 5.84 percentage points to 51.1% of the total structure.

Table 3. Structure of attracted funds deposits from clients different from credit institutions (in BGN '000):

	2013			2012		
	BGN	**CCY**	**TOTAL**	**BGN**	**CCY**	**TOTAL**
RESIDENTS	**170 935**	**134 794**	**305 729**	**164 998**	**150 357**	**315 355**
Households and individuals	90 065	121 384	211 449	74 675	136 671	211 346
State budget	14 841	353	15 194	9 807	322	10 129
Services	25 763	1 831	27 594	23 633	3 296	26 929
Industry	4 792	3608	8 400	5 765	3615	9 380
Trade	8 660	2 111	10 771	31 006	2 143	33 149
Transport	372	790	1162	432	525	957
Construction	15 001	1 300	16 301	11 125	1 260	12 385
Financial institutions	5 420	1956	7 376	2 254	1080	3 334
Agriculture	6 021	1 461	7 482	6 301	1 445	7 746
NON-RESIDENTS	**1843**	**45 912**	**47 755**	**1197**	**69 619**	**70 816**
Total	**172 778**	**180 706**	**353 484**	**166 195**	**219 976**	**386 171**

5. Capital and reserves

As of December 31, 2013 the capital of the Bank amounts to BGN 58.222 mln., which is 4.67% less than the prior year. The Bank still cannot cover the accumulated losses from previous years (BGN 7.704 mln.). The reserves amount to BGN 813 ths. The capital base in accordance with the requirements of BNB Ordinance 8 for capital adequacy of credit institutions is BGN 32.467 mln.

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

In 2013 the Bank allocated specific provisions for credit risk, representing excess of the carrying amount of loans over their exposures (calculated in accordance with the requirements of BNB Ordinance 9 on the evaluation and classification of risk exposures of the banks and the allocation of specific provisions for credit risk), calculated in accordance with the applicable accounting standards and recorded in these financial statements. For the purposes of assessment of specific loan provisions classified in "loss" group for a period more than 365 days, the value of collateral is considered null. As of December 31, 2013 the Bank allocated specific provisions for credit risk at the amount of BGN 25.101 mln.

In 2013 the capital adequacy ratios of Tokuda Bank AD are above the required levels. The Bank's capital position provides adequate cover of its risk exposures. As at December 31, 2013 the capital adequacy ratio and capital adequacy of tier one capital are 13.87% (at the end of 2012: 14.38%), which covers the legal requirements.

6. Office network

In 2013 because of the unfavourable economic situation as well as by maintaining conservative budgeting policy, during the past year the Bank has not undertaken expansion in its regional presence by opening of new regional administrative units.

The structure of the office network is as follows:

- Head Office
- Offices – 22
- Remote workplaces – 11

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

7. Correspondent relations

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

8. ***Human resources***

In 2013 the employees working in the Bank are 282 persons (respectively 270 in 2012).

The human resource is a key factor for realizing the strategic goals of the management. The Bank's management develops a system for managing of human resources and administration of the personnel - planning, selection, recruitment, movement and discharge.

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

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

9. ***Information technologies***

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

III. Development trends in 2014

During 2014 the Bank will continue operate in expected low economic growth in the European Union, as well as in Bulgaria, low demand of borrowing, continuing uncertainty and significant volatility in the international financial markets. All of these are new challenges related to pressure over the profitability and risk. Furthermore 2014 will be the year of the biggest change in the regulatory framework defined by the Bulgarian National Bank, which takes place in 15 years after the introduction of the Currency Board in Bulgaria. The new directives and regulations for the capital requirements, active since 01.01.2014, adopted by the European Parliament and the Council, will require changes in the operations of the Bank and its internal rules and regulations. Last but not least, it should be noted the ceasing of a number of regulations, such as regulations adopted by the Bulgarian National Bank, which will require a new approach of operations.

The main priorities of the Bank for its development in 2014 are in the following areas:

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

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

1. *Changes in share capital*

In 2013 there were no changes in the share capital of the Bank. As of December 31, 2013, the share capital is 68 000 000 (sixty eight mln.) Bulgarian Leva allocated in 6 800 000 (six million and eight hundred thousand) registered dematerialized voting shares each having nominal value of BGN 10 (ten Bulgarian leva) and issue value equal to the nominal.

Based on the Register of Shareholders at the Central Depository, shareholders of the Bank as of December 31, 2013 are as follows:

- International Hospital Service Co., Ltd., Japan (holding 99.53% of the share capital);
- Garant Co. 97 AD, Bulgaria (0.22%);
- AUC Establishment, Lichtenstein (0.2%);
- MM Holding AD, Bulgaria (0.05%).

Management

In 2013 the Bank preserved its two-tier management system. The bodies of the joint-stock company in 2013 have the following members:

Supervisory Board of the Bank

Arthur Stern – Chairperson of Supervisory Board.

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

Katsuyuki Noso – member of Supervisory Board until 30.06.2013 (relieved of his obligation through decision of the General Meeting of the shareholders).

Dimitar Vuchev - member of Supervisory Board.

Management Board of the Bank

Vanya Vasileva – Chairperson of Management Board and Executive Director.

Kiril Pendev – member of Management Board and Executive Director.

Lyubomir Manolov – member of Management Board and Executive Director.

The total amount of remunerations, received during the reporting period by the members of the Management and the Supervisory Boards amounts to BGN 338 thousand (three hundred thirty eight thousand Bulgarian Leva)

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

2. Dividends and policies

The Bank has not paid dividends.

V. Responsibility of the Management

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

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

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

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

Vanya Vassileva
Chairperson of Management Board and
Executive Director

Kiril Pendev
Member of Management Board and
Executive Director

ТОКУДА БАНК СОФИЯ

Sofia, April 7, 2014

INDEPENDENT AUDITOR'S REPORT AND
ANNUAL CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013

Deloitte.

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

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of
Tokuda Bank AD

Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of Tokuda Bank AD ("the Bank") and its subsidiary (together "the Group"), which comprise the consolidated statement of financial position as of December 31, 2013, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Group's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Group as of December 31, 2013, and its financial performance and its cash flows for the year then ended in accordance with IFRS, as adopted by the European Union.

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

Pursuant to the requirements of the Bulgarian Accountancy Act, article 38, paragraph 4 we have read the accompanying Annual consolidated report on the activities of the Group, prepared by the Group's management. The Annual consolidated report on the activities of the Group is not a part of the financial statements. The historical financial information presented in the Annual consolidated report on the activities of the Group prepared by the management is consistent, in all material aspects with the financial information disclosed in the consolidated financial statements of the Group as of December 31, 2013, prepared in accordance with IFRS, as adopted by the European Union. Management is responsible for the preparation of the Annual consolidated report on the activities of the Group dated April 7, 2014.

Deloitte audit OOD

Deloitte Audit OOD

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

Vasko Raichev
Registered Auditor
Proxy of the Statutory Manager Sylvia Peneva

Sofia
April 7, 2014

TOKUDA BANK AD

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
as of December 31, 2013
All amounts are in thousand BGN, unless otherwise stated

	Note	As of 31.12.2013	As of 31.12.2012
ASSETS			
Cash and cash balances with central banks	4	33,527	50,388
Loans and receivables from credit institutions	5	35,199	68,507
Financial assets held for trading	6	38,481	32,443
Financial assets available for sale	7	165	165
Loans and receivables from customers	8	209,692	210,239
Investments held to maturity	9	84,568	76,842
Non-current assets held for sale	12	7,455	13,920
Property, plant and equipment	10	3,294	3,924
Intangible assets	10	634	167
Tax assets	20.1	-	53
Other assets	11	4,486	809
TOTAL ASSETS		**417,501**	**457,457**
LIABILITIES			
Financial liabilities held for trading	13	1,370	840
Deposits from credit institutions	14	931	381
Payables under repurchase agreements	15	1,456	6,780
Deposits from clients other than credit institutions	16	353,483	386,171
Borrowings	17	38	400
Provisions	18	257	248
Allowances on credit facilities and guarantees	19	-	125
Tax liabilities	20.2	65	87
Other liabilities	21	1,687	1,354
TOTAL LIABILITIES		**359,287**	**396,386**
EQUITY			
Share capital	22	68,000	68,000
Reserves	22	813	1,159
Accumulated loss		(7,704)	(5,752)
Loss for the year		(2,895)	(2,336)
TOTAL EQUITY		**58,214**	**61,071**
TOTAL LIABILITIES AND EQUITY		**417,501**	**457,457**

These separate financial statements have been approved by the Management Board of Tokuda Bank AD on April 7, 2014.

Vanya Vassileva Executive Director	Kiril Pendev Executive Director	Desislava Beluhova Chief Accountant

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

ТОКУДА БАНК АД СОФИЯ

TOKUDA BANK AD

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
for the year ended December 31, 2013
All amounts are in thousand BGN, unless otherwise stated

	Note	Year ended 31.12.2013	Year ended 31.12.2012
Interest income	23	19,491	22,364
Interest expenses	23	(11,625)	(12,994)
Net interest income		**7,866**	**9,370**
Dividend income		30	25
Fee and commission income	24	4,288	3,956
Fee and commission expenses	24	(337)	(552)
Fee and commission income, net		**3,951**	**3,404**
Net losses on financial assets and liabilities held for trading	25	(2,866)	(2,767)
Net gains on foreign currency revaluation	26	4,662	4,244
Other operating income /(expense)	27	(700)	96
Impairment of non-financial assets	12	(80)	(515)
Administrative expenses	28	(10,904)	(11,158)
Depreciation/amortization	10	(514)	(598)
Allowances on credit facilities and guarantees	19	125	(125)
Impairment of investments held to maturity	9	1,212	(1,212)
Net expenses for impairment and uncollectability	29	(5,661)	(3,109)
LOSS BEFORE TAXATION		**(2,879)**	**(2,345)**
Income tax benefit/(expense)	30	(16)	9
LOSS FOR THE YEAR		**(2,895)**	**(2,336)**
Other comprehensive income		-	-
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		**(2,895)**	**(2,336)**

These separate financial statements have been approved by the Management Board of Tokuda Bank AD on April 7, 2014.

Vanya Vassileva Executive Director	Kiril Pendev Executive Director	Desislava Beluhova Chief Accountant

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

ТОКУДА БАНК АД СОФИЯ

TOKUDA BANK AD

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
AS OF DECEMBER 31, 2013
All amounts are in thousand BGN, unless otherwise stated

	Share capital	Reserves	Accumulated loss	Total
BALANCE AS OF JANUARY 1, 2012	**53,000**	**1,159**	**(5,752)**	**48,407**
Increase of share capital	15,000	-	-	15,000
Loss for the year	-	-	(2,336)	(2,336)
Other comprehensive income for the year	-	-	-	-
Total comprehensive income for the year	-	-	(2,336)	(2,336)
BALANCE AS OF DECEMBER 31, 2012	**68,000**	**1,159**	**(8,088)**	**61,071**
Increase of share capital	-	-	-	-
Released revaluation reserve of fixed assets	-	(346)	346	-
Deferred taxes on released revaluation reserve of fixed assets	-	-	38	38
Loss for the year	-	-	(2,895)	(2,895)
Other comprehensive income for the year	-	-	-	
Total comprehensive income for the year	-	-	(2,895)	(2,895)
BALANCE AS OF DECEMBER 31, 2013	**68,000**	**813**	**(10,599)**	**58,214**

These separate financial statements have been approved by the Management Board of Tokuda Bank AD on April 7, 2014.

Vanya Vassileva
Executive Director

Kiril Pendev
Executive Director

Desislava Beluhova
Chief Accountant

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

TOKUDA BANK AD

CONSOLIDATED STATEMENT OF CASH FLOWS
For the year ended December 31, 2013
All amounts are in thousand BGN, unless otherwise stated

	Note	Year ended 31.12.2013	Year ended 31.12.2012
OPERATING ACTIVITIES			
Net profit/(loss) for the year		(2,895)	(2,336)
Adjustments for reconciliation of net profit with net cash flows from operating activities::			
(Income tax benefit)/expense		16	(9)
Depreciation/amortization		514	598
Net expenses for impairment and uncollectability		5,661	3,109
Impairment of non-financial assets		855	515
Allowances on guarantees		(125)	125
Impairment of financial assets/investment held to maturity		(1,212)	1,212
Interest income		(19,491)	(22,364)
Interest expense		11,625	12,994
Dividend income		(30)	(25)
Loss on disposal of property, plant and equipment		14	14
Provisions		9	11
Interest income received		20,138	21,960
Interest expense paid		(13,755)	(14,408)
Dividend income received		30	25
Taxes paid		-	(15)
Cash flows from operating profit before changes in the operating assets and liabilities		**1,354**	**1,406**
Increase in loans and receivables from credit institutions with maturity over 3 months		-	-
(Increase)/decrease of financial assets and liabilities held for trading		(5,882)	8,849
Decrease of financial assets available for sale		-	-
(Increase)/decrease of receivables under repurchase agreements		-	2,190
(Increase)/ decrease in loans and receivables from customers		(3,041)	2,283
(Increase)/ decrease of non-current assets held for sale		1,446	92
(Increase)/ decrease of other assets		(396)	205
(Increase)/ decrease of tax assets		53	-
Increase / (decrease) of receivables under repurchase agreements		(5,324)	6,780
Increase of financial liabilities available for sale		530	840
Increase / (decrease) of deposits from credit institutions		550	(520)
Increase / (decrease) of deposits from clients other than credit institutions		(30,639)	24,498
Increase /(decrease) of other liabilities		333	771
Net cash flow (used in)/generated by operating activities		**(41,016)**	**47,394**

CONSOLIDATED STATEMENT OF CASH FLOWS (CONTINUED)
For the year ended December 31, 2013
All amounts are in thousand BGN, unless otherwise stated

	Note	Year ended 31.12.2013	Year ended 31.12.2012
INVESTING ACTIVITIES			
Payments for acquisition of investment held to maturity		(36,833)	(2,582)
Proceeds from investments held to maturity		30,175	5,700
Payments for acquisition of property, plant and equipment		(239)	(212)
Proceeds from sale of property, plant and equipment			36
Payments for acquisition of intangible assets		(137)	(149)
Net cash flow used in investing activities		**(7,034)**	**2,793**
FINANCING ACTIVITIES			
Repayments of borrowings		(362)	(652)
Increase of share capital		-	15,000
Net cash flow from/(used in) financing activities		**(362)**	**14,348**
Effect of exchange rate changes on the balance of cash held in foreign currencies		(1,757)	(145)
Net increase/(decrease) of cash and cash equivalents		**(50,169)**	**64,390**
Cash and cash equivalents at the beginning of the year		**118,895**	**54,505**
Cash and cash equivalents at the end of the year	32	**68,726**	**118,895**

These separate financial statements have been approved by the Management Board of Tokuda Bank AD on April 7, 2014.

Vanya Vassileva
Executive Director

Kiril Pendev
Executive Director

Desislava Beluhova
Chief Accountant

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

1. ORGANIZATION AND OPERATIONS

These consolidated financial statements of Tokuda Bank AD (The Bank) present the financial statement of the Bank and its controlled subsidiary "Tokuda security" EOOD (Subsidiary) as a reporting entity (the Group).

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

As of December 31, 2013 the issued share capital amounts to BGN 68,000,000 (sixty eight million levs), comprising 6,800,000 (six million and eight hundred thousands) registered voting shares with face value of BGN 10 (ten) per share.

As of December 31, 2013 the major shareholder of the Bank is International Hospital Service Co, Ltd., Japan, holding 99.53%.

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

The 2013 and 2012 activity of the Bank mainly consists of rendering of banking services related to granting loans to private companies, attracting deposits from customers, servicing of client payments both locally and internationally, performing transactions with government securities and securities under repurchase agreements, as well as other financial services in Bulgaria.

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

In 2013 the Bank operates through its Head Office and 33 offices, points of services and representative offices (2012: 35). As of December 31, 2013 the Bank has 282 employees (2012: 270).

2. BASIS FOR PREPARATION OF THE SEPARATE FINANCIAL STATEMENTS

2.1 General

These consolidated financial statements have been prepared for general purposes for the year ended December 31, 2013. The consolidated financial statements are presented in thousand Bulgarian Levs (BGN'000).

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

Tokuda Bank AD is a leading company in the preparation of these consolidated financial statements and as of December 31, 2013 The Bank owns 100% the subsidiary Tokuda Security EOOD, Sofia, Republic of Bulgaria. The investment in the individual financial statements of the Bank is disclosed at cost.

2.2 Accounting convention

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

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

2.2 Accounting convention (continued)

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

2.3 Changes in IFRS

Standards and Interpretations effective in the current period

The following amendments to the existing standards issued by the International Accounting Standards Board and adopted by the EU are effective for the current period:

- IFRS 13 "Fair Value Measurement", adopted by the EU on December 11, 2012 (effective for annual periods beginning on or after January 1, 2013);
- Amendments to IFRS 1 "First-time Adoption of IFRS" – Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters, adopted by the EU on December 11, 2012 (effective for annual periods beginning on or after January 1, 2013);
- Amendments to IFRS 1 "First-time Adoption of IFRS" – Government Loans, adopted by the EU on March 4, 2013 (effective for annual periods beginning on or after January 1, 2013);
- Amendments to IFRS 7 "Financial Instruments: Disclosures" - Offsetting Financial Assets and Financial Liabilities, adopted by the EU on December 13, 2012 (effective for annual periods beginning on or after January 1, 2013);
- Amendments to IAS 1 "Presentation of financial statements" – Presentation of Items of Other Comprehensive Income, adopted by the EU on June 5, 2012 (effective for annual periods beginning on or after July 1, 2012);
- Amendments to IAS 12 "Income Taxes" – Deferred Tax: Recovery of Underlying Assets, adopted by the EU on 11 December 2012 (effective for annual periods beginning on or after January 1, 2013);
- Amendments to IAS 19 "Employee Benefits" – Improvements to the Accounting for Post-employment Benefits, adopted by the EU on June 5, 2012 (effective for annual periods beginning on or after January 1, 2013);
- Amendments to various standards "Improvements to IFRSs (cycle 2009-2011)" resulting from the annual improvement project of IFRS (IFRS 1, IAS 1, IAS 16, IAS 32, IAS 34) primarily with a view to removing inconsistencies and clarifying wording, adopted by the EU on March 27, 2013 (amendments are to be applied for annual periods beginning on or after January 1, 2013),
- IFRIC 20 "Stripping Costs in the Production Phase of a Surface Mine", adopted by the EU on December 11, 2012 (effective for annual periods beginning on or after January 1, 2013).

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

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

2.3 Changes in IFRS (continued)

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

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

- IFRS 10 "Consolidated Financial Statements", adopted by the EU on December 11, 2012 (effective for annual periods beginning on or after January 1, 2014),
- IFRS 11 "Joint Arrangements", adopted by the EU on December 11, 2012 (effective for annual periods beginning on or after January 1, 2014),
- IFRS 12 "Disclosures of Interests in Other Entities", adopted by the EU on December 11, 2012 (effective for annual periods beginning on or after January 1, 2014),
- IAS 27 (revised in 2011) "Separate Financial Statements", adopted by the EU on December 11, 2012 (effective for annual periods beginning on or after January 1, 2014),
- IAS 28 (revised in 2011) "Investments in Associates and Joint Ventures", adopted by the EU on December 11, 2012 (effective for annual periods beginning on or after January 1, 2014),
- Amendments to IFRS 10 "Consolidated Financial Statements", IFRS 11 "Joint Arrangements" and IFRS 12 "Disclosures of Interests in Other Entities" – Transition Guidance, adopted by the EU on April 4, 2013 (effective for annual periods beginning on or after January 1, 2014),
- Amendments to IFRS 10 "Consolidated Financial Statements", IFRS 12 "Disclosures of Interests in Other Entities" and IAS 27 (revised in 2011) "Separate Financial Statements" – Investment Entities, adopted by the EU on November 20, 2013 (effective for annual periods beginning on or after January 1, 2014),
- Amendments to IAS 32 "Financial instruments: presentation" – Offsetting Financial Assets and Financial Liabilities, adopted by the EU on December 13, 2012 (effective for annual periods beginning on or after January 1, 2014),
- Amendments to IAS 36 "Impairment of assets" - Recoverable Amount Disclosures for Non-Financial Assets, adopted by the EU on December 19, 2013 (effective for annual periods beginning on or after January 1, 2014),
- Amendments to IAS 39 "Financial Instruments: Recognition and Measurement" – Novation of Derivatives and Continuation of Hedge Accounting, adopted by the EU on December 19, 2013 (effective for annual periods beginning on or after January 1, 2014).

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

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

- IFRS 9 "Financial Instruments" and subsequent amendments (effective date was not yet determined),
- Amendments to IAS 19 "Employee Benefits" - Defined Benefit Plans: Employee Contributions (effective for annual periods beginning on or after July 1, 2014),

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

2.3 Changes in IFRS (continued)

- Amendments to various standards "Improvements to IFRSs (cycle 2010-2012)" resulting from the annual improvement project of IFRS (IFRS 2, IFRS 3, IFRS 8, IFRS 13, IAS 16, IAS 24 and IAS 38) primarily with a view to removing inconsistencies and clarifying wording (amendments are to be applied for annual periods beginning on or after 1 July 2014);
- Amendments to various standards "Improvements to IFRSs (cycle 2011-2013)" resulting from the annual improvement project of IFRS (IFRS 1, IFRS 3, IFRS 13 and IAS 40) primarily with a view to removing inconsistencies and clarifying wording (amendments are to be applied for annual periods beginning on or after 1 July 2014);
- IFRIC 21 "Levies" (effective for annual periods beginning on or after 1 January 2014).

The Group anticipates that the adoption of these standards, amendments to the existing standards and interpretations will have no material impact on the consolidated financial statements in the period of initial application, except for the one noted below which might have material effect on the financial statements:

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

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

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

2.4 Going concern

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

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

2.5. Consolidation principles

The consolidated financial statements of the Group include the separate financial statements of Tokuda Bank AD and Tokuda security EOOD (subsidiary where the Bank exercises control and owns 100% the share capital). Control exists when the Bank has the power to govern the financial and operating policies of an enterprise, so as to obtain benefits from its activities.

The Bank is an entity which directly or indirectly, has an interest of more than 50% of the voting rights or otherwise has the power to exercise control over financial and operating policies of other entity (subsidiary).

A subsidiary is an entity in which the Group directly or indirectly, has an interest of more than half of the voting rights or otherwise has the power to exercise control over their financial and operating policies. Subsidiaries are consolidated from the date on which effective control is transferred to the Group and are no longer consolidated from the date that control ceases and is transferred outside the Group.

All acquisitions are accounted for using the purchase method of accounting as set out in IFRS 3 from the date on which the Group effectively obtains control of the acquiree. The Group has incorporated into its consolidated statement of comprehensive income the results of operations of the acquiree and has also recognised in the consolidated statement of financial position the assets acquired and the liabilities assumed and contingent liabilities of the acquiree as well as any goodwill arising on the acquisition.

The results of subsidiaries acquired or disposed during the year are included in the consolidated statement of comprehensive income from the effective date of acquisition and up to the effective date of disposal, as appropriate.

In preparing the consolidated financial statements, the financial statements of the Bank and its subsidiary are combined on a line-by-line basis by adding together like items of assets, liabilities, equity, income and expenses.

Where necessary, adjustments are made to the financial statements of the subsidiary to bring their accounting policies into line with those used by the Bank.

For consolidation purposes, all intergroup balances and intergroup transactions, income and expenses are eliminated in full.

Non-controlling interest in net assets and profit or loss of subsidiaries are presented separately from those possessed by the Group.

Goodwill incurred in business combinations is reviewed for impairment annually or more often if any events or changes in the circumstances provide indications for impairment.

Entities in which the Group has significant influence, but not control, are included in the consolidated financial statements at acquisition cost. Significant influence is defined as the right to participate in the financial and operating decisions of the associate, but not to control these decisions.

The subsidiary is fully consolidated from the date on which the Bank acquired control over it.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

3.1 Accounting estimates and accounting assumptions

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

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

- Allowance for impairment of loans and receivables from customers – to determine the amount of allowance for impairment of loans and receivables from customers the Group measures the recoverable amount of the assets. This process requires assumptions related to expected future cash flows, collateral values, and anticipated time of collateral realization. Note 34.1 describes the process applied by the Group to manage the credit risk and to determine the allowance of loans and receivables.
- Measurement of fair value of financial assets and financial liabilities carried at fair value – note 3.11 discloses detailed information for the main methods and assumptions for measurement and disclose of fair value;
- Useful lives of property, plant and equipment and intangible assets – the Group reviews the useful lives of these assets at the end of each reporting period and changes their useful lives, if needed. In 2013 there were no changes in the useful lives of these assets.

The entire 2013 passed in the conditions of the continuing economic crisis which determines that the Group continues its operations in uncertain market environment. As a result, the amount of impairment losses on loans and advances, financial assets available for sale, other financial instruments, as well as the values of other accounting estimates in subsequent reporting periods may differ substantially from those measured and reported in these consolidated financial statements. The recoverability of the loans and the adequacy of the recognized impairment losses, as well as the maintaining of the Group's liquidity ratios depend on the financial position of the borrowers and their ability to settle their obligations at contracted maturity in subsequent reporting periods. The Group's management applies the necessary procedures to manage these risks, as disclosed in note 34.

3.2 Financial assets

Financial assets at fair value through profit or loss

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.2 Financial assets (continued)

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

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

As of December 31, 2013 and 2012 the Group has no such assets.

Financial assets and liabilities held for trading

These are financial assets and liabilities, as well as all derivatives (excluding those, presented as hedging instruments), which were either acquired for the purpose of generating profit from short-term fluctuations in price or dealer's margin, or for the purpose of generating short-term profit from sales. These financial instruments are initially recognized and subsequently measured at fair value. Subsequent revaluations are based on market quotations. All realized gains on transactions with such financial instruments, as well as gains or losses on subsequent revaluations are included in the statement of comprehensive income. As of December 31, 2013 and 2012 and financial assets held for trading consist mainly of Bulgarian government securities and derivatives.

Purchase and sale of financial assets held for trading are recognized at transaction date, i.e. the date on which the Group engages to purchase or sale the asset.

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

As of December 31, 2013 and 2012 there are no transactions with derivative financial instruments that qualify for hedge accounting under the specific rules of IAS 39.

Investments held to maturity

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

Sales and acquisitions of financial assets classified as investment held to maturity are recognized on transaction date, i.e. when the Group commits to buy the asset or the asset matures.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.2 Financial assets (continued)

Financial assets available for sale

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

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

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

Sales and acquisitions of financial assets available for sale are recognized on transaction date, i.e. when the Group commits to buy or sale the asset.

Loans and receivables

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

Cash and cash equivalents

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

Derecognition and netting of financial assets

A financial asset is derecognized on the value date when the Group no longer has control over the contractual rights and transfers substantially all risks of ownership of the asset. This occurs when the Group realizes the rights, the rights expire, or when the Group surrenders those rights. A financial liability is derecognized when it is paid off.

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

Off-balance financial instruments

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.2 Financial assets (continued)

Impairment of financial assets

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

The objective evidence for impairment includes:

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

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

3.3 Loans and receivables

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

The allowance for impairment and uncollectability is measured considering the specific risk of the asset. The risk relates to those loans and receivables that have been specifically identified as watch, non-performing or loss exposures. In determining the level of the impairment required, management considers a number of factors including domestic economic conditions, the composition of the loan portfolio and prior irregular and non-performing debt experience, quality and liquidity of collateral.

The allowance for impairment and uncollectability is determined as the difference between the carrying amount of a financial asset and its estimated recoverable amount.

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.3 Loans and receivables (continued)

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

3.4 Receivables and payables under repurchase agreements (repo deals)

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

Receivables and liabilities under repurchase agreements are recognized at cost, which represents the funds placed/obtained by the Group, 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 Group's statement of financial position and are reported as financial assets held for trading. The difference between the sale price and repurchase price is considered as interest and is accrued proportionally for the term of the agreement.

3.5 Property, plant and equipment and intangible assets

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

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

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

Leasehold improvements for rented offices are amortized in accordance with the rent agreement term.

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

All amounts are in thousand BGN, unless otherwise stated

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

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

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

3.6 Interest income and expense

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

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

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

3.7 Fees and commissions

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

3.8 Foreign currency transactions

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

Currency	December 31, 2013	December 31, 2012
US Dollars	1.41902	1.48360
Euro	1.95583	1.95583

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

Net gains or losses resulting from change in exchange rates, arisen from revaluation of receivables, liabilities and from settlement of foreign currency transactions are recognized in the statement of comprehensive income in the period they occurred.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.9 Employee benefits

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

Employee benefits include:

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

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

In accordance with IAS 19 Employee Benefits the Group recognizes liabilities for retirement benefits, which are calculated by licensed actuary using the Projected Unit Credit Method (see note 18). The amount reported in the statement of financial position represents the present value of the long-term liabilities of the Group for retirement benefits.

3.10 Taxation

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

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

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

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

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

All amounts are in thousand BGN, unless otherwise stated

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.11 Fair value of financial assets and liabilities

The Group applies IFRS 13 "Fair value measurements" for the first time in the current reporting period. IFRS 13 establishes a single source of guidance for fair value measurements and disclosures without changing the requirements of other standards regarding which items should be measured or disclosed at fair value. The scope of IFRS 13 is broad applying to both financial and non-financial instrument items for which other IFRSs require or permit fair value measurements and disclosures.

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

Fair value hierarchy

The Group 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 following table summarizes the information for the assets measured at fair value in the statement of financial position as of December 31, 2013:

2013	Carrying amount	Level 1 – quoted market price	Level 2 – technique for evaluation – observable market data	Level 3 - technique for evaluation – not observable market data	Fair value not available
Assets measured at fair value					
Financial assets held for trading	38,481	157	38,324	-	-
Financial assets available for sale	165	-	-	-	165
TOTAL	38,646	157	38,324	-	165

The following table summarizes the information for the assets measured at fair value in the statement of financial position as of December 31, 2012:

2012	Carrying amount	Level 1 – quoted market price	Level 2 – technique for evaluation – observable market data	Level 3 - technique for evaluation – not observable market data	Fair value not available
Assets measured at fair value					
Financial assets held for trading	32,443	32,443	-	-	-
Financial assets available for sale	165	-	-	-	165
TOTAL	32,608	32,443	-	-	165

All amounts are in thousand BGN, unless otherwise stated

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.11 Fair value of financial assets and liabilities (continued)

Disclosure of fair value

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

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

	Carrying amount		Fair value	
	2013	2012	2013	2012
Financial assets				
Cash at central banks	33,527	50,388	33,527	50,388
Loans and advances to credit institutions	35,199	68,507	35,199	68,507
Loans and advances to customers	209,692	210,239	210,610	211,812
Investments held to maturity	84,568	76,842	86,208	77,802
Deposits from credit institutions	931	381	931	381
Payables under repurchase agreements	1,456	6,780	1,456	6,780
Deposits from clients other than credit institutions	353,483	386,171	363,871	394,120
Borrowings	38	400	38	400

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

2013	Level 1	Level 2	Level 3	TOTAL
Financial assets				
Cash at central banks	33,527	-	-	33,527
Loans and advances to credit institutions	35,199	-	-	35,199
Loans and advances to customers	-	-	210,610	210,610
Investments held to maturity	-	72,300	13,908	86,208
TOTOL	68,726	72,300	224,518	365,544
Financial liabilities				
Deposits from credit institutions	931	-	-	931
Payables under repurchase agreements	1,456	-	-	1,456
Deposits from clients other than credit institutions	-	363,871	-	363,871
Borrowings	-	-	38	38
TOTAL	2,387	363,871	38	366,296

All amounts are in thousand BGN, unless otherwise stated

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.11 Fair value of financial assets and liabilities (continued)

Disclosure of fair value (continued)

2012	Level 1	Level 2	Level 3	TOTAL
Financial assets				
Cash at central banks	50,388	-	-	50,388
Loans and advances to credit institutions	68,507	-	-	68,507
Loans and advances to customers	-	-	211,812	211,812
Investments held to maturity	-	63,604	14,198	77,802
TOTOL	118,895	63,604	226,010	408,509
Financial liabilities				
Deposits from credit institutions	381	-	-	381
Payables under repurchase agreements	6,780	-	-	6,780
Deposits from clients other than credit institutions	-	394,120	-	394,120
Borrowings	-	-	400	400
TOTAL	7,161	394,120	400	401,681

3.12 Provisions and contingent liabilities

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

3.13 Assets acquired from collaterals

Assets acquired from collaterals which the Group does not intend to use in the course of its business, and which are not investment properties are presented as "Other assets" in accordance with IAS 2 "Inventories" (see also Note 11). These assets are collaterals which the Group acquired from borrowers who became insolvent. The Group's policy is to sell the acquired collaterals when the Group finds profitable enough market for them.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.14 Non-current assets held for sale

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

- The asset is available for immediate sale
- The sale is highly probable, including:
  - Management is committed to plan to sell the asset;
  - Active program to locate a buyer and complete the plan is initiated;
  - The asset is actively marketed for sale at a price close to its current market value;
  - Sale is expected to take place within one year after the asset's classification as held for sale.

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

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

3.15 Comparative information

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

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

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

All amounts are in thousand BGN, unless otherwise stated

4. CASH AND CASH BALANCES WITH CENTRAL BANKS

	As of 31.12.2013	As of 31.12.2012
Cash in hand	6,665	6,949
Cash with the Central bank	26,862	43,439
TOTAL	33,527	50,388

Cash with the Central bank as of December 31, 2013 and 2012 include minimum non-interest bearing reserves at the amount of BGN 28,165 thousand and BGN 30,232 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 138 thousand and BGN 158 thousand, respectively. There are no limitations imposed by the Central bank for using the minimum reserves. The amount of the reserves depends on the deposits attracted by the Bank.

In 2013, the Bank has been successfully incorporated into Trans-European Automated Real-time Gross settlement Express Transfer system (TARGET 2).

5. LOANS AND RECEIVABLES FROM CREDIT INSTITUTIONS

	As of 31.12.2013	As of 31.12.2012
Current accounts with credit institutions	10,213	23,101
Amounts and deposits with credit institutions	24,986	45,406
TOTAL	35,199	68,507

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

	As of 31.12.2013	As of 31.12.2012
In BGN		
Nostro accounts with local credit institutions	112	216
Deposits with domestic credit institutions	4,000	26,000
	4,112	26,216
In foreign currency		
Deposits with domestic credit institutions	20,986	19,406
Nostro accounts with foreign credit institutions	10,042	22,819
Nostro accounts with domestic credit institutions	59	66
	31,087	42,291
TOTAL	35,199	68,507

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

	As of 31.12.2013	As of 31.12.2012
BGN	0.1%	0.1%
Euro	0.1%	0.2%
US Dollars	0.2%	0.2%
GBP	0.3%	0.2%

Deposits to banks as of December 31, 2013 and 2012 have maturity within 3 months.

All amounts are in thousand BGN, unless otherwise stated

6. FINANCIAL ASSETS HELD FOR TRADING

	As of 31.12.2013	As of 31.12.2012
Bulgarian government bonds	31,375	28,764
Foreign government securities	1,964	-
Corporate bonds of domestic and foreign issuers	4,985	3,558
Shares and participations of domestic enterprises	157	121
TOTAL	38,481	32,443

7. FINANCIAL ASSETS AVAILABLE FOR SALE

	As of 31.12.2013	As of 31.12.2012
Shares and participations of domestic enterprises	165	165
TOTAL	165	165

8. LOANS AND RECEIVABLES FROM CUSTOMERS

(a) Analysis by type of customers

	As of 31.12.2013	As of 31.12.2012
Private entities	178,193	179,817
Households and individuals	32,695	35,447
State budget	522	583
Financial entities	4,054	3,561
Finance lease	6,628	-
	222,092	219,408
Allowance for uncollectibility	(12,400)	(9,169)
TOTAL	209,692	210,239

(b) Analysis by sectors

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

	As of 31.12.2013	As of 31.12.2012
Consumer loans	27,001	29,562
Manufacturing	50,876	40,745
Construction	17,284	25,752
Trade	37,635	39,363
Agriculture	12,909	15,206
Health sector	15,887	18,365
Tourism	13,842	13,683
Transportation	3,152	3,585
Operations with real estate	3,601	5,673
Finance	4,054	3,561
State budget	522	583
Other sectors	35,329	23,330
	222,092	219,408
Allowance for uncollectibility	(12,400)	(9,169)
TOTAL	209,692	210,239

All amounts are in thousand BGN, unless otherwise stated

8. LOANS AND RECEIVABLES FROM CUSTOMERS (CONTINUED)

In 2013 receivables on loans written-off against allowances for impairment and uncollectibility are at the amount of BGN 2,430 thousand (see also note 29). No such in 2012.

Loans granted bear mainly floating interest. Weighted-average effective interest rates on loans are, as follows:

	As of 31.12.2013	As of 31.12.2012
Loans and receivables in BGN	8.0%	8.8%
Loans and receivables in EUR	8.0%	8.2%
Loans and receivables in USD	10.1%	10.0%

9. INVESTMENTS HELD TO MATURITY

	As of 31.12.2013	As of 31.12.2012
Bulgarian government bonds		
In BGN	34,549	34,064
In foreign currency	16,043	28,581
Foreign government securities		
In foreign currency	12,620	-
Corporate bonds of domestic and foreign issuers		
In BGN	12,130	13,631
In foreign currency	9,226	1,778
Impairment of corporate bonds of domestic issuers	-	(1,212)
TOTAL	84,568	76,842

As of December 31, 2013 and 2012 securities with carrying amount of BGN 19,002 thousand and BGN 8,250 thousand respectively, are pledged as collateral with BNB to secure attracted funds from the State budget.

As of December 31, 2013 and 2012 securities with carrying amount of BGN 1,375 thousand and BGN 5,815 thousand, respectively have been restricted as collateral under repurchase agreement.

As of December 31, 2013 the Group has an exposure to the sovereign debt of foreign governments with carrying amount of BGN 12,620 thousand.

All amounts are in thousand BGN, unless otherwise stated

10. PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLE ASSETS

	Land and buildings	Office equipment	Vehicles	Fixture and fittings	Other assets	Intangible assets	Assets under construction	Total
Cost								
January 1, 2012	2,741	2,728	928	1,806	670	807	405	10,085
Additions	-	27	71	72	42	19	130	361
Disposals	-	(184)	(26)	(1,231)	(31)	-	-	(1,472)
December 31, 2012	2,741	2,571	973	647	681	826	535	8,974
Additions	-	268	12	16	3	137	-	436
Disposals	-	(189)	-	(95)	(88)	(555)	(11)	(938)
Transfers	5	-	-	-	-	440	(445)	-
December 31, 2013	2,746	2,650	985	568	596	848	79	8,472
Accumulated depreciation/amortization								
January 1, 2012	(387)	(2,077)	(727)	(1,574)	(372)	(589)	-	(5,726)
Charged during the year	(60)	(298)	(41)	(76)	(53)	(70)	-	(598)
Written off	-	181	26	1,217	17	-	-	1,441
December 31 2012	(447)	(2,194)	(742)	(433)	(408)	(659)	-	(4,883)
Charged during the year	(60)	(205)	(42)	(58)	(46)	(103)	-	(514)
Written off	-	183	-	34	88	548	-	853
December 31 2013	(507)	(2,216)	(784)	(457)	(366)	(214)	-	(4,544)
Net book value								
As of December 31 2012	2,294	377	231	214	273	167	535	4,091
As of December 31 2013	2,239	434	201	111	230	634	79	3,928

All amounts are in thousand BGN, unless otherwise stated

11. OTHER ASSETS

	As of 31.12.2013	As of 31.12.2012
Deferred expenses	135	142
Guarantee deposits	65	60
Advance payments	72	43
Vat recoverable	407	-
Assets acquired from non-performing loans	2,905	-
Other receivables	902	564
TOTAL	4,486	809

In 2013 the Group reported assets at the amount of BGN 2,905 thousand as Assets, acquired from non-performing loans and latter are recognized in reduction of non-current assets held for sale.

12. NON-CURRENT ASSETS HELD FOR SALE

	As of 31.12.2013	As of 31.12.2012
Balance at the beginning of the year	13,920	14,012
Acquisitions during the year	5,730	616
Disposals during the year	(9,210)	(193)
Transferred assets, acquired from ordinary activities (non-performing loans)	(2,905)	-
Allowance for impairment	(80)	(515)
Balance at the end of the year	7,455	13,920

In 2013 the Group has signed long-term agreement for finance lease of current assets with a purchase option at carrying amount of BGN 6,229 thousand.

13. FINANCIAL LIABILITIES HELD FOR TRADING

	As of 31.12.2013	As of 31.12.2012
Derivatives	1,370	840
Balance at the end of the year	1,370	840

14. DEPOSITS FROM CREDIT INSTITUTIONS

	As of 31.12.2013	As of 31.12.2012
In foreign currency	931	381
TOTAL	931	381

Term deposits from credit institutions received as of December 31, 2013 and 2012 have maturity within 3 months. The contracted interest rates on deposits from credit institutions are, as follows:

	As of 31.12.2013	As of 31.12.2012
Deposits in USD	0,25%	0.2%

All amounts are in thousand BGN, unless otherwise stated

15. PAYABLES UNDER REPURCHASE AGREEMENTS (REPO-DEALS)

	As of 31.12.2013	As of 31.12.2012
Repo-deals with credit institutions	1,456	6,780
TOTAL	1,456	6,780

As of December 31, 2013 the residual maturity of all payables under repurchase agreements is within 1 month. The borrowings under repurchase agreements are secured with government securities with a nominal value of BGN 1,375 thousand.

16. DEPOSITS FROM CLIENTS OTHER THAN CREDIT INSTITUTIONS

	December 31, 2013			December 31, 2012		
	In BGN	In foreign currency	Total	In BGN	In foreign currency	Total
RESIDENTS	170,934	134,794	305,728	164,998	150,357	315,355
Households and individuals	90,065	121,384	211,449	74,675	136,671	211,346
State budget	14,841	353	15,194	9,807	322	10,129
Service	25,762	1,831	27,593	23,633	3,296	26,929
Manufacture	4,792	3,608	8,400	5,765	3,615	9,380
Trade	8,660	2,111	10,771	31,006	2,143	33,149
Transport	372	790	1,162	432	525	957
Construction	15,001	1,300	16,301	11,125	1,260	12,385
Financial institutions	5,420	1,956	7,376	2,254	1,080	3,334
Agriculture	6,021	1,461	7,482	6,301	1,445	7,746
NON-RESIDENTS	1,843	45,912	47,755	1,197	69,619	70,816
	172,777	180,706	353,483	166,195	219,976	386,171

The average contracted interest rates on deposits as of December 31, 2013 and 2012 are as follows:

2013	BGN	USD	EUR
Demand deposits	1.76%	0.59%	1.37%
Term deposits	4.76%	2.58%	4.53%

2012	BGN	USD	EUR
Demand deposits	2.11	0.72	1.13
Term deposits	5.36	2.56	5.13

All amounts are in thousand BGN, unless otherwise stated

17. BORROWINGS

As of December 31, 2013 and 2012 the Group has received long-term and short-term financing under contracts for the purpose of lending to customers, as follows:

	As of 31.12.2013	As of 31.12.2012
Long-term financing from::		
- State Fund "Agriculture"	-	39
	-	39
Short-term financing from:		
- State Fund "Agriculture"	38	361
	38	361
TOTAL BORROWINGS	38	400

Borrowings from State Fund „Agriculture“

On April 19, 2002 the Group has entered into a long-term contract with the State Fund "Agriculture" for refinancing by the Fund of granted loans to agricultural producers. The interest rate on the refinanced funds is 2% on an annual basis. The Group provides loans under investment projects of agricultural producers at 9% annual interest rate. Funds are repaid to the Fund on the basis of agreed loan repayment schedules with the borrowers. As of December 31, 2013 and 2011, the balance under this contract is at the amount of BGN 38 thousand and BGN 400 thousand.

18. PROVISIONS

As of December 31, 2013 and 2012 the provisions represent long-term employee benefits.

According to the provisions of the Labor Code, the Group is obliged to compensate employees upon retirement with two gross salaries. If the employee has worked for the Group in the last ten years the compensation amounts to six gross salaries. As of December 31, 2013 and 2012 the Group has accrued long-term employee benefits at the amount of BGN 257 thousand and BGN 248 thousand, respectively. The provision amount has been determined by a licensed actuary.

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

- Demographic assumptions;
- Mortality table and disability probability;
- Turnover rate – 0.17;
- Financial assumptions, salary growth;
- Discount rate – due to the long-term nature of the payable, annual discount rate of 6.54 % has been applied.

All amounts are in thousand BGN, unless otherwise stated

19. ALLOWANCES ON CREDIT FACILITIES AND GUARANTEES

	As of 31.12.2013	As of 31.12.2012
Allowances on credit facilities and guarantees	-	125
TOTAL	-	125

20. TAX ASSETS AND LIABILITIES

20.1 Tax assets

	As of 31.12.2013	As of 31.12.2012
Receivables on tax audit acts	-	-
Overpaid corporate tax advances	-	53
Total	-	53

In 2013 the Group has been refunded by BGN 53 thousand, representing advances on corporate tax.

20.2 Tax liabilities

As of December 31, 2013 and 2012 tax liabilities consist of deferred tax liabilities, arisen from the following temporary tax differences:

	As of 31.12.2013	As of 31.12.2012
Deferred tax assets:		
Unused paid leave	7	12
Long-term employee benefits	26	25
TOTAL DEFERRED TAX ASSETS	33	37
Deferred tax liabilities:		
Property revaluation upon transition to IFRS	-	(38)
Differences between accounting and tax amortization and depreciation	(98)	(86)
TOTAL DEFERRED TAX LIABILITIES	(98)	(124)
DEFERRED TAX LIABILITIES, NET	(65)	(87)

Deferred tax assets and liabilities as of December 31, 2013 and 2012 are calculated using tax rate of 10 % according to the Corporate Income Tax Act and applicable for the periods when the temporary differences are expected to be realized.

In 2013 deferred taxes reflected in equity at the amount of BGN 38 thousand, related to the revaluation of property upon the Bank's transition to IFRS in prior periods have been released.

All amounts are in thousand BGN, unless otherwise stated

21. OTHER LIABILITIES

	As of 31.12.2013	As of 31.12.2012
Ongoing bank transfers	1,079	519
Unused paid leave and other liabilities to personnel	64	94
Deferred income	-	23
Other creditors	3	360
Other liabilities	541	358
TOTAL	1,687	1,354

Ongoing bank transfers represent liabilities on money transfers ordered by customers in the last day of 2013 and 2012 respectively, with value date within two days. The transfers are processed up to the second working day of 2013 and 2012, respectively.

22. EQUITY AND RESERVES

Share capital

As of December 31, 2013 and 2012 the Bank's share capital is fully paid in and is distributed in registered, voting shares, as follows:

	As of 31.12.2013	As of 31.12.2012
Number of shares	6,800	6,800
Share nominal in BGN	10	10
SHARE CAPITAL	68,000	68,000

As of December 31, 2013 and 2012 the Bank's shareholder structure is as follows:

	As of 31.12.2013	%	As of 31.12.2012	%
International Hospital Services	6,767,950	99.53	6,767,950	99.53
Garant and Co 97" AD	15,000	0.22	15,000	0.22
A U C Establishment	13,300	0.20	13,300	0.20
MM Holding AD	3,750	0.05	3,750	0.05
TOTAL SHARES	6,800,000	100	6,800,000	100

Reserves

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

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

As of December 31, 2013 and 2012 reserves include Reserve Fund at the amount of BGN 813 thousand and BGN 1,159 thousand, respectively. The Bank has released reserves from revaluation of property to deemed cost upon adoption of IFRS at the amount of BGN 384 thousand presented net of deferred tax at the amount of BGN 38 thousand.

All amounts are in thousand BGN, unless otherwise stated

23. INTEREST INCOME/EXPENSE

	Year ended 31.12.2013	Year ended 31.12.2012
A. Interest income		
Operations in BGN		
Interest from financial assets held for trading	465	393
Interest from repo deals	35	22
Interest from loans and receivables	6,370	7,089
Interest from investments held to maturity	2,221	2,361
	9,091	9,865
Operations in foreign currency		
Interest from financial assets held for trading	1,040	856
Interest from repo deals	-	7
Interest from loans and receivables	8,549	10,429
Interest from investments held to maturity	811	1,207
	10,400	12,499
TOTAL	19,491	22,364

	Year ended 31.12.2013	Year ended 31.12.2012
B. Interest expenses		
Operations in BGN		
Interest on deposits from credit institutions	-	(6)
Interest on other deposits	(5,193)	(4,548)
Interest on loans received	(3)	(13)
	(5,196)	(4,567)
Operations in foreign currency		
Interest on deposits from credit institutions	(1)	(1)
Interest on other deposits	(6,422)	(8,426)
Interest on loans received	(6)	-
	(6,429)	(8,427)
TOTAL	(11,625)	(12,994)

24. FEE AND COMMISSION INCOME/EXPENSE

	Year ended 31.12.2013	Year ended 31.12.2012
Fee and commission income		
In BGN	3,238	2,842
In foreign currency	1,050	1,114
	4,288	3,956
Fee and commission expenses		
In BGN	(262)	(250)
In foreign currency	(75)	(302)
	(337)	(552)
FEE AND COMMISSION INCOME, NET	3,951	3,404

All amounts are in thousand BGN, unless otherwise stated

25. NET LOSSES ON FINANCIAL ASSETS AND LIABILITIES HELD FOR TRADING

	Year ended 31.12.2013	Year ended 31.12.2012
Loss from sale of securities held for trading	(55)	(3)
Gain from revaluation of securities held for trading	1,457	1,004
Loss from foreign exchange differences	(4,268)	(3,768)
	(2,866)	(2,767)

As disclosed in note 34.3 the Group uses derivative instruments to manage its exposure to currency risk including by currency forward contracts. Loss/gain from foreign exchange differences for 2013 and 2012 relate mainly to transactions and revaluation of these derivative instruments.

26. NET LOSSES FROM FOREIGN CURRENCY REVALUATION

Net gains from foreign currency revaluation at the amount of BGN 4,662 thousand in 2013 result from daily revaluation of the currency exposure of the Group.

27. OTHER OPERATING INCOME/(EXPENSE)

	Year ended 31.12.2013	Year ended 31.12.2012
Net realised gains on financial assets and financial liabilities not measured at fair value	29	20
Loss from non-current assets held for sale	(775)	(48)
Net loss from disposed assets other than held for sale	(14)	(15)
Other operating income	60	139
TOTAL	(700)	96

28. ADMINISTRATIVE EXPENSES

	Year ended 31.12.2013	Year ended 31.12.2012
Personnel costs	5,068	4,997
Materials, rents, consulting and other hired services	3,278	3,413
Taxes, fees, business trips, trainings, etc.	2,558	2,748
TOTAL	10,904	11,158

All amounts are in thousand BGN, unless otherwise stated

29. NET EXPENSES FOR IMPAIRMENT AND UNCOLLECTIBILITY

In 2013 and 2012 the Group reported net expenses for impairment and uncollectability on loans granted and receivables from customers at the amount of BGN 3,231 thousand and BGN 3,109 thousand, respectively.

Movement in the allowance for impairment and uncollectibility is, as follows:

	Loans and receivables from customers
BALANCE AS OF JANUARY 1, 2012	6,060
Impairment charged for the period	5,871
Reintegrated impairment for the period	(2,762)
Loans written-off against allowance for impairment	-
BALANCE AS OF DECEMBER 31, 2012	9,169
Impairment charged for the period	6,689
Reintegrated impairment for the period	(1,028)
Loans written-off against allowance for impairment	(2,430)
BALANCE AS OF DECEMBER 31, 2013	12,400

30. INCOME TAX BENEFIT/(EXPENSE)

Current tax expense represents taxes due under the Bulgarian legislation according to the applicable tax rate of 10 % for 2013 and 2012. Deferred tax income/expense arises as a result of a change in the carrying amount of deferred tax assets and liabilities.

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

	Year ended 31.12.2013	Year ended 31.12.2012
Current tax expense	-	-
Deferred tax income / (expense)	(16)	9
TOTAL TAX BENEFIT / (EXPENSES)	(16)	9
Reconciliation between profit before tax and tax expense:		
Loss before income tax	(2,879)	(2,345)
Income tax at applicable tax rate of 10 %	-	-
Tax effect on tax non-deductible expenses	-	-
Tax effect on the reversal of temporary differences	(16)	9
TOTAL TAX BENEFIT / (EXPENSES)	(16)	9
EFFECTIVE TAX RATE	-	-

All amounts are in thousand BGN, unless otherwise stated

31. RELATED PARTIES

As of December 31, 2013 and 2012 the Group has receivables from, payables to and contingent commitments to related parties, as follows:

Related parties and balances	As of 31.12.2013	As of 31.12.2012
Majority shareholder		
Deposits received	5,466	9,802
Companies under common control		
Other receivables	-	781
Deposits received	29,203	19,101
Key management personnel		
Loans granted	73	355
Deposits received	39	56

As of December 31, 2013 deposits received from the majority shareholder at the amount of BGN 5,466 thousand are blocked as collateral for loans and receivables from customers (2012: BGN 9,802 thousand).

Income from and expenses for related party transactions, generated by the Group in 2013 and 2012 are as follows:

Related parties and type of transactions	Year ended 31.12.2013	Year ended 31.12.2012
Majority shareholder		
Income from foreign exchange differences	2	1
Interest expense	98	26
Companies under common control		
Income from fees and commissions	162	186
Income from foreign exchange differences	31	28
Income from services	17	6
Interest expense	471	404
Expenses for fees and commissions	46	30
Loss from sale of investments	24	16
Key management personnel		
Interest income	6	10
Income from foreign exchange differences	-	1
Interest expense	-	2
Other expenses	33	39

The remuneration to Supervisory Board members in 2013 are at the total amount of BGN 40 thousand (2012: BGN 48 thousand). The remuneration to the Management Board members in 2013 are at total amount of BGN 305 thousand (2012: BGN 347 thousand).

All amounts are in thousand BGN, unless otherwise stated

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

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

	As of 31.12.2013	As of 31.12.2012
Cash in hand	6,665	6,949
Cash with the Central bank	26,862	43,439
Nostro accounts with domestic credit institutions	171	282
Nostro accounts with foreign credit institutions	10,042	22,819
Loans and deposits to credit institutions with original maturity up to three months	24,986	45,406
TOTAL CASH AND CASH EQUIVALENTS IN THE STATEMENT OF CASH FLOWS	68,726	118,895

33. COMMITMENTS AND CONTINGENCIES

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

As of December 31, 2013 and 2012 the Group has issued bank guarantees in favor of third parties at the amount of BGN 7,557 thousand and BGN 11,126 thousand, respectively, out of which BGN 4,904 thousand and BGN 9,712 thousand, respectively, are performance guarantees secured by restricted cash with the Group or by other customers' assets.

As of December 31, 2013 and 2012 unutilized loan and overdraft commitments are at the amount of BGN 19,955 thousand and BGN 20,113 thousand, respectively.

As of December 31, 2013 several legal proceedings are filed against the Group as well as potential claim at the amount of BGN 1,122 thousand. Management believes that no provision should be recognized, as on the basis of the available information, it is not likely that the Group will suffer any material losses.

34. FINANCIAL RISK MANAGEMENT

The risk for the Group 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 Group 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 Group in a comprehensive and conclusive manner.

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

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

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

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

The risk management organizational structure is centralized and structured in terms of competency levels as follows:

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

In 2013 and 2012 the Bank has not used derivative instruments to hedge risks. The Group uses derivative instruments in the form of forward currency contracts and currency swap transactions to manage its currency risk.

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

34. FINANCIAL RISK MANAGEMENT (CONTINUED)

34.1 Credit risk

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

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

Cash and cash balances with the Central bank at the amount of BGN 33,527 thousand and BGN 50,388 thousand, respectively as of December 31, 2013 and 2012 do not bear credit risk to the Bank due to their nature and the fact that they are at the Group's disposal.

Loans and receivables from credit institutions at the amount of BGN 35,199 thousand and BGN 68,507 thousand, respectively as of December 31, 2013 and 2012 represent mostly deposits in first-class international and Bulgarian financial institutions with maturity up to 7 days. The Group manages the credit risk associated with advances to banks as sets limits on exposure to counterparty.

Financial assets held for trading at the amount of BGN 38,481 thousand and BGN 32,443 thousand as of December 31, 2013 and 2012, respectively, bear mainly market risk to the Group, which is described in note 34.3.

Financial assets available for sale at the amount of BGN 165 thousand as of December 31, 2013 and 2012 represent shares in financial and non-financial enterprises, which bear exposure to credit risk up to the carrying amount of the investment.

Debt securities held to maturity and issued by the Republic of Bulgaria at the amount of BGN 50,592 thousand and BGN 62,645 thousand, respectively as of December 31, 2013 and 2012 do not bear credit risk to the Bank as they are guaranteed by the Bulgarian State.

Debt securities held to maturity and issued by foreign governments as of December 31, 2013at the amount of BGN 12,620 thousand do not bear credit risk for the Bank as they are guaranteed by foreign governments of the European Union.

Debt securities held to maturity and issued by domestic and foreign commercial companies at the amount of BGN 21,356 thousand and BGN 14,197 thousand, respectively as of December 31, 2013 and 2012 expose the Bank to credit risk to the amount of the investment, which is managed by periodically monitoring of the financial position of issuers.

All amounts are in thousand BGN, unless otherwise stated

34. FINANCIAL RISK MANAGEMENT (CONTINUED)

34.1 Credit risk (continued)

The Group's contingent and non-cancellable arrangements comprise issued guarantees and unutilized funds under loans agreed which amount as disclosed in note 33 represents the maximum credit exposure of the Bank.

Loans and advances to customers with carrying amount of BGN 209,692 thousand and BGN 210,239 thousand, respectively as of December 31, 2013 and 2012 expose the Group to credit risk. The exposure of the Group 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 required by the banking legislation in the Republic of Bulgaria.

The Group classifies loans and advances to customers in one of the following categories:

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

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

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

All amounts are in thousand BGN, unless otherwise stated

34. FINANCIAL RISK MANAGEMENT (CONTINUED)

34.1 Credit risk (continued)

Quality of the loan portfolio

Classification groups as of December 31, 2013:

	Loan granted			Unutilized commitment	Issued letters of guarantee		
Group	Amount	*% Share*	Allowance	Amount	Amount	*% Share*	Allowance
Regular	140,659	63.33	-	19,949	7,057	93.38	-
Watch	25,250	11.37	9	6	-		-
Non-performing	3,555	1.60	3	-	-		-
Loss	52,628	23.70	12,388	-	500	6.62	-
Total	222,092	100.00	12,400	19,955	7,557	100.00	-

Classification groups as of December 31, 2012:

	Loans granted			Unutilized commitment	Issued letters of guarantee		
Group	Amount	*% share*	Allowance	Amount	Amount	*% share*	Allowance
Regular	132,898	60.57	-	19,838	10,293	92.51	-
Watch	27,204	12.40	84	275	-		-
Non-performing	12,453	5.68	730	-	-		-
Loss	46,853	21.35	8,355	-	833	7.49	125
Total	219,408	100.00	9,169	20,113	11,126	100.00	125

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

Name of the Groups	As of 31.12.2013		As of 31.12.2012	
	Loans, granted to legal entities	Loans, granted to individuals	Loans, granted to legal entities	Loans, granted to individuals
Neither past due nor impaired	107,652	15,257	104,521	17,135
Past due but not impaired	15,843	1,906	9,234	2,008
Impaired on individual basis	65,902	15,532	70,206	16,304
Total	189,397	32,695	183,961	35,447
Allowance for impairment	9,273	3,127	6,913	2,256
Net loans	180,124	29,568	177,048	33,191

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

All amounts are in thousand BGN, unless otherwise stated

34. FINANCIAL RISK MANAGEMENT (CONTINUED)

34.1 Credit risk (continued)

Quality of the loan portfolio (continued)

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

	As of 31.12.2013	As of 31.12.2012
Consumer loans	12,097	14,002
Mortgage loans	3,160	3,133
Corporate clients	107,652	104,521
Total	122,909	121,656

The category of past due but not impaired include exposures that are overdue by up to 30 days and no other impairment indications exist. The Group believes that these overdue amounts are incidental and do not represent an indication for impairment of exposures.

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

	As of 31.12.2013	As of 31.12.2012
Consumer loans	1,697	1,408
Mortgage loans	209	600
Corporate clients	15,843	9,234
Total	17,749	11,242

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

2013	Carrying amount before impairment	Carrying amount before impairment	Carrying amount before impairment	Total highly liquid collateral
	Group II	Group III	Group IV	
Consumer loans	3,729	952	8,525	5,637
Mortgage loans	776	231	1,319	1,380
Corporate clients	20,745	2,373	42,784	30,893
Total	25,250	3,556	52,628	37,910

2012	Carrying amount before impairment	Carrying amount before impairment	Carrying amount before impairment	Total highly liquid collateral
	Group II	Group III	Group IV	
Consumer loans	4,222	2,002	7,927	7,926
Mortgage loans	560	526	1,067	1,632
Corporate clients	22,422	9,925	37,859	35,186
Total	27,204	12,453	46,853	44,744

All amounts are in thousand BGN, unless otherwise stated

34. FINANCIAL RISK MANAGEMENT (CONTINUED)

34.1 Credit risk (continued)

Quality of the credit portfolio (continued)

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

	As of 31.12.2013	As of 31.12.2012
Secured by cash and government securities	6,595	11,513
Secured by mortgage	148,731	133,915
Other collaterals	64,715	65,636
No collateral	2,051	8,344
Allowances for impairment	(12,400)	(9,169)
Total	209,692	210,239

Business sector, classification group and overdue amounts as of December 31, 2013:

Sector	Group	Amount: Number of transactions	Amount: Debt	Including overdue on: Principal	Including overdue on: Interest	Court receivables	Allowances	Unutilized commitment
Retail	Regular	1,072	17,164	15	12	-	-	410
	Watch	84	4,505	47	67	-	5	-
	Non-performing	20	1,182	25	38	-	2	-
	Loss	165	9,844	619	1	5,371	3,120	-
Total		1,341	32,695	706	118	5,371	3,127	410
Corporate	Regular	1,018	122,973	198	51	-	-	19,539
	Watch	55	20,745	391	239	-	4	6
	Non-performing	5	2,373	14	89	-	1	-
	Loss	88	42,784	8,734	1,323	15,549	9,268	-
Total		1,166	188,875	9,337	1,702	15,549	9,273	19,545
State budget	Regular	2	522	-	-	-	-	-
	Watch	-	-	-	-	-	-	-
	Non-performing	-	-	-	-	-	-	-
	Loss	-	-	-	-	-	-	-
Total		2	522	-	-	-	-	-
	Total portfolio	2,509	222,092	10,043	1,820	20,920	12,400	19,955

34. FINANCIAL RISK MANAGEMENT (CONTINUED)

34.1 Credit risk (continued)

Quality of the credit portfolio (continued)

Business sector, classification group and overdue amounts as of December 31, 2012:

Sector	Group	Amount		Including overdue on:				
		Number of transactions	Debt	Principal	Interest	Court receivables	Allowances	Unutilized commitment
Retail	Regular	1,072	19,143	8	12	-	-	1,055
	Watch	87	4,782	34	63	-	20	275
	Non-performing	41	2,528	96	73	-	15	-
	Loss	159	8,994	772	159	3,439	2,221	-
Total		1,359	35,447	910	307	3,439	2,256	1,330
Corporate	Regular	783	113,755	53	57	-	-	18,783
	Watch	46	21,839	134	135	-	6	-
	Non-performing	11	9,925	509	325	-	715	-
	Loss	76	37,859	7,804	1,117	12,512	6,134	-
Total		916	183,378	8,500	1,634	12,512	6,855	18,783
State budget	Regular	-	-	-	-	-	-	-
	Watch	1	583	31	8	-	58	-
	Non-performing	-	-	-	-	-	-	-
	Loss	-	-	-	-	-	-	-
Total		1	583	31	8	-	58	-
	Total portfolio	2,276	219,408	9,441	1,949	15,951	9,169	20,113

Concentration of credit risk

A significant percentage of the loan portfolio of the Group is concentrated in a limited number of borrowers. Despite the regulatory restrictions on large exposures, there is a risk that the Group'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 Group other than exposures to credit institutions (exposures which represent 10% or more of the Group's capital base) at their carrying amount as of December 31, 2013 and 2012 is presented in the table below:

	As of December 31, 2013		As of December 31, 2012	
	BGN'000	*% of the capital base*	*BGN'000*	*% of the capital base*
The largest total exposure to customer group	8,756	27.0%	8,460	24.9%
Total amount of the five largest exposures	38,093	117.3%	37,438	110.0%
Total amount of all exposures - over 10% of the capital	100,604	309.9%	101,660	298.8%

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

34. FINANCIAL RISK MANAGEMENT (CONTINUED)

34.2 Liquidity risk

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

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

The Bank's operations require stable cash flows to replace the existing deposits when they expired (at maturity) and to satisfy customer demand for additional loans. In liquidity management, the Group also considers commitments related to the not-utilized portion of loans granted and the level of all contingent liabilities.

To ensure the liquidity policy, the Group takes the following measures:

- develops rules and procedures for liquidity management;
- defines adequate liquid assets;
- develops an information system for monitoring the liquidity, based on the maturity table, regulated by Ordinance № 11 of the BNB;
- forms liquidity measurement indicators;
- appoints a liquidity regulation body and defines its responsibilities and tasks;
- establishes a system for management and control of liquidity risk;
- develops scenarios for the Group 's action in normal circumstances - "going concern" and in a period of "liquidity crisis";
- regulates the mandatory information for the current management needs, as well as for the reporting to the BNB.

The main parameters of the Group's liquidity policy are determined by the Bank's Management Board, and the overall organization of its implementation is assigned to the Assets and Liabilities Management Committee.

The main body for liquidity management of the Group is the Assets and Liabilities Management Committee of the Bank. It is directly responsible for the liquidity status and its ongoing management, based on the decisions of the Management Board, as well as for the ongoing management of assets and liabilities. The Committee meets at least once a month, and if necessary (at the risk of a liquidity crisis) it meets daily, in order to overcome any liquidity difficulties.

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

All amounts are in thousand BGN, unless otherwise stated

35. FINANCIAL RISK MANAGEMENT (CONTINUED)

34.2 Liquidity risk (continued)

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

The ratio of the portion of the Group's assets that will be invested in liquid assets /securities and money market placements/ and the portion that will be provided as loans to non-financial companies and/or individuals is determined by the Assets and Liabilities Management Committee and is approved by the Management Board of the Bank. At present, the ratio is 33:67 in favour of loans to non-financial companies and/or individuals.

Quantitative measure of the liquidity risk is the liquid assets coefficient, which represents the ratio between liquid assets (cash in hand and at accounts with the Central bank, Bulgarian government securities not pledged as collateral, placements with financial institutions with maturity up to 7 days) to the attracted funds of the Group. As of December 31, 2013 and 2012 the liquid assets ratio is 36.6% and 47.17 %, respectively. The Group maintains high amount of liquid assets in the form of cash in hand and cash balances with the Central bank, which guarantee Group's ability to meets its liquidity requirements. As of December 31, 2013 and 2012 cash and cash balances with Central Bank represent 8% and 11%, respectively of total assets of the Group.

As an additional instrument to provide high liquidity, the Bank uses loans granted and advances to credit institutions. These comprise mostly of deposits in first-class international and Bulgarian credit institutions with maturity up to 7 days. As of December 31, 2013 and 2012 loans and receivables from credit institutions represent 8% and 15%, respectively of total assets of the Group.

Government securities, issued by the Republic of Bulgaria, owned by the Group and not pledged as collateral as of December 31, 2013 and 2012 represent 14.8% and 15%, respectively of total assets. By maintaining above 31% (2012: 40%) of its assets in highly liquid assets, the Group ensures the ability to meet its all payment needs on matured financial liabilities.

The allocation of the Group's financial liabilities as of December 31, 2013 according to their residual term is, as follows:

	Up to 1 month	From 1 to 3 moths	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Total
FINANCIAL LIABILITIES						
Deposits from credit institutions	931	-	-	-	-	931
Liabilities under repurchase agreements (repo deals)	1,456	-	-	-	-	1,456
Deposits from customers other than credit institutions	138,723	77,462	117,313	19,985	-	353,483
Borrowings	38	-	-	-	-	38
TOTAL FINANCIAL LIABILITIES	141,148	77,462	117,313	19,985	-	355,908

All amounts are in thousand BGN, unless otherwise stated

34. FINANCIAL RISK MANAGEMENT (CONTINUED)

34.2 Liquidity risk (continued)

The allocation of the Bank's financial liabilities as of December 31, 2012 according to their residual term is, as follows:

	Up to 1 month	From 1 to 3 moths	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Total
FINANCIAL LIABILITIES						
Deposits from credit institutions	381	-	-	-	-	381
Liabilities under repurchase agreements (repo deals)	6,780	-	-	-	-	6,780
Deposits from customers other than credit institutions	148,499	105,090	113,661	18,921	-	386,171
Borrowings	38	114	209	39	-	400
TOTAL FINANCIAL LIABILITIES	155,698	105,204	113,870	18,960	-	393,732

The financial liabilities of the Group are mainly formed by attracted funds on deposits – retail and corporate. Large portion of them as of December 31, 2013 –40% (2012: 38%) are with residual term within one month. Traditionally, in the Republic of Bulgaria the customers prefer to sign a deposit agreement with one month term and to renegotiate it regularly for longer period. As a result, one month deposits are practically a long-term and relatively permanent resource of the Group.

34.3 Market risk

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

The Group manages its financial instruments, considering the changing market conditions. Exposure to market risk is managed in accordance with risk limits, set by the Group'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 Group has adopted limits for investments in financial instruments as follows:

- ✓ Foreign government securities - may be purchased only if they have a credit rating not lower than BBB/positive perspective on Standard & Poor's or an equivalent assessment of creditworthiness. Maximum level of exposure - 10%;
- ✓ Corporate bonds, issued by banks - at issuer's credit rating not lower than BBB/positive perspective on Standard & Poor's or an equivalent assessment of creditworthiness and total exposure - 20%;

34. FINANCIAL RISK MANAGEMENT (CONTINUED)

34.3 Market risk (continued)

- ✓ Corporate shares - the total exposure cannot exceed 1% of the total portfolio of securities;
- ✓ Corporate bonds - can only be purchased if they have a credit rating not lower than BBB/ positive perspective on Standard & Poor's or an equivalent assessment of creditworthiness. Otherwise, a precise analysis of quantitative and qualitative factors is performed to support the decision for their acquisition. Maximum level of exposure - 20%.

Market risk management includes:

- ✓ Determination of the ratio of Group's assets invested in liquid assets /securities and money market placements/ to the amount that will be provided as loans to non-financial companies and/or individuals. The ratio is determined by the Assets and Liabilities Management Committee and is approved by the Management Board of the Bank. At present, the ratio is 33:67 in favour of loans to non-financial companies and/or individuals.
- ✓ Determination of securities and money market placements ratio. This ratio is dynamic variable and as the ratio of investment/trading portfolio, it is determined, according to the maturity structure of the Group's attracted funds, cash inflows and outflows, liquidity needs, income level and objectives of the Group.
- ✓ 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 Group 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 Group 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 Group analyses the effect of certain standardized interest rate shocks. The price change in parallel shift of the yield curve by 200 basis points should not exceed 5% of the capital base, calculated in the last quarter.

34. FINANCIAL RISK MANAGEMENT (CONTINUED)

34.3 Market risk (continued)

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 Group aims to minimize the risk of decrease in the net interest income as a result of changes in interest rate levels.

The Group uses the GAP analysis method (gap analysis, misbalance method) to measure and assess the interest rate risk, allocating the interest-bearing assets and liabilities in time ranges, depending on the moments of their revaluation (for instruments with floating interest rate) and maturity (for instruments with fixed interest rate). Using this method the management of the Group 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 Group, 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 Group's portfolio to interest rate risk and its sensitivity to this type of risk as moderate in view of the volumes and structure of the operations.

In interest rate risk management, the Group 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 Group 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 Group has established a system for measurement of interest rate risk, which covers all sources of interest rate risk and assesses the effect of the fluctuations in interest rates.

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

In cases of assets and liabilities with floating interest rates, the Group is exposed to risk of fluctuations in the reference rates, which are used to estimate the interest rates, and which are determined based on floating interest rate indices, such as the basic interest rate or six-month LIBOR.

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

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

All amounts are in thousand BGN, unless otherwise stated

34. FINANCIAL RISK MANAGEMENT (CONTINUED)

34.3 Market risk (continued)

Interest rate risk (continued)

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

The interest-bearing assets and liabilities of the Bank as of December 31, 2013 are, as follows:

	Up to 1 month	Between 1 and 3 months	Between 3 months and 1 year	Between 1 and 5 years	Over 5 years	Total
INTEREST-BEARING ASSETS						
Loans and receivables from credit institutions	35,199	-	-	-	-	35,199
Financial assets held for trading	-	-	6,231	28,983	3,267	38,481
Loans and receivables from customers	198,612	371	1,804	874	8,031	209,692
Investments held to maturity	2,892	-	9,841	49,289	22,546	84,568
TOTAL INTEREST-BEARING ASSETS	236,703	371	17,876	79,146	33,844	367,940
INTEREST-BEARING LIABILITIES						
Deposits from credit institutions	931	-	-	-	-	931
Liabilities under repurchase agreements (repo deals)	1,456	-	-	-	-	1,456
Deposits from client other than credit institutions	138,723	77,462	117,313	19,985	-	353,483
Borrowings	38	-	-	-	-	38
TOTAL INTEREST-BEARING LIABILITIES	141,148	77,462	117,313	19,985	-	355,908
MISBALANCE BETWEEN INTEREST-BEARING ASSETS AND LIABILITIES, NET	95,555	(77,091)	(99,437)	59,161	33,844	

The interest-bearing assets and liabilities of the Bank as of December 31, 2012 are, as follows:

	Up to 1 month	Between 1 and 3 months	Between 3 months and 1 year	Between 1 and 5 years	Over 5 years	Total
INTEREST-BEARING ASSETS						
Loans and receivables from credit institutions	68,507	-	-	-	-	68,507
Financial assets held for trading	-	-	1,500	27,223	3,599	32,322
Loans and receivables from customers	206,976	-	1,489	612	1,162	210,239
Investments held to maturity	20,972	-	-	35,591	20,279	76,842
TOTAL INTEREST-BEARING ASSETS	296,455	-	2,989	63,426	25,040	387,910
INTEREST-BEARING LIABILITIES						
Deposits from credit institutions	381	-	-	-	-	381
Liabilities under repurchase agreements (repo deals)	6,780	-	-	-	-	6,780
Deposits from client other than credit institutions	148,499	105,090	113,661	18,921	-	386,171
Borrowings	38	114	209	39	-	400
TOTAL INTEREST-BEARING LIABILITIES	155,698	105,204	113,870	18,960	-	393,732
MISBALANCE BETWEEN INTEREST-BEARING ASSETS AND LIABILITIES, NET	140,757	(105,204)	(110,881)	44,466	25,040	

All amounts are in thousand BGN, unless otherwise stated

34. FINANCIAL RISK MANAGEMENT (CONTINUED)

34.3 Market risk (continued)

Interest rate risk (continued)

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

	Year ended 31.12.2013	Year ended 31.12.2012
Interest-bearing assets		
Loans and receivables from credit institutions	0.10	0.17
Financial assets held for trading	3.90	3.47
Loans and receivables from customers	6.58	8.22
Investments held to maturity	3.54	4.72
Interest-bearing liabilities		
Liabilities under repurchase agreements	0.29	-0.01
Deposits from credit institutions	0.14	-
Deposits from clients other than credit institutions	3.22	3.43
Borrowings	2.00	2.00

Currency risk

Currency risk is the possibility to realize losses for the Group 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 Group in EUR bear no currency risk for the Group.

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 Group. The main part of the assets and liabilities of the Group are denominated in EUR and BGN. The Group has significant foreign currency transactions in Japanese yen (JPY), since part of the deposit base of the Group is in this currency. The Group does not hold open positions in currencies other than EUR.

The foreign currency structure of financial assets and liabilities by carrying amount as of December 31, 2013 is as follows:

All amounts are in thousand BGN, unless otherwise stated

34. FINANCIAL RISK MANAGEMENT (CONTINUED)

34.3 Market risk (continued)

Currency risk (continued)

	BGN	EUR	USD	JPY	Other	Total
ASSETS						
Cash and cash balances with Central banks	18,199	14,351	657	168	152	33,527
Loans and receivables from credit institutions	4,112	21,569	480	8,951	87	35,199
Financial assets held for trading	13,469	21,576	3,436	-	-	38,481
Financial assets available-for-sale	164	1	-	-	-	165
Loans and receivables from customers	99,518	107,746	2,428	-	-	209,692
Investments held to maturity	46,679	33,306	4,583	-	-	84,568
TOTAL ASSETS	182,141	198,549	11,584	9,119	239	401,632
LIABILITIES						
Deposits from credit institutions	-	34	897	-	-	931
Liabilities under repurchase agreements (repo deals)	-	-	1,456	-	-	1,456
Deposits from client other than credit institutions	172,770	145,355	9,822	25,305	231	353,483
TOTAL LIABILITIES	172,770	145,389	12,175	25,305	231	355,870
NET EXPOSURE	9,371	53,160	(591)	(16,186)	8	45,762

The foreign currency structure of financial assets and liabilities by carrying amount as of December 31, 2012 is as follows:

	BGN	EUR	USD	JPY	Other	Total
ASSETS						
Cash and cash balances with Central banks	29,476	19,827	710	219	156	50,388
Loans and receivables from credit institutions	26,216	16,592	4,279	20,913	507	68,507
Financial assets held for trading	11,861	19,952	630	-	-	32,443
Financial assets available-for-sale	164	1	-	-	-	165
Loans and receivables from customers	94,752	112,673	2,814	-	-	210,239
Investments held to maturity	46,483	25,413	4,946	-	-	76,842
TOTAL ASSETS	208,952	194,458	13,379	21,132	663	438,584
LIABILITIES						
Deposits from credit institutions	-	227	154	-	-	381
Liabilities under repurchase agreements (repo deals)	6,780	-	-	-	-	6,780
Deposits from client other than credit institutions	166,196	157,384	13,777	48,152	662	386,171
TOTAL LIABILITIES	172,976	157,611	13,931	48,152	662	393,332
NET EXPOSURE	35,976	36,847	(552)	(27,020)	1	45,252

34. FINANCIAL RISK MANAGEMENT (CONTINUED)

34.3 Market risk (continued)

Currency risk (continued)

As of December 31, 2013 and 2012 the Group has significant net liabilities in JPY, due to the fact that part of the deposit base of the Group is denominated in that currency. The exchange rate of the Japanese yen is characterized by high volatility, which the Group manages using derivative instruments, including currency forward contracts and swap transactions. The derivative instruments are reported as financial assets held for trading and are reported at their fair value.

Price risk

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

Sensitivity to market risk

In accordance with the adopted objectives and principals, the Group applies: VaR (Value-at-risk) analysis, Duration analysis and Standardized interest rate shocks for identify and analyse the effect of different risk factors on the value and the profitability of the portfolio, and thus manages to find the optimal ratio risk to income. The risk exposure of the trading portfolio of the Group is assessed on daily basis by calculating VaR whose value is compared to the limit determined by the Asset Liability Management Committee of the Group. The daily VaR of the trading portfolio is calculated using Monte Carlo Simulation, confidence level of 99% and standard deviation of 2.33%. In 2013 and 2012 the limit of the value of VaR is 20%. To evaluate the interest rate sensitivity of the commercial portfolio, the Group uses the modified duration of the portfolio.

As of December 31, 2013 the Group performed analysis of its interest rate sensitivity on the basis of the assumption of increase by 200 basis points of the interest rate, applied to the interest rate misbalance. In addition, the Group has performed sensitivity analysis to decrease of the interest rate margin in view of the recent negative trend with respect to this indicator. The analysis shows that further decrease of the interest rate margin by 0.25% would result in a loss at the amount of BGN 898 thousand.

To evaluate the effect of potentially possible extreme fluctuations of interest rates, the Group analyses the effect of several Standardized interest rate shocks. The price fluctuation in the parallel shift of the yield curve by 200 basis points should not exceed 5% of the capital base calculated in the last quarter.

In accordance with the BNB regulations the market risk sensitivity indicators determined by the Bank are included when determining capital requirements of the Group as of December 31, 2013.

All amounts are in thousand BGN, unless otherwise stated

35. CAPITAL MANAGEMENT

The Bank is subject to regulations in relation to meeting the requirements for capital adequacy in accordance with the Bulgarian legislation. In Bulgaria the authorized share capital of a bank shall not be less than BGN 10 million and there is an additional requirement that at any time the equity (the capital base) of the bank should not fall below the required minimum.

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

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

The table below presents information regarding the capital adequacy as of December 31, 2013 and 2012. The Bank uses the standardized approach for calculation of capital requirements for credit risk and the approach of the basic indicator for measurement of operational risk.

Capital base	As of 31.12.2013	As of 31.12.2012
Tier I capital		
Share capital	68,000	68,000
Reserves	(6,891)	(4,940)
Current loss	(2,895)	(2,336)
Less: Intangible assets	634	167
Less: Specific provisions for credit risk	25,101	26,877
Total Tier I capital	**32,479**	**33,680**
Tier II capital	**-**	**347**
Total capital base	**32,479**	**34,027**
Capital requirements		
Capital requirements for credit risk	15,771	16,247
Capital requirements for exposure risk, foreign currency and commodity risk	908	705
Capital requirements for operational risk	2,046	1,984
Additional capital requirement - 4%	9,362	9,468
Total capital requirements – Standard approach	**28,087**	**28,404**
Ratios		
Total capital adequacy (%)	**13,87**	**14.38**
Tier I capital adequacy (%)	**13,87**	**14.38**

35. CAPITAL MANAGEMENT (CONTINUED)

One of the requirements of the BNB is that the specific provisions for credit risk should be deducted from the amount of the capital base. The specific provisions for credit risk represent the excess of the carrying amount of the loans, determined in accordance with the applicable accounting standards and reflected in these consolidated financial statements, over the risk value of the exposure, calculated in accordance with the requirements of Ordinance № 9 of the BNB. For the purposes of determining the specific provisions, for loans classified as loss for a period greater than 365 days, the amount of the collateral is assumed to be nil. As of December 31, 2013 the Bank has set specific provisions for credit risk at the amount of BGN 25,101 thousand.

In relation to the new statutory requirements on the application of Directive 2013/36/EU and Regulation 575/2013 of the European Parliament, effective from January 1, 2014, the Bank will suspend the reporting and deduction of specific provisions from the capital base.

The new legal framework as adopted by the European Parliament introduces currently applied rules and techniques for prudential supervision and additional tools providing flexibility of Supervision authorities in relation to the maintenance of adequate capitalization levels of the banking system.

36. EVENTS AFTER THE REPORTING DATE

In March 2014, the Bank has received an assignment order awarding real estate related to a credit exposure under legal collection, which has been acquired through a public sale. Following receipt of the assignment order, the Bank has recognized in the statement of financial position the acquired assets and reported an additional impairment loss at the amount of BGN 1,398 thousand, representing the difference between the expected cash as a result of the public sale and the carrying amount of the credit exposure.