Annual Management Activity Report and Corporate Governance Declaration

Independent Auditors' Report

Annual Financial Statements as at 31 December 2022

This is a translation of the Annual Financial Statements of Tokuda Bank AD for the year ended 31 December 2022.

Table of contents:

Tokuda Bank

MANAGEMENT ACTIVITY REPORT 2022

CONTENTS:

I. Environment in which Tokuda Bank AD operated in 2022

In 2022, the banking sector operated in an environment mostly characterized by the conflict in Ukraine, which resulted in the interruption of some traditional partnership and sustainable logistics chains, as well as to blocking a considerable portion of business activities globally as a result of the sanctions imposed against the Russian Federation. This on its part resulted in intensive fluctuations on the markets of raw materials and to the release of the inflation potential accumulated over the quantitative easing period. The acceleration of price indices resulted in lower household purchase power and in forming conservative attitudes among economic agents. For instance, the index of expected business condition in Bulgaria's industry reached its lowest value for the period since the pandemic started as early as March, and the share of industrial entrepreneurs that identified the uncertain economic situation as the main impediment to business development marked a 13-year record (62.2% in October 2022 compared to 62.9% in March 2010). In an attempt to rein in price trends, most central banks (including ECB) took measures towards monetary tightening, which could be said to have at least partially reached the desired outcome. For instance, after the October peak of 11.5%, the harmonized consumer price index in the EU began to slow down, and in March 2023 it decreased to 8.3% on an annual basis. The transmission of the effects of the monetary policy in Bulgaria resulted in simultaneous dynamics of the harmonized index for the country and after reaching a high of 15.6% in September, it began to drop (down to 12.1% in March 2023).

The calming of inflation processes was significantly supported by the lifting of bans on import of agricultural produce from Ukraine (that resulted in a decrease in the prices of raw materials for the production of some foodstuffs) and the favourable winter season (the second warmest one over the entire monitoring period). The unusually high winter temperatures significantly contributed to limiting gas consumption in the EU over the September 2022 – March 2023 period by over 17%, and the indicator is even higher for Bulgaria (20% for the same period). Along with the measures to replace Russian imports with volumes from alternative suppliers, this resulted in a calming of the fluctuations on exchanges and to sustainable decreases in quotes for all energy sources. For instance, at the end of the heating season, the gas futures of the Dutch hub TTF with delivery in June 2023 (TGM23.F) reached a price nine times lower than the peak after military actions started (36.87 EUR/MW at the beginning of May 2023 versus 343.15 EUR/MW in August 2022).

Despite the temporary slowdown in price increases, the conclusion for 2022 is that population's purchasing power is weakening. Expenditure per household member increase faster than income (respectively by 19.1% versus 16.9%), the consumption of most major food products is decreasing, the assessment of income compared to market prices shows that the average income per person in 2022 is sufficient for 9% less bread than in the prior year (3841 kg versus 4230 kg in 2021); almost 10% less cheese and respectively 15% and 20% less eggs and sugar. As far as goods from this category have a prevailing share in the budgets of households with relatively low income, the intensive increase of work salaries does not manage to offset the higher cost of life, which on its part forces people in this category to withdraw a portion of their savings. Along with that, the assets of fast loan companies continue to increase as a result of the migration of a segment of clients whose scoring is insufficient to obtain a bank loan.

Condition of the banking system in 2022

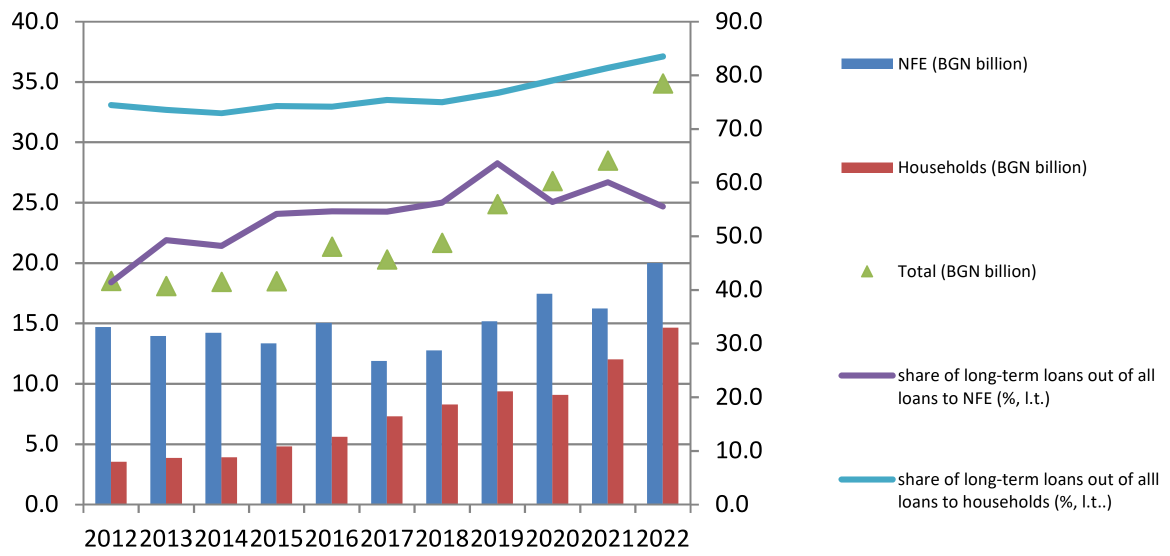
The banking system is adapting (without having to take any particularly active actions) to the changing situation, and in the conditions of automatically rising loan interest rates (as far as most loan agreements have been arranged under conditions for floating interest rate, or have a limited initial period of fixed interest rate), gross interest income increased by 19.4% on an annual basis to BGN 3,632 billion against a much more moderate increase in gross loans (13.5%). There is a comparable rate of increase (18,5%) in gross fees and commissions income, which in the past year reached BGN 1,758 billion and along with the increase in the net interest margin resulted in a record profit for the sector, at the amount of BGN 2,079 billion (or 46.8% more than in 2021). As a whole, 2022 was characterized by retaining intensive lending rates against the background of a still moderate increase of interest rates (which could be explained by the significant volume of liquidity buffers accumulated), a faster growth in operating expenses (interest on deposits and fees), which due to the much lower volume compared to gross revenue so far do not significantly affect net income; still continuing (though insignificant) costs for impairment and accrued provisions and most of all – the record increase in the sector's financial results.

In the conditions of serious challenges in the economic and regulatory environment, the Bulgarian banks continue to be sustainable, profitable, to retain high levels of liquidity and capital buffers. The immediate main trends in the sector are (directly and indirectly) dictated by the processes related to the conflict; the restructuring of assets and liabilities so as to limit risks resulting from the rising interest rates; maintaining an adequate dynamic balance between lending conditions and standards in an unfavourable macro environment, but also from the intensive processes of digital transformation and establishing the necessary basis for managing the processes related to transition to green economy.

Lending activity and loan quality

The analysis of data from the monetary statistics (Figure 1) shows that in 2021 the trend of growth in the nominal volume of loans of new business to non-financial entities continues. After the shrinking of contracted loans to corporate loans in 2021 and 2022, the statistics again point to growth (of BGN 3.8 billion). The gross amount of the increase exceeds the values reported since 2011, and the volume of new business in loans in the segment (BGN 19.9 billion) is a record both in terms of absolute and in relative value, since the ratio between new business for NFE and the amount of gross loans and advances in the segment at the end of December 2022 reached 44.52%.

Figure 1 New business volumes



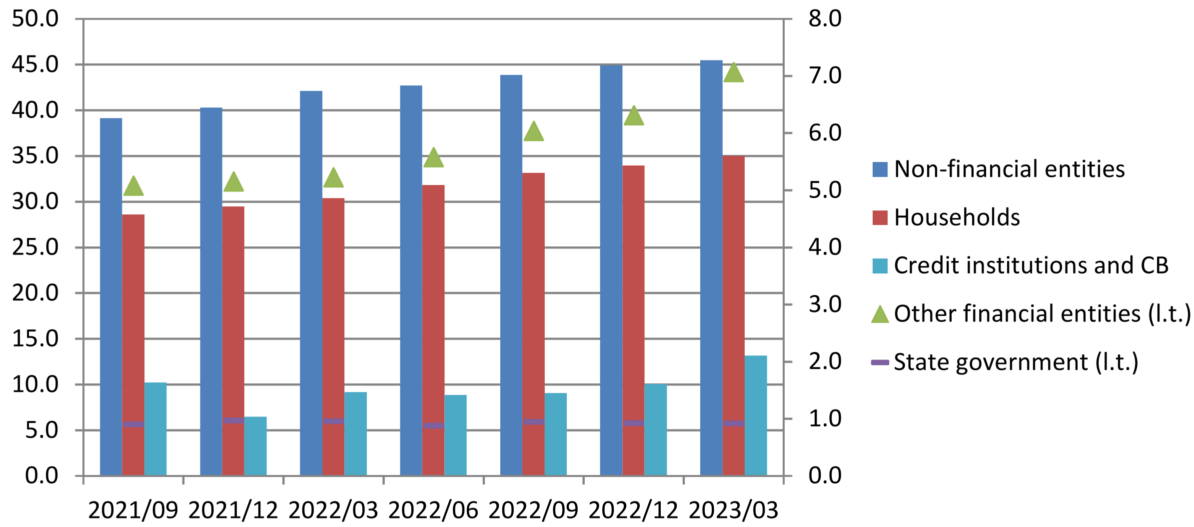
Source: BNB, own calculations

As a result of the increased activity, loans to entities at the end of last year reached BGN 44.9 billion (Figure 2), and it can be seen in the analysis of the maturity structure of new business in this segment that the share of long-term loans has decreased. Over BGN 11.10 billion of contracted loans in the segment have original maturity over 5 years, and thus the share of long-term loans reaches 55.52%, or 4.56 p.p. lower than in 2021. This can to a certain extent be explained with the different structure of lending activity which is due to the raising of reference rates, to which the effective interest rates are linked, but also with the lower optimism in the expectations of economic agents and the greater need of loans for working capital to finance operations, due to the intensively growing costs of manufacturing and principal activities.

Along with the increased interest on loans for working capital, the higher lending activity in the corporate segment can also be attributed to the retention of the lending policy of commercial banks. The summarised results from the BNB lending activity questionnaire show that more active actions to raise the interest spread were only taken in the beginning of the second half of the year, which incentivized economic agents in the prior period to benefit from the decreasing effective interest rate on loans.

The changes in the price and interest dynamics in the third quarter (when the price index began to slide from the maximum reached, and the reference rates and spreads compared to basic rates began to increase) resulted in interrupting this trend and respectively in the beginning of a period of recovery of actual interest, which will most likely impact the motivation of borrowers and will result in some weakening of demand in this segment. Along with that, it can be expected that given the rising risks of recession (both in Bulgaria and in its main trade partners) banks will be less prone to taking risks in corporate lending. The costs for provisions may start rising, which may provoke further tightening of both lending standards and the conditions of loans offered (in view of charging the increased risk premium as part of the price of the loan).

Figure 2 Gross loans before impairment at the end of the period (BGN billion)



Source: BNB, own calculations

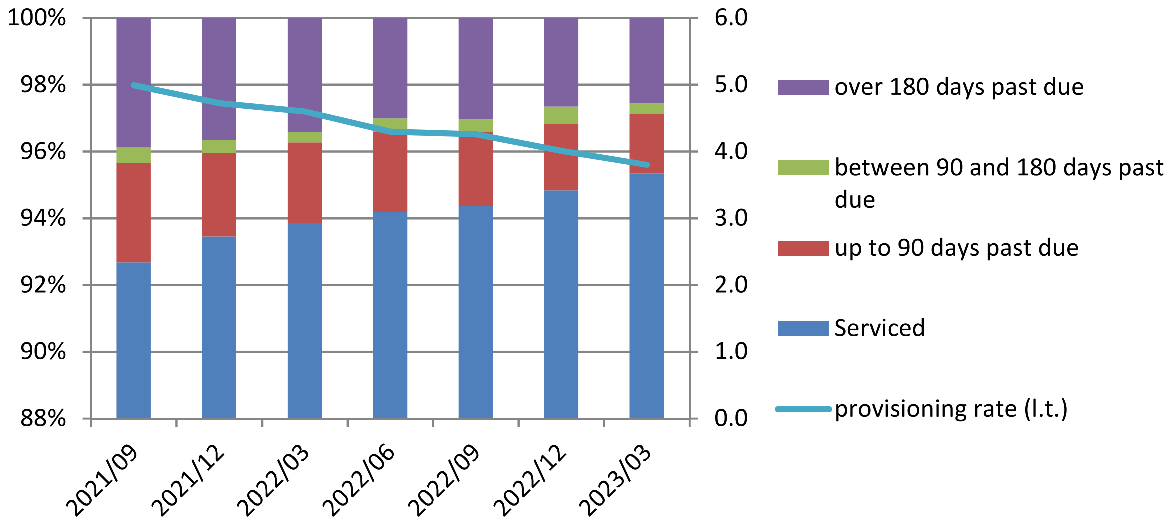
It can be seen that the nominal increase in loans to NFE (by 4.6 billion for 2022) is significantly faster than that of new business volumes in the segment (BGN 3.8 billion) and this could be partially explained by the continuing weakening of the pressure against the increase in the gross amount of the portfolio from forced collection of past due receivables and the writing-off of non-performing loans. In 2022 this trend was a to a large extent due to the rising share of performing loans (Figure 3), but also to the slower (compared to the nominal turnover rates in most sectors) increase in effective interest rates, respectively – in loan servicing costs.

To a limited extend, the above mentioned trend was also influenced by one of the factors mentioned in the previous report, namely the residual effect of the contracts concluded under the procedure for deferral of payables (which on its part still results in some restriction in forced collection activities, respectively – to maintaining exposures that would have otherwise matured).

Trends in retail lending

There were particularly favourable trends in retail lending (Figure 1). The sector demonstrated high activity and the total new business volume continued to grow, reaching BGN 14.65 billion for the year, which is BGN 2.63 billion (or 44.2%) more than in 2020. This trend proves to be sustainable, as far as the new business volumes for natural persons have constantly been increasing since 2010 (with the exception of 2010). Also retained was the trend of an increasing share of long-term household loans, which commenced in 2014. In the past year, this share increased by 214 basis points, from 81.37% to 83.51%, and this can be partially explained with the continuing (for the fourth consecutive year) increase in the share of home loans (from 45.03% last year to 45.63% this year). Last, but not least, the decision on determining the loan term in the past year was also impacted by the stagnation of real household income. As it was mentioned above, the faster growth in consumer prices and living costs compared to the nominal increase in salaries motivates natural persons applying for a consumer or home loan to structure their repayment plan so that the costs for servicing their debt take up the lowest possible share of their disposable income.

Figure 3 Quality of the loan portfolio



The negative trend in the number of property transaction registrations with the Registry Agency since the end of the first half of 2022 to a large extent explains the relatively small growth in the share of home loans in the past year (60 b.p.). In the prior year, this increase was three times higher (by 165 b.p., from 43.38% to 45.03%), while a year earlier the share of home loans increased by over 560 points. It is probable that demand and realization rates in the segment will weaken in 2023, which would result in a gradual decrease in the share of long-term loans within the overall contracted amount of loans to natural persons and households.

The increased activity in retail lending is reflected in the dynamics of the absolute volume of gross loans. In the past 2022, the consumer loan portfolio in the banking system grew by 12.8% on an annual basis (versus 11.1% on an annual basis in 2021) to BGN 16.1 billion. The home loans portfolio grew at a faster rate – of 16.1% on an annual basis (though this is lower than the 17.6% in 2021) to BGN 18.4 billion. The main contributor to the maintenance of high growth rates in this segment is the intensive increase in new business, which for the past 2022 was almost five times higher in volume (BGN 14.65 billion) than in the first years after the start of the global crisis in 2007-2008, which can be explained on the one hand with difficulties in meeting unforeseen costs as a result of the worse household budget balance, and on the other hand – with reaching the peak in real estate transactions. Last, but not least, an incentive is also the relatively weak dynamics of interest rates. According to the statistics, the average interest rates of newly disbursed home loans denominated in BGN have slightly decreased (from 2.62% at the end of 2021 to 2.60% at the end of last year), while there has been an increase in EUR-denominated loans, respectively from 2.91% to 3.35%. The average interest rate of BGN-denominated consumer loans increased by 110 b.p.

(from 8.55% at the end of 2021 to 9.65% in December 2022), while for EUR-denominated loans in this category the increase is by 160 b.p. (respectively from 3.10% to 4.70%).

The change in the parameters offered by individual banks on specialized websites, as well as the change in the balance of loan conditions (according to the results of the annual BNB survey) show without a doubt that the number of banks offering better conditions, especially in the past years, has decreased, and this has resulted in a lower number and gross amount of re-financing transactions in 2022. This trend may continue in the mid and long term, and this will initially result in an even greater shrinkage in the share of re-financing, followed by a limited new business volume for households in general.

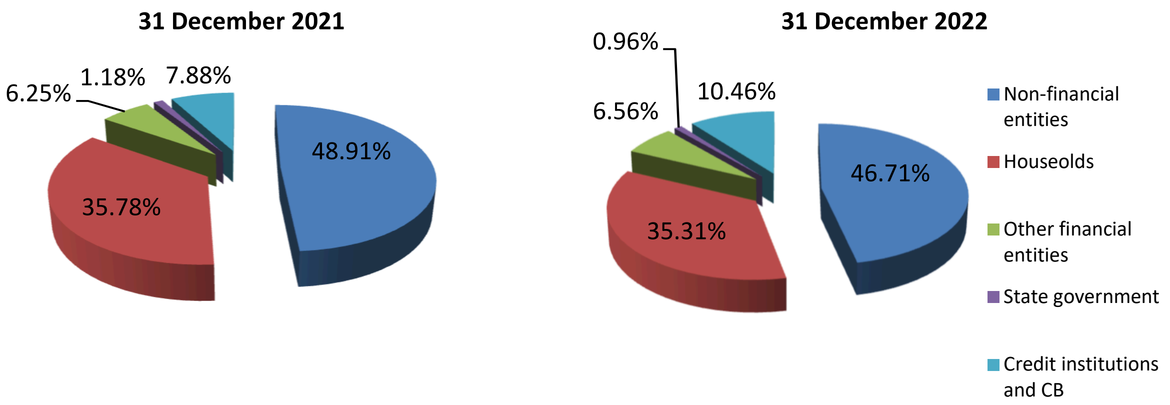
Structure of the assets of commercial banks

The overall impression from the observation of lending activity in 2021 is that after the faster growth in gross loans achieved in 2021 (excluding loans to banking institutions) compared to the overall volume of loans and advances, in 2022 this rate again began to slow down. In the past year, gross loans increased by 13.45% (from BGN 75.88 billion to BGN 86.08 billion), while if loans to non-banking financial institutions are included, the growth rate already reaches 16.75% on an annual basis. The reason for the identified difference is the stronger motivation of commercial banks to transfer most of their assets to foreign partners' current accounts, since the increase in interest rates in the lower end of the maturity curve (especially in the second half of the year) resulted in enhancing the attractiveness of risk-free assets. The comparison with the expected risk-weighted profitability from loans to the non-financial sector is still not in favour of the latter category, due to the delayed calculation of risk premium in the past year. Therefore, most financial intermediaries still prefer risk-free assets, and this trend will probably continue at least until the middle of 2023, when a sufficient increase could be expected in the risk premium for interest on loans to the non-financial sector.

The trend described above resulted in a significant increase in the share of loans for FI (by 1/3 – from 7.9% at the end of 2021 to 10.5% at the end of 2022) at the expense of the shares of all others, with the exception of non-banking financial institutions, whose share increased by 31 b.p. to 6.56% (Figure 4). The most significant decrease is seen in loans to non-financial entities (by 220 b.p., down to 46.71%), which could be explained by the growing risk of the environment and by the attempt to limit banks' risk appetite, incl. through strengthening diversification (by limiting the activity in the most affected sectors and decreasing the maximum amount of loans to a group of related parties).

Often in similar periods (of rising imminent risk) operations are focused to a larger extent on natural persons and households, since their exposures have lower individual amounts, and the market of loan collaterals is characterized by a much greater depth than the one of legal entities' collaterals. This can explain the significantly weaker growth in the share of household loans (by 47 b.p., to 35.31%, mainly at the expense of the slower growth rate in consumer loans).

Figure 4 Structure of loans and advances

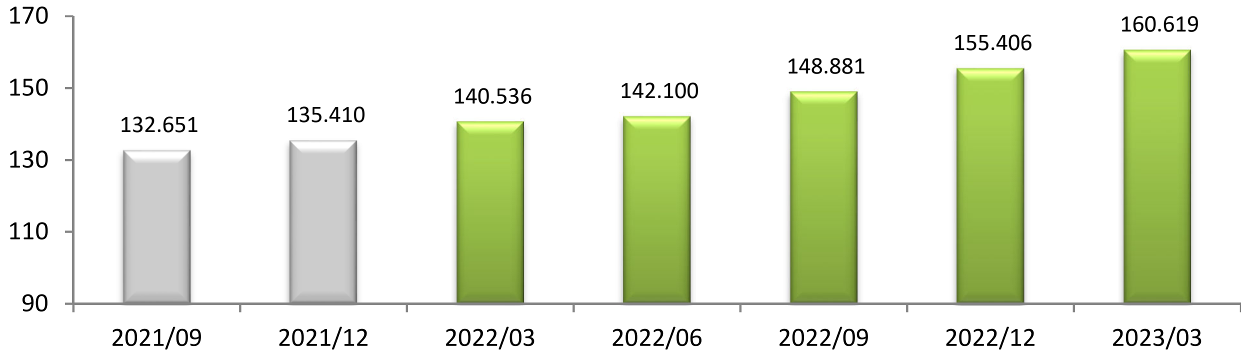


Source: BNB, own calculations

There are still certain possibilities for realization for non-banking institutions. Banks continued to lend to this sector in 2022, at rates half of those in the period of greatest dynamics in this segment (25-27% on an annual basis in 2017-2018). In 2022, the total amount of receivables from other financial entities grew by 11.47%, which is comparable to the result achieved in the previous year (10.09%) and still allows for placement of the excess of liquidity funds. It can be expected that in 2023 this rate will slow down, on the background of the recovery of interest rates in the other segment and the continuing process of placement of liquidity buffers.

Savings continue to grow irrespective of the slower rate of deposit interest raising and respectively the retention of negative actual profitability on all deposit products. The total amount of attracted funds from the non-financial sector grew by 15.41% on an annual basis (up to BGN 126.19 billion), rising by BGN 16.84 billion, mainly at the expense of legal entities. Banking supervision data show that in the past year liabilities from this source grew by over ¼ (to BGN 43.17 billion) mainly in the third quarter, which coincides with the period of the most adverse attitude of entrepreneurs to the economic environment. Natural persons and households increase their deposits at a much slower rate – by less than 1/10, and the growth achieved in the fourth quarter (BGN 2,96 billion) is comparable with the one for the entire remaining period of 2022 (BGN 3.22 billion). This could be partially explained with the weakening of positive attitude among natural persons, but also with the more significant increase in interest rates offered in the period, as well as with the beginning of disinflation processes at the end of the third and the beginning of the fourth quarter.

Figure 5 Commercial banks' assets [BGN billion]



Source: BNB

Regulatory environment

Against the background of the stable condition of the banking sector and the weakening of risks related to the COVID-19 pandemic as early as February 2022, BNB announced that it would discontinue the effect of the macroprudential measures imposed in March 2020 in relation to restrictions on banks' profit distribution for years 2019 and 2020. As from 1 April 2022 the effect of the measure for imposing individual and group limits on foreign counterparts aimed at limiting credit risk and the risk of concentration in the balances of commercial banks was also discontinued. The timely introduction of the above-mentioned measures had a crucial role in limiting the specific risks that arose in the period of the pandemic, but given their weakening, the lifting of measures at the beginning of last year was quite logical.

Along with that, the regulator took actions directed at the growing risk of cyclical decline, which were dictated by the prolonged high rates of credit growth and the increased economic uncertainty. As early as 2021, BNB announced two decisions to raise the level of the countercyclical capital buffer (respectively from 0.5% to 1.0%, as from 1 October 2022, and to 1.5%, as from 1 January 2023), and on 29 September 2022, a decision was made for another raising of the countercyclical capital buffer to 2.0%, as from 1 October 2023. During the annual review of the so-called other systemically relevant institutions (OSRI), eight banks were identified for which the levels of the OSRI-specific buffer in 2023 will range from 0.5% to 1%. In order to obtain a more precise assessment of the risk resulting from the high growth rate (and the increasingly probable adjustment) of home prices in the beginning of 2022, BNB introduced an additional reporting form providing detailed information about the real-estate-secured loans granted by banks to households.

The overall approach for managing the price dynamics (not only on the real estate market) continued in 2023, and by means of the amendments to Ordinance 21 of BNB adopted in April of the same year, as from 1 June 2023 the process of mandatory minimum reserves on attracted funds from non-residents will be made equal to those from residents (by increasing it from 1 to 10%), and a month later (as from 1 July 2023) mandatory minimum reserves on all attracted funds (from both residents and non-residents) will be raised from 10 to 12%. The latter actions are to a large extent similar to the period preceding the previous crisis (so-called “long recession”), when a package of measures was introduced that were directly aimed at limiting the growth rates of commercial banks’ assets, and on 19 July 2007 the Management Board of BNB passed an amendment to Ordinance 21, whereby as from 1 September 2022 the mandatory minimum reserves that banks kept with the BNB were raised to 12% of their deposit basis (versus 8% before the amendment).

As a whole, in 2022 commercial banks continued to demonstrate sustainable indicators despite the not particularly favourable conditions of the environment in which they operated, largely supported by the better economic performance compared to initial forecasts based on the excepted adverse effects of the conflict in Ukraine and the tightening of the monetary policy. The data from the banks’ unaudited financial statements show that as a whole the sector performed very well. Most group II and group III banks managed to achieve asset growth rates that significantly exceed the system average.

The main trends of 2022 are the processes of accelerated digitalization of banking products and services, as well as the record profit as a result of the automatic rise in the interest margin (in a situation of rising interest rates) and retention of the loan quality (hence low impairment and provision costs) thanks to the favourable conditions (populist fiscal measures, facilitation measures on fuel costs due to the warm winter, weakening of the inflation pressure as a result of dumping export from Ukraine, etc.).

It can be expected that changes will occur in the above trends in 2023, since the changes in the environment create conditions for a certain increase in the share of non-performing loans, hence – for a drop in the banking sector’s profitability indicators.

II. Review of the activity of Tokuda Bank in 2022

As at 31 December 2022, the assets of Tokuda Bank AD amount to BGN 459.660 million, which is 0.30% of the total amount of assets in the Bulgarian banking system (according to BNB data). When compared to the assets of Group Two banks, to which Tokuda Bank AD belongs, this share is 1.01%. The average monthly value of balance amount is gradually increasing; in the past year, the indicator reached BGN 449.1 million, and in 2020 – respectively BGN 415.6 million.

In the past year, the Bank has successfully met the challenges of its environment and continues to strictly observe the main priorities in its strategy. For instance, in relation to the priority for improving the structure of assets and liabilities, the following results may be indicated: gross loans increased by BGN 21.099 million above prior-year levels (reaching BGN 254.689 million compared to BGN 233.590 million at the end of 2021) at lower allowance for credit losses and an increased share of performing loans. The share of the loan portfolio following impairment in the overall assets structure takes up 53.90% of the total assets at the end of 2022 (compared to 52.55% in the previous year), and along with that, the quality thereof improved – in the past year, the Bank managed to shrink the share of non-performing loans by 2.27 percentage points, to 9.47% of the gross amount of loans to and receivables from customers.

This was one of the key challenges for the past year, against the uncertain environment and the moderate dynamic of the loan portfolio, which is a logical result of the insecure behaviour of indicators of the economic climate and the increased competition for clients with proven creditworthiness. The increase in the share of the loan portfolio as a whole in the structure of assets was at the expense of categories with generate relatively low income, like for instance receivables from banks.

The latter supports reaching the business objectives related to improving the profitability indicators, and it should be taken into consideration that the increase of their share in the structure of assets is accompanied by the improved quality thereof. The fulfilment of this objective may be tracked through the dynamic of the ratio between total operating expenses to the total operating income, which over the past year remained unchanged (decreasing by 7.93 p.p. to 81.49%), as a result of the increase in the total operating income, before impairment and loss provision to BGN 16.863 million for 2022 (compared to BGN 14.211 million for 2021), but also as a result of the limited increase in operational expenses by BGN 1.034 million (to BGN 13.742 million for 2022).

The latter fact is the natural result of fulfilling another key objective, namely, improving the effectiveness of the Bank's market presence through the continuing optimisation of the office network. Pursuant to this objective, the following offices were closed down in 2022: the offices Sliven, Haskovo, Hemus-Sofia; the optimisation process was carried out without a significant client outflow. Thus, the Bank managed to optimise its expenses and thus free resources to be relocated to the points that have the potential to generate higher added value.

There has also been successful fulfilment of another priority in the strategy and business plan, namely the effective management and control of the amount of customer deposits aimed at reducing the resource costs while maintaining stable financing. In 2022 the Bank managed to increase the amount of attracted funds by 8.18% (to BGN 412,932 million), but the share of more expensive financing, whose source are individuals and households, decreased (73.44% in the overall structure at the end of 2022 compared to 73.81% in the prior year), while the share of term deposits decreased by 3.72 percentage points to 47.37%. Thus the price of attracted resource continued its downward trend and for 2022 interest costs decreased to BGN 932 thousand despite the increase in the resource volume.

In 2022 the Bank realized a net profit of BGN 2.433 million. The result is significantly better than in 2021, when the Bank stated a net loss of BGN 492 thousand, and is due to both the increase interest and fee income and the difference in the impairment and provisions accrued.

1. ***Operating income and expenses***

In 2022, the Bank generated operating income before impairment and loss provisions at the amount of BGN 16.863 million (The rise in interest rates and the unstable market situation in the past year as a result of the disruption of some logistic chains due to the sanctions imposed against Russia resulted in some changes in the revenue structure (Table 1). In 2022 the share of the net interest income decreased by 1.12 p.p. and reached 58.33% of total revenue, while non-interest revenue retained its share, holding 41.67% (to compare – in the same period of last year these values were respectively 59.45% and 40.55%). The changes in the structure may be explained with the negative trend in revenue from the second category, which decreased by 1.12% on an annual basis (as a result of the lower rental income due to the disposal of some of the properties).

Table 1), which is BGN 2.652 million (18.66%) more than in 2021. Its dynamics over the past year was still influenced most of all by the effect of a moderate increase in interest rates in the country, resulting in the partially slower increase in gross interest income on loans, which while the volume of the performing portfolio increased by 12.95%, increased in the past year by 7.23% (BGN 662 thousand). The growth rate in interest income is negative (-15.20%), and the amount thereof was lower than in the prior year, mainly due to the limited number of agreed-maturity deposits (whose share in the overall structure of attracted resources decreased by 3.72 p.p.).

In 2021, the Bank continued to adhere to the adopted conservative policy regarding administrative expenses. As part of this policy, the management exercises systematic control over expenditure, which in the conditions of intensive consumer price growth results in a moderate increase in most costs within this category, as a result of which the total amount thereof in the past year grew by BGN 1.034 million (to 13.742 million).

The ratio of the total volume of operating expenses to the total operating income for the past year decreased by 7.93 percentage points (to 81.49%), which is due both to the above mentioned limited increase of operating expenses by BGN 1.034 million, and to the increase in overall operating income before impairment and loss provisions by BGN 668 thousand (from BGN 14.211 million in 2021 to BGN 16.863 million in 2022).

The rise in interest rates and the unstable market situation in the past year as a result of the disruption of some logistic chains due to the sanctions imposed against Russia resulted in some changes in the revenue structure (Table 1). In 2022 the share of the net interest income decreased by 1.12 p.p. and reached 58.33% of total revenue, while non-interest revenue retained its share, holding 41.67% (to compare – in the same period of last year these values were respectively 59.45% and 40.55%). The changes in the structure may be explained with the negative trend in revenue from the second category, which decreased by 1.12% on an annual basis (as a result of the lower rental income due to the disposal of some of the properties).

Table 1. Operating income

	2022	*2021*
Interest income	10,769	9,548
Interest costs	(932)	(1,099)
Net interest income	**9,837**	**8,449**
Income from fees and commissions	4,926	4,052
Expenses for fees and commissions	(366)	(291)
Net income from fees and commissions	**4,560**	**3,761**
Net profit from financial assets held for trading	**495**	**387**
Other operating income (expenses)	**1,971**	**1,614**
Total operating income	**16,863**	**14,211**

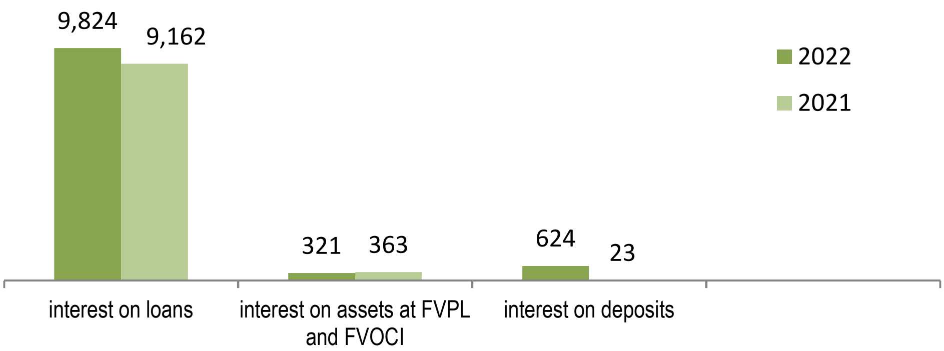
The gross income from interest on loans and other receivables increased by BGN 662 thousand to BGN 9.162824 million and continued to have the biggest relative share as compared to the total amount of interest income, which is due to the increase in performing loans and the general market trend of increase in interest rates. The main factor for the lagging behind rate of increase in gross revenue from the loan portfolio of Tokuda Bank AD is the retention of a low spread compared to reference indices aimed at ensuring the best conditions for Bank's clients compared to the current market levels. The effect of the relieved conditions is partially offset by limiting the share of non-performing exposures, which decreased by 2.27 percentage points to 9.47%). There was a positive growth in loan interest income (7.23% compared to 4.99% in 2021), however, against the background of the faster rate in interest income on deposits in 2022, the share of interest income on loans decreased by 4.73 percentage points compared to last year, reaching 91.22% at the end of the period.

Interest income from the debt instruments portfolio (Figure 6) decreased by BGN 42 thousand (or by 11.57% compared to the figure stated in 2021), to BGN 321 thousand for the past year, on the one hand due to portfolio amortisation and the sales made at the end of 2020 and the beginning of 2021, accompanied by intensive purchases, resulting in replacing the issues recognized in the Bank's balance sheet with new ones whose profitability is lower due to the market conditions. The accelerated rate of shrinkage of income from this source results in a noticeable decrease in the share of the first category in the total amount of interest income – from 3.80% to 2.98%.

A logical result of the continuing increase in interests on interbank deposits and their reaching positive values (resulting from effective transfer of the effects of the Eurozone's quantitative easing policy), the overall amount of revenue from this source increases by multiple times, reaching BGN 624 thousand (compared to BGN 23 thousand in 2021). The effect of the continuing increase in interest rate on this type of revenue is supported by the increase of the average annual amount of this group of assets in the past period (BGN 56.370 million in 2022 against BGN 45.992 million for the previous year).

The price of attracted funds remained above the average level for the country's banking system, as individual and household deposits maintained their relatively big share in the Bank's deposit base (73.44% versus 73.81% for the prior year). As a result of the relatively high share of fixed-maturity deposits initially contracted at interest rates lower than the effective ones, interest costs in the past year decreased by BGN 167 thousand (to BGN 932 thousand for 2022).

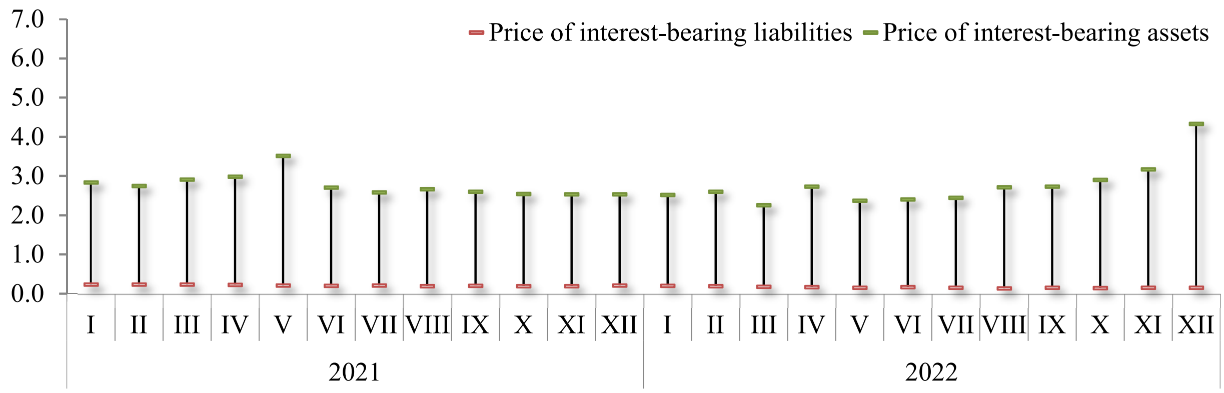
Figure 6. Interest income by sources (BGN million)



In 2022, the interest spread maintained its prior-year level (Figure 7), and during most of the reporting period the indicator varied within a relatively narrow range (2.3-2.7). The exception was the months of November and December, when the spread increased to 3.01 and 4.18 as a result of the recognition of court and awarded interest on some of the biggest non-performing exposures of the Bank. The comparison of the profitability of interest-bearing assets shows that over the past year, the average weighted profitability ratio increased by 8 b.p. (from 2.74% for 2021 to 2.82% for 2022), mainly as a result of the higher market interest rates, but also due to restricting the share of classified loans with delays on principal and interest payments by more than 180 days. Another factor that contributed to the spread increase was the decrease in the expense rate for attracted funds, which on decreased by 8 b.p. per annum on average – 0.21% for 2021 to 0.17% for 2022.

The moderate fees on higher current account balances and retaining more favourable (compared to the widespread) interest on fixed-term deposits in 2022 resulted in relatively slight changes in the maturity structure of attracted funds, and in the past year the share of current accounts increased by 3.72 percentage points (to 52.63%). This also supports a decrease in the price of the attracted resource, along with the increased reference indices realization of additional proceeds (from collected court receivables) in the past year had a positive effect on the interest spread. Thus the aggregate indicator in 2022 reached 2.66% (compared to 2.52% for the prior year).

Figure 7. Interest spread components (%)



Non-interest income

In 2022, non-interest income increased by BGN 1.264 million (21.94%) on an annual basis, reaching BGN 7.026 million, which is mainly due to the operating result, but also to the increase in revenue not related to principal activities. In the past year, other operating income increased by BGN 357 thousand (from BGN 1.614 million in 2021 to BGN 1.971 million in 2022).

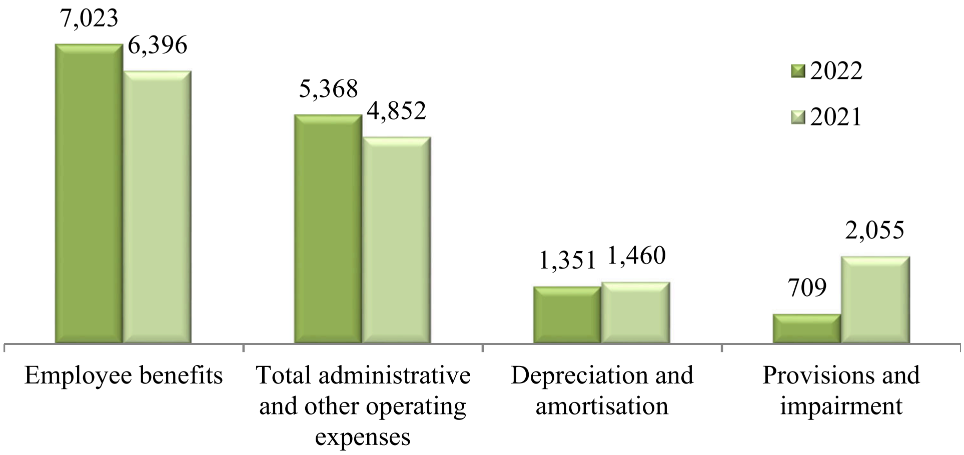
The largest share in this group of income remained that of net income from fees and commissions, which marked an increase by BGN 799 thousand (or 21.24% on an annual basis) to BGN 4.560 million as a result of the increased income from servicing of accounts, cards, and available cash. These increases were partly compensated for by the lower income from charges on cash transfers, which in the past year decreased by a total of BGN 104 thousand. The structure of receipts from fees and commissions over the past year did not undergo significant changes, and the biggest increase was that of fees on servicing accounts (9.01 percentage points, up to 33.41% of gross fees income), and the biggest shrinkage was that of transfers (1.33 percentage points, down to 18.88% of gross fees income).

The weakening expectations for subsequent increases in the main interest rates, which are gradually decreasing against the background of the aggravating military conflict and the slowing price increase rates have a favourable impact on the income from trade in securities, as a result of which the net trading income grew to BGN 495 for the past year (versus BGN 387 thousand from 2021).

Non-interest expenses

The Bank's non-interest expenses in 2022 amount to BGN 14.451 million (Figure 8), which is by BGN 312 thousand or 2.11% less than the preceding year. This is due to the decrease in the costs for impairment of non-financial assets by BGN 1.346 million compared to 2021, and to the BGN 109 thousand lower depreciation and amortisation expense. There is an increase in the other categories, reaching BGN 627 thousand in employee benefits expense (which increased to BGN 7.023 million as a result of catching up with the overall increase of employee benefits increase in the country). The other administrative operating expenses grew by BGN 516 thousand, reaching BGN 5.368 million in the past year as a result of the overall increase in price indices in the past year.

Figure 8. Non-interest expenses (BGN million)

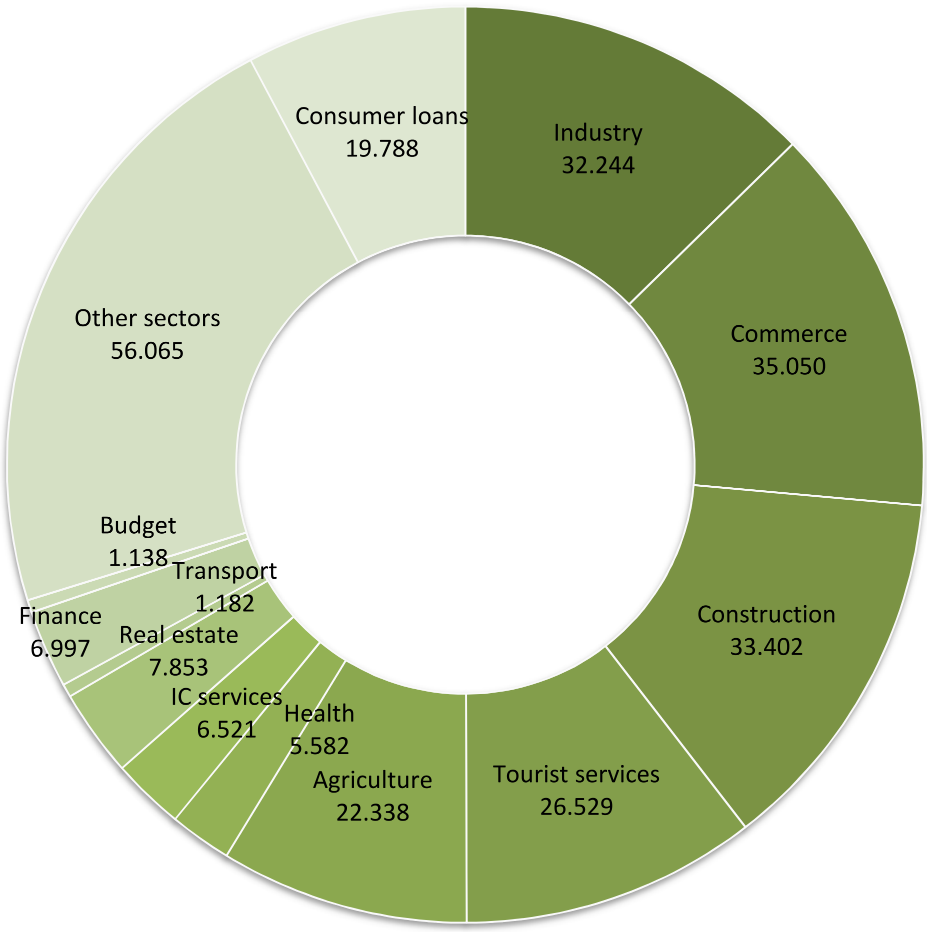


The clearly expressed dynamics of most portions of expenses in this group results in a change in its overall structure. For instance, the share of personnel expenses (including the labour remunerations and social security contributions) in the overall structure of non-interest expenses increased by 5.27 percentage points (from 43.32% to 48.60% over the past year), the share of total administrative and other operating expenses increased by 4.28 p.p. to 37.15%, and amortisation and depreciation costs in 2022 were 0.54 percentage points lower compared to the preceding year. The share of provisions and impairment expenses decreased by 9.01 p.p.

2. ***Loan portfolio***

At the end of 2022, the gross carrying amount of the Bank's loan portfolio (Figure 9) was BGN 254.689 million. After accounting for the allowance for credit losses at the amount of BGN 6.928 million, the net amount of the portfolio is BGN 247.761 million. The moderate increase is due to the uncertain indicators of the business climate and the retention of the high risk of the environment, but also to the intensified activity of collection of receivables classified in the "loss" group. The rate achieved somehow exceeds that of overall assets, which on its part resulted in an increase in the share of the loan portfolio following impairment in the overall assets structure by 1.35 percentage points – to 53.90% of the total assets at the end of 2021, against 52.55% in the previous year.

Figure 9. Loan portfolio allocation [BGN million]



The loans to corporate customers increased by BGN 14.439 million (to BGN 191.961 million before impairment), and their share in the gross amount of the credit portfolio (up to 75.37%) remained close to the one achieved in the prior year (to 76.00%), which is due to maintaining almost complete correspondence between the structure of lending activity and that of the existing credit portfolio.

The changes in the "*individuals and households*" segment were due to the intense activity in this category of borrowers. This segment's share increased from 23.44% in the structure of gross loans in 2021 to 24.18% in 2022. In an absolute value, the segment marked an increase 1/5 higher than last-year's growth, amounting to BGN 6.846 million, which is a growth of 12.51% compared to the previous year, when its share in the overall portfolio structure increased by 0.75 percentage points due to the faster growth compared to exposures to corporate clients.

In 2022 the Bank continued its traditional business with entities from the industry, commerce, construction, tourism, agriculture, healthcare, and other sectors. The share of loans to the trade sector in 2022 increased by 3.15 percentage points and now holds the biggest relative share (13.76%) in the loan structure, while industry dropped from second to third place despite the partial increase in its share by 0.54 p.p. (to 12.66% of gross loans) as a result of the effect of the sanctions imposed against the prices of raw materials. It was overtaken by construction, whose share increased by 1.33% (to 13.11%). The fourth place, like last year, was taken by tourism, followed by agriculture (8.77%), real estate (3.08%) and finance (whose share increased by 1.18 p.p. to 2.75%, as a result of which the sector climbed from 9th place in 2021 to 7th place in 2022).

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

To address the increased environment risk caused by the sanctions imposed against the Russian Federation and the relatively high inflation rate, the Bank continues to adhere to the list of identified (severely affected) sectors that it approaches with increased attention and only by exception, in case of inquiries for financing. In order to address the new challenges, this list was updated and made precise, and the Bank continues to maintain increased direct contact with existing borrowers, companies and individuals, in view of provision of timely information about trends in the businesses financed.

The changes in the portfolio's currency structure are moderate. The share of EUR-denominated loans has increased by 6.05 percentage points (to 16.51% of the carrying amount of the loan portfolio after impairment), which is mainly offset by BGN-denominated loans (increasing by 5.69 percentage points – to 82.95% of the carrying amount of the loan portfolio following impairment) and USD-denominated loans taking up 0.54% of the portfolio at the end of the past year.

Table 2.Loan portfolio allocation by classification groups under IFRS 9 (BGN million)

	2022			2021		
	gross amount	provisions according to IAS	carrying amount	gross amount	provisions according to IAS	carrying amount
Serviced	230,562	632	229,930	206,164	496	205,668
Unserviced (non-performing)	24,127	6,296	17,831	27,426	7,687	19,739
Total	254,689	6,928	247,761	233,590	8,183	225,407

Pursuant to one of its strategic objectives, in the past year the Bank managed to shrink the share of non-performing loans by 2.27 percentage points, to 9.47% of the gross amount of loans to and receivables from customers. Continuing this trend is becoming an even greater challenge given the continuing military conflict and the growing risk of recession, which is related to expectations for a delay in the growth rate of real income, incomplete employment, as well as growing environment uncertainty (to which the repeated interruptions of the new political cycle also contributed). The above factors will continue to put pressure on consumption patterns, hence – on the lending rate, which may result in a delay in lending activity and in the process of improving the portfolio quality.

In order to cover the risk of losses from loan impairment and in accordance with the requirements of IFRS 9, as at 31 December 2022 the Bank charged an allowance for expected credit losses at the amount of BGN 6.928 million, and the coverage coefficient has decreased from 3.50% to 2.72% due to write-off of impairment at the amount of BGN 1.656 million. The coverage of impairment provisions for performing loans increased by 6 b.p. compared the prior year (from 0.24% to 0.27%). Nearly the entire impairment (90.88%) has been allocated to unserviced (non-performing) receivables (Table 2).

3. ***Securities***

The securities portfolio has increased at the end of 2022 by BGN 35.875 million, to BGN 80.516 million. Thus, its share in the total assets amount has increased by 7.11 p.p. compared to the prior year, reaching 17.52%. The change rate is intensive (80.36%), as far as against the background of the slowing inflation indices and the growing expectation for forthcoming discontinuing of the monetary tightening policy cycle by ECB the Bank may increase the share of fixed-income instruments within the overall structure of assets without resulting in a significant increase in the risk of adverse changes in the profitability indicators. The increase in the volume of this category of assets is the result of a careful re-assessment of the Bank's recent policy aimed at re-positioning assets towards decreasing the share of low-income components as a result of the change in risk/profitability ratios in segments within this structure.

Most of the securities (55.75%) are classified within the portfolio of securities at amortised cost, and the carrying amount of this category in the past year grew from 0 to BGN 44.877 million. The securities measured at fair value through other comprehensive income continued to decrease, from BGN 2.953 million at the end of 2021 to BGN 249 thousand as at 31 December 2022.

Table 3. Securities portfolio (carrying amount) (BGN million)

	2022-12-31	2021-12-31
Stocks and shares in local enterprises	630	542
Bulgarian government securities (including Eurobonds)	36,207	31,041
Foreign government securities (including Eurobonds)	43,679	13,058
Corporate bonds of local and foreign issuers	-	-
TOTAL		**80,516**

Over the past year, there has been an increase in investments in foreign government securities by BGN 30.621 million (to BGN 43.679 million), while their share in the overall securities portfolio increased by 25.00 percentage points (to 54.25%). Regarding local government securities

(Bulgarian government securities and Euro bonds) there is a more moderate growth, which in 2022 was BGN 5.166 million. Thus the carrying amount of assets in this category grew to BGN 36.207 million, while its share in the overall structure shrank by 24.57 p.p. (to 44.97%) due to its slower pace compared to foreign sovereign securities (respectively 234.50% versus 16.64%).

Apart from investments in foreign government securities, there has also been a decrease in the share of local entities, whose carrying amount in 2022 increased by BGN 88 thousand to BGN 630 thousand, but due to the slower growth rate of this category its share in the overall structure decreased from 1.21% to 0.78% at the end of 2022.

4. __Attracted funds__

In 2022, the volume of attracted funds from customers increased by 8.18% and in the end of the year reached BGN 412.932 million. To some extent the effect of uncertainty in the economy was reflected into an increase in the savings of non-financial entities and the population, hence – into the banking system's liquidity. The sources of most of the Bank's attracted funds are persons and households (Table 4). In the past reporting period, the share of resources from this source has slightly decreased – by 0.37 p.p. (to 73.44% of the overall structure), mainly as a result of the Bank's purposeful efforts to maintain a stable structure of the resource. The changes are mainly at the expense of the lower share of term deposits by persons and households (by 3.57 p.p. to 41.18%), which is mainly offset by an increase in on-demand deposits from the same source, whose share increased by 3.20 p.p. to 32.26% at the end of 2022, as a result of which these deposits retained their second place in the structure of liabilities.

There are similar changes in the attracted funds from corporate clients, which also increased the share of current accounts (by 1.37 b.p. to 17.99%) and decreased that of term deposits (0.14 b.p. to 6.14% of attracted funds). The deposits of budget entities decreased their share by 0.90 percentage points – from 2.78% to 1.88%. The retention of the low share of attracted funds from non-banking institutions is explicable against the growing indicators for liquidity in the banking system. Over the past year, deposits from this source increased by BGN 328 thousand, and their share in the overall structure of attracted funds changed insignificantly from 0.51% to 0.55%.

Tokuda Bank is no exception from the banking system and keeps maintaining high liquidity, thus preserving a weak interest in attracting any resource from banks. The total amount of deposits from credit institutions in the past 2022 holds a negligible share of the Bank's liabilities (0.01%), decreasing from BGN 65 thousand to BGN 49 thousand at the end of 2022.

Table 4. Structure of attracted resources (BGN million)

	2022			2021		
	On-demand and savings deposits	Fixed term deposits	Total	On-demand and savings deposits	Fixed term deposits	Total
Accounts of local individuals	133,206	170,060	303,266	110,917	170,833	281,750
Budget accounts	7,748	0	7,748	10,603	0	10,603
Company accounts	74,294	25,339	99,633	63,434	23,966	87,400
NBFIs accounts	2,085	200	2,285	1,757	200	1,957
TOTAL	217,333	195,599	412,932	186,711	194,999	381,710

In 2022, activities continue for optimisation of the funding price and maturity structure of liabilities, including the management of fees on current account balances. As a result, the average contracted price of the resource in 2022 has decreased, from 0.21% to 0.17%, and its structure has been retained, and the share of fixed-term deposits shrank by 3.72 percentage points to 47.37%, while the share of on-demand deposits increased to 52.63%.

The changes in the currency structure of the attracted funds are insignificant and in favour of the single European currency, whose share over the last year increased from 36.79% to 39.48%, mainly at the expense of deposits denominated in BGN, whose shares decreased from 52.49% to 50.60%, and USD, which decreased by 0.76 p.p. to 9.37%. The shares of deposits denominated in JPY remained almost unchanged (0.03%), and deposits in other currencies (CHF, GBP) decreased by 0.05 p.p. and at the end of the period reached respectively 0.51% of the overall structure.

5. *Risk exposure*

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

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

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

Cash and cash balances with the Central Bank amount to BGN 95,441 thousand as at 31 December 2022 (respectively BGN 73,010 thousand as at 31 December 2021) and do not bear a credit risk to the Bank due to their nature and the fact that they are at the Bank's disposal.

Loans and receivables from credit institutions as at 31 December 2022 amount to BGN 7,571 thousand (respectively BGN 47,450 thousand as at 31 December 2021) and represent mostly deposits in first-class international and Bulgarian financial institutions with maturity of up to 7 days. The Bank manages the credit risk associated with loans and receivables from credit institutions, by setting exposure limits at counterpart level.

Loans to and advances to customers, with a carrying amount of BGN 247,761 thousand as at 31 December 2022 (respectively BGN 225,407 thousand as at 31 December 2021), expose the Bank to credit risk. In order to assess it, the Bank analyses the individual risk of each exposure by applying the criteria for risk assessment and classification according to the Policy for impairment of financial assets and contingent liabilities.

As at 31 December 2022, in order to calculate exposures to credit risk, Tokuda Bank AD applies the standard approach pursuant to Regulation (EC) No 575/2013. Due to the relatively small volume of financial instruments in the trading portfolio, capital requirements are calculated in accordance with the requirements of Regulation (EC) No 575/2013, applicable for the banking portfolio. To calculate the amount of capital necessary to cover operating risk losses, the basic indicator approach is applied.

Regarding **liquidity risk** (arising from the maturity gap of the assets and liabilities and the probable lack of sufficient funds of the Bank to meet its obligations on its current financial liabilities), it should be pointed out that Tokuda Bank maintains a high amount of liquid assets in the form of cash in hand and cash balances with the Central Bank, which guarantee the Bank's ability to meet its liquidity requirements. As at 31 December 2022, the Bank's cash and cash balances with the Central Bank represent 20.76% of the Bank's total assets (respectively 17.02% as at the end of 2021).

As an additional instrument to ensure liquidity, the Bank uses loans granted to banks. These comprise mostly deposits in first-class international and Bulgarian banks, with maturity of up to 7 days. As at 31 December 2022, loans and receivables from banks constitute 1.65% of the Bank's total assets (respectively 11.06% as at the end of 2021).

High-liquidity bonds owned by the Bank and not pledged as collateral as at 31 December 2022 amount to 15.70% of the Bank's total assets (compared to 7.76% at the end of 2021). By maintaining above 30.00% of its assets in highly liquid assets, the Bank ensures its ability to meet all its payment needs on matured financial liabilities.

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

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

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

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

In 2022, Tokuda Bank AD continued adhering to a conservative approach in risk management and assessment, including with respect to credit risk, forming 87% of all risk exposures as at 31 December 2022. The Bank takes actions to a balanced decrease the risk on all credit exposures (mostly at the expense of the portfolio of non-performing loans), as a result of which the share of risk-weighted assets for credit risks remained almost unchanged. Overall risk exposure has decreased by BGN 12.404 million compared to 31 December 2020, to BGN 209.477 million as at 31 December 2022.

Table 5 Risk-weighted assets

	2022-12-31		2021-12-31		change	
	BGN million	*share*	*BGN million*	*share*	*BGN million*	*rate*
For credit risk	183.289	87%	196.093	88%	-12.804	-7%
For market risk	0.5	0%	0.863	0%	-0.363	-42%
For operating risk	25.688	13%	24.925	12%	0.763	3%
Total	**209.477**	**100%**	**221.881**	**100%**	**-12.404**	**-6%**

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

6. Capital and reserves

As at 31 December 2022, the Bank's equity amounted to BGN 41.330 million, and the common equity according to the capital adequacy requirements for credit institutions is BGN 38.540 million.

The Bank's capital indicators are above the regulatory limits. Its capital position ensures an adequate coverage of risk exposures. The adequacy of the core Tier 1 capital has decreased compared to the previous year (by 15 basis points), reaching 18.40%, which exceeds the required regulatory limits.

As at 31 December 2022, the share capital amounts to BGN 68,000,000 /sixty-eight million/. The capital is allocated in 6,800,000 /six million and eight hundred thousand/ registered, non-materialised shares entitled to vote, with a nominal value of BGN 10 /ten/ each, and with an emission value equal to the nominal value.

According to the Book of Shareholders kept at the Central Depository, the Bank shareholders as at 31 December 2022 have remained, as follows:

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

7. Branch network

The Bank has a total of 17 offices and remote workplaces in the country. The regional structure ensures fast access to potential clients of the Bank, since the offices are located in the main administrative centres in the country, and the organisational and management structure provide conditions for direct and effective contact with existing and future clients, in view of offering solutions that meet their needs. In order to optimise the Bank's operations, in 2022 the Bank closed down the Sliven, Haskovo, and Hemus-Sofia offices. The optimisation was carried out without a significant outflow of clients.

The structure of the branch network as at 31 December 2022 is as follows:

- Headquarters
- Offices – 15 nos.
- Remote workplaces – 2 nos.

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

8. Relations with correspondents

The Bank corresponds to all Bulgarian banks, as well as to leading banks abroad, following a policy for continuous optimization and expanding its relations with correspondents. The Bank uses the services of two local services for custodian servicing of its activities for acquisition and disposal of financial instruments on the Bulgarian and/or foreign markets.

9. Human resources

The human resource is a key factor for achievement of the strategic objectives of the Bank, which was proven to a higher degree in the situation created by the COVID-19 pandemic, followed by the continuing conflict in Ukraine. The Bank's management has been developing a human resource management system through continuous optimization of the staff administration processes (planning, recruitment, appointment, monitoring, assessment, promotion and dismissal). In 2021 the number of employees decreased from 211 to 206 at 31 December 2022. This change is due to the closed divisions in the regional structure, which is partially offset by the recruitment of new employees in the office network and the head office.

A determining factor for fulfilling the Bank's mission and strategy is the quality of its employees – their qualification, professional skills, and loyalty. The Bank's employees take part in a number of trainings and communications related to the functions performed thereby, since improving qualifications is one of the main and proven means to improve the working environment, service quality, and Bank's performance. An effect of the forced restructuring of operations in the pandemic was the fast switch to remote communication and staff training. The team of Tokuda Bank faced the challenges with high commitment, adequate reactions, and maintained the Bank's operations throughout all periods of increased risk.

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

10. Information technologies

In the past year, the process of development of the upgraded electronic banking platform continued; the platform is an important channel for customer service in the conditions of limited physical contact. The Bank continues the promote the software platform upgraded in 2019 servicing the debit and credit cards issued by the Bank was completed. The initiatives aim to improve the quality of customer service and provide reliable information about the behaviour of Bank clients. One of the challenges in this area in 2023 will be to use the functionalities of the new systems in a way to support the better realization of Tokuda Bank's card products.

III. Development prospects in 2023

In 2023 the banking system will face various challenges, most of which are directly related to the uncertainty regarding the events in Ukraine and the sanctions related thereto. At this stage there are no grounds to expect that the conflict will be resolved soon, nor that balanced solutions will be reached when structuring subsequent sanction packages – just the opposite. Most member states confirm their intention for final severance of economic relations not only with Russia, but also with the countries that make it possible to find ways to circumvent the restrictions imposed. This on its part presupposes the formation of more moderate expectations to the economy, hence – to the banking system in the short term, namely the possible weakening in the growth in lending and the drop in profitability and sustainability indicators in 2023.

The concentration in the banking system will probably continue to grow, like throughout the period since the beginning of the pandemic (just in 2022, the share of the five biggest banks increased from 66.7% to 67.0%), as far as in the conditions of digitalization and transformation of banking services the migration of client mass will continue to focus on bigger banks that make bigger investments in developing new market realization channels and more active information channels for dissemination thereof.

The consolidation pressure will remain high as a result of the higher uncertainty of the environment, but also as a result of introducing new requirements related to the introduction of universal standards for reporting the environmental footprint of banking activities (developing models to assess environmental risks, building systems of rules and procedures to implement additional requirements on the procedure for applicant's assessment and approval, supplementing reports with new components, etc.).

Another focus in the sector's development until 2025 is the effect of the economic and legislative reforms related to Bulgaria's joining the Eurozone. The violation of the inflation criterion and the delay in the procedure for passing some of the legislative acts mandatory for harmonization resulted in the formal postponement of the indicative data announced for closing the currency mechanism period. Along with that there is pressure for another acceleration of the procedure, because after the necessary number of signatures were collected (over 600,000) to hold a national referendum on the matter, accelerated adoption (before a date is scheduled for a referendum) is the only possible way to close the process.

As a whole, the Bank's operating plan for 2023 envisages continuing the actions taken to optimise business processes and complete ongoing projects, as well as taking targeted measures for organizational and technological improvements aiming to help the Bank meet the latest regulatory requirements, customer needs and business expectations.

The Bank has developed a capital plan for the 2023-2026 period, indicating the means and mechanisms to ensure coverage of regulatory requirements in view of forthcoming changes as a result of the latest amendments of the European Regulations. The document was approved by the SB by means of decision No 271/15.12.2022 and is included as an integral part of ICAA.

Currently, the Bank's management intends to maintain a moderately conservative policy upon performing its main operations, in view of the further improvement its profitability indicators, and conduct active marketing campaigns in order to increase market share. The main objective for 2023 remains unchanged and is intensification of lending activity and improvement of the portfolio quality. The preliminary estimates in the financial plan show that the planned growth in activity may be achieved, as far as the Bank has a relatively small market share and has the potential to achieve lending rates that are above the average ones for the system.

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

In short, the main priorities for the Bank's development in 2023 have been retained in the way they were set upon determining its mid-term strategy, and may be summarised as follows:

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

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

1. *Changes in the share capital*

In 2022 there were no changes in the volume and structure of the Bank's share capital. The majority shareholder, holding 99.94% of the capital, is Tokushukai Incorporated, Japan. As at 31 December 2022, Tokuda Bank AD does not possess any own shares.

2. *Management*

In 2022, the Bank preserved its two-layer management system. The composition of the Management Board and the Supervisory Board remained unchanged.

As at the date of preparation of the financial statements, the members of the management bodies of the joint-stock company are as follows:

Bank's Supervisory Board

Arthur Sterne – Chairperson of the Supervisory Board;

Thomas Michael Higgins – Member of the Supervisory Board;

Chris Matlon – Member of the Supervisory Board.

Bank's Management Board

Dimitar Vouchev – Chairperson of the Management Board and Executive Director;

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

Todorina Doktorova – Member of the Management Board and Executive Director;

Savka Yondova – Member of the Management Board and Executive Director.

The total amount of remunerations received over the reporting year by members of the Supervisory Board is BGN 72 thousand (respectively BGN 72 thousand in the prior year). The total amount of remunerations received over the reporting year by members of the Management Board is BGN 491 thousand (respectively BGN 479 thousand in the prior year).

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

3. Dividend policy

In 2022 the Bank did not pay dividend. The 2023 strategy does not envisage the payment of dividends for prior years or the current year.

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

As from 5 February 2023, a ban has been in effect on the import of refined oil products from the Russian Federation in the EU. Under way is the structuring of an 11th package to focus mainly on overcoming omissions in the measures imposed so far. Along with that, the country's economic indicators will be impacted by the political instability and the continuing uncertainty surrounding the approval of the 2023 budget. The latter's unforeseeable nature makes it difficult to assess the end effects thereon on the Bank's business, respectively – the parameters of its future activities. The general expectation is that the effect of the sanctions introduced last year will be greater on indicators in the actual sector, which might put some pressure on lending activities, on the quality of loans already disbursed and on the value of certain categories of assets. It is the management's initial assessment that at this stage it is not possible to identify circumstances and factors that may contest the validity of the going concern principle.

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

Supervisory Board:

- Arthur Sterne – Chairperson of the Supervisory Board: shareholder and General Manager of Global Prime OOD, UIC 203874715;
- Thomas Michael Higgins – Member: shareholder (46% of the capital) in EASTISOFT Inc.; shareholder (13.3% of the capital) in YATOTO Inc. /USA/; Member of the Board of Directors and shareholder (27.5% of the capital) in EMP Invest Bulgaria AD with UIC 203120042; member of the management body of YATOTO EOOD with UIC 203831062; member of the supervisory body of Foundation for Business and Education with UIC 131468813;
- Chris Matlon – Member of the Board of Directors of America for Bulgaria Foundation (non-profit).

Management Board:

- Dimitar Vouchev – Member: owner and General Manager of Delta Capital EOOD, UIC 175278566; Member of the Board of Directors of the America for Bulgaria Foundation (NPO); Member of the Board of Directors of Partners Bulgaria Foundation (NPO);
- Anna Tsankova-Boneva – Executive Director: owner of the shares in Fine Line EOOD, UIC 201758352;
- Savka Yondova – partner in SE Zlaten Ogan OOD, UIC 21215822.

V. Responsibility of the management

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

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

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

VI. Activities in the field of research and development

Due to the specifics of its operations, in 2022 the Bank did not perform any activities in the field of research and development.

VII. Activity as investment intermediary

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

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

In 2022 and up to the date of this Report, there have been no tax consultations or any other forbidden services performed by either of the two audit firms – AFA OOD and ABVP-AUDIT STANDARD OOD, which carried out a joint independent financial audit of the Bank's annual financial statements for 2022. Over this period, the audit firms and their network companies have carried out the following permitted services:

- Agreed-upon procedures for the application at the Bank of Ordinance 10 of the Bulgarian National Bank (BNB) for the period 1 January 2022 – 31 December 2022 in compliance with the requirements of the International Standard on Related Services (ISRS) 4400 "Engagements to perform agreed-upon procedures regarding financial information" – the engagement was undertaken and performed jointly by the two audit firms, AFA OOD and ABVP-AUDIT STANDARD OOD;

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

Dimitar Vouchev	**Anna Boneva**
Chairperson of the Management Board and Executive Director	Member of the Management Board and Executive Director

ТОКУДА БАНК СОФИЯ

Sofia, 27 April 2023

CORPORATE GOVERNANCE STATEMENT OF TOKUDA BANK AD

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

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

In 2022, Tokuda Bank AD (the Bank) continued to comply, where appropriate, the National Corporate Governance Code (NCGC, the Code), published on the web page of the Bulgarian Stock Exchange AD (BSE), approved by means of decision No 461-ККУ dated 30.06.2016 of the member of the Financial Supervision Commission (FSC) acting as Deputy Chair of the FSC responsible for the Supervision of Investment Activities Directorate, as corporate governance code pursuant to Art. 100m, Para 8, p.1, letter "a" from POSA, last amended on 1 July 2021, approved by FSC decision dated 25 November 2021.

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

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

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

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

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

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

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

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

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

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

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

- SB – performs overall supervision over risk management; approves the Bank's development strategy, on which the institution's risk profile and risk appetite depends; approves a plan, budget and measures for the realization of the strategy and monitors their implementation. It appoints the head of the Risk Monitoring and Management Division (RMMD) and receives periodic and regular reports from the management, including capital management and capital plan; approves and confirms the capital plan prepared by RMMD and approved by the MB.

- MB – responsible for overall approach to risk management and for the approval of the plan, budget, principles and specific methods, techniques and procedures for risk management, as well as for approving the capital plan.
- RMMD – a specialised Bank unit for risk analysis, management and monitoring. The Division's functions are independent from the business units and from the units performing legal compliance and internal audit functions. The Division reports directly to the Bank's SB.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Units which perform risk-taking functions:

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

deposit of funds with other banks, and if necessary provides support in establishing correspondent relations.

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

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

As at 31 December 2022, the Bank has no direct or indirect shareholdings within the meaning Art. 85 of Directive 2001/34/EC.

As at 31 December 2022, the shareholder structure of the Bank is as follows:

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

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

4.2. The Bank has not issued shares with special rights of controls and has no shareholders, which own shares with special control rights;

4.3. The Statute of the Bank does not specify restrictions over voting rights of shareholders.

4.4. The rules that establish the appointment or change of the MB and SB and changes in the Statute:

- Statute of Tokuda Bank AD;
- Policy of Tokuda Bank AD;
- Rules on identification, management and prevention of conflicts of interests;
- Policy on selection and assessment of the fitness of the members of the Management Board and key employees of Tokuda Bank AD;
- Rules for activities of the Supervisory Board of Tokuda Bank AD;
- Rules for activities of the Management Board of Tokuda Bank AD.

4.5. The powers of the members of the Supervisory Board and Management Board of the Bank are established in:

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

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

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

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

The SB currently consists of three members, elected by the General Meeting of Shareholders for a five-year term.

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

The members of the SB as at 31 December 2022 are:

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

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

As at 31 December 2022, the members of the MB are:

- Anna Tsankova-Boneva – Member of the MB and Executive Director;
- Todorina Doktorova – Member of the MB and Executive Director;
- Dimiter Voutchev – Chairperson of the MB and Executive Director;
- Savka Yondova – Member of the MB and Executive Director.

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

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

As at 31 December 2022, the following committees are active within the Bank's structure:

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

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

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

The first level of the Credit Committee consists of: Credit Expert/ Retail Banking Team Manager/ Retail Banking Regional Manager/ Corporate Banking Regional Manager, who is proposing the respective loan transaction, and the Head of the Credit Risk Department – Small and Medium-Sized Customers in the Risk Monitoring and Management Division or the most senior of the following employees: Team/Department Head or Chief Expert of Retail Loans.

The second level of the Credit Committee consists of: Executive Director, Executive Director and Corporate Banking Division Head – votes on loans to legal entities, or the most senior of the following employees: Division/Team/Department Head or Chief Expert of Retail Loans– votes on loans to individuals, Head of the Risk Monitoring and Management Division, Chief Legal Advisor in the Legal Division.

The third level of the Credit Committee consists of: Executive Director, Executive Director and Corporate Banking

Division Head, Head of the Risk Monitoring and Management Division, Head of the Legal Division.

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

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

The Asset-Liability Committee (ALCO) is the main body for management of the liquidity of the Bank. It bears direct responsibility for the liquidity state and daily liquidity management based on decisions of the MB, as well as for the current management of the assets and liabilities. In compliance with the Rules on the organisation and activity of the Asset-Liability Committee of the Bank, ALCO consists of eight members, as follows:

- Executive Director – Chairperson;
- Executive Director – Deputy Chairperson;
- Head of Risk Monitoring Division – Member;
- Executive Director and Head of Corporate Banking Division - Member;
- Head of Office Operations and Customer Service Division – Member;
- Head of Treasury and Financial Markets Division - Member;
- Head of Finance and Accounting Division – Member;
- Chief economist - Member.

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

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

The Court Receivables Committee (CRC) is an operational decision making body at the Bank related to non-performing loans in foreclosure and workouts. CRC performs control over the actions taken by the Workouts and Foreclosure Department. CRC consists of:

- Executive Director in charge of Workouts and Forclosure Department – Chairperson;
- Executive Director – Member;
- Executive Director – Member;
- Head of Workouts and Forclosure Department – Member;
- Head of Legal Division – Member;
- Deputy Head of Monitoring and Risk Management Division – Member.

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

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

As at 31 December 2022, the members of the Audit Committee are:

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

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

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

The Bank ensures diversity by means of:

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

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

Dimiter Voutchev
Member of the Management Board and
Executive Director

ТОКУДА БАНК АД СОФИЯ

Anna Boneva
Member of the Management Board and
Executive Director

Sofia, 27 April 2023

AFA AUDIT FINANCE ACCOUNTING TAX LAW

АБВП ОДИТ СТАНДАРТ

INDEPENDENT AUDITORS' REPORT

To the shareholders of Tokuda Bank AD

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

Opinion

We have audited the financial statements of Tokuda Bank AD ("the Bank"), which comprise the statement of financial position as at 31 December 2022 and the statement of comprehensive income, the statement of changes in equity and the statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2022, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union (EU).

Basis for Opinion

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

Key Audit Matters

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

Key Audit matter	How this key audit matter was addressed in our audit
Impairment of credit losses on loans granted to and receivables from customers	
The Bank's disclosures regarding the impairment of credit losses on loans granted to and receivables from customers are included in *Note 3.2.1.4.* ***Impairment of financial assets****, Note 3.1.2.* ***Determining expected credit losses on loans to and receivables from customers****, Note 31,2,* ***Credit risk*** *and Note 8* ***Loans granted to and receivables from customers*** to the financial statements.	
Loans granted to and receivables from customers represent a substantial proportion (54%) of the Bank's total assets as at 31 December 2022. The gross carrying amount of these loans to and receivables from customers as at 31 December 2022 is BGN 254,689 thousand, and the respective allowance for accumulated credit losses therefrom is BGN 6,928 thousand. The Bank applies an impairment model for expected credit losses (ECL) on loans to and receivables from customers on an individual and portfolio basis, in accordance with IFRS 9. The application of such a model to determine the impairment of credit losses on loans granted and receivables to customers is related to the application of an increased complexity in the calculations and assumptions, as well as the involvement of significant judgements on the part of the Bank's management regarding the identification and the amount of expected credit losses. The key assumptions, judgements and parameters in determining ECL are related to the development of quantitative and qualitative indicators for:	In this area, our audit procedures included, among others: • Inquiries, walk-throughs and obtaining an updated understanding of the Bank's process of monitoring and impairment of credit losses on loans granted to and receivables from customers in the Bank, incl. additional procedures introduced due to the specific social and economic circumstances resulting from the continuing crisis related to the current international situation. We focused on the methodology applied by the Bank, on the internal policy and re-calibrated impairment model used, as well as on changes related thereto made during the current year. Inquiries to Bank experts responsible for the modelling and management of credit risk. • Review and assessment of internal procedures and key controls at organisation level regarding the impairment policy and model, including documentation supporting the model, as well as monitoring and update frequency and justification of the parameters applied. • Obtaining an updated understanding, assessing the design and application, and testing the operational effectiveness of certain key controls appropriate for the audit, over the process of monitoring, staging,

- determining a significant aggravation of the credit quality of exposure, presence of low and/or significantly increased credit risk, and respectively of exposures with objective evidence for impairment – to allocate the individual credit exposures in the respective stages (Stage 1: ***Exposures without a significant increase in credit risk***; Stage 2: ***Exposures with a significant increase in credit risk, but without objective evidence for impairment;*** and Stage 3: ***Exposures with objective evidence for impairment);***
- determining the components ***"probability of default"*** (PD), ***"loss given default"*** (LGD) and ***"exposure at default"*** (EAD). The higher degree of approximation, judgements and estimation uncertainty are inherent to calculations of expected credit losses of loans and receivables on a collective (portfolio) basis in Stages 1 and 2, which depends on the extent to which the Bank has sufficient supporting historical information to test the assumptions used and calibrate the accuracy of the PD and LGD estimates in the impairment model;
- the scope, accuracy and completeness of inputs and the computation logic applied, since the Bank applies model based on incoming parameters from both internal and external sources;
- inclusion of information about the future development of macroeconomic factors, given different scenarios, in determining ECL estimates;
- the assumptions and judgements applied by the management in the review of individually significant credit-impaired exposures at Stage 3, related to the set of probability scenarios regarding the amounts and time allocation of future cash flows and the end outcomes, and regarding the future sale of and collection of cash flows from collaterals;

and determining the amount of impairment of credit losses on loans to and receivables from customers. We involved our IT experts in the testing and assessment of general IT controls in the Bank's internal information system, used in the process of monitoring loans to and receivables from customers and determining expected credit losses.

- Assessing the consistency of application and continuing relevance of the methodology, the specific models to identify credit losses and calculate impairment, as well as the key assumptions and judgements used therein, in accordance with the requirements of IFRS 9 and in the context of the specifics of the Bank's loan portfolio and the availability of internal historical information, as well as data about the parameters' future development. Moreover, reasonableness analysis and assessment were carried out of:
  - the relevance of the criteria to identify a significant increase in credit risk;
  - the appropriateness of the staging of exposures, in accordance with the classification criteria set by the Bank;
  - the calculations of the indicators "probability of default" (PD), "loss given default" (LGD) through checking the assumptions and outputs used;
  - the approach to using forecast data in the models, incl. effects of the continuing crisis related to the current international situation.
- Analysis of the appropriateness of the results obtained as changes to the impairments stated in the context of our understanding of the development of the Bank's loan portfolios and the quality of the available, data. We also tested the mathematical accuracy of certain formulas used to calculate impairment in the models.
- Analysis of the Bank's loan portfolio and other analytical procedures regarding its structure, composition and development trends, incl. the interrelation of trends in the expenses stated for

- determining the impact of the social and economic consequences of continuing crisis related with the current international situation, with respect to the assumptions, judgements, parameters and resulting cash flows therefrom applied in the model.

Therefore, in 2022, the Bank addressed the identified uncertainties by reviewing some assumptions regarding the possibility of deterioration/loss, including differentiation and assessment of the cases that may be related to long-term financial problems experiences by the borrowers themselves and ones resulting from the post-pandemic and the expected aggravation of the macroeconomic environment, causing temporary liquidity difficulties.

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

impairment losses versus trends in loan portfolio development.

- Performing detailed tests and analysis, based on a risk-based sample of loans at all stages, for the purpose of assessing the relevance of the impairment charged of credit losses. For the respective exposures in the sample, the following audit procedures were performed:
    - analysis of the financial position and results of borrowers, and inspection of information and documents related to loan servicing;
    - review of collateral valuation reports of the respective exposures; for some collaterals, we used our expert appraisers regarding the assumptions and methods applied in the valuations of collateral realisable value;
    - analysis and assessment of the key assumptions and judgments made by the Bank's management upon calculation of specific provisions for credit losses on individual exposures at Stage 3;
    - testing and recalculation of the mathematical accuracy of the established amounts of expected credit losses on individual items, incl. versus certain changes in given parameters.

- Performing audit procedures for subsequent events focused on the development of loans granted to and receivables from customers from the abovementioned sample after the reporting date, so as to assess the consistency of the assumptions used by the Bank with respect to expected future cash flows.

- Assessment of the relevance, completeness and adequacy of the Bank's disclosures to the financial statements in relation to the impairment of credit losses on loans granted to and receivables from customers.

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

Information about the fair value estimates of financial assets used for the purpose of fair value measurement of review for impairment is disclosed in *Note 10* ***Non-current assets held for sale****, Note 11* ***Investment property****, Note 14* ***Other assets****, and Note 31.5* ***Fair value*** to the financial statements.

As at 31 December 2022, the Bank states non-current assets held for sale, at the amount of BGN 271 thousand, investment property at the amount of BGN 10,713 thousand, and other assets acquired under non-serviced loans, at the amount of BGN 13,060 thousand, consisting mainly of real estate acquired in exchange for debt from collaterals.

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

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

Due to the fact that the fair value estimates of non-financial assets (investment property, non-current assets held for sale and other assets) of the Bank is characterized by higher uncertainty related to the inputs used and the assumptions for the purposes of

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

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

fair value measurement and/or review for impairment, which may have a significant effect on both the carrying amount of non-financial assets, and the calculation of the Bank's capital adequacy as at 31 December 2022, we have determined this to be a key audit matter.	

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

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

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

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

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

We have nothing to report in this regard.

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

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

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

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

Auditors' Responsibilities for the Audit of the Financial Statements

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

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

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

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

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

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

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

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Additional Matters to be Reported under the Accountancy Act

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

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

Based on the procedures performed, our opinion is that:

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

Additional reporting in accordance with Ordinance No 58/2018 (Art.11) of the Financial Supervision Commission

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

Based on the audit procedures performed and the obtained knowledge and understanding of the Bank's operation and the context of our audit of the financial statements as a whole, the organisation established and applied in relation to the safeguarding of clients' assets complies with the requirements of Art. 3-10 of Ordinance No 58 of the FSC and Art. 92-95 of the Markets in Financial Instruments Act regarding the Bank's activities in its capacity as an investment intermediary.

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

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

- AFA OOD and ABVP-AUDIT STANDARD OOD were appointed as statutory auditors of the financial statements of the Bank for the year ended 31 December 2022 by the General Meeting of Shareholders held on 14 October 2022, for a period of one year.
- The audit of the financial statements of the Bank for the year ended 31 December 2022 represents a fifth consecutive statutory audit engagement carried out by AFA OOD and a sixth total statutory audit engagement carried out by ABVP-AUDIT STANDARD OOD.
- We hereby confirm that the audit opinion expressed by us is consistent with the additional report dated 27 April 2023, provided to the Bank's Audit Committee, in compliance with the requirements of Art. 60 of the Independent Financial Audit Act.

- We hereby confirm that no prohibited non-audit services, referred to in Art. 64 of the Independent Financial Audit Act, were provided.
- We hereby confirm that in conducting the audit we have remained independent of the Bank.

Audit firm
AFA OOD:

Valia Iordanova

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

Audit firm
ABVP-AUDIT STANDARD OOD:

Sevdalina Paskaleva

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

38, Oborishte Street
1504-Sofia, Bulgaria

Nadezhda I Residential Area, block 173, entr. B
1202- Sofia, Bulgaria

27 April 2023

This is a translation from Bulgarian of the Independent Auditors' Report on the Financial Statements of Tokuda Bank AD for the year ended 31 December 2022.

TOKUDA BANK AD
STATEMENT OF FINANCIAL POSITION
As at 31 December 2022

(all amounts are in BGN'000)

	Notes	**31.12.2022**	**31.12.2021**
ASSETS			
Cash and balances with the Central Bank	4	95,441	73,010
Receivables from banks	5	7,571	47,450
Financial assets at FVPL	6	249	2,953
Debt instruments at FVOCI	7	34,999	41,395
Equity instruments at FVOCI	7	381	293
Debt instruments at amortised cost	8	44,887	-
Loans and advances to customers	9	247,761	225,407
Non-current assets held for sale	10	271	1,070
Investment property	11	10,713	15,611
Property, equipment and right-of-use assets	12	2,830	3,593
Intangible assets	12	561	712
Deferred tax assets	13	174	153
Other assets	14	13,822	17,275
Total assets		**459,660**	**428,922**
LIABILITIES			
Deposits from banks	15	49	65
Deposits from customers	16	412,932	381,710
Other liabilities	17	3,390	3,719
Subordinated debt	18	1,959	1,959
Total liabilities		**418,330**	**387,453**
EQUITY			
Share capital	19	68,000	68,000
Reserves	19	730	3,302
Accumulated loss		(27,400)	(29,833)
Total equity		**41,330**	**41,469**
Total liabilities and equity		**459,660**	**428,922**

The accompanying notes 1 to 34 form an integral part of the annual financial statements.

The annual financial statements on pages 1 to 66 were approved for issue by the Management Board of Tokuda Bank AD and were signed on 27 April 2023 by:

Anna Tsankova-Boneva
Member of the Management Board
Executive Director

Dimiter Voutchev
Member of the Management Board
Executive Director

Svetlin Todorov
Finance Director

Financial statements on which our auditors' report was issued dated 27 April 2023

AFA OOD

ABVP – AUDIT STANDART OOD

TOKUDA BANK AD
STATEMENT OF COMPREHENSIVE INCOME
For the year ended 31 December 2022

(all amounts are in BGN'000)	Notes	2022	2021
Interest income		10,769	9,548
Interest expense		(932)	(1,099)
Net interest income	20	**9,837**	**8,449**
Fee and commission income		4,926	4,052
Fee and commission expense		(366)	(291)
Net fee and commission income	21	**4,560**	**3,761**
Net trading income	22	495	387
Other operating income	23	1,971	1,614
Operating income before loss on impairment and provisions		**16,863**	**14,211**
Net loss on impairment of assets and provisions	24	**(709)**	**(2,055)**
Personnel expense	25	(7,023)	(6,396)
Depreciation and amortisation	12	(1,351)	(1,460)
Other administrative and operating expenses	26	(5,368)	(4,852)
Administrative and operating expenses		**(13,742)**	**(12,708)**
Profit before tax		**2,412**	**(552)**
Income tax benefit	27	21	60
PROFIT/(LOSS) FOR THE YEAR		**2,433**	**(492)**
OTHER COMPREHENSIVE INCOME			
Items that may be reclassified to profit or loss			
Net loss from remeasurement of debt instruments at FVOCI		(2,660)	(268)
Reclassification of remeasurement of debt instruments at FVOCI disposed of in the year		-	(5)
Items that will not be reclassified to profit or loss			
Net gain on remeasurement of equity instruments at FVOCI		88	-
Remeasurement of retirement obligations		-	(5)
Total other comprehensive income		**(2,572)**	**(278)**
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		**(139)**	**(770)**

The accompanying notes 1 to 34 form an integral part of the annual financial statements.

The annual financial statements on pages 1 to 66 were approved for issue by the Management Board of Tokuda Bank AD and were signed on 27 April 2023 by:

Anna Tsankova-Boneva
Member of the Management Board
Executive Director

Dimiter Voutchev
Member of the Management Board
Executive Director

Svetlin Todorov
Finance Director

София

Financial statements on which our auditors' report was issued dated 27 April 2023

AFA OOD

ABVP – AUDIT STANDART OOD

TOKUDA BANK AD
STATEMENT OF CHANGES IN EQUITY
For the year ended 31 December 2022

(all amounts are in BGN'000)	Notes	Share capital	Reserves	Financial assets at FVOCI reserve	Accumulated loss	Total
Balance at 1 January 2021		**68,000**	**2,957**	**623**	**(29,341)**	**42,239**
Net loss for the year		-	-	-	(492)	(492)
Other comprehensive income for the year		-	(5)	(273)	-	(278)
Total comprehensive income for the year		-	(5)	(273)	(492)	(770)
Balance at 31 December 2021		**68,000**	**2,952**	**350**	**(29,833)**	**41,469**
Net profit for the year		-	-	-	2,433	2,433
Other comprehensive income for the year		-	-	(2,572)	-	(2,572)
Total comprehensive income for the year		-	-	(2,572)	2,433	(139)
Balance at 31 December 2022	19	**68,000**	**2,952**	**(2,222)**	**(27,400)**	**41,330**

The accompanying notes 1 to 34 form an integral part of the annual financial statements.

The annual financial statements on pages 1 to 66 were approved for issue by the Management Board of Tokuda Bank AD and were signed on 27 April 2023 by:

Anna Tsankova-Boneva
Member of the Management Board
Executive Director

Dimiter Voutchev
Member of the Management Board
Executive Director

Svetlin Todorov
Finance Director

ТОКУДА БАНК АД СОФИЯ

Financial statements on which our auditors' report was issued dated 27 April 2023

AFA OOD

ABVP – AUDIT STANDART OOD

TOKUDA BANK AD
STATEMENT OF CASH FLOWS
For the year ended 31 December 2022

(all amounts are in BGN'000)

	Notes	2022	2021
Cash flows from operations			
Profit/(loss) before tax		2,412	(552)
Adjustments from non-cash operations			
Depreciation and amortisation		1,351	1,460
Impairment and loss provisions		709	2,055
Net interest income		(9,837)	(8,449)
Dividend income		(28)	(27)
Loss on disposal of property and equipment and intangible assets		(12)	-
Gain on sale of investment property		(247)	(8)
Other non-monetary amounts recognized in profit or loss		75	(122)
		(5,577)	*(5,643)*
Interest income received		11,311	8,167
Interest paid		(1,144)	(1,123)
Dividend		28	27
Cash flows from operations before changes in operating assets and liabilities		*4,618*	*1,428*
Decrease in financial assets at fair value through profit and loss		2,641	6,607
Decrease/(increase) in financial assets at fair value through other comprehensive income		3,591	(3,226)
(Increase)/decrease in loans and advances to customers		(16,114)	545
Decrease in non-current assets held for sale		799	1,535
Decrease in other assets		869	1,051
(Decrease)/increase in deposits from banks		(16)	20
Increase in deposits from customers		31,429	30,680
Increase in other liabilities		393	500
Net cash flows from operations		**23,592**	**37,712**
Cash flows from investing activities			
Payment for acquisition of debt instruments at amortised cost		(54,778)	-
Proceeds from maturity of debt instruments at amortised cost		9,779	-
Acquisition of property and equipment		(169)	(414)
Proceeds from sale of property and equipment		20	1
Proceeds from sale of investment property		436	205
Acquisition of intangible assets		(38)	(136)
Net cash flows used in investing activities		**(44,750)**	**(344)**
Cash flows from financing activities			
Lease payments	17	(908)	(943)
Subordinated debt	18	-	1,956
Net cash flows (used in)/from financing activities		**(908)**	**1,013**
Net (decrease)/ increase in cash and cash equivalents		**(17,448)**	**39,809**
Cash and cash equivalents at the beginning of the year		120,460	80,651
Cash and cash equivalents at the end of the year	29	**103,012**	**120,460**

The accompanying notes 1 to 34 form an integral part of the annual financial statements.

The annual financial statements on pages 1 to 66 were approved for issue by the Management Board of Tokuda Bank AD and were signed on 27 April 2023 by:

Anna Tsankova-Boneva
Member of the Management Board
Executive Director

Dimiter Voutchev
Member of the Management Board
Executive Director

Svetlin Todorov
Finance Director

Financial statements on which our auditors' report was issued dated 27 April 2023

AFA OOD

ABVP – AUDIT STANDART OOD

1. CORPORATE INFORMATION ON THE BANK

1.1. Incorporation

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

1.2. Ownership

As at 31 December 2022, the issued share capital of the Bank amounts to BGN 68,000,000 (sixty eight million levs), comprising 6,800,000 (six million and eight hundred thousands) registered voting shares with a nominal value of BGN 10 (ten) per share.

As at 31 December 2022, the major shareholder of the Bank is Tokushukai Incorporated, holding 99.94% of the Bank's capital.

1.3. Main activities

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

In 2022 and 2021, the Bank's activity was mostly related to rendering banking services related to granting loans to private companies, attracting deposits from customers, servicing of client payments both locally and internationally, performing transactions with securities and other financial services in Bulgaria.

1.4. Structure and management

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

As at 31 December 2022, the Bank's management, represented by the Management Board (MB), consists of four members, namely: Dimiter Voutchev, Anna Tsankova-Boneva, Todorina Doktorova and Savka Yondova. All MB members are also Executive Directors.

As at 31 December 2022, the persons charged with the Bank's governance, represented by the Supervisory Board (SB) are: Arthur Stern – Chairperson of the SB, Thomas Michael Higgins – Member of the SB, and Chris Matlon – Member of the SB.

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

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

In 2022, the Bank operates through its Head Office and 17 offices and remote working places (2021: 20). As at 31 December 2022, 206 employees work at the Bank (2021: 211).

1.5. Legal environment

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

1.6. Main indicators of the economic environment

The main economic indicators of the business environment that have affected the Bank's activities throughout the period 2019 – 2022 are presented in the table below:

Indicator	2019	2020	2021	2022
GDP in million levs	120,396	120,553	139,012	165,041*
Actual growth of GDP	4.0%	-4.0%	7.6%	2.9%**
Year-end inflation (HICP)	3.1%	0.0%	6.6%	14.3%
Average exchange rate of USD for the year	1.76	1.61	1.73	1.87
Exchange rate of the USD at year-end	1.74	1.59	1.73	1.83
Basic interest rate at year-end	0.00	0.00	0.00	1.30
Unemployment rate at year-end	5.9%	6.7%	4.8%	4.7%
Credit rating of the Republic of Bulgaria by Standard & Poor's (long-term)	BBB	BBB	BBB	BBB
Credit rating of the Republic of Bulgaria by Moody's (long-term)	Baa2	Baa1	Baa1	Baa1
Credit rating of the Republic of Bulgaria by Fitch (long-term)	BBB	BBB	BBB	BBB

** Preliminary BNB data for 2022 as at 23 February 2023*
*** Preliminary BNB data as at 23 January 2022 for Q3 2022 versus Q3 2021.*

2. BASIS FOR PREPARATION OF THE FINANCIAL STATEMENTS

2.1. General

These financial statements have been prepared for general purposes for the year ended 31 December 2022.

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

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

2.2. Accounting convention

The annual financial statements of Tokuda Bank AD have been prepared in accordance with all International Financial Reporting Standards (IFRS), which comprise Financial Reporting Standards and the International Financial Reporting Interpretations Committee (IFRIC) interpretations, approved by the International Accounting Standards Board (IASB), as well as the International Accounting Standards (IAS) and the Standing Interpretations Committee (SIC) interpretations, approved by the International Accounting Standards Committee (IASC), which have been effective since 1 January 2022 and have been accepted by the Commission of the European Union**.** IFRS, endorsed by EU, is the generally accepted name of the general purpose framework – the basis of accounting equivalent to the framework introduced with the definition in § 1, p. 8 of the Additional Provisions of the Accountancy Act under the name of "International Accounting Standards" (IASs).

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

The adoption of these standards and/or interpretations, applicable for annual reporting periods beginning on 1 January 2022, has not caused changes in Bank's accounting policies, apart from some new and expanding already existing disclosures, without resulting in other changes in the classification and measurement of individual reporting items and transactions.

- Annual Improvements to IFRSs 2018-2020 Cycle, to IFRS 1 "First-time Adoption of International Financial Reporting Standards", IFRS 9 "Financial Instruments", Illustrative Example 13 to IFRS 16 "Leases" and IAS 41 "Agriculture" (in force for annual periods beginning on or after 1 January 2022, endorsed by EC). These improvements introduce partial amendments to the following standards: a) the amendment to IFRS 1 grants a relief for a subsidiary in first-time adoption of IFRS at a date later than the parent. It measures in its separate financial statements the assets and liabilities at the carrying amounts that would be included in the parent's consolidated financial statements based on which the parent acquired the subsidiary. The subsidiary may, in its financial statements, measure the cumulative translation differences using the carrying amount stated in the parent's consolidated financial statements based on the date of the parent's date of transition to IFRS, unless adjustments have been made for the purpose of consolidation procedures or to account for the business combination's effects. These amendments will also be applied for associates and joint ventures which have elected the same relief under IFRS 1. Entities shall apply these amendments for annual reporting periods beginning on or after 1 January 2022. Earlier application is permitted; b) the amendment to IFRS 9 clarifies which fees an entity includes when it applies the '10 per cent' test in assessing whether in case of a modification of a financial liability the conditions of the new or amended financial liability significantly differ from the conditions of the initially recognized one. According to the amendment, the entity includes only fees paid or received between the entity (the borrower) and the lender, including fees paid or received by either the entity or the lender on the other's behalf. The entity applies the amendments to financial liabilities modified at or after the beginning of the annual reporting period in which it first applies these amendments; c) the amendment to Illustrative Example 13 to IFRS 16 removes from the example the illustration of the reimbursement of leasehold improvements by the lessor in order to resolve any potential confusion regarding the treatment of lease incentives. Since the amendment refers to an illustrative example accompanying the standard and is not a part thereof, no enforcement date is specified; d) the amendment to IAS 41 removes the requirement for entities to exclude taxation cash flows when measuring the fair value of a biological asset using a present value technique.

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

- Amendments to IFRS 3 "Business Combinations" (in force for annual periods beginning on or after 1 January 2022, endorsed by EC). These amendments update IFRS 3 by replacing the reference to the old version of the Conceptual Framework for Financial Reporting with its latest updated 2018 version. They also add an exception from the principle for recognition of liabilities and contingent liabilities within the scope of IAS 37 "Provisions, Contingent Liabilities and Contingent Assets" and IFRIC 21 "Levies", explicitly specifying that contingent liabilities are not recognized at the date of acquisition. The amendments are applied prospectively.
- Amendments to IAS 16 "Property, Plant and Equipment" (in force for annual periods beginning on or after 1 January 2022, endorsed by EC). These amendments prohibit deducting from the cost for "testing whether the asset is functioning properly", which is part of the direct costs attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management, the net proceeds received from selling items produced while the entity is preparing the asset for its intended location and condition. Instead, the entity shall recognize the revenue from sales of such items and the respective costs related thereto within profit or loss for the period, in accordance with the other applicable standards. The amendments specify that testing whether the asset is functioning properly is in fact an assessment of whether the technical and physical performance and capacity of the asset correspond to its intended use in production, supply of goods or services, lease, or for administrative purposes. Additionally, the amendment requires entities to separately disclose the amounts of proceeds and costs relating to items produced that are not an output of the entity's ordinary activities. The amendments are applied retrospectively, but only for property, plant and equipment brought to the location and condition necessary for their intended use on or after the start of the earliest period presented in the financial statements for which the entity first applies the amendments.
- Amendments to IAS 37 "Provisions, Contingent Liabilities and Contingent Assets" (in force for annual periods beginning on or after 1 January 2022, endorsed by EC). The amendments specify that the 'cost of fulfilling' an onerous contract comprises the 'costs that relate directly to the contract', including: a) direct labour costs and direct cost of materials; and b) additional costs which related directly to fulfilling the contract – for instance, the allocation of the depreciation charge for an item of property, plant and equipment used in fulfilling the contract. Administrative and other general costs are excluded, unless specifically billable to the counterpart. The amendments also make a small adjustment to the clarifications for recognition of impairment losses before a separate onerous contract provision is created, by highlighting that these are assets used in fulfilling the contract rather than assets intended thereto, which was the requirement prior to the amendments' enforcement. An entity shall apply those amendments to contracts for which it has not yet fulfilled all its obligations at the beginning of the annual reporting period in which it first applies the amendments.

At the date when these financial statements have been approved for issue, there are several new standards and interpretations as well as amended standards and interpretations, issued but not yet in force for annual periods beginning on or after 1 January 2022, which have not been adopted by the Bank for early application. The management has decided that out of them the following are likely to have a potential impact in the future for changes in the accounting policies, and in the classification and value of reporting items in Bank's financial statements for subsequent periods, namely:

- Amendments to IAS 1 Presentation of Financial Statements and IFRS Practice Statement 2 Making

Materiality Judgements (in force for annual periods beginning on or after 1 January 2023, endorsed by EC). These amendments provide guidelines and examples regarding the application of the materiality concept upon judgements and decisions makings related to disclosures of the accounting policy, such as a) they replace the requirement for disclosing material accounting policies information instead of significant accounting policies; b) they provide clarifications on how the entities can identify material accounting policy information and to give examples of when accounting policy information is likely to be material; c) clarify that accounting policy information may be material because of its nature, even if the related amounts are immaterial; d) clarify that accounting policy information is material if users of the entity's financial statements would need it to understand certain material information in the financial statements; and d) clarify that the entity needn't disclose immaterial accounting policy information, this shall not result in omitting or obscuring obscure material accounting information. Earlier application is permitted. The management is in the process of research, analysis and assessment of the effects of the changes that might impact the disclosure of the Bank's accounting policy.

- Amendments to IAS 1 "Presentation of Financial Statements" (in force for annual periods beginning on or after 1 January 2024, not endorsed by EC). These amendments address the criteria for classification of liabilities as current or non-current. According to them, an entity classifies its liabilities as current or non-current depending on the rights thereof that are in existence at the end of the reporting period, and the classification is unaffected by expectations about whether it will exercise its right to defer settlement of the liabilities. The classification shall not be impacted by the entity's expectations for or events after the reporting period. The amendments made clear that "settlement" refers to the transfer to a counterparty of cash, equity instruments, other assets or services. The classification does not address derivatives of convertible liabilities, which constitute equity instruments. The amendments are applied retrospectively. Earlier application is permitted, but simultaneously with applying the amendments to IAS 1 Presentation of Financial Statements, Non-current Liabilities with Covenants. The management is in the process of research, analysis and assessment of the effects of the changes that might impact the accounting policy and the classification and presentation of the Bank's assets and liabilities.
- Amendments to IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors (in force for annual periods beginning on or after 1 January 2023, endorsed by EC). These amendments are related to clarifications aimed at a more accurate distinction between changes to the accounting policy, error adjustments and changes to accounting estimates, such as: a) "the definition of a change in accounting estimates" is replaced with a "definition of accounting estimates" – under the new definition, accounting estimates are "monetary amounts in financial statements that are subject to measurement uncertainty"; b) the entity develops and applies accounting estimates if the accounting policies require items in the financial statements to be measured in a way that involves measurement uncertainty; c) a clarification is made that a change in accounting estimate may result from a change in input or valuation technique, as well as from new information or new developments, unless it is the correction of a prior-year error; d) a change in an accounting estimate may affect only the current's period profit or loss, or the profit or loss of both the current period and future periods. Earlier application is permitted. The management is in the process of research, analysis and assessment of the effects of the changes that might impact the accounting policy and the classification and presentation of the Bank's assets and liabilities, transactions and results.
- IAS 12 Income Taxes (in force for annual periods beginning on or after 1 January 2023, endorsed by EC). Amendments to IAS 12 – Income Taxes – Deferred Tax related to Assets and Liabilities arising from a Single Transaction. The amendments restrict the scope of exemption from recognition of deferred tax liabilities, as a result of which it is not applied for transactions in which equal taxable and deductible temporary differences may arise upon initial recognition. Such transactions are the recognition of a right-of-use asset and lease liability by the lessee at the commencement date of a lease, as well as in the accrual of liabilities for dismantling, removing or restoring included as part of the cost of an asset. Upon the amendments coming into force, the entities should recognize each deferred tax asset (to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilized) and a deferred tax liability (for all deductible temporary differences) in accordance with the IAS 12 criteria for transactions related to assets and liabilities arising from a single transaction on or after the beginning of the earliest comparative period presented in the financial statements. The entities recognize the cumulative effect of initially applying the amendments as an adjustment to the opening balance of retained earnings or other component of equity, as appropriate, at that date. These amendments are effective for annual reporting periods beginning on or after January 1, 2023, and earlier application is permitted. The management is in the process of research, analysis and assessment of the effects of the changes that might impact the accounting policy and the classification and presentation of the Bank's assets and liabilities, transactions and results.

Additionally, with regard to the stated below new standards, amended/revised standards and adopted interpretations that have been issued but not yet in force for annual periods beginning on 1 January 2022, the management has judged that they are unlikely to have a potential impact resulting in changes in the accounting policies and the financial statements of the Bank:

- Amendments to IAS 1 "Presentation of Financial Statements, Non-Current Liabilities with Covenants" (in force for annual periods beginning on or after 1 January 2024, not endorsed by EC). These amendments specify that only covenants with which an entity is required to comply on or before the reporting date affect the entity's right to defer the respective liabilities for at least twelve months after the reporting date and respectively, only these are to be considered upon assessing the classification of liabilities as current or non-current. These amendments have an impact on whether the right exists at the reporting date, even if compliance with the conditions is determined thereafter (for instance, a covenant based on the entity's financial position at the reporting date, but assessed thereafter). Covenants calculated based on the entity's financial position after the reporting date (for instance, based on the entity's financial position six months after the reporting date) shall not be considered upon determining the classification o liabilities and the right of deferral thereof. Nevertheless, entities shall disclose information about the covenants comprising an observable period within 12 months from the end of the reporting period, in order to assess the risk of whether the liabilities would become due. The amendments are applied retrospectively. Earlier application is permitted, but simultaneously with the application of amendments to IAS 1 Presentation of Financial Statements regarding the classification of liabilities as current and non-current.
- Improvements to IFRS 17 Insurance Contracts (in force for annual periods beginning on or after 1 January 2023, endorsed by EC). The amendments are related to the Initial Application of IFRS 17 and IFRS 9 – Comparative Information. They provide a transitional provision regarding the comparative information on financial assets upon initial application of IFRS 17 in order to reduce accounting mismatches between financial assets and liabilities under insurance contracts in the comparative information upon initial application of IFRS 17 and IFRS 9. The application of the changes is optional and only applies to the presentation of comparative information upon initial application of IFRS 17.
- IFRS 17 "Insurance Contracts" (in force for annual periods beginning on or after 1 January 2023, endorsed by EC). This is an entirely new accounting standard on all types of insurance contracts, including some guarantees and financial instruments, and includes rules and principles on recognition and measurement, presentation and disclosure. The standard will supersede the effective standard up to date related to insurance contracts – IFRS 4. It establishes an entirely new overall model for accounting for insurance contracts and activities, covering all relevant accounting and reporting aspects, as well as the content and structure of financial statements (presentation and disclosure) of insurance entities.
- IFRS 10 (amended) "Consolidated Financial Statements" and IAS 28 (amended) "Investments in Associates and Joint Ventures" – regarding the sale or contribution of assets between an investor and its associates or joint ventures (postponed effective date, to be determined by the IASB). These amendments address the accounting treatment of the sale or contribution of assets between an investor and its associates or joint ventures. They confirm that the accounting treatment depends on whether the assets sold or contributed constitute in substance a business as defined in IFRS 3. If these assets as an aggregate do not meet the definition of a business, then the investor shall recognise gain or loss only to the extent of other unrelated investor's interests in the associate or joint venture. In cases of sale or contribution of assets, which as an aggregate constitute a business, the investor shall recognise the full gain or loss on the transaction. The amendments will be applied on a prospective basis. IABS postponed the initial date of application of these amendments for an indefinite period.
- Amendments to IFRS 16 "Leases" – Lease Liability in a Sale and Leaseback (in force for annual periods beginning on or after 1 January 2024, not endorsed by EC). The amendment aims to clarify requirements to the seller-lessee upon measuring a lease liability in sale and leaseback transactions. It requires a seller-lessee to subsequently (after the date of providing the underlying asset) determine lease payments and revised leased payments in a way that it does not recognize any amount of the gain or loss that relates to the right of use it retains. The amendments do not apply to the recognition of gains or losses in relation to partial or full termination of a lease. The amendments are applied retrospectively. Earlier application is permitted. The management has conducted research and has determined that the impact would not impact the Bank's operations.

2.3. Basis of measurement

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

2.4. Going concern

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

The aims on which the Bank’s strategic development plans are also based are:

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

The Bank covers the regulatory requirements, including for capital adequacy and the minimum requirement for own funds and eligible liabilities.

Based on the above, the management has determined and concluded that as at 31 December 2022, the Bank continues to have the potential and conditions to continue as a going concern. In addition, the Bank is also subject to current monitoring and regulation by BNB with respect to all of its licensed activities, financial status and stability.

3. SUMMARY OF THE SIGNIFICANT ACCOUNTING POLICIES

3.1. Accounting estimates

The presentation of financial statements in accordance with the International Financial Reporting Standards requires the Bank’s management to make best estimates, accruals and reasonably justified assumptions that affect the reporting values of assets and liabilities, of revenues and expenses and of disclosures of contingent assets and liabilities. These estimates, accruals and assumptions are based on the information available at the date of the preparation of the financial statements, therefore, the actual future results of the Bank may differ therefrom.
The items that require a higher degree of subjective judgement or complexity or for which assumptions and accounting estimates are material for these financial statements are as follows:

3.1.1. *Expected credit losses from financial assets with low credit risk*

Instruments with low credit risk are considered to be the instruments for which the risk of default is low, the counterpart’s ability to fulfil contractual conditions is stable, and long-term adverse changes in economic conditions and unlikely to change the ability to repay debts. For short-term receivables from banks and debt instruments measured at FVOCI (these are mainly government securities), the Bank assumes that the probability of default is unlikely, and therefore determines 12-month credit losses for these instruments. If in subsequent reporting periods the criteria for low credit risk are no longer met, the Bank analyses the change in the credit risk compared to initial recognition in order to determine the need of lifetime credit losses. Designating instruments as low credit risk ones requires judgement. Upon making this judgement, the Bank uses all the reasonable, grounded and relevant information accessible without making unnecessary costs or efforts (Note 31.2).

3.1.2. *Expected credit losses on loans and advances to customers*

When determining expected credit losses on loans and advances to customers, the Bank applies the general approach of IFRS 9 based on internal policies, rules, and calculation techniques. The Bank classifies its financial assets in three risk stages depending on changes in the credit risk following the initial recognition of the asset, and respectively determines 12-month credit losses if there is no change in the credit quality (Stage 1) and lifetime credit losses (Stages 2 and 3) if there is a significant increase in the credit risk. Upon determining how significantly the credit risk has increased compared to the initial recognition of the asset, the Bank uses all the reasonable and grounded information accessible without making unnecessary costs or efforts, incl. moratorium conditions and measures and effects for the industries and debtors affected by the COVID-19 pandemic.

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

Upon determining the amount of expected credit losses, the Bank uses forecast information about expected future changes in certain macroeconomic conditions and indicators, and assumptions for correlations of how changes in these indicators would impact the probability of default. The Bank has developed internal models to determine the probability of default by loans, mostly based on historical information for periods when such information is available. The assessment of the correlation between the historical default rates and the forecast economic indicators is a significant estimate. Note 31.2 describes the process applied by the Bank to manage credit risk and determine expected credit losses from loans and advances to customers.

3.1.3. *Fair value of financial instruments*

When the fair value of financial assets and financial liabilities carried in the statement of financial positions cannot be obtained based on quoted prices on active markets, their fair value is determined by using other valuation techniques, involving the use of mathematical models. The input used in these models is obtained from observable markets, where possible, but where this is not feasible, estimation is required in establishing fair values (Note 31.5);

3.1.4. *Recognition of tax assets*

On recognising deferred tax assets, the management of the Bank reviews the extent to which deductible temporary differences can be utilised and the ability of the Bank to generate sufficient taxable profit against which the differences can be utilised. As a result of this analysis, the management has decided to not recognise deferred tax assets in the annual financial statements, with the exception of the tax assets described in Note 13.

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

Acquired assets, which prior to their acquisition were held as collateral of loans granted, are classified by the Bank as non-current assets held for sale, investment property and other assets acquired from collaterals. Upon the initial acquisition of these assets, the Bank's management makes judgements regarding their classification, based on its intentions and possibilities for future use and/or disposal. The management performs an annual review, as at the date of the financial statements, of its assumptions and judgements based on the existing circumstances, and if necessary, the assets are reclassified. According to the Bank's accounting policy, assets classified as non-current assets held for sale or as other assets acquired from collaterals are subsequently measured at the lower of the their carrying amount and the fair value less costs for disposal. In order to determine the fair value of non-current assets held for sale and other assets acquired from collaterals, the Bank uses independent external valuators. Acquired assets classified as investment property are subsequently measured at fair value, whose amount is determined by independent external valuators appointed by the Bank, holding suitable professional qualification and valuation experience with respect to analogous assets. The application of the valuation approaches and techniques, and of the inputs used for each case of fair value measurement, is subject to mandatory discussion and coordination between the external expert valuators and the Bank's valuation specialists, as well as the approval of the valuation reports issued – especially with respect to significant assumptions and final conclusions (Note 31.5).

3.1.6. *Leases*

Determining whether a contract contains a lease or lease components

Upon identification and classification of a lease or a lease component of a contract, the Bank determines whether the contract contains an identifiable asset and whether it transfers the right of control over this asset for the contract term.

The Bank as lessor
The Bank has leased some of its investment properties and assets acquired from collaterals. In its capacity as lessor, based on the lease conditions, the Bank has determined that it retains all material risks and benefits from ownership of these properties and that the lease term does not cover a substantial part of the properties' economic life; therefore, it accounts for them as operating leases.

The Bank as lessee
The Bank has identified the leases of office premises as containing lease components. The Bank obtains all economic benefits from the use of the premises and determines the manner, time, location and degree of operation of the offices.

Determining of the lease term of leases contract with renewal and termination options – as lessee
The Bank determines the lease term as the non-cancellable period of the lease, together with both: a) periods covered by an option to extend the lease if it is reasonably certain to be exercised and b) periods covered by an option to terminate the lease if it is reasonably certain not to be exercised.

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

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

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

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

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

The Bank has performed a review and has determined that no indicators for impairment exist as at 31 December 2022.

3.2. Financial instruments

3.2.1. Financial assets

3.2.1.1. Recognition of financial assets

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

3.2.1.2. Initial measurement of financial assets

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

When the fair value of financial assets upon initial measurement deviates from the transaction price, the Bank recognises the difference within current profit or loss under the following conditions:
- if the fair value has been determined by means of a valuation technique based on observable inputs about the market participants, the difference is recognised as early as the first date within current profit or loss; and
- if the fair value has been determined by means of a valuation technique based on unobservable inputs, the difference is not recognised within current profit or loss until the data is observable or the financial instrument is written-off.

3.2.1.3. Classification and subsequent measurement of financial assets

Depending on their subsequent measurement, the Bank classifies its financial assets in one of the following categories:
- financial assets at amortised cost;
- financial assets at fair value through profit or loss (FVPL/PL);
- financial assets at fair value through other comprehensive income (FVOCI/OCI) with or without reclassification to profit or loss.

The classification of financial assets is determined based on the following two conditions:
- the Bank’s business model for management of financial assets;
- the characteristics of the financial asset’s contractual cash flows (SPPI).

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

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

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

The process of establishing characteristics of contractual cash flows includes:

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

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

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

<u>Financial assets at amortised cost</u>

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

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

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

<u>Financial assets at fair value through other comprehensive income (FVOCI/OCI)</u>
The Bank classifies in this category debt and equity securities.

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

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

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

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

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

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

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

3.2.1.4. Impairment of financial assets

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

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

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

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

Additional information about the assumptions used in determining ECL is presented in Notes 31.2 and 3.1.

3.2.1.5. Reclassification of financial assets

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

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

3.2.1.6. Derecognition of financial assets

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

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

3.2.1.7. Modification due to material change in terms and conditions

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

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

3.2.2. Financial liabilities and equity instruments

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

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

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

Financial liabilities are initially recognised in the statement of financial position at fair value, net of the directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest method. Interest costs are carried currently to the statement of profit or loss and other comprehensive income (within profit or loss for the year) systematically over the life of the instrument.

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

3.2.3. Netting of financial assets and financial liabilities

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

3.2.4. Financial guarantees and undrawn commitments

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

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

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

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

The nominal amount of financial guarantees, undrawn loan facilities (where the loan is agreed at market conditions) and letters of credit is not recognised and carried to the statement of financial position. This amount, together with the recognised losses, is disclosed in the notes to the financial statements (Note 31.2).

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

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

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

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

3.3. Investment property

Investment property is property held by the Bank to earn rentals or capital appreciation or both.

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

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

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

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

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

3.4. Leases

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

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

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

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

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

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

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

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

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

The Bank recognises lease liabilities at the commencement date, measured at the present value of the lease payments that are not paid at this date. Lease payments are discounted using the interest rate implicit in the lease. If this percentage could not be reliably determined, the Bank uses the incremental borrowing rate. As incremental borrowing rate, the Bank uses the effective interest rate on interest-bearing attracted funds. For year 2022, the incremental interest rate is 0.21% (2021: 0.29%). Lease liabilities are subsequently measured using the effective interest method. The carrying amount of the liability is remeasured to reflect any change in the lease or fixed payments.

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

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

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

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

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

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

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

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

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

The Bank has set a value threshold of BGN 300, below which the acquired assets, regardless of having the features of fixed assets, are treated as current expense at the time of their acquisition.

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

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

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

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

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

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

Right-of-use assets are stated within property and equipment in the statement of financial position, and the policy applied thereon is disclosed in Note 3.4.

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

3.6. Interest income and expense

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

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

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

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

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

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

3.7. Fees and commissions

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

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

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

3.8. Foreign currency transactions

Transactions denominated in foreign currencies are translated into BGN at the rates of BNB at the date of transaction. Receivables and payables in foreign currencies are revaluated on a daily basis. At the end of the year, they are revalued into the BGN equivalent at closing exchange rates of BNB.

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

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

3.9. Employee benefits

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

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

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

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

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

3.10. Income taxes

The current income taxes of the Bank are determined in accordance with the requirements of the Bulgarian tax legislation. Income tax is calculated based on the taxable profit for the period, determined in accordance with the provisions of the Corporate Income Taxation Act (CITA). The nominal income tax rate in Bulgaria for 2022 is 10% (2021: 10%).

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

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

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

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

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

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

As at 31 December 2022 the deferred income taxes of the Bank are computed at a tax rate of 10%, which is also valid for 2022 (31 December 2021: 10%).

3.11. Fair value of financial assets and liabilities

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

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

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

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

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

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

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

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

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

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

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

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

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

Note 31.5 and Note 11 provide information on the fair values of financial assets and liabilities, investment property, and assets held for sale.

3.12. Provisions and contingent liabilities

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

3.13. Assets acquired from collaterals

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

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

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

3.14. Non-current assets held for sale

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

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

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

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

3.15. Share capital and reserves

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

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

The Bank is obliged to set aside a Reserve Fund (statutory reserve) in accordance with the requirements of the Commercial Act on distribution of the profit (Note 19.2).

The financial assets at FVOCI reserve is being set aside from the difference between the carrying amount of financial assets at fair value through other comprehensive income and their fair values at the revaluation date.
The financial assets at FVOCI reserve is transferred to the current profit and loss in the statement of profit or loss and other comprehensive income, when the financial assets are sold or in case of lasting and prolonged impairment. The revaluation reserve of equity instruments upon derecognition is not reclassified to current profit in the statement of comprehensive income.

3.16. Cash and cash equivalents

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

3.17. Comparative information

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

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

4. CASH AND BALANCES WITH THE CENTRAL BANK

	31.12.2022	31.12.2021
Cash in hand	10,378	9,684
Cash with the Central Bank	85,067	63,332
	95,445	73,016
Allowance for credit losses	(4)	(6)
Total	**95,441**	**73,010**

As at 31 December 2022 and 2021 cash with the Central Bank includes mandatory minimum reserves at the amount of BGN 33,539 thousand and BGN 31,436 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 433 thousand and BGN 304 thousand, respectively. There are no limitations imposed by the Central Bank for using the minimum reserves. The amount of the reserves depends on the amount of deposits attracted by the Bank.

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

	2022	2021
Balance on 1 January	**6**	**2**
(Decrease)/increase of the impairment for expected credit losses	(2)	4
Balance on 31 December	**4**	**6**

5. RECEIVABLES FROM BANKS

Receivables from banks are as follows:

	31.12.2022	31.12.2021
Current accounts at local banks	441	347
Current accounts at foreign banks	833	1,699
Deposits at local banks	3,364	20,017
Deposits at foreign banks	2,934	25,389
	7,572	47,452
Allowance for credit losses	(1)	(2)
Total	**7,571**	**47,450**

Deposits placed with banks as at 31 December 2022 and 2021 have maturity of up to three months.

As at 31 December 2022 and 2021, receivables from banks are classified in Stage 1. Expected credit losses are calculated on an individual basis.

The movement in the allowance for expected credit losses on receivables from banks is as follows:

	2022	2021
Balance on 1 January	**2**	**3**
Increase in the impairment for expected credit losses	-	2
Reversal of the impairment for expected credit losses	(1)	(3)
Balance on 31 December	**1**	**2**

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

6. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT AND LOSS

	31.12.2022	31.12.2021
Foreign government securities	-	2,704
	-	**2,704**
Equity instruments at FVPL		
Stocks and shares in local entities	249	249
	249	**249**
Total	**249**	**2,953**

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

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

	31.12.2022	31.12.2021
Debt instruments at fair value through other comprehensive income		
Bulgarian government securities	32,238	31,041
Foreign government securities	2,761	10,354
	34,999	41,395
Equity instruments at fair value through other comprehensive income		
Shares and interest in local entities	381	293
	381	**293**
Total	**35,380**	**41,688**

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

	2022	2021
Balance at 1 January	**41,688**	**39,046**
Increase (purchases)	8,565	37,983
Decrease (sales and/or maturity)	(13,575)	(36,079)
Net effect of restatement to fair value	(2,572)	(268)
Interest income accrued	232	240
Net foreign exchange remeasurement	1,042	766
Balance at 31 December	**35,380**	**41,688**

As at 31 December 2022 and 2021 debt securities at fair value through other comprehensive income are classified in Stage 1. Expected credit losses are determined on an individual basis (Note 31.2).

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

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

	2022	2021
Balance on 1 January	**37**	**15**
Increase in the impairment on credit losses on debt securities	11	30
Reversal of the impairment on credit losses on debt securities	(23)	(8)
Balance on 31 December	**25**	**37**

As at 31 December 2022, government securities with carrying amount of BGN 7,737 thousand are pledged as collateral with BNB to secure attracted funds from the State Budget (31 December 2021: BGN 10,812 thousand).

8. DEBT INSTRUMENTS AT AMORTISED COST

	31.12.2022	31.12.2021
Debt instruments at amortised cost		
Bulgarian government bonds	3,969	-
Foreign government bonds	40,918	-
Debt instruments at amortised cost	**44,887**	**-**

	2022	2021
Balance at 1 January	**-**	**-**
Increase (purchases)	54,778	-
Decrease (maturity)	(9,779)	-
Increase in the impairment of credit losses	(2)	-
Recognised interest income	66	-
Net foreign exchange remeasurement	(176)	-
Balance at 31 December	**44,887**	**-**

The movement in the impairment of debt securities at amortised cost is as follows:

	2022	2021
Balance at 1 January	**-**	**-**
Increase in the impairment of debt securities at amortised cost	2	-
Balance at 31 December	**2**	**-**

As at 31 December 2022 and 31 December 2021 debt securities at amortised cost are classified as Stage 1.

9. LOANS AND ADVANCES TO CUSTOMERS

9.1. Analysis by type of customers

	31.12.2022	31.12.2021
Private entities	174,756	168,259
Households and individuals	61,590	54,744
State budget	1,138	1,324
Financial entities	6,997	3,655
Finance lease	10,208	5,608
	254,689	233,590
Allowance for credit losses	(6,928)	(8,183)
Total	**247,761**	**225,407**

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

9.2. Analysis by sectors

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

	31.12.2022	**31.12.2021**
Trade	35,050	33,979
Industry	32,244	28,321
Construction	33,402	27,518
Tourist services	26,529	22,796
Consumer loans	19,788	17,747
Agriculture	22,338	16,375
Real estate transactions	7,853	6,774
Healthcare	5,582	5,880
Information and communication services	6,521	4,993
Finance	6,997	3,655
Transport	1,182	1,843
State budget	1,138	1,324
Other sectors	56,065	62,385
	254,689	233,590
Allowance for credit losses	(6,928)	(8,183)
Total	**247,761**	**225,407**

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

	2022	**2021**
	Loans and advances	**Loans and advances**
Balance at 1 January	**8,183**	**9,263**
Accrued impairment	2,562	1,745
Increase in the allowance for impairment of unrecognized interest on loans in Stage 3	76	111
Reversed impairment	(2,237)	(1,047)
Impairment written of	(1,656)	(1,889)
Balance at 31 December	**6,928**	**8,183**

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

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

	31.12.2022	**31.12.2021**
Individually impaired		
Gross amount	-	5,512
Allowance for credit losses	-	-
Stage 2	-	5,512
Gross amount	19,256	21,745
Allowance for credit losses	(4,549)	(5,344)
Stage 3	14,707	16,401
Individually impaired	**14,707**	**21,913**
Collectively impaired		
Gross amount	195,152	150,416
Allowance for credit losses	(89)	(89)
Stage 1	195,063	150,327
Gross amount	35,410	49,682
Allowance for credit losses	(543)	(311)
Stage 2	34,867	49,371
Gross amount	4,871	6,235
Allowance for credit losses	(1,747)	(2,439)
Stage 3	3,124	3,796
Collectively impaired	**233,054**	**203,494**
Total	**247,761**	**225,407**

9.4. Analysis of finance lease receivables

Finance lease receivables are as follows:

	31.12.2022	**31.12.2021**
Up to 1 year	1,330	555
1 to 5 years	4,808	2,497
Over 5 years	7,669	4,457
Gross investments in finance leases, receivables	13,807	7,509
Less: unearned finance income	(3,599)	(1,901)
Net investments in finance leases	**10,208**	**5,608**

Net investments in finance leases are as follows:

	31.12.2022	**31.12.2021**
Up to 1 year	994	316
1 to 5 years	3,480	1,532
Over 5 years	5,734	3,760
	10,208	**5,608**

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

10. NON-CURRENT ASSETS HELD FOR SALE

	2022	2021
Balance at the beginning of the year	**1,070**	**2,605**
Additions during the year	93	-
Disposals during the year	(892)	(1,535)
Balance at 31 December	**271**	**1,070**

The fair values of non-current assets held for sale are categorized as Level 3 fair values based on the inputs used in the valuation approach. The valuations have been done in compliance with the methods set in IFRS 13 and the International Valuation Standards and the reference for market evidence based on transactions or bids for similar properties. Additional information about the inputs used in determining their fair value and the types of non-current assets held for sale is provided in Note 31.5.

11. INVESTMENT PROPERTY

	2022	2021
Balance at the beginning of the year	**15,611**	**15,476**
Granted under finance leases	(4,930)	-
Sold	(218)	(197)
Net remeasurement to fair value	250	332
Balance at 31 December	**10,713**	**15,611**

The fair value measurements of investment property are categorised as Level 3 fair values based on the input used in the valuation approach. The valuations were prepared using the methods and references set by IFRS 13 and the International Valuation Standards on market evidence from transactions or bid prices of similar properties (Note 31.5).

The Bank's investment property as at 31 December 2022 comprises hotel complexed, landed properties and retail sites. Some of the investment property is leased for a period of one year with an extension option and termination with one-month notice. The rental income from investment property for the year ended 31 December 2022 amounts to BGN 406 thousand (31 December 2021: BGN 399 thousand) and is included within "Rental income" in Note 23.

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

12. PROPERTY, PLANT AND EQUIPMENT, RIGHT-OF-USE ASSETS AND INTANGIBLE ASSETS

Property, plant and equipment and right-of-use assets

	Buildings	Right-of-use assets (buildings)	Office equipment	Motor vehicles	Furniture and fixtures	Other assets	Advances for acquisition of PPE	Total property, plant and equipment and right-of-use assets
Book value								
1 January 2021	751	4,745	2,745	733	568	483	-	10,025
Additions	-	492	63	-	14	-	337	906
Disposals	-	(8)	(235)	-	(11)	-	-	(254)
Sold	-	-	-	(16)	-	-	-	(16)
31 December 2021	751	5,229	2,573	717	571	483	337	10,661
Additions	-	574	112	-	2	-	56	744
Transfer	-	-	337	-	-	-	(337)	-
Disposals	-	(761)	(906)	-	(30)	(128)	-	(1,825)
Sold	-	-	(28)	(102)	(16)	-	-	(146)
31 December 2022	751	5,042	2,088	615	527	355	56	9,434
Accumulated depreciation								
1 January 2021	(243)	(1,905)	(2,352)	(733)	(457)	(427)	-	(6,117)
Depreciation charge for the year	(15)	(945)	(187)	-	(34)	(31)	-	(1,212)
Depreciation written off	-	-	234	16	11	-	-	261
31 December 2021	(258)	(2,850)	(2,305)	(717)	(480)	(458)	-	(7,068)
Depreciation charge for the year	(15)	(913)	(191)	-	(35)	(8)	-	(1,162)
Depreciation written off	-	425	926	102	44	129	-	1,626
31 December 2022	(273)	(3,338)	(1,570)	(615)	(471)	(337)	-	(6,604)
Net carrying amount								
31 December 2021	493	2,379	268	-	91	25	337	3,593
31 December 2022	478	1,704	518	-	56	18	56	2,830

As at 31 December 2022, tangible fixed assets include assets with a book value of BGN 2,462 thousand (31 December 2021: BGN 3,273 thousand), which have been fully depreciated, but continue to be used in the Bank's operations.

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

As at 31 December 2022, right-of-use assets are related to leases of office premises.

Intangible assets

	Licenses	Software	Advances for acquisition of IA	Total intangible assets
Book value				
1 January 2021	514	1,384	98	1,996
Additions	-	88	48	136
Disposals	-	98	(98)	-
31 December 2021	514	1,570	48	2,132
Additions	-	11	27	38
Transfer	-	12	(12)	-
31 December 2022	514	1,593	63	2,170
Accumulated amortisation				
1 January 2021	(336)	(836)	-	(1,172)
Amortisation charge for the year	(77)	(171)	-	(248)
Amortisation written-off			-	-
31 December 2021	(413)	(1,007)	-	(1,420)
Amortisation charge for the year	(64)	(125)	-	(189)
31 December 2022	(477)	(1,132)	-	(1,609)
Net carrying amount				
31 December 2021	101	563	48	712
31 December 2022	37	461	63	561

As at 31 December 2022, intangible assets include assets of book value BGN 205 thousand (31 December 2021: BGN 29 thousand), which have been fully amortised, but continue to be used in the Bank's operations.

13. DEFERRED TAX ASSETS

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

	Balance 31.12.2022	Effect on profit and loss 2022	Balance 31.12.2021	Effect on profit and loss 2021	Balance 31.12.2020
Deferred tax assets:					
Differences between accounting and tax depreciation and amortization	125	23	102	48	-
Long-term employee benefits	37	4	33	3	1
Unused paid leaves	12	(6)	18	9	-
Total deferred tax assets	**174**	**21**	**153**	**60**	**1**

Deferred tax assets and liabilities as at 31 December 2022 and 2021 have been calculated by applying a tax rate of 10%, determined in accordance with the Corporate Income Taxation Act and applicable for periods of temporary differences.

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

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

As at 31 December, the Bank does not recognise deferred tax assets at the amount of BGN 335 thousand (31 December 2021: BGN 277 thousand) on accumulated tax loss at the amount of BGN 3,349 thousand (31 December 2021: BGN 2,773 thousand) and at the amount of BGN 394 thousand (31 December 2021: BGN 459 thousand) for other temporary differences at the amount of BGN 3,938 thousand (31 December 2021: BGN 4,582 thousand), in so far as there is uncertainty regarding the future taxable profit against which they can be utilised.

14. OTHER ASSETS

	31.12.2022	**31.12.2021**
Assets acquired against debt from non-performing loans	13,060	16,517
Deferred expenses	310	309
Guarantee deposits	63	63
Advance payments	50	39
Other assets	339	347
Total	**13,822**	**17,275**

Assets acquired under non-performing loans
The fair values of assets acquired under non-performing loans are categorized for disclosure purposes as Level 3 fair values based on the inputs used in the valuation approach. The valuations have been done in compliance with the methods set in IFRS 12 and the International Valuation Standards and the reference for market evidence based on transactions or bids for similar properties. Additional information about the inputs used in determining their fair value and the types of assets acquired under non-performing loans is provided in Note 31.5. The net selling price of these assets as subsequent accounting measurement is determined based on their fair value (in accordance with the Bank's policy as disclosed in Note 3.13).

15. DEPOSITS FROM BANKS

The deposits from banks amount to BGN 49 thousand (31 December 2021: BGN 65 thousand) and have maturity of up to three months.

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

16. DEPOSITS FROM CUSTOMERS

	31.12.2022	**31.12.2021**
Individuals’ accounts		
- Deposits on demand and savings accounts	133,206	110,917
- Term deposits	170,060	170,833
State Budget accounts		
- On demand deposits	7,748	10,603
Corporate accounts		
- On demand deposits	74,294	63,434
- Term deposits	25,339	23,966
Accounts of other non-bank financial institutions		
- On demand deposits	2,085	1,757
- Term deposits	200	200
	412,932	**381,710**

As at 31 December 2022, 2.27% (31 December 2021: 2.26%) of customers’ deposits are funds of the main shareholder and related parties thereto.

Customer deposits includes customers’ cash blocked by the Bank: for collateral of loans and bank guarantees at the amount of BGN 2,192 thousand (31 December 2021: BGN 1,588 thousand), as well as accounts under special conditions: accumulation accounts at the amount of BGN 2,493 thousand (31 December 2021: BGN 2,671 thousand).

17. OTHER LIABILITIES

	31.12.2022	**31.12.2021**
Lease liabilities	1,711	2,390
Long-term retirement benefit obligation	369	328
Payables to suppliers	327	252
VAT payable	232	27
Accruals for unused paid leaves	100	153
Remeasurement of financial guarantees and loan commitments (Note 31.2)	65	23
Bank transfers in progress	9	238
Other liabilities	577	308
	3,390	**3,719**

Bank transfers
Ongoing bank transfers represent liabilities on money transfers ordered by customers in the last day of 2022 and 2021 respectively, with value date within two days. The transfers are processed up to the second working day of 2023 and 2022, respectively.

Payables to personnel
According to the provisions of the Labour Code, upon termination of employment relations, if the worker or employer is entitled to pension for length of service and age, the Bank is obliged to pay a compensation amounting to double the gross monthly remuneration. If the worker or employee has worked at the Bank over the last 10 years, the amount of the compensation equals 6 gross monthly salaries. As at 31 December 2022 and 31 December 2021, the Bank accrued BGN 369 thousand and BGN 328 thousand respectively for retirement benefit obligations, and the provision amount has been determined by a licensed actuary.

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

- Updated mortality rate and average longevity of population in Bulgaria by the National Statistical Institute;
- Statistical information on disability probability;
- Turnover rate – 0.2868;
- Financial assumptions, 1.5% salary growth as compared to the previous year;
- Discount rate – due to the long-term nature of the payable, annual discount rate of 2.91% has been applied.

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

	2022	**2021**
Balance at 1 January	**2,390**	**2,850**
Accrued interest	8	11
Principal payments	(908)	(943)
Interest payments	(8)	(11)
Extended	574	525
Terminated	(345)	(42)
Balance at 31 December	**1,711**	**2,390**

The maturity analysis of lease liabilities is presented in Note 31.3

18. SUBORDINATED DEBT

As at 31 December 2022, the balance of subordinated debt includes BGN 1,956 thousand – principal and BGN 3 thousand – interest currently accrued.

In September 2021 the Bank concluded a subordinated loan agreement with the main shareholder Tokushukai Incorporated. The agreement aims to support the Bank's growth and to optimise the structure of liabilities. The amount of the subordinated loan granted is EUR 1,000 thousand (BGN 1,956 thousand), and should be fully repaid by the Bank in January 2032. The interest is fixed at the amount of 5%.

In February 2022, BNB granted a permission for the loan to be included as Tier 2 capital.

19. EQUITY AND RESERVES

19.1. Share capital

As at 31 December 2022 and 2021, the Bank's share capital is fully paid and is distributed in registered voting shares, as follows:

	31.12.2022	**31.12.2021**
Number of shares	6,800,000	6,800,000
Share nominal in BGN	10	10
Share capital (BGN'000)	68,000	68,000

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

As at 31 December 2022 and 2021, the Bank’s shareholder structure is as follows:

	31.12.2022	**%**	**31.12.2021**	**%**
Tokushukai Incorporated	6,796,250	99.94	6,796,250	99.94
Gamma Holding Group AD	3,750	0.06	3,750	0.06
Total shares	**6,800,000**	**100**	**6,800,000**	**100**

19.2. Reserves

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

	31.12.2022	**31.12.2021**
Statutory reserves (Reserve Fund)	2,967	2,967
Other reserves - actuarial losses on revaluation of defined benefit retirement plans	(15)	(15)
Reserve of financial assets at fair value though other comprehensive income	(2,222)	350
	730	**3,302**

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

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

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

20. INTEREST INCOME AND EXPENSES

	2022	**2021**
Interest income		
Receivables from banks	624	23
Loans and advances to customers	9,824	9,162
Debt instruments at FVOCI	232	240
Debt instruments at amortised cost	66	-
Financial assets at FVPL	23	123
	10,769	**9,548**
Interest expenses		
Deposits, including:	551	757
Individuals	539	744
Corporate clients	12	13
Current accounts at other banks and other assets	275	314
Lease liabilities	8	11
Interest on subordinated debt	98	17
	932	**1,099**
Net interest income	**9,837**	**8,449**

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

In 2022 the Bank charged interest income on loans and advances to customers classified at Stage 3, at the amount of BGN 751 thousand (31 December 2021: BGN 840 thousand).

21. FEE AND COMMISSION INCOME/EXPENSE

	2022	**2021**
Fee and commission income		
Account servicing	1,646	989
Money transfers	1,199	1,303
Loans granted	930	819
Cash balance transactions	618	480
Card servicing	440	390
Guarantee servicing	72	62
Other	21	9
	4,926	**4,052**

Fee and commission expenses	**2022**	**2021**
Card servicing	290	218
Account opening and servicing	35	33
Money transfers	5	5
Insurance	2	3
Other	34	32
	366	**291**
Net fee and commission income	**4,560**	**3,761**

22. NET TRADING INCOME

	2022	**2021**
Loss on revaluation of financial assets at FVPL	(39)	(16)
Foreign exchange gains	534	403
	495	**387**

23. OTHER OPERATING INCOME

	2022	**2021**
Gain on non-current assets held for sale (acquired in return for debt)	811	521
Rental income	542	523
Net gain on remeasurement of investment property to fair value	250	332
Net gain/(loss) on foreign currency revaluation	67	(1)
Dividends	28	27
Gain on sales of property and equipment	19	1
Income on court loans	3	105
Net loss on assets written-off, other than assets held for sale	(7)	(1)
Other operating income (net)	258	107
	1,971	**1,614**

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

24. GAINS AND LOSSES ON IMPAIRMENT OF ASSETS AND PROVISIONS (NET)

	2022	2021
Impairment charge on loans and advances to customers	325	700
Effect of modification of loans and advances to customers	118	182
(Reversed)/accrued impairment of debt instruments at FVOCI	(12)	22
Accrued impairment of debt instruments at amortised cost	2	-
(Reversed)/accrued impairment of balances with the Central Bank	(3)	4
Remeasurement of financial guarantee contracts and loan commitments	42	4
Reversed impairment of receivables from banks	(1)	(1)
Accrued impairment of non-financial assets	238	1,144
	709	**2,055**

25. PERSONNEL EXPENSES

	2022	2021
Salary expenses	5,795	5,229
Social security contributions	687	608
Health insurance contributions	249	221
Expenses for additional mandatory pension insurance	136	120
Unused paid leaves	87	153
Long-term benefits	62	57
Occupational medical care	7	8
	7,023	**6,396**

26. OTHER ADMINISTRATIVE AND OPERATING EXPENSES

	2022	2021
External services	1,248	1,316
Contributions to the Deposit Insurance Fund	955	786
IT licences and support	859	664
Unrecognised VAT expenses	621	649
Utility costs	479	323
Fees to cover administrative costs of BNB	254	287
Office supplies	110	118
Litigation costs	76	11
Rentals	16	14
Other expenses	750	684
	5,368	**4,852**

The expenses for statutory joint audit of the annual financial statements for year 2022 amount to BGN 90 thousand (2021: BGN 84 thousand). The expenses for other services granted by the registered auditors in 2022 amount to BGN 11 thousand (2021: BGN 10 thousand).

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

27. INCOME TAX BENEFIT

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

	2022	2021
Deferred tax	21	60
Total benefit from income tax carried to the statement of comprehensive income (within profit or loss for the year)	**21**	**60**

Reconciliation between loss before tax and the tax benefit:		
Profit/(loss) before income tax	2,412	(552)
Tax at 10% applicable tax rate for 2022 (2021: 10%)	(241)	55
Effect of unrecognized amounts in the tax return related to:		
increases	(648)	(236)
decreases	968	213
Unrecognised tax asset for tax loss	(58)	-
Tax loss deducted	-	28
Total benefit from income tax carried to the statement of comprehensive income (within profit or loss for the year)	**21**	**60**

28. RELATED PARTY TRANSACTIONS

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

Related parties	Type of relation	Period of relation
TOKUSHUKAI INCORPORATED	Main shareholder	2021 and 2022
GLOBAL-PRIME OOD	Companies under common control	2021 and 2022
AMERICA FOR BULGARIA FOUNDATION	Company related through key management personnel	2021 and 2022
CREDITLAND EOOD	Company related through key management personnel	2021 and 2022

The key management personnel is disclosed in Note 1.

As at 31 December 2022 and 31 December 2021, the Bank has receivables from and payables to related parties, as follows:

Related parties and balances	31.12.2022	31.12.2021
Main shareholders		
Deposits received	6,409	6,427
Subordinated term debt	1,959	1,959
Companies under common control		
Deposits received	1,866	2,215
Companies related through key management personnel		
Deposits received	2,953	1,125
Key management personnel		
Loans granted	45	24
Deposits received	559	236

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

The income and expenses of the Bank in 2022 and 2021 from related party transactions are as follows:

Related parties and types of transactions	**2022**	**2021**
Main shareholder		
Fee and commission income	1	2
Interest costs	98	19
Companies under common control		
Fee and commission income	2	2
Interest expense	-	2
		-
Companies related through key management personnel		
Interest expense	10	3
Key management personnel		
Fee and commission income	2	1
Interest expense	1	1

The remuneration to the Supervisory Board members accrued and paid in 2022 amount to a total of BGN 72 thousand (2021: BGN 72 thousand). The remuneration to the Management Board members paid in 2022 amount to a total of BGN 491 thousand (2021: BGN 479 thousand).

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

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

	31.12.2022	**31.12.2021**
Cash with the Central Bank (Note 4)	85,063	63,326
Deposits to banks with original maturity of up to three months (Note 5)	6,297	45,404
Cash in hand (Note 4)	10,378	9,684
Current accounts with foreign banks (Note 5)	833	1,699
Current accounts with local banks (Note 5)	441	347
Total cash and cash equivalents in the statement of cash flows	**103,012**	**120,460**

30. COMMITMENTS AND CONTINGENCIES

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

	31.12.2022	**31.12.2021**
Guarantees	3,636	3,460
Undrawn loan commitments	43,443	41,286
	47,079	**44,746**

As at 31 December 2022, the Bank has charged provisions for credit losses on financial guarantee contracts and loan commitments at the amount of BGN 65 thousand (31 December 2021: BGN 23 thousand). The provisions accrued for credit losses in the statement of comprehensive income for years 2022 and 2021 are disclosed in Note 24.

31. MANAGEMENT OF THE RISK RELATED TO FINANCIAL INSTRUMENTS

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

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

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

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

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

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

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

31.1. Financial assets and liabilities

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

31 December 2022	Carrying amount	Fair value
Financial assets		
Cash and balances with the Central Bank	95,441	95,441
Receivables from banks	7,571	7,571
Loans and advances to customers	247,761	252,936
Financial assets at FVPL	249	249
Debt instruments at FVOCI	34,999	34,999
Equity instruments at FVOCI	381	381
Debt instruments at amortised cost	44,887	44,890
Total assets	**431,289**	**436,467**
Financial liabilities		
Deposits from banks	49	49
Deposits from customers	412,932	413,014
Lease liabilities	2,850	2,850
Subordinated debt	1,959	1,959
Other financial liabilities	803	803
Total liabilities	**418,593**	**418,675**

31 December 2021	Carrying amount	Fair value
Financial assets		
Cash and balances with the Central Bank	73,010	73,010
Receivables from banks	47,450	47,450
Loans and advances to customers	225,407	228,622
Financial assets at FVPL	2,953	2,953
Debt instruments at FVOCI	41,395	41,395
Equity instruments at FVOCI	293	293
Total assets	**390,508**	**393,723**
Financial liabilities		
Deposits from banks	65	65
Deposits from customers	381,710	351,260
Lease liabilities	2,850	2,850
Subordinated debt	1,959	1,959
Other financial liabilities	615	615
Total liabilities	**387,199**	**356,749**

31.2. Credit risk

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

In part of 2022, the Bank continued to apply measures to cope with the effect of the COVID-19 pandemic, introduced in 2020. As the measures were dropped during the year, the Bank discontinued restrictions with respect to the economic sectors of borrowers, amount, type and location of collaterals, etc.

The main factors that affected the Bank in 2022 include the military conflict in Ukraine and the accelerated growth of inflation. The Bank continues to maintain the assumption for a prolonged conflict on the territory of Ukraine and a stable situation on our domestic market; political instability in Bulgaria – the country is governed by caretaker cabinet; a liquid and highly competitive Bulgarian banking system with historically high profit in 2022. During the year, the Bank carefully monitored the development of the military conflict in Ukraine and the accelerated inflation rate. It made changes to the expected credit losses model, to the methodology for Pillar 2 capital requirements calculation, etc.

Cash and balances with the Central Bank, at the amount of BGN 95,441 thousand and BGN 73,010 thousand, respectively as at 31 December 2022 and 31 December 2021, do not bear credit risk to the Bank due to their nature and the fact that they are at the Bank's disposal.

Receivables from banks at the amount of BGN 7,571 thousand and BGN 47,450 thousand respectively as at 31 December 2022 and 31 December 2021 consist mostly of deposits with first-class international and Bulgarian banks with maturity of up to seven days. The Bank manages the credit risk related to receivables from banks, by setting exposure limits at counterpart level.

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

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

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

Financial assets at fair value held for trading, at the amount of BGN 249 thousand and BGN 2,953 thousand respectively as at 31 December 2022 and 31 December 2021 pose mainly a market risk to the Bank (Note 31.4). The maximum exposure to credit risk for these instruments is their carrying amount.

Debt instruments at FVOCI amount to BGN 34,999 thousand and BGN 41,395 thousand as at 31 December 2022 and as at 31 December 2021. The maximum exposure to credit risk for these instruments is their carrying amount.

Debt instruments at amortised cost amount to BGN 44,887 thousand as at 31 December 2022 and have a maturity of up to 3 months. The maximum exposure to credit risk for these instruments is their carrying amount. The Bank will maintain a portfolio of similar volume and term in the longer term with an investment purpose.

In 2022 there was no increased level of the credit risk related to receivables from banks and in the Bank's securities portfolio, including in the context of effects from crisis situations due to the COVID-19 pandemic and the military conflict in Ukraine. The Bank adhered to and continues to adhere to the established procedures for risk assessment and classification of financial assets and to monitor periodic changes in the credit ratings of bank counterparts and securities issuers, incl. as a result of the post-pandemic situation, the high inflation and the military conflict in Ukraine on a regional, state, and individual level. In 2022 the Bank was focused on and invested in lower-risk and short-term securities.

The growth in interest rates in 2022 resulted in impairment of the Bank's portfolio securities. On the other hand, the interest rate increase resulted in additional interest income from the cash market and eliminated fees and changes and negative interest on funds with the BNB.

The contingent liabilities of the Bank consist of guarantees issued and undrawn loan amounts, whose amount of BGN 47,079 as at 31 December 2022 and BGN 44,746 thousand as at 31 December 2021 (Note 30) is the Bank's maximum credit exposure.

Loans and advances to customers with carrying amount of BGN 247,761 thousand and BGN 225,407 thousand, respectively, as at 31 December 2022 and 31 December 2021, bear the main credit risk to the Bank. The exposure of the Bank to that risk is determined on the basis of individual assessment of each loan, as the Bank applies the criteria for assessment and classification of risk exposures according to the Policy for impairment of financial assets and contingent liabilities.

In relation to the military conflict in Ukraine and the accelerated inflation growth, the management has analysed and identified the following potentially risk-exposed sectors that require increased attention and individual assessment approach:

- Art, print media, media and advertising;
- Light manufacturing industry;
- Real estate and immovable property transactions, leasing and business services;
- Construction;
- Transport;
- Tourist services;
- Trade, maintenance and repair of vehicles and consumer goods;
- Natural persons and households;
- Financial and insurance services;
- Human healthcare, sports and social activities;
- Other social and personal service activities.

In order to limit the impact of the military conflict in Ukraine and the accelerated inflation rate on lending activities in 2022, internal documents were adopted that regulate changes in internal processes, business strategies, and risk assessment:

- The probability of default ("PD") calculation model was re-calibrated in order to account for the recent trends in loans migration and the macroeconomic parameters. The recalibrated model was applied as from 31 December 2022.
- Changes to loan portfolio ECL calculation model:
    - A technical adjustment was applied to PD calculated through the re-calibrated model for calculation of PD for risk sectors – as at 31 December 2022, a 50% increase was applied.
    - The Bank retained the extended terms for realization of collaterals in the LGD of collectively impaired loans accounted for the effect of the COVID-19 pandemic:
        - For residential properties – 3 years;
        - For non-residential properties – 5 years.
    - The Bank retained the extended terms for realization of collaterals in the cash flows for calculation of ECL on individually impaired loans managed by Corporate Banking.
- "Supplement to the Methodology for preparation of an Internal Capital Adequacy Assessment (ICAA) of Tokuda AD to account for the effect of the military conflict in Ukraine and the accelerated inflation growth in the Pillar 2 capital requirements" – for loans in risk-exposed sectors, an additional increase is applied in PD at the amount of 50%. This measure is an addition to the increase in the effective PD for credit risk and for concentration in the loan portfolio envisaged in the effective methodology.
- Increased weight of parameters of stress tests and scenario analysis for operational risk – the following additions have been included in the model to supplement the standard calculation approach for "expert opinion and assessment":
    - Three categories of risk are taken into consideration (instead of one) that historically have the

highest number of reported operational events;
- The result from the stress test using the "expert opinion and assessment" approach was calculated separately for the three categories in the above item and when determining the need of additional Pillar 1 capital for operational risk, the highest result from the simulation with the three categories was applied.

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

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

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

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

Credit risk monitoring and control are carried out at the level of:
- loan transaction:
  - upon forming the credit exposure.
  - after forming the credit exposure.
- loan portfolio.

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

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

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

<u>Internal structure and units involved in credit risk management</u>
The Corporate Banking Division and Retail Lending Division at the Bank's Head Office, as well as the loan specialists at the Bank's branches where such a position exists:
- identify, coordinate and are responsible for the Bank's customer relations on loan transactions, as well as for attracting new customers;
- collect the necessary information and prepare a company, market and financial analysis and loan proposals to the Credit Committee;
- administer, monitor and manage the loan portfolio, including collection;
- apply, coordinate and are responsible for and report on the results from the Bank's lending activity in accordance with the approved lending policy.

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

The Loan Administration (LA) Division at the Bank’s Head Office:
- reviews, approves and controls the loan documentation and its compliance with the competent bodies on the loan transactions;
- keeps a register of collaterals and of related parties;
- monitors and controls compliance with the conditions envisaged in the loan agreements and annexes thereto;
- controls the process of updates of collateral valuation, as well as validity of collaterals;
- controls the process of updates (renewal) of collaterals’ insurance.

The Workouts and Foreclosure Department at the Bank’s Head Office monitors and controls, together with other units, loans past due by over 90 days or upon the occurrence of other events requiring early repayment, and carries out the foreclosure proceedings.

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

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

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

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

According to the policy of the Bank:
A non-performing exposure is one that has significant breaches in its servicing or there is evidence that the financial position of the debtor is deteriorated to the extent that current and anticipated proceeds are insufficient to pay all its debts to the Bank and other creditors and when the Bank expects to incur losses. Non-performing is also exposure for which the debtor is assessed as unlikely to pay its credit obligations in full without realisation of collateral regardless of the existence of any past due amount or of the number of days past due, with the exception of exposures where the realization of collateral is set in the initial loan agreement repayment schedule. Additionally, an exposure is classified as non-performing when it meets any of the following criteria:
- it has accumulated arrears on principal or interest more than 90 days;
- the financial position of the debtor has substantially deteriorated, which may jeopardize repayment;
- debtor has been declared bankrupt or is in liquidation procedure and there is risk of leaving unsatisfied creditors;
- the balance sheet receivable is subject to legal proceedings or is granted to the Bank by the court but is not collected;
- other criteria as per the provisions of Art. 178 of Regulation (EU) 575/2013.

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

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

Policy and process of impairment of loans and advances to customers

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

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

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

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

Objective evidence of credit impairment of the financial assets includes:

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

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

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

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

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

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

Determining expected credit losses for loan exposures collectively assessed for impairment
The approaches used to determine expected credit losses take into consideration the historic behaviour of loan

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

exposures and the expected future development of certain macro-economic, market, statutory and other factors that impact the borrowers' ability to service their payables under loan exposures. Expected credit losses are determined at loan level and are calculated using the formula ECL = EAD x PD x LGD, where:

- EAD (exposure at default) = current balance sheet exposure + CCF x unused part of the available limit, where CCF – credit conversion factor; EAD for off-balance sheet commitments = CCF x off-balance sheet commitment;
- PD (probability of default) – the probability of occurrence of default applicable for the loan, calculated based on the model of calculation of possibilities of default. For loans at Stage 1, probability of default over the next 12 months is used. For loans at Stage 2 and Stage 3, probability of default over the financial instrument's life term is used;
- LGD (loss given default) – loss upon occurrence of default – it is the difference between the loan exposure and the total amount of NRV (as defined below) of the available loan collaterals (if NRV>0) and the amount of the loan exposure; if NRV of the collaterals exceed the credit exposure, LGD = 0;
- NRV (Net Realizable Value) – net realizable value of the collateral at the respective reporting date; determined as the sum of market values of the loan's collaterals calculated by using standard assumptions for (i) expected changes in value over time, (ii) expected realisation timeframe and (iii) expected realisation costs.

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

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

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

<u>Quality of balances with the Central Bank</u>
The table below provides information on the credit quality and maximum exposure to credit risk of exposures to the Central Bank according to the Bank's internal risk classification. The amounts presented reflect the movement in the amortised cost of exposures before the allowance for expected credit losses and the allowance for expected credit losses in the reporting period.

	2022		**2021**	
	Stage 1		**Stage 1**	
	Gross amortised cost	**Allowance for expected credit losses**	**Gross amortised cost**	**Allowance for expected credit losses**
Amount at 1 January	63,332	(6)	39,135	(2)
New exposures	2,604,386	-	1,743,896	(4)
Paid exposures	(2,582,651)	2	(1,719,699)	-
Amount at 31 December	**85,067**	**(4)**	**63,332**	**(6)**

<u>Quality of receivables from banks</u>
The table below provides information on the credit quality and maximum exposure to credit risk of exposures to banks according to the Bank's internal risk classification. The amounts presented reflect the movement in the amortised cost of exposures before the allowance for expected credit losses and the allowance for expected credit losses in the reporting period

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

	2022		2021	
	Stage 1		Stage 1	
	Gross amortised cost	**Allowance for expected credit losses**	**Gross amortised cost**	**Allowance for expected credit losses**
Amount at 1 January	47,452	(2)	31,193	(3)
New exposures	440,736	-	397,772	(2)
Paid exposures	(480,616)	1	(381,513)	3
Amount at 31 December	**7,572**	**(1)**	**47,452**	**(2)**

Quality of debt and equity instruments at fair value through other comprehensive income
Note 7 provides information on the credit quality and maximum exposure to credit risk of exposures to debt and equity instruments at fair value through other comprehensive income according to the Bank's internal risk classification.

Quality of debt instruments at amortised cost
Note 8 provides information on the credit quality and maximum exposure to credit risk of exposures to debt and instruments at amortised cost according to the Bank's internal risk classification.

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

Change in the gross amortised cost	**Stage 1**	**Stage 2**	**Stage 3**	**2022**
Amount on 1 January 2022	**150,416**	**55,194**	**27,980**	**233,590**
New exposures	84,609	2934	324	87,867
Paid exposures	(40,425)	(19,607)	(5,080)	(65,112)
Transfer to Stage 1	6,130	(6,021)	(109)	-
Transfer to Stage 2	(5,578)	5,921	(343)	-
Transfer to Stage 3	-	(3,011)	3,011	-
Amounts written-off	-	-	(1,656)	(1,656)
Amount on 31 December 2022	**195,152**	**35,410**	**24,127**	**254,689**

Change in the impairment allowance	**Stage 1**	**Stage 2**	**Stage 3**	**2022**
Amount on 1 January 2022	89	311	7,783	8,183
Impairment accrued	80	463	2,019	2,562
Reversed impairment	(80)	(189)	(1,968)	(2,237)
Increase in the impairment allowance for unrecognised interest on loans in Stage 3	-	-	76	76
Transfer to Stage 1	-	-	-	-
Transfer to Stage 2	-	-	-	-
Transfer to Stage 3	-	(43)	43	-
Amounts written-off	-	-	(1,656)	(1,656)
Amount on 31 December 2022	**89**	**542**	**6,297**	**6,928**

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

Change in the gross amortised cost	**Stage 1**	**Stage 2**	**Stage 3**	**2021**
Amount on 1 January 2021	**166,074**	**37,752**	**30,634**	**234,460**
New exposures	46,530	5224	719	52,473
Paid exposures	(45,041)	(4,238)	(2,175)	(51,454)
Transfer to Stage 1	4,845	(4,817)	(28)	-
Transfer to Stage 2	(21,697)	21,757	(60)	-
Transfer to Stage 3	(295)	(484)	779	-
Amounts written-off	-	-	(1,889)	(1,889)
Amount on 31 December 2021	**150,416**	**55,194**	**27,980**	**233,590**

Change in the impairment allowance	**Stage 1**	**Stage 2**	**Stage 3**	**2021**
Amount on 1 January 2021	**73**	**425**	**8,765**	**9,263**
Impairment accrued	59	236	1,449	1,744
Reversed impairment	(42)	(341)	(663)	(1,046)
Increase in the impairment allowance for unrecognised interest on loans in Stage 3	-	-	111	111
Transfer to Stage 1	1	(1)	-	-
Transfer to Stage 2	(2)	4	(2)	-
Transfer to Stage 3	-	(12)	12	-
Amounts written-off	-	-	(1,889)	(1,889)
Amount on 31 December 2021	**89**	**311**	**7,783**	**8,183**

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

Change in the amount of the commitments undertaken and financial guarantee contracts	**Stage 1**	**Stage 2**	**Stage 3**	**2022**
Amount at 1 January 2022	**42,694**	**1,975**	**77**	**44,746**
New exposures	25,833	4,210	-	30,043
Paid exposures	(27,197)	(436)	(77)	(27,710)
Transfer to Stage 1	762	(762)	-	-
Transfer to Stage 2	-	-	-	-
Transfer to Stage 3	-	(27)	27	-
Amount at 31 December 2022	**42,092**	**4,960**	**27**	**47,079**

Change in the provision	**Stage 1**	**Stage 2**	**Stage 3**	**2022**
Amount at 1 January 2022	**15**	**8**	**-**	**23**
Accrued	19	37	-	56
Reversed	(11)	(3)	-	(14)
Transfer to Stage 1	-	-	-	-
Transfer to Stage 2	-	-	-	-
Transfer to Stage 3	-	-	-	-
Amount at 31 December 2022	**23**	**42**	**-**	**65**

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

Change in the amount of the commitments undertaken and financial guarantee contracts	**Stage 1**	**Stage 2**	**Stage 3**	**2021**
Amount at 1 January 2021	**30,058**	**2,335**	**282**	**32,675**
New exposures	30,391	290	-	30,681
Paid exposures	(17,657)	(748)	(205)	(18,610)
Transfer to Stage 1	27	(27)	-	-
Transfer to Stage 2	(125)	125	-	-
Transfer to Stage 3	-	-	-	-
Amount at 31 December 2021	**42,694**	**1,975**	**77**	**44,746**

Change in the provision	**Stage 1**	**Stage 2**	**Stage 3**	**2021**
Amount at 1 January 2021	**11**	**8**	**-**	**19**
Accrued	5	3	-	8
Reversed	(1)	(3)	-	(4)
Transfer to Stage 1	-	-	-	-
Transfer to Stage 2	-	-	-	-
Transfer to Stage 3	-	-	-	-
Amount at 31 December 2021	**15**	**8**	**-**	**23**

The classification of loans and advances to customers is as follows:

31 December 2022	Loans and advances to customers			Undrawn commitment	Guarantees		
	Amount	Share in %	Impairment	Amount	Amount	Share in %	Provision for credit losses
Performing	230,562	90.53	632	41,209	3,609	99.26	21
Non-performing	24,127	9.47	6,296	77	27	0.74	-
Total	**254,689**	**100.00**	**6,928**	**41,286**	**3,636**	**100.00**	**21**

31 December 2021	Loans and advances to customers			Undrawn commitment	Guarantees		
	Amount	Share in %	Impairment	Amount	Amount	Share in %	Provision for credit losses
Performing	205,610	88.02	400	41,209	3,460	100.00	23
Non-performing	27,980	11.98	7,783	77	-	-	-
Total	**233,590**	**100.00**	**8,183**	**41,286**	**3,460**	**100.00**	**23**

	31.12.2022		**31.12.2021**	
	Unimpaired	**Impaired**	**Unimpaired**	**Impaired**
Not overdue	133,168	79,468	128,703	55,868
up to 30 days past due	10,860	15,264	17,351	1,636
31 to 60 days past due	296	41	5,434	2,623
61 to 90 days past due	122	379	213	76
91 to 180 days past due	9	391	380	215
over 180 days past due	-	14,691	3,164	17,927
Book value	144,455	110,234	155,245	78,345
Allowance for impairment losses	-	(6,928)	-	(8,183)
Carrying amount	**144,455**	**103,306**	**155,245**	**70,162**

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

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

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

	2022	**2021**
Secured by cash and government securities	679	758
Secured by mortgage	210,745	198,967
Pledge on machines and equipment	7,286	6,896
Pledge on receivables	25,178	19,621
Other collaterals	10,122	6,660
Unsecured	679	688
Impairment	(6,928)	(8,183)
Total	**247,761**	**225,407**

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

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

	31.12.2022		**31.12.2021**	
	Gross amortised cost	**Impairment loss allowance**	**Gross amortised cost**	**Impairment loss allowance**
LTV ratio/loan-value ratio				
Below 50%	12,240	-	8,499	-
51-70%	12,529	-	7,926	(4)
71-90%	14,776	(19)	9,713	(2)
91-100%	1,854	(9)	926	(1)
Over 100%	3,010	(142)	1,893	(119)
Total	**44,409**	**(170)**	**28,957**	**(126)**

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

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

	31.12.2022	**31.12.2021**
Balances with the Central Bank:		
rating BBB	85,063	63,326
Total balances with the Central Bank	**85,063**	**63,326**
Receivables from banks		
rating A	2,934	25,389
rating A-	836	1,699
rating AA-	-	10,360
rating BBB	3,791	7,662
rating BBB-	-	2,339
rating BB	10	-
no rating	-	1
Total receivables from banks	**7,571**	**47,450**
Financial assets at FVPL:		
no rating	249	2,953
Total financial assets at FVPL	**249**	**2,953**
Debt instruments at fair value through other comprehensive income		
rating AAA	-	10,354
rating BBB	32,238	31,041
rating BBB-	2,761	-
Total debt instruments at fair value through other comprehensive income	**34,999**	**41,395**
Equity instruments at fair value through other comprehensive income no rating	381	293
Total equity instruments at fair value through other comprehensive income	**381**	**293**
Debt instruments at amortised cost		
rating AA+	31,157	-
rating AAA	9,761	-
rating BBB	3,969	-
Total debt instruments at amortised cost	**44,887**	**-**

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

Concentration of credit risk

A significant percentage of the loan portfolio of the Bank is concentrated in a limited number of borrowers. Despite the regulatory restrictions on large exposures, there is a risk that the Bank's activities, its financial position and the result of its operations are negatively affected if some of the largest borrowers do not settle their obligations. Information on large exposures of the Bank other than exposures to credit institutions (exposures which represent 10% or more of the Bank's Tier 1 capital) at their carrying amount as of 31 December 2022 and 2021 is presented in the table below:

	2022		2021	
	BGN'000	% of Tier 1 capital	BGN'000	% of Tier 1 capital
Largest total exposure to a customer group	10,279	26.67%	11,667	28.34%
Total amount of the five largest exposures	41,530	107.76%	41,025	99.66%
Total amount of all exposures – over 10% of the Tier 1 capital	108,198	280.74%	114,201	277.42%

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

31.3. Liquidity risk

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

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

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

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

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

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

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

The Bank maintains large amount of highly liquid assets as cash in hand and balances with the Central Bank, which guarantee Bank's ability to meet its liquidity requirements. As at 31 December 2022 and 2021, cash and balances with the Central Bank represent respectively 21% and 17% of the Bank's total assets.

As an additional instrument to provide high liquidity, the Bank uses loans granted to banks. These comprise mostly of deposits in first-class international and Bulgarian banks with maturity up to 7 days. As at 31 December 2022 and 2021, receivables from banks represent respectively 2% and 11% of the Bank's total assets.

Government securities owned by the Bank and not pledged as collateral as at 31 December 2022 and 2021 represent respectively 16% and 8% of the Bank's total assets. By maintaining 39% (2021: 36%) of its assets in highly liquid assets, the Banks ensures the ability to settle all maturities of financial liabilities.

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

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

31 December 2022	up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Total
Deposits from banks	49	-	-	-	-	49
Deposits from customers	243,415	37,235	86,784	44,232	1,755	413,421
Lease liabilities	70	141	633	850	17	1,711
Subordinated debt	-	-	-	-	2,834	2,834
Other financial liabilities	803	-	-	-	-	803
Total financial liabilities	**244,337**	**37,376**	**87,417**	**45,082**	**4,606**	**418,818**

31 December 2021	up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Total
Deposits from banks	65	-	-	-	-	65
Deposits from customers	212,805	34,332	69,098	64,490	1,795	382,520
Lease liabilities	78	156	702	1,329	125	2,390
Subordinated debt	-	-	-	-	2,951	2,951
Other financial liabilities	615	-	-	-	-	615
Total financial liabilities	**213,563**	**34,488**	**69,800**	**65,819**	**4,871**	**388,541**

The financial liabilities of the Bank are mainly attracted funds on deposits – retail and corporate. Customers often prefer to sign a deposit agreement with one month term and to renegotiate it regularly for a longer period. As a result, one-month deposits are practically a long-term and relatively permanent resource of the Bank.

No negative effects have been identified on the Bank's liquidity as a result of the COVID-19 pandemic and the military conflict in Ukraine and the accelerated inflation growth.

31.4. Market risk

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

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

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

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

Deviations from the limits set are only allowed with the explicit permission of the Assets and Liabilities Management Committee.
Market risk management includes:

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

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

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

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

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

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

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

No additional adverse effects have been indicated on the market risk for the Bank as a consequence of the COVID-19 pandemic.

31.4.1. Interest rate risk

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

The Bank uses the GAP analysis method (gap analysis) to measure and assess the interest rate risk, allocating the interest-bearing assets and liabilities in time ranges, depending on the moments of their revaluation (for instruments with floating interest rate) and maturity (for instruments with fixed interest rate). Using this method the management of the Bank identifies the sensitivity of the expected income and expenses to changes in interest rates. The Gap analysis method aims to determine the exposure of the Bank, as a total amount and by separate types of financial assets and liabilities, in relation to expected interest rate fluctuations and their effect on the net interest income. It assists the management of assets and liabilities and is also an instrument for securing sufficient and stable net interest profitability. To assess the effect of interest changes on the economic value of the capital, the Bank applies stress tests according to Appendix III of Guidelines EBA/GL/2018/02 on the management of interest rate risk in the loan portfolio (IRRBB). The management assesses the exposure of the Bank's portfolio to interest rate risk and its sensitivity to this type of risk as moderate in view of the volumes and structure of the operations.

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

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

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

EUR are based on the quoted rates of the European Central Bank.

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

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

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

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

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

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

31 December 2022	**up to 1 month**	**1 to 3 months**	**3 months to 1 year**	**1 to 5 years**	**over 5 years**	**Total**
Interest-bearing assets						
Receivables from banks	7,571	-	-	-	-	7,571
Loans and advances to customers	212,579	7,520	1,326	1,945	24,391	247,761
Debt instruments at FVOCI	-	1,979	4,864	28,156	-	34,999
Debt instruments at amortised cost	31,158	13,729	-	-	-	44,887
Total interest-bearing assets	**251,308**	**23,228**	**6,190**	**30,101**	**24,391**	**335,218**
Interest-bearing liabilities						
Deposits from banks	49	-	-	-	-	49
Deposits from customers	243,413	37,226	86,605	43,980	1,708	412,932
Subordinated debt	-	-	-	-	1,959	1,959
Lease liabilities	70	141	633	850	17	1,711
Total interest-bearing liabilities	**243,532**	**37,367**	**87,238**	**44,830**	**3,684**	**416,651**
Gap between interest-bearing assets and liabilities, net	**7,776**	**(14,139)**	**(81,048)**	**(14,729)**	**20,707**	**(81,433)**

31 December 2021	**up to 1 month**	**1 to 3 months**	**3 months to 1 year**	**1 to 5 years**	**over 5 years**	**Total**
Interest-bearing assets						
Receivables from banks	47,450	-	-	-	-	47,450
Loans and advances to customers	193,382	135	2,001	6,868	23,021	225,407
Debt instruments at FVOCI	-	1,997	10,354	29,044	-	41,395
Total interest-bearing assets	**240,832**	**2,132**	**12,355**	**35,912**	**23,021**	**314,252**
Interest-bearing liabilities						
Deposits from banks	65	-	-	-	-	65
Deposits from customers	212,805	34,321	68,952	63,886	1,746	381,710
Subordinated debt	-	-	-	-	1,959	1,959
Lease liabilities	78	156	702	1,329	125	2,390
Total interest-bearing liabilities	**212,948**	**34,477**	**69,654**	**65,215**	**3,830**	**386,124**
Gap between interest-bearing assets and liabilities, net	**27,884**	**(32,345)**	**(57,299)**	**(29,303)**	**19,191**	**(71,872)**

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

	31.12.2022	**31.12.2021**
Interest-bearing assets		
Receivables from banks	0.81	(.21)
Financial assets at FVPL	5.32	2.86
Loans and advances to customers	4.12	3.97
Debt instruments at amortised cost	0.54	-
Debt instruments at FVOCI	0.59	0.72
Interest-bearing liabilities		
Deposits from banks	-	-
Deposits from customers	0.14	0.21
Lease liabilities	0.43	0.46
Subordinated debt	5.00	5.00

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

31.4.2. Currency risk

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

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

The currency risk is the risk of negative effect of the fluctuations of prevailing exchange rates on the financial position and the cash flows of the Bank. Currency risk management is based on limits on open positions in certain currencies and the active management of open exposures for the purpose of reducing the Bank’s exposure to this risk. The main part of the assets and liabilities of the Bank are denominated in EUR and BGN. The Bank aims to not hold open positions in currencies other than EUR.

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

31 December 2022	**BGN**	**EUR**	**USD**	**JPY**	**Other**	**Total**
Assets						
Cash and balances with the Central Bank	83,836	9,499	1,449	84	573	95,441
Receivables from banks	141	3,784	2,040	26	1,580	7,571
Financial assets at FVPL	249	-	-	-	-	249
Debt instruments at FVOCI	28,172	4,066	2,761	-	-	34,999
Equity instruments at FVOCI	381	-	-	-	-	381
Debt instruments at amortised cost	-	13,729	31,158	-	-	44,887
Loans and advances to customers	205,529	40,901	1,331			247,761
Total assets	**318,308**	**71,979**	**38,739**	**110**	**2,153**	**431,289**
Liabilities						
Deposits from banks	-	19	30	-	-	49
Deposits from customers	208,961	163,012	38,705	129	2,125	412,932
Subordinated debt	-	1,959	-	-	-	1,959
Lease liabilities	1,711	-	-	-	-	1,711
Other financial liabilities	798	5	-	-	-	803
Total liabilities	**211,470**	**164,995**	**38,735**	**129**	**2,125**	**417,454**
Net position	**106,838**	**(93,016)**	**4**	**(19)**	**28**	**13,835**

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

31 December 2021	BGN	EUR	USD	JPY	Other	Total
Assets						
Cash and balances with the Central Bank	64,616	6,676	648	99	971	73,010
Receivables from banks	124	21,462	24,648	12	1,204	47,450
Financial assets at FVPL	249	-	2,704	-	-	2,953
Debt instruments at FVOCI	26,646	4,395	10,354	-	-	41,395
Equity instruments at FVOCI	293	-	-	-	-	293
Loans and advances to customers	174,091	50,795	521	-	-	225,407
Total assets	**266,019**	**83,328**	**38,875**	**111**	**2,175**	**390,508**
Liabilities	-	34	31	-	-	65
Deposits from banks	-	34	31	-	-	65
Deposits from customers	200,366	140,413	38,670	90	2,171	381,710
Subordinated debt	-	1,959	-	-	-	1,959
Lease liabilities	2,390	-	-	-	-	2,390
Other financial liabilities	382	94	139	-	-	615
Total liabilities	**203,138**	**142,500**	**38,840**	**90**	**2,171**	**386,739**
Net position	**62,881**	**(59,172)**	**35**	**21**	**4**	**3,769**

31.4.3. Price risk

Price risk is related to the fluctuations in market prices of financial assets and liabilities, which can cause losses for the Bank. The main risk for the Bank is the decrease of market prices of the financial instruments at fair value through profit or loss or through other comprehensive income, which are mainly government securities.

31.4.4. Sensitivity to market risk

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

As at 31 December 2022, the Bank performed an interest rate sensitivity analysis based on the assumption of parallel shift in the interest curve applied on the interest gap. The expected effect on 200 b.p. shift is +/- BGN 780 thousand (2021: +/- BGN 150 thousand).

To assess the effect of potentially possible extreme fluctuations of interest rates, the Bank analyses the effect of several standardized interest rate shocks on the trading portfolio. The price fluctuation in the parallel shift of the yield curve by 100 basis points should not exceed 5% of the capital base calculated in the last quarter. As at 31 December 2022 there are no debt securities in the securities trading portfolio and the ratio amounts to 0.00% of the capital base (2021: 0.05%).

31.5. Fair value

Fair value of financial instruments
The Bank determines the fair value of its financial instruments based on the available market information or by using appropriate valuation techniques when no such information is available. Information about the carrying amounts and fair values of financial assets and liabilities is presented in Note 31.1.

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

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

31 December 2022	Carrying amount	Level 1 – quoted market price	Level 2 – valuation technique – observable market data	Level 3 – valuation technique – unobservable market data
Assets measured at fair value				
Financial assets at FVPL	249	249	-	-
Debt instruments at FVOCI	34,999	-	34,999	-
Equity instruments at FVOCI	381	-	-	381
Total	**35,629**	**249**	**34,999**	**381**

31 December 2021	Carrying amount	Level 1 – quoted market price	Level 2 – valuation technique – observable market data	Level 3 – valuation technique – unobservable market data
Assets measured at fair value				
Financial assets at FVPL	2,953	249	2,704	-
Debt instruments at FVOCI	41,395	-	41,395	-
Equity instruments at FVOCI	293	-	-	293
Total	**44,641**	**249**	**44,099**	**293**

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

31 December 2022	Level 1	Level 2	Level 3	Total
Financial assets				
Cash and balances with the Central Bank	10,378	85,063	-	95,441
Receivables from banks	-	7,571	-	7,571
Loans and advances to customers	-	-	252,936	252,936
Debt instruments at amortised cost	-	44,890	-	44,890
Total	**10,378**	**137,524**	**252,936**	**400,838**
Financial liabilities				
Deposits from banks	-	49	-	49
Deposits from customers	-	413,014	-	413,014
Subordinated debt	-	-	1,959	1,959
Lease liabilities	-	-	1,711	1,711
Other financial liabilities	-	-	803	803
Total	**-**	**413,063**	**4,473**	**417,536**

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

31 December 2021	Level 1	Level 2	Level 3	Total
Financial assets				
Cash and balances with the Central Bank	9,684	63,326	-	73,010
Receivables from banks	-	47,450	-	47,450
Loans and advances to customers	-	-	228,813	228,813
Total	**9,684**	**110,776**	**228,813**	**349,273**
Financial liabilities				
Deposits from banks	-	65	-	65
Deposits from customers	-	381,962	-	381,962
Subordinated debt	-	-	1,959	1,959
Lease liabilities	-	-	2,390	2,390
Other financial liabilities	-	-	615	615
Total	**-**	**382,027**	**4,964**	**386,991**

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

Fair value of non-financial assets
The tables below provide information on the main valuation methods and inputs used in determining the fair value of investment property (Note 11), assets acquired from non-performing loans (Note 14) and non-current assets held for sale (Note 10).

31 December 2022		Market comparables method – bid prices for sale used (EUR/square meter)	Income method – bid prices for rental used (EUR/square meter)
Type of investment property			
holiday	1,123	388-665	-
retail	9,431	235-3462	1-14
regulated landed property	159	35-39	-
Total	**10,713**		
Non-current assets held for sale			
holiday	271	150-400	-
Total	**271**		
Assets acquired against debt from non-performing loans			
holiday	207	231-368	1.0-3.0
retail	1,117	342-476	28-54
regulated landed property/landed property	723	1-68	-
industrial, administrative and other	10,710	126-800	3-6
residential	303	220-2167	5
	13,060		

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

31 December 2021		Market comparables method – bid prices for sale used (EUR/square meter)	Income method – bid prices for rental used (EUR/square meter)
Type of investment property			-
holiday	8,918	260-562	-
retail	4,384	117-1971	1-12
regulated landed property	159	35-36	-
industrial	2,150	215-386	1-3
Total	**15,611**		
Non-current assets held for sale			
holiday	1,070	150-400	-
Total	**1,070**		
Assets acquired against debt from non-performing loans			
holiday	2,354	215-1455	-
retail	539	342-476	-
regulated landed property/landed property	725	5-68	-
industrial, administrative and other	12,356	147-1236	1-6
residential	543	220-1294	-
	16,517		

31.6. Operational risk

Operational risk is the risk of a loss resulting from inadequately or poorly functioning internal processes, staff and systems or from external events. This risk includes legal and regulatory risk and excludes strategic and reputational risk. The main sources of the Bank’s operational risk are staff, processes, systems, and external events. The occurrence of operational risk could be caused by internal and external causes. The management of operational risk mainly aims to keep it at a level (general and by individual categories) that is adequate to the Bank’s operations, structure, and scope.

The Bank has developed internal rules for operational risk identification, assessment and control. In accordance with the regulatory and legal requirements, the Bank maintains a database of detailed characteristics of operational events (Register of operational events), and may upon its discretion collect additional information.

The losses resulting from the different combination of factors leading to an operational event are classified into seven different categories: internal fraud; external fraud; work safety and work process; clients, products and business practices; damage to physical assets; business interruption and system crashes; performance, delivery and process management.

For the purpose of operational risk analysis and assessment and forecasting expected losses on operational events, the Bank uses different statistical indicators to conduct stress tests and scenario analyses. The stress tests and scenario analyses are prepared and documented in line with the methodology developed and are reported to the Bank’s MB.

The Bank’s structure of operational risk management and control aims to create a working environment and a corporate culture to support the identification and resolution of issues related to operational risk at the Bank, to the involvement and contribution of all employees in prevention thereof. The unit responsible for the current monitoring and management of operational risk is the Operational Risk Management Department at the RMM Division. The bodies to which operational risks are reported are the Risk Management Committee and the MB.

There are three levels of protection in the Bank’s organizational structure: (1)risk identification and management at different units and business lines; (2)independent function for operational risk assessment and reporting at the unit holding control functions for operational risk management at the RMM Division; (3)independent function for monitoring and assessment of the processes related to countering operational risk performed by the Internal Audit unit.

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

For the purpose of capital adequacy, the Bank applies the basis indicator method.

32. OTHER REGULATORY DISCLOSURES

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

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

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

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

	2022	**2021**
Total operating income	16,863	14,211
Operating profit/(loss) before tax	2,412	(552)
Tax saving	21	60
Return on assets (%)	0.54%	-0.04%
Equivalent number of full-time employees as at 31 December	205	208
State subsidies received	-	-

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

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

33. CAPITAL MANAGEMENT

The Bank is subject to regulations in relation to meeting the requirements for capital adequacy in accordance with Directive 2013/36/EU on access to the activity of credit institutions, Regulation (EU) 575/2013 on prudential requirements for credit institutions and investment firms (package CRD IV), the Credit Institutions Act, Ordinance 2 of the BNB on licenses, approvals and permits issued by the Bulgarian National Bank pursuant to the Credit Institutions Act and other applicable statutory acts of the Bulgarian legislation. In Bulgaria, the minimum required paid-up capital upon a bank's incorporation shall be no 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.

Regulation (EU) 575/2013 (CIR) determines capital adequacy ratios as a percentage of the overall risk exposure, as follows:

- Common Equity Tier 1 capital ratio – 4.5%;
- Tier 1 capital ratio – 6%, and
- Total capital ratio – 8%.

The items of the common equity Tier 1 of the banking institution include:

- equity instruments meeting certain criteria;
- premium reserves related to the above stated equity instruments;
- retained earnings;
- accumulated other comprehensive income;
- other reserves;

- fund to cover general banking risks.

The items of the additional Tier 1 include:
- equity instruments, when certain conditions of the Regulation are met;
- premium reserves related to the above stated equity instruments.

The items and instruments of Tier 2 include:
- equity instruments, when certain conditions of the Regulation are met;
- premium reserves related to the above stated equity instruments;
- for institutions calculating the amount of risk-weighted exposures in accordance with certain conditions – the general credit risk adjustments, gross of tax effects, of up to 1,25 % of risk-weighted exposure amounts calculated in accordance with the conditions of the Regulation;
- for institutions calculating risk-weighted exposure amounts under certain conditions of the Regulation, positive amounts, gross of tax effects, resulting from the calculation laid down in the Regulation up to 0,6 % of risk weighted exposure amounts.

Directive 2013/36/EU (CRD IV) introduced the setting up of 5 new capital buffers:
- Capital conservation buffer,
- Bank-specific countercyclical capital buffer,
- Systemic risk buffer,
- Buffer for global systemically important institutions - G-SII buffer,
- Buffer for other systemically important institutions - O-SII buffer.

Directive 2013/36/EU (CRD IV), in its part concerning capital buffers, has been transposed into the Bulgarian legislation by means of Ordinance 8 of the Bulgarian National Bank. It sets the additional capital buffers that banks shall maintain above the minimum capital requirements. The requirements applicable to Tokuda Bank and applicable as at 31 December 2022 are as follows:

- Capital conservation buffer, equal to 2.5% of the Bank's total risk exposure;
- countercyclical capital buffer – 1% of the Bank's total risk exposure;
- Systematic risk buffer – 3% of the Bank's total risk exposure.

As from 1 April 2023, pursuant to a decision of the Management Board of BNB, the countercyclical capital buffer applicable to local credit risk exposures will increase to 1.5%.

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

The Bank maintains capital adequacy above the minimum regulatory ratios. The total capital ratio as at 31 December 2022 is 18.40% (31 December 2021: 18.55%).

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

Additional information is presented in the table below:

	31.12.2022	**31.12.2021**
Equity	40,496	41,165
Common equity Tier 1 capital	38,540	41,165
Tier 2 capital	1,956	-
Capital requirements		
Total risk-weighted assets for credit risk, credit risk from the counterpart and risk of dilution and free supplies	183,289	196,093
Total exposures to position, currency and commodity risk	500	863
Total risk exposures to operational risk	25,688	24,925
Total risk exposures	**209,477**	**221,881**
Capital ratios		
Common equity Tier 1 capital ratio	18.40%	18.55%
Excess (+)/Shortage (-) of common equity Tier 1 capital	29,114	31,180
Tier 1 capital ratio	18.40%	18.55%
Excess (+)/Shortage (-) of Tier 1 capital	25,971	27,852
Total capital ratio	19.33%	18.55%
Excess (+)/Shortage (-) of total capital	23,738	23,415

34. EVENTS AFTER THE REPORTING PERIOD

No events occurred that would result in additional adjustments and/or disclosures in the Bank's financial statements for the year ended 31 December 2022.