TOKUDA BANK AD

SEPARATE AND CONSOLIDATED
REPORT ON THE ACTIVITIES,
CORPORATE GOVERNANCE STATEMENT,
INDEPENDENT AUDITOR'S REPORT
AND SEPARATE AND CONSOLIDATED
FINANCIAL STATEMENTS

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Unofficial translation of the original in Bulgarian

Tokuda Bank

REPORT ON THE ACTIVITIES

2017

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I. Environment in which Tokuda Bank AD operated in 2017

In 2017 the economic growth in the country remained close to the level reached in 2016, as according to preliminary data of the National Statistical Institute (NSI) the growth rate for last year has slowed to 3.6% on an annual basis. In view of the external political instability and the growing expectations for economic stagnation, the Business Climate Indices remained fluctuating, while the external environment has remained in such condition that does not particularly support the processes of recovery of the economy in the country. The data obtained according to the method of final consumption expenditure (FCE) show that in 2017 the influence of the net export in the total growth in the Gross Domestic Product (GDP) marked a triple decrease (from 4.31% in 2016 to 1.53% in 2017). It is notable that in parallel to the decrease of the export share in the GDP structure, its structure is still dominated by low value-added products, due to which the component does not contribute significantly to the recovery potential of the local production.

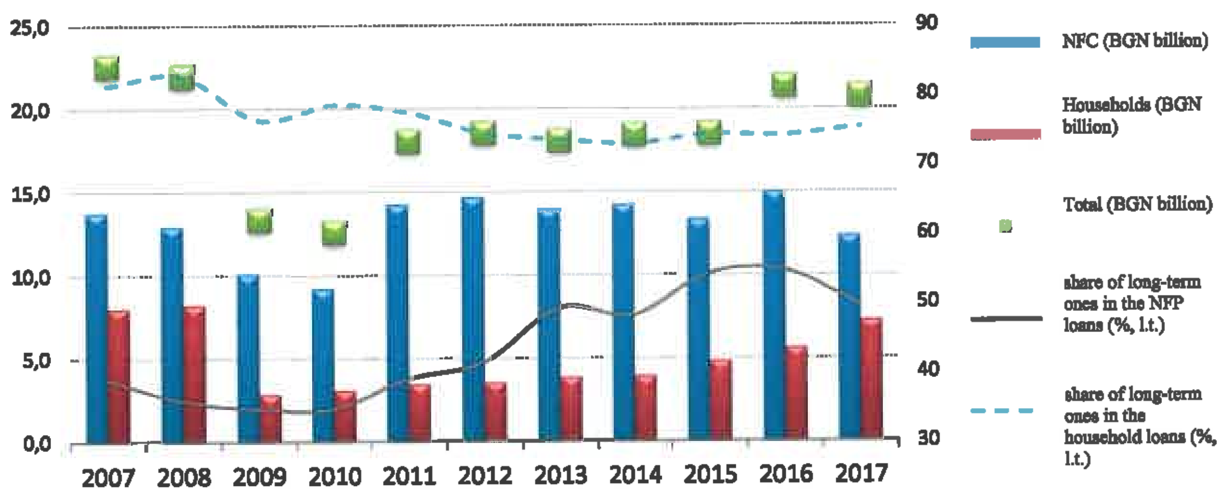
A positive trend in 2017 was the reported record growth of final consumption expenditure of households (by 4.8%), which was quite natural in view of the 11% increase of the average salary. A record rate (3.8%) was also reported for the component of gross share capital formation, which had been also expected to a considerable degree in view of the intensive decapitalization of local economy in recent 6-7 years – at an average of BGN 21.6 billion of gross share capital formation at fixed rates for the first three years since the EU accession, shortly after the beginning of the crisis their volume marked a tangible decrease, as since 2010 up to present it has been approximately BGN 16.2 billion per year. We may say that the acceleration of the accumulation rate in the last couple of years contributed to some extent to the increase of labour productivity in the local economy. However, the remaining average indicators of the dynamics in view of the specified component, as well as the expectations for the forthcoming end of the economic cycle prevailing hitherto, do not give specific grounds for making an assumption of any significant improvement of the potential GDP in a medium-term perspective.

The negative finding from the past year data analysis is that the achieved economic growth is still insufficient for the needs of convergence. What is more - there is no perceptible impact on poverty reduction neither upon the economic inequalities and social stratification. Despite the reported decrease for last year of some indicators of the share of people living in poverty and income inequality, Bulgaria has remained at the EU top, as most probably we can expect that in a medium-term plan the inequality to deepen and the process of convergence to slow down.

In view of the above, there were no significant changes in the established trends in the banking sector last year. Despite the ongoing processes of economic recovery and interest rate decrease, the lending activity has remained relatively weak. The monetary statistics data (Figure 1) show that last year the volumes of new business for non-financial enterprises reached only BGN 12.355 billion, which was 1/5 less than the last year's volume and significantly below the average value of realization for the preceding six years (approximately BGN 14.2 billion). It makes an impression that the weakened activity in the corporate segment is accompanied by a decrease of the share of long-term loans, thus showing that the decrease in the volume is mostly preconditioned rather by the lower demand for investment loans than by purely technical indicators, such as weakened activity of renegotiation and refinancing of old receivables.

Nearly 6.1 billion of the volumes of new business in the non-financial corporations (NFC) segment have an agreed maturity of over 5 years with the share of long-term loans thus reaching 49.6%, which is by 5.1 percentage points less than the one reported for 2016 (as a comparison – before the beginning of the financial crisis this share remained at levels of 35-37%), which has been a result of the reduced demand for investment loans and which is indicative itself of the lowered investment activity of enterprises, resp. indicative of the preservation of the pessimistic attitudes of the business in the short-term plan and in the medium-term plan and for this year.

Figure 1 Volumes by new business for the period I-VIII



Source: BNB, own calculations

In addition to the unfavorable business attitudes, the occurring change in the credit policy of the banks contributes to the reduced activity in the corporate segment – the summarized results from the bank lending survey of BNB show that since the last quarter of 2016 up to present they have been kept unchanged the standards for granting corporate loans (including to big enterprises), thus strongly impacting the volumes by new business in the segment. Meanwhile, the financial institutions have been striving to stimulate the lending activity by continuously relieving the conditions under the loans offered by them - during the entire year of 2017 the balance of opinions with respect to NFC lending interest rates remained highly negative, regardless of the slight improvement (of -66 for the first quarter up to -58 for the fourth quarter), due to the fact that more than half of all inquired banks reported for a decrease in the interest rates of recently granted loans in the mentioned segment. Obviously, this is not a stimulus strong enough for potential business clients, due to the fact that the number of respondents reporting on increased demand of company loans also decreased (from six in the first half to five in the second half).

It is notable that regardless of the lower business lending in 2017 the gross loans of legal entities printed a relatively low decrease - by BGN 20 million, to BGN 33.160 billion, while in 2016 they decreased by BGN 804.6 million, regardless of the reported larger volume by new business in this segment. The above may be explained mostly by the reduced amortization of the NFC portfolio, being the result of the increased share of long-term loans in the period 2014-2016, thus successfully compensating not only the reduced lending activity, but also the acceleration of the dynamics of nonperforming and restructured loans in the segment (which decreased by BGN 762 million to BGN 3.917 billion last year while in 2016 they decreased faster– by BGN 626 million).

Figure 2 Gross loans before impairment as at the end of the period [BGN billion]

Source: BNB, own calculations

There have been some favorable trends in retail lending. This segment has demonstrated a higher activity, as the total volume by new business has been marking an increase for eighth consecutive year by reaching BGN 7.252 billion for 2017, being 22.7% more than the achieved volume in 2016. One need to note that this trend demonstrates some good stability in time – actually, the volumes by new business in this segment have been constantly increasing since 2010 up to now. Furthermore, there has been also a stable trend in the dynamics of the share of long-term household loans. While just before the beginning of the financial crisis this share was about 81-82% of the total volume by new business in households lending, during the next six years the share of long-term loans decreased down to 72.9%. Since 2015 up to present the ratio has been increasing gradually (mostly due to the increased activity in the mortgage segment), thus reaching 75.3% in the end of 2017 (Figure 1).

The increased activity in retail lending had its impact on the dynamics of the absolute volume of gross loans. After the continuous slow-down of household lending (for the period after 2010), in the summer of 2016 the growth rates in this segment reached positive values of 0.17% on an annual basis in August), with the growth rate permanently remaining above 6% on an annual basis after the month of October 2017. The main reason for this abrupt change was the 23% increase in the volumes by new business, despite the fact that a considerable part of these volumes resulted from refinancing of old loans (indicated by the rate of reduction of overdrafts by the end of the first half of 2017).

The explanation of the increased household activity is purely intuitive, as far as throughout the entire period since the beginning of 2017 the growth of compensation of employees (labour costs and social security) have been accelerating (exceeding 11% in the end of 2017), as the unemployment continued decreasing for the sixth consecutive year (up to 7.1% for 2017 according to the Employment Agency), as the actual GDP growth has been remaining at relative good levels for the third consecutive year now. In parallel to the above, the policy of commercial banks also has a positive impact on the volume growth, as banks keep offering better lending conditions – the results from the regular BNB lending survey show that half of all respondents have undertaken actions towards decrease of the interest rates on the new consumer loans for the first and second quarter of 2017, as for the mortgage segment this share is even higher (decreased interest rates for the first quarter are reported by 13 out of 19 banks - respondents). The increased demand for household loans has resulted in a gradual change of banks' behavior, as less have reported a decrease in interest rates for the fourth quarter of 2017 (respectively to 6 in the consumer segment and to 9 in the mortgage segment).

The observation of the lending activity in 2017 came to an impression that despite its partial recovery it remained far below the target values of most of the local banks, for the rate of gross loans (excluding loans and advances to central banks and credit institutions) remained behind the total growth rate of lending, thus increasing last year by 2.97% on an annual basis, while the total volume of the loans and advances increased by 5.19% by reaching BGN 81.547 billion in the end of December. The above resulted in unfavorable changes in the structure of the loan portfolio, which changed in favor of low-interest and no-interest segments (loans to financial enterprises, credit institutions and central banks), whose share for the past 12 months increased by a total of 1.98 percentage points, mostly on the count of reduction of the NFC share (Figure 3).

The sustained lending standards in the corporate sector on the ground of the decreasing volumes by new business, shows that the local banks are more susceptible to keep the surplus of attracted resource, thus rather accepting the payment of the respective price (in the form of a negative interest rate on excess reserves) than lowering their standards in order to reduce the share of rejected requests and therefore to increase the sales of their free resource, while at the same time taking a risk in the realization of a loss from any eventual future worsening of the portfolio quality.

Financial intermediaries became less enthusiastic to purchase securities as a possible alternative to the use of their resource. The balances of commercial banks for the first three quarters show that until the end of September the securities in the portfolios of commercial banks significantly decreased (by over BGN 1 billion to BGN 12.082 billion), which could be explained mainly by the increased expectations for a forthcoming decrease of the market interest rates. In the process of preparing for the next possible cycle of interest rate increase, maturing holdings are just partially replaced by newly issued papers, as there is increased demand for shorter maturities in view of the minimization of the risk to recognize some negative revaluation when the profitability curve returning to normal. In the last quarter (in view of the partially reduced lending activity) purchases of papers resumed and the banks finished the year of 2017 with a portfolio to the amount of BGN 13.582 billion, as most of them with new issues were classified as available for sale.

Figure 3 Structure of loans and advances

Source: BNB, own calculations

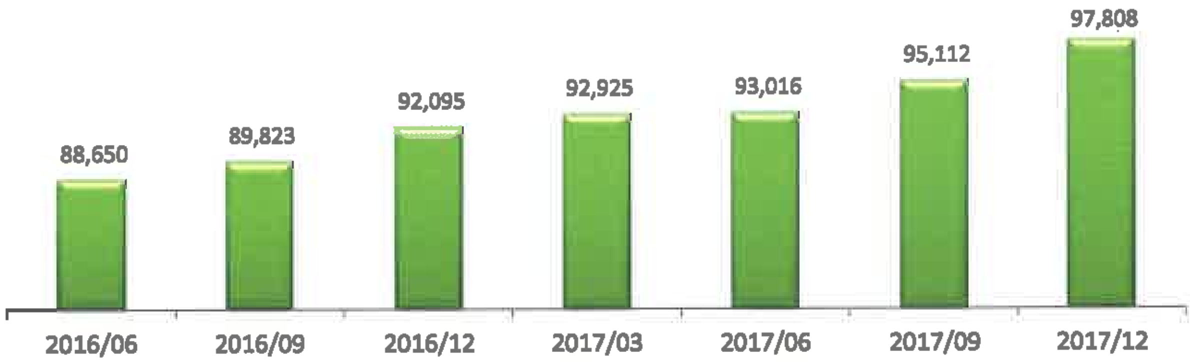
The insufficient lending activity last year is still compensated with the increase of loans to a non-bank financial institutions (NBFIs). In 2017 the portfolio in this segment increased by BGN 504.7 million (24.9%), which partially compensated the insufficient volume of gross loans, yet it could not compensate the aggravated profitability of interest-bearing assets. The second and more significant problem for such type of activity remodeling is that the re-direction of an increasingly larger part of the resource through the NBFIs channels towards the final consumers distort the quality picture to a certain extent, as the creditworthiness of candidates for a loan from NBFIs is significantly lower than the creditworthiness of the traditional clients of banks.

The changes of the assets' structure are unavoidable in view of the established complex of factors, which determine the activity of financial intermediaries. The level of uncertainty remains high, and the criteria for the quality of assets become more strict, which imposes a more cautious approach in lending activity. Meanwhile, the deposits in the banking system keep increasing faster than anticipated, thus resulting in a growth of the banks' assets - up to BGN 97.808 billion in 2017 (Figure 4), as the displacement of accumulated resource has remained with its focus on less-profitable categories, instead of redirecting to the business and household consumption.

In an attempt to break the unfavorable trend, BNB increased its negative interest rate on excess reserves from -0.4% to -0.6%, as of 4 October, 2017. Unfortunately, the experience from January 2016 (when BNB imposed for the very first time some sanctions on the excess reserves of commercial banks) showed that the effect was unconvincing to say the least. It was then – after the initial shock resulting in the reduction of the share of "cash and balances with central banks" item (to 18.5% in the end of 2016 Q1), this class of assets once again grew by reaching 19.5% of the total volume in the end of August 2016, and a year later it reached 21.2% of the commercial banks' assets.

The process in the end of 2017 was quite similar, as just for a month the total value of the "*cash and balances with central banks*" decreased by BGN 1.942 billion (from BGN 19.173 billion to BGN 17.230 billion), but in the next couple of months the negative growth was fully compensated and in the end of December the total value of this category of assets reached BGN 19.508 billion. As anticipated, the process was different in the separate banks. The nature of the adaptation in the participants was determined by their market advantages in lending, by the aggravated (for some of them) maturity structure of the attracted funds, as well as by the presence of an alternative that might be used by the bank groups.

Figure 4 Assets of commercial banks [BGN billion]



Source: BNB

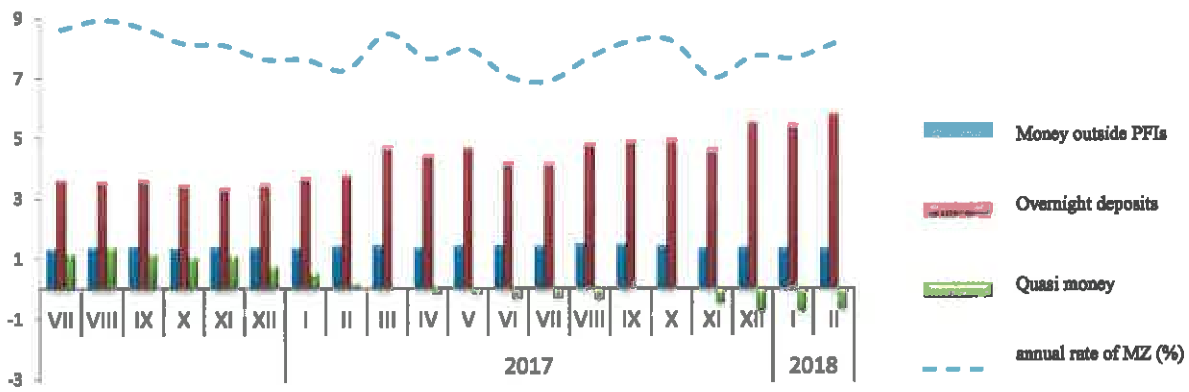
In the very first months of 2018 it became evident that the effect of the undertaken measure could be seen to a greater extent in the form of income reallocation between the financial institutions and to some extent in the form of support for the prices of Commercial papers, rather than in the form of actual stimulus for lending. The above is normal in view of the still low level of trust of the business in the local economy development, which is indicated by the high rates of growth of deposits from non-financial corporations (NFCs) (12.7% on an annual basis). Despite the economy growth achieved in 2017 and the preservation of the economic indicators of the main trade partners, a great part of the Bulgarian enterprises still refrain from the initiation of new projects and leave their unused resource stored with local banks.

One of the obstacles for the achievement of some effect after the undertaken sanction was the weakening trend to household saving, as far as this presupposes the accumulation of expectations for a forthcoming increase of the deposit interest. The indicator for the last trend is the delay of the rate of accumulation of household deposits. In 2017 they increased by BGN 2.259 billion, which was by 1/5 less than the preceding year (BGN 2.789 billion). The above could be perceived to some extent as a result of the continuous growth of population income and restoration of the trend towards consumption. And last but not least, this speaks of the intensifying preferences of households toward the alternative forms of preservation of value in time (properties, precious metals, mutual funds, etc.).

The decrease in the volume of quasi money aggregate (deposits with agreed maturity or deposits agreed for use after a notice of up to 3 months) since April up to now shows that local depositors do not renew a growing part of their fixed-term deposits (

Figure 5). The main reason for this is probably the smoothening of the yield curve, as well as the increasing expectations for a forthcoming normalization of interest rates. In view of the above, households prefer keeping their savings in a form that allows them to be quickly transferred to a better yielding alternative (a product with a higher interest rate or an alternative way of saving). It is notable that this trend intensified after the end of the third quarter when the reported negative growth in the aggregate quasi money varied from BGN 600 million to BGN 700 million on an annual basis.

Figure 5 Money aggregates (Annual growth, BGN billion)



Source: BNB, own calculations

The income data show that in 2017 the total net operating income of the banks decreased by BGN 193 million (to BGN 3.886 billion). This difference could be explained to some extent with the realization of extraordinary income from the deal between *Visa Europe and Visa Inc.* in June 2016.

Regardless of the fact that the single effect of this deal (estimated at BGN 186 million) corresponds to the obtained difference, it does not explain the decrease of the income from the main activity. The explanation may be rather sought in the exhaustion of the possibilities for decrease of the interest rates. The continuous decrease in interest rates in 2017 resulted in the drop of the income from interest on loans by BGN 255.9 million (to BGN 2.779 billion) while interest expense decreased by BGN 150.3 million (to BGN 289.3 million). The main reason for this lag was the lower (as compared to the income from interest from loans) gross volume of expenses, on one hand, and the growing cautiousness of banks during the past year, on the other hand (there were only three banks that decrease their offered interest rates on loans in December). In this case cautiousness is needed, for under conditions of slowing dynamics of saving and aggravated maturity structure of the deposits every significant decrease in interests would result in an exodus of the attracted resource.

The exhaustion of available reserves to improve the profitability on the count of the expenses for attracted resource is normal in view of the approaching near the psychological level of deposit interests. The sector managed to compensate to some extent the aggravation of the interest margin with a rise of the gross income from fees and commissions, which increased by 7.9% last year as compared to 2016. Regardless of the fact that as an absolute volume (BGN 84 million) the increase in this income category is not sufficient to compensate the decrease of the net interest income (by BGN 130.3 million), it is interesting from a point of view of the manifestation of a long-term trend since 2010 up to present. The net income from fees and commissions has been constantly increasing since 2010, as the growth rate has even accelerated – from 3.5% in 2010 and 2011 the rate has gradually increased up to 7.4% in 2015. The year of 2012 was an exception, when the change was negative (-0.9%), as well as in 2014, when the removal of Corporate Commercial Bank from reporting notably delayed the dynamics of all system indicators, and the income from fees reported an increase by only 1.2%.

In 2017 the increase of the gross income from fees and commissions already reached 8.15%, which was indicative of the stability of this trend. In view of the growing investments in new technology and the development of additional business lines, one may expect that in a medium-term the increase of the income from fees from some sources will keep growing. The main risk for the termination of this trend is the forthcoming expansion of the scope of Regulation (EC) No. 924/2009, which shall result in the standardization of the fees for outgoing transfers in Euro for all EU member states (up to the present moment this Regulation has been applicable only in the Eurozone countries). It is expected that the envisaged changes will enter into force as of 1.1.2019, which will result in considerable decrease in the income from fees under outgoing transfers, especially in Bulgaria, where they are at their highest levels (from EUR 15 to EUR 25).

An important regulatory change last year was the introduction of the new IFRS9. It was expected that the enforcement of this Standard on 1.I.2018 would have a shocking effect on the capital of commercial banks. However, the data from the first quarter of the current year show that the intensity of this change is relatively small, for most banks have taken advantage of the possibility for preceding treatment and the effect of the new Standard will be extended in time.

As a whole, the data for 2017 cannot disprove the expectations for preservation of the common picture in the field at an average growth of the lending, ongoing restoration of the quality of the loan portfolios, preservation of the less profitable structure of the assets, the delayed growth of the attracted resource at relatively constant prices and the retention of high liquidity. In view of the above, the pressure towards consolidation in this sector keeps intensifying supported also by purely administrative incentives , due to which new mergers of bank institutions may be expected in short-term.

II. Review of the activity of Tokuda Bank AD in 2017

As at 31.12.2017 the assets of Tokuda Bank AD amount to BGN 387.836 million, which (according to data of the Banking supervision) is 0.41% of the total value of the assets in the Bulgarian banking system and ranks the Bank at the 23rd place by size. Referred to the Bank's assets of Group Two, a part of which is also Tokuda Bank AD, this share is 0.95%. The average monthly value of assets is almost unchanged, as the indicator reached BGN 380.6 million last year, and respectively BGN 399.2 million in the preceding year.

In 2017 the Bank realized net profit of BGN 1.001 million, with which the potential income per share reached BGN 0.15. The reported result was significantly improved than in the preceding year of 2016, when the Bank reported a loss of BGN 1.739 million.

The dynamics of the loan portfolio kept its fluctuating nature in the last year due to yet uncertain rates of recovery of the economic activity in the country, which shaped the weak presence of good projects with proper profitability and investors with proven creditworthiness. In the end of the period the gross loans before impairment decreased up to BGN 199.947 million. The portfolio quality significantly improved and in the end of 2017 the share of regular loans increased by 9.48 percentage points, thus reaching 82.24% (at 72.76% in 2016).

The subsidiary company "*Tokuda Sigurnost*" EOOD kept functioning last year, as the Bank set the financial and operating policy of the enterprise. The Company was established in 2013 with registered capital of BGN 25 thousand (100% owned by Tokuda Bank AD) and its financial indicators are included in the Consolidated Financial Statement of the Group. On 21.12.2017, by a decision of the sole owner of the capital, "*Tokuda Sigurnost*" EOOD terminated its activity. At the moment the Company is under process of liquidation.

1. Operating income and expenses

In 2017 the Bank generated income from its main activity to the amount of BGN 17.359 million (Table 1), which was by BGN 2.704 million (18.45%) more than the preceding year. Their dynamics during the past period was still under the influence of mostly the effect of the decreasing local interest rates, which resulted in an overtaking decrease of interest costs – by 34.86% on an annual basis (or BGN 1.425 million in an absolute-value expression) as compared to the gross income from interests having a three time lower rate of decrease – 10.72% on an annual basis (BGN 1.477 million).

Last year the Bank kept adhering to the adopted conservative policy with respect to the administrative expenses. Within this policy the Management exerts systematic expenditure control by undertaking measures at the same time directed towards the Bank's rebranding and stimulation of employee efficiency. The holding of the abovementioned measures, as well as the occurrence of associated expenses, (for example, with the mandatory engagement of a second auditor for the certification of the annual reports) resulted in a certain growth of some items of the Group's operating expenses, due to which their total value last year increased by BGN 249 thousand (up to BGN 13.212 million).

The ratio of the total volume of operating expenses to the income from the activity in the last year decreased by 12.35 percentage points (to 76.11%), due to the fact that the increase of the income from the activity (BGN 2.703 million) was several times ahead of the increase of the operating expenses (the growth of which was BGN 249 thousand).

The continuous drop in the interest levels and the preservation of the not so favorable market situation in the last year resulted in noticeable changes in the structure of the total income from the Bank's activity (see Table 1). In 2016 the share of the net income from interest decreased by 10.60 percentage points and reached 55.55% of the total amount of net income, as the non-interest income increased its share, thus taking a share of 44.45%. During the same period last year those values were 66.15% and 33.85% respectively. These changes of the structure could be explained with the overtaking pace of non-interest income, which increased by 55.53% on an annual basis, (due to the recognition positive revaluation upon real estate sale – property of the Bank) as compared to the net interest income, which decreased by 0.54% (BGN 52 thousand) last year.

Table 1. Income from activity

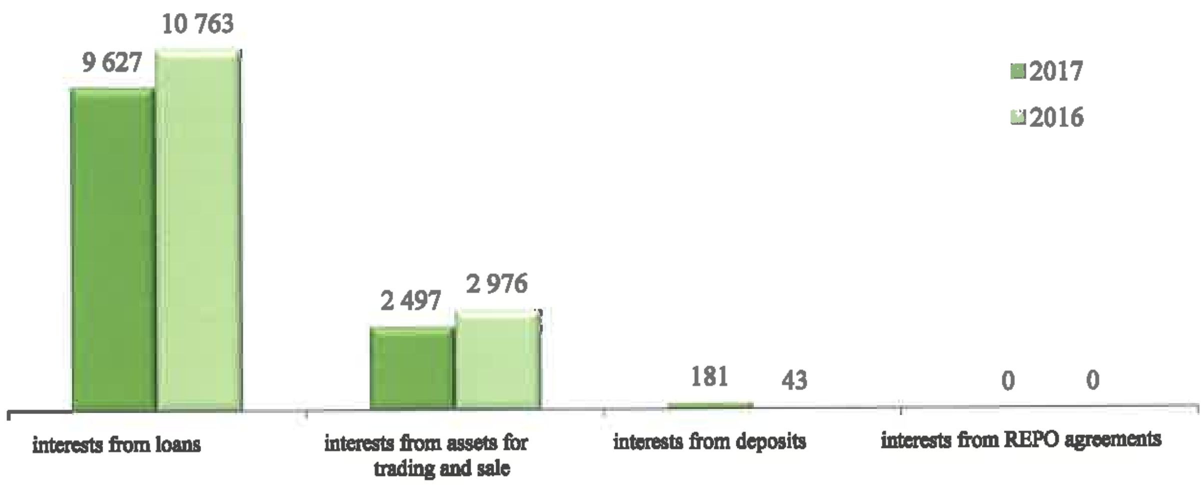
	2017	*2016*
Interest Income	12 305	13 782
Interest Expenses	(2 663)	(4 088)
Net interest income	**9 642**	**9 694**
Income from fees and commissions	3 837	3 772
Expenses for fees and commissions	(297)	(291)
Net income from fees and commissions	**3 540**	**3 481**
Net profit from financial assets held for trading	**283**	**791**
Other income (expenses) from the activity	**3 894**	**689**
Total income from the activity	**17 359**	**14 655**

The gross income from interest on loans and other receivables decreased by BGN 1.136 million to BGN 9.627 million and kept having the biggest relative share as compared to the total amount of interest income (78.24%). Regardless of the reported decrease of this income category (by 10.55%), in view of the outpacing rate of decrease of the income from interest on securities (16.10%), last year the share of the income from interest on loans increased by 0.14 percentage points (up to 78.24%) as compared to the one reported in 2016. One of the main factors for the reported decrease of the gross income from the loan portfolio of Tokuda Bank AD was the market trend directed towards the decrease of the interest levels, which was partially compensated with the improvement of the portfolio quality - the share of classified loans before impairment last year decreased by 11.71 percentage points (to 27.08%), and the share of the classified ones in '*loss*' – by 9.99 percentage points (to 15.00%).

The interest income from the securities portfolio (Figure 6) decreased by BGN 479 thousand (or by 1/6) as compared to the reported value in 2016 – up to BGN 2.497 million in the end of the last year, as a result of the portfolio amortization, thus resulting in the replacement of the maturing emissions with new ones with lower profitability. The share of this item in the total value of the interest income in the last year significantly decreased from 21.59% to 20.29%, due to the reporting of a comparable rate of decrease of the gross income from interest on loans. The interest income from granted deposits amounted to BGN 181 thousand which was by BGN 138 thousand more than the one reported in 2016 upon maintaining of approximately constant average annual value of this group of assets (BGN 22.702 million as compared to BGN 22.091 million in the last year).

The price of the attracted funds remained above the average level for the local banking system; however it followed the common downward trend. Last year the deposit base of Tokuda Bank AD continued to be dominated by individual and household deposits. In 2017 those expenses amounted to BGN 2.663 million, which was a decrease by 34.86% as compared to 2016 (when they amounted to BGN 4.088 million), as a result of the implemented efficient policy of management of liabilities and interest expenses.

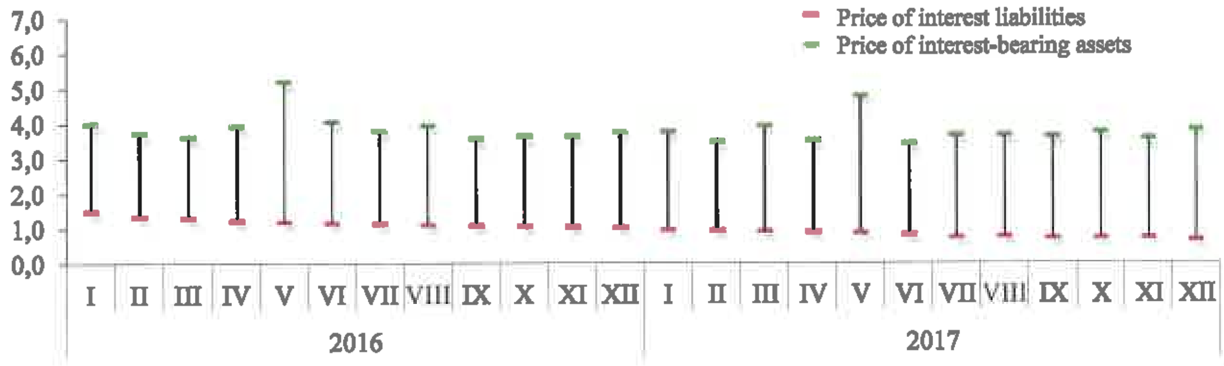
Figure 6. Interest income by sources



During the past period under review the interest spread has gradually stabilized (Figure 7), as in the second half of 2017 the indicator varied within relatively narrow borders (2.9-3.1). The comparison of the profitability of the interest-bearing assets showed that the average weighted profitability ratio last year printed an increase by 0.16 percentage points (from 3.91% for 2016 to 3.74% for 2017), despite the decrease of the share of classified loans with delays on the principal and interest by more than 180 days. This was a logical result from the decrease of interests on newly granted loans in view of the consideration of the market dynamics and was fully compensated by the decrease of the expenses on attracted funds, which on an average annual basis decreased by 0.38 percentage points (from 1.18% for 2016 to 0.80% for 2017). Such a change came as a result of the decreased interest levels and the repricing at maturity of a significant part of the relatively expensive deposits in the Bank.

The attraction of clients from the household segment had a favorable impact on the maturity structure of our resource and the past year it resulted in an increase of the share of fixed term bank deposits by 1.37 percentage points (up to 55.33%). The outpacing decrease of the expenses for attracted resource, as well as the realization of additional income during the last year (as a result of the realization of additional income from collected adjudged receivables) resulted in preservation of the profitability from interest-bearing assets upon reporting on accumulated base in 2017, relatively close to the one reported for 2016.

Figure 7. Interest spread components



Non-interest Income

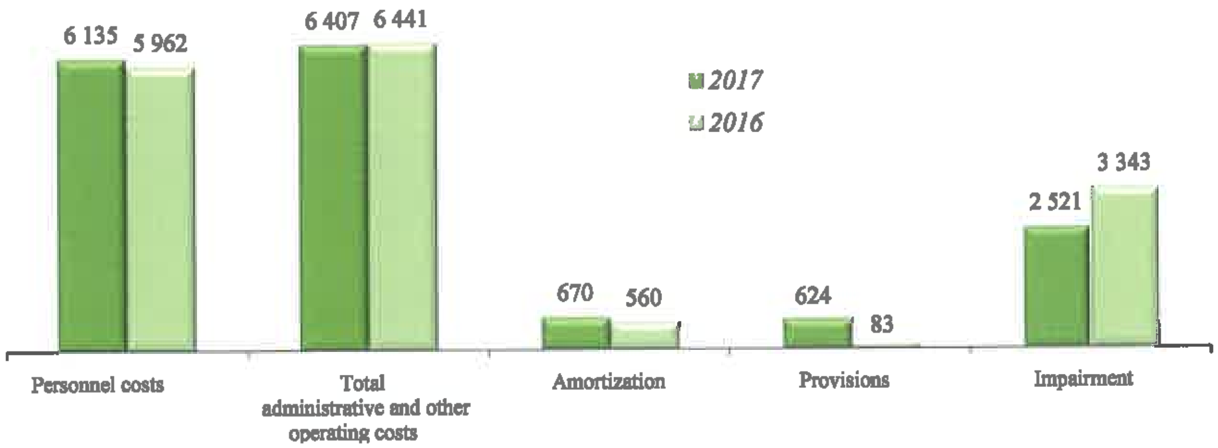
As compared to the preceding year the non-interest income in 2017 increased by BGN 2.756 million (55.53%) and reached BGN 7.716 million due to the poor growth of the net income by fees and commissions (by BGN 59 thousand), the income from dividends (which increased by BGN 40 thousand), as well as the increase of the profit from financial assets available for sale (by BGN 1.797 million – up to BGN 2.119 million). The largest share in this group of income remained taken by the net income from fees and commissions (BGN 3.540 million), which increased insignificantly last year (by 59 BGN thousand or 2% on an annual basis) as a result of the increased income from servicing of accounts (by BGN 172 thousand), cash desk services (by BGN 15 thousand) and outgoing transfers (by BGN 5 thousand), which compensated the decreased income from other sources, such as issued guarantees (by BGN 5 thousand), card services (by BGN 67 thousand) and granted loans (by BGN 108 thousand). As a whole, the structure of the fees and commissions last year was preserved without any significant changes.

The poorly expressed dynamics of prices and perpetuation of the unfavorable situation on the securities market had a negative impact on securities trading, due to which last year the income from financial assets in trading portfolio decreased three times (by BGN 508 thousand) and reached BGN 283 thousand. The recognition of income from sales of properties, machinery and equipment reached BGN 2.076 million (in comparison to BGN 37 thousand in 2016) and it had a significant contribution to the increase of the financial result in 2017.

Non-interest Expenses

The non-interest expense of the Bank in 2017 amounted to BGN 16.357 million (Figure 8), which was by BGN 32 thousand or 0.20% less than the preceding year. The most significant increase in this group was reported for the provisions expenses (by BGN 542 thousand) and the expenses for personnel, which increased by BGN 173 thousand (up to BGN 6.135 million), despite the insignificant changes in the administrative structure and the support of the average number of employees at a relatively permanent level (reaching 257 persons in the year-end as compared to 259 persons in the end of 2016). The amortization expenses increased by BGN 110 thousand (up to BGN 670 thousand) as a result of the measures for renovation of the technological equipment of the Bank. The most significant decrease in this category was reported for the expenses for impairment – impairment assessed for the last year (BGN 2.521 million) were by BGN 822 thousand (24.59%) less than those in the preceding year, and the total administrative expenses marked an insignificant decrease (by BGN 34 thousand, to BGN 6.407 thousand), due to the fact that a large part of the initiatives, resulting in the occurrence of additional expenses for services, rents, telecommunications, etc. related to the measures undertaken for offices relocation and rebranding at the points of presence, were initiated back in 2015.

Figure 8. Non-interest expenses



The poorly expressed dynamics of the expenses from this group resulted in the preservation of its structure without any significant change. Thus, for example, the share of personnel expenses (including the labor remunerations and social security insurances) in the common structure of the non-interest expenses increased by 1.13 percentage points (from 36.38% to 37.51% in the last year), the share of the total administrative and other operating expenses decreased by 0.13 percentage points (up to 39.17%), and the expenses for amortization in 2017 had a bigger share by 0.68 percentage points as compared to those in the preceding year. The share of provisions increased by 3.31 percentage points entirely on the count of expenses for impairment, which share decreased by 4.99 percentage points (to 15.41% in the last year).

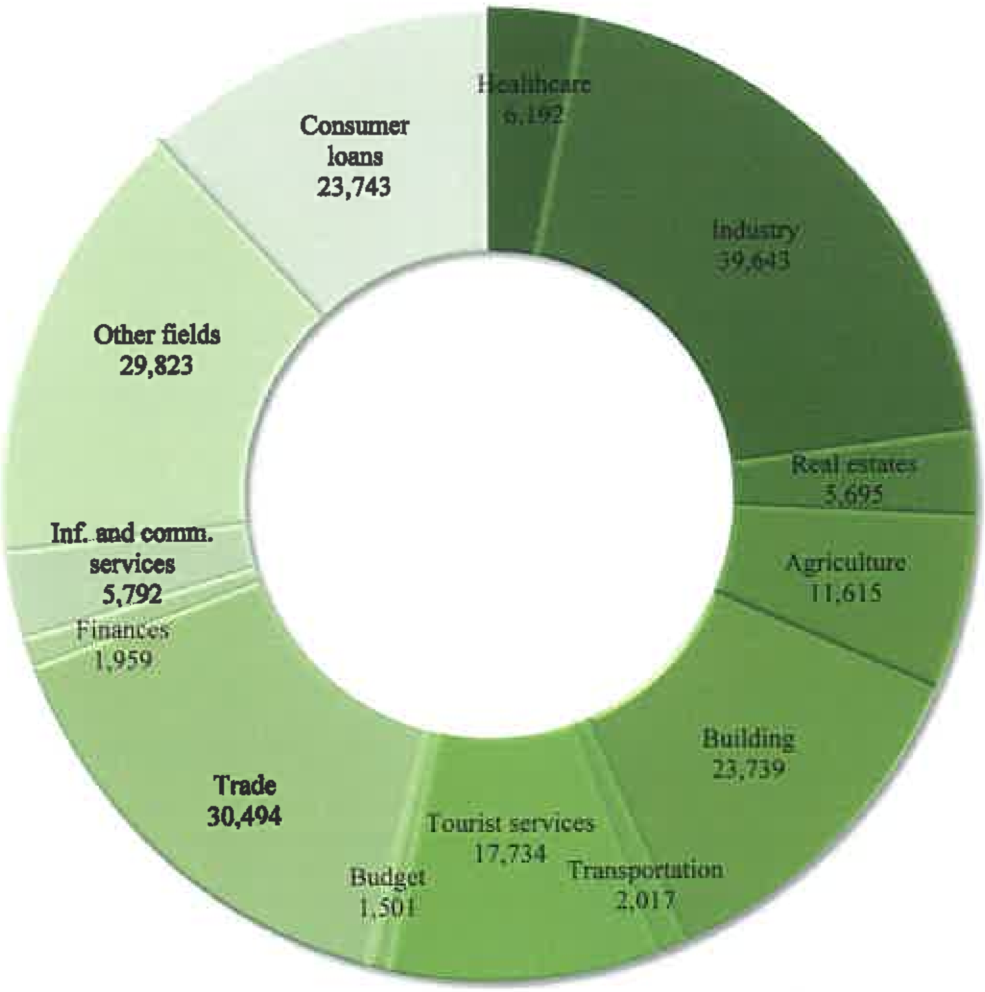
2. Loan Portfolio

In the end of 2017 the gross balance amount of our loan portfolio (Figure 9) was BGN 199.947 million. After allocating provisions for losses from impairment to the amount of BGN 18.563 million, the net value of the portfolio amounted to BGN 181.384 million. The small growth was due to the unfavorable conditions of the loan market and the retaining relatively high risk of the environment, but also of the intensified activity of realization of '*loss*' group exposures . In 2017 the balance value of the loan portfolio after impairment increased its share in the overall asset structure up to 46.77% (at 45.40% in the preceding year).

The loans to corporate clients increased by BGN 2.010 million (up to BGN 153.794 million before impairment), and their share of the gross amount of the loan portfolio decreased by 0.29 percentage points as compared to the preceding year (up to 76.92%), which was due to the intensification of the activity of compulsory collection of non-performing loans in this segment.

The changes in the 'individuals *and households*' segment were moderate. The share of loans in this segment increased from 22.03% of the total value of gross loans in 2016 to 22.33% in 2017. In absolute values, the segment reported positive growth of BGN 1.353 million, thus representing an increase by 3.12% as compared to the preceding year.

Figure 9. Loan portfolio allocation [BGN million]



In 2017 the Bank continued its traditional business with enterprises from the sectors of industry, trade, energetics, agriculture, healthcare, etc. The biggest relative share was for the loans allocated to industry, which preserved its share close to the level in the preceding year, as in the end of 2017 the loans in this sector reached 19.83% of the gross loans. According to the allocated share the next positions is taken by the trade sector (the share of which decreased from 16.24% to 15.25%), construction (the share of which increased by 0.19 percentage points to 11.87%) and tourism, the share of which increased up to 8.87% of the gross loans in 2017.

Last year the Bank kept following the adopted moderate conservative policy in lending, as new loans were approved for persons meeting high reliability and creditworthiness criteria. The adequacy of those criteria is indicated by the regular servicing of loans by the new clients. The balance achieved in the lending activity has been preserved, as during the current year the new individual and household loans take 24.88% of the total amount of all newly granted loans, and the share of the new loans allocated to enterprises and budget institutions is 75.12% (as those shares in the preceding year were 24.92% and 75.08%, respectively).

There are moderate changes in the currency structure. The share of loans in EUR decreased by 6.54 percentage points (up to 40.60% of the balance value of the loan portfolio before impairment) in exchange of the reduction of the share of loans in Bulgarian leva (by 6.68 percentage points) in USD (by 0.13 percentage points) and in JPY (by 0.01 percentage points). In the end of 2017 the loan portfolio after impairment was allocated as follows: 59.34% was denominated in BGN, 40.60% in EUR, and 0.07% in USD.

Table 2. Loan portfolio allocation by classification groups.

	2017			2016		
	gross value	provisions acc. to IAS	balance value	gross value	provisions acc. to IAS	balance value
Serviced	164 435	616	163 819	143 043	502	142 541
Unserviced	35 512	17 947	17 565	53 541	20 281	33 260
Total	199 947	18 563	181 384	196 584	20 783	175 801

Despite the presence of separate positive signals for the economy recovery, the increasing external political instability and the growing concerns for a forthcoming economic stagnation keep shaping the behavior of the Bulgarian enterprises and households. The persisting high share of people living in severe material deprivation, the intensifying social stratification, as well as the persisting insecurity of the environment exert pressure on the lending rate, thus not allowing at this point to compensate the aggravated quality of the portfolio through some more intensive increase of its volume. In view of the above, despite the success of all measures designed to decrease of the share of non-performing loans, in the last year their share remained relatively high (17.76%), which could be explained mainly by the insufficient intensification of the lending activity.

In order to cover the risk of losses from loan impairment, up to the present moment the Bank has allocated provisions to the amount of BGN 18.563 million, but because of the improvement of the portfolio quality the coefficient of coverage with accounting provisions has decreased from 10.57% to 9.28%. With regards to the performing loans, this coverage ratio increased by 0.02 percentage points, thus reaching 0.37%. Nearly the entire impairment (96.68%) has been allocated to the non-performing receivables (Table 2).

3. *Securities*

In the end of 2017 the securities portfolio decreased by 38.948 BGN million, thus reaching 74.927 BGN million. Therefore, its share was reduced by 10.09 percentage points reaching 19.32% of the total amount of all assets. The rate of change was intensive (-34.20%), despite the fact that in view of the poor restoration of the local lending, there were insufficient possibilities for relocation of the free resource towards the lending activity. The decrease this assets category is an expression of the policy adopted by the Bank and directed towards the gradual improvement of its assets profitability through shrinkage of the share of its less-profitable assets, as it is also motivated by the growing expectations for a forthcoming change in the situation of the securities market.

The predominant part of securities is in available for sale category, as last year their total value decreased by nearly 1/3 (up to BGN 60.801 million). The volume of the trading portfolio has also decreased at an even more intensive rate (-43%), to up to BGN 14.126 million.

Table 3. Securities portfolio

	2017	2016
Stocks and shares of local enterprises	551	293
Bulgarian state securities (including Eurobonds)	50 341	88 803
State securities of foreign governments (including Eurobonds)	22 222	21 103
Corporate shares of local and foreign issuers	1 890	3 753
Impairment	(77)	(77)
TOTAL	74 927	113 875

The policy aimed to improve the Bank's assets structure through shrinkage of the less-profitable assets in our Balance Sheet during the last year is predominantly focused upon the local government securities (Bulgarian state securities and Eurobonds). In 2017 the items in this category decreased by BGN 38.462 million reaching up to BGN 50.341 million. Therefore, their share in the total portfolio structure was reduced to 67.19%. The papers of foreign governments increased up to BGN 22.222 million, with which their share in the general structure of the securities portfolio reached 29.66%. In addition, the category of stocks and shares of local enterprises also had positive growth in the last year, as it increased by BGN 258 thousand to BGN 551 thousand, as the fastest rate of decrease was reported for the corporate bonds by local and foreign issuers, which in 2017 decreased by 49.64% (up to BGN 1.890 million).

4. Attracted Funds

In 2017 the volume of attracted funds from clients other than credit institutions decreased by 0.09%, reaching BGN 340.944 million in the end of the last year. The individuals and households were the source of most of the attracted resources (Table 4). In 2017 the share of the funds from this source increased by 5.16 percentage points (from 68.45% to 73.61% in the common structure). The deposits of non-financial enterprises remained at the second place when ranked by the share of the attracted funds. Last year the segment decreased by 4.66 percentage points (from 27.96% to 23.30%). The resource of the budget allocation entities remained nearly unchanged upon reporting a growth of its share from 2.14% up to 2.94%. The decrease of the attracted resource from non-bank financial institutions is completely explainable in view of the increasing indicators of liquidity in the banking system. The deposits from this source decreased in the last year by 89.22% to BGN 533 thousand, thus decreasing their share in the structure of attracted resources from 1.45% to 0.16%.

Tokuda Bank is no exception from the banking system and keeps maintaining high liquidity, thus preserving a relatively weak interest in attracting any resource from banks. The total value of the deposits from credit institutions increased from BGN 87 thousand in 2016 to BGN 191 thousand in the end of 2017, occupying a neglectful share of the Bank's liabilities (0.06%).

Table 4. Structure of attracted resources

	2017			2016		
	Demand deposits and savings deposits	Fixed term deposits	total	Demand deposits and savings deposits	Fixed term deposits	total
Accounts of natural persons	80 547	170 411	250 958	74 042	159 528	233 570
Budget accounts	9 015	1 008	10 023	6 297	1 009	7 306
Company accounts	62 201	17 229	79 430	76 274	19 141	95 415
NBFIs accounts	533	0	533	498	4 448	4 946
TOTAL	152 296	188 648	340 944	157 111	184 126	341 237

In 2017 decreases of the interest rates on the Bank's deposit products were undertaken in view of optimization of the funding price. As a result of the achievement of a good balance of the structure of those changes and compliance with the market trends the structure of our resource has changed in favor of the fixed term deposits (in contrast to the preceding couple of years), and the share of current accounts decreased by 1.37 percentage points reaching 44.67%.

The changes in the currency structure of the attracted funds are insignificant and in favor of the USD, which share in the last year increased from 6.05% to 7.60% in exchange for the deposits in EUR, the share of which decreased from 40.73% to 39.73%. The changes of portions of the other currencies were even smaller and in the end of the year the deposits in Bulgarian leva occupied 51.34%, and the deposits in Japanese yen and other currencies –1.12% and 0.21% of the total structure, respectively.

5. Exposure to Risk

As at 31 December 2017, for the purpose of calculating the risk exposures for credit risk, Tokuda Bank AD applied the standardized approach according to Regulation (EU) No. 575/2013. Due to the small volume of the financial instruments in the trading portfolio, the capital requirements are calculated in compliance with the requirements of Regulation (EU) No. 575/2013, applicable for the bank portfolio. The basic indicator approach is applied in order to calculate the amount of the capital for covering losses from the operating risk.

In 2017 Tokuda Bank AD kept adhering to a conservative approach upon risk management and assessment, including with respect to the credit risk forming 87% of all risk exposures as at 31.12.2017. The Bank undertook due actions for the decrease of the risk on credit exposures (mostly in exchange for the portfolio of nonperforming loans), as a result of which the share of risk weighted assets for credit risk has shown a slight increase (by 3 percentage points) reaching up to 87%. The total risk exposure moderately increased (by BGN 2.543 million) as compared to 31.12.2016.

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

Table 5 Risk weighted assets

	31.12.2017		**31.12.2016**			**change**
	BGN million	*shares*	*BGN million*	*share*	*BGN million*	*rate*
For credit risk	172.306	87%	164.301	84%	8.005	5%
For market risk	1.913	1%	8.25	4%	-6.337	-77%
For operating risk	23.8	12%	22.925	12%	0.875	4%
Total	**198.019**	**100%**	**195.476**	**100%**	**2.543**	**1%**

6. Capital and Reserves

As at 31.12.2017 the Bank's capital amounted to BGN 44.683 million. The basic capital according to the requirements for capital adequacy of the credit institutions is BGN 42.345 million.

The Bank's capital indicators are above the regulatory limits. Its capital position ensures an adequate coverage of its risk exposures. The adequacy of the core Tier 1 capital has decreased insignificantly - by 0.28 percentage points, by reaching 21.38%, thus covering the required regulatory limits.

As at 31.12.2017 the paid-up capital amounted to BGN 68 000 000 /sixty-eight million/. The capital is allocated in 6 800 000 /six million and eight hundred thousand/ registered, non-materialized 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 by the Central Depository, as at 31.12.2017 the shareholders of the Bank were as follows:

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

7. Branch Network

Due to the unfavorable economic situation, as well as due to the choice of a conservative policy upon the budget formation, in the last year the Bank refrained from expanding its office network. All efforts have been directed towards optimization of the regional structure and relocation of the points of presence to some better locations. In 2017 the Stamboliiski Office was moved to a new and more communicative location.

The structure of the branch network is as follows:

- Headquarter
- Offices – 22 in number
- Remote workplaces – 5 in number

The Bank's regional offices provide professional and quality services to their clients, as well as timely cooperation upon 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, such as BNP-Paribas SA, Paris; Commerzbank AG, Frankfurt/Main; Dresdner Bank AG, Frankfurt/Main; Bank of China, Beijing; Landesbank Hessen-Thueringen Girozentrale, F/M; Bank of Tokyo-Mitsubishi UFJ, LTD, Tokyo; Sumitomo Mitsui Banking Corporation, Tokyo; Banque Generale du Luxembourg S.A., Luxemburg; Banca Popolare di Milano S.C.A.R.L., Milano; Uniastrum Bank, Moscow; International Bank for Economic Cooperation, Moscow; Unistream Commercial Bank, Moscow; Banco Cooperativo Espanol S.A., Madrid; Credit Suisse, Zurich; Hyposwiss Privatbank AG, Zurich; Wachovia Bank, NA, London; Bank of New York, New York; CITIBANK N.A., New York, etc.

9. ***Human Resources***

The human resource is one of the key factors for achievement of the strategic goals of Tokuda Bank AD. The Bank's Management has been developing a system of the human resources management through the continuous optimization of the processes of staff administration (planning, recruitment, appointment, monitoring, assessment, promotion and dismissal). In the end of 2017 the total number of employees working at the Bank was 257 (respectively 259 in 2016).

A decisive factor for the realization of the Bank's mission and strategy is the quality of its employees – their qualification, professional skills, loyalty. Furthermore, the Bank's employees take part in a number of training initiatives connected with their functions, for the improvement of qualification is one of the main and proven (with regard to its reliability) ways of improvement of work efficiency.

For the purposes of the effective management of the human resources, the internal information system (portal) is subject to constant update, where the employees are provided with access to the internal company documents and news related to the Bank's activity.

10. ***Information Technologies***

In 2017 the process of optimization of the software platform servicing the Bank's main data flows has continued. The above contributed to the improvement of the technological processes and their control, to the improvement of the quality of customer services, and to the provision of reliable information on the needs of adequate management of the main activity. One of the challenges in this field in 2018 is the development and innovation of the system in a way that will contribute to the successful implementation of the recent changes in the regulatory framework and the forms of reporting.

III. Outlook for development in 2018

In the process of shaping the outlook for 2018, there are several presumptions made with respect to the environment, in which the Bank is going to manage its activity and more specifically, keeping the Bulgarian economic growth near the level achieved last year, sustain of the conservative investment attitudes in the country and restoration weak recovery of the household consumption. In view of the situation described above, the Bank plans to keep and follow a moderately conservative policy upon management of its main activity, aimed to some stabilization of the profitability indicators and establishment of preconditions for increase of its market share. The main purpose set for 2018 is the intensification of the lending activity and improvement of the portfolio quality. The preliminary estimates in the financial plan show that the planned growth 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 upon the shape of the development perspectives is the risk maintenance within reasonable limits, due to which the precise selection of appropriate clients and the reasonable credit risk assessment and management will remain the main priority of the activity this year.

In brief, the main priorities upon the Bank's development in 2018 may be systematized in the following fields:

- Improvement of the loan portfolio quality and optimization of the asset structure within the frame of policy for admissible credit risk and its coverage with capital;
- Improvement of the Bank's efficiency, decrease of the operating risks and building of a solid base for a stable growth in a long-term plan;
- More adequate use of contemporary information technologies for reaching a wide range of clients, which would provide an opportunity for quality improvement and expansion of the range of offered services;
- Intensification of the activity in the field of retail lending in view of the achievement of better risk diversification and improvement of the profitability indicators;
- Expansion of the market presence of the Bank by undertaking active measures aimed to increase the popularity of the brand" *Tokuda Bank*" and achievement of its better recognition amidst potential clients;
- Ensurance of stable income from the main activity, which would guarantee the achievement of higher return of the share capital;

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

1. *Changes in the share capital*

In 2017 there were no changes in the volume and structure of the share capital of a Majority shareholder holding 99.94% of the capital of Tokushukai Incorporated, Japan. As at 31.12.2017, Tokuda Bank AD does not possess any own shares.

2. *Management*

In 2017 the Bank preserved its two-level management system. In 2017 the joint-stock company had the following members of its bodies:

Bank's Supervisory Board

Arthur Sterne - Chairman of the Supervisory Board

Tokushukai Incorporated represented by Eiji Yoshida – Deputy Chairman of the Supervisory Board – until 27.06.2017

Thomas Michael Higgins – member of the Supervisory Board since 27.06.2017

Dimitar Voutchev - member of the Supervisory Board

Bank's Management Board

Vanya Vasileva – Chairman of Management Board and Executive Director until 6.12.2017;

Maria Sheytanova – member of Management Board and Executive Director;

Anna Boneva – member of Management Board and Executive Director;

Todorina Doktorova – member of Management Board since 6.12.2017

The total amount of the remunerations received during the year under review by the members of the Management Board and of the Supervisory Board amounted to BGN 497 thousand /four hundred and ninety-seven thousand BGN/.

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

3. *Dividend policy*

The Bank has not paid any dividends. The annual net profit for 2017 has been allocated for coverage of a part of the losses in the past years.

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

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

5. Participation of the Board member in other companies

Supervisory Board:

- Arthur Sterne - Chairman of the Supervisory Board: shareholder and Manager of "Global Prime" LTD, UIC: 203874715.
- "Tokushukai Incorporated", Tokyo, Japan, represented by Eiji Yoshida - Deputy Chairman of the Supervisory Board. Mr. Yoshida – no shares.
- Dimitar Voutchev – member: member of the Board of Directors of "Adamant Capital Partners" AD, UIC: 200413613; 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 the partners Bulgaria Foundation (NPO).

Management Board:

- Vanya Vasileva – Chairman of Management Board and Executive Director: member of the Board of Directors of the "Atanas Burov" Foundation.
- Maria Sheytanova – Executive Director: shareholder and Manager of "CTM Bulgaria" LTD, UIC: 201987988; Chairman of the Board of Directors of the "TMA Bulgaria" Association (NPO), UIC: 176928159.
- Anna Tzankova-Boneva – Executive Director: shareholder (70% of the capital) of "Fine Line" LTD, UIC: 201758352

V. Responsibility of the management

The prepared Annual Financial Statement is in conformity with the requirements of the legislation and of the International Financial Reporting Standards (IFRS) adopted by the European Union and applicable in the Republic of Bulgaria. The Annual Financial Statement reliably reflects the property and financial condition of the Bank.

Upon drawing up the Annual Financial Statement (AFS) the Management acknowledges that:

- the same has been developed in compliance with the International Financial Reporting Standards;
- the Statement has been executed upon observation of the principle of an operating enterprise and has been presented reliably;
- the applied accounting policy is appropriate and consecutively applied;
- the necessary judgements and proposals made are in compliance with the prudence concept;
- all measures necessary for protection of the Bank's assets and prevention of frauds have been undertaken.

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

In 2017 and up to the date of the present Report there have been no tax consultations or any other forbidden services performed by any of both audit firms, which had carried out a joint independent financial audit of the Bank's separate and consolidated financial statements for 2017. For this period the audit firms and their network companies have carried out the following permitted services:

- Agreed procedures for the application in the Bank of Ordinance No. 10 of the Bulgarian National Bank (BNB) for the period 1 January 2017 – 31 December 2017, 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 jointly undertaken and carried out by both audit firms.
- Agreed procedures for the application in the Bank of Ordinance No. 10 of the Bulgarian National Bank (BNB) for the period 1 January 2016 – 31 December 2016, 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 carried out by Deloitte Audit OOD, which performed the independent financial audit of the Bank's separate and consolidated financial statements for 2016.

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

Maria Sheytanova
Member of Management Board and
Executive Director

Anna Boneva
Member of Management Board and
Executive Director

ТОКУДА БАНК АД
СОФИЯ

Sofia, 15 May 2018

Tokuda Bank

CORPORATE GOVERNANCE STATEMENT OF TOKUDA BANK AD

(as per Article 40 of the Accountancy Law 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, „a" of POSA)**

   TOKUDA BANK AD (the "Bank") complies, where appropriate, with the National Corporate Governance Code (the "Code") published on the website of the Bulgarian Stock Exchange – Sofia AD (BSE), approved with decision № 461-ККУ from 30.06.2016 by the member of the Financial Supervision Commission (FSC), acting as deputy-chair of the FSC responsible for "Supervision of the Investment Activities" as a code for corporate governance compliant with art. 100m, para 8, p.1, letter "a" from POSA.

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

2. **Information about application of additional corporate governance practices (art. 100m, para 8, p. 1, letter „c" of POSA)**

   TOKUDA BANK AD considers that the terms 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 systems and risk management in relation to the financial reporting (art. 100m, para 8, p.3 of POSA)**

   3.1. The Bank has established 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 evaluation and control of risks;
   - Parameters and limits for transactions and operations related to credit, liquidity and market risks;
   - Reliable system for accounting and management information, which allows identification and control of different types of risks.

   The system for risk management has a preventive function for events that may cause losses and control over the amounts of incurred losses.

   The organization for management and control of risks in the Bank is in accordance with the characteristics and the volume of activities, the inherent risks and the level and scope of the management control over the activities. The specific activities included might be listed as follows:

   - Management control and control environment;
   - Risk control;
   - Control activities and segregation of duties;

- Information and communication;
- Monitoring and correction of deviations.

The strategy for development of the Bank is established by the Supervisory Board. On the basis of the strategy, the risk appetite and risk profile of the Bank are determined so as to define its business model. The business model is subject to the risk appetite within the limits and thresholds established by the Management Board with respect to significant risks, which the Bank faces. Based on the strategy, risk appetite and profile of the Bank, the Management Board approved plan and budget to accomplish the strategy, which includes targets, deadlines and measures to achieve the targets.

The responsible units, whose decisions regarding the management and risks lead to the formation of the risk profile of the Bank are:

1) Supervisory Board – performs overall supervision over risk management; approves the strategy for development of the Bank, on which the risk profile and risk appetite of the institution are based; approves plan, budget and measures for the realization of the strategy and monitors their implementation. It appoints the head of Monitoring and Risk Management Division and receives periodic and regular reports by management, including capital management and capital plan.
2) Management Board – responsible for overall approach for risk management and approves plan, budget, principles and specific methods, techniques and procedures for risk management.
3) Monitoring and Risk Management Division – specialized unit in the Bank for risk analysis, management and monitoring. The functions of the Division are independent from the business units and from the units responsible for the functions of compliance and internal audit. The Division reports directly to the Supervisory Board.

Monitoring and Risk 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 activities, targets, powers and responsibilities, reporting lines and types of audits performed by Internal Audit are regulated by the Rules for organization and activity of the specialized unit Internal Audit in TOKUDA BANK AD. The rules are compliant with the applicable legislation: Law on the Bulgarian National Bank, Law on Credit Institutions, Ordinance № 10 of the BNB on the Internal Control in Banks, Financial Supervision Commission Act, Law on Public Offering of Securities, Special Purpose Investment Companies Act, Law on Measures against Market Abuse with Financial Instruments, Markets in Financial Instruments Act.

The Internal Audit supports the Management and Supervisory Boards 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 in the efficiency of the corporate governance system, risk management and control processes by:
a) performs assurance engagements and provides independent and objectively documented opinion regarding:

- Reliability, accuracy, completeness and timeliness of financial reporting and management reporting;

- Efficiency and effectiveness of the operations and achieving of operational and financial goals and safeguarding of assets;
- Compliance with applicable laws and regulations.

b) offers suggestions for remediation of identified deficiencies and weaknesses in the control environment;
c) performs consulting 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;
d) performs extraordinary audit engagements and audits for fraud prevention.

The Internal Audit reports administratively to the Management Board and functionally to the Supervisory Board of TOKUDA BANK AD, which allows the necessary level of independence and effective performance of its responsibilities. The Head of the Internal Audit has direct and unrestricted access to the Management Board and Supervisory Board.

3.3. Internal Financial Control – ex-ante, current and post control is organized and exercised in the operational work of the Bank. Systems for internal control over financial reporting are established.

Ex-ante control is implemented over all types of accounting operations and precedes the performance of accounting operations 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.

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

3.4. The risk monitoring and management is performed by Monitoring and Risk Management Division. The Division receives and analyses information for assessment, control and monitoring of the inherent risks in the Bank, including:

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

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

- IT system and software used by the Bank – core banking system and software for management of portfolios and risk;

- Business units with respect to new loan proposals and information for monitoring of loan portfolio;
- Liquidity and Money Markets Division about information concerning the securities portfolio of the Bank;
- Legal Division (including Legal Compliance and Anti-money laundering with respect to information for legal risks, including court cases and risk of noncompliance of internal rules and procedures, bank products and other with legal and regulatory framework;
- Bank Security with respect to operational risks, including risks of fraud and other potential risks related to the security of the Bank;
- Chief economist of the Bank with respect to summarized information on daily basis for the development of the deposit base and the attracted funds;
- All employees of the Bank, clients and other external parties with respect to information for operational events and complaints.

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

- New credit exposures;
- Approval of new or change/discontinuance of existing loan or deposit products;
- New deals with securities and acquisition of securities;
- Establishment of correspondence relationships and open of new exposures of the Bank with other banks;
- Other proposals for open/close or change of positions, which might impact the risk exposure of the Bank.

Based on the received proposals, the Division prepares opinion addressed to the respective committees and the Management Board, which perform review and take decision on the proposal in compliance with the internal policies and procedures of the Bank, the rules for activities of the committees and the approved limits for risk taking of different units.

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 Monitoring and Risk Management Division regularly informs the Management Board regarding any significant operational event and identified deficiencies in the activities, which expose the Bank to operational risk.

The units, which perform functions on taking risks:

- Supervisory Board and Management Board 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, changes in terms of existing loans, measures for exiting of problem exposures, new investments in securities and other assets, etc.;
- Business units, including the office network and units, which provide lending services implement the following:
  - Decisions of the Credit Council and the Management Board for approval of new loans, changes in terms of existing exposures, actions for decreasing of problem exposures, etc., which are taken based on opinions provided by the Monitoring and Risk Management Division;
  - Decisions of the Credit Council and the Management Board for introduction of new loan or deposit products, discontinuance or changes in existing products;
- Liquidity and Money Markets Division implements decisions of the Assets and Liabilities Committee (ALCO) taken based on the opinions provided by Monitoring and Risk Management Division with respect to purchases of securities for the portfolios of the

Bank and establishment of correspondence relationships or deposit of funds with other banks.

4. **Information per art. 10, paragraph 1, letter "c", "d", "f", "h" and "i" of the Directive 2004/25/EC of the European Parliament and of the EU Council of April 21, 2004 related to takeover bids (as per 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 of 31.12.2017 TOKUDA BANK AD has no direct or indirect shareholdings within the meaning art. 85 of Directive 2001/34/EC.

As of 31.12.2017 the shareholder structure of TOKUDA BANK AD is as follows:

Shareholder	Number of shares	Share in capita (%)
Tokushukai Incorporated	6 796 250	99,94
Gama Holding Group AD	3 750	00,06
Total	**6 800 00**	**100,00**

Dr. Torao Tokuda is the owner of Tokushukai Incorporated, Tokyo, Japan, and he is the individual who controls the direct shareholder Tokushukai Incorporated because he: 1) owns over 50 percent of the voting rights in the General Meeting of Shareholders and 2) can nominate more than half of the members of the Management Board.

4.2. TOKUDA BANK AD 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 TOKUDA BANK AD does not specify restrictions over voting rights of shareholders.

4.4. The rules that establish the appointment or change of the Management and Supervisory Board and changes in the Statute:
- Statute of TOKUDA BANK AD;
- Rules for reporting of conflict of interest and ensuring confidentiality in the transactions and operations of TOKUDA BANK AD;
- Guidelines for the competencies of the members of the Management Board and key employees of TOKUDA BANK AD;
- Rules for selection of members of relevant management unit 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 TOKUDA BANK AD 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. According to the Statute, the share capital of TOKUDA BANK AD could be increased by decision of the General Meeting of Shareholders or by decision of the Management Board after approval of the Supervisory Board. The share capital of TOKUDA BANK AD could be decreased by decision of the General Meeting of Shareholders taken by qualified majority of two-thirds of the represented shares. The share capital of the Bank could be decreased only after written pre-approval by BNB according to the legal 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 (as per art. 100m, para 8, p. 5 of POSA)**

TOKUDA BANK AD has a two-tier management system, which includes Supervisory Board and Management Board with the following responsibilities, power and composition:

Supervisory Board (SB) includes individuals and legal entities appointed by the General Meeting of Shareholders of the Bank. 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 Supervisory Board in 2017 and as of the current moment are:

- Mr. Arthur Stern – Chairman of the Supervisory Board;
- Tokushukai Inc., represented by Mr. Eiji Yoshida – Deputy chairman of the Supervisory Board - until 27.06.2017;
- Thomas Michael Higgins – member of the Supervisory Board since 27.06.2017;
- Mr. Dimitar Voutchev – Member of the Supervisory Board.

The Management Board (MB) includes individuals appointed by the Supervisory Board of the Bank. 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 Supervisory Board and in compliance with the established vision, goals and strategy of the Bank.

The members of the Management Board are:

- Mrs. Vanya Vassileva – Chairperson of the Management Board and Executive Director – until 6.12.2017;
- Mrs. Maria Sheytanova – Member of the Management Board and Executive Director;
- Mrs. Anna Boneva – Member of the Management Board and Executive Director.
- Todorina Doktorova – Member of the Management Board since 6.12.2017;

Currently no changes in the Management Board are envisaged.

The members of the Management Board and Supervisory Board 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.

Different permanent committees are established (listed below) to the Management Board and Supervisory Board – consulting units for evaluation and taking decision in relation to credit activity, liquidity and securities portfolios, return on assets, risks and other aspects of the Bank's activities.

In 2017 and as of the current date, the structure of the Bank includes the following committees:

Credit Council (CC) in its role as a collective unit to the Management Board performs the following activities in compliance with the approved rules for its activities, the credit policy of the Bank and the applicable legal regulations:

- Reviews and takes decisions for approval of new loan exposures, changes in existing exposures (renegotiated and restructured), taking measures for exiting existing exposures, enforecement of problem exposures of clients or group of related clients with exposures up to 10% of the capital base of the Bank;
- Proposals for review and approval by the Management Board of credit deals for exposures over 10% of the capital base;
- Review and presentation to the Management Board of proposals for foreclosure by the Bank of collateral under problem loans, cession of loans and write off of loans under existing exposures.

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

As of the current date, the member of the Credit Council are as follows:

Third level:

- Vanya Vassileva – Chairperson of the MB and Executive Director – Chairperson of CC until 6.12.2017;
- Maria Sheytanova – Member of the MB and Executive Director – Deputy-Chairperson;
- Todorina Doktorova – Head of Corporate Banking Division;
- Sabin Simeonov – Head of Monitoring and Risk Management Division;
- Svetozara Stoyanova-Tavityan – Head of Legal Division.

Second level:

- Vanya Vassileva – Chairperson of the MB and Executive Director – Chairperson of CC until 6.12.2017;
- Todorina Doktorova – Head of Corporate Banking Division;
- Sabin Simeonov – Head of Risk Monitoring Division;
- Emil Krastev – Chief Legal Advisory in Legal Division.

First level:

- Veneta Yancheva – Head of "Credit Risk – small and medium clients" in Monitoring and Risk Management Division;
- Svetozara Stoyanova-Tavityan – Head of Legal Division;
- Regional manager proposing the lending deal.

The Committee for Analysis, Classification and Impairment is the responsible body of the Bank for monitoring, evaluation and classification of financial assets and contingent liabilities, and for assessment of the credit loss and impairment provisions. The Committee takes decisions for classification and assesment of the credit loss of financial assets and determines provisions for contingent liabilities. The Committee analyzes the grounds fr reclassification of credit expsoures and controls the compliance with the requirements and criteria of BNB and the internal policies and procedures in this respect.
The members of the Committee for Analysis, Classification and Impairment are as follows:

- Anna Boneva – Member of the Management Board and Executive Director –

Chairperson;
- Svetlin Todorov – Head of Finance and Accounting Division – Member;
- Miglena Ivanova – Head of Loan Administration Division – Member;
- Reny Paneva – Head of Court Receivables– Member;
- Delyan Pehlivanov – Chief expert in Credit risk – corporate clients in Risk Monitoring Division – Member;
- Marina Borisova – Legal advisor in Court receivables– Member.

Assets and Liabilities Committee (ALCO) is the main body for management of the liquidity of TOKUDA BANK AD. It bears direct responsibility for the liquidity state and daily liquidity management based on decisions of the Management Board and for current management of the assets and liabilities. ALCO performs monthly analysis of the existing interest and liquidity risk and presents it to the Management Board. In compliance with ALCO Internal Rules of the Bank, the Committee consists of seven members as follows:

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

Currently the members of ALCO are the following:

- Anna Boneva – Member of MB and Executive Director – Chairperson;
- Vanya Vassileva – Chairperson of MB and Executive Director – Member until 6.12.2017;
- Sabin Simeonov – Head of Risk Monitoring Division – Member;
- Todorina Doktorova – Member of MB since 6.12.2017 and Head of Corporate Banking Division;
- Teodora Stoyanova – Head of Retail Banking Division – Member;
- Dessislava Nikova – Head of Liquidity and Money Markets Division;
- Grigor Sariiski – Chief economist – Member.

Risk Committee is a specialized internal body of the management of TOKUDA 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 perform the goals and tasks of the Bank and with its suggestion and decisions, the Risk Committee supports the Management Board and the executive directors for effective risk management. As of the current date the members of the Risk Management Committee are:

- Sabin Simeonov – Head of Monitoring and Risk Management Division – Chairperson;
- Svetlin Todorov – Head of Finance and Accounting – Member;
- Grigor Sariiski – Chief economist – Member;
- Miglena Ivanova – Head of Loan Administration Division – Member;
- Emil Krastev – Chief Legal Advisor in Legal Division.

In 2017 due to personnel changes in the Bank the following members have left the Risk Committee: Biliana Todorova. As of the current date, no changes are envisaged.

The Audit Committee established in compliance with the Law on Independent Audit is a permanent specialized independent consulting body of the Bank, which aims to monitor the effectiveness and adequacy of the financial reporting process, risk management and control, including internal audit by complying with the applicable legislation and good practices. The Audit Committee is appointed by the General Meeting of Shareholders of TOKUDA BANK AD, which determines also its term and the number of members.

The Audit Committee performs its activities according to the approved by the Supervisory Board of the Bank rules for its activities and reports its actvities 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 registered external auditor and monitors his independence.

6. Description of the policy for diversity applied with respect to administrative, management and supervisory bodies (as per art. 100m, para 8, p. 6 of POSA)

TOKUDA BANK AD applies policy for diversity by:

- Balanced age and sex structure at all management and control levels;
- Educational level and diverse areas of expertise (finance, law, information technology) in compliance with national regulatory requirements and aimed at including a broad range of expertise and competencies;
- Adequate professional experience for the respective positions with compliance of regulatory requirements by maintaining balance of experience, professionalism, knowledge of the activities, as well as independence and objective presentation of opinions and decisions.

In addition, the diversity in TOKUDA BANK AD is related to the transition between historical traditions and fast adaptation to new technologies in the financial services area.

Maria Sheytanova

Executive Director
Chairperson of the Management Board

Anna Boneva

Executive Director
Member of the Management Board

ТОКУДА БАНК АД СОФИЯ

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

INDEPENDENT AUDITORS' REPORT

To the shareholders of Tokuda Bank AD

REPORT ON THE AUDIT OF THE SEPARATE AND CONSOLIDATED FINANCIAL STATEMENTS

Opinion

We have audited the accompanying separate and consolidated financial statements of Tokuda Bank AD (the "Bank") and its subsidiary (together referred to as "the Group"), which comprise the separate and consolidated statement of financial position as at December 31, 2017, and the separate and consolidated statement of comprehensive income, the separate and consolidated statement of changes in equity and the separate and consolidated statement of cash flows for the year then ended, and notes to the separate and consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying separate and consolidated financial statements present fairly, in all material respects, the financial position of the Bank/Group as at December 31, 2017, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRS"), 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 separate and consolidated financial statements section of our report. We are independent of the Bank/Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements of the Independent Financial Audit Act (IFAA) that are relevant to our audit of the separate and consolidated financial statements in Bulgaria, and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code and the requirements of IFAA. 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 separate and consolidated financial statements of the current period. These matters were addressed in the context of our audit of the separate and consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matter	*How our audit addressed the key audit matter*
Impairment of loans and advances to clients **Notes 8 and 29 to the separate and consolidated financial statements** Loans and advances to clients, net of impairment comprise 47% of the total assets of the Bank/Group as of December 31, 2017. As disclosed in note 8.1 of the accompanying separate and consolidated financial statements, the Bank/Group has recorded impairment allowance of BGN 18,563 thousand on loans and advances to clients as of December 31, 2017. The determination of impairment allowance on loans and advances requires application of significant judgement and key assumptions with respect to identification of incurred loss and estimation of future cash flows on the loan exposures. As disclosed in note 29.2 the Bank/Group classifies its loans as performing and nonperforming and estimates impairment allowance on individually significant loans on a case-by-case basis by reference to expected future cash flows. For a portfolio of loans with common credit risk characteristics impairment allowance is determined by reference to probability of default, exposure at default, expected cash flows after default from realization of collateral (discounted with the effective interest rate) and period for realization. Due to the estimation uncertainty involved, we identified impairment calculation for loans and advances as a key audit matter.	***In this area, our audit procedures included, among others:*** • Inquiries and obtaining an understanding of the processes and policies for determination of impairment of loans and advances, applied by the Bank/Group. • Assessment of the adequacy of the policies, procedures and implemented controls in the process for compliance with IFRS and industry's best practices. • Evaluation of the design and implementation of relevant controls for estimation of impairment allowance on loans and advances. • We challenged management's classification of loans and identification of impairment by selecting a sample of loans from the portfolio and performing detailed substantive procedures to verify the classification and amount of the loans. We analysed the financial condition of the borrowers and enquired about any breaches of the terms and conditions of the contract. We have considered the impact of the current economic conditions, the valuation of assets held as collateral, and other factors that may affect the recoverability of loans and advances included in our sample. • We applied our professional judgment to assess the inputs used in the calculation of impairment losses. We challenged management's calculation of impairment losses by applying our professional judgement to independently determine estimates and comparing them to the estimates applied by the Bank/Group. • We evaluated the adequacy of disclosures in the separate and consolidated financial

	statements, including disclosures of the main assumptions and estimates for compliance with IFRS.

Information Other than the separate and consolidated financial statements and Auditors' Report Thereon

The Management Board of the Bank (the Management) is responsible for the other information. The other information comprises the annual report on activities and the corporate governance statement, prepared by the management in accordance with Chapter Seven of the Accountancy Act, but does not include the separate and consolidated financial statements and our auditors' report thereon.

Our opinion on the separate and consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon, unless it is not specifically stated in our auditors' report and to the extent it is specifically stated.

In connection with our audit of the separate and consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the separate and consolidated 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 this 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 separate and consolidated financial statements

Management is responsible for the preparation and fair presentation of the separate and consolidated financial statements in accordance with IFRS as adopted by 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 separate and consolidated financial statements, management is responsible for assessing the Bank's/Group'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/Group or to cease operations, or has no realistic alternative but to do so.

The Supervisory Board and the Audit Committee of the Bank (Those charged with governance) are responsible for overseeing the Bank's/Group's financial reporting process.

Auditors' Responsibilities for the Audit of the separate and consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the separate and consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' 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 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 separate and consolidated financial statements.

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

- Identify and assess the risks of material misstatement of the separate and consolidated 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/Group'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/Group'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 separate and consolidated 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 auditors' report. However, future events or conditions may cause the Bank/Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the separate and consolidated financial statements, including the disclosures, and whether the separate and consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements.
- We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

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.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the separate and consolidated 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 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 June 13, 2017 by the Institute of Certified Public Accountants in Bulgaria and the Commission for Public Oversight of the Statutory Auditors in Bulgaria.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Additional matters, required to be reported by the Accountancy Act and the Public Offering of Securities Act

In addition to our reporting responsibilities according to ISAs described in section "Information Other than the separate and consolidated financial statements and Auditors' Report Thereon", with respect to the annual report on activities and the corporate governance statement, we have also performed the procedures required by the "Guidelines regarding new extended reports and communication by the auditor" of the Professional Organization of Registered Auditors in Bulgaria - Institute of Certified Public Accountants (ICPA). These procedures include tests over the existence, form and content of the other information in order to assist us in forming an opinion as to whether the other information includes the disclosures and reporting as required by Chapter Seven of the Accountancy Act and art.100m para 8 from the Public Offering of Securities Act (where applicable), applicable in Bulgaria.

Opinion under Article 37, paragraph 6 of the Accountancy Act

Based on the procedures performed, in our opinion:

- The information included in the annual report on the activities for the financial year for which the separate and consolidated financial statements have been prepared, is consistent with the separate and consolidated financial statements.
- The annual report on the activities has been prepared in accordance with the requirements of Chapter Seven of the Accountancy Act.
- The information required by Chapter Seven of the Accountancy Act and Art. 100m, para 8 of the Public Offering of Securities Act is presented in the corporate governance statement covering the financial year for which the separate and consolidated financial statements have been prepared.

Statement in accordance with Art. 33 of Ordinance 38 of the Financial Supervisory Commission (FSC) outlining the Requirements for the Activities of the Investment Intermediaries

Based on the performed audit procedures and the acquired understanding of the Bank's activities in the context and the course of our audit of the Bank's separate and consolidated financial statements as a whole, we have identified that the established and applied organization related to the keeping of clients' assets complies with the requirements of Ordinance 38 of FSC regarding the Bank's activity as an investment intermediary under art. 28-31 of the Ordinance.

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.

- Deloitte Audit OOD was appointed as a statutory auditor of the separate and consolidated financial statements of the Bank/Group for the year ended 31 December 2017 by the general meeting of shareholders held on 7 December 2017 for a period of one year.

- The audit of the separate and consolidated financial statements of the Bank/Group for the year ended 31 December 2017 represents seventh total consecutive statutory audit engagement for that entity carried by Deloitte Audit OOD and first consecutive statutory audit engagement for that entity carried by ABVP Audit Standard OOD.
- We hereby confirm that the audit opinion expressed by us is consistent with the additional report dated 21 May 2018, provided to the Bank's/Group's audit committee, in compliance with the requirements of Art. 60 of the Independent Financial Audit Act.
- 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/Group.
- For the period to which our joint statutory audit refers, we have not provided other services to the Bank and its subsidiaries in addition to the statutory audit, which have not been disclosed in the Bank's/Group's report on the activities or separate and consolidated financial statements.

Deloitte Audit OOD

Deloitte Audit OOD

Assen Dimov
Statutory Manager
Registered Auditor

103, Al. Stambolijski Blvd
1303 Sofia, Bulgaria

21 May 2018

ABVP Audit Standard OOD

Sevdalina Paskaleva
Statutory Manager
Registered Auditor

40B, Simeon Radev Str.
Sofia, Bulgaria

TOKUDA BANK AD
SEPARATE AND CONSOLIDATED STATEMENT OF FINANCIAL POSITION
31 DECEMBER 2017

(all amounts expressed in BGN thousand)	Note	As at 31 December 2017	As at 31 December 2016	As at 31 December 2017	As at 31 December 2016
		Separate		Consolidated	
ASSETS					
Cash and cash balances with central banks	4	70,362	52,160	70,362	52,160
Loans and receivables from credit institutions	5	25,114	17,671	25,114	17,671
Financial assets held for trading	6	14,126	24,790	14,126	24,790
Financial assets available for sale	7	60,801	89,085	60,801	89,085
Loans and receivables from customers	8	181,384	175,801	181,384	175,801
Non-current assets held for sale	9	6,734	7,271	6,734	7,271
Property, plant and equipment	10	2,022	2,656	2,023	2,664
Intangible assets	10	713	603	713	606
Investment property	11	9,853	1,274	9,853	1,274
Investments in subsidiaries	12	25	25	-	-
Other assets	13	16,702	15,880	16,702	15,878
Total assets		**387,836**	**387,216**	**387,812**	**387,200**
LIABILITIES					
Deposits from credit institutions	14	191	87	191	87
Deposits from clients other than credit institutions	15	340,944	341,237	340,942	341,231
Tax liabilities	16	95	93	95	93
Other liabilities	17	1,923	1,147	1,923	1,148
Total liabilities		**343,153**	**342,564**	**343,151**	**342,559**
EQUITY					
Share capital	18	68,000	68,000	68,000	68,000
Reserves	18	3,789	4,759	3,789	4,759
Accumulated loss		(28,107)	(26,368)	(28,118)	(26,379)
Profit/(Loss) for the year		1,001	(1,739)	990	(1,739)
Total equity		**44,683**	**44,652**	**44,661**	**44,641**
Total liabilities and equity		**387,836**	**387,216**	**387,812**	**387,200**

These separate and consolidated financial statements have been approved by the Management Board of Tokuda Bank AD on 15 May 2018.

Anna Tsankova-Boneva
Member of Management Board
and Executive Director

Maria Sheytanova
Member of Management Board
and Executive Director

Svetlin Todorov
Finance Director

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

Assen Dimov
Registered Auditor
Date: 21.05.2018

Sevdalina Paskaleva
Registered Auditor
Date: 21.05.2018

TOKUDA BANK AD
SEPARATE AND CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
31 DECEMBER 2017

(all amounts expressed in BGN thousand)	Note	Year ended 31 December		Year ended 31 December	
		2017	**2016**	**2017**	**2016**
		Separate		Consolidated	
Interest income	19	12,305	13,782	12,305	13,782
Interest expense	19	(2,663)	(4,088)	(2,663)	(4,088)
Net interest income		9,642	9,694	9,642	9,694
Fee and commission income	20	3,837	3,772	3,837	3,772
Fee and commission expense	20	(297)	(291)	(297)	(291)
Net fee and commission income		3,540	3,481	3,540	3,481
Net trading income	21	283	791	283	791
Other operating income	22	3,894	689	3,899	688
Operating income		17,359	14,655	17,364	14,654
Impairments and provisions for losses	24	(3,145)	(3,426)	(3,145)	(3,426)
Personnel costs		(6,135)	(5,962)	(6,159)	(5,987)
Operating lease rentals		(1,096)	(1,047)	(1,096)	(1,047)
Other expenses		(5,981)	(5,954)	(5,973)	(5,928)
Operating expenses	23	(13,212)	(12,963)	(13,228)	(12,962)
Profit/(Loss) before income tax		1,002	(1,734)	991	(1,734)
Tax expense	25	(1)	(5)	(1)	(5)
Profit/(Loss) for the year		1,001	(1,739)	990	(1,739)
Other comprehensive income					
Items that may be reclassified to profit or loss in subsequent periods					
Net change in fair value of available for sale financial assets		1,013	1,459	1,013	1,459
Reclassification adjustment ralating to available-for-sale financial assets disposed of in the year		(1,982)	(328)	(1,982)	(328)
Items that will never be reclassified to profit or loss					
Remeasurements of defened benefit liability		(1)	(4)	(1)	(4)
Total other comprehensive income		(970)	1,127	(970)	1,127
Total comprehensive income for the year		31	(612)	20	(612)

These separate and consolidated financial statements have been approved by the Management Board of Tokuda Bank AD on 15 May 2018.

Anna Tsankova-Boneva
Member of Management Board
and Executive Director

Maria Sheytanova
Member of Management Board
and Executive Director

Svetlin Todorov
Finance Director

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

Assen Dimov
Registered Auditor
Date: 21.05.2018

Sevdalina Paskaleva
Registered Auditor
Date: 21.05.2018

TOKUDA BANK AD
SEPARATE AND CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
31 DECEMBER 2017

Separate (all amounts expressed in BGN thousand)	**Share capital**	**Reval. reserve of fin. assets available for sale**	**Reserves**	**Accumulated loss**	**Total**
Balance at 1 January 2016	**68,000**	**2,820**	**812**	**(26,368)**	**45,264**
Loss for the year	-	-	-	(1,739)	(1,739)
Other comprehensive income for the year	-	1,131	(4)	-	1,127
Remeasurements of defined benefit liability	-	-	(4)	-	(4)
Net revaluation reserve of financial assets available for sale	-	1,131	-	-	1,131
Total comprehensive income for the year	-	1,131	(4)	(1,739)	(612)
Balance at 31 December 2016	**68,000**	**3,951**	**808**	**(28,107)**	**44,652**
Profit for the year	-	-	-	1,001	1,001
Other comprehensive income for the year	-	(969)	(1)	-	(970)
Remeasurements of defined benefit liability	-	-	(1)	-	(1)
Net revaluation reserve of financial assets available for sale	-	(969)	-	-	(969)
Total comprehensive income for the year	-	(969)	(1)	1,001	31
Balance at 31 December 2017	**68,000**	**2,982**	**807**	**(27,106)**	**44,683**

Consolidated (all amounts expressed in BGN thousand)	**Share capital**	**Reval. reserve of fin. assets available for sale**	**Reserves**	**Accumulated loss**	**Total**
Balance at 1 January 2016	**68,000**	**2,820**	**812**	**(26,379)**	**45,253**
Loss for the year	-	-	-	(1,739)	(1,739)
Other comprehensive income for the year	-	1,131	(4)	-	1,127
Remeasurements of defined benefit liability	-	-	(4)	-	(4)
Net revaluation reserve of financial assets available for sale	-	1,131	-	-	1,131
Total comprehensive income for the year	-	1,131	(4)	(1,739)	(612)
Balance at 31 December 2016	**68,000**	**3,951**	**808**	**(28,118)**	**44,641**
Profit for the year	-	-	-	990	990
Other comprehensive income for the year	-	(969)	(1)	-	(970)
Remeasurements of defined benefit liability	-	-	(1)	-	(1)
Net revaluation reserve of financial assets available for sale	-	(969)	-	-	(969)
Total comprehensive income for the year	-	(969)	(1)	990	20
Balance at 31 December 2017	**68,000**	**2,982**	**807**	**(27,128)**	**44,661**

These separate and consolidated financial statements have been approved by the Management Board of Tokuda Bank AD on 15 May 2018.

Anna Tsankova-Boneva
Member of Management Board
and Executive Director

Maria Sheytanova
Member of Management Board
and Executive Director

Svetlin Todorov
Finance Director

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

Assen Dimov
Registered Auditor
Date: 21.05.2018

Sevdalina Paskaleva
Registered Auditor
Date: 21.05.2018

TOKUDA BANK AD
SEPARATE AND CONSOLIDATED STATEMENT OF CASH FLOWS
31 DECEMBER 2017

(all amounts expressed in BGN thousand)		Year ended 31 December		Year ended 31 December	
	Note	2017	2016	2017	2016
		Separate		Consolidated	
Cash flows from operating activities					
Net profit/(loss) for the year		1,001	(1,739)	990	(1,739)
Income tax expense		1	5	1	5
Depreciation/amortization		670	560	673	563
Net impairments and provisions for losses		3,145	3,426	3,145	3,426
Net interest income		(9,642)	(9,694)	(9,642)	(9,694)
Dividend income		(68)	(28)	(68)	(28)
Gain on disposal of property, plant and equipment		(2,067)	(37)	(2,067)	(37)
Accruals		441	172	441	172
Interest income received		13,500	15,820	13,500	15,820
Interest expense paid		(4,610)	(4,341)	(4,610)	(4,341)
Dividend income received		68	28	68	28
Cash flows from oper. profit before changes in the oper. assets and liabilities		**2,439**	**4,172**	**2,431**	**4,175**
Decrease in Trading securities		10,461	3,086	10,461	3,086
Decrease in Financial assets available for sale		25,938	4,507	25,938	4,507
(Increase)/ Decrease in loans and receivables from customers		(6,977)	1,794	(6,977)	1,794
(Increase)/ Decrease of non-current assets held for sale		537	(136)	537	(136)
Increase in Investment property		(8,677)	(1,424)	(8,677)	(1,424)
Increase of other assets		(1,460)	(7,459)	(1,462)	(7,459)
Increase/(Decrease) of deposits from credit institutions		104	(476)	104	(476)
Increase/(Decrease) of deposits from clients other than credit institutions		1,654	(38,397)	1,658	(38,397)
(Decrease) of other liabilities		(290)	(594)	(291)	(594)
Net cash flow generated by operating activities		**21,290**	**(39,099)**	**21,291**	**(39,099)**
Cash flows from investing activities					
Payments for acquisition of property, plant and equipment		(497)	(811)	(497)	(811)
Proceeds from sale of property, plant and equipment		2,746	678	2,750	675
Payments for acquisition of intangible assets		(333)	(118)	(330)	(118)
Net cash flow used in investing activities		**1,916**	**(251)**	**1,923**	**(254)**
Net (decrease)/increase of cash and cash equivalents		**25,645**	**(35,178)**	**25,645**	**(35,178)**
Cash and cash equivalents at the beginning of the year		**69,831**	**105,009**	**69,831**	**105,009**
Cash and cash equivalents at the end of the year	27	**95,476**	**69,831**	**95,476**	**69,831**

These separate and consolidated financial statements have been approved by the Management Board of Tokuda Bank AD on 15 May 2018.

Anna Tsankova-Boneva
Member of Management Board
and Executive Director

Maria Sheytanova
Member of Management Board
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Svetlin Todorov
Finance Director

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

Assen Dimov
Registered Auditor
Date: 21.05.2018

Sevdalina Paskaleva
Registered Auditor
Date: 21.05.2018

1. ORGANIZATION AND OPERATIONS

Tokuda Bank AD (the Bank), UIC 813155318, is a joint stock company registered in the Republic of Bulgaria on December 27, 1994. The Bank's registered address is 21, Georg Washington Street, Sofia. The consolidated financial statements of Tokuda Bank Group present the financial statement of Tokuda Bank AD (The Bank) and its controlled subsidiary "Tokuda Security" EOOD (Subsidiary) as a reporting entity (the Group).

As of December 31, 2017 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 face value of BGN 10 (ten) per share.

As of December 31, 2017 the major shareholder of the Bank is Tokushukai Incorporated, holding 99.94% of the Bank's capital.

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

The 2017 and 2016 the activities of the Bank/Group mainly consists of rendering of banking services related to granting loans to private companies, attracting deposits from customers, servicing of client payments both locally and internationally, performing transactions with government securities and securities under repurchase agreements, as well as other financial services in Bulgaria.

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

In 2017 the Bank/Group operates through its Head Office and 27 offices, points of services and representative offices (2016: 27). As of December 31, 2017 the Bank has 257 employees (2016: 259). As of December 31, 2017 the Group has 258 employees (2016:262).

2. BASIS FOR PREPARATION OF THE SEPARATE AND CONSOLIDATED FINANCIAL STATEMENTS

2.1. General

These financial statements have been prepared for general purposes for the year ended December 31, 2017. The financial statements are presented in thousand Bulgarian Levs (BGN'000).

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

The Bank owns 100% the subsidiary Tokuda Security EOOD, Sofia, Republic of Bulgaria. According to a decision of the sole owner of the share capital of Tokuda Security EOOD, it is in liquidation since 21.12.2017.

2.2. Accounting convention

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

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

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

2.3. Changes in IFRS

Initial application of new amendments to the existing standards effective for the current reporting period

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

- Amendments to IAS 7 "Statement of Cash Flows" - Disclosure Initiative – adopted by EU on November 6, 2017 (effective for annual periods beginning on or after 1 January 2017),
- Amendments to IAS 12 "Income Taxes" - Recognition of Deferred Tax Assets for Unrealised Losses – adopted by EU on November 6, 2017 (effective for annual periods beginning on or after January 1, 2017),
- Amendments to various standards "Improvements to IFRSs (cycle 2014-2016)" resulting from the annual improvement project of IFRS (IFRS 1, IFRS 12 and IAS 28) primarily with a view to removing inconsistencies and clarifying wording – adopted by the EU on 8 February 2018 (amendments to IFRS 12 are to be applied for annual periods beginning on or after 1 January 2017).

Standards and amendments to the existing standards issued by IASB and adopted by the EU but not yet effective

At the date of authorisation of these financial statements, the following new standards issued by IASB and adopted by the EU are not yet effective as of the end of the reporting period:

- IFRS 9 "Financial Instruments" - adopted by the EU on November 22, 2016 (effective for annual periods beginning on or after January 1, 2018),
- IFRS 15 "Revenue from Contracts with Customers" and amendments to IFRS 15 "Effective date of IFRS 15" - adopted by the EU on September 22, 2016 (effective for annual periods beginning on or after January 1, 2018),
- IFRS 16 "Leases" – adopted by the EU on October 31, 2017 (effective for annual periods beginning on or after January 1, 2019),
- Amendments to IFRS 4 "Insurance Contracts" - Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts – adopted by the EU on November 3, 2017 (effective for annual periods beginning on or after January 1, 2018 or when IFRS 9 "Financial Instruments" is applied first time),
- Amendments to IFRS 15 "Revenue from Contracts with Customers" - Clarifications to IFRS 15 Revenue from Contracts with Customers – adopted by the EU on October 31, 2017 (effective for annual periods beginning on or after January 1, 2018),
- Amendments to various standards "Improvements to IFRSs (cycle 2014-2016)" resulting from the annual improvement project of IFRS (IFRS 1, IFRS 12 and IAS 28) primarily with a view to removing inconsistencies and clarifying wording – adopted by the EU on 8 February 2018 (amendments to IFRS 1 and IAS 28 are to be applied for annual periods beginning on or after 1 January 2018).

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

2.3. Changes in IFRS (continued)

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

At present, IFRS as adopted by the EU do not significantly differ from regulations adopted by the International Accounting Standards Board (IASB) except for the following new standards, amendments to the existing standards and new interpretations, which were not endorsed for use in EU as of the date of publication of these financial statements (the effective dates stated below is for IFRS in full):

- IFRS 14 "Regulatory Deferral Accounts" (effective for annual periods beginning on or after 1 January 2016) - the European Commission has decided not to launch the endorsement process of this interim standard and to wait for the final standard,
- IFRS 17 "Insurance Contracts" (effective for annual periods beginning on or after January 1, 2021),
- Amendments to IFRS 2 "Share-based Payment" - Classification and Measurement of Share-based Payment Transactions (effective for annual periods beginning on or after January 1, 2018),
- Amendments to IFRS 9 "Financial Instruments" - Prepayment Features with Negative Compensation (effective for annual periods beginning on or after January 1, 2019),
- Amendments to IFRS 10 "Consolidated Financial Statements" and IAS 28 "Investments in Associates and Joint Ventures" - Sale or Contribution of Assets between an Investor and its Associate or Joint Venture and further amendments (effective date deferred indefinitely until the research project on the equity method has been concluded),
- Amendments to IAS 19 "Employee Benefits" - Plan Amendment, Curtailment or Settlement (effective for annual periods beginning on or after 1 January 2019),
- Amendments to IAS 28 "Investments in Associates and Joint Ventures" - Long-term Interests in Associates and Joint Ventures (effective for annual periods beginning on or after January 1, 2019),
- Amendments to IAS 40 "Investment Property" - Transfers of Investment Property (effective for annual periods beginning on or after January 1, 2018),
- Amendments to various standards due to "Improvements to IFRSs (cycle 2015-2017)" resulting from the annual improvement project of IFRS (IFRS 3, IFRS 11, IAS 12 and IAS 23) primarily with a view to removing inconsistencies and clarifying wording (effective for annual periods beginning on or after January 1, 2019),
- IFRIC 22 "Foreign Currency Transactions and Advance Consideration" (effective for annual periods beginning on or after January 1, 2018),
- IFRIC 23 "Uncertainty over Income Tax Treatments" (effective for annual periods beginning on or after January 1, 2019).

The Bank/Group anticipates that the adoption of these new standards and amendments to the existing standards will have no material impact on the financial statements of the Bank/Group in the period of initial application, except for IFRS 9 Financial instruments and IFRS 16 Leases.

IFRS 9 Financial instruments is effective for annual periods beginning on or after 1 January 2018 and uses a single approach to determine whether a financial asset is measured at amortised cost or fair value, replacing the many different rules in IAS 39.

The main changes introduced by IFRS 9 are as follows:

- Classification and measurement - IFRS 9 introduces a new approach to the classification of financial assets based on the characteristics of the cash flows of the financial instruments and business model under which the respective financial asset is held.
- Impairment - A new impairment model is introduced based on recognition of expected credit losses, which will lead to earlier recognition of credit losses and higher impairment levels. A loan loss allowance for either 12-month expected credit losses or lifetime expected credit losses is required.
- Hedge accounting – can more closely reflect risk management with more qualifying hedging instruments and hedged items. Retrospective assessment of hedge effectiveness is no longer required and the prospective test is based on the principle of economic relationship. Significantly changed model of hedge accounting is introduced, with expanded information that should be disclosed about the risk management activities.

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

2.3. Changes in IFRS (continued)

In 2017 the Bank started a project, which ensured the transition to the requirements to the new standard: the Policy for impairment of financial assets and contingent liabilities was updated, the business model for managing the financial assets was approved, the existing categories of financial assets were analysed and assessed.

According to the strategy of the Bank in manging the financial assets, the Bank applies the following business models:

- **Business model whose objective is to collect contractual cash flows -** the Bank holds the financial instruments till maturity with objective to collect the contractual cash flows according to the contract. The assets held within this business model are not sold except in rare cases. The financial instruments measured at amortized cost as of December 31, 2017 are classified in this business model.
- **Business model whose objective is achieved by both collecting contractual cash flows and selling financial assets -** the Bank holds the financial instruments for both collecting contractual cash flows and selling. Compared with the business model whose objective is to collect contractual cash flows, this business model is characterized by higher frequency and higher amount of sales. The financial assets managed under this business model are used for supporting purposes such as management of the daily liquidity needs, maintaining interest revenue, balance between the maturity terms of the financial assets and liabilities funded by these assets. The main part of the available-for-sale financial assets available as of December 31, 2017 are classified in this business model. No significant reclassification effects are expected.
- **Business model whose objective is to sell the financial assets** - the Bank holds the financial instruments for trading purposes; although the Bank may receive different contractual payments of these instruments the final objective is to generate profit from price fluctiations. The financial assets held for trading as of December 31, 2017 are classified in this business model.

Depending on the existence of significant increase credit risk since initial recognition and credit impairment since initial recognition, credit exposures are reported in the following stages:

- Stage 1 – the credit risk on the exposure has not increased significantly since initial recognition.
- Stage 2 - the credit risk on the exposure has increased significantly since initial recognition (overdue payment of the loan over 30 days, significant increase in the 12 month probability of default, change in the internal rating/risk group of the exposure resulting in reporting to Stage 2 and other qualitative criteria).
- Stage 3 – the exposure is credit impaired (overdue payment of the exposure over 90 days, change in the internal rating/risk exposure group resulting in reporting to Stage 3 and other qualitative criteria including significant probability that the client will be declared insolvent, in liquidation or is subject to other form of financial recovery and others)

The stage of the credit exposures is determined on each reporting date on the basis of the existence of significant increase credit risk since initial recognition and credit impairment since initial recognition

The expected impact on equity from the initial application of IFRS 9 Financial Instruments is related to increase in the impairment for expected credit loss as follows:

in BGN thousand	
Expected effect on capital arising from	
Loans and receivables from customers	(618)
Loans and receivables from credit institutions	(20)
Debt insruments on amortized cost and capital insturments	(147)
Issued letters of guarantees and unutilized commitments	(10)
Total	(795)

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

2.3. Changes in IFRS (continued)

IFRS 16 introduces a comprehensive model for the identification of lease agreements and accounting treatments for both lessors and lessees. IFRS 16 will supersede the current lease guidance including IAS 17 Leases and the related interpretations when it becomes effective.

Distinctions of operating leases and finance leases are removed for lessee accounting, and is replaced by a model where a right-of-use asset and a corresponding liability have to be recognized for all leases by lessees except for short-term leases and leases of low value assets.

The right-of-use asset is initially measured at cost and subsequently measured at acquisition cost (subject to certain exceptions) less accumulated depreciation and impairment losses, adjusted for any remeasurement of the lease liability. The lease liability is initially measured at the present value of the lease payments that are not paid at that date. Subsequently, the lease liability is adjusted for interest and lease payments, as well as the impact of lease modifications, amongst other.

In contrast to lessee accounting, IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17, and continues to require a lessor to classify a lease either as an operating lease of finance lease.

The Bank/Group is currently assessing its potential impact of IFRS 16 on the financial statements, since it is lessee on operating lease contracts of bank offices and other assets.

Hedge accounting for a portfolio of financial assets and liabilities whose principles have not been adopted by the EU remains unregulated.

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

2.4. Going concern

The Bank/Group's financial statements have been prepared under the going concern assumption. As a result of the operations executed by the Bank/Group in prior reporting periods, losses have been accumulated that may cast doubt about the Bank/Group's ability to continue as a going concern. Despite the accumulated losses, the Management has analysed the ability of the Bank/Group to continue its operations and has undertaken actions to strengthen its positions through optimization of the banking products and services, improvements of the assets structure and expenses which will create conditions for generating future income. As of December 31, 2017 there is no significant doubt on the ability of the Bank to continue as a going concern.

2.5. Principles of consolidation

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

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

2.5. Principles of consolidation (continued)

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

In preparing the consolidated financial statements, the financial statements of the Bank and its subsidiary are combined on a line-by-line basis by adding together like items of assets, liabilities, equity, income and expenses. Where necessary, adjustments are made to the financial statements of the subsidiary to bring its accounting policies into line with those used by the Bank.

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

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

Goodwill incurred in business combinations is reviewed for impairment annually or more often if any events or changes in the circumstances provide indications for impairment. In these consolidated financial statements no goodwill was recognized from business combinations.

Entities in which the Group has significant influence, but not control (associates), are included in the consolidated financial statements at acquisition cost. Significant influence is defined as the right to participate in the financial and operating decisions of the associate, but not to control these decisions. As of December 31, 2017 and 2016 the Group has no associates.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

3.1. Accounting estimates and accounting assumptions

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.1. Accounting estimates and accounting assumptions (continued)

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

- Allowance for impairment of loans and receivables from customers – to determine the amount of allowance for impairment of loans and receivables from customers the Bank/Group measures the recoverable amount of the assets. This process requires assumptions related to expected future cash flows, collateral values, and anticipated time of collateral realization. Note 29.2 describes the process applied by the Bank/Group to manage the credit risk and to determine the allowance for impairment of loans and receivables.
- Measurement of fair value of financial assets and financial liabilities carried at fair value – note 29.5 discloses detailed information for the main methods and assumptions for measurement and disclose of fair value;
- Useful lives of property, plant and equipment and intangible assets – the Bank/Group reviews the useful lives of these assets at the end of each reporting period and changes their useful lives, if needed. In 2017 there were no changes in the useful lives of these assets.
- Impairment Analysis of non-current assets held for sale, investment property, other assets acquired from nonperforming loans – the Bank/Group reviews annually these assets for impairment, based mainly on external appraisals. When determining the fair value the independent appraisers use: comparative value method, capitalization of income method, depreciated replacement method, depending on the type of the appraised asset.

3.2. Financial assets

Financial assets at fair value through profit or loss

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

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

As of December 31, 2017 and 2016 the Bank/Group has no such assets.

Financial assets and liabilities held for trading

These are financial assets and liabilities, as well as all derivatives (excluding those, presented as hedging instruments), which were either acquired for the purpose of generating profit from short-term fluctuations in price or dealer's margin, or for the purpose of generating short-term profit from sales. These financial instruments are initially recognized and subsequently measured at fair value. Subsequent revaluations are based on market quotations. All realized gains on transactions with such financial instruments, as well as gains or losses on subsequent revaluations are included in the statement of comprehensive income. As of December 31, 2017 and 2016 financial assets held for trading consist mainly of Bulgarian government securities.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.2. Financial assets (continued)

Purchase and sale of financial assets held for trading are recognized at transaction date.

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

As of December 31, 2017 and 2016 there are no transactions with derivative financial instruments that qualify for hedge accounting under the specific rules of IAS 39.

Investments held to maturity

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

Acquisitions and derecognition of financial assets classified as investment held to maturity are recognized on transaction date.

Financial assets available for sale

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

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

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

Sales and acquisitions of financial assets available for sale are recognized on transaction date.

Loans and receivables

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

Cash and cash equivalents

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

Derecognition and netting of financial assets

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

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.2. Financial assets (continued)

Off-balance financial instruments

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

Impairment of financial assets

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

The objective evidence for impairment includes:

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

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

3.3. Loans and receivables

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

The allowance for impairment and uncollectability is measured considering the specific risk of the asset. In determining the level of the impairment required, management considers a number of factors including domestic economic conditions, the composition of the loan portfolio and prior irregular and non-performing debt experience, quality and liquidity of collateral.

The allowance for impairment and uncollectability is determined as the difference between the carrying amount of a financial asset and its estimated recoverable amount. For portfolios of expositions with similar credit risk characteristics and no objective evidence of impairment, the Bank/Group estimates portfolio impairments (incurred but not reported loss).

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

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

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

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

3.5. Investment property

Investment property includes buildings, that the Bank/Group holds for earning rentals or for capital appreciation, or both. The Bank/Group uses the fair value model for the measurement of the investment property after recognition. The assets in this category are revalued annually, based mainly on external appraisals.

3.6. Leases

The determination of whether an arrangement is or contains a lease is based on the substance of the arrangement. It requires an assessment of whether: (a) fulfilment of the arrangement is dependent on the use of a specific asset or assets (the asset); and (b) the arrangement conveys a right to use the asset.

Operating lease
Leases where a significant portion of the risks and rewards of ownership of the asset are retained by the lessor are classified as operating leases. The payments made under operating leases are charged to the separate and consolidated income statement on a straight-line basis over the period of the lease and are presented as rent expenses. When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognized as an expense in the period in which termination takes place. Assets leased out by the Bank/Group under operating leases are included in the separate and consolidated statement of financial position based on the nature of the asset. They are depreciated over their useful lives on a basis consistent with similar owned property. Rental income under lease contracts is recognized on a straight-line basis over the lease term and are presented as 'other operating income/expenses' in the separate and consolidated income statement.

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.7. Property, plant and equipment and intangible assets

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

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

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

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

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

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

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

3.8. Interest income and expense

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

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.9. Fees and commissions

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

3.10. Foreign currency transactions

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

Currency	31.12.2017	31.12.2016
US Dollars	1.63081	1.85545
Euro	1.95583	1.95583

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

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

3.11. Employee benefits

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

Employee benefits include:

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

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

In accordance with IAS 19 Employee Benefits the Bank/Group recognizes liabilities for retirement benefits, which are calculated by licensed actuary using the Projected Unit Credit Method (see note 17). The amount reported in the statement of financial position represents the present value of the long-term liabilities of the Bank/Group for retirement benefits.

3.12. Taxation

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.12. Taxation (continued)

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

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

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

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

3.13. Fair value of financial assets and liabilities

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

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

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

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

3.14. Provisions and contingent liabilities

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.15. Assets acquired from collaterals

Assets acquired from collaterals which the Bank/Group does not intend to use in the course of its business, and which are not investment properties are presented as "Other assets" in accordance with IAS 2 "Inventories" (see also Note 13). These assets are collaterals which the Bank/Group acquired from borrowers who became insolvent. The Bank/Group's policy is to sell the acquired collaterals when the Bank/Group finds profitable enough market for them.

Assets acquired from collaterals that meet the conditions of IFRS 5 and IAS 40 are presented as non-current assets held for sale (see Note 3.16) and investment properties (see Note 3.5), respectively.

3.16. Non-current assets held for sale

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

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

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

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

3.17. Comparative information

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

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

If any of these factors apply, the comparative information for each reporting period is changed to achieve comparability of information. There are no significant changes required to be made to comparative information in these financial statements.

4. CASH AND CASH BALANCES WITH CENTRAL BANKS

separate and consolidated in BGN thousand	2017	2016
Cash in hand	8,100	7,233
Cash with the Central bank	62,262	44,927
Total	**70,362**	**52,160**

Cash with the Central bank as of December 31, 2017 and 2016 include minimum reserves at the amount of BGN 43,419 thousand and BGN 23,861 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 377 thousand and BGN 269 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.

5. LOANS AND RECEIVABLES FROM CREDIT INSTITUTIONS

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

separate and consolidated in BGN thousand	2017	2016
Nostro accounts with domestic credit institutions	907	488
Deposits with domestic credit institutions	14,563	12,946
Deposits with foreign credit institutions	4,893	-
Nostro accounts with foreign credit institutions	4,751	4,237
Total	**25,114**	**17,671**

Deposits to credit institutions as of December 31, 2017 and 2016 have maturity within 3 months.

6. FINANCIAL ASSETS HELD FOR TRADING

separate and consolidated in BGN thousand	2017	2016
Bulgarian government bonds	12,183	9,912
Eurobonds of local governments	-	14,748
Foreign government securities	1,766	-
Shares and participations of domestic enterprises	177	130
Total	**14,126**	**24,790**

7. FINANCIAL ASSETS AVAILABLE FOR SALE

separate and consolidated in BGN thousand	2017	2016
Shares and participations of domestic enterprises	374	163
Allowance for impairment	(77)	(77)
Bulgarian government bonds	38,158	64,143
Foreign government securities	20,456	21,103
Corporate bonds of domestic and foreign issuers	1,890	3,753
	60,801	**89,085**

As of December 31, 2017 securities with carrying amount of BGN 10,716 thousand are pledged as collateral with BNB to secure attracted funds from the State budget (2016: BGN 12,072 thousand).

8. LOANS AND RECEIVABLES FROM CUSTOMERS

8.1. Analysis by type of customers

separate and consolidated in BGN thousand	2017	2016
Private entities	143,307	145,645
Households and individuals	44,652	43,299
State budget	1,501	1,501
Financial entities	1,959	13
Finance lease corporate clients	8,528	6,126
	199,947	196,584
Allowance for uncollectibility	(18,563)	(20,783)
Total	**181,384**	**175,801**

8.2. Analysis by sectors

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

separate and consolidated in BGN thousand	2017	2016
Manufacturing	39,643	41,082
Trade	30,494	31,927
Consumer loans	23,743	26,678
Construction	23,739	23,709
Tourism	17,734	15,267
Agriculture	11,615	10,978
Health sector	6,192	10,535
Information and communication services	5,792	5,771
Operations with real estate	5,695	3,483
Transportation	2,017	2,968
Finance	1,959	13
State budget	1,501	1,501
Other sectors	29,823	22,672
	199,947	196,584
Allowance for uncollectibility	(18,563)	(20,783)
Total	**181,384**	**175,801**

In 2017 and 2016 receivables on loans written-off against allowances for impairment and uncollectibility are at the amount of BGN 3,967 thousand and BGN 3,974 thousand.

Movement of impairment losses is as follows:

separate and consolidated	2017	2016
in BGN thousand	**Loans and receivables**	**Loans and receivables**
Balance as at January 1	**20,783**	**23,089**
Additional allowances for impairment losses	4,535	4,962
Reversals	(2,788)	(3,294)
Written off receivables	(3,967)	(3,974)
Balance as at December 31	**18,563**	**20,783**

8. LOANS AND RECEIVABLES FROM CUSTOMERS (CONTINUED)

8.2. Analysis by sectors (continued)

Analysis of the lease receivables of corporate clients

Lease receivables are as follows:

separate and consolidated in BGN thousand	2017	2016
Not later than 1 year	772	69
Later than 1 year but not later than 5 years	4,961	505
Later than 5 years	5,986	8,920
Gross investment in finance leases, receivable	11,719	9,494
Less: Unearned future finance income on finance leases	(3,191)	(3,368)
Net investment in finance leases	8,528	6,126

separate and consolidated in BGN thousand	2017	2016
Not later than 1 year	470	2
Later than 1 year but not later than 5 years	3,373	504
Later than 5 years	4,685	5,620
Finance lease receivables	8,528	6,126
Allowance for uncollectible minimum lease payments receivable included in the provision	(37)	-

9. NON-CURRENT ASSETS HELD FOR SALE

separate and consolidated in BGN thousand	2017	2016
Balance at the beginning of the year	7,271	7,135
Acquisitions during the year	2,092	6,837
Disposals during the year	(1,997)	(1,388)
Transferred to assets acquired from ordinary activities (non-performing loans)	(632)	(5,658)
Transferred from assets acquired from ordinary activities (non-performing loans)	-	345
Balance at the end of the year	**6,734**	**7,271**

10. PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLE ASSETS

Separate in BGN thousand	Land and buildings	Office equipment	Vehicles	Fixture and fittings	Other assets	Intangible assets	Total
Cost							
01 January 2016	2,746	2,335	898	537	476	1,103	8,095
Additions	-	676	-	70	65	118	929
Disposals	-	(326)	-	(67)	(13)	(2)	(408)
Sold	(768)	-	-	-	-	-	(768)
31 December 2016	1,978	2,685	898	540	528	1,219	7,848
Additions	-	351	-	69	77	333	830
Disposals	(961)	(244)	(58)	(24)	(35)	(60)	(1,382)
31 December 2017	1,017	2,792	840	585	570	1,492	7,296
Accumulated depreciation/amortization							
01 January 2016	(627)	(1,940)	(790)	(467)	(288)	(452)	(4,564)
Charged during the year	(45)	(220)	(41)	(28)	(60)	(166)	(560)
Written off	130	324	-	66	13	2	535
31 December 2016	(542)	(1,836)	(831)	(429)	(335)	(616)	(4,589)
Charged during the year	(39)	(271)	(41)	(36)	(60)	(223)	(670)
Written off	286	241	57	24	30	60	698
31 December 2017	(295)	(1,866)	(815)	(441)	(365)	(779)	(4,561)
Net book value							
31 December 2016	1,436	849	67	111	193	603	3,259
31 December 2017	722	926	25	144	205	713	2,735

10. PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLE ASSETS (CONTINUED)

Consolidated in BGN thousand	Land and buildings	Office equipment	Vehicles	Fixture and fittings	Other assets	Intangible assets	Total
Cost							
01 January 2016	2,746	2,335	909	541	476	1,108	8,115
Additions	-	676	-	70	65	118	929
Disposals	-	(326)	-	(67)	(13)	(2)	(408)
Sold	(768)	-	-	-	-	-	(768)
31 December 2016	1,978	2,685	909	544	528	1,224	7,868
Additions	-	351	-	69	77	333	830
Disposals	(961)	(244)	(70)	(24)	(35)	(65)	(1.399)
31 December 2017	1,017	2,792	839	589	570	1,492	7,299
Accumulated depreciation/amortization							
01 January 2016	(627)	(1,940)	(793)	(469)	(288)	(453)	(4,570)
Charged during the year	(45)	(220)	(43)	(28)	(60)	(167)	(563)
Written off	130	324	-	66	13	2	535
31 December 2016	(542)	(1,836)	(836)	(431)	(335)	(618)	(4,598)
Charged during the year	(39)	(271)	(43)	(37)	(60)	(223)	(673)
Written off	286	241	65	24	30	62	708
31 December 2017	(295)	(1,866)	(814)	(444)	(365)	(779)	(4,563)
Net book value							
31 December 2016	1,436	849	73	113	193	606	3,270
31 December 2017	722	926	25	145	205	713	2,736

11. INVESTMENT PROPERTY

separate and consolidated in BGN thousand	2016	2015
Balance at the beginning of the year	1,274	-
Acquisitions during the year	2,532	197
Transferred from assets acquired from ordinary activities (non-performing loans)	6,145	1,227
Revaluation	(98)	(150)
Balance at the end of the year	**9,853**	**1,274**

Fair value of the investment property has been categorized as fair value Level 3 based on the input data used in the valuation techniques. The independent appraisers have used the comparative value method for the determination of the fair value.

The investment property of the Bank as at December 31, 2017 consists of a hotel and commercial properties. The commercial properties are rented for a period of one year with prolongation option for another period and one month termination notice. Rental income from investment property for 2017 is at the amount of BGN 70 thousand (2016: BGN 17 thousand).

12. INVESTMENTS IN SUBSIDIARIES

Investments in subsidiaries are as follows:

in BGN thousand	Share		Carrying amount	
Company	2017	2016	2017	2016
„Tokuda Security" EOOD	100%	100%	25	25
Total			25	25

In the separate financial statements Investments in subsidiaries are presented at carrying amount (cost) in these separate financial statements. The subsidiary was established in 2013. As of December, 31 2017 the subsidiary is in liquidation.

The summarized financial information of the subsidiary as of December 31, 2017 and 2016 is, as follows:

„Tokuda Security" EOOD	2017	2016
Total assets	3	18
Total liabilities	-	(4)
Net assets	3	14
Bank's share in the net assets of the subsidiary	100%	100%

13. OTHER ASSETS

in BGN thousand	2017	2016	2017	2016
	Separate		Consolidated	
Assets acquired from non-performing loans	19,795	15,819	19,795	15,819
Allowance for impairment of assets acquired by the non-performing loans	(3,609)	(3,300)	(3,609)	(3,300)
Other assets	137	1,313	137	1,313
Impairment of other assets	(1)	(1,185)	(1)	(1,185)
VAT recoverable	-	1,221	-	1,221
Deferred expenses	196	150	196	150
Guarantee deposits	66	65	66	63
Advance payments	118	1,797	118	1,797
Total	16,702	15,880	16,702	15,878

13. OTHER ASSETS (CONTINUED)

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

Movement of impairment of other assets	2017	2016	2017	2016
	Separate		Consolidated	
Balance as of 1 January	1,185	1,393	1,185	1,393
Additional allowances for impairment losses	37	3	37	3
Reversals	(2)	(34)	(2)	(34)
Written off receivables	(1,219)	(177)	(1,219)	(177)
Balance as of 31 December	**1**	**1,185**	**1**	**1,185**

Movement of impairment of other assets	2017	2016	2017	2016
	Separate		Consolidated	
Balance as of 1 January	3,300	1,744	3,300	1,744
Impairment of assets sold	(332)	-	(332)	-
Additional allowances for impairment losses	641	1,556	641	1,556
Balance as of 31 December	**3,609**	**3,300**	**3,609**	**3,300**

14. DEPOSITS FROM CREDIT INSTITUTIONS

separate and consolidated in BGN thousand	2017	2016
Deposits from credit institutions	191	87
	191	87

Term deposits from credit institutions received as of December 31, 2017 and 2016 have maturity within 3 months.

15. DEPOSITS FROM CLIENTS OTHER THAN CREDIT INSTITUTIONS

in BGN thousand	2017	2016	2017	2016
	Separate		Consolidated	
Individuals accounts				
- Demand and savings accounts	80,547	74,042	80,547	74,042
- Term	170,411	159,528	170,411	159,528
	-	-	-	-
State budget funds	-	-	-	-
- Demand accounts	9,015	6,297	9,015	6,297
- Term	1,008	1,009	1,008	1,009
	-	-	-	-
Corporate accounts	-	-	-	-
- Demand accounts	62,201	76,274	62,199	76268
- Term	17,229	19,141	17,229	19,141
	-	-	-	-
Other non-bank financial institutions accounts	-	-	-	-
- Demand accounts	533	498	533	498
- Term	-	4,448	-	4,448
	340,944	341,237	340,942	341,231

16. TAX ASSETS AND LIABILITIES

16.1. Tax assets

As of December 31, 2017 and 2016 the Bank/Group does not recognize deferred tax assets on accumulated tax loss of BGN 10,977 thousand and BGN 12,087 thousand respectively, due to the fact that there is uncertainty regarding future taxable profits against which it can be utilized. In 2017 the Bank deducted tax loss realized in 2012 amounting to BGN 491 thousand and BGN 619 thousand realized in 2013 .

As of December 31, 2017 unrecognized deferred tax assets are as follows:

Tax loss occurred in	Amount	Unrecognized tax asset	Expiring in
2013	1,106	111	2018
2014	8,114	811	2019
2015	1,757	176	2020
Total	10,977	1,098	

Other temporary differences	Amount	Unrecognized tax asset
Revaluation on financial assets available for sale	2,981	298
Impairment on assets	4,185	419
Provisions for lawsuite and other liabilities to personnel	958	96
	8,124	812

16.2. Tax liabilities

As of December 31, 2017 and 2016 tax liabilities consist of deferred tax liabilities, arisen from the following temporary tax differences:

separate and consolidated in BGN thousand	2017	2016
Deferred tax assets:		
Unused paid leave	10	17
Long-term employee benefits	26	26
Total deferred tax assets	36	43
Deferred tax liabilities:		
Differences between accounting and tax amortization and depreciation	(131)	(136)
Total deferred tax liabilities	(131)	(136)
Deferred tax liabilities, net	(95)	(93)

Deferred tax assets and liabilities as of December 31, 2017 and 2016 are calculated using tax rate of 10 % according to the Corporate Income Tax Act and applicable for the periods when the temporary differences are expected to be realized.

17. OTHER LIABILITIES

in BGN thousand	2017	2016	2017	2016
	Separate		Consolidated	
Ongoing bank transfers	198	174	198	174
Unused paid leave	81	144	81	144
Long-term employee benefits	264	263	264	263
Provisions for lawsuite	625	83	625	83
Other liabilities	755	483	755	484
	1,923	1,147	1,923	1,148

Ongoing bank transfers represent liabilities on money transfers ordered by customers in the last day of 2017 and 2016 respectively, with value date within two days. The transfers are processed up to the second working day of 2018 and 2017, respectively.

According to the provisions of the Labor Code, the Bank/Group is obliged to compensate employees upon retirement with two gross salaries. If the employee has worked for the Bank/Group in the last ten years the compensation amounts to six gross salaries. As of December 31, 2017 and 2016 the Bank/Group has accrued long-term employee benefits at the amount of BGN 264 thousand and BGN 263 thousand, respectively. The provision amount has been determined by a licensed actuary.

Underlying assumptions used by the licensed actuary at determining the present value of the liability are as follows:
- Demographic assumptions;
- Mortality table and disability probability;
- Turnover rate – 0.1894;
- Financial assumptions, salary growth;
- Discount rate – due to the long-term nature of the payable, annual discount rate of 2.91 % has been applied.

18. EQUITY AND RESERVES

18.1. Share capital

As of December 31, 2017 and 2016 the Bank/Group's share capital is fully paid in and is distributed in registered, voting shares, as follows:

	2017	2016
Number of shares	6,800,000	6,800,000
Share nominal in BGN	10	10
Share capital (in BGN thousand)	**68,000**	**68,000**

As of December 31, 2017 and 2016 the Bank/Group's shareholder structure is as follows:

	2017	%	2016	%
Tokushukai Incorporated	6,796,250	99.94	6,796,250	99.94
MM Holding AD	3,750	0.06	3,750	0.06
Total shares	**6,800,000**	**100**	**6,800,000**	**100**

18. EQUITY AND RESERVES (CONTINUED)

18.2. Reserves

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

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

As of December 31, 2017 and 2016 reserves include Reserve Fund at the amount of BGN 807 thousand and BGN 808 thousand, respectively. The revaluation reserve of financial assets available for sale is at the amount of BGN 2,982 thousand (2016: BGN 3,951 thousand)

19. INTEREST INCOME/EXPENSE

separate and consolidated in BGN thousand	2017	2016
Interest income		
Interest from financial assets held for trading	415	610
Interest from loans and receivables from credit institutions	181	43
Interest from repo deals	-	-
Interest from loans and receivables from customers	9,627	10,763
Interest from financial assets available for sale	2,082	2,366
	12,305	13,782
Interest expenses		
Interest on other deposits	2,602	4,012
Interest on assets	61	76
	2,663	4,088
Net interest income	9,642	9,694

20. FEE AND COMMISSION INCOME/EXPENSE

separate and consolidated in BGN thousand	2017	2016
Fee and commission income		
Fees and commission income under money transfers	1,575	1,570
Fees receipts under accounts opening and closing	721	549
Fees and commission income under loan transactions	190	298
Fees income under servicing cards	345	412
Commission income under cash balances	324	309
Service guarantees	83	88
Other	599	546
	3,837	3,772

20. FEE AND COMMISSION INCOME/EXPENSE (CONTINUED)

Fee and commission expense	2016	2015
Fees for service of cards	209	193
Fees for money transfers	5	6
Insurances fees	11	15
Fees for opening and servicing of accounts	29	30
Fees to register securities	21	25
Other	22	22
	297	291
Net fee and commission income	3,540	3,481

21. NET PROFIT ON FINANCIAL ASSETS AND LIABILITIES HELD FOR TRADING

separate and consolidated in BGN thousand	2017	2016
Gain from sale of securities held for trading	34	15
Gain/(Loss) from revaluation of securities held for trading	(79)	468
Gain from foreign exchange differences	328	308
	283	791

22. OTHER OPERATING INCOME

in thousand BGN	2017 Separate	2016	2017 Consolidated	2016
Net gains / (losses) from foreign currency revaluation	8	2	8	2
Profit from revaluation from investment securities available for sale	2,119	322	2,119	322
Dividends	68	28	68	28
Net loss from disposed assets other than held for sale	(9)	(3)	(9)	(3)
Gain/(loss) from non-current assets held for sale	(567)	164	(567)	164
Gain on disposal of property, plant and equipment	2,067	37	2,067	37
Other operating income	208	139	213	138
	3,894	689	3,899	688

23. OPERATING EXPENSES

in thousand BGN	2017 Separate	2016	2017 Consolidated	2016
Personnel costs	6,135	5,962	6,159	5,987
Depreciation and amortisation	670	560	673	563
Operating lease rentals	1,096	1,047	1,096	1,047
Payments to Deposit Insurance Fund	888	999	888	999
Payments to Restructuring of banks fund	359	332	359	332
Other expenses	4,064	4,063	4,053	4,034
	13,212	12,963	13,228	12,962

24. IMPAIRMENT AND PROVISIONS FOR LOSSES

Net expenses of depreciation in 2017 and 2016 are presented in the table below:

separate and consolidated in BGN thousand	2017	2016
Impairment loss on		
Loans and advances to customers	1,747	1,668
Investment property	98	150
Other assets	675	1,525
Provisions for lawsuite	625	83
Net Impairments and provisions for losses	**3,145**	**3,426**

25. INCOME TAX EXPENSE

Current tax expense represents taxes due under the Bulgarian legislation according to the applicable tax rate of 10 % for 2017 and 2016. Deferred tax income/expense arises as a result of a change in the carrying amount of deferred tax assets and liabilities.

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

in BGN thousand	2017	2016	2017	2016
	Separate		Consolidated	
Current tax expense	-	-	-	-
Deferred tax expense	(1)	(5)	(1)	(5)
Total tax expenses	**(1)**	**(5)**	**(1)**	**(5)**
Reconciliation between profit/(loss) before tax and tax expense:				
Profit/(Loss) before income tax	1,002	(1,734)	991	(1,734)
Income tax at applicable tax rate of 10 % for 2017 (10% for 2016)	(100)	173	(99)	173
Tax effect of nondeductible expenses	3	(13)	3	(13)
Effect of unrecognized deferred tax asset on tax losses available for carryforward	111	72	111	72
Tax effect of revaluation of financial assets available for sale	97	(113)	97	(113)
Effect of other temporary differences, for which no deferred tax asset is recognized	(112)	(124)	(113)	(124)
Tax expenses	**(1)**	**(5)**	**(1)**	**(5)**

26. RELATED PARTIES

As of December 31, 2017 and 2016 the Bank/Group has receivables from, payables to and contingent commitments to related parties, as follows:

Related parties and balances (in BGN thousand)	2017 Separate	2016	2017 Consolidated	2016
Majority shareholder				
Deposits received	19,562	20,245	19,562	20,245
Companies under common control				
Deposits received	1,879	8,551	1,879	8,551
Key management personnel				
Loans granted	15	20	15	20
Deposits received	29	4	29	4
Subsidiaries				
Deposits received	2	5		
Other receivables	-	3		

Income from and expenses for related party transactions, generated by the Bank/Group in 2017 and 2016 are as follows:

Related parties and type of transactions (in BGN thousand)	2017 Separate	2016	2017 Consolidated	2016
Majority shareholder				
Income from foreign exchange differences	2	2	2	2
Interest expense	2	2	2	2
Companies under common control				
Income from fees and commissions	17	10	17	10
Interest expense	5	30	5	30
Subsidiaries				
Income from services	1	1		
Expenses for services	34	44		

The remuneration to Supervisory Board members in 2017 are at the total amount of BGN 43 thousand (2016: BGN 43 thousand). The remuneration to the Management Board members in 2017 are at total amount of BGN 454 thousand (2016: BGN 456 thousand).

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

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

separate and consolidated in BGN thousand	2017	2016
Cash in hand (note 4)	8,100	7,233
Cash with the Central bank (note 4)	62,262	44,927
Nostro accounts with domestic credit institutions (note 5)	907	488
Nostro accounts with foreign credit institutions (note 5)	4,751	4,237
Loans and deposits to credit institutions with original maturity up to three months (note 5)	19,456	12,946
Total cash and cash equivalents in the statement of cash flows	**95,476**	**69,831**

28. COMMITMENTS AND CONTINGENCIES

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

separate and consolidated in BGN thousand	2017	2016
Guarantees	7,971	3,894
Undrawn credit commitments	19,366	21,523
	27,337	25,417

29. FINANCIAL RISK MANAGEMENT

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

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

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

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

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

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

- Management board - determines the acceptable risk levels of the Bank/Group within the adopted business strategy;
- Specialized collective committees – approve the framework and parameters of the Bank/Group'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/Group;
- Heads of structural units within the Bank/Group - implement the adopted risk management policy within the operations of the respective organizational units.

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

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.1. Financial assets and liabilities

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

As of 31 December 2017 separate in BGN thousand	Trading	Loans and receiv-ables	Financial assets available for sale	Other amortised cost	Total carryng amount	Fair value
Financial assets						
Cash and balances with Central Bank	-	70,362	-	-	70,362	70,362
Loans and advances to banks	-	25,114	-	-	25,114	25,114
Loans and advances to customers	-	181,384	-	-	181,384	184,467
Financial assets held for trading	14,126	-	-	-	14,126	14,126
Financial assets available for sale	-	-	60,801	-	60,801	60,801
Total assets	14,126	276,860	60,801	-	351,787	354,870
Financial liabilities						
Deposits from banks	-	-	-	191	191	191
Due to customers	-	-	-	340,944	340,944	341,442
Other financial liabilities	-	-	-	198	198	198
Total liabilities	-	-	-	341,333	341,333	341,831

As of 31 December 2016 separate in BGN thousand	Trading	Loans and receiv-ables	Financial assets available for sale	Other amortised cost	Total carryng amount	Fair value
Financial assets						
Cash and balances with Central Bank	-	52,160	-	-	52,160	52,160
Loans and advances to banks	-	17,671	-	-	17,671	17,671
Loans and advances to customers	-	175,801	-	-	175,801	177,616
Financial assets held for trading	24,790	-	-	-	24,790	24,790
Financial assets available for sale	-	-	89,085	-	89,085	89,085
Total assets	24,790	245,632	89,085	-	359,507	361,322
Financial liabilities						
Deposits from banks	-	-	-	87	87	87
Due to customers	-	-	-	341,237	341,237	342,489
Other financial liabilities	-	-	-	174	174	174
Total liabilities	-	-	-	341,498	341,498	342,750

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.1. Financial assets and liabilities (continued)

As of 31 December 2017 consolidated in BGN thousand	Trading	Loans and receiv-ables	Financial assets available for sale	Other amortised cost	Total carryng amount	Fair value
Financial assets						
Cash and balances with Central Bank	-	70,362	-	-	70,362	70,362
Loans and advances to banks	-	25,114	-	-	25,114	25,114
Loans and advances to customers	-	181,384	-	-	181,384	184,467
Financial assets held for trading	14,126	-	-	-	14,126	14,126
Financial assets available for sale	-	-	60,801	-	60,801	60,801
Total assets	14,126	276,860	60,801	-	351,787	354,870
Financial liabilities						
Deposits from banks	-	-	-	191	191	191
Due to customers	-	-	-	340,942	340,942	341,442
Other financial liabilities	-	-	-	198	198	198
Total liabilities	-	-	-	341,331	341,331	341,831

As of 31 December 2016 consolidated in BGN thousand	Trading	Loans and receiv-ables	Financial assets available for sale	Other amortised cost	Total carryng amount	Fair value
Financial assets						
Cash and balances with Central Bank	-	52,160	-	-	52,160	52,160
Loans and advances to banks	-	17,671	-	-	17,671	17,671
Loans and advances to customers	-	175,801	-	-	175,801	177,616
Financial assets held for trading	24,790	-	-	-	24,790	24,790
Financial assets available for sale	-	-	89,085	-	89,085	89,085
Total assets	24,790	245,632	89,085	-	359,507	361,322
Financial liabilities						
Deposits from banks	-	-	-	87	87	87
Due to customers	-	-	-	341,231	341,231	342,489
Other financial liabilities	-	-	-	174	174	174
Total liabilities	-	-	-	341,492	341,492	342,750

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.2. Credit risk

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

Cash and cash balances with the Central bank at the amount of BGN 70,362 thousand and BGN 52,160 thousand, respectively as of December 31, 2017 and 2016 do not bear credit risk to the Bank/Group due to their nature and the fact that they are at the Bank/Group's disposal.

Loans and receivables from credit institutions at the amount of BGN 25,114 thousand and BGN 17,671 thousand, respectively as of December 31, 2017 and 2016 represent mostly deposits in first-class international and Bulgarian financial institutions with maturity up to 7 days. The Bank/Group manages the credit risk associated with advances to banks as sets limits on exposure to counterparty.

Financial assets held for trading at the amount of BGN 14,126 thousand and BGN 24,790 thousand as of December 31, 2017 and 2016, respectively, bear mainly market risk to the Bank/Group, which is described in note 29.4. The maximum exposure to credit risk on these instruments is their carrying amount.

Financial assets available for sale are at the amount of BGN 60,801thousand and 89,085 thousand as of December 31, 2017 and 2016 The maximum exposure to credit risk on these instruments is their carrying amount.

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

Loans and advances to customers with carrying amount of BGN 181,384 thousand and BGN 175,801 thousand, respectively as of December 31, 2017 and 2016 expose the Bank/Group to credit risk. The exposure of the Bank/Group to that risk is determined on the basis of individual assessment of each loan, as the Bank/Group applies the criteria for assessment and classification of risk exposures according to the Policy for impairment of financial assets and contingent liabilities.

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

The classification defined the methodology for allowances for impairment estimation is in line with the classification according to the rules set out in the regulations 2014/680 and 2015/1278. The management considers the expositions as non-performing and performing.

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/Group and other creditors and when the Bank/Group expects to incur losses. Non-performing is also exposure for which the debtor is assessed as unlikely to pay its credit obligations in full without realisation of collateral regardless of the existence of any past due amount or of the number of days past due, with the exception of exposures where the realization of collateral is set in the initial loan agreement repayment schedule. Additionally, an exposure is classified as non-performing when it satisfies any of the following criteria:

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

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.2. Credit risk (continued)

Performing exposure is exposure that cannot be classified as non-performing.

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

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

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

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

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

Information on exposure classification groups is as follows:

2017 separate and consolidated in BGN thousand	Loan granted			Unutilized commitment	Issued letters of guarantee		
Group	Amount	% Share	Allowance	Amount	Amount	% Share	Allowance
Performing	164,435	82.24	616	19,347	7,971	100.00	-
Non-performing	35,512	17.76	17,947	19	-	-	-
Total	**199,947**	**100.00**	**18,563**	**19,366**	**7,971**	**100.00**	**-**

2016 separate and consolidated in BGN thousand	Loan granted			Unutilized commitment	Issued letters of guarantee		
Group	Amount	% Share	Allowance	Amount	Amount	% Share	Allowance
Performing	143,043	72.76	502	21,516	3,894	100.00	-
Non-performing	53,541	27.24	20,281	7	-	-	-
Total	**196,584**	**100.00**	**20,783**	**21,523**	**3,894**	**100.00**	**-**

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.2. Credit risk (continued)

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

separate and consolidated in BGN thousand	Loans and advances to customers 2017	 2016
Assets at amortised cost		
Individually impaired		
Non-performing	23,449	35,264
Carrying amount before impairment	23,449	35,264
Impairment loss	(13,995)	(13,132)
Carrying amount	9,454	22,132
Collectively impaired		
Regular	22,083	15,292
Non-performing	7,139	10,883
Carrying amount before impairment	29,222	26,175
Impairment loss	(4,568)	(7,651)
Carrying amount	24,654	18,524
Past due but not impaired		
Regular	22,506	11,038
Non-performing	4,149	7,350
Carrying amount before impairment	26,655	18,388
Carrying amount	26,655	18,388
Neither past due nor impaired		
Regular	119,847	116,713
Non-performing	774	44
Carrying amount before impairment	120,621	116,757
Carrying amount	120,621	116,757
Total carrying amount	181,384	175,801

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

	2017		2016	
separate and consolidated in BGN thousand	Past due but not impaired	Impaired	Past due but not impaired	Impaired
Without arrears	-	22,481	-	14,895
Arrears up to 30 days	20,321	2,577	8,769	1,601
Arrears from 31 to 60 days	1,501	79	1,164	600
Arrears from 61 to 90 days	818	469	1,294	173
Arrears from 91 to 180 days	631	545	1,092	1,143
Arrears over 180 days	3,384	26,520	6,069	43,027
Carrying amount before impairment	26,655	52,671	18,388	61,439
Impairment loss	-	(18,563)	-	(20,783)
Carrying amount	26,655	34,108	18,388	40,656

The impaired exposures include exposures for which the Bank/Group has accounted for impairment.

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.2. Credit risk (continued)

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

separate and consolidated in BGN thousand	2017	2016
Secured by cash and government securities	715	1,440
Secured by mortgage	154,036	148,269
Pledge of machinery and equipment	7,604	6,123
Pledge of receivables	15,134	13,590
Other collaterals	19,255	24,532
No collateral	3,203	2,630
Impairment loss	(18,563)	(20,783)
Total	**181,384**	**175,801**

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

separate and consolidated in BGN thousand	2017	2016
Cash and cash balances with central banks:		
rating BBB	70,362	52,160
Total cash and cash balances with central banks	**70,362**	**52,160**
Loans and receivables from credit institutions		
rating A+	-	3,738
rating A	3,745	-
rating A-	9,998	-
rating BBB+	-	4,454
rating BBB	-	499
rating BBB-	6,183	6,217
rating BB+	-	2,467
rating BB	283	-
rating BB-	12	-
rating B	-	290
no rating	4,893	6
Total loans and receivables from credit institutions	**25,114**	**17,671**
Financial assets held for trading:		
rating BBB-	12,183	24,660
rating BB	1,766	-
no rating	177	130
Total financial assets held for trading	**14,126**	**24,790**
Financial assets available for sale		
rating A	1,890	1,787
rating BB	5,966	6,428
rating BB+	-	1,820
rating BBB	-	61,982
rating BBB-	52,648	15,016
no rating	297	2,052
Total financial assets available for sale	**60,801**	**89,085**

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

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.2. Credit risk (continued)

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.

Concentration of credit risk

A significant percentage of the loan portfolio of the Bank/Group is concentrated in a limited number of borrowers. Despite the regulatory restrictions on large exposures, there is a risk that the Bank/Group's activities, its financial position and the result of its operations are negatively affected if some of the largest borrowers do not settle their obligations. Information on large exposures of the Bank/Group other than exposures to credit institutions (exposures which represent 10% or more of the Bank's capital base) at their carrying amount as of December 31, 2017 and 2016 is presented in the table below:

	2017		2016	
separate and consolidated	BGN'000	% of the capital base	BGN'000	% of the capital base
The largest total exposure to customer group	8,660	20.45%	8,245	19.47%
Total amount of the five largest exposures	31,421	74.20%	32,301	76.29%
Total amount of all exposures - over 10% of the capital	68,500	161.77%	66,872	157.94%

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

29.3. Liquidity risk

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

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

The Bank/Group'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/Group also considers commitments related to the not-utilized portion of loans granted and the level of all contingent liabilities.

To ensure the liquidity policy complience, the Bank/Group takes the following measures:

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

The main parameters of the Bank/Group'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.

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.3. Liquidity risk (continued)

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

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

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

The Bank/Group maintains high amount of liquid assets in the form of cash in hand and cash balances with the Central bank, which guarantee Bank's ability to meets its liquidity requirements. As of December 31, 2017 and 2016 cash and cash balances with Central Bank represent 18% and 13%, respectively of total assets of the Bank/Group.

As an additional instrument to provide high liquidity, the Bank/Group uses loans granted and advances to credit institutions. These comprise mostly of deposits in first-class international and Bulgarian credit institutions with maturity up to 7 days. As of December 31, 2017 and 2016 loans and receivables from credit institutions represent 6% and 4%, respectively of total assets of the Bank/Group.

Government securities, issued by the Republic of Bulgaria, owned by the Bank/Group and not pledged as collateral as of December 31, 2017 and 2016 represent 13% and 19%, respectively of total assets. By maintaining above 40% (2016: 40%) of its assets in highly liquid assets, the Bank/Group ensures the ability to meet its all payment needs on matured financial liabilities.

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.3. Liquidity risk (continued)

The gross cash outflow of financial liabilities of the Bank/Group is as follows:

As of 31 December 2017 separate in BGN thousand	Up to 1 month	From 1 to 3 moths	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Total
Deposits from credit institutions	191	-	-	-	-	191
Deposits from customers other than credit institutions	176,762	22,706	88,426	52,308	3,087	343,289
Other financial liablilities	198	-	-	-	-	198
Total financial liabilities	**177,151**	**22,706**	**88,426**	**52,308**	**3,087**	**343,678**

As of 31 December 2016 separate in BGN thousand	Up to 1 month	From 1 to 3 moths	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Total
Financial liabilities	87	-	-	-	-	87
Deposits from credit institutions	185,722	26,097	103,081	25,749	3,872	344,521
Other financial liablilities	174	-	-	-	-	174
Total financial liabilities	**185,983**	**26,097**	**103,081**	**25,749**	**3,872**	**344,782**

As of 31 December 2017 consolidated in BGN thousand	Up to 1 month	From 1 to 3 moths	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Total
Deposits from credit institutions	191	-	-	-	-	191
Deposits from customers other than credit institutions	176,760	22,706	88,426	52,308	3,087	343,287
Other financial liablilities	198	-	-	-	-	198
Total financial liabilities	**177,149**	**22,706**	**88,426**	**52,308**	**3,087**	**343,676**

As of 31 December 2016 consolidated in BGN thousand	Up to 1 month	From 1 to 3 moths	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Total
Financial liabilities	87	-	-	-	-	87
Deposits from credit institutions	185,716	26,097	103,081	25,749	3,872	344,515
Liabilities under repurchase agreements (repo deals)	174	-	-	-	-	174
Total financial liabilities	**185,977**	**26,097**	**103,081**	**25,749**	**3,872**	**344,776**

The financial liabilities of the Bank/Group are mainly formed by attracted funds on deposits – retail and corporate. Large portion of them as of December 31, 2017 –52% (2016: 54%) are with residual term within one month. Traditionally, in the Republic of Bulgaria the customers prefer to sign a deposit agreement with one month term and to renegotiate it regularly for longer period. As a result, one month deposits are practically a long-term and relatively permanent resource of the Bank/Group.

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.4. Market risk

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

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

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

- Foreign government securities - may be purchased only if they have a credit rating not lower than BBB/positive perspective on Standard & Poor's or an equivalent assessment of creditworthiness. Maximum level of exposure - 30%;
- Corporate bonds, issued by banks - at issuer's credit rating not lower than BBB/positive perspective on Standard & Poor's or an equivalent assessment of creditworthiness and total exposure - 20%;
- Corporate shares - the total exposure cannot exceed 1% of the total portfolio of securities;
- Corporate bonds - can only be purchased if they have a credit rating not lower than BBB/ positive perspective on Standard & Poor's or an equivalent assessment of creditworthiness. Otherwise, a precise analysis of quantitative and qualitative factors is performed to support the decision for their acquisition. Maximum level of exposure - 20%.

Market risk management includes:

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

In accordance with principles and objectives adopted, the Bank/Group 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/Group analyses the risk/return ratio, and at given level of risk the instrument with higher return is selected; at given level of return, the instrument with lower risk is selected.

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.4. Market risk (continued)

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/Group uses the modified duration of the portfolio, calculated on a daily basis.

To assess the potential impact of possible extreme fluctuations in interest rates on the value of trading portfolio, the Bank/Group analyses the effect of certain standardized interest rate shocks. The price change in parallel shift of the yield curve by 200 basis points should not exceed 5% of the capital base, calculated in the last quarter. The Sensitivity to market risk is presented in note 29.4.4.

29.4.1. Interest rate risk

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

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

In interest rate risk management, the Bank/Group applies policy and procedures, according to the nature and complexity of its operations. By managing the interest rate risk, the Bank/Group 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/Group is based on the assessment of the amount and sensitivity of the exposure to fluctuations in the market interest rates and the probability for occurrence of such fluctuations. The Bank/Group has established a system for measurement of interest rate risk, which covers all sources of interest rate risk and assesses the effect of the fluctuations in interest rates.

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

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

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

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

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.4. Market risk (continued)

29.4.1. Interest rate risk (continued)

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

The interest-bearing assets and liabilities of the Bank/Group are, as follows:

As of 31 December 2017 separate in BGN thousand	Up to 1 month	From 1 to 3 moths	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Total
Interest-bearing assets						
Loans and receivables from credit institutions	25,114	-	-	-	-	25,114
Financial assets held for trading	7,638	-	-	6,488	-	14,126
Loans and receivables from customers	156,019	179	2,871	2,655	19,660	181,384
Financial assets available for sale	6,106	1,890	15,044	28,820	8,941	60,801
Total interest-bearing assets	**194,877**	**2,069**	**17,915**	**37,963**	**28,601**	**281,425**
Interest-bearing liabilities						
Deposits from credit institutions	191	-	-	-	-	191
Deposits from client other than credit institutions	176,757	22,679	87,933	50,770	2,805	340,944
Total interest-bearing liabilities	**176,948**	**22,679**	**87,933**	**50,770**	**2,805**	**341,135**
Mismatch between interest-bearing assets and liabilities, net	**17,929**	**(20,610)**	**(70,018)**	**(12,807)**	**25,796**	

As of 31 December 2016 separate in BGN thousand	Up to 1 month	From 1 to 3 moths	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Total
Interest-bearing assets						
Loans and receivables from credit institutions	17,671	-	-	-	-	17,671
Financial assets held for trading	1,637	-	-	8,405	14,748	24,790
Loans and receivables from customers	157,421	124	2,619	1,656	13,981	175,801
Financial assets available for sale	-	1,787	-	40,708	46,590	89,085
Total interest-bearing assets	**176,729**	**1,911**	**2,619**	**50,769**	**75,319**	**307,347**
Interest-bearing liabilities						
Deposits from credit institutions	87	-	-	-	-	87
Deposits from client other than credit institutions	185,711	26,036	102,189	24,809	2,492	341,237
Total interest-bearing liabilities	**185,798**	**26,036**	**102,189**	**24,809**	**2,492**	**341,324**
Mismatch between interest-bearing assets and liabilities, net	**(9,069)**	**(24,125)**	**(99,570)**	**25,960**	**72,827**	

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.4. Market risk (continued)

29.4.1. Interest rate risk (continued)

As of 31 December 2017 consolidated in BGN thousand	Up to 1 month	From 1 to 3 moths	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Total
Interest-bearing assets						
Loans and receivables from credit institutions	25,114	-	-	-	-	25,114
Financial assets held for trading	7,638	-	-	6,488	-	14,126
Loans and receivables from customers	156,019	179	2,871	2,655	19,660	181,384
Financial assets available for sale	6,106	1,890	15,044	28,820	8,941	60,801
Total interest-bearing assets	**194,877**	**2,069**	**17,915**	**37,963**	**28,601**	**281,425**
Interest-bearing liabilities						
Deposits from credit institutions	191	-	-	-	-	191
Deposits from client other than credit institutions	176,755	22,679	87,933	50,770	2,805	340,942
Total interest-bearing liabilities	**176,946**	**22,679**	**87,933**	**50,770**	**2,805**	**341,133**
Mismatch between interest-bearing assets and liabilities, net	**17,931**	**(20,610)**	**(70,018)**	**(12,807)**	**25,796**	

As of 31 December 2016 consolidated in BGN thousand	Up to 1 month	From 1 to 3 moths	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Total
Interest-bearing assets						
Loans and receivables from credit institutions	17,671	-	-	-	-	17,671
Financial assets held for trading	1,637	-	-	8,405	14,748	24,790
Loans and receivables from customers	157,421	124	2,619	1,656	13,981	175,801
Financial assets available for sale	-	1,787	-	40,708	46,590	89,085
Total interest-bearing assets	**176,729**	**1,911**	**2,619**	**50,769**	**75,319**	**307,347**
Interest-bearing liabilities						
Deposits from credit institutions	87	-	-	-	-	87
Deposits from client other than credit institutions	185,705	26,036	102,189	24,809	2,492	341,231
Total interest-bearing liabilities	**185,792**	**26,036**	**102,189**	**24,809**	**2,492**	**341,318**
Mismatch between interest-bearing assets and liabilities, net	**(9,063)**	**(24,125)**	**(99,570)**	**25,960**	**72,827**	

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.4. Market risk (continued)

29.4.1. Interest rate risk (continued)

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

separate and consolidated in BGN thousand	**Year ended 31.12.2017**	**Year ended 31.12.2016**
Interest-bearing assets		
Loans and receivables from credit institutions	0.80	**0.19**
Financial assets held for trading	2.21	**2.33**
Loans and receivables from customers	5.09	**5.54**
Investments held to maturity	2.51	**2.52**
Interest-bearing liabilities		
Deposits from credit institutions	-	**-**
Deposits from clients other than credit institutions	0.78	**1.16**

29.4.2. Currency risk

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

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

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

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.4. Market risk (continued)

29.4.2.Currency risk (continued)

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

As of 31 December 2017 separate in BGN thousand	BGN	EUR	USD	JPY	Other	Total
Assets						
Cash and cash balances with Central banks	21,898	47,687	588	72	117	70,362
Loans and receivables from credit institutions	498	756	19,516	3,745	599	25,114
Financial assets held for trading	11,057	1,098	1,971	-	-	14,126
Financial assets available-for-sale	18,255	38,807	3,739	-	-	60,801
Loans and receivables from customers	107,625	73,640	119	-	-	181,384
Total assets	159,333	161,988	25,933	3,817	716	351,787
Liabilities						
Deposits from credit institutions	-	159	32	-	-	191
Deposits from client other than credit institutions	174,879	135,560	25,989	3,817	699	340,944
Other financial liabilities	1	177	20	-	-	198
Total liabilities	174,880	135,896	26,041	3,817	699	341,333
Net exposure	(15,547)	26,092	(108)	-	17	10,454

As of 31 December 2016 separate in BGN thousand	BGN	EUR	USD	JPY	Other	Total
Assets						
Cash and cash balances with Central banks	25,249	25,943	715	48	205	52,160
Loans and receivables from credit institutions	348	381	13,108	3,738	96	17,671
Financial assets held for trading	8,171	16,273	346	-	-	24,790
Financial assets available-for-sale	18,148	64,882	6,055	-	-	89,085
Loans and receivables from customers	92,577	82,876	336	12	-	175,801
Total assets	144,493	190,355	20,560	3,798	301	359,507
Liabilities						
Deposits from credit institutions	-	10	77	-	-	87
Deposits from client other than credit institutions	177,365	139,201	20,572	3,800	299	341,237
Other financial liabilities	6	167	1	-	-	174
Total liabilities	177,371	139,378	20,650	3,800	299	341,498
Net exposure	(32,878)	50,977	(90)	(2)	2	18,009

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.4. Market risk (continued)

29.4.2. Currency risk (continued)

As of 31 December 2017 consolidated in BGN thousand	BGN	EUR	USD	JPY	Other	Total
Assets						
Cash and cash balances with Central banks	21,898	47,687	588	72	117	70,362
Loans and receivables from credit institutions	498	756	19,516	3,745	599	25,114
Financial assets held for trading	11,057	1,098	1,971	-	-	14,126
Financial assets available-for-sale	18,255	38,807	3,739	-	-	60,801
Loans and receivables from customers	107,625	73,640	119	-	-	181,384
Total assets	**159,333**	**161,988**	**25,933**	**3,817**	**716**	**351,787**
Liabilities						
Deposits from credit institutions	-	159	32	-	-	191
Deposits from client other than credit institutions	174,877	135,560	25,989	3,817	699	340,942
Other financial liabilities	1	177	20	-	-	198
Total liabilities	**174,878**	**135,896**	**26,041**	**3,817**	**699**	**341,331**
Net exposure	**(15,545)**	**26,092**	**(108)**	**-**	**17**	**10,456**

As of 31 December 2016 consolidated in BGN thousand	BGN	EUR	USD	JPY	Other	Total
Assets						
Cash and cash balances with Central banks	25,249	25,943	715	48	205	52,160
Loans and receivables from credit institutions	348	381	13,108	3,738	96	17,671
Financial assets held for trading	8,171	16,273	346	-	-	24,790
Financial assets available-for-sale	18,148	64,882	6,055	-	-	89,085
Loans and receivables from customers	92,577	82,876	336	12	-	175,801
Total assets	**144,493**	**190,355**	**20,560**	**3,798**	**301**	**359,507**
Liabilities						
Deposits from credit institutions	-	10	77	-	-	87
Deposits from client other than credit institutions	177,359	139,201	20,572	3,800	299	341,231
Other financial liabilities	6	167	1	-	-	174
Total liabilities	**177,365**	**139,378**	**20,650**	**3,800**	**299**	**341,492**
Net exposure	**(32,872)**	**50,977**	**(90)**	**(2)**	**2**	**18,015**

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.4. Market risk (continued)

29.4.3. Price risk

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

29.4.4. Sensitivity to market risk

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

As of December 31, 2017 the Bank/Group performed analysis of its interest rate sensitivity on the basis of the assumption of increase by 200 basis points of the interest rate, applied to the interest rate misbalance. In addition, the Bank/Group has performed sensitivity analysis to decrease of the interest rate margin in view of the recent negative trend with respect to this indicator. The analysis shows that further decrease of the interest rate margin by 0.20% would result in an additional loss at the amount of BGN 680 thousand (2016: BGN 672 thousand).

To evaluate the effect of potentially possible extreme fluctuations of interest rates, the Bank/Group analyses the effect of several Standardized interest rate shocks. 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.

29.5. Fair value

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

The following table summarizes the information for the assets measured at fair value in the statement of financial position:

2017 separate and consolidated (all amounts are in BGN thousand)	Carrying amount	Level 1 – quoted market price	Level 2 – technique for evaluation – observable market data	Level 3 - technique for evaluation – not observable market data	Fair value not available
Assets measured at fair value					
Financial assets held for trading	14,126	177	13,949	-	-
Financial assets available for sale	60,801	-	60,504	297	-
Total	74,927	177	74,453	**297**	-

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.5. Fair value (continued)

2016 separate and consolidated (all amounts are in BGN thousand)	Carrying amount	Level 1 – quoted market price	Level 2 – technique for evaluation – observable market data	Level 3 - technique for evaluation – not observable market data	Fair value not available
Assets measured at fair value					
Financial assets held for trading	24,790	130	24,660	-	-
Financial assets available for sale	89,085	-	88,999	-	86
Total	113,875	130	113,659	-	86

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

As of 31 December 2017 separate in BGN thousand	Level 1	Level 2	Level 3	Total
Financial assets				
Cash and cash balances at central banks	70,362	-	-	70,362
Loans and advances to credit institutions	25,114	-	-	25,114
Loans and advances to customers	-	-	184,467	184,467
Total	95,476	-	184,467	279,943
Financial liabilities				
Deposits from credit institutions	191	-	-	191
Deposits from clients other than credit institutions	-	341,442	-	341,442
Other financial liabilities	-	-	198	198
Total	191	341,442	198	341,831

As of 31 December 2016 separate in BGN thousand	Level 1	Level 2	Level 3	Total
Financial assets				
Cash and cash balances at central banks	52,160	-	-	52,160
Loans and advances to credit institutions	17,671	-	-	17,671
Loans and advances to customers	-	-	177,616	177,616
Total	69,831	-	177,616	247,447
Financial liabilities				
Deposits from credit institutions	87	-	-	87
Deposits from clients other than credit institutions	-	342,489	-	342,489
Other financial liabilities	-	-	174	174
Total	87	342,489	174	342,750

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.5. Fair value (continued)

As of 31 December 2017 consolidated in BGN thousand	Level 1	Level 2	Level 3	Total
Financial assets				
Cash and cash balances at central banks	70,362	-	-	70,362
Loans and advances to credit institutions	25,114	-	-	25,114
Loans and advances to customers	-	-	184,467	184,467
Total	95,476	-	184,467	279,943
Financial liabilities				
Deposits from credit institutions	191	-	-	191
Deposits from clients other than credit institutions	-	341,442	-	341,442
Other financial liabilities	-	-	198	198
Total	**191**	**341,442**	198	341,831

As of 31 December 2016 consolidated in BGN thousand	Level 1	Level 2	Level 3	Total
Financial assets				
Cash and cash balances at central banks	52,160	-	-	52,160
Loans and advances to credit institutions	17,671	-	-	17,671
Loans and advances to customers	-	-	177,616	177,616
Total	69,831	-	177,616	247,447
Financial liabilities				
Deposits from credit institutions	87	-	-	87
Deposits from clients other than credit institutions	-	342,489	-	342,489
Other financial liabilities	-	-	174	174
Total	87	342,489	174	342,750

30. OTHER REGULATORY DISCLOSURES

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

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

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

30. OTHER REGULATORY DISCLOSURES (CONTINUED)

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

separate	2017	2016
Operating income	17,359	14,655
Loss before income tax	1,002	(1,734)
Tax expense	(1)	(5)
Return on assets (%)	0.26%	-0.44%
Equivalent number of employees full-time at 31 December	257	259
Received state subsidies	-	-

consolidated	2017	2016
Operating income	17,364	14,654
Loss before income tax	991	(1,734)
Tax expense	(1)	(5)
Return on assets (%)	0.26%	-0.44%
Equivalent number of employees full-time at 31 December	258	262
Received state subsidies	-	-

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

The Bank provides services as an investment intermediary under the provisions of the Public Offering of Securities Act. As investment intermediary the Bank/Group must meet certain requirements to protect the interests of customers under the Markets in Financial Instruments Directive and Ordinance 38 issued by the Financial Supervision Commission. The Bank/Group has established and applies an organization rules and internal control procedures related to the execution and performance of contracts by customers with information requests from clients, record keeping and preservation of clients' assets in accordance with Regulation 38, Art. 28-31.

31. CAPITAL MANAGEMENT

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

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

As of December 31, 2017 the capital adequacy ratios of the Bank exceeded the minimum regulatory ratios.

32. EVENTS AFTER THE REPORTING DATE

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